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The review provides a detailed analysis of main trends in Russia's economy in 2008. The paper contains five big sections that highlight single aspects of Russia's economic development: the socio-political context; the monetary and credit and financial spheres; the real sector; social sphere; institutional challenges. The paper employs a huge mass of statistical data that forms the basis of original computation and numerous charts.

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Section 1. Socio-Political Context

1.1. The drama of 2008: from economic miracle to economic crisis

The main characteristic of 2008 – the one that will make it stand out in the economic history of both Russia and the world - is the rapidity with which the current economic crisis was developing, as well as the rapidity of the initial euphoria being replaced by the anticipation of doom. It took only several months for Russia and a number of other developing markets to travel all the way from the expectation of an economic miracle to anticipating an economic collapse. Over the past year, we traversed three stages of understanding the crisis which had began a year earlier in the USA.

Stage 1. The first months of the year demonstrated stable (and even growing) rates of growth, which was taking place against the background of booming prices for major Russian exports and low interest rates at the international financial market. While the financial crisis in the West was pushing down interest rates, there was an impression that a new powerful long-term factor of growth had come into play alongside the unshakably high prices of energy carriers. One of the hobby-horses of the Russian political elite was to discuss the issue of Russia's prospects by the year 2020 and to muse whether by that time the country would become the fifth or six largest economy in the world in terms of the volume of GDP.

Stage 2. The spread of the crisis from the USA to Europe, with the rates of growth remaining high in China, India and Russia, conduced to the theory of decoupling rapidly coming into fashion: according to this theory, it is the developing countries that would become the motor capable of stopping the crisis and to pulling out the developed countries from the situation of the already apparent deceleration of economic growth.

Stage 3. In August – September it became clear that the financial crisis was developing into an economic and global one, which meant that it would envelope all the major economies of the world – both in developed and developing countries. The situation of most of the economies, recently so proud of their successes, turned out to be shaky and fragile, and their political prospects – rather vague.

It cannot be said that the crisis was completely unexpected. In early 2008, we pointed to the instability of the two major factors forming the basis of Russian economic growth: the high prices of energy resources, and the presence of cheap money on world financial markets. And it should be remembered that the institutional environment - that is, the only thing that could create a stable foundation for economic growth, is still rather undeveloped in Russia, which means that Russian political institutions are unlikely to be able to soften and alleviate the consequences of a worsening economic and political situation.

Among the major sources of the crisis, one could single out the following factors: the beginning of global deceleration of economic growth; the fall in the prices of oil and other Russian exports; the emergence of deficit in the balance of payments, which resulted in the country's growing dependence on the inflow of foreign investments; the rapidly increasing external debt of Russian companies and a high probability of them becoming incapable of repaying their debts without being helped by the State in the event of a crisis; and also the dubious efficiency of many investment projects that had been started on the crest of the boom wave and were unlikely to survive a trial by crisis. Finally, in the course of its eight years of plenty, Russia produced a generation of politicians accustomed to 'managing the growth of

affluence" and quickly forgetting anything concerned with crisis management, and similar attitudes were on the rise among the general public. [1]

Suddenly the pessimistic forecasts became the reality. Moreover, the toughest scenario came true as well: the two main sources of Russia's economic growth evaporated simultaneously – prices for major Russian exports collapsed, and cheap financial resources disappeared from the world market.

The crisis has begun. Were we ready for it? If yes, to what extent?

1.1.1. The peculiarities of the present crisis

First of all, it would be necessary to address the nature of the present crisis. Of course, all the assessments we are going to offer are only preliminary, because the events are unfolding very rapidly and require constant reconsidering.

Over the past eight years, the Russian political and economic elite was busily bracing up for a crisis modeled on the one experienced back in 1998, so as not to repeat their previous mistakes. To a considerable degree, the lessons of the past were well learnt. But the situation turned out to be different. The crisis which unraveled ten years ago was brought to life by internal factors, such as the weakness of the authorities incapable of pursuing a responsible macroeconomic (first of all, budgetary) policy. Nowadays, Russia – for the first time in a hundred years – is confronted with a world crisis as a part of the global economic and financial system. Thus, Russia is gradually becoming a normal market economy.

However, the crisis unraveling in front of our eyes clearly falls outside the scope of a common cyclic one. What makes it unique is its thee specific features.

Feature one. The scope of this crisis which has begun in conditions of globalization is unprecedented, for it involves practically all the countries and regions which have been demonstrating dynamic development over the past ten years. We can see one important regularity: the countries most affected by the crisis are those that were the most successful ones in the previous decade, while stagnant countries and regions, on the contrary, suffer much less from its effects. This phenomenon is also typical of the internal-economic situation in individual states including Russia: the most serious problems are observed in the regions which underwent an economic boom, while the depressed regions experience practically no changes in their situation. This significantly complicates any exit from crisis: it is unclear as to who will be capable of becoming the locomotive of growth recovery.

Feature two. As the current crisis is structural by nature, it can be inferred that the structure of the world economy and its technological basis will be significantly renovated in the future. It is still too early to specify what structural changes are to be expected, but it is already clear that they will result in a redistribution of forces between industries and regions.

Feature three. The crisis has an innovational character. In recent years, a lot has been said about the necessity of innovations and the importance for the economy to be switched over to the innovational way of development – which has, in fact, already come true in the financial space. However, the crisis actually happened as a result of the emergence and widespread use of financial innovations – or, more particularly, new financial market instruments (which, as some believed at the time, would indeed be able to create appropriate conditions for endless financial growth) – but it has turned out so that many leaders of the financial world

[1] See V. Mau. The economic policies of the year 2007: successes and risks // Voprosy Ekonomiki (Issues in Economics). 2008. No 2.

had only a rather vague idea as to what they would really be like. The consequences of this approach were of two kinds.

On the one hand, the introduced financial innovations have considerably transformed a number of commodity markets, primarily those of the most important raw materials. Since the early 1970s, the behavior of the price of oil has been an absolutely unpredictable phenomenon. Nevertheless, it has been dependent, to a certain degree, on demand and supply, and therefore oil producers could control it – also to a certain degree. Among the indisputable historical facts one could refer to are the sharp rise in oil prices in 1973, organized by the Arab oil-exporting countries, and the calculated (and also politically motivated) actions aimed at drastically cutting oil prices in 1986. However, the subsequent development of secondary financial instruments markets has radically changed the situation. Nowadays, the price of oil has almost no relation to any actions on the part of oil-producers, and is almost irresponsive to the efforts of the OPEC and the countries linked with it. At present, the price of oil is formed at financial markets and exists inside the minds of financial brokers trading in the secondary financial instruments related to oil supplies (it should be noted that these instruments have practically nothing to do with the actual shipments of this commodity). The world is becoming not only flat, as T. Friedman put it, but also virtual, because the most important economic indicators are now formed at derivative financial instruments markets. It is unlikely that such a situation is going to last for ever, for a real deficit or surplus of material values will sooner or later manifest itself all the same. However, for the time being the fact of a considerable strengthening of the role of virtual factors in forming the most important economic ratios should by all means be taken into account.

On the other hand, the economic and political elite clearly lost control of the movement of financial instruments in the situation of the past economic boom. Therefore the current crisis could be defined as a “revolt of financial innovations” – a revolt against their own creators. Although very unpleasant, this phenomenon has repeatedly happened in history. Now it has become clear that the collapse of Barings Bank - which was ruined single-handedly in 1995 by Nick Leeson, a young trader working for its Singapore branch - was an omen of the impending crisis, a message sent to the world of finance. This message passed unnoticed.

To sum up, we should note the following.

The nature and mechanisms of great economic upheavals, such as the phenomenon we are confronted with, are always mysterious and not totally explainable. Great crises are debated for decades by economists, politicians and historians, with hundreds of dissertations and thousands of scholarly articles being devoted to them. It should be said that even economic historians invariably fail to give single answers to the questions raised in connection with such crises. The phenomenon of the Great Depression of the 1930s is not completely understandable even today: the debate regarding its causes and the adequacy of Franklin Roosevelt’s measures designed to exit the crisis is still far from being over.

1.1.2. The causes of the crisis

When analyzing the crisis unraveling before our eyes, it would be sensible to separately consider the three groups of causes which have made it inevitable. Firstly, there are the specific problems of the American economy; secondly, the systemic fundamental problems of current economic development; and thirdly, the specific Russian circumstances. As these fac-

tors act in different directions, and so anti-crisis measures should be designed with all the three groups being taken into consideration.

So far as the causes of the crisis are concerned, it has become a rule to criticize the activities of the US administration with regard to its inadequate budgetary and monetary policies. First of all, the case in point is its pursuance of a pro-cyclic policy after the 2001 recession, when the country continued, in conditions of economic growth, to increase its budget deficit - instead of returning to Clinton's policy of achieving a budget surplus. This was reflected, in particular, in the interest rate policy aimed at keeping interest rates low in conditions of economic growth (*Fig. 1*).

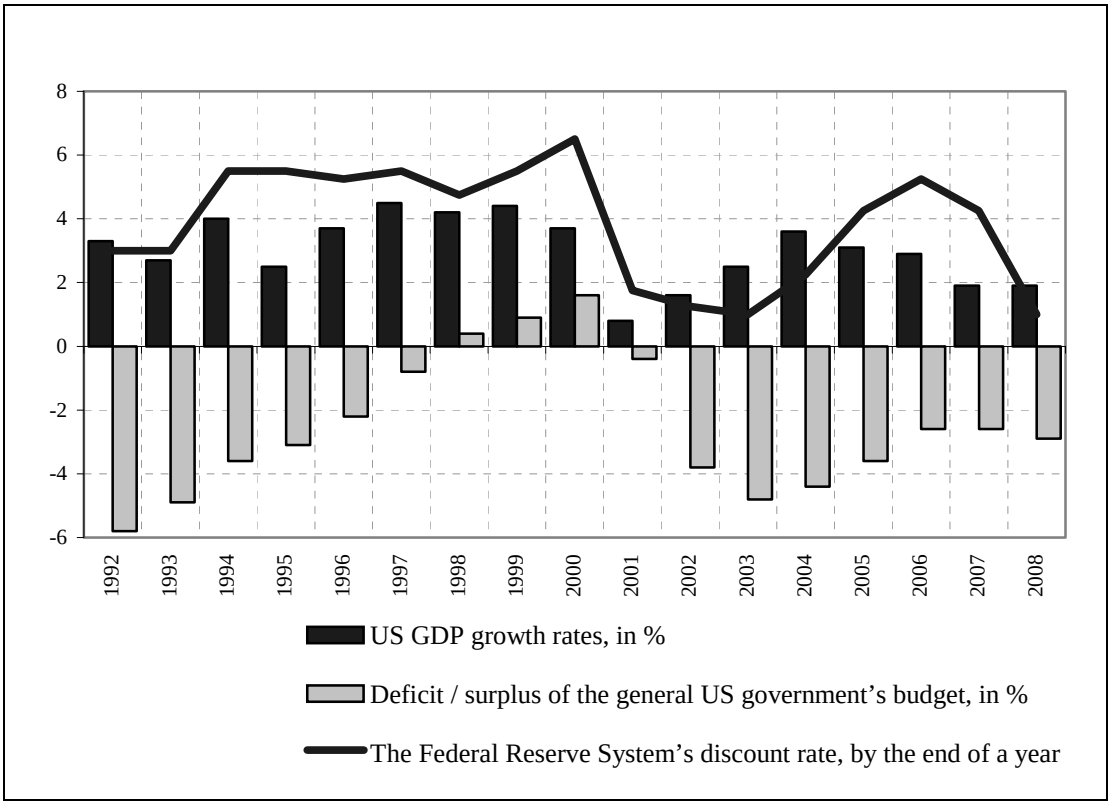


Fig. 1. The indicators of economic growth and the US budgetary system

That was a policy of artificial growth–stimulation, especially important for developed countries in connection with the double-digit economic growth of China. As a result, the governments of many countries took measures to spur growth, and the problem of overheating the economy started to look unfashionable: we have now gone too far from the Great Depression and, as it seemed, have also outgrown it intellectually. This logic was clearly shared by the Russian leadership when it set the goal of "doubling the GDP" in ten years' time, which also fixed attention on achieving predominantly quantitative, voluminous results. But while in the case of Russia this policy was based on the presence of the capacities left spare after the crisis of the 1990s, as well as on the enormous inflow of petrodollars, the American economy had to develop in conditions of two simultaneously waged wars which could not be financed without incurring a budget deficit.

There was also an independent crisis factor, namely, the unprecedented rates of economic growth which made it possible to increase world GDP by one quarter in the course of years. Such a rise inevitably generates systemic contradictions which remain unseen due to growing well-being. And most importantly, even if the existence of these contradictions is recognized, it is very difficult to interfere in the course of events and to correct anything: why should we take any restrictive or corrective measures when everything looks great all the same? Each time when somebody starts to express doubts in the correctness of the chosen course of action or to come up with warnings in such situations of economic boom, we will hear the confident statements that "this time it is different"[2].

Globalization has yet another aspect (apart from the new instruments), which was believed to be a source of perpetual financial success and steady growth. Niell Ferguson named this phenomenon *Chimerica* (China plus America). The case in point is the formation of a global disbalance which for decades was considered to be a source of stability of economic growth. As a result, there emerged an economic regime diametrically opposite to the model of globalization which existed at the turn of the 20th century: one hundred years ago capital was moving from the center (developed countries) to the periphery (the emerging markets of that time), while nowadays it is the developing markets that have become savings centers, with the USA and other developed countries predominantly playing the role of consumers.[3]

Finally, the spreading crisis has the following fundamental and most important cause. The case in point is the target function of business development, which in my view has undergone a serious transformation over the past two decades. Capitalization growth has become the key orienting point for corporate development. It is this index that shareholders are now most interested in, and it is by this index that the efficiency of management is evaluated. However, the tendency to achieve maximum capitalization inevitably comes into contradiction with the real basis of socio-economic progress - that is with increase in labor productivity. Of course, capitalization growth is linked with labor productivity, but only *in the long run* - while the shareholders must be given an account annually. And for an attractive annual report to be composed, its author needs something absolutely different from the things which secure productivity growth. Your reports will be good if they reflect mergers and takeovers, because the volume of assets is conducive to capitalization growth. And it is clear that you should not shut down backward enterprises because their closure will lead to a drop in capitalization in the current period. As a result, many big industrial corporations still keep open their old and inefficient plants and enterprises.

This situation was widespread in Soviet times, though it was then called "struggle to fulfil the plan". Enterprises preferred to produce outdated products rather than to switch over to

[2] Kenneth Rogoff and Carmen Reinhart paid special attention to the fact that this trap for policymakers, an illusion that "this time is different" dates from England's fourteenth-century default (See Carmen M. Reinhart and Kenneth S.Rogoff, *This Time is Different: A Panoramic View of Eight Centuries of Financial Crises*. NBER. 2008. No. 13882).

[3] Ferguson N. The Ascent of Money: A Financial History of the World. Penguin Books: New York, 2008. See also Martin Wolf's comment: "In the 19th century, the world's then most advanced country ran a savings surplus (out of national income), which was invested in the fast-developing countries of the time (mainly the countries of new settlement). Now, however, the world's most advanced country has been importing savings from poor countries and using them for public and private consumption. It doesn't seem very difficult to see that this process is at best stupid and at worst unsustainable. In my view, this system - sometimes called Bretton Woods II - is at the root of today's financial crisis".

producing new ones, because innovation would have resulted in a numerical (in kilograms, meters, rubles) fall in output, thus making it impossible to fulfil and over-fulfil the plan. Some economists characterized this attitude as *planning fetishism*[4].

Apart from the general factors of the current crisis, there are some specific reasons why it is now rapidly developing in Russia. The crisis quickly spread across a country which was characterized by an especially favorable macroeconomic situation - a country which had a double surplus (of its budget and balance of payments).

First of all, this phenomenon was the seamy side of the afore-said favorable environment. The double surplus was becoming a factor of attracting capital which actively flowed into the country - thus widening the "arm" of borrowings. And it was only natural that at the beginning of the crisis this "arm" contracted, which immediately resulted in a contraction of the stock market.

At the same time it turned out that, despite its tremendous growth in 2004 – 2007, the Russian stock market was still rudimentary, and its indices were thus capable of shrinking to a minimum. This fall in value, however dramatic it may be, has a certain internal logic. As is seen from *Fig. 2*, the collapse of the market resulted in the stock market indices coming approximately to the point where they could have been if the 2005 leap had not taken place. The roughly triangular curve in the graph is a graphic representation of the financial market bubble produced by the boom which led to a growth of disproportions.

The inefficiency of the branch structure of the economy and exports has also contributed to the aggravation of the crisis. The predominance of primary goods within the structure of exports makes Russia's balance of payments more dependent on cyclic fluctuations than if would have been in a country with a diversified economy. Once the multicative effect sets in, a reduction in the rate of growth and a drop in investment activity in importer countries can result in a sharp deceleration of an economy dependent on export of raw materials, and to launch the "crash-landing" scenario. This is the mirror effect of the phenomenon already experienced by Russia after the 1998 crisis. As the world economy was growing, there emerged demand for Russian products, which resulted in a boom as soon as prices for energy carriers started to rise. Naturally, much was said at the time concerning the necessity to carry out structural diversification, but nobody took the trouble of tackling this issue in earnest while the economy was booming.

The rapid growth of external corporate borrowings became one of the most serious problems. Another problem resulted from the fact that most of those debts were, in fact, quasi-state borrowings. Many borrower enterprises have close links with the State, which reflects on their logic characterized by the motto: "privatization of profits and nationalization of losses". That is how they are seen at the financial market, whose agents understand that, in the event of a crisis, the biggest Russian borrowers can always rely on assistance from the federal budget. Thus, there emerges moral hazard - the situation known since the 1997 Asian crisis, when some players can irresponsibly borrow money, while other players can lend it without sufficient reasons. But it is the State that will have to save the debtors in the event of an economic crisis. If we turn to the example of South-Korean *chaebols* – the firms actually existing under state control and dedicated to the same principle of "privatization of profits and nationaliza-

[4] For *planning fetishism*, see Mau V., Starodubrovskaia I. Planovyi fetishism: neobkhodima politico-ekonomicheskaia otsenka (Planning fetishism: a political and economic assessment is necessary) // Ekonomicheskie Nauki. 1988. No 4.

tion of losses" - we could notice a growing tendency towards "chaebolization" on the part of a number of leading Russian firms.

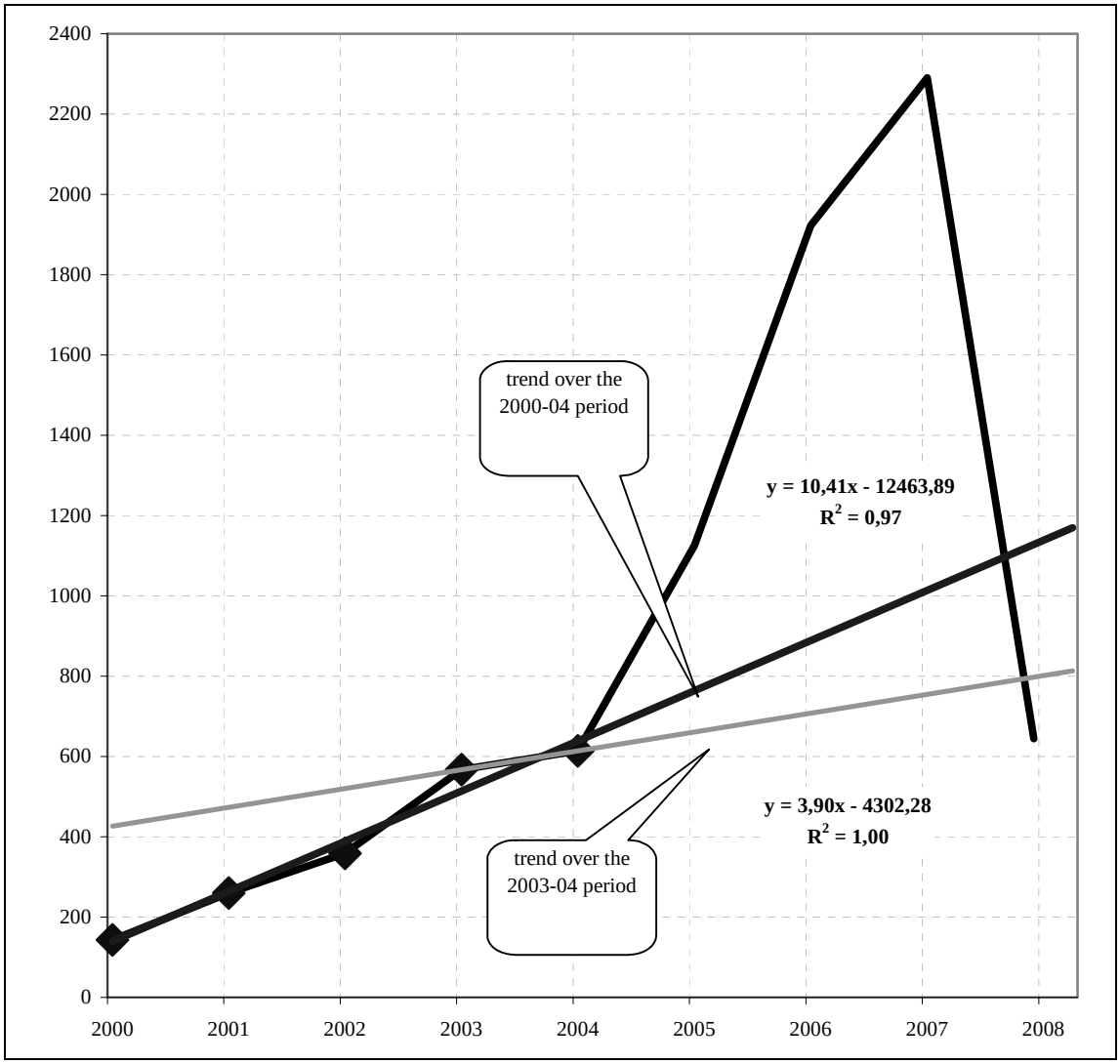


Fig. 2. The dynamics of the RTS index (as of the end of a year, closure)

The year 2007 saw a major change in the trend of the dynamics of external indebtedness: previously, the aggregate debt burden (both state and corporate) was decreasing, whilst now it began to grow. This considerably increased the dependence of Russia's economic situation on the fluctuations of the world financial market and rapidly led to the unraveling of a full-scale crisis. (*Fig 3*). A few words should also be said about yet another mistake made by Russian borrowers: they easily accepted various pledge schemes, although the successes achieved by the Russian economy in recent years frequently made it possible to refrain from resorting to pledges. As a result, when the crisis set in, these borrowers run into the problem of their pledges rapidly losing in value (i.e., the margin-calls mechanism was triggered), and were faced with a real threat of losing their assets.

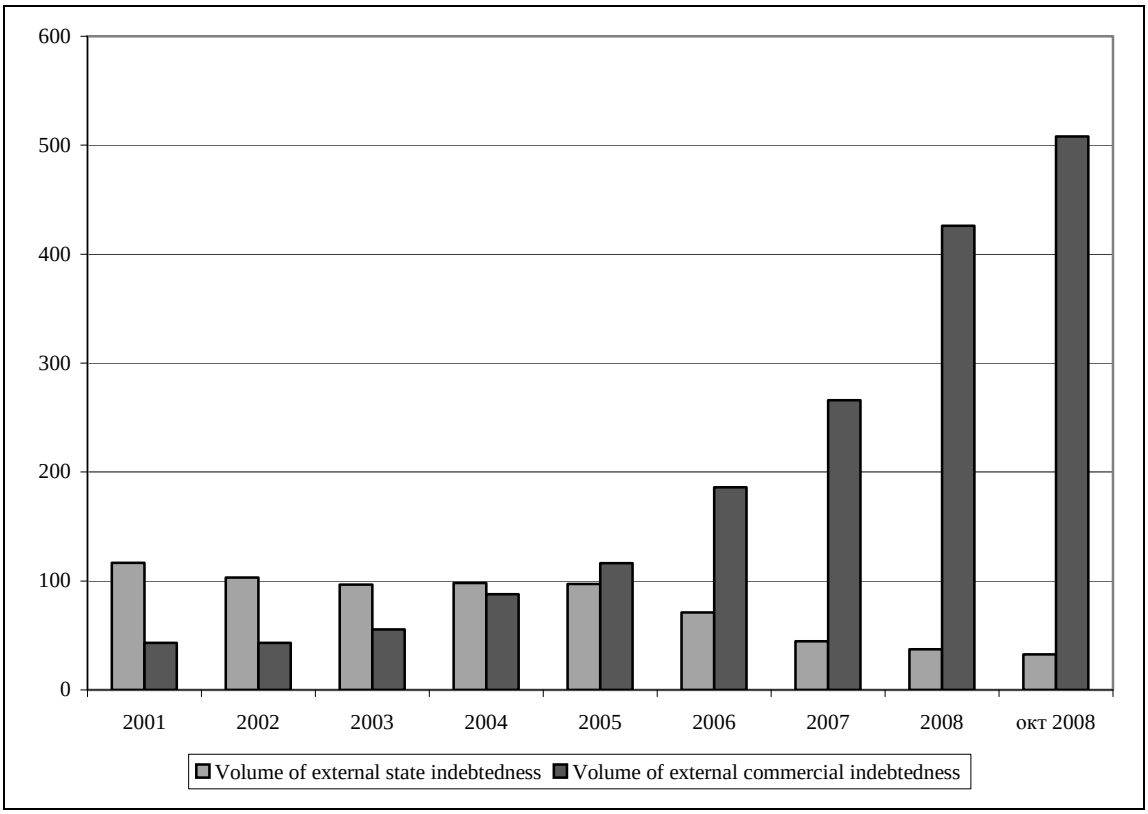


Fig. 3. The volume of RF external indebtedness, billions USD

This situation had a major impact on the development of budgetary and exchange-rate policies. On the one hand, the considerable indebtedness of prominent (including budget-connected) players, some of them owning strategically important assets, narrowed the possibility of lowering the exchange rate of the ruble, which would have inevitably increased the cost of servicing their debt. On the other hand, it was necessary for the State to render financial assistance to the borrowers in order to repurchase or repay their debt.

1.1.3. Reaction to the crisis

The world economic and political elite were deeply shocked by the crisis. The initial reaction to it was rather chaotic, with the governments of developed countries desperately trying to slow down its rapid development. Their attention was focused primarily on resolving two sets of problems. Firstly, to avoid the collapse of the credit system - that is, to save financial institutions. Secondly, to prevent recession or at least to weaken it, to avoid a deep slump in production.

At ideological and conceptual levels, this policy was manifested in a Renaissance of Keynesianism. The popularity of Keynesianism was rising as rapidly as the crisis was unraveling. The unexpectedness and the abruptness of the descent into catastrophe resulted in the adoption of a number of incoherent anti-crisis measures, most of which contradict many economic doctrines and political traditions – which until quite recently were deemed to be perpetual and indisputable.

The phrase “We are all Keynesians now”, placed on the Time magazine cover in the early 1960s, is once again becoming popular. As it was nearly half a century ago, the name of

Keynes is bandied about as a symbol of state interventionism, which is opposite to economic liberalism -irrespective of what the great economist actually wrote and thought on the subject. In any case, when Richard Nixon repeated this phrase, he used the guru's name in order to to give weight to the introduction of state regulation of prices, although it is unlikely that Keynes would have given his blessing to the economic policy of the US administration of that time. Meditation-prone policy makers treat this "collective Keynesianization" with skepticism and ridicule: the German Minister of Finance (a Social Democrat, by the way) characterized the actions of his EC partners as "crass Keynesianism".

Leave the consecrated term "Keynesianism" aside, and the majority of the decisions being made will certainly fall, one way or another, within the concepts of *dirigisme, socialism* and *populism*. These concepts are interrelated but not synonymous.

The *dirigistic* measures include the taking of individual decisions by institutions of state power, the deciding by them (and not by the market) as to who is innocent and who is guilty, and also the readiness of the State to dictate to the economic agents as to which services and goods they should render and produce. The situation with Lehman Brothers on the one hand, and with Bear Stearns, AIG and Citibank on the other, is very difficult to interpret from a market perspective. Some bigwig has decided to call to account one player and to help another – as it always happens in a centrally controlled economy.

The next - very logical - step is the adoption of government decisions concerning the activities of the actually nationalizes institutions. UK Prime Minister Gordon Braun has repeatedly stated that he would encourage the banks which have got under his control to invest more money in small businesses. Similar demands are being made to Russian state –owned banks, irrespectively of how this measures would reflect on the quality of their portfolios. Of course, support for small businesses is the sacred cow of every contemporary government. However, the consequences of such decisions are predictable: if the authorities instruct their bank where to invest its money, they would have to render assistance to this bank when the said politically motivated investments turn out to be inefficient. That is, the assistance of the State and the inefficiency of investments form a vicious circuit.

The *socialist* measures include the collectivization (or nationalization) of risks. By saving the borrowers, by pumping capital into the banks, and by increasing guarantees for private deposits, the State assumes the risks related to the decisions of all the major participants of economic life, including the bankers, the investors and the borrowers. (The more so because in practice they are the same person). Thus, the fundamental principle of capitalism – personal responsibility for the decisions taken – is put in question. So far as the Russian situation is concerned, one could assert that the risks of nationalization would become inevitable already at the next stage. This process is also beginning in the banking sector, which will result in the guarantees being extended to all the other companies and sectors.

Property relations - the holy of holies of every socio-economic system - are also undergoing a very serious transformation. What is under way is a de-facto nationalization of troubled corporations by way of rendering to them financial assistance. Their nationalization is carried on via at least three channels: through repurchasing the debts of individual firms; through recapitalization in exchange for shares; and through the inflation of accumulated liabilities. States are usually ready to assume all the liabilities of financial institutions – by way of rendering guarantees and by directly injecting capital. Thus, private property rights are immediately put in question.

The risks of *populism* are clearly on the rise. As usual, a drop in the rate of economic growth triggers calls to help commodity producers. It is amusing to read the analytical reports of Western banks, which contain exactly the same recommendations as we used to incessantly hear in Russia in the 1990s: what is necessary is to carry out massive budgetary and monetary expansion, which "could help to sustain the stability of aggregate demand". If Russia or any other country with developing markets had voiced such proposals just a few months ago, the only answer on the part of analysts would have been rigid – and well-founded – criticism.

In this situation, the handout of cheap money to commodity producers would have had dire consequences because it would result in increasing the rate of inflation. By the way, therein lies the difference between the situation in Russia and that in the USA. Russia (like most of other countries) does not have a printing press churning out the world's reserve currency. Therefore, monetary populism in our country would provoke a flight from the ruble - rather than stimulate growth.

The "turnabout" observed in the countries most deeply entrenched in capitalist tradition resembles the sharp switchover from "Military Communism" the NEP. As early as March 1921, nothing pointed to the impending rejection of the rigid model symbolizing the beginning of the realization of the Communist Dream. Suddenly, only a few weeks later, there was an abrupt turn towards the restoration of market relations. What had happened? The Soviet regime had found itself on the verge of destruction, and the Bolshevik leadership had clearly understood the message of the Kronstadt Uprising. The new economic policy was designed to defuse conflicts, to weaken social tensions, to decrease social tensions and to restore economic growth. According to Lenin, the NEP was "in earnest and long term", "but not for ever".

The turn to socialism is undoubtedly an attempt to get a respite in order to reappraise old values. It is still too early to say whether this turn will be long-term or not. But it is clear that it will not last for ever. Any excessive state regulation contradicts the flexible and dynamic character of modern productive forces, as well as the challenges of the post-industrial epoch - exactly as the chaos of market competition was in rather poor agreement with the goals of rapid industrialization in the early 20th century. That is why the market model of the NEP was scrapped only a few years after having been launched. And that is why it would be preposterous to affirm that the present statist-socialist tendencies "are in earnest and long term".

The longevity of the statist neo-NEP is difficult to predict as yet. A rapid exit from the crisis would apparently make most of the state regulatory measures unnecessary. If the crisis is long term (which is more likely), everybody will be rapidly cured of any illusions that state intervention in the economy ("crass Keynesianism") can remedy market falls. The logical inconsistency of the affirmation that the crisis has confirmed the necessity of further intensifying state regulation is already clear: the State *did regulate* these markets but this regulation was a *failure*. According to one US Congressman, there are absolutely no reasons to believe that the same state will henceforth begin to better regulate financial markets.[5] It is another matter that we need new institutional decisions which would increase the transparency and stability of financial markets.

[5] The Financial Times. 2008. Oct. 24, p. 4

1.1.4. Russia's struggle against the crisis

Fearing the collapse of the banking system and a deflationary shock, economically developed countries resorted to a number of aggressive measures designed to support the banking system and to stimulate production activity. The most important measures include the allocation of liquidity, the expansion of the deposit guarantee system for physical persons, the buy-out of some of the banks by the State, the aggressive reduction of refinancing rates, and the adoption of "stimulus plans" (envisaging budget injections into the real sector of the economy designed to stimulate demand therein). At the same time, the governments of many countries have resorted to lowering the exchange rates for their national currencies against the US dollar (see *Fig. 4*). This measure was designed to preserve those countries' foreign currency reserves and to become an additional factor of stimulating internal production. An analysis of the logic and the efficiency of these measures is beyond the scope of the present article. However, the key problem consists in the fact that these measures can indeed bring about a serious macroeconomic destabilization.

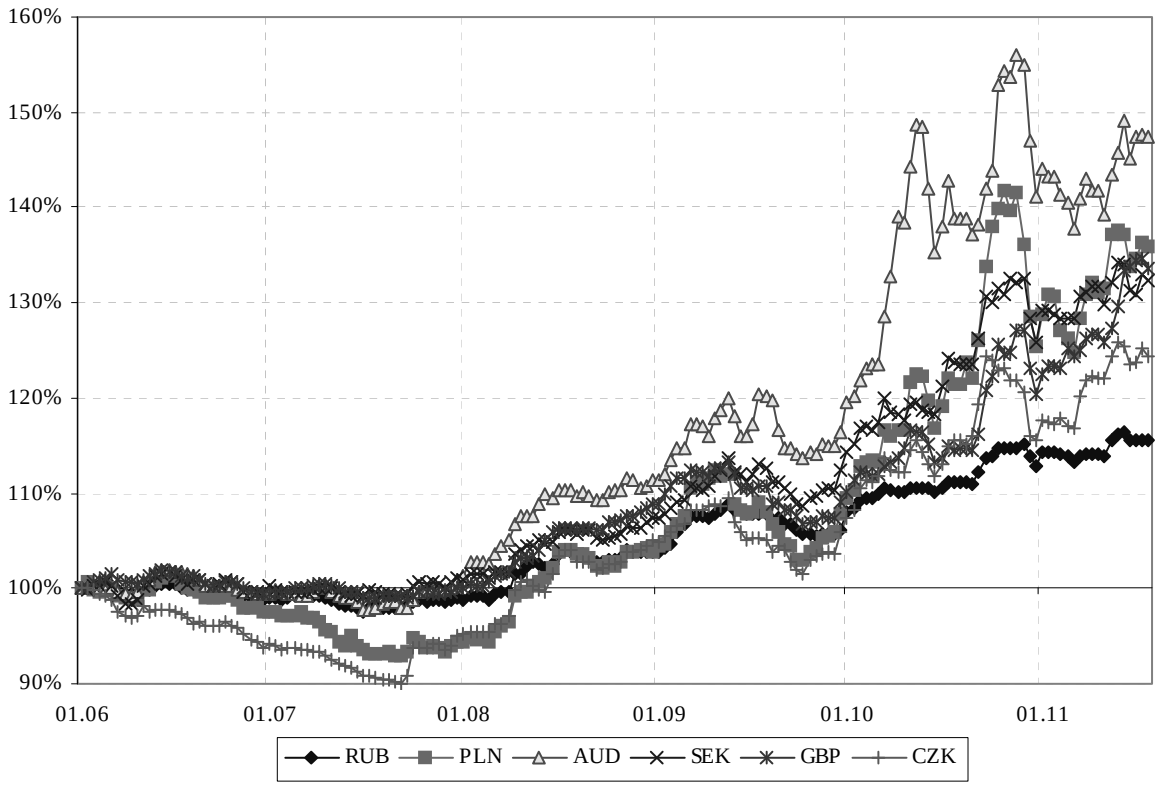


Fig. 4. US Dollar. The interbank exchange rate (1 June 2008 – 100%)

The Russian authorities also offered a number of sufficiently radical measures to soften the crisis. To a certain extent, those measures were similar to those taken by the governments of the most developed countries, but in some important aspects they considerably differed from the latter's initiatives.

Collapse of the credit system was prevented. Considerable financial resources were allocated to banks in an attempt to overcome the liquidity crisis. On the one hand, these measures

were designed to sustain productive activity. It is the availability of credit resources and not the stock market that constitutes the vehicle of growth of the real sector of Russia's economy. On the other hand, the stability of the banking system is also directly linked with the task of safeguarding socio-political stability in the country. Losses incurred by citizens because of bank failures would be incomparably more painful and politically dangerous than any losses resulting from a fall of stock indices.

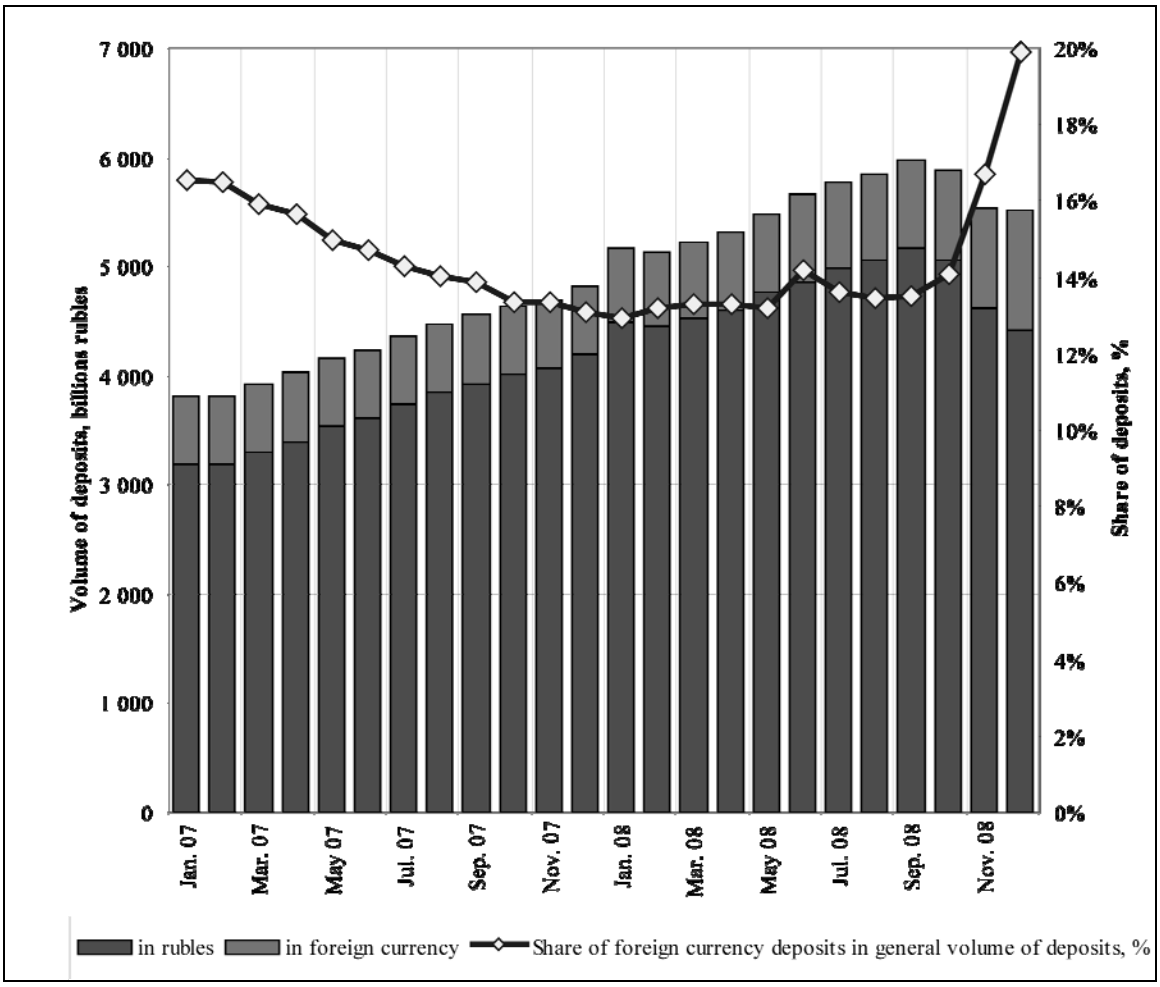
Naturally, there were some unavoidable dubious schemes. The banks which received liquidity from the State preferred to convert it into foreign currency as much as they could - in order to insure themselves against currency risks or to repay part of their debts to foreign creditors. From the point of view of economics, this behavior was quite reasonable, although it did not correspond to the intentions of the monetary authorities who had allocated the funds. Also, there emerged some situations when the re-allocation of state-allocated funds involved bribe-taking, which is not surprising when a resource in short supply is being allocated at an underestimated price. (It was expected that the monies received by primary recipients would be allocated to second-level borrowers not at the market rate but at a much reduced one, which would only slightly exceed the interest rate at which the initial allocation of funds had been effected).

The State made a half-hearted attempt to prop up plunging stock indices, but quickly abandoned this initiative. Although the dynamics of stock indices is breathtaking and dramatic, this is not the sphere where the State's resources should be concentrated today. Any attempt at supporting the stock exchange in the present situation would mean only one thing: helping the fleeing investors to sell their shares at a higher price and to depart with the money. Of course, it is very unpleasant for shareholders to see that the value of their shares is falling. It is also true that the collapse in share prices has produced a sharp rise in margin calls, but the solution of this problem lies in quite another sphere.

Decision makers have started a discussion on the ways of preventing a production crisis. The rapid economic growth achieved in recent years was caused to a major extent by the world market being awash in cheap money which was eagerly borrowed by Russian companies. However, the cheapness of money does not conduce to their effective investing, especially when the case in point is companies linked to the State especially favored by creditors who understand that come hell or high water, the State will never let these companies perish.

Now the situation has changed. There are no available credits, and the securities placed as collateral for credits are rapidly loosing in price. Of these debts, about 43 billion USD had to be repaid by the end of the year. The State expressed its readiness to allocate, via the Russian Bank for Development, a sum of 50 billion USD for eliminating the bottlenecks.

The currency policy was rather ambiguous as well. For political reasons, the authorities did not dare to completely abandon control over the ruble's exchange rate and therefore resorted to a gradual devaluation of the national currency. The causes of their circumspection in this matter are clear: with ruble savings being devalued for the third time in twenty years, confidence in the national currency could hardly be expected to rise. The population was given a chance to insure itself against a depreciation of the ruble. Practically everybody who wanted to exchange the rubles into dollars or euro could do so (*Fig. 5* and *6*).



Sourse: RF Central Bank, the author's estimates.

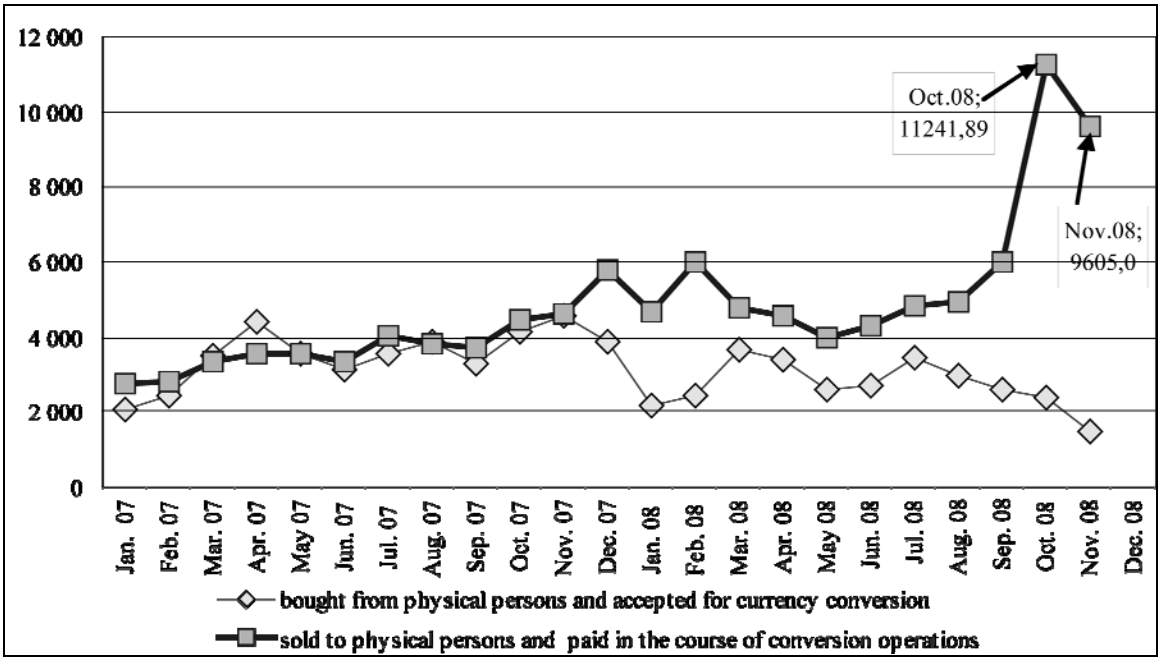
Fig. 5. Data on the volumes of deposits of physical persons, attracted by credit institutions

However, the smooth devaluation of the ruble has increased panic on the market and caused a considerable depletion of the gold and foreign exchange reserve, which may result in the emergence of a new equilibrium level of the ruble's exchange rate than in the case of its abrupt devaluation. Also, the uncertainty about the ruble's exchange rate has nearly completely frozen the activity of credit institutions. Expecting the exchange rate to drop, banks were not inclined to grant ruble credits, while potential borrowers, for the same reason, did not want to take foreign currency credits.

Moreover, a sharp devaluation of the ruble would have become an additional factor of supporting domestic production and of protecting the Russian market from imports, would have supported Russian exporters and created additional stimuli for the future inflow of foreign capital in the form of direct investments.

Finally, the government put forth a broad package of incentives - primarily in the sphere of taxation, which are designed to encourage the development of actual production, including tax cuts; initiated a number of measures aimed at supporting small businesses; and composed

a list of the system-forming enterprises enjoying special attention on the part of the State. Some of these measures are rather ambiguous.



Source: RF Central Bank, the author's estimates.

Fig. 6. The volume of transactions with currency holdings between authorized banks and physical persons (all kinds of currency, in millions of USD)

Support for small businesses is undoubtedly crucially important for both economic and social reasons, because this sector can play a significant role in reducing unemployment by absorbing the most active groups of the population. However, it should be borne in mind that in Russia, the problems of small businesses lie not in the economic sphere or the domain of law, but in the law enforcement and political spheres. Traditionally viewed with skepticism, small businesses in Russia have always been the most defenseless one when confronted with bureaucratic lawlessness and extortion. Small businesses will be capable of developing only on condition that the value orientation of Russian society and especially its elite would undergo some far-reaching serious changes.

There exist serious doubts as to the effectiveness of direct assistance to big enterprises. The main problems of production development consist not so much in the lack of money as in the mysfunctioning of economic mechanisms, and in the final account, in the inefficiency of many production sectors. Lavish financial injections will not solve the issue of increasing the effectiveness and the structural renovation of the economy, without which an exit from the crisis will be delayed. Nevertheless, such measures could certainly alleviate the current social problems.

1.1.5. Some lessons of the past anti-crisis experience

The discussion on the issues of the present crisis in one way or another revolves around historical precedents, including the genetic fears engendered thereby. First of all, it is the Great Depression, with its lengthy deflation and double-digit unemployment which was eradi-

cated only in the course of the Second World War. Less frequently mentioned is the 1970s crisis, which brought to life a new phenomenon – stagflation. As a matter of fact, it is those two historical precedents that should form the basis of any debate on the present economic situation. However, one should always bear in mind that historical precedents are nothing else but instruments of analysis, which cannot offer any ready solutions for a researcher.

Judging by the measures being taken by the governments of developed countries, their worst fear is deflation - which invariably takes a decade or more to struggle out of. Apart from the 1930s, this was exemplified by Japan in the 1990s.

In fact, the deflation and stagflation models of a crisis are alternatives. That is why they offer principally different mechanisms for overcoming it.

What is required to resist deflation is, first of all, growth stimulation - that is, an active budget policy and budget expansionism. In this case, it is permissible to cut interest rates and reduce taxes, and at the same time to increase budget expenditure.

In the case of stagflation, the set of measures to be applied is directly reverse – first of all, it is necessary to establish control over money supply - that is, to toughen the budget policy and to increase interest rates. After a decade of the permanent economic crisis of the 1970s, the exit was found only after FRS Chairman Paul Volcker had dared to resort to unprecedently tough measures and drastically increased the refinancing rate. As a result, the unemployment rate shot to over 10%, and interest rates climbed to more than 20%. The USA entered into an extremely severe recession, which caused President Jimmy Carter to lose his bid for reelection paid with his presidency, and in due course exited it with a renovated and dynamic economy.

Of course, any juxtaposition of these two models is a matter of convention, and it is unlikely that the present crisis will faithfully replicate any one of them. But it is important for us to understand that the prescriptions for treating an illness must always depend on that illness' nature, and so successful treatment sometimes requires prescribing medications characterized by their absolute dissimilarity rather than similarity.

The experience of both crises could turn out to be perfectly applicable in the present situation. Strictly speaking, developed countries are now pursuing a policy which they considered absolutely unsuitable for developing markets (including post-communist countries) in the 1980s and 1990s.[6]

The massive financial injections being carried out by the USA and the European Union may indeed prevent the economic situation from worsening to a politically unacceptable level. However, great caution is needed when such measures are attempted in developing economies. The thing is that the US monetary authorities have two powerful tools at their disposal. Firstly, they have the printing press churning out the world's reserve currency – and nobody questions the status quo in earnest, despite its having been relatively shaken by the current financial crisis. Moreover, the majority of countries (which keep their currency reserves in dollars) are interested in preserving this state of affairs.

Secondly, because of the special status of the dollar, US firms and households do not have any alternative instruments for hedging currency risks, and it is unlikely that they might rush to exchange their dollars for euro or yens - even if some doubts were to arise about the

[6] *Ferguson Niall*. Geopolitical Consequences of the Credit Crunch, September 2008, and Kenneth Rogoff, America Goes From Teacher to Student, February 2008, and Dani Rodrik, The Death of the Globalization Consensus, July 2008.

correctness of the policy pursued by the monetary authorities. That is why, despite the budget and monetary expansion of the past few months, the velocity of money circulation in the USA does not increase - as it would have been in other countries: instead, it slows down.

The majority of developing markets, and especially Russia, would respond to financial expansion absolutely differently. In a country whose national currency does not have a long credit history and, quite naturally, by no means constitutes a reserve currency, any relaxation of the budget and money policies is likely to result in an escape from the national currency, in an increase in the velocity of money circulation, and in inflation. When taking place against the background of a global recession, this course of events would inevitably lead to stagflation.

Such a policy would be especially dangerous for countries where the exports structure is determined by the predominance of by primary industries. The dependence of such economies on the world market situation is extremely high, because even a slightest drop in demand on external market immediately translates into a considerable production slump in primary exporting countries. If business activity in developed countries remains low and demand for exports from developing economies does not recover, those economies' depression could start to suffer from yet another calamity – an escape from the national currency. As budget expansion cannot compensate for a drop in external demand, inflation will go up without being accompanied by intensification of productive activity.[7]

Thus, the present crisis conditions are such that it is not unthinkable that one part of the world will experience deflation, while another will be hit by stagflation. The latter represents one of the most serious risks faced by present-day Russia.

All this brings us to a principally important conclusion concerning the unraveling crisis and the ways to get out of it. In essence, the world could encounter two crisis models materializing in parallel. The two versions of the crisis will need diametrically different approaches. The Western World will struggle with deflation thus pushing inflation out into the outside world, the world of developing and emerging economies. While repeating the Western approaches to combating the crisis, the latter will soon find themselves in the trap of stagflation.

Thus, Russia's anti-crisis policy should be primarily based on preventing its economic system from becoming macroeconomically unbalanced. Even if we are to be faced with a budget deficit in 2009, we should make use of all healthy resources to cover it, first of all domestic borrowing, without resorting to the printing press. And it would be extremely dangerous to hope that the artificial stimulation of demand, "crass Keynesianism", could resolve the key problems of Russia's socio-economic development.

1.1.6. The priorities and risks of the 2009 anti-crisis policy

Apart from the issue of safeguarding macroeconomic stability, we should specify a number of additional issues which will have to be resolved by the government in its struggle with the crisis.

As the crisis is most dangerous in its capacity to bring about socio-political destabilization, it is this issue that should be given maximum attention. Therefore, when it comes to alleviating the effects of the crisis, the first ones to get assistance should be workers - not enter-

[7] In May 2008, The Economist wrote in this respect: "There are alarming similarities between emerging economies today and the rich world in the 1970s when the Great Inflation lifted off." (Inflation's back // *The Economist*. 2008. May 24. P. 17).

prises, managers or shareholders. During the years of boom a lot of structural disproportions have been accumulated (many of them being survivals from the Soviet epoch), any attempt to keep enterprises afloat would simply delay the urgently needed structural changes in the economy. The State should safeguard socio-political stability, and it should not assist individual businesses.

When struggling with unemployment, the authorities should not vest much hope in public works. Although we have read a lot about the public works system in Soviet textbooks ("how it was in their case"), we tend to overlook the fact that it was a phenomenon of industrial society, when a significant percentage of redundant workforce were blue-collar industrial workers. It is unlikely that financial analysts recruited into public works would do much good either to themselves or to construction projects. Instead, various educational programs - enabling people to take advantage of the crisis in order to rethink and reassess their life strategies and then to retrain accordingly - can (and should) find broader application in today's world. Although the cost of such programs is smaller than it was in the case of public works, their effect will be highly significant - especially once the crisis is over.

When discussing the prospects of rendering assistance to individual ("system-forming") enterprises, it would be necessary to formulate some coherent criteria for entry into this category, and to distinguish between the various forms of assistance to be rendered to enterprises. Distinction should also be made between company towns - where the issue of closing an enterprise is primarily a social and political one (removal of obstacles in the way of developing small businesses), and infrastructure objects – when direct state assistance to enterprises is permissible if it can make them function properly.

But the most dangerous thing to do would be to use the pretext of assisting "system-forming enterprises" in order to prevent closure of failing plants and factories and to resist modernization of Russia's economy. That is why it would be necessary to drastically cut the practice of shifting responsibility to the State. And if the State is ready to save one or another business, it must to it publicly and in accordance with generally - known rules.

Now, it is time to immediately formulate a coherent agenda of future privatization. As a result of the current crisis, the state is likely to significantly increase the number of assets in its possession, but it will not be able to adequately control the quality of their management. This could lead to the reemergence of the situation typical of the early 1990s, when so-called red directors had a free hand to do whatever they wanted at the enterprises they managed – that is, they enjoyed the right of owner without having owner motivation. This can be avoided only if the manager knows that he will be taken to account by the actual owner.

Finally, Russia should do its best to avoid the adoption of protectionist measures and the curbing of international competition. So far as the present Russian situation is concerned, the most effective measures aimed at protecting the interests of domestic commodity producers would be a currency-exchange policy preventing an excessive strengthening of the ruble. By comparison with tariff measures, devaluation has at least one plus: its effects are the same for everyone, and it cannot be corrupted by lobbying for the import tariffs more profitable for private gains.

1.2. Anti-crisis policies in foreign countries

The crisis has shocked the world's economic and political elites. Initially, the reactions to it were rather chaotic, the governments of developed countries tried to slow down the fast

unwinding of the crisis. Main attention was paid to the solution of two groups of problems. Firstly, a collapse of the credit system should be prevented, i.e. financial institutions should be bailed out. Secondly, the recession should be mitigated and a deep decline in production should be prevented.

There can be singled out four spheres of influence of anti-crisis policies pursued by the authorities and, respectively, four groups of problems to be settled.

I. Measures aimed at the urgent rescue of the banking system.

Here, the central task is to avoid a bank panic and destabilization (halt) of national credit and banking systems. As yet, it is the most massive part of anti-crisis measures.

These measures include:

1. Recapitalization of banks (USA, Austria, Belgium, Germany, Greece, Spain, Italy, Cyprus, Luxemburg, Portugal, Finland, Hungary, Denmark, Switzerland, Hong Kong, Qatar, UAE, Saudi Arabia, Kazakhstan);

2. Extension of stabilization credits (USA, EU, France, Spain, Italy, Sweden, Norway, UK, Hungary);

3. Measures aimed at the restructuring of banking systems, including facilitation of bank mergers or nationalization of banks (Belgium, the Netherlands, Portugal, Iceland, Sweden, UK, Ireland);

4. Reduction of interest rates nearly to zero;

5. Sharp expansion up to 100 per cent of guarantees as concerns deposits of individuals in banks;

6. Measures aimed at the cleaning of banks' balances, including the provision of state guarantees with respect to distressed assets (USA, Canada, Germany, Spain, Italy, UK, Denmark, Sweden, Switzerland, Japan, Korea, Australia).

II. Monetary policy – a switching from anti-inflationary policy to quantitative easing.

These measures are aimed at the creating of incentives of economic growth and expansion of access to credit resources; an intention to prevent deflation (fight against inflation recedes into the background; stabilization of the internal market (via interest rate); stabilization of the balance of payments (via devaluation); enhancement of efficiency of measures pertaining to economic policy.

1. Reduction of interest rates in the majority of countries due to apprehension of deflation (USA, Canada, EU, Switzerland, Sweden, Norway, Denmark, UK, Australia, Japan, China, India, Vietnam);

2. Some countries have chosen the way of raising of interest rates (Hungary, Iceland, Byelorussia);

3. Drop in the exchange rate of the national currency (Iceland, Hungary, Poland, Vietnam, Korea, Brazil, Mexico, Ukraine, Byelorussia);

4. Reduction of reserve requirements (China, Brazil, Bulgaria);

5. Creation of new tools of crediting the economy up to the direct financing of state budgets by central banks.

III. Influence on the real sector – stimulation of demand.

By this it is meant the support of industries oriented towards the internal demand and ensuring the domestic employment. This policy can be defined as a *predominantly Keynesian* policy, a specific feature of which is the measures affecting demand, including an anti-cyclical fiscal policy.

Among these measures are:

1. Support of selected industries, including:
   - motor vehicle industry (USA, Canada, France, Sweden, China);
   - "new" power and energy industry and energy conservation (USA, France, Switzerland);
   - transport infrastructure (Canada, France, China, Hong Kong, Kazakhstan, Italy, Switzerland, Taiwan);
   - residential construction (Canada, UK, China, Argentina, Kazakhstan, Korea);
   - aerospace, mining and forestry industries (Canada);
   - innovative technologies (China, Kazakhstan);
   - agribusiness industry (China, Kazakhstan);
   - exports (China);
   - airlines (Argentina).
2. Direct or indirect reduction of tax rates (Germany, France, Switzerland, Japan, China, India, Taiwan, Argentina, Ukraine);
3. Raise of tax rates (Lithuania);
4. Support of small and medium sized businesses (Germany, Greece, Italy, UK, Japan, China, Kazakhstan, Hungary);
5. Creation of special budget funds (France, Brazil, Hong Kong, Kuwait);
6. Increase in government borrowings (Germany, France, Norway, Japan).

However, most of the measures listed above have been only announced, whereas implementation thereof is postponed due to the natural apprehension of significant influence on the part of respective industry lobbies.

Such measures cause serious concerns on the part of a number of responsible politicians. The Finance Minister of Germany has sharply criticized such steps defining them as "vulgar Keynesianism" in fact having in view the intentions demonstrated by the governments of UK, France and USA.

IV. Counteracting negative expectations of the population.

Such measures are intended to prevent the flight of the funds of the population from banks and to create incentives for saving.

These measures include:

1. Raising of the amounts of guarantees as concerns deposits (USA, Canada, Belgium, Spain, Italy, Cyprus, Luxemburg, the Netherlands, Slovenia, Finland, UK, Sweden, Norway, Switzerland, Bulgaria, Hungary, Poland, Romania, the Czech Republic, Turkey, Korea, Ukraine);
2. 100 per cent guarantees with respect to deposits (Germany, Austria, Greece, Ireland, Portugal, Denmark, Slovakia, Australia, Hong Kong, Jordan, Kuwait, UAE, Saudi Arabia, Taiwan);
3. Adoption of retraining and adaptation programs for the people who lost their jobs (USA, Canada, Greece, Italy);
4. Nationalization of pension funds (Argentina);
5. Making of pacts with the business on prevention of job cuts (Germany);
6. Increase of investments in education (France).

The measures taken by the governments of the majority of countries are characterized by three major specific features:

- chaotic nature of such measures (especially at the first stage);
- slackening of fiscal and monetary policies bordering on apparent populism;
- readiness of the state to take upon itself private risks up to a massive nationalization.

However, the main problem is the fact that as yet the undertaken measures have not envisaged a solution of strategic (structural) problems of the modern economy[8].

Therefore, there are pursued exactly the same policies, which have been sharply criticized over the last thirty years and from implementation of which there were strongly cautioned post-communist countries during the transformation crisis they experienced in the first half of 1990s.

The measures undertaken by the developed countries in order to save their economies should be viewed skeptically. Such measures should not be automatically copied in Russia. There are several reasons for that.

Firstly, these measures are of a chaotic nature and have acquired a certain logic only by the end of 2008.

Secondly, these measures base on the Keynesian recipes, while, as the practice of the last 70 years demonstrate, the measures based on this logic may help to settle the tasks of current regulation (the anti-cyclical policy), but are of little use in the situation of a systemic crisis. It is too late to undertake anti-cyclical measures – the US administration has pursued anti-cyclical policies for five pre-crisis years and thus significantly exacerbated the crisis. At the same time, the inefficiency of the Keynesian recipes as concerns the overcoming of a systemic crisis is clearly demonstrated both by the US experience of the 1930s and the experience of the prolonged depression in Japan in the 1990s.

Thirdly, the suggested (Keynesian) recipes are highly risky from the macroeconomic point of view. The use of such recipes is characterized by a rather high probability of transition from deflation to stagflation. Especially high risks are associated with the policy of quantitative easing pursued in the countries not controlling a printing press of a reserve currency. The implementation of such measures in Russia may provoke only a flight from money and a double digit increase in prices at the time of an economic decline.

[8] Structural shifts are planned in the US motor industry. Anyway, the provision of a US $ 17 billion aid package was determined by the carrying out of structural transformations ensuring an enhancement of competitive power of the companies to be bailed out. However, as yet it is impossible to evaluate to what extent this condition will be met.

Section 2. Monetary and Budgetary Spheres

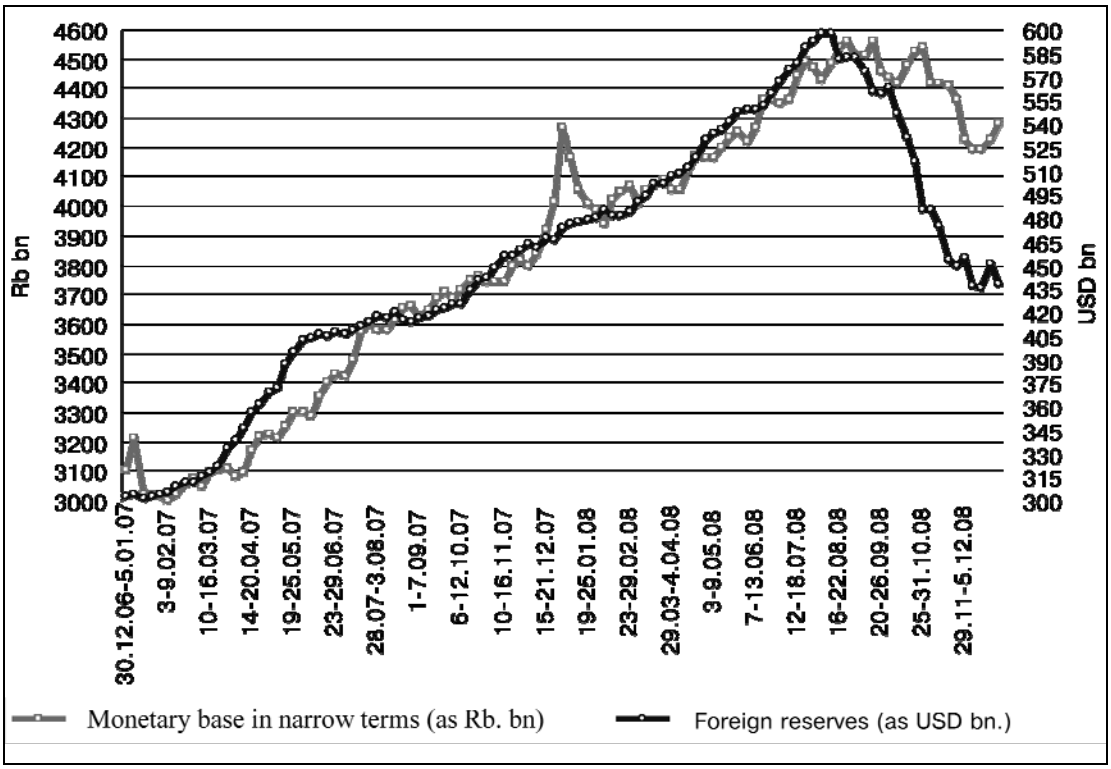
2.1. The Monetary and Credit Policy

The financial crisis was central to Russia's monetary and credit sphere in 2008. It exerted a significant influence on the national economy on the whole and the CBR's policy in particular. While over the first half-year the situation on the financial market was relatively calm, it sharply deteriorated between August and September. Below, we will consider in a greater detail causes for such developments and analyze inflationary processes, main tendencies and correlations on the national monetary market, and measures the CBR embarked upon in an effort to stabilize the situation on the financial markets.

2.1.1. The Monetary Market

Russia's foreign reserves have been rising substantially up to the early-August 2008 (Fig.1). Underpinning their rise were record-high prices for major Russian exports, primarily for oil, natural gas and metals. But the crisis developments on the global financial market, which were further aggravated by the military action in the Southern Ossettia triggered a sizeable capital outflow from the country. Plus, the slowdown of growth in the largest world economies engendered a substantial deterioration of trading conditions for Russia, because of which the inflow of foreign currency began to dry out sharply. As a result, the nation's foreign reserves started to shrink rapidly, as the CBR was compelled to spend them to maintain the Rb. exchange rate. In addition, the USD appreciated against the Euro on the global forex market, which caused a fall in the USD-equivalent value of the fraction of the foreign reserves denominated in Euro-.

So, by the end of the year the volume of the nation's foreign reserves accounted for USD 427.1bn (30.2% of GDP) against 478.7bn (35.5% of GDP) as of the beginning of 2008, while in August 2008 it accounted for the record-breaking USD 597.5bn. Hence, by the end of the year Russia's foreign reserves had dwindled at 28.5% against their peak value. Meanwhile, the volume of the reserves is still high by international parameters. More specifically, in the 4th quarter 2008, the reserves-to-imports ratio was 5.9, while a sufficient one is 1. But it should be understood that given a considerable capital flight (bolstered by the private sector repaying its debts in particular) and a sizeable negative balance of the trading account of the balance of payments, maintaining the Rb. exchange rate may coerce the Bank of Russia to spend a greater part of its reserves. Furthermore, had the monetary and credit authorities decided not to depreciate the national currency, they might have wasted all the reserves but had had to face the depreciation, nonetheless.



Source: the CBR.

Fig. 1. The Dynamic of the Monetary Base and Foreign Reserves in 2007-2008

The dynamic of money supply over the year of 2008 also went through two sub-periods. Let us consider it in a greater detail.

Over the year of 2008 the monetary base (in wide terms[1]) grew just by Rb. 65m and accounted for Rb. 5.6trln (+1.2%). As a reminder, by results of 2007 this index grew at 33.7%. As of January 1, 2008, the volume of monetary base in wide terms was Rb. 5.5trln (*Table 1*). As of January 1, 2009, the cash in turnover with account of credit institutions' cash balances accounted for some Rb. 4.4trln (+6.2% vs. January 1, 2008), the credit organizations' correspondent accounts with the Bank of Russia – Rb. 1,027.6bln (+28.1%), compulsory reserves – Rb. 29.9bn (-86.5%), the credit organizations' deposits with the Bank of Russia – Rb. 136.6bn (-49.5%), the value of the CBR's bonds held by credit organizations – Rb. 12.5bn (-87.6%).

A 6.2% growth in the volume of cash in circulation over the year, along with a drastic fall in the amount of compulsory reserves (-86.5%) resulted in a 2.9% expansion of the monetary base in narrow terms (cash + mandatory reserves)[2].

[1] According to the CBR methodology, the monetary base in wide terms characterizes the Bank of Russia's monetary and credit liabilities denominated in the national currency, which determine growth in money supply. The monetary base in wide terms comprises cash the CBR issued in circulation (with account of credit institutions' cash balances), balances of the compulsory reserves accounts which credit organizations deposit with the Bank of Russia, monies on correspondent accounts (including averaged balances of compulsory reserves) and deposit accounts the credit organizations have with the Bank of Russia, their investments in the Bank of Russia's bonds, backup funds by forex transactions deposited with the CBR, as well as the Bank of Russia's other liabilities by-with respect to operations with credit organizations in the currency of the Russian Federation.

[2] By the CBR methodology, the monetary base in narrow terms is the monetary aggregate (one of characteristics of money supply) fully controlled by the CBR. The monetary base in narrow terms comprises cash the Bank of

A considerable fraction of inpouring export revenues continued being accumulated in the national reserve funds, that is, the Reserve Fund and the National Welfare Fund. As of January 1, 2009, their aggregate volume accounted for Rb. 6,612.1bn (USD 225.1bn, or 15.9% of GDP) – up at Rb. 2763bn vs. January 1, 2008, when the respective figures were Rb. 3849.1bn (USD 156.8bn, or 11.8% of GDP). So, the favorable state of affairs on international markets allowed replenishing the reserve funds during the whole 2008. But their considerable fraction will be spent in 2009 to support the economy and finance the government's anti-crisis measures.

Table 1

The Dynamic of the Monetary Base in Broad Terms in 2008 (as Rb. Bn.)

	01.01.2008	01.04.2008	01.07.2008	01.10.2008	01.01.2009
Monetary base (in broad terms)	5513,3	4 871,4	5 422,9	5 317,8	5578,7
including:					
Cash in circulation, with account of credit organizations' cash balances	4118,6	3 794,4	4 077,2	4 285,3	4372,1
Credit organizations' corresponding accounts with the CBR	802,2	596,3	592,4	702,9	1027,6
Compulsory reserves	221,6	339,3	360,3	152,1	29,9
Credit organizations' deposits with the CBR	270,3	122,7	369,3	154	136,6
The CBR bonds held by credit organizations	100,7	18,8	23,7	23,5	12,5

Source: the CBR.

Let us note that the structure of the monetary base has undergone considerable changes in 2008. Underpinning these changes were crisis processes on the national financial market. First, despite problems with liquidity, in 2008, cash balances on the credit organizations' correspondent accounts with the CBR grew at nearly one-third. The trend is explained by the fact that with the crisis unfolding, the CBR provided banks with a sizeable volume of financing, particularly on the uncollaterilized basis. But, facing mounting risks, banks opted for scaling back volumes of lending and placing the funds with the CBR. Second, by results of the year the volume of credit organizations' compulsory reserves shrank dramatically, as the Bank of Russia had lowered the rates of their contributions to the compulsory reservation fund, to give credit institutions with additional liquidity.

The 2008 growth rate of the monetary base was very low, which can be attributed primarily to the crisis developments on the Russian financial market in the fall of the year. To pillar the Rb. exchange rate, which was under a strong pressure generated by capital outflow fueled by the deepening financial crisis, the Bank of Russia was selling foreign reserves to buy Rubles, thus reducing the monetary base. Interestingly, while the foreign reserves shrank to their October 2007 level, the value of the monetary base has grown over the year, nonetheless. An analysis of changes in the structure of assets in the CBR's balance sheet (see *Table 2*) reveals that between January and November 2009 it was credits and deposits provided to the national credit organizations that demonstrated the greatest growth rates (+Rb. 2.5trln, or 76% of the overall rise in the CBR's assets), while funds placed with non-residents[3] posted just a Rb. 0.7trln growth (or 21% of the rise in the CBR's assets). In the respective period of 2007,

Russia issued in circulation (with account of credit organizations' cash balances) and balances on accounts of compulsory reserves by attracted by credit organizations resources in the national currency equivalent deposited with the Bank of Russia.

[3] This item reflects change in the Bank of Russia's foreign reserves

the increment by these items was, accordingly, Rb. 24.5bn (a 0.6% rise in assets) and Rb. 3.4trln (a 85% rise in assets). In other words, in the crisis conditions, it is the CBR's operations on refinancing credit organizations which gradually become a major source of shaping the money supply – the practice long inherent in most developed economies. In such a situation, interest rates by the CBR's credits play a far greater role, as using them, the Bank of Russia can exercise a substantial influence on the situation in the monetary and credit sphere.

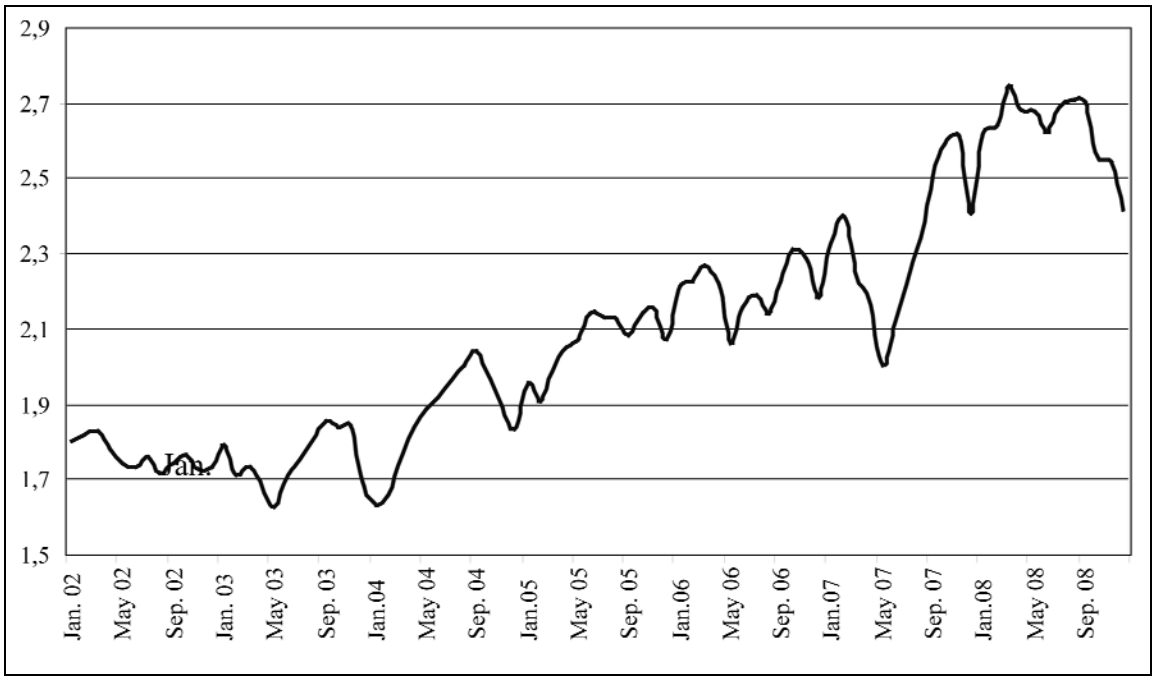
Table 2

The Balance Sheet of the Bank of Russia in 2008

	01.01.2008		**01.12.2008**	
	Rb. bn.	% assets/liabilities	Rb. bn.	% assets/liabilities
Funds placed with non-residents and foreign issuers' papers	11511,6	92,6	12222	77,6
Credits and deposits	37,1	0,3	2540,8	16,1
Precious metals	346,5	2,8	388,6	2,5
Securities	441,9	3,6	490	3,1
Other assets	99,5	0,8	106,5	0,7
Assets, total	**12436,7**	**100**	**15747,9**	**100**
Cash in circulation	4124,3	33,2	4215,9	26,8
Cash on accounts with the Bank of Russia	7609	61,2	9841,5	62,5
Cash in settlements	20,8	0,2	68	0,4
Securities issued	0	0	23,7	0,2
Other liabilities	196	1,6	1125,1	7,1
Capital	462,1	3,7	473,8	3
Profit by the reported year	24,6	0,2	0	0
Liabilities, total	**12436,7**	**100**	**15747,9**	**100**

Source: the CBR.

In 2008, money supply M_2 in national terms grew just by 1.7% and as of January 1, 2009, it accounted for Rb.1,3493.2bn, or 32.5% of GDP (as of January 1, 2008, monetary aggregate M_2 was Rb. 1,3272.1bn (40.2% of GDP). So, over 2008 the monetization of GDP plunged considerably. Underpinning the slowdown of the money supply growth rates were basically the same factors as in the case of the monetary base. In addition, in late-2008 the money multiplier plummeted considerably vs. its respective values reported between late-2007 and early-2008 (*Fig.2*). The fall was caused primarily by an overwhelming deceleration of the banking system's rate of lending to the private sector. In all likelihood, the money multiplier will keep on falling until Russian banks sense a growing attractiveness of lending to the private sector.

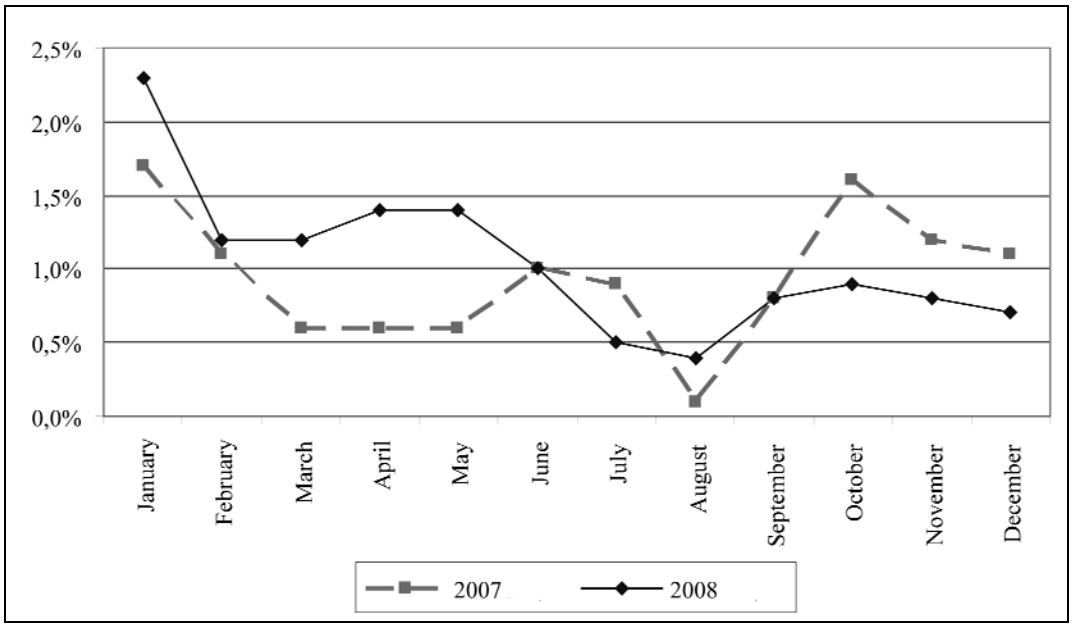


Source: CBR RF, the IET calculation.

Fig. 2. The Money Multiplier in RF in 2002-2008

2.1.2. Inflationary Processes

In early-2008, the inflationary pressure was still high compared with the respective period of the prior year (*Fig. 3*). The measures the RF government undertook in January to extend the October 2007 agreement on price freeze on some socially significant goods between largest producers and retailers proved to be fairly ineffective. Meanwhile, a rapid rise in money supply in late-2007 put an upward push on the price rise. But in the second half-year, because of the contraction of its foreign reserves the CBR was selling to maintain the Rb. exchange rate, money supply began to fall, while the price rise rate started to decelerate. In all, by results of the year CPI accounted for 13.3% vs. 11.9% reported in 2007. Let us consider the dynamic of inflationary processes over the year.



Source: Rosstat

Fig. 3. The Dynamics of CPI of RF in 2007–2008

As evidenced by data of *Table 3*, prices in the group of food stuffs grew at 16.5% (15.6% in 2007). So, like in 2007, food stuffs made the greatest contribution to the CPI increment over the year. Between January and December 2008, it was the price rise for pasta (+33.8%), bread and bakery (+25.9%), grits and legumes (+25.8%), meat and poultry (+22.2%) and sunflower-seed oil that made a major contribution to the price rise for food stuffs. The paid services to the population surged at 15.9% over the year (13.3% in 2007). It was prices for overseas tourism services (+22.9%), passenger transportation services (+22.5%), sanatorium and rehabilitation services (+21.2%), physical culture and sport services (+21%), preschool education services (+20.7%), household services (+18.7%), housing and communal services (+16.4%) and medical services (+16.3%) that demonstrated the greatest price rise rates over the year. As concerns non-food merchandise, prices for this group of goods rose at 8% on average over the year (in 2007 - at 6.5%). The price rise was powered chiefly by prices for tobacco goods (+16.1%), medicines (+16%), cleaning and washing goods (+17.5%) and construction materials (+11.3%). The growth in the basic index of consumer prices in 2008 accounted for 13.6% (vs. 11% reported over the respective period of the prior year). Thus, the main causes behind a significant inflation rate in 2008 was a rapid price rise for food stuffs, construction materials and paid services.

As shown by *Table 3*, between 2005 and 2008 it was the rise in the housing and utilities tariffs, which soared more than two-fold over the period in question, that formed a pivotal element of inflation. They are followed by the price rise for passenger transportation services (+86.8%), services delivered by institutions of culture (+79.9%), sanatorium and rehabilitation services (+79.5%), and some food stuffs. It is worth noting that gasoline prices demonstrated an insignificant rise over the year, which can be attributed to a drastic downfall in oil prices in the fall 2008. At the same time, prices for numerous food stuffs were rising at a pace greater than that in the prior years.

Table 3

The Annual Price Rise Rates for Some Kinds of Goods and Services in 2005–2008 (as%)

	2005	2006	2007	2008	2005 – 2008
CPI	**10.9%**	**9.0%**	**11.9%**	**13.3%**	**53.3%**
Food stuffs	9.6%	8.7%	15.6%	16.5%	60.4%
Sunflower-seed oil	*2.1%*	*-1.2%*	*52.3%*	*22.1%*	*87.6%*
Cream butter	*8.2%*	*6.8%*	*40.3%*	*10.5%*	*79.2%*
Pasta	*1.9%*	*4.7%*	*23.6%*	*33.8%*	*76.4%*
Grits and legumes	*0.2%*	*12.1%*	*24.7%*	*25.8%*	*76.2%*
Bread and bakery	*3.0%*	*11.1%*	*22.4%*	*25.9%*	*76.3%*
Milk and dairy products	*10.5%*	*8.7%*	*30.4%*	*12.2%*	*75.7%*
Meat and poultry	*18.6%*	*5.9%*	*8.4%*	*22.2%*	*66.4%*
Fish and seafood	*12.7%*	*7.8%*	*9.0%*	*15.1%*	*52.4%*
Non-food goods	6.4%	6.0%	6.5%	8.0%	29.7%
Construction materials	*9.1%*	*11.5%*	*16.2%*	*11.3%*	*57.3%*
Gasoline	*15.8%*	*10.9%*	*8.5%*	*1.2%*	*41.0%*
Paid services to the population	21.0%	13.9%	13.3%	15.9%	81.0%
Preschool education services	*32.1%*	*28.5%*	*11.8%*	*20.7%*	*129.1%*
Housing and utilities	*32.7%*	*17.9%*	*14.0%*	*16.4%*	*107.6%*
Passenger transportation services	*15.8%*	*14.2%*	*13.6%*	*22.5%*	*84.0%*
Cultural institutions' services	*17.7%*	*15.6%*	*14.5%*	*15.5%*	*79.9%*
Sanatorium and rehabilitation services	*11.2%*	*15.2%*	*15.6%*	*21.2%*	*79.5%*

Source: Rosstat.

In conclusion, let us compare the consumer price rise rates in RF with those in the CIS countries (*Table 4*).

Table 4

Consumer Price Indices in the CIS Countries in 2000−2008, as%

	2000	2001	2002	2003	2004	2005	2006	2007	2008
Azerbajan	2	2	3	2	7	10	8	17	20,8
Armenia	− 1	3	1	5	7	1	3	4	9
Belarus	169	61	43	28	18	10	7	8	14,8
Georgia	4	5	6	5	6	8	9	9	10
Kazakhstan	13	8	6	6	7	8	9	11	17
Kyrgyzstan	19	7	2	3	4	4	6	10	24,5
Moldova	31	10	5	12	12	12	13	12	12,7
Russia	20	19	15	12	12	11	9	12	13,3
Tajikistan	24	37	10	17	7	8	12	22	20,4
Ukraine	28	12	1	5	9	14	9	13	25,2

Source: The CIS Intergovernmental Statistics Committee (http://www.cisstat.com/).

Clearly, all the CIS nations saw inflation accelerate in 2008. At the same time, the global financial crisis that hit the world economy had a dual influence on inflationary processes in Russia and the other CIS countries. On the one hand, a sharp deceleration of growth rates of money supply in the second half-year leads to compression of the monetary inflation. Let us note that the compression of money supply took place despite the government's considerable anti-crisis spending, as economic agents opted for a mass conversion of their funds

into hard currency and the money multiplier was on decline. So, for the first time over the recent years Russia's economy once again experiences dollarization. The trend to decrease in money supply would continue in 2009, should the Bank of Russia further maintain the Rb. exchange rate at a level higher that the equilibrium one. If that happens, even a considerable budget deficit, which, as the government assumes, should in 2009 account for 8-10% of GDP, may not entail a serious expansion of money supply, but compensate its contraction, due to the above factors.

On the other hand, depreciation of the national currency engenders a price rise for imports and sparks inflationary expectations. Plus, the latter are on the rise along the growth of financial instability. Finally, a slowdown of economic activity gives rise to a lower demand for money, while economic agents loose confidence in the banking system and strive to convert their savings into foreign currency. In our view, in the conditions of Russian economy the Rb. depreciation will result in a mounting inflationary pressure and by results of 2009 CPI will prove to be greater than in 2008. Meanwhile, the pace of inflation acceleration is hard to estimate – it depends on numerous factors, including the volume of additional budget spending, the Bank of Russia's exchange rate management policy, and the magnitude of dollarization of the economy in particular.

According to the scenario-based forecast by the IET, in 2009 CPI should account for 15-25%, depending on the state of the nation's balance of payments, the mgnitude of depreciation of the national currency, and the size of the budget deficit.

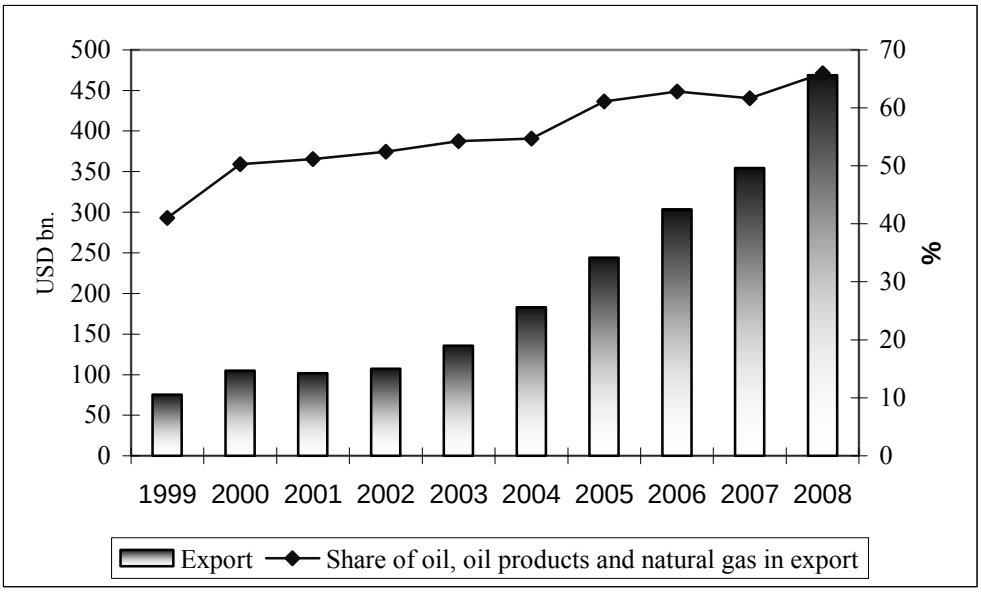
2.1.3. The State of the Balance of Payments[4]

In 2008, the sustainability of Russia's balance of payments was traditionally maintained thanks to exports, primarily, the fuel and energy sector's outputs. Despite a sharp downfall in prices for energy sources in the fall of 2008, thanks to a rapid rise in the prices over the first half of the year, the balance of trade ultimately posted a 34.9% growth, while that of balance of payments was up at 29.7%. Against the backdrop of high prices for energy sources Russian exports surged at 32%-plus, while imports showed a 30.9% rise. But the world financial crisis has so far resulted in a downfall in prices for major Russian exports and a massive capital flight out of the country. As a result, while by the end of the year the balance of payments seems fairly sustainable, a fast fall in exports and the private capital outflow noted in the 4th quarter have resulted in contraction of the nation's foreign reserves for the first time since 1998.

According to the CBR's preliminary evaluation of Russia's 2008 balance of payments, the positive balance of current account made up USD 98.9bn., i.e. at 29.7% up compared with 2007 (*Table 5*). More specifically, the positive balance of balance of trade soared at 34.9% (from USD 130.9bn to 176.6bn), with exports growing at 32.3% (from USD 354.4bn to 469bn) and imports surging at 30.9% (from USD 223.5bn to 292.5bn). The share of exported oil, petroleum derivatives and natural gas in the overall value of export accounted for 65.9% (in 2006- 62.8%, in 2007 – 61.7%) (*Fig. 4*). Thus, like in the prior years, the main factor that determined the value of the balance of current accounts was the balance of trade, whose balance in turn appeared to a significant degree dependent on dynamics on international markets of prices for energy sources and other major Russian exports. As evidenced by *Fig. 4*, the cor-

[4] The analysis of the balance of payments was conducted on the basis of the CBR's preliminary data: http://cbr.ru/statistics/credit_statistics/print.asp?file=bal_of_payments_est.htm

relation between world oil prices and Russia's balance of trade noted over 2002-2007 survived unchanged through 2008.



Source: the CBR.

Fig. 4. The Dynamic of Export of Merchandise and the Proportion of the Output of the Fuel and Energy Complex in 1999-2008

Deficit of the balance of services accounted for USD 25.8bn and posted a 30.5% growth vis-à-vis its 2007 index. Export of services was USD 50.8bn (+11.4bn, or 28.9% vs. the 2007 figures), while import of services soared at 29.4% and hit the level of USD 76.6bn.

The balance of labor compensations in 2008 continued to slide (to grow by module) and accounted for -14.5bn USD (vs. -7.9bn in 2007). The 2008 deficit of the balance of investment revenues surged at 45.5% vs. 2007 and accounted for USD 34.2bn. Driven by a substantial rise of the index in the banking sector (from USD 4.7bn to 7.4bn[5]) and across non-financial corporations (from USD 21.5bn to 26.4bn), investment gains due rose from USD 44.8bn to 53.3bn. Russia continued collecting sizeable investment earnings (USD 18.2bn) resulting from investing of a fraction of its foreign reserves. The rise of income receivable by non-financial corporations from USD 55.9bn to 71bn and that by banks from USD 9.9bn to 14.4bn was behind the growth in the overall income receivable from USD 68.3bn to 87.5bn.

The balance of current transfers[6] in 2008 accounted for -3.2bn USD (down 8.8% compared with 2007).

[5] Such a significant rise in earnings is attributed to the investing of a fraction of the nation's foreign reserves in other countries' bonds.

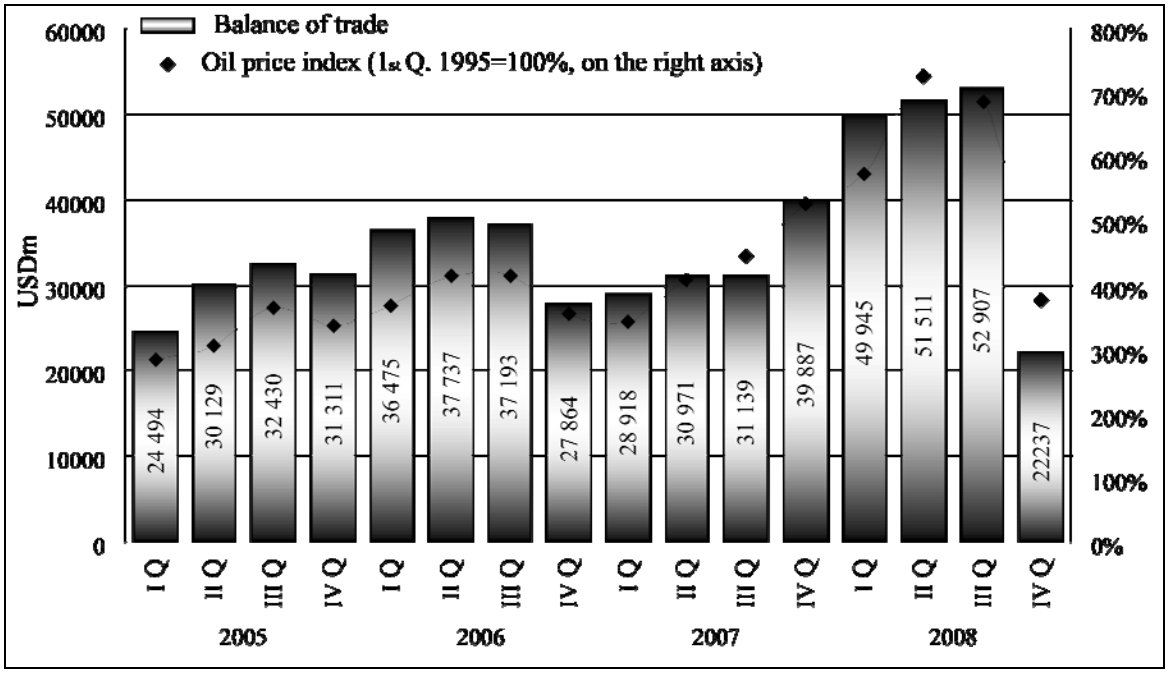
[6] According to the CBR, the current transfers bolster the level of disposable income and consumption of the recipient's goods and services and decrease the donor's disposable income and possibilities for consumption, for instance, humanitarian aid in the form of consumer goods and services. The current transfers are reflected in current accounts. Transfers other than current are conceived of as capital ones. They lead to a change in the volume of the donor or recipient's assets or liabilities and are reflected in capital accounts. In the event the donor and the recipient are non-residents to each other, the capital transfer engenders changes in the level of national wealth of

Table ???5

Main Items of the Balance of Payments and the Dynamic of External Debt in 2006–2008 (as USD bn.)

Статьи баланса	2006					2007					2008				
	I Q.	II Q.	III Q.	IV Q.	*Year*	I Q.	II Q.	III Q.	IV Q.	*Year*	I Q.	II Q.	III Q.	IV Q.*	*Year**
Current account	30.4	24.3	23.9	15.7	*94.3*	22.4	14.4	15.5	24	*76.2*	37.4	25.8	27.6	8.1	*98.9*
Capital and financial instruments account**	-7	15.7	-14.8	9.5	*3.4*	14.5	48.5	-3.6	26.5	*85.9*	-24.7	35.4	-9.4	-129.7	*-128.4*
Change in forex reserves («+» -"decline of reserves", «-» – growth in reserves)	-21.4	-40.9	-13.8	-31.3	*-107.5*	-32.9	-65.5	-7.9	-42.6	*-148.9*	-6.4	-64.2	-15	131	*45.3*
Net mistakes and omissions	-1	0.9	4.8	6	*9.7*	-4	2.7	-3.9	-8	*-13.2*	-6.3	3.1	-3.2	-9.4	*-15.8*
Change in external debt of RF («+» growth in debt, «-» – decrease of debt)	16.0	15.6	-19.5	41.3	*53.4*	37.4	43.9	39.1	32.5	*152.9*	13.9	47.4	15.7	–	–
Change in the external public debt of RF	4.0	-7.6	-24.5	-5.1	*-33.2*	3.6	-3.2	3.5	-6.1	*-2.2*	-5.4	-2.1	3.8	–	–
Change in the external debt of the private sector in RF	12.1	22.7	5.1	46.9	*86.8*	34.0	47.1	35.5	38.7	*155.3*	19.2	49.5	11.9	–	–

* Preliminary estimates.
** Less currency reserves.
Source: The Bank of Russia.



Source: the CBR, IFS, the IET calculations.

Fig. 5. Russia's Balance of Trade and the World Oil Price Index in 2005-2008

So, it was high prices for major Russian exports that were behind a huge positive balance of current accounts of Russia's balance of payments between the 1st and the 3rd quarters 2008. Their downfall in turn triggered a fall of the positive balance of current accounts. Let us

the economies they represent. Examples of capital transfers are a free-of-cost transfer of property rights for capital assets or debt forgiveness.

note that at the background of a sharp decline in the balance of current accounts at the end of the year, a huge debt private sector had accumulated to that date (see *Table 5*) engendered growth in the negative balance of investment earnings, even despite sizeable investment revenues the monetary and credit regulatory agencies collected from investing the nation's international reserve assets. Hence, the private sector repaying its external debt should have a significant impact on the balance of payments in 2009-2010.

In 2008, the balance of capital accounts slid substantially and reached-128.4bn USD. That was determined by the financial turmoil on the world and national markets stirred by the downfall in prices for energy sources. The 2008 balance of capital transfers accounted for USD 6bn. So, without regard to capital transfers, the 2008 deficit of the financial account amounted to USD 129bn.

The rise in the Russian issuers' liabilities before foreign creditors by results of the year was USD 87.5bn, or down at 58.1% vs. 2007 (USD 208.9bn).

As in the prior year, the federal administrative bodies likewise became net payers in relation to non-residents. Their external liabilities slid at USD 7.4bn resulting from repayment of Russia's external public debt. The balance of external liabilities across the RF Subjects remained unchanged. The liabilities held by the monetary and credit authorities amounted to USD 4.7bn. The intensifying global financial crisis sharply diminished possibilities for Russian economic agents to attract (refinance) their overseas borrowings. Consequently, the increment of the banking sector's liabilities (+USD 9bn) plunged by 87.4% compared with the same period of 2007. Investments by foreign economic agents in Russia's real sector accounted for USD 90.6bn (in 2006 - 144.7bn). So, while in 2008 non-residents' investments in the non-financial sector were down compared with the 2007 figures, they nevertheless were in excess of their investments in the banking sector. Direct investments in the non-financial sector posted a 22.7% growth over the year and accounted for USD 58.7bn vs. 47.9bn reported in the prior year. As concerns portfolio investments, they were down at USD 10.8bn compared with the USD 6.5bn rise in 2007.

The residents' foreign assets (foreign economic agents' liabilities before Russian ones) grew over 2008 at USD 216.5bn (in 2007 - at 112.8bn), with the bulk of the increment being secured by the private sector's operations.

Foreign assets of the federal administrative bodies rose at USD 2.4bn, while those of the monetary and credit authorities remained practically unchanged.

Because of the turmoil on the national financial market coupled with the downfall in prices for major Russian exports and, consequently, expectations of a significant depreciation of the national currency, Russian banks in 2008 began vehemently accumulating foreign assets. More specifically, by results of the year the rise in the banks' foreign assets accounted for USD 66.4bn., while the respective 2007 indicator did not exceed 25.2bn.

Export of capital out of the sector for non-financial enterprises and households rose at 56.3% compared with 2007 and accounted for USD 145.6bn. The volume of "the export gains not received on time, goods and services not supplied against transfers of monetary resources under import contracts, and transfers by fictitious operations with securities" practically remained unchanged when compared with 2007 and made up USD 33.2bn. At this point, it must be noted that it was "cash in foreign currency equivalent" that underwent the most profound changes, which evidences that the 2008 import of foreign currency in RF accounted for USD 24.8bn. compared with its USD 15.7bn-worth export in 2007. In other words, once the Rb.

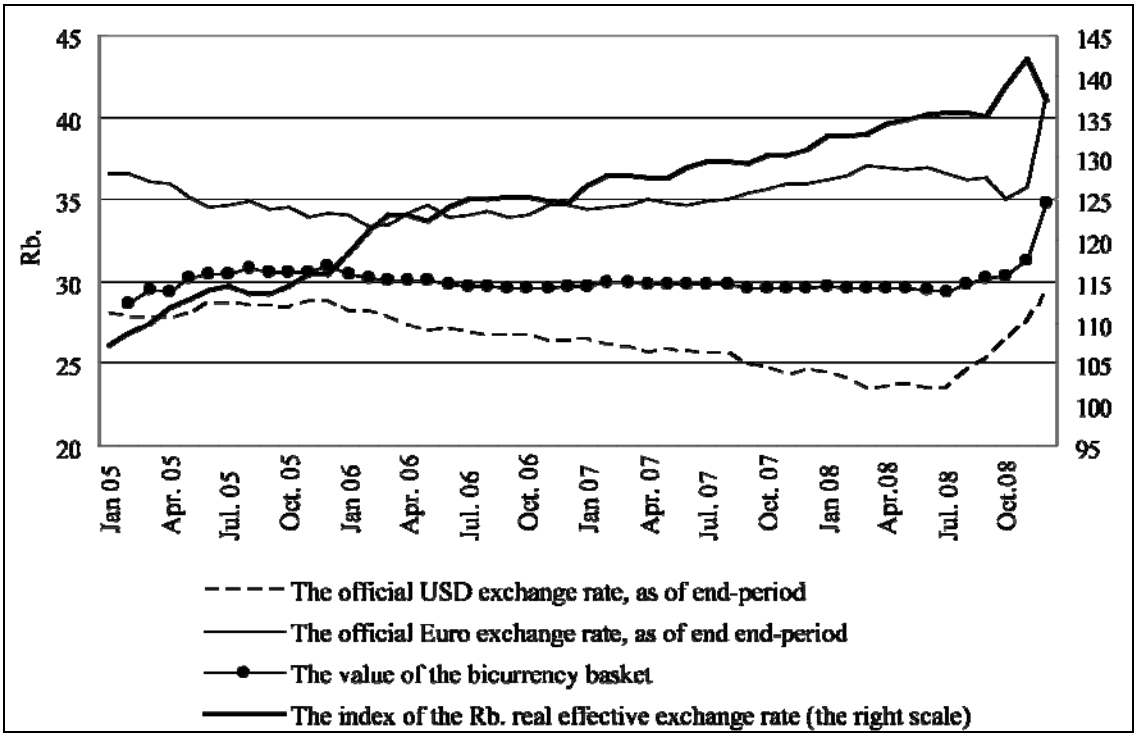
began to depreciate (both in nominal and real terms) against the bicurrency basket in the fall of 2008, the population and the non-financial sector once again began to vigorously buy foreign currency; that was noted for the first time since 1997.

Up to the end of the year growth in offer of foreign currency was fueled by its influx from overseas and its sales by the non-financial sector within the country. That resulted in a rising real effective exchange rate of the Rb - by results of the year it appreciated at 5.1% (see *Fig. 6*), primarily because of inflation rates in Russia being higher than in the countries that are Russia's major trading partners. Meanwhile, a massive fall of the balances of current accounts and capital account and financial instruments of the balance of payments in the 4th quarter resulted in a considerable excess of demand for foreign exchange over its offer. To maintain the Rb. exchange rate, the Bank of Russia was selling its foreign reserves. But in September, the Rb. began to gradually depreciate against the bicurrency basket – that was done in order not to waste all the CBR's foreign reserves. The pace of the Rb. depreciation was accelerating along with the downfall in prices for major Russian exports and with the acceleration of capital outflow. As a result, in December alone, the Rb. real effective exchange rate slid by 3.6%, while yet in October in November it was up at 2.7% and 2.5%, respectively. It was back in January 2000 when the index declined so dramatically. By results of 2008, the Rb plunged against the USD from 24.55 to 29.38 and against the Euro – from 35.93 to 41.44, while the bicurrency basket rose from 29.67 up to 34.81.

With the volume of the forex revenues inflow in the country drastically diminishing, it was possible to maintain the overvalued Rb. exchange rate by means of spending foreign reserves only over a limited time. Meanwhile, as the CBR was pursuing a gradual depreciation of the national currency, buying foreign exchange has become for economic agents a relatively low-risk and highly lucrative investment instrument, which led to an increasing demand for foreign exchange and the imperative for the CBR to spend more and more of its foreign reserves.

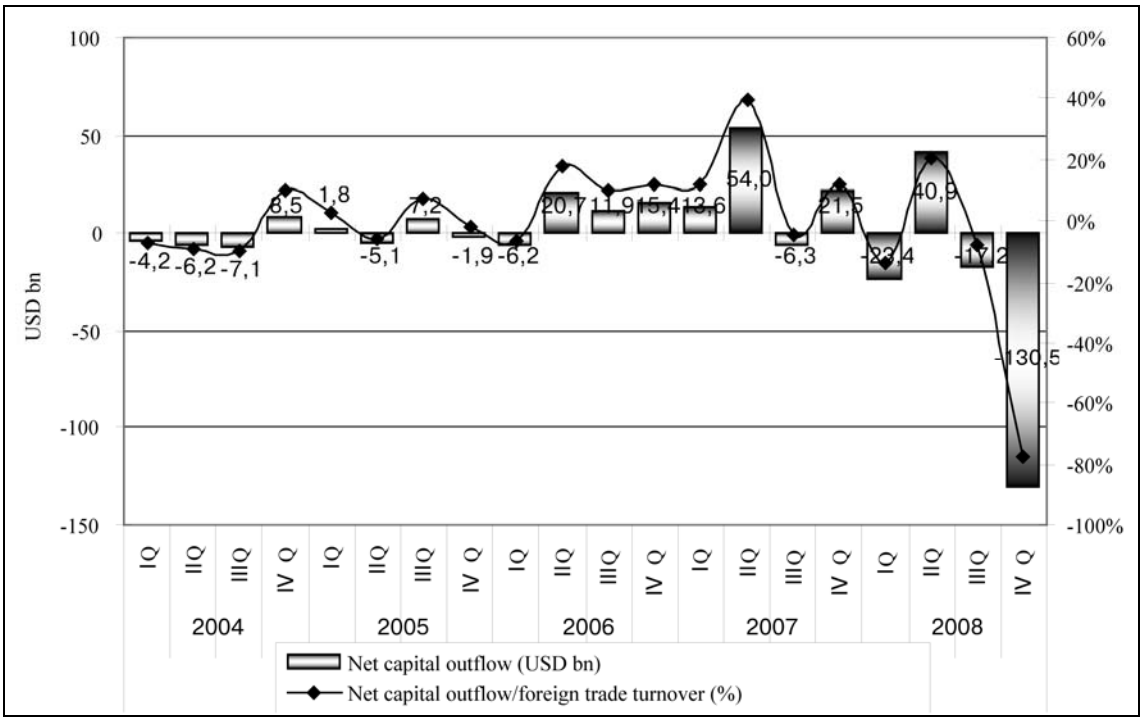
We believe that a single-step depreciation of the Rb. with a subsequent maintenance of a new announced level would become the most optimal move under such circumstances, as it would have enabled the CBR to save its reserves and lower depreciation expectations. The key factor that makes such a policy a success lies with the CBR's commitment to support a new exchange rate. Let us note that this commitment is in many ways determined by the Bank of Russia's ability to accurately estimate the equilibrium exchange rate. We presume that the level of support to the Rb. that would enable one to get demand and offer balanced on the forex market under the economic parameters of the early-2009 can be found within the range of 40-45 Rubles for the bicurrency basket. The problem is, in the conditions of the global financial crisis many factors are hard to estimate, which is why, should prices for energy sources decline further on, setting an equilibrium on the forex market may demand for a further depreciation of the Rb.

Let us also note that to ease its mission on supporting the Rb. exchange rate the CBR is able to undertake measures aimed at restriction of capital outflow from the country. In all likelihood, the set of such measures may include cutting volumes of liquidity provided to commercial banks, raising interest rates, as well as some administrative measures, such as a coercive reservation for legal entities a part of funds they are going to export and a compulsory sale by exporters of a part of their forex-denominated receipts.



Source: the CBR, the authors' calculations.

Fig. 6 Indicators of the Rb. Exchange Rate between January 2005 and December 2008



Source: the CBR; the IET calculations.

Fig. 7. The Dynamics of the Net Capital Outflow in 2004-2008

Addressing key tendencies in the dynamic of indicators of the 2008 balance of payments one should reference to contraction in the balance of current accounts of the balance of payments in the 4th quarter and a fairly sizeable net capital outflow from the non-financial sector which was worth a total of USD 130.2bn (in 2005-07, there was noted a capital inflow at the level of USD 2bn, 41.9bn and 82.8bn, respectively) (see *Fig. 7*).

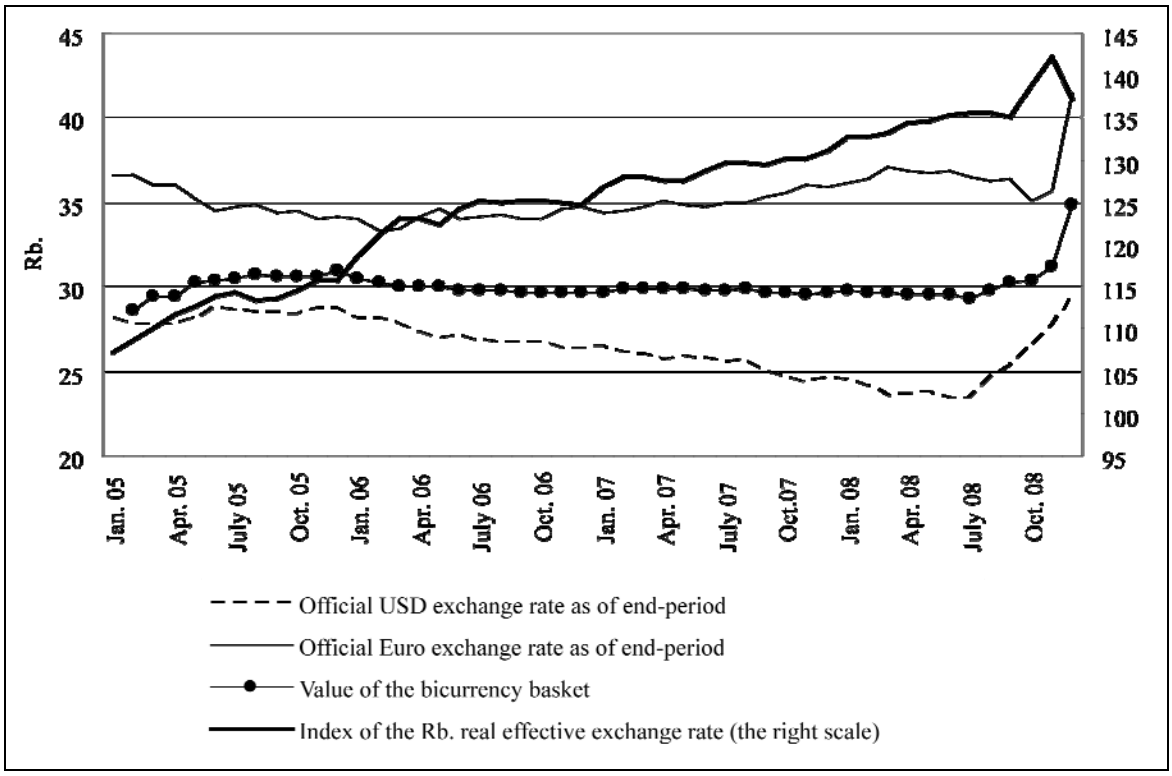
By results of the 2nd quarter 2008, there was registered a USD 40.9bn-worth capital inflow. However, the overall result for the period between January through September equals just USD 0.3bn, because of the capital outflow in the 1st and 2nd quarters. Between October and December, steered by a sharp slowdown in economic activity, expectations of the Rb. depreciation against the bicurrency basket and growth in risks for foreign investors, the capital outflow from the country accounted for USD 130.5bn. Thus, the net 2008 capital outflow is USD 130.2bn, or 17.1% of the nation's foreign trade turnover.

Let us note that against the background of a drastic shrinkage of the balance of current accounts of Russia's balance of payments, the problem of sustainability of the latter is further complicated by a huge foreign debt accumulated by Russian corporations, including quasi-public ones (i.e. banks and non-financial companies in which the public administration bodies and monetary and credit regulators hold, directly or indirectly, over 50% of participation in capital or otherwise exercise control over them). According to the Bank of Russia, as of October 1, 2008, the quasi-public companies' aggregate debt amounted to USD 146.1bn, including 14.4bn in a short-term (up to 1 year) debt. The aggregate external debt the private sector had accumulated as of the date in question was USD 351.6bn, including USD 87.5bn in short-term liabilities. So, in 2009 the national corporations will have to repay their USD 136bn-worth external debts (including repayment of the body of the debt and interest payments). In all likelihood, with chances for attracting foreign investors' resources into Russia being low, that will give rise to a sizeable negative balance by capital accounts and those on financial instruments.

In 2008, the unofficial capital outflow (capital flight) out of the country (*Fig. 8*) remained practically unchanged when compared with 2007. We estimate[7] its volume at the level of USD 49bn, or up just at 0.4bn compared with 2007. Accordingly, the year of 2008 evidenced a drop in the proportion of capital flight in the foreign trade turnover to 6.4% from 8.4% reported in 2006.

As concerns other peculiarities of the 2008 balance of payments, let us note that the proportion of revenues from export of energy sources in export of goods was still great. The downfall in prices for energy sources in late-2008 highlighted vulnerability of Russia's balance of payments. In 2009, the oil prices may stabilize at a low level or even demonstrate a further decline, which, given a stable exchange rate of the Rb., may lead to a further decrease in the balance of current accounts of the balance of payments. Hence, in the event a net capital flight from Russia continue, the balancing of the balance of payments may be secured by further depreciation of the Rb. exchange rate and, accordingly, decrease in import, as well as by the CBR selling its foreign reserves.

[7] We calculate capital flight using the IMF methodology: accordingly, it constitutes the sum of "trade credits and forward payments", "export gains not received on time, goods and services not supplied against transfers of monetary resources under import contracts", and "net mistakes and omissions".



Source: the CBR; the IET calculations.

Fig. 8. The Dynamic of Capital Flight in 2004-2008

2.1.4. Main Measures in the Monetary and Credit Policy Area

1. On March 1, the RF Statistical Service posted on its Homepage on the Internet a personal inflation calculator. Using it, one can calculate an individual consumer price index proceeding from one's personal structure of consumer expenses. It is known that the CPI published in RF is computed on the basis of the average statistical structure of the consumer basket. This structure is revised fairly rarely, while the structure of consumer expenses of each individual consumer may differ significantly from the average statistical one, which may result in the personal inflation deviating greatly from the average nationwide one.

Let us note that such tools are available to residents in many developed countries. Their use allows their governments to bolster economic agents' confidence in inflation indicators published by government statistical agencies.

2.On May 14, the Bank of Russia modified procedures of exercise of currency interventions. In addition to carrying out spot operations aimed at maintaining the value of the bicurrency basket, the CBR started to hold regular currency interventions depending on the state of affairs on the domestic and overseas financial markets. This move was launched in the frame of a gradual transition to the floating exchange rate mode. While the pressure on the Rb. was mounting in the fall of the year, the CBR once again became a leading player on the forex market by selling resources from its foreign reserves to maintain the Rb. exchange rate. As noted above, the 2008 gradual depreciation policy cost the CBR more than one-fourth of its foreign reserves. At the same time, we believe that, unlike the situation in the aftermath of

the1998 crisis, in the current conditions depreciation does not bear explicitly favorable consequences, both because of a smaller volume of idle production capacities that may be engaged in the import substitution process and due to a considerable amount of the national corporate sector's debt, which is on the rise because of the Rb. depreciation. Plus, by contrast with 1998, the current crisis has battered the developed economies, too, which has entailed contraction of demand worldwide and the absence of possibilities for a rapid renewal of the capital inflow in RF. At this juncture the monetary and credit authorities should estimate the Rb. exchange rate which would enable them to get the balance of trade balanced and protect an announced level from the bearish mood on the financial market.

3.Since July 1, 2008, the CBR modified its methodology of calculation of international reserve assets of RF. Since that date the bonds that are included in the composition of the reserves are accounted in the composition of the reserves at their market value. In the past, these instruments were included in reserves at their depreciation value, i.e. by their effective price plus interest accrued. Such an approach better matches the best international practices, and its employment allows a more adequate estimate of the current volume of reserves. At the same time, the new approach may lead to a greater volatility of the amount of foreign reserves.

4.In 2008, the CBR continued to publish reports on the structure and results of its foreign reserve management. This move is aimed at enhancement of transparency of the Bank of Russia's operations. But it should be noted that the respective data are published with a more than 6-month lag, which, in our view, goes well beyond reasonable limits. Plus, the report does not cite yields rates by all the investment instruments with a breakdown by kinds of currencies. If supplied, such information would allow a more complete assessment of the foreign reserve management outcomes.

The most interesting section of the reports is information on results of the foreign reserve management. According to the last report posted on the CBR's Homepage on the Internet in January 2009, between April 2007 and March 2008 the Bank's reserve assets soared by USD 167bn, including USD 28.5bn (15.4% of the overall rise) in interest earnings and revaluation of bonds. So, in the conditions of a sizable influx of foreign currency in the country, these earnings constituted a relatively insignificant factor of the dynamic of the nation's foreign reserves. But once the state of affairs in the foreign trade area aggravated and capital inflow began to dry out, the foreign reserve management outcomes undoubtedly started playing a greater role than before.

To evaluate the CBR performance with regard to its reserve management, the report suggests employing the so-called "normative portfolios", which essentially represent indices of markets whereinto the Bank carries out its interventions. In the composition of the CBR's assets denominated in reserve currencies, there are the operational portfolio and the investment one. In all likelihood, the operational portfolio is supposed to support a high level of liquidity of reserve assets the CBR needs to exercise its functions on pursuance of the monetary and credit, and currency policies. The investment portfolio, whose name speaks for itself, was established to invest respective funds in less liquid and more risky assets.

The yield rate of reserve assets management operations between April 2007 and march 2008 was 7.3% in USD equivalent, 4.5% in Euro equivalent, 7.9% in British pounds and 0.6% in Yen equivalent.

5. In 2008, the Bank of Russia continued to raise interest rates by instruments of attraction of credit organizations' funds. More specifically, interest rates by deposits on standard

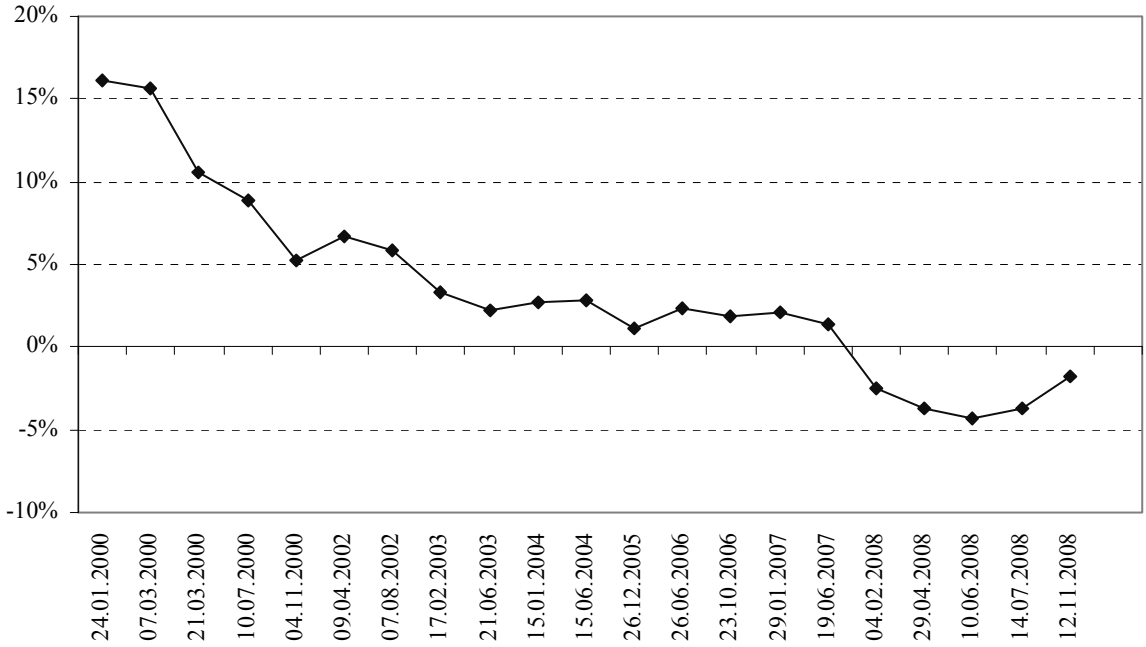
terms “tom-next”, “spot-next” and on-demand deposits were raised from 2.75% annualized to 6.75% annualized, while those by “one-week” and “spot-week” deposits were raised from 3.25% to 7.25% annualized. That was done for the sake of sterilizing the excessive liquidity in the summer and became possible thanks to changes in the domestic and external economic conditions. With the use of these measures the Bank of Russia continued its course towards a greater role played by interest rates in implementation of its monetary and credit policy. Meanwhile, because of the rise of liquidity shortages on the Russian market due to the financial turmoil on international markets, in 2008, the volume of commercial banks’ deposits with the CBR did not exceed Rb. 300bn vis-à-vis 1.2trln reported in 2007.

6. In 2008, the Bank of Russia also vehemently employed such a monetary and credit policy measure as modification of the compulsory reservation rates. They were raised four times through September and ultimately reached 8.5% annualized by the Russian banks’ debts before foreign credit organizations, 5.5% - by their Rb.-denominated liabilities to private individuals and 6% - by other liabilities. It is worth noting that it was the compulsory reservation rate by the banks’ debts to non-residents that was growing at the greatest pace. Apparently, that was explained by the CBR’s desire to decelerate the growth rate of the bank’s external debts to bolster their financial sustainability in the event of aggravation of problems on the world financial markets.

With the domestic financial turmoil on the rise, the Bank of Russia ruled to drastically decrease rates of contributions to the CRF effective as of October 15. In the aftermath of a two-stage decrease across all kinds of reserved obligations the rates were set at the level of 0.5%, but only for a certain period of time – they should have been raised up to 1.5% since February 1, 2009 and further up to 2.5% since March 1, 2009. Bu in January 2009, the Board of Directors of the bank of Russia decided to shift the timelines for a stage-by-stage raising of the rates of contributions to the CRF. According to the new decision, the new dates were set for May 1, 2009, and June 1, 2009. In all likelihood, the CBR made this decision because of a complex situation in the national financial sector steered by the world financial downturn. The Russian credit organizations should shortly face a rapid growth in failures to repay loans they have earlier issued, which should derail their financial health. Withdrawal of liquidity in the form of deductions to the CRF in such conditions would fuel the rise of financial instability.

7. In 2008, the Bank of Russia for six times raised its refinancing rate, which ultimately has grown from 10 to 13% annualized. Let us note that it was done in parallel with the raising of rates by the credit organizations’ deposits with the CBR and the acceleration of inflation in the country. But because of a rapidly mounting inflation pressure, the refinancing rate in real terms has remained negative practically over the whole year.

In the autumn of 2008, in the conditions of aggravation of the situation on the financial market, the commercial banks’ demand for the Bank of Russia’s credits grew sharply, which resulted in a higher value of the CBR’s interest-rate policy, as its resources have formed a major source of formation of money supply (see above). The CBR employed maintenance of low interest rates in real terms to vigorously credit commercial banks. Meanwhile, in the fall of the year the Bank of Russia increase the momentum of raising the refinancing rate to counter the capital outflow that started because of the development of the world financial crisis and was fueled by downfall in prices for major Russian exports (*Fig.9*).



Source: The CBR, the Statistics Service of RF.

Fig. 9. The CBR's Refinancing Rate in 2000-2008, in Real Terms

8. Due to the outgrowth of the financial crisis in late-2008, the national financial intermediaries in Russia faced liquidity shortages, which compelled the Bank of Russia to embark on a series of emergency measures (apart from lowering interest rates by its credits and reducing the CRF deduction rates), aimed at preclusion from a spreading of instability in the national banking sector.

More specifically, on October 10, the State Duma passed an act that allowed the bank of Russia to disburse unsecured loans to Rusian credit organizations. Such loans became available to credit organizations whose credit rating is not below a set value, and they could be disbursed for the term up to 6 months. This measure was aimed at supporting the national banking sector that had found itself in a hard situation. Because of a large-scale outflow of private capital from the country, a sizeable external indebtedness accumulated over the previous years, and the crisis in the real sector. Prior to the promulgation of the act, The CBR had been able to disburse credits to the national commercial banks against securities, hard currency, receivables under credit agreements or against a credit organization's pledge. But because the banks' huge need in credit resources, they lacked assets that might serve as a collateral against a CBR's lending. In such a situation, granting the CBR the possibility to disburse unsecured loans enabled it to support Russian banks, albeit it has increased potential risks associated with the borrowers' inequitable conduct.

To support the banking sector in the conditions of the deepening financial crisis the CBR began entering in agreements with large Russian banks on compensation for a fraction of their possible losses in the interbanking lending operations. As well, the Bank of Russia has undertaken such measures as provision of the REPO financing on security of an extended list of assets, extension of the REPO financing term, disbursement of subordinated credits to the

so-called "backbone" banks, and adoption of the legislation on loan guarantees for corporations. Plus, the capitalization of the Deposit Insurance Agency was boosted for the sake of financial rehabilitation of the banking system.

Finally, on December 30, 2008, the Bank of Russia modified procedures of formation by credit organizations of reserves to withstand possible credit losses. According to the effective procedures, credit organizations are bound to form reserves to back possible credit losses, depending on credit risks assessments. The procedures also imply that this diminishes the volume of funds available for commercial banks to carry out their current operations.

In compliance with the above decisions, the credit institutions were granted the right not to increase their credit reserves until December 31, 2009, in the event:

- the duration of the overdue indebtedness by the loan principal or interest on loan extends for the term of not more than 30 calendar days relative to the effective timeline;
- the loan has been restructured (for instance, the currency in which the loan was denominated was changed, or the loan period (with regard to the loan principal and/or interest on loan), or a change of the interest rate) has been modified in the period since October 1, 2008);
- the loan received since October 1, 2008, has been used to repay the earlier extended loan.

So, this measure has de-facto stimulated banks to credit more risky borrowers. But it should be understood that an overly liberal approach to the credit risk assessment procedures may derail the financial stability. In other words, this measure should be conceived of as a solely temporary help to the national financial system. Furthermore, in the late-2008, there appeared information that the government authorities instructed the largest Russian banks to bolster their credit portfolios at a certain rate. With the financial instability on the rise, such an approach may just entail accumulation of "bad' debts on the banks' balance sheets and trigger further challenges facing the credit organizations.

The Russian banks are going to shortly face yet another major challenge, that is, the rise in the volume of overdue debts on earlier extended credits. We think that at this juncture the main tasks in the area of support of the banking system are development of approaches to the diminishing of the banks' "bad" assets, easing the M&A processes in the banking sector, refinancing the banks' external debts on the arm's length terms, and improving the regulation and oversight procedures in the sector. International experiences show that an increasingly popular measure that complements the provision of banks with additional capital has been redemption of their bad assets by a special agency. Such a structure might be established in Russia, too; however, to minimize risks associated with the banks' inequitable conduct, it should redeem only the debts on loans extended in the pre-crisis period.

In conclusion, let us note that key factors that fuel the rise in volumes of crediting the real sector are subsidence of depreciation expectations and clarification of the magnitude and intensity of the crisis, which would enable banks to more accurately assess credit risks.

2.2. The State Budget

2.2.1. The General Characteristic of the Budget System of the Russian Federation

The dynamic of main parameters of the budgetary system of the Russian Federation in 2008 appeared substantially different from trends prevailing over the prior year. While in 2007 revenues and expenditures of budgets of all levels were on the rise vis-à-vis their respective figures of 2006, in 2008, changes were differently directed (*Table 1*) – against the backdrop of the economic crisis the enlarged government's revenues fell fairly significantly to 38.5% of GDP (at 1.7 p.p. of GDP vs. 2007) and so did revenues to the federal budget (down to 22.3% of GDP, or at 1.3 p. p. of GDP). At the same time, revenues to consolidated budgets of the Subjects of the Federation posted a 0.2. p. p. growth - up to 14.9% of GDP.

In the second half 2008, the progressive deterioration of the economic agents' financial health has inevitably entailed a fall in the budget revenues and put into question financial stability of the national budgetary system as a whole. The fall in the enlarged government's revenues against the 2007 figures was determined primarily by the contraction of tax revenues[8] (at 0.5% of GDP). It was the federal level where tax revenues slid most notably (at 0.1 p.p., down to 21.2% of GDP), while the fall of non-tax revenues (by 0.4 p.p. - to 1.1% of GDP) and uncompensated receipts form other budgets of the budgetary system (at 0.7 p.p. – to 0.03% of GDP[9]) have formed major factors behind the overall fall in the federal budget revenues in 2008. The growth in revenues to regional budgets is related solely to a 0.8 p.p rise in transfers from the federal budget – up to 2.7% of GDP (meanwhile, both tax revenues and non-tax ones were on decline).

Vectors of changes in the expenditure volume were also different across budgets of different levels. While the federal and regional budgetary expenditures rose at 0.1 p.p. and o.5 p.p. (up to 18.2% and 15.1% of GDP, respectively) vis-à-vis the 2007 figures, the enlarged government's budgetary expenditures, on the contrary, tumbled by 0.4 p.p. – to 33.7% of GDP. The point is the federal budget expenditures grew solely thanks to the rise in expenditures on interbudgetary transfers (at 0.7 p.p. – up to 6.4% of GDP). At the same time, a closer look at expenditures less this particular section of the functional classification allows noticing their fall at 0.6 p.p. of GDP. A similar situation is noted, as far as regional budgets are concerned. It was transfers to extrabudgetary funds that made growth in expenditures possible – they rose at 0.4 p.p. – up to 0.5% of GDP, while other sections on the whole were likewise on the rise, albeit at a more moderate rate (0.06% of GDP). So, the rise in the federal and regional budgetary expenditures in 2008 vs. the 2007 figures was fueled mostly by intebudgetary transfers and, accordingly, this rise cannot help but affect the enlarged government's volume of budgetary expenditures.

The rise in the federal budget expenditures vs. the 2007 figures took place against the background of plunging revenues, which resulted in a shrinking surplus of the federal budget (at 1.4 p.p. – down to 4.1% of GDP). Because of the advanced growth in expenditures of the

[8] For the purposes of the present analysis tax revenues comprise insurance premiums to the compulsory medical insurance and revenues from foreign trade (in compliance with effective provisions of the effective variant of the Budget Code of RF, these categories of revenues are attributed to nontax ones)

[9] This contraction is related to the fact that in 2007, this revenue item reflected the collection to the federal budget of additional revenues form YUKOS, while in 2008, there were no such transfers to the budget.

RF Subjects' budgets, the latter ran a minor deficit by results of 2008, which equaled to 0.1% of GDP. While the enlarged government's budgetary expenditures plunged in the shares of GDP equivalent, they did so to a far lesser degree than the revenues. That resulted in a substantial fall of the surplus at 1.3 p.p. – down to 4.8% of GDP.

Table 6

Execution of Revenues and Expenditures Across Budgets of All the levels of Government in 2000–2008 (as% of GDP)

	2000	2001	2002	2003	2004	2005	2006	2007	2008
The federal budget									
Revenues	15.5	17.8	20.3	19.5	20.1	23.7	23.3	23.6	22.3
Expenditures	14.2	14.8	18.9	17.8	15.8	16.3	15.9	18.1	18.2
Deficit (–) /Surplus (+)	1.4	3.0	1.4	1.7	4.3	7.4	7.4	5.5	4.1
Consolidated budgets of the RF Subjects									
Revenues	14.1	14.5	15.1	14.6	14.1	13.9	14.1	14.7	14.9
Expenditures	13.4	14.5	15.5	14.9	13.9	13.6	13.6	14.6	15.1
Deficit (–) /Surplus (+)	0.7	0.0	–0.4	–0.3	0.2	0.3	0.5	0.1	-0.1
The budget of the enlarged government									
Revenues	38.3	38.4	37.8	37.1	37.5	39.7	39.6	40.2	38.5
Expenditures	34.3	35.2	36.3	36.0	32.9	31.6	31.2	34.1	33.7
Deficit (–) /Surplus (+)	4.0	3.2	1.5	1.1	4.6	8.1	8.4	6.1	4.8

Source: The RF Ministry of Finance, the IET calculations.

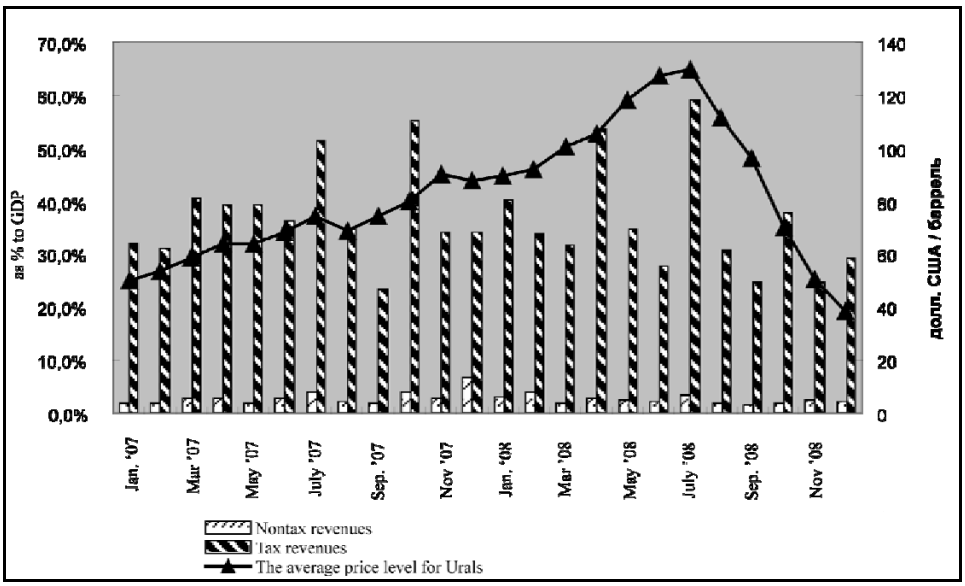
A distinctive feature of the dynamic of budgetary revenues on all the levels over the period in question became an intensifying swing of monthly tax revenues with an explicitly subsiding trend (*Fig.10*).

An important factor of changes in the dynamic of tax revenues compared with the 2007 figures became the domestic VAT, which has been paid on the quarterly basis since the beginning of 2008. This factor was behind spikes in tax revenues noted in January, April, July and October, as well as the subsequent two-month periods when revenues were on decline compared with the respective time periods of 2007, as in the absence of revenues from VAT, the budget kept on reimbursing economic agents. But because of the crisis, the RF government ruled to grant them with payments of the domestic VAT over the third quarter in installments. Hence, a fairly visible contraction in tax revenues in October 2008.

As evidenced by *Fig. 11*, in 2008, the share of oil-and-gas revenues to the federal budget in GDP fluctuated within the range between 6.6 and 13.4%. Affected by the aggravating state of affairs on the world market for oil, the indicator declined steadily in the second half-year. However, it should be noted that despite some decline, the proportion of O&G revenues still is fairly high.

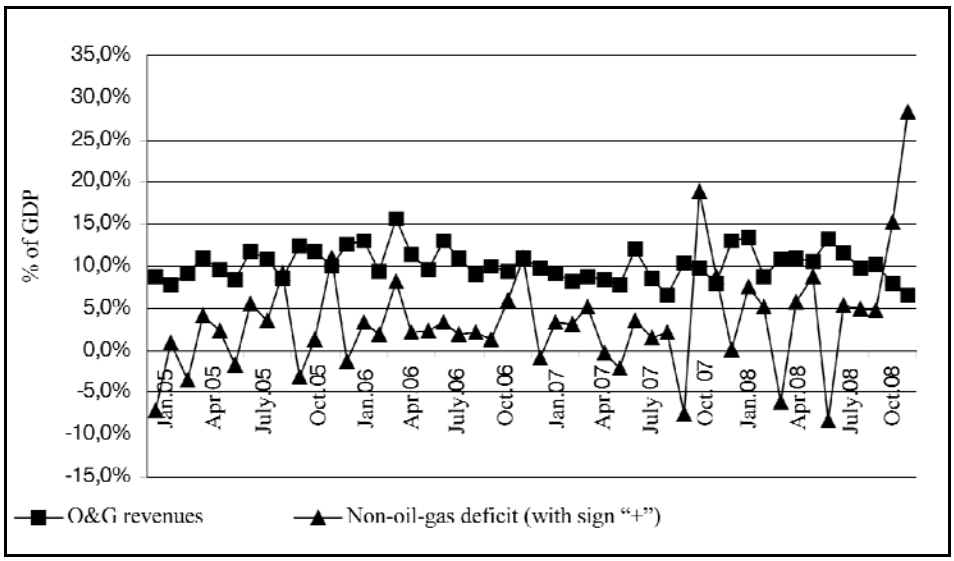
Meanwhile, the 2008 value of the non-oil-and-gas deficit of the federal budget was over 5% of GDP during nearly the whole year, except for the three months the budget was running a surplus. This evidences retention of serious market risks facing Russia's public finance system. One cannot help noticing a sharp rise in the non-oil-and-gas deficit of the federal budget by the end of the year, when it hit a record-breaking value (23.8% of GDP) ever observed

over the period between 2005 and 2008. The increase in expenditures in shares of GDP at the end of the year, that engendered such a deficit, is mostly related to the traditional unevenness of execution of expenditure obligations and the decline of the nominal GDP in December 2008 (tentatively at some 4.5% vs. December 2007).



Note: the monthly GDP was calculated on the basis of the Rosstat quarterly data and the RF Ministry of Finance's monthly data

Fig. 10. The Dynamic of Tax and Nontax Revenues to the Enlarged government's Budget



Note: the monthly GDP was calculated on the basis of the Rosstat quarterly data and the RF Ministry of Finance's monthly data

Fig. 11. The average Values of the Oil-and-Gas Revenues and the non-Oil-and-Gas Deficit of the Federal Budget in 2005-2008 (as% of GDP)[10]

[10] The non-oil-and-gas deficit is shown in the Figure with the sign "+" for a more demonstrative comparison with the volume of oil-and-gas revenues. Also, it must be noted that while calculating the non-oil-and-gas deficit, we

Huge oil-and-gas revenues collected in the prior year allowed a substantial financial reserve in the form of a budget surplus, which made it possible for the government not only to fulfill its expenditure obligations, but also to replenish the Reserve Fund and the National Welfare Fund every month (see *Table 7*).

Table 7

Avenues of the Use of the Oil-and-Gas Revenues to the federal Budget in 2008, as Rb. Bn

	02.08	03.08	04.08	05.08	06.08	07.08	08.08	09.08	10.08	11.08	12.08	Total
Oil-and-gas revenues	303.4	371.2	328.9	345.4	368.0	391.4	454.6	432.4	435.8	411.8	303.1	4145.8
Avenues of their use:												
On securing the oil-and-gas transfer	303.4	371.2	328.9	345.4	368.0	391.4	26.8	0.00	0.00	0.00	0.00	2135.0
Transfers to the Reserve Fund	0.00	0.00	0.00	0.00	0.00	0.00	420.6	0.00	0.00	0.00	0.00	420.6
Transfers to the National Welfare Fund	0.00	0.00	0.00	0.00	0.00	0.00	7.2	432.4	435.	411.8	303.1	1590.2

Source: the RF Ministry of Finance.

The size of the 2008 oil-and-gas transfer[11] was limited with a value equaling 6.1% of GDP. The O&G transfer had already been fully financed by August 2008. Since that moment the government started collecting O&G revenues to the Reserve Fund and the National Welfare Fund. As of the early-2009, the ultimate volume of resources accumulated in these two funds accounted for 9.7% and 6.2% of GDP in Rb. equivalent, respectively.

Furthermore, a rapid depreciation of the Rb. in January 2009 de-facto resulted in the Reserve Fund lacking just 0.7% of GDP to hit its threshold value set for early-February 2009. This means that because of the appreciation of the USD and Euro against the Rb., within a month the Reserve Fund rose just at more than Rb. 830bn, or some 2% of GDP.

The 2009 oil-and-gas transfer was set at the level of Rb. 2,531.1bn, while the January volume of collection of oil-and-gas revenues accounted just for Rb. 243.6bn, or 9.6% of the value of the oil-and-gas transfer. In other words, with this rate of replenishment of the budget, the transfer should be complete only in 10 months. That is why, should the effective prices for hydrocarbon minerals remain unchanged through the year, the nation should not hope for any additional revenues to the Reserve Fund.

In addition to a substantial fall of revenues from the mineral tax and customs duties to the federal budget, according to some moderate projections, the 2009 missing volume of budgetary revenues from other taxes may account for a. 2.9-3.3% of GDP. Hence, the bulk of the burden of execution of the undertaken expenditure obligations will be laid upon the Reserve Fund. Its resources undoubtedly appear sufficient to execute all the obligations stipulated in the 2009 Federal Budget Act. However, given the unforeseen expenditures (the anti-crisis package of measures on stabilization of the financial market, support of individual sectors of the economy, and social protection of the population the RF Ministry of Finance introduced to the government on March 19, 2009, in the form of amendments to the 2009 federal budget), a long-standing nature of the crisis, unpredictability of exchange rate fluctuations, stability of the budgetary system in the medium term depends on changes of a general vector

did not take into account revenues from managing the Stabilization und of RF (since 2008 – the Reserve Fund and the National Welfare Fund, because the accurate monthly data on these indicators is hardly accessible

[11] The oil-and-gas transfer is a fraction of the federal budget funds used to finance the oil-and-gas deficit of the federal budget at the expense of oil-and-gas revenues and resources of the Reserve Fund

of the budgetary policy towards restricting public expenditures and increasing requirements to their efficiency.

2.2.2. Analysis of execution of the federal budget of RF in 2008

In the initial draft of the bill on the 2009 federal budget, revenues to the federal budget were planned to make up Rb. 6,644.4bn, or at 4.6 p.p. down against the actual execution of the revenue part of the 2007 budget (*Table 3*). The planned for 2008 budget decrease of the share of revenues in GDP compared with the prior year was determined by extremely cautious projections of the 2008 values of Russia's main macroeconomic parameters and prices for minerals in particular. Meanwhile, the 2008 projection of the federal budget revenues, less contributions to the Stabilization Fund of RF (the Reserve Fund and the National Welfare Fund), was even increased at 0.5% of GDP compared with the level of the actual execution in 2007.

Despite a rapid downfall in oil prices since August 2008, their average annual values ultimately proved to be greater than those set in the 2008 budget. As in 2007, it likewise helped to outperform the plan with respect to revenues to the budgetary system. Accordingly, amendments to the Federal Budget Act implied an increase of its revenues up to Rb. 8,965.7bn and an increase of expenditures up to Rb. 7,773.8bn.

Table 8

Main Characteristics of the Federal Budget of RF in 2008

	For reference: executed in 2007		2008 – the Act		2008 the amended Act		2008 - execution	
	Rb. bn	**% of GDP**	**Rb. bn**	**% of GDP**	**Rb. bn**	**% of GDP**	**Rb. bn**	**% of GDP**
Revenues, including:	7 779.1	23.6%	6 644.4	19.0%	8 965.7	21.2%	9 274.1	22.3%
tax revenues	7042.0	21.3%	–	–	–	–	8817.6	21.2%
nontax revenues*	737.1	2.3%	–	–	–	–	456.5	1.1%
Contributions to the Reserve Fund and the National Welfare Fund (Stabilization Fund)	1 903.1	5.8%	248.1	0.7%	2 114.0	5.0%	2 342.6	5.6%
Revenues, less funds subject to collection to the Reserve Fund and the National Welfare Fund	5 876.0	17.8%	6 396.3	18.3%	6 851.7	16.2%	6 931.5	16.7%
Expenditures, including:	5 983.0	18.1%	6 570.3	18.8%	7 737.8	18.3%	7 566.6	18.2%
interest expenditures	143.1	0.4%	187.9	0.5%	157.4	0.4%	153.3	0.4%
non-interest expenditures	5 839.9	17.7%	6 382.4	18.2%	7 580.4	17.9%	7 413.3	17.8%
The federal budget surplus	1 796.1	5.5%	74.1	0.2%	1 227.9	2.9%	1 707.5	4.1%
Surplus /deficit (less funds subject to collection to the Reserve Fund and the National Welfare Fund)	–107.0	–0.3%	–174.0	–0.5%	–886.1	–2.1%	–635.1	–1.5%
GDP (estimates)	**32 987**		**35 000**		**42 240**		**41 540**	

* including uncompensated receipts.
Source: the RF Ministry of Finance, the IET calculations.

Fig. 3 presents the monthly dynamic of revenues to the federal budget in 2006-2008. It is worth noting a dramatic fall in the share of revenues in GDP over the last months of 2008 compared with the respective periods of 2006 and 2007. That was steered by the deteriorating situation in the foreign trade area and the unfolding of the financial crisis at the end of the year

(see *Table 4*). If not for a concomitant drop of the nominal GDP in December 2008, the fall in revenues in shares of GDP in December would have been yet more notable.

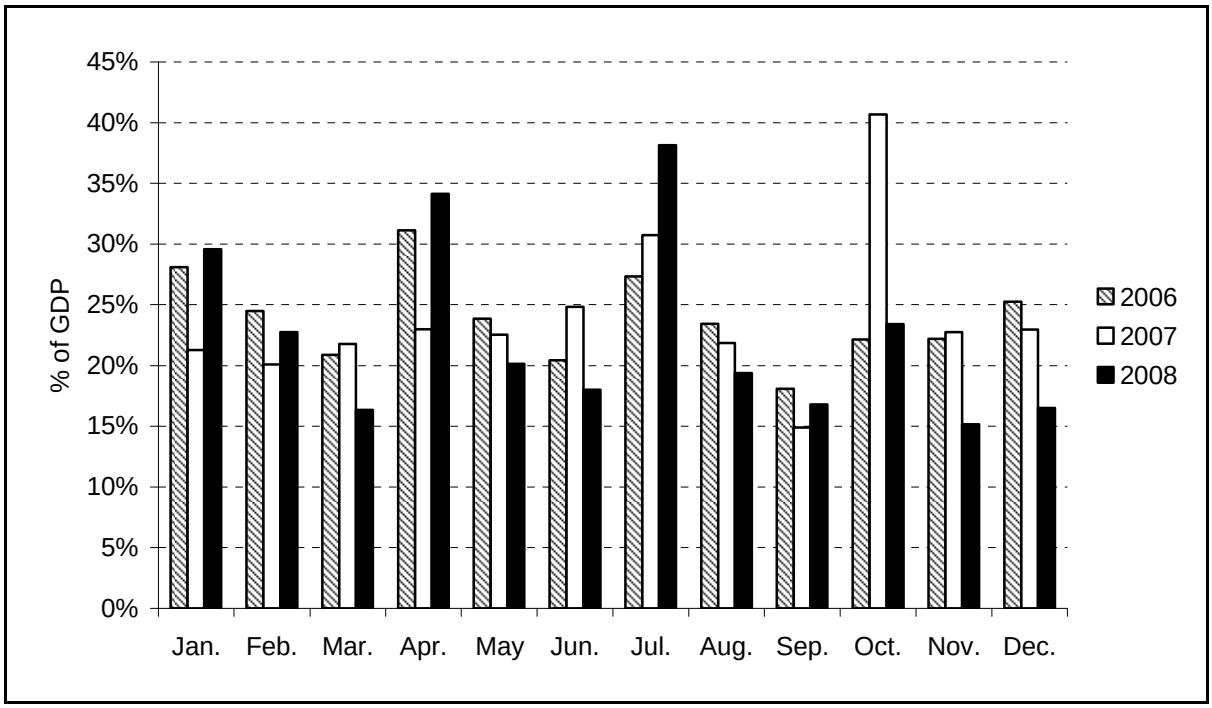


Fig. 12 The Federal Budget Revenues in 2006-2008 (as% of GDP)

Table 9

Oil Prices in 2005–2008 гг.[12]

The average level of Urals price, as USD/barrel	2005	2006	2007	2008
January	40.02	59.18	49.79	89.61
February	40.65	56.37	53.73	92.01
March	47.87	57.53	58.69	100.14
April	46.86	65.17	63.88	105.18
May	44.66	64.33	64.09	118.39
June	50.94	63.85	68.05	127.38
July	54.84	68.93	74.37	129.45
August	58.72	68.64	68.82	111.31
September	57.91	58.52	74.17	96.26
October	54.81	54.65	79.55	69.72
November	51.55	55.18	90.06	50.53
December	53.57	58.35	87.94	38.50
Averaged over the year	**50.20**	**60.89**	**69.43**	**94.04**

Source: the data of the Federal Tax Service of RF.

[12] These prices are used for purposes of taxation.

Intensification of the unevenness of the monthly dynamic of execution of the federal budget revenues in 2008 was to a significant extend determined by transition towards VAT collection on the quarterly basis (see above). Plus, the decline in business activity noted in the 4th quarter, due to the rise of crisis developments in the economy, manifested itself in falling volumes of revenues to the federal budget. To give a specific example, in the 4th quarter of the year the federal budget saw a considerable (at Rb. 665bn) fall in revenues vis-à-vis the prior quarter.

Against the background of the decline in budget revenues in shares of GDP equivalent against 2007, the softening of the budgetary policy was giving rise to a continuous growth of the expenditure part of the budget. Originally, the federal budgetary expenditures were set at the level of Rb. 6,570.3bn, or at 0.7 p.p. higher than in 2007 (see *Table 8*). Capitalizing on a favorable state of affairs in the foreign trade area has led to the approval of specified budgetary expenditures at a level being at Rb. 1,167.5bn greater than in the initial draft of the Federal Budget Act.

It should be noted that the allocation of budgetary funds in the late-2008 on financing the anti-crisis measures on support of the real sector and ensuring the banking sector's stability became possible thanks to the redistribution of the federal budgetary expenditures. Hence, by results of 2008, there was noted a notable rise in shares of GDP equivalent of expenditures on "The National Economy" item (at 0.4 p.p. against the 2007 figures), while expenditures on general government issues slid at 0.45 p.p. The traditional growth in interbudgetary transfers (at 0.7 p.p.) coincided in time with a 0.6 p.p. fall of expenditures on housing and utilities, which was related to the establishment in 2007 of a public corporation "The Fund for Assistance to the Housing and Utilities Complex Reform". The truth is, the federal budget expenditures on formation of the corporation's capital were inserted in a respective item under the "Housing and utilities Complex" section. That is why the year of 2007 saw a substantial rise in spending on the HUS as percentage of GDP (from 0.2% to 0.9% of GDP) against the 2006 figures. In the absence of such expenditures in 2008, the level of financing of this particular section was back to its normal level and accounted for some 0.3% of GDP.

The federal budgetary expenditures ultimately retained their stability – in 2008, they were executed at the level of 18.2% of GDP, or at 0.1% greater than in 2007.

The situation with the execution of expenditure obligations on the cash basis over the financial year still was unsatisfactory. While there were some minor positive shifts in this area compared with 2007 (by results of the first half-year the execution on the cash basis grew from 33.2% in 2007 to 38.7% in 2008), the tendency to expenditures growing by the end of the year has remained unchanged (*Table 10*).

It was the "Housing and utilities" item by which execution of expenditure obligations by the end of the year proved to be the worst one. By contrast, main directions of the social sphere were financed at the level of 99.7% on average. It should be particularly emphasized that execution of expenditures on the cash basis by the priority national projects improved notably – in 2008, it accounted for 94.5% vs. 82.1% in 2007 and 81.0% in 2006.

However, traditional causes for government agencies spending the budgetary funds unevenly, which manifested themselves in failures to meet timelines of conclusion of contracts on placement of orders on delivery of goods (works, services) for public needs, failures to meet contract timelines, the absence of documents needed for execution of the federal budget, etc. fall short of providing a comprehensive explanation of a record-breaking rise in

the share of expenditures in GDP in December 2008 (see *Fig. 13*). We assume that the rise in the share of expenditures in GDP in November and December 2008 was to some extent fueled by the fall in the nominal GDP at the end of the year, due to the decline in business activity in the country, which was affected by the crisis developments in the national economy and worldwide.

Table 10

Execution of the Federal Budget on the Cash Basis in 2008 (as% to the Budget Estimate over the Year)

	1st quarter	1st half-year	9 months	Year
EXPENDITURES	17.2%	38.7%	59.4%	97.8%
General government issues	22.3%	40.4%	61.4%	91.6%
of which: the public debt servicing	33.8%	47.6%	83.2%	97.4%
National defense	16.9%	39.9%	59.3%	99.7%
National security and law enforcement	19.4%	43.0%	65.9%	99.9%
National economy	8.2%	26.3%	42.0%	96.3%
Housing and utilities	2.6%	11.2%	24.8%	93.6%
Environment	13.1%	36.8%	60.0%	98.8%
Education	13.4%	37.6%	58.4%	101.1%
Culture, cinematography and mass media	13.7%	40.6%	60.5%	100.5%
Health care and sport	12.3%	33.7%	56.9%	98.9%
Social policy	22.9%	44.8%	68.5%	98.4%
Interbudgetary transfers	19.8%	42.6%	64.6%	98,6%

Source: the RF Ministry of Finance, the IET calculations.

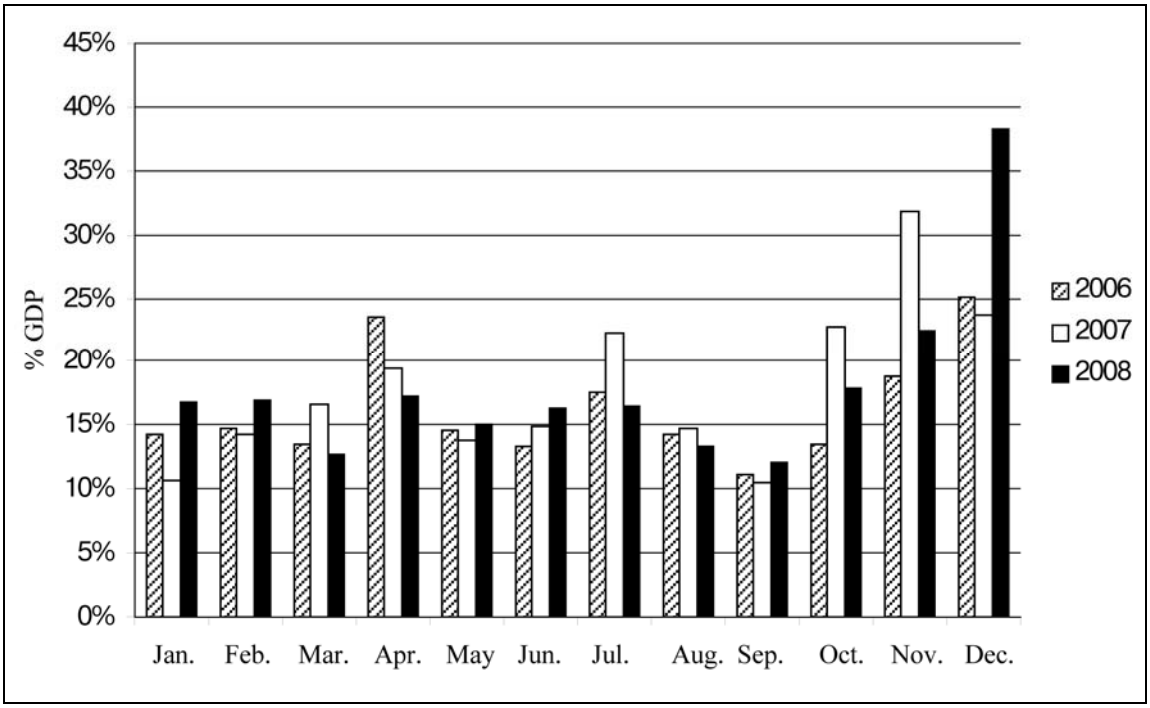


Fig. 13. The Federal Budget Expenditures in 2006-2008 (as% of GDP)

Clearly, the negative external background and fall in revenue volumes from the domestic taxes necessitate pursuance of a more conservative budgetary policy. Such a policy should rest upon the seeking of a proper balance between obligations undertaken and possibilities for their financing. One of directions of scaling back the federal budget expenditures can be revision of volumes of financing of the priority national projects. The fact is, the absence of a systemic approach to shaping their contents has led to an annual extension of the list of directions and measures of the government support. Hence, additional budgetary expenditures (to finance new bottlenecks, such as, for instance, getting schools connected to the Internet subsequently required payments for the Internet traffic, while the respective costs had not been foreseen in municipal budgets).

The implementation of the national projects generates additional expenditure obligations for the regional governments, too. The problem is, the spheres picked as the national projects mostly fall within the regional governments' mandate. Intervening in the regional governments' area of competence, the national projects generate for them latent unfunded expenditure mandates, such as:

- in the frame of projects "Education" and "Healthcare", additional stimuli and pay rises for individual categories of the so-called "budgetary" employees take place against the background of retention of a planned rise in labor compensations across the educational and healthcare sectors on the whole. To keep the staff, the regional authorities' natural reaction was compulsory pay rises for the other categories of employees in these sectors;
- the national projects do not provide in full for financing expenditures on maintenance and repair of high-tech medical equipment and training of specialists who are supposed to operate it.

2.2.3. Analysis of collection of main taxes to the budgetary system of RF

In his 2008 Budgetary Address to the Federal Assembly, President enunciated continuation of the course to lowering dependence of the budgetary revenues on the world prices as one of key priorities of, and guides for the national fiscal and budgetary policy. The rapid aggravation of the state of affairs in the foreign trade area in the second half f 2008 generated prerequisites for a compulsory realization of the President's thesis – the crisis made the need for seeking ways to compensate for the falling oil-and-gas budgetary revenues a pressing challenge. By results of 2008, the contraction in the tax revenue collection to the enlarged government's budget accounted for some 1 p.p. of GDP. The government has managed to avoid a more dramatic decline in budgetary revenues only thanks to sky-high prices for energy sources on the world markets over the first half of the year.

Another guide of the recent Budgetary Address was easing the tax burden on the economy. *Table 11* displays the dynamic of the tax burden on Russia's economy in 2001-2008 and proves that it has been fluctuating just insignificantly, being within the range between 35.3% - 36.3% of GDP.

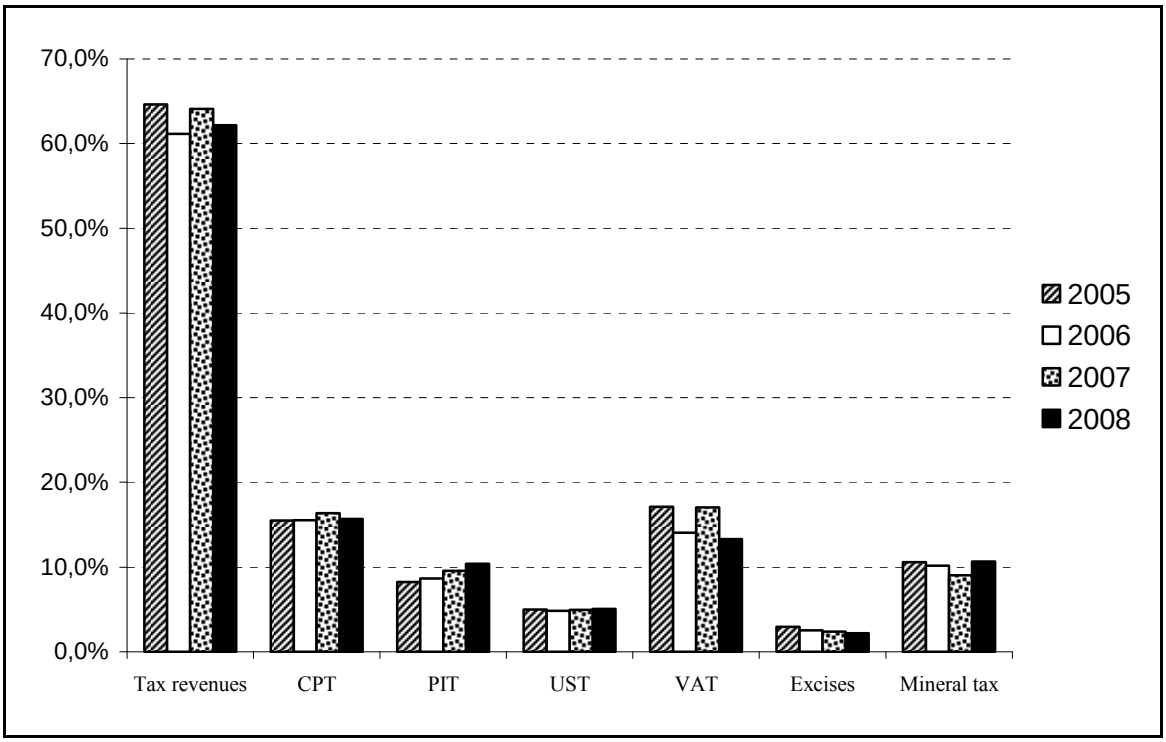
Table 11

The Dynamic of the Level of Tax Burden and Collection of Main Taxes to the Budget of the Enlarged Government of the Russian Federation in 2000–2008 (as% of GDP)

	2001	2002	2003	2004	2005	2006	2007	2008
The level of tax burden (1+2+3)	**36,17**	**36,29**	**35,28**	**35,82**	**36,30**	**35,94**	**36,06**	**35,58**
Tax receipts (1), including:	31,96	29,80	28,21	27,47	25,65	24,44	25,74	23,95
Corporate profit tax	5,75	4,28	3,98	5,09	6,16	6,21	6,58	6,05
Personal income tax	2,86	3,31	3,44	3,37	3,27	3,46	3,84	4,01
Uniform Social Tax*	5,79	4,13	3,68	3,49	1,99	1,94	1,98	1,95
VAT	7,17	6,96	6,66	6,27	6,81	5,62	6,86	5,13
excises	2,72	2,44	2,59	1,43	1,17	1,01	0,95	0,84
Mineral tax**	0,74	2,55	2,50	2,99	4,20	4,07	3,63	4,11
Insurance premiums on the compulsory pension insurance (2)	0,00	2,76	2,94	2,80	2,88	2,93	3,05	3,00
Revenues from foreign trade (3)	4,21	3,73	4,13	5,54	7,77	8,57	7,27	8,63

* without regard to insurance premiums on the compulsory pension insurance.
** for 2001- the value of mineral extraction fees instead of the mineral tax
Source: the RF Ministry of Finance, Rosstat, the IET calculations

The 2008 volume of tax revenues to the budgetary system tumbled by 1.8 p.p. of GDP vs. the prior year's figures. The structure of tax revenues to the budget of the enlarged government is given in *Fig. 14*.



* without regard to insurance premiums on the compulsory pension insurance

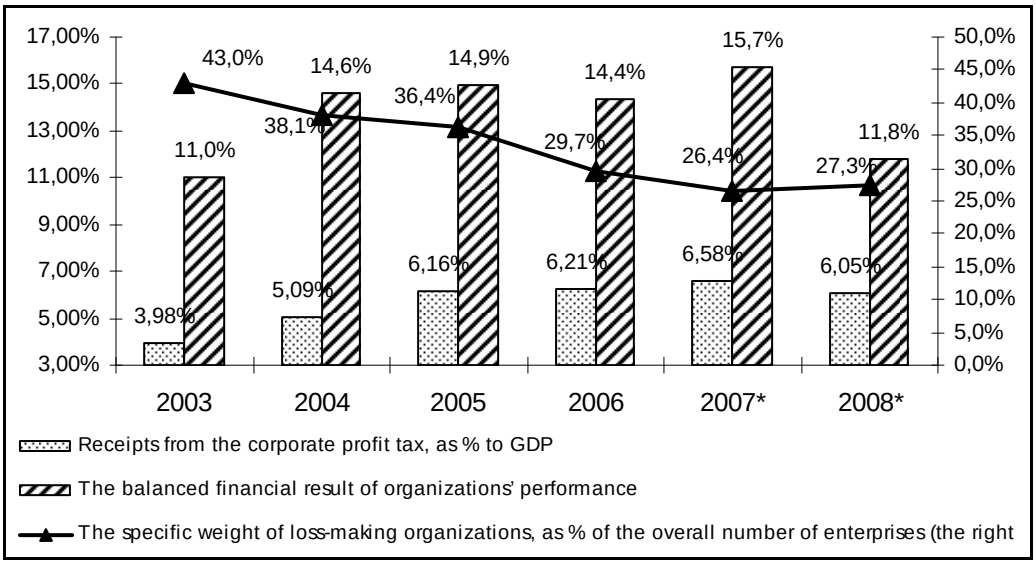
Fig 14. The Proportion of the Tax Revenues in the Aggregate Revenues to the Budget of the Enlarged Government in 2005–2008, as%

The 2008 structure of tax revenues underwent notable changes. More specifically, revenues from VAT plunged below their 2006 level; also, revenues from the corporate profit tax were on decline. These were crucial factors behind a substantial fall in tax revenues to the budget of the enlarged government vs. the 2007 level. However, it should be noted that notwithstanding some expectations, the proportion of the mineral tax in GDP and the amount of revenues from foreign trade did not share the path of the 2007 indicators – on the contrary, budgetary revenues from these specific taxes were on the rise in 2008. It should also be noted that in the period of 2005-08 there were noted sustained trends to rise in the share of the personal income tax, fall in the share of excises, and stabilization of the proportion of UST in GDP.

In 2009, let alone an expected decline in oil-and-gas revenues, it is the corporate profit tax, VAT, personal income tax and UST the budgetary revenues from which are envisaged to fall most dramatically, as they would be affected by aggravation of the corporations' financial standing, contracting business activity, growth in the number of the unemployed, and a general fall in incomes from labor and entrepreneurship activities. It is going to be property-related taxes (the corporate property tax, the land tax, the transport tax, etc.) revenues from which should remain stable in the crisis conditions; however, should the crisis persist for long, these revenues should tumble, too.

The corporate profit tax

In 2008, revenues from the corporate profit tax plunged at 0.5 p.p. compared with the 2007 figures and accounted for 6.05% of GDP. The main causes behind the fall were the slump in business activity and the downfall in oil prices. All this resulted in the rise of the specific weight of loss-making corporations in the economy, while the net balanced financial result of enterprises and organizations' performance in shares of GDP reported in 2008 evidences the tax base contracting with respect to the corporate profit tax (see *Fig. 15*).



* The values of the balanced financial result of organizations' performance and the specific weight of loss-making organizations are given by results of 11 months of 2007-2008

Fig. 15. The Dynamic of Revenue Collection from the Corporate Profit Tax to the Budgetary System of RF, the balanced Financial Result of organizations' Performance and the proportional Weight of Loss-Making Enterprises in 2003-2008

The following modifications of the tax law ensured some constraining impact on the dynamic of revenues from the corporate profit tax:

- the write-off of a debt before the state extrabudgetary funds is not recognized as proceeds (sp. 21 p.1. art. 251 of the tax Code of RF);
- it is allowed to apply zero rate of the corporate profit tax to incomes in the form of dividends, providing compliance with conditions stipulated in sp. 1. p.3. art. 284;
- the right is granted to apply to the basic depreciation rate a special coefficient, which should not be over 3 with regard to depreciated fixed assets utilized solely for the sake of R&D;
- the timeline of effect of zero rate of the corporate profit tax for agrarian producers was extended for 2008;
- the marginal size of R&D expenses effected in the form of contributions to formation of the Russian Fund for Technological development and other sectoral and inter-sectoral funds registered in the order as per the Federal Act "On science and the public research and technical policy" recognized for the taxation purposes was increased from 0.5 up to 1.5% of the taxpayer's income (gross earnings).

The personal income tax

The trend to growth in the PIT revenues started in 2005 and continued through 2008, when the revenues in question broke a new record of 4.01% of GDP, or nearly at 0.2 p.p greater than in the prior year. Interestingly, the growth took place against the background of the population's monetary incomes, less social payments, falling at 2.7 p.p. of GDP (see *Fig. 16*).

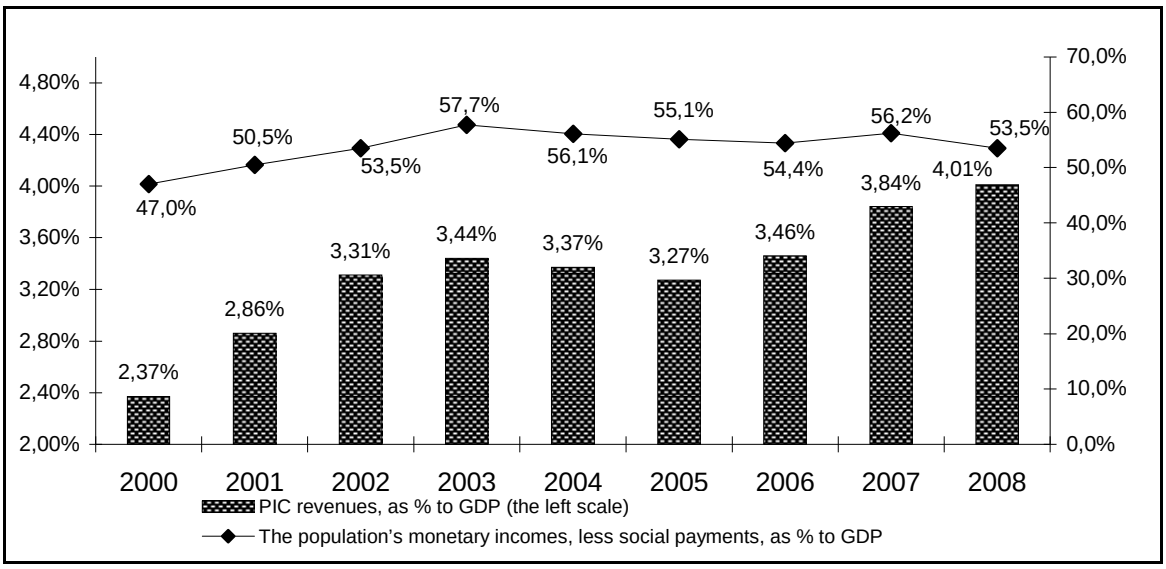


Fig. 16. The Dynamic of Revenue Collection from PIC to the Budgetary System of RF and the Population's Monetary Incomes Less Social Payments in 2000-2008

Contraction of the tax base of the personal income tax was caused particularly by changes in legislation effective as of January 1, 2008, in compliance with the following items were exempted from PIC:

– grants on support of science, education, culture and fine arts in the Russian Federation awarded to private individuals by Russian organizations, the list of which is subject to the RF government's approval;
– sums of nonrecurrent material aid provided to parents, adoptive persons, *in loco* parents against the birth (adoption) of a child within the limit of Rb. 50,000 per each child;
– the marginal amount of per diem up to 700 Rb. per every day of a business trip within the territory of the Russian Federation and up to Rb. 2,500 per every day of a business trip overseas.

The multidirectional dynamic of the population's real incomes, less social payments, and collection of the personal income tax under retention of the basic tax rates and some extension of tax remissions in the part of the tax collection presented by *Fig. 16* gives an illustrative evidence of the improving tax administration.

The uniform social tax

Despite the rise of the proportion of the labor compensations fund in GDP in 2008 against the 2007 figures (at 0.36 p.p. of GDP), revenues from UST and premiums on the compulsory medical insurance plunged at 0.08 p.p. of GDP. The fall is determined primarily by the regressivity of the UST scale and the absence of its indexation. This has entailed the situation in which a rise in salaries and wages in nominal terms lowers the effective UST rate.

In the conditions of economic growth, with the advanced rate of the population's incomes, the pace of growth of the UST base appeared greater than the pace of decline of its efficient rate. As a result, the respective revenues even posted growth in percentage to GDP. Such a situation was noted over 2006-2007. But in 2008 the rise in the tax base fell short of compensating for the decrease of the effective rate of UST and the revenues from this tax were on decline.

Table 12

Comparison of the Dynamic of Collection of Revenues from UST with the Dynamic of the Labor Compensations Fund in 2001–2008, as% to GDP

	2001	2002	2003	2004	2005	2006	2007	2008
Revenues from UST (without regard to the CMI premiums)	5,79	4,13	3,68	3,49	1,99	1,94	1,98	1,95
Premiums on the compulsory medical insurance	0,00	2,76	2,94	2,80	2,88	2,93	3,05	3,00
Revenues from UST and the CMI premiums combined	5,79	6,89	6,61	6,29	4,87	4,86	5,03	4,95
Labor compensations fund*	43,03	46,77	47,05	46,02	43,81	44,55	46,27	46,63

*labor compensations to employees (including latent labor compensations and mixed incomes).
Source: the Federal Tax Service of RF, Rosstat

Excise taxes

In 2008, the volume of tax revenues to the budgetary system from excises was Rb. 350bn in absolute terms vs. 314bn. The rise was powered by indexation of specific excise rates at a pace that outran the inflation rates and by the expansion of the tax base. However, in relative terms the revenues from excises tended to decline. The tendency had started back in 2004, and in 2008 the revenues from excises in relative terms accounted for 0.84% of GDP vs. 0.95% of GDP reported in 2007.

Back in 2007, the government promulgated Federal Act №75-FZ "On introducing amendments to article 22 of Part two of the Tax Code of the Russian Federation", which has set the formula of indexation of excise rates on excised merchandise for 2008-2010. The dynamics of indexation of excise rates on different groups of goods vary substantially. More specifically, while excise rates on oil products, tobacco and cigars remained unchanged, those on alcoholic beverages and passenger cars were raised at 7%, while excises for cigarettes were up at more than 23%[13].

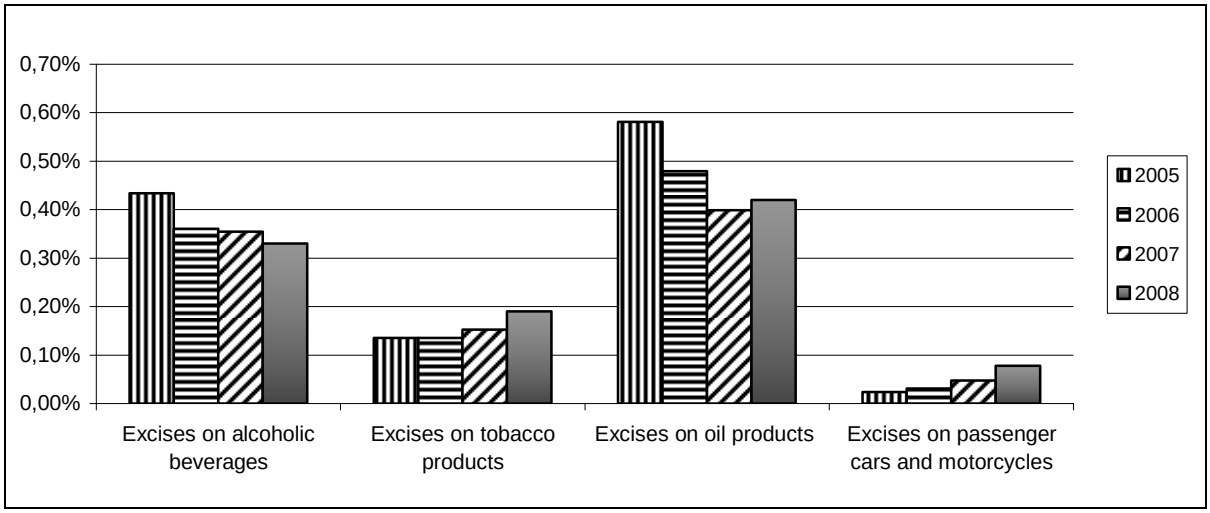


Fig. 17. Collection of Excise Revenues by Groups of Excised Merchandise, as% of GDP

The general trend of the period between 2000 and 2008 became the growth rates of the tax base by all the excised commodity groups, except for alcoholic products, falling behind the dynamic of the real GDP, which in large measure explains contracting volumes of collection of excises to the national budgetary system.

The value added tax

The year of 2008 saw a permanent stability of the tax base of VAT levied on sales of goods (works, services) on the domestic market, as evidenced by the dynamic of final consumption cleared from VAT and fluctuating since 2004 within 1 p.p. of GDP (see *Table 13*) [14].

Import in 2008 likewise continued the earlier started upward trend and by results of the year accounted for 16.0% of GDP vs. 15.5% registered in 2007. So, despite some deceleration of economic growth in the 4th quarter of the prior year, the dynamics of main macroeconomic indicators were generating quite positive prerequisites for growth in revenues from VAT over the above period of time.

[13] Thus, in 2008, the indexation of excise rates on cigarettes concerned both the specific part of the rate and the ad-valorem one. While in 2007 the excise rate on filter cigarettes was Rb. 100 per 1,000 pcs+ 5% of the estimated value, but not less than Rb. 115 per 1,000 pcs, the 2008 rate was Rb. 120 per per 1,000 pcs+ 5.5% of the estimated value, but not less than Rb. 142 per 1,000 pcs .

[14] We believe that as far as a macroeconomic characteristic of the tax base of VAT is concerned, it would be more appropriate to employ the value estimate of final consumption in market prices, less the tax, rather than the whole value added or GDP. Such an approach is quite fair, as the value added tax is a tax on consumption and as such it is not used for the sake of levying investment activities (the sum of the tax by capital goods is subject to reimbursement (rebate)), whose results are also reflected in the nation's GDP.

Table 13

The Dynamics of Final Consumption, Import and Collection of VAT in the Budgetary System of RF in 2000–2008 (as% of GDP)

	2000	2001	2002	2003	2004	2005	2006	2007	2008
Revenues from VAT, less revenues from YUKOS	6.20	7.17	6.96	6.66	6.27	6.17	5.62	6.13	5.13
Final consumption (less computed by tax returns VAT)	n/a	59.1	61.5	61.4	60.8	60.1	60.6	60.1	60.9*
Import**	13.0	13.7	13.4	13.3	12.8	12.9	13.9	15.5	16.0

* preliminary estimate
** The share of import in GDP was calculated as correlation between values of import according to the customs statistical data and GDP in USD equivalent computed on the basis of values of the average USD/Rb. nominal exchange rate in the respective year.
Source: Rosstat, the RF Ministry of Finance, the Federal Customs Service, the IET calculations.

However, against the background of an insignificant expansion of the tax base, there was no rise in revenues to budgets from VAT in relative terms in 2008. On the contrary, the share of VAT tumbled and accounted for 5.13% of GDP, or at 1 p.p. down vs. its respective value of 2007 (at the same time, from the volume of actual VAT-generated revenues was deducted a value equaling to the amount of repayment of YUKOS's tax arrears (some 0.7 p.p. of GDP).

The main factor underpinning such a failure by the budget to collect revenues from VAT is the transition to payment of the domestic VAT on the quarterly basis. Thus, when compared with 2007, the VAT revenues over the 4th quarter of 2008 were not collected within the same year. Plus, the VAT collection statistics in the last quarter was under an adverse effect of the growing liquidity shortages in the corporate sector and an accelerated reimbursement of VAT from the budget. More specifically, in the 4th quarter 2008, the revenues from the domestic VAT, which accounted for 1.84% of GDP, were not just substantially inferior to the respective index of the prior year's analogous period (4.87% of GDP), but dwindled notably vis-à-vis the preceding quarter of 2008 (3.13% of GDP).

The fall in collection of VAT-related revenues over the year found itself under a certain impact of growth in tax rebates and extension of the list of operations exempted from VAT. Specifically, since 2008 the following operations have been exempted from VAT:

- Sales of exclusive rights on inventions, useful models, industrial samples, software, databases, topologies of integral chips, now-how, and rights for the use of the said products of intellectual activity on the basis of a license agreement;
- Conduct of R&D and technological works pertaining to creation (improvement) of new products and technologies;
- Conduct of works (delivery of services) within territories of port economic zones by their residents.

Along with that, the government specified the list of cases in which sums of received forward payments are not included in the VAT tax base: against the upcoming shipping of goods (conduct of works, provision of services) the length of the production cycle of manufacture of which is over 6 months (providing compliance with the conditions stipulated in the Tax Code of RF); against delivery of goods (works, services) which are subject to 0 VAT rate

in compliance with p.1 art. 164 of the Tax Code of RF; and against delivery of goods (works, services) which are not subject to taxation (tax exempt).

The use of the 10% preferential rate of VAT is permitted in the event of sales (importation) of medicines designated for running clinical tests (pp. 4. p. 2 art 164 of the Tax Code of RF).

The mineral tax

In 2008, the revenues from this tax collected from oil companies accounted for 94% of the overall amount of the respective revenues. Accordingly, the dynamic of overall revenues from the MT to a critical extent is determined by factors that form tax revenues from the oil sector, that is, the volume of oil output, the level of the world oil prices, and the dynamic of the USD exchange rate. Though in the second half of 2008 oil prices tumbled more than 3-fold, the average annual price level was notably greater than in 2007, nonetheless. That was the main cause behind the rise in the share of the MT in GDP up to 4.11% against the backdrop of stabilization of oil output and production of gas condensate, as well as the 2008 unchanged basic rate of the mineral tax (see *Table 14*).

Table 14

The Dynamic of Revenues from the Mineral Tax and Main Macroindicators in 2002–2008

	2002	2003	2004	2005	2006	2007	2008
MT, as% to GDP	2.55	2.50	2.99	4.20	4.07	3.63	4.11
Oil output, including gas condensate, as m.t.	379.6	421.4	458.8	470.0	480.5	491.0	488.0
The average annual price level for URALS, USD/barrel	23.43	27.07	34.57	50.20	60.89	69.43	94.04

Source: Rosstat, the Federal Tax Service's data, the IET calculations.

In addition to the average annual rise in world prices for oil, it was depreciation of the Rb. that notably affected the level of collection of the mineral tax[15] - in 2008, the Rb. plunged against the USD at 3.5Rb., or 14.5%, with the greatest rate of the depreciation falling on the 4th quarter of the year, thus somewhat compensating for a rapid fall in the MT rate due to the downfall of the world prices for oil.

2.2.4. Expenditures of the Budgetary System

Main characteristics of the expenditure part of the RF budgets of all the levels are given in *Table 15.*

The most considerable volumes of financing were earmarked in 2008 on sections "Social policy", "National economy", "Education", "Healthcare and sport". Their share combined in the overall amount of the enlarged government's expenditures surged to 64.8% vs. 62.3% reported in 2007.

In 2008, the expenditure structure of Russia's budgetary system underwent no fundamental modifications. By results of the year it was only two sections of the fundamental classification by which expenditures were increased. Those were "National economy" (up at 0.7p.p. of GDP) and "Social policy" (0.4 p.p. of GDP). Meanwhile, the following sections saw a fall in the respective expenditures in shares of GDP: "Housing and utilities" (down at

[15] The USD/Rb/ exchange rate is used to calculate the oil price dynamic coefficient which is employed for the purpose of calculation of the MT rate with regard to oil production.

0.6 p.p.), "Healthcare and sport" (0.5 p.p.), "General government matters" (0.4 p.p.). All the other sections remained practically unchanged.

Table 15

Expenditures of the Enlarged Government in 2005–2008 (as% of GDP)

	2005	2006	2007	2008	the 2008-to-2007 rise
EXPENDITURES	31.54	31.19	34.09	33.68	–0.41
General government matters	3.49	3.07	3.54	3.10	–0.44
of which: servicing the public debt	1.11	0.74	0.53	0.46	–0.07
National defense	2.69	2.54	2.53	2.51	–0.02
National security and law enforcement	2.71	2.66	2.62	2.63	0.01
National economy	3.53	3.53	4.73	5.42	0.69
Housing and utilities	2.18	2.35	3.34	2.77	–0.57
Environment	0.10	0.09	0.08	0.08	0.00
Education	3.71	3.84	4.07	4.01	–0.06
Culture, cinematography and mass media	0.71	0.70	0.75	0.75	0.00
Healthcare and sport	3.69	4.00	4.20	3.73	–0.47
Social policy	8.74	8.40	8.24	8.68	0.44
Interbudgetary transfers	x	x	x	x	x

Source: the RF Ministry of Finance.

Like in the prior years, a positive development is contraction of the share of expenditures on servicing the public and municipal debts.

In all likelihood, in the conditions of a drastic fall in tax revenues and facing the need to tame inflationary processes and to lower risks of instability of public finance, the proportion of expenditures in the 2009 budget of the enlarged government will be shrinking, but the process should be coupled with compulsory modifications in reserves of financing in favor of anti-crisis expenditures.

Already today the anti-crisis nature of the 2009 budget has manifested itself in reallocation of federal expenditures (according to amendments to the 2009 federal budget considered at the government meeting on March 19, 2009, it was proposed to cut the earlier approved appropriations by Rb. 943.3bn) in favor of financing of priority avenues of the anti-crisis program approved by the RF government. Specifically, it is planned to spend Rb. 1.61trln on measures on stabilization of the financial market, support of certain sectors of the economy, and social support of the population. The banking system is going to receive an additional government support package worth a total of Rb. 300bn.; the agrarian sector is to receive Rb. 45bn via Rosselkhozbank and another 25bn via JSC "Rosagrolizing", and 17bn. in subisidies to regional budgets to reimburse for the agrarian producers' interest on loans; small businesses will receive Rb. 6.2bn; JSC Russian Railways – 50bn; automakers – 39bn; and the military and industrial complex – 70bn.

These measures have not come out of the blue – they were implemented to some degree over recent years. But in the present circumstances they formed the *Schwerpunkt* for the government. Hence, the attempt of a comprehensive remedy to the pressing challenges in the noted areas. But these measures are somewhat late already, and they are not preventive ones,

as the production slump and the fall in entrepreneurial activity have been already there. It is unlikely that the government would be able to reverse the trend, even by means of additional infusions of public funds, while there are no guarantees of their efficient use, but it is quite real to cushion the fall.

As concerns the social component of the anti-crisis package, it is intended to carry out pro-active employment policy measures (with Rb. 43.7bn allocated to this effect), raise unemployment benefits (Rb. 33.9bn), use the maternity capital to repay mortgage loans (Rb. 26.3bn). As a compensation for thus missing revenues, the state extrabudgetary funds should receive Rb. 388.5bn and the RF Subjects Rb. 150bn in additional interbudgetary transfers.

At the end of the day, the aggregate volume of the federal budget expenditures grew at Rb. 667.3bn. vis-à-vis the initially approved volume and now accounts for Rb. 9.69trln. There is a great probability that such an expenditure reallocation in favor of implementation of priority measures of support of the real sector and the population will be noted through the whole year of 2009 on the level of regional budgets, too. Hence, a question arises as to which expenditures will be axed down the road.

The comparative analysis of the functional structure of the enlarged government's expenditures in the OECD countries and RF presented in *Table 16*, allows noting that reserves for such an exercise should be looked for across such sections as "Housing and utilities" (in Russia, these expenditures are on average twice as high as in the OECD countries), "National defense" and "National security". It goes without saying, in the conditions of an objective deterioration of the criminogenic situation in the country, one should exercise a great deal of caution while scaling back expenditures on national security and law enforcement and be at pains to compensate for them by bolstering efficiency of the use of the remaining budgetary funds.

Table 16

Comparative Analysis of the Functional Structure of expenditures of the Enlarged Government in the OECD Countries and in RF, as% to GDP

	RF				OECD countries (averaged over the period of 2003-2007)									Other OECD countries (averaged over the period of 2003-2007)			
	2005	*2006*	*2007*	*2008*	*25 EU countries*	*UK*	*France*	*Germany*	*Bulgaria*	*Czech Republic*	*Romania*	*Poland*	*Hungary*	*Canada*	*Japan*	*S. Korea*	*USA*
GDP per capita, USD .m. (2007)	***5.3***	***6.9***	***9.1***	***11.8***	***32.6***	***35.7***	***32.7***	***34.4***	***5.0***	***16.2***	***7.7***	***10.7***	***13.4***	***38.5***	***33.6***	***24.8***	***45.5***
Expenditures, total	*31.56*	*31.49*	*34.09*	*33.68*	*47.0*	*43.3*	*53.0*	*46.4*	*39.5*	*44.8*	*34.5*	*43.3*	*50.0*	*39.9*	*37.4*	*29.5*	*36.7*
General government matters	*3.49*	*3.10*	*3.54*	*3.10*	*6.4*	*4.3*	*7.2*	*5.7*	*5.5*	*4.9*	*3.7*	*6.1*	*9.3*	*7.8*	*5.8*	*3.6*	*4.8*
National defense	*2.69*	*2.57*	*2.53*	*2.51*	*1.6*	*2.5*	*1.9*	*1.0*	*2.0*	*1.5*	*2.5*	*1.2*	*1.3*	*1.0*	*1.0*	*2.6*	*4.2*
National security and law enforcement	*2.71*	*2.68*	*2.62*	*2.63*	*1.8*	*2.5*	*1.3*	*1.6*	*2.9*	*2.2*	*2.2*	*1.7*	*2.1*	*1.6*	*1.4*	*1.4*	*2.1*
National economy	*3.54*	*3.57*	*4.73*	*5.42*	*3.9*	*2.9*	*3.0*	*3.6*	*5.0*	*7.4*	*5.9*	*3.9*	*6.1*	*3.4*	*4.0*	*7.4*	*3.7*
Environment	*0.10*	*0.09*	*0.08*	*0.08*	*0.7*	*0.7*	*0.8*	*0.6*	*1.0*	*1.1*	*0.2*	*0.6*	*0.7*	*0.5*	*1.3*	*0.9*	*0.0*
Housing and utilities	*2.18*	*2.37*	*3.34*	*2.77*	*1.0*	*1.0*	*1.8*	*1.0*	*0.8*	*1.4*	*2.0*	*1.3*	*0.9*	*0.9*	*0.7*	*1.3*	*0.6*
Healthcare	*3.69*	*4.04*	*4.20*	*3.73*	*6.5*	*6.8*	*7.2*	*6.4*	*5.1*	*7.1*	*3.8*	*4.4*	*5.4*	*7.1*	*7.0*	*3.5*	*7.5*
Culture, sport, leisure activities	*0.71*	*0.71*	*0.75*	*0.75*	*1.1*	*1.0*	*1.5*	*0.7*	*0.8*	*1.3*	*0.7*	*1.0*	*1.6*	*0.9*	*0.2*	*0.8*	*0.3*
Education	*3.71*	*3.88*	*4.07*	*4.01*	*5.3*	*6.0*	*6.1*	*4.0*	*4.1*	*4.9*	*3.8*	*5.9*	*5.8*	*7.2*	*3.9*	*4.8*	*6.3*
Social policy	*8.74*	*8.48*	*8.24*	*8.68*	*18.7*	*15.6*	*22.2*	*21.8*	*12.2*	*13.2*	*9.7*	*17.2*	*16.8*	*9.4*	*12.1*	*3.2*	*7.0*

Source: data of the RF Ministry of Finance, Eurostat, OECD.

2.2.5. Assessment of Budget Parameters without Regard to the Contribution of the Oil-and-Gas Sector and the Impact of the World Oil Prices

To have their national budgets balanced, countries whose tax revenues to a significant degree depend on mineral exports and prices on the world markets for minerals, have found it fundamentally important to single out the structural component and the market component in the tax burden for the sake of assessing market risks facing the government budget and margins of lowering of the tax burden on their economies.

The market component comprises a fraction of tax revenues which is determined by a favorable state of affairs on external markets, while the structural component reflects the level of taxes collected to the budgetary system under average multiyear parameters of the situation in the foreign trade area.

There exist various approaches to identification of the structural and market components of the tax burden. Whereas the dynamic of the world oil prices constitutes one of key factors of the market component of the dynamics of Russia's GDP and tax revenues, accordingly, one of possible ways is to find the market component is singling out oil-and-gas revenues in the budget. The RF Ministry of Finance has employed this approach since 2007 In a nutshell, it rests upon the division of taxes into "structural" and "market" ones. In this particular case it is taxes that appear directly dependent on prices for oil and gas that are attributed to "market" ones. An undisputable advantage of this approach is simplicity and the methodological certainty of the necessary calculations. Meanwhile, the approach in question does not take into consideration an impact the situation in the foreign trade area has on volumes of collection of revenues from other taxes. For example, it is pretty clear that the profitability rate of the oil-and-gas sector depends on price levels for oil and gas, which in turn affects the level of collection of revenues from the corporate profit tax.

The aforementioned drawback is overcome by employing a fundamentally different approach towards singling out the structural and market components of the tax burden. The approach is based upon singling out the structural and market components in revenues across major taxes, rather than on singling out two groups of taxes. The approach implies econometric modeling of correlation between GDP and tax revenues, and major market factors[16], such as:

– the domestic demand factors (real investments in fixed assets and the population's real disposable incomes),

[16] The equilibrium employed to single out the structural and market components of GDP takes the following form: $Y_t = a_0 + a_1 \mathrm{Re}v_t + a_2 Inv_t + a_3 P_{OILt} + a_4 REER_t + \varepsilon_t$,

where Y – GDP; C – consumption; Rev – the population's real disposable incomes; Inv – investments in fixed assets;

P_{OIL} – the nominal price level for URALS (as USD/barrel);

$REER$ – the real effective exchange rate of the Rb. (basing on CPI);

NEX – net export.

Variables Y_t, Rev_t и Inv_t in real terms – in prices of the 4th quarter 1998 г., the deflator- CPI.

As a result, we have got the following correlation: $Y_t = 239{,}75 + 1{,}38 * Inv_t + 8{,}69 * P_{OILt} + 3{,}19 * REER_t + \omega_t$ (apparently the positive sign of the coefficient under variable $REER$ is explained by the incomplete specification of the model).

The present analysis employed quarterly data of Rosstat and the International Financial Statistics database over the period between 1999 and 2008.

– external factors (the world price for oil),
– other factors (the Rb. real effective exchange rate, random factors that steer short-term fluctuations, etc.)

First we singled out the structural and market components of GDP. The *structural* GDP is a volume of GDP that might be obtained under average values of explanatory variables, while any biases from the average level constitute the *market component* of GDP. To estimate the structural component of GDP, we calculated smoothed value of explanatory variables of the model. Proceeding from the different nature of the respective variables, to smooth such factors as real investment in fixed assets and real effective exchange rate, we employed the Hodrick-Prescott filter. The average multiyear price for oil was calculated by the moving-average method over the period of 25 years.

On the basis of thus received coefficients we calculated shares of the market GDP explained by the aforemetioned different factors (see *Table 17*).

Table 17

The Dynamic of the Structural and Market GDP Estimated over the Period of 2000–2008

	2000	2001	2002	2003	2004	2005	2006	2007	2008 (est'd)
Structural GDP, as% of GDP	98.5	97.1	97.1	96.2	90.3	86.1	83.5	81.0	78.6
Market GDP, as% of GDP	1.5	2.9	2.9	3.8	9.7	13.9	16.5	19.0	21.4
Including factors affecting the market GDP dynamic:									
Domestic demand, as% of GDP	1.2	1.6	-0.9	-1.1	0.0	0.0	0.8	0.9	1.0
Oil prices, as% of GDP	1.0	1.2	3.1	4.6	8.1	12.6	14.0	16.1	18.1
Other factors, as% of GDP	-0.7	0.1	0.4	0.4	1.6	1.3	1.7	2.0	2.3
For reference: The nominal volume of GDP, as Rb. bn	7305.6	8943.6	10817.5	13243.2	17048.1	21625.4	26903.5	33113.5	41540.4
The real volume of GDP, as% to the prior year	110.0	105.1	104.7	107.3	107.2	106.4	107.7	108.1	105.6

Source: Roststat, IMF (IFS database, CD-ROM edition, December 2008), the IET calculations.

Tax revenues to Russia's budgetary system were split into the structural component and the market one on the basis of earlier obtained proportions of the structural and market GDP, and with the use of the calculation of the share of revenues that depend on oil prices (in the frame of the building of pair regressions models of the respective tax receipts from nominal oil prices).

Table 18

The Dynamics of the Structural and Market Components of Tax Revenues to the Budgetary System of RF[17], as Estimated over the Period of 2000–2008, as% to GDP

	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008 (est'd)
Tax revenues to the federal budget										
Revenues, total	***10.6***	***14.5***	***16.3***	***18.9***	***18.2***	***18.6***	***22.3***	***22.0***	***21.3***	***21.2***
Structural component	10.9	10.6	10.9	15.0	14.0	11.8	12.3	12.2	13.7	14.4
Market component, including	-0.3	3.9	5.5	3.9	4.2	6.8	10.0	10.0	7.6	6.8
domestic demand	*0.0*	*0.2*	*0.3*	*-0.1*	*-0.3*	*0.0*	*0.0*	*0.2*	*0.1*	*0.1*
oil prices	*0.0*	*3.8*	*5.1*	*4.0*	*4.4*	*6.4*	*9.7*	*9.5*	*7.3*	*5.6*
other factors	*-0.3*	*-0.1*	*0.0*	*0.1*	*0.1*	*0.4*	*0.3*	*0.4*	*0.2*	*0.1*
Tax revenues to the budget of the enlarged government										
Revenues, total	***31.4***	***35.7***	***35.7***	***35.6***	***34.6***	***35.3***	***36.9***	***36.9***	***36.8***	***35.7***
Structural component	32.0	30.2	29.9	32.6	31.0	28.2	26.3	25.9	28.2	29.0
Market component, including	-0.6	5.5	5.8	3.0	3.6	7.1	10.6	11.0	8.6	6.7
domestic demand	*0.0*	*0.4*	*0.6*	*-0.2*	*-0.4*	*0.0*	*0.0*	*0.3*	*0.2*	*0.1*
oil prices	*0.0*	*5.3*	*5.2*	*3.1*	*3.8*	*6.5*	*10.2*	*10.1*	*8.1*	*6.4*
other factors	*-0.5*	*-0.3*	*0.1*	*0.2*	*0.1*	*0.6*	*0.5*	*0.6*	*0.4*	*0.2*
Personal income tax										
Revenues, total	***2.4***	***2.4***	***2.9***	***3.3***	***3.4***	***3.4***	***3.3***	***3.5***	***3.8***	***4.0***
Structural component	2.4	2.3	2.8	3.2	3.1	3.0	2.8	3.1	3.1	3.3
Market component, including	0.0	0.1	0.1	0.1	0.3	0.4	0.5	0.4	0.7	0.7
domestic demand	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.1*
oil prices	*0.0*	*0.0*	*0.1*	*0.1*	*0.2*	*0.4*	*0.4*	*0.4*	*0.7*	*0.6*
other factors	*0.0*	*0.0*	*0.0*	*0.0*	*0.1*	*0.0*	*0.1*	*0.0*	*0.0*	*0.0*
Uniform social tax[18]										
Revenues, total	***-***	***-***	***5.8***	***7.0***	***6.6***	***6.3***	***2.0***	***2.0***	***2.0***	***1.9***
Structural component	-	-	6.0	6.8	6.4	5.7	1.7	1.7	2.8	2.7
Market component, including	-	-	0.2	0.2	0.2	0.6	0.3	0.3	-0.8	-0.7
domestic demand	-	-	*0.1*	*0.0*	*-0.1*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*
oil prices	-	-	*0.1*	*0.2*	*0.3*	*0.5*	*0.2*	*0.2*	*-0.7*	*-0.7*
other factors	-	-	*0.0*	*0.0*	*0.0*	*0.1*	*0.0*	*0.0*	*-0.1*	*0.0*
Corporate profit tax										
Revenues, total	***4.6***	***5.4***	***5.7***	***4.3***	***4.0***	***5.1***	***6.2***	***6.2***	***6.6***	***6.0***
Structural component	4.5	5.3	5.6	4.1	3.6	4.5	5.3	6.1	4.8	4.1
Market component, including	0.1	0.1	0.1	0.2	0.4	0.6	0.8	0.1	1.8	1.9
domestic demand	*0.1*	*0.1*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.1*	*1.3*	*1.5*
oil prices	*0.1*	*0.1*	*0.1*	*0.2*	*0.3*	*0.6*	*0.7*	*0.1*	*1.3*	*1.5*
other factors	*0.0*	*0.0*	*0.0*	*0.0*	*0.1*	*0.1*	*0.1*	*0.0*	*-0.8*	*-0.7*
Value added tax										
Revenues, total	***5.9***	***6.2***	***7.2***	***7.0***	***6.7***	***6.3***	***6.8***	***5.7***	***6.9***	***5.1***
Structural component	5.8	6.1	7.0	6.7	6.1	5.5	6.0	5.6	7.2	5.3
Market component, including	0.1	0.1	0.2	0.3	0.6	0.8	0.9	0.1	-0.3	-0.2
domestic demand	*0.1*	*0.1*	*0.1*	*-0.1*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*
oil prices	*0.1*	*0.1*	*0.1*	*0.3*	*0.5*	*0.7*	*0.7*	*0.1*	*-0.3*	*-0.1*
other factors	*-0.1*	*-0.1*	*0.0*	*0.0*	*0.1*	*0.1*	*0.1*	*0.0*	*0.0*	*-0.1*

Note. «-» – UST was not levied.
Source: the RF Ministry of Finance, Rosstat, IMF (IFS database, CD-ROM edition, December 2008), the IET calculations.

The rising oil prices made a great contribution to the market component of tax revenues to the budget of the enlarged government (*Table 18*): in 2006, the market component secured revenues to the said budget at a level of 11.0% of GDP (including 10.1% of GDP secured by

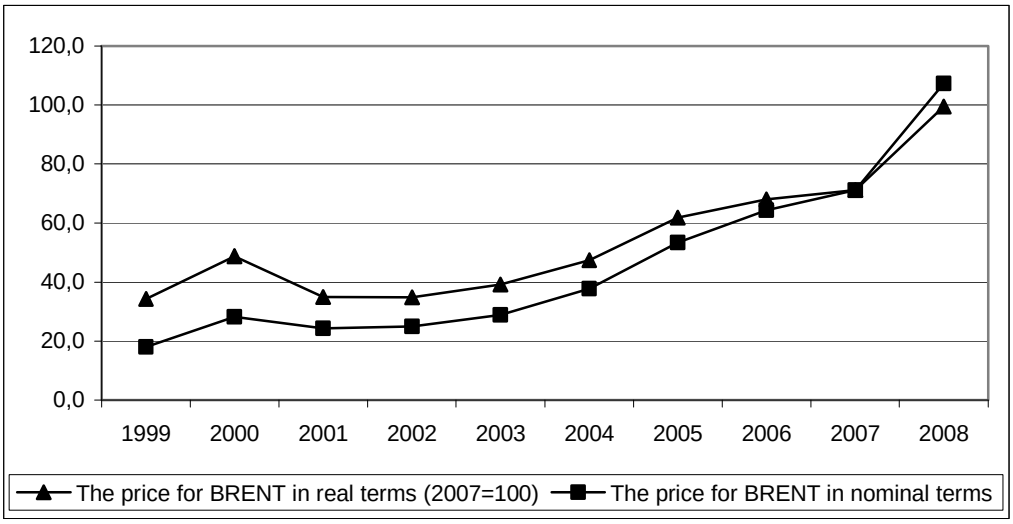
[17] For the purposes of our calculations we include in the tax revenues of the federal budget and the budget of the enlarged government over the period in question compulsory pension insurance contributions, revenues from foreign trade, and revenues of target extrabudgetary funds.
[18] Since 2005 the data are given without regard to the compulsory pension insurance premiums.

oil prices alone) and 10.0% of GDP - to the federal budget (the contribution of oil prices equaling 9.5% of GDP). The market component has been on decline since 2007, which can be attributed to a gradual exhaustion of the role market factors played in the dynamic of aggregate revenues. Thus, in 2007, the market component of the enlarged government's revenues accounted for 8.6% of GDP and 7.6% of the federal budget, while the respective figures in 2008 were 6.8% and 6.7% of GDP.

Such logic of the post-component division is also applicable to the personal income tax. As demonstrated by *Table 18*, the 2006 proportion of the market component of PIT was 0.4% of GDP, while in 2007 and 2008 it was 0.7% of GDP. In all likelihood, such a dynamic is explained by growth in the population's incomes in the conditions of a favorable situation in the foreign trade area in 2007, on the one hand, and the impact of the global financial downturn in late-2008, on the other hand.

The market component of the revenues from the uniform social tax in 2006 was 0.3% of GDP (of which 0.2% were backed by a positive dynamic of oil prices); in 2007 and 2008, the sign of the component has become negative (-0.8 and -0.7% of GDP, respectively), which can be explained by the regressive scale of the tax (in other words, with salaries and wages rising, the effective rate of the tax declines), and, accordingly, the growing role the structural factors played in tax revenues from the UST (2.8 and 2.7% of GDP, respectively) over the period in question.

Let us note that the 2006 proportion of the market component of tax revenues from the corporate profit tax was not a huge one – it accounted for 0.1% of GDP, with the bulk of the revenues secured by rising oil prices and factors of the domestic demand. By 2008, in contrast, it had soared up to 1.9%, which can be attributed to oil price spikes between the second half of 2007 and the first half of 2008 (see *Fig. 18*).



Source: IMF (IFS database, CD-ROM edition, October 2008), the authors' calculations.

Fig. 18. Dynamics of nominal and real (2007 prices) price on Brent crude oil (bar/dol) annualized, 1999-2008

Table 18 shows that as in the case of the UST, market factors had minor effect on VAT. More specifically, in 2006, the market component of revenues from this particular tax ac-

counted for a meager 0.1% of GDP, while in 2007 and 2008 its sign is negative (-0.3% and 0.2%, respectively). This can be explained by a greater role played by structural factors in the dynamic of VAT-based revenues – namely, the aforementioned recently promulgated modifications in the legislation that concern the tax in question.

Recapping on the analysis of the structural and market components of tax revenues to Russia's budgetary system over the period of 1999-2008 allows the following conclusions:

As evidenced by *Table 18,* the structural component of tax revenues had been mostly on the rise through 2002-2003. Post-2003, the favorable state of affairs in the foreign trade area exerted a positive influence on tax revenues and, accordingly, the structural component was on decline, while the market one was rising through 2006 when it hit its peak value. Then, fueled by an advancing growth in investment, the factors of the domestic economic activity resumed playing a greater role.

With account of the above, overall, between 2002 and 2008 the market component of tax revenues to the budget of the enlarged government rose from 3.0 до 6.7% of GDP, while that of tax revenues to the federal budget soared from 3.9 до 6.8% of GDP. Similarly, the market component of revenues from PIT increased from 0.1 up to 0.7% of GDP, while that of revenues from the corporate profit tax surged from 0.2 up to 1/9%. The favorable dynamic of the world prices for energy sources has had practically no effect on such taxes as UST and VAT, in respective revenues from which a more major role was played by structural factors, primarily modifications of the tax law and peculiarities of the functioning of these taxes.

In conclusion, it appears appropriate to once again focus on main trends of, and outlooks for the budgetary system of the Russian Federation.

1. Driven by the unfolding crisis developments in the national economy, the progressing decline of the economic agents' financial standing has inevitably engendered a fall in the budget revenues and called in question the financial stability of the national budgetary system as a whole. The revenues of the enlarged government tumbled at 1.7 p.p. of GDP vs. the 2007 figures. The fall was determined primarily by revenues from tax collection that were drying out (at 1.8 p.p. of GDP). The major factor of changes in the tax revenues dynamic vs. 2007 was the domestic VAT, the payments of which have become quarterly, effective as of the-early 2008. This factor was behind tax revenues spikes in January, April, July and October and the subsequent 2-month decline in revenues (when in the absence of the VAT-based revenues, the government continued to reimburse VAT to economic agents) compared with the respective period of 2007.

2. One should note the direction of the RF Ministry of Finance's 2008 policy, which is aimed at loosening the dependence of revenues to the national budgetary system on the world oil prices. More specifically, the debate between the RF Ministry of Finance and the RF Ministry of Economic Development in the summer of 2008 on the issue of lowering the rate of either VAT, or the corporate profit tax was won by the former agency, and the CPT rate was lowered to 20% since 2009. In the current conditions, with account of the existing trend to decrease of the structural component of revenues to the budgetary system (i.e. a component that does not depend on world oil prices), it is imperative to at least retain the quality of administration of base and rates of the taxes that to the least degree directly depend on the world oil prices.

3. In 2008, sky-high windfall revenues enabled the government to stock up a substantial financial reserve in the form of budgetary surplus. That in turn made it possible not only to

fulfill in full the government's expenditure obligations, but to replenish the Reserve Fund and the National Welfare Fund whose volume combined ultimately accounted, respectively, for 9.7% and 6.2% of GDP in Rb. equivalent, as of the early-2009.

4. While having plummeted in shares of GDP (at 0.4 p.p., down to 33.7% of GDP), expenditures of the enlarged government's budget, nonetheless, have decreased to a far less degree than its revenues. That has resulted in a substantial fall of the budgetary surplus at 1.3 p.p. - down to 4.8% of GDP. The situation with execution of expenditure obligations on the cash basis was still unsatisfactory over the financial year. While there was noted a slight progress in this area vs. the 2007 performance (by results of the first half- year the execution on the cash basis grew from 33.2% in 2007 г. to 38.7% in 2008), the tendency to growth in expenditures by the end of a year remained unchanged.

5. The negative backdrop in the foreign trade area and falling volumes of revenues from domestic taxes determine the need for pursuance a more conservative budgetary policy rested upon a reasonable balance between volumes of undertaken obligations and possibilities for their financing. The comparative analysis of the functional structures of the enlarged government in the OECD countries and RF allows noticing that reserves of cutbacks should be sought in such sections as "Housing and utilities" (in Russia, these expenditures are on average twice as high as in the OECD countries), "National defense" and "National security". It goes without saying, in the conditions of an objective deterioration of the criminogenic situation in the country, one should exercise a great deal of caution while scaling back expenditures on national security and law enforcement and be at pains to compensate for them by bolstering efficiency of the use of the remaining budgetary funds. Meanwhile, given that the crisis has already imposed certain budget constraints, a fully justified move would be to profoundly optimize military expenditures with a subsequent use of thus saved funds to finance the economy.

6. Notwithstanding the appropriateness of pursuance of a more conservative budgetary policy, the RF government proposed amendments to the 2009 Act on federal budget to bolster expenditure obligations as a means of financing anti-crisis measures.

When compared with the current version of the 2009 federal budget Act, the projected volume of revenues should fall from Rb. 10.93trln (21.23% of GDP) to Rb. 6.71trln. (16.6% of GDP). Over 60% of the decline in revenues fell on the contraction of revenues from MT and export customs duties that form the oil-and-gas revenues to the budget. In addition to the fall in the oil-and-gas revenues, it is the corporate profit tax, VAT, the personal income tax and UST, revenues from which should fall at most, which will be determined by the worsening state of Russian corporations, nose-diving business activity, rising unemployment and falling incomes from labor and entrepreneurial activities.

The anti-crisis nature of the budget manifests itself in the reallocation of expenditures (it was proposed to scale back the earlier approved appropriations at Rb. 943.3bn) in favor of financing the priority avenues of the anti-crisis program approved by the RF government. Specifically, it is planned to spend some Rb. 1.61trln on measures on stabilization of the financial market, support of industry branches, and on the social support of the population.

These measures have not come out of the blue – they were implemented to some degree over recent years. But in the present circumstances they formed the Schwerpunkt for the government. Hence, the attempt of a comprehensive remedy to the pressing challenges in the noted areas. But these measures are somewhat late already, and they are not preventive ones,

as the production slump and the fall in entrepreneurial activity have been already there. It is unlikely that the government would be able to reverse the trend, even by means of additional infusions of public funds, while there are no guarantees of their efficient use, but it is quite real to cushion the fall.

The overall volume of expenditures has ultimately increased at Rb. 667.3bn vs. the earlier approved volume and currently accounts for Rb. 9.69trln (24% of GDP). It is for the first time in the 2000s that the federal budget will run a deficit of Rb. 2.98trln. (7.4% of GDP). Because the deficit will be financed with the help of resources from the Reserve Fund, the inflationary pressure on the Rb. from the increase in expenditures will unlikely to be a significant one, as additional funds will be pouring in the economy against the background of the crisis in demand, when the value of cash grows significantly. Already now there is noted a downfall or stabilization of retail and producer prices across a number of group of goods, so an even spending of additional budgetary resources should not engender an explicit inflationary effect.

7. The government's refusal to continue the practice of drafting a three-year budget is particularly noteworthy. Under the present uncertainty, it is impossible of course to ensure a high quality of the three-year budgetary planning. But one should realize that a comeback to the annual budget planning constitutes a step back on the path towards development of the strategic budgetary planning, as it derails the public appreciation of the government's long-term budgetary and fiscal policy and does not allow transition to medium-term public contracts, nor it helps lay down the foundation for enhancement of transparency of financial fundamentals of the public investment expenditures.

2.3. Intergovernmental Relations and Subnational Finances

2.3.1. Major Trends in Relations between Budgets of Different Levels

Major trends in the relations between governments of different levels are reflected in the structure of revenues and expenditures of the RF consolidated budget. *Table 19* presents the data, reflecting the share of tax revenues and expenditures of the Russian Federation Subjects in the relevant indicators of the Russian consolidated budget.

Table 19

The Share of Some Indicators of Budgets of the Federation Subjects in the Consolidated Budget of the Russian Federation in 1992–2008 (%)

	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
Tax revenues	44.2	53.1	53.4	47.6	49.5	53.1	56.6	49.2	43.5	37.4	35.1	39.6	36.1	30.9	31.8	33.9	33.2
Expenditures	34.0	40.3	37.7	43.4	45.4	48.1	54.1	51.9	54.4	54.2	49.3	50.0	50.8	49.5	43.4	48.3	49.2

Source: Federal Treasury, IET estimates.

Reviewing the data of *Table 19*, one should note the following. During the period of 1999-2005, a significant centralization of tax revenues was observed, while the share of this type of revenue of the Russian Federation Subjects in the consolidated budget has decreased from 56.6% to 30.9%. At the same time, in 2006-2007 that indicator started to increase slightly, what reflected some adjustment of the trend towards centralization of tax revenues. It should be noted, that this adjustment was not due to the relocation of tax sources between the

levels of budgetary system, but rather due to the more rapid growth of tax revenues allocated to the regional budgets, as compared with tax revenues of the federal budget. In 2008, this share has somewhat decreased, but still remained at a significantly higher level than the indicator of 2005. Herewith, the share of regional expenditures in the consolidated budget of the Russian Federation continued its upward trend, approximating the indicators of 2002-2005.

There were no significant changes in the structure of tax revenues of the RF Subjects. As before, still more than half of tax revenues are obtained from two types of taxes: corporate profit tax (the share has decreased by 2.4%, to the amount of 40%) and personal income tax (its share in the total tax revenue, by contrast, has grown from 35% in 2007 up to 38% in 2008). The share of these taxes in tax revenue in the budgets of the Russian Federation Subjects has not changed and amounted to 78% (against 77.3% a year earlier). Analysis of the basic tax revenues in terms of GDP share allows to note the following (see *Table. 20*). Proceeds from personal income tax continued the trend of increasing, having reached 4.0% of GDP (3.8% in 2007). Corporate income tax revenue has demonstrated a slight decline from 4.6% to 4.2% of GDP. Regional budget revenues, generated by excise taxes, in the past year (as in a number of preceding years) have decreased and reached 0.46% of GDP (0.54% in 2007). Property tax share has somewhat decreased (from 1.25% to 1.19% of GDP). At the same time, the growth was recorded in regard to royalty on natural resources, from 0.23% to 0.25% of GDP and from small businesses taxation (from 0.37% to 0.39% of GDP).

Таблица 20

Tax Revenues in the Budgets of the RF Subjects in 2005-2008 (% in GDP)

	2005	2006	2007	2008
Tax revenues, including:	**10.32**	**10.24**	**10.97**	**10.56**
Corporate profit tax	4.42	4.32	4.64	4.22
Personal income tax	3.27	3.46	3.84	4.01
Excise tax on goods, sold in the RF territory	0.68	0.60	0.54	0.46
Aggregate income tax	0.33	0.36	0.37	0.39
Property tax, including	1.17	1.16	1.25	1.19
Business property tax	0.70	0.75	0.80	0.78
Royalty	0.25	0.25	0.23	0.25

Source: Federal Treasury, authors' estimates.

In 2008 the trend to a reduction in the inter-regional irregularity in the tax revenues of the RF Subjects on a per capita basis was sustained. The corresponding coefficient of variation value has significantly decreased from 96.7% in 2007 to 89.1% in 2008. It is worth noting, that in 2006-2008 there were no major changes in the allocation of revenue sources between government levels. Therefore, the reduction of irregularity in the distribution of tax revenues was based on the natural economic processes. This can be explained as follows.

First, the share of personal income tax in the tax revenue of the RF Subjects has significantly increased, that tax base (as opposed to corporate income tax base) is fairly evenly distributed across the regions. Second, the data obtained confirm the hypothesis put forward in previous surveys. Under this hypothesis, there are two factors in the reduction of the inter-regional differentiation across the major socio-economic indicators: rapid economic growth in

the number of regions, that are currently getting considerable donations, and the migration of people from unpromising areas of the country to the rapidly developing economic centers. As a result of the interaction of those processes, the currently underdeveloped regions will either «catch up» with their economically developed neighbors, or will lose nearly all their population. In both cases, the variation coefficient of tax revenues per capita across the RF Subject should be reduced. And third, in the last months of 2008, the crisis in Russia was aggravating, which especially affected the most economically underdeveloped regions. As a result, tax revenues in economically developed Subjects, if not declined in nominal terms in 2008, have grown to a much lower level than could have been reached under the more favorable economic conditions. Apparently, this factor will be the determining one for the changes in interregional differentiation in 2009.

In real terms, tax revenues of the consolidated budgets of the RF Subjects have grown by 7%, significantly lower than the indicator of 2007 (17.4%). The maximum growth in tax revenues in the preceding year was recorded in 2008 in Chukotka Autonomous Okrug, the Republic of Dagestan and in Perm Region. At the same time, in six regions this type of revenue has reduced in real terms[19]. The maximum decline was recorded in the Republic of North Ossetia, Krasnoyarsk Krai and Murmansk Region. In 2008, two regions with the high budget level, Krasnoyarsk Region and Moscow have been enclosed in that group, which in 2007 demonstrated a substantial increase in tax revenues, and Moscow has been a leader in that indicator.

In the majority of regions, the decline in revenues is largely based on the decrease in payments of corporate income tax. Thus, the corporate income tax revenues have fallen in real terms in the Krasnoyarsk Krai by 21.1%, in the Murmansk Region by 24.5%, in Moscow by 14.7%. Herewith, in Krasnoyarsk Region and in Moscow the share of corporate income tax in the tax revenues of the consolidated budget of the Subject has significantly exceeded the average countrywide level (42.3%) and amounted to 56.6% and 61.3% accordingly.

In 2008, for the first time since 2003, there was recorded a cumulative deficit of consolidated budgets of the Federation Subjects, which amounted to 0.13% of GDP. This deficit resulted from faster growth in expenditures, as compared with an increase in income as a percentage of GDP. Therefore, at the level of regions, the trend of recent years to increase public expenditures at a rapid pace was sustained. It is also important to note that if in 2007 the number of the regions with the budget surplus has exceeded the number of regions with the budget deficit (48 and 36, respectively), whereas in 2008, the situation was different: 45 regions have completed the fiscal year with a deficit and only 39 with a surplus (see *Table 21*). Herewith, the Subjects with a high budget level, such as Moscow and St. Petersburg had the largest budget surplus in 2007, whereas in 2008, by contrast, they have been the leaders in terms of the deficit volume.

It should be noted, that the above annual dynamics of the major indicators in the regional budgets revenue sources do not fully reflect the situation at the end of 2008. To make more adequate assessment of the impact of economic crisis on the formation of budgets of the RF Subjects, it is necessary to review the changes of the last months of the year in more detail.

[19] Moscow, Krasnoyarsk, Murmansk region, Republic of North Ossetia, Kamchatka Krai and the Republic of Kalmykia.

Table 21

Russian Regions Grouped as per Budget Deficit/Surplus

	2007		2008	
	No of regions	RUR, bln	No of regions	RUR, bln
Deficit of the RF consolidated budget	36	87,6	45	135.4
Surplus of the RF consolidated budget	48	126,0	39	80.9

Source: Federal Treasury, IET estimates.

Since November 2008, the economic crisis began to significantly affect the revenues of regional budgets. Initially, the reduction of revenue has especially affected economically developed Subjects of the Russian Federation (Tyumen Oblast, Orenburg Oblast, Khanty-Mansiysk, Chelyabinsk Region, etc.), whose revenue is largely dependent on the financial standing of the large taxpayers, engaged in the metallurgical, oil, chemical and other industries (see Table 4). In November-December 2008, tax revenues of the consolidated budget of the Russian Federation have declined in nominal terms in 34 regions, as compared with the level of 2007. Herewith, a significant decline (over 10%) was observed in 14 regions.

Table 22

Regions, which Revenues Have Especially Decreased as a Result of the Economic Crisis at the End of 2008

Region	Tax revenues decline in nominal terms in November-December 2008 in% against November-December 2007
Tyumen Region	–33.1
Orenburg Region	–25.5
Khanty-Mansiysk Autonomous Region	–23.6
Chelyabinsk Region	–22.0
Republic of Sakha (Yakutia)	–21.9
Vologda Region	–21.4
St. Petersburg	–20.8
Republic of Tatarstan	–20.1
Belgorod Region	–17.3
Ulyanovsk Region	–15.4
Sverdlovsk Region	–15.3
Murmansk Region	–14.6
Krasnoyarsk Region	–11.5
Udmurt Republic	–10.0

Source: Federal Treasury, IET estimates.

However, it can be assumed that as the economic crisis is expanding, its negative impact on sub-national budgets will involve more and more regions, with both, high and low economic development levels.

As in the analysis of annual trends, the above reduction in tax revenues was primarily based on the reduced revenue from corporate income tax proceeds, started at the end of the year. In November-December 2008, corporate income tax proceeds in the consolidated budget of the Russian Federation Subjects in nominal terms have decreased by 30.5%, as compared with the relevant period in 2007. the Downfall in revenues has affected virtually all Subjects of the Federation (65 regions).

Summarizing the analysis of revenues of regional budgets, it can be concluded, that the crisis provoked a substantial reduction in revenues of nearly all the Subjects of the Russian Federation. In some regions, receiving a permanent financial support from the federal budget, the situation is better. However, their situation is directly dependent on the sustainability of federal finances. It can be assumed that the execution of the Federal Subjects budget revenue will remain quite tense in January-April of 2009, until the refund of the over-paid corporate income tax in 2008. At the end of 2008, there aroused grounds for the softening of the RF Subjects revenues in the medium term. We are speaking of, first of all, of the «smooth devaluation», which is likely to positively affect the profits of exporting businesses. The weakening ruble rate and the end of the period of return of the overpaid corporate income tax will result in the stabilization of regional income, starting from May 2009. Moreover, in the absence of significant improvement of external economic conditions and a suspension of the crisis deepening in the economy, the proceeds of the Russian Federation will be substantially lower than the income in 2008 and within 2009-2010. Therefore, the majority of the Subjects of the Russian Federation will need to review their expenditure liabilities on the basis of the amended income.

Let us consider now the quantitative parameters of financial assistance to the regional budgets from the federal budget in 2008. As one can see from the presented in Table 5 data, in 2002-2006 there was observed a trend to a gradual reduction of the amount of federal financial resources, allocated to subnational budgets (from 3.03% to 2.17% of GDP). In 2007, this trend was suspended and the amount of intergovernmental transfers increased to 2.57% of GDP. In 2008, the growth in the share of funds, allocated from the federal budget for financial assistance to the regions was continued, and this indicator accounted to 2.64% of GDP.

A more detailed analysis of the structure of intergovernmental transfers allows to note the following. In 2008, donations to Regions for the adjustment of budget insufficiency from the Fund of Financial Support to the Regions (FFSR) in terms of GDP share remained at the level of 2007 (0.79% of GDP). Therefore, in 2007-2008 downgrading of FFSR volume as a share of GDP, observed in the period from 2002 to 2006 has stopped. Naturally, this fact should be assessed as positive. It seems that among all types of intergovernmental transfers, the FFSR should be given priority, as the allocation of its funds is performed in accordance with the relatively transparent procedures. Herewith, it should be noted, that the share of donations for the adjustment of the budgetary sufficiency in the total volume of transfers in 2008 has remained virtually unchanged as compared with 2007 and amounted to about 30%.

By the RF Government Decree № 593, dated August 12, 2008, some amendments have been introduced to the new method of donations distribution from the Fund for Financial Support to the Regions[20], which have entered into force on January 1, 2008. It is worth reminding, that as a result of the new way of tax estimates procedure, introduced in 2008, fiscal capacity of many regions has undergone significant changes. To avoid abrupt negative variations in the amount of subsidies, allocated for the Subjects of the Russian Federation, the new method of grants distribution from FFSR provided for a mechanism of compensation. The scope of compensation to the region for losses during the transfer to the new method depends on the regions performance indicators in terms of arrears redemption and an increase in revenue to the budget of the Russian Federation Subject (this is one of three requirements, set forth in the

[20] For details of the donations allocation from FFSR, effective from 2008, see the "Russian economy in 2007: Trends and Prospects". M., IET, 2008. PP. 164-167.

new methodology for the distribution of donations from the FFSR). It was proposed to allocate the donations for partial compensation to the Russian Federation Subjects for the reduced donations for their budget sufficiency adjustment as the level of 2007, basing on bringing the level of subsidies up to 100% in 2008 (95% in 2009, 90% in 2010, to 50% in 2011 and further years) on condition of performance of 2 or 3 requirements, to 90% (80% in 2009, 75% in 2010, in 2011 and subsequent years), on condition of performance one requirement and up to 85% (75% in 2009, 70% in 2010, 30% in 2011 and subsequent years) in case of failure to fulfill any requirements.

Amendments to the methodology, made in August 2008, first, have limited term of the said compensation mechanism (only through 2011), and second, have reduced the adjustment coefficients for 2009-2010. Since 2009, the amount of compensation is estimated on the basis of bringing the level of donations (as compared with 2007) to 90% in 2009 (80% in 2010 and 50% in 2011) under condition of performance of 2 or 3 requirements, up to 75% (to 60% in 2010, to 40% in 2011), under condition of fulfilling one requirement and to 70% (to 55% in 2010, to 30% in 2011) in case of failure to fulfill any requirements.

In 2008 the trend of recent years to increase funding from the **Compensation Fund** was sustained. The total amount of subventions from this fund has been increased against 2007 from 0.43% to 0.51% of GDP[21]. This trend is due to the distribution of authorities across the levels of the budgetary system and the tendency of the federal government to fund the federal challenges in full scope.

After an upsurge of the **Fund for Co-financing of Social Expenditure** growth from 0.04% of GDP in 2004 to 0,12% of GDP in 2005, urged by «benefits monetization» (a large share in the Fund expenditures made the subsidies for partial reimbursement of measures of social support to the veterans and other special categories of citizens), there occurred a gradual decline in this type of transfers in 2006-2008. In 2008, the share of subsidies for co-financing of social expenditures[22] in GDP fell down by 0.01 p.p. as compared with 2007 and accounted to 0,09% of GDP. The amount of subsidies, allocated from the federal budget for the reform of regional and municipal finances has been unchanged and amounted to about 0.01% of GDP. The share of subsidies to regional budgets for the development of social and engineering infrastructure of the Russian Federation Subjects and municipalities[23] remained at the level of 2007 and amounted to 0,02% of GDP.

Reduction of the share of donations for the measures to maintain the regional budgets sufficiency from 0.17% to 0.11% of GDP in 2008 should be regarded as a positive trend. Active usage of this funding mechanism aggravates the problem of «soft budget constraints». At the same time, a positive factor is the total rejection of such tool in the practice of intergovernmental fiscal relations as the transfer of funds under the terms of mutual-settlements. That tool in the inter-budgetary relations is one of the least transparent.

Reviewing the issues of financial relationship between the federal center and regions, one cannot fail to note the emergence of the new type of transfers in the Budget Code in 2008.

[21] For the purposes of this survey (to ensure comparability of the data), the amount of funding from the Compensation Fund for 2008 includes not only the subventions, but also a number of intergovernmental transfers that, included in that Fund in 2007.

[22] Before 2008, those subsidies have been merged into the Fund of social expenditures co-financing, since 2008, this Fund was not allocated.

[23] Before 2008, those subsidies have been merged into the Fund financing for Regions development.

The issue under review is the Article 138.1 of the RF Budget Code[24], defining the concept of the federal budget subsidies from the budgets of the Russian Federation Subjects. This type of subsidy is defined as an intergovernmental transfer, addressed to the federal budget from the budget of the Russian Federation Subject for co-financing of expenditure obligations of the Russian Federation, emerging from performance of liabilities of the state authorities of the Russian Federation in cases, stipulated by federal laws.

Objectives and conditions for granting and disbursing these subsidies are set forth by agreements between the federal executive authority and the relevant supreme executive authority of the Russian Federation Subject[25]. The Ministry of Finance of Russia has stressed, that granting of such subsidies is the right, rather than the responsibility of regional authorities. The emergence of this type of transfer in the Budget Code should not be regarded as an attempt of «negative transfer» application at the federal level. It should be emphasized, that neither the provisions, stipulated in Article 138.1 of the RF Budget Code, nor the rules of the appropriate agreements between the Federal Center and regions, approved by the RF Government do not provide grounds for an analogy between this kind of subsidies and «negative transfers», applied at the regional level. These subsidies serve as a mechanism for increasing flexibility of the existing allocation of authority.

Since 2004, the attempts were made to increase the transparency of inter-budgetary relations. Currently, the Fund of Financial Support to the Regions and the Fund of Grants, allocated for the reform of regional and municipal finance, as well as the development of social and logistics infrastructure are allocated under the methodology, approved by the RF Government. Under the formalized method, the subsidies are estimated for social expenditures. Nevertheless, the share of intergovernmental transfers, distributed on a formalized basis, in 2008 amounted to only about 60% of the total amount of funds, transferred to the federal subjects of Russia. It should be noted, that this indicator is based on an analysis of the distribution methods of transfers from public sources[26]. Therefore, the assessment does not mean that the balance of the federal financial assistance to regions is allocated regardless methodological and financial feasibility studies. Thus, according to the Ministry of Russia estimates, over 95% of intergovernmental transfers are allocated on the basis of uniform methodologies, based on objective indicators, determining the need for financing. However, the methodological approaches to the allocation of transfers, provided in such cases, have not been stipulated in the open-access legal regulations.

In 2008, there continued the practice of revising the Law on the Federal Budget and Increasing the Estimated Amounts of Financial Assistance to Regions. The amount of additional (not foreseen at the beginning of the fiscal year) aid amounted to about RUR 168 billion. In GDP percentage, the amount of additional assistance in 2008 has grown twice as compared to 2007 - up to 0.4% of GDP. It should be noted, that a significant increase of the transfers could be linked to the need for adjustment due to changes in the key macroeconomic indicators ad-

[24] Introduced by the Federal Law № 141-FZ, dated July 22, 2008 «On Amending Certain Legislative Acts of the Russian Federation to improve land relations».

[25] Regulations on conclusion of such agreements are approved by the Government Order of the Russian Federation № 752 of October 13, 2008 «On approval of agreements provisions between the federal executive and the supreme executive authority of the state power of the Russian Federation to grant the federal budget funds from the budget of the Russian Federation».

[26] «Consultant Plus» legal data base and official web-sites of Ministries and Government agencies.

justments. The first version of the Law «On the Federal Budget for 2008 and for the forecast for 2009 and 2010» was adopted back in July 24, 2007, and it laid the parameters (especially for GDP and inflation rate), later subjected to a significant adjustments. At the same time, it should be emphasized, that if amendments were made in regard to the macroeconomic forecast, the FFSR volume should have been amended, but it remained unchanged.

Examples of additional financial assistance are as follows:

1) donations for the balance of regional budgets have been increased during 2008 from RUR 31 billion to RUR 46 billion, i.e., by 48%;
2) subsidies to agricultural producers to recover the cost of interest on loans have been increased from RUR 27 billion to RUR 34 billion, i.e., by 25%;
3) subsidies to the Subjects of the Russian Federation for the land plots communal infrastructure support for the purpose of housing construction have been increased from RUR 5.9 billion to RUR 7.8 billion, i.e, by 33%;
4) subsidies to the Russian Federation Subjects for the measures to provide housing facilities to the categories of citizens on the basis of the decisions of the Government of the Russian Federation have been increased from RUR 328 million up to RUR 1.7 billion, i.e., by 509%.

Totally, the subsidies for the balance and additional funds under other financial assistance channels have amounted to about 18% of total inter-budgetary transfers from the federal budget, allocated to the regions in 2008. Such a large share of those two tools, that contribute to the effects of the «soft budget constraints» sources of the regional authorities is an important shortcoming of the currently effective distribution of financial assistance to regions.

Table 23

Financial Assistance, Provided to Consolidated Budgets of the RF Subjects from the Federal Budget in 1992–2008 (% of GDP)

	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
1. Financial assistance to the budget of other levels				1.8	2.3	2.5	1.6	1.18	1.43	1.79	2.2	1.94	1.7	1.65	1.52	1.79	1.89
1.1. The federal targeted programs, as well as subsidies to the RF Subjects for the support of agriculture, water management, small business and rehabilitation of children														0.05	0.15	0.39	0.54
1.2.Social expenditures financing											0.15	0.11	0.04	0.12	0.11	0.10	0.09
1.3. Fund for Financial Support to the Regions:	0	0	0.36	1.17	1.04	1.22	1.12	0.99	0.96	1.14	1.36	1.3	1.05	0.88	0.94	0.79	0.79
donations for adjustment of regional budget sufficiency	0	0	0.36	0.86	0.68	0.86	1	0.99	0.96	1.14	1.36	1.3	1.05	0.88	0.94	0.79	0.79
government support to the "Northern delivery"									0.06	0.08	0.08	0.07	-	-	-	-	-

	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
transfers at the expense of VAT	0	0	0	0.31	0.36	0.36	0.12	-	-	-	-	-	-	-	-	-	-
1.4. Donations and subventions, including:	0	0.02	0.09	0.06	0.09	0.13	0.1	0.06	0.15	0.54	0.28	0.29	0.27	0.36	0.21	0.31	0.22
donations for measures for adjustment of regional budget sufficiency													0.11	0.24	0.16	0.17	0.11
1.5. Assets of the Fund for regional finance reform										0	0.01	0.01	0.01	0	0.01	0.01	0.01
1.6. Other grants and non-recoverable transfers (subsidies and subventions)											0.01	0.01	0.01	0.01	0.08	0.17	0.19
1.7. Fund for financing Regions development									0.03	0.05	0.1	0.1	0.15	0.01	0.01	0.02	0.02
1.8. Funds, transferred under mutual settlements	0.61	1.95	2.54	0.42	0.81	0.43	0.36	0.14	0.28	0.05	0.2	0.14	0.12	0.01	0.05	0.02	-
1.9. Loans and budget credits less redemption of other levels of government management*	0.09	0.03	0.02	0.04	0.23	0.64	-0.03	-0.1	-0.08	0.02	0.09	-0.01	-0.02	-0.03	-0.04	-0.01	0.03
2. Compensation Fund										0.37	0.38	0.36	0.34	0.17	0.30	0.43	0.51
3. Other Intergovernmental transfers, including:								0.18	0.11	0.4	0.45	0.54	0.35	0.33	0.34	0.36	0.27
Public support to road facilities**								0.18	0.11	0.27	0.27	0.31	0.22	0.13	0.15	0.17	0.08
Total funds, transferred to the budgets of other government levels	1.49	2.7	3.4	1.8	2.3	2.5	1.6	1.36	1.54	2.56	3.03	2.84	2. 39	2.25	2.17	2.57	**2.67**

*Since 2005 – only budget credits.
**Currently the bulk of transfers for the support of road facilities is included in 1.1.
Source: Federal Treasury, IET estimates.

2.3.2. Measures, taken by the RF government to mitigate crisis impacts to the Regions

Trends observed in the sub-national finances in the last two months of past year, confirm the crisis expansion in the region's economy and, consequently, increase the tension in the area of regional finance. In view of these circumstances, the Ministry of Finance and the Government of Russia in late 2008 and early 2009 took a series of measures aimed at mitigating the impact of the crisis on the sub-national budgets.

On December 20, 2008, a letter[27] was sent by the Ministry of Finance of the Russian Federation to all the RF Subjects with explanations of the priority measures to be taken by the Subjects in 2009 with the aim of preventing crisis in the financing of expenditure liabilities of regional authorities. In general, the recommendation of the Ministry of Finance were addressed primarily to the most conservative expenditure estimates for 2009 with regard to the reduction in estimates for the tax bases growth (first, corporate profits and payroll fund). Herewith, it was highlighted, that expenditures sequestering, when the budget is under execution is undesirable.

It should be noted that in the above-mentioned letter states, that «The Ministry of Economic Development of the Russian Federation is developing an updated forecast of the socio-economic development of Russia for 2009-2011». Herewith, that forecast has not been approved neither at the end 2008, nor in the early 2009. Therefore, it is still unclear, on what basis the Regions should adjust their budget estimates. In our view, the Subjects of the Russian Federation, should have clear understanding, that the federal center expects them to take active measures to adapt to the new trends in economic development, including the development of regional socio-economic development estimates, based on local situation. This is primarily based on the fact, the macro-economic indicators, estimated at the federal level, in the period of high volatility in economic conditions can differ from the actual socio-economic development in specific regions. As a result, the awareness of regional authorities on the status of the largest taxpayers in the area can provide more adequate information for the budget indicators, than federal estimates.

The letter was also provided a number of specific recommendations to the Subjects of the Russian Federation. First, the need to address the surplus revenues, received in 2008, a reserve fund for 2009, rather than to finance expenditures of the current year (as it used to be done in all preceding years). Second, it was emphasized, that the decision to raise the salaries of the public sector employees should be implemented with due regard the capacity of regional budgets. Herewith, the salaries rate upgrading of the federal agencies offices should not be taken as a benchmark for similar solutions at the regional level. And third, the letter noted that the volume of the RF Subjects budgets deficits should be planned with regard to the available credit resources and opportunities for the debt securities placements.

Let us review the actual situation with the prospects for the formation of the financial reserves of the regional budgets. According to the RF Ministry of Regional Development, the untargeted balances, carried over to 2009, not addressed to cover the budget deficit in 2009, amounted to about RUR 273 billion. The largest balances are available in seven Subjects of the Russian Federation; their share exceeds 10% of the revenues, estimated for 2009 in the following regions: Lipetsk, Tver, Tyumen, Chelyabinsk, Sakhalin Region, Yamalo-Nenets and Chukotka Autonomous Region. Those regions have great potential to compensate for decreased revenues in 2009. However, the majority of Regions have no significant balances, carried over to 2009 and will be forced to significantly reduce their expenditures in the first quarter of 2009.

[27] Letter of the Ministry of Finance of Russia № 06-03-07, dated of 20.10.2008 «On recommendations on the formation of budgets of the Subjects of the Russian Federation in 2009 and for the planed period up to 2010 and 2011 years».

There are three main reasons for the fact that at the end of 2008, despite the recommendations of the Ministry of Finance of Russia, in the majority of the Russian Federation Subjects were unable to accumulate significant financial reserves (see *Table 24*):

- objective slowdown in revenue growth of consolidated budget of the Russian Federation Subjects at the end of 2008. In November-December 2008, the total income of the Subjects of the Russian Federation has grown only by 5.7% against the same period in 2007. It is obvious, that at the beginning of fiscal year many Subjects of the Russian Federation hoped for greater revenue growth in 2008. Consequently, the majority of the RF Subjects have not obtained considerable surplus revenue as compared to the estimates of the late 2008;
- inertia of the budget process. The Subjects of the Russian Federation failed to dismiss many expenditure liabilities on time;
- intentional reluctance of regional authorities to reduce expenses and accumulate financial reserves. In the situation, when the federal center has not provided a clear macroeconomic forecast for 2009, as well as the criteria for provision the financial assistance to regions, some regions have intentionally refused significantly to cut down in late 2008 and, accordingly, have failed to form necessary financial reserves. In some regions this was done out due to the doubts, that the federal center will provide emergency financial assistance only to those Subjects of the Russian Federation, who have a cash gap (i.e., no financial reserves).

Table 24

Russian Regions, Grouped with Regard to Budget Balances of 2008 versus 2007

	Number of Regions	Total balance at the end of the year, RUR, bln
Balance increased	36	33
Balance reduced	58	101

As a result, if at the federal level the expenditures can be maintained in the volume of 2008 for 1-1,5 years at the expense of by the Reserve Fund, the majority of the regions will not have such opportunity even in a the first quarter of 2009. The majority of regions in 2008 failed extend their reserves (balances), but have reduced them as compared with 2007. The most notable exceptions to this rule were Tyumen Region (balance in 2008 was extended by 9%), Perm Region and Chelyabinsk Region (growth by 6%).

At the end of 2008 amendments were made to a number of articles of the Tax and Budget Codes, related to revenue sources of regional budgets. First, amendments were made to the Art. 284 on the Tax Code[28], regulating the corporate tax rate. The total rate is reduced from 24% to 20% since January 1, 2009. Herewith, the reduction is carried out exclusively at the expense of the federal budget. Moreover, 0.5% of the tax rate has been transferred to the budgets of the Russian Federation Subjects. Therefore, the amount of tax, assessed at the tax rate of 2%, is transferred to the federal budget (6.5% earlier), and the tax amount, assessed at the tax rate of 18% is addressed to the regional budgets (17.5% earlier). Herewith, the bottom threshold for the regional tax rate has remained unchanged - 13.5%, which has resulted in an upgrading the maximum level regional benefit for the tax on profit from 4% to 4.5%. A num-

[28] Federal law № 305-FZ of December 30, 2008 «On amendments to Article 284 of Part Two of the Tax Code of the Russian Federation».

ber of amendments was made to the Budget Code[29] as well. In particular, amendments were introduced to Art. 56, defining the tax revenues of the budgets of the Russian Federation Subjects. From January 1, 2009, revenues from excise taxes on motor gasoline, straight gasoline, diesel fuel, motor oil for diesel and carburetor (injector) motors shall be transferred to the regional budgets at the rate of 100% (60% earlier).

Also, the changes have affected part of the legal acts, relating the budget credits (Articles 93.2 and 93.3 the RF Budget Code). First, the terms, for which the budget credits are provided, is expended from one to three years. Second, the Subjects of the Russian Federation, located in the areas of the Far North and similar territories, where the term of cargo delivery is limited, up to January 1, 2011 are granted the right to provide budget credits (at the expense of regional budgets) to legal entities for the purchase and delivery of fuel to those Subjects. Earlier, the right to provide budget credits to legal entities (including foreign legal entities), was only in the authority of the Russian Federation, and even then only at the expense of targeted foreign credits (borrowings), even in the case of liabilities (debts) restructuring of legal entities for the earlier credits, provided form the budget and in cases, stipulated by Chapter 15 of the RF Budget Code («RF External Debt Claims»). In addition to amendments in the number of articles of the RF Budget Code, related to budget credits, it is planned to amend the rate on the total amount of budget credits from the federal budget in 2009. In the adopted Law «On the Federal Budget for 2009 and planning period 2010-2011» this rate is set at RUR 20 billion. The Ministry of Finance of the Russian Federation plans to increase this rate at least at RUR 100 billion. This indicator is assessed, basing on the fact that in 2008, according to the Ministry of Finance of Russia, regional budgets have attracted about RUR 150 billion of commercial credits. Herewith, the Ministry is pursuing the objective to partially compensate a significant reduction in the capacity of regions to attract credit resources in 2009. In the future, apparently, the limit on the total amount of budget credits will be further upgraded.

On December 31, 2008 the Resolution of the RF Government N 1089 «On subsidies from the federal budget to the budgets of the Russian Federation Subjects for implementation of additional measures, aimed at reducing tension in the labor markets of the RF Subjects». It is planned to allocate RUR 43.7 billion from federal budget for such subsidies in 2009.

Subsidies are provided for co-financing regional programs on implementation of the following additional measures on reducing the tension in the labor market of the RF Subjects:

a) advanced vocational training for employees in the event of a threat of mass dismissals (establishment of a part-time working day, temporary suspension of works, leaves without pay, arrangements for the release of employees);

b) public works, temporary employment, internships to gain experience for the unemployed citizens, job seekers, including graduates of educational institutions, as well as workers in the event of a threat of mass dismissals;

c) targeted support to citizens, including arrangement of their moving to another location of their new jobs, created in the framework of federal targeted programs and investment projects;

d) assistance to small business and self-employment development.

[29] Federal law № 310-FZ of December 30, 2008 «On Amendments to the RF Budget Code and the Federal Law «On Amendments to the Budget Code in terms of the budget process management and bringing legislative acts of Russia in line with the budget legislation of the Russian Federation».

It should be noted that the allocation of subsidies on the fourth measure is partially duplicating another federal program on co-financing regional programs for the support of small and medium-sized businesses for which it is supposed to allocate RUR 10 billion from the federal budget.

The subsidy assessment is implemented on each of the four above measures in accordance with the formula, provided in the regulations on this type of subsidies.

It should be noted that along with the standard requirements (such as reasonable grounds for implementation of relevant measures, a list of beneficiaries, etc.), the regional program should include measures, aimed at reducing the number of foreign employees.

Review of regional programs is implemented by the Ministry of Health and Social Development of the Russian Federation with the participation of interested federal executive authorities. The Ministry of Health and Social Development of Russia within 10 days from the date of receipt of the regional program should develop an expert opinion and submit it to the Government of the Russian Federation. Selection of regional programs for subsidies allocation is implemented by the interdepartmental working group on monitoring the situation in the labor market.

The criteria for selection of the Russian Federation Subjects subsidies allocation are:

a) growth of unemployment level in the Russian Federation Subject;

b) increasing number of employees of the Russian Federation Subject under the threat of mass dismissals (or establishment of part-time, temporary suspension of works, provision of leaves without pay, arrangements for the release of employees);

c) presence or core businesses in the Subject of the Russian Federation.

Subsidies are provided in accordance with the decision of the interdepartmental working group on the basis of agreements, concluded by the Federal Service for Labor and Employment with the government authorities of the Russian Federation Subjects. The scope of co-financing of regional programs, aimed at reducing tension in the labor market, is set up at 95% to be allocated from the federal budget.

2.3.3. Federal budget draft for 2009 and until 2011 for the allocation of intergovernmental transfers to other levels of the budgetary system

The total amount of funds, planned to be transferred to the regional and local budgets in 2009 is about RUR 1228 billion. This is 1.12 times more than the funds actually allocated for this purpose from the federal budget in 2008. Herewith, the total expenditures of the federal budget will grow 1.19 times. As a result of slower growth of intergovernmental transfers to other levels of the budgetary system, their share in the federal budget expenditures will decrease as compared with 2008: from 14.5% to 13.6%. Given that in the late 1990-s only the share of donations from the Fund for Financial Support to the Regions was 14% of the federal budget, and the major revenue sources are currently concentrated in the federal budget, the reduction of the share of intergovernmental transfers, allocated to other levels of the budgetary system in the federal budget is challengeable.

It should also be noted, that the system of intergovernmental transfers is becoming increasingly complex and confusing. In developed countries with a federal form of government, as a rule, there are 1-3 major transfers from federal funds to the budgets of territories and 3-15 smaller transfers. In the Russian Federation, according to the draft budget for 2009 and until 2011 there are over 130 different transfers (6 donations, 90 sub-grants, including federal tar-

geted programs and sub-programs and 16 related to the category of other intergovernmental transfers). The question arises, whether such a system is effective. By analogy with taxation, the number of transfers should be acceptable for the effective administration. Under 58 objecives, the funding is less than RUR 1 billion. This means that for an individual Subject of the Russian Federation the funding for several objectives can amount to tens or hundreds thousands rubles. It is obvious that with the targeted nature of the majority of subsidies (grants and subventions), expenses to assess the targeted utilization of those assets, not to mention the assessment of the effectiveness, can exceed the benefits from the allocated funds.

In our view, it is necessary to thoroughly review the allocation of powers between the federal center and regions, in order to delegate a number of powers to the regions, but some powers should be returned to the federal level. It should be noted, that the recently the revision powers delegation among the levels of budget system occurs nearly every year, what reduces the predictability of the basic parameters of the budgetary system for the regional and local authorities and adversely affects the quality of the state and municipal finances management.

In this regard, it would be inexpedient to make significant changes in the delegation of authorities on fiscal management during the three years of 2009-2011. This period should be used for monitoring and assessment of the existing system efficiency.

Starting from 2012, an opportunity should be provided to review the current system powers delegation in order to reduce the scope of authority, as well as to delegate to each level of government those powers, which can be most effectively accomplished by this level of power.

An additional way to address the problem of the large number of insignificant in volume targeted intergovernmental transfers, and to improve management of the allocated financial resources is their incorporation in block transfers. The main point of block transfers is that the financial resources, provided within a single intergovernmental transfer can be used in many ways. Herewith, the level of government, from which budget the block transfers is allocated, can establish the terms for distribution of those transfers, as well as the objectives of their disbursement. The level of authority, that receives a transfer block, can independently choose the scope of funds to be addressed to each objective.

This will improve the quality of public and municipal finance management with the best regard of local population preferences and national priorities. After 2010, it seems appropriate gradually to replace the majority of disparate regional subsidies by the intergovernmental block transfers. In view of a high degree of differentiation of the tax capacity and the cost of budgetary services to the regions of the Russian Federation, it looks appropriate to allocate block transfers from the federal level with regard to the regions' budget sufficiency. However, the scope of financing regional budgets adjustment should be lower the funding, allocated from the Fund for Financial Support to the Regions. It is proposed to allocate block transfers in proportion to the regional budgets deficiency against the fiscal sustainability of the richest region.

In the medium term, it seems appropriate to achieve the unification of subsidies preferably in one inter-industry block of transfers in order to ensure a real, rather than a declared independence of the regions in those assets management to achieve socially meaningful results. Industry-addressed subsidies do not provide such opportunities, further strengthening the authority of federal ministries over the region. An inter-industry approach is required, whereas:

- the volumes of the subsidies to the regions should be assessed by a uniform methodology that takes into account the budgetary sufficiency;
- each federal branch ministry within their competence should develop the terms for spending the assets according to their objectives;
- regional authorities should be given the right to choose independently the area (the industry), to which the funds will be spent.

The major channels of financial assistance to regional authorities are to the donations for the assistance for budget sufficiency adjustment from the **Fund for Financial Support to the Regions**, which will to grow by 13.8% (as compared with 2008) and reach RUR 374 billion. It should be noted, that in the initial budget estimates for the fiscal years of 2009-2011 an attempt was made to overcome the decline trend in the share of the fund in the intergovernmental budget transfers: according to the draft law on the federal budget for 2009 and until 2011, the FFSR share in the intergovernmental transfers to other levels of the budget system will grow to 30.0% in 2008, to 30.4% in 2009, to 32.8% in 2010 and to 35.3% in 2011. However, it should be noted that the initial draft budget is significantly different from its final execution. Branch ministries, as a rule, are able to lobby increasing subsidies and other intergovernmental transfers, while FFSR, estimated by the formula remains unchanged during the fiscal year. As a result, we put the trend, observed in the draft federal budget to increase the role of this channel of intergovernmental transfers, under doubt. There is a particularly high risk of reducing the role of FFSR in intergovernmental transfers during the financial crisis. Thus, the draft federal budget for 2008-2010 also provided for the FFSR growing share in intergovernmental transfers from 33.6% in 2007 to 35.6% in 2008, to 38.8% in 2009 and to 42.7% in 2010. However, due to the unplanned growth of subsidies volume there was no growth in the FFSR share, mentioned above, in 2007-2008. It seems that among all types of intergovernmental transfers, in the long run, the FFPR in particular should be given priority, as the organization of that fund is in line with the best international practice, and allocation of funds is carried out in accordance with the relatively transparent procedures. This conclusion can be slightly adjusted, since in the situation of the economic crisis there can be required to provide emergency assistance to the Subjects of the Russian Federation. However, the economic crisis should not serve as an incentive for inconsiderate changes in the most transparent and effective budget management tools.

It should also be noted that there is a barrier in achieving the primary objective of the allocation of grants from FFSR (to provide all regions relatively equal opportunity for fiscal services); it is an attempt to achieve other goals, initially not foreseen for the Fund: to improve financial discipline in the regional authorities, to avoid sharp volatility in the volume of subsidies, to encourage regional governments to accumulate their own tax potential. For all the importance of these secondary objectives, an attempt to address them all together with a single financial instrument can result a failure to reach any of those tasks.

Since 2005, the assets for financing all federal spending, set out in explicit legal form are accumulated in the **Compensation Fund** (hereafter CF). The draft federal budget for 2009 and until 2011 provides some stability in the FC share in the intergovernmental transfers to other levels of the budget system (18-20%). It should be noted that the share of subventions in the intergovernmental transfers to other levels of the budget system is still high. On the one hand, the desire of the federal government to finance their expenditure objectives is an abso-

lute advantage of the budget system in general. On the other hand, in the medium term, it is appropriate to verify the effectiveness of the existing delegation of authority and, if necessary:

a) to abandon delegation to the regions a number of federal powers by their funding transfer directly from the federal budget;

b) transfer a number of federal authority to the Federal Subjects in full scope with the corresponding increase of the non-targeted transfers and flexible terms of expenditure of funds received and/or expansion of revenues of regional budgets. For example, to transfer to the regions the authority to pay for housing and communal services to certain categories of citizens. Herewith, at the federal level, it I reasonable to take appropriate measures of social support to those categories of citizens in the form of increased pensions and social benefits, as well as increase funding from the Fund of Financial Support to the Regions. This will help to continue «monetization of benefits» in line with the social support, provided to those categories of citizens at the federal level and in creating opportunities for all regions for further support to those beneficiaries by increasing subsidies from FFSR.

c) consider delegation/centralization of some powers on a contractual basis, with clear, legally stipulated terms of such contracts. It is worth noting, that Russia has a substantial negative experience in terms of auhtorities delegation on a contract basis, though international experience often witnesses in favor of the effectiveness of this mechanism. Therefore, return to this issue can be useful in the long term and will require a thorough legal and economic development.

In terms of **subsidies**, a significant growth is planned in 2009 budget draft for 2009 and until 2011: the subsidies in 2009 will grow to 1.52-fold as compared with the planned in the federal budget draft for 2008 and for the period up to 2010 - up to RUR 482.3 billion. The basic areas of expenditure of these funds in 2009 are:

- federal targeted program «Modernization of transport system of Russia (2002-2010 years)» - 16,2% of total subsidies;
- subsidies for highways - 7.3% of the total amount of grants;
- to support agricultural production - 14,4% of the total amount of subsidies;
- subsidies to support agricultural production - 14,4% of the total amount of grants;
- social support – 7.2% of the total amount of subsidies.

Subsidies from the federal budget for road facilities and the Federal Target Program «Modernization of transport system of Russia (for 2002-2010)» have a high social value in order to maintain the unity of the national territorial and economic environment, the support of the population mobility. The commitments on the implementation of the major road projects are high enough and in many cases can not be financed solely by the regional (and local) budgets. In this context, it seems appropriate to maintain the existing mechanisms for the distribution of those subsidies, which in general conform to the requirements of such instruments.

Herewith, in view of the more effective planning and spending of these funds, at least two features of the allocation of subsidies for road facilities should be taken into account. First, it is necessary to strengthen matching of the projects objectives, funded from subsidies, with the general trends and priorities of regional development, federal and local roads in the region, as well as other mechanisms and the scope of allocated financial assistance (decision on the allocation of subsidies for the road facilities one should take into account the budget sufficiency and the scope of financial assistance, obtained by the region receives for other ob-

jectives). Second, it is necessary to tighten the project selection criteria in terms of social and economic efficiency in applications for subsidies with regard to the region co-financing opportunities.

With regard to subsidies for agricultural production, the situation is significantly different. Transfer to the regional level the authority in support of agricultural production has resulted in the situation, when the most active support is provided is not in the regions with the most favorable natural and climatic conditions, but in those, where the largest financial resources are required to implement such policy. The allocation of federal budget funds for agricultural production on the basis of co-financing can strengthen this trend, in particular, result in the support of the most financially strong regions in the «trade competition wars» for agricultural markets in the more financially weak regions. The effectiveness of such subsidies raises serious doubts. The solution of this issue is the centralization of the federal subsidies for the support of agricultural production, accompanied by minimization of regional expenditure for this objective. At the same time, the role of the Federation in co-financing of expenditures for social development of rural areas should be increased.

As to co-financing of social expenditures, some adjustments have to be made in this area. In particular, it is appropriate to gradually abandon the co-financing of social support to the Veterans of Labor, for example, through the transitional period of 5 years, upon which the co-financing in this field will be canceled. The title «Veterans of Labor» is continued to be provided in the Russian regions, though the criteria for its provision significantly differ from region to region. Thus, this aspect of social support is not objective and fair, so co-financing of such expenditures from the federal budget in the long term can not be considered appropriate. Herewith, to initiate the procedure of co-financing of social support to the Veterans of Labor rejection during the economic crisis seems socially dangerous. For example, social support to the rehabilitated persons and victims of political repressions, as well as Prodders of the Rear is advisable to be implemented from the federal level. Those categories of beneficiaries have emerged as a result of decisions, taken by the supreme leadership of the country, rather than regional or local authorities. Therefore, the provision of social assistance should be the power of the state authorities of the Russian Federation. However, under the existing authority allocation, social support for these categories of the population is within the competence of the Russian Federation, and in order to transfer those powers to the federal level, amendments should be made to several federal laws[30]. However, during the economic crisis, the revision of authorities delegation in social policy seem to be socially dangerous, as there is a high probability of difficulties in the administration of those powers. In this regard, in the period of economic instability a palliative solution could be the concentration of financial and administrative resources of the federal and regional authorities in carrying out social obligations to the public.

As a general approach, the appropriateness of the allocation of small amounts of co-financing for those or other regional powers looks doubtful. Obviously, the minor scopes of co-financing do not allow to provide significant additional funding to the Federal Subjects.

[30] Law of the Russian Soviet Federative Socialist Republic № 1107-1, dated April 26, 1991 «On the Rehabilitation of Repressed Peoples», Law of the Russian Federation № 1761-1, dated October 18, 1991 «On the Rehabilitation of the Victims of Political Repressions», federal law number 5-FZ of January 12, 1995 «On Veterans», № 184-FZ of October 6, 1999 «On the general principles of organization of legislative (representative) and executive bodies of state power of the Subjects of the Russian Federation».

During the economic crisis, this fact is aggravated by the procedure of subsidies allocation. In many cases regional authorities should actually make the expenditures in advance, and then the federal center will compensate for a part (in most cases 50%) of their such extenses. During the economic crisis, this approach should be changed[31]. The level of co-financing the subsidies on the part of the Subject of the Federation in the period of crisis should be extremely low. Herewith, funding allocation should be made in accordance with the consolidated budget estimates, rather than after the expenses are made (in fact, currently the subsidies are made as compensations for prior expenditures).

In conclusion, it should be noted, that the economic crisis not only sets up certain risks for the system of intergovernmental fiscal relations, but opens opportunities for enhancing its effectiveness as well. The main risks to the system of intergovernmental fiscal relations are: 1) increase the role of discretionary intergovernmental transfers, allocated in the non-formalized manner, which create disincentives for the fiscal discipline of regional powers, 2) improper amendment the most transparent and effective budgetary management tools to adapt them to the changed conditions, 3) replenishment of the losses of the Subjects of the Russian Federation budget revenues at the expense of reducing the revenue base of local budgets (through the redistribution of income sources and increased use of negative transfers). The main opportunity for improving the efficiency of intergovernmental fiscal relations is a significant reduction in the number of the subsidies areas, addressed from the federal budget to the budgets of the Russian Federation Subjects, accompanied with an increase of the volume of other subsidies and their concentration at the solution of 3-4 most important priorities of the regions. The probability of making such decisions is increasing under conditions of reducing federal budget revenues and necessity to finance prioritized objectives of regional budgets.

2.4. Tax Policy in Crisis Situation

Defining the trends in the tax policy for the coming years, it is necessary to take into regard both, long-term objectives of economic development, and the problems, emerged in mid-2008 due to the expanding global economic crisis and the beginning of the crisis processes development in Russia. Herewith, one should disregard the existing objectives of the Russian tax system, which were set up, but not resolved in recent years.

The major developments in the tax reforms, achieved in the 2000-s, were the vividly improved structure of the tax system, design and procedure for the basic taxes charges. The implemented reforms enabled significantly to upgrade transparency, fairness and effectiveness of the tax system. It is, above all, the elimination of turnover taxes, the introduction of flat rates for income and regressive social tax, the elimination of benefits for corporate profit tax, while decreasing its rates, improved value added tax system. Herewith, there was implemented proper progressive taxation in view of the global markets of raw materials and energy sources by the mineral extraction tax and export duties.

However, many necessary measures of tax reform have not been implemented due to various reasons. There should be highlighted the transition to VAT flat rate, progressive growth of income taxation due to increasing the standard tax deduction rate, unified social tax index scale, the convergence of income and social tax bases, introduction of real estate tax,

[31] Ref. A.G. Siluanov, Conference «Economy of Megapolises and Regions» http://www1.minfin.ru/ru/official/index.php?id4=6882

improvement of special tax regimes for small business and agricultural producers to provide benefits only to the clearly defined targeted groups of taxpayers.

Measures of tax administration improvement were not consistently implemented, among which there are changes in tax audit procedures in order to reduce administrative pressure on businesses, measures to ensure tax compliance, including the suspension of operations of the accounts and seizure of property of the taxpayer, which should not be routine, but very seldom used as a tool of tax administration. Such developed, but not implemented measures include the establishment of effective monitoring tools over transfer pricing, consolidated taxpayer and foreign companies corporate income tax.

The majority of the necessary, but so far unrealized measures is mentioned in the relevant section of the Concept of long-term development until 2020. However, in the long run, Russia will face the problems, the approaches to the solution of which is currently not developed yet and that require discussion and evaluation. Herewith, one should note at least two problems. First, demographic trends lead to a substantial population aging and the need for additional resources in the amount of about 4% of GDP to fund pensions at the socially acceptable level. Secondly, the restructuring of the Russian economy in the long run is closely correlated with the abolition of export duties, which means the support to domestic consumers of raw materials and energy in the form of subsidies. In addition to the above, it is clear that the expansion of the economic crisis in the Russian Federation has changed the schedule of tax reform: some measures are prioritized, and others should be postponed to the future.

2.4.1. International Experience in Tax Policy[32]

Expansion of the financial crisis, that has begun in the US in the 2008, to the other countries of the world, the impact of crises development in the real sector made many countries to apply or consider the application of anti-crisis programs, aimed at mitigating the adverse impact of the crisis. These programs complement to traditional anti-cyclic measures of fiscal policy, which have been launched more or less automatically.

1. Measures of fiscal policy seem to be the most frequent response to the crisis among the countries under consideration. Corporate income tax changes include:

- reduced tax rates and rejection of the tax rates upgrading (Canada, Hungary);
- accelerated depreciation, including one-time complete or partial allocation the cost of depreciable assets to expenses (Canada);
- some tax benefits for targeted investments and certain types of income (France, United Kingdom);
- discounts and credits for targeted investments and jobs formation (France, United Kingdom);
- extended opportunities for the losses for tax purposes (United States);
- restrictions in acceptance for tax purposes the expenses of the remuneration to the company management (USA);
- abolition of incentives for outsourcing (United States).

With regard to VAT, there are two tools:

- acceleration of VAT reform in regard to consumption tax (China, India);

[32] Materials on the international experience in tax policy in the situation of the current financial crisis are provided by M.Alexeyev and R. Conrad.

– tax rate reduction (China, European Union, the United Kingdom).

It is clear that these measures are often used as opposed to targeted spending to promote specific companies or sectors of the economy. Accordingly, it looks that those changes are aimed at supporting those sectors o economy, which do not benefit directly from the targeted programs. Jobs creation or temporary reduction of dismissals is one of the obvious objectives to be regarded in the framework of tax credits and expansion of tax incentives.

2. Small business is an important sector in terms of jobs creation and investment growth. However, many tax benefits and incentive programs are aimed at large businesses in banking, finance and manufacturing sectors (for instance, automobile production). Therefore, programs designed specifically for small businesses became more prevalent as a response to the crisis in order to ensure wider support to the offer part in the economy.

There are four types of changes in regard to income tax, which were adopted in response to the crisis:

– reduction in tax rates and/or postponement of the taxes growth(Canada, United Kingdom);
– tax credits: small and medium-sized businesses can get the special tax credits on investment, for instance, such as the Canadian credit for certain types of scientific activity;
– accelerated depreciation and single write-off of depreciable assets as expenses(Canada, United States): those countries have recently increased the possibilities for a single write-off of depreciable assets to the costs by small and medium-size businesses by increasing the applicable threshold. Moreover, in the United States, a 50% single write-off to expenses is introduced for certain assets, put into service after the crisis;
– mitigation of tax arrears treatment (United States, United Kingdom). Governments are responsible for the growth of tax arrears as a result of the crisis, the mitigation of approach to collection of tax arrears. This includes a reduction of fines, sometimes to zero, and penalties on tax arrears. These changes are designated for small and medium-size businesses, as large companies have formed the reserves for tax payment and should retain the opportunity to pay taxes in the ordinary way.

There are two basic types of changes in regard to VAT:

– tax rates reduction (China, United Kingdom): flat rate of VAT - a standard program for small businesses in the European Union – the rates have been reduced for both, agriculture, as well as for other sectors. In China, VAT rates were also reduced for small and medium-sized businesses;
– increase of thresholds: thresholds, above which tax return has to be filed, were applied to relieve small and medium enterprises from registration as VAT taxpayers. Among other countries, those thresholds have been upgraded in India (for indirect tax).

3. Changes in taxation of physical entities.

In the countries under review, incentives to enterprises were prevailing over changes in the taxation of individuals, or, probably, changes in taxation of physical entities were not as extensive as incentives of enterprises.

Changes in taxation of individuals are aimed at encouraging certain activities, such as acquisition of housing facilities, as well as the growth of after-tax income of consumers. Significant changes include the following:

– increased tax exemptions to individuals (Canada, United Kingdom);
– larger amounts, that can be allocated at the tax-exempt savings accounts (Canada, United States);

- reduction or cancellation charges made before to pension savings funds (Canada, United States);
- incentives to individuals for housing facilities acquisition (China, United Kingdom, United States);
- reduction of VAT rates on consumer durable goods (India);
- mitigation of enforced seizure in regard to retirement pension savings (USA);
- allocation of funds to lower levels of government, required to reduce the rate property tax growth (United States).

2.4.2. Some Theoretical Considerations in Regard to Effectiveness of Counter-Cyclic Tax Incentives in Economic Activity

An important question, which has to be answered in the process of anti-crisis measures development in the tax area, concerns the correlation of regulations and discretionary decisions.

Discretional fiscal policy in the period of the economic crisis, aimed at reducing tax rates and providing various kinds of benefits, as is known, is criticized for the fact, that its implementation will inevitably urge the lags in defining the right time to implement appropriate measures. The process of developing and adopting the necessary measures also requires extra time and, finally, there is a time lag between the adoption of measures and the impact of their implementation, based on the change in behavior of economic agents.

All those time lags provoke the situation, when tax benefits, designed to help economic agents in the period of recession, are coming into effect, when the need for them is no longer in place, i.e., in the period of recovery. As a result, the cyclic measures can turn into pro-cyclic ones. At the same time, political incentives often restrain the rejection of the measures, originally conceived as temporary, when the need for them is no longer in the effect.

Tax policy provisions, discussed in relation to the obvious drawbacks of discretionary solutions, constitute formal liabilities of the State to implement various fiscal measures under certain economic conditions. For example, in 2000, after the adoption of a medium-term socio-economic development program, the government has implemented a widely declared approach to reduce the non-oil tax budget revenue (as a structural component of tax revenue). It is obvious that this policy has been pro-cyclic and currently, when oil budget revenues have expressly declined, has created financial problems, caused by low levels of non-oil revenues in the budget structure at a high level of public expenditure commitments.

In addition to that approach, which should be applied in a counter-cyclic way, there should be stabilizers built in the Russian tax system. As noted above, the Russian tax system is dependent on the global oil price: under the high prices in the world market of raw materials and energy sources the effective tax rate is high, while under reducing world prices for raw materials and energy sources the efficient tax rate decreases. This is achieved through a legally approved tax regulations for raw materials and energy sources extraction, as well as by the nonlinear amendments of the profit tax and income tax base in the changing conditions of external trade. In addition, income tax, regardless its progressive character is an automatic stabilizer of economic dynamics, as it reduces the response of the production to the changes in aggregate demand, i.e., reduces the autonomous expenditure multiplier.

We know that a tax incentive policy, envisaging lower tax rates and tax benefits, under certain conditions should lead to an increase in aggregate demand, extended labor market,

lower costs of labor, increasing investment demand. However, tax rates decrease with unchanged public expenditures leads to an increase in the budget deficit, which has to be financed by increasing public debt. This can provoke growth of interest rates and, consequently, to reduce investments and impede economic growth. For the transition economies, particularly in the situation of instability of the global financial system, a significant growth of public debt is hardly acceptable, therefore, a significant reduction in tax rates can lead to the need for financing budget deficits through the Central Bank emissions[33], that would cause, particularly after the exhaustion of foreign currency resources, high inflation, uncertainty of exchange rates dynamics, i.e., disruption of the long-term economic growth.

Accordingly, in development of tax incentive measures, the basic criteria should be taken into regard, that implementation of such measures would not cause a significant growth in the budget deficit, which is impossible to finance without an upsurge in interest rates and the emission of the Central Bank. Specific tax innovations should be agreed with the budget estimates, based on pessimistic macroeconomic forecasts, characterized by low world prices for raw materials and energy sources (oil price not exceeding USD 30 per barrel) and the low rates of the world economic growth in 2009-2010 (from zero to 1% per annum).

A conservative approach to budget planning should not (or should to a low extent) consider an opportunity of tax revenues growth with the introduction of tax benefits due to the new tax multiplier. The point is, that first, on the basis of theoretical considerations, the tax multiplier is lower than the multiplier of government expenditures, as the share of revenue from the reduced taxes is saved, while the government expenditures growth increases the aggregate demand, and second, the empirical assessment of the fiscal policy multiplier value are not reliable. Similarly to taking into regard the interrelation between the tax rates reduction and growth of aggregate demand in the budgetary planning, one should be extremely prudent with regard to the impact of tax policy on the level of production from the supply side.

Proponents of production encouragement by tax measures substantiate the effectiveness of such actions by Laffer curve mechanism, suggesting that reduced tax rates can urge growth of investment and labor supply. However, the mechanism, based on Laffer curve, finds no empirical evidence, which is explained, apparently, by the fact that tax rates are in fact, not so high as to be estimated by Laffer model, i.e., they are set in the range that their reduction does not lead to taxes growth.

Research of the fiscal policy, based on demand encouragement, also do not demonstrate expressed results, confirming its effectiveness. This is because the mechanism of aggregate demand multiplier requires a number of assumptions, which are not always available in practice.

Aggregate demand encouragement by income tax reduction implies, that the tax rate decrease urges an increase in personal consumption, which in turn causes production growth, based on increased demand. However, output growth at the background of increased demand

[33] Financing of the budget deficit from the Reserve Fund in short term is similar to financing through the direct loans to the Government by the Central Bank. Herewith, the Central Bank can maintain its policy of quasi-fixed RUR rate and, consequently, sterilize the emission through foreign currency intervention, using the accumulated foreign currency reserves. In this case, the impact of budget deficit on inflation will be limited by the impact on inflation and devaluation expectations of economic agents, which will be growing, while foreign currency reserves will be getting decreased. An alternative policy Central Bank can be a floating exchange rate, when the Central Bank does not spend foreign exchange reserves. However, in this case, the financing of budget deficit will lead to increased inflation and a decline in the exchange rate.

can take place, only when coupled with the availability of relevant factors of production (free production facilities, extra labor force, unused natural resources), prices of those factors are not too high, and the factors are efficiently utilized. However, this assumption does not always work. As a result, investors can be pessimistic in the expectations of the prospects for economic conditions and the level of investment will remain low. Therefore, the growth in the aggregate demand might not urge the increased production, increased efficiency and growth of the productive capacity of the economy.

Major reasons, restricting the effectiveness of measures, addressed at upgrading the demand by lowering the income tax rates, are based on theoretical considerations that the distribution of income between consumption and savings are not determined by current income and short-term consumption capacity. The volume of consumption and savings can be based on the volume of permanent income, which is an average level of income over several years or even over the entire life cycle of an individual. Therefore, favorable tax regime may not lead to predictable results. At the same time, if the individual is unable to select the optimal level of consumption with the help of a credit, a temporary decrease in income tax rate can mitigate the liquidity restrictions and result in increased consumption.

Conclusions, arising from Ricardian equivalence of tax and debt financing of public expenditure, suggests that an individual might not respond to increase his income due to the tax reduction. This is because the individual assumes that in the future, to catch-up with the public debt level, caused by tax reduction, the government will increase the tax burden again. To compensate for this future growth of the individual tax burden, the individual has to save the income resulting from the current tax decline.

Temporary reduction of indirect taxes for aggregate demand encouragement (both, general taxes on consumption, and excise taxes on certain types of goods) can have greater impact on consumption than the temporary reduction of income tax. This is because the temporary decrease in income tax leads to a modest increase in permanent income or income over the life cycle consumption. Temporary reduction in indirect taxes is changing relative prices of present and future consumption, resulting not only the income effect, but the effect of substitution of future consumption by the current consumption.

However, the effectiveness of lowering indirect taxes during the economic slowdown is limited due to the fact that consumers change their behavior before the reduction and after the increase of the relevant tax. Demand for taxable goods gets decreases during the period from the point of awareness of the plans to introduce such measures until actual tax reduction, as well as in the period when the tax is increased, because the purchases are carried over to the period, when the tax get lower. Moreover, it should be taken into regard, that the effect of indirect taxes reduction depends on the ratio of demand and supply flexibility, as well as on competition. Thus, in a situation of flexible supply, when the sellers seek to dispose all their goods for the old prices, tax reduction will lead to the decline of prices for consumers and to the growth of production output and consumption. In the situation, when the demand is not flexible, the consumers will benefit, but the volume of goods production will not change after the tax reduction. In the intermediate situation, the benefits will be shared between consumers and producers.

Reduction of the corporate profit tax can also result in an increased consumer demand to the extent of the owners' profit growth (in case of profits distribution) or their wealth (due to undistributed profits growth) as a result of lower tax rates. However, for the owners of enter-

prises this effect should not be overestimated because of the effect of «corporate veil», distorting a realistic assessment of the changes in the financial position by business owners. This would affect the employees in case they would benefit from the tax burden reduction, but in the current situation, the wages increase due to the corporate income tax decrease is unlikely.

Encouragement of investments in the fiscal policy framework is implemented by such tools as investment tax credit, provided in the form of a decrease in the amount of tax liabilities by a percentage of the investments volume, accelerated depreciation, lowering the profit tax rates. Theoretically, such measures could help to increase the level of investments, scheduled by enterprises to be implemented under certain level of interest rates.

Application of the investment tax credit as a temporary pro-cyclic measure has the same negative effect, as the reduction of indirect taxes for encouragement consumer demand: it reduces the investment activity in anticipation of this measure and, after its abolition, provoking volatility of investments. The tool of accelerated depreciation works similarly to lowering the tax rate, if it is used as a temporary measure. In case the investment tax credit and accelerated depreciation are applied as permanent measures to encourage investments, it is important to understand that they are cyclical, when reducing the marginal corporate profit tax rate during investments upsurge and tax rate upgrading when investments get down. Therefore, in the crisis situation, the corporate profit of companies is subject to higher effective tax rates.

In assessing the effectiveness of reducing the corporate profit tax rate in terms of growth in investment activity it should be borne in mind, that the tax on business profit does not effect investment decisions, since the reduction of the tax rate relevantly decreases the marginal expenses and marginal revenue from investment projects. However, this is true only if there is an opportunity of financing the investments through loans, when the inflation is low and the terms of tax depreciation are consistent with the rules of economic depreciation. If the banks are rationing credits, what always happens in practice, and especially during crisis, the decline in corporate profit tax, mitigating the restriction in the liquidity, can contribute to investment growth. At the same time, fiscal measures, addressed at favorable taxation of corporate profit, affect those taxpayers who make profit, i.e., those who need assistance is less than others the crisis period.

It should be noted again, if the tax incentives for investment involve growth of government borrowing or emission financing, they will hardly be attractive to businesses. In the first case, increased government borrowing provokes higher interest rates and the corresponding higher cost of financial resources for enterprises (the effect of private investments replacement by government spending). In the second case, tax incentives for growth can provoke a breach of macroeconomic stability, to the collapse of credit system, the unpredictability of the interest rate dynamics, the exchange rate, relative prices of production factors and thereby, make it impossible to implement any long-term investment plans.

Encouragement of production development and unemployment reduction with the help of tax instruments can be implemented by lowering the cost of labor due to reducing the social tax. Apparently, such measure can be only temporary, since in the long term, due to the imbalance of the pension system, taxation of labor has to be increased (otherwise it will be necessary to increase the funding of pensions at the expense of other taxes, neglecting the principles of the pension insurance system). Nevertheless, in the short term, measures can be taken to a temporary reduction of social tax. Moreover, like in the case of measures aimed at increasing demand in the economy and, thereby, reducing unemployment, in the case of social tax reduc-

tion one can not be sure that the companies will use the benefit from decreased tax to expand production and employment rather than to pay dividends or reserves accumulation.

2.4.3. Necessary Measures of Tax Policy in the Russian Federation

Basing on the above, out of the entire range of tools of fiscal policy, which could be implemented currently to mitigate the crisis processes. It is advisable to implement those measures which, first, are suitable to be implemented in any economic situation, i.e, those that should not be cancelled at the stage of economic recovery (this refers to the tax incentives), and second, those which improve the tax system sustainability.

Individual Taxes Execution[34]

Items 1-3, provided below present incentive measures, that are not temporary and do not require cancellation at the beginning of economic recovery. The remaining Items include measures, that increase the level of neutrality, fairness and efficiency of the tax system.

1. The increase of non-taxable threshold for Income Tax. If the standard «universal» tax rate is raised from RUR 400 to RUR 4330 (the minimum wage rate as of January 1, 2009) with a simultaneous increase of the taxable income threshold from RUR 40 000 to RUR 52 000. Uncovered revenues of physical entities income tax about 7% of total revenue in 2009 (0.25% of GDP). If the «universal» standard tax rate is increase from RUR 400 to ½ of minimum wage (RUR 2165), while not changing the threshold of accrued income (RUR 40 000), then uncovered revenues of physical entities income tax in 2009 will reach approximately 2.5% of the total income (0.09% of GDP).

2. Introduction the tax-exempt threshold for the social or imposition of a reduced tax rate for income, close to the minimum wage. If the non-taxable threshold is introduced in regard to the unified social tax, similar to the standard tax rate on NDFL (tax on physical entities income) at RUR 4330 with the same threshold of wages (RUR 52 000), the loss of revenue will make about 0.5% of GDP. With the introduction of that threshold at the level 0f ½ of minimum wage and the threshold wage at the level of RUR 40 000, the losses will amount to 0.18% of GDP in terms of 2009.

3. Delegation to regional authorities the right to the dramatic increase in progressive scale in regard to tax on vehicles will result in the growth of the rates for powerful cars.

4. Introduction of VAT flat rate at the level, that would ensure the sustainability of budget revenues (at 16-17%). The transition to the flat rate will simplify tax administration, but will reduce progressiveness of the tax revenue to targeted groups (in case of tax liability transfer to the consumers), since namely for the low-income individuals the majority of expenditure in the consumer's basket is allocated for food, medicines, agriculture products, etc.

[34] This Section presents proposals, repeatedly discussed in the IET works. Ref. A.Zolotarev, A. Kireeva, N. Korniyenko "Tax Administration. The main outcomes of the reform. Moscow: IET, 2008; E. Shkrebela. Taxation of small business in Russia: problems and prospects of solutions. Moscow: IET, 2008, L. Anisimova, T.Malinina, E. Shkrebela "Corporate profit tax: major issues and ways of improvement". Moscow: IET, 2008; S. Sinelnikov-Murylev, I. Sokolov, I. Trunin "Study of the major trends in the development of indirect taxation system in Russia within 2000-2007. Moscow: IET, 2008, L. Anisimova at al. " The reform of income taxation in Russia: results of 2000-2007. Moscow: IET, 2008.

The losses of such groups of population should be covered at the expense of relevant through appropriate budget expenditures.

5. Improving the efficiency of corporate income tax: enhancement of identification and recording of confirmed by documents necessary business expenses, transfer to the annual reporting period. It is reasonable to establish a beneficial taxation regime for non-profit organizations, including the budget ones, as well as special regimes enhancement.

6. Measures to improve the taxation of transactions with securities, the taxation of banks and interest income. These measures for legal entities include procedures for corporate income tax and value added tax on depository receipts, swaps and other financial instruments. They also include clear definition in the legislation of the securities market value in the event of their sale, through the international electronic systems among other methods; clarification tax procedures for transactions with securities and financial instruments, in particular, formation of reserves for impairment of securities, revaluation of the requirements and liabilities under fixed-term transactions, methods of securities disposal, clarification on taxation of REPO transactions and securities lending transactions, procedure for hedging some tax accounting.

For individuals it is necessary to resolve the issue of taxation of tangible benefits from the acquisition of property rights or futures financial instruments; expanding the list of futures financial transactions and a list of asset base of financial instruments, granting the right to individuals to transfer losses from securities, financial instruments, futures transactions and property rights for future periods, similar to the arrangements applicable to legal persons.

7. Enhancement of oil production taxation: expansion and improvement of tax holidays application for NDPI or the use of reduction factor to the tax rate (extraction at different sites the continental shelf, development of small oil fields); consideration of the threshold reduction rate for customs duty on crude oil, development and imposition of tax on surplus income on extraction of hydrocarbons in new fields.

8. Changing the tax system of natural gas extraction: application of NDPI rate for the extraction of natural gas, similar to NDPI on oil production with regard to gas prices in the domestic market and the presence of non-taxable threshold; differentiation of NDPI rates in view of production conditions – application of reduction factor to the rate of tax for gas fields with a high degree of stock depletion, tax holidays or reduction factors for new deposits in the undeveloped regions and on the continental shelf, transfer to the taxation of surplus income in the long term.

9. Formation of an efficient system of taxation of real estate, which includes creating an cadastre of the real estate objects in the short term, the development of methods of mass valuation of real estate based on the cadastre data and expansion of regional and local authorities powers in the area of real property taxation at the background of high non-taxable threshold during the crisis.

10. Avoidance to increase the tax burden on small businesses by maintaining the correction factors of the basic profitability index of imputed tax. Replacement of the simplified tax rate reduction for tax refund paid by small business for the period (2007-2008)[35].

[35] Actions taken to resolve the simplified tax rate reduction to 5% create the preconditions for withdrawal of the small businesses, using employees, in the shadow, as in this case the payment to employee wages in cash from the income of small entrepreneurs is more beneficial.

Tax Administration Enhancement

1. Reduction of fines and penalties in the period of crisis (for example, the 2009-2010).

2. Establishment an effective system for transfer pricing control to avoid the use of this tool to minimize tax liabilities. Draft laws on amendments to Articles 20 and 40 of the Tax Code should be introduced, in conjunction with the introduction of consolidated tax reporting of organizations.

3. Enhancement of VAT neutrality: improved procedures for the calculation and reimbursement of tax.

4. Pursue the activities on restriction the rights of supervising authorities in regard to audits by the following measures:

- clarification of the grounds and proceedings on administrative incompliance, such as inspection of premises of the taxpayer, objects and documents, located there in and seizure of documents. The measures should be applied by amending the Code of Criminal Procedure and Chapter 27 of the Administrative Code;
- reduction of the terms and frequency of tax audits of small businesses (up to 1 month and not more than 1 time per year) with the right to suspend or extend business operations, provided only to superior tax authorities;
- transfer to the planning of tax audits on the basis the system of tax evasion assessment, applicable regardless of the discretion of tax officials, with the reduction in the number of annually audited companies to no more than 5-10% of the total number;
- imposing a ban on the enforcement of decisions to bring the taxpayer responsible for committing a tax offense, in case the taxpayer files an appeal to the court (within the established term upon the decision the higher tax authority). The decision to bring the taxpayer responsible for committing a tax offense should be suspended before the court judgement entry into legal force;
- establishment of call-centers for entrepreneurs to distribute the updated information about their rights, the rights of government local authorities for audit procedures.

5. With respect to the tax administration for small businesses, there should be implemented the measures identified below, with simultaneous strengthening of control over the transactions between small businesses affiliated with each other or with large business, and monitoring to ensure that goods or services, provided to small businesses were not fictitious, or supplied under transfer prices. The procedures should be simplified for administration and payment of taxes and charges (fees) for enterprises that use the simplified taxation system and taxation system in the form of imputed tax, and eliminate the need for small businesses to visit any other authorities except for tax offices for the issues of registration, tax return filing and payment of taxes and levies (contributions) to extra-budgetary funds by the following means:

- abolishment of the need to the small businesses, hiring the employees to be registered in the extra-budgetary funds and the transfer of relevant information directly from the tax authorities;
- a unified declaration filing for a tax period results and the abolition of the need to file (for review) the details to the extra-budgetary funds;

- o unification of social contributions paid to the various funds in one payment, abolition of splitting of payments for obligatory pension insurance and the unified social tax (advance tax payments);
- o elimination of the need for payment of contributions for compulsory pension insurance and the subsequent set-off in the simplified tax or imputed tax and the introduction of direct contributions from the Federal Tax Service of Russia to the Pension Fund after the tax has been paid by an enterprise or an entrepreneur;
- o permit for an opportunity to pay value added tax by the small businesses, applying special tax regimes by introducing a system of voluntary registration for VAT (having foreseen the measures to counteract tax evasion), to avoid the loss of competitive advantage of small businesses, when purchasing products can not be accepted the VAT credit;
- o it is reasonable to introduce for small agricultural businesses a special tax regime for commodity personal subsidiary farms (through the use of patents in a single agricultural tax).

2.5. Russian financial markets

2.5.1. The government securities market

As is seen by the results of the year 2008, the volume of RF government domestic debt reflected in government securities increased by approximately 13.82% – from 1,248.85 to 1,421.44 bn rubles (as a share of GDP, government debt increased only slightly – from 3.79 to 4.05% of GDP) (*Table 25*).

Table 25

Volume of government securities on the domestic market, bn rubles (as% of GDP)

Types of securities	as of 01.01.2008	as of 01.01.2009
GKO	–	–
OFZ-PK	–	–
OFZ-PD	288.42 (0.87)	328.17 (0.93)
OFZ-FK	51.43 (0.16)	33.83 (0.10)
OFZ-AD	807.59 (2.45)	882.03 (2.51)
GSO-PPS	10.42 (0.03)	45.41 (0.13)
GSO-FPS	91.00 (0.28)	132.00 (0.38)
Total:	1,248.86 (3.79)	1,421.44 (4.05)

Source: The RF Ministry of Finance.

In January – September 2008, the volume of RF government foreign debt (bodies of state authority and monetary regulation) decreased from 46.4 to 42.7 bn USD (according to data released by the RF Central Bank). Thus, the reduction in the absolute sum of foreign debt of the RF bodies of state authority amounted to 7.97%. At the same time, the private sector (banks and the other sectors) increased their debt to non-residents during the same period from 417.1 to 497.8 bn USD (or by 17,05%). Thus, the aggregate foreign debt of Russia, as demonstrated by the results of the first 6 months of 2008, increased from 463.5 to 540.5 bn USD (or by 16.61%).

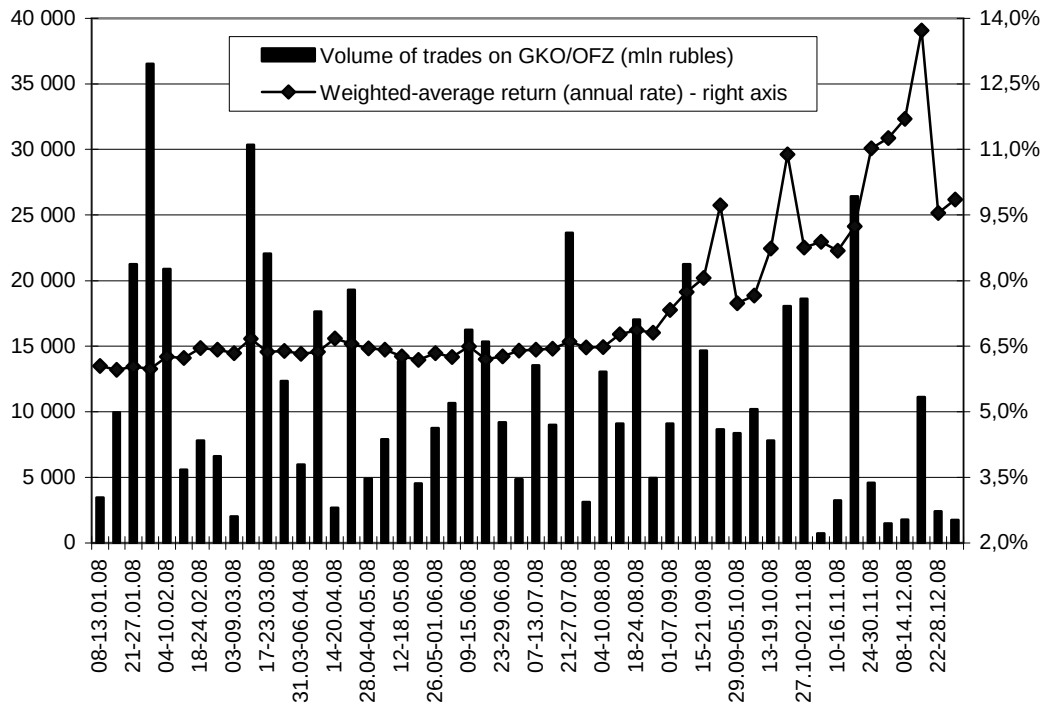
The market of government securities traded on the domestic market

In 2008, the market of ruble-denominated government debt was characterized, on the whole, by an upward dynamics of the average weighted yield. Thus, as of the end of the trading session on 31 December 2008, the average weighted yield increased 1.5 times – to 9.46% per annum against 6.14% per annum as of the beginning of 2008 (*Fig. 19*). At the same time, right until September the situation on the market remained sufficiently stable, whereas in the last four months there was an upsurge in volatility. Whilst before September the average weighted yield had been fluctuating, on the average, between 5.96% and 6.87% per annum, and had been characterized by a gradual growth of the yields, in September – December the scope of fluctuations became much wider – 7.33 –13.72% per annum and was now demonstrating both dramatic falls and periods of rapid growth in yields.

A separate note should be made of the fact that investor activity in 2008 markedly declined as compared to that in 2007. Thus, the aggregate turnover volume of the GKO-OFZ market in 2008 was approximately 584.36 bn rubles against 1,405.13 bn rubles in 2007. So, the market over that period shrank by almost 2.5 times. At the same time, against the backdrop of a considerable reduction in the aggregate turnover, as seen by the results of the year 2008, there was also a marked drop in the average weekly indices, which now amounted to approximately 11.24 bn rubles against 27.55 bn rubles in 2007. The highest weekly turnover volume in 2008 was approximately 36.53 bn rubles (against approximately 278.73 bn rubles in 2007), the lowest – approximately 0.73 bn rubles (against approximately 2.15 million rubles in 2007). Thus, last year (2008) the market of ruble-denominated government bonds demonstrated a significant reduction in its turnover volume – by comparison with the previous year – which, among other things, was also reflected in the noticeable drop in the upper indices of turnover volume.

While analyzing the market dynamics in 2008, one can distinguish several periods during which the patterns of changes in quotations were becoming different. Over the first period (January – July), the average weighted yield of GKO-OFZ was demonstrating a slight upward trend with short-term fluctuations in both directions; while the average weighted yield remained within the limits of 6–6.7% per annum. This situation continued until the end of July, after which this trend on the market gave way to a confident rise in the overall dynamics of their yields, with occasional sharp drops. Thus, from mid-August through mid-December, the average weighted yield more than doubled (from 6.47% to 13.72% per annum), while by the year's end it dropped to 9.85% per annum. Now let us discuss in more detail the month-by-month dynamics of the government ruble-denominated debt market.

During the first month of 2008 there was mainly an insignificant gradual decline in the level of yields. The level of activity on the debt market also somewhat decreased, which was the result of the continuing negative situation on the foreign markets, including the effect of the data published in January concerning the financial losses of several of the biggest international banks. At the same time, the auctioning activity of the RF Ministry of Finance on the government securities market in January became significantly more extensive by comparison with December 2007 – in the course of a single month, four auctions took place on the primary market, their total volume being 31.9 bn rubles (against 4,3 bn rubles in December 2007). With due consideration for the existing rather high demand for government securities, a face-value volume of 21.5 bn rubles was placed, which amounted to approximately 67% of total supply.



Source: IA "Finmarket"; the authors' estimations.

Fig. 19. Dynamics of the market of GKO-OFZ in 2008

In the period from February through April, further aggravation of the negative situation on the foreign market against the backdrop of decelerating economic growth in the USA and investors' concerns associated with future financial losses of a number of international financial companies, coupled with the forthcoming placements on the primary market, resulted in only a slight growth of government securities' yield and a lowering activity on the debt market. Also, a rather strained situation characterized the level of liquidity in the banking sector. However, despite all the efforts of the RF Ministry of Finance on the government securities market, the placements of OFZ were met with a rather low level of demand on the part of investors. Thus, in February there were seven auctions on the primary market, with the total volume of 56.4 bn rubles (against 31.9 bn rubles in January). Nevertheless, considering the demand for government securities, 30.9 bn rubles' worth of such securities was placed, which amounted to approximately half of the supply volume. A similar situation was observed in March, when the actual placement volume was approximately 34% (or 16,8 bn rubles) of the planned volume. At the same time, in April the placement of OFZ on the primary market was more successful – then, the placement of 81% (or 24.2 bn rubles) of the planned volume of 30 bn rubles was achieved.

In May, the market of ruble-denominated government debt displayed predominantly negative trends. The increasingly unfavorable inflation expectations, as well as the negative situation on the world's leading trading floors and the information published by some international companies concerning their writing-off of losses in Q first 2008, were all conducive to a moderately downward dynamics of the yield on ruble-denominated bonds and of the activity on the secondary market. However, by mid-month the decline in quotations had become less rapid – in part due to the RF CB having raised its rate of refinancing. Early in the third week

of May the market continued its downward trend following that displayed by US bonds and Russian Eurobonds; but towards the very end of the month the situation became stable, and the former quotations were in part restored.

Throughout the next two months the market of ruble-denominated government debt was displaying mostly positive trends due to the improved situation with liquidity; the anti-inflation measures of the RF CB, which included an increase in volume of currency interventions and a rise in the rate of refinancing and in the overnight repo rate; and to the strengthening of the ruble against the dollar. In June the bulk of investor operations shifted towards the primary market, resulting from which the activity on the secondary market declined, while due to a substantial drop in the supply of government securities by comparison with May the demand for the securities being placed on the primary market outgrew their supply, thus encouraging the placement of their nearly entire volume (20.96 bn rubles from 21.0 bn rubles). However, in July, although the RF Ministry of Finance in respect of the auctioned OFZ issues granted a premium on their yield on the secondary market, investors were displaying far interest in the primary OFZ market, and so their placement volume amounted to a total of 15.34 bn rubles (or 43% of their initially planned issue volume (35.38 bn rubles)).

In August, the market of ruble-denominated bonds also demonstrated an upward dynamics of the yields, but the growth rate was now slightly higher, while the average daily turnover dropped by comparison with previous months against the backdrop of the negative foreign and domestic situations on the market on the one hand, and a declining rate of inflation in the RF, on the other. Thus, as seen by that month's results, the average weighted yield increased from 6.5% to 6.81% per annum. At the same time, the supply volume of government securities (40 bn rubles) remained at the previous month's level, and the level of its placement was approximately 25 bn rubles (or 60%).

In September, the situation on the Russian stock market worsened alongside the deepening world financial crisis. Quotations dropped dramatically in response to the pressure of external factors, while the level of ruble-denominated liquidity in the banking sector also declined, which had a negative impact on the activity of the participants in the primary market of domestic bonds. Because of lack of demand for government bonds at the offered rate of yield, several planned auctions of the RF Ministry of Finance were cancelled or deemed to have never been conducted. As a result, in September there was only one auction. With the average weighted rate of yield being at the level of 8.37% per annum, and also considering the premium on the secondary market, the placement volume was now more than 75% the planned volume. At the same time, the market of ruble-denominated government debt was characterized by a sharp upward dynamics of the yields, when the average weighted yield increased by almost 3 - to 9.72% per annum. Moreover, in order to ensure the necessary liquidity level, Russian banks were also striving to sell securities, which exerted an additional pressure on the market.

Over the first week in October the yields, within the framework of their adjustment, dropped to the level of 7.5% per annum. Beginning from the second week in October and until the month's end, Russian ruble-denominated bonds once again demonstrated a sharp upward dynamics of yields (up to 10.9% per annum) due to the declining demand on the government bonds market against the backdrop of the continuing collapse of the Russian share market in response to the negative foreign news, on the one hand, and the increasing liquidity crisis and solvency deficit, which happened in spite of a number of anti-crisis measures undertaken by

the government in order to support the banking sector and stock market on the other. At the same time, in October, just as it had happened a month earlier, there was only one auction for an additional placement of OFZ. Out of the total issue volume of bonds worth of 9.57 bn rubles, a total of 0.25 bn rubles worth of bongs was placed; there was a discount on the yields on the secondary market. Besides, in view of the fact that some auctions in September were cancelled, the RF Ministry of Finance decided to suspend until the end of the year 2008 any further auctions for the placement of OFZ.

Similar trends in the dynamics of yields were also observed on the ruble-denominated debt market in November. After the substantial increase in the yields in the previous month, over the first week of November the yields dropped by 2% within the framework of technical adjustment. Later on this trend once more gave way to a sharp rise, and so by the month's end the yield reached the level of 11% per annum. Throughout November there was a marked deficit of ruble-denominated liquidity, as well as negative trends in the inflation rate. In order to somewhat level down the situation, the RF CB increased the rate of refinancing, as well as suggested that money should be supplied to the banking sector by means of refinancing operations. No auctions for the placement of OFZ were held in November.

In December, Russian ruble-denominated bonds demonstrated a multi-vector yield dynamics in face of a negative foreign situation, the continuing high deficit of ruble-denominated banking liquidity, and the anti-crisis measures being implemented by the RF Government. However, the RF CB's currency policy, which was oriented towards weakening the ruble's exchange rate and increasing the key rates, was not conducive to greater investment attractiveness of government bonds, and so the liquidity of the government bonds market was low, while the turnover on the secondary OFZ market dropped nearly 3-fold. No auctions for the placement of OFZ were held in December, either.

Throughout the year 2008, the RF Ministry of Finance conducted 41 auctions for the placement of GKO–OFZ, their aggregate volume being approximately 336.3 bn rubles (in 2007, there had been 25 auctions, with a total volume of approximately 280.7 bn rubles). The actual placement volume was 185.3 bn rubles. or 55% of the planned volume (against 243.9 bn rubles, or 87% of the planned volume in 2007). The yields on the average weighted auction price varied between 6.22% and 8.37% per annum (in 2007, the yields fluctuations had been 5.93 – 7.06% per annum). It means that in 2008, in contrast to the previous year, the volume of government borrowings on the domestic market was shrinking alongside an increasing yields, while the volume of supply, on the contrary, was demonstrating significant rise on the year 2007. As of 31 December 2008, the volume of the GKO–OFZ market was 1,144.02 bn rubles in face value, and 1,032.59 bn rubles in market value. The duration of the GKO–OFZ market portfolio was 5.38 years, thus having diminished by 140.8 days by comparison with its index recorded as of the year's beginning – 5.77 years.

The market of government securities traded on the foreign market

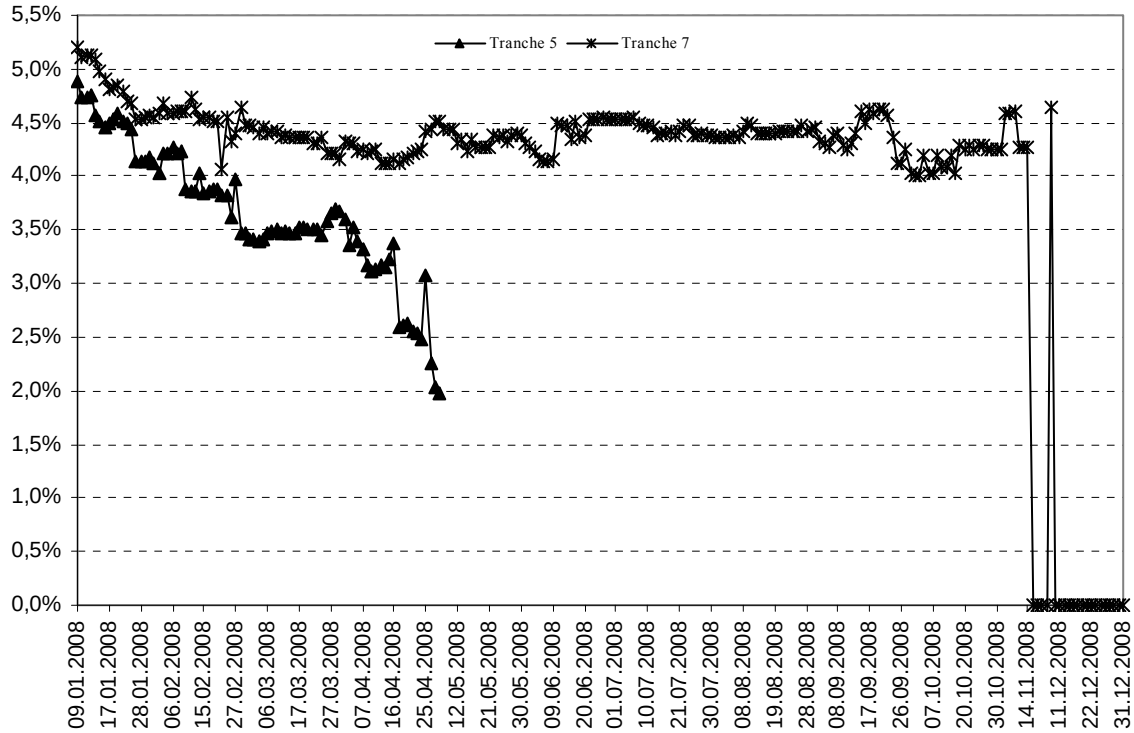
The situation on the foreign–currency- denominated bonds market, as demonstrated by the majority of tradable securities, was characterized by a low volatility of yields during the first months 2008 - as compared to its level as of the year's beginning, and then by a somewhat higher volatility during September - December 2008 in face of the influence of the ag-

gravating global financial crisis (*Fig. 20, 21*). In particular, as of the end of December 2008,[36] the yield on Tranche 7 of Minfin bonds was 4.65% per annum (5.20% as of the year's beginning). The dynamics of the yield on Tranche 5 of Minfin bonds had been displaying a marked downward trend until the moment of its redemption on 14 May 2008 by Vneshekonombank (which acts as a payment agent and depositary of the RF Ministry of Finance). Thus, after the redemption of Tranche 5, the securities of only one issue of Minfin bonds remained in circulation – Tranche 7 in the amount of 1.75 bn USD, with maturity on 14 May 2011. In its turn, the yields on RUS-30 over that year, on the contrary, increased from 5.49% to 9.90% per annum; that of RUS-28 – from 5.82% to 10.99% per annum; and that of RUS-10 – from 5.48% to 7.71% per annum. The yield to maturity on RUS-10 as of the end of December, on the contrary, went down and became negative (–1.65% per annum).

In 2008, one could point out several factors that were having the strongest impact in the behavior of the Russian Eurobonds market. Among those exerting a positive influence on quotations there were, firstly, the lowering of the discount rate by the US Federal Reserve System (FRS) several times over the year; the considerable growth of prices in the first half-year on the world oil and metals markets; and the RF Government's measures designed to support Russia's economy, in particular those dealing with the problem of liquidity in the banking sphere. The main negative factors influencing the market throughout the whole year were the dramatic worsening of the situation on the US debt market; the growing inflation rate in the US national economy; the slump on the world financial markets; the dramatic drop of oil prices on the international market in the second half-year (oil prices being one of the mainstays of the Russian economy); the downgrading of the ratings granted to the Russian Federation by the Standard&Poor's, Fitch Rating and Moody's international rating agencies; and the shortage of ruble-denominated liquidity.

When analyzing the behavior of Russian securities over the past year, one can distinguish several periods of relative change in the market situation. Thus, up to the end of August the yields on Eurobonds remained within the range of 5 – 6%, with the exception of the yield on RUS-10 Eurobonds. In the period from September through December, the yields were stably on the rise, the exception once again being the yield on RUS-10, which as of the year's end was negative. Now let us discuss in detail the main factors behind this particular pattern of changes displayed by the Russian Eurobonds market.

[36] In December there were no sales of Minfin bonds (Tranche 7), except those on 9 December, whose yield to maturity amounted to 4..5% per annum.



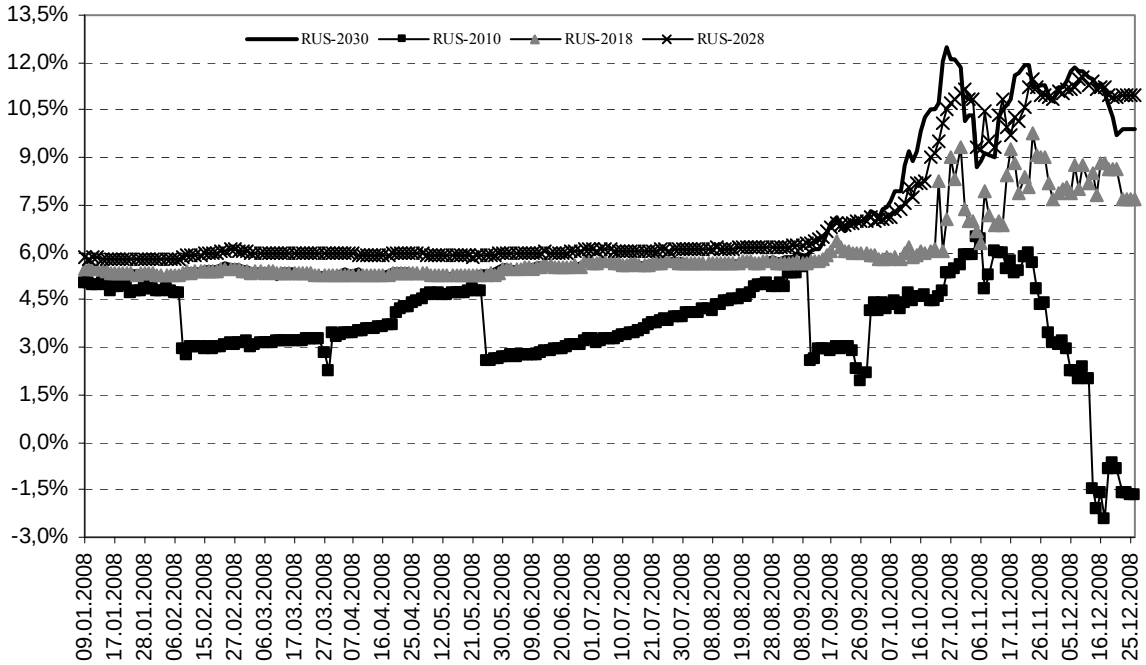
Source: IA "Finmarket".

Fig. 20. Minfin bonds' yield to maturity in 2008

The market of government Eurobonds in the first half-year was undergoing a period of stable dynamics of quotations - without any sharp changes – displayed by the majority of Russian Eurobonds, their yields being within the range of 5 – 6% per annum. In contrast to these, the yields on RUS-10 Eurobonds were demonstrating multidirectional changes over the whole of that period. Thus, in January there was a period of a slow decline of yields, while growth in February – August was sometimes disrupted by dramatic short-term drops in early February, late March and late May. At the same time, the overall dynamics of Minfin bonds was displaying a downward trend, with occasional short-term adjustment towards growth. This trend was most graphically observed in the behavior of Tranche 5, which from January through May (with maturity on 14 May) dropped from 4.89% to 1.97% per annum. With regard to the main factors that determined the market dynamics in the first half-year it should be noted that, as a result of the negative situation on the world's leading trading floors, the yields on Russian Eurobonds in January became somewhat lower. However, beginning from the end of that month, after the basic rate in the USA was lowered in January (to 3.5%), this trend gave way to a slowly rising one. During the period under consideration the market was responding to the information coming from the US debt market, the situation on the world's leading trading floors and the increasing inflation expectations. In June – July, Russian Eurobonds were demonstrating, on the whole, an upward trend in the rate of their yield – as a result of the Government's anti-inflation measures, including the raising (several times) of the rate of refinancing by the RF CB (to 11% per annum). An additional positive factor for Russian securities in

the first half-year was a considerable rise of oil prices on the world market – to 141 USD/barrel.

Similar trends were prevalent on the market until the end of August, when the trend of stability gave way to volatility – as a result of the aggravating global financial crisis.



Source: IA "Finmarket".

Fig. 21. Yields to maturity of the Russian Eurobonds with maturity in 2010, 2018, 2028 and 2030 in 2008

In September, Russian Eurobonds were mainly demonstrating an upward dynamics of the yields due to the declining demand on the government bonds market; this happened against the backdrop of collapse of the Russian share market in response to negative external news, on the one hand, and the aggravating crisis of liquidity – all the measures being undertaken by the Government in order to control it notwithstanding (including the raised norm for compulsory reserve), on the other hand. The deepening world financial crisis alongside the increasingly threatening liquidity crisis and solvency deficit conduced to a sharp rise in the growth rate of yields to maturity of Russian Eurobonds in October. Thus, for example, the yields to maturity of RUS-28, as seen by the month's results, increased from 7.01% to 10.87% per annum (by 55%).

In November – December the market of government Eurobonds was displaying multi-directional dynamics of yields as a result of the negative foreign and domestic situations, dramatic drop of the oil prices on the world market, the increasing liquidity deficit and the anti-crisis measures being implemented by the RF Government in order to support the banking sector and the stock market. At the same time, the raising of the key rates of the RF CB and the policy aimed at devaluation of the ruble's exchange rate resulted in a decreased investment attractiveness of government bonds, in connection with which the liquidity of the government bonds market was low.

2.5.2. The market for the Municipal and Subfederal Borrowing

The dynamic of development of the market

By results of 2008 the consolidated regional budget and budgets of the territorial government extrabudgetary funds ran a budget deficit of Rb. 48.7bn (0.12% of GDP). The deficit has aroused for the first time since 2003. Between 2004 and 2007 the territorial budgets ran a surplus (*Table 1*). For example, in 2007, the surplus of the territorial budgets and extrabudgetary funds accounted for Rb. 38.5bn (0.12% of GDP).

In 2008, budgets of the RF Subjects and those of the territorial government extrabudgetary funds ran a deficit of Rb. 38.2bn; budgets of urban districts – with a deficit of Rb. 13.2bn; budgets of intra-city municipal entities in the city of Moscow and St. Petersburg – with a surplus of Rb 0.1bn; budgets of municipal districts- with a deficit of Rb. 2.7bn; budgets of urban and rural settlements – with a surplus of Rb. 5.2bn.

In 2007, budgets of the RF Subjects and those of the territorial public extrabudgetary funds ran a surplus of nearly Rb. 25.2bn; budgets of urban districts – with a surplus of Rb. 12.0bn; budgets of intra-city municipal entities in the city of Moscow and St. Petersburg – with a surplus of Rb 0.4bn; budgets of municipal districts- with a deficit of Rb. 0.3bn; budgets of urban and rural settlements – with a surplus of Rb. 3.1bn.

Table 26

Territorial Budget Surplus (Deficit) to Budgetary Expenditures Ratio (as%)

Year	Consolidated regional budget	Regional budgets*	Minicipal budgets
2008	–0.7	– 0.7	
2007	0.8	0.6	
2006	3.7	4.4	
2005	1.6	2.3	–0.8
2004	1.1	1.6	0.2
2003	–2.6	–2.3	–3.2
2002	–2.7	–3.0	–2.8

*With account of the government extrabudgetary funds.
Source: the IET calculations basing on the data of the RF Ministry of Finance.

Table 27

Net Borrowing by Regional and Local Budgets (as% of GDP)

Year	budgets of intra-city municipal entities in the city of Moscow and St. Petersburg	Budgets of urban districts	Budgets of municipal entities	Budgets of urban and rural settlements
2008	–1.47	1.09	–0.26	2.72
2007	5.34	1.23	–0.04	2.34

As of January 1, 2009, the consolidated budget was running a deficit in as many as 45 Russian regions (vs. 37 ones[37]in 2007). The aggregate volume of the deficit accounted for Rb. 132.7bn, or 3.1% of the revenue part of the regions' budgets (in 2007 – Rb. 89.0bn, or -5.0%).

[37] In the 2007 reports on execution of budgets of the RF Subjects published by the RF Ministry of Finance (the Federal Treasury) the data on the Evenk and Taymyr (Dolgan-Nenets) AOs are not singled out. In 2008, following the decisions to enlarge some Subjects of the Federation, their number slid to 84.

The median level of the budget deficit was 3.8% relative to revenues to the respective budget. The greatest budget deficit-to-the revenue part of the budget ratio was registered in Arkhangelsk oblast -6.9%, Ulyanovsk oblast -6.8%, and Kamchatka krai –6.7%. Roughly a half (45.0%) of the aggregate budget deficit fell on three Subjects of the Federation - namely, Moscow -19.5%, or Rb. 25.9bn, Moscow oblast -12.9%, or Rb. 17.1bn, and St. Petersburg - 12.6%, or 16.7bn (Table 5).

By contrast, as many as 39 Subjects of the Federation (vs. 50 ones in 2007) ran their consolidated budgets with a surplus. The aggregate volume of budget surplus in these regions accounted for Rb. 84.0bn, or 3.9% of the amount of the revenue part of their budgets (in 2007 – Rb. 126.1bn, or 4.1%). The median value of the budget surplus made up 2.4% of the revenue part of the budget.

The greatest surplus-to-revenue level to the consolidated budget ratio was noted in the Republic of Ingoushetia – 30.5%, Sakhalin oblast – 14.1%, Perm krai – 13.3%, Yamal-Nenets AO – 8.5%, and the Republic of Bashkortostan – 7.6%. Some 40% (39.6%) of the aggregate surplus of the consolidated regional budget was secured by 3 Subjects of the Federation – namely, Perm krai – 18.2% or Rb. 15.2bn, the Republic of Bashkortostan – 11.1%, or Rb. 9.3bn, and Sakhalin oblast – 10.4%, or Rb. 8.7bn.

Change in the structure of the accumulated debt

The amount of the debt on current borrowings accumulated by the consolidated regional budget climbed over 2008 up to Rb. 118,049.2m, or 0.29% of GDP (*Table 27*). The external debt of the regional consolidated budgets shrank at Rb. 559.0m, while the domestic one surged at Rb. 118,608.2m.

Table 28

Net Borrowing by Regional and Local Budgets (as% of GDP)

Year	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
Borrowing by subfederal and local governments, including:	0.33	0.15	–0.29	–0.04	0.47	0.37	0.26	0.09	0.21	0.17	0,29
Repayable loans from budgets of other levels	–0.09	–0.11	–0.03	0.04	0.12	–0.1	–0.02	–0.03	–0.04	–0.01	0,03
Subfederal (municipal) bonds	–0.01	–0.05	–0.27	–0.07	0.16	0.31	0.29	0.09	0.14	0.08	0,17
Other kinds of borrowing	0.43	0.31	0.01	–0.02	0.19	0.6	…	0.03	0.11	0.10	0,09

Source: the IET calculations basing on the data of the RF Ministry of Finance.

The structure of borrowings

The 2008 aggregate volume of borrowings by the regional consolidated budget accounted for Rb. 409,669.4m, of which external borrowings accounted for Rb. 591m. Like in 2007, the only region that became a recipient of external loans once again became the Republic of Bashkortostan.

The aggregate volume of regions and municipalities' domestic borrowings accounted for Rb. 409,078.4m. The biggest borrowers on the domestic market were: the city of Moscow –

Rb. 96.3bn, Moscow oblast - 91.7bn, Omsk oblast -34.6bn. Their share combined in the total volume of domestic borrowings was 54.4%. When compared with 2007, the volume of domestic borrowings in nominal terms grew at Rb. 146.8bn, or at 35.3%.

In the overall volume of domestic borrowings by the consolidated regional budget the security issuance accounted for 43.7%, loans from superior budgets – 5.0%, other kinds of borrowings (primarily, banking credits) – 51.4%.

The level of securitization of borrowings by the RF Subjects soared at more than 12 p.p. and accounted for 51.9% of borrowings. Meanwhile, the level of borrowings by municipal entities tumbled by 5 p.p. With the structure of borrowings by the consolidated regional budgets being dominated by borrowings by the Subjects of the Federation (Rb. 344bn vis-à-vis Rb. 651.bn borrowed by municipal entities), the level of securitization of the regional consolidated budget rose at more than 11 p.p. and reached 43.7% (*Table 28*).

Table 29

The Structure of Domestic Borrowings by Subnational Budgets (as%)

	2008			2007			2006		
	Regional consolidated budget	Regional budgets	Municipal budgets	Regional consolidated budget	Regional budgets	Municipal budgets	Regional consolidated budget	Regional budgets	Municipal budgets
Security issuance	43.7	51.9	1.9	32.1	39.5	7.1	29.4	37.1	9.7
Budgetary loans	5.0	5.9	0.2	3.8	4.9	0.1	4.4	6.0	0.3
Other borrowings	51.4	42.6	97.8	64.2	55.6	92.8	66.2	56.9	90.1

The greatest net borrowings-to-budget revenues ratio was noted in Moscow oblast – 14.3%, Astrakhan oblast – 7.0%, Arkhangelsk oblast – 6.8%, Samara oblast -6.0% (*Table 29*).

The biggest net borrowers were: Moscow oblast – Rb. 45.1bn, the city of Moscow – 25.4bn, Samara oblast -6.9bn.

The following regions were most successful in cutting their accumulated debt: St. Petersburg – at Rb. 4.5bn, Yamal-nenets AO – 2.3bn, Khanty-Mansy AO – 1.5bn, the Republic of Bashkortostan – 1.0bn, and Amur oblast – 1.0bn.

Table 30

Execution of Consolidated Budgets by the Subjects of the Russian Federation in 2008

	Budget revenues (Rb.thos.)	Budget deficit (surplus) (Rb. thos.)	Deficit (surplus) to revenues ratio, as%	Attracted borrowed capital to revenues ratio, as %	Net borrowing to revenues ratio, as%	Debt repayment costs to revenues ratio, as%	Net borrowings to deficit (surplus), as%
The Central Federal District							
Belgorod oblast	59 605 666 692,13	2 261 412 178,80	3.79	2.86	2.28	–0.58	60.08
Bryansk oblast	28 643 626 844,21	1 612 131 254,83	5.63	15.61	4.65	–10.96	82.64
Vladimir oblast	39 844 180 435,23	–106 988 900,06	–0.27	0.51	0.36	–0.15	–134.50
Voronezh oblast	59 135 128 486,94	–1 013 124 661,15	–1.71	2.21	–0.49	–2.70	28.51
Ivanovo oblast	26 612 415 133,75	603 087 098,82	2.27	0.88	0.52	–0.37	22.73
Tver oblast	42 394 595 743,41	–453 583 216,79	–1.07	11.43	3.58	–7.85	–334.23
Kaluga oblast	34 208 587 262,77	–124 313 785,44	–0.36	8.65	1.48	–7.16	–407.58
Kostroma oblast	19 266 272 609,91	–782 714 596,04	–4.06	16.03	–3.64	–19.68	89.65
Kursk oblast	32 979 883 918,89	–1 304 723 336,12	–3.96	0.05	0.00	–0.05	–0.02

	Budget revenues (Rb.thos.)	Budget deficit (surplus) (Rb. thos.)	Deficit (surplus) to revenues ratio, as%	Attracted borrowed capital to revenues ratio, as %	Net borrowing to revenues ratio, as%	Debt repayment costs to revenues ratio, as%	Net borrowings to deficit (surplus), as%
Lipetsk oblast	41 629 358 926,63	–1 178 491 439,92	–2.83	3.61	3.59	–0.02	–126.85
Moscow oblast	314 210 333 197,46	17 071 053 286,66	5.43	29.17	14.34	–14.83	263.91
Orel oblast	20 837 663 203,70	–501 555 634,38	–2.41	0.73	–0.25	–0.98	10.48
Ryazan oblast	31 358 933 262,76	1 440 013 797,43	4.59	17.09	7.41	–9.68	161.40
Smolensk oblast	24 185 955 769,98	1 182 510 286,73	4.89	7.05	5.40	–1.65	110.45
Tambov oblast	26 767 964 721,70	1 146 643 713,62	4.28	9.64	5.35	–4.28	125.00
Tula oblast	44 759 353 751,18	–551 458 048,00	–1.23	7.76	–0.19	–7.95	15.82
Yaroslavl oblast	44 521 182 362,10	2 231 236 289,50	5.01	11.57	3.50	–8.06	69.94
City of Moscow	1 327 891 668 535,20	25 865 101 111,25	1.95	7.25	1.91	–5.34	98.25
Subtotal	**2 218 852 770 857,95**	**47 396 235 399,74**	**2.14**	**10.22**	**3.72**	**–6.50**	**173.95**
North-West Federal District							
Republic of Karelia	29 165 736 571,00	210 756 249,16	0.72	13.87	3.69	–10.18	511.19
Komi Republic	46 467 800 137,91	315 437 050,16	0.68	0.76	0.07	–0.69	10.64
Arkhangelsk oblast	55 098 965 394,43	3 814 493 802,60	6.92	11.83	6.78	–5.04	98.01
Vologda oblast	53 064 759 110,49	–273 743 179,62	–0.52	0.40	–0.33	–0.73	63.66
Kaliningrad oblast	38 873 933 534,92	–798 163 297,56	–2.05	3.93	0.16	–3.76	–7.91
Leningrad oblast	66 523 934 056,64	–968 236 812,18	–1.46	0.14	0.05	–0.09	–3.48
Murmansk oblast	49 457 450 762,48	355 716 617,83	0.72	2.69	–0.13	–2.82	–17.77
Novgorod oblast	23 044 307 316,44	1 074 188 235,95	4.66	7.61	6.45	–1.16	138.37
Pskov oblast	19 201 078 481,33	–494 811 097,27	–2.58	0.00	–0.80	–0.80	31.06
St. Petersburg	355 797 167 696,96	16 743 467 952,88	4.71	0.59	–1.28	–1.86	–27.15
Nenets AO	9 640 274 648,83	565 616 105,64	5.87	0.00	–0.09	–0.09	–1.51
Subtotal	**746 335 407 711,43**	**20 544 721 627,59**	**2.75**	**2.40**	**0.20**	**–2.20**	**7.23**
Southern Federal District							
Republic of Dagestan	57 589 326 554,02	–3 356 302 767,77	–5.83	0.87	0.87	0.00	–14.90
Kabardino-Balkar Republic	20 183 718 104,65	334 684 616,24	1.66	7.95	1.99	–5.96	120.05
Republic of Kalmykia	9 033 515 222,95	–53 271 235,23	–0.59	11.66	2.57	–9.10	–435.44
Republic of North Ossetia- Alania	21 022 948 827,44	–497 451 645,48	–2.37	13.51	5.63	–7.87	–238.13
Republic of Ingoushetia	13 498 445 681,61	–4 120 201 314,27	–30.52	0.00	0.00	0.00	0.00
Krasnodar krai	148 004 550 650,20	4 255 620 890,24	2.88	1.09	0.56	–0.53	19.33
Stavropol krai	67 011 611 883,58	–1 966 135 002,56	–2.93	0.90	–1.16	–2.07	39.70
Astrakhan oblast	36 143 497 406,22	1 750 722 254,39	4.84	34.07	8.91	–25.16	184.01
Volgograd oblast	73 344 754 379,74	926 469 571,92	1.26	5.53	0.05	–5.48	4.35
Rostov oblast	111 595 132 888,08	–4 875 838 005,65	–4.37	0.00	0.00	0.00	0.10
Republic of Adygea	11 361 326 137,04	–755 150 394,79	–6.65	1.79	0.89	–0.90	–13.40
Karachai-Cherkes Republic	11 175 229 394,86	–507 861 610,39	–4.54	6.44	1.34	–5.11	–29.40
Chechen Republic	67 087 138 476,81	85 665 995,12	0.13	0.22	0.22	0.00	175.10
Subtotal	**647 051 195 607,20**	**–8 779 048 648,23**	**–1.36**	**3.97**	**0.93**	**–3.04**	**–68.55**
Volga Federal District							
Republic of Bashkortostan	123 072 642 584,17	–9 312 236 581,01	–7.57	0.48	–0.83	–1.31	10.99
Republic of Mary-El	17 163 722 891,08	661 448 681,31	3.85	8.75	3.88	–4.87	100.67

	Budget revenues (Rb.thos.)	Budget deficit (surplus) (Rb. thos.)	Deficit (surplus) to revenues ratio, as%	Attracted borrowed capital to revenues ratio, as %	Net borrowing to revenues ratio, as%	Debt repayment costs to revenues ratio, as%	Net borrowings to deficit (surplus), as%
Republic of Mordovia	26 206 955 732,41	1 680 267 109,56	6.41	3.85	3.38	–0.47	52.68
Republic of Tatarstan	145 308 110 344,38	7 706 603 301,66	5.30	6.47	1.95	–4.52	36.78
Republic of Udmurtia	45 256 120 527,73	675 420 153,58	1.49	6.25	0.39	–5.86	26.41
Republic of Chuvashia	36 612 658 685,67	2 098 649 254,12	5.73	5.89	5.33	–0.55	93.06
Nizhegordoskayaoblast	112 740 897 435,93	1 022 289 057,80	0.91	2.77	0.99	–1.78	109.06
Kirov oblast	38 829 065 660,32	–615 692 364,82	–1.59	7.19	2.03	–5.16	–128.15
Samara oblast	115 752 878 458,58	2 311 995 187,60	2.00	7.63	5.99	–1.63	299.98
Orenburg oblast	69 341 414 926,82	–275 382 134,70	–0.40	0.01	–0.21	–0.22	54.10
Penza oblast	35 754 368 817,70	1 142 350 521,99	3.19	9.22	4.23	–4.98	132.50
Perm krai	114 628 150 619,70	–15 254 000 944,25	–13.31	0.96	0.87	–0.09	–6.57
Saratov oblast	66 328 492 714,86	3 594 714 443,49	5.42	9.76	5.37	–4.38	99.14
Ulyanovsk oblast	35 840 065 752,86	2 444 552 021,42	6.82	3.21	2.97	–0.24	43.47
Republic of Bashkortostan	123 072 642 584,17	–9 312 236 581,01	–7.57	0.48	–0.83	–1.31	10.99
Subtotal	**982 835 545 152,21**	**–2 119 022 292,25**	**–0.22**	**4.50**	**2.17**	**–2.33**	**–1 006.39**
Ural Federal District							
Kurgan oblast	25 276 434 874,82	125 152,98	0.00	1.20	1.06	–0.14	213 471.71
Sverdlovsk oblast	164 961 774 284,81	346 456 942,93	0.21	0.32	–0.02	–0.34	–8.73
Tyumen oblast	166 856 227 159,26	–542 849 719,97	–0.33	0.00	0.00	0.00	0.79
Chelyabinsk oblast	111 369 588 083,92	5 408 567 194,37	4.86	0.62	0.20	–0.42	4.07
Khanty-Mansy AO	186 809 163 962,27	4 900 864 007,86	2.62	0.51	–0.82	–1.33	–31.32
Yamal-Nenets AO	91 166 535 590,70	–7 707 420 289,26	–8.45	0.35	–2.53	–2.88	29.94
Subtotal	**746 439 723 955,78**	**2 405 743 288,91**	**0.32**	**0.37**	**–0.45**	**–0.83**	**–140.90**
Siberian Federal District							
Republic of Buryatia	36 564 399 592,71	–708 481 407,14	–1.94	10.93	2.42	–8.51	–125.03
Republic of Tyva	13 603 994 471,56	–288 378 978,56	–2.12	1.06	–1.04	–2.10	49.04
Altay krai	65 331 360 856,44	–1 742 822 124,80	–2.67	1.36	0.22	–1.14	–8.35
Krasnoyarsk krai	163 917 190 013,99	–2 775 929 202,08	–1.69	1.82	0.35	–1.47	–20.89
Irkutsk oblast	90 361 387 170,78	1 591 995 402,00	1.76	12.39	2.48	–9.91	140.84
Kemerovo oblast	123 214 523 412,25	–4 128 340 328,52	–3.35	1.68	–0.70	–2.38	20.86
Novosibirsk oblast	97 637 243 229,24	–1 158 824 148,85	–1.19	4.78	–0.21	–4.99	17.29
Omsk oblast	58 711 990 179,12	3 405 910 703,34	5.80	58.89	6.13	–52.75	105.73
Tomsk oblast	39 883 171 808,53	2 149 411 614,36	5.39	30.11	6.51	–23.60	120.80
Chita oblast	36 367 800 276,54	–707 308 168,21	–1.94	6.87	1.66	–5.22	–85.22
Altay Republic	10 478 432 188,47	230 062 379,30	2.20	4.93	2.52	–2.40	114.98
Republic of Khakassia	16 636 473 356,21	149 238 825,00	0.90	0.45	0.34	–0.11	37.45
Aginsky Buryatsky AO	5 537 192 445,71	173 731 200,08	3.14	0.07	0.00	–0.07	0.04
Subtotal	**758 245 159 001,55**	**–3 809 734 234,08**	**–0.50**	**9.97**	**1.29**	**–8.69**	**–256.48**
Far-East Federal District							
Republic of Sakha (Yakutia)	82 699 931 032,12	3 684 411 149,22	4.46	5.07	1.32	–3.75	29.61

	Budget revenues (Rb.thos.)	Budget deficit (surplus) (Rb. thos.)	Deficit (surplus) to revenues ratio, as%	Attracted borrowed capital to revenues ratio, as %	Net borrowing to revenues ratio, as%	Debt repayment costs to revenues ratio, as%	Net borrowings to deficit (surplus), as%
Primorsky krai	69 887 317 635,49	–2 803 314 985,87	–4.01	1.13	0.13	–1.00	–3.20
Khabarovsk krai	67 574 170 547,41	1 316 197 926,11	1.95	0.38	–0.91	–1.29	–46.60
Amur oblast	38 104 502 229,30	–1 361 458 518,06	–3.57	4.64	–2.57	–7.21	71.95
Kmachatka krai	30 620 270 460,90	2 059 644 371,36	6.73	19.56	3.91	–15.65	58.06
Magadan oblast	16 928 068 320,06	–192 418 059,20	–1.14	6.08	–1.18	–7.27	104.10
Sakhalin oblast	62 058 524 085,87	–8 728 913 069,47	–14.07	3.16	–0.02	–3.18	0.13
Jewish AO	7 909 464 756,10	101 185 604,97	1.28	0.38	–0.12	–0.50	–9.60
Chukotka AO	15 977 212 646,10	–998 314 058,10	–6.25	4.26	–1.08	–5.33	17.26
Subtotal	**391 759 461 713,35**	**–6 922 979 639,04**	**–1.77**	**4.26**	**0.10**	**–4.16**	**–5.64**
Federal districts, total	**6 491 519 263 999,47**	**48 715 915 502,64**	**0.75**	**6.31**	**1.82**	**–4.49**	**242.32**

Source: the IET calculations basing on the data of the RF Ministry of Finance.

Domestic bonded loans

In 2008, as many as 24 Subjects of the Federation and 7 municipal entities had their prospectuses for bond issues registered (vs. 27 regional bonded loans and 12 municipal ones in 2007).

The 2008 total volume of placed bonds accounted for Rb. 178.6bn vs. 84.2bn reported in 2007 (up at 94.4bn or 1.9 times in real terms). Over the year the volume of issuance of subfederal and municipal bonds rose from 0.26% to 0.43% of GDP (*Table 31*).

Table 31

The Volume of Issuance of Subfederal and Municipal Securities (as% to GDP)

Year	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
Issuance	0.63	0.77	0.47	0.31	0.19	0.17	0.27	0.46	0.47	0.37	0.28	0.26	0.43
Redemption	0.47	0.56	0.48	0.36	0.46	0.23	0.10	0.15	0.19	0.28	0.14	0.18	0.26
Net financing	0.16	0.22	–0.01	–0.05	–0.27	–0.07	0.16	0.31	0.29	0.09	0.14	0.08	0.17

Source: the IET calculations basing on the data of the RF Ministry of Finance.

In 2008, the RF Ministry of Finance registered prospectuses for bond issues by the following Russian regions: Republic of Chuvashia, Republic of Sakha (Yakutia), Republic of Karelia, Komi Republic, republic of Udmurtia, Krasnoyarsk krai, Stavropol krai, the city of Moscow, St. Petersburg, Volgograd, Tomsk, Moscow, Yaroslavl, Lipetsk, Nizhegorodskaya, Tver, Samara, Kaluga, Penza, Ivanovo, Ulyanovsk, Belgorod, Kurganks oblasts, and cities of Tomsk, Lipetsk, Magadan, Krasnoyarsk, Volgograd, Bratsk, Novorossiysk.

The larges securities placements were made by the city of Moscow – Rb. 96.2bn, or 53.9% of the total volume of the territories' issuances, Moscow oblast -53.1bn (29.7%), Samara oblast – 8.3bn (4.6%), Tomsk oblast – 3.5bn. (2.0%). So, the proportion of the four largest issuers combined accounted for 90.2% of the overall volume of issuances of placed regional and municipal bonds.

As well, large volumes of issuance were placed by Tver oblast and the Republic of Sakha (Yakutia)- Rb. 2.5bn each, and St. Petersburg – 2.1bn (*Table 32*).

Table 32

Placement of Subfederal and Municipal Papers in 2008b

Subject of the Federation	Volume of issuance (Rb. thos)	The share of the issuer in the total volume of issuance (as%)	The volume of issuance – to-the domestic borrowings ratio (as%)
Central Federal District			
Belgorod oblast	596 200,0	0.3	35.0
Tver oblast	2 500 000,0	1.4	51.6
Kaluga oblast	414 449,8	0.2	14.0
Kostroma oblast	657 007,6	0.4	21.3
Lipetsk oblast	1 500 000,0	0.8	99.9
Moscow oblast	53 084 905,7	29.7	57.9
Yaroslavl oblast	65 002,7	0.0	1.3
City of Moscow	96 233 498,7	53.9	99.9
North-West Federal District			
Republic of Karelia	800 000,0	0.4	19.8
St. Petersburg	2 082 111,4	1.2	100.0
Southern Federal District			
Republic of Kalmykia	278 759,0	0.2	26.5
Krasnodar krai	267 321,0	0.1	16.6
Volgograd oblast	1 452 147,0	0.8	35.8
Volga Federal District			
Republic of Udmurtia	1 000 000,0	0.6	35.3
Republic of Chuvashia	1 000 000,0	0.6	46.4
Samara oblast	8 300 000,0	4.6	94.0
Siberian Federal District			
Krasnoyarsk krai	34 037,0	0.0	1.1
Novosibirsk oblast	1 819 250,0	1.0	39.0
Tomsk oblast	3 491 048,0	2.0	29.1
Far-East Federal District			
Republic of Sakha (Yakutia)	2 500 000,0	1.4	59.6
Amur oblast	9 993,6	…	0.6
Magadan oblast	480 000,0	0.3	46.6
Russian Federation, total:	**178 565 731,4**	**100.0**	**43.7**

Source: the IET calculations basing on the data of the RF Ministry of Finance.

Presently it has been mostly the largest issuers that posted a high level of securitization. More specifically, the respective figure for the city of Moscow is 99.9% and that for Samara oblast – 94.0%. Meanwhile, St. Petersburg and Lipetsk oblast borrowed solely in the form of security issuance.

The 2008 aggregate volume of net borrowings in the market for regional papers accounted for Rb. 73.0bn, thus posting a growth of 2.7 times vs. the 2007 figures (23.7bn) in real terms. At the same time, due to the three-fold fall in placement of papers by municipal entities, the volume of resources spent on redemption of municipal bonds was three-fold greater than the volume of the placed papers (*Table 33*).

Table 33

Volumes of Net Borrowing on the Market for the Domestic Subfederal and Municipal Papers, as Rb. Thos.

	Consolidated regional budget	Regional budgets	Municipal budgets
2008			
Net borrowing	68 851 271,9	72 984 947,8	- 4 133 675,9
Attraction of capital	178 565 731,4	177 324 359,3	1 241 372,1
Redemption of principal	-109 714 459,5	104 339 411,5	5 375 048,0
2007			
Net borrowing	25 867 011	23 691 970	2 175 041
Attraction of capital	84 159 197	79 889 761	4 269 436
Redemption of principal	58 292 185	56 197 791	2 094 394
2006			
Net borrowing	36 489 742	35 161 627	1 328 115
Attraction of capital	73 288 653	66 524 832	6 763 820
Redemption of principal	36 798 911	31 363 205	5 435 706
2005			
Net borrowing	20 887 596	16 939 894	3 947 703
Attraction of capital	81 220 540	75 016 756	6 203 783
Redemption of principal	60 332 944	58 076 863	2 256 081
2004			
Net borrowing	47 880 300	44 470 128	3 410 172
Attraction of capital	79 436 708	74 995 965	4 440 743
Redemption of principal	31 556 408	30 525 837	1 030 571
2003			
Net borrowing	41 908 199	40 043 511	1 864 688
Attraction of capital	61 712 635	59 012 901	2 699 734
Redemption of principal	19 804 436	18 969 390	835 046
2002			
Net borrowing	17 696 530	17 153 760	542 770
Attraction of capital	29 141 777	28 169 158	972 619
Redemption of principal	11 445 247	11 015 398	429 849
2001			
Net borrowing	6 601 447	6 667 592	–66 145
Attraction of capital	15 123 785	14 226 931	896 854
Redemption of principal	8 522 338	7 559 339	962 999
2000			
Net borrowing	–1 877 328	–2 286 175	408 847
Attraction of capital	13 042 220	10 090 208	2 952 012
Redemption of principal	14 919 548	12 376 383	2 543 165

Source: The RF Ministry of Finance.

Most regions that regularly practice bonds issuing continued to do so in 2008, too. Specifically, St. Petersburg and the Republic of Chuvashia, Volgograd oblast have held annual bond issuances since 1999, Tomsk oblast - since 2000, Irkutsk oblast - since 2001 (*Table 34*).

Table 34

Registration of Prospectuses for Issues of the Subfederal and Municipal Papers in 1999–2008

Issuer	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
Subjects of federation										
St. Petersburg	*	*	*	*	*	*	*	*	*	*
Republic of Chuvashia	*	*	*	*	*	*	*	*	*	*
Volgograd oblast	*	*	*	*	*	*	*	*	*	*
Tomsk oblast		*	*	*	*	*	*	*	*	*
Irkutsk oblast			*	*	*	*	*	*	*	*
Moscow oblast				*	*	*	*	*	*	*
Republic of sakha (Yakutia)				*	*	*	*	*	*	*
Yaroslavl oblast					*	*	*	*	*	*
Krasnoyarsk krai					*	*	*	*	*	*

Issuer	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
Republic of Karelia						*	*	*	*	*
Lipetsk oblast						*	*	*	*	*
Nizhegorodskaya oblast						*	*	*	*	*
Tver oblast				*	*		*	*	*	*
Samara oblast					*		*	*	*	*
Kaluga oblast						*		*	*	*
Penza oblast								*	*	*
Republic of Udmurtia							*		*	*
Ulyanovsk oblast									*	*
City of Moscow	*	*	*	*	*	*	*	*		*
Republic of Komi		*	*	*	*	*	*	*		*
Belgorod oblast				*	*		*	*		*
Kurgan oblast								*		*
Stavropol krai			*							*
Republic of Bashkortostan			*	*		*	*	*	*	
Voronezh oblast						*	*	*	*	
Irkutsk oblast								*	*	
Novosibirsk oblast	*				*	*	*		*	
Kostroma oblast				*	*		*		*	
Krasnodar krai						*			*	
Ivanovo oblast									*	
Republic of Kalmykia									*	
Tula oblast								*		
Khabarovsk krai				*	*	*	*			
Kabardino-Balkar Republic		*					*			
Leningrad oblast			*	*	*	*				
Yamal-Nenets AO					*	*				
Bryansk oblast						*				
Khanty-Mansy AO				*	*					
Murmansk oblast				*	*					
Republic of Mordovia				*						
Sakhalin oblast				*						
Kursk oblast				*						
Primorsky krai		*								
Municipalities										
Tomsk					*	*		*	*	*
Lipetsk								*	*	*
Magadan								*	*	*
Krasnoyarsk					*	*	*		*	*
Volgograd	*	*	*	*	*		*	*		*
Bratsk										*
Novorossiysk										*
Ekaterinburg		*	*	*	*	*	*	*	*	
Kazan							*	*	*	
Klins district, Moscow oblast							*	*	*	
Noginsk district, Moscow oblast						*		*	*	
Blagoveschensk								*	*	
Cheboksary	*						*		*	
Electrostal, Moscow oblast									*	
Balashikha, Moscow oblast									*	
Novosibirsk					*	*	*	*		
Odintsovo district, Moscow oblast							*	*		
Astrakhan								*		
Bryansk								*		
Voronezh								*		
Orekhovo-Zuevo, Moscow oblast								*		
Yaroslavl								*		
Yuzhno-Sakhalinsk					*	*	*			

Issuer	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
Novocheboksarsk	*		*			*	*			
Angarsk							*			
Vurnarsky district, Republic of Chuvashia							*			
Shumerlya, Republic of Chuvashia							*			
Ufa				*	*	*				
Barnaul						*				
Perm						*				
N. Novgorod				*						
Kostroma	*	*								
Arkhangelsk	*									
Dzerzhinsky	*									

Source: The RF Ministry of Finance.

Credit rating

In the conditions of the global economic downturn, the international credit rating agencies downgraded Russia's credit rating by liabilities denominated in foreign currency to the level «BBB» (forecast negative) on the Standard&Poor's and Fitch scales vis-à-vis the BBB+ level (forecast positive) noted back in the first half 2008. Meanwhile, the Moody's has retained Russia's credit rating unchanged at the level Baa1, which had been awarded in the first half 2008.

Accordingly, Standard&Poor's and Fitch downgraded credit ratings of the city of Moscow and St. Petersburg to the level of BBB, while keeping unchanged the Republic of Tatarstan's BBB- rating, which was awarded by the Fitch in April 2008.

Due to the failure by Moscow oblast to honor its Rb. 5.2bn-worth offer on bonds issued by the Moscow Oblast Mortgage Agency, which is owned at 100% by the Moscow oblast government, Standard & Poor's downgraded the region's long-term credit ratings from «B-» to «SD», which reference to a selective default.

The default was engendered by the court of law's ruling to freeze all payments with regard to the issuance as a part of the investigation procedure against the third party - namely, the organizer of the issuance. Accordingly, the court of law ruled to freeze all the transactions pertaining to this particular issuance, including the respective repayments. According to Standard & Poor's, if the ban on the deal with Moscow Oblast Mortgage Agency is lifted and the region repays the debt, its rating «SD» might be revised (*Table 35*).

Table 35

International Credit rating by Standard&Poor's in the 1st quarter 2009

Name of issuer	In foreign currency / forecast	In the national currency / Forecast
	Sovereign ratings	
Russian Federation	«BBB»/Negative/	«BBB+»/Negative/
	Ratings of regional and local governments	
Bashkortostan	BB+/Stable/	BB+/Stable/
Bratsk	B+/CreditWatch Negative/	B+/CreditWatch Negative/
Volgograd oblast	BB-/Stable/	BB-/Stable/
Vologda oblast	BB-/Stable/	BB-/Stable/
Urban district Balashikha	B/Negative/	B/Negative/

Name of issuer	In foreign currency / forecast	In the national currency / Forecast
Dzerzhinsk	B-/Stable/	B-/Stable/
Irkutsk oblast	B+/CreditWatch Negative/	B+/CreditWatch Negative/
Krasnodar krai	BB/Stable/	BB/Stable/
Krasnoyarsk krai	BB+/Stable/	BB+/Stable/
Leningrad oblast	BB/Stable/	BB/Stable/
City of Moscow	BBB/Negative/	BBB/Negative/
Moscow oblast	SD/--/	SD/--/
N. Novgorod	BB-/Stable/	BB-/Stable/
Novgorod oblast	B/Stable/	B/Stable/
Novosibirsk	BB-/Stable/	BB-/Stable/
Samara oblast	BB+/Stable/	BB+/Stable/
St. Petersburg	BBB/Negative/	BBB/Negative/
Sakha (Yakutia)	BB-/Stable/	BB-/Stable/
Sverdlovsk oblast	BB/Stable/	BB/Stable/
Stavropol krai	B+/Stable/	B+/Stable/
Surgut	BB-/Stable/	BB-/Stable/
Tatarstan	BB/Позитивный/	BB/Позитивный/
Tver oblast	B+/Negative/	B+/Negative/
Tomsk oblast	B-/CreditWatch Negative/	B-/CreditWatch Negative/
Ufa	BB-/Stable/	BB-/Stable/
Khanty-Mansy AO	BBB-/Negative/	BBB-/Negative/
Yamal-Nenets AO	BB+/Stable/	BB+/Stable/

Source: Standard&Poor's.

2.5.3. The corporate bond market

The beginning of the year 2008 was marked by the presence of some very positive trends on the domestic market of corporate bonds, especially in view of the crisis in mid-2007. Alongside capital inflow into this country, primary placements were being made, the yields of securities became stabilized at the level of approximately 8.5 – 9.0%, and the volume of trading on the secondary market testified to the high activity of investors. In the course of 2008, 310 bond issues were registered, their aggregate face value amounting to 1,191 bn rubles (for reference: in 2007, 360 issues were registered in the amount of 941.7 bn rubles). However, over that year only 158 issues of corporate bonds were actually placed, their total amount being 599.1 bn rubles (in 2007 – 204 issues worth of 468.9 bn rubles), the main bulk of which was placed in the first half-year. The biggest issues of securities were put in circulation by the following companies: Open-end Joint-stock Company "SIBUR Holding" (4 series of bonds in the amount of 120 bn rubles); Open-end Joint-stock Company "Rossiiskie zheleznye dorogi" ["*Russian Railways*"] (3 series of bonds in the amount of 50 bn rubles), Open-end Joint-stock Company "Mobil'nye TeleSistemy" ["*Mobile Tele-Systems*"]» (3 series of bonds in the amount of 30 bn rubles); Open-end Joint-stock Company "Rossiiskii sel'skokhoziastvennyi bank" [*Russian Agricultural Bank*"] (3 series of bonds in the amount of 20 bn rubles); Joint-Stock Commercial Bank "Bank Moskvy" ["*Bank of Moscow*"] (Open-end Joint-stock Company) (2 series of bonds in the amount of 20 bn rubles).

Among the main factors influencing the situation on the domestic debt market, two have been pointed out: the monetary policy of the RF Central Bank (in particular, the increased rate of refinancing) and the weakening of the national currency. As a result, the second half-year 2008 was a period of "large-scale placements by big issuers", whereas the securities of small and medium-sized businesses were gradually disappearing from the market as a result of the execution of their offering and redemption.

The volume of the domestic corporate bonds market (that is, the aggregate face value of securities in circulation) over the past year had been increasing, and then in December – at the peak of the financial crisis – it reached its historic high of the period under consideration (1,666.5 bn rubles). However, this trend – at a first glance a positive one – arose as a consequence of the activity on the debt market in the first half-year 2008, when a sufficiently large quantity of bond issues were registered and placed. The duration of a corporate bonds portfolio in Q IV had dramatically shrunk, and so in late December it was 587 days – in fact, it dropped to the 2004 level, while as late as the previous September this index had been approximately 1.5 times higher.

In Q IV of last year the index of the Russian corporate bonds market - IFX-Cbonds – dropped to its historic low since mid-2006, while the scope of reduction as such, in relative terms, became a record figure for the whole period since it had been estimated for the first time.

At the tender for determining the rate of coupon yield in January – February 2008, it was established at the level of 9 – 11% per annum, while in November – December it was already at least 13 – 14%. Over last year, the average weighted effective rate of coupon yield on the secondary market increased by more than 2.5 times, and so by late 2008 it had reached the level of more than 20%. Whilst in the first half-year bonds were traded at Close-end Joint-stock Company "FB MICEX" at the level of ± 1–2% of their face value, in Q IV the bonds of big issuers this index had dropped to approximately 80 – 90% of their face value, while the securities issued by small companies – to 20 – 40% of their face value, or even lower.

In last year's final months the idea of default became firmly rooted on the debt market. From mid-2007 onwards, the issuers had been declaring default (mainly on the payment of coupon yield or offering execution) on one or two issues every month, this rate increasing in Q IV 2008 to more than 10 defaults per month. Technical default (delay in fulfilling an obligation) was usually declared by several issuers every day. In this connection, the offerings presented to the holders of securities in the second half-year were, in fact, early redemptions of an entire issue.

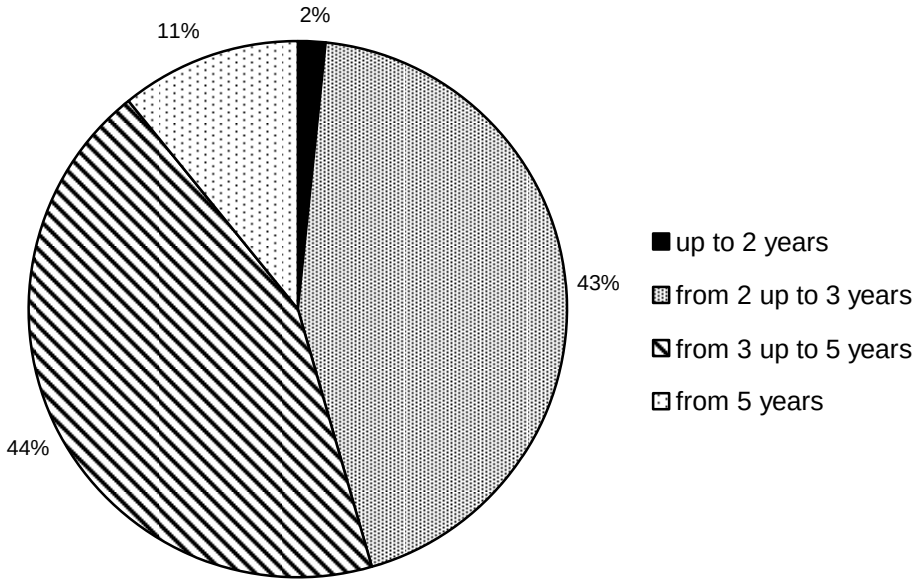
The majority of issue annulments over last year happened in the period from September through December, due to failures to place even a single security (in the first half-year, no more than two issues of bonds per month were usually deemed to be ineffective and so were annulled by the RF Federal Financial Markets Service (FFMS), while in the second half-year this figure increased to more than five issues per month). Many issuers delayed the placement of their securities until 2009.

Over the year, 111 issuers redeemed 115 bond loans to the total value of 127.2 bn rubles, which is almost by 10% higher than the 2007 level, including the loan of Open-end Joint-stock Company "Federal'naia setevaia kompaniia Edinoi energeticheskoi sistemy" ["The Federal Network Company of the Single Energy Grid"] to the value of 7 bn rubles, and that placed by Open-end Joint-stock Company "Russkii aliuminii finansy" [Russian Alumi-

num Finances"] – to the value of 6 bn rubles. In 2009, the redemption of 206 issues of corporate bonds of the total volume of 302.6 bn rubles is expected.

The world financial crisis resulted in the introduction of certain amendments to Russian legislation on securities. In particular, on 30 December 2008, changes were introduced in Article 27.5.2. of Federal Law 22 April 96, No 39-FZ, "On the securities market", which addressed the specific features of issuing and circulation of exchange bonds. In accordance with these newly introduced changes, the range of issuers entitled to issue exchange bonds was considerable expanded: whilst previously the issuers of such bonds could only be open-end joint-stock companies whose shares were included in the quotation list of a stock exchange which could admit such bonds to trading, now this right has been extended to economic societies, state corporations or international financial institutions, if the quotation list of the stock exchange which admits such bonds to trading includes the shares and (or) bonds of the aforesaid issuers. It should be noted that at present the majority of issuers on the corporate bonds market are limited liability societies which, prior to the introduction of those changes in legislation, could not use exchange bonds as a debt instrument.

Also, the period of fulfillment of obligation against exchange bonds was extended from one to three years. Considering that the procedure of registering the issues of exchange bonds is much simpler by comparison with the registration of so-called non-exchange bonds, these new changes in legislation are aimed at lowering the barriers in the way of issuers' entry to the Russian domestic debt market. Thus, for example, even before the aforesaid amendments were made, in 2008 the volume registered exchange bonds amounted to 12.3% of the total face value of registered issues of Russian domestic corporate bonds. And, as approximately half of the issues of bonds presently in circulation have the period of circulation of approximately three years (*Fig. 22*), their share is going to significantly increase as a result of the extension of the period for the fulfillment of liabilities under exchange bonds.



Source: According to the data published by RusBonds' information portal.

Fig. 22. The structure of bond loans, depending on their period of circulation

2.5.4. The stock market

The share market

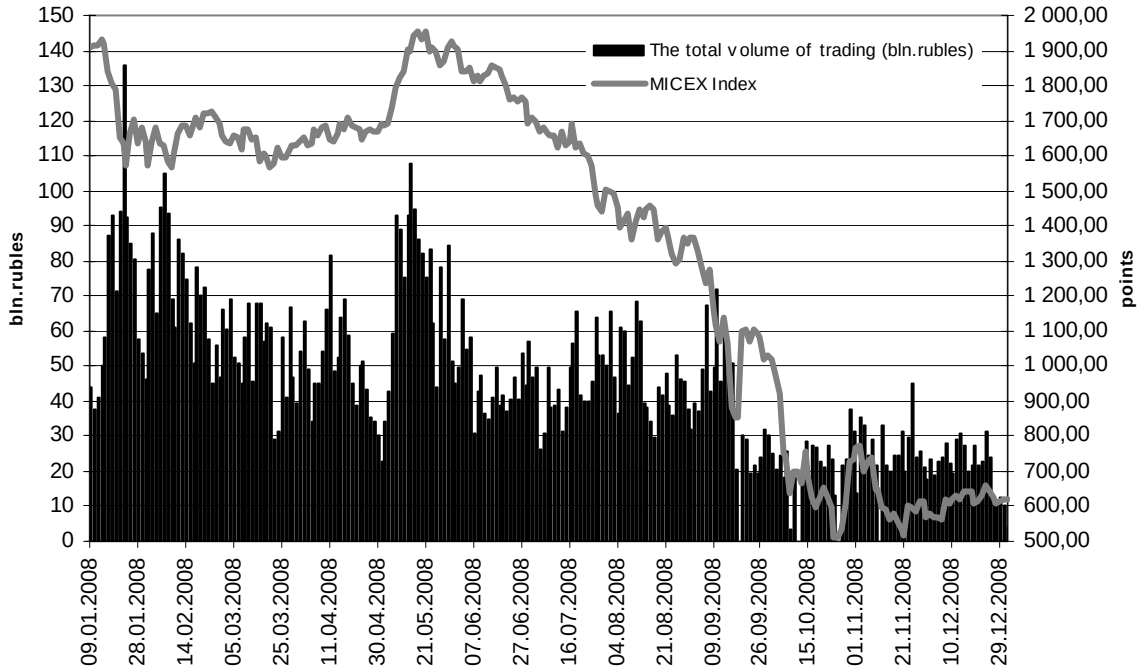
During the year 2007 the Russian stock market, in contrast to the situation existing a year earlier, was demonstrating a multi-vector dynamics. Among the main factors that had determined the emergence of this trend on the Russian stock market, the following events were especially noteworthy: the negative situation on the US mortgage market; the world credit crisis; highly volatile prices on the international oil market; the bankruptcy of two biggest US investment banks and the takeover of the third one; partial nationalization of several biggest banks, insurance companies and mortgage agencies; as well as the weakening of USD exchange rate in the first half-year, followed by its strengthening in the second half-year; and a revival of investor activity in absence of negative external news. Besides, in 2008 there was a dramatic decline of liquidity in the banking sphere, and so the Central Bank of the Russian Federation had to implement certain measures that had a transient positive effect on the behavior of the Russian market. Additional support to international markets was provided by the decision of the US FRS, as well as of the central banks of some other countries, to lower the level of the key rates and to develop certain anti-crisis measures designed to sustain their national economies.

The domestic news was also highly important. Thus, the collapse of "Mechels" quotations in July, the abrupt slowdown in industrial production in the second half-year, the growing rate of inflation, the August events in South Osetia and Abkhazia, the frequent suspension of trading on the Russian exchanges – MICEX and RTS – by the RF Federal Financial Markets Service (FFMS) (from mid-September onwards), the recall of licenses of some credit institutions because of their inability to timely fulfill their obligations, and the dramatic weakening of the ruble against the USD and the euro in the last quarter of 2008 were all conducive to the decreasing attractiveness of the Russian stock market in the eyes of investors. Another factor which had a noticeable effect on the market was the lowered rating of some of the companies actively trading in shares.

At the same time, beginning from late August and September 2008, the negative trends on the Russian stock market began to be felt more strongly, against the background of the deepening financial crisis (for the main events that shaped the behavior of the Russian financial market in September – December 2008, see Annex 1).

Over the past year (2008), the Russian stock index (MICEX) suffered a record drop - by 1,287.33 points (from 1,906.86 to 619.53 points, or more than 3 times) from its value registered as of the closure of trading on 9 January 2008 (in 2007 its growth amounted to 20.16%). Thus, in 2008 the stock market, in contrast to the previous year, demonstrated an impressive rate of decline. The lowest value of the MICEX index in 2008 – 513.62 points – was recorded on 24 October (against 1,516.09 points a year earlier), and on 19 May it reached its historic high – 1,956.14 points (against 1,969.91 points in 2007). As for investor activity, in 2008 it also declined by comparison with the previous year. In particular, the volume of trade in the shares constituting the base of the MICEX index on the MICEX in 2008 amounted to approximately 1,1434.32 bn rubles, with the average daily trading being at the level of 45.74 bn rubles (in 2007, the aggregate trading volume had been approximately 13,611.71 bn rubles, with the average daily trading of 55.33 bn rubles). Thus, the trading volume in 2008 dropped by comparison with the corresponding index of 2007 by 16%.

The market dynamics throughout the year 2008 was characterized by a rather high volatility, and there were several periods of decline and rise of the MICEX index (*Fig. 23*). Thus, in January the MICEX index dropped 17%, with the simultaneously increased trading volume. In period from February through April, the MICEX index remained in the range of 1600 – 1700 points, while the changes in the dynamics of quotations were displaying periodical multidirectional deviations, and the trading volume was demonstrating, on the whole, a downward trend. In May there was an upward trend displayed by both the quotations (by 11%) and the trading volume (by 30%). The next period (from June through October 2008) was characterized by a distinct downward trend in the MICEX index (by more than 3.5 times, as seen by the period's results). At the same time, in that period there were also occasional slight upward adjustments of the index. In late October – early November, the MICEX index rose by almost 45%, after which (in mid-November) it once again dropped (by 30%). In the last period (from late November through December) there were multi-vectored changes of the MICEX index in the range of 560 – 660 points. At the same time, from mid-September and until the end of December, the market demonstrated low trading volumes – less than half of the values recorded during the first eight months of 2008.



Source: The Moscow Interbank Currency Exchange (MICEX).

Fig. 23. Dynamics of the MICEX Index and of the trading volume in 2008

While analyzing the month-to-month dynamics of the Russian stock market, we must take note of the fact that, with the onset of trading in January 2008, the share market demonstrated a marked decline caused by the negative information concerning the state of the US debt market and the resulting decreased trading volume on world exchanges. The FRS's decision to lower the discount rate to 3.5% per annum (by 0.75 percent points) was by no means conducive to any improvement of the situation. Thus, the trading volume decreased 13% by

comparison with December 2007, while the MICEX index dropped 17% (from 1,906.86 to 1,574.33 points). This decline of the index' value reflected the overall trend of devaluation displayed by the quotations of the shares issued by the most liquid Russian companies. The most resistant to these downward trends was the telecommunications sector (shares in "Rostelekom" dropped by mere 2%).

Throughout the next period (February – April) the factor determining the behavior of Russian shares was, as before, the situation on the world market, which was characterized both by a neutrally-negative news background and the appearance of a positive outlook on the part of investors. Among the main events that occurred during that period, we can note the information concerning the expectations of still more substantial financial losses of international financial companies, the collapse of one of the biggest international investment banks – Bear Stearns, and the weakening of the US dollar's positions in the USA. All this was reflected by the slight multidirectional changes in the MICEX index – mainly within the range of 1600 – 1700 points, and by the marginal downward trend in the trading volume, which occasionally gave way to short-term upward adjustments. The prices of Russian shares were also displaying some volatility. Thus, on the whole, in that period approximately half of Blue Chips on the Russian exchanges were demonstrating positive dynamics (by 1 – 18%), while at the same time the remaining part was displaying a negative trend (1 – 15%). In particular, as the shares of "*LUKOIL*" and "Rosneft" demonstrated a stable rise of their prices, those issued by "Rostelekom", on the contrary, were losing value.

The situation on international commodities markets, which was reflecting the continual growth of oil prices in May (up to their historic high of 135.09 USD/barrel in the month's second half), was the determining factor in the upward dynamics of the share market. It promoted growth in the value of the majority of shares on Russian exchanges (as demonstrated by the trading results in May), as well as an upshoot of the main Russian stock indices. Besides, on 19 May 2008 the RTS index reached a new historic high of 2,487.92 points. The trading volume also rose significantly (almost by 30%) by comparison with April, thus responding to the positive background. Among the securities that had a positive impact on quotations, one should note those issued by some companies in the oil sector ("Tatneft", "Gazprom Neft", "Surgutneftegaz", "Rosneft'" and "LUKOIL"), whose value significantly increased (by 17 – 19%) following the growth of oil prices on the international market.

June was the month during which the situation on the Russian share market worsened, in face of a slight growth of market volatility. The negative international situation that developed as a result of the continuing credit crisis in the USA and was sensitive to the writing-off of their new losses by some big financial companies resulted in decreased value of the majority of shares on Russian exchanges, as demonstrated by the trading results on June, as well as by the drop the main Russian stock indices. At the same time, some support to the quotations of the shares of Russian oil companies was provided by the rising of oil prices to their new historic high (more than 141 USD/barrel in the month's second half). Besides, among the significant events on the share market in June, one should note the rounding-up of the final stage of the reorganization of RAO "UES of Russia" on 30 June 2008.

The negative external background produced by the writing-off of their new financial losses by the biggest financial companies, the trends associated with the adjustments of oil prices, and the slowdown of economic growth in the USA caused further decline on the Russian financial market over the next month. The panicking activity on the Russian stock market

and its collapse (including the significant drop in the value of shares on Russian exchanges as demonstrated by the trading results in July (to 28%), the fall of the MICEX and RTS indices and the contraction of the trading volume (by more than 15%)) also resulted in part due to the domestic news: the collapse of "Mechel"'s quotations (by 38%) and the reduction overnight, by one-third, of the company's capitalization, caused by the criticism of it by Prime Minister V. Putin; the disappointing reporting documents of "Sberbank of Russia"; and Rosstat's information on the significant slowdown of industrial production in June.

In August, Russian shares also demonstrated a sharp decline. The main reason behind this severe market slump was the dramatic drop if oil prices, the military conflict between Russia and Georgia, the passive expectation on the part of investors as to how the situation with the company "Mechel" was going to be resolved, and the considerable weakening of the ruble against the US dollar. The "promotion" of the rating of the Russian banking system by Standard&Poor's from Group 8 into the more "reliable" Group 7 in early August had no significant effect on the market.

The rate of the Russian stock market's decline became even more rapid in September, in face of the deepening world financial crisis aggravated by the bankruptcy of one of the biggest US investment banks – The Lehman Brothers; by the takeover of Merrill Lynch by a commercial bank and the potentially similar fate of the two remaining biggest investment banks in the USA; by the nationalization of the two leading US mortgage agencies; and by the government bailout of AIG, the biggest US insurance company which had found itself on the verge of bankruptcy. The abrupt collapse of the Russian share market (including the plunging of the most liquid shares on Russian exchanges, as demonstrated by the September results, up to 40%, and of the MICEX and RTS indices– by more than 20%) in the wake of these events was the reason why the RF Federal Financial Markets Service had to resort to such unprecedented measure as the closure of the Russian exchanges - MICEX and RTS – on 17 and 18 September 2008. Besides, one of the negative consequences was the 10-15% fall, by the month's results, in the capitalization of biggest Russian companies.

In October, the meltdown of world financial and commodities markets, the increasingly negative investor expectations concerning the deepening financial crisis, and the panic on the Russian exchanges further deteriorated the situation on the Russian share market. Besides, the frequent application, during that month, by the RF Federal Financial Markets Service of such measures as suspension of trading on the MICEX and RTS, the emergence of the first victims of the financial crisis in Russia among credit institutions resulting from their failure to timely fulfill their obligations, the downgrading, on 23 October, of Russia's rating by Standard&Poor's from "stable" to "negative" – against the backdrop of the unraveling liquidity crisis, and the diminishing trust in the RF financial system all resulted in a drop in the value of the most liquid shares on Russian exchanges, as seen by the trading results in October (to 70%), as well as of the quotations of MICEX and RTS indices (by more than 50%). The capitalization of biggest companies also displayed a continuing downward trend (on the average, by 15 – 20% by month's results).

The negative background created by foreign and domestic news, the drop in international oil prices, on the one hand, and the implementation by the governments of some countries, including the RF, of certain measures designed to stabilize their financial systems, on the other, produced the multidirectional trends on the Russian share market that could be observed in November – December 2008. Thus, whilst late October – early November was

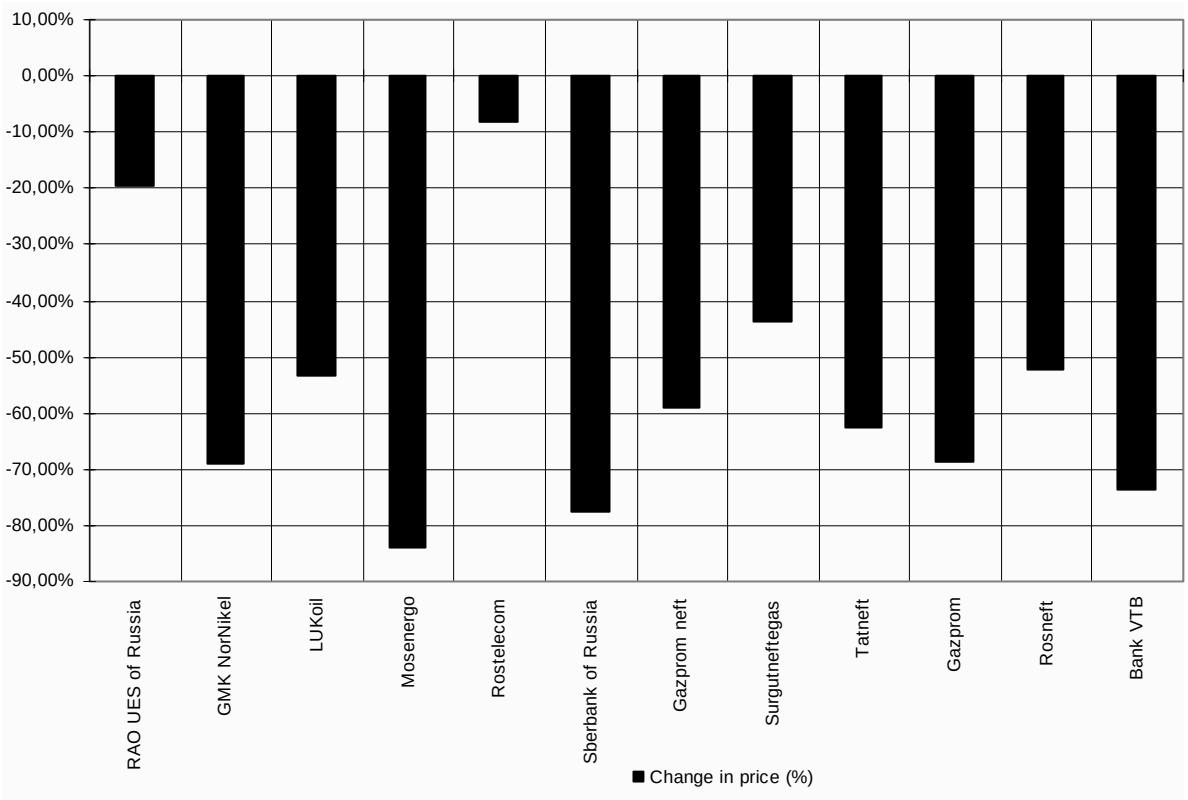
marked by an increase in the main stock indices (the MICEX index rose by nearly 45%), in the second half of November this upward trend gave way to a downward one, and from the end of November and through December the market was demonstrating variable dynamics. The deterioration of the situation on the stock market during that period was contributed to by such factors as the recall of the licenses of several credit institutions because of their failure to timely fulfill their obligations, the considerable drop of the ruble against the US dollar and the euro as a result of the ruble depreciation policy pursued by the RF CB, the raising of the RF CB's refinancing rate to 13% per annum, as well as the downgrading of Russia's sovereign rating by Fitch Ratings and Standard & Poor's from "stable" to "negative". However, the actions undertaken by the RF Government to support Russia's financial market had, on the whole, a favorable effect on the mood of investors. Besides, any dramatic changes in investors' expectations were leveled down during that period by applying the already habitual method – suspending trading on the MICEX and RTS. All these factors resulted in the former trend's reversal and in the growing prices of the majority of the most liquid shares on Russian exchanges (as demonstrated by the results of trading in November (to 30%) and December (to 40%), as well as of the quotations of the MICEX and RTS indices (by more than 15%). At the same time, the capitalization of companies, by the November results, decreased on the average by 40 – 45%, and the results of December demonstrated a decline within the range of 10%.

In 2008, in contrast to the situation one year earlier, the value of the most liquid Russian shares dropped considerably (*Fig. 24*) due to the negative impact of the world financial crisis on the Russian stock market. Thus, last year the most unprofitable investments were in shares in "Mosenergo", "Sberbank", "Surgutneftegaz", and VTB Bank, which shed 83.98%, 77.45% and 73.47% of their value respectively. These were followed, in terms of rating, by securities of GMK "NorNikel'", "Gazprom" and "Tatneft'", which over last year lost 69.04%, 68.50% and 62.67% of their value respectively. A relatively high rate of decline was demonstrated by "Gazprom Neft" securities, which dropped in 2008 by 59.2%, as well as those of "LUKOIL" (-53.31%) and "Rosneft'" (-52.14%). Somewhat smaller losses were associated with "Surgutneftegaz" shares – which dropped 43.90%, and with those of RAO "UES of Russia"[38] (as of 6 June 2008). In 2008, the lowest rate of devaluation among all the Blue Chips was demonstrated by shares in Open-end Joint-stock Company "Rostelekom", which fell 8.18%.

On the MICEX, the most traded securities of the year 2008 were shares in "Gazprom", which accounted for approximately 35% of aggregate turnover on the MICEX share market. These were followed by shares in the Open-end Joint-stock Company "Sberbank of Russia', which constitute approximately 15% of the aggregate trading volume. Next came shares in Open-end Joint-stock Company "LUKOIL", whose index was at the level of approximately 13%. They were closely followed by shares in GMK "NorNikel'" and "Rosneft'", which ranked fourth and fifth with 12% and about 7% respectively. Thus, in 2008, the percentage of transactions with shares of these five issuers on the MICEX was approximately 82%, which is somewhat lower than this index' value of the previous year (approximately 90%). It should be noted that in 2008, by comparison with the situation a year earlier, the companies' rating with regard to their trading on the MICEX somewhat changed because of the reorganization of

[38] On 6 June 2008, the shares of the RAO "UES of Russia" went out of circulation on the exchanges as a result of the company's reorganization.

RAO "UES of Russia" and its ceasing to exist a juridical person as of 1 July 2008; so, the fifth place in the leaders' rating now belonged to another company – "Rosneft".



Source: The Moscow Interbank Currency Exchange (MICEX).

Fig. 24. Dynamics of the Russian Blue Chips in 2008

According to data published by the MICEX, as of December 31 2008, the top five companies who were leaders by the scope of their capitalization as estimated on the basis of the average monthly indices could be described as follows: "Gazprom" – 2,359.07 bn rubles (against 7,448.4 bn rubles as of the end of 2007); "Rosneft'" – 955.40 bn rubles (against 2,269.9 bn rubles in 2007); Open-end Joint-stock Company "Lukoil" – 706.42 bn rubles (against 1,883.3 bn rubles in 2007), "Surgutneftegaz" – 562.54 bn rubles (1,085.4 bn rubles as of the end of 2007); and "Sberbank of Russia" – 539.24 bn rubles (against 2,160.9 bn rubles in 2007). Thus, as a result of the dramatic shrinkage of capitalization in 2008, the companies' rating by level of their capitalization in 2008, by comparison with that in 2007 had undergone certain changes: GMK "NorNikel" was surpassed by "Surgutneftegaz". Importantly, as seen by last year's results, four out of the five most highly capitalized companies in Russia are representatives of the oil and gas sector. Among the companies belonging to sectors other than the raw-materials one, the highest capitalization level, just as a year before, was demonstrated by "Sberbank of Russia".

The futures market

Every year, turnover on the futures market had been demonstrating significant growth, and the year 2008 was no exception. Thus, according to last year's results, the aggregate turnover of trade in futures and options on this segment of Russia's financial market was approximately 11,157.24 bn rubles, against approximately 7,531.2 bn rubles in 2007. Thus, the turnover of the market for futures contracts, FORTS, in 2007 increased almost 50% on the previous year. The participants in trade concluded more than 28.7 million transactions and 239.8 million contracts (against approximately 11.7 million transactions and 145.1 million contracts in 2007). The average daily volume of open positions on standard contracts was in 2008 approximately 247.5 bn rubles and 6.2 million contracts, having increased by comparison with 2007 by 50% in rubles and by 47.6% in the number of contracts (in 2007: 164.9 bn rubles, 4.18 million contracts). During the year 2008 the volume of open positions reached its historic high of 466.96 bn rubles and 12.8 million contracts (on June 7), as well as its historic low – 29.05 bn rubles and 1.3 million contracts (on December 15). In the segment of futures contracts, in 2008 – similarly to the previous year – the bulk of transactions was constituted by those with futures, which accounted for approximately 84.2% of aggregate turnover, or 9,394.5 bn rubles (against 6,207.3 bn rubles in 2007), whereas with regard to options the number of concluded transactions was to the value of only 1,762.7 bn rubles (against 1,323,9 bn rubles in 2007).

As for ratings, the most popular instrument among investors on the RTS futures market were RTS index futures, then the ruble/USD exchange rate, followed by contracts for shares in the open-end joint-stock companies "Gazprom" and "LUKOIL". The most popular options were those on RTS index futures and on shares in Open-end Joint-stock Company "Gazprom".

In 2008, several new instruments appeared on the FORTS market. One of them was the futures contract "Shares in Energy Industry Companies" launched on May 19 2008, with the execution date as of 15 December 2008, which was designed to support the liquidity of the shares of electric power companies after the termination, June 6, of RAO "UES of Russia"'s trading on the exchange market. In this connection, the basic asset of futures from 1 July onwards was the "basket" of 23 shares in the companies spinning off from RAO "UES of Russia", namely OGK - 1, OGK - 2, OGK - 3, OGK - 4, OGK - 6, TGK - 1, TGK - 2, TGK - 4, TGK - 6, YuGK TGK - 8, TGK - 9, TGK - 10, TGK - 11, TGK - 14, Volga TGK, the Yenisey TGK, Mosenergo, Kuzbassenergo, FSK, GidroOGK, INTER RAO YeES Holding, Holding MRSK, and RAO "Energeticheskie systemy Vostoka" ["Energy Systems of the East"].

In the changes occurring on the RTS futures market in 2008 one can single out several periods on the basis of certain typical features. Thus, while in January – August 2008 monthly turnover was in the range of 1000 – 1300 bn rubles, from September 17 and until the month's end there was a marked drop in investor market activity (the turnover volume was approximately 800 bn rubles by the results of September, or more than 20% less than previously) because of the dramatically rapid deterioration of the Russian financial market as a result of negative foreign events associated with the worsening of the world financial crisis. In October, the RTS futures market demonstrated an even more considerable drop in the volume of its monthly turnover (almost by 2.3 times) - to 380 bn rubles. In November, this downward trends continued, but the rate of decline decreased, dropping by 10% on the previous month (342 bn rubles). And, finally, in December the dynamics of the futures market, influenced by

the positive expectations of investors coupled with the anti-crisis measures adopted by the governments of some countries, changed its vector and began to climb. Thus, in December investor activity started to rise (by 11%) on the previous month; while turnover reached approximately 378 bn rubles

Somewhat different situation was observed in 2008 on the MICEX futures market. Thus, its turnover, as demonstrated by the February results, was declining, having dropped by almost 20% by comparison with January – to 216 bn rubles. Later on, this trend gave way first to moderate growth (by 3% in March), and then to dramatic growth – by more than 70% in April (to 380 bn rubles). In the next two months there was a downward trend – turnover shrank 4% in May and 45% in June (its volume by the results of June was approximately 200 bn rubles). After that, there was growth once again: turnover by the results of July rose by more than 35%, in August – by almost 50% (to 400 bn rubles), and in September – by 17% (to 460 bn rubles), which happened mainly due to the considerably increased turnover of trading in ruble/USD futures. Investor activity in October, because of the worsening situation on the Russian financial market, decreased by almost 15% by comparison with the previous month (turnover being approximately 398 bn rubles). But the most obvious impact of the global economic crisis on the MICEX futures market was observed in November, when the turnover volume dropped almost 8.5 times by comparison with the previous month – to a total of 47 bn rubles, as demonstrated by the month's results. In December the market was making an upward adjustment, in the course of which it climbed almost 67% – to 78.5 bn rubles.

On the whole, as seen by last year's results, the aggregate turnover of trading in futures on the MICEX futures market amounted to approximately 3,314.19 bn rubles; a total of more than 22.4 thousand transactions and 130.6 million contracts were concluded. In 2008, the average daily volume of open positions for standard contracts amounted to approximately 8.8 bn rubles and 340.3 thousand contracts. In this connection, the highest turnover volume in 2008 was achieved with regard to ruble/USD futures – 3,240.5 bn rubles (5.9 thousand transactions, 130.4 million contracts).

Factors determining the dynamics of the Russian stock market

The dynamics of the Russian stock market in 2008 was determined by a number of factors which, for the sake of convenience, can be subdivided into the following groups:

- the domestic political situation;
- relations with international financial institutions and organizations;
- the situation on international financial markets;
- the situation on international raw-materials markets (in particular, oil markets);
- the world economic crisis;
- corporate news.

Each of these groups of factors produced varying effects, throughout the year 2008, on the behavior of different segments of the Russian financial market. Most of them have already been mentioned when analyzing the dynamics of different segments of the Russian financial market.

Relations with international financial institutions and organizations

Over the past year, Russia's relations with international financial institutions were developing against the backdrop of this country's increasing foreign debt, dramatic decline of the international reserve volume from August 2008 onwards, and the deteriorating domestic financial situation in response to the world economic crisis, which was reflected by the lowered sovereign ratings of the Russian Federation.

Thus, on September 19 2008, the international Standard&Poor's rating agency downgraded the forecast of Russia's sovereign rating from "positive" to "stable" – as a result of the support of Russia's financial market with funding from the state budget, as well as of the lowered reserve norms in face of the deepening liquidity crisis. And on October 23, Standard&Poor's lowered the RF's rating even further - from "stable" to "negative", as a result of the implementation of anti-crisis measures by the RF Government, which were designed to continue the support of the banking sector with budget funding in order to counterbalance against the liquidity crisis and diminishing trust in the financial system. Besides, on December 8 2008 Standard&Poor's, in response to a dramatic shrinkage of international reserves and investment flows, lowered the RF's long- and short-term credit ratings on foreign-currency obligations: from "BBB+/A-2" to "BBB+/A-3"; the long-term sovereign credit rating on its national-currency obligations – from "A" to "BBB+"; and the short-term rating on Russia's national-currency obligations was confirmed to be at the level "A-2".

On November 10 2008, Fitch Ratings, the international rating agency, downgraded the forecast of Russia's sovereign rating from "positive" to "negative" – in view of the risks of deposit outflow and capital flight, as well as the systemic flaws in the banking system and the relatively high inflation rate.

On July 16, the Moody's agency upgraded the rating on Russia's foreign-currency debt obligations, as well as its ceiling for foreign-currency deposits from Baa2 to Baa1, and later, on 12 December, downgraded the forecast of Russia's rating from "positive" to "stable".

The situation on international financial markets

The past year - 2008 – saw a rapid deterioration of the situation on the world stock markets (see *Table 36*), as compared to the results of the previous year.

In particular, US stock indices, by the results of the year 2008, demonstrated a significant decline. Thus, US stock index Dow Jones Industrial dropped by 33.84% (or by 4,488.43 points); NASDAQ Composite index plunged even further – by 40.54% (or by 1,075.25 points) (see *Fig. 25*). One can distinguish, with regard to the changes in US stock indices, three main periods which are characterized by different trends (*Fig. 25*). Thus, whilst until the end of July the market was demonstrating, on the whole, multidirectional changes, later on, from August through October, this situation gave way to a sharp drop in the values of the world's main indices (especially as seen by the results of October 2008 – mainly by more than 25%). In November – December 2008 the. market once again began to demonstrate multidirectional changes, but at the same time the indices' values in the periods of growth did not exceed those registered as of the end of August 2008. Such trends were displayed by all the international stock indices.

Table 36

Behavior of world stock exchange indices in 2008

Data as of 31 December 2008	Code	Index value	Change from year's beginning
MICEX (Russia)	MICEX index	619.53	–67.20
RTS (Russia)	RTSI	631.89	–72.41
Dow Jones Industrial Average (USA)	DJI	8 776.39	–33.84
NASDAQ Composite (USA)	NASD	1 577.03	–40.54
S&P 500 (USA)	SPX	903.25	–38.49
FTSE 100 (UK)	FTSE	4 434.17	–31.33
DAX-30 (Germany)	DAX	4 810.20	–40.37
CAC-40 (France)	CAC	3 217.97	–42.68
Swiss Market (Switzerland)	SSMI	5 534.53	–37.01
Nikkei-225 (Japan)	NIKKEI	8 859.56	–42.12
Bovespa (Brazil)	BUSP	37 550.31	–41.22
IPC (Mexico)	IPC	22 380.32	–24.23
IPSA (Chile)	IPSA	2 376.42	–22.13
Straits Times (Singapore)	STI	1 761.56	–49.41
Seoul Composite (South Korea)	KS11	1 124.47	–40.73
ISE National-100 (Turkey)	XU100	26 864.07	–51.63
Morgan Stanley Emerging Markets Free Index	EFM	457.64	–54.44

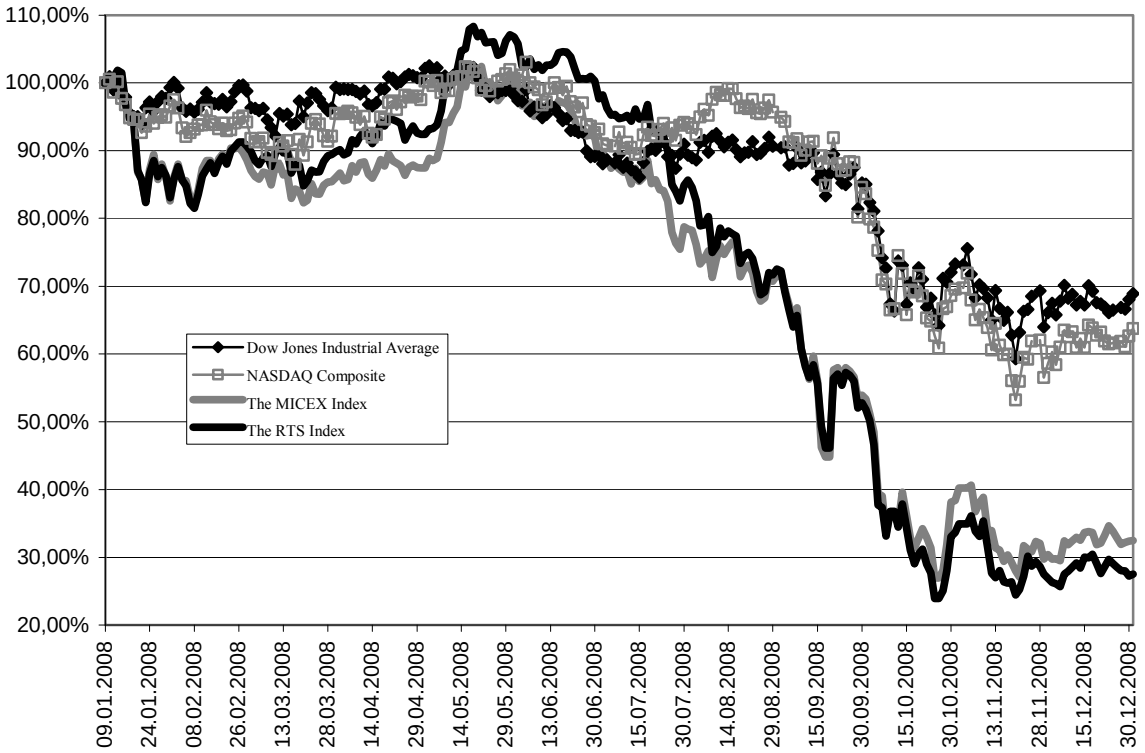


Fig. 25. Dynamics of the main USA and Russian stock indexes in 2008 (January 9, 2008 = 100%)

So, if one looks at the stock markets of other developed countries, it will become obvious that these also declined, as shown by the results of 2008. Some stock indices of European countries dropped on the whole in the same degree as did US indices. Germany's DAX-30

dropped over last year by 40.37%, whereas France's CAC-40 – by 42.68% (*Table 36*). Japan's stock index Nikkei-225 also plunged 42.12% by comparison with the year's beginning.

The stock markets of developing countries demonstrated in 2008 a similar trend by shedding 20 – 50%. As a result, the decline of the aggregate stock index of developing countries, as estimated by Morgan Stanley on the basis of the annual results, amounted to approximately 55%.

While analyzing the main factors determining the indices' dynamics, one should note the following events in the period of January through July 2008: the negative situation on the US debt market which triggered the world economic crisis; negative macroeconomic and corporate news, the considerable growth of international oil prices from February onwards (to the level of 150 USD/barrel. in the first half of July 2008); the USD's weakening on the world market; the bankruptcy of one of the world's biggest investment banks, Bear Stearns (in March); and the repeated lowering of the US FRS's discount rate (to 2%). At the same time, in February, April and May investors began to display positive attitudes, and there was a revival of activity on the international stock exchanges, in particular in connection with growing oil prices, and positive macroeconomic reports and corporate news.

In August, the situation on the world financial markets worsened as a result of the news of the big losses suffered by two US leading mortgage agencies – Freddie Mac and Fannie Mae and the potential prospect of their nationalization; Lehman Brothers' search for investors who would be ready to buy part in this biggest investment bank's investment business; the negative macroeconomic statistics of the USA; the substantial drop in oil prices and the weakening of the ruble against the US dollar.

Among the main factors associated with the negative global situation that had their impact on the Russian market in September, it is worthwhile to note the dramatic decline of the US share market, followed by its European and Asian counterparts, as a result of the bankruptcy of one of the biggest investment banks in the USA – Lehman Brothers, and of the takeover of another one – Merrill Lynch – by the Bank of America, as well as the news of the forthcoming bankruptcy of the biggest US insurance company – AIG – and the nationalization of the mortgage agencies Freddie Mac and Fannie Mae, a slowdown of the growth rate of the world economy, and the continuing rapid decline of oil prices (below the level of 100 USD/barrel. All these factors resulted in the lowering of the main indices of developing countries by 3 – 12%, and those of the USA and Europe – by 3 – 10%, as demonstrated by the month's results.

In October the dynamics of world financial markets was developing against the background of the global liquidity crisis aggravated by a solvency crisis, negative macroeconomic statistics published in the USA, the slowdown of growth of the world economy, still further considerable drop of oil prices (below the level of 60 USD/barrel at the month's end), the consolidation of the US dollar's position, negative forecasts for the developing markets, and lowering demand for raw materials. The measures adopted by the governments of some countries in order to support the financial sector only confirmed the existing fears of further deepening of the financial crisis. All this resulted in the continuation of the downward trends displayed by the basic international stock indices, which dropped on the markets of developing countries by 15 – 40%, and on the markets of the USA and Europe – by 20 – 30%.

In November and December the situation on world financial markets was characterized not only by periods of dramatic decline against the background created by negative news, but

also by those of temporarily growing investor optimism as a result of the adoption, by the governments of some countries, of measures designed to ensure the stabilization of their financial systems. Among the main factors determining the negative global situation, we should note the following ones: the US Treasury Department's refusal to buy out from banks their non-liquid mortgage-related assets; the aggravation of the global liquidity crisis, the dwindling profits of US motor-car companies (General Motors, Ford) and biggest banks (Citigroup, J.P.Morgan Chase&Co, Goldman Sachs and Morgan Stanley); considerable losses of the Swiss bank *Credit Suisse* and of the biggest French bank *BNP Paribas*; the purchase by the UK Government of 57.9% of shares in the country's biggest bank – the Royal Bank of Scotland; the negative macroeconomic news from the USA; the plummeting oil prices (they dropped below 50 USD/barrel in November and then sunk under 35 USD/barrel by late December); and the strengthening of the US dollar against the euro on the international currency market. On the other hand, growth on world markets was promoted by: the US Treasury Department's decision to allocate financial aid to Citigroup in the amount of 20 bn USD; the lowering key rates of the US FRS, the European Central Bank (ECB), the Bank of England, and the Central Banks of Switzerland, Sweden and South Korea; the US Administration's decision to grant a government credit to US motor-car companies (General Motors Corp. and Chrysler Ltd.) in the amount of 17.4 bn USD; as well as the development, by some governments, of other measures designed to support the national economies of their countries. These factors created the multi-vector movements of the basic international stock indices in November – December 2008. Thus, in November the markets of developing countries displayed an increase of the main indices by 5 – 20%, the markets of the USA and Europe – both the rise of some indices by 2 – 8% and the decline of the other main indices, on the average, by 1%. In December, the stock indices of developing countries generally demonstrated an increase of 1 – 12%, while those of the markets of the USA and Europe were in the main declining (by 1 – 4%).

Corporate news

The changed credit ratings. The improved performance of some Russian corporations was reflected by their earning of relatively high long-term credit ratings or by the revision of their current rating status. At the same time, the world financial crisis inevitably resulted in some adjustment of these ratings.

Thus, on March 17 2008, the international rating agency *Standard&Poor's* (S&P) revised its forecast of the rating on the Open-end Joint-stock Company "Rostelekom" and then changed it from "stable" to "positive"; its long-term credit rating was confirmed to be at the level "BB-", while on December 16 its long-term credit rating was changed from "BB-" to "BB" – with a stable forecast, due to the improvement of the company's indices.

On April 1 2008, the rating agency *Fitch Ratings* upgraded its long-term ratings (foreign- and national-currency denominated) on the Open-end Joint-stock Company "Gazprom" from "BBB-" to "BBB", and its forecast of the company's ratings – from "positive" to "stable", since its financial indices had improved.

On July 11 2008, the agency *Fitch Ratings* upgraded its long-term foreign currency rating on the Open-end Joint-stock Company "Tatneft'" (denominated in foreign currencies) from level "B+" to "BB", and its rating forecast from "positive" to "stable", due to the improvement of company's corporate governance.

On July 16 2008, the international rating agency *Moody's Investors Service* upgraded its long-term rating on foreign-currency deposits of Sberbank of Russia from Baa2 to Baa1 (the highest rating ever granted to a Russian bank by *Moody's Investors Service*); the rating forecast was upgraded to "positive". Besides, the forecast of ratings on the issues of outstanding notes floated by Sberbank of Russia under MTN Program. was changed from "stable" to "positive".

On August 20, the international rating agency *Standard&Poor's* confirmed its BBB- credit rating for the Open-end Joint-stock Company "GMK "NorNikel'", after having analyzed its financial and operational indices and the shareholder structure; besides, it confirmed its forecast ("stable"). *Standard&Poors* also confirmed the BB long-term credit rating and the ruAA national scale rating on the Open-end Joint-stock Company "Mosenergo"; the forecast was "stable".

On October 24, the international rating agency *Standard&Poor's* downgraded its forecast of the rating on Open-end Joint-stock Company "Gazprom" from "stable" to "negative" BBB+/A-2 BBB+/A-2 (while confirming its BBB credit rating); the forecast of the rating on VTB Bank was also changed from "stable" to "negative", which coincides with the forecast of the Russian Federation's sovereign ratings; the bank's BBB+/A-2 long- and short-term credit ratings and its ruAAA national scale rating were confirmed. Also on 24 October, *Standard&Poor's* confirmed its rating on Open-end Joint-stock Company "Gazprom Neft", its forecast being "stable".

On November 13, the international rating agency *Standard & Poor's* recognized Open-end Joint-stock Company "NK 'Rosneft'"" one of the best in Russia in terms of its information openness (second place), while on 8 December it confirmed its "stable" forecast of the rating on the above company.

Besides, on December 10 2008 *Standard&Poor's*, in connection with the deteriorating conditions for the activity of the Russian oil sector downgraded its forecast of the rating on Open-end Joint-stock Company «LUKOIL» from "positive" to "stable"; it also confirmed the company's BBB long-term credit rating and its ruAAA+ national scale rating.

Results of financial activity. In October – December 2008, many companies published their financial results for the current year, among which the following information is noteworthy.

On October 28 2008, Open-end Joint-stock Company "Gazprom Neft" published its Q III 2008 results for Q III 2008: net profit increased by 11% - to 21.5 bn rubles, while the amount of net profit in the first 9 months of 2008 increased by 51% - to 83.4 bn rubles.

On November 10, Open-end Joint-stock Company "Rostelekom" published its financial results for the first 9 months of 2008 in accordance with the Russian accounting standards (RAS): its profit from sales rose by 8.1% - to 8,852.6 million rubles; its OIBDA-based rate of return amounted to 26.0%; proceeds - to 46,414.0 million rubles; and its net profit – to 6,929.5 million rubles (against 8,844.8 million rubles in the same period of 2007). And on December 8 Open-end Joint-stock Company "Rostelekom" published its non-audited consolidated results for the first half-year 2008 in accordance with the IAS: its net profit increased to 9.8 bn rubles (fourfold - by comparison with the same period of 2007); its OIBDA (operating profit before depreciation, devaluation of its non-operating assets; and the loss (profit) from withdrawal of fixed assets) – to 7.8 bn rubles (14% higher than in 2007); its OIBDA-based rate of return amounted to 25%.

On November 14, Open-end Joint-stock Company "Mosenergo" published its financial results for the first 9 months of 2008 in accordance with the Russian accounting standards: its net profit rose by 201.49 million rubles by comparison with the same period of 2007 - to 1,466.83 million rubles; profit from sales amounted to 1,740.31 million rubles, which is by 955.57 million rubles (or 121.8%) higher than in 2007; proceeds were as high as 66,078.16 million rubles, having increased by 12,914.03 million rubles (or by 24.3%) by comparison with the level of 2007. And on 25 December Open-end Joint-stock Company "Mosenergo" published its IAS-based non-audited consolidated intermediate financial report for Q III and the first 9 months of 2008: the proceeds of sales in the first 9 months of 2008 amounted to 66,079 million rubles (a 12,915 million rubles (or 24.29%)-rise on the same period of 2007); the proceeds in Q III 2008 increased by 5,678 million rubles (or by 46.03%).

On December 1, Open-end Joint-stock Company "NK «Rosneft" published its consolidated financial report based on US GAAP for Q III and the first 9 months of 2008: net profit in the first 9 months of 2008 amounted to 10.3 bn USD (by 139.0% more than the sum of 4.3 bn USD received in the first 9 months of 2007); EBITDA amounted to 17.08 bn USD (by 81.7% more than in the first 9 months of 2007). In Q III 2008, EBITDA amounted to 5.3 bn USD (31,4% higher than the sum of 4,1 bn USD in Q III 2007), and net profit – to 3.47 bn USD (by 79.9% higher by comparison with the sum of 1.93 bn USD received in 2007).

On December 11, Open-end Joint-stock Company "LUKOIL" published its consolidated financial report for the first 9 months of 2008 based on US GAAP: its net profit amounted to 10,765 million USD (by 70,9% more than that received in the first 9 months of 2007); EBITDA rose by 60.6% and amounted to 16,652 million USD; the proceeds of sales increased to 89,265 million USD, or by 56.3%.

On December 15, Open-end Joint-stock Company "Gazprom Neft" published its financial results based on US GAAP for Q III and the first 9 months of 2008: its net profit in Q III 2008 was 1,594 million USD (against 957 million USD in 2007); its profit before taxes and interest and depreciation charges (EBITDA) amounted to 2,642 million USD (against 1553 million USD in 2007); its proceeds amounted to 9,,638 million USD (against 5435 million USD in Q III 2007). Net profit in the first 9 months 2008 was 5,201 million USD (by 84.5% higher than in 2007); EBITDA amounted to 7,761 million USD (by 73% higher than the 2007 index); and proceeds – 27,315 million USD (by 86% higher than in 2007).

On 22 December, "Sberbank of Russia" published its financial results of the first 11 months of 2008 in accordance with the Russian accounting standards: profit before profits tax amounted to 146,0 bn rubles (against 148,9 bn rubles in the first 11 months of 2007), net profit – to 113,2 bn rubles (against 118,4 bn rubles in 2007).

Also on December 22, Open-end Joint-stock Company "Tatneft" published its non-audited consolidated intermediate abridged financial report, based on US GAAP, for the first 9 months 2008: its proceeds from sales amounted to 14,973 million USD (against 10,235 million USD in the same period of 2007); and its net profit – to 1,204 million USD (against 1,169 million USD in the same period of 2007).

On December 30, Open-end Joint-stock Company "Gazprom" presented its IAS-based consolidated intermediate shorter financial report for the first half-year 2008: the amount of its proceeds from sales (less excises, VAT and customs duties) increased by 52% - to 1,743 bn rubles; its operating expenses rose 30% to 1,026.6 bn rubles; and its profit amounted to 609,35 bn rubles (53% higher than in the same period of 2007).

Mergers, takeovers, partnerships, reorganizations. In 2008, some Russian companies continued to acquire new assets – including foreign ones, and to establish long-term contacts designed to expand and enlarge their businesses, and to improve their performance. Besides, some companies reorganized and restructured their businesses.

Open-end Joint-stock Company "Gazprom"

On February 21 2008, Open-end Joint-stock Company "Gazprom" signed, with *Total* and *StatoilHydro* an agreement on the creation of a special-purpose company, *Shtokman Development AG*, in order to implement the first stage of the development of the Shtockman deposit (in *Shtokman Development AG*'s capital "Gazprom" holds 51%, Total – 25%, and StatoilHydro – 24%); the company is registered in Switzerland.

On March 18 2008, Open-end Joint-stock Company "Gazprom" and the Bolivian state-owned oil-and-gas company *YPFB* signed an Agreement on prospecting work in the territory of Bolivia (Sunchal, Acero and Carohuaicho).

On April 3, Open-end Joint-stock Company "Gazprom" and *Siemens AG* signed an Agreement on strategic partnership, which opened up new opportunities for their more extensive cooperation in the territory of Russia and other countries in the oil and gas sphere.

On May 23, OJSC "Gazprom" and the company *Petrovietnam* signed an Agreement on their further cooperation, which envisaged prospecting work and further development of four new blocks on Vietnam's continental shelf, as well as the establishment of a joint venture, "GazpromViet", designed to promote participation of these two companies in oil and gas projects in the territories of Russia and other countries.

On September 29, OJSC "Gazprom" and *Kogas* signed a Memorandum of Mutual Understanding for supply of natural gas from Russia to Korea, which envisaged the possibility of putting a pipeline for supplying natural gas to consumers in the Republic of Korea across the Korean Peninsula, as well as prospecting along this route.

And on October 2, OJSC "Gazprom" and the German company *E.ON AG* signed an Agreement on joint participation in a project for developing the South Russian oil and gas deposits, which envisaged an exchange of assets as a result of which E.ON AG was to receive 25% minus one ordinary registered share in the charter capital of OJSC "Severnefteegazprom", and thus to take part in the development of the South Russian oil and gas deposits. OJSC "Gazprom" was to receive 49% in Close-end Joint-stock Company "Gerosgas", the owner of 2.93% of shares in OJSC "Gazprom".

OJSC «Gazprom Neft»

On May 28, OJSC "Gazprom Neft" and OJSC "Moskovskaia neftegazovaia Kompaniia" ["Moscow Oil-and-Gas Company"] (MNGK) registered a joint venture on the principle of parity (50% of its charter capital belongs to OJSC "Gazprom Neft", and 50% – to MNGK) for managing the company *Moscow NPZ Holdings B.V.*

On July 4, OJSC "Gazprom Neft" and *Yokogawa Electric Corporation* signed an agreement on strategic cooperation, whereby the cooperation of these two companies was envisaged in implementing the state-of-the-art systems for managing technological processes, measurement systems and information technologies manufactured by *Yokogawa Electric Corporation* at the enterpris incorporated in OJSC "Gazprom Neft".

On July 23, OJSC "Gazprom Neft" and OJSC "Aviatsionnaia kompaniia 'Transaero'" ["The 'Transaero' Airline"] signed an agreement on cooperation designed to further improve

the efficiency and stability of the fuel supply systems at St. Petersburg and in other regions of the Russian Federation.

OJSC «LUKOIL»

In February, OJSC "LUKOIL" and OJSC "Gazprom Neft" launched their joint business of fuelling aircraft at Pulkovo Airport. Besides, OJSC "LUKOIL" completed the deal whereby it acquired 100% of shares in Close-end Joint-stock Company "Assotsiatsiia sotsial'no-ekonomicheskogo, nauchnogo I delovogo sotrudnichestva "GRAND"" [Association for Socio-Economic, Scientific and Business Cooperation "GRAND"], as well as 100% of shares in "Mega-Oil M" Limited Liability Company, among whose assets there are 122 filling stations situated in Moscow City and Moscow Oblast, as well as 26 filling stations in Pskov, Kaluga, Novgorod and Rostov Oblasts. The volume of sales of these filling stations is estimated to be more than 300 thousand tons per annum.

In March, "LUKOIL Overseas" (a 100-% affiliated company of OJSC "LUKOIL") completed a deal to the value of approximately 580 million USD with Close-end Joint-stock Company "MGNK 'Soiuzneftegaz'" for the acquisition of 100% of shares in *SNG Holdings Ltd.* group, including the company "Soiuzneftegaz Vostok Limited", a party to the production-sharing agreement (PSA) with regard to the deposits in the Southwest Gissar and Ustyurt region in the Republic of Uzbekistan. The other party to this PSA, as the government's empowered agency, was the national holding company "Uzbekneftegaz".

On April 30, *LUKOIL Europe Holdings B.V.* (a 100-% affiliated company of OJSC "LUKOIL") closed the deal for the purchase of the Croatian company *EUROPA-MIL*. The number of assets thus acquired includes 9 filling stations in Zagreb and Split, 5 land plots for the construction of filling stations, and a sea/railway petroleum-product terminal with a capacity of 8,000 m^3. The average daily volumes of sales of petroleum products by the filling stations belonging to *EUROPA-MIL* amounts to 11 tons.

On June 23, OJSCC "LUKOIL" and the Italian company *ERG S.p.A.* signed an agreement for the creation of a joint venture for managing the oil-processing complex ISAB near Priolo (Sicily). In the new joint venture, OJSC "LUKOIL" will own 49%, *ERG* – 51%. The value of the deal was 1,347 bn euro, less the value of stocks of oil.

On July 22, OJSCC "LUKOIL" and PDVSA – the National Oil Company of Venezuela – signed an agreement on the joint exploration of Junin-3 block in the Orinoco heavy oil belt in Venezuela (for a fixed period of two years with the possibility of prolongation), in the course of which a joint study will be performed to evaluate the project of extracting extra-heavy oil, its further refining in the territory of Venezuela and subsequent export; the cost of exploration will be evenly shared between the two parties.

On November 24 2008, OJSC "LUKOIL" completed a deal whereby it acquired a big wholesale outlet in Turkey – 100% of shares in the Turkish company *Akpet*.

RAO «UES of Russia»

In 2008, the process of reorganizing RAO "UES of Russia" was continued.

On February 11, the sale of 49% of shares in OJSCC "Kostromskaia sbytovaia kompaniia" ["Kostroma Sales Company"], formerly owned by RAO "UES of Russia", to the value of 150 million rubles, took place; the buyer was "TK Altai Limited Liability Company". On 28 February there was an open auction for the sale of a 14.17-% block of shares in OJSCC "Novosibirskenergo", owned by RAO "UES of Russia", for a sum of 3.4 bn rubles. On 17 March, a 450 million rubles deal for the sale of 49% of shares in OJSCC "Kolenergosbyt"

["Kola Electricity Selling Company"] (formerly owned by RAO "UES of Russia") was completed, with the shares having been sold through the ISTRA Trading and Information System.

On May 1, the reorganization of Close-end Joint-stock Company "Inter RAO UES", OJSCC "Severo-Zapadnaia TETs" ["North-West Power Stations"], and OJSCC "Ivanovskie PGU" ["Ivanovo Power Generating Stations"], in the form of their merger with OJSCC "Inter RAO UES" (its former name being OJSCC "Sochinskaia TETs" ["Sochi Power Stations"]) was completed. As a result of the merger, these companies acquired the status of branch companies of "Inter RAO UES" and thus were terminated as independent joint-stock societies.

On May 28, there was an open auction for the sale of a 50.9% block of shares in OJSC "Mosenergosbyt" ["Moscow Electricity Selling Company"] belonging to RAO "UES of Russia", and on 29 May – open auctions for the sale of shares in OJSC "Komi energosbytovaia kompaniia" ["Komi Electricity Selling-Supplying Company"] (50.11% of shares), OJSC "Stavropol'energosbyt" ["Stavropol Electricity Selling Company" (55.13%), OJSC "Brianskaia sbytovaia kompaniia" ["Briansk Electricity Selling Company"], (49%) and OJSC "Arkhangelskaia sbytovaia kompania" ["Archangelsk Electricity Selling Supplying Company"] (49%), which were owned by RAO "UES of Russia". On 17 June, there was an open auction for the sale of a 48,43-% block of shares in OJSC "Energosbyt Rostovenergo" ["Rosrovenergo Elictricity Selling Company"] owned by RAO "UES of Russia"; on 18 June – an auction for the sale of a 100-% block of shares in OJSCC "Tiumenskaia energosbytovaia kompania" ["Tiumen Electricity Selling Company"]; and on 25 June, a deal was closed for the sale of 49% of shares in OJSC "Cheliabenergosbyt" [Cheliabinsk Electricity Selling Company] belonging to RAO "UES of Russia".

On June 6, the shares of RAO "UES of Russia" were no more circulated on the exchange. As a result of the final stage of its reorganization, from 1 July 28 holding companies were separated from RAO "UES of Russia". RAO "UES of Russia", simultaneously with the spinning-off of the holding companies, was merged with Federal Network Company and so was terminated as a juridical person.

"Sberbank of Russia"

On February 1, "Sberbank of Russia" and OJSC "Federal'naia gidrogeneriruiushchaia kompaniia" ["Federal Hydrogenerating Company"] (OJSC "GidroOGK") concluded a general agreement on cooperation in the sphere of developing electric power engineering.

On June 7, "Sberbank of Russia" and *Deutsche Bank AG* signed a Memorandum of Mutual Understanding, which envisaged further development of cooperation between the two banks in the part of providing their clients with efficient financial instruments and joint services on international capital markets; in the sphere of project financing and structured products; corporate, trade and export financing; was well as retail business. The parties are planning to work jointly on the financing of projects within the framework of preparation for and conduct of the 2014 Winter Olympic Games at Sochi.

Other companies

On May 20, the Ministry of Foreign Affairs of the Russian Federation and OJSC "GMK 'NorNikel'" signed an agreement on cooperation, which envisaged the Ministry's support of "GMK 'NorNikel'"'s foreign economic activity OJSC and the provision of relevant information and consulting, and on the other hand – the company's assistance to the Ministry, as well as their joint activity in the international sphere.

And on 4 July, a joint venture, of OJSC "Таtneft'" and Preiss-Daimler Group, for the production of fiber optic materials was launched in the Alabuga special economic zone.

Attraction of capital. In the past year, Russian company were rather actively pursuing the policy aimed at attracting additional investments, including on foreign financial markets, as well as were consolidating their position on world capital markets.

In February 2008, OJSC "NK «Rosneft" attracted a syndicated bank credit in the amount of 3 bn USD from a group of international banks for the period of 5 years at a rate of LIBOR + 0.95% (secured by export contracts for the sale of oil). By attracting this credit, as well as using its own monies, OJSC "NK 'Rosneft", on 14 March, redeemed in full the second tranche (5.2 bn USD) of the short-term credit attracted by this company in early 2007 in order to finance its newly acquired assets. And on 17 September OJSC "NK 'Rosneft" redeemed the third and final tranche (2.3 bn USD) of the bridge loan granted to it by *ABN AMRO*, *Barclays*, *BNP Paribas*, *Calyon*, *Citibank*, *Goldman Sachs*, *J. P. Morgan Chase*, and *Morgan Stanley*, in the amount of 22 bn USD, which had been attracted in early 2007.

On June 17, OJSC "GMK 'NorNikel" attracted a syndicated bank credit for the period of 3 years in the amount of 1.5 bn USD, these monies then being used for refinancing the short-term unsecured loan in the amount of 2.5 bn USD, granted to it by the banks *BNP Paribas* and *Societe Générale Corporate&Investment Banking (SG CIB)* for acquiring all the issued and circulating ordinary shares of the company *LionOre Mining International Limited*.

On June 20, OJSC "LUKOIL" attracted a syndicated bank credit in the amount of 1 bn USD, which was used to repay the residual debt of LUKOIL Finance Ltd. To a syndicate of international banks against the credit attracted in 2005 for financing the purchase of the company *Nelson Resources*.

In July, OJSC "Gazprom Neft" closed the deal of attracting a syndicated bank credit in the amount of 1 bn USD, which consisted of two tranches: a three-year tranche and a five-year tranche (with margins of 1.5% and 1.75% respectively). It is intended to use this credit for general corporate needs, as we'll as for the refinancing of the existing outstanding debt. Besides, on 15 December, OJSC "Gazprom Neft" and Vneshekonombank signed an agreement on the granting of a credit line with the limit of 750 million USD (five tranches, in the amount of 150 million USD each) for the refinancing, in part, of the payments earmarked for the redemption of the main debt against the syndicated bank credit in the amount of up to 2.2 bn USD, which had been granted to this company by a syndicate of foreign banks.

On October 3, "Sberbank of Russia" signed an agreement on a syndicated bank credit (to be used for general corporate needs) in the amount of 1.2 bn USD for the period of 3 years, at a rate of 0.85% per annum over LIBOR. The participants in the syndicate were 15 financial institutions in Europe, North America, and Japan. And on 18 December, "Sberbank of Russia" attracted a subordinated credit in the amount of 200 bn rubles from the Bank of Russia within the framework of the government strategy of recapitalization of system-forming banks during the period of financial instability.

On October 24, VTB Bank and Vneshekonombank signed an agreement on the attraction of a subordinated credit in the amount of 200 bn rubles for the period until the end of the year 2019 at a rate of 8% per annum (in accordance with Federal Law of 13 October 2008, No 173-FZ, "On Additional Measures Designed to Support the Financial System of the Russian Federation").

On November 25, OJSC "GMK NorNikel" and a group of western financial institutions signed a credit agreement for 10 years to be covered in the amount of 278 million euro (in USD equivalent) by *Euler Hermes* credit agency, for the purpose of refinancing NorNikel''s shipbuilding program.

Placement of capital. Within the framework of the government program designed to control the financial crisis, the most liquid Russian companies of the financial sector (VTB Bank and "Sberbank of Russia") began implementing, from August 2008 onward, a policy aimed at supporting Russian companies in the real sector.

Thus, on 11 August, VTB Bank and Landesbank Berlin AG organized a syndicated bank credit for OJSC "Binbank" in the amount of 27 million USD for the period of one year, the attracted monies to be used to finance the bank's clients' trade contracts.

On 26 August, the VTB Group signed an agreement on the granting of a syndicated bank credit in the amount of 150 million USD to the Russian cargo air carrier "Volga-Dnepr", the monies to be used for refinancing the bridge loan granted in July 2007 to the companies belonging to the "Volga-Dnepr" group in the amount of 80 million USD, as well as for refinancing part of the short-term outstanding debt against other bank loans; 7 banks became participants in this syndicate.

In late October and through November, within the framework of implementing the Government Program designed to support trade networks, VTB Bank started the financing of retail companies: the first tranche in the amount of 300 million rubles was received, on 27 October, by the *Magnet Group*; the lending limit in the amount of 7 bn rubles for the period of 1.5 years was established for the company *X5 Retail Group*; the lending limit in the amount of 3 bn rubles for the operating period of up to one year was established for Close-end Joint-stock Company "Corporation GRINN", which incorporates the hypermarket chain "LINIA". In November, within the framework of expanding its cooperation with enterprises belonging to the priority sectors of the Russian national economy, VTB Bank granted financing to OJSC "AVTOVAZ" in the amount of 4 bn rubles for the period of 12 months, in order to replenish its operating assets.

Also, in order to expand its cooperation with enterprises belonging to the real sector of the economy, VTB Bank in November granted loans to the three Russian plants owned by "Trubnaia metallurgical company" (TMK) ["Pipe Metallurgical Company"] in the amount of 5.5 bn rubles for the period of one year; the financing to the enterprises belonging to *Euras Group S. A.* in the amount of 10 bn rubles; the financing to the three enterprises belonging to "UGMK-Holding" in the amount of 4.8 bn rubles; and it established for the Close-end Joint-stock Company "Transmashholding" a 6.5 bn rubles lending limit.

Besides, within the framework of expanding its cooperation with enterprises in the real sector, VTB Bank established, on 4 December, a 7 bn rubles documentary credit limit for OJSC "KAMAZ"; it granted credits to the motor plant belonging to the "SOLLERS" group in the amount of 4 bn rubles for the period of one year, besides, it opened credit lines for three enterprises belonging to the "Mechel" group in the amount of 15 bn rubles for the period of one year, in order to replenish their operating assets. On 10 December, VTB Bank granted credit to OJSC "Magnitogork Metallurgical Combine" in the amount of 4 bn rubles for the period of one year, also in order to replenish its operating assets. On 19 December, VTB Bank granted financing to JSC "ALROSA" in the amount of 44.2 bn rubles for the period of 600 days, designed to refinance its current short-term outstanding debt against the credits and

loans granted to it by Russian and foreign investors. On 24 December, VTB Bank granted financing to the regional mining subdivision of OJSC "Sibirskaia ugol'naia energeticheskaia kompania" ["Siberian Coal Energy Company"] (SUEK) in the amount of 2.5 bn rubles for the period of one year in order to provide financial backing for its current activity and for further development of its production capacity. Besides, on 25 December, VTB Bank granted financing to OJSC "NPO 'SATURN'" in the amount of 7.5 bn rubles, which was used to provide financial backing for its financial and economic activity, as well as for effectuating payments on its bonds and promissory notes.

And, on 30 December, "Sberbank of Russia" and OJSC "Magnitogork Metallurgical Combine" signed a credit agreement on the opening, for the aforesaid joint-stock company, of a non-renewable credit line in the amount of 3 bn rubles for the period of two years, earmarked for the financing of its current project of constructing a thick sheet mill.

Dividend policies. It is a well-known fact that one of the methods for increasing the attractiveness of shares is an efficient dividend policy.

On 21 May 2008, the annual general shareholder meeting of OJSC "Mosenergo" made the decision, with due regard for the fact of this joint-stock company having paid dividends on its ordinary shares, by the results of Q I 2007, in the amount of 296,290 thousand rubles, that no dividends be paid on its ordinary shares by the results of the year 2007.

On 5 June 2008, the annual general shareholder meeting of OJSC "NK 'Rosneft" made the decision to earmark, for the payment of dividends on its shares for the year 2007, the sum of 16.96 bn rubles, or 1.6 rubles per ordinary share (the payment of dividends is to be effectuated until 31 December 2008); this approved sum exceeds, by 20%, the dividends paid by the results of the year 2006.

On 9 June, the annual general shareholder meeting of OJSC "Rostelekom" approved the distribution of its profit, by the results of the year 2007, in the following way: 7,067.9 million rubles, or 75% of net profit, was earmarked for augmenting the company's own capital; and 2,356.0 million rubles (or 25% of net profit) was earmarked for the payment of dividends on its shares.

On 20 June, the annual general shareholder meeting of OJSC "Gazprom Neft" adopted the decision on the payment of dividends by the results of the year 2007 in the amount of 5.4 rubles per ordinary share (to be paid until 31 May 2009).

On 26 June, the annual general shareholder meeting of OJSC "LUKOIL" approved the payment of dividends, in the amount of 42 rubles per ordinary share (against 38 rubles by the results of 2006).

On 26 June, the annual general shareholder meeting of OJSC "Tatneft'" approved the payment of dividends, by the company's results in the year 2007, in the amount of 565% of face value per ordinary share, and 565% of face value per preference share (the period for the payment of dividend was established to be from 1 July through 31 December 2008).

On 27 June 2008, the annual general shareholder meeting of OJSC "Gazprom" made the decision concerning the distribution of its profit by the results of that financial year, including the payment of dividends per annum in the amount of 2.66 rubles per share (growth by 4.7% by comparison with that in 2006). The total sum to be earmarked for the payment of dividends by the results of 2007 was 62,971.5 million rubles, or 17.5% of net profit; the date established for the completion of the payment of dividends was 31 December 2008.

Judicial and tax disputes and proceedings. The year 2008 was also marked by several court hearings and tax disputes involving certain companies belonging to the category of Russian Blue Chips.

On 8 February 2008, Inter-regional Inspectorate of the RF FTS No 7 determined the amount of its claims against OJSC "Rostelekom" on the basis of the results of its activity in 2004 – 2006, which was 1.812 bn rubles. Of this amount, 1.412 bn rubles was constituted by taxes, and 0.4 bn rubles – by fines and penalties. OJSC "Rostelekom" disagrees with the resolutions adopted by Inter-regional Inspectorate of the RF FTS No 7, and so it is going assert its rights through judicial procedures – and, probably, through administrative procedures as well.

On 17 March 2008, OJSC "Tatneft'" announced the beginning of international arbitration proceedings against Ukraine in connection with the unlawful takeover, in October 2007, of Kremenchug NPZ (JSC "Ukrtatnaft"), the bulk of whose shares belongs to *Tamneft'* and the shareholders attached to it.

On 24 November there was a meeting of the RF Federal Antimonopoly Service, which considered an administrative case initiated against OJSC "Gazprom Neft" in connection with certain indicia of it having violated the antimonopoly law; in accordance with the meeting's resolution, a fine in the amount of more than 1.3 bn rubles was imposed on OJSC "Gazprom Neft".

Annex 1

Chronology of the main foreign and domestic events that have influenced the dynamics of the Russian financial market in September – December 2008

Date	Main Events
1 September	– low rates of deductions to the mandatory reserve fund from 1 September
11 September	– RF CB publishes the notification that from 29 August through 5 September the volume of gold and foreign exchange reserves decreased by 8.9 bn USD
1 – 14 September	– a moderate decline, on the Russian share market, of the value of the majority of Blue Chips – by 2 – 4%, against the backdrop of lowering oil quotations and world stock markets' contraction
15 September	– the announcement of the bankruptcy of *Lehman Brothers*, one of the biggest US investment banks – the takeover of another biggest investment bank in the USA – *Merrill Lynch* – by a commercial bank (Bank of America, for 44 bn USD) – the news of the impending bankruptcy of biggest US insurance company – *AIG* – the news of the possibility of purchase of the investment bank *Morgan Stanley* by another bank – *Wachovia* – the refusal of the USA Federal Reserve Service (FRS) to change its basic discount rate – a dramatic drop of rates on world exchanges, including the Russian stock market
16 September	– a drop of the main Russian indices to their three – year historic lows: MICEX index by 17.5% - to 881.17 points; RTS index – by 11.5% to 1,131.12 points; a drop of Blue Chips (by 10 – 20%) – the FRS invests 70 bn USD in the national financial system, in order to bring down the discount rate on interbank credit
17 September	– a drop of Blue Chips (to 30%) and – as a result – RTS and MICEX indices; a collapse of the Russian share market, an outflow of investors from the Russian exchanges; the decision of the RF Federal Financial Markets Service (FFMS) to close down the MICEX and RTS for two days (on 17 and 18 September 2008) – panic on the world financial markets; pessimistic expectations concerning the future prospects of *Morgan Stanley* investment bank, whose shares over the period of 15 – 17 September tumbled 42% – FRS buys out 79.9% of shares in the biggest insurance company – *AIG*
18 September	– FRS grants to banks a credit in the amount of 55 bn USD – the European Central Bank, the Bank of England, the Bank of Japan, the Bank of Canada and the Swiss National Bank allocate 180 bn USD to support of financial markets – the RF CB lowers the norms of deductions to the mandatory reserve fund by 4 p. p. (in this connection, it is envisaged that each of the established norms for mandatory reserves should be gradually increased – beginning from 1 February 2009 by 2 p. p., and then from 1 March 2009 – by another 2 p. p.) – the RF CB lowers by 0.5 – 1 p.p. the interest rates on its credits granted to commercial banks – the RF CB raises the adjustment coefficients applied for calculating the value of pledges for the credits granted against "non-marketable" assets – the RF CB publishes the information that over the period from 5 through 12 September the volume of gold and foreign exchange reserves decreased by 13.3 bn USD

Date	Main Events
19 September	– a revival on the world stock markets in response to the announcement of the US Government's readiness to allocate 700 bn USD to buying out from banks their troubled assets, and to the ban imposed in the USA and the UK on short-term sales of shares issued by financial companies; also, support is promised to the share funds on the US money market; growth of the main world indices (by 3 – 8%); a sharp rise of the US share market where profiteering gains the upper hand (*Morgan Stanley*'s shares jump 20.7%) – reopening of trading on the Russian stock exchanges – the MICEX and RTS, a prevalence of profiteering inclinations (a rise of all Blue Chips by 8 –60%, led by those of VTB Bank and "Rosneft'"), a sharp rise of the exchange indices (growth of the MICEX index by 28.7% - to 1,098.95 points, of the RTS index – by 22.4% to 1,295.91 points; a suspension of trading on the MICEX and RTS for several hours, in order to bring down the market fever – the decision of the RF government to allocate more than 3 trillion rubles from the state budget to support the domestic stock and financial markets – the downgrading, by *Standard&Poor's*, of the forecast of Russia's sovereign rating from "positive" to "stable" in connection with "the growing uncertainty as to the economic policy" and "the lowering of the limits established by world banks for Russian borrowers" – the news of the purchase of part of the business of the bankrupt *Lehman Brothers* bank by *Barclays* and *Nomura* – the bankruptcy of the twelfth US bank (since the year's beginning) –*Ameribank Inc.*
22 September	– the announcement of a change in the status of the two remaining banks of the "big four" – the biggest independent investment banks in the USA (*Goldman Sachs* and *Morgan Stanley*), which became banking holding companies from 21 September; as a result of their changed status, these two banks began to enjoy the right to receive extraordinary credits from the FRS on a permanent basis – the declaration of *Mitsubishi UFJ Financial Group Inc*. of its consent to acquire a 10 – 20% stake in *Morgan Stanley* –the news of the planned upgrade of its inflation forecast by the RF Ministry of Economic Development and Trade and the introduction of a new mechanism for the payment of VAT within the framework of struggle against the liquidity crisis (the quarterly VAT can now be paid in three installments) – an increase of oil quotations, a drop in the value of US shares
24 September	– a suspension of trading on the MICEX for one 1 hour, for technical reasons – Warren Buffet 's decision to invest 5 bn USD in *Goldman Sachs* – growth of oil prices – a plan for the stabilization of the USA national economy is published, whereby it is envisaged that the US government would buy out the bad debts of US financial companies
29 September	– a sharp drop in the leading indices of the US share market in response to the refusal to adopt a draft law on the allocation of 700 bn USD to support the US financial market; growing fears of investors that the economic crisis in the USA in deepening; the key US indices fall 7 – 10% – the announcement of the purchase of *Warchovia*'s banking operations by *Citigroup*, with the US government acting as an intermediary, for 2.1 bn USD – the nationalization, by the UK government, of the UK bank *Bradford&Bingley* – the nationalization of *Fortis,* the biggest Belgian financial group – a dramatic drop in oil prices (below 100 USD/barrel) – the announcement of the acquisition, by *Mitsubishi UFG Financial Group*, of 21% in *Morgan Stanley* for 9 bn USD
30 September	– a suspension of trading on the MICEX and RTS, by order of the Federal Financial Markets Service, from 10.30 to 12.20, in connection with a record drop on the US market in response to the rejection of the draft law designed to provide support to the US financial market
1 October	– the coming into force of the RF CB's requirements concerning a mandatory notification, by banks, of their large-scale investments in securities and the granting of big loans
3 October	– a suspension of trading on the RTS – thrice during one day – the approval by the US Congress of the 700 bn dollar bailout plan to prop up the US financial sector
4–5 October	– the adoption by the Government of Germany and a consortium of private banks of a plan to rescue Germany's biggest mortgage bank – *Hypo Real Estate Holdings AG* – the French bank *BNP Paribas* takes the decision to purchase the financial group Fortis (biggest in Belgium) – the announcement, by the second biggest bank in Italy – UniCredit – of its plans to attract additional capital – the decision to provide guarantees for all bank deposits in Germany – South Korea's decision to allocate 240 bn USD from the government reserve to support the banking sector – a ban imposed in the USA on the deal of merging *Wachovia* with *Wells Fargo*
6 October	– a suspension of trading on the MICEX – three times during one day – in response to the drop of the MICEX technical index by more than 5% by the onset of trading; a suspension of trading RTS twice during one day – the issue of permission, by the RF Federal Antimonopoly Service, for the purchase, by Vneshekonombank, of OJSC "AKB 'Sviaz'-bank'" – a drop of oil prices, by the day's results, to less than 90 USD/barrel; an increasing USD's exchange rate and a lowering euro's exchange rate
7 October	– a suspension of trading on the MICEX and RTS, by the FFMS' order, for 3 and 2.5 hours respectively – the approval, by the USA FRS, of the deal of purchase, by the Japanese bank *Mitsubishi UFG Financial Group*, of up to 24.9% of shares in *Morgan Stanley* – the nationalization of the second big bank in Iceland – Landsbanki, and the allocation, to Iceland's biggest bank, of credit in the amount of 500 million euro in order to sustain its necessary level of financing; the downgrading, by the Moody's rating agency, of Iceland's credit ratings to "negative"

Date	Main Events
8 October	– a suspension of trading on the MICEX until 10 October or until a special order of the FFMS, and on the RTS until a special order of the FFMS, because of their technical indices having dropped below the established threshold; Blue Chips ended trade 10% lower than their previous close. – the cutting of interest rates by the central banks of the USA (to 1.5%), European Union (to 3.75%), the UK (to 4.5%), Canada (to 2.5%), Sweden (to 4,25%), Switzerland (to 2.5%) and China (to 6.93%) – the price of the OPEC's oil basket, for the first time that year, dropped to 80 USD/barrel
9 October	– the RF CB announces that the RF international reserves have shrunk by 16.7 bn USD over the period from 26 September through October – the announcement of the US FRS of the granting, by the US government, to the insurance company *AIG* of a new credit in the amount of up to 37.8 bn USD, against a pledge of securities – the cutting of interest rates by the central banks of South Korea (to 5%), Hong Kong (to 2%) and Taiwan (to 3.25%) – news of the nationalization of the biggest bank in Iceland – *Kaupthing*, designed to support the banking system – the decision of *Bank of America Corp*. t buy back the previously sold preference shares to the aggregate value of 4.7 bn USD – the recall of the banking license of the Close-end Joint-stock Company "MKB 'Eurasia-Center'", for its failure, among other things, to fulfill its obligations
10 October	– a suspension of the trading in shares on the MICEX and the RTS, with the exception of repo and targeted transactions – the declaration, by Moody's rating agency, of the possibility of downgrading the credit rating on the bank *Morgan Stanley* – the bankruptcy of the Japanese insurance company Y*amato Life Insurance Co.* – the continuing strengthening of the USD on the world currency market – the adoption, by the UK government, of a plan for rendering financial support to the banking sector
12 October	– the decision of the European Union governments to allocate more than 1.5 trillion euro to underwriting interbank credits – the completion of the acquisition of 21% of shares in Morgan Stanley by the Japanese bank *Mitsubishi UFG Financial Group* for 9 bn USD
13 October	– a suspension of trading on the MICEX and RTS due to the initial growth and the subsequent decline of their technical indices below the established threshold – the approval, by the government of Germany, of the plan envisaging the rendering of financial support to banks in the amount of 480 bn USD; the decision of the government of France to underwrite interbank credits in the amount of 320 bn euro
14 October	– the coming into force of the laws designed to ensure stabilization of the Russian financial market: on the granting to banks of the sum of up to 50 bn USD for the redemption of their foreign credits and loans (through Vneshekonombank) and on the granting, by the RF Central Bank, of unsecured credits to the banks whose ratings are not lower than the established level – the coming into force of the alterations introduced in the RF Tax Code concerning the payment of VAT by installments (on a monthly basis, for three months after the relevant tax period) – the announcement of the plan to purchase, for 1.9 bn USD, of 75.65% of shares in the US company *Sovereign Bancorp* by the Spanish bank *Banco Santander*
15 October	– a temporary suspension of trading on the MICEX and RTS because of their technical indices having dropped below the established threshold; the majority of Blue Chips ended trade 10% lower than their previous close – the purchase of *Sobinbank* by *Gazenergoprombank* for a symbolic sum – the lowering, by the RF CB, of the mandatory reserve norms
16 October	– the RF CB announces that the RF international reserves have shrunk by 15.5 bn USD over the period from 3 through 10 October
17 October	– the purchase of the bank "Globeks" by Vneshekonombank for a symbolic sum as a result of the former's problems with liquidity
22 October	– the announcement of the losses suffered by the US bank *Wachovia Corp*. in Q III 2008 in the amount of 23.89 bn USD – the announcement of the losses suffered by one of the biggest Swiss banks – *Credit Suisse* – in the amount of 1.46 bn euro in the first 9 months of 2008 – oil prices drop below 70 USD/barrel; the USD strengthens on the world currency market – the purchase of OJSC "AKB Rossiiskii kapital" by the bank "OJSC 'Natsional'nyi reservnyi bank'" for a symbolic sum as a result of the latter's problems with liquidity – the recall of the banking license of the bank "Russkii bankirskii dom", for its failure, among other things, to fulfill its obligations
23 October	– the RF CB announces that the RF international reserves have shrunk by 14.9 bn USD over the period from 10 through 17 October – the downgrading of Russia's rating by *Standard&Poor's* rating agency from "stable" to "negative"
24 October	– a suspension of trading on the MICEX and RTS until 28 October or until a special order of the Federal Financial Markets Service because of their technical indices having dropped below the established threshold; Blue Chips ended trade more than 10% lower than their previous close – the OPEC cuts oil production quotas to 1.5 million barrels per day from 1 November 2008 – oil prices drop to 62 USD/barrel
27 October	– the granting to the RF CB of the right to participate in trading on stock exchanges

Date	Main Events
	– the adoption of a supplementary set of measures designed to prevent the bankruptcies of banks through special measures to be applied by the Deposit Insurance Agency (the execution of the functions of a temporary administration) and the RF CB
	– a suspension of trading on the MICEX and RTS in the second half of the day because of their technical indices having dropped more than 10% by the opening of trading
30 October	– the RF CB announces that the RF international reserves have shrunk by 31 bn USD over the period from 17 through 24 October
	– the decision is taken that Vneshekonombank will grant *UC Rusal* a credit in the amount of 4.5 bn USD against the pledge of 25% of shares in GMK "NorNikel'"
	– a temporary suspension of trading on the MICEX and RTS because their technical indices have increased more than 10% by the opening of trading
	–the US FRS cuts its rate of refinancing to 1%
	– the price of oil climbs to 65 USD/barrel
4 November	– B. Obama wins the presidential election in the USA
6 November	– the RF CB announces that the RF international reserves have shrunk by 0.1 bn USD over the period from 24 through 31 October
	– the conclusion, by the RF CB, of agreements with OJSC "MDM-Bank", the Close-end Joint-stock Company "Raffaizenbank", and "Sberbank of Russia" on the compensation of part of their losses resulting from transactions on the interbank market
	– oil prices drop below 60 USD/barrel; the USD strengthens on world currency markets
7 November	– the lowering of the discount rate of the European Central Bank (ERF CB) to 3.25%, of that of the Bank of England – from 4.5% to 3%, and of that of the Central Bank of Switzerland – to 2%
	– publication of US macroeconomic statistics indicating that the level of unemployment in the USA decreased in October to 6.5%
10 November	– the forecast of Russia's sovereign rating is downgraded by Fitch Ratings, the international rating agency, from "stable" to "negative"
11 November	–the RF CB expands the corridor for bi-currency basket fluctuation by 30 kopecks in both directions
	– a temporary suspension of trading on the MICEX and RTS because of their technical indices having dropped by more than 5% by the opening of trading
	– oil prices drop below 56 USD/barrel
12 November	– the RF CB cuts its rate of refinancing to 12% per annum
	– the recall of the banking licenses from Close-end Joint-stock Company "MIRA-BANK" and Close-end Joint-stock Company "EKOHATSBANK", for their failure, among other things, to fulfill their obligations, as well as the annulment of the banking license of Joint-stock Commercial Bank "MSB" in connection with its decision to terminate its operation
	– a suspension of trading on the MICEX for a whole day, and on RTS – for the second half of the day
	– the announcement, by the US Department of the Treasury, of its refusal to buy out banks' non-liquid mortgage assets
	– oil prices drop to 52 USD/barrel; the USD strengthens against the euro
13 November	– the RF CB announces that the RF international reserves have shrunk by 9.2 bn USD over the period from 31 October through 7 November
	– a suspension of trading on the MICEX until 17 November because of its technical indices having dropped below the established threshold
14 November	– the recall of the banking license of Joint-stock Commercial Bank "Lefko-bank" for its failure, among other things, to fulfill its obligations
16 November	– the decision of the Government of Italy to allocate 80 bn euro to the stabilization of the country's national economy
	– the bank *J.P.Morgan Chase&Co* makes public a 60-% decline in its net profit over the first 9 months of 2008; the announcement of large-scale dismissals of its personnel
17 November	– Citigroup's announcement that its personnel will be reduced
	– announcement of the development of a draft law designed to render support to the US motor industry
20 November	– the RF CB announces that the RF international reserves have shrunk by 21.9 bn USD over the period from 7 through 14 November
	– the recall of the banking licenses from OJSC Commercial Bank "Sibkontakt" and "Sochi" Limited Liability Company for their failure, among other things, to fulfill their obligations
	– a substantial drop of the quotations of US biggest motor companies – *General Motors* and *Ford Motor*, as well as of shares in the three US biggest banks – *Citigroup*, the Bank of America and *J.P.Morgan Chase & Co*
	– oil prices drop below 50 USD/barrel.
21 November	– the adoption of additional measures designed to render support to the RF real sector, in particular the cutting of the rate of profits tax to 20% from 1 January 2009 and the increasing of the amount of tax deduction
	– the closure of three US banks – *Downey Savings and Loan Association*, PFF *Bank & Trust*, and *The Community Bank*
24 November	– the RF CB applies, in order to estimate the credit potential of credit institutions, the rating methodology developed by the national rating agencies "RusRating" and "Ekspert RA"
	– the allocation, by the US Department of the Treasury, of 20 bn USD to *Citigroup* in order to stabilize its capital
	– preparation of an additional package of measures designed to support the US national economy

Date	Main Events
	– the imposition of a fine, by the RF Federal Antimonopoly Service, on TNK-BP (1.112 bn rubles) and "Gazprom Neft" (1.357 bn rubles) for their having violated antimonopoly legislation
27 November	– the RF CB announces that the RF international reserves have shrunk by 3.6 bn USD over the period from 14 through 21 November
	– the recall of the banking licenses from OJSC Commercial Bank "INTEGRO" and Joint-stock Commercial Bank "Kurganprombank" Limited Liability Company for their failure, among other things, to fulfill their obligations
28 November	– the decision of the UK Government to purchase 57.9% of shares in one of the country's biggest banks – the Royal Bank of Scotland
	– the RF CB expands the corridor for bi-currency basket fluctuation by 1%
1 December	– the RF CB cuts its rate of refinancing to 13% per annum
	– the allocation, by the RF CB, of credit to the Deposit Insurance Agency in the amount of 65.9 bn rubles, for the clean-up of banks
2 December	– a temporary suspension of trading on the RTS because of its technical index having dropped by more than 5% by the opening of trading
	– oil prices drop below 50 USD/barrel.
3 December	– the announcement of a merger of MDM Bank and "Ursa Bank"
4 December	– the recall of the banking licenses from OJSC "Tiumenenergobank" and OJSC Commercial Bank "Gazinvestbank" for their failure, among other things, to fulfill their obligations
	– the RF CB announces that the RF international reserves have shrunk by 5 bn USD over the period from 21 through 28 November
	– the cutting of the discount rate of the European Central Bank (ERF CB) to 2.5%, of that of the Bank of England – to 2%, and of that of the Central Bank of Sweden – to 2%
	– it is announced that the Swiss bank *Credit Suisse* suffered new losses in November and that it is planning to further reduce its personnel (by 5.3 thousand)
	– oil prices drop below 44 USD/barrel
	– the emergence of market rumors about the possibility of bankruptcy of *General Motors Corp*. and *Chrysler Lt.* in connection with their operating losses and inability to repay to their credits
	– publication of negative US macroeconomic statistics regarding, in particular, the continuing low demand for energy carriers in the USA, the growth of unemployment, and the reduction in the number of jobs and sales of new houses
	– the decision of the government of China to implement a policy aimed at the national currency's depreciation
5 December	– the RF CB expands the corridor for bi-currency basket fluctuation by 30 kopecks in both directions
	–oil prices drop below 40 USD/barrel.
8 December	– Standard&Poor's rating agency downgrades the forecast of Russia' credit rating in connection with the rapid shrinkage of its international reserves and investment flows from "stable" to "negative", and the City of Moscow's long-term rating, also from "stable" to "negative"
	– the emergence of information that a new anti-crisis plan designed to support US infrastructure and rehabilitation of the national economy is being developed
	– the bankruptcy of a big US media company – *Tribune Co*
	– oil prices rise to more than 43 USD/barrel.
10 December	– an increase of US budget deficit in November by 64.7% (by comparison with November 2007) to 164.4 bn USD
	– the decision of the Government of Sweden to grant financial aid to the country's motor companies in the amount of 2.9 bn euro.
11 December	– the RF CB announces that the RF international reserves have shrunk by 17.9 bn USD over the period from 28 November through 5 December
	–the Central Bank of South Korea cuts its discount rate (from 5.25 to 3%)
	– the RF CB expands the corridor for bi-currency basket fluctuation by 30 kopecks in both directions
12 December	– a temporary suspension of trading on the MICEX and RTS because of their technical indices having dropped by more than 5% by the opening of trading
	– a plans of US biggest bank – *Bank of America Corp*. – to reduce its personnel by up to 35,000 over the next three years
15 December	– Moody's rating agency downgrades the forecast of Russia's sovereign rating from "positive" to "stable"
	– the RF CB again expands the corridor for bi-currency basket fluctuation
16 December	– the US FRS cuts its rate of refinancing to 0 – 0.25% per annum
	– it is announced that the net profit of the US bank *Goldman Sachs Group Inc*. has shrunk over the 2007 – 2008 financial year by 80% (to 2.32 bn USD), and of that of *Morgan Stanley* – by 49% (to 1.58 bn USD)
17 December	– the RF CB expands the corridor for bi-currency basket fluctuation
	– it is announced that the biggest French bank –BNP Paribas has lost 701 million euro in the first 11 months of 2008
18 December	–the RF CB announces that the RF international reserves have shrunk by 1.6 bn USD over the period from 5 through 12 December
	– the RF CB expands the corridor for bi-currency basket fluctuation
	– the decision of the US Government to grant credit to US motor car companies (*General Motors Corp*. and *Chrysler Ltd.*) in the amount of 17.4 bn USD
	the decision of the Government of Japan to allocate 54 bn USD within the framework of its plan designed to control the economic crisis

Date	Main Events
19 December	– the recall of the banking licenses from OJSC "ZelAK-Bank", Joint-stock Bank "SETEVOI NEFTIANOI BANK" (Close-end Joint-stock Company) and the commercial bank "Baltkredobank" (Close-end Joint-stock Company) for their failure, among other things, to fulfill their obligations
22 December	– the RF CB expands the corridor for bi-currency basket fluctuation by more than 1% – the decision to adopt measures designed to support the motor car industry of Russia, in particular to allocate approximately 200 bn rubles and to subsidize the interest rates on the credits granted for purchase of inexpensive cars
24 December	– the RF CB expands the corridor for bi-currency basket fluctuation by nearly 40 kopecks – oil prices drop below 35 USD/barrel.
25 December	– the RF CB announces that the RF international reserves have shrunk by 15.4 bn USD over the period from 12 through 19 December
26 December	– the recall of the banking licenses from Commercial Bank "Borovitskie vorota" Limited Liability Company, Commercial Bank "Kapital Kredit" Limited Liability Company, and Commercial Bank "Elektronika" (OJSC) for their failure, among other things, to fulfill their obligations – the RF CB expands the corridor for bi-currency basket fluctuation
29 December	– the approval of the Strategy for the Development of RF Financial Market in the Period Until 2020 – oil prices climb to 40 USD/barrel.
30 December	– the recall of the banking license of OJSC "Agrokhimbank" for its failure, among other things, to fulfill its obligations – the decision of the US Government to purchase 5 billion worth of shares of GMAS, the financial arm of General Motors Corp., within the framework of the US government program designed to support the national motor car industry
31 December	– the adoption of the decision that the RF Government's credit guarantees in the amount of 300 bn rubles should be granted to Russia's key enterprises, and that 150 bn rubles should be allocated to support the labor market and the real sector of the national economy – the US FRS announces its plan to buy out 500 bn USD worth of securities backed by housing mortgages – the RF CB announces that the RF international reserves have shrunk by 12.6 bn USD over the period from 19 through 26 December

2.5.5. Investments of pension savings in the system of mandatory pension insurance in 2008

In the first three quarters of 2008 the value of assets in the funded component of the mandatory pension system, less the amount of insurance contributions to the Pension Fund of the Russian Federation (PFR), decreased by 0.3%. In particular, during the first half-year this index went up by 1.8% (from 402 to 409 billion rubles), as compared to growth by 2.6% in the first half-year 2007, while in the third quarter it declined by 2.1% (see *Table 37*)[39].

Table 37

Value of assets in the funded component of the mandatory pension system, 2007 - 2008 (in billion rubles)

Date	Value of assets in which pension savings transferred to asset managers were invested			Pension savings accumulated in IPF**	Total
	subtotal	including by GAM*	including by PAM*		
01.01.2007	276.2	267.1	9.2	9.96	286.2
01.04.2007	270	260.7	9.4	19.85	289.85
01.07.2007	274.5	265.1	9.4	19.25	293.75
01.10.2007	340.1	329	11.1	25.55	365.65
01.01.2008	375.1	362.9	12.2	26.8	401.9
01.04.2008	360.7	348.7	12.1	42.6	403.3
01.07.2008	366	353.7	12.3	43.1	409.1
01.10.2008	360.6	350.05	10.55	39.92	400.5
01.01.2009	no data	343.1	no data	no data	no data

Note. The estimations do not include the amount of contributions to the funded part of pension savings in the PFR.

[39] Hereinafter, the data published by the PFR and the Federal Service for Financial Markets (FSFM) are applied.

Source: * – value of net assets as estimated on the basis of data published on the PFR's website www.pfrf.ru. ** – based on the Summary Data on the activity of IPFs posted by the Federal Service for Financial Markets (FSFM) to its website www.fscm.ru.

The share of the government asset manager (GAM) in the asset value of the funded component of the mandatory pension system (less the amount of insurance contributions to the PFR) during the first three quarters decreased from 90.3% to 87.4%. This was mainly caused by switchovers of insured persons from the PFR into IPFs. In this connection, a relevant factor in the third quarter became the GAM's more conservative strategy. In conditions of crisis on financial markets its assets turned out to be better protected, and so the share of GAM in the aggregate assets constituting the funded component of the mandatory pension system increased by one percentage point.

The share of IPFs increased during the period under consideration from 6.7% to 10%. The share of private asset managers (PAM) declined from 3% to 2.6%, mainly due to the diminished market value of the assets in Q III (*Table 38*).

Table 38

The distribution of assets between asset managers and IPFs within the funded component of the mandatory pension system, 2006 – 2008 (%)

	01.01.2006	01.01.2007	01.01.2008	01.07.2008	01.10.2008
Share of assets held by GAM*	95.9	93.3	90.3	86.5	87.4
Share of assets held by PAMs*	3.0	3.2	3.0	3.0	2.6
Share of assets held by IPFs**	1.1	3.5	6.7	10.5	10.0
Total	100	100	100	100	100
Including the share of PAMs and IPFs	4.1	6.7	9.7	13.5	12.6

Note. The estimations do not include the amount of contributions to the funded part of pension savings in the PFR.

Source: * – value of net assets as estimated from the data published on the PFR's website www.pfrf.ru. ** – based on the Summary Data on the activity of IPFs posted by the Federal Financial Markets Service to its website www.fscm.ru.

More than half of the pension savings held by PAMs in trusteeship management under their agreements with the RF Pension Fund is concentrated at 5 companies (61% as of the end of Q II 2008). The two leaders – UK "Pensionnyi reserv" and UK Rosbank – were holding 13.8% and 12.6% of the total pension savings managed by PAMs respectively. On the other hand, the 10 smallest investment portfolios add up to only 0.3% of the aggregate investment portfolio held by PAMs. The average size of the investment portfolio managed by PAMs amounted to 198 million rubles, whereas the market value of 13 out of 62 investment portfolios was less than 10 million rubles

As of mid-2008, 53% of all the operating IPFs had the right to engage in mandatory pension insurance. The number of the IPFs actually involved in the mandatory pension insurance market, if taken as a percentage of the number of those endowed with the right to engage in mandatory pension insurance, was as of the same date 81% (106 out of 130 IPFs operating as insurers under the mandatory pension insurance program had had savings by mid-2008).

The sum of pension savings per IPF in mid-2008 was 406 thousand rubles, this figure still being incomparably lower than the average value of the same index in the OECD countries. As of the end of 2007, the ratio of pension savings to the number of IPF operating under the mandatory pension insurance program amounted to $ 12 thousand. In 2007, the minimum value of thin index in developed countries was $ 3 million.

The five biggest IPFs (by the volume of attracted pension savings) by mid-2008 had accumulated between them. 56% of the total sum of pension savings transferred to IPFs.

Investment of pension savings by asset managers. The structure of investments made by the GAM and the aggregate investment portfolio of all the PAMs as of the end of 2007, as well as the figures recorded as of the end of the second and third quarters of 2008 are shown in *Fig. 26–31*.

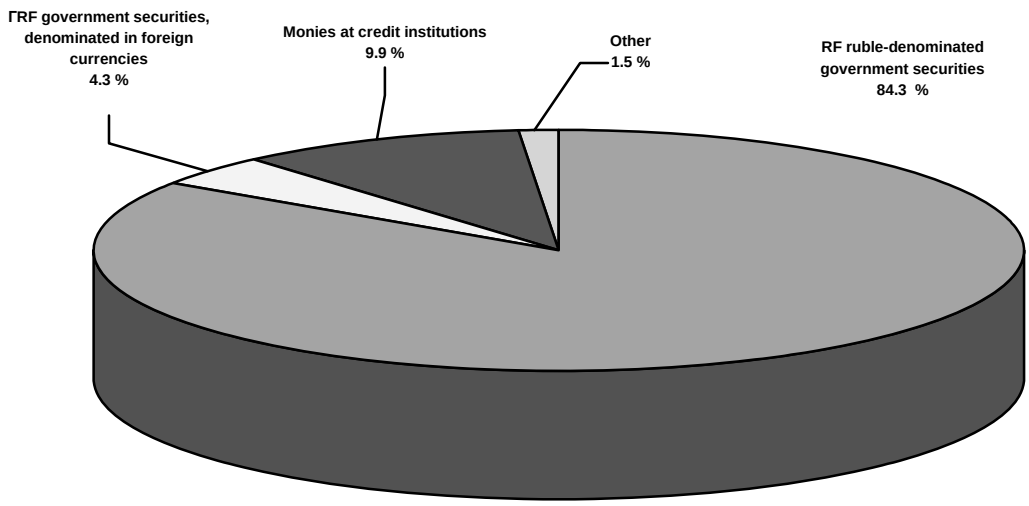


Fig. 26. The structure of the investment portfolio of the GAM (Vneshekonombank), as of the end of 2007

Investments by the GAM. In the first half-year 2008, the investment portfolio of the GAM (whose functions are performed by Vneshekonombank) was characterized by an increasing overall share of securities (from 88.6% to 96.6%) and a declining share of the funds held on accounts at credit institutions (from 9.9% to 1.4%). At the same time, the share of investments in government saving bonds (GSO)[40] in the investment portfolio of GAM increased from 28% to 38%,

[40] Government saving bonds (GSO) are the non-marketable securities issued by the RF Ministry of Finance for institutional investors. The investments in GSO were opened from mid-2007 onwards. There are no such securities in PAMs' portfolios.

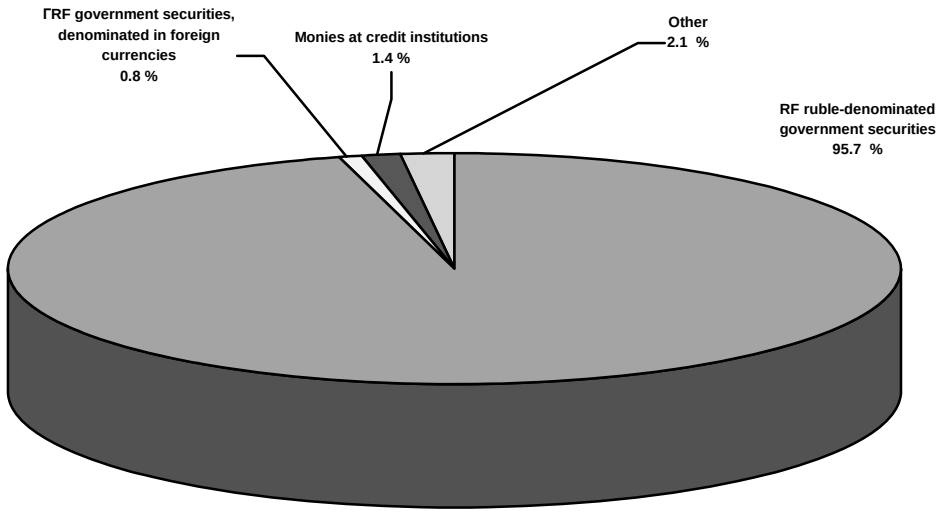


Fig. 27. The structure of the investment portfolio of the GAM (Vneshekonombank), as of mid-2008

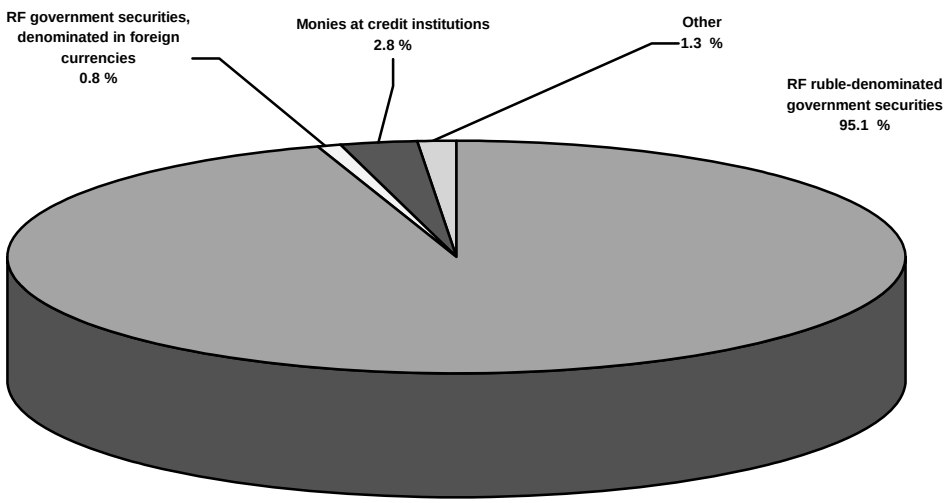


Fig. 28. The structure of the investment portfolio of the GAM (Vneshekonombank), as of end of Q III 2008.

The third quarter saw no significant changes in the structure of the GAM's investment portfolio. An increase in the amount of funds held on accounts at credit institutions (from 1.35% to 2.8%) can, however, be noted, although in the fourth quarter thin index declined to 0.9%.

Investments by PAMs. In the structure of investments made by PAMs in the first half-year 2008 the same trend (which first appeared in 2007) was observed, characterized by a decreasing share of RF government securities and the increasing one of corporate bonds. The share of federal debt liabilities diminished in 2007 from 10.4% to 4.4%, and in the first half-year 2008 it further declined to 2.7%. The share of subfederal debt liabilities changed only slightly – from 11.2% to 10.9%. Simultaneously, the share of corporate bonds in the PAMs' aggregate investment portfolio increased from 38.8% to 47.1%.

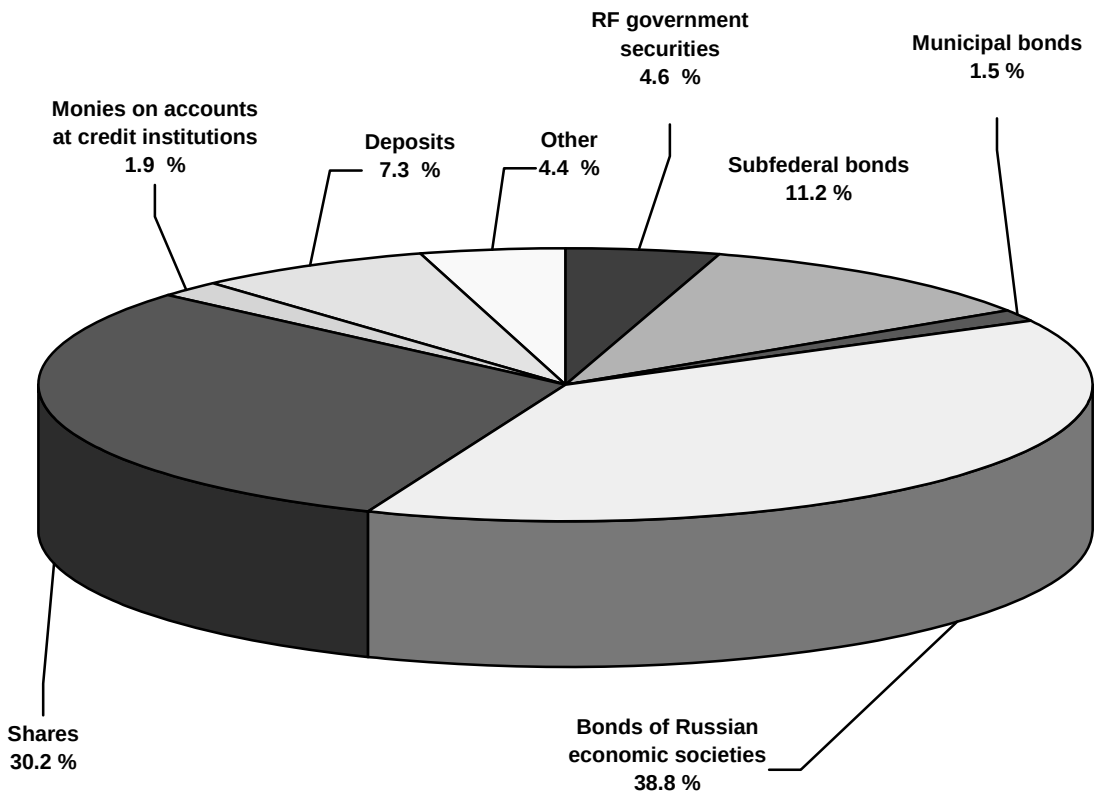


Fig. 29. The structure of the investment portfolio of private asset managers, as of the end of 2007.

In the short term the growth of the share of corporate bonds indeed could have been well-justified. As is seen from *Fig. 32*, the indices of corporate and government bonds were changing during the period under consideration according to rather similar patterns. In this connection, the OFZ index[41] increased by 2.1%, while the index of corporate bonds – by 2.4%; however, in June 2008 the latter index began to decline, and in 12 trading days it fell by more than 1%[42]. During the second half-year the discrepancies demonstrated by the values of the two indices became even more noticeable.

[41] The bonds of the federal loan.

[42] The MICE corporate bonds index is not a sufficiently precise value to be applied in estimating the effectiveness of investments made by PAMs in corporate bonds, because its composition is much broader than the bonds included in the top-level quotation list and permitted for PAMs to invest pension savings in. However no estima-

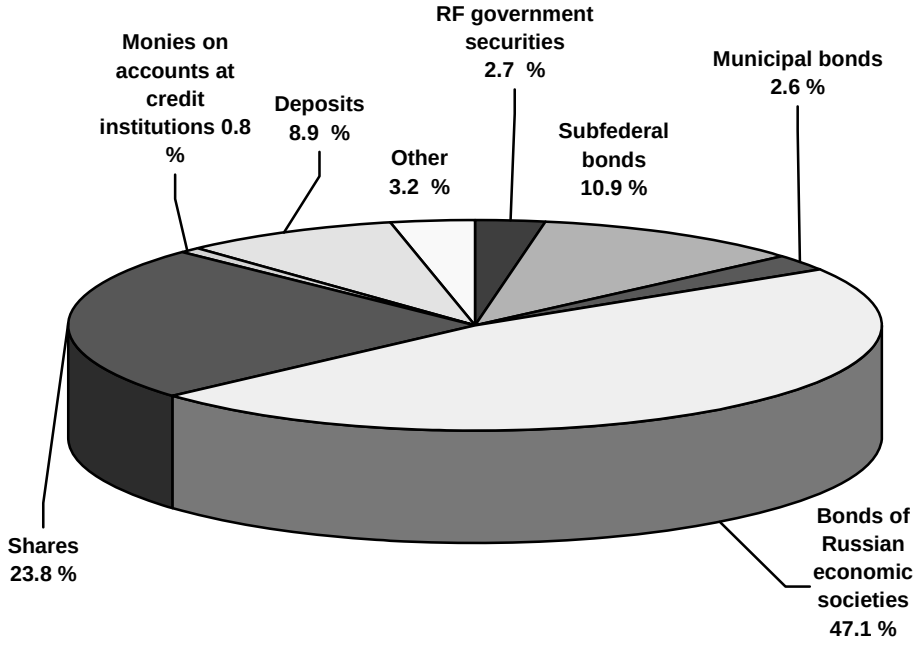


Fig. 30. The structure of the investment portfolio of private asset managers, as of end of Q II 2008.

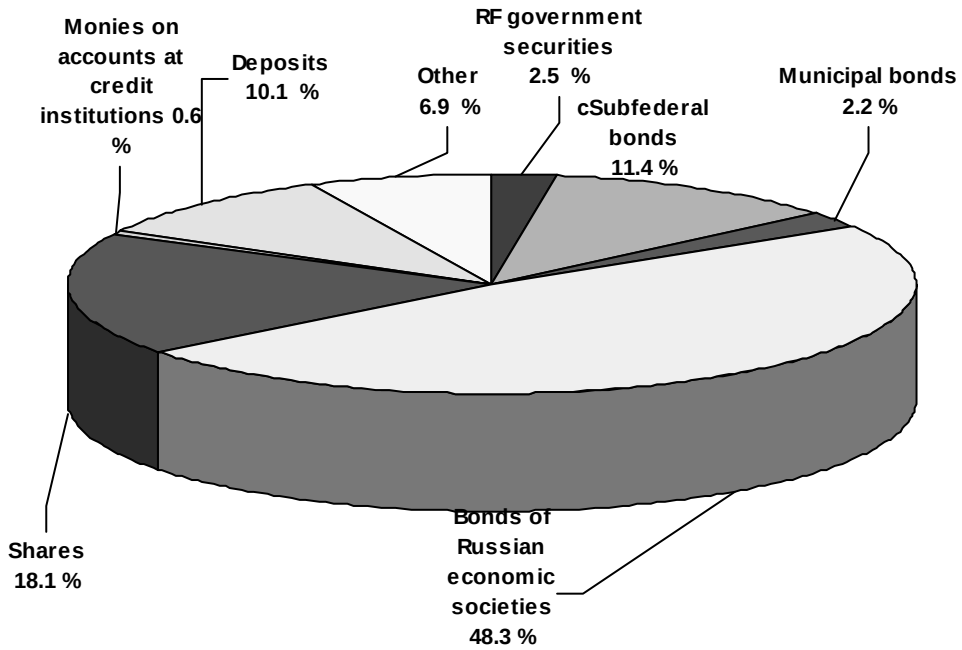
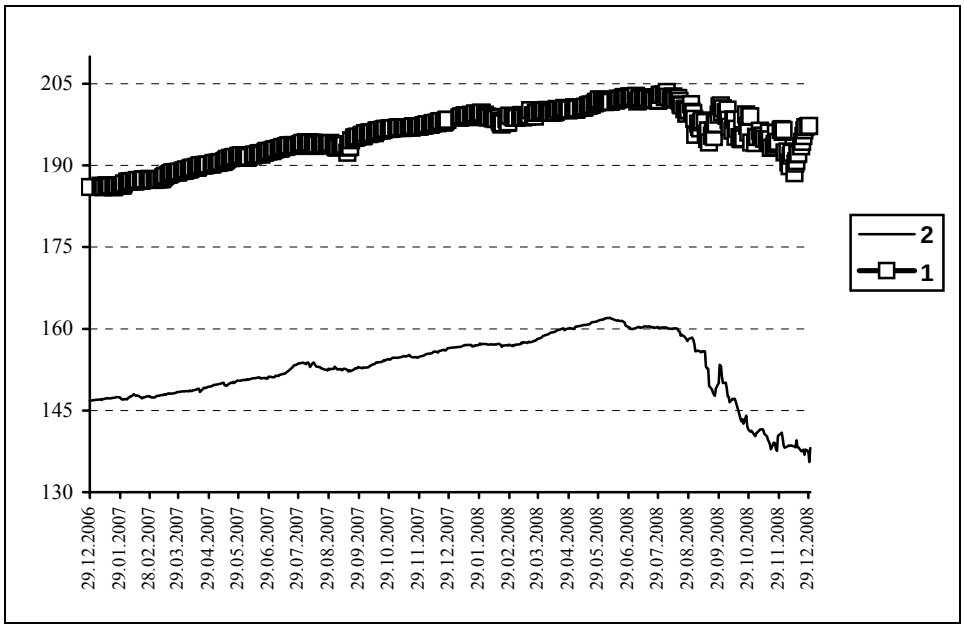


Fig. 31. The structure of the investment portfolio of private asset managers, as of the end of Q III 2008.

tion was made of the index oriented to the investment portfolio of PAMs and based on the funded component of the mandatory pension insurance system.



1 – The ZENIT Bank's index of RF government bonds (ZETBI-OFZ).
2 – The MICE corporate bonds index (MICEX RCBI-TR).
Sources: The MICE's and the ZENIT Bank's websites.

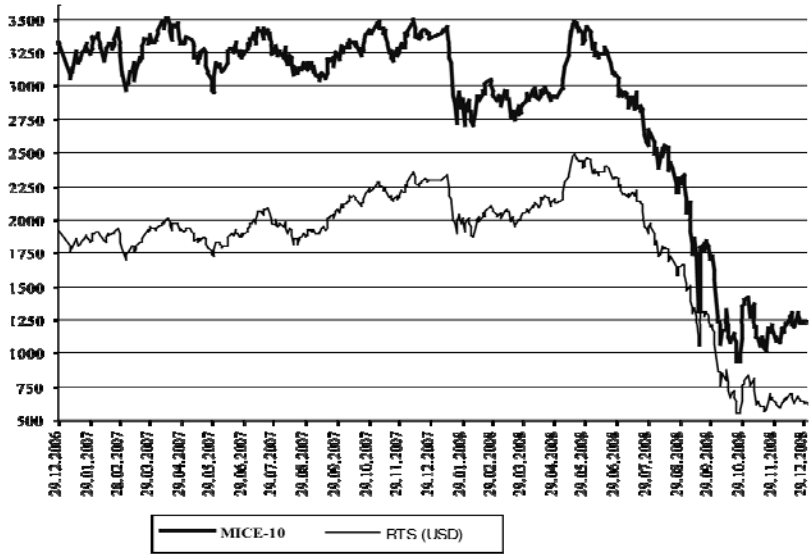
Fig. 32. The dynamics of OFZ and corporate bonds indices in 2007 – 2008.

The percentage of shares in the aggregate investment portfolio of PAMs over the first half-year 2008 decreased by 21.2% (from 30.2% as of the end of 2007 to 23.8% as of the end of Q II 2008). The MICE-10 index[43], which in the first approximation yields a certain picture of the dynamics of prices of Russian 'blue chips', during the same period declined by only 8.85% (see *Fig. 32*). Such a ratio makes it possible to conclude that the percentage of shares in the aggregate investment portfolio of PAMs decreased not only due to the drop in their market value, but also because of the recent changes in their policy aimed at decreasing the percentages of assets with varying returns.

In Q III 2008 the drop on the share market amounted to 43%, as demonstrated by the MICE-10 index. The percentage of shares in the aggregate investment portfolio of PAMs during that period amounted to 5.7 percentage points. As of the end of Q III 2008, the aggregate investment portfolio of PAMs contained 18.1% of shares, which means that it began to acquire the features of a very conservative portfolio where more than 80% of its total asset value was represented by instruments with fixed return rates. In this connection, among the instruments with fixed return rates the highest growth was demonstrated by the percentage of 'other assets' (compare *Fig. 30 и 31*), their bulk being represented by monies on the accounts with brokers. Thus, the traditional 'retreat towards quality', typical of the situation of a developing crisis, took a rather peculiar form – if it was felt at all. The least risky assets, from the point of view of PAMs, were the monies on the accounts with brokers at credit institutions – and not

[43] MICE-10 index, due to its composition, is better suited to reflect the changes in prices of those shares in which pension savings can be invested. Besides, in contrast to RTS index, it is estimated on the basis of ruble-denominated prices. However, not all of the companies encompassed by this index are included in the top quotations lists of Russian stock exchanges, and so some of them are not available for investing pension savings in.

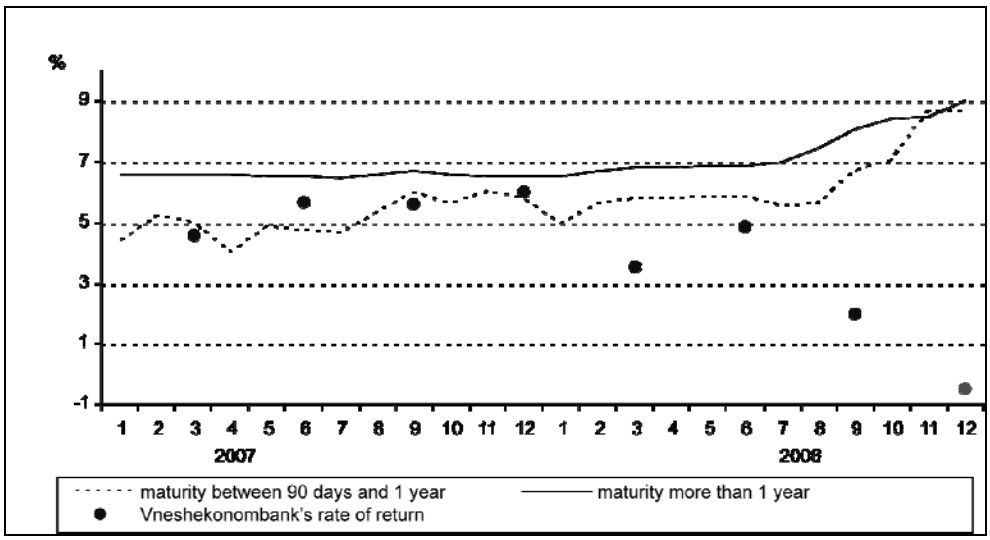
government securities whose share, although increased by 1.2 percentage point, still remained twice as low as its marginal value established by legislation.



Source: MICE, RTS.

Fig. 33. RTS and MICE -10 indices in 2007 – 2008.

Rate of return on investments. The rate of return on the pension savings invested by the GAM, as seen by the results of the first half-year 2008, amounted to 4.85% and turned out to be better than the results of Q I but lower than interest rates on OFZ during the same period (see *Fig. 34*).



Note. The data on the rates of return achieved by Vneshekonombank are for the periods starting from each year's beginning, in per annum values.
Source: RF CB, Vneshekonombank.

Fig. 34. Average weighted interest rates on the OFZ market and the GAM's rate of return in 2007–2008.

In Q III the net asset value dropped by 1%, while the rate of return on the pension savings invested by the GAM in the first three quarters amounted to only 2% per annum.

The nominal value of the aggregate investment portfolio of PAMs in the first half-year 2008 amounted to - 6.2% per annum (relative to the average net asset value as estimated in accordance with the requirements stipulated in Article 16 of the Federal Law "On investing the funds to finance the funded part of labor pension in the Russian Federation"). The rates of return on some of the investment portfolios fluctuated between 7,2% and –21,3% per annum, positive rates being displayed by only 14 investment portfolios out of all those managed by PAMs. In this connection, there existed a rather high negative correlation between the percentage of shares in investment portfolios and the rates of return (– 73.7%). The results as of mid-2008, obtained by the holders of the biggest (in absolute values) investment portfolios, are shown in *Table 39*. It demonstrates that the difficult situation on the stock market indeed made an impact on the investments results displayed by all of them. Four out of five asset managers had negative rates of return in real terms, while if taken over a longer period (three years) their rates of return are higher than the average per annum rate of return on the investments made by the GAM during the same period (the latter index amounting to 7.3% as of mid-2008).

Table 39

Rates of return on investments of PAMs with the most substantial investment portfolios, as of mid-2008

Asset managers	Portfolio's market value, million rubles	Rate of return in first half-year 2008% per annum	Rate of return in three previous years,% per annum
Pensionnyi reserv	1698.9	0.26	13.59
Posbank	1549.1	–5.15	8.4
Uralsib	1205.6	–12.81	15.22
Troika Dialog	1085.4	–21.3	18.14
Sopid Management	982.1	–10.56	13.84

Source: estimated on the basis of the data published at the PFR's website www.pfrf.ru.

According to the results of Q III, the investment portfolios of only three PAMs could remain 'on the positive side'. The losses sustained by the others varied between –2.8% and –45.5% per annum. The average index amounted to –17.6% per annum (relative to the average value of net assets as estimated in accordance with the requirements stipulated in Article 16 of the Federal Law "On investing the funds to finance the funded part of labor pension in the Russian Federation"). However, if taken over a three-year period, the bulk of the investment portfolio managed by the GAM demonstrated a positive rate of return in nominal terms.

The results of investments made by PAMs in Q IV 2008 have not yet been declared, but bearing in mind that the bulk of pension savings is held in trust management by the GAM, one can draw some preliminary conclusions. The assets managed by the GAM shrank over last year by 19,8 billion rubles, including by 6 billion rubles in Q III; at the same time, during the same period nearly 18 billion rubles was transferred to the PFR, to be transferred further to IPFs and PAMs, as a result of the exercise by insured persons of their right to make a choice

of an asset manager or an IPF; meanwhile, the transfer of new contributions from the PFR was halted[44].

The rate of return demonstrated by the GAM in 2008 was –0,46% in nominal terms, or –12,1% in real terms. If this index is compared to the results obtained by the pension funds of other countries in the first 10 months of 2008, it can be concluded that the GAM's losses so far have been lower than those suffered by the majority of the OECD members.

2.6. Scenarios of Development of Russian Economy in 2009

Below, we present a few possible scenarios of development of Russia's economy in 2009. The forecasts are built on the basis of a structural econometric model designed by the Institute for the Economy in Transition. In the current economic conditions, which are characterized by a drastic rise of uncertainty and the collapse of the entrenched trends, the accuracy of forecasting, including the one that rests on results of the econometric evaluation of dynamic correlations in the economy, lowers dramatically. That is why, in contrast to the previous years, we did not contemplate building medium-term (at least for the upcoming three years) forecasts, but present results just for the quarter-by-quarter forecasts through the end of 2009.

We will be considering four possible scenarios.

Scenario 1 (basic) was built in conformity with major prerequisites the RF Ministry of Economic Development and the RF Ministry of Finance employed to develop the 2009 forecast of Russia's socio-economic development, and with the specified 2009 draft of the federal budget. Thus, the average annual price level for oil (Urals) was assumed at the level of USD 41/barrel, while the capital outflow from the country (with account of the article "Omissions and mistakes" of the balance of payments) was set at the level of USD 80bn. The volume of the federal budget expenditures was assumed to amount to Rb. 9.69trln, with the federal budget deficit financed primarily from the Reserve Fund of RF. The Euro/USD exchange rate was assumed to remain stable at the level of USD 1.35/Euro.

In addition, in the framework of the scenario it is presumed that the problem of "bad' debts in the national banking sector should further aggravate in the 3rd quarter of 2009. More specifically, we assume that the level of such debts can account for 10% of the overall volume of credits disbursed to the non-financial sector of the economy. Accordingly, we take into account the need for an additional supply of the banking system with liquidity by the Central Bank of RF (in a volume of up to Rb. 700bn) and a further decline of the lending activity in the economy and the fall of the money multiplier from 2.5 to 2.2 between the 3rd and the 4th quarters of 2009. Whereas the federal budget deficit should be funded from the Reserve Fund, i.e. effectively by means of monetization of deficit, in an effort to sterilize it, the Bank of Russia would not refinance the earlier disbursed and due to be repaid this year uncollateralized loans to Russian banks.

[44] The financial crisis influenced the funded component of the pension system not only in terms of the negative rate of return on investments observed in 2008. Some problems also appeared in the functioning of the mechanism of transfer of the insurance contributions to the funded part of labor pension from the PFR to IPFs and into the trusteeship management by asset managers. As it was noted by the press, in 2008 the PFR failed to transfer insurance contributions to the funded part of labor pension both to IPFs and asset managers. As the main reason, they pointed to the negative dynamics of the prices of OFZ in which the contributions had been invested

Scenario 2 (the scenario of low prices) implies consideration of a situation in which the average annual oil price has plunged to USD 32/barrel. With account of a preliminary estimation of oil prices in the 1st quarter (USD 44/barrel), this conforms with the price downfall between the 2nd and the 4th quarters of 2009 to USD 28/barrel. Apart from this, all the other prerequisites appear analogous to the basic variant.

The 3rd scenario and the 4th one deal with various modifications of the basic scenario. *Scenario 3* (the scenario of a crisis of the external debt) suggests an aggravation of the situation with repayment of the national corporations and banks' external debt. In the framework of this particular scenario we assessed consequences for the economy generated by a rise in capital outflow from the country in 2009 which matches the initial debt repayment timetable set for 2009 (by the CBR data), i.e. in a volume of some USD 120bn (including USD 117.1bn-worth repayment of the debt principal).

Scenario 4 (the budgetary expansion) matches the variant of an additional (against the draft federal budget as of March 19, 2009) increase of budgetary expenditures at 2.5% of GDP, .e. at Rb. 1.0 trln.

Results of the forecast of the dynamics of the basic indicators of Russia's socio-economic development are presented in *Table 40*.

Table 40

The Forecast of the Dynamics of the Basic Indicators of Socio-Economic development of RF

	1st Q*	2nd Q	3rd Q.	4th Q	2009
Oil prices, Urals, as USD/barrel					
Scenario 1, 3, 4	44	40	40	40	41
Scenario 2	44	28	28	28	32
Real GDP, as% to the respective period of the prior year					
Scenario 1	–4.8	–4.1	–2.8	–0.5	–3.1
Scenario 2	–4.8	–4.9	–3.2	–1.0	–3.5
Scenario 3	–4.8	–4.1	–2.9	–0.7	–3.2
Scenario 4	–4.8	–4.1	–2.9	–0.6	–3.2
The federal budget deficit (as% of GDP)					
Scenario 1	0.8	10.1	9.1	8.2	7.0
Scenario 2	0.8	10.8	9.6	9.1	7.7
Scenario 3	0.8	9.3	8.1	7.3	6.5
Scenario 4	0.8	10.1	13.7	12.6	9.4
The CBR's international reserves (as USD bn.)					
Scenario 1	396.5	396.5	395.6	395.0	395.0
Scenario 2	396.5	395.3	393.4	391.2	391.2
Scenario 3	396.5	388.1	382.9	380.9	380.9
Scenario 4	396.5	396.5	395.6	395.0	395.0
CPI,%					
Scenario 1	5.2	2.7	1.0	1.9	11.2
Scenario 2	5.2	5.5	3.9	3.2	18.4
Scenario 3	5.2	7.1	2.6	2.4	18.4
Scenario 4	5.2	2.7	2.2	3.4	15.4
Rb/USD exchange rate					
Scenario 1	35.26	35.3	35.3	35.4	35.32
Scenario 2	35.26	40.7	45.0	45.0	41.49
Scenario 3	35.26	46.2	46.5	46.5	43.62
Scenario 4	35.26	35.3	35.9	36.4	35.72

*Assessment of actual data over January or between January and February 2009

So, according to the basic scenario, in 2009, Russia's real GDP should fall at 3.1%, with the nominal volume of GDP accounting for Rb. 40,828bn. The decline of investment in fixed assets over the year would account for 5.8% on the whole, while the fall in the population's

real incomes makes up 3.8%. At the same time, some stabilization of the rate of decline of the population's real incomes is expected in the 4th quarter of the year.

According to our calculations, by results of the year the federal budget deficit should account for 7% of GDP, with the aggregate volume of revenues making up Rb. 6.82trln. (16.7% of GDP), which is slightly in excess of the RF Ministry of Finance's forecast (6.71trln).

In the frame of this particular scenario the situation with the nation's balance of payments is presumed to be fairly comfortable. Providing that the trend to the restructuring of the Russian private corporations and banks' debt is in place and the volume of the foreign debt repayment does not exceed USD 70-80bn, a positive balance of current accounts would enable the Russian monetary authorities to save their international reserves, without resorting to a further depreciation of the Rb. More specifically, according to our forecast, the 2009 volume of export should reach some USD 248bn (down at 47.5% against its 2008 level), while that of import – USD 136.0bn (-53.5% to the 2008 level). So, the positive balance of the balance of trade should account for not less than USD 112bn.

Accordingly, the Central Bank of RF would be capable to hold the declared band of fluctuations of the bicurrency basket, that is, at a level not higher than 41 Rb., through the end of the year, with its international reserves maintained at the level of USD 395.0bn. Thus, the contraction in the reserves over the year (some USD 32bn) would fall on the period between January and February.

Stabilization of the Rb. exchange rate and a fairly conservative monetary and credit policy (the Rb. emission sterilized between the autumn of 2008 and the winter 2009, capping the budgetary deficit at the level of 7% of GDP, and the CBR providing a limited support to the national banking system) would allow one to count on fairly low inflation rates (11.0-11.5% over the year). At the same time, nearly a half of the price rise (5.0-5.5%) would fall on the 1st quarter of the year. Overall, by results of the year the increment in the monetary base is envisaged to be within 10%, with money supply (M2) remaining roughly at the level reported as of the late-2008.

However, should oil prices further slide down to the average annual mark of USD 32/barrel (as suggested by Scenario2), the fall in GDP might reach 3.5% of GDP, the fall in real volumes of investment – 6.6%, the population's real incomes would be down at 4.7%. Meanwhile, due to the contraction of volumes of export (-USD 29bn vis-à-vis the basic scenario), the Bank of Russia would be compelled to once again depreciate the Rb. against the bicurrency basket – tentatively, to the level of 52 Rb. - by the end of the year (at 26% relative to the current upper margin). If this happens, the Rb/USD exchange rate would become Rb. 45/USD. Accordingly, inflation on the consumer market will accelerate up to 18.4%.

A higher inflation and the depreciating Rb. would bolster the nominal volume of GDP (up to Rb. 41.98trln), and engender a slight drop in the nominal revenues to the federal budget (Rb. 6.5trln). So, the federal budget deficit would grow just at 0.7 p.p. of GDP, i.e. up to 7.7%.

Equally dire for Russia's economy would become consequences from a renewal of the capital outflow from the country. It may restart, for example, in the event the Russian corporations and banks would no longer be able to successfully negotiate their external debt restructuring, as they have done in February-March 2009. According to *Scenario 3*, the decline in the real GDP would accelerate (up to 3.2%) and so would do the decline in real investment (6.7%). To secure stability of the nation's balance of payments, the Central Bank would be

compelled to depreciate the Rb. exchange rate against the bicurrency basket to R 53.5-54.0 Rb., equivalent to the Rb/USD exchange rate of Rb. 46.5/USD. As in the case of the scenario of low oil prices, inflation would likewise accelerate to 18.4%. A "positive" aspect of this particular scenario would become a 6.5% contraction of the federal budget deficit, due to growth in nominal volumes of GDP and revenues to the federal budget.

In the frame of *Scenario 4* we estimated consequences of the budgetary expansion between the 3rd and the 4th quarters of 2009. Powered by growing budget expenditures (up to Rb. 10.7trln over the year), the deficit would surge up to 9.4% of GDP. An additional emission would fuel not only inflation (up to 15.4%), but a new round of the Rb. depreciation as well. The Central Bank would ultimately face a situation in which it would not be able to hold the declared upper marginal rate of the bicurrency basket without sacrificing its reserves. Should the policy of saving the reserves at the current level be pursued, the Rb. exchange rate should plunge roughly at 5% against the current level, i.e. down to Rb. 42.-42.5/bicurrency basket, equivalent to Rb.36.5/USD.

The above results of the scenario-based forecasting calculations of the dynamic of the basic macroeconomic indicators of RF evidence that it is the most probable scenario (the basic one) in the frame of which Russia has a chance to survive through the year with minimal macroeconomic shocks, which might form a favorable starting position for exiting from the crisis.

But the positive forecast is very unstable, and the range of fluctuations of exogenous parameters under which the situation is favorable appears an extremely narrow one. A further downfall in oil prices, an additional capital outflow and a new increase in budget expenditures would result in very dramatic dire consequences. More specifically, those may become a sharp acceleration of inflation and a new drastic depreciation of the national currency. In conjunction with this the Central Bank and the RF government should pursue a maximally conservative policy, so that to preclude a new wave of economic agents' negative expectations from rising.

Section 3. Real Sector

3.1. Macrostructure of production

3.1.1. Influence of Internal and External Demand on GDP Dynamics and Structure

In 2008 a considerable slow-down replaced the growth of the Russian economy observed in the period of 2003-2007, when the average annual growth rates of the indices were the following: GDP – about 7%, investments in fixed assets – 14%, final consumption of households – 11%. According to the preliminary data for 2008, GDP increase was equal to 5.6%, approaching the figures of 2001-2002, which have been the minimum of the ten-year recovery period. The growth rates of investments in fixed assets slowing down to 9.1% in 2008 as compared with 21.7% in 2007, which was not compensated by the corresponding growth of the consumption of the population, accounted for the gradual decrease of the internal demand. The inflation increasing, the growth rates of the real incomes of the population slowing down to 2.7% versus 12.1% in 2007, real wages -to 9.7% versus 17.2%, the growth rates of the retail trade turnover made 113.0% and were 3.1% below the level of the previous year, while that of the paid services rendered to the population – 104.9% versus 107.9% a year ago. Slow-down of industrial production growth rates to 102.1% versus 106.3% in 2007 had a considerable influence on the internal market.

Table 1

Indices of the Basic Macroeconomic Indicators in 1999–2008, as a percentage versus the previous year

	2001	2002	2003	2004	2005	2006	2007	2008	2008 by quarters			
									1	2	3	4
Gross Domestic Product	105.1	104.7	107.3	107.2	106.4	107.4	108.1	105.6	108.5	107.5	106.2	101.1
Real final consumption of households	108.2	107.7	106.7	110.2	110.5	109.8	111.0	111.5	114.1	112.2	112.4	109.7
Investments in fixed assets	110	102.8	112.5	111.7	110.9	116.7	121.1	109.1	119.1	113.0	109.8	101.9
Commissioning of residential building	104.6	106.7	107.7	112.6	106.1	116.1	119.4	105.3	108.1	99.1	105.7	105.1
Industrial production	102.9	103.1	108.9	108.0	105.1	106.3	106.3	102.1	106.2	105.5	104.7	93.9
Agriculture production	107.5	101.7	101.3	103	102.4	102.8	103.3	110.8	104.5	104.2	108.5	59.2
Freight turnover	103.2	105.8	108	106.5	102.7	102.5	102.2	100.6	105.1	102.9	101.5	93.0
Communication services amount	119.1	115.6	127.5	129	115.7	124.0	120.1					
Retail trade turnover	111	109.3	108.8	113.3	112.8	114.1	116.1	113.0	116.7	114.4	114.4	108.2
Paid services rendered to population	101.6	103.7	106.6	108.4	106.3	107.6	107.9	104.9	107.7	105.6	105.3	102.0
Foreign trade turnover	103.8	108.1	126	132.4	131.5	127	120.8	132.2	148.8	147.9	149.3	95.4
Real disposable monetary income	108.7	111.1	115	110.4	112.4	113.5	112.1	102.7	107.8	106.0	106.6	94.2
Real wages	119.9	116.2	110.9	110.6	112.6	113.3	117.2	109.7	113.4	112.5	112.2	102.5
Real amount of accrued pensions	121.4	116.3	104.5	105.5	109.6	105.1	104.8	118.1	119.0	113.7	122.7	116.9
Average number of those employed in the economy	100.7	100.9	100.6	100.6	100.6	100.6	101.3	100.6	100.8	101.2	100.8	99.7
Number of officially registered unemployed	89.1	97.9	92.3	101.6	90.2	96.0	84.9	104.3	96.5	94.2	105.6	123.0
Consumer prices indices	118.6	115.1	112.0	111.7	110.9	109.0	111.9	113.3	104.8	103.8	101.7	102.5
Industrial producers' prices indices	108.3	117.7	112.5	128.8	113.4	110.4	125.1	93.0	103.0	113.6	100.5	79.1

Source: Federal State Statistics Service.

In 2008 macroeconomic situation was characterized by highly unsteady dynamics of the main indices throughout the year (*Table 1*). GDP growth rates slowed down from 8.5% in the 1st quarter to 1.1% in the 4th quarter. The inertial growth of the first half of 2008 supported by the accumulated potential, favorable situation at the world market of raw materials, was replaced by the slow-down of the economic development in the second half, which was accounted for by a sudden worsening of the foreign economic situation and the crisis of the financial and crediting institutions. In October-December 2008 the situation was aggravated by the spread of the crisis phenomena throughout the economy. The most dramatic decrease in production was observed in construction, transport and industrial production. According to the data of the Federal State Statistics Service, in the 4th quarter 2008 the volume of the industrial production was 93.9%, the commercial freight turnover – 93.3% as on the level of the corresponding period of the previous year. The growth rates of the investments in fixed assets continued to slow-down for two quarters in a row, their volume in December 2008 being 2.3% below the volume of December 2007. The increase in gross accumulation of fixed capital in 2008 was estimated to be 110.3% as compared with 121.1% in 2007.

Starting with the second half of 2008 the trade has been occupying the leading positions in the national economy anew. The share of the wholesale and retail trade in the GDP produced was 21.7% in 2008. The dynamics of the consumer demand in 2008 was still determined by the consumption of households. The increase in household consumption is estimated to be 111.5% in 2008, as compared with 113.6% in 2007. In connection with the slow-down of labor remuneration growth in the 4th quarter of 2008, the growth rates of retail trade turnover and of the paid services rendered to the population have dropped. Although the growth rates of the retail trade turnover went down to 8.2% in the 4th quarter 2008 versus 16.2% in the corresponding period of the previous year, the investments in fixed assets – to 1.9% versus 20.6%, this enabled to support the positive dynamics of the GDP in October-December, though at the level which has been the minimum since 2001.

The situation was aggravated by a large-scale outflow of capital. Whereas in the first half of 2008 the trend for the inflow of the foreign capital at the amount of USD 18 billion sustained, in the second half 2008 the outflow of capital reached USD 147.9 billion.

Starting with the second half of 2008 the unsteady dynamics of the main macroindices, as well as sudden fluctuations of prices and demand at the world market of raw materials resulted in the international agency Standard&Poor's lowering the rating of Russia from "positive" to "stable" in September, and from "stable" to "negative" in October, leaving the rating itself unchanged. In December the agency lowered long-term and short-term foreign currency credit ratings of the Russian Federation: from "BBB+/A-2" to "BBB/A-3". Besides, the long-term sovereign local currency credit rating was lowered: from "A-" to "BBB+", retaining the short-term local currency rating at the level of "A-2".

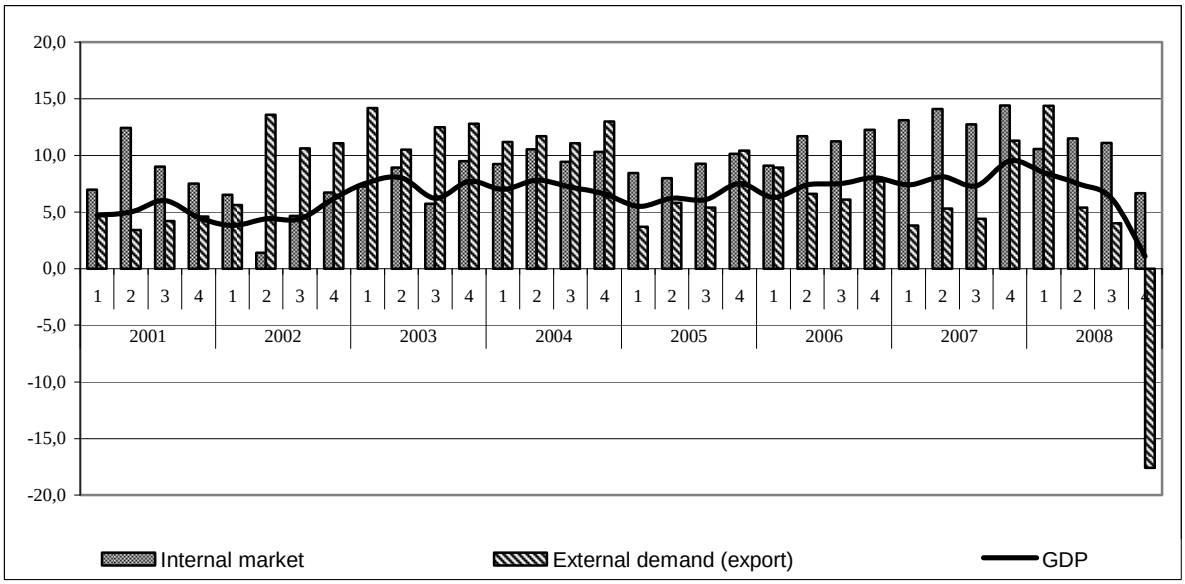
The forecast "negative" for the sovereign credit rating of the Russian Federation reflected the possibility for further decrease in the ratings if the expenditures for the support of the financial system increase and the measures adopted for the prospects of long-term development exert bigger negative influence.

In January 2009 analytical agency Fitch lowered Russia's rating down to the level of BBB, which was due to both the decrease in prices for raw materials and the aggravation of the situation at the global markets of capital, as a result of which the Russian banks had difficulties with refinancing of the external debt. International reserves of the Russian Federation

had decreased down to USD 427.1 billion by the end of the year versus USD 597.5 billion at the beginning of August 2008.

Throughout 2008 the decrease in the economic growth rates was determined by the simultaneous reduction in the external and internal demand (*Fig. 1*). Starting with the 3rd quarter 2008, a sharp drop in the world prices for raw materials and contraction of the demand of the world market was accompanied with the reduction of export volumes both in physical and value terms. In the 4th quarter, according to preliminary estimations, the export of goods reduced by nearly 17%. However the dynamics of export being high in the first half, on the whole over 2008 the export of goods and services increased by 0.2% versus 6.4% growth in 2007. It should be noted that the anticipating growth of import as compared to export in terms of both the physical volume and value was a characteristic feature of 2006-2008, which in the end resulted in the absolute reduction of net export volume in the GDP.

The analysis of the formation of the resources of retail trade demonstrates that staring with 2005 the trend for the growth of the proportion of import supplies of both the foodstuffs and non-food goods. In 2008 the proportion of the import in the structure of retail trade commodity resources increased up to 47%, the growth of foodstuffs being 34.0% and of non-foods goods – 54.4%. A high proportion of the import goods secured the balance of supply and demand at the investment market as well. In January-September 2008 the expenditures for the purchase of the import equipment made 19.9% of the total volume of investments into machinery and equipment. Other conditions being equal, a dynamic growth of import contributed in the formation of the competitive environment, but a high proportion of import in the retail trade turnover and in the volume of investments in machinery, equipment and transport vehicles strengthened the dependence of the balance of the trading resources at the internal market on the changes in the external economic situation.



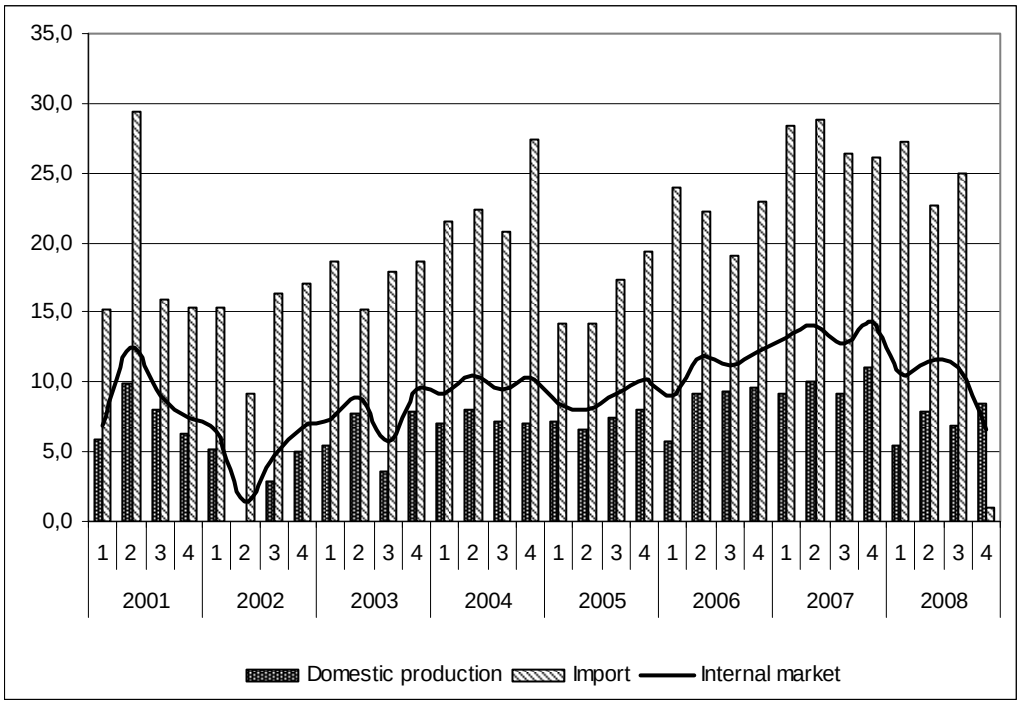
Source: Federal State Statistics Service

Fig. 1. Changes in GDP Dynamics As Broken by Components of Internal and External Demand in 2001-2008, As Percentage to Corresponding Quarter of Previous Year

In 2008 the slow-down of the dynamics of the investment and consumer demand occurred against the background of the considerable decrease in the volume of goods and ser-

vices import. As a result of 2008 the growth of the physical volumes of goods and services import made 17.7% versus 26.6% a year ago, the growth of import being twice as intensive as the growth of the internal production.

In 2008 the combination of the internal factors regulating the level of the business activity did not compensate the influence of the contraction of the external demand on the economic growth rates. As a result of three quarters of 2008 the increase in internal demand made 11.1% versus 13.6% in 2007. Against the background of slow-down of the rates of the domestic production, the positive dynamics of the internal market was sustained by the increase in import supplies throughout the first half of the year. As a result, the proportion of the goods and services produced domestically in the structure of the internal demand coverage decreased steadily. Starting with August 2008 the situation changed radically. Under the influence of the contraction of the investment, production and consumer demand as a result of the credit crisis there was an absolute reduction in the volume of goods import in terms of value observed in the 4th quarter 2008. In such a situation the state of the internal market was supported by the increase of both the share of services, and the enhancement of the stocks of the material liquid funds due to the contraction of the internal demand. The turnover of the organizations of the wholesale trade started decreasing in the 4th quarter 2008 and made 93.7% as compared with the corresponding period of the previous year. The increase in the material liquid funds was 33.1% on the whole over 2008, their share in the GDP being at the level of 4.1%. Thus, in the 4th quarter 2008 the situation at the internal market was defined by a considerable excess of supply over demand for the first time since 1999 (*Fig. 2*).



Source: Federal State Statistic Service

Fig. 2. Changes in Internal Demand Growth Rates in 2001-2008, As Percentage to Corresponding Quarter of Previous year

In 2006-2008 the economic growth was in fact at the stage of the quantitative accumulation and was not supported by the structural changes in the investment activity, foreign trade, production, as well as by institutional reforms, securing favorable conditions for effective operation of economic agents. This defined the vulnerability of the Russian economy in the environment of global changes in the situation at the world market.

The means of the stabilization funds (Reserve Fund and Fund of National Welfare) were insufficient to damp the negative influence of the external factors. Use of accumulated funds and measures for the gradual change of the ruble exchange rate against the basket of currencies, decrease in tax burden on producers do not allow stopping negative trends in the investment sphere, goods and services production, in the sphere of employment and maintenance of life standard.

3.1.2. Final Consumption of Households and Changes in Parameters of Population's Life Standard

During January-September 2008 the share of expenditures in for final consumption in the structure of the use of the GDP decreased systematically and in he 3rd quarter became equal to 61.6%, which is 1.8 per cent below the figure of the corresponding period of the previous year (*Table 2*). The decrease occurred mainly due to the contraction in the expenditures of households. The slow-down of the rates of household consumption was caused by a decrease in the incomes of the population, an increase in wages arrears, a contraction of the solvent demand of the population against the background of high inflation, an increase in the cost of credit funds. As a result of 2008 the share of labor remuneration in the structure of the incomes of the population made 68.5%, exceeding by 1.0 per cent the figure of 2007, and the share of social payments went up from 11.3% to 12.9%. At the same time it should be noted that the incomes from the property in monetary incomes of the population went down by 2.3 per cent and were equal to 6.6%. At the same time the anticipating growth of pensions and social payments in the first half of 2008 allowed to restrict the growth of the number of the population with the incomes below the subsistence level even in the environment of high inflation (*Table 3*).

Table 2

Structure of Use of Gross Domestic Product

	2007					2008*				
	Annual	quarters				Annual	quarters			
		1	2	3	4		1	2	3	4
GDP	100	100	100	100	100	100	100	100	100	100
expenditures for final consumption	66.0	71.4	67.5	63.4	63.8	66.0	69.9	65.0	61.6	68.4
of households	48.2	50.1	48.4	46.4	47.5	48.5	48.7	46.6	45.2	48.9
of state management	17.2	20.7	18.6	16.6	15.8	16.9	20.6	17.9	16.0	14.1
Gross accumulation	24.3	18.7	22.8	28.7	26.3	26.2	19.1	24.5	30.3	20.1
Net export	8.6	10.1	8.9	7.3	8.9	8.9	12.5	10.5	9.1	4.0

* preliminary results, statistical deviation = 1.1
Source: Federal State Statistics Service

Table 3

Number of Population with Monetary Incomes below Subsistence Level

	Million of people	As percentage to the total number of the population
2005		
1st quarter	34.9	24.5
1st half of the year	31.4	22.1
Annual	25.2	17.7
2006		
1st quarter	31.7	22.4
1st half of the year	27.0	19.1
Annual	21.6	15.3
2007		
1st quarter	25.8	18.3
1st half of the year	22.3	15.8
January-September	20.9	14.8
Annual	21.5	15.2
2008		
1st quarter	23.0	16.3
1st half of the year	20.7	14.7
Annual		13.2

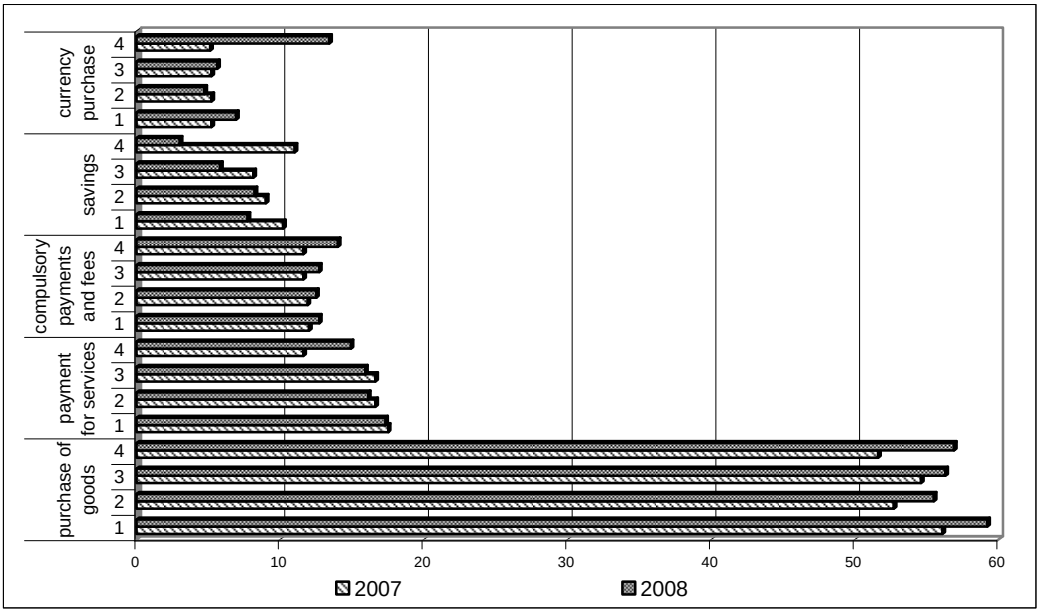
Source: Federal State Statistics Service

The investment market contracting dramatically, in 2008 the level of the consumer demand remained the main source of the economic growth despite the fact that in the 4th quarter the increase in the retail trade turnover made 8.2% as on the corresponding period of the previous year versus 15.5% in the first half of the year and 14.5% in the 3rd quarter. Against the background of the slow-down of the growth rates of the real incomes of the population in January-September and their decrease by 5.8% in the 4th quarter 2008 for the first time since 2000, the trend for the dynamics of the retail trade turnover being higher than the real incomes of the population testified that the inclination of the population to save decreased steadily. The dynamics of the savings of the population was considerably influenced by the acceleration of the inflation, periodic problems with the liquidity of the banks, ruble weakening and negative phenomena (slow-down of housing implementation, growth of interest rates for mortgages) at the real estate market. Massive outflow of savings was accompanied with the population being more active at the market of foreign currency (*Fig. 3*). In the 4th quarter 2008 the share of expenditures for purchase of the currency was equal to 13.4% of the incomes of the population, and in December of the same year – to 14.9% versus 4.8% in the corresponding period of 2007. As a result the share of expenditures for purchase of goods made 56.9% in the 4th quarter 2008 versus 59.2% in the 1st quarter.

The volume of credits given to the natural persons by banks increased by nearly 1.35 times over the first eleven months of 2008 and was equal to RUR 4054.8 billion at the beginning of December. The volume of credits given to natural persons by crediting institutions for purchase of accommodation (in rubles and in foreign currency) made RUR 614.5 billion in January-September 2008 versus RUR 424.1 billion in the analogous period of the previous year, including mortgage credits of, correspondingly, RUR 537.3 billion versus 362.8 billion. It should be noted that by October 1, 2008 the arrears of credits issued to natural persons went up to RUR 4004.1 billion as compared with RUR 2658.3 billion as on October 1, 2007.

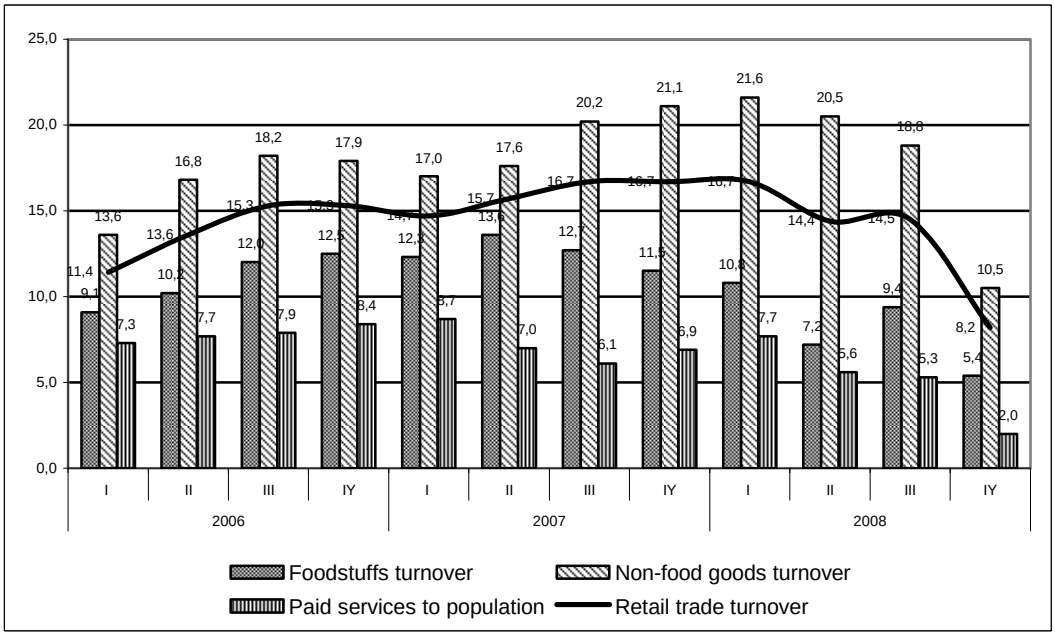
As compared with October 2007, in October 2008 there was a decrease in the proportion of arrears of consumer credit in the total volume of arrears of credits of natural persons, the arrears of credits for the purchase of housing growing up to 28.7% versus 23.4% a year ago and for mortgage up to 24.3% versus 18.7%.

The share of the expenses of the population for the purchase of the real estate in the 4th quarter 2008 made 3.0% (6.0% on average over the year) versus 11.0% (9.6%) in the corresponding period of the previous year.



Source: Federal State Statistics Service

Fig. 3. Structure of Use of Monetary Incomes of Population in 2007-2008, as percentage to total



Source: Federal State Statistics Service

Fig. 4. Dynamics of Retail Trade Turnover and Paid Services to Population in 2006–2008, As Percentage to Corresponding Quarter of Previous Year

The volume of sales of non-food goods continued to develop at higher rates than that of foodstuffs (*Fig. 4*). Starting with the beginning of the year prices for non-food goods went up by 8.0% and for foodstuffs – by 16.5%. The ratio of the growth rates of these indices, on one hand, indicates that the solvent demand of the population contracted and, on the other hand, reflects the formation of the pent-up demand for non-food goods.

3.1.3. Dynamics and Proportion of Gross Saving and Gross Accumulation in GDP

In 2003-2007 a favorable combination of factors of the domestic business activity and the price situation at the world market of raw materials accounted for the intensive increase in the scales of gross saving. In that period the growing incomes of the economy from the foreign economic activity obviously stimulated economic activity. It should be noted that starting with the 2nd quarter 2008 there was a strengthening of the influence of the investment component on the dynamics of the economic growth observed. The growth rates of the investments in fixed assets reached the maximum level of 121.1% in 2007 versus 113.7% in 2006 and 109.5% on average over the period of 2000-2005. However whereas in 2007 the volume of the GDP exceeded that of pre-reform 1991 by 10%, the investments in fixed assets were 1/3 below the corresponding figure. During the past seven years the proportion of gross saving was in the range from 31.1% to 38.7% of the GDP as compared with 24.0% in the pre-default 1997. In 2007 the proportion of the gross national saving made 34.0% and remained at that level in 2008. The investment demand was quick to react to the changes in export earnings and defined the characteristics features of the internal market functioning. The slow-down in the growth rates of the investments in fixed assets was accompanied by structural changes in the use of national saving throughout 2008. Although on the whole over 2008 the improvement in the characteristics of transformation of savings in investments and the increase in their share in the GDP can be noted (*Table 4*), the sharp decrease in the growth rates of investments, implementation of fixed assets and intensive growth of the volumes of unfinished construction in 2007-2008 had a negative impact on the nature of the economic growth by the end of 2008.

Table 4

Structure of GDP Use on Gross Saving and Accumulation in 2000-2008, As Percentage to Total

	2000	2001	2002	2003	2004	2005	2006	2007	2008
GDP	100	100	100	100	100	100	100	100	100
Including:									
Gross saving	38.7	34.2	31.1	31.9	33.1	33.8	34.2	34.0	34.0
Of which:									
Gross accumulation	18.7	21.9	20.1	20.8	20.9	20.1	21.4	24.3	26.2
Gross accumulation of fixed capital	16.9	18.9	17.9	18.4	18.4	17.7	18.5	21.1	22.1
Changes in stocks of material liquid funds	1.8	3.1	2.1	2.4	2.5	2.3	2.9	3.2	4.1
For reference:									
Share of investments in GDP	15.9	16.8	16.3	16.5	16.8	16.7	17.6	20.0	20.7

Source: Federal State Statistics Service

3.1.4. Specific Features of Formation of GDP as Broken by Incomes

Dynamic growth of the incomes of the population was one of characteristic features for the development of the Russian economy in the past decade. The sustenance of the dynamics of the internal market was based on the growth of the real wages and was accompanied with the redistribution of incomes from enterprises to population. In the 4th quarter 2008 the growth rates of real wages made 102.5% and were the minimum since 2000. In 2008 the proportion of labor remuneration of employees in the GDP was somewhat below the figures of 2007. Comparative analysis of the formation of the GDP by incomes demonstrates that the proportion of the labor remuneration of the employees in the first and second quarters of 2008 roughly corresponded to the figures of analogue periods of 2007, but in the 3rd quarter the share decreased down to 42.1% (*Table 5*).

Table 5

Structure of GDP Formation by Incomes in 2006-2008, As Percentage to Total

	2007					2008				
	annual	quarters				annual	quarters			
		1	2	3	4		1	2	3	4
Gross domestic product	100	100	100	100	100	100	100	100	100	100
including:										
labor remuneration of employees (including hidden)	46.3	49.5	47.4	43.1	44	46.6	49.1	46.3	42.1	49.9
net taxes on production and import	18.7	19.5	19.2	18.1	19	20.4	19.7	21.0	20.5	20.1
gross profit of economy and gross mixed incomes	35.4	31	33.4	38.8	37	35.0	31.2	32.7	37.4	30.0

Source: Federal State Statistics Service

Only 8% of the working population account for the persons that do not work for wages – these are employers hiring employees to work at their enterprises on the permanent basis and self-employed persons. Correspondingly, this defined the specific features of formation of incomes of the population and the GDP. About 70% of the incomes of the population was accounted for by the labor remuneration of the employees, the proportion of the incomes from entrepreneurial activity and property reducing.

Low efficiency of the use of production factors is one of the main reasons for the decrease of the competitive advantages of the Russian goods. The broadening of the gap between the labor productivity rates and wages for the benefit of the latter (see inset below) had a negative influence on the qualitative indices of the economic dynamics.

There sustained a high differentiation of the wages by kinds of economic activities. In the industry the degree of the differentiation in wages was defined by the increase in the gap of the labor remuneration rates between the extractive and processing branches of industry. The nominal accrues wages in minerals extraction was 1.9 times higher than the average level in the economy, and in the fossil fuels extraction was 2.3 times higher. In the processing industry the wages were 94% of the average in the economy and 43% of the figure for the extractive production. The exceeding of the average figure for the accrued wages in the economy by 2.2 and 2.1 times was observed in oil products production and transportation of fossil fuels, correspondingly. In education, health care the average wages were 65-75% of the average in the economy, in the state management and provision of military security – 119%, in financial activity – 240%. The specific feature of labor remuneration by kinds of economic activities had a substantial influence on the formation of the structure of incomes and expenditures of

the population, on the consumer demand of the population and on the distribution of the work resources in the economy.

The slow-down of the industrial growth rates defined the trend for the reduction of the average number of the industrial and production staff. According to the estimation of the Federal State Statistics Service, the number of economically active population was 75.8 million by the end of October 2008, or more than 53% of the total number of the population. Starting with July 2008 there has been a trend for the monthly growth of the unemployment observed. The total number of the unemployed in December 2008 was equal to 5.8 million of people or 7.7% of the economically active population and increased by 26.1% or by 1200 thousand of people as compared with the corresponding period of 2007.

The need for the employees claimed to the state employment services by the employers decreased by the end of 2008 as compared with the end of 2007 by 231.6 thousand of people, the number of vacancies at the end of December 2008 being 894.7 thousand of people. The tension coefficient (ratio of the unemployed citizens registered in the employment services per one vacancy) increased from 1.5 in December 2007 to 1.9 in December 2008.

Factors of Economic Growth, GDP and Added Value in the industrial Sector in 2005-2008

Below the results of the decomposition of the growth of the production index (GDP and added value) in 2005-2008, obtained in accordance with the methodology as stated in the IET work ("Factors of Economic Growth"[1]). The decomposition is based on the breaking the economic growth down to the extensive and intensive components, which enable estimating the quality of the growth and forecast further trends of the economic development. The presented results characterize the transformation of the structure of the economic growth enable highlighting the most important factors that define changes in the dynamics of output growth rates. The estimations are made in accordance with the differential form of the macroeconomic production function, which allows determining the contribution of the main factors (labor and capital) in the output growth and getting the residue that cannot be explained by the factors. This residue (usually interpreted as the TFE) includes the influence of the factors that were unaccounted for in the production function, most important of which are the fluctuations of the production efficiency and the changes in the price situation.

In concordance with the results of the decomposition (table 6) the reduction in GDP growth rates in 2008 is accounted for by the decrease in total factor efficiency against the background of negligible increase in the growth rates of the main factors.

In 2008 the influence of input of the main factors (accumulation of labor and capital taking into account the intensity of their use) on the GDP growth observed increased. Input of efficiency in GDP makes about 40% not taking into account prices for oil and after exclusion the estimation of the input of the price situation at the world markets of raw materials.

In 2008 on the whole throughout the economy the increase in the output was accounted for by the change in the volumes of the capital involved in the production by 49.4%. Despite the considerable level of deterioration of fixed assets sustained and reached 46.2% by the beginning of 2008, the growth of the investments in fixed assets in recent years allowed increasing the rates of the fixed assets renewal. According to the preliminary estimations, in 2008

[1] *"Factory ekonomicheskogo rosta", seria Nauchnye trudy, No 70, IET, Moscow, 2003*

input of this component in the dynamics of the growth made 27.8%. The intensity of the facilities utilization, in contrast, reduced, so the input in GDP growth rates defined by the change in the degree of the capital utilization, made only 21.6% in 2008, which is somewhat below the average figures for 2005-2007.

The increase in input of labor was also due to the change in "stocks", that is in the number of the employees: in 2008 the increase in the value of the index was 0.9%[2], which exceeds the average value of 2005-2007. It should be noted that the growth of the number of the employed occurred mainly thanks to the sector of services, whereas in the sector producing goods the employment reduced. At the same time in 2008 hours of work of one employee per year increased but slightly[3], and the input of the change in the hours of work in GDP growth rates doe not exceed 1%.

In 2008 TFE growth rates made 2.37%, which is two times less than the level of 2007, when the corresponding figure was equal to 4.86%. Thus, on average over the period of 2005-2008 the annual reduction in TFE growth rates made 0.58 per cent (in accordance with the linear trend the growth rates reduce annually by 0.38 per cent)).

In 2008 the input of TFE in output growth rates decreased as well, making 42.4% as compared with 2007, when the value of the index was equal to 56.9%. The dependence on the value of the indices used for the estimation makes estimations of TFE as well dependent on the factors of the situation at the market, for instance, on prices for oil. According to the preliminary estimations, in 2008 there was an increase in the input of price component in the GDP growth rates observed, which made 66.5% despite a considerable decrease in prices for oil that started in September. At the same time the input of the intensive component of the growth became negative for the first time since 2000.

In contrast to the economy on the whole, in minerals extraction there was an increase of GAV growth rates observed in 2008 as compared with 2007. In 2005-2008 the kind of activity "minerals extraction" was the only in the industrial sector to demonstrate the reduction in GAV growth rates by 0.1 per cent (in concordance with the linear trend 0.02 per cent). In accordance with the results of decomposition input of labor in output growth rates of this kind of economic activity has been positive since 2006, which is determined by the increase in the hours of work of the employees at the extractive enterprises. The input of capital in this kind of economic activity is increasing which is mainly due to the increase in productive facilities against the background of considerable fluctuation in the intensity of their utilization.

The dynamics of GAV of the extractive sector is distressing: the extractive enterprises are the only in the industrial sector to demonstrate the negative efficiency growth rates, starting with 2005. On average over the period of 2005-2008 the TEF growth rate of the extractive enterprises decreased by 0.61 per cent (by 1.52 per cent in accordance with the linear trend). At the same time in 2005-2007 there is an intensification of the trend for the decrease in the total efficiency of the main factors observed down to 12% in 2007. In 2008 the process of TEF decrease slowed down and the value of the index was 4.7%.

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[2] For estimation index of growth over January-November 2008 was used.

[3] For calculations growth index over January-September 2008 was used. Taking into account the degree to which the crisis phenomena have spread at the labor market, the main instrument for whose adaptation to the changes in the market situation being the manipulation with the length of the hours of work, correction of 2008 decomposition taking into account the number of hours of work over the 4th quarter will result in the decrease in labor input in GDP growth rates.

Table 6

Decomposition of Annual Growth Rates of GDP and Gross Added Value of Industrial Production in 2005–2008[4]

	GDP	Input of factors	Including:						TFE
			Labor	Including:		Capital	Including:		
				Number of employed	Hours of work*		Volume of fixed assets**	Degree of facilities utiliza-tion***	
Total through-out economy	6.40	2.29	0.02	0.22	-0.20	2.27	1.17	1.09	4.11
	7.70	4.48	0.37	0.21	0.15	4.11	1.50	2.61	3.22
	8.10	3.49	0.40	0.33	0.08	3.09	1.75	1.34	4.61
	5.60	3.23	0.46	0.41	0.05[5]	2.77	1.56[6]	1.21[7]	2.37
Minerals ex-traction	0.50	3.40	-0.66	-0.66	-	4.06	3.71	0.35	-2.90
	-3.30	-0.22	0.02	-0.12	0.14	-0.23	4.53	-4.76	-3.08
	-2.60	10.13	0.07	-0.08	0.14	10.07	5.39	4.68	-12.73
	0.20	4.94	0.20	0.08[8]	0.13	4.74	4.74	-	-4.74[9]
Processing industries	6.00	5.17	-0.94	-0.94	-	6.11	2.31	3.80	0.83
	7.30	5.71	-0.23	-0.44	0.21	5.94	2.69	3.25	1.59
	7.80	6.02	0.30	0.07	0.23	5.73	3.21	2.51	1.78
	0.90	2.46	-0.52	-0.49	-0.02	2.97	2.97	-	-1.56
Electricity, gas and water production and distribution	1.20	0.67	0.30	0.30	-	0.37	0.37	0.00	0.53
	5.70	0.87	0.41	0.28	0.13	0.46	0.46	0.00	4.83
	-0.70	0.11	-0.69	-0.57	-0.12	0.80	0.80	0.00	-0.81
	1.20	0.18	-0.98	-1.39	0.41	1.16	1.16	-	1.02

** - per one employee*

*** - for 2005–2007 on the basis of the data for physical volumes of fixed assets*

**** - estimation for the change in the degree of the facilities utilization on the whole throughout the economy is based on the data of the consumed electric energy, and in industrial production – on the data of the level of utilization of average annual productive capacity of the enterprises producing definite kinds of goods*

The dynamics of the TFE of the extractive sector depends on the price situation at the world markets of raw materials. It should be noted that the apportionment of the component determined by the growth of oil prices from the TFE of this kind of economic activity testifies that the technological efficiency of the sector started to decrease at higher rates since 2005. Against the background of the favorable price situation at the world market of raw materials

[4] For each kind of the economic activities the decomposition of the growth for 2005 is represented in the first line, for 2006 – in the second line, for 2007 – in the third line, estimated for 2008 – in the fourth line. Deviation form the data published earlier are due to the change in the data submitted by the Federal Statistics Service.

[5] Annual estimation is based on the data for January-September 2008.

[6] Preliminary estimation of the growth of the physical volume of fixed assets in 2008 is based on the supposition that the coefficient of the fixed assets retirement and the share of the investments direct for their renewal being constant.

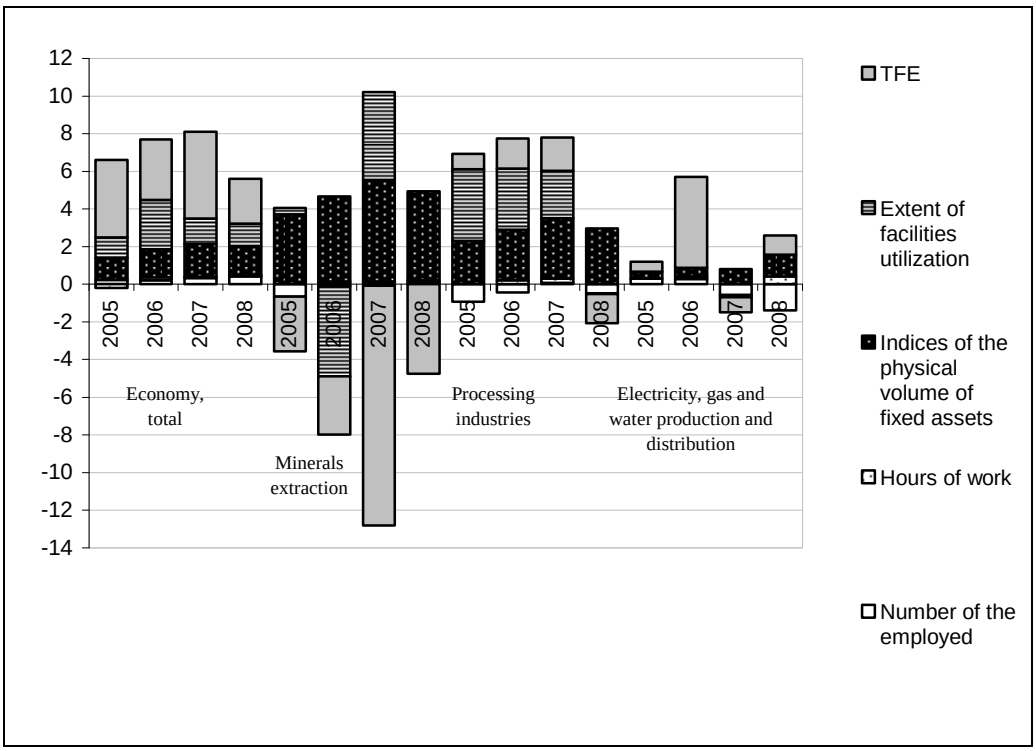
[7] Preliminary estimation of the changes in the degree of facilities utilization is based on the supposition that the share of the electric energy consumed in the amount of the electric energy produced is constant.

[8] Preliminary estimation of the growth rates for the number of the employed is based on the data of the filled job vacancies in January-October 2008 on the supposition of the ratio of the employed by kinds of economic activities to the number of the vacant positions filled being constant.

[9] The estimation of the TFE in industrial production in 2008 may be biased because of the on changes in the extent of the facilities utilization by the enterprises of these kinds of economic activities were not taken into account.

this indicated the worsening of technological characteristics of functioning of extractive enterprises, for instance with the implementation of fields characterized by lower efficiency, with the decrease in the quality of management in the environment of the changes in price situation. The drop of prices for oil at the end of 2008 was the cause for the decrease in the input of "price" factor in TFE of the extractive sector, and, as a consequence, the negative dynamics of the TFE "technological" component.

In 2008 the processing industries demonstrated the sharp slow-down of GAV growth rates: on average over the period 2005–2008 GAV growth rates of the sector decreased by 1.7 per cent (by 1.48 per cent in correspondence with the linear trend). In correspondence with the results of the decomposition for the whole period of 2005-2008 (with the exclusion of 2007) the decrease in the number of the employed at the processing enterprises defines the negative input of labor in output growth rates in this kind of economic activity. The growth of physical volumes of fixed assets secures a steady positive input of capital stocks in output growth rates, which in combination with the increase in the intensity of productive efficiency utilization defined the dominating role of the capital input, as a factor of economic growth of processing industry in 2005–2007. In 2008 there are changes in the structure of the of the added value of this kind of economic activity: increase in output of the processing enterprises is completely defined by the changes in capital input, whereas input of labor and TFE lead to the slow-down of this growth (Fig. 5).



Note. In 2005 the break-down for the industrial production was carried out not taking into account the hours of work because of the absence of the data.

Fig. 5. Structure of Gross Added Value on the Whole Throughout Economy and in Industrial Production in 2005–2008

As a result of 2008 it is the electricity, gas and water production and distribution that demonstrates the increase in GAV growth rates being equal to 3.1% versus 2007. It should be noted that in 2005-2006 the output growth rates of this kind of economic activity demonstrated the most successful dynamics characterized by the increase in growth rates. In 2008 against the background of the growth of the volume of fixed assets and the work hours by the employees small values of the main factors input growth rates are accounted for by the decrease in the number of the employed at the enterprises of this kind of economic activity, thus in 2008 input of the main factors in GAV growth rates of the enterprises on electricity, gas and water production and distribution does not exceed 15% and the increase in production is determined exclusively by the increase in TEF growth rates.

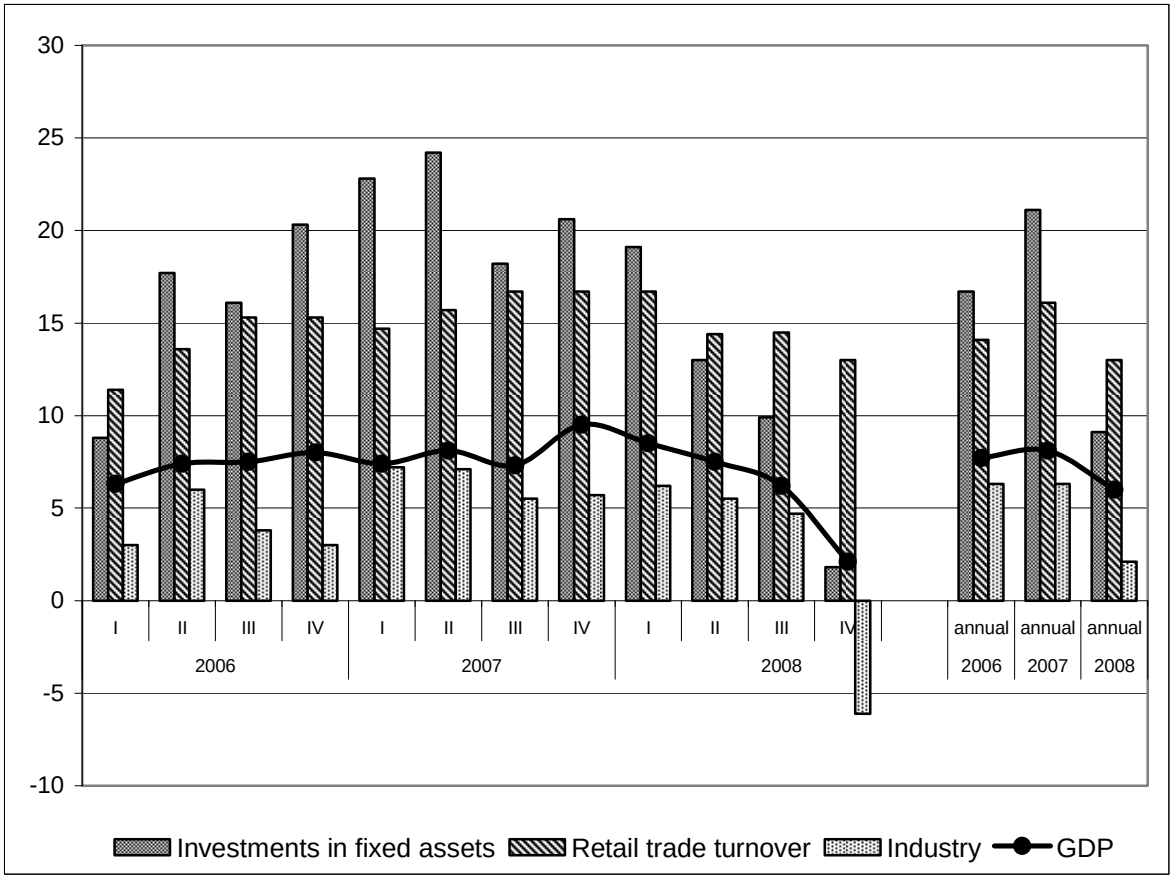
In the industrial sector the structure of TFE is uneven: as a continuation of the trend for the slow-down of the efficiency rates that outlined in 2005-2007, in 2008 the enterprises of the extractive and processing sector demonstrate the reduction of TFE; at the enterprises for electricity, gas and water production and distribution, in contrast, there is an increase in TFE growth rates observed, it acting as a dominating factor that defines the growth of this sector of industry.

3.1.5. Dynamics and Structure of production by Kinds of Economic Activities

There are two periods that can be distinguished in the development of the Russian economy throughout 2008 (*Fig. 6*). Thus, whereas in the first half of 2008 the situation was defined by the influence of the inertia factors and trends of the economic growth that had outlined in 2007-2006, starting with the second half of the year the nature of the development was more and more affected by the situation at the global financial markets and intensive decrease in the level of prices and demand at the world market of minerals, raw materials and commodities.

In 2008 the slow-down of the development rates was observed in nearly all kinds of economic activities. Macroeconomic situation was formed against the background of a sudden slow-down of the growth rates of the investments in fixed assets, workload in construction, output of industrial production, the retail trade turnover remaining at quite a high level. First, the slow-down of production rates was registered in the kinds of economic activities orientated at the export, and further it spread to processing industries, whose development had been characterized with higher growth rates in recent years.

The domestic production reacted to the reduction of the investment activity and the contraction of the internal and external demand by the decrease in the producers' prices by 20.9% in the 4th quarter as compared with the 3rd quarter 2008. Under the influence of the dramatic drop in the world prices for energy carriers and mineral products producers' prices in the sector of minerals extraction reduced by 5.4% in the 3rd quarter 2008 as compared with the preceding and quarter, and by 44.9% in the 4th quarter. On the whole over 2008 the decrease in prices in minerals extraction made 38.4%. In December 2008 producers' prices in fossil fuels extraction made 57.8% of the level of last December the prices growing by 1.58 times over the same period. A sharp decrease in prices was accompanied by the reduction in production's profitability and resulted in the consideration of the corporate investment programs, interruption of production and reduction in the number of employees. According to the estimation, in 2008 the growth of gross added value was 0.2% in minerals extraction, 0.9% in processing industries, 1.2% in electricity, gas and water production and distribution (*Table 7*).



Source: Federal State Statistics Service

Fig. 6. GDP, Investments in Fixed Assets, Retail Trade Turnover, Industrial Production Growth Rates in 2006-2008, As Percentage to Corresponding Quarter of Previous Year

Table 7

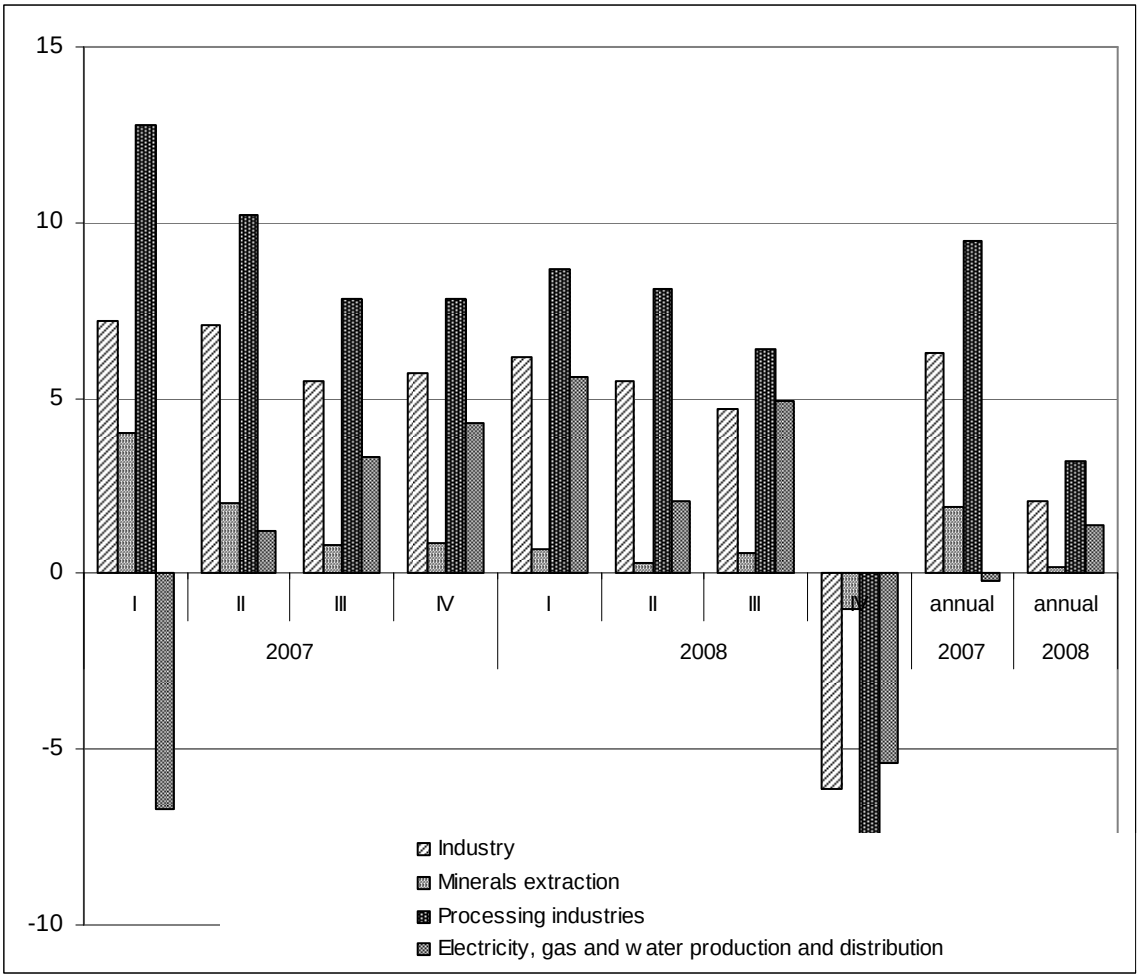
Dynamics of Physical Volumes of GDP and Gross Added Value As Broken By Kinds of Economic Activities in 2007-2008, As Percentage to Corresponding Period of Previous Year

	2007					2008			
	annual	quarters				annual	quarters		
		I	II	III	IV		I	II	III
Gross added value	108.1	107.4	108.1	107.3	109.5	105.6	108.5	107.5	106.2
including: agriculture, hunting and forestry	102.6	102.4	102.8	102.6	104.6	108.4	103.2	103.2	106.3
fishing and fish-breeding	100.6	104.6	87.7	104.8	115.5	96.8	100.0	120.2	87.7
minerals extraction	97.4	102.4	97.4	98.7	103.0	100.2	101.5	99.0	99.6
processing industries	107.8	108.5	107.4	106.8	107.2	100.9	107.6	105.6	104.9
electricity, gas and water production and distribution	99.3	90.1	99.6	101.4	103.4	101.2	105.3	101.7	104.0
construction	109.3	128.1	119.6	111.4	113.0	113.2	128.3	118.7	109.3
wholesale and retail trade	113.7	111.1	113.2	113.2	114.0	108.4	111.9	111.7	108.4
hotels and restaurants	114.9	112.7	112.1	109.8	113.7	109.9	111.7	108.8	109.3
transportation and communication	103.4	108.7	108.4	107.1	106.6	106.9	109.8	109.4	106.5

	2007					2008			
	annual	quarters				annual	quarters		
		I	II	III	IV		I	II	III
financial activity	112.5	111.1	111.5	111.4	111.8	106.6	109.7	109.7	107.9
operations with real estate	120.2	107.0	108.5	111.3	113.3	110.3	109.1	108.1	109.7
state management, provision of military security, compulsory social guarantees	103.9	107.8	108.2	107.1	107.8	103.5	103.7	102.9	103.2
education	101.2	100.9	101.0	101.0	101.2	100.7	100.2	101.0	100.2
health care and social services rendering	102.7	103.3	103.1	102.3	102.6	100.5	101.1	100.7	101.6
rendering of other utilities, social and personal services	107.4	110.6	111.4	111.2	107.9	103.8	105.9	106.5	103.1

Source: Federal State Statistics Service

On the whole over 2008 the growth rates of the industrial production remained in the field of positive values, being 100.2% in minerals extraction, 103.2% in processing industries, 101.4% in electricity, gas and water production and distribution (*Fig. 7*).



Source: Federal State Statistics Service

Fig. 7. Change in Production Growth Rates as Broken By Kinds of Economic Activities in 2007-2008, As Percentage to Corresponding Quarter of Previous Year

Extractive industries

It should be noted that the trend for the slow-down of the growth rates of the fossil fuels extraction lasting for a long time, even taking into account the extremely favorable situation at the world market, the results of the first half of 2008 demonstrated the stagnation of the output. Prices at the world market of hydrocarbons changing, since August 2008 there was a sharp drop in fossil fuels extraction rates observed in terms of both the value and physical volumes. Starting with autumn 2008 the situation in the extractive sector was aggravated by the contraction of the demand and the decrease in prices for raw materials for metallurgy and for its production at the world market, intensified contraction of the internal market under the influence of the drop of production in machine-building and construction complexes. The slow-down of growth rates has been observed since the second half of 2007, but, the investment activity remaining high, external economic situation being favorable, this did not cause serious grounds for negative forecasts.

Oil and Gas Sector

Oil and gas sector is the basis for the Russian economy, playing a leading role in the formation of state budget earnings and trade balance of the country. The price situation at the world markets as well as an objective worsening of conditions for oil and gas production, decrease in its production at “old” oil fields and the higher costs connected with the development of new ones, especially in the undeveloped regions lacking infrastructure had a determining influence on the position of the oil and gas sector in the Russian economy in 2008.

World prices in 2008 were at an exceptionally high level, exceeding USD 100 per barrel (*table 8*). In July 2008 average monthly prices for oil reached unprecedented maximum in both nominal and real terms. The main factors contributing in the growth of prices were increased demand for oil due to high world economy growth rates, in particular the economies of China, India and other Asian countries, conservative politics of OPEC concerning the increase in oil production by member countries, as well as low growth of oil production in the countries that are not OPEC members. The decrease in growth rates of oil production in Russia and the reduction of oil production in the oil fields of the North Sea has also had a considerable influence on the dynamics of oil production in recent years. Another serious factor contributing in the increase of oil process at the world market was the inflow of speculative capital at the trade exchanges. In September-December 2008 the slow-down of the economy growth, reduction of demand for oil in the developed countries and outflow of capital from he trade exchanges resulted in a considerable drop in the world prices for oil. According to the data of the OECD International energy agency, in the 4th quarter 2008 the reduction of the demand for oil in OECD countries reached 5.2% versus the corresponding period of the previous year (*table 9*).

Despite a considerable decrease in price over the last months of the year the average price for oil in 2008 (USD 97 per barrel for oil grade Brent) is exceptionally high not only for the period of the post-reform development of the Russian economy,bit also from the point of view of historic retrospective. The level of world prices for oil that can be compared with the present has only been observed in 1979-1980 since 1900, when the average annual price for oil grade Brent in real terms was equal to USD 90.7-93.1 per barrel (in prices of 2007), the prices in nominal terms being USD 31.6-36.8 per barrel. For reference it could be noted that in 1998 average annual price for oil grade Brent was USD 16.7 per barrel. In real terms in

2007 prices (USD 12.7 per barrel in nominal terms), and the average price for 1990-ies was USD 25.9 per barrel.

Table 8

World Prices for Oil in Nominal Terms in 2000–2008, as USD per barrel

	2000	2001	2002	2003	2004	2005
Price for oil grade Brent, Great Britain	28.5	24.4	25.0	28.8	38.2	54.4
Price for oil Urals, Russia	26.6	23.0	23.7	27.0	34.5	50.8
Price for oil basket of OPEC member countries	27.6	23.1	24.3	28.1	36.1	50.6

Table 8 (continuation)

	2006	2007	2008 1 quarter	2008 2 quarter	2008 3 quarter	2008 4 quarter	2008
Price for oil grade Brent, Great Britain	65.2	72.5	96.9	121.4	114.8	54.9	97.0
Price for oil Urals, Russia	61.2	69.4	93.3	117.5	113.2	54.1	94.5
Price for oil basket of OPEC member countries	61.1	69.1	92.7	117.6	113.5	52.5	94.1

Source: OECD International Energy Agency, OPEC.

Table 9

World Demand for Oil in 2008, as percentage to the corresponding period of the previous tear

	2008 1 quarter	2008 2 quarter	2008 3 quarter	2008 4 quarter	2008
Over the world, total	0,8	0,7	-0,6	-2,5	-0,4
OECD countries	-1,7	-2,0	-4,6	-5,2	-3,4
including:					
Northern America	-3,3	-3,5	-7,1	-5,2	-4,8
Europe	0,1	-0,2	-0,1	-2,9	-0,8
Asia-Pacific region	-0,5	-0,7	-5,0	-9,2	-3,9
non-OECD countries	4,2	4,3	4,6	1,0	3,5
including:					
China	7,1	2,9	7,2	0,1	4,3

Source: OECD International Energy Agency.

Monthly dynamics of world prices for oil in 2008 was characterized by an unsteady growth till July 2008, when the maximum level of oil prices was reached and the following sharp decrease starting with August 2008. By the end of the year the price for Russian oil at the world market lowered to USD 39.9 per barrel, that is it dropped by more than two thirds as compared with the level of July. The data on the monthly dynamics of the world prices for oil in 2008 are presented in *Table 10* and *Fig. 8.*

Table 10

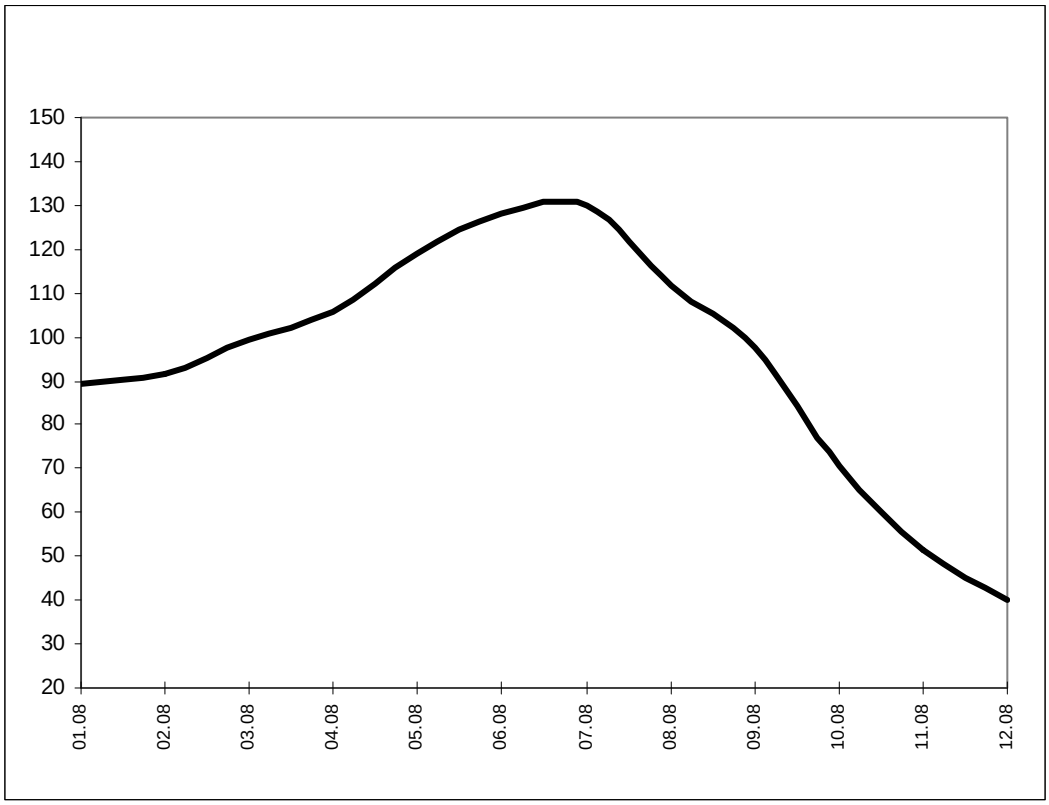
World Prices for Oil in Nominal Terms in 2008, as USD per barrel

	2008 January	2008 February	2008 March	2008 April	2008 May	2008 June
Price for oil grade Brent, Great Britain	92.0	95.0	103.7	109.0	122.7	132.4
Price for oil Urals, Russia	89.4	91.4	99.2	105.7	118.8	128.1

Table 10 (continuation)

	2008 July	2008 August	2008 September	2008 October	2008 November	2008 December
Price for oil grade Brent, Great Britain	133.2	113.0	98.1	71.9	52.5	40.4
Price for oil Urals, Russia	130.1	111.9	97.5	70.8	51.5	39.9

Source: OECD International Energy Agency, OPEC.



Source: Ministry for Trade and Economic Development of the Russian Federation.

Fig. 8. Price for Oil Grade Urals in 2008, as USD per barrel

In the environment of the sharp decrease in the world prices for oil the OPEC has adopted a number of resolutions on reduction of oil production by member countries in order to support prices for oil. In September 2008 the OPEC decided to adhere to the quota of September 2007 corrected taking into account the joining of Angola and Ecuador to the cartel but not including Iraq and Indonesia[10], which decreased the volume of oil production by the member countries by 520 thousand of barrels as compared with July 2008. In October 2008 the OPEC adopted the resolution on reduction of the production by 1.5 million of barrels a day on the level of September 2008 starting with 1 November 2008. In December 2008 the decision on the reduction of oil production by 4.2 million of barrel per day as on the level of September starting with January, 1 2009.

These decisions did not, however, have any visible effect on the market. This is due to both the incomplete fulfillment of the liabilities taken by the OPEC member countries and the

[10] Indonesia became netto exported of oil in 2008 and declared its withdrawal from OPEC. From 2009 Indonesia is not a member of OPEC.

decrease in demand for oil in the developed countries in the environment of the started recession.

The increase in oil production in Russia of the first half of 2000-s (*Table 11*) was connected with the expansion of the opportunities for its export, in particular in connection with the creation of Baltic pipeline system and the use of railway transportation, intensification of exploitation of oil fields currently in operation and the broadening of investment opportunities for oil producing countries as a result of the growth of the world priced for oil. In recent years the oil production growth rates in Russia have decreased considerably. Whereas in 2004-2006 increase in oil production made 9-11% a year, in 2006-2007 the annual increase was equal only to 2.1%, and in 2008 there was a decrease in oil production observed for the first time (*Table 12*). This indicates the exhaustion of reserves for oil production at the expense of intensification of the exploitation of the oil fields in operation and testifies the necessity to develop new oil fields more actively.

Oil processing has been growing at higher rates than oil production in recent years, which was accounted for by the fast growth of oil products export. In 2005-2008 the growth rates of primary oil processing made 3.2-6.2%, oil production growing at the rate of 2.1-2.2% in 2005-2008 and decreasing by 0.7% in 2008. As a result the proportion of oil processing in its production has increased from 42.5% in 2004 to 48.4% in 2008, which is nevertheless below the level of 2000-2001, when more than a half of the oil produced was directed for processing.

At the same time the extent of oil processing has increased but little and was equal to only 72% in 2008, whereas in the leading industrial countries it reaches 90-95%. The efficiency of oil processing and quality of the oil products made in Russia remain substantially below the world level.

Table 11

Production and Processing of Oil and Production of Gas in Russian Federation in 2000-2008

	2000	2001	2002	2003	2004	2005	2006	2007	2008
Oil production, gas condensate included, as million of tons	323.2	348.1	379.6	421.4	458.8	470.0	480.5	491.3	488.5
Primary oil processing, as million of tons	173	179	185	190	195	208	220	229.0	236.3
Proportion of oil processing in its production, as percentage	53.5	51.4	48.7	45.1	42.5	44.3	45.8	46.6	48.4
Extent of crude oil. processing, as percentage	71	71	70	70	71	71.6	71.9	71.7	72.0
Natural gas production, as billion of cu m	584.2	581.5	594.5	620.3	634.0	636.0	656.2	654.1	664.9

Source: Federal State Statistics Service, Ministry for Power Industry of the Russian Federation

In 2002-2008 the natural gas production was characterized by slow growthwith the exception of 2007 when the decrease in its production was observed (0f 0.8% as compared with 2006). The main reason for the reduction in gas production in 2007 was the decrease in the external demand for it, and, correspondingly, its export under the influence of warm winters as well as the increase in prices for gas supplied in CIS countries.

Table 12

Oil, Oil Products and Natural Gas Production in 2002-2008, as percentage on the previous year

	2000	2001	2002	2003	2004	2005	2006	2007	2008
Oil, gas condensate included	106.0	107.7	109.0	111.0	108.9	102.2	102.1	102.1	99.3
Primary oil processing	102.7	103.2	103.3	102.7	102.6	106.2	105.7	103.8	103.2
Car petrol	103.6	100.6	104.9	101.2	103.8	104.8	107.4	102.1	101.8
Diesel oil	104.9	102.0	104.7	102.0	102.7	108.5	107.0	103.4	104.1
Furnace oil	98.3	104.2	107.1	100.3	97.8	105.8	104.5	105.2	101.9
Natural gas	98.5	99.2	101.9	103.4	101.6	100.5	102.4	99.2	101.7

Source: Federal State Statistics Service

In 2008 the biggest amount of oil was produced by oil companies Rosneft, LUKOIL, TNK-BP, Surgutneftegas and Gazprom. The share of these 5 companies is 77.4% of the total oil production in the country. The share of the medium-scale companies (Tatneft, Slavneft, Russneft, Bashneft) accounted for 14.7% of the total oil production. Production share agreement operators produced 2.5% of the Russian oil in 2008. The share of other producers, to which more than 100 small scale oil producing enterprises belong, was only 4.9% of oil production in the country (*Table 13*)

Table 13

Oil Production By Different Oil Companies in 2006–2008

	Oil production in 2006, mln of tons	Share in the total production,%	Oil production in 2007, mln of tons	Share in the total production,%	Oil production in 2008, mln of tons	Share in the total production,%
Russia - total	**480.5**	**100.0**	**491.3**	**100.0**	**488.5**	**100.0**
Rosneft	81.7	17.0	110.7	22.5	113.8	23.3
LUKOIL	90.4	18.8	91.4	18.6	90.2	18.5
TNK-BP	72.4	15.1	69.4	14.1	68.8	14.1
Surgutneftegas	65.6	13.7	64.5	13.1	61.7	12.6
Gazprom+Gazpromneft	46.1	9.6	45.8	9.3	43.4	8.9
Of which:						
Gazprom	13.4	2.8	13.2	2.7	12.7	2.6
Gazpromneft	32.7	6.8	32.6	6.6	30.7	6.3
Tatneft	25.4	5.3	25.7	5.2	26.1	5.3
Slav-neft	23.3	4.8	20.9	4.3	19.6	4.0
YUKOS	21.5	4.5	-	-	-	-
RussNeft	14.8	3.1	14.2	2.9	14.2	2.9
Bashneft	11.7	2.4	11.6	2.4	11.7	2.4
NOVATEC	2.6	0.5	2.6	0.5	2.7	0.6
Operators of production share agreements	5.1	1.1	13.8	2.8	12.0	2.5
Other producers	19.9	4.1	20.7	4.2	24.1	4.9
State-owned companies - total:						
Rosneft+Gazprom+Gazpromneft	127.8	26.6	156.5	31.9	157.2	32.2

Source: Ministry for Industry and Power, author's calculations.

The increase in the state-owned companies influence in the oil sector was quite characteristic trend for the recent years. The positions of the state-owned companies strengthened considerably due to the purchase of private-owned companies assets. In 2004 oil company Rosneft purchased Yuganskneftegas, the main oil producing enterprise of YUKOS, in 2005 Gazprom purchased oil company Sibneft. In 2006 Gazprom purchased controlling stock in "Sakhalin-2" project, which is being fulfilled by foreign investors on conditions of production share agreement. In 2007 the share of state-owned companies at the market increased due to the purchase of the remaining oil producing and oil processing assets of YUKOS – enterprise was declared bankrupt in 2006 - by Rosneft.

As a result of such redistribution taking place Rosneft became the biggest oil company of the country and the share of state-owned companies (in federal property) in all-Russian oil production reached 32.2% in 2008. Taking into account companies controlled by the subjects of the Federation (Tatneft, Bashneft), the share of the state companies in oil production made 39.9%. For reference it could be noted that in 2003 the share of Rosneft and Gazprom in all-Russian oil production accounted for only 7.2%, and the total share of state companies, raking into account Tatneft and Bashneft, made 16.1%.

Gazprom, whose share in all-Russian production was equal to 83.2% in 2008, commands as usual the gas production (*Table 14*). The share of the oil companies in gas production remains quite low (8.2%). At the same time the share of NOVATEK company, production share agreement operators and other producers in gas production has increased.

Table 14

Gas Production By Various Producers in 2007–2008

	Gas production in 2007, bln of cu m	Share in the total production, %	Gas production in 2008, bln of cu m	Share in the total production, %
Russia - total	**654.1**	**100.0**	**664.9**	**100.0**
Gazprom+Gazpromneft	**551.9**	**84.4**	**553.1**	**83.2**
Of which: Gazprom	**550.1**	**84.1**	**550.9**	**82.9**
Oil companies	**56.9**	**8.7**	**54.8**	**8.2**
NOVATEC	**28.5**	**4.4**	**30.8**	**4.6**
Operators of production share agreement	**6.7**	**1.0**	**8.5**	**1.3**
Other producers	**10.1**	**1.5**	**17.6**	**2.6**
State-owned companies - total: Rosneft+Gazprom+Gazpromneft	**568.9**	**87.0**	**566.1**	**85.1**

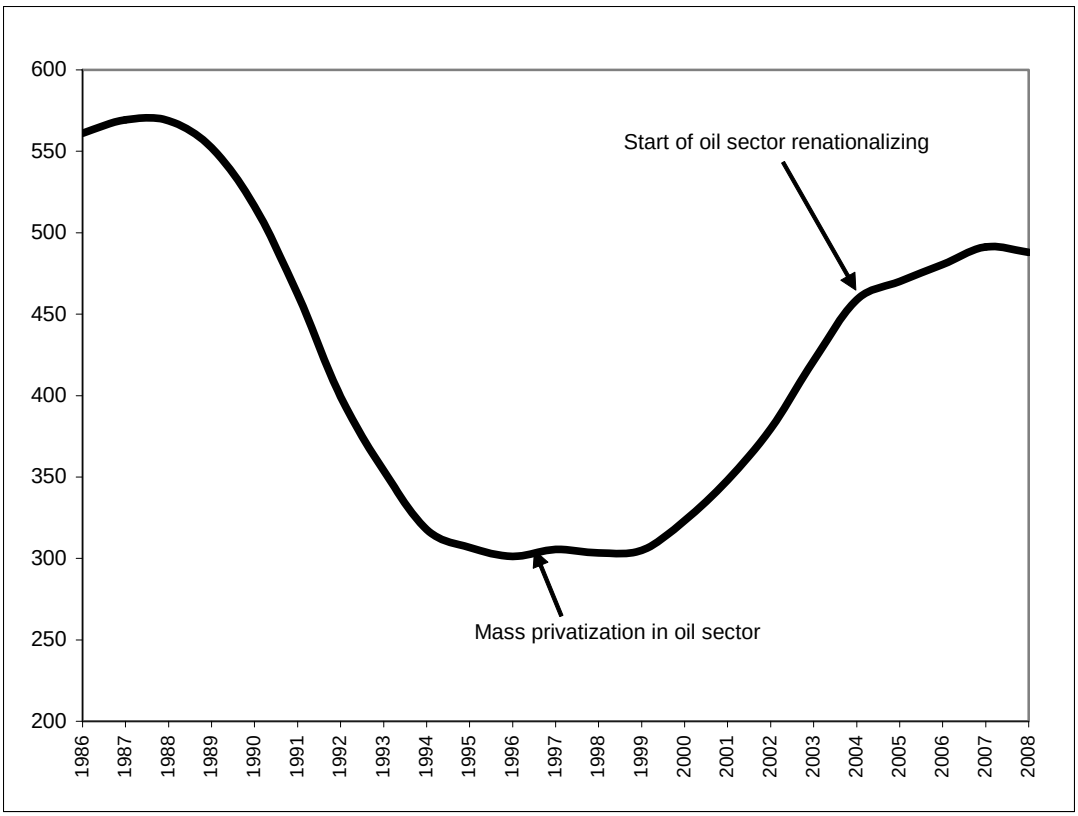
Source: Ministry for Industry and Power, author's calculations.

Data on oil production by oil companies demonstrate that increase in oil production in Russia even in 2007 was mainly due to a considerable growth of oil production by projects of production share agreement operators and primarily by the project Sakhalin-1. Not taking into account production share agreements projects the increase in oil production in Russia was equal only to 0.4% in 2007. In 2008 the production of oil demonstrated the negative dynamics: as compared with the previous year it reduced by 0.6%.

Decrease in oil production growth rates is primarily accounted for by the objective worsening of the conditions for its production. A considerable part of the oil fields currently in operation is at the stage of the decreasing production and new oil fields in most cases are characterized by worse mining and geological conditions, their development requiring higher capital, exploitation and transportation costs. At the same time the existing taxation system does not provide necessary decrease in the taxation load when developing new fields with higher costs, which limits the investments in new projects. As a result the investments made do not provide the increase in oil production that would compensate the decrease in its production at "old" oil fields.

The government expansion in the oil sector has obviously somewhat influenced the dynamics of the investments in recent years as well, contributing in the growth of apprehensions on further uptake of the private business and, as a result, the lowering of stimuli for long-term investments at oil companies. At the same time the state companies are limited in their investments amounts by the necessity to make huge repayments for credits attracted by them to purchase new assets.

It can be supposed that the instability of property relations having affected negatively the dynamics of investments in the branch was one of the factor for the decrease in oil production observed in the country (*Fig. 9*).



Source: Federal State Statistics Service

Fig. 9. Oil Production in Russia in 1986–2008, as million of tons

Against the background of production decrease in 2008, for the first time over the recent years there has occurred a reduction in physical volumes of oil export (*Tables 15* and *16*). Net oil and oil products export was equal to 358.1 million of tons in 2008 and decreased by 2.5% as compared with the previous year. The share of the net oil and oil products export in oil production was 73.3%. Net oil export in 2008 made 49.3% of its production. In 2008 the share of export in furnace fuel production was 83.0%, in diesel fuel production – 54.2%, in car petrol production – 12.5% (for reference: in 1999 the share of export in car petrol production was 7.2% in 1999, 18.5% in 2005, 18.3% in 2006, 17.1% in 2007).

In 2008 there was an increase in oil products import observed, though the share of import in the covering of the internal demand remained low. Thus, in 2008 the share of import in petrol resources was 0.7% (for reference: the share of import in petrol resources was 8.7% in the first half of 1998, 0.02-0.04% in 2005-2007). The same figure for diesel fuel and furnace fuel was 0.4-0.5%.

Table 15

Oil, Oil Products and Natural Gas Export from Russia in 2002-2008, As Percentage on the Previous Year

	2002	2003	2004	2005	2006	2007	2008
Oil, total	113.9	117.8	115.0	98.4	98.0	104.0	94.0
including:							
to non-CIS countries	109.9	118.9	116.3	99.1	98.0	104.8	92.6
to CIS countries	137.3	112.4	108.3	94.9	98.0	99.4	102.6
Oil products, total	118.5	103.6	105.5	117.9	106.3	108.0	105.0
including:							
to non-CIS countries	119.1	102.6	104.9	119.1	104.5	107.6	102.0
to CIS countries	102.8	132.3	117.9	94.6	148.8	115.3	152.2
Gas, total	102.4	102.0	105.5	103.7	97.6	94.6	101.8

Source: Federal State Statistics Service

In the gas sector production was mainly orientated to the internal market. At the same time in 2008 some increase in gas export was observed (by 1.8% after is decrease by 5.4% in 2007). The proportion of the net export in gas production in 2008 made 28.3% (*Table 16*).

Table 16

Ratio of Energy Supplies Production, Consumption and Export in 2000–2008

	2000	2001	2002	2003	2004	2005	2006	2007	2008
Oil, mln tons									
Production	323.2	348.1	379.6	421.4	458.8	470.0	480.5	491.3	488.5
Export, total	144.5	159.7	187.5	223.5	257.4	252.5	248.4	258.4	243.1
Export to non-CIS countries	127.6	137.1	154.8	186.4	217.3	214.4	211.2	221.3	204.9
Export to CIS countries	16.9	22.7	32.7	37.1	40.1	38.0	37.3	37.1	38.2
Net export	138.7	154.7	181.3	213.4	253.2	250.1	246.1	255.7	240.6
Domestic consumption	123.0	122.9	123.5	129.8	124.2	123.1	131.2	124.1	130.4
Net export, as percentage to the production	42.9	44.4	47.8	50.6	55.2	53.2	51.2	52.0	49.3
Oil products, mln tons									
Export, total	61.9	70.8	75.0	78.4	82.1	97.0	103.5	111.8	117.9
Export to non-CIS countries	58.4	68.3	72.5	74.9	78.0	93.1	97.7	105.1	107.6
Export to CIS countries	3.5	2.5	2.6	3.5	4.1	3.9	5.8	6.7	10.3
Net export	61.5	70.5	74.8	78.2	81.4	96.8	103.2	111.5	117.5
Oil and oil products, mln tons									
Oil and oil products net export	200.2	225.2	256.1	291.6	334.6	346.9	349.3	367.2	358.1
Oil and oil products net export, as percentage of oil production	61.9	64.7	67.5	69.2	72.9	73.8	72.7	74.7	73.3
Natural gas, bln. cu. m									
Production	584.2	581.5	594.5	620.3	634.0	636.0	656.2	654.1	664.9
Export, total	193.8	180.9	185.5	189.3	200.4	207.3	202.8	191.9	195.4
Export to non-CIS countries	133.8	131.9	134.2	142.0	145.3	159.8	161.8	154.4	158.4
Export to CIS countries	60.0	48.9	51.3	47.3	55.1	47.5	41.0	37.5	37.0
Net export	189.7	176.8	178.3	180.5	193.5	199.6	195.3	184.5	187.9
Domestic consumption	394.5	404.7	416.2	439.8	440.5	436.4	460.9	469.6	477.0
Net export, as percentage to the production	32.5	30.4	30.0	29.1	30.5	31.4	29.8	28.2	28.3

Source: Federal State Statistics Service, Ministry for the Industry and Power, Federal Customs Service, IET calculations.

The share of oil products export having increased to some extent, the crude oil export, being 67.2% of the total export volume, still prevailed in the structure of oil export. It was the furnace fuel oil, which is used as a primary product in Europe for further processing, and diesel oil that consisted the main part of the oil products export. The main part of the energy supplies (84.3% of oil, 91.3% of oil products and 81.1% of gas) was exported beyond CIS countries.

As it is demonstrated by the analysis of the Russian oil export dynamics over the long period of time the increase of oil products share in oil export has been observed, growing from 18.2% in 1990 to 32.8% in 2008 (*Table 17*). In the environment of the sharp reduction of domestic oil consumption (according to our calculations it has decreased from 269.9 million tons in 1990 to 130.4 million tons in 2008, that is more than by half) the share of oil and oil products net export in oil production increased over this period from 47.7% to 73.3%.

Table 17

Net Export of Oil Products in 2002–2008

	2002	2003	2004	2005	2006	2007	2008
Oil products net export, mln tons	**74.8**	78.2	**81.4**	**96.8**	103.2	111.5	117.5
The share of oil products in net export of oil and oil products, as percentage	**29.2**	**26.8**	**24.3**	**27.9**	29.5	30.4	32.8

Source: Federal State Statistics Service, Federal Customs Service, IET calculations

The given data testify that the export orientation of oil sector in comparison with the pre-reform period has considerably reinforced. It should be, however, taken into account that it is connected not only with the increase of the absolute export volumes, but also with a considerable decrease in the domestic oil consumption as a result of Russian economy market transformation. In recent years in the environment of fast economic growth the volumes of internal consumption of oil have been quite stable in the country, which gives evidence for the decrease in the oil capacity of the GDP in Russia.

Increase in world prices for oil determined considerable incomes growth in the oil sector of the economy (*Fig. 10* and *11)*. In 2008 total earnings from oil and main kinds of oil products export (car petrol, diesel oil and furnace fuel oil) reached USD 228.9 billion., which exceeds the earnings from oil and oil products export in 2007 by 38.8% and is a record level over the whole post-reform period (*Table 18*). For reference it can be noted that the minimum level of oil export earnings was observed in the environment of world oil prices fall in 1998, when the export profit was only USD 14 billion.

Table 18

Oil and Oil Products Export Earnings in 2000–2007, USD bln

	2000	2001	2002	2003	2004	2005	2006	2007	2008
Oil and main kinds of oil products export earnings	34.9	33.4	38.7	51.1	74.6	112.4	140.0	164.9	228.9

Source: calculated on the basis of the Federal State Statistics Service data

In 2008 the physical volumes of oil export decreasing by 6.0% as compare4d with the previous year, the export in value terms increased by 32.6% due to the growth of world prices for oil. As to the gas export in 2008, its value volume increased by 54.1% as compared with the previous year.

At the same time as a result of the drop of oil prices in the forth quarter of 2008 there was a considerable reduction in oil export earnings observed (*Table 19*).

Table 19

Oil and Oil Products Export Earnings in 2008, as USD billion

	2008 1 quarter	2008 2 quarter	2008 3 quarter	2008 4 quarter
Earnings from the export of oil and main kinds of oil products	53.2	64.4	68.9	42.4

Source: calculated on the basis of Federal State Statistics Service

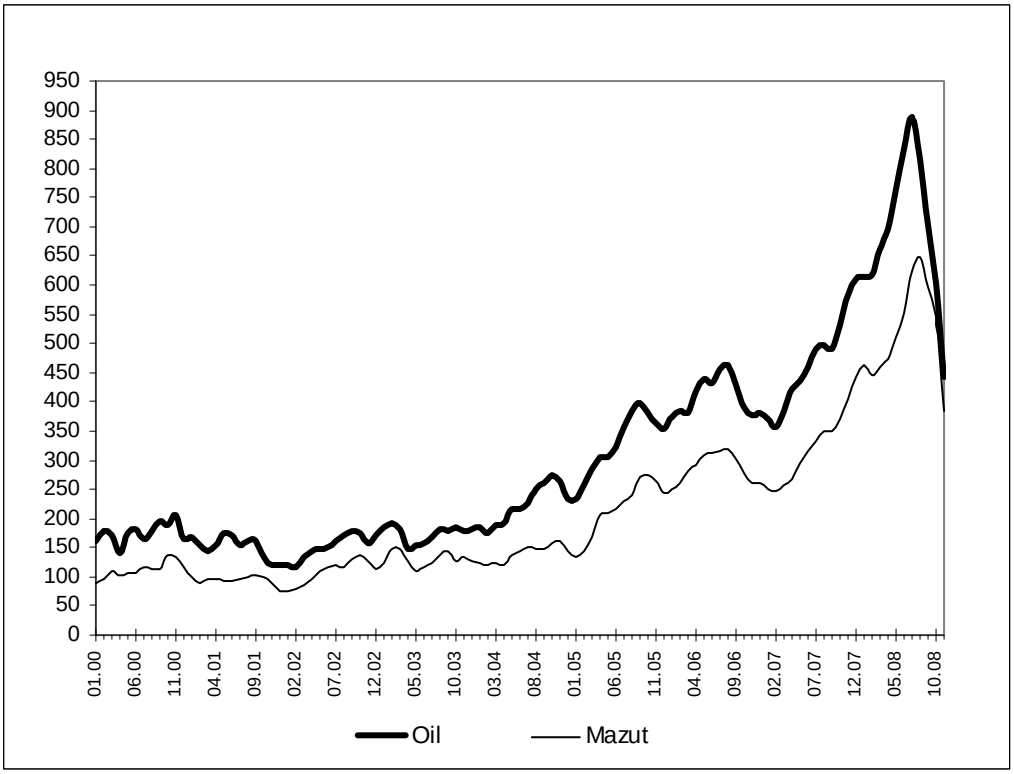
Under the influence of the increase in world prices for oil and gas the share of power and energy commodities in Russian export in 2008 reached 68.6%, of which crude oil accounted for 34.4% and natural gas – for 14.8%. (*Table 20*).

Table 20

Value and Share of Fuel and Power Commodities in 2005–2008

	2005		2006		2007		2008	
	USD bln	%*	USD bln	%*	USD bln	%*	USD bln	%*
Fuel and Power commodities, total	154.7	64.1	196.9	65.4	225.6	64.0	321.1	68.6
of which: oil	83.8	34.7	102.3	34.0	121.4	34.4	161.2	34.4
natural gas	31.4	13.0	43.9	14.6	44.8	12.7	69.1	14.8

* as percentage to the total volume of Russian export
Source: Federal State Statistics Service

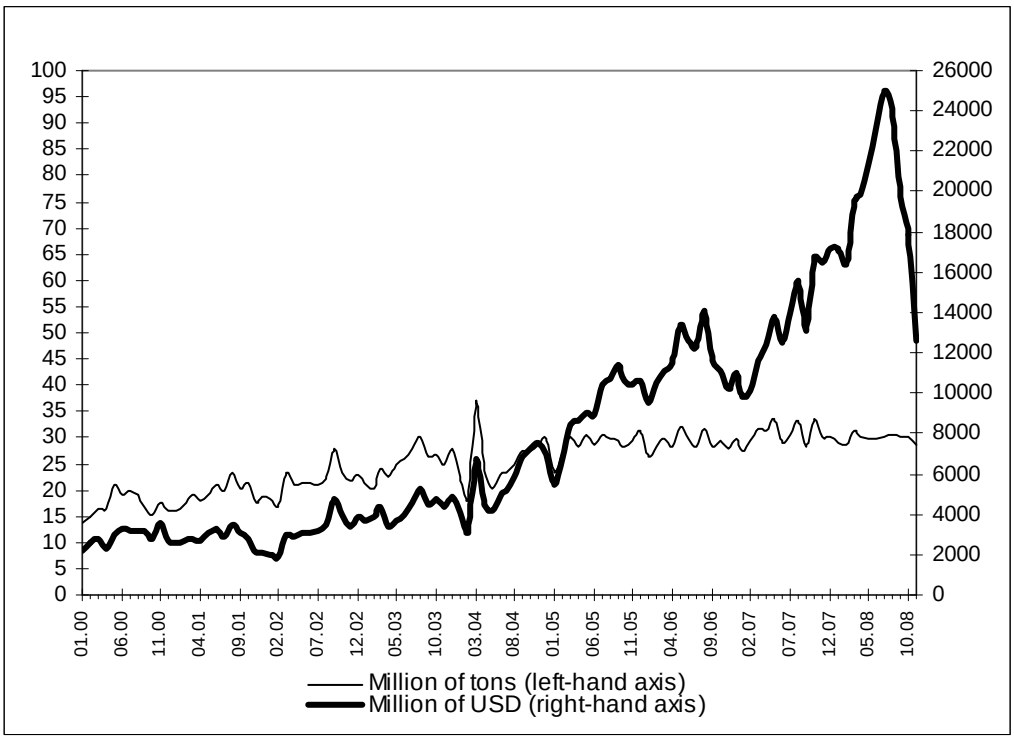


Source: calculated on the basis of the data by Federal State Statistics Service

Fig. 10. Average Prices for Oil and Furnace Oil (Mazut) Export in 2000–2008, as USD per ton

Under the influence of world prices for oil during the biggest part of 2008 there was a considerable growth of prices observed at the internal market (*Table 21*, *Fig. 12* and *13*). In summer 2008 the producers' prices for oil, car petrol, diesel fuel and furnace fuel reached the figures that were the maximum for the whole post-reform period. In July 2008 the average internal prices for oil (producers' prices) reached USD 410.2 per ton, and the average price for car petrol – USD 810.3 per ton. Internal prices for natural gas have also increased. The gas producers' prices reached USD 20 per 1 thou. cu. m in June 2008. Average price for gas purchase in the industry, including both the gas production price and its transportation costs and

trade and sales extra charge reached USD 97.4 per 1 thou. cu. m. In September-December 2008 under the influence of decrease in oil prices at the world market and the decrease in ruble exchange rate there has been observed a decrease in the internal prices for oil and oil products (producers' prices) in dollar terms.



Source: calculated on the basis of the data by Federal State Statistics Service

Fig. 11. Oil and Oil products Export in Natural and Value Terms in 2000–2008, million of tons, USD million

Table 21

Internal Prices for Oil, Oil Products and Natural Gas in Dollar Terms in 2000-2008 (average producers' prices as USD per ton)

	2000 December	2001 December	2002 December	2003 December	2004 December	2005 December
Oil	54.9	49.9	60.7	70.1	123.5	167.2
Car petrol	199.3	151.5	168.8	236.9	333.1	318.2
Diesel fuel	185.0	158.5	153.8	214.3	364.3	417.0
Furnace fuel	79.7	47.1	66.1	66.0	69.4	142.7
Gas, USD/1 thousand cu m	3.1	4.8	5.9	4.4	10.5	11.5

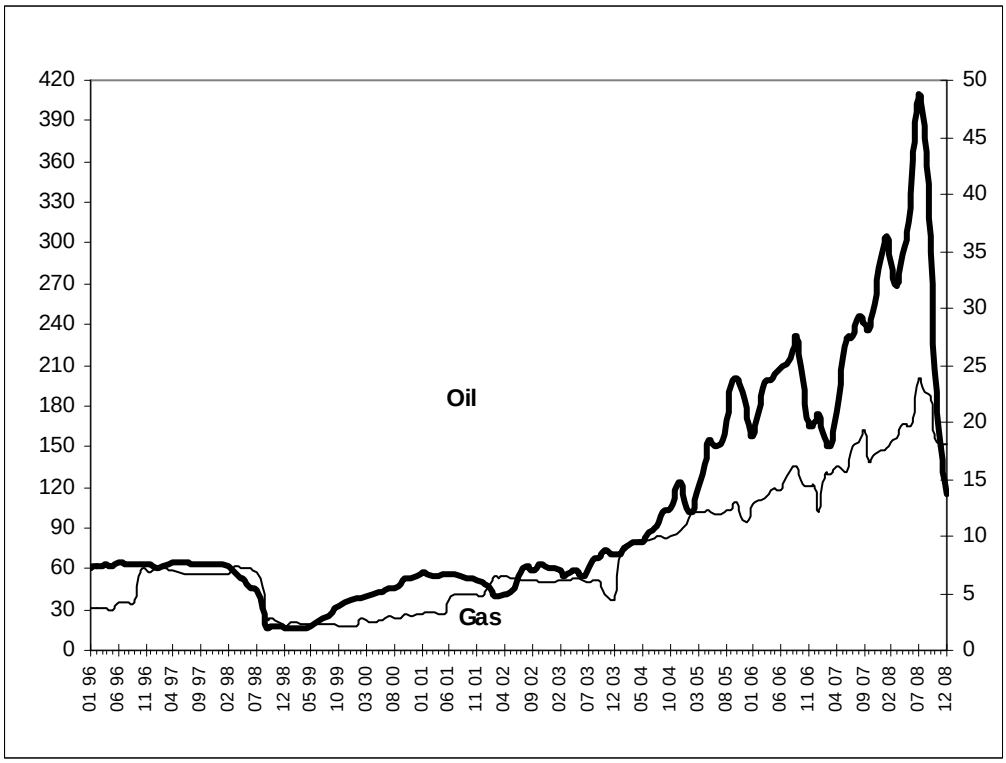
Table 21 (continuation)

	2006 December	2007 June	2007 December	2008 June	2008 July	2008 December
Oil	168.4	230.3	288.2	360.4	410.2	114.9
Car petrol	416.5	491.7	581.2	763.6	810.3	305.1
Diesel fuel	426.1	442.0	692.5	850.7	902.8	346.5
Furnace fuel	148.8	181.6	276.5	337.2	392.8	125.0
Gas, USD/1 thousand cu m	14.4	15.6	17.6	20.0	23.8	18.1

Source: calculated on the basis of the data of the Federal State Statistics Service

Internal prices for oil and gas in Russia still remain considerably below the world prices. The gap between world and internal prices is accounted for by the presence of export duty rate and additional transportation costs for export. The price for oil at independent internal market (segment of market at which the oil is sold not at transfer prices) in recent years is practically formed on the basis of its world price deduced by the export duty rate and expenditures for export. Internal prices for gas are still regulated by the state and established by the government.

In forthcoming years a gradual increase in internal prices for gas up to the level securing the equal profitability of its sales at the internal and external market is envisaged. The gap between the world and internal prices for gas in this case will reduce, but the internal prices will remain below the world ones (by the value of export duty rate and transportation costs).

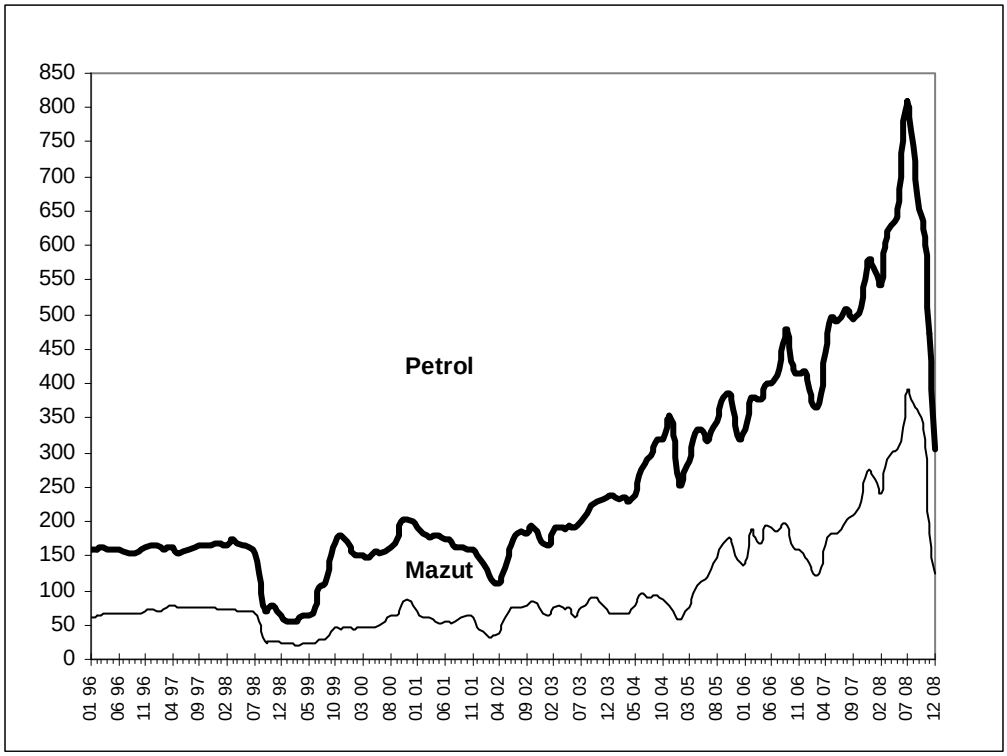


Source: calculated on the basis of Federal State Statistics Service data

Fig. 12. Average Producers' Prices for Oil and Gas as USD in 1996-2008, as USD per ton, USD per thousand of cu m

In 2008 a number of serious decisions concerning the improvement of the taxation of the oil sector of the economy was adopted. System of oil industry taxation, which was introduced in 2002, is based on severance tax, which is levied on flat specific rate (*Table 22*) and did not take into account existing differences in oil production conditions because of mining and geological characteristics of oil field, their location, as well as the stage of exploitation. As a result, oil production economy at oil fields with higher costs has been worsening, selective choice of the most effective reserves and pre-term cessation of exhausted fields has been encouraged. At the same time putting new fields with higher costs in operation, especially in

the undeveloped regions with undeveloped or lacking infrastructure has been becoming more complicated.



Source: calculated on the basis of Federal State Statistics Service data

Fig. 13. Average Producers' Prices for Car Petrol and Furnace Oil (Mazut)
As USd in 196-2008, as USD per ton

Table 22

Severance Rate for Oil Production in 2002–2008

	2002	2003	2004	2005	2006	2007	2008
Severance base rate, RUR per ton	340	340	347	419	419	419	419
Coefficient, characterizing the oil world prices dynamics (Cp)		(P-8)xR/252			(P-9)xR/261		

Key: P is the average price level for oil grade Urals in USD per barrel over the taxation period; R is the average over the taxation period value of USD to RUR rate exchange, which is fixed by the Central Bank of the Russian Federation

Source: tax Code of the Russian Federation, Federal Law No 151-FZ from July 27, 2006, Federal Law No. 33-FZ from May 7, 2004, Federal Law No. 126-FZ from August 8, 2001.

Imperfections of severance tax flat rate provoked the search of variants for differentiation of tax rate, taking into account real mining and geological, geographical differences in oil production conditions. In 2007 the system of oil production taxation was supplemented with new elements:

1. Step-down coefficient Ce to severance tax rate has been introduced for oil fields with exhaust of reserves of more than 80%. This coefficient is calculated according to some gen-

eral formula and lies in the range from 1 (level of exhaust is 0.8) to 0.3 (level of exhaust is 1 or more).

2. Tax vacations from severance tax are introduced for oil fields in East-Siberian oil and gas province in the Republic Sakha (Yakutia), Irkutsk oblast, Krasnoyarsk krai. The oil fields situated in the regions will be subject to zero severance tax rates till 25 mln tons of accumulated oil production volume on the subsoil area is achieved or when period of exploitation is less than 10 years, or for 10 years for the license to use subsoil with the aim of exploration and for 15 years in case of the license for simultaneous geological exploration and oil production from the moment of the state registration of the license.

The severance zero rate for the period before reaching of 25 million tons of accumulated oil production volume on the subsoil area or the period of exploitation of less than 10 years, calculated from 1 January 2007, is also applied to all oil fields of these region in the process of development, if the extent of exhaust does not exceed 0.05.

3. Zero severance tax rate is established for superviscous oil fields.

These amendments adopted are aimed at the stimulation of the development of exhausted and new oil fields. Severance rate differentiation with regard to reserves exhaust enables to prolong exhausted fields development periods and increase oil extraction extent. The extension of exhausted fields exploitation provides extra inpayments of severance (collected with the lowered rate) as well as other taxes (profit tax, export duties etc.). Severance rate reduction for new oil fields makes it possible to stimulate the development of East Siberia oil and gas province, create the basis for future income of the state budget.

At the same time passed amendments envisage that severance preferences for new and exhausted oil fields can only be received when applying a direct method of oil production quantity control at the subsoil area. As applied to exhausted oil fields, this regulation limits substantially the sphere of tax remissions application, for the majority of exhausted oil fields (licensed lots) have not got a direct control of oil production quantity. As a result, application of this privilege is rather limited, that is the task of stimulation and prolongation of exhausted fields exploitation is solved only partially and in limited scope.

The changes made did not solve also the task to stimulate by taxation new oil fields with higher costs development that are not a part of East-Siberian oil and gas province, that is located in other regions and on continental shelf. Higher capital, exploitation and transport costs lead to inefficiency of fulfillment of these oil fields development projects under general tax regime.

New oil fields are usually characterized by worse mining, geological and geographical conditions their exploitation requiring increase in capital, operating and transportation costs. At the same time existing taxation system does not provide necessary decrease of tax burden while exploitation of new oil fields with high costs that limits investments in new projects. Start of such oil fields development is connected with higher costs, especially in the undeveloped regions with undeveloped or lacking infrastructure and requires improvement of the existing system of oil sector taxation, pursuing of special tax policy, which provides necessary incentives for investments in oil production.

In 2008 the amendments to the Tax Code of the Russian Federation aimed at the reduction of tax burden on oil sector of the economy, stimulation of new and exhausted oil fields development in undeveloped regions and on the continental shelf were elaborated and adopted. The amendments come into effect on 1 January 2009. The most important among them influencing the economy of oil production are the following:

1. In the formula used for calculation of Cp coefficient, which characterizes the world oil prices dynamics and applied to the severance tax basic rate, the price minimum not levied with the tax was increased from USD 9 to USD 15 per barrel, the formula now being:

$$Cp = (P – 15) \times R / 261 ,$$

where P is average level of oil grade Urals price in USD per barrel, R – average exchange rate of Us dollar against ruble, established by the Central Bank of the Russian Federation.

As it is demonstrated by calculations, change in Cp calculation formula inflation will lead to considerable decrease in the applied rate of severance tax on oil production. Owing to these factors, under forecast conditions for 2009 the severance tax rate in real terms will decrease by more than 25% as on 2007.

Such a decrease in severance tax rate will reduce tax burden on oil sector, allow oil companies to have additional financial resources to use, increase profitability of investments into development of new oil fields, will stimulate deeper exploitation of exhausted oil fields.

2. The requirement for application a direct method of oil production quantity control at the subsoil area for the established severance tax privileges to be used at oil fields with high level of exhaustion and at oil fields in East-Siberian oil and gas province (in the territory of the Republic Sakha (Yakutia), Irkutsk oblast and Krasnoyarsk krai) is abolished.

The opportunities to apply the established privileges for severance tax and primarily the deflation coefficient to severance rates at exhausted fields were substantially limited by the requirement for the application of a direct control of oil production quantity. Since taking technical steps to secure direct control over oil production at such oil fields is economically ineffective in the majority of cases, this prevented using the severance privilege, established for them, which led to pre-term cessation of their exploitation and loss of oil in subsoil areas.

Application of severance tax privileges on the basis of the system of oil production control currently in use at some subsoil plots will allow application of privileges at all exhausted oil fields, which will secure the prolongation of the period of their exploitation, additional oil production and extra tax earnings.

This will also allow application of severance tax privilege (tax vacations) at new small oil fields of East-Siberian oil and gas province and other privileged regions. The organization of the direct method for oil production at such oil fields is economically ineffective and they will remain undeveloped unless there is a severance privilege.

At the same time it should be noted that upon application of the existing system for the control over the quantity of oil produced the oil producing companies get some incentive for manipulating when distributing the volumes of oil produced among the separate licensed plots. Therefore the government has to secure necessary control over the reliability of such accounts.

3. For oil fields on the continental shelf of the Russian Federation, situated to the north of the Arctic circle zero severance tax rate is established up to achievement of oil production of 35 million of tons or for the period of 10 years for licenses for subsoil exploitation for exploration or for 15 years for licenses for subsoil exploitation to simultaneous exploration and minerals extraction from the date of government registration of the corresponding license. For subsoil plots situated in these areas licenses for which are given before 1 January 2009 and the level of whose exhaust does not exceed 0.05 zero severance tax rate is in effect till 35 million tons of oil production is reached or during 10 years, starting with 1 January 2009.

4. For oil fields situated in Azov and Caspian seas zero severance tax rate is established for the period until accumulated volume of oil production of 10 million tons is reached at a subsoil plot or for 7 or 12 years from the date of government registration of the license depending on the kind of license for subsoil exploitation. For subsoil plots situated in these areas licenses for which are given before 1 January 2009 and the level of whose exhaust does not exceed 0.05 zero severance tax rate is in effect till 10 million tons of accumulated volume of oil production is reached or during 7 years, starting with 1 January 2009.

5. For oil fields situated in the territory of Nenets autonomous okrug (the north of Timano-Pechor oil and gas province) and on the Yamal peninsula in Yamalo-Nenets autonomous okrug zero severance tax rate is established for the period until accumulated volume of oil production of 15 million tons is reached at a subsoil plot or for 7 or 12 years from the date of government registration of the license depending on the kind of license for subsoil exploitation. For subsoil plots situated in these areas licenses for which are given before 1 January 2009 and the level of whose exhaust does not exceed 0.05 zero severance tax rate is in effect till 15 million tons of accumulated volume of oil production is reached or during 7 years, starting with 1 January 2009.

The measures enumerated will stimulate deeper development of the exploited oil reservoirs and start of development of new oil fields.

Processing industry

Throughout three quarters of 2008 the growth of the industrial production was of inertia nature and over January-September the increase in production volumes of processing industries made 107.7%, extractive industry growing by 0.5% and electricity, gas and water production and distribution – by 4.3%.

The situation changed radically in November 2008, when the negative dynamics for nearly all microindices had been registered for the first time for last three years. In the 4th quarter the reduction in the output of processing industries reached 7.7%, electricity, gas and water production and distribution – 5.4%, minerals extraction – 1%.

The potential of the idle facilities having been exhausted, the increase of the volumes of investments in fixed assets became one of the main factors for acceleration of the industry's growth rates. As a result, it was kinds of activities focused on the production of the goods of the investment demand that had the biggest influence on the maintenance of the dynamics of the processing industries production.

The dynamics of the processing industries is quite substantially differentiated by kinds of economic activities, the biggest influence being exerted by the ratio of production rates of investment and consumer goods (*Table 23*). The fluctuations of growth rates by kinds of activities of processing industries being quite large, a dramatic drop in the output of machine-building production in November-December 2008 was the primary factor having a negative effect on the level of the business activity of adjacent industries of construction materials production and other kinds of goods of intermediate demand production. In the 4th quarter the production of machinery and equipment made 88% of the corresponding figure of the previous year, production of electric, electronic and optical equipment – 92.1% and transport vehicles and equipment production – 91.3%.

Table 23

Changes in Production Rates As Broken By Kinds of Activity of Processing Enterprises in 2007–2008, as percentage to the corresponding period of the previous year

	2007					2008				
	annual	quarters				annual	quarters			
		I	II	III	IV		I	II	III	IV
Processing industries	109.3	112.8	110.2	107.8	107.8	103.2	110.7	108.1	106.4	92.3
Foodstuffs production, beverages and tobacco included	106.1	109.8	105.4	104.1	105.9	101.1	106.4	103.9	101.7	93.7
Textile and sewing production	99.7	102.5	98.7	95.6	98.3	95.5	102.6	101.8	97.9	83.8
Leather, leather goods and footwear production	99.9	109.9	107.1	94.1	90.7	101.7	106.6	108.5	105.1	92.9
Wood processing and production of goods thereof	106.2	104.2	103.5	104.1	113.2	101.4	115.6	110.9	102.4	83.6
Pulp-and-paper industry; publishing and printing	109.0	109.5	107.1	109.4	110.4	100.8	107.8	106.0	101.2	88.9
Coke and oil products production	102.7	106.1	103.0	102.0	100.8	102.7	105.0	101.6	102.9	101.2
Chemistry industry	106.1	108.3	105.3	106.6	104.3	95.8	103.7	103.1	101.8	78.5
Rubber and plastic goods production	123.0	113.2	114.8	125.2	131.7	112.5	130.4	116.5	119.0	101.0
Other non-metal mineral commodities production	110.8	123.3	110.0	107.8	105.6	99.1	108.6	109.1	100.2	86.4
Metallurgy industry, production of finished metal goods	102.0	107.3	101.7	99.5	100.3	99.8	108.6	101.1	100.5	94.7
Machinery and equipment production	119.3	126.0	125.6	116.2	111.5	104.0	116.4	105.4	111.6	88.0
Electric, electronic and optic equipment production	112.8	117.1	121.2	101.7	109.7	92.1	93.3	91.3	98.9	87.0
Transport vehicles and equipment production	115.9	117.0	113.3	119.1	112.7	109.5	114.4	119.1	116.4	91.3
Other branches of industry	105.0	105.6	106.7	102.3	106.1	104.6	118.6	116.2	106.6	106.1

Source: Federal State Statistics Service

Import continued to exert a significant influence on the dynamics and the nature of the development of machine-building. This is also connected with many kinds of machinery and equipment being non-competitive with the import analogues with respect to “price to quality” ratio, as well as with there being no facilities for production of modern kinds of equipment, which considerably limited the market of the domestic machine-building.

Influence of import differs considerably in various sectors of economy and goods markets. At the market of the investment machine-building the increase in import supplies was one of the main factors for the fulfillment of the investment projects, modernization of production and implementation of technological innovations. At the same time there was an intensified competition with the import observed, for instance, in such machine-building productions as machine tools construction, agriculture engineering, road equipment construction, motor vehicles production. Characteristic for these productions are low investment activity, high level of the fixed assets deterioration, outdate technologies. It is the active implementation of the assemblage mechanisms and the transfer of foreign companies’ activity into the territory of Russia that is one of the promising directions for their development. The anticipating growth of output at the enterprises with the participation of the foreign capital changed the competitive conditions and stimulated the activity of the traditional structures. However these enterprises turned out to be most vulnerable in the environment of the crisis since there had been no radical measures undertaken to develop the production of componentry at the domestic enterprises for a long time. Taking into account the ramified system of inter-branch connections in machine building, in particular, in motor vehicles construction, a sharp drop in the

production affected the adjacent productions, branches of infrastructure and had a painful effect on the level of the employment of the population.

In recent years the economic growth remained to be mainly of quantitative nature. This defined vulnerability of Russian economy in the environment of global changes of the prices and the situation at the world market.

3.2. Situation in Industry

The section is based on the data of surveys conducted among the managers of industrial enterprises. These surveys have been conducted by the IET according to the European harmonized methodology on a monthly basis since September 1992 and encompass the whole territory of the Russian Federation. The panels' size is approximately 1100 enterprises, which employ more than 15% of those employed in the industry. The panel has a shift towards large-scale enterprises in each of the specified subindustries of the national economy. The return of questionnaires makes 65-70%.

These business surveys among the managers of enterprises represent a quick method for collecting the data concerning the state of affaires at their enterprise and the expected (planned) changes in the main indices of their performance. Business surveys are relatively new instrument when applied to economic analysis. The first survey was conducted by IFO Institute (Munich, Germany) in 1949. Before long this method came into practice in the UK, France and Italy. And since 1962 the EU has been working on harmonization of the surveys in different countries (making them comparable).

A questionnaire form applied in a business survey contains a limited number of questions, no more 15-20. The questions are of qualitative, not quantitative nature. A simple structure of questions and answers makes it possible for the respondents to fill in the questionnaire quickly and in short period of time without consulting any other employees or documentation. It is of exceptional importance for the respondent at each enterprise to hold an executive position of the highest level possible, having a full vision of the state of affaires at the enterprise and participating in management directly. In 2008 30% of the filled-in questionnaires were returned by the directors of enterprises, 375 – from the deputy directors and 23% - from the heads of the economic departments.

When analyzing the business surveys, we apply a specific derivative index, termed balance. The balances are calculated as the difference between the percentage of those who have replied "is growing" (or "above the norm") and the percentage of those having replied "is decreasing" (or "below the norm"). The result thus obtained makes it possible to picture the distribution of answers to each question by one digit with "+" or "-" sign.

The balance is interpreted as the first derivative or rate of the process. In case the balance of answers to the question on the expected change in prices has the sign "+", one can conclude that the average prices are going to rise in the nearest future (the enterprises reporting a forecast growth of prices hold a majority). The increase in balance from +10% to +17% over a month signifies that the average prices in industry will grow at faster rates, since the abundance of enterprises forecasting their growth has increased. A negative balance implies the decrease in the average prices (the enterprises intending to lower the prices prevail). A change in balance from -5% to -12% is interpreted as the growth of the intensity of price decline.

3.2.1. Beginning of Crisis: Chronicle 2008

Dynamics of Demand for Industrial Production

The beginning of 2008 was quite discouraging for the Russian industry. According to the estimation of the enterprises the drop in the demand growth rates in January was bigger than that in the previous year: -23 balance points (b.p. hereinafter) versus -7 b.p. before exclusion of the seasonality. In February the intensity of the solvent demand growth increased (though insignificantly). Upon exclusion of seasonality the demand growth rates made +7 points (which is by 2 per cent better than in January, a figure of the previous year being +15 points). In March the demand for the industrial goods went on growing, but the sales growth rates (upon the exclusion of seasonality) reduced as compared with February by 4 per cent, and as compared with March 2007 – by 18 per cent. In other words, in the first quarter of 2008 the demand growth rates obviously slowed down (see *Fig. 14*).

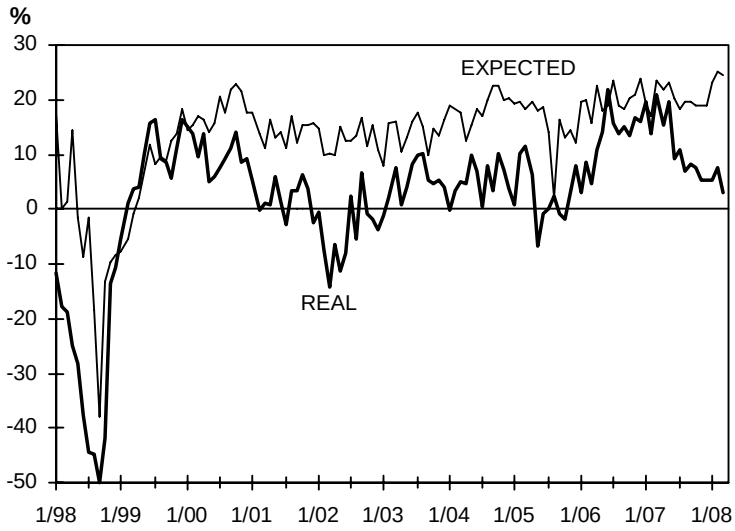


Fig. 14. Changes in Solvent Demand, Seasonality Excluded
(balance =% growth –% decrease)

Such dynamics of demand caused the continuous dissatisfaction with the volumes of sales. In January 2008 65% of enterprises considered the demand for their production as normal, whereas the absolute maximum registered in August 2007 makes 72%. In February the dissatisfaction with the demand in the Russian Industry went up to 33%, which is the worst (maximum) result of the preceding 18 months. The share of such enterprises in the light industry is equal to 71%, in machine-building – to 39%, in the construction materials industry – to 36%. By the end of the quarter the enterprises had accustomed to low growth rates of demand. This is testified by the dynamics of the estimations of the volumes of demand. In March the share of the “normal” estimations ceased decreasing and stabilized at the level of 63%.

The second quarter of 2008 became critical in the dynamics of the Russian industry. In this period the demand for industrial production was growing, but less intensively (two times slower, to be precise) than in the first half of 2007. And at the end of the quarter the situation

changed suddenly for the worse. According to the estimations of the enterprises the growth rates of the demand upon exclusion of seasonality the demand growth rates made 7 balance points in May-June, which is three times as worse as figures of last May and two times as worse as those of June. The exclusion of seasonality demonstrated the growth of sales of approximately 2-3 points, which was the minimum over the preceding two and a half years.

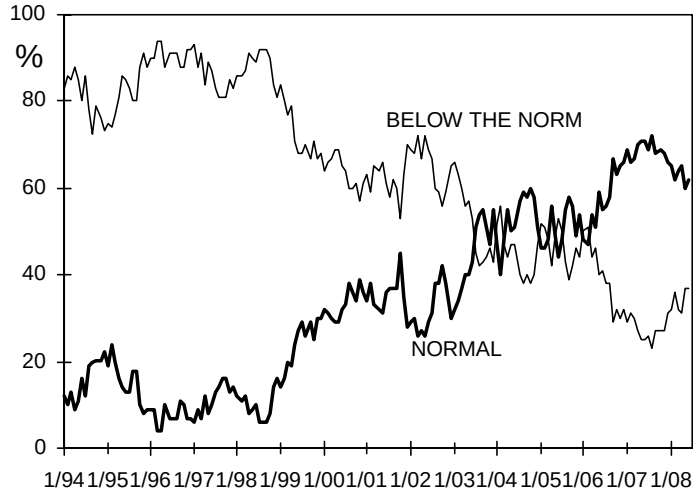


Fig. 15. Dynamics of Main Estimations of Solvent Demand

Low growth rates of the demand resulted in the decrease of the satisfaction with the demand volumes down to the level that is extremely low for the past years (see *fig. 15*). In May-June 2008 only 61% of the Russian industrial enterprises regarded the demand for their goods as normal. This had been the worst result for the preceding 24 years.

The results of the monitoring in the third quarter completely confirmed the conclusion on the change in the trends in the dynamics of the Russian industry. According to all the figures (initial, upon exclusion of seasonality, upon exclusion of occasional fluctuations) the sales growth rates went down to 4 balance points, which had been the worst result since the end of 2005. In August the solvent demand for the industrial goods started decreasing in absolute terms. Initial data demonstrated the minimum growth of demand: the balance (growth intensity) was equal to +1 point. This was the worst figure of the whole post-default period of 1999-2008. Moreover the exclusion of seasonality indicated the decrease in sales. So far, however, of the minimal intensity (-2 balance points), but supported by the similar result on exclusion of occasional fluctuations as well. As a result the trend for the decrease in demand growth rates that first outlined in the second quarter of 2007 reached its logical conclusion.

Data of September put the end to the hopes that the Russian industry would escape the world financial crisis: demand for industrial goods started decreasing at higher rates. In September the initial (that is before the exclusion of seasonality and occasional fluctuations) decrease rates made -15 balance points. Over the past years such a difference between the answers “is growing” and “is decreasing” has been registered only in January, when the whole country has a holiday for the first ten days. There had never been the absolute decrease in demand after the default. The exclusion of seasonality did not change the demand decrease rates in essence: now its value was equal to -13 b.p. and had been the worst result since the middle

of 2002. That is starting from May 2002 the surveys had not registered such low growth rates (in this case decrease rates) of the demand. In that period the changes of the demand had always been better (a less intensive decrease or simply growth) than in September 2008.

At the beginning of the fourth quarter the intensity of the decrease in the demand for the industrial products reached the levels that had been unexampled in the post-default period. In October the balance dropped to -27 points. The exclusion of seasonal and occasional fluctuations corrected the figures but little and they remained record-breaking: there had not been such an intensive decrease in the demand since October 1998. But at that time the industry still (though unexpectedly) was coming out of the crisis, and this time the crisis in the industry had just started.

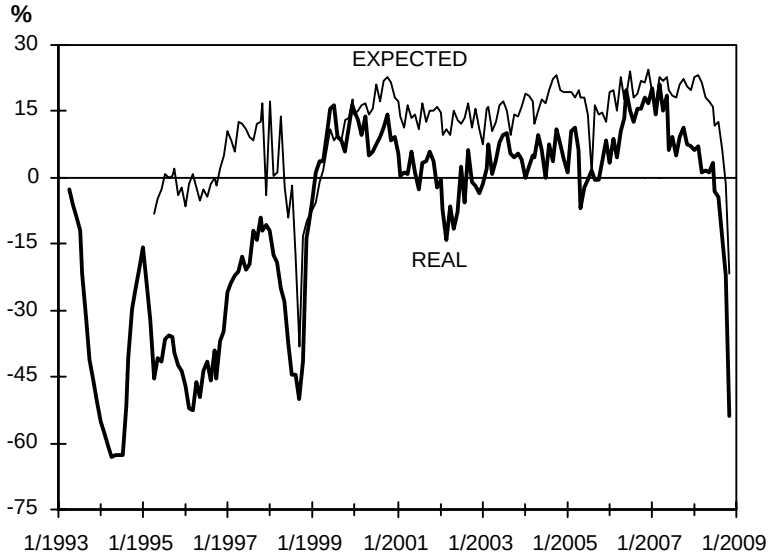


Fig. 16. Changes in Solvent Demand, Seasonality Excluded
(balance =% growth -% decrease)

In November the rates of the decrease of the demand for the industrial products reached the values that earlier were registered only in the 90-ies (see *Fig. 16*). This figure dropped down to -59 balance points, whereas in August the value was +3, and in June - +14 points. In November two thirds of the enterprises reported the decrease in the sales of their production, the proportion of such answers in August being only 15%. The exclusion of seasonality corrected the rates of sales decrease but slightly: it became equal to -51 points and gave the way only to the results of 1994. Then the demand decreased with the intensity of –63…–58 points.

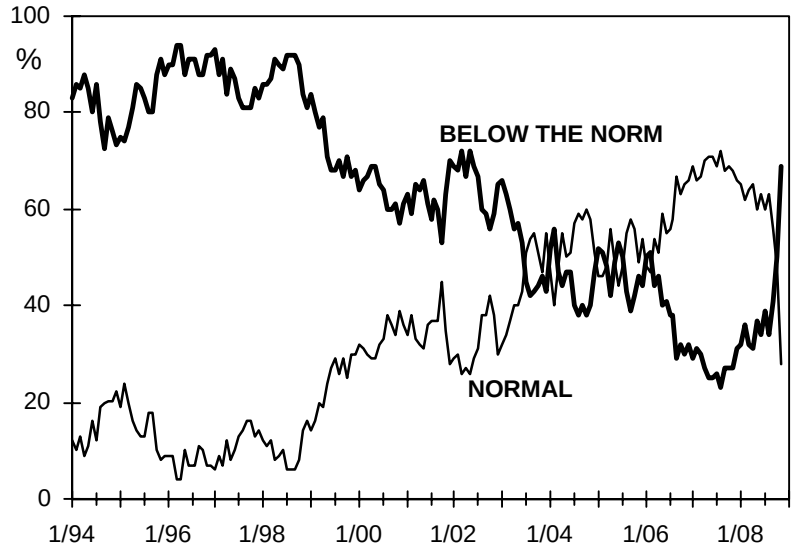


Fig. 17. Dynamics of Main Estimations for Solvent Demand

As a result, the estimations of the sales volumes changed sharply. In November only 26% of enterprises were satisfied by them and 71% regarded them as "below the norm" (see *Fig. 17*). In August 2007 the estimations were opposite: 72% of enterprises considered the demand as "normal", and 23% of enterprises – as "below the norm". At the worst times of the 90-ies the share of estimations "below the norm" exceeded 90%.

In December the intensity of the demand decrease did not change when compared with November. After the November drop of -59 balance points, which had been preceded by -30 points in October, the decrease down to -60 points seems negligible. This was testified by the exclusion of seasonal and calendar factors: in December the balance of the changes of the solvent demand remained at the previous level of -51 points. The absolute levels of December however look gloomy. The initial -60 points repeat the absolute record of the whole sixteen-year period of the demand dynamics monitoring: the demand decreased so intensively only in distant 1994. Upon exclusion of seasonality the demand is below only the figures of some months of 1996 and 194. Even in 1998 the demand did not decrease at such high rates as now, at the end of 2008. It would be good news if it was the turning point of the crisis, but, taking into account the macroeconomic situation, the beginning of the progress on the way out of the crisis in the imminent future seems unlikely.

The stabilization of the intensity of the decrease in demand did not put a stop for the decrease in the satisfaction with its volumes. In December only 21% of the enterprises could estimate the volumes of their sales as normal. Just four months before that there were three times as many of such estimations (63%). At the end of 2008 this figure went back to the level of the spring 1999, when the industry was coming out of the crisis.

Industrial Production and Stocks of Finished Goods

At the beginning of 2008 the dynamics of output demonstrated low growth rates as well. According to the data before the exclusion of seasonality the balance of changes in production

(growth rates) were equal to -23 balance points in January, whereas a year ago this figure was equal to -7 points. Upon the exclusion of the seasonal component the balance of changes in output (growth rates) in January 2008 remained at the level of December 2007, which had been the worst figure for the preceding 24 months without taking into account the drop in September 2007. In February the output growth rates upon exclusion of seasonality turned out to be some points below those of January and two times as bad as in February of the previous year. The production did not want (or was not able) to follow the demand or, rather, to anticipate it as usual. The results of the first quarter of 2008 demonstrated (see *Fig. 18*) that the slow-down of the demand growth rates did not enable the industry to increase production. According to the estimations of the enterprises' managers the output growth rates by the end of the quarter had become stable at the level of 17-19 per cent (seasonality excluded). In March 2007 the intensity of the output growth made 28 per cent.

Fig. 18. Changes in Production, Seasonality Excluded (balance =% growth -% decrease)

By the end of the first quarter obvious and continuous decrease in demand growth rates had resulted in a considerable "negative" gap between the output dynamics and the sales dynamics (positive gap can be defined as a situation when the enterprises are behind the dynamics of the demand). In other words, the enterprises produced more than they were able to sell. In March the share of the producers whose output was ahead of the demand reached 28%, which had been uncharacteristic for the recent years. The opposite ratio (demand ahead of output) was registered at 7.4% of the enterprises. This figure was nearly the absolute minimum for the post-default period (the index going down to 6.6-6.2% in spring 2006). Another evidence for the negative gap is the dynamics of the estimations of the finished goods (see *Fig. 19*). In March the balance of these estimations (above-below the norm) reached +13 points, which had been the worst figure for the preceding two years. In the first months of 2008 the industry accumulated unusually large quantities of the finished goods at storehouses relative to the current demand and did not see the prospects for selling the accumulated stocks in the forthcoming months.

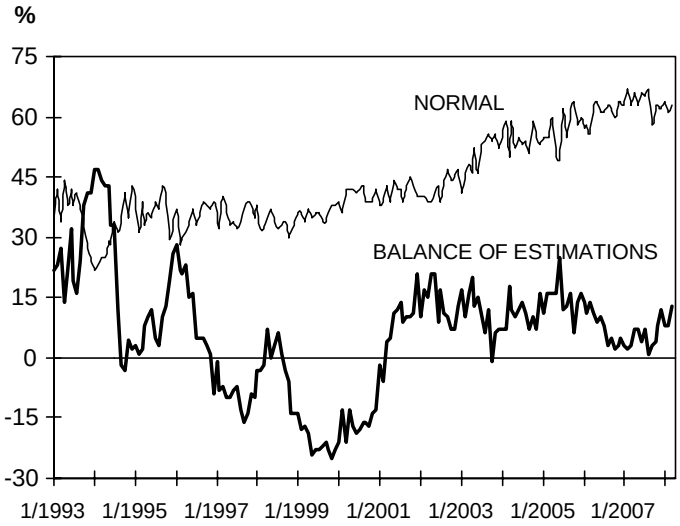


Fig. 19. Balance of Estimations of Finished Goods Stock (balance =%growth–%decrease)

At the beginning of the second quarter the growth of the industrial production remained at the level of the first quarter. All the indices calculated on the basis of surveys demonstrated stable output growth rates in February-April 2008. In 2007 the output growth rates were one and a half times as high. The stabilization of the industrial output occurred due to the stabilization of the demand for the industrial goods.

In June the intensity of the output growth went down by all the calculated induces, following the demand. The initial data demonstrated the slow-down of the growth by 6 points, upon exclusion of seasonality – by 4 points, and upon exclusion of occasional fluctuations as well – by 3 points. As a result all three indices demonstrated approximately the same result: in June the balance of output change was equal to 10 points. This value had been the worst in 2008 and was half of the result of June 2007. The deceleration of the output growth occurred in all branches of industry excluding foodstuffs production. The stocks of finished goods also gave evidence against the steady industrial growth. In June the balance of their estimations worsened by 6 points at once. It should be taken into account that the proportion of the responds “above the norm” went up to 25% and turned out to be the worst for the preceding 26 months.

The pressure of the demand made the enterprises restrict the growth of production even more severely. In July all the indices calculated on the basis of surveys’ data demonstrated the deceleration of the demand down to 12 balance points. This had been the worst result for the previous two and half years, that is the production had not grown that slow since the beginning of 2006.

In August the output growth further decelerated. Then the initial figures for growth rate had been the worst for the period of 1999-2008. Even in August 2001-2002 and 2005 that were the most difficult years for the industry after the default the output increased one and half times as quick as in 2008. The exclusion of seasonality led to the figure that had been the worst for the past year and a half. Like the demand, the output growth in the Russian industry started decelerating in the second quarter 2007.

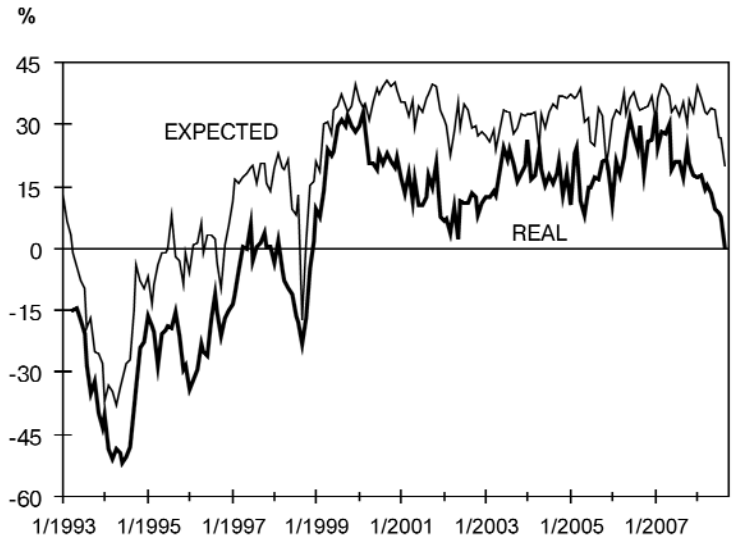


Fig. 20. Changes in Production, Seasonality Excluded (balance =%growth –%decrease)

In September the absolute decrease in demand forced the enterprises to reduce the output volumes. This conclusion follows from the initial data of the surveys. The exclusion of seasonal and occasional factors demonstrated the full stop of the output growth (0 balance points – see *Fig. 20* – upon exclusion of seasonality and +3 b.p. upon exclusion of occasional fluctuations as well). Such figures had not been registered in the Russian industry during the post-default period. Figures of October 2008 had been the worst since November 1998. The situation was most difficult in metallurgy. Other branches of industry either were on the verge of zero growth or had to reduce the output.

The dramatic drop of the demand in November forced the industry to reduce the output likewise (see *Fig. 21*). Whereas in October the intensity of the decrease in production was minimal, in November this figure dropped to -41 b.p. Higher output decrease rates were observed only in 1994. 61% of enterprises reported the reduction of the output in November, whereas in August there were only 17% of such responses. Such a reduction in output, however, proved to be insufficient, the estimation for the stocks of the finished goods in the industry started changing for worse. The proportion of the responses “normal” reduced from 61 to 47%, and the proportion of the responses “above the norm” went up from 23% to 35%. Over the month the balance (above – below the norm) worsened by 8 points and went to the level of +19 points, which actually is the maximum of the preceding five years.

In December the stabilization of the demand decrease rates enabled enterprises to stabilize the rates of the output decrease as well. In December this figure practically did not change. The balance upon exclusion of seasonality makes -41 points at the end of 2008, while in summer its value was +8, and in spring +15 points. A worse value (that is more intensive decrease in production) was registered only in the first half of 1994.

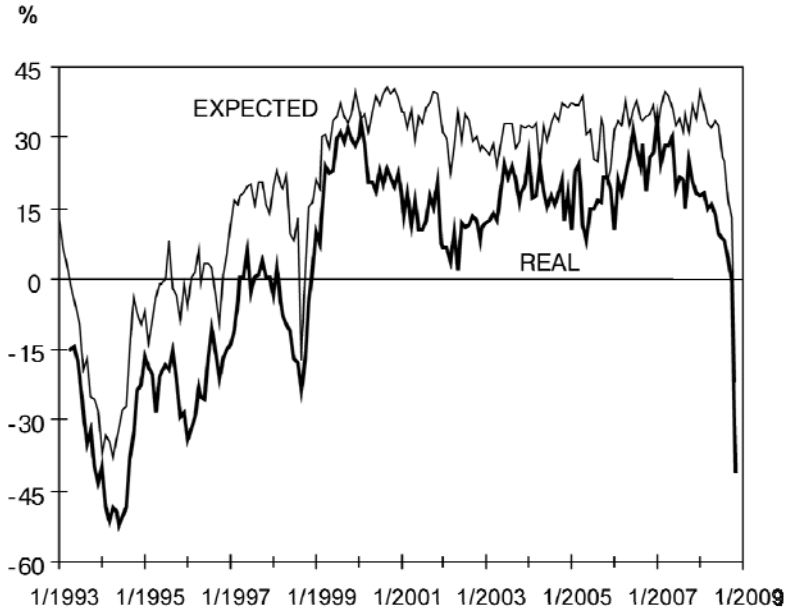


Fig. 21. Changes in Production, Seasonality Excluded (balance =%growth–%decrease)

In December estimations of finished goods stocks were out of the range that had been traditional for the preceding years – the filling of storehouses with the excessive stock continued. In December the balance of estimations went up to +29 points and turned out to be the maximum of the previous thirteen years. The average value of the balance in 2007 was +5 points, and in 2006 it was +8 points.

Obstacles to Industrial Growth in 2008

The dynamics of the structure of the obstacles for the output growth in 2008 was an exact picture of the features of the economic development in the year.

Accelerated growth of prices that was registered by all the indices at the beginning of 2008 played a trick with the Russian industry: its production lost competitive advantages it had had above the import. Now it was the import that represents an obstacle for the production growth at 26% of the enterprises, whereas in the fourth quarter of 2007 the frequency of this obstacle citation was only 17%. There had never been such a sharp increase in the frequency of this obstacle citation in 1996-2008. But it was the shortage of staff that remains the most serious obstacle for the growth of output (see *Fig. 22*). This obstacle had held the first place in the rating of the obstacles by the second quarter in the row after the decrease in the frequency of its citation by 2 points at the beginning of 2008 and the growth in the frequency of other obstacles citation. The second place was held by the shortage of the liquid funds, the third – by the low demand, which went up by 4 p.p. over the last two quarters.

It was in the middle of 2007 when the Russian industry experienced the most acute deficit of staff that was connected with the expected changes in the demand. At that time 27% of enterprises believed they did not have enough staff to satisfy the expected growth against 6% of enterprises with the excessive employment. By the end of 2007 against the background of the slow-down of the production growth rates and the decrease in the optimism of their forecasts the deficit of specialists started to diminish and was registered at 23% of enterprises at

the beginning of 2008, while the excessive employment remained at the level of 6%. The deficit of production facilities, on the contrary, expanded. At the beginning of 2008 19% of enterprises reported the shortage of equipment as compared with 11% that had its excess. The total balance made -8 points, which had been the absolute minimum of 1993-2008. At the beginning of the year the problems of the banking sector also influenced the industry. The monitoring of the credits availability demonstrated the reduction in the proportion of "normal" estimations down to 71% in the first quarter of 2008, which had been the worst figure for the preceding eight quarters (see *Fig. 23*).

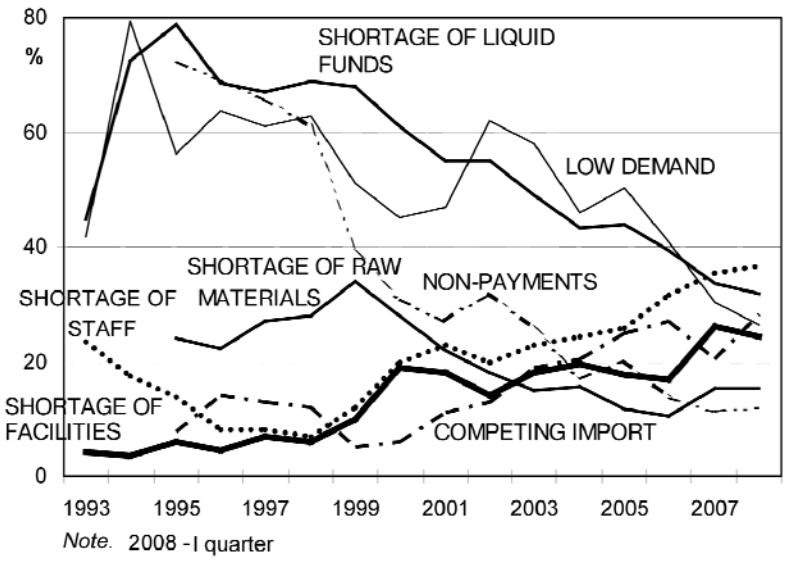


Fig. 22. Obstacles for Production Growth (average annual data)

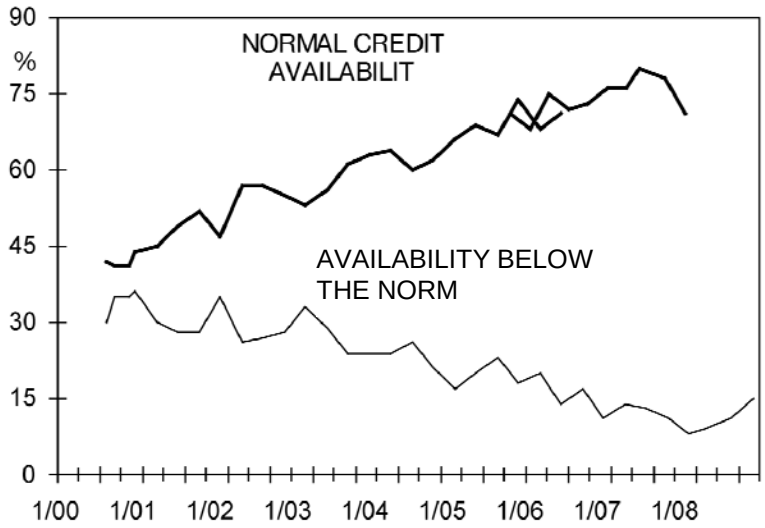


Fig. 23. Characteristics for Credits' Availability

In the second quarter it was the insufficient demand that started to be cited more and more often as an obstacle for the growth of the output. Whereas in July 2007 26% of the enterprises regarded it as an obstacle, in April 2008 there were 31% of such (see *Fig. 24*). The growth certainly was not considerable, but obvious and continuous for three quarters in the row. The proportion of the enterprises that were prevented from the growth of the output by the lack of liquid funds was a bit bigger and made 36% of the enterprises. But it was still the lack of staff that remained the biggest problem for the industry. The frequency of its citations in April reached the total of 49% (versus 36% in January 2008 and 7% in April 1998), which means that nearly a half of the Russian enterprises was short of the staff. In machine-building and light industry there were 62% of enterprises that complained about the shortage of staff in the second quarter. The foodstuffs industry experienced the fewest problems with the staff (frequency of citation of 7%). Import the necessity of protection against which had been discussed for such a long time started in fact to hinder the growth of the output in the Russian industry. The frequency of its citation went up to 31% in April 2008 although the propaganda in this field remained at the same level, whereas in October 2007 it was reported only by 17% of enterprises. The figures nearly doubled. A quarter of the Russian enterprises lack the equipment to increase the production. This result was not so spectacular when compared with other obstacles, moreover in 2007 it reached the figure of 325 (absolute maximum for the frequency of the citation of this obstacle) but still quite worrying: one more resource inherited from the socialistic economy had been exhausted.

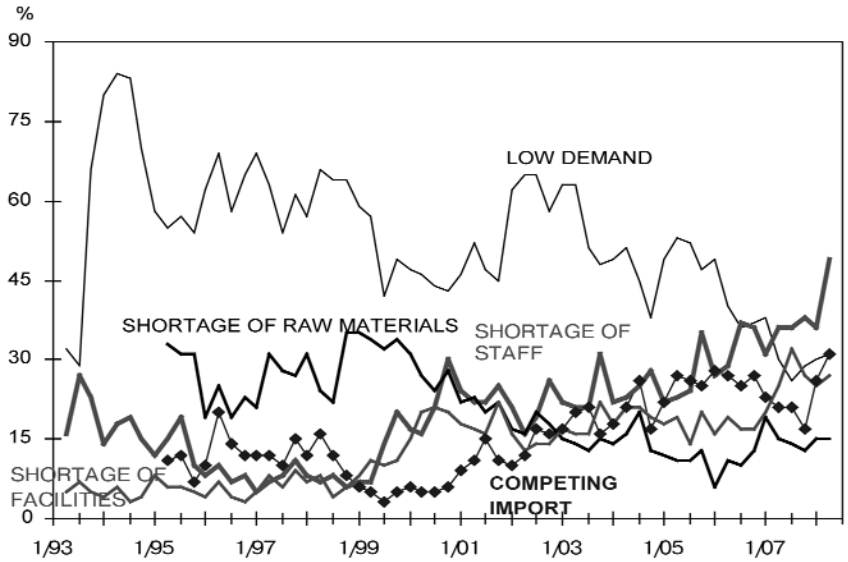


Fig. 24. Obstacles for Growth of Production

It was the lack of liquid funds (69% of citations in 2008) that was and is considered as the main obstacle for the investment activity at the beginning of 2008. The beginning of the reduction in the limiting influence of this factor in 2004-2007 was aborted by the construction boom and the acceleration of the inflation (which resulted in the growth of prices for equipment and building and assembly jobs, the frequency of this obstacle citation going u to 46%), as well as recession in the banking sector (high interest rates and the difficulties associated with the obtaining of long-term credits were more often cited as obstacles). However, by the end of the second quarter of 2008 the situation with the credits availability had improved a bit.

The proportion of the enterprises with the normal availability of credits ceased decreasing (the trend that had been observed since the autumn 2007) and had even gone up by 2 points (see *Fig. 19*). As a result 72% of enterprises were satisfied with the credits availability in the second quarter. The credits were mainly attracted by the enterprises to fulfill the liquid funds (65%). The second place (see *Table 24*) was held, leaving the other reasons far behind, by the modernization of the production (47%), the third – by the expansion of the production (30%) and the fourth – by the payment of wages (19%).

Table 24

Directions of Credits Usage in Industry (as percentage to the number of respondents)

	2003	2004	2005	2006	2007	2008
no credits	12	8	10	9	9	9
for R&D, know-how, licenses purchase	2	6	6	2	1	6
for production modernization	22	31	36	36	36	47
for expansion of production	13	23	24	25	27	30
for replenishment of liquid funds	66	68	70	62	57	65
for organization of sale	2	1	2	1	1	3
for payment of wages	27	27	22	26	19	19
for carrying out export contracts	8	7	11	12	7	6
for repayment of a debt to another bank	6	9	7	9	5	5
for repayment of debts to suppliers	14	9	11	13	9	11

As the crisis phenomena were evolving, the demand for the domestic goods was becoming ever bigger obstacle for the growth of production. In the third quarter the frequency of its citation as an obstacle reached 40%. This had been the maximum for the previous nine quarters and was the second biggest obstacle in the third quarter. However it was the lack of staff that had been the leading obstacle for the fourth quarter in the row. The frequency of its citation went up by 13 p.p. over the year, and by 6 p.p. over the second quarter, hindering 49% of enterprises (61% in machine-building, 58% in the light industry and 12% in foodstuffs production). The third place was held by competing import, which 32% of enterprises regarded as an obstacle, whereas a year ago the figure was only 21%.

The slow-down of the demand growth rates eliminated the deficit of the facilities in the Russian industry. The lack of equipment was first registered by surveys in the second quarter 2007 and reached -10 points by the beginning of 2008. However over three months of the second quarter the proportion of “insufficient” estimations lowered from 21% to 12%, while the proportion of “more than enough” responses went up from 11% to 17%, the balance becoming again positive. Thus, the demand ceased justifying the investments efforts of the Russian enterprises in recent years. This thesis was supported by the statistics of the obstacles for the output growth. Whereas a year ago the lack of equipment was an obstacle for the output growth at 32% of enterprises (holding the third place among 10 factors being monitored), in the third quarter 2008 it was cited only by 21% of enterprises (fifth place). In the third quarter no principle change concerning the credits’ availability occurred. For 69% of producers it remained normal and equal to that of the first and the second quarters of 2008. A year ago the figure was higher by 10 points.

The deficit of staff is still a widespread phenomenon in the Russian industry despite the slow-down of the demand and output. A quarter of the Russian enterprises reported the shortages of qualified staff in connection with the expected changes in demand in the third quarter of 2008, which is only by 2 p.p. lower than the absolute maximum of this index registered a year before. The main cause of the staff shortage was considered to be the low wages that en-

terprises offer when hiring the employees. Only 49% of enterprises pay "normal" wages to their workers and engineers.

In the fourth quarter the structure of the obstacles for the output growth started to change (see *Fig. 25*). As it should have been expected it was the "internal solvent demand" that held the first place. It was considered as an obstacle by 45% of enterprises, growing by 9 points as compared with the third quarter and by 19 points as compared with the absolute minimum registered in the third quarter of 2007. The second place in the rating was held by the shortage of liquid funds. Since two thirds of enterprises use credits to replenish these funds the contraction in credit availability made this obstacle grow by 8 points over the quarter, and when compared with the absolute minimum (the first quarter of 2007) – by 12 points. As a result the provision of the enterprises with the stocks of raw materials dropped sharply by 13 points over the quarter: at the end of the year only 63% of the enterprises had normal stocks, which had been the worst figure for the preceding 11 quarters. The situation was aggravated by the amount of non-payments beginning to increase. The frequency of its citation in the industry nearly doubled over the quarter (from 12% to 21%). It should be noted however that by the end of the year this obstacle held only the fifth place, while at the beginning of 2008 it occupied 8th-9th places.

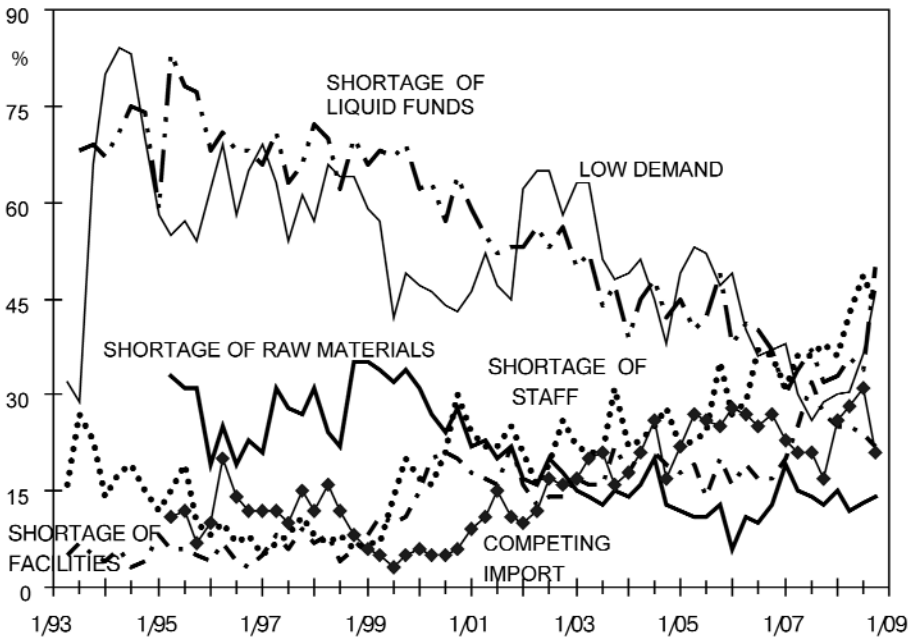


Fig. 25. Obstacles for Production Growth

The third place of the obstacle "lack of qualified staff" with 41% of responses seems soothing in the environment of the crisis. During the preceding seven quarters the factor mentioned took the first place five times and the second – two times. In other words the enterprises still regard the employees as quite a precious resource and understand that in the environment of the degradation of the vocational education and devaluation of the higher education even mass dismissals in other sectors of economy will not let them find qualified workers and engineers quickly in case of necessity. The pressure of the competing import,

non-payments and low export demand share the fifth place in the rating of obstacles, but the frequency of the citation of the former has lowered down to 21% in the processing industries after the absolute maximum of 31% registered in the third quarter. This is obviously a result of the decreased price ambitions of the Russian producers, evolving efforts to decrease the costs and changes in exchange rates.

3.2.2. Competition in Russian Industry

Peculiarities of Competition Formation

The monitoring of the competition formation at sales markets of Russian industrial enterprises that was started by the IET in 2000 demonstrated the peculiar features of this process taking into account a representative set of factors, most of which are described in the economic theory, but do not have adequate and regular statistical depiction. Four surveys with the interval of 23-26 months (that is in two-year cycle) were conducted. The last survey was made in February 2007. Taking into account the rising economic and social significance of the competition, the following estimation of the factors contributing to its formation was made not after 2 years but after 12 months – in February 2008. This review revealed specific features of competition formation at the final stage of the recovery growth and a new period of the development of the Russian industry that started.

As it is demonstrated by the analysis of new data, the input of the majority of factors forming competition in the Russian industry was not subjected to principle changes concerning either the resulting trend (increases - decreases) or their effect. Only input of two factors changes considerably: (a) presence/absence of potential competitors able to enter the sales markets and (b) possibility/impossibility for a new producer to find suppliers and consumers at new sales markets (see *Fig. 26*). In general, these two factors are interconnected and the changes in their influence on the competition demonstrated the specific features of the behavior of Russian enterprises at sales market in contemporary conditions.

According to the estimations of enterprises the influence of the presence/absence of potential competitors able to enter the market intensifying the competition lowered over the year, but remained positive, that is this factor is still making the competition stronger. However the change in the value of the influence of the factor under consideration on the competition turned out to be the biggest among all the factors monitored. In other words the level of the support for the competition at the sales markets by the possibility of potential competitors entering the market lowered to the greatest extent. If earlier (in 2002-2007) the influence of potential competitors held 1st-2nd places among the factors positively affecting the competition, now it lowered to the fifth place. It should be noted that the presence of this factor and its positive influence should not be attributed to the Russian Government efforts, it is just an incidental result of the complicated market reforms. The latter created a considerable excess of facilities and a smaller – of the staff, which were the main sources of the threat for such an intervention. It should be emphasized that these interventions could be very fast (large amounts of idle facilities created at the time of the USSR) and aggressive (non-payments, barter and other adventures of 90-ies taught the Russian enterprises to act directly). Thus, anti-monopoly service loses its most active assistant that helped form and support the competition. Another advantage of that assistant was that it was free of charge, at least for the service.

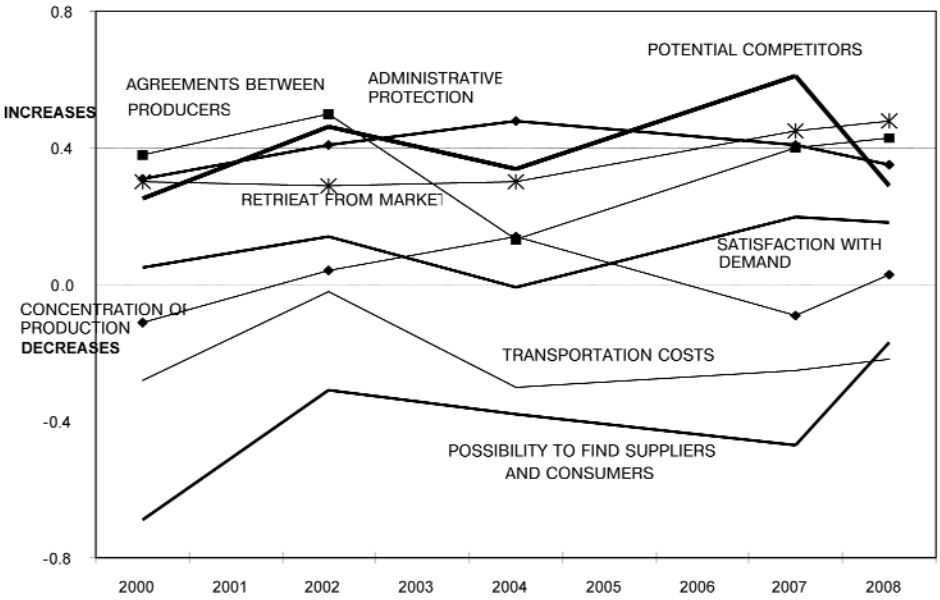


Fig. 26. Dynamics of Input of Main Factors in Competition

The threat of potential competitors (as a factor contributing in the increase of the competition) at sales market gives less support to most of the branches of Russian industry in 2008. Only the enterprises of timber processing and light industry consider their "neighbors" still having the wish and the opportunity to enter other sales markets and are seriously worried about such attacks. In the light industry such apprehensions are especially high. The most probable explanation for such spirits at the enterprises of light industry is connected with the fact that this branch of industry reached fewest successes even in the environment of the industrial growth that had began. In the first quarter of 2008 only 45% of its enterprises were satisfied with the demand for their production, whereas on the whole in the industry this index was equal to 64%. This makes the enterprises of the industry search new markets actively and this includes the exclusion of traditional producers from the sphere. Such apprehensions steadily and continuously prevail in the light industry. In the timber processing the balance of this factor influence reached 0.9 in 2008, whereas in 2007 it was equal to 0.32. As a result the biggest increase in the pressure of the threat of the potential competitors on the competition is observed in the timber processing complex.

In other branches of industry positive (supporting) influence of potential competitors on the competition lowered. The amount of the support decreased most dramatically in metallurgy: after a considerable positive influence on the competition in 2007 (balance of +0.67), in 2008 the amount of support nearly vanished (balance of +0.01). The amount of support of competition given by the potential competitors reduced by half in machine building (balance of support of +0.67 in 2007, and +0.32 in 2008). A drop of a similar value was registered in the foodstuffs production (+0.84 in 2007 and +0.52 in 2008). Chemistry enterprises reported the decrease by half (+0.48 in 2007 and +0.24 in 2008).

Such a change in the influence of the factor under consideration on the level of the competition lies within the logic of the contemporary economic development. By the beginning of 2008 the Russian industry had fully exhausted the reserves of its facilities and staff. Moreover,

the excess was replaced with the shortage, reaching considerable values. The industry simply does not have enough machinery and employees to satisfy the increasing growth. And at that time the demand really grew and satisfied two thirds of Russian enterprises. Thus, the majority of producers were satisfied (or even considered excessive) the traditional sales markets and did not need to enter other markets any more. Moreover, whereas the trend for the growth of the demand for the Russian enterprises sustains, the deficit of staff and facilities is not to be eliminated (or at least reduced), the necessity to expand to other markets will further reduce, and hence the support given by the threat of the competitors entering the market will also decrease.

Another factor (possibility/impossibility for a new producer to find suppliers and customers at new sales markets) experienced considerable changes in 2007, decreasing the competition level at the sales markets of the Russian industrial enterprises less intensively than before. At the beginning of 2008 its negative influence made the balance of -0.17. This is the maximum (that is the best) figure for this index; the minimum made -0.69 and was registered in 2000. In 2007 the balance was -0.47, that is the negative (limiting) influence of this factor on the competition lowered by 0.30 points over the year. Now the factor is no longer an obvious and permanent negative leader but holds the second place, giving the way (though by little yet) to the transportation costs.

The decrease in the negative influence of the difficulties connected with the search for suppliers and consumers has occurred in all the industries with the exception of the construction materials industry. In this branch the limiting influence of the factor under consideration doubled, which in the environment of the construction boom (though regional, not national yet) can be explained by unsuccessful attempts of the construction materials producers from the regions with low construction activity enter the markets of the regions characterized by larger scale of construction works. In other branches the situation has changed for the better. This is especially so for the timber processing complex, in which the balance of estimations became positive, which means that there are fewer difficulties when searching for counteragents at new markets that the opportunities to solve this problem. Taking into account the fact that the threat of the producers from other regions entering the market was registered to be the highest in this branch of industry, it can be assumed that the producers of timber and goods thereof supported their aggressive plans with the serious marketing research. In chemistry and machine-building industries the difficulties connected with the search for suppliers and consumers lowered by 0.49 and 0.41 points, correspondingly. As a result the balance of positive and negative changes for the influence of this factor on the competition became nearly zero.

Such a positive shift can be explained by two circumstances. First, a large number of enterprises are now satisfied with the developed markets (for the details see above). Second, the lower want to enter new markets has reduced the necessity for the search for the counteragents there. The enterprises focus (with the aim master) on those markets only that are easier to access, because of the fact that they are better-studied as well.

Thus, the competition decreases to a lower extent under the influence of the difficulties for a new producer to find suppliers and consumers at new sales markets. This trend, in the opinion of the Federal Antimonopoly Service of the Russian Federation, is positive. However, in 2008 the factor still had a negative influence on the competition in the Russian industry, that is the majority of the enterprises held that the loyalty of the suppliers and consumers to the traditional producers was an obstacle for the entrance of new enterprises to the markets.

In the field of the formation of competition at the sales markets of Russian industrial enterprises there were other changes occurring, which were not as important as those mentioned above but worth mentioning.

By the positive effect on the level of competition the factor "difficulty of retreat from the market (impossibility to return the funds invested in the equipment and premises)" holds the first place. Its supporting effect on the competition is 0.48 points bigger than the influence of the factor "easiness of the retreat from the market (real possibility to return funds invested in the premises and equipment)", weakening the competition. The positive effect of the difficulties associated with the retreat from the market has been growing since 2002. Now this factor is the strongest in supporting the competition in the light industry, where the balance of the effect of this, though doubtful, factor, reached 2.32, which was the maximum for the branches of industry in 2008. It seems that the objective Russian difficulties in retreating from the markets are aggravated by the large number of such intentions in this unfortunate branch.

The positive influence of the absence of the administrative protection for the market on the competition is decreasing. On one hand, it could be explained by the loss of interest for the "other's" markets, when the capacity of own markets is sufficient. In such a situation any barriers for the entrance to the market become less important, that is they are not taken into account. On the other hand, the growth of own markets and the experience of their protection with the help of the administrative measures may make the enterprises use more elaborated methods for the protection of their "private mains" with the help from the local government. The positive influence of the absence of administrative barriers in the construction materials industry has disappeared altogether. In other words, whereas in 2007 the majority of the cement, bricks, panels etc. were of opinion that the absence of quotas, licensing, bans for import-export and other similar features makes the competition at their sales markets more intense, now the proportion of the opinions on their absence is equal to the proportion of the opinions on their presence. As a result the change for the worse in the influence of the factor under consideration on the competition in the construction materials industry turned out to be the biggest. It seems that it is in the production of construction materials where the most serious administrative barriers according to the estimations of producers appeared. It seems that the risk pays back. The competition is best supported by the absence of the barriers in the light industry and ferrous metallurgy.

While the enterprises succeed in reaching a compromise with the government and in getting additional protection for their markets, reaching agreement with other producers is becoming more and more complicated. The balance of the influence of the factor "having-not having the agreements among the producers on the division of the markets, price policy etc" is gradually increasing its positive influence on the competition, that is the absence of such agreements, in the opinion of the enterprises, stimulates the competition at the sales market of the Russian industry. However, as it is demonstrated by the analysis of the data for the branches of industry, the conclusion on the stimulating influence of the absence of agreements can be applied only to the construction materials industry. According to the estimations of the enterprises the extent of the refuse from the cooperation with the competitors was most serious. Moreover, there was a radical turn taking place in the construction materials industry. Whereas in 2007 the balance of the influence of the factor under consideration on the competition was negative (that is the competition rather decreased under the influence of the agreements between the producers), in 2008 the competition in the industry was strongly supported by the refusal of the producers from such negotiations. Again, this is probably the result of the

growing possibilities for large profit due to the construction boom. It is also likely that the profits in question are big enough for everybody without negotiations. In either case the anti-monopoly services may not bother about the harmful agreements in the branch. A positive trend was registered in the machine-building as well, where the absence of the agreements became prevailing as compared with the readiness to sign them. In other branches of industry the trends are negative: there the enterprises start searching for the ways to make agreements with competitors and not for the ways to struggle till final victory. The resulting balance nevertheless is positive for all branches: the competition is more often supported by the absence of collusions, not weakened by their presence.

The level of the concentration of the production (index traditionally monitored by the Federal Antimonopoly Service) does not have an appreciable influence on the competition in the opinion of enterprises. Its positive effect (low level of concentration) is nearly equal to the negative (high level of concentration) on the whole throughout the Russian industry. In most of the branches of industry the situation has become better over the year, that is the decrease in the level of concentration supported the competition better. This trend is most evident in metallurgy, construction materials industry and light industry. Negative changes (decrease in the level of the competition as a result of the growth in the concentration of production) were observed in chemistry and machine-building.

Influence of Competition on Prices

The unflagging struggle against the inflation forces the authorities to use all the measures, means and methods available. However the efficiency (the results) of the undertaken measures is not always or (and) immediately obvious, which can be deceitful both for the authors of the anti-inflation policy and for the society. In such a situation (which is however quite frequent in the economic policy due to the lack of the statistical data and, as a consequence, the use of not the figures that are needed but the figures that are available) the estimation of the influence of the competition on the price policy of the Russian enterprises can be a useful instrument. This is especially true when taking into account the fact that the competition itself is not easy to measure, especially regularly and comparably for its main kinds (internal Russian competition and the competition with non-CIS countries' producers). However the survey approach (surveys of the enterprises' managers) allows learning directly how two above-mentioned kinds of competition influence their sales prices and give correct estimation for the priorities.

It should be taken into account at the same time that the competitive penetration of import in the sales markets of Russian industrial producers is lower than the share of competitive markets with the internal Russian competition. The latter comprised 89% in 2007, whereas 67% of Russian enterprises experience the competition with the import. This conclusion is testified by the proportion of the enterprises that either had difficulties in estimating the influence of the competition on their price policy, or claimed that there was no such influence. In case of the internal Russian competition the sum of such responses makes 47%, in case of competition with import – 56%. The complement of these figures up to 100% shows the proportion of the enterprises whose price policy is vulnerable towards the competition. The branch most vulnerable towards the competition with the import is the machine-building, 58% of whose enterprises change prices, taking into account the import pressure (42% of enterprises being unaffected by the import - see *Table 25*). The second place by this index is held by the foodstuffs production, chemistry and petrochemistry industry (47-48% vulner-

able, 52-53% unaffected). The third place is held by the light industry (38% versus 62%). It seems logical that the industry of construction materials production is characterized by the minimal influence of competition with the import on prices.

Table 25

Proportion of Enterprises Unaffected by Different Kinds of Competition by Branches, As Percentage

	Internal Russian competition	Competition with import
Ferrous metallurgy	47	81
Non-ferrous metallurgy	88	85
Chemistry and petrochemistry	19	53
Machine-building	44	42
Timber processing complex	48	65
Construction materials industry	38	91
Light industry	65	62
Foodstuffs production	32	52

Source: IET Survey, February 2008

Internal Russian competition has the most moderate influence on prices in non-ferrous metallurgy, 88% of enterprises of the branch holding that their prices do not depend on the competition with the counterparts within the country. Taking into account low influence of the competition with import on prices in this branch as well, the enterprises feel free when setting their sales prices. The second place in the list of the weak influence of internal Russian competition on prices is held by the light industry, 65% of enterprises not taking into account this factor in their price policy. Internal Russian competition has the biggest influence on prices of the enterprises of chemistry industry, 81% of enterprises having to take this factor into account. The last but one place in the rating is occupied by the foodstuffs production, of which 68% of enterprises experience the influence of competition and 32% - do not.

The figures for the branches given above estimate only the scale of influence of two types of competition on prices but not the direction of this influence. To calculate the influence of the competition on prices one can use a balance method which is traditional for the practice of IET surveys (and what is more important which is customary for our respondents), according to which the proportion of responses “towards the increase” is deduced by the proportion of responses “towards the decrease” (this is the way in which the enterprises are suggested to estimate the influence of the competition on their prices). Then the negative value of the balance is a sign of the decrease in prices under the pressure of the competition, while the positive – of the increase in prices.

As it is demonstrated by the latest (February 2008) metering of the influence of the competition on the price policy of the enterprises, the Russian producers decrease prices under its influence more often than increase them. This is especially true for the competition with import. The balance of the influence of the latter on the processing industry as a whole makes -24 p.p. That is there is a prevalence of 24 points of the proportion of the enterprises that reduce their prices under the pressure of the competition with the import (34%) over those that have to increase prices (for instance, as a result, of the increase in costs connected with the improvement of the goods quality, whose proportion is equal to 10%). The pressure of the in-

ternal Russian competition on the prices of the Russian enterprises on average in the processing industry is less intensive: –13 p.p. (33 versus 20%).

Table 26

Balance of Influence of Different Types of Competition on Enterprises by Branches, As Percentage

	Internal Russian Competition	Competition with Import
Ferrous metallurgy	0	6
Non-ferrous metallurgy	5	–14
Chemistry and petrochemistry	–18	–37
Machine-building	–18	–28
Timber processing complex	–9	–14
Construction materials industry	–15	–6
Light industry	–8	–24
Foodstuffs production	–33	–37

Source: IET survey, February 2009

It is the enterprises of foodstuffs industry that experience the biggest influence of the competition on their prices (see *Table 26*), both types of the competition forcing the enterprises to decrease their prices to approximately the same extent (balances of –33 and –37 p.p., that is import if it is present presses a bit harder down on prices). Thus, the hopes to decrease the prices for the foodstuffs by stimulating the competition in this branch of industry are least likely to succeed: here the competition has already made the biggest contribution possible, and import, according to IET surveys, does not worry the foodstuffs producers.

The second place by the level of the positive influence of competition on prices is held by chemistry and petrochemistry, competition from the import having the same positive influence on prices as in foodstuffs production, but the internal competition being by far less influential. The third place of the rating is occupied by the machine-building, whose prices also are more prone to decrease under the import pressure (if there is such). Light industry experiences minimal positive influence from the internal Russian competition and quite strong one (the third place) – from the competition with import.

It is the ferrous metallurgy in which neither type of competition has a limiting influence on prices. Moreover, in this branch of industry the competition with import enables (or forces) raising the prices. The situation in non-ferrous metallurgy is similar, internal Russian competition enabling to increase the prices, limiting influence of import being low.

3.2.3. Competitiveness of Russian Industry

Competitive Advantages of Russian Enterprises

In 2008 the IET continued to monitor competitive advantages of the production made by the Russian enterprises, which was made for the first time in 2006. The results obtained picture the real situation in this field most accurately and comparably.

At the internal market it is long-lasting contacts with consumers that are traditionally regarded as the main competitive advantages of the goods the Russian enterprises produce (see *Table 27*). In 2008 61% of producers cite this factor, which is 10 points below the figure of the previous year. Nevertheless it remained the leader in the majority of branches of industry, giving the way to “better quality of the goods produced” only in the light industry and metal-

lurgy. As to the construction materials industry and the foodstuffs production, there the connections with consumers and the quality of production are cited with nearly equal frequency. Long-lasting contacts with consumers remain the leader among the competitive advantages of the Russian goods at the external markets as well.

Table 27

Competitive Advantages of Production by Russian Processing Industry at Different Kinds of Markets, As Percentage

	Internal market			External market		
	2006	2007	2008	2006	2007	2008
1) lower prices	31	28	32	59	52	41
2) better quality of production	42	55	43	26	38	37
3) quick shipping of goods	17	22	27	13	13	13
4) convenience of payments for production	14	17	17	9	9	12
5) service after sale	19	17	19	15	13	11
6) proximity to the consumers	22	19	17	5	8	3
7) fulfillment of nearly any orders of the customers	32	37	30	28	27	22
8) absence of similar production	21	21	22	8	11	12
9) reputation of the brand	43	44	37	33	41	28
10) long-lasting contacts with the customers	56	71	61	38	52	43
11) possessing license, patents, quotas	18	17	16	15	15	17

Sources: IET surveys January (2006), May (2007), August (2008)

The factor "better quality of the production made" remains in the second place. Over the year it has also lost 12 points at the internal marker and but the frequency of its citation when external markets are concerned remained the same. Better quality of production helps Russian machine-building enterprises less at the internal markets in competition, only 28% of enterprises counting on it now, whereas a year ago the figure was 50%. As a result the quality of production holds only the 7th place in the rating out of 11 positions of competitive ability factors for the machine-building. When it comes to competition with the import the production of domestic plants loses the competition. However, the same factor can be interpreted in a way that really high-quality goods are imported in the country, obviously surpassing the domestic production. At the external markets, of which the enterprises have a choice, the quality of Russian machine-building enterprises also is not an asset: it holds only the 5th place (21% of citation frequency). Russian goods are more likely to be promoted at the external markets thanks to lower prices (53%), long-lasting contacts with consumers (38%) and reputation of the brand (26%).

The light industry, however, seems to win a "quality competition". The factor mentioned maintained the frequency of its citation in the branch (68% after 75% in 2007) at the internal market and still holds the first place. The quality is an asset for the light industry at the external markets as well. This factor is used by 71% of producers at the external markets and holds there the first place. At the external markets of the branch the second place is held by "long-lasting contacts with the consumers" (35%), the third – by the "lower prices" (31%). This means that the frequency of "quality" citation is twice as high!

The reputation of the brand (trademark) is regarded as a competitive advantage by 37% of enterprises when the internal markets are concerned (the third place in the rating), and by 28% of enterprises when the external markets are concerned (the fourth place). Over the year the factor has become less frequently cited at all the markets, decreasing by only 1 point at the external markets, where the better quality started to be cited more often. The reputation is especially important for the machine-building at the external markets (2nd place in the rating for the branch with 43% of citations), construction materials industry (3rd place, 50%) and foodstuffs production (3rd place, 47%). However in the timber processing the factor holds only the 7th place (33% of citations), the same as in the light industry (22%). At the external market it is the Russian foodstuffs production that is the most reputed. This is the factor they count on most often (49% of cases), quality (47%) and contacts with consumers (41%) following. Thanks to the price the Russian producers of the foodstuffs can win the competition abroad only in 25% of cases.

On the whole in the Russian industry the argument of the price is used with the same frequency as in 2006-2007. Now 32% of enterprises regards it as their advantage. It is most widely used in timber processing (49% of citations, 2nd place in the rating for the branch) and machine-building (40%, 3rd place). At the external markets our exporters make the use of prices less often. Whereas in 2006 59% of enterprises regarded lower prices as their competitive advantage, there are only 41% of such in 2008. This factor is used only by 53% of exporters of the machine-building production (1st place in the rating for the branch), and by 47% of those of construction materials industry (also 1st place). It is in chemistry and petrochemistry industry where this factor is used least often.

Tools and Obstacles for Formation of Competitive Ability

In the environment of the pressure from the import that evidently increased in 2008 the improvement of the competitive ability of the goods produced becomes not just a regular motto for the enterprises, but the barest necessity. The results of the long-term monitoring by the IET demonstrate which measures have been undertaken and are undertaken by the Russian enterprises (see *Table 28*).

Table 28

Spread of Measures to Increase Competitive Ability in Russian Industry, 1996–2008, as percentage to number of respondents

	1996	1997	1998	1999	2000	2002	2004	2006	2008
1) research of customers' requirements	71	65	63	57	60	56	54	45	52
2) decrease of costs	67	68	67	63	56	70	66	58	49
3) advertising	36	40	31	37	33	39	35	38	32
4) research of competitors	41	38	35	36	38	37	33	39	33
5) increase in the quality of goods produced	57	61	60	59	63	79	72	82	80
6) creation and production of new kinds of goods	24	58	57	65	57	60	56	61	51
7) equipment modernization		25	19	22	25	39	41	46	48
8) purchase of new equipment		21	16	23	31	39	38	44	54

Source: IET surveys 1996–2008

On the whole over all the period of the monitoring the enterprises paid the biggest attention to the increase of quality of the goods produces, which is quite logical. Admittedly, before the default this measure held only the 3rd place, giving the way to such actions as the decrease of costs or study of consumers' requirements. However, starting with 1999 the problem of quality of the goods has become an obvious leader (at least in the opinion of the respondents), and reached the frequency of citation which is 82% of enterprises in 2006 (80% in 2008). As a result, the enterprises consider the problem of the quality of the goods produced not the most important problem of their competitive ability (see *Table 29*).

Table 29

Factors Decreasing Competitive Ability of Russian Enterprises' Production, 2006–2007, (as percentage to number of respondents)

	2006	2007
1) outdated equipment	48	57
2) insufficient qualification of employees	27	27
3) low quality of raw materials and components	23	20
4) lack of new products (technologies)	22	15
5) excessive ruble against dollar exchange rate	12	14
6) low quality of goods produced as compared with RUSSIAN analogues	3	3
7) low quality of goods produced as compared with IMPORT analogues	13	16
8) high prices for power resources	39	46
8) high transportation costs	31	32
10) high final costs	30	28

Source: IET surveys 2006–2007

The decrease of costs had lowered to the 5th place by 2008 and was used in the environment of higher inflation expectations by 49% of the enterprises. The figure is, however, rather high, but minimal for this factor. It was in 2002 when the decrease of costs was applied most actively as a factor for the competitive ability increase in the Russian industry. Research of consumers' requirements has also been becoming less popular: whereas in 1996 this measure was most popular (71%), in 2006 it holds the 5th place, the frequency of citation being 45%. In the environment of the increasing demand and the limited supply the enterprises seem to be less interested in the requirements of consumers.

In 2008 the second place was won by the purchase of the equipment. Whereas in 1998 this factor was used (or at least was considered as necessary to be used) by 16% enterprises in struggle for competitive ability, now there are 54% of such. The growth is considerable but not sufficient. The outdated equipment remains, in the opinion of the enterprises, the main obstacle for the increase in competitive ability of the goods produced. In 2007 57% of enterprises were of such opinion, in 2006 – 48%. The situation is aggravated by the shortage of facilities in the Russian industry that evolved in 2007 and became more acute in 2008. The main source for the increase of facilities, that is the launch of the idle ones, has been exhausted. Moreover, those that were launched earlier are to be replaced, since mainly it was created at the time of the USSR. That is why the modernization of the equipment is becoming ever wider spread as a measure to increase competitive ability in the Russian industry. Whereas in 1998 it was cited by 19% of enterprises, in 2008 there were 48% such.

It should be noted that the innovation way of increasing the competitive ability, that is creation and production of new kinds of goods, is becoming less popular in the Russian industry. In 2008 it was cited only by 51% versus 61% in 2006. This factor was less frequently cited only as long ago as 1996 (24%).

Competitive Ability: Price and Quality of Russian Production

In 2008 IET continued to monitor the competitive ability of the goods produced by the Russian processing industry basing on the direct estimations of price and quality of the goods produced by the managers of the enterprises as compared with the price and quality of the import present at the market and competing with them. For the first time such a survey was conducted in April 2007, and the same questions were asked to the enterprises in May 2008.

As it has been shown by both the surveys, a considerable part of the Russian industry is free from the competition with the import, and, consequently, from its influence. In 2007 there were 33% of such enterprises (not taking into account power and fuel industry), and in 2008 – only 26%. However there are obvious changes, whether positive or negative is a matter of separate consideration, having occurred.

The same trend is observed for all the branches of industry (according to Standard Industrial Classification). The dimension of changes, however, differ greatly (see *Fig. 27*).

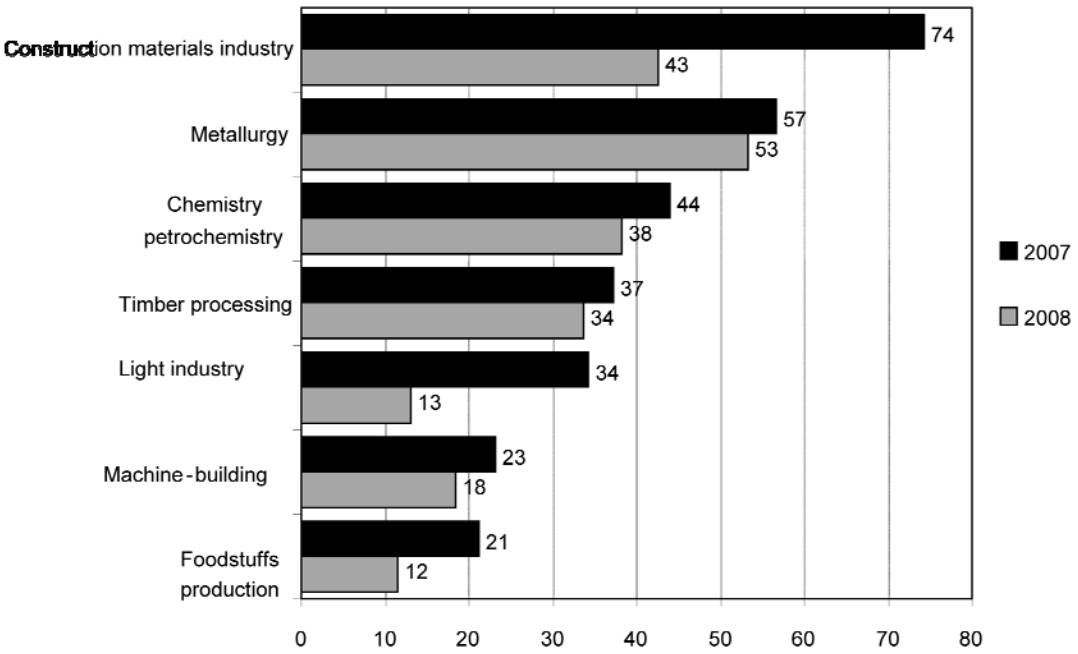


Fig. 27. Share of Markets without Competition with Import as Broken According to Standard Industrial Classification, As Percentage

Import has had the biggest success at the markets of construction materials, where the share of enterprises non-competing with it has reduced from 74% to 34% over the year. As a result the construction materials industry gave the first place in the rating of the branches of industry free from the influence of import to the metallurgy. In these branches, like in many others, the import has also enhanced the extent of its presence but rather negligibly – by 3-6 points. The second place in the list of the industries in which the import presence has changed most is held by the light industry. In 2008 only 13% of enterprises of the branch do not compete with the import, whereas in 2007 there were 34% such. As to the foodstuffs production, there the import became wider-spread by 9 points.

While the Russian enterprises regard their production as comparable with the import goods present at their sales markets (and in this case import is competitive), the price and the quality of the Russian goods can either exceed those of import ones or yield to them.

About 53% of the Russian goods that come across import at sales markets is comparable to it (the markets where there is competing import are regarded as 100%). Results of 2007 were similar. That is the Russian industry on the whole was able to hold the quality parity with the import actively invading the markets. The balance (higher quality of import minus lower quality of import) even improved from 29 to 23 points.

As to the share of the production of the same quality it is the foodstuffs production that retained its leading positions (74% of the enterprises regarding their production as comparable with the import in terms of quality, the figure of 2007 being 87%). The second place is sustained by the metallurgy (66%, 64% in 2007), the third is occupied by chemistry and petrochemistry (57%, 36% in 2007). The proportion of the Russian enterprises regarding the quality of the goods produced as higher than that of the competing import enhanced up to 12% (versus 9% in 2007). The construction materials industry retained the leading position with regard to the qualitative superiority (46%), whereas the machine-building industry, in which only 5% of the plants ventured to estimate the quality of their production as better than that of the import, remained the outsider. Vice versa, 43% of the machine-building enterprises recognized the quality superiority of the import (42% in 2007). No other branch of industry had such a pessimistic estimation of the quality of the goods they produce. The situation in timber processing complex, 40% of enterprises recognizing the superior quality of the import, and chemistry and petrochemistry (34%) is a bit better.

In contrast to 2007, the import no more costs the same as the domestically produced goods on the whole at all the markets. A year ago, there was nearly parity at the markets of processing industries competing with import: at 37% of the markets the prices for the import were higher, and at 35% - lower than the prices of Russian goods. 28% of the Russian enterprises considered their prices as nearly equal to the prices of the competing import. In 2008 42% of the competing import is more expensive than domestically produced goods, and 27% - cheaper. 31% of the Russian enterprises hold that their production has the same price as the import production. The balance in the light industry and the construction materials industry is, however, unfavorable for the domestic producer: there the competing import is cheaper than the domestically produced goods, and quite often, it should be noted.

Combined analysis of the “quality to price” ratio demonstrated that over the year the Russian industry has not lost its competitive advantages, and, taking into account the ongoing invasion of the import (or, in other words, the frequency of encountering the import), has even strengthened them.

First, at 16% of the markets the import is non-competitive since its prices are higher or equal to the prices of the domestically produced goods, the quality of the import goods being the same or lower than that of the domestically produced. A year ago there were 10% of such markets. It is in the foodstuffs production where such markets have spread considerably (59% versus 17% in 2007). In other sectors the scale of change is much more moderate, but also positive for the domestic producer. Only the machine-building and timber processing remained at the same positions.

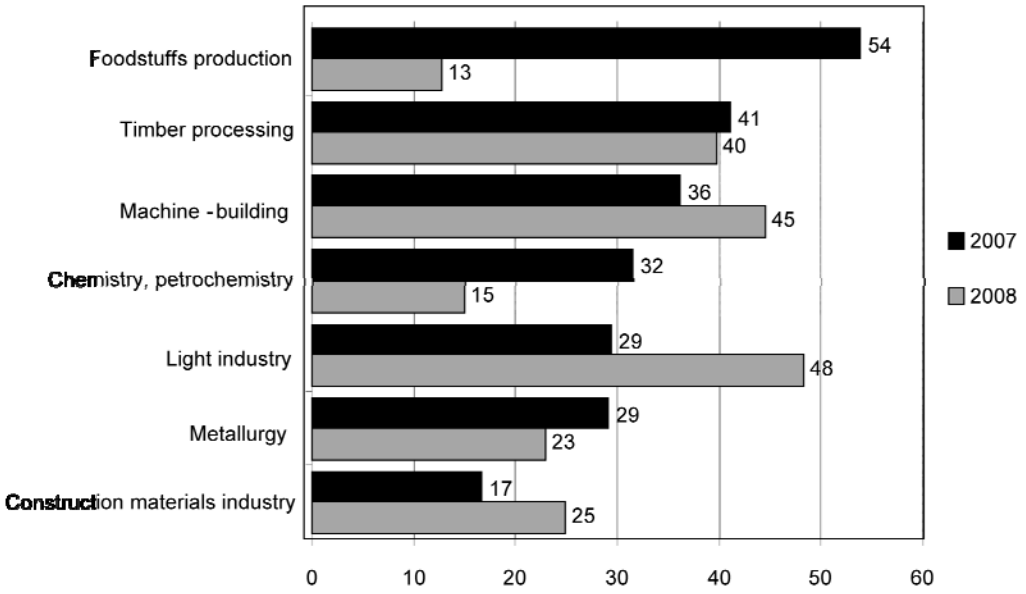


Fig. 28. Proportion of Markets At Which Import Competes with Domestically Produced Goods "On Equal Terms", As Broken by Branches of Industry According to Standard Industrial Classification, As Percentage

Second, the Russian industry succeeded in retaining the share of markets with the correct (adequate) ratio of price to quality of the goods produced domestically and those imported. That is higher quality of import is there combined with the higher price, equal quality – with equal price, lower quality – with lower price when compared with the Russian goods. At such markets the Russian goods compete with the import on equal terms by the ratio "price to quality". The same as a year ago there are 36% of such markets on the whole throughout the industry. However if in 2007 it was the foodstuffs production that held the leading positions when the equal competition was concerned, now it is the light industry that holds the first place (see *Fig. 28*). For the latter branch of industry this is an indisputable success, taking into account the large-scale invasion of the competing import.

Third, the scale of noncompetitiveness in the Russian industry on the whole remained practically the same. The same as a year ago, 22% of Russian enterprises admitted that the goods they produce are inferior to import goods in respect of the ratio "price to quality". The situation by sectors of industry is however less simple (see *Fig. 29*). Whereas the light industry, machine-building and metallurgy succeeded in maintaining the scale of their noncompetitiveness at the same level or even in lowering it, the timber processing industry, foodstuffs production and chemistry industry, as well as production of construction materials yielded to import. The construction materials industry experienced the most problems, noncompetitiveness growing by 13 points over the year.

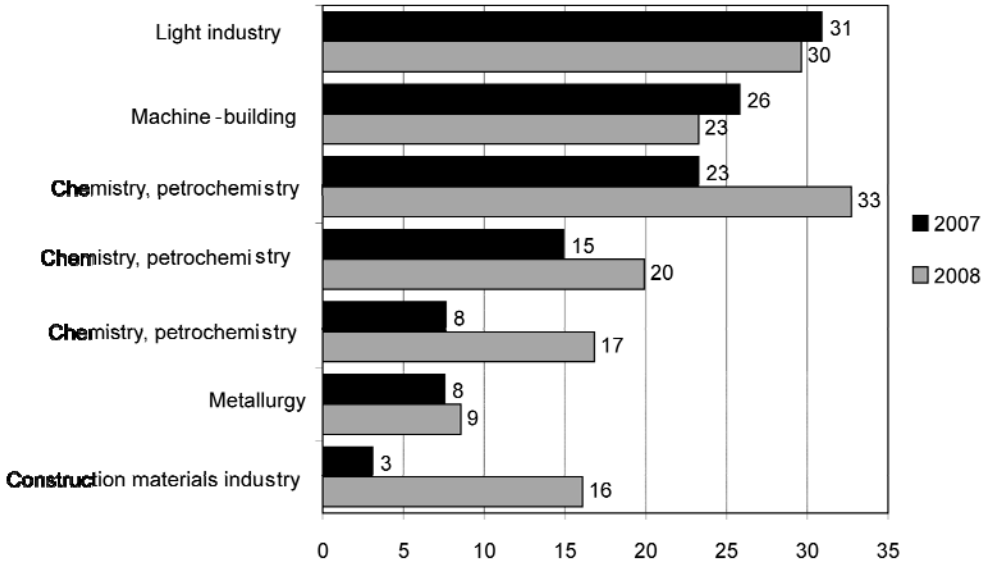


Fig. 29. Share of Markets by Branches of Industry, According to Standard Industrial Classification, In Which Domestic Production Is Noncompetitive, As Percentage

As a result, according to the estimations of the enterprises, there is still 78% of the goods produced by the Russian processing industry that are competitive with the import. This figure of 78% includes the markets with no import present at all, the markets at which the import is non-competitive because of the "price to quality" ratio and the markets where the competition with the import is going on equal terms. As broken by branches, the proportion of such markets vary from 67% in chemistry to 91% in metallurgy in 2008. The structure of the competitive ability (and consequently the extent of protection of the enterprises) is different by branches (see *Fig. 30*). The position of the Russian enterprises is best protected at the markets where the import is present but is non-competitive with the domestically produced goods by the ratio "price to quality". That is why it is the positions of the Russian foodstuffs production, where 59% of the enterprises are superior to the import, are most favorable. Other branches of industry are by far less protected (7–16%). The positions of the Russian enterprises are more vulnerable if they have to compete with the import on equal terms, since in future the import can receive the advantage. The equal competition, however, testifies that the Russian enterprises are ready to and are able to protect their positions. But it is the absence of competition with the import that is the most dangerous for the Russian industry. Such existence with no problems can soon come to the end, and it is unclear whether the enterprises that do not have the experience of the competition with the market will be able to hold the position at the competing market.

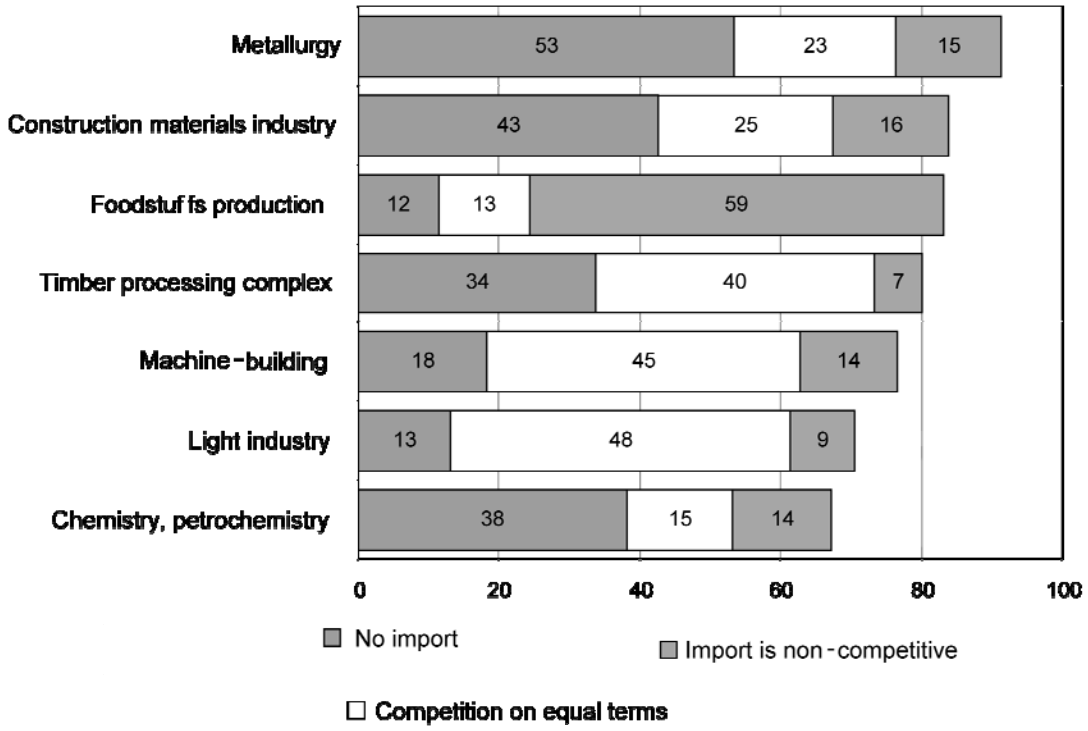


Fig. 30. Proportion of Markets As Broken by Branches of Industry, At Which There Is No Import Or Import Competes with Domestically Produced Goods On Equal Terms, Or Import is Non-competitive, 2008, As Percentage

3.2.4. Staff and Labor Productivity

Causes and Results of Staff Shortage in Russian Industry

Despite obvious slow-down of the demand and output growth rates, the Russian industry is still short of staff. In the third quarter of 2008 26% of enterprises reported the number of staff being insufficient taking into account the expected changes in the demand, and in the fourth quarter of 2008 there were 25% of such. It is in the light industry where the staff deficit was the most acute, 56% of enterprises not having enough staff. In other branches of industry the situation is better by far: in machine-building 28% of plants experience the lack of staff, in the construction materials industry – 27% and in foodstuffs production – 23%.

On the whole (on average) the situation with the provision with staff for the industrial growth has aggravated in 2008 (see *Table 30*). Nearly in all the branches of industry the proportion of the enterprises with the lack of the qualified staff increased. Only the construction materials industry and timber processing complex succeeded in preventing the staff deficit from becoming more acute. The situation in foodstuffs production and metallurgy appear to be relatively happy, but even there 2008 was the least favorable year over thirteen years of monitoring.

Table 30

Proportion of Enterprises with Insufficient Number of Staff By Branches of Industry (Average Annual Data, As Percentage to the Number of Those Responded)

	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
Metallurgy	4	3	3	6	3	3	2	8	5	6	6	7	8
Chemistry and petrochemistry	2	4	7	5	10	10	6	10	6	10	7	10	13
Machine-building	13	9	6	12	25	22	17	18	19	18	21	27	32
Timber processing complex	6	4	4	6	9	8	7	8	7	9	10	20	18
Construction materials industry	6	5	4	10	13	12	14	14	18	13	18	32	31
Light industry	6	9	13	15	28	30	28	28	41	26	41	55	59
Foodstuffs production	2	2	2	4	7	5	2	7	7	4	6	8	11

Source: IET business surveys, 1996–2008

As it is demonstrated by IET monitoring, in 2008 the enterprises experience more difficulties in hiring new employees of three out of four main categories. Whereas in 2007 70% of enterprises did not have many problems when hiring unqualified workers, now there are 56% of such. Similar changes occurred in the category of qualified workers (in 2007 29% of enterprises did not have difficulties in finding them, in 2008 – 22%) and engineers and office workers (2007 – 40%, 2008 – 30%). The absence of difficulties when hiring managers remained at the same level of 30%. Thus, in 2008 the qualified workers were the category of staff most difficult to hire (see *Table 31*).

Seeing difficult situation with training and searching for qualified workers the enterprises like experienced generals start to increase their reserves. Whereas in 2007 9% of enterprises had such reserves, in 2008 there are 13% of such. It seems that we may once again get the effect of excessive employment, though now these employees are not the dead weight but a precious resource. The reserves of managers at enterprises have also increased. But since the deficit of this category of workers is by far less than the deficit of workers, there are no grounds of talking about the purposeful creation of the reserves by the enterprises.

Table 31

Obstacles for Hiring of Main Categories of Employees in Industry in 2007and 2008 (As Percentage to Those Responded)

Obstacles	Workers				Engineers and office workers		Shop foremen, heads of departments	
	unqualified		qualified					
	2007	2008	2007	2008	2007	2008	2007	2008
no special obstacles	70	56	29	22	40	30	30	30
there is a reserve of necessary employees	7	6	9	13	25	23	32	36
necessary employees cannot be fired	4	3	1	1	8	8	2	2
lack of “idle hands” in the region	7	7	31	30	8	15	12	17
no graduates from educational institutions	1	1	30	32	19	18	12	8
no applications	1	1	5	6	4	2	6	3
low wages at enterprise	17	20	45	49	32	39	24	24
hard working conditions at the enterprise	12	15	13	13	5	1	4	1
not satisfied with applicants’ experience, qualification, age	13	11	26	15	22	13	16	8
taxation of the enterprise and taxation advantages of other enterprises	2	1	5	1	4	1	3	1
other	0	2	3	0	1	0	1	1

Source: IET surveys in March 2007 and July 2008

Low wages, the same as a year ago, remain the main obstacle for employees hiring. The extent to which it is spread has increased over the year for three categories of employees out of four (only when hiring the managers, the obstacle remained at the same level as a year ago). When hiring qualified workers low wages are obstacle for half of enterprises already. This circumstance hinders especially the enterprises in machine-building and light industry (see *Table 32*). The third place is held by the chemistry industry, though there had been a considerable progress as compares with the preceding year. For other categories of workers this obstacle is cited less frequently by 10 points (engineers and office workers), by 25 points (shop foremen and heads of departments) and by 30 points (unqualified workers). However in all cases it is cited most frequently.

Table 32

Frequency of Citation of Low Wages As an Obstacle for Hiring of Qualified Workers and Specialists by Branches of Industry in 2007 and 2008 (as percentage to the number of those responded)

Branches of Industry	Qualifies workers		Engineers and office workers	
	2007	2008	2007	2008
Metallurgy	43	17	32	13
Chemistry industry	68	46	42	42
Machine-building	45	59	33	44
Timber processing complex	35	43	24	35
Construction materials industry	34	35	23	34
Light industry	44	49	36	44
Foodstuffs production	31	40	29	39

Source: IET surveys in March 2007 and July 2008

Insufficient number of the graduates from the secondary and higher educational institutions is considered as the second important obstacle for the hiring of the qualified staff. However over the year the frequency of its citation has not changed, which is certainly a plus for the growing economy with the ruined system of the secondary vocational education and devaluated system of higher education. The big role, however, was played by the fact that the requirements of the enterprises for the candidates have lowered. The obstacle “not satisfied with the qualification, experience, age of the applicants” was cited twice less frequently in the Russian industry. It is highly unlikely, however, that such changes occurred to the applicants visiting the personnel departments of factories.

The shortage of “idle hands” in the region holds the third place in the resulting rating. This is a somewhat demographic problem and is especially frequently cited for the category of the qualified workers. It is cited tow times less often for the engineers, office workers and managers.

Situation with the “dead weight” of the staff has not changed over the year in the industry. The same as before this circumstance hardly prevents the enterprises from hiring (or trying to hire) new employees. If any problems exist, they concern engineers and office workers, whom 8% of the enterprises still cannot discharge.

The Russian industry, as it is demonstrated by the results of thirteen-year monitoring, was first faced with the shortage of staff in 2000. All the years that followed the industry had

to take this obstacle into account. Such a long story of staff shortage let the enterprises work out strategies of behavior and estimate their consequences to the sufficient extent.

The most wide-spread consequence of the staff shortage in the Russian industry was the decrease in the quality of the goods produced. This was reported by a half of entrepreneurs (see *Fig. 31*). This phenomenon is especially wide-spread in the construction materials industry (65% of enterprises) and machine-building (59%). It is in the construction materials industry where the situation is most dramatic, the decrease in the quality of the goods produced being 3-4 times as widespread as other consequences of staff shortage. The second place in the branch rating is occupied by the increase on wages, but it is cited by only 19% of the directors of enterprises producing construction materials. It is in the foodstuffs production where the quality of the goods produced is least affected by the shortage of staff, only 23% of enterprises citing such a consequence. In this branch the enterprises are more prone to increase the wages than to decrease the quality of the goods produced. This fact is certainly quite comforting for the population. The problem of staff shortage in the branch is minimal (see *Table 30*).

The second place is held by the impossibility to increase the output even if there are orders present. Such a consequence of staff deficit was registered at more than two thirds of the enterprises. It is the machine-building that turned out to be an undisputable leader with respect to this consequence, the output being restricted at a half of the enterprises. The enterprises of light industry react a bit better, the growth of production being limited only at one third of the enterprises.

A quarter of the Russian industrial enterprises has to reduce the output volumes because of the shortage of staff. It should be noted that in this case it is a question of the reduction of the production, not of the impossibility to increase the production. This reaction to the staff shortage is equally spread in the branches with the exception of the light industry, where it is the most frequently cited (48%), exceeding even the decrease in the goods quality (45%).

Only 15% of enterprises can afford investments measures in response to the problem of staff shortage. They prefer purchasing more productive equipment. In machine-building industry such strategy is applied by 23% of enterprises, the figure for other industries being substantially below.

Thus, the major (most widely spread) consequence of staff deficit in the Russian industry is the decrease in the quality of the goods produced (49%) and no the limitation for the growth of the output (36%). However the staff shortage has even more serious negative effect on the production of the industrial goods: 26% of enterprises have to decrease the output because of it. As a result, not regarding repeat count, the shortage of staff has a negative effect on the dynamics of production at 53% of the enterprises.

As a result, not making repeat count, only 19% of the Russian industrial enterprises can afford active counteraction to the staff shortage (increase in labor productivity, modernization of the equipment, purchase of more productive equipment). Obviously the balance is not favorable for the creation of the competitive innovation economy.

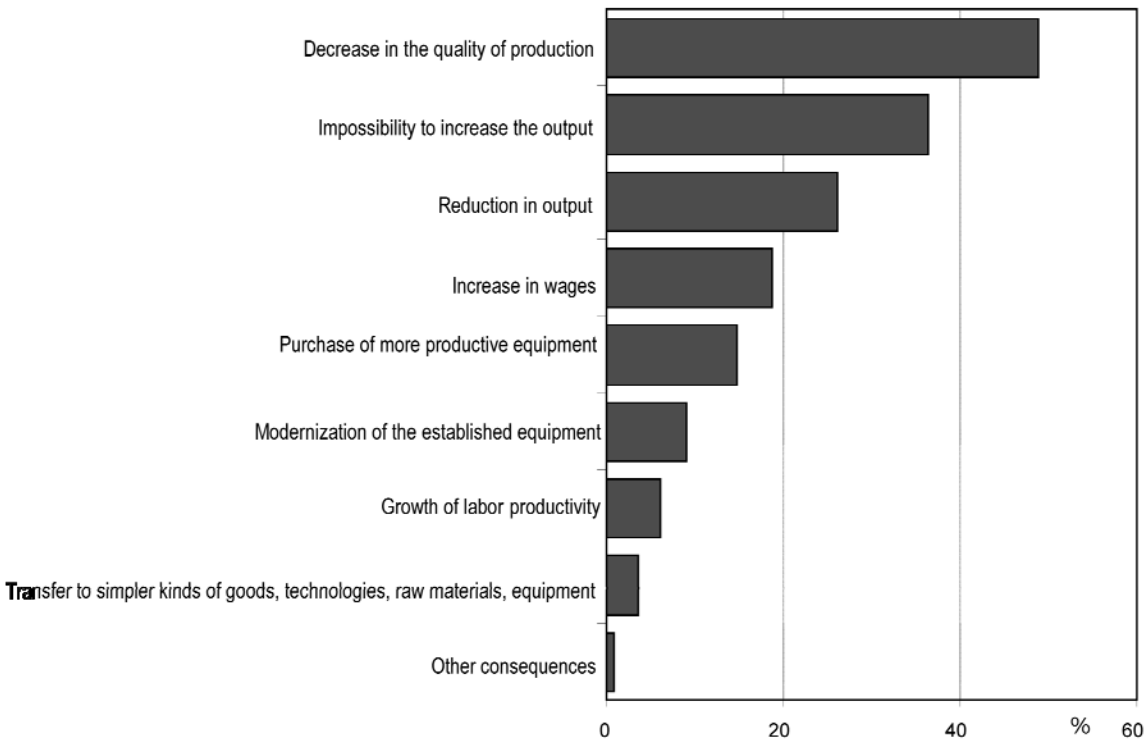


Fig. 31. Estimation of Consequences of Staff Shortage in Russian Industry, as percentage to number of respondents

Labor Productivity

Addressing the State Duma of the Russian Federation on May 8, 2008 V.V. Putin referred to only one problem as a big one and mentioned it in the first place. This problem is the labor productivity. Such priorities of the new chairman of the Government, close attention of the experts and little progress in this field let us refer to the labor productivity as one of the most serious problem of contemporary Russia.

The slogans of authorities and the attention of the experts are but one aspect. Another aspect is the enterprises' opinion of the productivity, since they are the very organizations to increase it. But do they want to increase the labor productivity of the employees, do they need to? The answer to these questions may cast the light on the problem from quite a different angle.

Regular panel polls of the directors of the industrial enterprises allow receiving the picture of the attitude to the problem of labor productivity at the enterprises themselves. It should be noted that when some questions are concerned the information is provided by a relatively long (for the post-reform period of the Russian economy) monitoring taking into account the factors that could be registered only through the surveys.

In 2008 the labor productivity satisfies 68% of the enterprises in the Russian industry, and only 25%of the producers consider it as below the norm. Thus, only a quarter of enterprises in the Russian industry agree with the opinion of the external observers. The highest

degree of dissatisfaction is observed in the timber processing complex (35%) and machine-building (33%). The leaders of the ratings of the satisfaction with the demand are chemistry and petrochemistry (88%). The second place is shared by the foodstuffs production (73%), construction materials industry (72%) and metallurgy (70%). The last place is held by the light industry, but even in this branch more than a half of enterprises (53%) consider their labor productivity as normal (see *Fig. 32*). In such a situation one can hardly expect that the Russian enterprises will respond to the calls of the authorities to increase the labor productivity actively.

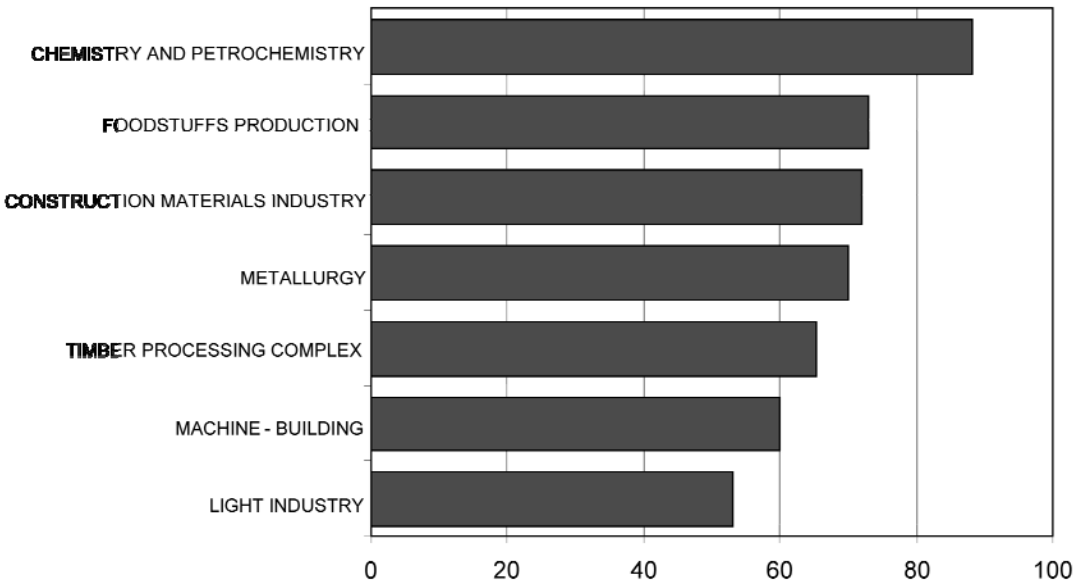


Fig. 32. Proportion of Enterprises with Normal Labor Productivity, by Branches, in 2008, As Percentage

The question on the plans for the changes of the output and the plans for the changes in the number of those employed, which are included in the list of the European harmonized survey questionnaire and are asked to the IET panel respondents since 1993, enable estimating the intentions of the industrial enterprises in the field of labor productivity over 16 years of economic reforms. The results of the calculation basing on the complimentary matrixes provide two main characteristics of these intentions: the share of enterprises planning to increase the labor productivity in the forthcoming months and the share of enterprises intending to leave it unchanged.

The first results (see *Fig. 33*) testify that the majority of the Russian industrial enterprises prefer changing the output and the employment unilaterally, that is leaving the labor productivity unchanged. The share of such enterprises varied from 48 to 77% over the period of monitoring, and was on average equal to 60%.

This means that the majority of the Russian enterprises has always preferred not to plan the change in the labor productivity. Or to be more precise: the majority of the Russian enterprises planned such changes in output and employment that resulted in retaining the existing labor productivity. There were only three times when the quarterly monitoring of the enter-

prises' intentions indicated the decrease of the intentions to retain the productivity down to 48-50%, i.e. to the level at which there could be more intentions to increase the labor productivity in the Russian industry. However this did not happen. The intentions to increaser the productivity just reached their maximum levels at that time (45-46%).

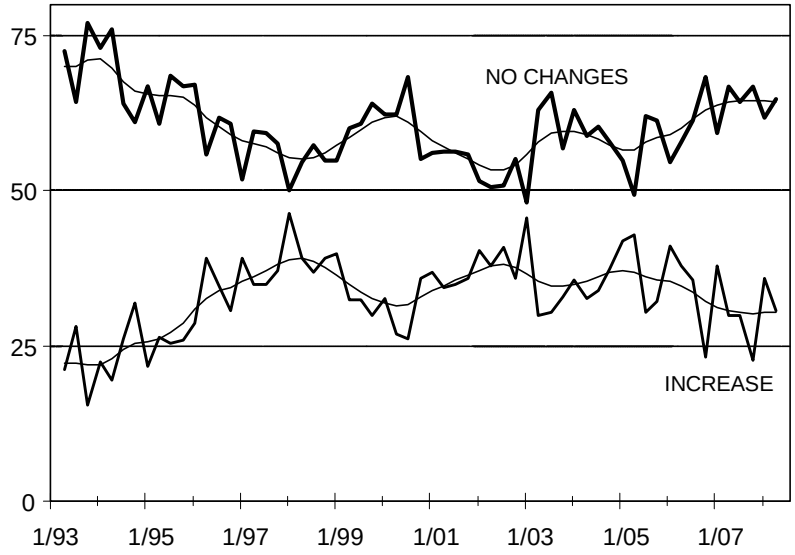


Fig. 33. Proportion of Enterprise Intending to Change Labor Productivity, 1993–2008, as percentage

The intentions to change/retain the labor productivity in the Russian industry were characterized by certain dynamics. The first period that seems to have started with the beginning of the economic reforms came to the end at the beginning of 1998, a several months before the default. At first it was characterized by a high level of the desire to retain the existing labor productivity, and, correspondingly by low level of the desire to increase it. At the end of 1993-the beginning of 1994 the share of enterprises not intending to change the productivity reached 76%, and of those desiring to increase it was just 16-19%. However such a ratio of enterprises plans (not a favorable one) started to change gradually to the better and by the beginning of 1998 the share of such intentions was 46%. On average over 1998 the proportion of these plans made 40%. Both the results of 1998 are absolute record-breaking: the first for the quarterly dynamics, and the second – for the annual dynamics. Thus, before the default of 1998 there was the biggest number of the Russian enterprises observed which were ready to increase the labor productivity. The readiness was especially high in the metallurgy and the chemistry industry (see *Fig. 34*). The situation in the light industry and foodstuffs production was opposite in 1998, their readiness to increase the labor productivity being two times lower than the leader's.

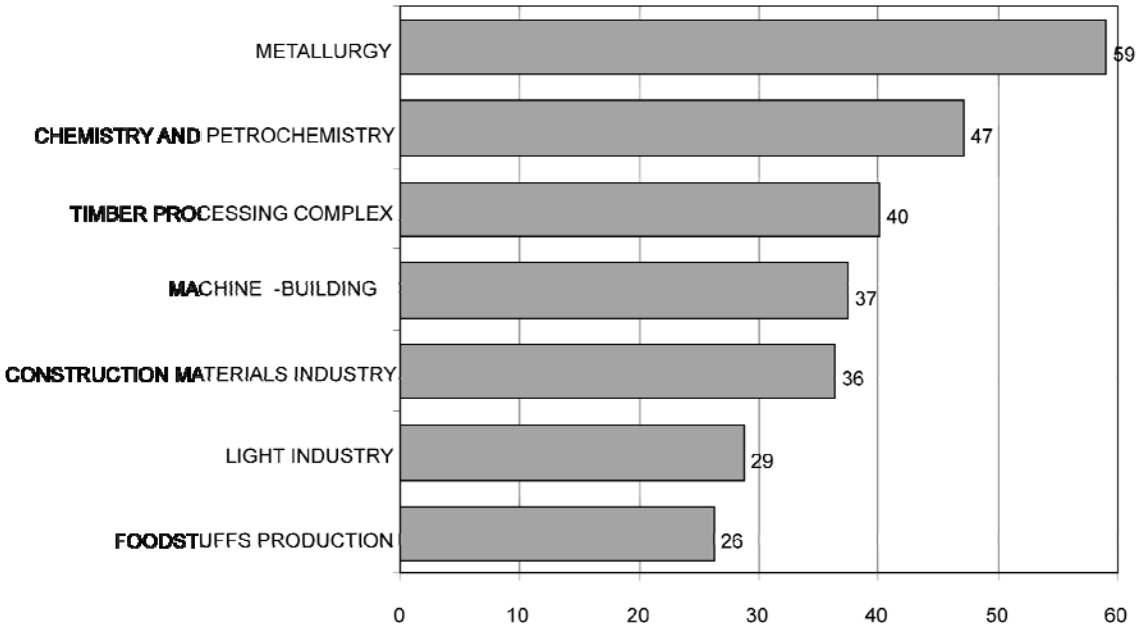


Fig. 34. Proportion of Enterprises Intending to Increase Labor Productivity, As Broken By Branches, in 1998, As Percentage

Thus, the trying conditions of pre-default development for the Russian industry (severe limitations of the demand, non-payments, barter, largely advertized competition with the import and other features of the 90-ies now forgotten) still made the enterprises plan the increase in labor productivity. At least that was true before the 1st quarter of 1998. Two more metering of the enterprises' plans to increase labor productivity (April and June 1998), that were before the default, demonstrated the decrease in the intentions to increase the productivity down to 37%, the intentions to retain the productivity growing up to 50%. Though there were no obvious reasons for that: solvent demand and output continued to drop, their forecasts became worse and worse. There were no sudden changes in the economic situation in Russia envisaged.

It seems that the enterprises were ready to fight for the growth of productivity only before the 1st quarter 1998. Then such a desire disappeared, which is most probable due to the fact that they realized lack of prospects when applying such measures in the existing economic situation.

Thanks to the default the Russian industry came out of the crisis … and the necessity to increase the labor productivity lowered at the Russian enterprises. The first (positive) consequences of the default were experienced by the Russian industry only in November-December 1998. Then the demand decrease rates slowed down and the forecasts for the changes in the indices became better. The general panic (ruble devaluation, crash of the banking system, drop in the level of life of the population) did not enable the industrial enterprises (and not only them) to appreciate the consequences of the default to the full extent. That is why there were no fundamental shifts in the plans for the changes in labor productivity at the end of 1998 – the beginning of 1999: the readiness to increase labor productivity remained in the range of 37-39% (the same as in three preceding quarters). However in the 2nd and the 3rd quarters

1999 the inclination to increase the productivity decreased down to 32%, and it reached 26% in the 3rd quarter 2000, which has been the absolute minimum of the ten-year period (from January 1996 to July 2006). It is obvious that the reason for such a decline in the intentions to increase labor productivity was the fundamental change in the dynamics and the nature of the industrial growth after the default. By that time there were not only the changes in the development of the main indices occurring in the industry, but the attitude of the enterprises towards their position at the market had changed. They became sure in the steadiness of the trends for the industrial growth and in its normal (non-barter) nature. This change in the understanding is testified by the change in the policy for the management of the finished goods stocks by the Russian enterprises: whereas earlier the producers tried to minimize their stocks at any opportunity, in 2000 they transferred to the manageable maintenance of the excesses of finished goods, which enabled them to serve new customers quickly without putting additional strain on the production. Under such conditions the necessity to increase labor productivity decreased.

On the whole in 2000 in the industry this figure made only 30%, i. e. only 30% of enterprises planned such a change in output and employment that could provide the increase in labor productivity. 62% of enterprises preferred to leave it unchanged. In 2000 the readiness to increase labor productivity reduced in all the branches of the Russian industry. As a result 2000 was one of the worst years with the respect to the number of enterprises intending to increase labor productivity (see *Fig. 35*).

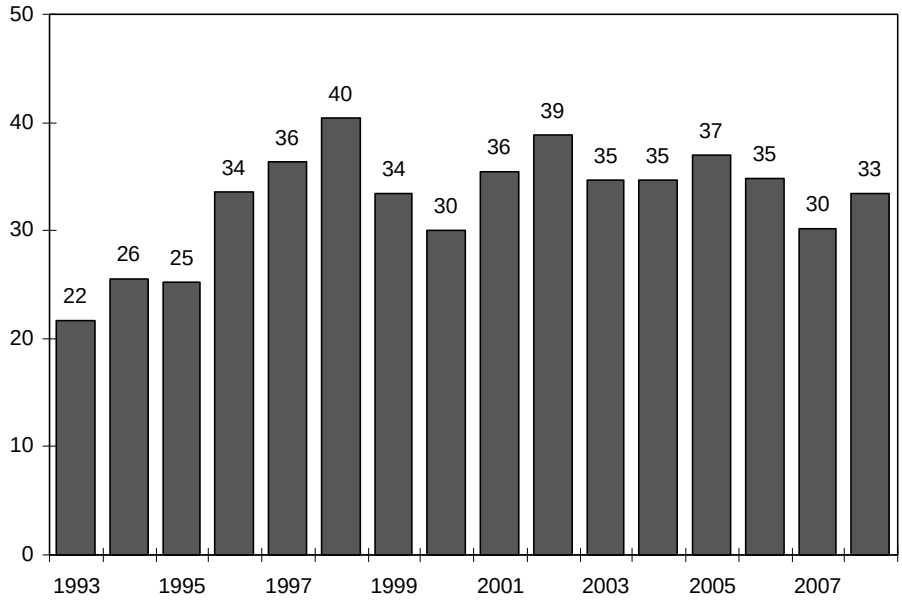


Fig. 35. Share of Enterprises, Expecting Labor Productivity to Grow, Average Annual Data, As Percentage

However in 2001-2001 the dynamics of demand and output made the enterprises concern the problem of labor productivity once again. in that period the sales and production growth rates lowered to the values that had been the worst in the post-default period. The extent to which the intentions to increase productivity had spread went up to 46% by the end of

2002 (the same as at the beginning of 1998). Average annual figures of 2002 demonstrated that 39% of Russian enterprises had plans to increase productivity, which was only 1 per cent below the figure of 1998 and was the record-breaking figure for the post-default period.

The period of 2003-2004 let the Russian enterprises "forget" about the necessity to increase labor productivity. Increase in sales and production growth rates together with good provision with finished goods reduced the extent to which the plans to increase the productivity were spread in the industry to 30-37%, average annual figure being 35%. 2005 was the last favorable year for the increase in labor productivity. The level of the intentions to increase it went up to 42-43% in the first half, average annual figure being 37%, 2005 holding the third place after 1998 and 2002 as a result.

Last years of 2007 and 2008 turned out to be most unfortunate for the plans for the increase in labor productivity. In 2007 the inclination of enterprises to increase it lowered down to 30% (the minimum figures of the post-default period), in 2008 it made 33% (the last but one place in the post-default period). The enterprises obviously do not have a need to increase labor productivity.

The analysis of the plans to increase labor productivity by branches has shown that it is the machine-building that has been the leading industry in this sphere most often (see *Fig. 36*). Only in 1996 this branch was considerably behind light industry and foodstuffs production. Now only 28% of enterprises are registered to have plans to increase labor productivity, whereas in 2002 this figure reached 41% (according to average annual. figures). The largest part of machine-building plants has always planned to change the output and employment in such a way so as to maintain the existing level of productivity. In the first half of 2008 71% of the enterprises in the branch had such intentions, which was the absolute maximum of fourteen-year monitoring. However same proportion of plans to preserve the situation (70%) was registered in 2008 in light industry and foodstuffs production. In these branches, however, the results are not record-breaking: foodstuffs production was mare conservative in 1993 (79%) and the light industry – in 1997 (76%).

As it is demonstrated by the calculations, the share of enterprises that do not have intention to change labor productivity is biggest in machine-building, light industry and foodstuffs production (see *Fig. 37*). The second place is held by timber processing complex and metallurgy (such plans are characteristic for 59% of enterprises), the third place – by construction materials industry and chemistry industry (49–50% of enterprises). Thus, the main branches of Russian processing industries (machine-building, light industry and foodstuffs production) are least ready to support the summons of the Government to increase labor productivity.

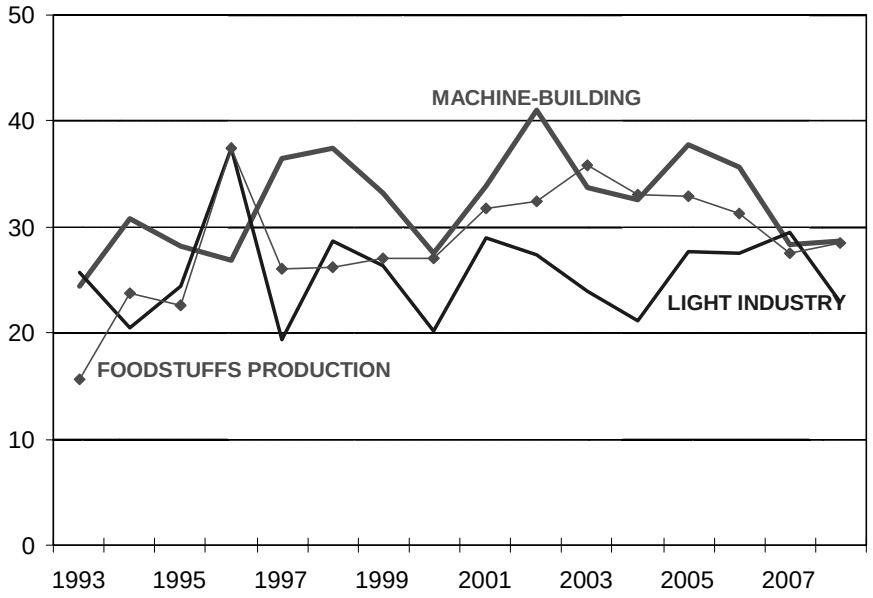


Fig. 36. Share of Enterprises Expecting Growth of Labor Productivity by Branches, Average Annual Data, As Percentage

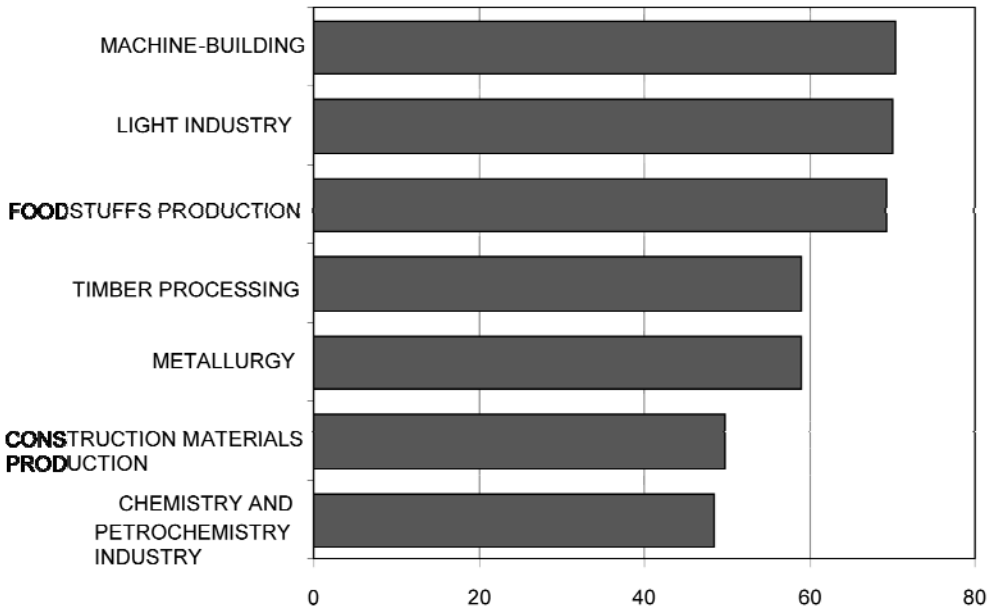


Fig. 37. Share of Enterprises Intending to Retain Labor Productivity by Branches of Industry in 2008, As Percentage

The monitoring of the competition that was started by the IET in 1995 allows calculating the inclination to increase the labor productivity at enterprises operating under different

competitive conditions for two main kinds of competition: competition with Russian producers and competition with the producers from non-CIS countries.

As it is demonstrated by calculations the strongest and most widespread competition is that between the Russian enterprises. However the intensity of the internal Russian competition does not affect the readiness of enterprises to increase labor productivity (see *Fig. 38*).

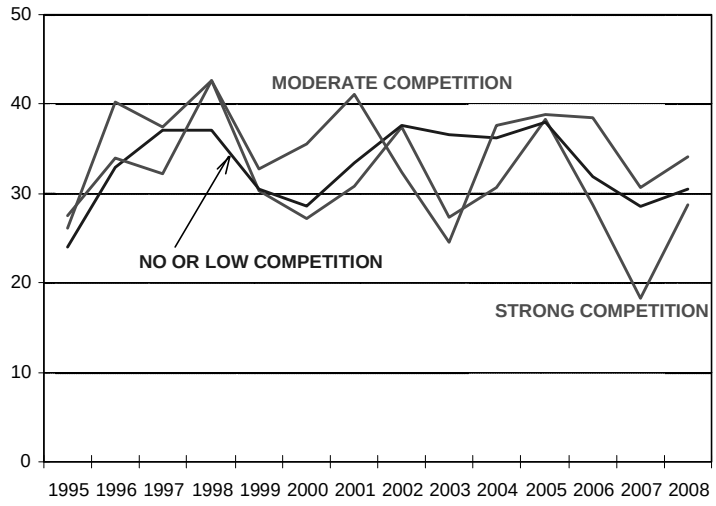


Fig. 38. Readiness to Increase Labor Productivity Intensity of Internal Russian Competition Being Different, As Percentage

When it comes to the competition with the producers of non-CIS countires the situation is similar (see *Fig. 39*).

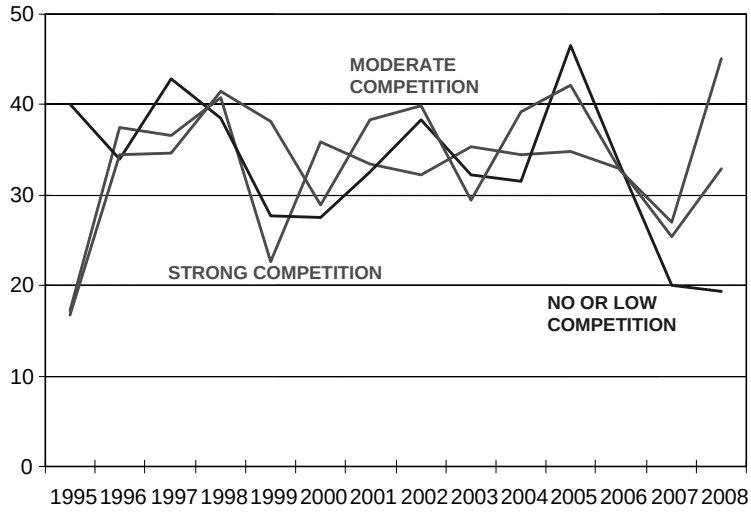


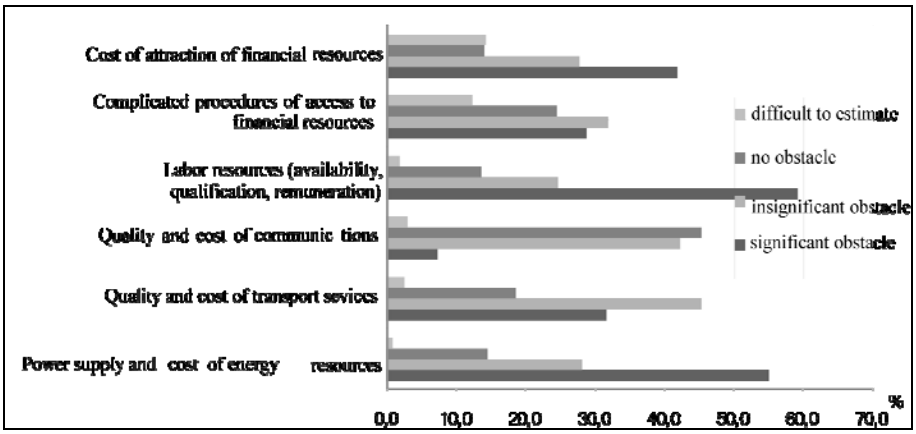
Fig. 39. Readiness to Increase Labor Productivity Intensity of Competition with Non-CIS countries Being Different, as percentage

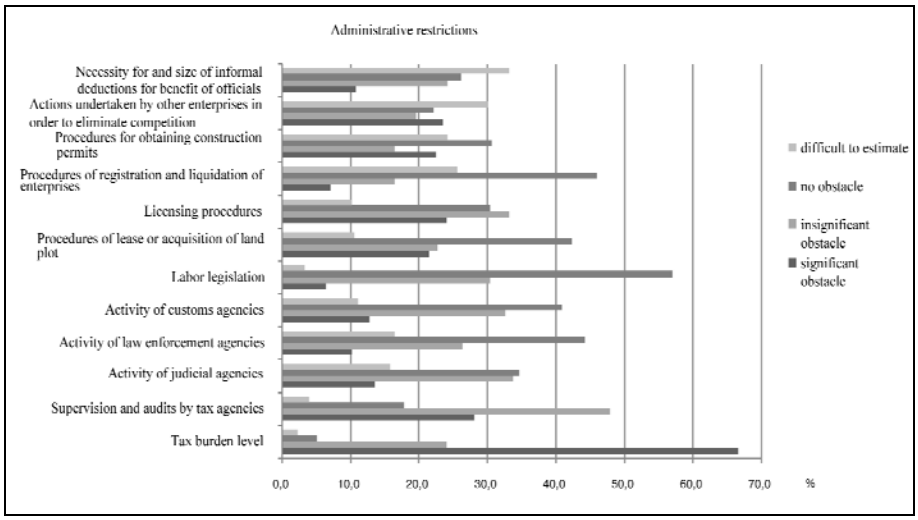
3.3. Restrictions to economic growth in industry on the eve of the crisis

In September 2008, the IET's Department for Economic Situation Surveys conducted a poll among Russian industrial enterprises aimed at identifying the existing obstacles to successful economic development. Within the poll's framework the directors of enterprises were offered questions concerning their assessment of the influences of various factors on their enterprises' development. The factors potentially restrictive to development were subdivided into *3 groups: resource-linked restrictions, administrative restrictions and macroeconomic restrictions*. These questions were fully or partly answered to by the directors of 545 enterprises. In this connections, the questions concerning the first group of restrictions were answered on the average by 97.7% of the respondents; those concerning the second group – by 96.7%; and those concerning the third group – by 97.4%.

It should be emphasized that the poll took place in September, i.e. during the period when the real sector of the national economy was still faced with only minimum negative effects produced by the global financial crisis. Evidently, as the crisis aggravated, the perception of obstacles to production development underwent rapid changes, and so towards the end of 2008 it, most probably, already became markedly different from that demonstrated by the poll's results. Nevertheless, the analysis of the "pre-crisis" answers of enterprises is still of significant interest, since it reflects the ways the obstacles to growth in industry were viewed at the end of the period of relatively successful economic development of 2000 – 2008, and also in a certain sense determines the structure of obstacles as it emerged in the framework of a certain specific development model (characterized by high prices of raw materials, relatively easy access to external financing, and the State's increasing participation in economic life).

The distribution of enterprises' answers by each factor group included in the poll is shown in *Fig. 40* and in *Table 33*. *Fig. 41* presents the balance (as%) of the answers relative to each group, i.e. the difference between the number of enterprises pointing to a given factor as a significant obstacle to the development of their production and the number of those not regarding that factor as an obstacle.





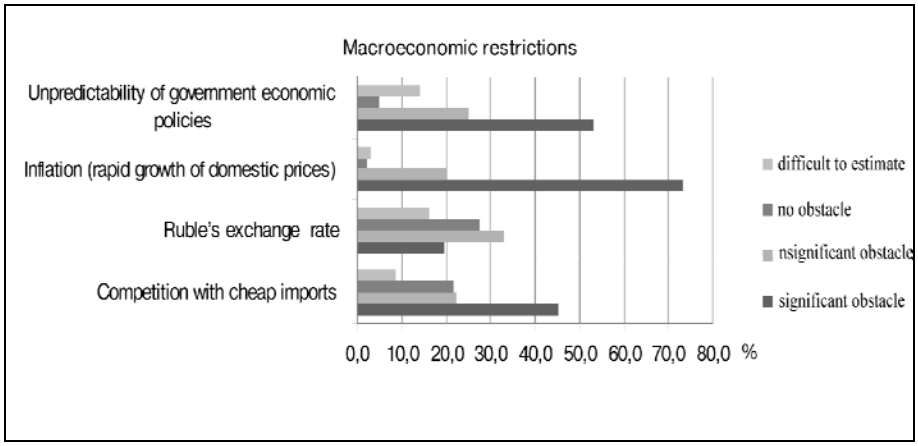


Fig. 40. Restrictions to production development, as% of the number of enterprises participating in the poll

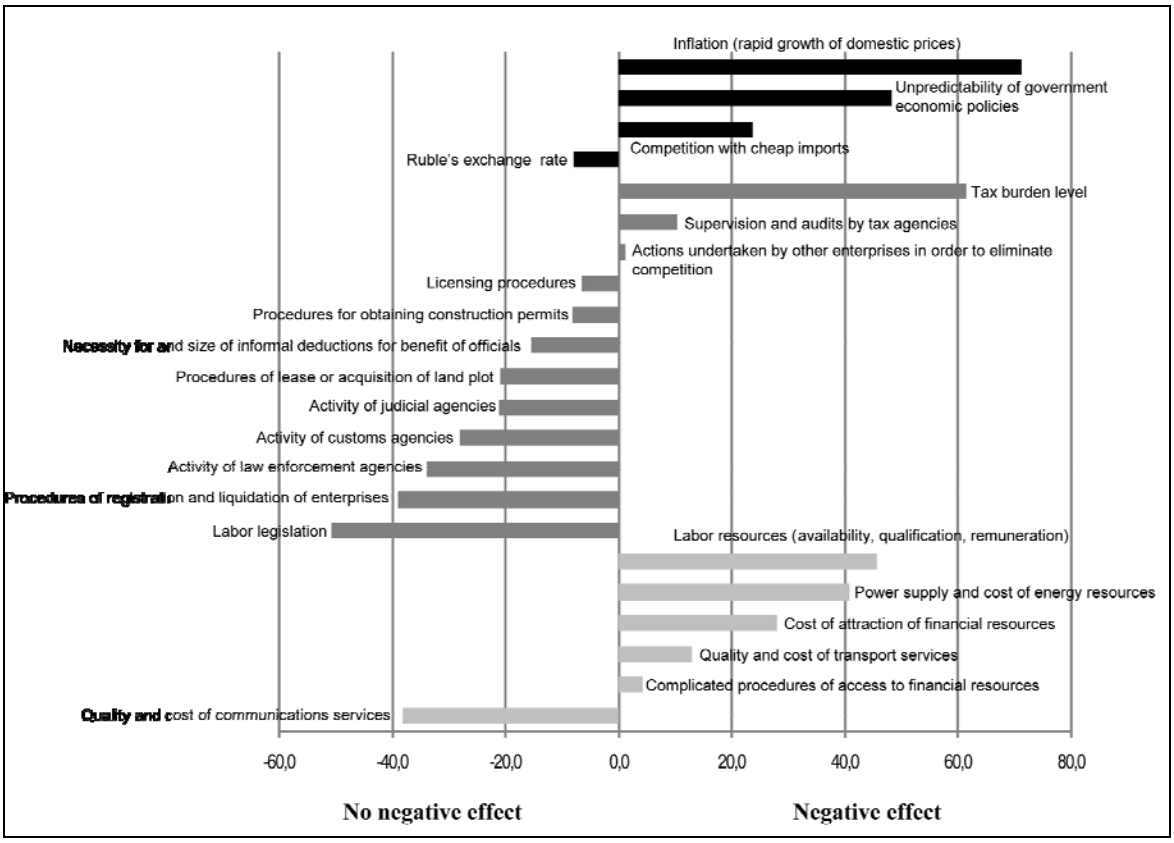


Fig. 41. Balance of answers (difference between answers "significant obstacle" and "no obstacle") concerning the degree of seriousness of obstacles for the development of enterprises by separate components, as%

Table 33

Results of the poll concerning restrictions to production development

	How serious, at present, as obstacles for development of enterprise are:	Distribution of answers across groups, as% of sample:				% of enterprises that have answered this questions
		significant obstacle	insignificant obstacle	no obstacle	difficult to estimate	
Resource-linked restrictions	Power supply and cost of energy resources	55.0	28.1	14.3	0.7	98.2
	Quality and cost of transport services	31.6	45.1	18.5	2.4	97.6
	Quality and cost of communications services	7.2	42.2	45.3	2.8	97.4
	Labor resources (availability, qualification, remuneration)	59.1	24.6	13.4	1.8	98.9
	Complicated procedures of access to financial resources	28.6	31.7	24.4	12.1	96.9
	Cost of attraction of financial resources	41.8	27.5	13.9	14.1	97.4

	How serious, at present, as obstacles for development of enterprise are:	Distribution of answers across groups, as% of sample:				% of enterprises that have answered this questions
		significant obstacle	insignificant obstacle	no obstacle	difficult to estimate	
Administrative restrictions	Tax burden level	66.6	24.0	5.1	2.4	98.2
	Supervision and audits by tax agencies	28.1	47.9	17.8	4.0	97.8
	Activity of judicial agencies	13.6	33.8	34.7	15.8	97.8
	Activity of law enforcement agencies	10.3	26.4	44.2	16.5	97.4
	Activity of customs agencies	12.8	32.7	40.9	11.2	97.6
	Labor legislation	6.4	30.5	57.1	3.3	97.2
	Procedures of lease or acquisition of land plot	21.5	22.8	42.4	10.6	97.2
	Licensing procedures	24.0	33.2	30.5	10.3	98.0
	Procedures of registration and liquidation of enterprises	7.2	16.5	46.1	25.7	95.4
	Procedures for obtaining construction permits	22.6	16.5	30.6	24.2	93.9
	Actions undertaken by other enterprises in order to eliminate competition	23.5	19.6	22.2	30.1	95.4
	Necessity for and size of informal deductions for benefit of officials	10.8	24.2	26.2	33.2	94.5
Macroeconomic restrictions	Competition with cheap imports	45.3	22.4	21.7	8.4	97.8
	Ruble's exchange rate	19.4	32.8	27.3	16.1	95.8
	Inflation (rapid growth of domestic prices)	73.4	20.2	2.2	3.1	98.9
	Unpredictability of government economic policies	53.2	25.0	5.0	14.1	97.2

On the whole, the economic environment in September 2008 can be described as moderately satisfactory. Among the 16 factors included in the poll, five were named as significant obstacles to production development by more than half of the enterprises participating in the poll. Another seven factors represent either significant or insignificant obstacles more than half of the enterprises across the sample. Only one factor out of 16 (prevailing labor legislation) is described as no obstacle to development by more than half of the sample. At the same time, the significance of the three different groups of factors is by no means similar: according to the respondents, resource-linked and macroeconomic restrictions were producing much stronger influence on the development of enterprises than administrative (institutional) restrictions did. This latter finding is rather unexpected. Traditionally, it has been believed that it is the institutional restrictions, linked to the State exercising its regulating and supervisory functions, that are the most restrictive to the development of the real sector of Russia's national economy[11].

Among the factors of the first group, which are associated with *resource-linked restrictions*, the majority represented significant obstacles to the development of enterprises. The

[11] V.V. Dashkeev, L.M. Freinkman. *Rossiia v 2007 godu: riski zamedleniia ekonomicheskogo rosta na fone sokhraniaiushcheisia institutsional'noi stagnatsii*. [Russia in 2007: risks of slowdown in economic growth against the background of persistent institutional stagnation.] Voprosy ekonomiki [Issues of Economics], 2008: 4: 75–93.

strongest concern of the directors of enterprises was the shortage of labor resources: 59.1%[12] of the respondents named it as a 'significant obstacle' to growth; 24.6% - as an 'insignificant obstacle'; and only 13.4% of the respondents regarded it as no problem at all. Next in importance[13] among the restrictions to growth, according to most of the enterprises, were problems with power supply and the cost of energy resources – in 55.0% and 28.1% respectively of all answers this factor was described as a 'significant' or 'insignificant obstacle', and only 14.3% of the enterprises has no problems with power supply. The quality and cost of transport services, the cost of attracted financial resources and difficult access to these resources were also restricting production development at a majority of the enterprises being surveyed, although with regard to these three factors the difference between the answers 'significant obstacle' and 'no obstacle' is smaller than in case of the first two factors. It is also noteworthy that a considerable portion of the respondents could not assess the effect on their production of the cost of attracted financial resources and difficult access to them (14.1% and 12.1% respectively). The only factor in the group of resource-linked restrictions that presented no obstacle for the development of a majority of the enterprises in September 2008 was the quality and cost of communications services.

In contrast to the first group, *administrative restrictions* are not regarded by the majority of the enterprises surveyed as a serious obstacle. The most important growth-restricting factors in this group were the size of the tax burden and the supervision and audits conducted by tax agencies. The shares of enterprises estimating the first of these factors as an obstacle - either a 'significant' or an 'insignificant' one - are 66.6% and 24.0% respectively, and only 5.1% respondents did not see any problems in their taxation level. Tax audits were regarded as a source of serious worries by a somewhat smaller number of enterprises – 28.1%; nevertheless, the fact that the estimation 'insignificant obstacles' constituted nearly half (47.9%) of all the answers to that question demonstrates that this factor was also restricting development to a significant degree. It is necessary to note that the much higher significance for enterprises of the obstacles associated with the actual level of tax burden, as compared to the problems of tax administration, was one of the unexpected findings resulting from that poll. This finding differs from the results of earlier polls among Russian enterprises and therefore, no doubt, requires further monitoring[14]. We think it rather unlikely that any dramatic improvements could have occurred lately in the quality of tax administration in the Russian economy.

The other administrative restrictions were not regarded by the majority of respondents as serious obstacles to the development of their enterprises. The most favorable, from this point of view, were the administrative procedures reflecting the situation with labor legislation and the procedures registration and liquidation of enterprises. A total of 6.4% and 7.2% of enter-

[12] The statistical significance of the shares of respondents that gave certain specific answers to the questions concerning different factors is sufficiently high in all the cases, if not stated otherwise in the text. We applied the standard test for the difference between two population proportions.

[13] It should be noted that the statistical significance of the differences between the shares of enterprises that gave the answers "significant obstacle" and "no obstacle" in regard to various pairs of factors is also sufficiently high in the majority of cases.

[14] Thus, for example, in BEEPS survey (2005) the number of enterprises considering tax administration to be an obstacle to their business (60%) was higher than the number of those believing the levels of tax rates to be such an obstacle (54%) (see *Table 38*). The available comparable international data based on the 2006 estimates also point to the relatively favorable character of the Russian situation with regard to tax rates, while tax administration, by contrast, appears to be complex and cumbersome (Paying Taxes 2008. The Global Picture. The World Bank and PricewaterhouseCoopers. 2007).

prises respectively encountered serious problems caused by the effect of these factors; on the contrary, 57.1% and 46.1% of the respondents experienced no difficulties in these spheres. At the same time, it should be noted that an unexpectedly high percentage of directors of enterprises failed to offer any estimates of the influence on production of many administrative factors, such as the necessity to make informal deductions for the benefit of government officials (33.2% of answers), actions undertaken by other enterprises in order to eliminate competition (30.1%), the procedures of registration and liquidation of enterprises (25.7%), the obtaining of construction permits (24.2%), and the activity of law enforcement (16.5%) and judicial agencies (15.8%).

In the group of *macroeconomic restrictions* the first place, by its negative effect on the development of enterprises, is inflation: 73.4% of the respondents pointed to rapid growth of domestic prices as being a significant obstacle, and only 2.2% did not consider inflation to be a restricting factor. Second came the factor of "unpredictability of government economic policies" (53.2% и 5.0% respectively), and the third place was occupied by competition with cheap imports (45.3% and 21.7%). In this group only the ruble's exchange rate was named by the majority of respondents either as an insignificant obstacle to their development (32.8% of the answers) or as no obstacle at all (27.3%).

Also of interest are the differences between the answers offered by directors of enterprises depending on how they estimated their prospects for increasing output (*Table 34*). Significant[15] differences are noted in the estimations of the effects of many of the factors in all the three groups of restrictions. On the whole, the optimistically-minded directors (i.e. those expecting an increase in their production) gave more positive estimations of their economic environment and noted less restricting factors with regard to their production development that their more pessimistic counterparts (i.e. those expecting a fall in output). The difference in the corresponding balances of answers was between 8 and 20 p. p.

Table 34

Distribution of answers depending on prospects of increasing output*

	How serious, at present, as obstacles for development of enterprise, are:	Significant obstacle, as% of sample		No obstacle, as% of sample		Balance of answers, as% of sample		Significance of differences	
		expect increase in output	expect declining output	expect increase in output	expect declining output	expect increase in output	expect declining output	Z - statistics	P - value
Resource-linked restrictions	power supply and cost of energy resources	52.47	53.45	12.96	16.38	39.51	37.07	0.41	0.6808
	quality and cost of transport services **	27.16	37.07	22.22	18.97	4.94	18.10	–3.54	0.0005
	quality and cost of communications services	8.02	10.34	49.38	45.69	–41.36	–35.34	–1.01	0.3113
	labor resources (availability, qualification, remuneration),	61.73	51.72	11.73	15.52	50.00	36.21	2.28	0.0232
	complicated procedures of access to financial resources	28.40	33.62	21.60	24.14	6.79	9.48	–0.82	0.4129
	cost of attraction of financial resources	40.74	43.97	11.11	12.93	29.63	31.03	–0.25	0.8016

[15] At significance level of 5%.

	How serious, at present, as obstacles for development of enterprise, are:	Significant obstacle, as% of sample		No obstacle, as% of sample		Balance of answers, as% of sample		Significance of differences	
		expect increase in output	expect declining output	expect increase in output	expect declining output	expect increase in output	expect declining output	Z - statistics	P - value
Administrative restrictions	tax burden level	63.58	68.97	3.70	7.76	59.88	61.21	–0.22	0.8232
	supervision and audits by tax agencies	24.69	30.17	14.20	18.10	10.49	12.07	–0.41	0.6811
	activity of judicial agencies	11.73	12.93	32.72	39.66	–20.99	–26.72	1.11	0.2661
	activity of law enforcement agencies	7.41	8.62	45.68	45.69	–38.27	–37.07	–0.20	0.8385
	activity of customs agencies	8.64	12.93	40.12	47.41	–31.48	–34.48	0.53	0.5994
	labor legislation	8.02	6.03	53.09	60.34	–45.06	–54.31	1.52	0.1294
	procedures of lease or acquisition of land plot	19.14	25.00	41.36	42.24	–22.22	–17.24	–1.02	0.3081
	licensing procedures	24.07	19.83	35.19	33.62	–11.11	–13.79	0.67	0.5015
	procedures of registration and liquidation of enterprises	6.17	6.90	47.53	50.00	–41.36	–43.10	0.29	0.7715
	procedures for obtaining construction permits	22.22	26.72	32.10	28.45	–9.88	–1.72	–2.72	0.0069
	actions undertaken by other enterprises in order to eliminate competition	17.28	25.00	28.40	16.38	–11.11	8.62	–5.39	0.0000
	necessity for and size of informal deductions for benefit of officials	9.88	10.34	29.01	31.03	–19.14	–20.69	0.32	0.7487
Macroeconomic restrictions	competition with cheap imports	40.12	47.41	24.07	25.86	16.05	21.55	–1.17	0.2435
	ruble's exchange rate	18.52	22.41	25.93	32.76	–7.41	–10.34	0.86	0.3906
	inflation (rapid growth of domestic prices)	74.07	73.28	3.70	0.86	70.37	72.41	–0.37	0.7108
	unpredictability of government economic policies	49.38	62.93	6.17	3.45	43.21	59.48	–2.68	0.0079

* Answers were received from 162 enterprises expecting increase in their output and from 116 enterprises expecting drop in their output.
** Hereinafter the rows are marked where differences are significant for two groups of enterprises.

Thus, among the optimistic directors the balance of answers with regard to the factor 'quality and cost of transport services' was 4.9 p. p. whereas among the pessimistic ones – 18.1 p. p. The optimistic directors also have noticeably less complaints concerning problems with obtaining construction permits (the balance answers: – 9.9 against – 1.7), with the actions undertaken by other enterprises in order to eliminate competition (– 11.1 against + 8.6), and with the unpredictability of government economic policies (43.2% against 59.5). Probably, these differences can be explained by the fact that pessimistically-minded directors are inclined to blame external factors for the intrinsic problem of their enterprises.

At the same time, the directors of enterprises expecting an increase in their output were confronted by a more acute shortage of labor resources: the balance of their answers with regard to that factor is 50.0 p. p., while the corresponding index of the pessimistically-minded ones is only 36.2 p. p.

Similar differences were also noted in the answers received from enterprises with different forms of ownership, of different size and belonging to different sectors (*Tables 35, 36* and *37* respectively). Thus, state-owned companies complain less often than private companies of

the problems associated with power supply, transport and personnel, as well as with relations with tax, judicial and law enforcement agencies. Bigger enterprises, on the whole, complain less often than smaller ones (with the total number of staff less than 100 persons) of their economic environment. In particular, small-sized enterprises perceive as more problematic such issues as credit accessibility and ease in obtaining licenses and construction permits. Besides, small-sized enterprises believe more often than big ones that the development of their activity is suppressed by the unpredictability of government policy and competition with imported commodities. At the same time, small-sized enterprises voice far less complaints relating to the level of tax burden which, quite evidently, can be explained by their opportunities for applying simplified taxation regimes.

Table 35

Distribution of answers depending on enterprise's size*

	How serious, at present, as obstacles for development of enterprise are:	Significant obstacle, as% of sample		No obstacle, as% of sample		Balance of answers, as% of sample		Significance of differences	
		State-owned companies	Private companies	State-owned companies	Private companies	State-owned companies	Private companies	Z - statistics	P - value
Resource-linked restrictions	Power supply and cost of energy resources	34.38	56.34	18.75	14.04	15.63	42.30	–2.98	0.0030
	Quality and cost of transport services	25.00	31.97	31.25	17.74	–6.25	14.23	–3.26	0.0012
	Quality and cost of communications services	6.25	7.21	40.63	45.61	–34.38	–38.40	0.45	0.6494
	Labor resources (availability, qualification, remuneration)	46.88	59.84	18.75	12.87	28.13	46.98	–2.08	0.0383
	Complicated procedures of access to financial resources	34.38	28.27	25.00	24.37	9.38	3.90	1.49	0.1355
	Cost of attraction of financial resources	37.50	42.11	15.63	13.84	21.88	28.27	–0.78	0.4345
Administrative restrictions	Tax burden level	65.63	66.67	6.25	5.07	59.38	61.60	–0.25	0.8021
	Supervision and audits by tax agencies	18.75	28.65	21.88	17.54	–3.13	11.11	–2.53	0.0116
	Activity of judicial agencies	12.50	13.65	50.00	33.72	–37.50	–20.08	–2.34	0.0195
	Activity of law enforcement agencies	6.25	10.53	59.38	43.27	–53.13	–32.75	–2.36	0.0185
	Activity of customs agencies	0.00	13.65	59.38	39.77	–59.38	–26.12	–4.06	0.0001
	Labor legislation	0.00	6.82	75.00	55.75	–75.00	–48.93	–2.86	0.0044
	Procedures of lease or acquisition of land plot	12.50	22.03	56.25	41.33	–43.75	–19.30	–3.31	0.0010
	Licensing procedures	21.88	24.17	40.63	29.63	–18.75	–5.46	–3.02	0.0027
	Procedures of registration and liquidation of enterprises	9.38	7.02	37.50	46.59	–28.13	–39.57	1.29	0.1981
	Procedures for obtaining construction permits	15.63	23.00	43.75	29.82	–28.13	–6.82	–4.29	0.0000
	Actions undertaken by other enterprises in order to eliminate competition	25.00	23.39	25.00	22.03	0.00	1.36	–0.67	0.5063
	Necessity for and size of informal deductions for benefit of officials	3.13	11.31	21.88	26.51	–18.75	–15.20	–0.54	0.5902
Macroeconomic restrictions	Competition with cheap imports	46.88	45.03	34.38	20.86	12.50	24.17	–1.51	0.1313
	Ruble's exchange rate	18.75	19.49	25.00	27.49	–6.25	–7.99	0.35	0.7230
	Inflation (rapid growth of domestic prices)	65.63	73.88	3.13	2.14	62.50	71.73	–1.12	0.2636
	Unpredictability of government economic policies	34.38	54.19	9.38	4.68	25.00	49.51	–2.69	0.0073

* Answers were received from 32 state-owned and 513 private companies.

Table 36

Distribution of answers depending on enterprise's size*

	How serious, at present, as obstacles for development of enterprise, are:	Significant obstacle, as% of sample		No obstacle, as% of sample		Balance of answers, as% of sample		Significance of differences	
		personnel number <100	personnel number >100	personnel number <100	personnel number >100	personnel number <100	personnel number >100	Z - statistics	P - value
Resource-linked restrictions	Power supply and cost of energy resources	65.52	54.56	10.34	14.56	55.17	40.00	1.62	0.1063
	Quality and cost of transport services	31.03	31.65	13.79	18.83	17.24	12.82	0.69	0.4915
	Quality and cost of communications services	10.34	6.99	37.93	45.83	–27.59	–38.83	1.21	0.2257
	Labor resources (availability, qualification, remuneration)	48.28	59.81	17.24	13.01	31.03	46.80	–1.66	0.0981
	Complicated procedures of access to financial resources	37.93	28.16	24.14	24.47	13.79	3.69	2.63	0.0088
	Cost of attraction of financial resources	37.93	42.14	13.79	13.98	24.14	28.16	–0.47	0.6392
Administrative restrictions	Tax burden level	41.38	68.16	3.45	5.24	37.93	62.91	–2.69	0.0073
	Supervision and audits by tax agencies	24.14	28.35	24.14	17.48	0.00	10.87	–1.87	0.0613
	Activity of judicial agencies	17.24	13.40	34.48	34.76	–17.24	–21.36	0.53	0.5974
	Activity of law enforcement agencies	13.79	10.10	37.93	44.66	–24.14	–34.56	1.15	0.2494
	Activity of customs agencies	10.34	13.01	44.83	40.78	–34.48	–27.77	–0.78	0.4342
	Labor legislation	10.34	6.21	65.52	56.50	–55.17	–50.29	–0.51	0.6092
	Procedures of lease or acquisition of land plot	20.69	21.55	37.93	42.52	–17.24	–20.97	0.48	0.6302
	Licensing procedures	37.93	23.30	24.14	30.68	13.79	–7.38	4.16	0.0000
	Procedures of registration and liquidation of enterprises	10.34	6.99	44.83	46.21	–34.48	–39.22	0.51	0.6107
	Procedures for obtaining construction permits	27.59	22.33	24.14	31.07	3.45	–8.74	2.29	0.0221
	Actions undertaken by other enterprises in order to eliminate competition	20.69	23.69	17.24	22.52	3.45	1.17	1.06	0.2889
	Necessity for and size of informal deductions for benefit of officials	6.90	11.07	10.34	27.18	–3.45	–16.12	1.84	0.0668
Macroeconomic restrictions	Competition with cheap imports	65.52	44.08	3.45	22.72	62.07	21.36	5.03	0.0000
	Ruble's exchange rate	10.34	20.00	13.79	28.16	–3.45	–8.16	0.91	0.3611
	Inflation (rapid growth of domestic prices)	72.41	73.59	0.00	2.33	72.41	71.26	0.13	0.8939
	Unpredictability of government economic policies	72.41	52.04	0.00	5.24	72.41	46.80	2.69	0.0074

* Answers were received from 29 enterprises with personnel of no more than 100 persons and from 515 enterprises with personnel of more than 100 persons.

Table 37

Distribution of answers depending of enterprises' types of activity

	How serious, at present, as obstacles for development of enterprise, are:	Significant obstacle, as% of sample		No obstacle, as% of sample		Balance of answers, as% of sample		Significance of differences	
		extracting industry	processing industry	extracting industry	processing industry	extracting industry	processing industry	Z - statistics	P - value
Resource-linked restrictions	Power supply and cost of energy resources	52,63	55,45	15,79	14,34	36,84	41,11	–0,37	0,7104
	Quality and cost of transport services	57,89	30,78	10,53	18,74	47,37	12,05	4,46	0,0000
	Quality and cost of communications services	21,05	6,50	26,32	46,27	–5,26	–39,77	3,04	0,0025
	Labor resources (availability, qualification, remuneration)	31,58	60,23	31,58	12,43	0,00	47,80	–4,11	0,0000
	Complicated procedures of access to financial resources	26,32	28,68	31,58	24,09	–5,26	4,59	–2,01	0,0448
	Cost of attraction of financial resources	31,58	42,26	21,05	13,77	10,53	28,49	–1,72	0,0868
Administrative restrictions	Tax burden level	73,68	66,73	5,26	4,97	68,42	61,76	0,59	0,5570
	Supervision and audits by tax agencies	26,32	28,11	21,05	17,59	5,26	10,52	–0,74	0,4602
	Activity of judicial agencies	31,58	13,00	21,05	35,18	10,53	–22,18	3,39	0,0007
	Activity of law enforcement agencies	21,05	9,94	21,05	44,93	0,00	–34,99	3,17	0,0016
	Activity of customs agencies	10,53	13,00	36,84	40,92	–26,32	–27,92	0,15	0,8786
	Labor legislation	15,79	6,12	47,37	57,36	–31,58	–51,24	1,68	0,0927
	Procedures of lease or acquisition of land plot	47,37	20,65	36,84	42,64	10,53	–21,99	3,38	0,0008
	Licensing procedures	31,58	23,71	15,79	30,98	15,79	–7,27	3,73	0,0002
	Procedures of registration and liquidation of enterprises	10,53	7,07	42,11	46,27	–31,58	–39,20	0,67	0,5038
	Procedures for obtaining construction permits	15,79	22,94	21,05	30,78	–5,26	–7,84	0,41	0,6801
	Actions undertaken by other enterprises in order to eliminate competition	15,79	23,90	42,11	21,41	–26,32	2,49	–6,88	0,0000
	Necessity for and size of informal deductions for benefit of officials	10,53	10,71	10,53	26,77	0,00	–16,06	1,90	0,0579
Macroeconomic restrictions	Competition with cheap imports	21,05	46,27	31,58	21,03	–10,53	25,24	–3,55	0,0004
	Ruble's exchange rate	21,05	19,50	21,05	27,53	0,00	–8,03	1,29	0,1990
	Inflation (rapid growth of domestic prices)	63,16	74,19	0,00	2,29	63,16	71,89	–0,83	0,4073
	Unpredictability of government economic policies	57,89	52,77	0,00	5,16	57,89	47,61	0,88	0,3784

* Answers were received from 19 enterprises in the extracting industry and 523 enterprises in the processing industry.

There are also some differences with regard to several factors between enterprises belonging to the extracting and processing industries. However, in all these cases any interpretation of the obtained results must be done with caution, because the groups of enterprises vary considerably in number (the poll encompassed 32 state-owned and 513 private companies, 29 small-sized and 515 big enterprises, 19 enterprises in the extracting and 523 in the processing industries).

Of separate interest in the comparison of the results of the IET's poll with those of similar surveys conducted by the World Bank in 2002 and 2005[16] (*Table 38*). This comparison points to significant improvement of the economic conditions in industry: as compared to the years 2002 and 2005, in 2008 a number of factors were producing a far less marked negative influence on the development of Russian enterprises. These factors are: the quality and cost of communications services; difficult access to financial resources and the cost of their attraction; the functioning of tax, judicial and customs agencies; the actions undertaken by other enterprises in order to eliminate competition; too complicated licensing procedures; bribe-extolling by officials; and the unpredictability of the government's economic policy.

Table 38

Comparison of the results of the polls conducted by the IET and BEEPS

		Percentage of enterprises considering factor to be 'significant obstacle'		
		BEEPS 2002	**BEEPS 2002**	**BEEPS 2002**
Resource-linked restrictions	Power supply and cost of energy resources	10.22	11.51	55.05
	Quality and cost of transport services	12.00	12.46	31.56
	Quality and cost of communications services	12.45	8.13	7.16
	Labor resources (availability, qualification, remuneration)	32.24	37.37	59.08
	Complicated procedures of access to financial resources	44.83	35.94	28.62
	Cost of attraction of financial resources	43.39	45.42	41.83
Economic environment	Tax burden level	56.00	54.10	66.61
	Supervision and audits by tax agencies	61.57	59.59	28.07
	Activity of judicial agencies	26.62	30.41	13.58
	Activity of law enforcement agencies	–	–	10.28
	Activity of customs agencies	27.74	25.51	12.84
	Labor legislation	9.92	17.06	6.42
	Procedures of lease or acquisition of land plot	28.43	24.40	21.47
	Licensing procedures	31.85	34.04	24.04
	Procedures of registration and liquidation of enterprises	–	–	7.16
	Procedures for obtaining construction permits	–	–	22.57
	Actions undertaken by other enterprises in order to eliminate competition	36.83	39.02	23.49
	Necessity for and size of informal deductions for benefit of officials	29.12	39.34	10.83
Macroeconomic factor	Competition with cheap imports	–	–	45.32
	Ruble's exchange rate	–	–	19.45
	Inflation (rapid growth of domestic prices)	–	–	73.39
	Unpredictability of government economic policies	62.83	59.01	53.21

[16] World Bank Business Environment and Enterprise Performance Survey – BEEPS. Additional information concerning BEEPS can be found, e. g., in: Raj M. Desai and Itzhak Goldberg, Eds. 2007. Enhancing Russia's Competitiveness and Innovative Capacity. The World Bank. Washington, DC.

On the contrary, if we take some resource-linked factor, there was a dramatic deterioration of the existing situation – in terms of the quality and cost of transport services, and the availability of labor resources and power supply. By comparison with 2005, the share of enterprises noting a growing number of obstacles represented by these factors increased by 19.1, 21.7 and 43.5 p. p. respectively.

Especially noteworthy is the fact that the IET's poll has revealed a significantly lower level of dissatisfaction on the part of enterprises with the existing administrative restrictions than that demonstrated by BEEPS' results. Thus, for example, the share of enterprises viewing as a serious obstacle to their development the factor represented by the supervision and auditing conducted by tax agencies decreased by 31.5 p.p. by comparison with 2005; the factor of bribes to officials - by 28.5 p.p.; the factor of the activity of judicial agencies – by 16.8 p.p., the factor of the actions undertaken by other enterprises in order to eliminate competition – by 15.5 p.p., and the factor of the activity of customs agencies – by 12.7 p.p. This is a rather unexpected finding, for which we can offer several mutually supplementing explanations.

Firstly, it should be recognized that in the past 4 or 5 years there were some evident improvements in the quality of economic environment. This, in particular, was demonstrated by the results of monitoring of the administrative barriers in the way of development of small businesses conducted by the Center for Economic and Financial Research (CEFIR)[17]. Some of these improvements were directly linked to the adoption, in 2002 – 2003, of federal laws on registration, licensing, inspections and simplified taxation. The slights improvements that took place after 2003 were explained by the CEFIR's researchers with better enforcement of these laws, with the resulting gradual reduction in direct violations of prevailing legislation – such as, for example, unlawful demands that enterprises should license their activity. Below we present more detailed comparisons between our results and those obtained by the CEFIR.

However, the improvements that actually occurred in economic environment are obviously insufficient. This is testified to by the following facts:

- the scale of improvements in Russia falls behind that characterizing the business climate in the majority of East European countries, which is confirmed by studies across countries. In the prestigious international rankings on the ease of doing business published by the World Bank, Russia ranks low, and does not seem to be able to change it in any marked degree (106th out of 178 countries in 2007)[18];
- the improvement of economic conditions had varying effects on different groups of enterprises. The greatest benefit from the improvements was gained by bigger and well-established enterprises, which have for many years been operating on their relevant markets and learned how to effectively deal with the administrative problems they are now and then have been confronted with. The economic conditions for the functioning of small-sized enterprises, as follows from the poll's results, are noticeably less favorable. Besides, we assume than the terms for the entry on the market of new players are very hard, just as before. That is why we see so few newly emerging enterprises and such a low level of competition. However, this latter assumption cannot be verified on the basis of only the data obtained through our polls, because those failing to get through the "entry" barriers do not participate in them;

[17] Monitoring administrativnykh bar'erov na puti razvitiia malogo biznesa v Rossii. [Monitoring of the administrative barriers in the way of small businesses' development in Russia.] Round 6. CEFIR. June 2007.
[18] Doing Business 2008. World Bank. 2007

- in 2007–2008, Russian industrial enterprises were confronted with relatively new resource-linked restrictions to their growth (first of all, shortages of labor and energy resources). Against this background it appears rather natural that the estimations of traditional administrative restrictions became less prominent. The changes in the level of administrative obstacles to development might have actually been rather moderate, but in face of the new problems their significance for the enterprises noticeably diminished It seems that the results of the IET's poll have demonstrated only a relative, and not absolute (as compared to the effects produced by other factors) decrease in administrative barriers.

Secondly, the differences between the results obtained by the IET and BEEPS are also linked to the differences in the properties of relevant samples. The BEEPS' poll encompasses a greater number of small-sized enterprises (only 34% of them having their staff in excess of 50 persons), while the IET's sample displays a strong shift towards big enterprises (94% of enterprises with staff of more than 100 persons). Besides, all the 545 enterprises in the IET's panel are industrial ones, whereas in the BEEPS' 2005 poll only 40% were in industry. Therefore, the much lower level of complaints concerning administrative restrictions revealed by the IET can largely be explained by the fact that among the respondents there are too few small-sized enterprises, such restrictions being much more important for the latter category. This means that the scale of the actual reduction in administrative barriers in the Russian economy in the period of 2005 – 2008 was, most probably, markedly lower than that displayed in *Table 38*. In other words, the results of the IET's poll, because of the sample's structure, underestimate the problems relating to the still existing administrative restrictions.

Thirdly, as has been mentioned earlier, the unexpectedly high share of respondents in the IET's poll failed ("found it difficult") to answer the questions concerning the influence of administrative factors on the development of their enterprises. This has led us to the assumption that administrative restrictions actually represent a more serious problem in industry than it can be concluded on the basis of the poll's results, but in the present situation the directors of enterprises are by far not so ready to openly discuss it than they did back in 2002 or 2005. This, in our opinion, also attests to the fact that the poll's results indeed underestimate the scope of the problems associated with administrative restrictions.

Fourthly, the low level of concern displayed by the respondents with regard to administrative (institutional) restrictions can also be explained by the extremely favorable market situation in Russian industry in the period from 2006 to the first half-year 2008. The high growth rate, coupled with a comparatively low level of competition on the domestic market, provided the majority of enterprises with high and sufficiently stable profits. In that situation of stable and considerable financial improvements, institutional restrictions were treated by managers as a secondary problem, especially by comparison with the resource-linked factors which were acting as direct obstacles to production expansion in a situation of high economic demand. As a consequence, in view of such favorable conditions businesses were displaying only minimum demand for institutional reforms.

Within the framework of this latter explanation, enterprises are found to be more sensitive to the limitations of their institutional environment, when on the markets become tougher, and so even small excessive costs associated with superfluous administrative barriers may be of critical significance for their competitive capacity. If this interpretation can indeed accurately explain the prevailing sentiments among Russian industrial enterprises, it means that, as the financial crisis of 2008 – 2009 deepens, the relative importance of administrative restric-

tions will become higher. And thus the demand on the part of businesses for reforms aimed at strengthening the key market institutions will become much greater.

At the same time, this IET's poll addressing the problems faced by Russian businesses is by no means the first one where the answers of respondents pointed to a rather low level of concern with the scope of corruption in this country. Thus, for example, the surveys among small businesses conducted in 2005 and 2006 by "Buttress of Russia" and the All-Russian Center for Public Opinion Studies (VTsIOM) have shown that, although corruption is a widespread phenomenon and represents a source of significant expenditures (on the average taking up between 8% and 10% of their aggregate proceeds), in that period it was not regarded by companies as a serious obstacle to development. In particular, in answer to the question as to the most important threats to the development of a business, only 16% of respondents classified corruption as being such a threat. By contrast, such factors as increasing taxes and rent payments were estimated at the level of 63 and 61% respectively[19].

Also of some interest is the comparison between the results of the IET's poll and those of the CEFIR's monitoring. It is worth emphasizing that, with regard to a number of factors, there exist considerable discrepancies in the estimates as to the direction of the changes observed: the CEFIR's monitoring recorded an improvement in the situation over time (between 2004 and 2006), while the IET's poll (2008) points to an improvement by comparison with the BEEPS' results (2005). These factors are as follows:

- taxation level (the average estimate of negative effect in the CEFIR's monitoring decreased from 2.78 to 2.65 by five-point scale),
- lack of economic stability (from 2.89 to 2.54),
- tax administration (from 2.59 to 2.34),
- difficulties in attracting capital (from 2.42 to 2.25),
- formalization of lease of land (from 2.68 to 2.52),
- licensing (from 2,22 to 2,13).

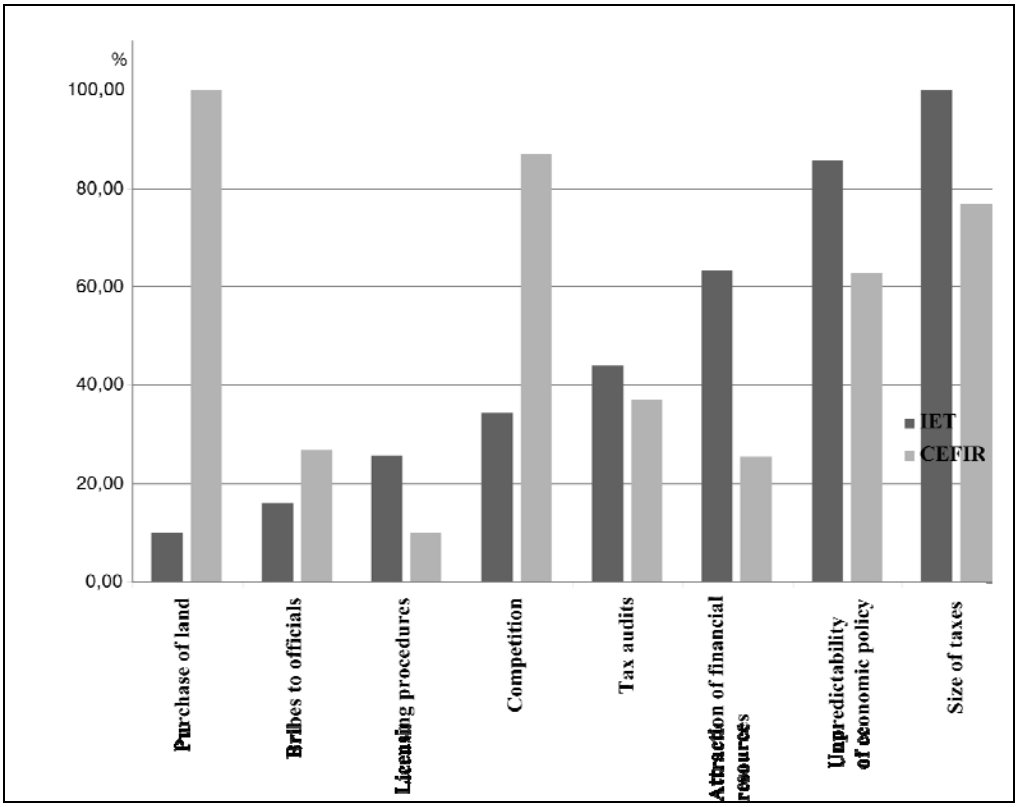
Besides, the presence of considerable differences should also be noted in the results of the polls conducted by the IET and the CEFIR. In *Fig. 42* the different factors applied in these two polls are ranged in accordance with the strength of their negative effect on the development of enterprises (in terms of per cent, 100% represents the most unfavorable factor). The important quality-linked similarities of the results of the two polls are as follows:

- tax issues are considerably more significant for the development of enterprises than the problems associated with corruption or licensing. The last two factors are not perceived by enterprises as significant restrictions to their development;
- the level of tax burden is perceived as more negative than the quality of tax administration;
- the factor of uncertainty (unpredictability of economic policy) appears to be very significant in both the polls.

At the same time, the estimations of the other three factors are fundamentally different. The complicated procedure of land acquisition and the character of competition with other enterprises appear to be very important for the participants of the CEFIR's poll, but are not

[19] Usloviia i factory razvitiia malogo predprinimatel'stva v regionakh Rossii (The conditions and factors of the development of small businesses in Russia" Moscow: OPORA ROSSII and VTsIOM ("Buttress of Russia" and the All-Russian Center for Public Opinion Studies), 2006.

regarded as significant restrictions to growth in the IET's poll. A directly opposite picture emerges in respect of the factor 'terms for the attraction of financial resources'.



* 100% represents the most unfavorable factor.

Fig. 42. Ranging of restrictions in the polls conducted by the IET and CEFIR*

Just as in the case of the BEEPS' poll, certain departures from the results obtained by the CEFIR can be explained by differences between the samples studied. As mentioned earlier, in the IET's poll all respondents are industrial enterprises, and predominantly big ones. As for the CEFIR's poll, it encompasses only small-sized enterprises, mainly in the services sector (those producing industrial goods constitute only 9.9% of the sample).

Also of interest is the comparison between the results of two surveys of industrial enterprises conducted by the IET in 2007[20] and 2008. In the first one the heads of enterprises were offered the question as to how the situation with various restrictions to growth had changed in the last 7 years; in the 2008 survey the emphasis was placed on comparative estimations of the importance of different restrictions to growth existing at that moment. Thus, a comparison of the results of two surveys makes it possible to pool the estimations of current levels and dynamics of the quality of the economic environment.

On the whole, the 2007 survey demonstrated that Russian industrialists were not satisfied with the changes in the economic environment that had taken place in the previous years.

[20] V. Dashkeev, L. Freinkman. 2008. Institutsional'nye i obshcheekonomicheskie ogranicheniia ekonomicheskogo rosta (rezul'taty oprosa promyshlennykh predpriiatii) (The institutional and general-economic restrictions to economic growth (the results of a poll of industrial enterprises) // Ekonomiko – politicheskaia situatsiia v Rossii (The economic and political situation in Russia), IET, February, pp. 45–46. http://www.iet.ru/files/text/trends/02-08.pdf

An improved situation was noted with regard to only 2 (access to financial resources and labor legislation) out of the 13 components of economic environment included in the survey. The other 11 components were estimated to be negative. In this connection, a positive estimation of changes in the access to financial resources was typical only of big and medium-sized enterprises (the balance of answers is +26 p. p.), while no improvement was observed by the small-sized ones (the balance of answers is –7.9 p. p., indicative of worsening access). The most serious worsening of the economic environment was observed in the following spheres: shortage of labor resources (this was the most significant negative development; 50.4% of the respondents pointed to a deteriorating situation in this sphere, whereas only 8.0% noted its improvement); power supply (49.3% of the answers were indicative of a deteriorating situation, while only 12.0% - of its improvement); and the actions undertaken by other enterprises in order to eliminate competition (25.6% and 4.4% respectively). It is noteworthy that all the groups of enterprises, irrespective of their form of ownership, size or sectoral distribution pointed to the large-scale character of the negative changes occurring in these three spheres.

Besides, it was revealed that the more optimistic managers (those expecting increased output volumes) were less negative than the pessimists in their estimations of the changes in the main factors acting as restrictions to output – power supply and labor resources (the corresponding balances of answers being different by more than 30 p. p.). This finding is well correlated with the results of the 2008 survey mentioned above.

It should be noted that although, with regard to a number of administrative restrictions (the operation of judicial, customs and law enforcement agencies), the summary results of the 2007 survey are indeed negative, the scale of the observed deterioration is not large (the balances of answers being within the range of –10 p. p.). Nevertheless, this result, in our opinion, confirms the earlier conclusion that it is still too early to speak of a consistent lowering of the administrative barriers in the way of economic growth.

On the whole the results of the 2007 survey demonstrate a noticeable – from the point of view of the enterprises – deterioration of the conditions for their economic existence. The fact that the enterprises did not express any serious concerns about the existing administrative restrictions to development in the extremely favorable economic situation of mid-2008 should by no means be interpreted as lack of such concerns in view of the medium-term prospects for the development of the economic environment in the future.

The comparison of the results of the two surveys (*Table 39*) has demonstrated that fairly recently the only growth factor demonstrating significant improvement while simultaneously not posing as a significant restriction to development at the time of the 2008 survey was that of labor legislation (the difference between the answers ‘the situation improved over 7 years’ – ‘the situation worsened over 7 years’ being approximately +13 p. p.; more than 50% of the respondents believed that in September 2008 that factor was not restricting their development). Favorable changes were also noted in the factors relating to access to financial resources and the cost of their attraction (the balance of answers concerning the situation’s dynamics amounting to approximately +20 p. p.). However their estimates received in mid-2008 are not unanimous: the cost of attraction of financial resources remained a serious problem (the balance of answers ‘significant obstacle’ – ‘no obstacle’ amounted to +27.9 p. p.), whereas the procedure of gaining access to them was found to be problematic by a far lesser number of enterprises (the corresponding – +4.2 p. p.). This leads to the conclusion that, despite the continuing decline in the cost of attraction of resources, the scale of that decline was still too small to satisfy the respondents.

Table 39

Current status (September 2008) and changes (over the period of 2000 – 2007) of each economic environment component, as estimated on the basis of the IET's 2007 and 2008 polls

		Changes in 2000–2007	
		Improvement	**Deterioration**
2008	Not a significant obstacle	Labor legislation	–
	A significant obstacle	Cost of attraction of financial resources	Tax burden level, Supervision and audits by tax agencies, Power supply and cost of energy resources, Availability of labor resources

* The table shows the factors for which the difference in the balances of answers stating their positive or negative influence (or either improvement or deterioration) amounts to more than 10 p. p.

And finally, several factors simultaneously demonstrated a deterioration of the existing situation by comparison with that of 2000 and the prevalence (at the time of the poll in September 2008) of the estimations 'significant restrictions to growth'. This was true of the availability of labor resources, tax burden level, supervision and audits by tax agencies, and power supply and cost of energy resources.

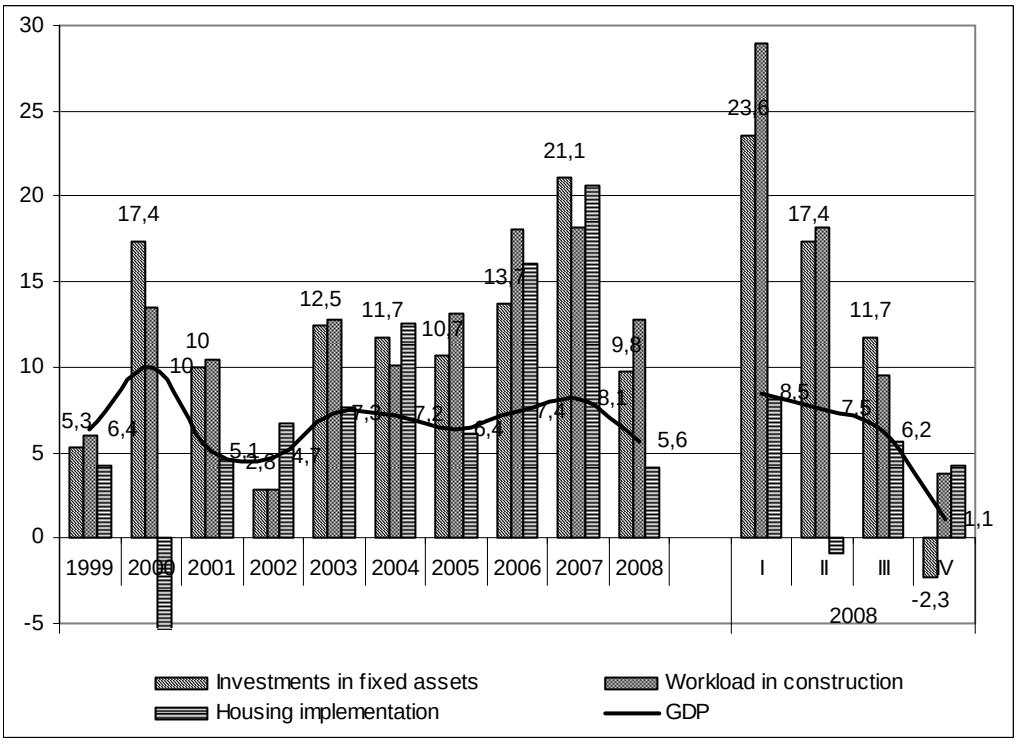
* * *

- The results of the IET's poll (September 2008) recorded the estimates offered by enterprises with regard to the existing restrictions to their development as of the moment of the onset of the financial crisis. Thus, these results represent a useful baseline for monitoring further development of the situation involving the barriers in the way of growth during the impending period of crisis.
- On the whole, the economic environment can be characterized as moderately satisfactory. The resource-linked (labor, energy) and macroeconomic (inflation, lack of policy stability) factors are perceived by enterprises as key restrictions to growth. Most of the administrative barriers (including corruption) are not regarded by enterprises as serious obstacles to their development.
- There are grounds to believe that, by comparison with the earlier half of this decade, the administrative obstacles to the development of enterprises have become weaker. At least, operating enterprise have by now learned how to effectively deal with them. However, this improvement does not apply equally to all the groups of enterprises. Small-sized enterprises have a higher level of complaints concerning their economic environment. Besides, the poll's results have provided no grounds for a statement that there are presently less barriers in the way of new enterprises' entry into business.
- A comparison between the results of polls conducted in 2007 and 2008 makes it possible to note that, although the enterprises did not perceive the majority of institutional restrictions to growth as significant, in the medium term they, nevertheless, note a certain deterioration of the situation associated with such restrictions.
- It can also be assumed that, when faced with a deepening financial crisis and deteriorating financial situation, enterprises will become to display a much less tolerant attitude towards the traditional limitations of the institutional environment – in contrast to their formerly rather relaxed treatment of such problems in the period of rapid growth and high rates of return. If this observation proves to be correct, in the next few months one may expect a noticeably increased demand for institutional reform on the part of the organized business community.

3.4. Investments in Real Sector of Economy

3.4.1. Internal Domestic Investments in Fixed Assets

The trend for the investments in fixed assets to grow at higher rates than the GDP has been observed in the Russian economy since 2002. In 2008 this ratio sustained, though, as compared with 2007, the growth rates of both the GDP and the investments in fixed assets have slowed down considerably. In 2008 the growth of the GDP made 5.6% versus 8.1% in 2007, while the investments in fixed assets went up by 9.8% versus 21.1% (*Fig. 43*).



Source: Federal State Statistics Service

Fig. 43. GDP, Investments in Fixed Assets, Workload in Construction, Housing Implementation growth rates in 1999–2008, as percentage to the previous year

Slow-down of economic growth rates changed the situation in the investments sector. Throughout the whole 2008 there was a gradual slow-down of investments growth rates observed: from 123.6% in the 1dt quarter to 117.4% in the 2nd and 11.78% in the 3rd quarter. Over January-September investments in fixed assets went up by 13.1% versus the growth of 21.3% in the corresponding period of 2007. In the environment of the financial crisis in November 2008 the decrease of the investments in fixed assets of 0.9% was observed, while the decrease in December 2008 made 7.5% as compared with the corresponding months of 2007. As a result, in the 4th quarter 2008 for the first time since 2000 the investments growth rates turned negative and made 97.7% versus the corresponding period of the previous year.

The anticipating growth of construction of the production and infrastructure objects as compared with the sharp slow-down in the rates of housing implementation was characteristic for 2008. Over January-September 2008 the total volume of workload in construction growing by 14.5%, increase in housing implementation made 4.0% versus, correspondingly, 18.1% and 30.9% in the analogous period of the previous year. Slow-down of the growth rates of the workload in construction occurring in the 4th quarter 2008 to 103.8% versus 118.2% in the 4th quarter 2007 was accounted for by the stabilization of the volumes of housing implementation in November 2008 and the volumes of production construction in December 2008 at the level of the corresponding periods of 2007.

In 2008 the proportion of investments in housing construction in the structure of investments in fixed assets remained at the level of the previous year and made 7.5%, the expenditures for buildings and installations increasing by 2.2 per cent up to 52.4%. the trend for the decrease of the proportion of the expenditures for machinery and equipment strengthened: as a result of 2008 this proportion was equal to 33.0%, being 1.8 per cent below the figure of the previous year. It should be noted that the most significant changes in the structure of investments as broken by branches of industry occurred in the 4th quarter 2008 (*Table 40*).

Table 40

Structure of investments in Fixed Assets by Kinds of Key Assets in 2006–2008, as percentage to the total

	2007	2008	including	
			January-September	October-December
Investments in fixed assets, total	100	100	100	100
including by kinds of key assets:				
housing	7.5	7.5	7.6	7.3
buildings and installations	50.1	52.4	51.3	54.2
machinery, equipment, transport vehicles	34.8	33.0	33.6	32.0
other	7.6	7.1	7.5	6.5

* not including the subjects of small business and parameters for informal activity
Source: Federal State Statistics Service

Import supplies of machinery and equipment increased, while the domestic machine-building developed at moderate rates when compared with the dynamics of the investment expenditures and characteristics of fixed assets reproduction. In 2008 the investments for the purchase of import machinery, equipment, transport vehicles (not taking into account the subjects of small business and the parameters for informal activity) made RUR 414.1 billion, or 20.0% of the total amount of investments in machinery, equipment and transport vehicles versus 17.8% in 2007.

The growth rates of the economy slowing down, the change in the role of the budget funds among the sources of financing of the investments in fixed assets is observed (*Table 41*). In January-September 2008 RUR 658.2 billion was financed at the expense of budget funds, which made 16.8% of the total volume of investments in fixed assets on the whole throughout the economy, and 10.0% was financed at the expense of the federal budget. In October-December 2008 the total volume of investment decreasing in absolute terms the increase in the volume and share of the federal budget funds in the structure of sources of investments financing was one of the conditions for mitigation of negative aftermaths of the sharp limitations of enterprises' own funds. In the 4th quarter 2008 RUR 295.5 billion of investments in fixed assets was financed at the expense of the federal budget funds as compared with RUR 214.9 billion over the first 9 months of the same year.

Table 41

Structure of Investments in Fixed Assets As Broken By Financing Sources, as percentage to the total (not taking into account the subjects of small-scale enterprise and the parameters for informal activity)

	2007	2008	Including	
			January-September	October-December*
Investments in fixed assets, total	***100***	*100*	*100*	*100*
including by the sources of financing:				
own funds	40.4	40.0	42.8	35.8
of which:				
profit	19.4	18.6	20.1	16.1
borrowed funds	59.6	60.0	57.2	64.7
of which:				
banks credits	10.4	11.1	11.0	11.0
including by foreign banks	1.7	2.4	1.7	3.7
borrowed funds from other organizations	7.1	6.5	6.8	6.1
budget funds:	21.5	21.0	16.8	28.1
federal budget	8.3	8.1	5.5	12.6
budgets of the subjects of the Russian Federation and local budgets	11.7	10.4	10.0	13.7
other	20.1	21.1	22.3	19.1
of which funds received for the share participation in construction	3.7	3.3	3.5	2.9
of which means of the population	1.5	1.5	1.7	1.0
Foreign investments in the total amount of the investments in fixed assets	4.3	4.6	5.2	3.7

Preliminary data
Source: Federal State Statistics Service

In 2008 the Federal Targeted Investment Program envisaged financing of 2801 construction sights, objects and measures, 1349 of which were envisaged for putting into commission in the same year. By January 1st, 2009 1075 were fully financed and 583 objects had the technical readiness from 51.0% to 99.9%.

As a result of 2008 371 objects was put into commission, 301 of which – at full capacity and 70 – at partial capacity.

Throughout 2008 some changes were made to the List of construction sights and objects, as a result the total volume of budget allocation envisaged for financing FTIP in 2008 made RUR 533.1 billion versus RUR 517.7 billion of the federal budget that was envisaged initially. In 2008 the volume of budget allocation envisaged for construction of capital construction objects of the state property of the Russian Federation increased by RUR 85.2 billion or 19.0% as compared with 2007. Nearly all the amount of the increase in the budget allotments mentioned was for the program part of FTIP[21].

It should be noted that in 2008 the investments at the expense of the federal budget were directed only to the objects of capital construction of the state property of the Russian Federation, as well as to the open joint-stock companies. The objects of the property of the subjects of the Russian Federation and of the municipal property were not included in the List of construction sights and objects for 2008.

For the objects within the framework of federal targeted programs FTIP envisages RUR 289.5 billion, and for the non-program part objects – RUR 130.7 billion. The volume of funds

[21] Data for financing and use of the federal budget funds for FTIP realization in 2008 are given taken into account the redistribution of budget allotments from 2008 to 2009 at the total sum of approximately RUR 39.6 billion or 9.4% of the total volume of FTIP in 2008.

envisaged for financing of special works included in the state defense order was equal to RUR 112.9 billion.

In 2008 FTIP financing not taking into account construction sights and objects included in the state defense order was equal to RUR 286.4 billion or 73.1% of the yearly limit. This figure is higher than the one of the previous year (70.1%), which is mainly due to the fact that the List of construction sights and objects was adopted one and a half month earlier than in 2007.

According to the account of the Federal State Statistics Service on the FTIP construction sights and objects, not taking into account construction sights and objects included in the state defense order, financing of the yearly limit of public investments was equal to RUR 286.4 billion, including RUR 49.7 billion at the expense of the budgets of the subjects of the Russian Federation and other sources of financing. In 2008 the state customers used RUR 285.9 billion of the state investments or 63.7% of the yearly limit of funds, envisaged for construction works. On average throughout Russia 85.1% of the total amount of financed funds at the expense of all sources of financing was used.

The year limit of state investments within the framework of the industrial (87.1%) and special (75.7%) complexes was financed to substantially higher extent than the average, whereas within social complex the financing was considerably below the average (57.1%) (*table 42*). The level of funds use by different complexes differs considerably. It should be noted that the level of funds use in special complex is substantially below the average, which is connected with the financing of a number of new objects included in the List of construction sights and objects in the fourth quarter 2008.

Table 42

Objects Envisaged By Targeted Investment Program for 2008

	As units				As RUR billion			
	Number of objects		Put into commission in January-July 2008		Limit of state investments		Financed from the federal budget	Investments used at the expense of all sources of financing*
	total	including with the date of commissioning in 2008	to full capacity	partially	total	including from the federal budget		
Total	**2801**	**1349**	**301**	**70**	**448.9**	**391.5**	**286.4**	**285.9**
including:								
transportation complex	418	129	31	5	152.9	149.2	131.4	123.7
agriculture complex	462	296	40	35	13.3	11.0	8.1	8.7
special complex	210	65	10	2	92.7	66.0	50.0	38.4
social complex	1611	811	209	27	179.9	156.9	89.5	107.0
other objects	100	48	11	1	10.1	8.4	7.4	8.0

*Not including investments allocated from the federal budget to purchase equipment and conduct design and survey works for construction sights and objects included in the Federal Targeted Investment Program for 2008 and being on the balance of the state customers (builders) that manage these investments

As to the territorial aspect, in 2008 the limit of funds for financing FTIP construction sights and objects was used at a considerably higher extent than the average in Southern, North-Western, Privolzhski and Siberian federal okrugs. The use of investments in Central, Ural and Far Eastern Federal Okrugs is substantially below the average (*Table 43*).

Table 43

Limit of State Investments and Their Actual Use At the Expense of All Sources of Financing by Federal Okrugs

Federal okrug	Limit of state investments allocated from the federal budget for 2008	Actually used at the expense of all sources of financing	
	as RUR billion	as RUR billion	as percentage of the yearly limit
Russian Federation – total	391.5	285.9	63.7
Central	151.6	76.8	47.3
North-Western	82.5	83.4	76.1
Southern	52.9	51.8	84.0
Privolzhski	20.6	17.5	81.4
Ural	20.1	11.6	53.7
Siberia	23.1	18.2	75.3
Far Eastern	40.7	26.5	55.5

The shift from the financing of the investments in fixed assets at the expense of the enterprises and organizations' own funds to the expansion of the participation of the borrowed funds was a fundamentally new feature in the economic growth of the recent five years. As a result of 2007 59.6% of the total amount of investments in fixed assets was accounted for the borrowed funds. As a result of 2008 the share of the borrowed funds in the structure of sources of investments financing made 60%, which corresponds well with the figure of the previous year.

The development of this process was accounted for by the increase in the activity of the banking sector, growth of the investments in housing building by the population and the intensive inflow of the foreign capital. Until recently low real value of credit resources contributed in increase in number of the borrowing organizations. Among the factors influencing the dynamics of the credits and other borrowed funds one can highlight the growth of the organized forms of population's savings. As a result of 2008 the share of funds directed to the share participation in the construction made 3.3% of the total amount of the investments in fixed assets, of which the means of the population were 1.5%.

Financial crisis defined the specific features of the investors' behavior at the market of housing construction. Whereas in January-September the share of funds received for the share participation in the construction made 3.5%, of which the funds of population accounted for 1.7%, in the fourth quarter these figures were equal t0 2.9% and 1.0%, correspondingly.

In 2008 the share of banks in the structure of investment resources made 11.0% against 10.4% in 2007 and 9.3% in 2006, however the trend for the increase of the insurance and investments companies', industrial and trading enterprises in the financing of the investment activity did not sustain.

Attention should be paid to the peculiar features of foreign banks' participation in the financing of investment activity. Increase in the share of foreign investments and the growth of foreign banks' participation in financing of the investments in fixed assets in the Russian economy has been observed since 2000. In January-September 2008 the share of foreign investments in the total volume of investments was 5.2%, and the share of credits issued by foreign banks increased up to 1.7% versus 1.1% in the corresponding period of the previous year. In the fourth quarter the volumes of direct foreign investments decreasing in absolute terms by 4.0% as compared with the corresponding period of the previous year, the share of foreign investments being 3.7% of the total volume of investments in the Russian economy.

In contrast to the preceding years in 2008 the net outflow of the capital and foreign investments is observed. According to the preliminary estimation of the Central Bank of the Russian Federation, in the 4th quarter 2008 net outflow of the of the private capital made USD 130.5 billion (*table 44*).

Table 44

Net Import/Export of private Capital, According to Data of Balance-of-payments, as USD billion

	Net import/export of private capital, total	including:	
		Net export/import of capital by banks	Net export/import of capital by non-financial enterprises and households
1999	–20.8	-4.3	–16.5
2000	–24.8	–2.1	–22.8
2001	–15.0	–1.3	–16.2
2002	-8.1	2.5	-10.6
2003	–1.9	10.3	-12.2
2004	-8.9	3.5	-12.4
2005	0.1	5.9	-5.8
2006	41.8	27.5	14.3
2007	83.1	45.8	37.3
I quarter	13.9	0.1	13.9
II quarter	54.5	36.9	17.6
III quarter	-7.0	-3.5	-3.5
IV quarter	21.7	12.3	9.3
2008	-129.9	-57.5	-72.5
I quarter	-23.1	-9.9	-13.2
II quarter	41.1	22.1	19.0
III quarter	-17.4	-13.4	-4.0
IV quarter (estimation)	-130.5	-56.2	-74.3

Source: Central Bank of the Russian Federation

Throughout 2008 quite considerable changes took place in the structure of investments in fixed assets by kinds of economic activities (*Table 45*). As a result of 2008 the growth rates of investments in the industry remained in the positive field, the increase in investments in fossil fuels extraction being 4.6%, in processing industries – 7.8%, in electricity, gas and water production and distribution – 11.3%. It should be noted at the same time that the increase in the concentration of the investments resources in industry up to 44.1% of the total volume of investments in the economy occurring in January-September 2008 was replaced by the reduction of the investment activity scale in extractive and processing industries, as well as in electricity, gas and water production and distribution in the fourth quarter 2008. As a result, the share of investments in industry in the total volume of investments in the fixed assets in the economy was equal to 38.4% over the period of October-December 2008.

As compared with 2007, there was reduction of investments observed in construction (by 8.3%), in trade (by 4.4%), in communication (by 4.9%). The investments in the transportation maintained quite high dynamics at the expense of railway transportation, making 112.4% on 2007.

Table 45

Structure of Investments in Fixed Assets by kinds of Economic Activity (Not taking into account the subject of small-scale business and the parameters of informal activity)

	2007	2008	including	
			January-September	October-December*
Total	100	100	100	100
including by kinds of economic activities:				
agriculture, hunting and forestry	4.5	3.9	4.2	3.4
industry	40.7	42.0	44.1	38.4
minerals extraction	16.8	16.6	18.3	13.7
of which fossil fuels extraction	15.3	15.1	16.7	12.6
processing industries	15.6	16.5	17.5	14.8
electricity, gas and water production and distribution	8.3	8.9	8.3	9.9
Construction	2.7	2.4	2.7	2.0
Wholesale and retail trade; motor vehicles and motorcycles services; repair of household appliances and items of private use	3.6	2.7	2.7	2.7
Transportation	18.9	21.9	20.4	24.2
Communication	4.7	4.1	4.1	4.1
Financial activity	1.4	1.2	1.2	1.2
Operations with real estate, rent and services rendering	12.8	11.7	11.9	11.3
Education	2.4	2.2	1.8	2.8
Public administration and military defense security; compulsory social security	2.1	2.0	1.6	2.7
Health care and social services rendering	2.8	2.6	2	3.5
Rendering of other utilities, social and personal services	2.8	2.9	2.8	3.4

*preliminary data
Source: Federal State Statistics Service

Low figures of investments activity in the fourth quarter of 2008, increase in the volumes of the unfinished construction, high interest rates and limited availability of credits account for the unfavorable environment for the economy development in 2009.

3.4.2. Foreign Investments

In 2008 the total of USD 103.8 bln of foreign investments was received by the Russian economy, which is 14.2% below the corresponding figure of 2007 (*Table 46*).

Table 46

Structure of Foreign Investments in Russian Economy

	As USD billion				As percentage to the previous year			
	Total	Direct	Portfolio	Other	Total	Direct	Portfolio	Other
2004	40 509	9 420	333	30 756	136.4	138.9	83.0	136.6
2005	53 651	13 072	453	40 126	132.4	138.8	136.3	130.5
2006	55 109	13 678	3 182	38 249	102.7	104.6	700.0	95.3
2007	120 941	27 797	4 194	88 950	219.5	203.2	131.8	232.6
2008	103 769	27 027	1 415	75 327	85.8	97.2	33.7	84.7
January-September	75759	19201	1296	55295	86.2	97.7	83.7	82.8
October-December	27976	7826	119	20031	84.8	96.0	4.5	90.2

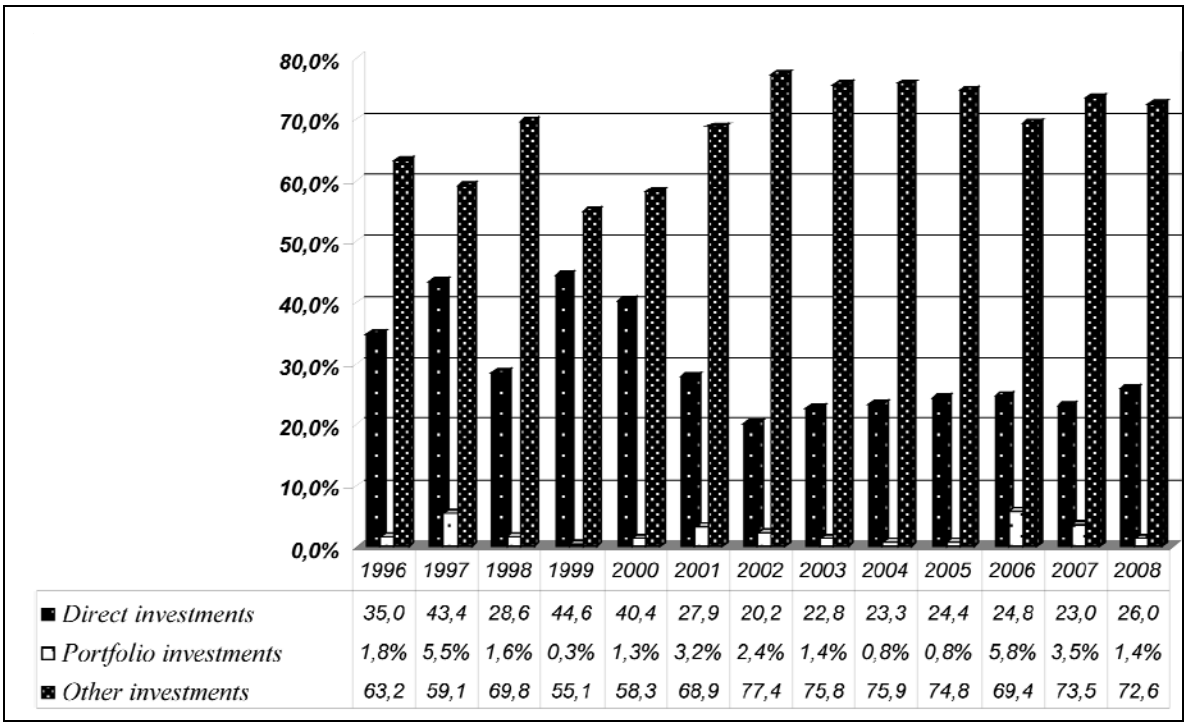
Note. Direct investments are investments in real assets, purchase of the controlling stock or holding of stock that gives the right to participate in management; portfolio investments are investments in securities with the sole purpose of getting profit; other investments are investments made on repayable basis (credits of international financial organizations, trade credits etc.)
Source: Federal State Statistics Service.

According to the report on investments by UN Conference on Trade and Development published in October 2008, in 2007 Russia held the ninth place in the world by the volume of

direct investments attracted (in 2006 – 10th, in 2005 – 15th). The same as in the previous year Russia is the second among the developing countries, the first place being held by China (in 2005 – 3rd place)[22].

In December international Rating Agency S&P lowered Russia's sovereign rating from BBB+ to BBB, the forecast for the rating being negative. In the opinion of the agency, "the lowering of ratings reflects the risks connected with the sharp decrease in foreign currency reserves and other investment flows that result in the increase of the costs and difficulties arising in saturation of the country with the external financing". Moody's agency did not follow the example of S&P lowering the Russia's rating, instead it confirmed the positive forecast for the Russian federation concerning its debt liabilities and deposits (in June 2008 Moody's agency increased the Russia's rating from Baa2 to Baa1, the forecast being positive).

As a result of 2008 the volume of the direct investments in the Russian economy has lowered by 2.8% as compared with 2007. The decrease was due to the component of credits received from the foreign co-owners of organizations that reduced by 16.3% over the period under consideration. In contrast, the payments to the authorized capital stock went up by 7.4% up to USD 15.9 billion. Thus, the proportion of credits received from the foreign co-owners of the companies in the structure of direct foreign investments in the Russian federation reduced from 42.0% in 2007 to 36.2% in 2007, whereas the share of the payments to the authorized capital stock went up from 53.2% to 58.8%.



	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
Direct investments	35,0	43,4	28,6	44,6	40,4	27,9	20,2	22,8	23,3	24,4	24,8	23,0	26,0
Portfolio investments	1,8%	5,5%	1,6%	0,3%	1,3%	3,2%	2,4%	1,4%	0,8%	0,8%	5,8%	3,5%	1,4%
Other investments	63,2	59,1	69,8	55,1	58,3	68,9	77,4	75,8	75,9	74,8	69,4	73,5	72,6

Source: Federal State Statistics Service

Fig. 44. Structure of Foreign Investments in Russian economy in 1996–2008, as percentage

[22] In accordance with the data presented in the report «World Investment Report», UNCTAD 2007, 2008.

In the total structure of the foreign investments received by the Russian economy in 2008 it was in the segment of portfolio investments where the most considerable decrease (of 66.3%) was observed, the majority of which are accounted for by the investments in shares and stocks (95.5% of the total portfolio investments in 2007, 79.6% in 2008).

In 2008 the amount of other investments lowered by 15.3% as compared with 2007. The proportion of trade credits in the structure of foreign investments went up from 12.7% in 2007 to 21.5% in 2008. As to the periods of funds attraction, the volume of credits for the period over 6 months decreased by 27.1%.

Thus, as compared with the previous year, in 2008 the structure of foreign investments in the Russian economy was subject to some changes (*Fig. 47*).

The same as in the previous year, the highest concentration of investments in trade and industry sustained. It should be noted that as a result of 2008 the foreign investments in industry did not change considerably as compared with 2007, and the investments in trade reduced by half. A considerable reduction in the investments in trade resulted in the decrease in its proportion in the structure of foreign investments as broken by branches of industry when compared with the previous year. The distribution of foreign investments by main branches of Russian economy is represented in *Table 47*.

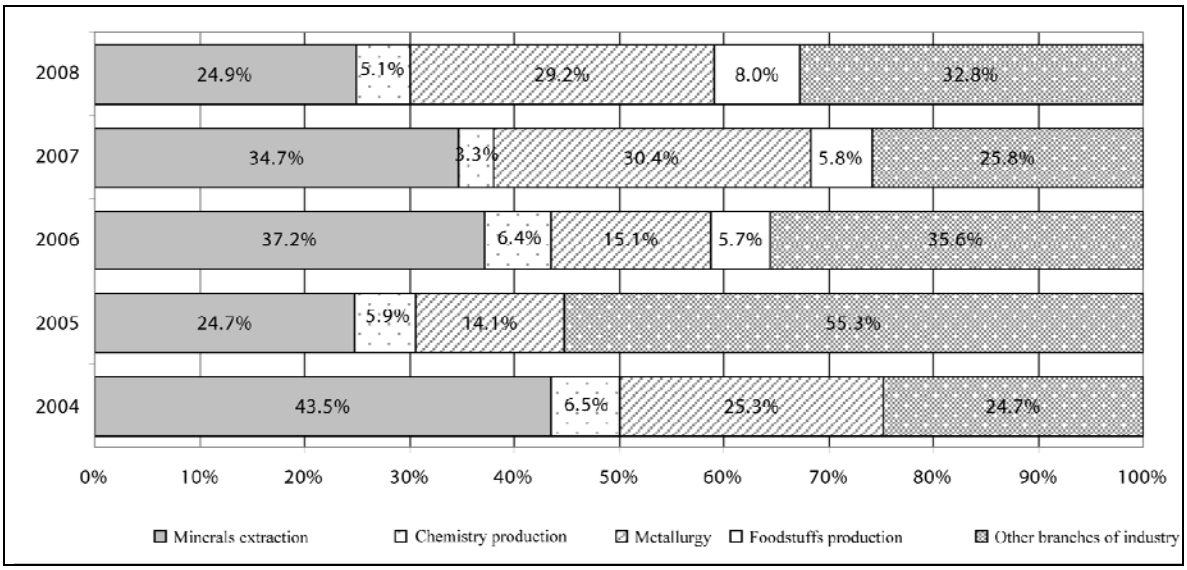
Table 47

Structure of Foreign Investments in Russian Economy as Broken by Branches in 2006-2008

	As USD million			Change as percentage on the previous year			As percentage to the total		
	2006	2007	2008	2006	2007	2008	2006	2007	2008
Industry	24 607	50 163	49 704	101.2	203.9	99.1	44.7	41.5	47.9
Transport and communication	5 297	6 703	4 861	137.9	126.5	72.5	9.6	5.5	4.7
Wholesale and retail trade; motor-vehicle and motorcycles servicing; repair of household appliances and private items	13 089	47 310	23 905	64.0	361.4	50.5	23.8	39.1	23.0
Operations with real estate; rent and services rendering	5 998	8 414	15 378	230.1	140.3	182.8	10.9	7.0	14.8
Financial activity	4 698	4 450	4 977	259.1	94.7	111.8	8.5	3.7	4.8
Other branches	1 420	3 901	4 944	231.8	274.7	126.7	2.5	3.2	4.8

Source: Federal State Statistics Service

The decrease in the investments in minerals extraction of 28.7% was observed in the structure of foreign investments in industry as a result of 2008 (in 2007 there was a growth of 1.9 times). Foreign investments in processing industries went up by 6.2% (in 2007 the growth of investments in processing industries made 2.1 times). As to processing industry, the investments in foodstuffs production increased by 36.7%, in chemistry industry – by 53.8%, reaching the figure of USD 4.0 billion and USD 2.5 billion, correspondingly. Foreign investments in metallurgy decreased by 4.88% in 2008 as compared with the preceding year and made USD 14.5 billion.



Source: Federal State Statistics Service. There are no data available for investments in foodstuffs production in 2004-2005

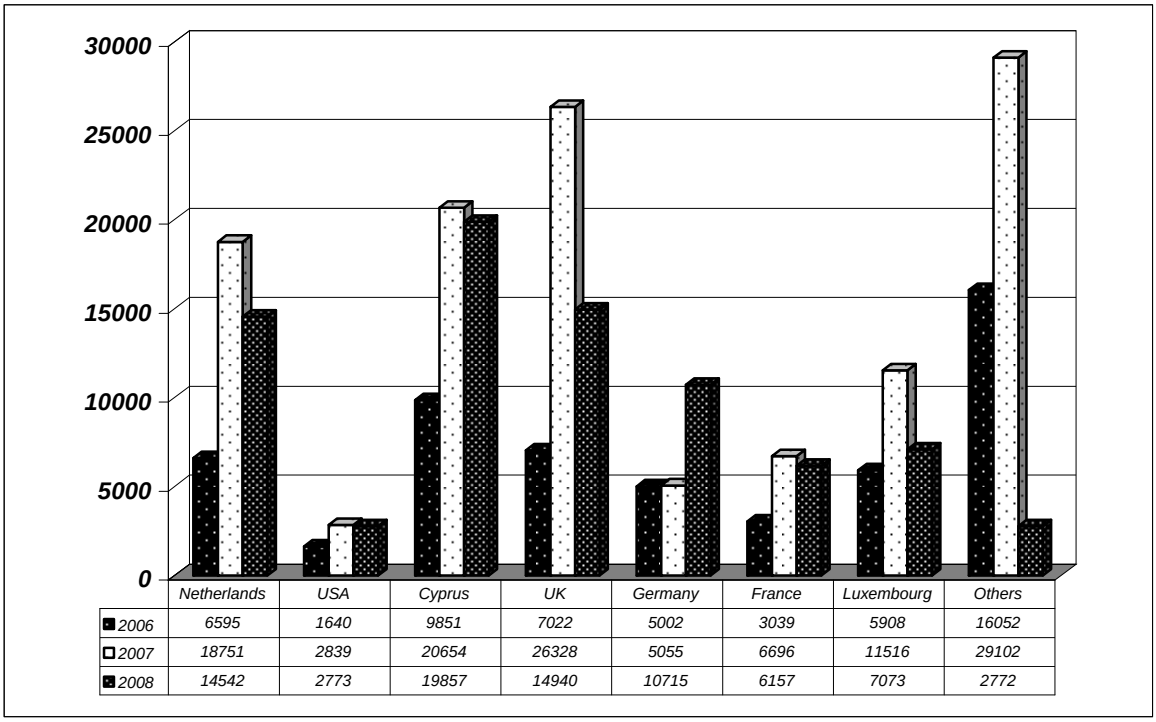
Fig. 45. Structure of Foreign Investments in Russian Economy in 2004–2008

In 2008 direct and portfolio investments in the industry decreased by 27.3% and 64.5%, correspondingly, as compared with 2007. Other investments in industry, in contrast, went up by 22.8% versus the previous year. Thus, the proportion of direct and portfolio investments in the industry decreased from 36.3% and 8.5% in 2007 to 26.6% and 2.3% in 2008, the share of other investments increasing from 57.3% to 71.1% over the same period.

The changes were also observed in the structure of foreign investments by kinds of economic activities in the industry *(Fig. 45)*. In the sphere of minerals extraction the direct investments reduced by 2.8 times, which resulted in the contraction of their proportion in the total investments in this sphere to 40.2% (80.1% in 2007). The share of other investments in extractive industries, whose growth is estimated to be 2.1 times as a result of 2008 (up to USD 7.3 billion), increased up to 59.0% (19.8% in 2007).

The same as in the previous year, in 2008 the biggest part of foreign investments in the processing industry was accounted for by other investments, which went up by 10.5% versus 2007, reaching the figure of 81.9% in the resulting figure for the investments in processing industry. Over the same period the direct foreign investments in processing industries went up by 44.3%. The proportion of the direct investments in the processing industry went up to 17.5% (12.8% in 2007).

Cyprus, the UK, the Netherlands, Germany and Luxemburg retained their leading positions when the geographic structure of the foreign investments received by the Russian economy in 2008 is considered. As a result of 2008 the biggest amount of the investments (USD 19.9 billion, 19.1% of the total volume of foreign investments received by the Russian economy over the period mentioned) was directed from the Cyprus, USD 14.9 billion (14.4%) was received from the UK and USD 14.5 billion (14.0%) – from the Netherlands (*Fig. 46*).



	Netherlands	USA	Cyprus	UK	Germany	France	Luxembourg	Others
2006	6595	1640	9851	7022	5002	3039	5908	16052
2007	18751	2839	20654	26328	5055	6696	11516	29102
2008	14542	2773	19857	14940	10715	6157	7073	2772

Source: Federal State Statistics Service

Fig. 46. Geographic Structure of Foreign Investments in Russian Economy in 2006–2008, as USD million

In 2008 it was the investments from Germany that grew at fastest rates, increasing by 2.1 times versus 2007. At the same time investments from Cyprus decreased by 3.9%, from France – by 8.0%, from the USA – by 2.3%. The investments that decreased most considerably were from Ireland – by 43.9%, from the UK – by 43.3%, from Luxembourg – by 38.6% and from the Netherlands – by 22.4%.

The differences in the investments' dynamics resulted in the changes in the geographic structure of the foreign investments in the Russian economy.

The same as in the previous year the Cyprus investors were mainly interested in operations with real estate, trade, financial activity and construction, investing in these spheres 30.9%, 21.5%, 8.4% and 6.0%, correspondingly, of the total investments from Cyprus into the Russian Federation. As a result of 2007 these spheres accounted for 19.0%, 45.5%, 7.1% and 4.7%, correspondingly, of investments from Cyprus.

The entrepreneurs of the UK continued to invest in trade, though in 2008 this sphere received 2.9 times less investment than in 2007. As a result of 2008 the trade accounted for 39.1% of the total investments of the UK in the Russian Federation (64.2% in 2007). The share of processing industries in the structure of UK investments increased from 27.7% in 2007 to 31.7% in 2008.

As to the structure of investments in the Russian Federation from the Netherlands, there the decrease of the proportion of the fossil fuels extraction from 67.1% in 2007 to 33.1% in 2008 occurred. Russian power industry accounted for 14.7% of investments directed from the Netherlands in the Russian Federation in 2008.

As on the end of 2008 the accumulated foreign capital not taking into account the institutions of monetary and credit regulation, commercial and savings banks, including ruble investments recalculated in US dollars made USD 264.6 billion, which is 19.9% above the corresponding figure of the beginning of the year.

It is the Cyprus, the Netherlands, Luxembourg, the UK and Germany that still hold the leading positions in the total volume of accumulated foreign investments, their share being 70.3% (72.0% in 2007). At the same time the share of the first five leading countries in the segment of direct and other investments reduced to 73.4% and 57.6% (77.0% and 67.85 in 2007), and in the structure of portfolio investments it went up to 75.3% (65.1% in 2007) (*Table 48*).

Table 48

Accumulated Foreign Investments as Broken by Main Investing Countries

	Accumulated by 01.01.2009, USD million				Change calculated on 01.01.2008, percentage			
	Total	**Direct**	**Portfolio**	**Other**	**Total**	**Direct**	**Portfolio**	**Other**
USA	8 769	3 193	662	4 914	102.2	87.8	54.8	131.5
Germany	17 425	7 275	26	10 124	147.8	161.9	26.5	140.7
France	9 542	1 927	1	7 614	161.2	124.0	3.2	175.7
UK	30 811	4 647	2 339	23 825	105.4	135.2	101.1	101.5
Cyprus	56 902	40 732	1 728	1 442	114.7	115.0	101.6	11.6
Netherlands	46 346	35 931	41	10 374	118.6	101.9	78.8	275.8
Luxembourg	34 402	1 217	273	32 912	118.0	165.6	124.7	116.7
Other countries	60 402	27 470	557	45 375	127.8	148.3	50.3	164.3
Total	**264 599**	**122 392**	**5 627**	**136 580**	**119.9**	**118.8**	**83.6**	**123.3**

Source: Federal State Statistics Service

It is other investments that prevail in the structure of foreign investments accumulated by the end of 2008, their share being 51.6%. The corresponding figure for direct foreign investments was 46.3%.

In the environment of reduction in the amount of foreign investments in the Russian economy the volume of withdrawn capital in the form of profit of foreign investors transferred abroad as well as in the form of payments of interest for the use of credits and credits repayments went up by 16.4% in 2008 as compared with 2007, making USD 67.95 billion (65.5% of the foreign investments received in 2008). In 2007 48.3% of the received foreign investments was withdrawn.

3.5. Russian Agrifood Sector: Performance and Trends

3.5.1. Organizational structure of agriculture

The organizational structure of agriculture consists of corporate farms of different ownership types, individual private farms and household farms. Table 1 shows the number of these entities and their share in agricultural output. Over 95% of all agricultural entities are private. The dominating legal forms are limited liability companies (37.8%) and agricultural

production cooperatives (35.4%). In most entities joint stock, contributions or shares are dispersed among hundreds of participants.

Table 49

Number of agricultural entities as of January 1 (thousand) and their share in gross agricultural output (%)

Types of agricultural entities	1990		2000		2008	
	number	% of GAO	number	% of GAO	number	% of GAO
Corporate farms and institutions	29.4	73.4	27.6	43.4	24.0	43.4
incl. state farms and institutions, %	16.6*	n.a.	4.9	n.a.	4.2	n.a.
Small entities		n.a.		n.a.	23.3	n.a.
Individual private farms	4.4	0	261.7	3	265.0	7
Individual entrepreneurs	-		-		92.2	
Household farms, million**	16.3	26.6	16	53.6	22.7	49.6

* - including 13 thousand state farms.
** - the share in agricultural output is given for household farms in general irrespective of their type since their performance by types is not statistically recorded.
Source: Russian Agriculture. Russian Agrifood Sector, RF Ministry of Agriculture. Russian Statistical Yearbook.

According to data of the 2006 Agricultural Census the share of actually operating entities in the total number of registered entities of respective types equaled: corporate farms – 68.6% (70.6% for large and medium farms and 63% for small ones), individual private farms and individual entrepreneurs engaged in agricultural business – 51.7%[23].

Household farms formally are not regarded as small entrepreneurial entities although they produce about one half of agriculture's gross output and about one third of its commodity output. They are traditionally considered to be small entities.

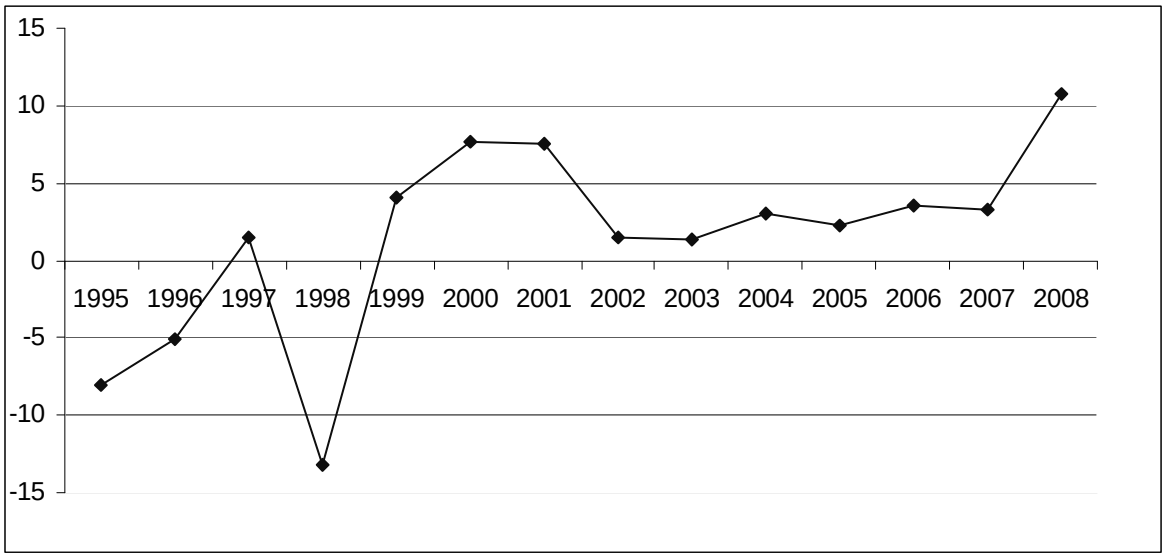
In recent years the role of agroholdings in Russian agriculture was discussed. However, their exact number is not known. According to estimates of V.Ya.Uzun[24] about 21% of large and medium corporate farms are associated into such holdings. They produce 26.5% of the total output of this group of farms. 318 private holdings associate only 6.5% of the total number of large and medium corporate farms. Most efficient are the entities incorporated in agroholdings with foreign mother companies – their profitability was more than twice above the average for large and medium corporate farms.

3.5.2. Agricultural output and structure of farm production

In 2008 the gross agricultural output in Russia was below the pre-reform level. Still, the 2008 farm performance should be regarded as positive: the annual production growth was maximum over the whole examined period (*Fig. 47*).

Household farms continue to play quite an important role in agricultural production. Before the start of agrarian reform in 1990 they accounted for 26.6% of gross agricultural output. During the transition period this share sizably grew – up to 58.6% in 1998. In the following years it was reducing and by the end of 2007 fell down to 49.6% (as of January 1, 2008). There has also formed and is steadily developing the sector of individual private farms. Yet, its share in GAO is still relatively small – about 7%.

[23] 2006 All-Russian Agricultural Census, preliminary results. Vol.2, pp. 20-21.
[24] Uzun V.Ya. Rating of large and medium corporate farms in Russia in 2004-2006. Moscow, All-Russian Institute of Agrarian Problems and Informatics named after A.A.Nikonov, 2007.



Source: Rosstat.

Fig. 47. Russia: percent change of annual gross agricultural output in 1995-2008

The role of small entities (small enterprises, individual private farms, household farms, individual entrepreneurs engaged in agriculture) differs greatly by RF regions. In 6 of them such entities account for over 90% of gross agricultural output, in 24 – for over 70%. They produce less than 30% of GAO only in Belgorod oblast where agroholdings are rapidly developing and in three northern regions where due to unfavourable climatic conditions population has actually stopped producing farm products while corporate farms subsidized from the budget still continue doing that (Murmansk oblast, Chukotsky and Nenetzky autonomous districts).

Despite their small share in gross agricultural output of the country at large, individual private farms play quite an important role in some RF regions. For instance, in Astrakhan and Magadan oblasts, Kalmyk, Kabardino-Balkarian and Yakutia republics they produce 23-29% of GAO. In 7 RF regions the share of individual private farms in gross agricultural output is larger than that of corporate farms of all organizational and legal types. The high share of household farms in agricultural production after 1990 is traditionally attributed to slower production decline as compared with corporate farms. However, that's not true. Output of household farms was growing (in 1994 it was 57% above the 1990 level in comparable prices) while output of corporate farms was falling (by 37% over the same period[25]).

In 9 months 2008 index of agricultural production by all types of farm producers amounted to 106.5% (104% - livestock production and 109% - crop production), in January-October 2008 – 108.8% as compared with the respective period of 2007.

Crop output is prevailing in the structure of GAO – in the recent 6 years its share ranges from 52.8 to 55.4%.

[25] Russian Agriculture. Official edition. Moscow, State Committee for Statistics. 1995, p.30.

Crop production

2008 is considered to be one of the most successful years as regards agricultural production starting from the early 1990s. Output of grain, sunflower seeds and vegetables exceeded all the preceding annual averages beginning from 1986-1990 (*Table 50*).

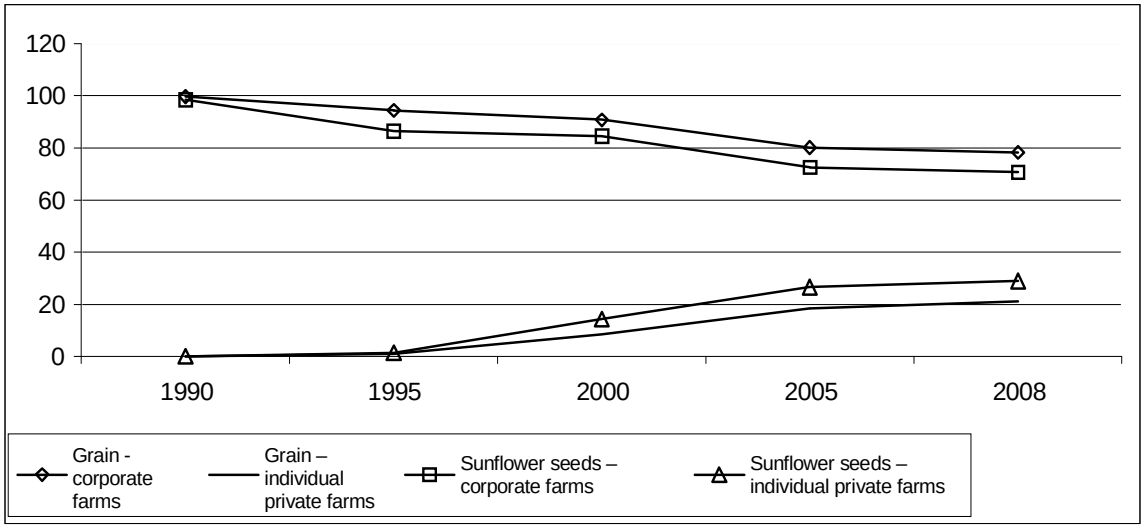
Table 50

Gross output of basic farm crops, million tons

	Annual average			2005	2008
	1986-1990	1991-1995	1996-2000		
Grain (weight after primary processing)	104.3	87.9	65.2	78.2	108.1
Potatoes	35.9	36.8	34.5	37.3	28.9
Vegetables	11.2	10.2	11.4	15.2	13.0
Sunflower seeds	3.1	3.1	3.3	6.4	7.3
Sugar beets	33.2	21.7	14	21.4	29.0

Source: Rosstat.

Similarly to previous years, in 2008 corporate farms remained the basic producers of grains (78.2%), sugar beets (89.2%) and sunflower seeds (70.7%). Potatoes and vegetables continue to be traditionally grown in household farms – 83.5% and 70.7% respectively. Individual private farms already account for over 21% of the country's grain output and 28.9% of the total output of sunflower seeds.



Source: Rosstat.

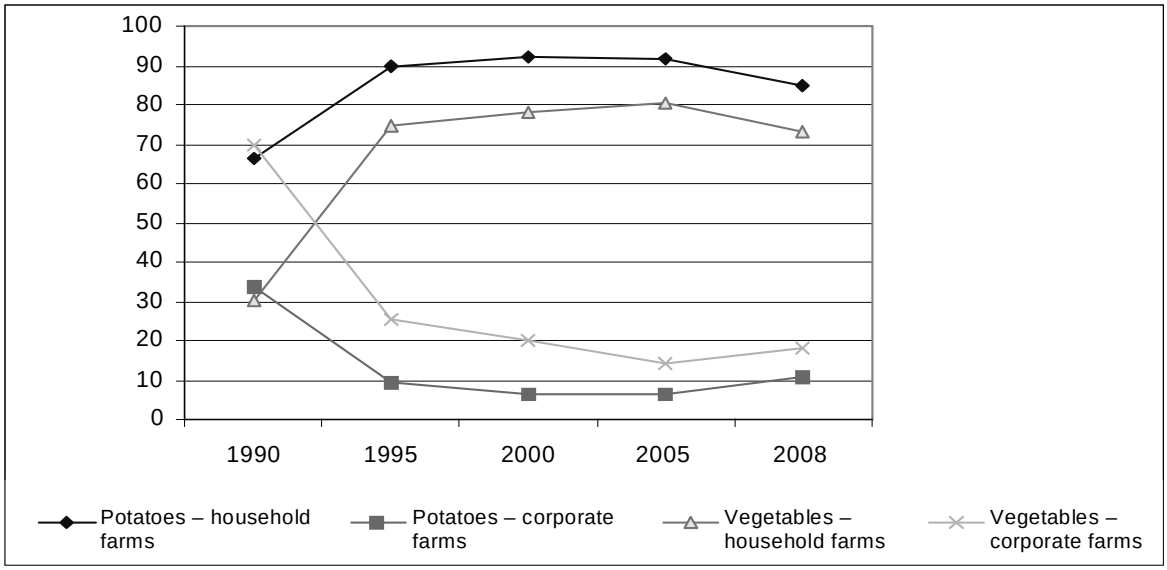
Fig. 48. Production of grain and sunflower seeds in corporate farms and individual private farms (as % of the total)

The extreme lowering of prices received by farms in October-November 2008 (down to 4 rubles per kg for food grain and 2.5 rubles per kg for feed grain[26]) served the basis for forecasts predicting contraction of areas planted and consequently smaller gross grain output in 2009. However, the Rosstat data so far do not confirm these forecasts: areas planted in winter grains in autumn 2008 are 5% larger than in 2007. At the same time the area of autumn

[26] http://www.mcx.ru/dep_doc.html?he_id=949&doc_id=20253

ploughing reduced by 2% preconditioning smaller areas under spring crops. One can observe a trend towards minor shifting of grain and sunflower production from corporate farms to individual private farms (*Fig. 48*).

In 2005 the trend towards larger production of potatoes and vegetables in household farms observed since 1990 reversed – the share of corporate farms and individual private farms in their output started to grow. As compared with 2007 the share of household farms in output of potatoes fell by 2%, in that of vegetables – by 1.7% (*Fig. 49*).



Source: Rosstat.

Fig. 49. Production of potatoes and vegetables in corporate farms and household farms (as % of the total)

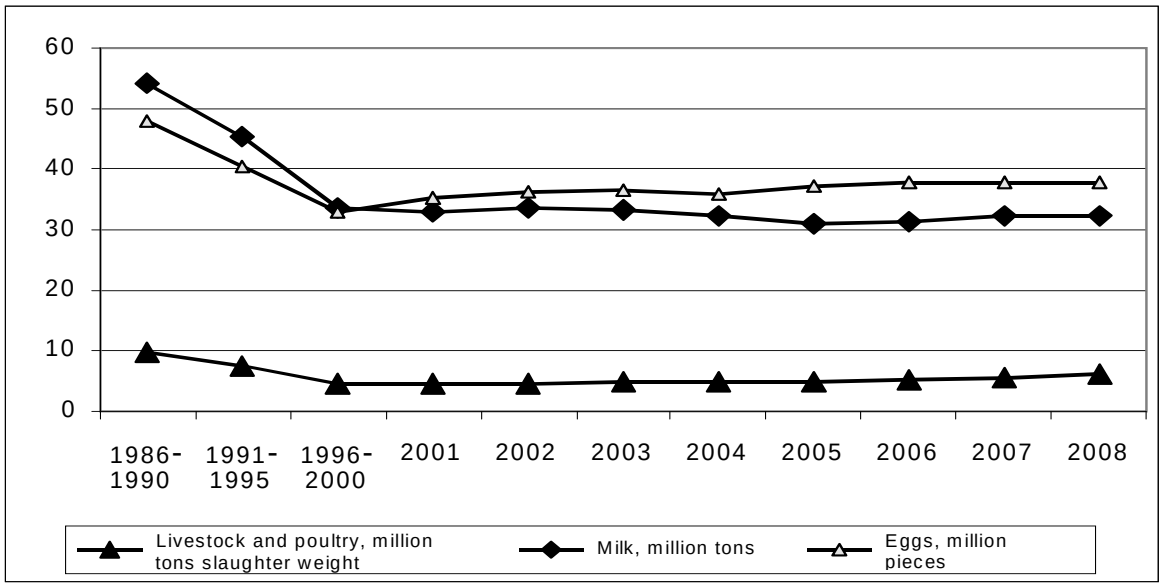
Livestock production

In the pre-reform period over 75% of livestock output was produced in corporate farms. From the early 1990s to 2000 the share of corporate farms in livestock production fell down to 40%. Starting from 2001 it was gradually growing and in 2008 approached 49%[27].

Fig. 50 shows the aggregate average annual output of basic livestock products in all farms.

As compared with 2007 the total production of meat in all types of farms increased by 6.7%. The increase is primarily due to larger output of poultry meat (up 19% as compared with 2007) and pork (up 14%) meaning growing application of intensive technologies in meat production. Although livestock sector is growing since 2001, the current output of meat approaches only the 1970 indicator, the output of milk – the indicator of 1958[28]. In 2008 the output of slaughter livestock equaled 81.3% of the respective 1991-1995 indicator, the output of milk – 71.4%, the output of eggs – 93.8%. Production of meat and milk is growing since 2006, production of eggs – since 1996.

[27] Rosstat.
[28] Russian Statistical Yearbook. Official edition. Moscow, 2006, p. 457.



Source: Rosstat.

Fig. 50. Output of basic livestock products

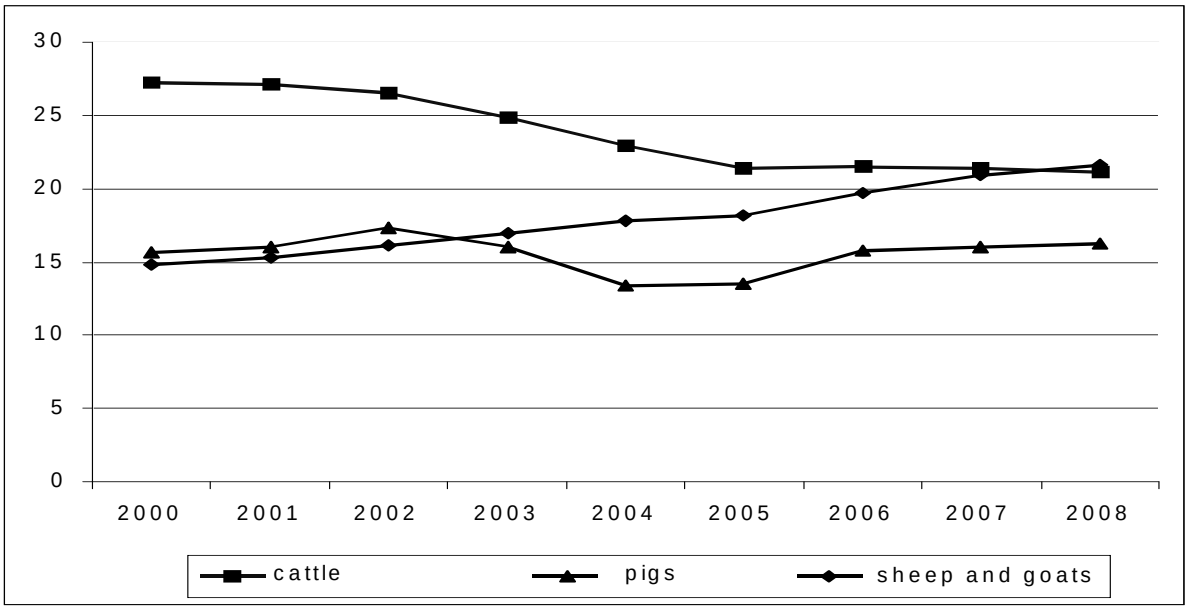
Since the start of land reform rural population has got better access to hay and pasture lands: in the early 1990s over 20 million hectares of former collective and state farms' agricultural lands were transferred into the jurisdiction of rural administrations. The privatization of these former farms' agricultural lands (about 124 million hectares) in favour of most part of rural residents has also contributed to production increase in household farms. This is due to the traditional practice when tenants (corporate farms and individual private farms) pay the rent to land owners / lessors in the form of grain used for feeding livestock and poultry in household farms rather than for food purposes. At the same time rural residents could exchange their shares in land transferred to them in the course of privatization from former collective and state farms for physical plots outside rural settlements to be used for extending household farming. The area of such plots can amount to dozens of hectares per rural family. They are also largely used for livestock production. This enables households to keep 47.5% of the total cattle inventories, 33.8% of pigs and 52.1% of sheep and goats. In 2008 production of pork shifted to corporate and individual private farms while the share of households fell by 3.8%.

At present livestock production in household farms is supported in the framework of State program for agricultural development and regulation of agricultural and food markets for the 2008-2012 period. However, one should admit that the share of budget funds allocated to the support of such farms is small and does not correspond with their share in commodity agricultural output. The situation in livestock production is traditionally worse than in crop production. This is primarily due to the fact that actually all livestock products need to be sold within 1-2 days. Producers of milk and meat are forced to agree to any terms set by the purchasers.

Awaiting the introduction of new technical regulation for milk[29] dairy plants reduced purchase prices for whole milk down to 6.5-8 rubles per litre (September 2008). It's obvious that within the period till December 20, 2008 they hurriedly utilized stocks of dried milk. Such policies of dairy plants often incorporated in a limited number of dairy holdings are extremely harmful and undermine the opportunities for larger domestic production of farm products in the long term.

There are also problems with marketing of livestock products produced by domestic agriculture. The collection of non-dressed carcasses and the forming of homogeneous lots of primarily processed products for delivery to food producers or traders require larger transaction costs as compared with import of such products. Given that imported products remain attractive, importers won't re-orient towards buying domestic output and developing the system of work with small meat producers. This stimulates small producers of farm products to self-organize and learn to protect their interests[30].

The dynamics of livestock inventories in 2000-2008 are shown at *Fig. 51*.



Source: Rosstat.

Fig. 51. Livestock inventories, million heads by the end of the period

By the end of October 2008 cattle inventories in farms of all types totaled 21.1 million heads (2.6% below the corresponding indicator of the previous year) including 9.2 million cows (down 1.3%), inventories of pigs – 16.3 million heads (up 1.2%), inventories of sheep and goats – 21.6 million heads (up 2.7%). The decrease of livestock and poultry inventories is accompanied by the improvement of their productivity – *Table 51*. However, the average annual milk production per cow despite being the highest ever in the history of Russian corpo-

[29] The new technical regulation prohibits the use of name "milk" for products made out of dried milk.
[30] Address of representatives of 422 rural settlements in Volgograd oblast to the RF President D.Medvedev about restriction of meat import in view of the growing production in household farms. 26.01.2007. Shelestovo rural settlement of the October district of Volgograd oblast.

rate farms (it's currently approaching 4 thousand kg) still remains far below the level of developed countries[31].

Table 51

Livestock and poultry productivity

	1990	1995	2000	2001	2002	2003	2004	2005	2006	2007	2007 as % of 1990
Annual milk production per cow, kg	2731	2007	2343	2553	2808	2979	3065	3280	3564	3758	137.6
Annual egg production per laying hen, pieces	236	212	264	273	279	285	292	301	302	301	127.5
Annual wool production per head, kg	3.9	2.7	3.2	3.1	3.1	3.2	3.1	2.8	2.7	2.7	69.2

Source: Russian agrifood sector in 2007, RF Ministry of Agriculture.

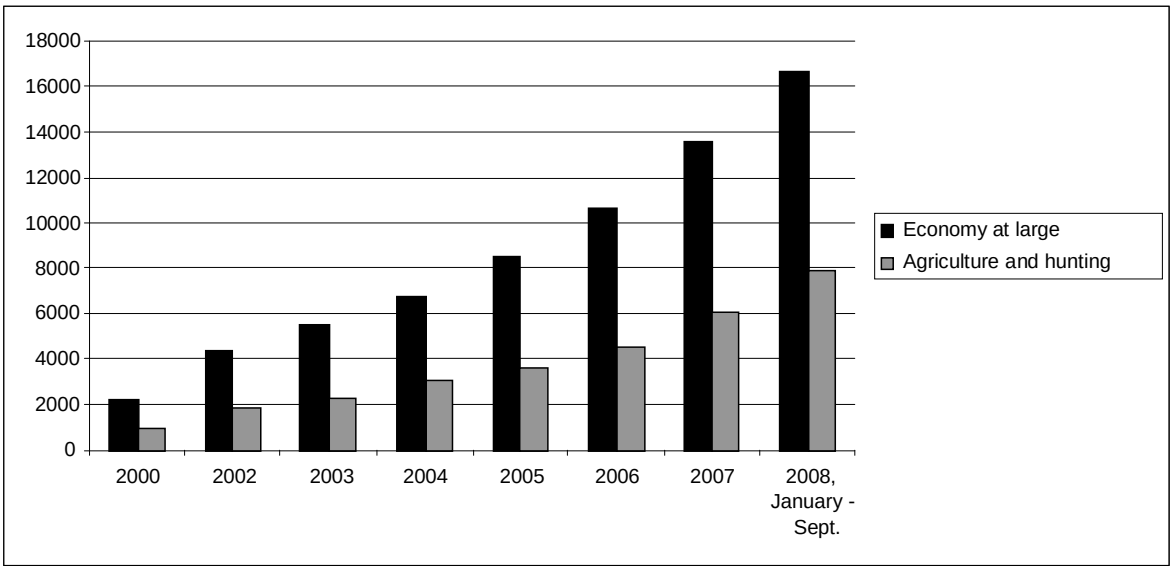
The quality dynamics are also positive: from 2004 to 2007 the share of highest-grade milk in the total milk sales grew by 20%; the share of marketed slaughter livestock and poultry of the best and first category finish is also expanding.

3.5.3. Agricultural labour

Since about one half of agricultural output in Russia is produced by household farms it's not easy to estimate labour resources engaged in farming. According to data of the Agricultural Census, as of July 1, 2006 there were 22.8 million household and other individual farms in the country of which 88.7% were engaged in agricultural activities. The Census also for the first time provided data about the distribution of household and other individual farms by the number of employed in farm works. Household farms are usually small and micro entities that over the year employ not more than 2 persons in such works (69%); the share of farms employing more than 4 persons therein does not exceed 4%. The number of employees in corporate farms totaled 2613.9 thousand, in peasant (individual private) and individual entrepreneurs' farms – 553.5 thousand; on the average one corporate farm employed 80 workers, one peasant or individual entrepreneur's farm – 4 workers. Beginning from 1995 agricultural employment is steadily shrinking both absolutely and relative to the total number of employed in the national economy. In 2007 the average annual number of employed in farming, hunting and forestry equaled 6756 thousand (10% of the total employment in the national economy).

For the third successive year wages in agriculture are growing at accelerated rates. In January-September 2008 they increased by 37.3% while in the economy at large – by 28.7%. During this period the average monthly wage in the sector equaled 7883 rubles, or 47.4% of the national economy's average. Such situation persists for quite a long time (*Fig. 52*). The average wage in agriculture continues to be one of the lowest as compared with other economic activities.

[31] In 2007 the average annual milk production per cow in the US was about 9.2 thousand kg. http://www.census.gov/compendia/statab/tables/09s0831.xls



Source: Federal Service of State Statistics.

Fig. 52. Average nominal monthly wages in agriculture, hunting and the economy at large, rubles

Meantime the actual average work time of workers on payroll in corporate farms is the longest among all kinds of economic activity (7.63 hours in January-September 2008). Notwithstanding, vacancies are few: in January-September they equaled 1.2% of the payroll by the end of the period; lower indicators were observed only in education and fishery. During October wage arrears in agriculture grew by 9.6% (in economy at large – by 33.6%); however, situation on the agricultural labour market gives no grounds for optimism since the employment rate in rural areas is still low – 59.3% in August 2008 (in urban areas – 66.3%). Many rural residents are forced out to the non-formal sector. In August 2008 the share of rural residents employed in non-formal sector amounted to 33% of the total rural employment while that of urban residents – to 16% respectively. The biggest number of employed in non-formal sector work in agriculture (30.3%) and trade (32.5%).

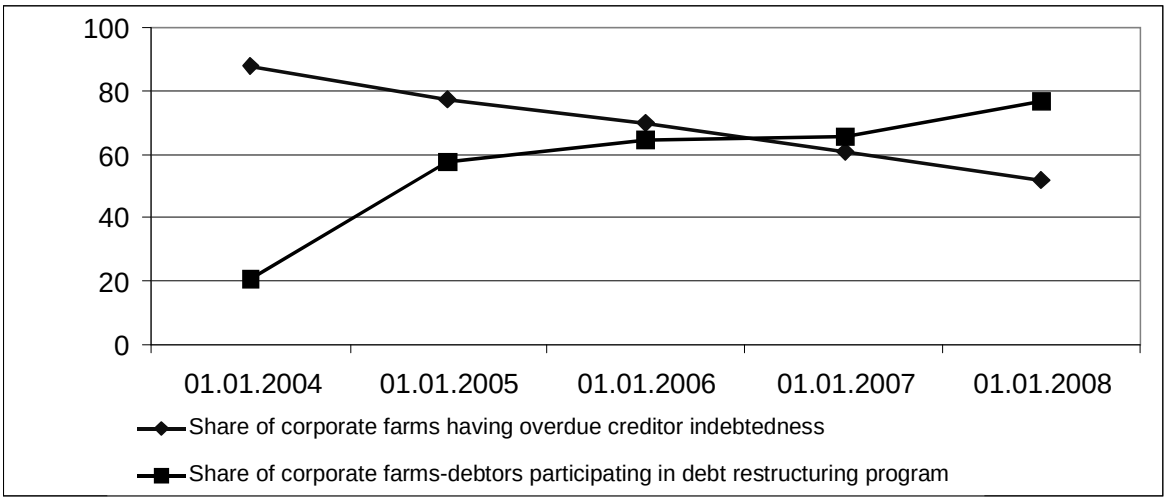
In August 2008 there were 1762 thousand unemployed rural residents, or 39.4% of the country's total. Out of them 0.7 million or 41.5% were unemployed stagnantly (looked for a job for 12 months and more).

As productivity grows able-bodied population is forced out from corporate farms to the sector of household farms, to the non-formal sector. Due to the lack of alternative employment opportunities wages of rural residents won't grow sizably implying difficulties in solving the housing problem (low wages preclude farm workers from getting a credit for buying dwellings that is envisaged by the State program). Therefore the creation of alternative employment opportunities in rural areas should be made a central point of rural development policies or the outflow of young people from these areas will continue.

3.5.4. Farm financial performance

From 1990 to 1998 the share of loss-making corporate farms grew from 3 to 88%, overdue debts were accruing. These developments necessitated the working out of a state program for restructuring farm debts. Such a program was adopted on July 9, 2002 in the form of Fed-

eral Law "On financial recovery of agricultural commodity producers" (No.83-FL). By the beginning of large-scale implementation of the state debt restructuring program almost 90% of corporate farms had overdue creditor indebtedness. The main creditor of corporate farms was the state through its tax bodies and non-budget state funds. The program of restructuring envisaged delay (for not less than 5 years) and spreading (for not less than 4 years) of the principal debt's repayment and the writing off of penalties and fines (both lump sum and as the principal debt is being repaid). The dynamics of corporate farms' enrolment in the state debt restructuring program is shown at *Fig. 53*.



Source: RF Ministry of Agriculture. http://www.mcx.ru/index.html?he_id=734

Fig. 53. Enrolment of corporate farms in the debt restructuring program, %

During the years of program's implementation the number and share of corporate farms with overdue creditor indebtedness have notably reduced. By the beginning of 2008 they accounted for 52% of the total number of corporate farms. More and more debtors get enrolled in the restructuring program: by the beginning of 2008 76.8% of farms with overdue creditor indebtedness (primarily to tax bodies) became its participants. As a result of its implementation they will have to repay 39.9 billion rubles while 43.8 billion rubles of penalties and fines will be written off. The necessary condition for joining the debt restructuring program is the debtors' obligation and ability to make current payments under their commitments. During the program's implementation (as of January 1, 2008) over 4.8 thousand entities lost the right to participate in it having failed to meet current payment commitments. Over 9.3 thousand corporate farms with overdue debts cannot participate in the program, one of the causes being ongoing bankruptcy proceedings.

In 2008 the process of bankrupting corporate farms slowed down that is probably due to the termination of earlier initiated proceedings. While in 2005 7.4 thousand bankruptcy proceedings were underway, in 2006 – 10 thousand, as of January 1, 2008 – only 4.2 thousand. There is no information about restoration of corporate farms' solvency as a result of bankruptcy proceedings (financial sanation and external management). Practice shows that the only effective proceeding is the one when an entity ceases to exist as a single property complex.

The enrollment in restructuring program enabled farms to exclude rescheduled debts from the list of outstanding ones and improved the entities' balance, making them more attrac-

tive for direct investments and trustworthy for granting credits. Selected indicators of the sector's financial performance are given in *Table 52*.

Table 52

Selected indicators of corporate farms' financial performance

	2004	2005	2006	2007	2008 (est.)
Profitability including subsidies, %	10.5	7.8	9.9	17.2	7.2
Profitability less subsidies, %	5.3	2.1	2.6	8.1	–2
Share of profitable entities, %	63	58	65	75	81.8
Share of entities having overdue debts, %	87.8	77	69.9	61.1	51.9
Creditor indebtedness as % of receipts	89.6	89.1	105.8	112.7	n.a.

Source: RF Ministry of Agriculture.

In 2004-2005 subsidies from the state budget provided for about 5% of the corporate farms' profitability rate. In 2006-2007 this indicator already ranged from 7 to 9%.

The growth of creditor indebtedness is not a sign of negative trends. Taking into account bigger receipts and higher share of profitable entities, it evidences larger use of bank credits that has a positive effect on the sector's development. The amount of credits received by the agrifood sector in 9 months 2008 is 20 billion rubles above the previous year indicator and totals almost 324 billion rubles[32]. According to data of the RF Ministry of Agriculture at present the principal direct foreign investors in the Russian agrifood sector are Cargill, Nestle, Bunge, Coca-Cola, Craft, Mars, PepsiCo, Tetra Pak, British American Tobacco, Unilever. In 2005-2008 the amount of direct investments made by these companies in the launched or already implemented projects on the territory of the Russian Federation totaled over 1.8 billion US dollars including 649 million dollars in January-September 2008. Investments are made both in the construction of new technologically advanced enterprises and the extension and modernization of already existent production capacities. Such enterprises meet the highest modern ecological standards and quality requirements.

In 2008 the sector's production indicators were rather good while its financial performance deteriorated. The lowering of profits received and profitability rates of corporate farms was first of all due to the growth of prices for agricultural inputs. For instance, in 9 months 2008 prices for mineral fertilizers rose by 70% as compared with December 2007. In the sowing and harvesting periods prices for diesel fuel surged by over 30% as compared with the beginning of the year. At the same time prices for agricultural products on the whole grew by only 1.6% and prices for livestock products even fell by 2.7%[33].

3.5.5. Production and availability of agricultural inputs

Despite a certain growth of agricultural inputs' production, the availability of some machinery for farm commodity producers decreases due to the accelerated retirement of outdated machines (*Table 53*).

As of October 15, 2008 (current departmental information) there were 493.35 thousand tractors, 146.9 thousand ploughs, 179.45 thousand cultivators and 222.4 thousand seeders in

[32] Data of RF Ministry of Agriculture.
[33] Data of RF Ministry of Agriculture.

the country. From the beginning of the year agricultural producers bought 19.6 thousand tractors, 8.4 thousand grain harvesters and 2.2 thousand fodder harvesters[34].

From January 1, 2008 farms got 620 tractors, 14 harvesters, 327 trucks and 326 units of other agricultural machinery on leasing terms through the open joint-stock company "Rosagroleasing".

The technical and technological modernization of agriculture is a separate component of the State program for agricultural development in 2008-2012. Altogether the purchase of over 175 thousand tractors and 55 thousand grain harvesters is to be supported within this period. By 2012 the renewal of machinery taking into account its retirement will amount to 40% for tractors and 50% for grain harvesters (as compared with 2006). 38.1 billion rubles over the 5-year term are envisaged for these purposes in the federal budget and are to be used for partial subsidizing of expenditures on loan interest. In addition 6 billion rubles will be invested in the "Rosagroleasing's" authorized capital.

At present the demand of agricultural producers for tractors is primarily satisfied by import supplies although in 2008 their domestic production has largely grown. All the 8 operating tractor plants are currently united into "Agromachholding".

Production of grain and fodder harvesters has also expanded so that both domestic and export demand is satisfied. "Rostsel'mach" produces 80% of all harvesters in the country and meets 65% of the respective market demand while Krasnoyarsk plant (that was rather strong in Soviet times) has recently cut production to a great extent (in 2007 "Rostsel'mach" produced 5185 grain harvesters while the Krasnoyarsk plant – only 1626)[35].

Table 53

Production of selected farm inputs, thousand pieces

	1990	1995	2000	2001	2002	2003	2004	2005	2006	2007	I-X 2008 as % of I-X 2007
Tractors	214	21.2	19.2	14.2	9.2	8.1	8.4	9.6	11.0	13.4	178.8
Tractor ploughs	85.7	4.0	2.8	3.1	2.3	1.0	1.3	2.4	1.1	n.a.	146.1
Tractor seeders	51.1	1.6	5.2	6.4	5.3	4.2	5.7	6.5	5.2	n.a.	137.5
Tractor cultivators	101	2.0	4.7	5.6	6.6	6.2	8.3	8.8	6.6	n.a.	129.3
Grain harvesters	65.7	6.2	5.2	9.1	7.5	5.43	8.05	7.47	6.87	7.16	121.8
Mineral fertilizers, million tons	16.0	9.6	12.2	13.0	13.6	14.1	15.8	16.6	16.2	17.3	103.9

Source: Rosstat (1990-2002), RF Ministry of Agriculture (2003-2006), Soyuzagromach (2007).

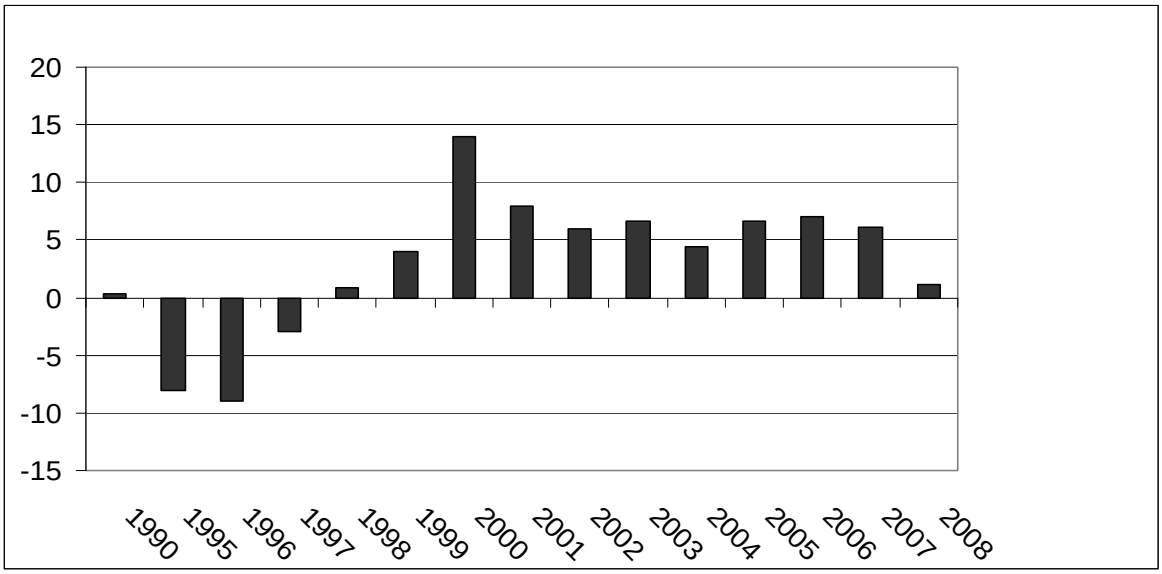
As different from farm machinery sector production of mineral fertilizers grew as compared with 1990 since during all these years it was a stable source of export revenues (about 90% of output was exported). Exports of potash fertilizers increased 2.2 fold, of nitrogen fertilizers – by 80.3%. Domestic demand for mineral fertilizers grows insignificantly. As compared with the previous year production of herbicides and other agrochemicals decreased slightly – down to 86% (Rosstat data for January-October 2008).

[34] The report of Agricultural Minister A.V.Gordeev at the State Duma session "On the implementation in 2008 of the State program for agricultural development and regulation of agricultural and food markets in 2008-2012 and the objectives for the future". Published on November 5, 2008.– www.mcx.ru

[35] Data of Soyuzagromach.

3.5.6. Food industry performance and food security doctrine

In 2008 the index of food (including beverages and tobacco) production amounted to 101.1% as compared with 2007. In the first half of the year the sector developed more dynamically but due to the production decline in October (91.3% as compared with September 2008) the annual increase was insignificant (*Fig. 54*).



Source: Rosstat.

Fig. 54. Percent change of food industry output in 1990-2008

The most dynamic sector of food industry is the production of meat and meat products and especially of poultry meat and products that are more affordable for all strata of population (the increase being 17.4%). The outputs of sausage, margarine and pasta products have reached the pre-reform level and those of granulated sugar and vegetable oils have even surpassed it almost twice (*Table 54*).

Table 54

Production of basic food products, thousand tons

	1990	1995	2000	2001	2002	2003	2004	2005	2006	2007	I-X 2008 as % of I-X 2007
Meat	6484	2370	1193	1284	1456	1677	1698	1827	2100	2561	111.6
Sausage products	2283	1293	1052	1224	1468	1700	1832	1957	2010	2411	101.4
Butter	833	421	267	271	279	285	271	277	274	272	102.2
Whole milk products in milk equivalent, million tons	20.8	5.6	6.2	6.7	7.7	8.5	8.7	9.5	10	10.5	95.5
Vegetable oils	1159	802	1375	1281	1197	1598	1867	2206	2600	2735	90.2
Granulated sugar	3758	3155	6077	6590	6165	5841	4852	5588	5800	6112	96.0
Flour, million tons	20.7	14	12.1	12	10.9	11.2	10.8	10.2	10.2	10.3	98.5
Groats	2854	1418	932	994	951	890	893	926	966	1113	97.0
Pasta	1038	603	704	764	821	874	950	982	1028	1014	100.7
Margarine products	808	198	462	515	536	542	561	630	677	752	95.6

Source: Rosstat.

In recent years the demand for food products grew faster than the average real incomes of population but due to the financial crisis this trend may discontinue. The first to drop will be the demand for highly income-elastic products of foreign origin – fruits, cheese and coffee. In 2008 the share of food products in the structure of retail trade turnover totaled 45.3%.

The deepening of the crisis and the surge of prices for food products revived concerns for food security issues in the RF Ministry of Agriculture. From the point of view of Agricultural Minister A.V.Gordeev "the food security of our state can be deemed guaranteed if in case of terminated food supplies from abroad the country doesn't plunge into a food crisis. It is assured by the high share of domestic agricultural and food products in consumption: 95% for potatoes, 90% for grain, milk and milk products, 85% for edible salt, 85% for meat and meat products, 80% for fish and fish products, sugar and vegetable oils"[36].

It should be noted that fears about getting dependent on food supplies from abroad are not justified: the share of imported products in consumption exceeds 20% only for meat and meat products (*Table 55*). In 2007 this share fell as compared with 2006.

Table 55

Share of imports in the consumption of food products in 2007, thousand tons

	Potatoes	Vegetables and melons	Meat and meat products	Milk and milk products	Eggs, million pieces
Imports	334	2391	3177	7134	856
Personal and industrial consumption	35532	17801	8745	38647	38360
Exports	132	715	66	590	398
Imports minus exports	202	1676	3111	6544	458
Imports minus exports as % of consumption	**0.6**	**9.4**	**35.6**	**16.9**	**1.2**

Source: calculated using balances of commodity stocks of food products. Rosstat, 2007.

The Ministry of Agriculture submitted to the RF Council of Federation a draft Doctrine of food security that has rather a political than economic implication[37]. The document justly asserts that in order to provide food security one should first of all "assure *economic affordability of foodstuffs* and for this purpose … take measures for raising personal incomes, ensuring state support to low-income social groups and encouraging food quality improvement". At the same time it contains target indicators for "lowering the share of imports in the supply of meat and meat products from 34 to 12%, milk and milk products – from 17 to 12%, granulated sugar – from 39 to 20%".

3.5.7. Foreign trade

In 2008 the trend towards increasing the turnover of foreign trade in agricultural and food products preserved. In 9 months 2008 imports of respective items amounted to 27.7 billion USD – up 35.5%. On the contrary, exports of food commodities (less raw agricultural products) reduced, e.g. the sale of basic export item – grains – fell down to 7472 thousand tons (76.9% of the respective previous year indicator), the sale of sunflower seeds – down to 28.5 thousand tons (30.8%)[38].

[36] Speech of A.V.Gordeev in the RF Council of Federation "On the current food security of the Russian Federation and measures for guaranteeing it". October 28, 2008. www.mcx.ru
[37] Doctrine of food security – draft. www.mcx.ru
[38] Rosstat – www.gks.ru

Thanks to the government foreign trade policies targeted at the restriction of sugar import and accelerated development of domestic production of sugar beets (pursued during the 3 recent years), sugar supplies from abroad tend to decrease (*Fig. 56*).

Table 56

Imports of basic agricultural and food products in 2000-2007, thousand tons

	2000	2001	2002	2003	2004	2005	2006	2007	I-IX 2008 as % of I-IX 2007
Beef	282.3	459.2	504.6	507.8	510.9	696.2	1411.3*	1489.4*	124.5
Pork	212.9	369.6	602	535.2	455.2	562.9			
Poultry meat	687.2	1383.3	1375.2	1190	1101.3	1318.5	1282.4	1294.9	97.5
Milk	48.0**	85.4**	11.8**	26.5**	256.3	313.9	297.3	250.9	101.5[c]
Butter	45.4	81.4	94.1	114	70.3	66	164.8	129.4	
Sunflower oil	149.5	182.8	175.7	200.8	161.2	131.5	100.0	132.0	99.4
Cereals	3333.5[a]	1123[a]	713.7[a]	850.2[a]	2898.5	1449	2313.4	1066.6	n.a.
Flour and groats	-	-	-	-	129.4	74.1	82.2	87.8	n.a.
Sugar	4818[b]	5553.5[b]	4604.2[b]	4263.1[b]	3209.7	3512.2	2981.9	3709.4	73.1[d]

* Meat less poultry meat.
** Condensed milk and cream (data of the RF Federal Customs Service).
[a] Wheat and wheat/rye mix + corn.
[b] Raw sugar + white sugar.
[c] Milk and milk products.
[d] Raw sugar.
Source: Rosstat.

The aggregate imports of dairy products grew insignificantly while those of dried milk increased by 65.7%. Similarly to previous years import supplies of fresh and frozen meat and vegetables were also up. The increase of food imports in 2008 was conditioned by the growth of personal incomes that continued till September. The scope of the global financial crisis' slackening effect on this trend won't be clear till the middle of 2009.

Russia still retains its traditional status of net importer of food and agricultural commodities. The trend towards growing deficit of agrifood trade that originated in 2000 persists. In January-September 2008 the negative balance of trade in respective items amounted to 19.4 billion dollars.

3.5.8. Basic commodity markets

Grain market

Market situation

The market of grain that is largely oriented towards export is the most affected by the global financial crisis. In 2008 the Russian grain market experienced excessive supply that was due to several reasons:

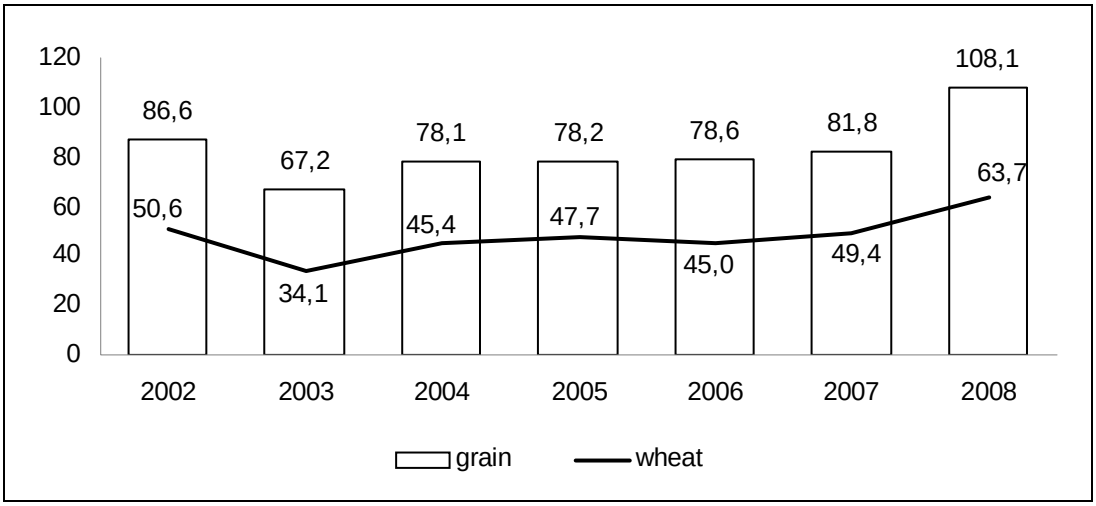
- record grain crop in 2008;
- factors hindering export;
- crisis in the banking sector that led to the shortage of funds for buying grain.

According to estimates the gross output of grains in 2008 is about 108 million tons, which is the record indicator over the last 15 years (Picture 9). It is conditioned by the sharp growth of production as compared with 2007: wheat – by 29% (up to 63.7 million tons), bar-

ley – by 48.5% (up to 23.1 million tons) and corn – by 76.3% (up to 6.6 million tons) (*Fig. 55,56*).

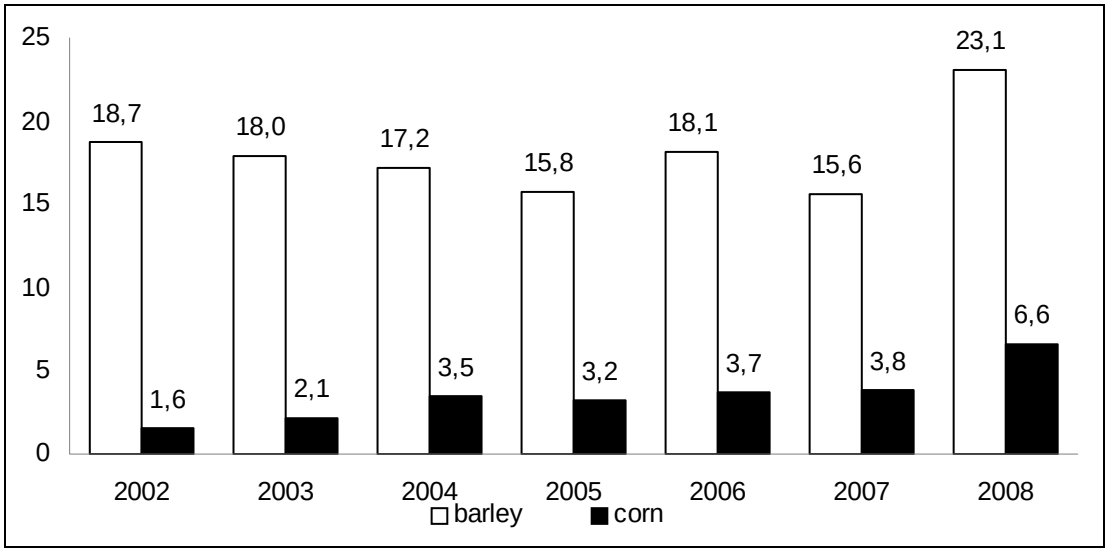
The principal increase was provided by regions oriented towards export of grain – the Central and Southern federal districts, while the gross output of grain in the Urals and Siberian regions reduced.

Under the pressure of large new crop supplies domestic prices for grain at the beginning of 2008/2009 MY started to fall (*Fig. 57*). Over 6 months (from April 2008 when prices hit the highest point, to November 2008) the price for food wheat #3 fell two fold – from 9150 rubles per ton to 4475 rubles per ton (EXW Northern Caucasus). The drop of prices for feed wheat and barley was most dramatic – 2.5 fold on the average.



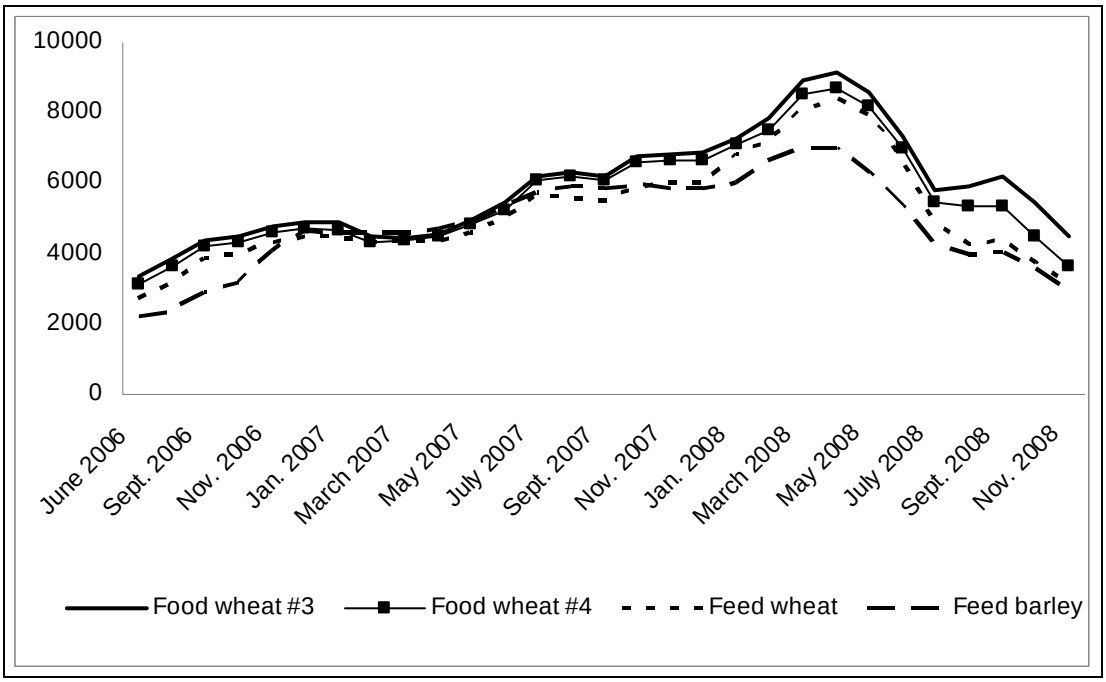
Source: Rosstat, "Sovecon" Analytical Center.

Fig. 55. Russia: gross output of grain and wheat, million tons



Source: Rosstat, "Sovecon" Analytical Center.

Fig. 56. Russia: gross output of barley and corn, million tons



Source: "Sovecon" Analytical Center.

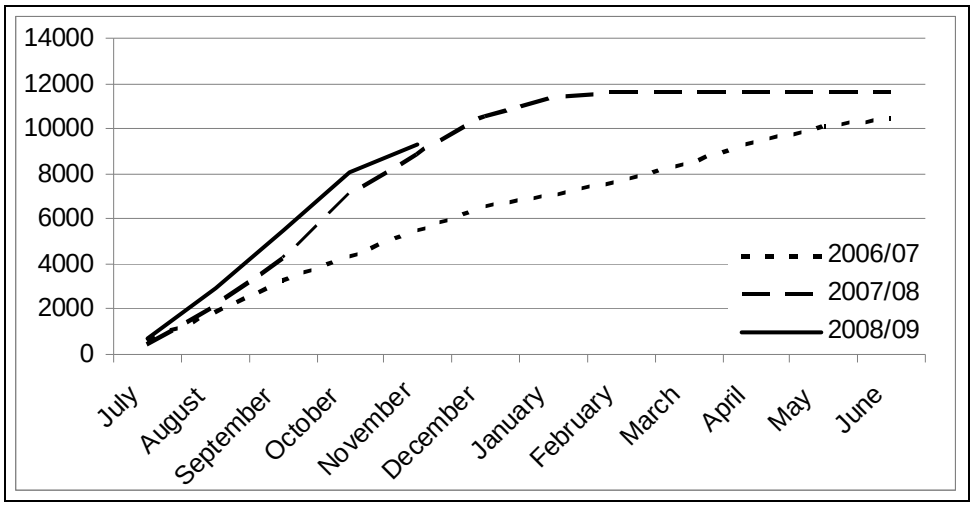
Fig. 57. Domestic prices for grains (EXW Northern Caucasus), rubles per ton

In the conditions of excessive grain supply and negative price dynamics the market could be supported by the increase of domestic consumption, exports and state purchases.

The financial crisis has largely limited opportunities of the domestic market. First, processors got short of funds and had to reduce purchases of domestic grain. As a result the marketing of grain with long-term delay of payment became a common practice.

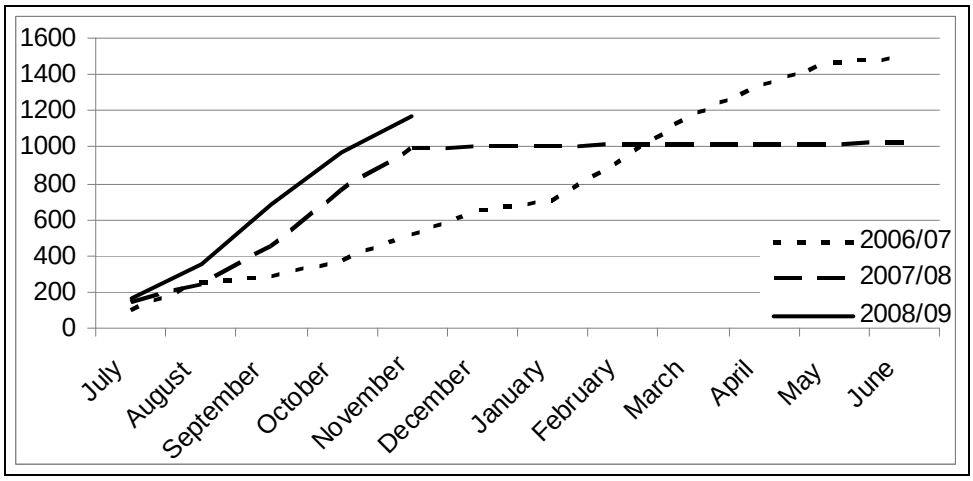
Second, prospects for larger consumption of feeds in livestock production are questionable. In 2008 rates of pig inventories' growth were below those of the previous year. Smaller consumer demand for livestock products due to lower purchasing power of population in the crisis situation will also have a negative effect. According to estimates of "Sovecon" Analytical Center domestic consumption of grains in 2008/2009 MY won't change substantially as compared with 2007/2008 MY and will amount to 74 million tons versus 70 million tons respectively.

The prospects for increasing Russian grain exports are also not so bright. From the beginning of 2008/2009 MY the country exported large volumes of wheat and barley that were above the previous years' indicators. In July-October 2008 8.07 million tons of wheat and 974 thousand tons of barley were exported. But in October-November export supplies started to decrease due not only to the developments on foreign markets but also to the changing situation on the domestic market, i.e. the growth of state purchases of grain (*Fig. 58,59*).



Source: calculated using data of "Sovecon" Analytical Center.

Fig. 58. Cumulative wheat exports, thousand tons



Source: calculated using data of "Sovecon" Analytical Center.

Fig. 59. Cumulative barley exports, thousand tons

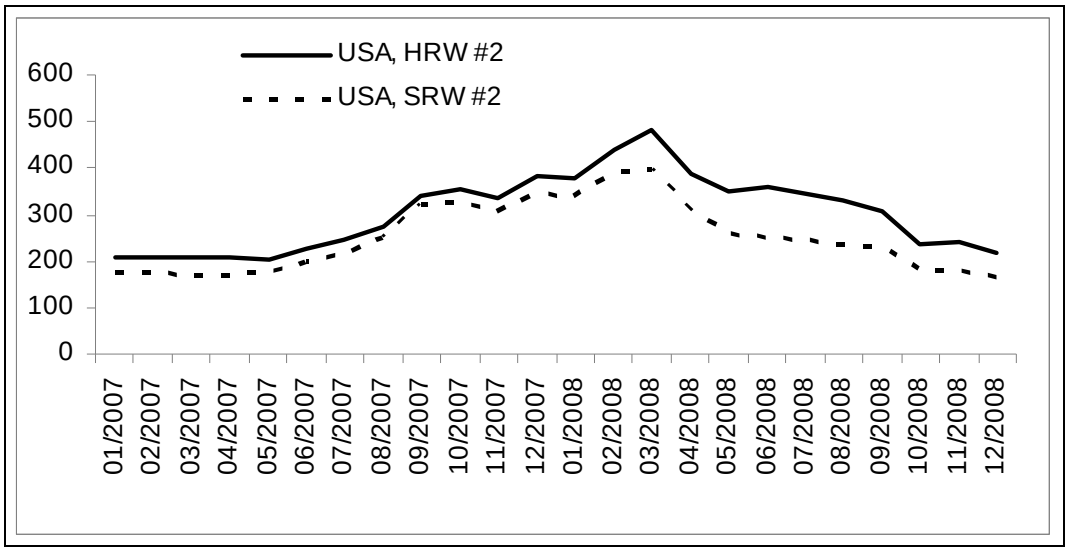
Large supplies of food wheat from Russia and Ukraine at the beginning of 2008/2009 MY resulted in saturation of markets in basic countries-importers of grain in the Black Sea region, first of all Egypt and Pakistan. Lower interest in purchase of cheap poor quality wheat from Russia and Ukraine may be accompanied by the shifting of demand towards non-expensive but higher quality food grain. In this situation the main competitor for the Black Sea-origin wheat on the Mediterranean markets will be Australia. The growing importance of the country on the world market is due to the restoration of its production capacities and a sharp drop of freight rates that raises the competitiveness of Australian grain in the Mediterranean region. The world freight rates are lowering for all classes of vessels and for all routes[39].

[39] Data of the International Grain Council.

From the price point of view Russian wheat still remains competitive. The average price offer for Russian grain at the GASC tender in November 2008 was about 175 dollars per ton, for French wheat – 185 dollars per ton[40].

The global financial crisis that coincided with grain harvesting in major exporting countries led to the accelerated decline of the world prices for grain (*Fig. 60*). Prices for corn depend on the prices for oil: the lowering of oil prices pulls down prices for corn that is a raw input for producing biofuel. Such dynamics of the world market steadily undermine price advantages of the Russian grain.

The policies of state purchase of grain into the intervention fund can also result in the lowering of Russian grain export competitiveness (see below). As prices on the domestic market fell, the interest in sale of grain to the state started to grow. The prices at which the state buys food wheat are 30% above prices of the domestic market[41]. In September 2008 state purchases of grain amounted to 207 thousand tons, in October – to 403 thousand tons, in November – to 851 thousand tons. So, export flows may re-orient towards domestic market.



Source: International Grain Council.

Fig. 60. World prices for wheat, dollars per ton

State policies

In 2008 state policies on the domestic grain market were rather active. The volume of intervention purchases into the state fund in 2008/2009 will be quite large – 6-8 million tons. In the previous good crop years it never exceeded 2 million tons.

Given the current market situation this measure is rather contradictory. On the one hand, state intervention purchases are a key factor of domestic market support and slowing down of domestic price decline. On the other hand, they entail a conflict of interests between export supply and sale on the domestic market (into the intervention fund).

[40] The State Egyptian company.
[41] Data of "Sovecon" Analytical Center.

In the situation of financial crisis there is a need to relieve tension in the agrifood sector as regards crediting and normalization of payments and to encourage export that demonstrates slowing down.

A whole set of measures to support grain export is envisaged for 2009:

- subsidizing of export;
- reduction of infrastructure costs – railway and port transshipment rates;
- accelerated procedure of repaying export VAT;
- granting of bound credits to importers for purchasing Russian grain and flour.

Market outlook

According to expert estimates in case weather conditions in 2009 will be close to the climatic average over the last few years, the gross output of grain will be large – over 90 million tons[42]. Combined with high ending stocks it may again cause oversupply of grain on the domestic market.

The competition on the world market will remain rather tough. Consumption of wheat in Asian and Central African countries is expected to fall – due to lower oil prices they reduce state support to grain importers. At the same time the International Grain Council forecasts a record consumption of wheat for feeding purposes in 2008/2009 MY – 119 million tons (30 million tons above the previous season indicator).

Efficient state policies will be needed to support the market, first of all as regards problems connected with transportation infrastructure. In the coming years the deficit of railway grain cars will get worse. While in 2008 it equaled 2033 units, in 2009 this indicator will grow up to 8781 units, in 2013 – to 20466 units or 35.9% of the total grain car fleet[43]. Given the current misbalance between export potential and the potential of grain export infrastructure the envisaged measures for encouraging grain export supplies won't bring the desired result. Besides, the Ministry for economic development and trade forecasts that by 2020 the output of grains in Russia will further grow – up to 120-125 million tons[44] - and there won't be enough capacities for export.

Sugar market

Market situation

In 2008 the situation on sugar market was not as favourable as before: profitability of sugar beet production declined and areas planted in this crop contracted. The surge of grain production profitability in 2007 has shifted producers' interest from sugar beets to grains.

In 2007 areas under sugar beets were record over the last 15 years – 1065.4 thousand hectares. But while prices for grains and oilseeds in 2007/2008 grew, those for sugar beets remained actually the same. Just a minor rise is expected in 2008/2009 – up to 1.4 thousand rubles per ton from 1.3 thousand rubles per ton in 2007/2008[45]. At the same time the growth of prices for fertilizers and fuels and oils raised production costs.

[42] "Sovecon" Analytical Center's estimate.
[43] Data of "RusAgroTrans".
[44] Concept of long-term social and economic development of Russian Federation (of August 5, 2008).
[45] Data of IKAR (Institute for Agricultural Market Studies).

Lower profitability combined with higher expenditures forced many producers to reduce areas planted in sugar beets. In 2008 they declined by 22% down to 819 thousand hectares. While several years ago the profitability of sugar beet production was around 30%, at present it fell to 10-15%. Only companies having long-term contracts with buyers or their own processing facilities still retain interest in sugar beet business.

Due to the intensification of production – higher yields and sugar content – the output of sugar in 2008 will reduce to a smaller extent than areas planted in sugar beets – by 11.7% (from 3.14 to 2.77 million tons)[46].

Table 57

Production indicators of Russian sugar market

	2001	2002	2003	2004	2005	2006	2007	2008 (estimate)
Areas sown in sugar beets, thousand hectares	772.8	809	924.2	850.8	805.3	1002.9	1065.4	819.3
Yields of sugar beets, 100 kg per hectare	188.4	193.6	209.7	256.8	266	307.7	265	288
Gross output of sugar beets, million tons	14.5	15.6	19.3	21.8	21.4	30.8	28.2	30.7
Output of sugar out of sugar beets, million tons	1.6	1.6	1.9	2.2	2.4	3.2	3.1	2.7

Source: Institute for Agricultural Market Studies (IKAR).

State policies

Sugar market in Russia is a subject of tight government regulation. The duty on white sugar import is 340 dollars per ton. The import of raw sugar is regulated by variable import duty that depends on the average monthly price for raw sugar at the New York Board of Trade. In 2008 the rate of domestic market protection against respective import amounted to 140 dollars per ton. Besides, for the second year running raw sugar import is subject to seasonal duties – 220-270 dollars per ton (depending on the exchange quotations) from December 1, 2008 to May 31, 2009.

A big problem for the market is sugar import from Ukraine. Till 2009 sugar was excluded from the free trade regime between Russia and Ukraine. This means that unless the problem is settled by the Government supplies of beet sugar from Ukraine after January 1, 2009 won't be subject to import duties. Experience shows that under the guise of beet sugar Ukraine can export to Russia cheap sugar made out of raw sugar free of duty. Ukraine has big stocks thereof and large sugar processing facilities.

It should be noted that the problem of minimizing risks from commodity import from Ukraine is one of the most acute since Ukraine has already joined WTO on more liberal terms than are offered to Russia. Unless measures are taken to regulate mutual trade between the two countries, Russia may face either import of goods from the third countries after minor repacking in Ukraine or larger supply of Ukrainian commodities for which the above goods will substitute in Ukraine.

[46] Forecast of IKAR (Institute for Agricultural Market Studies).

Market outlook

Production of sugar turned out to be more sustainable to the crisis than, for instance, production of grain. In the situation of global financial crisis the world sugar markets do not demonstrate sharp drops. The slump in grain prices makes sugar beets more profitable as compared with other crops. Besides, the mechanism of regulating raw sugar market makes prices for sugar in Russia more predictable. Therefore in 2009 the situation on sugar market will look more promising than that on markets of other crops. Acreage under sugar beets is expected to stabilize or even grow. However, here too the financial crisis will have its effect and accelerate the following market processes:

- non-efficient farms will withdraw from the market;
- the share of independent beet producers will reduce while the number of vertically integrated structures will grow;
- processors will more actively invest in sugar beet production. According to expert estimates sugar producers currently own over half of areas planted in sugar beets in the country[47]. In two years time processors will grow 80% of domestic sugar beets.
- small and non-profitable processing plants will close. According to data of "Soyuzrossahar" there were 84 sugar processors in the country of which only 75 were operating in 2008. 6 operators ("Prodimex", "Euroservice", "Rusagro", Sucden, "Dominant" and "Razguliay") control a large share of the market (over 60%)[48].

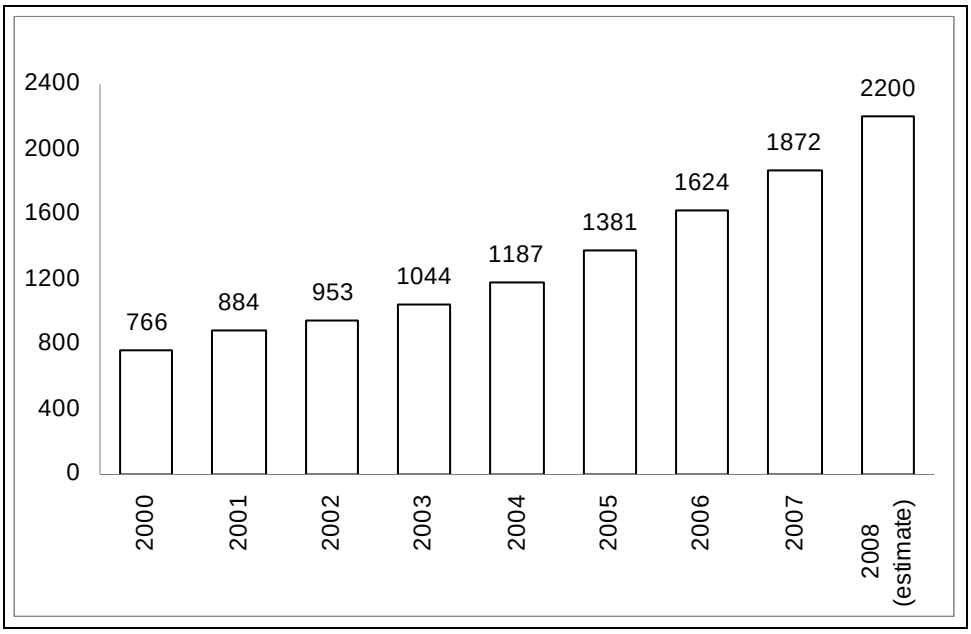
Meat market

Market situation

In 2008 trends on the Russian meat market remained the same as in the previous years, i.e. positive dynamics in pig and poultry production preserved. According to preliminary data the output of poultry meat in farms of all types grew by 16% as compared with 2007 up to 2.2 million tons, the output of pork – by 8% up to 19.7 million tons (*Fig. 61,62*).

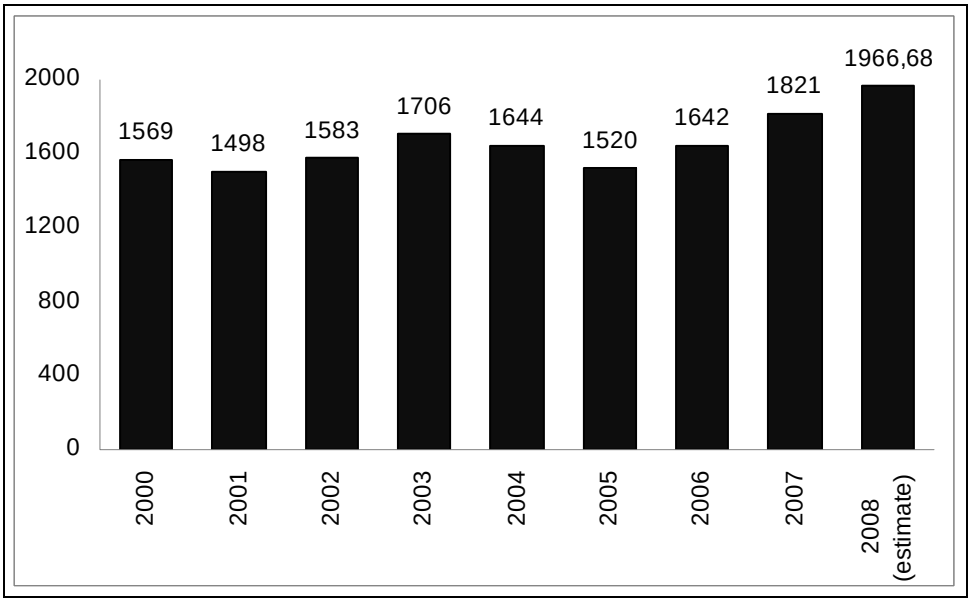
In recent years the average annual growth rates in poultry production range from 15 to 20%. The domestic output of chicken meat increases 20 fold faster than imports. In 2007 1.3 million tons of poultry meat were imported and the 2008 indicator will most likely be close to this level. The share of imported poultry on the Russian market is about 38%. According to estimates of the Russian Meat Union by 2010 it should fall down to 29%. Import of poultry meat (similarly to other kinds of meat) is regulated by tariff quotas. In 2009 this regime will be tightened with the view to create favourable conditions for further development of Russian poultry production.

[47] Data of investment group "Capital".
[48] Data of IKAR (Institute for Agricultural Market Studies).



Source: National Meat Association.

Fig. 61. Russia: poultry meat production, thousand tons (slaughter weight)



Source: National Meat Association.

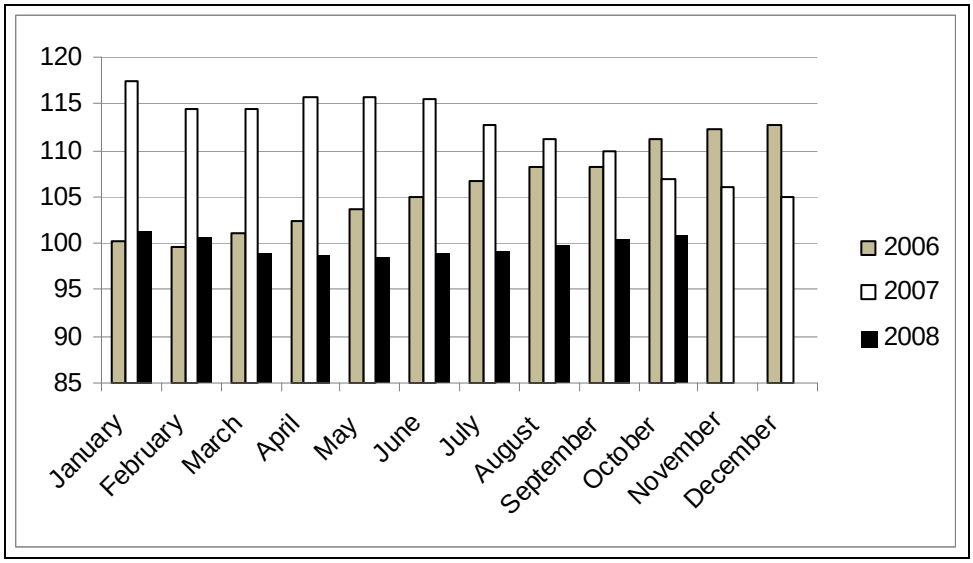
Fig. 62. Russia: production of pork, thousand tons (slaughter weight)

First investments in the Russian pig breeding were made in 2005. In 2006 the trend was supported in the framework of the National Project "Development of agrifood sector". This resulted in a sharp growth of pig inventories in farms of all types – in 2006 they were up 17% as compared with 2005. After putting in operation several large pig breeding complexes the trend preserved in 2007 but as compared with the previous year growth rates slowed down noticeably (*Fig. 63*). As of January 1, 2008 pig inventories increased by only 4.3% as compared with January 1, 2007. Lower growth rates in pig breeding were conditioned by the

change of economic situation on the market. The drop of prices for pork in 2007 and the rise of prices for grain and fuels and oils resulted in the decline of sector's profitability from 25-30% in 2006 to 15-20% in 2007[49].

In 2008 pig inventories stopped to increase. The reason is that most pig breeding complexes recently put in operation should have reached their full capacity in 2008-2009. But the financial crisis caused problems with additional financing of the approved plans. In this situation one can speak only of implementing the already launched projects rather than of expanding pork production.

In the context of current market developments the Government is preparing a branch target program for the development of pig breeding. According to the "Concept of pig production development in the Russian Federation till 2020" worked out by the Ministry of Agriculture the output of pork by 2020 should be increased 3 fold – up to 7.7 million tons (live weight).



Source: Rosstat.

Fig. 63. Inventories of pigs in farms of all types (as % of the previous year)

Table 58

Imports of meat to Russia, thousand tons

	2002	2003	2004	2005	2006	2007	2008 (Jan.-Oct.)	
							thousand tons	as % of Jan.-Oct. 2007
Beef	330	320	405	687	695	726	1335.4	121.8
Pork	580	500	445	550	650	664		
Poultry meat	1360	1145	1270	1303	1265	1308	978.8	94.6

Source: Rosstat.

[49] Data of the National Meat Association.

State policies

Beginning from 2003 import of meat to Russia is constrained by tariff quotas: within the quota set by the Government imported meat is subject to lower customs duties while duties for meat supplied in excess of this quota are much higher. This restricting mechanism will continue to be applied in 2009 but out-of-quota tariffs on import of poultry meat and pork will be raised sharply (*Table 59*).

The previous years' experience showed that imported cheap frozen meat remained competitive on the Russian market even in case it was subject to high out-of-quota duty. For instance, about 25-30% of pork is imported in excess of the quota. In the context of projected growth in Russian pig and poultry production a more rigid limitation of import looks quite justified. But one should take into account that meat processors use mostly frozen imported meat. According to estimates of the Institute of Agrarian Marketing this meat is 15% cheaper than Russian meat. Its replacement with more expensive domestic meat can result in higher prices for processed products.

Table 59

Tariff quotas on import of meat to Russia

	2006	2007	2008	2009
Beef, fresh or chilled				
Quota, thousand tons	27.8	28.3	28.9	29.5
Within-quota tariff	15%, but not less than 0.2 EUR/kg	15%, but not less that 0.2 EUR/kg	15%, but not less that 0.2 EUR/kg	15%, but not less that 0.2 EUR/kg
Out-of-quota tariff	40%, but not less than 0.4 EUR/kg	40%, but not less than 0.4 EUR/kg	30%, but not less than 0.3 EUR/kg	30%, but not less than 0.3 EUR/kg
Beef, frozen				
Quota, thousand tons	435	440	445	450
Within-quota tariff	15%, but not less than 0.15 EUR/kg	15%, but not less than 0.15 EUR/kg	15%, but not less than 0.15 EUR/kg	15%, but not less than 0.15 EUR/kg
Out-of-quota tariff	40%, but not less than 0.4 EUR/kg	40%, but not less than 0.4 EUR/kg	30%, but not less than 0.3 EUR/kg	30%, but not less than 0.3 EUR/kg
Pork including trimmings				
Quota, thousand tons				
pork	476.1	484.8	493.5	502.2
trimmings	-	26.5	28	29.7
Within-quota tariff	15%, but not less than 0.25 EUR/kg	15%, but not less than 0.25 EUR/kg	15%, but not less than 0.25 EUR/kg	15%, but not less than 0.25 EUR/kg
Out-of-quota tariff	60%, but not less than 1.0 EUR/kg	60%, but not less than 1.0 EUR/kg	60%, but not less than 1.0 EUR/kg	75%, but not less than 1.5 EUR/kg
Poultry meat				
Quota, thousand tons	1130.8	1171.2	1211.6	952
Within-quota tariff	25%, but not less than 0.2 EUR/kg	25%, but not less than 0.2 EUR/kg	25%, but not less than 0.2 EUR/kg	25%, but not less than 0.2 EUR/kg
Out-of-quota tariff	60%, but not less than 0.48 EUR/kg	60%, but not less than 0.48 EUR/kg	60%, but not less than 0.48 EUR/kg	95%, but not less than 0.8 EUR/kg

Source: RF customs legislation.

Market outlook

At present meat market in Russia is characterized by high fragmentation. The share of the 10 largest companies in domestic pork output is only 25.2%; in poultry production it's higher – 53.8% (*Table 60*). These are small producers who will be most affected by the current financial crisis. Due to that in 2009 the meat sector (and first of all pig breeding) is expected to actively consolidate. Small and medium producers will go bankrupt while large companies will find new opportunities for expanding their business by taking over entities unable to sustain competition.

Table 60

Russia: structure of poultry meat and pork production in 2007

Market of poultry meat (tons of slaughter weight)		Market of pork (tons of live weight)	
"Cherkizovo" group	12.1%	Prodo Management	5.9%
"Prioskolie"	8.8%	Agroholding	3.0%
Prodo Management	8.4%	Agro-Belogorie	2.9%
"Belgrankorm"	5.3%	"Cherkizovo" group	2.9%
"Kochetkov"	4.6%	"Povolzhskoye"	2.5%
Sibirskaya guberniya	4.4%	Miratorg	2.2%
Mossel'prom	3.9%	Sibirskaya AG	1.9%
Resource	3.4%	Exima	1.6%
Stavropolsky broiler	2.9%	"Aleyskzernoproduct"	1.3%
Other	46.2%	Other	74.8%

Source: Institute of Agrarian Marketing.

3.5.9. Agricultural land market

Land privatization in Russia primarily concerned farmlands included in the category of "lands of agricultural destination". As of January 1, 2008 both corporate farms and individual private farms based their land use on agricultural lands of which about 70% were owned not by the state but by individuals and legal bodies. Lands of other categories have actually kept on being the state property. The approaches applied to privatization of former collective and state farms' agricultural lands determined the emergence of a special type of ownership – the common share one. In place of a former collective or state farm one plot running to several thousand hectares was formed that consisted of hundreds of fields, perennial plantations, hay and pasture lands separated by natural or man-made boundaries. The title to this entire plot was transferred to hundreds of persons – employees and pensioners of former collective and state farms and workers of rural social sphere. Each of them became a co-owner of the plot and got a share in title to it – the so-called land share. Actually such a share-owned plot is either entirely used by a corporate farm – the legal successor of this former collective or state farm, or is divided to parts that are transferred to different corporate or individual private farms.

Table 61

Structure of ownership for agricultural lands used by different groups of farm producers (as of January 1, 2008)

	Total, million ha	incl. private, million ha	of them owned by user		
			million ha	% of the total	% of the privately owned
Individuals not registered as individual private farmers	41.5	17.2	16.6	40.0	96.5
Individual private farms	20.5	12.7	6.6	32.2	52.0
Partnerships, companies, cooperatives	113.2	94.1	4.2	3.7	4.5
State institutions	10.7	0.7		0.0	0.0
Other institutions	4.6	1.4	0.2	4.3	14.3
Total	190.5	126.1	27.6	14.5	21.9

Source: Rosnedvizhimost.

Household farms use farmland plots with different types of permitted use (for household farming, vegetable gardening and horticulture, haying, pasturing, etc.) of which only 40% are

owned by individuals-users (Table 13). Members of individual (family) farms own only one third of the used agricultural land. 79% of farmlands used by agricultural partnerships, companies and cooperatives are in common share ownerships of individuals. All other agricultural lands remain in state ownership.

It's not clear how this active transfer of land from owners to users is effected – official statistics do not give an answer to this question. This is due to several reasons. First, different classifications are used when collecting statistical data about land transactions thus complicating the analysis. In one case the gathered information reflects transactions with plots of land of agricultural destination but doesn't specify how many of them are acquired by farm producers. In another case – transactions with plots acquired by corporate and individual private farms without indicating the category and type of lands. In the third case – transactions with plots for farming purposes without indicating the buyer. In the fourth case the number of transactions with agricultural plots includes transactions with plots for individual dwelling and summer suburban (dacha) construction that does not necessarily imply farming activities (*Table 62*).

Table 62

Transactions with agricultural land plots situated outside settlements

	2004		2006		2007	
	Trans-actions, thou-sand	Area, thou-sand ha	Trans-actions, thou-sand	Area, thou-sand ha	Trans-actions, thou-sand	Area, thou-sand ha
State and municipal lands:						
Sale to individual private and corporate farms	0.240	8.1	2.9	194.5	2.1	285.7
Sale to individuals for individual dwelling and summer suburban construction, household farming, vegetable gardening and horticulture, etc.	3.3	0.7	4.4	0.8	2.3	0.8
Lease of lands of agricultural destination	92.8	54289.8	127.9	88569.5	102.8	97337.4
Plots of individuals and legal bodies:						
Sale of plots to individuals and legal bodies for farming purposes	1.4	49.1	7.7	180.2	8.3	368.2
Sale of plots by individuals for household farming, gardening and livestock production	177.8	28.4	187.2	68.9	203.8	33.4
Total	275.5	54376.1	330.1	89013.9	319.3	98025.5

Source: Rosnedvizhimost.

Second, statistical recording is organized in such a way that only transactions with land plots are traced. In respect to farmlands this approach is unacceptable: the most part of them are a common share property of hundreds of co-owners and transactions with such plots are impossible since they would require a unanimous agreement of all the participants. In this case land titles are transferred not through the purchase and sale of plots but through the purchase and sale of land shares with further parceling out of physical plots that become objects of individual private ownership.

Till 2008 Rosnedvizhimost submitted information about the share of commonly owned lands that are leased out. Beginning from 2008 this data is not available. As of January 1, 2007 about 68% (i.e. about 60 million hectares) of lands being common share property were

leased out to corporate farms. But as can be seen from the Table such a widespread transaction is not subject to the federal state statistical recording.

In addition to all the above, information about transactions for the federal state statistical recording is collected through district departments of Rosnedvizhimost while transactions themselves are registered in the district departments of judicial bodies authorized to register real estate titles and transactions with them. The legal ambiguity in exchange of information entails non-transfer of information about transactions from the judicial bodies to Rosnedvizhimost agencies. As a result the error in data about land transactions averages 20%[50].

The problem with gathering information about land transactions is obvious if one compares data of the above Tables: farm producers employ 162.9 million hectares of agricultural land belonging to outside owners while the recorded transactions embrace only 98 million hectares. So, the re-distribution of land ownership and use titles in agriculture is largely beyond statistical recording. One can estimate the scale of land re-distribution, prices for land purchase and lease only by carefully studying selected cases. Transaction costs connected with carrying out of land transactions and entering information about earlier acquired land titles in the Single State Register of Real Estate Titles and Transactions are extremely high[51].

The issue of high costs of preparing information about plots for their registration in the State Real Estate Cadastre is more or less discussed in the society. At the same time the issue of extremely high costs of access to the system of registering land titles and transactions is beyond the government's concern. Only at the end of 2008 amendments to the RF Tax Code were introduced that reduced the amount of state fee for registering titles and encumbrances to land plots of agricultural destination. For instance, the state fee for registering a share in the common title to a land plot was cut 10 fold. Up to then each co-owner was charged the 500-ruble fee. As a result the fees received by the budget for registering two similar plots differed 50 fold in case one of them was an individual property and the other – the common property of 50 persons. One more problem is that the growth of transaction costs is determined by provisions of the acts that are not subject to broad discussion and are not to be approved by legislators. For instance, the surrender of title to a land plot that incorporated adjacent fields being common property of a group of individuals resulted in forming of dozens of plots each of them being a common share property of these individuals. This new provision was introduced by departmental directives, orders, letters and software applied in cadastre recording. As a result expenditures of each co-owner on registering his land titles increased as many fold as many plots were formed. The expenditures of a corporate farm leasing these plots also grew as many fold as many new plots commonly owned by a group of lessors became new objects of cadastral recording. High transaction costs create ample conditions for the mass transfer of land titles from the initial owners (who got their titles in the course of privatization) to the ones who can bear these costs.

Since farmlands are not protected against their withdrawal from agricultural production[52] there is a stimulus for the respective market's invasion by operators interested in nonag-

[50] State (national) report "On the condition and use of lands in the Russian Federation in 2007". Moscow, Rosnedvizhimost, 2008, p.174.
[51] Shagayda N.I. Market of lands of agricultural destination: the practice of limitations. – "Voprosy economiki", No.6, 2005, pp. 119-128.
[52] Shagayda N.I. Protection of lands from withdrawal from agricultural production. – Eco, No.5, 2008, pp. 138-147.

ricultural utilization of such lands[53]. As a result the market of farmlands is distorted: it includes transactions with agricultural land plots priced as sites for construction development. Imperfection of institutions and documents proving land titles causes their large-scale taking away from the owners who acquired their property rights in the course of land reform[54].

One of the specific features of agricultural land transactions is their conclusion not by direct agreement with the land owner but by agreement with the owner's trustee. Usually one person carries out transactions by procuration for and on behalf of dozens and hundreds of owners. This evidences that the seller doesn't know the price of the deal and that such deals are not transparent.

3.5.10. State program for agricultural development and regulation of agricultural and food markets in the RF constituent members for 2008-2012

Beginning from January 2008 the country's farm sector is financed in the framework of the State program for agricultural development and regulation of agricultural and food markets in the RF constituent members for 2008-2012 that was approved by RF Government Resolution No.446 of July 14, 2007 (hereinafter referred to as the State Program) (*Fig. 64*).

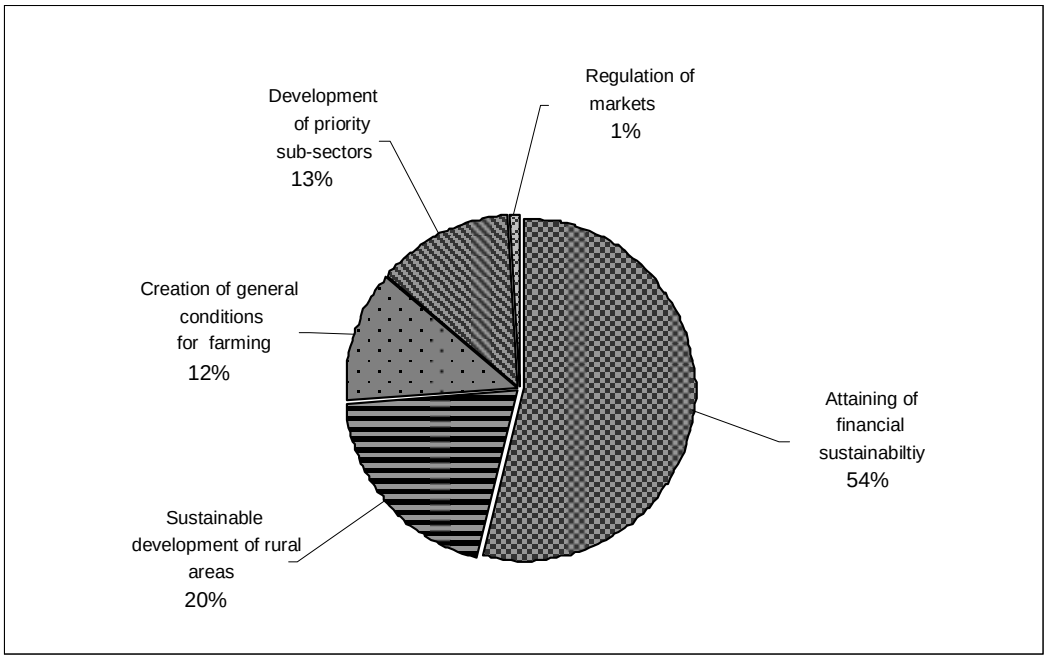


Fig. 64. Share of expenditures by components of the State Program for 2008-2012

[53] Studies show that about 80% of owners sell their land shares in case there is a buyer.

[54] One of the scenarios of taking away: new members enter the entity, shares are concentrated, land title is registered in the name of the entity although documents belong to individuals, land is sold. The technology is widely used in the Moscow region. In Russia at large the share of farmlands owned by agricultural partnerships, companies and cooperatives equals 4.5% of the lands used by them, in the Moscow region – 28%.

Among the Program's targets the first place belongs to the "sustainable development of rural areas, growth of employment and improvement of living standards of rural population". Such a positioning of rural development problems may be regarded as revolutionary for agricultural administrative bodies. The input supply section included in Part "Sustainable development of rural areas" contains no provisions pertaining to the employment rate: funds are envisaged for measures to improve housing conditions, to develop water supply and gasification and to support complex compact construction in rural settlements in the framework of pilot projects. The planned financing of sustainable rural development in the framework of the State Program in 2008 accounts for less than 10% of the total expenditures on its implementation. Though other Parts of the document also contain measures directly pertaining to sustainable development (e.g. consulting support of farm producers) this is rather an exception. The amount of funds for creating non-agricultural employment in rural areas is small (these are subsidies for compensating interest rate on credits and loans taken to develop folk handicrafts, gathering of mushrooms and berries, rural tourism, etc.) although higher employment rate in rural areas is declared to be the Program's main goal.

The most sizable component of the State Program (292.7 billion rubles over 5 years or 54% of the total funds) is the ***attaining of agriculture's financial sustainability***. The envisaged measures include:

- subsidizing of interest rate on short-term and investment credits (loans in credit cooperatives) for agricultural commodity producers of all organizational and legal types;
- improvement of financial sustainability of small entities to be achieved through credit (loan) subsidizing and enlargement of "Rosselkhozbank's" authorized capital;
- technical and technological modernization of agriculture including subsidies for partial compensation of expenditures on interest rate and contribution to the authorized capital of "Rosagroleasing";
- lowering of risks in agriculture, i.e. partial compensation of insurance premiums from the budget funds.

The State Program sets quite ambitious plans for attracting credits to agriculture. To fully benefit from the funds envisaged for subsidizing, farm producers should get credits to the amount of 911 billion rubles over 5 years. Non-program agrifood sector activities require additional credit support of not less than 500 billion rubles, 70% of which should be long-term credits. In 9 months 2008 the amount of credits received by the Russian agrifood sector exceeded the corresponding 2007 indicator by 20 billion rubles and totaled almost 324 billion rubles[55].

The main focus is made on and principal funds are allocated to the subsidizing of interest rate. Studies[56] show that the mechanism of distributing budget funds in the framework of the National Project "Agrifood sector development" (2005-2006) was meant to support primarily large commodity farms and this practice gets continued in the State Program.

The distribution of funds by groups of farms is very uneven: 6% of corporate farms got over 50% of all subsidies and compensations. Farms of this group accounted for 29% of the total receipts and each of them on the average received 12 million rubles of budget funds

[55] Operational information of the RF Ministry of Agriculture.

[56] Uzun V.Ya., Gataulina A.A., Yanbykh R.G. et al. Methods of estimating the efficiency of state support to large and small business in the agrifood sector. All-Russian Institute of Agrarian Problems and Informatics, scientific report. 2008, p.92.

which was almost 89 fold above the average amount received by one farm in the fourth group and 525 fold above respective indicator in the fifth group. It should be also noted that far from all corporate farms of the first group were profitable, i.e. efficient. Of 926 corporate farms of this group 114 had balance losses to the amount of 1.6 billion rubles, i.e. the state actually covered their losses. Others received no subsidies even despite their successful performance.

In 2008 profits of corporate farms grew up to 117.5 billion rubles, i.e. by almost 10 billion rubles or 9% as compared with 2007. The share of profitable farms in the total number of corporate farms (23015) amounted to 82%, i.e. was up 1% as compared with the previous year.

Table 63

Share of corporate farms in the total amounts of subsidies and compensations by groups in 2007, %

Groups of farms by the amount of received subsidies and compensations, thousand rubles	Share in the total number of corporate farms	Share in subsidies	Share in balance profits	Share in receipts	Share in the total number of employed	Share in farmland area
1. Over 5000	5.5	52.5	46.3	28.7	18.0	10.7
2. 4999-1000	20.5	34.8	38.5	32.3	32.2	30.6
3. 999-250	24.9	10.8	12.1	17.1	23.1	26.7
4. 249-50	16.0	1.7	0.9	7.0	10.4	12.9
5. 49-0.1	8.1	0.1	1.3	2.5	3.9	5.3
6. No subsidies received	24.9	0.0	0.9	12.4	12.3	13.8
Total	100.0	100.0	100.0	100.0	100.0	100.0

Source: Uzun V.Ya., Gataulina A.A., Yanbykh R.G. et al. Methods of estimating the efficiency of state support to large and small business in the agrifood sector. All-Russian Institute of Agrarian Problems and Informatics, scientific report. 2008.

The strict co-financing requirements set in the State Program may deprive farm producers in most deficit-budget regions of the federal support. The working out of regional programs and their coordination with the federal State Program should have coincided with amending budgets of the RF constituent members but it didn't happen. Besides, regions should have appraised the real need in funds and planned expenditures basing on these estimates and not only on available limits of federal financing. So, the situation is possible when RF regions won't fully utilize limits under some Program components due to the lacking demand while other components will suffer from a dramatic shortage of federal co-financing funds.

One more broadly advertised component of the State Program was the *facilitation of small-scale farming* that, however, was to receive only 7.9% of the total program funds (43.8 out of 551.3 billion rubles). Besides, one third of these allocations should be used for enlarging the authorized capital of "Rosselkhozbank" [57] (Russian Agricultural Bank). Meantime the financing of such really efficient measures as subventions for the development of material and

[57] The decision to enlarge authorized capital of "Rosselkhozbank" by 33.5 billion rubles taken at the end of 2008 envisages equal amounts to be used for subsidizing interest rate and replenishment of the bank's working capital. The decision is also taken to grant "Rosselkhozbank" subordinated credit to the amount of 25 billion rubles "for overcoming the deficit of credit resources". Besides, at the meeting in Odintsovo district of Moscow region in December 2008 the Prime-Minister V.V.Putin declared the RF Government's intention to allocate additional 45 billion rubles "for the replenishment of working capital" in the nearest time.

technical basis of agricultural cooperatives, replenishment of credit cooperatives' fund of mutual financial assistance, creation of security funds for granting guarantees to small business is not envisaged in the State Program. It should be noted however that about 10% of RF regions have still found funds for additional support to development of small rural business primarily through assisting agricultural cooperation.

The network of agricultural cooperatives continued to develop. According to RF regions' preliminary data, as of January 1, 2009 there were 5100 agricultural consumer cooperatives in the country including 912 processing, 2450 purchase, supply and marketing and 1738 credit cooperatives. According to estimates of the Ministry of Agriculture only 65% of them are actually working. Among credit cooperatives this indicator averages 71.5%, among processing ones – 57%, among purchase, supply and marketing cooperatives – 63.4%. Over the year the number of working cooperatives grew by 1137. Agricultural cooperation is most developed in Volgograd and Tjumen oblasts and Mordovia republic (over 100 stably operating cooperatives in each), republic Sakha (Yakutia) – 205 operating agricultural cooperatives. Also in the framework of the National Project many cooperatives were founded in Belgorod, Orenburg, Rostov, Penza, Irkutsk, Omsk, Chita oblasts, Buryat, Tatarstan, Kalmyk and Chuvash republics, Krasnodar and Krasnoyarsk regions.

According to data of the Ministry of Agriculture in 2007 out of agricultural consumer cooperatives that submitted annual reports 912 were making profit (to the amount of 104 million rubles) and 181 were making losses (to the amount of 11.1 million rubles). By the end of the year there were almost 110 thousand members in the system of agricultural cooperation; they got 76.5 thousand loans (over 60% - household farms).

However, the *system of agricultural consumer cooperation* faces some problems the basic of which are under-capitalization of credit cooperatives and impossibility to get a credit without sufficient mortgage, difficulties with marketing of output and low skills of cooperative managers. Besides, the getting of subsidies is arranged in such a way that it's easier to apply for a credit to "Rosselkhozbank" than to a credit cooperative. This also weakens the system of agricultural cooperation.

The role of small-scale entities is difficult to overestimate since they are often the only employment opportunity for rural residents. For instance, in Kurgan oblast over half of agricultural workers are employed outside corporate farms, over half of farmlands earlier cultivated by corporate farms currently belong to land share owners.

State support to small-scale entities creates favourable conditions for their development: the consolidated budget subsidizes their expenditures on paying interest rate on credits to the amount of 100% of discount rate. Individual private (family) farms have the same rights to state support as corporate farms[58].

Still, the government efforts to support small-scale farming are obviously not sufficient. An overview of support measures financed from the regional budgets shows that the share of funds envisaged for smallholder entities is incomparable with their share in agricultural output. It usually ranges around 1% of the total budget of regional programs for supporting agri-

[58] According to data of RF regions in 2008 the amount of credits and loans received in Russian credit institutions and credit consumer cooperatives for the development of small-scale farming amounted to 48.1 billion rubles while the target annual indicator was 30 billion rubles. So, the actual amount exceeded the target one 1.6 fold. Credits and loans received by small rural entities accounted for 11.3% of the total subsidized credits and loans to agriculture.

culture. Besides, even these funds are not allocated in full. The repayment of small entities' expenditures on interest rate is sometimes dragged out for a year.

A chronically unsettled problem is the inclusion of household farmers in the state insurance system through the simplified procedure of making installments from the declared income or through the system of patents. One more issue to be addressed is VAT paid by processors purchasing output of small farms that are not subject to VAT. The delay results in lower prices received by small entities. Otherwise processors have to increase their expenditures on VAT when selling their output since they cannot reduce them to the amount of VAT included in the cost of purchased agricultural products. One should also adjust the system of accounting for consumer cooperatives and relationships with their members in order to avoid double income taxation.

As of November 10, 2008 the State Program's financing amounted to 88.4% of the limit of allocated funds (*Table 64*).

Table 64

Financing of State Program's components, million rubles

	Limit	Allocations	% of the limit
I. Sustainable development of rural areas	8 135.5	6 047.6	74.3
II. Creation of general conditions for farming	17 892.1	14 257.8	79.7
incl. subsidies for mineral fertilizers	10 300	8 597.8	83.3
III. Development of priority agricultural sub-sectors	15 228.5	12 263.5	80.5
IV. Attaining of agriculture's financial sustainability	77 245.2	71 616.0	92.7
incl. easier access to credits	34 349.8	28 765.1	83.7
V. Regulation of agricultural and food markets	580.0	320.4	55.2
In addition – subsidies for mixed feeds	10 000.0	8 398.0	84.0
TOTAL under the State Program	**118 208.1**	**104 505.3**	**88.4**

Source: Ministry of Agriculture.

In recent months the 2008 State Program's budget got additionally about 60 billion rubles, i.e. was increased by approximately ¾.

In particular, the decision was taken to allocate additional funds to the partial compensation of expenditures on purchase of mineral fertilizers (to the amount of 8 billion rubles) and mixed feeds for pig and poultry production (10 billion rubles) and to the compensation of farm producers' extra expenditures on diesel fuel.

In 2009 the percentage of subsidizing interest rate on credits will grow from 2/3 (66.7%) up to 80% of the Central Bank's discount rate and for livestock entities – up to 100% thereof. The amount of credits to the sector is supposed to reach 866 billion rubles (in 2008 it was over 700 billion rubles)[59]. However, the financial crisis and the expected sequestering of the 2009 budget will surely adjust all the planned indicators downwards.

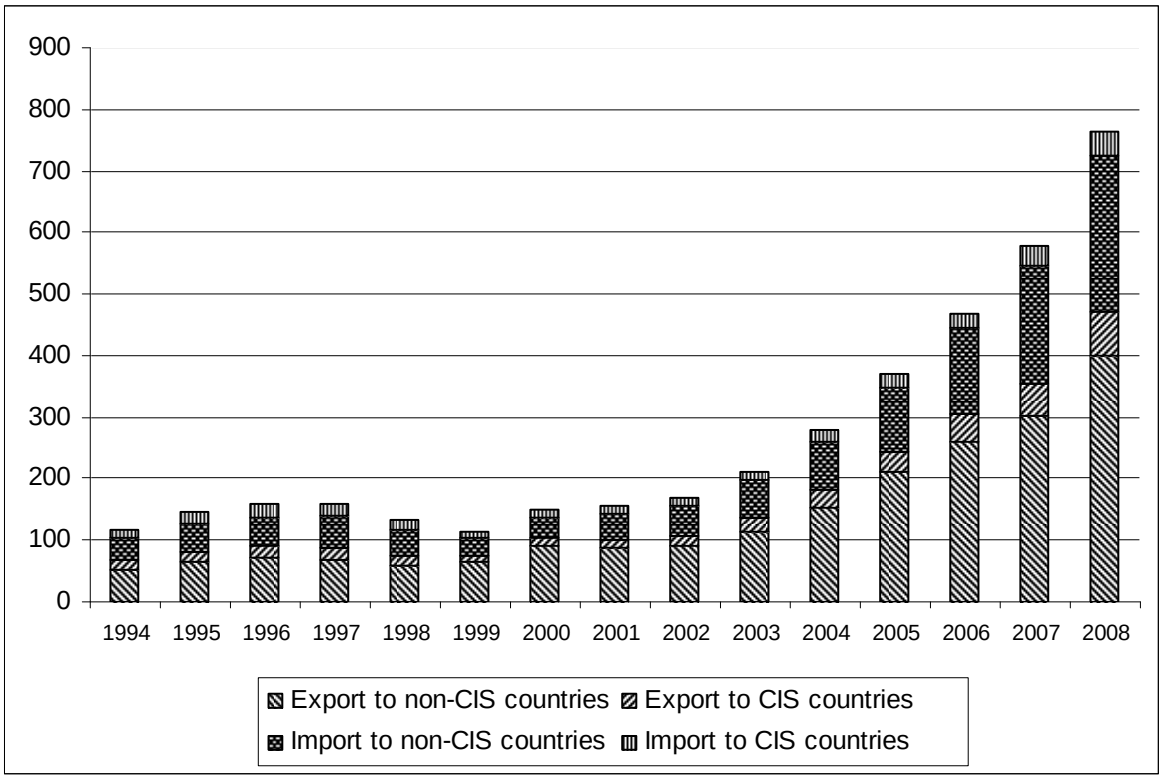
[59] The report of the First Vice-Premier V.Zubkov at the session of RF Government in January 2009.

3.6. Foreign Trade

3.6.1. Foreign Trade Turnover

The formation of the Russian foreign trade in 2008 proceeded under the effect of the following key factors: a considerable price rise for energy resources at the world market in the first eight months of the year and a sharp drop starting in September, slow down of the world industrial production, instability of the international financial flows, which is connected with crisis at the biggest world stock exchanges. The increase in the aggregate internal demand at the beginning of the year stimulated the import expansion, however the ruble depreciation and the decrease in the incomes of the population in recent months have resulted in the considerable reduction of import supplies.

Despite the slow-down of the world economy growth rates and the worsening of the situation at the world market in the second half of 2008 a considerable growth of the main indices allowed to reach high values as a result of the year.



Source: Central Bank of the Russian Federation

Fig. 65. Russian Foreign Trade Turnover (as USD billion)

In 2008 indices characterizing Russia's foreign trade hit 18 year-high values. Russian foreign trade turnover calculated on the basis of the balance-of-payments methodology made USD 763.7 billion, exceeding the figure of 2007 by 32.2% (*Fig. 65*). it should be noted that in the 4th quarter the trade turnover was 4.6% below the corresponding figure of 2007. The export dropped by 10.4% and import went up by only 4.4% versus the 4th quarter 2007.

The share of export in the total amount of the turnover was 61.8% in 2008 (61.4% in 2007), while that of import - 38.2% (38.4%).

Due to the plummeting prices for oil and raw materials in the first 7 months of 2008 there was an anticipating growth of export observed as compared with the import. As a result the foreign trade balance in 2008 made USD 179.8 billion, exceeding by 37.3% as on the prior year. However the decrease of prices in September and the drop of prices for many raw materials and especially for oil in October that followed resulted in the correction of the foreign trade indices. The problem of contraction of the foreign trade balance again becomes acute in 2007 the prospect of the deficit balance looming in the nearest future.

The coefficient of trade balance disequilibrium (ratio of positive trade balance to foreign trade turnover) increased from 22.8% in 2007 to 23.5% in 2008.

3.6.2. Situation on the World Market

In the report of the International Monetary Fund[60] on the state and prospects of the development of the world economy prepared in October 2008 it was noted that in 2008 the world economy entered the period of deep recession, which was caused by sharp worsening of the situation at the world market (the similar recession was noted in 1930ies). In the period from 2004 to the middle of 2007 the world economy was steadily on the rise. The world GDP went up by 5% a year on average (the highest figure since 1970ies), approximately three quarters of this growth were accounted for by the countries with the developing economy and countries with the transitional economy. The level of inflation remained comparatively low, though there was a trend for its increase observed.

In 2007 the world market was unfavorably influenced by the deepening crisis at the world financial market, downward trend at the housing market of many developed countries as well as plummeting prices for raw materials. The first evidence of the financial crisis evolved in August 2007 and by September 2008 the crisis had entered into a new stage characterized by sharp loss of creditability in financial institutions and markets. The growing apprehensiveness concerning the worsening of the situation at the financial market resulted in a number of bankruptcies, as well as merges of financial companies and the state intervention in the USA and Western European countries, which has led to a considerable change in the structure of the financial sector.

Negative trends at the financial market resulted in a considerable slow-down of the growth of the world economy. In the period from the 4th quarter 2007 to the 2nd quarter 2008 the GDP growth rates were on average only 1% whereas in the 1st-3rd quarter of 2007 they made 2.5%. It was the USA economy where the first evidence of recession appeared, however the slackening of the financial policy conducted by the Federal Reserve System of the USA as well as the packet of measures adopted by the American Government as well as the steady growth of export against the background of dollar slackening allowed to alleviate a negative effect of the financial crisis, but the growth rates of the American economy starting with the 4th quarter 2007 on average did not exceed 1.25%.

In 2008 the GDP of the USA went up by 1.3%, which is the lowest figure since 2001, when it was connected with the terroristic attacks in New York and other cities of the USA. It

[60] http://www.imf.org/external/russian/index.htm

should be noted that in the 4th quarter 2008 the GDP of the USD dropped by 3.8%. This is the lowest figure since 1982, which was the time the American economy suffered deep recession.

The business activity in the countries of Western Europe has slowed down considerably, which is due to a downward tendency on the housing market of a number of countries, stagnant economic situation in the USA and the appreciation of the euro exchange rate. According to the report of the European committee published in January 2009[61], the GDP of Eurozone increased only by 0.1% in 2008. At the same time the European Committee is forecasting that in 2009 the GDP of the Eurozone will drop by 1.9%, this being the first time the economy has fallen as a result of the year after the Euro was introduced in 1999. It is also mentioned in the report that the recession in the Eurozone started in the second quarter of 2008, when the GDP of the region dropped by 0.2% as compared with the previous quarter. In the fourth quarter the drop aggravated to 1.5%.

In 208 the economy of Japan officially entered the period of recession the GDP of the country having decreased by 3.0% and 0.5% in the second and the third quarter of the year, correspondingly. At the same time the volume of the GDP in Japan dropped by 12.1% at once in the fourth quarter, which has been the most dramatic fall since the first quarter of 1974 (then the GDP volume dropped by 13.1%). Earlier it had been expected that the GDP of Japan was to fall by 4.1% in the fourth quarter in year terms.

The developing countries and countries with transitional economy also were not able to avoid the economic recession. Average rates of GDP increase in them lowered from 8% in the first-third quarters of 2007 to 7.5% in the fourth quarter of 2007- 2nd quarter of 2008, the growth of net export and internal demand slowing down. The slow-down of the economic development was most considerable in the countries that have close trading relations with the USA and Western Europeans countries. The countries whose deficits of balance-of-payments are financed at the expense of the inflow of the foreign investments, which has reduced considerably due to the crisis, have also been hard hit.

During last months of 2008 the world volume of production and trade contracted considerably. The continuation of the financial crisis connected with the political elite being unable to eliminate uncertainty resulted in a dramatic decrease in price of assets in all the countries with the developed economy and the countries with the market in process of formation, which led to the decrease in the well-fare of the population, and, thus the contraction of the consumers' demand. Besides, the negative expectations of the population made the people to postpone the expenditure, decreasing the demand for the consumer and investment goods even further.

In January 2009 the International monetary fund reduced the forecast for the growth of the world economy in 2009[62] by 1.7 per cent versus its latest forecast published in November 2008 – from 2.2% to 0.5% (*Table 65*). According to the report of the International Monetary Fund, the growth of the economy this year will be the lowest since the Second World War. Despite the efforts of the Government of different countries, the paralytic situation in the financing and banking system cannot be overcome, which inevitably results in the slow-down of the development of the real sector of economy. In this connection, the IMF suggests devising new measures, which will enable clearing the market from the helpless institutions and non-liquid assets and reanimate the financial flows.

[61] http://ec.europa.eu/news/economy/
[62] http://www.imf.org/external/russian/pubs/ft/weo/2009/update/01/pdf/0109r.pdf

According o the new version of the forecast the economies in nearly all the developed countries will reduce on average by 1.5-2.5% in 2009. Thus, the decrease in the GDP in the USA will make 1.6% as a result of the year, in Japan – 2.6%, in the UK – 2.8%. The GDP of Eurozone countries will drop by 2.0%. The smallest fall is forecast for Canada, where the reduction of the GDP will make only 1.2%.

As to the developing markets, they did not live up to the hopes of the economists regarding them as a force able to lead the world economy out of the recession, For instance, the forecast for the GDP in China for 2009 was corrected by 1.8 per cent down to the growth of 6.7%, and in India – by 1.2 per cent, down to 5.1%.

The IMF has also reduced the forecast for the growth of the Russian economy in 2009 by 4.2% as compared with its latest forecast published in November 2008. Now the fund expects that this year not only the GDP will not increase by 3.5%, but in contrast it will decrease by 0.7%. Moreover, the authors hold that the increase in the Russian economy by 2010 will make only 1.3% (instead of the growth of 4.5% that was forecast before).

The forecast for the economies of the CIS countries for 2009 was also reconsidered: from the growth of the total GDP by 3.2% to the decrease of the index by 0.4 per cent. It should be noted that the CIS countries will return to the growth by 2010, though it is now forecast to be at the level of 2.2% (not 4.5%).

Table 65

Dynamics of Global Gross Product and World Trade
(as percentage to the previous year)

	2004	2005	2006	2007	2008 [1)]	2009 [2)]	2010[2)]
GDP							
World, total	105.3	103.4	105.1	105.2	103.4	100.5	103.0
Industrially developed countries	103.2	102.6	103.0	102.7	101.0	98.0	101.1
USA	103.9	103.1	102.8	102.0	101.1	98.4	101.6
Countries of Eurozone	102.1	101.5	102.8	102.6	101.0	98.0	100.2
Japan	102.3	101.9	102.4	102.4	99.7	97.4	100.6
Other developed countries	104.6	103.9	104.5	104.6	101.9	97.6	102.2
Developing countries and countries with transitional economy	107.7	106.8	107.9	108.3	106.3	103.3	105.0
Countries of Central and Eastern Europe	106.5	105.6	106.7	105.4	103.2	99.6	102.5
CIS countries	108.4	106.6	108.2	108.6	106.0	99.6	102.2
Russia	107.2	106.4	107.4	108.6	106.2	99.3	101.3
Asian countries	108.8	109.2	109.9	110.6	107.8	105.5	106.9
China	10.1	110.4	111.6	113.0	109.0	106.7	108.0
World trade with goods and services	110.6	107.5	109.2	107.2	104.1	97.2	103.2
Import							
Industrially developed countries	109.1	106.1	107.5	104.5	101.5	96.9	101.9
Developing countries and countries with transitional economy	116.4	112.1	114.7	114.5	110.4	97.8	105.8
Export							
Industrially developed countries	108.8	105.8	108.4	105.9	103.1	96.3	102.1
Developing countries and countries with transitional economy	14.6	111.1	111.0	109.6	105.6	99.2	105.4

[1)] Estimation [2)] Forecast
Source: http://www.imf.org/external/russian/pubs/ft/weo/2009

According to the forecasts of the WTO the volume of the international trade will reduce by more than 2.1% in 2009, whereas in 2008 there was a growth of 6.2% registered. The number of antidumping investigations increased by 40% as compared with the corresponding figure of 2007. For the first time limitations of foreign trade introduced in order to fight the recession may in fact complicate finding the way out of the crisis for the world economy.

3.6.3. Situation at World Market

On the whole in 2008 the situation with prices for the main goods of the Russian export was favorable despite a drop of prices for oil and many other raw materials in the 3rd and the 4th quarters (*Table 66*).

Throughout 2005-2007 there was a plummeting growth of prices for oil observed. At the beginning of 2008 the situation at the oil market was highly optimistic: prices for American stocks started to decrease at quite high rates, dollar continued weakening, developing markets also did not seem stable in case the world financial crisis had aggravated. Under such conditions the investors preferred placing funds in the instruments they understood best, namely, oil and gold.

As a result of high demand for energy carriers not only from the main consumers but also from the investors in March 2008 world prices for oil exceeded USD 100 per barrel.

The ascending accelerated when on May 2, 2008 the prices starting with the level of USD 110.5 per barrel went up to USD 125.5 per barrel in seven trading sessions. There was a number of factors that caused such increase. A bi oil company, Shell, had to additionally reduce the production in connection with the military campaign in Nigeria. Besides, the growing tension between Iran and Western countries also contributed into the increase in oil prices. The traders purchased oil more actively, expecting Iran to reduce its supplies.

On June 5, 2008 oil quotations rose from USD 121.75 to USD 137.5 per barrel. The renewal of the growth was caused by the proceeding weakening of US dollar, as well as by the aggravation of the situation with Iran. This was an incentive for aggressive purchase of oil. As a result of the growth that followed, on July 11, 2008 the price of oil grade Brent reached the unexampled maximum of USD 147.11 per barrel.

As a result of the decrease in consumption in the USA and the expectations of the Saudi Arabia increasing oil production over the period from July 15 to July 18 oil grade Brent became cheaper by more than 10%.

In the second half of 2008 a cautious growth of prices was observed only for a few times. On September 23, 2008 the long-lasting decreasing surge started, which brought the quotations back to the level of the beginning of 2005. The reasons for the drop for prices were the apprehensions connected with the world demand for oil, as well as the refusal of the investment funds to use borrowed funds. The participants of the market started to sell all the assets they had to get liquidity. Further drop was more of a collapse and up to the present has been defined by a number of the same factors: decrease in the real demand for oil from the USA and the developing countries, apprehensions about the slow-down of the world economy and further decrease in consumption.

This year the highest price for oil grade Urals was registered on July 11, being USD 139.87 per barrel, which was a new record-breaking level. The lowest price was observed on December 5, being USD 34.88 per barrel.

Following the oil, oil products started to go down in price as well. Petrol and diesel fuel cheapened by 4-6% on average in the 3rd quarter. Prices for natural gas, furnace fuel (mazut) and coal continued to grow (becoming, correspondingly, 17.9, 12.8 and 17.4% more expensive than in the 2nd quarter).

In the 1st quarter 2008 at the markets of metals a moderate increase in the quotations was observed against the background of natural disasters (floods, earthquake in China), strikes becoming more frequent (Chile, Peru), moderate growth of the demand for metals, weakening

of the dollar and growing price for oil. All these factors supported the balance of the demand and supply of metals and forced the prices to grow.

In the 2nd quarter 2008 in connection with the increase of the influence of the contraction of the demand from the OECD countries on the market, the prices for basic metals started to decrease. Economic recession in the USA and at the key European markets connected with the collapse in the real estate sector had a negative influence on the demand for basic metals.

In the second half of 2008 the decrease in prices for metals was caused not only by the reduction of the demand but also by the strengthening of dollar, development of crisis phenomena, provoking the start of the recession in the developed and developing countries, and by the slump in the industrial sector. The stagnation in the economy of China, which is the main consumer of non-ferrous metals, and problems in the motor-vehicle industry of the USA and Europe had the biggest impact on the metal quotations.

In 2008 aluminum dropped in price by nearly 40% - from USD 2445.5 per ton (average monthly price in January) to USD 1490.4 per ton (average monthly price in December). At the beginning of July there was a sharp plummeting of the prices for aluminum observed, provoked by the decision of 20 leading producers of aluminum in China to reduce the output of the metal by 5-10% because of the shortages with the electric power. However in August 2008 against the background of the decrease in the demand for metal from the construction companies and motor-vehicles producing concerns there began a decrease in prices for aluminum.

In 2008 world prices for copper decreased by 43.5% - from USD 7061 per ton at the beginning of the year to USD 3071.98 per ton in December. Despite the fact that prices for oil demonstrated the increase in the first half of 2008, even then there were conditions created for the drop of quotations. As long ago as March the International Copper Study Group reported on the existing excesses of metal at the market of 17 thousand of tons, and on the total excess of 19 thousand of tons in the 1st quarter 2008 versus the deficit of 80 thousand of tons in 2007. At the same time in the middle of 2008 the quotations at the market of copper were supported by a large number of strikes, interruptions of the production, floods and terroristic attacks. The financial crisis that broke out provoked the drop in demand for copper and in copper quotations.

Over past few years the prices for nickel grew steadily. In 2007 the price for a ton of the metal reached the unexampled record value of USD 51650 per ton. However over the whole 2008 the prices for nickel kept decreasing due to the growth of excesses of the metal at the world market. On July 23 the price for nickel dropped below the level of USD 20000 per ton. On the whole over the year the decrease was equal to 35% - from USD 27689.5 per ton in January 2008 to USD 9686.43 per ton in December.

Prices for other raw materials of the Russian export (excluding wood and timber) were considerably higher than in January-September 2007.

In October the index of 19 major raw materials by Reuters/Jefferies CRB dropped by 53% from the peak in July due to the apprehensions that the world recession would undermine the demand for raw materials. Up to that moment, over the period from 2001 to December 31, 2007 the index nearly doubled its value. The rate at which the price for oil decreased was record-breaking, and prices for copper and gold decreased at the rates that were maximal for the past two decades.

Table 66

Average Annual Prices

	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
Oil (Brent), USD/barrel	14.1	15.9	28.19	24.843	25.022	28.83	37.4	54.38	65.15	72.32	99.53
Natural gas, USD/1 mln BTU	2.5469	2.1876	4.3442	3.9764	3.3857	5.461	5.993	8.870	12.2	7.27	9.103
Petroleum, USD/gallon	0.511	0.529	0.887	0.7922	0.755	0.891	1.197	1.508	1.81	2.06	2.703
Copper, USD/ton	1775.3	1539.9	1863.9	1613.6	1592.9	1785.6	2808.2	3606	6851	7119	6970
Aluminum, USD/ton	1413.5	1318.0	1550.0	1444.7	1350.7	1424.7	1693.2	1871	2619	2639	2576
Nickel, USD/ton	5352.5	5239.5	8624.0	5966.0	6175.1	9580.8	13757	14692	22038	37230	21108

Source: calculated on the basis of London Metal Exchange, Intercontinental Oil Exchange (London)

Prices for the main kinds of foodstuffs imported by Russia had a diverse dynamics at the world markets. Prices for crops, vegetable oils and animal fats decrease, those for meat and sugar – increased.

After a sharp increase in world prices for wheat, observed from June 2007 to March 2008, in April the trend for the decrease in prices prevailed, which was connected with the expectations of big harvest and was strengthened in the 3rd quarter by the situation in the world economy. As compared with the previous quarter in the 3rd quarter 2008 the American wheat became 8.3% cheaper, and Canadian wheat – 19.4% cheaper. Prices for corn and barley under the influence of the remaining high demand for these crops (including in the production of biofuel) continued to increase throughout all the first half of 2008.

However in the 3rd quarter the trend for the decrease of prices appeared at these markets as well: con started to go down in price in July, and barley – in August. As compared with the 2nd quarter of 2008 the prices for American corn decreased by 5.5% , and the prices for Canadian barley – by 9.4%. However despite the decrease the prices for crops in January-September 2008 were considerably higher than in the corresponding period of the previous year: American wheat went up in price by 58.5% (by 21.4% in January-September 2007 as compared with January-September 2006), Canadian wheat – by 90.1% (by 23.1%), American corn – by 49.5% (46.0%), Canadian barley – by 36.0% (54.1%). A sharp acceleration of growth of prices for rice in the 2nd quarter (by 1.8 times versus the preceding quarter) was caused by low harvest, decrease in stocks, restrictions for export by some countries and evolving deficit at the world market of rice. The expectations of good harvest and the general trend for the decrease in prices at the markets of raw materials contributed in the decrease in prices for rice as well (it cheapened by 17.8% in the 3rd quarter).

As a result o nine months of 2008 the price for rice was 2.1 times higher than in the corresponding period of the previous year (by 4.7% in January-September 2007 as compared with January-September 2006).

The increase in prices for energy and for fodder as well as the enhancement of the world demand resulted in the growth of prices for meat. At the same time the expectations of good harvests of crops, decrease in prices for fuel and energy, slow-down of demand growth rates connected with the unfavorable situation in the economy of the leading countries, decrease of the world prices at the majority of the trading markets affected the dynamics of prices at the meat markets as well: beef started cheapening in August, pork and poultry – in September

2008. However as a result of the 3rd quarter of the previous year, as compared with the preceding quarter beef went up in price by 11.9%, pork – by 8.7%, poultry – by 5.4%. In January-September 2008 versus the corresponding period of the previous year the prices for beef went up by 26.3% (by 3.75 in January-September 2007 as compared with January-September 2006), prices for pork – by 0.3% (by 4.3%), prices for poultry – by 7.0% (13.1%).

After a considerable growth of prices at the world market of milk and dairy products in 2007, from the beginning of 2008 the prices at this market generally decreased, mainly due to the increase of these goods supplies to the world market.

As a result in the 3rd quarter the average contract import price for milk decreased by 6.1% as compared with the preceding quarter. In January-September 2008 the average contract price for milk import in Russia went up by 12.8% as compared with the corresponding period of the previous year (by 47.8% in January-September 2008).

In the 2nd and 3rd quarters of 2008 the growth of prices for butter slowed down and made 4.2 and 0.4%, correspondingly (as compared with 27-28% in two preceding quarters). In January-September 2008 the butter at the world market was 1.9 times more expensive than in January-September of the previous year (by 8.7% in January-September 2007).

The growth of prices for sunflower seed oil in the first half of 2008 took place under the influence of the reduction in its production in two preceding agriculture years as well as the sharp decrease in its export from Argentina and Ukraine. In the 3rd quarter the trend for the lowering of prices for oil outlined: as compared with the preceding quarter the prices for it decreased by 29.4%. However the level of prices for vegetable oils at the world market remained high in January-September 2008: as compared with the corresponding period of 2007 the sunflower seed oil was 1.9 times more expensive (by 1.4 times in January-September 2007).

At the world market of sugar the trend for the growth of prices was observed in January-September 2008. The steady growth of demand for sugar against the background of the reduction of its production in India and Europe in the first place, resulted in the decrease of its export and the contraction of the world stocks of sugar. In the 3rd quarter prices started to grow at higher rates and as compared with the preceding quarter: raw sugar went up in price by 13.9%, white sugar – by 13.4% (in the 2nd quarter went down in price by 11.0 and 1.4%, correspondingly). As a result of nine months of 2008 as compared with the same period of 2007 prices for raw sugar went up by 16.8%, for white sugar – by 13.6% (in January-September 2007 sugar cheapened by 40.7and 34.0%, correspondingly).

Table 67

Dynamics of Average World Prices for Some Agriculture Goods

	2005	2006	2007	2008			
				August	September	October	November
Wheat, USD/ton							
Canadian, CWRS	197.6	216.8	300.4	400.8	369.1	316.4	324.7
American, HRW	152.4	192.0	255.2	329.3	295.6	237.4	226.8
American, SRW	135.7	159.0	159.0	255.4	223.8	185.9	183.0
Corn American, USD/ton	98.7	122.0	163.0	235.0	233.8	183.1	163.8
Barley, USD/kilo	95.0	117.0	172.0	212.3	189.5	143.4	130.1
Soybeans, USD/kilo	274.4	268.4	384.0	556.0	509.0	394.0	379.0
Soy oil, USD/ton	545.1	598.6	881.0	1322.0	1226.0	928.0	813.0

Source: World Bank.

3.6.4. Dynamics of Main Russian Indices of Foreign Trade

Export

In 2008 value volume of export increased by 33.1%, in 2004 the figure reached 34.8%, in 2005 – 33.1%, in 2006 – 24.5%, in 2007 – 16.8%. The basis for the high rates of export growth was the extremely favorable dynamics of world prices for oil and other energy carriers in the first half of the year. In 2008 export increased due to the growth of prices despite the decrease of physical volumes (*Table 68*).

Table 68

Dynamics of Russian Export

	2000	2001	2002	2003	2004	2005	2006	2007	2008
Export, USD billion	105.0	101.9	107.2	135.4	183.2	245.3	303.9	355.2	471.8
Including:									
non-CIS countries	90.8	86.6	91.0	113.9	152.9	211.6	260.6	301.5	400.7
Growth rates, as % to the previous year									
Index of physical volume	110.2	104.2	115.0	109.5	110.7	104.7	105.8	105.0	96.8
Price index	128.2	93.8	86.0	113.4	122.7	126.9	119.7	110.9	137.4

Source: Central Bank of Russian Federation, Ministry for Economic Development

In 2008 monthly dynamics of export demonstrates that the increase in export volumes occurred mainly in the first half of the year: from USD 34.5 billion in January to USD 47.8 billion in July. However, starting with August in connection with the worsening of the foreign economic situation at the world trading markets and the decrease in the world prices for oil and oil products, value volumes of the Russian export decreased from USD 45.6 billion in August to USD 38.9 billion in October, USD 30.1 billion in November and USD 26.3 billion in December 2008.

At the same time the main positions of the goods hardly changed. The first place is still occupied by the export of goods of fuels and energy complex, whose share increased by 4.4 per cent as on the level of 2007 (*Fig. 66* and *67*).

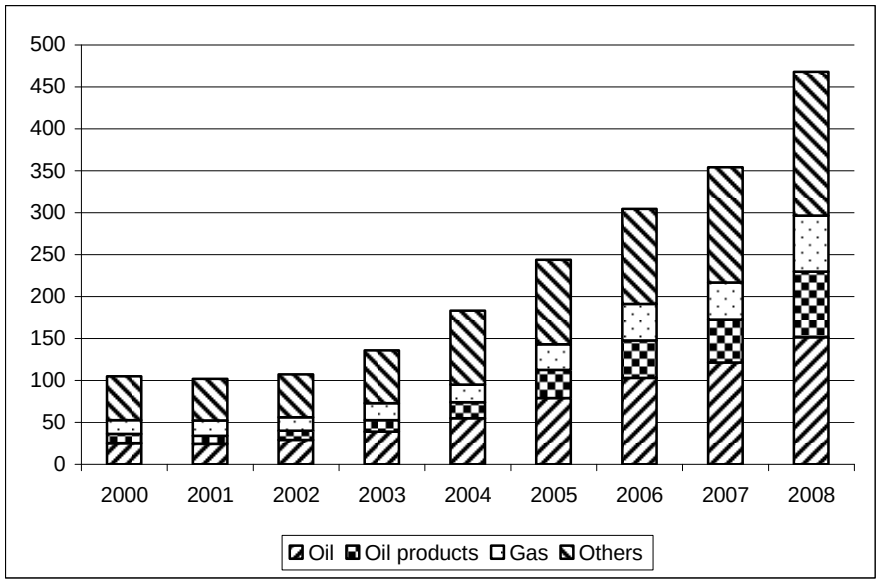


Fig. 66. Russian Export (as USD billion)

The expansion of the proportion of fuel and energy commodities in the total volume of the Russian export (*Table 69*) was primarily defined by the growth of prices for oil by 1.4 times, the physical volumes of export reducing by 7%, and the export of oil products and natural gas increasing considerably both due to the increase in contract prices by 1.46 times and 1.53 times and due to the increase in physical volumes of supplies by 3.6% and 1.72%, correspondingly.

Table 69

Value Volumes of Russian Export of Oil, Oil Products and Gas (as USD million) and Their Share in Total Volume of Russian Export (as percentage)

	Oil		Oil products		Gas	
	as USD million	%	as USD million	%	as USD million	%
1992	6662	12.4	2202	4.1	6389	11.9
1993	8061	13.5	3061	5.1	6964	11.7
1994	8948	13.3	3398	5.0	7939	11.8
1995	12297	15.2	4108	5.1	13381	16.5
1996	15578	17.6	7442	8.4	14683	16.6
1997	14346	16.2	7145	8.1	16420	18.6
1998	10254	13.7	4262	5.7	…	…
1999	14101	18.8	4713	6.3	…	…
2000	25284	24.1	10938	10.6	16644	16.1
2001	24576	24.1	9402	9.4	18303	18.3
2002	28950	27.0	11227	10.5	15897	14.9
2003	38816	28.6	14064	10.5	19981	15.0
2004	55024	30.0	18998	10.5	20918	11.5
2005	79216	32.5	33650	13.6	30424.2	12.9
2006	96675	31.7	44217	14.5	42815	14.1
2007	114145.2	32.4	51470.4	14.6	42755.1	12.1
2008	151668.6	32.4	78 325	16.7	66 399.7	14.2

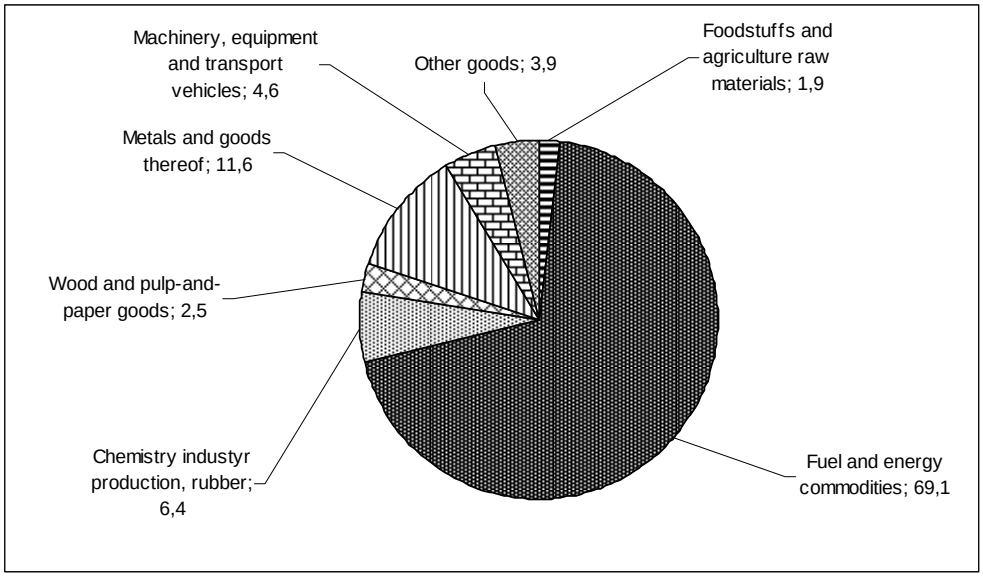
Source: Federal State Statistics Service data, Federal Customs Service data for 2008

The share of metals and goods thereof in the structure of the Russian export reduced considerably due to the fact that the export of this group of commodities grew at slower rates (111.7%) than the export in general (133%). The growth of the total value of metal and metallic goods supplies was mainly connected with the increase in the value volume of the ferrous metals export.

As compared with 2007 the increase in export of chemistry industry goods was substantially affected by the growth of prices for the largest group of goods, namely, fertilizers. As a result the value volume of the export of chemistry industry production increased by 45.5%.

Timber and pulp-and-paper goods export lowered by 5.7%, export of unprocessed and processed wood decreasing, correspondingly, by 15.6% and 13% due to the reduction in the physical volumes of supplies.

Export of machinery, equipment and transport vehicles went up in terms of value by 17% in 2008 as compared with 2007. Despite the increase in the export of some kinds of machine-building production, its share in the total volume of Russia's export continued to decrease.



Source: Federal Customs Service of the Russian Federation

Fig. 67 Structure of Russian Export by Kinds of Commodities in 2008 (as percentage)

Favorable situation at the world market in the first half of 2008 secures a considerable growth in contract prices for the main goods of the Russian export (*table 70*).

Table 70

Average Contract Prices for Main Goods of Russian Export (supplies to non-CIS countries, as USD per ton)

	2000	2001	2002	2003	2004	2005	2006	2007	2008
Crude oil	179.9	156.4	162.4	181.2	231.9	344.3	429.8	485.4	684.3
Oil products	171.9	145.2	147.9	180.2	230.3	340.6	430.1	464.1	678.7
Natural gas, thousand of cu. m	85.91	105.21	91.4	112.3	113.6	154.7	–	240.6	381.0
Ammonia	97.5	81.7	72.4	118.5	158.3	176.2	195.7	224.2	456.5
Nitrogenous fertilized	57.9	61.8	60.6	76.0	103.1	139.1	146.0	197.3	352.9
Potassium fertilizer	86.6	76.8	74.9	77.8	94.3	133.9	150.3	174.5	447.0
Roundwood, cu m	43.4	45.6	44.8	47.8	56.2	59.6	63.8	84.0	95.1
Pulp	352.2	293.4	300.0	321.7	371.9	386.1	436.7	545.6	569.8
Newsprint	386.6	421.7	332.2	338.3	387.9	455.3	498.6	527.0	599.2
Cast iron	80.7	86.2	91.1	126.8	242.7	274.4	244.4	313.6	483.6
Ferrous alloys	625.6	601.7	625.7	634.6	1097.8	1582.5	1492.3	1673.2	2487.2
Copper	1675	1465.3	1371.4	1564.9	2587.6	3389.8	6361.7	6657.8	6086.6
Nickel	8629	5730.9	6143.9	8584.0	12660.0	14242.5	22674.4	33852.1	19615.8
Aluminum	1296	1176.3	1036.9	1050.0	1162.1	1299.2	1633.5	1984.0	2178.1

Source: Federal Customs Service

However the decrease of prices at the world markets of fuel and raw materials affects the dynamics of the Russian export stronger and stronger. Whereas in August last year the decrease of prices was characteristic only for oil among the main goods of the Russian export, in September 2008 the decrease of prices affected a larger number of goods. Thus, according to the data of customs statistics, besides the decrease in export prices for oil by 13.2% in September on August, the decrease of prices was observed for oil products – by 9.8%, for natural gas – by 10.8%, for copper – by 9.4%, for aluminum – by 1.2%, for unprocessed wood – by 3%, for processed wood – by 3.6%, for ferrous metals – by 8.4%. In last months of 2008 the rates of decrease of contract prices for oil, oil products, non-ferrous metals accelerated.

The steady orientation of the export at non-CIS countries persists, their share in the total volume of Russia's export increasing from 84.7% in 2007 to 85% in 2008.

Import

Import of goods was characterized by a considerable growth, reaching in 2008 USD 291.97 billion, which is by 30.6% higher than the level of 2007. However whereas in the 1st-3rd quarters the growth versus the corresponding quarter of the preceding year made more than 40%, in the 4th quarter it was only 4.4% (*Table 71*).

In 2008 in the monthly dynamics of the Russian import there was an increase in terms of value observed from USD 15.6 billion in January to USD 29 billion in July. In August-October the value volumes of Russian import remained at practically the same level and were equal to approximately USD 27 billion. In November the value of the import goods reduced considerably and made USD 21.7 billion, in December – USD 23.9 billion, which is, correspondingly, 20.1% and 11.9% below the figures of October. Such dynamics was a consequence of the contraction of the investment and consumer demand as a result of credit crisis. Starting with November the biggest banks practically stopped issuing consumer credits and the volume of credits in the real sector increased but negligibly.

Table 71

Russian Import (as USD billion)

		2000	2001	2002	2003	2004	2005	2006	2007	2008
Import, total		44,9	53,8	60,5	76,1	97,4	125,3	163,9	223,1	291,97
Including:										
non-CIS countries		31,4	40,3	48,2	60,1	76,4	103,5	138,6	191,2	253,1
Growth rates, as % to the previous year										
Index of physical volume	84,4	129,2	129,1	117,6	119,2	124,2	122,4	130,1	127,1	113,5
Price index	82,1	86,7	94,3	93,4	98,7	106,1	106,5	105,5	107,6	117,8

Source: Central Bank of the Russian Federation, Ministry for Economic Development

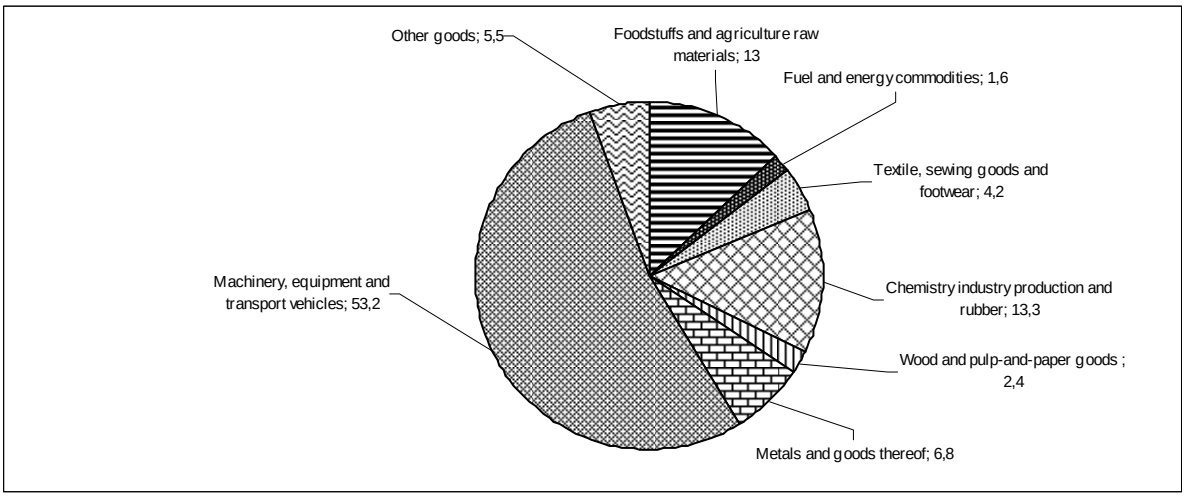
Physical volumes of supplies from decreased by 2.3%, the prices growing by 25.5%. Import from non-CIS countries increase at the expense of both the physical volume, and the prices by, correspondingly, 16.2% and 16.6%.

High import growth rates were accounted for mainly by the increase in machinery, equipment and transport vehicles import by 38.4%. The proportion of the goods of this group in the structure of the Russian import increase by 1.8 per cent in 2008. import of passenger cars and trucks went up by 41.8% and 39.5% in terms of value and by 24.7% and 10.5% in terms of physical volume, correspondingly. (*Fig. 68*).

As compared with 2007, in 2008 value volume of foodstuffs and agriculture raw materials import increased by 27.35 and mainly due to the increase in contract prices for the main kinds of foodstuffs. The value of import of fresh and frozen meat, poultry, cheese, curd, crops, butter, and sunflower seed oil increased to the highest extent. The value of import of wheat, wheat and rye mixture, barley, raw sugar and white sugar decreased.

The value indices for import of textile, textile goods and footwear increased by 34.9%. The supplies of leather clothes and footwear rose at especially high rates, their value volume growing by 1.5 and 1.3 times, correspondingly.

Import of the goods of chemistry industry increased in value by 27.4%. To a significant extent the growth was accounted for by the increase in medications supplies.



Source: Federal Customs Service of the Russian Federation

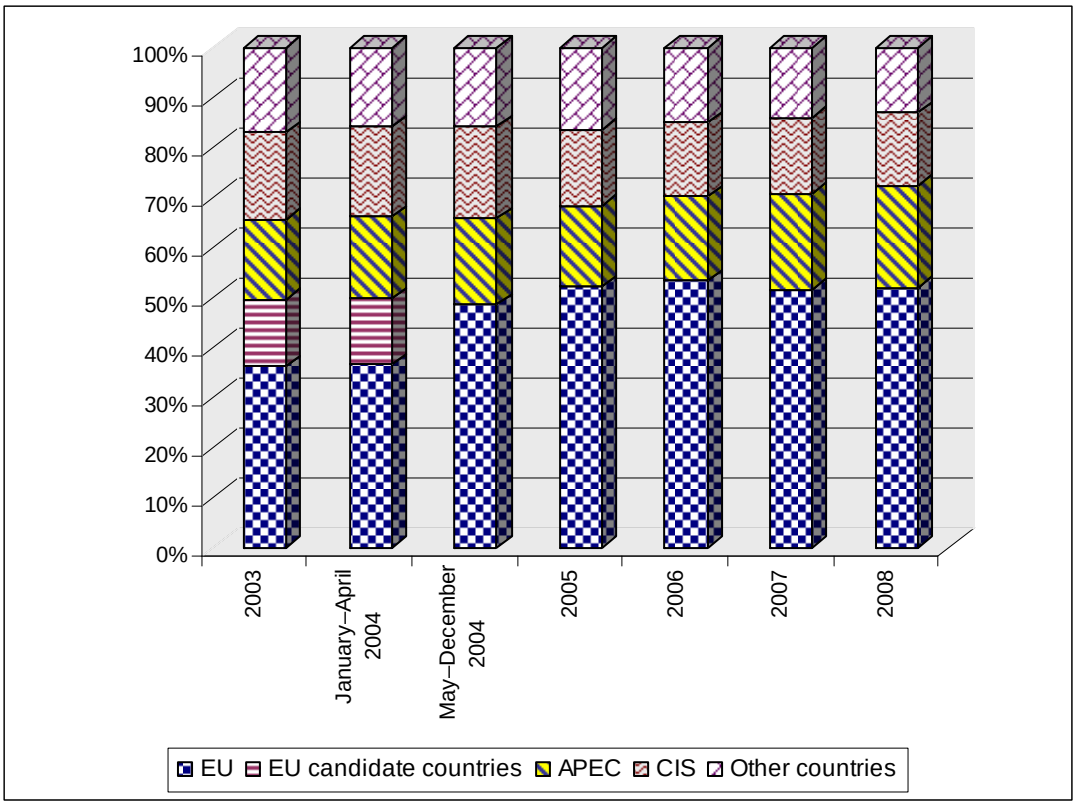
Fig. 68. Structure of Russian Import by Goods in 2008 (as percentage)

3.6.5. Geographic Structure of Foreign Trade

In 2008 the share of the EU in the structure of Russia's foreign trade turnover enhanced by 0.7 per cent. It is still Germany that remained the main trading partner of Russia, though its share decreased by 0.4 per cent down to 9.2%. The second place by the volume of the foreign trade turnover is occupied by the Netherlands, whose share decreased by 0.1 per cent and was equal to 8.4%. Italy was the third by the volume of the foreign trade with Russian among the countries of the European Union, its share being 7.2%, having increased by 0.2 per cent as compared with 2007. On the whole, in 2008 the countries of the European Union enhanced the volume of trade with Russia by 35% as compared with 2007, the volume of the Russian export growing by 35.6%, and import – by 33.6%.

The share of the countries of Asia-Pacific economic cooperation in the Russia's foreign trade turnover increased from 19.3% to 20.4%. The growth of import was 39.8% and of export – 40.9% as compared with 2007. The main Russia's trading partner in this group is China, whose share in the foreign trade turnover went up by 0.3 per cent, reaching 7.6%. the second place in this group is still occupied by the USA, whose share increased from 3.2% to 3.7% of the total Russia's foreign trade turnover. The share of Japan increased by 0.2 per cent and was equal to 3.95 as a result of the year.

The share of CIS countries in the Russia's foreign trade turnover reduced from 15.2% to 14.5%. The main trading partners in this group are Ukraine and Belorussia, whose shares are 5.4% and 4.7%, correspondingly. On the whole Russia's foreign trade turnover with the countries of this group increased by 29% as compared with 2007, import increasing by 22.5%, export – by 32.7% (*Fig. 69*).



Source: Federal Customs Service of the Russian Federation

Fig. 69. Geographic Structure of Russia's Foreign Trade

The trade balance with all the groups of countries, excluding APEC, is positive.

In 2008 Russia had negative trade balance with 24 countries, whose share in the total Russia's foreign trade turnover was 32.9%. It was China (-13.6 USD billion), Japan (-8.1 USD billion), Korea (-2.7 USD billion), Brazil (-2.6 USD billion), Malaysia (-1.5 USD billion) that made the most considerable contribution to the formation of the negative trade balance.

Among non-CIS countries it was Germany, the trade turnover with which was USD 67.3 billion (127,2% on 2007), the Netherlands – USD 61.8 billion (132.3%), China – 55.9 billion (138.6%), Italy – 52.9 billion (146.7%), Turkey – USD 33.8 billion (149.0%), Japan – 29.0 billion (142.4%), the USA – USD 27.3 billion (153.2%), Poland – USD 27.2 billion (151.8%), the UK – 22.5 billion (134.8%), Finland – USD 22.4 billion (142.1%) that were the main trading partners of the Russian Federation (*Fig. 70*).

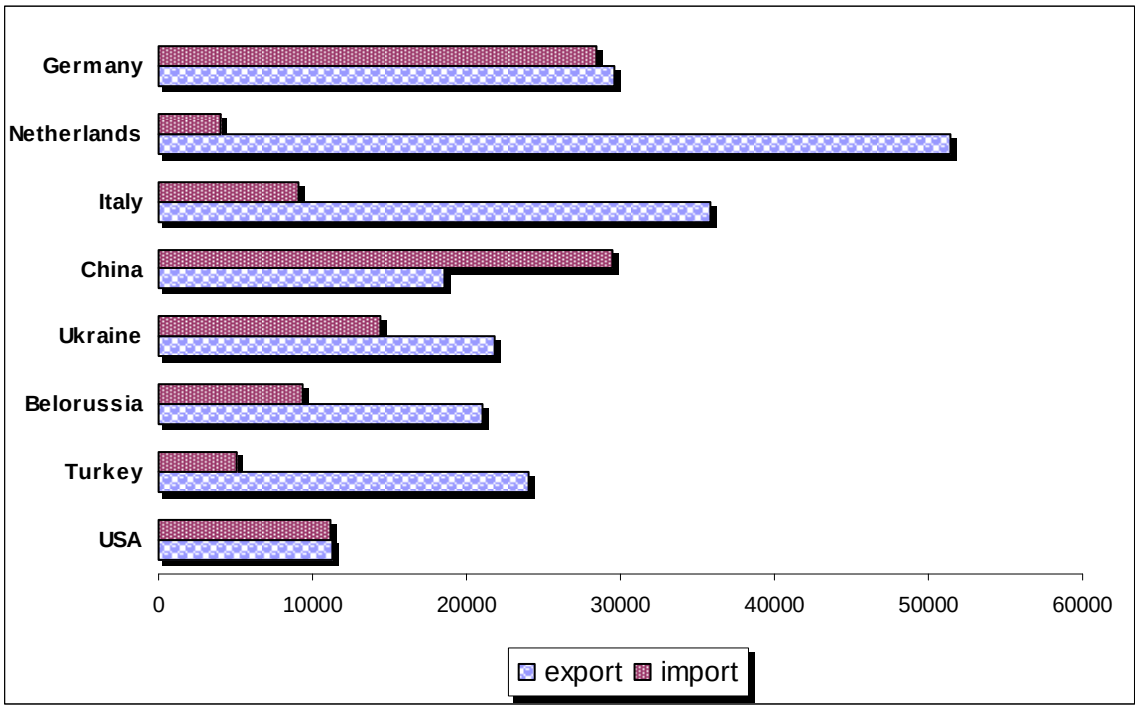


Fig. 70. Major Trading Partners in 2008 (as USD million)

3.6.6. Regulation of Foreign Trade

In 2008 69 decrees on the changes in the customs duties rates were developed and adopted by the Government of the Russian Federation, most important of which are the following:

- from 11.03.08 No 159 "On approval of customs duty rates for some kinds of fertilizers exported outside the countries participating in the agreements on Customs Union"

The main purpose of the export duty rates for the fertilizers, mineral or chemical, nitrogenous complex fertilizers at the rate of 8.5% or for the potassium fertilizers at the rate of 5% of the customs value of the commodity is to decrease the prices for the fertilizers for the domestic agriculture producers;

- from 20.03.08 No191 "On approval of export duty rates for sulfur in all forms, except sublimed precipitated or colloid sulfur, as well as for the natural calcium phosphates, aluminum-calcium phosphates and phosphate chalk"

In connection with the steady trend for the increase in world prices for sulfur and apatite concentrate the export duty rates were increased from 0% to .5% of the customs value of commodity;

- from 29.03.08 No 225 "On approval of export duty rates for wheat, wheat and ray mixture and barley exported outside the countries participating in the agreements on Customs Union"

In order to increase the reserves of crops at the internal market and to prevent the increase in the internal prices the customs duty rate for wheat and ray and wheat mixture was increase by the decree up to 40%, but no less than Euro 0.105 per kilo;

- from 28.03.08 No 218 “On making changes to the decree of the Government of the Russian Federation from October 12, 2007 No 671 “On seasonal duties on raw cane-sugar and some kinds of sugar imported into the territory of the Russian Federation in 2007 and 2008”

This decree prolongs the period of action of the seasonal duty till the end of May 2008 by abolition of the reservation on the pre-term cancellation of the action of the seasonal duty rates in case average monthly price for raw sugar at New-York raw materials exchange exceeds USD 259.99 per ton;

- from 05.07. 2008 No 421 “On prolongation of the action of export duty rates on some kinds of vegetable oils”

By this decree the period of action of the reduced export duty rates (5%) for some kinds of vegetable oils was prolonged;

- from 04.06. 2008 No 428 “On temporary import duty rates on live chickens and some kinds of eggs of poultry”

In order to develop poultry production the import duty rates for incubatory eggs and pedigree chicks at zero rate;

- from 06.06.08 No 439 “On prolongation of the action of import duty rates on some kinds of tropical oils”;

Duty-free import of tropical oils will allow to maintain the positive dynamics of the production of oil and fats, reduce expenses of enterprises connected with import, will contribute to limitation of the prices for the production form the vegetable oils, as well as for the production of adjacent branches of industry (bakery, confectionery, dairy industries), which will result in the increase of the competitiveness of the domestic foodstuffs production;

- from 16. 09. 2008 No 695 “On seasonal duties for raw cane sugar and some kinds of sugar imported in the territory of the Russian Federation in 2008 and in 2009”

This Decree envisages the prolongation of the effect of the seasonal duties for raw sugar for the period of December 1, 2008 to May 31, 2009 in the range of USD 220-270 per ton depending on the level of the world prices for cane raw sugar. The purpose of this measure is to equalize the economic conditions for the production and sale of sugar from raw sugar and beetroot, as well as to stimulate investments in domestic sugar production;

- from 11.09.2008 No 659 “On making changes to the customs tariff of the Russian Federation with respect to plasma module (screens) and devices on liquid crystals”

According to this decree import duty rates for the components for the production of plasma and liquid crystals television sets were nullified. Up to that moment only the companies working in the special economic zone of Kaliningrad enjoyed the preferences for their privileged import. The segment of the production of plasma and liquid crystals equipment was practically absent in Russia and the rate of 10% of customs duty was an additional obstacle for the development. Before the duties were abolished the production of television sets with these components was 25-30% more expensive in Russia than in Japan or China. Up to 60% of the cost of the finished goods is accounted for the plasma or liquid crystals modules. It is supposed that the abolition of duty rates will enable the Russian enterprises to become more competitive with regard to Asian and Eastern European producers. In those countries the duties for components were abolished several years ago.

- from 05.12 2008 No 903 “On making changes to customs tariffs on some kinds of motor-vehicles”

The Decree was adopted within the framework of the series of measures for the diminution of the crisis aftermaths for the domestic motor vehicles production. According to the introductions the import duty rates for passenger cars and trucks are increased, the period after which the passenger cars are regarded as used is changed from 7 to 5 years. Import duty rates for passenger cars with the period of exploitation from 1 to 5 years were increase on average from 25% to 30% of the customs value with the proportional increase of the specific rate, calculated in terms of Euro (per 1 cu. cm of the engine volume) (*Table 72*).

Table 72

Customs Duty Rates On Some Kinds of Motor Vehicles

	Passenger cars	
Engine volume less than 1000 cu. cm (8703 21)		
New		30%, but no less than Euro 1.2 per 1 cu. cm of the engine volume
Used	older than 5 years	Euro 2.5 per 1 cu. cm of the engine volume
	others	30%, but no less than Euro 1.2 per 1 cu. cm of the engine volume
Engine volume from 1000 до 1500 cu. cm (8703 22)		
New		30%, but no less than Euro 1.2 per 1 cu. cm of the engine volume
Used	older than 5 years	Euro 2.7 per 1 cu. cm of the engine volume
	others	35%, but no less than Euro 1.45 per 1 cu. cm of the engine volume
Engine volume from 1500 to 3000 cu. cm (8703 23)		
New	engine volume from 1500 to 1800 cu. cm	30%, but no less than Euro 1.5 per 1 cu. cm of the engine volume
	engine volume from 1800 to 2300 cu. cm	30%, but no less than Euro 2.15 per 1 cu. cm of the engine volume
Used	older than 5 years and engine volume from 1500 to 1800 cu. cm	Euro 2.9 per 1 cu. cm of the engine volume
	others	35%, but no less than Euro 1.5 per 1 cu. cm of the engine volume
	older than 5 years and engine volume from 1800 to 2300 cu. cm	Euro 4 per 1 cu. cm of the engine volume
	others	35%, but no less than Euro 2.15 per 1 cu. cm of the engine volume
Engine volume more than 3000 cu. cm (8703 24)		
New		30%, but no less than Euro 2.8 per 1 cu. cm of the engine volume
Used	older than 5 years	Euro 5.8 per 1 cu. cm of the engine volume
	others	30%, but no less than Euro 2.8 per 1 cu. cm of the engine volume
Engine volume less than 1500 cu. cm (8703 31)		
New		30%, but no less than Euro 1.45 per 1 cu. cm of the engine volume
Used	older than 5 years	Euro 2.7 per 1 cu. cm of the engine volume
	others	35%, but no less than Euro 1.45 per 1 cu. cm of the engine volume
Engine volume from 1500 to 2500 cu. cm (8703 32)		
New		30%, but no less than Euro 2.15 per 1 cu. cm of the engine volume
Used	older than 5 years	Euro 4 per 1 cu. cm of the engine volume
	others	35%, but no less than Euro 2.15 per 1 cu. cm of the engine volume
Engine volume more than 2500 cu. cm (8703 33)		
New		30%, but no less than Euro 2.8 per 1 cu. cm of the engine volume
Used	older than 5 years	Euro 5.8 per 1 cu. cm of the engine volume
	others	35%, but no less than Euro 2.8 per 1 cu. cm of the engine volume

Source: Decree of the Government of the Russian Federation from December 5, 2008 No 903 “On making changes to Customs Tariff of the Russian Federation with regard to some motor transport vehicles”

New duties came into effect on January 12, 2009 and will be in effect for 9 months, after which period the Government is to decide how it will continue the customs policy with regard to the import cars.

Thus, new cars assembled by the producers of motor-vehicles in Russia will become more competitive than their import analogues and the production of AvtoVAZ will be protected from the competition of used import cars. Mainly it is the producers that do not have plants in Russia that will suffer from the toughening of the rules for import of cars. Thus, the prices for Mitshubishi, Mazda, Nissan models, as well as the cars of premium class of Mercedes-Benz, BMW, Audi, Volvo will increase.

At the end of 2008 the growth of the Russian motor vehicles market slowed down sharply. Import of passenger cars in the Russian Federation from non-CIS countries increased by 31.1% in 2008, making 1.84 million of units. On the whole cars worth USD 30.3 billion were imported. The first half of 2008 was especially good, when the volumes of sales increased annually by 43-54%. However in November 2008 the volume of sales had decreased for the first time for last four years, which testifies the general worsening of the situation at the car market. The decrease of sales in November 2008 was equal to 15% as compared with the corresponding period of 2007. As compared with the previous month, the sales dropped by 19.5%. In October the sales of import cars went down by 5.75 as compared with September.

- from 8.12.2008 No 918 “On temporary import customs rates on some kinds of meat of cattle, pork and poultry and on making changes to the Decree of the Government of the Russian Federation from December 5, 2005 No 732”

According to the document, from January 1, 2009 rates for pork import are increased up to 75%, but no less than Euro 1.5 per kilo. Duty rates for poultry imported above the quota is increased up to 95%, but no less than Euro 0.8 per kilo. At the same time the duty rate for beef import was decreased don to 30% but no less than Euro 0.3 per kilo.

At present the duty rate for pork import into the territory of the Russian Federation is 60% of the customs value, but no less than Euro 1 per kilo, for poultry – also 60%, but no less than Eur0 0.48 per kilo.

Within the framework of the support for the Russian producers the Government considered the possibility to decrease the quotas for the import of pork and chicken. In 2009 only the quota for chicken was reduced – by 300 thousand of tons from 1.25 million of tons in the current year to 953 thousand of tons. For the USA the quota was reduced by 180 thousand of tons and for the European Union – by 60 thousand of tons.

The quota for pork import was somewhat increased by including trimming in it (earlier regarded as a separate position) – up to 532 thousand of tons, the quota of the USA increasing up to 100 thousand of tons from 50.7 thousand of tons.

In concordance with the article of the Law “On customs tariff” the Decrees from 14.01.2008 No 5, from 17.03.2008 No 173, from 22.05.2008 No 378, from 21.07.2008 No 547, from 19.09.2008 No 699 “On approval of export duty rates for crude oil and some kinds of commodities produced from oil exported from the territory of the Russian Federation outside the countries participating in the agreement on Customs Union” were adopted (*Table 73*).

On November 21, the State Duma of the Russian Federation and on November 26, 2008 the Council of Federation approved the Law “On making changes to article 3 of the Law “On customs tariff”. In order to provide quicker and more flexible application of the measures of customs and tariffs regulation and the government support of oil industry in connection

with the drop of world prices for oil the bill envisages that starting with October 15, 2003 the monitoring for the prices for crude oil grade Urals at the world markets of oil raw materials will be made starting with the 15th of each calendar month until the 14th of the next calendar month. The period for the effect of the export customs duty rates for oil is reduced from 2 to 1 calendar month. The decisions of the Government of the Russian Federation on the changes in the rates are to be published no later than 1 day before they come into effect (earlier – no later than 10 days before coming into effect).

Table 73

Export Duty Rates for Oil and Oil Products in 2008 (as USD per ton)

	Oil	Oil products	
February, 1	333.8	237.2	127.8
April, 1	340.1	241.4	130.1
June, 1	398.1	280.5	151.1
August, 1	495.9	346.4	186.6
October, 1	372.2	263.1	141.7
November, 1	287.3	205.9	110.9
December,1	192.1	141.8	76.4

Source: Decrees of the Government of the Russian Federation

In order to protect Russian producers of goods with the implementation of the mechanisms of trading protection – compensatory, antidumping and special protective measures – the following measures were used.

As a result of the investigations carried out earlier the following measures were introduced:

- special duty with regard to dry baking yeasts imported into the territory of the Russian Federation from March 22, 2005 for the period of 3 years;
- antidumping duty rate with regard to import channels of Ukrainian origin, from July 7, 2005 for the period of 3 years;
- antidumping duty rate with regard to three-phase asynchronous motors of Ukrainian origin, from October 15, 2005 for the period of 3 years;
- antidumping duty rate with regard to some kinds of steel pipes of Ukrainian origin, from January 31, 2006 for the period of 5 years;
- import quota for the import of incandescent lamps from March 3, 2006 for the period of 3 years;
- antidumping duty rate with regard to flat rolled metal containing nickel from EU countries, from March 20, 2007 for the period of 3 years;
- special duty rate with regard to the increased import of pipes of large diameter from December 21, 2006, for the period of 3 years;
- antidumping duty rate with regard to machine-building hardware of Ukrainian origin in the form of approval of voluntary price liabilities of JCS “Druzhkovskyi hardware plant” and in the form of antidumping duty at the rate of 21.8% for other Ukrainian producers from May 14, 2007 for the period of 5 years;
- special duty rate with regard to nets from glass fiber imported into the customs territory of the Russian Federation from December 10, 2007 for the period of 3 years;
- antidumping duty rate with regard to frictionless bearings (excluding needle-bearings) of Chinese origin, from January 21, 2008 for the period of 5 years.

The following investigations are being carried out:

- antidumping investigation with regard to polyamide technical fibers of Ukrainian origin imported into the customs territory of the Russian Federation;
- special protective investigation with regard to the increased import of the stainless pipes imported into the territory of the Russian Federation.

The following investigations have been started:

- special protective investigation with regard to the increased import of harvesters imported into the territory of the Russian Federation;
- antidumping investigation with regard to rolled metal with polymer coat originating in the People's Republic of China, the Republic of Korea, the Kingdom of Belgium, the Republic of Finland, the Republic of Kazakhstan;
- special protective investigation with regard to the increased import of the table settings imported into the territory of the Russian Federation.

In 2008 a big attention was paid to the issues of the provision of the free or at least non-discriminatory access of the Russian goods and services to the external markets.

In 2008 100 restricting measures concerning Russian goods, which were applied by foreign countries in order to protect their internal markets, were registered, which included 42 antidumping measures, 7 special protective measures and 51 measures of non-tariff regulation of the trade, including measures of administrative regulation. Besides, there are 3 antidumping investigations and 5 reconsideration of the antidumping measures introduced earlier in process.

At the moment the most troublesome markets in which the Russian exporters are interested and at which the aggressive policy of the protection against the Russian export is pursued are the markets of the EU, Mexico, Australia, USA, Belorussia and Ukraine.

The antidumping measures are most actively used against Russian ferrous metals and goods thereof (more than a half of all the antidumping measures introduced). The second place is held by mineral fertilizers.

3.6.7. Negotiations on Accession to World Trade Organization

As on December 1, 2008 the bilateral negotiations on the conditions for the access to the markets of goods and services were concluded with all the member of the Working Party on Russia's accession to the WTO. In the 2nd quarter 2008 the protocols on conclusion of negotiations with the United Arab Emirates and Saudi Arabia were signed.

The Russian party expected to conclude multilateral negotiations on the system issues by the end of 2008, so as to become a member of the WTO in 2009. However a number of political and economic events, namely, the changes in the USA administration, Doha round of negotiations, aggravation of the situation in the Caucasus, as well the world financial and economic crisis, procrastinate the negotiation process. The Russian authorities have many times confirmed that the course to access the WTO remained.

The heads of APEC at a recent summit in Peru countries and the leaders of G20 at a meeting in Washington at the beginning of November called for the end of the Doha round of negotiation that had been going for many years. The main dispute at Doha round is between the developed and developing countries with the respect to the level of agriculture subsidies and tariff measures to protect the markets.

At the meeting in Geneva in November 2008 a regular reading of the report of the working party on Russia's accession to the WTO in new version approved in August 2008 took

place. This document consolidates the results of the negotiations starting with 2004 and upon its scan reading it can be discovered that there are very few questions.

There are three questions that remained unsolved: the level of export duty rate for wood, the conditions for the operation of the state-owned trading enterprises as well as subsidies to the agriculture. Russia continues to insist on the level of support for agriculture of USD 9.2 billion (currently less than USD 3 billion). The members of the WTO hold that USD 3 billion is enough.

European countries strive for Russia to cancel the increase of duty rates for roundwood, which increased from Euro 2.5 to 15 per 1 cu. m, and should have increased up to Euro 50 starting with January 1, 2009.

The prohibitive duties were considered to be the necessary requirement to secure inflow of large-scale investments in the wood processing complex. As additional stimulating measures the duties for the production even at the first stage of processing were nullified, and the wood processing concerns were suggested the privileges for the period of the construction of processing facilities. In the first half of 2008 the export of non-processed wood reduced by 23.8% down to 20.1 million of tons (according to the strategy of the development of the wood processing complex it should reduced to 5 million tons a year up to 2020). By the end of the summer 2008 the Ministry of Industry and Trade had more than 200 investment projects with the total sum of more than RUR 1.1 trillion.

The decrease in the volumes of the wood export destabilized the paper industry of the Scandinavian countries, placing it on the edge of bankruptcy. However the increase in duty rates resulted in the internal problems in Russia as well. The most difficult situation is observed at the timber enterprises of the regions where there are no pulp and paper mills or their number is insufficient. The ports and the transport enterprises were also the victims, since the wood transportation reduced by nearly half by the 3rd quarter 2008.

After the meeting of Prime Ministers of Russia and Finland the Government of the Russian Federation promised to postpone the adoption of new customs duties for roundwood by 9-10 months, explaining this with the desire to help Finnish timber enterprises that were in the state of crisis. The increase was envisaged by the decree of the Government of the Russian Federation from February 5, 2007 No 75. However the introduction of new duties was postponed by a year. The corresponding decree of the Government of the Russian Federation was adopted on December 24, 2008 and came into effect on January 1, 2009.

In prospect the increase of the duties will take place as a measure to increase the processing in the country. But it is necessary to optimize the increase of export duty rates for roundwood connecting it with the growth of processing facilities in the country.

Within the framework of the negotiations in Geneva in November 2008 Russia conducted about ten bilateral consultations on system issues, including those with Ukraine and Saudi Arabia. Saudi Arabia, negotiations with which were concluded in the summer of 2008, insisted on Russia taking liabilities on equalizing export and internal prices for energy carriers as a member of the working party. Some time ago the European Union had the same requirements, but it abolished it as a result of the negotiations and they were not inserted in the protocol on the conclusion of bilateral negotiations. Later Saudi Arabia recalled its application on energy carriers.

At the meeting with the Ukrainian party in Geneva the issues concerning the report of the Working party were discussed. Ukraine became a WTO member in May 2008 and at the

same time it became a member of the working party on Russia's accession to the WTO, claiming that it reserves the right to start bilateral negotiations on the conditions for the accession of its goods and services to Russia's market.

At the meeting of the Working Party the representative of Georgia declared that he reserves the right to set new questions to Russia. These questions, however, have not been asked yet, and it is doubtful that the Georgian party has serious commercial interests since there is a duty-free regime of free trade between Russia and Georgia. It should be noted that when there have been cases when the countries were accepted to the WTO despite the objections of some members of the organization.

3.6.8. Project of External Economic Strategy of Russian Federation Up To 2020

Ministry for Economic Development of the Russian Federation has prepared the project for External Economic Strategy of the Russian Federation up to 2020, defining key priorities and parameters of the external economic policy of the country in connection with long-term goals and tasks of its internal policy.

This document is based on the statements of the Concept for Long-term Socio- Economic Development of the Russian Federation up to 2020 (further referred to as SLSED-2020), Main direction for Actions of the Government of the Russian Federation for the period up to 2012, Concept for Foreign Policy of the Russian Federation, long-term strategies and programs for the development of some branches of industry and regions, regulatory legislative acts etc.

The necessity to develop such a document arises from the fact that presently a fundamentally new situation evolves in the sphere of external economic links of the Russian Federation, which is accounted for by both the external and the internal factors. Internal factors can be seen, first of all, in the intensification of trading and political influence of foreign countries on the sphere of the international trade which requires the whole spectrum of the external economic instruments to be applied adequately in Russia. Internal reasons are connected primarily with the necessity for the country to transfer to innovation model of socio-economic development. These factors on the whole define the necessity for preparation and further fulfillment of the external economic strategy for long-term prospect.

At present the world economy suffers from the deep financial crisis. Not only the developed, but also developing countries are affected by the crisis. In the long run it is possible that the world economy growth will recover, but its dynamics will be subject to cyclic fluctuations in contrast to the pre-crisis period.

The scenario being favorable, average annual growth rates of the global GDP in 2010-2015 will be equal to 4.0-4.2%, in 2016-2020 – to 2.7%, versus 3.9% in 2001-2006 and 3.3% in 1991-2000. At the same time the nowadays crisis of the world economy may start the long period of the slowed development, characterized by the increased inflation and acute conflict between old and new international centers of power, countries exporting raw materials and post-industrial economies[63].

External economic policy is the continuation of the internal economic and social policy of the state aimed at the strengthening of the economy and the improvement of the level of life

[63] Concept for Long-term Socio- Economic Development of the Russian Federation up to 2020, P.200-201, site of the Ministry for Economic Development of the Russian Federation, October 16, 2008, www.economy.gov.ru

of the population. The document defines key priorities, goals and parameters of foreign economic activity of the Russian Federation taking into account long-term goals and tasks of the external economic policy of the Russian Federation at the stage of the transfer to innovation type of socio-economic development. In the course of its preparation the main trends of the development of the global economy and the present condition of the external economic links of the Russian Federation were taken into account.

The long-term goal for the external economic policy of the Russian Federation is the winning of the global leading position of the country as one of the leading economic powers of the 21st century. In this connection the External Economic Strategy is based on the key statements of the SLSED-2020, including section 6 "External Economic Policy", where the goals, principles, priority directions and geographic diversification of the Russia's external economic links are stated[64].

The main target indices of the External Economic Strategy are the following:

- increase in the share of Russia in the world economy from 3.2% of the global GDP(by parity of purchase capacity) in 2007 to 3.8% in 2015, 4.3% in 2020;
- increase in Russian export from USD 354 billion in 2007 to USD 630-650 billion in 2015 and more than USD 9000 billion in 2020 (fluctuations of world prices for oil being in the range of USD 80-90 per barrel in prices of 2007);
- increase in the export of machine-building production by more than 6 times (up to USD 110-130 billion);
- increase in the export of transportation services by nearly 4 times (up to USD 45 billion) by 2020 as compared with 2007;
- the winning of 5-10% share at the markets of high-tech goods by 5-7 consolidated positions.

The external economic strategy is to contribute in the fulfillment of long-term initiatives and large projects made within the framework of the world economy. In this connection the following are the important tasks: complex support of the Russian enterprises by the Government in the sphere of export and investment in the foreign countries, creation of the system for identification and lift of the barriers for the entrance to the external markets, as well as application of fundamentally new external economic instruments.

The achievement of the strategic goal of the external economic policy is made through the realization of its priority directions, tight connection of actions on each of them with the internal tasks being solved and the needs and opportunities of the Russian economy:

- winning of leading positions at the world markets for high-tech goods and services by Russia in concordance with its specialization in the global scientific and technological sphere;
- help provided to export and achievement of the global competitiveness cof the processing industry and the sphere of services;
- integration of Russian in global transportation network and realization of the transit potential of the Russian economy;
- increase in the role played by Russia in the guaranteeing of the global energy security and strengthening of its positions at the market of hydrocarbons;
- integration of the Eurasia economic space with the center in Russia;

[64] Concept for Long-term Socio- Economic Development of the Russian Federation up to 2020, P.200-201, site of the Ministry for Economic Development of the Russian Federation, October 16, 2008, www.economy.gov.ru P.165

- creation of the international financial center in Russia, conversion of ruble in the regional reserve currency;

- intensification of Russia's participation in the formation of the world economic system.

At the same time the achievement of the strategic goals envisages the fulfillment of the regional and country priorities of the Russia's external policy in middle0term and long-term prospect. Geographic diversification and development of the external economic links will contribute into the decrease of the risks connected with the constant changes in the balance of power in the world and the transformation of the international economic system.

It is the countries of CIS, EU countries, China, USA as well as rapidly developing countries of Asia that are the most important partners of the Russian Federation in economic and political spheres. It is with these countries that Russia actively develop trade, investment and technological cooperation, which can be the basis for the improvement of the structure of the Russian export, entrance to new markets and realization of the transit transportation potential of the country.

At the same time India, countries of Latin America, as well as countries of Africa that are rich with the natural resources get ever bigger significance from the point of view of the development of Russia's external economic links. It is envisaged that the activity of the Russian Federation in economic organizations and regional groups (APEC, SCO) will become more intensive.

It is the necessity to affect international entrepreneurial activity of the domestic companies and to increase the role of the subjects and territories of the Russian Federation at the world markets that is the characteristic feature of the modern model for the management of the external economic activity in Russia.

The fulfillment of the external economic policy requires the creation of the system of institutions that secure the national interests of Russia in the world economy, increase of the competitiveness of the Russian enterprises at the world markets, flexibility and effectiveness of the Governmental regulation in the sphere of external economy, the possibility to react to external risks adequately and rapidly.

Such a system of institutions includes three big blocks: complex support for export and direct investments abroad, regulation of the access of the foreign goods and investments to the Russian markets, management support in the external economic sphere.

To follow the priority directions of the external economic policy under the conditions of the new model for the state regulation of the external economic activity, the introduction of new tools and documents for day-to-day management is envisaged:

- there will be short-term programs for the advancement of the industrial export prepared, defining key directions, taking into account the priority and specific features of the separate foreign markets and the requirements of the domestic exporters;

-bilateral plans for trade and economic cooperation will be developed for the key partner countries of the Russian Federation;

- the programs and plans mentioned will be fulfilled with the attraction of the potential and Russia's trading representatives abroad;

- "Main directions for customs and tariffs policy" will be approved annually;

- on the basis of the discovered opportunities and potential threats for the main branches of industry and the geographic directions of external economic activity necessary corrections to the external economic policy of the country will be made.

The adoption and the fulfillment of the External Economic Strategy of the Russian Federation by 2020 will enable: to define major directions of the external economic policy of the country in the long run; to single out the priorities for Russia's external economic policy with respect to some countries and regions of the world; to chose adequate instruments to pursue the external economic policy; to set vectors for the development of the institutes of external economic policy and of the regulation of external economic activity.

Section 4. Social Sphere

4.1. The population's finances and the consumer market

Money incomes. In the year 2008 the population's real money incomes increased, according to preliminary estimates, by 2.7% - that is, at a much lower rate than in 2007 (12.3%).

If one compares last year's month-to-month dynamics of the population's real money income fluctuation with that observed in 2007, the following conclusions can be arrived at. In the first three quarters of 2008, by comparison with the corresponding period of the previous year, the dynamics of this index was much lower (6.6%) than the rate of growth typical of 2007 if set against the corresponding periods of 2006 (11.4%). And in Q IV real incomes fell by 5.8%, whereas in the previous year they had demonstrated growth by 13%. Further reduction of incomes was noted in November (by 6.1%) and December (by 11.6%), the most dramatic decline of per capita incomes being observed in Moscow – by 40%, and in St. Petersburg – by 38% (the November 2008 data set against November 2007).

If the real income dynamics is compared with that observed in the preceding period, it can be concluded that in the last few years, the same month-by-month "picture" of income fluctuation had been repeating itself right until September 2008. Thus, in January 2008 the real incomes of the population, owing to the typical January leap of inflation and decreased economic activity, on the one hand, and the large-scale payments received by the population in December, on the other, were reduced nearly by half, and later on once again began to climb back towards the previous level. But – in contrast to the period of 2006 – 2007 – this process was halted in September – October, when monthly declines were recorded (by 2–3%). Traditionally, in December incomes rose on November by by 29.4% (in 2007 - by 37.4%), but the rate of growth in December by comparison with September 2008 was twice as low as that observed during the same period in 2007 (23% against 46%).

On the whole, in 2008 the average per capita incomes of the population, computed by month, amounted to 15,106 roubles (in December – to 20,587 roubles); the population's real disposable incomes in real terms rose on 2007 by 2.7%.

Real wages in 2008 increased by comparison with the 2007 level by 9.7%. The highest growth rates of real wages, just as in recent years, occurred in December – when this index rose 14.2% on the previous month. However, this is significantly lower than the December leap observed in 2007, when real wages increased by 25.5%. The ratio of mean wages per employed person to per capita income in 2008 continued to grow and reached the level of 113%, against 108 and 104% in 2007 and 2006 respectively.

Last year's important distinctive feature was the growth of arrears of wages, coupled with the increasing number of employees belonging to this group (to whom unpaid wages are due) – this becoming a widespread phenomenon throughout the national economy. The growth of arrears of wages was first recorded in September 2008. During the period from January through August the size of arrears of wages was continually shrinking, while the slight increase in their total amount during the summer month cam be explained by the seasonal factor. From January through October 2008 the number of employees to whom unpaid wages were due remained virtually unchanged, and amounted to approximately 200 thousand.

However, in November the number of such persons suddenly increased to 300 thousand, and December saw still further growth of this index – to 600 thousand.

The most noticeable changes in the structure of the population's money incomes in 2008 (*Table 1*) were associated with diminishing property incomes, whose share in 2008 shrank by one-quarter – to 6.6%, and the most noticeable decline in property incomes was seen in Q IV when they dropped by one-third. In absolute terms, property incomes were estimated by the Rosstat in Q IV 2007 as amounting to 643 billion rubles, while in Q IV 2008 – to only 485 billion rubles (shrinkage by one-quarter). The diminishment of property incomes both in absolute and relative terms was caused by the lowered interests payments on the population's deposits in Q IV – it being the result of the overall dramatic drop in the volumes of bank deposits placed by the population (the ruble-denominated deposits shrank during the quarter preceding 1 January 2009 by 355 billion rubles) as well as of the mass-scale recall of ruble-denominated deposits in response to the decreased stability of the banking system. Another important factor was the loss-making character of transactions on the stock market.

Table 1

The structure of money incomes of the population in 2000 – 2007 (in%)

	2000	2001	2002	2003	2004	2005	2006
Total money incomes	100	100	100	100	100	100	100
Incomes from entrepreneurial activity	15.4	12.6	11.9	12.0	11.7	11.4	11.2
Wages	62.8	64.6	65.8	63.9	65.0	64.8	66.4
Social payments	13.8	15.2	15.2	14.1	12.8	12.9	13.2
Property incomes	6.8	5.7	5.2	7.8	8.3	8.9	7.2
Other incomes	1.2	1.9	1.9	2.2	2.2	2.0	2.0

Source: the Rosstat.

In 2008, the inter-branch differentiation of the average wage levels remained fundamentally unchanged. The lowest labor cost was recorded in agriculture, public education and health care, while the highest values of this index were observed in the extracting industries and the financial sector. At the same time, it should be noted that in 2008 the rate of growth of the amount of charged wages at the enterprises engaged in the extraction of mineral resources remained significantly lower than the average growth rate of this index across the national economy as a whole, and this is even more true of the financial sphere.

In 2008, in contrast to the previous period, the relative worsening of the material status of pensioners by comparison with that of the employed, was observed no more. The ratio of the average pension to the average monthly wage in 2008 increased to 24.5% against 22.8% in 2007. At the same time, this index is still worse than it was back in 2006 – 25.6%. Thus, the negative medium-term trend, that had been present in Russia since 2002, still persisted. However, the purchasing power of a pension in 2008 rose by 18% on the previous year (in 2007 – by 5%).

According to the RF Ministry of Economic Development and Trade, in 2008 the number of persons with incomes below the subsistence level remained basically unchanged, the share of this group amounting to 13.2% of the country's total population (against 13.3% in 2007). The poverty level and the degree of inequality of the population by income level in Russia are noticeably higher than in the developed world and the countries of Central Europe. The results of household surveys published by the Rosstat have demonstrated that in the year 2008 the main indices of the population's differentiation by incomes remained the same as in 2007. The income concentration index (measured by applying the Gini coefficient) remained fundamen-

tally unchanged and amounted to 0.424 against last year's 0.423; the income differentiation coefficient was 16.9 against 16.8.

In 2008, the prices of good and services included in the minimum subsistence basket grew more quickly than the general consumer price index.

Money expenditures of the population. In 2008, the share of the population's expenditures on commodities and services, as a percentage of the total incomes of the population, noticeable rose on 2007 (from 69.6 to 73.1%). During the same period, the share of the population's savings became considerably lower (decreasing from 9.6 to 6%). In 2008, the population's money expenditures became higher – although only slightly so (by 4.1 billion rubles) – than its money incomes[1]. It should be noted that the excess of expenditures over incomes in January was already noted in the previous years (due to the considerable lumpsum payments received in December), while the dramatic excess of expenditures over incomes in November and December – as far as it can be concluded on the basis of the available statistical data – was observed for the first time in modern Russia's history.

In September – December the population's savings in deposits and securities were declining; the savings in ruble-denominated bank deposits in the last four months of 2008 dropped by 460 billion rubles, as a result of which the overall volume of savings in ruble-denominated bank deposits also declined over the year - by 82 billion rubles (– 1.8%). The total volume of ruble- and foreign-currencies-denominated bank deposits during that period increased by 14%[2]. The last considerable drop in the amount of savings in deposits was observed in Q III 1998.

At the same time, while in 2006 – 2007 there was a trend towards a decline in the amount of purchased foreign currencies (with the share of the corresponding expenditures decreasing from 6.8% in 2006 to 5.2% in 2007), in 2008 this share in the population's overall expenditures was at first stabilized and amounted to approximately 5.7% in the first nine months, while later, in Q IV, leaping to 12.8% in October, to 12.1% in November, and to 14.9% in December (the quarter's average being 13.4%, which roughly corresponds to the indices recorded in 1998 – 1999). As a result, in 2008 on the whole, the share of the expenditures on the acquisition of foreign currencies amounted to 7.9% of the total volume of the population's money incomes.

Retail turnover. Retail turnover (in terms of mass of commodities) in 2008 grew by 13%, which is consistent with the dynamics observed in 2006 – 2007, when it was increasing 14 – 15% on the average per annum. The month-by-month changes in retail turnover in 2008, though, were different from the pattern that has already become a typical one for many years – when the highest growth rate by comparison with the previous period was recorded in Q IV, mainly due to the December leap (in 2007, the growth of commodities turnover in December against the November level was 20.3%). Such a leap was also observed in 2008 – although it was less dramatic (16.7%); however, on the whole Q IV became a 'failure' – such was the effect of the absolute reduction of the physical volumes of sales in November. The year's end was characterized by a diminishing assortment of commodities, the disappearance of many items, and the lowering demand for commodities in the premium and sub-premium segments.

In the first nine months of 2008 the volume of commercial services rendered to the population increased by 6% (in comparable terms), while in the last two months it remained at

[1] As is known, for the last time this phenomenon was observed in 1970.
[2] http://www.banki.ru/news/lenta/?id=829076

the 2007 level. With regard to individual commodities and services markets, it can be noted that in Q IV 2008 there was a reduction in the volume of sales of motor cars (a short-term leap in their sales was observed only in December – which can be explained by 'investments' in this item in a situation characterized by money depreciation); the sales of tourist packages for the most popular destinations (Egypt, Turkey) dropped by 20 – 30%; the same it true of air travel (the passenger flow in December 2008 shrank by comparison with December 2007 by 14.5%); and there emerged a trend towards a decline in the volume of restaurant services. As in 1998, the most marked drop was observed in the demand for entertainment and tourist services, as well as for passenger transport services.

In the retail turnover structure, the share of foodstuffs in 2008 remained at the previous year's level and amounted to 45.3% (45% in 2007).

In the overall volume of retail turnover growth in 2008, the highest share belonged to growth in the turnover of trade organizations – it increased by 15.6% (in 2007 - by 22.5%). The physical volume of the markets contracted by 1.4%, which is much lower than in the previous year when the reduction amounted to 10.2%.

Consumer prices. On the whole over last year, prices on the consumer market increased more considerably than in 2007, their general index being 113.3% against 111.9%. Accelerated inflation was first recorded in January and, although in September – December 2008 the growth of prices became somewhat slower, it was not possible to keep the inflation rate at the forecasted level (112%). The most noticeable growth rate was displayed by foodstuffs (116.5%) and services (115.9%).

The baseline inflation rate for that period is estimated by the Rosstat to be at the level of 113.6%. In this connection, administrative decisions also had their impact on the overall growth of prices. Thus, the indices of prices and tariffs on the housing and utilities services amounted on the whole to 116.4%, those of the passenger transport services – 122.5%.

Consumer expectations. The results of the opinion polls conducted by the Rosstat in Q IV 2008 demonstrate a significant worsening in terms of the population's consumer expectations. The consumer confidence index fell on Q III 2008 by 21 p. p., while its level reflects the pooled opinions of the consumers as to the situation faced by the national economy and their personal material status – it corresponds to the results recorded in Q IV 2000. Worse estimations of the existing situation were offered by the population only in 1998 and 1999.

The population viewed rather pessimistically the possibility of any positive developments in the economy: Russia's economic future is assessed negatively by 35% of the respondents, while positively – by only 15%. Nearly all of them foresee the worsening of their own material status, while every one in eleven expressed hopes for the better. Young people offer the most pessimistic estimations of the current economic situation.

If we look at the value of the consumer confidence index in Russia (– 20%), it will become clear that in many EU countries the consumers estimate the current situation as being much worse. Thus, in November this index in Greece was – 55.3%, in Hungary – 54.3%, in Portugal – 47.5%, in Spain – 43.8%, in France – 29.3%, in Slovakia – 26.9%, in the United Kingdom – 26.8%, and in Italy – 25.9%. The lowest figures were recorded in Finland (– 2.1%), Denmark (– 2.9%) and Sweden (– 7%).

4.2. Migration processes

In 2008, the country saw further implementation of the major migration "projects", which had been initiated earlier and were concerned with normalizing migration estimation and the situation with temporary labor migration, and also with the resettlement of compatriots to Russia under the state program of the same name. The realization of each of these projects was fraught with a number of difficulties caused by underestimation of the degree of complexity of migration processes, by the lingering contradictions in the interests of individual groups (migrants, the indigenous population, employers, the administrative apparatus of various levels, etc.), as well as in the interests of the center and the regions, and by the re-emerged desire of the authorities to control rather than to coordinate migration processes. Nevertheless, had it not been for the crisis that started to manifest itself in the second half of the year – which migration, being always very sensitive to any disturbances, especially on the labor market, could not but respond to, in one way or another[3], - the migration processes of 2008 would have been identical in many respects to those of 2007.

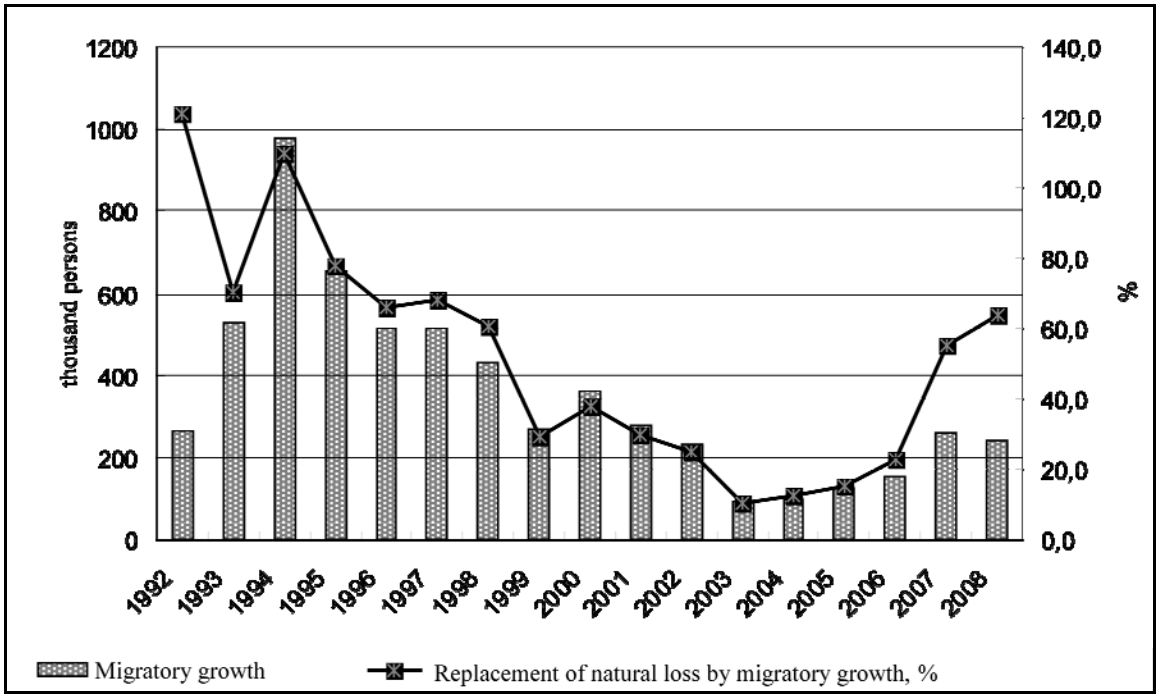
4.2.1. The role of migration in population size dynamics

In 2008, changes in the age structure of reproductive women, couples with the measures undertaken within the framework of the project "Maternity (Family) Capital", resulted in an increase in the number of newly borns almost everywhere in the country.[4] Although the population's natural loss was continuing, the composition of the mortality and natality processes conduced to a reduction in its rate by comparison with 2007. Therefore, it was relatively easier than before to compensate for natural loss by migration growth. In January – October 2008, net migration made up for 64% of natural loss.

An extrapolation of the trends of the January – October 2008 natural and migration processes onto the end of that year makes it possible to suggest that, despite a rise in the index of the so-called "compensatory migration", there was no increase in the absolute size of net population inflow into Russia (*Fig. 1*). Taking into account the seasonal decrease of migration inflow into the country during the pre-New Year period, it can be affirmed that net migration almost certainly did not grow at all.

[3] So far as we know, no scientifically justified conclusions (for example, obtained in the course of examining employers and / or migrants) concerning the problem of the current crisis' effect on migration and the "migrant module" of the labor market has not been made as yet.

[4] It is likely that this increase is of temporary nature (the so-called "timing shift of natality") and deals with the objective wish of women who in principle were inclined to bearing a second (third) child, to shift the birth from some vague date in the future to 2007-2008, when the project "Maternity (family) Capital was still in effect.



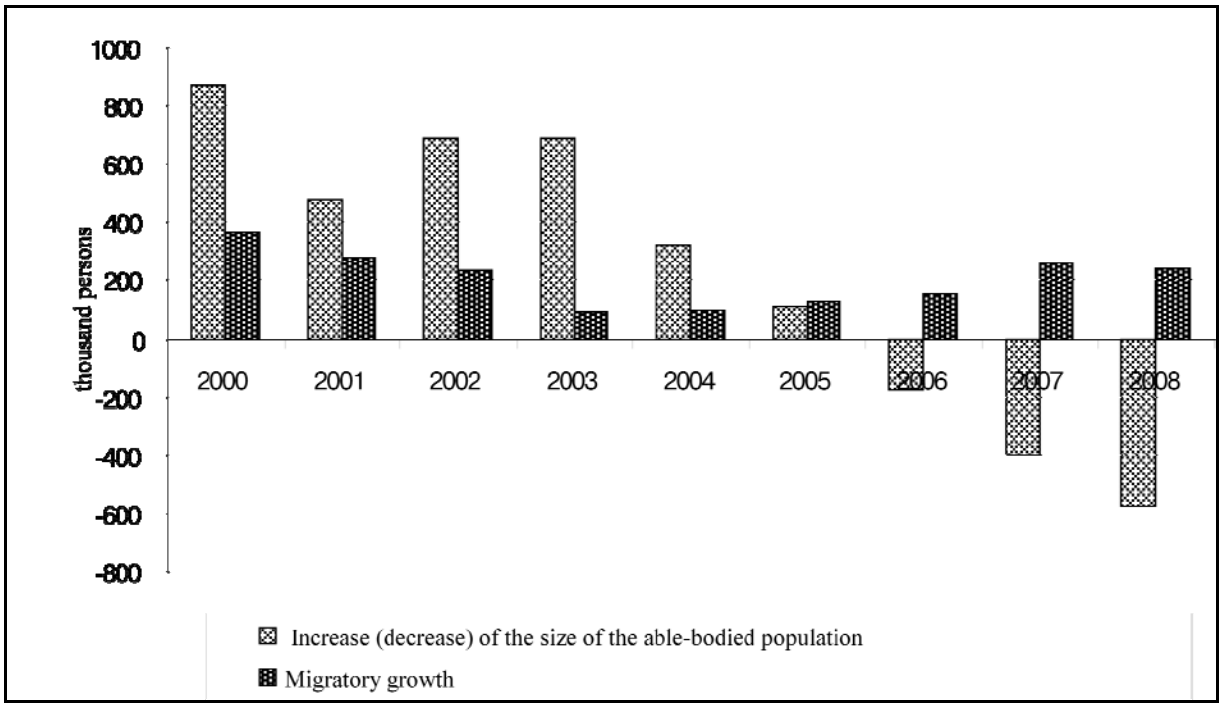
* For 2008 – the author's estimates based on the extrapolation of the January-October 2008 trend.
Source: Rosstat data.

Fig. 1. Migratory growth (thousand persons) and the replacement of natural population loss by migratory growth (in %), Russia, 1992-2008.

Replacement of natural population loss by migratory growth – however important this goal might be – cannot alone solve the whole problem. In developed countries, migratory population growth is called upon to compensate for a loss in the size of the able-bodied population, rather than for a natural population loss (if it is present). In 2006, Russia, for the first time in the 2000s, started to experience certain aggravation of the labor market situation, caused by nothing else but a fall in the size of the able-bodied population taking place in a situation of economic growth[5]. In 2007 – 2008, the downward trends in the size of the able-bodied population continued. Due to its age and behavioral peculiarities (in normal, uncompelled flows young and able bodied persons clearly prevail[6]), as well as to the social requirements of the receiving party, the migration component of population reproduction is expected to have the function of replacing this very "deficiency". However, the task of replacing the increasing natural loss in the size of the able-bodied population by migration – or, at least, by its registered segment – is becoming increasingly difficult, bearing in mind the diametrically opposite character of the general dynamics of the population size (Fig. 2). The difference between the annual migratory growth – even a rising one (as it was in 2007 by comparison with 2006, which resulted from a change in the principles of statistical estimation of newly arrived

[5] *Naselenie Rossii 2006. Chetyrnadtsatyi ezhegodnyi demograficheskii doklad* (Russia's Population 2006. The Fourteenth Annual Demographic Report). Editor in Charge A. G. Vyshnevskii. Moscow: GU – VshE (State University – Higher School Of Economics). 2008. P. 230.
[6] In 2006, the share of able-bodied population in the registered migratory growth amounted to 72.4%; in 2007 its share rose to 77.4%. So far as the age structure of Russia's population is concerned, the share of able-bodied persons amounted to 63.3% in 2006 and to 63.4% in 2007.

migrants and from the adoption of new measures in the sphere of migration policies) – and the natural loss in the size of the able-bodied population is increasing. As the latter's decline will remain, and its degree is even expected to grow in 2009, the current crisis on the labor market, unlike the transformational crisis of the mid-1990s and the 1998 crisis, will be taking place in conditions of contraction of the able-bodied population intrinsic size, and thus may indirectly contribute to a decrease in the actual mass of workers being dismissed.



* For 2008 – estimates of the natural loss of able-bodied population were made on the basis of population size data by age group in accordance with the average forecast of Rosstat as of 01.01.2009 and the same indicator as of 01.01.2008; estimates of the migratory increase for 2008 – on the basis of the afore-stated extrapolation.
Source: Rosstat data.

Fig. 2. The migratory increase and the natural increase (decrease) in the size of Russia's able-bodied population, thousand persons, 2000 – 2008.

Similar to previous years, Russia's registered migratory increase mainly depends on the intensity of migration contacts with CIS countries. In 2008, links with the CIS determined more than 92% of Russian net migration. However, the vague and sometimes destructive policy that has been pursued by Russia over a number of years in the sphere of migration relations with CIS countries, the palpable exhaustion of the migration potential of the Russian-speaking population, the reorientation of the format of migrations (as it happens all over the world, the predominance of permanent migrations is gradually replaced by that of temporary labor migration), and a number of socio-economic processes in the republics of near abroad make it impossible to instantly speed up migration processes – even if some steps are taken in this direction.

Announced in 2006, the *State Program for Assistance to Voluntary Resettlement of Compatriots Leaving Abroad to the Russian Federation* has failed to meet the declared objectives within the established timeline. By the end of 2007, only 682 persons had come to Rus-

sia within the framework of the Program, although it had been planned that, in the course of 2007, 23 thousand persons would indeed be resettled. The results of 2008 were better – 4,125 participants of the Program and 4,732 members of their families[7]; but even these new figures have fallen far short of the target ones.

There were many reasons as to why the Program for Assistance to Voluntary Resettlement of Compatriots was frustrated, including the following ones: weak coordination between the federal and regional power-holding structures; the practice of decisions being imposed on the regions "from above"; the insufficient understanding of the realities of local labor markets; the legislative weakness of the documents being adopted; and – last but not least – the belatedness of this action, since the migration potential of those compatriots living abroad who were still ready to resettle to Russia, after they had spent more than 15 years without the USSR and experienced numerous political, economic and other difficulties in those other countries and partly adapted to them, has shrunk dramatically[8]. Experts' data indicate that nowadays the Program indeed plays in these republics – to a certain extent – simply the role of a moral "shelter" ("we have where to go"). Such a negative experience, associated with the low efficiency of the Program, should be a lesson to the authorities: in social processes, as in business, any proposal, apart from having organizational and legislative foundations, should above all be trusted, however with criticism, by people. If this trust fails to materialize, the authorities should take special pains to convince people of the correctness of the adopted decisions. In this case, the necessity of the intended solution has not been sufficiently understood by either the potential repatriates or, even to a greater extent, by the regions earmarked for their reception. At the outside conference devoted to analyzing the implementation of the Program, which took place in Lipetsk in January 2008, the Program's frustration in 2007 was justified, among other things, by noting that "the actual applications in the regions were not for [the reception of] 50 [thousand], but for approximately 7 thousand persons"[9]. Regional authorities do not always understand the necessity of implementing the program, but even when this necessity is indeed understood at the regional level, the actual task of accommodating the resettling compatriots is shouldered by municipal authorities, who in their turn do not always fully understand the decisions imposed on them from above. Moreover, Federal Law of 6 October 5 2003, No 131 – FZ , "On the General Principles of Organizing Local Self-Government in the Russian Federation" does not legislatively consolidate the functions and responsibilities of municipal authorities with regard to such activities. It should be expected that in conditions of the current crisis, the non-financed powers dealing with the implementation of the Program

[7] Source: the RF Federal Migration Service http://www.fms.gov.ru/about/ofstat/stat_1_rd/part_9.php

[8] "The cost of the issue": to finance the resettlement of 50 thousand persons, 4.6 billion rubles was allocated (2007), which amounts to slightly more than 100 thousand rubles per resettler. As the cost of actual adaptation to a new place of residence is naturally much higher, the low activity on the part of compatriots is quite explainable. "The geography of the issue": according to the Program, the pilot regions (12 regions in 2007; yet another 57 regions were officially included in this category in 2008; 14 regions declined to take part in this Program) were divided into three groups: with the best, medium and the worst socio-economic conditions. The most generous adaptation package was allotted to compatriots who were ready to resettle to the worst regions, that is to the regions which in the 1990s-2000s turned out to be unable to resolve their own socio-economic problems.

[9] Gosudarstvennaia programma sodeistviia pereseleniiu sootechestvennikov okazalas' pod ugrozoi sryva (the State Program for Assistance to Voluntary Resettlement of Compatriots Leaving Abroad is on the verge of failure) // *Sel'skaia Zhizn'* (Rural Life). 17 January 2008.

on a local level would not be executed in every region among those participating in the Program.

In the main, registered-migration data for January – October 2008 point to the continuation of the earlier trends that had been materializing, in particular, in 2006 and 2007. The role played by the CIS in resettlements to Russia is still crucial: the CIS accounts for 95 – 96% of all arrivals, and there are no objective reasons for this situation to change. On the one hand, effective levers for stimulating migration to Russia from other countries are still missing. On the other hand, there exists an enormous hinterland encompassing the former union republics with a population of more than 135 million, which is still capable of annually "gifting" 200 – 250 thousand persons to Russia. Meanwhile, in 2006 and then in 2007-08, for the first time in the whole contemporary period, Russians accounted for less than one-half of the officially registered migrant arrivals for a term of one year or more. However, even today the main participants of registered migration are those persons that already have Russian citizenship (they account for no less than three-quarters of migrants from the CIS).

As in 2007, the republics of Central Asia remained the main source of migrants to Russia (in the aggregate, 34% of all arrivals from the CIS in 2008 vs. 36.8% in 2007), with Uzbekistan clearly in the lead. The second place was traditionally taken by the countries of Transcaucasia.

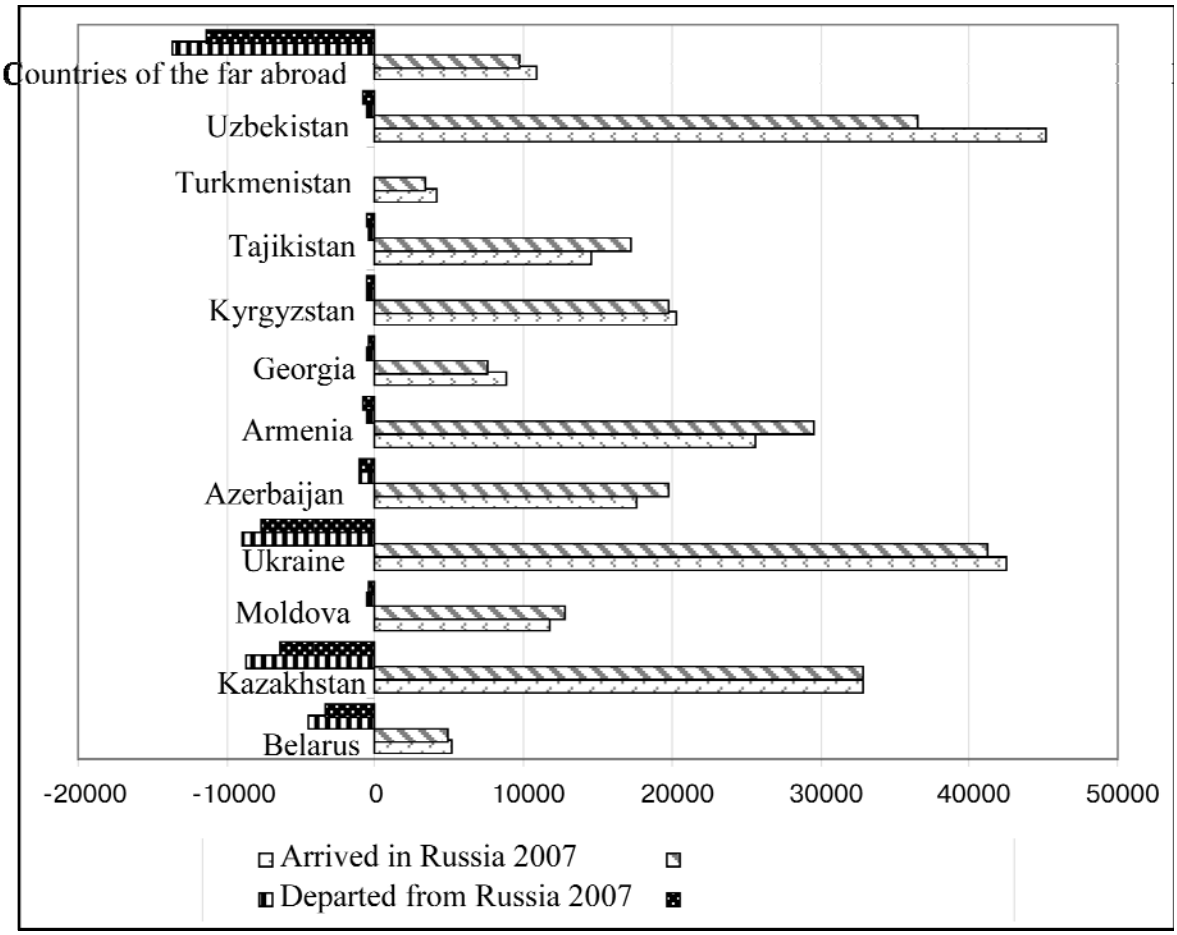
The distribution of rankings on the list of "source countries" remains practically unchanged by comparison with 2007 – as regards arrivals, Uzbekistan ranks second after Ukraine, but because of the presence of a counter-flow of migrants to Ukraine and virtually no counter-flow to Uzbekistan, these two countries interchanged their rankings in Russia's migratory population growth. However, by comparison with the same period of last year, there was an almost 20-percent decrease in the flow of migrants from Uzbekistan and Turkmenistan. By contrast, the inflow from Tajikistan significantly increased, and the number of migrant arrivals from Armenia and Georgia continued to grow (*Fig. 3*). This rather unexplainable differently directed dynamics of migrant arrivals in Russia from the republics which are similar in their socio-economic situations and are territorially proximate to each other have cast certain doubts as to the reliability of statistics.

By and large, by comparison with the same period of 2007, the first ten months of 2008 displayed such an insignificant decline in the number of registered migrants that, bearing in mind the "approximateness" of the indices being used, one should not interpret this decrease as a significant actual drop.

According to official statistics, the number of departures from Russia also continued to decline. It is noteworthy that the size of this decline – by 16% – was much larger than in the case of arrivals. Moreover, this trend involved both the departures to CIS countries and those to the far abroad. As previously, Russia did not have any noticeable outflows in the population exchange with any CIS country, excepting Belarus. For every 10 persons who departed from Russia for Belarus there were 14 persons who arrived in Russia from Belarus – which makes this population exchange relatively balanced. The departures / arrivals ratio with other CIS countries lacks any parity: for every 10 persons who departed from Russia to Kazakhstan, Ukraine, Azerbaijan, and Kyrgyzstan there were 51, 53, 186, and 360 persons who arrived in Russia from Kazakhstan, Ukraine, Azerbaijan, and Kyrgyzstan respectively.

It should be emphasized once again that the statistically registered data on migrant arrivals in Russia and on migrant departures from Russia only approximately reflect the real state

of affairs. The scale of the unregistered part of migration could also be estimated only approximately. In particular, the official number of persons arriving in Russia for a term of one year and more does not include the migrants who stay in this country for two or three years (and sometimes much longer) and repeatedly – and absolutely legally – prolong their temporary residential permits.



Source: Rosstat data.

Fig. 3. The number of persons arrived in Russia and departed from Russia, January-October 2008 and January-October 2007.

So far as departures are concerned, statistics clearly fails to reflect the considerable number of those persons resettling to far-abroad countries under labor contracts and for educational purposes who do not cancel their registration at the place of residence for quite a long time. Expert data indicate that statistics also underestimates the scope of resettlement to some CIS countries, in particular – in 2007 and 2008 – to the rapidly increasing its economic might Kazakhstan, especially from the nearby, economically depressed, regions of the Urals and Siberia.

The obvious failure of migration statistics makes it impossible to reconstruct any precise picture of migrational population growth. It is clear that, over the first ten months of 2008, the so-called migrational growth associated with resettlement “to the permanent place of resi-

dence" (from 2007 onwards – to a term of one year and more) was at least 1.5 times higher than the registered growth (201.4 thousand persons). However, it is the very task of segmenting the migration flows of temporary and permanent migration that becomes ever more complicated with the passage of time. Like the rest of the world, Russia and the countries which are migrationally connected with it are presently being confronted with, more and more frequently, with the phenomenon of temporary migration being smoothly transformed, in due course, into permanent migration (for example, educational migration can be nowadays characterized as such with an almost 100-percent probability); and, on the contrary, migration aimed at taking root at a new place for a long time – if not forever – transforms itself into temporary migration in response to difficulties in socio-economic adaptation. Therefore, it is becoming increasingly difficult to separately estimate the actual size of migration flows. According to the expert estimations made by Zh. A. Zaionchkovskaya and N. V. Mkrtchan, as of the end of 2006, the number of migrants simultaneously present in Russia at any given moment of time amounted to about 7 million persons, 3 or 4 million of whom[10] constituted the mass of so-called "illegal migrants"[11]. Earlier, in 2005, similar results were obtained by V. I. Mukomel' on the basis of a comparative analysis of Russian and foreign sources and examinations[12]. The estimations published by the Federal Migration Service of Russia were much higher – 10 to 15 million persons[13], but in this case the overestimation of figures had been predetermined by the Service's desire to increase its personnel, powers, and financing.

The alterations which have been introduced since 2007 in the procedure for registering migrants have undoubtedly been conducive to some part of migrant having legalized their status[14]. By and large, their effect has confirmed the general estimates of migrants' presence in Russia: in 2007, the FMS received about 8 millions of arrival notifications from migrants, while in 2008, approximately 9.2 million persons were registered as migrants. With the possibility of repeated crossings of the state border being taken into account, these figures correspond to the estimates putting the number of migrants at 7 to 7.5 million. The similarity of these estimates makes it possible to suggest that the illegal immigration figures put forth by researchers were equally trustworthy.

4.2. 2. Labor migration

Since the mid-2000s, *labor migration* has been a strategically significant phenomenon for Russia. Both the requirements and the segmentation of labor markets resulted in the necessity to use migrant labor in the two diametrically opposite niches – the high-skilled labor

[10] Naselenie Rossii 2006. Chetyrnadtsatyi ezhegodnyi demograficheskii doklad (The population of Russia 2006. The fourteenth annual demographic report). Ed. A. G. Vishnevskii. Moscow: GU-VShE (The State University – Higher School of Economics). 2008. P. 235-236.

[11] The term "illegal immigration" is not entirely proper, because the overwhelming majority of migrants enter RF territory on absolutely legal grounds, becoming illegals later – by not having (or not extending) registration, by staying in the country after their visas have expired, by working "under an oral agreement", etc.

[12] Mukomal', V. I. Migratsionnaia politika Rossii: postsovetskie konteksty (The migration Policy of Russia: the post-Soviet contexts). Moscow. 2005. P. 196-197.

[13] Konstantin Romadanovskii. Inostrantsy stroiat pol-Rossii, a my gordimtsia ee preobrazheniem (It is foreigners that build up half of Russia, and it is us who are now proud of its transfiguration) // Prophil' (The Prophile). 4 February 2008.

[14] For more details, see the previous IET reviews (The Russian Economy in 2006, The Russian Economy in 2007).

niche and the low-skilled labor niche. When the issue is formulated this way (and that is exactly how labor markets treat migrants in all developed countries), the data, *per se*, on the balance between supply of local workforce and the vacancies announced by employers fade into the background. Thus, a surplus in supply of local engineers cannot make good a deficiency of loading workmen or janitors. Offers of such jobs are usually ignored by local workforce. Moreover, the Russian labor market, as a general mechanism of demand for and supply of workforce, is still very ephemeral – because of the considerable vastness and emptiness of Russia's space, the low density and integrity of the transport network, the low mobility level of the workforce, the underdevelopment of state and legal institutions, and significant migration risks. Therefore, it is unlikely that any major redistribution of workforce from those Russian regions and cities where labor is overabundant to those (also Russian) regions and cities where labor is in short supply is going to take place in the foreseeable future[15]. Finally, there is a strong inclination on the part of employers to use the services of certain job contenders, and to ignore others. At the same time, if law-abiding employers can be forced to fill their vacancies exclusively with local workforce (despite its characteristics), it would inevitably increase their business costs, which cannot be attractive to any of the interested parties. And there is a segment of employers that cannot be forced to do this at all: the still very much alive 'shadow sector' of the Russian economy is still generating enormous demand for illegal migrant labor (hired under "oral agreements"). The preliminary results of the 2008 survey of migrants, carried out in five Russian regions by the Center for Migration Studies, have indicated that no less than 60% of workers from the CIS are currently employed under such agreements[16]. Eager to keep at least some part of their businesses in the shadow economy, entrepreneurs do not conclude labor contracts with workers and pay their wages in an "envelope" (without paying any taxes). According to the Federal Migration Service, in 2007 the foreign worker employment notifications submitted by employers covered only 46.7% of the work permits issued to CIS citizens; in 2008, this figure dropped to 35.6%. This means that more than half of those *legal* labor migrants to whom work permits were issued are employed in the 'shadow sector' of the economy (meaning that the employers reluctant to declare those migrants as their employees do nor submit relevant notifications to the Federal Migration Service and to the Federal Service for Employment and Labor Relations).

In the mid-2000s, economic growth increased the country's dependency – and especially that of its most dynamically developing urban agglomerations' – on the import of workforce.

[15] When such a replacement is possible, it frequently leads to labor markets in out-migration regions being stripped of workforce. Nowadays, a typical case of searching for a plumber or a wall painter in a small town can be described as follows: "The biggest problem in a small town is to find a good plumber, tiler or welder. The precious telephone number is passed from hand to hand. When instead of "the subscriber is temporarily unavailable" you finally hear "listening", it can be considered good luck. However, this does not mean that it would be necessary today that the plumber will come to mend your tap. And even when he comes, his services won't be cheap. There is no competition – the potential competitors of the only plumber remaining in town are all in Moscow, like everybody else earning money there… / O. Lebedushkina. Do Moskvy odna noch' (At a distance of one-night journey from Moscow) / Otechesvennye Zapiski. 2008. No 5.

[16] The survey of 750 migrants from the CIS was carried out in September-November 2008 in Moscow, Voronezh, Astrakhan, Kazan and Krasnodar by the Center for Migration Studies (headed by E. V. Tiuriukanova) within the framework of the John D. and Catherine T. McArthur Foundation,s project "On Managing Migration under Conditions of Demographic Crisis".

Each subsequent year – 2006 vs. 2005, 2005 vs. 2004 – displayed an increase in the number of labor migrants officially working in Russia[17].

Since early 2007, when Russia introduced new migration legislation which established a sufficiently liberal procedure for labor migrants from the visa-free CIS countries' entry into Russia and finding employment therein, the upward trend in registered migration has become stronger. In 2007, 2,260 thousand labor migrants (or 2.2 times more than in 2006) were issued work permits, which does not mean that the number of migrants in Russia doubled in just one year – it simply points to a change in the ratio between legally and illegally employed migrants. According to the RF Federal Migration Service, over the year 2008, work permits were issued to 2,080 thousand migrants[18].

The main intermediate outcome of the introduction of the new migration legislation is the redistribution of the legal and illegal migration components on the labor market. Judging from the earlier obtained ratios, this redistribution might be as follows: in 2006 (prior to legislation having been altered)[19], the share of migrants with work permits amounted to 30 – 35%; in 2008 (under the new regulations), their share was 25 – 30%. Thus, despite all the contradictions and obscurities of the new migration legislation, the main objective – legalization of migrants – began to be implemented. However, as everywhere else, the process of legalization in this sphere is fraught with problems.

That this process has failed to become more effective can be explained by the following factors: the scale and the immenseness of the turnover of Russia's shadow business – that was, and is, interested in the presence of a large mass of illegal immigrants; the absence of public – private institutions capable of playing the role of mediators between the employer and the migrant, and thus to hinder the spread of "shadow" ethnic mediation; and the incoherent and insufficiently reasoned method of quoting. In 2008, the quota – initially designed to protect the interests of the local population[20] – actually became a barrier, which was partly to blame for migrants being turned into illegals once again. In 2007, the quota established for migrants from the CIS was gigantic – 6 million persons, while the quota approved for 2008 amounted to 1 million 828, plus a 30-percent reserve. Formally, this government decision was reasoned by the actual volume of employers' applications for migrant workforce submitted by them, in accordance with the law, by 1 May 2007. Even at the moment when this decision was made[21], there existed serious doubts as to the possibility of it being actually implemented without pushing migrants back into illegality. The causes of these doubts were as follows:

[17] For more details, see Migratsionnye protsessy // Economika perekhodnogo perioda: Ocherki ekonomocheskoi politiki postkommunisticheskoi Rossii. Ekonomicheskii rost 2000-2007 (Migration Processes // An Economy in Transition: Essays on the Economic Policy of Post-Communist Russia. Economic Growth in 2000-2007) Moscow: The Publishing House *Delo* of the Academy of National Economy. 2008. Chapter 27.

[18] The Federal Migration Service of Russia http://www.fms.gov.ru/about/ofstat/stat_1_rd/part_6.php

[19] Including those who came to Russia for permanent residence.

[20] The term "protection of the interests of the local population" permits a relatively broad range of interpretations: it can be understood not only as preventing the labor market from being dumped by migrants, but also as a possibility to increase regional / city tax collection and, accordingly, to increase the general social costs emerging when migrants are legally employed. Moreover, the legitimate status of employed migrants is instrumental in increasing their wages; to a certain degree, this status is an anti-dumping mechanism in its own right.

[21] Decree of the RF Government, of 29 December 2007, No 982 "On the Approval of the 2008 Quota on the Issuance of Work Permits to Foreign Nationals".

- the objective difficulties of forecasting the number of employed, migrants including – with 8 months being a forecasting minimum. This task was – and is – especially difficult for small and medium-sized economic entities;
- the absence of necessary experience in submitting and motivating applications on the part of employers. Moreover, some employers, despite having been heavily fined for illegally employing migrants, believed, and still believe, that it was, and is, more profitable for them "to come to terms with the police";
- the lack of any experience in establishing quotas on the part of regional migration services (for example, the aggregate annual application for visa-exempt migrants in Primorskii Krai was for 176 persons. Thus, those more than 2 thousand persons who received permission for temporary residence in Primorskii Kai[22] were not included in the quota (because temporary residence was, and is, subject to another quota);
- the weakness of employers' motivation to submit applications for foreign workforce – which was, and is, caused by the fact that, in accordance with existing regulations, the quota was, and is, taken up irrespective of whether or not one or other company had actually taken part in collecting data on the size of demand for foreign workforce (which meant that those companies which had submitted, in due time, their applications would not necessarily "get hold of" the migrants they had applied for – simply because the quota had already been taken out by those economic entities that had not submitted their applications[23]);
- it was, in fact, impossible for those migrants who were employed by physical persons as governesses, nannies, housekeepers, nurses, builder-repairmen, etc. to get included into the quota[24]. Because of the character of employment by physical persons, the services sector was, and is, especially prone to attracting illegal workforce – both in Moscow and other largest Russian cities with high effective demand;
- the lack of proper structure in the existing legislative procedures: if a migrant who had come from a visa-waive CIS country and registered at the place of his residence succeeded in finding a job, but the quota had already been taken out, after 3 months he automatically becomes an illegal worker[25]; the impossibility for migrants from the CIS – as opposed to those migrants who came from visa countries – to extend their work permits beyond the established period without exiting to "their own" country.

[22] For migrants eager to stay in Russia permanently, to be issued a temporary residence permit is the first stage of the process leading to their full naturalization. Stage two is to be issued a permanent residence permit; Stage three is to apply for Russian citizenship and have all the necessary papers processed.

[23] In this connection it is very important that some tools of encouragement should be applied to entrepreneurs. Prohibitory measures such as prohibiting the companies which have ignored the application campaign from hiring foreign workforce (as was contemplated by the RF Ministry of Public Health and Social Development) are unlikely to be appropriate because they would also result in extending the sphere of illegal use of migrant labor.

[24] According to the estimations of the head of the RF Federal Migration Service, K. O. Romodanovsky, there are no less than 40% of such persons // Do piati tysiach rublei mogut zaplatit' grazhdane za nezakonnyi naim migrantov {Up to five thousand rubles can be paid by citizens for hiring immigrants illegally] // Rossiiskaia gazeta {The Russian Newspaper]. 25 January 2008.

[25] Such a migrant cannot even freely exit from the territory of Russia (he has at least to pay a fine for violation of the passport regime), which creates an additional trap for migrants – they can enter this country legally without a visa and then register, but they will not be able to leave the country if they fail to fit into a quota.

As a result, already by the beginning of June 2008, the Federal Migration Service announced that in 11 regions of this country the issue of work permits to foreign citizens was suspended because the quotas had already been taken out (including in the city of Moscow, Moscow Oblast, Kaluga Oblast, Perm Krai, Stavropol Krai, and the Republics of Dagestan and Kabardino - Balkaria). In the first four months of 2008 – a period that was far from being the most active from the point of view of the labor market's demand for migrants – the quota was taken out by almost 45% (approximately 800 thousand permits[26]). As a result, during the year the quotas established for certain regions had to be repeatedly increased – the procedure which, due to the specific features of the operation of regional and federal bureaucratic apparatus, coupled with the involvement of not one but two government agencies (the Federal Migration Service and the Ministry of Health Care and Social Development), was by no means conducted in an online mode – and so did not conduce to effective legalization of migrant labor.

Thus, for example, the initially established 2008 quota for Moscow was to be 300 thousand; as of 1 July, it was increased by 59 thousand; then, in the autumn, another 240 thousand was added. In the intervals, when the quota had already been taken out, and a new order of the Ministry of Health Care and Social Development concerning the allotment of new jobs had not yet been issued, the city evidently was increasing its stocks of illegal labor force.

In addition to the quotas (apart from those established for the whole country and each of its regions, there also exist quotas for certain professions, specializations and qualification levels), the other regulating components of the system "migration – labor market" were to be as follows:

– the share of foreign workforce in some sectors – just as in 2007, no migrants were allowed into retail trade, and their number in athletics was restricted;
– the demand for foreign labor by priority profession / qualification groups (in contrast to quotas, it has no by-region distribution)[27].

The same instruments will still be applied in 2009[28]. However, the total quota was increased, and was approved in November 2008 in the amount of 3,977 million, including a 30-% reserve (including 1,251 million arriving by invitation from visa countries, and 2,726 million – from the visa-free CIS countries)[29]; then, in December, the reserve was adjusted to 50%, with the possibility of both upward and downward adjustment[30].

The geography of labor migration into Russia is still very broad: it encompasses almost 100 countries. However, more than 4/5 of it is represented by the eight CIS republics with

[26] Gastarbaiter v teni. [A Guest Worker in the Shade] // Novye izvestiia [The New News] . 6 June 2008.
[27] For more details, see O. Vykhovanets, S. Gradirovsky. Komu vygodny kvoty [For whom the quotas are profitable] //"Polit.ru". 11 August 2008. http://polit.ru/analytics/2008/08/11/kvota.html
[28] These will be augmented by "The list of professions (specialties, posts) most highly in demand to which the quotas for labor activity in Russia are not to be applied", which was developed in October 2008 and is to be in effect from 2009. Among other occupations, it also lists those of biophysicist, biochemist, several engineering specialties, and manager).
[29] Decree of the RF Government of 7 November 2008, No 834, "On determining, for the year 2009, of the need for attracting foreign workers into the Russian Federation".
[30] Decree of the RF Government of 7 November 2008, No 835 "On approving, for the year 2009, of the quota for the issue of work permits to foreign citizens".

which the Russian Federation has entered into visa-waiver agreements[31]. The significance of labor migration from the former USSR republic, after Russian migration legislation was amended in 2006[32], rose from 53% in 2006 to 82% in 2008. Simultaneously, there was a temporary increase in the share taken up by the Central Asian republics, and in particular - by Uzbekistan and Tajikistan. In 2008 there was no new upsurge in the arrivals from these two republics; nevertheless, in the officially registered flows of labor migrants, just as it was in 2007, they were ahead of Ukraine, West Europe becoming increasingly significant for that country's labor migrants.

The parameters of the presence of migrants from the CIS countries on the Russian labor market, as estimated by the statistics of the donor countries, are also indicative of the prevalence of the central Asian component: thus, every year, up to 1 million arrives in Russia from Tajikistan, 2 – 4 million – from Uzbekistan; and between 300 thousand and 1 million – from Kyrgyzstan[33].

The national economies (GDP) of Tajikistan, Kyrgyzstan, and Moldova depend on migrant transfers by nearly 20 – 30%, and Uzbekistan – by 10%[34]; at first, these simply became a form of survival for individual households, and then were actually came to represent the development strategies of some of Russia's closest neighbors ("export of labor").

According to the data of the Central Bank of Russia[35], in the first three quarters of 2008 the balance of cross-border transactions carried on by physical persons was negative for Russia (–21286 million USD for all countries). Physical persons transferred from Russia a total sum of 29676 million USD, which is roughly equal to the same index for the entire year 2007. Transfers to CIS countries were increasing at a higher rate than those to other foreign countries (*Fig. 4*). However, the total sum of transfers to the CIS, as before, amounts to nearly half of that to other countries. In contrast to foreign transfers outside the CIS, the transfers within the former USSR space are mainly formed as migrants' transfers, the volumes of transfers for each country are, on the whole, compatible to that country's position in terms of its number of labor migrants. From the data presented in *Fig. 5* it follows that it is only for Armenia and Georgia that the sums of transfers do not fully correspond to their officially registered numbers of labor migrants. On the whole, Russia transfers to all the countries of the CIS (except Kazakhstan) the amounts of money which are larger than those coming in the other directions.

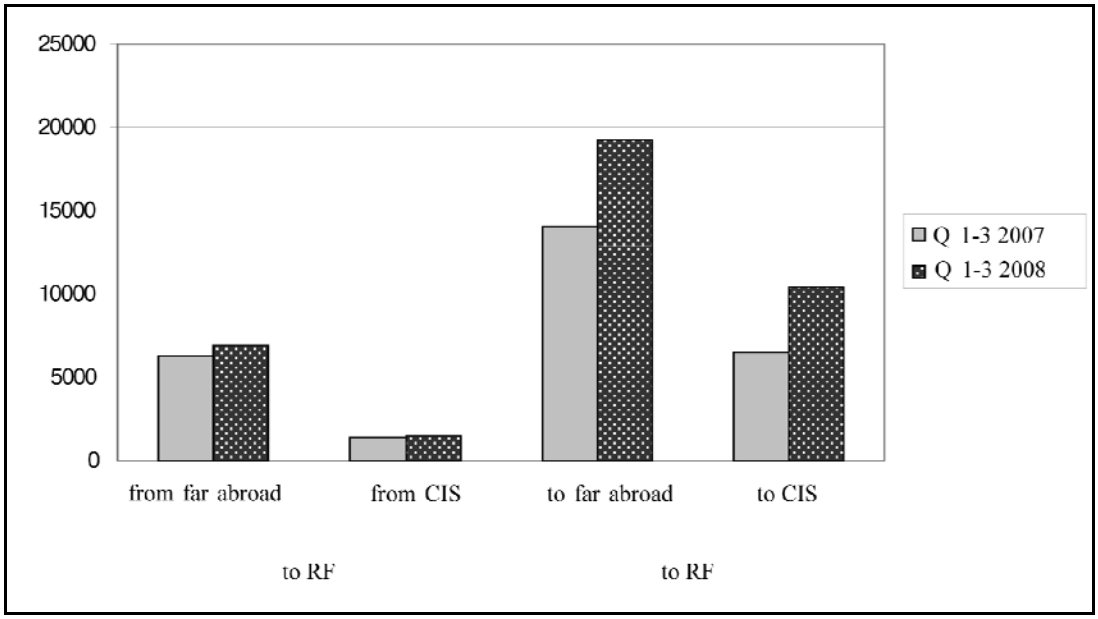
[31] Migrants from Belarus, in accordance with existing legislation, do not have to get work permits, so these are not included in labor migration statistics.

[32] For mode details, see Karachurina L. Migration processes //The Russian Economy in 2006. Trends and Prospects. M.: IET, 2007, Section 4.3. P. 492 – 513.

[33] Nezavisimaia gazeta {The Independent Newspaper]. 8 December 2008.

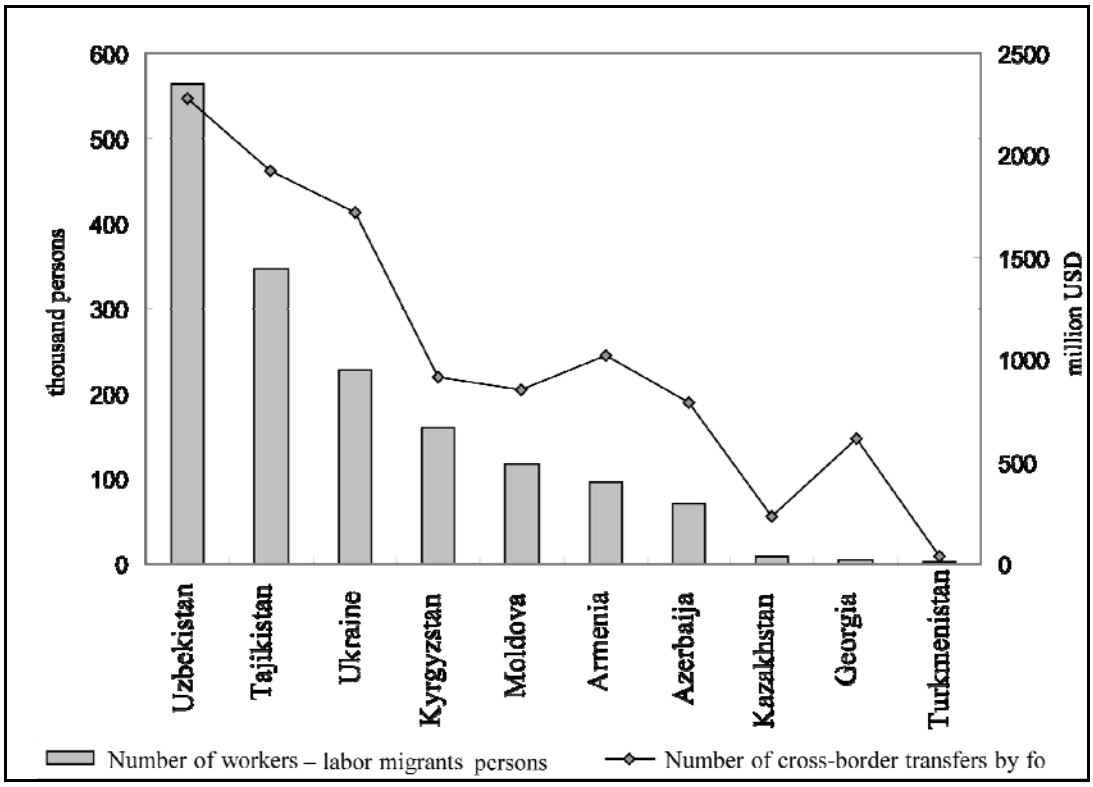
[34] Nezavisimaia gazeta {The Independent Newspaper]. 8 December 2008. See also: Glushchenko G. I. Vliianie mezhdunarodnoi trudovoi migratsii na razvitie mirovogo I natsional'nogo khoziaistva. [The influence of international labot migration on the development of the global and national economy.]. M.: Information and Publishing Center "Statistics of Russia", 2006.

[35]The RF Central Bank's official website http://www.cbr.ru/statistics/print.aspx?file=CrossBorder



Source: RF Central Bank.

Fig. 4. Cross-border transactions of physical persons, Q 1 – Q III 2007 and 2008, million USD



Source: the Federal Migration Service, the RF Central Bank.

Fig. 5. The by-country distribution of labor migrants from the CIS in Russia (thousand persons) and the distribution of volumes of cross-border transactions concluded by physical persons on their exit from Russia (million USD), Q I – III 2008.

Despite the impressive overall volumes of money being transferred, the general macroeconomic indices of the "migration sector" point to the fact that the revenues from migrants are substantially higher than the corresponding expenditures. As estimated by the head of the RF Federal Migration Service, K. O. Romodanovsky, migrants' contribution to this country's GDP amounts to 6 – 8%. Total revenues received by the Federal Migration Service for Russia's state budget in 2007 amounted to approximately 10 billion rubles[36], half of which was accounted for by fines imposed on employers. If one considers the problems with quotas that occurred in 2008 and the resulting "additional" expansion of migration's "illegitimate zone", the revenues from fines imposed for illegal use of foreign workforce could hardly be less. The share of those of them employed in the national economy constitutes, in Russia on the average, from 3% (if based on official data concerning the attraction of foreign workforce) to 10% (if based on the tentative aggregate estimates of legalized and non-legalized migrants) of its total workforce. In some Russian regions, especially in those centered on urban agglomerations with capacious labor markets (primarily in Moscow and Moscow Oblast, and in Sverdlovsk Oblast), in raw materials exporting regions (Yamalo-Nenets Autonomous Okrug, Khanty-Mansi Autonomous Okrug, Nenets Autonomous Okrug), and in some border regions (Kaliningrad Oblast, Jewish Autonomous Oblast), the involvement of migrants in certain segments of the labor market has already become a system-forming factor.

The main spheres of activity of legally employed migrants in 2008 remained without changes – these are construction and trade (*Table 2*). According to statistics, nearly 2/3 of all migrants work there. The data provided by sample surveys of migrants have made it possible to conclude that the true significance of these two sectors, as well as of the services sector can even be somewhat greater than the officially recognized level, since it is there that the share of non-legalized migrants is higher.

Table 2

The distribution of attracted foreign workforce in Russia, by type of activity, as%

Type of activity	Labor migrants, Q I – III 2008	Labor migrants, 2007	For reference: Russia's population, 2007 г.
Agriculture and forestry	6.3	6.4	10.2
Extraction of mineral resources, processing industries	10.9	9.2	18.2
Construction	43.7	40.3	7.8
Trade, car repairs	16.7	19.5	17.2
Transport and communications	3.8	4.4	8.0
Education	0.2	…	8.9
Health care, social services	0.2	0.2	6.8
Utilities, social and personal services	4.4	4.8	3.8
Other types of activity	13.8	15.2	19.1
Total	*100*	*100*	*100*

Source: RF Federal Migration Service, Rossiiskii statisticheskii ezhegodnik – 2008 [The Russian Statistics Yearbook - 2008]. Rosstat, 2008.

The economic crisis, which has already had a noticeable impact on the construction industry (the decline in production volume in this industry across Russia is estimated to be as great as 30 – 50%[37]), probably "urged" some labor migrants to return home (as seen by the more large-scale than usual homecoming for the winter), as well as caused their redistribution

[36] The sum of fines imposed on employers for hiring illegal immigrants in 2007 was 4.5 billion rubles. // Kommersant. 24 January 2008.
[37] Operatsiia 'Lishnie ruki' [The Operation 'Redundant Hands'] // Kommersant – Den'gi. 15 December 2008.

between sectors – for example, from the construction sector into the housing-and-utilities and transport sectors. The results of studies and estimations presented by Chairman of Russlavbank's Board of Directors, N. Gusman, whose bank ten years ago was the first one in Russia to develop the payment system "Kontakt" (Contact) for migrants' personal money transfers, have demonstrated that from September through November 2008, in response to the annual "seasonal" factor, a total of 320 to 450 thousand persons left Russia, and another 540 to 760 thousand labor migrants departed as a result of the crisis[38]. It is noteworthy that it was mostly non-legalized migrants who were leaving this country, because their position is less secure, and so it is easier for them to survive a crisis by relying on their own natural economy. It is also reasonable to expect that a crisis situation can be used to their own advantage by dishonest employers, who will want to reduce their expenses through attracting more illegal workers, which during a period of crisis is even less able to protect their own rights[39].

Nevertheless, one can hardly expect for a majority of labor migrants to leave Russia's territory, because it is improbable that the unstable economies of the Central Asian republics are going to suffer from crisis less than Russia. The already sparse offer of jobs on local labor markets will shrink even further. The differences in incomes per capita between Russia and the other CIS countries were already very significant even before the onset of the crisis, so the withdrawal of labor migration from Russia as a result of "labor supply crisis" is unlikely (*Table 3*). However, it is also unlikely from the point of view of "crisis of Russian consumers' demand for migrant labor": the rigid segmentation of the labor market in the early 2000s resulted in the "unskilled labor zone" being allotted to labor migrants. It is nearly impossible to imagine a situation when Russian workers might be wiling to return there. The current experience of European countries demonstrates that such comebacks never occur even during recession periods[40]. On the other hand, it is very likely that the presence on the Russian labor market of skilled foreign workers will become far less prominent. Business immigration into Russia represents the least well-studied phenomenon of contemporary migration flows; still, some fragmentary data make it possible to assume that it will indeed shrink dramatically.

On the whole, the year 2008 – the period prior to the active phase of crisis and after its onset – once again demonstrated that now it is labor migration – as opposed to the 1990s, when immigration was the predominant trend – that represents the leading vector of Russian migration processes.

[38] Ibid.

[39] Thus, according to G. Dzhuraeva, head of the legal center "Migration and the Law", Tajikistan Foundation, the number of complaints about the non-payment of wages increases by geometric progression. The rise of non-payments is mostly observed among those employers who work on the shadow market – they hire illegals, then sack them and hire others. // V Rossii massovo bastuiut tadzhikskie gastarbaiters (In Russia, Tajik gastarbeiters are on mass strike // Novosti. dn.ua. 2 December 2008 г.

[40] At the beginning of the current crisis, the United Kingdom introduced a points-based immigration system for labor migrants, which takes into account such parameters as education, previous work experience, knowledge of the English language, etc. As soon as the new system was put into effect, it turned out that, because the English themselves were not prepared to work as junior medical personnel for 7 pounds (about 300 rubles) per hour, and migrant labor was in short supply, some of the homes for the elderly were getting ready for being shut down. // Deviatyi val migratsii (The ninth wave of migration) // Novye izvestiia. 18 December 2008.

Table 3

Some socio-economic indices of the Russian Federation and other CIS countries, 2007

	Poverty level,%	Actual household final consumption purchasing power parities, RF=100	GDP per capita at Purchasing Power Parity, USD
Russian Federation	13.4	100	14400
Belarus	7.7	85	10740
Moldova	25.8	37	2930
Ukraine	29.3	59	6810
Armenia	26.5	34	5900
Azerbaijan	15.8	46	6370
Georgia	…	40	4770
Kazakhstan	12.7	69	9700
Kyrgyzstan	35.0	24	1950
Tajikistan	no data	19	1710
Uzbekistan	no data	no data	1680
Turkmenistan	no data	no data	6640

Source: RF and world countries, 2008. Rosstat, 2008; Demoscope Weekly http://demoscope.ru/weekly/app/world2008_3.php

4.2.3. Emigration

The real scale of *emigration* from Russia is, unfortunately, only weakly reflected by Russian statistics. Statistics on temporary labor migration abroad demonstrates mostly the cases of sailors contracting to naval vessels of Liberia, Antigua and Barbuda, or Malta, with the official intermediary services being provided by the Federal Migration Service (approximately 40 thousand in the first half-year 2008). Exit statistics published by Rosstat records only emigration with permanent resettlement; such cases are becoming, every year, more and more rare; their age structure is indicative of an ongoing shift towards older groups (because these are mostly the parents and grandparents of those who have been the first to emigrate); the ethnic profile is also becoming increasingly indistinct (instead of the prevalence of Jews in the early 1990s, and Germans in the second half of the 1990s and early 2000s, it is now mixed, with Russians in the lead). Nowadays, skilled specialists leave Russia mainly with work permit visas, which are not included in the statistics of departures abroad for permanent residence. Also, for example, the people who depart for the USA with green cards often keep their Russian Federation citizenship. Sometimes, same is true of persons resettling to Israel. In recent years, with real estate prices in Russia becoming high, and the receiving parties not requiring immigrants to provide proof of the absence of any Russia-based sources of livelihood, emigrants apparently have been preferring to keep (and rent out) their dwellings in Russia, thus not getting withdrawn form records at their former place of residence.

The 2008 official statistics reveal the following country preferences on the part of emigrants: 36.3% depart for Germany, 12.8% – for the USA, 8% – for Israel. The volumes of emigration to Canada, Finland and the Baltic States were also relatively significant. Despite all the inaccuracies of statistics, we should admit that it does, nevertheless, adequately reflect the basic directions of emigration: Germany, the USA and Israel were the leading countries of reception for emigrants from Russia throughout the 1990s and 2000s. In the second half of the 2000s, because of the aggravation of geopolitical problems in Israel and the actual curbing of

repatriation-linked and Jewish immigration to Germany[41], the range of countries being chosen for emigration began to expand, with Finland and Canada becoming popular emigration destinations. From 2007 onwards, statistics of emigration to the far abroad have included the Baltic States which had previously been included in the category of "the countries of the CIS and the Baltic". With these statistical changes taken into account, it becomes clear that, since 2006, the shares of the countries – the main recipients of emigrants from Russia have indeed been changing, but not too rapidly: the share of Germany slightly contracted, while the flows of emigrants to Israel (very small for a number of years) and the USA have remained almost unchanged.

The results of the July 2008 survey (of 1,600 persons aged 18 and older), designed to explore the permanent or temporary (labor) emigration intentions of Russians[42], indicate that almost 80% of the respondents exclude the possibility of permanently leaving the country, while 64% do not consider leaving it at all, even temporarily. On the other hand, 4% of the respondents "constantly think" of temporarily leaving Russia, and 2% - of departing abroad for permanent residence; 8% of the respondents "rather frequently think" of temporarily leaving Russia, and 5% - of departing abroad for permanent residence. So, it has turned out that the indices of the emigration intentions of Russians are even somewhat higher than the statistically significant indices of the contemporary migration activity of Russians in the domestic space. It is noteworthy that the most affluent (the "frequently and constantly" responses – 9–10%), highly educated (11%), and young respondents think of departing "frequently and constantly" much more than the persons with low standard of living, those with initial or secondary education, and those belonging to middle or senior age groups.

The above data clearly indicate that the emigration attitudes of Russians have not become a thing of the past, as it might have seemed from the incomplete statistics of emigration from Russia. These attitudes could be strengthened, if in-migration in the East European countries (which lost a considerable part of their own workforce over the period of the 1990s-2000s (especially after having joined the EU) due to its westward out-migration) is additionally stimulated. In order to compensate for their losses, these countries could more actively attract to their markets labor migrants from the Slavic countries, including Russia. In particular, Poland has already introduced, from 1 February onwards, a simplified procedure for labor migrants from Russia, Ukraine and Belarus to stay in its territory[43]. It is expected that Poland's example will be followed by Czechia, Hungary and Finland (where Russian physicians have already occupied one of the labor niches[44]). Thus, it is hardly advisable to assess the re-

[41] For more details, see Tolz, M. Postsovetskie evrei v sovremennom mire (Post-Soviet Jews in contemporary world) // Demoscope Weekly. 2007. No 303. http://www.demoscope.ru/weekly/2007/0303/tema02.php; Plian, P. Russkogovoriashchie v Germanii (Russian – speakers in Germany). // Demoscope Weekly. 2004. No 183. http://demoscope.ru/weekly/2004/0183/analit04.php; Karachurina, L. Immigratsionnaia politika Germanii: uspeshnyi i neuspeshnyi opyt (The immigration policy of Germany: successful and unsuccessful experience) // *Mirovaia politika i mezhdunarodnye otnosheniia* (The World Economy and International Relations). 2008. No 7. Pp. 50 – 60; and Demoscope Weekly. 2008. No 351. http://www.demoscope.ru/weekly/2008/0351/analit02.php.

[42] "Nashe "My": zadumavshiesia ob ot''ezde ("Our "we": those who are contemplating departure // Vedomosti (News-Bulletin). 12 August 2008 г.

[43] Pol'sha pretenduet na kadry iz Rossii (Poland lays claim to cadres from Russia) // Nezavisimaia gazeta (Independent Newspaper). 31 January 2008 г.

[44] Mer Khelsinki boitsia migrantov (The Mayor of Helsinki is afraid of migrants) // *Novye izvestiia* (New News). 20 January 2009 г.

alities of the migration interaction between Russia and far abroad countries only from the point of view of motivations of the Russian side.

4.2.4. Internal migration

In the second half of the 2000s, *intra-Russian migration* – which played such an important role in Soviet times with regard to land development, industrialization and urbanization, and then transformed in the 1990s into westward "home-bound" migration – radically changed its form: internal migration for permanent or long-term residence now became less popular, and was largely replaced by temporary modifications. According to official data, in January – October 2008, 1.62 million persons changed their places of residence inside Russia; although this figure is small, it is still much larger than the figure recoded in the corresponding period of 2007, which in its turn demonstrated a similar trend by comparison with 2006.

The specific socio-economic polarization of Russia's space is positively influenced by a limited number of factors (the agglomeration effect; the administrative "resource"; the exportable natural resources; and in some cases – an advantageous location) which create obvious preferences for a very limited number of regions / cities. Given the sparsity of both population and infrastructure, as well as high resettlement risks and costs (they are caused nowadays by the absence of available information services relating to settling down at a new place of residence, and of a single "operating" job-vacancies data bank, rather than by the institutions of registration of residence, as it was only ten years ago), these factors have created a situation of virtual choicelessness for internal migrants. Living in Moscow or Moscow Oblast became for many Russia not a matter of choice – but the consequence of its absence. Apart from the region centered on the capital, the enormous expanse of Russia has no more than seven to ten places which are more or less attractive for internal migrants: St. Petersburg and Leningrad Oblast, Samara, Belgorod, and Kaliningrad oblasts, Tatarstan, and Krasnodar Krai. The majority of the regions more or less attractive for internal migrants are territories centered on major urban agglomerations, or, more precisely, these cities themselves – because of the relatively broad opportunities they can offer for a job-seeker. Generally speaking, cities with population over 250 thousand, or still better – over 500 thousand residents – are the most attractive ones for migrants, even when the region itself is an out-migration one. Thus, Eastern Siberia and the Far East – two regions unattractive for internal migrants – have some islands of stable attractiveness, such as Irkutsk, Krasnoyarsk, and other large regional centers. Like a magnet, such cities attract migrants both from their vicinities and – in lesser numbers – from afar.

On the whole, so far as long-term internal migration is concerned, the level of the Russians' mobility is relatively low. The results of a survey commissioned by Roslabor[45] and carried out on the eve of the active stage of the crisis in October 2008 (it was aimed at assessing the readiness of unemployed and job seekers to resettle to another region / town where they

[45] The survey of unemployed persons and job seekers was carried out by a working group of research associates of the Institute of Demography of the State University – Higher School of Economics and of the Russian School of Economics under the state contract with the Federal Service for Employment and Labor Relations, entitled "The Development of a Model of Organizing the Employment, in Another Locality, of Citizens Searching for Work, by the Bodies of the State Employment Service, and the Recommendations Concerning its Administering". The researchers have processed the questionnaires filled in by 425 respondents residing in eleven Russian regions in settlements of different types.

could find employment) indicate that this type of mobility is not regarded as highly attractive by the population. In particular, approximately 88% of the respondents were not ready even to consider a job opportunity outside their region. The readiness to resettle (if it exists at all) is expressed by unemployed persons and job seekers only when if the wage difference between the present place of residence and the potential future one is really big – on average, when the potential wage is four times larger than that "at home". At the same time, unemployed persons in Sakhalin and Tiumen Oblasts and Krasnoyarsk Krai are oriented to a much lower wage difference than those from the republics of the North Caucasus, officially very problematic from the point of view of the level of unemployment.

As regards resettlement to East Siberia and the Far East, which is viewed in many contemporary state documents as a necessary step in the policy of "a new opening-up of Siberia and the Far East" [46], it turns out to be totally unattractive among jobless persons from the European part of Russia, as is reflected by the small number of the positive answers received in the course of the survey. "The cost of the issue" is also very high. If the average level of an acceptable wage, capable of stimulating "in principle" resettlement to another region of the country, amounted to 38.1 thousand rubles (the current wage level of the average respondent was 9.6 thousand rubles), in the case of resettling to East Siberia and the Far East the required wage rate went up to 66.1 thousand rubles. The survey results do not indicate that unemployed persons in the most problematic raion centers are more than averagely ready to become "mobile".

Russian households coped with the crisis of the early 1990s by resorting to mass-scale "shuttle" migration – in which, according to experts' estimations, 4 – 5 million persons were involved[47] (up to 8% of Russia's total employment level). However, during the years that passed since then, Russians have lost, to a certain degree, their former skills and experiences of business of this sort; the formerly existing niches for self-employment in trade and small-scale go-between services have also become narrower. On the whole, Russians presently display a rather low level of general labor mobility[48]. In such conditions, the current strategies of households in response to the crisis are still unclear, and have not yet become distinctly manifest. The crisis may cause a back flow of temporary migrants who had not managed prior to the crisis to settle at their new place of work, including in big cities. The current prospects, in terms of real migration, for "mono-towns" are not very clear, either (these constitute 40% of Russian towns, 25% of total population). On the one hand, a crisis experienced by one or two big town-forming enterprises in a poorly diversified economy may conduce to relatively mass-scale migrational relocations. One can expect that the degree of migration mobility will increase at export-oriented "mono-towns", where the residents have got used to rather high con-

[46] The section "*Prostranstvennoe razvitie*" (space development) of "*Strategiia dolgosrochnogo razvitiia* do 2020 goda" ["The strategy for long-term development until the year 2020"], prepared by the RF Ministry of Regional Development in 2006.

[47] Zh. A. Zaionchkovskaya. Trudovaia migratsiia v SNG s pozitsii obshchestva, sem'i i lichnosti (Labor migration in the CIS from the viewpoint of society, family and personality) // *Migratsiia naseleniia* (Population Migration). Vyp. 2 (Issue 2): Trudovaia migratsiia v Rossii (Labor Migration in Russia). Moscow. 2001. P. 10.

[48] The results of a survey carried out by the All-Russian Center for Public Opinion Studies (VTsIOM) in March 2008 indicate that, over the past three years, 68% of the employed respondents did not change their main place of work, 21% changed it once, and only 3% changed their main place of work more than thrice // VTsIOM. Press-vypusk (press-release) No 905 http://wciom.ru/arkhiv/tematicheskii-arkhiv/item/single/9841.html?no_cache=1&cHash=15319fa730

sumer standards (for example, the metallurgical towns Kachkanar or Nizhnii Tagil in Sverdlovsk Oblast, Saianogorsk in Khakassia, etc.). On the other hand, the available evidence of a high pre-crisis unemployment level in some "mono-towns" which are not export-oriented (Sorochinsk in Orenburg Oblast, Azov in Rostov Oblast, Vil'sk or Pugachev in Saratov Oblast, Yelets in Lipetsk Oblast, Arsen'ev in Primorskii Krai, etc.) contradicts the assumptions that migration outflow from these towns can be the only possible response to crisis.

4.3. Brunches of socio-cultural sphere

4.3.1. Development of the Educational System in 2008

Main Trends in Development of Education

Behind development of the national educational system in Russia in 208 were the same tendencies as in 2007.

The economic crisis that began manifesting itself between the third quarter and the fourth quarter of 2008 has left the educational system practically untouched, except for a minor segment of the higher education associated with the implementation of an educational credit program "Credo" held by Krein corporation in cooperation with Soyuz bank.

In 2008, key factors in development of the educational system were the demographic growth and the rise in budgetary expenditures on the sphere's functioning.

The formal education saw the number of students fall and, consequently, the schools network shrink (*Table 4*).

Table 4

The Number of Comprehensive Schools and the Number of Students (as of the Beginning of the Academic Year, Thos.) in 2007 and 2008

	2007/08	As% to the prior year	2006/2007	As% to the prior year
Public and municipal full-time educational institutions				
The number of educational institutions, units	53556	96.1	55710	95.0
of which: grammar schools	1407	102.4	1374	104.2
lyceums	1021	102.8	993	105.1
Number of students, as Thos.	13362.6	97.6	13694.7	95.8
of whom: in grammar schools	948.2	105.4	899.2	103.2
In lyceums	624.7	105.1	594.2	106.3
Non-public full-time educational institutions				
The number of educational institutions, units	691	99.1	697	96.9
of which: grammar schools	80	114.3	70	100.0
lyceums	60	96.8	62	96.9
Number of students, as Thos.	73.2	102.6	71.3	100.1
of whom: in grammar schools	11.0	113.5	9.7	105.2
In lyceums	6.1	95.3	6.4	93.6

Source: Rosstat, Rossiya v tsifrakh.

Meanwhile, the Rosstat's data conflict with the agency's data across the general education system on 206-07 and the Rosobrazovaniye's ones for 2007-08 academic year presented in *Table 5*.

Table 5

The Number of Comprehensive Schools and the Number of Students and Teachers in Theses Institutions (as of the Beginning of the Academic Year, Thos.)[49]

	2000/01	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08
The number of comprehensive educational institutions – total	**68804**	**67431**	**66207**	**64908**	**63174**	**61042**	**60845**
including:							
Full time	67063	65662	64466	63182	61497	59402	59260
Of which:							
Public and municipal	66428	64979	63759	62474	60771	58683	58562
Non-public	635	683	707	708	726	719	698
Public and municipal evening schools	1741	1769	1741	1726	1677	1640	1585
The number of students in comprehensive educational institutions-total	20554	18918	17798	16631	15631	14798	14021
including:							
Full time	20074	18440	17323	16168	15185	14373	13670
Of which:							
Public and municipal	20013	18372	17254	16098	15113	14302	13600
Non-public	61	68	69	70	72	71	71
Public and municipal evening schools, including extramural training	480	478	475	463	446	425	351
The number of teachers in comprehensive educational institutions-total	1767	1719	1684	1633	1594	1537	1482
Including:							
Public and municipal	1751	1701	1666	1614	1575	1518	
Non-public	16	18	18	19	19	19	

Source: Rosstat, Rossiya v tsifrakh. The data on the 2007/08 academic year – Rosobrazovanie.

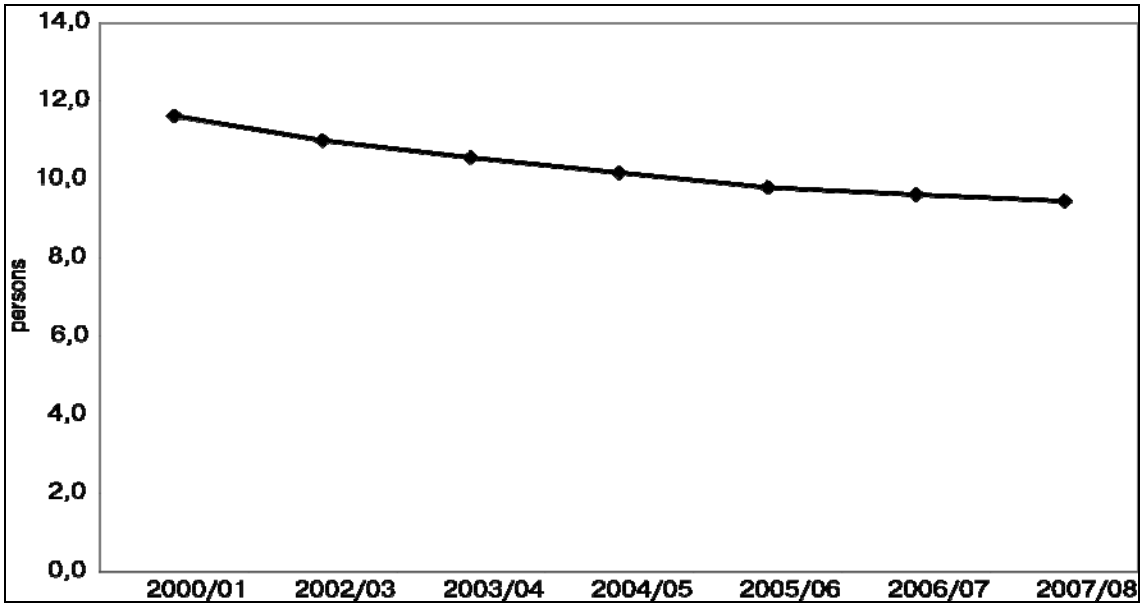
Perhaps, the noted controversies in the number of comprehensive educational institutions can be attributed to the fact that Rosstat considers schools without subsidiaries, while Rosobrazovanie considers the latter, too.

Bu this aspect is critical, as the conclusion on trends of the schools network restructuring is drawn on the basis of these data. Proceeding from the data of *Table 4*, one can conclude that the network shrank at 2, 154 educational institutions over 1 year, while *Table 5* makes him assume that it contracted only by 197 schools. *Table 1* allows one to assert that the dynamic of the network follows that of the number of students. But *Table 5* suggests that the process of the schools network restructuring is practically over, or, at least, that further steps in this area will be fraught with great difficulties. We believe that Rosobrazovanie's data ap-

[49] There are no complete data on the 2007/08 academic year as yet.

pear more accurate, as the agency breaks the whole totality of institutions of comprehensive education into head schools and subsidiary schools. Taking into account the subsidiaries network makes the information of the schools network more complete, thus allowing a more accurate consideration of the processes therein. At the same time, one has to admit that the educational statistics are in need for improvement, otherwise the quality of managerial decisions would in jeopardy .

Between 2000 and 2008 the number of students in public and municipal schools of comprehensive education fell at 31.7%, while the number of public and municipal schools tumbled just at 11.8%, and that of teachers – at 16.1%. As a result, the number of students per 1 teacher has recently been on decline: from 11.7 in the 2000-01 academic year down to 9.5 in the 2007-08 academic year (*Fig. 6*).



Source: Rosstat, Rossiya v tsifrakh. The data on the 2007/08 academic year – Rosobrazovanie.

Fig.6. The Students-to-Teacher Ratio in Comprehensive Schools
(the Number of Students per 1 Teacher)

While considering the ongoing modifications in the schooling sector of the educational system, one should take into account that the process of contraction in the number of schools and teachers faces grave social constraints, particularly in subsidized regions with a high unemployment level, with released teachers struggling to find some other job (*Fig. 7*).

In highly subsidized regions, the proportion of employees in the educational sector is substantially greater than in donor regions and those with the average level of economic development. The Republic of Sakha-Yakutia is an exception in this respect – in the region, the average per capita incomes are greater than the average ones across RF; but, at the same time, the level of unemployment defined according to the ILO standards is high there - it accounts for 8.5% of the working population. So, education in many Russian regions constitutes a sphere with low salaries but a high level of employment, thus absorbing the rising unemployment.

The current trends have given rise to a peculiar age structure of the teacher cadres, which cannot help but raise concerns. For example, 36.6% of teachers working with senior students had worked in school over 20 years, while their proportion in the primary school is over 38.4%. Given that in 1995 only 54.2% of teachers in the primary school had the record of service over 10 years, while in 2006 their proportion accounted for already 84.3%[50].

Overall, it can be argued that the age structure of the teacher cadres appears pretty unfavorable vis-à-vis the age structure of the employed in the economy (*Fig. 8*).

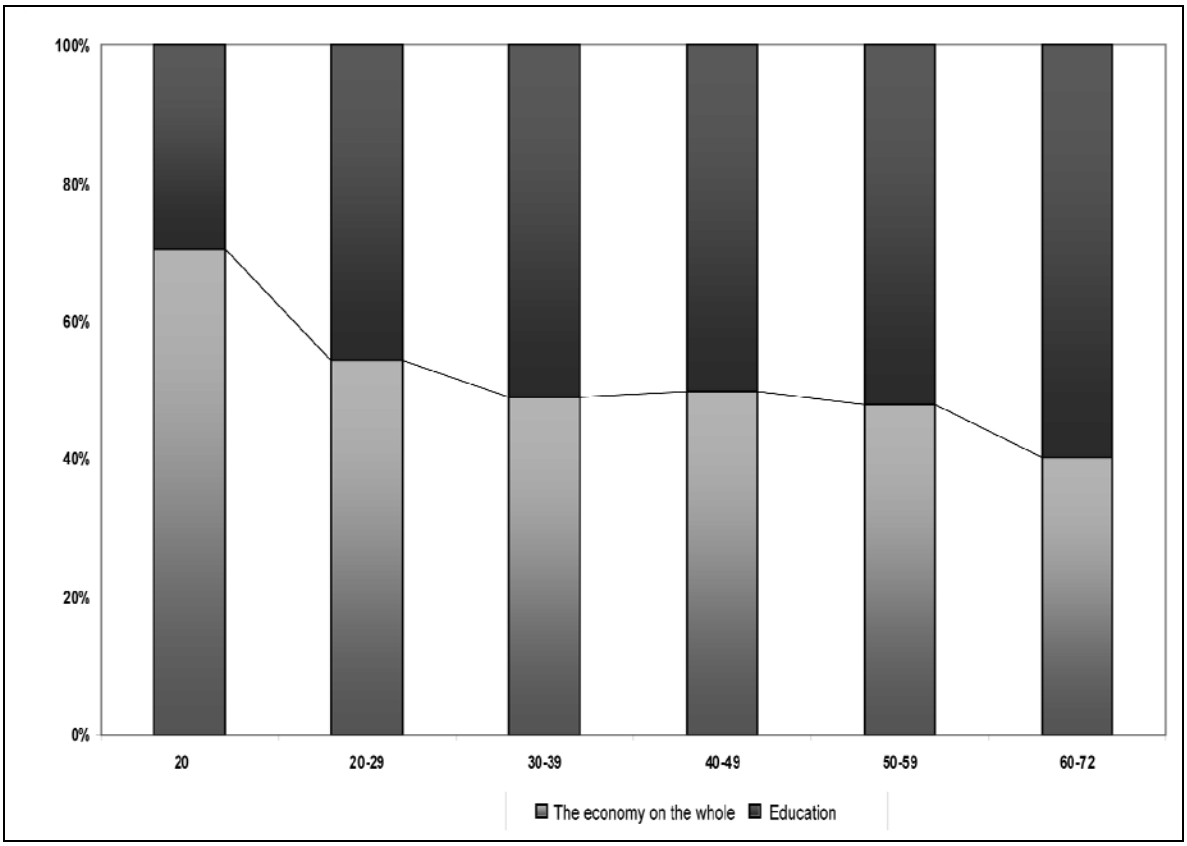
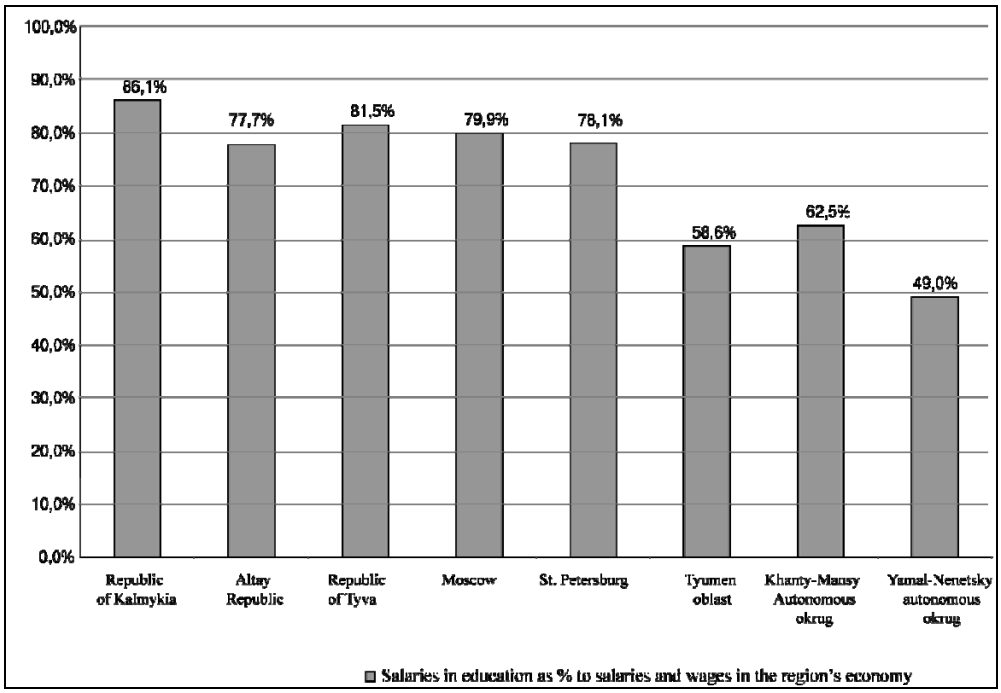


Fig. 8. Distribution of Employees in the Economy and the Educational Sector by Age Groups

It should be noted that in highly subsidized regions the level of teachers' salaries in comparison with the average salaries and wages across the economy is often greater than in donor regions (*Fig.9*).

[50] The year of 2006 is the last year by which the official data are available



Source: Obrazovaniye v Rossiyskoy Federatsii. M. GU-VSHE, 2007.

Fig. 9 Salaries in Education Relative to Salaries and Wages in Some Regions' Economies in 2006 (as%)

Table 6

The Institutions of the Primary Vocational Training [1)]

	The number of institutions (as of end-year)	The number of students[2)], as Thos.	Students admitted [2)], as Thos.	The number opf graduated qualified workers [2)], as Thos.
1993	4273	1742	1007	922
1995	4166	1689	928	841
2000	3893	1679	845	763
2001	3872	1649	837	759
2002	3843	1651	842	745
2003	3798	1649	823	722
2004	3686	1604	783	708
2005	3392	1509	688	703
2006	3207	1413	630	680
2007	3169	1253	586	656
Including:				
Full-time institutions	2743	1169	480	548
Of which:				
Departments on the basis of comprehensive education	2515	906	294	353
Departments on the basis of the secondary comprehensive education	1909	157	124	124
Groups in which the youths does not receive the secondary comprehensive education	1483	106	62	71
Evening and other institutions	426	84	106	108

[1)] By Rosobrazovanie data
[2)] In the educational institutions of primary, secondary and high vocational training that implement the primary vocational training program
Source: Rosstat, Rossiya v tsifrakh.

The primary vocational training has been recently viewed as one of the most challenging sectors of the national educational system. At the same time, an increasing number of the young people aged between 15 and 17 have enrolled in such institutions (*Table 7*).

Table 7

Coverage of the Youths with the Primary Vocational Training (the Number of Students in Primary Vocational Training Institutions to the Population Aged 15-17 Ratio in 2004–2006, as%

	2004	2005	2006
Russian Federation	**22.33**	**22.55**	**23.03**
Central federal okrug	21.59	22.24	22.48
North-western federal okrug	26.82	27.55	28.81
Southern federal okrug	16.72	16.61	16.36
Volga federal okrug	23.42	23.14	24.11
Ural federal okrug	23.96	25.30	25.99
Siberian federal okrug	24.06	24.37	24.95
Far-eastern federal okrug	23.25	22.46	23.29

As seen from the data of the *Table 7*, the rise in the number of the youths enrolling in primary vocational institutions is noted across all the federal okrugs, except for the Southern one. This okrug comprises the Subjects of the Federation wherein the respective figures are the lowest ones – the Republic of Dagestan and the Republic of Ingoushetia. It can be assumed that a low rate of coverage of the youths with the primary vocational training testifies to a hard economic situation in these particular regions. More specifically, between August 2007 and May 2008 the unemployment level in Ingoushetia accounted for 45% of the total number of economically active population, in the neighboring North Ossetia- 11.2%, and in Dagestan – 18.5%.

According to the 2006 survey by the Levada-Center, corporate executives are of a very low opinion of the PVTI graduates' professional expertise and skills. More than this, their assessment is on decline – in 2005, it accounted for 3.4 points by a 5-point scale, while in 2006 it slid to 3.3 points[51].

Employers are unhappy about the PVTI graduates' personal qualities and the level of their qualifications[52].

So, it can be concluded that the state of the primary vocational training can form a serious obstacle to Russia's further economic advancement.

In the conditions of the current crisis this segment of the vocational training system has become the focal point for presently developed vocational retraining programs for the unemployed. The efficiency of this measure can be questioned, and the quality of the programs will be low, even though they have been tagged as "advanced" ones. This conclusion to a significant degree is based on the recognition of the fact that the PVT system lately has consistently failed to duly meet the employers' needs in qualified staff. Plus, there has been no pre-crisis record of a successful and efficient retraining of the unemployed population in the regions where its level has been greater than the average nationwide one.

[51] Monitoring ekonomiki obrazovaniya. M., GU-VSHE, Levada-Center, 2007.
[52] See: Avraamova E.M. et al. Trebovaniya rabotodateley k systeme professionalnogo obrazovaniya. M.: MAKS PRESS, 2006, 160 p.

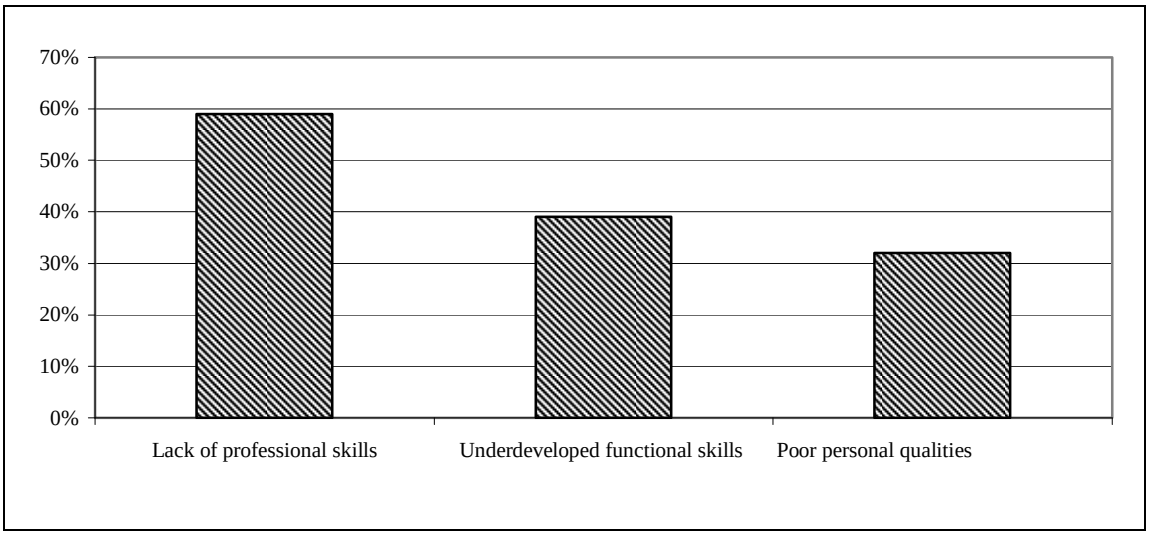


Fig. 10. Main Drawbacks of Graduates from the PVTI System as Conceived of by Employers

Table 8

Public and Municipal Institutions of Primary Vocational Training

	2008	As% of 2007	For reference	
			2007	As% of 2006
The number of institutions, units	2535	98.8	2566	97.5
The number of students, Thos.	2136.1	93.3	2288.5	95.8
Admission, Thos.	670.1	91.7	730.3	96.6
Graduation, Thos.	631.7	96.1	657.0	99.9

Source: Rosstat, Rossiya v tsifrakh.

As seen from *Table 5*, in 2008, admission in the public and municipal secondary vocational training institutions fell by 60.3 Thos., or at 8.3% vs. the 2007 figures. According to Rosstat, as many as 190,400 first-year students (28.4% of the total number of admitted students) were admitted under the conditions of a complete compensation for tuition costs (in 2007, there were 238,100 such students, or 32.6%). So, the 2008 admission in the SVT institutions on the paid basis tumbled at more than 20%. This can be attributed to the demographic situation in the country, as the fall in the number of the youths of the respective age under the number of the retained so-called “budgetary” (paid by the government) admissions engenders a contraction of the number of students that pay for their education by themselves. On the other hand, we believe that a sharp acceleration of the process (in 2007, the admission in the SVT institutions on the paid basis fell just at 9% vs. its respective figures of 2006) evidences the intensification of the redistribution of grade cohorts between the secondary vocational training and higher professional training.

It should be noted that currently the secondary school (11 years) graduates have found it fairly problematic to make their choice in favor of the PVT and SVT institutions – practically all of them, regardless of the area they reside in, eye the university education as a priority.

Table 9

Educational Preferences of Seniors in Schools and Their Parents Depending on the Region of Residence

Region of residence	Educational preferences						
	Toss-up	General sec-ondary	PVT	SVT	HVT	University Degree	Total
Moscow	6.8	0.0	0.4	10.	80.0	2.8	100
N. Novgorod	16.0	0.8	1.2	10.4	70.8	0.8	100
Vologda	12.8	0.5	0.5	11.2	72.9	2.1	100
Ivanovo	3.2	0.8	0.4	8.0	86.7	0.8	100
Across sample on the whole	9.5	0.5	0.6	9.8	78.0	1.6	100

Source: ICEPN research (lead by E.M.Avramova).

Table 9 proves the fact that for the secondary school graduates and their parents the choice in favor of a PVT institution is under 1%, for those of SVT- within 10%. Notably, seniors in schools located in the city of Ivanovo, which is the center of a highly subsidized region, have emphasized their eagerness to receive university education to a greater degree than their Moscow peers. It can be assumed that behind their aspirations are their families that hope to get out of an unfavorable economic situation by having their children receive a university degree.

Meanwhile, it should be noted that as in the case of the primary vocational training, the coverage of the youths aged 15-19 with the secondary vocational training has been likewise on the rise (*Table 10*)

Table 10

Coverage of the Youths with the Secondary Vocational Training (the Number of Students in Secondary Vocational Training Institutions to the Population Aged 15-19 Ratio) in 2004–2006, as%

	2004	2005	2006
Russian Federation	**21.24**	**21.91**	**22.67**
Central federal okrug	20.41	21.14	21.95
North-western federal okrug	18.77	19.57	20.49
Southern federal okrug	18.05	18.7	19.16
Volga federal okrug	23.83	24.66	25.76
Ural federal okrug	24.25	25.18	25.44
Siberian federal okrug	22	22.31	23.10
Far-eastern federal okrug	21.21	21.37	22.23

As shown by *Table 10*, by contrast to the situation with the PVT system, the coverage of the youths with the secondary vocational training is on the rise across all the federal okrugs. Meanwhile, sociological surveys show that this particular kind of education is increasingly growing into a “transit” level of professional training – the overwhelming majority of its graduates are keen to enroll in a university. More specifically, 76% of graduates from the SVT institutions would like to continue their education, with 91% of them, or nearly 70% of the overall number of the SVT graduates, opting for a university degree[53].

[53] Monitoring nepreryvnogo obrazovaniya: instrument upravleniya I sociologicheskye aspekty|Series “Monitoring. Obrazovaniye. Kadry”. M. :Maks Press., 2006.

The data of the Levada-Center's research show that in the eyes of employers the SVT graduates with their professional expertise and skills score 3.5 points on average by the 5-point scale[54].

Table 11

The Higher Educational Institutions

	2008	As% of 2007	For reference	
			2007	As% of 2006
Public and municipal institutions of the higher professional education				
The number of educational institutions, units	660	100.3	658	99.7
The number of students, Thos.	6214,8	100.1	6208,4	101.2
Admission, Thos.	1362,7	98.5	1384,0	100.5
Graduation, Thos.	1125,3	101.5	1108,9	105.0
Non-public l institutions of the higher professional education				
The number of educational institutions, units	474	105.3	450	104.7
The number of students, Thos.	1298,3	103.6	1252,9	106.5
Admission, Thos.	279,0	93.7	297,6	105.9
Graduation, Thos.	233,2	102.9	226,6	113.8

Source: Rosstat, Rossiya v tsifrakh.

The number of students has been on the rise both in public and municipal, and non-public universities. It has accounted for 7.51m. In the public sector it grew just by 6.400 (0.1%), while in the non-public one – by 45.400 (3.6%).

The overall 2008 admission in universities accounted for 1,641.700 persons, thus being down at 39,900 vs. the 2007 figure. Admission in the public and municipal universities plummeted at 21.300 (1.5%), mostly at the expense of full-time students (their number plunged by 47,700 or at 6.7%). At the same time, the number of students admitted in the distance education soared at 29,800, or 5.1%.

Admission under the "budgetary" quota at public and municipal universities plunged for the fifth year in a row. Overall, between 2004 and 2008 the "budgetary" admission was down at 67,300, or 10.7% of students (*Table 12*).

The year of 2008 saw a 1.7% fall in the number of students admitted in the public and municipal universities on the paid basis, while admission in the non-public universities plunged by 6.3%. Of the number of students admitted in 2008 as many as 65.8% will pay for tuition.

The admission in universities has remained pretty much in excess over the graduation from the secondary school – in 2008 the respective figure was 641,700 students, thus showing the rise in the number of students at 59,800 vs. 2007 (*Fig. 11*).

[54] Monitoring ekonomiki obrazovaniya. M., GU-VSHE, Levada-Center, 2007

Table 12

Dynamics of Admission in Public and Non-Public Universities in 2000-2008

Years	Public and municipal universities			Non-public universities
	Total	"Budgetary" admission	Paid admission	
2000/01	1140,3	586,8	553,5	152,2
2001/02	1263,5	587,9	675,6	198,2
2002/03	1299,9	608,0	691,9	204,0
2003/04	1411,7	622,6	789,1	231,7
2004/05	1384,5	628,6	755,9	274,5
2005/06	1372,5	613,5	759,0	268,0
2006/07	1376,7	585,3	791,4	280,9
2007/08	1384,0	568,8	815,2	297,6
2008/09	1362,7	561,3	801,4	279,0

Sources: Rostat, Rossiya v tsifrakh.

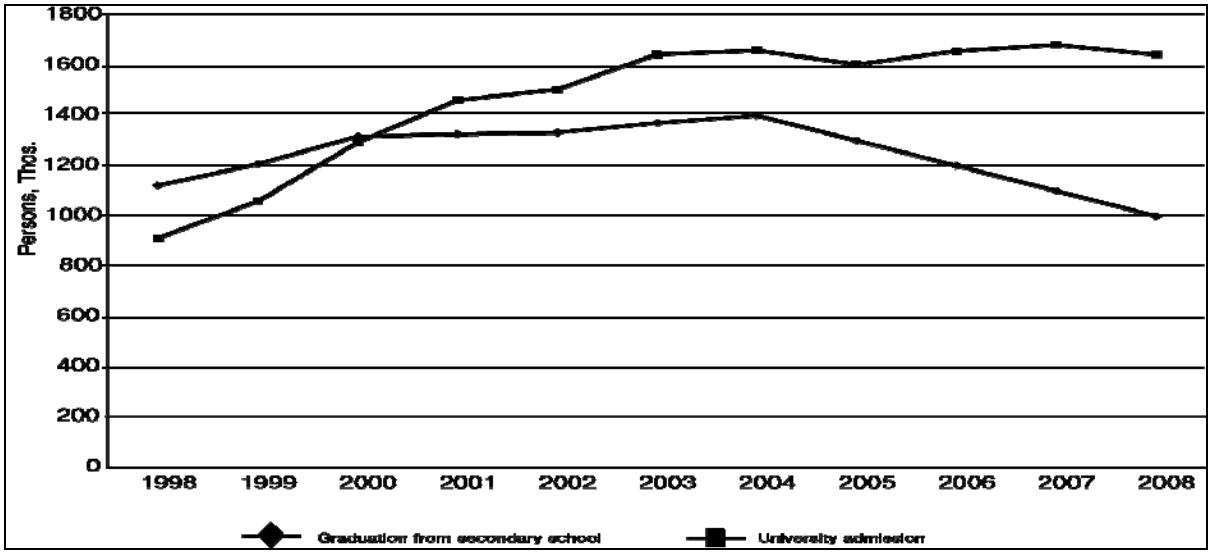


Fig. 11. University Admission and Graduation from the Secondary School

The year of 2008 has exposed yet another negative tendency, that is, the rise in the number of students that opt for distance education. As noted above, in 2008, the number of full-time students contracted vis-à-vis a simultaneous growth in the number of those who have opted for distance education.

By the number of university students per 10,000 of population Russia has become the second nation worldwide after the US. But if one considers students at the secondary vocational training institutions, the country is an absolute leader with 695 students per 10,000 of population.

In 2004-2006, as many as 31.2-33% of the youths aged between 17 and 25 was covered by the higher professional education (*Table 13*).

Table 13

Coverage of the Youths with the Higher Professional Education (the Number of Students in Institutions of Higher Professional Education to the Population Aged 17-25 Ratio) in 2004–2006, across Federal Okrugs and Some Subjects of the Russian Federation as%

	2004	2005	2006
Russian Federation	**31.16**	**31.73**	**33.01**
Central Federal Okrug	**41.30**	**40.80**	**43.84**
City of Moscow	89.54	83.89	93.84
North-western federal okrug	**33.61**	**34.36**	**35.21**
St. Petersburg	63.37	61.52	64.34
Southern federal okrug	**23.78**	**24.71**	**25.71**
Rostov oblast	29.98	31.34	32.87
Volga federal okrug	**29.12**	**30.46**	**31.04**
Republic of Tatarstan	36.82	38.42	38.71
Nizhny Novgorod oblast	32.51	36.02	38.44
Samara oblast	35.25	36.82	36.56
Ural federal okrug	**28.06**	**29.02**	**29.84**
Tyumen oblast	28.88	30.32	30.66
Chelyabinsk oblast	27.28	28.91	30.50
Siberian federal okrug	**27.53**	**27.89**	**28.75**
Novosibirsk oblast	38.83	39.74	40.09
Omsk oblast	44.00	37.27	44.21
Far-eastern federal okrug	**27.42**	**28.75**	**28.90**
Khabarovsk krai	33.99	35.04	35.70
Magadan oblast	26.57	38.84	40.83

* In each federal okrug, we have identified Subjects of the Federation in which the coverage of the youths with the higher education proved to be a maximal one or close to a maximal by a given okrug.

As shown by *Table 10*, the coverage of the youths with the higher education has been on the rise across all the okrugs. Meanwhile, the data show that the notion of an "absolute domination of the higher professional education" is a strong exaggeration. Apart from the city of Moscow and St. Petersburg wherein, accordingly, nearly 94% and 64.3% of the young residents aged 17-25 are university students, in many regions, their proportion appears comparable to that of the youths covered by SVT and even PVT.

The current boom in the higher education is in many ways fueled by individuals aged 25-plus – their number in public and municipal universities accounts for nearly 20%. This factor also seems to be behind a rapid rise in the number of students that opt for distance education. In 2007-08, the specific weight of this category of students at public and non-public universities hit 45.1% against a fall to 47.9% in the proportion of full-time students. That is to assert that the proportions of full-time university students and those practicing distance education have become almost equal.

The HPE system has recently evidenced yet another critical shift – the objective of securing accessibility of the higher education was increasingly evidently substituted by the struggle for improving its quality. In the conditions of the economic crisis and a drastic rise in

unemployment, particularly among university graduates, priorities may change again. The higher education system may once again become a social haven for the youths, with a mission to preserve them until better economic times, thus absorbing a mass unemployment of the youths.

The Policy of Financing of Education

In 2000-2008, both the public and private sources have been increasing their spending on education (*Tables 11 and 12*).

Table 14

Budgetary Expenditures on Education in 2000–2007

	2000	2001	2002	2003	2004	2005	2006	2007
Consolidated budget on education, Rb. bn	214.8	277.8	408	475.6	593.2	801.8	1033.3	1342.3
Federal budget	38.1	54.5	81.7	99.8	121.6	162.1	201.6	278.5
Territorial budgets	176.7	223.3	326.3	375.8	471.6	628.6	831.7	1063.8
Proportion of educational expenditures in the consolidated budget, as% of GDP	2.9	3.1	3.8	3.6	3.5	3.7	3.9	4.1
Federal budget	0.5	0.6	0.8	0.8	0.7	0.8	0.8	0.8
Territorial budgets	2.4	2.5	3.0	2.8	2.8	2.9	3.1	3.3
Proportion of educational expenditures in the consolidated budget, of RF, as%	9.7	9.7	10.2	12.0	12.7	11.8	12.3	11.9
Proportion of educational expenditures by the federal budget in the consolidated budget expenditures, as%	1.7	1.9	2.0	2.5	2.6	2.4	2.4	2.5
Proportion of educational expenditures by territorial budgets in the consolidated budget expenditures, as%	8.0	7.8	8.1	9.5	10.1	9.4	9.9	9.5

Sources: Rostat, Rossiya v tsifrakh, the RF Ministry of Finance.

Table 15

Volume of Paid Services in the Educational System in 2000–2008

	2000	2001	2002	2003	2004	2005	2006	2007	2008
Volume of paid services in the educational system, as Rb. bn.	41.5	56	72.9	95.4	118.7	147	189.6	231.7	281.0
as% to GDP	0.6	0.6	0.7	0.7	0.7	0.7	0.7	0.7	0.8

Source: Rostat, Rossiya v tsifrakh.

Table 12 demonstrates that in 2008 the specific weight of the population's expenses on education in GDP has grown for the first time since 2002. This can be attributed primarily to the growing costs of university education, which were rising following the growth in the budgetary financing of the higher school per 1 "budgetary" student.

In 2008, the federal budget expenditures on education rose at 20.9% vs. the respective figure of 2007. Meanwhile, expenditures on the higher professional education in 2008 accounted for Rb. 263,2bn, thus posting a 22.9% growth vs. 2007.

Whereas the number of the "budgetary" students in 2006-08 has been growing at a pace slower than that of the budgetary expenditures on the higher education, the budgetary expenditures per 1 student at public universities have posted a significant growth. Thus, in 2004, the average budgetary expenditures per 1 budgetary student per year were just Rb. 18,000, in 2005

they soared to 25,600, in 2006 – further up to Rb. 37,500, in 2007 – to 51,600, and in 2008- to Rb. 63,500[55]. With account of the structure of students at public universities, i.e. the full-time students to those practicing on-site and off-site training to students engaged in distance education ratio, the 2008 average expenditures per 1 "budgetary" full-time student exceeded Rb. 80,100 on average.

Table 13

The Federal Budget Expenditures on Education in 2000–2008

	2000	2001	2002	2003	2004	2005	2006	2007	2008
The federal budget expenditures on education, as Rb. bn	38.1	54.5	81.7	99.8	121.6	160.5	201.6	278.0	336.1
The federal budget expenditures on the university education, as Rb. bn	22.5	31.3	44.4	56.8	72.1	114.7	155.1	214.0	263.2
The federal budget expenditures on education, as% of GDP	0.5	0.6	0.8	0.8	0.7	0.7	0.8	0.8	0.8
The federal budget expenditures on the university education, as% of GDP	0.3	0.3	0.4	0.5	0.4	0.5	0.6	0.6	0.6
Proportion of educational expenditures in the federal budget expenditures, as%	3.8	4.1	4.1	4.1	4.9	4.6	4.7	4.2	4.8
Proportion of expenditures on the university education in the federal budget expenditures, as%	2.3	2.4	2.2	2.3	2.8	3.2	3.6	3.3	3.8

Source: Rostat, the RF Ministry of Finance.

The general education (schooling) is financed chiefly out of regional and local budgets. The dynamic of these expenditures and those per 1 student are given in Table 17.

Table 17

The Dynamic of Budgetary Expenditures on the General Education (Schooling) per 1 Student in 2000–2007

	2000	2001	2002	2003	2004	2005	2006	2007
Expenditures, as Rb.m	107931	143972.8	215261.2	236600	298100	356084.7	475900	398750.6
Number of students, Thos.	20073.8	19429.1	18439.7	17322.9	16168	15185.1	14362.3	13670.1
Expenditures per 1 student (Rb.)	5377	7410	11673	13658	18438	23450	33135	40851.98
Increment in costs per 1 student vis-à-vis the prior year		37.8%	57.5%	17%	35%	27.2%	41.3%	23.3%
Inflation rate		18.6%	15.1%	12%	11.7%	10.9%	9%	11.9%

Source: The RF Ministry of Education and Science, Rosstat.

With account of inflation, the dynamic of budgetary expenditures per 1 student in the system of general education takes the form (see *Fig. 12*):

[55] We consider expenditures on provision of an educational service (tuition), which roughly account for 70% of the total expenditures on the high education.

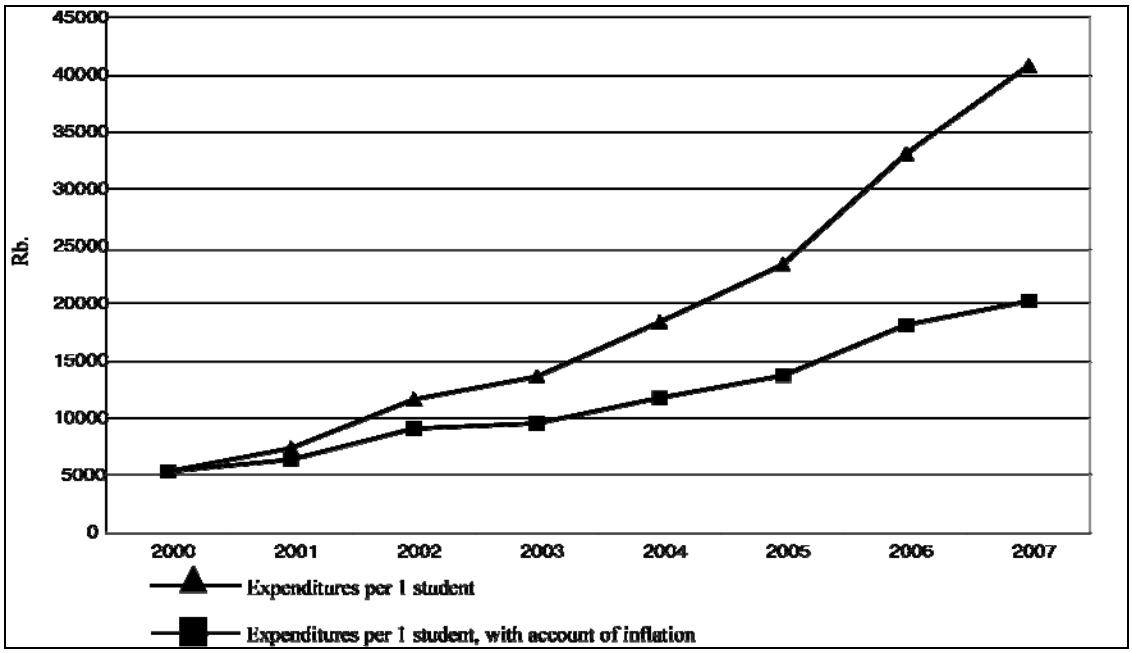


Fig. 12. The Dynamic of Nominal and Real Budgetary Expenditures per 1 Student in the System of General Education in 2000-2007

So, the real rise in budgetary expenditures per 1 student in the system of general education was practically twice as low vs. the nominal one.

In 2008, the government continued its work on introducing into the educational system of a new labor compensation system (NLCS). It was the Subjects of the Russian Federation that carried out comprehensive programs of modernization of regional educational systems that took the most pro-active stance with regard to introduction of the novelty.

At the same time, the latest available data show that there persists a fairly high differentiation between Russian regions, as far as wages in the educational sector are concerned. This is in many ways a manifestation of the differentiation of educational expenditures noted region-wise.

Table 18

The Teachers' Average Nominal Wages Due (the Data in the Last Column Are Arranged in the Ascending Order)

Subjects of the Russian Federation	The teachers' average monthly wages due, as Rb.	
	2006	2007
Republic of Ingoushetia	4590.72	5137.79
Karachay-Cherkess Republic	4492.28	5177.19
Republic of Dagestan	4991.33	5268.61
Bryansk oblast	4860.05	5447.93
Kostroma oblast	5049.97	5511.38
Kursk oblast	4970.19	5566.22
Smolensk oblast	4879.93	5764.63
Penza oblast	5724.95	5766.22
Republic of Adygeya	5034.08	5828.8
Kabradino-Balkar Republic	4291.45	5850.5
Republic of Mary-El	5163.61	5904.34
Ryazan oblast	5237.05	5916.58
Ivanovo oblast	4742.87	5965.33

Subjects of the Russian Federation	The teachers' average monthly wages due, as Rb.	
	2006	2007
Republic of Mordovia	4064.22	6037.16
Tambov oblast	5117.17	6045.92
Republic of Chuvashia	5304.29	6077.02
Orenburg oblast	5596.03	6174.47
Ulyanovsk oblast	4679.39	6491.1
Orel oblast	5967.93	6586.67
Republic of Udmurtia	6034.04	6684.47
Kirov oblast	5922.53	6693.67
Saratov oblast	4917.06	6697.71
Rostov oblast	5021.95	6777.7
Republic of Bashkortostan	5909.57	6865.44
Volgograd oblast	5469.28	6870.68
Altay krai	6293.78	6883.42
Tula oblast	6195.72	6918.09
Tver oblast	5754.07	6944.83
Chechen Republic	7312.81	7035.54
N. Novgorod oblast	5851.15	7123.88
Kurgan oblast	5593.31	7172.87
Pskov oblast	6017.34	7182.87
Republic of Tatarstan	5749.32	7184.68
Chelyabinsk oblast	6544.76	7279.13
Voronezh oblast	5629.77	7537.99
Belgorod oblast	5742.52	7620.65
Perm krai	6750.44	7641
Republic of Altay	6665.25	7721.21
Omsk oblast	7248.01	7739.45
Astrakhan oblast	6499.11	7767.82
Republic of Kalmykyia	5523.54	7888.81
Lipetsk oblast	6584.55	7967.46
Novgorod oblast	7129.78	8064.62
Republic of North Ossetia-Alania	5122.91	8066.09
Krasnodar krai	5857.59	8092.95
Yaroslavl oblast	6232.57	8202.71
Stavropol krai	5113.86	8520.94
Vologda oblast	7203.21	8590.1
Republic of Khakassia	7133.38	8872.84
Vladimir oblast	5510.35	8889.42
Kaluga oblast	6856.76	8935.54
Novosibirsk oblast	6608.76	9018.94
Republic of Buryatia	7515.91	9262.15
Ust-ordynsky Buryatsky autonomous okrug	8171.75	9317.34
Chita oblast	8908.14	9323.23
Kemerovo oblast	7631.78	9389.34
Tomsk oblast	8922.96	9780.16
Primorsky krai	9203.07	9790.78
Amur oblast	8154.5	10091.44
Kaliningrad oblast	7076.95	10145.02
Irkutsk oblast	9062.41	10228.79
Jewish Autonomous oblast	8859.7	10471.96
Sverdlovsk oblast	7965.66	10758.82
Tyumen oblast	17604.8	11055.16
Republic of Karelia	9294.88	11096.73
Agynsky Buryatsky autonomous okrug	8822.74	11291.24
Arkhangelsk oblast	9863.01	11542.89
Krasnoyarsk krai	10940.1	11598.67
Leningrad oblast	9216.75	11816.37
Samara oblast	7130.38	11905.03
Republic of Komi	10730.5	12044.24
Khabarovsk krai	10442	12391.3

Subjects of the Russian Federation	The teachers' average monthly wages due, as Rb.	
	2006	2007
Republic of Tyva	10185.3	12674.13
St. Petersburg	10770.1	13324.12
Moscow oblast	10153.1	14512.4
Murmansk oblast	12996.9	14845.44
Republic of sakha (Yakutia)	11441.3	14915.42
Kamchatka krai	15676.6	19062.62
Magadan oblast	16199.2	19580.17
Moscow	13859.1	20657.69
Nenetsky autonomous okrug	17237.2	22918.58
Sakhalin oblast	14365.8	23506.63
Yamalo-Nenetsky autonomous okrug	19843.9	24968.35
Khanty-Mansy autonomous okrug	21141.3	25286.61
Chukotka autonomous okrug	23052.9	27125.54

Source: the RF Ministry of Education and Science.

Table 18 demonstrates that in 2007 the teachers' average monthly salaries across the RF Subjects are differentiated more than 5.3 times., with the gap being wider than in 2006, when it had been 5-fold.

Institutional Transformations in the Educational Sector

The year of 2008 saw continuation of the institutional transformations that have recently taken place in the educational sector.

The uniform state examination

The year of 2008 became the final year of the USE experiment with participation of all the regions of RF.

With its Order of September 5, 2008, № 256 the RF Ministry of Education and Science approved the list of directions of training (specialties) by which admission in public and municipal educational institutions of the higher education to Bachelor's programs and programs on specialists' training implies holding additional entry creative and/or professional examinations. In addition, the Order identified 24 universities that were granted the right to conduct interviews and additional entry examinations. The list comprises all the leading national universities, including the Moscow Lomonosov University and St. Petersburg State University, which were the staunchest opponents to introduction of the USE.

While the use of results of academic competitions together with the USE results is justified by unconventionality of a fraction of enrollees (accordingly, such individuals may not be subject to uniform approaches and procedures), underpinning the introduction of additional examinations are an advanced nature of a university and a tailor-made training therein.

We believe that introduction of additional examinations by a number of universities may seriously discredit the concept of USE in the population's eyes. First, one would not be able to enroll in the university by simply submitting his papers, as the enrolee's presence will be mandatory. This will seriously increase the population's expenses on enrollment in such high-profile universities, which will make them inaccessible for children from needy families. Second, the existence of an additional barrier may give rise to corruption, which the USE was supposed to counter. Also, important is that corruption should rise in the most prestigious universities, which once again will deceive the population's expectations. As concerns the

USE, its results for the said fraction of universities will be seriously depreciated, which in principle can undermine the school graduates and their families trust in it.

It should be noted that the 2008 USE exposed profound challenges that graduates from secondary school will face in full already in 2009. These are very low scores across major subjects – mathematics, the Russian language, and literature - 25%, 11% and 23% of the 2008 graduates, respectively, scored 2 points - a very poor performance - by the 5-point scale. The USE experiment implied a provision "+1", which means that while the USE results were recalculated into traditional school marks, and extra point was added to every single score. So, having passed the USE, the graduate could not help but get the general certificate. That means that he in any case could enroll in a university, albeit universities considered the USE results. This provision is no longer effective, and the USE has entered a routine mode. We believe that it was the very aspect that stirred a great deal of criticism of the USE, as receiving the higher education has long turned into a kind of social standard in Russia, while the USE has now formed an obstacle to its realization. As concerns the university community, in the conditions of the demographic hole and a sharp contraction in the number of school graduates, the rise of an additional obstacle to admission of some 130,000 former school pupils[56] also poses serious challenges to its members, including financial ones.

In the conditions of the current economic crisis the problem of prevention of a mass unemployment among the young Russians may require a revision of a series of decisions with respect to the USE. More specifically, one will need to make it clear for the society what is going to happen with those who will fail to pass the mandatory examinations on mathematics and the Russian language. These problems have not been seriously tackled so far, which has given rise to various speculations and corruption around the USE, and sparked a wave of frustration with its introduction.

Autonomous Institutions

On November 3, 2006, Federal Act №74 "On autonomous institutions" was promulgated, and there arose a possibility to start introducing a new type of institution, that would secure a greater independence and transparency of the public and municipal educational organizations' operations. However, a heated debate around the issue has not subsided as yet – the university community and rectors appear very much in alert as far as transformation of universities into autonomous institutions is concerned.

Their concerns with regard to transition to the AI status to a significant degree are explained by the fact that its objectives are not clear to most of the parties concerned.

Back in the early-2000s, the reform of the budgetary sector was designed in a fundamentally different situation, with the deficit of budgetary financing of the social sphere and education in particular running as high as 65-70%. Because of that, numerous educational institutions compensated for the deficit of the budgetary financing mostly with of introduction of paid educational services.

In 2005-08, the budgetary spending on education has grown dramatically, while, at the same time, the specific weight of extrabudgetary gains from paid services in the educational institutions' overall volume of proceeds was contracting, albeit for a whole array of prestigious universities it remained a leading source of funding.

[56] The computation was made basing on the USE data and the dynamic of graduation from secondary schools.

The situation has lately begun undergoing fundamental changes. Yet in the pre-crisis situation, residents in many regions have seen their possibilities to pay for education hit the limit, particularly without existence of an efficient system of tuition credits. But in the conditions of the current financial and economic crisis, it is hard to expect fundamental progress to happen in the system of tuition loans, albeit it seems that this measure has been pretty sound for educational institutions from the perspective of having students capable to pay tuition to keep on receiving their training, or else Russia would face a mass unemployment among the youths.

Tuition Loans

As noted above, the looming problems with implementation of the educational loan facility Credo became one of a very few explicit signals in the 4th quarter 2008 of the effect the economic crisis would have on the educational system. As many as 22 universities participate in the program. As soon as Soyuz bank began experiencing problems, Krein corporation, the program's operator, suspended transfers and began to negotiate tuition tax credits. At present, there have been attempts to have Sberbank shoulder the problem. The situation showed that the system of educational credits cannot operate without government guarantees, as it is done in most countries.

The Priority National Project "Education"

The Priority National Project "Education" (PNPO) was supposed to give the national educational system an innovational impetus, which became particularly visible, as long as the general and higher educational systems are concerned. The magnitude of the project implementation was just a bit more modest in the primary and secondary vocational training, but it was assumed that the respective effect was and would be considerably less there.

Region-wise, the Project covered 31 Subjects of the Federation that launched comprehensive regional education modernization programs. Underlying those were introduction in schools of a standard per capita financing, restructuring of the educational institutions network, and introduction of a new labor compensations system.

The higher education system saw the start of formation and institutialization of an innovational nucleus. The government identified 57 universities whose programs were recognized as innovational ones; two federal universities were established, while establishment of the third one is underway. Plus, on October 7, 2008, the RF President signed a Decree "On implementation of the pilot project on establishment of national research universities". In compliance with the Decree, there started the work on creation of the National research nucleus university on the basis of the public educational institution of the higher professional education "Moscow engineering and physics institute (public university)" and the National research technological institute on the basis of the federal public educational institution of the higher professional education "The state technological university "Moscow institute of steel and alloys".

But the economic crisis is most likely to freeze these processes for long, as their extension requires huge financial injections.

Professional education and labor market

The problem of the necessity to bring the system of professional education in interface with the labor market has been intensively discussed lately. The society and the government

believe that the mere fact of a considerable fraction of university graduates opting for a specialty utterly differing from what they have studied at the university is the manifestation of the educational system's poor performance.

Employers claim that problems caused by low qualifications of staff are among the most pressing ones, as long as major challenges facing Russian businesses are concerned (*Table 19*) and seriously blame all the levels of professional education.

Table 19

Corporate Executives' Opinions on Obstacles to Doing Business

Kinds of obstacles	Significance of obstacles (the number of enterprises, as% of respondents that provided a significant feedback)											
	2000						2007					
	1 (min)	2	3	4	5 (max)	*Всего*	1 (min)	2	3	4	5 (max)	*Total*
No support from government agencies	38.1	12.5	24.3	9.5	15.6	*100*	27.8	10.9	25.8	20.7	14.8	*100*
Lack of qualified managers	30.2	16.0	28.2	14.7	10.9	*100*	18.6	13.5	27.9	23.6	16.4	*100*
Lack of qualified workers							14.8	12.4	19.9	24.8	28.1	*100*
Low level of infrastructure development	42.8	18.2	23.4	9.9	5.7	*100*	38.6	23.7	18.4	11.7	7.6	*100*
Intense competition	21.5	16.6	28.5	17.0	16.4	*100*	13.2	17.7	24.7	22.0	22.4	*100*
High tax rates	6.3	2.2	9.7	19.0	62.8	*100*	5.7	11.1	23.9	26.5	32.8	*100*
Problems with getting credits	38.1	9.5	14.7	14.3	23.4	*100*	43.1	17.3	14.5	13.4	11.7	*100*
Unstable legislation	13.7	9.7	22.3	23.3	31.0	*100*	15.3	19.4	22.1	20.7	22.5	*100*
Red-tape corruption	41.6	14.3	19.6	8.1	16.4	*100*	28.7	17.1	19.4	15.4	19.4	*100*
State interfering with business	55.1	13.7	16.2	7.3	7.7	*100*	48.1	20.0	16.7	8.6	6.6	*100*
Racket, exaction	78.4	9.3	6.1	2.4	3.8	*100*	66.5	11.2	9.9	8.3	4.1	*100*
Unfair competition							25.6	16.8	23.9	22.5	11.2	*100*
Natural monopolists' pressure and abuse							18.3	16.9	21.7	20.5	22.6	*100*

Source: A survey of 500 corporate executives in different sectors in 8 Russian regions. M., GU-VSHE, levada-Center, 2007.

As follows from *Table 16*, corporate executives believe that the lack of qualified workers poses the second gravest factor (after high tax rates) that inhibits doing business in Russia. The lack of qualified managers was not as significant as the shortage of qualified workers, nonetheless, this factor was also considered to be a more significant one than a low level of infrastructural development, difficulties with getting credits or unfair competition. It should be also noted that while the significance of such factors as high tax rates, difficulties with getting credits or unstable legislation have been declining notably between 2000 and 2007, the significance of the shortage of qualified managers, on the contrary, have risen. That occurred even despite the fact that many universities have established departments of management and produced more and more managers. That is why when one argues that there are too many economists, lawyers and managers in Russia, he implies primarily a low quality of their expertise, while qualified cadres in these sectors are still hard to find.

At the same time, the constantly persisting task of interfacing specialists' training with the labor market's needs is unlikely to be solved. The problem is that, objectively, most enterprises can plan development of their HR strategy for a maximum of 1-3 years.

Table 20

The Planning Horizons of the Corporate HR Strategy in Relation to Enterprises' Financial Position

Economic situation of an enterprise	Horizon of planning			
	Up to 1 year	1-3 years	3-5 years	Over 5 years
Good	28.5	53.8	10.0	7.7
Rather good	33.3	54.7	10.3	1.7
Satisfactory	37.1	52.1	6.6	4.2
Rather bad	72.7	27.3	0.0	0.0
Bad	50.0	33.3	10.7	0.0

Source: A survey of 500 corporate executives in different sectors in 8 Russian regions. M., GU-VSHE, levada-Center, 2007.

Table 17 highlights on a fundamental discrepancy between the length of specialists' training and the identification of the need for them. Accordingly, the current system of professional education will never be able to train the much-needed cadres if it focuses on the current corporate demand for them. All what institutions of professional education can do is to reduce the length of training, but this resource is fairly non-elastic. The transition to the two-level system of the higher professional education to a significant extent takes into account the need to shorten the length of training in order to catch up with the market demand. Yet employers are still apt to viewing bachelors as sophomores and prefer - at least they claim so - hiring university graduates with the 5-year record of training.

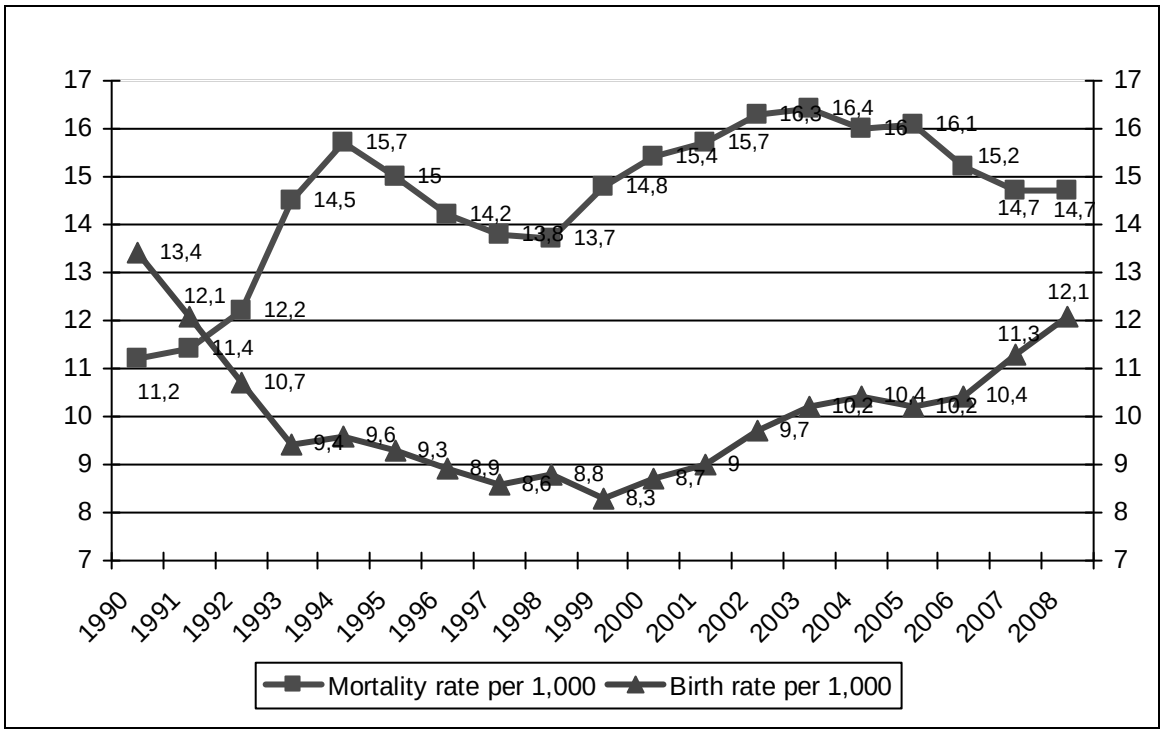
At the same time, quite a number of university seniors are employed and combine their work with training. So, employers are likely to hunt for a symbolic capital, rather than genuine expertise and skills.

Sociological research shows that regardless of which university a fresh professional has graduated from, in the overwhelming majority of cases it was his relatives or acquaintances (in more than 52% of observations) that help him with employment. It can be assumed that graduates from prestigious universities were recommended by their relatives or acquaintances for a more prestigious job; however, this hypothesis needs an additional testing.

It has become crystal clear that the economic crisis shall dramatically change relations between the educational market and the educational system. On the one hand, the corporations' planning horizons of their HR strategies will further draw in, while on the other hand, a considerable number of qualified and experienced workers and managers will flow into the labor market, and employers will be keen to pick them, rather then fresh graduates from the professional education system.

4.3.2. Health Care

The year of 2008 saw a continuous rise of the birth rate that had started in 2006. Over the past three years it grew at nearly 19% and at 7% in 2008 alone. At the same time, the positive changes in the mortality rate index noted since 2006 have stalled in 2008.



Source: Rosstat.

Fig. 13. Birth and death in 1990–2008 in Russia

Like in 2007, the federal budget continued to finance the healthcare sector at a high increment rate – the respective expenditures surged at 36% – from Rb. 169.8bn to 231.4bn in nominal terms (in 2007 – at 33%) and at 14.5% in real terms. The financial crisis has not affected the 2008 federal budget spending on healthcare. The 2009 budget mirrored a government's fairly optimistic stance – healthcare appropriations are planned at the level of Rb. 272.2bn, which means retaining the last year's level of spending in real terms. While approving in December 2008 the Program of state guarantees on provision of free medical assistance for 2009 57 the government demonstrated a precarious optimism with respect to possibilities to finance the Program out of regional budgets and employers' payments for compulsory medical insurance. The per capita annual rate of costs of provision of free medical assistance was increased 1.7 times - from Rb. 4.500 in 2008 up to Rb. 7.600 in 2009. Such a rise in costs over a year could hardly be expected even under a favorable economic situation. Under the current budgetary system it is unlikely that a formal increase of the rate would have seriously influenced the RF Subjects' administrations and inspired them to revise budgetary priorities in favor of healthcare. While revenues to the 2009 regional budgets are declining due to the financial crisis, such a decision devalues gravity of the problem of public guarantees lacking solid financial fundamentals of provision of free medical assistance.

[57] Resolution of the RF Government № 913 of December 5, 2008: «On the Program of state guarantees of provision of citizens of the Russian Federation with free medical assistance for 2009"

Table 21

Standards of Financial Costs Per Unit of medical Assistance Provided for by Programs of State Guarantees of Provision of Free medical Assistance to the Population, as Rb.

Standards of costs	2005	2006	2007	2008	2009
Per 1 call for emergency ambulance	853.6	913.3	1064.0	1213.3	1710.1
Per 1 visit to a polyclinic organization	93.9	100.5	116.9	133.3	218.1
Per 1 bed-day at a hospital	549.9	588.4	674.3	758.9	1380.6
Per provision of free medical assistance per person per year	3157.0	3378.0	3951.7	4503.0	7633.4

Sources: Resolutions of the RF Government № 690 of November 26 ноября 2004; № 856 of December 30, 2005.; № 885 of December 30, 2006.; № 286 of May 15, 2007; № 913 of December 5, 2008.

Last year, the main dominants driving changes in the national healthcare system were implementation of the National Project "Health", completion of a pilot project aimed at enhancement of the quality of services in the sector, and building a new concept of development of healthcare.

The National Project "Health"

Originally scheduled for 2 years (2006-2007), the National Project "Health" was continued in 2008. But the mass media lost interest in it shortly in the aftermath of the presidential election. The volumes of its funding out of the federal budget shrank from Rb. 116.0bn in 2007 to 100.2bn in 2008. With account of spending out of the Federal Fund of Compulsory Medical Insurance and the Fund of Social Insurance, the overall expenditures on the project in 2008 accounted for Rb, 118.8bn vs. 139.5bn reported in 2007. All this proves that the project was launched primarily in pursuit of short-term political objectives.

Table 22

Expenditures on Implementation of the Priority National Project in the Sphere of Healthcare, as Rb. Bn.

The Project implementation avenues, kinds of expenditures and funding sources	2006	2007	2008
Federal budget			
Priority «Development of the primary medical assistance"			
Training and retraining of family doctors, physicians and general pediatricians	0.15	0.3	0.3
Cash allowances to of family doctors, physicians and general pediatricians and nurses working with them	14.6	21.9	19.5
Cash allowances to medical attendants, obstetricians, and doctors, paramedics and nurses employed in the emergency ambulance system	4.1	11.2	8.0
Provision of outpatient and polyclinic institutions at municipal entities with diagnostic equipment	14.3	15.4	0.05
Provision of emergency ambulances to institutions to Emergency Call Service institutions	3.6	3.9	0.2
Immunization of the population	4.5	6.1	5.0
Prevention of AIDS, hepatite B and C, identification and treatment of AIDS-infected individuals	2.8	7.8	8.0
Check-ups of newborn babies on galactomoesia, adrenogenital syndrome, Clarke-Hadfield syndrome	0.4	0.4	0.4
Priority «Provision of the population with a Hi-Tech medical assistance"			
Construction of centers for Hi-Tech medical technologies	3.2	28.8	9.4
Provision of Hi-Tech medical assistance	9.8	17.5	24.0
Development of Hi-Tech medical technologies			7.7
Priority «Decrease of mortality rate from preventable causes»			
Improvement of organization of medical assistance to persons suffered in road traffic incidents	–	–	3.2
Improvement of medical assistance to patients with vascular diseases	–	–	3.6
Priority «Development of blood banking»	–	–	3.3

The Project implementation avenues, kinds of expenditures and funding sources	2006	2007	2008
Conduct of the additional standard medical examination of the working population			3.9
Implementation of the pilot healthcare modernization project		2.0	3.4
Implementation of informational support and project management	0.6	0.7	0.2
At the expense of the federal budget funds, total	58.1	*116.0*	*100.2*
Federal Fund of Compulsory Medical Insurance			
Conduct of the additional standard medical examination of the budgetary employees aged between 35 and 55	1.6	4.0	–
Additional payment for primary medical and sanitary assistance provided to non-working pensioners	4.3	–	–
By FFCMS, total	*5.9*	*4.0*	–
Social Insurance Fund of the Russian Federation			
Payment for medical assistance to women at public and municipal healthcare institutions during the period of pregnancy and birth (*aka* "the Child Birth Certificate	9.0	14.5	16.6
Payment for services on the additional standard medical examination of the working population and primary medical and sanitary assistance provided to them	3.9	3.0	–
Additional medical check-ups of employees in noxious and/or hazardous production factors	1.9	2.0	2.0
By SIF, total	*14.8*	*19.5*	*18.6*
Total	***78.9***	***139.5***	***118.8***
Total, as of % GDP	***0.29***	***0.42***	***0.29***

Source: data of the RF Ministry of Healthcare and Social Development.

The project's structure has undergone a series of modifications in 2008. Its two main priorities - «Development of the primary medical assistance" and «Provision of the population with a Hi-Tech medical assistance" were complemented by another two ones - «Decrease of mortality rate from preventable causes» and «Development of blood banking» (the measures focused on decreasing the mortality rate from vascular diseases and road traffic incidents). The proportion of spending on these two new directions accounted for 8.5% of the overall expenditures. Meanwhile, the allocation of funds across other priorities experienced far greater changes. In 2008, procurement of diagnostic equipment for the municipal entities' outpatient and polyclinic institutions and emergency ambulance was practically discontinued, while the spending on the population's immunization was cut. The proportion of funds earmarked to finance measures in the frame of the priority «Development of the primary medical assistance" ultimately plunged drastically – from 48.0% to 34.9%. But in the project's 2008 budget the earmarking on development of new cutting-edge medical technologies accounted for 6.5%. Notably, these expenditures were not previously included in the National Project and they were funded by some other federal budget items. Expenditures on provision of Hi-Tech medical aid were likewise on the rise – their proportion soared from 12.5% up to 20.2%. Overall, with account of the new measures, the National Project's structure saw a notable rise in spending on extension of the stationary aid – from 33.2% up to 42.8%.

Last year became particularly visible the fact that the pace of construction of new high medical technology functions fell behind the original timelines. As a reminder, when the project was approved in the fall of 2005, it was intended to complete construction of 14 such centers in 2008. The construction was supposed to follow the module principle – module blocks were purchased overseas to form the buildings. Despite this technology, in 2008 just 1 out of 14 such centers was put in operation, that is, the Penza federal cardio-vascular center. Predictably, the center instantly faced the cadres challenge, and attraction of professionals to work there required extra costs. Another two centers the completion of which had been reported back in 2007 – the federal center of traumatic surgery, orthopedics and endoprothstetic surgery in Cheboksary and the one for cardio-vascular surgery in Astrakhan - were not put in operation in 2008. In yet another three cities, assembling works were underway, in 6 others – basements were being constructed, and yet another 2 cities saw looming groundbreaking

ceremonies but no construction as yet. In 2008, the amount of earmarking on the construction of new centers was thrice as low as in 2007.

This practice of procrastinated construction has proved what experts rightly ascertained at the project's start – they questioned the appropriateness of whopping costs of construction of new medical centers in remote regions instead of building up the existing federal clinics' capacity and increasing the government order for their services.

The changes in the National Project occurred in 2008 has left its institutional component practically untouched. Complementary perks to employees of the primary link were kept at the same level, they are available to all the stuff under the same conditions, thus not generating incentives to improve quality of their performance. In all fairness, the Government drew a lesson from such a selective (only by certain categories of the budgetary staff) pay rise and did not repeat this later. Instead, the decision was made to introduce in 2008 new systems of compensations to employees at the federal budgetary institutions, which provide for a possibility to adequately link the size of labor compensation to performance. The systems were put in effect since December 2008 and they were coupled by a 30% growth of the labor compensations fund. The Government recommended the RF Subjects to follow its move; however, the current crisis has prejudiced the possibility to follow the recommendation and, accordingly, depreciated the impact of the stimulating possibilities the new labor compensations systems would ensure otherwise.

The National Project implies retaining the birth certificates mechanism. It proved to be a fairly efficient instrument, and the value of certificates has been raised. In addition, the Government funded completion of a pilot project run since July 2007 in 19 RF Subjects (see below). The National Project provided for no other new transformations in organization and funding of healthcare in 2008.

Like in the prior years, evaluation of performance under National Project poses a complex challenge, as it has been shaped as a cash-consuming one, with its measures centering on improvement of individual elements of the medical aid delivery system. Hence, it is hard to single out the impact actual costs had on changes in the population's health indicators.

Meanwhile, evaluation of the substance and implementation of the National Project in 2008 proves accuracy of conclusions drawn in 2007 and even a year before that. The project falls short of ensuring a substantial progress in addressing fundamental challenges that faced the national healthcare system. Poor indicators of the population's health, a lax protection of the population from risks of medical treatment costs, disparities in allocation of the burden of such costs and inequity in availability of medical costs across different social and territorial groups, a low efficacy of the healthcare system prove that the sector is in need for a sweeping reforms in the area of organization and financing of healthcare. To this effect the National Project lacks sufficient financial resources and provides for no large-scale institutional transformations.

Completion of the Pilot Project Aimed at Boosting the Quality of Healthcare Services

In 2008, a federal pilot project was completed in 19 Russian regions. It has been running since July 2007. Originally, the project was scheduled for 12 months, to be completed in July 2008. Its implementation cost the federal budget Rb. 5.4bn, of which 2.0 bn. was spent in 2007, and the remaining 3.4bn - in 2008. The federal budget discontinued to fund the project

in July 2008, bit its formal implementation was extended through the end of the year, to be funded solely out of the RF Subjects' budgets.

The project comprised 5 components:

transition to a single-channel funding. This novelty was tested in 15 out of 19 regions. Six regions tested "extended" tariffs of payments for medical aid in the frame of the compulsory medical system. According to the general rules, in the current CMI tariffs compensate for 5 kinds of the medical polyclinic institutions' costs - salaries and wages, and the respective taxes, procurement of medicines, soft stock and costs of patients' meals. By contrast, the extended tariffs also cover some additional kinds of costs;

introduction of the federal standards of medical aid into mechanisms of financing of the medical and polyclinic institutions' operations. This novelty was tested in 13 regions;

new mechanisms of funding the outpatient and polyclinic institutions were tested in 10 regions, with 8 of them trying out different variants of organization of intra-economic settlements between divisions within an outpatient and polyclinic institution. District doctors were encouraged economically to increase volumes and quality of delivery of medical aid and to decrease the number of patients' visits to narrow specialists or the number of hospitalizations. Kaluga oblast and Khabarovsk krai tried mechanisms of stimulation of outpatient and polyclinic institutions to boost effectiveness of treatment of the ascribed population and to decrease the number of patients' visits to other medical institutions;

the labor compensations system reform was tried out in 13 regions;

introduction of systems of the personified account of volumes of medical aid provided was conducted in 18 regions.

Table 23

Avenues of Transformations in the RF Subjects That Participated in the 2007-2008 Pilot Project

RF Subjects	Avenues of transformations				
	1	2	3	4	5
	Single-channel funding through the CMS	Funding on the basis of standards of medical aid	New mechanisms of funding outpatient and polyclinic institutions	Reforming the labor compensations	Personified account of the volume of delivered medical aid
Belgorod oblast	X	X	X	X	X
Vladimir oblast	X	X	X	X	X
Vologda oblast	X	X	X	X	X
Kaliningrad oblast	X	X	X	X	X
Kaluga oblast	X	X	X	X	X
Leningrad oblast	X	X	X	X	X
Tomsk oblast	X	X	X	X	X
Republic of Chuvashia	X	X	X	X	X
Khabarovsk krai	X	X	X	X	X
Astrakhan oblast		X			X
Krasnodar krai	X	X			
Perm krai	X				X
Republic of Tatarstan	X				X
Rostov oblast				X	X
Samara oblast				X	X
Sverdlovsk oblast		X		X	X
Tver oblast			X	X	X
Tyumen oblast					X
Khanty-Mansy Autonomous District		X			X
Total	12	13	10	13	18

Source: data of the RF Ministry of Health and Social Development.

The progress in the pilot project implementation has proved that the selection of directions for testing the new healthcare sector funding mechanisms was correct. The project has encouraged the RF Subjects to put forward and test initiative innovations in the healthcare funding mechanisms. It has demonstrated that regions can on their own develop and implement institutional transformations across the said directions. These are indisputable positive outcomes.

At the same time, organization of the experiment suffered substantial flaws. There was no explicit setting of questions to which the experiment was supposed to give answers. There were no alternative solutions to test in the course of experiment. So, the experiment focused on testing possibilities for implementation of variants of organization of a single-channel financing, building tariffs in the CMI system, funding the primary link of delivery of medical aid, the system of labor compensations to medical staff, as proposed by the regions themselves. As well, the project was to help expose barriers that might arise in this respect. The reform avenues selected for the pilot project require a far longer time to implement. The experiment outputs appear insufficient for solving the task of shaping a more efficient CMI system – it requires a far greater transformations – particularly, an increase of the role played by insurers and extension of their functions, and their transformation into genuine bearers of financial risks, a radical modification of payment mechanisms for medical aid, transformation of the system of contractual relations with medical organizations, formation of real grounds for competition between insurers and medical organizations, etc.

Designing a New Concept of Healthcare Development

In the year of the presidential election, the federal agencies drastically intensified their efforts to develop a public healthcare policy. In February 2008, the RF Ministry of Health and Social Development established a big commission with the mandate to design a Concept of healthcare development through 2020. To launch a public discussion on the project, it crafted a specialized homepage on the Internet located at: http://www.zdravo2020.ru, and every citizen got the right to introduce his proposals to the draft of the future Concept. As of late-2008, the site received over 600 proposals and over 2,200 comments on them. Notably, this has become the first experience of organizing a broad public discussion of a future concept. This undoubtedly constitutes an important step towards emergence of new democratic institutes of public administration. But the Ministry apparently lacked resources to evaluate such an abundant array of proposals. Initially, it was announced that the first draft of the Concept would be ready by May, but de-facto it was completed only by December.

At the same time, the Government continued its work on the Concept of the long-term socio-economic development of the Russian Federation for the period through 2020, approved by Resolution of the RF Government of November 17, 2008, №1662-r. Its Section “Development of healthcare” and the Concept of healthcare development trough 2020 specified the following priority objectives:

- provision of public guarantees of delivery to citizens of free medical aid in a full volume, including their specification and a legal fixing with respect to kinds, volumes, procedures and conditions of delivery of free medical aid;
- establishment of an efficient model of formation of financial resources of the Program of public guarantees, including transition to a single-channel financing of delivery of medical aid on the basis of the compulsory medical insurance (CMI), setting federal requirements

to the size of the RF Subjects' contributions to the non-working population's compulsory medical insurance;

- modernization of the CMI system, including formation of a competitive CMI model, implying selection of an insurer and medical organization by the insured individual, etc.;
- increasing efficiency of the system of organization of medical aid;
- improvement of provision of citizens with medicines in outpatient conditions, including a greater availability of medicines to citizens under the outpatient treatment on the basis of a combination of public programs of provision of medicines and the citizens' medical insurance;
- informatization of the healthcare sector;
- establishment of a system of protection of the population's health;
- implementation of the priority National Project "Health" (2009-2012).

Overall, these objectives appear adequate to the actual challenges facing the healthcare system. The proposed avenues of institutional transformations to solve these challenges also appear basically justified. Nonetheless, a whole range of problems require additional consideration, and numerous provisions of the draft Concept necessitate a substantial specification and changes.

The draft Concept falls short of providing a blueprint of the future Russian healthcare. Presently we see a model of a fragmented healthcare, including:

- territorial healthcare systems that appear considerably differring from each other by the level of development and a real implementation of public guarantees;
- the public and private systems of delivery of medical aid that practically do not interact;
- autonomously functioning systems of provision of the primary, specialized outpatient and stationary aid, lack of comprehensiveness of the treatment and diagnostic process;
- poorly interacting vertical programs of combating individual diseases.

The model will persist, should the government fail to undertake decisive actions to reform the healthcare sector.

In the meantime, the social vectors of development of the public and private healthcare systems appear alternated, and in the future we may see a model of the socially differentiated healthcare with the co-existence of the public and private systems of delivery of medical aid focusing on different categories of the population (the public system centering on the needy, while the private one – on the wealthy and the middle class), each system forming a relatively closed one and providing a full spectrum of kinds of aid.

An alternative to the fragmented and socially differentiated healthcare is an integrated healthcare model in the frame of which:

- the public system retains its focus on provision of medical aid to all the population;
- the private system complements the public one in provision of services beyond the guarantees and contributes to implementation of the public guarantees;
- the state and the professional community effectively controls the functioning and development of different, albeit interlacing kinds of aid, territorial systems, the public and private systems.

It appears appropriate to outline key characteristics of such a model in the Concept.

The realism of target health indicators cited in the Concept can be questioned. The list of healthcare development objectives trough 2020 comprises attainment of the population of 145m and rise in the life expectancy up to 75 years. Meanwhile, the Concept of the long-term

socio-economic development of the Russian Federation for the period through 2020 sets more realistic indicators – the population of 140m and the increase of the life expectancy indicator up to 75 years to be attained just by 2025.

The declared public policy priorities fell short of adequately mirroring a series of profound challenges facing the healthcare system. These are primarily the problem of a considerable inequality in distribution of the burden of healthcare costs between groups with different incomes (with the poor being compelled to spend a great proportion of their disposable income on payment for treatment), huge differences in availability of medical aid for residents of different types of settlements (the rural population and residents of small towns have less possibilities for receiving a specialized outpatient aid), for the working population and pensioners (the latter enjoy far worse possibilities for check-ups and have to wait for hospitalization longer than the former group).

The Concept also lacks a sufficient mirroring of the problem of mitigation of regional disparities. The document suggests that the rate of the CMI contributions payable by the working population should increase from 3.1 to 5.1% of the labor compensations fund. But the amount of the share centralized at the Federal CMI Fund should remain unchanged, that is, at 1.1%. This will be insufficient to solve the problem of mitigating the level of the financial provision of medical aid, whose delivery the state guarantees to all the citizens. The proposed decision would intensify the regional differentiation with respect to possibilities for implementation of the Program of public guarantees.

It was a right move to give priority to the task of specification of public guarantees. Likewise, the proposed remedy, that is, by means of development and approval of medico-economic standards of treatment appears correct. But the authors should have more explicitly enunciated their stance on the problem of high costs of the already existing standards (which are 3…4-fold greater than the current treatment costs). This problem manifested itself particularly in the course of the pilot experiment held in the healthcare sector in 2007-2008.

While crafting the Concept, one should have emphasized that development of the medico-economic standards should take into account actual possibilities for increasing the government financing of healthcare on the one hand, to form a pillar for justification of the size of this funding and allocation of resources, on the other hand. To solve this contradiction one needs to establish priorities in the use of the standards as a ground for provision of guarantees of delivery of free aid. That is, to identify an array of diseases that cause a maximum damage to the society's health (and, perhaps, not the most widespread ones) and, using them, to develop standards and economically justified tariffs, to secure necessary financial resources by this list, to exclude, in this part of the therapeutic institutions' operations, provision of paid services, to set up a monitoring of a real delivery of the guarantees and penalties applied to the therapeutic institutions for violating the prohibition to deliver paid services and charge informal fees.

Over the past decade, time and again the governmental strategic documents have been setting objectives of a priority development of the primary medical and sanitary aid, increase of its efficiency by introducing the institution of general practitioners and development of daily stationeries. The draft Concept also emphasizes priority of the task of development of the primary medical and sanitary aid, albeit the document fails to reference to organizational and economic mechanisms of tackling it. It also omits the problem of development of the institution of general practitioners and factors behind a slow progress in this direction.

Finally, the Concept does not consider problems of organization of, and compensation for labor in the healthcare sector. It looks like the decisions on introducing a new sectoral system of labor compensations in the sector made in early-2008 are considered to be sufficient. It is hard to agree with this approach, as the reforming of labor compensations mechanisms in healthcare may not be reduced to single actions like pay rises to certain categories of employees, as per the National Project, and introduction of a new sectoral labor compensations system. Healthcare is in need of a long-term action plan in this regard.

The critical flaw of the draft Concept lies in the failure to present mechanisms of encouragement of subjects of healthcare financing (agencies managing healthcare on the regional and local levels, and insurers) to increase the healthcare system's efficiency and quality of performance.

The allocation of powers between levels of government with respect to organization and financing of healthcare needs to be revised. There has arisen the need to delegate the mandate on financing provision of stationary aid to the level of RF Subjects. In so doing the Government would limit the scale of financially unsecured and sometimes simply excessive capacities, extending at the same time possibilities for establishment of inter-district centers for specialized aid and generating conditions for overcoming a duplication of government institutions' operations.

The draft Concept has failed to mirror the presidential target of extending possibilities for patients to pick a medical organization and a doctor. In such a document one should have articulated that the government consistently pursues the policy of fostering competition environment for public, municipal and private organizations, including:

competitive selection of medical organizations of all property forms to implement public and municipal orders;

development of clear operational guidelines for private medical institutions, extension of their participation in the CMI system with the use of tariffs that mirror real costs for the medical aid delivery;

facilitation of the consumer's choice on the basis of collection and dissemination of information about medical organizations' performance, building ratings of uniform medical organizations by these indicators;

promotion of the system of birth certificates and getting private medical organizations involved into it, to name a few.

The draft Concept suggests having the primary medical and sanitary aid to be paid for out of the CMI funds on the basis of differentiated tariffs for visits (for the sake of prevention of diseases, treatment, active or passive casework) with a subsequent transition to per capita standards with respect to the local residents "fixed" with a given medical institution. It is suggested setting tariffs in such a way so that to stimulate, at the first stage, an increase in the directivity of the primary medical and sanitary aid towards prevention of diseases. The approach will most likely to be a mug's game. One has got to blankly dump the indicator of a doctor's visits as the unit of payment for outpatient services and to switch to the per capita method of financing of the "fixed" local residents. This should be done yet in 2009, rather than in a few years, as the Concept suggests.

Employment of the per capita method immediately encourages one to shift the focus of the primary medical and sanitary aid towards preventive activities, which is proved by other nations and a number of Russian regions' experiences.

It is appropriate to use the per capita financing method in combination with additional stimulus mechanisms, including incentive payments for attainment of pre-set indicators of the primary link's performance and the system "polyclinic – holder of funds".

The document correctly references to the need for modifying organizational and legal forms of medical institutions; however, at the same time, it does not specify stages of implementation of such transformations. It should be emphasized that it is appropriate to retain some kinds of institutions in the current form of budgetary institution, with new forms complementing, rather than replacing, this particular form. So, some of the currently existing healthcare institutions will retain their form, while others will undergo a transformation into new forms.

It is possible to single out the following two conditions of retaining a medical organization in the same form:

its major operational profile cannot be adequately measured with volume-based (resultant) indicators;

it is more important to ensure the possibility to deliver medical aid, rather than to optimize the loading of an institution's capacity.

Matching these conditions are the sanitary and epidemiological control centers, infective hospitals and psychiatric asylums, tuberculosis dispensaries, drug abuse clinics, AIDS centers.

It appears necessary to transform other institutions that provide medical services into autonomous ones. Once transformed, they would enjoy a greater independence in attraction and use of resources, a greater economic responsibility, thus being more sensitive to methods of financing that would make them more focused on a greater operational quality and efficacy.

Overall, it is possible to recap the above with the following conclusion: the conceptual proposals on development of healthcare so far have appeared overly generalized and they risk sharing the destiny of all the preceding documents of this kind, that is, to remain a sign of an executed ritual, rather than to form operational guidelines.

Challenges Facing the Healthcare System in the Crisis Conditions

The intensifying financial and economic crisis has already battered the earlier planned revenues to the RF Subjects' budgets and, accordingly, the planned increment in healthcare expenditures; in 2009, these expenditures may fall in absolute terms. The production slump in a number of industry branches, possible delays with salaries and wages and rising unemployment can have an adverse impact on the envisaged receipt of funds by the CMI system. At such juncture it should be expected that the CMI system would shift the risks of financing of medical aid provided to the population to medical institutions, which in turn would strive to pass them over onto the population by cutting spending on medicines and increasing the proportion of medical aid offered on the paid basis.

Depreciation of the Ruble will fuel the price rise for medicines. That can result in contraction in real terms of amounts of medicines procured for the Program of delivery of medicines to social security beneficiaries and medical institutions.

Inflation will be devaluing the medical staff's salaries and push them to mount pressure on patients for the sake of ringing up informal payments.

The declining real incomes and the price rise for medicines will constrain the population's possibility to buy necessary medicines and pay for medical services officially or under the counter.

As a result, the accessibility of medical aid will be declining, particularly for the poor categories of the populations. The increasing number of patients will be compelled to refuse applying for medical aid or receiving it in full.

The distinctive feature of the current crisis lies in its gradual nature and an envisaged long-lasting period of exit out of it. That is why the above processes will be unfolding gradually, which should mitigate the intensity of the looming problems and may create an illusion of a relative safety of the healthcare system vis-à-vis other sectors. But delays with reaction to these processes may engender irreversible shifts in the level of availability of medical aid at a fee, emergence of practices that involve informal payments, a lower availability of medical aid to a considerable part of the population, and, ultimately, deterioration of the public health indicators.

So far as the mitigation of effects from the financial and economic crisis is concerned, the main objectives of the public policy in the healthcare area are:

a maximal buffering of decline of availability of medical aid with the emphasis on two categories of the population:

the needy strata whose current incomes and material position exclude or strongly limit a paid-for medical treatment;

individuals with "catastrophic" expenses on medical aid that account for over half of their disposable income – primarily individuals with chronic diseases whose treatment requires particularly considerable costs;

implementation of measures on reducing zones of an inefficient use of the healthcare system's resources.

To tackle these problems, it would be appropriate if the government takes steps in the following directions:

- determining priorities in ensuring guarantees of delivery of free medical aid;
- strengthening the regulation of conditions of delivery of paid medical services;
- improving of provision of the target categories of the population with medicines;
- strengthening the regulation of pricing for medicines;
- revising allocation of resources in the frame of federal and regional target programs;
- initiating development in the RF Subjects of plans of urgent and medium-term measures on the increase of availability of medical aid and formation of a rational medical organizations network;
- increasing the level of concentration of the healthcare system's financial resources;
- introducing methods of payments for medical aid and labor compensation system that would encourage medical institutions to enhance their performance.

4.4. State of the Sphere of Research and Innovation in 2009

4.4.1. Strategic Plans of Development of Science and Technological Innovation

Last year saw development of several core documents that concern the sphere of research and innovation, of which the principal ones were the Concept of the long-term socio-

economic development of the Russian Federation through 2020 (CLD) and the Long-term forecast of the scientific-technological development of the Russian Federation (through 2025).

The Concept of the long-term socio-economic development of the Russian Federation through 2020 proclaims transition to an innovational socially-oriented development. This suggests "formation of a national innovational system, including such elements as an integrated with the higher education R&D system which in a flexible fashion reacts to demands on the part of the economy, engineering business, innovational infrastructure, institutions of the market for intellectual property, mechanisms of encouragement of innovations, and others; formation of a strong scientific-technological complex securing attainment and maintenance of Russia's leadership in research and technologies across priority avenues"[58].

Specifically, it is planned to reach the following indicators of scientific and innovational development: the proportion of industrial enterprises that implement technological innovations should grow up to 40-50% (2007-8.5%), while the share of the innovational production in the aggregate volume of output should rise up to 25-35% (2007- 5.5%). Ultimately, by 2020 Russia should be able to secure a significant (5-10%) position on markets for Hi-Tech goods and intellectual services, at least in 5-7 sectors.

According to CLD, it is planned to complete formation of a national innovational system, modernization of the fundamental and applied research and professional training. It is planned to integrate by 2020 the national innovational system into the global innovational one and to complete integration of science, education and business. By 2012 expenditures on R&D should reach 1.4 -1.6% of GDP, and further rise to 3% of GDP by 2020[59]. The Concept becomes fairly unarticulated when it comes to means by which these objectives will be reached. Rather, the document cites areas in which they are going to be undertaken, but it remains unclear what exactly, and how that will be done. To exemplify the drawback, the list of measures comprises development of the competitive environment; encouragement of investments in modernization of technological base, conduct of research and developments, commercialization of their findings and capitalization of intellectual property; creation of conditions for an efficient market appraisal of the accumulated and created intellectual property, to name a few[60]. As concerns development of research, the respective measures appear more articulated, but they have already diverged from the Government's actual plans.

Results of the Long-term forecast of the scientific-technological development of the Russian Federation (through 2025)[61] should have been considered in the process of designing the CLD; however, the Forecast was completed far later than the Concept. The analysis of its projections allows conclusion that its objectives are hardly attainable. For example, according to the Forecast, in the short run the national scientific-technical complex is to face such con-

[58] Concept of the long-term socio-economic development of the Russian Federation through 2020 . Approved by Resolution of the RF Government of November 17, 2008 № 1662-p, section "Directions of transition towards innovational socially-oriented type of economic development".

[59] Different sections of the document quote somewhat controversial figures – 2.5%, 2.7% and 3% of GDP by 2020.

[60] Concept of the long-term socio-economic development of the Russian Federation through 2020. Approved by Resolution of the RF Government of November 17, 2008 № 1662-p, section "Development of science, the national innovational system, and technologies"

[61] The document is analyzed by its version available as of late-December 2008. The work on the Forecast is underway now.

straints as a further contraction and degradation of the quality of its research potential, coupled with the aging of the cadres, degradation of the material and technical base of research; Hi-Tech and "medium-tech" industries will be facing an accrescent shortage of highly qualified staff[62]. Notably, the respective projections partly, albeit not in full, match those given in the CDL. According to the Forecast, the proportion of the domestic R&D costs in the nation's GDP should account for 2% by 2015 and 3%- by 2020. Meanwhile, a number of indicators given in the Forecast raise certain doubts: for instance, the document foresees a fall in the number of researchers to 400-600 Thos., while already today the Russian science can boast just some 390,000 researchers[63]. As well, the document projects that between 2008 and 2010 the amount of extrabudgetary funds in the domestic R&D costs should surge from 45.0% up to 56.0%, while the extrabudgetary funds currently account for 39%, rather than 45%. Hence, a series of inaccurate original parameters undermines confidence in the projections.

From the perspective of innovation policy measures, the Government, as per the Forecast, will focus on two major avenues – namely, implementation of initiatives which would secure creation of the technological development capacity in the long run (fostering nanotechnologies as an example) particularly through implementation of critically important nationwide innovation projects (*aka* VIP-projects) of a great magnitude. The other avenue implies cultivation of the national innovational system's institutions and infrastructure, which will ensure companies' access to the much-needed technologies and, at the same time, orient the R&D sector towards creation of demanded by businesses technological solutions by means of formation of financial institutions, development of innovation clusters, and creation of a system of governmental support to (small-sized) innovational start-ups.

The Concept and the Forecast combined have fallen short of giving an explicit understanding of a strategy of the innovation system's development, particularly, in the crisis conditions, as well as of consistency and contents of the government regulation measures.

4.4.2. Developing the Legal Regulation of the Scientific and Innovational Activities

The Government's strategic documents ascertain it will be at pains to have business provide greater investments in research and innovation, so that they will be increasing at a pace greater than that of the government's ones. But this objective necessitates developing general regulation measures that encourage private investment in innovation projects. Such instruments so far have appeared underdeveloped. A step in this direction was made yet in late-2008, with the passage of the Federal Act "On transfer of rights on unique technologies"[64], which was vehemently coined in 2008.

The research community has long been anticipating this Act, for it hoped to get a unequivocal description of procedures and conditions of technology transfer from the public sector to business in the event the intellectual property created at the expense of budget's funds is fixed with the organization that developed it. Postulation of the transfer of rights to a developer (fixed in Art. 77 Section IV of the Civil Code of RF) without description of a

[62] The Long-term forecast of the scientific-technological development of the Russian Federation (through 2025), p. 3.4. "domestic conditions for the scientific-technical complex".
[63] The 2007 data. Source: Osnovnye pokazateli razvitiya nauki v Rossiyskoy Federatsii v 2000-2007 gg. Express-informatsia. M.: TSISN, 2008, p. 26.
[64] Federal Act of 25.12.2008 № 284-FZ

mechanism of the further transfer of these rights to business (industry) for the sake of commercialization of technologies inhibits introduction of results of the scientific and technical activity into economic turnover.

Such a law should have encouraged developers to create technologies and it should have lifted the existing administrative and financial barriers to commercialization. For example, at present the permit that grants research organization with the right to conduct financial operations has fallen short of identifying a system of usage of license payments. In the event a given organization (budgetary institution) sells a patent or a license, all the respective income is subject to accrual to the budget. That is why the research stuff and administration of research institutions do not have any incentives to register objects of intellectual property and sell the respective licenses. But the Act has failed to identify a mechanism of introduction into the economic turnover of intellectual property in the event it has been created at the expense of budgetary funds and fixed with the organization that developed it. The Act solely regulates situations when the rights for a unique technology belong in part or in full to the Russian Federation and/or Subjects of RF. In compliance with Art 77 of the Civil Code of RF, there exist three such cases (p.1 Art 1546 of the CC of RF):

1) the unique technology is directly associated with the RF's defense and security;
2) prior to creation of the unique technology or in the aftermath the Russian Federation assumed financing of works on developing the unique technology up to the stage of its use in practice;
3) the developer has failed to complete within six months upon the end of the works all the actions needed for recognition for him or acquisition of exclusive rights for results of intellectual activity which constitute elements of the technology.

The Act reads that the unique technology created at the expense of budgetary funds is transferred to private investors basing on an open tender or an auction in exchange for their obligations to ensure its commercialization. The respective proceeds from its sale will be channeled to the budget, while the Government with its special Resolution will identify conditions of the developers' remuneration. This approach appears particularly disputable in the event the Russian Federation or its Subject acquire control over a technology due to the developer's failure to secure within six months upon the end of the works on creation of the unique technology completion of all the actions needed for recognition for him or acquisition of exclusive rights for results of intellectual activity which constitute elements of the technology. In this case, in compliance with p. 3 Art 1546 of the Civil Code of RF, the developer is not dispensed from the duty to seek registration of rights for results of the intellectual activity that form elements of the technology. Thus the developer is bound to register the said rights under his name and, consequently, to assign them to the RF or its Subject. The appropriateness of this provision appears doubtful in a situation when the RF or its Subject's right for a technology arises due to the failure to honor the obligation to acquire and recognize exclusive rights. Such technology should then be sold at a tender or an auction held by the state, with an actual doer (the entity that has organized creation of the unique technology) enjoying a preferential right for acquisition of the right for it.

So, developers of a unique technology have found themselves in a disadvantageous, if not absurd, position. They develop a technology and then, due to reasons not always dependant upon their intents and desires, fail or find themselves unable to register their rights for results of intellectual activities that constitute an element of the unique technology within a six-

month period (to apply for a patent, state registration of results of intellectual activity, etc.), and that is why they are bound to reassign the right to the state. To do this, they anyway have to spend money on registration of the intellectual property and then to reassign the rights to the RF. The government then holds an auction or a tender, and the doer (organization) can acquire the right to use the technology it has developed.

Finally, in compliance with the law, the victory in a tender or an auction is given to a bidder who has offered the best conditions for the use of the unique technology. But the law does not stipulate how and on the basis of which criteria the government will be overseeing fulfillment of the winner's technology commercialization plan or whether it can be modified.

This arrangement contradicts the long-tested international practices, which imply that commercially promising results obtained at the expense of budgetary funds are given to developer organizations that negotiate with the private sector on their own, while the parties are bound to follow general framework conditions set by the state. Under such an approach the costs the government has incurred to develop the technology are compensated in the form of tax receipts from its commercialization, rather than direct payments to the budget.

The approaches stipulated in the law appear particularly inefficient in the conditions in which businesses do not display an enthusiastic demand for created in the public sector R&D, while overall volumes of sales of technologies in the country are still very low.

The legal lacunas in the area of regulation of rights for intellectual property result in a low level of its introduction into economic turnover. According to Rospatent, only 20% of public contracts have engendered registration of copyrightable results, while the other 80% have been written off without capitalization[65].

An important avenue of encouragement of innovation activities is helping small-sized enterprises' development. Budgetary institutions, such as research organizations and universities, have so far had no right to found small innovational firms, which conduced to underutilization of the commercial potential of R&D and research institutions and universities loosing intellectual property. In 2008, there was being developed a Resolution which would grant public scientific institutions the right to establish small-sized enterprises. According to the draft Resolution, public research institutions and universities would be able to contribute with rights for their intellectual property into the newly established small-sized firms' authorized capital. The progress with the bill is very slow, because the Ministry of Finance sticks to provisions of the Budgetary Code and Tax Code which prohibit research institutions to do business.

Improvement of the R&D financing mechanisms was also carried out through development of amendments to Federal Act № 94-FZ "On placement of orders on delivery of goods, completion of works, provision of services for public and municipal needs". A series of much-needed for the scientific and technical sphere amendments were taken into account in the Act, that should take effect as of March 1, 2009[66]. Now it is allowed to conclude a contract with several participants under placement of an order on execution of two and more scientific and research works with regard to the same subject and with the same terms and conditions of the contract, as per the tender documentation, that form one lot.

[65] Poisk, № 10, March 7, 2008, p. 3

[66] Federal Act of the Russian Federation of December 30, 2008, № 308-FZ «On introducing amendments to the Federal Act "On placement of orders on delivery of goods, completion of works, provision of services for public and municipal needs and individual legislative acts of the Russian Federation"

The law so far has equaled research to government's specific procurements, which engendered a whole series of problems. Judging the statistics of the number of applications and conducted tenders by the federal target program (FTP) "Research and development by priority avenues of development of the scientific and technological complex of Russia for 2007-2012" (*Table 24*), the imperfection of the law entailed considerable labor costs, as one had to form a great number of lots and to run a separate tender and to pick a sole winner by each of it. That occurred even if the commissioned works were identical (for instance, lots on support of technology transfer centers, business incubators, etc. in various regions of RF). The possibility for picking several winners by a lot should lower the level of bureaucratization of the process of allocation of financing in the frame of the FTP.

Table 24

Applications and Tenders by the FTP "Research and Developments by Priority Avenues of development of the Scientific and Technological Complex of Russia for 2007–2012 "

	2007	2008
The number of applications on formation of the tenders' subjects	5265	3180
The number of bids	4845	1597
The number of tenders	377	759
The number of contracts concluded by tenders' results	1297	731

Source: http://www.strf.ru/organization.aspx?CatalogId=221&d_no=17039

The other important amendment is modification of timelines of conduct of project evaluation – they were extended from 10 days to 30 days. The Russian and overseas foundations' experiences show that a high-profile evaluation of a research project takes some 3 months. The tight timelines of conducting an evaluation previously stipulated in the Act have complicated co-financing of research projects out of Russian and foreign sources.

Meanwhile, the quality of projects selection finds itself affected not only by the evaluation timelines, but also by the selection criteria set by the Act. Presently the correlation of "weights" between the project evaluation criteria appears inadequate to selection of R&D projects, and no amendments have been introduced in this area. The aggregate weight of such criteria as "the quality of works" and "the participant's qualification" for an R&D project may not exceed 45%. That is why, in compliance with the law, it is inexpensive research projects reporting by which is fast and easy that should be financed in the first place.

Finally, one of important avenues of developing connections between research and education, and enhancing the quality of research output is intensification of their integration with the educational process. In late-2007, the Federal Act "On introducing amendments to individual legislative acts of the Russian Federation on matters of integration of education with research" (№308-FZ) was enacted. The Act grants research institutions with the right to conduct training by postgraduate professional educational programs, as well as by educational programs of an additional professional training. The Act permits educational and research institutions to jointly use material and cadres resources to carry out both educational and research activities. Universities and research institutions are granted the right to provide each other, on the contractual basis and *pro bono* in particular, with their movable and immovable property, as well as to establish integrated structures, such as chairs and laboratories. But the Act suffers a whole lot of lacunas. To cite a few ones, the above integration options are available solely for public non-for-the-profit organizations, while unitary enterprises or joint-stock companies (i.e. research organizations in the sector) may not establish integrated structures

with universities, nor can they carry out a *gratis* cooperation. Such a restriction blocks solving a profound challenge, that is, strengthening of cooperation between science and business. In addition, the recent practice shows that even creation of joint organizational structures likewise poses problems. The Act reads that procedures of establishment of such structures fall under the RF Government's competence, but they have not been developed as yet. Specifically, this inhibits processes of the organizational unfolding of such forms of university research as Scientific-Educational Centers (SEC). So, the Act allows integration, albeit to a certain extent, but falls short of providing any measures to promote it.

4.4.3. Financing of Research: Indicators and Mechanisms

Our analysis of distribution of budgetary funds on fundamental and applied research allows conclusion that the expenditure cross-section has undergone just minor changes. There are only two novelties:

1. The planned gradual contraction in the specific weight of expenditures on fundamental research in the aggregate volume of financing of civic R&D. The proportion of expenditures on fundamental research has been so far on the rise, particularly due to implementation of a pilot project on improvement of the system of labor compensations in the system of public academies that was completed in 2008.
2. Allocation of considerable resources on boosting nanotechnologies.

From the perspective of sections of the functional classification, there practically are no changes vis-à-vis the prior years. The bulk of expenditures on civic R&D fall on sections "the National Economy" and "General Public Matters", with the latter one concentrating all allocations on fundamental research. Such pivotal matters as healthcare and protection of environment are still financed in nearly symbolical amounts. This greatly distinguish the structure of Russia's budget from the developed nations ones, as in the western countries science associated with improvement of living standards (primarily, medical science, biology and cognitive science) is increasingly forming a top policy priority.

The departmental structure of the budgetary expenditures underwent no fundamental changes, as the institutional structure of sciences has remained unchanged. The principal recipients of budgetary funds on civic R&D have remained, from top to bottom, the Federal Space Agency, RAS with its regional branches, the Russian Agency of Education, and the Russian Academy of Medical Sciences.

Since 2009 the RAS has seen new principles of its financing, that is, on the basis of the Program of fundamental research of public academies of sciences for 2008-2012[67]. The Program suggests such critical fundamentals of financing as: securing stability of financing, concentration of resources on areas picked by the research community itself, promotion of the competition environment, creation of an objective research evaluation system. It is planned that by the moment of completion of the Program – namely, by 2012 – the specific weight of tender-based financing in funds allocated to RAS for R&D should grow from the present 15% up to 25%.

The year of 2008 saw formation of the research agenda. It so far has been built following the same guidelines as those for topics of the projects financed in the frame of the FTP, that is, by integrating focused, subject-based directions suggested by research institutes. This

[67] Approved by Resolution of the RF Government of February 27, 2008, № 233-р

will complicate realization of the principle of competition-based allocation of budgetary funds, for as it happens in most cases with tenders held in the frame of the FTP, it is applicants who will most likely become contractors. Overall, the Academy has opted for increasing the number of programs put forward by its Presidium and, accordingly, volumes of support of most of them were clipped. The greatest amounts were earmarked for molecular and cytobiology research (albeit the increment in funding proved to be insignificant vs. the prior year), and nanotechnologies.

From the perspective of the expenditure cross-section, the financing in the frame of federal targeted programs practically remained unchanged. As concerns attraction of extrabudgetary funds, according to the 2008 data, a core FTP in the research and technology sphere – "Research and development by priority avenues of development of the scientific and technological complex of Russia for 2007-2012"[68] - even has beaten its co-financing target.

That said, the current methods of budgetary financing via FTP and RAS's fundamental research programs have long stirred concern, as tender-based procedures so far appear insufficiently transparent, and financial discipline and conditions of earmarking of the respective budgetary funds have not been fully worked out. Thus, projects funding is de-facto earmarked in the middle of the year, rather than at the beginning, and by stages, without regard to specificity of the production cycle in science. Meanwhile, revision of the general plan of works is *de-facto* prohibited, while it has to form a natural practice in the process of conducting research. Finally, the cycle of financing is an annual one, even in the event of a multi-year project, which affects planning of works.

As for requirements to research outputs, most projects in the frame of the FTP "Research and development by priority avenues of development of the scientific and technological complex of Russia for 2007-2012" do not envision production of objects of intellectual property. Thus the financing of applied R&D implies chiefly vague commercial results. Meanwhile, target indicators of the Program implementation (11 ones in total) which characterize the use of new technologies appear very generous: thus, it was planned for 2008 to introduce 1-2 cutting-edge commercial technologies by one of which RF enjoys international priority. By results of the 10 months of 2008, only one cutting-edge technology was introduced by which Russia has no international priority[69].

In this context, the objectives of the FTP become not quite clear. Potential contractors form lots by themselves, while the FTP sets government priorities in the form of generally formulated directions. The fact of availability of extrabudgetary financing by itself does not constitute a proof of the project's success, as far as its economic significance is concerned. According to the FTP's leadership, one of the program's principal informal objectives is the launching and fine-tuning of a mechanism of tender-based financing of research, i.e. creating an expert community, working out tender procedures and evaluation mechanisms[70]. But tack-

[68] The 2008 planned indicators of extrabudgetary financing by the program were Rb. 6.5-7bn, while the actual ones accounted for 9.25bn. Source: Poisk, 06.02.2009, p. 5

[69] Implementation of the Federal Target Program "Research and development by priority avenues of development of the scientific and technological complex of Russia for 2007-2012" in 2008. The data by the Rosnauki of RF as of October 30, 2008

[70] Motor konkursnogo finansirovaniya nauki. Interview with A. Petrov, Director General of the public institution "Gosudarsvennaya direktsia tselevoy naychno-tekhnicheskoy programmy"// Nezavisimaya gazeta – nauka, 10.12.2008, p.11

ling this challenge by such an expensive method appears unwise, for this can be done by means of pilot projects. Judging how this problem is solved, the result does not seem fairly successful, as distinctive features of this FTP are lobbying, the existence of a permanent array of contractors, and concentration of resources within a selected number of organizations.

It is envisaged that the 2009 R&D budget is going to face sequestration – by 15-20% on average. For reference, in the conditions of crisis the western European nations and the US have embarked upon a different strategy. In the US, the newly elected President ruled to allocate extra funds on R&D, particularly to support fundamental research, which indirectly implies granting support to universities. In the EC countries, it is planned to extend a tax and grant-based support to innovational activities, primarily in the automaking industry and pharmaceutical sector which are the R&D principals[71]. These policies is the West's response to the businesses' scaling back on their spending on R&D.

4.4.4. Supporting Mobility of Research Cadres

In 2008, the HR policy centered on problems of support and attraction of the young into research and promotion of connections with the erstwhile Russian researchers working overseas for the sake of their attraction, on a permanent or temporary basis, to the Russian science. Last year saw discussions on the problems that had become priority ones in 2007, that is, encouragement of mobility, transformation of bran-drain into circulation of cadres, etc., but implementation of practical measures will start only in 2009. That is why the year of 2008 can be viewed as a stage of preparation and coordination of the governmental initiatives.

Meanwhile, there has been a notable result. The Russian Foundation of Fundamental Research launched a competition entitled "Mobility of young researchers" in the frame of which the Foundation supports young researchers' participation in scientific events in Russia and overseas, their work in national leading research organizations, and that of young scientists from the CIS countries in Russian research organizations. In 2008, the Government earmarked Rb. 300m on the program implementation, but young researchers displayed such a low activity in applying for grants that only Rb. 85.6m was spent over the year[72]. Given that the specific weight of the young in the structure of research staff is on the rise, this result is hardly explainable. It may result from poor information of existing opportunities or from an already sufficient level of support in the frame of standard grants and contracts. Finally, this can be a consequence of one's inertia. In any rate, the competition has failed to encourage mobility.

The problem of keeping in the national science young researchers who already defended their theses has been a grave one. To resolve it, one needs to have job openings at universities and research centers, to secure a sufficient level of labor compensation and, wherever possible, to solve the housing problem. From the perspective of securing these conditions, it is only salaries and wages that can be conceived of as a fairly favorable factor, as university and research centers' administrations are keen to support young researchers out of their funds. Plus, a series of special young researcher support programs are still in force. Meanwhile, the problem of securing adequate wages rates cannot be resolved unless the fundamentals of uni-

[71] I. Sterligov. Evropeyskaya nauka v krizise. http://www.strf.ru/material.aspx?d_no=17645&CatalogId=221&print=1
[72] Decision by the RFFR Council of December 18, 2008//Poisk, №5, 30.010.2009., p.7

versities and research centers' functioning are modified. Over the past two years, in the RAS's system there were secured special pools to make sure fresh PhDs earn decent money, but these funds were slashed in 2008[73]. The housing problem has also aggravated in 2008 and it is most likely to further persist as a grave one in 2009. Thus, in the RAS's Siberian branch, the number of new apartments for researchers has plunged 10fold over the past four years[74].

The distinctive feature of 2008 became a growing "quite emigration"[75]. It means an outflow of research cadres from the country, driven mostly by social factors, rather than dire straits in science. Factors that compel researchers to go overseas comprise surging living costs, particularly in Moscow and St. Petersburg, growing bureaucratization on all the levels of government, and personal safety. The discussion of new amendments to Art. 275 and 276 of the criminal Code of RF, that concern such concepts as state security, state secret and others, do not encourage the young to solve the "leave or stay" dilemma in favor of the motherland. The amendments provide for punishment for disclosure of classified information not only to a foreign organization, but to any international one, public or private alike[76]. Should the amendments be enacted, if need be, law enforcement agencies may conceive of any communication with international organizations as a high treason. This can most seriously affect the international scientific cooperation, as with such an extended definition of main concepts any exchange of scientific information may be interpreted ambiguously.

Against such a background the Government started developing measures on attraction to cooperation and a possible repatriation of the Russian scientific Diaspora, which is now viewed as a critical resource for advancement of the national research. It should be noted that there are no accurate data both on the number of the former Russian researchers working overseas and on the number of those who have come back or periodically visited Russia to lecture or conduct joint research. In contrast to recent years, an important twist in the Government stance on the issue is that the Diaspora is now viewed as a source of emergence in Russia of a system of an independent and high-profile evaluation of both projects underway and new research tasks, as well as of approaches to the scientific sphere reform.

The Government's intents to promote contacts with the Diaspora have gradually transformed into concrete steps. The RAS's Presidium approved "The Statute on the Council of the RAS on work with compatriot researchers residing overseas"[77]. The Council will assist to coordination of research conducted by Russian scientists who work overseas and the RAS's scientific organizations, particularly by means of organization of research workshops and conferences and publication of research papers.

The RF Ministry of Education and Science included in the composition of a new FTP "Scientific and research and pedagogical cadres of the innovation Russia for 2009-2013" a special event entitled "Conduct of research by collectives led by visiting researchers". It provides for the financing of projects to be carried out by Russian research teams led by renown

[73] Poisk, №9, 29.02.2008, p.3
[74] Inteview with A.L. Aseev, Chairman of the Siberian branch of RAS//Troitsky variant, 09.12.2008, p.2
[75] M. Delyagin. Vybor nevelik: emigratsia ili degradatsia//Novaya gazeta, №70 22.09.2008. www.novayagazeta.ru/data/2008/70/14.html
[76] I. Rodin, R. Ukolov. Shpionom mozhet okazatsya luboy//Nezavisimaya gazeta, 15.12.2008. http://www.ng.ru/politics/2008-12-15/4_sutagin.html
[77] Resolution of the Presidium of the RAS №427 of 24.06.2008 "On approval of the Statute on the Council of the RAS on work with compatriot researchers residing overseas and the composition of the Council". http://www.ras.ru/presidium/documents/directions.aspx?ID=6e92523d-30c4-464c-8732-933e24bbe85b

Russian researchers currently working overseas. Every year, as many as 100 biannual research projects worth Rb.2m each will be selected; a mandatory condition for a team leader will be to stay in Russia for two calendar months a year.

In late-2008, the Ministry started collecting proposals on possible subjects of research. The work at the same time became an effort to identify areas in which the competition can be held. As of late-January 2009, the Ministry has received over 280 proposals and applications, so, the competition is likely to be held.

Meantime, there exist a number of problems, which this measure does not resolve, but which can complicate its realization. These problems concern a broader context, that is, conditions in which the returning researchers will have to operate. The major challenges are associated with material, organizational, as well as value-based factors. Representatives of the Russian research Diaspora have developed a system of demands, expectations and values different from that of the Russian scientists. That is why they deem their comeback as a very problematic move, primarily due to personal reasons, rather than because of the level of competitiveness of conditions offered for their work in Russia. Representatives of a number of research sectors will find their return particularly challengeable, for experts assert that the respective sectors of research lack a critical mass of high-profile researchers in Russia.

The "repatriants" will face organizational challenges in fitting their newly created teams into the existing hierarchic structures of research institutes and universities. A remedy can be found in establishment of new, independent chairs at universities or departments at research institutes, as well as in creation of interdisciplinary research centers[78] funded largely out of private sources. That should help lift a number of constraints the budgetary funds face. From this perspective, they may find attractive specialized research centers with their up-to-date equipment currently created on ROSNANO's initiative and with its support. They will both emerge as brand new structures and be created within existing organizations[79]. Yet another complex of organizational problems is granting citizenship to those who would be keen to get it, problems associated with security clearance[80], hence, problems of employment of non-citizens.

A specific challenge is qualifications of the services and auxiliary staff, that is, the quality of performance by such divisions as grant departments (in Russia, they are usually represented by accounting and planning offices). Their level of organization is such that the researcher is compelled to spend a great deal of time on paperwork (processing grant and contract-related documentation). This affects the pace of research and the respective output (publications).

Despite all the aforementioned problems, representatives of the research Diaspora eager to promote cooperation with their former compatriots have already made the first steps to

[78] The diaspora appears very supportive of the latter idea. See, for instance, discussions at a roundtable "Ispolzovanie potentsiala rossiyskoy nauchnoy diaspory", 18.11.2008, http://www.strf.ru/material.aspx?d_no=16926&CatalogId=221&print=1

[79] For example, currently ROSNANO is in negotiations with the Moscow State University and "Kurchatovsky institute" about creation of nanotechnological centers in the existing facilities. Source: Nanoskop//Poisk, №5, 30.01.2009, p.11

[80] According to Art. 23 of the List of data subsumed to the national security information approved by presidential Decree of November 30, 1995 № 1203 (amended by presidential Decree of February 11, 2006 № 90) secret is information of achievements of science and technology, as well as technologies that can be used in creation of fundamentally new items, technological processes in various sectors

meet them half-way. Thus, in October 2008, Marseille hosted the first meeting and conference of USSR-born researchers currently working in the materials science in overseas centers[81].

In addition to purely scientific problems, they discussed such issues as supporting Russian students and postgraduates' internships with the best western institutions, promoting co-operation, including long-term visits to Russia. The Russian delegation led by the RF Minister of Education and Science attended the conference, and it was decided to hold such meetings on a regular basis.

4.4.5. Organizational Reform of Science

In 2008, the Government initiated a new stage of the organizational reform of research organizations and universities that fall under the public sector of the economy. These are organizations that operate in the organizational and legal form of institution, federal public unitary enterprise (FPUE), or economic companies in the authorized capital of which the government owns over 50% of stock, as well as economic companies in the authorized capital of which over 50% of stock is owned by FPUEs or the noted economic companies. According to representatives of the RF Ministry of Education and Science, these organizations will become subject to an inventory check. This move pursues the goal of their performance evaluation and making respective executive decisions[82]. As many as over 3,600 organizations that receive budgetary funds in one form or another will be evaluated.

No doubt evaluation is needed – it has been long publicly admitted that the public sector in science does not fit in the modern system of economic relations. The increasing budgetary funding of research over the recent years have so far fallen short of securing an anticipated return – by the index of citation and number of publications Russia has been sinking in the global ratings; the level of innovational activity remains low, Russian universities have failed to enter the elite corps, etc. In the post-soviet era, the government has launched numerous attempts to restructure the research institutions network. It tried different methodologies: reforming the network of the budgetary institutions of science, management of property complexes, including academic research organizations; formation of the network of national laboratories, among others. But as the mission was always assigned to departments that controlled these organizations, the output, even if the department resolved to action, proved to be meager. No one has ever succeed with initiating a reform "from outside", on the basis of independent commissions' conclusions, as the offices concerned could and did not want to seek consensus (the conflict between the RF Ministry of Education and Science and the Russian Academy of Science on numerous scientific policy issues has become a norm over recent years).

The new initiative is based on the same self-reforming approach, that is, the very departments that control research organizations and universities will define how to evaluate them and to conduct the evaluation. At this point, the novelty is they will have to follow a standardized methodology currently designed under the aegis of the RF Ministry of Education and Science.

The Ministry failed to clearly articulate objectives of the exercise, which will entail other problems – selection of objects, approaches, and an indicators system. The draft Resolu-

[81] Poisk, №43, 24.10.2008, p.10

[82] A. Khlunov. Resursy dlya razvitiya – tem, kto effektiven. Interview to the Internet-site "Nauka i teknologii RF", September 16, 2008. http://strf.ru/material.aspx?d_no=15496&CatalogId=223&print=1

tion of the RF Government "On assessing effectiveness of research organizations of the Russian Federation" reads that the objective is "formation of an efficient system of research organizations and growth of their contribution to innovational development of the economy". Attached to the draft Resolution is the document entitled "Procedures of evaluation of performance of research organizations in the Russian Federation", which contains no description of objectives, but stipulates how evaluation results can be used: to redistribute budgetary funds and optimize the research organizations network. The latter implies transformation, reorganization, liquidation of research organizations, and implementation of a complex of measures on improvement of their performance. So, even if the organization does not receive an estimate-based funding, thus not being demanded to spend it efficiently, it is subjected to performance evaluation for a possible subsequent change of its property form or even a closure. Given the objectives, it remains unclear what will be the optimized organizations' mission and fundamentals of their relationship with the government.

Meanwhile, the standardized methodology developed for conducting the evaluation appears a more detailed than previous analogous instruments. It presents new and important approaches, such as:

1. The requirement to each of the departments assigned with the task to conduct the evaluation to form a Commission on evaluation of research organizations' performance. Its operations should be based on such fundamentals as independence and a minimal additional burden on the evaluated research organization, among others;
2. Delegating to the federal bodies of executive power and state academies of science rights and responsibility for adaptation of the standardized evaluation methodology with account of a specific profile of their subordinated organizations;
3. Selection of reference groups of organizations, which should secure a more adequate evaluation of research organizations and universities.

Problems as to who should conduct evaluation, what should become its subject, and how it should be conducted have not been fully worked out as yet.

International experiences of conducting such evaluations show that they usually involve domestic, outside and foreign experts. The methodology in question does not imply attraction of foreign experts, while the state of the official expert community in Russia so far does not allow objectivity of assessments (to fully avoid a conflict of interests).

Evaluation of applied institutes that do not have the estimate-based financing should be conducted with a mandatory participation of their consumers, that is, businesses, but the methodology does not take into account this peculiarity, either. In addition, the statute of evaluation commissions' operations references to the presence in their body of representatives of departments that are their customers. To ensure a genuine independence of evaluation, it should be conducted without participation of representatives of the federal bodies of executive power or leadership of state academies of science.

Another critical aspect of evaluation is its subject. The methodology only suggests evaluation of research organizations, but it is not supposed to address mechanisms of allocation of budgetary funds. Meanwhile, institutes and universities appear somewhat "secondary" in their operations, as they follow procedures of receipt of budgetary funds set by the public agencies. Hence, the research institutions' performance may be greater, should methods of their funding be simultaneously reviewed. Overseas, not only public centers and laboratories

are subject to evaluation, but also all the agencies that finance R&D are, for this help assess to what degree they are successful in accomplishing their mission with respect to science.

Classification of organizations by the evaluation results also raises questions. The suggested breakdown into reference groups is built upon formal characteristics of their departmental attribution or organizational and legal form of functioning, and it does not take into account the substance of their research. Because of this, practically all institutes of the physics profile have been attributed to the fundamental science, while FSUEs - to applied institutions, which is not correct. A more complex problem is that all Russian institutes and universities are non-homogenous and comprise both "strong" and "weak" laboratories. A ranged list of organizations provides too rough an averaging-out, which does not match the reality. But the breakdown of institutes into clusters entails fairly tough managerial decisions with regard to those of them that have failed to join in the group of leaders. The inadequacy of the methodology to the purpose of ranging was proved by a series of attempts to try it, for instance, on the cluster of academic institutions of astronomic profile. The experiment showed that the strongest and most reputed internationally institutes failed to enter the leading group[83].

A separate group of challenges comprises methods and indicators of evaluation. The Ministry of Education and Science has embarked on a quantitative method that rests upon a resultant of a great number of formal performance indicators, despite the existence of the precedent that displays its limitation – namely, the applied over the past three years research activity performance indicator (RAPI) introduced at academic institutions to evaluate their research staff's performance. RAPI's deficiencies have been depicted in every detail, particularly exposing the fact that the use of the quantitative method has resulted in a poor accounting of operational peculiarities in some areas and specializations, and in researchers' reorientation towards formal performance indicators[84] and, consequently, in the fall in the quality of research. That is why it is important to have evaluation of the organizations combine quantitative methods with qualitative ones, with the final expert evaluation of the organization as a whole having a critical role. One should also test the indicators on a pilot cluster or a group of organizations. Introducing such methodologies overseas provides for a three- to five-year transitional period for their adjustment and adaptation. In addition, as collection and processing of indicators and the work with the expert commission lays a considerable burden on the organization under review, the evaluation interval might be extended from three to five years.

So far the number of indicators by which it is intended to conduct the evaluation appears excessive, and they mostly focus on evaluation of resources, rather than efficacy of their utilization. Thus, it is supposed to request from universities data on the number of patents, rather than their licensing; on the number of chairs, rather than on the number of graduates who have opted to working with research organizations; on the existence in the structure of an institute of a technology transfer center, rather than whether the institute employs some transfer center's (for instance a regional one) services.

By some indicators budgetary institutions will *apriori* display performance poorer than, for instance, FSUEs. But this will happen not because their capacity is lower, but due to the current legal restrictions. This mostly concerns indicators of commercialization of research

[83] Sources: Roundtable: "Evaluation of performance of research organizations in the Russian Federation". 19.09. 2008. Notes. http://strf.ru/organization.aspx?CatalogId=221&d_no=15594**;** BV. Pokrovsky. Gaechny kluych dlya nauki// nezavisimaya gazeta – Nauka, 08.10. 2008. http://www.ng.ru/printed/216904

[84] Rossiyskaya ekonomika v 2007 u/ Tendentsii i perspektivy. Issue 29.M.:IEPP, 2008, p. 442-443

output. Finally, the block of commercialization indicators cannot adequately mirror the research institutes and universities' actual performance, for as long as the business's demand for research findings is low, research organizations cannot boast a high efficacy of their innovational activity.

So, minuses of the proposed evaluation methodology have so far prevailed over its pluses. It would be logical to work out not only some technical moments and the set of indicators, but to review the fundamentals and objects of the evaluation. This would enable the government to more accurately assess the public institutions' genuine capacity and efficiency and then to extend target support to a fairly broad group of those in need of any resources or conditions to ensure a high level of performance.

This initiative replaced the last year's governmental plans on implementation of development programs for research institutes[85], as the Government decided first to run an inventory of public research organizations and universities and only after that to proceed with crafting their development programs.

4.4.6. Integration of Science with Education, Creation of the Research Universities Network

The year of 2008 saw completion of the Innovation Educational Program (IEP) in the frame of the national project "Education". Over the year a substantial budgetary support was pouring in as many as 57 universities. Despite the advancement of research at the universities and its integration with the educational process did not constitute the IEP's direct objectives, nonetheless, university research could and should have gotten a due impetus, as the quality of education in many ways depends on the level of conducted research. The problem of development of university research still persists, and the Government has cited it as a priority in all its strategic documents. Over the past decade, the proportion of the faculty participating in research plummeted from 38% to 17.7%; only 45% of Russian universities currently conduct research, while some 80% of the higher education curricula is not based upon research[86]. Meanwhile, the budgetary funding of the university research remains very scarce.

The analysis of mission statements the universities designed specifically for the IEP implementation reveals that there were only few of them that have explicitly set for themselves avenues for advancement of research and its integration with education and translated their vision into the form of concrete objectives, tasks and approaches.

Recapping the Program outputs, it is possible to single out the following approaches the IEP university participants employed to promote their research activities:

- building of complexes of a new, unique equipment;
- creation of a new research infrastructure;
- design and procurement of methodologies and software;
- employment of remote research mechanisms, including online conferences, symposia, other scientific events;

[85] In late-2007 the RF Government developed draft Resolution "On measures of state support in 2009-2011 of research organizations that implement development programs in the frame of the priority avenues of development of science and technologies in the Russian Federation", however, in 2008 this activity has been halted.

[86] Gohberg L., Kitova G., Kuznetsova T. Strategiya integratsionnykh processov v sfere nauki i obrazovaniya//Voprosy ekonomiki, №7, 2008, p.116

- establishment of corporate structures with attraction of production and research teams from a respective sector;
- promotion of cooperation with sectoral and academic research institutions;
- selection and implementation of priority avenues of advancement of research with account of the federal priorities and regional structures.

As evidenced by the analysis of the IEP outputs, the main factors that helped boost the university research were:

1. Emergence of flexible and integrated organizational structures, including the rise of innovational university infrastructure;
2. Development of ties with businesses and other employers;
3. Purchases of new equipment.

Striving to promote ties with business, universities faced a profound challenge - being public institutions, the universities that participate in the IEP mostly focus on the budgetary funds. That is why they are keen to develop the R&D avenues that form government priorities, particularly from the perspective of volumes of government appropriations. Thus, practically every single non-humanitarian university that participated in a survey on results of the IEP implementation had established under its aegis some research and innovation structures or developed ties in the area of nanotechnology.

Meanwhile, there also persists the problem of scarce financing of R&D by business. To change gears, just the universities' willingness to cooperate with businesses is insufficient. There is a series of legal problems: specifically, a serious barrier to the rise in the number of corporate orders on R&D is formed by Federal Act № 94 "On placement of orders on delivery of goods, completion of works, provision of services for public and municipal needs". Tender-based procedures stipulated therein considerably extend timelines of completion of R&D, while the customer insists on a prompt completion of the work.

But overall, the ties were developing, and it is possible to identify a number of avenues for joint actions:

1. Conduct of joint R&D in the frame of flexible organizational structures, such as joint laboratories, the so-called "basic" chairs, educational-research- production structures, technoparks, to name a few;
2. establishment of a project team that operates beyond organizationally formed structures;
3. conduct workshops and roundtables to promote university research;
4. training in the area of innovation management, including that carried out at the expense of cooperation with foreign organizations.

A great boost was given to research by recently purchased new equipment. In general, it is possible to identify the following avenues of university research that have been modernized thanks to renewal of the material research base:

1. Emergence of new avenues of research;
2. the rise of the possibility to set new experimental tasks or to enhance the quality of already conducted applied research;
3. promotion of cooperation with academic research institutions, organizations and business, thanks particularly to the IEP formation, giving RDA to a unique equipment, including that owned by business partners;
4. a greater effectiveness, which is assessed by the gowing number of publications in the western scientific media. The availability of a new equipment has enabled one to more

thoroughly and accurately conduct experiments and testing of scientific hypotheses, which in turn increased the value of findings and possibility for their publication overseas;

5. activation of students' research, particularly at the expense of their inclusion in international projects;
6. a greater quality of the post-graduate education, as there arose the possibility for conducting complex and expensive research projects and extending their subjects and volumes.

Meanwhile, purchases of new equipment and start of its use highlighted a series of natural challenges. First, numerous universities noted they lack qualified staff to maintain the equipment, while the IEP provided no funding to train the maintenance staff and pay for the outsourced staff's services.

Secondly, after the warranty period expires, the repair costs turn out to be very high, and it is unclear how universities will cope with this challenge.

So, as evidenced by the analysis of the state of research at the universities that took part in the IEP, the mere earmarking of budgetary funds does not guarantee a university's progress on all fronts. Whilst the universities in question are the strongest ones in the country and have become victors in a very tight competition for the right to take part in the IEP, they differ greatly by the level of maturity of their research and the degree of marrying research with education. It should be noted that such a striking difference is noted not only in quantitative indicators of research outputs, volume of financing of R&D and the level of the integration of research with education. Likewise, it manifests itself in the degree of the university leadership and project leaders' appreciation of development as a mission. That manifested itself in the way they formulate their strategies, particularly in the area of management of research projects. Should universities be transformed into the legal form of autonomous institution, the advancement of their research and innovation activities would gain a far greater momentum. But such a transition so far has been planned only for a group of selected universities (including the federal ones) and under the government's visible pressure.

The IEP has become the first step in realization of the government's plans to solidify and boost up university research. In 2009, it is planned to pick on the basis of a tender 10-15 universities and ultimately grant them with the status of the national research universities for the term of 5 years. In October 2008, the RF President signed the Decree "On implementation of the pilot project on creation of national research universities (of 07.10.2008 №1448). In compliance with the Decree, two universities were awarded the national research university status without holding a contest. These were Moscow Engineering and Physics Institute and the State Technological University "The Moscow Institute of Steel and Alloys". Whilst MEPI is becoming a core university for the nuclear industry and to this effect it is going to embrace 24 subsidiaries across the country, the MISA should become a backbone university in the area of metallurgy and material sciences. The status is coupled with a substantial additional budgetary financing, including allocations for purchases of new equipment, and versatile preferences, including the most favorable treatment with regard to solving land and property matters.

The Government's new project on establishment of research universities to a significant degree replicates what has already been implemented in the frame of the IEP from the perspective of possible avenues of budgetary expenditures, albeit the focus of support has been shifted towards research and innovation, rather than educational activity. The purposes of granting the status are to ensure training of cadres for Hi-Tech production and giving a boost

to research, primarily the applied one, and commercialization of research outputs[87]. It is envisaged that it is research universities whereinto Russian scientists that work overseas would like to come back. All this should ensure that in 10-15 years form now the national research universities would ultimately join the list of the top 500 universities worldwide.

It is assumed that like in the case of IEP, the research universities will be able to spend public funds to solidify their material and technical base, purchase equipment, and to conduct staff training and retraining. A novelty is the possibility to award grants to young researchers and faculty. The universities will also have to secure a 20% extrabudgetary co-funding. For the sake of promoting research at such universities, they are not supposed to merge with research institutions, though alliances between them for the sake of implementation of research projects will be welcomed.

It is intended to conduct a two-stage selection of universities pretending for the status. At the first stage, an overall university's capacity will be assessed basing on its performance data over the previous three years, while at the second stage it has to submit for evaluation its development program. Such an approach should make sure the circle of pretenders is not limited by the 57 universities that have become victors in the IEP. These universities have mastered the project-based method and the art of drafting applications and reports, and in this sense they clearly find themselves in a far advantageous position than others. Universities will be selected basing on 25-30 indicators whose composition is still being worked out. This number is far greater than that used internationally (while indicators of research universities vary from country to country, as a rule, they do not outnumber 5-9). The indicators of volume and quality of research hold a pivotal place in the developed system of indicators. Specifically, evaluation will cover a university's cadres potential, including the presence of visiting researchers, its research infrastructure, performance in the area of research and innovation (the proportion of the faculty engaged in research, indicators of publication and patent activities, the number of research laboratories), as well as its international and national recognition, gauged in particular by the proportion of foreign students.

The project on creation of research universities constitutes a priority for the Government – according to the RF Ministry of Education and Science, the program shall be launched even in the event the budget is sequestrated[88]. The apprehension of the concept of research university at the level of the RF Government appears different from that in the West. For example, in the US, the concept of research university was introduced in the early 1970s in conjunction with the development of a classification of universities and colleges. Underlying the classification were two parameters – the number of PhDs and the volume of budgetary funding of R&D. Using these criteria, there have been established five main categories of universities and colleges. The first group (accounting for some 5% of the overall number of universities and colleges in the US) was tagged as "research universities with PhD programs". Notably, there is no officially set concept of research university, and this category is identified by a university's actual performance and as a result of their voluntary participation in ratings. But research universities share a series of distinctive traits, of which the most critical characteristics are:

[87] Universitetatm sozdayut usloviya dlya samorazvitiya. 10.12.2008. http://www.strf.ru/material.aspx?d_no=17015&CatalogId=221&print=1

[88] Andrey Fursenko:Vazhnyi fakt razvitiya natsproekta «Obrazovanie" – vozmozhnost sozdavat malye innovatsionnye kompanii http://www.strf.ru/organization.aspx?CatalogId=221&d_no=17035

- the proportion of R&D in the research university's aggregate budget is a. 50%;
- the share of postgraduates (including MAs) is greater than that of students;
- visiting scholars and researchers account for 30-60% of the total number of faculty and researchers.

So, the RF Government's approach is based upon the concept of additional budgetary injections in universities picked on the basis of competition. While recognizing its right for existence, one should admit that if Russia strives to attain parameters characteristic of internationally renowned research universities, financing should be complemented by creation and adjustment of a number of conditions that regulate the universities' operations.

4.4.7. The Innovational Infrastructure at Work: Institutes of Development

The business's innovation activity in the area of technological innovations has remained relatively low. The proportion of innovationally-active corporations accounted for less than 8.5%. This is the evidence of a further decline compared with the prior years[89], and the tendency was characteristic of large and small-sized businesses alike. Affected by the crisis, the situation had aggravated by the end of the year, as large corporations began to slash their own research institutes or divisions. To exemplify, RUSAL axed its research staff by 80%[90], while NorNickel has not so far cut its research institutes, but reduced R&D. OAK, SIBUR and other companies followed the same strategy.

The crisis has also battered small-sized innovation companies' standing, as large and medium-sized corporations not only began to cut back on their own research divisions but considerably lowered volumes of the outsourced R&D – the orders they would place with small-sized science-intensive firms. Banks in turn suspended loans to such firms as the least sustainable clients in terms of development[91]. All this has put in jeopardy small-sized innovation firms and posed a serious threat of collapse of their "critical mass".

As businesses began saving on their own R&D funds, they became keener to fall back on public funds. Thus, in the end of 2008, the FTP "Research and development by priority avenues of development of the scientific and technological complex of Russia for 2007-2012" announced two tenders, and the organizers received 5-10 applications per project, instead of traditional two ones[92]. Once business has focused on the budget, one of possible forms of support of small-sized companies could become the financing of consortia formed by research institutions/universities, large corporations, and small-sized innovation firms. This is a regular international practice of supporting small-sized businesses and their connections with large companies. But in Russia, there persists a risk of emergence of fake small-sized companies created solely for the sake of getting hold of budgetary funds.

An important recent trend has become the companies' focus on imitational style of innovations, that is, innovations basing on borrowed, mostly in the west, technologies. While this presets certain backwardness from the research and technologically advanced nations, it is anyway better than a complete absence of innovational activity. Meanwhile, in the conditions of economic crisis there arises an increasing probability of import substitution, with corpora-

[89] Nauka, tekhnologii i innovatsii Rossii-2008. Kratkiy statisticheskiy sbornik. M.:IPRAN RAN, 2008, p. 54
[90] Kompaniya RUSAL sokraschayet raskhody na nauku http://strf.ru/science.aspx?CatalogId=222&d_no=17095
[91] Devalvatsia innovatsiy. http://www.strf.ru/innovation.aspx?CatalogId=223&d_no=17567
[92] Poisk, №52, 26.12.2008, p.5

tions being compelled to purchase domestic equipment and technologies. This might fuel a gradual transition from the imitational development model to the innovational one. But the domestic manufacturers of modern equipment and technologies face their own engendered by the crisis challenges. Numerous kinds of domestic equipment are produced with the use of import assembly parts the costs of which have surged considerably due to depreciation of the Ruble. That is why it is envisaged that a series of Hi-Tech production cycles will be stalled[93]. This should affect the state of the research institutions' material base, and its renewal will pose a serious problem for the year or two ahead. Plus, the crisis should most severely batter natural sciences, as practically all the chemicals and expendables are imported and there is no base at hand to quickly launch their domestic production.

Last year, of all the measures of encouragement of innovation activity and promotion of ties between research and business the Government preferred initiatives on support of the infrastructure represented both by technical infrastructure (tekhnoparks, incubators, technology promotion centers, etc.) and financial or development institutions (RVK, ROSNANO, the Aid Fund, RFTD, to name a few).

By December 2008 the Russian Nanotechnology Corporation had financed only 6 projects out of some 750 applications submitted to that date[94].

Such a poor performance can be explained by the fact that the corporation has been altering its operational priorities over the year. At the beginning of the year, its management ascertained their main objective was to generate profit, which in the circumstances was possible only by putting temporarily free resources on financial markets, rather than by fostering nanotechnologies[95]. Thanks to depositing its funds with 8 banks, the corporation expected to post some Rb. 5bn in profit. Meanwhile, the financing of the already approved projects was slow – as of late-September 2008, the corporation had not funded a single project, because drafting and signing the respective agreements took a dog's age[96].

Priority was given to large-scale ambitious projects with a well though-out business plan which implied industrial production in the medium term. That has immediately cut off projects that were at an early stage, start-ups, and numerous research teams. At the same time, the corporation's requirements to project applications were opaque, the selection procedures remained vague, and there was no external oversight of the ROSNANO's operations. Nonetheless, the Government has already invested in development of nanotechnologies huge funds in a volume exceeding the leading nations' investments in this area.

With the appointment of Mr. A. Chubais as ROSNANO's new Director General, the corporation's priorities have been modified – at least, judging its official statements. Mr. Chubais has declared that ROSNANO's mission no longer implies generation of profits, but creation of a maximum number of production cycles in Russia[97]. He also claims ROSNANO

[93] Devalvatsia innovatsiy. http://www.strf.ru/innovation.aspx?CatalogId=223&d_no=17567
[94] ROSNANO za 8 let planiryet investirovat v razvitiye proizvodstva v sfere nanoindustrii 24 milliarda rubley. http://stfr.ru/material.aspx?d_no=16882&CatalogId=222&print=1
[95] Nanoskop, №2, 29 February 2008, p.7
[96] Nanoskop, №9, 26 September 2008, p.7
[97] ROSNANO za 8 let planiryet investirovat v razvitiye proizvodstva v sfere nanoindustrii 24 milliarda rubley. http://stfr.ru/material.aspx?d_no=16882&CatalogId=222&print=1

is committed to become more open in its operations[98]. The new course better matches the original idea of the corporation as a development institution than the previous one.

Table 25

Comparative Investments in Nanotechnologies, across Some Nations (2008)

Country	USD bn, in current prices	USD bn by the purchasing power parity
Russia	1.00	2.107
China	0.51	2.034
USA	1.821	1.821
Japan	1.128	995

Source: Otchet of perspektivakh nanotekhnologiy– 2008. Information company "Cientifica". http://stfr.ru/material.aspx?d_no=16882&CatalogId=222&print=1

In 2008, the venture funds with the governmental participation (RVK and "Rosinfokominvest" have been stagnating. This can be explained by a number of problems – the legislation that was supposed to introduce new forms of their creation has not been passed[99], while foreign financial institutions' participation in the venture funds' operations was constrained by the absence of tax incentives, and there was no external strategic audit of the companies. As a result, Rosinfokominvest did not even start a formal selection of projects, while RVK contributed to formation of a sole venture fund ("VTB- Fond Venchurny"). As of mid-2008, the Fund had considered some 400 project applications and approved 16 of them[100]. In June 2008, the RVK completed the second contest on selection of management companies and identified five winners in it.

RVK's plans imply support of start-ups; however, so far the Corporation has focused on support of companies with the annual turnover of up to Rb. 150m as of the date of the first purchase of their papers. Such companies do not necessarily constitute a start-up. Rather, they can turn out to be mature firms with the said turnover. Rosinfokominvest faces the same problem. It was created as a mutual fund of compound investments, which is why it has to invest chiefly in the companies quoted at RTS and MICEX. In contrast, start-ups, as a rule, are founded in the form of limited liability companies, which makes them ineligible for funding from mutual funds.

The Foundation for Assistance to Development of Small Forms of Enterprises in the scientific and technical sphere was implementing its usual initiatives, while the Russian Foundation for Technical Development appeared more passive; however, there arose the need for both of them for a more pro-active contribution to encouragement of ties between research organizations, universities and small-sized companies (in the case of the FADSFE) or with the industrial sector (RFTD). The foundations' operations have so far failed to fuel medium-sized or big corporations' demand for innovations.

So, drawbacks of the operating development institutions are first, a low or even no support of risky projects, focus on mature companies and, consequently, replacement of private

[98] Anatoly Chubais: Dlya resheniya zadachi po sozdaniyu v RF nanoindustrii nuzhno vovlecheniye seryeznykh chastnykh resursov. http://www.stfr.ru/science.aspx?CatalogId=222&d_no=16941

[99] This problem was considered in every edtail a year ago. See: Rossiyskaya ekonomika v 2007 g/ Tendentsii i perspektivy. Issue 29.M.:IEPP, 2008, p. 464

[100] Itogi sovmestnoy raboty RVK i venchurnogo biznesa gruppy VTB- "VTB-Fond venchurnyi" otchitalsya za pervyi god deyatelnosti. 23.09.2008 г. http://www.rusventure.ru/press-service/news/detail.php?ID=79

investments with public ones, which is "the state's failure", rather than the liquidation of "market failures". Secondly, the financial infrastructure is of no help to research, small-sized and large businesses in developing mutual ties. The factor of existence of such ties does not form a priority in the course of allocation of financing, and it is not taken into account.

Worldwide, it is not only foundations, but business angels as well that finance early stages of companies' development. Business angels (both legal entities and private individuals) invest in innovation companies at their seed and initial stages of development. In Russia, there has been established the first community of business angels, which unites individual and institutional investors[101]. There are over 100 of them, with the institutional investors clearly dominating in the group. For reference, in the US, there are over 225,000 business angels. The magnitude of operations of the Russian community of business angels has so far been very modest: it considered some 500 applications and approved funding of just about 10 of them. It is unlikely that their activity will intensify in the times of crisis.

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In the period in question, the institutional structure of research has undergone practically no change, with science and the sphere of technological innovations continuing to function somewhat autonomously from the nation's economic development. To ensure its sustained progress, the research sector undoubtedly needs a certain degree of independence, particularly when it comes to the sphere of fundamental research; however, a certain balance between autonomy and integration of research into the economic system should be maintained, but currently there is no such balance in place.

Dissecting changes that took place in the area of science and research in 2008 allows one to conclude that under an optimistic scenario, the progress in the government initiatives in 2008 can be viewed as a transitional period of development of critical decisions in the cadres, financial and innovation policy areas. A pessimistic view of the situation suggests the last year's processes being stagnation, with numerous important matters under consideration but ultimately being put off. Meanwhile, effects from implementation of earlier made decisions were minimal, if not negative (suffice it to refer to the development institutions' performance and the state of the innovation infrastructure). It is worthwhile noting that in the view of the looming financial crisis the role of the state is growing, but this does not mean a greater degree of its direct intervention. Rather, the state should play a greater role as a regulator that ensures interaction between research, business, technological intermediaries and the educational system. The tendency has so far been reverse - the state has intensified its direct participation by focusing on public corporations' operations and contributing to sweeping infrastructure projects. But the government regulations do not seem systemic, with many *ad hoc* decisions made, which makes the research and innovation policy inconsistent and basically lacking tangible strategic guidelines.

[101] http://www.strf.ru/innovation.aspx?CatalogId=223&d_no=14481

Section 5. Institutional Problems

5.1. Property Policy in the Financial Crisis

5.1.1. The overall process of property redistribution

Even the roughest assessments make it evident, that the financial crisis, started in 2008, leads to a noticeable intensification of several inter-related property processes. First of all, the general property redistribution process in the scope of the Russian economy gets new incentives, just like after the crisis of 1997-1998.

General assessments of the market of mergers and acquisitions in 2008 are very similar with a noted downgrading as compared with 2007, whereas the first ones took place after a long period of steady growth within 2002-2007. Absolute assessments of the reducing market capacity are differed, depending on the methods used: by 36 per cent, from USD 120-122 bln to USD 77.5 bln (with regard to transactions from USD 5 mln, as per M & A Intelligence), or by 9 per cent to USD 120 bln, nearly USD 100 bln of which were addressed to the Russian assets purchase (with regard to all transactions, as per Ernst & Young estimates)[1].

The assessments of the prospects for this market in 2009 are much more controversial. In general, it is expected a further reduction in the market capacity (up to 60 per cent as compared with the level of 2008), but the forecasts on the qualitative trends are rather different (depending on the further market restraints due to the problems with working capital and external funding access, up to the market reviving from mid-2009 at the expense of the purchase of problem assets and companies). In fact, it is clear that, with an overall downgrading in the market of mergers and acquisitions in the situation of the financial crisis, this channel remains «working» particularly for those businesses, which have kept liquidity and were able to take this advantage to purchase the depreciating assets (from May 2008 to February 2009 the capitalization of the Russian stock market has fallen down 4-fold, from USD 1.5 trillion to USD 370 bln).

At the same time, the activity of the insiders is growing (primarily major shareholders and Managers, which is often identical in the Russian model). According to the available information on the dynamics in the 500 largest public companies transactions, in the second half of 2008 the number of transactions on the sale of the shares by the management of the companies has significantly reduced. On the contrary, there is noted an increase in the number of transactions, in which the insiders were acting as the buyers of shares of their company, even in cases, when in earlier periods they had acted as sellers[2]. With some reservations, the same policy, as demonstrated below, was typical in crisis situation and for the state as well.

Although the statistics is not available (primarily due to the restricted access to such information), a significant channel for the assets redistribution (including foreign assets) in 2008 could become the forced sales of bank margin securities (margin calls) of the Russian

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[1] Hereinafter the in the analysis of various processes in the corporate sector and measures of public anti-crisis support ther used the information and materials, allocated on the official websites of the leading news agencies and periodicals (of publishing houses) for 2008-2009. (in particular, www.vedomosti.ru, www.kommersant.ru, www.ma-journal.ru etc.).

[2] However, it is not surprising in the face of crisis, especially for problem companies, when capitalization, for example, of «RBC Information Systems» for the year has fallen down 21 times in the RTS. Ref: Forced Acquisitions. - Dengy, № 3, 26 Jan, 2009.

companies. The problem assets in autumn 2008 there were found shares of Magna (Canada) and Hochtief (Germany), pledged on «Bazela» loan (disposed by creditors), as well as the share of O. Deripaska in Strabag, the company of X5 Retail Group, VimpelCom (Depository Receipts have been pledged under the Alfa-Bank loans), Rosneft, Norilsk Nickel (25per cent pledged under «Rusal» loans), «LUKOIL», Sviazinvest, STS Media (shares were pledged under Alfa Bank loans), AFK «System» (in the mortgage securities of «Sistema-Hals» Company and Bashkiria oil assets were pledged), Wimm-Bill-Dann, Seventh Continent, Novatek and others[3]. There are also many credit agreements, secured by the minority packages of the largest Russian companies with the state participation, but (due to the state-owned control stake), the transfer of ownership is quite possible (for example, the transfer of ADR and «Gasprom» shares in the amount of 0.77per cent of Vostok Gas share to Deutsche Bank).

The majority of companies managed, however, to retain their assets. One of the peculiarities of the Russian credit market is the predominance of the Russian banks in the corporate credit portfolio (92.7 per cent in September 2008, while the total credit portfolio of the Russian banks in the non-financial sector was RUR 11.8 trillion), but the practice of margin calls is not typical to them. Sberbank of Russia, being the largest creditor of the non-financial sector (over 1/3 of the total loan portfolio), according to the available data, is not utilizing this opportunity yet. VTB has become one of the few major Russian creditors (about 10 per cent of credit portfolio), which has used this mechanism in practice[4]. Some companies purchased their shares at the open market as early as in summer (for instance, «Norilsk Nickel», MTS), although with the continued decline in the market, this measure could not work to full extent[5].

According to estimates of Fitch Ratings agency, in the 4-th quarter of 2008 the corporate sector has repaid of USD 36 bln, under external debt, while 55 per cent of external credits has been carried over, including margin calls, burdened with debts. In 2009, about USD 140 bln need to be accumulated for the corporate debts payment.

The transition of assets can be also caused by the started in 2008 defaults in corporate debt obligations. By early November 2008, the aggregate amount of emissions under default has amounted to about RUR 30 bln.

By early 2009, there emerged a practice of debt liabilities settlement through the transfer of assets to the creditor banks (primarily in construction, retail trade, retail mobile communication services, foodstaffs production, etc.). In January 2009, there was also the case of transfer of oil and gas fields as for the debt settlement (Urals Energy to cover the to Sberbank). Among the recipients of assets we can also mention the VTB, Alfa-Bank, Yunikreditbank, Trust Bank and others. A subsequent exposure of the assets on sale is most likely (due to the inconsistency of the acquisitions to the basic banking activities, the lack of relevant experts, etc.), what urges intensification of the corporate control in the market.

[3] Ref.: Corporate secret, № 46, November 24, 2008.
[4] Ref: Merges and acquisitions, 2008, № 12, pp.10–16.
[5] Undoubted interest was attracted autumn of 2008 by the receipt by «Don-construction», specializing in «elite real estate», credit lines in VTB in the amount of USD 0.5 billion. Herewith, the government support (at the federal and Moscow levels) was expressly promised only to the economy class developers.

5.1.2. External corporate debt and a new phase of state expansion

A specific feature of the present crisis (as opposed to the crisis of 1997-1998) is the *active participation of public* and state-controlled businesses in the process of property redistribution. Moreover, the current situation becomes in fact a mirror reflection of the well-remembered shares-for-loans auctions (arranged in November-December 1995), when the government, receiving the funds from private companies to supplement the budget, has placed in pledge shares of 12 major (strategic) Russian enterprises to fulfill public liabilities. Among them, in particular, there were packages of shares of «YUKOS», «LUKOIL», «Surgutneftegas», «Sibneft», «Norilsk Nickel», «Novolipetsk Metallurgical Works» and others, but there were no cases, when such quasi-credit was repaid, which according to the vast majority of evaluations, actually meant privatization of those blocks of shares by manifold reduced prices.

In autumn 2008, the roles have been drastically changed: on the publicly declared announced grounds of «economic security», the Government expressed willingness to refinance those external credits of public and private companies, incompliance of which could result in the loss of national control over the Strategic Asset (by the state or by national capital). This means, in particular, that the objects of *actual nationalization* can be not only the shares of the public sector in the direct meaning of the word (those, where participation of the state capital exceeds 50 per cent), but also strategic businesses (though the definition of that term in the Russian legal framework is rather vague) of the private sector.

Back in 2006, it was noted in the IET works[6], that further development of the companies with the state participation, which have become the «core targets» of the state expansion, will be defined, among other things, *by their ability to redeem credits* in view of global prices for energy sources. The most pessimistic estimates were based on the expressed downfall in prices for energy sources, greatly affecting the largest state-owned companies-borrowers business. It was noted that along with the downfall in oil prices, an access to financial resources in the external markets for the debts refinancing will be decreased, whereas the price for credit services will be increased. In this situation, short-term outflow of foreign capital, downfall of the stock market and severe problems in the banking system, based on reduced liquidity were expected.

In 2000-2005 external debt of the Russian state-owned companies has increased many times: USD 570 mln in 2000, USD 12 bln in 2002, USD 28 bln in 2005, that is, according to the estimates, it amounts from 30 to 40 per cent of the total external corporate debt of Russia. Thus, in 2005, the external loans of Sberbank, Vneshtorgbank, Vnesheconombank and Rosselkhozbank amounted to nearly USD 6.45 bln (about 36 per cent of the funds raised by Russian banking sector). «Gazprom», «Rosneft», «Sovkomflot», OJSC «Russian Railways», «Transneft» and «Alrosa» total external debt reached USD 28.2 bln. The tear of 2006 has been characterized by a new wave of the debt growth: the external debt of non-financial companies and commercial banks amounted to USD 135.4 bln and USD 78.5 bln accordingly (whereas the share of public companies is estimated at over 50 per cent of the total external corporate debt of Russia).

[6] Ref.: Russian economy in 2005 . Trends and prospects. M., IET, 2006 and: Interview with E.Gaydar // Expert. 2006. N3. P. 6.

By July 1, 2008, according to the Bank of Russia, the total external debt of Russian companies, banks and government administration authorities reached USD 527.1 bln (an increase only within the second quarter of 2008 totaled nearly to USD 50 bln). Herewith, the share of external debt of financial institutions amounted to USD 191.3 bln (the debt growth has exceeded USD 21 bln per quarter). The dept of non-financial companies, regardless debt liabilities to the direct investors, amounted to USD 263 bln (nearly USD 25 bln growth per quarter).

As of July 1, 2008, external public debt of Russia amounted to approximately USD 41 bln. It is estimated, that the debts of state-owned companies and banks currently make around 50-60 per cent of external corporate debt of Russia (for example, «Gazprom» - around USD 60 bln, «Rosneft» - about USD 26 bln, VTB – USD 11.4 bln, subject to redemption before the end of 2009)[7].

According to common formal indicators (the ratio of the company debt against operating income), the largest Russian borrowers have not reached the critical «threshold». Nevertheless, various control measures (restrictions) of public companies external debt have been extensively discussed since 2005. From the standpoint of the Ministry of Finance, the State should take some responsibility for the activities of such companies through the development of common approaches t external and domestic debts of the state-owned companies. External debts should not be banned, but they should be limited in scope and, where possible, be replaced by credits in the domestic financial market[8]. There were some expectations from the state representatives in the Boards of Directors. Since the borrowing issue is closely related to the companies' net profit allocation (dividends to shareholders, including the State), documents were being developed for establishment of a unified system of borrowing and dividend policy. *Overall, by mid-2008, no regulations or standards of these processes have been implemented.* Moreover, the administrative restriction of state companies' access to external financing sources can be hardly regarded as an effective inflation curbing mechanism. The issue of external borrowing for the state holdings should be resolved from a different point, namely

[7] Investment company ATON estimates: as of Oct. 5, 2007, Russian external debt grows due to state-owned companies www.svobodanews.ru. Nevertheless, it should be noted, there are difficulties in assessing the debt of the state-owned companies: first, because of the lack of consolidated corporate registers (at least disclosed ones). Secondly, there are methodological inconsistencies. Relevant statistics of the Central Bank on external debt (detailed analytical report for 2008, ref.: www.cbr.ru/statistics) takes account of external debt for public and private sectors separately, and in the public sector includes only those banks and non-financial companies «in which the government or monetary and credit authorities direct or indirect participation makes 50 or more percent in the form of shares ownership or in any other way of control over the capital». All other public companies (combined patterns of ownership), apparently, belong to the private sector. Assuming that all the major «debtors» with the state participation over 50 % are related in the Central Bank records to the public sector, the total amount of the external corporate and bank debt is notably less than the general expert estimates (USD 141.9 billion, or 34, 7 % of the total external debt of banks and public and private companies as of April 1, 2008).It should be noted, that even the debts of «Gazprom» and «Rosneft», the companies, that can be undoubtedly related to «non-financial companies» as per the definition of the Central Bank (whose debt amounts to about USD 86 billion) has already exceeded the total amount of debt of non-financial companies of «public sector» (USD 74.5 billion). And thirdly, there is in fact «double counting», because according to the estimates, some assets, recorded by the Central Bank as external debt, are in fact, the domestic credits, provided within the groups of companies (holdings), which have no relation to external debt in economic terms.

[8] RIA "Novosty". December 8.

by definition of their priority in government issues, ensuring the transparency of financial flows and effective management of targeted assets.

It is known, that a substantial share of the leading state companies' debt has been associated with operations in the market of corporate control in 2005-2007. In other words, a large share of borrowed funds was addressed not to the existing business development, but to the process of the new property redistribution, i.e., the purchase of assets, changes in the equity capital, etc. Unlike the forceful redistribution of preceding years (for example, «YUKOS case»), the new phase, when the leaders are the state companies and number of companies, enjoying political support from the government, is the market-power by nature. Assets are sold not entirely voluntarily, but at a close to the market price (it is enough to mention the history of 50 per cent share acquisition in the project «Sakhalin-2»). As a result, the transition to the state-capitalist economic model contributes to the market growth and investments attraction. In conditions of high liquidity and favorable macroeconomic situation the state companies actively attract credit resources for the purchase of new assets, which leads to their market capitalization growth[9].

Although the State is not responsible for the debts of the mixed-type companies, in fact, their debts are estimated as sovereign ones. Moreover, for investors, investing in such businesses becomes a source of virtually guaranteed profit, as the government demonstrates willingness to support those companies in both, political and state regulation terms (the program for gas prices upgrading for domestic consumers). This predetermines the extreme popularity of Russian shares in the offshore hedge funds, for which the *deterioration of the institutional environment (especially «double standard» policy) in Russia is favorable in terms of profits.* At the same time, foreign banks are willingly provide credits under low interest for the purchase of new assets by the state companies (note the expressed marked increase in the debt of non-state borrowers in the second quarter of 2008, i.e., during the global financial crisis).

It is obvious, *that this model of market growth is largely speculative one, as there is no significant capital investment in production[10] and the model is applicable only in the background capital inflow to emerging markets, as well as companies' revenues growth due to increasing prices for their products and the redistribution of assets in their favor.* Furthermore, such a speculative market growth conceals the real economic problems and distortions, provoked by deterioration of the institutional environment (while the state participation in the economic sphere is being expanded). It should be reminded, that in mid-2008, ten most capitalized companies provided 66 per cent of the total market capitalization, while 50 per cent of capitalization was derived from oil and gas extraction and refining[11]. The huge inflow of funds is ensured by the small number of the leading companies, that are getting political sup-

[9] Ref: A. Abramov, Radygin, Rogov Model Development: The Trap of the State Capitalism / / Vedomosty. 2007. April 9, P. A 4.

[10] According to A.E. Abramov estimates (based on stock exchanges and Russian Statistical Service), only within the period from 2005 to the first half of 2008, the share of investment from the corporate bonds issues, invested in the fixed assets, ranged from 0.4 to 2,2 %. Only slightly better was the use of funds by companies and banks involved in the IPO. In 2007, the most successful year in terms of IPO only 3.6 billion dollars, or 10.9per cent, were implemented for the growth of real capital, out of 33 billion dollars, derived from primary and secondary placements of shares.

[11] The Russian stock market. The first half of 2008. NAUFOR, SKOLKOVO Moscow Management School, 2008.

port, while in general, the allocation of investments in the economy is restrained by institutional environment failures.

This model is clearly projected on the situation and the *financial crisis of 2008-2009*, when emergency measures of the Russian companies and banks support are being discussed.

5.1.3. Anti-Crisis measures in the context of increasing public sector

There are several trends, that should be highlighted in the package of anti-crisis measures, taken by the Russian government authorities in September-October 2008, in respect to the problems of expanding of the public sector.

1. *Public credits for foreign loans service* of the Russian companies and banks (initially – USD 50 bln in 2008).

According to available data[12], in the IV quarter of 2008, the amount of payments of Russian companies on external debts was estimated at USD 47.5 bln, and at USD 115.7 bln in 2009 with regard to extensions of redemption share USD 115.7 bln. Deposits (in the amount of USD 50 bln), allocated by Central Bank in «Vnesheconombank Bank Development», were enough finance companies for payments in 2008.

Herewith, it is justified, that credit terms are estimated as extremely tough (including such terms as «temporary nationalization»): securities pledge, a pledge of export earnings, undisputable and acceptance-free write-off of funds from any account of the borrower to recover credit, the inclusion the representatives of the Bank in the administration of the borrowing company, agreement with the bank to attract other loans and transactions on sale of more than 10 per cent of the company value, credit securities similar to foreign credits, etc. However, the VTB retains an unprecedented right for decision-making with regard to any increase in the pledge, as well as the opportunity to choose between debt redemption or the «set off» by the pledge.

By mid-October, 2008, applications were submitted for refinancing of «Rosneft», VTB, «Gaspromneft», TNK-BP, «Lukoil», UC Rusal, the AFC «System», Severstal, Michel and other companies. The minimum standard amount of the refinancing at the level of USD 100 mln (according to the Memorandum of the Bank financial policy), relates only to the largest companies and banks. OAO «Gazprom», having initially declared that there was no problem with payments, apparently can turn into an applicant for public funds, though, due to the exclusive status in view the Russian authorities, the refinancing terms and schedule can be different from common ones.

2. *Direct («anti-crisis») public intervention* in the stock market (RUR 175 bln in 2008 and 2009.)

In mid-October 2008, it was also decided to allocate assets from the National Welfare Fund for the purchase of the Russian companies shares (for RUR 350 bln in 2008-2009). Currently there is no official information on the interventions, the exact amount of investments and purchased shares, as well as the beneficiaries thereof. It would be at least reasonable to ask a question about the *expediency of the monopolization of virtually all transactions* in «Vnesheconombank-Bank of Development», on the procedures for the selection of Comptrol-

[12] For more information, including detailed diagrams and charts of government anti-crisis «injections», it is enough to refer to the official web sites of the major news agencies and periodicals for October 2008 (in particular, www.vedomosti.ru, www.kommersant.ru , www.expert.ru, etc.).

lers (professional agents) for the transactions, which have been executed or will be executed in future, including the commission terms.

One of the very reasonable questions, that arise in relation to this kind of VEB activity, is on the source of the funds, allocated for the intervention. As you know, one of the key optimal objectives of the National Welfare Fund establishment was pension reform financing. It would be quite reasonable in the crisis situation to place the blocks of shares, acquired by the Fund in the open market, namely in the Pension Fund (or its equivalent) to ensure pension payments in future (at the stage of market capitalization growth). It is still unknown, where and to whom, in the existing nontransparent situation, the blocks of shares, purchased by VEB in 2008 and possibly in 2009-2010 will be transferred.

The issue of *transparency criteria for the expediency of these transactions and their public control is* no less important. According to the Decree of the RF Government dated of October 15, 2008, the Ministry of Finance has the right to invest in stocks and bonds up to 80 per cent of the National Welfare Fund assets, including up to 50 per cent[13] in the securities, listed in MICEX and RTS, or included in the MSCI World Index and FTSE All-World Index, and in the funds, that carry out relevant investments.

Judging only by indirect information, such injections began only from Oct.17, 2008 in the shares of «Gazprom», «Rosneft» and Sberbank, and, according to the available data, in the shares of «Lukoil». Leaving aside general theoretical considerations of the near-to-zero efficiency of budgetary funds investments in stabilization of the stock market during the crisis[14], according to the available expert estimates, no overall strategy of intervention, no proved anti-crisis measures with regard to divergent market trends are implemented even in relation to the narrow range of the leading companies-emitters.

Apparently, there were three possible trends: random counteraction against *margin calls*, acquisition of certain problematic assets and the attempts to market adjustments in favor of individual emitters, selected by the government. The problem of insider trading and, in the broad sense, a general policy against any kind of financial abuses (theft of funds) becomes particularly acute in this context.

According to the VEB, by the end of November, 2008 the Treasury of the Bank has received RUR 115 bln (from the National Welfare Fund). RUR 85 bln was spent to the «support the financial market». The funds were addressed to «the acquisition of shares and corporate bonds of the top Russian emitters», and the actions under those operations «were approved by the Ministry of Finance»[15]. Although there is no more recent data on this type of interventions, in February 2009, the issue of VTB participation in this scheme, was also under consideration.

3. In October 2008, as one of the extreme measures of support, an option was considered of the *acquisition of preferred shares and convertible bonds* (new emissions) of the emitters, supported by the government. This tool is common and has been used in a number of countries (UK, Switzerland) to support the problematic banking groups. Moreover, its appli-

[13] In the scope of USD 45–50 bln at the Fund amount as of October 2008.

[14] It is estimated that during the week of October 17-24, 2008 there was spent at least USD 1 billion, but the downfall in securities equities of the supported issuers, was continued (from 15 to 33 %). This means at least direct government funds losses, although in the short-term prospect the rates downgrading would be more significant in the absence of government interventions.

[15] Commersant, December 12, 2008.

cation does not make it necessary for the country to interfere in the operational management or directly participation in the stock equity.

By the end of February 2009 no information was available on the allocated for that purpose financial resources and the target of their allocation. Nevertheless, such proposals were submitted, for example, in late January, 2009 in regard to OC «Rusal» (conversion in preferred shares of the company debt to public banks in the amount of USD 6 bln. The pledge included 25 per cent of GMK «Norilsk nickel» shares, owned by «RUSAL»).

Apparently, in early 2009, *the policy of support has undergone significant changes* at the background of an overall shift of accent from the statements, made in autumn 2008, that «there is enough money for everybody» to the more sober strategy of reserves preservation till 2010-2011, selective support of the largest banks, rather than the global support to the companies.

First, through the above-mentioned program of foreign loans refinancing in the corporate sector, about 100 applications were submitted to VEB, totaling to USD 75 bln. However, the program was closed, when its expenditures reached USD 11 bln. Among the recipients were: Rosneft (USD 800 mln), UC Rusal (USD 4,5 bln), VimpelCom, Euras and some others. On the one hand, the program has been recognized inexpedient, as the majority of the participants have accumulated sufficient foreign currency reserves and were able to solve their problems with creditors independently (about USD 85 bln by February, 2009, which is, according to Government estimates, enough to settle credit payments in 2009)[16].On the other hand, the terms of such credits, apparently, seamed too strict to the applicants (which is however, points to the undisclosed internal resources of companies to solve their financial problems without tighter government control).

Nevertheless, it should be noted, that even on the allocated credits, transparent public information on the selection criteria of the participants of the public support program is virtually not available. It is also not clear, how VEB intends to dispose the blocks of shares, obtained as a pledge, after the established one-year term (maximum credit maturity).

Secondly, in October 2008 it was envisaged to allocate RUR 450 bln from the National Welfare Fund for allocation with the «Vnesheconombank Bank Development», followed by RUR 225 bln. Allocation in the banking system for co-financing of the capital increase (by February 2009, private banks have selected RUR 17 bln.). Nevertheless, the policy of extensive infusions of funds into the banking system (by mid-February, 2009 it amounted to nearly RUR 3.4 trillion, including RUR 1.9 trillion of the dept of the banks to the Bank of Russia under unsecured credits[17]) did not result in the renewal of the mass bank investments in industrial sector. On the contrary, it is estimated, that the total credit, requested by the Russian enterprises from the government, was about RUR 3.5 trillion, while in December 2008, the relevant estimates of the Russian budget for 2009 imposed only RUR 325 bln for the crisis measures, and RUR 300 bln (including RUR 100 bln for defense enterprises) for the government guarantees[18].

This has served, in particular, as a motivation to search for the new ways to support enterprises of the real sector by the government.

[16] Money, № 6, February 16, 2009.
[17] Power, № 6, February16, 2009 .
[18] Merges and Acquisitions, 2009. № 1–2, P. 4.

The program for recapitalization of the banking system for lending to the enterprises of the real sector (in fact, that means the increase the state participation in capital), claimed in 2009, could cost about USD 40 bln (that is, actually equivalent to the «balance» of the suspended 2008 program of credit refinancing). The number of banks, which can participate in this program, is not defined yet, but there notably different official estimates, depending on the scope and models of public support and on participation (according to Vladimir Putin there should be 81 banks, according to I.Shuvalov - up to 50 in the case of subordinated credit co-financing, from 4 to a maximum of 30 banks in the case of additional emissions redemption).By early February, 2009 the model of support, when a direct state participation in the capital is foreseen only in 3 banks (VTB, VEB, Gasprombank) looked mostly realistic. Herewith, Sberbank, VEB, VTB and Gasprombank are instructed to extend credit portfolios by at least 2 per cent per month[19]. It is envisaged to provide subordinated credits to private banks in the (total) amount of RUR 100 bln. In particular, that means the government unwillingness to take the risks of operational management as a shareholder.

Back in 2008, a discussion has started of alternative (financial) approaches to the support of the Russian enterprises, operating in «important sectors of economy». By the end of December 2008 the absulute number of potential recipients of the state assistance within a short term has decreased 5-fold (1500 on the initiative of Vladimir Putin, 500 – proposed by I. Shuvalov, 295 – by E. Nabiullina). Among the formal requirements for companies' enrollment in the anti-crisis program are such terms as: at least 5000 employees, RUR 15 bln of revenues, or the company is the principal local employer and mainstay. VEB should become the government agent in this trend of the state support. Companies will be able to invest up to 50 per cent of the government guarantees (enterprises of military-industrial complex - up to 70 per cent) as credit security. Herewith, the maximum amount of public guarantee to each applicant is limited to RUR 10 bln.

For 293 enterprises from 25 industries, which eventually have been included in the list of the RF Ministry of Economic Development and Trade, the credit support instruments are provided, but the range of possible solutions is much wider: the government guarantees (which are widely used as an anti-crisis measures in developed countries in the amount of nearly USD 10 trillion and require only a conditional reservation of funds), interest rates support funding, restructuring of the tax arrears, public contracts, customs and tariff policy. Some measures on mitigation the "negative social and economic impact of the businesses closure" are foreseen, apparently, in the event of bankruptcy[20].

By mid-February 2009, the information was disclosed on the applications of the largest Russian manufacturers for government guarantees under credits (from AvtoVAZ, GAZ, Kamaz and Sollers, totaling to RUR 29.5 bln). Among other methods of public support to the Russian automobile industry, the redemption of bonds up to RUR 60 bln and public procurement contracts for the amount of RUR 12.5 bln are envisaged. In the militry-industrial complex there were taken decisions on state guarantees provision to 3 enterprises, on subsidies for 19 enterprises, balance of capitalization of RSK «MiG», amounting to RUR 15 bln. The state corporation «Rostehnologies» (which has received 20 of the local economic mainstays and

[19] Vedomosty. February 3, 2009 .
[20] Ref.: Public feeder for three hundred hamsters.– www.gazeta.ru, 26.12.2008.

278 of strategic enterprises) has requested the state guarantees in the amount of RUR 110.8 bln (in addition to RUR 151.32 bln of material contribution)[21].

Though from a technical point of view, the range of anti-crisis measures of support is doubtless, there are at least two issues in terms of quality. First, the privileged list puts at an obvious risk the basis of the market (microeconomic) incentives to overcome crisis challenges on their own, namely in «the major» industries. Though the list is declared as an open one, an open tender procedure for applications for some kind of support (in case of anti-crisis programs availability) from any Russian enterprise would be more fair (if the traditional corruption component is ignored). Second, one can easily assume, that many of the problems of the enterprises are associated not only with the crisis as such, but with the management quality and credit policy, carried out in 2005-2007. It would be reasonable, if one of mandatory requirements to provide any kind of public support was the replacement of the existing operational management, perhaps, similar to the anti-crisis management (if the threat of corporate raiding and team replacement for the operation of remaining benefices are neglected).

Bankruptcy can also be regarded as a way of anti-crisis public interference. Herewith, the issue is not in the company liquidation or disintegration, rather than in the owner replacement or in the introduction of supervision by the authorized government body.

In any case, it is too early to give any more detailed assessments to the current developments, at least due to the lack of a critical mass of actually performed transactions, as well as insufficient open information, at least in regard to the scope and criteria for the State interventions. *There are grounds for the most pessimistic estimates at least in regard to the basis of the overall assessment of the institutional environment, which problems, in our view, have become one of the typical «Russian» indicators of the current financial crisis in the Russian economy*[22] *.*

Nevertheless, the conclusion s to the beginning of a new phase in the state property expansion (even with regard to the objectively needed anti-crisis component) is indisputable. If capitalization of the Russian market would be sustained at the level of mid-October 2008, then, according to a simple calculation, one could predict the increase of the public share in the corporate sector within 2009-2010, or from 3-4 per cent (lower threshold) up to 9-10 per cent only due to the funds, allocated for intervention in the stock market. The scope of further expansion of the state sector is impressive, though there is no certainty about the Government plans yet:

- retention of public property the blocks of shares, pledged in VEB in the framework of the refinancing program in 2008 (USD 11 bln), performance term is late 2009;
- retention of public property the shares, acquired in the open stock market (USD 350 bln at the 2009-2010), decision-making deadline is in 2013-2014;
- further expansion of the state companies in the strict sense (despite partial withdrawal of the allocated financial resources);

[21] It is remarkable, that it is planned to address RUR 34 billion to finance the purchase of shares in OAO «VSMPO-Avisma» by public corporation. Ref: Vedomosti, February 9-10, 2009, Kommersant, February 6, 2009.

[22] Ref: A.D. Radygin. Stability or stagnation? Long-term institutional issues of development of the Russian Economy / / Economic policy. 2007. N 1 (5). P. 23-47.

– acquisition by public banks assets of commercial companies, provided under the security of issued credits and through the direct acquisitions, formation of new state holdings[23];
– the increase of the state share in the bank capital in the framework of recapitalization program in the banking system (USD 40 bln). According to the Bank of Russia, the aggregate capital of Russian banks in early 2009 made RUR 2.5 trillion. With the level of the recapitalization scope, declared for 2009, it means that the state can claim for 32 per cent more of bank capital at the background of the overall growth of the state share up to 75-80 per cent[24].

At the same time, (other things being equal, including political and rent-corruption issues), a qualitative threshold of such expansion is obvious: the larger the public sector, the more limited are the opportunities for effective management and control. This is confirmed, in particular, by the experience of the introduction (the attempts of introduction) of any new instruments of management and control over the unitary enterprises and joint-stock companies with the state share at the late 1990-2000-ies. By analogy, with the evolution of Russian private business groups in the second half of the 1990's - early 2000-ies[25], in the medium term, one should expect some reorganization procedures, aimed at optimization of the structure of the acquired assets and organizational and management aspects of the public companies (groups) restructuring. In view of the financial crisis of 2008-2009, this process can be accelerated due to the need of companies (both, public and private ones) to attract financial resources through the disposal of a number of assets, not directly connected with their basic activity.

Moreover, the quantitative growth of direct government participation in the economy or a large permanent share of the latter are not extraordinary in the current global situation, especially during the crisis. According to the available estimates, by the end of 2008, in the framework of anti-crisis support, various countries have spent about USD 1.4 trillion for the companies' capitalization and about USD 880 bln for the new assets acquisition. Nevertheless, among the leading global countries, taking anti-crisis actions, large direct purchases of private assets in 2008 were performed only by the USA (USD 663 bln) and Norway (USD 51 bln), while the Great Britain, France, Italy, Germany, Netherlands and Japan carried out capitalization without the direct purchase of assets[26].

In fact, the financial crisis of 2008-2009 has resulted in the contradiction, or at least in the ambivalent situation.

On the one hand, the crisis events have urged a sound understanding of public sector scope expansion. The issues of the extended public sector management (in all its aspects, such as operational management, management expediency, ethical risks, «principal - agent» relations, corruption, rent, etc.) seem to be understood by the government. This is, apparently, confirmed by the gradual withdrawal of the government (during the crisis) from the direct

[23] In mid-February 2009, for example, the scheme of the key communications companies consolidation was discussed through the VEB, which has already received 90 % of shares «Svyaz-Bank» in autumn 2008 (purchase of 40 % of «Rostelecom» shares from «CIT Finance», 90 % of which belong to OAO «RZD» and ALROSA since autumn of 2008, as well as 25 % +1 share purchase in «Svyazinvest» holding from AFC «System»).
[24] Commersant, February 4, 2009; Money, N 5, February 9, 2009 .
[25] See, for example, A.Radygin. The evolution of integration and management models: the major Russian companies and groups experience//Russian Journal of Management. 2004. V.2. N 4. October-December. P. 35-58
[26] State Capitalism (Special issue). – SmartMoney, N 143, February, 16, 2009.

methods of support by direct public participation in the capital of problematic private companies and banks. Moreover, the ability of launching a new «program of global privatization», rather than the investment economic growth is becoming one of the options, discussed once again in the crisis. On the other hand, there is no reason to speak about withdrawal from the direct control principles, since the suspension of direct «anti-crisis» expansion, which is currently replaced by the stronger indirect control through a small number of banks, supported by the government, the formation of preference lists of «significant» enterprises, and through the continued activity of state corporations and state holdings (the few market subjects, having an opportunity for the new merges), the inevitable (though not as extensive as expected) and the nationalization of problem assets in its «hard» or «soft» options.

In view of the above, the most acute issues in the scope of the qualitative assessments, primarily the precise strategy, the objectives (incentives) and long-term results (costs) of the process are the most acute ones.

5.1.4. Privatization

By the end of 2008, if was evident, that privatization process was expressly slowed down, if not completely terminated. Large-scale transactions in this area were rare within the preceding years (although the reasons were different), but poor financial standing of potential buyers, as well as the reasonable reluctance of the government to dispose any assets for a trifling sum, in the face of crisis urged the slowdown in privatization of medium and small objects as well. In autumn 2008, in particular, such methods of privatization, that could beat down the price of the objects enjoying minimum demand, were suspended. Apparently, a similar situation takes place in regard to the renewable revenues from public property (the suspension of dividend payments by companies with a state share of capital, land repurchase, etc.).

According to the official data of the Russian Property Agency, in mid-January of 2009, there were 1293788 objects of movable and real property in the Register of Federal Property (including more than 1.1 million of registration objects, owned the holders of relevant legal property right, and about 107,000 of the state treasury objects). The Register comprises also 3600 blocks of shares and nearly 67000 land areas, owned by Russian Federation. About 5700 Public Unitary Enterprises still remain in the property of the Russian Federation as well.

The plan for 2008 envisages the sale of share packages or public shares in 404 joint-stock companies and privatization (incorporation) of 440 Public Unitary Enterprises. The plan for 2009 (as of September, 2008) envisages the sale of securitirs or public shares in 291 joint-stock companies and the incorporation of 235 Public Unitary Enterprises. Herewith, the annual federal budget revenues from privatization of federal property in 2008 - 2010 were estimated at RUR 12 bln.

Initially, there were no large objects in 2008-2009 privatization plans, but this is based not only on the «suspension» of public sector in the background of state capitalism policy, routine conflict of interests and resistance of official authorities. Among other reasonable grounds, the rejection to use privatization techniques to replenish the budget and some technical problems should be mentioned. First of all, there is a one-year deficit (versus the official plan of privatization) in regard to such transactions even for a number of small and medium-sized enterprises. However, in accordance with the effective legislation, the transactions,

failed to be executed before December 31 of the planned year, will be automatically shifted to the plan of the next year or dismissed from the scope of privatization process.

By some estimates, a number of innovations in the sphere of state management, that have been discussed or have already started to be implemented in 2008, could have serve as a prelude to a new phase of «global privatization». First of all, this is an appointment of independent Directors to the large joint companies, starting from summer of 2008 (i.e., the image incentive to improve the quality of corporate management preceding public offerings), an opportunity for the privatization plan extension from 1 to 3 years (what allows to take time before passing through the entire cycle of preparations for the sale of a block of shares), tentative incorporation (in the true sense of the word), of the state corporations, established in 2007-2008.

Even at the level of official comments, plans for the new large sales are cautiously related to the year of 2010. Rather reasonable estimates of the crisis duration in the Russian economy for at least 2009-2010 leave the issue unresolved for a longer period (even only with regard to economic factors, i.e., beyond the policy of state expansion). Nevertheless, two extreme scenarios are already quite evident.

The first scenario is clearly based on the forced return to the privatization instruments implementation for the growing budget deficit financing (as in the 90-s.), despite the low cost of the disposed assets. In the macroeconomic context, this scenario has enough chances to be realized at the peak of the crisis, when oil prices are low, financial (gold) reserves are being exhausted and the budget deficit is growing. In fact, we are speaking about the sale of a part of public assets at dumping prices, though the internal motivation might be different - from the short-term (due to non-restorable source) assurance of the previous social commitments, up to the «non-transparent» allocation of assets, privatized for trifling sums among a narrow range of subjects. The combination of these two options is quite realistic, though in the first case one can speak about a wrong economic policy, and in the second case - about future suspension of «privatization of profits, nationalization of losses» model.

The second option, much more optimistic one, is based on the «soft» exit out of the crisis after 2010, gradual restoration of the stock market capitalization (assets value) regain and the beginning of single sales at the new wave of economic recovery. Thereby, the «large-scale privatization» should not be targeted at fiscal problems, but rather, like in 2000-2007, it should solve the problem of quantitative optimization of public sector and the government rejection of inappropriate functions of business entities management.

An alternative option of those two scenarios still remains in force, i.e., further quantitative expansion of public sector (direct and indirect) in the framework of anti-crisis measures of direct control, followed-up unlimited term of state ownership of the obtained objects. With regard to the anti-crisis measures of early 2009, mentioned above, it is nevertheless possible to imply, that the indirect measures are predominant, what implies both scenarios of privatization.

5.2. The State of Property Relations, the Role of the Public Sector, and Privatization

5.2.1. The Magnitude of the Public Sector, Its Elements and Main Characteristics

Like in 2003-2006, in the second half 2008, the Russian government discussed approval of the next privatization program.

But like the previous analogous document approved in spring 2007, the 2009 Prognostic Plan (program) of privatization and main guidelines of privatization of the federal property for 2010 and 2011 contained data on the number of unitary enterprises in federal property (FUEs) and joint-stock companies with the RF's participation in their capital only as of the beginning of the calendar year[27]. That is why there are no sufficient data to objectively judge dynamics of these particular components of the public sector.

Let us consider in a greater detail the changes that took place within main categories of economic agents that fall under the federal property.

Federal Public Unitary Enterprises

Table 1 below displays dynamics and the sectoral structure of FPUEs between 2004 and 2007. In 2007, their overall number tumbled at 12.6%, down to slightly over 5,700 units.

Table 1

Dynamics and Sectoral Structure of the Federal Public Unitary Enterprises between 2004 and 2008

Sector	As of June 1, 2004		As of June 1, 2005		As of June 1, 2006		As of June 1, 2007		As of June 1, 2004	
	units	%	units	%	units	%	units	%	units	%
Non-production sphere	4,069	44.1	3,617	43.6	1,817	25.3	1,670	25.55	1,151	20.2
Industry and construction	3,012	33.0	2,773	33.45	2,376	33.1	2,207	33.8	1,744	30.5
Agriculture	1237	13.4	1111	13.4	913	12.7	826	12.65	618	10.8
Transport & communication	809	8.8	725	8.75	612	8.55	536	8.2	409	7.2
Forestry	65	0.7	67	0.8	53	0.75	49	0.75	37	0.65
Other sectors	–	–	–	–	1407	19.6	1245	19.05	1750	30.65
Total	9,222	100.0	8,293	100.0	7,178	100.0	6,533	100.0	5,709	100.0

Source: the 2004 Federal Property Privatization Program (Prognostic plan (program) of privatization of federal property for 2004 and main guidelines of privatization of the federal property through 2006); the 2005 Prognostic plan (program) of privatization of federal property; the 2006 Prognostic plan (program) of privatization of federal property and main guidelines of privatization of the federal property between 2006 and 2008; the 2007 Prognostic plan (program) of privatization of federal property and main guidelines of privatization of the federal property between 2007 and 2009; the 2008 Prognostic plan (program) of privatization of federal property and main guidelines of privatization of the federal property between 2008 and 2010; the 2009 Prognostic plan (program) of privatization of federal property and main guidelines of privatization of the federal property between 2010 and 2011; the authors' calculations.

The main trend exhibited by changes in the sectoral structure of FPUEs in 2007 was a drastic rise in an absolute number of enterprises that fall under the group of "other sectors" not included in the basic classification. As of early-2008, they formed the biggest group vis-à-vis

[27] The 2003-06 prognostic plans (programs) of privatization approved in the end of the summer contained data on the number of FPUEs and JSCs with federal blocks in them as of June 1 of each year.

other sectors (some 30.7% of the overall number of FPUEs). A somewhat smaller number of enterprises were those from the industrial sector and construction industry (30.5%). The representation of the block of sectors of the non-industrial sphere and agriculture was fairly substantial (20.2% and 10.8%, respectively), while 7.2% of FPUEs were those of the transport and communication sectors and less than 1% of FPUEs represented forestry.

With the rise in the proportion of enterprises that fall under the "other sectors" group up to 30.7% as of early-2008 vs. slightly over 19% in the prior year, the proportional weight of all other sectors decreased. The most drastic fall was noted across sectors of the non-production sphere – their proportion in the aggregate structure of FPUEs tumbled at nearly 5.5p.p., while at 3.3.p.p. plunged the proportion of industrial and construction enterprises.

Joint-stock companies whose stock are owned by the federal government

Let us consider in a greater detail the recent sectoral dynamic of the number of joint-stock companies whose stock is owned by the federal government:

Table 2

Dynamic and Sectoral Structure of Joint-Stock Companies Whose Stock Is Owned by the Federal Government or to Which the Special Right of "Golden Share" is Used in 2004–2008

Sector	As of June 1, 2004		As of June 1, 2005		As of June 1, 2006		As of Jan. 1, 2007		As of Jan. 1, 2007	
	units	%	units	%	units	%	units	%	units	%
Non-production sphere	1,781	45,6	685	18,1	356	9,6	405	10,1	638	17,4
Industry and construction	1,710	43,8	2365	62,5	2,152	57,8	2,201	55,05	1,878*	51,1
Agriculture	356	9,1	459	12,1	396	10,6	353	8,9	397	10,8
Transport & communication	43	1,1	229	6,1	363	9,7	534	13,35	761	20,7
Forestry	15	0,4	45	1,2	99	2,7	88	2,2	–	–
Other sectors	–	–	–	–	358	9,6	416	10,4	–	–
Total	3905	100,0	3783	100,0	3724	100,0	3997	100,0	3674	100,0

*– including the industrial sector and construction per se (695 units, or 18.9%), the fuel and energy complex (597 units and 16.25%) and the military-industrial complex (586 units, or 15.95%)

Source: the 2004 Federal Property Privatization Program (Prognostic plan (program) of privatization of federal property for 2004 and main guidelines of privatization of the federal property through 2006); the 2005 Prognostic plan (program) of privatization of federal property; the 2006 Prognostic plan (program) of privatization of federal property and main guidelines of privatization of the federal property between 2006 and 2008; the 2007 Prognostic plan (program) of privatization of federal property and main guidelines of privatization of the federal property between 2007 and 2009; the 2008 Prognostic plan (program) of privatization of federal property and main guidelines of privatization of the federal property between 2008 and 2010; the 2009 Prognostic plan (program) of privatization of federal property and main guidelines of privatization of the federal property between 2010 and 2011; the authors' calculations.

As of early-2008, the sectoral structure of JSCs whose stock is in federal property was dominated by industrial and constriction enterprises accounting for over 51% of the totality of such JSCs. But it should be noted that this aggregate figure comprises, in addition to industrial and construction enterprises *per se*, the JSCs that fall under the fuel and energy complex (FEC) and military-industrial complex (MIC) as well. Their consolidation in the same group with industrial and construction companies is necessitated by the need to ensure comparability with the data of the previous period when in the structure of the JSC with the federal stakes the TEC and MIC ones were separated from the group. By contrast, in early-2008, the data on the construction sector was combined with those on the industrial sector.

With that in mind, as of early-2008, the sectoral structure of JSCs whose stock is in the federal property displayed the most extensive representation of the agrarian sector (20.7%), followed by the industrial sector and construction (18.9%) and the block of non-production sectors (17.4%). As for TEC and MIC, which are represented by roughly the same number of enterprises (some 16% each), they appear slightly inferior to the non-production sphere, but well outpacing the transport and communication sector (10.8%).

Speaking of the 2007 shifts in the sectoral structure of JSCs whose stock is in the federal property, it is with a great deal of confidence that one can maintain it saw a notable rise of the specific weight of agriculture – at nearly 7.5 p.p. (from less than 13.4% as of early-2007 up to 20.7% as of early 2008). The proportion of transport and communication JSC posted a slight rise (at 2.p.p. – up to 10.8%). It is the specific weight of the bloc of sectors of the non-production sphere that posted the greatest growth rate (at 7.3 p.p. –up to 17.4%). But that said, as of early-2008, the sectoral structure of JSCs whose stock is in the federal property displays the absence of the group of "other sectors" that were not included in the basic classification, which allows assumption that they are attributed to sectors of the non-production sphere and, perhaps, FEC, and MIC. This complicates the task of a correct comparing of proportions of the non-production sphere, the industrial and construction sectors as of early 2007 with those of the respective period of 2008.

Equally important characteristic of JSCs with the government participation in the capital is their distribution depending on the size of the share the government owns in them (*Table 3*).

Table 3

Dynamics and Structure of Joint-Stock Companies in with Governmental Participation in the Capital in 1999–2008 (Including the Use of the Special Right "Golden Share") Proceeding from the Size of the Governmental Stake

Date	Total		Up to 25%		between 25 and 50%		between 50 and 100 %		100 %		"Golden share", units	
	units	%	units	%	units	%	units	%	units	%	Total, units	Without stock, units
1999.	3,316/3,896[a]	100	863	26.0	1601		48.3	470	14.2	382	11.5	580[b]
January 1, 2001	3,524[c]	100	1746	49.55	1211	34.4	506	14.35	61	1.7	…	…
August, 2001	3,949[d]	100	1843	46.7	1393	35.3	625	15.8	88		2.2	542[b]
January 1, 2002	4,407	100	2270	51.5	1401	31.8	646	14.65	90		2.05	750[b]
January 1, 2003	4,222[d]	100	2152	51.0	1382	32.7	589	13.95	99	2.35	1076	118
June 1, 2003	4,205	100	2148	51.1	1339	31.8	600	14.3	118	2.8	…	…
October 1, 2003	4,035	100	2051	50.8	1308	32.4	552	13.7	124	3.1	640	148
January 1, 2004	3,704	100	1769	47.75	1235	33.35	540	14.6	160	4.3	591	251
June 1, 2004	3,905	100	1950	49.9	1183	30.3	499	12.8	273	7.0	…	…
March 1 2005	4,075/3,791#	100	1697	44.8	1154	30.4	487	12.85	453	11.95	…	284
June 1, 2005	3,783/3,524##	100	1544	43.8	1093	31.0	474	13.5	413	11.7	…	259
June 1, 2006	3,724/3,481##	100	1063	30.5	885	25.4	397	11.4	1136	32.6	…	243
January 1, 2007	3,997/3,816##	100	932	24.4	814	21.3	368	9.6	1702	44.6	…	181
January 1, 2008	3,674	100	771	21.0	645	17.6	269	7.3	1989	54.1	…	…

[a] – The 1999 Concept for state property management and privatization cites 3,896 economic companies (including 3,611 JSCs, 251 closed-end JSCs and 34 LLCs wit the RF's participation in them . The figure of 3,316 units is a computed value resulting from summing up the number of stock (share) packages of different size cited in the Concept.

[b] – the total number of JSCs with the use of the special right of "golden share", without singling out of JSCs in which the government has no stock packages;
[c] – joint-stock companies, less 48 shares and stock packages in overseas companies; there also are data evidencing that Russia owns 119 shares and stock packages in overseas companies with a book value of USD 1.4bn;
[d] – data of a 2002 draft privatization program the RF Ministry of Federal Property submitted to the government. At the time, according to data of the Ministry's register, as of September 1, 2001, the federal government owned 4,308 stock packages in JSCs;
[e] – only open-end JSCs, without regard to 118 open-end JSCs in which the government exercised the special right of "golden share" (with no stock in presence); stakes in 102 JSCs reassigned under FPUE Rosspirtprom's operative management, 75 closed-end joint-stock companies and shares in the authorized capital of LLCs transferred on the basis of Order by the RF Government of April 2, 2002, № 454-p «On termination of the government participation in authorized capital of credit institutions" or received in the order of succession, gift, or under other grounds;
3,791 units – the design number of JSCs whose stock is owned by RF, without regard to 284 JSCs in which the government exercised the special right of "golden share" (with no stock in presence). To ensure comparability with data on the preceding dates, the proportional weight of JSCs with this or that share in the capital was computed proceeding from this figure . For reference: as of January 1, 2005, the federal government owned stake in 3,767 JSCs, less the aforementioned ones in which the government exercised the special right of "golden share" (with no stock in presence) and shares in authorized capital of 24 LLCs reassigned to the Treasury on the basis of of Order by the RF Government of April 2, 2002, № 454-p «On termination of the government participation in authorized capital of credit institutions";
– the design number of JSCs whose stock is owned by RF, without regard to the JSCs in which the government exercised the special right of "golden share" (with no stock in presence). To ensure comparability with data on the preceding dates, the proportional weight of JSCs with this or that share in the capital was computed proceeding form this figure
Sources: www.mgi.ru; Rossiyskaya ekonomika v 2001 godu. Teendetsii i perspektivy (Issue 23). Vol. 2. M.: IEPP, March 2002. p. 62; Braverman A.A. O merakh po povysheniyu effektivnosti upravleniya gosudarstvennoy sobstvennostyu i kriteriyakh ee otsenki. // Vestnik Minimuschetstva Rossii. 2003. № 1. pp. 13–14; Predpriyatiya s gosudarstvennym uchastiyem. Institutsionalno-pravovye aspekty i ekonomicheskaya effektivnost. Series "Nauchnye doklady: nezavisimy ekonomichesky analiz" Enterprises with state participation. Institutional and legal aspects and economic efficiency № 155. M.: Moskovsky obschetsvenny naucnyi fond; Assotsiatsiya issledovateley ekonomiki obschetsvennogo sektora, 2004. p. 47; the 2004 Federal Property Privatization Program (Prognostic plan (program) of privatization of federal property for 2004 and main guidelines of privatization of the federal property through 2006)// Vestnik Minimuschetstva Rossii. 2003. № 3. pp. 4–5. Klyuchevye problemy povysheniya effektivnosti upravleniya federalnoy sobstvennostyu i osnovnye napravleniya dividendnoy politiki Rossiyskoy Federatsii // Vestnik Minimuschetstva Rossii. 2003. № 4. p. 8; Andrianov V. Rossiya v globalnoy ekonomike // Obschestvo i ekonomika. 2003. № 11. p. 84; the 2005 Prognostic plan (program) of privatization of federal property; Materials for the meeting of the RF Government of March 17, 2005 "O merakh povysheniya effektivnosti upravleniya federalnoy sobstvennostyu"; the 2006 Prognostic plan (program) of privatization of federal property and main guidelines of privatization of the federal property between 2006 and 2008; the 2007 Prognostic plan (program) of privatization of federal property and main guidelines of privatization of the federal property between 2007 and 2009; the 2008 Prognostic plan (program) of privatization of federal property and main guidelines of privatization of the federal property between 2008 and 2010; the 2009 Prognostic plan (program) of privatization of federal property and main guidelines of privatization of the federal property between 2010 and 2011; the authors' calculations.

Forestalling this analysis, it should be noted that by early-2008, the total number of these JSCs had accounted for 3,674 units, which is not just less than the analogous figure of 1999, but it forms the minimum one over the whole period of 1997-2007, except for 2001, when the respective data, perhaps, were not complete. If compared with early-2007, the number of JSCs whose stock is in the federal property fell by over 8% (or at 323 units)[28].

[28] Regretfully, there are no data available on the number of JSCs where by early 2008 the government used its special right for participation in management – the golden share.

In 2007, there intensified a tendency that had been gaining momentum since mid-2005, namely, the growth in the proportion of packages that enabled the government, thanks to their size, to exercise a full-rate corporate control thanks to a drastic growth in the proportion of full packages (100% of all shares), which resulted from a real increase in the number of incorporated FPUEs.

While as of early 2007, the government could exercise a majority control or the full control in more than 54% of all the companies, while the share of those with the 100% state-owned capital was under 45%, as of January 1, 2008, all the mass of the companies with federal stakes was at 54% represented by JSCs with the 100% of state-owned block, while the aggregate specific weight of JSCs in which the government owned 50%-plus of capital exceeded 61%. Thus, for the first time since the late-1990s the state has become not just a majority, but the sole shareholder in more than a half of all the economic companies with its participation. Meanwhile, the absolute quantity and shares of minority (up to 25% of capital), blocking (between 25 and 50% of capital) and majority (over 50%, but under 100% of capital) stakes in the overall structure of the federally-owned stock packages plummeted in 2007, with minority and blocking packages being the first to suffer at most because of this development.

Another source of data on the quantitative composition of the public sector is the Rosstat's monitoring[29]. Its data suggests the following quantitative dynamic of economic agents noted between 2007 and the first half 2008 (*Table 4*).

Table 4

The Number of Organizations of the Public Sector of the Economy Accounted by Territorial Bodies of the State Property Agency and Bodies Controlling the Public Property of the Subjects of RF in 2007-2008

Date	Total[a]	FPUEs, including treasury enterprises	Public institutions	Economic companies in whose capital 50%-plus of stock (shares) are owned by	
				The government	Economic companies that fall under the public sector of the economy
As of January 1, 2007	82,410	12,735	64,295	3,920	1,439
As of July 1, 2007	81,076	11,351	64,159	4,111	1,440
As of January 1, 2008	80,570	10,598	64,440	4,111	1,410
As of July 1, 2008	77,461[b]	9,864	62,571	3,930	1,089

[a]including organizations whose founding documents that have passed the state registration fail to stipulate concrete kinds of operations, as a result of which the total number of organizations is in excess of that of PUEs, institutions and economic companies, but without regard to joint-stock companies whose 50%-plus stock (shares) is/are jointly owned by the government and a foreign proprietor.

[b]Record of the federal property is exercised in compliance with Resolution by the RF Government of July 16, 2007, № 447 "On improving the record of the federal property".

Source: O razvitii gosudarstvennogo sektora ekonomiki Rossiyskoy Federatsii v 2006 godu. M. Rosstat, 2007, p.120; O razvitii gosudarstvennogo sektora ekonomiki Rossiyskoy Federatsii v I gjlygodii 2007 goda. M. Rosstat, 2007, p.111; O razvitii gosudarstvennogo sektora ekonomiki Rossiyskoy Federatsii v 2007 godu. M. Rosstat, 2008, p.123; O razvitii gosudarstvennogo sektora ekonomiki Rossiyskoy Federatsii v I gjlygodii 2008 goda. M. Rosstat, 2007, p.87

[29] On the basis of Resolution by the RF Government of January 4, 1999, № 1, its composition comprises the following economic agents of the federal and regional levels: (1) public unitary enterprises with the right for economic conduct and operative management (treasury); (2) public enterprises; (3) economic companies in the authorized capital of which over 50% of stock (shares) is in the state property; (4) economic companies in whose authorized capital over 50% of stock (shares) is owned by economic companies that fall under the public sector

Overall, in 2007, the number of organizations of the public sector of the economy plunged by 2.2%, to be followed by another 3.9% drop in the first half 2008.

The number of public unitary enterprises was shrinking at an advancing pace: by 16.8% in 2007, by 6.9% - over the period between January and June 2008 (overall, at 22.5% over a year and a half). Considering the dynamics over the said period, the number of economic companies in whose authorized capital over 50% of stock (shares) is/are owned by the economic companies that fall under the public sector of the economy experienced a drop greater than PUEs' (at 24.3%); however, by contrast with the first group, this contraction was noted chiefly during over the first half of 2008 (at nearly 23%).

The other subsectors of the public sector displayed ambiguous dynamics. Thus, the number of public institutions posted some growth in 2007 (at 0.2%), but dropped in the first half 2008 at 2.9%. A similar pattern was characteristic of the dynamic of the number of economic companies whose 50%-plus stock (shares) is/are owned by the state – it grew by some 5% in 2007 and fell between January and June 2008by roughly the same rate, thus bouncing back to the early-2007 level.

The structure and composition of the federal assets cannot be reduced to FPUEs and federal stock packages, of course.

According to Rosimuschestvo, as of mid-January 2009, the register of the federal property comprised 1,239.788 immovable and movable property objects (including over 1,100.000 objects owned by possessors of rights by the respective special property and some 107,000 treasury objects). The register also comprises over 3,500 stock packages belonging to the RF, and nearly 67,000 federally-owned land lots.

Rosimuschestvo has practically completed the inventory of assets that form the RF's state treasury. The agency continued to work with possessors of rights (FPUEs, federal public institutions, other entities) for the purpose of a complete and timely submission for filing a respective record in the register of the federal property fixed with them under respective special property terms. At this point, it should also be noted that Rosimuschestvo conducts the work on compiling the register and organizing the procedure of record maintenance of the federal property on the basis of Resolution by the RF Government of July 16, 2007, № 447 "On improving the record of the federal property". The document specifies the sequence of the record-keeping procedure. From the moment of its enactment (September 6, 2007), practically all the legal and other acts pertaining to matters of keeping record on, and conducting the register of the federal property, as per the said Resolution[30], have been passed.

5.2.2. Medium-Term Privatization Plans

Back to the approved by Resolution by the RF Government of September 1, 2009, №1272-p Prognostic plan (program) of privatization of the federal property for 2009 and main guidelines of privatization of the federal property for 2010 and 2011, it should be noted that the document follows the pattern of analogous documents developed over recent years. It once again proposes to privatize and sell in 2009-2011 all the federal public unitary enterprises that fail to exercise the state functions of the Russian Federation, as well as to do so with stock packages of the joint-stock companies created in the course of incorporation of FPUEs, except

[30] www.rosim.ru; 27.01.2009.

for JSCs included in the list of strategic joint-stock companies or those contributing to formation of integrated structures.

In 2009, it is envisaged to privatize and offer for sale the following FPUEs of the agro-industrial complex, road complex, geology and communication:

- stock packages whose size does not exceed 50% of the authorized capital of respective joint-stock companies, except for JSCs included in the list of strategic joint-stock companies or participating in formation of integrated structures, as well as stakes the sale of which will be carried out proceeding from needs in formation of the revenue part of the 2009 federal budget and for the period through 2011, as per the perspective financial plan;
- stakes in JSCs of the fuel and energy complex, construction complex, agro-industrial complex, chemical, petrochemical and polygraphic industry, geology, water transport, and joint-stock companies in the machine-engineering sector (except for strategic joint-stock companies);
- assets of the RF treasury, that do not provide for public functions.

In all, approved by the RF Government, the 2009 Prognostic privatization plan comprises 235 FPUEs and stakes in 291 JSCs, as well as 3 shares in LLCs and 18 objects of other kinds of property. Sales of these assets should secure Rb. 12bn in revenues to the federal budget.

Notably, by contrast to analogous documents of the two past years, the current privatization program lacks any reference to the largest federal property objects due to be privatized – the priority is to continue between 2009-2011 works on shaping integrated structures in strategic sectors on the basis of joint-stock companies whose stock is owned by the federal government.

In conjunction with this, the Federal State Property Management Agency was assigned with yet more ambitious tasks to exercise managerial functions within the limits of their powers with regard to such integrated structures as public corporations Rostekhnologii, Roasatom, JSCs “United aircraft-building corporation”, “United ship-building corporation”, etc. (21 structure in total).

The Government considered the RF Ministry for Economic Development and Trade’s plans to extend the life-span of privatization plans from 1 to 3 years. Such a modification synchronizes it with a new time horizon of budgetary planning and may serve as an additional catalyst of the privatization process.

As shown by the recent years’ practices, upon promulgation of the 2001 Act on privatization, the current procedures allow one to privatize during a year not more than 1/3 of initially included in the list objects, while privatization of the remaining part of objects required repetition of the procedures the next year. Such a situation enabled management of the privatized assets (primarily unitary enterprises) to indirectly influence the progress with their privatization by delaying conciliatory procedures, etc. Besides, even if the management had no such intents towards large objects, completion of privatization procedures could take a longer time, due to a greater degree of requirements to the pre-privatization preparation (picking a favorable moment from the perspective of the situation on the stock market, the need in creation of consortiums of investment banks, accumulation of sizeable amounts of funds to take part in privatization)[31].

[31] Netreba P., Butrin D. Privatizatsii nakidyvayut srok. In: Commersant, №145/P (3962) of 18.08.2008.

At this point, as a reminder, from the perspective of formal declarations, since 2003 the Russian privatization has got a three-year time horizon. The respective document (the 2004 Prognostic plan (program) of privatization and main guidelines for privatization of the federal property through 2006) was approved by Resolution of the RF Government of August 15, 2003, № 1165-p. The document was accompanied with declarations of the privatization program's three-year time horizon (2004-2006), with the ultimate objective being completion of privatization of the assets that are not pertaining to execution of the government function by 2006 and completion of the privatization process as a whole by 2008.

The government thenceforth every year approved ample prognostic plans (programs) of privatization of federal assets for the next year with main guidelines for the next two years[32]. These plans and guidelines comprised hundreds of FPUEs and stock packages (shares) in economic companies of different sectoral attribution; in reality, however, the documents contained a list of privatized assets only for a year ahead.

So far the effective Act on privatization has borne a provision that implies an annual approval of the prognostic plan (program) of privatization of federal assets, which is why transition to the three-year planning will require introduction of modifications into the Act, while a practical transition to the three-year privatization plan is hardly achievable earlier than in 2010.

Perhaps by that time there have taken shape certain prerequisites for introducing into the privatization process (not excluding a public placement of new stock of an additional issuance) of large objects, which by their importance are comparable with those privatized prior to 2005. It is absolutely evident that as of today, this is constrained by the world financial crisis and a clear solidification of the institution of public corporations, to which assets, many of which are potential objects for privatization, are assigned as a property contribution.

As concerns the 2008 privatization, there have been no notable developments, as it concerned objects of no particular interest to the state.

To judge as to what extent assets formed specific objects of privatization deals, one needs to study into a scarce information about outcomes of such deals published by Rosimuschestvo. Thus, the 100% stake in JSC "Samara Hyppodrom"was sold for Rb. 370,318.000, while the 100% of stock in "Kuzbassgrazhdanproekt"- for Rb. 113,364.000. Against this background the sale of a 25.12% stock in JSC "Rosterminalugol (Leningrad oblast) for Rb. 573m in November 2008 seems a more impressive outcome. Interestingly, in all these deals, the excess of the selling price over the initial one was not more than 2%[33].

A few amendments were introduced in the privatization law last year. There were not fundamental, though, and of all the amendments worth noting is the one to Art. 3. This particular amendment identifies the sphere of effect of the Act with the provision that particularities of small- and medium-sized businesses participation in privatization of leased public or municipal immovable property can be set by the federal law. If promoted, the provision may have certain significance for stimulation of small-and medium-sized businesses' development beyond the framework of the privatization law.

In conclusion, it is worth mentioning that the spring of 2008 saw the end of a long-lasting heated conflict between two federal agencies involved in regulation of property rela-

[32] The sole exception was the 2005 Prognostic plan (program) of privatization, whose title (but not the content) lacked a reference to the next years.
[33] www.rosim.ru

tions. In compliance with presidential Decree of May 12, 2008, №724, the Federal Agency for Federal Property Management (FAFPM) was transformed into the Federal Public Property Management Agency. It was delegated the mandate of the specialized public institution under the RF Government "The Russian Federal Property Fund" (RFPF) on organization of sales of privatized public assets, sales of assets arrested as per rulings by the court of law or acts of bodies that were granted the powers to make decisions regarding full recourse as well as the functions on sales of confiscated, movable ownerless, withdrawn, and other assets taken to the state in compliance with the RF law. The liquidation in late-June 2008 of RFPF, whose main function since the moment of its creation in 1991 had been conduct of privatization, seems a fairly symbolical move, as long as evolution of property relations in the country is concerned.[34]

5.2.3. The Impact of the Dominial Presence of the State on the Structural Policy in Individual Sectors and Problems of Solidification of Its Position in the Economy

The most notable developments in this area were the ultimate formation of a new structure of the electricity sector and a continuous influence exerted by public corporations founded in 2007.

The new structure of the electricity sector has resulted from numerous decisions taken in 2004-2007 with respect to the sector restructuring on the basis of reforming RAO UES Russia. At the time, the holding's regional electricity companies were undergoing a vigorous reorganization through separation or encapsulation, with establishment of new legal entities with different profiles, primarily wholesale generating companies (*aka* OGKs) and territorial ones (TGKs), and their servicing and other structures.

As a reminder, the first stage of the reorganization, in the frame of which JSC OGK-5 and JSC TGK-5 were separated from RAO, was completed on September 3, 2007. Resulting from the first reorganization, in addition to their stakes in JSC RAO UES Russia, the shareholders in RAO UES were given stock in JSC OGK-5 and JSC TGK-5 in proportion to their share in the energy holding's authorized capital. Meanwhile, the number of their respective stock in RAO UES Russia remained unchanged. Upon completion of the first stage of the reorganization the government's share in the authorized capital of JSC OGK-5 made up 26.43% and that in the authorized capital of JSC TGK-5 – 25.09%.

At their meeting on October 26, 2007, the RAO UES Russia's shareholders supported the company's final reorganization. Between December 2007 and January 2008 the formation of a target structure of all thermal OGKs and TGKs, the first stage of consolidation of JSC GydroOGK, and the process of selection of network companies were completed. As many as 56 main network companies were established on the basis of the reorganized energo-JSCs[35].

In the course of the second stage that ended on July 1, 2008, the structural transformation of the energy holding's assets was over and all the companies of the sector's target structure (FSKs, OGKs, TGKs, etc.) separated from RAO UES Russia and the head company JSC RAO UES Russia discontinued their operations.

[34] It does not necessarily mean a full stagnation of the privatization process, though. A serious conflict between the RFPF and FAFPM that was at pains to limit the Fund's independence was one of the reasons behind the slowdown of privatization post-2004.
[35] www.rao-ees.ru

All the shareholders were given stock of the following 23 electricity and energy companies:

- JSC Gosudarstvenny holding and JSC Minoritarny holding FSK UES with a simultaneous joinder to JSC FSK UES;
- JSC Gosudarstvenny holding JSC Gosudarstvenny holding GydroOGK and Minoritarny holding GydroOGK with a simultaneous joinder to JSC Rusgydro;
- JSC OGK-1 Holding with a simultaneous joinder to JSC OGK-1;
- JSC OGK-2 Holding with a simultaneous joinder to JSC OGK-2;
- JSC OGK-3 Holding with a simultaneous joinder to JSC OGK-3;
- JSC OGK-4 Holding with a simultaneous joinder to JSC OGK-4;
- JSC OGK-6 Holding with a simultaneous joinder to JSC OGK-6;
- JSC TGK-1 Holding with a simultaneous joinder to JSC TGK-1;
- JSC TGK-2 Holding with a simultaneous joinder to JSC TGK-2;
- JSC Mosenergo Holding with a simultaneous joinder to JSC Mosenergo;
- JSC TGK-4 Holding with a simultaneous joinder to JSC TGK-4;
- JSC TGK-2 Holding with a simultaneous joinder to JSC TGK-2;
- JSC TGK-6 Holding with a simultaneous joinder to JSC TGK-6;
- JSC Volzhskaya TGK Holding with a simultaneous joinder to JSC Volzhskaya TGK;
- JSC YYUGK TGK-8 with a simultaneous joinder to JSC JSC YYUGK TGK-8;
- JSC TGK-9 Holding with a simultaneous joinder to JSC TGK-9;
- JSC TGK-10 Holding with a simultaneous joinder to JSC TGK-10;
- JSC TGK-11 Holding with a simultaneous joinder to JSC TGK-11;
- JSC Kuzbassenergo Holding with a simultaneous joinder to JSC Kuzbassenergo;
- JSC Eniseyskaya TGK Holding with a simultaneous joinder to JSC Eniseyskaya TGK (TGK-13);
- JSC TGK-14 Holding with a simultaneous joinder to JSC TGK-14;
- JSC INTER RAO UES Holding with a simultaneous joinder to JSC INTER RAO UES.

The public holdings (JSC Gosudarstvenny holding[36] and JSC Gosudarstvenny holding GydroOGK[37] were intermediate companies. Their separation was carried out along with a simultaneous joinder to JSC FSK UES and JSC GydroOGK, respectively. That secured the government's direct participation in the companies' capital. Because of the transfer of the government share in OGKs and TGKs onto the balance sheet of JSC FSK UES and JSC GydroOGK the government increased its share in the Federal Network Company to a level not less than 75%+ 1 share and that in JSC GydroOGK – to a level of not less than 50%+ 1 share.

[36] The following stock was to be transferred to the balance sheet of the JSC Gosudarstvenny holding: from the "governmental" stake in JSC FSK UES (at the amount proportional to the share of participation by RF in the RAO UES Russia's authorized capital as of the moment of making the decision on its reorganization), main network companies, heating generating companies (OGK and TGK) or assets acquired resulting from sales of these or those "state-owned" stock packages in OGK/TGK (a fraction of stock packages of companies that fall at the share of the RF's participation in the RAO UES Russia's authorized capital

[37] The following stock was transferred to the balance sheet of JSC Gosudarstvenny holding GydroOGK: stock of JSCs GydroOGK (in a volume of the proportion of the RF's participation RF in the RAO UES Russia's authorized capital as of the moment of making the decision on its reorganization) and stock from the "state-owned"s stock packages in heating OGK and TGK or assets acquired from sales of the shares in these OGK/TGK (a fraction from the 52% of stock owned by JSC RAO UES Russia).

All the other holdings (except for JSC Minority holding FSK UES[38] , JSC Minority holding GydroOGK[39] and JSC IINTER RAO UES Holding[40]), i.e 5 minority OGK holdings and 13 minority TGK holdings, owned "minority" stakes in just a sole company (all the heating OGK, except for the separated in the course of the first stage OGK-5 and all the TGKs, except for the separated in the course of the first stage TGK-5).

All the stock in "Minority holding FSK", "Minority holding GydroOGK" and minority holdings TGK/OGK were distributed exclusively in favor of the JSC RAO UES Russia's minority stakeholders, except for the special shareholders (JSC CTsentrenergoholding, JSC Sibir Energoholding and JSC Intergeneratsia[41]). The separation of the above minority holdings was also carried out with their simultaneous joinder to a respective target company. Such a division of assets enabled one to fix shares of the RAO UES Russia's assets due to be distributed in favor of the state and minority shareholders of the former energy monopolist, and to make individual decisions regarding managing the "governmental" and "minority" shares of the JSC RAO UES Russia's assets.

In addition, as ruled by an early general shareholder meeting of October 26, 2007, the two newly created companies of the target structure of the energy sector, JSC "Holding MRSK[42]" and JSC "RAO Energeticheskiye systemy Vostoka[43]", as well as holding companies - special shareholders that are fully owned by JSC RAO UES Russia's concrete minority shareholders (JSC Tsentrenergoholding, JSC Sibenergoholding and JSC Intergeneratsia) were separated.

JSC CO UES (the System Operator) was not separated in the course of the reorganization, and 100% of its stock were be assigned to the state. The System Operator will redeem and paid for a RAO UES Russia's stock package in this company, hence, the government will consequently become a sole proprietor of JSC COUES. Upon completion of separation of all the newly created companies, JSC RAO UES Russia, on whose balance sheet, in accordance to the company's separation balance sheet there remained a fraction of assets that did not attribute to the target companies' technological operations, was to join JSC FSK UES. Thus, the RAO UES Russia's shareholders received a share of participation in JSC FSK UES not only as shareholders of the separated JSC Gosudarstvenny holding or JSC Minority Holding FSK UES, but in their capacity of a shareholder of JSC RAO UES Russia.

So, the structural transformation has resulted in the government being an owner of:

– a 75%-plus stake in the Federal Network Company (with account of contribution with the federal budget funds and a part of the "public" portion of stake in OGK/TGK);

[38] JSC Minority Holding FSK UES owned a "minority" fraction of stock of FSKs (48% of stock owned by JSC RAO UES Russia.

[39] JSC Minority Holding GydroOGK owned a "minority" fraction of stock of GydroOGKs.

[40] Inter RAO UES Holding was an aonwer of a stake in JSC Inter RAO UES and assets subjected to transfer to pay for the JSC Inter RAO UES's authorized capital.

[41] Three special holdings separated in the course of the reorganization according to the additions to the scheme of reorganization approved by the Board of Directors of JSC RAO UES Russia on April 27, 2007. Shares of each of them were distributed only to a concrete shareholder of RAO UES Russia, while on their balance sheets they received shares in heating generation companies, JSC FSK UES, JSC GydroOGK, and other assets that had fallen under the given shareholder's stock in the JSC RAO UES Russia's authorized capital.

[42] JSC Holding MSRK is an owner of stakes in MSRK and a number of distributive network companies.

[43] Holding JSC RAO Energeticheskiye Systemy Vostoka is an owner of stakes in JSC Dalnevostochnaya energeticheskaya kompaniya and in isolated electricity systems.

- a 75%-plus stake in the System Operator (with account of contribution with the federal budget funds);
- a 50%-plus stake in JSC GydroOGK (with account of contribution with the federal budget funds and a part of the "public" portion of stake in OGK/TGK);
- a 50%-plus stake in JSC Inter RAO UES;
- a 52%-plus stake in JSC Holding MSRK and JSC RAO Energeticheskye Systemy Vostoka.

With account of a possible sale of the government stock packages in heat OGKs and TGKs, the government may fully abandon its participation in the heat generating companies.

The minority shareholders in turn have become owners of:

- up to 100% of heating generating companies;
- under 25% of stock of JSC FSK UES;
- under 50% of stock of JSC GydroOGK and JSC Inter RAO UES;
- some 48% of stock of JSC Holding MSRK and JSC RAO Energeticheskye Systemy Vostoka.

The distribution of shares of the companies separated in the course of reorganization of JSC RAO UES Russia between its shareholders had been completed by July 23, 2008. The securities were placed by registrars on the day of the state registration of the separated companies, i.e on July 1, 2008, while nominal holders of different levels placed the securities between July 1 and 14, 2008. All stock was inducted to the shareholders' individual accounts.

The liquidation of the electricity monopolist was preceded by its redemption by January 9, 2008, of the stock rendered by the RA UES Russia's shareholders that enjoyed the right to take part in the early meeting on matters of the final reorganization of the company on October 26, 2007 and voted against that decision or failed to take part in the voting[44].

So, the electricity sector saw the completion of a colossal structural transformation. It has resulted in decentralization of the sector with activation of the market competition mechanism and launch of the mechanism of attraction of private investments. But it should be noted that companies with a government's share in their capital (such as Gasprom and Rosneft) have become large shareholders of many OGKs and TGKs. By the 2007 results, the aggregate proportion of electricity generating companies owned by JSC Gasprom and JSC SUEK, with which Gasprom was going to merge its generating assets, accounted for some 20%.

In 2007, the transition to a sweeping creation of public corporations (PC) has become one of directions of the government's new policy in the property area.

From the formal perspective, it did not continued in 2008 – there was no passage of special federal acts on establishment of new economic agents of this organizational and legal form[45], albeit a detailed discussion was initiated on variants of creation of PCs in the road maintenance and grain procurement sectors.

Meanwhile, some PCs founded in 2007 have succeeded in expending notably in their sphere of interests. This particularly concerns PC Rostekhnologii which has formed a nucleus of an emerging holding of the clearly conglomeration type.

[44] www.rao-ees.ru

[45] Created on the basis of Federal Act of July 24, 2008, №161-FZ, the Federal Fund for Assistance to Development of House Building formally has the organizational and legal form of foundation, while de-facto appears fairly close to already emerged public corporations. They all are non-for-the-profit organizations.

As a reminder, in compliance with presidential Decree of November 26, 2007, №1577, the corporation was given the 100% stake of the transformed into JSC Rosoboronexport (ROE), whose structure enveloped a great number of companies from various industries (a helicopter-building holding; AvtoVAZ, VSMPO-Avisma, Motovilikhinskiye zavody, Russpetsstal, to name a few). In addition to ROE, since early-2008, PC Rostekhnologii has begaun vigorously lobbying a reassigning to it by the government of numerous assets in other sectors as a property contribution. The move was often countered by the federal and regional authorities and other influential companies[46].

According to the final variant stipulated in presidential Decree of July 10, 2008, №1052, Rostekhnologii should be assigned 183 FPUEs. These structures should be subject to incorporation with the subsequent transfer to the newly created JSC of all their equity, as well as 246 shares in various economic companies (overall, it was initially planned to assign to the company over 480 enterprises), including the state-owned share in Obyedinennaya Promyshlennaya Korporatsia after an increase of its authorized capital with the payment by the state for additionally placed equity with stock packages in 12 companies and Nauchno-porizvodstvenny predpriyatiye "Motor" (Ufa), which is to be transformed from FPUE into JSC. Meanwhile, it is provided for a founding by Oboronprom of the daughter JSC Upravlyauyshaya kompaniya "Obyedinennaya dvigatelestroitelnayay korporatsia" with its authorized capital to be paid with state-owned stock packages with the prospect for an increase of the share in these companies up to the size of a controlling stake.

Despite the defense enterprises assets assigned to the public corporation Rostekhnologii clearly dominated over other assets, it should be noted that a part of the latter falls under civil sectors, including several air companies (Rossiya, Kavminvodyavia, Orneburgskiye avialinii, Saratovskiye avialinii), foreing trade companies, and the RF's shares located overseas (in Russian-Mongloian LLCs Erdenet and Mongolrostsvetmet (49% in each) and in the Russian-Vietnamese corporation Visorustekhs – 32%).

Shortly before that the federal stakes in air companies Domodeovskiye avialinii, Krasnoyarskiiye avialinii, and Samara were assigned to Rostechnologii. A year before that, they were picked for contributing with them to the authorized capital of a new holding, Air Union. The intended for 2007 consolidation of public and private assets of 5 air companies of the alliance should have resulted in the rise of the third biggest air carrier in the country, Airunion[47]. Interestingly, by contrast to most recently created holdings, one admitted a possibility for the government to own in the newly created structure a stake less than the controlling one (45%). Such a structure of the company's capital has borne a greater risk of conflicts between the state and other shareholders, which manifested themselves yet in early-2008 - in the failure to convene the founding meeting caused by shareholders' different appraisals of the assets they were going to contribute with to the new company.

[46] Such a situation was noted, for example, in conjunction with the PC Rostekhnologii's claims for inclusion in its structure of Nauchno-proizvodstvennaya korporatsia Uralvagonzavod (the former FPUE Proizvodstvennoye obyedineniye Uralvagonzavodnamed after F.E. Dzerzhinsky) located in the town of Nizhny Tagil, Scredlovsk oblast. In autumn 2007, the company was transformed into JSC, with its 100% stake fixed in the federal property. The company was regarded as a head one for the formation of a panzer holding.

[47] It was supposed that the new company will inherit in the Russian spelling the name of the alliance (Air Union), in which several independent air carriers had earlier participated.

An intermediate final became a sudden deep crisis that battered the air companies of the alliance between late-August and early-September 2008. It took the form of a sudden rise of huge debts to their counterparts, lawsuits and the danger of bankruptcy, delays with, and cancellation of flights, suspension of tickets sales, etc. At that juncture, it was announced that PC Rostekhnologii, together with the Moscow city government[48] and that of Krasnoyarsk krai, were to found a new air carrier, the structure of which had not been set as of that moment. Meanwhile, already in early-2009 the presidential Decree confirmed assigning to Rostekhnologii the federal stakes in Domodeovskiye avialinii (50.04%), Krasnoyarskoiye avialinii (51%), and Samara (46.5%), complemented by those in Vladivostok Avia (52.17%), Dalavia and Sakhalinskiye aviatrassy (100% in each).

Yet another government's contribution in the form of assets to Rostekhnologii should become all the equity of JSC Transportno-vystavochny kompleks "Rossiya" established on the basis of assets of 2 FPUEs in the town of Zhukovsky (Moscow oblast). Upon the exercise of measures of state support for the sake of preclusion from their bankruptcy, these FPUEs were subject to their transformation into a JSC with the subsequent introduction of 100% of their equity into the authorized capital of Obyedinennaya aviastroitelnaya korporatsia in an order of payment for additional equity it was to place due to an increase of its authorized capital.

The other public corporation keen to grow into a huge structure to manage public assets across the sector has become Rosatom. In 2008, the corporation's structure has become visible. The government's equity contribution to Rosatom is formed by the 100% package in JSC Atomny energopromyshlenny complex (AEP), stock packages in yet another 2 JSC (research institutions) (50% minus 1 share in each). In addition, the government should contribute with all the equity of JSC Inter RAO UES due to be assigned to the government as a result of the reorganization of RAO UES Russia. The Inter RAO UES's authorized capital should increase thanks to introducing in it all the federally-owned stakes in the two power plants - Kaliningrad TETS-2 and Sangtudinsky GES-1 in Tajikistan (which is built with Russia's participation, with funds allocated out of the federal budget).

In addition, PC Rosatom's mandate includes the power to exercise on the government's behalf the powers of a proprietor of assets of 100 FPUEs and 9 federal public institutions (FPIs), as well as the powers of a shareholder of JSCs founded by means of transformation of 55 FPUEs, to the extent of contributing with all the federally-owned equity of these JSCs in the JSC AEP's authorized capital in an order of payment for additional equity it was to place due to an increase of its authorized capital.

With account of the transfer of the 100% of AEP's equity to Rosatom, the said enterprises will find themselves under its control. In all likelihood, this prospect is real for federal enterprises and institutions with respect to which this PC is given the right to exercise the proprietor's powers, as Federal Act of December 1, 2007, № "On public corporation on nuclear energy "Rosatom" contains a provision that reads that the delegation to the PC the respective mandate with regard to FPUEs and FPIs will retain its effect during a transitional period, until their assets are assigned to the Corporation as a property contribution.

Besides the liquidation of RAO UES Russia and expansion of a number of public corporations' domains, the following developments are worth a certain attention, too.

[48] The city owns control blocks of Atlant-Soyuz air carrier that has assumed the Air Union's operations and those of Vnukovo airport wherein it is based.

Notwithstanding numerous speculations in 2006-2007 that JSC Rosneftegas, which was founded in late-2004 to complete a deal on boosting the federal stake in Gasprom up to a control figure, might be liquidated or reorganized after the deal was over in the summer of 2005, the company not just lingered as an independent legal entity, but has begun to extend its structure in the course of additional stock issuances. Its authorized capital, in an order of payment for the government's share, absorbed a 90.6% stake in Kamchatgasprom and stakes of different value in 78 JSCs of the gas sector (including a 74.55% stake in JSC Rosgazifikatsia, the owner of a 0.87% package of Gasprom's equity).

In the summer 2008, the government increased the federal stake in JSC ALROSA, the national diamond monopoly, up to the control figure (from 37% to 51%). That became possible by contributing to its authorized capital with assets of the production and research institution Yakutalmaz. The agreement on the assignment of the latter to the federal property was reached in 2006, after long-lasting discussions with the local authorities of the Republic of Sakha (Yakutia) and the Rosimuschestvo's filing a lawsuit to the Supreme Arbitration Court of RF[49].

In December 2007, the RF government decided to withdraw from the FPUE Rosspirtprom's operative management a great fraction of assets (immovable property of its 18 affiliated structures, the exclusive rights for results of intellectual activity (28 patents and 82 trade marks) stakes and shares in 58 economic companies) and to contribute with them to the authorized capital of a company with the same name, the 100% stake in which will belong in the federal property. The control stakes in 11 JSCs are to be reassigned for repayment of the company's obligations before the Bank VTB by credit agreements made in 2006, but it is the newly created JSC Rospirtprom that should exercise their trust management. A great number of objects of the social, cultural, and communal and utilities spheres fixed with Rosspirtprom are subject to reassignment to the municipal property.

As concerns developments in the defense sector in 2008, it is worth noting the introduction, as the federal contribution, of the federally owned stakes (100% minus 1 share) of 1 JSC in the authorized capital of JSC Contsern "Morskoye Podvodnoye Oruzhiye – Gydropribor", and those of 2 JSCs – in the authorized capital of JSC Contsern "Granit-Elektron" in an order of payment for additional stock placed by the companies; as well, there took place a reorganization of 2 FPUEs of the space sector by adding to each of them a unitary enterprise.

A logical effect from the increased activity of companies with the government share in their capital should have become a notable expansion of the public sector to be mirrored by various final indicators of economic activity. But the Rosstat's monitoring of the indicators in question has only partially proved this assumption (*Table 5*).

[49] In this case the Republic of Yakutia was to loose its power to collect rental payments from JSC ALROSA. These fees constituted a considerable fraction of its budget revenues, which was compensated by the right for collecting in a full volume of the tax on extraction of diamonds (before that, as much as 40% of the respective revenues were to be assigned to the federal budget) and prospects for greater revenues generated by corporate profit tax, tax on corporate property, and dividends on the stake owned by the Republic of Yakutia's government.

Table 5

Proportion of the Public Sector Across Some Indicators in 2005–2008, as %

Indicator	2005	2006	2007	Ist half 2008
Volume of shipped output, works completed and services by producers				
– extraction of minerals	5,5	6,0	12,8	13,7
– production of fuel and energy fossil minerals	2,9	3,9	11,8	13,6
– processing production	8,9	8,2	8,4	8,6
– electricity, natural gas and water production and distribution	13,7	10,7	11,4	12,8
Volume of construction works completed by companies	5,5	4,4	4,0	3,0
Passenger traffic by transportation organizations [a]	68,7	68,5	65,9	64,5
Volume of commercial shipments of cargo completed by transportation organizations (less the pipeline transport)	44,9	67,2	72,9	73,3
Commercial cargo turnover completed by transport organizations (less the pipeline transport)	41,8	93,9	94,6	94,2
Communication services [b]	9,3	9,8	9,8	9,8
Domestic costs of R&D	69,3	70,4	72,4	71,3
Volume of paid services delivered to the population	18,5	17,2	16,4	16,2
Investments in fixed assets out of all the sources of financing [c]	19,1/14,9	18,1/14,4	19,5/15,0	17,9/12,5
Net earnings from sales of goods, products, works, services (less VAT, excise taxes and other analogous compulsory payments)	11,2	10,2	10,2	9,6
Staff on the payroll	25,6	26,0	24,9	24,1

[a] – less organizations of the urban electric passenger transport;
[b] – Net earnings from sales of goods, products, works, services (less VAT, excise taxes and other analogous compulsory payments);
[c] – in numerator- without regard to small-sized businesses
Source: O razvitii gosudarsvennogo sektora ekonomiki v 2005 godu. M., Rosstat, 2006, pp. 8, 85, 92–93, 94, 103, 137, 139, 146–147, 167; O razvitii gosudarsvennogo sektora ekonomiki v 2006 godu. M., Rosstat, 2007, pp. 8, 82, 89–90, 91, 100, 134,136, 143–144, 164; O razvitii gosudarsvennogo sektora ekonomiki v 2007 godu. M., Rosstat, 2008, pp. 9, 42, 90–91, 92, 103, 134, 136, 143–144, 164; O razvitii gosudarsvennogo sektora ekonomiki v I polugodii 2008 goda. M.,Rosstat, 2008, pp. 8, 50, 58–59, 60, 71, 93, 95, 102–103, 124.

As highlighted by *Table 5*, the period between 2007 and the 1st half 2008 saw the same picture as all the 2000s did – namely, by most indicators the proportion of the public sector remained insignificant and did not exceeded 10-15%. It was a bit greater by investments (15-20%, without regard to small-sized businesses) and employment (24-25%), but it was only transport shipments and domestic R&D costs that stood aside as genuinely significant exceptions (70-90% and over 70%, accordingly).

Meanwhile, the official statistics noted a substantial rise in the public sector's specific weight between 2007 and 2008 vs. 2005, as far as mineral output (primarily extraction of fuel and energy minerals) and cargo shipment are concerned. Some growth was also noted across the communication services sector, domestic R&D costs and investments50.

As a result, in 2005-2006, the proportion of the public sector in mineral output was lower than the value of the indicator in the manufacturing sector, while exceeded that in terms of production and distribution of electricity, natural gas and water, in the period between 2007 and the 1st half 2008 it proved to be in excess of the noted figures. It should be particularly noted that the proportion of the public sector in production of fuel and energy minerals, which earlier had been notably inferior to the respective indicator of the public sector's contribution to mineral extraction on the whole, has practically caught up with that.

A more detailed evaluation allows one to note that by results of the period between 2007 and the 1st half 2008 it is just a few sectors by which the public sector's positions were monopolistic. Those were electricity generation at nuclear power plants, reforestation, cargo

[50] However, results of the 1st half 2008 fell short of proving the said trend with respect to the last two indicators.

shipment and passenger railroad transportation. In some cases, the public sector held a dominant position on the market, as exemplified by production of caustic ash. In most other cases, its share was below 20%, except for production of cooking salt, ethyl hydroxide from food raw materials, cross-ties of a wide gage, some machine-engineering products (wagons, tractor seeding machines), and all kinds of paid services in which its share did not exceed 50%, anyway.

That said, one should bear in mind that the Rosstat data are based upon the definition of the public sector given in Resolution of the RF Government of January 4, 1999, №1 "On forecast of development of the public sector of the economy of the Russian Federation"(in the effective version of the document adopted by Resolution of the RF Government of December 30, 2002, №939), which fairly incompletely mirrors a real specific weight of the public sector in the economy[51].

For example, according to the Rosstat's monitoring, the proportion the public sector holds in production of natural gas, electricity at the heating and hydro power plants, cargo shipment accomplished by the major pipeline transport organizations between 2007 and the 1st half 2008 did not exceed 1%, which clearly conflicts with well known facts of the domination of the largest corporations with government participation (Gasprom, RAO UES Russia, Transneft with its newly absorbed asset - Transnefteproduct) over the respective sectors. The assessment of the public sector's contribution in oil output (including gas condensate) between January and June 2008 seems somewhat more realistic (16.8%). Meanwhile, by the 2007 results the proportion of public companies – if we include in their list Rosneft (including Yuganskneftegas) and Gasprom (including Gaspromneft that consolidated all the gas giant's oil assets) in oil output accounted for 31.9%[52], and it could hardly tumble substantially in the 1st half 2008.

The current conditions of an evident absence of transparency of property rights for a particular enterprise and the presence of a multi-stage corporate control system at public companies (by analogy with the private ones) necessitates the urgency of holding a special applied research to calculate the government's specific weight in the economy.

5.2.4. Budgetary Effect of the State Property Policy in 2000-2008

An increasingly evident effect of the world financial crisis on Russia since the autumn 2008 quite logically leads one to have a detailed examination of particular aspects of Russia's economy over recent years of a vigorous advancement. One of such aspects worth a particular attention is effects the governmental property policy has on the budgetary system.

The post-1999 shift of the emphasis of the policy from privatization onto the public property management suggests a more detailed study into financial aspects of the process and its interrelation with the budgetary system's functioning. First and foremost one discusses a considerable absolute increase in the number of sources that help complete the revenue part of the budget and their substantial diversification.

[51] See in a gretare detail: Rossuyskaya ekonomika v 2007 godu. Tendentsii i peespektivy (issue 29). M., IEPP, March 2008, pp. 485-490. A new additional factor that diminishes the accuracy of the data fixed by the official statistical reporting is the rise of several public corporations in 2007-08 and assignment to them certain assets.
[52] See: Rossiyskata ekonomika v 2007 g. Tendentsii i perspektivy (Issue 29). M., IEPP, March 2008, pp. 253-254.

The leading role in organization of the work on mobilization of respective revenues to the federal budget has been assigned to the Agency on management of the federal property[53], which regularly, shortly after the calendar year is over, publishes preliminary data on revenues to the federal budget raised through the state property management and privatization. Meanwhile, the final figures (with account of various adjustments and specifications) published in the budgetary statistics differ from the noted data by a whole range of positions.

All the revenues the federal budget collects from the state-owned property can be split into two parts, depending on their nature and sources. One group is formed by revenues from the use of the said property (renewable sources). The other group embraces occasional revenues, which may not be renewed due to the transfer of ownership from the state to other legal entities and private individuals after its sale, particularly in the frame of privatization process (non-renewable sources).

By means of classification of renewable sources of revenues from the use of the federal property, one can break them down into domestic (located within Russia) and overseas (beyond the country's borders). In the latter case, it is possible to discuss just the earnings of the Russian participant in the Vietsovpetro joint venture. The domestic sources can also be split into two groups: (1) revenues from economic operations and (2) revenues from rent (leasing) operations. The qualitative distinction between them lies in the specificity of the government's role: in the first case, it mobilizes revenues from independent economic agents that operate mostly in the competitive environment on certain markets for goods and services, and such operations are subject to the governmental direct (in the case of unitary enterprises) or indirect (economic companies) control. By contrast, in the latter case, the government appears just a passive recipient of rental fees (for the use of real estate and land lots), without being involved in organization of the tenant companies' business processes. The array of the domestic renewable sources has extended since 2001, thanks to a part of earnings raised by FPUEs and rent payments for land lots to the federal budget.

Tables 6 and *7* below present the data contained (with minor exceptions) in the 2000-2007 federal budget acts in the part of the use of the public property and its sales only in the form of material objects[54].

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[53] Presently - the Federal Agency for the Public (until May 2008 – Federal) Property Management, aka Rosimuschestvo; prior to 2004 – the RF Ministry of Property Relations.

[54] The present evaluation deliberately ignores revenues to the federal budget received as payments for natural resources (including water biological ones, revenues from the use of the forest fund and subsoil reserves), compensations for losses caused to agriculture in conjunction with withdrawal of agricultural land, resulting from financial operations (revenues from placement of budget funds (revenues by the federal budget's balances and from their placement, since 2006 –also revenues from placement of funds of the Stabilization Fund of RF, revenues from placement of sums accumulated in the course of auctions on sales of stock under the ownership of RF), interest earned by extending budgetary loans within the country at the expense of the federal budget funds, interest on intergovernmental loans (receipts from governments of foreign states and their legal entities as interest payments on loans extended by RF, receipts from corporations and organizations as interest and guarantee payments on loans RF received from governments of foreign states and international financial organizations)), from provision of paid services or compensation for the government's costs, transfers of the CBR's profit, some payments made by public and municipal corporations and organizations (patent fees, registration fees for the official registration of PC software, databases and topologies of integral microchips, and other revenues which prior to 2004 were a component of payments from public organizations (apart from earnings from operations by Vietsovpetro joint venture since 2001 and transfers of a part of FPUEs's earnings since 2002), revenues from production sharing agreements, revenues from management and sales of confiscated and other property appropriated

Table 6

The Federal Budget Revenues from the Use of the Public Assets (Renewable Sources) in 2000–2008 гг., as Rb.m

year	total	Dividends on stock (2000–2008) and revenues from other forms of participation in capital (2005–2008)	Leasing payments for the public land	Rental payments for public assets	Revenues from transferring a part of FPUEs' post-tax profit	Revenues from the joint venture Vietsovpetro's operations
2000	23244,5	5676,5	–	5880,7	–	11687,3[a]
2001	29241,9	6478,0	3916,7[b]	5015,7[c]	209,6[d]	13621,9
2002	36362,4	10402,3	3588,1	8073,2	910,0	13388,8
2003	41261,1	12395,8	10276,8[d]		2387,6	16200,9
2004	50249,9	17228,2	908,1[e]	12374,5[f]	2539,6	17199,5
2005	56103,2	19291,9	1769,2[g]	14521,2[h]	2445,9	18075,0
2006	69173,4	25181,8	3508,0[g]	16809,9[h]	2556,0	21117,7
2007	80331,85	43542,7	4841,4[g]	18195,2[h]	3231,7	10520,85
2008	76266,7	53155,9	6042,8	114587,7[h]	2480,3	–

[a] – by the data of the RF Minimushestvo РФ, not stipulated as a separate line in the 2000 Federal Budget Act, the sum of payments from public companies was set (Rb. 9887.1m) (without concrete elements);
[b] – the amount of rent payments for (i) the farming land (ii) for urban and settlements' land;
[c] – the sum of revenues form leasing the assets fixed with (i) research organizations, (ii) educational institutions, (iii) healthcare institutions, (iiii) public museums, public institutions of culture and fine arts, (iiiii) archive institutions, (iiiiii) the RF Ministry of Defense, (iiiiiii) organizations under the RF Ministry of Transportation, (iiiiiiii) organizations of the research services of the academies of sciences that have the public status, and (iiiiiiiii) other revenues from the lease of property owned by the state;
[d] – basing on the data of the RF Minimuschestvo, were not singled out as a separate item in the 2001 Act on execution of the federal budget, the amount coincided with the amount of other revenues in payments from public and municipal organizations;
[e] – the total value of revenues from leased the state-owned property (without singling out of rental payments for land) ;
[f] – the amount of rental payments for (i) urban and settlements' land (ii) land lots in the federal property after the division of the public land ownership;
[h] – the amount of revenues for the leased property fixed with (i) research organizations, (ii) educational institutions, (iii) healthcare institutions, (iiii) public institutions of culture and fine arts, (iiiii) public archive institutions, (iiiiii) postal institutions of the Federal Postal Service of the RF Ministry for Communication and Informatization, (iiiiiii) organizations of the research services of the academies of sciences that have the public status, and (iiiiiiii) other revenues from the lease of property owned by the state;
[i] – rental payments after the division of the public property for land and funds generated by sales of the right to conclude rental contracts on land owned by the federal government (for 2008 г. – except for the federal autonomous institutions' land lots);
[g] –revenues from leasing the property under operating management by federal government bodies and created by them institutions, and under the FPUEs' economic management: the property assigned under operating management to having the public status: (i) research institutions, (ii) organizations of the research services of the Russian Academy of Sciences and sectoral academies of science, (iii) educational institutions, (iiii) healthcare institutions, (iiiii) institutions of the Federal Postal Service of the RF, (iiiiii) public institutions of culture and fine arts, (iiiiiii) public archive institutions, and (iiiiiiii) other revenues from the leasing of assets under operating management by the federal bodies of executive power and founded by them institutions, and under the FPUEs' economic man-

by the state (including appropriated property in the form of gift, or succession, or treasure-trove, revenues from conduct of lotteries, other revenues form the use of property and rights owned by the federal government (revenues from management of rights for results of intellectual activities (R&D and technological works) of the military, special and dual use, revenues from operations and use of property of highways and other revenues from the use of property owned by RF), as well as from permitted kinds of organizations' operations subject to credited to the federal budget, and revenues from sales of the government inventory of precious metals and precious stones.

agement[55] (for 2006–2008- less revenues from permitted kinds of activities and use of the federal assets located beyond the RF Territory, which were collected overseas and were not singled out at all over the previous years[56]).

Source: the 2000-2007 Acts on execution of the federal budget; the report on execution of the federal budget as of January 1, 2009; the authors' calculations.

The structure of revenues raised from renewable sources saw the proportion of domestic sources rise. This can be explained by the government's direct involvement in economic operations. More specifically, in 2004-06, after a non-stop growth in the specific weight of dividends in the aggregate volume of such sources was over 1/3 vs. ¼ reported in 2000-2001 and reached 54.2% in 2007. The maximum value of the contribution of the FPUEs' earnings transferred to the budget was noted in 2003 (5.8%). The indicator has been on decline since then – 6% in 2007, nonetheless, still being in excess of the 2001-02 figures.

After experiencing certain fluctuations, the proportion of revenues from leased federal assets in 2005 accounted for 25.9%, thus being just slightly in excess of its 2000 figure (25.3%); over the other years of the period in question it found itself within the range between 22 and 25% (except for 2001, when it plunged to 17.2%). Revenues of the rented land were significant only in 2001-02 (10%-plus), while after that they have never exceeded 5-6% of all the revenues from the renewable sources (2005-2007), which is apparently associated with the process of division of the government land ownership and the start of its actual assignment to the lower level of the public power.

At the same time, one cannot help but pay attention to a significant role played by revenues out of external renewable sources. In 2000, the RF's revenues from operations of the Russian-Vietnamese joint venture Vietsovpetro accounted for more than a half of all the revenues out of renewable sources. This share has declined since then. But despite of its fall (to 30% in 2006) by its absolute value this revenue item of the federal budget only once, in 2005-06, became the second major source after dividends on owned by the federal government shares and revenues from other forms of participation in capital within the country, respectively (in 2004, these revenues appeared comparable), thus outpacing the aggregate volume of revenues form leased federal assets and land lots. In 2007, the absolute value of revenues from Vietsovpetro experienced a sharp (more than twice) fall (below the 2000 level) and, consequently, this item found itself outpaced by dividends and revenues from leased federal assets in the list of the renewed sources.

As concerns other kinds of renewable sources, the absolute values of revenues by them have been soaring over the whole period of 2000-2007, except for some fall in aggregate revenues from leased federal assets and land lots in 2003, when the land rent fees were not singled out as a separate item, while a part of the FPUEs' earning stagnated in 2005-2006.

In 2008, the major shift in the structure of revenues to the federal budget from renewable sources became the growing role of dividends (up to 70%) and a full absence of revenues

[55] In 2008, FPUEs as a source of revenues from leasing the assets under their economic management were not mentioned, while leasing of assets under operating management by the federal bodies of state power and institutions founded by them exclude the federal autonomous institutions' assets.

[56] According to the RF Minimuschestvo, revenues from the use of the federal assets located overseas (apart from the revenues on the share of the Russian participant in joint venture Vietsovpetro) accounted for Rb. 315m in 1999 and 440m in 2000. Then a major role in the organization of the commercial use of the federal overseas assets was assigned to FPUE "Predpriyatiye po upravleniyu sobstvennostyu za rubezhom".

from Vietsovpetro[57]. The 2008 absolute value of dividends soared at Rb. 9.7bn vs. 2007. But if compared with the aggregate amount of dividends and earnings raised through Vietsovpetro's operations, one has to admit its downfall. The volumes of the downfall proved to be insignificant (less than 2%), as dividends were paid by results of economic operations in 2007, when the economy did not practically sense signs of the forthcoming crisis as yet. As concerns a fraction of FPUEs' earnings due to be transferred to the budget and revenues generated from leasing public assets, the situation is far worse – these figures tumbled at 20-25%. Accordingly, also plummeted their proportion in the overall structure of renewed revenues – it has made up some 3% and 19%, respectively. The only source which in 2008 has demonstrated an unequivocal growth was land rent payments – the respective revenues to the federal budget grew by nearly ¼, while their specific weight – up to 8%.

Proceeding to the analysis of the federal budget revenues from privatization and sales of public assets (*Table 7*), it should be noted that since 1999 revenues from sales of the bulk of such assets (stock and – since 2003- land lots[58]) have begun to being attributed to sources of financing of the federal budget deficit.

Table 7

Revenues to the Federal Budget from Privatization and Sales of Assets (Non-Renewable Sources) in 2000–2008, as Rb.m

Year	Total	Sales of assets owned by the federal government (2000–2008) and other forms of participation in capital (2005–2008)#	Sales of land lots	Sales of different assets
2000	27,167.8	26,983.5	–	184.3[a]
2001	10,307.9	9,583.9	119.6[b]	217.5+ 386.5+0.4 (NTA)[c]
2002	10,448.9	8,255.9[d]	1,967.0[e]	226.0[f]
2003	94,077.6	8,9758.6	3,992.3[h]	316.2+10.5[g]
2004	70,548.1	6,5726.9	3,259.3[i]	197.3+1,364.6+0.04 (NTA)[к]
2005	41,254.2	3,4987.6	5,285.7[l]	980.9[м]
2006	24,726.4	17,567.9	5,874.2[l]	1284.3[n]
2007	25,429.4	19,274.3	959.6[o]	5,195.5[q]
2008	18914.1/12375.9[r]	6665.2+29.6	1,202.0[p]	11,017.3+0.025 (NTA) / 4,479.1[c]

#Refer to the sources of domestic financing of the federal budget deficit; in 2009 29.6 mln. rub. were attributed to the federal budget revenues.

[a] – attributed to sources of domestic financing of the federal budget deficit revenues from privatization of organizations owned by the state;

[b] – attributed to the federal budget revenues receipts from sales of land lots and rights for rent of land lots owned by the state (with the separation of those on which privatized enterprises are located);

[c] – the amount of receipts from (1) sales of assets in the federal property, which are attributed to sources of domestic financing of the federal budget deficit, (2) receipts from (i) apartment sales, (ii) sales of public production and non-production assets, means of transportation, other equipment and inventories, as well as (3) revenues from sales of non-tangible assets (NTA) attributed to the federal budget revenues;

[d] – including Rb. 6m from raised through sales of stock controlled by the RF Subjects;

[e] – attributed to the federal budget revenues gains from sales of land and NTA the amount of receipts by which was not single out in an individual order;

[f] – attributed to sources of domestic financing of the federal budget deficit revenues from sales of public assets (including Rb. 1.5m from sales of assets belonging to the RF Subjects;

[57] In 2007, measures on developing JSC Zarubezhneft were completed. To the company's authorized capital were assigned stakes in 2 JSCs – research institutions and the 50% share of the Russian participant in the Vietsopvpetro joint venture.

[58] In 2003-04, with account of sales of the rental right.

[h] – including collected to the federal budget receipts from: (1) sales of land lots whereupon immovable property objects are located, which prior to their alienation had constituted federal assets, (2) sales of other land lots and sales of the right for conclusion of contracts on their rent, (3) – collected to the federal budget and attributed to sources of domestic financing of the federal budget deficit receipts from sales of land lots upon the division of land ownership, as well as from sales of the right to conclude contracts on their rent;
[i] – the sum of (1) attributed to sources of domestic financing of the federal budget deficit receipts from sales of assets owned by the federal government and (2) attributed to the federal budget revenues receipts from sales of non-tangible assets ;
[g] – comprises revenues: (1) collected to the federal budget from sales of land lots prior to the division of ownership for land whereupon immovable property objects that prior to their alienation fell under the federal property, (2) from sales of other land lots and sales of the right for conclusion of contracts on their rent, (3) collected to the federal budget and attributed to sources of domestic financing of the federal budget deficit receipts from sales of land lots upon the division of land ownership, as well as from sales of the right to conclude contracts on their rent;
[к] – the sum of (1) attributed to sources of domestic financing of the federal budget deficit revenues from sales of assets owned by the federal government, collected to the federal budget receipts from (i) apartment sales, (ii) sales of public production and non-production assets, means of transportation, other equipment and inventories, as well as well as (iii) from sales of vessel utilization products, (iiii) from sales of assets of FPUEs, institutions and military inventories, (iiiii) from sales of products of utilization of armaments, military equipment and ammunition, (3) attributed to the federal budget revenues receipts from sales of non-tangible assets (NTA), relevant to the budget revenues;
[l] – comprises receipts from: (1) sales of land lots prior to the division of ownership for land whereupon immovable property objects that prior to their alienation fell under the federal property, (2) collected to the federal budget receipts from sales of land lots upon the division of land ownership, (3) attributed to sources of domestic financing of the federal budget deficit revenues from sales of other land lots that had been the government property prior to the division of land ownership and which are not designated for house building (the latter specification concerns solely the year of 2006);
[m] – revenues from sales of tangible and non-tangible assets (exclusive of the federal budget funds raised through management and sales of confiscated and other appropriated by the state assets include receipts from (i) apartments sales, (ii) sales of FPUEs' assets, (iii) sales of assets under the federal institutions' operative management, (iiii) sales of military assets, (iiiii) sales of products of utilization of armaments, military equipment and ammunition, (iiiiii) sales of other assets under the federal ownership, (iiiiiii) attributed to the federal budget revenues receipts from sales of non-tangible assets;
[n] – revenues from sales of tangible and non-tangible assets (exclusive of revenues in the form of a share of the government's profit production in the course of execution of production sharing agreements and the federal budget funds raised by managing and selling appropriated by the state escheat and other assets), comprise revenues from включают доходы (i) apartments sales, (ii) sales of FPUEs' assets, (iii) sales of assets under the federal institutions' operative management, (iiii) sales of military assets, (iiiii) sales of products of utilization of armaments, military equipment and ammunition, (iiiiii) attributed to the federal budget revenues receipts from sales of other assets owned by the federal government;
[o] – attributed to sources of financing of the federal budget deficit revenues from sales, upon the division of land ownership, of the previously owned by the federal government land lots;
[p] – revenues from sales of tangible and non-tangible assets (less revenues in the form of the government's profit products under execution of production sharing agreements and the federal budget funds from management and sales of escheat and other assets taken by the state, and sales of sales of sequestrated timber) include receipts from (i) apartments sales, (ii) sales of FPUEs' assets, (iii) sales of assets under the federal institutions' operative management, (iiii) sales of released movable and immovable military, and other property of federal agencies of executive power, which provide for the military and equaled to it service, (iiiii) sales of military goods the federal gencies of executive power have in the frame of military and technical cooperation, (iiiiii) attributed to the federal budget revenues receipts from sales of other assets owned by the federal government;
[q] – attributed to the federal budget revenues receipts from sales of land lots owned by the federal government (except for land lost of federal autonomous institutions);
[r] – receipts from sales of government assets (less revenues in the form of the government's profit products under execution of production sharing agreements and the federal budget funds from management and sales of escheat and other assets taken by the state, and sales of sales of sequestrated timber), include those raised by (i) apart-

ments sales, (ii) sales of FPUEs' assets, (iii) sales of assets under the federal institutions' operative management (except autonomous ones)[59], (iii) sales of released movable and immovable military, and other property of federal agencies of executive power, which provide for the military and equaled to it service, (iiii) from sales of products of utilization of armaments, military equipment and ammunition, (iiiii) sales of military goods the federal gencies of executive power have in the frame of military and technical cooperation, (iiiiii) sales of products of utilization of arms and military equipment in the frame of the Federal Target Program "Industrial utilization of arms and military equipment (2005–2010), (iiiiiii) sales of special raw and fissionable materials, (iiiiiiii) attributed to the federal budget revenues receipts from sales of other owned by the federal government assets, as well as receipts from sales of non-tangible assets (NTA); in the common denominator – without regard of receipts from sales of special raw and fissionable materials, which is necessary for a correct comparison with the prior years.
Source: the 2000-2007 Acts on execution of the federal budget; the report on execution of the federal budget as of January 1, 2009; the authors' calculations.

It was sales of the federal stakes that held a pivotal place in the structure of the asset-related federal budget revenues from non-renewable sources. But the specific weight of this particular source has been gradually declining from 85% in 2005 to 71% in 2006 and 76% in 2007 vs. 90%-plus in the preceding years, except for 2002 (79%).

Meanwhile, the proportion of budget gains from sales of land lots was on the rise, accounting for 12.8% in 2005 and 23.8% in 2006 vs. less than 5% reported in the prior years, except for 2002, when it made up 18.8%. The proportion of receipts from sales of other kinds of assets, including sales of the FPUEs and other institutions' assets and military property, has been fairly modest since 2004, except for 2001 and 2006 when it stood at 5-6%. In 2007, these sources of budget revenues traded places with each other: the specific weight of assets sales posted a sharp growth up to 20.4%, while that of sales of land lots plummeted to below 4%.

Having reached its maximum value in 2003 (some Rb. 89.8bn), the absolute amount of revenues from equity sales has been on decline over the next years. The fall was particularly notable in 2005-06, when the revenues plunged nearly twice. Nonetheless, even after such a drastic fall the 2006-07 the revenue volumes were practically twice as high compared to those back in 2001-2002. Characterizing the 2007 outcomes, Rosimuschestvo emphasized that despite there were no sales of large and the largest joint-stock companies' equity (worth in total of Rb. 3bn-plus), the respective receipts accounted for some Rb. 193.3bn, or 10% more than in the prior year. The agency also noted that without regard to receipts from such sales, during the last 4 years the collected to the federal budget annual amount of receipts from privatization grew nearly 2.5 times vs. the sum of Rb 7.8bn reported in 2004 (Rb. 11.8 bn. in 2003, some 12.95bn in 2005 and 12.1bn. in 2006)[60].

Revenues raised through sales of land lots demonstrated a clear trend to growth (with the year of 2004 being a minor exception). But they failed to compensate for the fall in revenues (which accounted for some Rb. 5.9bn in 2006) from equity sales. The next year they shrank drastically - under Rb. 1bn. Receipts from sales of various kinds of assets have been fluctuating within an ample range – they exceeded Rb. 1 bn only in 2004 and 2006, and 2007, when they accounted for Rb. 5.2bn.

[59] Less receipts from sales of the FPUEs' assets as well .
[60] Otchet o privatizatsii federalnogo imuschestva v 2007 g. M., FAUFI, 2008.

The year of 2008 saw the absolute value of the federal budget revenues from privatization and sales of assets fall more than twice61.

Receipts from equity sales shrank nearly 3-fold, while those from sales of various assets plunged at 14%. At the same time, receipts from sales of land lots posted a nearly ¼ growth – the specific weight of land lots in the overall structure of non-renewable sources has clearly been on the rise. But this particular source still was the least significant one vis-à-vis receipts from equity sales (54.1%) and those from sales of various assets (36.2%).

The budgetary statistics show that constancy has not been a salience of the aggregate volume of revenues from privatization and use of the government property (*Table 8*). This proportion became the most weighty one in 2003-2004 (Rb. 135.3bn and 120.8bn, respectively). In the next 2 years, it plunged to less than Rb. 100bn, albeit still being practically twice as high vs. the annual indicators of 2000-2002. In 2007, the amount of the federal budget revenues from privatization (sales) and use of the public property once again exceeded Rb. 100bn, albeit being inferior to the 2003-2004 indicators.

Table 8

Structure of the Federal Budget Revenues of Property Nature out of Various Sources in 2000–2008

Year	Aggregate revenues from privatization (sales) and use of the public assets		Receipts from privatization (non-renewable sources)		Receipts from the use of the public property(renewable sources)	
	Rbm.	As % to result	Rbm.	As % to result	Rbm.	As % to result
2000	50,412.3	100.0	27,167.8	53.9	23,244.5	46.1
2001	39,549.8	100.0	10,307.9	26.1	29,241.9	73.9
2002	46,811.3	100.0	10,448.9	22.3	36,362.4	77.7
2003	1,35338.7	100.0	94,077.6	69.5	41,261.1	30.5
2004	1,20798.0	100.0	70,548.1	58.4	50,249.9	41.6
2005	97,357.4	100.0	41,254.2	42.4	56,103.2	57.6
2006	93,899.8	100.0	24,726.4	26.3	69,173.4	73.7
2007	10,5761.25	100.0	25,429.4	24.0	80,331.85	76.0
2008	88,642.6	100.0	12,375.9	14.0	76,266.7	86.0

Source: the 2000-2007 Acts on execution of the federal budget; the report on execution of the federal budget as of January 1, 2009; www.roskazna.ru; the authors' calculations.

There occurred a cardinal shift in the structure of aggregate revenues from privatization (sales) and use of federal assets in favor of the renewable sources. While in 2000 the proportion of revenues from privatization and sales of assets accounted for some 54% of the aggregate revenues, the next year it shrank more than twice, while in 2002 one had noted its minimal value over the whole 7-year period (22.3%). The situation reversed drastically in favor of the privatization and assets sales revenues in 2003 – at the time, they secured nearly 70% of the volume of the aggregate revenues.

The period between 2004 and 2006 saw a steady rise in the proportion of revenues from use of public assets against a constant fall in the specific weight of revenues from privatization and sales, which in 2007 accounted just for 24%, which is comparable with the 2001-2002 figures. As a result, in 2005-2007, like in 2001-2002, revenues from use of public assets

[61] In 2008, in receipts from sales of assets there appeared a new revenue item – receipts from sales of special and fissionable materials, which was non-existent over the prior years. That is why a correct comparison requires not to take into account this kind of receipts while evaluating the receipts raised through both sales of various assets and aggregate receipts from non-renewable sources on the whole.

secured over a half of all the aggregate revenues. Of particular notice is the fact that in 2001-02 and 2006-07 they secured over 70% of the aggregate budget revenues.

The 2008 financial results in the part of the structure of the asset-related federal budget revenues out of different sources have increasingly solidified this trend. The proportion of revenues form use of the public assets accounted for 86% - the maximum value ever reported over the 2000s. Accordingly, the proportion of revenues generated by privatization was the minimum one – 14%.

One should help but notice a more than a 16% fall of the indicator of the aggregate revenues vis-à-vis 2007. Its absolute value (Rb. 88.6bn) proved to be the minimum one over the period since 2003. Having managed not sink below their 2006 level, the revenues from use of public assets became a kind of buffer, while those from privatization and sales of various kinds of assets were just slightly over their respective indices of 2001-2002, but proved to be lower than both the results of all the subsequent years and figures reported in 2000.

In the conditions of the unfolding crisis, however, one cannot count on a stable influx into the budget of revenues from renewable sources, primarily because of the aggravating financial and economic state of corporations with the government participation and an overall contraction of business activity.

In this sense, the situation with dividends is quite illustrative. Rosimuschestvo proposed the RF Ministry for Economic Development and Trade to differentiate the dividend policy by breaking down all the corporations of this kind into three groups:

- the companies with publicly traded stock (for example, Gasprom, VTB, Rosneft, Aeroflot) whose approaches to the dividend policy should remain unchanged;
- the companies bound to pay dividends only on preferred stock (Transneft);
- the companies unsusceptible to the financial crisis, which must pay dividends, unless they can produce grounded plans and budgets to prove their need in funding for the ongoing operations and investment ones.

The agency believes that paying dividends by other companies is inappropriate. This primarily concerns dividends of the public companies that have failed to join in the Top-20 ones and which in 2008, by results of 2007, secured Rb. 1.9bn in dividends payable to the federal government.

Meantime, according to Rosimuschestvo, the Top-20 group of the largest public companies secured 96.4% of all the dividend payments to the budget. Of this group the following companies have their shares publicly traded: Gasprom, VTB, Sovkomflot, Aeroflot, Novorossiysk maritime commercial harbor, Irkutskenergo, FSK UES. Transneft has only its preferred shares publicly traded, while Svyazinvest – only its daughter companies' stock. As for companies with non-traded stock, the group comprises ALROSA, Zarubezhneft, Concern PVO "Almaz-Antey", JSC RZHD, International Airport Sheremetyevo, SG-trans, Tuapse maritime commercial harbor, Rosagrolizing, Sevzapelectrosetstroy, Rosgazifikatsia, Rosneftegas[62].

By the 2007 results, Gasprom paid 17.5% of its profit to the shareholders (the government's share accounted for some Rb. 31.5bn), Rosneft approved dividends at an amount of 10.5% of its net profit by Russian Accounting Standards (the government's share is Rb. 12.75bn), VTB- 50% (Rb.6.7bn), Transneft – 18% (Rb. 750m), Aeroflot- 25% (some Rb.

[62] While not exercising economic operations, Rosneftegas is an owner of the government stakes in Gasporm and Rosneft, and as such, it pays dividends.

760m[63]), Sheremetyevo – 10% (Rb. 104m). JSC RZHD blew with just 0.6% of its profit and paid to the government Rb. 512.2m, but the railway monopolist has had a special situation, with its profit being a paper-and-pencil one as a result of the asset revaluation.

Not daring challenge minority shareholders of the public companies, Rosimuschestvo proposes to indirectly alleviate their situation, too, – the agency claims it will not insist on sizeable payments. It believes that the government should hear boards of directors' recommendations, rather than forward directives on a minimum level of payments out of the net profit. Until now Rosimuschestvo has recommended the public corporations to pay not less than 25% of their profit in dividends.

In the crisis conditions, the refusal to pay dividends can be regarded as a way to somewhat shake off the financial load – a measure to complement the tax policy ones and target aid granted by the state. This measure can give a much-needed upper hand to relatively small, nonpublic corporations.

In all, the agency hopes that in 2009 it would ultimately cash in just Rb. 30.7bn., instead of Rb. 50.7bn-worth, in dividends. This inevitably requires adjustments to budget orders[64], albeit it cannot be excluded that the cold truth of the crisis would compel the government to dump the idea of collecting dividends at all.

5.2.5. A Possible Effect of the Financial Crisis on the State of Property Relations

The gradual intensification of negative developments in Russia's economy was noted through the whole year of 2008. It has affected primarily the national financial markets (including the stock market) and the investment process, and raised the question of the beginning of a new stage of Russia's as a whole.

While speaking of the country's macroeconomics and financial system, one with a greater or lesser degree of certainty can reference to possible trends of future changes, their determination by a known set of parameters (world prices for energy sources, export and import volumes, exchange rate, etc.), but the sphere of property relations exhibits a far greater level of variability, which is associated with both the impact of the global financial crisis and the start of a new business and political cycle in the country.

The crux inevitably lies in the problem of the nature of mergers and acquisitions - the usual companions to economic crises in a market economy. An evident deceleration of the privatization process post-2004, particularly on the federal level wherein the state was an owner of the most weighty and attractive assets, has chronologically coincided with the start of the today's stage of mergers and acquisitions in the economy, when corporations with governmental participation have notably expanded across a number of sectors as buyers of assets.

Investors have begun to regard the presence of a government-owned package in a company's capital as an extra factor of its reliability and sustainability, as reflected by international rating agencies' assessments. The dark side of the trend to the public companies' greater activity on the market for corporate control has become a sharp rise of their accounts payable. That highlighted the problem of alternative choices with respect to financial invest-

[63] The only large corporation that was following the recommendation to forward not less than ¼ of its net profit on payment of dividends.

[64] Rebrov D., Kiseleva E., Shapovalov A. Bezdokhodnoye proizvodstvo//Kommersant, №226/P (4043) of 11.12.2008.

ments and investments in fixed assets, sources of their financing and the regulatory role the government plays as a key stakeholder in tackling this problems.

The quantitative assessments available over the period between 2003 and 2007, along with new avenues of the government's property activity over the last two years, so far have not given grounds to assume that the state has slowed down with its expansion in the sphere of property, though 2008 highlighted respective signs of that.

As the RF President declared in his Address to the Federal Assembly of November 5, 2008, the crisis would not engender a nationalization of the industrial sector and finance. Addressing the economic agenda, since the early-2009 the top political leadership put forward a comparatively new thesis of urgency of the task of acquiring of assets located overseas. The players on the M&A market (which in the pre-crisis 5-year period were mostly public companies) may interpret it as a signal to focus their efforts on what lies beyond the country's borders.

The completion of a deal between Gasprom and the Siberian Coal Energy Company (SUEK) scheduled for the end of the summer of 2008 faced the Federal Anti-Monopoly Service's opposition[65].

SUEK was going to hold an additional stock issuance, to be paid for with Gasprom's electricity assets (from its share in RAO UES Russia after the reorganization of the electricity monopolist), as well as the already received by the latter shares in new companies that had emerged in the course of the process (a 15.61% stake in JSC OGK-2, a 17.13% stake in JSC OGK-6, a 5.27% stake in OGK-5, and a 5% stake in TGK-5. If completed (and with account of the summer 2007 swap of RAO UES Russia's equity between Gasprom and other minority shareholders of the electricity monopolist) , the deal would have resulted in SUEK getting control blocks in JSCs OGK-2 and OGK-6, while the natural gas monopolist should have acquire a 50%+1 share in one of the biggest national energy corporations.

Such a format of interaction between Gasprom and SUEK might imply establishment of an indirect control by the state over a considerable fraction of generating capacities in the national electricity sector, as Gasprom's control over own energy assets and SUEK's ones would complement the already existing to that day full ("Rosenergoatom" concern, which was due to be included in the structure of "Atomny energopormyshlenny kompleks" (AEP) holding, which in turn was to be assigned as a property contribution to PC "Rosatom") or partial presence of the state in assets of individual segments of this sector.

As concerns signs of a slowdown in the government's property expansion, one of them became drastic cuts in the list of the strategic enterprises and joint-stock companies. As many as 176 unitary enterprises and 195 JSCs were crossed out, to be replaced by just 1 FPUE and 2 JSCs. But the exclusion of the overwhelming majority of the assets was associated with their assigning to PC Rostekhnologii.

The formal nature of representation of the state on boards of numerous companies wherein the government has a share in the capital vis-à-vis the role played by the top executive management has made the practice of attraction of independent directors thereinto a hot issue. Of the largest corporations with a government share, it was RAO UES Russia (until its liquidation), Rosneft, Sberbank,VTB aand RZHD that attracted independent directors. By contrast, they are absent in boards of Gasprom, Svyazinvest (though there are independent di-

[65] www.opec.ru, 09.06.2008.

rectors on all its daughter companies' boards), Transneft, Rosneftegas, Sovkommflot, and Aeroflot[66].

At this juncture, given what the government representatives (I. Shuvalov, the First Vice-Premier of the RF Government, at the XII St. Petersburg International Economic Forum and A. Dvorkovich, the presidential aide, in June 2008) have ascertained, there will be steps made to limit the bureaucrats' sitting on the public corporations' boards by means of rotation of their composition, along with a gradual increase in the number of independent directors, primarily in the JSCs in which the government holds the 100% stake[67]. But so far there is no clarity with respect to proportions of such a replacement and the array of companies where bureaucrats will keep on representing the state interests. In practice, the novelty has already been tested at 11 public companies with the 100% government-owned stake. According to Mr. I. Shuvalov, in June 2008, independent directors were co-opted to their boards to improve corporate governance, albeit a fairly widespread opinion is that the move constitutes a first step in preparations for a possible sale of the federal stock packages in such companies[68].

In this respect it should also be noted that amendments introduced by Resolution of the RF Government of July 28, 2008 № 572 to the approved in December 2004 Statute on management of owned by the federal government equity of open-end joint-stock companies and use of the special right of the Russian Federation for managing open-end joint-stock companies ("the golden share") have excluded individuals, whose candidacies the Russian Federation had proposed for electing in boards of directors as independent directors, from the group of state representatives that exercise their duties on the basis of the Statute.

Furthermore, along with representatives of the RF's interests, independent directors have now been given the right to initiate at Rosimuschestvo and other government agencies, with invitation of other governmental representatives, discussions on matters put on the agenda of a JSC's board of directors and to receive necessary information, except for the one the company is bound to provide them with.

At the same time, the circle of matters, by which Rosimuschestvo is bound to issue directives in writing to government representatives, has been slightly narrowed; plus, directives on other matters that fall under the board of director's competence, may be used, only sobeit the chairman of the board puts a respective proposal.

Let us note that against such a background, other novelties in the federal property management area appear fairly questionable. This concerns the possibility for trust FPUEs and public JSCs at the stage of their incorporation to sectoral ministries. A suggested pilot project involves road-building organizations with the prospect for creation on their basis of a huge public company or a new public corporation[69].

The concept of competition between ministries and federal agencies, that currently administer unitary enterprises, explicitly conflicts the approaches declared by the 2004 administrative reform. Besides, it additionally complicates the already sophisticated pattern of interaction between different government agencies in the course of implementation of managerial procedures with regard to the economic agents under the federal ownership which lacks an undivided authority. As well, this move compels one to question the mere possibility for min-

[66] Malkova I., Surzhenko V. Nezavisimye pomogut//Vedomosti, 14.09. 2007, №173 (1947), B 01.
[67] Den nezavisomogo direktora. 9.06.2008. Interfax.ru
[68] Netreba P., Butrin D. Privatizatsii nakidyvayut srok. In: Commersant, №145/P (3962) of 18.08.2008.
[69] Netreba P. Pravitelstvo vzyalos za dorozhny vopros// Commersant, №145/P (3962) of 18.08.2008.

istries to be capable of an efficient administering of the respective sector (their mandate) on the whole, and the possibility for agencies of being capable of dealing with implementation of their respective mandates that proceed from the law (primarily, the Act on unitary enterprises). Furthermore, the effective trust mechanism emerged in the 1990s implies attraction to managing government stock packages (but not FPUEs) of legal entities (but not government agencies) on the competitive basis and with a potential orientation to getting efficient managers from the private sector involved in the process.

Yet more dubious appears a delegation to the RF Ministry of Defense of powers to exercise, on behalf of the government, the stockholder's rights (remarkably, independently by a number of issues) with respect to JSCs founded resulting from privatization of subordinated to the Ministry FPUEs, whose stock is owned by the federal government, as well as, upon the government's decision, with respect to other joint-stock companies with the federal stakes in them. This novelty was introduced in the aforementioned Statute on management of owned by the federal government equity of open-end joint-stock companies and use of the special right of the Russian Federation for managing open-end joint-stock companies ("the golden share") by Resolution of the RF Government of December 29, 2008, №1053 'On some measures on managing the federal property"[70].

The absence of announced plans on a further comprehensive expansion of the sphere of the governmental entrepreneurship across whole sectors of the economy, as it had been already done in the air transportation and nuclear sectors, and the ship-building industry, does not mean an automatic contraction of the size of the public sector itself due to advancement of privatization, as inclusion in a respective program of sizeable assets that by their significance appear comparable with those privatized prior to 2004 (for instance, the government stake in the telecom giant Svyazinvest, whose sales were repeatedly postponed in the past) is questionable. In conjunction with this, it should be remembered that the previous financial crisis, which had battered the economy in 1997-98, reduced the privatization procedures to minimum, because of a multiple price downfall for assets, abandonment of the national market by numerous potential investors, and the political uncertainty, albeit at the time, it was only some emerging markets (the south-east Asian and Latin American ones), rather than G-7 countries, as today, that fell prey to the crisis.

The impact of the financial crisis of the autumn of 2008 on the Russian market for corporate control has still been not quite clear. On the one hand, having gone down in value, the assets constitute a natural object for potential mergers and acquisitions, particularly in the eyes of both public and private companies. On the other hand, the accumulated debt load and the loss of the ease of access to loans should objectively help one sell a part of the assets, or, at least, they should arrest new purchases.

Much will depend on magnitude and format of the government support to be granted to the Russian banks, their priorities of crediting the real sector, and the degree to which the state would be keen to participate on the stock market.

The major channels of extension of financial support out of budgetary funds and through CBR's loans have undoubtedly become the economic structures with the governmental par-

[70] This document also introduced amendments to Resolutions by the RF Government of June 6, 2003, №333 and of December 3, 2004, №738, which defined the mechanism of realization by government bodies of powers of proprietor of FPUEs' assets in the part that concerns legal powers exercised by the RF Ministry of Defense.

ticipation – PC Vneshekonombank (VEB), Sberbank, and the Agency for Mortgage Loans (AIZHK).

At the same time, public companies have not dominated over the group of recipients of the funds in question – quite the opposite, it was well known private corporations, such as RUSAL, Alfa-Group, JSC Mechel that were among the first to receive cheap credits from the VEB. This contradicts to the recently established opinion of the public companies' privileged position, thanks to their interaction with authorities.

As well, one should not help noting that the comeback to the practice of extending soft loans has heralded a certain revision of principles of financial responsibility, impermissibility of soft budget constraints with respect to economic agents' operations, consistency in application of insolvency (bankruptcy) procedures, whose introduction into the national economy back in the 1990s was painful and costly. Furthermore, at the time, it was the agrarian sector, coal-mining and defense industries that were main candidates for such a support. Those were the sectors, which, due to their specificity, constituted, as proved by international experience, certain deviations from typical models of organization and conduct of business. Nowadays, the group of pretenders for the support comprises corporations from the sectors that owed their recent successful advancement to market forces (the mineral sector, metallurgy, construction and trade). It should be noted, though, that the credits to refinance the loans taken overseas were extended against their equity. Should the borrower fail to repay the loan, the VEB would be in a position to exercise the ownership right. For instance, RUSAL received Rb. 121bn on security of the blocking package in Nornickel, while Alfa-Group received a collateral loan against its stakes in X5 retailer and Vympelkom.

As well, some banks have received 10-year loans from the VEB: specifically, Vneshtorgbank received Rb. 200bn, Rosselkhozbank – Rb. 25bn, some regional banks – 225bn, and Sberbank – 500bn. (a 10-year loan from CBR)[71]. It is critical what will be their actual credit policy priorities.

As concerns the VEB, in addition to resources to ensure direct credits for the real sector (Rb. 1.3trln to refinance corporations' overseas borrowings) and for the banking sector (Rb. 450bn), it received Rb. 175bn to buy stock and bonds on the exchange market, another 75bn to guarantee completion of transactions at exchanges, and 30bn to credit small- and medium-sized businesses.

Meanwhile, some business groups have failed to get access to the government support. For them the crisis, which has already drastically constrained a possibility for attraction of borrowed capital, should become a catalyst of their restructuring with a prospect of a possible change of their owners. Time will show how deep and sweeping such a restructuring will be, as far as public companies are concerned. As the recent experience (albeit in the conditions of economic growth and a positive dynamic of the financial markets) already showed, the restructuring may well comprise a sale of a fraction of the accumulated assets. That should engender a change of the role the companies with a government share in their capital would play on the M&A market and lead to their transformation from major buyers into sellers[72]. It can-

[71] In addition, the RF Ministry of Finance has placed Rb. 1.5trln on deposits with commercial banks.

[72] In this respect, one can reference to the practice of reforming natural monopolists, primarily, the electricity sector. Also, similar processes may be envisaged in the railroad transportation sector.

not be excluded, of course, that these companies may try new mergers and acquisitions themselves, with new corporations in various sectors being their targets.

That said, there arises an inevitable question of the role played by the state. It will be compelled to act indirectly, via its representatives in managing bodies of such companies, granting a permit to execute such deals or blocking them, rather than directly, as it was noted under standard privatization procedures. At this point, contiguous problems are the dividend policy (in the light of collection extra revenues complementing proceeds from current operations) and identification of prospects for the government with respect to retaining its participation in the corporate capital.

It is in the medium term that it shall become clear whether a reorganization of the managerial and organizational aspects of individual companies' functioning means optimization of the public sector as a whole.

Reflecting on efficiency, the government's presence in the economy in terms of property relations has to be brought in line with its real managerial capability, which is fairly modest. Hence, the government should center its efforts on optimization of the existing assets, enhancement of efficiency in managing the already existing public companies by identifying their place in the system of the state priorities, securing transparency of financial flows, and disseminating the best practices and standards of corporate governance.

As concerns the problem of the public companies' participation in mergers and acquisitions, the focal point should become restricting acquisitions of non-core assets and a more thorough selection of decisions that require consent of the government both as an owner and the market regulatory authority. Because of the financial crisis, it is fairly possible that in the nearest future the privatization process in the country will decelerate. Hence, a very possible scenario under which the government would for long remain an owner of a huge volume of assets, including those not directly associated with its public functions. That is why one can presently assert that as far as the sphere of public property management is concerned, the priority mission for several years to come will remain an ultimate implementation of the set of measures on improvement of management of public assets as outlined in the "Concept for management of public property and privatization in the Russian Federation"[73].

5.3. Public Corporations: main development directions and trends in 2007-2008

An important element of government policy in 2007 was the establishment of large public corporations. The government has established six of the them: Bank for Development and Foreign Economic Affairs (Vnesheconombank), Russian Corporation of Nanotechnologies («Rosnanotech» or «ROSNANO»), Housing and Utility Reform Foundation, Public Corporation for the construction of Olympic facilities and the development of Sochi as a mountain resort («Olympstroy»), «Rostehnologies» and «Rosatom»[74].

Those public corporations have obtained a wide range of functions and significant scope of national property (federal budget funds, various industrial and financial assets) to secure their activities over a long term. Herewith, these public corporations are rather different in

[73] Resolution by the RF Government of September 9, 1999, №1024.
[74] In this section, we do not consider the activities of the public corporation «Deposit Insurance Agency», established in 2003.

terms of objectives, functions and basic principles of operation[75]. In 2007-2008 the dynamic development of the government-established corporations took place along with the expansion of their scope and sometimes trends of their activities as well. In this section, we will primarily focus on the *analysis of major trends of the public corporations development*.

5.3.1. Specifics of public corporations development in 2007-2008

Development of the established public corporations' activities

State corporations, established in 2007 can be roughly split into three main groups:

1) Vneshekonobank and «ROSNANO» basic objectives are filling in the «gaps» in both, the market, and public administration system, as well as establishment of financial institutions for development in the form of public corporations;
2) Housing and Utility Reform Foundation, «Olympstroy» objectives are enhancement of efficiency and flexibility of the administrative system, «outsourcing» of some functions of government bodies at the level of public corporations;
3) «Rosatom», «Rostehnologies» objectives are competitive upgrading of certain strategic sectors (industries), national security support, restructuring and consolidation of the relevant national assets.

Public corporations development is rather diversified, and in some cases looks ambiguous. Let as consider some important events in each of public corporations development.

Vnesheconombank

Reviewing the public corporation as a new institution of development, the Vnesheconombank Memorandum on financial policy, defining main trends, indicators and restrictions in it's investment and financial activities[76], adopted 2 months after the official establishment of the corporation should be regarded as the starting point. The first solutions on the approval and support of the investment projects, that meet the Memorandum requirements, were adopted in March 2008, i.e., 10 months after the public corporation official registration. By October 2008, the Supervisory Board of Vnesheconombank has approved the public corporation participation in more than 20 large projects with the funding of nearly RUR 200 bln. From the point of its incorporation, the public corporation has signed a number of agreements on cooperation and collaboration with federal authorities, regional administrations, the largest public companies, such as OAO «Russian Railways», OAO «United Aircraft Corporation», GK «Rostehnologies», OAO «Rosneft», OAO «United Shipbuilding Corporation ».

Currently Vneshekonombank is an important instrument, ensuring financial stability of domestic banks and of real sector companies. In accordance with the federal law «On additional measures for the support to the financial system of the Russian Federation»[77], this public corporation has the right to:

[75] For the details on the establishment of public corporations in 2007, the basic assumptions and characteristics of the process, the key characteristics of structures, see, for example: Yu. Simachev, M. Kuzyk. The creation of public corporations as an important instrument of institutional policy in 2007 / The Russian Economy in 2007. Trends and Prospects. (Issue 29) - Moscow: IET, 2008, pp.505-534.

[76] Memorandum on financial policy of «the Development Bank and foreign trade activities (Vnesheconombank)» public corporation is approved by the Order № 1007-p of the RF Government on July 27, 2007.

[77] Federal Law №173-FZ, dated of October 13, 2008 «On supplementary measures for the support of the Russian federation financial system».

provide credits to organizations for repayment or service of foreign debt, as well as acquire the right of claim to the foreign creditors;

provide long-term subordinated loans without security;

provide subordinated loans to OAO «Bank VTB», amounting up to RUR 200 bln and to OAO «Rosselhozbank», amounting up to RUR 25 bln.

Also Vnesheconombank was authorized to act as the RF Government Agent in 2009 on provision and execution of national guarantees under credits, attracted by the strategic enterprises of military-industrial complex, as well as by other companies, selected in accordance with the procedure, established by the Government, for implementation of the basic business activities and capital investments[78].

Vnesheconombank has implemented a number of measures of both, targeted and regular support, such as:

acquisition of 98 % shares in OAO AKB «Svyaz-Bank» and 99 % shares in ZAO «Globex»;

provision of subordinated credits to a number of Russian banks (besides «VTB Bank» and «Rosselkhozbank», mentioned in the Law): «Alfa-Bank», «NOMOS-BANK», «the Khanty-Mansiysky Bank», «Gazprombank» for the total amount, exceeding RUR 30 bln;

participation in refinancing of fuel and energy sector, mining, metallurgy industry, microelectronics companies and OAO «Bank VTB» transactions for the amount of nearly USD 14 bln[79].

To ensure the implementation of anti-crisis measures, additional resources were provided to the public corporation. Thus, in accordance with federal law «On additional measures to support the financial system of the Russian Federation», the Bank of Russia has placed in Vnesheconombank deposits totaling up to USD 50 bln for one year, and it is also foreseen to place the "National Welfare Fund's assets amounting to RUR 450 bln, in Vnesheconombank till the end of 2019. Herewith, there was taken the decision on contribution into the charter capital of Vnesheconombank in the amount of RUR 75 bln to implement measures to support financial market[80] .

In the future, the use of Vnesheconombank as a priority instrument to ensure sustainability of the Russian financial system and of the real sector, without doubt, will continue and, most likely, will be extended. Herewith, we believe, it would be rather difficult to ensure a reasonable combination of measures to overcome the financial crisis and the opportunity of long-term support for innovation and investment projects within one public corporation (there is a risk, that efforts will be concentrated in the first direction at the expense of t second one).

"ROSNANO" Public Corporation

Practical activity of the public corporations to support the development projects in nanotechnology started, in fact, 10 months after the date of its formal establishment. However, before that point, the public corporation has was carried out significant preparatory work: a large amount of documents was obtained, a number of departments were established, the

[78] Resolutions of the RF Government N 103, 104 dated of February 14, 2009.

[79] It should be noted, that in early February 2009 Vnesheconombank has suspended the applications for the companies' debt refinancing . Ref.:http://www.veb.ru/ru/about/press/news/index.php?id32=5036

[80] RF Government resolution N1665-p, dated November 19, 2008.

scope of activities has been investigated, etc. In May 2009, the strategy of the corporation until 2020 was approved[81].

During the first year of the public corporation operation, about 650 applications from more than 350 organizations for the amount exceeding RUR 400 bln were received, but only one of them was approved, at the end of May, 2008 the Supervisory Board has approved the first investment project for production of aspheric optical elements. However, afterwards, the process was accelerated and by early 2009, the corporation management took the decisions on seven projects refinancing in amount of about RUR 6 bln.

An important area in the public corporation activity is its participation in the infrastructure projects and programs. The public corporation is working to deploy, support and coordinate both, new and existing elements of nanotechnological infrastructure: it participated in co-financing of the development of material-technical base of the centers of collective usage, scientific and promotional centers, including engineering centers, as well as non-profit development institutions, such as technology parks, technology transfer centers, special economic zones and business incubators. Ten infrastructure projects have been submitted to the state coproration.

Currently, the corporation is developing the concept of infrastructure scientific and tehnological nano-centers development network for the support of business processes in different sectors of nanotechnological industry. Herewith, in late 2008, the «ROSNANO» management and the Moscow State University have agreed to establish a Center for Nanotechnology, on the basis of which research and experimental work will be carried out, as well as pilot production.

In December 2008, the «ROSNANO» Supervisory Board has approved a project in establishment the first private equity fund of venture investments. As a result of a tender among the Russian business schools, «SKOLKOVO», Moscow School of Management was selected as the «ROSNANO» corporate partner, which is going to attract to the mutual fund RUR 1 bln from co-investors. The total amount of the fund accounts to RUR 2 bln. «Troyka Dialog» will become the management company of the Fund.

The public corporation plans to launch several educational projects, aimed primarily at training and retraining the specialists needed to implement investment projects in the field of nanotechnology, which «ROSNANO» finances or is planning to finance[82]. There already have been received applications from several leading national universities for implementation of pilot projects, one of which was approved by the Supervisory Board at the end of September 2008. The project will be implemented jointly with the Moscow Institute of Steel and Alloys and with the Moscow Physical-Technical Institute. The project budget amounts to RUR 13.1 mln, whereas the share of «ROSNANO» makes RUR 11,2 mln.

The public corporation is making significant efforts to the development of communication system and to promotion of its activities, including the international level. In the preceding period, cooperation agreements are concluded with a number of federal authorities, regional administrations, Russian authorities(including the GC «Rosatom») and foreign companies, research centers (RRC «Kurchatov Institute»), Universities (Moscow State University), as well as the Russian Academy of Sciences. An important milestone in the activities of the corporation was the organization and carrying out a representative international forum

[81] The document was approved by the «ROSNANO» Supervisory Board on May 29, 2008.
[82] http://www.rosnano.ru/Publication.aspx?PublicationId=860

on nanotechnologies[83] in December 2008, which was attended by more than 7 thousand people.

In general, over the preceding period, the public corporation activity was basically associated with the preparation for the immediate implementation of functions to support the development of nanoindustry - the study and analysis of the situation in the markets, the development of strategy of its activities, selection of principles and procedures for projects support, partnerships formation, promotion of its activity, whereas the actual implementation of projects has been started nearly a year after the corporation establishment. In the future, with regard to the distinct provisions on the public corporation activity, procedures for pilot projects selection, one can be expect intensification and expansion of the corporation activity in the search and selection of the innovation projects in nanotechnologies [84].

Housing and Utility Reform Foundation

This public corporation started its practical activities on the resources provision about six months after its formal establishment. Nevertheless, in late 2007 - early 2008 a number of documents on practical activity of public corporation and its interaction with the regions was adopted.

The first application for financial support has been approved by the public corporation management in February 2008. However, by the end of July, the number of approved applications has reached 60. Simultaneously, efforts were taken for the development of regional authorities awareness on the procedures of interaction with the fund, its assets investment, etc. In addition, the public corporation started to carry out audits of the allocated funds utilization. Currently, such audits are performed regularly.

According the law on public corporation provisions and amendments[85], adopted in December 2008, until the end of 2009 the Fund was granted the right to provide financial support to the subjects of the Russian Federation from its assets of RUR 50 bln for resettlement of citizens from the shabby housing fund. Only 10 days later, the fund management has approved the first applications for the financial support from the the corporation funds for the resettlement of citizens from the shabby housing fund.

Currently, applications of approximately 80 subjects of the Russian Federation have been approved and financial support is provided. Moreover, to a number of regions several applications have been approved. In 2008, according to the Fund records, the corporation has transferred RUR 45.7 bln to the regional and municipal budgets in the framework of regional programs financing of apartment houses restructuring and resettlement of citizens from the worn-out housing fund. RUR 37,5 bln of this amount was addressed at capital renovation co-financing and nearly RUR 10 bln for co-financing of citizens resettlement from the worn-out housing facilities. The volume of regional co-financing of the relevant programs amounted to approximately RUR 27.5 bln[86].

[83] The high level of the event was confirmed by the fact that it was approved by the Order of the RF Government N 1169-p of August 12, 2008.

[84] It should be noted, that according to the public corporation management estimates, it will start to work «at full scope» in the middle of 2009, when there will be considered five-six projects per month with funding of about RUR 1 billion. http://www.rusnano.com/Rubric.aspx?RubricId=494.

[85] Federal Law N 225-FZ of December 1, 2008 «On Amendments to the Federal Law «On Housing and Utility Reform Foundation» and separate legislative acts of the Russian Federation».

[86] http://www.fondgkh.ru/news/27931.html

It should be also noted, that the public corporation has entered into agreements on cooperation with a number of federal authorities, which should support its activities.

In late 2008, the Housing and Utility Reform Foundation was to a certain extent involved in the implementation of anti-crisis measures: it has allocated on the deposits of 11 banks an amount of RUR 35 bln for six months under special condition to the banks to provide loans in the amount of at least 50 % of the deposits to the Russian companies, operating in the areas of housing construction, military industrial complex, agriculture, automobile production, agricultural production, aviation, electronics industry or metallurgy.

In our view, the procedures for the operation of the public corporation are effective enough, the foundation operates in the «regular» mode, participates in the anti-crisis measures, despite the considerable volume of funds, addressed for this purpose (about 7% of the capital, allocated by the government) can hardly significantly affect the fund performance of its core functions. Therefore, the risks, associated with further development of the corporation seem to be relatively low.

Public Corporation «Olympstroy»

Practical operation of this public corporation, in fact, has been started after the RF Government has approved the Program of construction of the Olympic objects and development of Sochi city as a mountain resort at the end of December 2007, when the amount of contribution from the Russian Federation budget to the public corporation was determined[87].

Currently the «Olympstroy» is actively implementing the construction program: plans the land allocation, transfers tenders, carries out procedures, related to the repurchase and acquisition of real estate and land areas, enters into contracts for construction objects, organizes public events, including public hearings.

Perhaps, the most notable events in the activities of the public corporation are still the replacement of its president[88] (urged, according to some experts, by the backlog in the construction of Olympic facilities schedule[89]), expansion of the Supervisory Board[90] of the corporation[91], as well as an increased property contribution from the Russian Federation in the corporation to finance the program of the construction of Olympic facilities and development of Sochi city as a mountain resort. It is remarkable, that such increase occurred twice with the intervals of less than two months: in early November 2008, by RUR 25.2 bln (or approximately by 16 %)[92] and in late December of the same year by at RUR 61.2 bln (34%)[93]. The latter case is interesting not only due to significant volume of additional resources, in both, absolute and relative terms, but also because of the diverse amendments, made to the financial plan: if in the period from 2008 to 2010 an extended financing is foreseen, in 2011 its decline

[87] Resolution of the RF Government N 991 of December 29, 2007 (as amended by the RF Government Resolution N 443 from June 11, 2008) «On the Program of construction of Olympic objects and development of Sochi city as a mountain resort».
[88] Decree of the RF Government N 509-p of April 17, 2008, V.V. Kolodyazhniy has been appointed the President o the public corporation.
[89] For example: D. Butrin, D. Rebrov, A. Sborov. «Olympstroy» lived to restructuring. – «Commersant» N66, April 18, 2008.
[90] RF Government Resolution N 1091-p, dated of July 30, 2008.
[91] RF Government Regulation N 807, dated of November 6, 2008.
[92] RF Government regulation N 807 of November 2008.
[93] RF Government regulation N 1086 of December 31,2008.

is planned. Herewith, according to the representatives of the Russian Government and of the corporation information, the extended financing of the Russian Federation to «Olympstroy» was planned, based on the transition from the stage of projects expert assessment to the construction process.

Public Corporation «Rostehnologies»

Development of the public corporation activities was largely based on the expansion and diversification of its property by various kinds of industrial assets:

- almost simultaneously with the creation of the public corporation, it was decided to transfer to it 100 % of shares of the OAO, created on the basis of FSUE «Rosoboronexport»[94];
- at the end of May 2008 it was also decided to transfer large packages in the shares of three public aircompanies for the OAO «Air union» establishment together with a group of outside investors[95];
- in early January 2009, the RF President has cancelled the earlier decision on the allocation of the transfered shares of air companies to the GC «Rostehnologies» in the charter capital of OAO «Air union», and also decided to transfer large blocks of shares of three more carriers[96];
- in July, 2008, a decision was taken to transfer to the corporation blocks of shares from 183 joint stock companies, established through FSUEs conversion, from 243 existing joint-stock companies, as well as 2 joint ventures with the RF share in the capital[97] (the majority of those enterprises and the societies represent the various sectors of defense industry. In addition, a number of organizations belong to the sphere of foreign economic activity, science, engineering, metallurgy, aviation, and non-productive sector as well)[98];
- in the middle January it was decided to transfer to GC "Rostecknologies" 18,83% of shares from OAO "AvtoVaz", which were in economic management of «Rosoboronexport» company[99] (the latter, however, continues to operate as FSUE, despite the decision on corporization, taken more than a year ago).

In February 2009, the transfer of industrial assets was continued already at the regional level; in accordance with cooperation agreement between the GC «Rostehnologies» and the Government of Tatarstan, the blocks of shares of 5 companies of the radio-electronic sector, owned by Tatarstan Republic, will be invested into the corporation[100].

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[94] RF President's Decree N1577 of November 26, 2007.

[95] RF President's Decree N853 of May 26, 2008. It should be noted, that the decision on OAO «AirUnion» incorporation was taken in the first part of 2007 by the RF President's Decree N570of April 28 2007.

[96] RF President's Decree N28 of January 2009.

[97] RF President's Decree N1052 of July 2008.

[98] It is remarkable, that the original list of companies, subject to be included in the corporation, contained about 250 names, then their number has been extended to about five hundred, but at the stage of interdepartmental coordination, a number of companies was excluded from the list, in particular, «Uralvagonzavod», the largest manufacturer of civil and military equipment. See, for example: E. Kiseleva, A. Gritskova. «Rostehnologies» get on the track. - «Kommersant» N 11, dated January 28, 2008; E. Kiseleva, R. Yanbayeva, A. Gritskova. Wagons are detached form «Rostehnologies» detach. - «Kommersant» N55, dated April 3, 2008; E. Kiseleva, A. Gritskova, K. Lantratov. Trillionth Technology - «Kommersant» N 70, dated of April 24, 2008.

[99] RF President Decree N53, dated of January 13, 2009. It is worth noting, that the document also provides for the exclusion of companies from the list of FSUEs, transferred into joint stock companies, 100% of the shares are subsequently to be transferred to the GC «Rostehnologies».

[100] http://www.rostechnologii.ru/upload/984/RT+tatarsnan%2010%2002%202009%201.pdf

It should be noted, that in addition to obtaining the granted industrial assets, the corporation also carried out purchase thereof: at the end of 2008, GC «Rostehnologies» has purchased 25,1 % of the WiMax Holding Ltd shares, the sole owner of WiMax-operator «Skartel»[101]. The deal was estimated at not less than USD 75 mln[102].

Along with the vast-scale growth in productive assets, this public corporation also had additional functions in regard to its subsidiaries, by, including the works in the framework of the government military program, the national defense order and mobilization plan, federal target programs and military-technical cooperation, as well as the restructuring of subsidiaries, establishment of integrated structures on their basis. Furthermore, additional powers have been provided to the supervisory board, among them:

approval of work programs and public corporation restructuring;

upon agreement with the RF Government, approval on the alienation of shares, owned by the public corporations and holding companies;

approval of effectivness indices of the public corporations management[103].

- In spring 2008, the «Rostehnologies» management has taken the initiative to provide to the public corporation an authority of the Administrator and the Recipient of budgetary funds, as well as of the State Contractor in respect of the national defense order and six Federal Targeted Programs; a draft project was submitted to the RF Government by the corporation[104]. However, this act was not adopted, primarily due to objections of the Federal Antimonopoly Service, as in this case the corporation would act as both, the business owner and the buyer of products at the state budget funds;
- At the end of October 2008, a group of the State Duma Deputies has introduced a bill, thay provides, in particular, «Rostehnologies» with the authority of the Administrator and the Recipient of budgetary funds (as well as the rights of ownership for FSUEs property to be included in the corporation ownership, until corporatization thereof)[105], which however, has not been approved even the first reading;
- In December 2008, the property complex SC «Rostehnologies» has been replenished with a significant amount of monetary assets in accordance with the introduced a month earlier amendments to the Budget Law, made by the RF Government, the decision made to extend the corporation fund by RUR 1,5 bln[106] as a financial contribution from the Russian Federation;
- In January 2009, the corporation has appealed to the Ministry of Economic Development of Russia for considerble volumes of financial support: RUR 262 bln, out of which RUR

[101] http://www.rostechnologii.ru/upload/742/Yota_RT.pdf
[102] See, for example: A. Malakhov. «Rostechnologies» have grown up. – «Kommersant» N204, dated of November 11, 2008.
[103] RF President Decree N1052, dated of July 10, 2008.
[104] Ref., for instance: E. Kiseleva, A. Gritskova, K. Lantratov. Trillionth technology. - «Kommersant» N70, dated of April 24, 2008.
[105] Draft Federal Law N118175-5 «On specifics of the transfer of property contribution from the Russian Federation Public Corporation «Rostehnologies» and on amendments to some legislative acts of the Russian Federation in view of the adoption of the Federal Law «On «Rostehnologies» Public corporation».
[106] RF Government Order N 1847-p, dated of December 8, 2008.

151 bln - in the form of monetary assets, RUR 111 bln - in the form of the national garanties[107].

The third key focus of the SC «Rostehnologies» activity in the preceding period (in addition to the accumulation of production and financial assets) has become the promotion of the included (or just going to be included) enterprises into the corporation, by attracting investors, entering into strategic partnerships, implementation of anti-crisis measures, and, in some cases, the formation of new businesses:

- At the end of 2007, the corporation has signed a Memorandum of Understanding with the companies Troika Capital Partners and Renault[108] and in February 2008 it has entered into agreements, in which in addition to the above-mentioned companies, the partners were FSUE «Rosoboronexport», OAO «AvtoVAZ» and «Troika Dialog» Group of companies. Those documents were focused on the strategic partnership between Renault and AvtoVAZ, which assumed the acquisition by the Renault group of 25% in the «AvtoVAZ» shares from «Troyka Dialog». In October 2008, SC «Rostehnologies», «Troyka Dialog»Group of companies, Renault and OAO «AvtoVAZ» companies have signed a shareholders' agreement, aimed at harmonizing the actions of the parties in decision-making process[109];
- At the end of June 2008, the public corporation has informed on intention to create a holding to produce automotive parts together with «AvtoVAZ» and «Troyka Dialog»[110];
- In August 2008, Pirelli Group and the SC «Rostehnologies», with the support of the Government of Samara Region have signed an agreement, under which there will be established a joint venture to produce automobile tires[111]. The total investment in the project should reach EURO 300 mln[112];
- In December 2008, German automobile concern Daimler AG, OAO «KAMAZ», SC «Rostehnologies» and «Three Dialogue» group of companies have signed an agreement, defining the terms of an exclusive strategic partnership and principals of cooperation, under which Daimler AG acquires from «Troyka Dialog» Group of Companies 10% of «KAMAZ» shares in the amount of USD 250 mln[113];
- in July 2008, SC «Rostehnologies» and «Metalloinvest» holding have signed an agreement to establish a joint venture for the development of the world's largest deposits of copper in Udokansk[114]. The share of public corporation in the enterprise should make at least 25 %. Currently, the SC «Rostehnologies» and «Metalloinvest» holding consider an opportunity of incorporation their metallurgy assets[115];

[107] E. Kiseleva. «Rostechnologies» have rejected the national budget assets. – «Kommersant» N25, dated of February 12, 2009.
[108] http://www.gzt.ru/auto/2007/12/08/205926.html
[109] http://www.lada-auto.ru/cgi-bin/pr.pl?id=0&id_article=40267&prev=1
[110] http://www.rostechnologii.ru/upload/57/pr_015.pdf
[111] http://www.rosbalt.ru/2008/08/05/510397.html
[112] http://www.interfax.ru/business/news.asp?id=44017
[113] Herewith, in case of positive results of financial and economic performance of OAO «KAMAZ» in 2012, Daimler AG will have to pay another USD 50 million http://www.rosbalt.ru/2008/12/12/602667.html
[114] http://www.rosbalt.ru/2008/07/18/505433.html According to the Agreement terms, the joint venture will be established in case SC Mikhailovsk (Metalloinvest member company) winns the tender for the development of Udokansk deposit. In September 2008 the enterprise was declared the winner of the tender.
[115] http://www.mc.ru/page.asp/news/nw/news_id/2145

- in September 2008, in response to the crisis, in which has got OAO «AirUnion» happenned to be, the SC «Rostehnologies» has provided the to the avia alliance the financial guarantee, amounting to USD 100 mln[116]. Around that time, the public corporation in cooperation with the authorities of Moscow and Krasnoyarsk Region, in agreement with the RF Government, made the decision to create a new consolidated aircompany «Airlines of Russia» on the basis of OAO «AirUnion», as well as a number of "Rostechnologies". Herewith, the control stock of the «Russian Airlines» shares will belong to «Rostehnologies»[117];
- In November 2008, SC «Rostehnologies» and Italian group Finmeccanica have signed an agreement on common activities on establishment of a number of enterprises in the production of components out of composite materials (carbon fiber)[118];
- In December 2008, the public corporation has started to establish a holding company in the optical industry, OAO «NPC «Optical Systems and Technologies», which will consolidate 20 companies[119];

Therefore, up to the current date, there are two interrelated trends in the public corporation activities: the expansion of assets, extension of their functions, powers and implementation of measures on formation of production holdings, strategic alliances and creation of new businesses. There is a high degree of uncertainty in the scope and trends of further expansion of this public corporation.

Public corporation «Rosatom»

The public corporation was designed to replace the state authority, the Federal Agency for Atomic Energy, that is why the starting point for its activity as an independent entity should be considered the abolishing of the agency and transfer its functions to the public corporation. The decision was taken on March 2008, nearly 4 months after the formal establishment of the corporation[120].

An important objective of its activity, along with the implementation of the state authority functions, is the management of state property. The decision to transfer to the corporation the first «tranche» of the national assets was made in early February 2008[121], even before the relevant federal agency liquidation. Then, simultaneously with the agency liquidation, it was decided to transfer to the public corporation the shares of 5 joint stock companies, as well as the right to perform powers of ownership for a hundred of of FSUEs on behalf of the Russian Federation.

[116] http://www.rian.ru/economy/20080905/150997652.html
[117] Herewith, it is planned that in the long run, the GC «Rostehnologies» will retain only the blocking minority, and the remaining shares will be sold at the market. http://www.ma-journal.ru/news/57297/
[118] http://www.akm.ru/rus/news/2008/november/06/ns_2520270.htm
[119] http://www.mashportal.ru/company_news-13826.aspx
[120] RF President's Decree N 369, dated of March 20, 2008 «On measures on creation of the Public Corporation in Atomic Energy «Rosatom».
[121] In accordance with the law «On the Public Corporation on Atomic Energy «Rosatom», the Order of the RF Government N 116, dated February 5, 2008, has stipulated 100 % transfer of OAO «Atomic power industry complex» to the Public Corporation.

An important step in the development of the public corporation was the adoption of its long-term (2009-2015)[122] program of activities in September 2008. The significance of this program is based on the fact that, along with the overall objectives, the public corporation defines also a precise list of measures to be implemented and the scope of budget financing of each of them.

In fact, the corporation is not so much an economic entity, as a government authority. As the scope of the corporate profile, its long-term objectives and targets seem clear, in our assessment, there are good prospects for its development.

Plans to create new public corporations

The intensity of different corporations formation in 2007 has assured various power authorities, that this trend of national policy could be significantly expanded[123]. Due to such understanding, plentity of proposals for the creation of new corporations have been developed, which provoked strengthening of relevant lobbying. Thus, at the end of 2007, the Ministry of Transport has presented an initiative on the establishment an «Autodor» public corporation to carry out the functions of the global federal road network operator (repair and maintenance of roads of federal importance, as well as investors' attraction to build new commercial highways)[124]. Around the same time, "Rosrybolovstvo" management has informed on the plans to establish «Rosrybflot» public corporation and transfer 27 fishing vessels in its ownership[125]. In 2008, an idea was considered on the possibility of establishing a public corporation for the transfer of unused government land for housing construction[126]. The mass media has also reported on proposals to form public corporations for medicines procurement, export of grain, insurance services rendering, etc.

By mid-2008, the flow of initiatives to establish new public corporations was virtually exhausted. Most of the previously proposed projects and initiatives have been rejected and it was decided to establish some of the structures in a different organizational and legal form («Rosrybflot» and «Rosavtodor» in the form of open joint stock company, the Federal Fund for Housing Development in the form of the Foundation 45).

Nevertheless, in September 2008, the RF Ministry of Finance has proposed to establish a public corporation «the Russian Financial Agency» for the Fund of National Welfare[127] management. It was expected, that the Ministry would submit the relevant bill to the RF Government in October 2008. According to the proposed document, a share of the Fund will be managed by special companies, selected by public corporation, while the balance of funds will be invested in government securities under the supervision of the RF Central Bank[128]. However, till the end of 2008, the draft law has not been submitted to the Russian government.

For the purpose of the allocated funds management, in the early years of its activities, the corporation should attract professional managers, both, domestic and possibly foreign

[122] RF Government Regulation N 705, dated September 20, 2008 «On the long-term program of Public Corporation on Atomic Energy "Rosatom" (2009–2015)»
[123] http://www.newsru.com/finance/26sep2007/fisch.html
[124] http://www.newsru.com/finance/26sep2007/fisch.html
[125] E. Kiseleva, A. Ekimovskiy. Mintrans is on the big rode. – «Kommersant» №176, September 27, 2007.
[126] E. Kiseleva, A. Ekimovskiy. Mintrans is on the big rode. – «Kommersant» №176, September 27, 2007.
[127] It is worth noting, that earlier that Ministry restrained form the initiatives on the public corporations establishment.
[128] http://www.minfin.ru/ru/official/index.php?id4=6545

ones. Later, it is expected, that the corporation will be able to invest the assets independently in accordance with the approved national investment policy.

According to the representative of Russian Ministry of Finance, establishlent of public corporation is the best way to invest funds in the effective management, while maintaining public control over the investments. At the same time, the experts' assesments of that initiative are ambiguous. Some of them believe, that the formation of a new financial corporation will allow to delegate to it excessive functions of the Central Bank and Vneshekonombank, while other experts consider this as a premature measure, at least during the crisis[129].

As a result of the above analysis of major trends and characteristics in the formation and development of public corporations, one can note the following:

1. In the majority of cases, the practical operation of public corporations on the specific objectives, set forth for them, was started with a backlog (from a few months to a year), as before that, the process of development and coordination of various documets, regulating their activities and other necessary arrangements had to be made. However, to date, one can say, that all of the corporations have passed through the initiate stage and proceeded directly to their key activities.

2. The desire to expand assets (financial or industrial) and additional powers is evident in the actions of some corporations, that could result in negative consequences, such as the state intervention in the economy, deterioration of business environment, especially in the situation of insufficiently clear regulation of corporations, their objectives and functions.

3. As the financial crisis is aggravating, some of the public corporations get more actively involved in implementing of various kinds of anti-crisis measures, for example, for Vnesheconombank this trend actually has become a priority. Herewith, the extensive involvement of public corporations as anti-crisis instruments can not fail to provide an adverse affect on the efficient implementation of their major functions.

4. In late 2007 - early 2008 among some executive and the legislative authorities there was certain «euphoria» in regard to public corporations and their potential capacity to resolve serious problems of socio-economic development, which urged a large number of proposals to create such structures. By mid-2008, the threat of continuing extensive establishment of public corporations and expansion of the process to the regional level got restrained. However, the financial crisis has re-awakened the interest of the power authorities to this instrument of government policy.

5.3.2. The development of corporate management in the established public corporations

With regard to the status of public corporations, it is very important to estimate the quality of corporate management. In this regard, we will try to assess the major developments in the formation of corporate management in public corporations and the level of progress in various trends.

[129] Ref: N. Ivanitsky, E. Pismennaya, D. Zhelobanov. Chief Manager of trillions. - «Vedomosti» N 3, dated January 13, 2009; T. Afanasieva. Powers of the Ministry of Finance and Central Bank will be reduced. - «Rossiyskaya Gazeta» N 4826, dated January 14, 2009.

Strategy

The availability of targeted strategies and publicity thereof seem to be a necessary foundation for building an efficient system of corporate management in public corporations, objective assessment of their performance, management motivation system development and restriction of conceals lobbying of various authorities and political elites. Herewith, the progress in this trend seems inadequate.

The laws on the public corporations establishment (except for «Rosatom» and «Olympstroy»[130]) do not define the need to develop and adopt any strategies (long-term programmes) for their activities and moreover, there are no legal regulations, defining the requirements to such strategies, their development and discussion, as well as the updating thereof.

Currently the strategies are defined for two public corporations, Vnesheconombank and «ROSNANO»[131]. Moreover, long-term programs of activities are developed for «Olympstroy» and «Rosatom» public corporations. Herewiith, it is worth noting, that with the exception of «Olympstroy», those documents were accepted with a significant (nearly a year) delay from the point of corporations establishment.

Therefore, up to now, there are no strategies for Housing and Utility Reform Foundation and «Rostehnologies» public corporations. Tere is no problem in regard to the Foundation, as its activities are operational and are regulated in detail by the law. As to «Rostehnologies» public corporation, in view of the large-scale and diversified activities, its active participation in the restructuring of various sectors of the economy, including the civil ones, the lack of the activities strategy decreases the predictability in a number of the economy sectors and consequently, increases the risks to the investors.

In regard to Vnesheconombank and «ROSNANO» strategies, it should be noted, that there are no «milestones» set up to them for the short and medium-term, and the current policy effect is estimated in the long run. This is significantly limiting the to possibility to assess the results of the ongoing activities of the corporations and management quality in terms of incentives and effectiveness.

Stakeholders participation in the Supervisory Boards

The advanced system of stakeholders and their subgroups participation in the Supervisory Boards is an essential provision to ensure an unbiased assessment of their performance, balanced representation of public interests in the public corporations activities, reduce the risks of subjectivism, prevent from lobbying the interests of certain groups and voluntarism in the decisions. Relatively broad representation of various stakeholder groups interests is ensured in such public corporations as the Housing and Utility Reform Foundation, «ROS-

[130] There is no provision on strategy development in the Federal law «On the Public Corporation on Atomic Energy «Rosatom», but there is Chapter 4 «The long-term program of the corporation activities and its financial support». There is also no direct provision for strategy development in the Federal Law «On the Public Corporation for the construction of Olympic facilities and Sochi city development as a mountain resort», but herewith, it is defined that the activities of the corporation shall be performed in accordance with the Construction Program, approved by the RF Government (Article 3).

[131] Vnesheconombank development strategy for 2008-2012 is approved by the Corporation Supervisory Board on April 3, 2008. «ROSNANO» strategy to 2020 was approved by the corporation Supervisory Board on May 29, 2008.

NANO», «Olympstroy»: their Supervisory Boards structure is more extended as compared with other public corporations[132], whereas the participation of various power branches to be included in their Supervisory Boards is well defined[133]. As a result, about one-third of the members of the Supervisory Boards of the above mentioned public corporations are not the representatives of federal authorities, which make for the broader representation of stakeholders' interests.

The distribution of authorityies and responsibilities between management and supervisory boards

The principal problem is the following : in the laws on public corporations establishement, there are provisions for their management authority, but neither the spheres, nor the forms of the responsibility of various structural management members for the decisions and performance results are stipulated neither in regard to the state, no to the corporations.

It is foreseen in the laws on corporations, who can take the decision on early termination of the powers of the Supervisory Board members Chairman and their executive bodies, but there is no definition, even in the most general terms, of the «motivation» for making such decisions, requirements to appointments, early termination of powers. This provokes uncertainty in the allocation of responsibility for poor performance of corporations, as well as external motivation for public corporations management[134]. In this regard, we would like to note, that by October 2008, there were top management replacements in two public corporations, «Olympstroy» and «ROSNANO»[135]. Herewith, in none of those cases, such decisions were not officially and publicly reasoned and were not aligned with any purpose (such as, for example, conflict of interests, the completion of start-up phase in the corporation, ineffective management, etc.) The laws on public corporations envisage «traditional» distribution of powers between management and supervisory boards: the Supervisory Board sets the priorities, principles, activities of corporations, approves major transactions, hears the Corporate Leader reports on performance, while the executive authority ensures practical implementation of the activities of the corporation actions in the framework of the preset rules, goals and objectives. At the same time, in the majority of public corporations (except for the Housing and Utility Reform Foundation and GC «Olympstroy») the positions of the leaders, appointed by the President of the Russian Federation have gained «stronger» positions. In general, that factor could be regarded as a tool for higher personal responsibility for the results of the cor-

[132] The greatest number of the Supervisory Board members, who are not the staff members in the public corporation, is found in the Housing Reform Foundation, «Olympstroy» and «ROSNANO», namely, 16, 15 and 14, respectively, whereas the supervisory boards of other public corporations are far les extensive: there are only eight members in the supervisory boards of «Rostehnologeis» , «Rosatom», «Vnesheconombank».

[133] Thus, the Supervisory Board of the GC «ROSNANO» is formed on the basis of «quota» allocated by the President, Federal Assembly, or Government. Similar principle is applied in regard to the Supervisory Board of the Housing Reform Foundation, which is formed under the applications of the President, Federal Assembly, the Government, the Public Chamber.

[134] By the Decree of the RF Government № 509-p, dated of April 17, 2008, V.V. Kolodyazhniy has been appointed the «Olympstroy» President. By the RF President N 1401, dated of September 22, 2008, A.B. Chubays has been appointed the "ROSNANO" Corporation General Director.

[135] By the Decree of the RF Government N509-p, dated of April 17, 2008, V.V. Kolodyazhniy was appointed the President of «Olimpstroy» public corporation, by the President's Decree N 1401, dated September 22, 2008, A.B. Chubays was appointed the General Director of «Rosnano» public corporation.

porations' performance, but in the absence of legible system the corporation's management assessment, that is a problem, rather than an advantage. In such public corporations as Vnesheconombank and «ROSNANO», the Supervisory Board should approve of projects, which are supported by these public corporations (although such approval is not foreseen by the laws on their establishment). As a result, the Supervisory Boards take the responsibility not only for the regulations development and monitoring, but for management decisions in the framework of these rules as well.

For the consistent implementation of the strategic lines of the public corporations development and strengthening of the Supervisory Board members accountability for the company performance, it is important to appoint the members of the Supervisory Board for a sufficiently long term (herewith, of course, the terms for the early termination of their powers should be explicit) and to decrease the dependence of the Supervisory Board structure on the political environment and changes in the federal government. This approach is particularly important in regard to the public corporations, implementing large projects within the preset deadlines (Housing and Utility Reform Foundation - in 2012, «Olympstroy» - in 2014).

Actually, there are some relevant provisions in the laws on the establishment of public corporations: it is specified, that the members of «ROSNANO» Supervisory Board should be appointed by the RF Government for the term not exceeding 4 years, those of «Rostehnologies» are appointed by the RF President for the term not exceeding 5 years, of Vnesheconombank – by the RF Government for the term of 5 years, of the Housing and Utility Reform Foundation – they are appointed by the RF Government for the term of the Fund activities (i.e., before January 1, 2012)[136]. Furthermore, in accordance with the Law on the Bank for Development, the Vnesheconombank Supervisory Board member retirement from the civil service does not provide grounds for termination of his membership in the supervisory board[137]. In our view, this approach is positive, since it strengthens the value of personal characteristics for the appointment to the Supervisory Board as compared with the official position. This approach extension to all public institutions of development could contribute to the «evolution» of independent Directors.

Regulation of public corporations activities

The major barrier in the full-scale implementation of public corporations capacity is the incomplete definition of their activity principles and decision-making procedures. It should be noted, that only the law on «Rosatom» public corporation establishment there are provisions on the mandatory regulation of its activity[138].

One of the potential benefits of all public corporations is a significantly greater flexibility in funds management and a wider range in budget spending as compared with other instruments of public policy. However, to reduce the risk of abuse and (or) the risk of irrational use of resources, these additional capacity should be «balanced» by transparent and suffi-

[136] Herewith, it seems rather strange that, in respect to the Supervisory Board of the GC «Olympstroy» there is this kind of requirement in rehard to the Olympics schedule

[137] Part 6, Art. Of the federal law (On the Bank for Development"

[138] Article 33 «Regulations of the Corporation» of the federal law on «Rosatom» nuclear power public corporation provides a list of the mandatory sections of the regulations(there is in particular, a section on the interaction of the corporation with the government authorities) and the requirement for the approval of the of the corporation regulations by the RF Government.

ciently detailed regulations, procedures for decision-making and performance assessment. This is particularly relevant in view of the facts that, on the one hand, there are internal functional inconsistencies in some corporations (for instance, between the non-profit nature of the corporation and commercial activities of the joint stock companies, managed by the corporation). On the other hand, in view of the extensive resources with their uncertain position in the implementation of public policy, relations with public authorities, the ambiguity of development strategies, many corporations are affected by some interested parties.

A major focus of regulatory activity in public corporations is a clear definition of principles and procedures for their interaction with the government authorities. This is particularly important in regard to financial institutions of development, which should for the successful operation have a certain level of «autonomy» from the Government in making immediate decisions in conformity with the long-term priorities of their activities. There is an expressed prohibition to the public authorities in the laws on public corporations establishment(except for Housing and Utility Reform Foundation) to interfere in the activities of public corporations (except for the cases, stipulated in federal laws). At the same time, provisons on the relations between public authorities and corporations, are rather general and are usually limited to the definition of the powers of the President and the Government in the appointment of the corporations' management, members of the supervisory board. Only in some cases, such authority is related to the definition of strategic objectives, principles and programs of their activities[139]. The need of regulation the interrelations with public authorities is mentioned only in the law on «Rosatom»[140] establishment.

Transparency of the results and principles of activities

Transparency of both, the corporations performance, and the basic principles, procedure (criteria), decision-making process (especially for public corporations, acting as financial institutions for development) are the most important task of corporate management improvement. A notable progress is observed in improving the transparency of the public corporations: their official web-sites provide sufficiently detailed information on their objectives and trends, management bodies, their powers and structure, major developments in the public corporations and the most important decisions, in many cases - informative reports on their performance results (Vnesheconombank looks better than others in this respect).

Considering the legislative requirements to the activities of public corporations, it can be noted, that the requirements to the performance transparency are defined far better than those to the transparency principles and regulations of operation thereof.

All the laws on the public corporations establishment stipulate the standards for the disclosure of their reporting, fixed assets structure, included in the annual report, their performance results to be presented in their official web-sites. At the same time, if there are legal provisions for the annual report disclosure for such public corporations as Vnesheconombank, the Housing and Utility Reform Foundation, «Olympstroy», «Rostehnologies»[141] , in the case of «ROSNANO» corporation only aggregate data of annual report is presented, whereas the pro-

[139] Vnesheconombank – the government approves the Memorandum on financial policy, Rosatom - the government approves the long-term program for the corporation development.
[140] As one of the mandatory sections of the corporation regulations, the procedure of its interaction with public authorities is outlined.
[141] For GC "Rostechnologies", the requirements to national security information.

cedure of the annual report of «Rosatom» disclosure, including the information scope to be disclosed, should be established by the Supervisory Board.

For individual public corporations (Housing and Utility Reform Foundation, «Olympstroy», «ROSNANO») there are legislatively defined responsibilities for the regular monitoring of supported projects (programs) in the relevant reports. This is particularly important to assess the efficiency of those public corporations, which implement large complex long-term projects or act as financial institutions for development. In this context, there is a significant gap, i.e., the absence of legislative requirements for monitoring of projects with regard to Vnesheconombank. It should also be noted, that if the annual reports of the Housing and Utility Reform Foundation and «Olympstroy» public corporations have to be monitored (and hence, those results are subject to mandatory publication), there are still no requirements to the report on the projects monitoring in respect to «ROSNANO» public corporation. Moreover, the report of the monitoring results is presented to the RF President[142]. As to the transparency of principles of the public corporations' activities and the decision-making process, one can note, that despite the very limited legal requirements to the disclosure of the decision-making procedure, the corporation themselves are quite active in this regard. To a certain extent, the leader here is «ROSNANO», which has placed on its site practically all basic documents, regulating the activities of the corporation and the decision-making process[143]. The principles of decision-making in the «Olympstroy» (with an overall high level of internal regulation of the corporation)[144] and «Rostehnologies» remain still non-transparent.

According to the results of the analysis, the development of corporate management in public corporations, one can note the following:

1. A notable progress is observed in the development of public corporations corporate management, especially in terms of transparency of their activities, but in general, the system of corporate management became not only the major barrier is their capacity implementation and the decisions on the long-term objectives, but also a source of additional risks and problems.
2. Problems of corporate management in public corporations are largely dependant on the overall disadvantages in the representation of public interests, and in many ways are similar to corporate management problems in large shareholding companies, 100% shares of which are state-owned.
3. There is a significant potential for improvement corporate management in public corporations as through the extension («transfer») of certain provisions of the laws of their estab-

[142] Part.5, Art. 7 of the federal law «On the Russian Nanotechnologies Public Corporation».

[143] It should be noted that as of March 1, 2008, many of the regulatory documents of the GC «Rosnano» were not available for public access, whereas as on October 1, 2008 the situation has improved: the following documents heave been presented at the company web-site: business strategy, the concept of corporate involvement in the improvement of legislation; provisions on the Supervisory Board; on the Science and Technology Council, on the Management Board, on the Audit Committee, the requirements to the structure and content of projects in the field of nanotechnology, the procedure and conditions for R & D projects financingthe field of nanotechnology, the concept of the projects' expertise; qualification requirements to the experts, consolidated data of annual report.

[144] The «Olympstroy» Supervisory Board has approved by a wide range of regulatory documents on the corporation activity : Regulations on the Supervisory Board activity, Management Policy, Checkup Committee, Audit, the selection of appraisers procedure, investors, works and services contractors, decision-making on entering into transactions of acquisition (disposition) of property, etc., but these documents are not displayed on the official website of the corporation.

lishment, as by filling in the «regulatory gaps» by means of additional documents, developed at the level of public corporations, governing their current activity and development (strategy, selection of projects/contractors, etc.), ensuring transparency of such documents. These initiatives can not be standard, but have to be tailored to the individual public corporation.

5.3.3. Major trends in the changing of roles and positions of public corporations

The existing public corporations significantly differ in their purpose and objectives, the structure property, invested by the Russian Federation, their administrative status and interaction with public authorities, specifics of corporate management, the level of legislative regulation of their activities (see *Table 9*).

Table 9

Individual Parameters of Public Corporations,, Established in 2007

	Vnesheconombznk	ROSNANO	Housing and Utility Reform Foundation	Olympstroy	Rostechnologies	Rosatom
Filling in the "gaps" investments and innovations investments	+	+				
Upgrading of public functions performance			+	+		
Restructuring of national production facilities, integration structures establishment					+	+
Significant productive assets in the RF property contribution					+	+
Delegation of authorities and right from public management authorities					+	+
Corporations financing in the framework of a targeted long-term program				+		+
Wide stakeholders' representation in Supervisory Board		+	+	+		
High administration level of the Corporation Head	+	+			+	+
Transparency of performance and decision-making process		+	+			
Ability to apply earlier experience (skills)	+				+	+
Clear and accurate portioning of the Corporation	+	+	+	+		+
Detailed presentation of objectives and purpose of activities in terms of law			+			
Validity term definition			+			

As a basis for the public corporations classification, we will define, if there are or there are no signs of: (1) the rights and functions of government management, (2) significant production assets. In this case, the following *major categories (models) of public corporations*[145] *(See Fig. 1):*

1. Financial Institutions of Development (Vnesheconombank, «ROSNANO»);

[145] For more details about the proposed classification of public corporations, see: Yu Simachev, M. Kuzyk - decree. cit., and Yu Simachev, M. Kuzyk. The establishment and development of public corporations: Institutional challenges and new opportunities. Articles collection «Public sector reformation: Issues of the Iincreased Efficiency» / Ed. T.M. Sklyar and I.N. Baranova. S. - Petersburg State University PH., 2009.

2. Government agents, the operators, implementing certain functions of public authorities (the Foundation for the reform of housing and communal services, the «Olympstroy»);
3. Quasi-holdings («Rostehnologies»);
4. Quasi-ministries («Rosatom»).

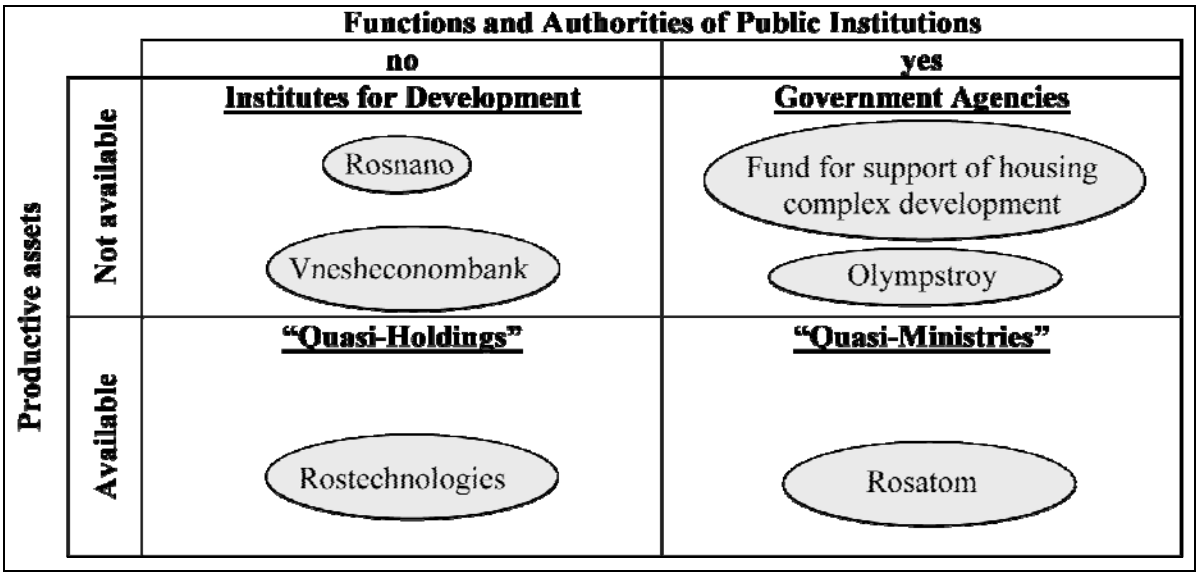

Fig. 1. Typology of public corporations, established in 2007

Let us consider the fundamental trends of the created *corporations "drift" and the role thereof*: the likely trends of their transformation within the proposed classification, changes in their position and role.

For the Institutions for development, a substantial likelihood of drift from the long-term strategy to the execution of current orders is observed. Herewith, in while the instrument of development is tarheted at the support of major projects, the risk of political lobbying in the choice of such projects is increasing. Public authorities are increasingly regarding the Institute of Development as a source of additional resources for the implementation of anti-crisis measures, financing the ongoing projects and programs, funded from the federal budget. On its own part, the Institute for Development, in an effort to reduce political risks and to relocate responsibility, can increasingly focus on the support to the projects of large companies with the state involvement and pay less attention to the search for the projects of private business and the support projects for small and medium businesses. In this context, multiplication of project risks and replacement of the real public-private partnership by consolidation at the project level of the institutes for developmenet and budgetary resources consolidation is expectable.

In our view, there are expressed indicators of such a drift of Vnesheconombank, which is now increasingly used as an instrument of «rapid reaction» for solving the current problems

of national policy issues. The likelihood of such developments in relation to the «ROSNANO» seems reduced due to the focus of its activities on the development of the new sectors of the economy (as a consequence of the lack of large «players»), is focused on the small and medium-scale projects, related to the venture and direct investments.

For the Government agents, which are tightly tied to a particular period, can seek a chance to «unify» their activities, to find new challenges in order to justify the indefinite the term (or extend a specified term) of their activities. It is more likely n regard to «Olympstroy» and to a lesser extent - to the Housing and Utility Reform Foundation, for which the law has established the validity term of activities. In addition, in the case of «Olympstroy», because of the need to meet the deadlines for completion of the construction of Olympic facilities, as well as due to approximate estimates of necessary resources, it is likely to strengthen further attempts to obtain additional public monetary resources[146].

For the «quasi-holdings», the main trend in terms of their assets, rights and powers, i.e., the strengthening of their positions as the subjects their establishment and public policy implementation. In case of insufficiency (abcense) the initial investments, public corporations of the given group can seek for strengthening their role in the budgetary resources, for example, within the Federal Program or the Federal Defense Order Fund. In the absence of a clear sectoral (framework) boundaries, they are likely to focus on obtaining additional assets from the state.

The signs of such changes are clearly tracked in the «Rostehnologies» activity. The public corporation is largely focused on expanding its production and financial assets extension (usually at the expense of the state). In addition, the corporation is increasingly positioned as a kind of «anty-crisis center» on solving the problems of development of individual sub-sectors (automotive, air transportation, etc.), based on the use of direct and indirect rights on the companies management, while increasing «conglomeration» of its structure.

Finally, for the *quasi-ministries*, due to the specifics of this group, is straight focused on the implementation of clearly outlined public functions, the possibility of the drift seems limited, and the chances thereof are rather low.

* * *

Reviewing the overall development of the established public corporations, trends in changing of their roles and positions, problems and prospects for improving corporate management, one can summarise, that ther is *the opening opportunities/threats, related to the public corporations development*.

As *«opening opportunities»*, we have identified:

(1) formation of new agents in the development and implementation of economic policy, particularly in relation to the development of new sectors of the economy; creation of the «sites» for consolidation of the new power elites, interested in diversification and innovation; personification of responsibility;

[146] It is worth reminding, that in 2008 the growth of the Russian Federation investment in the corporation was doubled.

(2) implementation of activities, focused on the long-term prospective due to autonomy, independence from political trends, available «stock» of funds; implementation of targeted approach with flexibility of resource utilization;

(3) development of the new instruments to urge economic development, public-private partnerships formation (not only in projects implementation, but also in priorities), restructuring of the public sector; improvement of selected areas of administrative system.

In our view, the most significant threats (in terms of sustainable long-term economic development) are:

(1) decline in performance (in terms of the long-term prospective) and effectiveness of public corporations due to poor representation of the interests of «stakeholders», risks of the «shadow» lobbying of the interests of different parties, enhancing situational decision-making, «blurred» responsibilities between the government and public corporations management and supervisory bodies thereof, the lack of motivation among representatives of government authorities in principle improvement of public corporations management;

(2) irrational expansion of financial and property obligations of the State to ensure the activities of public corporations due to ambiguity of the public corporations strategic position;

(3) overall enhancement of consolidation of resources to support the development of the largest businesses (primarily public sector), extension of counteraction between public corporations;

(4) strengthening of direct government involvement in the economy and rationality reduction as a result of the expansion of the existing public corporations beyond the «market gaps» and due to the potential creation of the new public corporations;

(5) deterioration in the business environment due to the lack of predictability of public corporations performance, risks of fair competition violation, abuses in rights and powers;

(6) «slowdown» in the development of the institutional environment, lack of (reduced) activity of public authorities in improvement the indirect instruments of stimulation socio-economic development.

In that period before the financial crisis public corporations, in general, significantly improved the quality of corporate management, strategic planning, enhanced transparency in principles and results of performance, the development of practical work in accordance with the preset tasks, although there were some signs of a «drift» to the execution of the agents' functions of the institutions for development and «kvazi-holdings». Within this period, the probability of creating new public corporations has significantly decreased.

In the face of the aggravating economic crisis, the demand of the state for public corporations' agency functions in implementation of anti-crisis measures has essentially increased, while their functions as institutions of development has retreated to the second place. Extension of the agency functions of public corporations, combined with a reduction of system functioning and transparency of their activities, has reduced the scope of the «stakeholders», who actually have an impact on the decision-making processes. During this period, the sources for the creation of new public corporations within the models of «agents of the Government», and possibly, «kvaziholdings» have significantly increased.

5.4. Corporate Conflicts

The problem of corporate conflicts in Russia has presently persisted as a pressing one. By mid-2007, there were 107 public corporate conflicts unfolding in the country, with the to-

tal value of disputed assets accounting for some USD 7bn.[147] Some experts[148] believe that the list of leading sectors in this regard comprises the food-processing industry, agriculture, machine engineering and the fuel and energy complex (which holds a leading place by volume of disputed assets worth over USD 2bn), while other analysts refer to the fuel and energy complex, the wood-working industry, telecom and machine-engineering sector[149]. Region-wise, by the number of corporate conflicts the garland, as before, should be given to the Central Federal Okrug, followed by Volga and Ural ones[150]. As evidenced by the period between 1994 and 2005, the most disruptive conflicts in Russian joint-stock companies arise between large shareholders striving to change the structure of corporate control therein[151]. The year of 2008 saw corporate conflicts occur in such huge corporations as OSAO Ingosstrakh, Norilsk Nickel mining company, TNK-BP, Vympelcom[152].

Typical reasons behind conflicts of interests between different groups of stockholders are[153]:

- rush to a high current rate of return on stock and their liquidity, and a short-term rise in the company's value;
- focus on the interest in a long-term surge of value of the stock, spending resources on the company's development to the detriment of current benefits;
- trend to boosting up revenues of one or a few companies in a group (holding) at the expense of redistribution of current costs and the tax burden between affiliated companies (which may result in an underdeclaration of earnings, rise of artificial losses, etc. in other companies of the group (holding));
- rush to a greater profitability of the group of companies, which determines reallocation of resources between companies, changes in their market shares, which results in an overdeclaration of some companies' earnings and market value at the expense of the other ones (at this point, one may resort to transfer pricing, decrease of the tax base, etc.);
- interest in an artificial scaling back on a company's level of output, earnings and production capital to suppress competition on the market, maximizing the affiliated companies' market value and niche on the market;
- interest in an artificial decrease of a company's market value (for the sake of stakebuilding, loosening the tax burden pertaining to a shareholder or their group, resisting attempts to take over the company, etc.);

[147] The data of "Sliyania i pogloschenia" journal. Taken into account were only the public conflicts under which the value of the respective enterprises was in excess of USD 5m and the disputed matter was the right for the operative control over a company/property complex.
[148] See in a greater detail: "Reydery menyaut orientatsiyu"///www.ma-journal.ru
[149] "Expert", №15, 16.04.2007
[150] "Reydery menyaut orientatsiyu"///www.ma-journal.ru
[151] P. 2.1.2.2. "Metodiki otsenki uscherba, nanesennogo protivopravnymi deystviyami na finansovyk i fondovykh rynkakh" ("Methodologiy of appraisal of damage caused by illegal actions on financial and stock markets"), approved by Executive Order of the Moscow city government of 08.09.06 №1766-RP "O systematizatsii mer po presecheniyu protivopranykh deystviy na finansovykh i fondovykh rynkakh".
[152] "Antireydersky paket zakonoproektov".- "Kommersant", 01.12.08
[153] See: P. 2.1.2.2. "Metodiki otsenki uscherba, nanesennogo protivopravnymi deystviyami na finansovyk i fondovykh rynkakh" ("Methodologiy of appraisal of damage caused by illegal actions on financial and stock markets"), approved by Executive Order of the Moscow city government of 08.09.06 №1766-RP "O systematizatsii mer po presecheniyu protivopranykh deystviy na finansovykh i fondovykh rynkakh".

– shareholders-managers and employees' urge to ensure greater awards to the detriment of a cost-saving policy, a current dividend and market return on equity;
– rush by stakeholders that form a minority group to grasp control from those forming a majority group (on the open market, by redeeming the company by its employees or managers, on the basis of M&A deals, etc.).

It is the obtaining of control over corporate assets that often forms the cause for the most serious and long-lasting corporate conflicts that frequently take the form of a criminal seizure of corporate assets. Nowadays, the level of the danger of loosing control over a company is estimated as being a fairly high one, which determines the "classified" nature of all the information concerning a significant number of entrepreneurs' business practices. According to the Accounting Chamber of RF[154], the country has annually seen some 70,000 corporate seizures, while according to the data[155] presented by A. Volkov, Chairman of the Commission on the Legal Provision for Countering Corruption, "every year, there occur over 60,000 raider[156] attacks in Russia. Their greatest number is noted in Moscow, and some 90% of Moscow-based enterprises have found themselves in the focus of raiders' interests". That said, the phenomenon of corporate raid, aka *reyderstvo*, in Russia "exhibits its mass and terrifying nature: as a result of property redistribution, raiders break and destroy key strategic enterprises, drive a profit-making and efficient production out of business"[157]. As far as corporate conflicts in Russia are concerned, this problem appears to be among the most critical ones.

Generally speaking, aggressive actions on the corporate control market are typical of the emerging M&A markets, of which Russia's constitutes, perhaps, the most dynamic one. Back in 2003, PriceWaterhouse Coopers asserted that Russia was "a major driving force of the M&A market in the central and eastern Europe"[158]. Along with the absence of traditions of the corporate control market, the widespread of offenses against corporate assets appears determined primarily by corruption, particularly within law enforcement agencies, judicial system, government executive agencies, and by lacunas and imperfection of the corporate law, including a series of unregulated legal matters pertaining to conduct of securities registers, to name a few.

Criminal seizures of corporate assets, which some experts in corporate law unreasonably attribute to hostile takeovers[159], became widespread in the early-2000s, when the initial process of stakebuilding and consolidation of stakes in the largest Russian enterprises had come to an end, while the bankruptcy procedures which had been vigorously used in the 1990s for the sake of assets stripping) had undergone modification (in 2002). To acquire a

[154] "V Gosdume pogovorili o probleme reyderstva i reshili, chto antireyderskiye zakony budut prinyaty v kontse 2008 g", 14.11. 2008, - www.notheft.ru
[155] "Reyderam gotovyat ugolovny sostav prestupleniya. Gosduma obeschaet prinyat "antireudersky" paket k rontsu 2008 g.", http://www.cig-bc.ru
[156] The widespread in Russia term "raider" means an entity that carries out a seizure of corporate property on behalf of a customer or his own. The seizure involves the use of criminal methods, among others. As such this term should not be confused with the definition used in the West wherein it defines a company striving to take over another one by means of acquisition of control blocs. Such companies' actions are not criminal.
[157] "V Gosdume pogovorili o probleme reyderstva i reshili, chto antireyderskiye zakony budut prinyaty v kontse 2008 g", 14.11. 2008, - www.notheft.ru
[158] For greater details, see: "Sovet direktorov v systeme korporativnogo upravleniya kompanii", ed. By Belikov I.V., M., 2005, p. 390.
[159] In the western corporate practice, the "hostile takeover" means acquisition of a company's control blocs without its shareholders' consent. This, too, does not imply an action subject to criminal punishment.

control bloc, in addition to a legal stakebuilding, one began to employ versatile methods of stock stealage – scheming with shareholder registers, falsifying instruments of share transfer, as well as using rulings by a court of law located in a remote region, blocking a principal shareholder's access to the stock, convening repeated general shareholder meetings, among others[160].

Once the control block has been acquired, one sought to complete the takeover of the company and assets stripping through the chain of nominally existing companies to reach a bona fide purchaser. To ensure the takeover, one often resorted to forced seizures of objects using armed staff of private security firms or police spetznaz. Such seizures allowed one to exercise the physical control, that is, to ensure access to the company's corporate seal, accounts, commodity and cash flows, and to launch a dialogue with owners of the remaining stock package from the posture of strength.

At the time, there occurred: seizure of the Kachkanar mining plant (2000) and a new property redistribution in the ferrous and non-ferrous metallurgy; "vegetable-oil" wars between Rusagro Holding and Razgulyay Group for Anninsky oil-extracting factory (2001) and between GK Sigma and TPK Russkaya Bakaleya for Kropotkinsky oil-extracting plant's assets; redistribution of the "wood" market – the war between Bazovy Element Holding with Ilim Pulp company that owns the biggest assets in the sector (Kotlassky, Bratsk and Ust-Ilim paper and pulp plants (2001). In the course of the "wood" war, the parties attempted to initiate reprivatization processes, to arrange official inquiries from MPs and innumerous inspections by fiscal structures, as well as lawsuits and PR campaigns.

Experts name the year of 2002 the Rubicon in the history of corporate seizures in Russia, as the corporate owners sharply scaled back on the number of aggressive actions for the sake of acquisition of assets. The reason behind such a drastic behavioral change was their aspiration to build a reputation that would enable them to attract credit resources, new investors and partners to boost up their companies' advancement. Such a twist in the corporate policy has resulted in emergence of a huge number of individuals with an impressive record of a direct participation in corporate conflicts. They began offering their services on the market - created their own companies, whose profile became stockbuilding and acquisition of corporate assets by illicit ways and means, in particular. One of such means applied in 2003 became stealage of shares in limited liability companies (OOOs) to acquire control over commercial real estate (stores, etc.). That was made with the use of a fake contract on cession of the share which was registered with the tax agency. The real estate object then was resold several times.

Post-2004, there began the use of the "sponsored" criminal cases as a means to exercise pressure on owners of a business for the sake of taking over corporate assets. Typically, such cases were based on genuine or forge facts of violations of the tax, customs, environmental, etc. law. It is no accident that the beginning of this period coincided in time with the YUKOS case. The "technology" is also vigorously used today. Underpinning it are criminalization of law enforcement agencies, an inefficient functioning (dependence on the governmental executive agencies) of, and corruption in the judicial system.

An analysis of the publicly available information about criminal seizures of corporate assets between 2007 and 2008 exposes the fact that in the course of their preparation the organizers keenly employed representatives of government agencies, including police, tax au-

[160] See here and below: Nobatova M. "Evolyutsia korporativnogo reyderstva v Rossii: ot skupki aktsiy v podvorotne do zakaznykh ugolovnykh del".- "Sliyaniya i pogloscheniya", 2007, №11, p.66

thorities, local government agencies or bankruptcy commissioners. The above authorities/individuals are supposed to falsify documents, exercise coattail, ensure adoption of apriori illegal rulings or execution of apriori illicit actions, and illegally supply relevant information. In short, their mission is to secure access to a company's assets and to give the criminals' deeds the semblance of legitimacy. Most often criminal seizures are made in the form of imposition committed by an organized group and with the use of fake documents that certify the right for share ownership.

Sometimes, co-owners of a business are keen to pile up their stake in the company at the expense of their partner's (or partners). Most often, it is stockholders (participants in a company) who own a minor share in its authorized capital and have no actual possibility either to influence corporate governance, or share its earnings that feel like doing this.

Yet another method to ensure the criminal seizure is to spread false information about a company's financial standing. This particularly concerns banking structures. Even if the seizure attempt fails, the damage caused by mass withdrawal of deposits from a bank may be a significant one, while the criminal punishment for spreading defamatory information in practice does not end up with incarceration. As concerns the most recent novelties pertaining to criminal seizures of corporate assets, experts reference to recognition of a corporate asset to be material evidence under a filed criminal case and its further safekeeping by one of participants in the conflict, followed by its ultimate alienation[161].

It is medium- and small-sized companies that most often fall prey to corporate raiders' attacks. Notably, the raiders may become interested even in a most insignificant asset, while the company's poor performance does not repel them – the aggressor claims that it is a consequence of a poor management or embezzlement which will be terminated after the change of the owner.

The period between 2006 and 2008 saw the growing efficiency of law enforcement agencies' performance in this direction. Meanwhile, there emerged economic grounds for changing the situation in certain regions (for example, in the city of Moscow, the number of potential objects for raiders' assaults has declined). According to the Investigative Committee under the RF Ministry of Interior, the number of criminal charges filed in conjunction with facts of illicit seizures of property complexes has been on the rise. More specifically, in 2007 the preliminary investigation agencies considered 512 criminal cases on crimes of this category, and 130 cases were submitted to the court of law. Some experts[162] believe that the revitalization of the law enforcement agencies' activity has resulted in a decline of the number of criminal seizures of enterprises in the country, despite an overall rise of offenses against corporate assets.

Participants in the M&A market believe that the recently noted distinction between criminal raisers and those who illegally acquire corporate equity will be widening further on, with criminal seizures mostly drifting from the central part of the country to its remote regions. According to preliminary forecasts, the situation should be stabilizing, but a certain level of criminal seizures – of some 500 objects a year – will still be occurring in Russia nonetheless.

[161] See here and below: Nobatova M. "Evolyutsia korporativnogo reyderstva v Rossii: ot skupki aktsiy v podvorotne do zakaznykh ugolovnykh del".- "Sliyaniya i pogloscheniya", 2007, №11, p.69.
[162] See in a greater detail: "Reydery menyaut orientatsiyu"///www.ma-journal.ru

In addition to the above, experts[163] lately have noted positive trends associated with:

- decline in the number of discreditable practices with stockholder registers determined by a growing efficiency of a registrar's operations on the securities market;
- decline in the intensity of cases of stealage of assets by means of the court of law's verdicts;
- emergence of facts of bringing judges to justice for issuing "*apriori* untrue verdicts"[164];
- decline in the number of big corporations that render services in the area of criminal acquisition of assets.

Hostile corporate takeovers have remained widespread in Russia. They often are accompanied by failures to pay an adequate compensation to shareholders. The volume of hostile takeovers on the M&A market may account for 30-40% of the overall number of public deals[165]. The most frequently employed methods in this respect are abuse of law, breaching unregulated by the law standards of corporate ethics and decent behavior.

It was the biggest financial-industrial groups and integrated structures that until recently have been major initiators of redistribution of corporate property in Russia[166]. The rise of the business empires was often associated with acquisition of control over assets concerned by developing and implementing of both friendly deals and corporate seizures. In early-2000s, when most vertically-integrated group had already taken shape, while political risks had grown, the large capital considerably fell back with its activity on the M&A market. It was replaced by medium-sized integrated structures represented by corporations of the second and third echelons as most active players on the market. By some estimates, it is spouses seeking divorce and the partition of property that have increasingly often become initiators of conflicts associated with redistribution of corporate assets.

The main methods employed in the process of hostile takeovers have remained unchanged over the past decade. In a nutshell, they can be reduced to the following group:

1) buying stock packages on the secondary market;
2) lobbying privatization (trust) deals involving state-owned equity;
3) administrative leading into holdings or other groups;
4) buying up debts and transforming them into participation in property and stock;
5) seizure of control through bankruptcy procedures;
6) initiating judicial verdicts; the use of an issuer's mistakes in the course of registration of a securities issuance is particularly widespread.

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[163] Nobatova M. "Evolyutsia korporativnogo reyderstva v Rossii: ot skupki aktsiy v podvorotne do zakaznykh ugolovnykh del".- "Sliyaniya i pogloscheniya", 2007, №11, p.70

[164] In April 2006, the Supreme Court gave a severe opinion of a judge of the Arbitration Court of the Republic of Ingoushetia, whose verdict was used by Sigma Group to seize Kropotkinsky Ooil-extracting plant. In May 2006, the Supreme Court satisfied the Prosecutor General's citation on bringing to justice a judge of the Leninsk-Kuznetsky city court (Kemerovo oblast) for rendering an "*apriori* untrue verdict", etc. –For details, see: Nobatova M. "Evolyutsia korporativnogo reyderstva v Rossii: ot skupki aktsiy v podvorotne do zakaznykh ugolovnykh del".- "Sliyaniya i pogloscheniya", 2007, №11, p.70

[165] Gvardin S.V., Chekun I.N. Finansirovaniye sliyaniy & pogloscheniy v Rossii.-M.BINOM. Laboratoriya znaniy, 2006, p.11. By some data, the city of Moscow every day sees at least one attempt of the so-called "hostile takeover" of an enterprise with the budget of up to USD 1m

[166] See here and below: Molotnikov A. Sliyaniya i pogloscheniya. Rossiysky opyt. – M., SPb "Vreshina", 2007, pp. 25-32

It is fairly rare noted a case that assets belonging to large financial-industrial groups and integrated structures become objects of a hostile takeover – in most cases a corporation is sold by astipulation. Exceptions are the cases of an active participation of government agencies in acquisition of control over a company, as exemplified by the YUKOS case. It should be noted that public companies have never been objects of corporate seizures.

In 2006-07, the government undertook a number of steps to preclude from, and counter criminal seizures of corporate assets. Such measures include regulation of the corporate takeover (i.e. acquisition by an entity or a group of mutually related entities of a control stock package or a large one) procedures. The mechanism of such regulation pursues the goal of securing a balance of interests between the purchaser of the stock, "ertswhile" shareholders, and the company's management. If efficient, the regulation makes a mala fide takeover becomes a more costly and risky, and, consequently, less lucrative than a legitimate takeover, exercise. The Federal Act[167] promulgated in January 2006 provides the following mechanisms in this respect:

a) *non-mandatory offer – the option for purchase of a stake of an open-end corporation by entities that intend to acquire over 30% of the total number of common shares and preferred shares of an open-end company that give them voting authority*[168] , by submitting to the open-end company a public offer addressed to its shareholders[169], and the method of its implementation (Art. 84.1 of Federal Act "On joint-stock companies"). Meanwhile, prior to submission of the non-mandatory offer to the open-end company, it should be submitted, together with copies of all the documents provided to the shareholders, to the federal agency of executive power overseeing the securities market (the Federal Service for Financial Markets) (p.1. Art. 84.9). The agency has the right to demand to have the offer be brought in consistency with the stipulated in the law requirements (p.4. Art. 84.9).
b) *mandatory bid – the obligation of the entity that has acquired over 30% of the total amount of the open-end company's stock to put forward a bid to its shareholders* that own the remaining stock and owners of the convertible into shares securities regarding purchasing from them the said securities. This obligation should also be fulfilled by submitting a public offer. The timeline for fulfillment of the obligation is 35 days from the moment of introducing the respective record to the personal account (the custody account) or from the moment the entity has become (or should have become) aware that he independently or together with affiliated entities owned the said amount of equity in question (p.1. Art. 84.2). The FSSM's powers in this case are the same as above.

In the practice of arbitration courts there appeared the first disputes associated with challenging the FSSM's rulings on bringing non-mandatory and mandatory bids on acquisition of securities in consistency with the legal requirements. These disputes are initiated both by the companies that have submitted their bids/offers and those ones that have failed to sell their papers due to the agency's rulings. The list of reasons behind the FSSM' belief a given offer on the purchase of securities is illegal comprises:

– provisions violating the timelines for acceptance of such bids;

[167] №7-FZ of 05.01.2006 «On introducing amendments to Federal Act "On joint-stock companies".
[168] While identifying the 30%, one considers the stock owned by this entity and its affiliated entities.
[169] The public offer can also contain an offer to purchase from owners of convertible into shares equity securities these papers.

– failure to meet the timelines within which securities should be accrued to the personal account (custody account) of the entity that submitted the non-mandatory offer, as well as the timelines for payment for the papers;
– failure to meet the timelines for, and the sum of the banking guarantee that should provide for the guarantor's obligation to pay the erstwhile owners of the securities the price of the papers sold in the event of the failure by the entity that has submitted the non-mandatory/ mandatory bid to honor its obligations;
– failure to honor the obligation to pay for the acquired securities in time.

In some cases, the FSSM's regulations were recognized as partially illegal. For example, some FSSM's requirements were recognized null and void due to their inconsistency with the law with regard to a compulsory bid on the purchase of securities of "Samarsky Podshipnikovy zavod" JSC[170].

The provision concerning the price offered for purchased securities and procedures of its defining raises numerous questions. The price for papers purchased on the basis of a mandatory bid "may not be lower than their average weighted price defined by results of trading by the organizer of trading on the market for securities over the six month antecedent to the date of submission of a mandatory bid to the federal agency of executive power in charge of the securities market". As to the papers that are not publicly traded or which have been in circulation for less than six months, their price "may not be below their market value as set by an independent appraiser" (p. 4 Art. 84.2.). While the legislators' concept is crystal- clear, the practical side of implementation of the provision pertinent to the exercise of an independent equity appraisal will not allow this provision to make equity redemption a legal and justified deal. The state of the institution of appraisal – its legal regulation, the effective regulations of the market for appraisal services, the factual absence of the practice of bringing one to justice for violating requirements to appraisal operations – makes it incapable to secure the respective compliance and protection of interests of shareholders of the companies whose stock do not circulate at exchanges. FSSM will not be able to oversee appraisers' operations at such a volume, and in this sense the aforementioned novelty cannot form an efficient instrument of solving M&A-related matters, as long as the sphere of asset valuation fails to become civilized.

The legislature's requirements regarding the size of the price of the purchased equity or ways of its identification under a non-mandatory offer were stipulated in the law in July 2007[171]. The act reads that in the event procedures of identification of the price of purchased securities are found in the non-mandatory offer, "there should be secured a uniform purchase price of securities of the same kind, category (type) for all their owners". At this point, there is no reference to the need to redemption at a market price. That is why under such a legal regulation of the redemption problem, the owners of small packages may find themselves in a situation when they will have to choose between being happy with a lower price for their stakes and an absolute absence of the possibility to exert influence on the company's operations, as its controlling owner has changed. With such procedures the government has on hand

[170] For details, see: Resolution of the Federal Anitrust Service of Moscow okrug of 03.10.2007, 10.10. 2007 №KG_A40/9123-07 by case A40-77840/06-17-491.
[171] Federal Act of 24.07.2007№220-FZ «On introducing amendments to Federal Act "On joint-stock companies" and individual legal acts of RF".

no efficient and civilized instrument of the M&A market, thus having replaced the concept of countering criminal actions on the market for corporate control with yet another profanation.

c) *The right for every entity to submit, upon receipt by the open-end company of the non-mandatory or mandatory bid, a competitive bid on purchase of equity* (Art 84.5.). It should be sent to the open-end company not later than within 25 days prior to expiration of the term of receipt of the last bid of the ones the open-end company received earlier.
d) *The obligation to redeem shares by the entity, that has become the owner of more than 95% of the total amount of equity, on their owners' request* (Art. 84.7).
e) *The right for the entity that that has become the owner of more than 95% of the total amount of equity (with account of the stock owned by the entity and his affiliated entities) to redeem the remaining stock* (Art. 84.8)

The arbitration court has already seen the first examples of application of the mandatory stock redemption. Thus, Alu Process Holding Limited, which as of July 1, 2006 was the owner of 96.31% of common registered stock in SUAL company redeemed a 3.69% stake in JSC SUAL at Rb. 29.93 per share. Meanwhile, JSC Kognito Investment, a minority stakeholder, demanded to recognize the transaction invalid, being a fraudulent action, and to compel the defendant to return 873,036 shares in the company. The plaintiff, however, failed in the court[172]. Former stockholders filed a lawsuit on recovery of losses against JSC Rusal Novokuznetsky Aluminum Plant, as they believed the stock was redeemed at a knock-down price. The plaintiffs insisted it should be Rb. 412.29 apiece, rather than Rb.50 as set by the appraiser and paid for by the majority shareholder. The lawsuit was declined on the grounds the procedures of conduct of the appraisal were in full conformity to law[173].

The question as to whether Art. 84.8 of the Federal Act "On joint-stock company" is in conformity with the RF Constitution was considered by the Constitutional Court of RF. According to its verdict of July 3, 2007 №714-O-P, the said legal provision conforms to the Constitution. The Court also noted that *"a mandatory alienation of assets upon condition of a preliminary and equivalent compensation is possible not only for public needs, but in the cases it is exercised in pursuance of the "overall benefit for the joint-stock company"* as well. The verdict also ascertains that the Constitutional court "thus has extended boundaries for application of guarantees of the right for private property stipulated in Art. 35 (part 3) of the Constitution of the Russian Federation"[174]. The question as to how the court of law can find that the

[172] For details, see: Citation by SC of RF of 17.03.08 №3398/08 by case №A60-5846/2007-C2.
[173] For details, see: Resolution of the Federal Anitrust Service of Moscow okrug of 21.01.08 №KG-A40/13933-07 by case №A40-23574/07-48-185.
[174] According to the Constitutional Court's conclusions, "An efficient guarantee of maintenance of the balance of interests between participants in the respective legal relationship in the procedure of mandatory equity redemption and, consequently, protection of minority shareholders' rights is the exercise of a comprehensive judicial control over the said procedure, which implies both "the evaluation of accuracy of price-setting for the redeemed equity and the presence of losses the plaintiff has incurred due to an unduly identification of the price" and studying into factual circumstances pertaining to the mandatory redemption or the rise of the right for such a redemption, which may evidence an essential violation of legal requirements or abuse of powers and which can impact setting a fair price for the redeemed equity". Only if the court of law stands by these requirements, may the provided for by the law procedures of cassation with regard to legitimateness of rulings on mandatory redemption and filing a lawsuit on recovery of losses caused in conjunction with an unduly identification of the price for the redeemed equity be recognized as an effective means of the judicial protection of rights of the owners of the redeemed equity".

stock redemption pursues the goal of the "overall benefit for the joint-stock company" remains unanswered.

Practical conclusion from the above is that while considering disputes pertaining to the mandatory equity redemption, the court of law is bound to study into all findings that may testify to an essential violation of requirements of the law or abuse of powers and thus affect a fair pricing for the redeemed equity. Meanwhile, the minority shareholders' rights are secured by observance with a duly judicial procedure, compliance to requirements of law at each of its necessary stages, reasonable timelines under the securing of an efficient judicial control. That said, the court of law does not have to "check an economic appropriateness of decisions made by boards of directors and a general shareholder meeting, which exercise independence and an ample discretion in the sphere of business".

The concept of compulsory equity redemption is not a new one – this mechanism is practiced in France, Germany, and some other countries. But Russia has different institutional conditions, which do not allow an efficient implementation of the compulsory equity redemption procedure, including, as stated above, a nascent appraisal market, numerous abuses in the area of financial reporting and conduct of shareholder registers, a lax administrative control over transactions with securities of joint-stock companies whose shares are not traded publicly, use of insider information, to name a few. In the circumstances, mandatory equity redemption may grow into a method of stripping minority shareholders off their shares without paying an adequate compensation.

In addition, factors that condition understating the stock appraisal are the legislature's failure to fix a moment as of which the market value should be set, the possibility for the professional players on the market to "form" a pricey with account of insider information, an understated value of companies, particularly due to the employment of transfer pricing.

Regulation of the mechanism of exercise of the administrative control over completion of transactions on mandatory redemption of stock not included in exchanges' listing appears to be a failure, as the redemption bid sent out to shareholders may be submitted simultaneously with forwarding the notification of the upcoming deal to the FSSM bodies (Art.84.9). So, in the event of abuse of the shareholders' rights, the FSSM bodies' actions would not be preventive ones, but centered on minimization of effects from illicit actions. It should be noted that the rights of the minority shareholders who own stock listed at exchanges will be protected far better, as having notified a FSSM body, the majority shareholder is bound to wait for 15 days, and only if there is no order from the authorities to remedy an abuse, should he forward an offer to shareholders.

The selected method of legal regulation was predetermined by significance for the government of a way in which the largest Russian corporations' assets are redistributed, as well as by the presence therein of a considerable number of foreign corporate minorities.

Recapping on mandatory equity redemption, it should be noted that in the current conditions the recent novelties are incapable of growing into an efficient mechanism of regulation of relations between the controlling stockholder and minority ones, due to the aforementioned legal deficiencies of the respective provisions and the absence of conditions of their efficient implementation.

In addition, in spring 2007, the State Duma considered in the first reading the governmental (designed by the RF Ministry of Economic Development and Trade) package of amendments aimed on improving the corporate law. The novelties therein center on counter-

ing criminal seizures of corporate assets. The bill is aimed at improving the effective arbitration law in the part of resolution of, and preclusion from corporate disputes, and legal regulation of joint-stock companies, partnerships and cooperatives' operations.

The most important novelties[175] in the law are:

- introduction of the concept of "corporate dispute" and singling out corporate disputes as a separate category of cases;
- limitations on introduction of the possibility for interim measures by corporate disputes only by the arbitration court by the legal entity's location;
- a mandatory integration into the same judicial proceedings of closely interwoven claims proceeding from the same corporate dispute. In addition, informers and plaintiffs are under a duty to notify of the associated with the corporate dispute future on ongoing trial;
- reduction in the limitation of actions under challenging corporate executive bodies' rulings;
- a preliminary judicial control over conduct of an early shareholder meeting which provides for the prerogative of the court of law to convene the general meeting in the event a board of directors' has unjustifiably refusal to do this.

In the autumn of 2007, while preparing the bill for the second reading, the RF Ministry of Economic Development and Trade, together with the Supreme Arbitration Court and the State Duma Committee for Property, had designed new amendments to the document. The amendments concern primarily the adjective section of the Administrative-Processual Code and the shareholder register. It is planned to specify in a greater detail what the register and the contract on its conduct are. In addition, the administrative and law enforcement agencies' rights for issuing the register or an extract from it will be defined more clearly. Also, the bill now provides for a greater responsibility of the register holder. The document also specifies legal regulation of procedures of appeal decisions made by an organization's managerial bodies,a s well as large-scale deals and interest-party transactions. Finally, amendments concern the definition of the concept of 'corporate dispute", exclusion of an "arbitrary" locus standi, both territory- and subordination-wise ones, elimination of controversies in judicial verdicts.

The package of legislature aimed at countering criminal seizures of corporate assets provides for introducing criminal sanctions for fraudulence "against the legal entity associated with acquisition/establishment of control over it and its assets", with a maximum penalty (Art. 159 of the Criminal Code of RF) in the form of incarceration for up to 8 years. In addition, it is proposed to introduce criminal sanctions for forgery for the sake of seizure of an enterprise with a maximum penalty in the form of incarceration for up to 10 years.

The State Duma was initially going to consider the legislative package in 2008; however, as of February 2009, it has not been passed as yet. The novelties were supposed in many ways help eradicate favorable conditions of corporate wars with the use of the "administrative resource" and enable one to drive the corporate law, as a integral system of relations, onto a different level. While evaluating the novelties, it is worthwhile noting that if thoroughly elaborated and prepared, they would have helped create a simpler and more transparent system of legal provisions regulating procedures of consideration of corporate disputes and conduct of shareholder registers. They would complicate seizing corporate assets, yet they would

[175] Rossiyskaya gazeta, 23.01.2007.

fall short of preventing them, due to the specificity of the institutional environment as a whole.

As concerns the corporate conflicts that do not pursue the goal of seizing control over a company, at this point, it is possible to single out typical of Russia conflicts between majority and minority shareholders determined by the absence of the board of director's independence of a large shareholder, deeply rooted traditions of conducting business, and efficient legal mechanisms that fix accommodation of interests of various groups of parties concerned. The other significant group of corporate conflicts comprises those between managers and shareholders. Underpinning these conflicts is the shareholders' aspiration to maximize the value of the stock and/or collect sizeable dividends, while managers (individuals that participate in a company's governing bodies) strive to increase expenses on payment of remunerations and their possibilities to influence the business[176]. In their capacity, managers are in possession of confidential information and appear far better than shareholders au fait with the state of affairs within the company, particularly with respect to earnings. The latter can have an account of the managers' performance only at the annual general meeting. In such a situation, managers remain beyond the shareholders' real control, which often allows them to fairly successfully pursue their interests. The board of directors, whose mission is to secure control over the executive bodies' actions, most often appears dependent on the controlling owner and sticks to a policy aimed at pursuance of the latter's interests in the first place.

In conclusion, as a positive trend should be noted - the legislature's attention to the problem of criminal seizures of corporate assets and attempts to improve a series of legal mechanisms which can alleviate the intensity of corporate conflicts and ensure the law enforcement agencies' more pro-active stance in this area. The passage of these measures is clearly a delayed reaction, nonetheless, they are capable of correcting the situation to some extent. But in addition to corporate wars unleashed by private individuals, there has recently been a rise in the number of offences against businesses and their assets by the state, public corporations and commercial structures affiliated with high offices. The outcome in this field is practically predetermined, while the most often employed instruments include selectivity in committing for trial for failures to pay taxes, illegal entrepreneurship and fraudulence, putting an owner and/or company's executives on the "wanted" list or their incarceration and the bankruptcy intimidation display. The employment of the civil service for the sake of redistributing assets or addressing other political and economic tasks constitutes one of the most pivotal causes behind assets stripping, a very low level of investments in capital assets and the general aptness to "closeness" of business.

5.5. Stock Market in the Crisis Conditions: Accumulation of Institutional and Structural Imbalances

5.5.1. On the Stock Markets' Capacity and Risks

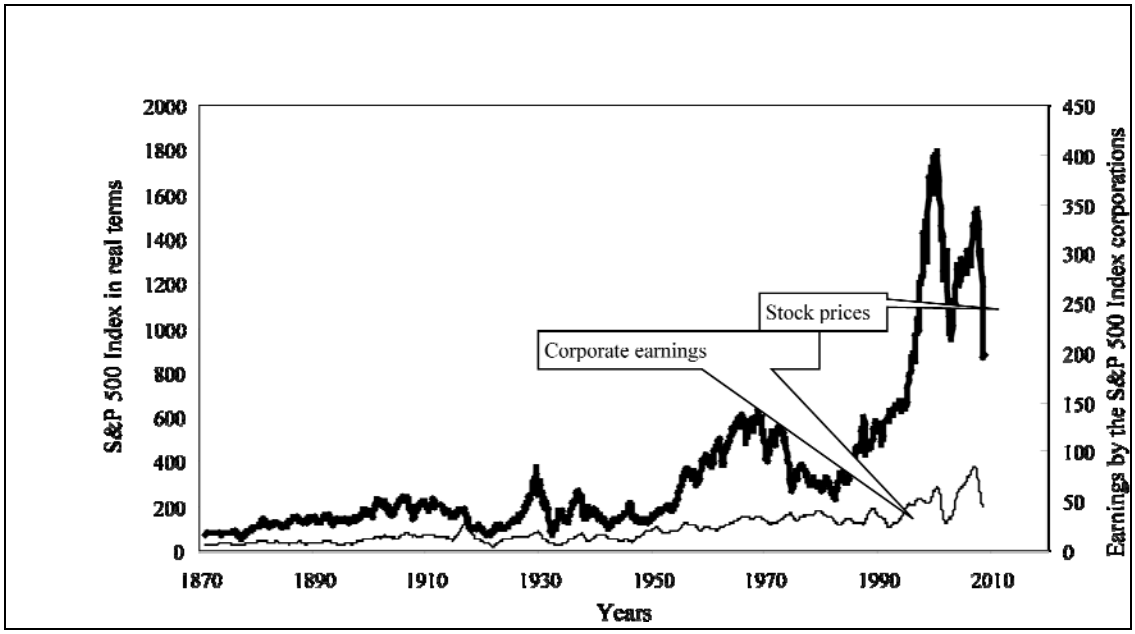
Stock market can be viewed as a mechanism that allows attraction of investments, pillars economic growth and increases the citizenry's welfare. Once its competitiveness is on the

[176] See: Kirilin A.V. Sovet direcktorov i ispolnitelny organ aktsionernogo obschetsva: kompetentsia iotvetstvennost///www.businessmix.ru

rise, a national stock market exhibits a better capability to fulfill the said fundamental economic and social mission.

Regretfully, a spontaneous advancement of stock markets often drives them aside from performing the above mission, fuelling a rapid growth of short-term speculations and inflation of financial assets. In this case financial markets grow disruptive – they disorganize pricing for assets, block an influx of investments into an economy and exert a destructive influence on the nation's welfare and human psyche. The markets' cataclysmic forces reach their climax in periods of financial crises, like those ones occurred in Russia in 1997-98 and 2008-09. Meanwhile serious financial crises do not result from an accidental conjunction. Rather, they mirror irrationalities and imbalances accumulated in an economy and the financial sphere. It is the standpoint from which one can view the 2008-09 Russian financial crisis.

In the long run, financial markets grow following the dynamic of the fundamental indicators, such as corporate net earnings and GDP. As a proof to this ascertainment *Fig.2* presents calculations by R. Schiller of the Yale University (USA). The historical time series of data on the S&P 500's stock capitalization and their issuers' earnings evidence that the most serious crises in the US history, particularly the Great Depression of 1929-1933, the collapse of the Internet companies bubble in 2000-02 and the current crisis fell on the periods when stock quotations sharply outpaced the growth in earnings.

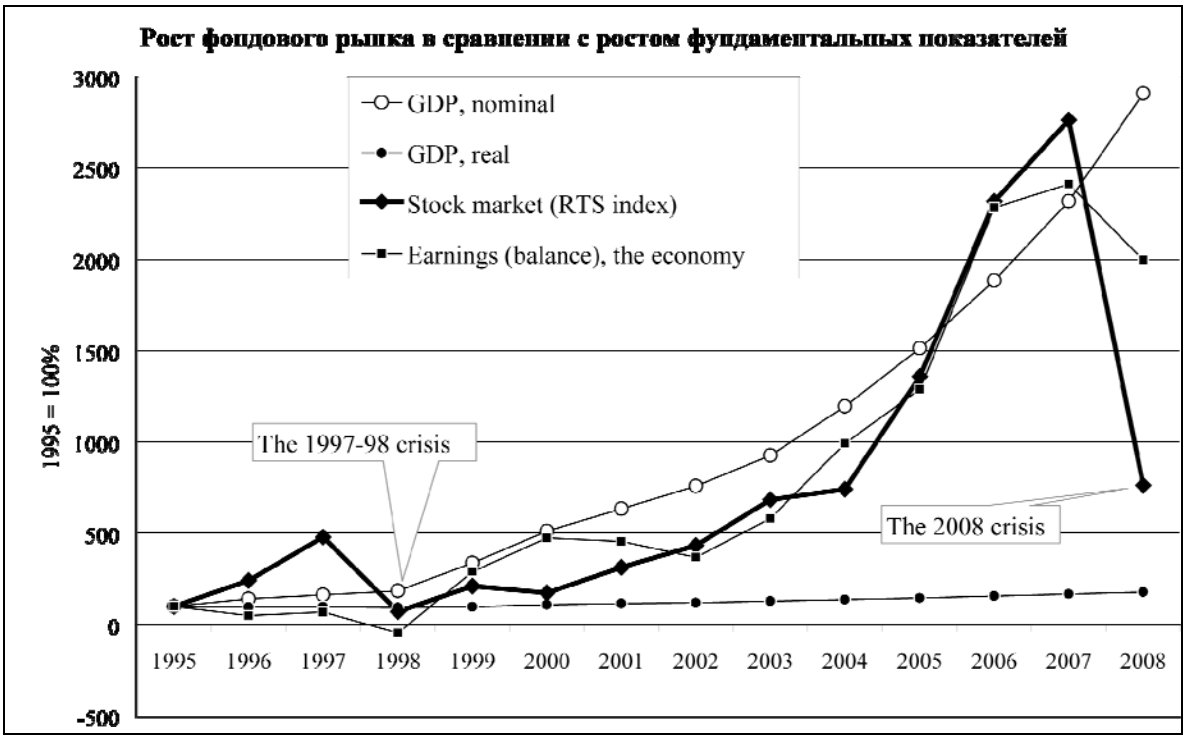


Source: www.econ.yale.edu/~shiller/data.htm

Fig. 2. Growth in Stock Prices and Earnings by the US Corporations (in Real Terms, with Account of Inflation)

The author of this section has completed computations of the correlation between the dynamic of growth of stock markets and the leading economic indicators across 12 developed capital markets over the past 50 years. They evidence that the average pace of growth of stock

indices, as a rule, corresponds to the average pace of growth of GDP in nominal terms[177]. *Fig. 3* provides data on the correlation between the pace of growth of the RTS Index, GDP and Russian corporations' earnings. The data evidence that the periods of the stock markets' crisis collapses in 1997-98 and 2008 fall on the moments in time on the eve of which growth rates of financial indices were far ahead of those of GDP and corporate earnings[178].



Source: basing on the data of RTS and Rosstat

Fig. 3. Growth in Stock Market Vs. growth in the Fundamental Indicators

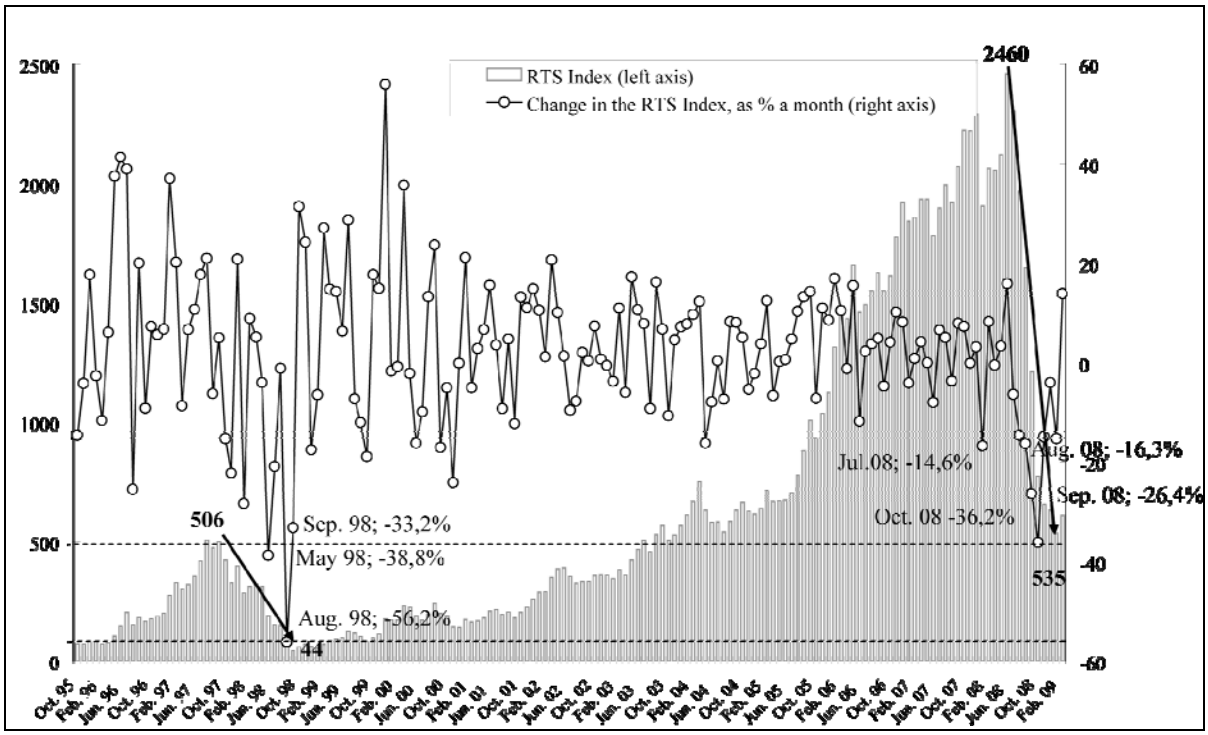
So, an irrational behavior by the securities market, particularly a far greater growth rates in securities' quotations vis-à-vis the fundamental economic indicators often herald dramatic financial crises. In this sense the latter can be regarded as forces that return stock markets to their original fundamental values.

5.5.2. Main Parameters of the 2008-09 Crisis on the Financial Market

The year of 2008 has become the year of one of the most intense financial crises in Russia. The rise of the stock market, that started in the late-1990s and continued up to May 2008, was replaced by its collapse since the second half of the year. At the initial phase of the crisis, between June 2008 and February 2009, it was the stock market that suffered at most, as seen on *Fig. 4.*

[177] Section 1.3. of the presentation to NAUFOR. Rossiysky fondovyi rynok i sozdaniye mezhdunarodnogo finansovogo tsentra. Idealnaya model finansovogo rynka na dolgosrochnyu perspektivu (do 2020 goda). Moskva, 2008. Posted at: www.naufor.ru

[178] In this case capitalization of the RTS Index, GDP and earnings is quoted in nominal terms, without adjusting all the indicators in question to the inflation rate.

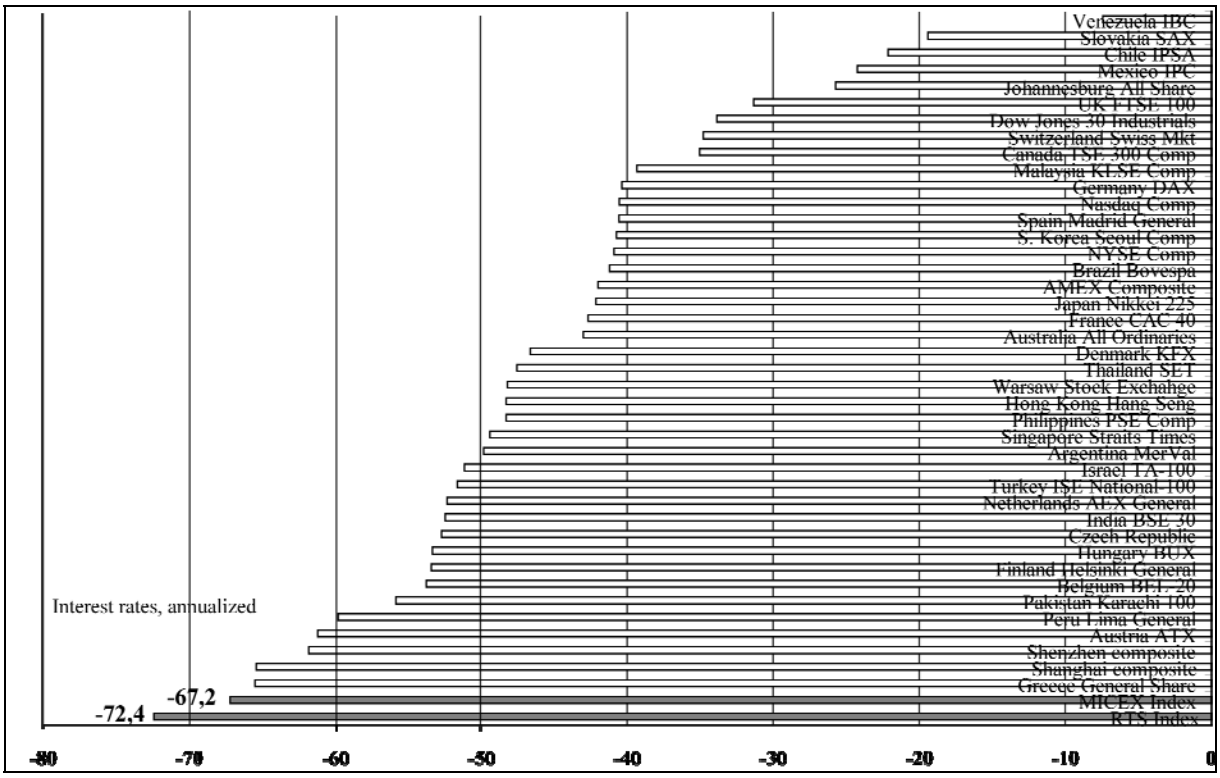


Source: basing on the data of JSC RTS

Fig. 4. Dynamic of the RTS Index, October 1995 – February 2009

Since June 2008 and over the next 8 months the RTS Index has plummeted from 2,460 to 535 points, or at 78.3%. Ten years ago, from the August ’97 pick value it had been falling over the next 14 months from 506 to 44 points, i.e. at 91.3%. In the times of the Great Depression in the US, the DJIA since September 1929 and over the next 34 months had been plunging at 88.7%. So, while in terms of the depth and length of its 2008 fall the RTS Index has fallen short of breaking the “record values” of the Great Depression and the Russian crisis of 1997-98, the ongoing crisis, by its intensity and length, appears comparable to the most dramatic turmoil in the national and world financial systems over the past centennium.

The Russian market is notorious for its greater volatility against other national ones – over recent years it has been among leading or outsider major capital markets worldwide. In 2008, by the depth of its fall it has outrun practically all the emerging and developed financial markets (see *Fig. 5*).



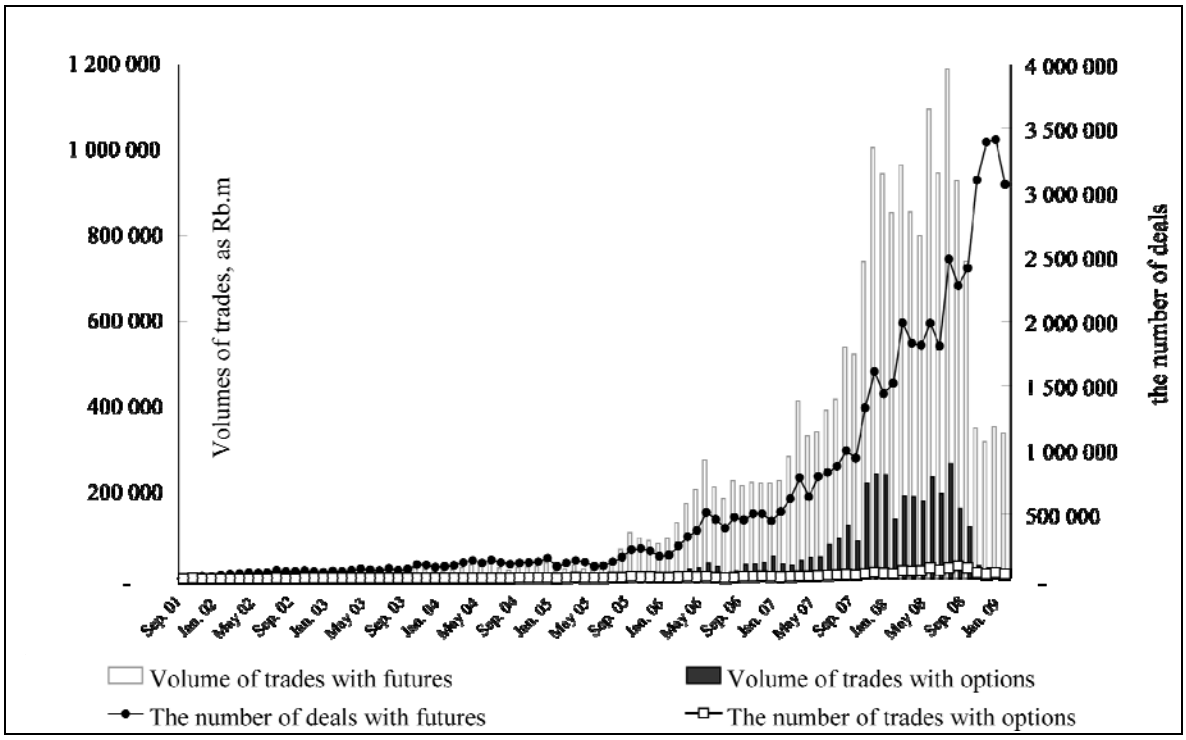
Source: by the data of RBK and the World Federation of Exchanges

Fig. 5. Stock Indices by Results of 2008

By the 2008 results, the RTS Index plummeted by 67.2%, and that of MICEX - by 72.4%. By contrast, indices of other emerging markets also battered by the crisis experienced a less dramatic decline: China (Shanghai Exchange) sank at 65.4%, India - 52.5%, Turkey – 51.6%, Argentina – 49.8%, Hong Kong- 48.3%, Brazil – 41.2%.

The downfall in the value of Russian companies' stock and stock indices has resulted in a drastic contraction in the volume of trading and liquidity on the futures and options market at RTS, which had been on the rise since 2005, as shown on *Fig. 6.*

Since August 2008 the monthly volumes of trading on the futures and options market have plummeted manifold. Meanwhile, it should be noted that the RTS's market for derivatives remained intact and the number of contracts therein even continued to rise. In contrast to the crisis of the forex terminal at MICEX in 1998, at the RTS exchange the shock on the market for basic assets has not resulted in a systemic crisis on the market for derivatives.



Source: basing on the data of JSC "RTS"

Fig. 6. Volume of Trading and the Number of Deals on the Futures and Options Market JSC RTS between 1.09.2001 and 31.01.2009

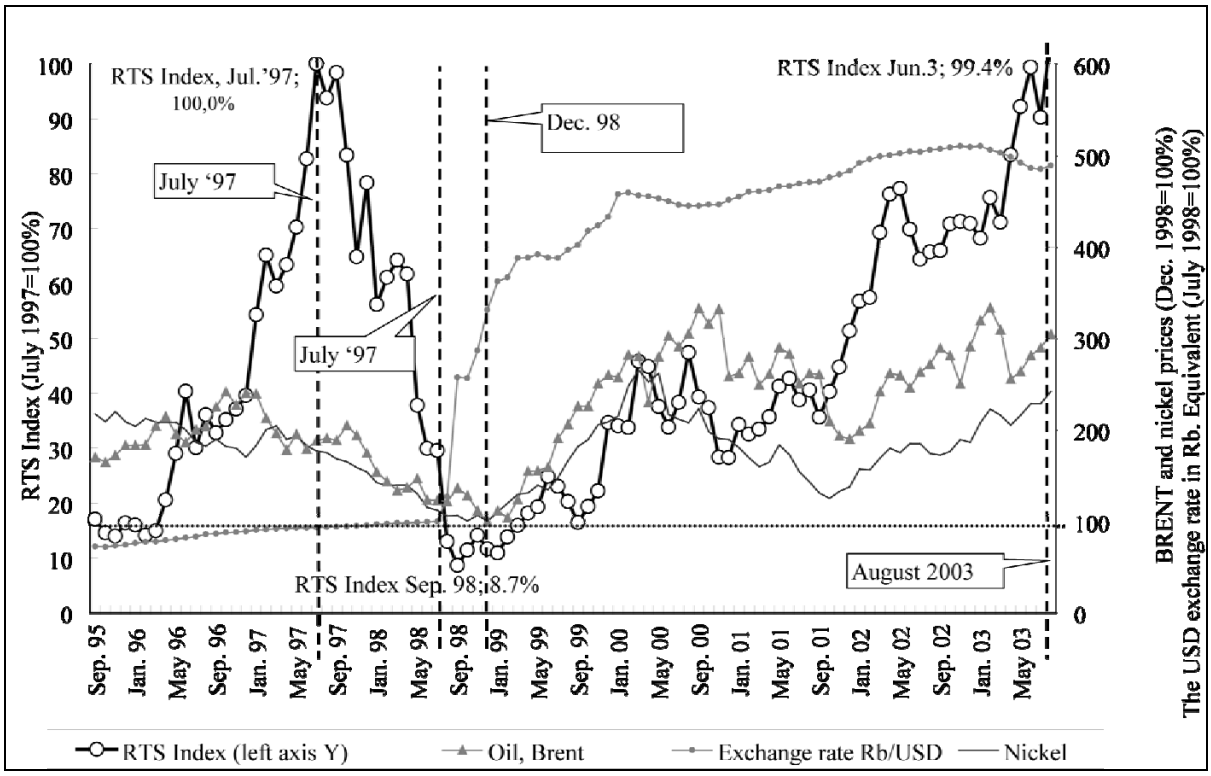
5.5.3. Common and Distinguishing Features of the 1997–98 and 2008-09 Crises

While the 1997-98 and 2008-09 crises exhibit numerous differences between them, the latter should not be overestimated.

The Russian crisis of the late-1990s is usually associated with the events unfolding post-August 1998, i.e. with the default on the market for the Russian government short-term obligations (*aka* GKO), an uncontrolled depreciation of the Rb., and the banking crisis. The crisis did not constitute a global one, nor it suggested there were contagion effects caused by the world economy or overseas markets. In such interpretation, the 1998 crisis resulted from the then existing authorities' inefficient financial policy, which manifested itself, among other things, in their inability to maintain the level of public expenditures in balance with the budget revenues.

By contrast, it was the stock market which received the most severe blow from the ongoing financial crisis. The unfolding of the crisis in the banking system and on the market for bonds was arrested by the government and the financial authorities' vehement use of foreign reserves the nation had accumulated by the initial phase of the crisis.

Meanwhile, these two crises that occurred in Russia over the past decade have much in common. Most importantly, they were engendered by the cyclic nature of the national economy, which has appeared strongly dependent on the world mineral prices. This can be found in a separate consideration of scenarios of each of them on *Fig. 7* and *8*.



Source: basing on the data of JSC RTS and the International Monetary Fund

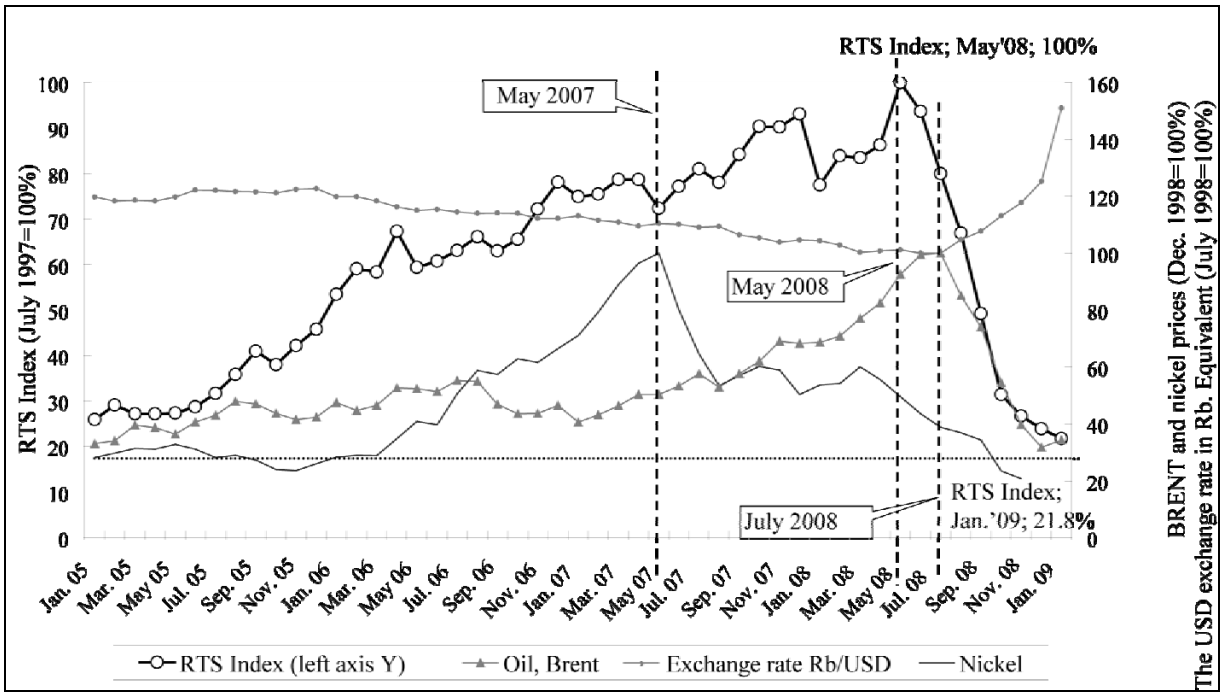
Fig. 7. The 1997-98 Crisis on the Stock Market and Its Factors

The 1997-98 crisis was unfolding by the following scenario. After hitting its peak value in July 1998, the stock market nose-dived in August. The fall had been lasting for 14 months - through December 1998. The start of the collapse of stock was associated with the investors' anticipation of a drastic mounting of Russia's country and macroeconomic risks, which were attributed to the price downfall for mineral exports. As numerous researchers rightly pointed out, current quotations of the Russian blue chips are very sensitive to changes in future prices for oil and gas with some 9-month lag[179]. Plus, a sharp decline of the stock market in 1997-98 was fueled by anticipation of a considerable depreciation of the Ruble. The collapse of the Asian stock markets that year also had a strong impact on the 1997 Russian stock market crisis, which fueled the foreign investors' negative sentiments towards emerging stock markets, including Russia.

The downfall of the stock quotations in 1997 became a detonator for the subsequent credit and banking crises. The falling stock prices intensified risks persisting on the national market due to capital flight, the deficit of balance of payments and anticipation of the Ruble's depreciation. Concomitant with the growing budget deficit and accumulation of imbalances in the baking system, particularly those between the banks' forex-denominated assets and liabilities, that resulted in the crisis situation in August 1998. At the time, the Ruble was depreciated nearly three-fold, the government defaulted on its domestic debt, while inspired by the state, Russian banks refused to pay off their debts to foreign creditors and the population.

[179] Mirkin Y.M. Rynok tsennykh bumag Rossii: vozdeystviye fundamentalnykh faktorov, prognoz i politika razvitiya.-M.: Alpina Pablisher, 2002.- p. 146.

The unfolding of the 2008-09 crisis is shown on *Fig. 8*. Factors fueling the fall of the Russian stock market this time proved to be the same as those back in 1997. These are the price downfall for metals since May 2007 and oil since August 2008, the foreign capital outflow, and growing risks against the backdrop of anticipation of depreciation of the national currency. As a result, the stock market collapsed since June 2008. By contrast to the situation noted 10 years ago, the said factors affected the economy to a different degree. In 1997-98, the mineral prices were declining at a slower pace, while the Rb. depreciation was rapid and uncontrolled. Under the current circumstances a moderate controlled depreciation of the Ruble was coupled with a more acute and sudden downfall of oil prices by 3.5 times over several months.

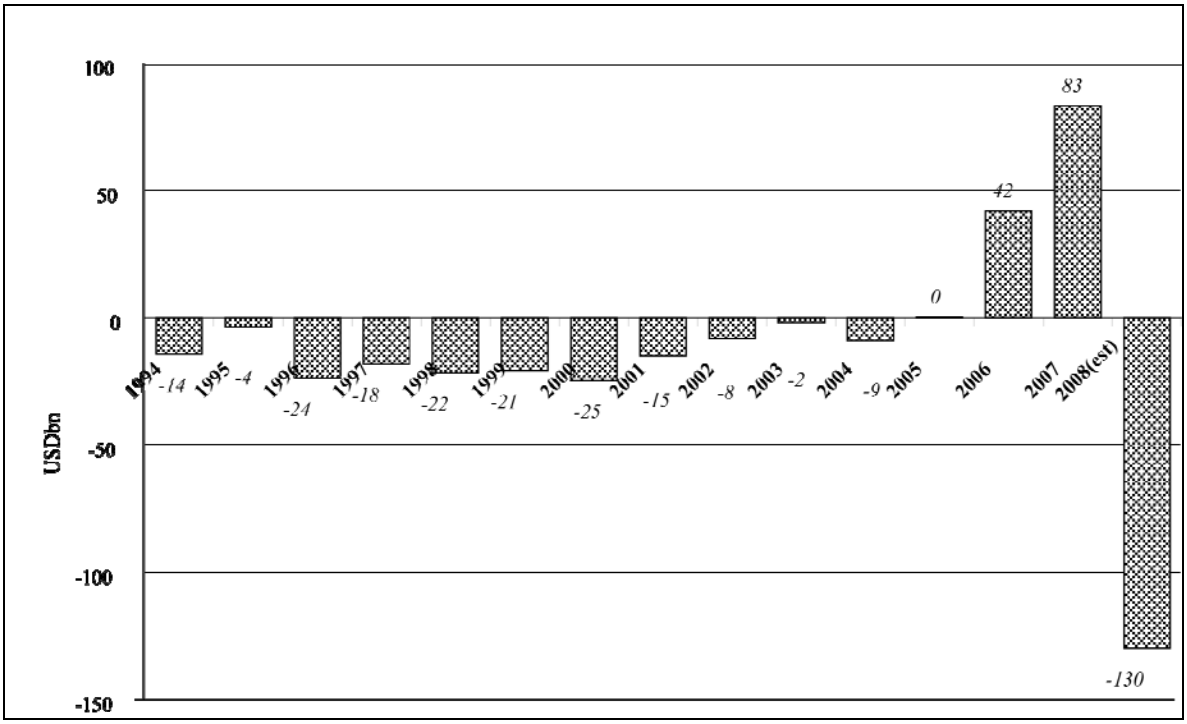


Source: basing on the data of JSC RTS and the International Monetary Fund

Fig. 8. the 2008-09 Crisis of Stock Market and Its Factors

The impact on the stock market by movement of the private capital, whose in- or outflow the Bank of Russia computes as difference between the growth of the Russian banks and non-financial companies' assets and liabilities is shown on *Fig. 9*. During the 1997-98 crisis, as much as some USD 20-25bn was annually exported out of the country. The amount was greater than the government foreign reserves at the time and that mostly was the residents' capital flight driven by uncertainty about stability of the domestic economic and political situation. The capital flight decelerated in the 2000s; more than that, in 2006 and 2007, the government boasted a net capital inflow accounting for USD 42bn and 83bn, respectively. But the precipitation of the oil prices in the second half of 2008 paired with the unfolding global financial crisis has changed the situation dramatically. According to the Bank of Russia, the 2008 capital outflow from the country accounted for USD 130bn., thus being in excess of the amount of its inflow over the two prior years combined. This evidences both the cyclic nature of the capital in- and outflow in/out of Russia determined by the state of affairs on the world

mineral markets and the respective prices, and the fact that the structure of the attracted foreign capital has been dominated by short-term investments and borrowed resources.

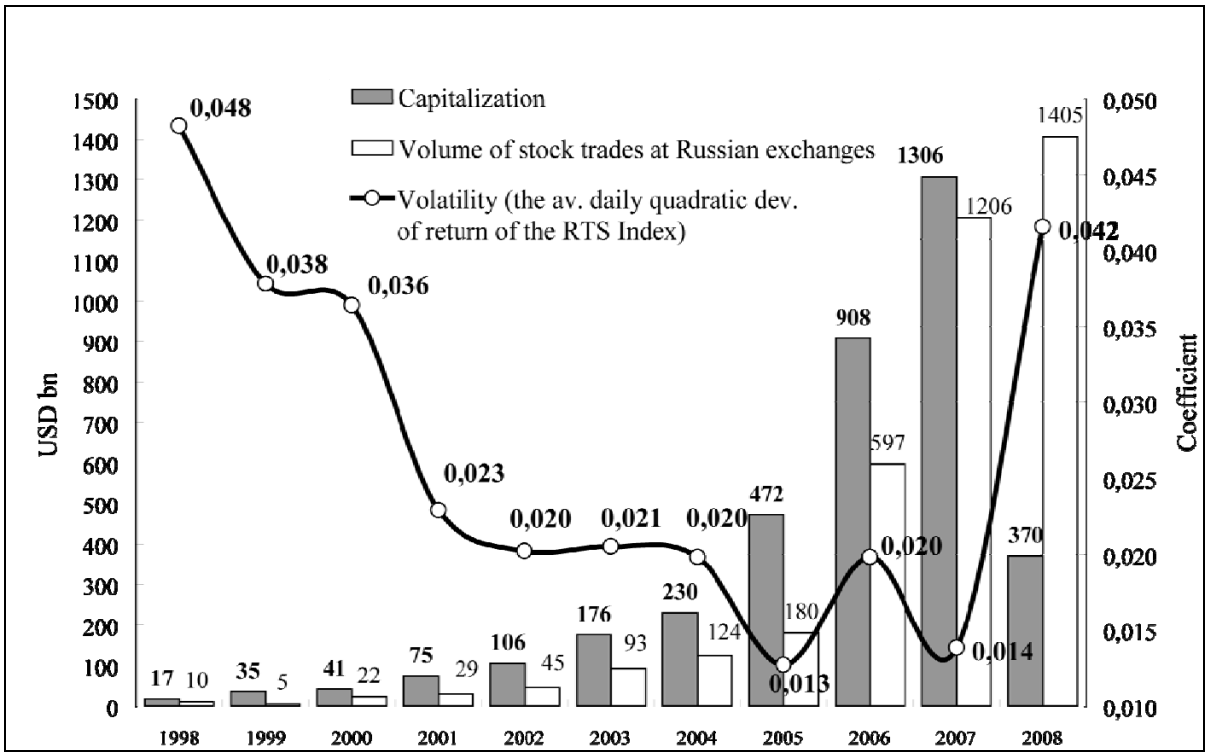


Source: basing on the Bank of Russia's data

Fig. 9. The Capital Inflow by the CBR's Data

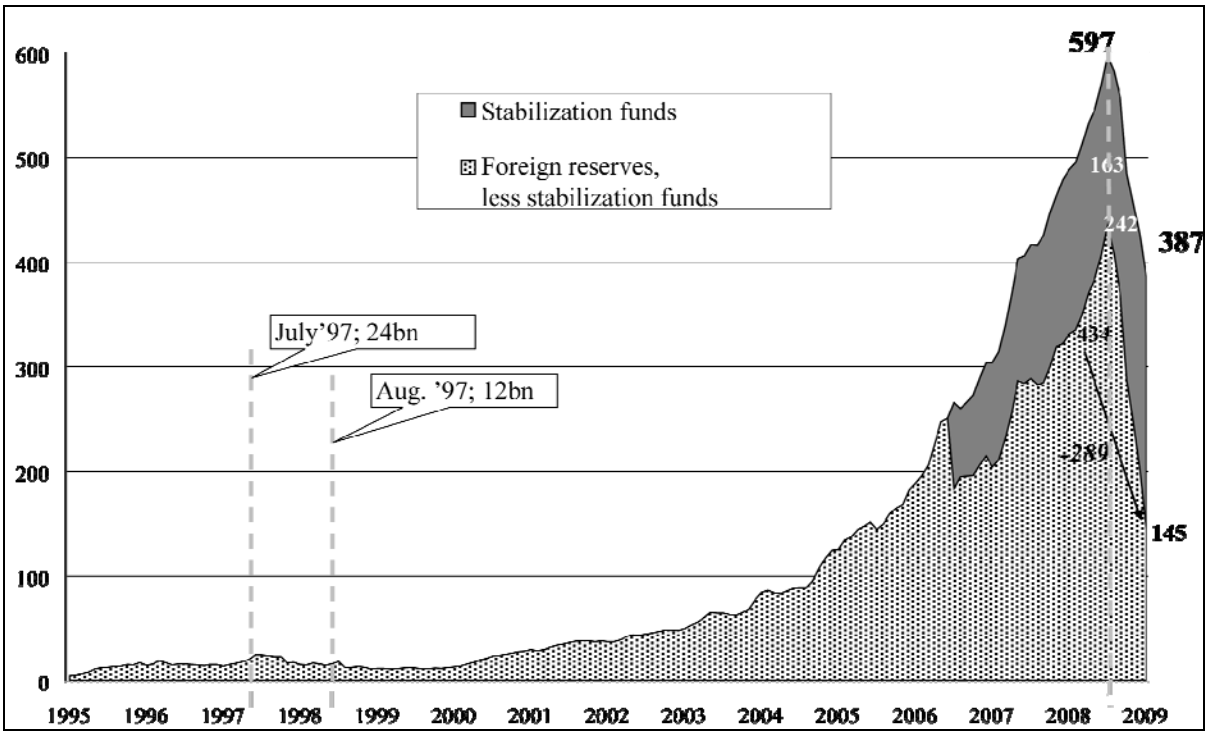
The 1998 and 2008 situations on the market for the Russian issuers' stock appear similar from the perspective of the stock market's capitalization and volatility. (see *Fig. 10.*). A fall of the stock market is accompanied by a growing volatility measured with the use of the standard quadratic deviation of the daily return of the RTS Index. In the period of the last crisis, it accounted for 0.048; over the period the market was being on the rise it plunged to 0.013 in 2005 and 0.014 in 2007. But in 2008 it soared up to 0.042, thus hitting the 1998 level. The value of the Russian stock market's capitalization plummeted from USD 1,306bn in 2007 to USD 370bn in 2008. The distinctive feature of the 2008 crisis became the fact that the fall in the value of the financial assets had practically no effect on volumes of stock trading at Russian exchanges. The explanation of this phenomenon lies in the fact that in 2008 the growth of the stock market was secured chiefly by the REPO deals, with which public banks have been extending short-term loans to non-banking brokers and dealers.

In contrast to the 1997-98 crisis, the ongoing one so far has not encompassed the banking system and the market for debt instruments. That became possible thanks to the government's extension of an unprecedented financial support to banks and non-banking backbone companies. The magnitude of the government support is evidenced by the data on the dynamic of decline of the volume of foreign reserves in Russia between August 2008 and January 2009 given in *Fig.11.*



Source: basing on the data of JSC RTS and the International Monetary Fund

Fig. 10. Capitalization, Liquidity and Volatility Rates of the Russian Stock Market



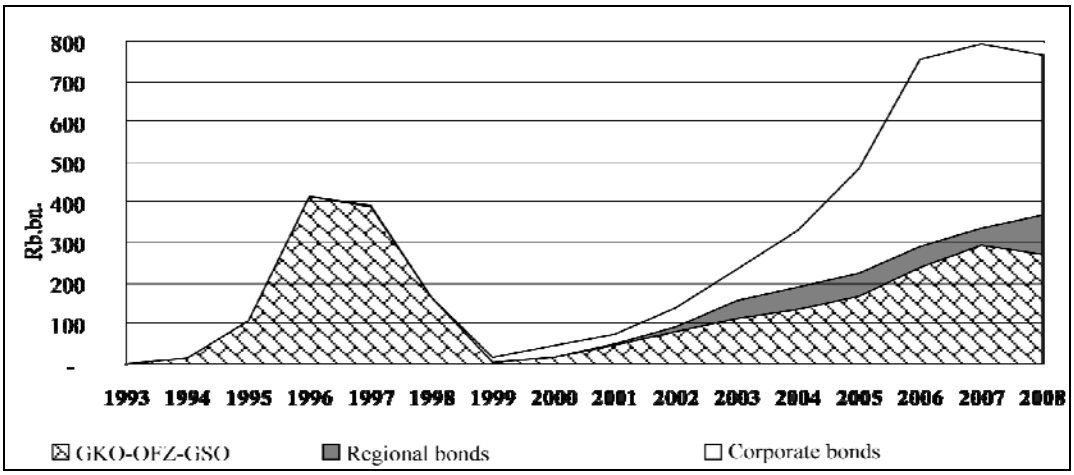
Source: basing on the data of the Bank of Russia and the RF Ministry of Finance

Fig.11. Foreign Reserves and Their Elements, as USDbn.

The nation's foreign reserves comprise two parts, that is, the Stabilization Fund, which in early-2008 was transformed into the Reserve Fund, and the National Welfare Fund, and a part of the reserve governed by the Bank of Russia. The first two funds constitute target funds designated for financing a federal budget deficit (the Reserve Fund) and the pensions delivery (the National Welfare Fund). As seen on *Fig.11*, between the beginning of the 2008 crisis (when the stabilization funds combined accounted for USD 163bn) through January 2009 they have not shrunk but posted a robust growth, up to USD 242bn.

By contrast, the part of foreign reserves controlled by the CBR has dried out from USD 434bn in August 2008 to 162bn as of early-February 2009, or at 62.7%. This means that over the five crisis months the Bank of Russia spent as much as USD 271bn to maintain the Rb. exchange rate and to extend financial support to banks and corporations. Our computations show that some USD 90bn. (Rb. 3.1. trln.) was included in the banks' balance sheets in the form of a contribution to their capital and as borrowed resources. In 2009, the RF Ministry of Finance is going to extend another USD 27bn (Rb. 950bn) to banks for the sake of recapitalization and in the form of subordinated loans[180]. At the time of the 1997-98 crisis, the government had no such funds at hand. As of the start of the crisis, in July 1997, its foreign reserves accounted for USD 24bn. which plunged to 12bn by August 1998.

At present it is hard to judge to what degree the steps undertaken to date would allow stabilization of the situation with banks and on the debt market. So far, as shown on *Fig. 12*, the latter has displayed a notable deceleration of growth of placement of corporate and government obligations in 2007 and contraction of their volumes in 2008. Since the second half of 2008 there emerged a growing wave of defaults in the form of refusals to honor obligations on redemption of bonds, coupon payments and redemption of tenders. The defaults in question have already totaled some Rb. 60bn. By our estimates, in 2009, the volume of redemption of corporate and regional bonds should make up some USD 20bn. Given the absence of a possibility to refinance this debt, this may accelerate the default tsunami on the market for Rb.-denominated bonds.



Source: basing on the data of JSC RTS and the International Monetary Fund

Fig.12. The Volume of Bonds Placement

[180] Long-term loans without the right for an early withdrawal extended, as a rule, under a moderate and fixed interest rate.

So, with all the peculiarities of the 1997-98 and 2008-09 crises, underlying them were in large measure similar economic phenomena. The Russian stock market has appeared considerably dependent on the cyclic nature of the world pricing for oil, natural gas and metals, which, according to the data of the nation's balance of payments, secure 80% of its export gains. Drastic price downfalls for these minerals inevitably entail crises on the domestic stock market and in the financial system. The foreign reserves accumulated over the 2000s form a critical mechanism that allows cushioning of a financial crisis's effect on the domestic market, but this is not enough. Stability of the national financial market strongly depends on effectiveness of the government economic policy measures focused on lowering the economy's dependence on the world prices for mineral exports. In the 2000s, there has been no visible progress in this direction. Furthermore, by our estimates, the degree of dependence of the nation's forex revenues and those to the federal budget from export sales of mineral resources has grown notably over the period in question. Back in 2000, export of oil, petroleum derivatives, natural gas and metals secured 71.6% of Russia's forex-denominated gains, while in 2008 the respective proportion surged to 79.9%[181].

The other direction of lowering the domestic financial market's dependence on the world price situation for minerals might lie with boosting its attractiveness in the eyes of foreign institutional investors who focus on long-term and conservative investment portfolio management strategies.

5.5.4. Problems with Attracting Foreign Institutional Investors to the Russian Market

Whilst between 2000 and 2007 the Russian stock market offered lucrative returns, the country has failed to attract the most capitalized conservative investors, primarily western pension funds' resources. To understand why, one should evaluate practices of the California Employees' Retirement System (CalPERs) the largest US pension fund whose reserves account for some USD 170bn.

Until 2007 the CalPERs has been long applying a methodology of building an emerging markets rating from the perspective of investment opportunities. The methodology was public, and it was based on credible research into emerging markets, including the Freedom House's ratings of civil freedoms and freedom of press, the World Economic Forum's global competitiveness rating, the Oxford Analytica's rating of protection of stockholders and creditors' rights, the Heritage Foundation and the Wall Street Journal's assessments of economic freedom indices, Wilshire Compass and stock exchanges' analytic data, and other sources of information.

The CalPERs methodology suggested evaluation of investment opportunities in the emerging markets proceeding from two groups of factors, that is, country risks and risks inherent in a specific financial market.

CalPERs assessed country risks using the following criteria:

- Political stability: the state of civil freedoms, the degree of the judicial system's independence, and political risks;

[181] Calculated by the data of the Russian Federation's balance of payments published by the Bank of Russia and Rosstat

- Informational openness, including assessment of the freedom of press, the level of information disclosure with respect to the nation's monetary policy and budget, the quality of listing at stock exchanges, efficiency of application of international accounting standards (IAS);
- The labor law's meeting requirement of international standards of regulation of labor relations, including ratification of the ILO Convention, the labor law's meeting the ILO standards, and efficiency of law enforcement.

In other words, the country risks suggest assessment of investment climate and institutions as fundamentals of financial markets.

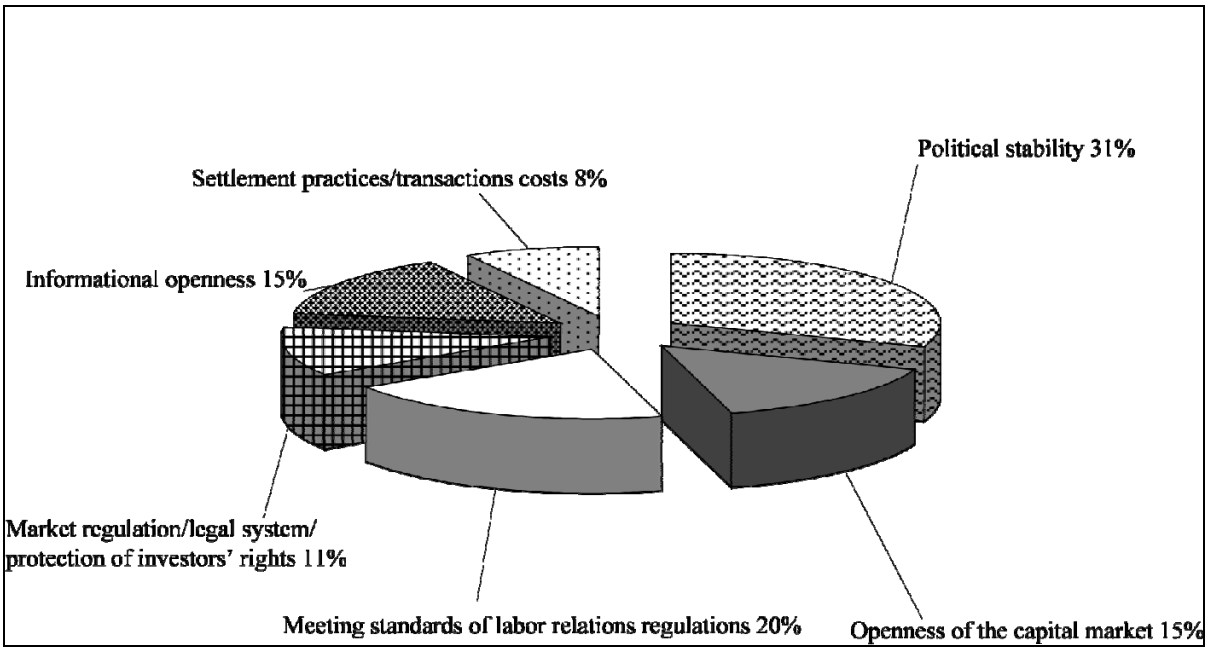
The other group of risks suggests evaluation of quantitative and qualitative parameters of the emerging capital markets, including the following indicators:

- The stock market's liquidity and volatility, including assessment of the market capitalization and pace of its growth, the coefficient that characterize the exchanges' monthly trading turnover to market capitalization ratio, the growth in the number of companies included in the listing, volatility of the stock market and risk/return coefficients;
- Evaluation of efficiency of the banking supervision and law enforcement on the stock market, level of protection of creditors and shareholders' rights;
- Evaluation of the degree of an economy's openness to foreign investments, liberality of the regime of regulation of banks and financial institutions, restrictions on security purchases;
- Evaluation of effecieincy of settlement mechanisms in the stock market and the level of transaction costs, particularly tax ones under settlement of transactions on the securities market and income payments to their owners.

The maximum score a market could get is 3. If a country scored over 2.0, it was to be included in the list of markets available for investing CalPERs's investment assets therein. If a market failed to score the above points, it would fall under the category of markets prohibited for investing.

In 2007, inspired by R. Reed, its new Investment Director who had worked in the company for a year by then, CalPERs modified the investment decision-making methodology applied to emerging markets. Portfolio managers thenceforth were granted the right to independently pick companies from the emerging markets to invest, with a due account of risks inherent in different countries and stock markets. But even with account of the recent policy modifications of 2007-08, CalPERs has not started investing in the Russian issuers' papers. This means that the Fund's approaches to evaluation of the Russian stock market *de-facto* remained unchanged, and they are still relevant for understanding of the market's deficiencies as seen by conservative foreign investors.

In 2007, by the CalPERs's methodology the Russian stock market scored just 1.91 points, less than 2.0, which made it impossible for the Fund to invest in the country. *Fig. 13* highlights on main factors that did not allow the Russian market to get the maximum 3.0 points by the CalPERs's scale.



Source: www.CalPERs.ca.gov

Fig.13. Factors Precluding Russia from Scoring the Maximum Investment points by CalPERs's Methodology in 2007

The country risks, including political stability, informational openness and compliance of the national labor law with the international standards and requirements cost Russia 66% of the score.

Political stability in the country got 1 point out of the possible 3. The main reasons behind such a miserable score are a low assessment of civil rights, independence of the judicial system and reliability of protection of property rights, and the stability of Russia's political system.

The nation's level of informational openness performed better and earned 2.0 points – a pass to the club of permitted for investing markets. With relatively high points granted for measures on disclosure of information of the monetary policy and the budgetary system, and the exchange listing, the main challenges in this particular area were the state of freedom of press and efficiency of application of IAS (US GAAP).

The degree to which Russia's labor law meets the International Labor Organization's standards was awarded with 1.7 points out of 3.

By contrast to the conservative assessment of efficiency of the institutional factors, the quantitative and qualitative parameters of the Russian stock market have appeared quite respectable. But in this area Russia, too, has an underrun of the much-needed 34% to hit the necessary 2 points. This can be explained by existence of the following problems.

The quality of market regulation in the banking sphere and stock markets scored the average 2 points. Getting a higher score was blocked by an insufficient level of efficiency of the banking supervision and law enforcement on the stock market, as well as deficiencies in protection of creditors' rights. As concerns the criterion of openness of the capital market, the country scored a low 1.7 points, due to the existing restrictions for banks and insurance companies' entering the market.

As concerns efficiency of settlements and transactions costs, the Russian market was awarded with a high 2.3 score for their efficiency, with efficiency of settlements on the securities market earning 3.0 points, even in the absence of a central depository and a system of the guaranteed settlements without a preliminary depositing of assets. By contrast, transaction costs, that mirror the level of taxation of incomes and transactions involving securities, proved to be unsatisfactory and scored a meager 1.5 point out of 3. The main claim to taxation is the existence of the 24% corporate tax rate on sales of papers (today, this particularly strongly affects non-residents who buy Russian corporate papers and compels them to invest in Russia solely via off-shore zones), and the rate of taxation of dividends, which is greater than in other emerging economies.

Events occurred between 2008 and early-2009 have unlikely succeeded in dissipating the foreign conservative investors' prejudices with regard to high political risks of investing in Russia and feebleness of institutional factors that affect investors' risks on the stock market.

In June 2008, according to the MasterCard's Worldwide Centers of Commerce Index, Moscow held the 51st place out of 75 largest commercial hubs worldwide, or sank 1 line below its 2007 position. That Moscow's rating was lowered the research team explained by deteriorating legal and political living conditions, a lower economic stability, business climate and infrastructure of business centers. That month, according to the Freedom House, a US NGO, Russia was recognized as a non-free country, while a year before that it enjoyed the status of a partially free nation.

In July 2008, in its research into the state of corruption in 180 countries worldwide Transparency International gave Russia the 143rd position and emphasized the aggravation of the situation with corruption over recent years. The World Economic Forum raised Russia's position in its Global Competitiveness Rating from 58th position in 2007 to 51st in 2008, nonetheless, citing corruption as a major challenge facing competitiveness of its economy.

In 2008, foreign investors received numerous negative signals regarding the country risks and the Russian economy's institutional weakness. The process of Russia's accession to WTO has practically stalled. The recently promulgated law on foreign investment substantially constrained opportunities for attraction of foreign investments into the country under market terms. Public companies were granted exclusive rights to develop the most promising oil and gas fields without any tender or auction procedures. The law enforcement practices exemplified by the TNK-BP, Arbat Prestizh, Russneft and Sakhalin-2 cases, to name a few, gave rise to concerns about protection of property rights in the country. Because of the PM's reckless comments on the government's claims to the metallurgic giant Mechel's tariff policy in July 2008, the corporation lost one-third of its capitalization, or a total of USD 5bn, at the NYCEX. The events around the North Ossetia and Abkhazia have not lowered political risks in the eyes of foreign investors, either. Between September and October the negative factors that increased investment risks in Russia were complemented by the trend to downfall in oil prices.

All these cases demonstrated that the fact of a selective law enforcement in the corporate conflict around YUKOS was not a sole event. Rather, it constituted the reality of the authorities' current economic policy. Here is how the head of BP Group T. Hayward commented on the outcome of the notorious conflict between the British and Russian shareholders in TNK-BP in October 2008. Answering the question as to what degree the Russian side's requirements were satisfied in an amicable agreement, he was quoted by a Russian newspaper,

as saying, "You are not aware of what their actual claims were, are you? You know just what they have said in public…I am afraid you will never know it"[182]. Regardless of what requirements the CEO of BP referred to, his words show how opaque for shareholders and the public at large the biggest Russian corporations' operations had become by late-2008. This evidences a serious crisis in the corporate governance practices.

As concerns the "YUKOS case", events of January 2009 showed that despite the liquidation of the oil giant back in 2007, it still persists as a serious factor of country risk for Russia. On January 29, 2007, the European Court on Human Rights in Strasburg ruled that the YUKOS's application with respect to the Russian government's actions was grounded. This gives a possibility for its *ad rem* consideration.

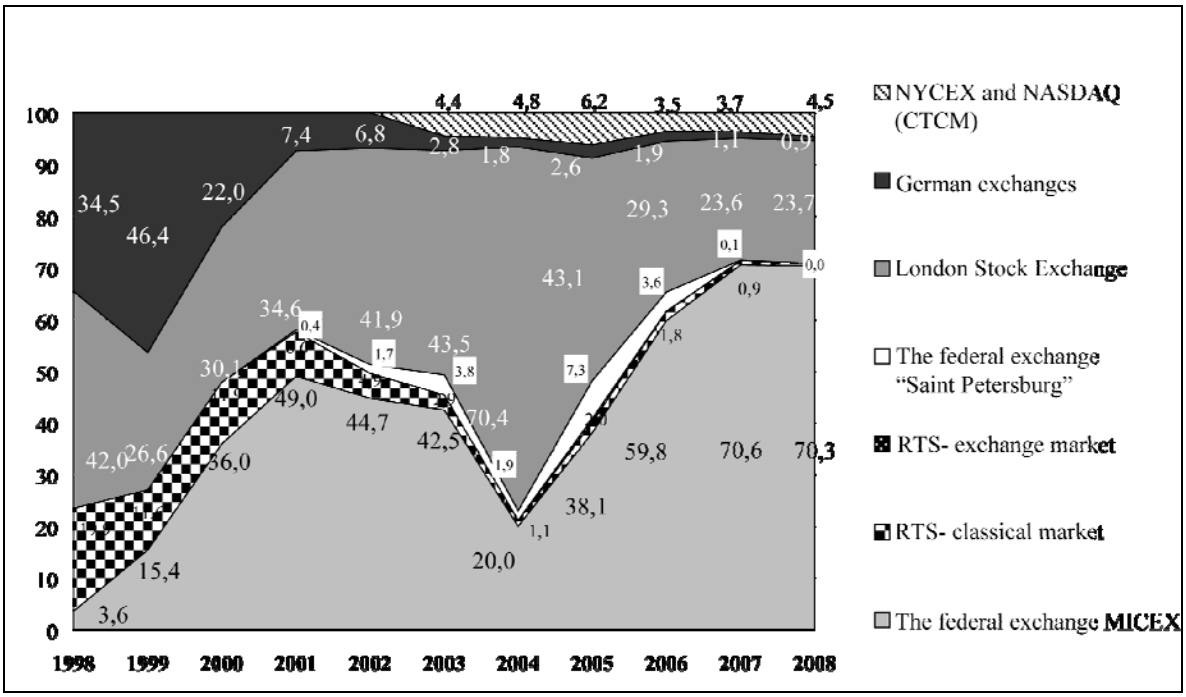
Since the second half of 2008, to the then existing investment risk assessments of Russia added serious macroeconomic risks steered by fears of an envisaged fall in Russia's 2009 GDP, decrease in export revenues from energy sources and minerals, depreciation of the Ruble, fall in foreign reserves, and the budget deficit. According to the RF Ministry of Economic Development and Trade, in 2009 Russia will see its GDP sink at 2.2% - far greater a pace than in all the developed economies and the other BRIC nations.

Recapping on the analysis of various factors influencing an assessment of the investment attractiveness of the Russian stock market as exemplified by the CalPERs's one, it should be noted that main claims concerned institutional factors and investment climate in the composition of country risks, the level of development of the capital market in the part of taxation of investors' earnings, efficiency of the banking supervision, and law enforcement practices. Potential of a further improvement of Russia's rating at the expense of the quantitative characteristics of the stock market and improvement of the infrastructure is close to zero, as the country was has won maximal scores in these areas. So, it is the very directions by which Russia has fallen behind its competitors that the nation must focus its efforts on, so that the future growth of the national stock market could be fueled not only by an inflow of speculative short-term capital, but contributions by the largest overseas portfolio investors as well.

5.5.5. Impact of the Stock Marker on the Economy

Last year, the national exchange stock market has managed to retain its competitive positions by volume of trading despite falling stock quotations and corporations' capitalization, decisions to suspend trading at the Russian exchanges reported time and again between September and November 2008, temporary bans on marginal deals and short sales for brokers. The proof of this is the data on correlation between trading volumes with Russian stock and depository receipts for Russian corporations' stock at the domestic exchanges and overseas given on *Fig. 14*.

[182] Vmeshatelstvo rossiyskogo pravitelstva ne bylo pryamym, tolko kosvennym. Kommersant, 6 October 2008, p.20



Source: the author's calculations basing on the exchanges' data

Fig. 14. The Proportional Weight of Exchanges in Trading Volumes with *Stock* of Russian JSCs

In 2004, the domestic exchanges' proportion in the stock turnover plunged to 23%, and there arose a real risk of the center of pricing for, and liquidity of the domestic corporations' stock migrating overseas, to the LSE. But the perilous trend was overcome over the next years. The national exchanges and MYCEX in particular regained their positions as centers of pricing for, and liquidity of the Russian issuers. In 2008, the MICEX's proportion in the turnover of the Russian corporations' shares accounted for 73%. More than that, the spot market for stock in Russia de-facto was centralized at MICEX, while the share of RTS on this segment of the market has practically reduced to zero. Meanwhile, RTS has grown as a principal trading floor for the rising financial terminal, which after collapsing at MICEX in August 1998 was being practically non-existent over a few years. That the Russian exchanges have consolidated their positions on the market for the Russian issuers' shares became possible mostly thanks to an advanced growth in the absolute volume of stock trading at MICEX between 2005 and 2008.

Meanwhile, in addition to the problem of the stock market's liquidity, the increasingly pressing is becoming the question as to how this particular segment of the stock market affects solution of fundamental problems facing the economy. The stock market and the economy are interlaced. On the one hand, as shown above, the stock market is strongly dependent upon ongoing processes in the national economy, while on the other, it has a reciprocal impact on the economy and attraction of investments and economic growth in particular. But stock quotations and capitalizations on the rise, IPOs on track *per se* do not mean the stock market has positive effects on investments and economic growth rates. To make it play a constructive role in the process, one needs to build a number of prerequisites.

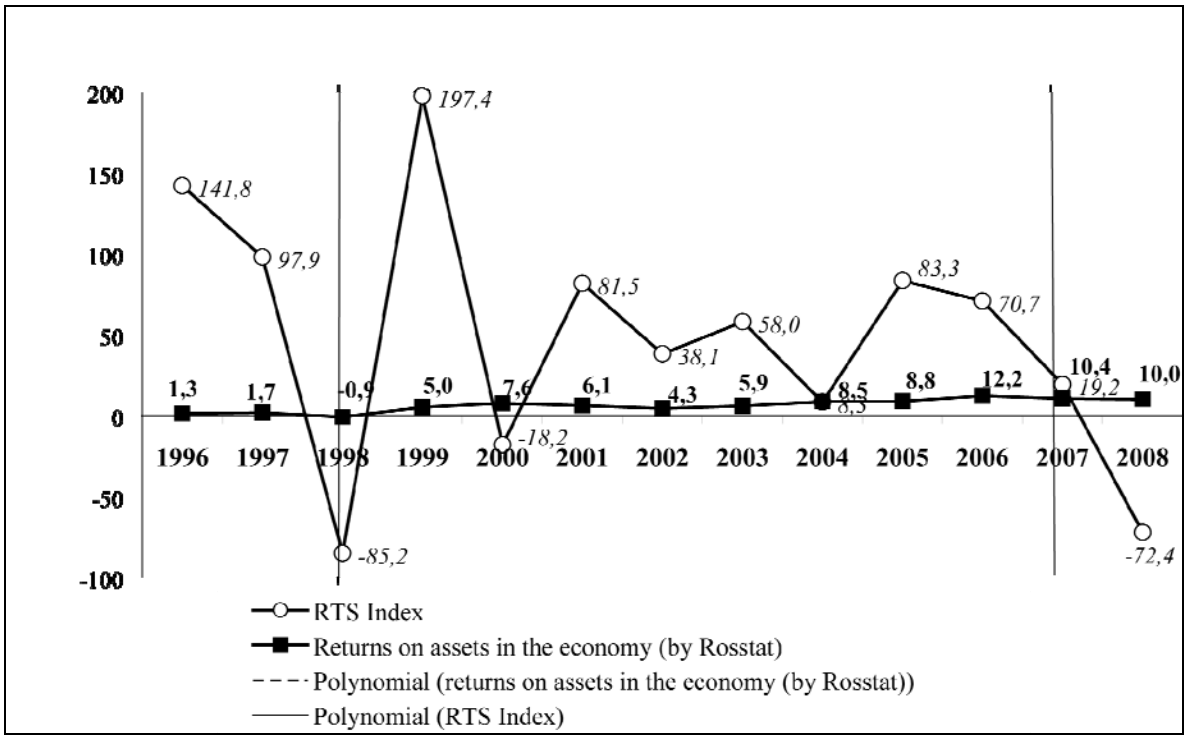
The stock market should contribute to growth in real investments in capital assets and production inventory. Emphasizing the links between investments and economic growth, the Nobel Prize winner in economics Neokeynesian P. Samuelson noted that "investments … are made only when a tangible capital is created"[183]. In other words tangible capital constitutes a generator of economic growth.

Investments in creation of new production capacities should be economically more lucrative than exchange purchases of stock, including those under M&A transactions, sales of stock packages to strategic or market investors, etc. The clue to the problem at the individual company level in part lies in the method of evaluation of efficiency of investment decisions on the basis of the so-called Q coefficient suggested by the Nobel Prize winner in economics J. Tobin, Professor of Yale University. The coefficient shows correlation between a company's market capitalization and its present value, i.e. the costs of capital assets analogous of those in operation. Under a low value of the coefficient, for instance, below 1, a company's shares are undervalued, and in this case it would be more profitable to invest in buying its shares. Should the company's Q value is greater than those of competitors', its stock is overvalued, thus making it profitable to invest in tangible assets. Unfortunately, data on the present value of most of Russian corporations are unavailable. Hence, to evaluate efficiency of investments in purchases of stock or in creation of new assets, one can try a different approach, that is, comparing returns rate on investment in a corporation's stock with its rate of return on assets. Should the former substantially exceed the latter, transactions on the secondary stock market become more economically attractive than investing in production capacities and material inventories.

Fig. 15 provides data on ROI in stock in the form of an RTS Index portfolio and return on assets, which can be employed as a criterion for making an investment decision with regard to efficacy of investments in boosting production capacities.

Between 1996 and 2008 it was only the two crisis year (1998 and 2008) out of all the 13 years when the rate of return on corporations' assets was greater than that of return on stock. In the conditions of an advanced price rise for shares, other conditions being equal, business will be keen to invest greater resources in stock purchases at the secondary market and in the IPO process than in creation of new production capacities and material inventories. In these cases corporations often resort to credit leverage, i.e. purchases of stock packages at the expense of collateral loans. It multi-fold boosts attractiveness of such investment strategies in the period of a rapid price rise. The stock market discontinues exerting an effective impact on attraction of real investments in corporations and economic growth. The influx of funds into the secondary stock market contributes to growth in its liquidity, price hikes for stock and, ultimately, emergence of a bubble at the stock market. In the conditions of euphoria steered by a long-lasting rise in stock quotations, as it was noted in Russia in the 2000s, businesses find it hard to catch a moment, when, according to the Tobin's Q criterion, shares have become overvalued, to drastically modify their investment strategies in favor of investing in creation of new production capacities.

[183] Samuelson P.E; Nordhaus William D. Economics: transl. from Engl.: the 16th ed.: "Williams" Publishers, 2005.- p. 389.



Source: the author's calculations basing on the data of RTS and Rosstat

Fig.15. Returns on Stock and Returns on Assets in the Economy

Because of this and due to a drastic downfall in stock quotations, by late-2008 numerous representatives of the national financial-industrial oligarchy had found themselves balancing on the verge of the financial abyss. The market value of their financial assets plunged below costs of their obligations before creditors. Perhaps, a certain role in the situation played the fact that, by contrast to other developed economies, in Russia, it was owners of large businesses personally coined M&A deals, rather than professional direct investment fund managers. The corporate owners have found it very challenging a mission to combine the task of developing production capacities and the production process on the whole with the investment business in the M&A area.

That in the 2000s business employed the Russian stock market as a mechanism for sales and purchases of financial assets and short-term speculations can be proved by data of the OPI statistics. In the 2000s, Russian corporations regularly held placements of corporate bonds and IPOs on the domestic market. For instance, in 2007 alone, corporations and banks placed Rb-denominated bonds worth a total of USD 18bn and attracted another as much as USD 33bn through primary and secondary stock placements. In 2007, Russia became one of the leaders on the global capital markets in terms of IPO volumes, mostly thanks to IPOs its public companies were holding at the time.

The bulk of attracted on the stock market resources was spent on redemption of businesses from their former owners, debts refinancing, and servicing M&A deals, including acquisitions of huge stakes. It was just a tiny fraction of the attracted on the stock market resources that was to form real investments (in new production capacities and material inventories), thus helping maintain economic growth. This is evidenced by *Tables 10* and *11*.

Table 10

Parameters of the Market for Russian Corporations' Stock (as USDbn)

	2005	2006	2007	2008
Capitalization	549	1 057	1 407	370
Secondary market, including REPO	374	882	1 230	1 348
IPO	5	17	33	7*
To equity	0.3	2.5	3.6	1.9
The same as % to capitalization	0.1	0.2	0.3	1.8
The same as % of the volume of IPO	5.8	14.7	10.9	27.0
The volume of M&A deals	32	40	122	78

* with account of private placements of some companies' stock to strategic investors.
Source: calculations made basing on the data of exchanges and Rosstat. Volumes of M&A deals are given by the data of the M&A-Intelligence analytic group published in Expert, №6, 16–22 February 2009 , p. 46–48.

In the most favorable from the perspective of IPO volumes year of 1997, out of USD 33bn cashed in from primary and secondary stock placements, only USD 3.6bn., or some 10.9%, was spent to increase the tangible capital. In 2008, under a clear fall in the IPO volumes due to the financial crisis, there occurred some improvement in employment of the IPO-generated funds, with 27.0% of cash attracted through stock placement, or USD 1.9bn, being spent on shopping for capital assets. The volumes of cash collected over the 2000s through IPOs for the sake of increasing production capacities appear meager when compared with the volumes of M&A deals. For example, as noted above, in the pre-crisis 2007, the IPOs generated USD 3.6bn subsequently spent on purchases of capital assets, while the M&A market boasted a whopping USD 122bn volume.

At this point, yet more illustrative are the data on use, for the sake of real investments, of funds attracted by means of corporate bonds issuance, as given in *Table 11*.

Table 11

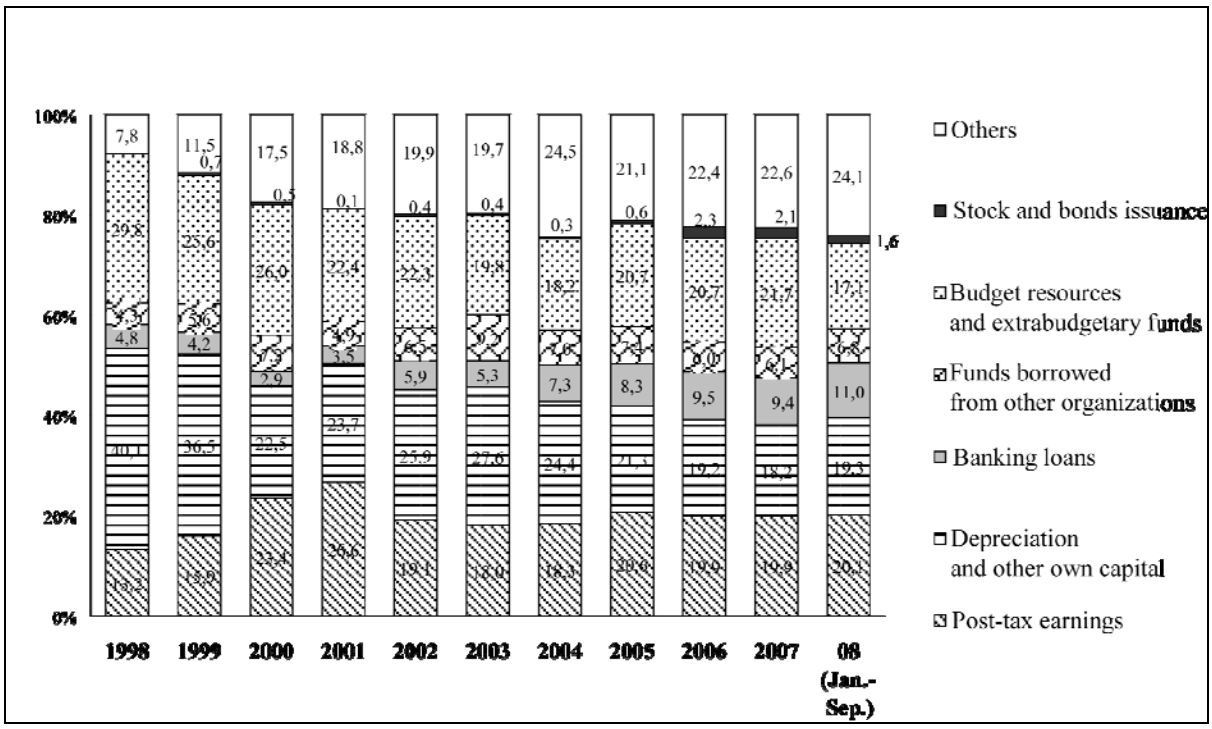
Parameters of the Market for Ruble-Denominated Bonds (as USDbn)

	2005	2006	2007	2008
Capitalization	17.0	32.8	48.2	66.5
Secondary market, including REPO	44.2	134.9	371.4	454.0
IPO	9.2	16.0	17.9	15.9
To equity	0.2	0.06	0.4	0.2
The same as % to capitalization	0.2	0.06	0.4	0.3
The same as % of the volume of IPO	2.2	0.4	2.2	1.3

Source: calculated basing on the data of exchanges, Cbonds.ru and Rosstat.

Despite a dashing rise in volumes of placements of corporate bonds from USD 9.2bn in 2005 up to 17.9bn in 2007 and 15.9bn in 2008, the volume of capital spent on creation of new capital assets was extremely low. For example, with a total volume of bonds placements in 2008 worth USD 15.9bn, just as much as USD 170m was spent on buying capital assets. Overall, between 2005 and 2008 the proportion of investments in the total volume of issuances of corporate bonds channeled to the fixed capital has been fluctuating between 0.4% and 2.2%.

As shown on *Fig. 16*, the main sources of financing of capital assets of the real sector companies remained their own savings, the government's aid, extrabudgetary funds and banking loans. In 2008, their proportion in the total volume of investment sources in capital assets stood at nearly 70%. Over the 2000s, despite an impetuous surge of the stock market up to 2008, the proportion of funds attracted by means of bonds and stock issuances in the sources of financing of corporations' capital assets has remained practically invisible. While in 1999 it accounted for 0.7% of the volume of sources of capital assets financing, in 2008 it grew just to 1.6%.



Source: calculated by the data of Rosstat.

Fig. 16. Structure of Sources of Investment in Capital Assets

Thus, the analysis of the role the Russian stock market played in the capital assets financing sources shows that in the 2000s the stock market had a fairly loose effect on growth in tangible capital and, accordingly, on economic growth on the whole. The stock market retained its virtual nature, mostly helping corporate owners vigorously play on the market for mergers and acquisitions, efficiently quit their former business by selling it to outside investors, refinance debts, secure cash for participants in corporate M&A transactions. During the period in question, the rate of return on such deals, that did not lead to creation of new production capacities and just indirectly affected economic growth, was substantially greater than that on investment in new capacities and material inventories. Like the market for junk bonds and IPO in the developed economies, securities placements on the Russian stock market helped one to employ borrowed and other resources to secure concentration of property in the hands of individual groups. Along with the administrative resource and selective law enforcement practices, the use of the financial leverage constituted one of the factors of a dashing advancement of the market for mergers and acquisitions, redistribution of property and

increase in the government's role of an owner of assets. An inevitable consequence of these processes became increasing credit risks on the market for bonds and an unfavorable for investors dynamic of the post-IPO capitalization of corporations[184]. In parallel with that, foreign investors conceived of Russia's country risks as growing ones, due to accompanying the M&A process mass violations of property rights, raiders' activity, corruption and the increasing government's intervention in the largest companies' structure of property.

As in the early-2000s, the government's economic policy currently does not answer to the question as to at the expense of which mechanism it is supposed to complete the structural rebuilding of the economy in order to lower its dependence on oil, gas and metal exports. The stock market does not cope with this task, as with its use corporations attract less than 2% of investment sources to their capital assets. Banking credits play somewhat a role greater– the proportion of banking loans in sources of financing of capital assets accounts for 11.0%; however, they appear insufficient to ensure a radical redistribution of resources. The current model of the financial system suggests concentration of financial surpluses at the level of the governmental sovereign welfare funds, large companies that export minerals, and a number of public corporations (the Fund for Assistance to the Housing and Utilities Reform, Rostehnologii, Rosnanotech, Olympstroy, the Development Bank, among others). These mechanisms are unlikely to efficiently cope with the task of the economy restructuring. The sovereign funds center mostly on portfolio investments in overseas markets; the exporters appear are keen to invest chiefly in their own development; the public corporations focus just on individual sectors of the economy and so far have failed to demonstrate a notable performance in implementing huge investment projects.

To ensure progress in renewing the Russian economy, the government should more vigorously engage the banking system and the domestic stock market's capacity.

5.5.6. Fundamental Challenges of the Domestic Market for Bonds

A curious phenomenon of the 2000s became the unfolding of the market for Rb-denominated bonds (see *Fig.17*). Its capitalization sky-rocketed from Rb. 46bn in 2000 to 1,633bn in 2008, with the annual increment rates averaged 55%. The total value of regional bonds surged over the period in question from Rb. 23bn to 303bn, with the annual growth rate of 36.5%.

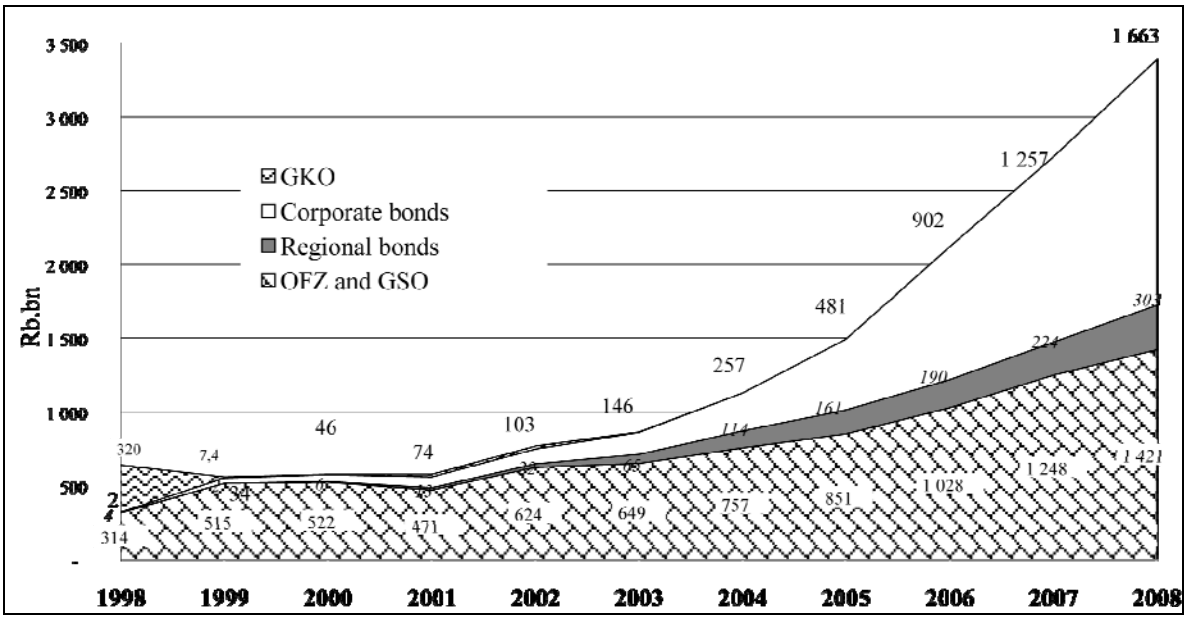
Because of the 1998 crisis, the government short-term bonds (GKO), with the use of which a classical financial pyramid had been built, have left the scene. In the process of novation, the government made a compulsory change of the discounted GKO for the federal bonds (OFZ). Post-crisis, the volume of the federal and savings bonds (OFZ and GSO) soared from Rb. 522bn in 2000 up to Rb. 1,421bn in 2008, with the average growth rate of 13.0%, which was clearly inferior to rates noted across the other segments of the market for Rb.-denominated bonds. This is natural, as in the conditions of a huge surplus of the federal budget, there was no economic sense in issuing government bonds, except for the need to replenish the Pension Fund's portfolio.

Regretfully, the years after the crisis of the late-1990s saw no resurrection of a liquid secondary market for federal bonds. It was the Pension Fund of RF and public banks that remained major players on this particular market. As a result, the market for government securi-

[184] By our calculations, return rates of 75%-80% of Russian corporations that have held IPO on the regular basis proved to be lower than those of RTS and MICEX Indices.

ties practically discontinued playing a significant role as an instrument of refinancing the banking system – these functions were reassigned, in the relationship between the Bank of Russia and commercial banks, to the CBR's bonds, while on the market for interbank loans – to more risky corporate and regional bonds.

Because of a low level of development of the market for government papers, despite a rise in absolute indicators of bonds placements, the relative indices of advancement of the bonds market in the 2000s have remained modest. In Russia, the 2008 total volume of corporate bonds to GDP accounted just for 3.8%. By its indicator of a relative level of development of the market for national bonds Russia has notably fallen behind most developed stock markets and large emerging ones.



Source: basing on the data of the RF Ministry of Finance and Cbonds.ru

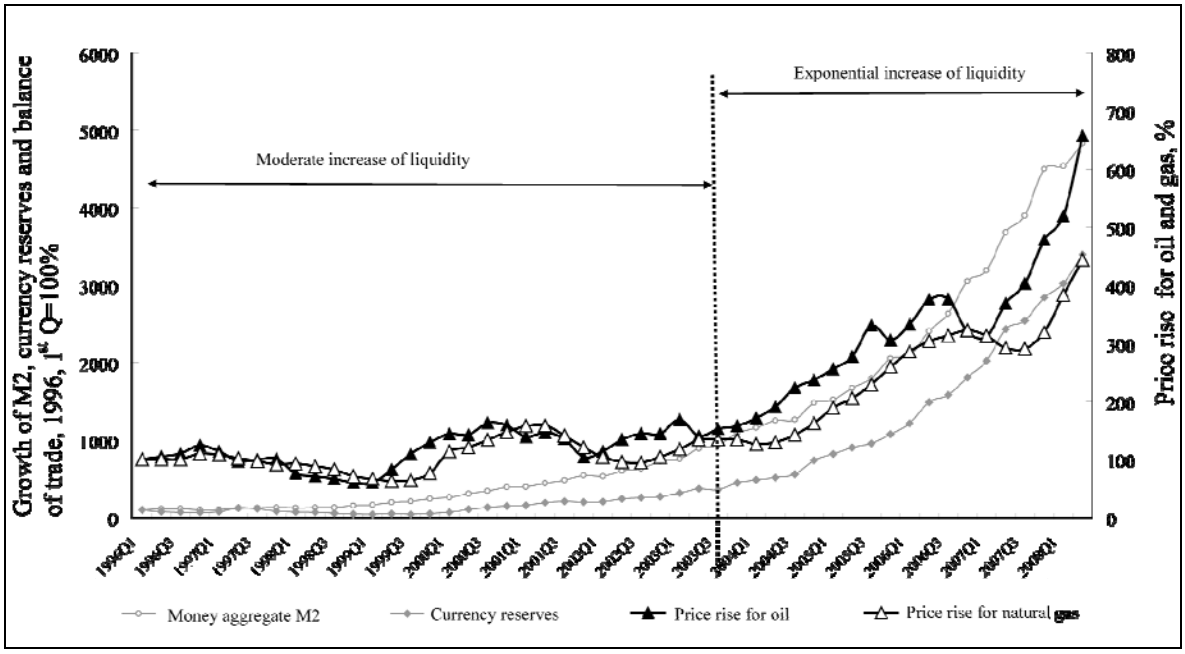
Fig. 17. Volumes of Rb-denominated bonds in circulation

An important achievement of the nowadays market for Rb.- denominated bonds vis-à-vis the situation prior to the 1998 crisis became emergence of a positive correlation between the market for bonds and the real economy's needs. Prior to 1998, high costs of attraction of resources onto the GKO market would kill the mere possibility for issuing bonds for the sake of financing corporate investment projects.

At the same time, one should not overestimate the intensity of the process of transformation of the domestic market for bonds towards its re-orientation to the real economy's needs. The existing debt market appears in part a virtual one, granting greater opportunities to enjoy handsome earnings to short-term speculators, rather than the much-needed real investment- to business or chances for citizens to build long-term individual savings plans. The problem is not just the already discussed fact that funds raised thanks to corporate bonds issuances practically fail to get into the economy in the form of real investments – yet more alarming is the fact that the national market for bonds has appeared practically unprotected from carry trading, while the government's pursuance of a soft financial policy resulted in mainte-

nance and even acceleration of inflation rates; the government practically encouraged a vigorous application of this strategy by Russian banks and overseas hedge funds.

In a nutshell, the carry trading strategy is simple – to raise funds by means of their borrowing in the national currency of the country wherein interest rates are low (the funding currency) for the sake of their subsequent investing in financial instruments of the country with relatively high interest rates denominated in the national currency (the investing currency). According to the Bank of International Settlements, the list of the most popular currencies comprised the JPY, Swiss franc and the USD, while that of investing currencies included the Australian, New Zealand and the emerging markets' currencies[185]. To implement the carry trading strategy one needs three prerequisites: depreciation of the currency in which the loan is arranged; low interest rates in the country where the loan is arranged; and existence of a liquid and relatively stable forex market and financial assets denominated in the national currency. It was the very prerequisites that had emerged in Russia by late-2003 (see *Fig. 18*). At the time, the period of a moderate price rise for oil and gas was over – they began rising by the exponential trend. The oil Dollars and natural gas Euros pouring in Russia's economy gave rise to an accelerated increase of its foreign reserves and money supply. The Ruble took the path of a long-term appreciation.



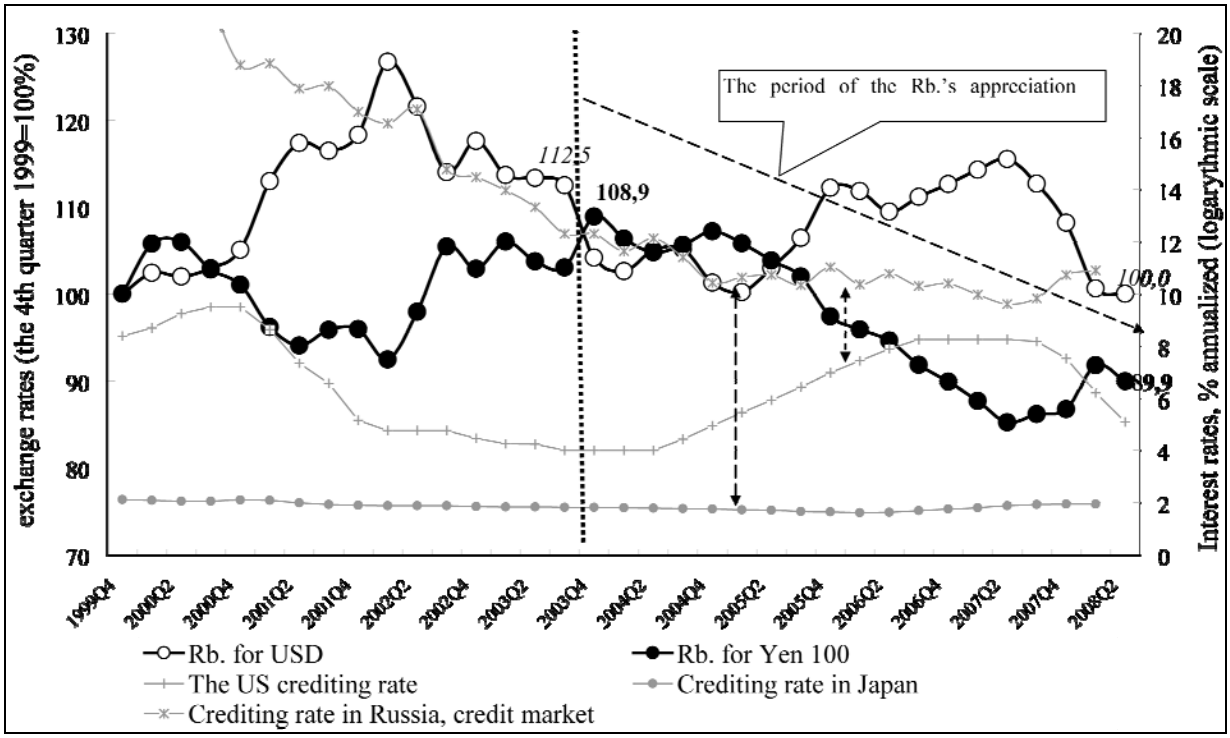
Source: calculated by the IMF financial statistics database.

Fig. 18. Price Rise for Energy Sources and Growth in the Cash Surplus in Russia (the 1st Quarter 1996=100%)

[185] Galati G., Heath A., McGuire P. Evidence of carry trade activity. BIS Quarterly Review, September 2007, pp.28–29.

As evidenced by *Fig. 19*, since late-2003 the Rb. has been appreciating against the JPY and USD. If one takes the rate of the former currency in Rb. equivalent as of the end of the 4th quarter 1999 as equaling 100%, by the end of the 4th quarter 2003 the JPY appreciated against the Rb. at 8.9%, and after that up to the 2nd quarter 2008 it has depreciated in total of 20 p.p., down to 89.9%. Since 2004 the USD rate in Rb. equivalent has displayed a greater uncertainty in its behavior, but, anyway, it dropped at 12.5 p.p. At the same time, as evidenced by *Fig. 19*, through all the period in question costs of credit resources in Rb. equivalent have been substantially greater compared with those of borrowing on the US and Japan's markets.

Hence, by late-2003 in Russia there formed exceptionally favorable prerequisites for pursuing the carry trading strategy. It should also be noted that at the time the international rating agencies awarded Russia with investment ratings, which solidified the foreign investors' confidence.



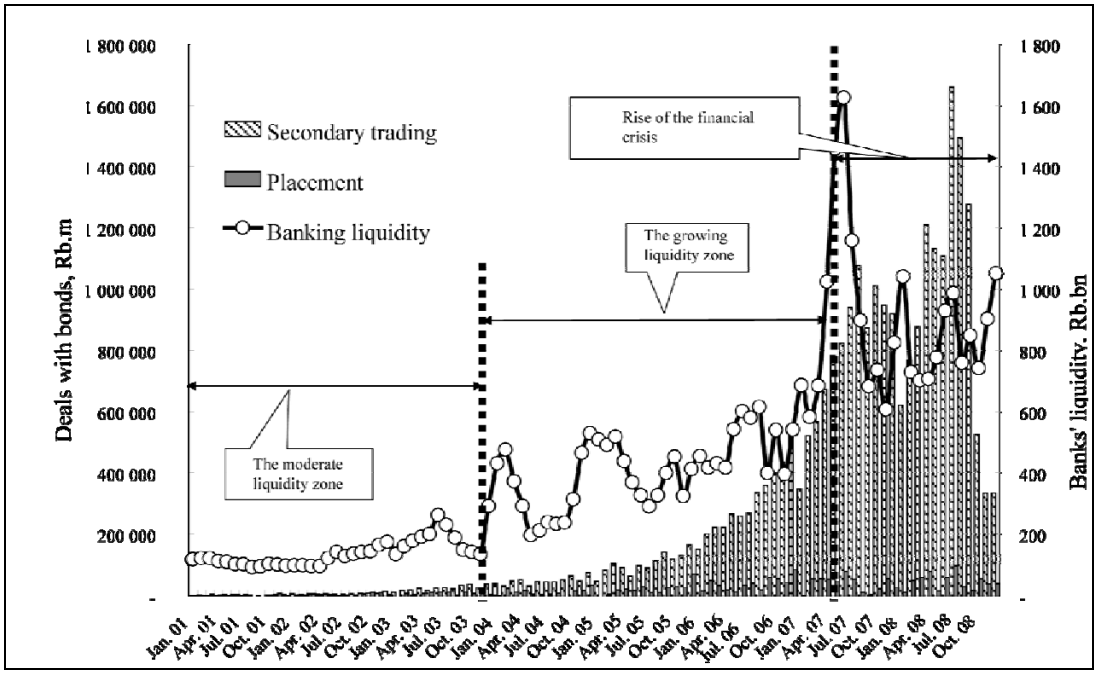
Source: calculated by the IMF financial statistics database.

Fig. 19. Interest Rates and Dynamics of Exchange Rates of the US, Japanese and Russian Currencies

All that contributed to the growing popularity of the carry trading strategy on the Russian stock market, which, in our view, fueled a dashing rise in the Russian stock market's liquidity between the end-2003 and roughly through the 3rd quarter of 2007. Since the second half 2007 this strategy has begun to exhaust itself, with the aggravation of the crisis of confidence on the world financial market, which had started with unsecured mortgage loans. The problems have sparked the crisis of confidence, and cheap funds have become increasingly hard to attract. Since the second half 2008 it became impossible to attract any funds.

The main terminals in pursuing the carry trading strategy on the Russian financial market became commercial banks and overseas hedge funds. It is fairly complex a task to assess in quantitative terms the proportion of sources of financing attracted with the use of this strategy in the overall value of the Rb.–denominated stock and bonds. For example, according to the Greenwich Associates, in 2006 as much as 45% of volumes of trading with bonds offered by issuers from the emerging countries fell on hedge funds[186].

The impact the carry trading exerted on different segments of Russia's financial market can be assessed by means of analysis of the changes that were taking place in the market liquidity area since 2004, when the strategy was first tried in Russia, and since August 2007, when Russian corporations and banks began to face serious difficulties with attraction of borrowed resources.



Source: by the data of the CBR and MICEX

Fig. 20. Operations with Corporate Bonds and Banking Liquidity between 2001 and January 2009

Fig. 20 provides data on the state of the banking liquidity (the banks' balances on the corresponding accounts and deposits with the Bank of Russia), and volumes of placement of, and the secondary exchange market for Rb.-denominated corporate bonds. In 2001-2003 the market for corporate bonds and the volume of banking liquidity have been rising fairly moderately by the linear trend. Between 2004 and July 2007 the banks' balances with the CBR began to grow at a faster pace, and their amounts were growing substantially. The process was followed by a dashing rise of the market for Rb.-denominated bonds. Meanwhile, the secondary exchange market for bonds posted a rate of growth outpacing that of volumes of bonds placements. This can be explained by the fact that fueled by REPO transactions (which form

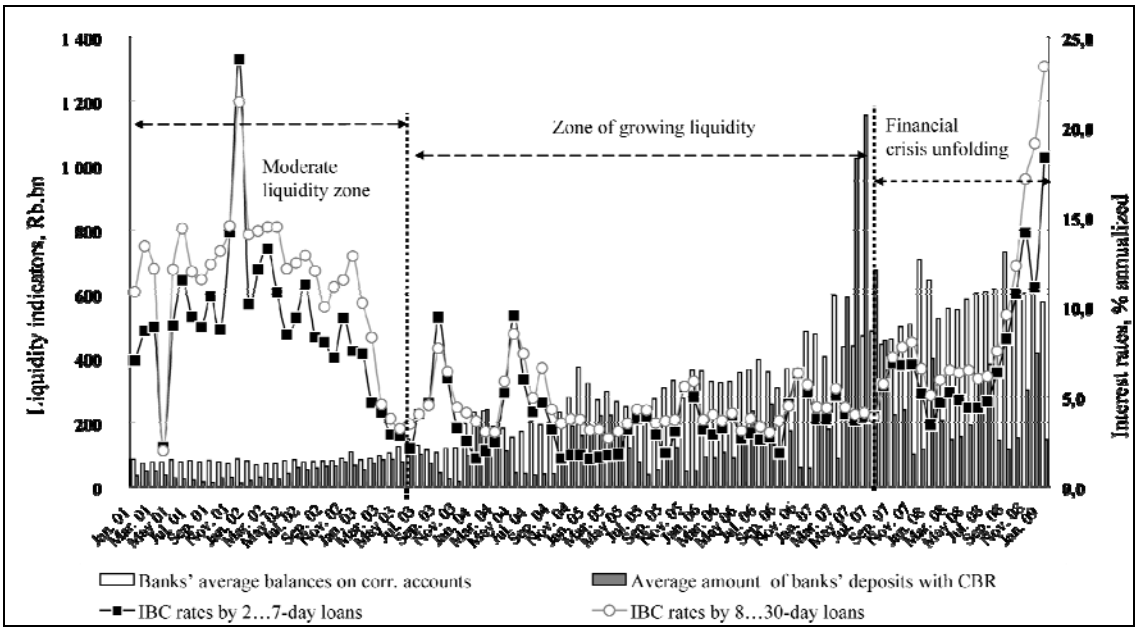
[186] Major findings were published in the Wall Street Journal on August 30, a 2007. See also OECD. Financial Markets Trends, Volume 2007/1, №92, p.42.

an a analogue to collateral loans against securities), the market for corporate bonds has increasingly emerged as one of main mechanisms of interbank crediting. A sharp fall of banking liquidity started in August 2007. By late-2008 the inflow of cheap resources from overseas had dried out, which resulted in a dramatic fall in the trading volumes and primary placements of corporate bonds.

All the three stages in the dynamic of indicators of the corporate bonds market and banking liquidity coincide with the development stages of the carry trading strategy. The advanced growth in liquidity and in the bonds market between 2004 and July 2007 coincides with a vigorous implementation of the carry trading strategy by the Russian banks and foreign hedge funds.

Fig. 21 presents an analysis of the correlation between banking liquidity and interest rates on the interbank credit market. Indicators are interest rates on interbank loans for the term between 2 and 7, and 8 and 30 days published by the Bank of Russia. In the period of a moderate liquidity of 2001-2003, the rates on the interbank credit market were high and very volatile. They would reach 15-20% annualized and fluctuate within the range between 3 and 25%. The inflow of liquidity in the period between 2004 and the first half 2007 made them and the level of their volatility tumble to some 4-5%. The only banking liquidity crisis occurred at the time (between May and June 2004) was more of a crisis of confidence – it was provoked by the CBR representatives' reckless statements concerning certain claims to a number of commercial banks. Since the second half 2007, with the global financial crisis unfolding and cheap resources on overseas financial markets growing hard to get, the interbank credit market interest rates began to soar and so did their volatility.

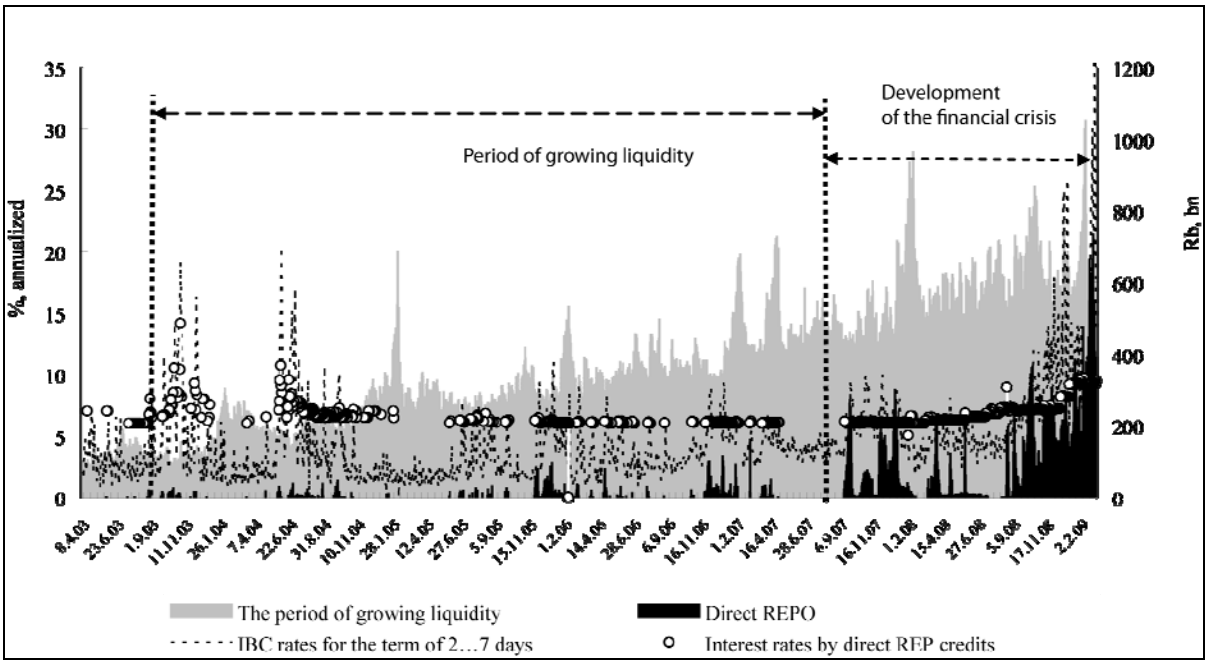
Between late-2008 and early-2009 the IBC rates practically hit the level of the early 2000s. Thus, the size of, and volatility on the IBC market and the banking liquidity were changing fairly synchronously with the intensity of the use of the carry trading strategy.



Source: by the CBR data

Fig. 21 The Average Monthly Indicators of Banking Liquidity and Interest rates on the Interbank Credit Market between 2001 and January 2009

Fig. 22 exhibits the correlation between interest rates on the IBC market and the direct REPO mechanisms employed by the CBR. In the time of growing liquidity, the Bank of Russia appeared quite efficient in affecting an excessive surge of interest rates on the IBC market by extending short-term loans to banks in the form of the direct REPO transactions involving public, corporate and regional bonds. Since the second half 2007 the CBR has continued to vigorously employ this mechanism; however, it demanded from the Bank of Russia far greater amounts of credit injections to tame an excessive growth of the IBC rates. Since September 2008 volumes of such credits have posted a substantial growth, and by today they have practically caught up with the bank's cash balances on corresponding accounts with the CBR.



Source: by the CBR data.

Fig. 22. Use of the Direct REPO Mechanism for Regulation of Banking Liquidity in 2003-2008

So, as exemplified by the market for corporate bonds, banking liquidity, and interest rates on the IBC market (*Fig. 20–22*), it is clear that the start of banks and hedge funds' employing the carry trading strategy coincided in time with a rapid growth of banks' cash balances, volumes of placement and turnover on the secondary market for Rb.-denominated bonds, decline in the level and volatility of rates on the IBC market. And vice versa, the growing complications in employment of carry trading noted from the second half 2007 were accompanied by a tumbling banking liquidity, decline on the market for bonds, growth in the level and volatility of the IBC rates. Referencing again to *Fig. 10*, one can note that a dashing surge of the stock market also fell on the period between 2004 and the first half 2007, i.e. the period of a vigorous application of the carry trading strategy. All this allows one to assume that the carry trading strategy was playing a critical role in an accelerated growth of the Russian stock market in the 2000s, while the subsequent collapse of the stock market, deceleration of the growth and the rising risk of defaults on the market for corporate and regional

bonds appear determined by difficulties that arose in conjunction with the employment of this strategy since the second half 2007.

What threats does the carry trading strategy bear and what are its effects? Let us note three aspects – growing liquidity risks in the banking sector; the threat of a rapid shrinkage of the government's foreign reserves; and suppression of the population's incentives to long-term savings with the use of Rb-denominated bonds.

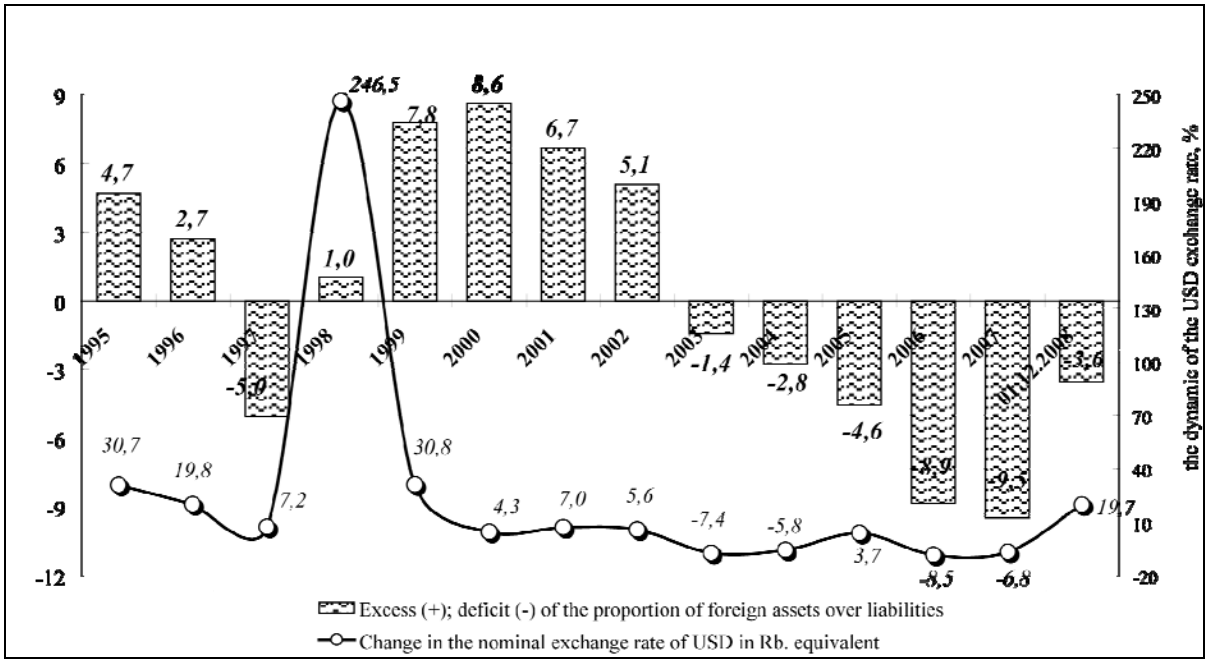
In the banking system, it leads to accumulation of the imbalance between the banks' forex-denominated assets and liabilities in the form of a substantial excess of the value of forex-denominated obligations vis-à-vis that of forex-denominated assets. This poses a major risk factor that has steered the liquidity crisis in the banking system. According to the IMF experts, participation of banks from the emerging economies in carry trading for the sake of funding growth in crediting the population constitutes one of the major risks these nations' financial markets may face[187].

As shown on *Fig. 23*, in 1997, on the eve of the August crisis, the rate of the excess of the banks' forex-denominated obligations vis-à-vis their forex-denominated assets was 5% of the value of the latter. Ignorant of risks of loosing liquidity and careless of currency risks, large banks kept on attracting huge loans from foreign creditors in the form of futures. After the Rb. depreciated in August 2008, the majority of such banks could not pay off their obligations before their foreign creditors and, following that, before Russian deponents. The decision the national monetary authorities made back in August 1998, according to which banks were temporarily banned to repay their foreign debts, still appears fairly disputable. The decision did not impact the advancement of the crisis, but resulted in an inefficient use of a part of the funds allocated to keep the banking system buoyant and became an indirect bonus for the collective irresponsibility of the bankers who had partially fathered the banking crisis.

The story with carry trading *per se* appears a replica of the 1998 banking crisis. Since 2003 the banks saw a dashing rise of the imbalance between their obligations denominated in foreign exchange and the size of their forex-denominated assets. Banks were vehemently borrowing resources denominated in foreign exchange and invested them in Rb-denominated assets, primarily in the form of consumer and mortgage loans, bonds and loans extended to public companies. By results of the first seven months of 2008, the amount of the excess of obligations denominated in foreign exchange over forex-denominated assets accounted for 9.4% of the banks' balance-sheet totals (the respective index in 2007 was 9.5%). That was nearly twice as high as on the eve of the 1998 crisis, with a number of big banks reporting the respective figures to be far greater than the above ones. That made the threat of a serious crisis of the banking system terrifyingly real.

The aforementioned imbalance testifies to grave problems in the sphere of supervision and regulation of banking operations. Hence, the question as to how, in the conditions of various standards that regulated the financial sustainability, accumulation of such an imbalance in the national banking sphere, which at any moment can trigger a systemic financial crisis became possible.

[187] IMF. Global Financial Stability Report. Financial market Turbulence: Causes, Consequences, and Policies. September 2007, pp. 22-25.

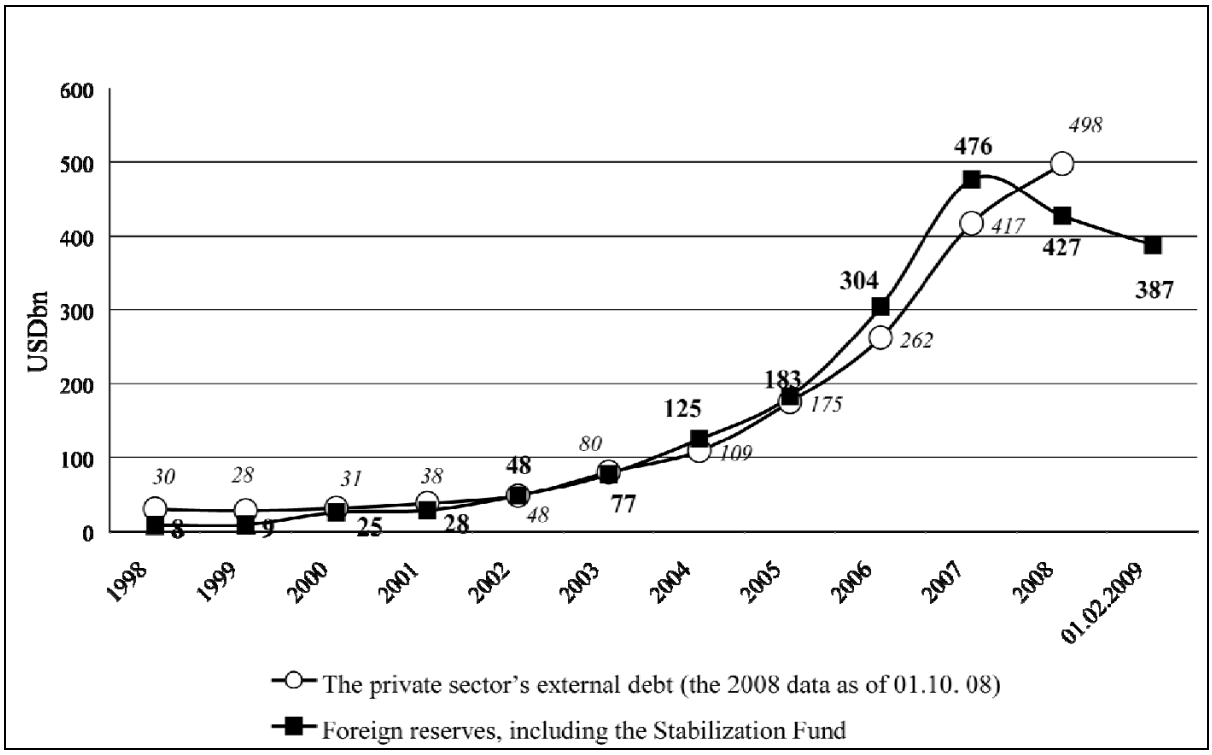


Source: calculated by the CBR's data

Fig. 23. Excess (+) and Deficit (-) of the Banks Foreign Assets over Liabilities (the Proportion of the Banks' Value of Assets (Liabilities), as %)

Between late-2008 and early-2009, the government took unprecedented steps to heal the situation. By our estimates, as noted above, the banking sector received some Rb. 3.1trln in loans, which allowed a partial solution of the imbalance problem. As of December 1, 2008, the rate of the imbalance sank to 3.6% of the banks' balance-sheet totals. That has so far alleviated the intensity of the risk of a systemic crisis in the banking sector. By our estimates, only this step alone cost the Bank of Russia USD 50bn spent out of its foreign reserves.

The carry trading strategy, that has resulted in the accumulation of a huge foreign debt by the Russian banks and companies, has engendered the threat of a fast "eating away" of the nation's foreign reserves and a wave of defaults, primarily by the non-banking businesses that do not enjoy such a generous governmental support at the expense of the country's foreign reserves as bankers do. *Fig. 24* presents the correlation between the government's foreign reserves and the volume of the private sector's external debt. The key link of the economic policy in the 2000s has been withdrawing a surplus of cash savings resulting from a favorable state of affairs on international markets and channeling it into the sovereign funds (the Stabilization Fund and the CBR's foreign reserves). To bridge the resulting cash gap, corporations and banks had to borrow overseas. As a result, the amount of the foreign reserves appears comparable to the size of the aggregate corporate external debt.



Source: basing on the data of the balance of payments over a number of years.

Fig. 24. The Surge in Debts by the Private Sector and in the Government's Financial Surpluses

According to the First Deputy Prime Minister I. Shuvalov, as of the moment of preparation of this paper, the government had already earmarked as much as USD 85bn in long-term credits to businesses to cover their foreign debts. By our estimates, the majority of big Russian banks and non-banking companies presently have at hand some USD 130bn to finance their foreign debts repayment in 2009.

But the mission of foreign reserves is far more ample than a mere financing of corporate foreign debt. As highlighted in comments to *Fig. 11*, as of January 2009, the government had an instantly available USD 145bn to support the Rb. exchange rate, boost capitalization of the banking system and refinance the external debt. The businesses' external indebtedness at that time, with account of a partial repayment of their debt obligations in the late-2008, should account for some USD 450bn. Thus, the private companies' cumulative external debt already appears three-fold in excess of the government reserves on hand.

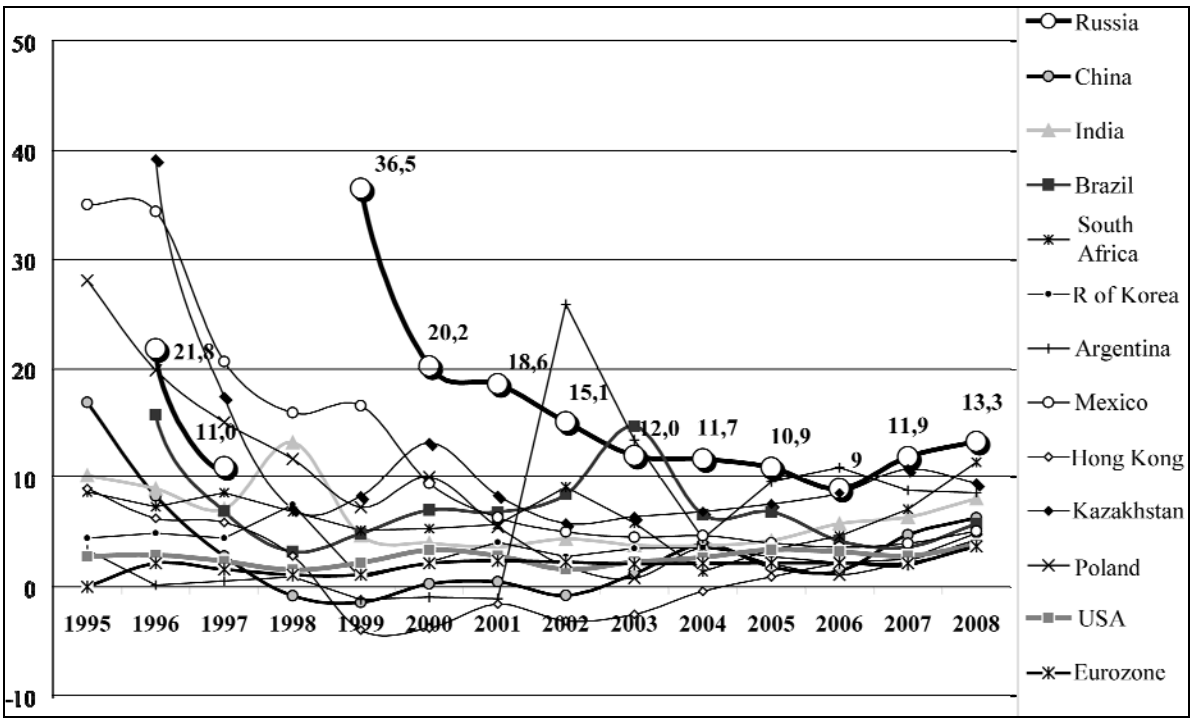
The other negative consequence the carry trading bears for the national market is maintenance of a rate of borrowing resources on the domestic market at the level below the inflation one. This weakens competitiveness of the domestic institutional investors (investment and pension funds, and insurance companies) whose funding is effected in Rubles and who therefore have no possibility to capitalize on the advantages borne by carry trading.

Implementation of long-term strategies of individual savings plans and building the domestic institutional investors' differentiated portfolios, necessitates these portfolios comprising, in a sufficient volume, instruments with fixed yields, primarily bonds. In compliance with the Russian law, such categories of institutional investors as non-public pension funds and

insurance companies should have Rb- denominated bonds as a prevailing part of their portfolios. But mostly because of the carry trading strategy, the real rates of return on these instruments have been steadily negative.

There are many ways for the government to combat the influx of cheap and short-term resources in the economy. But the most efficient measures are the ones aimed at a radical decrease of inflation rates. The higher the domestic inflation rate is, the greater the spread between the domestic Rb-denominated borrowing rates and the costs of attraction of resources from overseas are, and the more efficient the carry trading strategy for speculators is.

Fig. 25 provides data on the level of inflation in Russia vis-à-vis the largest developed and emerging markets. It is evident that in Russia it notably greater than elsewhere. This serves as a partial explanation to a greater volatility of the national stock market and its greater dependence on speculative capital. At the same time, the level of the Russian households' private savings is lower than in the noted countries. So, the struggle for domestic savings should start with combating inflation.



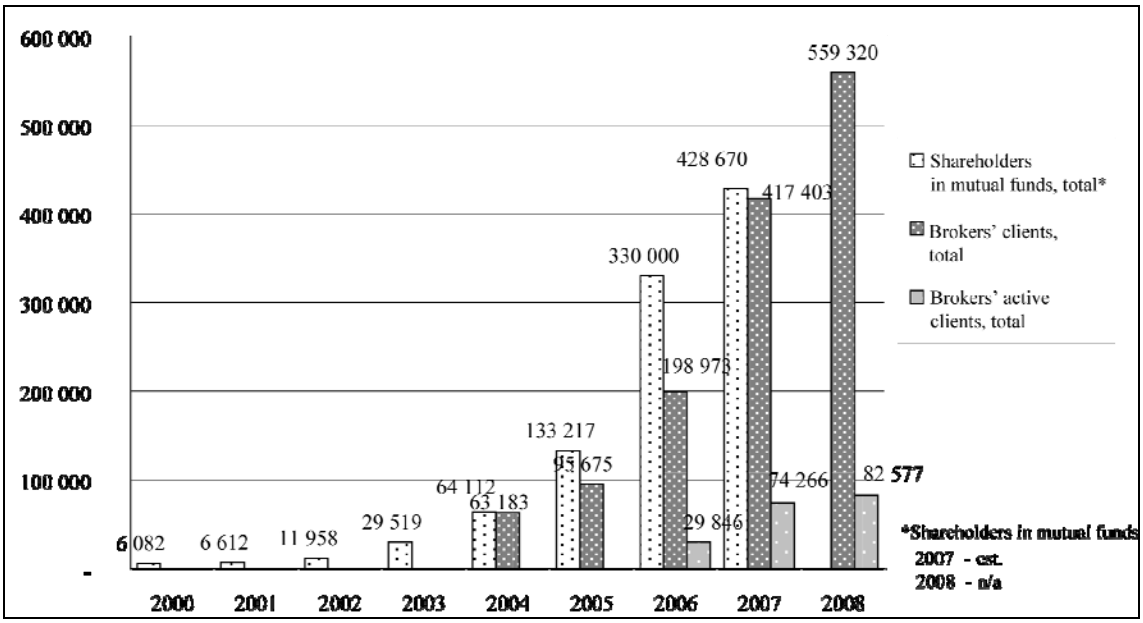
Source: basing on the IMF and national statistical data.

Fig. 25. Inflation in Russia Compared with Other Countries, as % Annualized

The urgency of anti-inflationary measures as a means of pillaring the domestic savings system is yet much more important in light of the government's efforts to create a Moscow-based international financial center. The problem is that under a high inflation in Ruble equivalent, creating a center that should secure for large foreign investors, including foreign sovereign welfare funds, an easy access to the domestic market multiplies risks associated with carry trading. Such risks may result in the rates of Rb-denominated instruments falling to a minimal level and, in the event of a high inflation, securing a negative rate of return for the domestic investors whose sources of financing are funded in Rubles.

5.5.7. The Interconnection between the Stock Market and Residents' Savings

According to Rosstat, there are some 6m households with the annual income starting from USD 30,000 in Russia. This gives some idea of a total number of households with investment potential. But only a tiny fraction of this population buys securities such as stock, bonds, shares in mutual funds. *Fig. 25* highlights on available data on the number of individual accounts with brokerages and in the records of owners of shares in mutual funds.



Source: basing on the CBR and Rosstat data.

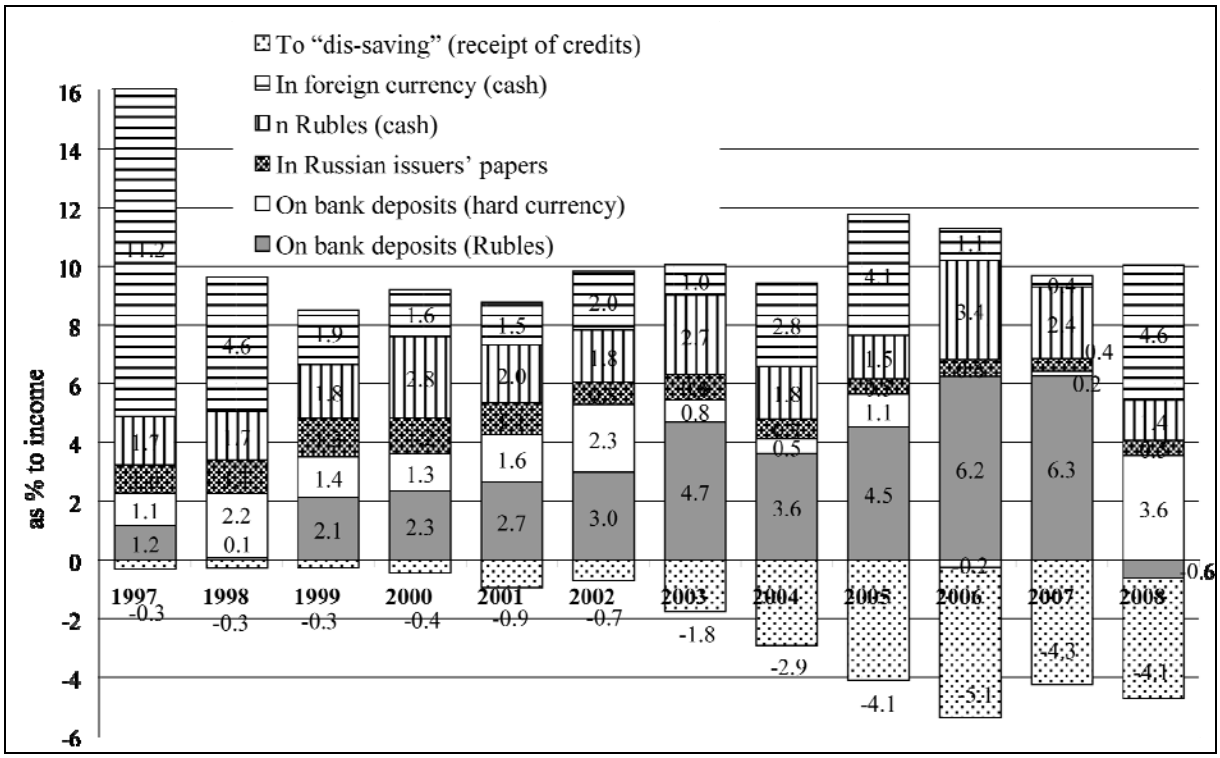
Fig. 26. The Number of the Management Companies and Brokerages' Market Retail Clientele

In 2007, by our estimates, the total number of private individuals investing in securities either directly, or via mutual funds accounted for 845,000. The 2008 data on the number of market shareholders in mutual funds have not been published as yet. The number of residents taking part in the exchange trading grew from 417,000 in 2007 up to 560,000 in 2008, including the number of those who strike at least one deal a month – from 74,000 up to 83,000.

That less than 100,000 individuals out of 6m households with a real investment potential regularly buy stock on the market evidences that the stock market, in the population's eyes, so far has not become a mechanism of realization of a long-term savings strategy. The majority of residents view investments in mutual funds and corporate papers as a way of short-term investing, that is, they are speculators, rather than investors.

This is also proved by the Rosstat data on the population's aptness to savings in various kinds of financial assets, as shown by *Fig. 27*.

The 2008 crisis has drastically broken the residents' private savings system. Citizens have abandoned more organized forms, such as Rb-denominated bank deposits, in favor of cash in Rubles and bank deposits in hard currency. By some preliminary estimates, in 2008, the population scaled back on their savings on the Rb-denominated bank deposits. While in 2007 residents placed as much as 6.3% of their income on such deposits, in 2008 this figure tumbled drastically and currently stands at 0.6% of households' incomes.



Source: basing on the CBR and Rosstat data.

Fig. 27. Disposition of the population to saving in 1997–2008

In 2007 only 0.2% of residents' incomes was spent on raising their savings in hard currency equivalent put in banks. In 2008, the figure was 3.6%. Plus, savings in the form of hard currency cash posted a sharp growth - up to 4.6% of the households' incomes.

The level of the population's debts by consumer credits remains high – in 2008, the increment in the sums of these credits accounted for 4.1% of the households' incomes.

The 2008 proportion of the population's incomes invested in papers made up 0.5%, or thrice down vis-à-vis the 1998 crisis. It also appeared inferior to the 2006 level of savings in papers, which accounted for 0.6% of the population's incomes.

Transformation of the residents' savings into a genuine catalyst of growth of the domestic market necessitates not only millions of individuals' coming to the market, but the overwhelming majority of them sharing confidence in the potential offered by long-term (for 10,20, 30-year and longer) savings plans. So far only a very few believe in these strategies. A substantial obstacle to implementation of long-term investment strategies is the absence of Rb-denominated instruments with the fixed yields above the inflation level. A compulsory condition of implementation of a long-term investment strategy is the presence of bonds in an investor's portfolio. The older the investor is, the greater the proportion of bonds in his portfolio should be. But because under a high level of inflation in Rb. equivalent the domestic market for bonds is dominated by carry trading strategies, bonds, with their negative real rates of return, have grown practically unavailable to the domestic investors.

The above allows one to conclude that while several hundred thousand individual investors came to the domestic stock market over the favorable 2000s, it has failed to mobilize their capacity, nor it succeeded in becoming a means of implementation of their long-term invest-

ment strategies. This forms one of the most critical flaws of the Russian stock market. Yet worse, over the period in question, the government has failed to offer the national middle class an adequate pension system – launched back in 2002, the pension reform has practically become a failure.

Conclusions and Recommendations

Hence, unfolding on the Russian stock market since 2008, the serious crisis can be only partially conceived of as an unheralded one and triggered by the global financial crisis. The domestic factors of the national economy and advancement of the stock market in the 2000s have made a substantial contribution to its depth and intensity. In the period of a dashing growth in the market's capitalization and liquidity, which in many ways were fueled by the inflow of foreign speculative capital and the carry trading strategy, the financial regulators did not pay a sufficient degree of attention to risks growing in the banking system in the form of the imbalance between the banks' forex-denominated liabilities and assets. Today, the imbalance constitutes the main reason for the liquidity crisis in the banking sector. Plus, there have been other speculative strategies of funding financial intermediaries, particularly attraction of funds with the use of REPO transactions at the exchanges.

A serious deficiency of the Russian stock market that causes conservative foreign investors' distrust in it is the continuous weakness of institutional factors and high country risks. A sustained development of the domestic stock market and a successful implementation of the declared by the government project of creation of an international stock center in Russia are impossible without addressing such challenges as guarantees of protection of property rights, the judicial system's independence, progress in the area of civil rights and freedoms, openness of the financial system and the economy to foreign investments, creation of a law enforcement system on the financial markets whose efficiency should be recognized worldwide. The current crisis has demonstrated that putting stakes on public corporations as a major redistribution and crisis management mechanism on the financial market does not allow preventing financial crises, nor it ensures an efficient use of resources. One of the most efficient instruments of preclusion from financial crises lies in a greater role played by the civil society which normally exercises an independent control over processes in the economy and in the financial sphere.

The virtual nature of the Russian stock market, that is, its loose ties with economic growth and real investments, as well as its image in the population's eyes as a place for speculative, rather than savings-oriented investment strategies poses a critical challenge. A future competitiveness of the domestic stock market can be ensured only if it rests upon the domestic investors' potential. To this effect, building a domestic investment base should form a priority avenue of the national stock market's development strategy.

The growing dependence of Russia's economy on mineral exports compels one to more vigorously seek ways to boost efficiency of the financial system's impact on economic growth and the economy modernization. Clearly, the stake on an efficient redistribution of resources in favor of manufacturing industries and the new economy with the help of public corporations and sovereign welfare funds has appeared unworkable in Russia. While public corporations provide too scarce information of their performance, the sovereign funds appear to a greater degree focused on portfolio investments overseas. In Russia, there are no success stories of using sovereign funds for investing in the domestic economy, like public investment corporations in Singapore and China have done.

Meanwhile, as exposed by the 2008-09events, in the conditions of the Russian financial market's great dependence on the state of affairs in the world economy, the sticking to the Keynesian model of stimulation of the domestic demand by encouraging the population's consumption, consumer and mortgage crediting poses increased risks. With the first signs of crisis there starts a dashing growth in unpaid credits and social conflicts fueled by execution of recoveries by private debts before banks. An excessive stimulation of the population's consumer behavior entails the absence of long-term savings, which leads to reproduction of an inefficient and dangerous for the government distributive pension system.

Plus, as far as the developed economies are concerned, it is most likely that problems of the Keynesian consumption stimulation policy should be revisited. More specifically, new in-depth research should focus on the fact that a pro-Keynesian economic policy results in constraints to an investment inflow into the most capital-intensive sectors, thus giving rise to imbalances in development of different industries and production spheres[188]. As shown in the section on the impact a securities market has on an economy, the problem appears a fairly urgent one as far as the Russian economy concerns.

All this testifies that the government should center on the financial institutions reform, for the latter forms a main direction of the government's efforts to boost up efficiency of the financial system's impact on economic growth and rearmament of the Russian economy. The reform objective should become creation of a large and competitive intermediary community, which should be able to solve problems of accumulation and retention of the population's savings, businesses and governmental oil and other revenues for the sake of their efficient introduction in the crediting and financing of investment projects.

Given magnitude of the problem of the population's switching to long-term savings on the stock market, the government should design a sound reform policy for the domestic stock market, which should comprise the following steps:

- bringing inflation rates down to 4-5% annualized over next 2-3 years; adoption of restricting measures with respect to the carry trading strategy;
- adopting measures on a drastic increase of the banking and non-banking financial intermediaries' reliability and efficiency, and the transparency level of their operations; developing infrastructure, lifting obstacles to introduction of new kinds of financial products and services (for instance, investment consultancies and clubs);
- adopting measures on tax stimulation of long-term savings;
- introducing a uniform organizational structure and fundamentals of management of resources of the savings pension system and those of government sovereign funds; introducing the system of citizens' individual savings plans with the right to transfer these funds to specialized broker accounts and trust accounts;
- introducing a system of a moral and material encouragement of professional literature which explains benefits from the long-term investing

The above measures do not form a closed list, of course; however, they show that Russian residents are unlikely to switch to long-term strategies by themselves – these steps require decisive actions from the government.

[188] Jesús Huerta de Soto. Dengi, bankovsky kredit i ekonomicheskiye tsykly.M: "Sotsium" Publishers, 2008, p. 259-262.

5.6. Practices of Regulation of Monopolistic High Prices in Russia in 2008

Restrictive business practices that constitute a possibility for producers to exert influence on market agents' economic conditions with respect to collecting extra earnings inhibit advancement of respective industries. The setting and maintaining of monopolistic high prices by individual producers of merchandize and services poses a profound challenge to Russia's economy.

While exposing tendencies that characterize peculiarities of the Russian practice of regulation of monopolistic high prices, one needs to examine correlation between the following factors:

- Abuse of the antimonopoly law in the part of setting a monopolistic high price;
- The sectoral specificity of a given market;
- The size of the market;
- Initiative of an investigation;
- Signs of a monopolistic high price

Table 12 systematizes cases of setting and maintaining monopolistic high prices in 2008.

Table 12

Abuses of Part 1 p. 1 Art. 10 of the Federal Act "On protection of competition" (setting a monopolistic high price) exposed by the Federal Antimonopoly Service in 2008 [189]

№	Company	Commodity/ Service	Initiator of the investigation	Size of the market	Signs of abuse of the antimonopoly law
1	Gaspromdobycha Orenburg LLC (the Gasprom group)	Block granulated sulfur	Consumers	National	Unjustified price rise
2	JSC MMK, JSK Oskolsky electrometallurgical plant	Metal products used to manufacture bearing parts	FAS	Individual production	No price decrease under the changed market situation
3	JSC Metallorukav, Trading House Metallorukav LLC	Metal bonding braid for airspace engines	Consumer	Individual production	Unjustified price rise
4	JSC SUEK, JSC "Holding Copmany "Yakutugol"	Thermal coal	Consumer	Several regional	Unjustified price rise
5	Holding Sibuglemet LLC, JSC Subuglemet, JSC Mezhdurechye, JSC "OF Mezhdurechenskaya", JSC "OFAntonovskaya) (Holding "Sibuglemet" Group	Concentrate of baking coal of crozzling marks	A number of consumers, FAS	National	Unjustified price rise
6	JSC KD Avia	Rent of office space in the air terminal facility	Consumer	Local	Unjustified price rise
7	JSC Vnukovo Invest	Parking lot by the air terminal	Consumer	Local	Unjustified price rise
8	Alcoa RUS LLC, JSC Samarsky metallurgical plant	Individual kinds of aluminum profiles	Consumer	Individual production	Unjustified price rise
9	JSC Yuzhkuzbassugol	Coke-coal	FAS	National	Unjustified price rise
10	JSC "Ruspoliment"	Circular billets from nickel alloy	Consumer	Individual production	Unjustified price rise
11	Rosneft oil company»	Gasoline, diesel fuel, aviation kerosene, fuel oil	FAS	National	No price decrease under the changed market situation
12	JSC LUKOIL	Gasoline, diesel fuel, aviation kerosene, fuel oil	FAS	National	No price decrease under the changed market situation
13	JSC Domodedovo Aerootel	Parking lot by the air	Consumer	Local	A relatively high pricing

[189] The data was systematized on the basis of press releases posted on the FAS's official Homepage in the Internet www.fas.gov.ru in 2008

№	Company	Commodity/ Service	Initiator of the investigation	Size of the market	Signs of abuse of the antimonopoly law
		terminal			
14	TH Mechel, JSC MC "Yuzhny Kuzbass", JSC "Holding Copmany "Yakutugol", JSC Raspadsky ugol	Concentrate of baking coal of crozzling marks	FAS	National	Unjustified price rise
15	JSC Gasprom, TNK-BP Holding	Oil products	FAS	National	Unjustified price rise
16	Zhanr LLC	Access to cable TV	Consumer	Local	Unjustified price rise
17	JSC "OC Lukoil", LUKOIL-Ukhtaneftepererabotka LLC, LUKOIL-AERO LLC (the LUKOIL Group)	Aviation kerosene	FAS	Regional	Unjustified price rise
18	Toplivno-obespechivayuschaya kompaniya	Aviation kerosene	FAS	Regional	A relatively high pricing
19	JSC Avialinii Dagestana	Air tickets	FAS	Regional	A relatively high pricing
20	JSC LUKOIL-Nizhegorodneftesintez, LUKOIL-AERO LLC	Jet fuel	FAS	Regional	Unjustified price rise
21	JSC BRK Invest Limited, JSC Domodedovo Aerootel	Parking lot by the air terminal	Consumers	Local	A relatively high pricing
22	JSC Silvinit	Potash chloride	Consumer	National	Unjustified price rise
23	Bryansky dairy plant	Dairy products	FAS	Regional	Unjustified price rise
24	JSC Uralsvyazinform	Leasing of cable in the telephone conduit channels	Consumers	Regional	Unjustified price rise
25	Electrolsatl metallurgic plant	Circular billets	Consumer	Individual production	Unjustified price rise
26	Magadan center for standartization, metrology and certification	Equipment testing services	Consumer	Regional	A relatively high pricing
27	Pervy khlebokombinat	Bread	FAS	Local	Unjustified price rise
28	JSC Uralkaliy	Potash chloride	Consumers	National	Unjustified price rise

According to the FAS, in 2008, the Agency investigated 28 cases in conjunction with setting and maintaining monopolistic high prices (Part 1 p. 1 Art. 10 of the Federal Act "On protection of competition").

According to the Agency's data, a minimal threshold of the exposed monopolistic high price is 35%. In 64% of cases the Agency exposed a sole producer's high price, while in 36% cases the law was abused by a group of companies. The sectoral structure of monopoly abuse is given in *Fig. 28.*

The bulk of cases of the setting of a monopolist high price for services (parking lot charges by airways terminals of the Moscow hub) falls on consumers. Meanwhile, the proportion of the services sector in the overall number of exposed cases of monopoly abuse is a minimal one.

The sectoral structure of abuses generally correlates with the structure of the Russian export – the maximum proportion falls on the fuel and energy sector's output, and that of the chemicals sector, while the industrial production and the food-processing sector hold a lesser proportion.

The markets wherein the aforementioned cases of monopoly abuse were exposed can be broken down size-wise into the national, regional, local ones, and the market for individual production. The latter category matters for a market that functions in the conditions of a lim-

ited number of producers and buyers (for instance, the market for metal bonding braid for air-space engines).

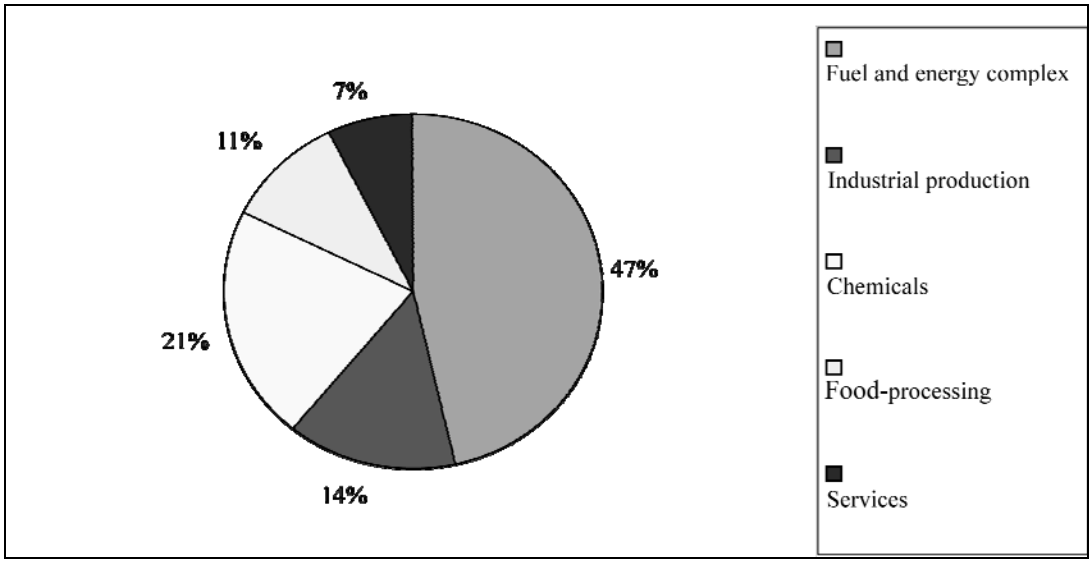


Fig. 28. The Sectoral Structure of Cases of Setting and Maintaining the Monopolistic High Price

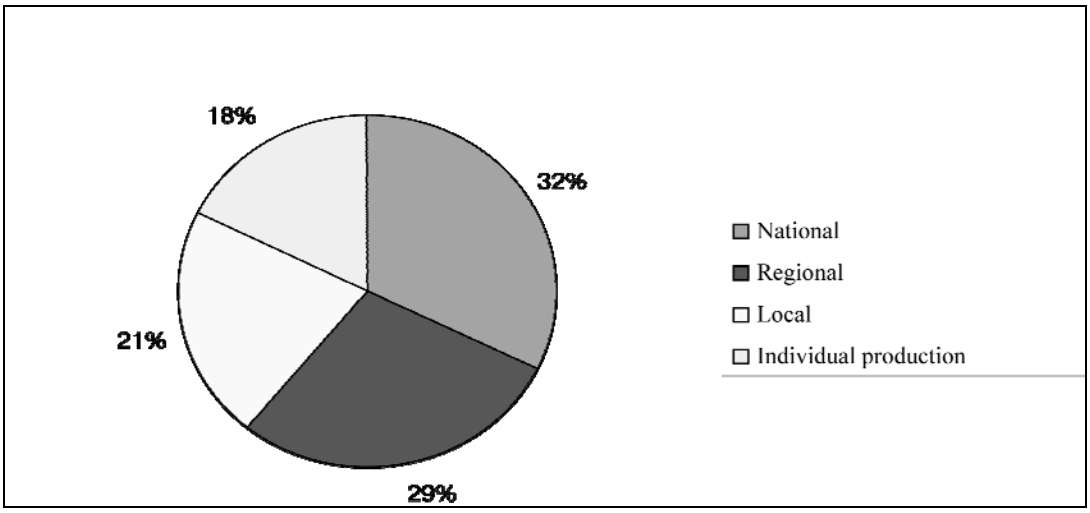


Fig. 29. Specific Weight of Cases of Setting a Monopolistic High Price Depending on the Market Size

A considerable proportion of monopoly abuse cases (*Fig. 29*) falls on exposures of a monopolistic high pricing on the national and regional markets.

A significant for the analysis sign of the monopoly abuse is the initiator of the investigation. According to the data in question, that can be a consumer (consumers) or the FAS (the federal agency itself or its regional divisions). In total, the consumers' share accounts for 57% of the exposed cases, while that of the FAS, accordingly, stands for 43% (*Fig. 30*)

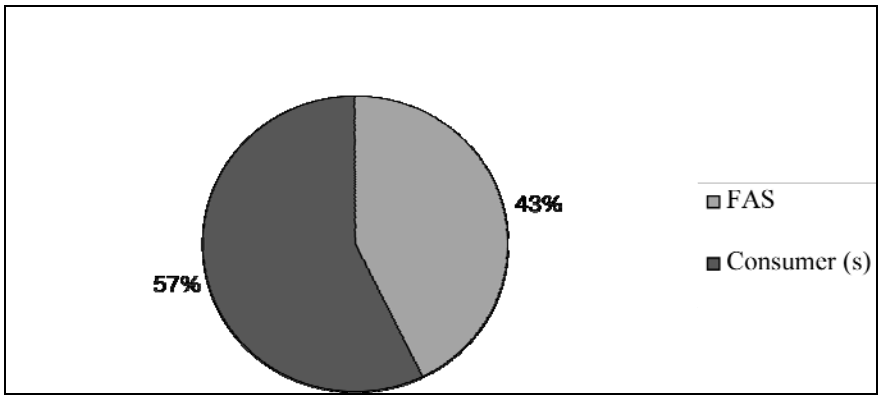


Fig. 30. The Structure of Cases of Setting a Monopolistic High Price Depending on the Initiator of the Investigation

Let us consider monopoly abuses depending on exposed signs of monopolistic high prices in 2008.

In compliance with Art. 6 of Federal Act № 135 "On protection of competition", monopolistic high price for the merchandise is the one set by an economic agent that holds a dominating position, if:

1. the price is greater than the one, which in the conditions of competition on the merchandize market comparable by quantities of goods sold over a certain period of time, composition of consumers or sellers of the product and conditions of access, is set by economic agents not affiliated with buyers or sellers within the same group and not holding a dominating position on the comparable merchandise market;
2. the price is in excess of the sum of costs and proceeds necessary for production and sales of this product.

Plus, in compliance with Part 1, p.1. Art. 10 of the Act "On protection of competition", the economic agent that holds a dominating position is prohibited to exercise action or inaction, the result of which becomes or may become nonadmission, restriction, elimination of competition and/or infringement of other entities' interests, including the following actions (inaction): an overt setting, maintaining a monopolistic high price for a product.

According to the law, the abuse can take the form of the setting and maintaining of a monopolistic high price.

The practice of regulation of monopolistic high prices includes exposure of:

– signs of a maintenance of relatively high price levels;
– signs of a setting of unjustifiably high prices.

The economic situation in 2008 highlights the rise of such a sign of monopoly abuse as maintenance of price levels at the time the changed market situation dictates their decrease. Hence, a failure to decrease prices is equivalent to the setting of a monopolist high price.

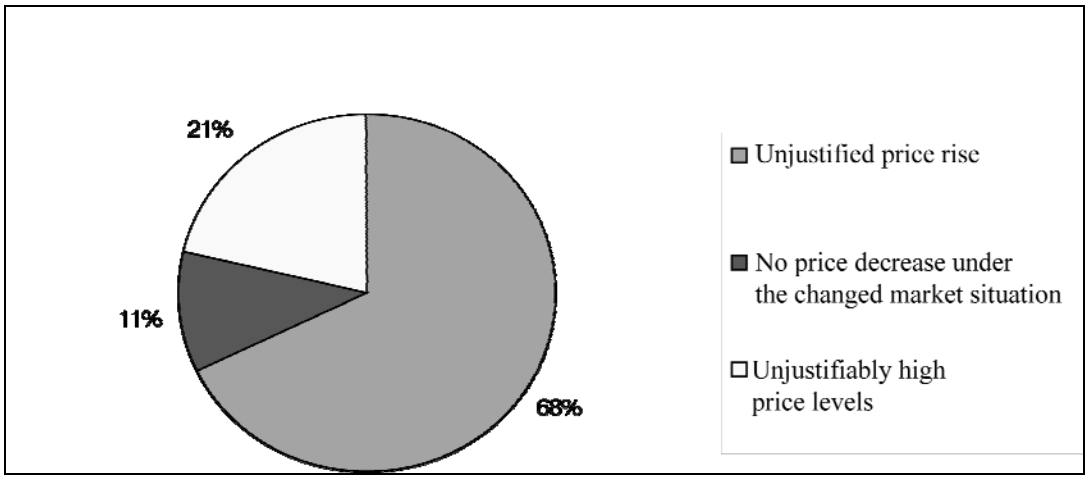


Fig. 31. The Specific Weight of Cases of Setting a Monopolist High Price Depending on Signs of Abuse

Whilst considering cases of setting a monopolist high price in relation to signs of abuse, it can be argued that their considerable proportion (79% in total) is associated with the setting of a monopolist high price; accordingly, only 21% is associated with the maintenance of a monopolistic high price.

The contingency tables presented in the chart form (see *Fig. 32–35*) have allowed one to expose the following correlations between indicators therein:

– initiator of investigation – signs of abuse;
– signs of abuse – sector;
– size of the market – signs of abuse;
– initiator of investigation – size of the market

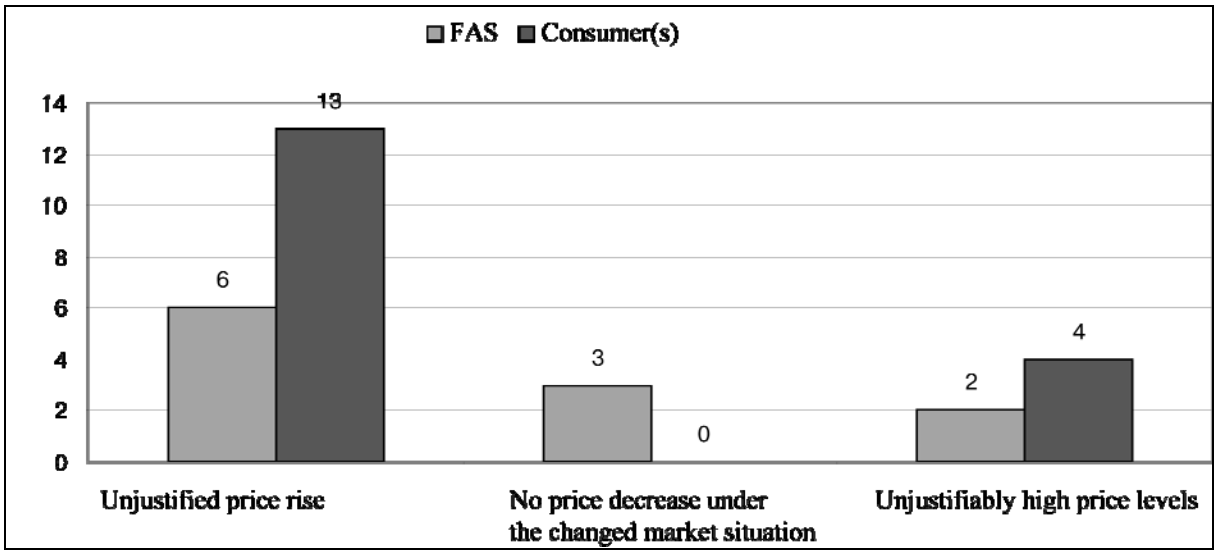


Fig. 32 Initiators of Investigation Depending on Signs of Abuse

The above data allows the following conclusions:

First, consumers to a greater degree are apt to being initiators of exposing monopolistic high prices in the event of their unjustified rise and a relatively high price level;

Second, it was only the FAS that exposed abuses in the form of the absence of a price decrease under the changed market situation.

Third, the data of contingency between the indicator of the sign of monopolistic high prices and sectors wherein the abuse has been exposed allows one to ascertain that an unjustified price rise appears to a greater extent inherent in the material production, while an unjustifiably high price level is more typical of the services sectors.

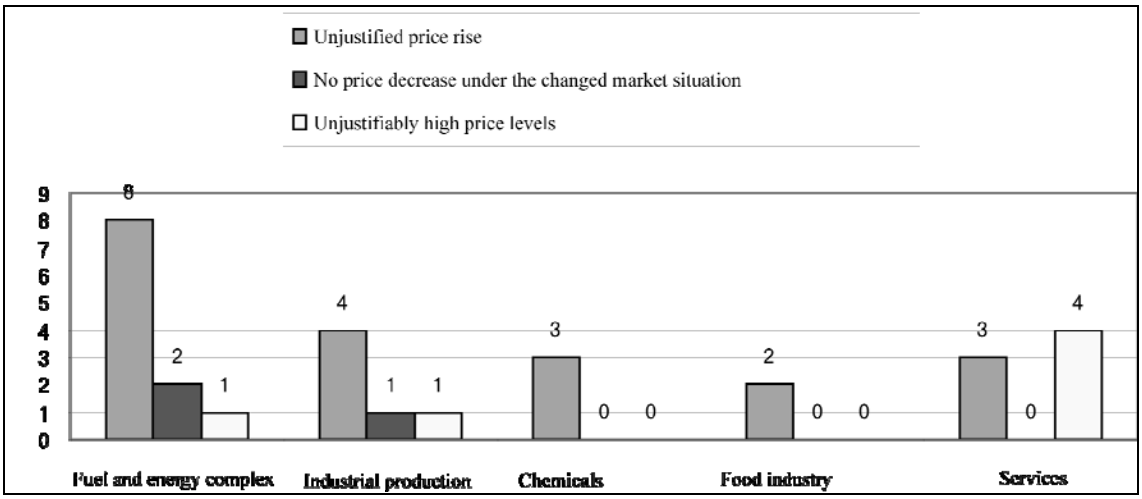


Fig. 33. Signs of Unjustified Price Hikes across Sectors

Fourth, there exists correlation between unjustified price rise and the size of the market.

Fifth, an unjustified price rise (maintenance of a high price) is typical of regional and local markets, while the distinctive feature of the national market is abuses with signs basing on price-setting.

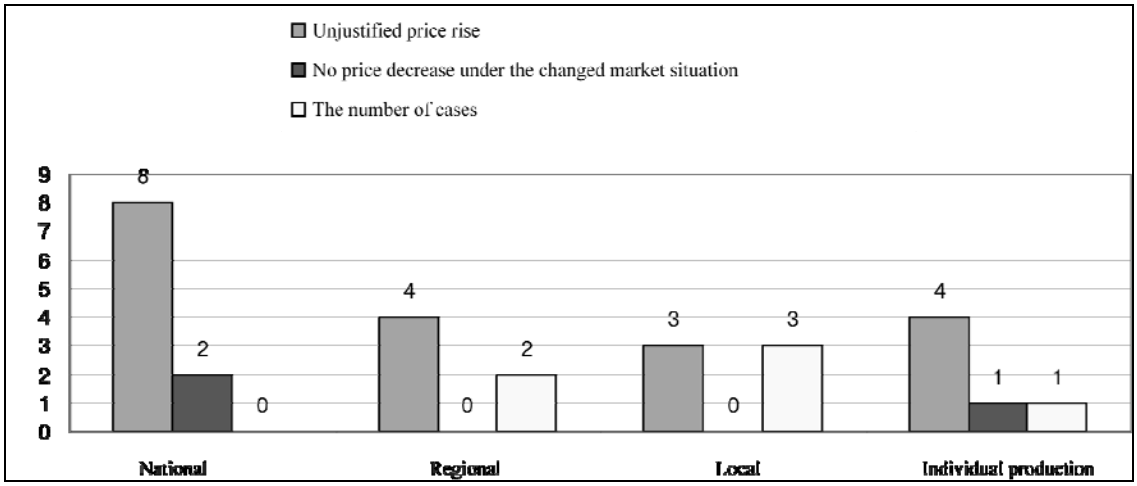


Fig. 34. Signs of Unjustified Price Hikes Depending on the Size of the Market

While considering the correlation between the size of the market (*Fig. 8*) and the initiator of the investigation, it can be argued that the FAS more often exposes signs of abuses at the national and regional markets, while consumers do so on the local markets and those associated with servicing an individual production.

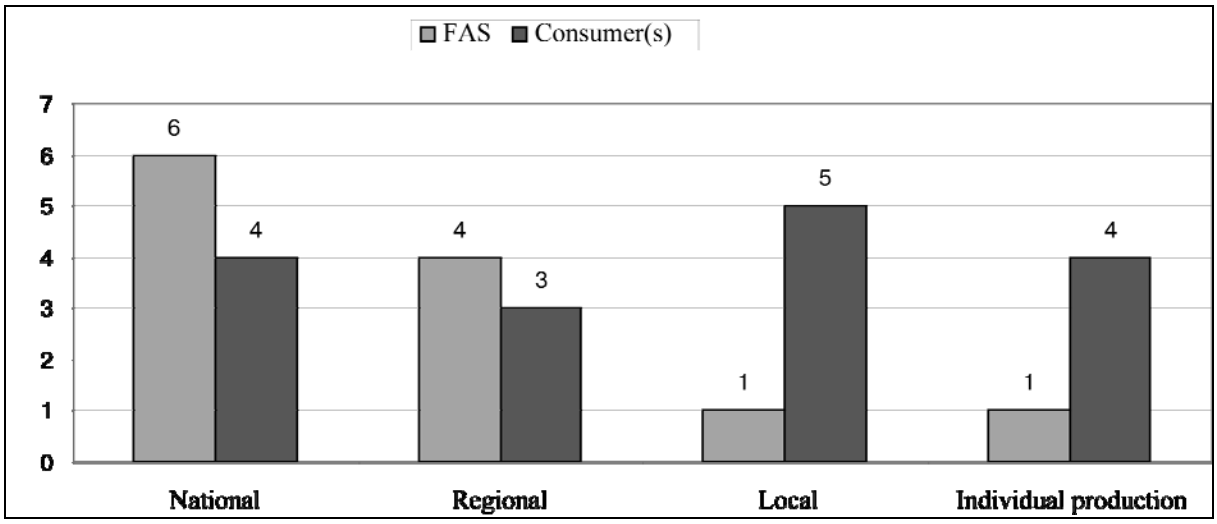


Fig. 35. Initiators of Exposures of Signs of Abuses Depending on the Size of the Market

On the basis of the examination of 28 cases of the proved abuses of the antimonopoly law in the area of setting a monopolistic high price one can also draw the following statistically grounded conclusions.

According to the 2008 data, the proportion of the services market exhibits a minimum number of cases of exposure of monopolistic high prices, and their considerable fraction was exposed with the use of consumers' claims.

The FAS appears to be more efficient in exposing abuses in the event of:

– the absence of a price decrease under the changed market situation and an unjustified price rise, i.e. in the case of setting a monopolist high price;
– exposing an abuse on the national or regional markets.

By contrast, consumers are more efficient in exposing signs of abuses associated with the maintenance of a monopolistic high price on local markets and on those related to the servicing of an individual production.

5.7. Russian Market for Housing and Mortgage

5.7.1. The Russian Housing Market in 2008: from a Eight-Year Growth to the Crisis

In the previous eight years the overall growth of the national economy has been accompanied by a steady price rise for residential property, which has grown into one of the most attractive direction of investment. By contrast, in 2008, the housing market has found itself heavily battered by the crisis developments that had manifested themselves yet in 2007.

But, with all the negative impact the world crisis has had on Russia's economy, it is worth noting that the peculiarity of the housing market manifested itself in the next phase of

stabilization of prices on the market coinciding in time with a drastic intensification of the impact of the crisis on the national economy

Price situation: the main results of the year[190]

Forestalling an in-dept analysis of the price dynamics on the national market for residential property in 2008, it should be remembered that in the fall of 2007 there started a new round of price rise on this particular segment of the real estate market. Underpinning that were envisaged changes of the nation's political leadership, which has prevented a possible capital flight and encouraged the population to resume the deferred demand fueled by a substantial rise in real incomes and savings, and a drastic price rise for oil – suffice it to note that in the autumn of 2007 oil prices hit the level of some USD 100/barrel. Against that background there emerged new challenges to the financial stability in the form of an inflation hike on the consumer market in the autumn of 2007, the continuous fall of both the USD and stock indices, and some deterioration of situation with mortgage credits as a reaction to the crisis in the US. At the same time, as the crisis on the US mortgage market had a clearly limited effect on the situation with residential property in Russia, the prevailing view in the country was that the echo of the noted developments would not last for more than 6-9 months[191].

The projections of price dynamics in the city of Moscow and some other Russian cities[192] at that time allowed the assertion that a nationwide price rise would continue further on. At the time, they were expected to rise over the next three years (2007-2009) as follows: in Moscow oblast, Izhevsk, the city of Moscow, Yaroslavl – 1.7-1.9 times, in Ekaterinburg, Rostov-on-Don, St. Petersburg – 25.-2.8 times, in Perm, Novosibirsk – 3.4-3.5 times, and in Ulyanovsk – 3.7 times. At the same time, a longer-range forecast (for the next10-15 years) suggested a steady price rise (in the nominal USD equivalent) at an accelerated pace at 25-30% annually, with the monthly growth rates being within the range between 0% and 8-12%.

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[190] The authors conducted all the calculations basing on the monthly data on the average specific offer price for housing in Russian cities supplied by the certified by the Russian Realtor Guild (RRG) analysts of the real estate market V. Lutskov, L. Kazimir (AKTS, Miel Holding), S. Sternik (Sternik's Consulting LLC), independent analysts A. Beketov, A. Sapozhnikov (all – the city of Moscow and Moscow oblast), S. Bobashev (Bullyuten nedvizhimosti, St. Petersburg), V. Kaminsky (TITAN, Tver), V. Khorkov, A. Antasyuk, G. Tukhashvili (all RITS UPN, Ekaterinburg), P. Smelov, T. Vysotskaya (Sibakademstroynedvizhimost, Novossibirsk), E. Ermolayeva (RID Analytics, Novosibirsk, Kemerovo, Barnaul, Krasnoyarsk), R. davletshina (Prespektiva Konsalting), E. Epishina (Kamskaya dolina, all-Perm), A. Evstafyev (Villan LLC, Krasnodar), A. Chumakov (Titul), E. Proskurin (YUGRO, all- Rostov-on-Don), M. Reshetnikov (Agentstvo maksimum, Tomsk), N. Afanasyeva (Adalin-Ekspertiza sobstvennosti, Yaroslavl), V. Troshina (Informatsionno-analitichesky tsentr Brok, Tyumen), A. Stepanova (SAN EXPERT, Ufa), A. Cheremnykh (UK ASSA-Story, Izhevsk), S. Blinkova (IKPKG Zhilye), E. Kalinina (Megapolis-nedvizhimost, all- Penza), N. Yarsina (Tsentr nedvizhimosti), M. Isayeva, I. Suponey (Zolotoy klyuch, all-Ulyanovsk), A. Trushnikov (B.I.N. Expert, Sterlitamak), and a group of analysts that are currently undergoing the certification procedure: G. Zyryanova (KuzbassInvestStroy, Kemerovo), A. Derbusaliyev (ISK Volga-grupp, Samara), S. Taruta "Nedvizhimost" journal, Omsk), M. savina (Agentstvo pechati i informatsii, Ryazan). The data was supplied in the currency in which the housing was quoted on the local market.
In addition, the authors employed the official data on the average monthly rates of the USD exchange rate, inflation and other macroeconomic indicators published by the CBR and Rosstat.

[191] S. Domnin. Ne tak strashen chert….In: Kvartirny ryad, 20-26 December 2007, №51 (674), p.1.

[192] Sternik G.M., Pechenkina A.V. Chto proiskhodit na rynke zhilya Moskvy. Makroekonomichesky podkhod (a presentation at the analytical conference of the Moscow Realtor Association "Rynok nedvizhimosti: situatsiya, tendetntsii, prognoz" of August 30, 2007) - www.realtymarket.ru, August 2007

The dynamic of the first half of 2008 was proving a high probability of that scenario.

Between December 2007 and September 2008 the housing prices in the USD equivalent were on the rise in most cities presented in *Table 13*. Quite surprisingly, it was Tver that topped the list of leading cities in terms of the dynamic of prices for residential property – over the 9 months in question they posted a nearly 47% growth there. The traditionally attractive for investing capital cities (Moscow and St. Petersburg) and Moscow oblast posted an impressive (at more than 1/3) price rise. Also notable in this respect was a positive price dynamic in Rostov-on-Don (up at nearly 20%), Tomsk (over 17%), Penza and Yaroslavl (nearly 13%), and Kemerovo (11%). Meanwhile, there were emerging increasingly explicit signs of price stabilization – in a big group of cities, the price rise failed to exceed 7-8%, while in Tyumen, Ekaterinburg, Izhevsk and Omsk there was noted a slight downfall in housing prices.

Table 13

The Dynamic of the Average Specific Offer Price for Housing in 2006–2008

City (region)	USD/sq.m.				Index			
	Dec. 2006.	Dec. 2007	Sep. 2008	Dec. 2008	Dec. 2007/Dec. 2006	Sep. 2008 /Dec. 2007	Dec. 2008/Sep 2008	Dec. 2008./Dec. 2007
Moscow	4828	5429	7437	6641	1,124	1,370	0,893	1,223
St. Petersburg	2593	3165	4252	3601	1,221	1,343	0,847	1,138
Moscow oblast	2522	2529	3362	3235	1,003	1,329	0,962	1,279
Samara	…	2437	2634	2289	…	1,081	0,869	0,939
Tver	1370	1828	2682	2222	1,334	1,467	0,828	1,216
Ekaterinburg	2416	2607	2516	2211	1,079	0,965	0,879	0,848
Novosibirsk	1658	2401	2476	2112	1,448	1,031	0,853	0,880
Perm	1431	2271	2429	2069	1,587	1,070	0,852	0,911
Krasnodar	1370	2164	2338	2026	1,580	1,080	0,867	0,936
Rostov-on-Don	1563	2115	2536	2005	1,353	1,199	0,791	0,948
Krasnoyarsk	1115	2210	2393	1888	1,982	1,083	0,789	0,854
Tomsk	…	1892	2215	1881	…	1,171	0,849	0,994
Yaroslavl	1758	1913	2157	1866	1,088	1,128	0,865	0,975
Tyumen	1598	2186	2124	1849	1,368	0,972	0,871	0,846
Kemerovo	1369	1862	2066	1813	1,360	1,110	0,878	0,974
Ufa	1744	1994	2168	1799	1,143	1,087	0,830	0,902
Izhevsk	1843	1846	1737	1497	1,002	0,941	0,862	0,811
Omsk	1058	1798	1730	1493	1,699	0,962	0,863	0,830
Penza	1065	1517	1721	1493	1,424	1,134	0,868	0,984
Barnaul	…	…	1677	1415	…	…	0,844	…
Ryazan	990	1498	1523	1330	1,513	1,017	0,873	0,888
Ulyanovsk	859	1243	1329	1198	1,447	1,069	0,901	0,964
Sterlitamak (Bashkortostan)	840	1070	1143	1000	1,274	1,068	0,875	0,935

The wave of the world financial crisis that battered Russia between August and September 2008 and the dramatic changes in the macroeconomic parameters (primarily, the start of the depreciation of the Rb against the USD) seriously affected the price trend on the Russian housing market.

In the span of three months (between September and December) the prices in USD equivalent plunged notably. In most cities presented in *Table 13* (including Moscow) they dwindled at 10-15%. A greater downfall was noted in Ufa and Tver (17%), while Rostov-on-Don and Krasnoyarsk saw their record downfall of more than 20%. The opposite pole was formed by Moscow oblast where the price downfall was minimum and accounted for less than 4%. The price pullback happened nearly everywhere and resulted in a price level lower (albeit in some locations and not for long) than that of December 2007, except for the two capitals

and Moscow oblast and Tver. Interestingly, the December 2008 price level in Ekaterinburg and Izhevsk proved to be even lower than that of December 2006.

Overall, by results of 2008 the prices in USD equivalent soared in Moscow oblast (at nearly 28%), Moscow and Tver (21-22%), as well as St. Petersburg (under 14%). The prices slid at more than 10% in Ryazan, Novosibirsk, Krasnoyarsk, Ekaterinburg, Tyumen, Omsk, Izhevsk. In the other cities of the sample presented in *Table 13* the downfall accounted for less than 10%, while in Tomsk, Penza, Yaroslavl and Kemerovo it made up not more than 3%.

It should be noted, however, that despite the downfall of housing prices, in 2008 they were over USD 6,000/sq.m. in the city of Moscow, 3,000 - in Moscow oblast, 2,000 - in Tver, while in the early autumn 2008 in the city of Moscow they would hit even a higher level (some USD 7,500/sq.m.). In St. Petersburg, the ultimate 2008 price level accounted for under USD 4,000. In a whole array of cities (Tomsk, Yaroslavl, Kemerovo, Ufa), the housing prices had overshot USD 2,000/sq.m. by the early autumn, but consequently slid under this mark by the end of the year. The same is true for Tyumen and Krasnoyarsk, though in late-2007 the local prices there had been above USD 2,000/sq.m. By the late-2008 Ekaterinburg had left the trio of leading cities in terms of the price level for residential property and found itself falling behind not only Moscow oblast, but Samara and Tver as well.

As by the autumn of 2008, when the crisis developments were sensed pretty clearly, most local housing markets had already undergone dedollarization (a partial one was noted only in Moscow and Moscow oblast), the price dynamic in Rb. equivalent is worth examining, as a rise in the USD exchange rate meant an inevitable loss of a fraction of a housing price in hard currency equivalent.

In the city of Moscow and Moscow oblast, the Rb-denominated prices have been growing almost through the end of the year, and their first drop was noted only in December 2008. St. Petersburg, Ekaterinburg and Tyumen underwent the same development after a short (2-3-month) stabilization occurred between September and November. In most of the other cities (Novosibirsk, Rostov-on-Don, Perm, Krasnoyarsk, Tomsk, Izhevsk, Kemerovo, Omsk, Tver, Ufa, Penza) a gradual fall in the Rb-denominated prices for residential property was noted for the whole 4th quarter. Meanwhile, Ryazan's price dynamic was somewhat different and basically followed Moscow, Moscow oblast and Sterlitamak's – through the 2nd half of the year the local prices have been fluctuating within the range of Rb. 28-29,000/sq.m.

Taking on an analysis of real (less the inflationary) housing prices, one should reference to the dynamics of the main macroeconomic indicators. In 2008, consumer prices rose at 13.3%. For the first time since 2002 the nominal exchange rate of the national currency not just failed to appreciate, but depreciated substantially, albeit at a relatively gradual pace. Accordingly, the 2008 USD inflation rate in Russia was 0.989. So, for the first time over the decade (since the 1998 crisis) the USD discontinued to depreciate, while its purchasing power has grown, albeit at a meager 1%.

The index of real (adjusted for inflation of both the Rb. and the USD) housing prices (the IGS index[193]) by results of 2007, 2008, 2007-2008 vis-à-vis December 2006 in the cities of the sample is given in *Table 13*.

[193] The IGS index is computed by the following formula: IGS=Ipr/Icpi=Ipd/Idi, где Ipr – the housing price index in Rb. equivalent рублях, Icpi – Consumer Price Index, Ipr – the housing price index in USD equivalent, Idi = Iri/Idrd – the USD inflation rate in Russia (vs. the consumer prices dynamic), Idrd – the USD-to-Rb depreciation index

Table 14

Nominal and Real Housing Price Indices in 2006–2008

City (region)	Nominal price index			IGS		
	Dec. 2007/Dec. 2006	Dec. 2008 /Dec. 2007	Dec. 2008/Dec. 2006	Dec. 2007/Dec. 2006	Dec. 2008 /Dec. 2007	Dec. 2008/Dec. 2006
Moscow	1,124	1,223	1,375	0,939	1,236	1,160
St. Petersburg	1,221	1,138	1,389	1,020	1,150	1,172
Moscow oblast	1,003	1,279	1,283	0,838	1,293	1,083
Samara	…	0,939	…	…	0,949	…
Tver	1,334	1,216	1,622	1,114	1,229	1,369
Ekaterinburg	1,079	0,848	0,915	0,901	0,857	0,772
Novosibirsk	1,448	0,880	1,274	1,210	0,889	1,075
Perm	1,587	0,911	1,446	1,326	0,921	1,220
Krasnodar	1,580	0,936	1,479	1,320	0,946	1,248
Rostov-on-Don	1,353	0,948	1,283	1,130	0,958	1,083
Krasnoyarsk	1,982	0,854	1,693	1,656	0,863	1,429
Tomsk	…	0,994	…	…	1,005	…
Yaroslavl	1,088	0,975	1,061	0,909	0,985	0,895
Tyumen	1,368	0,846	1,157	1,143	0,855	0,976
Kemerovo	1,360	0,974	1,324	1,136	0,984	1,117
Ufa	1,143	0,902	1,031	0,955	0,912	0,870
Izhevsk	1,002	0,811	0,812	0,837	0,820	0,685
Omsk	1,699	0,830	1,411	1,419	0,839	1,191
Penza	1,424	0,984	1,401	1,190	0,994	1,182
Ryazan	1,513	0,888	1,343	1,264	0,897	1,133
Ulyanovsk	1,447	0,964	1,395	1,209	0,974	1,177
Sterlitamak (Bash-kortostan)	1,274	0,935	1,191	1,064	0,945	1,005

As demonstrated by *Table 14*, the rise in real housing prices in 2008 was noted only in Moscow oblast (at more than 29%), the city of Moscow and Tver (at 22-23%), and St. Petersburg (at 15%). In Tomsk, the prices remained unchanged. As for the other cities, the real (adjusted for inflation) housing prices declined, with the drop being the most substantial one (at 14-18%) in Krasnoyarsk, Ekaterinburg, Tyumen, Omsk and Izhevsk. It is worth noting that in the city of Moscow and Moscow oblast, St. Petersburg and Tver the IGS growth rate overrun that of the prior year, with the capital regions experiencing some decline in the real housing prices in 2007. Apart from the above group, it was only Yaroslavl where the 2008 IGS index proved to be greater than in 2007, albeit it continued highlighting on some decrease in the real prices for residential property.

But an analysis of the two-year period of 2007-08 draws up a somewhat different picture. In the period in question, the Rb-to-USD depreciation index accounted for 1.07, while the USD depreciation index made up 1.185, with its purchasing power dwindling at more than 15.5%.

Unlike the year of 2008, the real housing prices grew over the two- year period in most cities, except for Tyumen, Ufa, Ekaterinburg, Izhevsk and Sterlitamak. The leading cities in terms of the IGS growth rates in 2007-2008 became Krasnoyarsk (+nearly 43%) and Tver (+nearly 37%), followed by Krasnodar and Perm (+ 22-25%). As concerns the capital cities, by results of the two-year period both Moscow and St. Petersburg found themselves in a fairly big group of cities wherein the rise in the real housing prices made up between 11 and 19%, while in Moscow oblast, together with Rostov-on-Don and Novosibirsk, it was 7-8%.

The most recent stage of the price rise for residential property in Russian cities proved to be substantially shorter than the prior two ones (the “oil-fueled” price rise of 2002-2004 and the “mortgage- and- oil-fueled” one of 2005-2006). Yet a more critical peculiarity of the

last stage of price rise for residential property was that it ended up with a crisis, rather than stabilization.

In light of this it is quite natural a step to attempt to compare the 2008 situation on the housing market with developments of the 1998 crisis. The comparative price dynamics are given in *Table 15*.

Table 15

Nominal and Real Housing Price Indices in 1997–1998 and 2007–2008

City (region)	Nominal price index		IGS	
	Dec. 1998/Dec. 1997	Dec. 2008 /Dec. 2007	Dec. 1998/Dec. 1997	Dec. 2008 /Dec. 2007
Moscow	0,939	1,223	1,713	1,236
St. Petersburg	1,036	1,138	1,891	1,150
Moscow oblast	0,893	1,279	1,630	1,293
Tver	0,744	1,216	1,358	1,229
Ekaterinburg	0,624	0,848	1,139	0,857
Novosibirsk	0,479	0,880	0,875	0,889
Perm	0,356	0,911	0,650	0,921
Rostov-on-Don	0,929	0,948	1,695	0,958
Krasnoyarsk	0,431	0,854	0,786	0,863
Tomsk	0,368	0,994	0,671	1,005
Tyumen	0,383	0,846	0,699	0,855
Kemerovo	0,411	0,974	0,750	0,984
Omsk	0,453	0,830	0,827	0,839
Ryazan	0,763	0,888	1,392	0,897
Ulyanovsk	0,397	0,964	0,724	0,974

The above data show that the impact of the current crisis on the housing market so far has been far lighter than the previous one's.

First, 10 years ago, the price downfall occurred practically everywhere. By contrast, in 2008 (by results of the year), the capital cities, which undoubtedly are a nucleus of the whole Russian market, evidenced a price rise for residential property. It was also noted in Moscow oblast and Tver – the locations bordering on, accordingly, Moscow and St. Petersburg.

Secondly, the maximum intensity of the fall so far has been far less – given that in 1998, the lowest points were within the range between 35-40% of the December 1997 level, in 2008 the fall did not exceed 17%.

Third, the 2008 price downfall across all the cities by which a comparison can be drawn was less drastic than that of 1998, with its respective rate across many of them accounting for 2-3-fold. It was Ekaterinburg, Rostov-on-Don and Ryazan that proved to be dangerously close to following the 1998 pattern.

But considering the real (adjusted for inflation of both the Rb. and the USD) housing prices (IGS), the picture appears less unequivocal. Despite the 2008 price rise for residential property in Moscow, St. Petersburg, Moscow oblast and Tver, its rates proved to be less than 10 years ago. In Ekaterinburg, Rostov-on-Don and Ryazan the 2008 IGS plummeted, while in 1998 it had surged. One cannot help but note that in all these cities the prices at the time had been quoted in USD.

Meanwhile, the other half of the sample presented in Table 3 demonstrated a rise in the housing prices vs. their 1998 level. In the 1990s, in this group of cities (Novosibirsk, Perm, Krasnoyarsk, Tomsk, Tyumen, Kemerovo, Omsk) the housing prices were quoted in Rb. Also, interestingly, these cities (except for Perm) all represented Siberia.

While the 2008 developments so far have appeared more merciful than those of 1998, it is worth noting drastic differences between them. Despite some similarity (for instance, the price downfall for energy sources on the world market), the nature and magnitude of crisis phenomena are different.

The current crisis to a certain extent battered all the leading economies worldwide, while back in 1998 it had spread over a relatively narrow circle of nations, including Russia, the south-east Asian economies, and, partly, Latin American countries. When compared with 1998, Russia's economy (including the housing market and the construction sector, as well as the volume of borrowing from overseas) is far bigger than 10 years ago[194].

Yet another distinction lies in the level of the country's institutional development. Ten years ago, the crisis coincided in time with a period of completion of a long-lasting transformational slump of the 1990s and the rise of basic market institutions. The depreciation of the Rb. became a powerful catalyst of a nearly immediate renewal of growth fueled by certain spare resources on hand (idle production capacities, staff, etc.) These factors of growth had exhausted by now. The length and intensity of today's crisis developments in Russian economy are hard to estimate so far.

Forestalling formulation of possible scenarios in the development sector with account to the world financial crisis, it is appropriate to examine in a greater detail the situation in the house-building sector in 2008.

Deceleration of construction volumes and placement of new hosing in operation

Like in the prior 7 years, in 2008 Russia boasted a growth in the volume of placement of new housing in operation. But its annual growth rate (4.6%) proved to be less than in 2007 (20.6%) and the least one over the period of the 2000s, equaling just to the 2001 indicators (*Table 16*). In all, by the preliminary data, in 2008, as many as 765.6m flats of total area of 63.8m sq.m. were put in operation, while the target had been 66.0m sq.m. (plus 10%).

Table 16

Placement of Housing in Operation in Russia in 1999–2008

year	Total area, as sq.m. million	Growth rates, as %	
		To the prior year	To 2000
1999	32,0	104,2	105,6
2000	30,3	94,7	100,0
2001	31,7	104,6	104,6
2002	33,8	106,6	111,5
2003	36,4	107,7	120,1
2004	41,0	112,6	135,3
2005	43,6	106,3	143,9
2006	50,6	116,0	165,7
2007	61,0	120,6	201,3
2008	63,8	104,6	210,6

Source: Rossiysky statistichesky ezhegodnik. 2007: Stat. sb./ Rosstat, M., 2007, p. 507; Sotsialno-ekonomicheskoye poliozheniye Rossii, 2007 god, M., Rosstat, pp. 87–88, the authors' calculations.

The slowdown of the rate of putting new residential property in operation started yet in the last quarter of 2007, when the growth rates was no longer accounted for double digits. The tendency continued through the first quarter 2008. By results of the first half of 2008, the vol-

[194] In terms of the banking system and the real sector. A positive phenomenon, a considerable shrinkage of the public debt in the 2000s has fallen short of forming an inhibitor to the nation's growing overall external debt.

ume of placement of new housing in operation grew just by 3.3% compared with the respective period of the prior year; the respective figures of the second quarter of 2008 proved to be even lower than in the second quarter 2007.

All that became a consequence of the gradually rising complexities and constraints the developers had begun to experience since the mid-2000s, even despite adoption of the priority national project "Affordable and comfortable housing - to Russian citizens" (hereinafter referred to as "The Housing"). The situation in the construction sector began exacerbating, following the looming world financial crisis. In the 3rd and 4th quarters of 2008, volumes of placement of new residential property in operation rose at slightly over 5%, or nearly twice as lower vs. their respective values of the 4th quarter 2007 and 1st quarter 2008.

By contrast with 2007, the individual house construction has no longer played the role of catalyst of the construction process as a whole. The volumes of placement in operation of residential property built at the expense of funds (one's own and the borrowed ones) have grown roughly pro rata equal to those demonstrated by the indicator of the volume of placement in operation of all new housing. As a result, the proportion of the residential property put in operation at the expense of the population's funds remained at its 2007 level (42.6%), which, nonetheless, still is a peak value ever reported over the whole period of the 2000s.

Notwithstanding an evident deceleration of growth rates in house building across most Russian regions, the 2008 volumes of placement of new residential property in operation have grown nevertheless. Of a particular notice is the fact that they grew at more than 25% in nine Subjects of RF, including Bashkortostan and N. Novgorod oblast, i.e. in the regions whose capital cities are home to 1m-plus residents (*Table 17*). It is also worth noting in this respect that St. Petersburg and Chelyabinsk oblast posted a 20%-plus growth in the volume of residential property put in operation.

Table 17

Placement of Housing in Operation in Russian Regions in 2008 г.
(Ranked by Growth Rates)

Regions with a positive rate	Placement(as sq.m. Thos.)	Increment to the same period of the prior year	Regions with a negative rate	Placement(as sq.m. Thos.)	Increment to the same period of the prior year
Kamchatka	63,4	в 3 раза	Yamal-Nenetsky autonomous okrug	225,2	–11,2
Ingoushetia	59,2	+80,7	Sakha (Yakutia)	280,2	–12,5
Sakhalin oblast	146,2	+38,4	Irkutsk oblast	476,2	–17,2
Kaluga oblast	628,6	+37,2	Tver oblast	343,8	–17,9
Tyva	44,7	+34,9	Kalmykia	59,1	–23,9
Tula oblast	417,2	+29,5	The city of Moscow	3279,9	–32,0
Nenetsky autonomous okrug	46,5	+26,9	Murmansk oblast	7,5	–40,9
Bashkortostan	2351,3	+26,6	Astrakhan oblast	382,5	–47,3
Novgorod oblast	259,0	+26,6	Chukotka autonomous okrug	1,1	–82,9
Нижегородская областьN. Novgorod oblast	1353,3	+26,2			

Source: O zhilischnom stroitelstve v 2008 godu, www.gks.ru.

Meanwhile, as many as 18 regions saw their volume of housing construction fall vis-à-vis 2007 (in 2006-2007, there were just 5-6 such regions). The data is poorly informative, though, as in the 2000s, up to the moment of a rapid promotion of "The Housing", every year there were at least 20 regions whose volumes of placement of new residential property in op-

eration proved to be lower than respective indices of the prior year. In this sense, a specific aerial of the spread of the slump in the house-building sector appears far more important.

Table 5 present regions wherein the 2008 level of placement of new residential property in operation accounted for more than 10%. Clearly, most of them are relatively densely populated territories with no largest cities therein, and the absolute value of volumes of house building is insignificant there. The city of Moscow, with a nearly 1/3 drop in the respective index, clearly stands apart against this background. Interestingly, in Moscow oblast, the respective index has remained unchanged since 2007. It is also worth noting the fall in the volumes of house building in Perm and Krasnoyarsk krais, Omsk and Irkutsk oblasts, with that in Irkutsk oblast accounting for 17%-plus. The consequence of the above became a notable deconcentration of house building in the capital region. The aggregate proportion held by the city of Moscow (5.1%) and Moscow oblast (12.2%) in the nationwide house-building volumes accounted for 17.3%, thus being lower than in 1999 (18%). However, between 1999 and 2003 volumes of placement of new residential property in operation in Moscow oblast were lower than in Russia's capital. For reference: in 2007, the share of the capital region in the overall countrywide volume of placement of new housing in operation was over 1/5, including a 12.8% share of Moscow oblast and a 7.9% one – of the city of Moscow.

With construction volumes in the city falling behind the 2008 guides, the Moscow city government confirmed their commitment to fulfill a program on construction of the so-called "social housing". At an auction held in the fall of 2008 the Mayor's office bought 378,000 sq.m. of residential property, of which 90,000 sq.m. are located in the city of Moscow (it had been planned to procure 80,000 sq.m.) and 288,000 sq.m. – in Moscow oblast (against the planned 420,000 sq,m.). The starting price for sq.m. of residential property in the capital was Rb. 65,000 and in Moscow oblast - 54,000[195]. The missing for completion of the 2008 plan 120,000 sq. m. are to be procured in 2009, together with another 380,000 sq.m. needed for completion of the 2009 social programs.

Challenges and risks engendered by the financial crisis. Assessment of prospects for their overcoming and main scenarios of developments on the housing market

So, in late-2008, when the Russian market found itself half-way to the next stage of price stabilization envisaged in 2009, the national economy began to increasingly clearly sense the impact of crisis developments in the world economy (including the second wave of the mortgage crisis in the US, when the growth in the proportion of overdue loans was coupled with the downfall in housing prices), which battered financial markets, particularly after September 2008.

The crisis threatened to dry out liquidity in the banking sector, constrain the population and developers' access to banking lending, and have the population's real incomes fall due to inflation. The population began to realize additional risks of investing in newly built residential property, as such construction projects were at peril of suspension, and the demand for residential property plunged drastically. Spooked by the financial crisis, liquidity losses, prospects of devaluation of collaterals and possible bad mortgage loans, banks in turn began to reduce volumes of mortgage lending. The factor of their loosing capitalization exerted an equal impact, as at a certain level the value of a bank's own assets automatically bans credit-

[195] Simonov V.V kontekste nyneshnikh problem. In: Kvartirny ryad, 5-11 February 2009, №4 (731), p.6.

ing. As early as in September 2008, daughter companies of large western banks and corporations registered in Russia got signals of the need for an urgent discontinuation of financing housing projects.

As a result, numerous construction corporations were cut off of the much-needed liquid capital and construction rates slowed down, with no new projects in sight.

Already in the first half 2008, the foreign capital inflow in Russia began drying out vs. the respective period of the prior year. While the inflow was still there in July and August, because of the mounting problems on the financial and stock markets, as well as the military action in the Southern Ossetia and Abkhazia, there began a mass capital (mostly portfolio investments) outflow, which intensified dramatically in the 4th quarter. Consequently, by the final results of 2008 the net capital outflow accounted for some USD 130bn - a peak value over the whole period starting from the mid-1990s.

The uncertainty and unpredictability of external operational conditions on local housing markets in Russian cities predetermined the need in employment of a scenario-based forecasting method for the sake of identification of a few variants of the dynamic of the external conditions. Under each variant it is possible to quite accurately calculate the market's behavioral pattern, while average weighted parameters of the most probable variant are computed on the basis of estimates of probability of each scenario.

All the diversity of possible options of the external conditions and developments on the real estate market can be reduced to *four scenarios*. Their original premises may become two most recent in the short history of the Russian housing market scenarios of transition to stabilization that date back to 2007 and 2004. The key question is whether the situation develops basically in line with such patterns, or it takes a genuinely original form.

Scenario №1 – the conservative one: a "soft" transition to stabilization, like it was noted in late-2006.

The local housing markets in Moscow, St. Petersburg, and a number of other cities saw the start of a natural decline in demand and sales volumes that by December 2006 had resulted in the price stabilization. Prices in St. Petersburg remained practically stalled through autumn 2007, while in Moscow they even slid at 3-5%, albeit for a short while, and it was only in October that year that they bounced back to the December 2006level. But the decline in sales volumes did not seriously affect the construction companies' ROI rates, nor it hit rates of construction of new housing.

This scenario had been fairly realistic through the spring of 2008, while the model forecast of changes in pricing was confirmed by actual data through September 2008.

Scenario №2 – a moderately pessimistic one: a "hard" transition to stabilization by analogy with the year of 2004.

At the time, after a rapid rise in 2003, a subsequent natural decline on the housing market was intensified by macroeconomic factors that took the form of a drastic rise in capital outflow as a consequence of an increasingly mounting conflict between the government and business. That triggered a 40-50% decline in sales of newly built residential property and financial difficulties for developers coupled with the liquidity crisis in the banking system (aggravated by the oversight authorities' elephantine moves), which mutually complemented and intensified each other. The housing prices in the capital cities discontinued their rise in the summer of 2004 and remained stable for a year in Moscow and year and a half in St. Petersburg, with a short period of decline in the spring of 2005. Other effects included frozen con-

struction sites, a number of construction corporations going bankrupt, protest actions by the deceived private investors, etc.

The first signs events could take such a course had manifested themselves by the summer of 2008. After three years of a steady growth in the volume of placement of new residential property in operation practically across all the regions, in the first half of the year the increment of this indicator vs. its prior year's value accounted for slightly over 3%, with the leading regions in terms of real estate prices (the city of Moscow, Moscow oblast and St. Petersburg) becoming the most problematic ones.

Since the early autumn of 2008 it seemed that the developments followed this particular scenario – in the 3rd quarter, there capital flight, banks faced liquidity shortages, a number of construction projects were brought to a halt, some developers went bankrupt, M&A processes intensified, objects and other assets were being redistributed, and new deceived private investors in residential property appeared, etc.

It was companies that banked on fast returns on their own minor investments through selling shares to private investors, i.e. by circumventing Federal Act of December 30, 2004, № 214-FZ "On participation in shared construction of blocks of apartments and other real estate objects and on introducing amendments to some legislative acts of the Russian Federation", which still is a fairly widespread practice, that were the first to face financial challenges. Chances for making such projects a success lie in a drastic growth in effective demand, which today seems highly unlikely.

Meanwhile, according to the analytical center "Inidikatory rynka nedvizhimosti IRN.RU", in 2007, there were just 9.2% of objects in Moscow built in compliance with provisions of the aforementioned Act; in Moscow oblast, the compliance rate was between 11% and 15%, while in the number of regions this figure was far greater. Notwithstanding these provisions, many corporations, including the largest, oldest and most credible ones, attempt to bypass the law, while the contract on shared participation in construction has formed nearly a sole guarantee that a given construction project will be completed. Companies that chiefly operate in compliance with the law overcome organizational complexities of the initial stage of construction by getting funds to finance their pojects from affiliated banks (including such options as acquisition by the bank of a stake in the developing company or a share in the project), which allows some hope for alleviation of risks associated with the declining market demand.

The companies that sought financial support from the domestic non-profile banks currently are at a greater risk of going bankrupt, as such banks have recently seriously tightened their lending conditions or stopped crediting developers at all. But there was some hope that the governmental measures of financial support of the banking sector and the stock market undertaken in the fall of 2008, would preclude the process from unfolding.

It was the companies that have recently completed large-scale borrowing on external markets by means of issuance of promissory notes, bonds and holding IPO that currently face the gravest financial challenges. Developers contributed to some degree to a sharp increase of the domestic corporate sector's indebtedness. The world financial crisis, increase in interest rates limited their possibilities for further borrowing overseas and complicated refinancing of such loans, which eventually undermined their financial health.

Under such scenario, one might have envisaged the offer housing prices to dwindle already since the late-2008, to further decline at 5-10% over the next half-year and to return to

the path of growth afterwards. Turning this scenario into reality in 2009 necessitates a high efficiency of the financial authorities' moves and market players' operations back-upped by the nationwide consensus between elites, mass media and the population.

Scenario №3 – the crisis one: despite the authorities' attempts, the financial crisis in the country mutates into the economic one.

Because of a contraction in orders and staff lay-offs, first in the financial sector, trade and construction, followed by many subsectors of the industrial sector, the population's solvency declines and, accordingly, the demand for residential property falls. There starts a sweeping M&A process in the construction sector. Should this scenario become a reality, the housing prices should fall at 40-50% over the year and their rise would start beyond 2010.

Scenario №4 – the catastrophic one: despite the measures undertaken by the US and European authorities and supported by other countries (including Russia), the world financial system that currently rests on the USD, would completely collapse, while establishment of a new one would take much time and colossal efforts.

The nations would take on the barter exchange coupled with a limited use of regional currencies. Because of distortion of their structures of import, the US, European, Russian and other countries' economies (including the real estate market) would follow the financial sector into an abyss, and their restoration (with an optimistic estimate of containment of armed conflicts) would take years, if not decades.

With account of the real developments in the autumn of 2008, the greatest chances to be realized had scenario №2 (75%), while realization of the other three ones looked highly unlikely (scenario №1- 0%, scenario №2- 20%, scenario №4- 5%).

These assessments allowed identification of the average weighted parameters of the price dynamic on the housing market that *formed scenario №5 as the most likely one*.

With account of the recent measures on support of the financial system and the construction sector (loans for banks, public procurements of residential property to fulfill social programs, increase in the financing of social benefits granted to certain categories of the population), the probability of a crisis in the development sector was estimated as a low one, assuming that it was going to be the crisis of individual (both small-sized and large) companies, rather than a systemic one. According to calculations made on the basis of some assessments, the price downfall should last roughly for a year and make up 20% on average relative to September 2008 (i.e. prices should be down to the December 2007 level).

Growth rates of placement of residential property in operation would fall with a prospect of contraction of their absolute value in 2008-2009. The fall in demand due to deterioration of the mortgage lending conditions would fuel modifications in the structure of house building (particularly in conjunction with the rising proportion of the budgetary financing in regions) , that is, relinquishing the upscale, so-called "business-class", housing in favor of the "economy-class" one, with its smaller-size apartments and lower prices.

Meanwhile, the liquidity crisis in the banking system and a possible redistribution of the market (bankruptcies, mergers and acquisitions among the developing and construction companies, the rise of new players) would reduce offer and modify its structure in favor of a high-quality housing, as all the levels of government may be keen to sell a notably greater share of the economy-class housing off the market, in the frame of government programs of support of construction companies.

In the current conditions, an appropriate move for the government is to support the market by boosting the population's effective demand, rather than to help individual developers. Should the effective demand be restored by 2010 against a shrunken volume of construction and offer of residential property, the market may enter a new cycle of renewal and housing prices rising up to a level that would secure a reasonable for developers ROI rate.

Given the analysis of the situation as of the start of the crisis, the average profitability rate of the construction business should drop for a year and a half, with no prospect for it to bounce upwards to the recent sky-high levels. So, large players that will have survived on the market by then, will be coerced to dump their former aggressive strategies and exercise more caution in weighing up business strategies.

Changes in the situation in the late-2008 and adjustment of the forecast

The change in the state of affairs in the economy, adoption of additional regulatory measures in the financial sphere on the federal and local levels, changes in the corporate and banking sectors' behavior demanded for a revision of estimates of probability of each of the above scenarios with a further adjustment of parameters of the fifth scenario as the most probable one.

More specifically, despite the deepening of the world financial crisis, such facts and developments as the appreciating USD and the November 2008 G-20 summit outcomes evidenced that the USD-based world financial system would not collapse any time soon. The new US Administration and its new ideas afforded certain grounds to assume that having survived through the period of recession, in 2-3 year time the US economy and its currency would step out of the crisis stronger than before. The possibility for a radical transformation of the financial system as a factor of the world economic crisis is still there, nonetheless. That is why the probability rate of scenario 4 remains unchanged.

Meanwhile, hopes for a better domestic macroeconomic situation, efficient government measures securing development of the situation according to scenario №2 have not come true as yet, with the course of events more and more heading for scenario №3.

First, the downfall in prices for oil as a major source of export revenues. In all likelihood the price downfall would last longer than a year, so the prices will remain low beyond 2009. Because of that, the RF Government was compelled to modify main parameters of the three-year federal budget for 2009-2011.

The correlation between the oil prices and the state of the housing market and price growth rates in Moscow and other Russian cities was researched into in the 2000s[196]. More specifically, studies into the correlation between the oil price dynamics and housing prices in the city of Moscow in 2002-2003 showed that the rise in oil prices at USD 5/barrel fueled a 1.2% monthly growth in housing prices on average. The further research in this direction proved the fact that the level of international oil prices was a core factor that affected housing prices nationwide, thus enabling one to single out in the development of the Russian housing market in the 2000s the stages of the "oil-fueled" growth (2002-2003) and the "mortgage-and-oil-fueled" one (2005-2006)[197].

[196] Sternik G.M. Statisticheskaya svyaz mesyachnykh tempov rosta na zhilye v Moskve i tsen na neft.- www.realtymarket.org, February 12, 2003.
[197] See: Rossiyskaya ekonomika v 2002 godu. Tendentsii i perspektivy (Vypusk 24). M., February 2003, pp. 472-473. Rossiyskaya ekonomika v 2003 godu. Tendentsii i perspektivy (Vypusk 25). M., February 2004, p. 386.

Second, a serious appreciation of the USD and EURO against the Rb. has emerged as a reality of the fall of 2008. The widening of the currency band was followed by a gradual depreciation of the Rb., which continued through the first two months of 2009.

In the conditions of a ubiquitous dedollarization of the real estate market, with the USD exchange rate rising from Rb. 25 in September 2008 up to Rb. 35 in February 2009 , it means an automatic 30% decrease of the USD equivalent of housing prices relative to those denominated in Rb.

The studies of the 1998-1999 crisis situation[198] revealed that the bicurrency nature of the domestic housing market led to fundamentally different ways the housing prices behaved in the conditions of a sharp depreciation of the Rb. and a high inflation.

In the city of Moscow and other cities with prices quoted in USD (Russia-1), supply prices remained practically unchanged through the late-1998, while falling behind the rising prices in Rb. equivalent, buyers had walked out of the market by October that year, and transactions stalled. They came back to life only in 2-3 months, in the aftermath of the drop of the USD-denominated prices, which had been lasting for some two years.

In cities where the housing prices were denominated in Rb. (Russia-2, as well as the primary market in the city of Moscow) they continued to grow for 2 years, but their USD equivalent had fallen already by September 1998. Crushed by the downfall in the USD-denominated prices, the sellers had left the market yet in October, and all the deals were suspended. Meanwhile, the USD price equivalent had been just slightly decreasing over the two years.

Depending on possible inflation rates and depreciation of the Rb. against the USD, various combinations of developments can occur – either the sellers leaving the market, or an additional number of buyers doing the same. It is not quite clear whether the current dedollarization of most markets (in the city of Moscow and Moscow oblast - the partial one) is going to be there for long.

Third, the recent capital flight, which became catastrophic over the last three months of 2008, has constrained the CBR's capability to counter the depreciation of the national currency. The Bank of Russia ended up with a notably shrunken volume of the nation's foreign reserves. But if the CBR had abandon that policy, the reserves would have exhausted in a relatively short time.

Having cut the volume of its interventions in the forex market between the autumn of 2008 and the winter of 2009, the CBR saved roughly as much as 2/3 of the reserves. But the question as to for how long they will last under the current price level for oil and the domestic economic situation remains unanswered.

The next negative development that added to the mounting pressure on the Rb. became the banks. Indeed, after non-residents fled the market in September 2008, the domestic banks stepped in, with their pockets full of the government financial aid, as major players in the capital-flight game.

Naïve were hopes that the authorities would exercise an efficient control over a target use of the government aid. By the results of the year the capital flight became gargantuan and

Rossiyskaya ekonomika v 2007godu. Tendentsii i perspektivy (Vypusk 29). M., March 2008, pp. 551-553; also Sternik G.M. Prognoz razvitiya rynka zhilya Moskvy do 2005 goda.- Otchet AEKSIP, April 2003, www.realtymarket.org

[198] Sternik G.M. Tri Rossii – tri rynka nedvizhimosti.- www.realtymarket.org. November 20, 1998.

totaled USD 130bn. On its way to the real sector the financial aid fell short of passing through certain "clots".

It is banks that dominate in the group of recipients of the governmental aid. More specifically, the public corporation Vneshekonombank (VEB) granted Rb. 200 bn. in a 10-year loan to Vneshtorgbank, Rb. 25bn – to Rosselkhozbank, Rb. 225bn- to regional banks, and Rb. 500 bn – to Sberbank[199]. It is not clear as yet how high the banks are going to place the construction industry and the real sector as a whole on the scale of their lending priorities.

The above should result in a fall of investments in capital assets in the real sector, including the house-building industry. The situation is further aggravated by the fact that, unlike a number of other industry branches, the house-building sector cannot boast large and connected with the government public corporations that form the group of main pretenders for the governmental aid. Furthermore, in the conditions in which the RF Subjects cannot any longer extend credits out of their budgets or play the role of a fidepromissor, the housing market saw no notable institutional novelties.

The only exception became the passage of Federal Act of July 24, 2008, №161-FZ "On assistance to promotion of house building". The Act suggests creation of a special federal fund for assistance to house building and sets termination of the organizations' right for the permanent use of land lots owned by the federal government without their consent and regardless of provisions of the Land Code of RF, should the powers on control and development of these lots for the sake of promotion of house construction are assigned to regional governments or the land lots themselves are assigned to the Fund to form its assets.

According to Mr. A. Braverman, the Fund's head, his structure might contribute to support of the construction sector (referring to projects that were halted due to the financial crisis) by stimulating the final demand with a subsequent sale of the residential property in question or its reassignment to municipalities[200]. There have been no updates on the Fund's operations so far, while the supreme political leadership already this year expressed an explicit displeasure with the tempo of works on procurement of the residential property sold to government agencies in the frame of the governmental support of construction companies.

From perspective of implementation, it is the capability of the public corporation "The Fund for assistance to the housing and utilities reforming" (FAHUR) created yet in 2007. The recently amended federal act allows a FAHUR-sponsored relocation of citizens from wrecking housing into newly constructed economy-class residential property, sobeit the construction of such housing is completed strictly within 6 months upon conclusion of a respective public contract. The Fund currently manages Rb. 50bn which is supposed to be spent on completion of construction of residential property in the regions, and a fraction of these funds is supposed to solve the above problem. According to the Association of Builders of Russia, presently construction of some ¾ of all the housing projects in progress in the country is sponsored by private investors. Their community accounts for nearly 2m[201] . That is why bringing construction projects to stall may spark a new wave of protests by deceived private investors who have invested their savings at the outset of a construction project. Some regional developers have already had their clientele face the dilemma: either they pay money in full, or the project will

[199] Along with that, the RF Ministry of Finance has placed Rb. 1.5trln on deposits with commercial banks
[200] A. Braverman, cit. by: Pora razmorazhivat. In: Kvartirny ryad, 22-28 January 2009, №2 (729), p.2
[201] Cit. by: Kvartirny ryad, 5-11 February 2009, №4 (731), p.11

be brought to halt. Other corporations try to pacify their patrons by offering them a compensation for a failure to meet a project timelines.

At this juncture a certain role for future developments on the housing market and formation of a subsequent demand for mortgage credits may be played by a mortgage credits restructuring program the Agency for Mortgage Credits (AMC) adopted in the early-2009. But the program concerns a very narrow array of individuals – namely, those who have already bought residential property, which naturally crosses it out from the list of measures on shaping the future demand for housing[202]. Like many other banks and companies, the Agency is to receive Rb. 60bn. in government aid to redeem the housing regional banks are holding as collateral by mortgage credits. Plus, the CBR proposed to establish on the basis of the AMC and Sberbank a special public agency on redemption of the mortgaged housing, that is, to enable insolvent borrowers to continue reside in such apartments and pay a rental fee at a level lower than the market one[203].

In all, the governmental measures aimed at preservation of social programs chiefly concern only the groups of the population (pensioners, budgetary employees, the military, etc.) who have not entered the housing market earlier and were, as a rule, recipients of the social housing from the state. Meanwhile, retention or drop in incomes of the major group of buyers of housing formed by the private sector employees (not all of them, of course) depends on their corporations' financial state, as a part of them can face bankruptcy. Additional measures to lower the tax pressure on individuals (the tax rebate in the case of purchase of a housing has been doubled) and business (the corporate profit tax is now down at 4%) can alleviate, but not preclude the economy from sweeping head cutting and private individuals' incomes from falling.

Overall, as ascertained by E. Nabiullina, the RF Minister for Economic Development, the global financial crisis has exposed the exhaustion of the Russian economy's growth pattern which had rested upon high oil prices and the influx of cheap foreign credits to banks and corporations.

The developments in the period between December 2008 and the early-2009 (the continuous depreciation of the Rb., a further downfall in oil prices, a colossal capital outflow by the 2008 results, a miserable state of the stock market, problems with delivery of the government financial aid to the real sector, a 6% fall in the volume of industrial output in the 4th quarter 2008 and at another 16% in January 2009, the rising unemployment) allow one to discuss tangibility of a more pessimistic course of events compared to the forecast made in the autumn of 2008.

The above, with account of the real dynamic of the economic situation in the country in the 4th quarter 2008 and its impact on the market for residential property, compels one to appreciate appropriateness of adjustment of assessment of probability of scenarios №2 from 75% to 0% and №3 - from 20% to 95%, respectively.

The weighing gives the most probable scenario – №5, which de-facto contains all the prerequisites of scenarios №3 and №5 and includes the 2009 projections of the price for barrel of oil at the level of 40-45 USD, the USD/Rb exchange rate of 1:35, and a 13-14% inflation rate (*Fig. 36*).

[202] www.ahml.ru
[203] Cit. by: Gavrish A. Povorot syuzheta. In: Kvartirny ryad, 5-11 February 2009, №4(731), p.16

Under such scenario, at the lowest point (by late-2009) the housing prices in USD equivalent in the city of Moscow may fall at 40-45% vs. the September 2008 ones, while over the year – at 30-35%.

The Rb.-denominated housing prices should fall in 2009, too, but the level of their drop substantially depends on inflation. Should it be tamed within the range of 13-14% as per the government's forecast, the housing prices would slide at no more than 10-15%. But if the inflation rate surges up to 20-40%, the Rb-denominated housing prices can experience a trend setback and begin to surge, while the 2009 USD- denominated housing prices would plunge by 20-25%.

In contrast to the 1998 crisis, whose price trend took the **U**-form, under the current circumstances the market should begin to reinstate itself in 2011-2012, and the process should not be as fast as it was envisaged by the initial forecast (the **L**- shape of the trend) made in the autumn of 2008.

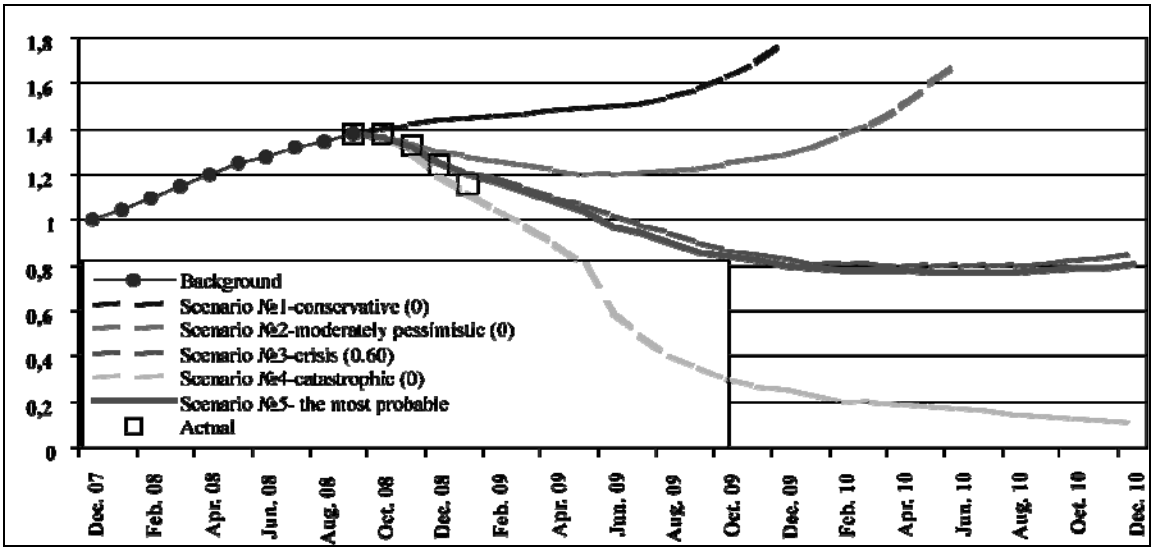


Fig. 36. The Scenario-Based Forecast of the Dynamic of Housing Prices in the City of Moscow

This forecast is close to the one designed by the Sberbank's Center of Macroeconomic Research (CMR) (the estimates are given below).

In the event of a "soft" development of the situation, in 2009, the housing prices in Moscow would plunge at 20% in Rb. equivalent and at some 30% in USD equivalent. But with account of the fall in the 4th quarter 2008, when residential property began to loose its value, the ultimate downfall should account for 20-30% in Rb. equivalent and up to 46% in forex equivalent. In the event the situation develops following the worst possible scenario, as of the end of 2009 vis-à-vis the 3rd quarter of 2008 the prices for residential property in the capital city would plummet roughly at 40% in Rb. equivalent and at 60% in USD equivalent, while the drop on the secondary market would account for 25% in Rb. equivalent and 50% in USD equivalent. Both scenarios imply a price downfall on the primary market being far more dramatic than that on the secondary market.

Nationwide, according to the CMR's forecast, the overall price downfall on the primary and secondary real estate markets would be less drastic when compared with that in the city of

Moscow. Under scenario №1, at the end of 2008 the price downfall (in nominal Rb-denominated prices) on the primary and secondary markets should have accounted for some 2.5% and in 2009 – between 5% and 5.3%. The aggregate price drop in USD equivalent should have been 25%. Under scenario №2, the aggregate downfall in prices between the late-2008 and the late-2009 should account on average for some 10-12% in Rb. equivalent and 40-42% in USD equivalent. The less drastic fall in prices in the regions is explained primarily by their less significant rise in the period of growth, which is attributed to a looser impact the capital inflow had on the regional housing markets.

Main conclusions

In 2008, the national economy and the housing market, too, found themselves under pressure of the world financial and economic crisis, which has derailed the regular phase of its growth at the moment it started to come to an end.

The year of 2008 split into two time periods that display quite opposite trends. While until the end of the summer the price rise for residential property was noted across most of Russia's cities, since the autumn and especially in the 4th quarter of the year the prices were dwindling notably, which has led to their overall decline by results of the year. But the price fall was not ubiquitous, as there was a whole array of cities wherein the level of both nominal prices and real (with account of adjustment for inflation) prices posted growth vis-à-vis the late-2007. The composition of the group of such cities (Moscow, Moscow oblast, St. Petersburg and Tver) allows one to assume the impact of the "capital-city factor", that is, a particularly significant role the capital cities play in the national economy. The price downfall was particularly dramatic in the Ural and Siberian cities. The main factors behind the price downfall were the capital outflow, credit squeeze, a drastic deceleration of growth in the population's incomes, and rising wage arrears.

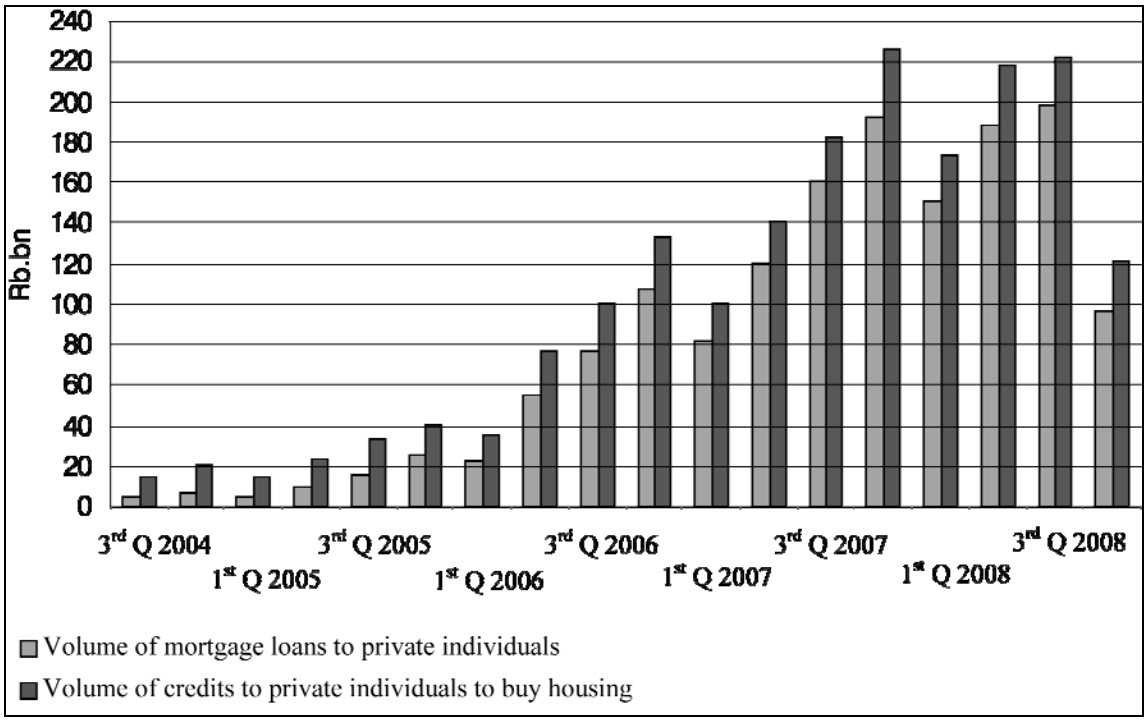
It can also be argued that the current crisis has so far battered the housing market more languidly than the 1998 one. More specifically, in 2008, the housing construction saw a drastic fall in the rate of placement of new volumes of residential property in operation, rather than their absolute contraction, albeit in the city of Moscow the respective volumes dwindled at 1/3 by results of the year.

Meanwhile, the overall situation in the economy leaves little chances for a soft overcoming of the crisis on the housing market. The regulatory measures by the government have left the housing market and the construction sector practically untouched. The mortgage lending mechanism found itself naturally squeezed, due to challenges facing the whole Russian financial system, with mechanisms supposed to substitute for it failing to emerge. In such conditions attainment of the target guides provided for by the national project on housing appears doubtful. Meanwhile, the effective term of the organizational and financial mechanism of its implementation and that of the federal target program "Housing" will expire in 2010. The current forecasts, however, suggest at best restoration of the housing market by that time. Accordingly, a new program should take into account the realities of the today's crisis and proceed from possible scenarios of the post-crisis renewal.

5.7.2. The Mortgage Market

The primary mortgage market

The volume of mortgage credits disbursed over the first three quarters of 2008 accounted for Rb. 537,463m. The volume of indebtedness over the period in question was Rb. 974,956m. The volume of mortgage crediting over the period grew 1.48 times vs. its respective period of 2007. At the same time, as of October 1, 2008, the volume of indebtedness by mortgage credits was twice as high vs. the respective figure as of October 1, 2007. The volume of mortgage debts as of January 1, 2008, accounted for 1.85% of GDP, while as of October 1, 2008 – 2.35% of the 2008 GDP. Accordingly, the indebtedness by all credits extended for the sake of house purchases was 2.30% of GDP, as of January 1, 2008, and 2.77% of the 2008 GDP, as of the end of the 3rd quarter 2008. The volume of mortgage credits disbursed in 2007 equaled 1.69% of GDP, while that over the 3 quarters of 2008 – 1.79% of the 2008 GDP.



Source: the CBR data.

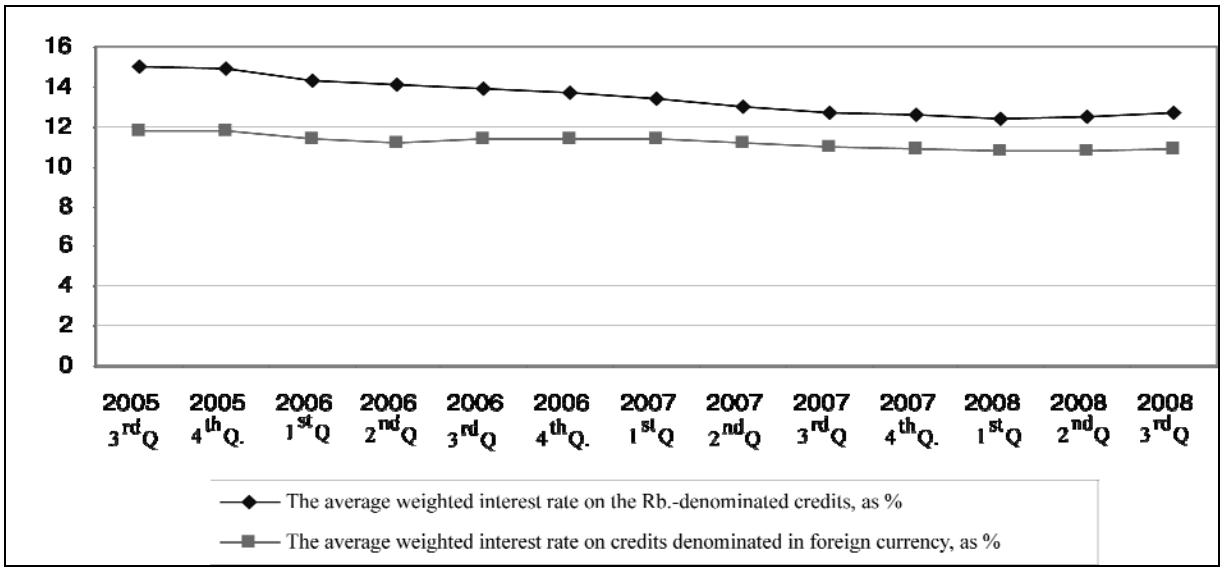
Fig. 37. The Volume of Disbursed Mortgage Credits and Housing Purchase Credits

As shown by *Fig. 37*, the 3rd quarter of 2008 saw growth in disbursement of housing purchase credits to private individuals practically discontinued, while growth in extension of mortgage loans was still there, albeit demonstrating a dynamic lower than that in the 2nd quarter.

Having reached its peak figure of 587 units, as of January 1, 2007, the growth in the number of credit institutions that disbursed mortgage credits stalled. As of April 1, 2008, it slid to 552 units, to bounce back to 586 units, as of October 1, 2008. According to printed

media and expert opinions, in the 4th quarter of 2008, the creditors not just reduced volumes of disbursement of mortgage credits, but many of them simply stopped granting them.

The growth in the proportion of indebtedness under mortgage credits in the overall volume of consumer credits was being on the rise. Over the 3 quarters 2008 the proportion of indebtedness under mortgage credits accounted for 24.31% of the volume of credits extended to private individuals, while in 2007 the respective figure was 18.23%.



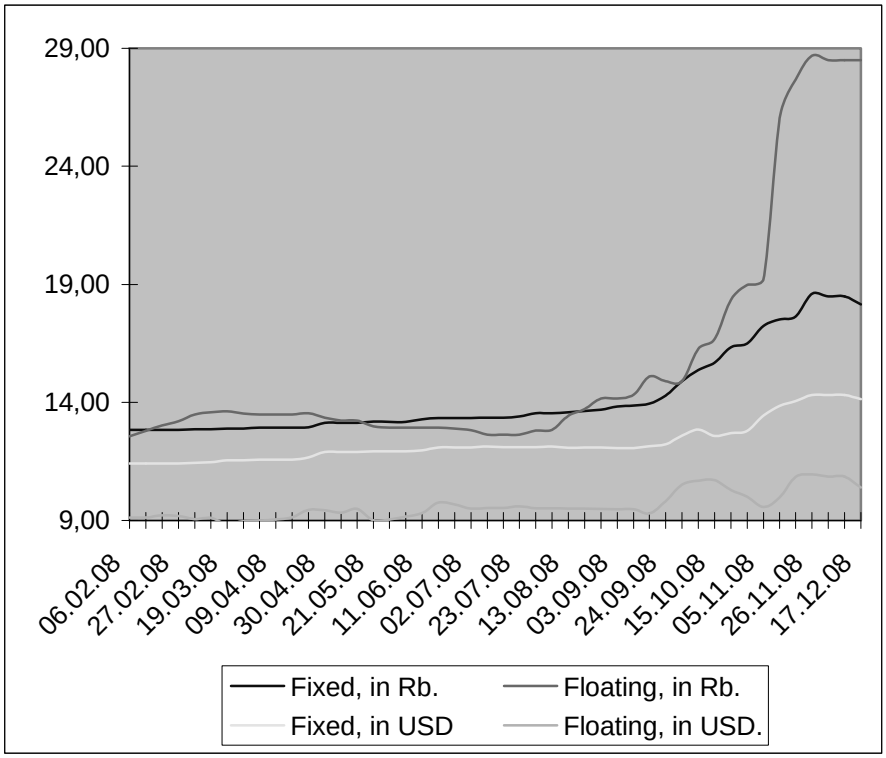
Source: basing on the CBR data.

Fig. 38. The Average Weighted Interest Rates

According to the CBR, in the first half 2008 the interest rates by Rb.- and forex-denominated mortgage credits in Russia (*Fig. 38*) still tended to decrease, and it was only in the 3rd quarter of the year that they began to rise. Between the 1st quarter and the 3rd quarter, the interest rates by Rb.-denominated credits soared at 0.3 p.p. – from 12.4% up to 12.7%. Meanwhile, the interest rate on forex-denominated credits surged at 0.1 p.p. – from 10.8% in the 2nd quarter to 10.9% in the 3rd quarter of the year.

The behavioral peculiarities of mortgage interest rates in the 4th quarter 2008 are highlighted by the average weighted offer rates on mortgage loans (*Fig. 39*) calculated on the basis of loan programs run by 25 banks (calculations and monitoring by Creditmart). In the 4th quarter, the fixed Rb.- denominated rate was over 18%, while the floating one – over 28%. As of end-December, the average weighted offer rates on mortgage credits calculated by the 25 banks' programs (calculations and monitoring by Creditmart) were:

– Fixed, in Rb. – 18.15%;
– Fixed, in USD -14.13%;
– Floating, in Rb. – 28.50%;
– Floating, in USD -10.39%.



Source: Creditmart company

Fig. 39. The Average Weighted Offer Rates by Mortgage Credits

Region-wise, the average weighted mortgage rates display a substantial dispersion. As of October 1, 2008, the average weighted Rb.-denominated mortgage rate in Khanty-Mansy autonomous okrug was 11.8%, in Volgograd oblast – 13.0%, and in Chechen Republic-13.3%. The mortgage rate as of the same date in Nenetsky autonomous okrug was 6.5%, while in Kurgan oblast – 12.3%.

The average weighted mortgage terms has tended to grow steadily. According to the CBR, in the 3rd quarter 2008 they reached 213.9 months for Rb. –denominated credits and 206.9 months for forex-denominated credits.

The first half-year of 2008 saw persistence of the trend to growth in the proportion of indebtedness under Rb.-denominated mortgage credits in the aggregate volume of Rb.- and forex-denominated credits. More specifically, the share of loan debts rose from 78.7% as of early-2007 up to 86.7% as of July 1, 2008 with a subsequent 0.7% drop as of October 1, 2008. But due to the depreciation of the Rb. concomitant with a respective rise in forex-denominated risks, the proportion of forex-denominated credits was down in the 4th quarter 2008. More specifically, as evidenced by “Kommersant” on December 25, 2008, Sberbank announced a moratorium on disbursement of forex-denominated credits to private individuals for an unspecified term, while Rosbank canceled its program of issuance of mortgage credits in foreign currency.

The list of leading banks by volume of loans disbursed in the first half 2008 is topped by Sberbank (Rb. 157bn and 167,000 credits), followed by VTB Group (51bn and 19,500 credits), Uralsib (14bn and 8, 600 credits), DeltaCredit, etc. The leading credit organizations continued concentrating mortgage portfolios – while in 2007 the top ten credit organizations held

54% of the national mortgage market, their market share in the first half 2008 was already 83%. As of beginning of the 4th quarter 2008, volumes of the Russian banks' mortgage portfolios were as follows (see *Table 18*):

Table 18

Volumes of the Russian Banks' Mortgage Portfolios

Sberbank	Rb. 243bn
VTB24	n/a
URALSIB	Rb. 46.4bn
KIT-Finance IB	Rb. 42.4bn
Absolute Bank	Rb. 34.775bn
Raiffaisenbank	Rb. 28.6bn
Bank of Moscow	Rb. 21.7bn
Rosbank	Rb. 16.323bn
RIB	Rb. 11.3bn
Gasprombank	Rb. 5.6bn (as of August 7, 2008)
Promsvyazbank	Rb. 2.151bn

Source: RealEstate.ru.

It is now common knowledge that it was subprime borrowers' failure to repay their debts that triggered the mortgage crisis in the US. In Russia, the proportion of outstanding debts by all credits to private individuals was being on the rise in 2008 and reached 3.7% by the end of the year (*Table 19*).

Table 19

The Dynamic of the Rise in Indebtedness across of Kinds of Credits in Russia

	01.01.07	01.01.08	01.07.08	01.09.08	01.10.08	01.11.08	01.12.08	01.01.09
Credits to private individuals, as Rb. bn	1877	2963,6	3580,7	3880	4007,5	4072,8	4043,9	4005,8
Overdue indebtedness, as Rb. bn	50,3	96,4	119,1	123,3	131,2	133,7	143,3	148,3
Overdue indebtedness, as %	2,68	3,25	3,33	3,18	3,27	3,28	3,54	3,70

Source: The CBR data

According to the CBR data, the overdue debts under Rb. 339,185v- worth mortgage loans granted in the 1st half 2008 totaled Rb. 2,519m, or a.31% of the overall volume of indebtedness. The volume of indebtedness under mortgage credits over the three quarters of 2008 accounted for Rb. 974.5bn, of which the overdue debts made up Rb. 4.95bn, or 0.51%. These figures testify to a high quality of mortgage loans disbursed at the time; however, with the crisis gaining momentum, this quality may be not enough.

Table 20

The Sum of Balances of Debt under Overdue Credits to the Sum of Balances of Debt by All Credits Ratio in the Agency for Mortgage Credits's Portfolio Ratio

Date	1.06.08	1.07.08	1.08.08	1.09.08	1.10.08	1.11.08	1.12.08	1.01.09
Ratio, as %	5.18	5.53	5.59	5.64	6.03	6.50	7.51	7.95

By results of the 3rd quarter 2008 the averaged nationwide proportion of delinquent loans on the Agency's balance- sheet accounted for 6.03%. By results of the 4th quarter of the year it surged up to 7.95%.

In a number of regions it has run record high: as of October 1, the proportion of defaulted loans in Stavropol krai was 25.9%, Kostroma oblast – 24.2%, Republic of Mary-El- 26.8%, and in the Republic of Altay – 23.4%. The proportion of credits with the length of default over 180 days rose at 1.4 p.p. and accounted for 4.8%. In the 4th quarter 2008, the biggest proportions of overdue debts were noted in Saratov oblast and Kostroma oblast (31.8% and 27.7%, respectively).

The other refinancing institutions also face the problem of rising proportion of overdue credits. But so far the failures to repay credits can be attributed to borrowers breaking the financial discipline, rather than to defaults, as there has been no respective rise in foreclosures.

To lower credit risks in the crisis conditions, many banks have tightened their requirements to borrowers, particularly by raising the threshold value of the first installment under credit, cutting volumes of disbursed credits or suspending crediting. Pre-crisis, the market even saw credit offers with a 5% first installment or no installment at all. Since October 2008 the banks began approving mortgage loans against the 30% first installment.

Since that time, the state-owned banks have drastically cut mortgage lending volumes. Specifically, effective as of October 4, VTB24 (as a reminder, No. 2 in terms of volume of mortgage lending) announced a moratorium on acceptance of applications on purchase of housing whose construction was in progress and applications on improvement of housing conditions. As well, the bank cut its credit programs at 13% down to Rb. 7.7 bn. Sberbank also reiterated that it is the quality of a credit portfolio, rather than the volume of disbursement, that forms a priority.

Having raised its interest rates on Rb.- and USD-denominated credits, Alfa-bank ruled to cut limits on its "automobile" and housing credits five-fold vs. the 2008 figures, down to USD 150m by each segment. The Moscow Mortgage Agency (*aka* MIA) also increased its rates and suspended a lending program with floating interest rates.

But since December 2008 some banks have begun decreasing their mortgage lending rates. For example, Alfa-bank and DeltaCredit cut them by 2 p.p. on average. The banks refer to an easier access to financing both on the domestic and international markets.

Refinancing, the secondary market

JSC "The Agency for Mortgage Credits" has become the first public refinancing institution. As many as 145 organizations in 75 Russian regions extend mortgage credits using the AMC Standards. As of January 1, 2009, the Agency refinanced 135,857 mortgage credits worth a total of Rb. 105,294bn.

The AMC attracts financial resources to the market for mortgage credits by issuing two kinds of bonds. These are mortgage bonds secured by discharged mortgages and corporate bonds under the governmental guarantees. The Agency placed 11 series of corporate bonds. The first one has been already repaid. As well, the Agency completed issuance of 2 series of mortgage bonds worth a total of Rb. 3.3 bn and 10.7bn, respectively. In compliance with the 2008 Federal Budget Act, the government granted the Agency guarantees under its corporate bonds worth a total of Rb. 28bn (4 series have been registered to date) and may provide additional guarantees worth a total of Rb. 36bn. in 2009.

Table 21

Volumes of Mortgage Retirements by Leading (According to the Rusipoteka's Rating) Refinancing Organizations on the Secondary Market for Mortgage Lending (as Rb.m.)

Company	2001	2002	2003	2004	2005	2006	2007	3 months 2008	6 months 2008	9 months 2008	12 months 2008
AMC	7	36	678	3 952	7 829	27 053	39 298	4 764	12 995	20 248	26 427
GPB-Ipoteka	–	–	–	–	4 071	13 203	13 930	3 281	5 716	7 763	n/a
ATTA-Ipoteka	–	–	–	–	778	6 643	3 781	–	–	–	n/a
KIT Finance	–	–	–	–	–	3 241	6 740	n/a	10	10	n/a
VTB	–	–	–	–	–	–	11 675	5 518	10 853	14 548	n/a
Russky Ipotechny bank	–	–	–	–	–	–	1 658	Н/д	1 872	2 545	n/a

Source: Rusipoteka.

As of November 6, 2008, the Federal Service for Financial Markets has registered issuances of nonconvertible housing bonds with the AMC mortgage hedging worth a total of Rb. 11, 33 bn.

The Agency is going to complement a direct retirement of mortgage from the banks operating according to its Standards with retirement of mortgage bonds issued by any other banks. In addition, the Agency is going to issue to banks warrantees that will guarantee the quality of the Agency's mortgage bonds and inclusion of such papers in the Bank of Russia's Lombard List. The Agency is going to spend over Rb. 600 bn. on support of the mortgage lending system. The government has recently ruled to increase the Agency's authorized capital by Rb. 60bn. With these resources at hand, the AMC is going to issue yet another pool of warrantees to primary creditors worth a total of Rb. 500bn.

Getting the banks' existing mortgage bond portfolios into turnover in many instances is challenged by their failure to meet the legislative restriction which demands that residential mortgage-backed securities may be issued only under a cost recovery involving mortgage bonds the credit under which does not exceed 70% of the value of the collateral. The banks earlier would circumvent the restriction by means of external securitization and attraction of capital from overseas sources.

Also possible is an arrangement under which the AMC and the bank enter into a swap deal, i.e. the Agency swaps its corporate or mortgage bonds for the bank's mortgage credits portfolio. The bank can also use that as collateral against REPO funds it receives from the CBR.

In addition, the government ruled to earmark from the budget an additional Rb. 200bn to the AMC to support the population and banks that deal with mortgage lending. In the crisis conditions, the borrowers who no longer can honor their obligations under a mortgage credit are going to have a grace period, thanks to the Agency restructuring their mortgage credit.

In addition to cooperation with the AMC, Sberbank is going to grant borrowers, who have lost their incomes due to job cuts or have their incomes plunge drastically, a grace period and installment plans by credits not pertaining to mortgage.

In late-November 2008, Sberbank disbursed Rb. 5bn in a loan to the AMC under guarantees of receiving Rb. 60bn the government had earmarked to boost the Agency's capital.

Between 24 and 28 November, the Agency refinanced as many as 1,247.000 mortgage bonds, or at 23% more than during the whole month of October. While the October volume of refinancing made up slightly over Rb. 1bn, the last 4 days of November saw the redemption of mortgage bonds worth a total of Rb.1.3bn-plus. As of early-December 2008, direct purchases of mortgage bonds from banks accounted for 80% of the Agency's ongoing operations. Initially, the Agency carried out refinancing operations via its regional mortgage operators, as the market was nascent and banks had no experience of working with the AMC. The regional operators were primary creditors themselves; in parallel with that, they were buying mortgage bonds from banks. Now that the banks have accumulated credit portfolios sufficient to carry out the direct refinancing operations, they have found it more profitable to work directly with the Agency, as this enables them to expedite the refinancing of the disbursed credits, thus boosting up their own liquidity.

The AMC considers a possibility for a deferral for 1 or 2 years of the discount under redemption of mortgage bonds from banks. In September 2008, the Agency introduced a discount or even a premium, depending on rates of redeemed mortgage credits. The discount rate varies from 2 to 6% depending on the quality and the rate of return on the credit. Because of the introduction of the discount, the Agency's regional partners may loose some Rb. 300bn.

Legislation and legislative acts

In compliance with the recent amendments passed by the State Duma, the size of the tax rebate pertaining to the purchase of residential property was retroactively doubled and currently accounts for up to Rb. 2m, effective as of January 1, 2008.

The government plans to procure from the market over 40,000 standard apartments and is going to allocate Rb. 83bn to this effect.

On December 19, 2008, the State Duma passed in three readings at once the Act on the possibility to use the maternity capital to repay mortgage credits. The Act has become effective as of the early-2009.

On November 19, 2008, the Duma passed in the second reading amendments to the Act "On mortgage (mortgage of real estate)" and some other legislative acts of RF that specify procedures of transferring rights on mortgagers. The amendments are to improve procedures of a transfer of huge "pools" of mortgagers. The document proposes to establish an institution which would run depository records of rights for mortgagers, which suggests that transactions that involve mortgagers are to become fixed in respective records, particularly using special technical means, by the depository institution. The establishment of such an institution should bring mortgager turnover costs down.

The CBR is going to moderate for 1 year its provisioning rates across all types of credits for banks, thus substantially extending the timeline for a coercive increase of the provisioning rate. Now the loan servicing will be recognized as a "good" one in the event the repayment delay for private individuals does not exceed 60 days and that for legal entities – 30 days. The "moderate" credit is the one the delay with repayment of which for private individuals does not exceed 90 days and that for legal entities – 60 days. Finally, the "bad" credit is the one the delay with repayment of which for private individuals does not exceed 120 days and that for legal entities – 90 days. From now on the fact of the loan restructuring *per se* will not affect its quality, as well as disbursement of a new credit to repay the previous ones will not have an adverse effect on the quality of the portfolio.

5.8. The Military Economy and a New Stage of the Russian Military Reform

The 2008 military and economic processes in RF have found themselves affected by changes in the nation's military and political leadership – the new Supreme Commander-in-Chief, new faces on key positions in the Ministry of Defense and the General Staff of the Armed Forces of the Russian Federation. A new stage of the military reform that started in 2007 was pursued more vehemently, which can partly be attributed to the events in the Southern Ossetia and Abkhazia. The military conflict between Russia and Georgia showed that the Russian armed forces had not been quite ready even for such a "five-day" war. Hence not only the intensification of the military reform, but its revision in many aspects.

Russia's military economy has also begun being affected by the global financial crisis.

5.8.1. Doctrinal Documents and their Impact on the Military Economy

The traditional fundamental documents of a long-term effect – namely, the 2000 Concept for National Security and the equally outdated Military Doctrine of RF mostly have fallen short of matching the changed environment. Their revision was clearly procrastinated. All experts sensed that; however, different generals have different vision of prospects for reforming the Russian army.

Delays with designing the military-strategic conceptual documents can be partly explained by the fact that it had been envisaged to develop in 2008 a uniform long-term government strategy and strategies proceeding from that (subordinated conceptual documents) by individual aspects of the government policy. *Table 22* presents an attempt to regulate individual provisions stipulated in the conceptual documents, starting with an analysis of the Concept-2020 as a backbone one[204].

A new military doctrine should appear, of course, upon approval of the National Security Strategy; however, one should start with revising the *mission* of the nation's Military Establishment and its components, such as the Ministry of Defense and the legislative concept of "defense" in particular.

The fact is that back in 1996, the Act "On defense" failed to include a reference to the *population* as a principal object of defense exercised by the Armed Forces of RF. As a reminder, the concept of "defense" was revised after a series of exceptional events, including the use of the armed forces in the territory of RF to solve political and domestic problems in Moscow in October 1993 and, later - starting from December 1994 – in Chechnya. The exceptional use of the armed forces originally designated for protecting the nation from an armed aggression from outside was explained by a special appropriateness. But was the exalting of this peculiarity to the rank of a permanently effective law, thus conflicting with the RF Constitution and a more general Act "On security" a legitimate move? The current Act "On defense" has been de-facto reduced to the military security of the state only, which has affected the whole complex of works on modernization of the army[205]. An assessment of the Russian armed forces' performance, its equipment, orientation of the combat service and operational training in the peacetime depends on the formulation of the mission, objectives and tasks of the armed forces' activities.

[204] The Concept for the long-term development of RF for the period through 2020.

[205] Tsymbal V.I. Osobennosti modernizatsii voennoy organizatsii Rossii, obuslovlennye voennoy reformoy//Vooruzheniye. Politka. Konversiya. 2005.№4, pp. 30-35.

Table 22

Outputs of the Analysis of Conceptual Documents

№	Conceptual documents and their major provisions	Comments
1	The Concept for the long-term development of RF for the period through 2020.	The section of target guidelines references to the importance of ensuring the society and citizens' security, which "should create conditions for releasing the population's innovational potential and a dynamic development of business". As a separate issue the Concept enunciates the need for attaining a high level of fighting efficiency of the Armed Forces of RF, which should match " the level of the advanced in military terms nations", particularly on the basis of the economic and social development of the nation's military organization. Notably, there are no purely military challenges in the list of concrete ones, proceeding from which the military build-up should be planned. This means that the traditional approach to the planning that suggests orientation to an envisaged type of a war or even a probable enemy is unqualified.
2	Strategy of the national security of RF – through 2020	Has not been complete in 2008. Judging updates on the content of the draft, it should specify objectives and indicators that characterize all challenges and aspects in the security area, starting from the economic one and including military security indicators, among others.
3	Strategy of building-up and development of the Armed Forces of RF- through 2020	Approved in early 2008 as a classified document.
4	Strategy of the social development of the Armed Forces of RF- through 2020[206].	Approved by the decision of the Collegium of the Ministry of Defense of 28.03.2008. In compliance with Order №241 of 28.04.2008 by the RF Minister of Defense, a Commission on the strategy implementation was established.
5	Main guidelines of activities of the RF Government - through 2012	The document contains a sub-section entitled "Ensuring the citizenry's private safety". It characterizes avenues of the Interior Ministry and the RF Ministry of Civil Defence and Emergency Response's (aka EMERCOM) operations, and a section entitled "Provision of the national security" which characterizes activities by the Ministry of Interior, FSA and other law enforcement agencies with respect to various aspects of the national security, including "security in the economic sphere. Regretfully, even this particular document carries controversial provisions. For example, it declares promotion of "attractiveness of the military and law enforcement activities on the labor market", but, at the same time, cites such allegedly "stimulating" bonuses to the contract soldiers' monetary allowance that fail to bring it closer to the average salaries and wages nationwide. The document also lacks any reference to the priority of boosting up the dual-use knowledge, technologies and innovations.

As a reminder, from the perspective of the effective national law on defense, the "first Chechen campaign" resulted in the RF Ministry of Defense's success in accomplishing its mission, which is "securing the country's territorial integrity". Meanwhile, the fact that the then accomplished mission led to battle deaths of the Russian troops and- to a far greater extent – casualties among ordinary citizenry, as well as colossal damages to the population was interpreted only as costs inevitable under pursuance of the mission. That is why the Russian army used the warfare designed to counter an external aggressor, and there was no stress was laid upon using special, nonlethal, or precision weapons. Nowadays, an evaluation of arms programs and reports on their implementation suggests that no special attention has been paid to these means. With the effective formulation of the concept of defense, even the mission of the aerospace defense also appears a secondary one. In this context, declarations of the need for reinforcing protection from airstrikes of military, industrial and governmental objects, rather than the population, do not look accidental[207].

[206] Strategiya sotsialnogo razvitiya Vooruzhennykh Sil Rossiyskoy Federatsii na period do 2020 goda//Krasnaya zvezda. 2008. 18.04 (№67).
[207] Gavrilov Yu. V koltse zenitok//Rossiyskaya gazeta. 2008. April 30 (№94)

The focus on a genuinely voluntary manning of the regular components and increase of the status and legal protection of the army men, and provision of the safety of the military service in the peacetime have fallen short of being on a duly level.

The above rationales for amending the Act "On defense" have been in part already published[208], but they had been prepared prior to the August 2008 events, which proved the *actualite* of our proposals.

5.8.2. The August 2008 Events and Their Effects on the Military Reform

In many countries worldwide, analysts have studied with gusto the August 2008 military actions, which were carried out in all the spheres, including the informational one. As for experts in the military economics area, it is not less important a task for them to analyze the military-economic aspects of the said events, either. First, the war once again has proved informativity of a series of military-economic indices serving as indicators of an aggressor's military preparations. The rise in the level of military expenditures (in absolute terms and as a share in GDP), participation in combat missions outside a country coupled with an intense rotation of the combat staff – these and other indicators signaled of a high probability of Georgia's invasion of the former soviet autonomous establishments' territory.

While motivations behind Georgia's military preparations and actions are of a sheer political nature and as such they transcend the framework of a military-economic analysis, we are keen to examine conclusions that lie within the noted framework.

First and foremost, the conflict has proved correctness of the course towards *professional training of troops and their equipment with precision warfare* pursued by most contemporary states.

There also arise several conclusions related to the warfare means the sides applied.

It appears extremely inhuman that the aggressor used jet-propelled volley-fire systems of the Russian and foreign origin, heavy ordnance and panzer forces, as well as aerial bombs. But, regretfully, to force the aggressor to peace, the Russian side likewise deployed mostly the same warfare. The Russian forces' dominance was obvious; however, the comprehensive support still raises questions. The Georgian troops were equipped with GRS receiver-indicators, combat identification systems, and far more sophisticated communication means, while the Russians used primitive ones.

The warfare, too, exposed numerous problems, and not only from the perspective of their reliability. To ensure its retaliatory strike, Russia should have used precision antimateriel weapons to cover the enemy's AA systems and core ground military objects (targets). Russia supplies such warfare to other countries – suffice it to remember it has helped India to launch their production and supplies to the national armed forces. But the Russian army had had no such weaponry on hand by the start of the August conflict.

Hence, once again there arose problems associated with development of Russia's military-industrial complex, which is fenced off the public control and fair competition. It appears disconnected from new domestic production which could contribute with its potential and ideas to the military R&D sphere.

[208] Tsymbal V. neobkhodimost sovershenstvovaniya kontseptsiy i systemy upravleniya voennoy bezopasnostyu Rossii//Economico-politicheskaya situatsiya v Rossii. 2008. May. pp. 65-70.

5.8.3. Changes in the Military Manpower Policy, the System of Manning and Social and Economic Provision of the Military

The previous federal target program (FTP) of the army's transition to the voluntary contract-based principle of manning failed in late-2007. The promised "final fulfillment" of the FTP by early-2008 failed, too. Furthermore, the analysis of the events of August 2008 in Southern Ossetia suggests that, having spent some Rb. 100bn on the FTP, we have failed to achieve its major objective, that is, the manning of the units of constant combat readiness (CCRU) with contract soldiers, even in the North Caucasus – contrary to the earlier heard from high offices assurances that conscript personnel would not take part in combat, in reality, just days after joining in the army and absolutely untrained, they did commit together with the contract soldiers.

While evaluating the newly adopted 2008 FTP, one would like to know if it takes into account of the mistakes of the previous stage, as far as the reform of the manning system is concerned. Let us compare these two programs.

1. The title. The previous program was entitled "Transition to the manning with the military doing their service under contract of a number of units and formations for 2004-2007". The title of the new program is far more prolix and bombastic –"Improvement of the system of staffing positions of sergeants and privates with the military transferred to the military service under contract and implementation of the manning of positions of sergeants (sergeant majors) of the Armed Forces of RF, other service arms, military formations and agencies, as well as seamen of the shipboard personnel of the RF Navy with the military doing their service under contract (2009-2015)".

2. Justification for the need for improvement of the manning system in the approved by V. Putin Concept of the FTP[209] contained a fairly accurate ascertainment that, "if maintained, the system of the mixed manning shall inevitably result in: decrease in the number of the military doing their service under contract; a further decrease of attractiveness of the military service in the Armed Forces of the Russian Federation; loss of specialists capable of securing a qualitative maintenance of the military hardware and accomplishing assigned tasks; an inefficient work on training the junior command personnel".

However, the recently adopted FTP has set such parameters that would preserve the mixed manning system of the regular forces, at least, through 2016. The above fragment has been crossed out of the finally adopted FTP, which is most likely to testify to the presence in the echelons of power of a mighty "lobbying" on behalf of corruptionists.

3. Discrepancies in formulation of objectives. The previous FTP stipulated as objectives both "ensuring transition to manning with the military doing their military service under contract of military positions due to be substituted by privates and sergeants in formations and military units of constant combat readiness of the Armed Forces of RF, military units of the border-security forces and the Interior Ministry troops transferred to the new way of manning" and "improvement of combat readiness of the noted formations and military units". The new FTP contains no reference to combat readiness – the objective now is "manning by 2016 by contract of positions of sergeants (sergeant majors) of the Armed Forces of the Russian Federation, other service arms, military formations and agencies, as well as seamen of the shipboard personnel of the RF Navy".

[209] Resolution by the RF Government of 15.07.2008, №1016-r.

4. Chronology. The new FTP was formally approved in the aftermath of the military clash in the Southern Ossetia and Abkhazia. However, an in-depth analysis reveals that it has failed to take it into consideration. It was later that the Russian leadership realized that the Russian Armed Forces' combat efficiency is very low. The RF President demanded to transfer "all the military units" "to the constant combat readiness" category. But no one has made any reference to the FTP, while it is evident that its objective is against the dictates of the time and situation.

5. Main tasks of the new FTP and direction of the planned measures: 1) improvement of conditions of housing for contract troops of rank and file, including those transferred to contracts under the already completed FTP of 2004-2007, and 2) ensuring attractiveness of the contract enlisted service and creation of conditions for the manning. Once it comes to the stimulation by means of monetary allowance, the FTP appears very laconic - for the seamen of the shipboard personnel of the RF Navy the "stimulating allowance" was kept at the present, long depreciated level – Rb. 3,300 a month, while that for sergeants and sergeant majors it is even lower and accounts for 100% of the rates of pay according to the military position, which currently are Rb. 2,304 and 2,496 a month.

There is no reference to the task of increasing the combat efficiency, which corresponds to the general "logic" of the FTP, as an army manned by even very well trained sergeants and untrained privates (who would form the bulk of it) cannot boast a high level of combat efficiency.

6. The planned expenditures on implementation of the new FTP made up a total of Rb. 243,437.64bn in the prices of the current years. The Program reads that the sum in full shall be spent on capital construction.

7. The comparison of socio-economic efficacy of these programs raises numerous questions. The previous FTP envisaged the following outputs: 1) lowering the public dissatisfaction with the then existing system of manning the Armed Forces, other service arms, military formations and agencies with conscripts and deploying those for military service in flash points; 2) establishing prerequisites for reducing the length of the military conscription to one year since 2008. But even after that FTP was complete, conscripts are still deployed to "flash points" and take part in military action, with consequent war and nonwar casualties.

The new FTP contains expressed in trait words hard-to-check intentions: 1) increase of the prestige of the military service and promotion of the Armed Forces of RF, other service arms, military formations and agencies' positive image; 2) improvement of the moral and psychological climate by promoting the junior commanders' status and credibility. Meanwhile, the FTP has failed to provide for assessment criteria of fulfillment of these objectives. For example, what about a twist of the moral and psychological climate in a situation when a sergeant who is a secondary school graduate with the inadequate monetary allowance is in charge of a university graduate? To make things even worse, let us assume the latter is a young father "distracted" for a year of military service from the average salary (which in RF is twice as high vs. the sergeant's monetary allowance), while his wife is entitled to a monthly compensation of Rb.6,000. What will the relationship between these two military be like? And how will they get along in their joint service?

8. The organizational and managerial aspect raises a certain concern, too. Judging the wording of the newly adopted FTP, it has left the systemic defects of the previous one fully untouched (let us note the deficiencies in question had underpinned its failure in 2007). The

extra-departmental control is missing, and so is the public one. For example, the appropriations under the auspices of the previous FTP, particularly those on capital construction, have been already spent, but contract troops still have nowhere to live, and the situation needs to be remedied in the frame of the new FTP. At the new stage, there are no guarantees of an efficient control over the budgetary spending, unless the public control is in place.

The above evaluation suggests the following conclusions:

1. The newly adopted FTP will ultimately fail to ensure progress in the system of manning. The Program centers on tackling a much-needed objective of fixing the life of contract troops and their families, albeit it essentially is a sub-mission. It is only in this sense it can be of a certain avail, and it should have been entitled in this manner. If, however, an FTP is supposed to deal solely with capital construction, while it is tagged as "improvement of the manning system", the title becomes a smokescreen, behind which there is some generals' unwillingness to abandon drawbacks of the current system of manning and the present nature of the military service, as someone benefits from them.
2. The new FTP has to be urgently revised, along with a mandatory attraction of independent experts and representatives of public organizations. Paradoxically, in this situation, public organizations should enter into alliance with V. Putin and D. Medvedev and make them aware of the situation with the new FTP. This would enable the Russian leadership to ensure an efficient and swift resolution of the problem of manning the army. As a reminder, it was V. Putin who approved the concept that contained an absolutely accurate assessment of the need for transferring the armed forces of RF on the contractual basis; likewise, it was D. Medvedev who demanded to ensure the permanent combat readiness of all combat military formations. But this is impossible to do without a forced transition to the voluntary, contract-based method of manning coupled with the securing of a great attractiveness of the military service.

The above IET's assessments and recommendations were published in analytical materials, submitted to the Ombudsman of RF and made available to the general public. It is hard to measure efficiency of such steps, but in conclusion it is worth noting that in early-January 2009, an excerpt of a decree on the size of the national armed forces was published. Shortly thereon the society was informed[210] of some new four-year FTP, which should allegedly result in "as many as 85,000 junior commander positions becoming professional by 2013". The number of professional sergeants should grow up to 250,000. Their training would take three years, and this mission will be assigned to a number of institutions of the higher military education and the former schools for warrant officers. There have been many repetitious statements like this, but the FTP has remained unchanged.

5.8.4. Modification of the Military-Technical Policy and Plans of Equipage of the Armed Forces of RF

Between June and September 2008 the RF government proved the constancy and continuity of the national military-technical policy on the whole as well as means of ensuring these policy characteristics.

At the government meeting of June 30, 2008, on discussion of the 2009-2011 draft federal budget, the Chairman of the RF Government V. Putin announced that the proportion of

[210] Gavrilov Yu. Million shtykov k 2016 godu//Rossiyskaya gazeta. 2009. January 14 (№2).

expenditures on development of the Armed Forces of RF in the overall budgetary expenditures would start growing since 2009 to ultimately reach 70%[211] by 2015, i.e. confirmed the course the Security Council of RF had embarked upon during his term in office. But the current Russian leadership's military-technical policy objective should become securing the necessary level of the country's defense capacity, rather than pumping money into the military-industrial complex. Unfortunately, even Russian economists do not always understand this[212].

The PM is undoubtedly well aware of the national military–technical policy bottlenecks. In three weeks prior to the noted statement Mr. Putin participated in a meeting on problems of planning the state defense order in the 2009-11 draft federal budget. He put the following tasks before participants in the meeting: transition to commercial supplies of new military hardware, concentration of resources on completion of promising projects, sobeit one fixes the situation with project completion timelines and with prices[213]. Prime-minister emphasized both the danger of inflation and his hopes for Rosoboronpostavka's[214] pro-active stance with respect to stabilization of prices for military merchandise.

In this context it is interesting to examine an interview given by Mr. S. Ivanov, the Chairman of the Military-Industrial Commission and Deputy Chairman of the RF Government, and in this capacity a key player of the Russian military-technical policy[215].

But after the August 2008 events, it became clear that the arms program was bad and in need of a drastic modification.

Mr. S. Ivanov identified the following challenges facing implementation of the military-technical policy: anarchy in pricing, a customers' poor justification for technical specifications, and breaking the compulsory 2-month deadline for placing the defense order (by late-April 2008, the contracts that had been concluded to date were worth a total of 65% of the respective volume of budgetary appropriations). Plus, Mr. Ivanov noted that the number of corporations that refused to take part in tenders on placement of the state defense order was on the rise. Echoing the PM's words, Mr. Ivanov believes that the main cause behind such a situation is the manufacturers' overpricing, despite Resolution of the government №549 of August 2007 "On approving Procedures of development and implementation of the state arms programs".

The negative tendency to an increasing inefficiency of the budgetary spending on defense is unlikely to be reversed by a mere boosting up of the volume and proportion of expenditures on development against the background of the Soviet legacy - namely, inefficient institutions of the arms program and the state defense order. The Chairman of the Military-Industrial Commission can lament infinitively about unscrupulous producers' pricing, but until, for instance, Resolution #549 remains unpublished in open media, it will be up to the contract parties' freedom of will, rather than his to set rules of the game (and, accordingly, prices for military merchandize) on the domestic market.

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[211] As quoted on http://www.government.ru/content/rfgovernment/rfgovernmentchairman/chronicle/ archive/2008/06/30/1884577.htm. In the accompanying video, V.Putin references to 50%.

[212] For example the PM spoke to defense expenditures, which is very correct, as today they are spent, mostly guzzled away. But defense expenditures should be allocated for development. This suggests utterly different methods and approaches in this sphere, which is very subtle and delicate". Quoted by: Gontmakher E. Zatyazhka inlflyatsiye//Rossiyskaya gazeta. 2008. July 7 (№143p)

[213] Text of the speech see at: http://www.government.ru/content/rfgovernment/rfgovernmentchairman/ chronicle/archive/2008/06/10/7048457.htm.

[214] The Federal Agency on Supplies of Arms, Military, Special Hardware and Material Inventories.

[215] Zakaz na oboronu//Rossiyskaya gazeta. 2008. July 9 (№146)

Without making urgent political decisions aimed at reducing substantially the proportion of the classified budgetary expenditures, excluding them from the sections of the budget that have nothing to do with defense and security, declassifying legal documents, including those pertinent to the state arms program, and making them available to the general public, as well as information by all the contracts concluded both within the frame of the state defense order and beyond it, Russia's Military Establishment should remain poorly equipped even in 2020.

5.8.5. Peculiarities of the Military-Budgetary Policy and the Problem of Openness

The time gap between approval by the second and the third presidents of RF of the initial[216] and the last (fifth)[217] drafts of the 2008 federal budget is about 15 months. In the interim, appropriations by Section 02 "The national defense" rose from Rb. 958,346m up to 1,031.558m, with the overall rise in the federal budget spending accounting for 6.87%. The 2008 increment by this particular section in real terms[218], accounts for some 3.5% compared with the respective figures of 2007. Meanwhile, the proportion of these expenditures in GDP dwindled by 0.05%- down to 2.48%. Hence, no substantial changes in the planned volumes of financing.

Unfortunately, the form of presentation of the federal budget itself has changed fairly substantially – to the extent when the officially published texts of the respective federal acts have made it impossible to try even simplest assessments of volumes of similar to the above appropriations across sections and subsections of the expenditure classification.

The fact is that in the immediate aftermath of the introduction of regular amendments to the Budgetary Code that took effect since January 2008[219] the annexes to the federal budget lacked tables displaying allocation of the federal budget expenditures across sections and subsections of the functional classification of expenditures. More than this, the mere concept of the functional classification became missing, too. Because of this *innovation* by the RF Ministry of Finance, the act on the federal budget now gives no possibility to know a full volume of budgetary appropriations not only on defense and security, but amazingly, on all other state functions. That is why the below analysis employs both the federal budget acts and the Federal Treasury's data on execution of the consolidated budget of RF[220].

Thus, despite an insignificant rise in the level of secrecy of the 2008 federal budget expenditures (*Table 23*), the transparency rate of the budget as a document plunged to a decade-low level. So it appears absolutely logical that the 2008 budget carries Rb. 15,200m in classified appropriations within the subsection "The social provision of the population", thus leaving just a sole open section of the document, that is, "Protection of environment", free from the secrecy fever.

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[216] On 2008 Federal Budget and on the planned period of 2009-2010: Federal law № 198-FZ, adopted by the Duma on July 6, 2007.

[217] On introducing changes in the Federal law "On 2008 Federal budget and on the planned period of 2009-2010": Federal law № 193-FZ, adopted by the Duma on October 23, 2008.

[218] By using GDP deflator index.

[219] On introducing changes in the Budget Code of the Russian Federation in the way of regulating the budgetary process and bringing in line with the budgetary legislation of the Russian Federation of separate legal acts of the Russian Federation: Federal law № 63-FZ, adopted by the Duma on April 13, 2007.

[220] Report as of January 1, 2009. See: http://www.roskazna.ru/store/reports_file404.xls.

Table 23

The Proportion of Classified Appropriations in the 2003-2008 Federal Budget expenditures, as %

Code and name of the section (subsection) that contains classified appropriations	2003	2004	2005	2006	2007	2008
The federal budget expenditures on the whole	9.73	9.83	11.33	11.80	10.33	11.92
0100 General state issues	n/ap [221]	n/ap	3.67	6.28	5.52	8.66
0108 International relations and international cooperation	31.88	18.04	–	0.01	< 0.01	3.66
0110 State material reserve	97.73	93.33	82.86	89.23	92.18	90.17
0111 Fundamental research	–	–	2.13	1.22	1.12	0.97
0115 Other general issues	n/ap	n/ap	0.05	0.72	0.28	4.42
0200 NATIONAL DEFENSE	37.22	38.40	42.06	42.77	45.33	46.14
0201 Armed Forces of the Russian Federation	35.39	36.11	33.07	35.59	37.11	39.04
0204 Mobilization preparation of the economy	100.0	100.0	100.0	100.0	100.0	100.0
0205 Preparation of, and contribution to provision of collective security and peacekeeping operations	–	–	100.0	100.0	100.0	–
0206 Nuclear and arms complex	100.0	100.0	100.0	100.0	100.0	100.0
0207 Implementation of international obligations in the sphere of military and technical cooperation	100.0	41.05	45.22	46.90	50.65	100.0
0208 Applied research in the national defense area	n/ap	n/ap	98.37	93.94	93.69	93.20
0209 Other issues in the national defense area	n/ap	n/ap	2.49	8.79	24.38	29.21
0300 NATIONAL SECURITY AND LAW ENFORCEMENT ACTIVITIES	23.33	20.79	28.52	31.64	31.07	31.84
0302 The RF Ministry of Interior's bodies	3.40	3.01	4.76	6.31	5.16	4.97
0303 The RF Ministry of Interior's military forces	13.21	11.10	11.76	10.31	9.80	10.25
0306 Security bodies	100.00	98.91	97.80	95.49	97.31	99.05
0307 Border-guard forces	19.73	22.88	100.00	98.97	97.62	100.00
0309 Protection of the population from emergency situations of natural and technogenic nature, civil defense	43.69	41.74	59.02	62.39	50.65	51.39
0312 Applied research in the area of national security and law enforcement activity	n/ap	n/ap	73.95	66.41	64.43	75.49
0314 Other issues in the area of national security and law enforcement activity	n/ap	n/ap	8.26	50.71	39.95	56.32
0400 NATIONAL ECONOMY	n/ap	n/ap	0.05	0.02	0.44	0.64
0411 Applied research in the national economy area	n/ap	n/ap	–	–	5.23	5.84
0412 Other issues in the national economy area	n/ap	n/ap	0.12	0.06	< 0.01	0.31
0500 HOUSING AND UTILITIES	n/ap	n/ap	–	3.42	0.85	6.96
0501 The housing sector	n/ap	n/ap	–	4.22	5.69	15.97
0700 EDUCATION	–	–	2.76	2.69	2.39	2.55
0701 Preschool education	–	–	2.03	2.17	2.44	2.48
0702 General education	–	–	1.51	1.91	2.14	2.00
0704 Secondary vocational training	–	–	1.06	1.03	1.02	0.86
0705 Professional training and retraining	–	–	16.85	15.78	17.22	1.80
0706 The higher professional and postgraduate education	–	–	3.15	2.93	2.53	3.08
0709 Other issues in the area of education	–	–	0.30	0.33	0.28	0.29
0800 CULTURE. CINEMATOGRAPHY AND MASS MEDIA	–	–	0.17	0.17	0.21	0.17
0801 Culture	–	–	0.14	0.10	0.16	0.10
0804 Periodical printed media and publishing	–	–	13.46	7.45	2.57	2.62
0806 Other issues in the area of culture, cinematography and mass media	–	–	0.02	0.15	–	–
0900 HEALTH CARE, PHYSICAL CULTURE AND SPORTS	–	–	4.30	3.99	2.57	4.14
0901 Stationary medical aid	–	–	5.61	4.66	2.94	3.24
0902 Outpatient medical aid	n/ap	n/ap	n/ap	n/ap	n/ap	13.94
0905 Sanatorium and rehabilitation aid	n/ap	n/ap	n/ap	n/ap	n/ap	14.07
0907 sanatorium-epidemological welfare	n/ap	n/ap	n/ap	n/ap	n/ap	2.09
0908 Physical culture and sports	–	–	0.28	0.26	0.24	0.42
0910 Other issues in the area of health care, physical culture and sports	–	–	–	–	–	1.74
1000 SOCIAL POLICY	–	–	–	–	–	0.01
1003 Social provision of the population	–	–	–	–	–	0.02
1100 INTERBUDGETARY TRANSFERS	–	–	–	–	0.16	–
1101 Financial aid to budgets of other levels	–	–	–	–	0.50	–

Source: The IET computations basing on the 2003-2008 federal budget data (the data on 2003-2007 were adjusted to the respective sections and subsections of the budget classification that became effective as of January 2008). The 2008 data are based on the data of Federal Act № 193-FZ of November 8, 2008 and the report on

[221] Non-applicable due to the change in the structure of the budget classification.

execution of the consolidated budget of RF as of January 1, 2009, by the Federal Treasury.

While the dynamic of the proportions of classified appropriations proves the preservation of the long-lasting protecting tendencies, it would be fair to mark some positive developments.

Thus, the draftsmen of the federal budget have finally appreciated an obvious fact that appropriations by Section 0205 "Preparation of, and contribution to provision of collective security and peacekeeping operations" may not be classified ones per se. In addition, the proportion of classified appropriations in Subsection 0705 "Professional training and retraining" of Section 07 "Education" tumbled from 17.2% in 2007 to 1.8% in 2008.

The core tendency has remained in force, nonetheless. For example, all the newly introduced in 2008 subsections of Section 09 proved to be classified ones, while the top secret one – Subsection 0905 "Sanatorium and rehabilitation aid", which accounts for 14.1%, apparently forms a key element of the national defense and security system. Similarly, expenditures on the physical culture and sports in Subsection 0908 proved to be twice as secret vs. 2007. But it is appropriations by Subsection 0501 "The Housing and utilities" that with a rise at over 10 p.p. topped the list of expenditures with the greatest increment in the secret proportion of appropriations. The reason behind that is unknown, of course.

Absolute and relative values of main components of direct military appropriations in the federal budget and their change vs. 2007 according to the final version of the 2008 federal budget are given in *Table 24* (the recalculation to the 2007 prices was made using the first assessment by Rosstat of the 2008 deflator index of GDP[222]).

Table 24

Direct Military Appropriations out of the Federal Budget by Section 02 "The National Defense"

Names of sections and subsections	2008, as Rb.m / in the 2007 price equivalent	Change in 2008 vs. 2007, as Rb.m/increment, as %	Proportion of appropriations, as %/ change vs. 2007, as p.p.	
			In the 2008 federal budget	In GDP
1	2	3	4	5
NATIONAL DEFENSE	1 031 558	29 212	14.69	2.48
	868 315	3.48	1.84	–0. 05
Armed Forces of RF	748 934	24 253	10.67	1.80
	630 416	4.00	1.38	–0.03
Mobilization and paramilitary training	5 045	90	0.07	0.01
	4 246	2.16	0.01	–
Mobilization preparation of the economy	3 500	–1 789	0.05	0.01
	2 946	–37.79	–0.02	–
Preparation of, and contribution to provision of collective security and peacekeeping operations	559	354	0.01	<0.01
	471	302.43	0.01	–
Nuclear and arms complex	17 084	2 282	0.24	0.04
	14 380	18.86	0.06	–
Implementation of international obligations in the sphere of military and technical cooperation	3 911	–3 372	0.06	0.01
	3 292	–50.60	-0.05	–0.01
Applied research in the area of national security and law enforcement activity	133 343	–10 518	1.90	0.32
	112 241	–8.57	0.02	–0.05
Other issues in the national defense area	119 182	17 914	1.70	0.29
	100 322	21.74	0.44	0.04

Source: the IET calculations.

[222] O proizvodstve i ispolzovanii valovogo vnutrennego produkta (VVP) za 2008 gjd. M.: Rosstata, February 3, 2009. See: http://www.gks.ru/bgd/free/B04_03/IssWWW.exe/Stg/d02/13vvp30.htm

The introduced by the Budget Code since 2008 Subsection 0202 “Modernization of the Armed Forces of the Russian Federation and Military Formations” appeared missing in the open part of the federal budget. Considering the match between the amount of appropriations across its subsections with that by Section 02 as a whole[223], it was omitted in the classified annexes, too.

Military appropriations out of the other sections of Russia’s federal budget are given in *Table 25*.

Table 25

Direct and Indirect Military Appropriations by The Other Sections of the Federal Budget

Name of the subsection or *the nature of appropriations*	2008, as Rb.m / in the 2007 price equivalent	Change in 2008 vs. 2007, as Rb.m/increment, as %	Proportion of appropriations, as %/ change vs. 2007, as p.p.	
			In the 2008 federal budget	In GDP
In Section 03 “National security and law enforcement activities”				
The RF Ministry of Interior’s armed forces	54 951	–139	0.78	0.13
	46 255	–0.30	0.07	–0.01
Security bodies	146 363	7 246	2.08	0.35
	122 201	6.25	0.31	–
Border-guard bodies	68 444	686	0.97	0.16
	57 613	1.20	0.10	–0.01
EMERCOM armed forces and civil defense	36 781	5 311	0.52	0.09
	30 960	20.71	0.13	0.01
In Section 04 “The national economy”				
Presidential program “CW destruction”	2 604	–725	0.04	0.01
	2 192	–24.86	–0.01	–
Subsidies to transportation organizations that procure automotive equipment for completing the road transport vehicles for motorcades	94	–	<0.01	<0.01
	79	–	–	–
Subsidies on the functioning of the Russia-NATO coordination center	23	–	<0.01	<0.01
	20	–	–	–
Construction of special and military objects	6 279	–5 125	0.09	0.02
	5 285	–49.23	–0.07	–0.02
FTP “Industrial utilization of arms and military hardware (2005-2010)	89	–17	<0.01	<0.01
	75	–18.19	–	–
Classified expenditures	5 408	1 364	0.08	0.01
	4 552	42.81	0.03	–
Section 05 “Housing and utilities”				
Presidential program “CW destruction”	1 792	–1 652	0.03	0.00
	1 509	–52.26	–0.02	–0.01
Provision of the military with housing perks and permanent housing	33 808	14 335	0.49	0.09
	29 787	92.77	0.25	0.04
Classified expenditures	8 611	4 737	0.12	0.02
	7 248	188.62	0.08	0.01
In Section 07 “Education”				
The RF Ministry of Defense’s expenditures	35 091	1 568	0.50	0.08
	29 538	5.60	0.07	–
Classified expenditures	8 623	397	0.12	0.02
	7 258	5.78	0.02	–
In Section 08 “Culture, cinematography, mass media”				
The RF Ministry of Defense’s expenditures	2 714	–144	0.04	0.01
	2 285	–5.93	–	–
Classified expenditures	159	–14	<0.01	<0.01
	134	–9.68	–	–

[223] See the Federal Treasury data on execution of the consolidated budget

Name of the subsection or *the nature of appropriations*	2008, as Rb.m / in the 2007 price equivalent	Change in 2008 vs. 2007, as Rb.m/increment, as %	Proportion of appropriations, as %/ change vs. 2007, as p.p.	
			In the 2008 federal budget	In GDP
In Section 09 "Health care, physical culture and sports"				
The RF Ministry of Defense's expenditures	25 186 21 200	–233 –1.09	0.36 0.03	0.06 –
Classified expenditures	9 414 7 924	812 11.41	0.13 0.03	0.02 –
In Section 10 "Social policy"				
Pension provision of the RF Ministry of Defense	96 048 80 849	–49 118 –37.79	1.37 –0.62	0.23 –0.16
Pension provision of the FSA	15 634 13 160	–495 –3.62	0.22 0.01	0.04 –
Procurement of housing for the retired and dismissed military	12 057 10 149	–19 232 –65.46	0.17 –0.28	0.03 –0.06
Additional monthly material allowances to disabled due to military trauma	305 257	–386 –60.01	<0.01 –0.01	<0.01 –
Provision of refurbishment of individual housing belonging to family members of the military that have lost a family provider	290 244	49 25.25	<0.01 –	<0.01 –
Compensations to families of the died military	1 453 1 223	125 11.37	0.02 –	<0.01 –
Subsidies and compensations to the military, individuals equaled to them and to the dismissed from the military	8 088 6 808	–1 200 –14.98	0.12 –0.01	0.02 –
Classified expenditures	15 13	– –	0.00 –	0.00 –
In Section 11 "Interbudgetary transfers"				
Subsidies to the closed administrative-territorial entities	9 778 8 230	–908 –9.93	0.14 –	0.02 –
Support of measures on provision of balanced budgets of administrative-territorial entities	1 134 955	–105 –9.93	0.02 –	<0.01 –
Development and support of the social and engineering infrastructure of administrative-territorial entities	5 816 4 896	–575 –10.51	0.08 –	0.01 –
Implementation of the primary military records in the territories wherein are no military comissariats	1 625 1 368	178 15.00	0.02 –	<0.01 –
Lump-sum benefit to the pregnant wife of the conscript and the monthly benefit for the child of the conscript	1 090 918	– –	0.02 0.02	<0.01 –
Relocation of residents out of administrative-territorial entities	1 234 1 039	–115 –9.93	0.02 –	<0.01 –
Material provision of specialists of the nuclear arms complex of RF	2 255 1 898	53 2.89	0.03 –	0.01 –
Presidential Decree of August 1, 2005,№887 "On measures on improvement of the situation of the disabled due to a military trauma"	670 564	– –	0.01 0.01	<0.01 –

Source: the IET calculations.

When compared with 2007, appropriations to the RF Ministry of Defense on housing construction under Section 02 "The national defense" rose at 35% in real terms; in addition, appropriations to the military under Section 05 "Housing and utilities" were increased at 93%. But, at the same time, the budgetary spending on the housing certificates shrank at 65% and that on the mortgage system for the military dropped by 61%. Notably, the volume of the latter was cut from Rb. 8,270bn in the initial draft of the 2008 federal budget to 4,063bn in the final one.

In 2008, the military's pay was raised twice at 9%, while appropriations on the RF Ministry of Defense's military personnel rose at 19% in real terms. But the objective President Putin had set back in 2005 – to increase the military's incomes 1.5 times in real terms by late-2008 - was not attained. With the account of the CPI (113.3% in 2008) the military's incomes grew just by 25% over the past three years.

It was planned to allocate Rb. 28,554bn (+39%) on combat training, with the lion's share of the sum (26,961bn), as usual, falling on fuel and lubricants. By the RF Minister of Defense's decision of December 2007 other components of the combat training expenditures were quadrupled- from Rb. 244m up to 1,055 bn. But the picture changes, should one consider the fact that right before that the Head financial-economic division of the Ministry had accomplished a reverse move of cutting these very expenditures 4-fold[224].

Appropriations on the material and technical supplies accounted for Rb. 113,214bn, thus being at 1% down vs. 2007. It is already clear that despite the draftsmen of the three-year federal budget were confident that this would be an amount sufficient to ensure an annual procurement of not less than 3.2m. t. of fuel and lubricants, the respective 2008 procurements by the RF Ministry of Defense did not exceed 2.8m.t., while the respective appropriations made up Rb. 57,204bn (a 52% nominal growth). At this juncture the growth in the average flying time of the Russian Airforce pilots from 42 up to 55 hours over the year, as asserted by the head of the Head Division of combat training and troop service of the RF Airforce[225], cannot be attributed just to the price downfall for oil products by the end of the year.

Whilst the RF Ministry of Defense declared 2008 the year of the Food Service, appropriations on the food supplies (Rb. 24,404 bn.) proved to be at 12% down in real terms vs. 2007. The Russian authorities displayed a similar attitude to the material support, where the respective cuts in real terms accounted at 23% - that is to say, they still are at pains to adhere to a negative rate of material supplies of 60-70%.

The 2008 appropriations on the pension provision of the RF Ministry of defense slid at 3-7% in real terms vis-à-vis 2007[226] (depending on the deflation method - using either CPI, or the deflator index of GDP). This can also be regarded as an effect from the reduction in the number of military pensioners under the auspices of the Ministry – the most recent statistical data available date back to January 1, 2006.

Direct military appropriations (*Table 26*) in the 2008 federal budget computed in accordance with the UN military expenditures standard accounted for 3.6% of GDP, while with account of appropriations associated with the earlier military activities (military pensions[227], CW destruction, etc.) they amounted to 3.9% of GDP.

[224] Raschepkin K. Teper nastupaem po vsem napravleniyam…//Krasnaya zvezda. 2008. February 5 (№18).
[225] Krasnaya zvezda. 2008. 11 February (№23).
[226] Without regard to the amount earmarked to the RF Ministry of Finance in 2007 to pay off the accumulated between 1995-1998 debt to the military pensioners.
[227] Until 1998 the Ministry of Defense's pension expenditures had been included in the composition of the Section 'The national defense".

Table 26

Aggregate Indicators of the Military Appropriations and Other Associated with Them Appropriations from the Federal Budget

Name	Amount, as Rb.m.	Proportion of appropriations, as %/ change vs. 2007, as p.p.	
		In the 2008 federal budget	In GDP
Overall direct military appropriations	1 494 049	21,28 3,07	3,60 0,01
Aggregate direct and indirect military appropriations pertaining to the current and former military activities	1 636 584	23,31 2,16	3,94 –0,23
Aggregate appropriations by sections “The national defense” and “national security and law enforcement activities”	1 860 980	26,50 3,32	4,48 –0,09

Source: The IET calculations.

The execution of the 2008 federal budget in the part of military expenditures has basically remained unchanged vis-à-vis 2007. More specifically, the Federal Treasury reports show a Rb. 5,034bn.-worth excess of the limit of expenditure by the aggregate budget financing targets of the federal budget over the respective appropriations already from March. The said excess hit its peak in November 2008 (Rb. 18,406bn.) and fell by the end of the year to 12,643bn.

While the RF Ministry of Finance publishes the budget financing targets[228], their data does not allow identification of sources of growth in the military expenditure. These are most likely the remnants of the 2007 federal budget appropriations on the Federal Treasury’s accounts (over Rb. 7bn by Section “The national defense”) and additional revenues the RF Ministry of Defense has cashed in from sales of real estate, arms utilization and CW destruction.

The data on the monthly execution of the 2008 federal budget military expenditures and other pertaining to them expenditures are given in *Table 27* and *Fig. 40–42*. The trend to shifting the spending to the last month of the year has become increasingly obvious in 2008, particularly because of the RF Ministry of Finance’s auctions on placement of free federal budget funds. The negative effect such a manner of financing has on the combat efficiency, the military’s everyday life and operations, and the whole military economy is evident.

[228] See, for example: http://www1.minfin.ru/ru/budget/federal_budget/budj_rosp/

Table 27

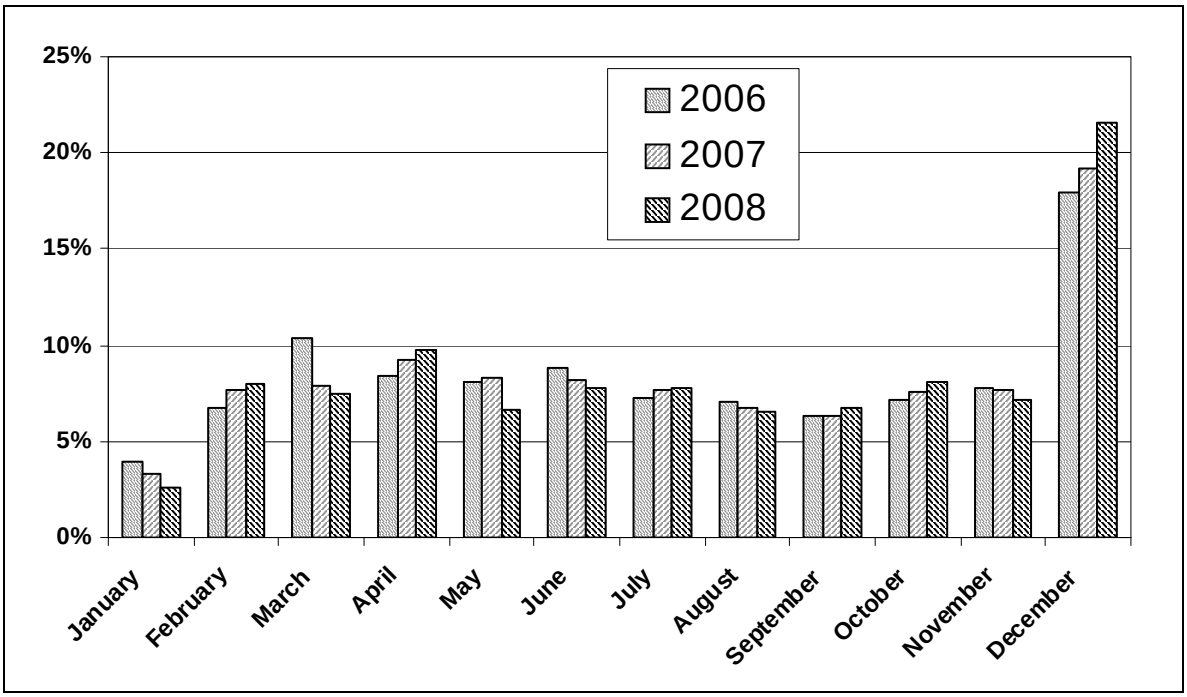
The Monthly Execution of the Military and Other Pertaining Expenditures of the 2008 Federal Budget, as Rb.bn.

Наименование расходов	As provided for by the 200FB[229]	The 2008 FB, modified[230]	January	February	March	April	May	June	July	August	September	October	November	December	Saved (over-spent)
NATIONAL DEFENSE	**958,3**	**1 031,6**	**22,5**	**71,6**	**77,1**	**97,4**	**71,5**	**72,1**	**80,5**	**60,7**	**60,7**	**82,2**	**78,6**	**261,2**	**(9,3)**
The Armed Forces of RF	701,8	748,9	20,0	61,7	57,5	75,5	51,7	60,5	59,8	50,5	51,9	62,5	55,0	166,9	(22,7)
Mobilization and paramilitary training	5,2	5,0	0,0	0,6	0,2	0,2	0,2	1,3	0,2	0,1	0,2	0,2	0,3	1,0	0,5
Mobilization preparation of the economy	3,5	3,5	0,0	0,5	0,7	1,0	1,3	0,1	0,2	0,1	0,1	0,2	0,1	0,3	(1,2)
Preparation of, and contribution to provision of collective security and peacekeeping operations	0,1	0,6	–	–	–	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,1	0,2	0,2
Nuclear and arms complex	17,1	17,1	0,8	–	8,9	1,6	–	–	2,3	0,1	–	0,2	1,6	2,4	–
Implementation of international obligations in the sphere of military and technical co-operation	3,1	3,9	0,8	0,1	–	–	–	0,6	0,1	0,1	0,1	–	0,6	0,6	1,2
Applied research in the area of national defense	127,8	133,3	0,6	8,2	7,2	14,2	6,9	6,2	9,2	3,9	4,4	4,9	5,7	50,6	3,7
Other issues in the national defense area	99,7	119,2	0,2	0,6	2,6	4,9	11,3	3,4	8,7	5,9	4,1	14,2	15,2	39,2	9,1
NATIONAL SECURITY AND LAW ENFORCEMENT OPERATIONS	**772,2**	**829,4**	**27,9**	**53,8**	**62,1**	**66,9**	**61,6**	**68,8**	**66,0**	**60,3**	**65,9**	**71,1**	**75,9**	**137,0**	**(6,1)**
The RF Ministry of Interior's armed forces	51,6	55,0	1,3	2,5	3,8	4,0	4,4	4,8	4,5	4,1	4,7	4,4	5,1	10,4	0,2
Security bodies	137,4	146,4	5,1	9,4	11,0	11,2	10,4	11,9	12,3	10,3	10,2	12,8	13,3	26,2	(1,3)
Border-guard bodies	65,1	68,4	1,7	4,2	4,2	4,8	4,9	5,1	5,7	5,0	4,6	6,3	5,0	11,9	3,5
Protection of the population from emergency situations of natural and technogenic nature, civil defense	45,0	47,8	1,6	2,2	5,2	5,0	3,3	3,1	3,5	3,1	3,6	3,8	3,9	10,2	(2,1)
Applied research in the area of national security and law enforcement activity	6,7	6,7	0,2	0,4	0,4	0,5	0,4	0,5	0,6	0,4	0,5	0,6	0,6	1,6	(0,2)
Other issues in the area of national security and law enforcement activity	4,8	5,9	0,2	0,2	0,2	0,8	0,4	0,3	0,3	0,2	0,3	0,2	1,1	0,5	1,0

Source: the IET calculations basing on the Federal Treasury data.

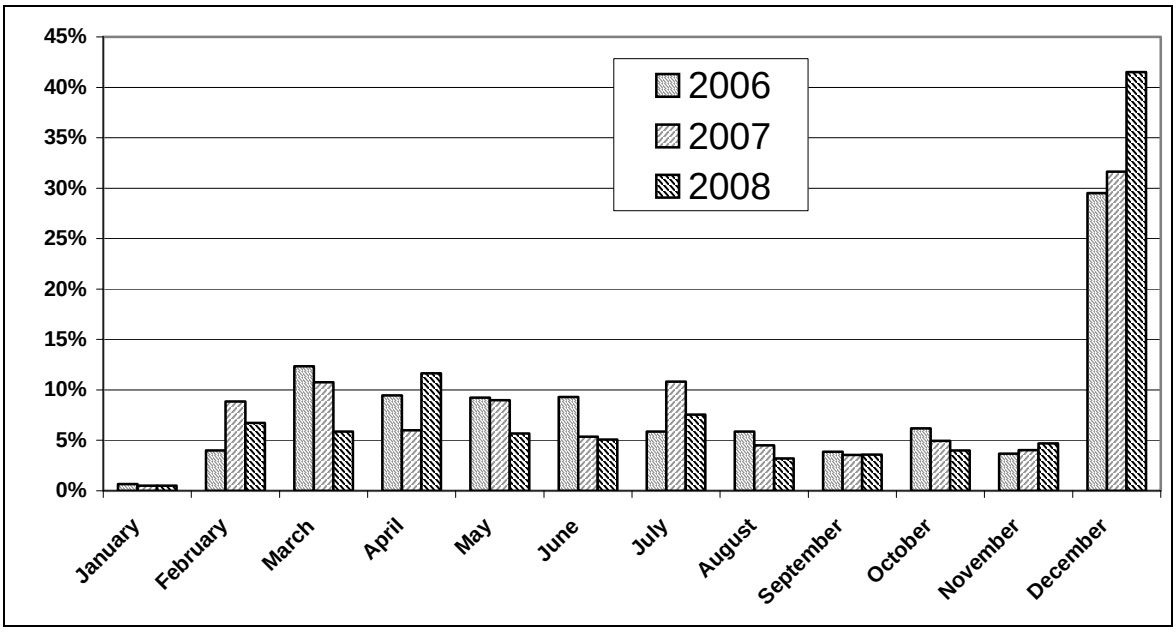
[229] On the federal budget for 2008 and the planned period of 2009 and 2010: Federal Act № 198-FZ: passed by the State Duma on July 6, 2007.

[230] On introducing amendments to the Federal Act «On the federal budget for 2008 and the planned period of 2009 and 2010 Federal Act № 193-FZ: passed by the State Duma on October 23, 2008.



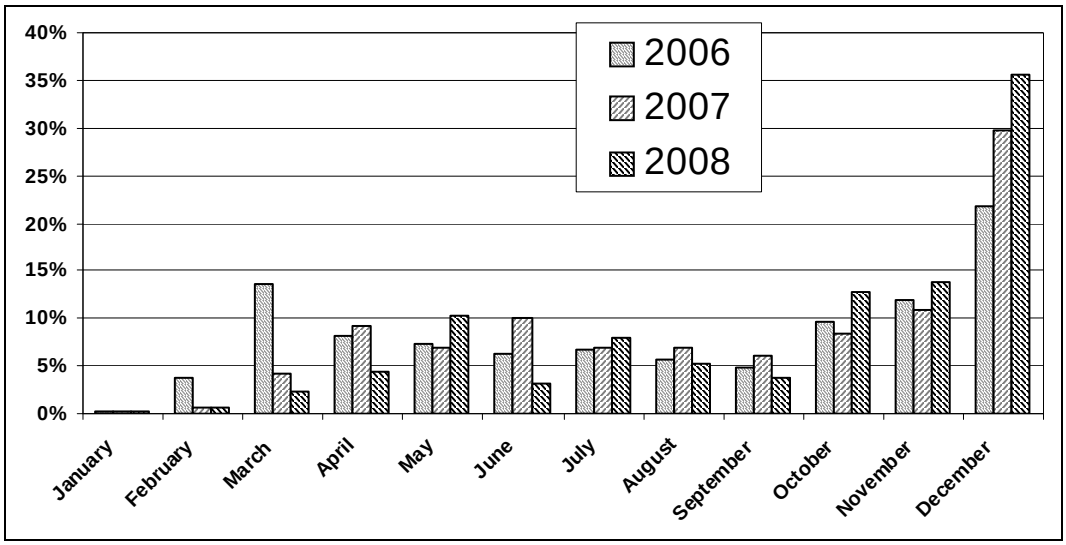
Source: the IET calculations basing on the Federal Treasury data.

Fig. 40. Execution of the Federal Budget Expenditures by Subsection 0201 «The Armed Forces of the Russian Federation»in 2006–2008



Source: the IET calculations basing on the Federal Treasury data.

Fig. 41. Execution of the Federal Budget Expenditures by Subsection 0207 “Applied Research in the Area of National Defense” in 2006–2008



Source: the IET calculations basing on the Federal Treasury data.

Fig. 42. Execution of the Federal Budget Expenditures by Subsection 0208 "Other Issues in the Area of National Defense" in 2006–2008

Evaluation of the Federal Treasury's reports on execution of the consolidated budget of RF showed that the earlier nearly non-existent and, consequently, not taken into consideration, military expenditures of governments of Subjects of RF have grown into fairly comparable with the central government's ones, as far as a number of subsections of the Classification are concerned. Since 2005 they also have appeared in the Section "The national defense" (see *Table 28*), albeit not in excess of 0.3% of the federal government's aggregate military expenditures.

Table 28

Military Expenditure of Consolidated Budgets of the Subjects of RF in 2003–2008 , as Rb.m.*

Name of the subsection of the Classification of expenditures	2003	2004	2005	2006	2007	2008
The Armed Forces of the Russian Federation	–	–	–	3,5	0,5	0,3
	–	–	–	0,1	0,3	0,3
Modernization of the Armed Forces of the Russian Federation and military formations	–	–	–	–	–	1,0
	–	–	–	–	–	0,5
Mobilization and paramilitary training	13,1	–	65,6	899,3	1 351,9	1 797,9
	13,2	–	65,6	808,6	1 245,6	1 702,2
Mobilization preparation of the economy**	449,7	532,4	485,4	708,3	861,2	1 137,2
	405,6	500,6	468,6	692,8	840,9	1 063,9
Other issues in the area of national defense	–	–	109,6	32,8	5,5	0,7
	–	–	97,5	32,1	5,7	0,5
The RF Ministry of Interior's armed forces	14,6	12,4	9,9	3,5	1,0	0,3
	12,7	12,2	9,9	1,4	1,0	0,3
Security bodies	3,7	6,7	0,3	16,5	0,1	0,0
	2,1	6,5	0,3	16,5	0,1	0,0
Border-guard bodies	–	–	0,1	–	–	–
	–	–	0,1	–	–	–
Protection of the population from emergency situations of natural and technogenic nature, civil defense	6 511,0	7 968,2	11 184,6	15 636,4	19 118,4	23 895,8
	6 244,1	7 281,3	10 958,9	14 367,0	18 292,6	21 456,7

*Numerator – allocated, common denominator – actual earmarking.
** Until 2995 this Subsection was not included in the Section "The national defense"
Source: the Federal Treasury

Presented in *Table 29* results of a 10-year (1998-2008) statistical monitoring of Russia's military expenditures (to avoid double count) do not include the data of *Table 28*, as there is no clarity as yet with respect to sources of financing the RF Subjects' military expenditures (in relation to the proportion of transfers out of the federal budget) provided therein. In addition, while evaluating the dynamic of Russia's aggregate military expenditure over the period in question, it should be taken into account that initially underlying the system of their calculation was an approach that rested on a formal connection between the Military Establishment's spending and military missions and operational objectives. Hence, it is not always possible to draw a direct comparison of such statistics with the NATO members' military expenditures, as since 2004 most of them have attributed to military agencies only those ones which, with their training and arms, are capable of a direct participation in a combat action and, accordingly, do not attribute expenditures on security agencies analogous to Russia's FSA to the military ones.

Table 29

Main Indicators of Military Expenditures of the Russian Federation in 1999–2008

	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
1. In nominal terms (in current prices) as Rb. bn.										
Execution of the FB expenditures by the Section "The national defense" under the current budget classification[a]	115,6	191,7	247,7	295,4	355,7	430,0	581,1	681,8	831,9	1 040,8
Appropriations from FB by the Section "The national defense" under the current budget classification	93,7	209,4	214,7	284,2	354,9	427,4	578,4	686,1	839,1	1 031,6
placed into other section of the budget classification[b]	–	–	–	–	–	–	44,3	77,7	91,3	121,0
in the comparable budget classification	93,7	209,4	214,7	284,2	354,9	427,4	622,6	763,9	930,4	1 152,5
Military expenditures, the UN data[c]	–	202,6	294,4	325,9	447,0	499,0	665,0	822,1	850,2	–
Overall direct military expenditures[d]	128,9	270,4	283,4	357,7	464,2	552,7	770,3	1 003,9	1 214,4	1 494,0
Aggregate direct and indirect military expenditures pertinent to the current and past military activities[e]	144,0	304,6	329,6	460,1	602,3	638,8	855,1	1 090,4	1 375,6	1 636,6
2. In real terms (in the 2008 prices)[e], as Rb. bn										
Execution of the FB expenditures by the Section "The national defense" under the crrent budget classification	1 012,2	1 093,0	1 050,6	987,3	997,4	1 007,3	1 093,5	1 032,1	1 039,9	1 040,8
Appropriations from FB by the Section "The national defense" under the current budget classification	820,5	1 194,0	910,6	949,8	995,2	1 001,2	1 088,2	1 038,7	1 048,9	1 031,6
placed into other section of the budget classification	–	–	–	–	–	–	83,3	117,7	114,1	121,0
in the comparable budget classification	820,5	1 194,0	910,6	949,8	995,2	1 001,2	1 171,5	1 156,3	1 163,0	1 152,5
Military expenditures, the UN data	–	1 155,2	1 248,8	1 089,4	1 253,4	1 168,9	1 251,2	1 244,4	1 062,8	–
Overall direct military expenditures	1 128,7	1 1541,7	1 202,1	1 195,4	1 301,7	1 294,6	1 449,4	1 519,7	1 518,0	1 494,0
Aggregate direct and indirect military expenditures pertinent to the current and past military activities	1 261,0	1 736,7	1 397,9	1 538,0	1 688,8	1 496,5	1 609,0	1 650,6	1 719,4	1 636,6
3. In real terms (in the 1999 prices (as Rb. Bn.)										
Execution of the FB expenditures by the Section "The national defense" under the crrent budget classification	115,6	124,8	120,0	112,8	113,9	115,0	124,9	117,9	118,8	118,9
Appropriations from FB by the Section "The national defense" under the crrent budget classification	93,7	136,4	104,0	108,5	113,7	114,3	124,3	118,6	119,8	117,8
placed into other section of the budget classification	–	–	–	–	–	–	9,5	13,4	13,0	13,8

	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
in the comparable budget classification	93,7	136,4	104,0	108,5	113,7	114,3	133,8	132,1	132,8	131,6
Military expenditures, the UN data	–	131,9	142,6	124,4	143,1	133,5	142,9	142,1	121,4	–
Overall direct military expenditures	128,9	176,1	137,3	136,5	148,7	147,9	165,5	173,6	173,4	171,0
Aggregate direct and indirect military expenditures pertinent to the current and past military activities	144,0	198,3	159,6	175,6	192,9	170,9	183,8	188,5	196,4	187,2
4. The military burden of the economy, as % of GDP										
Execution of the FB expenditures by the Section "The national defense" under the cuurrent budget classification	2,40	2,62	2,77	2,73	2,69	2,52	2,69	2,53	2,51	2,51
Appropriations from FB by the Section "The national defense" under the current budget classification	1,94	2,87	2,40	2,62	2,68	2,51	2,67	2,55	2,53	2, 48
placed into other section of the budget classification	–	–	–	–	–	–	0,20	0,29	0,28	0,29
in the comparable budget classification	1,94	2,87	2,40	2,62	2,68	2,51	2,88	2,84	2,81	2,77
Military expenditures, the UN data	–	2,77	3,29	3,01	3,38	2,93	3,07	3,06	2,57	–
Overall direct military expenditures	2,67	3,70	3,17	3,30	3,51	3,24	3,56	3,73	3,67	3,60
Aggregate direct and indirect military expenditures pertinent to the current and past military activities	2,99	4,17	3,69	4,25	4,55	3,75	3,95	4,05	4,15	3,94
5. By purchasing power parity (in current prices), as USD bn..										
Execution of the FB expenditures by the Section "The national defense" under the current budget classification	21,9	26,8	30,2	31,9	34,2	36,2	45,6	48,2	54,2	62,8
Appropriations from FB by the Section "The national defense" under the current budget classification	17,7	29,3	26,2	30,7	34,1	35,9	45,4	48,5	54,6	62,3
placed into other section of the budget classification	–	–	–	–	–	–	3,5	5,5	5,9	7,3
in the comparable budget classification	17,7	29,3	26,2	30,7	34,1	35,9	48,9	54,0	60,6	69,6
Military expenditures, the UN data	–	28,3	35,9	35,2	42,9	42,0	52,2	58,1	55,4	–
Overall direct military expenditures	24,4	37,8	34,6	38,6	44,6	46,5	60,5	71,0	79,1	90,2
Aggregate direct and indirect military expenditures pertinent to the current and past military activities	27,2	42,6	40,2	49,6	57,9	53,7	67,1	77,1	89,6	98,8
For reference										
GDP deflator, as % to the prior year	172,5	137,6	116,5	115,5	114,0	120,1	119,2	115,8	113,5	118,8
Expenditure deflator on final consumption by public administration[f], as % to the prior year	138,5	153,6	134,4	126,9	119,2	119,7	124,5	124,3	121,1	*125,0*
The purchasing power parity[h], Rb./USD.	5,29	7,15	8,19	9,27	10,41	11,89	12,74	*14,14*	*15,36*	*16,57*

[a] For 2008 – preliminary data of the Federal Treasury on execution of the federal and consolidated budgets

[b] Expenditures of the RF Ministry of Defense and classified expenditures by sections 04–09 and 11 of the 2005–2008 federal budgets.

[c] The 1999 data was not submitted by the RF government to the UN, the 2008 ones shall be submitted in 2009; they include.expenditures on supplies of the RF Minister of Interior's armed forces , the border- guard forces, and the civil defense in particilar.

[d] Inclusive of supplies of the RF Minister of Interior's armed forces , the border- guard forces, the civil defense forces, and other elements of the Military Establishment.

[e] Plus pensions to the military. Deflated with the use of the expenditure deflator on final consumption by public administration

[g] For 2008- the IET estimates.

[h] For 2006–2008 – the linear trend of values of the previous years (the IET estimates).

Sources: The 1999-2008 federal budget acts and acts on execution of the 1999–2007 federal budgets.; Natsionalnye scheta Rossii v 1997–2007 godakh: Sta.sb./Rosstat. M., 2005–2008; Obyektivnaya informatsiya po voennym voporsam, vklyuchaya transparentnost voyennykh raskhodov. Doklady Generalnogo Sekretarya OON 2001–2008 gg.; Rosstat; The Federal Treasury.

5.8.6. Development of Russia's Military Establishment: Trends and Outlooks

Because of a number of factors, of which the most critical one became military action in the Southern Ossetia and Abkhazia in August 2008, the government has taken on the implementation of the design of the long-needed military reform. But what raises concern is not a reactionaries' counterstand or the removal of the Federation Council from the decision-making process. Rather, it is the absence of support to the reformers' efforts on the part of the bulk of the military and the society, as the reform blueprint was coined privately, the decisions were made without discussion and justification. That is why its mistakes become visible only at the stage of the reform implementation - hence the déjà-vu effect of the situation around the notorious "monetization of benefits".

The equally pernicious factor of a possible failure of the reform may become corruption, which, as a nationwide challenge, is not foreign to the Military Establishment. The situation aggravated in 2008, which can be partly explained by the forthcoming mass dismissal of officers and warrant officers from the so-called plum jobs.

The time calls for legislative action. The priority should become a proposal to amend the wording of Art. 34 "On military conscription and military service" to eliminate the possibility to compel conscripts to sign a contract after the half year of service. The military in the barrack, beyond the normal framework of civil rights – such a situation is pregnant with a great number of offences. The respective proposals on amending the law were drafted in cooperation with Russian human rights organizations and submitted to the Ombudsman of RF to promote them through official channels.

The year of 2009 should become the first one of implementation of the new FTP on improvement of the system of manning of the national Military Establishment. But, as the analysis of the Program showed, it was approved in such a form that not just exacerbates its drawbacks, but ultimately blocks the intention to transfer all the regular troops to the category of military units of permanent combat alert. In a hope for a sound reaction of the veteran officers who will be in charge of such troops, one can pray of a prompt adjustment of the FTP, as it appears beneficial just for criminal structures that capitalize on defects of the manning system and the citizenry's fear of the military service.

Otherwise the country would face a social outbreak as soon as in 2009 or any time soon. The desperate contract soldiers and conscripts, including those who will be under pressure to sign military contracts will be joined by dismissed officers. Yet more negative may become sentiments of the officers who will be retained in the army, albeit being deprived of the currently declared attractive conditions of service, including a high pay and guaranteed housing. The authorities proposed, with no public discussion whatsoever, a procedure of "picking" a *corps d'elite* among the officer corpse to be awarded with a stunningly lavish compensation. This move seems very dubious and may result in a growing frustration and cachexy of the officer corpse. Considering the President and PM's statements, the nation's leadership cares more of developing the warfare, rather than the cadres problem. While the need in new arms is

no doubt matters, without solving the problem as to in whose hands they will go, their manufacturing and supplies to the army may not ensure a desired enhancement of the combat efficiency.

Hence, other earlier discussed proposals remain in force. These are:

1. The society must be aware of the assessment of outputs of the recently completed FTP, as well as parameters of the new one. The latter program concerns not only the Military Establishment and the government, as the problem of the manning of the Military Establishment affects interests of the overwhelming majority of the RF citizenry and impacts all the sectors of the economy. There is the need in promulgation of legislation that would unambiguously read that conscription is effective only in the peacetime, solely for the sake of obtaining a military specialty which shall be needed for a further career in the standing army or for completing the reserve force.
2. Let us note that the government implements proposals we put forward in the last year's analysis of the military economy – namely, it increases allowances to officers of the standing army and cuts their number – chiefly in the formations that do not fall under the permanent alert category. But while raising their pay, one should do the same, as far as sergeants and even privates (seamen) are concerned, otherwise the Military Establishment would not advance on the labor market, nor contract soldiers would qualify for the military service. The hope that the current economic crisis would increase the number of the unemployed and help cut the average salaries and wages nationwide, which in turn would ensure a great influx of young and healthy individuals into the army, seems very shaky. Should there be any progress in this regard, its effect will be a temporary one.
3. As the military action in the Northern Ossetia and Abkhazia has exposed numerous drawbacks in equipage of our armed forces and triggered a consequent adjustment of the State Arms Program and the State Defense Order, an urgent problem became an extradepartmental control over this sphere of the military economy.
4. As far as budgetary problems are concerned, the year of 2008 saw no progress in this respect. Rather, the negative tendencies intensified in this particular sphere.

It is important to bring the budget classification of RF in line with the mission, goals and objectives of the national Military Establishment; equally critical appears the need in building a clear inter-relation between indicators that characterize these activities and funds spent on their exercise.

In 2008, the secrecy around the military expenditure did not dilute, but intensified. This means that the propensity for corruption in the national budgetary system will continue exerting its negative influence both on the military economy and the national economy as a whole.

5. The world financial and economic crisis, too, has contributed to the overall aggravation of the situation. It is still an unanswered question as to whether its impact on Russia's military economy may be positive and result in a greater financial discipline, a genuine optimization of management, halting of corruption and thievery, growth in the military's welfare, and, ultimately, solidification of the country's defense capacity. It may well happen that things will turn to the worse and engender a sequestration of the budget, back-out with regard to all the promises given to the military, and a lower combat efficiency. Under such circumstances the public control over the Military Establishment and the military economy forms an efficient means of getting out of the crisis with minimum sacrifices of the country's defense capacity.

Annex 1. An overview of important alterations in the sphere of tax regulation and civil legislation introduced in 2008[1]

In 2008, as before, the reforming of tax legislation with the aim of its further improvement and better coordination was continued. Over the year, some alterations and amendments were introduced into nearly all the chapters of Part Two of the Tax Code of the Russian Federation. The most significant changes were as follows: the lowered rate of the profits tax; the altered procedure for the payment of the value added tax; the granting to RF subjects the right to establish differentiated tax rates for the taxpayers applying the simplified taxation system, as well as the subsequent switchover from the payment of single social tax to the payment of insurance contributions. Most of these changes have indeed improved the taxpayers' situation, while some others are directly detrimental to their situation.

Besides, some relevant alterations introduced in civil, antimonopoly, and labor legislation should also be mentioned.

1. The main alterations introduced in the RF Tax Code (Part Two and Part One) Profits tax[2]

From 1 January 2009, the rate of the tax on profit of organizations was lowered from 24% to 20% at the expense of that part of the tax which is to be transferred to the federal budget (the sum of the tax transferred to the federal budget is diminished from 6.5% to 2.5%), which on the whole is compatible with the current global trends in taxation reforming [3]. The sum of profit tax is defined as the percent share of the tax base corresponding to the tax rate (Item 1 Article 286 of the RF Tax Code), while the tax base is calculated by the results of a tax period (Item 1 of Article 54 of the RF Tax Code). Therefore, when paying profit tax in 2009 for the year 2008, organizations must apply the previously established rate of 24%.

The newly introduced alterations envisage a special procedure for the payment of the monthly advance payments of the tax on profit of organizations (from Q IV 2008). The calculation of the sum of the tax on profit of organizations may be based on the actual amount of

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[1] This section has been prepared with the aid of the legal system KonsultantPlus.

[2] See the following Federal Laws: of 1.December 2008, No 225-FZ, "On introducing alterations into the Federal Law "On the Fund for promoting reforming of the housing and utilities sector" and some legislative acts of the Russian Federation"; of 26 November 2008, No 224-FZ, "On introducing alterations into Part One, Part Two of the Tax Code of the Russian Federation and some legislative acts of the Russian Federation"; of 22 July 2008, No 158-FZ, "On introducing alterations to Chapters 21, 23, 24, 25 and 26 of Part Two of the Tax Code of the Russian Federation and some other acts of the Russian Federation's legislation on taxes and levies"; of 22 July 2008, No 135-FZ, "On introducing alterations into Article 256 of Part Two of the Tax Code of the Russian Federation and on deeming to be null and void some of the provisions of the legislative acts of the Russian Federation on taxes and levies"; of 30 June 2008, No 108-FZ, "On the introduction of alterations into the Federal Law "On concession agreements" and into some legislative acts of the RussianFederation"; and of 30 April 2008, No 55-FZ, "On introducing alterations into some legislative acts of the Russian Federation in connection with the adoption of the Federal Law "On the additional insurance contributions to the funded part of labor pension and government support of the formation of pension savings".

[3] See Kommentarii IEPP, T. A. Malinina, "Izmeneniia v poriadke ischisleniia naloga na pribyl' organizatsii" [Commentary of the IET, T. A. Malinina, "Alterations in the procedure of calculating the tax on profit of organizations"], http://www.iet.ru/ru/kommentarii/izmeneniya-v-poryadke-ischisleniya-naloga-na-pribyl-organizacii.html

profit[4] (as a growing grand total for the period from the beginning of a tax period to the end of the month preceding the month during which the advance payment is made). If an organization decides to apply the aforesaid norm, the corresponding alteration in the procedure of calculating the advance payments of profit tax must be reflected in its accounting policy for the purposes of taxation. This innovation helps to avoid situations when advance payments of profit tax exceed the size of the ultimate tax obligation, which results in crediting the budget and withdrawal of money from a taxpayer's turnover (however, with a later set-off against the excess payment).

New wordings have been adopted for the provisions concerning the procedure for including depreciable property into specific depreciation groups, as well as for the method and procedure for charging the depreciation sums. The procedure for charging depreciation by applying non-linear method has been fundamentally changed. Depreciation is charged not to a separate fixed or intangible asset, but to an entire depreciation group (Item 1 of Article 259 of the RF Tax Code). The value of all the objects included in a given depreciation group creates its summary balance (Item 2 Article 259.2 of the RF Tax Code), which is then diminished, on a monthly basis, by the sums charged to that depreciation group (Item 4 Article 259.2 of the RF Tax Code). In this connection, for each of the depreciation groups listed in Item 5 Article 259.2 of the RF Tax Code RF its own monthly depreciation norm is established: for Group I – 14.3, for Group II – 8.8, for Group III – 5.6, and so on. If the summary balance of a depreciation group becomes less than 20,000 rubles, in the next month the organization is granted the right to liquidate that depreciation group, and the amount of the summary balance is then charged to non-realization expenditures (Item 12 of Article 259.2 of the RF Tax Code). After expiration of the useful life of the property it should be excluded from the depreciation group, while the group's summary balance remains unchanged (Item 13 Article 259.2 of the RF Tax Code).

While previously it was possible to arbitrarily apply one or other method of charging depreciation for each object of depreciable property, now this possibility has been eliminated. Either linear or non-linear method should be applied to all depreciable property (paragraph 2 of Item 3 of Article 259 of the RF Tax Code); and the taxpayer must consolidate its choice in its accounting policy.

The only exception is represented by buildings, structures, transmission devices and intangible assets, which are included into Depreciation Groups VII – X (that is, items whose useful life exceeds 20 years). Depreciation for these groups is charged only by applying linear method (paragraph 1 of Item 3 of Article 259 of the RF Tax Code).

From January 2009 onwards, the size of the depreciation premium for the fixed assets with the period of use of 3 to 20 years is increased from 10 to 30%.

It is established that those organizations that applied special coefficient 0.5 to the basic depreciation norm established in respect of passenger cars and passenger vans whose initial value had been in excess of 600 000 rubles and 800 000 rubles respectively, from 1 January 2009 shall no more apply the aforesaid coefficient.

From January 2009 onwards the lessor who under a contract is obliged to compensate to the lessee the latter's capital expenditures in leased fixed assets may begin to depreciate these assets from the 1st day of the month following the month in which the property was put into

[4] At present, monthly advance payments are calculated on the bssis of the results of previous periods" (Article 286 of the RF Tax Code).

service. Now the beginning of the depreciation period is not linked to the actual payment of the compensation for such expenditures to the lessee (Item 3 of Article 259.1; Item 6 of Article 259.2 of the RF Tax Code).

The amendments to the RF Tax Code have consolidated the right of organizations to charge depreciation for fixed assets revealed during an inventory. Thus, the initial value of fixed assets revealed during an inventory is determined in accordance with Item 20 of Article 250 of the RF Tax Code, that is, as the value of excessive material and product stock and other property revealed during an inventory. In accordance with paragraph 2 of Item 2, Article 254 of the RF Tax Code, the value of both material and product stock and other property revealed during an inventory should be determined as the sum of the amount of tax paid on the income generated as a result of that property having been revealed. Consequently, the fixed assets revealed as a result of an inventory will be depreciated, and their initial value will be made up by the amount of income tax paid at the moment of their discovery.

From 2009, organization enjoy the right to charge to costs the full amount of the per diem and field allowances paid to their employees dispatched on business trips, in accordance with their actual expenses. The norms restricting these expenses have been abolished (paragraph 4, Subitem 12 of Item 1 of Article 264 of the RF Tax Code).

Taxpayers now can recognize not only their expenses incurred in connection with the training or retraining of their staff, but also those associated with their employees' education – their studies under main and supplementary professional education programs (Subitem 23, Item 1 of Article 264 of the RF Tax Code).

In accordance with the newly introduced paragraph 5 of Item 2 of Article 262 of the RF Tax Code, some types of their expenditures on research and research-and-development work, including those that yielded no results, can be recognized by organizations on a lumpsum basis, instead of being evenly distributed throughout the whole year; besides, they may apply 1.5 upward coefficient (that is, their costs will include the sum 1.5 times larger than their actually incurred expenditures). The exact list of the types of research and research-and-development work to which the new rule is going to be applied must be established by the RF Government.

When exercising their property rights (or shares, or stakes), organizations now enjoy the right to diminish their incomes from such transactions by the price paid for the acquisition of such property rights, as well as by the sum of expenditures associated with their acquisition and realization (Subitem 2.1 of Item 1 of Article 268 of the RF Tax Code). If the incomes from the realization of property rights are less than the acquisition price and related expenditures, then loss is generated. Now a reference to Subitem 2.1 of Item 1 of Article 268 of the RF Tax Code has been added, and so the loss from the realization of property rights can be recorded in the accounting documentation.

In accordance with the new amendments, the contributions paid by the employer are to be charged to labor costs, and in the aggregate sum of contributions paid for their employees under long-term life insurance contracts, voluntary pension insurance plans or private pension savings plans these are to be taken into account for the purposes of taxation in the amount of

no less that 12% of the sum of labor costs (paragraphs 1 and 7 of Item of 16 Article 255 of the RF Tax Code)[5].

Lower rates of profit tax are established for those agricultural producers which have abstained from the switchover to the payment of the single agricultural tax, and remained instead subject to the general taxation regime. These rates are applied to activities associated with the sale of produced (as well as produced and processed on their own) agricultural goods. By the newly introduced alterations, the zero rate of the tax (which was to be abolished in 2008) is now extended until 2012.

Value Added Tax (VAT)[6]

A positive development for the organizations applying the general taxation system has become the recently introduced amendment in accordance with which, beginning from October 2008, they have the right to pay VAT in equal installments distributed over a quarter. Thus taxpayers have been granted a kind of an installment plan with regard to VAT.

Once again exempt from VAT has become the realization of scrap and waste ferrous metals (Subitem 25 of Item 2 of Article 149), as well as the import into the RF of technological equipment that has no analogues produced in the RF (Article 150 of the RF Tax Code RF).

Now VAT is no longer levied on the transactions involving the transfer of the rights to use, in the territory of Russia, inventions, practical models, industrial samples, software, databases, topologies of integral circuits, and know-how (Subitem 26 of Item 2 Article 149 of the RF Tax Code RF) Besides, the following operations have been made exempt from VAT:

– research and development works, on condition that they include the construction development of an engineering object;

– development of new technologies or creation of industrial samples for an organization's own needs;

– cession (or acquisition) of rights (or liabilities) under loan or credit agreements.

The expenditures of a taxpayer on scientific research and (or) research and development work executed in the form of deductions charged to the formation of the Russian Technological Development Fund, or to other branch-based or inter-branch funds for the financing of research and development work, registered in the procedure envisaged by the Federal Law "On science and state policy in the sphere of science and technology", are now recognized as costs for the purposes taxation within the limit of 1.5% (previously – 0.5%) of the taxpayer's income (or gross proceeds).

From 2009 onwards, a new procedure for calculating the tax base for VAT is established in respect of the realization of automobiles purchased from physical persons (who are not payers of this tax) for their subsequent resale (Articles 154 and 164 of the RF Tax Code). The

[5] See also the introduction of alterations to SST and PIT. Such contributions are not levied by SST and PIT within the limit of 12,000 rubles per annum per employee (those employees for whom the contributions were paid).

[6] See the following Federal Laws: of 13 October 2008, No 172-FZ, "On introducing alterations into Article 174 of Part Two of the Tax Code of the Russian Federation"; of 19 July 2007, No 195-FZ, "On introducing alterations into some legislative acts of the Russian Federation in the part of creating favorable tax conditions for the financing of innovative activity"; of 26.November 2008, No 224-FZ, "On introducing alterations into Part One, Part Two of the Tax Code of the Russian Federation and some legislative acts of the Russian Federation"; and of 4 December 2008, No 251-FZ, "On introducing alterations into Articles 154 and 164 of Part Two of the Tax Code of the Russian Federation".

tax base in such cases is to be determined as the difference between the sale price of an automobile (including tax) and the price of its acquisition for its subsequent resale. Prior to the introduction of these alterations the tax base for VAT was determined as the value of these automobiles calculated on the basis of their market prices less VAT.

One significant alteration with regard to VAT is that the buyer, after having transferred to the seller an advance payment, now enjoys the right to accept for deduction the amount of VAT charged to this advance payment, without waiting for the actual delivery of goods (or performance of works, or provision of services, or transfer of ownership rights). Relevant alterations have been introduced into Articles 168, 169, 170, 171, and 172 of the RF Tax Code.

It is no longer necessary to transfer to the seller the amount of VAT by a separate payment order when settling mutual setoffs, exchanging goods or using securities by way of settling a transaction. By Paragraph 2 of Item 4 of Article 168 of the RF Tax Code this obligation is abolished.

The amounts of VAT charged to the construction and installation works carried out for an organization's own use will be accepted by a taxpayer for deduction as of the moment of determining the tax base those construction and installation works, that is, as of the last day of each tax period or the last day of each quarter (paragraph 2 of Item 5 of Article 172; Item 10 of Article 167 of the RF Tax Code). As a result, the VAT will be charged to the payment the construction and installation works carried out for an organization's own use and these amount will be accepted for deduction during one and the same tax period, and not in different tax periods as it was previously.

Organizations and individual entrepreneurs will be deemed to be tax agents not only when leasing state and municipal property, but also in the instances of the sale (or transfer) to them of state (or municipal) property which is not consolidated to any state (or municipal) enterprises or institutions and instead belongs to the RF Sate Treasury, or to the treasury of a RF subject or a municipal formation (paragraph 2 of Item 3 of Article 161 of the RF Tax Code). In the capacity of a tax agent they will now be obliged to determine the amount of tax by an accounting method, deduct it from the sum of income and transfer the corresponding payment to the budget.

Taxpayers are now allowed to submit to tax agencies, in order to confirm their right for a VAT refund when exporting goods, special registers of customs declarations instead of customs declarations proper (Article 165 of the RF Tax Code).

If during an in-house audit of VAT declarations with sums of the tax earmarked for refund the tax inspectorate reveals certain violations of tax legislation, but without identifying any misdeeds in regard of part of the sum to be refunded, it must issue two decisions: the first one concerning the granting of a partial refund of the tax amount, and the second one - concerning the refusal to refund the remaining amount of the tax (Item 3 of Article 176 of the RF Tax Code). Thus, the taxpayer now has an opportunity for an immediate refund of the amount of VAT which is not disputed by the tax inspectorate.

Single social tax (SST)[7]

In accordance with of Item 1 of Article 8 of Federal Law of 30 April 2008, No 56-FZ, "On the additional insurance contributions to the funded part of labor pension and state support of the formation of pension savings", an employer is now empowered to make the decision concerning the payment of contributions from his own means for the benefit of those employees who pay additional insurance contributions. This employer's decision concerning the payment of such contributions is formalized either as a separately issued order, or is entered as a clause into a collective labor agreement or into a labor contract. In accordance with the new alterations introduced into the RF Tax Code, the contributions paid by the employer for an insured person within the limit of 12,000 rubles per annum per employee are not subject to SST (Subitem 7.1 of Item 1 of Article 238 of the RF Tax Code)

From the year 2009 the list of payments exempt from SST will be expanded. This list contains the following types of payments:

– the sums paid as fees for core and supplementary professional training programs, as well as for the professional training and retraining of employees (Item 16 of Article 238 of the RF Tax Code);

– the sums paid by organizations (or individual entrepreneurs) to their employees for the purpose of compensating for their payment of interest on the loans (or credits) taken in order to make possible the acquisition or construction of a dwelling (Item 17 of Article 238 of the RF Tax Code).

These sums will not be subject to SST if they are recorded as costs for the purposes of profits tax. These will not be taken into account, either, when calculating the amount of PIT (Items 21 and 40 of Article 217 of the RF Tax Code).

As far as the compensation of interest payments is concerned, the exemption from SST will be in effect until 1 January 2012.

It should also be noted that by Order of the RF Government of 17 November 2008, No 1663-r, the document "On main directions of the activity of the Government of the Russian Federation in the period until 2012" was approved, whereby the priority medium-term socio-economic goals are determined. During these years, it is intended to introduce certain measures designed to further improve the tax system, in particular to achieve the switchover from SST to insurance contributions paid by type of mandatory social insurance from 1 January 2010 onwards. As a result, the burden imposed on taxpayers will be increased, because the aggregate rate of insurance contributions will amount to 34% against the currently existing SST rate of 26%.

[7] See the following Federal Laws: of 22 July 2008, No 158-FZ, "On introducing alterations into Chapters 21, 23, 24, 25 and 26 of Part Two of the Tax Code of the Russian Federation and some other acts of the Russian Federation's legislation on taxes and levies"; and of 30 April 2008, No 55-FZ, "On introducing alterations into some legislative acts of the Russian Federation in connection with the adoption of the Federal Law "On the additional insurance contributions to the funded part of labor pension and government support of the formation of pension savings".

Personal Income Tax (PIT)[8]

Some alterations have also been introduced in Article 218 of the RF Tax Code, which is concerned with standard per child deductions from the amount of tax. Thus, the amount of this deduction has been increased from 600 to 1,000 rubles, while the upper margin of a taxpayer's annual income for the granting of such a deduction has been raised from 40,000 to 280,000 rubles. The list of persons entitled to this standard deduction from tax now included the spouse of a foster parent.

It is envisaged that under an agreement concluded between the parents (or foster parents), for one of them the amount of this standard deduction from tax can be doubled, while to the other no such deduction will be granted. To do this, one of the parents must submit an application concerning his or her refusal to be granted the deduction from tax.

The deduction in the amount of 400 rubles per month is granted to employees from the beginning of year 2009 and until their annual income exceeds the sum of 40,000 rubles, instead of the previously established upper margin of 20,000 rubles (Subitem 3 of Item 1 of Article 218 of the RF Tax Code).

The size of the property-linked deduction from PIT in an event of purchase (or construction) of a dwelling is increased from 1 million rubles to 2 million rubles (Article 220 of the RF Tax Code). This alteration applies to those citizens who purchase (or construct) a dwelling after 1 January 2008.

The maximum deduction from tax for education and medical care has also been changed (Article 219 of the RF Tax Code). Its amount has been increased to 100,000 rubles. The same margin is envisaged for the new type of social deduction, which is equal to the sum of pension contributions paid under agreements of private pension provision and voluntary pension insurance.

A separate note should be made of the contributions to co-finance pension savings, as well as the contributions paid by employers for the benefit of their insured employees. Additional insurance contributions can be paid by a physical person either independently or through his or her employer[9]. The employer, on receiving an application concerning the payment of additional contributions from an employee, must send this application, within three workdays, to the territorial agency of the RF Pension Fund at the place of its registration as an insurer, and then from the first day of the month following the month in which the application was received it must withhold and transfer these additional contributions. The citizens paying these additional contributions are entitled to state support for 10 years in the form of addi-

[8] See the following Federal Laws: of 26 November 2008, No 224-FZ, "On introducing alterations into Part One, Part Two of the Tax Code of the Russian Federation and some legislative acts of the Russian Federation"; of 1 December 2008, No 225-FZ, "On introducing alterations into the Federal Law "On the Fund for Promoting Reforming of the Housing and Utilities Sector" and some legislative acts of the Russian Federation"; of 22 July 2008, No 121-FZ, "On introducing alterations into Article 218 of Part Two of the Tax Code of the Russian Federation"; of 22 July 2008, No 158-FZ, "On introducing alterations into Chapters 21, 23, 24, 25 and 26 of Part Two of the Tax Code of the Russian Federation and some other acts of the Russian Federation's legislation on taxes and levies"; and of 30 April 2008, No 55-FZ, "On introducing alterations into some legislative acts of the Russian Federation in connection with the adoption of the Federal Law "On the additional insurance contributions to the funded part of labor pension and government support of the formation of pension savings".

[9] See Federal Law of 30 April 2008, No 56-FZ, "On the additional insurance contributions to the funded part of labor pension and government support of the formation of pension savings".

tional payments from the federal budget to cover their amount, but not in excess of 12,000 rubles per annum.

For the purpose of PIT, the following sums will not be deemed to be part of an employee's income:

– those paid within the framework of state support for the contributions to co-finance the formation of pension savings (Item 38 of Article 217 of the RF Tax Code);

– the contributions paid by the employer in amounts not exceeding 12,000 rubles per annum per employee, estimated by the number of employees for whom such contribution have been paid (Item 39 of Article 217 of the RF Tax Code).

The sum of the additional insurance contributions paid by a physical person in the amount of the actually incurred expenditures on the funded part of labor pension is included in the deduction of social tax charged to PIT (Subitem 5 of Item 1 of Article 219 of the RF Tax Code). In this connection, the upper margin for the social tax deduction is increased from 100,000 to 120,000 rubles (Item 2 of Article 219 of the RF Tax Code). In order to be granted the right to deduction, a physical person has to submit either the documents confirming the actual payment of the additional contributions, or a statement issued by a tax agent concerning the withheld and transferred contributions.

Besides, PIT will not be levied on:

– the sums paid as fees for a physical person's core and supplementary universal and professional training programs, as well as for his or her professional training and retraining at Russian educational establishments holding corresponding licenses or at foreign educational establishments of corresponding status (Item 21 of Article 217 of the RF Tax Code);

– the sums paid by organizations (or individual entrepreneurs) to their employees in order to compensate for their payment of interest on the loans (or credits) taken in order to make possible the acquisition or construction of a dwelling, which are included in costs for the purposes of profits tax (Item 40 of Article 217 of the RF Tax Code).

It should be noted that, as far as training fees are concerned, for the purposes of PIT it is irrelevant whether the amount of these fees is recorded as part of costs with regard to profits tax or not.

Excises[10]

From January 2008, Chapter 22 of the RF Tax Code was effective in the wording as established by Law of 16 May 2007, No 75-FZ, whereby a new procedure has been introduced for establishing the rates of excises, which were to be approved for the next three years, and Article 193 of the RF Tax Code was supplemented by a corresponding table of excise rates.

The rates for the year 2009 have been changed as follows. The rates of excise on beverages containing ethyl alcohol have been raised, by comparison with their planned level, for all products with per cent volume of ethyl alcohol over 9% and with per cent volume of ethyl alcohol up to 9% inclusive. The rates of excises on natural wines and beers were increased; however, the newly established rates for champagnes and sparkling, carbonated and prickling wines are slightly lower than planned (10.5% – in 2009, and 11.5% – in 2010).

The rates of excises on tobacco products have also been changed: thus, for cigarillos, filter-tipped cigarettes, filter – tipless cigarettes, and cigarettes with cardboard mouthpieces the

[10] See Federal Law of 22 July 2008, No 142-FZ, "On introducing alterations into Chapter 22 of Part Two of the Tax Code of the Russian Federation".

previously established have already been raised from 2009 onwards, while the rates for tobacco and cigars are still applied as established by the wording of Law of 16 May 2007, No 75-FZ, but from the year 2011 these will also be raised.

The rates of excise established for the years 2009 and 2010 for passenger cars with engine capacity of above 67.5 kW have been raised, as well as the rates for straight-run petrol; the rates of excise on motor oils will remain unchanged only until the year 2010 inclusive – in 2011 it will also be raised.

Significant alterations can be expected by the taxpayers engaged in the sale of car petrol and diesel fuel. These excisable goods are separated in the list of rates into a separate table. The rates currently established for the years 2009 and 2010 will remain unchanged, whilst from the year 2011 onwards a new system for levying excises on these types of fuel will be introduced – the rates of excises on petrol as well as on diesel fuel will be directly dependent on their belonging to a certain class. The classes of fuels will be determined in accordance with a technical regulation to be established by the RF Government.

The rule has been established that, if as a result of mixing excisable products an item is obtained for which a lower rate of excise is established, the excise is not paid altogether. In accordance with the alterations introduced into Item 3 of Article 182 of the RF Tax Code and coming into force from the year 2009 onwards, the production of excisable goods by mixing products at the place of their storage and sale is recognized as production process only if as a result of this mixing an item is obtained for which in accordance with Article 193 of the RF Tax Code a higher rate of excise is established than that for the products used as raw materials. That is, if such mixing yields excisable goods, the rate of excise for which is lower than the rate established for the products used as raw materials, the organization in question is deemed not to be the producer of excisable goods, and therefore it is not obliged to charge and pay excise to the state budget.

The notion of ‘brand of tobacco product’ has been defined more precisely (Article 187.1 of the RF Tax Code). Now brand (or brand name) is understood as the position of a tobacco product in the assortment of other products which is different from other brands by one or several of the following features: an individual mark (or name) given to it by its manufacturer or license-holder; recipe; size; presence or absence of a filter tip; and packaging. That is, if any such item has at least one of the afore-listed distinctive features, it can be deemed to be a separate brand of tobacco products. This alteration now makes it possible for a manufacturer to establish different upper margins of retail prices of cigarettes (or cigars, or cigarettes with cardboard mouthpieces) bearing one and the same name and characteristics, but displaying slight distinctions (for example, in their packaging).

Special tax regimes[11]

Under the general rule, the taxpayers who apply the simplified system of taxation (SST) enjoy the right of making choice between two objects of taxation: total income (with the rate of tax being 6%), or income less expenditures (with the rate of tax being 15%). Previously, the object taxation could not be changed by a taxpayer for 3 years from the beginning of using SST (Article 346.14 of the RF Tax Code RF). Now the payers of tax under the SST are granted the right to switchover, on an annual basis and from the beginning of a new tax period, from their previously chosen object of taxation - on condition that they duly notify thereof tax agencies before 20 December of the year preceding the year in which this switchover is to take place. No switchover from one object of taxation to another is allowed *during* a tax period. Since it is established that this norm is to be applied to the legal relations that have arisen from 1 January 2008, the taxpayers who operate under the SST and are willing to switchover from their former object of taxation for the year 2009 may inform thereof their tax inspectorate as early as 2008. If an organization applying general taxation regime decides to switchover to SST from the next year onwards, it must submit an application to this effect to its tax inspectorate prior to 30 November of a current year.

In order to decrease the tax burden in the existing economic situation, Article 346.20 of the RF Tax Code RF, whereby the tax rate is established at 15%, in an event of the object of taxation being incomes less costs, is augmented by a clause that the laws adopted by subjects of the Russian Federation may introduce differential tax rates within the range of 5 to 15%, depending on taxpayer category. On the one hand, this decision may be regarded as favorable for taxpayers, since such a measure on the part of a RF subject will mean real support in terms of relieving tax burden. On the other, it raises the issue of fair play, since if the lowering of the rate of tax (or the introduction of differential rates) is made to be dependent on taxpayer category, this enables RF subjects to lower it only for some specific categories of taxpayers (which may, for example, be affiliated to regional authorities, or the authorities may have a vested interest in their activity). We believe that it would be necessary, if such a decision is indeed to be taken, that RF subjects should lower the rate of tax simultaneously for all the categories of taxpayers operating under the SST applying as the object of taxation their incomes less costs.

From the new year onwards, the taxpayers operating under the SST and applying “incomes less costs” as their object of taxation are allowed to increase their costs when estimating their taxable base, that is, to write off their per diem allowances on the basis of their actual expenses, without any limits (the norms having been abolished, Article 346.16 of the RF Tax Code); to recognize as costs their mandatory insurance of responsibility (Article 346.16 of the RF Tax Code); to charge to costs their raw materials on the basis of their actual payments for them (the requirement of writing them off to production has been abolished, Article 346.17 of the RF Tax Code); and to diminish the tax base when carrying forward the losses of previous

[11] See the following Federal Laws: of 26 November 2008, No 224-FZ “On introducing alterations into Part One, Part Two of the Tax Code of the Russian Federation and some legislative acts of the Russian Federation”; of 24 November 2008, No 208-FZ, “On introducing alterations into Article 346.14 of Part Two of the Tax Code of the Russian Federation”; of 22 July 2008, No 155-FZ, “On introducing alterations into Part Two of the Tax Code of the Russian Federation”; No 158-FZ “On introducing alterations into Chapters 21, 23, 24, 25 and 26 of Part Two of the Tax Code of the Russian Federation and some other acts of the Russian Federation’s legislation on taxes and levies”.

tax periods without any limitations (the 30% limit having been abolished, Article 346.18 of the RF Tax Code). The procedure for carrying forward losses by taxpayers operating under the SST is approximated to a similar procedure applied by the payers of the tax on profit of organizations: now the losses incurred in previous periods can be applied in full in order to diminish the tax base.

Certain alterations have been introduced into Item 2 of Article 346.11 and Item 1.1 of Article 346.15 of the RF Tax Code: the organizations operating under the SST are recognized as payers of profits tax in respect of their received dividends.

The submitting of reports has been made much simpler (Article 346.23 of the RF Tax Code). From January 2009, it is no longer necessary to submit on a quarterly basis the tax declarations for the tax paid under the SST. From now on, the taxpayers under the SST will submit only one tax declaration by the results of a tax period (a year)[12]. In this connection, it should be noted that advance payments are paid by the results of reporting period in the same procedure as before.

Significant alterations were introduced to Article 346.25.1 of the RF Tax Code which regulates the procedure for applying the SST by individual entrepreneurs on the basis of a patent, whereby the sphere of its application has been made much broader.

Taxpayers are now allowed to simultaneously engage in several types of entrepreneurial activity instead of only one type, as it used to be previously, and to involve their employees in such activities. Thus, one can point to the emergence on the market of independent subjects of small entrepreneurship (with no more than 5 fully occupied employees during each tax period). Besides, the already listed 61 types of patented activities are augmented by the following ones:

– public catering services;

– services associated with the processing of agricultural produce, including the manufacturing of meat, fish and dairy products, bakery, vegetable, fruit and berry products, finished and half-finished products made of linen, cotton, hemp and timber (with the exception of shaped timber);

– services associated with sales of agricultural products (storage, grading, drying, packing and transportation);

– the rendering of services associated with the servicing of agricultural production (mechanical, agrochemical, amelioration, and transport works);

– grazing of cattle;

– running hunting businesses and hunting;

– private medical practice or pharmaceutical activity carried out by holders of licensees to these types of activity;

– private detective services rendered by persons – holders of corresponding licenses.

From 2009 onwards a patent can be taken for any number of months in a year (from 1 to 12, instead of the previously established periods of 3, 6, 9 and 12 months). Besides, from 1 January 2009, the legislative bodies of RF subjects have been excluded from the. list of subjects vested with the right to regulate the application of this special tax regime. Item 12 of Article 346.25.1 of the RF Tax Code has been augmented by a clause to the effect that the tax-

[12] This alteration is concerned not only with the single tax payable in accordance with the application of the simplified taxation regime (Article 346.23 of the RF Tax Code), but also the transport tax (Article 363.1 of the RF Tax Code) and the land tax (Article 398 of the RF Tax Code).

payers operating under the SST on the basis of a patent are obliged only to keep tax records of their incomes.

It is also worthwhile to note the alterations introduced into the chapter on the single tax on presumptive income (STPI).

Organizations and individual entrepreneurs alike are not allowed. from the year 2009 onwards, to apply STPI if the number of their staff over the preceding calendar year has exceeded 100 (Subitem 1 of Item 2.2 of Article 346.26 of the RF Tax Code); an organization cannot apply STPI if the share in its charter capital belonging to other juridical persons is more than 25% (Subitem 2 of Item 2.2 Article 346.26 of the RF Tax Code RF). It should be noted that the restriction imposed on the participation in the charter capital of an organization does not apply to those taxpayers whose charter capital is composed entirely of the contributions of non-governmental associations of the disabled, consumer co-op organizations, and those enterprises whose sole founder is a consumer co-op organization.

The list of the types of activity for which a switchover to STPI is allowed has been shortened (Subitems 4 and 5 of Item 2.2 Article 346.26, paragraph 7 of Article 346.27 of the RF Tax Code). No switchover to STPI is allowed for the following entities:

– the organizations belonging to the spheres of public education, health care and social security – in the part of their entrepreneurial activity relating to the rendering of public catering services (Subitem 8 of Item 2 Article 346.26 of the RF Tax Code). In this connection it is stipulated that these public catering services must constitute an unalienable component of their operation and to be rendered directly by those organizations (Subitem 4 of Item 2.2 of Article 346.26 of the RF Tax Code);

– organizations and individual entrepreneurs providing services relating to leasing- out petrol filling stations and compressed natural gas filling stations (Subitem 5 of Item 2.2 Article 346.26 of the RF Tax Code RF);

– services relating to the manufacturing of furniture and construction of private houses (paragraph 7 of Article 346.27 of the RF Tax Code).

Some alterations have been introduced in the dominions of the types of activity that could previously be switched over to the STPI regime. Thus, for example, the rendering of public catering services in premises with the size of the customer area less than 150 sq m by educational establishments, health care and social security organizations will become subject to STPI – however, on one condition: that such. services cannot constitute an unalienable component of their operation.

STPI will be applied by taxpayers engaged in the distribution of outdoor advertising involving the use of special installations and the placement of advertising media on transport vehicles и (Subitem 10 и 11 of Item 2 Article 346.26 of the RF Tax Code RF).

From 1 January 2009 the norm previously stipulated in paragraph 3 of Item 6 of Article 346.29 of the RF Tax Code, whereby taxpayers were granted the right to adjust on their own, for purposes of keeping their accounting records, the value of the coefficient K2 applied to the actual period of their entrepreneurial activity, has been abolished. Thus, the payers of STPI, when determining the tax base, can no more enter in their records the actual period during which they engage in their entrepreneurial activity over a given tax period.

It has been specified that the annually established value of the deflator coefficient K1 must be calculated by multiplying the coefficient applied in a previous year by the coefficient describing the fluctuations of the consumer prices of goods (or works, or services) recorded in

the Russian Federation over a previous calendar year (paragraph 5 of Article 346.27 of the RF Tax Code). Presently the deflator coefficient reflects only the fluctuations of the consumer prices of goods (or works, or services) over a previous year.

The realization of goods or products through vending machines belongs to the sphere of retail trade (paragraph 12 of Article 346.27 of the RF Tax Code).

For the purposes of applying STPI, the values of physical indices are to be rounded off, and the values of price indices are to be expressed in full rubles. The values of price indices which are less than 50 kopecks (0.5 unit) are to be rounded down, and those amounting to 50 kopecks (0,5 unit) or more are to be rounded up to a full ruble (or whole unit) (Item 11 of Article 346.29 of the RF Tax Code).

With regard to certain specific types of activity a taxpayer must register not at the place of actual operation but at the place of an organization's location or the place of residence of an individual entrepreneur (paragraph 3 of Item 2 of Article 346.28 of the RF Tax Code).

Some alterations aimed at further improving tax administration[13]

The procedure for conducting in-house tax audits. In accordance with Item 2 of Article 88 of the RF Tax Code (in the wording existing prior to 1 January 2009), an in-house tax audit was to be conducted within 3 months from the date of submitting a declaration and the и documents attached to it. Such a definition made it impossible to determine precisely as to which moment was to be applied as the starting point for auditing – the date of submitting the declaration or the date of submitting the attached documents. From 2009 this problem had been removed: now, an in-house audit is to be conducted within 3 months from the date of submitting, by a taxpayer, a tax declaration (or a tax estimation).

It has also been specified that, if during an audit a taxpayer submits an adjusted declaration, the auditing of the previously submitted declaration is terminated, and a new in-house audit of the adjusted version of the declaration is started instead (Item 9.1 of Article 88 of the RF Tax Code). Thus, in such a situation the three-month period established for conducting an in-house audit starts from the moment of submitting an adjusted declaration (Item 2 of Article 88 of the RF Tax Code).

Prior to the year 2009, Article 100 of the RF Tax Code contained no indication of the period during which the act of a act tax audit was to be delivered to a taxpayer. The addition introduced into Item 5 of Article 100 of the RF Tax Code explains that this act should be delivered to the person in respect of whom an audit has been conducted - or to that person's attorney - within 5 days from the date of it being drawn up. These rules are applied when formalizing the results of both on-site and in-house tax audits. A 5-day period (from the date of it being drawn up) is also established for the delivery of a tax inspectorate's decision concerning the bringing of a taxpayer to tax responsibility (or a refusal to resort to this measure) (an alteration to this effect is introduced into Item 9 of Article 101 of the RF Tax Code).

A procedure for pre-judicial settling of disputes has been introduced. At present a taxpayer, if it disagrees with the decision of a tax agency concerning the results of an audit, is

[13] See the following Federal Law: of 27.July 2006, No 137-FZ, "On introducing alterations into Part One, Part Two of the Tax Code of the Russian Federation and some legislative acts of the Russian Federation in connection with the implementation of measures designed to improve tax administration"; of 26 November 2008, No 224-FZ, "On introducing alterations into Part One, Part Two of the Tax Code of the Russian Federation and some legislative acts of the Russian Federation".

endowed with the right to choose on its own the procedure in accordance with which such a decision can be disputed (that is, the decision to bring the taxpayer to responsibility for having committed a tax violation, or the decision concerning a refusal to resort to this measure). In accordance with Article 138 of the RF Tax Code, a taxpayer has the right either to apply to the tax agency of a higher level, or directly to a court of justice. From the beginning of the year 2009, the amendment to Article 101.2 of the RF Tax Code came into force, whereby it is established that an appeal to a court of justice against the decision made by a tax agency must necessarily be preceded by an appeal to the tax agency of a higher levels. Thus, taxpayers can no longer enjoy the right to settle their disputes with tax inspectorates directly through judicial agencies – instead, they must first undergo the procedure of pre-judicial regulation of a dispute. This means that, from January 2009 onwards, the procedure of a taxpayer's defending its interests will take al least as long as one month, due to the pre-judicial procedure[14]. We believe that this norm will worsen the position of a taxpayer, because it eliminates the possibility of choice, increases the volume of documentation and envisaged a longer period of time.

Some alterations and additions were introduced into Articles 63 and 64 of the RF Tax Cod; besides, the Code was augmented by new Article 64.1, which envisages a special procedure for delayed payment (payment in installments) of federal taxes. The essential meaning of these alterations is that now the RF Minister of Finance is endowed with the right to make a decision concerning the granting of delays of up to 5 years with regard to the payment of federal taxes, penalties and fines, as well as concerning the alterations in the timelines for the payment of federal taxes by organizations whose outstanding debt is over 10 billion rubles. The organizations applying for a delayed payment or an installment plan, must submit a number of documents: a statement by a tax agency concerning the situation with the settling of tax, penalty and fine payments; the suggested schedule for the payment of the outstanding debt; the documents and other information necessary to prove the existence of a threat of unfavorable socioeconomic consequences in an event of the outstanding debt being settled as a lump-sum payment; and the written consent of the organization to the disclosure of the information classified as a tax secret in connection with the consideration of the application submitted by the organization. In this connection, interest in charged to the sum of outstanding debt in respect of which it has been decided that the payment should be delayed or an installment plan should be applied – at a rate amounting to half of the rate of refinancing established by the RF Central Bank for the period over which the payment is to be delayed or installment plan applied. The delayed payment or installment plan can be granted without providing the methods for their backing. .

Besides, certain alterations were introduced into the existing procedure of arresting bank accounts, which are also in effect from 1 January 2009. Now tax agencies enjoy the right to arrest a bank account not only in an event of underpaid taxes, but also if there exists an outstanding debt with regard to penalties and fines. In this connection, tax agencies are obliged to

[14] The procedure for the consideration, by tax agencies, of taxpayers' complaints is established in the *Regulation for the Consideration of Tax Disputes*, approved by Order of the RF Ministry of Taxes and Levies of 17 August 2001, No BG-3-14/290. A tax agency must consider a complaint submitted to it within one calendar month from the date of its receipt (Paragraph 2.1 of Article 2 of the Order). However, this period can be extended by the tax agency's decision for another 15 days in order to acquire the documents necessary for considering the complaint, or relevant information from a tax inspectorate (Item 3 of Article 140 of the RF Tax Code). The taxpayer must be notified concerning the adopted decision within 3 days.

abolish their decision concerning the suspension of operations on an account during one workday (and not one operating day) from the moment of resolving a conflict situation. In addition, a tax agency will now be charged interest for its failure to lift the arrest of an account in due time, or for its failure to notify its owner concerning this act (this rule will come into force from 2010).

The list of the grounds for granting an investment tax credit is augmented by an instance of an organization fulfilling a government defense order. The procedure for suspending the operations on a taxpayer's bank accounts and for conducting tax audits has been defined more precisely. It is forbidden to use evidence obtained as a result of violation of the RF Tax Code.

2. Some alterations introduced in the sphere of civil, antimonopoly, and labor legislation

Autonomous institutions

From 2007, Federal Law of 3 November 2006, No 174-FZ, "On autonomous institutions" came into force, whereby a new type of a state (or municipal) institution – an autonomous institution - was established.

It should be reminded that an autonomous institution (AI) is to be recognized as a not-for-profit organization created by the Russian Federation, or by its subject, or by a municipal formation[15] for the purpose of carrying out works or rendering services in order to execute the powers granted to the bodies of state authority and local self-government in the spheres of science, education, public health care, culture, social security, employment, physical culture and sports. An autonomous institution is a juridical person and may, in its own name, acquire and execute ownership rights and personal non-ownership rights, bear responsibilities, and act as a plaintiff or a defender in a court of justice.

In order to ensure the practical implementation of the Law "On autonomous institutions", it was necessary to adopt a number of subordinate acts, which regulate the following issues:

– the procedure for considering the proposals concerning the creation of federal autonomous institutions through altering the type of an already existing state institution;

– the proposal form relevant for the creation of an autonomous institution through altering the type of an already existing state or municipal institution;

– the procedure for determining the types of especially valuable movable property of autonomous institutions;

– the list of institutions which, in accordance with their type, are not subject to such alteration;

– the terms and procedure for formulating, by the founder, of an assignment for an autonomous institution, and the procedure for providing financial backing to the execution of that assignment by the autonomous institution;

– the procedure for publishing the reports on the activity of an autonomous institution and on the use of property consolidated to it;

[15] The joint foundation of autonomous institutions (including by different bodies of authority or local self-government) is not allowed.

– the procedure for performing the functions and executing the powers of the founder of an autonomous institution by bodies of executive authority in respect of autonomous institutions.

These issues are to be regulated by the bodies of federal, regional and municipal authority for the institutions in their jurisdiction.

Nearly all the aforesaid subordinate acts on the federal level were adopted in 2007. Let us consider the only document adopted in order to further develop the provisions of the Law "On autonomous institutions" in 2008, that is the document "On the terms and procedure for formulating a founder's assignment in respect of an autonomous institution created on the basis of property in federal ownership and the procedure for providing financial backing for the fulfillment of that assignment" put into effect by Decree of the RF Government of 18 March 2008, No 182.

The assignment is compulsory for a federal autonomous institution.

The founder establishes in the assignment relevant requirements as to the quality and (or) volume (or content), conditions, procedure and results of the services rendered or works carried out by a federal autonomous institution in order to ensure the execution, by federal bodies of executive authority, as envisaged by legislation of the Russian Federation, of their powers in the spheres of public education, health care, culture, social protection, employment, physical culture, and other spheres, with due regard to the existing demand for such state services; as well as determines the procedure for exercising control over the fulfillment of the assignment, including the terms and procedure for an early termination of the assignment.

The assignment consists of the following documents:

a) an extract from the register of spending obligations concerning those spending obligations the fulfillment of which is necessary for carrying out an assignment;

b) the list of categories of the consumers of services provided within the framework of an assignment, with separation of those consumer categories that enjoy the right to free-of-charge services and (or) partial payment for the services rendered to them, as well as the planned number of the consumers of these services (if the assignment's character envisages the possibility of planning the number of consumers);

c) the indices denoting the quality and (or) volume (or composition) of the services rendered by a federal autonomous institution for the next financial year within the planning period for which a certain assignment is issued (if possible – estimated per capita within each consumer category), the methodology for calculating the values of these indices, the requirements to the qualifications and experience of the personnel providing such services, the requirements to the material and technical backing, and the actual procedure of rendering the services with the reference to the legal act whereby the specific requirements to the quality of services are established (if such an act indeed exists);

d) the procedure for the rendering of services to physical and (or) juridical persons, with the reference to the regulation or another document whereby that procedure is established. In an event of absence of such a regulation or (another document), the following papers should be attached:

the description of main procedures for the rendering of services by a federal autonomous institution;

the procedure for informing of potential consumers as to the rendering of specific services;

the list of the grounds for suspending the rendering of services or for a refusal to render services;

e) the upper threshold for the prices (or tariffs) of specific services established for physical and (or) juridical persons (if by legislation of the Russian Federation it is envisaged that the corresponding works (or services) should be performed on a commercial basis), or the procedure for establishing these prices or tariffs;

f) the procedure for exercising control over the fulfillment of an assignment, as well as the conditions for and the procedure for its early termination;

g) the requirements to the reporting to be submitted by a federal autonomous institution concerning the fulfillment of an assignment (including the form of the report concerning the fulfillment of an assignment and the schedule for submitting such reports);

h) the timelines for the fulfillment of an assignment;

j) the procedure for altering an assignment.

Assignments are issued in accordance with the main activity of a federal autonomous institution as envisaged by its charter, and with due regard for the following circumstances:

a) the proposals submitted by a federal autonomous institution concerning the existing demand for relevant services, estimated on the basis of forecasted changes in the quality of specific consumer services, the level of satisfaction with the volume and quality of the services currently being rendered, and the capacity of a given federal autonomous institution to render such services;

b) immovable property or especially valuable movable property consolidated to a federal autonomous institution by its founder, or acquired by that autonomous institution at the expense of the funding issued to it by its founder for the purpose of acquisition of such property, for the upkeep of which no financial backing is provided by the founder, which has been leased out with the consent of its founder;

c) the indices for the fulfillment, by a federal autonomous institution, of the assignment issued to it in a given reporting financial year;

d) the volumes of budget allocations and the limits imposed on budget obligations, of which the founder of a federal autonomous institution has been duly informed in the established procedure.

It should be reminded that the list of budget allocations that may be earmarked for the transfer to a budget-funded institution is strictly limited (Article 70 of the RF Budget Code); by contrast, no such list is established for autonomous institutions, and so such allocations are earmarked by its founder when granting corresponding subsidies to it from the budget when forming a specific assignment.

Thus, financial backing for the fulfillment of an assignment is provided by means of budget allocations earmarked for a given federal autonomous institution:

a) subsidies designed to compensate for the standard costs of rendering services to physical and (or) juridical persons;

b) subsidies designed to compensate for the standard costs of the upkeep of immovable property and especially valuable movable property consolidated to a federal autonomous institution by its founder, or acquired by a federal autonomous institution at the expense of the funding issued to it by its founder for the purpose of acquisition of such property (with the exception of property leased out with the consent of its founder), as well as subsidies earmarked

for the payment of tax levied on relevant property recognized as the object of taxation, including land plots.

Besides, it is established in addition that to a federal autonomous institution created as a result of altering the type of an already existing federal state institution, within the period of 3 years since the date of its creation, a subsidy should be granted from the federal budget for the purpose of equalizing the amount of financial backing for the fulfillment of the assignment issued to that federal autonomous institution by its founder. In particular, the size of subsidy for such autonomous institutions is to be determined as the difference between the amount of budget allocations granted to a budget-funded institution for the period of a current year and the planning period and the size of subsidy designed to compensate for the standard costs of the rendering of services by the autonomous institution and for the standard costs of the upkeep of the corresponding immovable property and especially valuable movable property.

By the same Decree the RF Ministry of Economic Development and Trade was also delegated with the task to approve, in coordination with the RF Ministry of Finance, the methodological recommendations for calculating the standard costs of the upkeep of immovable property and especially valuable movable property consolidated to an autonomous institution created on the basis of property in federal ownership (hereinafter – federal autonomous institution) by its founder, or property acquired by a federal autonomous institution at the expense of the funds allocated to it by its founder for the acquisition of such property (with the exception of property leased out with the consent of its founder), as well as for the payment of taxes levied on relevant property recognized as the corresponding object of taxation, including land plots. In this connection, it is prescribed to federal bodies of executive authority performing the functions and executing the powers of the founder of a federal autonomous institution, to develop and approve, in coordination with the RF Ministry of Finance, the standard costs of the upkeep of property consolidated to an autonomous institution.

Besides, by this Decree it is also established that the size of standard costs of the fulfillment of an assignment is to be estimated by the founder on the basis of the approved standard costs of the rendering of services to physical and (or) juridical persons within the framework of an assignment, as well as the standard costs of the upkeep of the corresponding immovable property and especially valuable movable property and the payment of taxes, except in the cases established by acts issued by the RF President and the RF Government.

Subsidies are to be transferred, in the established procedure, to an account opened for the federal autonomous institution at a credit institution.

The granting of such subsidies to a federal autonomous institution during a financial year is effectuated on the basis of agreements concluded between the founder and the federal autonomous institution concerning the procedure and conditions for the granting of special privileges. The founder may amend and make more precise the wording of such an agreement with due regard for a given sector's specific features. The schedule for the transfer of subsidies during a financial year, as well as their size, are to be determined by the aforesaid agreement.

Thus, legislation grants to the relevant bodies of executive authority the powers necessary for determining the standard costs incurred by an autonomous institution in accordance with the two types of subsidies allocated to them, while the estimation of such standards is also associated with the need to develop the corresponding methodological base.

Neither the Law "On autonomous institutions" not this Decree contain any stipulations as to whether the activity of an autonomous institution within an assignment should be profitable or not. Evidently, these issues will be dealt with at the time of developing the founders' assignment and establishing the tariffs on the services being rendered within the framework of these assignments.

Improvement of legislation aimed at protecting competition

By Federal Law of 8 November 2008, No 195-FZ, "On the introduction of alterations in Federal Law"On the protection of competition" certain alterations were introduced in order to lift some of the restrictions established with regard to transactions with state and municipal property, as well as with property of commercial organization; besides, this law abolished some of the obligations of credit institutions established within the framework of antimonopoly control over their activity. The powers of the antimonopoly body concerning the consideration by it of the petitions filed by economic subjects, as envisaged by the Law 'On the protection of competition', were thus defined more precisely.

The regulation of transactions with state and municipal property.

In accordance with the Law "On the protection of competition", the conclusion of contracts of lease, non-reimbursable use, trust management, or other contracts envisaging the transfer of the rights of ownership and (or) use in respect of state or municipal property may be effectuated only on the basis of the results of contests or auctions for the right to conclude such a contract. No compliance with that procedure in respect of state or municipal property which is not consolidated by the right of economic jurisdiction or operative management is required in those cases when the aforesaid rights to property are granted on the basis of acts issued by the RF President or the RF Government, court rulings, or Federal Laws whereby another procedure for the disposal of that property is established.

The Law has been augmented by this list of exclusive cases, and so no contests or auctions for the right to conclude contracts envisaging the transfer of the rights of ownership and (or) use in respect of state or municipal property are required in the following instances: when such rights are transferred on the basis of international treaties; or to state bodies, or to bodies of local self-government, or to state off-budget funds, or to the RF Central Bank; and also in the instances when such rights are transferred for a period of no longer than 30 days (in this connection, it is forbidden to grant the aforesaid rights to such property to one person for a total period of more than 30 calendar days without conducting contests or auctions). However, it is possible to conclude, without contests or auctions, the contracts for the transfer of property intended for religious use into the non-reimbursable use by religious organizations, including buildings and structures (Subitem 'a' of Item 1 Article 1 of this Law).

The list of cases when it is possible to conclude the contracts envisaging the transfer of the rights of ownership and (or) use of state or municipal property without contests or auctions is extended to state or municipal property consolidated by the right of economic jurisdiction or operative management to state and municipal enterprises and institutions (Subitem 'b' of Item 1 of Article 1 of the Law).

The Law has been augmented by the norm whereby it is established that until 1 July 2010 it is permitted to renew, without auctioning, the contracts of lease of state or municipal property concluded prior to 1 July 2008 with small and medium-size business entities. In this connection, the conclusion of the aforesaid contracts of lease can be possible for a term no

longer than until 1 July 2010. besides, it is specified that this permission is not extended to the conclusion of contracts of lease of state or municipal property with small and medium-size business entities in the form of credit institutions, insurance undertakings (with the exception of consumer cooperatives), investment funds, non-government pension funds, professional participants in the securities market, pawnbrokers, parties to product sharing agreements, gambling enterprises, non-residents of the Russian Federation (with the exception of cases envisaged in international treaties), as well as small and medium-size business entities engaged in the extraction and procession of mineral resources (with the exception of the most common types of mineral resources) (Item 5 of Article 1 of the Law).

From the Law "On the protection of competition", whereby it is stipulated that it is mandatory to conclude agreements envisaging the transfer of the rights of ownership and (or) use of state and municipal property consolidated by right of economic jurisdiction or operative management to state and municipal enterprises and institutions only on the basis of the results of tenders or auctions (with the exceptions as determined by the Law), any mention as to trusteeship management agreements has been abolished (Subitem 'b' of Item 1 of Article 1 of the Law).

The regulation of transactions with the property of commercial organization concluded with the preliminary consent granted by the antimonopoly body.

The Law "On the protection of competition" established the list of transactions with the property of commercial organizations that in the presence of some specially determined conditions can be concluded only with the preliminarily obtained consent of the antimonopoly body. These conditions, in particular, are as follows: the aggregate value of assets belonging to the person acquiring the property and of those belonging to the person whose property is being acquired; or the aggregate proceeds from the sale goods in combination with asset value, or the fact of one of the parties to a given transaction being entered in the register of economic subjects occupying a certain share of the market.

The transactions which, under the aforesaid conditions, should be subject to preliminary coordination with the antimonopoly body are, in particular, the receipt into ownership, use or holding by an economic subject (or a group of persons) of the fixed assets or intangible assets of another economic subject (with the exception of a financial institution), if the balance-sheet value of the property constituting the object of a transaction or related transactions exceeds twenty per cent of the balance-sheet value of the fixed assets or intangible assets of the economic subject executing the alienation or transfer of property.

The newly introduced alterations have excluded, from among the aforesaid fixed assets (and thus also from the category of objects the transactions with which are subject to preliminary coordination with the antimonopoly body), land plots, as well as buildings, structures, premises and parts of premises, or uncompleted construction objects not intended for industrial use (Item 2 of Article 1 of the Law).

The issues of antimonopoly control over the activity of financial institutions.

The Law "On the protection of competition" establishes the responsibility of financial institutions (the category of which, in particular, encompasses credit institutions and insurance undertakings, stock and currency exchanges, leasing companies and asset managers) to submit to the federal antimonopoly body notifications concerning all the agreements achieved between them in any form, or their agreements with bodies of local self-government, or with any organizations. The agreements that do not require such notifications are those concluded be-

tween financial institutions whose aggregate share on the commodities market is smaller than the norm established by the RF Government, as well as those representing agreements concerning the rendering of financial services, or those representing agreements concluded between financial institutions in the course of their routine economic activity.

It is specified by the newly introduced alterations that the antimonopoly body must be notified only concerning the agreements concluded in writing between financial institutions or financial institutions and bodies of executive authority (federal or RF subjects'). In other words, from now on there will be no mention of "the federal" antimonopoly body as the addressee for such notifications, or any mention of agreements achieved in any form other than in writing, or of agreements with bodies of local self-government and "any organizations".

The list of agreements which are not subject to mandatory notifications is now augmented by the following types of agreements: the agreements between financial institutions which are not concerned with the rendering of financial services to third parties; the agreements that must be achieved under the contracts of rendering financial services; the agreements concerning the cancellation of previously achieved agreements; the agreements concerning the alteration of previously achieved agreements without altering in any significant way the terms stipulated therein; and the agreements representing a preliminary agreement.

A new definition is now introduced for another type of agreements which is also included in the list of exceptions from the mandatory notification procedure – the agreements concluded between financial institutions whose asset value, as estimated on the basis of the accounting balance as of the last reporting date prior to the date of concluding the agreement, is not in excess of the value threshold established by the RF Government. As is mentioned earlier, the list of exceptions previously included the agreements between those financial institutions that "had an aggregate share on the commodities market below the normative value established by the RF Government".

From the list of documents to be attached to the notification, the financial and economic reporting documents that must be submitted to the RF Central Bank and to the federal bodies of executive authority regulating the financial services market have been excluded (Item 4 of Article 1 of the Law)

It is specified by the newly introduced alterations that those financial institutions that failed to notify, in accordance with the Law "On the protection of competition", the antimonopoly body concerning their agreements concluded prior to the date of these alterations coming into force, if their duty to notify it concerning such agreements is indeed envisaged by the Law "On the protection of competition", must submit the relevant notifications to the antimonopoly body within 9 months from the date of these alterations coming into force. Such notifications, if submitted within the aforesaid period, will be deemed to be submitted within the proper timelines established by antimonopoly legislation (Article 2 of the Law).

The procedure for the consideration, by the antimonopoly body, of the petitions concerning the preliminary coordination of transactions.

When considering petitions concerning the preliminary coordination of transactions in the instances envisaged by the Law "On the protection of competition", the antimonopoly body shall have the right to make the decision concerning the satisfaction of such a petition, the prolongation of the timelines for its consideration, or the refusal to satisfy it.

By these alterations it is established that the antimonopoly body is empowered to make the decision concerning the prolongation of the timelines for the consideration of such a peti-

tion, in addition to the previously established cases, also in an event when a transaction or another act declared in the petition should be subject to preliminary coordination in accordance with the Federal Law "On the procedure for making foreign investments in the economic societies which are of strategic importance for ensuring this country's defense and state security" prior to the date of making a relevant decision in regard of such a transaction, or another act as envisaged in accordance with this Federal Law. If, in accordance with the aforesaid Federal Law, it is decided that the preliminary coordination of that transaction or another act should be denied, the antimonopoly body must also make the relevant decision concerning its refusal to satisfy the petition for granting a permission for such a transaction or another action (Item 3 of Article 1 of the Law).

A new system for the regulation of auditing

From 1 January 2009, Federal Law "On auditing activity" of 30 December 2008. No 307-FZ, came into force. By this Federal Law, a switchover to a new system of regulating auditing activity is envisaged, which will be different from the previously existing one (which was established by the former Federal Law of 7 August 2001, No 119-FZ, "On auditing activity"). In particular, this new Law envisages the abolition, from 1 January 2010 onwards, of licensing of this type of activity, with the simultaneous introduction of compulsory membership of auditors and audit organizations in one of the self-regulating auditors' organizations (SAO), which are endowed with the relevant powers to control the quality of the auditing services being rendered. From 1 January 2010, the auditing licenses will no longer be valid, and so those audit organizations and individual auditors which will have not joined the self-regulating audit organizations will no more have the right to do audits and render related services. An audit organization or an auditor may be members in only one self-regulating auditors' organization.

The newly adopted Law makes a distinction between the notions of auditing activity and audit. It is established that auditing activity incorporates not only audit (that is, an independent check of the accounting (financial) reporting documentation of the person being audited), but also the rendering of related services, the list of which is to be established by the federal auditing activity standards.

The Law also determines the requirements for entering a not-for-profit organization in the State register of self-regulating audit organizations, as well as the rights and duties of such organizations. A not-for-profit organization in entered in the State register of SAOs on condition of it uniting no less than 700 physical persons or no less than 500 commercial organizations. That is, the members of a self-regulating auditors' organization can be physical persons and (or) organizations which are – respectively - neither auditors nor auditors' organizations. In accordance with the provisions of the previously existing Law No 119-FZ, a professional auditors' association could be granted accreditation on condition of it uniting no less than 1000 attested auditors and (or) no less than 100 audit organizations.

Besides, for a not-for-profit organization to be entered in the State register of SAOs, it is necessary, in order to secure additional liability of its members, to create a compensation fund, to approve the rules for external control of its performance level, and to adopt the Code of Auditors' Professional Ethics. A SAO is obliged to participate in the creation (including the provision of financial backing) and activity of a single attestation board. In addition, a SAO is

also delegated with the function to keep a register of its members - auditors and audit organizations.

The new Law established the requirements to membership in a SAO. In addition to the requirements previously envisaged by Law No 119-FZ, a new requirement is introduced for auditors and audit organizations – irreproachable professional reputation. Besides, it envisages the requirements to the charter capital of an audit organization: the share of the charter (or joint-stock) capital of a commercial organization belonging to auditors and (or) audit organizations must be no less than 51%.

It is determined that until 1 January 2011 auditors will enjoy the right to carry out auditing activity in accordance with the type of their auditor's qualification certificate, and from 1 January 2011 onwards a single auditor's qualification certificate will be introduced, which will grant the right to do audits in any branch of the national economy. An auditor's qualification certificate will be issued on the basis of the results of a passed qualification examination. The procedure for such an examination, the range of questions offered to an applicant, as well as the procedure for evaluating the results of a qualification examination will be established by an empowered federal body. On the whole, the Law has toughened the requirements to applicants for a qualification certificate. Thus, in particular, it is established that, in order to receive a qualification certificate, an auditor - physical person must have an employment history of no less than 3 years of auditing activity or of keeping accounting records and preparing accounting (financial) reporting documents to the day on which the results of the qualification examination are announced. At least 2 years of the last 3 years within that employment history period must be spent with an audit organization. Previously the necessary requirement to an applicant for an auditor's qualification certificate, as stated in the previously existing Law No 119-FZ, was an employment history of no less than 3 years in an economic or legal sphere.

As before, an auditor in obliged, during each calendar year beginning from the year following the one in which the qualification certificate was received by that auditor, to undergo training under a continuing training curriculum. The SAOs must approve the curricula for such training, as well as determine the minimum duration of a training course, which cannot be less than 120 hours in three successive calendar years and less than 20 hours in each year.

The new rules for sending employees on employment business trips

"ON THE SPECIFIC FEATURES OF THE PROCEDURE FOR SENDING EMPLOYEES ON EMPLOYMENT BUSINESS TRIPS" of 13 October 2008, No 749.

The Statute clearly specifies the documentation to substantiate the fact of a business trip. It is mandatory that a report, in written form, on the work performed during the business trip should be submitted.

The Government of the Russian Federation, by Decree of 13 October 2008, No 749, in accordance with Article 166 of the RF Labor Code, approved the *Statute* designed to define the peculiarities of sending workers on employment business trips. The *Statute* entered into force from 28 October 2008.

The *Statute* defines the peculiarities of sending workers on employment business trips, both in the territory of the RF and in the territory of foreign states.

The *Statute* offers a more precise definition of the norms that in the past usually gave rise to certain problems due to the possibility of their different interpretations.

Prior to the adoption of this Provision, all employers had to comply with the Instruction, issued by the USSR Ministry of Finance, the USSR State Labor Committee and the All-Union Central Council of Trade Unions (ACCTU) as of 7 April 04.1988, No 62, and entitled "On business trips in the USSR". In accordance with Article 423 of the RF Labor Code, this Statute was applied in the part that was not contrary to the RF Labor Code (and it has not been abolished to this day).

The notion of a business trip is explained in Article 166 of the RF Labor Code, where it is understood as an employee's trip at the instruction of the employer for a determined period of time, in order to fulfil an employment commission outside the place of their permanent work. The trips made by employees whose permanent occupation involves travel or is associated with travels are not deemed to be business trips. The place of permanent work should be understood as the place of location of the organization (or its separate structural subdivision) the employee's work at which is stipulated by a labor contract. *According to* Article 57 of the RF Labor Code, the terms stipulated in a labor contract should on a mandatory basis include, among other things, the definition of the place of work, and in the event of a person being employed to work at an organization's affiliation, representative office or some other separate subdivision situated in another region, the place of work should be defined with specifying this separate subdivision and its place of location. In the new Statute there exists a separate stipulation to the effect that the business trip, embarked on by an employee at the instruction of the employer or of the person empowered to do so by the employer, to a separate subdivision of the sender (or to its representative office or branch establishment) situated outside of the place of permanent work, should also be recognized as a business trip.

First of all, it should be noted that, whilst previously the maximum period of a business trip was limited to 40 days, without counting en route time, now this restriction has been lifted. In accordance with Item 4 of the new Statute, the length of a business trip is to be determined by the employer with due regard for the volume, complexity and other specific features of the assignment in question. This helps to solve the problem of remuneration for long-term business trips, since previously a business trip exceeding the 40-day limit was qualified as transfer to other work (Article 72.1 of the RF Labor Code).

In this connection, the abolition of the maximum period of a business trip should by no means be interpreted so that employees can be dispatched on very long business trips. The fulfillment of an employment commission (as a business trip is defined by Article 166 of the RF Labor Code) does not require permanent work at the place of a business trip. Instead, it can involve the signing of contracts, control measures, supervision, acceptance of work, participation in seminars, and so on. In other words, the period of a business trip is determined by the specific features of such a commission. If, however, an employee performs some continuous functions at the place of a business trip, then it must be treated as transfer to other work.

It should also be noted that the restrictions specified in Decree of the RF Government of 17 February 2007, No 97, "On confirmation of cases allowing foreigners and stateless persons temporarily staying (residing) in the Russian Federation to work outside the administrative subject of the Russian Federation their work permit (temporary residence permit) is valid for" have also remained in force. Thus, foreigners who arrive in Russia for a temporary stay may indeed be dispatched on a business trip, but for no more than 10 calendar days over the whole period of validity of their work permit. For temporarily residing foreigners the overall period of a business trip cannot be longer than 40 calendar days within 12 calendar months.

The documents that organizations are obliged to formalize in connection with business trips have remained the same as before: a business trip certificate; an employment commission; the employer's decision (or order); an advance accounting report; and a report on the completion of work.

In accordance with Item 8 of the Statute, the RF Ministry of Health Care is obliged to determine the procedure and forms for registering the employees who depart from the sending organization and arrive to the organization where they have been sent on a business trip. Until these procedure and accounting forms are duly approved, organizations will have to apply as registration forms the journals for recording arrivals (departures) of their employees to and from business trips approved as Annexes to the old Statute No 62.

In accordance with Item 15 of the Statute, the dispatching of an employee on a business trip outside the RF territory is done on the employer's order, without issuing a formal business trip certificate. However, in an event of a business trip to the CIS countries which have joined intergovernmental agreements whereby the border service agencies make no entries into the documents carried by the citizens who cross their borders concerning the crossing of a State border, it will be necessary to issue a business trip certificate. It is in this business trip certificate that the receiving party must, as before, make entries concerning an employee's arrival and departure.

As before, the employee sent on a business trip is given an advance payment to cover the cost of travel and lodging, as well as per diem[16].

One significant innovation is that the list of expenditures to be refunded in connection with a business trip abroad is augmented by the cost of obtaining a foreign passport, visas and other necessary documents; mandatory consulate and airport fees; levies for the right of entry or transit of motor vehicles; compulsory medical insurance; and other compulsory payments and fees (Item 23 of the Statute). The inclusion of the cost of compulsory medical insurance into this list will have a positive effect on the law enforcement practice and serve as the grounds for justifying, in the eyes of tax agencies, the inclusion of these expenses into the costs of business trips in order to diminish the tax base for profits tax (Subitem 12 of Item 1 of Article 264 of the RF Tax Code). Because previously tax agencies believed that the norms stipulated in the RF Tax Code did not allow such a possibility[17].

In accordance with Item 16 of the old Statute No 62, the employee who had fallen ill while on a business trip was reimbursed for the cost of lodging (except in cases of hospitalization), and also was paid per diem for the whole period of time during which it was impossible, for reasons of health, to fulfill the commission or to return to his or her place of permanent residence (but no more than 2 months). In the new Statute (Item 25) this restriction has been abolished: now an employee enjoys the right to receive per diem and to have the cost of lodging be reimbursed by the employer over the whole period of illness.

If an employee can every day return from the place where he or she has been sent on a business trip in the RF territory, no per diem is paid (as before) (Item 11 of the Statute). Even

[16] Irrespective of the size of per diem set by the local normative act of an organization, personal income tax should not be levied on the per diem paid in accordance with RF legislation, on condition the amount actually paid does not exceed 700 rubles per day during a business trip in the RF territory and 2,500 rubles per day during a business trip abroad.

[17] See, for example, Letter of the RF Ministry of Finance of 10 May 2006, No 03-03-04/2/138; and Letter of the Administration of the RF Federal Tax Service for the city of Moscow of 19 May 2006, No 20-12/43886@.

if by a local normative act and (or) by a collective agreement it is envisaged that per diem should be paid during such business trip, these sums, nevertheless, cannot be charged to costs for the purpose of taxation of profit.

On the contrary, if an employee is sent to a one-day business trip abroad, then in accordance with Item 20 of the Statute per diem will be paid, but in the amount of 50% of the norm established for this type of expenses as determined by a collective agreement or by a local normative act.

In accordance with Item 5 of the new Statute, if an employee sent on a business has to work on days off or non-working days (public holidays), he or she is reimbursed in accordance with RF labor legislation, and in particular the rules stipulated in Article 153 of the RF Labor Code, whereby an employer is obliged to pay remuneration for the work on such days in the amount of no less than a double rate of tariff (or salary), or (if so desired by the employee) at a single rate but with granting an extra day off at another time.

In accordance with Item 26 of the new Statute, an employee, on returning from a business trip, must submit within 3 workdays the following documents:

– the advance accounting report on the expenses incurred in connection with the business trip and to settle them against the advance money paid to him or her before the departure on the business trip. The following documents are attached to the advance accounting report: the properly formalized business trip certificate; the document confirming lodging expenses and travel costs (including the insurance contribution to cover mandatory passenger insurance, the cost of issuing travel documents and of the bed-sheet package on the train); and other expenses associated with the business trip;

– a written report on the work performed during the business trip, in coordination with the hear of the employer's structural subdivision.

Annex 2. Legal backing behind the attractiveness of the tax system of Cyprus for Russian taxpayers

An important method of planning and minimizing taxation consists in organizing foreign economic activity is such a way so as to make use of subjects residing in countries with beneficial taxation. This section presents an overview of the principal methods of minimizing taxation applied by Russian entrepreneurs when operating in Cyprus. In this connection, the majority of tax planning methods are based not so much on the norms stipulated in the 1998 agreement between the Russian Federation and Cyprus to avoid double taxation (which in its content does not differ from similar agreements concluded by the Russian Federation with other countries) than on the beneficial provisions of Cyprus domestic legislation. At the same time, in this section it is pointed out that the inclusion of certain additional norms into Russian tax legislation could make it possible to reduce the size of tax losses and capital outflow from Russia to Cyprus without infringing on the rights of taxpayers.

1. Privilege-granting provisions of the domestic legislation of the Republic of Cyprus

An agreement for the avoidance of double taxation between the Russian Federation and Cyprus[18] was signed in December 1998 (and has been applied since 1 January 2001). This Agreement replaced the previously concluded 1982 Agreement between the USSR and Cyprus.

It should be noted that the Russian Federation – just as almost every other country – bases its international agreements for the avoidance of double taxation on the 1963 *Model Convention With Respect to Taxes On Income and On Capital* of the Organization for Economic Co-operation and Development (OECD) [19].

The agreement signed by Russia and Cyprus in 1998 contains norms which are compatible with the requirements and recommendations of the OECD, as well as with domestic legislations of the two countries. This Agreement has been subject to much criticism. Moreover, it was proposed that it should be denounced. Such proposals were put forth in connection with the "beneficial investment climate" created in Cyprus for Russian entrepreneurs. The majority of those who have criticized the agreement share the opinion that the provisions stipulated in its norms offer to Russian companies numerous ways to minimize their taxation – or provide them with opportunities for applying various schemes for tax avoidance. However, from early 2002 onwards this Agreement between Russia and Cyprus began to be viewed differently. This happened because in 2001 Cyprus had come to occupy the topmost position among the countries providing the national economy of the Russian Federation with foreign investments[20]. Besides, in 2004 Cyprus joined the European Union, and so its tax legislation was brought in conformity with the EC and OECD requirements, and it was officially deprived of the status of an offshore zone (the main alteration was that the rate of profit tax in Cyprus was increased from 4.25 to 10% both for resident and non-resident companies).

However, it is necessary to distinguish between the beneficial investment climate existing in Cyprus due to its domestic legislation and the beneficial investment climate created by the provision of the 1998 Agreement concluded between Russia and Cyprus with respect to the avoidance of double taxation of taxes on income and on capital. Besides, in Russia's domestic legislation there also exist certain gaps – and in particular, in tax legislation – which are also conducive to tax evasion in Russia by means of capital transfers abroad on perfectly legal grounds.

The domestic legislation provisions of Cyprus on the basis of which Russian companies enjoy the opportunities for minimizing taxation in order to increase their own profit, to keep their savings and to export their capital are as follows:

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[18] "The Agreement for the avoidance of double taxation with respect to taxes on income and on capital", concluded between the RF Government and the Government of the Republic of Cyprus of 5 December 1998. Published source: Legislative Assembly of the RF. 13 September 1999 No 37, Article 4447; Bulletin of International Agreements. 1999. No 12. The Agreement was ratified by Federal Law of 17 July 1999, No 167 – FZ.

[19] http://www.oecd.org/dataoecd/50/49/35363840.pdf (1963 Model Convention With Respect to Taxes On Income and On Capital of the Organization for Economic Co-operation and Development (OECD), as of July 2005); http://www.oecd.org/dataoecd/48/60/40489100.pdf (the 2008 Update to the 1963 Model Tax Convention of the OECD).

[20] Nikolaev D. V. *O pol'ze i vrede nalogovogo soglasheniia Rossii s Kiprom* [On the benefit and harm of the tax agreement between Russia and Cyprus] //Vash nalogovyi advokat [Your tax lawyer]. No 1.Q I 2003.

1) the beneficial taxation regime for companies – residents of Cyprus: the rate of tax on corporate profit is only 10% (in Russia – 20%);

2) tax-free transfer of the profit received by a company (a resident of Cyprus) to its shareholders abroad who are not residents of Cyprus. This is due to the fact that the affiliated companies – residents of Cyprus, when they are created by a Russian parent company and pay their received profit ion the form of dividends to the shareholders of that Russian parent company – resident of the Russian Federation – do not pay tax on dividends in Cyprus at the rate of 10% (withholding tax – 0%);

3) the profit received from the sale by a company – resident of Cyprus of its shares in Cyprus is exempt from the payment of tax. Similarly, the profit received from the sale of other securities is not levied by taxes – both in respect of juridical and physical persons;

4) the profit received by a parent Cyprus company from its permanent affiliated company situated outside of the territory of Cyprus is fully exempt from the tax on profit in Cyprus. However, the dividends received by residents of Cyprus from their non-resident affiliated companies are levied by the defense tax at the rate of 15%. But the dividends received by a resident company from a non-resident company are exempt from this tax if the participation of the resident company in the charter capital of the non-resident company amounts to more than 1%. This exemption means, in fact, that the dividends transferred by an affiliated company (a resident of Russia) to its parent company (a resident of Cyprus) in the majority of cases are not levied by any taxes;

5) the immovable property tax is levied only on property situated in Cyprus. The size of the annual immovable property tax depends on the value of that immovable property. If the value of immovable property is less than 100 000 Cyprus pounds (approximately USD 223 000), the rate of tax is zero;

6) a Cyprus company is registered by applying the institution of nominal shareholders, that is, such a company is managed by nominal directors who undertake no actions without the orders thereto of the real owner whose name is hidden under the mask of the “nominals” and is unknown to the national tax and supervisory agencies. As demonstrated by practice, Article 26 of the Agreement for the avoidance of double taxation between the Russian Federation and Cyprus, which is designed to regulate the exchange of information between the tax and supervisory agencies of the Contracting States, is not operative. Exchange of information between the empowered bodies of two countries must represent an efficient mechanism for eliminating double taxation between these countries. Regular exchange of information must serve as a mechanism designed to control the outflow of incomes and capital from a country and to ensure timely and in full payment of tax.

However, in actual practice even the most developed countries of the European Union and the USA have begun, relatively recently (since 2001) and with the substantial aid and support provided by the OECD, to work on practical implementation of the norms prescribing it as their duty to exchange information with other countries. This has been necessitated, in particular, by the fact that each country has its own grounds for disclosing information, the types of such information and the mechanism for its relating / receiving as established by the norms of national legislation, etc. The OECD’s goal in this connection is to unify all these notions and processes without violating the legislative sovereignty of any of the countries. Article 26 of the Agreement between the Russian Federation and Cyprus is contrary neither to the norms established by the OECD nor to the norms stipulated in the domestic legislation of each of

these two countries, but at the same time it contains no mention of the grounds for disclosing information, or of the grounds for a refusal to disclose information, or of the timelines for disclosing or refusing to disclose information. Thus, Article 26 of the Agreement established no mechanisms for implementing it in actual practice, which makes it significantly more difficult to apply;

7) in 2008, certain groups of companies – residents of Cyprus were freed from the responsibility to submit *consolidated financial reports* (this amendment increases the attractiveness of Cyprus for registering *holdings* there: if a core company is registered in Cyprus, then only the reports of that particular company, and not the whole holding, are submitted to the tax agencies);

8) The rate of value added tax in Cyprus is 15% (in Russia – 18%). The reduced VAT rate is 5%;

9) commercial navigation companies flying the flag of Cyprus are exempt from tax on profit[21]. Besides, the salary and other payments to the master, commanding officers and other members of the crew of a vessel flying the flag of Cyprus are exempt from taxes and social security deductions. If a vessel or shares owned by a commercial navigation company are sold or transferred, the capital gains tax in the territory of Cyprus is not levied.

The main advantage of registering a company in Cyprus is that a Russian entrepreneur thus obtains a fully controllable foreign Cyprus-based company. Such a possibility to have "one's own" company in Cyprus opens up vast opportunities for carrying on a variety of business transactions – on a foreign or sometimes even on a domestic basis (in Russia). It is essential that from the point of view of law this foreign company controlled by its owner is a fully-fledged juridical person capable of participating, on absolutely lawful terms, in any commercial transactions.

Below we are going to discuss the most commonly applied schemes with the participation of Cyprus companies whose purpose is capital accumulation, planning and legal minimization of taxation.

2. The main legal schemes with the participation of a Cyprus company

It is feasible for Russian entrepreneurs to conduct their businesses through establishing holding companies within the framework of beneficial tax jurisdiction offered by Cyprus. This has become possible both due to the existing domestic tax legislation of Cyprus and to the norms stipulated in the Agreement for the avoidance of double taxation signed between Russia and Cyprus.

A holding company is an entity consisting of two or more juridical persons (participants in a holding company) related in such a way that one of the participants (the core company) is granted the right to govern the activity of the other participants in a given holding company by determining their decision-making process.

The reason for creating a holding company is the need to organize financial flows. Holding company schemes provide solutions to many problems: they unite into a single structure companies engaged in different types of activity; they optimize taxation inside a holding com-

[21] In Part 4 of the 1992 Law "On commercial navigation" (with later amendments) a regime is envisaged for the commercial navigation companies Cyprus whereby any profits and dividends arising from the operation of the fleet flying the flag of Cyprus are fully exempt from any taxation. The vessels flying the flag of Cyprus are those that are registered in the a Cyprus register of naval vessels.

pany; and they help to arrange incomes in the form of dividends and to apply the most convenient taxes. Besides, holding company schemes help to minimize taxation of domestic entrepreneurs when they conduct export and import operations, as well as when paying royalties[22]. In addition, a Cyprus company participating in a holding company may act as a Russian company's contractor and thus decrease the taxable base for the tax on profits in the Russian Federation, and in the capacity of a naval vessel's owner – to minimize the taxes on servicing naval vessels and the tax on profits. Also, a Cyprus company participating in a holding company may act as a leasing company in order to transfer capital to foreign banks and to decrease the taxable base for the tax on profits in Russia by means of specially concluded contracts, etc..

The legal scheme for optimizing the taxation of dividends

The principal factors determining the choice of Cyprus as a jurisdiction for building under it a holding company scheme designed to minimize the taxation of dividends are as follows:

1) the payments of dividends by affiliated companies – residents of Cyprus transferred to their parent company which is a resident of Russia are not subject to taxation in Cyprus, which means that the incoming dividends due to the shareholders non-resident in Cyprus are fully exempt from any taxes in Cyprus;

2) the shareholders who are not residents of Cyprus are obliged, when receiving dividends in the territory of Russia, to pay tax on profits at the rate of 9%;

3) a Cyprus-based company affiliated to a Russian company may carry on active business transactions in Cyprus while paying the tax on profits in Cyprus at the rate of 9 10%[23];

4) from 1 January 2008 onwards, those non-residents who have an intention to establish a company in Cyprus, or to acquire shares in already existing Cyprus companies in or outside of the territory of Cyprus, no longer need to apply for the permission of the Central Bank of Cyprus. As a result of this decision, the only regulating body in the sphere of direct investments made by non-residents is now the Ministry of Finance of Cyprus; thus, the procedure for establishing a company in territory of Cyprus has become considerably simpler.

As noted earlier, the payment of dividends by affiliated companies (residents of Cyprus) to their parent company (a resident of Russia) are not subject to any tax in Cyprus. In accordance with the provisions stipulated in Article 10 of the Agreement between Russia and Cyprus, dividends may be taxed in that other State where those dividends have been received (that is, where the recipient of dividends is situated). At the same time, such dividends may also be taxed in the State where these dividends are actually paid (that is, at the source of payment of dividends), if the persons enjoying the right to receive these dividends is a resident of the State where such dividends are transferred (i. e., Cyprus). In this case the tax on dividends should not exceed 5 and 10% (depending on the amount of investment in capital – no less than 100,000 USD and less than 100,000 USD respectively).

[22] The term "royalty" (as applied to intellectual property) is not determined by Russian laws, although they do sometimes make use of this term. In the 1963 Model Tax Convention of the OECD (in Article 12): "royalty" is understood as payments of any kind received as a consideration for the use of, or the right to use, any elements of intellectual property.

[23] http://www.worldwide-tax.com/cyprus/cyprus_tax.asp. The Income Tax Law, 2002.

From 1 January 2008, amendments were introduced into the Tax Code of the Russian Federation which envisage, in respect of the taxation of dividends received both from Russian and foreign juridical persons, that the rate of tax on profit of 9 and 0% respectively should be applied. The rate of 0% may be applied only in cases when dividends are transferred from a state which is not included in the list (approved by the RF Ministry of Finance) of states and territories that grant beneficial taxation regimes (where the rate of tax on profits is below 16%), and on condition that as of the day on which the decision as to the payment of dividends was made the recipient organization had been the owner, uninterruptedly, for no less than 365 days of a no less than 50% stake (or share) in the charter (or joint-stock) capital (or fund) of the organization – the payer of dividends, and on condition that the value of the acquisition and (or) transfer into ownership of the stake (or share) in the charter (or joint-stock) capital (or fund) of the latter organization is more than 500 million rubles.

As Cyprus, where the rate of tax on profit is only 10%, is included in this "blacklist" of the Ministry of Finance, the rate of tax on profit for a Russian organization receiving dividends from a Cyprus company will be 9%, instead of the beneficial 0%, irrespective of the period of ownership, the size of share and the amount of contribution in the charter capital.

However, it can hardly be expected that the introduction of these amendments will result in the RF tax system's increased competitive potential on the international scale. In particular, one cannot agree that these amendments will create additional incentives for establishing affiliated and holding companies in the Russian Federation or in other countries with standard taxation systems instead of in Cyprus, because the conditions stipulated in Part 3 of Article 384 of the RF TC concerning the period of ownership and the size of shares (365 days and 50% respectively) – and moreover, those concerning the amount of the charter capital of an affiliated company (500 million rubles) – are too difficult for most of the rank-and-file Russian companies to comply with.

By way of arbitrary example, one can compare the financial results of two Russian companies. Let us ssume that the first company has an affiliate in Germany. In addition, all the conditions established by Part 3 of Article 384 of the RF TC are complied with, that is, the Russian parent company holds a 50% stake in that affiliated company for a period longer than 365 days. The charter capital of the affiliated company is 501 million rubles If this affiliated company pays tax on 100 euro of its profit at a rate of 15%[24], the net sum of dividends received will be 85 euro. In accordance with the terms of the Agreement for the avoidance of double taxation between Russia and Germany [25], in the instance of the payment of dividends in Germany the sum of 85 euro will be taxed at a rate of 5%, levied on the amount actually transferred. Consequently, the amount received in Russia will be 80.75 euro. Due to the new exemption, this sum will not be levied by tax in Russia (the rate of tax on profit – 0%).

Now assume that another Russian company has an affiliate in Cyprus. In this connection, neither the size of stakes, nor the period of ownership, nor the size of the charter capital of that affiliated company are of any importance, because Cyprus belongs to the RF Ministry of Finance's "blacklist". If 100 euro of profit received by the affiliated company is levied by the Cyprus tax on profit at the rate of 10%, the sum of dividends will be 90 euro. In accor-

[24] The rate of profits tax in Germany in 2008 (http://www.worldwide-tax.com/germany/germany_tax.asp).

[25] Agreement as of 29 May 1996 between the Russian Federation and the Federal Republic of Germany for the avoidance of double taxation with respect to taxes on incomes and on property // Sobranie zakonodatel'stva RF [Collection of RF Legislation]. 23 February 1998. No 8. P. 913.

dance with the Cyprus laws, no additional taxes are levied in connection with the payment of dividends, and so the amount received in Russia will be 90 euro. Since the RF Ministry of Finance does not deem Cyprus to be a state that grants a beneficial taxation regime, the Russian organization will pay tax on profits on this sum at the rate of 9%, after which it will have net profit of 81.9 euro. Thus, in case of an affiliated company registered in Cyprus, the amount of tax loss will be 1.15 euro less.

Thus, in spite of everything said, it is still feasible for companies – residents of the RF to create their affiliates in Cyprus, because the dividends paid by an affiliated company in Cyprus to its Russian parent company are not taxed in the instance of payment of dividends (in contrast to what happens in other countries with standard taxation systems) – no matter what the size of shares, the period of ownership, or the amount of the charter capital of the affiliated company might be. Consequently, the main incentives for the placement, by Russian entrepreneurs, of their capital in Cyprus are the beneficial provisions stipulated in the Cyprus laws, and not the standard provisions incorporated into the Agreement between Russia and Cyprus.

The legal schemes for the payment of royalties

In order to minimize taxation, the holder of the right for an object of intellectual property can be a company registered under a low-taxing jurisdiction. In this connection, a licensing or sub-licensing agreement is concluded with a Russian organization (depending on the length of the chain of participants). Under this scheme, royalties[26] are consistently transferred from the final licensee[27] in Russia to the licensor (the owner of a patent, copyright, etc.) situated abroad.

In international practice it is quite common to use Cyprus companies for the transfer to them of the ownership right to intellectual property (copyrights, patents, trademarks, etc.). The reason is that intellectual property [28], by definition, can easily be transferred to a Cyprus company because it is non-material and does not require that any additional expenses be incurred in its transfer – in addition to the conclusion of a relevant licensing agreement. If different types of intellectual property are involved, this means that their owner will receive certain amounts of royalties from third parties. The receipt of royalties specifically in the territory of Cyprus is associated with the lowest tax losses. This has to do both with domestic legislation of Cyprus and with the provisions of the Agreement for the avoidance of double taxation between Russia and Cyprus. Below we discuss different *variants of schemes for the payment of royalties, which differ by their subjects – the owners of intellectual property.*

[26] "Royalties" means compensation received as a consideration for the use of a patent, copyright, natural resources, or other types of property, paid in the form of interest on the value of sold products and servioces for the production of which patents, copyright, etc. have been used.

[27] Licensee is the person obtaining from the owner of an invention, a patent, industrial or commercial know-how, etc. (the licensor) a license for the right to use it.

[28] See the Convention Establishing the World Intellectual Property Organization adopted at Stockholm on 14 July 1967); Article 1225 of the RF CC // Civil Code of the Russian Federation (Part Four) of 18.12.2006, No 230-FZ. A Collection of RF Legislation. 25.12.2006. No 52 (P. 1). Article 5496.

1. The owner of intellectual property is a company which is not a resident of Cyprus[29]. This company does not pay taxes on its incomes received outside Cyprus; however, it is not subject to the tax agreements concluded by Cyprus, because it is not a resident of that state. Thus, in the event of the payment of royalties from the Russian Federation, they will be levied by the Russian tax on profits at their source at a rate of 20%. No tax arises in Cyprus. No tax at the source arises during the subsequent distribution of the profit of the Cyprus company or the payment of dividends, either (0%).

2. The owner of intellectual property is a company which is a resident of Cyprus. When a Russian company pays royalties to the Cyprus company, the latter pays, in Cyprus, the tax on the received profit in the amount of 10% (because, being a resident of Cyprus, it is subject to that country's domestic tax legislation). In this connection, the Russian company pays no taxes, because no tax at the source is levied in the instance of payment of royalties from Russia (see Item 1 of Article 12 of the Agreement between the Russian Federation and Cyprus[30]). As in the case of the previous scheme, no tax at the source arises during the distribution of the Cyprus company's profit or the payment of dividends (0%).

3. The owner of intellectual property is a foreign company (a resident of any tax-free offshore jurisdiction). This company (registered in the territory of countries like Panama, etc.), being the owner of intellectual property, transfers under a concluded licensing agreement the right to issue sub-licenses for the use of a given patent (or trademark, or copyright) to a company which is a resident of Cyprus. Later on, the Cyprus company signs a licensing agreement[31] with a Russian company. Due to the fact that the country of registration is a tax-free jurisdiction, and Russia has no agreements for the avoidance of double taxation with that state, whereas Cyprus, on the contrary, does have such agreement both with Russia and with the tax-free state, the low rate of the tax on profits in Cyprus (10%) and the beneficial provisions stipulated in the agreements make it possible to use Cyprus-based companies as transit components in the schemes designed to minimize the tax load associated with royalties.

By Article 12 of the Agreement between Russia and Cyprus for the avoidance of double taxation with respect to taxes on income and on capital, a zero rate of tax on profit at the source is established for outgoing royalties. In order to be able to take advantage of this exemption, a Cyprus-based company must be a resident of Cyprus. Thus, in our case no tax on profit at the source arises when royalties are paid from Russia to Cyprus. Then, the Cyprus company, as the licensee, must transfer the sum of royalties as determined in the licensing agreement to the offshore company (licensor). Tax at the source is levied on the outgoing roy-

[29] A non-resident is a company which has a registered office in a given country and is managed by local directors but is owned by non-residents of the country of registration. Such companies have no right to conduct their activity inside the country of registration. Such companies are fully exempt from the payment of all taxes in the country of registration and have no right to make use of any norms of the domestic legislation of the country of registration or of any international agreements concluded by that country with other countries.

[30] Royalties arising in a Contracting State and paid to a resident of the other Contracting State shall be taxable only in that other State (Item 1 of Article 12 of the Agreement between the Government of the Russian Federation and the Government of the Republic of Cyprus for the avoidance of double taxation with respect to taxes on income and on capital) of 5 December 1998).

[31] With the written consent of the licensor (the owner of an intellectual right) the licensee (the user of an intellectual right under a licensing agreement concluded with the licensor) may, under the agreement, grant the right to use the result of intellectual activity or the means of individualization to another (third) party. (Article 1238 of the RF CC).

alties at the rate of 10% only if the services being rendered are actually used in the territory of Cyprus (for example, the rate of the tax on profit with regard to film-lending services is 3%). The tax on profit in Cyprus is paid be resident companies on the difference between the amount of royalties received (from a Russian company) and paid (by an offshore company) at the rate of 10%. In this connection, the tax on profit is not levied on outgoing royalties in Cyprus (0%). In its turn, there is no duty to pay tax on profits on the sum of royalties received in the tax-free jurisdiction, either.

Thus, the creation of companies – owners of intellectual property and recipients of royalties in Cyprus and in other offshore zones respectively represents a tax planning method which is commonly applied by Russian entrepreneurs. This can be explained by the low rates of the tax on royalties withheld in Cyprus and by the provisions stipulated in the Agreement for the avoidance of double taxation between Russia and Cyprus, which are designed to regulate the process of the taxation of royalties.

The legal schemes applied in the export / import of goods (or services)

In international trade, it is indeed possible to conclude the import / export transactions with companies registered in Cyprus in order to minimize the level of taxation with regard to tax on profits. In this connection, within the framework of such import / export transactions between Russian and Cyprus companies the method of transferring profit is envisaged which involves the generation of the main income from the transaction not under the jurisdiction with a high taxation level (in Russia) but in the zone of beneficial taxation (in Cyprus). To achieve this end, it is enough to include an intermediary company situated in the zone of beneficial taxation in the chain of operations carried on between the companies situated in the jurisdiction with a high taxation level.

However, when applying the schemes for the import / export of goods (or services) described below, it is necessary to take into account national legislation on transfer pricing and the insufficient capitalization rules.

Transfer pricing means the setting and applying of prices the size of which is determined by the parties to a given transaction not by a market method – that is, not for commercial purposes, but only in order to reduce their tax load. Russian tax legislation, in Articles 20 and 40 of the RF TC, stipulates the main norms designed to prevent transfer pricing. By Article 20 of the RF TC it is determined which persons are recognized as mutually dependent for the purpose of taxation (these are, in particular, parent, affiliated and dependent entities). Article 40 of the RF TC established directly the limited list of cases when tax agencies have the right to check the correspondence of a contract price to the market one (these are: transactions between mutually dependent persons; barter and foreign trade transactions; and all those transactions in which the deviation from the market price or from the prices applied by the taxpayer during a short period of time is more than the permitted 20%).

Thus, tax agencies, in accordance with Articles 20 and 40 of the RF TC, are granted the right to check the justification for the price indicated in a contract concluded between mutually dependent persons in an event of foreign trade transactions. Besides, tax agencies can check all the transactions where the deviation from the market price or the prices applied by the taxpayer during a short period of time is more than the permitted 20%.

Russian tax legislation envisages certain sanctions for violation of the insufficient capitalization rules. One of the main indicia of insufficient capitalization is the high share of bor-

rowed funds against that of joint-stock capital. Such a high share of debt in an organization's total capital can be an indication that a given group of companies is making efforts in order to obtain tax benefits. All other conditions being equal, a group incorporating a parent company may, with regard to the corporation as a whole, pay a lower amount of tax if the profit of the affiliated company is transferred to the parent one in the form of interest on a loan, and not as dividends on shares: the sums of interest on a loan decrease the taxable income of the affiliated company, while dividends are paid from the sum of profit after tax.

The special norms designed to limit opportunities for misdeeds by means of applying insufficient capitalization are stipulated in Article 269 of the RF TC, which establishes the conditions whereby a Russian organization's debt to its foreign creditor is to be deemed to be controlled[32]. Article 269 of the RF TC restricts the sum of interest to be deducted from the amount of tax on profit if a loan is obtained from a foreign mutually dependent person, and the value of the capitalization coefficient falls within certain limits; that is, the size of debt obligations which are not redeemed by the borrower cannot exceed by more than three times (for banks and organizations engaged in leasing operations – by more than 12.5 times) the size of its own capital.

The consequence of such debt having been recognized as controlled by tax agencies is that, for the purpose of taxation, the positive difference between interest charged and marginal interest on dividends is treated as the obligation to pay tax on dividends at the rate of 15% from the relevant sum of recognized dividends.

The legal scheme for the import of goods with the participation of a Cyprus company as an intermediary

A Russian company buys goods from a foreign company. A Cyprus company acts as an intermediary, thus making it possible for the Russian company to alter the price of the goods. In this connection, it becomes possible to deliberately increase the prices entered into the contract in order to diminish the profit of the Russian company, and as a result – to decrease the sum of tax on profit.

Suppose the Russian company buys goods from a foreign one at the price of 120 rubles per unit, which are then sold in the territory of Russia at 140 rubles per unit. The company's profit amounts to 20 rubles, from which it will have to pay tax on profit at the rate of 20% in the amount of 4 rubles. However, if it establishes an additional company in Cyprus, the Russian company will then be able to carry out this transaction through its Cyprus affiliate. The Cyprus company thus buys goods from the foreign company at 120 rubles per unit, then sells

[32] Debt liabilities of Russian organizations in respect of foreign creditors may be recognized by tax agencies to be controlled if interest is paid by these Russian debtors:
1) against a debt liability in respect of a foreign organization which directly or indirectly has under its ownership more than 20 per cent of the authorized (pooled) capital (fund) of this debtor;
2) against a debt liability in respect of a Russian organization recognized in accordance with legislation of the Russian Federation to be the affiliated person of a foreign organization which directly or indirectly has under its ownership more than 20 per cent of the authorized (pooled) capital (fund) of the Russian organization – the borrower;
3) against a debt liability in respect of a company for which a foreign organization, which directly or indirectly has under its ownership more than 20 per cent of the authorized (pooled) capital (fund) of the borrower, or which is its affiliated person, acts as surety, guarantor, or in any other ways is responsible for the execution of the aforesaid debt liability (Article 269 of the RF CC).

them to the Russian company at 135 rubles per unit. The latter sells them in the territory of Russia at 140 rubles per unit goods. The profit of the Russian company will be 5 rubles, and the amount of tax on profit – 1 ruble. The profit of the Cyprus company amounts to 15 rubles, from which it will have to pay tax on profit at the rate of 10% in the amount of 1 ruble 50 kopecks. Thus, the Russian company will save 2 rubles on the payment of tax on profit in the territory of Russia (in this case, the Russian entrepreneur pays almost 40% less of taxes than when the transaction is carried out directly, without an intermediary – a Cyprus company).

The legal scheme for the import of goods with the participation of a Cyprus company as an intermediary and by applying the mechanism of credit against goods

It is possible to implement a scheme for the import of goods by applying the provisions stipulated in Article 11 ("Interest") of the Agreement for the avoidance of double taxation between Russia and Cyprus. For example, a Russian entrepreneur creates a company in Cyprus which, in its turn, creates its affiliated company in Russia. The Cyprus company buys goods from a foreign company (say, a resident of Germany), and then grants to the Russian company (its affiliate) credit against goods [33] in the form of purchased goods. The interest paid by the Russian company on that credit against goods diminishes its taxable profit. The monies transferred from the Russian company to the Cyprus one as interest on the credit against goods are then accumulated, and tax on profit is levied in Cyprus at the minimum rate of 10%. For the Russian company to be able later to make use of these transferred monies, the Cyprus company grants to it a loan in the amount of the aforesaid monies, or – as a parent company – invests these monies in the fixed assets of its affiliated Russian company. Thus, all other conditions being equal, an affiliated company in Russia, whose ratio of borrowed and its own funds is high, pays a lower tax on profits than a company whose ratio of the same indices is low.

If this scheme is applied by a Russian entrepreneur, then there arises the risk of being brought to responsibility for violation of tax legislation in the part relating to the compliance with the insufficient capitalization rules (thin capitalization) described earlier.

The legal scheme for the import of goods with the participation of an intermediary (a Cyprus company) and by applying the mechanism of a leasing agreement

The application of a leasing scheme makes it possible for a Russian company to purchase goods on behalf of a Cyprus company, while at the same time diminishing the taxable base for the tax on profits for that Russian company by exporting capital to Cyprus.

Under a leasing agreement the lessor is obliged to acquire into ownership the property specified by the lessee from a certain seller and then to grant to the lessee that property, on a commercial basis, for disposal and use for entrepreneurial activity. The implementation of the scheme based on a leasing agreement, in accordance with which a Cyprus company becomes

[33] Goods credit is a borrowing obligation which provides for the duty of one party (the creditor) to grant to the other party (the borrower) things determined by generic indicia, while the borrower pays to the creditor specially determined and regularly payable interest. The transfer of the right of ownership of the goods under a goods credit contract takes place at the moment of its actual transfer of the goods from the creditor to the borrower (Article 822 of the RF CC).

the lessor, and a Russian company – the lessee, makes it possible for the Russian company to lawfully diminish its payments of tax on profit.

Suppose that it is necessary for a Russian entrepreneur to purchase certain equipment from a foreign company (a resident of Germany). So, the former establishes an additional company in Cyprus, which purchases the necessary equipment; then, the Russian company concludes a leasing agreement, that is, the Russian company leases the equipment from the Cyprus company. The profit generated as a result of the activity of the Russian company is transferred to Cyprus in the form of leasing payments, which under this agreement are paid by the Russian company to the one in Cyprus, where these payments, in their turn, are levied by tax on profits at the rate of 10%. At the same time, the leasing payment decreases the Russian company's taxable base for tax on profit.

With regard to the use of this scheme, it is necessary to address the issue of property depreciation in accordance with a leasing agreement. The depreciation deductions are made by that party to the leasing agreement on whose balance sheet the subject of leasing in kept. In this connection, the subject of leasing transferred to the lessee under a leasing agreement is entered in the balance sheet of either the lessor or the lessee, in accordance with their mutual agreement. Since depreciation decreases the taxable base for tax on profits, it is the Russian company (the lessee) who benefits from keeping the subject of leasing on its balance sheet because it thus can make the deductions in order to minimize the payments of tax on profits (because in Russia the rate of tax on profits is 20%, and in Cyprus – only 10%).

The legal scheme for the export of goods

For the purpose of minimizing the sum of payments of tax on profit, it is convenient for Russian companies to use a Cyprus company as an intermediary when selling their goods / services to a foreign partner.

Let us assume that a Russian company exports goods to a foreign company (for example, a resident of Germany) at a price of 120 rubles per unit. The profit then received by the Russian company amounts to 20 rubles per unit. There arises the duty to pay tax on profit, the rate of which in Russia is 20%; so, the Russian company will pay 4 rubles

Now let us consider the scheme envisaging the participation of a Cyprus company. The owners of the Russian company, *which must* sell its goods / services to a foreign company, create their company in Cyprus and conclude with it an export contract, but the price entered into it is 101 rubles per unit instead of 120 rubles. The profit of the Russian company is thus decreased to 1 ruble, and tax profit (at the rate of 20%) - to 0.20 rubles The Cyprus company, in its turn, sells goods to the foreign company at the old price – 120 rubles per unit. The profit of the Cyprus company amounts to 19 rubles From this sum the Cyprus company is going to pay in Cyprus the amount of tax on profit at a rate of 10% - 1 ruble 90 kopecks. The total sum of Russian (0.20 rubles) and Cyprus (1 ruble 90 kopecks) tax on profit will thus amount to 2 rubles 10 kopecks. The amount saved by the Russian entrepreneur as a result of using a Cyprus company as an intermediary in this scheme will be 1 ruble 90 kopecks (a domestic entrepreneur pays 30% less in tax).

When such schemes are applied in carrying on the import / export of goods, there is a risk of the taxpayer being brought to responsibility for violating the provisions of Russian tax legislation on transfer pricing described above.

In this case, Russian entrepreneurs minimize the profit of a Russian company and the sum of tax on profit by means of concluding the import / export transactions with a Cyprus company, thus concentrating the bulk of their monies in Cyprus, where a Cyprus company pays the minimum tax on profit at a rate of 10%.

As noted earlier, the RF Tax Code presently contains only two articles designed to prevent the use of transfer prices – Articles 20 and 40 RF, in accordance with which tax agencies have the right to check the justification for using certain prices in contracts, and in an event when the price indicated in a contract does not correspond to the level of market prices – to charge additional tax on profit and to oblige the taxpayer to pay penalties and fines.

All the aforesaid conditions, under which the price indicated in a contract can be checked by tax agencies in order to verify whether or not it corresponds to the market price, are fully applicable to the tax planning schemes with the participation of a Cyprus company in the import / export of goods (or services). In order to avoid sanctions imposed by tax agencies, it is necessary for the Cyprus and Russian companies not to be mutually dependent from a formal point of view (the Russian company cannot be the founder of the Cyprus one, while the founders of the Russian company cannot at the same time be the founders of the Cyprus company, etc.)[34]. Besides, the price indicated in a contract cannot be more than 20% higher (or lower) than the level of market prices for similar (or identical) goods / services, i. e., the raising (or lowering) of price must be simultaneously feasible from the point of view of economics and take into account the potential risk of sanctions to be imposed by tax agencies in connection with violation of the provisions of Russian legislation concerning transfer pricing.

The legal schemes for self-financing of holding companies

In international practice it is quite common for Cyprus companies to participate in the process of financing an international group of companies (or a holding company) in order to minimize the taxable base for tax on profits of a company situated in a country with a standard system of taxation.

The essence of such a scheme is that a Cyprus company issues a credit[35] or loan[36] to its partners situated in the territory of Russia and having the status of Russia's residents. Under such a scheme, the credit can be repaid to the Cyprus company together with the interest agreed upon, while the monies received by the Russian company in the form of a loan from the Cyprus company will be partly spent on the repayment of the loan and the payment if in-

[34] Natural persons and (or) organizations, the relations between which may exert influence the conditions or the economic results of their activity or activity of the persons represented by them, shall be deemed for the purposes of taxation to be inter-dependent persons, namely 1) one organization directly and (or) indirectly participates in another organization, and the total participatory share of such participation comprises more than 20%; 2) one natural person is subordinated to another natural person with regard to official position; 3) persons are in accordance with family legislation of the Russian Federation in marriage relations, relations of kinship or affinity, adoptive or adopted, and also trustee and ward (Article 20 of the RF TC).

[35] Under a credit contract a bank or other credit organization (creditor) is obliged to grant monetary means (credit) to the borrower in the amount and on the conditions provided for by the contract, and the borrower shall be obliged to return the monetary amount received and to pay interest on it (Article 819 of the RF CC).

[36] Under a contract of loan one party (the lender) is obliged to transfer or transfers a thing for temporary uncompensated use to the other party (the recipient), and the last is obliged to return this thing in the same state in which it was received, taking into account normal wear and tear, or in a state stipulated by the contract (Article 689 of the RF CC).

terest on it. The purpose of this scheme is to reduce the Russian company's taxable base for tax on profit (it has costs because it has to repay credit) and to concentrate profit with the Cyprus company (which receives monies in repayment of the credit with the agreed amount of interest, while paying profit tax on half of its received interest at the rate of 10%). As has been noted earlier, this method of financing can be preferable to direct contributions to charter capital, because the payment of interest reduces the taxable base for tax on profit in Russia. When paying interest to a Cyprus company, a Russian company pays no profit tax in the territory of Russia. In accordance with the provisions of Article 11 of the Agreement between Russia and Cyprus, profit tax on only half of the amount of charged interest is paid by the recipient of interest, in this case – by the Cyprus company[37]. This happens so because, in accordance with the domestic legislation of the Republic of Cyprus, a company resident in Cyprus is exempt from the payment of profit tax on 50% of the monies received by it. Physical persons in Cyprus are fully exempt from the payment of profit tax on their received interest[38].

Consequently, this scheme makes it possible, with minimum tax expenses, first to export, and then to return monies to Russia: the interest paid by a Russian company to a Cyprus company under a credit agreement reduced the sum of taxation in Russia and is subject to minimum taxation in Cyprus.

When implementing this scheme, it is necessary to remember the insufficient (thin) capitalization rules. As the creditor in this scheme is a resident of a foreign state (Cyprus), no taxation of interest in the country of source (i. e., in Russia) is envisaged by the Agreement for the avoidance of double taxation (Article 11 of the Agreement for the avoidance of double taxation). At the same time, the recipient of interest in Cyprus pays profit tax only from 50% of the received amount of interest at the rate of 10%. Thus, as a result of this scheme, the tax base is reduced in the country of source (in Russia).

Special norm designed to limit opportunities for misdeeds based on thin capitalization are stipulated in Article 269 of the RF TC. As a result of the application of this norm by tax agencies, the amount of interest paid in excess of the marginal level is treated in tax records as the payment of dividends by a Russian affiliate to its parent company (in Cyprus), and so it is taxed in Russia accordingly – at a rate of 15%.

The legal schemes for decreasing the taxable base for tax on profits of a Russian company based on rendering fictitious services

This scheme results in minimization of tax on profits through increasing a company's costs. A Cyprus company created by Russian entrepreneurs may render to a Russian company legal, informational, auditing or other services which are essentially fictitious – that is, non-existent. The monies paid to the Cyprus company are thus accumulated on its account, the Cyprus company, in its turn, paying profit tax on them at a minimum rate – 10%. In this connection, the sums spent by the Russian company decrease its taxable base for tax on profit in accordance with Articles 251 – 254 of the RF TC.

[37] Interest arising in a Contracting State and paid to a resident of the other Contracting State shall be taxable only in that other State (Item 1 of Article 11 of the Agreement between the Government of the Russian Federation and the Government of the Republic of Cyprus for the avoidance of double taxation with respect to taxes on income and on capital) of 5 December 1998.

[38] The Income Tax Law of 2002 (as amended, 2004) (Cyprus) art.8 (19).

The legal scheme for exporting the capital of a Russian company to Cyprus by using promissory notes

A promissory note is a security that confirms the obligation of the issuer of the promissory note to pay a certain sum to the bearer of the promissory note. The application of a scheme based on investment promissory notes with the participation of a Cyprus company makes it possible to export a certain sum of money belonging to a resident of Russia to Cyprus, thereby decreasing the Russian company's tax base for tax on profits in the territory of Russia and decreasing the tax expenses relating to tax on profits for the Cyprus company. Besides, Russian currency and customs legislation imposes no restrictions on the removal, by residents or non-residents of the Russian Federation, of any promissory notes out of its territory. The use of a promissory note as a means for exporting capital to Cyprus allows the participants in such a transaction not to pay customs duties when carrying promissory notes through the border of the RF (Article 35 of Federal Law of 21 May 1993, No 5003-1, "On customs tariffs"), and not to request the permission for capital export from the RF Central Bank.

The scheme may be arranged in the following way: a Russian company issues a discounted promissory note with face value of 100 rubles The sum of the actual placement of the promissory note is 80 rubles, i. e. the amount of discount on it is 20 rubles

It is necessary to note that a discounted promissory note may also be interest bearing, thus implying the obligation of the promissory note's issuer to pay to its bearer, on it being presented for payment, not only the sum of the promissory note's face value, but also interest on that sum. The bearer of the promissory note thus becomes the previously registered Cyprus company which had acquired it from the Russian company for 80 rubles. When carrying on operations with its own promissory notes, their bearer (the Russian company) incurs certain expenses which, in accordance with Chapter. 25 of the RF TC, are recognized as non-realization costs: the cost of the making (or acquisition of) promissory note forms and their servicing (Subitem 3 of Item 1 of Article 265 of the RF TC), as well as expenses in the form of interest charged on a promissory note (Subitem 2 of Item 1 of Article 265 of the RF TC). The discount on a promissory note, as stipulated in the provisions of the RF Tax Code, is treated as interest. So, the issuer of a promissory note thus bears expenses in the form of interest (or discount) on the promissory note, which are distributed evenly over the period of circulation of the promissory note and are included in the tax base either on a quarterly (or a monthly) basis depending on the duration of a reporting period, or as of the date of the redemption of the debt obligation (Item 8 of Article 272 of the RF TC).

From 2005 onwards, the sum of discount on a promissory note can be charged to non-realization costs only by the organization who issues the promissory note. This means that the next owner of the promissory note who acquires it from the issuer with the intention to subsequently resell it to a third party with a new discount will have no such right.

After purchasing the promissory note, the Cyprus company presents it for payment to the Russian company and receives income in the form of discount on a promissory note and/or interest charged on the promissory note (if the promissory note is discounted and/or interest bearing), which happens in the territory of Cyprus. Of course, income in the form of interest on securities, according to the provisions of Article 11 of the Agreement for the avoidance of double taxation between Russia and Cyprus, is subject to tax on profit in the territory of Cy-

prus at a rate of 10%, which halves the expenses of the participants in such a transaction (in Russia, the rate of the tax on profits is 20%[39]).

It is also possible to implement an investment scheme with promissory notes, with the participation of a Russian bank. A Russian company purchases from a Russian bank a discounted (and/or interest bearing) promissory note. In order to decrease its payments of the tax on profits when receiving income on a promissory note, the Russian company sells the promissory note to a Cyprus company at the same price which was paid when purchasing it from the bank. In this case no VAT is paid, because this transaction generates no added value. It is not profitable for the Russian company to sell the promissory note with a new discount in order to decrease its taxable base for tax on profits, because due to the provisions of the RF Tax Code only the issuer of a promissory note (a bank) enjoys the right to charge the sum of discount to non-realization costs. For the Russian company this discount represents a loss. Then the Cyprus company, who is the bearer of the promissory note, presents it for payment to the Russian bank and thus receives income, which is levied by the tax on profits in the territory of Cyprus at a rate of 10%.

Thus, the investment scheme based on the use of promissory notes with the participation of a Cyprus company allows Russian entrepreneurs to export their capital in an amount equal to the discount and/or interest on a promissory note, thus decreasing their tax payments. The purpose of such a scheme is to export capital from Russia and then to invest it[40]. In this connection, when using the schemes based on promissory notes it is necessary to remember the norms of Russian tax legislation designed to prevent the failure of taxpayers to fulfill the duty to pay taxes in the territory of Russia – that is, the norms concerning the thin capitalization rules and transfer pricing.

The legal schemes for non-payment of tax on the profit received from alienation of Russian immovable property

In the event of sale of immovable property (a house, a building, etc.), the profit received from this operation in Russia is levied by the tax on profit at the rate of 20%. If it is sold by a foreign company without a permanent representation office in Russia, the profit thus received is subject to tax on profit at the source of payment, without any possibility of decreasing the tax rate in accordance with the terms of international tax agreements.

However, it is much more feasible for Russian entrepreneurs, in order to minimize taxation, to realize immovable property by selling shares or stakes in the company owning that

[39] Article 284 of the RF TC.

[40] In confirmation of the actual existence and importance of such investment scheme based on the use of promissory notes, we can point to Letter of the RF Central Bank of 4 July 2008, No 80-T, which specifically addresses this problem. In particular, it is pointed out that the initial holders of promissory notes within a short period of time after their acquisition transfer these notes to other Russian juridical persons. However, these promissory notes are then presented for payment to Russian credit institutions by non-residents of Russia, who in many instances are registered in offshore zones are clients, in particular, of banks of Latvia and Cyprus. The growing scale of such operations has made it possible to assume that their true purposes may be not only tax avoidance (and so Cyprus or Latvia are chosen), but also the avoidance of customs control and customs duties, withdrawal of money from the Russian Federation outside of the framework of currency control, and money laundering. In this connection, as a measure of supervision, the RF CB recommends in this letter that Russian credit organizations, when identifying the presence of such operations, to submit the relevant information on them to the authorized body – the Federal Financial Monitoring Service.

immovable property, after registering that company in Cyprus. This is due to the fact that at present, in accordance with Article 13 of the Agreement for the avoidance of double taxation between Russia and Cyprus, the incomes from alienation of any property (including shares), except immovables, are subject to taxation only in that State where the person alienating the property is a resident. Shares – even if they are set in a company's balance sheet against immovable property – are movables, and so the income from their realization must be taxed only in that state where the person alienating such shares is registered as a resident.

Thus, the following scheme, which involves the construction and subsequent sale of Russian immovable property, becomes possible. Russian entrepreneurs register a company in Cyprus with a minimum charter capital; the founders can be either those entrepreneurs, or any other Cyprus company, which was previously registered there. Then the Cyprus company establishes in the territory of Russia a construction company, which takes a credit or loan in the amount necessary for erecting a building in the territory of Russia, while enjoying the status of a RF resident. As a result, the Cyprus company becomes the owner of the building erected in the territory of Russia, because the Cyprus company owns shares in the Russian company which has erected it. After completing the construction of the building, the Cyprus company advertises it for sale in the territory of Russia at a market price, which is higher that the construction price The Cyprus company sells the building by means of selling shares in the Russian company, in whose balance sheet these shares are set against the newly constructed immovable property, to the Russian company at a price corresponding to the real value of that building, and that company then begins to exploit the building. As a result, the Russian company (the seller) becomes the owner of Russian immovable property through purchasing shares belonging to the Cyprus company. Thus, the transaction of sale of the shares is effectuated in Cyprus, because the seller is the Cyprus company in the capacity of the owner of shares in the Russian company, in whose balance sheet these shares are set against that immovable property situated in Russia. In this connection, no duty to pay the capital gains tax in Cyprus arises as a result of such a transaction

Consequently, in Cyprus there exist conditions that make it much more feasible to place capital there and carry out through companies registered in Cyprus the transactions of alienating Russian immovable property, which involve construction and subsequent sale of Russian immovable property.

The legal scheme applied for minimizing the taxation of ship-owning (commercial navigation) activity

Cyprus is one of the main centers for foreign ship-owning companies to carry on their ship-owning activity, commercial navigation and the rendering of sea carriage services.

The established form of a ship-owning company registered in Cyprus is a private limited liability company engaged in ship-owning activity and commercial navigation. Such a company, which owns or charters vessels flying the flag of Cyprus and operates in international waters is fully exempt from all taxes and duties, including the duty to pay profit tax, the tax on the payment of dividends and the tax on remuneration of personnel. Exceptions are represented by the annual duty, registration fees, and the duty on re-registration of a vessel. Besides, no tax is levied on incomes from capital gains in the event of a sale or resale of a vessel, or of a division of a commercial navigation company.

The responsibility of a ship-owning company to keep accounting records, draw up annual reports and submit audit reports arises only in cases when at least one of its shareholders is a juridical person.

Thus, it is feasible for those Russian entrepreneurs whose main source of profit is precisely their ship-owning activity to register their companies in the territory of Cyprus.

3. Proposals concerning the introduction into Russian legislation of some amendments designed to prevent the non-payment of tax on profit in the territory of Russia and to ensure control over capital outflow to Cyprus

The introduction of certain new norms into Russian legislation may decrease the attractiveness of capital export to Cyprus for Russian companies. It would be feasible to augment the system of national legislation by the norms concerning controlled foreign companies.

Controlled foreign companies (CFC) are those companies which are situated, as a rule, in beneficial tax jurisdictions, and certain shares in which are held by domestic companies. The general rules concerning CFCs envisage that if the holders of shares (the parent company) are situated in the country where such norms concerning CFCs are in force, a certain part of undistributed profits of their foreign affiliated company must be included into the parent company's taxable income. The main idea behind this procedure is that part of the income received by a foreign affiliated company is to be actually treated as shareholders' (or parent company's) profit that has been exported beyond the borders of the tax jurisdiction of the parent company's country as a result of inter- company deals.

When the draft wording of Chapter 25 of the RF TC was being prepared, it was envisaged that proper regulation should be introduced, but the final and currently effective version of that chapter have never contained and does not contain now any of the necessary norms[41].

Let us consider a case when a parent company is registered in Russia, while its affiliated company is registered in Cyprus, and both companies are independent juridical persons. Under existing legislation, the Russian parent company reports only its incomes received independently, as well as the incomes received in the form of dividends and other incomes (interest, royalties, etc.) received from its foreign affiliate. The affiliated company's undistributed profit is not included in the Russian parent company's taxable income, including in the income from sale of its shares in the affiliated company (profit from sale of shares not being subject to taxation in Cyprus). Consequently, the introduction into Russian legislation of the norm concerning CFCs would have made it possible, in the case described above, to record the profit received by the affiliated company in the tax declaration submitted by the parent core company in the RF – on condition that there is indeed a well-functioning mechanism for exchanging information between the competent authorities of the Republic of Cyprus and Russia.

Certain changes can also be introduced into the Agreement for the avoidance of double taxation between Russia and Cyprus, which would reduce the scope of capital outflow from Russia. Thus, Article 26 of the Agreement, which addresses the issue of information exchange between the competent authorities of Russia and Cyprus, could provide an effective mecha-

[41] Kornienko N. Yu. Nekotorye aspekty podkhodov k probleme bor'by s nedobrosovestnoi nalogovoi konkurentsiei v kontekste begstva kapitalov [Some aspects of the approaches to the problem of struggle against dishonest competition in the context of capital flight] // Rossiiskaia ekonomika v 2006: tendentsii i perspektivy [Russian economy: Trends and Perspectives]. M.: IET, 2007.

nism for regulating the financial flows in both directions between Russia and Cyprus, as it has been proven by the OECD experience. However, this Article, which on the face of it does not contradict the OECD norms or the norms stipulated in the domestic legislations of both countries, contains neither the grounds for information disclosure nor the grounds for a refusal to disclose information nor the timelines for the disclosure or the refusal to disclose information by any of the two countries. Thus, Article 26 of the Agreement provides no mechanisms for implementing it in actual practice, which considerably hinders its application.

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