

Economic Outlook

‘Russian Economic Developments’

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The Russian Economy in December 2012: Preliminary Data and Major Trends

The Political Background: A Quest for a New Mainstay

The most noteworthy events of December 2012 were the adoption, by the U.S. Congress, of the so-called 'Magnitsky Law', whereby sanctions were introduced against the Russian officials directly involved in human rights violations; and the passing, by the RF State Duma, of a retaliatory anti-American law. The adoption of the 'Magnitsky Law' was inherently related to the abolition of the Cold-War-era Jackson-Vanik Amendment. In retaliation for the 'Magnitsky Law', the Kremlin, greatly pained by the passage of the new U.S. legislation, instructed the Russian State Duma to adopt a 'symmetric' anti-American law. This retaliatory law (the 'Dima Yakovlev Law') introduced a ban on the financing of Russian non-governmental organizations by U.S. funds, forbade dual U.S./Russian nationals to participate in the activities and functioning of Russia's NGOs, and banned the adoption of Russian children by US citizens. And it was the ban on adoptions that immediately caused a wave of indignation all over the world, including to some extent Russia. The case in point is that the brunt of the anti-adoption measures announced in the 'Dima Yakovlev Law' will be carried by disabled children, who have no chance to be adopted or receive proper medical and rehabilitative assistance in Russia. Also, the 'Dima Yakovlev Law' contradicts the U.S.-Russia Adoption Agreement and the United Nations Convention on the Rights of the Child.

One of the aims of that law is to prevent European countries from passing laws similar to the 'Magnitsky Act': the 'Dima Yakovlev Law' directly envisages that its sanctions should be extended to any country which follows the example of the United States in this respect. At the same time, the 'Dima Yakovlev Law' apparently also has some domestic purposes: anti-Americanism is frequently used by hybrid regimes as a means of political consolidation. Although by the end of 2012 the decline in the popularity of Russia's political regime and its leaders had become less rapid than in 2011, the negative trend had not been eliminated. Therefore the quest for a new consolidation agenda remains a top political priority for the Russian authorities.

In his first post-reelection annual Presidential Address to the RF Federal Assembly, Vladimir Putin was relatively restrained in his rhetoric and did not touch upon the most acute problems, including his relations with the Opposition. As far as the political initiatives put forth in Putin's speech are concerned, special attention should be paid to the idea of restoring single-member electoral districts and allocating 50% of State Duma seats to their representatives.

A number of years ago, the abolition of single-member electoral districts was an important step in the implementation of the Kremlin's strategy of creating a one-and-a-half-party system in Russia. In such systems, the rule of one or other party becomes permanent, and that party rapidly establishes itself as the most important element of state governance, the vehicle for inter-elite interaction and the principal control and feed-back mechanism in the central authority's relations with regional elites. This type of authoritarianism is considered to be the most stable one. Seen in this light, the Kremlin's proposal that Russia should return to the old system (and its decision to restore direct gubernatorial elections) means an indirect

acknowledgement of *United Russia*'s defeat at the December 2011 elections and represents an important step toward restoring Russia's political institutions which existed in the early 2000s. Moreover, this proposal means an acknowledgement of the fact that Putin's political reforms of the mid-2000s have largely failed. The restoration of single-member electoral districts will make it possible for *United Russia* to gain a majority of State Duma seats in a situation when it cannot win a majority of the votes cast in party-list elections. At the same time, the restoration of the old model will increase the representation, in the State Duma, of the interests of regional authorities, who can exert considerable influence on the outcome of elections in single-member districts.

The second highlight of the Presidential Address was Putin's call to stimulate Russia's domestic production and economic growth through economic measures similar to those used by developed countries - that is, to boost her economy by increasing budget expenditure and by expanding central bank liquidity provision. It is quite possible that these measures will even include the abolition of the recently adopted budgetary rule. The ideas stated in the Presidential Address were further elaborated in the December letter of the RF Ministry of Economic Development. The letter acknowledged the fact that Russia's economic growth had considerably slowed down in the second half of 2012. As a result, the 2012 economic growth rate could amount to 3.5% (vs. 4.3% in 2011). According to the Ministry of Economic Development, this drop in economic growth should be countered by an increased emphasis on domestic consumption.

Macroeconomics: A Year When Oil Prices Did Not Grow

In December 2012, oil prices remained stable. On the whole, in Q4 2012 the average price of oil was the same as in Q3. As a result, the average annual prices of Brent Crude and Urals Crude were practically the same as in 2011. This circumstance should certainly be taken into account when analyzing the development of the Russian economy in 2012. The point in fact is that Russia's economic growth in 2010 and 2011 was taking place against the background of a year-on-year rise in average annual oil prices: in 2010 average annual oil prices were 28% higher than in 2009, and in 2011 they were 39% higher than in 2010.

In December, Russia's stock exchanges demonstrated a steady growth in quotations, thus gradually compensating for their decline in the previous two months. At the same time, by the end of 2012, the Russian stock market had failed to produce a definite trend (the MICEX Index fluctuated between 1400 and 1500 points). It should be noted that in 2012 the stock exchanges of developed countries (the EU, the USA and Japan) demonstrated a 10 to 20% annual growth in quotations. Over the course of 2012, the price of shares in *Gazprom* dropped by more than 18% (December 2012 vs. December 2011). In comparison with their April 2011 record high, the price of shares in that company fell by 40%. At the same time, by the end of 2012, Russia's oil companies had shown a considerable rise in capitalization.

Over the course of December, the Russian ruble steadily strengthened against the US dollar (+2%), although its rise was not as intensive as in the final ten days of November. Pulled down by this process and by the volatility of the euro, the value of the bi-currency basket dropped from Rb 35.17 as of 30 November 2012 to Rb 34.80 as of 30 December 2012.

Over the course of December, the international reserves of the RF Central Bank increased by \$ 3.8bn, to \$ 532bn. Thus, since the beginning of the year, these reserves have grown by

6.8%, to 89% of their pre-crisis record high registered in 2008. According to the Bank of Russia, over the period from September through November 2012, the outflow of capital from Russia amounted to \$ 59bn. The Bank of Russia forecasted that net capital outflow from Russia in 2012 would amount to \$ 65 to 75bn. As a result, the outflow of capital would be only slightly smaller than that in 2011 when it amounted to \$ 80bn.

In December, consumer prices rose by 0.5%, bringing annual inflation to 6.6%, which is 0.5 percentage point higher than in 2011. In the first half of 2012, the annual inflation rate in Russia hovered around 4%; in the autumn it rose to 6.5-6.6%. Thus, in Q4 2012, the difference between Russian inflation and inflation in the EU amounted to +4 percentage points.

In November, after declining for three months in a row, Russia's broad monetary base registered a growth (+2.6%). In year-on-year terms, the broad monetary base grew by 10.6%. In November, the Russian banking sector's liquidity situation notably improved. After suffering a significant decline in October, the excess reserves of commercial banks began to grow once again (+17.5%). The Bank of Russia continued its policy of providing funds to the banking sector. The benchmark interest rate of overnight ruble loans at the interbank credit market also continued to grow, eventually reaching 6.5%.

At the end of 2012, the Russian personal savings rate considerably increased. However, neither this rise in bank deposits nor the ongoing active assistance rendered by the State to the banking sector could prevent a slowdown in the growth of loans provided to the population and corporate borrowers. In the final months of 2012, in spite of the fact that Russia's monetary authorities remained the principal creditor of credit institutions, the banking sector continued to be the main channel of capital flight from the Russian Federation.

The Real Sector of the Economy: A General Slowdown

In November 2012, the volume of investment in fixed assets and the volume of construction work increased, on November 2011, by 1.1% and 0.3% respectively. Bearing in mind that the level of investment activity was rather low in October and November 2012, it was expected that in Q4 2012 the rise in the investment volume would amount to 103.7% by comparison with Q4 2011. As a result, the RF Ministry of Economic Development forecasted that in 2012 the annual growth rate of investment in fixed assets would amount to about to 107.8%, vs. 108.3% in 2011. The unstable dynamics and lack of any qualitative changes displayed by the investment activity in 2012 also influenced the forecasts for 2013. According to the data update released by the RF Ministry of Economic Development, it is expected that 2013 will see the growth rate of investment dropping to 106.5%, which is by 0.7 percentage point lower than the corresponding estimated figure included in the federal budget for 2013.

The lackluster performance of the residential construction industry notably aggravated the situation in the housing market. Thus, the housing availability index rose by 9%, while the average growth rate of housing prices notably exceeded the growth rate of population incomes. In 2012, the decline in the average weighted interest rate on the housing mortgage loans in rubles issued since the year's beginning, recorded over the course of 2010 and 2011, was replaced by growth. Thus, the average weighted interest rate on the housing mortgage loans in rubles issued over the course of a month rose from 11.4% as of 1 December 2011 to 12.4% as of 1 November 2012.

In November 2012, the growth rate of retail trade turnover rose by 4.4% on November 2012 (while in November 2011 it rose by 9.1% on November 2010); over the course of the first 11 months of 2012, the growth rate increased by 6.0% on the corresponding period of 2011 (by 6.8% one year earlier). In the second half of 2012, a decline in the rates of growth was also registered in the commodity market and the services sector. It was caused, most likely, by the decrease in the growth rates of real wages and real disposable incomes by comparison with the end of 2011 and the beginning of 2012.

The fact that wage growth outpaces labor productivity growth by 5.4 percentage points (according to preliminary estimates for 2012) results in a rise in production costs and in the general worsening of the financial and economic indicators of enterprises. In the first half of 2012, the share of gross profit in GDP was by 1.7 percentage points lower than in the corresponding period of 2011. As regards Russia's economy as a whole, the profit margin from the goods sold from January through September 2012 amounted to 10.0% (vs. 11.2% in the corresponding period of 2011), including to 32.6% in the extraction industry (vs. 36.4% in 2011) and to 11.9% in the manufacturing industry (vs. 13.4% in 2011).

In the period from January through November 2012, the industrial production index amounted to 102.7% (vs. 105.0% in the corresponding period of 2011), including in the extraction of mineral resources – to 101.2% (vs. 101.9% in 2011), and in the manufacturing industry – to 104.4% (vs. 106.8% in 2011). At the same time, in November 2012 the volume of mineral resource extraction and the volume of manufacturing output declined by 2.2% and 0.3% respectively on November 2011. A considerable role in the decline of the growth rate of the Russian economy was played by the poor performance of the agro-industrial complex (in November 2012, Russian agricultural output amounted to 92.6% of November 2011's output) and a slow-down in the machine-building complex (107.5% vs. 114.5% in November 2011). In 2012, the share of domestically-produced goods in the structure of retail-trade commodity resources notably dwindled – thus, unlike in 2011, the share of food imports in retail-trade resources significantly increased.

The negative trends reflected by official statistics are confirmed by the results of recent market studies. In the final months of 2012, the IEP Industrial Optimism Index continued to decline due to a weak demand for industrial products. In November, the key indicators of demand dropped to their three-year lows registered in July 2012 (-17 points). It should be noted that enterprises did not expect that the situation would improve in the nearest future. The Sales Satisfaction Index dropped by 18 points to its 32-month low: 54% of enterprises considered the volume of sales to be 'below the norm', and 45% of them considered it to be 'within the norm' (while only one month earlier the situation was exactly the reverse).

However, enterprises did not reduce their output: for several months in a row, the corresponding index hovered around zero. As a result, in November the percentage of enterprises where changes in output outpaced changes in demand rose to 31%. Thus, the afore-mentioned stagnation in demand increased the risk of output collapse, when enterprises would be forced to adjust their output to match demand. The correspondence between production plans and demand forecasts rose to 80% in November 2012. It should be noted that in November 2008 this index climbed to 83%, and reached 88% in December 2008.

In order to balance demand and output, enterprises also resorted to cutting prices: over the course of one month, the balance dropped to -13 points, to its four-year (2009-2012) low. It was the sharpest drop in disbursing prices since December 2008, which had been the time of the apogee of the current crisis. Production plans indicated that enterprises were ready to continue to use prices as an instrument of sales intensification. It should be noted that, in November 2012, industry managed to slow the decline in the number of workers, which had already dropped to a critical level.

The investment plans of enterprises continued to lose optimism: in November they dropped by another 4 points, while over the course of the past two months they dwindled by 8 points. Investment plans remained positive only in the fuel sector, non-ferrous metallurgy and the timber-industrial complex. In all the other sectors, quarter balances shifted into the negative zone within the range from -3 points in machine building to -17 points in light industry. At the same time, according to enterprises, November saw no principal changes in the terms of loans issued to industrial enterprises: aggregate credit availability (‘above the norm’ + ‘within the norm’) amounted to 69%, which corresponded to the average aggregate credit availability registered in the second half of 2012.

S. Zhavoronkov

The Political and Economic Results of December 2012

In December 2012, the so-called ‘Magnitsky Law’ came into force in the United States. This law empowers and obliges the U.S. President to compose the list of persons responsible for the death of the Hermitage Capital Management investment fund’s counselor Sergey Magnitsky and persons violating human rights in Russia. The persons on that list will be barred from entry into the United States, and their assets in U.S. banks will be frozen. Although none of the influential Russian officials has been placed on this list so far, and any ‘symmetric’ counter-measures would evidently be futile, the Russian authorities have announced their intention to ban the adoption of Russian children by U.S. citizens, and the Russian parliament has passed the corresponding law. This response to the ‘Magnitsky Law’ is likely to further increase tensions in the relations between Russia and the United States. However, it cannot be ruled out that Vladimir Putin will refrain from signing this law because of its incompatibility with Russia’s international obligations, as he has already hinted in the course of a recent press conference. In December, Vladimir Putin announced that single-member electoral districts would be restored, and that 50% of seats in the State Duma would be allocated to their representatives. In the past, single-member districts were considered by the Russian authorities as a dangerous means for undesired politicians to enter Parliament. Nowadays the Kremlin is more interested in the prospect that United Russia, the ruling party, should gain an absolute majority in the State Duma, which becomes rather problematic because of its failure to win even 50% of the vote, and in some districts – even one-third of the vote, in elections under the current election system exclusively based on party lists. Vladimir Putin also announced that Russian officials will retain the right to own real estate abroad, although some unspecified restrictions will be introduced on their right to own foreign bank accounts and shares. This is a clear indication of the fact that the interests of his entourage are more important to Vladimir Putin than any gain in electoral votes that the introduction of such restrictions might bring him.

From Russia’s point of view, the most eye-catching events of December 2012 were the adoption of the long-expected but still highly contentious ‘Magnitsky Law’ in the USA and the attempts of the Russian authorities to somehow respond to it. A few words about the pre-history of these developments: lawyer Sergey Magnitsky who worked as a counsel for the Russian investment fund *Hermitage Capital Management*, once known as one of the biggest operators on the Russian share market, died in a pretrial detention facility after a gang of crooks had defrauded the Russian treasury of Rb 5.4bn in the form of fictitious VAT refunds by using the seals and documents seized by law enforcement officers in the course of a criminal investigation. It should be said that even major exporters usually have to spend years in litigating against the Tax Inspectorate for their VAT refunds. Surprisingly, in the ‘Magnitsky Affair’ the Tax Inspectorate had satisfied the claim for such exorbitant VAT refunds in the course of only one day, and then the law enforcement officers and tax inspectorate officials involved in this case began to purchase prestigious foreign real estate. The scandalous case was further aggravated by the fact that the then head of the Investigative Committee of the RF Ministry of Internal Affairs, Aleksey Anichin, and Deputy Prosecutor General Viktor Grin had taken part in the initiation of the investigation, while the officials who had approved the release of money to the crooks were, in fact, a number of ladies from the entourage of former head of the RF Tax Service and then

Minister of Defense Anatoly Serdiukov. So far, the position of the Russian authorities with regard to that case has been ambiguous: on the one hand, they seem to reluctantly acknowledge that the money was stolen and that Magnitsky did not get proper medical care, which led to his death; while on the other hand, they have found nobody - not even a single scapegoat – that they may put the blame on for these crimes. In due course, Aleksey Anichin was removed from office without any fuss, one of the investigators was put in jail for extortion in another case, while the rest of the ‘team’ provided evidence of their ‘total innocence’ and retained their jobs. The first attempts at imposing U.S. sanctions against the persons involved in the ‘Magnitsky affair’ and against human rights violators in Russia were made three years ago. For a long time, these attempts were blocked by the Obama administration who did not want to spoil their relations with the Russian authorities. However, later on, bearing in mind the looming U.S. presidential election, U.S. lawmakers - Democrats and Republicans alike – came to the conclusion that such a law should finally be adopted. Having haggled long and hard, President Obama managed to force an important concession from the Congress to the effect that the ‘Magnitsky List’ (the list of Russian officials who are going to be barred from entry into the United States and to have their assets in the USA frozen) should be personally composed by the U.S. President, while the opinion of the Congressmen will be recommendatory only. So far, the ‘Magnitsky List’ has not been published; at first, it even seemed that there was a good chance (for the Russian authorities) that the list would be limited to only the second-rate persons directly involved in the ‘Magnitsky affair’ ...

It is clear that the Russian authorities are simply unable to generate a ‘symmetric response’ to this US law. Of course, they can impose a ban on entry into Russia of any American politicians disliked by the Kremlin, or to deprive them of the right to own Russian assets. However, any such bans would be totally futile, because American politicians are not eager to live in Russia or to carry on any business activities therein. Therefore, the Russian authorities have invented a different law, which imposes sanctions against persons involved in violation of the rights of the Russian children adopted in the USA. They have also banned the adoption of Russian children by US citizens, and have also adopted yet another restrictive law which forbids the receipt of funding from any foreign sources for the purpose of conducting political activities in Russia. It should be noted, however, that although the Russian authorities have always tended to characterize as political any activities carried out by non-governmental organizations, none of the NGOs has so far been closed – in spite of numerous threats to do so. *United Russia* named the anti-US adoption law after Dima Yakovlev, the two-year-old boy who had died in 2008 after his American adoptive father left him locked for hours in a sweltering car. The US judge, after considering this tragic case, had ruled that Dima Yakovlev’s death was an accident and had acquitted his adoptive father. Although the law was voted for by the heads of all four State Duma factions, some members of three of those factions (*United Russia*, the CPRF, and *Fair Russia*) abstained from voting. The decision of the Russian parliament caused a wave of indignation across the world, focused on the adoption ban. Among other things, these international protests were fueled by the fact that Russia has more than half a million of abandoned children, who are in fact orphans, although most of them have parents; while foreigners, even before the adoption of the new law, were permitted to adopt only sick children, whose chances to find adoptive parents in Russia were very slim. And finally, in Russia the number of accidents involving orphans is many times higher than in more developed countries.

If the Russian authorities had been resolved to further retaliate for the ‘Magnitsky List’, they could have undoubtedly resort to numerous other measures that would have been really harmful to US interests – from putting an end to NATO’s cargo transit to Afghanistan to the withdrawal of government assets from US treasury bonds to the imposition of various restrictions on US exports to Russia (in a manner favored by Russia’s chief sanitary inspector Gennady Onishchenko), which would have looked quite understandable to both Americans and Russians. They did not do so. Nevertheless, the recent decision of the RF State Duma immediately escalated tensions in US-Russia relations. Thus, a petition demanding that the Russian lawmakers who had supported the retaliatory Russian law be added to the ‘Magnitsky List’ appeared on the White House website and in the course of a few days collected many thousands of signatures. It should be noted that the petition targeted a number of prominent Russian businessmen and persons from Vladimir Putin’s entourage. However, it is far from certain that the law will actually be signed by Putin in its present version – in his December press conference he approved of the bill in principle, but refrained from giving any definite answer to the direct question of whether or not he would sign it. Instead, he referred to the necessity to analyze the bill in order to make sure that it complied with Russia’s international obligations (the draft law is clearly dubious from the point of view of the UN Convention on the Rights of the Child and the Russia – United States Bilateral Adoption Agreement, which is valid over one year beginning from the date of its annulment by one of the parties).

The second most important event of the month was the traditional New Year’s Eve press conference of Vladimir Putin and the annual Presidential Address to the RF Federal Assembly. The press conference lasted four hours. One of its undeclared aims was to refute the rumors of Putin’s serious illness, fueled by his having stopped travelling for 8 weeks in October and November. The highlights of the press conference were as follows. Vladimir Putin announced that he was satisfied with the work of the RF Government, thus making it clear that the cabinet would not be sacked - at least for the time being. As regards the fate of former Minister of Defense Anatoly Serdiukov who had been accused of corruption in Russian media reports, Putin said that it was better to ‘wait and see how the court decides’ (however, Serdiukov has not been declared a suspect as yet, and for now criminal proceedings are expected to be initiated only against several of his subordinates). President Putin was evasive when asked about Magnitsky, Khodorkovsky and the detained suspects in the Bolotnaya case (the May 6 riots in Moscow). On the other hand, he referred - although not directly but in the form of a lengthy discourse - to the possibility of canceling gubernatorial elections in a number of subjects of the Russian Federation. On the whole, the style of the press conference was rather surprising – the journalists put to the President a lot of poignant and unpleasant questions (concerning the political situation in Russia, corruption, the administration of justice, and the strange reply to the US ‘Magnitsky Law’, etc.), while Putin, as usually, skillfully parried them, but did not say anything new.

Vladimir Putin’s annual Presidential Address to the RF Federal Assembly was much more informative. It was announced that several legislative initiatives were to be launched in the nearest future. As regards the field of politics, Putin declared that Russia should return to the pre-2004 system of elections to the State Duma, whereby 50% of Duma members were elected in single-member districts. Also, Putin proposed to ‘think about’ restoring the electoral blocs’ right to participate in elections, although he refrained from promising anything more definite with regard to that issue. Given current conditions, the former initiative is clearly advantageous for

United Russia – for example, if the 2011 elections had been held under an electoral system whereby 50% of the legislative seats were allocated to single-member districts, the Opposition would have been able to win only in 5 or 6 districts out of 225 (in St. Petersburg, Maritime Krai, Yaroslavl Oblast and Sverdlovsk Oblast) and, in absence of any fraud, in several other districts in Moscow and Moscow Oblast. In a situation characterized by the existence of multiple political parties vigorously competing with one other, United Russia will have a clear advantage from the very start. In 2004, the authorities had had a very different aim – to purge the political arena of any non-systemic players who could have won in some places due to their personal popularity (e.g. Vladimir Ryzhkov in Altai Krai, or Yevgeny Roizman in Sverdlovsk Oblast). At present, the authorities believe it to be more important for them to secure a stable majority for *United Russia*, which has become much less confident of the outcome of any party-list electoral contest among political parties – because people have begun to vote for anybody but *United Russia*'s nominees. This fact makes it necessary for *United Russia* to take into account the interests of its coalition partners – the CPRF or the LDPR, while the few disloyal ‘lone wolves’ are now considered as a lesser evil. Unlike this initiative, the idea of restoring the electoral blocs’ right to participate in elections, clearly advantageous for the Opposition, is likely to remain on paper.

The second important issue touched upon in the annual Presidential Address was the ‘national question’. Apparently having forgotten that only four years previously he had called himself and Dmitry Medvedev ‘*nationalists in a good sense of the word*’, Putin now severely criticized nationalism. At the same time, Putin made an attempt at treading lightly on that issue – thus, having said that Russia should combat illegal migration, that no later than 2015 entry into Russia should only be made possible for those CIS citizens who hold international passports, and that ‘*we would not allow the emergence of closed ethnic enclaves in Russia with their informal jurisdiction, existing outside the country’s common legal and cultural norms, and disdainfully disregarding the accepted standards, laws and regulations*’, he did not mention the most important thing – that the procedure for acquiring Russian citizenship must be considerably simplified. In this connection, it should not be forgotten that, as early as November 2012, several members of the RF Federation Council introduced into the State Duma an outrageous draft law whereby Russian citizenship should be granted to all citizens of the USSR and the Russian Empire and their direct descendants, irrespective of whether or not they are proficient in the Russian language. Having encountered public outcry and, apparently, some strong opposition in Russia’s corridors of power (for example, Viktor Ivanov, the influential head of the Federal Drug Control Service (*Gosnarkokontrol*), has always been an outspoken proponent of tightening Russia’s migration regime), the draft law was stopped in its tracks. Its authors put a brave face on a sorry business and exculpated themselves by saying that their draft was focused exclusively on the indigenous ethnic groups populating the Russian Federation’s constituent republics, such as the Tatars or the Mordvins, and not to the tens of millions of Uzbeks, Tajiks and Kyrgyz. However, judging from the Presidential Address to the RF Federal Assembly, it should be expected that the attempts to rapidly replace the ethnic Russian population by immigrants from Central Asia will continue under the pretext of stimulating Russia’s economic growth. Yet another - and probably even more important - reason for such initiatives is to increase the number of voters for United Russia. It should be noted that the degree of success of these attempts will totally depend on Russian society.

Finally, Vladimir Putin came up with a compromise between the idea of ‘nationalizing’ Russia’s elite and the protests of that elite who do not want to be nationalized because they believe that it is much safer to own assets in countries ruled by law rather than in Russia. Finally, he fleshed out his reasoning as follows: ‘...*the right of civil servants to have bank accounts, securities and shares abroad should be restricted. How can the public have confidence in an official or politician who says high-sounding words about the national good but at the same time tries to take his money and assets out of the country? [...] As for the ownership of foreign real estate, it must be declared in accordance with the law, and the official must submit a report on the cost of the property, and the origin of the funds used to purchase it.*’ Thus, it is clear that officials will certainly be permitted to own real estate abroad (where it is very difficult to hide one’s immovable property), while their ownership of bank accounts and shares will be somehow ‘restricted’. Despite the active PR campaign in favor of depriving Russia’s officials of the right to own foreign assets and the huge popular support for this idea, such an outcome of this ‘anti-corruption crusade’ indicates that Vladimir Putin continues to seriously take into account the interests of his entourage, while this entourage will continue to depend on foreign jurisdictions.

N. Luksha

Inflation and Monetary Policy

Significant slowdown in the growth rate in prices for non-food goods and maintained prices for commercial services at the level of the preceding month resulted in the fact, that the baseline inflation slowed down from 0.5 % per month in October to 0.3% in November (against 0.4% in November 2011). In December, due to the growth of consumer activity at the background of the New Year Eve, growth rate of consumer prices increased: consumer price index as of 17 days of the month made 0.3%, having matched the indicator of the same period of preceding year. As a result, the cumulative inflation since the beginning of the year amounted to 6.3% as of December 17 (compared to 6% in 2011). Herewith, from December 11, 2012 the Bank of Russia has again increased the interest rate on the RF CB ruble deposits on fixed terms by 0.25 p.p. up to 4.5% and decreased the rate of the RF Central Bank ruble transactions “currency swap” by the same amount to 6.25%.

In November, there was a slowdown in prices growth: as of the month results, the consumer price index amounted to 0.3%, which is lower than in November last year (+0.4%). This resulted in a significant reduction in the rate of price growth for non-food products, as well as for commercial services.

The growth rate for industrial goods has decreased almost by half - from 0.7% in October to 0.4%, mainly due to a significant reduction in gasoline price growth (+0.5% versus +2.4% in the previous month). Moreover, the growth rate of prices has declined for a variety of non-food goods – by 1.5 times for tobacco (+0.8%), twice - for fabrics and medicines (+0.3%) and construction materials (+0.1%). Like in previous months, audio visual goods became cheaper (-0.2%).

In November, prices and tariffs for commercial services did not grow (as compared with growth by 0.1% in October). It was due to the significant decline in prices for passenger transport (-1.7%), as well as to slowing growth rate for housing utilities by half (0.2%). As in the previous month, there was continued a decline in healthcare and recreational services (-0.7%) and foreign tourism (-0.5%). Growth rate of education services also decreased (+0.1% versus +0.6% in October). The most significant growth in prices was noted in November in the services of cultural organizations (+1.3%).

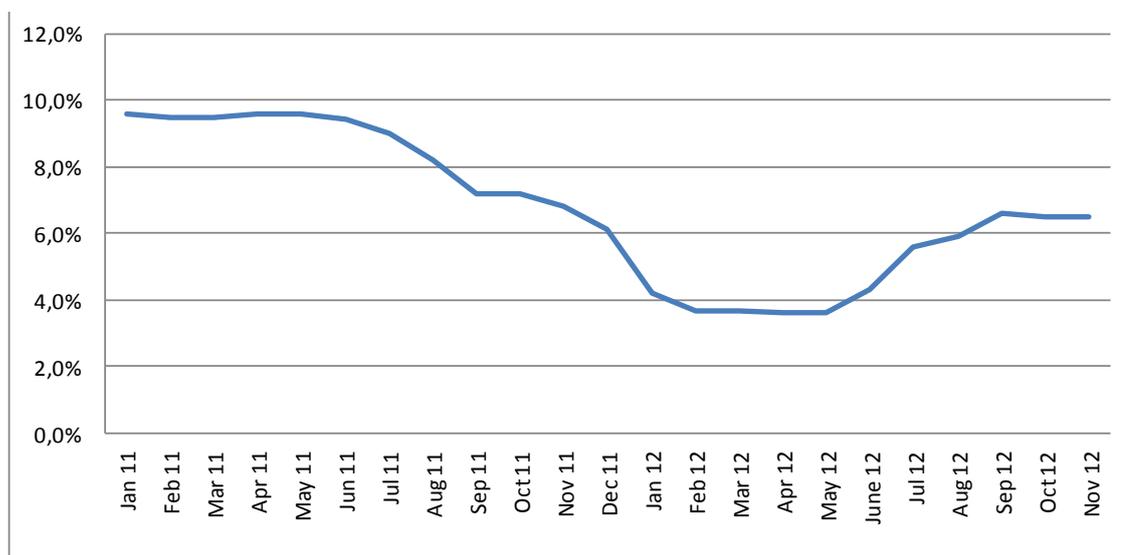
Like in October, prices for foodstuffs in November rose by 0.5%. Dynamics of prices for most of food products in November was similar to October indicators. There was continued a decrease in prices for sugar (-1.6%) and fruit and vegetable products (-1.3%). The utmost growth in prices, like in October, was observed for sunflower oil (+2.5%) and eggs (+3.7%).

In November, the inflation in annual terms (November 2012 against November 2011) remained unchanged as compared with October and amounted to 6.5% (see *Fig. 1*). For comparison, as of the same date of 2012 the inflation made 6.8%. In November, the core consumer price index¹ continued to decline (+0.5% against +0.6% in October). Annual core

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

inflation in November against November also remains at the same level within the second consecutive month and makes 5.8% against 6.9% in 2011.

In December, inflation was coherently accelerated: as of 17 days it amounted to 0.3%. As a result, cumulative inflation since the beginning of the year reached 6.3%, which is by 0.3 p.p. more than in the last year. Thus, it can be already noted, that the annual rate of price growth will exceed the 2011 inflation.



Source: RF Statistical Service.

Fig. 1. The Growth Rate of the CPI in 2011-2012 (% year to year)

After three months of reducing, the monetary base in broad definition in November rose to Rb 8,257bn (+2.6%). All components of the monetary base were growing. The utmost growth was demonstrated by banks' correspondent accounts with the RF Central Bank and banks' deposits with the Central Bank, which rose, accordingly, by 14.8% to Rb 827.4bn and by 36.5% to Rb 138.3bn. In annual terms, the monetary base in broad definition rose by 10.6%.

In November liquidity situation in the banking sector has improved. The October decline of the excessive reserves of commercial banks² in November was replaced with their growth. As of the month results, they increased by 17.5% to Rb 965.7bn. The Bank of Russia in November continued to fund the banking sector. High demand for REPO auctions was sustained. The scope of provided liquidity increased significantly: the limit of the one day REPO has grown by December 20-s to Rb 600-760 bn. Amounts of overdue loans of credit institutions rose to almost Rb 2 trillion (see Fig. 2). Indicative rate on ruble loans for 1 day in the interbank market in December also continued to grow up to 6.5%. The situation with bank liquidity should improve by the end of December, when the traditional increase in budget spending is expected. However, most likely in early 2013 the increase in the refinancing of the banking system will continue.

² Under the excessive reserves of commercial banks with the RF Central Bank is understood the sum of correspondent accounts of commercial banks, their deposits with the RF CB and the RF CB bonds of commercial banks.

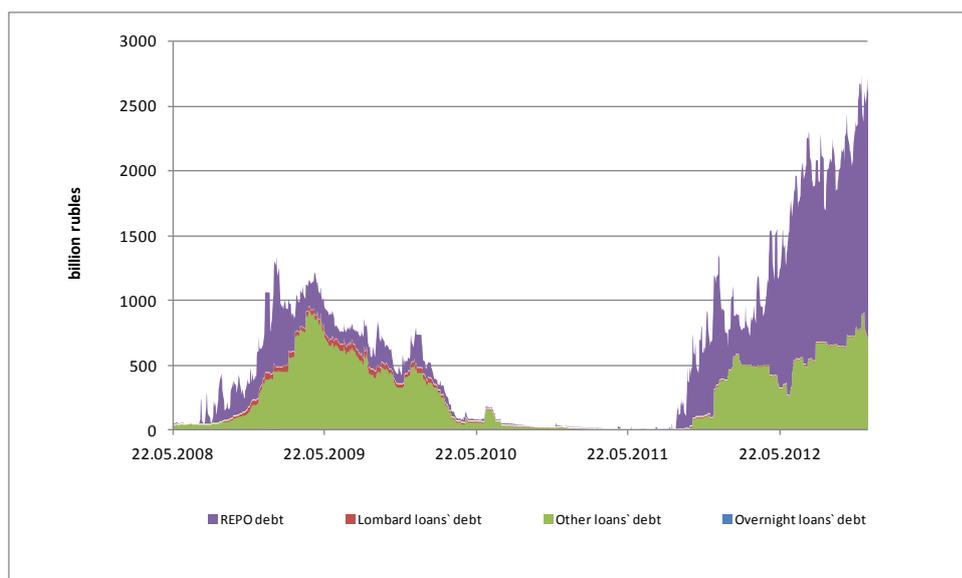


Fig.2. Arrears of commercial banks with the Bank of Russia in 2008–2012

In November, monetary base in narrow definition (cash plus mandatory reserves) has increased: over the month it rose by 0.9% to Rb 7.2913 trillion (see Fig. 3).

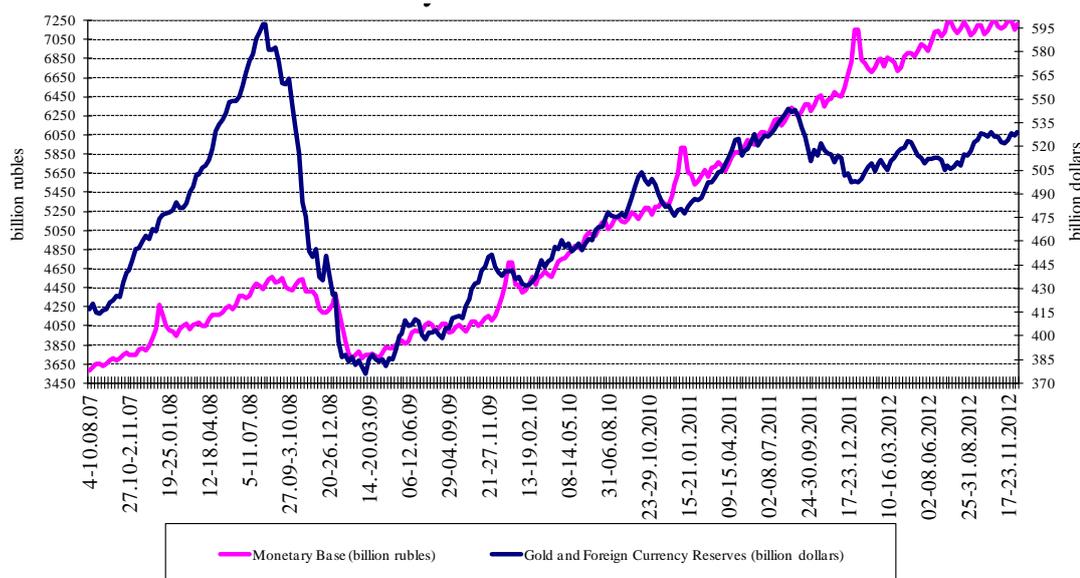
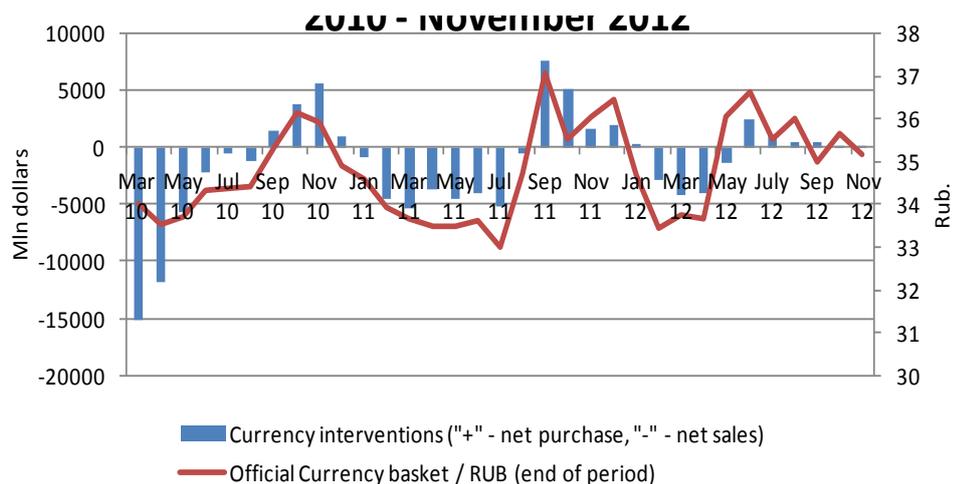


Fig. 3. Changes in the Monetary Base in the Gold and Foreign Currency Reserves in 2007-2012

In November the net sales of foreign currency of the RF CB was low and amounted to \$55m (see Fig. 4). Within the first three weeks of December the Bank of Russia was not involved in currency trading.

In November the volume of international reserves remained virtually unchanged, amounting to \$528.2bn by December 1 (+0.3% vs. November 1). Since the beginning of the year to mid-December the international reserves increased by 6%, or by \$30.2m.

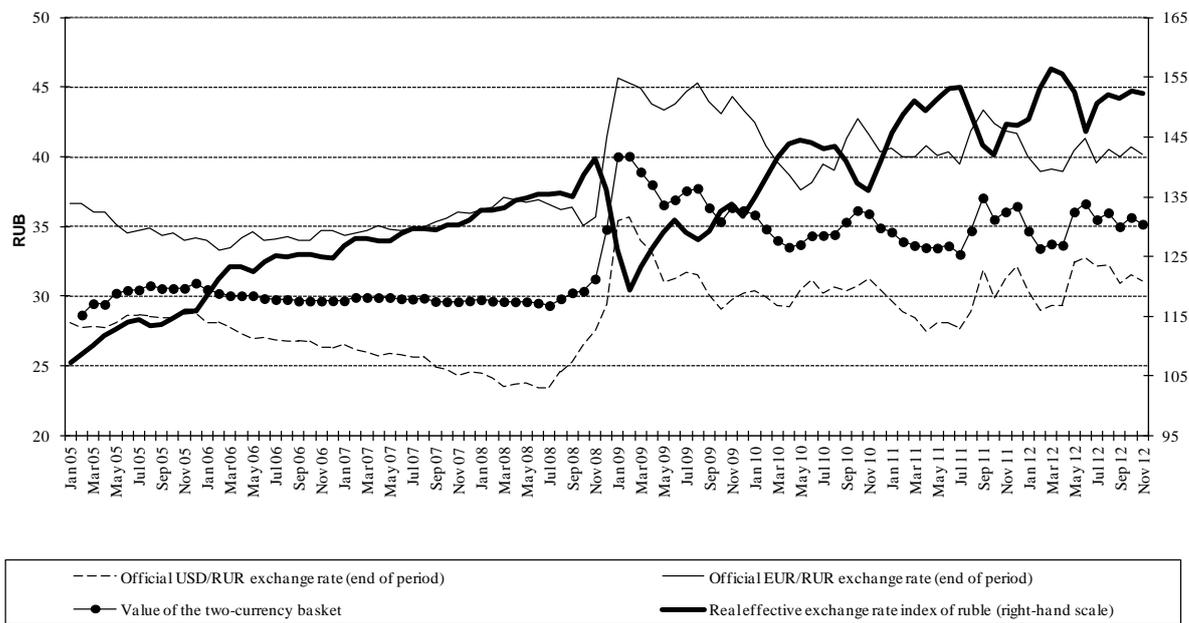


Source: RF Central Bank, author's estimates.

Fig. 4. Central Bank currency Interventions and Dynamics of Ruble Exchange Rate in March 2010 – October 2012

According to tentative estimates of the RF Central Bank, the net outflow of private capital from Russia in January-November of this year reached \$59bn. In December due to the upcoming payments on external debt by banks and companies, the outflow is likely to increase.

After October strengthening, the real effective exchange rate of ruble declined again in November (-0.3%) (See Fig. 5). Since the beginning of the year, the real effective ruble exchange rate rose by 3.8%. In nominal terms, the ruble exchange rate against major currencies in November remained virtually unchanged



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

Source: RF Central Bank, author's estimates.

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

On December 10 the Bank of Russia announced, that it upheld the refinancing rate and interest rates on most of the basic operations of the Bank of Russia. At the same time, since December 11, the operating standards for "currency swap" have been changed: the interest rate

of the ruble amount was reduced from 6.75% per annum to 6.5%. In addition, from December 11 the RF Central Bank has increased interest rate on deposits of the Bank of Russia on fixed terms by 0.25 p.p., now it will make 4.5% per annum.

In our view, changes in the interest rates made by Central Bank are aimed primarily at improving the efficiency of its interest rate policy by narrowing the interest rate corridor, through which the Bank of Russia influences the financial markets. Recall that in the periods of excessive liquidity an important role in determining the interest rates in the interbank market were playing the rates on deposit operations of the RF Central Bank, and in the periods of liquidity shortage – the rates of the RF Central Bank on liquidity provided to the banks (including "currency swap" operations). Gradual reduction of the spread between interest rates on liquidity provision and absorption allows the Bank of Russia to manage market interest rates more effectively.

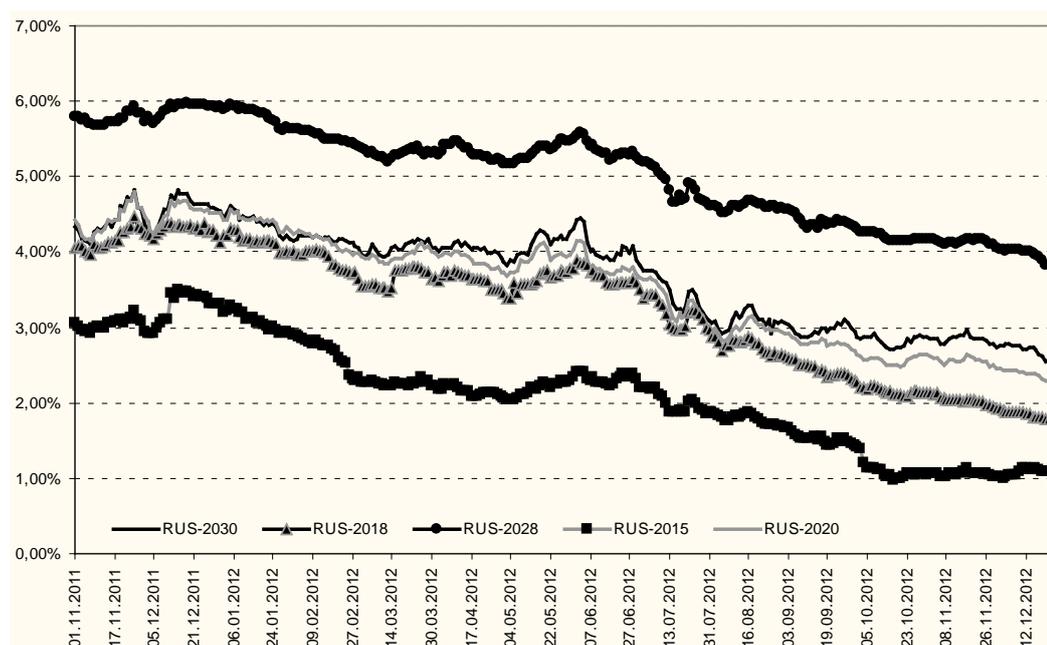
N. Burkova, E. Khudko

Financial Markets

In December 2012, the Russian financial markets demonstrated a similar trend to the previous months, characterized by significant volatility. An average monthly trading volume of the Russian Federation for the period increased by 4%, while the market for government securities and futures decreased by 2% and 4%, respectively. Positive trend in the domestic corporate bond market was reflected by the key market indicators: market volume and index, as well as by the activity of issuers and investors in the primary and secondary markets. During the month, a number of long-term mortgage bond issues were offered in the market.

Government securities market

In December the stagnation of global financial markets was continued in the absence of any significant domestic and external developments which could provide an effect in the market: the yield to maturity of government securities continued to decline (by 8-12%), despite the decreased investors' activity in this sector. Growth of 1.4% showed only Eurobonds RUS-15, one of the shortest securities in the market (See Fig. 1).



Source: Finmarket Information Agency data

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

Within the period from November 26 to December 23, 2012, the total turnover in the secondary market of government bonds amounted to Rb 60bn with an average daily turnover at the level of Rb 3bn, which means the decline of the average monthly turnover by 1.7% as compared with the preceding period.

From November 26 to December 23 there were held six auctions (vs. four auctions a month earlier) in federal loan bonds (OFZ) placement in the primary market (See Table 1). The total actual amount of placement made 74% of the planned volume (against 84% in the

preceding month). There were no auctions on additional OFZ issues placement in the secondary market.

Table 1

OFZ placements in the primary market

Auction date	Emission	Emission volume, RB m	Emission volume at face value, RB m	Average weighted yield
28.11.2012	ОФЗ-25080-ПД	15 000.00	13 499.00	6.80
05.12.2012	ОФЗ-26207-ПД	25 000.00	9 091.00	6.99
12.12.2012	ОФЗ-25080-ПД	19 989.00	19 989.00	6.48
12.12.2012	ОФЗ-26209-ПД	30 000.00	30 000.00	6.81
19.12.2012	ОФЗ-26207-ПД	16 479.65	6 564.00	7.03
19.12.2012	ОФЗ-26210-ПД	30 000.00	21 439.00	6.61
Total:		136 468.65	100 582.00	

Source: Russian Ministry of Finance.

Stock market

Factors of the Russian stock market dynamics

The growth of the Russian stock market in December was affected by the information on increased U.S. GDP over QIII 2012 by 2.7% in annual terms, the decision of Germany on new measures to support Greece, sustained key interest rates by the European Central Bank and the Bank of England. Herewith, factors hindering the growth of the Russian market were the reduced long-term credit rating of the Eurozone Stabilization Fund from "AAA" to "Aa1" with "negative" outlook by Moody's international agency, the revision of the Bundesbank its June forecast of German GDP growth in 2013 from 1.6% to 0.4%, declined OECD forecast growth in the Russian economy for 2012 (from 4.5 to 3.4%) and for 2013 (from 4.1 to 3.8%).

Since the beginning of the year the global market has increased by 1-39%, except for the Chinese and Chile markets, whose basic stock indices Shanghai Composite and IPSA have declined by 8 and 1% accordingly (see *Table 2* and *Fig.2*).

Table 2

DYNAMICS OF THE GLOBAL STOCK INDICES

Index	Value (as of 23.12.2012)	Dynamics within the month (%)*	Dynamics from the year beginning (%)
MICEX (Russia)	1 477.44	4.55	0.78
RTS (Russia)	1 512.18	5.58	3.65
Dow Jones Industrial Average (USA)	13 190.84	1.39	6.48
NASDAQ Composite (USA)	3 021.01	1.83	13.88
S&P 500 (USA)	1 430.15	1.49	12.05
FTSE 100 (UK)	5 939.99	2.08	4.43
DAX-30 (Germany)	7 636.23	4.48	23.92
CAC-40 (France)	3 661.40	3.76	11.68
Swiss Market (Switzerland)	6 889.54	2.60	13.12
Nikkei-225 (Japan)	9 940.06	6.12	10.78
Bovespa (Brazil)	61 007.03	5.96	1.44
IPC (Mexico)	43 621.62	4.06	13.06
IPSA (Chile)	4 293.78	3.63	-0.82
Straits Times (Singapore)	3 163.56	5.83	12.96
Seoul Composite (South Korea)	1 980.42	3.61	4.69
ISE National-100 (Turkey)	76 684.74	8.00	38.50
BSE 30 (India)	19 242.00	3.97	19.75
Shanghai Composite (China)	2 153.31	6.21	-7.82
Morgan Stanley Emerging&Frontier Markets Index	823.37	4.68	8.47

* – versus index values as of November 25, 2012.

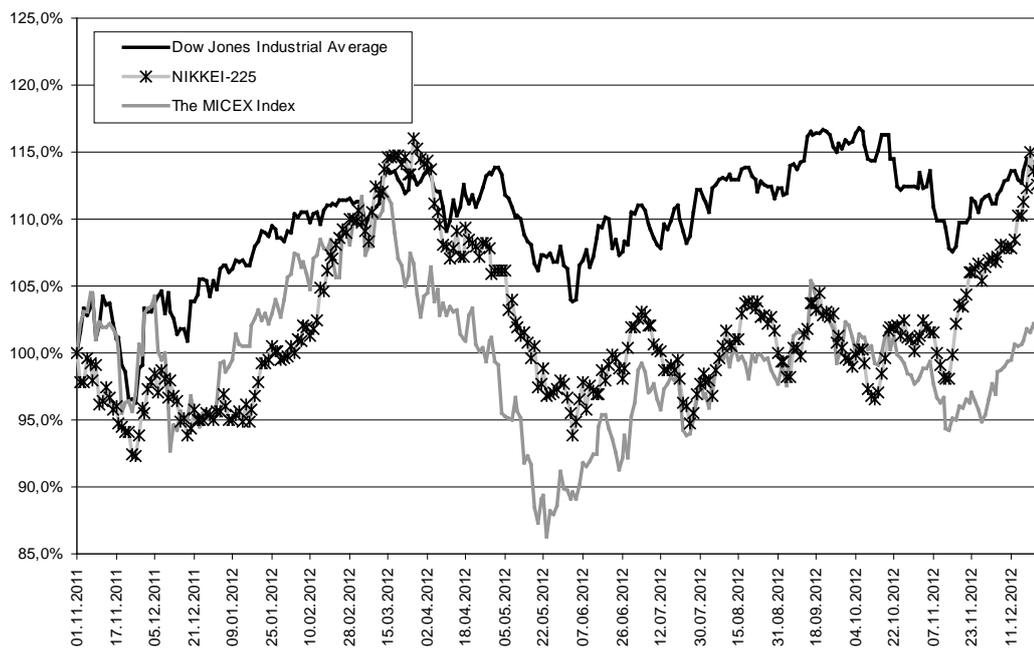
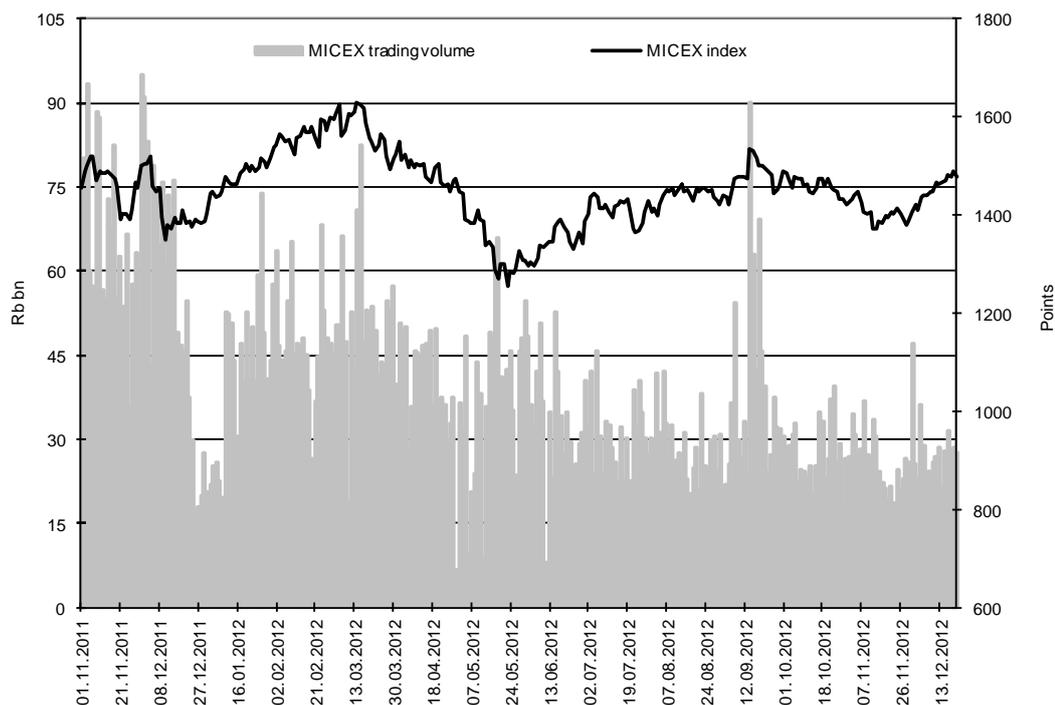


Fig. 2. Dynamics of the main USA, Japanese and Russian stock indices (in % to the date 01.11.2011)

Stock market situation development

Within the month, the maximum value of the MICEX index was demonstrated on December 20, having reached 1,488.2 p. (versus 1,446.5 p. in the preceding month). The minimum value of the MICEX index at 1,411.8 p. has been reached on December 4 (against 1,372.2 p. in the preceding month) (See Fig. 3).

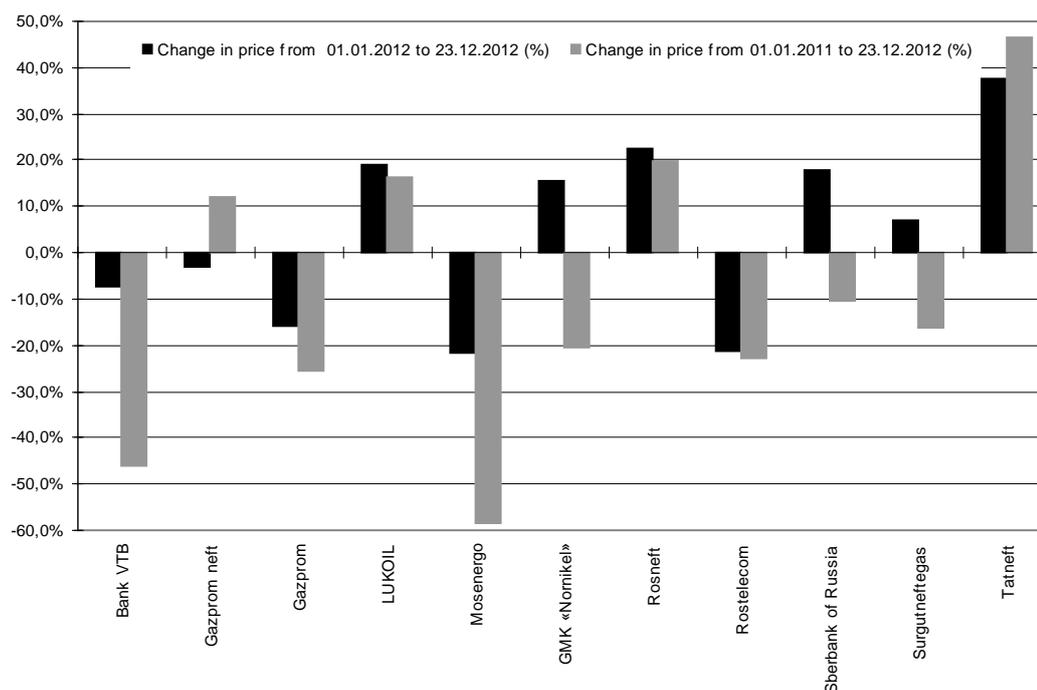


Source: OAO MICEX

Fig. 3. Dynamics of MICEX Index and trading volume

Overall, in the period from November 26 to December 23, 2012, the MICEX index has increased by 4.6% (from December 24, 2011 to December 23, 2012, the MICEX index has increased by 7.4%), and the turnover of auctions included in the MICEX index reached Rb 507.4bn. Average daily activity of investors in the stock market in December has decreased by 3.7% as compared with the previous month.

Since the beginning of the year through December 23, 2012 the leaders in the value growth among the “blue chips” were securities of Tatneft, which value has increased by 37.6, while the leaders of decline, like a month earlier, were Mosenergo securities, downgraded by 21.8% (See Fig. 4).



Source: OAO MICEX

Fig. 4. Dynamics of the Russian Blue Chips

According to the OAO MICEX, on December 23 of this year, five leaders of the domestic market in terms of capitalization were as follows: Gazprom – Rb 3,394bn (against Rb 3,354bn on November 25, 2012), Rosneft – Rb 2,766bn (against Rb 2,556bn), Sberbank of Russia – Rb 2,019bn (against Rb 1,916bn), LUKOIL – Rb 1722bn (against Rb 1,604bn) and GMC Nornikel – Rb 1,085bn (against Rb 893bn).

Futures and Options Market

In FORTS market, the average daily activity of investors from November 26 to December 23, 2012 has decreased by 4% as compared with the previous month. Herewith, the leaders in terms of trading in futures were contracts for the RTS index, followed with a significant lag by the contracts for Rb/\$ rate, for Euro/\$ rate, for the securities of Sberbank of Russia and Brent crude. Prices of the recent transactions, concluded for futures contracts for Rb/\$ rate with the date of execution on March 15, 2013 were mostly within the range of Rb/\$ 31.1.-31.7, i.e., ruble weakening (by 1.2-3.2%) is expected by market participants as compared with the indicator of December 23, 2012 (to Rb/\$ 30.72), and with the date of execution on June 15, 2013 - within the range of Rb/\$ 31.6–32.1. Prices of recent transactions concluded on futures contracts for Rb/Euro rate with the execution date on March 15, 2013 were mostly in the range of Rb/Euro 40.5–41.4, i.e., a depreciation of the ruble by 0-2.1% is expected as compared with the indicator of December 23, 2012.

The value of the futures contract for RTS index (based on prices of recent transactions) with the execution date on March 15, 2013 was within 1420–1530 p., i.e., market participants expect a 0-6% decline against the indicator of December 23, 2012. By June 15, 2013 market participants expect the RTS index value to be in the range of 1360-1490 points. Prices of recent transactions in futures contracts for the MICEX index with the date of execution on March 15, 2013 were in the range of 1400-1500 points, i.e., market participants in general expect a decline

of MICEX index in the range of 0–5.2%, as compared with December 23, 2012. By June 15, 2013 market participants expect the MICEX index in the range of 1380-1490 p. Options enjoyed a far less demand, from November 26 to December 23, 2012 their trading turnover made about Rb 235.1bn (versus Rb 3495.6bn in futures). The leaders in terms of trading turnover were the marginal options for futures contracts on the RTS index.

Corporate bonds market

In December the volume of domestic corporate bonds market in Russia (at par value of circulating securities denominated in local currency) has grown again by the same value as in previous month and reached the level of Rb 4 040.3bn, which is by 1.5% more than its value at the end of November³. As earlier, the growth of the market capacity is mainly based on an increased number of bond issues (881 issues of corporate bonds were offered in national currency against 865 emissions at the end of the previous month), whereas the number of emitters recorded in the debt sector has increased insignificantly (338 emitters against 333 companies in November). In circulation there remain a number of bonds emissions issued in US dollars and one bonds issue in Japanese yen.

Investment activity in the secondary market of corporate bonds in December has somewhat increased. Thus, from November 26 to December 21, the total volume of transactions in the MICEX amounted to Rb 129.1bn (for comparison, from October 30 to November 23, the trading turnover was equal to Rb 116.3bn), and the number of transactions within the period under review made 27.500 (against 21.800 in the previous period)⁴.

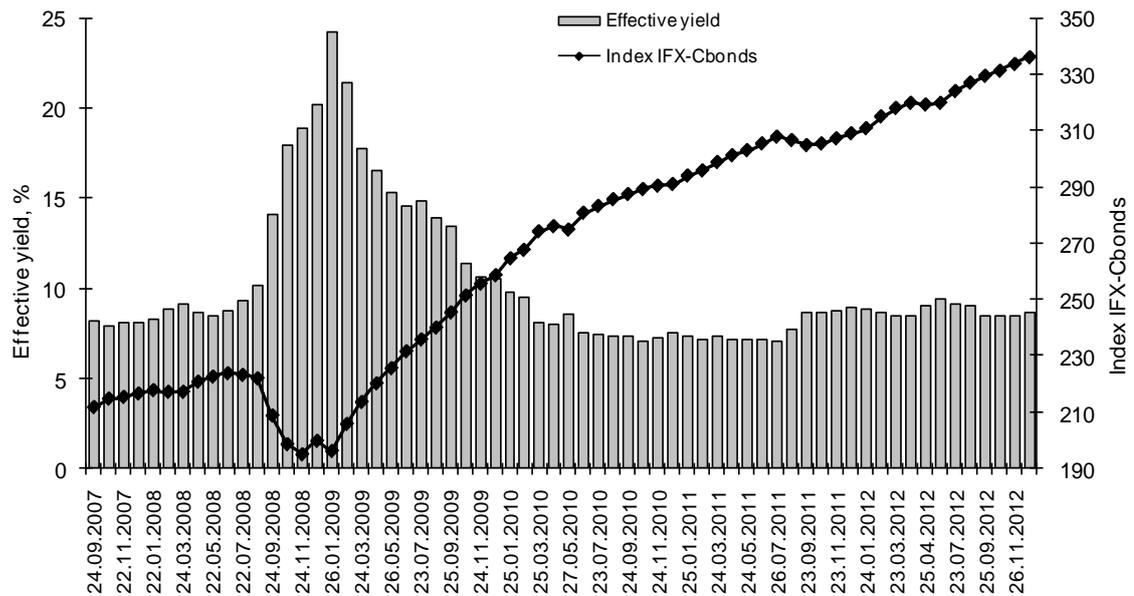
Index of the Russian corporate bond market IFX-Cbonds continued its steady growth trend. By the end of December its value increased by 2.4 points (or 0.7%) as compared with the value of late November. The average weighted yield of corporate bonds after three-month stability has grown from 8.47% in previous month to 8.67% (See *Fig. 5*). Some increase in the yield in the last month of the year is a seasonal factor that has been observed in 2010 and 2011. The market is also affected by negative news background. In addition to the Eurozone problems, the negative impact was provided by a reduced outlook of the UK rating by Standard & Poor's. A growing concern of investors is provoked by the lack of compromise measures of the U.S. government to prevent "fiscal breakdown". In early December, the OECD has lowered its forecast for GDP growth in 2013 almost for all countries - members of the organization⁵.

The portfolio duration indicator of corporate bonds has unexpectedly grown after a steady declining trend in previous months. At the end of the year duration made 601 days, which is by 54 days more than at the end of previous month.

³ Rusbonds Information Agency data.

⁴ Finmarket Information Agency data.

⁵ Cbonds Information Agency data.



Source: Cbonds data

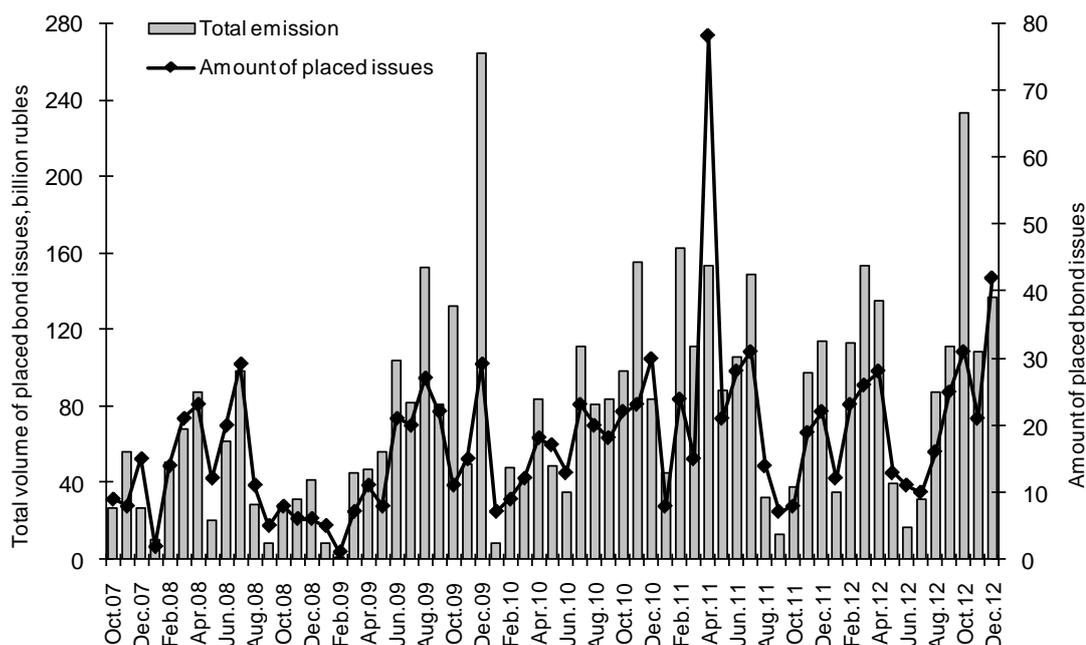
Fig. 5. Dynamics of the Russian corporate bonds market index and average weighted yield

Despite an insignificant growth of weighted average yield in the bond market, the most liquid bond issues were decreasing, which was especially expressed in manufacturing and energy sectors. The yield of high-tech companies⁶ issues remained virtually unchanged over the month. There was no common trend this time in the financial sector: bond yields of some large issuers was volatile. The most severe volatility of various bond issues yields, were demonstrated by securities of "Bank VTB", "MDM Bank", "Credit Bank of Moscow", "Nomos-Bank", "UniCredit Bank".

Issuers' activity in December this year has slightly decreased, although still remained at a high level. Thus, in the period from November 27 to December 21, 17 issuers of registered 33 bond issues for the total value of Rb 148.4bn (for comparison, from October 25 to November 26, there were 68 series of bonds at face value of Rb 305.2bn). Nearly half of registered issues were stock bonds. It should also be said that in December several mortgage bonds were offered by the largest mortgage agents: Mortgage Agent "VTB 24", NOMOS Mortgage Agent, Mortgage Agent "Asian-Pacific Bank" Mortgage Agent "Europe 2012-1".

In the primary market both, issuers and investors have shown even greater activity. From November 27 to December 21 this year, 31 issuers have placed 42 bond issues totaling to Rb 137.1bn (from October 25 to November 26, there were placed 27 issues worth Rb 107.9bn). Such an upsurge of IPOs is based on seasonal factor (See Fig. 6). This month, the exchange bonds made only a quarter of all offered issues. Again, there were placed several long-term loans: three issuers have raised funds for 10 years, one issuer - for 16 years, and mortgage agents placed bonds for maturity period from 30 to 33 years.

⁶ Finmarket Information Agency data.



Source: Rusbonds data

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

In December this year, FFMS of Russia has recognized as invalid two bond issues due to the non-placement of any securities, followed by rejection of state registration in previous months, eight bond issues were recognized invalid)⁷. However, this indicates not the lack of investment demand at the bond market, but rather the changes of borrowing programs of issuers themselves, given that in December there were cancelled securities of "Stock Oil Company" Bashneft".

From November 27 to December 21 of the current year, fourteen emitters were to pay off fifteen issues for the total amount of Rb 66.4bn. However, like a month ago, one emitter failed to fulfill its liabilities to the bondholders in due time and announced a technical default. In January 2013, only four corporate bond issues totaling to Rb 0.5bn are expected to be paid off⁸.

The situation with the announcement of actual default (when the issuer is unable to pay return to securities holders even in a few days after the due date of liabilities) has changed to the better for the first time since the crisis onset. Thus, in the period from November 27 to December 21, like in the previous period, all issuers have fulfilled their current liabilities and repaid the nominal value of bonds, and early redemption of the securities on offer were accomplished by all issuers in due time or at least within the framework of a technical default⁹.

⁷ FFMS of Russia data.

⁸ Rusbonds data.

⁹ Cbonds data.

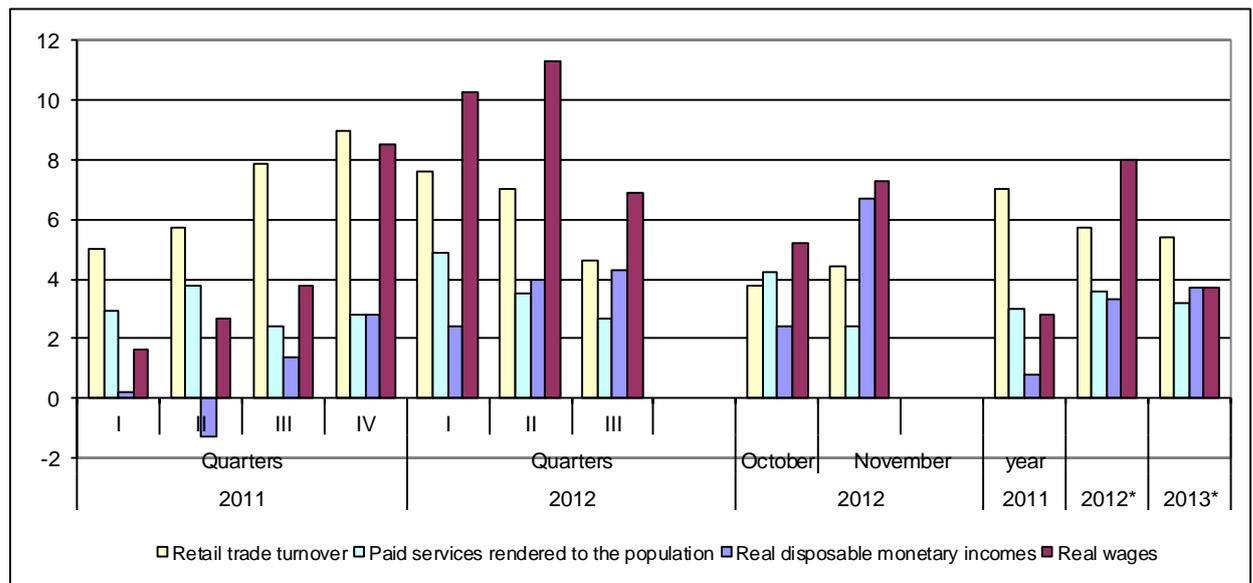
O. Izryadnova

Real Economy: Trends and Factors

As compared with November 2011, in November 2012 the investments in fixed assets increased by 1.1%, and the workload in construction - by 0.3%. The industrial production growth rates made 101.9% against November 2011, growth rates in manufacturing industry being 104.0%. The dynamics of manufacturing industry development is significantly affected by the weakening of the machine-building complex growth rates. Positive dynamics of the general and registered unemployment is also worrying this November as compared with the previous month. In November 2012 the economic growth slowing down, the real income of the population increased by 6.7% and real wages - by 7.3% compared to November 2011

According to the RF Ministry of Economic Development estimations, GDP growth will slow down from 102.9% in Q3 2012 to 102.5% in Q4 2012 versus the corresponding period of the previous year and will make 103.5% as a result of the year. The situation in agriculture has a negative impact on economy dynamics. In November 2012 the agricultural output equaled 92.6% of the corresponding figure of 2011 (95.8% in January-November). In general, for 2012 the RF Ministry of Economic Development lowered the estimates for the agriculture production index from 95.6% to 94.7%.

This year quarterly dynamics of retail trade turnover demonstrates that the decline in the growth rates of the real income of the population and real wages was accompanied by a gradual slowdown in consumer demand growth rates. Acceleration of the inflation starting with H2 2012 due to the changes in prices and tariffs for paid services rendered to the population also had a negative impact on consumer demand. In Q3 2012, the retail trade turnover increased by 4.6% versus the corresponding period of the previous year as compared with 7.9% a year ago. In November 2012, the growth rate of the retail trade turnover made 104.4% compared to November 2011 (109.1% a year ago) and 106.0% in 11 months of this year compared to January-November of the previous year (106.8 % a year ago). In H2 2012 slowdown of the growth rates was recorded both at the goods and at the services market. Peak demand for services was observed in H1 2012, and in November 2012 the growth rate of services sector was 102.4% compared to November 2011.



*)2012 – preliminary data; 2013 – projected

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

Fig. 1. Dynamics of Retail Trade Turnover, Paid Services Rendered to the Population, Growth Rates versus the Corresponding Period of the Previous Year, as Percentage

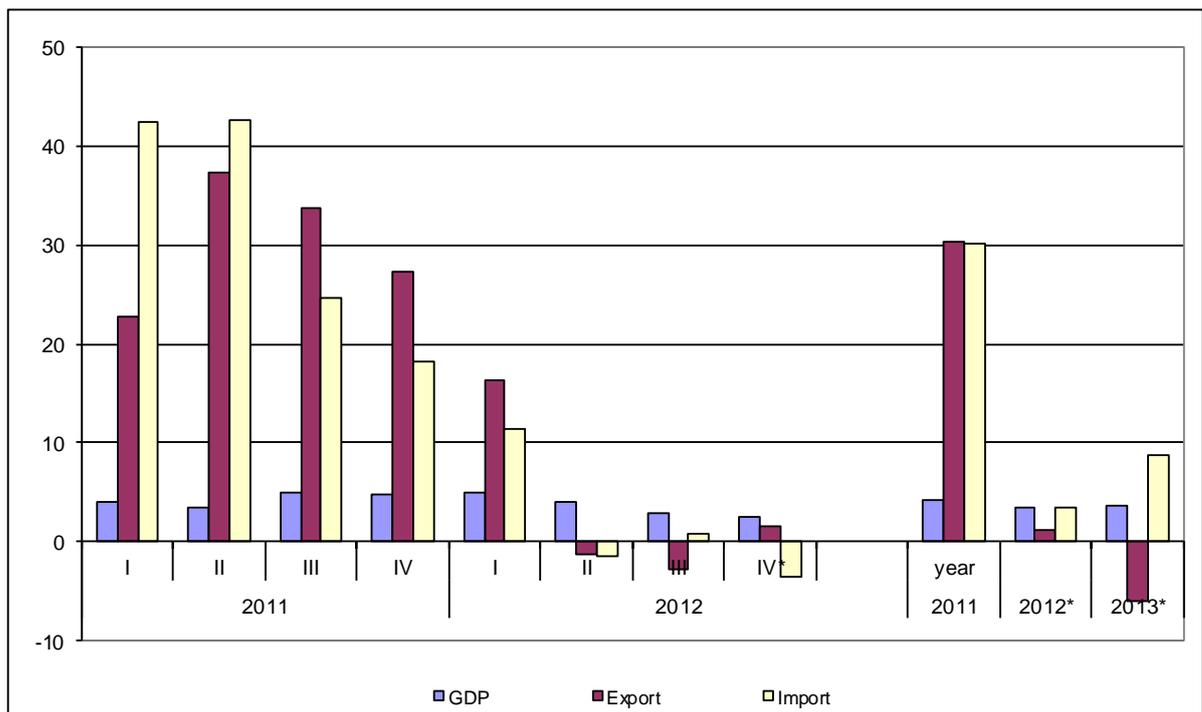
The RF Ministry of Economic Development, taking into account the current trend in the consumer demand in October and November, corrected the estimations of the macroeconomic indicators for the current year, and parameters of the forecast for next year. In 2012 according to the RF Ministry of Economic Development, the retail trade turnover growth rate will make 105.7% as compared to the previous year (a decrease of 0.4% compared with the data published earlier), but the outlook for 2013 is maintained at the same level - 105.4% for the time being. The growth rate of the market of paid services according to the corrected data will be 103.2% (an increase of 0.2%). According to the revised estimates, the growth rate of consumer prices will be 106.5% in 2012 (the previous estimation by the RF Ministry of Economic Development - 107.0%). On the whole over 2012 the growth rate of real wages is expected to be at the level of 108.0%, which is 1.1% lower than the previously published figure. At the same time the estimations of the real income of the population growth rates were raised by 0.3% up to 103.3%. The forecast for social parameters of living standards for 2013 will remain the same: the growth rates of both the real incomes of the population and the real wages are 103.7% versus 2012 figure.

Anticipating growth of wages by 5.4% versus labor productivity (preliminary estimation for 2012) results in an increase in the production costs and reduction of the financial and economic performance of enterprises. The proportion of gross profits in the GDP was 26.2% in H1 2012, being 1.7% lower than in 2011. In January-September profitability of sold products on the whole throughout the economy made 10.0% (11.2% in 2011), the figure for the extractive industry being 32.6% (36.4% in 2011), in manufacturing industry - 11.9% (13.4%).

Despite the increase in the growth rates of investment up to 110.3% in January-September 2012 compared with the same period of the previous year (105.0% a year ago), their impact on the annual dynamics of the GDP has weakened considerably. In October-November 2012 the investment activity being low, the expected estimation of the investment growth in Q4

2012 is 103.7% compared to Q4 2011. As a result, the growth rate of investment in fixed assets in 2012 is estimated by the RF Ministry of Economic Development at the level of 107.8% versus 108.3% in the previous year. Unsteady dynamics and absence of qualitative changes in the investment activity in 2012 also affected the forecast for 2013. According to corrected data of the RF Ministry of Economic Development, in 2013 the investment growth is expected to slow down to 106.5%, which is 0.7% below the projected figure adopted to determine the parameters of the budget for 2013.

In 2012 the macroeconomic situation was considerably influenced by the decrease in the foreign trade turnover growth rates in Q2 and Q3 2012, which strengthened the trend towards the GDP growth rates deceleration. Taking into account the growth of the foreign trade turnover in October 2012 versus the corresponding month of 2011 and the preceding month of the current year, the RF Ministry of Economic Development holds that in Q4 2012 the positive dynamics might recover thanks to the export supplies. According to its latest estimations, export value volume will expand by 1.2%, import value volume – by 3.5%, physical volumes – by 0.4% and 5.5%, correspondingly (-1.3% as compared with the estimations used earlier). Given the corrected dynamics for 2013, it is forecast that the value volume of the foreign trade turnover will decrease by 0.5% as compared with the previous year. At the same time next year import value volume (108.8%) is expected to grow at anticipating growth rates as compared with the export (93.7%).



**)2012 – preliminary data; 2013 – projected*

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

Fig. 2. Dynamics of Export and Import Value Volumes and GDP Real Volume, as Percentage to the Corresponding Period of the Previous Year

In January-November 2012 the industrial production index made 102.7% compared to 105.0% in the previous year, in minerals extraction being 101.2% versus 101.9%, in the manufacturing industry - 104.4% versus 106.8%. At the same time, in November 2012 compared

with the previous month the decline in the output volume of extractive and manufacturing industries was observed when compared with October 2012 by, respectively, 2.2% and 0.3%.

In 2012 annual growth rate of the manufacturing industry will reach 104.3% versus the previous year. It was the foodstuff production, production of rubber and plastic goods, construction materials production that grew at faster rate as compared with the previous year. Since the post-crisis dynamic recovery of machine-building has had a significant impact on the aggregated indices of manufacturing industry development, it should be noted that this year the machine-building complex growth rates will make 107.5% versus 114.5% in 2011. It is worth mentioning that in 2012 it was only the production of transport vehicles and equipment that reached the pre-crisis level of 2007. In 2012 machinery and equipment production as well as electric, electronic and optical equipment production remain about 15% below the figure of 2007.

As to the production of consumer goods, sustainable growth was recorded only in food production. Textile and sewing industry, as well as leather, leather goods and footwear production are contracting as compared with the previous year. Given the existing dynamics of the consumer goods production, the proportion of the domestic products is decreasing in the structure of the retail trade resources. It should be noted that in contrast to 2011 this year the share of imported goods in the resources of the foodstuffs retail market has been observed to increase.

The RF Ministry of Economic Development has downgraded the estimates for the industrial growth to 103.2% in 2012 (-0.4% with respect to the figures published previously). The correction concerned virtually all manufacturing industries: estimations were lowered for of machinery and equipment production (by 3.2%), transport vehicles and equipment production (by 2.2%) and the production of other non-metal mineral products (by 1.1%).

According to the corrected forecast for 2013, the industry growth rate was maintained at 103.6%, of manufacturing industries – at 105.1% compared to the previous year, with the anticipating growth of the chemical and machine-building complexes. It should be noted that the dynamics of the machinery and equipment as well as construction materials production in 2013 is below the growth rates of investment in fixed assets, which indicates the expansion of imports for these types of products.

S. Tsukhlo

Russian Industry in November 2012

According to the data of surveys carried out by the Gaidar Institute¹⁰, the situation of enterprises changed sooner for the worse, rather than improved. The demand kept falling and its forecasts suggested no optimism. In such conditions, even the existing stagnation of production results in the advanced dynamics of output as compared to that of sales. Such a situation contributes to accumulation of risks of production failure and makes enterprises introduce serious negative adjustments into their output plans and use a price reduction as an incentive for the demand.

The Industrial Optimism Index

In November, the Industrial Optimism Index (*Fig. 1*) kept falling due to weak demand on the output.

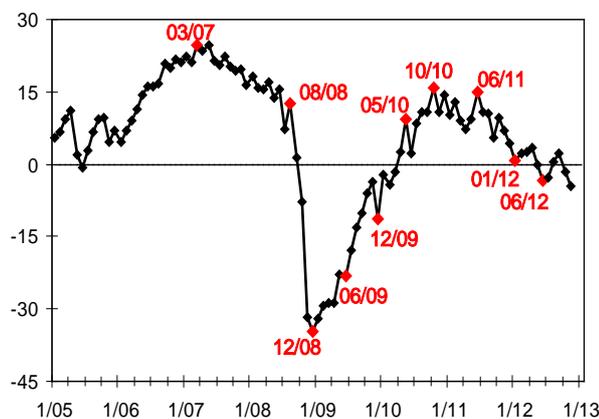


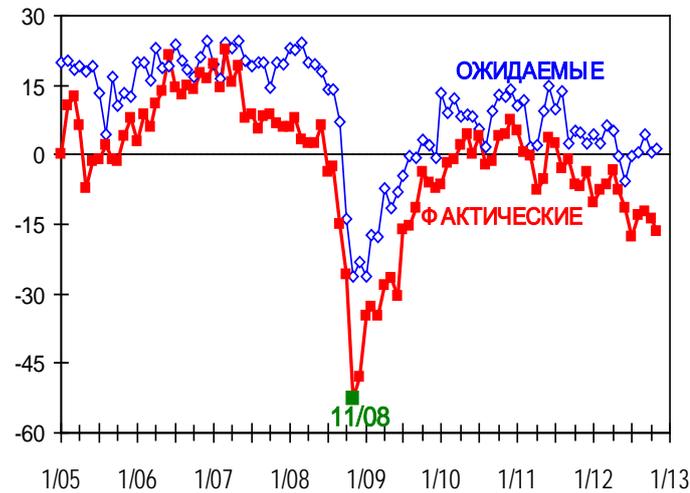
Fig. 1. The IEP Industrial Optimism Index, 2005-2012

The Demand on Industrial Produce

In November, the rates of reduction of the demand on industrial produce increased. The initial data showed that it amounted to -22 points after -17 points in October and became the worst one in the past three and a half years if the January dips are not taken into account. The data cleared of the seasonal factor showed that it decreased to -17 points; a similar result was received in July 2012, as well (*Fig. 2*). The above values are the absolute minimum in the past three and a half years... The demand forecasts do not suggest optimism, either. According to the initial data, they were revised downward to the three-year minimum. With the seasonal factor cleared, they returned to the zero level at which they have remained from May 2012 (however, there were two exceptions in June and September).

¹⁰ Surveys of managers of industrial enterprises are carried out by the Gaidar Institute in accordance with the European harmonized methods on a monthly basis from September 1992 and cover the entire territory of the Russian Federation. The size of the panel includes about 1,100 enterprises with workforce exceeding 15% of workers employed in industry. The panel is shifted towards large enterprises by each sub-industry. The return of queries amounts to 65–70%.

Both the negative dynamics of the demand and a lack of expectations of its revival (particularly on the threshold of the January national holidays) pushed significantly downwards the level of satisfaction with current sales. Within a month, the index fell by 18 points to the 32-month minimum. At present, 54% of enterprises regards their sales volumes “below the norm” against 45% of enterprises which assess them as normal. A month ago, the situation was quite the opposite. The demand started to get weaker again to the extent which is critical to enterprises.

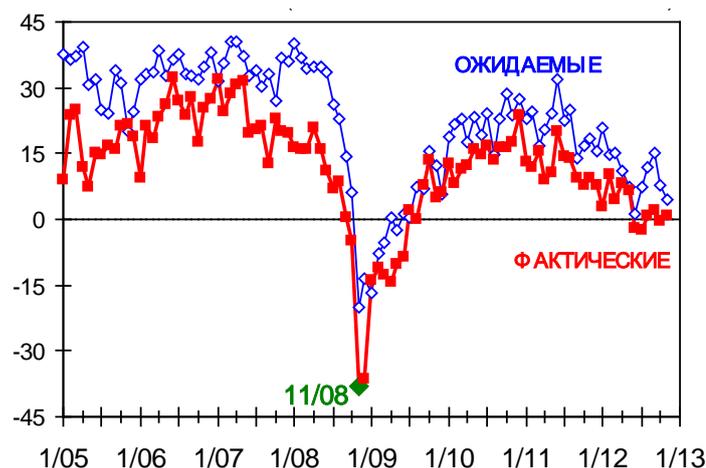


EXPECTED ACTUAL

**Fig. 2. CHANGES IN THE SOLVENT DEMAND CLEARED OF SEASONAL FACTOR
(BALANCE=%GROWTH-%DECREASE)**

The Output

In November, the output growth rates did not change and remained at the zero level. Such a situation is registered by surveys from June 2012 and confirmed later by the official statistical data. Clearing of the seasonal factor does not introduce any particular changes in the initial data and demonstrates changes in the output growth rates for six months running in the range of from -2 points to +2 points (*Fig. 3*). Output stagnation in Russian industry still prevails. Unfortunately, that stagnation may entail serious consequences which are not explicit on the basis of preliminary official data.



EXPECTED ACTUAL

**Fig. 3. CHANGES IN OUTPUT VOLUMES CLEARED OF SEASONAL FACTOR
(BALANCE=%GROWTH-%DECREASE)**

They include the advanced dynamics of changes in the output as compared to that of the demand. In November, the share of enterprises with the advanced dynamics of changes in the output as compared to that in the demand amounted to 31% though earlier in 2012 that index was in the range of 12% to 29%. So, the explicit stagnation of the output builds up production failure risks in a situation where enterprises will have to bring their output in line with the demand on their products.

The first signs of such an adjustment can be found in November output plans of enterprises. Within a month, the initial plans decreased straight by 15 points and turned out to be the worst ones in the 2010–2012 period having surpassed even traditional weak December forecasts. Clearing of the seasonal factor showed a decrease of the mere 4 points, but to the values which were the worst ones since the mid-2009 (if a dip in June 2012 is not taken into account). As a result, in November 2012 adjustment of output plans with demand forecasts amounted to 80% which is the record value in the 2009–2012 period. In November 2008, that index rose to 83%, while in December, to 88%.

Prices of Enterprises

Another measure which was aimed at ensuring the balance between the output and demand was prices of enterprises. In November, the industry shifted from the minimum price rises (normally, in the range from +2 to +6 points) to sharp price cuts (*Fig. 4*). Within a month, the balance fell to –13 points and hit the absolute minimum of the 2009–2012 period; that is, selling prices never fell so sharply from December 2008 when the industry went through the peak of the current crisis. Enterprises' plans show that industry is going to use the pricing lever in future as well to promote actively the sales of its produce. In November, the balance of plans decreased straight by 9 points and hit the four-year minimum, too. Such dynamics of pricing plans is not typical of the last months of the calendar year and was observed only once late in 2008.

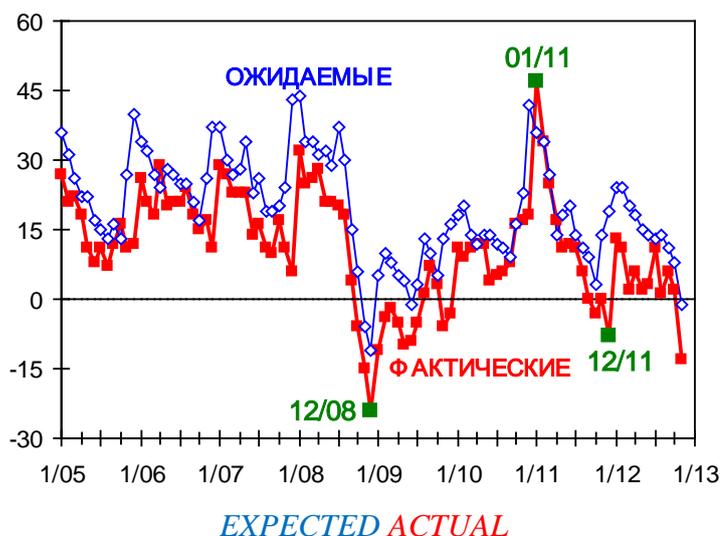


Fig. 4. CHANGES IN SELLING PRICES (BALANCE-%GROWTH-%REDUCTION)

Actual Dynamics and Lay-Off Plans

In November, the industry managed to slow down reduction of the number of workers, but at the level which is critical even to the stagnation period. (Fig. 5). The October forecasts showed that enterprises' ability to correct imbalances between the employment and demand decreased. In the beginning of the 4th quarter, only 62% of enterprises had such expectations of changes in employment as could reduce its redundancy, preserve the balance and ensure growth in the number of personnel in a situation of personnel shortages. November forecasts got even worse by another 9 points. The industry does not expect any principal changes in solution of its personnel problems. The above factor is a serious obstacle on the way of implementation of the official policy of modernization and upgrading of the competitive edge of the Russian industrial produce.

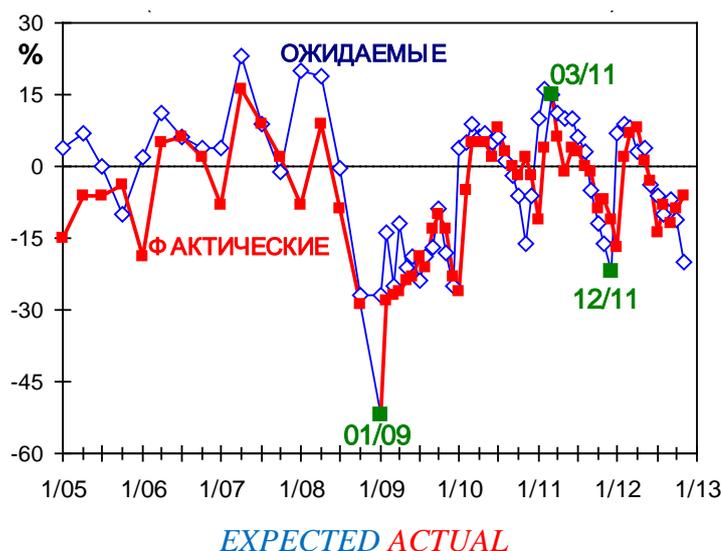


Fig. 5. CHANGES IN EMPLOYMENT (BALANCE=%GROWTH-%DECREASE)

Enterprises' Investment Plans

Enterprises' investment plans keep losing optimism. In November, they fell by another 4 points, while during two months of the 4th quarter of 2012 they lost 8 points. It is to be noted that in the 3rd quarter the industry's investment plans stabilized at the lowest level since the beginning of 2010 after they had lost 16 points in the 2nd quarter. Enterprises keep reducing their investment intensions in a situation of excess capacities and pessimistic forecasts of both output and demand (*Fig. 6*).



WITHOUT CHANGE BALANCE OF CHANGES

Fig. 6. EXPECTED CHANGES IN INVESTMENTS IN CAPITAL FUNDS ON THE PREVIOUS YEAR (BALANCE=%GROWTH-%DECREASE)

In the 4th quarter, investment plans remained positive only in fuel industry, nonferrous-metals industry and lumber industry. In other sectors of industry, quarterly balances moved to the negative zone and were in the range of from –3 points in engineering to –17 points in light industry. Calculation of the index on the basis of the forms of incorporation showed that only state enterprises had a positive balance (+25 points) of investment plans.

Lending to Industry

According to assessments of enterprises, in November terms of lending to industry did not undergo principal changes. The aggregate availability of loans (“above the norm” + “normal”) amounts to 69% and corresponds to the average level of the current half-year. In November, the average minimum interest rate offered to industry amounted to 12.6% and preserved sectorial differences which are typical of Russian industry (*Fig. 7*).



Fig. 7. Dynamics of the average minimum interest rate offered by banks on ruble loans, %

In the 4th quarter of 2012, the ability of industrial enterprises which received loans to repay them did not change and amounted to 87%. Within a year, that index showed a striking stability and remained in the range of 86% to 88%. When monitoring of that index started in 2009, only 61% of enterprises stated that they were able to service outstanding loans, while within that year the share of such evaluations rose from 52% to 68%.

O. Izryadnova

Investments in Fixed Assets

On December 14, 2012 Federal State Statistics Service published updated data on volumes and dynamics of investment in fixed assets in Q2 and Q3 2012. As a result, the figure for the investment in fixed assets growth rates in January-September 2012 against the corresponding period of the previous year has been raised up to 10.3% (+3.1% compared to figures published earlier). Because of this the RF Ministry of Economic Development increased the estimated growth rate of the investments in fixed assets by 2.3% as compared with the one projected earlier for 2012 up to 7.8 % (8.3% in 2011). In Q4 2012 it is forecast that the growth rates of the investments will decline further to 3.7% versus the corresponding period of the previous year.

In January-November 2012 investments in fixed assets made Rb 10090.7bn, having increased by 8.4% on the corresponding period of the previous year. It should be noted that in November 2012 compared with October 2012 an absolute contraction of the investments volume was recorded, which has not been typical for the Russian economy of the recent months¹¹. Under the existing dynamics in October-November the expected growth rates of the investments in fixed assets in Q4 2012 is estimated at the level of 103.5% in annual terms as compared with 113.6% a year ago.

On December 14, 2012 the Federal State Statistics Service published updated data on volumes and dynamics of investment in fixed assets in Q2 and Q3 2012. It was the figures of April-September 2012 that were subject to correction.

As a result, according to the corrected data, the volume of investments in fixed assets in January-September was increased by Rb 213.3bn as compared with the data published previously and made Rb 7524.6bn. As compared with the corresponding figure of the previous year, in Q3 2012 the growth rates of the investments in fixed assets was raised up to 107.3%, the previous estimation being at the level of 101.4%. On the whole over January-September the growth rates of the investments now equal 110.3% as compared with 107.2% (previous estimation).

It should be noted that at the same time the workload in construction made 97.3% in Q3 2012 on Q3 2011 and 101.9% in January-September 2012 versus the corresponding period of 2011. The correction of the indices did not influence the general trend of quarter-by-quarter slowdown of the investments in fixed assets growth rates.

Thus, in January-September 2012 the growth rates of the investments in fixed assets made 10.3% versus 5.0% in January-September 2011, of the workload in construction – 1.9% versus 4.1% a year ago.

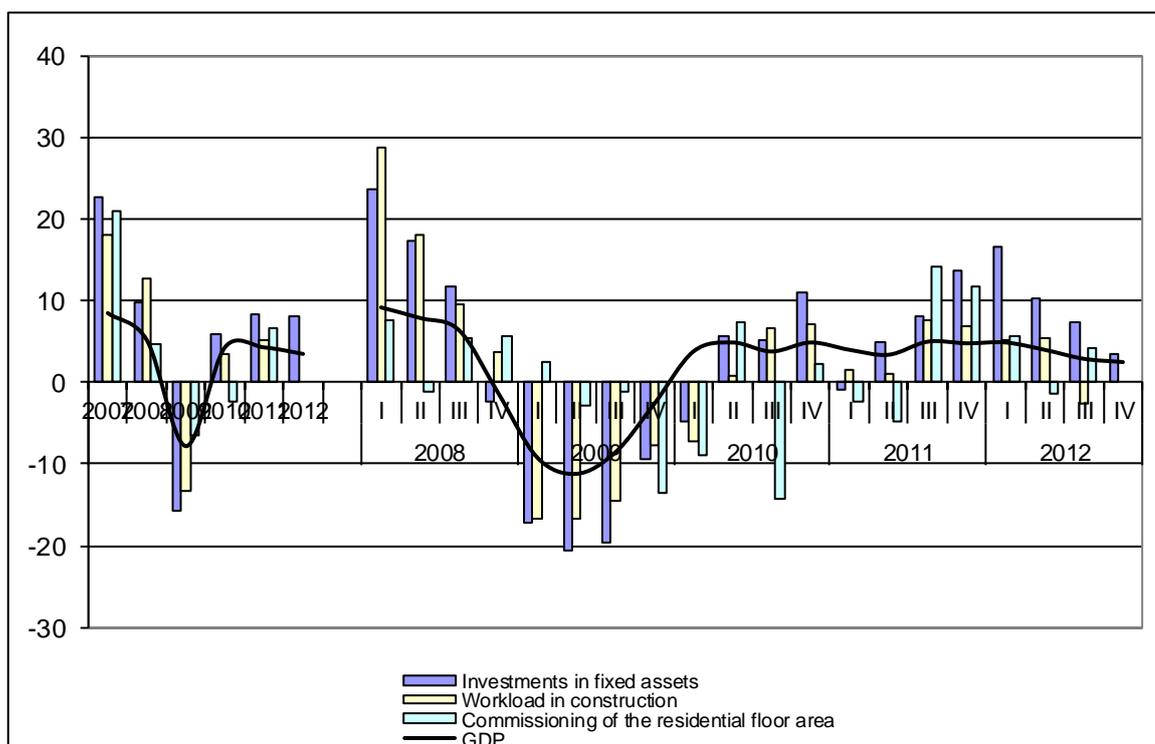
In 2012 the preservation of business activity in the investment sector of the economy was characterized by the anticipating growth rates of the investments with respect to the GDP

¹¹ Traditionally in November-December the positive dynamics of the investments is registered when compared with the preceding period of the year, which is connected with the characteristic features of the investment cycle and statistical reporting. In 1999-2012 the contraction of the investments in fixed assets in November as compared with October was observed only in November 2008.

dynamics. Impact of investments on economic growth dynamics in this situation cannot be assessed unambiguously. It should be noted that higher growth rates of investment in fixed assets, the dynamics of the workload in construction remaining the same, indicate a decrease in the efficiency of the use of the capital, which in general has a negative impact on the economic growth.

It was the slowdown of the investment growth rates throughout the year that was the characteristic feature of the investment process in 2012. It should be remembered that in Q1 2012 investments in fixed assets growth rates in annual terms reached 116.6% and it was the first time in the post-crisis period such high growth rates were registered. Starting with Q2 2012, however, the business activity has been observed to weaken in the construction complex, which was accompanied by the contraction of the enterprises' profits and the recovery of the growth of the average weighted interest rate on credits in rubles issued for a year or less.

In September 2012 investments in fixed assets decreased by 0.2%, the workload in construction - by 5.6%, and commissioning of the residential floor area - by 7.2% compared to September 2011. This resulted in a further weakening of the investments dynamics in Q3 2012 and determined sluggish investments growth in October-November 2012. The changing investments dynamics is partly due to the effect of the high base of the corresponding months of 2011, when there was a sharp increase in business activity, but the fundamental causes of the investment process instability are accounted for by the internal factors of the economy functioning.



Source: Federal State Statistics Service

Fig. 1. Dynamics of the Investment Activity Indices and GDP in 2008–2012, as Percentage to the Corresponding Period of the Previous Year

Over January-September 2012 investments made by the large and medium-scale business, which accounted for 72.6% of the total volume of the investments in fixed assets

throughout the economy, increased by 8.6% as compared with the corresponding period of the previous year, which is 3.5% below the growth of 9 months of 2011 and 1.7% below the growth rates of the total volume of the investments in fixed assets over the corresponding period of the current year (*table 1*). The anticipating growth of the investment activity in January-September 2012 in the small business segment was unsteady and was not supported by the fundamental changes in the investment climate.

Table 1

Dynamics of the Physical Volumes of the Investments in Fixed Assets in January-September 2009-2012, as Percentage to the Corresponding Period of the Previous Year

	2009	2010	2011	2012
Investments in fixed assets (for all organizations, including adjustment for investments not observed by direct statistical methods)	81.1	103.7	105.0	110.3
Large and medium organizations (investments in fixed assets not taking into account the subjects of small-scale entrepreneurship and the volume of investments not detected by the direct statistical methods)	86.7	96.2	112.1	108.6

Source: Federal State Statistics Service

In January-September 2012 the proportion of the own funds of the enterprises in the investments programs financing expanded, having increased up to 47.7%, exceeding by 2.4% the figure of the corresponding period of the previous year (*table 2*).

Table 2

Structure of Investments in Fixed Assets as Broken by the Sources of Financing in January-September 2009-2012, as Percentage to the Total (excluding the subjects of small-scale entrepreneurship and parameters for informal activities)

	2009	2010	2011	2012
Investments in fixed assets - total	100	100	100	100
of which by sources of financing:				
own funds	38.3	43.0	45.3	47.7
of which:				
profit remaining in the organization (accumulation fund)	15.5	16.0	17.6	19.1
borrowed funds	61.7	57.0	54.7	52.3
of which:				
bank loans	11.1	9.1	8.6	8.2
of which loans from foreign banks	3.4	2.7	1.8	1.5
borrowings from other organizations	8.9	6.6	5.5	5.6
budget funds	18.7	17.4	16.2	14.2
of which:				
from the federal budget	8.6	8.5	8.8	7.0
from the budgets of subjects of the Russian Federation	9.1	7.8	7.4	6.2
off-budget funds	0.2	0.3	0.2	0.3
other	22.8	23.6	24.2	24.0
of which:				
funds from overhead organizations	16.2	16.7	18.0	18.9
funds for share participation in construction (from the population and organizations)	2.6	2.0	1.8	2.1
of which funds of the population	1.0	1.1	1.1	1.4
funds from corporate bonds emission	0.1	0.02	1.0	0.0
funds from stocks emission	0.8	1.4	1.0	1.1
Foreign investments in the total volume of the investments in fixed assets	5.4	4.8	3.7	3.3

Source: Federal State Statistics Service

Despite that, it is the borrowed funds that serve as the main source of investments in fixed assets financing in January-September 2012, which accounted for 52.3% of the total volume of investments in the economy.

The change in the volume and proportion of the borrowed funds in the sources of financing was accompanied by the change in their structure. The public demand for the production and services of the Russian enterprises is supported through the fulfillment of the planned investments projects in the sphere of transportation, telecommunication etc. within the framework of FTP and FTIP as well as the large infrastructure projects of the Investment Fund.

In accordance with the federal targeted investment program approved by the RF Ministry of the Economic Development, in 2012 (taking into the account specification of October 1, 2012) the allotments of Rb 757.0bn were allocated, of which Rb 725.6bn – from the federal budget, for construction of 3626 objects of capital construction, purchase of real estate objects and fulfillment of measures (consolidated investment projects). 964 objects are scheduled only for project and exploratory work. In 2012 it is planned to put 1422 objects into commission, during January-September 190 objects were put into commission, 170 – to the full extent, 25 – partially. As on October 1, 2012 657 objects (not taking into account those that are scheduled only for project and exploratory work for future construction) the extent of the technical readiness is in the range from 51.0% to 99.9%.

In January-September 2012 Rb 363.3bn of the year limit was financed from the federal budget and Rb 17.7bn – from budgets of the subjects of the Russian Federation and other sources.

In January-September 2012 the proportion of budget funds in the sources of the investments financing made 14.2% or 1.77% of the GDP versus, correspondingly, 16.2% and 1.90% a year ago.

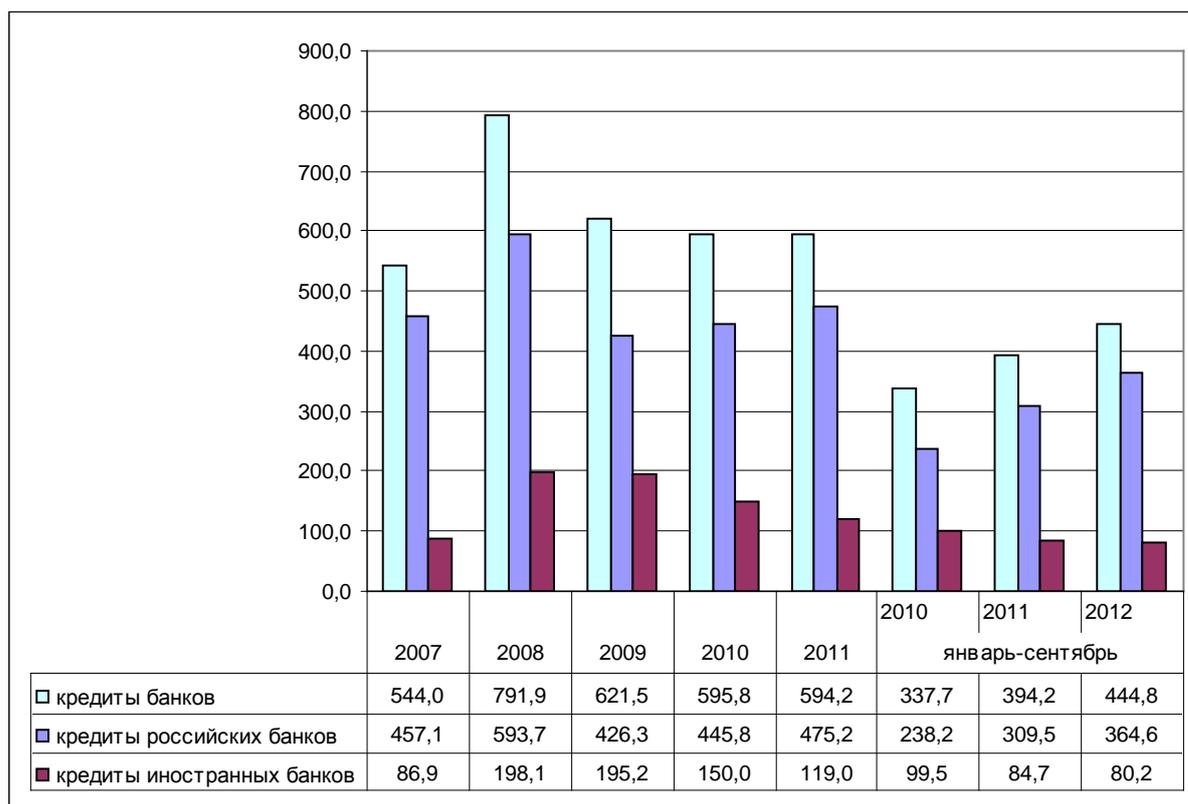
Table 3

Objects Envisaged by Targeted Investment Program and Volumes of Public Investments in 2012 (not taking into account construction sights and objects included in the state defense order)

	Number of objects for 2012		Put into commission in January-October 2012		Limit of public investments in 2012		Financed from the federal budget in January-October 2012	Investments used at the expense of all sources of financing in January-October 2012
	total	of which with the commissioning deadline in 2012	to the full extent	partially	total	of which from the federal budget		
	units				Rb billion			
Total	3704	1424	197	34	753.5	719.8	392.5	302.7
of which:								
agriculture, forestry and hunting	134	59	10	4	5.1	5.1	4.8	3.3
fishing and fish breeding	21	5	-	-	2.1	2.1	no data	0.9
manufacturing industries	51	11	-	-	8.1	7.0	no data	1.3
electricity, gas and water production and distribution	40	19	-	-	44.2	42.5	25.6	29.9
construction	108	52	2	1	20.5	17.7		9.3
transportation and communication	600	283	42	5	309.2	298.2	209.0	159.7
operations with real estate, rent and services rendering	1299	139	3	3	149.3	143.9	no data	17.0
state management and military security	626	489	129	18	53.5	52.7	33.4	23.3
education	207	112	8	2	41.8	39.7	25.4	17.9
health care and social services provision	190	96	1	1	59.3	55.8	30.5	20.0
other utilities, social and personal services	417	157	2	-	58.0	52.9	no data	19.1
other types of activity	11	2	-	-	2.2	2.2	no data	1.0

Source: Federal State Statistics Service

Starting with 2009 the proportion of the bank and the borrowed capital in the structure of the attracted funds for the financing of the investments in fixed assets has decreased. In January-September 2012 the proportion of the bank capital in the structure of the borrowed funds remained approximately at the level of January-September 2011, the ratio of the credits changing towards the expansion of the domestic banks proportion.



January-September

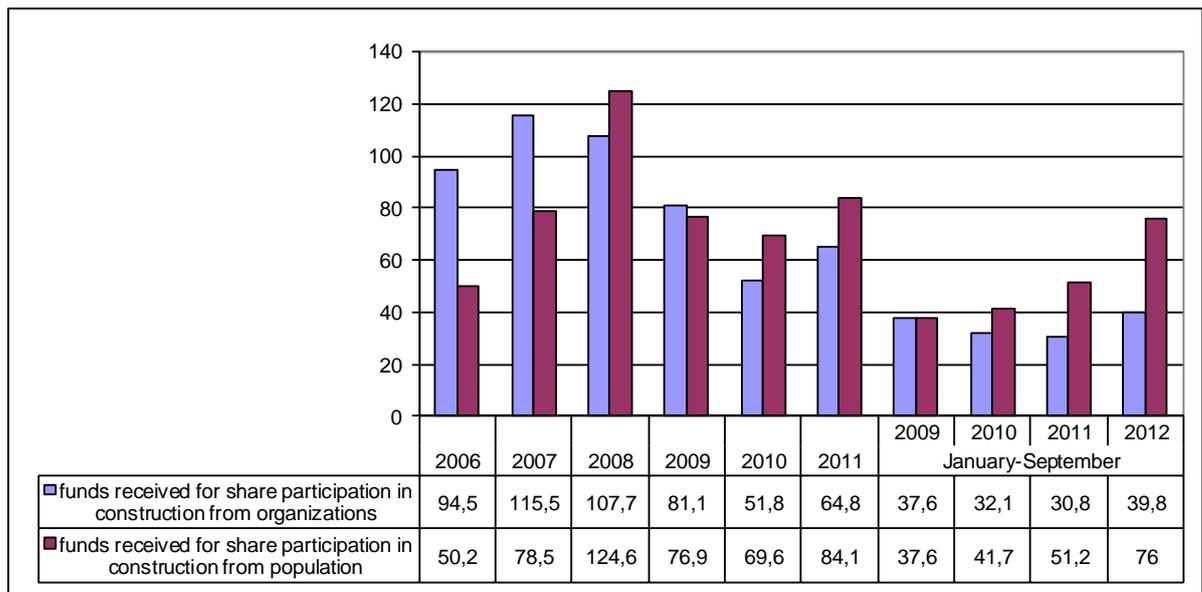
Note. Bank loans; Loans issued by Russian banks; Loans issued by foreign banks

Source: Federal State Statistics Service

Fig. 2. Banking Credits for Financing of the Investments in Fixed Assets in 2007–2012, Rb billion

The contraction of the foreign banks' credits, slowdown of the direct foreign investments in fixed assets growth rates to 104.6% in January-September 2012 as compared with 143.2% a year ago resulted in the decrease in the proportion of foreign investments in the total volume of investments in fixed assets down to 3.3% versus 3.7% in the corresponding period of 2011.

Analyzing the changes in the structure of investments in fixed assets financing, the specific features of the housing construction should be noted. In 2011 the reduction of the investments in housing construction in absolute terms ceased (taking into account small business and adjustment of investments), which predetermined the activity stirrup in 2012. The incomes of the population in January-September 2012 increasing as compared with the corresponding period of the previous year, the growth of the funds of the population allocated for the share participation in construction made Rb 24.8bn. The stirrup of the investment activity of the population was supported by the growth of the demand for the credits. The volume of the housing credits issued in January-September 2012 made RB 717.2bn versus Rb 489.9bn over the corresponding period of 2011, of which mortgages accounted for Rb 689.1bn versus Rb 452.7bn a year ago.



Source: Federal State Statistics Service

Fig. 3. Funds for Share Participation in Construction in 2007-2012, Rb billion

The analysis of the structure of the investments in fixed assets in January-September 2009-2012 allows singling out general and specific features of the investments demand as broken by the types of economic activity. In 2009-2012 the structural shifts of the investments in fixed assets were defined by the expansion of the proportion of the industry in the total volume of the investments in fixed assets (excluding the subjects of small-scale entrepreneurship). In January-September 2012 the proportion of the industry accounted for 49.2% of the investments in the fixed assets on the whole throughout the economy as compared with 47.2% on average over the corresponding period of 2011-2010. In January-September 2012 the investments in the industry went up by 16.2% as compared with the corresponding period of the previous year. At the same time a considerable differentiation of the investments growth rates by types of economic activities was observed. The recovery from the crisis was accompanied by higher growth rates of both the fuel and energy and extraction complexes as well as by higher dynamics of the investment demand growth. In January-September 2012 investments in fixed assets in the extractive industries went up by 14.6% as compared with January-September 2008, in electricity, gas and water production and distribution – by 46.7%, while in the extractive industries the investments made 99.8% of the pre-crisis level. It was in the coke and oil products production, electric, electronic and optical equipment production, production of leather, leather goods and footwear that the highest growth rates of the investments among the manufacturing industries were observed. Investment activity in machinery and equipment production, production of transport vehicles remained below the pre-crisis level of January-September 2008. Besides, the dynamic growth of the investments in the development of the pipeline transportation should be noted.

Analysis of the dynamics and the structure of the investments demonstrates that the recovery of the investment activity in the machine-building complex occurs at significantly slower rates as compared with other types of economic activity.

According to the data of the sampling survey of the investment activity conducted by the Federal State Statistics Service, the same as in the preceding years it was the replacement of

outdated equipment and technology that was the main purpose of the investments in fixed assets. Starting with 2009 the structure of the investments in fixed assets the steady increase in the expenses for the purchase of machinery, equipment and transport vehicles has been observed; at the same time the shift towards the domestic models of the equipment has been observed. However one should hardly overestimate the significance of these changes taking into account the situation in the Russian machine-building.

As to the structure of the investments in fixed assets by the types of the fixed assets, it should be noted that since 2009 the proportion of the investments in housing construction has been observed to contract, the growth rates of the housing commissioning decreasing.

Table 4

Structure of Investments in Fixed Assets as Broken by Types of Fixed Assets in January-September 2009-2012, as Percentage to the Total (excluding the subjects of small-scale entrepreneurship and parameters of informal activities)

	Rb billion				As percentage to the total			
	2009	2010	2011	2012	2009	2010	2011	2012
Investments in fixed assets	3604.4	3712.5	4581.7	5461.4	100	100	100	100
including: housing	221.5	225.4	222.3	260.2	6.1	6.1	4.8	4.8
buildings (excluding housing) and constructions	1974.8	1991.8	2477.6	2847.1	54.8	53.6	54.1	52.1
machinery, equipment and transport vehicles	1119.2	1209.0	1529.0	1954.4	31.1	32.6	33.2	35.8
of which: imported	257.4	244.6	313.7	338.2	7.1	6.6	6.8	6.2
other	288.9	286.3	361.6	399.7	8.0	7.7	7.9	7.3

Source: Federal State Statistics Service

On December 14, 2012 the RF Ministry of Economic Development reconsidered the estimated growth rate of the investments in fixed assets towards the increase up to 7.8% (+2.3% as compared with the figure projected earlier) maintaining the GDP growth estimation at the level of 3.5%.

E. Iliukhina

Foreign Investment in the Russian Economy

In the period from January through September 2012, the inflow of foreign investment in the Russian economy declined on the previous year by 14.4%, which happened due to a drop in the volume of ‘other’ investments, made on a refundable basis. Their share in the aggregate structure of foreign investment constituted 87.9%. The share of direct investment is estimated to be 10.7%; that of portfolio investment – 1.4%. Industry has become a more alluring target for foreign investors, followed by financial activities and trade. The volume of investment outflow from Russia over the period from January through September 2012 continued to be on the rise, amounting to 95.6% of the total volume of foreign investment inflow over the same period.

As of the end of September 2012, accumulated foreign investment in the Russian Federation, less the assets of financial regulatory agencies, commercial and savings banks and including ruble-denominated investment recalculated in US dollar terms, amounted to \$ 353,3bn, which is 1.8% above the index registered as of 1 January 2012 and 9.3% above that as of 1 October 2011.

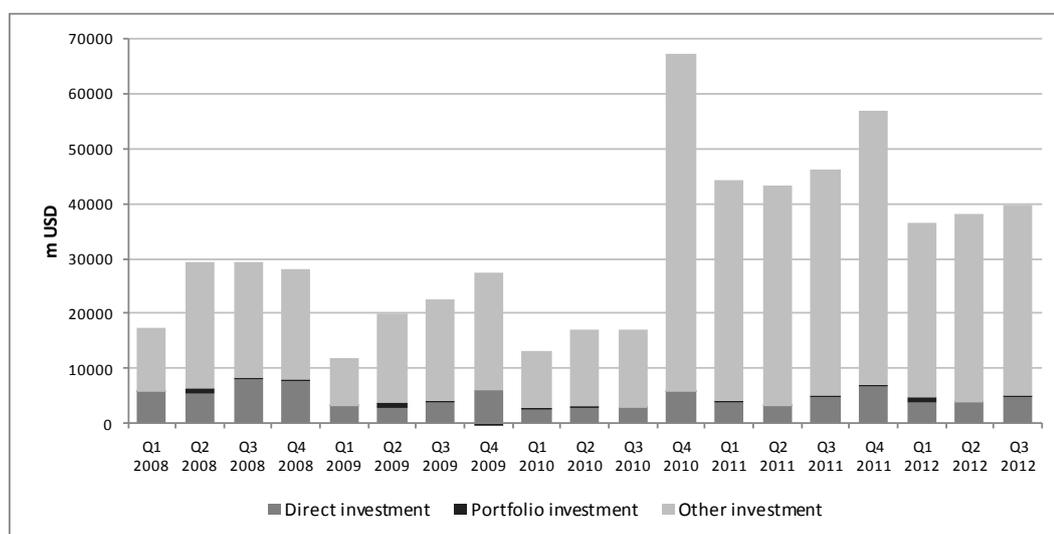
Table 1

Foreign Investment Inflow in the Russian Economy in January-September 2008–2012

	In m USD				As % of previous year			
	Total	Direct	Portfolio	Other	Total	Direct	Portfolio	Other
2008	75,792	19,201	1,296	55,259	86.2	97.7	83.8	82.8
2009	54,738	9,975	1,019	43,744	72.2	51.9	78.6	79.1
2010	47,488	8,196	866	38,426	86.8	82.2	85.0	87.8
2011	133,784	11,736	535	121,513	281.7	143.2	61.8	316.2
2012	114,463	12,277	1,571	100,615	85.6	104.6	2.9-fold	82.8

Source: RF Federal State Statistics Service.

The decline of aggregate indices occurred due to the downward movement of ‘other’ investment, which by the results of the first 9 months of 2012 dropped by \$ 20.9bn on the period of January-September 2011.



Source: RF Federal State Statistics Service.

Fig. 1. Quarterly Movement of Foreign Investment Inflow in the RF in 2008–2012

In 2012, the quarterly volumes of ‘other’ investment made by foreign investors amounted to approximately \$ 33.5bn, thus demonstrating a decline on the corresponding periods of the previous year.

Growth, on the corresponding period of the previous year, of direct foreign investment in the Russian economy was noted in Q2 2012. In Q1 and Q3, the decline amounted to 0.7% and 0.4% on the same periods of 2011.

In contrast to ‘other’ and direct foreign investment, the portfolio investment segment in 2012 demonstrated growth on the corresponding periods of the previous year. In Q1 2012, the volume of portfolio investment increased 8.3 times.

The difference in the movement of each type of foreign investment in the Russian economy resulted in the following changes in the foreign investment structure: as seen by the results of the first 9 months of 2012, the shares of direct and portfolio foreign investment increased to 10.7% and 1.4% respectively (over the first 9 months of 2011 – to 8.8% and 0.4% respectively), while the share of other investment shrank to 87.9% (over the first 9 months of 2011 – to 90.8%)

In Q3 2012, the focus of foreign investment continued to be industry, the financial sphere and trade, which received 90.2% of the aggregate volume of foreign investment in the RF (in Q1 and Q2 2012 – 93.2% and 94.8% respectively).

The decline in the volume of investment in financial activities and the transport and communications sector against the backdrop of increasing investment in other branches of the economy resulted in some alterations in the by-sector structure of foreign investment by comparison with the previous year.

Table 2

By Sector Structure of Foreign Investment in the Russian Economy in January-September 2010-2012

	In m USD			Change, as %, on previous year			As % of total		
	2010	2011	2012	2010	2011	2012	2010	2011	2012
Industry	28, 022	44, 291	46, 343	132.6	158.1	104.6	59.0	33.1	40.5
Transport and communications	3, 952	5, 494	3, 377	46.4	139.0	61.5	8.3	4.1	3.0
Wholesale and retail trade; repair of motor vehicles, motorcycles, household utensils and articles of personal use	8, 688	12, 363	18, 074	53.4	142.3	146.2	18.3	9.2	15.8
Operations with real estate, renting and service rendering	3, 843	4, 782	7, 150	68.7	124.4	149.5	8.1	3.6	6.2
Financial activities	1, 764	65, 711	38, 300	89.5	3725.1	58.3	3.7	49.1	33.5
Other sectors	1, 219	1, 143	1, 219	97.1	93.8	106.6	2.6	0.9	1.1

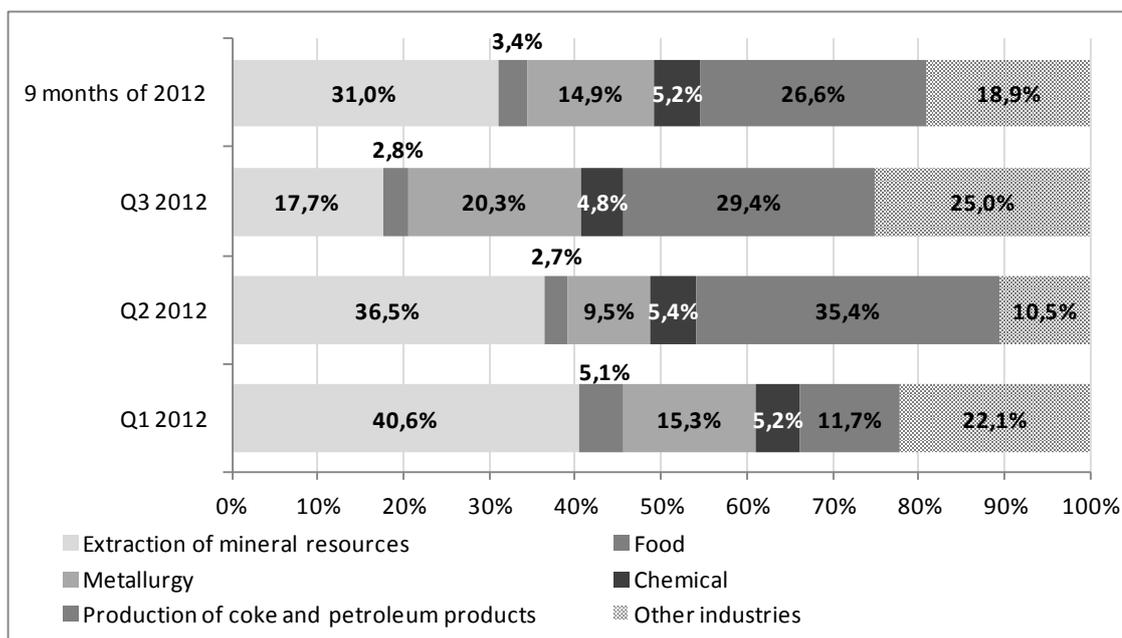
Source: RF Federal State Statistics Service

In the structure of foreign investment in industry, as demonstrated by the results of the first 9 months of 2012, the top position is occupied by the processing industry, where the volume of investment increased on January-September 2011 by 11.1% (in 2011, growth amounted to 46.4%). Investment in the extraction of mineral resources over that period declined by 10.5% on January-September 2011 (in 2011, growth amounted to 85.5%).

In the processing industry, investment in the production of coke and petroleum products increased by 23.4%, and in metallurgy – by 13.2%, thus amounting to \$ 12.3bn and 6.9bn respectively (over the period of January-September 2011, the volume investment in the production of coke and petroleum products doubled, and investment in metallurgy increased by 20.3%). Foreign investment in the chemical and food industries over the first 9 months of 2012 dropped on the corresponding period of 2011 by 34.4% and 19.4% to \$ 2.4bn and 1.6bn respectively (the period of January-September 2011 saw growth of investment in these two industries – 2.2 times and 5.3% respectively).

The highest growth of foreign investment in industry on the same period of 2011 was noted in Q1 2012 (by 27.4%). In Q3 2012, the rate of growth amounted to 1.5%, after a decline by 5.6% in Q2.

Foreign investment in metallurgy in Q1 and Q3 2012 increased by 85.7% and 59.3% respectively on the same periods of 2011, while in Q2 this index dropped by 45.6% on Q2 2011. The interest of foreign investors in the extraction of mineral resources increased by 11.5% in Q1, while in Q2 and Q3 2012 it declined by 8.2% and 36,6% respectively. The volume of foreign investment in the food industry in Q1 2012 increased on the same period of 2011 by 57.9%, while in Q2 and Q3 2012 it declined by 27.7% and 49.3% respectively. Changes in foreign investment in the chemical industry was as follows: –4.7% in Q1; +31.7% in Q2; and –64,4% in Q3 2012.



Source: RF Federal State Statistics Service.

Fig. 2. By Sector Structure of Foreign Investment in Industry in 2012

The share of direct investment in industry, as seen by the results of the first 9 months of 2012, shrank to 14.4% from 16.2% registered by the end of the corresponding period of 2011; while the share of ‘other’ investment over that period remained practically unchanged and amounted to 83.0%, and the share of portfolio investment increased from 0.6% to 2.5%.

Some changes can also be noted in the structure of foreign investment by type of economic activity in industry. In the extraction of mineral resources, the volume of direct

investment by the results of the first 9 months of 2012 dropped by 40.3% - to \$ 2.3bn, which brought down its share in the aggregate investment volume in that industry to 15.8% (vs. 23.7% in January-September 2011). The share of other investment in the extraction of mineral resources, which over the course of 2012 remained practically unchanged and amounted to \$ 12.0bn, was 75.8% (in January-September 2011 – 76.0%).

The bulk of investment in the processing industry over the period of January-September 2012 was also constituted by ‘other’ investment’, which rose on 2011 by 4.5%, thus amounting to 88.8% in the processing industry’s resulting values (vs. 88.4% over the first 9 months of 2011). Direct foreign investment in the processing sectors increased by 33.2%. The share of direct investment in the processing industry over the period of January-September 2012 increased to 13.6% (over the first 9 months of 2011 – to 11.3%). Portfolio investment in the processing sectors over the period under consideration grew 11.1-fold, which increased their share to 3.4% (in 2011 – 0.3%).

The three leaders in the geographical structure of the foreign investment inflow into the Russian economy over January-September 2012 were the same three countries. The highest volume of investment – more than \$ 40bn – came from Switzerland; The Netherlands invested \$ 15.7bn, followed by Cyprus with its volume of investment in the Russian economy in the amount of \$ 11.8bn.

Table 3

Movement of Foreign Investment in the RF, by Major Investor Country, in 2012

	Inflow, m USD			As % of corresponding period of 2011			As % of total		
	Q1	Q2	Q3	Q1	Q2	Q3	Q1	Q2	Q3
Switzerland	17,703	13,010	9,869	68.6	63.2	44.8	48.5	34.0	24.9
Germany	1,519	1,056	1,224	86.2	27.4	48.1	4.2	2.8	3.1
UK	2,011	5,524	3,083	89.9	326.9	127.9	5.5	14.4	7.8
Cyprus	2,994	3,196	5,598	110.4	66.3	103.0	8.2	8.4	14.1
The Netherlands	3,601	5,680	6,395	89.4	149.4	118.6	9.9	14.8	16.1
Luxembourg	1,657	256	3,480	228.2	39.0	612.7	4.5	0.7	8.8
Other countries	7,049	9,533	10,025	99.3	120.4	130.0	19.3	24.9	25.3

Source: RF Federal State Statistics Service.

Country-specific differences in the behavior of investment flows caused some changes in the geographical structure of foreign investment in the Russian economy. The share of Switzerland in the aggregate volume of foreign investment inflow in the RF declined from 51.1% in January-September 2011 to 35.5% over the same period of 2012. Over that period, the share of Germany shrank from 6.1% to 3.3%; while that of Cyprus increased from 9.7% to 10.3%, that of the UK – from 4.7% to 9.3%, that of France – from 1.8% to 3.0%, and that of Luxembourg – from 1.5% to 4.7%.

As demonstrated by the results of the first 9 month of 2012, the financial sphere remained the main focus for investors from Switzerland. This sector of the Russian economy received 87.9% of the aggregate volume of investment from Switzerland and 93.2% of all foreign investment in that sphere (over 9 months of 2011 – 92.3% and 96.1% respectively).

The structure of investment from The Netherlands demonstrated a decline in the share of investment in the extraction of fuel and energy resources – from 50.5% in January-September

2011 to 44.2% in January-September 2012. As seen by the results of the first 9 months of 2012, the trade sector received 30.3% of the total volume of investment flowing from The Netherlands into the RF (in January-September 2011 – 19.8%); the transport and communications sector – 1.2% (in January-September 2011 – 12.1%); and metallurgy – 13.5%.

Over the period of January-September 2012, the business community from Cyprus – similarly to the situation in the previous year – focused on the processing industry, having invested in it 39.7% of their aggregate volume of investment in the RF (in January-September 2011 – 41.6%). The share of operations with real estate in the structure of investment from Cyprus increased from 13.5% in January-September 2011 to 21.3% by the results of the first 9 months of 2012.

The results of the period of January-September 2012 demonstrate that the countries with the highest volume of investment accumulated in Russia are Cyprus, The Netherlands, Luxembourg, China and the UK, whose aggregate share amounts to 65.7% (by the results of the first 9 months of 2011, the share of the top five investor countries (where the place now occupied by the UK had belonged to Germany) was 64.2%). The share of the top five investor countries in the segment of direct investment dropped to 59.7% (in January-September 2011 – 66.4%); their shares in the structure of portfolio and other investment were 60.5% and 69.8% respectively (in January-September 2011 – 20.4% and 64.7%).

Against the decline in the volume of foreign investment in the Russian economy, the volume of capital withdrawal in the form of foreign investors' incomes transferred abroad, as well as interest paid on loans and loan redemption over the first 9 months of 2012 dropped on the same period of 2011 by 17.2% and amounted to \$ 99.7bn, or 87.1% of the foreign investment volume received over the first 9 months of 2012 (vs. 90.0% over the first 9 months of 2011). It should be noted that while in Q1 2012 the amount of capital withdrawal from Russia was equal to 98.4% of the volume of foreign investment inflow over the same period, in Q2 and Q3 this index dropped to 82.4% and 81.3% respectively.

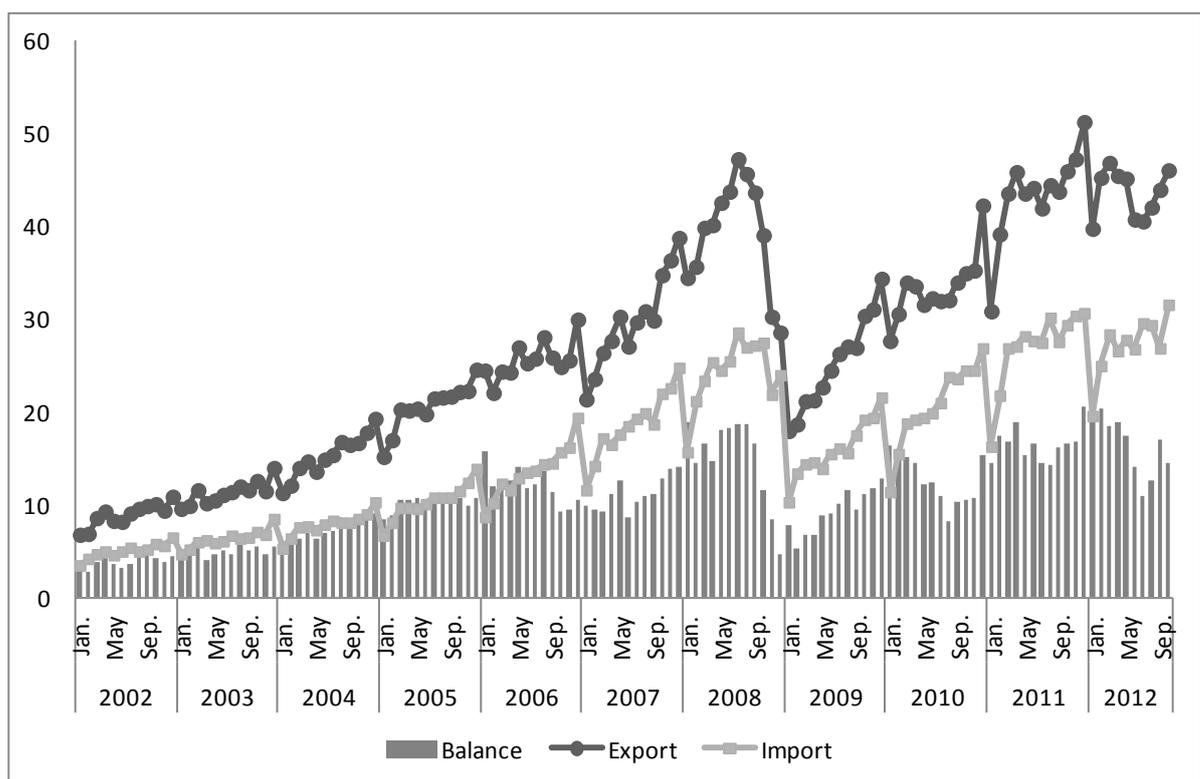
By the results of the first 9 months of 2012, investment outflow from Russia amounted to \$ 109.4bn, or was equal to 95.6% of the total volume of investment in the Russian economy (vs. 72.3% over the first 9 months of 2011). In Q1 and Q2 2012, the ratio of the investment outflow volume from Russia to foreign investment inflow in the Russian economy was estimated at the level of 86.8% and 98.8% respectively. In Q3 2012, investment outflow from the RF was equal to 100.5% of the investment inflow over the same period.

N. Volovik and K. Kharina

Foreign Trade

In October 2012, growth in the Russian foreign trade turnover took place as a result of expansion of trade relations with far abroad states. In October 2012, the value of Russian import amounted to the record-high level in the entire period of observation. At the same time, the number of countries which Russia has a negative trade balance with has increased.

In October 2012, though the main Russian foreign trade indices demonstrated positive dynamics their growth rates lagged much behind the respective indices of October 2011. In October 2012, Russia’s foreign trade turnover calculated on the basis of the methods of the balance of payments amounted to \$77.6bn which is 2.9% higher than the respective index of the previous year. Russia exported \$46.1bn worth of goods which figure exceeded by the mere 0.02% the respective index of 2011. It is to be noted that the export to far abroad states increased by 1.1%, while that to CIS states decreased by 5.5%. As compared to October 2011, import deliveries rose by 7.3% to \$31.6bn having achieved the record-high level in the entire period of observation, which situation can be explained by growth of 8.9% in import of goods from far abroad states with a 2% decrease in deliveries from CIS states.



Source: The Central Bank of the Russian Federation

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

Though the trade balance was a positive one (\$14.5bn), however, due to fast growth rates of import deliveries it decreased by 12.9% as compared to October 2011.

At present, prices on fuel and energy goods remain at a high level which factor contributes to the positive dynamics of Russian export. In the last quarter of 2012, the Brent oil

price fluctuated at the level of \$110 a barrel with the maximum level of \$115.89 a barrel and the minimum level of \$105.5 a barrel registered on October 11 and November 3, respectively. In October 2012, the monthly average price amounted to \$111.6 a barrel which is 2% higher than the respective index of 2011.

In October 2012, the average Urals oil price rose to \$110.38 a barrel having exceeded by 1.84% the level of October 2011.

According to the data of monitoring of the Ministry of Finance of the Russian Federation, from November 15 till December 14, 2012 the average Urals oil price amounted to \$108.66 a barrel. By Resolution No. 1368 of December 21, 2012 the rate of export duty on crude oil was set in the amount of \$395.6 per ton from January 1, 2013 (\$396.5 per ton in December 2012).

From January 1, 2013, the single rate of export duty on light and dark oil products, except for petroleum, will virtually remain at the same level of \$261.1 per ton (\$261.7 per ton in December). It is to be noted that in January 2013 the duty on petroleum preserved at the level of 90% of the oil duty will not virtually change, either. It will amount to \$356 per ton (\$356.8 per ton in December).

Growth in prices on non-ferrous metals which started in September stopped in October due to a drop in demand in them on the part of leading metal consumers. So, as compared to September 2012, in October prices on copper, aluminum and nickel fell by 0.3%, 4.4% and 0.7%, respectively. In January-October 2012, aluminum, copper and nickel cost 18.1%, 12.1% and 26.0% less, respectively, than in the same period of 2011.

Table 1

Monthly average global prices in October of the respective year

	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Oil (Brent), USD/ a barrel	27.2	29.59	49.82	58.52	58.38	82.86	72.84	73.19	82.92	109.47	111.97
Natural gas, USD/1m BTU	3.28	3.88	4.83	7.28	8.97	9.16	15.93	7.6	8.28	11.42	11.58
Copper, USD/per ton	1519.0	1916.4	3012.0	4060	7500	8008	4925.7	6286.8	8292.4	7347.5	8082
Aluminum, USD/per ton	1313.2	1474.8	1822.8	1929	2659	2442	2121.4	1877.8	2447.0	2172.0	1974.3
Nickel, USD/per ton	6840.9	11030	14483	12403	32348	30999	12140	18514	22167	18886	17169

* The market of Europe, average contractual price, Franco-border.

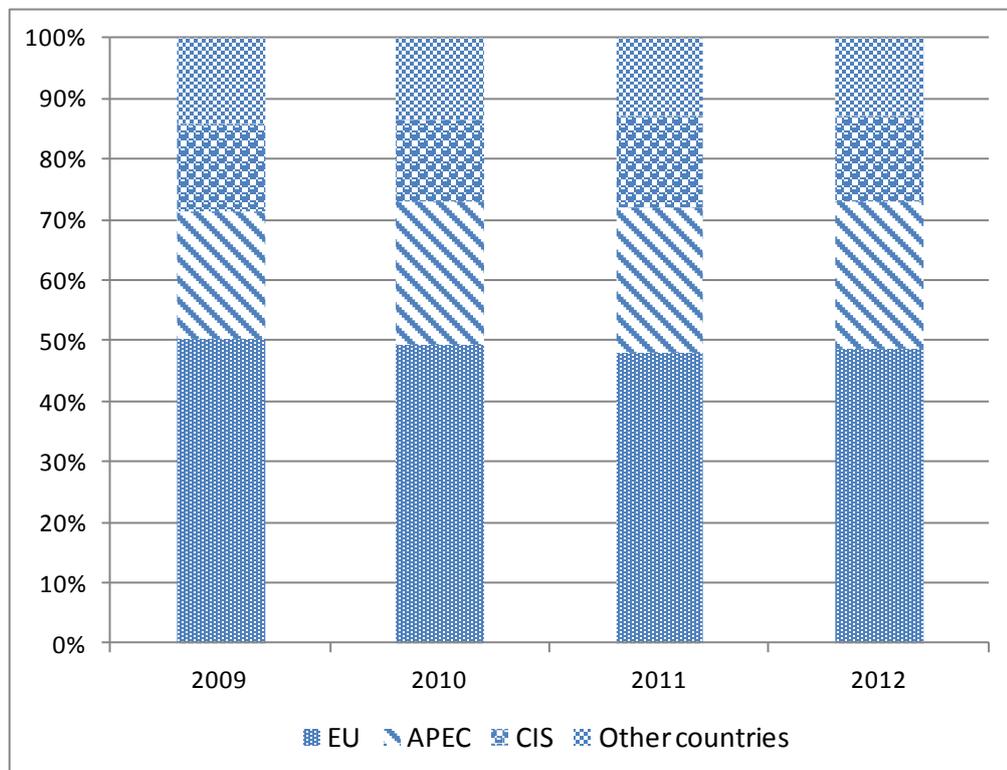
Source: calculated on the basis of the data of the London Metal Exchange and the Intercontinental Oil Exchange (London).

In October 2012, in the market of food products a drop in prices was observed, as well: the average value of the FAO food price index amounted to 213 points which is 2 points lower than the September index. Such a reduction can be mainly explained by a drop in global prices on grain and vegetable oil and fats; it compensated growth in prices on sugar and dairy products. Meat prices remained at the same level. During ten months of 2012, food prices fell on the average by 8% as compared to the respective index of 2011.

In January-October 2012, Russia's foreign trade turnover calculated on the methods of the balance of payments amounted to \$708.4bn which is 3.3% higher than the respective index of the previous year.

In January-October 2012, the trade balance surplus amounted to \$164.6bn which is 2.5% higher than in January-October 2011.

In the past few years, the geographic structure of the Russian foreign trade did not undergo significant changes. The Russian Federation’s main foreign trade partner is still the European Union. In January-October 2012, the share of the European Union in the foreign trade turnover of the Russian Federation increased by 0.7 p.p. to 48.8% as compared to January-October 2011. Russia’s main foreign trade partner in that group of countries was the Netherlands whose share rose by 1.7 p.p. and amounted to 10%. Germany was rated the second; its share in the Russian foreign trade turnover grew from 8.7% in January-October 2011 to 8.9% in the same period of 2012. In 2012, Italy was rated the third; its share in the Russian foreign trade turnover amounted to 5.3% having decreased by 0.2 p.p. as compared to 2011. Generally, in ten months of 2012 the EU states increased by 4.4% the volume of foreign trade with Russia including growth of 4.5% and 4.3% in Russian export and import, respectively, as compared to the same period of 2011.



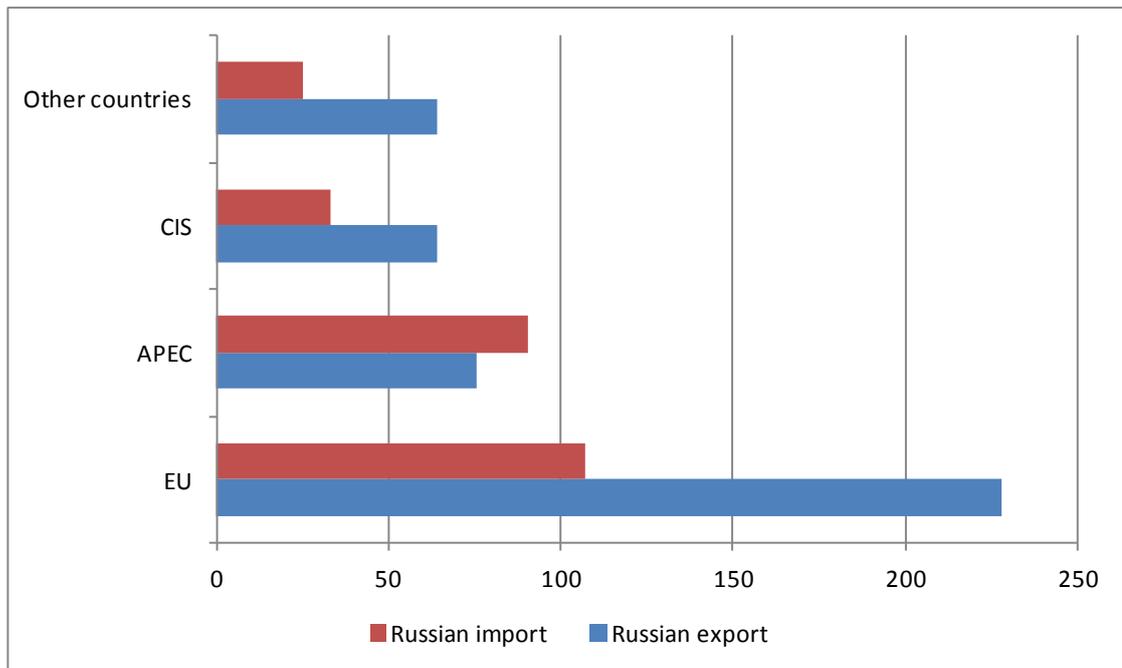
Source: *The Federal Customs Service of the Russian Federation*

Fig. 2. Geographic structure of Russian foreign trade (%)

The share of APEC countries in the Russian foreign trade turnover increased from 23.9% in January-October 2011 to 24.2% in January-October 2012. Russia’s main foreign trade partner in that group of countries is China whose share in the foreign trade turnover grew by 0.5 p.p. to 10.6%. Japan is rated the second; its unit weight grew from 3.6% to 3.8%. On the contrary, the US unit weight decreased from 3.8% to 3.4% – the third place in that group of countries. In ten months of 2012, Russia’s foreign trade volume with APEC countries increased by 4% as compared to the same period of 2011. It is to be noted that Russian export to those countries increased by the mere 1%, while Russian import, by 6.7%.

In January-October 2012, the share of CIS states in the foreign trade turnover with Russia decreased from 15.2% to 14.1% as compared to the same period of 2011. Russia’s main partners in that group of countries are Ukraine and Belarus. In ten months of 2012, Russia’s volume of trade with those countries decreased by 4.7% as compared to the same period of 2011; Russian import fell by 21.6%, while export, by 0.7%.

In January-October 2012, the trade balance with all the groups of countries was positive, except for that with APEC countries (–\$14.4bn).



Source: The Federal Customs Service of the Russian Federation

Fig. 3. The main Russian foreign trade indices by the group of countries (billion USD)

While in January-October 2011 the Russian Federation had a trade balance deficit with 21 countries whose share in Russia’s total trade volume amounted to 22.8%, in January-October 2012 it had a trade balance deficit with 26 countries whose share in the Russian trade volume grew to 35.4%. In 2012, Russia had a considerable trade balance deficit with China (–\$13.4bn), France (–\$2.1bn), Canada (–\$1.7bn), Austria (–\$1.6bn) and Germany (–\$1.4bn).

T. Tishchenko

State Budget

Federal budget revenues in January-November of this year totaled to Rb 11406.8bn, or 20.5% of GDP, expenditures made Rb 10615.5bn, or 19.1% of GDP. In the past 11 months the federal budget was executed with a surplus of 1.4% of GDP. Meanwhile, the federal budget dynamics in the last three months shows that it will be extremely difficult to ensure the estimated revenue level Rb 12914.6bn as per the year result and reach a zero deficit.

Analysis of key indicators of the federal budget execution over January–November 2012

Federal budget revenues in January-November 2012 with respect to the corresponding period of the last year decreased by 0.4 p.p. of GDP, while oil and gas revenue has grown by 0.1 p.p. of GDP. Federal budget expenditures increased by 1.0 p.p. of GDP. In absolute terms, the increase in revenues was Rb 1241.7bn, while expenses increased by Rb 1795.5bn. As a result, the federal budget was executed with a surplus of Rb 791.3bn, which is by 1.3 p.p. of GDP below the level of the corresponding period of 2011. The volume of non-oil deficit amounted to Rb 5051.2bn (9.1% of GDP), which exceeds the level of 11 months last year by 1.5 p.p. of GDP (See *Table 1*).

Table 1

Key indicators of the RF federal budget within January-November 2011–2012

	January-November 2012		January-November 2011		Change, p.p. of GDP
	Rb bn	GDP%	Rb bn	GDP%	
Revenue, including:	11406.8	20.5	10165.1	20.9	–0.4
Oil and gas revenue	5842.5	10.5	5058.7	10.4	0.1
Expenditures, including:	10615.5	19.1	8820.0	18.1	1.0
Percentage expenditures	299.1	0.5	237.9	0.4	0.1
Non-percentage expenditures	10316.4	18.6	8582.1	17.6	1.0
Federal budget surplus (deficit)	791.3	1.4	1345.1	2.7	–1.3
Non-oil and gas deficit	–5051.2	–9.1	–3713.6	–7.6	–1.5
GDP estimates	55460		48541		

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

The dynamics of the federal budget in January-November 2012 (see *Table 2*) demonstrates an increase in the revenue from MET (by 0.7 p.p. of GDP) and some increase in domestic excise tax - by 0.1 p.p. of GDP, as compared to the same period of the previous year. In regard to VAT on goods sold in the RF territory and income from foreign economic activity a marked reduction of GDP share is noted in revenue to the federal budget over 11 months of this year as compared with January-November 2011 to 0.2 p.p. of GDP and 0.4 p.p. of GDP, respectively.

Table 2

Dynamics of federal budget revenues from basic taxes in January–November 2011–2012

	January–November 2012		January–November 2011		Change, p.p. of GDP
	Rb bn	GDP%	Rb bn	GDP%	
1. Revenue, including:					
corporate profit tax	342.6	0.6	311.8	0.6	0.0
VAT on goods sold in the RF territory	1653.1	2.9	1547.4	3.1	–0.2
VAT on goods imported to the RF territory	1507.4	2.7	1344.2	2.7	0.0
Excise duties on goods manufactured in the RF territory	308.1	0.5	211.5	0.4	0.1
Excise duties on goods imported to the RF territory	47.1	0.0	41.3	0.0	0.0
MET	2221.2	4.0	1625.5	3.3	0.7
2. Revenue from external economic activities	4471.1	8.0	4125.0	8.4	–0.4

Source: Federal Treasury, Gaidar Institute assessments

The growth of federal budget expenditures (see Table 3) in terms of GDP share in January–November of this year as compared with the same period of the last year is observed under the budget lines "National Security and Law Enforcement" - by 0.6 p.p. of GDP, «Social Policy" - by 0.5 p.p. of GDP, «National Defense" - by 0.4 p.p. of GDP. In each of the three sections: "Education", "Healthcare" and "Public and municipal debt servicing" an increase in expenditures made 0.1 p.p. of GDP. In three sections of federal budget expenditures in the first 11 months of the year have been decreased as compared with the same period of the last year, including "National Economy" - by 0.1 p.p. of GDP, «Housing and public utilities" - by 0.3 p.p. of GDP, «Intergovernmental transfers" - by 0.3 p.p. of GDP. Under the other sections of the federal budget expenditures over 11 months of 2012 in terms of GDP share remained at the level of January–November 2011.

Cash execution of the federal budget for the first 11 months of the year made 81.5% of the approved expenditures for 2012, against 76.0% in the same period last year. The worst situation with cash execution of the federal budget as broken down by sections of functional classification for the first nine months is observed in the section "Housing and public utilities": over the first 11 months of this year, cash execution under this budget line made only 43.0% of the approved amount, while in the relevant period last year the execution accounted to 76.0% of the approved amount.

Table 3

Federal budget expenditures in January–November 2011–2012

	January–November 2012		January–November 2011		Change, p.p. of GDP
	Rb bn	GDP%	Rb bn	GDP%	
Expenditures, total, including:	10615.5	19.1	8820.0	18.1	1.0
Federal issues	665.6	1.2	618.5	1.2	0.0
National defense	1460.8	2.6	1107.0	2.2	0.4
National defense and law enforcement	1470.7	2.6	999.8	2.0	0.6
National Economy	1349.6	2.4	1247.9	2.5	–0.1
Housing and public utilities	103.2	0.1	210.4	0.4	–0.3
Environmental protection	19.4	0.0	13.6	0.0	0.0
Education	541.1	0.9	431.4	0.8	0.1
Culture and cinematography	71.4	0.1	61.7	0.1	0.0
Healthcare	484.2	0.8	369.9	0.7	0.1
Social policy	3538.0	6.3	2840.0	5.8	0.5
Physical training and sports	37.8	0.0	35.3	0.0	0.0
Mass media	65.0	0.1	54.3	0.1	0.0
Public and municipal debt servicing	299.1	0.5	237.9	0.4	0.1
Intergovernmental transfers	509.4	0.9	591.8	1.2	–0.3

Source: Federal Treasury, Gaidar Institute assessments

As of early December, the amount of public domestic debt amounted to Rb 4,647.755bn (over the last month it increased by about Rb 52bn), the amount of public external debt made about \$40bn.

RF Subjects consolidated budget execution in January–October 2012

According to the Federal Treasury, revenues of the consolidated budget of the Subjects of the Russian Federation for the first ten months of 2012 reduced by 1.3 p.p. of GDP against the relevant period of the last year to 13.1 p.p. of GDP, or to Rb 6,568.9bn (see Table 4). In absolute terms, the growth of consolidated regional budgets of the RF Subjects for the 10 months of this year against January–October 2011 amounted to Rb 292.6bn.

Table 4

Key indicators of the RF Subjects consolidated budget in January–October 2011–2012

	January–October 2012		January–October 2011		Change, p.p. of GDP
	Rb bn	GDP%	Rb bn	GDP%	
Revenues, including:	6568.9	13.1	6276.3	14.4	–1.3
Corporate profit tax	1709.8	3.4	1678.7	3.8	–0.4
Individual income tax	1749.8	3.5	1534.9	3.5	0.0
VAT, domestic	0.2	0.0	0.3	0.0	0.0
Excise duties in the RF territory	368.2	0.7	310.1	0.7	0.0
Aggregate income tax	257.1	0.5	201.1	0.4	0.1
Property tax	698.5	1.4	595.8	1.3	0.1
Non-repayable proceeds from other budgets of the RF fiscal system	1248.7	2.5	1307.4	3.0	–0.5
Expenditures, including:	6198.5	12.4	5458.3	12.6	–0.2
Surplus/Deficit of the RF Subjects consolidated budget	370.4	0.7	818.0	1.8	–1.1
GDP estimates	49799		43314		

Source: Federal Treasury, Gaidar Institute assessments.

Reduction of proceeds to the consolidated budget of the RF Subjects over ten months of the current year against the relevant period of the last year is observed in corporate income tax -

by 0.4 p.p. of GDP, non-repayable proceeds from other budgets of the RF fiscal system - by 0.5 p.p. of GDP, whereas growth was noted in aggregate income tax - by 0.1 p.p. of GDP and in property tax - by 0.1 p.p. of GDP. Revenue from personal income tax, VAT and excise duties to the budgets of the RF Subjects over 10 months of 2012 in terms of GDP share remained at the level of the same period last year.

Expenditures of the consolidated budget of the RF Subjects in January-October this year decreased against the same period last year by 0.2 p.p. of GDP (see *Table 5*) and reached 12.4% of GDP.

Slight growth in expenditures of the RF Subjects consolidated budget in the period under review compared with January-October 2011 was observed in the sections "Education" - by 0.2 p.p. of GDP, «National economy" - by 0.1 p.p. of GDP, «Healthcare» - by 0.1 p.p. of GDP. Reduction of regional budget expenditures under the section "National Security and Law Enforcement" in the current year by 0.3 p.p. of GDP was predictable as a result of the transfer of police funding from the regional to the federal level in 2012. Decrease in expenditures under budget lines «Federal issues", "Housing and public utilities", "Social Policy" was noted in January-October this year as compared to the same period of the last year by 0.1-0.2 p.p. of GDP. In the other sections of consolidated budget of the RF Subjects over ten months of this year expenditures in terms of GDP share remained at the same level as in the last year.

Cash execution of the consolidated budget of the RF Subjects in terms of expenditures by the results of 10 months of the year made 68.6%, against 66.0% in the 10 months of the last year.

Table 5

RF Subjects consolidated budget execution in terms of expenditures in January-October 2011–2012

	January–October 2012		January–October 2011		Change, p.p. of GDP
	Rb bn	GDP%	Rb bn	GDP%	
Expenditures, total, including:	6198.5	12.4	5458.3	12.6	–0.2
Federal issues	384.6	0.7	349.7	0.8	–0.1
National defense	2.8	0.0	2.5	0.0	0.0
National defense and law enforcement	65.0	0.1	196.0	0.4	–0.3
National Economy	1088.4	2.1	892.1	2.0	0.1
Housing and public utilities	618.6	1.2	630.5	1.4	–0.2
Environmental protection	14.9	0.0	11.9	0.0	0.0
Expenditures, total:	1582.6	3.1	1263.4	2.9	0.2
<i>Including</i>	198.8	0.3	166.4	0.3	0.0
Healthcare	1025.4	2.0	842.4	1.9	0.1
Social policy	1010.6	2.0	915.9	2.1	–0.1
Physical training and sports	108.6	0.2	97.1	0.2	0.0
Mass media	29.1	0.0	24.4	0.0	0.0
Public and municipal debt servicing	53.4	0.1	53.0	0.1	0.0
Intergovernmental transfers	15.8	0.0	12.9	0.0	0.0

Source: Federal Treasury, Gaidar Institute assessments.

Over the 10 months of 2012 the consolidated budget of the Russian Federation Subjects is executed with the surplus of 0.7% of GDP (Rb 370.4bn), which is by 1.1 p.p. of GDP lower than in the same period of 2011.

M. Khromov

Russian Banking Sector

In November of this year the rate of individual savings in bank deposits has significantly increased. However, neither this fact, nor the continued active government support to the banks failed to prevent the slowdown of lending to both, individuals and corporate borrowers. Also, the banking sector continued to act as a channel of capital outflow from the country, despite the fact that monetary authorities are still the major lender of credit institutions.

In November 2012 total assets of the banking sector¹² increased by 1.6%, which means a slowdown in growth rate as compared with previous months (1.9% in September, 2.3% in October), as well as compared with November 2011 (2.7%). Annual growth rate of assets as of the end of November made 20.1%, which is the minimum value from September 2011.

The aggregate profit of the banking sector in November reached Rb 96bn, which is the maximum indicator since January this year. Return on banking assets in annual terms in November made 2.4%, and equity - 20.3%. Both indicators of profitability in November are roughly equal to the average values of the last 12 months (2.3% and 21.3%, respectively). This means that return on assets is largely dependent on the expansion of bank assets volume.

Raised funds

The inflow of funds to the *deposits of individuals* with the banking sector has significantly increased. The growth of assets at the accounts and deposits of individuals over the month made 2.0% and 20.2% in annual terms.

November accelerating growth of individuals' assets with the banks was mainly reached through accumulation of accounts and deposits denominated in rubles. The volume of funds in national currency increased over the month by 2.1%, while those in foreign currencies in USD equivalent grew by only 1.2%. The share of individual accounts in foreign currencies has somewhat declined over the month to 18.5%, but still remains higher than the minimum post-crisis level reached in February this year (17.5%).

In November the rate of household savings has significantly increased. The individuals have allocated in bank accounts 8.5% of their disposable incomes. Herewith, only for the period of January-November 2012, this ratio made 5.0%. Overall, as of the year result, the savings rate of population with bank deposits may exceed 6.5%, if the December peak in deposits growth remains at the level of previous years.

The volume of corporate customers' assets with the banks in November has increased only by 0.6%, and the annual growth rate fell down to 12.1%. In absolute terms the November inflow of funds to bank accounts and deposits companies and organizations (Rb 64bn) was 4 times less than the individual accounts (Rb 262bn). Over 12 months balances of corporate clients' accounts have increased nearly twice less than the funds of individual accounts (Rb 1189 vs. Rb 2279bn).

¹² Hereinafter growth rates of balance sheet are adjusted for exchange rate revaluation of foreign currency component, unless otherwise indicated.

Like individuals, in November corporations were also accumulating ruble balances in their bank accounts (1.2%), while the dollar equivalent of accounts in foreign currencies has even decreased (1.4%). Herewith, the corporate sector continues to keep a larger share of funds in foreign currency (22.6%) than individuals.

For more than a year term deposits dominate in the structure of banks' corporate clients. As of December 1, they accounted for 53% of the total funds in the bank accounts. According to our estimates, based on the banks reporting, the most of the term deposits are placed by legal entities for a period over a year. The share of deposits made by non-financial organizations for a period over a year was 42.4%, and that of financial institutions - 57.6% in total amount of deposits.

Foreign liabilities of the banking sector grew in November by \$1.3bn, which is less than 1% of the total foreign funds raised by banks. Given the fact that the growth of banks' foreign assets was 3.5 times greater (\$4.6bn), the outside world in November remained net borrower. Total amount exported from the country by the banks in autumn was \$14bn (the difference between the growth of foreign assets and liabilities).

Table 1

Structure of the Russian banking system liabilities (end of month), as % of total

	12.07	12.08	12.09	12.10	12.11	03.12	06.12	07.12	08.12	09.12	10.12	11.12
Liabilities, Rb bn	20125	28022	29430	33805	41628	41533	44266	45090	45523	45861	47096	47669
Own assets	15.3	14.1	19.3	18.7	16.9	17.5	16.8	16.8	16.9	16.9	16.7	16.7
Loans of the Bank of Russia	0.2	12.0	4.8	1.0	2.9	3.5	5.1	5.7	5.3	5.1	5.4	6.0
Interbank operations	4.1	4.4	4.8	5.5	5.7	5.1	4.8	4.8	5.0	5.1	5.1	5.1
Foreign liabilities	18.1	16.4	12.1	11.8	11.1	10.2	11.3	11.4	11.4	11.0	11.1	10.9
Private deposits	26.2	21.5	25.9	29.6	29.1	29.4	29.4	28.8	28.9	28.7	28.2	28.4
Corporate deposits	25.8	23.6	25.9	25.7	26.0	25.7	24.0	23.5	23.1	23.3	23.2	22.9
Accounts and deposits of state agencies and local authorities	1.5	1.0	1.0	1.5	2.3	1.4	1.5	1.7	2.3	2.5	2.7	2.4
Securities issued	5.8	4.1	4.1	4.0	3.7	4.8	4.5	4.5	4.6	4.8	5.0	5.0

Source: Central Bank of Russia, IEP estimates

Investments

In November bank's *retail lending* growth rates was at the minimum level since February. Over the month, the volume of outstanding liabilities on loans of individuals to the banks increased by 2.5%. Nevertheless, annual growth rates remain above 40%.

The quality of retail loan portfolio indicators of the banking sector remained unchanged over the month. Currently the share of overdue debt decreased from 4.5% 4.4%, and the ratio of provisions for possible losses to the total outstanding liabilities remained at 6.3%.

The retail lending in November in terms of the cost of current consumption has also slightly decreased. In our estimates, within a month the volume of loans to individuals amounted to 24.7% of retail trade, the cost of food and commercial services to population. Overall, in January-November this ratio reached 25.5%, which is by 4.5 p.p. more than in the relevant period of 2011 (21.0%).

The rate of lending to *corporate borrowers* in November was also insignificant. Over the month, this segment of the credit market has grown by only 0.7%, while the annual growth rate declined to 16.0%.

Over the month there were no essential changes in terms of corporate lending as well. The share of overdue loans remained at 4.8%, and the ratio of provisions for losses to total credit portfolio decreased from 7.8 to 7.7%.

Liquidity and government support

Liquidity of the banking sector in November has grown from 4.5 to 4.8% of assets, though regardless the assets of monetary powers the dynamics remains negative. The growth of total debt to the Bank of Russia and the RF Ministry of Finance in November made Rb 288bn, whereas the value of liquid assets increased by only Rb 169bn. The negative value of the banking sector own liquidity has risen to -2.5% of total assets.

Government support of the banking sector continues to focus primarily on the state banks. Their share exceeds 70% of the monetary authorities assets, allocated with the banks. Herewith, there is an interesting trend: each body of monetary regulation focuses on "its own" bank. For example, almost half (48%) of loans of the Bank of Russia is granted to banks to Sberbank, and 51% of deposits of the RF Ministry of Finance are placed with VTB Group banks (including the Bank of Moscow and TransCreditBank).

Table 2

Structure of the Russian banking system assets (end of month), as% of total

	12.07	12.08	12.09	12.10	12.11	03.12	06.12	07.12	08.12	09.12	10.12	11.12
Assets, Rb bn	20125	28022	29430	33805	41628	41533	44266	45090	45523	45861	47096	47669
Cash and precious metals	2.5	3.0	2.7	2.7	2.9	2.4	2.5	2.5	2.5	2.6	2.6	2.6
Deposits with the Bank of Russia	6.9	7.5	6.9	7.1	4.2	3.2	3.0	3.2	2.9	2.8	2.7	2.9
Interbank operations	5.4	5.2	5.4	6.5	6.4	6.2	5.8	5.7	5.9	5.8	6.1	6.1
Foreign assets	9.8	13.8	14.1	13.4	14.3	14.2	14.2	14.5	14.0	13.9	14.3	14.2
Individuals	16.1	15.5	13.1	13.0	14.4	15.3	16.0	16.1	16.5	16.8	16.8	17.0
Corporate sector	47.2	44.5	44.5	43.6	44.0	44.4	43.6	42.7	43.7	43.4	42.9	42.5
Government	4.1	2.0	4.2	5.1	5.0	4.9	3.8	3.4	3.4	3.3	3.2	3.0
Property	2.2	1.9	2.7	2.6	2.3	2.4	2.3	2.3	2.3	2.3	2.3	2.2

Source: Central Bank of Russia, IEP estimates

Yu. Bobylev

The Oil and Gas Sector

The world market in 2012 was characterized by the persistence of high global oil and natural gas prices. The average price of Russian Urals crude oil on the European market, according to preliminary estimates, amounted to \$ 110.3 per barrel, and that of Russian natural gas – to \$ 418,2 per 1,000 m³, which translated into high profits of Russian oil and gas companies and considerable revenues of the state budget. Oil production in Russia in 2012 will amount to approximately 516m tons, which is the historic high of the last twenty-two years. Some additional tax measures designed to stimulate the development of new hydrocarbon deposits have been introduced.

In 2012, the situation on the global oil market was characterized by the stubborn persistence of high oil prices. The average price of Russian Urals crude oil in 2012, according to preliminary estimates, was \$ 110.3 per barrel, which exceeded last year’s average (Table 1). The main factors responsible for the persistence of high global oil prices were the rising demand for oil caused by world economic growth, led by the economies of China, India and other Asian countries; the sufficiently conservative policy of the OPEC; and also the geopolitical risks hanging over the oil market. In the European market, prices for Russian natural gas were also impressively high, well in excess of their last year’s level. At the same time, they experienced a downward influence of the changing situation in the European natural gas market, caused by a considerable increase in natural gas supplies from other producers and a lower level of natural gas spot prices in comparison with the prices for long-term contracts with *Gazprom*. This urged *Gazprom* to notably reduce its sale price on the European market.

Table 1

International Prices of Oil and Natural Gas in 2008–2012

	2008	2009	2010	2011	2012 Q1	2012 Q2	2012 Q3	2012 Q4*
Price of Brent (UK), USD/barrel	97.7	61.9	79.6	111.0	118.5	108.9	110.0	110.1
Price of Urals (Russia), USD/barrel	94.5	61.0	78.3	109.1	116.9	106.5	109.0	108.8
Price of Russian gas on the European market, USD/1,000 m ³	473.0	318.8	296.0	381.5	444.7	452.4	409.9	418.2

* Preliminary estimate.

Source: IMF, OECD/IEA.

In 2012, the volume of oil production in Russia, according to preliminary estimates, will amount to approximately 516m tons, thus hitting its twenty-two year record high (Table 2). Among other things, crude oil output was pushed up by the beginning of exploitation of several major new oil fields in the north of European Russia and in eastern Siberia, as well as by a number of changes in taxation, designed to reduce the tax burden on the oil sector, to stimulate the efficiency of oil production at Russia’s traditional oil fields and to give impetus to the development of new oil areas. At the same time, the volume of oil refining continued to grow at a faster rate than that of oil extraction, mainly due to a rise in RF petroleum product exports. Russia’s oil refining efficiency remains at a low level: in January–November 2012 it amounted to 71.6% (vs. 70.8% in January–November 2011).

Table 2

Production of Oil, Petroleum Products and Natural Gas in 2005–2012, as a Percentage of the Previous Year

	2005	2006	2007	2008	2009	2010	2011	2012 January–November*
Oil, including natural gas condensate	102.2	102.1	102.1	99.3	101.2	102.1	100.8	100.9
Primary crude oil distillation	106.2	105.7	103.8	103.2	99.6	105.5	103.3	104.6
Motor gasoline	104.8	107.4	102.1	101.8	100.5	100.5	102.0	104.1
Diesel fuel	108.5	107.0	103.4	104.1	97.7	104.2	100.3	97.8
Furnace fuel oil	105.8	104.5	105.2	101.9	100.8	108.5	104.6	101.6
Natural gas	100.5	102.4	99.2	101.7	87.9	111.4	102.9	96.8

* As % of January–November 2011.

Source: RF Federal State Statistics Service.

The year 2012 saw, alongside a slight decline in crude oil exports, a continuing rise in petroleum product exports: in January–September they grew by 5.4% on the corresponding period of 2011 (Table 3). As previously, the largest share of petroleum product exports consisted of fuel oil, which is used in Europe as a raw material for further reprocessing into diesel fuel. In January–September 2012, the share of exports in the total volumes of diesel fuel amounted to 59.1%, that in the volume of motor gasoline - to 8.5%. At the same time, petroleum product imports and their share in the coverage of domestic demand significantly declined. In January–September 2012, motor gasoline imports dropped threefold, thus reducing their share in the total volume of motor gasoline resources to a mere 0.7%.

Table 3

Export of Oil, Petroleum Products and Natural Gas in 2005–2012, as a Percentage of the Previous Year

	2005	2006	2007	2008	2009	2010	2011	2012 January–September*
Oil, total	98.4	98.0	104.0	94.0	101.8	101.2	97.6	99.2
including: exports to non-CIS countries	99.1	98.0	104.8	92.6	102.9	106.1	95.7	99.9
Petroleum products, total	117.9	106.3	108.0	105.0	105.3	106.2	98.5	105.4
including: exports to non-CIS countries	119.1	104.5	107.6	102.0	107.1	109.6	94.6	99.2
Gas, total	103.7	97.6	94.6	101.8	86.2	105.6	104.0	95.5

* As % of January–September 2011.

Source: RF Federal State Statistics Service.

Against the background of high global oil and natural gas prices, in January–October 2012 the share of fuel and energy products in Russian exports amounted to 70.6%, including crude oil exports – to 34.7% (Table 4).

Table 4

Value of Petroleum Product Exports and Their Share in the Total Volume of Russian Exports in 2005–2012

	2005		2010		2011		2012 January–October	
	bn USD	%*	bn USD	%*	bn USD	%*	bn USD	%*
Fuel and energy products, total	154.7	64.1	267.7	67.5	357.2	69.2	304.8	70.6
including: crude oil	83.8	34.7	134.6	34.0	179.1	34.7	149.9	34.7
natural gas	31.4	13.0	47.6	12.0	63.8	12.4	50.9	11.8

* As % of the total volume of Russian exports.

Source: RF Federal State Statistics Service.

As the prices of crude oil and petroleum products in Russia are set as netback prices, equal to the international price of a product less the amount of export customs duty and export freight costs, the behavior of producer prices for crude oil and petroleum products reflects the behavior of their international prices (*Table 5*). The domestic natural gas prices, which are still subject to state regulation, over the course of the current year significantly increased in response to their latest adjustments within the framework of price indexation designed to eventually equalize the profitability of Russian natural gas sales on the domestic and foreign markets.

Table 5

Domestic Prices of Oil, Petroleum Products and Natural Gas Expressed in USD in 2005 – 2012 (Average Producer Prices, USD/ton)

	2005 December	2006 December	2007 December	2008 December	2009 December
Oil	167.2	168.4	288.2	114.9	219.3
Motor gasoline	318.2	416.5	581.2	305.1	457.4
Diesel fuel	417.0	426.1	692.5	346.5	394.8
Furnace fuel oil	142.7	148.8	276.5	125.0	250.8
Natural gas, USD/1,000 m ³	11.5	14.4	17.6	18.1	16.9

	2010 December	2011 December	2012 January	2012 июнь	2012 September	2012 November
Oil	248.2	303.3	319.3	281.8	410.3	340.5
Motor gasoline	547.9	576.9	544.4	542.3	678.2	678.9
Diesel fuel	536.1	644.9	674.9	597.1	725.3	735.7
Furnace fuel oil	246.3	274.6	300.2	276.8	333.0	298.8
Natural gas, USD/1,000 m ³	20.5	21.3	28.5	28.8	35.2	35.1

Source: based on data published by the RF Federal State Statistics Service.

A positive influence on Russia’s oil sector was also produced by a number of alterations in the system of taxation. In recent years, in order to stimulate the development of untapped basin provinces with no adequate infrastructure, Russia established tax holidays with regard to Mineral Resources Extraction Tax (MRET). From the beginning of 2012 onwards, the MRET tax holidays regime is also established for the new oil fields situated in Yamalo-Nenets Autonomous Okrug north of 65°N and for the oil fields in the Back Sea and the Sea of Okhotsk. In order to create incentives for developing small oil fields with initial producible oil reserves of up to 5m tons, Russia’s fiscal authorities have introduced a downward coefficient to be applied to the rate of MRET levied on oil extraction, which specifies the size of oil reserves in a given oil field.

In 2012, Russia adopted some additional measures designed to stimulate oil production. For the new oil fields in eastern Siberia, the MRET tax holidays is extended from 2017 to 2022. Besides, the mechanism for applying reduced rates of export duty on crude oil from new oil fields in eastern Siberia, Yamalo-Nenets Autonomous Okrug and Nenets Autonomous Okrug was legislatively established. Previously, this approach had already been tried in actual practice: reduced rates of export duty on oil were applied to oil fields in eastern Siberia and the Caspian Sea, to Prirazlomnoe oil field on the Arctic Ocean shelf and to extra-heavy oil fields (*Table 6*). However, the mechanism itself for applying such rates had not been legislatively approved.

Table 6

Rates of Export Duties on Oil and Petroleum Products in December 2012, USD/ton

	2012 December
Export duty on oil	396.5
Export duty on oil for oil fields in eastern Siberia, Caspian Sea, and from Prirazlomnoe oil field	193.3
Export duty on extra-heavy oil	39.6
Export duty on gasolines	356.8
Export duty on other petroleum products	261.7

Source: RF Government's Decree of 22 November 2012, No 1201.

At the same time, the tax burden on the gas sector was increased. In November, it was legislatively established that the rate of MRET on natural gas production was to be raised to Rb 788 per m³ in 2015. (Table 7). In conditions of rising domestic natural gas prices, such an increase in the MRET rate should enhance the capture of natural gas rent and thus substantially augment the revenues of the state budget.

Table 7

MRET Rate for Natural Gas in 2010–2015

	2010	2011	2012	2013 1 st half-year	2013 2 nd half-year	2014	2015
MRET rate, Rb/1,000 m ³	147	237	509	582	622	700	788

Source: RF Tax Code (2010–2012 wording); Federal Law of 29 November 2012, No 204-FZ.

The continental shelf of the Russian Federation contains considerable untapped resources of oil and natural gas. However, the development of shelf oil and natural gas fields is associated with very high capital expenditures and operating expenses, and so it is not going to be cost-effective in the framework of the existing general tax system. In December 2012, the RF Ministry of Finance, the RF Ministry of Energy and the RF Ministry of Economic Development agreed upon a coordinated concept of levying taxes on hydrocarbon extraction on the continental shelf, which envisages a special preferential tax regime to be applied to offshore oil and natural gas production.

This tax regime will be based on two pillars: a reduced ad valorem rate of MRET, which is to be differentiated depending on different categories of project complexity, and tax on profit. All shelf development projects are subdivided into four complexity categories. The rate of MRET is to be established, depending on the category of complexity assigned to each project, in the amount of 30, 15, 10 or 5% of the sale price for the extracted hydrocarbons. It is not intended to levy any export duty on the products exported in the framework of the continental shelf development projects.

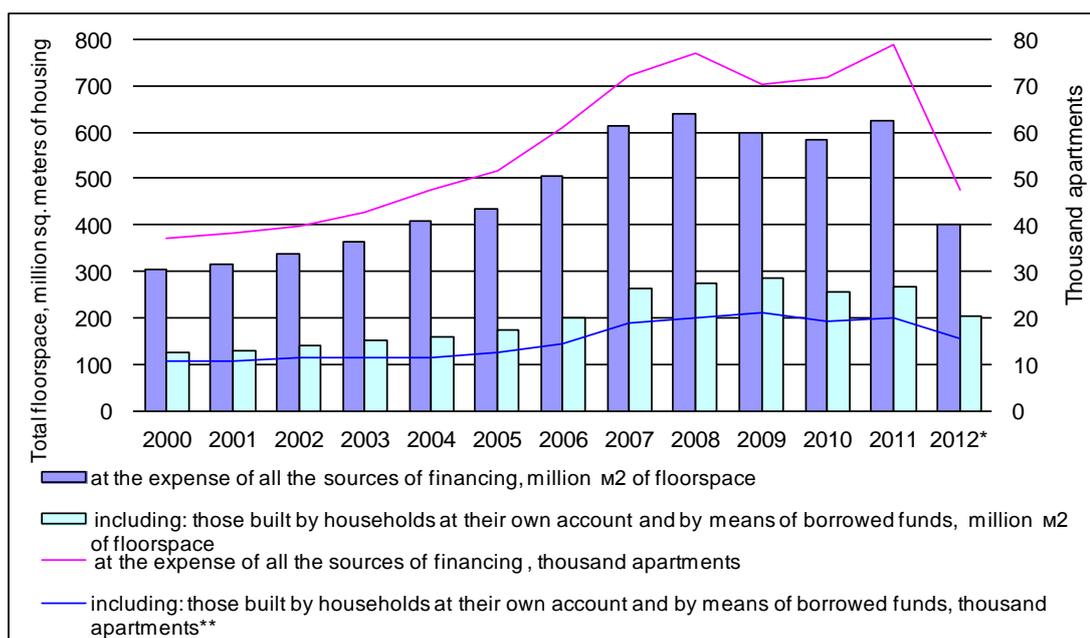
Thus tax regime is expected to create the necessary economic conditions for the development of new oil and natural gas fields on the continental shelf.

G. Zadonsky

The Real Estate Market in the Russian Federation

In January-October 2012, entities of all the forms of ownership built 476,500 apartments with the total floorspace of 40.1m sq. meters which amounts to 103.8% on the respective period of 2011. The ratio between the price of housing and households' income in 2012 points to the fact that housing became less affordable both on the primary and secondary markets. The weighted average interest rate on mortgage housing loans (MHL) in rubles increased within a month from 11.4% as of December 1, 2011 to 12.4% as of November 1, 2012. The debt on MHL as a share of GDP increased to 4.11% as of October 1, 2012 which figure exceeds by 1.51 p.p. the highest pre-crisis value of the year 2008.

According to the data of the Rosstat, in January-October 2012 entities of all the forms of ownership built 476,500 apartments with the total floorspace of 40.1m sq. meters (Fig. 1) which amounted to 103.8% on the respective period of 2011. Of the above number, 67,900 new apartments with floospace of 5.5m sq. meters were built in October 2012. In January-October 2012, individual developers built 20.5m sq. meters of housing (Fig. 1) or 51.1% of the total volume of housing commissioned in January-October 2012 against 50.3% in the same period of 2011.



*) January-October 2012;

***) the statistical data on the number of apartments commissioned by households at their own account and by means of borrowed funds within the specified period is unavailable; the values stated are approximate ones.

Source: the data of the Rosstat.

Fig. 1. Commissioning of apartment houses

As a result of realization of state housing certificates issued to persons who were dismissed from military service and law enforcement agencies, as well as persons made equal to them, 734 apartments were bought in 2012. The total floorspace of housing bought amounted to

40,200 sq. meters, and Rb 1,455.4 m was spent on that including Rb 1,399.2m worth of subsidies which amounted to 96.14% of the utilized funds.

In January-October 2012, 280.5 sq. meters of housing per thousand persons was commissioned on average in the Russian Federation which figure is 2.71% higher than in the respective period of 2011. The largest amount of floorspace was commissioned (*Table 1*) in the Krasnodar Territory where they built 633.6 sq. meters per thousand persons. The benchmark of 400 sq. meters per thousand persons was surpassed as well by the Belgorod Region, the Republic of Tatarstan, the Tyumen Region, the Leningrad Region, the Lipetsk Region, the Chuvash Republic, the Southern Federal District as a whole and the Kaliningrad Region. Moscow is rated the 86th with the index of 103 sq. meters per thousand persons.

Table 1

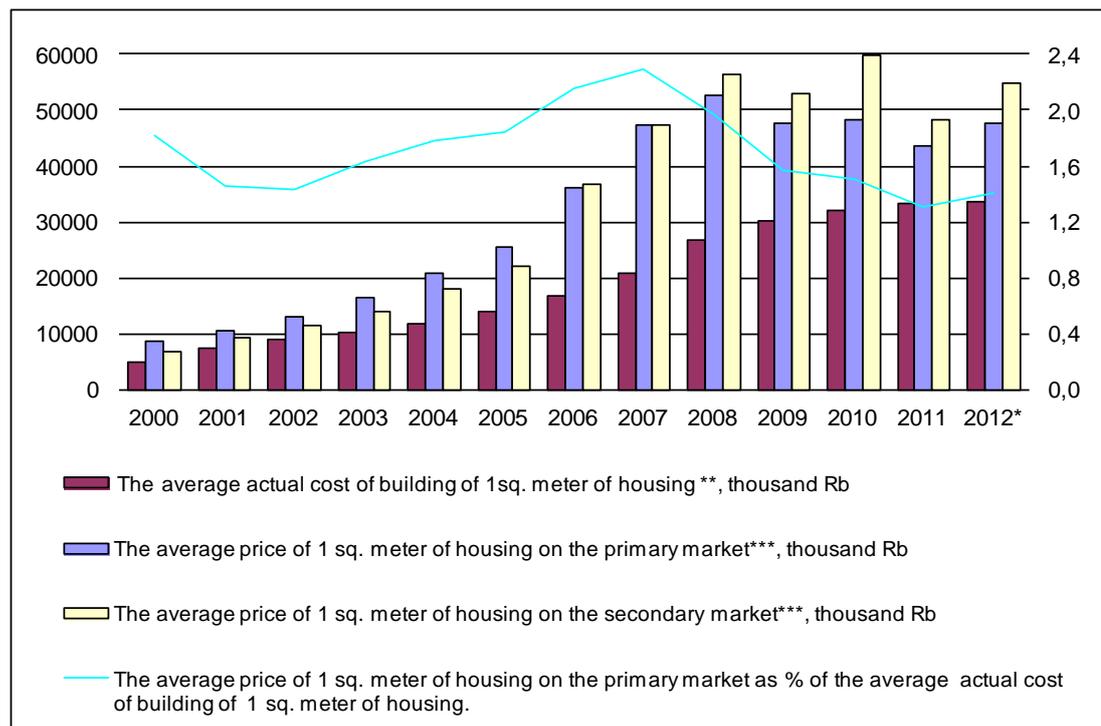
Building of apartment houses by constituent entities of the Russian Federation in January-October 2012, sq. meters per thousand persons

2012*	Regions of the Russian Federation	Commissioned in 2012			Position as regards the number of sq. meters per thousand persons in 2009, 2010 and 2011, respectively
		In the period from the beginning of the year, thousand sq. meters	as % of the respective period of the previous year	Sq. meters of floorspace per thousand persons	
1	The Krasnodar Territory	3,348.5	118.1	633.6	5,4,3
2	The Belgorod Region	887.2	119	577.6	3,3,2
3	The Moscow Region	3,804.5	96.5	528.5	1,1,1
4	The Republic of Tatarstan	1,852.2	97.5	487.0	13,10,8
5	The Tyumen Region	1,544.6	109.5	446.5	9,12,9
6	The Leningrad Region	760.8	109.6	438.8	7,6,6
7	The Lipetsk Region	486.9	105.4	417.6	8,7,7
8	The Chuvash Republic	520.4	95.4	417.3	4,5,4
9	The Southern District (from 2010)	5711	111.6	411.3	17,16
10	The Kaliningrad Region	386.1	104.8	407.8	6,9,12
26	The Privolzhsky District	9,143.1	101.4	306.7	28,27,25
29	The Urals District	3,570.1	110.8	294.0	23,35,31
32	The Russian Federation	40,127.8	103.8	280.5	27,28,30
38	The North-Western District	3,639.6	105.8	266.4	26,26,33
39	The Central District	10,255.7	100.2	266.1	15,19,19
40	The North-Caucasian District	2,374.5	119.3	250.1	52,49,50
46	The Siberian District	4,394.5	95.4	228.2	49,44,44
75	The Far Eastern District	991	97.3	158.2	79,70,62
86	The City of Moscow	1,195.8	83.2	103.0	70,84,84

*) January–September 2012

Source: on the basis of the Rosstat's data

In 2012, the ratio of the average price of a square meter of new housing of the “all apartments” category to the actual cost of building of a sq. meter increased by 9.74 p.p. to 140.85% against the previous lowest value of 131.1% in 2011 (*Fig. 2*). According to the data of the Rosstat, in January-September 2012 the highest cost of development which exceeded by 50% the national average level was observed in the Sakhalin Region (Rb 59,065), Moscow (Rb 53,406), the Yamalo-Nenetsk Autonomous Region (Rb 50,133), the Chechen Republic (Rb 49,580) and the Republic of Sakha (Yakutia) (Rb 49,572). The cost of development is below the national average level in 52 constituent entities of the Russian Federation with the lowest one registered in the Republic of Adygeia (Rb 18,862), the Republic of Karachaevo-Cherkessia (Rb 21,907) and the Lipetsk Region (Rb 21,957).



*) January–September 2012.

**) Average actual cost of building of a sq. meter of housing of detached houses (all the apartments) without additional buildings, overstories and built-in premises in the Russian Federation (without those built by people at their own account and by means of borrowed funds);

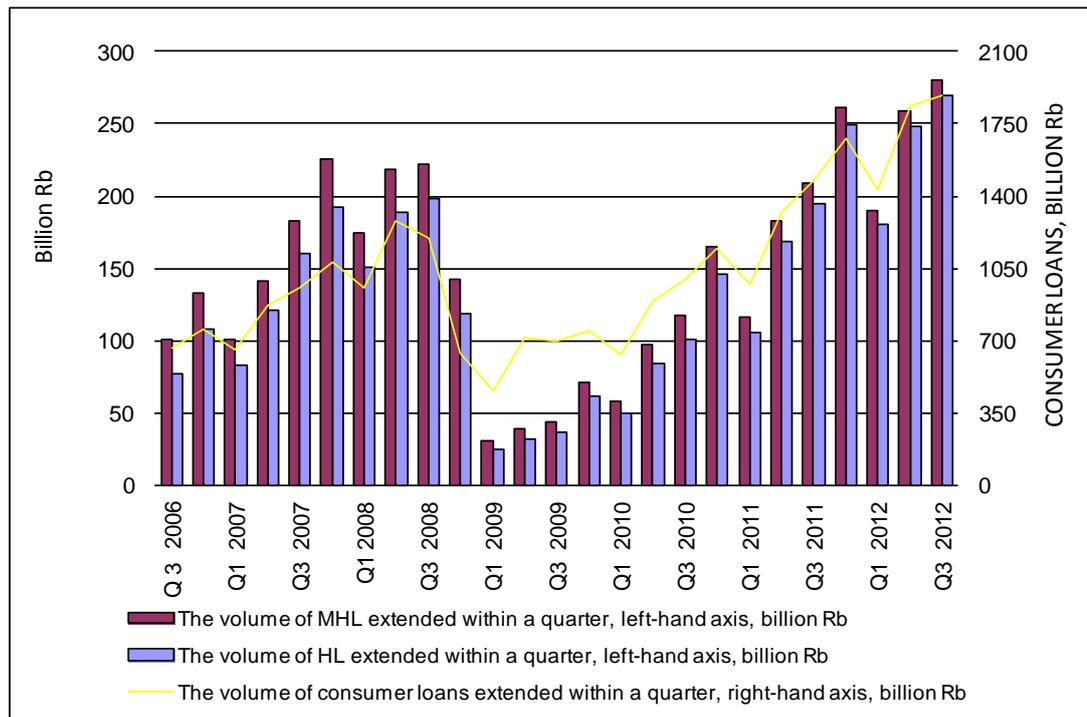
***) all the apartments.

Source: the Rosstat's data.

Fig. 2. The cost of building of a sq. meter of housing and prices of a sq. meter of housing on the primary and secondary markets of the Russian Federation

The housing affordability ratio (HAR) as relation of the cost of a standard 54 sq. meter apartment to the annual income of a family of three members amounted as of October 1, 2012 to 3.47 years and 3.53 years on the primary market and the secondary market, respectively, which figures are 7.07% and 10.74% higher than the respective HAR values as of January 1, 2012.

According to the data of the Central Bank of the Russian Federation, as of November 1, 2012 661 credit institutions extended 544,968 mortgage housing loans (MHL) for the total amount of Rb 801,304bn which exceeded by 49% the volume of MHL extended as of November 1, 2011 (Fig. 3). In the 3rd quarter of 2012, the share of MHL in the consumer lending volume rose by 0.98 p.p. as compared to the 3rd quarter of 2011 and amounted to 14.25%. In the 3rd quarter of 2012, the share of HL in the consumer lending volume exceeded by 0.55 p.p. the share of HL in the 3rd quarter of 2011. According to the Rosreestr's data, the share of mortgaged real property projects in the total number of real property projects registered in real-estate transactions kept growing and according to the January-September 2012 data every fifth transaction with real property was a mortgaged one.



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

Fig. 3. Dynamics of lending to individuals within a quarter

As of October 1, 2012, the volume of MHL amounted to 1.59% of the respective value of GDP against 1.31% in 2011 and 1.67% – the highest pre-crisis value -- in 2007 (Fig. 4). As of October 1, 2012, the debt on MHL amounted to 4.11% of the respective GDP which figure exceeds by 1.4 p.p. and 1.51 p.p. the 2011 value and the highest pre-crisis value in 2008, respectively (Fig. 4).



*) January–September 2012

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

Fig. 4. Dynamics of mortgage housing lending as % of GDP

In 2012, the outstanding debt on MHL in rubles kept growing, while the share of the overdue debt on MHL in rubles in the outstanding debt kept decreasing. As of November 1, 2012, the debt on MHL in rubles increased by 42.8% as compared to November 1, 2011 and amounted to Rb 1,737.78bn. The overdue debt decreased by 3.13% against November 1, 2011 and as of November 1, 2012 amounted to 1.44% of the outstanding debt or Rb 25.01bn. Within the same period, the outstanding debt on MHL in foreign currency decreased by 19.05% and amounted to Rb 129.64bn, while the overdue debt increased by 5.93% and as of November 1, 2012 amounted to 15.16% of the outstanding debt or Rb 19.65bn. The share of the total overdue debt in the total outstanding debt kept decreasing and amounted to 2.39% as of November 1, 2012.

As of November 1, 2012, the share of debt without overdue payments (Rb 1,769.94bn) in the total debt amounted to 94.78%, which is 0.72 p.p. higher than that as of January 1, 2012. As of November 1, 2012, the share of the debt on MHL with payments overdue for over 180 days (the debt of defaulted loans) in the total debt amounted to 2.65%, which figure is 1.01 p.p. lower than that as of January 1, 2012.

Reduction of the weighted average rate on MHL in rubles extended from the beginning of the year (it took place throughout 2010 and 2011) changed for growth from 11.9% as of January 1, 2012 to 12.2% as of November 1, 2012. The weighted average rate on MHL in rubles extended within a month increased from 11.4% as of December 1, 2011 to 12.4% as of November 1, 2012. In 2012, the weighted average rate on MHL in foreign currency extended from the beginning of the year remained unchanged and amounted to 9.7%. As of November 1, 2012, the weighted average period of lending as regards MHL in rubles amounted to 14.88 years which is 0.2 years more than that as of January 1, 2012, while that as regards MHL in foreign currency amounted to 11.63 years.

In 2012, the share of MHL extended in foreign currency from the beginning of the year in the total volume of MHL does not exceed 1.5%. While the share of debt on MHL in foreign currency in the total debt kept decreasing and amounted to 6.94% as of November 1, 2012, the share of the overdue debt on MHL in foreign currency in the total overdue debt varied at about 44%.

According to the expert evaluation of OAO AHML, the share of mortgage lending for buying of housing on the primary market kept growing and in January-September 2012 amounted to 19.16% of the total volume of MHL having exceeded by 5.12 p.p. the 2011 index (Table 2).

Table 2

MHL dynamics on the primary and secondary housing markets

2005	2006	2007	2008	2009	2010	2011	January–September 2012	Forecast: the year 2012
Mortgage loans for buying of housing on the secondary market*, billion Rb								
NA	NA	NA	534.9	136.9	340.1	609.4	558.9	640–800
Mortgage loans for buying housing on the primary market*, billion Rb								
NA	NA	NA	120.9	15.6	38.8	107.5	139.7	160–200
The volume of the primary market of MHL as % of the total volume the MHL extended								
NA	NA	NA	15.98	8.56	8.88	14.04	19.16	19.05

*) The share of loans on the primary and secondary housing markets is determined on the basis of the expert evaluation of OAO AHML.

Source: OAO AHML

In January-November 2012, OAO AHML refinanced 40,806 mortgage loans in rubles for the total amount of Rb 54.7bn (*Table 3*) which figure exceeded by Rb 3.49bn the 2011 result. It is to be noted that the Agency’s mortgage redemption rate amounted to 10.93% (as regards standard products and the *Military Mortgage* product) which is 1.27 p.p. lower than the weighted average annual rate according to the data of the Central Bank of the Russian Federation.

*Table 3***Redemption by OAO AHML of mortgages in 2012 (as of December 1, 2012)**

	By all the products	Standard product	Military mortgage	Maternity capital	New building	Other
Redemption of mortgages, units	40806	24937	7345	3910	4578	36
Redemption of mortgages, thousand Rb.	54748 316	29244907	14635551	5373451	5370361	124045
Average mortgage value, thousand Rb.	1342	1173	1993	1374	1173	3446

Source: the data of OAO AHML.

According to the data of AHML, in the period from October 1, 2009 till November 1, 2012 within the frameworks of the Stimul program the Agency assumed Rb 71.58bn worth of liabilities of which Rb 15.88bn was invested in fulfillment of obligations. AHML refinanced at the rate of 7.7% Rb 29.03bn out of Rb 48.45bn provided by banks to legal entities at the average rate of 12.53% for housing development purposes within the frameworks of the Stimul program.

K. Kazenin

Health Resort Construction in the North Caucasus: Exarcebation of the Land Issue

The plans involving a number of health resort construction projects elaborated by OJSC Kurorty Severnogo Kavkaza [Health Resorts of the North Caucasus] (KSK), a company belonging to the North Caucas tourism cluster, are now faced with some serious problems that have to do with land issues. These problems had already existed prior to the emergence of these projects, but it is largely due to them that the situation became more acute. It is further aggravated by the fact that the real economic interests of the current residents of the future health resort construction zone are interlaced with the issues of ‘historic ownership’ of the land plots earmarked for these projects.

Referring, by way of example, to the recent developments in the Republic of Kabardino-Balkaria, we are going to demonstrate that the situation around the land plots earmarked for the ‘health resort projects’ began to heat up as early as the first half-year of 2012, although the major events in this connection occurred in the second half-year of 2012.

In January, the residents of three villages situated in Cherek raion of Kabardino-Balkaria created a ‘task group’ of 12 persons, who were to exercise public control over the implementation of the ‘tourism cluster’’s activity. According to the information previously released by OJSC KSK, their plans involved the construction of a health resort facility capable of housing simultaneously 15 thousand tourists and incorporating 170 km of alpine ski tracks)¹³. As the company explained, some of the health resort facilities were to be situated in the territory of the Khulamo-Bezengi Gorge. Part of the lands in that gorge are owned by an agricultural federal state unitary enterprise (FSUE). However, the residents of the village of Bezengi claim that these lands are ‘historically theirs’ and insist that it is the village that the ‘tourism cluster’ should conclude the agreement with concerning the allocation of land for the construction project, and that its residents should control each phase of the project’s implementation. The most vocal advocates of that idea are the public leaders who represent the opposition to the raion’s head, Arsen Kanokov. One of the opposition’s veterans, ex-head of the village of Bezengi Muradin Rakhaev, in March made the following declaration: ‘The lands around these places – a ‘titbit’ for the oligarchs – is a recreation territory, to be fully occupied by the ‘tourism cluster’. Probably, in a few years the village of Bezengi will simply disappear from the map of Russia’¹⁴. So, for political purposes, the ‘tourism cluster’ theme was simultaneously being exploited in two different directions: on the one hand, for providing a foundation for the opposition to the business interests of people attached to the Republic’s bodies of authority, who were allegedly going to derive personal profit from the ‘tourism cluster’’s construction; and for the sake of safeguarding the ‘historical territory’ of the Balkarian people, on the other (Balkarians constitute the majority of population in the zone earmarked for the planned health resort construction project, although in the Republic of Kabardino-Balkaria as a whole they are third in number, and

¹³ Nezaviscimaia gazeta [The Independent Newspaper], No 174, 29 August.

¹⁴ Kavkazskii uzel [The Caucasus Knot], 6 March (<http://www.kavkaz-uzel.ru/articles/202503>)

in the post-Soviet period their public organizations became expert in making use of the ‘ethnic minority’ rhetoric for the protection ‘the rights of their people’).

The first response of OJSC *KSK* and the Republic’s officials to the first manifestations of the public opposition to the health resort project was guarded, and they chose to abstain from any specific actions. In May 2012, chairman of OJSC *KSK*’s board of directors Akhmed Bilalov effectively shifted all responsibility for settling the situation onto the government of Kabardino-Balkaria, promising that no construction work will be started under the health resort project until all the land issues were properly regulated¹⁵. Meanwhiler, head of Cherek raion Makhti Temirzhanov announced that, on the initiative of Kabardino-Balkaria’s head, preparations are underway for the transfer of the aforesaid FSUE’s lands in the health resort project’s zone in Cherek raion into municipal ownership¹⁶.

The next round of public confrontation concerning the land issue in Cherek raion began after the presentation, on **28 July**, of the health resort construction project by OJSC *KSK*. Following the presentation, on **18 August** and **7 September**, meetings were held across the raion where the participants demanded that no construction of tourist facilities should be started until the relevant land plots were transferred into municipal ownership to be exercised by the local rural settlements. The number of participants in those meetings varied between 50 and 100 people. In response to the meetings, deputy general director of OJSC *KSK* Rostislav Murzagulov once again emphasized, on behalf of his company, that the necessary steps to settle the land issues should be taken by the authorities of Kabardino-Balkaria. At the same time, Murzagulov declared that until the conflict was not resolved, OJSC *KSK* would restrict its activities in Kabardino-Balkaria to organizing the construction of health resort facilities in Elbrus raion, where no public protests were taking place¹⁷. It should be noted that the new wave of protests against the health resort construction project in Cherek raion coincided with the signing, on **22 August**, of an agreement between Akhmed Bilalov and head of Kabardino-Balkaria Arsen Kanokov concerning the transfer into management to OJSC *KSK* of the controlling stakes in the companies *Kanatnye dorogi Prielbrus’ia* [The cableways of the Elbrus region], *Elbrustourist* and *Kurort Elbrus* [Health Resort ‘Elbrus’]. These companies (OJSCs) own the bulk of the alpine ski infrastructure situated on the eastern slope of Mount Elbrus (Elbrus raion).

After the suspension of the preparatory work under the construction project in Cherek raion and the transfer, by the republican authority, of control over the major infrastructure complexes in Elbrus raion, the public dispute focused on the impending health resort construction projects in Zolsky raion. The Government of the Republic of Kabardino-Balkaria on 22 November released information on the completion of the procedure of outlining the special economic zone in that raion (special economic zones are created in all the raions of Kabardino-Balkaria where health resort construction projects are planned or already being implemented). Almost simultaneously with this event, several deputies of the rural settlements situated in Zolsky raion of Kabardino-Balkaria informed the mass media that the settlements’ assemblies had vetoed any activity of OJSC *KSK* in the raion’s territory, because the land issues there had not been properly settled yet. The heads of those settlements responded by saying that their

¹⁵ Information Agency REGNUM, 11 May (<http://regnum.ru/news/1529618.html>)

¹⁶ ITAR-TASS, 18 August (<http://www.itar-tass.com/c183/499203.html>)

¹⁷ Kavkazskii uzel [The Caucasus Knot], 7 September (<http://www.kavkaz-uzel.ru/articles/212307>)

population was not opposed to the construction projects, while no decisions had been made with regard to the relevant lands because no proposals from OJSC *KSK* had yet been submitted¹⁸.

The land situation in the future health resort construction zone in Zolsky raion, which is situated in the northwest of Kabardino-Balkaria, differs from that in Cherek raion. Much of the territory of Zolsky raion is a mountain plateau covered by pastures. In the Soviet era, the pastures in Zolsky raion, famous for the high quality of their grass, were used by the livestock-breeding farms from several of the republic's raions. In accordance with the Republican Law ‘On the Status and Borders of the Municipal Formations of the Republic of Kabardino-Balkaria’ of 27 February 2005, Zolsky raion's pastures were placed in the category of inter-settlement territories. Since then, two Balkarian villages situated in the close vicinity of those pastures (Kichmalka and Khabaz) have repeatedly submitted their demands that the pastures be included in the borders of those municipal formations. Although in many other cases over the period of 2006–2009 the former inter-settlement territories were transferred to villages under the legislative acts issued by the Parliament of Kabardino-Balkaria, no such decision was adopted in regard of the pastures in Zolsky raion, which represent one of the most attractive mountain territories in Kabardino-Balkaria. Meanwhile, independently from the borders of municipal formations, the status of that territory is subject to the Republican Law of Kabardino-Balkaria ‘On the Procedure for Determining Territories and Using Lands for the Purposes of Transhumance’. In accordance with that Law, which in many respects is a replica of a similar law adopted in Dagestan, the lands for transhumance are recognized to be republican property and are leased to the farms. Thus, at present there exist two legal barriers preventing the deputies of Zolsky raion to make any decisions concerning the destiny of those lands: they lie outside of the municipal borders of the villages and are subject to administration by the Republic's government. Besides, the local deputies have no precise information as to where exactly in the raion's territory the health resort projects are going to be implemented: OJSC *KSK* is planning to start the discussion of that issue only in 2013. However, it is a known fact that the initial demands voiced by the villages of Kichmalka and Khabaz were concerned with the incorporation in their municipal borders of all the relevant lands, including the northern slope of Elbrus, which means that the planned health resort projects are part of their ‘sphere of interests’.

In the second half-year of 2012, the reaction of the government of Kabardino-Balkaria to the land-related problems that arose in the future construction projects' zones had two facets. On the one hand, it was evident that the republican government intended to prove to the local population that their claims had no substantiation, because their interests would be taken into consideration when coordinating the construction projects. Head of Kabardino-Balkaria Arsen Kanokov, in his November interview with the Internet edition of *Kavkazskaia politika* [Caucasus Policies], said as follows: ‘Of course there are those who excite the population by spreading rumors that lands allegedly will be taken away from the local residents, and that there will be nowhere to graze their livestock or to open their businesses. But this is absurd! Nobody is going to take away anything... Some people are attempting to gain cheap popularity in this way. There are no more than 50 of those who stage the meetings, and half of them are not locals, they

¹⁸ IA REGNUM, 4 December (<http://regnum.ru/news/1600606.html>)

are newcomers’¹⁹. On the other hand, the head of Kabardino-Balkaria thus confirmed the plans to implement land reform in the region. Speaking on **24 October** at the meeting of the Public Council under the region’s head, Kanokov named the four core ideas of that reform: ‘Land is allocated from the general land pool and is legally formalized as the private property of a certain group of rural residents, the forms of economic activity can be multiple, agricultural lands cannot be divided into plots less than 10 hectares, and big and medium-sized efficiently operating economic entities are to be preserved’²⁰. Then he also declared that the reform must gradually be completed by 2015–2017.

However, the implementation of land reform in the zone assigned to the health resort construction projects will inevitably give rise to the question as to whether the land plots earmarked for construction will be included in the lands to be transferred to ‘a certain group of rural residents’. It should be noted that no matter what solution is offered for that issue, it will inevitably be fraught with a new upsurge in political protests because, since 2005, a tradition has emerged in Kabardino-Balkaria that involves disputes between different public organizations: the public leaders speaking on behalf of Balkarians insist that all mountain lands must be transferred to Balkarian villages, while those who speak on behalf of Kabardinians refer to the disputable character of the ‘ethnic borders’ in the mountains and to the fact that, in the Soviet era and even earlier, the mountainous lands around Elbrus could also be freely used by the people who lived on the neighboring plain²¹.

Thus, the land-related problems that arose in connection with the North Caucasus ‘tourism cluster’ are far from being resolved, as seen by the example of Kabardino-Balkaria. An overview of the main events of the second half-year of 2012 has led to the following conclusions with regard to the land-related situation in the area pinpointed for the future health resort construction projects:

1. The current status of many lands in that zone is such that the lands are administered by structures that are in no way connected to the local residents. The latter can neither influence the future destiny of those lands in the capacity of stakeholders nor through their village administrations.
2. The public declarations on behalf of the residents of local villages to the effect of protecting their rights to these lands can be heard precisely at the moment when the plans for implementing the health resort construction projects begin to be discussed. Thus it can be assumed that the relevant lands are regarded by the local population (or by those public figures who speak on behalf of that population) primarily as a source of rent, and not as an agricultural resource.
3. The federal structures responsible for the health resort construction projects, and first of all OJSC *KSK*, refrain from any participation in settling the conflict situations

¹⁹ Kavkazskaia politika [Caucasus Policy], 20 November (<http://kavpolit.com/arsen-kanokov-turizm-prioritetnoe-napravlenie-dlya-kabardino-balkarii/>)

²⁰ Interfax, 24 October (<http://www.interfax-russia.ru/South/main.asp?id=355348>).

²¹ For more detail, see K. I. Kazenin. Kabardino-Balkaria: politicheskie protsessy v. 2000-2010 gg. [Kabardino-Balkaria: Political Processes in 2000-2010]. // I. G. Kosikov (Ed.): Severnyi Kavkaz v 2000-2010 gg.: mezhnatsional’nye otnosheniia i vzaimootnosheniia s federal’nym tsentrom [The North Caucasus in 2000-2010: Inter-ethnic Relations and Relations with the Federal Center]. M.: Nauka. 2012.

around the relevant lands, expecting, instead, that some decisions would be taken in this respect by the region’s administration. However, the freedom of manoeuvre for Kabardino-Balkaria’s government is severely limited by the fact that the land issue is closely interlaced with ideology and belongs to the so-called sphere of *Geschichtspolitik* (‘historic policy’).

Ye. Bashkina, T. Edimenchenko

The Development of the Human Resource Capacity of the Federal Target Program ‘Research and Development in the Top Priority Areas of Russia’s Scientific and Technological Complex, 2007-2013’

Analysis of the quantitative and qualitative composition of the personnel directly or indirectly engaged in R&D carried out within the framework of the Program indicates that, since 2009, their numbers have begun to grow. This trend was also apparent in 2011. Among the factors behind this trend was also the fact that not only the state sector and universities, but also the private sector of the economy began to be increasingly interested in the Program. Over the course of five years since the launch of the Program, the average age of R&D personnel engaged in R&D within the framework of the Program has dropped by more than 3% on 2007.

The Federal Target Program ‘Research and Development in the Top Priority Areas of Russia’s Scientific and Technological Complex. 2007-2013’ (hereinafter to be referred to as the Program) is an instrument of the State’s support for science and technology development in Russia.

One of the major tasks of the Program’s implementation consists in the preservation and maintenance of the proper level of qualification of the Russian scientists engaged in R&D. Its second major task is to stimulate the inflow of young specialists into this sphere. The implementation of the Program promotes the development of talent pools as the most important component of the resource base of Russia’s R&D sector, and greatly improves the quality of this component.

Shown below are the results of an analysis of the quantitative and qualitative composition of the personal engaged in the implementation of the Program-related state contracts over the course of 5 years of the Program’s implementation (2007-2011). The initial data for the analysis were taken from the reports submitted by the contractors for the work under the aforesaid state contracts.

Since 2009, there has been a rise in the numbers of personnel engaged in R&D carried out within the framework of the Program. This trend was also apparent in 2011. Among the factors behind this trend was the fact that not only the state sector and universities but also the private sector of the economy began to be increasingly interested in the Program (it has accounted for approximately 20% of the contracts concluded since the launch of the Program).

In 2011, 1,477 contracts were being implemented within the framework of the Program.

The total number of personnel engaged in the execution of work under the Program amounted to 54,767. Of this amount, 45,122 persons were directly engaged in R&D (82% of the total amount of persons engaged in the execution of work under the Program in 2011), while 9,645 persons performed other types of work.

The qualitative (professional) composition of persons directly engaged in R&D in 2011 was as follows:

- researchers and science educators – 33,469, including researchers and science educator aged up to 35 years inclusive – 9,010;
- engineers and technicians – 11,653.

The number of R&D personnel holding doctoral degrees amounted to 7,725, 236 of whom were young (aged up to 35 years inclusive).

The number of R&D personnel holding candidate of sciences degrees amounted to 15,213, 6,203 of whom were young (aged up to 35 years inclusive).

The number of postgraduate students among R&D personnel amounted to 4,461; the number of higher education students amounted to 4,830.

Over the course of five years since the launch of the Program - that is, by the end of 2011 - the average age of R&D personnel engaged in R&D within the framework of the Program has dropped by more than 3% on 2007. In 2011, the average age of this personnel amounted to 41 years (*Fig. 1*).

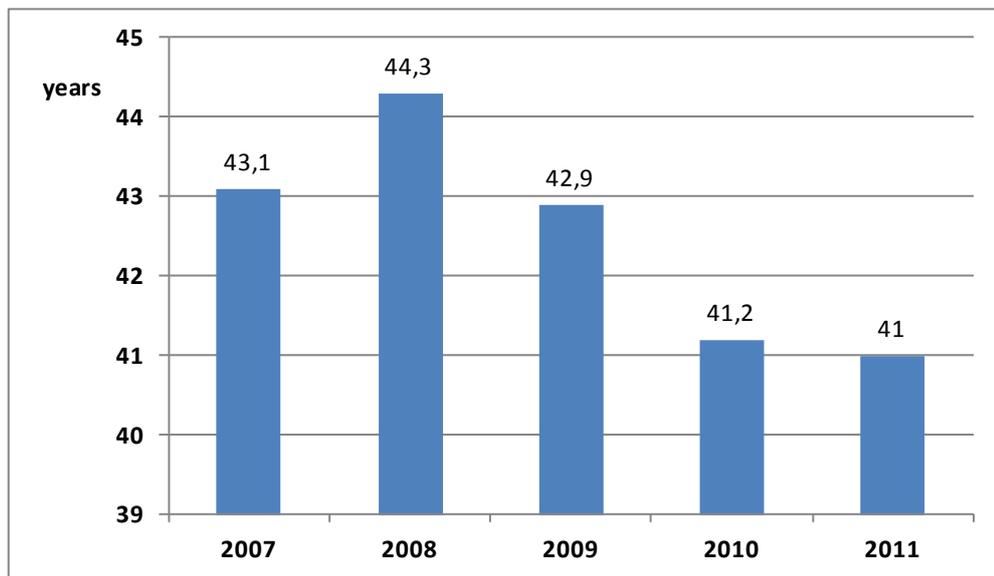
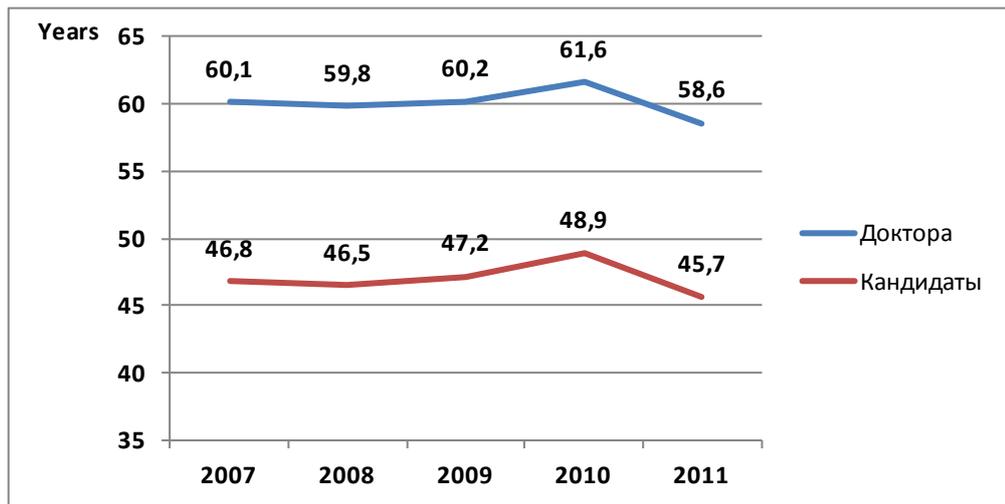


Fig. 1. The Average Age of R&D Personnel

The analysis has shown a rise in the share of researchers holding doctoral and candidate of sciences degrees. In 2011, the average age of doctoral degree holders was 58.6 years, while that of candidate of sciences degree holders was 45.7 years. The reduction, in 2009 and 2010, in the number of contracts concluded under the Program, caused by cuts in financing, resulted in a drop in the number of R&D personnel (including young specialists). As a result, in 2010, the average age of specialists of top qualification notably increased (*Fig. 2*).



Note. Candidates of Sciences; Doctors

Fig. 2. Changes in the Average Age of R&D Personnel Holding Doctoral and Candidate of Sciences Degrees

Table 1 illustrates changes in the numbers and the qualitative composition of personnel engaged in the execution of projects (calculated per contract).

Table 1

Number of R&D Personnel Per Contract, in 2007-2011

Calculated Per Contract	2007	2008	2009	2010	2011
Total	31.07	29.80	34.83	36.90	40.36
including R&D personnel	25.02	24.48	28.11	29.57	32.26
Researchers	16.28	17.13	18.20	19.15	21.76
including aged up to 35 years inclusive	4.92	5.16	5.22	5.75	5.77
Engineers & Technicians	8.74	7.35	9.91	10.42	10.50
Other executors of work	6.05	5.32	6.72	7.33	8.10
Holders of doctoral degrees	3.37	3.74	4.51	5.21	5.22
including aged up to 39 years inclusive	0.13	0.13	0.14	0.15	0.15
Holders of candidate of sciences degrees	7.75	7.75	9.5	9.8	9.90
including aged up to 35 years inclusive	2.65	2.95	3.48	3.91	3.93
Postgraduate students	2.41	2.37	2.52	2.63	2.64
Higher education students	2.24	2.48	2.48	3.21	3.21
Number of contracts being implemented	1297	1363	996	496	1477

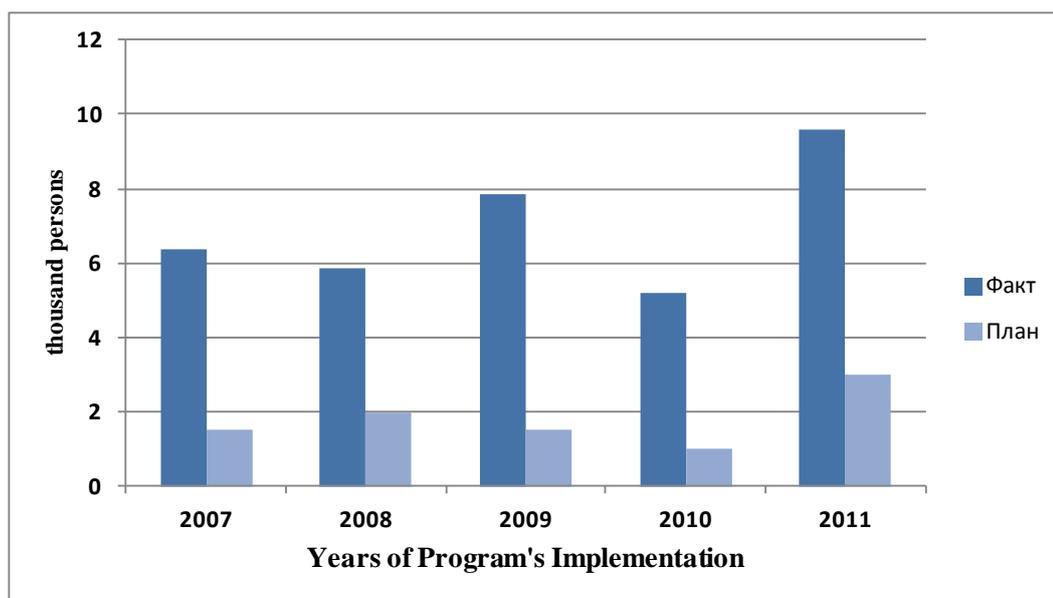
The data presented in Table 1 show a trend toward a reduction in the age of personnel engaged in the projects: the share of young researchers is steadily on the rise, and the same is true for the shares of higher education students and postgraduate students.

One of the major aims of the Program is to boost the inflow of young specialists into the field of R&D. This inflow is seen as one of the principal factors of increasing the ranks of Russia's scientific community.

Under the conditions stipulated in the Program, the category of young specialists should include workers aged no more than 35 years inclusive, who have acquired a higher professional education or secondary vocational training, or final-year students of professional-education establishments, including those without work experience, just starting their careers. The duration of young specialists' participation in research should be no less than two uninterrupted weeks. In order to rule out the possibility of double counting, a young specialist should have the right to be

registered as a participant in only one project being implemented by one or other contractor within the framework of the Program.

In each of the five years (2007–2011) since the Program’s inception, the ‘Number of Young Specialists’ indicator has exceeded two to three times the benchmarks set in the Program. Over the course of that period, 33.84 thousand persons were directly engaged in R&D, while the plan envisaged that only 20 to 23.5 thousand R&D specialists would participate in the Program in 2007-2013. On the average, in each year since the Program’s inception, approximately 7 thousand young specialists were engaged in R&D within the framework of the Program (*Fig. 3*).



Note. Actual; Planned

Fig. 3. Number of Young Specialists Engaged in R&D

In 2011, the ‘Number of Young Specialists Engaged in R&D’ indicator amounted to 9.59 thousand, with the target set at between 3 and 3.5 thousand. In 2011, there were 6.5 young specialists per contract; they accounted for 46% of persons engaged in work under the Program-related contracts.

The age distribution of persons participating in work under the aforesaid contracts was as follows (*Table 2*):

Table 2

The Age Distribution of the Persons Participating in Work under the Program-related Contracts, by Year of the Program’s Implementation, %

Age in Years	2007	2008	2009	2010	2011
16–20	2.29	1.21	1.33	0.35	1.63
21–25	16.60	11.92	16.62	14.26	16.78
26–30	13.16	12.47	14.70	16.56	15.58
31–35	8.02	9.24	9.33	11.48	11.78
36–40	6.01	6.04	6.45	6.72	6.12
41–45	7.11	6.61	6.35	5.28	5.41
46–50	8.89	9.64	8.05	7.30	6.04
51–55	10.57	11.05	9.81	8.99	8.39
56–60	11.08	11.28	9.68	9.45	8.26
61–70	12.74	15.14	13.16	13.50	10.08
Over 70	3.52	5.31	4.76	6.10	7.27

Table 2 shows that

- the share of such workers, aged 26 to 35 years, increased on 2007 (by more than 2.5%);
- the share of such workers, aged 51 to 60 years, decreased on 2007 (by approximately 2 to 3%);
- the share of such workers, aged 36 to 50 years, remained relatively unchanged (at about 20% of the total amount of workers under those contracts).

The age distribution of the persons participating in the work under the Program-related contracts is shown in *Fig. 4*. It can be seen that the share of young specialists significantly exceeds the share of specialists belonging to other age categories.

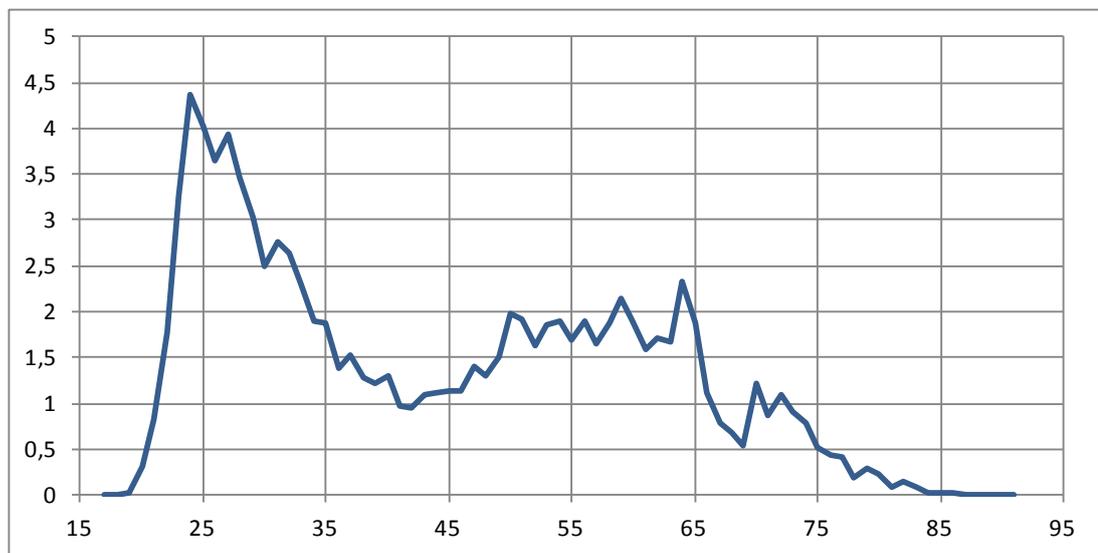


Fig. 4. Age Distribution of the Persons Participating in Work Under the Program-related Contracts in 2011

M. Goldin

Review of Meetings of the Government of the Russian Federation in December 2012

In December 2012, at the meetings of the Presidium of the Government of the Russian Federation the issues of introduction of mandatory pre-trial procedure for appealing by taxpayers against all the non-normative acts of tax authorities, as well as amendments to Federal Law No. 402-FZ of December 6, 2011 on Accounting were discussed.

On **December 7**, at the meeting of the Government of the Russian Federation draft Federal Law “On Amendment of Part I of the Tax Code of the Russian Federation and Recognition as Null and Void of Article 1 (53) of Federal Law No. 229-FZ of July 27, 2010 “On Amendment of Part I and Part II of the Tax Code of the Russian Federation and Some Other Statutory Acts of the Russian Federation, as well as Recognition as Null and Void of Individual Statutory Acts (Provisions of Statutory Acts) of the Russian Federation in Connection with Settlement of the Debt on Payment of Taxes, Duties, Penalties and Fines and Some Other Issues of Tax Administration””.

By amendments to the Tax Code of the Russian Federation, a mandatory pre-trial procedure for appealing by taxpayers against all the non-normative acts of tax authorities is introduced. According to the concept of the architects of the draft law, it is aimed at upgrading of such a procedure for pre-trial settlement of disputes between tax authorities and taxpayers as was set by the existing legislation on taxes and duties, reduction of the load on the judicial system and ensuring of consistency between the pre-trial and trial stages of settlement of such disputes.

On **December 13**, at the meeting of the Government the draft federal law on Amendment of Federal law No. 402-FZ of December 6, 2011 on Accounting was discussed. By amendments, the following changes and additions are introduced:

1. Released from carrying out mandatory book-keeping are individual entrepreneurs and persons engaging in private practice if in accordance with the legislation of the Russian Federation on taxes and duties they keep record of revenues and expenditures and (or) other items of taxation or physical parameters typical of the specific type of business activities. It is to be noted that in accordance with Section 26.3 of the Tax Code of the Russian Federation such indices are accounted for by individual entrepreneurs which use the uniformed imputed income tax.
2. A provision is introduced to the effect that it is inadmissible to accept for book-keeping purposes documents certifying facts of business activities which never took place, as well as fraudulent and imaginary transactions (Article 9). In Article 10, a ban is imposed on recording in ledgers fraudulent and imaginary items of book-keeping. Deemed as an imaginary item is a non-existent item recorded just pro-forma in ledgers (for example, foregone costs and non-existing liabilities), while fraudulent items mean an item which is shown in ledgers for cover-up purposes instead of another one.
3. Accounting (financial) statements are to be prepared on the basis of the data included in ledgers. It is to be noted that book-keeping other than ledgers is inadmissible. Thus, it is explicitly stated that any shadow reporting is illegal.

I. Tolmacheva

Review of Economic Legislation²²

In December, the following amendments were introduced in the legislation: the minimum amount of wages and salaries was increased; from the New Year a new composition and volumes of the consumer goods basket in the Russian Federation in general were formed, and the subsistence level in the Russian Federation will be set on the basis of the new procedure for determination of the consumer goods basket.

I. Federal Laws of the Russian Federation

1. Federal Law No. 232-FZ of December 3, 2012 on AMENDMENT OF ARTICLE 1 OF FEDERAL LAW ON THE MINIMUM AMOUNT OF WAGES AND SALARIES

From January 1, 2013, the minimum wages and salaries are set in the amount of Rb 5,205 a month (earlier, from June 1, 2011 the minimum wages and salaries were set in the amount of Rb 4,611 a month).

2. Federal Law No. 227-FZ of December 3, 2012 on CONSUMER GOODS BASKET IN THE RUSSIAN FEDERATION IN GENERAL

From January 1, 2013, a new composition and volumes of the consumer goods basket in the Russian Federation in general were formed. For the purpose of upgrading the quality of nutrition, the norm of consumption per person a year of meat food, fish products, dairy products, eggs, vegetables, cucurbits crops and fresh vegetables was on average increased, while the norm of consumption of bread, potatoes, vegetable oil, margarine and other fats reduced. Also, the ratio of non-food products and services to the cost of food products (as a percentage of the cost of food products) was set. Earlier, non-food products were set in physical measures.

Table 1

Food products included in the consumer goods basket for the main social and demographic groups of the population in the Russian Federation in general

Name	Unit of measurement	Volume of consumption (on average per person a year)		
		Working population	pensioners	children
Bread products (bread and pasta in terms of flour, flour, cereals and bean)	kg	126.5	98.2	77.6
Potatoes	kg	100.4	80.0	88.1
Vegetables and cucurbits crops	kg	114.6	98.0	112.5
Fresh fruits	kg	60.0	45.0	118.1
Sugar and confectionery in terms of sugar	kg	23.8	21.2	21.8
Meat food	kg	58.6	54.0	44.0
Fish products	kg	18.5	16.0	18.6
Milk and dairy products in terms of milk	kg	290.0	257.8	360.7
Eggs	pieces	210	200	201
Vegetable oil, margarine and other fats	kg	11.0	10.0	5.0
Other products (salt, tea and spices)	kg	4.9	4.2	3.5

²² The review was prepared with assistance of the KonsultantPlus legal system.

As before, the consumer goods basket for the main social and demographic groups of the population (working people, pensioners and children) in the Russian Federation in general will be determined at least once in five years.

3. Federal Law No. 233-FZ of December 3, 2012 on AMENDMENT OF THE FEDERAL LAW ON THE SUBSISTENCE LEVEL IN THE RUSSIAN FEDERATION

From January 1, 2013, in the Russian Federation the subsistence level will be set on the basis of the new procedure for determination of the consumer goods basket. The law provides for new determination of the consumer goods basket, that is, the minimum package of food, non-food products and services which are required for maintenance of health and support of life activity; the cost of non-food products and services is determined in correlation with the cost of the minimum package of food products.

The new procedure will replace the existing regulatory method of determination of the subsistence level on the basis of sets of food products, non-food products and services specified in physical measures. The consumer goods basket will be developed with participation of the Russian tripartite commission on regulation of social and labor relations, while in constituent entities of the Russian Federation, with participation of commissions on regulation of social and labor relations in constituent entities of the Russian Federation. The Government of the Russian Federation will approve guidelines for determination of the consumer goods basket for the main social and demographic groups of the population in constituent entities of the Russian Federation, as well as set the procedure for calculation of the value of the subsistence level per capita and per main social and demographic group of the population in the Russian Federation in general.

II. Instructions, Letters and Orders

1. Order No. 223 of November 30, 2012 of the Ministry of Justice of the Russian Federation ON THE PROCEDURE FOR MAINTENANCE OF REGISTER OF NON-PROFIT ORGANIZATIONS WHICH CARRY OUT FUNCTIONS OF A FOREIGN AGENT

The Order was registered at the Ministry of Justice of the Russian Federation under No. 25980 on November 30, 2012.

An application for a non-profit organization to be entered into the register of non-profit organizations which carry out functions of a foreign agent may be submitted directly or by mail or in the form of an electronic document via the Internet to the units of the Ministry of Justice of the Russian Federation.

An application (in conformity with the form approved by the Order) for a non-profit organization to be entered into the register is submitted simultaneously with its registration to a territorial unit of the Ministry of Justice of the Russian Federation; an application of the earlier registered non-profit organization to the effect that it started its activities as a non-profit organization which carries out functions of a foreign agent is to be submitted (prior to the beginning of those activities) to the Ministry of Justice of the Russian Federation.

The register is maintained on paper and electronic carriers with the data included in the register placed on the official Web-site of the Ministry of Justice of the Russian Federation. Such information on the entity includes, in particular, the purpose and types of its political activities,

the data on the purpose of spending of cash funds and utilization of other property received from foreign sources and information on foreign sources of origination of cash funds and other property, that is, a foreign state, a public authority of a foreign state, an international or foreign organization, a foreign national or a stateless person.

L. Anisimova

An Overview of Normative Documents on Taxation Issues for November-December 2012

In December 2012, a number of amendments and alterations were introduced into tax and budget legislation, as well as into legislation regulating the sphere of mandatory payments and government off-budget funds. An analysis of the possible scenarios for further development of the taxation system and the system of mandatory payments must be done with due regard for the Annual Presidential Address to the RF Federal Assembly delivered by President Vladimir Putin on 12 December 2012 and for the initiatives put forth by the RF Government and the RF Ministry of Finance.

The President Putin’s Address to the RF Federal Assembly confirmed that the flat rate of personal income tax (PIT) would be preserved²³, while the RF Ministry of Finance was charged with the task to ensure that, in 2013, a tax on luxury should be introduced as a substitute for PIT’s progressive scale. The RF President noted that it was intended to strengthen the financial base of Russia’s regions and municipal formations. Thus, in particular, the bulk of taxes levied on small businesses (which are now operating subject to special tax regimes) will be transferred to the municipal level. Besides, many federal exemptions from taxes on property and land owned by legal entities have been abolished. These funds will also be allocated to regional and local budgets. The regions, in order to strengthen their own tax base, will be granted the right from the year 2014 onwards to switch over to immovable property taxation based on its cadastre value; it is planned that by that time the process of valuating immovable property units and verifying the information on their owners will have been completed.

Given the fact that the National Welfare Fund (NWF) has been created in an amount compatible with existing legislation, RF President suggested that the Fund’s surplus receipts (Rb 100bn) should be invested in infrastructure projects through purchasing the liabilities issued by Russian investor organizations.

RF Government has recently become more active in its efforts to search for ways to overcome the currently increasing trend towards stagnation in the Russian economy. In particular, this was demonstrated by the agenda of the discussion concerning the need to fundamentally alter the RF tax system, with the abolition of VAT as an ultimate measure (the discussion was to take place on 26 December 2012). The scheme for government reserve placement has also been changed: the monies borrowed against RF debt obligations will no longer be invested in treasury bonds issued by the governments of the world’s leading countries (as it was routinely done under former RF Minister of Finance Alexei Kudrin); instead, such monies will be invested in various instruments on world markets (including on the domestic market) in order to increase the yield on operations carried on within the framework of RF

²³ A flat rate ensures an automatic tax collection by deduction tax at source. Russia has already accumulated some experience of applying a progressive scale; if it is introduced once again, citizens will be obliged to submit tax declarations on an individual basis and to face the risk of sanctions being imposed on them for potential tax violations.

government debt management and create a source of ‘long money’ for businesses²⁴. At the same time, experts have warned the RF Government of the necessity to maintain proper macroeconomic balance, noting the current lack of coordination between the standpoints of different ministries and departments and the absence of any detailed plan for joint actions of the RF Ministry of Finance and the Bank of Russia on the financial and monetary markets²⁵.

We share the experts community’s opinion as to the necessity of a gradual abandonment of the spontaneous initiatives put forth by the RF Government in response to transient economic circumstances and, for our own part, we believe it to be necessary to more strictly correlate the current policy with the recommendations stipulated in the *Strategy 2020*.

By introducing the basic rule in the budgeting process, keeping the insurance contributions’ margin at the level of 30% and abolishing some of the tax exemptions that expand the base on which insurance contributions are levied will, no doubt, serve as factors that will somewhat suppress any further growth of government expenditure. At the same time, the elimination of the mandatory funded component of the insurance contributions to the RF Pension Fund and the transfer of part of government reserves for placement on the domestic market may give rise to an illusory impression that cheap liquidity has become available, and that investments are on the rise. But the essence of the problem here is that excessive liquidity is created not by the monies owned by commercial structures and citizens, but by mandatory government reserves that have been poured onto the market. If the investments funded by this cheap liquidity are ‘frozen’, the government will be forced to urgently seek a way to cover the current shortage of funding, which may cause a reversal of the proclaimed tax policy course. Therefore, in view of the RF Government’s goal – to speed up the development of infrastructure in this country – we think that the scale of involving government reserves in infrastructure development projects must be very limited. From the point of view of economics, it is better to consider the financing of infrastructure projects as part of budget expenditure while keeping government reserves in the form of risk-free assets – that is, to invest them in treasury securities issued by the governments of the world’s economic leaders.

The proposal that VAT should be replaced by sales tax is evidently a measure aiming to overcome stagnation. The discussion concerning the abolition of VAT is being perpetually revived for the following reasons. VAT is paid by entrepreneurs in advance and is refunded only at the moment of sale of goods (or work, or services), which means that approximately 20% of revenue is thus constantly immobilized in the budget. A sales tax, on the other hand, is paid only in the phase of retail trade – that is, after money has been paid by to the seller. In truth, if VAT is abolished, it will not mean that some additional resources will pour onto the market; soon, the macroeconomic balance between effective demand and supply will once again be reestablished – but at a new level of prices. However, the abolition of VAT may tip the balance between the volumes of commodity turnover and the available budget resources, thus having a harmful effect

²⁴ Yu. Barsukov, D. Butrin. *Fond tronulsia. Vladimir Putin reshil potratit’ iz fonda natsional’nogo blagosostoianiiia dlia nachala 100 mlrd rub.* [The ball has finally started to roll... Vladimir Putin has decided that, for starters, Rb 100bn should be spent from the National Welfare Fund. See Kommersant.ru, the *Kommersant* newspaper No 236 (5021), 13 December 2012.

²⁵ Ye. Gavrilentov. *Neposledovatel’naia politika finansovikh vlastei razgoniaet inflatsiiu* [The inconsistent policy of the financial authorities speeds up inflation]. See Vedomosti.ru 10 December 2012.

on state finances. Besides, if VAT is abolished, an accelerated growth of the shadow market can be expected²⁶.

After President Putin’s Address to the RF Federal Assembly, in which the RF President specifically emphasized the necessity of maintaining a strong state in the Russian Federation²⁷, the RF Ministry of Economic Development almost immediately – in any event, prior to the meeting with Chairman of the RF Government Dmitry Medvedev set for 26 December – adjusted its standpoint towards preserving VAT. (It should be reminded that previously we have repeatedly pointed out that VAT is one of the most important taxes levied on the federal level and generating federal budget revenue alongside mineral extraction tax and customs duties; after Russia’s accession to the WTO its importance will only be increasing – in contrast to customs duties whose role is going to gradually dwindle)²⁸. It is noteworthy that the issue of VAT abolition has recently been raised by foreign – rather than Russian – manufacturers and financiers²⁹. Their attitude is quite understandable: the abolition of VAT in conditions of market globalization and the declining importance of customs duties essentially means the State’s refusal to control imports, because the operation of that tax is based on the principle ‘pay first, and then import and sell’. It is specifically VAT that prevents traders to import into RF territory and stockpile there those outdated commodities that have failed to find their buyers on other markets, because VAT paid on unsold commodities is not refunded. In view of Russia’s accession to the WTO it is undesirable to weaken the role of VAT. Besides, as we have already noted, VAT really prevents the shadow market’s growth. Commodity producers prefer to buy those products whose price incorporates a clearly stated VAT, because thus they can later on get a refund against the amount of incoming tax, which is part of a product’s market price.

Over the period under consideration, the RF Ministry of Finance put forth some initiatives aimed at improving the taxation of personal income. These have to do with equalizing the terms of taxation of personal incomes derived in the form of interest on deposits and bonds, as well as incomes generated by sale of real estate and securities³⁰.

While, generally speaking, we are not opposed to the idea of tax unification with regard to the interest derived by physical persons, the following point must, nevertheless, be emphasized. We do acknowledge the fact that the rate of refinancing increased by 5%, which is

²⁶ The RF Central Bank has explained that the restrictions on cash turnover for individuals proposed by the RF Ministry of Finance as a measure of control over the shadow economy violate the rights and freedoms of citizens guaranteed by the Constitutions.

²⁷ Which implies a fiscally sustainable budget.

²⁸ V. Visloguzov, T. Edovina. *Fiskal’noe udvoenie: Minekonomiki protiv naloga s prodazh, no predlagaet ego vvesti* [A case of tax duplication: The RF Ministry of Economic Development is against the sales tax, but suggests that it should be introduced] See Kommersant.ru, *The Kommersant* newspaper No 241 (5026 of 20 December 2012)

²⁹ In particular, this issue was raised during First Deputy Chairman of the RF Government Igor Shuvalov’s visit to the New York Stock Exchange in December 2012 (see A. Bashkatova. *Svetloe nalogovoe budushchee ot Shuvalova. Deistvuiushchego prezidenta nazvali garantom fiskal’noi stabil’nosti* [The bright fiscal future according to Shuvalov. The current Russian president has been called a guarantor of fiscal sustainability]. See www.ng.ru of 5 December 2012).

³⁰ *Minfin predlagaet uravniat’ nalogooblozhenie po depozitam, aksiyam i obligatsiyam* [The RF Ministry of Finance suggests equal taxation to be levied on deposits, shares and bonds]. Finmarket Information Agency, 28 November 2012, www.vedomosti.ru;

Yu. Barsukov. *Minfin sulit naseleniiu nalogovye vychety. Grazhdane mogu poluchit’ nalogovye l’goty pri investirovaniy v tsennye bumagi* [The RF Ministry of Finance promises tax deductions to the population. Citizens may be granted tax exemptions when investing in securities]. See Kommersant-online, 28 November 2012.

taken into account when determining the size of deduction from the tax base for interest on deposits, is established by the Bank of Russia, and the banking licenses issued to banks confirm that they know the rules for applying that rate; but the other market participants issuing interest-generating liabilities (bonds) are not obliged to know how that rate should be applied. At the same time, we believe that the possibility of replacing the Bank of Russia’s refinancing rate by an absolute deduction (in the amount of Rb 1m) (which is being considered by the RF Ministry of Finance) is not feasible. There can exist multiple interest-generating sources, and if an absolute deduction is applied in every case, then the greater the number of brokers and deposits, the greater the resulting accumulated amount of absolute deduction. As a result, the recipient of interest will be obliged to go to a tax inspectorate, to personally submit a tax declaration and a pile of documents confirming all the received amounts of interest, and then to pay the additional amount of tax. As a result, one of the most important advantages of personal income tax’s flat rate of 13% is that tax is automatically deducted at source, thus freeing the taxpayer from the cumbersome necessity to go personally to a tax inspectorate and to wait in line to be received there, to collect the necessary documents, and to lower the risk of tax arrears and the resulting sanctions. It can be recommended that the RF Ministry of Finance, in order to unify the rules for levying tax on interest, should legislatively establish the rate of tax to be deducted from the received interest (similarly to the rate of refinancing established by the Bank of Russia) instead of establishing the amount of absolute deduction.

As for the proposal that unified rules should be established for the taxation of incomes from sale of real estate and securities, it is not quite clear what exactly it means. The taxation of individual investors’ operations with securities and derivatives circulating on the organized financial market have been long ago brought in conformity with the taxation scheme established for individual entrepreneurs and investor organizations (Article 214.1 of the RF Tax Code). To those securities and derivatives that are not circulated on the organized market, the same procedure as established for the income from sale of real estate is actually applied (Article 217, Item 17.1). The tax-exempt incomes, alongside the income derived from sale of real estate that has been owned by a taxpayer over a period of 3 or more years, also includes the incomes from sale of other property owned over a period of 3 or more years (securities which are not circulating on an organized market are fully compatible with the definition of ‘other property’, in contrast to stakes which are not formalized as securities).

Within the framework of the elaboration of Federal Law No 216 of 3 December 2012 on the federal budget for 2013 and the planning period 2014 – 2015, a package of amendments to the RF Tax Code and the legislation regulating other mandatory payments was adopted.

1. By Federal Law of 3 December 2012, No 245-FZ an exemption from VAT is established for the import of cultural valuables purchased by state and municipal institutions irrespective of the source of funding for the purchase – budget funds, incomes from other commercial activities, or other incomes allowed by legislation.

2. By Federal Law of 29 November 2012, No 203-FZ the list of excisable goods is expanded (to include household furnace fuel), and the rates of excise duties on petrol, alcohol beverages and alcohol-containing products are raised.

3. By Federal Law of 29 November 2012, No 205-FZ, in order to protect the interests of low-income citizens, courts of justice are granted the right to exempt such persons from the payment of state duty on a case being considered by a given court of justice.

An exemption from personal income tax (PIT) is established for the sums of additional benefit received by families with children; for the sums of compensation paid to medical practitioners; and for state and municipal immovable property granted to taxpayers free-of-charge.

4. The most important clarifications introduced into the RF Tax Code by Federal Law of 29 November 2012, No 206-FZ we believe to be as follows.

In the main body of the RF Tax Code, the issue of reinstating a depreciation premium as part of the income derived from the sale of fixed assets effectuated between two mutually dependent persons. It should be reminded that, for a long time, this has been one of the most painful issues because, in absence of any mechanism of control over transactions concluded between mutually dependent persons, the requirement of the RF Ministry of Finance concerning the reinstatement of a depreciation premium served as an artificial obstacle to tax-free withdrawal of incomes outside of the jurisdiction of the Russian Federation during a transfer of property from one mutually dependent person to another at an underestimated price, and so it was constantly disputed by taxpayers. In the new version of paragraph 4 of Item 9 of Article 258 of the RF Tax Code it is directly stipulated that in an event of sale of a fixed asset (to which a depreciation premium has been applied) to a mutually dependent person, the said depreciation premium is to be charged to overheads for a period of five years since the moment of putting that asset into operation. Accordingly, when a depreciation premium is reinstated, the balance sheet value of the sale of that fixed asset will be increased by the same amount. As a result, the sum of the tax will be the same – whenever that item is sold to a mutually dependent person or to another entity.

The list of commodities to be levied by VAT at the rate of 10% is extended, to include culinary and baking fats, milk fat and cocoa butter substitutes, spreads, and melted blends.

In order to determine the tax base for tax on profit levied on mobilization facilities put in reserve and not used in production, the general depreciation procedure is applied. All the current expenditures on mobilization training, including the cost of the upkeep of the assets and facilities needed for the fulfillment of the mobilization plan, are to be treated as the taxpayer's overheads. In this connection, the RF Tax Code does not mention budget allocations as a source of funding. It seems that budget subsidies allocated for these purposes are now treated as the payment for the services involved in the maintenance of mobilization facilities.

The notion of ‘bad debt’ (irrecoverable debt) has been defined more precisely. This is a very important clarification, because it specifies the conditions for recognizing debt as such for taxation purposes – the existence of an order issued by a court bailiff concerning the termination of proceedings, which confirms the futility of the effectuated measures due to the impossibility of locating the debtor, the debtor's property and deposited monies.

The trust management founder, for the purpose of calculating the amount of its taxable profit, is not allowed to recognize the losses incurred under those trust management agreements

where it is not recognized as a beneficiary. At the same time, a beneficiary is not allowed to recognize the losses incurred under such agreements for the purpose of profit taxation, either.

The date of realization of immovable property is specified more precisely: for the purpose of levying tax, this date is recognized to be the date of transfer of such property to the buyer under an act of immovable property transfer.

5. By Federal Law of 3 December 2012, No 243-FZ ‘On Introducing Alterations into Some Legislative Acts of the Russian Federation on Mandatory Pension Insurance Issues’, the rates of insurance contributions in state off-budget funds are prolonged through the years 2014 and 2015: the general rate – 30% (of which 22% goes to the RF Pension Fund, 2.9% - to the Social Welfare Fund, and 5.1% - to the Federal Fund for Compulsory Medical Insurance), the amount in excess of the established margin³¹ is 10% (this type of payment is to be transferred only to the RF Pension Fund). From 2014 onwards, the mandatory funded component of the pension insurance tariff for the persons born after 1967 will be decreased to 2%. An exception is made for those individuals who, as of 31 December 2013, will have concluded mandatory pension insurance agreements and submitted notification stating that their funds have been switched over a non-governmental pension fund, or submitted notifications informing of their choice of a government asset manager’s investment portfolio. Such individuals, from 1 January 2014, will be granted the right to make a choice between different variants of pension provision: to transfer to the funded component of their labor provision either 2% or 6% of their insurance contribution tariff.

Some additional insurance contributions are introduced for the benefit of individuals engaged in underground work, or work with harmful and/or dangerous conditions of labor, or work in hot shops – in the amount of 4%, with the subsequent increase in the rate of the tariff to 9% by 2015; for those employed in the textile industry with increased labor intensity and some other categories of employees, the additional tariff size will amount to 2% in 2013, and then will be gradually increased to 6% in 2015. These additional tariffs are to be applied to the entire insurance base, without taking into account the margin established for each financial year.

The size of insurance contributions to the RF Pension Fund has also been increased for individual entrepreneurs, lawyers, notaries and self-employed persons. For them, the fixed size of contributions to the RF Pension Fund will be determined on the basis of a double size of minimum monthly salary established as of the beginning of a relevant financial year. In other words, the taxation base will now be calculated by multiplying the double minimum monthly wage amount by 12 (months). The fixed size of contributions to the Federal Fund for Compulsory Medical Insurance will be determined, as before, on the basis of a single minimum monthly wage amount.

6. By Federal Law of 29 November 2012, No 202-FZ a number of alterations is introduced into the RF Tax Code with regard to tax on property of organizations, and transport and land taxes. Tax on property will no longer be levied on newly acquired (or created) movable property belonging to the category of fixed assets. Besides, this tax is no longer to be levied on cultural heritage objects of federal importance, nuclear installations used for scientific purposes,

³¹ In 2012 – Rb 512K, in 2013 – Rb 568K, in accordance with the RF Government’s Decree of 10 December 2012, No 1276.

nuclear waste repositories, nuclear-powered icebreakers, outer space systems, and vessels entered in the Russian International Register of Vessels. It should be reminded that these types of property are no longer to be placed in the category of objects of taxation – that is, they are not subject to regulation by the RF Tax Code in the part of tax of property of organizations.

Tax on property (at a lower rate) is from now on to be levied on railway tracks, trunk pipelines and electric power transmission lines.

Lower rates of land tax are established for those land plots that are granted for the purposes of state defense, security and customs service and are subject to restricted turnover in accordance with RF legislation.

7. One of the spheres regulated by tax legislation is usually the verification of compatibility of taxpayers' incomes and expenditures. In the Russian Federation, the system of control over incomes and expenditures is treated within the framework of anti-corruption legislation, which lies beyond the domain of the RF Tax Code. The normative base for control over the consistency of taxpayers' incomes with their expenditures is explained in Letter of the RF Ministry of Finance of 25 July 2012, No 03-02-07/2-107 and Letter of the Federal Tax Service of 31 August 2012, No ED-4-3/14509. In December 2012, several legislative acts were adopted in order to further specify the mechanism of control over the consistency of the incomes of civil servants, other high-rank officials, members of the RF Government, the staff of state and municipal administrations and their next of kin, including minors, with their expenditures.

In particular, in connection with the adoption of Federal Law of 3 December 2012, No 230-FZ 'On Control over the Consistency of the Expenditures Made by Persons Holding Government Offices, and by Other Persons, with Their Incomes', some alterations have been introduced by Federal Law No 231-FZ of 3 December 2012 in the federal laws whereby it is established that those citizens who apply for or occupy the posts that are subject to tax control will be obliged to submit, in the established procedure, information concerning their expenditures, as well as the expenditures of their spouses and children of minority age, incurred in the course of each transaction of purchase of a land plot, other immovable property object, means of transportation, securities, shares (or equity stakes or participating interests in the charter (or share) capital of an organization), if the amount of transaction exceeds the family's aggregate income received over three previous years, and information concerning the sources of monies covering the amount of the transaction. The corresponding alterations were introduced in the RF Federal Laws 'On Banks and Banking Activity', 'On the Tax Agencies of the Russian Federation', 'On the Prosecution Service of the Russian Federation', 'On the Status of Judges in the Russian Federation', 'On the Audit Chamber of the Russian Federation', 'On Service in the Customs Bodies of the Russian Federation', 'On Military Duty and Military Service', 'On the General Principles of the Organization of the Legislative (Representative) and Executive Bodies of State Authority of Subjects of the Russian Federation', etc.

Besides, the alterations introduced into Item 2 of Article 235 of the RF Civil Code establish the possibility of 'converting, by a court decision, into the revenue of Russian Federation, the property in respect of which no proof has been presented as to its acquisition with money received as a lawful income in accordance with the anti-corruption legislation of the Russian Federation'.

By the alterations introduced into the RF Labor Code (Item 7.1. Article 81) it is envisaged that failure, ‘on the part of a worker, to implement measures designed to prevent or settle the conflict of interests that he or she is a party to, their failure to submit information on their incomes, expenditures, property and property liabilities, or their submission of incomplete or not authentic information thereon, or their failure to submit or their deliberate submission of incomplete or incorrect information on the incomes, expenditures, property and property liabilities of their spouses and children of minority age, or their deliberate submission of incomplete or not authentic information thereon in the cases envisaged by federal laws and normative legal acts issued by the RF President and the RF Government, if the said acts can provide grounds for a loss of trust in the worker by his or her employer’, can constitute appropriate grounds for not giving this citizen the job he or she has claimed for, or for dismissing this citizen from such a job.

By Federal Law of 3 December 2012, No 4-FKZ amendments were introduced to Article 10 of the Federal Constitutional Law ‘On the Government of the Russian Federation’. In accordance with these amendments, the members of the RF Government will also have to declare not only their incomes, but also their large-scale expenditures, including the expenditures of their spouses and children of minor age.

The expenditures incurred by a member of the RF Government, his or her spouse and children of minor age, the information of which must be submitted by the member of the RF Government, are defined as transactions involving the purchase of a land plot, other immovable property objects, means of transportation, securities, shares (or equity stakes or interests in the charter (or share) capital of an organization), if the amount of the transaction in question exceeds the aggregate income received by the member of the RF Government and his or her spouse over three years prior to the transaction. It will also be necessary to specify the source of monies covering the amount of the transaction.

8. By Regulation of the RF Government of 3 December 2012, No 2250-p the plan of measures designed to improve normative legal regulation for the purpose of preventing tax evasion is approved. First of all, these measures are aimed at ensuring the freedom of access for tax agencies to the information on monies kept on the bank accounts (or as deposits) by organizations and individuals; access to the information on the activity of third parties who act as participants (or intermediaries) in especially large transactions concluded by a taxpayer; the list of grounds for a denial of State registration to a legal entity is specified; the proposals aimed at preventing tax evasion via offshore jurisdictions are prepared, including the introduction in legislation of the notions ‘tax resident – organization’ and ‘actual recipient of income’, the definition of the procedure for levying taxes on non-distributed profit of controlled foreign companies; the publication in the Internet of the list of payers, tax agents, and banks that delay for 2 months or longer the payments in regard of the claims filed by tax agencies, etc.

9. One of the key events in the sphere of taxation that occurred over the period under consideration was the publication of Resolution of the RF Supreme Arbitration Court of 29 November 2012, No VAS-13840/12. The essence of the Resolution is by no means the subject of the dispute, which was as follows: OJSC *Sibirskaja energeticheskaja kompania* [Siberian Energy Company], having read Explanatory Letter of the RF Ministry of Finance of 4 April 2012, No 03-03-10/34, arrived at the conclusion that the explanation concerning a zero rate being not

applicable to dividends paid from previous years' profits imposed on taxpayers an additional burden of paying profit tax. To put this matter straight, the company submitted to the RF Supreme Arbitration Court a petition that the said letter should be recognized as null and void. The RF Supreme Arbitration Court decided that the Ministry's letter referred to an unspecified range of taxpayers, and therefore it was an act adopted (or issued) by a federal body of executive authority empowered to perform the function of elaborating government policy and exercising normative legal regulation in the sphere of taxes and levies, and so it contained explanations that were to be applied on a multiple basis and was to be considered from the point of view of its essence (thus the Court confirmed that the issuance of such explanations was within the sphere of competence of the RF Ministry of Finance). Having considered the issue from the point of view of its essence, the RF Supreme Arbitration Court disagreed with the standpoint of the RF Ministry of Finance, recognized it to be incompatible with existing legislation, and ruled that the letter should be recognized as null and void and demanded that the legal costs should be paid by the RF Ministry of Finance for the benefit of OJSC *Sibirskaja energeticheskaia kompania* in the amount of Rb 2,000.

Thus, what in reality took place was a judicial expert's estimation of the status of the explanatory letters issued by the RF Ministry of Finance. The recognition to be null and void of an act adopted by a federal ministry with regard to issues placed within the sphere of that ministry's competence entailed no payment of any penalties from the budget, and the taxpayer did not suffer, either, because the court required the RF Ministry of Finance to pay court costs. Thus, the RF Supreme Arbitration Court has explicitly shown that it is possible, in the framework of existing Russian tax legislation, to implement in practice the form of operative control, by judicial instances, over the compliance of acts issued by ministries and departments with the existing laws in absence of any actual property dispute, and the abolition of such acts in the event of their incompatibility with the norms stipulated in the laws – in full correspondence with international legal practice.

M. Goldin

Changes in the Regulatory Base of the Budgetary Process

In December 2012, some expenditure liabilities of the federal budget were suspended and some rules of the budgetary process changed.

By Federal Law No. 237-FZ of December 3, 2012 on Suspension and Recognition as Null and Void of Individual Provisions of Statutory Acts of the Russian Federation in Connection with Federal Law on the Federal Budget in 2013 and the 2014-2015 Planned Period some expenditure liabilities of the Russian Federation were suspended.

So, until January 2014 such provisions of Federal Law No. 247-FZ of July 19, 2011 and Federal Law No.306-FZ of November 7, 2011 as provide for indexation against the inflation rate of the amount of a pay (in accordance with the military rank and title) of servicemen of the Armed Forces of the Russian Federation, internal security troops of the Ministry of the Interior of the Russian Federation and law-enforcement agencies of the Russian Federation are suspended.

Also, suspended for one more year are the following provisions:

1) such provisions of Federal Law No. 73-FZ of June 25, 2002 on the Projects of Cultural Heritage (Monuments of History and Culture) of Peoples of the Russian Federation as provide for:

- assignment to public authorities of constituent entities of the Russian Federation of powers as regards preservation, utilization and promotion of cultural heritage projects which are in federal ownership;
- compensation of preservation expenses incurred by the owner of the cultural heritage project of federal importance included in the single state register of cultural heritage projects (monuments of history and culture) of peoples of the Russian Federation or the one who uses it on the basis of a free-use agreement;

2) such provisions of Federal Law No. 329-FZ of December 4, 2007 on Physical Culture and Sport in the Russian Federation as provide for:

- assignment of powers of the Russian Federation in the sphere of physical culture and sport to public authorities of constituent entities of the Russian Federation;
- expenditure liabilities of the Russian Federation as regards execution and maintenance of sport passports.

By Federal Law No. 244-FZ of December 3, 2012 On Amendment of the Budget Code of the Russian Federation and Individual Statutory Acts of the Russian Federation, significant amendments were introduced into the Budget Code of the Russian Federation as regards regulation of the budgetary process. Without making pretence for a comprehensive analysis of all the amendments provided for by the Federal Law, let's consider some of them.

So, norms of distribution of allocations to budgets from payment of some taxes and other mandatory payments were changed. For instance, it was established that the amount of money

sanctions (fines) for a failure to comply with municipal statutory acts is subject to be paid on the basis of the norm of 100% to budgets of municipal entities which approved the respective municipal statutory acts. Earlier, there was a legal gap as regards the above area of legal regulation.

Also, allocations from payment of excise duties on alcohol products with the ethanol volume concentration of over 9%, except for beer, wine, pop wine, sparkling wine (champagne), and wine drinks produced without adding of rectified ethanol produced out of food raw materials and (or) alcoholized vinicultural or other fruit mash and (or) wine distillate and (or) fruit distillate will be paid on the basis of the norm of 60% to the budget. Earlier, 50% of the amount of the paid excise duties on alcohol products was paid to the federal budget.

In addition to the above, revenues from the individual income tax payable by foreign nationals in the form of a fixed advance payment in carrying out by them of labor activities on the basis of a patent in the territory of the Russian Federation are subject to payment to the federal budget on the basis of the norm of 50%. Earlier 100% of the above payment was transferred to the budget of the constituent entity of the Russian Federation.

If a three-year period of budget planning is fixed by the legislation of the constituent entity of the Russian Federation, a moratorium will be in force on reduction of single norms set by the regions on allocations to budgets of municipal neighborhoods and urban districts from individual federal and (or) regional taxes and duties and taxes provided for by a special tax regime within three years from the day of entry into force of the law of the constituent entity of the Russian Federation on the deadlines for drawing up and approval of budgets of municipal neighborhoods and urban districts and (or) introduction of single norms of allocations to budgets of municipal neighborhoods and urban districts, respectively, except for cases of introduction by federal laws of amendments which result in growth in expenditures and (or) decrease in revenues of budgets of constituent entities of the Russian Federation.

Apart from the existing 20% norm on allocation to local budgets of tax revenues of the consolidated budget of the constituent entity of the Russian Federation from the individual income tax, amendments to the Budget Code of the Russian Federation introduce an obligation for public authorities of the constituent entity of the Russian Federation to set differentiated norms of allocations to local budgets from payment of excise duties on motor and directly distilled gasoline, diesel fuel and motor oil for diesel and (or) carburetor (injector) engines produced in the Russian Federation on the basis of crediting to local budgets of at least 10% of the tax revenues of the consolidated budget of the constituent entity of the Russian Federation from the above tax.

It is to be noted that the amounts of the above differentiated norms of allocations to local budgets are determined on the basis of the length of local motorways which are in ownership of relevant municipal entities.

Also, the Budget Code of the Russian Federation sets such rules of establishment and operation of investment funds of constituent entities of the Russian Federation as are similar to provisions of the Budget Code of the Russian Federation as regards the Investment Fund of the Russian Federation.