Section 6. Institutional Issues

6.1. Public Sector Status and Privatization Process

6.1.1. Public Sector Share of the Russian Economy

The quantitative federal property data[1] from official sources (*Table 1*) proves with assurance that in 2011 the total number of property assets registered with the federal property register decreased by more than 12% against the peak (1.562 million items) in the beginning of 2011. As of the beginning of 2012, however, it outstripped the value reported two years ago.

Table 1

The number of organizations using federal property, and property assets registered with the federal property register in the period between 2008 and 2011 (units)

Date*	Federal State Unitary Enterprises (FSUEs)	Business entities (JSCs and LLCs) with federally held share (interest)		Total number of federal property assets registered with the registry	
		Total	special right ("golden share") without interest holding	on paper	in the Computerized Federal Property Accounting System (CFPAS)
as of January 1, 2008	5709	3801/3647**	127	…	…
as of January 1, 2009 (December 31, 2008)	3765	3503/3338**	136	701325	14096
as of January 1, 2010 (December 31, 2009)	3517	3066/2920**	117	1276572	1193121
as of January 1, 2011 (December 31, 2010)	…	3077	120	1562018	1552121
as of January 1, 2012 (December 31, 2011)	…	2930***	111	1371266	1367975

* – according to the quantity of federal property assets registered with the registry in the CFPAS as of December 31 of the relevant year;
** – only JSCs as denominator;
*** – as of December 28, 2011, including 2794 JSCs, 25 LLCs and 149 JSCs with the special right of the Russian Federation to participate in management ("golden share") (without a federally held interest in 111 of them), 2822 JSCs with state participation are managed through the Federal Agency for State Property Management.
Source: Forecast Plan (Program) for the Federal Property for 2009 and the Guidelines of Federal Property Privatization for 2010 and 2011, the Forecast Plan (Program) for the Federal Property for 2010 and the Guidelines of Federal Property Privatization for 2011 and 2012, the Forecast Plan (Program) for the Federal Property and the Guidelines of Federal Property Privatization for 2011–2013; the data of the Ministry of Economic Development and Trade of Russia on the basis of the federal property register, www.rosim.ru.

The aggregate quantity of business entities with state participation also decreased by 4.8% in 2011, however, it decreased by much more in 2008 and 2009, whereas a small growth was reported in 2010. As a result, the number decreased for the first time below 3,000 as of the

[1] In 2011, given the Forecast Plan (Program) for the Federal Property Privatization for 2011-2013 approved at the end of November 2010. No new annual privatization program was approved by the Russian Federation Government, as it did in the 2000s. In the meantime, it is these documents that traditionally contained the data on the quantity of federally held enterprises (FSUEs) and joint stock companies with a state-held interest as of the beginning of the calendar year. Therefore, there is no sufficient information that would allow an impartial judgment to be made as to the dynamics of these components of the public sector in 2011, however, the federal property registry's data allows evaluation of the trends in the movement of the total number of the registered companies and business companies with a state-held interest.

beginning of 2012[1]. The number of JSCs which are subject to a special right of state participation in management thereof ("golden share") (about 100 companies) was also minimum throughout the entire 2000s.

The turn back in the upward trend, which developed as early as the mid-2000s, towards share holding which allows the state to realize a comprehensive corporate governance at business entities, became a new phenomenon in the corporate sector with state participation in 2011 (*Table 2*).

Table 2

Dynamics and quantity structure of business entities with state capital participation (save for JSCs which are subject to a special right ("golden share") without interest holding) in 2008 – 2011

As of January 1	Business entities (JSCs and LLCs) with federally held share (interest)											
	Total quantity	interest, %	state-held interest									
			100%		50–100%		25–50%		2–25%		less than 2%	
			q.	%	q.	%	q.	%	q.	%	q.	%
2008	3674	100.0	1989	54.1	269	7.3	645	17.6	421	11.5	350	9.5
2009	3367	100.0	1850	54.9	202	6.0	503	14.9	305	9.1	507	15.1
2010	2949	100.0	1688	57.2	167	5.7	377	12.8	296	10.0	421	14.3
2011	2957	100.0	1840	62.2	136	4.6	336	11.35	265	9.0	380	12.85
2012*	2819	100.0	1617	57.4	112	4.0	272	9.6	254	9.0	564	20.0

* – as of December 28, 2011

Source: the data provided by the Ministry of Economic Development and Trade of Russia on the basis of the federal property register, IET's estimates.

As of 2011 year-end, the state could have a minority or majority controlling interest in more than 61.4% of all the entities (the level as of the beginning of 2008) against 67% in the preceding year.

Such a shift resulted from reduction in the total structure of federal share holding (interest holding), both full share holding (100% participatory interest) from 62.2% to 57.4% and majority share holding (more than 50%, but less than 100% of equity) from 4.6% to 4%. Blocking share holding (from 25 to 50% of equity) decreased much more (more than 1.5 percentage points (p. p.)), whereas minority share holding (up to 25% of equity) increased considerably (less than 22% to 29%) through the increase (less than 13% to 20%) in the smallest share holding (less than 2% of equity). A special emphasis should be placed on the doubled growth in the latter category of federal share holding (interest holding) vs. the pre-crisis period, while only full share holding (interest holding) saw a small increase of only 3.3 p.p. among other categories.

In the period between 2008 and 2011, the absolute number of majority, blocking share holding (interest holding) decreased by almost 60% as well as the share holding (interest holding) accounting for 2% to 25% of equity. Full share holding decreased by much less (less than 19%). The same trends were reported in 2011. However, the number of the smallest share holding (interest holding) increased 1.6 times vs. as of the beginning of 2008, 1.5 times in 2011, while their number was getting smaller in 2009 – 2010 after a rapid growth in 2008.

The upward trend for the minority share holding, especially the smallest share holding during and after the economic crisis is questionable. Its negative nature is quite obvious, because

[1] Considering only business entities with a state-held interest (exclusive of JSCs which are subject to the "golden share"), the given value was reached as early as the beginning of 2010.

the size of such share holding gives no opportunity to the state to either sell at best or provide sufficient control over business entities.

Regarding trends in the structure of the whole body of property assets registered with the federal property registry (according to the data provided by the CFPAS), they can be seen through the data provided in *Tables 3* and *4*.

Table 3

Dynamics and structure by type of the federal property assets registered with the federal property registry, in 2008 – 2011

As of December 31	Total quantity of immovable and movable property assets, total		by type					
			immovable property assets (save for land plots)		land plots		movable property assets	
	q.	%	q.	%	q.	%	q.	%
2008	14096	100.0	7538	53.5	1517	10.75	5041	35.75
2009	1193201	100.0	600842	50.35	116274	9.75	476085	39.9
2010	1552121	100.0	718114	46.3	165281	10.6	668726	43.1
2011	1367975	100.0	800143	58.5	192825	14.1	375007	27.4

Source: the data provided by the Ministry of Economic Development and Trade of Russia on the basis of the federal property register, IET's estimates.

It should be reminded that paper inventory of the federal property assets registered with the state federal property database as of the effective date of Russian Government Order No. 447, dd. July 16, 2007 was completed by the beginning of the summer of 2010. This hard work on converting the relevant data into e-format by entering thereof to the Computerized Federal Property Accounting System in 2010 – 2011 allowed the paper data to be covered almost in full with the relevant e-data (*Table 1*).

As of 2011 year-end, immovable property assets (58.5%) dominated in the structure of federal property, which was also typical of the previous periods (except as of the end of 2010). The category of movable property assets was ranked #2. These items decreased from 43.1% to 27.4% during the year, mostly because in April thru May 2011 movable property assets with a value of less than Rb 500,000[1] were withdrawn step by step from the CFPAS. Land plots account for a total of about 14% of federal property assets, but this has been the max. value over the recent few years. It should also be noted in this context that the area of federally owned land plots has increased more than 1.7 times to reach 1,007,938,198 ha over the recent eighteen months, as based on the data provided by the Federal Agency for State Property Management[2]. Such a growth could result from intensified delimitation of public ownership of land by level of public authority and state registration of the Russian Federation ownership of land plots.

A major part (more than 2/3 as of 2011 year-end) of the federal property assets are secured for titleholders on the basis of operational management basically applicable to government agencies. The process of reducing the number of unitary enterprises is also reflected in the structure of federal property, where a pronounced reduction trend in the property assets secured on the basis of economic management, however, in 2011 it remained almost at the level reported in the previous year (nearly 18% vs. more than 24% as of 2008 year-end). Further-

[1] The foregoing movable property assets were excluded because Order No. 47 issued by the Government of Russia on February 4, 2011 entered into force, under which the minimum initial value of movable property assets regarded as stand-alone property was to be increased from Rb 200,000 to Rb 500,000.

[2] www.rosim.ru.

more, a share of federal treasury items increased slightly (about 15% vs. 11 to 12% in 2009 – 2010) in the previous year.

Table 4

Dynamics and structure of the federal property assets registered with registry by category of titleholders, in the period between 2008 and 2011

As of December 31	Total quantity of Total quantity of immovable and movable property assets, total		By category of property right					
			secured for titleholders on the basis of economic management		secured for titleholders on the basis of operational management		constituting a state treasury of the Russian Federation *	
	q.	%	q.	%	q.	%	q.	%
2008	14096	100.0	3418	24.2	8202	58.2	2476	17.6
2009	1193201	100.0	226818	19.0	827234	69.3	139149	11.7
2010	1552121	100.0	279402	18.0	1096547	70.6	176172	11.4
2011	1367975	100.0	245060	17.9	921252	67.35	201663	14.75

* – net of business entities' share holding (interest, deposits).
Source: the data provided by the Ministry of Economic Development and Trade of Russia on the basis of the federal property register, IET's estimates.

According to the Rosstat's public sector composition monitoring, the quantity dynamics of public sector economic agents in the period between the mid-2010 and mid-2011 can depicted as follows (*Table 5*).

Table 5

The number of public sector organizations registered with territorial offices of the Federal Agency for State Property Management and government bodies for management of state-owned property of the constituent territories of the Russian Federation in the period between 2009 and 2011

Date	Total*	SUEs, including state-run enterprises	Government agencies	Business entities with more than a 50%	
				state-held share (interest)	share (interest) held by public sector business entities
as of July 1, 2009*	77082**	8706	63019	4007	1350
as of January 1, 2010*	76658**	8122	63087	4089	1360
as of July 1, 2010*	74867**	7230	61493	3915	2229
as of January 1, 2011*	73498**	6761	60266	4051	2420
as of July 1, 2011*	72047**	6245	59483	3928	2391

* – federal property is subject to accounting pursuant to Russian Government Order No. 447, dd. July 16, 2007, "On the Enhancement of Federal Property Accounting";
** – including organizations whose state registered articles of association registered contains no specific types, but excluding joint stock companies with more than 50% shares (interest) held on the basis of joint state and foreign ownership.
S*ource:* On the development of the public economic sector of the Russian Federation in H1 2009 (p. 7), in 2009 (p. 7), in the first half of 2010 (p. 7), in 2010 (p. 7), in the first half of 2011 (p. 7). M., Rosstat, 2009 – 2011, IET's estimates.

As is seen from *Table 5*, the total number public sector organizations decreased 6.5% over the two years (from July 1, 2009 till July 1, 2011) (or more than 5,000) to amount to about 72,000 as of July 1, 2011.

The result was achieved basically through a decrease of 28.3% (or almost 2,500) in the number of unitary enterprises. Though the number of agencies deceased much less (5.6%), it was more impressive in absolute value (3,500). The number of business entities with more than 50% state-held interest decreased even less, only 2% (or about 80) July 1, 2011. In this respect, the number of business entities with more than 50% interest held by public sector

business entities, increased more than 1.7 times. Their number grew up more than 1040 to reach almost 2,400 as of July 1, 2011, i.e. the historic maximum throughout the entire 2000s.

Within a period of one year, between the mid-2010 and mid-2011, the total number of public sector organizations decreased by 3.8% (or more than 2,800 entities) basically due to a reduction of 13.6% (or almost 1,000) in the number of unitary enterprises. Though the number of agencies deceased much less, only 3.3%, its absolute value was found to be twice as much as that of unitary enterprises (2,000).

At the same time, the number of business entities with more than 50% state-held interest remained almost at the previous level (3,900 entities). In this context, however, it should be emphasized that the number of business entities with more than 50% interest held by public sector business entities increased (up 7.3%). They grew up more than 160.

The crisis of 2008 – 2009 raised a question of how they effected the state as manufacturer of (works, services) in the economy. The Rosstat's monitoring only partially supports the view of growing state participation in different final figures of economic performance (*Table 6*).

Table 6

Public sector's share according to various indicators in the period between 2008 and 2011, %

Indicator	2008	2009	2010	H1 2011
Volume of shipped goods produced by the company, completed works and services w/o subcontracting :				
- mineral recourses production	13.5	11.5	9.8	17.0
- fuel and energy recourses production	13.2	11.1	9.0	17.0
- manufacturing sector	8.5	9.5	8.7	9.5
- production and distribution of electric power, gas, and water	13.0	14.0	17.8	22.5
Scope of construction works performed w\o subcontracting	3.6	3.8	4.1	4.1
Passenger turnover at transportation companies *	63.9	63.2	56.1	66.1
Volume of commercial transportation (dispatch) of cargos by transportation companies (net of companies involved in pipeline transportation)	71.1	76.6	78.4	78.5
Commercial cargo turnover performed by transportation companies (net of companies involved in pipeline transportation)	94.3	93.8	93.6	93.7
Communication services **	9.9	13.9	15.2	14.5
In-house research and development costs	72.6	74.4	73.4	73.5
Volume of paid services rendered to the general public	16.3	16.5	18.9	18.8
Capital investments from all sources of financing ***	21.5/ 15.9	22.8/ 17.1	24.5/ 17.8	26.0/ 19.9
Net proceeds from sales of goods, works, services (net of VAT, excise taxes and other similar mandatory payments)	9.8	10.6	18.9	11.7
Average staffing number	24.0	24.6	24.9	25.2

* – save for municipal electric passenger transport organizations;
** – net revenues from sale of goods, products, works, services (net of VAT, excises and other mandatory payments);
*** – in the numerator, net of small enterprises and volume of investments which can't be observed through direct statistical methods.
Source: On the development of the public economic sector of the Russian Federation in 2008 (c. 13, 43, 45-46,47, 53, 61-62, 63, 67-68, 88), in 2009 (c. 13, 45, 47-48, 49, 52, 60-61, 62, 66-67, 87), in 2010 (c. 13, 46, 48-49, 50, 53, 61-62, 63, 67-68, 88), in the first half of 2011 (c. 13, 33, 35-36, 37, 40, 43-44, 45, 49-50, 70). M., Goskomstat of Russia (Rosstat), 2009-2011, IET's estimates.

However, as it can be seen from *Table 6*, in 2010 and H1 2011, However, as it can be seen from *Table 3*, in 2009 and H1 2010, like throughout the entire period of 2000', that the public sector had an insignificant share in most indicators (no more than 10–15%), with a slightly bigger share in the field of investments (more than 15–25%) and employment (24–25%),

whereas only cargo transportation (more than 60–90%, depending on an indicator) and internal research and development costs (more than 70%) remained significant exceptions.

However, official statistics reported a small decrease in 2010–2011 vs. 2008 in the public sector's participation share in the field of production and distribution of electric power, gas and water, communication services, capital investments, paid services to the general public, and such a generalized financial indicator as net proceeds from sales of goods, works, services (net of VAT, excises and other mandatory payments) [1].

A substantial increase of up to 17% in the first half of 2011 vs. 11 to 13% in the period between 2008 and 2009 in the public sector's participation share in mineral production (including fuel and power minerals) should be noted. The same is true with generation and distribution of electric power, gas and water, where at the end of H1 2011 the public sector reached 22.5% (against 13 to 14% in the period between 2008 and 2009), and passenger traffic of transportation organizations in which public sector's share increased again after a visible fall in 2010, thus exceeding 2/3 of the total volume vs. 63 to 64% in the period between 2008 and 2009.

A closer look at the situation reveals that at year-end 2010 the public sector was dominating in some of the industries, namely railway cargo shipment and passenger transportation, forest regeneration, production of sodium carbonate, externally powered broadcasting radio receivers, helicopters. In most other cases the public sector accounted for less than 20%, save for production of ethyl alcohol made of food raw material, wooden unimpregnated railway and tramway sleepers, cargo mainline cars, production of electric power at hydroelectric power stations, passenger automobile transportation service, all types of paid services, where the public sector accounted for less than a half anyway. An increase, up to 21.8% vs. 15.9% at 2010 year-end, in the public sector's participation share in oil production, including gas condensate, should be noted among the changes highlighted in the first half of 2011.

It should be noted, however, that the foregoing data should rather be regarded as minimal given the complexity of measuring the public sector's share for the following reasons: (1) limited reliability of the Rosstat's data amidst the multistage corporate control system employed at many state-owned enterprises, which excludes several levels (by analogy with private companies), (2) impossible impartial and reliable assessment of the state indirect effect on property relations based on the results of the anti-recessionary measures taken in 2008 – 2009 and (3) potential incompleteness of accounting by public agencies.

6.1.2. Privatization Policy

Since the privatization Program for the period of 2011–2013 approved by the Government of Russia in November 2010 was developed on the basis of the amendments which were made to the applicable law on privatization at the end of May 2010 and provided for a 3-year extension of the planning effective period of the Forecast Plan (Program) for the Federal Property, in 2011 the foregoing document was only amended and updated. A total of 13 relevant statutes and regulations were adopted by the Government of Russia through Enactment No. 2102-r, dd. November 27, 2010, since the approval of the Forecast Plan (Program) for Federal Property Privatization and the Guidelines of Federal Property Privatization for 2011–2013, two of

[1] With regard to the latter indicator, the data on the end of H1 2011, which saw a considerable growth (against the previous few years) in 2010, also tend to increase a bit as to the public sector's share for the other specified indicators, which needs refinement as to the year-end results in general.

which were issued as early as the very end of 2010 and in January 2012. Government of Russia Enactment No. 513-r, dd. March 24, 2011, contained a major part of the amendments.

The list of the property subject to privatization was expanded as to all types of assets (SUEs, JSCs, LLCs, other property). The list of the latter category which is basically represented by immovable property assets and land plots, was updated most. Whereas the originally approved version of the privatization Program for the period of 2011–2013 included 73 items of other property assets, it was updated to include 468 items, or up 6.4 times, as early as 2011 year-end.

In addition, the privatization program was complemented with special instructions providing for incorporation of a part of the FSUEs subject to privatization which are 100% owned by the federal government (shares (a part thereof) are subsequently to be contributed to the charter capital of a relevant integrated entity, or 100% shares are subsequently to be assigned as the state asset contribution to Russian Technologies state-owned corporation, as well as provide for the terms of privatization to be defined by the state with regard to specific blocks of shares[1].

Given the updates and amendments made, the Privatization Program for the period of 2011–2013 provides for privatization of a total of 1396 federally held shares of joint stock companies, 276 federal state unitary enterprises and other 468 property assets as part of the Russian Federation treasury.

A special emphasis should be placed on that the list of the 10 super large companies in which the government allowed state capital participation to be reduced in 2011 – 2013, remained unchanged, but were specified with regard to the Federal Hydropower Generating Company (RusHydro) and the United Grain Company (UGC).

The Ministry of Economic Development and Trade of Russia and the Ministry of Energy of Russia were assigned to see, jointly with the Federal Agency for State Property Management, that the federally held interest in OJSC Federal Hydrogenation Company (the city of Krasnoyarsk) is duly sold under a favorable market situation until July 1, 2012, to the extent that the state retains 50% plus one share in the said joint stock company. The same corporate governance threshold was determined for the United Grain Company (UGC).

A privatization transaction was closed with regard to the foregoing companies, which became the largest transaction throughout the entire period of 2000. In February 2011, OJSC VTB Bank floated a federally held interest of 10% among Russian and foreign investors during a secondary public offering (SPO) at $6.25 per global depository receipt (GDR). According to the data provided by the bank, a total of 1,046,054,133,732 shares of the Russian company were floated in the form of GDRs and common shares. A total of Rb 95.68bn proceeds were obtained.

LLC Merrill Lynch Securities was authorized to organize and close the transaction on behalf of the state under an agency contract. As early as the fall of 2010, LLC Merrill Lynch Securities Merrill Lynch Securities was assigned to be the sole contractor of the public contract on purchase and sale of the federally held ordinary registered shares of OJSC VTB Bank (up to 10% of charter capital) at least at a market price specified on the basis of the market value assessment report made by an independent appraiser.

[1] The originally approved version of the Privatization Program included an instruction for the to-be privatized shares of some of the OJSCs scheduled for contribution to the charter capital of the relevant integrated entity on the basis of the decisions made by the President and Government of Russia.

Gazprombank in the same manner under an agency contract closed a transaction on purchase and sale of the federally held interest in OJSC Prosvescheniye Publishing House, for a total of Rb 2.25bn.

Apart from the sale of OJSC VTB Bank and OJSC Prosvescheniye Publishing House, five investment banks to be engaged in purchase and sale of the federally held interest in six companies were determined in 2011 as part of the work performed by the Ministry of Economic Development and Trade of Russia.

In all other respects, the Privatization Program for 2011 started traditionally with the bid, which was announced as early as 2010, and summing up the results thereof.

In particular, at the end of December 2010, the Federal Agency for State Property Management announced a purchase and sale of the federally held interest in 16 JSCs (incl. OJSC Tolmachevo Airport) of the 26 investment-attractive joint stock companies (seaports, river ports and shipping lines, airports) included into the privatization program for 2010 for the purpose of subsequent sale under Russian Government Order No. 1321-p, dd. August 4, 2010, following the President's decision to shorten the list of strategic enterprises and JSCs (Order No. 762, dd. June 18, 2010). The results of the relevant auctions were summed up as early as 2011.

All in all, the shares (interest in charter capitals) of 359 joint stock companies were sold in 2011, including 38 JSCs whose purchase and sale was announced in accordance with the Forecast Plan (Program) for Federal Property Privatization for 2010, and decisions on the terms of privatization were made with regard to 143 federal state unitary enterprises.

Comparing the provided data with the results of the privatization programs implemented in the previous years (*Table 7*), it is obvious that the number of FSUEs doubled, for which the terms of privatization were made, and the number of sold shares increased 2.7 times vs. 2010. At the same time, more than 500 shares were sold annually in the mid-2000s, and the results achieved in 2011, 2000 and 2006 thru 2007 are the same. The results are less impressive as to privatization of unitary enterprises.

Furthermore, more important is their inclusion into the composition of vertically integrated entities. For example, almost 2/3 (92) out of the 143 FSUEs, for which the Federal Agency for State Property Management made decisions on the terms of privatization, were incorporated as part of the integration processes. The same picture also can be seen with regard to registered OJSCs (30 out of 42).

The issue of lack of bids from those companies who were supposed to be the bidders in the relevant procedures remained to be resolved in spite of a large scale of privatization in the previous year. For example, more than a half (375) of the shares of 730 JSCs which were offered for sale in 2011 (information announcements were published), were reoffered for bid.

In particular, the same was reported with regard to the shares of OJSC Cheboksary River Port and OJSC Northern River Shipping Lines, which were a part of the aforementioned group of 26 joint stock companies delisted from the list of strategically important enterprises and companies in 2010. Another 10 companies of the list were expected to be privatized in 2011 as part of the implementation of the Forecast Plan (Program) for Federal Property Privatization for 2011–2013 on the basis of the Government of Russia decisions on the terms of privatization of the federally held shares of Murmansk (25.5%) and Novorossiysk (20%) Commercial Seaports.

Table 7

Comparative data on the dynamics of privatization of federal state unitary enterprises and federally held shares in the period between 2000 and 2011

Period	The number of federally owned privatized enterprises (units) (according to the Federal Agency for State Property Management, and the Federal Agency for State Property Management of Russia until 2004)	
	privatized FSUEs[a], q.	JSC shares sold, q.
2000	2	320
2001	5	125[b]
2002	102	112[b]
2003	571[c]	630
2004	525	596[d]
2005	741	521
2006	…	356[e]
2007	377	377
2008	213	209[b]
2009	316+256[f]	52[b]
2010	62	134[b]
2011	143	359[b]

[a] – all preparatory arrangements have been completed and decisions on the terms of privatization made;
[b] – including blocks of shares which were announced for sale in the previous year;
[c] – net of the FSUEs whose assets were contributed to the charter capital of OJSC Russian Railways;
[d] – including 31 blocks of shares which were announced for sale in 2004, but the results thereof were summed up in 2005;
[e] – estimated value based on the data provided in the FPMA's Report "On Federal Property Privatization in 2007";
[f] – the number of FSUEs for which the decision on incorporation was made by the Ministry of Defense of Russia in addition to those when a similar decision was made by the Federal Agency for State Property Management.

Source: www.mgi.ru; The materials for the meeting of the Government of Russia which was held on March 17, 2005. "On Measures Aimed at Improving the Effectiveness of the Federal Property Management"; Federal Agency for State Property Management (FPMA) Report "On Federal Property Privatization in 2005". M., 2006; Federal Agency for State Property Management (FPMA) Report "On Federal Property Privatization in 2007". M., 2008; Federal Agency for State Property Management. Performance Report for 2008. M., 2009; the data provided by the Ministry of Economic Development and Trade of Russia, the Federal Agency for State Property Management.

Transport assets were sold more or less successfully throughout the entire year. Of most importance were the privatization transactions of the federally held interest in Tolmachevo Airport (the Novosibirsk Oblast, 51%, Rb 2.806m), Volga Shipping (Nizhny Novgorod, 25.5%, Rb 1,042.646m), Tuapse Seaport (25%, Rb 1,612.1m), North Western River Shipping Lines (25.5%, Rb 934m), Vostochny Port (Nakhodka, 20%, Rb 912m), Osetrovsk River Port (the Irkutsk Oblast, Rb 361,821m), Moscow River Shipping Lines (25.5%, Rb 302.994m), Vostok Aviation Company (the city of Khabarovsk, 51%, Rb 263.4m), Astrakhan Airport (51%, 216,875m Rb), Volgograd International Air port (about 38%, Rb 177m), South River Port (Moscow, Rb 134.881m), Volgograd River Port (25.5%, Rb 112,825m), Azov Seaport (25.5%, Rb 100.390m). The sale of blocking interest in Eisk and Taganrog Seaports, Rostov River Port generated less than 100m Rb each[1].

The sale price exceeded the initial price in some of the transactions closed, which is not typical of privatization in Russia: (4 times as much) for the federally held interest in Azov Seaport, (2.95 times as much) in Volgograd Airport and (more than 2.5 times) in Tolmachevo Airport, (1.74 times as much) in Volgograd River Port. At the same time, most of the other

[1] www.rosim.ru

specified federally held shares were sold when the sale price was equal to the initial price, save for Vostok Aviation Company, Vostochny Port, Eisk and Taganrog Seaports, Rostov River Port, where the sale price slightly outstripped the initial price.

The sale of 55% interest in Vaninsk Commercial Seaport should have been the largest privatization transaction in terms of absolute value (apart from the sale of 10% interest in VTB) (Rb 10,824,125m) and excess of the sale price over the initial price (11.6 times as much), however, the results thereof were cancelled, because the contractor refused to meet the payment commitments. Furthermore, the contractor was to pay a penalty of Rb 75.114m under the arbitration court order, though the Federal Agency for State Property Management demanded much more, Rb 300.46m.

Neither blocking interest auctions for Murmansk River Shipping Lines and Yenisei River Shipping Lines, Samara River Port and Tver River Port, Anapa Airport were held, nor the shares of the foregoing Cheboksary River Port and North Western River Shipping Lines were sold through public offering due to lack of bids.

Given the outdated data of the share market value assessment reports and availability of up-to-date financial figures, as well as the need to engage the maximum number of interested investors, the Federal Agency for State Property Management decided to cancel the sale of the shares of OJSC S7 Airlines and OJSC Murmansk Fishing Seaport which was scheduled for the end of September.

The federally held shares of joint stock companies of various economic sectors, including air transport and water transport (including seaports and river ports), were sold through more than 50 privatization transactions at a value of more than Rb 100m closed in the previous year by the Federal Agency for State Property Management and its territorial offices. It suffice to refer to transactions at a value of more than Rb 300m.

Among these were specialized installation entities (Specialized Building and Construction Works for Electrification of the Moscow Railway Junction (Rb 1065.41m) and Elekrotsentrmontazh (Moscow, Rb 330m), Moscow research institutes (NIITECHIM (Rb 554.615m), Vitamin Research Institute (100%, Rb 491,546m), MNIIRS (Rb 355.175m)), agricultural sector enterprises (OJSC Doskoye (Rb 476.49m) and the First Horse Cavalry Stud Farm (Rb 303m) (both are located in the Rostov Oblast)). Also Buryatia Hotel and Tourist Complex (Ulan-Ude, Rb 508.2m). The overwhelming majority of the foregoing cases included the sale of 100% participatory interest held by the state[1].

Therefore, it may be suggested that the emerged investment priorities mean the opportunity to have access to sought-after resources (land, immovable property in major cities) and large-scale cash flows, which in markets with high entry barriers created through capital-intensive and highly specialized equipment must generate the demand of natural monopolies with potential co-financing on the side of the state, rather than interest in the offer to run business in one or another sector of the economy.

An effort to launch a large-scale sale of other property assets as part of the treasury of Russia became another specific feature of privatization in 2011.

In 2010, decisions on the terms of privatization of such assets (only 10 property assets) were made and publication of information announcements of sale were published not until the very end of the year, while the results were summed up as early as the beginning of 2011: six of the eight property assets were sold for a total of Rb 196.91m

[1] www.rosim.ru

Of 132 property assets subject to sale under the Privatization Program for the period of 2011–2013[1], and 86 of those offered for sale, the results in 2011 were summed up only for 16 property assets, of which only three were sold at no more than Rb 5m, and no sale took place for 13. Eleven sales of other property assets for a total of Rb 84.3m have been recognized as completed since the beginning of 2012. Therefore, no success was achieved.

Nevertheless, the amount of the proceeds generated in 2011 from sale of the federal property subject to privatization totaled Rb 121.44bn, i.e. 2.5 times as much as the total amount of revenues generated from the this source in the previous four years (2007 thru 2010), as the Ministry of Economic Development and Trade of Russia and the Federal Agency for State Property Management reported. More details on the federal budget revenues from privatization and usage of state-owned property assets are provided in other sections herein based on the budget statistical data.

6.1.3. Updates to the Law on Privatization

The law on privatization was constantly improving during the previous year, like the year before that[2].

Four federal laws were issued a time in July 2011 to amend and update the Law "On Privatization of Public and Municipal Property" of December 21, 2001, (No. 178-FZ). The Federal Law of July 1, 2011, No. 201-FZ, was considered most important, as it intended to amend the applicable Law on Privatization, whereas the other three laws updated the same in the context of other legislative initiatives.

The following significant amendments and updates to the Law were made:

– it is accepted that disposal of 15 categories of property which are not covered by the law[3], can be regulated not only by other federal laws, but also other regulations (only regulations adopted under federal laws were mentioned previously);

[1] The main part (about 72%) of the treasury property assets included into the program was subject to be included into integrated entities.

[2] See Annual Review "Russian Economy in 2010. Trends and Outlooks (Issue 32)" issued by IET (P. 6.1.5. New Stage in the Implementation of National Policy on Privatization of State-Held Property: Key Priorities and Objectives, Actions and Risks, p. 426-459).

[3] It was in the original version of the law that relations arising out of transfer of property were not supposed to be within the scope thereof, namely transfer of (1) land, safe for transfer of land plots on which property assets are located, including property complexes; (2) natural resources; (3) public and municipal residential properties; (4) public and municipal property, (5) property assets located outside the territory of the Russian Federation; and in (6) the cased provided for by international agreements (accords) signed by the Russian Federation; (7) faith-based buildings and facilities, including the land plots which pertain thereto, and other faith-based property owned by the state and municipalities which are transfer on a compensation-free basis to faith-based organizations which will use thereof for the faith-based purposes; (8) public and municipal property to non-profit organizations and entities established as a result of transformation of public and municipal institutions; (9) the property assigned to state and municipal unitary enterprises, state and municipally institutions on the basis of economic management or control; (10) public and municipal property on the basis of a relevant court order; (11) shares (interest) in the cases when the Russian Federation, constituent territories of the Russian Federation and municipalities become legally entitled to demand from a joint stock company to purchase such shares (interest).
Later these were complemented with the following types of property: (1) publicly and municipally owned land plots on which buildings, facilities and structures owned by all-Russia societies of the disabled and organizations are located, and these societies are the sole founders of such property being transferred to them on a compensation-free basis (in 2005, this types of property was combined into a single category with faith-based property being transferred to faith-based organizations); (2) the stocks of a joint stock company (OJSC), including securities to be converted into such stocks, in case of retirement thereof pursuant to the procedure set forth in

- the composition of one of the foregoing category of property was extended through transfer of the title of public and municipal property to non-profit organizations (NPOs) established as a result of transformation of public and municipal unitary enterprises (the category previously included the property transferred to NPOs established as a result of transformation of public and municipal institutions, as well as the federal property transferred to public corporations as an asset contribution from the Russian Federation);
- there is a provision for the possibility to privatize unitary enterprises through incorporation thereof not only into open joint stock companies (OJSCs) (as previously) but also limited liability companies (LLCs), which, consequently, resulted in many updates to the text of the law, including the emergence of "business entities" category which within the meaning of it covers a wider population of business organizations;
- it is the size of the charter capital of a company established through privatization that serves as the criterion for bidding of one of the foregoing methods: if the size is smaller than the minimum charter capital requirement for OJSCs established by the Russian laws, a unitary enterprise shall be transformed into LLC, if its charter capital equals or beyond the requirement, it should be incorporated into a joint stock company, but if one of its performance figures (such as (1) average staff headcount, (2) proceeds from sale of goods (works, services) net of VAT in the period of three calendar years prior to the privatization, (3) the amount of residual value of its fixed assets and intangible assets as of the latest reporting date) is equal or less than the ceiling established for small business entities pursuant to Federal Law No. 209-FZ, dd. July 24, 2007 "On the Development of Small and Medium Size Enterprises in the Russian Federation", the unitary enterprise property complex also can be privatized through transformation thereof to LLC;
- LLCs like OJSCs may not buy their interest; the emergence of a special regulation, i.e. if the buyer of public or municipal property was not entitled to purchase thereof, the relevant transaction shall be deemed null and void. This regulation is of general nature though;
- an explicit rule was included into the law on that the size of the charter capital of a business entity established through transformation of unitary enterprise equals to the book value of the unitary enterprise's assets subject to privatization which includes the value of land plots;
- the text of the law was complimented with a provision on that to define the composition of the privatized property complex of a unitary enterprise, creditors' claims shall be duly considered without having to obtain the consent of creditors as to address their claims to a successor in title of the unitary enterprise;
- a list of the data to be included into a decision on federal property privatization was complemented with data on the size of charter capital of OJSCs' or LLCs' established through transformation of unitary enterprises, the number, category and par value of a share in OJSCs and interest in LLCs which is held by one or another level of public authority;

Article 84.8 of Federal Law No. 208-FZ dd. December 26, 1995, "On Joint stock Companies" which regulates the retirement of securities of joint stock companies as demanded by a person who holds at least 95% of interest in such OJSC (2006); (3) property to be transferred to public corporations (state-owned companies) (2007) and the Russian Housing Development Foundation as an asset contribution from the Russian Federation (2008); (4) property transferred to the RF Presidential Center for Historical Legacy which ceased to perform its duties (2008); (5) federal property pursuant to the decisions of the Government of Russia made for the purpose of creating conditions for the attraction of investments, stimulation of the stock market, as well as modernization and technical development of the national economy (2010).

- some amendments were made to the regulation on how buyers of privatized property should submit relevant documents: (1) instead of having to provide a written decision on the purchase of property made by a relevant governing body, legal entities must have a document which confirms the powers of the head of a legal entity to act on its behalf without a power of attorney or with a power of attorney authorizing him/her to act on behalf of an bidder[1]; (2) a requirement that the bidder or a representative thereof bind, enumerate, seal and sign (required for legal entities) all the pages of documents (or specific volumes thereof) submitted together with bids, attach (to a bid) two copies of the record statement thereof, one for the seller, another one for the bidder; (3) the bidder must observe the foregoing requirements, which means that bids and the documents to be attached thereto are submitted on behalf of the bidder[2];
- the same way one should consider a new explicit rule emerged in the law, which prohibits to impose other requirements on the documents to be attached to bids, as well as require other documents upon the abolishment of the previous rule requiring that the bidder prove that he is entitled to purchase public or municipal property;
- with regard to social guarantees to the workers employed in OJSCs and LLCs established through privatization, it was ascertained that a new collective agreement may be entered into or the previous agreement may be extended for a period of up to three years upon expiration of three months from the date of registration thereof (previously, the agreement in effect was allowed to be revised without having to specify its terms, in addition to a new one);
- in case of privatization through tenders, shares or a participatory interest in the charter capital of OJSCs or LLCs, accounting for more than 50% of their charter capital, may be sold, whereas previously the unitary enterprise property complex might be sold along with the sale of more than 50 per cents of OJSC's charter capital;
- a list of the terms and conditions of tenders was added to the change in assigning specific property assets used for scientific or/and research purposes;
- a procedure for reimbursement on invalid transactions on purchase and sale of public and municipal property: budgets at a relevant level became the only source of financing thereof, whereas previously budgetary funds could be used subject to shortage of the proceeds from sale of property to other buyers under other privatization transactions prior to allocation thereof;
- public and municipal title must be protected the same way, i.e. with relevant budgets, while the priority of the norms set forth in the Budget Code of Russia was established with the regard to the money received with regard to defaults on privatization transactions, like interest transaction for the amount equal to the provided installment payment for privatized property;
- given the possibility to transform unitary enterprises into LLCs fully owned by the state (municipality), it was established that the charter of such LLCs may not provide for the prerogative right to buy the interest sold by its holder, as well as they are not subject to the norms set forth in the Federal Law "On Limited Liability Companies" on joint and

[1] Where the power of attorney authorizing to act on behalf of the bidder is signed by a person authorized by the manager of a legal entity, the bid also must contain a document which certifies the powers of such person.

[2] Inappropriate meeting by the bidder of the requirement that all pages of documents attached to the bid must be enumerated is not considered a ground for denying the bid, though no sanctions are provided for in this respect.

several obligations of the members of such LLCs and an independent appraiser to bear subsidiary liability in case of shortage of LLCs' property if non-cash payment for a participatory interest in the charter capital under their obligation is made to the extent equal to an overvalued amount of the property paid for a participatory interest in the charter capital made within three years from the date of state registration of the company or making amendments to the charter thereof;

- the wording of the article on the specifics of legal status of OJSCs and LLCs whose shares, participatory interest in the charter capital are held by the Russian Federation, constituent territories of the Russian Federation or municipalities was rectified to refer to shares and participatory interest which are not assigned to state and municipal unitary enterprises and institutions;
- due to acceptance of engaging legal entities, apart from public authorities, in organizing sale of privatized property pursuant to the duly established procedure, an allowance is made for such sellers to sell in specific cases to exercise on behalf of the state some of the rights which the shareholders or members of LLCs are entitled to;
- with respect to OJSCs and LLCs with a 100% federal or municipal government ownership (100% participatory interest in the charter capital) are held by the state or a municipality it was ascertain that procedures for preparation and holding a general meeting of shareholders (members of a joint stock company) are not to be applicable, except for the provisions regarding the dates of an annual general meeting of shareholders, general meeting of the members of a joint stock company;
- the text of the law was supplemented with a provision on that OJSCs and LLCs established through privatization of unitary enterprises are to be entitled to conduct the types of activities provided for by their charters based on licenses and other permits issued to such unitary enterprises.

A series of amendments and updates were made in December 2011 to the applicable Federal Law "On Privatization" in the context of the development of the legislation on the protection of competition:

- the format of information support of privatization which after the amendments dated May 2010 must include, apart from having to be published in official printed publications, posting of relevant information on official websites, also supplemented with the official website of the Russian Federation for posting information on bidding as determined by the Government of Russia;
- the requirement for a period of acceptance of bids for auctions (at least 25 days) was supplemented with a rule specifying that such auctions must be held not less than 10 days from the date on which the bidders are accepted (the same rule is to be applicable to a special auction, tender, sale through public offering);
- second, (5 to 15 working days from the date of summing up the results of an auction) the term for concluding a purchase and sale agreement with the winner was extended (the same must be applicable to sale through public offering from the date of winner pronouncing notice);
- a duration applicable for auctions (tenders) was a bit shorter (10 to 15 working days);
- however, no agreement may be entered into on the basis of the results of auctions, sale through public offering, sale without specifying the price within less than 10 working

days from the date when a protocol containing the results of sale of privatized property is posted on websites;

– a new version of Article 22 of the applicable Federal Law "On Privatization" is to take effect next year (on January 1, 2013), which will regulate sale of OJSCs' shares through a securities market operator, in which this notion and notions derived from this notion were replaced with the 'exchange auction', etc. with relevant drafting amendments.

The following should be highlighted in assessing numerous updates to the Federal Law "On Privatization".

The duration of entering into a purchase and sale agreement with the winners of privatization procedures was extended; a regulation on the minimum time interval between the acknowledgement of bidders and the moment of conducting procedures themselves must raise the level of competition in the sale of privatized assets.

Improving information support of privatization by adding more channels of dissipation of relevant information through the official website of the Russian Federation together with the introduction of the minimum time interval between posting of a protocol of sale of public or municipal property on websites and conclusion of an agreement on the basis of such sale is intended to contribute to a more transparent privatization process as a whole thus counteracting corruption and organized crime.

The regulation on the right of OJSCs and LLCs which are established through privatization, to conduct activities on the basis of licenses and other permits issued to a relevant unitary enterprise is supposed to further strengthen the status of new owners and privatized enterprises themselves.

Changes in the procedure for reimbursing under invalid transactions of purchase and sale of public and municipal property, which prohibits the use for this purpose of the proceeds from sale of property to other buyers under other privatization transactions prior to allocation thereof, is likely to streamline the process of privatization.

The way of incorporation of unitary enterprises into LLCs seems to be ambiguous. On the one hand, many options of incorporation of business entities of this type can be made available by using this way together with the regulations set forth in the relevant special law[1,2].

The formerly used type of incorporation of almost all[3] unitary enterprises (including many small enterprises) into OJSCs with a 100% state-held interest was related to a formal necessity to incur expenses arising out of the requirements set forth in the laws on of joint stock companies and securities[4] with questionable prospects of attracting investments through enlisting in the stock market, but a substantial increase in subsequent public expenses on representation of its interests (the need to increase the number of its representatives in the gov-

[1] Federal Law No. 161-FZ, dd. November 14, 2001, "On Public and Municipal Unitary Enterprises" allows these to be transformed into public and municipal institutions and, based on the recent amendments, autonomous nonprofit organizations as well.

[2] The procedure for participation of public representatives in the top management body of autonomous nonprofit organizations and the Procedure for Corporate Governance of LLCs with a State-Held Interest Established Through Privatization were approved by RF Government Regulations No. 33 and No. 34, dd. January 27, 2012.

[3] Except for sale of the unitary enterprise property complex which was abolished on the basis of analysis of the amendments made to the Federal Law "On Privatization" in the summer of 2011.

[4] The obligation to annually publish profit & loss reports, balance sheets, disclose information on general meetings of shareholders, the need to engage a special registrar in maintaining a register, etc.

erning bodies of OJSCs while having to maintain their qualification at an adequate level and adequately using corporate governance arrangements[1]).

On the other hand, there arises a certain contradiction with the orientation – which was typical of the entire period of reforms of ownership relations in Russia as early as the 1990s – of property management agencies towards minimization of public participation in the economy in any legal form which differs from OJSC because the latter is more transparent. However, this perspective should be accepted as realistic due to that an interest held by the state (municipality) in a LLC may not be bought in full at a time in the course of privatization. Furthermore, the use of criteria applicable to small businesses which provide for the possibility itself of incorporation of a part of unitary enterprises into LLCs, is not mandatory and diverse.

Enlarging the list of terms and conditions for sale during tenders (auctions) by restricting changes regarding the purpose of specific property assets used for scientific and/or research activities may have an adverse effect due to the threat of formal approach towards privatization without considering sector-related specifics, and the notorious problem of following up the observation of the terms and conditions of tenders (auctions).

It also is worth noting that there was a continued trend towards enlarging the already exclusive prerogatives of the government in the world of privatization without actual external control over privatization, as evidenced by a newly appeared regulation on the transfer of property of 15 categories which are not covered by the law, other federal laws and also other norms and regulations.

The update issued in 2010 – it still remains to be adequately formalized – allows other legal entities besides government authorities[2] to be engaged in organizing sale of privatized property, was supplemented with the possibility in some cases for such legal entities to exercise on behalf of the state the specific rights to which LLC shareholders or interest holders are entitled, without defining any set of such rights and conditions under which they can be delegated.

Hence, summing up the results, one may say that the amendments and updates made to the Federal Law "On Privatization" in Russia in 2011 materialized the proposals of the Ministry of Economic Development and Trade of Russia and the Federal Agency for State Property Management which were prepared as early as 2005, on how to raise the level of effectiveness and enhance the mechanism of privatization process and optimize decisions on the management of state-owned property assets, followed the logic of the important updates included into the Law "On Privatization" in 2010.

However, the latter, being focused on a large-scale privatization of large aggregate of relatively small assets and expansion of the conditions, potential mechanisms of privatization of large and super large public companies, are imposed to a significant potential of risks related to poor transparency of sale of property to strategic investors, ill-defined reciprocal obligations of the state and buyers, unclear mechanisms of enforcement of such obligations. With regard to privatization of large companies, a special focus is placed on "individual" decisions, but even general frameworks of such decisions remain to be defined, while the powers of the

[1] The activity of the Board of Directors of OJSCs is a certain precondition for being subject to a strict control over management. However, lack of regular meetings and red tape cast some doubt on the effectiveness of incorporation of unitary enterprises.

[2] A relevant mechanism should be developed on a competitive basis, which is not mentioned in the law, to create conditions for making decisions on engaging private sellers in selling privatized federal property. A list of such organizations, 23 legal entities, including Sberbank and VTB, was approved as early as 2010.

Government of Russia in making such decisions were enhanced and their role made more important[1].

The circumstances require that further efforts be made to create objective preconditions for strengthening the structural trend of privatization which require a significant progress in developing institutional environment, long-term and transparent "game rules" for interaction between the state and business community.

Among the applied regulations which have an effect on the privatization process, a special emphasis should be placed on Russian Government Regulation No. 71, dd. 12 February 2011, which specifies – as part of the implementation of the amendments adopted in 2010 to the Federal Law "On Privatization" – the rules for sale through public offering, establishes the transition to setting the initial sale price through market-driven mechanisms on the basis of the report made by an independent appraiser, updates the rules for submission of documents for bidding at privatized property sale auctions.

Order No. 208 which was issued by the Ministry of Economic Development and Trade of Russia on May 11, 2011, approved the Procedure for Disclosure of Information by OJSCs whose shares are held by the state or municipalities, and public (municipal) unitary enterprises since the moment of enlisting into the Forecast Plan (Program) for Federal Property Privatization. These rules are applicable at the federal, regional and municipal levels, save for FSUEs subject to transformation – based on decisions of the President and the Government of the Russian Federation – into OJSCs with a 100% federal government ownership and to be contributed to the charter capital of OJSC or a public corporation as an asset contribution from the state, as well as OJSCs whose shares are to be contributed to the charter capital of other OJSC on the basis of decisions made by the President and the Government of the Russian Federation.

In addition, Russian Government Order No. 1094, dd. December 22, 2011, approved the amendments to the Rules for the Development of the Forecast Plan (Program) for Federal Property Privatization issued at the end of 2005. The amendments regulate, in particular the procedure for delisting federal property from the privatization program, establish the procedure and terms within which the Ministry of Finance of Russia and the Federal Antimonopoly Service of the Russian Federation are to approve the proposals on delisting federal property from the privatization program which federal government executive bodies submit to the Federal Agency for State Property Management, as well as the procedure and terms within which discrepancies on this issue are to be considered. The foregoing procedure provides for the following. Federal property can be delisted from the privatization program on the basis of consideration at a meeting held by the Government. Provisions on privatization of a state-held interest in LLCs were also included into the Rules for the Development of the Forecast Plan (Program) for Federal Property Privatization.

6.1.4. Enhancing corporate governance of business entities with state participation

A series of significant amendments were made during 2011 to the applicable regulations which regulate the corporate governance of business entities with state participation.

[1] See Annual Review "Russian Economy in 2010. Trends and Outlooks (Issue 32)" issued by IET (P. 6.1.5. New Stage in the Implementation of National Policy on Privatization of State-Held Property: Key Priorities and Objectives, Actions and Risks, p. 426-459).

The amendments were made on the basis of Russian Government Regulation No. 1214, dd. December 31, 2010, *applicable* to *federally owned JSCs,* and approved a pro-forma structure of the reports made by such JSCs, and some updates to the previously issued Russian Government regulations.

It was established that from March 1, 2011 federal executive bodies must cooperate on the issues regulated by the Provision on Management of Federally Held Shares of Joint stock Companies and the Use of the Special Right of Participation of the Russian Federation in Corporate Governance of Joint stock Companies ("Golden Share") approved by Russian Government Order No. 738, dd. December 3, 2004, through an Internet-based Special Interdepartmental Portal on State-owned property Management operated by the Federal Agency for State Property Management.

The first stage of the Interdepartmental Portal was put into pilot production in 2010 and the second stage was scheduled for 2011. The Federal Agency for State Property Management used the Portal to control the activity of joint stock companies, in particular allocation of net profit retained as of the end of the previous year, reduction of expenses and management cots, implementation of investment programs.

The Portal was designed to play an important role in the set of public management tools, because representatives of state interests in the governing bodies of federally owned joint stock companies undertook to submit quarterly progress reports to the board of directors (Steering Committee) of JSCs and annual financial reports by posting thereof on the Portal.

The Ministry of Economic Development and Trade of Russia was put in charge of approving a form of the report made by those who represent the interests of the Russian Federation in the governing bodies of joint stock companies with federally held shares, and a filling-out manual, which the Ministry did by issuing Order No. 164, dd. 12 April[1].

More details were specified as to the contents of the annual report on the management of federally held shares of JSCs and exercising the special right ("golden share") in the previous year which the Ministry of Economic Development and Trade of Russia is to submit to the Government of Russia. The report must include information on: (a) execution of the orders issued by the President and the Government of the Russian Federation, including information on target and actually achieved characteristics and indicators of the sector-based performance in the previous year, (b) measures aimed at enhancing the corporate governance system, (c) all decisions on payment of dividends (including the amount dividends paid), including by sector, including large dividend payers, as well as JSCs which made a decision to pay no dividends, (d) business performance results, the dynamics of net profit and debt load against the sector average, including retrospective dynamics and analysis of capital adequacy, (e) the results of general meetings of shareholders which were held in the reporting year.

Formalized were the requirements to persons whom the state offers as independent directors and their relatives[2], in nominating candidates for election to the board of directors of JSCs with state participation. Within the three recent years such persons must not:

[1] The former standard forms of the reports to be made by representatives of the public interests in the management bodies of JSCs and general managers of FSUEs ceased to be in force under Government of Russia Regulation No. 499, dd. June 20, 2011.

[2] Their family members (spouse, parents, children, adoptive parents, adopted persons), as well as blood and half-blood brothers and sisters, grandparents.

- hold management positions, be employed at an JSC or its subsidiaries and related companies, as well as hold management positions, be a member of the governing body or the manager of an JSC;
- be an affiliate with any JSC or its subsidiaries and related companies, save for being a member of the board of directors (steering committee) of a joint stock company;
- act as an auditor of an JSC (including an officer of an auditor), as well as be an affiliate with the auditor of the JSC;
- perform obligations or be an officer of a company which performs obligations under an agreement with an JSC, if a total amount of transactions closed for the purpose of executing the agreement accounts for at least 10% of the book value of the JSC's assets within a period of one year;
- represent the interests of persons or legal entities bound under an agreement with JSCs with whom a total amount of transactions accounts for at least 10% of the book value of the JSC's assets within a period of one year;
- receive from JSCs remunerations, compensations or any other types of payment whose value accounts for at least 10% of the total annual income of the foregoing persons, safe for payments relating to the activity as an independent director and closing of transactions in order to satisfy personal, household, family or other non-business needs, as well as participate in optional programs of the company.

In addition, a person whom the state as shareholder nominates as an independent director in the board of directors, must not:

- fill offices of state civil service or be a staff member of the Central Bank of Russia;
- be an elected member of the board of directors (steering committee) of a company within the recent five years;
- be in the capacity of manager or employed in any other JSC in which any member of the governing body of a company to which the person is nominated as independent director, is a member of the HR and remuneration committee under the board of directors of the company;
- be in the capacity of independent director of more than three joint stock companies.

In addition, formal revisions replacing the previously used notion 'open joint stock company' with 'joint stock company', meant that the foregoing regulations cover a wider population of business entities, because the state participates in the capital of some CJSCs besides OJSCs.

A new revision of a paragraph of the Provision on management of federally held shares of joint stock companies and exercise of the special right to participation of the Russian Federation in corporate governance of joint stock companies ("golden share") approved by Russian Government Order No. 738, dd. 3 December 2004, with regard to the status of those who represent state interests in boards of directors, became the most important amendment in 2011.

First of all, it should be noted that representatives of state interests and the persons whom the state nominated as independent directors were differentiated.

After that, the state was entitled to vote for the election of persons as representatives of state interests whom the state as shareholder didn't nominate for the board of directors, if such persons entered into an agreement on representation of state interests in the governing body of JSCs with federally held shares.

The provision issued in 2004 was also supplemented with regulations concerning professional agents, i.e. persons who act under the foregoing document and agreement and may rep-

resent the state interests together with persons filling public offices or offices of state civil service.

The agreement must stipulate that professional agents are entitled to initiate a discussion with relevant government authorities and invite other representatives of state interests in a joint stock company to discuss the issues brought up for meetings of the board of directors, and receive information which they need to exercise their powers and duties.

The agreement specifies the following powers to delegate to professional agents: (1) exercise in good faith and reasonable manner the delegated powers and duties within the scope of competence of board of directors, (2) notify promptly of their meetings whose agenda includes the issues which require directives to be issued, (3) vote in accordance with the issued directives (if issuance of directives is specified in the agenda of a meeting of the board of directors), (4) participate in the committees and commissions of the board of directors (if an agent is elected as a member of such committees and commissions), (5) convene a meeting of the board of directors and add to the agenda thereof the issues proposed by the Russian Federation as shareholder (if an agent is elected the chairman of the board of directors)[1].

Following the Ministry of Defense of Russia, the Department for Presidential Affairs of the Russian Federation was entitled to exercise on behalf of the state the rights of shareholder of joint stock companies established through privatization of subordinated federal state unitary enterprises with federally held shares.

With regard to FSUEs, the aforementioned Russian Government Order No. 1214, dd. December 31, 2010, established a threshold to the value of property on which various decisions must be made on the basis of decisions of the Government of Russia, the Chairperson of the Government of Russia or decisions made by Deputies Chairperson by Chairperson's order[2].

With regard to FSUEs which are not enlisted into the Forecast Plan (Program) for Federal Property Privatization, such a threshold was established to coordinate (1) transactions relating to management of a contribution (share of) to the charter (pooled) capital of business entities or partnerships, as well as shares held by a company, and (2) make decisions on participation of companies in business and non-profit organizations, as well as conclusion of a simple partnership agreement.

With regard to FSUEs which are enlisted in the Forecast Plan (Program) for Federal Property Privatization, such a threshold was established to coordinate (1) closing of large transactions as well as transactions relating to the extension of loans, issuance of sureties, banking guarantees, other encumbrances, assignment of claims, debt transfer, fundraising (2) transactions relating to the management of a contribution (shares of) to the charter capital of business entities or partnerships, as well as the shares held by an enterprise, (3) decisions on participa-

[1] Previously, the issues related to the activity of proxies were regulated by still applicable Government of Russia Regulation No. 625, dd. May 21, 1996, which approved the Standard Agreement on Representation of State Interests in the Governing bodies of Joint stock Companies (Business Partnerships) Whose Stocks (Interest, Contribution) are Partially Held by the Federal Government and the Procedure for conclusion and registration of such agreements. This aspect, however, was not adequately reflected in the legal framework in the 2000s, concerning the management of state held shares (special Provisions which were approved by following each other government regulations issued in 2000, 2003 and 2004).

[2] More than Rb 150m pursuant to the law on valuation activities. This threshold value and the specified procedure for coordination have been applied in different variations since 2003 for the purpose of regulating FSUEs' transactions with the federal immovable property located in Russia and assigned to them for economical management.

tion of companies in business and non-profit organizations, as well as conclusion of a simple partnership agreement[1].

Russian Government Order No. 499, dd. June 20, 2011, established that federal government executive bodies (FGEBs) should interact with regard to corporate governance of FSUEs which are basically governed by regulations concerning the functioning of entities of this type[2], the same way as with JSCs with state participation, namely through the interdepartmental portal dedicated to the management of state-owned property assets.

The Federal Agency for State Property Management was placed in charge of regulation of interaction of FGEBs with regard to corporate governance of enterprises through the portal, while government authorizes themselves must start to approve corporate development strategies for the period of three to five years. Relevant guidelines were approved by Order No. 683 issued on November 18, 2011 by the Ministry of Economic Development and Trade of Russia.

Important amendments were made to the Procedure for the Reporting of Managers of FSUEs[3] and other regulations in force which regulate their functioning.

For example, Russian Government Ordinance No. 228, dd. April 10, 2002, "On the Measures of Enhancing Effective Use of the Federal Property Secured to Federal State Unitary Enterprises for Economic Management" with regard to approval by FGEBs of development strategies of their subordinated entities, established that they should be based on the approved programs and decisions made by the President and the Government of the Russian Federation. Corporate development strategies must be duly approved by a government authority[4] by engaging (as may be appropriate) representatives of other federal government executive bodies, while FSUEs' activity programs must be based on their duly approved corporate strategy.

Russian Government Regulation No. 739, dd. December 3, 2004, "On the Powers of Federal Government Executive Bodies to Exercise the Title to the Property of Federal State Unitary Enterprises" was supplemented with a regulation on that FGEBs shall make decisions on coordination of (1) closing of large transactions as well as transactions relating to the extension of loans, issuance of sureties, banking guarantees, other encumbrances, assignment of claims, debt transfer, fundraising (2) closing of transactions in which the manager of an enterprise acts as stakeholder, (3) transactions relating to the management of a contribution (shares of) to the charter capital of business entities or partnerships, as well as the shares held by an enterprise, (4) decisions on participation of companies in business and non-profit organizations, as well as conclusion of a simple partnership agreement, provided that such deci-

[1] The scope of actions was also changed for this group of FSUEs. To do such actions, a decision of industry-specific authorities requires a motivated position of the Federal Agency for State Property Management, which is to be submitted in written within 10 working days from the date of receipt of relevant proposals from them.

[2] Russian Government Ordinance No. 228, dd. April 10, 2002 (together with the Rules for the Development and Approval of Operational Programs and Determination of a Profit of Federal State Unitary Enterprises which is Subject to Transfer to the Federal Budget, No. 333, dd. June 6, 2003 and No. 739, dd. December 3, 2004.

[3] Apart from the changes relating to the transition towards cooperation in managing FSUEs through the portal and approval of their development strategies, the procedure for reporting by their managers was changed by adding a provision on submission of information to the Federal Agency for State Property Management on participation of a company in the capitals of legal entities (this requirement was previously imposed on participation in the capital of foreign legal entities only).

[4] Except for the enterprises enlisted into the forecast plan (program) on federal property privatization, or the enterprises to be privatized on the basis of duly made decisions.

sions are in line with the measures provided for by their corporate development program, volumes and sources of financing, corporate budget items for the planning period.

Many amendments and updates were made to the currently applicable regulations which regulate the functioning of FSUEs.

In particular it was established that transactions on purchase and sale of property should be conducted by selling property at auction pursuant to the procedure established by the federal antimonopoly agency, whereas a reference to provisions set forth in the Law "On Privatization" which regulate sale of state-owned property assets and state-held shares of OJSCs at auction, was applied for this purpose in the previous periods.

In December 2011, the powers of the Federal Agency for State Property Management with regard to FSUEs, save for those FSUEs which are in the scope of competence of the Ministry of Defense of Russia and the Department for Presidential Affairs of the Russian Federation, with regard to coordination based on the proposals of a federal authority which is in charge of supervision over transactions with the immovable property assets secured to the enterprise on the basis of economic management, were supplemented with a qualifying regulation on leasing these property assets under agreements whose standard terms and conditions are approved by the Ministry of Economic Development and Trade of Russian, unless otherwise provided for by other norms and regulations adopted in accordance with the federal laws.

Special Russian Government Instruction No. 1060-r, dd. June 20, 2011 approved a list of 13 FSUEs to be subject to a special procedure for decision-making on specific issues concerning the activity of such enterprises, including appointment of the general manager thereof, conclusion, revision and termination of labor contracts therewith, approval of the development strategy and program, determination of a corporate profit to transfer to the federal budget, as well as approval of the estimate of income and expenses of federal state-run enterprises.

With regard to this group of enterprises, decisions on coordination of transactions relating to purchase, assignment or possibility of assignment, directly or indirectly, by enterprises owning property assets whose value exceeds 25% of book value of the corporate assets based on its accounting reports as of the latest reporting date, should be made by a FGEB on the basis of decisions of the Government of Russia, the Chairperson of the Government of Russia, or decisions made by Deputies Chairperson by Chairperson's order. The same procedure was established for reorganization of such FSUEs.

From the practical point of view, the update to corporate governance of federally owned joint stock companies can be characterized as follows (*Table 8*).

In the period since 2008 the number of JSCs whose governing bodies included elected professional directors, increased by 41 times, incl. 1,7 times in 2011, to reach 739 persons.

Hence, the percentage of JSCs with federally held shares, which engaged professional directors (net of JSCs which are subject to the special right "golden share", and LLCs), stood at more than 26% (against about 8% in 2009, 15.3% in 2010)[1].

[1] In analyzing this indicator, one should consider incomplete comparability of the give values, because in 2009 and 2010 they were obtained by comparing the number of JSCs which had professional directors in their governing bodies, with the total number of JSCs with federally held shares, as of the beginning of the year. Moreover, in 2011 the value was obtained by comparing it with a smaller group of JSCs with state participation at the year-end, which means that it was slightly overestimated. In addition, there is no knowing whether or not the membership of professional directors nominated by private shareholders apart from those nominated by the state was taken into account.

Table 8

Dynamics of engaging professional directors in the governing bodies of joint stock companies with state capital participation in the period of 2008–2011

Indicator	2008	2009	2010	2011
Number of professional directors, per., including	112	610	921	1568
- independent directors, per.	41	180	296	369
- professional agents, per.	71	430	625	1199
Number of JSCs in which they were elected as members of the governing body thereof	18	269	448	739

Source: G.S. Nikitin, E.Y. Litvina. Comprehensive Development of the Systems of Corporate Governance of Joint Stock Companies with State Participation. – B: "Joint stock Company: Corporate Governance" No. 12 (91), 2011, PP. 13-15, www.rosim.ru.

A total number of professional directors increased by 14 times, incl. by 1.7 times in 2011, in the foregoing JSCs. The number of professional agents increased almost by 17 times (1.9 times in 2011), independent directors by 9 times (about ¼ times in 2011). As a result, the latter accounted for 23.5% of the total number of professional directors in 2011, whereas this indicator the percentage was a bit higher in the previous periods (36.6% in 2008, 29.5% in 2009, 32.1% in 2010). Six hundred and two professional agents became Chairpersons of the Board of Directors (supervision boards) of companies with state participation, or half of the total number of those engaged.

Less success was achieved in other fields of corporate governance modernization. A total of 194 JSCs approved their mid-term strategic development program, 241 companies approved a system of key performance indicators. Different number of specialized committees (e.g., committee for strategic planning, HR and remuneration committee, audit committee, etc) were established under the board of directors of 261 JSCs, a position of corporate secretary was envisaged in 129 JSCs. The performance-based assessment of top manager remuneration, which is essential in crisis and post-crisis periods, was introduced through the use of key performance indicators in some joint stock companies: a provision of management remuneration was approved in 296 companies (of which 250 companies introduced remuneration on the basis of key performance indicators), but a provision on remuneration of the members of boards of directors was approved only in 122 companies[1].

Following are important events that took place within the property strategy framework at the federal level. The CEOs of various large companies with state capital participation (e.g., the United Aircraft Corporation) were replaced, but it was not the case with natural monopolies, and deputy prime-ministers, ministers, managers of other federal government executive bodies and members of the Presidential Office were replaced with independent directors and professional agents in the board of directors of joint stock companies with state participation.

This measure is intended among others to improve the investment environment and cover about 20 largest companies with state capital participation and was supposed to be implemented within the first half of the year, when meetings of shareholders in the foregoing companies were supposed to replace ministries and other heads of government authorities assigned to regulate some or other market segments, who often were in the capacity of chairperson the board of directors of such companies. Not every civil servant was supposed to

[1] G.S. Nikitin, E.Y. Litvina. Comprehensive Development of the Systems of Corporate Governance of Joint stock Companies with state participation. – B: "Joint stock Company: Corporate Governance" No. 12 (91), 2011, P. 10, www.rosim.ru

be replaced with an independent director, government authorities were placed in charge of instructing state representatives on most important issues to consider.

The effect of this measure seems to be mixed. On the one hand, it creates potential preconditions for improving corporate governance, which is a key objective of the new privatization program. On the other hand, given the shortage of independent directors who would meet the requirements arising out of the materiality of companies with state capital participation, the situation is very likely to become the same as that at the very beginning of the 2000s, when senior civil servicemen represented state interests in these companies. In any case, it is undesirable if the state loses its leverage on the managers of these companies due to weakened status of state representatives in boards of directors and possible requirements to independent director candidates, and the issue of looking for efficient corporate governance arrangements in companies with state participation which provide for adequate balance of strategic interests of the state and private shareholders, still remains to be topical.

6.1.5. State participation in the economy and structural policy

Ownership of assets doesn't mean that the state can influence the configuration of a specific industry and indirectly the structure of economy at large, including through stimulating or opposing to some or other changes in specific sectors. In this respect, the year of 2011 was characterized by a relatively small changes vs. the recent few years.

A list of strategic enterprises and joint stock companies was updated. From the quantitative point of view, the changes were smaller vs. a large-scale reduction that took place in the preceding year. Only one unitary enterprise and two OJSCs were enlisted, and seven unitary enterprises (of which two unitary enterprises were subject to conversion into state-funded institutions) and two OJSCs, including Oboronservice, an integrated entity established in 2008, were delisted. Two OJSCs underwent changes in the format of their presence in the foregoing list: the state-held interest decreased from 100% to 50% +1 share after Sherementyevo International Airport (SIA) and the United Grain Company (UGC) were allowed to increase their charter capital through additional offering.

The same size of state-held interest was established in the middle of the year for Federal Hydropower Generating Company (RusHydro), through a tentative contribution of federally owned shares of 12 OJSCs to its charter capital in addition to a large number of other property assets, of which most significant were Pavlodolsk HPP in North Ossetia (100%), Kamchatka Gazenergy Complex (96.58%), RAO Energy System of East (52.68%). A state-held interest in the three of the rest of companies was bigger than the blocking interest.

Apart from the electric-power industry, the plan for integrated entities includes decisions relating to the geological and agricultural sectors.

The existing OJSC Centrgeologiya will be renamed into Rosgeologiya with subsequent contribution in the form of payment of additional federally-held shares of 24 OJSCs (100% -1 share) and OJSCs established as a result of transformation of 13 FSUEs, to be floated by this joint stock company.

OJSC Rosspirtprom's property complex underwent significant changes. On the one hand, its charter capital was increased through a state contribution of a great number of immovable property assets[1] withdrawn from operating management of federal state-run enterprise (FSRE)

[1] This can explain in part a sharp increase in the number of property assets subject to privatization which fall under the category of "Other property" in the privatization program for the period of 2011-2013.

Rosspirtprom. On the other hand, the number of business entities whose shares and interest were contributed to the charter capital of OJSC Rosspirtprom, decreased from 58 to 39, whereas the possibility to delegate exclusive rights to intellectual activities which previously were to be included therein, ceased to be in force. FSUE Central Moscow Hippodrome was incorporated into a OJSC with a 100% federally held interest, consolidating hippodromes of the Russian Federation. This is why the property assets of 27 state stud farms (SSF) left after liquidation of federal state institutions (FSI) were contributed as a state contribution to its charter capital.

An OJSC, Strategic Points of Control, started to build up in the defense industry. Such entities as the Concern Sozvezdiye and Concern Morinformsystem – Agat were expected to enlarge.

In 2011, a total of 29 integrated entities (including the Russian Technologies State Corporation) (26 integrated entities in 2010) were formed on the basis of the decisions made by the President and the Government of the Russian Federation.

As part of this process the Federal Agency for State Property Management made decisions on the terms of privatization of 92 unitary enterprises (24 unitary enterprises in 2010), shares of 44 JSCs (46 JSCs in 2010) and another 12 JSCs established as a result of transformation of FSUEs eligible for the Privatization Program and subject to become a part of integrated entities (two integrated enterprises in 2010), as well as 336 other property assets to contribute to the capital of OJSC Federal Hydropower Generating Company (RusHydro) and OJSC Rosspirtprom. The shares of 10 JSCs established through privatization of unitary enterprises were transferred as a state contribution to the Russian Technologies State Corporation.

With regard to 11 integrated entities (OJSC Concern PVO Almaz-Antey, Precision Instrument-Making Systems Research and Production Corporation, Uralvagonzavod Research and Production Corporation, Center of Excellence of Live Stock Reproduction, Rosneftgaz, Moscow Thermotechincs Institute Corporation, INTER RAOUES, OJSC Federal Hydropower Generating Company (RusHydro) and such FSUEs as “MMPP “Salut”, Khrunichev State Research and Production Space Center, Rosoboronexport), the decisions of the President and the Government of the Russian Federation were implemented in 2011 (the data provided by the Ministry of Economic Development and Trade of Russia).

At the end of October, OJSC Russian Railways sold 75% -2 shares (Rb 125,5bn) to its subsidiary Pervaya Gruzovaya Kompaniya. A blocking interest to Transcontainer was considered to be sold in the same manner[1]. However, the rolling stock was transferred to Pervaya Gruzovaya Kompaniya and Vtoraya Gruzovaya Kompaniya, other subsidiaries and independent companies because it became impossible to provide cargo transportation serviced on the side of the largest all-Russian railway carrier, which raised a question of introducing a category of “outsourced cars” which the Russian Railways should lease from other operators, including subsidiaries, to provide to consignors at special prices[2].

Under such circumstances, apart from the structural policy aspects, it is the dividend policy of the state as shareholder of integrated entities that becomes important in terms of generating extra revenues from sale of assets in addition to operating income. The state may expect a certain amount of compensation for contributing free assets to these entities. In some cases, the

[1] http://www.1prime.ru, 28.10.2011, M. Kukushkin. The Case is in Container // Moscow News, No. 159 (159), November 11, 2011, p. 07.
[2] Direct investments, No. 1 (117), 2012, p. 66.

state may accept discounting of budget-related problems by integrated entities in implementing "big privatization", which requires a mandatory set of behavior requirements to such business entities with regard to pricing policy, participation in mergers and acquisitions, investments, etc.

6.1.6. Budget effect of the state property policy in the period between 2000 and 2011

The downturn the Russian economy has been facing since the fall of 2008, naturally resulted in reduction of budget revenues, including revenues from the implementation of the state property policy. In 2011, like in the preceding year, economic growth was followed by a visible growth in state-funded revenues relating somehow to state-owned property assets.

It should be reminded that all federal budget revenues from state-owned property assets can be divided into two groups in terms of nature and sources thereof. One group includes revenues from the use of state-owned property (renewable sources). The second group comprises revenues of single origin, which are non-renewable, because once they are sold the state assigns the title thereto to other legal entities and individuals, incl. as part of the privatization process (non-renewable sources).

Below (*Tables 9* and *10*) are the data on the revenues (save for the data on the preceding year) specified in the laws on the implementation of the federal budget for the period of 2000–2010, with regard to the use of state-owned property assets and sale thereof only in the form of tangible assets[1].

[1] Outside the investigation remained federal budget revenues from mineral tax payments (including aquatic biological resources, revenues from the use of forest resources and mineral resources), compensation for losses in agricultural productivity relating to forfeiture of agricultural lands as a result of financial operations (revenues from allocation of budget funds (revenues from balances of budget funds and allocation thereof, from 2006 also revenues from management of funds allocated in the Stabilization Fund of the Russian Federation (in 2009 – the Reserve Fund and the National Wealth Fund), revenues from allocation of money accumulated during state-held shares auctions), interest from domestic budget loans extended with federal budget funds, interest on sovereign loans (cash inflow from foreign governments and legal entities thereof as repayments for loans extended by the Russian Federation, revenues from enterprises and organizations as payments of interest and guarantees on loans issued to the Russian Federation by foreign governments and international financial organizations)), from the provision of paid services or compensation for government expenses, transfer of profit to the Central Bank of Russia, some types of payments from public and municipal enterprises and organizations (patent fees and registration dues payable for official registration of software, data banks and integrated circuit layouts and other revenues which prior to including 2004 formed an integral part of payments due by government organizations (apart from revenues from the Vietsovpetro Joint Venture since 2001 and allocation of a part of the profit of FSUEs since 2002)), revenues from exercise of product sharing agreements (PSA), revenues from disposal and sale of confiscated properties converted into the revenues received from the usage and sale of confiscated and other property returned to the state (including properties whose title was transferred to the state by way of inheritance or gift, or contributions), revenues from lotteries, other revenues from the use of state-owned properties and title (revenues from exercise of rights to intellectual activity (R&D and technological works) of military, special and double purposes, revenues from exercise of rights to the state-owned results of scientific and research activity, revenues from operation and use of motor road assets, motor road tolls payable for vehicles registered overseas, and other revenues from the use of state-owned property assets), as well as from permitted types of activity of organizations, federal budget revenues from sale of precious metals and stones as part of the national reserve of the same.

Table 9

Federal budget revenues from the use of state-owned property assets (renewable sources) in the period between 2000 and 2011, m Rb

Year	Total	Dividends on shares (2000–2011) and revenues from other forms of capital participation (2005–2011)	Rental payments for state-owned land	Revenues from leasing of state-owned property assets	Revenues from transfers of a part of after-tax profit and other mandatory payments payable by FSUEs	Vietsovinvest Joint Venture Revenues
2000	23244,5	5676,5	-	5880,7	-	11687,3[a]
2001	29241,9	6478,0	3916,7[b]	5015,7[c]	209,6[d]	13621,9
2002	36362,4	10402,3	3588,1	8073,2	910,0	13388,8
2003	41261,1	12395,8	10276,8[e]		2387,6	16200,9
2004	50249,9	17228,2	908,1[f]	12374,5[g]	2539,6	17199,5
2005	56103,2	19291,9	1769,2[h]	14521,2[i]	2445,9	18075,0
2006	69173,4	25181,8	3508,0[h]	16809,9[i]	2556,0	21117,7
2007	80331,85	43542,7	4841,4[h]	18195,2[i]	3231,7	10520,85
2008	76266,7	53155,9	6042,8[h]	114587,7[i]	2480,3	-
2009	31849,6	10114,2	6470,5[h]	113507,6[i]	1757,3	-
2010	69728,8	45163,8	7451,7[h]	12349,2[j]	4764,1	-
2011	104304,0	79441,0	8210,5[h]	111241,25	4637,85	773,4

[a] – according to the Federal Agency for State Property Management of Russia, the Law "On the Implementation of the Federal Budget for 2000" contained no separate line for these; the amount of payments from state-owned enterprises (Rb 9887,1m) was specified (no specific elements were shown);
[b] – amount of rental for (i) agricultural lands and (ii) lands of cities and settlements;
[c] – total revenues from leasing of the property assets secured to (i) research institutions, (ii) educational institutions, (iii) medical institutions, (iiii) public museums, public institutions of arts and humanities, (iiiii) archive institutions, (iiiiii) Ministry of Defense of Russia, (iiiiiii) organizations under the Traffic Ministry of Russia, (iiiiiiii) organizations providing services to public academies of science and (iiiiiiiii) other revenues from leasing of state-owned property assets;
[d] – according to the Federal Agency for State Property Management of Russia, the Law "On the Implementation of the Federal Budget for 2001" contained no separate line for these; the value coincided with the value of other revenues from payments due by public and municipal organizations;
[e] – total amount of revenues from lease of state-owned property assets (without specifying land rental);
[f] – amount of rental for (i) lands of cities and settlements and (ii) state-owned land after the delimitation of land ownership;
[g] – total revenues from leasing of the property assets secured to (i) research institutions, (ii) educational institutions, (iii) medical institutions, (iiii) public institutions of arts and humanities, (iiiii) public archive institutions, (iiiiii) federal postal agencies under the Federal Communications Agency, (iiiiiii) organizations providing services to public academies of science and (iiiiiiii) other revenues from leasing of federally owned property assets;
[h] – rental after the delimitation of land ownership and proceeds from sale of the right to conclude contacts on leasing of state-owned land (net of land plots owned by autonomous (2008–2011) and state-funded (2011) institutions);
[i] – revenues from leasing of property assets which are operatively managed by federal government bodies and the institutions established thereby and on the basis of economic management by FSUEs: transferred for the purpose of state-status operating management (i) scientific institutions, (ii) institutions providing scientific services under the Russian Academy of Science and industry-specific academies of science, (iii) educational institutions, (iiii) medical institutions, (iiiii) federal postal agencies under the Federal Communications Agency, (iiiiii) public institutions of arts and humanities, (iiiiiii) public archive institutions and (iiiiiiii) other revenues from leasing of property assets which are operatively managed by federal government bodies and the institutions established thereby and on the basis of economic management by FSUEs[1] (for 2006–2009 net of overseas reve-

[1] In 2008-2009, FSUEs, as a source of revenues from leasing of property assets being under economic management thereby, were not mentioned, and leasing of property assets being under operating management by federal government authorities and the institutions established thereby excludes property assets owned by federal autonomous institutions.

nues from permitted types of activity and the use of federal property assets located overseas, which were not shown in the previous years[1]);
[j] – revenues from leasing of property assets which are operatively managed by federal government bodies and the institutions established thereby (save for state-funded and autonomous institutions): transferred for the purpose of state-status operating management (i) scientific institutions, (ii) institutions providing scientific services under the Russian Academy of Science and industry-specific academies of science, (iii) educational institutions, (iiii) medical institutions, (iiiii) public institutions of arts and humanities, (iiiiii public archive institutions, (iiiiiii) on the basis of economic management by the Ministry of Defense of Russia and its subordinated bodies, (iiiiiiii) federally owned with functions of disposing thereof being assigned to the Department for Presidential Affairs of the Russian Federation (2010) and (iiiiiiiii) other revenues from leasing of property assets which are operatively managed by federal government bodies and the institutions established thereby (net of overseas revenues from permitted types of activity and the use of federal property assets located overseas).
Source: The laws on the implementation of the federal budget for the period of 2000–2010, the Report on the Implementation of the Federal Budget as of January 1, 2012, www.roskazna.ru; IET's estimates.

Proceeding to analysis of preliminary results of the budget effect of the state property policy in 2011 with regard to renewable sources, first of all it is worth noting that dividends were growing and their value visibly increased 76% vs. 2010. Transfers of a part of the profit of unitary enterprises decreased a bit (less than 3%). A similar picture was seen in budget revenues from leasing. Revenues from leasing of land kept growing (more than 10%) like they did in 2010 as revenues from leasing of federal property decreased by 9%.

Finally, the dividends which were accumulated in the budget (Rb 79,44bn)[2] and land rental (Rb 8,21bn) exceeded in terms of absolute value all of the previously reported indicators. Transfers of a part of the profit of FSUEs (Rb 4,64bn) were found to be maximum too throughout the entire 2000x, save for 2010. In the meantime, revenues from leasing of property assets were continuously dropping since 2008 to reach the level of 2004.

The structure of the federal budget revenues from renewable sources saw continued growth of dividends in percentage terms (more than 76% in 2011 vs. 64.8% in the preceding year). The percentage of other sources decreased vs. 2010: by 10.8% for revenues from leasing of property assets, 7.9% from leasing of land, 4.4% for the profit transferred by FSUEs.

Proceeding to analysis the federal budget revenues from privatization and sale of state-owned property (*Table 10*), it should be noted that since 1999 revenues from sale of a major part of such assets (shares, and also land plots in 2003–2007[3]) became classified as sources of financing of the federal budget deficit.

[1] According to the Federal Agency for State Property Management, revenues from the use of federal property assets located overseas (net of revenues of the Russian participant in Vietsovpetro Joint Venture), totaled Rb 315m in 1999 and Rb 440m in 2000. Thereupon, Overseas Management Enterprise, a FSUE, began to play the key role in organizing commercial use of federally owned immovable property assets located overseas.
[2] This value also exceeds the aggregate value of federal budget revenues prior to the crisis in 2007 from domestic dividends on shares of Russian JSCs (Rb 43,5bn) and revenues from the Russian participant in the Vietsovpetro Joint Venture (about Rb 10,5bn). After completion of the development program for OJSC Zarubezhneft, during which a 50% interest held by the Russian participant in the Vietsovpetro Joint Venture was contributed to the Zarubezhneft charter capital in 2007 along with the shares of two joint stock companies as research institutes, this source of federal budget revenues ceased to exist and was not even recognized in the structure of revenues from renewable sources in 2008-2010. In 2011, Vietsovpetro Joint Venture's revenues (Rb 773,4m) were transferred to the federal budget in terms of settlements on revenues generated in the previous years.
[3] In 2003-2004, given the sale of leasehold right.

Table 10

Federal budget revenues from privatization and sale of property assets (non-renewable sources) in the period between 2000 and 2011, Rb m

Year	Total	Sale of federally held shares (2000–2011) and other forms of interest holding (2005–2011)[a]	Sale of land plots	Sale of various types of property
2000	27167,8	26983,5	-	184,3[b]
2001	10307,9	9583,9	119,6[c]	217,5+ 386,5+0,4 (IAs)[d]
2002	10448,9	8255,9[e]	1967,0[f]	226,0[g]
2003	94077,6	89758,6	3992,3[h]	316,2+10,5[i]
2004	70548,1	65726,9	3259,3[j]	197,3+1364,6+0,04 (IAs)[k]
2005	41254,2	34987,6	5285,7[l]	980,9[m]
2006	24726,4	17567,9	5874,2[l]	1284,3[n]
2007	25429,4	19274,3	959,6[o]	5195,5[p]
2008	12395,0	6665,2+29,6	1202,0[q]	4498,2+0,025 (IAs)[r]
2009	4544,1	1952,9	1152,5[q]	1438,7[r]
2010	18677,6	14914,4	1376,2[q]	2387,0+0,039 (IAs)[r]
2011	136660,2	126207,5	2425,2[q]	8027,5[r]

[a] – refer to sources of internal financing of the federal budget deficit, total amount of Rb 29,6m in 2008 (according to the data provided in the Report on the implementation of the federal budget as of January 1, 2009) was classified as federal budget revenues but not specified in the Federal Law "On the Implementation of the Federal Budget in 2008";

[b] – revenues from privatization of state-owned organizations classified as sources of internal financing of the federal budget deficit;

[c] – revenues from sale land plots and leasehold rights to state-owned land plots (specifying the land plots on which privatized enterprises are located) classified as federal budget revenues;

[d] – amount of proceeds from (1) sale of federally owned property classified as sources of internal financing of the federal budget deficit, (2) revenues (i) from sale of living quarters, (ii) from sale of public productive and nonproductive assets, means of transport, other equipment and other tangible assets, as well as (3) revenues from sale of intangible assets (IAs) classified as federal budget revenues;

[e] – including Rb 6m from sale of shares held by constituent territories of the Russian Federation;

[f] – revenues from sale of land and intangible assets, without specifying the amount of proceeds therefrom, classified as federal budget revenues;

[g] – proceeds from sale of state-owned property (including Rb 1,5m from sale of the property owned by constituent territories of the Russian Federation) classified as sources of internal financing of the federal budget deficit;

[h] – includes proceeds (1) from sale of land plots, which include immovable property assets owned by the federal government prior to transfer, to be allocated to the federal budget, (2) from sale of other land plots, as well as from sale of the right to conclude contracts on leasehold thereof, (3) from sale of land plots prior to the delimitation of land ownership, as well as from sale of the right to conclude contracts on leasehold thereof, to be allocated to the federal budget, classified as sources of internal financing of the federal budget deficit;

[i] – the amount (1) of proceeds from federally owned property classified as sources of internal financing of the federal budget deficit, and (2) revenues from sale of intangible assets classified as federal budget revenues;

[j] – includes proceeds (1) from sale of land plots prior to the delimitation of state ownership of land, which include immovable property assets owned by the federal government prior to transfer, to be allocated to the federal budget, (2) from sale of other land plots, as well as from sale of the right to conclude contracts on leasehold thereof, (3) from sale of land plots prior to the delimitation of land ownership, as well as from sale of the right to conclude contracts on leasehold thereof, to be allocated to the federal budget, classified as sources of internal financing of the federal budget deficit;

[k] – the amount (1) of proceeds from federally owned property classified as sources of internal financing of the federal budget deficit, (2) revenues (i) from sale of living quarters, (ii) from sale of equipment, means of transport and other tangible assets, to be allocated to the federal budget, (iii) from sale of ship utilization products, (iiii) from sale of the property owned by SUEs, institutions and military equipment, (iiiii) from disposal of military products, equipment and ammunition, (3) revenues from sale of intangible assets (IAs) classified as federal budget revenues;

[l] – includes proceeds (1) from sale of land plots prior to the delimitation of state ownership of land, which include immovable property assets owned by the federal government prior to transfer, (2) from sale of land plots prior to the delimitation of land ownership,, to be allocated to the federal budget, (3) from sale of other land plots which were owned by the state prior to the delimitation of state ownership of land and are not to be used for housing construction (the latter update is referred to 2006 only) and are classified as sources of financing of the federal budget deficit;
[m] – revenues from sale of tangible and intangible assets (net of federal budget revenues from disposal and sale of confiscated and other property converted into state income), include revenues (i) from sale of living quarters, (ii) from sale of the property of FSUEs, (iii) from sale of the property operatively managed by federal institutions, (iiii) from sale of military property, (iiiii) from disposal of military products, equipment and ammunition, (iiiiii) from sale of other federally owned property, (iiiiiii) from sale of intangible assets, classified as federal budget revenues;
[n] – revenues from sale of tangible and intangible assets (net of revenues which represent a public share in profit products in executing product sharing contracts (PSCs) and federal budget revenues from disposal and sale of vacant, confiscated and other property converted into state income), include revenues (i) from sale of living quarters, (ii) from sale of the property of FSUEs, (iii) from sale of the property operatively managed by federal institutions, (iiii) from sale of military property, (iiiii) from disposal of military products, equipment and ammunition, (iiiiii) revenues from sale of other federally owned property classified as federal budget revenues;
[o] – proceeds from sale of land plots prior to the delimitation of land ownership, which were owned by the federal government and are classified as sources of financing of the federal budget deficit;
[p] – revenues from sale of tangible and intangible assets (net of revenues which represent a public share in profit products in executing product sharing contracts (PSCs) and federal budget revenues from disposal and sale of vacant, confiscated and other property converted into public revenues, proceeds from sale of sequestered lumber), include revenues (i) from sale of living quarters, (ii) from sale of the property of FSUEs, (iii) from sale of the property operatively managed by federal institutions, (iiii) from sale of released movable and immovable military and other property available at federal government executive bodies in which military and equivalent to military services are envisaged, (iiiii) from sale of military products available in federal government executive bodies within the framework of military and technical cooperation, (iiiiii) revenues from sale of other federally owned property classified as federal budget revenues;
[q] – revenues from sale land plots owned by the state (save for land plots of federal autonomous and state-funded (2011) institutions), classified as federal budget revenues;
[r] – revenues from sale of tangible and intangible assets (net of revenues which represent a public share in profit products in executing product sharing contracts (PSCs) and federal budget revenues from disposal and sale of vacant, confiscated and other property converted into public revenues, proceeds from sale of sequestered lumber, revenues from sale of special raw materials and fertile materials), include revenues (i) from sale of living quarters, (ii) from sale of the property operatively managed by federal institutions (save for state-funded and autonomous institutions (2011), (iii) from sale of released movable and immovable military and other property available at federal government executive bodies in which military and equivalent to military services are envisaged , (iiii) from disposal of military products, equipment and ammunition, (iiiii) from sale of military products available at federal government executive bodies within the framework of military and technical cooperation (2008 and 2010–2011), (iiiiii) from disposal of military products, equipment as part of the federal special program on Industrial Utilization of Arms and Military Equipment for the period of 2005–2010, (iiiiiii) revenues from sale of other federally owned property, as well as revenues from sale of intangible assets (IAs) classified as federal budget revenues;
Source: The laws on the implementation of the federal budget for the period of 2000–2010, the Report on the Implementation of the Federal Budget as of January 1, 2012, www.roskazna.ru; IET's estimates.

A rapid, more than 7-fold growth in the federal budget property-related revenues from nonrenewable sources took place in 2011 against the preceding year, which is comparable with the results of 2003, when a 9-fold growth was reported.

Proceeds from sale of shares increased most (by 8.5 times) and exceeded by 40% in terms of absolute value (Rb 126,2bn) the best results since 2003. However, it should be understood

that most of these revenues were generated from a single transaction with 10% shares of OJSC VTB Bank (Rb 95,68bn).

Revenues from sale of various types of property increased almost 3.4 times, revenues from sale of land plots increased by 76%. While the revenues from the former exceeded in terms of absolute value (more than Rb 8bn) the previous maximum (Rb 5,2bn) in 2007, federal budget revenues from sale of land plots were much less (more than Rb 2,4bn) than in 2003–2006, but exceeded by 2–2.5 times those in 2007–2010.

All in all, proceeds from sale of shares in 2011 accounted for more than 92% of total revenues from nonrenewable sources vs. almost 80% in 2010. Other sources of revenues were insignificant: revenues from sale of various types of property stood at 5.9% (13% in 2010), revenues from sale of land stood at mere 1.8% (7.4% in 2010).

Total federal budget revenues from privatization (sale) and the use of state-owned property assets (*Table 11*) in 2011 increased more than 2.7 times vs. 2010. The reached an absolute maximum of about Rb 241bn from the beginning of the 2000s.

Table 11

Structure of federal budget property-related revenues from various sources in the period between 2000 and 2011

Year	Total revenues from privatization (sale) and use of state-owned property assets		Revenues from privatization(nonrenewable sources)		Revenues from the use of state-owned property assets (renewable sources)	
	Rb m	% of total	Rb m	% of total	Rb m	% of total
2000	50412,3	100.0	27167,8	53.9	23244,5	46.1
2001	39549,8	100.0	10307,9	26.1	29241,9	73.9
2002	46811,3	100.0	10448,9	22.3	36362,4	77.7
2003	135338,7	100.0	94077,6	69.5	41261,1	30.5
2004	120798,0	100.0	70548,1	58.4	50249,9	41.6
2005	97357,4	100.0	41254,2	42.4	56103,2	57.6
2006	93899,8	100.0	24726,4	26.3	69173,4	73.7
2007	105761,25	100.0	25429,4	24.0	80331,85	76.0
2008	88661,7	100.0	12395,0	14.0	76266,7	86.0
2009	36393,7	100.0	4544,1	12.5	31849,6	87.5
2010	88406,4	100.0	18677,6	21.1	69728,8	78.9
2011	240964,2	100.0	136660,2	56.7	104304,0	43.3

Source: The laws on the implementation of the federal budget for the period of 2000–2010, the Report on the Implementation of the Federal Budget as of January 1, 2012, www.roskazna.ru; IET's estimates.

Nonrenewable sources in the structure of total revenues from privatization (sale) and the use of state-owned property assets in 2011 increased by more than 2.5 times (up to 56.7%) vs. the preceding year and doubled a half thereof for the first time over the last 7 years. The foregoing value is comparable with the results of 2000 and 2004, and a bit smaller than those in 2003 (69.5%). On the contrary, revenues from the use of state-owned property assets decreased from 79% in 2010 to 43.3% in 2011. In the meantime, the results of 2011 were maximum in terms of absolute value and outstripped by 30% the results 2007, while revenues from privatization (sale) of property outstripped by 45% the previous maximum (2003)

The results of privatization in 2011 allows one to assume that the "new privatization policy" which was under discussion in 2009–2011 and supported by a series of legal updates, has a chance, under otherwise equal conditions, to be implemented in full in the ensuing years.

6.2. "New Privatization Policy": Risks, Stakeholder Groups, Constraints, Potential Innovations

The worldwide downturn that hit economies at the end of the first decade of 21st century, has led to a series of socio-economic changes whose effect in terms of radicality requires quite a long time to comprehend[1]. Even today, however, it is quite obvious that both leading market institutions of the western world, namely the US institution based on the principles of free market competition, and the European institution governed by socially oriented principles, have failed to offer adequate countermeasures at the initial phase of the crisis, when the first signs thereof emerged. However, it is only the nations with more powerful influence on their economy that have managed to counteract the developments leading to financial and economic collapse. And Russia belongs to this nations, with some reservations though.

However, the effect of a large-scale government intervention in the economy, which is positive amid crisis, may often become adverse at the stage of stable, long-term economic growth.

6.2.1. "New privatization policy" background

More than 20 years of experience in Russia and other economies in transition proves that the process of denationalization is complex and time-consuming[2]. The dynamics of denationalization process in Russia was conditioned by two opposite trends in the 2000s.

On the one hand, the privatization process continued with different degrees of intensity. The Government of Russia approved annual comprehensive forecast plans (programs) of privatization of federally owned property, which include thousands of FSUEs and shares (interest) of business entities operating in various sectors. As is evident from the previous section, a total number of federal state unitary enterprises and joint stock companies with state participation decreased about 40% in the period between 2007 and 2010. This trend, however, is most typical of the federal level. The number of unitary enterprises changed in different ways at the regional and local levels. Even a formal decrease in the number of state-owned enterprises at the federal level depends largely on the formation of "integrated structures" and state-owned corporations.

The rate of privatization slowed down after 2005, as evidenced by the results achieved in 2006–2008. No positive dynamics was reported until 2010, as evidenced not only by quantity of property assets but also budget revenues. According to the Ministry of Economic Development and Trade of Russia, revenues from sale of privatized federally owned property assets in 2010 totaled Rb 22,67bn[3] and outstripped many times the federal budget revenues from

[1] Based on the materials provided by the Expert Group on Management of State-Owned Property and Privatization which was established in January 2011 as part of the updated Concept of Socio-Economic Development of the Russian Federation until 2020 ("Strategy 2020").

[2] More information on the initial stages of privatization in Russia is provided in the following publications: *A.D. Radygin*, Ownership Reform in Russia: From the Past to the Future. M., Respublika, 1994; *A.D. Radygin, P.M. Entov*, Institutional Issues of the Corporate Sector Development: Ownership, control, securities market. M.: IET, 1999; *Radygin A.* Privatization, Ownership Redistribution, and Formation of the Institutional Basis for Economic Reforms. - In: The Economics of Russian Transition. Ed. by Y. Gaidar. Foreword by S. Fischer. The MIT Press, Cambridge, Massachusetts, 2003. Chapter 14. P. 395 –459.

[3] However, according to the preliminary data provided in the Report on the Implementation of the Federal Budget as of January 1, 2011, www.roskazna.ru, federal budget revenues from privatization and sale of property assets (including land plots) totaled Rb 18,68bn.

privatization of state-owned property assets in 2008 (Rb 7,19bn) and 2009 (Rb 1,93bn), and outstripped the target figures, which was not the case in the recent successive years. In 2011 this trend became more evident, with some reservations though (Rb 121bn) (Rb 126bn, according to the Report on the Implementation of the Federal Budget as of January 1, 2012).

On the other hand, the state has strengthened its influence vs. the 1990s. In the period between 2000 and 2003 the state was focused mainly on optimizing its direct participation in the economy which was retained after the implementation of the programs on voucher (1992–1994) and cash (1995–1999) privatization. The next 5-year period (from 2004 to 2008) was characterized by a wider participation through acceleration of the activity of companies with state capital participation which tended to expand and diversify their business by engaging in mergers and acquisitions. The strategy of consolidation of the remainder of scattered state-owned assets into integrated entities was accelerated in the period of 2006–2007. The public ownership policy was distinguished by the establishment of state-owned corporations, some of which were industry-specific (aviation and nuclear power industries, shipbuilding industry), including manufacturing of civil products.

Enhanced state participation in the economy was reflected in the national policy documents as well. It is highlighted in the Concept of Long-Term Socio-Economic Development of the Russian Federation until 2020 (which was adopted in 2008) that public sector fits well into the Russian economy and acknowledges that state-owned enterprises play an important role. However, with regard to state-owned property management (of specific categories of property assets), this document provides for basically the same approaches envisaged in the previous government programs implemented in the 2000s. The requirement that the composition of state-owned property must comply with not only powers and functions of the state, but also structural changes in any given industry, can be considered an important feature.

The recession of 2008–2009 was not responsible for a large-scale growth in the public sector, because the anti-recessionary strategy was focused on minimizing direct participation of the state in the capital of distressed private companies and banks. Furthermore, according to the official data provided by the Rosstat (without consideration of pyramidal ownership in the mixed sector) testifies to the fact that the public sector continued to decrease its participation in the economy in the period between 2008 and 2010 as well. However, most of expert estimates show that the state increased its participation in the Russian economy due to both activities of mixed sector companies in corporate control market and indirect recession countermeasures taken by the state. In particular indirect influence of state-controlled banks and entities acting as its agents in taking recession countermeasures, increased.

According to the EBRD, by 2009 the public sector of the Russian economy increased from 30 to 35% of GDP. Though this data is very illustrative in terms of dynamics, it seems to be underestimated as applicable to the public sector scope. According to the available estimates (Troika Dialog, 2008), federal and regional authorities controlled about 40% of capitalization in the Russian stock market at the end of 2007 vs. 24% in 2004. According to the Expert-400 rating, by the beginning of 2008 “the depth of ownership concentrated” in the hands of the state stood at 40 to 45%, whereas in 2009 this indicator stood at within 50%, according to various expert assessments.

Active “structural” privatization policy was commenced at the end of 2009, when the Russian economy began to recover from acute recession phase. The following “standard” objectives of privatization were set in the period between 2006 and 2008: generate federal budget revenues, undertake privatization of the property assets which were not involved in govern-

ment functions, undertake incorporation of unitary enterprises. Public statements of top officials of the Government of Russia in September-October 2009 made notes for the first time of a "structural" privatization aimed at reducing the scope of state direct participation in the Russian economy, enhancing competition in industries, generating investments in long-term corporate development, improving the effectiveness of large companies with state participation.

A new stage of privatization was started when the Government of Russia (November 30, 2009) approved another Forecast Plan of Privatization of Federally Owned Property for 2010 and the Guidelines of Privatization of Federally Owned Property for the Period of 2011–2012. The plan had some specific features, namely generation of extra budgetary investments in the development of privatized companies was set as a top-priority task; the list of sectors (industries) scheduled for privatization was expanded essentially; focus was placed on privatization of a series of the largest (budget revenue generating) companies. The foregoing allows one to say that a "new privatization" policy was launched in Russia at the beginning of 2010.

In general, *two groups of preconditions for the transition to "new privatization"* can be underlined. The first group included fundamental factors which are not linked directly to the recent worldwide downturn:

- the state has an ambiguous and controversial status (as lawmaker, regulator and direct participant in large companies);
- there is no appropriate environment in place to ensure fair competition and enhance investment activity through private businesses in industries with high level of direct state participation;
- large companies with state participation show active behavior in acquiring assets, including extension of non-core assets;
- there are objective limits which interfere with higher quality of corporate governance in public sector companies;
- there are many public sector entities which are not effectively managed and supervised by the state.

However, radical changes in the contents of state privatization policy in 2010, which were focused on the structural component thereof and denationalization of the largest companies, specific sectors, were, in our opinion, largely conditioned by awareness of the issues which became topical as a result of the recent downturn (second group of preconditions):

- the state is strengthening its participation (influence) in the economy amid crisis, and the level of direct state participation is too high;
- the risk of that in the post-crisis period the state would strengthen its participation in the economy due to uncertainty about what may happen with companies' shares pledged as collateral for state anti-recessionary support if such companies fail to discharge their loan obligations;
- poor competitiveness of a series of public sector large companies, the need to undertake restructuring and technological modernization thereof;
- the need to generate considerable extra budgetary investments, including the development of the key sectors within the infrastructure framework;

– there are stronger doubts about prospects of rapid post-crisis growth in the Russian economy; social budget expenditures have been extended, which may result in the need to impose stronger budget constraints (looking for more budget revenues).

In general, the issues of structural effect of privatization for the development of the Russian economy have been placed to the foreground of 'state agenda'. In our opinion, the privatization policy's structural approach is evidenced by both official statements and actions which have been undertook over the last two years to update regulation of privatization, reduce drastically the list of strategic enterprises, plan privatization of the largest public sector companies, improve corporate governance of companies with state participation.

First, a series of significant updates and amendments were made to the Federal Law "On Privatization"[1], in particular:

– the transfer to mid-term planning of privatization of federally owned property was undertaken, the Government of Russia was entitled to define possibilities to draft forecast plans (programs) of privatization for a period of 1 to 3 years (previously, forecast plans were drafted annually) and add new entities to privatization plans;
– the Government of Russia was entitled to make decisions on privatization of state-owned property of the scope of the 'standard' procedures established by the Federal Law "On Privatization" for the purpose of creating conditions for investments, promoting the development of the stock market, as well as modernization and technological development of the economy;
– the Government of Russia was entitled to delegate to legal entities the functions of seller of privatized federally owned property assets;
– the use of the principle of standard price of assets subject to privatization was abolished; standard price was defined pursuant to the procedure for minimum price at which such assets may be sold, established by the Government of Russia;
– conditions for privatization of small federally owned property assets were simplified, potential buyers were granted more assess to be able to participate in privatization (the possibility to sell state-owned property assets in electronic format was defined; the relevant procedure was refined through public offering – Dutch auction; the required amount of tender or auction guarantee was reduced);
– transparency requirements for privatization procedures were upgraded.

Second, drastic changes in the list of strategic enterprises and joint stock companies[2] should be mentioned in the context of extension of the privatization base: the number of eligible organizations was more than halved, down to 200 in 2010. Making industry-specific examination of the delisted organizations, it should be noted that a major part thereof (about 1/4) are somehow linked to the transport industry and the relevant infrastructure.

Third, plans on privatization of the shares of 10 largest Russian companies and banks (Rosneft, RusHydro, Federal Grid Company of United Energy System, Sovcomflot, Sberbank of Russia, VTB Bank, United Grain Company, Rosagroleasing, Russian Railways,

[1] Federal Law No. 106-FZ, dd. May 31, 2010, "On the Amendments to the Federal Law "On Privatization of State-Owned and Municipal Property"".

[2] Russian President Order No. 1009, dd. August 4, 2004, "On the Approval of the List of Strategic Enterprises and the List of Strategic Joint Stock Companies". It should be noted that under the applicable Federal Law "On Privatization", strategic enterprises and the shares of strategic joint stock companies may not be included into the forecast plan (program) of privatization of federally owned property unless they are excluded from the list of strategic enterprises and joint stock companies.

Rosselkhozbank)[1] leading in relevant industries were defined for 2011–2015. The shares of the foregoing companies are planned to privatize subject to relevant decisions of the President and the Government of Russia, i.e. on a case-by-case basis. It was established that state participation would be reduced both through sale of a part of state-held shares and second offering to generate investments for the benefit of companies.

Fourth, in addition to defining plans and preparations for sale of the shares of largest public sector companies and banks, it should be noted that the process of preparation and implementation of privatization of smaller public sector companies and enterprises was accelerated. For example, the Forecast Plan of Privatization of Federally Owned Property for 2010 was largely extended by enlisting about 500 enterprises, of which FSUEs totaled more than 200[2]. A special emphasis should be placed on that a series of large JSCs operating in the transport industry and transport infrastructure (sea and river shipping line companies and ports, airports), were added to the list.

It should be noted that high dynamics of actions within the framework of state privatization policy remained unchanged in 2011 (see the previous section herein). Both new political statements (about enhancing the privatization process) and applied innovations in the field of e-trading, development of FSUE strategies, withdrawal of top state officials from boards of directors, creating a greater variety of methods of transformation of unitary enterprises.

Hence drafting and implementation of the "new" privatization policy in 2009–2010 were definitely considered among the top priority objectives of the state. However, in spite of positive developments, this process is quite complex and requires constant maneuvering and temporal trade-offs. In our opinion, drafting and implementation of the state privatization policy are characterized by a special role of political decisions, a particular system of 'presumptions' with regard to this field, due to objectively limited possibilities of assessing a socio-economic effect, high diversity of the public sector and specifics of various state-owned assets. In the meantime, it goes without saying that political decisions can't define all the complementary measures to be taken by the state, thus increasing the role of various stakeholder groups with a positive agenda in defining specific measures on the implementation of political decisions, whereas rivalry between these stakeholder groups defines 'driftage' of the privatization policy.

6.2.2. Stakeholder groups and principal risks

In our opinion, the development of "new privatization" ideology can be distinguished, with certain reservations, by three different but not mutually exclusive approaches which are somehow linked to different stakeholder groups in constructing the relevant public policy.

First – 'budget' – approach implies that privatization should firstly serve as a tool for generating more budget revenues and eventually ensuring current and mid-run macroeconomic stability. In doing so, however, revenues from renewable sources, including privatization, are

[1] Refer to, above all, the Forecast Plan (Program) of Privatization of Federally Owned Property and the Guidelines of Privatization of Federally Owned Property for the period of 2011–2013, as well as the information published by the Ministry of Economic Development and Trade of Russia on planned sale of the shares of large companies leading in relevant industries of the Russian economy, in 2011–2015 (http://www.economy.gov.ru/minec/activity/sections/investmentpolicy/doc20101123_08). This list was extended in July 2011.

[2] No unitary enterprises were originally listed in the Forecast Plan (Program) of Privatization of Federally Owned Property for 2010.

supposed to be made much less available to finance current budget expenditures. Shrinking of the public sector as a result of privatization is also considered a way to reduce the number of 'recipients' of state support.

Second – 'structural' – approach means that privatization should basically be used as a tool to improve competitive power of companies subject to privatization as well as the structure of selected industries and activities. Decisions on privatization of companies should be governed by expediency-based practice of engaging strategic private investors, investment inflow (including a secondary issue of shares to reduce a state capital participation), higher level of corporate governance, promotion of competitive and business environments, etc., rather than fiscal interests.

Third – 'sectoral' – approach is focused on ensuring social stability and control over the situation, triggering processes of modernization of specific industries through direct state participation. This may result in the need to maintain (increase, as appropriate) direct state influence on the development of industries and sectors 'sensitive' for the general public and the development of the economy at large. This approach is based on large and extra large state-owned companies. The principal tools are implementation of large investment projects and programs (innovative ones, whenever appropriate), establishment of state controlled (state-owned companies) integrated structures, etc.

Each of the approaches has both advantages and is exposed to certain issues and risks. This is why forecasts of expected revenues from privatization may differ largely in the level of declarativity of selected revenue base as well as the status of a regulatory document, and quite often are conventionally estimative (see *Table 12*).

Table 12

Forecast of revenues from privatization in the period between 2011 and 2014: assessment, Rb billion

	2011	2012	2013	2014
The Forecast Plan (Program) of Privatization of Federally Owned Property for the period of 2011–2013 (approved by Russian Government Order dd. November 27, 2010)*	6	5	5	-
Federal Law "On the Federal Budget for 2011 and Planning Period of 2012 and 2013" No. 357-FZ, dd. December 13, 2010, (as revised on June 1, 2011, No. 105-FZ)	-	-	-	-
Basic principles of the budget strategy for 2011 and planning period of 2012 and 2013; for 2012 and planning period of 2013 and 2014.	298	276,1	309,4	300,0
Budget quarterly breakdown for 2011, item "revenues from sale of shares and other forms of capital participation, federally owned property" (www.roskazna.ru)	297,954	-	-	-
The Office of the President of Russia (11.07.2011, Moscow News): at least	450	450	450	450
Government of Russia (17.06.2011, http://www.rg.ru/2011/06/17/privatizacia-site.html): about	500	-	-	-
the Ministry of Economic Development and Trade of Russia (25.07.2011, Vedomosti)	1000	1000	1000	1000

* It was assumed that "The forecast of revenues from sale of federally owned property can be updated if the Government of Russia makes relevant decisions on privatization of the shares of the largest companies which are highly attractive for investment, in which case revenues from sale of federally owned property in 2011–2013 may total (with consideration for a market situation) about Rb 1 trillion". The forecast remained the same in spite of five amendments made in the period between December 2010 and July 2011.

Realistic assessment of available sources of financing of ambitious privatization plans is a special and extremely complicated problem as part of the 'budget' approach. Putting aside any options relating to active behavior of largest companies and banks with state participation (as buyers who have indirect, preferred access to state financial resources), the first thing that

comes to mind is international financial markets, where, however, competition between national governments wishing to implement certain privatization projects resumed its intensity in the period between 2010 and 2011.

Furthermore, according to a severe assessment of A. Vedev, "when we talk about prospects of privatization of, say, state-owned corporations, state-owned banks, state-owned property assets, we must understand clearly that we have no internal resources for privatization". Referring to analysis of the structure of institutional cash flows of the Russian economy as of January 1, 2011, enterprises have been net borrowers over the last decade (net debt due by accounted for 15% of gross assets of the banking system, or accounted for about 10% of GDP)[1].

From this it is inferred that "the new privatization policy" can be implemented with success depending on a set of decisions relating to the system-wide development of the institutional and investment environments, and the financial system of Russia. First of all, it means constraints on foreign legal entities with regard to strategic industries, title guarantees and law enforcement in general, promotion of internal long-term sources of investment, also through modernization of the funded pension system, collective investment institutions and stock market technologies.

However, the 'budget' approach neither is focused on fundraising to develop privatized companies, nor requires any mandatory transfer of control over privatized companies from the state to private owners. These are advantages of the 'structural' approach which, however, is exposed to the risk of subsequent state intervention in the activity of privatized companies, ensures no efficient use of companies' borrowings and is not focused on the development of most "notable" business entities. Though the 'sectoral' approach can be used for aggressive, relatively rapid reconstruction of selected sectors in creating "national champions", it may result in unregulated overgrowth of the public sector, deterioration of the competitive environment and restriction of private initiatives (see *Table 13*).

Table 13

Principal advantages and risks relating to different approaches towards drafting of state policy as part of "new privatization"

Approach	Advantages	Problems and risks
"Budget" approach	Lower (or full absence of) barriers for buyers; reasonable presales preparation; focus on privatization of largest companies; general reduction of the number of SUEs and OJSCs with state participation	Value of privatized shares is not important; possible state control in large companies; focus on sales of "no-problem", liquid assets; focus on a relatively short-term perspective
"Structural" approach	Increasing investment trend in using revenues from privatization; Focus on attracting strategic investors; actual reduction of a public sector share in the economy	Ill-defined mutual obligations in the long-term outlook; Issues relating to the selection of efficient strategic investors; focus on the development of basically large and extra large companies; problems of inefficient usage of extra budgetary borrowings by companies
"Sectoral" approach	Development and advanced modernization of largest public sector companies; higher level of attractiveness of large state-owned companies for potential investors; provision of social stability	Poor incentives to develop sectoral regulation; retained (increased) direct state participation in the economy; risk of uncontrolled "overgrowth" of companies with state participation and deterioration of competitive environment; risks of "nontransparent exchange", "administrative bargaining"

[1] The records of the meeting of the Expert Group on Management of State-Owned Property and Privatization held on July 6, 2011, http://2020strategy.ru/g15/news/32746132.html

Competition for influence between the selected "stakeholder groups" leads to some investigations.

First effect – a certain frequency of increase (or decrease) in influence of "stakeholder groups" on decisions made in the world of privatization. Seniority of a specific approach depends largely on a situation (expectations) relating to budget balance, serious problems encountered in some of the "socio-sensitive" markets. For example, it was in the period (May thru June) of discussion of the draft budget parameters when a trend towards increase in the role of privatization in generating extra budget revenues became well-marked, when deficiencies in regulation of certain markets came into surface, the rationale increased for the need to maintain direct state participation in certain large companies as "compensation" for market failures.

Second effect – half-way nature of decisions made, incompleteness and inconsistency of implemented measures. Following are some of the recently (2010 – 2011) available examples:

- positive decision on widening the representation of independent directors in companies with state participation is not supported by measures aimed at increasing the role and liability of boards of directors, changing the procedure for appointment of senior managers therein;
- generation investments for corporate development in the course of privatization (denationalization, to be more precise) is possible for only a small number extra large companies on the basis of individual decisions, whereas no relevant tools and mechanisms (methods of privatization) are available for other companies;
- refusal to use state-owned corporations as a type of business entity is accompanied by setting a task on working out a new form of "public entity"[1];
- given a general focus on reduction of the use of the institute of unitary enterprises, no efforts are made to determine tools of transparent financing of solution of public objectives (functions) through companies, including the private sector.

Third effect – predominantly concealing nature of lobbing interests as part of privatization, more opportunities for making individual decision amid ill-defined legal framework, poor official rationale for decisions made. In our opinion, a certain "lack of focus" regarding the conditions of privatization, in particular of large companies, is, to a certain extent, reasonable costs conditioned by an effort to change in reasonable time the situation amid high administrative barriers as coordination of well-defined regulations and rules of privatization between 'stakeholder groups'. The same, however, boosts "competition" between different approaches towards privatization and leads to lesser predictability of its conditions at the level of every large company with state participation.

With respect to prospects of privatization, provision of the effective socio-economic development given the significance of a series of political decisions (provision of structural effect, restriction on direct representation of sector-specific ministries in the governance of companies, defining the possibility for the state to give up its controlling interest in a series of largest companies), the following *significant risks* are worth noting.

First risk – expansion of the public (quasi-public) sector amid privatization processes. In our opinion, the scales of denationalization, on the one hand, and consolidation of assets

[1] See the schedule of measures of transformation and liquidation of state-owned corporations and Avtodor state-owned company, approved by the Chairman of the Government of Russia on December 29, 2010, No. 6793p-P13.

within specific large companies (banks) with state participation, their "growth" in competitive activities, on the other hand, can be found to be comparable. This risk seems to be more important in the near term.

Second risk is more important in the mid- and long-term prospects: *lack of efforts for the development of sector-specific regulation of privatization of large companies will subsequently increase an informal effect on them from the state*. This can be explained by that given poor regulation in certain sectors, which previously was "offset" by direct state participation in the governance of certain large companies, if the state withdraws from such governance, it would need other tools for resolving publicly relevant objectives. The major problem here is represented by even more deteriorated transparency of public interests with regard to such companies, preconditions for replacement of public interests with parochial (both departmental and administrative) interests vs. the option of direct state participation in the capital. In addition, a positive structural effect of privatization may be limited significantly by the retarding nature of "external" measures aimed at improving the investment environment.

Third risk – ill-defined conditions and criteria of privatization of large companies with attracting investments for the development thereof; discrepancies which may arise between the state and the owners of such companies in perception of mutual obligations. This makes the parties put more pressure on each other, and provides politicians with more chances to appeal to a segment of the society which is traditionally focused on "injustice" and "cheapness" of privatization.

Fourth risk – the quality of state-owned property management tools available for the state (it means unitary enterprises and shareholding) *seems to have reached its objective ceiling*. The risk of conservation of the prevailing model of governance remains very high, which may result in palliative measures and reduce the effectiveness of any measures aimed at further denationalization.

6.2.3. "New dimension" of denationalization

The policy of state-owned property management and privatization must move to a "new dimension" in the near future. The *following important approaches* should be considered.

'Gradual' approach. The remaining scope and "quality" of most of public sector assets prevent from implementing an analogue of accelerated "large-scale" privatization. Denationalization should be based on the principle of "controlled steadiness" of privatization, which requires a whole package of preparatory measures and stepwise approach. Unnecessary radicalization of the approaches makes equal the expected advantages and losses.

'Multisector' approach. A big variety of public sector assets implies availability of differentiated models (planning) of privatization and governance.

'Strategic nucleus model'. There are no visible arguments against (temporal) retaining a series of largest companies in state ownership, but there are reasonable arguments in favor of gradual decrease in control thresholds, creating equal competitive conditions, transparency and modification (of quality) of corporate governance.

'Structural' approach. Economic effect of privatization (efficient owner) is unlikely to be achieved without having to implement modernization of the sector; the sector can't be modernized amid state domination/without widening the private sector; there is no point to widen the private sector without changing the quality of the institutional environment.

'Pragmatic' approach means identification of strategic nucleus of the economy (strategic, core enterprises), priority of "deep" privatization of large companies, getting rid of anachro-

nistic and palliative types of business entity and illiquid assets, modernization of the existing system of state-owned property management.

In our opinion, *the state long-term policy* of state-owned property management and privatization must be governed by the following general *principles*:

- make sure that privatization is "reasonable"; follow the principle under which all companies, save for a selected group of companies, with state participation, unitary enterprises, state-owned corporations and state-owned companies may be subject to privatization;
- make sure that participation of foreign investors in the capital of privatized companies, including large companies, is reasonable;
- maintain the existing social commitments and/or provide direct reduction of public sector functions;
- create alternatives to direct state participation in the capital of companies in terms of meeting public interests; constantly combine efforts of privatization and widening of institutional and economic preconditions for privatization;
- take any measures which directly or indirectly increase the state "weigh" in the economy, including through the mixed sector, must be exclusive, reasonably sufficient and well coordinated;
- state controlled companies must not operate in the sector with private entrepreneurial initiative, establish terms of competition, on the one hand, build up barriers to prevent new companies from entering markets within "their" scope, on the other hand;
- ensure high priority of structural effect of privatization on economic development;
- the principle of "reasonable aggression", succession and "gradualism", limitation of risks;
- ensure transparency of the processes of state-owned property management and rationale for decisions made; openness to various forms of public control and assessment;
- create an integral system of incentives for all players; inviting the society and business community to participate in a dialogue with the state on the policy of privatization and state-owned property management.

Two stages should be reasonably highlighted from the point of view of general top objectives of the state policy of state-owned property management and privatization: 2012–2015 and 2016–2020. These stages differ in objectives to achieve, the level of expected risks and the need to take a series of preparatory measures.

Ensure high priority of implementation of current plans, making minimum radical decisions, getting rid of illiquid assets, making a "site" ready for the second stage *at Stage 1*. The level of potential risks can be assessed as minimal. In particular the following should be reasonably foreseen as part of this stage:

- implement the target plans on reduction of a share of state participation in largest and large companies;
- impose constraints on companies with state participation (their subsidiaries and related entities) for purchase of privatized assets, receive financing from state-owned banks and state-owned companies, consolidation of assets within state-owned companies;
- increase the number of large companies with mixed ownership (privatization up to a level of 75% +1 share);
- enhance significantly the quality of corporate governance at companies with state participation (enhance the status of independent directors, incentives for managers and their reporting to boards of directors, etc.);

- reduce the number of state-owned entities through liquidation of a wide range of FSUEs which went out of business;
- undertake privatization of illiquid assets (small value minority shares);
- implement a package of measures aimed at widening the potential base for privatization at Stage 2;
- identify principles and special features of privatization at the regional and municipal levels;
- implement a 'small-scale action' strategy (ensure transparency of progress reports on privatization, changes in the public sector's socio-economic role, accounting and registration of all assets owned by unitary enterprises, state-owned corporations, integrated structures with state participation, etc.);
- create a single media space of sale of federal, regional and municipal property assets.

At Stage 2, provision should be made for drastic reduction of direct state participation in the economy, which may be exposed to a higher level of multidimensional risks. The following key measures can be implemented at this stage:

- undertake "deeper" privatization with regard to largest companies (or full privatization or privatization through holding a blocking interest);
- restrict state participation in state-owned institutions for development and special banks;
- restructure assets of large companies, identify and privatize sub-holdings of conglomerate integrated structures;
- reorganize state-owned corporations (a part thereof are to go out of business, another part thereof are to be incorporated into OJSCs and subject to a certain degree of privatization);
- applying the principle of multiplicity of options, transform unitary enterprises operating on the basis of economic management, depending on the nature and scope of the core activity, into OJSC (standard scheme); into state-run enterprises; into non-profit organizations; into public institutions;
- undertake privatization of most mid-sized and large companies with state participation (even a blocking interest, whenever appropriate).

The foregoing stages can be identified with two different (in terms of the degree of radicality) *scenarios of state policy* in the field of privatization and state-owned property management. With some degree of conventionality, the first (inertial) scenario suggests extrapolation of the first stage objectives in the period of 2012–2020. The second (radical) scenario implies full-fledged implementation of the key measures at the first and second stages in the period of 2012–2020.

This suggests development of the existing mechanisms and implementation of a wide range of measures which serve as the basis for six *most significant functional lines of state policy* in the field of state-owned property management and privatization.

1. Limit risks of "overgrowth" of the public sector in the economy, increase its "weight" in certain sectors, widen the range of state-owned entities.

2. Ensure sustainable and orderly reduction of direct state participation in the economy.

3. Achieve structural effect of privatization: "depth" of privatization of large companies; modernization of the sector and replacement of direct control with sector-specific regulation; improving the terms of participation in privatization of foreign investors; engaging efficient owners and developing a competitive environment.

4. Undertake institutional optimization of the public sector: reduce the number of state-owned entities, liquidate and reorganize inefficient enterprises of the public sector.

5. Enhance effectiveness of the "nucleus" of public sector, define its scope, and optimize levels of required direct state participation.

6. Enhance corporate governance in companies with state participation.

Each of above listed lines provides for a wide range of potential innovations and applied measures with the possibility to vary the degree of radicality. Without getting into a detailed analysis, let us provide just a few examples (see *Table 14*).

Table 14

New key points of the state policy of state-owned property management and privatization: potential innovations

Line	Available approach	Suggested approach
Determining the composition of state-owned property assets for privatization	Drafting privatization plans on the basis of proposals of federal executive bodies	"Declarative principle" – drafting privatization plans on the basis of business proposals, potential investors in combination with the "privatize or explain publicly" principle for federal executive bodies
Constraints on privatization	Regulatory restriction system	Replace a part of constraints with legally established encumbrances for owners
Privatization under conditions (under the Federal Law "On Privatization")	Investment tender; sale based on the results of as a result of trust management	A combination of investment tender and trust management
Generating investments to companies in the course of privatization	For extra large companies privatized on the basis of custom-made schemes	Define "investment mechanisms" under the Federal Law "On Privatization" for all large enterprises (e.g., with a net asset value of more that Rb 3m against the minimum monthly wage)
Unitary enterprises	The single possible option of transformation – into OJSC with a 100% state participation	Provide many options of transformation: – в OJSC with a 100% state-held interest, в LLC, into a public institution, non-profit organization
Privatization of unitary enterprises	Two separate procedures: incorporation, sale of shares	Provide a single procedure (incorporation with subsequent privatization of a part of the shares)
Interest in the development of companies with state participation	State interest maximization model (both short- and long-term), costs incurred on the majority model of corporate governance	Undertake transition of the "positive conflict" model (long-term state interests – short-term business interests) with delegation actual rights to boards of directors within the "influence – independence – awareness" reference system
The mechanism of representation of state interests	Directive institution	The institution of recommendations in combination with higher responsibility of the members of boards of directors and delegation of more rights to independent directors
The institution of independent directors	Not representatives of federal executive bodies	Impose restriction on "cross government" between companies with state participation
Appointing top managers in companies with state participation	Political decisions, nontransparent selection, limited role of boards of directors	Open tender, public recommendations of boards of directors to general meetings of shareholders
Assessing parameters of the public sector and privatization	Administrative approach – assessment of the number of state-owned entities, privatized entities (by type of enterprise, by state participation, by industry)	Economic approach – assessment of the socio-economic role of the public sector and effect of privatization on the development (contribution to GDP, GRP, export, market concentration, investment generation, etc.)

It still remains to be seen whether the "new dimension" of the privatization policy is feasible or not. State measures may both increase and mitigate the afore mentioned risks. However, a major lesson learned in the 1990–2000s is still of extreme importance: effect of privatization can be nothing but long-term, while the rate of achieving the effect depends on the quality and rate of implementation of the entire package of lines of socio-political and economic reforms (the "institutional environment" factor).

6.3. Russian Financial Development Institutions: Their Rise and Main Challenges on the Path toward Improvement of Their Performance[1]

It is already for roughly a decade and a half that the RF Government undertook various efforts to build and fine-tune the financial development institutions in the country. This direction of the national economic policy is congruent with the common international practice: there exist a string of tasks and fundamental reasons behind many nations' strive to shape up development institutions and support their operation[2].

In their general form, major drivers for governments to shape up and improve the development institutions' performance are associated with the need to compensate for market failures, lower risks facing private investors, secure substantial positive externalities, assist in overcoming various barriers and cutting down transaction costs, ensure "synchronization" of changes in the economic subjects' behavior. Hence it is not accidental that the most typical development institutions' operational areas include boosting expansion of small- and medium sized businesses, backing import-export operations, infrastructure development, bolstering regional development, support of individual sectors of an economy (agriculture as a model example).

As a marginal note, there is no any strict definition of the phenomenon of development institution. We believe that experts are keen to define it as some kind organization (forms of whose incorporation may vary) which exhibits a combination of at least some of the following signs:

- it was created on the government's initiative and with its participation;
- it centers on compensating for market failures and securing a demonstration effect;
- it is financed through one-time government contribution (in that case, such funding suggests it loss-free operation) or on the basis of regular budget appropriations;
- its operations pursues a long-term prospect, attainment of set for it strategic objectives;
- it operates on the basis of a specific legal base and special regulatory requirements;
- it focuses on employing private-public partnership mechanisms;
- as far as tactical decision making is concerned, it is autonomous from the government.

By various estimates there are a few hundreds of development institutions worldwide, and they fall under different classifications[3] (e.g., basing the nature of services they deliver); however, one singles out, as a rule, the group of financial development institutions, which operate in various forms, including, *inter alia*, development banks, funds and agencies[4].

[1] The present Section was prepared in 2011 using findings of a project "Institutional analysis of problems of functioning of the financial development institutions system for the benefit of the support of innovation activity" completed by the Interdepartmental analytical center at the commission of the Russian Academy of National Economy and Civil Service under the President of Russian Federation.

[2] For more details about the concept and typology of development institutions, objectives, tasks and directions of their operations, see: O.G. Solntsev, M.Yu. Khromov, R.G. Volkov. Development institutions: an analysis and assessment of the international record. Problems of prognostication, 2009, No. 2.

[3] See, for example, a presentation by I.G. Sokolov, Research Fellow of the Gaidar Institute "Development Institutions and the budget: results and prospects" (July 2011 r.).

[4] For a more detailed classification and examples of public development institutions overseas, see presentation by Gref G.O., the RF Minister of Economic Development and Trade: "On creation of a public financial development institution (On the bill "On the Development Bank")" (December 2006).

While citing the need for a government's interference to compensate for market failures with regard to innovation development in particular[1], experts, at the same time, point at certain risks associated with such interference. As to the risks associated with the public development institutions, it is appropriate to single out the following ones:

– reallocation of support in favor of inefficient companies;
– "seizure" by the state of projects its supports;
– generation of sizeable biases into the market environment;
– substitution for private expenses.

In general it is believed that to lower such risks, nations need to employ more sophisticated systems of corporate governance and institutional organization.

6.3.1. Main Stages of the Rise of the Russian System of Financial Development Institutions

From our perspective, it is possible to provisionally identify *five main stages* in the process of the rise and advancement of development institutions in Russia since the late 1990s. (see *Table 15*). Our phasing to a significant degree is determined by changes in the state's resource capacity and a certain evolution, at the government level, of prevailing notions of the urgency and significance of support to innovation development "against the backdrop" of other directions of public policy.

Overall, until 2007 the mode of Russian development institutions' development had been an evolutionary one: the evolution suggested a gradual (and not that costly for the budget) fine-tuning of individual vehicles of support to investment and innovation projects, which were implemented largely in the frame of assistance to the small- and medium-sized entrepreneurship (hereinafter - SME). At the time, implementation of a policy implying the economy diversification and innovation policy went on the back burner as far as the government (as well as allocation of budget resources) was concerned and was reduced to individual experiments and random initiatives.

The switch to an intense shaping up of financial development institutions and fuelling a substantial expansion of their resource base occurred in 2007. Behind that was a political decision[2] to use a fraction of resources under management of the National Welfare Fund (some Rb 300bn) to capitalize several development institutions. In all likelihood there were numerous and heterogenic reasons behind the decision, but we assume a fundamental one was a strive for a certain compromise in the conditions where for one part the government was under a mounting pressure of advocates of a significant increase of public investment in the economy (enemies to a further accumulation of public financial reserves), while on the other hand, the government bent an ear to staunch champions of macroeconomic stability who had managed to organize a systemic resistance to an increase in the level of public spending. Investing a fraction of accumulated public financial resources in development institutions would "link" them to their future investment use, without giving a strong boost to public spending.

Meanwhile, the Russian leadership's view on the main role of the national financial institutions system underwent several changes over the past five years. Back in 2007, extension of the development institutions' mandate was linked primarily to the task of the economy diver-

[1] Igniting innovation: rethinking the role of government in emerging Europe and Central Asia / Itzhak Goldberg [et al.]. The World Bank, 2011.
[2] The Address by the RF President to the Federal Assembly of RF of 26 April 2007.

sification, advancement of its individual sectors, lifting infrastructure barriers. By contrast, in 2009-2010 the emphasis was already made on "fine-tuning" of the development institutions system[1] for the sake of implementation of the innovation policy, technological modernization, attraction of additional investments, with account, *inter alia*, of an insufficiently favorable investment climate.

Table 15

Main Stages of Emergence of the Development Institutions System

Period	External conditions	Key developments	Peculiarities
1999–2000	Tight budget constraints, encouragement of innovations is on the periphery of public policy	The Russian Development Bank * and the Venture Innovation Bank are created**	Emphasis on creation of relatively small self-financing institutions
2004–2006	Budgets constraints softened, a steady economic growth, greater attention to its "quality"	The Russian Development Bank launched the program of support of SME through regional partners; the Fund for Assistance to Development of Small Forms of Enterprises in the Research and Technical Sphere launched the "Start" program; the rise of regional venture funds; establishment of the Russian Venture Company (RVC); decision made to establish the Russian Investment Fund for ICT	Emphasis on the regional support of SME
2007–2008	A huge volume of budget revenues, encouragement of innovation as one of major public policy avenues, an attempt to link substantial resources to individual directions of development	Establishment of public corporations: the Bank of Development and Foreign Economic Acitivity (Vnesheconombank), the Russian Corporation for Nanotechnologies (Rosnanotech) ***	Launch of the biggest institutions
Late 2008 – 2009	The economic crisis, slashing of resources spent on encouragement of innovation along with a greater attention to the effectiveness of measures implemented	Most of resources temporarily withdrawn from Rosnanotech; the Fund for Assistance to Development of Small Forms of Enterprises in the Research and Technical Sphere launches the "Anticrisis" program instead of a string of earlier implemented ones; the Seed Investment Fund is established under RVC	A vigorous use of the institutions and/or their resources to implement the anticrisis policy; the beginning of the process of establishment of the "second-tier" institutions
since 2010	Improvement of the economic situation, attempts to learn lessons from the crisis, innovations form one of top priorities declared by the state	RVC and ROSNANO founded a range of new institutions, including those centering on infrastructure, and funds overseas; establishment of the Foundation for Development of the New Technologies Development and Commercialization Centre ("Skolkovo Foundation"); on the government's initiative Vnesheconombank founds the Russian Fund for Direct Investment (RFDI) and the Russian Agency for Export Credit and Investment Insurance (EXIAR); the Russian Development Bank begins implementing a program on support of modernization and innovation	A vigorous process of establishment of new institutions; expansion of international operations; a greater attention paid to improvement of the investment climate

* Currently JSC Russian Bank for Small and Medium Enterprises Support (JSC SME Bank).
** The first public development institution created by the "fund of funds" model in 2000 to support the venture industry. However, it began operating only in 2000 and at a fairly moderate scale, because of a relatively humble capital of Rb 100mn of which, as suggested by data available, only a half was financed, and due to a very strict cap (10%) on participation in venture funds' capital .
*** In March 2011was transformed into joint-stock company – JSC ROSNANO.

The record of the emergence of the Russian development institutions system to date (see *Fig. 1*) allows the following conclusions:

[1] See in particular: Minutes of the meeting of the Commission under the RF President on modernization and technological development of Russia's economy of 25 November 2009.

1) the period between late 1990s and 2008 saw a gradual shift toward shaping up institutions focused on support of projects at their later stages. In this respect a milestone development became the rise of the public corporations Vnsehseconombank and Rosnanotech. But since 2009 some of the then existing development institutions (RVC and ROSNANO) have expanded their operations to encompass earlier stages too. Plus, the newly created institutions ("Skolkovo" Foundation in particular) have become to a significant extent focused on support of projects at their early stages too;

2) there exists a steady trend to expansion of both the institutions and Funds' resources and the size of projects they support: while between late 1990s and early 2000s it was largely "low-cost" instruments (the Fund for Assistance to Development of Small Forms of Enterprises in the Research and Technical Sphere, the Venture Innovation Fund, the Russian Development Bank), a number of institutions (Vnesheconombank, Rosnanotech, RFSI), which were created later, boast a far greater resource capacity and use it to support fairly huge projects (worth a total of some Rb 1bn each);

3) the actual launch of the institutions in question suffered from substantial delays accounting from one to several years. That said, while in the case of RVC and ROSNANO the delay was basically a technical one (dictated by the need to shape up management bodies, craft their mandates, adopt of corporate regulations and statutes, organize of tenders, etc.), in the case of the Venture Investment Fund and the Russian Investment Fund for ICT[1] delays were caused by substantial deficiencies built in the respective rules and standards;

4) in a number of cases, while creating new institutions, the performance record (including the negative one) of earlier created instruments was taken into account: thus, created by the same model as the Venture Investment Fund (that is, a public "fund of funds"), RVC does not exhibit the latter's fundamental normative defects;

5) Roughly since late 2009 there started a large-scale process of "secondary" creation of development institutions. In the frame of the process, the existing structures found new ones, with the government initiating the process just in a handful of instances (RFSI, EXIAR). Meanwhile, in other cases those were the development institutions' initiatives, with RVC and ROSNANO being particular active in this regard;

6) The period between 2010 and 2011 saw the rise of the trend to a rapid expansion of the national development institutions' operations: not only has their circle been growing, but directions of their functional profiles and instruments employed expanded, and the volume of their resources and the number of innovation projects they support was on the rise.

The financial institutions established by today appear fairly versatile (see *Table 16*): they focus on support of both small-and medium-sized firms and large corporations' innovation activity; they orient to different phases of a company's development (from the seed and initial ones to maturity), and their mechanisms of support are associated with awarding grants, investment, disbursement of loans and guarantees. Let us note that different models of encouragement of innovation are realized under individual functional directions: thus, in addition to grant-based mechanism (the Fund of Assistance to Innovation), seed projects are supported through a seed investment vehicle (The Seed Investment Fund under RVC); support to venture investments is carried out via both the "fund-of-funds" model (RVC and, to a lesser ex-

[1] The institution was established back in 2007, but has not yet started investment activity due to a legislatively set strict requirement to reduce the government's participation in its capital to 51%.

tent, ROSNANO) and on the basis of a mechanism of a program-based support of creation of regional venture funds.

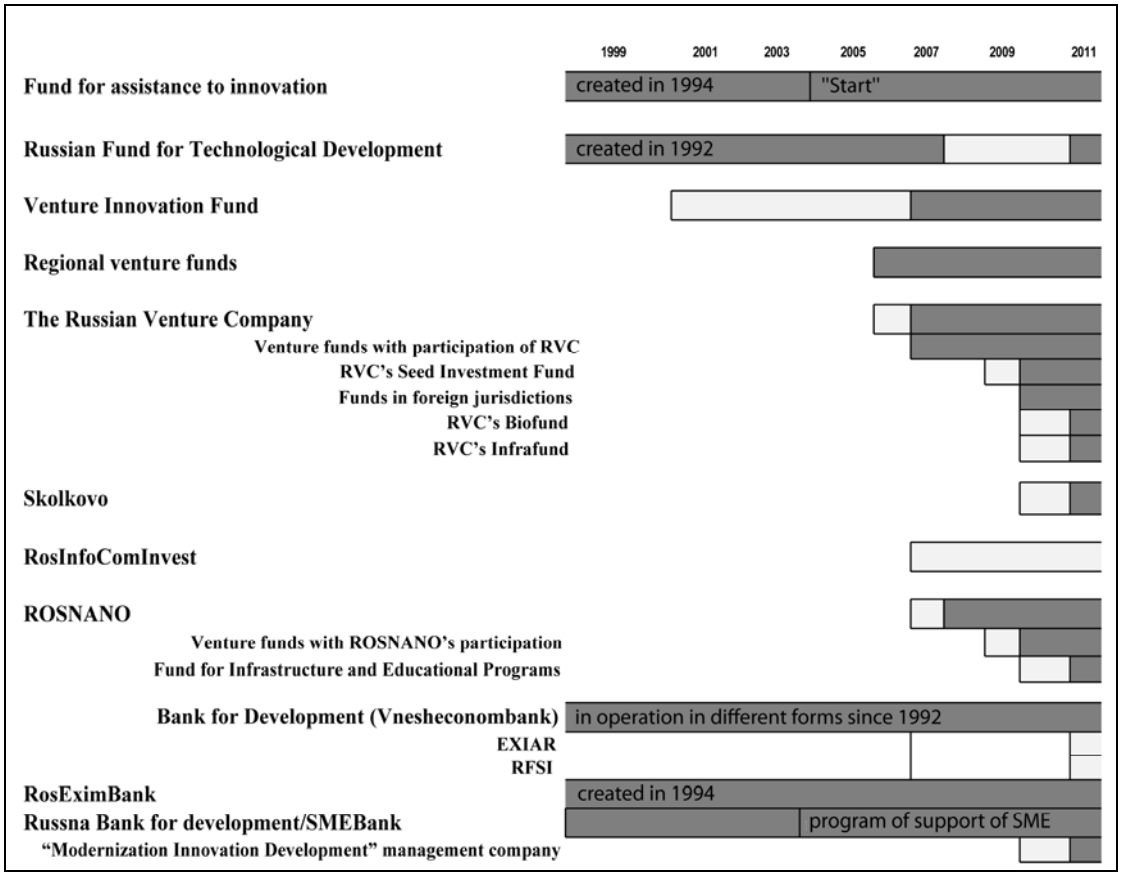


Fig. 1. Process of Creation of Russian Development Institutions

In general, the system of Russian financial development institutions has undergone a dramatic transformation and become far more exuberant vis-à-vis its nascent state in the early 2000s: it indeed became richer in the proper sense of the word, that is, in terms of aggregate volumes of resources under management, and in a figurative sense – in terms of variety of types of the institutions in question. Furthermore, over the past two years the government has been far more active in extending the development institutions system and, particularly, in implementing its earlier designed blueprints.

Table 16

Characteristics of Main Existing Financial Development Institutions

Development institution	Year of incorporation	Legal form	Participants	Modus operandi	Forms of support	Stages supported	Resources
1	2	3	4	5	6	7	8
Fund for assistance to development of small forms of entrepreneurship in the scientific-technical sphere (The Fund for assistance to innovation)	1994	Federal public budget institution	Russian Federation	Funding small innovation firms' R&D at the expense of public funds	Grants	Pre-seed, seed	Budget allocations in 2010 – Rb 3.4bn, 2011. – 4bn, 2012 – 4bn

cont'd

1	2	3	4	5	6	7	8
Russian Venture Company (RVC)	2006	Open-end joint-stock company	Russian Federation	The state fund of funds for seed, venture and direct investment	Investment	Seed Venture Later stages	As of late 2010, net assets worth a total of Rb 34.5bn
The seed Investment Fund under RVC	2009	LLC	RVC – 99%; Fund for assistance to innovation – 1%.	Investment fund for early stages	Investment	Seed	Authorized capital of Rb 2bn
Regional venture funds	2006–2009	Closed-end mutual investment funds for particularly risky (venture) investment	Regional funds for assistance to investment to small-sized enterprises in the research and technical sphere (funded in equal proportion out of the federal and regional budgets) – 50%; outsider investors– 50%	«Classical» venture funds	Investment	Venture	As of early 2012, the aggregate volume was Rb 9.2bn
Foundation for Development of the New Technologies Development and Commercialization Centre ("Skolkovo Foundation"	2010	Non-for-profit organization	Russian Academy of Sciences, Vneshekonombank, Fund for assistance to innovations, Bauman Technical University, ROSNANO, RVC	Funding of innovation projects of companies t participating in the innovation center	Grants	Pre-seed Seed Venture	Budget allocations in 2010 – Rb 10.3bn, 2011. – 15.5bn, 2012 – 27.1bn
The Russian Investment Fund for information and communication technologies (Rosinfocominvest)	2007	Open-end joint-stock company	Russian Federation	Sectoral direct investment fund	Investment	As a rule, late	Authorized capital – Rb 1.45 bn
Russian Fund for Technological Development (RFTD)	1992	Federal state autonomous institution	Russian Federation	Support of R&D on the reverse basis	Loans	As a rule, late	n/a

cont'd

1	2	3	4	5	6	7	8
ROSNANO	2007	Open-end joint-stock company	Russian Federation	Financing of innovation companies, venture and investment funds	Investment	Creation and development of production	Net assets as of June 2011- Rb 61.3bn; long-term borrowings (under state guarantees) – Rb 43bn; Russian Federation's contribution to the authorized capital in 2011 – Rb 47.2bn
Bank for Development and Foreign Economic Activity (Vnesheconombank)	2007*	Public corporation	Russian Federation	State development bank, including exercise of support of investment projects	Loans, investment, guarantees	As a rule, late	As of late 2010, assets were worth a total of Rb 1,782.8bn
The state specialized Russian export-import bank (Roseximbank)	1994	Closed-end joint-stock company	Vneshe-conombank	Specialized bank for support of export	Loans, guarantees	As a rule, late	Assets as of October 2011 – Rb 9.1bn
Russian Bank for Small and Medium Enterprises Support (SME Bank)	1999	Open-end joint-stock company	Vneshe-conombank	Support to SME through target financing of regional partners represented by banks and infrastructure organizations	Loans (incl. microfinancing), leasing, investment	As a rule, late	Operational assets as of early 2012 - Rb 103.9 bn
Russian Fund for Direct Investment (RFDI)	2011	Open-end joint-stock company	Vnesheconombank	Large investment in leading domestic corporations in a proportion equal to foreign institutional investors'	Investment	As a rule, late	Russian Federation's target contribution to Vneshe-conom-bank's in 2011 – Rb 62.6bn.**
Russian Agency for Export Credit and Investment Insurance (EXIAR)	2011	Open-end joint-stock company	Vnesheco-nombank	Insuring Russian exporters and investors' business and ;political risks	Insurance	–	Authorized capital – Rb 30bn

* The year of creation of a public corporation by reorganization of the Bank for Foreign Economic Activity of the USSR, which had been operating in various forms since 1922.
** It is planned that within next 5 years the Government will form the Fund's capital in a volume of USD 10bn.
Sources: the development institutions' official web-pages, official reporting, federal acts on the federal budget.

6.3.2. The Development Institutions' Operational Objectives and Priorities, and Conditions of Projects Support

Whilst considering the totality of objectives developed for public financial development institutions (*Table 17*), it is worthwhile to note that most of them cite assistance to the public policy implementation in the respective area as a principal operational profile, while tasks and targets that complement it are likewise formulated very broadly. Notably, mission of some financial development institution stretches beyond the framework of delivery of solely financial services and outlines a broader sphere of their operations. This, the Fund for Assistant to Innovation is to help attract extrabudgetary investment in the area of small-sized innovation-based entrepreneurship, while RVC is tasked to deliver technological and consulting assistance to the innovation market agents and bolster the infrastructure supporting innovation clusters, as well as professionalism of participants in the innovation ecosystem and encouragement of demand for innovation corporations' produce.

Objectives of the two largest development institutions, Vnesheconombank and ROSNANO, are somewhat nonpareil ones and worth a particular notice. In case of Vnesheconombank, in addition to general objectives, targets and tasks for each of its major operational directions were set (including support of investment projects) in a very concrete form and with measures on their improvement. Meanwhile, ROSNANO's peculiarity lies in a fairly specific (at least, vis-à-vis other institutions) and very ambitious objective, namely, the being first strategy, as far as the global markets for nanotechnological projects are concerned.

Table 17

Operational Objectives, Tasks and Priorities of Development Instutions

Development institution	**Objectives**	**Sectoral and/or subject-wise priorities**
1	2	3
Fund for assistance to innovation	Mission: assistance to implementation of the state scientific-technical policy and bottom-up research projects, efficient employment of the scientific-technical capacity and engagement of scientific and technical achievements in the production sphere to bolster development of small forms of enterprises in the scientific-technical sphere, whose operations imply practical introduction (development) of intellectual deliverables, - small-sized innovation entrepreneurship agents, the innovation infrastructure, generation of job opportunities for an efficient building on the existing national scientific and technical potential . Tasks: – Implementation of the public policy on development and support of small-sized enterprises in the scientific-technical sphere; – Delivery of a direct financial, information and other support to small-sized innovation enterprises which implement projects on development of new kinds of science-intensive products and technologies on the basis of belonging to them intellectual property; – Creation and bolstering of the infrastructure of support of small-sized innovation-based entrepreneurship; – Assistance to generation of new job opportunities for an efficient building on the existing national scientific and technical potential; – Attraction of extrabudgetary investment in the sphere of small sized innovation-based entrepreneurship; – Cadres training (including engagement of the youth in innovation activities)	In the frame of the «Start» program: • 5 thematic directions: – IT; – Medicine of the future; – Modern materials and technologies of their development; – New devices and apps; – biotechnology; • 80 sub-directions. In the frame of the «Development» program: – Sub-program in the energy-saving sphere («Energo»); – Sub-program in the sphere of diagnostics, prevention and treatment of the most socially significant diseases («Frama»); – Sub-program in the IT sphere («Soft»)

cont'd

1	2	3
Russian Venture Company	Mission: ensuring an accelerated unfolding of an efficient and competitive on a global scale national innovation system by creating a self-developing venture industry in interaction with other development institutions with the help of engagement of private venture capital, bolstering innovation-based entrepreneurship and technological business expertise and mobilizing human capital in Russia. Purpose: assistance to implementation of the public policy in the sphere of development of Russian innovation industry and the innovation market's infrastructure, shaping up a system of Russia's own venture investment industry, creation of infrastructure for the innovation-venture ecosystem and encouragement of its expansion, giving a fillip to demand for innovation companies, and generation of profits from business operations. Strategic objectives for the period through2020.: ensuring an unfolding of an independently developing venture industry and innovation-technical entrepreneurship. Tasks: – Integration into global technological chains and support of export of innovation products; – Attraction of international investment resources in a "cash-and-expertise" form to fund Russian innovation industry; – Improvement of innovation Russian companies' investment attractiveness; assistance to increase in the number and enhancement of the quality of technological investors at all stages of the venture investing process; – Communication for the Russian market for innovation, technical and consulting assistance to innovation market agents particularly by organizing workshops, conferences, symposia and roundtables; – Bolstering the back-end infrastructure of innovation clusters, companies at early stages of venture financing and corporations rendering universal services to innovation firms; – Bolstering professionalism of the innovation ecosystem agents, encouragement of demand for innovation corporations' products; promotion of innovation-entrepreneurial, scientific-technical and invention, venture investment activities, in particular, by assisting to creation and advancement of professional contests and awards. Main tasks for the period through 2020: engagement of private venture capital in development of venture entrepreneurship and assistance in creation of the institutional and sectoral venture infrastructure	Venture funds with participation of RVC: • Current priority directions of development of science, technologies and technics of the Russian Federation: – Security and countering terrorism; – The nanosystem industry; – ICT systems; – Life sciences; – Promising kinds of arms, military and special equipment – Rational natural management; – Transportation and space systems; – Energy efficiency, energy saving, nuclear energy; • List of critical technologies of Russian Federation (27 titles therein). The RVC's biofund: biotechnological, pharmaceutical and medical industries
The RVC's seed fund	Tasks: – Boosting advancement of the national sector of seed investment under the venture financing industry; – Boosting a venture partner network for seed investment funds for the sake of a maximum engagement of professional managers, experts and business angels in the process of creation of new technological companies; – Generation of conditions for shaping up an continuous flow of transactions into venture funds, including those established with participation of the JSC RVC's funds; – A significant increase in the number and quality of small-sized technological businesses consequently claiming for receipt of venture investors and early-stage funds' investment	Priority directions of development of science, technologies and technics (see above); The list of critical technologies of Russian Federation
Skolkovo Fund	Shaping up a full cycle of innovation process, including education and research, development efforts and commodization of their deliverables	Priority directions of modernization and technological advancement of Russia's economy ("President's Priorities"): – Energy efficiency and energy saving; – Nuclear technologies; – Space technologies, telecommunications and navigation systems; – Medical technologies; – Strategic computer technologies and software

cont'd

1	2	3
Rosinfo-cominvest	Purposes: – Facilitation of access to financial resources for the most promising Hi-Tech and rapidly expanding companies of small and medium-sized capitalization in the ICT sphere; – Boosting attractiveness of ICT organizations in the eyes of potential investors through the Fund's participation in their authorized capital and management; – Attraction of domestic and foreign investment to secure production and technological cooperation between domestic and foreign enterprises of the ICT sector, development of mutually complementary and supplier/consumer production; – Assistance to bolstering Russian ICT companies' investment activity with respect to attraction of foreign investment in Hi-Tech sectors of Russia's economy. – Exclusive operational profile: investing assets in objects referenced to in the investment declaration (certain kinds and categories of securities, cash on bank accounts and deposits)	ICT
RFTD	Purpose: assistance to implementation of the public policy in the sphere of scientific, research and technical and innovation activity. Object of activity: securing provision of financial support to Russian organizations implementing scientific, scientific-technical and innovation projects, including those in the frame of international research and technical cooperation.	Technological platforms, including, primarily: – medicine of the future; – bioindustry and bioresources; – bioenergy production; – innovation laser, optical and opto-electronic technologies – photonics; – environmentally friendly high-efficiency thermal power; – cutting-edge renewable energy technologies; – small-sized distributed energy production; – metallurgy materials and technologies; – technological platform for solid minerals; – carbohydrates production and use; – intense processing of carbohydrate resources; – ocean development; – green growth technologies. Priority directions of research, technologies and technics (see above)
ROSNANO	Mission: assistance to implementation of the public policy aiming at having Russia joined the group of leading nations in the nanotechnology area. Purposes: – assistance to implementation of the public policy in the sphere of establishment and development of the nanoindustry and the respective innovation infrastructure; – financing investment nanotechnology production projects; – building technological chains securing the rise of new production units in the nanoindustry area in the territory of Russian Federation; – Generation of profit in the course of implementation of the above purposes. Main objective: Russia winning leading positions on global markets for nanotechnological products. Main purposes: securing commodization of the nanoindustry's R&D and coordination of innovation activities in the sohere of nanoindustry. Main vehicle: investment projects	Nanotechnologies

cont'd

1	2	3
Vnesheconombank	Mission: the national development bank, assisting to implementation of the public socio-economic policy, bolstering the national economy's competitiveness and its innovation-based modernization. Purpose: securing an increase in competitiveness of the Russian Federation's economy, its diversification, encouragement of investment activity by exercising investment, foreign economic, insurance, consulting and other provided for by law activities with regard to implementation of projects both in Russian Federation and overseas, including those with participation of foreign capital, aiming at bolstering infrastructure, innovation, special economic zones, environment protection, support of export of Russian products, works and services, and support of small-and medium-sized entrepreneurship. Strategic objective for the period through 2015: boosting the activity on securing a sustained innovation socio-economic development of Russian Federation on the basis of the national economy's modernization and increasing competitiveness. Implementation of this objective requires a considerable increase in the volume of financing of investment projects, expansion of support of export of Hi-Tech products and implementation of support programs for SME, as well as introduction of best practices with regard to project development and management. The Bank's contribution to solving the government's task of the national economy modernization requires an increase in its credit portfolio of the share of loans associated with the funding of investment projects. Strategic objective in the area of contribution to implementation of investment projects: boosting the volume of financing of investment projects across major avenues and sectoral priorities. To implement this objective the Bank will need to tackle the following tasks: – To ensure a greater efficiency of investment projects to implementation of which the Bank contributes, including improvement of internal documents with respect to project evaluation and selection; – To improve the system of control over implementation of investment projects (including, inter alia, with respect to financial monitoring, monitoring of progress in projects implementation and their efficiency); – To render assistance to organizations in preparation of project documentation in accordance with the Bank's requirements; – To create private equity funds and specialized sectoral investment funds to attract the domestic and foreign capital; – To expand the range of instruments of the Bank's contribution to implementation of investment projects by creating development corporations and funds	Sectoral priorities: – aircraft engineering and aerospace complex; – ship-building; – electronics industry; – nuclear sector, including nuclear energy; – transport, special and power machine building; – metallurgy (production of special kinds of steel); – wood-working industry; – defense-industrial complex; – agroindustrial complex; – strategic computing technologies and software; – ICT; – Medical technics and pharmaceutical sector. Priority directions of modernization and technological advancement of Russia's economy (the "Presidential priorities", see above)
Roseximbank	Purpose: implementation of the public policy of supporting and encouraging the national export, creation of import-substituting production and assistance in attraction of investment into Russia's economy. In its capacity of an agent of the RF Government with regard to extension of the state financial support to Russian exports the Bank is responsible for the following tasks: Pursuance of the state policy in the area of guarantee-based support of Russian exports oriented towards solidification of Russian exporters' standing competition-wise on traditional markets of developing and the CIS countries; Rendering assistance to Russian exporters with regard to marketing their industrial products; Granting Russian exporters access to long-term loans, including pre-export lending at minimal market rates. The Bank's operation as the RF Government's agent with regard to state support of exports should help: – Boost the number of national exporters and countries wherein their supply their products; – Promote Russian companies' competitiveness on the global market; – Create import-substituting production units, including innovation ones; – Attraction of investment in Russia's economy; - Generation job opportunities in the country	The manufacturing sector

cont'd

1	2	3
SME Bank	Strategic objective in the area of support of SME: expansion of the financial support of development of SME agents for the sake of diversification of the economy's structure, increase in employment, bolstering self-employment growth in GDP, boosting tax revenues, emergence of the middle class. Tasks in the area of support of SME: – Ensuring equal opportunities to small- and medium-sized businesses to medium- and long term financial resources throughout the territory of Russian Federation, including resource-scarce regions in the first place; – Organization of financial support to production corporations in the first place, as well as those implementing innovation and Hi-Tech projects, thus promoting changes in the sectoral structure of the lending; – Funding development of the support infrastructure for small-and medium-sized businesses (microlenders, business incubators, leasing companies, regional funds of support of MSE, technoparks, multifunctional business centers for MSEs, etc.)	Primarily production sector
RFDI	Mission, values: – Maximization of return on investment to secure a greater corporations' efficiency, generation of job opportunities and promotion of the economy's competitiveness; – Assistance in modernization of Russian economy; – Ensuring the foreign investment inflow; – Ensuring the inflow of the most advanced technologies and the best cadres into Russia; – Ensuring transparency of the corporate governance procedures	Fundamental sectors of modernization: – Advanced processing of mineral resources; – Technological development of critical deposits; – Agriculture and food retail; – House construction and construction materials; – Transport and logistics. Priority directions of modernization and technological development of Russia's economy («Presidential priorities», see above)
EXIAR	Objective: support of national exports and investment outside of Russia across the following directions: – Insuring of export loans from entrepreneurial (business) and political risks; – Insuring Russian investments to overseas from political risks. Tasks: – Marketing Russian export of equipment and technologies; – Monitoring and insurance support of national exporters on new and risky markets overseas; – Design and introduction of a modern system of financial support of export under the Agency's insurance coverage; – Increase in transparency of Russian export transactions and international investment	–

Sources: statutory and other title documents, including development institutions' internal documents, approved strategies and development programs, the development institutions' official homepages.

The development institutions' current operational priorities appear fairly versatile, having different nature and "origin" and, generally speaking, they raise some questions. More specifically, in accordance with the statute on investment policy of the Russian Venture Company, venture funds in which creation it participates and the Fund for Seed Investment should follow in their operations officially set priority directions of development of research, technologies and technics, and the list of critical technologies of Russian Federation; investments made by Skolkovo Foundation should be consistent the with priority directions of modernization and technological development set by the RF President; the "Start" program operated by the Fund for Assistance to Innovation provides for technological "framework" (a fairly big one, *apropos*) set by the Fund itself. That said, there are serious doubts about appropriateness of employment of any priorities and restrictions at the stage of seed – and even more so – pre-seed financing.

At this point, it is worth noting a fairly peculiar prioritization scheme devised by the Russian Fund for Technological Development. The Fund focuses on support of projects matching

respective approved technological platforms and, primarily, those related to technologies of live systems, future energy engineering and rational environmental management. Vnesheconombank centers on sectoral priorities which encompass practically all major manufacturing industries. Meanwhile, it is only one of them, namely, metallurgy for which a priority was identified, that is, a relatively narrow segment of special steel production, with no meticulously identified priorities for the other sectors. Lastly, a range of development institutions have a clear technological specialization (ROSNANO- nanoindustry, Rosinfocominvest – ICT, RVC's Biofund – bioindustry and pharmaceuticals), but it is not clear why other Hi-Tech sectors have thus far been neglected in this respect.

In all, the current system of development institutions' priorities cannot be viewed as a sufficiently consistent. Quite opposite, it appears even "spontaneous", with no general layout or ideology underpinning it.

While considering the current requirements to quantitative parameters of supported companies and projects (*Table 18*) it should be noted a drawback of the current development institutions system, as follows: it does not appear to a sufficient degree oriented toward supporting mid-size projects worth in the region between several hundred million and one billion Rubles. It is only ROSNANO which can afford to support such projects (provided they are directly associated with the nanotechnology sphere), and so can some of RVC's venture funds. As to other development institutions, they center on either bigger, or smaller projects. The SME Bank's operations nominally focus on small- and medium-sized businesses, but due to the effective caps on volume of funding (Rb 150mn for innovation and modernization projects and Rb 60mn – for all other projects), they largely center on support of small-sized businesses.

Table 18

Main Parameters of and Restrictions on the Development Institutions' Operations on Support of Innovation Companies and Projects[1]

Development institutions	Forms of support	Characteristics of supported companies			Characteristics of supported projects		
		«Age», as years[a]	Number of employees[a]	Volume of revenues (income) as Rb mn[a]	Volume of support, as Rb mn	Term of support, years	Co-financing, as %
1	2	3	4	5	6	7	8
Fund for assistance to innnovation ("Start" program)	Grants	Up to 2	No more than 100	Up to 0.3	Year I – up to 1; Year II – up to 2; Year III – up to 3	1–3	Year I – 0; Year II – no less than 50; Year III – no less than 50
RVC's Fund of Seed Investment	Investment	No more than 3		No more than 10	Up to 25	1–5	No less than 25
Skolkovo Foundation	Grants				1,5–300	Up to 10[b]	0–75
Regional venture funds	Investment		Up to 250	Up to 1000	Up to 36–120[c]	Up to 7[d]	25–75
RVC's Venture funds	Investment			No more than 75	Up to 300–1000	Up to 5–10	
RVC's biofund	Investment				No more than 100[e]		No less than 50

[1] In this case we do not consider support of infrastructure, educational, etc. projects

cont'd

1	2	3	4	5	6	7	8
Russian Fund for Technological Development	Credits				As a rule, no more than 300	Up to 5	
Rosinfocominvest	Investment				No more than 150	2–6	No less than 50
ROSNANO	Investment			No less than 250[f]	300–1300	No more than 10	No less than 25–50
	Loans		Up to 250	Up to 1,000	Up to 60; microfinanc-ing – between 0.1 and 1 per contract (no more than 10 by all the contract with a given SME agent); funding for innovation and moderni-zation – up to 150	From 0,5 Up to 5; Microfinanc-ing – from 0,25 Up to 2; Financing of innovationas and moderni-zation – from 1 Up to 5–7[g]	0 or no less than 15[g]
	Leasing	No less than 1	Up to 250	Up to 1,000	Between 0.15–60 up to 60–150[b]	Up to 5	No less than 15–30[g]
	Investment		Up to 250	Up to 1,000	Up to 60	5–7	No less than 15[h]
Vnesheconom-bank	Loans				No less than 1000 (the volume of the project – no less than 2,000)	As a rule, more than 3 (pay-back time - over 5)	No less than 20
Russian Fund for Direct Investment	Investment				1500–15,000[i]		No less than 50

Note.
[a] – as of the moment of the beginning of support;
[b] – the term of effect of the status of participant in the Innovation Center Skolkovo;
[c] – due to the volume of the Fund;
[d] – the term of trust of the funds;
[e] – during the first round of investment;
[f] – in 5 years after the start of the project;
[g] – due to conditions of a concrete direction of support (product);
[h] – from the total value of the project; investment – no more than 25% of the total value, credit support – no more than 60%;
[i] – 50–500 $ mn.

There exist some barriers to the "innovation lift" at early stages, particularly to the "capture" by the RVC's Seed Investment Fund of successful projects earlier supported by the Fund for Assistance to Innovation. This can be explained by the fact that the Seed Investment Fund grants support on a far greater (up to Rb 25mn) level, and the recipient company should be no more than 3-year old. By contrast, the Fund for Assistance to Innovation extends support to companies aged under 2 years and with the volume of proceeds at the onset of no more than Rb 0.3mn. So, objectively, companies' chances for managing to "grow up" to a level at which they can qualify for the Seed Investment Fund's support are limited.

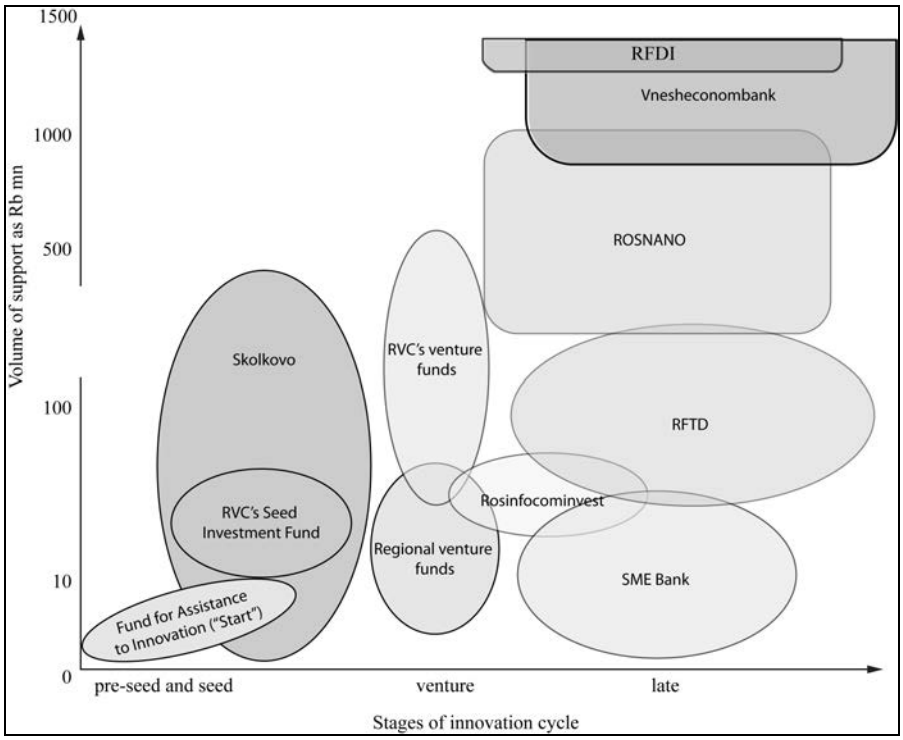


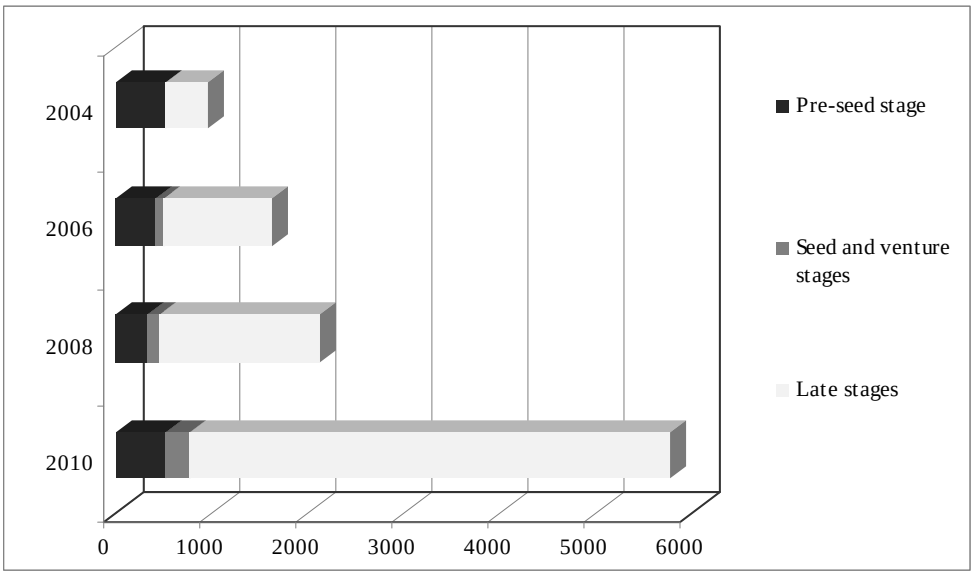
Fig. 2. "Positioning" of Financial Development Institutions by Stages of Projects and Volumes of Their Support

It should be noted that there has recently emerged a tendency to extension of the upper margin of support: thus, the Fund for Assistance to Innovation raised it by 1/3, SME Bank now is in a position to disburse loans of up to Rb 150mn to innovation and modernization projects (with another 60mn to be potentially invested in SME implementing such projects), while earlier the cap for the said categories of project was Rb 60mn. Plus, some of recently established institutions and funds allow far greater projects financing volumes than the existing institutions centering on the same stages of the innovation cycle (the most shining examples in this respect are Skolkovo and RFDI).

6.3.3. Assessment of the Scale and Outputs of the Development Institutions' Performance, Main Tendencies and Recent Critical Changes

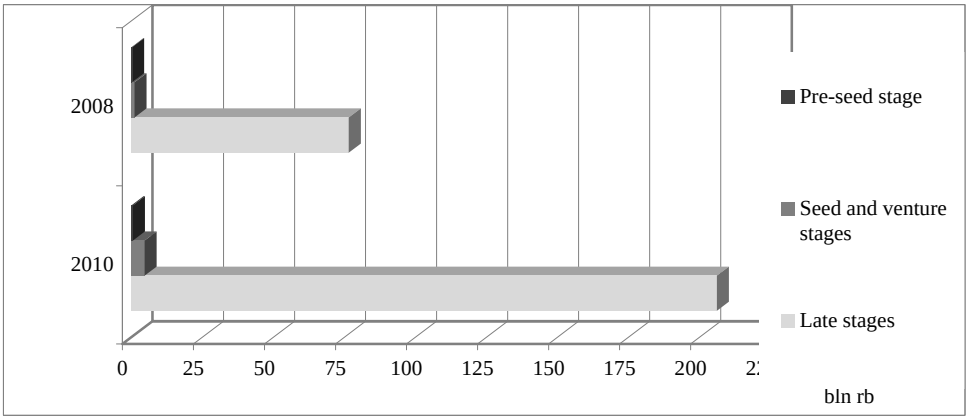
The number of supported projects recently has steadily been on the upsurge (*Fig. 3*), and in 2009 – 2010 it nearly tripled, which can be ascribed largely to a substantial expansion of SME Bank's operations. The rise was practically exclusively fueled by projects at late stages of the innovation cycle, which resulted in a very considerable "bias" towards those: while in 2004 the number of supported projects at early stages roughly equaled the one of late-stage projects, in 2010 the latter accounted for nearly 90%.

The prevalence of late-stage projects is yet more visible in the structure of financing (*Fig. 4*), which, however, is quite natural, as the size of support granted at early stages is more humble. As well, let us note that in the overwhelming majority of cases the size of support of projects implemented in 2010 was fairly small and accounted for up to Rb 50mn per project.



* Hereinafter without regard of the projects supported by SME Bank via the infrastructure organizations.
Source: estimates by the interdepartmental Analytical Center on the basis of materials of Russian development institutions and RVCI.

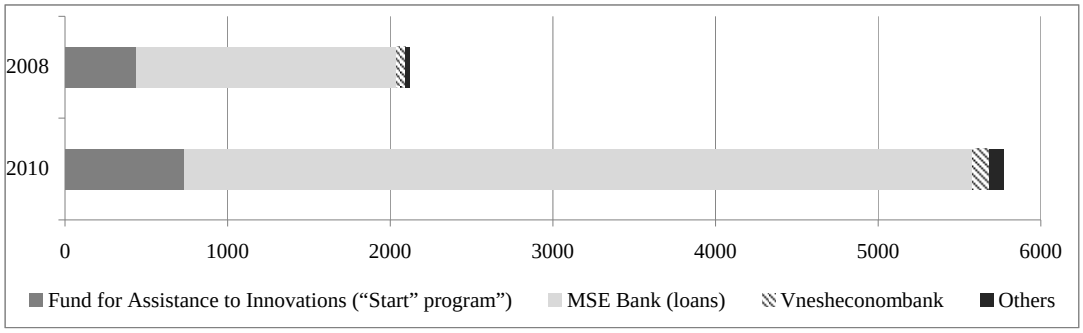
Fig. 3. Dynamic of the Number of Supported by Development Institutions Projects by Main Stages of Innovation Cycle*



Source: estimates by the interdepartmental Analytical Center on the basis of materials of Russian development institutions and RVCI.

Fig. 4. Volume of Financing of Supported during the Year Projects by Development Institutions by Main Stages of Innovation Cycle

It was the Fund for Assistance to Investment and SME Bank's performance which proved the most "mass-scale" one (*Fig. 5*): in the case of the former institution, there were hundreds of objects of support over the year, while in the latter case they were counted in thousands. Common for the institutions in question is their focus on support of relatively small projects: in the former case the grant typically does not exceed Rb 1mn, while loans disbursed in the latter case account for some Rb 4mn each. That said, the institutions' operations center on the "polar" stages of the innovation cycle: that is to say, the Fund supports projects at their early (mostly pre-seed) stages, while the Bank does the same for projects on late stages.



Source: estimates by the interdepartmental Analytical Center on the basis of materials of Russian development institutions and RVCI.

Fig. 5. The Number of Projects Supported by Development Institutions over the Year

When it comes to the performance of two particular development institutions, SME Bank and Vnesheconombank, which carry out fairly large-scale support programs (in the former case – in terms of the number of supported objects, while in the latter case – volume-wise), their common peculiarity lies in a relatively low proportion of the "investment component": thus, the institutions themselves estimate the specific weight of innovation projects in the overall amount of support at the level of ¼ for SME Bank (as of 2009) and a meager 3% for Vnesheconombank (as of 2010). Meanwhile, SME Bank has recently launched a program "Financing of innovation and modernization" which should intensify its activity in the area of innovation; as to Vnesheconombank, we feel the above estimate appears lower than in reality, as some projects which the Bank did not label as innovation ones are directly associated with innovation, nevertheless. As well, it is worth noting that the Bank's recently adopted strategy through 2015 provides for an increase of the proportion of investment projects in its credit portfolio up to 20%.

While comparing the magnitude of the development institutions' operations in 2008 with the 2010–2011 one (*Table 19*), it is worthwhile to note their substantial expansion for most of the institutions and, sometimes, in tandem with diversification of their activities. In a number of cases that was determined by the fact that back in 2008 some institutions (like RVC or ROSNANO) basically kicked off into existence and were way below their "projected capacity". However, in certain instances, it can be ascertained that already mature institutions (such as SME Bank) expanded their operations considerably. Against the general backdrop RFTD appears a notable looser, as not only did the Fund fail to expand its R&D financing operations, but de facto put them on halt. That said, as noted above, it was announced in 2011 that the Fund was going to renew its operations in the capacity of development institution.

Table 19

Magnitude and Performance of Development Institutions with Regard to Support of Innovation Projects

Development institutions	Magnitude and performance	
	2008	2010–2011
1	2	3
Fund for Assistance to Innovation	Between 2004 and 2008 in the frame of the "Start" program 8,700 applications were considered, over 2,000 projects were supported, including some 270 ones – at the second stage and around 50 – at the third stage	By late 2010 in the frame of the "Start" program over 12,000 applications had been received and some 3,000 projects were supported. As many as 82 small-sized innovation companies had completed a three-stage cycle of the program

cont'd

1	2	3
Russian Venture Company	As many as 7 venture funds with a total volume of a. Rb 19bn were formed. Three funds invested some Rb. 1.8bn in 15 companies	By late 2011 venture funds had selected 45 projects to be financed. The Seed Investment Fund was created (see below). Two Funds were created under foreign jurisdictions and USD 20mn was invested. The RVC's InfraFund was established , 9 projects were selected. The RVC's BioFund was established
RVC's Seed Investment Fund	–	By the end of 2011 41 projects were selected for financing
Regional venture funds	As many as 14 funds created in 12 Russian regions with a total capitalization of some Rb 5.5bn. A. 30 porjects were funded, and the aggregate amount of investment hit Rb 1.3bn	There are 22 funds in 20 regions with the aggregate capitalization of over Rb 9bn. By late 2010 they had approved a. 50 projects for financing, and the aggregate amount of investment was Rb. 3.3bn
Skolkovo Foundation	–	By late 2011 as many as 85 grants worth a total of Rb 5.8bn were approved and the volume of co-financing hit Rb 4bn. The grant recipients de facto received Rb 1.9bn
Russian Fund for Technological Development	Over 800 projects worth a total of Rb 7.4bn were financed*	
ROSNANO	By late 2008 a. 400 applications and proposals for financing were received for a total of Rb. 464bn, including 310bn out of the corporation's funds. ROSNANO approved 7 projects (6 investment and 1 educational one) worth a total of Rb. 10.3bn, including 5.5bn – out for the Corporation's funds. Another 2 projects were launched with the funding amounting to Rb 0.2bn	By late 2011 as many as 1,884 applications for project financing worth a total of Rb 4,064bn, including 1,764bn out of the Corporation's funds (in 2010 – 439 applications, Rb 1,867bn and 556bn, respectively). Of the said number 104 projects worth a total of Rb 347bn, including ROSNANO's co-funding in the amount of Rb 140bn, were approved (in 2010 – 44 projects, Rb 146bn and 47bn, respectively). The Corporation allocated Rb 64bn for 49 projects, including32bn – in 2010. ROSNANO fulfilled its investment obligations by 11 projects. ROSNANO's participation with Rb 30bn in creation of 8 venture funds worth a total of Rb 62bnwas approved. Of the said number 4 funds were financed (Skolkovo-Nanotech, Advanced Nanotechnologies, Nanomet, Rosnano Capital), of which 3 are up and running
Vnesheconombank	By late 2008 as a creditor contributed to financing of 54 investment projects, of which contributed to 5 projects as an investor, too, while to another two projects – as a guarantor. The volume of loans on implementation of investment projects accounted for Rb 129.9bn. In 2008, the Bank started financing 21 new investment projects in Russia	By late 2010 Vnesheconombank contributed to funding of 97 investment projects, of which to 94 – as a creditor. As well, the Bank provided guarantees to 2 investment projects. The volume of disbursed loans accounted for Rb 306bn, the balance-sheet value of stock the Bank acquired in the process of allocation of support to the project was Rb 27bn, and the volume of guarantees provided was a. Rb 11bn. In 2010 the Bank began financing 27 new investment projects and disbursed Rb 126bn in loans on projects implementation, including Rb 61bn- on new projects, and invested in corporate stock over Rb 20bn
Roseximbank	By late 2008, the Bank's credit portfolio accounted for Rb 4bn, including some 2.5bn extended in the form of pre-export funding. The volume of loans disbursed in 2008 was Rb. 29bn	By late 2010, the Bank's credit portfolio accounted for Rb. 5.1bn, including some 3bn extended in the form of pre-export and investment lending (aiming, as a rule, at modernization of equipment of manufacturing corporations seeking to reduce production costs of their exports). In the course of the year, Rb 3.7bn was disbursed (prolonged) in loans
SME Bank	In 2008, as many as 1,600 loans worth a a total of Rb. 7.8bn were disbursed to SMEs. In all, since 2004, the Bank extended nearly 6,500 loans to SMEs for a total of over Rb 23bn	In 2010, MSEs were granted some 5,000 loans for a total of over Rb 27bn. By the end of the year, the aggregate volume of the support to SMEs accounted for, on an accrual basis, some Rb 80bn. In the frame of the "Financing for innovation and modernization" program in 2010 alone the Bank disbursed 12 loans for a total of Rb. 0.8bn

* By 2008 RFTD had de facto terminated its project financing operations.
Sources: the official corporate reports, the development institutions' official homepages.

Importantly, a number of Russian development institutions *have lately substantially modified* operations (or, at least, modifications began to emerge therein), *and, as a rule, for the better:*

- As the most visible recent tendency it is worth noticing the aforementioned activation of efforts to complete building the system of development institutions, primarily in respect to creation of new ones both by the state (Skolkovo Foundation) and by the already existing institutions (RVC and ROSNANO's venture and infrastructure funds, among others – see *Fig. 6*);
- The processes of Russian development institutions' integration into the global innovation system have gained a notable momentum: at this point, it would be appropriate to cite a string of programs with Vnesheconombank's participation (co-funding of projects in the area of infrastructure, industrial production, energy efficiency and resource management with the World Bank; a joint program with EBRD on funding investment projects in the frame of the Russia-EU "Partnership for Modernization" initiative, and incorporation by RVC and ROSNANO of subsidiaries and foundations under foreign jurisdictions;
- An important operational direction for the institutions and funds in question has recently been support of development of various elements of the innovation operational (information, educational one, etc.) infrastructure. At this point, it should be noted that while creation by ROSNANO of the Fund for Infrastructure and Educational Programs allows to speak about incorporation of the respective operational direction in the individual legal entity format, creation, for instance, of the InfraFund and BioFund under RVC (in the focus of the latter are both innovation and service companies that deliver laboratory, information-analytical and consulting services) constitutes the every initiation of the respective operational directions under the aegis of Russian Venture Company;
- Meanwhile, the development institutions have substantially bolstered their cooperation with respect to support of innovation activities. The most visible manifestations of the process in question are the "Agreement of the Nine" aiming at securing a perpetual funding of innovation projects[1]; bilateral agreements between individual funds and institutions, such as creation of the RVC's Seed Investment Fund with participation of the Fund for Assistance to Innovation, the RVC running evaluation of projects that seek funding out of regional venture funds. Besides, it is worthwhile to note the recently started "mutual penetration" of managing structures of different development institutions, which is most visible at the level of their Boards (Advisory Councils);
- The search for optimal forms of organization of development institutions' operations, shaping up new directions and instruments of support, including in pursuit of strategic prospects, is under way. To cite particular moves or core initiatives in this area suffice it to refer to the incorporation of ROSNANO and the planned for a foreseeable future privatization of a fraction (up to 10%) of the newly established joint-stock company's stock; the transformation of RFTD from public institution into an autonomous one and renewal of its operations on supporting R&D with the emphasis on projects implemented in the frame of tech-

[1] In 2010, a number of public development institutions, including Vnesheconombank, ROSNANO, the RF Ministry of Education, Fund for Assistance to Innovation and RVC, as well as 2 non-profits (OPORA Rossii and the Russian Association fof Direct and Venture Investment), and MICEX, and the Federal Agency for Youth concluded a cooperation agreement which provides for organization of a prompt information exchange about projects in progress to arrange for their "transfer" from one institution to another.

nological platforms; the already repetitiously cited creation of RVC and ROSNANO's funds; initiation by the Russian Bank for Development of the "Financing for Innovation and Modernization" program. It is also worth noting a practically completed process of development of strategic guidelines (plans, programs, etc.) for core institutions for years to come[1];

- Development institutions have to some degree succeeded in solidifying trust in them through their leadership's professional reputation. In this regard the most shining example is the composition of the RVC's Board, with 3 out of its 7 members being independent directors and renowned business community representatives.

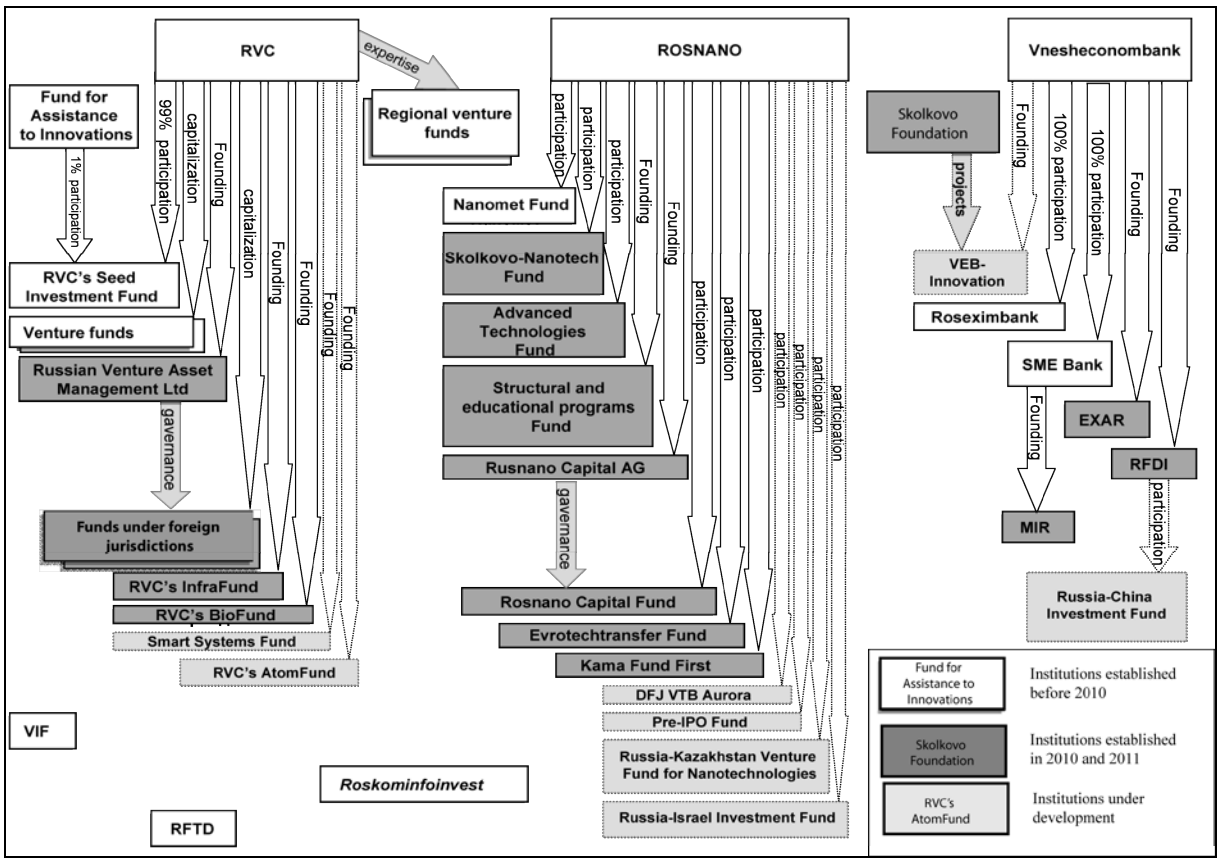


Fig. 6. The System of Existing Financial Development Institutions and the Ones under Development

While considering the balance of the development institutions' strengths and weaknesses (*Table 20*) it can be noticed that each of them is in possession of a substantial spare capacity to bolster operations on support of innovation: for example, the Fund for Assistance to Innovation could raise its caps on both the volume of support and the size of supported companies, as well as enhance its operational transparency and improve the overall performance; Vnesheconombank could bolster the innovation component; Rosinfocominvest could tackle nor-

[1] The only clear "lacuna" today is the absence of such a public document for the Fund of Assistance to Innovation; however, it has already crafted a draft medium-term action plan.

mative hurdles to the start of its investment operation; and practically all the institutions could expand the array of forms of support and intensify their efforts to attract private resources.

Table 20

Main Strengths and Weaknesses of Development Institutions with Respect to Support of Innovation

1	Strengths 2	Weaknesses 3
Fund for Assistance to Innovation	Implements a grant-based scheme of support, no problems with "walking out" from the supported projects. A developed territorial structure in place, a broad "encompassing" of Russian regions, a well-developed evaluation system. Credibility, the possibility for a substantial scaling of "Start" and "SMART" programs without lowering the selection quality bar. Flexibility and creativity in shaping up new programs. Possibility for building a program of new directions of support, particularly with regard to small business – exporters	Financial resources are limited. A significant fraction of programs suspended during the crisis. The Fund's support may go only into funding R&D and works directly related to R&D implementation. A fairly low cap on support of a single project. Restrictions on subjects of supported projects (albeit not so stringent) appear excessive on the seed stage and on the pre-seed one in particular. Possibilities for purchasing special equipment are considerably restricted by the effective standards[1], ergo, problems with supporting start-ups where costly equipment is needed. No approved development strategy and public performance reports available
RVC	Possibilities for flexible participation in creation of various funds together with private businesses. RVC's lessen principle with regard to decisions on projects selection generate general framework for private initiative and risk allocation. In addition to "typical" venture funds, shaping up specialized ones (seed, infrastructure, sectoral (BioFund). High activity, regular putting forward new practical initiatives on creation of new funds, development of the innovation-venture ecosystem, etc.	Shift of the focus on creation of funds without co-sponsors. Due to the established prioritization (priority directions of development of research, technologies and technics, and the list of critical technologies of RF) there may exist a lack of attention to interdisciplinary projects, new, rapidly growing sectors that have failed to make it into the list of officially set priorities
RVC's Seed Investment Fund	With account of a substantially higher (compared with the 'Start" program) cap on support of a individual project –s the possibility for implementation of investment-intensive projects at the seed stage across a broad spectrum of thematic directions. No caps on kinds of financial costs associated with projects implementation, flexible conditions with regard to projects implementation timelines. Focus on capitalization of innovation firms. Possibility for creation in the future of a steady flow of transactions on "walkaway" from projects with the help of the system of venture partners	Overly strict capping on marginal earnings of a company potentially applying for support – in reality it is micro-companies, not even small-sized businesses which are subject to support. Due to the innovation pattern of the "seeding", the problem of "walkaway" from projects. Requirement to supported companies' operations to be in line with priority directions of development of research, technologies and technics, and the list of critical technologies of RF appears excessive
Regional venture funds	Attraction of RF Subjects' funds to develop the venture industry. A due account of the regional specificity of venture investment, possibility for flexible "walkaway" timelines. Decreasing small-sized innovation companies' costs of access to support Requirement for RVC to run evaluation of projects seeking the funds' investment can positively influence the quality of supported projects	Low level of investment activity: as of late 2010 the average transactions-to-fund ratio was just around 2 to 1. The need for an "intermediary link" – The need for «regional funds for assistance to venture investment in small-sized enterprises in the technical sphere most of which are used to create a sole venture fund. A broad representation of RVC on the funds' Boards in tuned, with evaluation of projects can result in an excessive concentration of real control powers in the hands of RVC. Negative record of interaction with private management companies (in Tyumen oblast, Stavropol krai). An insufficient level of the overall transparency of the system of created funds and their deliverables
Skolkovo Foundation	Considerable amount of support, grant-based operational pattern. Possibility to combine financial support with other mechanisms provided for residents of the Skolkovo Innovation Center: large-scale tax, customs and tariff benefits, a simplified procedure of employment of foreign workforce, softening administrative barriers to doing business with the use of an independent institutional regulation system	The priorities embrace just a fraction of promising directions of technological development. The current concept of the Foundation and the Innovation Center is better suited to accommodate large, well-established companies, rather than innovation startups

[1] Proportion of funds used to purchase special equipment may not exceed 15% of the value of the contract .

cont'd

1	2	3
Rosinfocominvest	Focus on a partial privatization, possibility to refine the scheme of attraction of private investment at the Fund's level which can prove effective in the ICT sector, along with implementation of a broad totality in respect of short-term projects	Ban on the Fund investing until the moment the government reduces participation in its capital to 51%, the absence of any progress in attraction of private shareholders and, as a consequence, the absence of the Fund's profile operations. The cap on investment in a given single project may prove insufficient, as the Fund has not right to invest in LLCs of which such a volume of investment is more typical than of JSCs
RFTD	A significant record of selection and support of applied research projects. A mature system of communication with research organizations and corporations. As the focus is on support of projects in the frame of technological platforms, the high demand for the projects' outputs is highly likely	Just a sole mechanism of support is permitted, that is, target loans, which is not always the best mechanism for innovation projects by companies and new and small-sized ones in particular. The selection of a fraction of technological platforms as top priority ones is not clear
ROSNANO	Holistic approach to operations (support of innovation projects, innovation infrastructure development, education, improvement of regulation. Sizeable financial resources at hands. Upon incorporation there emerges a possibility (and plans have been shaped up already) for attraction of private investors. Highly active, primarily in regard to investment projects rollout across a broad range of directions. A considerable number of initiatives associated with the innovation infrastructure development. A fairly high degree of transparency, including that of operational pillars and regulations; a well-developed public awareness and communications system.	Gradual drift to support of increasingly larger programs and projects. With no strictly established corporate development framework in place, the risk of an unjustified expansion of the scale and functions. The de-facto refusal to finance R&D (beyond the frame of innovation projects), while support of R&D was set as one of the company's major functions
Vnesheconombank	A sizeable resources volume, possibility to support huge long-term investment projects. Pre-crisis, a high efficacy with regard to organization of selection and support of implementation of huge investment projects. The resource and organizational capacity on hand to support projects that secure significant multiplying effects for advancement of the national economy and the rise of progressive technological shifts. Rainbow of forms of support: loans, investment, guarantees – and the possibility to combine them. Possibility to expand projects on support of regional innovation infrastructure	No strictly determined methodology of assessment and principles of support of investment projects on development of innovation as yet. A gradual expansion of the Bank's functions in its capacity of the RF Government's agent (which became particularly significant during the crisis) which reduces the Bank's capacity with regard to a consistent and systemic implementation of functions of development institution. There are signs of a certain trend to reallocation of resources in favor of infrastructure projects with resources on support of innovation projects being limited. No strictly determined requirements to the extrabudgetary project co-financing. The risk of using the Bank's resources as a "surrogate" of extrabudgetary funding in side-projects (including those implemented by other development institutions)
Roseximbank	Employment of various schemes, provision of support at different stages, including the pre-export one. Support of export as a major profile, a substantial record in this sphere	Relatively moderate magnitude of operations and humble resource capacity on hand. A certain inclination to supporting traditional industries. The support was not customized to meet small-sized companies' needs
SME Bank	Well-developed and fairly effective operational pattern of a mass provision of support to SMEs on the basis of agent agreements with banks and infrastructure organizations. Sizeable volume of resources to support SMEs. A very broad "encompassing" (in terms of the number of supported projects). Rainbow of forms of support: loans, including microfinancing), leasing, investment. Expansion of the scope and employment of new forms of support, in particular, in the innovation sphere	Because of the effective caps on loans, the Bank focuses largely on support of small-sized and micro-firms, rather than medium-sized businesses. A special program of support of innovation activity was launched just in 2010 and, funds-wise, has thus far been fairly modest
RFDI	Possibility to implement very large, backbone for an industry, region or the economy as a whole, projects Focus on attraction of foreign investors, including institutional ones. Intention to invest in rapidly expanding sectors and industry leaders	Taking into account prospective projects – relatively small capital of the fund. No publicly available documents to specify the procedure and conditions of investment activity. The risk of "megalomania" in the course of selection of projects to

6.3.4. Critical Challenges and Possible Ways of Improvement of the System of Public Financial Development Institutions with Regard to Support of Innovation Activity

So, there has recently emerged a tendency to a notable expansion of Russian financial development institutions' scope of operations: the volume of their investment is on the rise, as the number of investment projects they back is. Our estimates suggest that the aggregate volume of support of investment and innovation projects by development institutions increased from Rb 78bn in 2008 to 211bn in 2010, while the number of supported projects grew over the same period from 2,100 to 5,800. As noted above, it was expansion of the Russian Bank for Development's operations on support of MSEs that accounted for a critical contribution to the rise in the number of supported projects. Meanwhile, the growth in the overall volume of support was secured by expansion of the Vnesheconombank's operations on lending to investment projects and ROSNANO's funding production projects.

In its most general form, as far as the innovation sphere is concerned, the development institutions system should ensure addressing the following tasks:

1) Support of creation of new innovation companies, R&D commodization processes, and technology transfers;
2) Ensuring conditions of a rapid expansion of successful innovation firms, including by compensating for market failures and granting access to financing at different stages of the innovation cycle;
3) Ensuring a demonstration effect for the economy, boosting private resources in the innovation sphere.

The businesses' assessment[1] *of the development institutions' impact* allows the following conclusions: on the one hand, their influence on the corporate sector's innovation performance may appear fairly limited: only 4% of enterprises in the sample noted the presence of such an effect from VEB and ROSNANO's operations, while another 2% of respondents noted the same with regard to venture funds' operations. On the other hand, however, those are not small figures, given the narrow focus of the development institutions' operations and comparing them with the respective figure of the impact of financing of innovation projects in the frame of the FTP (8% of respondents).

More important is what category of enterprises noted a positive effect from development institutions' operations. Having run a regression analysis, we found out that it is corporations with government participation and those with a solid financial standing which more often cite a positive effect from Vnesheconombank and ROSNANO's operations. Meanwhile, it is medium-sized companies (with up to 250 employees), corporations with government participation and those with a solid financial standing which more often ascertained the same with regard to venture funds. As a positive fact, let us note that the positive effect in question was more often cited (given other conditions being equal) by companies with a higher level of spending on technological innovation, a positive dynamic of such costs and boasting cutting-edge innovation produce.

[1] On the basis of a survey on executives of 600 medium-sized and large industrial corporations run in October-November 2011 and individual interim findings of the project of the Interdepartmental analytical center on assessment of various instruments of encouragement of innovation implemented for the benefit of the RF Ministry of Education and Science.

It appears quite logical that the development institutions' operations generally prove more significant to robust companies, while venture funds' operations in particular – to smaller-sized companies. That said, interpretation of some shift of the "group of beneficiaries" towards companies with government participation is a tricky question. We assume there might be at least two explanatory hypotheses: (1) being controlled by the state, public development institutions' focus of operations is shifted toward support of companies with government participation; (2) where private corporations receive funding from public development institutions, they face the need to give up a fraction of corporate control in the course of implementation of an investment project, while companies with government participation are not particularly concerned about such anti-motivations.

An accelerated and multidirectional expansion of Russian development institutions, particularly coupled with an insufficiently developed independent audit of their performance, inevitably increases risks associated with the rise (intensification) of certain systemic imbalances in their operations. It is possible to identify the following tentative groups of such imbalances:

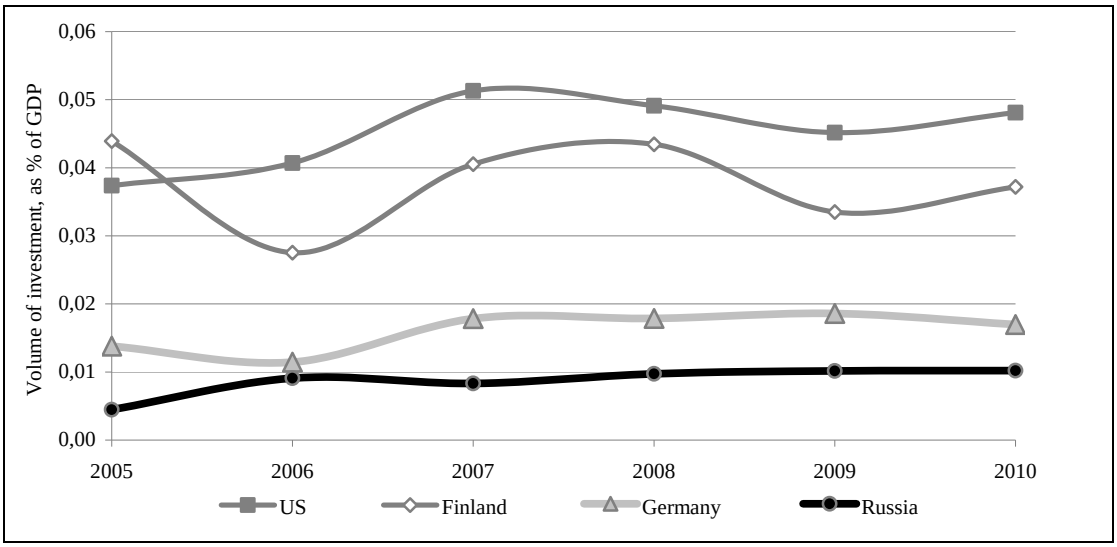
- «vertical» ones, which appear to be determined by an insufficient balance of support at different stages of innovation ;
- «horizontal», which are associated with thematic directions of development institutions' operations and peculiarities of their prioritization; and
- Institutional ones, determined by the normative framework of conditions of provision of support and a loose combination of instruments applied.

Let us first examine *general trends of development of the Russian market for investment at venture stages* vis-à-vis mature innovation economies. Between 2005 and 2010, Russia first posted some advanced growth of the level (vs. GDP) of investment at venture stages followed by its stabilization at the level of 0.1% of GGDP since 2008 (*Fig. 7*), with the indicator in question nationwide during the whole period being substantially lower than in countries with a mature venture industry, such as US and Finland and thus far having exhibited no trend to its *post-crisis growth.*

While analyzing *operations on the Russian market for venture and direct investment sector-wise*, it should be noted that thus far it has not undergone any substantial, sustained shifts in terms of "diversification" of thematic directions. According to RAVI[1], in 2007–2010, investment in three sectors – telecommunications, financial services and consumer market – accounted for 70-80% in the structure of private equity and venture funds' investments. Throughout the period in question, investments in the medicine and health care sector were being steadily on the rise. After the crisis 2009 tendencies to growth in investment renewed in such sectors and energy, industrial equipment, agriculture, while investment activity in such sectors as chemicals, biotechnology, light industry, and environmental management remained low.

The public institutions' operations at venture stages also gravitate more toward "traditional" thematic direction, though with some attention being paid to certain other sectors, such as medicine and energy engineering.

[1] Russian Association for Direct and Venture Investment. Direct and venture investment in Russia 2010. A preliminary market review. 2011

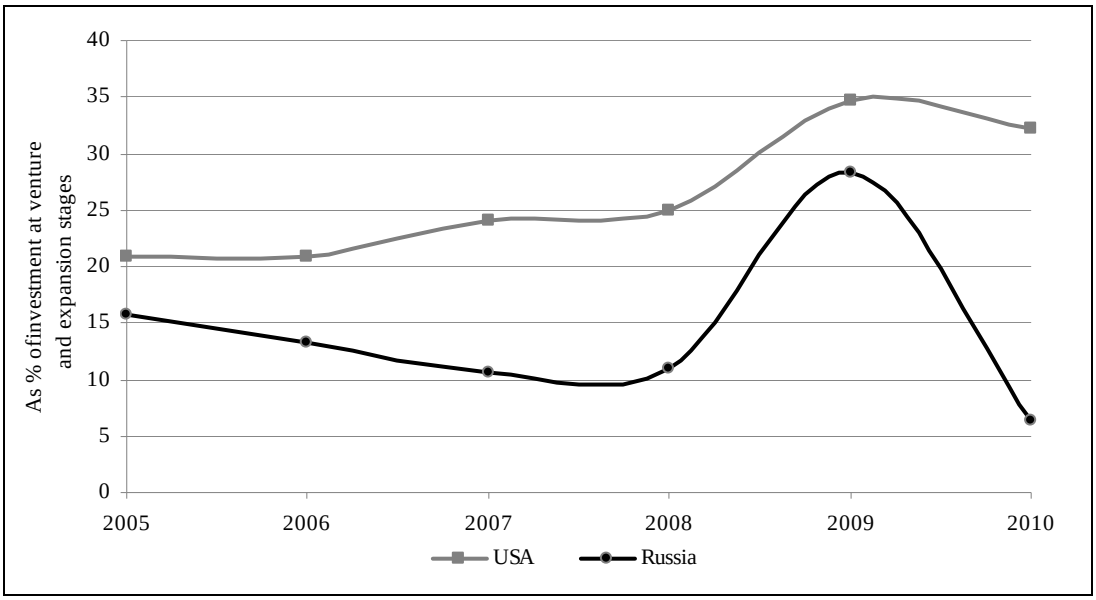


* Venture stages include the seed, initial and early stages (by the RAVI methodology) and analogous stages as classified overseas.
Source: assessments of the Interdepartmental analytical center on the basis of data of RAVI (Russia), NVCA (UD), EVCA (Germany).

Fig. 7. Dynamic of the level of Investment at Venture Stages * in Individual Countries, as % to GDP

As to the direct investment market, ROSNANO is particularly active there, but, of course, only in the frame of its core mission of development of nanoindustry. Meanwhile, as far as such a promising direction as bioindustry is concerned, the existing development institutions do not exert any significant influence on its advancement. In our view, due to the industry's huge capital intensiveness and dependence of its development prospects on improvement of regulation, it is imperative to establish a specialized PPP-based biotechnological direct investment fund. There might as well be a certain niche to form other funds (both venture and direct investment ones) to focus on such directions as fine chemistry, alternative energy, robotics.

Despite a certain progress, the Russian industry of venture capital and direct investment has still *remained unbalanced phase-wise:* between 2005-10 investment at the stage of expansion proved nearly 10-fold greater than investment at venture phases, while developed economies exhibit a greater level of investment at the latter stages. If in our consideration we cross out a "formal" increase in the share of investment at venture stages during the crisis period (determined by contraction of private businesses' investment activity at expansion stages), it can be noted that US demonstrated a tendency to increase in the share of investment at venture stages, while in Russia this share was down: in 2005, the proportion of investment at venture stages in the aggregate volume of investment at venture stages plus those at expansion stages was over 15.7%, in 2010 it dwindled to 6.3% (*Fig. 8*). We believe this effect was engendered by the strive for practical results from development institutions' operations in the short run and by the shift of operation of the whole system of development institutions toward later-, "commercial" stages with more visible direct deliverables.



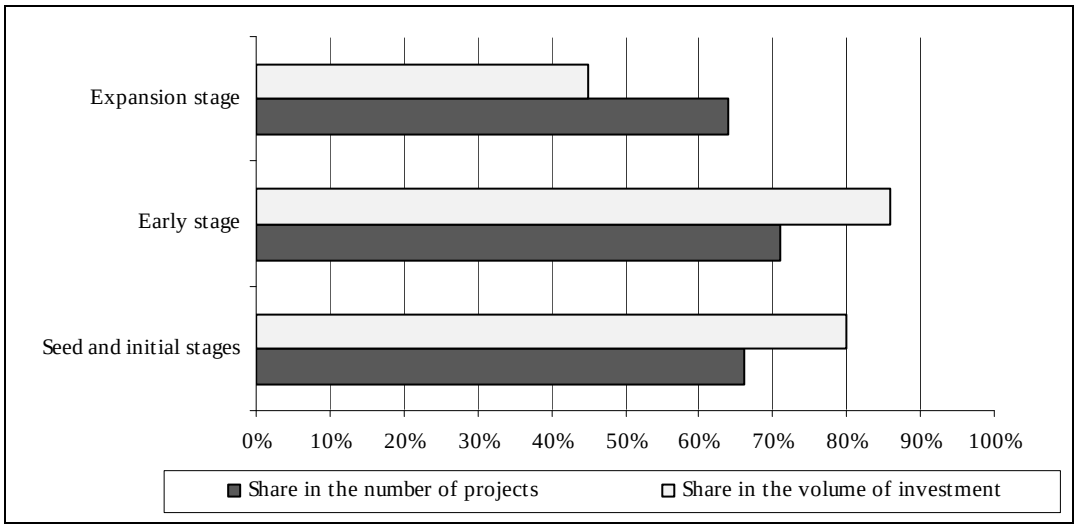
* The category of venture stages comprises seed, initial and early stages (by the RAVI methodology), and their analogues in foreign classifications.
Source: estimates by the Interdepartmental analytical center on the basis of RAVI (Russia) and NVCA (US) data.

Fig. 8. Dynamics of the Proportion of Investment at Venture * Stages in the Volume of Investment at Venture and Expansion Stages

It is common knowledge that it is early stages when the role of the state (and development institutions) with regard to support of innovation is critical, as at these stages private initiative is missing at most. But the Russian system of public development institutions appears insufficiently mature as far as the said stages are concerned.

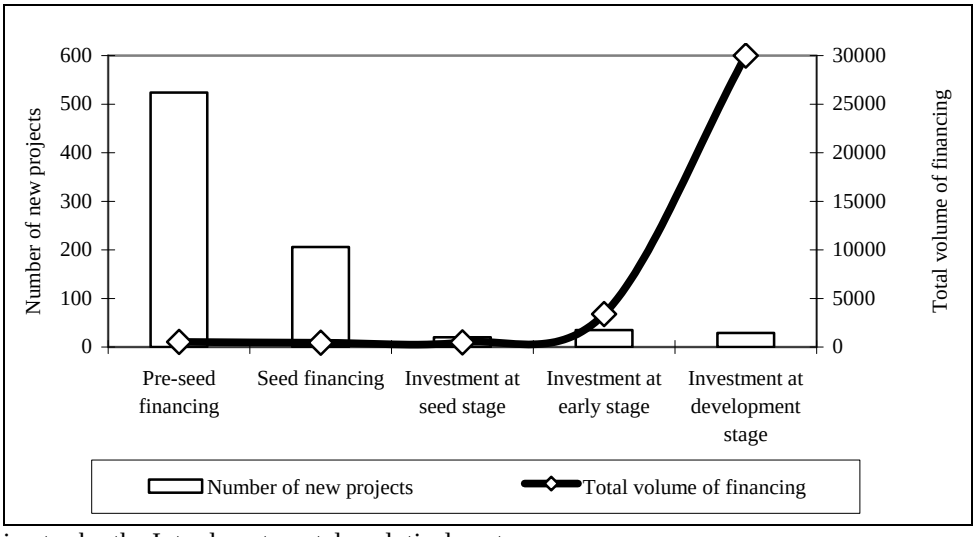
On the one hand, Russia's development institutions do play the greatest role at venture stages. Thus, we estimated that in 2010 alone, their and their daughter funds' direct contribution to the aggregate volume of investment in companies at venture stages accounted for 85% (RAVI estimates it at a level of 75%), and another 45% - in the total volume of investment in companies at expansion stage (*Fig. 9*). Let us note the critical role played by the Fund for Assistance to Development at the pre-seed stage.

On the other hand, the main "increase" in Russian development institutions' activity in 2010, both investment-wise and in terms of the number of supported projects, was associated with later-stage investment. While comparing the magnitude of public development institutions' operations in terms of different stages of the innovation cycle, an insufficient "broadness" of support (in terms of the number of projects) at venture stages in general (*Fig. 10*) and with regard to seed investment in particular (despite expansion of the RVC's Seed Investment Fund' operations) is particularly noticeable. This substantially constraints possibilities for private investment to embrace later-stage projects and blocs the rise of a steady "flow" of innovation projects.



* Assessments by RAVI are used as basic values with regard to aggregate volumes of direct and venture investment in Russia.
** The Seed Investment fund, venture funds founded with RVC's participation, regional venture funds, ROSNANO.
Source: estimates by the Interdepartmental analytical center with the use of RAVI's estimates of aggregate volumes of direct and venture investment in Russia.

Fig. 9. Assessment of Contribution* of Public Financial Development Institutions (and Funds Created with their Participation)** in Russian Market of Venture and Direct Investment in 2010



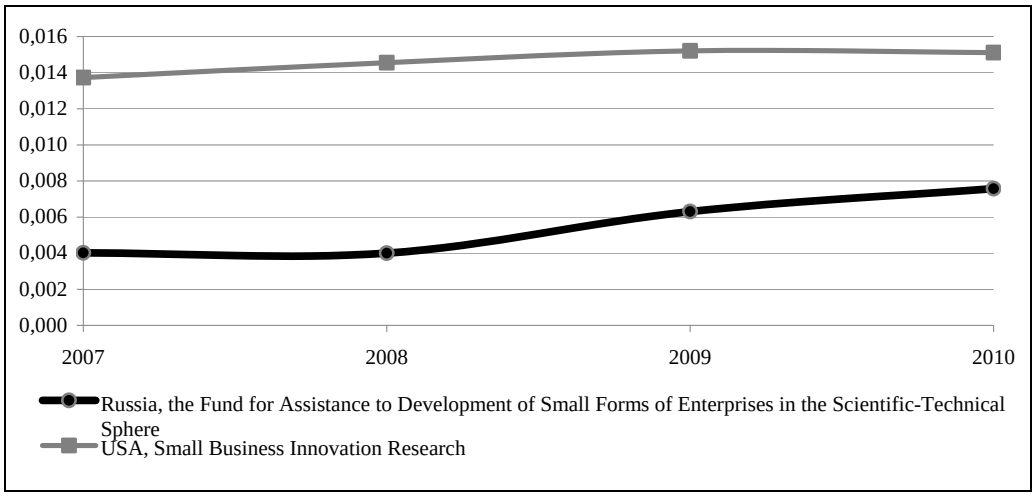
Source: estimates by the Interdepartmental analytical center

Fig. 10. Estimated Correlation between the Scale of Public Development Institutions' Operations on Support of Innovation Projects at Different Stages

An insufficient project "flow" at the pre-seed and seed stages appears a critical challenge to the task of ensuring a broad general economic effect from the development institutions' operation. Let us note the limited nature of grant-based support arrangements in the first

place (this modus operandi is noted only for the Fund for Assistance to Innovation and Sklokovo Foundation).

In principle, the state-sponsored grant-based support of projects at the pre-seed stage is unfolding in Russia, but its magnitude has thus far been far smaller than in the US: the grant-based support to GDP ratio displayed by the Fund for Assistance to Development of Small Forms of Enterprises in the Scientific-Technical Sphere is nearly twice as little as the respective figure of its US vis-à-vis, the Small Business Innovative Research (*Fig. 11*).



Source: estimates by the Interdepartmental analytical center on the basis of public information about operation of the Fund for Assistance to Development of Small Forms of Enterprises in the Scientific-Technical Sphere (Russia) and about implementation of SBIR (USA)

Fig. 11. Level of State Support of projects at the Pre-seed Stage

But the challenge does not lie solely in the above: it is imperative to pay attention to a fairly low size of individual grants the Fund in question is authorized to award (even after the cap was raised up to Rb 1mn) vis-à-vis other nations' practice. Plus, while using such grants, there are stringent restrictions with regard to the volume of spending on equipment (which objectively is explained by the fact that the Fund's operation is financed out of the state budget in the frame of the R&D expenditure). This constraints possibilities for effective implementation of the pre-seed stage across a string of cash-intensive technological directions.

We believe that a limited demonstration effect in the innovation sphere from Russian development institutions' operations appears to a significant degree associated with external institutional constraints, as well as peculiarities of the authorities' "expectation overhang". So far there have been substantial institutional barriers in place to implementation of the "venture" model of innovation development basing on a high activity on creation of new innovation businesses and a rapid expansion of successful companies.

First, the inflow of new entrepreneurs is limited, due to an insufficiently conducive entrepreneurial environment and negative, rather than positive, public perception of entrepreneurship: more specifically, a recent monitoring of entrepreneurship[1] evidences that in 2010 only 4.3% of Russian residents were going to start their own business in 3 years to come, but,

[1] Verkhovskaya.O., Doronina M. National report "Global monitoring of entrepreneurship. Russia. 2010". High School of Management of the St. Petersburg State University, 2011

given that entrepreneurs accounted for a. one-third of them, the prospective inflow of entrepreneurs makes up a meager 2.6% (one of the lowest figures vis-à-vis other countries). The same research exposed such fundamental challenges to expansion of entrepreneurship in Russia (vs. other nations) as a weak cultural background, nascent competition, and a low level of availability of venture capital.

Second, the national policy on support of small-sized business has thus far been to a greater degree oriented towards its social mission, that is, a mechanism to generate new job opportunities and mitigate social problems, rather than a major driver of economic development and emergence of new sectors. There emerged a significant "tax lacuna" for small businesses, due to which (as well as because of risks of increase of the administrative burden and a limited array of instruments of support tailored for small businesses) their motivations to transition to (over time) the category of medium-sized ones prove substantially arrested.

Third, the pace of the process of formation of a civilized market for mergers and takeovers has been very slow, which can be ascribed primarily to problems with protection of property rights, including intellectual ones, and risks associated with raiders' operations. Because of this, on the one hand, owners' motivations to capitalize their companies are limited, while venture investors have problems with an efficient "walkaway" from corporate capital, on the other.

Fourth, there exist external constraints to a cardinal increase of the number of projects supported at the pre-seed and seed stages. There of course exists a potential positive short-range effect from measures on development of organizational infrastructure for formation of new innovation projects (e.g. a model with venture partners for search of projects and assistance in preparing high-quality business offers, which is implemented by the Seed Investment Fund). But we believe that the future will see an increasing exhaustion of scientific-technological capacity across a number of demanded by business thematic directions and an adverse impact of the insufficient effectiveness of instruments of assistance to commercialization of R&D outputs.

The government's underestimation of external constraints and its excessive expectations, in our view, lead to *a certain deformation of motivations behind, and assessment of, the development institutions' performance.*

The *first peculiarity* in this regard is the strive to demonstrate to a broad array of stakeholders notable successes in the innovation sphere already in the short run, at the expense of the development institutions' operation.

At the development institutions level, this results in stronger motivations to demonstration of their outputs, implementation of milestone, "worth-bragging-about" projects. That the development institutions have received sizeable resources is an additional factor fuelling the anticipation of significant and understandable to a broad audience deliverables. Conceptual opponents to the development institutions accentuate an insufficient efficiency of their contribution to economic development, while individual groups of champions of the government's proactive role in encouragement of innovation criticize them for a slow pace of spending.

An inseparable and fundamental component of development institutions' operation is *securing a demonstration effect for private businesses*, diffusion of best practices, improvement of regulation, the environment for innovation and, ultimately, a gradual overcoming of "market failures". That said, *principles of assessment of the development institutions' performance*

appear to a far greater degree oriented toward their direct performance metrics, with the emphasis on employing formal indicators which characterize the use of resources.

Due to their profile, development institutions respond to expectations of the public administration system and various interest groups by boosting the scale of their projects, their uniqueness, spending, and by launching new initiatives.

Second, strive for ensuring dynamic structural shifts, scientific and technological breakthroughs through the development institutions.

We believe this sometimes results in *development institutions' operation in certain cases beginning to drift away from general market trends and investors' preferences*. This problem is further exacerbated by the view that capitalization of the development institution and expansion of their operational scale can help promptly compensate for drawbacks of the investment climate. *Having been oriented toward support of huge projects, development institutions become prone to a strong political pressure*, which gives rise to preconditions of their following the "agent – of - the government" model, rather than the "development institution" one.

Even with locally efficient operations and successful direct project outputs, such an approach arrests possibilities to attract private investment in development institutions' operation, fuels their hunger for additional public resources and encourages their shift from the PPP model to a public-quasipublic partnership one, concentration of the state banks and development institutions' resources on implementation of individual projects.

Third, the desire to increase direct return from their operation, no readiness for risk-taking (costs- wise), strive for localization of all the effects in the frame of the national economy.

The problem of bolstering the development institutions' efficiency is often viewed from the perspective of the need for their concentration solely on provision of financial support to projects implementation, without pursuing any organizational, educational and methodological goals. With very stringent criteria of assessment of success of projects they support and direct effectiveness of the development institutions' costs there arise *extra motivations to shifting main risks with regard to failures in innovation projects implementation onto recipients of the support.*

Focusing on early stages, development institutions appear objectively limited in delivering immediate results, as main positive effects from their operation become visible at later stages. In this regard more motives emerge to extend the development institutions' resources at the later stages which are capable to demonstrate the said results.

Despite the above problems with improvement of the development institutions system (which to a significant extent can be ascribed to costs of its rapid growth), basically, it can be ascertained that there has been made a substantial progress in the area concerned. More specifically, development institutions secured the following positive qualitative effects:

- demonstration to business of possible prospects with regard to obtaining support at different stages of development;
- cementing trust in development institutions on the part of the business community and the new, medium-sized business in the first place;
- working out various new, complex patterns of support of innovation and investment activity; laying ground for diffusion of respective qualifications and skills;
- design and promotion of proposals on improvement of market regulation and investment climate;

– identification of policy bottlenecks and critical challenges in the area of innovation development; a substantial public administration system's progress in appreciation of tasks and instruments of innovation policy.

In conclusion, let us single out the following possible *avenues of improvement of the Russian system of development institutions*:

1. It is imperative to expand the scope of their support of early-stage innovation, primarily at the pre-seed and seed stages. For a steady flow of projects to rise it is necessary to substantially broaden the "array" of the supported projects: up to several thousand – at the level of the Fund for Assistance to Development, and up to several hundred – at the level of the Seed Investment Fund.
2. It seems appropriate to expand the scale of grant-based support at early stages (where risks are maximum), namely, at the pre-seed one, as well as to spread this mechanism onto the seed stage of innovation. It is desirable, in the frame of measures on development of the university R&D, to consider a possibility for support of creation by research universities of special seed funds (capitalization of the existing ones).
3. With regard to development of grant-based innovation support patterns in Russia, it should be noted that a string of nations apply the "matching grants" mechanism to encourage innovation development. Good practices evidence that provision of such public grants to private businesses appears more effective than tax incentives for innovation[1]. When compared with "regular" grants, the mechanism in question is less exposed to the risk of "substitution" of private resources with public ones in the course of exercise of investment activity, and it to a greater extent helps attract businesses' extra resources into the innovation sphere.

In principle, in Russia, there is a similar mechanism associated with provision of subsidies on financing of innovation projects corporations implement together with universities[2]. However, an additional flexibility of this mechanism and prospects of its expansion could be ensured either by positioning it as a basic operational vehicle of one of public funds engaged in support of innovation activity, or by creating a special fund.

1. An important source of new innovation projects may become small innovation companies created under universities. This appears important from the perspective of expansion of the community of innovation-oriented entrepreneurs at the expense of university graduates: in the frame of the aforementioned monitoring, experts referenced to a substantial potential of the university environment in this regard: some 8.5% of students are ready to become entrepreneurs[3].

While noting a substantial progress in terms of reduction of normative barriers to creation of small-sized innovation firms under universities, it can be ascertained, nonetheless, there should be additional measures (mechanisms) in place to support integration of such companies into global value creation chains. The current emphasis on the number of newly founded companies and their focus mostly on local niches arrest potential to their dynamic growth.

[1] See, for example: Maloney, William. 2005. "Global Patterns of Innovation". World Bank

[2] Resolution of the RF Government of 9 April 2010 No. 218 "On measures of state support to development of cooperation between Russian institutions of high education and organizations implementing complex projects on creation of highly technological production".

[3] Verkhovskaya.O., Doronina M. National report "Global monitoring of entrepreneurship. Russia. 2010". High School of Management of the St. Petersburg State University, 2011.

1. The task to broaden the circle of projects supported at the pre-seed and seed stages cannot be solved momentarily, as it requires improvement of conditions of formation of new innovation projects and companies. So, it is imperative to increase funding of applied R&D at the pre-commercial stage to ensure an accelerated rise of the scientific and technological capacity to get university students engaged in conduct of research and commercialization of research outputs.
2. Solution to the problem of bolstering the development institutions' operational efficacy appears in many ways associated with implementation of measures on attraction of foreign investors to participate in their capital. This allows counting on a fair assessment of the quality of governance and "value" of the respective structures, improvement of selection of projects to support, and mitigation of the risk of a "timeserving" influence of the state. So far it has been only ROSNANO which has developed plans to attract private investors; however, such medium-term tasks seem rational for the Russian Venture Company and – in a more remote future – for Vnesheconombank (upon separation from it the Bank for Development per se and its transformation into an adequate organizational and legal form), too.
3. It is imperative to promote efforts with regard to dissemination of development institutions' best operational practices, public demonstration of success stories associated with specific projects, and special educational programs. It is critical to ensure a substantial progress in monitoring and assessment of qualitative, indirect effects from development institutions' operations[1]; meanwhile, assessment of such external effects requires organization of regular independent audit.

6.4. Bankruptcies in 2009–2011: Post-crisis Dynamics; New Trends; Regulation

6.4.1. Dynamics of Bankruptcies (2009–2011)

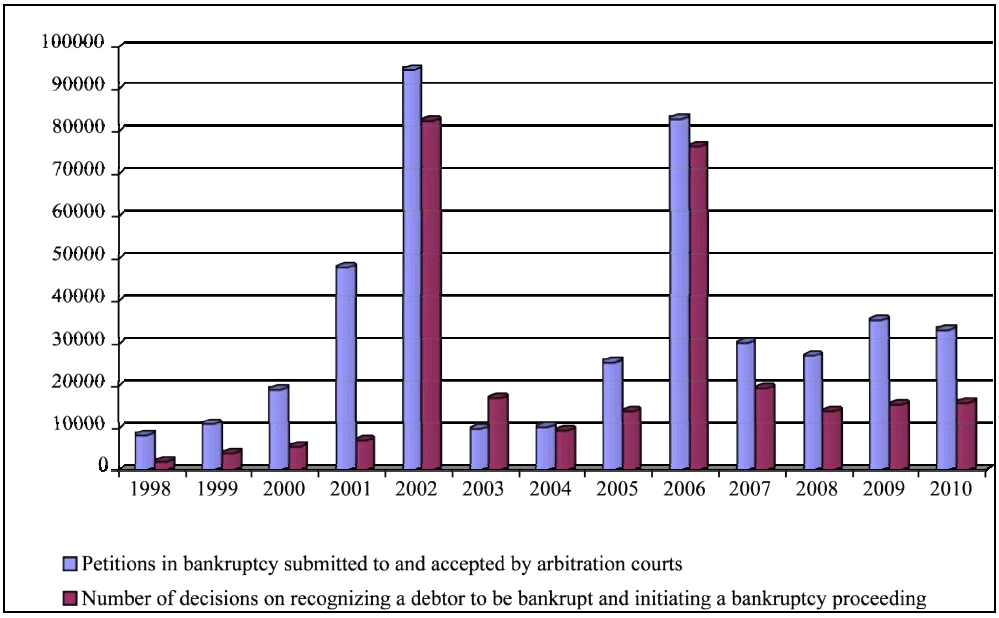
The overall situation in the field of bankruptcy over the period under consideration was shaped by the following four key trends.

1. First of all, it is necessary to *note the beginning, in first half-year 2011, of a decline in the number of bankruptcies and the number of petitions in bankruptcy submitted to court that followed the period of growth of these indices in 2009–2010*. Thus, over the period of 2009–2010, the number of court decisions concerning the recognition of a debtor to be bankrupt and the initiation of a proceeding in bankruptcy rose by more than 15% (in 2008 – 13.9 thousand; in 2009 – 15.5 thousand; in 2010 – 16 thousand cases[2]). In the first half-year 2011, there occurred a significant drop (by nearly 20%) in the number of petitions in bankruptcy filed with courts of justice (first half-year 2010 – 21,037; first half-year 2011 – 16,853); and a drop by 13.5%, on the same period of 2010, in the number of decisions issued to the effect that a relevant debtor should be deemed to be bankrupt (first half-year 2010 – 8,047; first half-year

[1] See, also: Simachev Yu., Kuzyk M. Institutions in Development.- Direct investment, 2010, No. 4.

[2] Out of 16,009 decisions on deeming a debtor to be bankrupt and initiating a proceeding in bankruptcy in 2010:
– 3.2% (or 508 cases) have to do with state and municipal unitary enterprises;
– 13.1% (or 4,882 cases) have to do with individual entrepreneurs;
– 5% (or 800 cases) have to do with agricultural producers;
– 1.4% (or 224 cases) have to do with financial institutions.

2011 – 6,955)[1]. The changes in these indices that occurred over the period of 1998–2010 are shown in *Fig. 12*.



Sources: Statements prepared by the Supreme Arbitration Court of the Russian Federation concerning the consideration, by the arbitration courts of subjects of the Russian Federation, of insolvency (bankruptcy) cases in the period of 1998–2010.

Fig. 12. Changes in the Number of Decisions on Bankruptcy Petitions over the Period of 1998–2010

The surges in the number of bankruptcy cases in 2002 and 2006 and its growth in 1998–2002 (analyzed previously elsewhere)[2] resulted from the government's activity in connection with the need to 'clear the field' of effectively abandoned enterprises through recognizing the absent debtors to be bankrupt and allocating the necessary budget funding to the achievement of that goal.

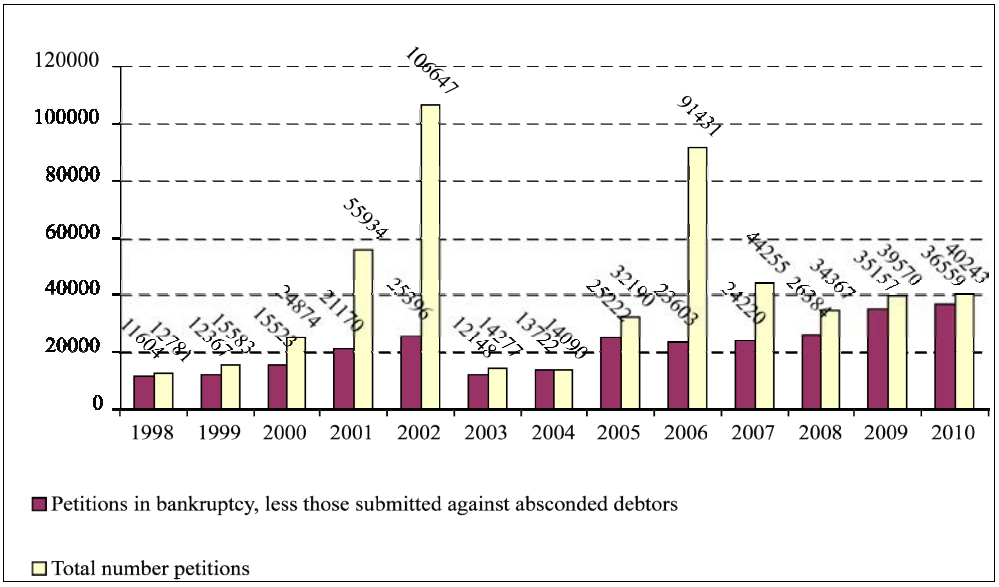
The years 2009–2010 saw a continuation of the growth (since 2008) of both the overall number of submitted petitions in bankruptcy (2008 – 34.4 thousand; 2009 – 39.6 thousand; 2010 – 40.2 thousand) and the number of petitions submitted with regard to substantive debtors[3] (in 2008 – 26.4 thousand; in 2009 – 35.2 thousand; in 2010 – 36.6 thousand). Thus, over the period of 2009–2010 *the number of petitions in bankruptcy filed against substantive debtors rose by 38.6%*, while the overall growth in the number of petitions in bankruptcy amounted to approximately 17.1%. The peak of growth was observed in 2009. The data on the bankruptcies of 'substantive' debtors for 2011 are not yet available, but it can be reasona-

[1] Statement on the consideration, by the arbitration courts of the Russian Federation, of insolvency (bankruptcy) cases in 2008–2010; in the first half-year 2011 – see www.arbitr.ru

[2] *Ekonomika perekhodnogo perioda. Ocherki ekonomicheskoi politiki postkommunisticheskoi Rossii 1998–2002*. [The Economy in Transition. Essays on the Economic Policy in Post-Communist Russia of 1998–2002.] M.: IET, 2003, p. 505; *Ekonomika perekhodnogo perioda. Ocherki ekonomicheskoi politiki postkommunisticheskoi Rossii* 2000–2007. [The Economy in Transition. Essays on the Economic Policy in Post-Communist Russia of 2000–2007.] M.: IET, 2008, p. 473.

[3] Substantive debtors are understood to be all the debtors less absconded ones.

bly assumed that this index is going to decline in accordance with the general downward trend displayed by the number of bankruptcy proceedings. The dynamics of the number of petitions to recognize 'substantive' debtors to be insolvent (or bankrupt) over the period between 1998 and 2010, set against that of the overall number of petitions in bankruptcy, can be seen in *Fig. 13.*



Sources: Statements concerning the consideration, by the arbitration courts of subjects of the Russian Federation, of insolvency (bankruptcy) cases over relevant periods; analytical notes to the statistical reports on the operation of the arbitration courts of the Russian Federation over relevant periods, prepared by the Supreme Arbitration Court of the Russian Federation.

Fig. 13. The Number of Petitions for Recognizing a Debtor to Be Bankrupt Submitted in 1998–2010

2. *A diminishing influence of government policy measures on the dynamics of bankruptcies*, including the regulatory activity of tax agencies relating to the recognition of debtors to be bankrupt[1]. Thus, while in 2008 more than 67% of petitions in bankruptcy were submitted by relevant empowered agencies (in the main tax agencies), in 2010 the share of indices belonging to that group dropped to 39.2%.

Against the backdrop of both general growth and the increasing frequency of the application of bankruptcy procedures in some segments, an opposite trend was displayed by the number of bankruptcies of agricultural producers, which declined by more than 5 times between 2006 and 2010 (in 2006 – approximately 4,000 bankruptcies; in 2007– 2,465; in 2008 – 1,614; in 2009 – 1,036; in 2010 – 800). This was the result of the government's agricultural support measures that involved broader crediting, restructuring of tax liabilities, and allocation of dotations to cover purchases of petrol, oil and lubricants, etc.

[1] On the impact of the activity of government agencies in the sphere of legal entity liquidation on the general trends in the bankruptcy sphere, see Apevalova E. A., Radygin A. D. *Bankrotstva v 2000-e gg.: ot instrumenta reiderov k politike "dvoinogo standarta"*. [Bankruptcies in the 2000s: from Raiders' Instrument to "Double Standard" Policy] – *Ekonomicheskaia politika* [Economic Policy], August 2009.

At the same time, bankruptcy indices were increasing elsewhere: thus, for example, the number of bankruptcies of individual entrepreneurs more than doubled over the period of *2007–2009 by comparison with the previous years:* in 2004–2006 there were 200–700 bankruptcies per annum; in 2007 – 2,478; in 2008 – 4,751; and in 2009 – 5,423). In 2010 there occurred a certain decline to a total of 4,882 bankruptcy cases (by 10% on 2009).

3. *A more noticeable activity of creditors, from the year 2009 onward, in the sphere of protection of their interests in the framework of bankruptcy procedures, and in 2010 – also in the initiation of bankruptcy proceedings*.

Thus, over the period of 2009–2010, the number of applications, disputes, complaints and petitions files in the framework of *bankruptcy* procedures effectively *doubled*: from 111,521 in 2008 to 232,845 in 2010; the rate of growth of opened and considered bankruptcy cases was noticeably lower. The main reason for that growth was the considerably increased number of petitions filed with courts in connection with failures to comply with and violation of contractual obligations; the general economic situation; as well as changes in bankruptcy legislation in the part of granting some new rights to the participants in bankruptcy proceedings. In particular, this had to do with the right to dispute the transactions carried out by a debtor; the right to bring the persons and entities controlling a debtor to subsidiary responsibility; the right to submit a petition concerning the intention to redeem claims relating to mandatory payments, etc.[1] In the first half-year 2011, this index became somewhat adjusted by dropping by 10.9% on 2010.

Besides, the year 2010 saw a rise of 31.7% on 2009 in the number of petitions submitted on behalf of creditors in bankruptcy, which in 2010 amounted to 39.1% of the total number of petitions. The share of petitions filed by debtors shrank from 23.1% in 2009 (9,145 petitions) to 21.7% in 2010 (8,727 petitions)[2].

4. *In the period of 2010–2011 there emerged an upward trend in the number of concluded amicable agreements, financial recoveries of enterprises and external management procedures.*

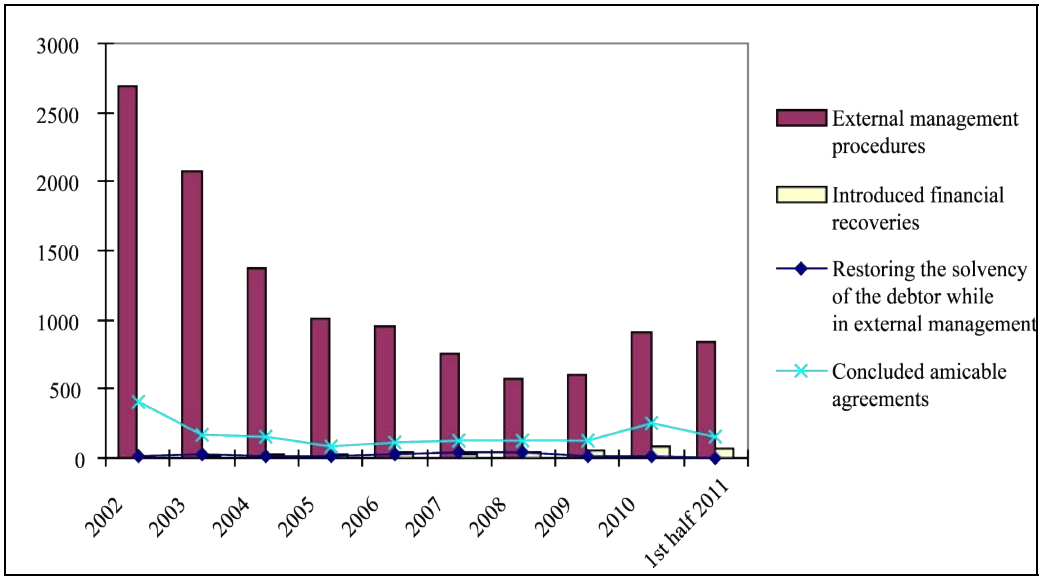
Thus, while the level of solvency recovery of enterprises as a result of the imposition of external management was traditionally low, the number of external management procedures actually effectuated in the first half-year 2011 rose by 30.9% on 2010 (839 in the first half-

[1] Out of 232.8 thousand of applications, disputes, complaints and petitions, 165 thousand (or 70.1%) is constituted by documents concerning the determining the amount of creditor claims. That index also significantly rose on 2008 (by 2.4 times: in 2008 – 67.6 thousand), while the number of petitions concerning the dismissal of an arbitration commissioner was no longer declining, and in 2010 it even slightly increased – to 13,416 (or to 5.8% of the total number of applications, disputes, complaints and petitions).
As follows from statistical data, the number of creditor complains concerning the violation of their rights and lawful interests considered in 2010 rose on 2009 by 73.5%. The number of petitions concerning the determining of the amount of creditor claims increased by 33.2%; and the number of petitions concerning prolongation of a bankruptcy proceeding increased by 27.5%.
The bulk (62.4% of the total number) of petitions, applications and complaints were considered by courts in the phase of a bankruptcy proceeding. In the phase of supervision, 33.4% of the petitions were considered. The number of petitions considered during external management procedures nearly tripled, increasing from 2,158 to 5,749.

[2] Here and throughout the text bankruptcy statistics are taken from *Analiticheskaia zapiska k statisticheskomu otchetu o rabote arbitrazhnykh sudov Rossiiskoi Federatsii v 2010* [Analytical Note to the Statistical Report on the Operation of the Arbitration Courts of the Russian Federation in 2010], pp.16–19.

year 2011 against 641 over the same period of 2010). The period of 2002–2008 had been characterized by a 5-fold drop in the number of external management procedures.

The dynamics of the number of external management procedures, financial recoveries and amicable agreements in 2002 and the first half-year 2011 is shown in *Fig. 14.*



Source: Statement on the consideration, by the arbitration courts of subjects of the Russian Federation, of insolvency (bankruptcy) cases in 2006–2010 and the first half-year 2011.

Fig. 14. The Dynamics of the Number of External Management Procedures, Financial Recoveries and Amicable Agreements over the Period of 2002 – First Half-year 2011

By all indications, the year 2011 saw a historic high of the number of concluded amicable agreements for the entire period of 2002–2011, which amounted to approximately 300. That year would have also seen a peak in the number of cases when financial recovery procedures were applied. In the first half-year 2011, 76 such cases were already registered, which is by 13.4% higher than the previous historic high of 67 cases achieved in the same period of 2010.

The ongoing (for two years in a row) growth in the number of concluded amicable agreements and actually introduced financial recovery and external management procedures was triggered, for the most part, by the tax innovations introduced in 2010; by the increased opportunities for applying installment plans and delays in redeeming the accumulated arrears of mandatory payments, and for writing off uncollectable payables; as well as by the innovations designed to prevent bankruptcies of financial institutions (including insurance organizations) and to regulate the special bankruptcy procedures established for independent (non-state) pension funds, professional participants of the securities market, and asset managers of investment funds and mutual investment funds.

6.4.2. Bankruptcy Legislation in 2009–2011

The global economic crisis acted as an external stimulus for the implementation of some long-due alterations and the abandonment of the formerly inertia-based policy of the Russian government in the field of bankruptcy. Another reasons for an upsurge in the lawmaking ac-

tivity in that direction were the mounting payables owed by some of Russia's biggest banks, loans issued to some big companies against their assets and the deterioration of the financial indices of many of those companies, and the anticipated growth in the number of bankruptcies of enterprises in 2009–2010.

In order to correctly estimate the latest innovations introduced in the bankruptcy field with regard to certain specific sectors of the economy, it is important to understand the status of and the situation faced by the relevant objects of regulation.

According to a study undertaken by the All-Russian Public Opinion Research Center (*VTsIOM*) and the Deposit Insurance Agency, in 2010, 40% of Russians, or about 40 m persons, had a deposit or account with one or other bank. For more than 57% of citizens, the most important criterion when selecting a bank was whether or not it was state-owned[1]. In 2009 and 2010, the number of banks was falling due to the imposition, by the RF Central Bank, of more rigorous standards for credit institutions. As a result, in 2009, 44 banks had their licenses recalled, and in 2010, 28 more credit institutions were liquidated[2]. More than 50% of the banking system is directly or indirectly controlled by the State. Thus, on the one hand, the State has clearly embarked on a process of creating a fully-fledged banking system, while on the other hand, it is taking measures designed to protect depositors' interests.

In the last few years, the number of insurance organizations was decreasing by approximately 10 to 12% per year (as of the end of 2010, Russia had 618 insurance organizations registered in the *Unified State Register of Insurance Entities*; as of the end of 2009, their number was 702; and as of the end of 2008, it was 779)[3]. The introduction, in 2010, of more stringent equity capital requirements for insurance organizations, and the intensification of competition will be conducive to consolidation of the insurance market. According to some forecasts, between 200 and 250 insurance companies will be liquidated. Over the next five years, the share of Russia's top twenty companies in total premium volume will increase from 69 to 80-85%, while that of the top ten companies – from 55 to 65-70%[4]. At the same time, the compulsory motor-vehicle liability insurance *OSAGO* and the voluntary motor-vehicle insurance *KASKO* still represent the largest segments of the insurance market.

Russia's non-state pension funds (hereinafter NSPF) have rather successfully survived the acute phase of the crisis. Their 2010 results had more than compensated for their losses in 2008. However, according to the Expert RA rating agency, the gap between the yield on the placement of pension reserves and inflation, accumulated over the past 5 years, remains no less than 10 to 15 p.p. This means that the issue of assets' depreciation in real terms remains high on the agenda. The resolution of that issue can be brought about through upgrading the pension funds' investment policy[5].

---

[1] Ye. Kukol. *Stavki katiatsia vniz.* [The Rates are Tumbling Down] // *Rossiskaia Gazeta* – Stolichnyi Vypusk [The Russian Gazette – Moscow Issue]. No 5166, 23 April 2010.

[2] On the liquidation of credit institutions (as of 1 January 2011) – www.cbr.ru

[3] *Igroki strakhovogo rynka i ikh kapitaly*. [Players of the Insurance Market and Their Finances] – www.allinsurance.ru, 14 February 2011.

[4] The Marillion company's forecast of the insurance market's development. www.allinsurance.ru, 20 December 2010.

[5] In Q4 2010, the NSPF's assets increased by a staggering $ 30-35bn. The key factor of that surge in assets was the considerable rise in the stock market (thus, in the course of the afore-said period the MICEX Index grew by 18%). According to the Expert RA rating agency, the volume of pension reserves and pension savings rose to Rb 790-800bn. By the end of 2011, the NSPF's aggregate assets are likely to rise to Rb 1.5-1.2 trillion, depend-

In 2009, the NSPFs managed to occupy the central niche in the trust management market, where they now accounted for up to 40% of operations carried out by asset management companies (AMC). It should be said that the market did not suffer even a single major bankruptcy, while the State totally refrained from giving any assistance to the system. Nevertheless, the NSPFs still have to deal with such issues as the wide-spread dishonesty of their agents, and the necessity to increase people's trust in the system, to create compensatory mechanisms, to establish a single concept of market development, etc.[1]

In the next three years a stable growth and consolidation of the market can be expected: 69% of participants in the opinion poll conducted by Expert RA Rating Agency are anticipating that, towards the end of 2012, the volume of the NSPF market will exceed Rb 1.5 trillion (which means that it will have more than doubled over 3 years). At the same time, 72% of the respondents believe that more than 90 funds will remain on the market (and 39% think that their number will be no more than 70). However, this does not mean that the potential for NSPF growth will be exhausted – 68% of participants in the survey expect that no more than 7m insured persons are going to transfer their pension savings into these funds[2].

Over the past decade, the securities market has been experiencing a rapid growth of quotations coupled with an increasing interest in that market displayed by private investors. As of 1 September 2006, 1,402 organizations were operating as professional securities market participants under broker licenses; 1,410 organizations held licenses of professional securities market participants authorized to operate as dealers; 1,048 organizations held licenses of professional securities market participants for the conduct of trust management; 9 organizations held licenses for the conduct of clearing activities on the securities market; 748 organizations operated under professional securities market participant licenses for depositary operations; 77 organizations operated under licenses to run registers; 5 organizations held licenses for organizing trade in the in the securities market; and 6 organizations held licenses to operate a stock exchange[3].

The number of companies – professional participants of the securities market and the collective investments market in recent years has been displaying a gradual downward trend, which is going to continue. First of all, the number of professional securities market participants will be declining in response to the coming in force, from 1 July 2010, of alterations introduced in the specifications of sufficiency of own funds for professional participants in the securities market and the asset managers of mutual investment funds and independent pension funds[4]. The tougher requirements established by the regulator will result in either

ing on the market situation. See *Itogi 2010 na rynke NPF: v poikakh effektivnosti* [2010 NSPF market results: a quest for efficiency] - www.raexpert.ru

[1] *Krizis proshol – riski ostalis'*. [The Crisis Is Over – The Risks Are Still There.] An Overview by the Expert RA Rating Agency of the NSPF Market Based on the Results of the Year 2009. – see www.raexpert.ru

[2] *Solidarnost' v detaliakh i voprosy po sushchestvu. Resul'taty oprosa reguliatorov finansovogo rynka, top-menedzherov negosudarstvennynkh pensionnykh fondov i upravliaiushchikh upravliaiushchukh kompanii na konferentsii 'Budushchee pensionnogo marketa'* [Solidarity in Details and Some Essential Issues. Results of Surveys of Financial Market Regulators, Top Managers of Non-State Pension Funds and CEOs of Asset Managers at the Conference *The Future of Russia's Pension Market*]. See www.raexpert.ru

[3] Sovershenstvovanie nadzora na finansovom rynke Rossii [Improving Russia's financial market supervision] – see www.raexpert.ru

[4] Thus, from 1 July 2010 onwards, the professional participants in the securities market engaged in dealer and (or) broker operations, as well as securities management, must possess a charter capital in the amount of no less than Rb 35m, and from 1 July 2011 onwards – Rb 50m.

these companies being ousted from the market and then liquidated, or in their merger with some other structures.

The years 2003–2007 saw a robust development of mutual investment funds (hereinafter MIF) against the backdrop of the then favorable macroeconomic situation. Thus, the volume of aggregate net assets over that period increased more than 35 times (Rb 11.7bn as of 1 January 2003, and up to Rb 420.5bn as of 1 January 2007). According to the National League of Management Companies, as of 29 August 2008 the number of functioning MIFs was 1,058; the number of MIFs being created was 19; the number of asset managers (AM) was 287; net asset value (NAV) of all Russian MIFs amounted to approximately Rb 507bn, of which that of close-end funds amounted to Rb 365bn; that of open-end funds amounted to Rb 104bn; and that of interval unit investment funds amounted to Rb 38bn. As for the situation in 2008–2010, we may describe it as follows:

- a stable decline in the net asset value of MIFs and asset managers from May 2008 through December 2009 by nearly 44.4% (from Rb 552.81bn to Rb 307.4bn respectively);
- growth in the number of MIFs, from 1 January 2009 through 1 January 2010, by more than 19% (from 1,050 to 1,252 respectively);
- considerable growth in the number of asset managers, from 1 January 2009 through 1 January 2010, by more than 4.8 times (from 68 to 328).

According to a survey of 2,000 developers carried out by the Association of Russian Builders in 2009, two-thirds of Russia's building companies were either on the verge of bankruptcy or had already gone bankrupt. This circumstance was fraught with serious danger not only for one of Russia's most important industries, but also for the social and economic right of investors (individuals and organizations alike).

Thus, the State's innovations in the field of prevention and introduction of a special bankruptcy procedure clearly represent, on the one hand, instruments for regulating consolidation and liquidation processes in the corresponding markets, and a means for preventing the negative social consequences of these developments.

The further course of bankruptcy legislation development, centered on the idea of *creating favorable conditions for satisfaction of the creditors' interests and for improvement of their rights' protection*, was determined by two factors. The first factor was the State's decision to provide assistance to the banking sector, and to take measures designed to preserve the stability of that sector, including by creating conditions for keeping banks' bad loan levels low. The second factor was large-scale irregularities in repayments under loan agreements. The idea itself can be deemed to be both an anti-crisis decision (because 40% of Russian citizens have bank deposits) and a decision that satisfies the interests of the currently strong financial

The companies operated under a license to provide depositary services unrelated to security settlements effectuated through organizers of trading in the securities market or through entities authorized to execute depositary operations on behalf of investment funds (MIFs and NSPFs) – Rb 60m, and from 1 July 2011 onwards – Rb 80m.

For market participants engaged in clearing activities and trading in the securities market – Rb 80m, and by 1 July 2011 – Rb 100m. The size of the charter capital of companies providing services of running registers of securities holders – Rb 100m, and from 1 July 2011 – Rb 150m; of stock exchanges – Rb 150m, and from 1 July 2011 – Rb 200m. The specifications of sufficiency of own funds for asset managers of investment funds, mutual investment funds and non-state pension funds established from 1 July 2010 envisage the floor of Rb 60m, and from 1 July 2011 – Rb 80m. – *Chislo professional'nykh uchastnikov rynka tsennykh bumag okruga snizhaetsia, I eta tendentsiia sokhranitsia*. [The Number of the District's Professional Securities Market Participants is Declining, and This Trend is Bound to Persist]. – http://www.verbacapital.ru, 21 September 2010.

lobby. Most likely, some combination of all these aspects was taken into account by the authorities before making the afore-said decision.

Within the framework of implementation of that idea, Russia adopted Federal Law, of 30 December 2008, No. 296-FZ, '*On the Introduction of Alterations in the Federal Law 'On Insolvency (Bankruptcy)*" and Federal Law, of 28 April 2009, No. 73-FZ '*On the Introduction of Alterations in Some Legislative Acts of the Russian Federation*'. Those alterations were designed to *increase the transparency of bankruptcy proceedings*, mainly by changing the rules regulating the activities of arbitration commissioners and their self-regulatory organizations (SROs); *by increasing their responsibility*; and by introducing a number of other innovations.

1. Arbitration Commissioners

Firstly, the new laws *have raised the level of responsibility* of arbitration commissioners. The non-performance or improper performance by an arbitration commissioner of his or her duties, including those envisaged by federal standards, now constitutes a ground for his or her being removed from the process of management, which is to be carried out by one or other arbitration court on demand of the persons taking part in the bankruptcy case. Also, the procedure for implementing the decision on an arbitration commissioner's disqualification is now specified in detail[1].

Secondly, the introduced alterations have changed the system of commission-fee payments to an arbitration commissioner and the persons invited thereby to render their services in the course of the bankruptcy process. The newly introduced mechanism of commission-fee payments is designed to stimulate an arbitration commissioner's activity on behalf of the creditors. It envisages that the commission fee of an arbitration commissioner should be fixed at 15 to 45 thousand rubles per month[2], depending on which stage of bankruptcy process management is conducted, and that an additional payment can be made to an arbitration commissioner on the creditors' initiative[3].

The amount of money that may be spent by an arbitration commissioner on the services of specialists invited by him or her is also subject to detailed regulation, and depending on the size of the balance sheet value of the debtor's assets it may be equal to 10% of the value of assets from Rb 200,000 to Rb 2,995,000; and to 0.01% of sums in excess of Rb 1bn, if asset value is above Rb 1bn[4]. Also, the size of payments for such services, as it is determined by

[1] Later on, in December 2010, it was established, by Federal Law No. 429-FZ, of 28 December 2010, *'On the Introduction of Alterations in the Federal Law 'On Insolvency (Bankruptcy) and on the Invalidation of Parts 18, 19 and 21, Article 4 of the Federal Law 'On the Introduction of Alterations in the Federal Law 'On Insolvency (Bankruptcy''*, that requirements to the property liability of arbitration commissioners for the non-performance or improper performance of their duties could be extended by the inclusion of federal standards professional activity standards and regulations. Data from the Register of Disqualified Arbitration Commissioners should be entered in the Unified Federal Register of Bankruptcy Information.

[2] This amount can be increased by a court decision on the petition filed by participants in a bankruptcy case.

[3] For more details, see Items 10-14, Article 20.6 of the Federal Law '*On Insolvency (Bankruptcy)*'.

[4] In July and December 2009, the size of interest payments due to arbitration commissioners and the size of payments for the services rendered by the persons invited by an arbitration commissioner were slightly changed. For more details, see Items 10 and 11, Article 20.6 and Item 3, Article 20.7 of the Federal Law *'On Insolvency (Bankruptcy)'* as amended by Federal Law of 17 December 2009, No. 323-FZ, '*On the Introduction of Alterations in Articles 20.6 and 20.7 of the Federal Law 'On Insolvency Bankruptcy)' and Article 4 of the Federal Law 'On the Introduction of Alterations in the Federal Law on Insolvency (Bankruptcy)'*.

the law, and the payments themselves can be recognized as unjustified on the basis of a petition filed by the persons taking part in the bankruptcy case, if such services are not related to the aims of the ongoing bankruptcy proceedings or to the duties imposed on the persons invited by the commissioner in bankruptcy, or if the size of payments for such services is '*clearly not proportionate to the expected result*'.

Thirdly, the new legislation has extended the duties of arbitration commissioners in the part of provision of information to participants in bankruptcy proceedings: to the creditors – with regard to the transactions and actions that will entail or can entail the civil liability of third parties, and with regard to the revealed indications of fraudulent bankruptcy; and to the corresponding government agencies – with regard to the revealed administrative violations and crimes.

Fourthly, the new laws *have introduced rigid requirements to the compulsory liability insurance contracts concluded by arbitration commissioners*. The law has defined the objects of compulsory insurance, the insurance event and the insurance risks under liability insurance contracts, and has defined the procedure for the effectuation of payments due under such contracts. In July 2009[1], the amounts of insurance payments to be due under the contracts concluded by arbitration commissioners were slightly reduced.

2. Self-Regulatory Organizations (SROs) of Arbitration Commissioners

Firstly, the new laws *have extended the powers and increased the responsibility of self-regulatory organizations (SROs) of arbitration commissioners*. Thus, starting in 2009, these SROs have been granted the right to issue accreditation to the insurance organizations, valuators, and professional securities market participants that are involved in the maintenance of a register, as well as to other persons invited by arbitration commissioners within the framework of implementation of their duties in the course of one or other bankruptcy case. Also, the SROs in question are obliged to develop standards and rules for arbitration commissioners' activities and to supervise their implementation, as well as to make sure that commissioners in bankruptcy duly observe all the requirements concerning compulsory liability insurance.

In December 2010[2], SROs of arbitration commissioners were also authorized to issue accreditation to electronic trading floor operators who organize bidding for the sale of debtors' property.

Secondly, the new legislation has established that *self-regulatory organizations of arbitration commissioners should be obliged to disclose data on their activities*, including the data concerning their compensation funds; asset managers; and all the instances of disciplinary measures being applied against arbitration commissioners.

Thirdly, *the new legislation has established the procedure for the use, by SROs of arbitration commissioners, of their compensation funds, from where payments to debtors are made*: the procedure for presenting claims with regard to compensatory payments; the timelines for making compensatory payments; the conditions for the placements of monies held in a compensation fund; the asset manager's responsibilities; the procedure for transfer of the monies

[1] For more details, see Item2, 2 Article 241 of the Federal Law '*On Insolvency (Bankruptcy)*' as amended by Federal Law of 19 July 2009, No. 195-FZ.

[2] By Federal Law of 28 December 2010, No. 429-FZ 'On the Introduction of Alterations in the Federal Law "On Insolvency (Bankruptcy)" and Recognizing as Null and Void Parts 18, 19 and 21 of Article 4 of the Federal Law "On the Introduction of Alterations in the Federal Law 'On Insolvency (Bankruptcy)".

held in a compensation fund to the national association of arbitration commissioners when the information on a self-regulatory organization is struck off the register.

Fourthly, *the government's control over the activity of SROs of arbitration commissioners has been* toughened. The control functions delegated to the Federal Service of State Registration, Cadastre and Cartography (*Rosreestr*, formerly *Rosregistration*) were strengthened through giving the Service some additional powers:

- the right to initiate proceedings against an arbitration commissioner, a self-regulatory organization of arbitration commissioners and (or) that organization's official in an event of their having committed an administrative violation, and to consider that case or to refer it for consideration to an arbitration court;
- the right to enter information on not-for-profit organizations in the Unified State Register of Self-Regulatory Organizations of Arbitration Commissioners and to take part in its maintenance;
- the right to establish the status of the association of self-regulatory organizations of arbitration commissioners as a national one;
- and some other powers.

In an event of a failure of a SRO of arbitration commissioners to comply with the instructions issued by the controlling (or supervisory) agencies with regard to correcting relevant violations committed in the process of elaborating standards and operative rules, or dealing with complaints submitted with regard to certain actions committed by that organization's members, representatives of the government agency are obliged to apply to an arbitration court with a petition that the relevant organization be struck off the *Unified State Register*.

3. Other Measures

1. The desire to achieve the maximum degree of satisfaction of creditors' claims was the reason for *the introduction of a number of mechanisms for disputing transactions aimed at withdrawal of a debtor's assets* – 'suspicious transactions' and 'deals that result in preference being given to one creditor at the expense of another'. In fact, that was the first time in five years when the State adopted some legislative measures designed to narrow the 'grey field' in the field of bankruptcy regulation.
2. Then, *responsibility of the debtor's owners is established.* For the first time, alongside the aforesaid persons, real owners – 'the persons controlling a debtor', understood to be those persons that have possessed, during a period of less than two years prior to the petition in bankruptcy being submitted against the relevant debtor to an arbitration court, the right to issue to that debtor instructions that had to be complied with, or in any other way determine the debtor's actions, – can be brought to subsidiary responsibility[1].

[1] A debtor's actions may be determined by a controlling person, including by means of coercing the director or members of the board of directors of a debtor organization, or by exerting a leading influence on the said director or members of the board of directors in another way (in particular, the persons that control a debtor may be the members of a liquidation commission; or a person authorized on the basis of a power of attorney, a normative legal act, or special authorization to conclude transactions on behalf of the debtor, or a person empowered to dispose of 50% or more of voting shares in a joint-stock company, or more than half of the charter capital of a limited liability company). Federal Law of 28 April 2009, No. 73-FZ '*On the Introduction of Alterations in Some Legislative Acts of the Russian Federation*'.

The possibility to actually bring such persons to responsibility is doubtful – given the fact that very often the real owners and beneficiaries of valuable Russian assets cannot be identified even in the course of criminal investigation.

The responsibilities of the directors and owners of credit institutions arising in an event of the situation of imminent bankruptcy are determined, as well as some new sanctions to be applied against them, including a 10-year ban forbidding such persons to acquire shares in credit institutions in an amount of more than 5%, and a three-year ban forbidding them to occupy the post of director of a credit institution.

3. *The possibility for a closed sale of debtor assets has been narrowed.* Elaborate legislative regulations have been introduced with regard to the procedure for the sale of an enterprise, these rules being also extended to the sale of a debtor's property or part of that property (Articles 110, 111 and 139 of the Federal Law 'On Insolvency (Bankruptcy)'). While the possibility of a closed sale of assets has been preserved, that sale now being termed 'bidding with sealed price proposals', numerous necessary technical innovations are introduced (the definition of the procedure for submitting an application for the participation in bidding and the requirements for such an application; the requirements to the conclusion of the contract of purchase and sale of an enterprise; the scope of open information concerning the process of sale of an enterprise has been increased, etc.).

The procedure for a formally open bidding has been proclaimed, but the practice of selling debtor's assets to 'VIP' buyers (even under a somewhat limited scenario) will continue, especially if one takes in consideration the increasing pressure exerted by the State on arbitration commissioners whose role, in fact, is to actually organize the bidding or to attract a third organization specifically to perform that function.

In addition to those procedures, a bankrupt enterprise may now be sold at an auction or through a tender – in those cases when the buyer must comply, in regard of a given enterprise, with the conditions set by a creditor committee or a creditor meeting.

As an improvement on the existing procedure one may regard the introduction of *an online bidding procedure with regard to a bankrupt enterprise*. By Order of the RF Ministry of Economic Development of 15 February 2010, No. 54 the following procedures and requirements are approved:

- the procedure for an online open bidding for a debtor's estate (or an enterprise) to be sold in the framework of a bankruptcy proceeding;
- the requirements to the online auction floors and operators of online auction floors relating to open online bidding for a debtor's estate (or an enterprise) to be sold in the framework of a bankruptcy proceeding;
- the procedure for confirming the compliance of online auction floors and operators of online auction floors with the established requirements.

Besides, the *Unified Federal Register of Bankruptcy Information* has been created that contains and makes public a broader spectrum of issues relating to the conduct of procedures applied in bankruptcy cases (concerning the initiation of each proceeding in bankruptcy; the conduct of bidding on the sale of property of debtors and the results of biddings; the suspension or dismissal of arbitration commissioners, etc.).

In December 2010, the Federal Law regulating the procedure for the creation and functioning of the Register was signed [1]. Thus, in particular, the creation and functioning of the Unified Federal Register of Bankruptcy Information is to be effectuated by the operator of the Unified Federal Register of Bankruptcy Information, that operator being a legal entity registered in the territory of the Russian Federation and in possession of appropriate technical appliances enabling the said operator to ensure the creation and keeping of the said Register in an electronic form, and also an entity selected specifically for the performance of the said functions by the regulatory agency.

The procedure for selecting the operator of the Unified Federal Register of Bankruptcy Information is to be confirmed by the regulatory agency and must ensure the possibility of participating in the selection procedure of all the entities that comply with the criteria established by the regulatory agency. Alongside the information that will have to be published under the Federal Law, the Unified Federal Register of Bankruptcy Information should also incorporate certain other types of information, the list of which is to be established by the regulatory agency.

The reliability of the information on a given debtor as of the moment of it being entered in the Unified Federal Register of Bankruptcy Information is to be checked by an operator of the Unified Federal Register of Bankruptcy Information by means of comparing it with the information contained in the Unified State Registere of Legal Entities and/or the Unified State Register of Individual Entrepreneurs.

The information to be published under the bankruptcy law is to be entered in the Unified Federal Register of Bankruptcy Information from 1 April 2011[2].

In July 2009[3], the status of creditors in the framework of proceedings in bankruptcy was further strengthened.

Firstly, *the distribution of responsibility and the powers with regard to the sale of enterprises were defined more precisely*: from now on, it has been consolidated in legislation that the functions of the organizer of bidding are to be performed by an external manager; the procedure and conditions for the conduct of bidding are not to be determined in advance by a creditors' committee, as it happened earlier, but are to be approved on the basis of an application submitted by an external manager. In this connection, the terms for the sale of a debtor's estate have been expanded and further specified, and in addition these terms have to be coordinated with the arbitration commissioner, or a creditor committee, or a creditor meeting. Among these terms are, for example, the composition of the estate; the form of bidding (an auction or a tender); the terms of the tender, the form of presenting the proposal of price (close or open); and the starting price of the estate; the mass media organs where the announcements of the bidding are to be published (Item 1 of Article 139 of the Federal Law *'On Insolvency (Bankruptcy)'*).

Thereby, the level of debtor-creditor asset sale transparency was increased, while opportunities for abuse on the part of arbitration commissioners, including by restricting access to auctions by pooling (when assets are grouped into large auction lots); and by publishing up-

[1] Federal Law of 28 December 2010, No. 429-FZ *'On the Introduction of Alterations in Federal Law "On Insolvency (Bankruptcy)" and Recognizing as Null and Void Parts 18, 19 and 21 of Article of the Federal Law "On the Introduction of Alterations in the Federal Law 'On Insolvency (Bankruptcy)'"*.

[2] Item 2 of Article 4 of Federal Law of 28 December 2010, No. 429-FZ.

[3] Federal Law of 19 July 2009, No. 195-FZ *'On the Introduction of Alterations in Some Legislative Acts of the Russian Federation'*.

coming auction announcements in small-circulation newspapers and magazines and then buying out all the copies, etc.

Secondly, a number of *innovations relating to the satisfaction of creditor claims secured by a pledge* were adopted. This enables an arbitration court to determine both the process and conditions of sale of the subject of pledge, should any differences arise between the commissioner in bankruptcy and a creditor in bankruptcy with regard to the liabilities secured by the pledge. And this means that, in the event of a repeat auction being declared as having failed, such creditor is now endowed with the right to retain the subject of pledge, valuing it in an amount which must be 10% lower than its initial selling price at the repeat auction. Moreover, this means that the creditor is not to take advantage of the right to retain the subject of pledge, and the latter can be sold by way of public sale (Items 4, 4.1 of Article 138 of the Federal Law 'On Insolvency (Bankruptcy)').

The adopted legal norms represent a natural continuation of the previous innovations introduced in the field of civil law that made it possible for ownership of the subject of pledge to be transferred to the pledgeholder without resorting to judicial proceedings[1]. These innovations make it possible for pledgeholders, of which banks with high degree of state control constitute the majority, to provide solutions to that problem by applying lawful methods.

Thirdly, the *extension of tax norms to the regulation of relations pertaining to settlements with regard to mandatory payments* (paragraph 2 of Item 3 of Article 84; paragraph 2 of Item 2 of Article 194 (in regard of strategic enterprises) of the Federal Law 'On Insolvency (Bankruptcy)') was abolished. The abolition of that norm is conducive to a more frequent application of the instruments of amicable agreements and financial recovery of enterprises.

In Aprile 2010,[2] *large-scale innovations were introduced that were designed to prevent bankruptcies of financial institutions (including insurance companies), as well as to regulate the special procedure for the conduct of bankruptcy proceedings against non-state pension funds, professional securities market participants and the asset managers of investment and mutual investment funds.*

On the whole, these innovations were based on the model of financial recovery and interim management regulation initially stipulated in Federal Law of 25 February 1999, No. 40-FZ 'On the Insolvency (Bankruptcy) *of Credit Institutions'*, which was now substantially expanded to encompass a broader range of issues to be regulated and the categories of persons to which these new legal norms were to be applied.

The range of persons that were to be subject to the new special bankruptcy norms was expanded to include asset managers of investment funds, mutual investment funds, and non-state pension funds, which under the new law were placed in the category of financial institutions.

The range of issues to be regulated encompasses measures designed to prevent bankruptcies of financial institutions similar to the measures for financial recovery of credit institu-

[1] Federal Law of 30 December 2008, No. 306-FZ '*On the Introduction of Alterations in Some Legislative Acts of the Russian Federation in Connection with Improving the Procedure for Levying Execution on Pledged Property'*.

[2] Federal Law of 22 April 2010, No. 65-FZ "*On the Introduction of Alterations in the Law of the Russian Federation 'On the Organization of Insurance Business in the Russian Federation' and Some Legislative Acts of the Russian Federation"*.

tions[1]: the provision of financial aid to an organization by its founders; alterations introduced in the organization's structure of assets and liabilities; reorganization and other measures that are not forbidden by legislation (Article 183.1 of the Federal Law 'On Insolvency (Bankruptcy)').

In an event when proper grounds arise for applying the measures designed to prevent bankruptcy of a financial institution, the said institution is obliged to approve and submit to the controlling agency – the RF Central Bank – a plan for restoring its solvency, including an analysis of its financial situation, a list of measures to be implemented in order to prevent its bankruptcy, and the timelines for their implementation that should not exceed a period of 6 months.

The grounds for implementing the measures designed to prevent bankruptcy of a financial institution are as follows (Article 183.2 of the Federal Law 'On Insolvency (Bankruptcy)'):

1) multiple refusals, within the period of one month, to satisfy the claims of creditors in regard of financial liabilities;
2) failure to fulfill obligations in regard of mandatory payments within the period of more than 10 working days from the date established for the execution of those payments;
3) insufficiency of available cash for timely fulfillment of financial liabilities and (or) obligations in regard of mandatory payments, if the fulfillment of such liabilities and (or) responsibility is already due.

In each of the aforesaid cases the financial institution is obliged to submit to the controlling agency, within 15 days, a notification with an attached plan for restoring its solvency (if any indicia of bankruptcy in this connection are absent).

Within 30 working days, the controlling agency must make the relevant decision concerning the introduction of interim management of the financial institution, or lack of feasibility of introducing interim management.

Interim management is introduced in the following instances:

1) the controlling agency reveals the instance of multiple refusals, within the period of one month, to satisfy creditors' claims in regard of financial liabilities; or failure to fulfill obligations in regard of mandatory payments within the period of more than 10 working days from the established date for their execution, if in each of these instances the financial institution failed to notify the controlling agency of the presence of those circumstances;
2) the controlling agency made the decision that interim management should be introduced on the basis of the results of its on-site audit or its analysis of the submitted plan for restoring the financial institution's solvency;
3) the financial institution fails to fulfill or improperly fulfills the plan for restoring its solvency (Item 1 of Article 183.5 of the Federal Law 'On Insolvency (Bankruptcy)').

The controlling agency's decision to introduce interim management must be published and posted on the website of the controlling agency. The purpose of interim management introduction is to restore the solvency of a financial institution and/or to guarantee the safety of property.

The aims of interim managers are as follows:

[1] Article 7 of Federal Law of 25 February 1999, No. 40-FZ 'On the Insolvency (Bankruptcy) of Credit Institutions'.

– to adopt measures designed to prevent bankruptcies and/or to control the application of such measures;
– to eliminate the existing grounds for suspension or limitation of the license of a financial institution.

The composition of an interim management team, as well as the procedure and the grounds for changing its composition, should be approved by the controlling agency. The person appointed head of an interim management team should be an arbitration commissioner who has passed an additional examination which is to entitle him or her to exercise relevant managerial functions in the afore-listed institutions. The head and members of an interim management team should be selected by the controlling agency in the procedure established by the regulatory agency. On his or her appointment, the head of the interim management team should conclude a liability insurance contract.

The controlling agency has the right to send its representatives to a financial institution for the purpose of exercising control over the activities of that financial institution and its interim managers.

The Law sufficiently thoroughly regulates the functions of interim managers, the consequences of their appointment, their duties, and the consequences of limitation and suspension of the powers of the executive bodies of a financial institution (Articles 183.7–183.11 of the Federal Law 'On Insolvency (Bankruptcy)').

The term in office of interim managers is between three and six months, with the possibility of an extension of up to three months.

Interim managers should carry out an analysis of the financial situation of the financial institution in their charge, and no later than 45 days after the date of their appointment should submit, to the controlling agency, a conclusion on the financial situation of that financial institution. In the event the conclusion suggests the possibility of restoring the solvency of the financial institution, the interim managers should submit, to the controlling agency, a plan for solvency restoration. In the event of the impossibility thereof, the interim managers should recommend that a petition for bankruptcy be filed.

On conclusion of their term in office, interim managers should submit a report on the results of their activities.

The new law has introduced *a new definition of the indicators of bankruptcy of a financial institution*. While previously a petition for bankruptcy of a credit institution was primarily associated with a license recall and a court ruling confirming the existence of monetary obligations, the new procedure envisages the following indicators of bankruptcy:

1) the amount of claims against a debtor, constituting its monetary obligations and/or mandatory payments, is no less than 100 thousand rubles, and the debtor has failed to satisfy those claims over the course of 14 days;
2) a debtor has failed to implement, within 14 days from the entry into force of the court decisions on the recovery of the debt; in such cases, the debtor should be deemed as bankrupt irrespective of the amount of claims against it;
3) the value of a debtor's property is insufficient to cover its money obligations to the creditors and its mandatory payment liabilities;
4) the solvency of a financial institution has not been restored in the period of its interim management team's activity.

It should be emphasized that a financial institution should be deemed to be incapable of meeting the demands of its creditors and/or fulfilling obligations in regard of mandatory payments even in the presence of only one of the above-listed indicators of bankruptcy.

As far as the peculiarities of insurance organization bankruptcy prevention are concerned, special attention should be paid to the additional grounds for the application of bankruptcy prevention measures to an insurance organization. These grounds are as follows:

- multiple violations, within one year after the discovery of the first violation, of the standard ratio between the amount of the entity's own financial resources as established by the existing norms, and the amount of its assumed liabilities or the requirements to the composition and structure of its assets necessary for covering its insurance reserves and own funds;
- recall or suspension of the license for effectuating the established types of compulsory insurance, as well as limitation of that license.

In these cases, interim management should be appointed by the Federal Insurance Supervision Service (Rosstrakhnadzor). The right to file with an arbitration court a petition in bankruptcy, in addition to some other entities, is granted to a professional association which is recognized to be endowed with the right to present claims to a debtor – insurance organization – within the limits equal to the amount of entrance fees, membership fees, special-purpose contributions and other payments transferred to the professional association, as well as compensatory payments and other related expenses.

Legal regulation was introduced with regard to the transfer (or sale) of the insurance portfolio during the implementation of the measures designed to prevent bankruptcy, as well as in the course of a proceeding in bankruptcy. The sale of the insurance portfolio may be effectuated upon its coordination with the Federal Insurance Supervision Service's agencies. The transfer of the insurance portfolio (Article 184.9 of the Federal Law 'On Insolvency (Bankruptcy)') implies its transfer to another insurance organization(s) or to its management company.

In this connection, the insurance portfolio being transferred must include:

a) outstanding liabilities under insurance policies as of the date of the decision concerning the transfer of the insurance portfolio (or insurance reserve);

b) assets received in order to cover the insurance reserves created by the insurer.

The procedure for the transfer of the insurance portfolio, including the procedure for fulfilling the obligations assumed under insurance policies, and the procedure for fulfilling the obligations of the management company are established by the Federal Insurance Supervision Service. In an event of insufficiency or lack of assets at the disposal of that insurance organization, the outstanding liabilities under insurance policies may be covered by the professional association with the monies earmarked for covering compensatory payment.

The notification concerning the transfer of an insurance portfolio must be published. Within the period of one month from the date of its publication, insurers and insurance policy holders have the right to present to the insurance organization a request that the insurance policy the rights and liabilities under which are to be transferred should be annulled.

Besides, *the order of priority with regard to claims of third-priority creditors has been altered* (Article 184.10 of the Federal Law 'On Insolvency (Bankruptcy)').

Highest priority will now go to claims under compulsory insurance policies. Previously this category included only compulsory individual insurance, while all the other types of compulsory insurance were given second priority. In addition, the Federal Law's articles have

been augmented by those regulating the claims concerning refunds of compensatory payments and insurers' claims.

Second priority will go to the claims under life insurance policies and other types of personal insurance. The range of claimants has also been expanded by including therein insurers.

Third priority, instead of claims under individual insurance policies, will now be granted to claims under civil responsibility insurance policies presented for causing damage (harm) to the life or health.

Fourth priority, instead of 'claims of other creditors', will go to claims presented under civil responsibility insurance policies for causing damage property of third parties and under property insurance policies.

Fifth priority will be granted to claims presented by other creditors.

The specific feature of an amicable agreement concluded with an insurance organization is the necessity to redeem the outstanding claims of first- and second-priority creditors, the claims of insured persons, beneficiaries, insurers under compulsory insurance policies, as well as the claims pertaining to refunds of compensatory payments and related expenses.

It should be noted, among the specific features of bankruptcy of professional securities market participants [1], asset managers of mutual investment funds, investment funds and non-state pension funds, that the primary goal of the interim management team after its appointment is to ensure safety of the monies and securities owned by their clients. Besides, interim managers must establish the sufficiency of monies and securities owned by the clients and kept on a special broker account, depo account, or a separate bank account for the satisfaction, in full, of the clients' claims with regard to restitution in regard of their monies and securities (Article 185.2 of the Federal Law 'On Insolvency (Bankruptcy)').

On the whole, the relations arising in connection with bankruptcy of the aforesaid organizations are to be regulated by the same norms as the bankruptcies of financial institutions (which has been discussed earlier), with a few specific variations.

Thus, in order to satisfy the clients' claims in the course of supervision or a proceeding in bankruptcy, the arbitration commissioner or register keeper keeps a register of the clients of a relevant professional securities market participant or asset manager. The participation of the register keeper is mandatory if the number of clients exceeds 100. The contract with the register keeper may be concluded only in an event of the latter having insurance liability coverage with regard to inflicting losses on the clients.

The claims of the clients of a professional securities market participant or asset manager are satisfied in full if the amount of the clients' funds kept on their accounts is sufficient for satisfying their claims. If the amount of the clients' funds pooled in one account is insufficient to satisfy their claims in full, these funds should be transferred to the clients in amounts proportional to their claims. The unsatisfied claims of the clients are to be entered in the creditor register and given a third order of priority.

Besides, there exist a number of specific features of the actual conduct of the procedures of supervision and a proceeding in bankruptcy. Thus, for example, the clients' funds are not included in the bankrupt estate of a professional securities market participant, asset manager or clearing institution, if these are kept on a special broker account, depository account, transit

[1] In accordance with Federal Law of 22 April 1996, No. 39-FZ '*On the Securities Market*', professional securities market participants are to be understood as persons carrying on broker, dealer, depositary activity, management of securities, keeping of securities registers, organization of trade on the securities market. From 1 January 2013, clearing will also be recognized as a type of professional activity on the securities market.

account, depo account, individual account of a securities holder, or a separate bank account opened for carrying on settlements against transactions relating to trust management. This also applies to the funds transferred for trust management to an asset manager or credited as investment units.

The securities owned by a professional securities market participant or asset manager and circulating on an organized market must be sold through an organizer of trading on the securities market. The securities that cannot be traded in that way must be sold in the procedure determined in Article 111 of the Federal Law 'On Insolvency (Bankruptcy)'.

Some specific bankruptcy features are also consolidated with regard to non-state pension funds.

1. Apart from the general grounds, the new legislation has established the following additional grounds for the imposition of bankruptcy prevention measures:
   - the standard size of pension reserves for fixed-parameter pension schemes has dropped, by the end of a relevant quarter, below the level envisaged by the controlling agency;
   - the actuarial deficit, as reflected in the latest annual actuarial assessment of a non-state pension fund, has increased on the previous year.
2. Liabilities under contracts on non-governmental pension provision and the composition of the list of creditors whose claims are due to be satisfied at the expense of pension reserves and pension savings, as well as the amount of payables, should be determined and entered in the register of creditors' claims by the interim manager.
3. Within 6 months from the date of an arbitration court's ruling that a non-state fund should be deemed to be bankrupt and bankruptcy proceedings should be initiated, the commissioner in bankruptcy should ensure:
   - the transfer of pension savings to the RF Pension Fund and the conclusion of proper settlements with the creditors of the pension investment fund;
   - the payment or transfer to other funds of the redemption sums or their transfer as an insurance premium payment under the pension insurance contracts concluded with insurance organizations;
   - the transfer of the fund's duty with regard to the payment of non-governmental lifetime pensions, and its pension reserves to another non-state pension fund.
4. A bankrupt pension fund's pension savings and pension reserves should not become part of the bankrupt's assets, and are to be used only for the afore-said purposes. The procedure for satisfying the creditors' claims at the expense of pension reserves and pension savings is been regulated by Article 186.7, 186.8 of the Federal Law 'On Insolvency (Bankruptcy)'.
5. When bankruptcy-prevention measures are being applied or bankruptcy proceedings are being implemented, the duties with regard to payment of non-governmental lifetime pensions and pension reserves can be transferred, with the concurrence of the controlling agency, to another non-state pension fund.
6. All transactions for the sale of non-state pension funds' properties in which pension reserves and pension savings are invested should be registered by a specialized depositary. The procedure for such accounting operations should be set by the controlling agency.
7. The sale of the enterprise and the replacement of any assets of a non-state pension fund are not permitted.

Thus, the State increases the levels of protection of the various types of pension savings, insurance contributions, share deposits and investments. On the macroeconomic and political levels, the positive social effect of such innovations is clear and evident. On the negative side, the implementation of these legal norms might end up with the State regulating the number of monetary asset management funds and companies and their mergers and takeovers, as well as redistribution of the corresponding markets in favor of influential big players with good political connections.

In February 2011[1], the bankruptcy law was extended to include the specific features of bankruptcy of clearing institutions, concerning, among other things, the determination of the size of the monetary obligations arising from financial contracts. Monetary obligations arising as a result of contracts concluded under a general agreement (or a joint contract) which corresponds to the model contractual terms (envisaged by Article 51.5 of the Federal Law 'On the Securities Market'), and (or) the rules of the staged auction, and (or) clearing rules and regulations, should be terminated in the procedure envisaged by the afore-said general agreement (or joint contract), and (or) the rules of the staged auction, and (or) clearing rules and regulations. The afore-said termination inevitably results in a monetary obligation, whose size should be determined in the procedure envisaged by the general agreement, and (or) the rules of the staged auction, and (or) clearing rules and regulations.

An interim manager has the right to refuse to implement only those financial contracts concluded between the creditor and the debtor that belong to the afore-said contract types. Creditors whose claims relate to net obligations are deemed to be third-priority creditors.

The afore-said legal innovations have been in force since 11 August 2011.

Since 11 February 2011, 'transactions handled at public auctions on the basis of even a single bid addressed to an unlimited range of auction participants, as well as actions aimed at implementing the obligations and duties arising from such transactions, cannot legally be challenged' as suspicious and resulting in preference being given to one creditor at the expense of another.

The most important innovations of that period are as follows:

1) the abolition of judges' *exclusive* right to determine whether or not supervision should be introduced, to consider petitions, applications and complaints in bankruptcy cases; disputes concerning the amount of the creditors' claims; the creditors' claims whose validity has been contested; the creditors' claims in the bankruptcy cases of failed financial institutions and absentee debtors;
2) the extension of grounds for recognizing a transaction as null and void in the event of an 'interrelated contract' that should be understood as 'a contract concluded with the central contracting party on the basis of an offer, including the bid, submitted at an auction, on whose basis the now invalid contract with the central contracting party was concluded' (Item 5, Article 61.6 of the Federal Law 'On Insolvency (Bankruptcy)'). Interrelated contracts that entail losses eligible for recovery can be concluded in the course of suspicious transactions or the debtor's transactions resulting in preference being given to one creditor at the expense of another.

[1] Federal Law of 7 February 2011, No. 8-FZ *'On the Introduction of Alterations in Some Legislative Acts of the Russian Federation in Connection with the Adoption of the Federal Law 'On Clearing and Clearing Activities'*.

In July 2011, Russia adopted a new bankruptcy regulation[1] specifically targeting developers[2]. Item 6, Article 201.1 of the Federal Law, of 12 July 2011, No. 210-FZ contains an extensive list of grounds for deeming a person to be a creditor of a developer, reflecting the various forms of consolidation of legal relationships introduced into practice in the field of construction.

As of the date of introduction of supervision upon an indebted developer, the debtor has the right to conclude contracts envisaging transfer of residential property and agreements altering or dissolving those contracts only after having been granted an express written permission of the interim manager. The same holds true for any other real estate transactions, including transactions in land.

The court decision on the imposition of supervision upon a developer should be forwarded by the arbitration court to the agencies carrying out the state registration of real property rights and real estate transactions, at the place of location of the developer's land plots.

The decision of the creditors' meeting that an amicable agreement should be concluded in a debtor's bankruptcy case, should be taken by a majority vote of all creditors in bankruptcy and the authorized state agencies, in accordance with the register of the creditors' claims. This decision will be deemed to be adopted if it has been voted for by all the creditors whose claims related to the debtor's obligations are secured by pledge, and by no less than three-quarters of participants a given construction project.

Unlike in all the other categories of bankruptcy cases, the bankruptcy case of a developer is participated in by the participants in a construction project who have claims for residential property transfer, and the authorized executive agency of a RF subject, exercising control and supervision over the participatory share construction of blocks of flats and (or) other real estate objects in the area where the said construction project is being implemented.

In response to a petition filed by the applicant or some other person-participant in the bankruptcy case of a developer, the application court has the right to take measures designed to satisfy the creditors' claims and the debtor's interests (measures ensuring the performance of obligations) in the form of *a ban on the lessor concluding a contract on the lease of the land plot with any other person but the developer*, and *a ban on the lessor disposing of that plot in any other way*.

As of the date of introduction, by the arbitration court, of supervision upon an indebted developer, any claims against the developer for the transfer of residential properties and (or) any monetary claims except those regarding current payments should be filed against the developer only within the framework of the developer's bankruptcy case throughout the whole period of supervision and the duration of all the subsequent procedures applied in the developer's bankruptcy case, in accordance with the established procedure for filing a claim against a developer.

[1] Federal Law of 12 July 2011, No. 210-FZ, 'On the Introduction of Alterations in the Federal Law 'On Insolvency (Bankruptcy) and Articles 17 and 223 of the Code of Arbitration Procedure of the Russian Federation with Regard to the Determination of the Particulars of the Bankruptcy of Developers Having Attracted Monetary Resources of Participants of Construction'.

[2] Developer is a legal entity irrespective of its organizational-and-legal form, including a housing construction cooperative society or an individual entrepreneur, to which claims are presented for the transfer of residential property, or monetary claims. The special bankruptcy rules should be applied irrespective of whether or not the developer has any ownership, rental or sublease rights to the land plot, and also irrespective of whether or not the developer has ownership rights or any other property rights to the construction object.

As of the date of introduction of supervision upon an indebted developer, the implementation of the documents of execution concerning the claims filed by participants in a construction project, should be suspended for the whole period of supervision and all subsequent procedures applied in the developer's bankruptcy case. As of the date of opening of bankruptcy proceedings, the implementation of the said documents of execution should be discontinued.

Within 5 days from the date of confirmation of supervision and bankruptcy proceedings, the interim manager and the commissioner in bankruptcy should inform all the participants in the construction project known to them, of the introduction of supervision or the opening of bankruptcy proceedings. They should also inform these participants in the construction project that they are now eligible to file claims for the transfer of residential properties and (or) monetary claims, and that a participant in the construction project is now eligible to unilaterally refuse to implement a contract envisaging the transfer of a residential property.

The opening of bankruptcy proceedings against a developer constitute a ground for a participant in the relevant construction project to unilaterally refuse to implement a contract envisaging the transfer of a residential property. This refusal can be stated, within the framework of the developer's bankruptcy case, in the process of determining the amount of the monetary claim of that participant in the construction project.

When determining the amount of the monetary claim of a participant in a construction project, the court should take into account the amount of his or her losses in the form of the actual damage caused by violation of the developer's obligations relating to the transfer of the residential property. The amount of that damage represents the difference between the cost of the residential property (determined as of the date of dissolution of the contract envisaging the transfer of the residential property) that should be transferred to the participant in the relevant construction project, and the amount of the monetary resources paid prior to the dissolution of that contract, and (or) the cost of the property (determined by the contract envisaging the transfer of the residential property) transferred to the developer.

When the validity of claims for the transfer of residential properties is being considered by the arbitration court, it is required that evidence confirming the fact that a participant in the relevant construction project has indeed made a full or part partial payment in pursuance of his or her duties towards the developer should be submitted thereto.

The claim for the transfer of a residential property, declared to be valid by an arbitration court should be entered in the register of claims for the transfer of residential properties.

The rules for maintaining a register of claims for the transfer of residential properties, including the content of information required to be entered in that register and the procedure for release of information from the register of claims for the transfer of residential properties should be in conformity with the established federal standards.

As of the date of introduction, by an arbitration court, of supervision over an indebted developer, the following claims against the developer on the part of other persons or against other persons on the part of the developer should be submitted and considered throughout the whole period of supervision and all subsequent procedures applied in the developer's bankruptcy case only within the framework of the developer's bankruptcy case:

1) claims for the recognition of the existence or non-existence of a property right or any other right or encumberment with regard to real estate, including uncompleted construction objects;

2) claims for the recovery of real estate, including uncompleted construction objects, from the unlawful possession of another person;

3) claims for the demolition of an unauthorized structure;

4) claims for the declaration of a real estate transaction to be invalid or non-concluded, and for the application of the consequences of the invalidity of that void transaction;

5) claims for the transfer of real estate for the purposes of performing an obligation by a debtor to transfer that real estate in ownership, economic jurisdiction or operative management, or to transfer that real estate for use to the claimant;

6) claims for the State registration of the transfer of title to real estate (Article 201.8 of the Federal Law 'On Insolvency (Bankruptcy)').

In the course of bankruptcy proceedings against a developer, the creditors' claims, except the creditors' claims relating to current payments, should be satisfied in the following order of priority:

1) first priority should be given to the claims for the compensation for damage (harm) caused by the debtor to the life or health of citizens; their settlement involves the capitalization of the corresponding time payments and the payment of compensation for the inflicted moral damage;

2) second priority should be given to the claims for severance benefits, for the payment of labor of persons working or having worked under labor contracts, and for the remuneration payable to the authors of intellectual activity results;

3) third priority should be given to the monetary claims of citizens-participants of construction;

4) forth priority should be given to the claims filed by other creditors.

In the process of financial recovery, external management and bankruptcy proceedings, in the event that a debtor developer has an uncompleted construction object, the arbitration commissioner should put forward for consideration at a meeting of participants of construction, no earlier than 1 month and no later than 2 months after the date of his or her appointment, the issue of addressing the arbitration court with an appeal that the claims filed against the developer by participants of construction be settled by way of transferring the developer's rights to the uncompleted construction object and the land plot to a housing cooperative or to a specialized consumer cooperative of another type.

The transfer of an uncompleted construction object to participants in the relevant construction project may be carried out if the following conditions are simultaneously met:

1) the value of the debtor's rights to the uncompleted construction object and the land plot does not exceed by more than 5% the aggregate amount of the participants of construction's claims entered in the register of the creditors' claims and the register of claims for the transfer of residential properties; or the decision that the uncompleted construction object should be transferred to participants of construction has been approved by the affirmative vote of three-quarters of the forth-priority participants of construction; or the necessary amount of money has been paid into the deposit account of the arbitration court in accordance with Item 4, Article 201.10 of the Federal Law 'On Insolvency (Bankruptcy)';

2) the value of the property remaining in possession of the debtor after the transfer of the uncompleted construction object is sufficient for covering the current payments and for settling the claims filed by the first-priority and second-priority creditors; or the necessary amount of money has been paid into the deposit account of the arbitration court in accordance with Item 5, Article 201.10 of the Federal Law 'On Insolvency (Bankruptcy)';

3) the register of the creditors' claims does not contain any claims filed by the creditors who are not participants in the relevant construction project with regard to the obligations se-

cured by a pledge of the developer's rights to the uncompleted construction object and the land plot; or the afore-said creditors have given their assent to the transfer of the uncompleted construction object; or the necessary amount of money has been paid into the deposit account of the arbitration court in accordance with Item 6, Article 201.10 of the Federal Law 'On Insolvency (Bankruptcy)';

4) on completion of construction of the uncompleted construction object, it contains a number of residential properties sufficient to satisfy the claims filed by all participants in the construction project with regard to that particular construction object, entered in the register of the creditors' claims and the register of claims for the transfer of residential properties, in accordance with the terms of the contracts envisaging the transfer of residential properties (and there are no instances when one and the same residential property in the block of flats is simultaneously claimed by two or more participants in the construction project, except for the instances envisaged by Item 7, Article 201.10 of the Federal Law 'On Insolvency (Bankruptcy'). With the consent of a participant in the construction project, he or she may be allotted a residential property whose layout design, floor space and location will differ from those stipulated in his or her contract envisaging the transfer of residential property;

5) the uncompleted construction object belongs to the developer by right of ownership;

6) the land plot where the uncompleted construction object is situated belongs to the developer by right of ownership or any other property right;

7) participants in the relevant construction project have adopted a decision that a housing cooperative or a specialized consumer cooperative of another type, corresponding to the provisions of Item 8, Article 201.10 of the Federal Law 'On Insolvency (Bankruptcy), should be established.

In the event that a debtor developer has a block of flats whose construction has been completed, the arbitration commissioner should put forward for consideration at a meeting of participants in the construction project, no earlier than 1 month and no later than 2 months after his or her appointment (if the object's construction is completed within the period of bankruptcy proceedings, no later than 2 months after the date of its completion), the issue of addressing the arbitration court with an appeal that the claims filed against the developer by participants in the construction project should be settled by transferring ownership of residential properties in that block of flats to participants in the construction project.

The transfer of residential properties to participants in a construction project may be carried out if the following conditions are simultaneously met:

1) a completed block of flats has been issued an official completion certificate authorizing its commissioning;

2) the developer and participants in a construction project have not signed the deeds of real estate or any other documents concerning the transfer of residential properties to participants in the construction project;

3) the value of the residential properties to be transferred does not exceed by more than 5% the aggregate amount of the claims filed by participants in the construction project, entered in the register of the creditors' claims and the register of claims for the transfer of residential properties; or the decision that residential properties be transferred to participants in the construction project has been approved by the affirmative vote of three-quarters of the forth-priority participants in the construction project, with the exception of the juridical persons-participants in the construction project; or the necessary amount of money has been paid into

the deposit account of the arbitration court in accordance with Item 4, Article 201.10 of the Federal Law 'On Insolvency (Bankruptcy)';

4) the value of the property remaining in possession of the debtor after the transfer of residential properties to participants in a construction project is sufficient for covering the current payments and for settling the claims filed by the first-priority and second-priority creditors; or the necessary amount of money has been paid into the deposit account of the arbitration court in accordance with Item 5, Article 201.10 of the Federal Law 'On Insolvency (Bankruptcy)';

5) the register of the creditors' claims does not contain any claims filed by the creditors who are not participants in construction with regard to the obligations secured by a pledge of the developer's rights to the completed block of flats, the land plot and the residential properties to be transferred; or the afore-said creditors have given their assent to the transfer of residential properties to participants in the construction project; or the necessary amount of money has been paid into the deposit account of the arbitration court in accordance with Item 6, Article 201.10 of the Federal Law 'On Insolvency (Bankruptcy)';

6) all participants in a construction project are allotted residential properties in accordance with the provisions of their contracts envisioning the transfer of residential property, and the number and the size of the residential properties being transferred is sufficient to satisfy the claims filed by all participants in the construction project with regard to that particular construction object, entered in the register of the creditors' claims and the register of claims for the transfer of residential properties, in accordance with the terms of the contracts envisaging the transfer of residential properties (and there are no instances when one and the same residential property in the block of flats is simultaneously claimed by two or more participants in the construction project, except for the instances envisaged by Item 7, Article 201.10 of the Federal Law 'On Insolvency (Bankruptcy'). With the consent of a participant in the construction project, he or she can be allotted a residential property whose layout design, floor space and location will differ from those stipulated in his or her contract envisaging the transfer of residential property.

* * *

On the whole, as far as the situation in the field of bankruptcy in 2009-2011 is concerned, it was the first time since 2004 that we saw a systemic development of Russia's bankruptcy legislation. The impetus for those changes came from outside the legislative domain – it was provided by the crisis phenomena in the global and Russian economy that resulted in a more than 15% rise in Russia over the period of 2009-2010.

The fact that the State made use of the key ideas for exiting the crisis – supported the banking sector and protected financial institutions in their role of creditors by reducing the level of bad debts – determined the adoption of a number of urgently needed legislative measures primarily designed to strengthen the creditor's position and to improve the overall transparency of the bankruptcy process.

However, the motives behind the recent legislative initiatives have inevitably narrowed the State's focus and thus have left a number of most important issues on the waiting list. Some of those issues are as follows:

– the issue of participation of the tax agencies in bankruptcy procedures (for the purpose of eliminating the conflict of interests between their major task of collecting taxes and the necessity of liquidation of potentially lucrative enterprises, and for the purposes of pre-

venting the Federal Tax Service's bodies from hampering the application of financial recovery mechanisms and the conclusion of amicable agreements);
- issues relating to the development of bankruptcy prevention mechanisms (bankruptcy hindrance mechanism, mechanism for the conclusion of amicable agreements, financial recovery mechanism), and to the restoration of the solvency of enterprises and their preservation (especially those whose output is export-oriented and competitive) in the instances when this approach is economically and/or socially feasible;
- the issue of supervision over the activities of SROs of commissioners in bankruptcy and SROs of valuators still failing to efficiently perform their functions and to provide high levels of service;
- the issue of monitoring and analyzing the practical implementation of legislation, of detecting problems in the areas of application of the new legal norms (adopted over the period December 2008 through January 2011) concerning the activities of commissioners in bankruptcy and their SROs (including the legal norms on the application of liability measures, by a SRO, to arbitration commissioners, and by the controlling agencies – to a SRO and the legal norms regulating the accreditation, by a SRO, of organizations of valuators and organizations maintaining registers of securities); the issue of the practical effectiveness of the legal norms establishing the liability of person exercising control over companies, and the issue of the practical effectiveness of the legal norms for contesting 'suspicious transactions' and 'transactions resulting in preference being given to one creditor at the expense of another'.

6.5. Self-Regulated Organizations – the Evolution of the Law (2007–2011)

The development of the Laws on Self-Regulated Organizations [1] (hereinafter – SRO) can be conventionally divided into two stages:
- I – April 1994 – July 2007;
- II – August 2007 – till now.

Let us review their main features.

At the 1st stage that began in April 1994 by the establishment of "self-regulated associations" as a SRO prototype for professional participants of the security market and ended in July 2007, self-regulated organizations were created spontaneously and on a limited basis. During this period, the SRO establishment was regulated by certain types of professional businesses limited to isolated areas, outside industries and major markets such as evaluation/appraisal business, investment foundations managers, bankruptcy commissioners, etc.

The key elements and tools of regulating SROs during this period were:
1) definition of the notion of a self-regulated organization as an entity established for coordination of its activities, representation of its members and for the purpose other than profit generation;
2) identification of state authorities that would control the self-regulated organizations;
3) the right and procedure for development of SRO performance standards and control over activity of the SRO members by the SRO.

[1] As of November 1, 2010, 634 self-regulated organizations have been registered in Russia. Out-of-court settlement of disputes in SRO – Bankruptcy Commissioner, 2010, No. 6.

During this period, SROs were not in majority: for 13 years they were set up in three areas only: valuation/appraisal (in May 1998), bankruptcy commissioners (October 2002) and audit boards of agricultural cooperatives (November 2006).

Starting 2001, the process of establishment of self-regulated agencies has intensified – each year new legal norms regarding SRO were established in Federal Laws such as: "On investment foundations" (2011), "On insolvency (bankruptcy) (2002), "On communications" (2003), "On housing and construction cooperatives" (2004), "On organization of insurance" (2005), "On advertisement" and "On agricultural cooperatives" (2006).

With the enforcement of Federal Law of 01.12.2007 No. 315-FZ "On self-regulated organizations" in July 2007, the *2nd stage* of the development of the Laws on self-regulation began. Efforts to introduce the self-regulation intensified, and the share of organizations with mandatory self-regulation increased considerably.

The SRO Laws developed in two directions: by enforcing and amending the general Federal Law and by enforcing special Laws in all the areas where self-regulation was adopted.

6.5.1. Federal Law of 01.12.2007 No. 315-FZ «On self-regulated organizations"

According to the new Law, a self-regulated organization shall be a non-commercial organization based on the membership that unites the subjects of entrepreneurship by one of the following attributes:

- a unity of the sector of production of goods (works, services), e.g. construction. communications;
- a unity of the market of produced goods (works, services), the e.g. market of real estate/ appraisal services/cadaster services;
- unification of subjects of professional business of a certain type, e.g. mediators, patent attorneys, auditors.

Such division, however, seems very conventional since the subjects of a certain professional activity can render their services on one market and can satisfy two attributes simultaneously, e.g. support to the commercial infrastructure of electric energy wholesale market - the Market Council.

The content of "self-supported and initiative" activity of such associations includes:

- development and establishment of SRO standards and rules;
- control over compliance with these standards and rules.

According to Federal Law "On self-regulated organizations" (Federal Law "On SRO") (jointly with special norms about SRO), all self-regulated organizations were divided into *3 categories:*

1) SRO to which the general legal norms are not applied and which are governed by special norms (see section 6.5.3 for details);

This category includes mainly SROs[1] established before 2001 that had sufficiently developed legal framework of regulation and practices of application of the legal norms; these relate to a financial market segment. Among these SRO are professional participants of the securities market, share investment funds, non-state pension funds, etc. [2];

[1] SRO of housing funded cooperatives enforced in 2004 are an exception.
[2] See item 3, Article 1 of Federal Law "On self-regulated organizations" for details.

2) SRO that are governed by special norms on a number of issues defined by the general law; however these SRO are subject to general norms of the Federal law "On SRO";

3) SRO that are not governed by special norms but are regulated by FZ "On SRO" exclusively; however special norms can be enforced also.

Two categories of entities can become SRO members:

1) subjects of entrepreneurship are individual entrepreneurs and legal entities engaged in entrepreneurship. To set a SRO, at least 25 such entities are required if the applicable federal laws do not provide otherwise;

2) subjects of professional activity are individuals (physical persons) engaged in professional business. To set a SRO, at least 100 such subjects of a certain type are required.

An organization is considered a self-regulated one if it meets the attributes of a non-commercial organization as set forth in the RF Civil Code and has the above mentioned number of members, if standards and rules of entrepreneurial or professional activity of a certain type are available (if the applicable federal laws do not provide otherwise) and if each SRO member will have additional property liability before consumers of produced goods (performed works and/or rendered services) and other persons [1].

The SRO membership is voluntary according to the general rule. However, the federal laws can provide also for mandatory membership in SRO.

A SRO develops SRO *standards and rules* that are requirements to be obligatory complied with by all SRO members; these requirements relate to entrepreneurship or professional activities. The SRO standards and rules can contain requirements that are additional to those established by the law.

Disciplinary sanctions are provided for breaches of the SRO standards and rules.

The SRO standards and rules shall:

- comply with the business ethics rules;
- remove or mitigate a conflict of interests of the self-regulated organization members, their employees and members of a collegial governance body of the SRO.

The SRO standards and rules shall prohibit SRO members to perform any actions that could damage other subjects of entrepreneurship or professional activity; they also shall protect from:

- unfair competition;
- actions causing moral or other damage to the consumers of goods (works, services) and other persons;
- actions damaging the SRO business image or that of a SRO member.

The SRO shall ensure release of the information about activities of the SRO members that may affect the rights and lawful interests of any person.

The functions of a SRO are similar to those of a non-commercial entity: to develop and establish the membership; to take disciplinary sanctions against their members, etc. The SRO has very large authorities in the area of *control over activities of their members*.

The SRO reviews the activities of their members using reports and other documents approved by the general meeting and provided to the SRO. Besides, the SRO:

1) complaints against actions of the SRO members and incidents of breaching the SRO standards and rules and the membership terms by SRO members;

[1] See, Article 13 of Federal Law "On self-regulated organizations" for details.

2) conducts scheduled and off-scheduled audits of activities of the SRO members. (The controls entrepreneurship and professional activities of their members relating to compliance of the SRO standards and rules and the SRO membership terms;
3) reviews scheduled audit is held at least once every three years while an off-schedule audit is held in response to a claim of standards and rules breaching, and in some other cases).

Two key mechanisms of responsibility of the SRO members are established by the law:

1) disciplinary;
2) property-related.

Disciplinary sanctions can be taken against a SRO member based on the review results of complaints on the actions of the SRO member related to non-compliance with the SRO standards and rules and the SRO membership terms.

The following disciplinary actions can be taken against a SRO member:

1) an order to remove identified breaches by the set deadline;
2) a note of warning;
3) a fine;
4) a recommendation to exclude the member from the SRO; this recommendation is reviewed by the SRO standing collegial governance body.

Any decision on expulsion from the SRO members likewise any abuse of the rights and lawful interests of the SRO members by actions/no actions of the SRO and its employees and/or governance bodies can be contested in court. The SRO member concerned is entitled to demand from the SRO compensation for caused harm.

Property liability of the SRO members to the consumers of goods, works and services manufactured/performed/rendered by the SRO members and other persons can be insured by using the compensation fund and the system of individual and/or collective insurance.

The compensation fund is initially formed by SRO members fees in the amount at least Rb 3,000 from each member. The minimal insured sum under a contract of liability insurance of each SRO member shall be at least Rb 30,000 per year.

Federal Law “On self-regulated organizations” regulates thoroughly the issues of placing cash funds of the compensation fund (Article 13). The Law also provides for broad opportunities in certain sectors/markets and type of business for SRO to define independently, by using the Federal Law and in some cases – the SRO internal documents – other terms including the procedure of building up the compensation fund, placement of its money, the minimal size and the procedure of insuring liability of the SRO members.

According to general rule, the SRO shall be liable for obligations of any SRO member (up to the compensation fund amount) that have arisen as a result of causing damage by defects of goods (works, services) manufactured by the SRO member. The SRO obligations may not be recovered from the assets of the compensation fund.

The Federal Law “On self-regulated organizations” sets a rather high level of requirements to information transparency about the SRO activities (Article 7, FZ “ On SRO”).

The enhanced control functions of the SRO require a specific procedure *of interaction of the SRO with the authorized bodies of executive power.* Thus, the SRO shall:

1) forward to the authorized body the SRO standards and rules, the membership terms and changes inserted in these documents;
2) data on the scheduled and conducted audits by the SRO of the activities of the SRO members and the audit findings.

The authorized body shall:

1) send to the SRO information about the findings of the conducted audits or entrepreneurial and professional activities of the SRO members;
2) appeal to court to delete the data on the non-commercial organization from the SRO State Registry; if the claim is met, the self-regulated organization loses its status (item 6 Article 3, FZ "On SRO").

The SRO governance bodies are:

1) general Meeting of the SRO members – a supreme body convened at least once a year; the body deals with such issues as approval of the Charter, making changes therein, election of a standing collegial governance body, approval of the procedure for applying disciplinary sanctions, etc[1];
2) standing collegial governance body – is made of the SRO members and independent members who do not have employment relations with the SRO and its members. Independent members shall make at least 1/3 in the standing collegial body of the SRO. If the Federal Law does not stipulate otherwise, the SRO standing collegial governance body's Terms of Reference include approval of SRO standards and rules, decisions on joining and withdrawal from the SRO membership, setting specialized bodies of the SRO, etc.[2] The functions of this body can be exercised by the General Meeting of the SRO members;
3) SRO executive body resolves issues of SRO economic and other activities that do not fall within the scope of competencies of the two bodies mentioned above.

Federal Service for State Registration, Cadaster and Mapping (RosReestr) maintains the SRO Federal Registry if no federal body is set up with control and supervision functions in a certain business area. The Registry data are deemed open and public. When a non-commercial entity is entered in the SRO Registry, this entity shall acquire the SRO status; when an entity is excluded from the SRO Registry, its status is lost. The State Registry Maintenance Procedure is set by Ministry of Economic Development of the Russian Federation[3].

Distribution of supervision and control functions over self-regulated organizations between different state authorities (*Table 21*).

Table 21

Distribution of supervision and control functions over self-regulated organizations between different state authorities

State control/supervisory authority	Sector or type of activity of a SRO
1	2
RF Ministry of Finance	- SRO of auditors; - SRO of credit cooperatives; - SRO ina micro-finance sector
Federal Service for Financial Markets (FSFM of Russia)	- SRO on the securities market; - SRO in the area of investment funds managing companies; - SRO in the area of housing funded cooperatives;
Federal Service for State Registration, Cadaster and Mapping (RosReestr)	- SRO of appraisers (in part); - SRO of bankruptcy commissioners (in part)
Federal Service for Insurance Supervision (Rosstrakhnadzor)	- SRO of insurers
RF Ministry of Agriculture	SRO of auditing councils of agricultural cooperatives
RF Ministry of Energy	Activity in support of functions of the commercial infrastructure of the electric energy wholesale market (Market Council)

[1] See item 3, Article 16 of FZ "On self-regulated organizations" for details.
[2] See item7, Article 17 of FZ "On self-regulated organizations" for details.
[3] Article 5.2.28.19 of Regulation of the RF Government of 05.06.08 No. 437 (version of 24.03.11with amendments of 06.04.2011) "On Ministry of Economic Development of the Russian Federation".

cont'd

1	2
RF Ministry for Economic Development	- SRO of appraisers (in part); - SRO of bankruptcy commissioners (in part)
RF Ministry of Communications (Mincomsvyaz of Russia)	- SRO in communications
RF Ministry of Regional Development	- SRO in the construction sector (in part)
Federal Service for Ecological, Technological and Nuclear Supervision	- SRO in the construction sector (in part)

Where there is no control/supervisory body it means the Law does not specify it.

Coming back to general provisions on the SRO, note that the rights of the SRO, its officials and employees are limited by a number of terms. Thus, the SRO shall not:

1) execute entrepreneurial activity;
2) incorporate economic partnerships and companies engaged in entrepreneurship which is the subject of self-regulation for the particular SRO and become a member of such partnerships and companies:
3) exercise a number of actions and deals (if the federal laws do not specify otherwise) such as:
   - pledge the SRO property or make the property a surety against obligations of other persons;
   - grant surety for persons that are not SRO employees;
   - act as a mediator in selling goods (works, services) manufactured by the SRO members;
   - etc.

There is also a number of restrictions for the sole executive body of the SRO[1].

6.5.2. Development of the SRO general laws in 2008–2011

During 2007–2011, the right to establish self-regulated organizations was fixed in the above mentioned Federal Law and in other 8 Federal Laws. In 5 cases out of 8, the establishment of a SRO in this or that form is mandatory and the segments to which such norms apply are critical segments of the economy in terms of their social importance like construction, electric energy wholesale market, design and engineering, etc.

For the reviewed 4-year period considerable changes in the Federal Law 'On self-regulation" occurred only once – *in July 2008 No. 148-FZ of 22.07.08* (hereinafter – Federal Law "On SRO" - new version). Exceptions are the right of using compensation fund assets not only to secure the property liability of the SRP members and the right of return of contributions of the SRO members as per the applicable federal laws; these rights were enforced in July 2010 (No. 240-FZ of 27.07.10). Such innovations have been typical for legal regulation starting from the mid of the 2000'es. They have been actively used, e.g. in the bankruptcy law[2]. On one hand, such clauses ensure flexibility of the application of laws while on the other hand – they establish unjustified "specific" conditions for separate market players thus disrupting competition. Thus, a SRO engaged in construction and design, and engineering

[1] See items 4 and 5 of Article 14 of FZ No. 315-FZ dated 01.12.2007 "On self-regulated organizations" for details.

[2] E. A. Apevalova, A. D. Radygin. Bankruptcies in the 2000's: from a raider instrument to the "double standard" policy– "Economic Policy" August, 2009.

surveys is allowed, e.g. to invest the assets of the SRO compensation fund in order to increase its size. Such SRO has also the right of return of the SRO members' contributions [1].

The new version of the Federal Law 'On SRO" was not an exception as it also contains "specific" new clauses regulating particular cases:

1) possible establishment of a SRO not only for self-regulation but for other purposes that will be specified in "other federal laws";
2) possibility not to establish control bodies that supervise the compliance of the standards and rules by the SRO members, if this possibility is established" by a federal law";
3) non-obligatory key requirements to the SRO activity (sub-items 1-3, Federal Law "On SRO", new version) in the instances "established by federal laws":
   - availability of standards and rules of entrepreneurship/professional activity mandatory for compliance by the members;
   - securing additional property liability of the SRO members to consumers of works and services by insurance and establishing compensation funds;
4) no obligation to disclose information to the majority of consumers of the manufactured goods and services and to shareholders, investors, creditors in the instances "established by a federal law" (p. 4, Article 7, Federal Law "On SRO", new version).
5) possibility to use the compensation fund assets to keep, increase and invest the assets not by managing companies, if this is "specified by a federal law" (P. 5, Article 13, Federal Law "On SRO", new version). The reduced control over placing and investment of funds is usually used to derive unlawful profits, to misuse funds, to abuse authorities, etc. Eventually all these reduce the performance efficiency.

While in some instances we talk about the necessity to have a flexible regulation with account for sector and regional specifics, in the above mentioned cases a specific institutional environment will be created for a narrow group of people, thus the legal environment will be diluted and the effect of the legal regulation will be reduced.

As for systematic innovations, we'd like to focus on the following:

1. *Enhanced risk of reduction of protection of the consumers' rights* as a result of establishment by the federal laws of a different procedure for the formation of the compensation fund, its minimal size, investment of the fund assets and insurance of the liability of the SRO members (p. 4, Article 13, Federal Law "On SRO", new version). Earlier, the federal laws could specify only *additional requirements* to the size of the compensation fund and insurance.

2. *Expansion of the area that would be regulated by special federal laws* by incorporating issues relating to the SRO legal status; the procedure of enrolling members and the rules of the SRO membership, control over the SRO members activity (part 2, Article 1, Federal Law "On SRO", new version).

3. *Additional authorities granted to the SRO*:

- review of complaints on the SRO members' actions and cases of abuse of the standards and rules and membership terms by the SRO members. This function corresponds to introduction of administrative responsibility for abuses in this area (see below);
- other authorities provided by the federal laws.

[1] For details see: 4-5, Art. 3.2 of Federal Law dated 29.12.04 No. 191-FZ "On Enforcement of the Town Planning Code of the Russian Federation".

4. *Application of the Law on SRO to organizations registered outside the Russian Federation – now these organizations can become SRO members* (p. 3, Article 2, Federal Law "On SRO", new version).

5. *Imposition on the SRO of the obligation to assure transparency of information* that affects rights and lawful interests of any person (p. 5, Art. 4, Federal Law "On SRO", new version).

6. Fixing the general rule – the approval of the Procedure for regular and one-off payments by the SRO members at the General Meeting of the SRO members. However, a federal law or a SRO Charter can provide otherwise.

7. *Possibility to redistribute the authorities from the standing collegial body to the General Meeting of the SRO members* on the issues of approval of SRO standards and rules (and amendments thereof), setting SRO special bodies, approval of the regulations on such special bodies and rules on their activity.

8. *Extension of the list of grounds for refusal to enter the data on SRO in the State Registry (*e.g. where there are no standards and rules for entrepreneurial and professional activities, or additional property liability of the SRO members is unsecured, etc.). In such cases we can talk about the improved level of requirements to the SRO responsibilities and performance.

9. *Extension of the list of grounds for expulsion of a non-commercial organization from the State Registry* due to incompliance with the legal requirements (e.g. the number of the SRO members, the size of the compensation fund).

10. *Extension of the list of grounds for expulsion of a non-commercial organization from the State Registry in response to the request of the federal authorized body*. This actually means the termination of the SRO activities. If, e.g. more than two requirements of the Federal Law "On SRO" are abused by the SRO within one year (in addition to the requirements set forth in part 3, Article 3); or if other federal laws are breached and these breaches are not corrected or cannot be corrected.

11. Establishment of periodicity of the General Meeting of the SRO members – at least once a year.

12. An open list of rights that can be delegated by the members of a SRO association (union) to an association (union).

13. Fixing the SRO membership right in other (except Chambers of Commerce and Industry) non-commercial entities.

6.5.3. SRO legal regulation by special laws and its development in 2008–2011.

The Federal Law "On SRO" is the main law regulating the relations that emerge with the acquisition and termination of the SRO status and the SRO activity. However, other federal laws can also regulate specific relations associated with the SRO (p. 2 Art. 1, Federal Law "On SRO"). There are 20 such laws altogether, and each of them highlights this issue differently (see *Table 22*).

Table 22

SRO legal regulation by special laws

			SRO						SRO members vs SRO		Means of securing property liability of the SRO members						
				Type of association							Compensation fund				Insurance		
			Notion	Mandatory	Voluntary	Procedure of acquisition and termination of the SRO status	Number of members	Functions, rights and obligations	Rights and obligations	requirements to membership	Envisaged	Size of SRO members' contributions	Terms and procedure of investing the fund assets, restrictions	Compensatory payments	Envisaged	Type of insurance: Obligatory	Type of insurance: Voluntary
1			2	3	4	5	6	7	8	9	10	11	12	13	14	15	16
The Federal Law "On SRO" applies to	**Law "On the organization of insurance in the RF** of 27.11.1992 No. 4015-1		–	–	–	–	–	–	–	–	–	–	–	–	–	–	–
	FZ "On agricultural cooperation" of 08.12.1995 No. 193-FZ		+	+	–	+	+	+	+	+	+	–[1]	–	+	–	–	–
	FZ "On valuation activity in the RF" of 29.07.1998 No. 135-FZ	SRO	+	+	–	+	+	+	+	+	+	+	+	+	+	+	-
		National Council on Valuation Activity	+	–	+	+	+	+	–	–	+	–	+[2]	+[3]	–	–	-
	FZ "On insolvency (bankruptcy)" of 26.10.2002 No. 127-FZ	SRO	+	+	–	+	+	+	–[4]	+	+	+	+	+	+	+	-
		National Association of the SRO of bankruptcy commissioners	+	–	+	+	+	+	–	+	+	–	+	+[5]	–	–	-
	FZ "On electric energy" of 26.03.2003 No. 35-FZ		+	+	–	–	–	+	–	+	–	–	–	–	–	–	–
	FZ "On communications" of 07.07.2003 No. 126-FZ		–	–	–	–	–	–	–	–	–	–	–	–	–	–	–
	"City Planning Code of the RF" of 29.12.2004, No. 190-FZ	SRO (of respective tupes[6])	+	+	–	+	+	+	–	+	+	+	+	–	+	–	+
		SRO National Associations (of respective types)	+	+	–	+	–[7]	+	–	+	+	–[8]	+[9]	–	–	–	-
	FZ "On advertisement" of 13.03.2006 No. 38-FZ		+	–	–	–	–	+	–	–	–	–	–	–	–	–	–
	FZ "On the State Real Estate Cadaster" of 24.07.2007 No. 221-FZ		+	–	+	–	–	+	–	–	–	–	–	–	–	–	–
	FZ "On patent attorneys" of 30.12.2008 No. 316-FZ		–	–	+	–	–	–	–	–	–	–	–	–	–	–	–
	FZ "On auditing activity" of 30.12.2008 No. 307-FZ		+	+	–	+	+	+	–	+	+[10]	–	–	–	–[11]	–	–
	FZ "On credit cooperation" of 18.07.2009 No. 190-FZ		–	+[12]	–	+	+	+	–	+	+	+	+	+	+	–	+
	FZ " On energy saving and improvement of energy efficiency" of 23.11.2009 No. 261-FZ		–	+	–	+	+	+	+	+	+	–	–	–	–	–	–
	FZ "On micro-financial activity and micro-financial organizations" of 02.07.2010 No. 151-FZ		–	–	–	–	–	–	–	–	–	–	–	–	–	–	–
	FZ "On the mediation procedure" of 27.07.2010 No. 193-FZ		–	–	+	+	+	+	–	–	–	–	–	–	–	–	–
	FZ " On heat supply" of 27.07.2010, No. 190-FZ		–	+	–	+	+	+	–	+	+	+	–	–	+	–	+

cont'd

1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	1
The Federal law "On SRO" shall not apply to	**FZ "On the securities market"** of 22.04.1996 No. 39-FZ	+	–	+	+	+	+	–	–	–	–	–	–	–	–	–
	FZ "On non-state pension funds" of 07.05.1998 No. 75-FZ	+	–	+	–	–	+	–	–	–	–	–	–	–	–	–
	FZ "On investment funds" of 29.11.2001 No. 156-FZ	+	–	–	+	–	+	–	–	–	–	–	–	–	–	–
	FZ "On funded housing cooperatives" of 30.12.2004 No. 215-FZ	–	–	+	–	–	+	–	–	–	–	–	–	–	–	–

[1] The minimal size of the fund is established (part 4, Article 33.1, part 12 Article. 33.1).
[2] If a SRO is liquidated and/or the data on this SRO are deleted from the Unified State Register of the SRO of Appraisers, the assets that make up the SRO compensation fund shall be transferred to National Council on Valuation Activity. The requirements to the procedure of investment of the transferred assets are similar to the requirements to the procedure of investment of assets of the SRO compensation fund. The assets of the SRP compensation fund that have been transferred to the National Council shall be returned, after 4 years, in cash form to the persons that were the members of the said SRO. (Art. 24.8).
[3] A request t to receive a compensatory payment from the compensation fund can be submitted, also to the National Council on Valuation Activity, if the assets of the compensation fund of the SRO of appraisers have been transferred thereto (Art. 24.8).
[4] A small number.
[5] To the procedure of investment of the SRO compensation fund assets that are transferred to a National Association of the SRO and to the procedure of compensatory payments from its funds, are similar to the requirements to the procedure of investment of assets from the SRO compensation fund and the procedure of compensatory payments from the fund assets (item. 23 Art. 25.1).
[6] SRO based on the membership of persons engaged in engineering surveys, preparation of design documents and construction (Art. 55.3).
[7] All SRO.
[8] Within thirty days from the date of entry of the SRO data into the SRO State Registry the SRO shall pay an affiliation fee to the National Association of the SRO and make other payments for the needs of the National Association of the SRO of the respective type according to the procedure in the amounts set forth by the All-Russia Congress of the SRO, this is a specific feature of self-regulation in this area (part. 5.1 Art 55.20).
[9] After the data about a SRO are excluded from the SRO State Registry, the assets of the compensation fund shall be credited to the account of the National Association of the SRO of the respective type and can be used for payments only associated with SRO subsidiary liability for the obligations of the members of such organization. The National Association of the SRO shall invest the assets of the said compensation fund according to part 4, Art. 55.16 (p. 8 Art. 55.16).
[10] The establishment of the compensation fund and investment of its assets shall be made according to the procedure set forth in Art. 13, FZ "On SRO"(i. 14 Art. 17).
[11] An auditing company /individual auditor during the audit have the right to insure liability against breaches of the contract on auditing services and/or liability for damaging property of other persons as a result of the audit (Art 13). However, this is not related to the SRO membership.
[12] Except credit cooperatives of the second tier (item. 3 Art. 35).

The following Federal Laws do not have a clause on the SRO: "Organization of the insurance in the RF", "On communications", "On micro-financial activity and micro-financial organizations. They only refer to a possibility of a SRO being established.

The *Federal Law "On patent attorneys"* neither regulates the SRO activities. However this Law provides for several norms related to the SRO (Art. 5, part. 2 Art. 6, part. 2 Art. 9).

The Federal law "On advertisement" includes Chapter 4 that has two clauses only: the one deals with the SRO notion (Article 31) while the other – with the SRO rights (Art. 32).

The Federal Law "On the State Real Estate Register" also establishes the SRO rights only (Art. 34).

The Federal Law "On the mediation procedure" regulates the procedure of acquiring the SRO status and the SRO functions (Art. 18, 19).

Regardless of the importance to self-regulate the commercial infrastructure of the wholesale market, *the Federal Law "On electric energy"* has only one article on the SRO purpose, functions (Market Council) and requirements to the membership of a Market Supervisory Board and its competences (Art. 33).

Only organization of the wholesale market of electric energy and capacity is based on self-regulation of its participants (part 2, Art. 31), and there is no SRO for retail markets. The membership in the SRO (Market Council) for the wholesale market participants and those of wholesale electric energy is compulsory (Art. 35).

The following group of the Federal Laws regulates the SRO activities in more details.

The Federal Law "On agricultural cooperation" contains provisions regulating the activity of the SRO of the auditing boards of agricultural cooperatives, and such provisions can be found in a number of articles (Art. 1, 31 & 32). Their main part, however, is summed up in Article 33.1 which regulates the SRO activities in full.

This SRO has specific membership: a cooperative or a board of cooperatives must compulsory become a member of an auditing board (p. 3 Art. 31) while the auditing board must be a member of one of the SROs (part. 7 Art. 31).

Many articles of the *Federal Law "On valuation activity"* deal with SRO. In addition, Chapter III "Regulation of valuation activity" including 22 Articles regulates the SRO activity.

The National Council on Valuation Activity is a special feature of self-regulation in this area (Art. 24.10) likewise the compulsory way of securing property liability of the SRO members (Art. 24.6).

The Federal Law "On insolvency (bankruptcy)" (Art. 21–26.1) describes self-regulation in a similar way.

Chapter 6.1 "Self-regulation in the area of engineering surveys, architectural and construction design, construction, reconstruction and capital repair of capital construction facilities (Art. 55.1 – 55.23) of the *RF City Planning Code* contains the main provisions about the SRO.

The self-regulation rules can set requirements to insurance of civil responsibility by the SRO members (part. 12 Art. 55.5). Such requirements, however, can be compulsory if the SRO sets forth the size of contribution to the compensation fund which is lower than the legally established minimal size (with no requirement to insurance) (Art. 55.4, 55.5, 55.16).

The SRO membership issue is resolved ambiguously.

The types of works that affect the safety of capital construction facilities must be performed only by individual entrepreneurs or legal entities that have work permits issued by the SRO. Other types of work can be performed by any individual person or a legal entity (Art. 47, 48, 52). In other words, the membership is compulsory for those individual entrepreneurs or legal entities only that intend to execute a certain type or types of work that can affect the safety of capital construction facilities.

The SRO can expel from the SRO members an individual entrepreneur or a legal entity if the individual entrepreneur or the legal entity has no permit certificate for at least one type of work that may affect the safety of capital construction facilities (p. 2 Art. 55.7).

However, Article 55.15 on disciplinary sanctions imposed by the SRO against SRO members sets forth the following actions:

- termination of the term of the work permit certificate for the works that may affect the safety of capital construction facilities in relation to a certain type or types of work (item 4 part 2 Article. 55.15);
- Expulsion from the SRO membership (item 5 part 2 Art. 55.15).

According to this Article, the termination of the work permit does not mean the expulsion from the SRO members as these are two different sanctions. This runs contrary to the above mentioned Article 55.7, which says that the absence of the work permit certificate for *at least one type of work* that may affect the safety of capital construction facilities leads to a decision of expulsion from the SRO members.

Many provisions of the *Federal Law "On auditing activity"* deal with self-regulation, but there are also special articles about the SRO of auditors (Art. 17–22).

This Federal Law sets very strict requirements to the SRO membership (Art. 18).

Auditing Activity Board is worth mentioning (Art. 16). Unlike the mentioned above SRO National Associations this Board is established as an authorized federal body. Among its members are so many representatives from the SRO of auditors that makes the Board critical for self-regulation purposes.

In terms of regulation of the SRO activity, *the Federal Law "On credit cooperation"* is equal to such laws as the Federal Law "On valuation activity in the RF", the Federal Law "On insolvency (bankruptcy", the RF City Planning Code and/or the Federal Law "On auditing activity (Art. 35–41).

The Federal Law "On energy saving and improvement of energy efficiency" describes in detail the procedure of self-regulation. However, it does not contain provisions on securing property liability of the SRO members.

The Federal Law "On heat supply" is rather new. Probably because of this, the self-regulation of this area has a lot of questions.

Thus, a non-commercial organization can become a SRO in the area of heat supply provided this organization secures additional property liability of each member before the consumers by using the following (Art. 24):

a) the compensation fund of at least RUR50,000 for each member of the non-commercial organization if the organization established a requirement to insure the civil liability by its members; inception of the insurance cover may occur in case of damage caused by defective works and services in heat supply – in the amount of at least RUR15,000 per each member of the non-commercial organization;

b) the system of individual and/or collective insurance of the liability.

The text of the Article assumes that in order to acquire a SRO status, the property liability must be secured by both ways. However, looking at item "a" we see that the compensation fund size depends on the requirement to its members to insure the civil liability.

The liability insurance requirements to the SRO members are compulsory if the compensation fund is at least RUR50,000 per one member (part 1 Art. 24).

The Federal Law does not keep any direct reference to the nature of association in SRO. Thus, a number of issues may arise.

1. A non-commercial organization can receive a SRO status in the area of heat supply if its members are legal entities supplying heat and/or they are heat network companies, and/or individual entrepreneurs (part 1 Art. 24).

A heat supplying company is a company that sells to consumers and/or heat supplying companies generated or purchased heat energy (capacity), a heat carrier and that owns, by the

property right or on any other lawful ground. the sources of heat energy and/or heat networks in the heat supply system by which the consumers receive heat energy.

A heat network company is a company rendering services in transferring heat energy.

These provisions apply to regulation of similar relations with involvement of individual entrepreneurs (Art. 2).

The membership in the SRO is not specified as a compulsory condition for performing these types of activity.

2. SRO in the area of heat supply must develop and approve the requirements to issuance *of a work permit certificate in relation to works that affect the safety of the heat supply facilities* (part 3 Art. 24). In this case, the membership in the SRO will be compulsory only for the individual entrepreneurs or the legal entities that intend performing works affecting the safety of the heat supply facilities.

Further in the Law the legislator gives the following definition of the permit certificate: "*a permit certificate to execute certain types of work or types of work in the area of heat supply*" (e.g. part 1 Art. 25 and others), this seems to be a more general notion. Thus the range of entities for which the membership in SRO is compulsory expands.

3. A person/entity in relation to whom the permit certificate is refused to be issued, must, jointly with the local government authorities of a settlement or a city district where this person/entity supplies heat, prepare a plan of actions for securing reliable heat supply under no permit certificate conditions. If certain types of work are performed by a person with no permit certificate, the SRO in the area of heat supply this person is a member of shall not be liable for this person action (no action) with the assets of the compensation fund (part 8 Art. 27).

To become a member of a SRO in the area of heat supply, an individual entrepreneur or a legal entity files an application for this SRO membership by stating certain type or types of work in the area of heat supply for which they intend to receive work permit certificates (item 1 part 2 Art. 26).

The person/entity who becomes a SRO member and meets the permit certificate requirements , is issued such certificate no later than within three business days after the date when the respective decision is made, the membership fee is paid and the contribution is made to the compensation fund of this SRO (part 5 Art. 26).

Incompliance with the permit certificate requirements for certain types of works/activities in the area of hear supply can be a basis for refusal to admit an individual entrepreneur or a legal entity as a member of the SRO (part 4 Art. 26).

It means that the refusal to issue the certificate is equal to the refusal in SRO membership. Thus, a person/entity *who has been denied a permit certificate cannot become a SRO member in the heat supply business,* and this contradicts the provisions of part 8, Art. 25. The Federal Law does not have the provisions that would state that an individual entrepreneur or a legal entity being a SRO member may *not be refused* a certificate.

4. The following disciplinary sanctions are imposed on the SRO members (part 6 Art. 27):

a) suspension of the permit certificate term of action;

b) termination of the permit certificate term of action;

c) expulsion of a faulty person/entity from the SRO membership.

In the first instance, a SRO member continues to be its member regardless of the absence of the right to carry out business in the hear supply area. Two other sanctions demonstrate that

the termination of the permit certificate term would not automatically lead to the expulsion from the SRO membership. These are two different actions.

Thus one can talk about a mandatory membership for those individual entrepreneurs or legal entities who intend to do works that may affect the safety of the heat supply facilities.

The action of the Federal Law "On SRO" does not apply to the SROs of professional participants of the securities market, joint-stock investment funds, managing companies and specialized depositaries of investment funds, shared investment funds, funded housing cooperatives, non-state pension funds, credit agencies, credit history agencies (item 3, Art. 1 of the FZ "On SRO").

The Law establishes that the relations arising in connection with the acquisition or cessation of the status of such SRO and their activities shall be defined by federal laws regulating the respective type of activity. However, by now, the following federal laws have been enforced: regulating activities of the professional participants of the securities market (Federal Law "On the securities market"), activities of non-state pension funds (Federal Law "On non-state pension funds"), activities of the managing companies of investment funds (Federal Law "On investment funds"), activities of the funded housing cooperatives (Federal Law "On funded housing cooperatives"). However, there are not many provisions on the self-regulation in the said laws.

Federal Law "On funded housing cooperatives" specifies that the SRO of the funded housing cooperatives is regulated by the Federal Law and therefore refers to the special Federal Law on the SRO of the funded housing cooperatives. However, such law has not been adopted yet. Joining a SRO is voluntary. Three Federal Laws state this implicitly (Federal Law "On the securities market", Federal Law "On non-state pension funds" and Federal Law "On funded housing cooperatives").

The SRO functions, rights and obligations in the above mentioned laws correspond to the main functions, rights and obligations provided for in the Federal law "On SRO".

According to part 5, Art. 3, Federal Law "On SRO", the obligatory requirement on securing by the SRO of additional property liability of each SRO member before the consumers of the manufactured goods (works and services) and other persons as per Art. 13 of Federal Law "On SRO" (the creation of a system of individual and/or collective insurance; setting up a compensation fund) shall be mandatory if the Federal Law does not provide otherwise. If the Law specifies a means of securing the property liability that differs from the compensation fund or insurance, these will not run contrary to the Federal Law "On SRO".

Thus, the means of securing the liability specified by the laws that are not covered by the Federal Law 'On SRO" will not contradict the norms of the Federal Law "On SRO".

Though *the Federal Law "On the Securities market"* does not specify any means of securing the property liability of the SRO members, one should apply Art. 17 of the Federal Law of 05.03.1999, No. 46-FZ (the version dated 04.10.2010) "On the protection of rights and lawful interests of investors on the securities market" that states that the SRO shall establish a compensation and other funds to reimburse for damage incurred by investors who are physical persons as a result of activities of the professional participants who are members of the SRO.

The Federal Law "On non-state pension funds" establishes that the SRO shall secure a warranty fund or a mutual insurance society to finance the liability to indemnify losses caused by the SRO members in performing their activities (part 5, Art. 36.26).

According to the *Federal law "On investment funds"*, before a federal law is enforced that sets forth the terms and the procedure of compensatory payments to individuals for damage

caused as a result of non-performance or improper performance by the joint-stock investment funds, managing companies, specialized depositaries and the persons maintaining registries of the owners of investment units imposed on them by the relevant law or the agreement on obligations, the procedure of protection of property rights of individuals shall apply according to which the losses in the form of actual damage caused by the individuals who are shareholders of joint-stock investment funds, individuals who are owners of investment units shall be compensated from the assets of the federal compensation funds set up as per the RF Law "On the protection of rights and lawful interests of investors on the securities market" (art. 63)[1]. This fund, however, is not related to self-regulation.

The Federal Law "On funded housing cooperatives" provides for creation of a reserve fund which assets can be used to secure contingent expenses only and to cover cooperative losses. Such assets may be contributed to a unified reserve fund set up by the SRO of funded housing cooperatives if a cooperative is a member of the SRO. The aims of the formation of the reserve fund, however, do not correspond to the main aims of setting up the compensation fund.

All the laws may be divided into ***three groups*** in terms of changes in the SRO special legislation.

The ***1st group*** includes the laws enforced before the Federal Law "On SRO". These laws are: "On the organization of insurance activity in the RF", Federal Laws "On agricultural cooperation", "On the valuation activity in the RF", "On insolvency (bankruptcy)", "On electric energy", "On communications", "On advertisement" and "On the State Real Estate Cadaster", the RF City Planning Code.

The Federal Laws "On communications", "On advertisement" and "On the State Real Estate Cadaster" initially included the provisions on the SRO. Such provisions were also incorporated in the Law *"On the organization of insurance activity in the RF*" on March 7, 2005, and in the *Federal Law "On agricultural cooperation"* – on March 11, 2006. In both cases no substantial changes on the SRO activities were made.

The Federal Law "On electric energy" had the notion of self-regulation at the start. On 04.11.2007, however, the provision was modified, and the Trade System Administrator of the wholesale market was replaced for Market Council. A direct reference was also made that the SRO is the Market Council.

The first version of the *Federal Law "On the valuation activity in the RF*" dated 29.07.1998 contained the SRO provisions. Self-regulation was considered as an addition to the state regulation (Art. 22, 24).

Since 27.07.2006, the SRO membership has been a mandatory condition for performance of valuation. The following changes have been made:

1. The following requirements become mandatory for appraisers: insurance of liability (Art. 4, 24.6, 24.7), compliance with the standards, valuation rules and the rules of business and professional ethics; also the requirement to pay contributions (Art. 15).

2. Now the valuation activity is regulated not only at the government level. National Board on Valuation Activity develops federal standards for valuation. The SRO of appraisers develops and approves the standards and rules of valuation (Art. 18, 20).

[1] Art. 19, Federal law of 05.03.1999 , No 46-FZ (the version dated 04.10.2010) "On the protection of rights and lawful interests of investors on the securities market".

3. The number of Articles regulating SRO has increased from one to sixteen (Art. 22, 22.1-22.3, 23, 24.1-24.10). They include, among others:

a) the notion of the SRO (Art. 22);

b) the procedure of entry of a non-commercial organization in the Unified State Registry (hereinafter – the USR) of the SRO of appraisers and the grounds thereof (including the requirement of the minimal number of members and availability of a compensation fund) (Art. 22, 23, 24.2, 24.6, 24.8, 24.9);

c) a larger list of the SRO functions, rights and obligations and the requirements to the SRO membership (Art. 22.1, 22.2, 22.3, 24, 24.1);

d) the procedure for SRO control over valuations and the procedure of application of disciplinary sanctions to the SRO members (Art. 24.3, 24.4);

e) the provisions/norms regulating activities of National Board on Valuation Activity and other associations of the SRO of appraisers (Art. 24.10).

The norms regarding the SRO Expert Council appeared in the version dated 24.07.2007 (Art. 24.2).

Since 27.12.2009, a state duty has been established for the entry of a non-commercial organization in the USR of the SRO of appraisers (Art. 23).

On 22.07.2010, (with the introduction of Chapter III "State Cadaster Value") Art. 24.16 on the expert review of the report on definition of the cadaster value by the SRO was included in the Federal Law.

On 01.07.2011, the list of documents required for inclusion of non-commercial organizations into the USR of the SRO of appraisers was extended (Art. 23).

Significant amendments were made in the Federal Law on 11.07.2011 including:

1) norms on the single qualification test: if a member of the SRO of appraisers passes this test, this member can become a member of the SRO Expert Council; and on the qualification certificate issued in confirmation of passing the single qualification test (Art. 16.2, 21.1, 21.2, 24.2);
2) the SRO of appraisers which expert has prepared and got approved a positive expert opinion shall bear a joint liability for losses caused to the customer who concluded a valuation contract or for property damage caused to third parties by the action (no action) of an appraiser, as a result of identified violations of the federal standards on valuation and the valuation standards and rules (Art. 24.6).

The Federal Law "On insolvency (bankruptcy") in its first version of 26.10.2002 required compulsory membership in the SRO.

Material changes were made in the version of 30.12.2008, e.g.:

1. Norms on the SRO National Associations were added (Art. 2, 26.1).

2. The compulsory terms of the SRO membership were changed.

The minimal service record on a leading position was reduced from 2 years to one year. At least two years of probation were included for an assistant to the bankruptcy commissioner as an equal alternative to the requirement for the leader's service record and the period of at least 6 months for probation as an assistant to the bankruptcy commissioner (part 2 Art. 20).

The requirement of no record of convictions for economic crimes and crimes of moderate severity, grave and exceedingly grave crimes was substituted for the requirement of no penalty/punishment in the form of disqualification for administrative offences or in the form of termination of right to hold certain positions or to perform certain types of activity as a result

of the court sentence, and also the requirement to have no record of convictions for deliberate crime (part 2 Art. 20).

The registration as an individual entrepreneur was excluded from the list of compulsory terms.

New requirements have been developed: a SRO member shall have a contract of compulsory insurance of the liability; a SRO member shall pay contributions as stated by the SRO, including contributions to the SRO compensation fund (part 3 Art. 20).

The SRO is entitled to set other requirements to competences, integrity and independence of the bankruptcy commissioner as the membership conditions (part 4 Art. 20).

3. The activities of the STO governance bodies and the specialized bodies are now regulated by a separate article – 21.1.

4. The compensation fund provisions were incorporated into a separate article 25.1.

5. The scope of the SRO rights and obligations has expended (Art. 22). The SRO now has the right to certify insurance companies, appraisers, professional participants of the securities market who maintain the registry of the securities owners and other entities that a bankruptcy commissioner may engage to secure commissioner's obligations from the debtor's funds.

The following articles dealing with the SRO activities are considered new: 22.1, 22.2, 23.1, 24.1, 25.1 и 26.1.

The later versions regarding self-regulation have not changed considerably.

Since 27.12.2009, a state duty has been imposed on the entry of a non-commercial organization in the USR of the SRO of bankruptcy commissioners (part 1 Art. 21).

From 22.04.2010, the SRO functions have been extended due to changes in §4 dealing with the bankruptcy of financial organizations.

On 28.12.2010 it was established that the federal standards, the standards and rules of professional activity can set forth additional requirements to securing property liability of the bankruptcy commissioner for non-performance or improper performance by the commissioner of his/her obligations relating to bankruptcy (part 5 Art. 20.4).

Though the *RF City Planning Code* was enforced back in 2004, the norms regulating the SRO activity (including separate Chapter 6.1 (Art. 55.1–55.23)) appeared only on 22.07.2008. On the same date the second version of the Federal Law "On SRO" was passed; this version had the greatest number of changes for the entire term of action of this Law.

On 27.07.2010, the following major amendments were introduced in the Code:

1) where the works on preparation of design documents (part 5.1 Art. 48), organization of construction, reconstruction and major overhaul (part 3.1 Art. 52) of a capital construction facility are included in the list of works that may affect the safety of capital construction facilities, the person/entity who prepares the design documents or the construction of such facility must have a permit certificate issued by the SRO allowing for doing works in preparation of design documents or organization of construction;
2) article 60 that sets forth the procedure for indemnification of damage caused as a result of defective works was supplemented with the following provisions:
   – whenever the data on a SRO that issued the permit certificate for works that affect the safety of the capital construction facilities are removed from the SRO State Registry, the National Association of SRO of the respective types shall have the joint liability up to the assets of the compensation fund of the said SRO credited to the account of this National Association (part 3.1 Art. 60, part 8, Art. 55.16);

- part 5 defines persons/entities, SRO among them, who can bear joint liability for damage caused by defective works (e.g. the Russian Federation, an RF subject. etc.) (part 5, Art. 60);

3) to receive a permit certificate, the set of requirements has been supplemented by the notion of "certification" (sub-item б, item 1, part 6, Art. 55.5, item 3, part. 8, Art. 55.5);
4) minimal requirements have been established to the issuance of the work permit certificate for preparation of design documents (part 8.1, Art. 55.5) and organization of construction (part 8.2, Art. 55.5);
5) it is established that an individual entrepreneur or a legal entity who have the permit certificate are entitled to perform the said works provided the cost of their preparation under one contract does not exceed the estimated cost of work execution based on which the respective SRO member paid its contribution to the compensation fund. The number of contracts that the SRO member can conclude is not limited (part 1.1 Art. 55.8);
6) the permit certificate is issued to a SRO member only after the SRO member has paid a contribution to the SRO compensation fund to increase the total size of the contribution of this member up to the contribution size set forth by the SRO for the members who have received the permit certificate for the said types of works but not lower than the minimal size of the contribution to the SRO compensation fund. (part 10.1, Art. 55.8);
7) the provision according to which the same person cannot be a leader of the standing collegial governance body of the SRO for two terms in succession was excluded (part 4 Art. 55.11);
8) the SRO rights on control over activities of the SRO members have been expanded (part 1, Art. 55.13);
9) if earlier the cash assets of the SRO compensation fund could be invested in the assets only for the purpose of the fund maintenance and increase, now the cash assets of the compensation fund can be invested in deposits and/or deposit certificates in Russian credit agencies (part 4, Art. 55.16);
10) the minimal size of the contribution to the SRO compensation fund for one SRO member was established (part 6, Art. 55.16, part 7, Art. 55.16);
11) it is established that only one National Association of the SRO of the respective type can be created (part 2.1, Art. 55.20);
12) the functions of All-Russia SRO Congress have been supplemented. The Congress elects President of the National Association of the SRO for 2 years and determines its authorities. The same person cannot hold the position of the President of the National Association of the SRO for two terms in succession (item 2.1, part 3 Art. 55.21);
13) an Article on state control of the National Associations of the SRO has been introduced (Art. 55.23);
14) a SRO shall be a member of the National Association of the SRO of the respective type since the date of entry of the respective data thereof in the SRO State Registry. This SRO must pay a membership fee to the National Association of the SRO of the respective type within 30 days as well as other contributions for the needs of the National Association of the SRO of the respective type according to the procedure and in the amount established by the All-Russia SRO Congress (part 5.1 Art. 55.20).

The ***2nd group*** comprises the Federal Laws passed after the Federal Law "On SRO". These include: *"On patent attorneys", "On audit activity", "On credit cooperation", "On energy*

saving and improvement of energy efficiency", "On micro-financial activity and micro-financial organizations", "On the mediation procedure", "On heat supply".

Their common feature is that the SRO provisions were adopted together with these laws. There were no changes in the legal provisions, and in cases changes have been made they have been minor. Thus, *the Federal Law "On auditing activity"* was amended on 01.07.2010 as follows:

- each SRO of auditors shall adopt the rules of independence of the auditors and audit companies endorsed by the Audit Board. The SRO of auditors is entitled to include in these rules additional requirements (item 2.1 Art. 8);
- requirements to the membership for an individual auditor in the SRO are to comply with the internal control rules over work quality (sum-items 5, item 3, Art. 18, sub-items 4.1 item 6, Art. 18).

The amendments of 28.12.2010 clarify that the SRO of auditors issues to an auditor a qualification certificate (item 1 Art. 11).The SRO of auditors shall not place any demands or conditions while issuing the auditor's qualification certificate. The SRO of auditors has the right to charge a fee for the issuance of the auditor's qualification certificate in the amount not exceeding the certificate manufacturing and shipment costs. The issuance date of such certificate shall be the date when the SRO of auditors makes a decision to issue the qualification certificate to the auditor (item 7 Art. 11).

The ***3rd group*** includes the federal laws that are not covered by the Federal Law "On SRO".

In the federal laws such as *Federal Law "On the securities market", "On investment funds" and "On funded housing cooperatives*" the SRO provisions were specified since the date of enforcement of these laws. The SRO provisions in the last two laws have not been amended considerably while the *Federal Law "On the securities market*" was amended on 15.04.2006 by adding training of individuals in the area of professional activity on the securities market and also if a SRO is an agency accredited by the relevant federal executive authority for the securities market; grading qualification examinations and issuing qualification (Art. 49).

In the version dated 11.07.2011, Article 51.5 "Approximate terms of agreements and general agreement (the uniform contract) on the financial market" was added that specifies some of the SRO rules.

SRO provisions were included in the *Federal law "On non-state pension funds"* only on 10.01.2003. The version of 06.12.2007 clarified that now the SRO shall be the SRO of funds *and* organizations that keep pension accounts under respective agreements with the funds (Art. 36.26).

6.5.4. Development prospects of the SRO legislation

It is obvious that the process of implementation of the general policy on reducing the role of the government in the economy will trigger an intensive process of partial transfer of the control and supervision functions over SRO various activities, sectors and markets.

Thus the RF State Duma of the Federation Council during 2010–2011 reviewed in the first reading the draft laws envisaging the establishment of SRO in the following sectors

1) health care;
2) protection of animals;
3) water supply and sewerage;

4) fire safety;
5) actuarial activity.

There are also proposals to introduce self-regulation for cadaster engineering, patent attorneys, expert reviews of industrial safety, real estate management. A draft law on setting a SRO for housing and public utilities is also reviewed.

Besides, a possibility is reviewed to set requirements to compulsory membership in the SRO for some professional participants of the securities market (brokers and the persons/entities who manage securities and render services to those who are not qualified investors). All SROs support the idea of compulsory membership of professional participants and managing companies, however, those who are not SRO members have a different opinion. Mid-size and small companies consider the compulsory membership as an additional financial load, and their concerns are justified and confirmed by the SRO with compulsory membership. While making a decision on this issue, the interests of investors should be also taken into account as the level of their protection can be improved considerably at the expense of compensation funds which will be used as a source of compensatory payments for losses incurred.

There are also sectors where the proposals on the SRO initiated in 2011 were not adopted as legal provisions including SRO of managing companies of multifamily houses (though the ruling party was very active in their promotion); SRO of the compulsory inspection centers for transportation vehicles.

The degree of preparedness of the market/sectors for self-regulation is a critical issue that must become a corner stone. However, the implementation of the government objectives to reduce the degree of state regulation, to reduce budget costs etc. is not enough to make SRO activity effective. Before a SRO is established the following is required:

- to analyze the market/sector to see whether they are prepared for “independent and initiative actions”, effective control by the SRO bodies of the activities of the SRO members, and implications of introducing a SRO on the market/in the sector;
- to develop measures of state control and supervision during a transition period and further to compensate for inefficient implementation of the self-regulation functions by non-commercial companies.

As practices show, in such sectors as valuation the control and supervisory functions are ineffective; unfair players and poor professionals are not “washed out” even by bringing them to responsibility; thus the applicable legislation must be corrected and the functions of the control and supervisory bodies must be modified in this sector.

Establishing SROs in the sector of heat supply and possibly in water supply and sewerage sectors would be extremely negative in the country where 42% of rural residential houses only are equipped with water pipes, 32% - with sewerage, 20% - with hot water pipes. The scale of the task (required capex) has been beyond the government capacity; and it would be an urban utopia to rely on the SRO effectiveness.

In February 2011, the draft law “On amendments in the Federal law “On the securities market” and other legal acts of the Russian Federation” No. 469229-5 was passed in the first reading. However the law was not enforced by the end of 2011. This new draft envisages the following provisions:

1. Obligation to be members of the SRO of professional participants engaged in brokerage and management of securities if they provide services to non-qualified investors.

2. Obligation to be members of the SRO of managing companies which rules of the trust management include the issue of equity shares to non-qualified investors.

3. Obligation of the SRO of brokers and/or managing companies, the managing companies of shared investment funds to set up compensation funds to compensate individuals who are not qualified investors for losses caused as a result of insolvency (bankruptcy) of the said professional participants of the securities market and managing companies.

4. Requirements to the content of standards (rules) of the SRO of brokers, managers and dealers.

The proposed actions are deemed to be justified and they could improve effectiveness of the SRO activities and protection of the interests of the qualified investors on the securities market.

There is also a number of ideas which discussion and implementation could be quite successful:

1. Proposals from the professional community of bankruptcy commissioners regarding higher level of responsibility of the bankruptcy commissioners to ensure the effective instrument of compensation for losses incurred in the course of the bankruptcy procedure are quite fair. Thus, some of the community representatives propose increasing the minimal size of the compensation fund up to RUR20 mln. If so, the compensatory payments for one case could reach RUR5 mln.
2. The concept of passing regulatory acts on the development of mechanisms of out-of-court settlement of disputes and arbitrations that was not incorporated in the legislation seems to be quite constructive; this concept have been implemented practically in a number of SRO at the level of the National Association of the SRO of bankruptcy commissioners.
3. At the moment, the National Association of the SRO of bankruptcy commissioners does not have the functions of control and supervision over the SRO of bankruptcy commissioners; these functions are proposed to be introduced with the regulatory function being the main one.
4. The right to develop standards and rules in construction must be replaced by the respective duty fixed by law, with the requirements to the content of such documents and responsibility for performance. Given the complexity of the SRO structure, diversity of the SRO members and types of works, this duty possibly will be established at the level of NOSTROY[1].
5. In the area of the construction SRO, Rostekhnadzor supervisory functions should be enhanced; today they are poorly implemented, and there is a significant number of offenses committed by SRO.
6. To introduce a common responsibility instead of a special administrative responsibility in each sector for offenses committed by the SRO and their leaders is proposed; this will considerably enlarge the area of application also in relation to the SRO types regulated by the law.
7. The list of works affecting safety at the capital construction facilities should be reduced as the list contains works that do not affect the safety of the facilities; also there is certain duplication of works in the general and special (for hazardous and technically complicated facilities) lists.
8. Uncertainty in the authorities of the SRO and the federal government should be resolved in connection with the right to issue a work permit certificate with regards to works that af-

[1] NOSTROY – National Association of builders is a non-state non-commercial organization based on the obligatory membership of self-regulated organizations in the construction sector.

fect safety of the capital construction facilities (the uncertainty emerged after the Russia's Ministry of Regional Development issued Order No 624 on December 30, 2009).

9. To improve transparency of the SRO activity on the financial market is required by publishing a SRO annual report at the SRO web-sites and the web-sites of the Federal Service for Financial Markets. Besides, to assess self-regulation efficiency, the RF Ministry of Economic Development suggests stepping-up demands to the SRO on information disclosure by the member-companies including publishing of all member companies' reports at the SRO site.
10. As the legislation does not regulate administrative responsibility of persons/entities engaged in professional activities and the officials of the SRO of appraisers (as a result of this, corruption is facilitated, the number of unfair appraisers grows, and the officials of the SRO of appraisers often demonstrate arbitrary behavior towards their members), to make changes in the RF legislation is necessary to establish responsibility of the persons who carry out professional activities and of the SRO officials.
11. In general we can speak about the absence of a special responsibility of self-regulated organizations for abusing the SRO members in their internal activities and of a more specialized responsibility in some of the sectors like valuation[1] of agricultural and financial cooperatives, etc.

6.6. Russian Market for Real Estate

Like other sectors of the national economy, the state of the market for real estate in 2011 was driven by controversial dynamics of macroeconomic and financial indicators.

On the one hand, most last year's indicators of the nation's socio-economic development (GDP, industrial output, investment in capital assets) posted a positive dynamic.

Affected by developments in the Middle East, the trend to increase in international oil prices which had emerged yet in H2 2010 continued in Q1 2011. After hitting their record highs in April, the oil prices were then slightly down. That affected the dynamic of the Rb exchange rate: in early 2011 Rb was on the rise against USD, but in Q4 2011 it depreciated and bounced back to the values noted a year ago and finally slightly outran them by the end of the year.

On the other hand, like in the past three years, the country saw a continuous capital outflow whose value ultimately proved greater than in 2009-10. The capital outflow continued through the whole year, with its quarterly dynamic increasing since H2.

Negative dynamic of the population's real disposable incomes had a yet more significant impact on the real estate market. According to Rosstat, their average nationwide increase in 2011 was a meager 0.8% (vs. 5.1% in 2010 and 2.3% in 2009).

[1] The RF Ministry of Economic Development, e.g. identifies the following gaps in the legal regulation of the SRO on valuation that must be corrected:

1) no legal provision that would fix the obligation of the SRO of appraisers to submit to the authorized body documents and information as per the Law on valuation activity;
2) no legal provision that would fix the notion and types of the expert review of reports on valuation, and requirements to the experts of the SRO of appraisers;
3) no approved procedure for supervision of the activities of the SRO of appraisers, neither there is a list of legal grounds for RosReestr to perform off-scheduled audits;
4) no legal provision that would fix the authorities to develop and approve the procedure for monitoring the SRO of appraisers' activities and for monitoring of this SRO by the relevant executive authorities.

That said, in H1 of 2011, real incomes did not post any increase nationwide, while in Moscow, they tumbled by 7.3% and climbed up by 1% in Moscow oblast. In H2, the electoral campaign fueled the rise in population incomes. According to data for the 11 months of 2011, the increase rate in the population's real disposable income in Moscow oblast was 4%, St. Petersburg – under 2%, while in the city of Moscow the said incomes slid by 2.5%[1].

Despite insignificant increase rates of the population's incomes, in the conditions of stable major macroeconomic and financial indexes, the earlier delayed effective demand began to unfold in 2010, which had a positive effect on the real estate market. In 2011, the effect of the factor of delayed demand proved mostly exhausted, and the 2010 recovery of the market proved insignificant in the conditions of falling rates of the population's income growth.

6.6.1. The Land Market

According to Rosreestr, the land area owned by residents tends to shrink and as of 1 January 2011 accounted for 121.4m hectares, or 7.1% of Russia's land vs. 124.3m hectares (7.3%) in 2009 (*Table 23).* By contrast, the land in corporate ownership expands and accounts for 12.1m hectares, or 0.7% of Russian land, up 02 p.p. vs. 2009 and 01 p.p. vs. 2010.

Table 23

Classification of Land in Russian Federation by Types of Ownership

Property form	As of01.01.2009		As of 01.01.2010		As of 01.01.2011	
	M hectares	% to result	M hectares	% to result	M hectares	% to result
Public and municipal	1576.9	92.2	1576.3	92.2	1576.4	92.2
Residents', including	124.3	7.3	123.2	7.2	121.4	7.1
Residents' land shares	107.4	6.4	104.3	6.1	100.8	5.9
Corporate	8.6	0.5	10.3	0.6	12.1	0.7
Private	132.9	7.8	133.5	7.8	133.4	7.8
Total	1709.8	100.0	1709.8	100.0	1709.8	100.0

Source: by data of Rosreestr.

By results of privatization, as of 1 January 2011, most land falls under the joint share property, including unclaimed shares (*Table 24*).

Table 24

Classification of Privatized Land by Forms of Property and Proprietors as of 1 January 2011

	Thos. of hectares	%
Joint share property (land shares owned by residents)	76 131.3	57.1
Residents' property (farming, agricultural, personal subsidiary farming, individual housing, gardening, summer housing, etc.)	20 546.5	15.4
Joint collective property	698.7	0.5
Land owned by corporations	12 064.1	9.0
Unclaimed land shares and land shares owned by residents	24 005.5	18.0
Total	133 446.1	100.0

Source: by data of Rosreestr.

According to Rosstat, as of 1 January 2011, out of land owned by residents (20, 546.5 Thos. hectares), 2.1% or 434.100 hectares, was allocated under individual housing (*Table 25*), while the respective figure as of 1 January 2010 was 439,300 hectares.

[1] Socio-economic situation in Russia in 2011, www.gks.ru

Table 25

Land Owned by Residents

	As of 01.01.2011	
	Thos. of hectares	**%**
Owners of land lots	8 374.5	40.80
Personal subsidiary farming	5 414.6	26.30
Peasants' (farmer) economy	4 809.1	23.40
gardening	797.9	3.90
Individual housing	434.1	2.10
Self-employed in agricutlure	532.8	2.60
Other purposes	183.5	0.90
Total	20 546.5	100.0

Source: by data of Rosreestr.

The greatest area in residents' ownership per 1,000 residents in 2010 was reported in Nenetsky Autonomous okrug – 20.7 hectares per capita (*Table 26*). The leading position in this regard among federal super-regions (okrugs) is held by Siberian Federal Okrug (0.85 hectares per capita), while at the bottom of the list was North-Western Okrug (0.32 hectares per resident).

Table 26

Classification of Land of Russian Federation by Property Forms across Subjects of Russian Federation and Federal Okrugs, as Hectares per 1,000 Residents (as of January 2011)

	Total area, Thos. hectares	**Land in residents' ownership, Thos. hectares per 1,000 residents**	**Land in residents' ownership, as % of the total area**	**Land in corporations' ownership, as % of the total area**	**Ranking in terms of the land area in residents' ownership per 1,000 residents**
1	2	3	4	5	6
Russian Federation	**12048.3**	**855.3**	**7.10**	**0.71**	
Nenetsky Autonomous Okrug	341727.9	20696.1	6.06	0.59	1
Republic of Kalmykia	26391.2	4603.7	17.44	0.05	2
Trans-Baikal krai	38666.3	3805.9	9.84	0.17	3
Orenburg oblast	5854.6	3453.7	58.99	2.26	4
Kurgan oblast	7544.4	3253.4	43.12	2.59	5
Altay Republic	44087.3	2917.5	6.62	1.44	6
Altay krai	6744.9	2572.6	38.14	1.36	7
Novgorod oblast	8647.8	2425.2	28.04	1.15	8
Volgograd oblast	4358.4	2418.6	55.49	2.83	9
Omsk oblast	7014.6	2278.3	32.48	3.66	10
Saratov oblast	3947.2	2178.0	55.18	6.93	11
Novosibirsk oblast	6708.1	2074.9	30.93	0.63	12
Khanty-Mansy Autonomous Okrug	5753.8	1940.9	33.73	1.28	13
Orel oblast	3034.0	1698.0	55.97	4.70	14
Tambov oblast.	3166.2	1692.6	53.46	8.74	15
Republic of Khakassia	11419.6	1633.3	14.30	0.11	16
Stavropol krai	2440.2	1479.5	60.63	5.39	18
Rostov oblast	2387.2	1461.6	61.23	4.11	19
Republic of Buryatiya	36464.7	1448.9	3.97	0.17	20
Kirov oblast.	8653.4	1438.6	16.62	3.53	21
Kursk oblast	2611.6	1428.9	54.71	8.59	22
Ryazan oblast	3439.6	1390.0	40.41	6.11	23
Amur oblast	42048.8	1382.3	3.29	0.10	24
Moscow oblast	678.2	112.2	16.54	11.13	71
Siberian federal okrug	26302.0	1559.2	5.93	0.28	17
Southern federal okrug	3069.1	1313.5	42.80	2.94	25

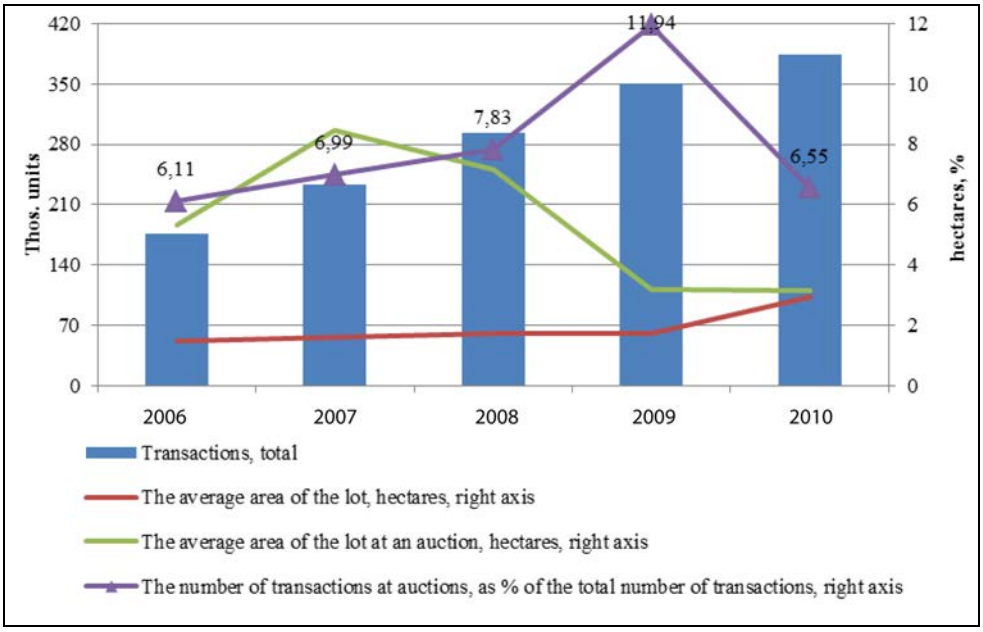
cont'd

1	2	3	4	5	6
Volga federal okrug	3444.0	1062.0	30.84	3.73	33
Ural federal okrug	14808.5	757.1	5.11	0.32	42
Central federal okrug	1751.7	558.5	31.88	5.93	55
North-Caucasian federal okrug	1841.6	463.1	25.15	2.15	63
Far-East federal okrug	95791.3	345.3	0.36	0.03	69
North-Western federal okrug	12554.6	324.3	2.58	0.31	70

Source: The state (national) report "On the state and use of land in Russian Federation in 2010" национальный)

The number of cases of sale of public and municipal land was rising steadily, and in 2010 alone, there were 384,600 transactions involving land plots of total area of 1,124.680 hectares, with the average area of a land plot expanding up to 2.92 hectares (*Fig. 15*). When compared with the 2009 figures, the number of land plots sold increased by 33,894 and their area grew by 513,940 hectares.

The number of transactions of auctioned land plots nationwide in 2010 slid to 25,185 from 41,868 transactions reported in 2009. Area-wise, the 2010 total area of sold at an auction land plots was 79,044.77 hectares vis-à-vis 133,028.2 hectares a year before. The number of transactions made at auctions hit its peak in 2009 (11.94% of all the land transactions) and dwindled to 6.55% in 2010. The average area of land plots sold at an auction, on the contrary, is down; thus, the gap between it and the average area of public and municipal land lots sold is narrowing (*Fig. 15*). As many as 14.369 land lots of the average area of 7,204.52 hectares were sold at an auction for individual housing and summer housing, while 5,864 land lots with the average area of 1,139.08 hectares were sold for personal subsidiary farming, gardening, vegeculture, cattle breeding. In the overwhelming majority of cases the cost of auctioned land was higher than the price at which it was redeemed from the public and municipal property.



Source: The state (national) report "On the state and use of land in Russian Federation in 2010".

Fig. 15. Dynamic of Sales of Public and Municipal Land

According the 2010 State (national) report, Russian residents bought 268,736 land lots of total area of 4,921.000 hectares for individual and summer housing, personal subsidiary farming, vegeculture, gardening and cattle breeding. That was at 25,736 lots more than in 2009, with the average area of such lots having changed from 0.66 to 0.18 hectare

When compared with 2009, the national average price of land lots in settlements designated for individual and summer housing remained unchanged, with the fall accounting for a meager 0.09%. Federal Okrug-wise, price differences are substantial: in the Central Okrug prices were up 140%, while in the Ural one – down 62%. (*Table 27*). Prices for land lots designated for the said purposes but located outside settlements were down 54.62%. The average national prices of land lots for industrial construction were likewise in decline, but prices for land lots designated for agrarian production were on the upsurge (*Table 27*).

Table 27

Average Prices of Public and Municipal Land Lots Sold to Private Individual and Corporations in 2010 (as Rb/M²)

Federal okrugs	Citizens and their associations:				Legal entities for industrial and other special use		Peasant (farmer)households, other agrarian organizations	
	Individual and summer housing		Personal subsidiary farming, vegeculture, gardening and cattle breeding					
	In settlements	Outside settlements	In settlements	Outside settlements	In settlements	Outside settlements	In settlements	Outside settlements
Russian Federation	58.05	2.9	14.14	6.09	74.78	12.18	11.03	4.76
Change over the year, as %	-0.09	-54.62	-58.59	31.82	-54.00	-9.64	181.38	230.56
Central	94.56	0	20.27	15.08	255.57	17.53	74.82	1.2
Change over the year, as %	140.30	n/a	-64.36	129.53	-73.48	28.33	1262.84	-4.76
North-Western	21.53	8.43	7.91	9.68	38.31	22.6	0.85	1.61
Change over the year, as %	-82.79	2.68	-83.44	137.25	153.54	-23.70	-14.14	71.28
Southern	26.5	0.55	12.27	1.28	41	10.29	2.96	1.18
Change over the year, as %	0.04	25.00	-26.35	-50.58	152.62	17.20	218.28	-83.81
North-Caucasian	101.58	0	18.93	0.14	138.85	10.62	0.8	1.28
Change over the year, as %	-7.04	n/a	-81.93	-17.65	-3.90	477.17	-40.30	265.71
Volga	28.43	8.92	12.19	6.71	30.58	18.09	2.02	11.85
Change over the year, as %	24.97	-52.45	27.91	-29.52	-7.14	-54.83	81.98	2135.85
Ural	19.66	0.41	4.33	2.62	46.82	9.66	5.53	2.6
Change over the year, as %	-62.39	-79.90	-19.07	12.45	5.90	74.68	276.19	1633.33
Siberian	43.92	3.59	5.79	8.04	23.69	6.94	1.27	6.9
Change over the year, as %	15.18	-79.74	-5.24	53.14	-38.96	15.28	111.67	702.33
Fra-East	128.23	1.33	31.46	5.15	23.39	1.7	0.02	11.48
Change over the year, as %	149.23	n/a	20.63	-19.91	-48.02	-28.27	-99.90	6652.94

Source: The state (national) report "On the state and use of land in Russian Federation in 2010".

The specific weight of lease of public and municipal land in the overall volume of the land market in terms of the number of transactions accounts for 64.0%, and area-wise – 87.1%. In 2010 to 2009, the number of various effective lease agreements plunged from 3,514.600 units (113, 081.800 hectares) to 3,403.600 units (138, 576.700 hectares). The average rental payment for public and municipal lots for (summer) housing in settlements in 2010 was up 28.6%

compared to 2009 and accounted Rb 17.27/m², while that outside settlements dropped 32.3%, down to Rb 0.86/m² (*Table 28*).

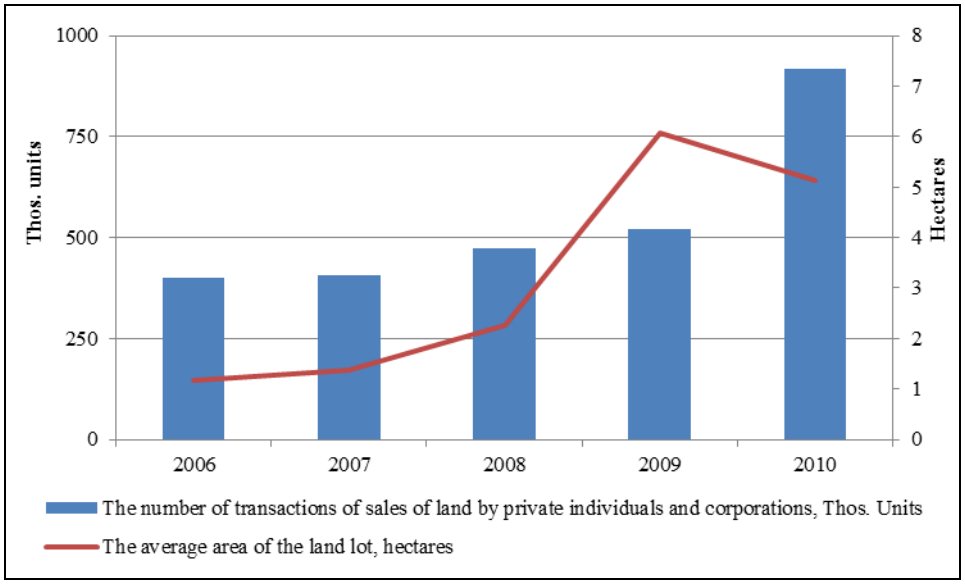
Table 28

The Average Size of Rental Fee for the Use of Public and Municipal Land in Russian Federation (as Rb/M²)

Tenants	2007		2008		2009		2010	
	In settlements	Outside settlements	In settlements	Outside settlements	In settlements	Outside settlements	In settlements	Outside settlements
1.Corporations, organizations, institutions: from the industrial sector								
Transport, communications, construction	20.59	3.45	19.62	10.36	29.48	40.40	58.81	4.75
Trade, public catering, household and consumer services	74.19	9.69	719.2	22.08	200.52	14.85	131.20	24.73
Agricultural corporations	0.33	0.03	3.76	0.22	2.76	2.23	10.42	0.8
2. Residents, their associations, using land lots for construction of housing and summer housing								
construction of housing and summer housing	3.68	1.03	7.47	5.95	13.43	1.27	17.27	0.86
Personal subsidiary farming, vegeculture, gardening	0.36	0.15	0.66	0.07	1.49	0.17	2.02	1.07

Source: The state (national) report "On the state and use of land in Russian Federation in 2010".

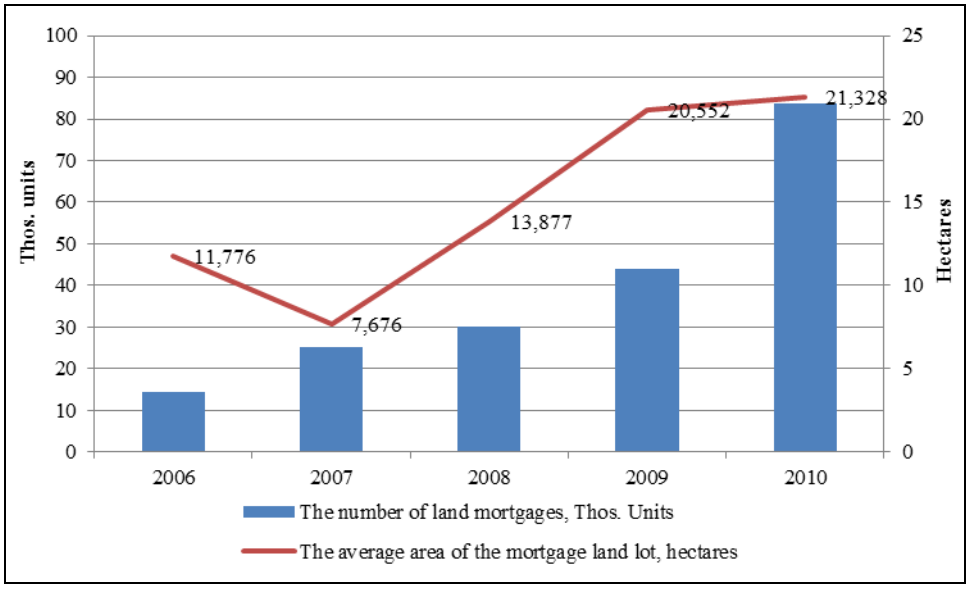
The 2010 turnover of private land lots accounted for 917,354 transactions (*Fig. 16*) of the total area of 4,706.821 hectares, or up 76.3% transaction-wise and 49.0% - area-wise vs. the 2009 figures. The average area of a land lot per transaction in 2010 was 5.13 hectares vs. 6.07 hectares in 2009.



Source: The state (national) report "On the state and use of land in Russian Federation in 2010".

Fig. 16. Dynamics of Sales by Private Individuals and Corporations of Privately Owned Land Lots

The number of mortgage transactions involving land lots in 2010 was 1.9 times greater than in 2009 (*Fig. 17*), with the total mortgage area accounting for 1,786.079 hectares. The average area of the mortgaged land lot in in 2010 was 21.3 hectares, or slightly over the 2009 figure.



Source: The state (national) report "On the state and use of land in Russian Federation in 2010".

Fig. 17. Dynamic of Mortgaging of Land Lots by Private Individuals and Legal Entities

The share of the area of privately owned (by private individuals and corporations combined) mortgaged land lots in the total area of a federal okrug varies from 0.24% in far-East Federal Okrug to 2.44% in the Central one. The 2010 average national figure was 1.33%, or nearly twice as high as in 2009 (*Table 29*). The share of mortgaged agricultural land in the total area of mortgaged land was down to 79.54% from 86.88% in 2009.

Table 29

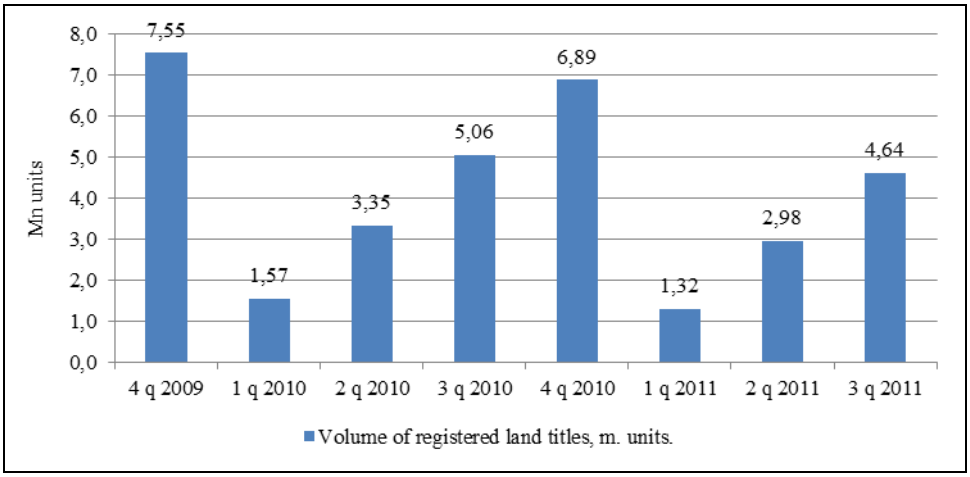
Characteristic of Mortgaged Land in Russian Federation in 2010

Federal okrugs	Land owned by private individuals and corporations	Of which mortgaged		Including agricultural land	
	(by state accounting), Thos. hectares	hectares	%	hectares	%
Russian Federation	**133446.1**	**1 786 079.51**	**1.33**	**1 420 645.88**	**79.54**
Central	24582.2	598 936.52	2.44	577 217.34	96.37
North-Western	4873.8	30 892.23	0.63	16 500.46	53.41
Southern	19249.5	76 375.36	0.40	45 668.32	59.79
North-Caucasian	4652.3	25 207.41	0.54	22 196.90	88.06
Volga	35847.8	554 631.38	1.55	531 866.40	95.90
Ural	9874.5	204 812.89	2.07	37 661.23	18.39
Siberian	31959.6	289 376.52	0.91	185 963.30	64.26
Far-East	2406.4	5 847.23	0.24	3 571.94	61.09

Source: The state (national) report "On the state and use of land in Russian Federation in 2010".

According to Rosreestr, the 2011volume of registered land titles was down vs. respective periods of 2010 (*Fig. 18*), which may evidence a decline of the turnover of land lots. More

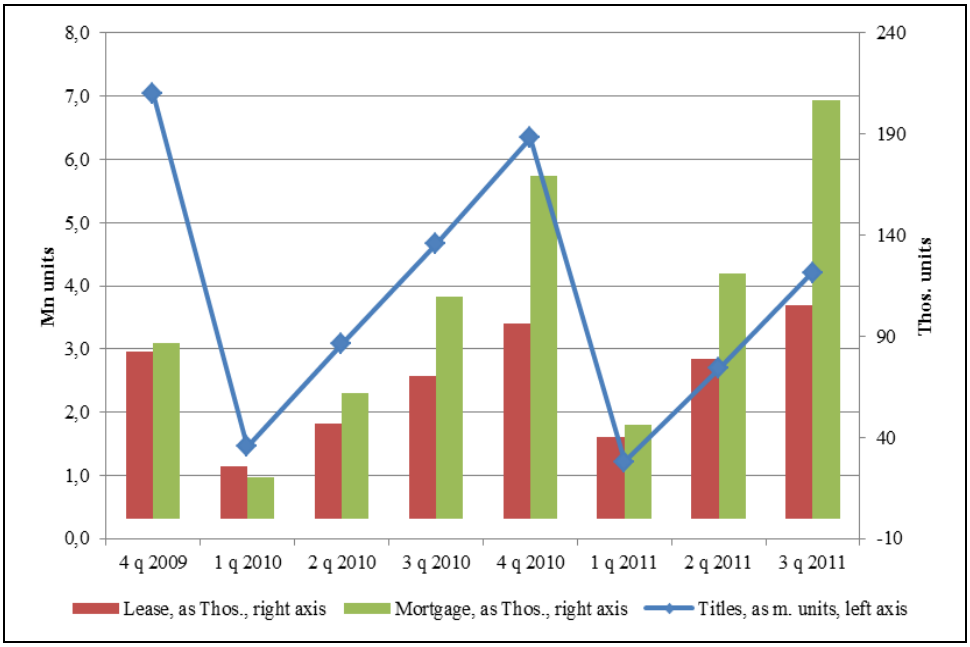
specifically, the fall in Q1 2011 vs. Q1 2010 was 15.8%, H1 2011 vs. H1 2010 – 11.1%, and over the first three quarters 2011 vs. the same period of 2010 – 8.4%.



Source: data of Rosreestr.

Fig. 18. Volume of Registered Land Titles

While the volume of state registration of private individuals' land titles over the three quarters 2011 was down 9.7% vs. the same period of 2010, volumes of registration of land lease and mortgage contracts by private individuals over the period in question rose by 49.5% and 88.5%, respectively (*Fig. 19*).

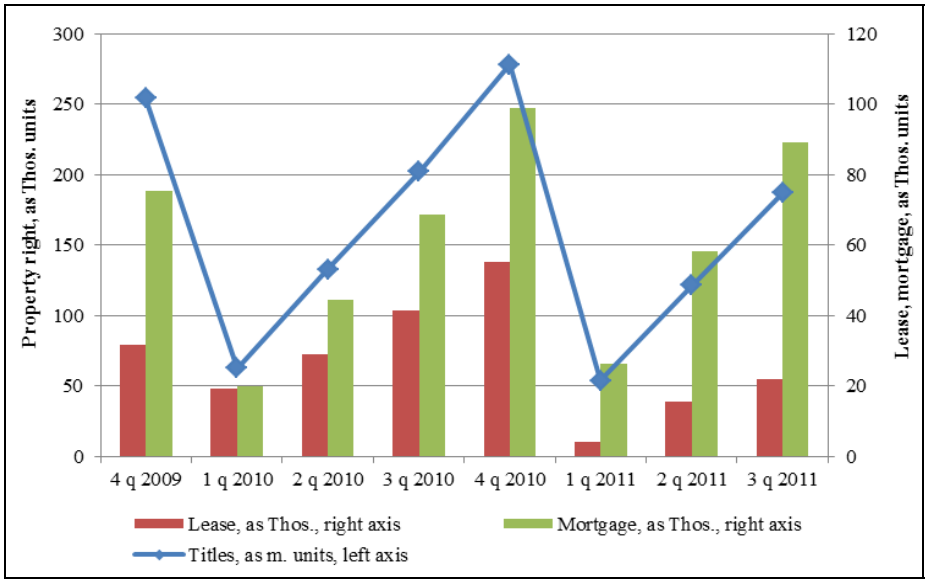


Source: data of Rosreestr.

Fig. 19. Dynamic of Registration of Private Individuals' Rights to Land Lots

According to Rosreestr, as of 1 October 2011, volumes of state registration of property rights to, and lease of land lots by legal entities were down 7.4% and 47.1%, respectively, on

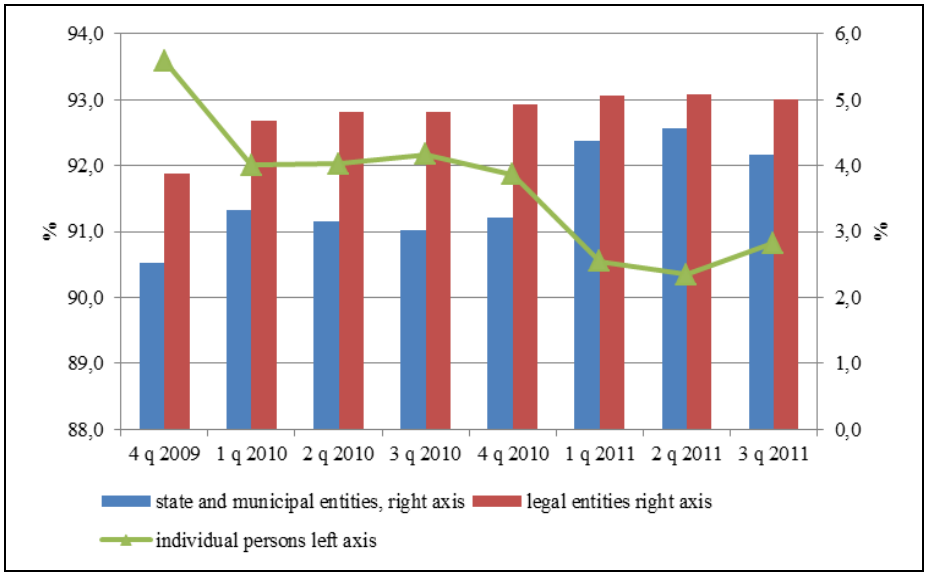
a year-on-year basis, while the volume of registration of mortgaged land lots over the period in question rose by 29.7% (*Fig. 20*).



Source: data of Rosreestr.

Fig. 20. Dynamic of Registration of Corporate Rights to Land Lots

The distribution pattern of volume of state registration of land titles (*Fig. 21*) shows that in terms of the number of registrations 90% of the land lots turnover falls on private individuals. As of 1 October 2011, the share of registrations of land titles by private individuals was down by 1.35 p.p. compared with 1 October 2010 and accounted for 90.82%, while shares of corporations and public and municipal entities were up 0.2 p.p. and 1.15 p.p., respectively.



Source: data of Rosreestr.

Fig. 21. Dynamic of Distribution of Registered Land Titles between Private Individuals, Corporations and Public and Municipal Entities

On 1 February 2011, Rosreestr submitted to territorial bodies of the Federal Tax Service data on all the land lots subject to taxation. The tax base to calculate the land tax I formed by the cadaster value of a land lot, with the land tax rate calculated as percentage thereof and the actual amount of the tax is set accordingly. Specifically, the 2006 weighted average national cadaster value of 1 hectare of agrarian land was up by Rb 8,067 vs. the 2003 figure. The increase in the specific indicator of cadaster value was particularly notable in the Central, North-Caucasia and Southern federal okrugs where the average value of 1 hectare of agrarian lands rose more than 1.8 times; in the North-Western and Volga federal okrugs, the respective figure was 1.7 times up. By results of cadaster valuation works, the most valuable agrarian lands whose cadaster value stand at Rb 8.39/m² are located in Krasnodar krai.

Most municipal legislatures (a. 60% of them) rule to establish maximum cadaster value-based land tax rates within their jurisdictions. In compliance with the Tax Code of Russian Federation, the maximum land tax rate on land lots falling under the categories of agrarian land, as well as land lots designated for housing and engineering infrastructure, personal subsidiary farming, vegeculture, gardening or cattle breeding, as well as summer housing, accounts for 0.3% of the cadaster value of the lands. Meanwhile, as to other lands not exempt from the land tax, the maximum tax rate on them is 1.5% of their cadaster value.

According to FTS, in 2010, as much as Rb 109,414bn was collected from cadaster-based land tax payments, or 18% up vs. the respective period of 2009 (Rb 92.44bn).

Since 1 January 2012, while registering property rights to land plots under industrial enterprises, the effect of the beneficial redemption rate of 2.5% of the cadaster value was terminated and replaced with market prices. The RF Ministry of Economic Development estimates the share of enterprises having passed the re-registration procedure at the level of no more than 70%.

6.6.2. Price Situation on the Housing Market[1]

In 2009, the price downfall on the housing market was ubiquitous. In 2010, the city of Moscow saw the beginning of a gradual price rise (up by 10%), while most cities in the sample were experiencing an oscillating price stability. Price increases in nominal terms were noted everywhere, except for Nizhny Novgorod, Stavropol and Shakhty; however, in real terms they were down practically everywhere, except Moscow and Novosibirsk.

In 2011, the dynamic of nominal housing prices across the sample of 20 cities and Moscow oblast was as follows (*Table 30*):

[1] All calculations were made on the basis of monthly data on the average specific housing offer price in Russian cities provided by certified by RGR real estate market analysts Sternik S.G. (Sternik′s Consulting Ltd.), Beketov A.G (all from Moscow and Moscow oblast), Bobashev S.B., Bent M.A., GK «Real Estate Bulletin» (St. Petersburg), Khorkov M.A. Antasyuk A.A., Tukhashvili G.T. (all from RITS UPN, Ekaterinburg), Sosnitsky E.G., Titul (Rostov-on-Don), Chemodanov A.L., "Indicators of Nizhny Novgorod Real Estate" (Nizhny Novgorod), Ermolaeva E.A., Salmina K.A., RID Analitics (Novosibirsk, Kemerovo, Barnaul, Krasnoyarsk), Molodkina C., ALCO Association (Tyumen), Epishina E.D., Epishina Yu.V., GK "Kama Valley" (Perm), Khairullina N.A., "United Regions (Ufa), Zyranova G.N., «KuzbassInvest Stroy» (Kemerovo), Moskalev A.A., «InvestOtsenka» (Voronezh), Kovalchuk N.I., RK «Sluzhba nedvizhimosti» (Chelyabinsk), Savina M.Yu., «Agentstvo pechati i informatsii», Kazakov R., «Ryazan Real Estate» newspaper (all from Ryazan), A.M. Cheremnykh, UK «ASSO-Stroy» (Izhevsk), Trofimov A.S., "Ilecta" center (Stavropol), E.R. Gamova., «Real Estate» Center (Ulyanovsk), Trushnikov A.V., «B.I.N.-Expert» (Sterlitamak), Eydlin G.Yu., «Realty» (Shakhty).

Table 30

Dynamic of the Average Specific Apartment Offer Price on the Secondary Housing Market

City (region)	Тыс. руб./кв. м			Index relative to Moscow		Increase to 2010, %	
	December 2009	December 2010	December 2011	December 2010	December 2011	Nominal	Real
Moscow	153.0	168.5	185.5	1	1	10.1	3.8
St. Petersburg	81.1	82.3	88.3	0.488	0.476	7.3	1.1
Moscow oblast	71.5	73.0	80.0	0.433	0.431	9.6	3.3
Ekaterinburg	53.0	55.5	63.8	0.329	0.344	15.0	8.3
Rostov-on-Don	48.4	50.5	55.8	0.300	0.300	10.5	4.1
Nizhny Novgorod	46.4	45.8	49.58	0.272	0.267	8.3	2.0
Novosibirsk	45.5	49.7	50.8	0.295	0.274	2.2	–3.7
Tyumen	43.1	45.4	53.0	0.269	0.286	16.7	10.0
Perm	42.4	44.1	48.4	0.262	0.261	9.8	3.4
Krasnoyarsk	40.3	43.5	48.8	0.258	0.263	12.2	5.7
Ufa	41.0	43.9	49.2	0.261	0.265	12.1	5.6
Kemerovo	40.3	40.6	44.4	0.241	0.239	9.4	3.1
Voronezh	Н/д	35.8	41.3	0.212	0.223	15.4	8.7
Chelyabinsk	36.8	37.2	39.9	0.221	0.215	7.3	1.1
Ryazan	35.4	37.7	40.8	0.224	0.220	8.2	2.0
Barnaul	34.4	35.1	40.2	0.208	0.217	14.5	7.9
Izhevsk	33.3	34.9	39.6	0.207	0.213	13.5	6.9
Stavropol	32.1	30.5	31.6	0.181	0.170	3.6	–2.4
Ulyanovsk	31.0	31.8	34.2	0.188	0.184	7.5	1.4
Shakhty (Rostov oblast)	27.0	26.3	27.6	0.156	0.149	4.9	–1.1
Sterlitamak (Bash-kortostan)	22.9	23.7	28.5	0.141	0.154	20.3	13.3

In 2011, nominal prices were on the rise in all the cities of the sample, with the range of the increase being a broad one: from 2.2% in Novosibirsk to more than 20% in Sterlitamak. In Moscow, the price rise accounted roughly for 10%, like a year ago. It mostly was Ural and Siberian cities (Tyumen, Ekaterinburg, Barnaul, Izhevsk, Krasnoyarsk, Ufa), as well as Voronezh and Rostov-on-Don, where the price increases were greater than in Moscow.

By contrast, the group of cities where price increases were lower than in Moscow is located largely in the European part of Russia (Moscow oblast, Nizhny Novgorod, Ryazan, Ulyanovsk, St. Petersburg, Shakhty, Stavropol), as well as Perm, Kemerovo and Chelyabinsk. Quite notably, like Moscow oblast, Perm and Kemerovo's price increases were just slightly below Moscow's.

The Russian capital remained an absolute leader in terms of the price level for housing. In more than a half of the cities of the sample housing prices were at a level of 20 to 30% of Moscow's. The gap was somewhat narrower in Ekaterinburg (0.344), Moscow oblast (0.431) and St. Petersburg (0.476) prices. Meanwhile, at the bottom of the list (15-20% of Moscow's price level) were Ulyanovsk, Stavropol, Sterlitamak, and Shakhty.

In most cities of the sample the December 2011 price level vis-à-vis Moscow's one was less than in December 2010, except for a few cities in the Urals and Siberia (Ekaterinburg, Ufa, Izhevsk, Sterlitamak, Krasnoyarsk, Barnaul), and Voronezh, albeit all those changes were quite negligible.

Unlike the prior year, the 2011 the housing prices in real terms (less the 6.1% annualized inflation on the consumer market) (the IGS index)[1] were on the upsurge in most of the cities in question, except for Novosibirsk, Stavropol and Shakhty, where real prices were down (1–4%). Atop the leading group in terms of increase in real housing prices were Sterlitamak (13.3%), Tyumen (10%), Voronezh, Ekaterinburg, Barnaul, Izhevsk, Krasnoyarsk, Ufa (between 5 and 9%).

As to the correlation between prices on the primary and secondary markets, it is worthwhile to note Moscow, with the specific price on the secondary market being lower than that on the primary one (in 2011 – at 12–17%) (*Fig. 22*).

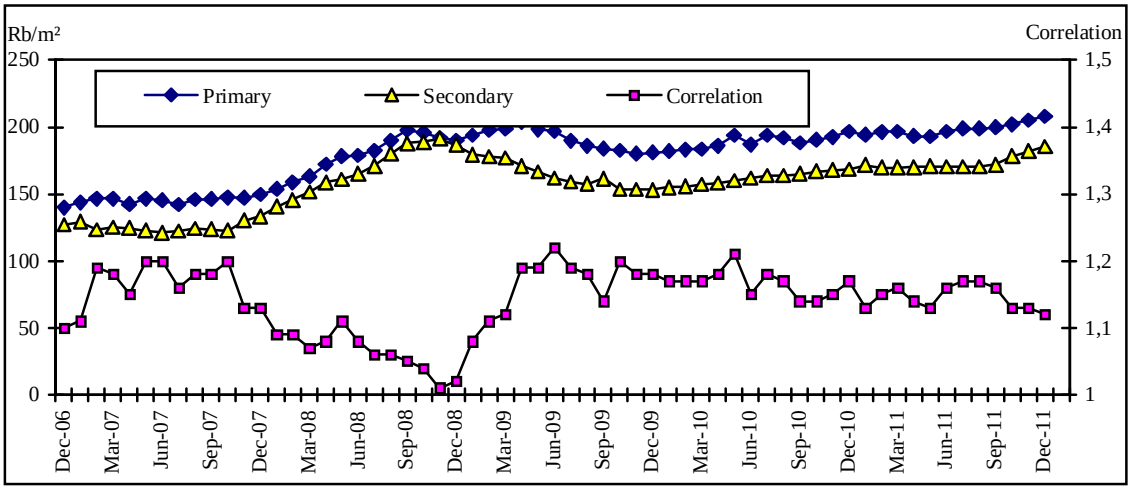


Fig. 22. Price Correlation between the Primary and Secondary Markets in Moscow

By contrast, prices in most other cities, as a rule, were higher on the secondary market: the gap was: in Izhevsk – 2–7%, Ryazan – 5–15%, St. Petersburg – 13–16,3%, Stavropol – 16,5–20%, Perm – 13–21%, Moscow oblast – 15–20%, Novosibirsk – 17–25.5%, Tyumen – 22–27%.

In this context, mavericks became Chelyabinsk and Ufa, where the gap proved pretty narrow, and Nizhny Novgorod where through most of 2011 prices on the secondary market have been following the trend noted in other cities, but by the fall they had caught up with or exceeded those on the secondary market.

The main driver of such differences is the differentiation of the quantitative-qualitative structure of housing on the markets concerned. In Moscow, roughly a half of the offer on the primary market is formed by residential property of advanced quality (business and elite class housing). By contrast, in the other cities, the absolute bulk of offer concentrates in the economy-class and middle-class segment. Plus, the quality of newly built housing differs across the cities with regard to the presence/absence of interior works and their quality, and stages of construction (and, accordingly, the cost) as of the moment of payment of the co-investment contract. The price correlation also changes in time, due both to changes in the quality of housing under construction and the state of the market determined by developers' price differences in response to change in demand during the crisis.

[1] The IGS index is calculated using the following formula: IGS=Ipr/Icp, where Ipr is the housing price index in Rb. equivalent, Icp – consumer price index.

6.6.3. Revitalization on the Real Estate Market

Revitalization of the real estate market started yet in late 2009. In 2010, with the deferred demand back to the market, it bounced back to the pre-crisis level. The distinctive feature of the 2011 housing market became its expansion, which was fueled both by the deferred demand and deferred offer ("investment" apartments, collaterized housing, etc.), which resulted in a considerable increase of offer and secured a lack of shortages on the housing market.

Data on Moscow serves a perfect illustration of the trend. Back in 2009, the number of apartment sales accounted for 55,680 deals, thus being at its record lows over the whole post-Soviet history of the market. By contrast, in 2010 the volume of deals added 54% and hit 85,700, thus having caught up with the all-time pick of 2003. In 2011, the number of deals cleared a new height by having added another 6.4% and accounting for 91,200 deals (*Fig. 23*).

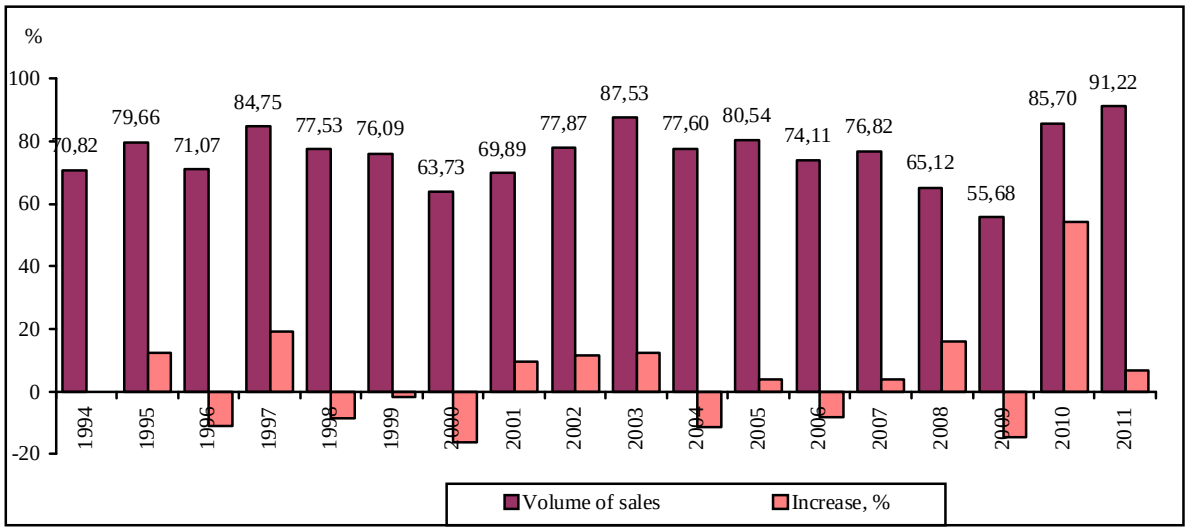


Fig. 23. Annual Volume of Apartment Sales on Moscow's Secondary Market

Such a combination of dynamics of the market indicators (moderate price rise rates under a rally on the market) shows that the market has found itself in the phase of revitalization with a tendency to transition to the phase of growth: with demand having renewed, offer now matches demand and, should the population's incomes continue growing, the price rise rates may accelerate.

In 2011, Moscow saw continuation of the rise in the volume of mortgages – they accounted for 24,000 vs. 20,000 a year before. The increase (roughly by 20%) of course is no match to a nearly 4-fold one in 2010, but at the time, we noted a post-crisis bounce back of the mortgage mechanism from a very low 2010 benchmark.

Increase in the proportion of mortgage deals in the aggregate number of housing deals slowed down in 2010–2011 at the level of 23–26% (26–29% in individual months of 2011), which roughly corresponds to the share of direct apartment purchases (with the rest of the deals being alternative ones, which are financed at the expense of sales of the existing apartments).

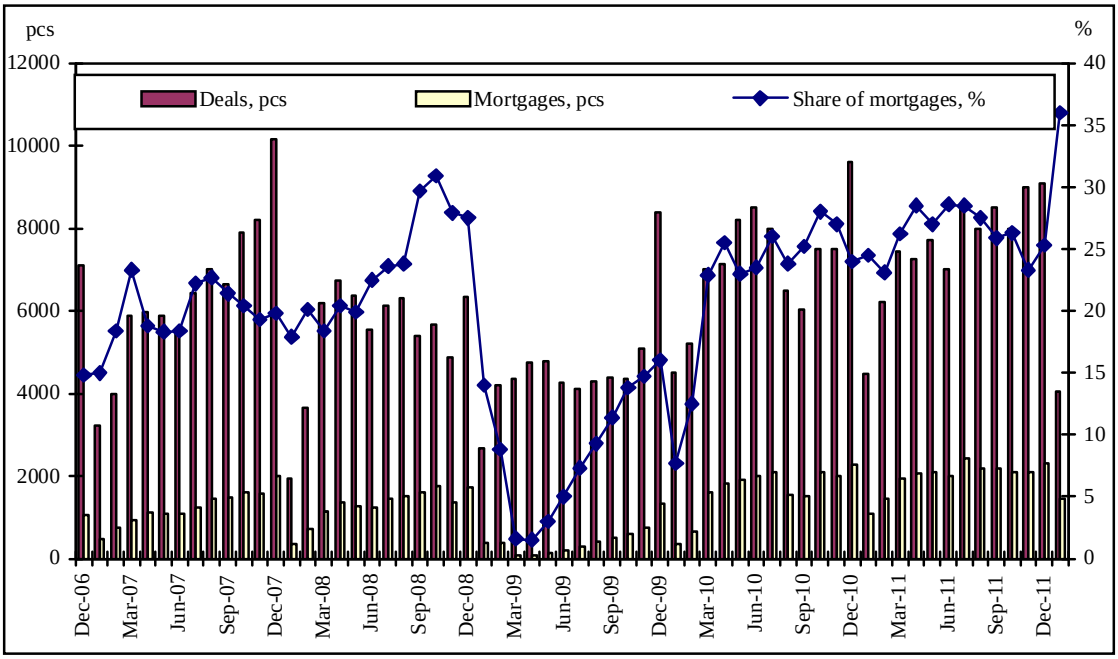


Fig. 24. Dynamics of Turnover of Housing and Mortgage Markets in Moscow

6.6.4. Dynamic of Placement of new Housing in Operation and Prospects for Institutional Development of Housing Provision Mechanisms

In 2011, volumes of placement of new housing in operation have posted growth for the first time since the start of the financial crisis (by 6.6% on a year-on-year basis). The volume of such housing accounted for 788,200 apartments with the total area of 62.3m m² (*Table 31*), with the increase being noticed only since H2.

Table 31

Placement of Housing in Operation in Russia in 1999–2011

Year	M m² of total area	Increase rates, %	
		to the prior year	to 2000.
1999	32.0	104.2	105.6
2000	30.3	94.7	100.0
2001	31.7	104.6	104.6
2002	33.8	106.6	111.5
2003	36.4	107.7	120.1
2004	41.0	112.6	135.3
2005	43.6	106.3	143.9
2006	50.6	116.0	167.0
2007	61.2	120.9	202.0
2008	64.1	104.7	211.5
2009	59.9	93.4	197.7
2010	58.4	97.5	192.7
2011	62.3	106.6	205.6

Sources: Russian Statistical Yearbook. 2007: Stat. collection./ Rosstat, M., 2007, p. 507; Russian Statistical Yearbook. 2011: Stat. collection/ Rosstat, M., 2011, p. 461; On housing in 2011, www.gks.ru, the authors' calculations.

So, the year 2011 saw the record-breaking figures of placement of new housing in operation, well in excess of the pre-crisis 2007 figures, which in turn were twice as big as the 2000 ones. This creates good preconditions for hitting the historic peak for the 2000s already reported once in 2008 (despite the rise of a sharp phase of crisis in the fall of the year, effects from the investment collapse echoed in the house-building sector only in 2009).

The proportion of individual house construction in the aggregate area of housing completed in 2011 accounted across Russia for 42.9%. In terms of the rate of placement of housing in operation (4.6%) individual house construction roughly corresponded to the 2009 figures, while in terms of its specific weight –the 2008 figures. Individual house construction prevailed in a number of regions (Altay Republic, Bashkortostan, Ingushetia, Dagestan, Tyva, Kabardino-Balkaria, Karachaevo-Cherkessia, Chechnya, Astrakhan and Belgorod oblasts) and accounted for between 73.3 and 94.5% of the total area of completed housing construction projects.

Positive dynamics of housing construction was noted in the overwhelming majority of Russian regions, including those where the aggregate volumes of placement of housing in operation exceeded 1m m² (*Table 32*).

Table 32

Dynamics of Placement of Housing in Operation in Russian Regions in 2011 (Adjusted by Housing Placement Rates)

Region	Housing Placement Rates, as % to 2010.
Samara oblast	127.8
Chelyabinsk oblast	122.6
Tatarstan	118.2
Stavropol krai	115.1
Tyumen oblast	113.9
Kemerovo oblast	108.0
Dagestan	107.7
Krasnoyarsk krai	106.3
Bashkortostan	105.1
Belgorod oblast	104.3
Rostov oblast	104.0
Moscow oblast	103.5
Leningrad oblast	103.0
Sverdlovsk oblast	102.7
Krasnodar krai	102.3
Moscow	102.1
Saratov oblast	102.1
St Petersburg	101.9
Nizhny Novgorod oblast	101.4

Source: On housing construction in 2011, www.gks.ru.

As evidenced by *Table 32*, Samara. Chelyabinsk, Tyumen (including Khanty-Mansy and Yamal-Nenetsky autonomous okrugs[1]), Tatarstan and Stavropol krai reported the dynamics of placement of new housing in operation be in excess of the average national figures (over 10%). Meanwhile, the increase in volumes of housing construction in the city of Moscow and St. Petersburg roughly made up a meager 2%. Moscow oblast posted a higher increase rate (3.5%), which was nearly twice as low as the national averages nonetheless.

That said, it should be remembered that since 2004 Moscow oblast has been the leading region nationwide in terms of absolute figures of placement of new housing in operation,

[1] That said, Yamal-Nenetsky Autonomous Okrug proved one of 13 regions where volumes of placement of new housing in operations were in decline.

while the city of Moscow started sinking along the respective ranking in the course of the last crisis and has plunged below a whole range of regions, including – for the second straight year – St. Petersburg. The specific weight of the capital region in the aggregate volume of the nationwide housing construction accounted just for 16.1% (16.4% in 2010), of which the lion's share (13.2%) fell on Moscow oblast's, while the share of the city of Moscow was 2.9%[1].

Such a situation seems quite logical. Throughout the whole 2011, the newly appointed City Hall has been busy reviewing earlier concluded 1,000-plus investment development contracts, including those in the housing construction sector. As a result, as many as 200 out of some 600 contracts were terminated. The canceled contracts mostly concerned downtown and infill development. The fact of the revision of the contracts of course has affected construction expansion rates in the city[2].

A mighty tool to clear the capital's urban space to give room to implementation of new approaches to the local development policy will be provisions of Federal Act of 12.12.2011 No. 427-FZ "On introducing amendments to Art 2 and 3 of the Federal Act "On implementation of the Land Code of Russian Federation" and individual legislative acts of Russian Federation" which provide for the following critical amendments.

A contract of lease of a public or municipal land lot located within the limits the of city of Moscow or St. Petersburg and concluded prior to 1 January 2011 for the sake of construction, reconstruction of real estate objects may become subject to early termination unilaterally by a respective public agency or local self-government body[3], where there has occurred a substantial breach of terms and conditions of the agreement of lease of such a land lot and or a substantial change of circumstances from which the parties to the agreement proceeded while entering into it.

The list of cases of the substantial breaches which may form the reason for a unilateral termination of such contracts by a public agency or local self-government body, include the following ones: (1) failure to honor obligations with respect to construction, reconstruction of the real estate object within the timelines provided for by the agreement, or (2) where there are no such timelines stipulated in the said agreement, for the term of which the permit on construction, reconstruction of the said object was granted, in the event the degree of the construction completion of the real estate object as of the last day of such a term is under 40% of the overall volume of its construction, reconstruction provided for by design documentation approved following the procedure established by the RF law; (3) an absence, upon expiration of 5 years from the date of conclusion of the said contract of permit for construction, reconstruction of the real estate object, construction of which is provided for by the said contract, in

[1] At this point, it should be noted that the Rosstat data also evidence that in 2011 in the territory of the city of Moscow, including the area of Lubertsy Fields, as much as 2,107.300 m² of total area of housing was placed in operation (106.9% to the 2010 figures), or roughly 300,000 m² more than in the aggregate table across all Russia's regions (1,805.200 ²m). No earlier published data on the aggregate placement of housing in operation over a number of years, including the housing built under the Moscow Government's program beyond the city's territory, were available.

[2] Boykova M. The epoch of construction minimalism.-In: Direct Investment, No. 12 (116), 2011, p.99.

[3] The contract of lease of such a land lot is considered terminated upon one month from the date of dispatch by the government agency or local self-government body of the contract termination notification. Prior to expiration of the said timeline, the party to the contract may forward the said agency/body its objections in writing with regard to the termination of the contract. In that case, the contract is deemed terminated since the date of dispatch of the notification of confirmation of the earlier made decision.

the event the contract in question does not provide for a date of completion of construction, reconstruction of the said object.

A material change of circumstances, from which the parties to the contract proceeded while entering into a contract of lease of the land site, under which the government agency or local self-government body is permitted to unilaterally terminate the contract, is termination of another agreement between the said agency/body and a public or municipal institution or unitary enterprise which provides for construction, reconstruction of a real estate object on such a land site leased per the said contract.

Provisions introduced with respect to investment contracts appear analogous to the above, except for a slightly reworded formulation of the material change of circumstances from which the parties thereto proceeded while entering into the contract and which allows its unilateral termination by the state. The material change of circumstances is the impossibility to fulfill obligations with regard to completion of construction, reconstruction of real estate objects due to the impossibility to allocate a land plot s per the law, as well as due to existence of a real burden or encumbrance with respect to titles held by third parties which prevent its construction, reconstruction.

Approved in September 2011, the city of Moscow's state program "Housing" for the medium term (2012-16) provides for construction over the period in question of 12.7m m² of housing at the expense of all sources of financing, including 3.8m m²-at the expense of budget funds. So, average annual figures should make up some 2.5m m² and 0.8m m², respectively, or less than those reported in the crisis 2009, to say nothing of the pre-crisis H2 2010.

Together with continuation of already existing programs of improvement of housing conditions (free allocation of housing, social mortgage, installment sale, resettlement of slum, rundown and morally obsolete housing and the one subject to demolition), the new accent in the City Hall's policy should become expansion of the housing fund for lease (construction of commercial and unsubsidized residential property) and major overhaul of the existing housing in a volume nearly twice in excess of the one of newly constructed housing (23.5m m²). The City Hall should also fulfill obligations with regard to provision of housing (with account of various payments) before 88,000 families (208,000 people)[1].

Prospects of expansion of housing construction in the capital region will be in many ways driven by effects from the decision to expand Moscow to South-West made on the federal level in the summer of 2011.

The ambitious plans to develop the so called 'New Moscow" suggest building in new territories some 60m m² of housing and 45m m² of office space (particularly to accommodate to-be-relocated plethora of government agencies and a financial center). The holistic approach to development of newly acquired city territories provides for creation of more than 1m highly qualified job opportunities and provision of housing to 2m Muscovites, and construction of office space and social, cultural and household objects. At the same time, the density rate in the newly developed areas is envisaged to be lower than within the Moscow Ring Road, particularly thanks to low-rise housing constructed with the use of modern technologies. It is planned to allocate huge funding out of the federal budget for the project implementation.

The factor of Moscow's expansion has already strongly affected the state of the real estate market in the capital region. Once announced, the future change of the metro's limits immedi-

[1] Resolution of the Government of Moscow of 27 September 2011 No. 454-PP.

ately caused a spike of previously unseen activity on the real estate market, with mass media fanning the boom.

Despite the summer holidays and traditional tranquility in all the business sectors, July and August 2011 broke long-standing record in terms of demand for apartments on the primary market. Between the late summer and early autumn 2011, developers' front offices were overstretched, and the pressure concerned both projects located in the new Moscow's territory other areas in Moscow oblast, too. Between the summer and early autumn 2011, demand for apartments on the market for newly built housing in the areas adjacent to the city of Moscow increased 2.5 times, while the number of deals with newly built housing in the territories to be added to Moscow was momentarily up 4-fold and remained on a fairly high level through October 2011. Presently, the level of activity is lower than last summer, but remains fairly high nonetheless. Some decline in the boom of demand is noticed on the market for newly built housing both in New Moscow and other areas near the city of Moscow.

Because of the change of the city of Moscow's limits by including therein a sizeable area south-west of the city and the subsequent record-breaking increase in demand, initially, prevailing sentiments on the local metro market were:

(1) anticipation of a rapid speculative price rise for real estate on the primary and secondary markets in the areas in question to make a fortune on rumors of inclusion of certain territories in the city of Moscow;

(2) anticipation of a mass increase in the number of new investment and development projects in the new Moscow's territory and their entering the market any time soon;

(3) anticipation of some price adjustments on the Moscow city real estate market, particularly in the territories adjacent to the future Moscow areas.

That said, by results of the period in question, no drastic price rise for housing in the above territories was noted. For instance, some complex residential development projects saw average prices having added just 5 to 7% over the 3-4 month-long period. At this point, it should be noted that similar price rise rates were noted across all the projects located in the same region, except for a few projects where prices were raised by 20-30%. Those, however, were unique cases and out of the mainstream trend.

It is prospects of the project's further development which will largely affect the atmosphere on the real estate market, the degree of consumer trust and demand. Disappointment of those who, spurred by discussions on Moscow's expansion, have already invested in real estate in the new territories may emerge as a significant factor fueling a collapse of the market and the rise of mass claims to return private investments, which would mean sizeable losses for developers operating in New Moscow.

As to the general situation across Russia, in 2011, the nation's leadership vowed to bolster availability of mortgage for some groups of residents by cutting the interest rate and the amount of the initial installment. Meanwhile, alternative to mortgage approaches to the housing problem, such as cooperative housing societies (CHS) and housing savings societies (HSS), and building-and-loan-associations (BLA), started drawing an increasingly greater attention.

One of the first steps in that direction became enactment of amendments to Federal Act of 24.07.2008 No. 161-FZ "On assistance to expansion of housing construction".

Presently, employees at regional and municipal educational, healthcare institutions were added to the list of groups of residents[1] who, while establishing a HSS, have the right to apply to the Federal Fund for Assistance to Development of the House Construction (FFADHS) for a free land plot for a cooperative housing construction project. Such an arrangement generates certain preconditions for cutting down construction project costs, as the FFADHS's principal vehicle nonetheless are auctions on land plots, which implies the market interaction between demand and offer, which clearly falls short of securing a greater availability of housing. Plus, HSS enjoy some tax benefits, while their members potentially have possibilities to influence progress in a construction project implementation (by electing the project management, having access to documentation, etc.).

While assessing this novelty, it is worthwhile to note first that an evident hurdle to the spread of the mechanisms in question remains the problem of a low level (relative to costs of housing) of labor compensations in the economy in general and in the public sector in particular. The challenge will inevitably arise under any organizational and legal arrangement (whether a share-based contribution while joining an HSS, or the amount of the initial installment while obtaining a mortgage).

That said, the alternative mechanisms bear certain risks. More specifically, by contrast with participation in a shared construction project, membership with a housing association does not necessitate a compulsory project declaration, obtaining a construction permit and registration of all transactions. HSS members may face expulsion, the need to bear subsidiary responsibility for the association's obligations within the limits of a non-invested fraction of an additional contribution of each HSS member and cover possible losses by collecting additional contributions under the threat of liquidation of the HSS pursuant to its creditors' claims[2].

It is quite likely that the alternative vehicles have a long and winding road to travel, as far as the problem of improvement of their operational mechanisms is concerned, thus following the dependency path of shared construction projects back in the mid-'2000s. The proportion of housing put in operation by HSSs in the overall volume of housing placed in operation in 2008-10 thus far has fallen short of exceeding even 1% (2000 – 2.4%, 2005 – 1.4%)[3].

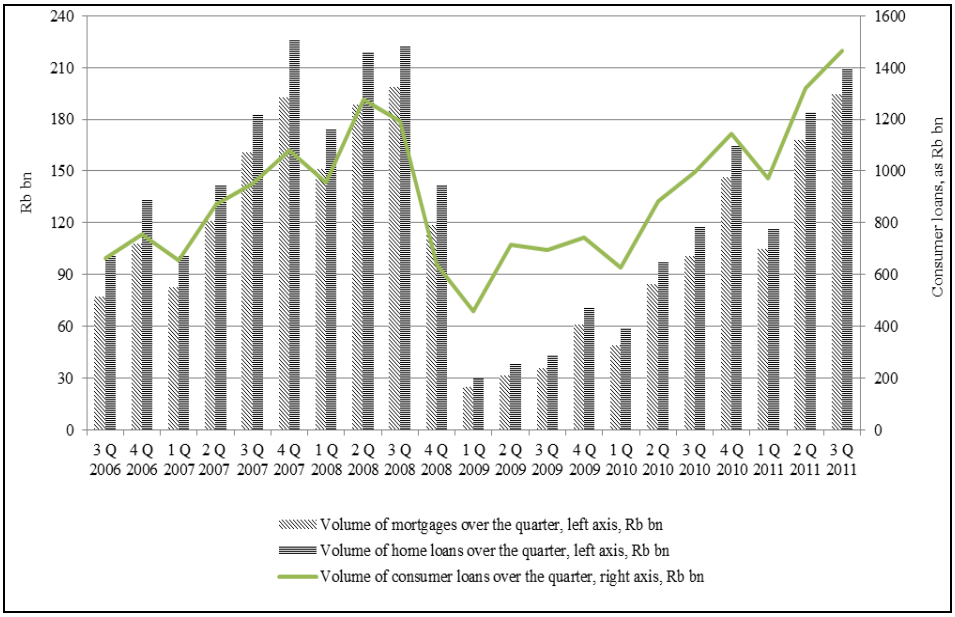
As well, problems of administrative barriers and monopoly in the housing construction sector have remained persistent, though the crisis has given rise to an ongoing process of shaping up of a new configuration of the construction market. Thus, in the early autumn of 2011, a co-owner of BIN-bank in tandem with "Sberbank Investment Ltd", a Sberbank's subsidiary, acquired JSC Inteco, Paritet and all their affiliated structures (though the Sberbank Investment's stake is a symbolic 5%). The assets, which were not limited to construction and development, were acquired for as much as USD 1.2bn[4].

6.6.5. The Home Loan Sector

According to the CBR, over 11 months 2011, as many as 656 credit institutions disbursed 449,210 mortgage loans (ML) for a total of Rb 613,355bn, or up 1.95 times vs. the respective figure as of 1 December 2010. The number of ML as of 1 November 2011 evidenced the out-

[1] The right in question was earlier granted solely to the federal-level public servants (including the military), staff of federal public enterprises and unitary enterprises, educational and academic research institutions.
[2] Sanzhiev D. Associations may challenge mortgage //Economics and Life, No. 01 (9417) 13 January 2012, p. 19.
[3] Russian statistical yearbook. 2011: Stat. comp./Rosstat, M., 2011, p. 461.
[4] Inteco sold - In: Direct investment, No. 10 (114)б 2010, p. 72.

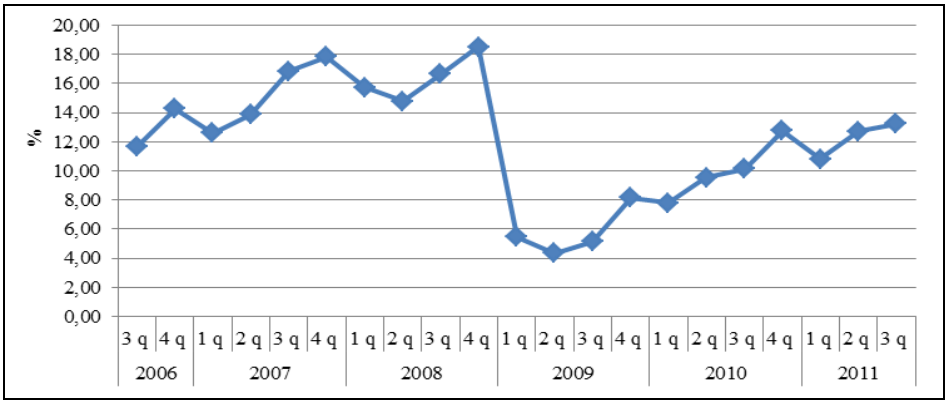
running of 2008 when 602 credit institutions extended, throughout the year, 349,502 ML worth a total of Rb 655.8bn; by volume of extended ML Q3 2011 practically caught up with Q3 2008 (!*Fig. 25*).



Source: data of CBR.

Fig. 25. Quarterly Dynamic of Loans Extended to Private Individuals

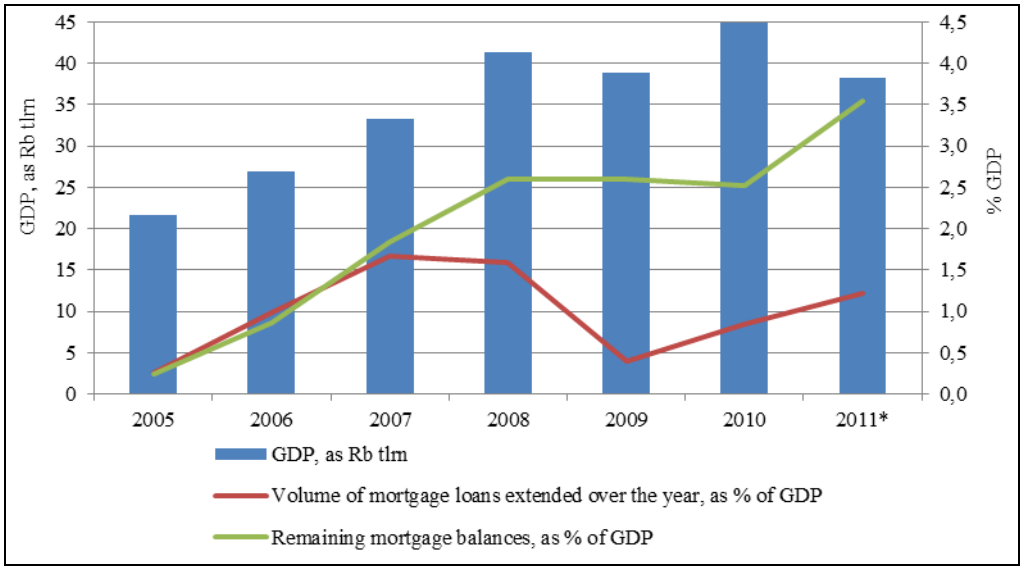
In Q3 2011, the share of ML in the volume of consumer lending added 3.13 p.p. vs. Q3 2010 and hit 13.25% (*Fig. 26*). The volume of consumer lending in Q3 2011 accounted for Rb 1,466.78bn (the proportion of ML therein making up 13.25%), thus having outrun the pre-crisis peak of Rb 1,275.46bn. (the share of ML – 14.77%) reported in Q2 2008 (*Fig. 26*). The increase rate of the respective share of ML trails behind the increase in the volume of consumer lending. The pre-crisis peak values of shares of ML and HL in the volume of consumer lending (Q408: 18,5% and 22.24%, accordingly) were not attained either.



Source: the CBR data.

Fig. 26. Dynamic of the Proportion of ML Extended to Private Individuals over the Quarter in the Volume of Consumer Lending, as %

The volume of ML extended as of 1 October 2011 accounted for 1.22% of the respective GDP vs. 0.85% in 2010 and the 2007 peak pre-crisis value of 1.67%. (*Fig. 27*). The arrears by ML as of 1 October 2011 accounted for 3.54% of GDP, or 1.3% higher than in 2010 and 0.93 p.p. higher than the peak pre-crisis value in 2008.

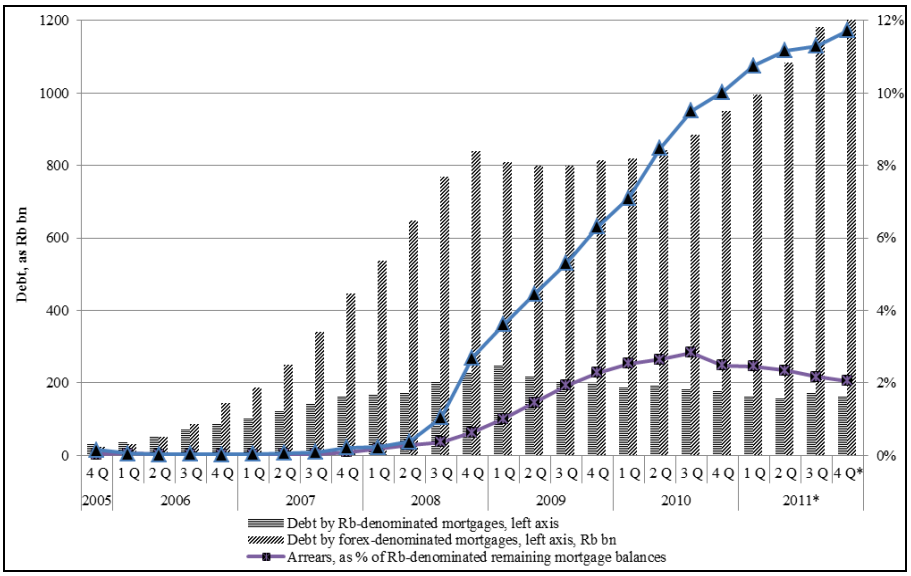


Source: the CBR data.

Fig. 27. Dynamic of Mortgage Lending, as shares of GDP, %

The year of 2011 saw continuation of the increase in the remaining Rb-denominated mortgage balances and decline in the share of outstanding payables in the remaining debt balances (*Fig. 28*). As of 1 December 2011, the Rb-denominated mortgage arrears rose by 37.3% vs. 1 December 20101 and accounted for Rb 1,261.878bn. The volume of arrears was down 0.78 p.p. vis-à-vis 1 December 2010 and accounted for 2.06% of the outstanding payables. During the period in question, the volume of forex-denominated remaining mortgage balances tumbled by 12.4% and made up Rb 163,357bn, while outstanding debt was up 1.74 p.p. and hit the level of 11.72%. As of 1 December 2011, the Rb-denominated remaining mortgage balances in cash equivalent increased up to Rb 26,006bn, while the forex-denominated ones climbed up to Rb 19,152bn.

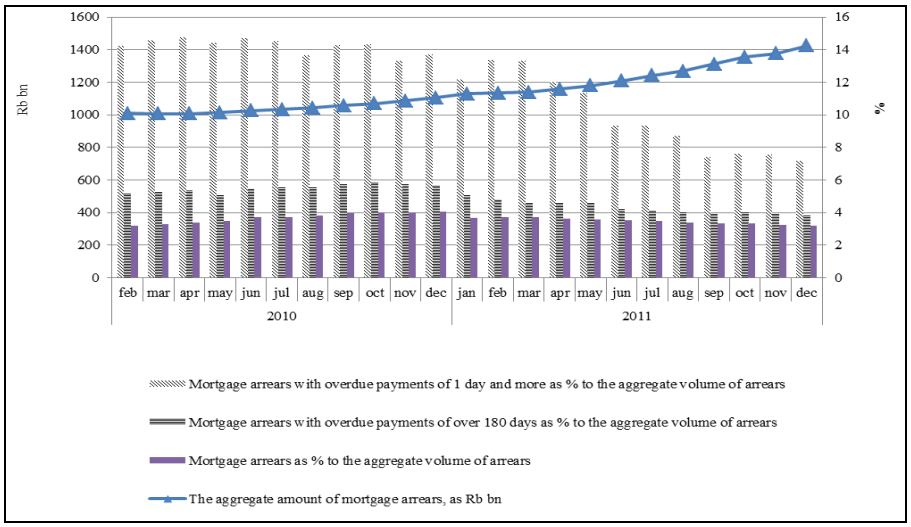
According to data of the Federal Service for State Registration, Cadaster and Cartography, as of 1 October 2011, private individuals had registered as many as 683,032 cases of mortgage lien with the United State Titles Registry Database.



Source: the CBR data.

Fig. 28. Dynamic of Remaining Mortgage Balances and Mortgage Arrears

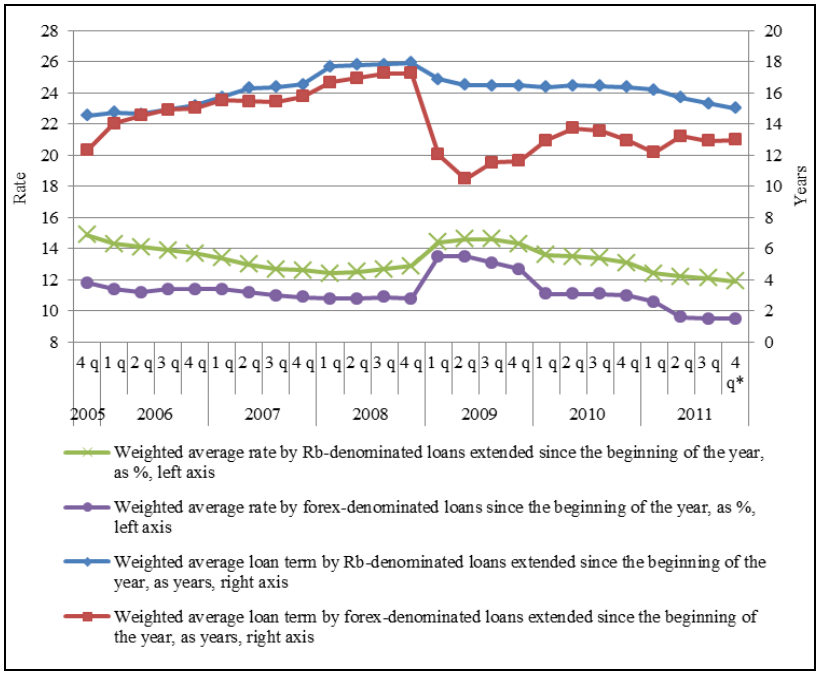
The year of 2011 saw increase both in remaining mortgage balances without outstanding payments and their proportion in the overall amount of the debt (*Fig. 29*). As 1 December 2011, the proportion of such arrears (Rb 1,324.185bn) in the total amount of the debt accounted for 92.91%, or down 5.08 p.p. vs. 1 January 2011. The proportion of mortgage arrears with overdue payments over 180 days (default loan arrears) in the overall amount of arrears as of 1 December 2011 was also down by 1.27 p.p. vs. 1 January 2011. In 2011, there was noticed a trend both to fall in the proportion of mortgage arrears with overdue payments over 180 days and decline in proportion of mortgage arrears in the overall debt.



Source: the CBR data.

Fig. 29. Dynamic of Mortgage Arrears and Overdue Payments in Terms of Payment Delays

In 2011, the weighted average rate by Rb-denominated mortgages disbursed since the beginning of the year slid from 13.1% as of 1 January 2011 down to 11.9% as of 1 December 2011 (*Fig. 30*). The weighted average rate by forex-denominated mortgages was also down since the beginning of the year from 11.0% to 9.5%.

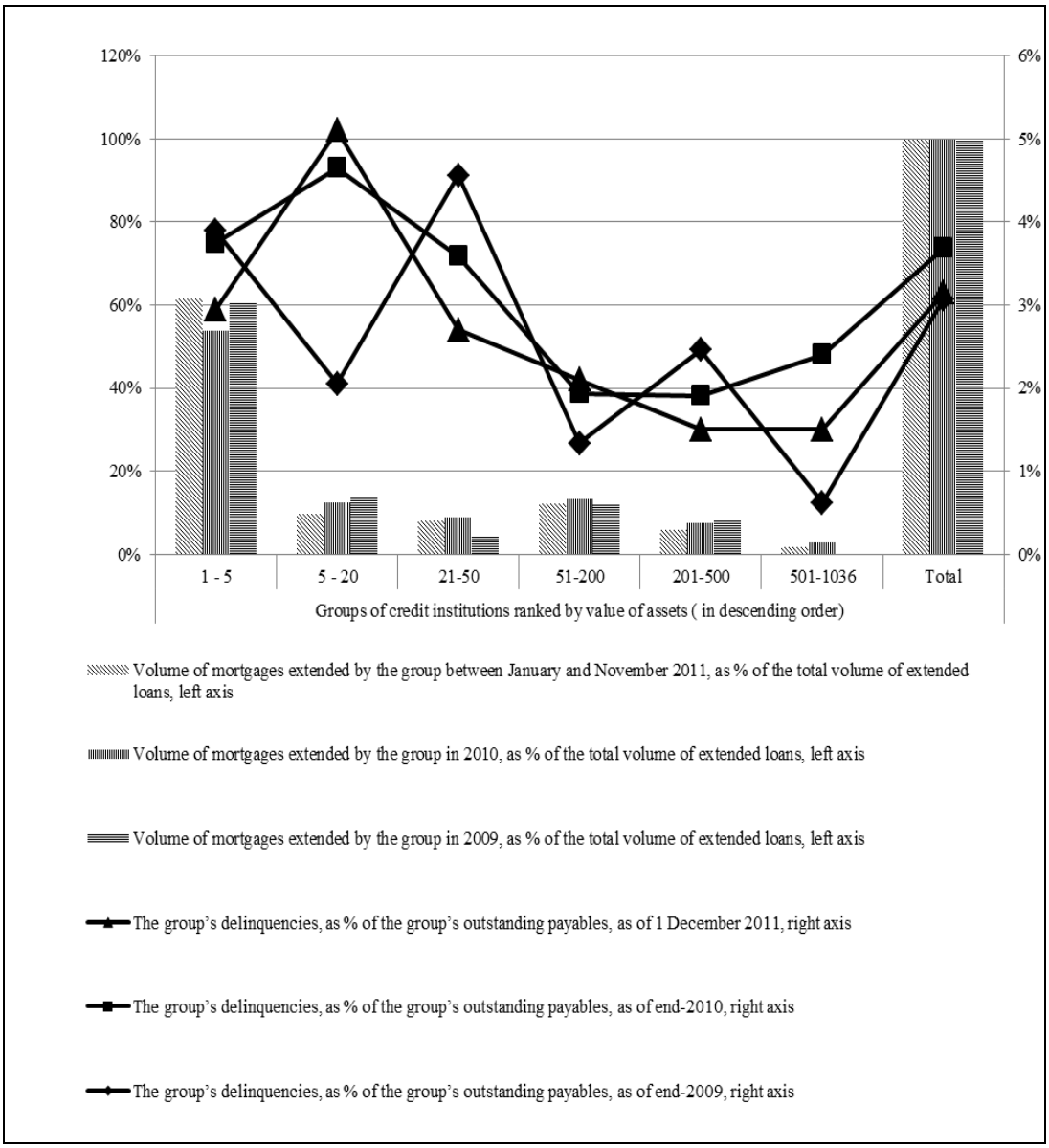


Source: the CBR data.

Fig. 30. Weighted Average Interest Rates and Loan Term by Disbursed since the Beginning of the Year Rb- and Forex-Denominated Mortgages

The weighted average loan term with regard to Rb-denominated mortgages extended since the beginning of the year was down from 16.36 years as of 1 January 2011 to 15.02 years as of 1 December 2011, while the weighted average loan term by forex-denominated mortgages made up 12.98 years as of 1 December 2011. (*Fig 30*).

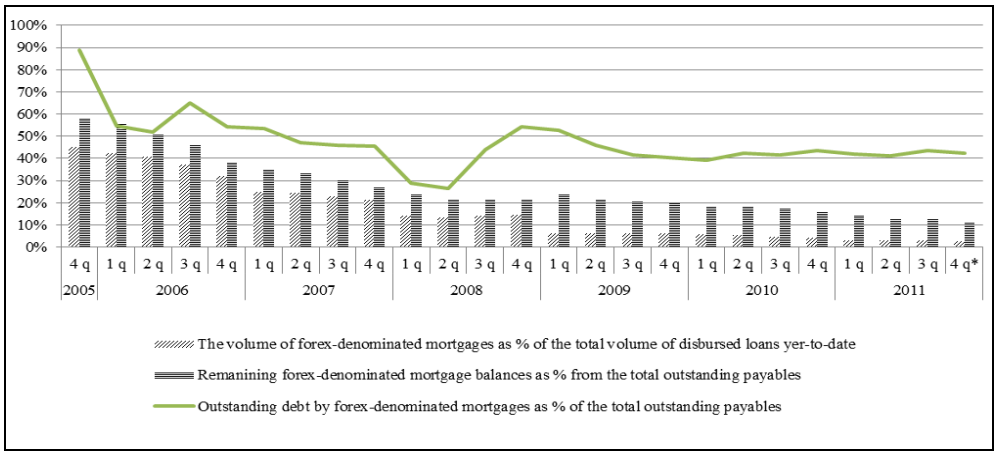
The fall to 54.02% in 2010 in the share of the Top-Five assets-wise credit institutions in the overall volume of ML extended throughout the year was replaced between January and November 2011 with its rise up to 61.88% and redistribution of volumes between other groups (*Fig. 31*). In 2009, it was the third group which exhibited the greatest share of arrears (4.56%), while in 2010-2011 it was the second group whose mortgage portfolio proved the most risky one (4.65% в 2010 and 5.12% in 2011). The second and third groups proved close to each other when it comes to volume of lending; however the third group's mortgage portfolio (2.80% of arrears) proved less risky than the second one's (5.1%).



Source: the CBR data.

Fig. 31. Quantitative and Qualitative Expansion of ML across groups of Credit Institutions Ranked by Value of Assets

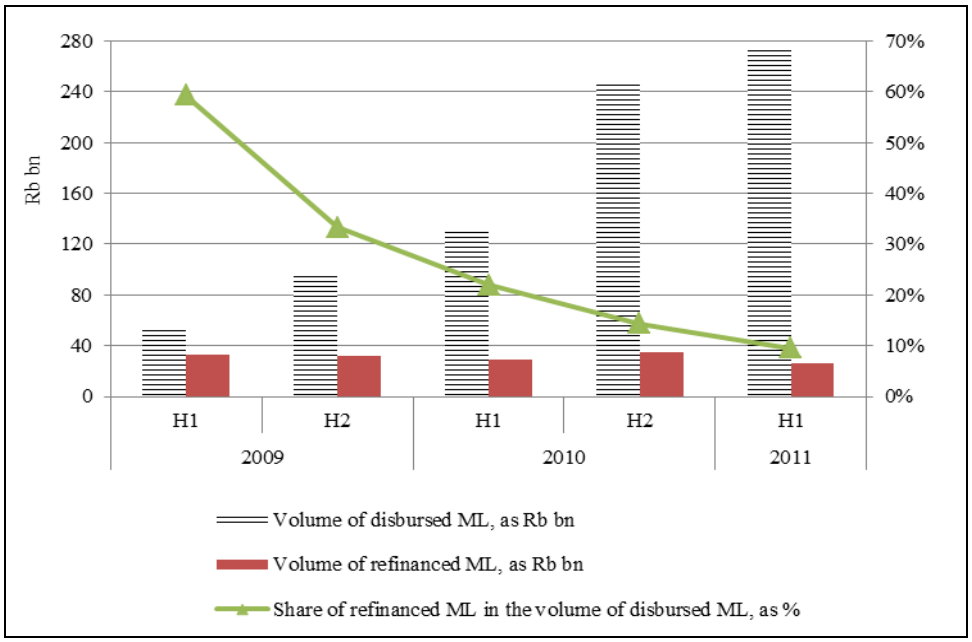
When compared with Q211, the proportion of forex-denominated ML in the total volume of ML surged 0.35 p.p. and accounted for 3.2%, while the proportion of forex-denominated remaining ML balances in the overall debt soared 0.02 p.p., up to 12.79%. The proportion of arrears by forex-denominated mortgages between 2010 and 2011 varies between 39.06% and 43.4%, and as of 1 November 2011 accounted for 43.36% (*Fig. 32*).



*as of 1 December 2011.
Source: the CBR data.

Fig. 32. Correlation between Rb-Denominated and Forex-Denominated Mortgages

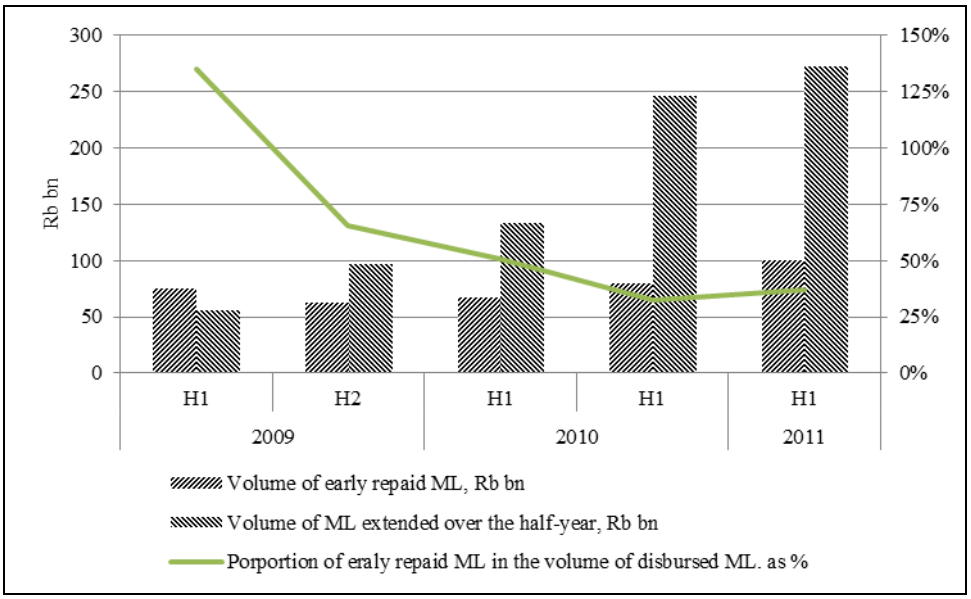
According to CBR, in H1 2011, as many as 131 organizations, including 19 credit ones, re-financed ML with the sale of the pool (rights of claim with regard to mortgage loans) worth a total of Rb 25.9bn (*Fig. 33*), or 9.5% of the volume of mortgage loans disbursed over the first half-year. The proportion of 102 specialized resident organizations accounted for 86.4% of the volume of refinancing, with no refinancing carried out by non-resident organizations.



Source: the CBR data.

Fig. 33. Dynamic of Refinancing of ML (Rights of Claim)

As of 1 July 2011, the amount of early repaid ML accounted for Rb 100.3bn, or 36.75% of the volume of loans extended in the first half-year, with borrowers having repaid Rb 80.401bn with their own moneys. In the first half 2010, as much as Rb. 67.6bn was repaid, or 50.67% of the volume of disbursed ML (*Fig. 34*).



Source: the CBR data.

Fig. 34. Dynamic of Early Repayment of ML

In 2011, JSC AHML refinanced 40,255 mortgages for a total of Rb 51.3bn (*Table 33*).

Table 33

Redemption by JSC AHML of Mortgages in 2011

	Across all products	Standard product	Military mortgage	Maternity capital	Newly built housing	Others
Mortgages redeemed, pcs	40 225	22 719	9 829	3 053	4 437	162
Mortgages redeemed, Rb m	51 255	23 827	18 575	3 632	5 005	185
Average value of mortgage, Thos. rb	1 274,2	1 048,8	1 889,8	1 189,7	1 128,2	1 147,2

Source: data of JSC AHML.

6.6.6. Outlook for the Housing Market

Forecasting the pricing dynamic on the Russian housing market in the previous years[1] was built on the premise of the 2010 price stabilization and anticipation of the beginning of a price rally in 2011-2012; that said, the price rise was anticipated to be more moderate than in 2000-01 (with the trend taking the **L-form**).

The outlook for 2011 and beyond followed the methodology built upon the use of a mathematical model of correlation between price rise rates and the pace of increase of average per capita incomes for different types of markets[2].

The data on the pace of increase of the population's real incomes and anticipated inflation was borrowed from the Medium-Term Forecast of Socio-Economic Development of RF for 2011 and 2012-13[3] and corresponding regional forecasts, with dynamics of main socio-

[1] See the IET 2009 and 2010 annual reviews of the state of Russia's economy.
[2] Sternik G.M., Sternik S.G. Typology of real estate markets by propensity to generate price bubbles. – Journal "Property relations in RF" No. 8 (95) 2009, p. 18–28.
[3] Sternik G.M. Methodology of forecasting housing prices due to the type of market. – Journal "Property relations in RF" 2011, No. 1, pp. 43–47.

economic indicators therein being closer to average national figures, except for Perm krai[1]. The type of the market assumed for 2011 was: for Moscow- an expanding one, for St. Petersburg, Moscow oblast – stable in the first half of the year and expanding in the 2nd half-year, and for Perm (with account of a lower increase in real incomes and a higher inflation rate) – stable throughout the year.

The comparison between the actual data and the outlook for 2011 shows that the latter proved true only partially.

In Moscow, the actual figures biased downward from the forecast, which should be ascribed to a smaller increase in the population's incomes vis-à-vis the government's forecast. By contrast, real prices on the secondary housing market in Perm, Moscow oblast and St. Petersburg slightly outpaced the forecast ones, which can be attributed to the actual increase of the local residents' incomes slightly outpacing the forecast value.

The outlook for 2012 was calculated following the same methodology and using the original data on the rate of increase in the population's incomes, as stipulated in the said Medium-term program (*Fig. 35*).

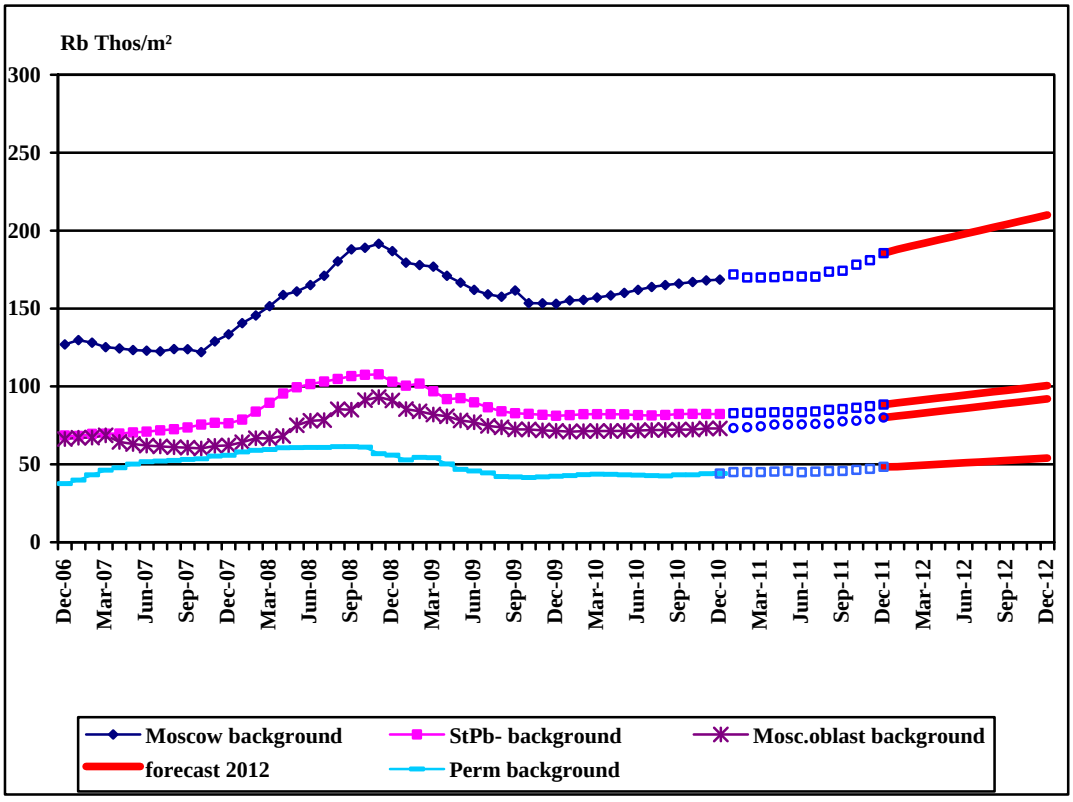


Fig. 35. Offer Price Outlook for the Secondary Housing Market

Given the instability and the impact of the ongoing socio-political and macroeconomic situation (relatively high oil prices, an appreciating Rb, and slightly decelerating inflation), the year of 2012 may see a slight increase in the population's incomes, which is the major

[1] Basic data for the development of scenarios of economic development of the Perm Krai through 2012 (main scenario factors). – http://www.gorodperm.ru. They envisage slow growth of the real income of the population (2%) and greater regional inflation (12,5%).

factor affecting the price dynamic on the housing market. Price rise rates can accelerate, should the population's incomes keep soaring. According to the outlook, the price rise rates in Moscow and across the other cities should make up between 11 and 14%.

6.7. Military economy and the military reform in Russia

The transition to "a new image" of the Armed Forces of the Russian Federation that started back in 2008 and continued through 2011 was clearly planned, as the Russian top military leaders affirmed. In practice, however, these plans proved to be "unbaked" and required on-line corrections and removal of deficiencies.

Likewise was the financial and economic support to the military construction. The encouraging statement made by Finance Minister A. Kudrin on the eve of 2011 that "the ministries and departments will receive 98% of the budget expenditures for their full disposal[1] " have come to nothing. A new government arms program (GAP) for 2011 – 2020 signed by President D. Medvedev on the last day of 2010, was not aligned, as appears, with a regular federal target program for upgrading the military-industrial complex that had not been adopted in 2011. It is obvious that these events could not but affect negatively the quality of planning and execution of the state defense order (SDO) for 2011.

The 2011 results in the military economy and the military reform demonstrate that there are more than enough grounds to talk about serious problems and contradictions at the new stage of the military reform in the RF in addressing five key tasks set by President D. Medvedev more than three years ago[2].

6.7.1. Structural transformations of the Armed Forces

Even a recap of the organizational and structural transformations in the RF Armed Forces that took place during the last three years makes a great impression. Late 2008, a new military administrative division of the RF was established: four military districts were set up instead of six and accordingly four united strategic commands (USC) were established to control all military forces based on the territory of such districts except strategic forces. At the top levels of the military hierarchy, a tree-tier command and control system was set up: the district USC - operative command (armies) – brigades and other military units. In 2009, the structure of the Armed Forces changed from the division-regiment based to the brigade-based one (except the Airborne Landing Forces and Strategic Missile Forces)[3].

As a result of functioning of the Armed Forces in their new structure in 2010, a number of issues was identified including maintenance of the AF combat readiness at a high level and having a mixed compulsory and voluntary system of enlisted and junior command personnel.

The establishment of Aerospace Troops (AST) as an independent unit is a major structural innovation of 2011. To some extent this may be considered as a restoration of the ex-USSR Armed Forces type called national Air Defense Forces.

The division of the command and control functions into two "branches" during the last three years was another important structural innovation: the first branch was in charge for comprehensive support (Russia's Ministry of Defense and the Armed Forces) while the second branch – in charge of the Armed Forces buildup, planning of troops employment and

[1] V. Petrov. In a week-s time.// Rossijskaya Gazeta.2010. December 2 (No. 272).
[2] Russian Economy in 2009, Trends and Prospects (Ed. 31) M., Gaidar's Institute. 2010. p.637–638.
[3] Russian Economy in 2009, Trends and Prospects (Ed. 31) M., Gaidar's Institute. 2010. p.640.

their combat training. The first branch is staffed mainly with civilian specialists (according to the practices of the civilized states) while the second – with military persons. Note that the move to this structure that was selected back in May 1992 as the most reasonable for Russia took almost 20 years. At that time it was announced at a Joint Staff conference as a target set by the then President of Russia Boris Eltsin by the top military leaders: Minister of Defense P. Grachev and his First Deputy A. Kokoshkin. The Russian Generals apparently did not support the proposed restructuring and tried to impede the process striving to keep the key financial and economic levers in their hands together with the associated capabilities. A lot of efforts and time was wasted.

Now the first command and control branch acquired two major tasks – financial and economic support to all the activities of the Ministry of Defense and the Armed Forces and interaction with the defense-industrial complex to ensure supplies of military equipment and hardware.

The newly created procurement services of the RF AF united in the second branch structure the rear services support and the technical services support; that was also in line with the best practices of the advanced countries. The reduced scope of tasks led to reduction of the administrative military staff by four times while the remaining administrators were reoriented to military objectives. Many purely economic activities were withdrawn from the RF Ministry of Defense and included into the scope of services of OJSC Oboronservice namely: maintenance of arms/hardware and military equipment, modernization, repairs, liquidation of surplus stocks, utilization of arms and limitary equipment, maintenance of all real property facilities, production and supply of agricultural products and goods, trade and daily services, catering, printing products, hotel services, etc. As for other procurement functions, some of them were outsourced (wholly or partially) to third parties and covered such types of procurement as food supplies, bath and laundry service – for the military people; aerodrome maintenance, truck shipments, fuelling, technical maintenance and service – for troops and military equipment and arms. As a rule, OJSC Oboronservice has acted as a general agent of the Ministry of Defense using the bidding system for contractors.

The Ministry of Defense and the Armed Forces have never gone through such radical changes before. Their functioning in 2011 revealed both pluses and minuses. Among the pluses, there have been quite valuable results, in particular regarding troops disposition. It is worth noting that the number of guarded military settlements reduced from 22,000 down to 4,000 with the prospects to continue reduction to a less than a thousand of such settlements. Only 7,000 people will be employed to guard them. The Air Force airfield network that used to have 356 airfields has been reduced down to 7 air bases with a more powerful infrastructure; this ensures better quality of airfields maintenance and operation. The released settlements and other facilities have been passed over to the local governments.

6.7.2. The RF military policy and its implementation

Early autumn 2011 it appeared that the Ministry of Defense could not approve the contracts for construction of two nuclear submarines of “Borey” type and one multipurpose nuclear submarine of “Yasen” type with OJSC OSK (United Shipbuilding Corporation). As A. Serdyukov, Defense Minister, announced, OSK refused to disclose the price structure on its products as the customer demanded (the last portion of Rb 20bln out of Rb 581bn as a total value of the state order for 2011 were involved).

Though this scandal did not directly affect the combat potential of the Russian sea-based nuclear forces (there were no missiles for new submarines), still it was very disturbing since the government officials made a lot of promises to settle the situation in the second half of the summer. It is clear now that the attempts of Russia's President and the Federal Government Chairman to get involved helped to save their faces only. Both officials made very important statements with regards to the military expenses and the national military and technical policy.

Thus President D. Medvedev addressing the members of the strategic exercise "Center-2011" on September 27, 2011, in the Chelyabinsk region[1] announced that "spending on defense, new arms, money allowances for the servicemen, their household activities and their apartments will remain the highest priority of the government. There are no two ways about it." Having evaluated this statement as an ethic prescription ("… this is imperative") he reaffirmed that "we (though the budget may regret this) will always have large expenses to support the defense and the security as this is our mission in relation to our citizens and our neighbors" and linked this to such factors as the territory of Russia and its membership in the UN Security Council and availability of nuclear arms.

Unfortunately this statement of Russia's President not only creates doubts as to his logics (regarding the mission of Russia with regards to the neighbors) bur contradicts Articles 23 and 112 of the RF National Security Strategy for the period ending 2020 approved by President (SNB-2020)[2], that do not include military expenses as one of the national security priorities or any aspect of the national security. Moreover, this document does not give the definition of the notion of "a supreme priority" (unlike the notion of "the strategic national priority"). Misunderstanding or ignoring the optimal balance concept expressed in SNB-2020 means that the "great power' status and not the growth of national welfare is given preference, that the investment resources will be frozen and rates of economic growth decline in a long-term perspective.

V. Putin. Chairman of the Federal Government, in his introduction to the meeting dedicated to the issues of the defense and industrial complex on October 7, 2011[3] declared that "there is a great large-scope task in front of us: to re-equip fully our army and Navy in the near 10 years". Though earlier D. Medvedev stated that the aim of our state arms program for the period 2011 – 2020 was a 70% re-equipment (30% by 2016) and not a 100%.

The challenge of a 100% or 70% re-equipment during 10 years seems to ignore the native and/or foreign experience and demonstrates that the program developers have not been aware of the balance principle and unable to look beyond the 10-year horizon.

The rationale of the 2020 state arms program and the opportunity for its implementation looks doubtful with account of the statements made by V. Putilin, the then First Deputy of the Chairman of the Military-Industrial Commission at the RF Government that the Ministry of Defense had no reasonable justification of the program; the former Deputy to Defense Minis-

[1] Meeting with unit commanders involved in combat exercise "Center 2011" (short-hand notes) September 27, 2011. http://news.kremlin.ru/transcripts/12836.
[2] National security Strategy of the Russian Federation up to 2020. Approved by RF President Decree of May 12, 2009 No. 537.
[3] V. Putin's introduction at the meeting on the issues of development of the defense and industrial complex (short-hand notes) October 7, 2011. http://premier.gov.ru/events/news/16656/.

try V. Popovkin also made it clear in March last year [1] that in Russia "the share of state-of-art arms in the military equipment fleet is 20% for strategic nuclear forces and under 10% for general-purpose forces. For comparison: in the armies of the leading foreign states such share is 30% to 50%."

If these data about the situation in the Armed Forces of the leading works countries are true, it means that Russia must reach these indicators as early as 2016 and surpass this level by 2020. It looks that the developer of the Russian arms program for 2011-2020 has never asked himself why the share of new arms and equipment in the world leading countries does not exceed 50%? The announced 70% re-equipment plans by 2020 are unreachable due to the poor potential of the national economy, and the first year of the program delivery has proved this. What the plants of the defense and industrial complex will do if after 2020 the Army and the Navy are fully re-equipped: will they have to re-orient themselves to foreign markets since the arms samples have a service life of 25 to 30 years.

It is impossible to make a correct assessment of the Russian military and technical policy in 2011 without the account for the events occurred in 1H. May 2011 was extremely important in this respect since on May 10, President D. Medvedev held in the Gorky a meeting[2] dedicated to the development of the Russia' military and industrial complex where he informed that for the state arms program adopted late 2010 budget allocations would be four times larger than for the previous program.

On March 21, 2011, Prime Minister Vladimir Putin addressing the meeting in Votkinsk on the implementation results of the state arms program[3], and on April 20, in the report of the RF Government on the results of his activity for 2010 in the State Duma affirmed that for the new arms program the government intends to allocate funds by approximately three times more vs the previous program[4]. It is obvious that if we compare the arms programs (for all power ministries) the President's assessment of May 10 is more correct than the government assessment given the declared growth of allocations from Rb 4.9 trillion up to Rb 21.5 trillion. It is worth noting that the said growth for the arms program of the Ministry of Defense was actually five times higher (more accurately by 4.9 times: from Rb 4 trillion to Rb 19.5 trillion).

It is hard to understand why the federal government has been disseminating false information for such a long time. Possibly,t our government is used to ignore such "trifles" and/or this is a simple arithmetic error. But it is quite probable that the use of such " not fresh" information determined, to a certain extent, the successful, in terms of the Russian military-industrial complex, approval of the state arms program by President since in terms of the budget almost triple growth of the budget allocations is not so "frightening" than the fivefold.

The approval of the state arms program for 2011-2020 by President Dmitry Medvedev is a case study. This fact became known only late February 2011 when Deputy Defense Minister Vladimir Popovkin announced at the meeting with journalists that the program was approved by President back on December 31, 2010, and this information was unexpected for the major-

[1] We cannot afford buying poor arms// Military Industrial Courier. 2011. 2–8 March (No. 8); D. Litovkin "Triumph" and "Circon" march off to troops// The News. 2011. 11 March; National Defense. 2011. March.

[2] Meeting on the issues of development of the Russia's state arms program (Short-hand notes) 10 May 2011. http://www.kremlin.ru/transcripts/11206.

[3] Introduction by V. V. Putin at the meeting on the implementation of the state arms program for 2011–2020 . (Short-hand notes). Votkinsk, 21 March, 2011. http://premier.gov.ru/events/news/14545.

[4] Short-hand notes of the RF State Duma meeting of April 20, 2011. http://transcript.duma.gov.ru/node/3423/?full.

ity of the attendees since the Defense Ministry liable sources asserted otherwise through January.

What made the Russian government conceal the approval of the state arms program worth over Rb 20 trillion for more than two months is difficult to say. The reference to the secrecy of the Decree does not sound convincing as there is an official practice of publication of extracts, statements and information about the signing of classified documents. It may be possible that the program was signed in the first days of January 2011 retroactively in order not to repeat mistakes made in signing two previous programs when unexplainable intervals between their approvals reached 10-12 months.

The previous practice with the state arms programs has shown that the attempts to delay their signing in order to improve the quality are not successful since the last minute finalized programs have not been duly implemented. The Russian state arms programs are unachievable in principle.

This fact escapes the interested community, possibly, due to the unique combination of ten-year (horizon) planning with the five-year plan adopted for our programs in the ex-USSR. It is often believed that the new state arms program is passed because the previous program failed – this is not true since the new program is adopted because time has come to do it: in Russia there is an established practice to adopt such programs once every five years. As the development of the next program starts several years before the first part of the previous program is finished the developers indeed have no possibility to review the results of the program implementation. However, the implementation results can be seen with a naked eye regardless of the traditional screen of the state secret. It is quite possible that the government authorities did not want to make a focus on the actual approval of the state arms program because of this. The implementation results of the state military order in the first year of the program confirm our skepticism.

Thus, instead of the growth of the military production by 14% expected by the RF Ministry of Industry and Trade[1] in shipbuilding, this production fell down by 15.7[2] while commissioning of "Borey" strategic ballistic missile submarines that, according to some optimistic declarations[3] are almost ready for combat alert duty, is 6 to 12 months behind the schedule and expected at best by the end of 2012.

In 2010 and 2011, the shipbuilding production under the state military order was worth Rb 126 bn and Rb106bn and 765m accordingly, and these enable spending of Rb4,7 trillion of the state program for re-equipment of the Russian Navy[4] only under the condition of annual growth of military shipbuilding production by 30.6% during the remaining 9 years. In 2020, the shipbuilding production under the state military order will exceed the 2011 production tenfold.

In a more realistic assessment of the production surplus by 10% at best, the required allocations for the shipbuilding part of the state military program do not exceed Rb1.7 trillion, in other words, the budget spend for the Navy equipment can be reduced by 64% (almost by three times). Thus a logical step (not in terms of budget saving but in terms of spending the

[1] Report of the RF Ministry of Industry and Trade: 2004–2011.
[2] Shipwrights will not corrode, Red Star, 2012, February 4 (No. 19).
[3] E.g. see "To be strong: the guarantees of national security for Russia// Russian Gazette. 2012. February 20.
[4] Buildup of the force// Vzglyad (A View)// 20122, February 6.

allocated budget) is to procure foreign warships like "Mistral" in France. However the need to include the four procured warships in the Pacific Fleet looks doubtful [1].

The forecast of delivery of the 2012 state order by the shipbuilders is not very optimistic: when allocations for the 2012 draft federal budget were prepared in July-August 2011, there was no information on the prices for the sector products. The 2011 contracts under the state military order for nuclear submarines that were to be built and tested in the White Sea were signed by the Defense Ministry and USC on November 9, 2011 in the presence of Prime Minister Vladimir Putin: actually two weeks before the established date of the product delivery. After the contracts were signed, USC continued to resist disclosing the information on the price structure for their products, which may be understandable in the context of price fluctuations in the shipbuilding sector reflected in Russian statistics of the national accounts in the previous years.

On the other hand, the efforts of the Ministry of Defense in 2011 aimed to implement the resolutions of the RF President of November 25, 2010, Order No. Pr-3443, proved to be successful by the year-end. According to Joint Staff Commander, General of the Army N. Makarov[2] the contract prices on diesel submarines were reduced by 34%, on corvettes – by 15% and on frigates – by 26%.

The behavior of certain military and fleet commanders considerably aggregates the situation with the implementation of the military and technical policy and the state arms program. For example, the Navy Chief Commander Admiral V. Vysotsky, obviously violating the line of authority and contradicting the statements of the state first persons not to build aircraft carriers[3], continues advocating the plan of their building starting from 2015[4] . Note that the full protection of information about the state arms program allows such behavior.

Unfortunately, a similar situation with the equipment is observed in the Air Force:

- SU-34, a bomber aircraft, bought back in 2008, was officially passed into service by the state commission in September 2011;
- a fighter aircraft SU-35M that was bought earlier still undergoes testing;
- a surface-to-air missile system C-400 "Triumph" was made operational in 2007, but up to now it has not been equipped with 400 km distance missiles though it was given the index 400 according to this type of missile; the development of the missile is to be completed this year, though federal funds for construction of two plants for the C-400 serial production have been released since 2010.

In 2011, the Air Force did not receive a new bomber aircraft Su-34, a fighter aircraft SU-35M, three Su-27SM, two helicopters "Ansat-U". Besides, a strategic bomber aircraft TU-95MS and an airborne interceptor MiG-31B remained under repair.

Given the absence of advance models ready for manufacturing, the Leaders of the Ground Forces and the Airborne Forces almost stopped procurements of armored vehicles and focused on modernization. The purchases of missile and artillery materials have been insignificant due to the same reason. On the whole, for 2011, the Russian defense industry did not ful-

[1] The Fleet: priorities and prospects // Red Star. 2012. February 15–21 (No. 26).

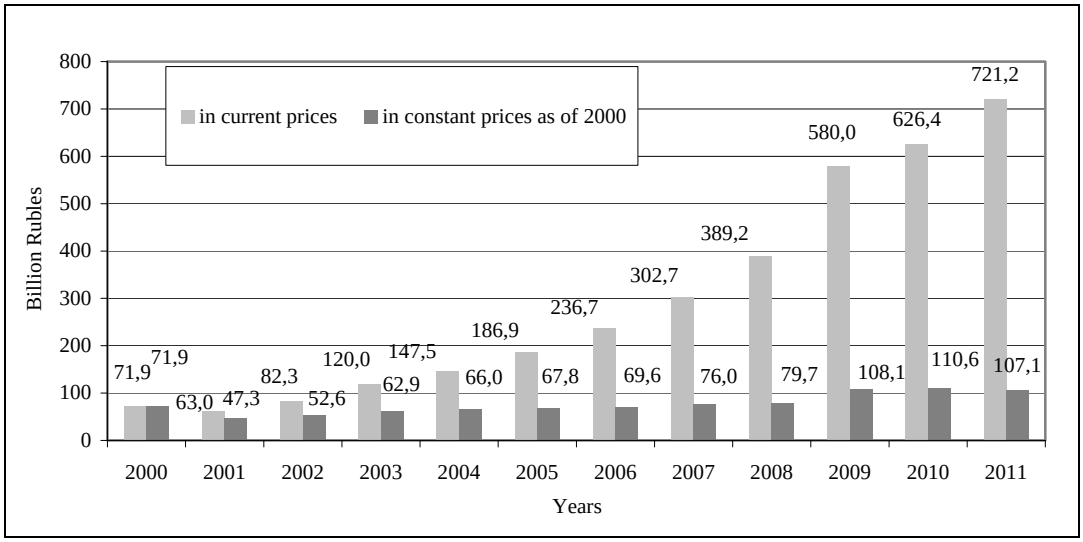
[2] The military reform as it is. Speech by N. Makarov, Russian Joint Staff Commander, at the Public Chamber. M. November 17, 2011. http://www.oprf.ru/files/Prezentaciya_mioboroni.ppt.

[3] e.g..: So far we do not have this in our plans" (V. Putin). // Short-hand notes of the meeting in Sarov on February 24, 2012 at http://premier.gov.ru/events/news/18248/.

[4] The Fleet: priorities and prospects//Red Starr. 2012. February 15–21 (No. 26).

fill the state order under 84 contracts for Rb 42bn[1], i.e. the 2011 state military order was delivered at under 94%.

The results of the multi-year policy of building up budget spend for the state military order by the Ministry of Defense in the situation of full secrecy is shown on *Fig 36* (an expenditure deflator for the final consumption of the state services is used).



Source: Rosstat.

Fig. 36. State Military order of the Russia's Ministry of Defense in 2000–2011

The confidence of the Russia's leadership in that the state guarantees a minimal productivity at 20% in the industrial and defense sector which will ensure the transition to its innovatory development and the required output[2] actually has no basis and is a result of promotion efforts by the Russian military-industrial lobby who is interested in re-distribution of the oil rent income. According to PwC (former PriceWaterhouseCoopers)[3], the average profitability in 100 leading western airspace and defense companies was 7.8% and 9.0% in 2010 and 2011 respectively, and such indicators enabled their development based on innovations, to step up their production and pay out dividends to their shareholders.

6.7.3. Improvement of the legal and regulatory framework of the Armed Forces operation

This stage of transformations of the RF Armed Forces required the improvement of the legal and regulatory framework. First, to review the set of program and regulation documents was required that regulated the procedures and the rules of modern military actions with account of their types and administration of troops and forces. Secondly, a lot of efforts were taken to revise the documents regulating the functions of the Armed Forces in peaceful times,

[1] V. Litovkin. Bottleneck in the state military order // Independent Military Review. 2012. February 3–10 (No. 3).

[2] "We assume that the profitability of the enterprises should be at least 13–15%, even let it be 20%" (V. Putin) // Short-hand notes of the meeting at Komsomolsk-on-Amur, February 20, 2012 http://premier.gov.ru/events/news/18194/.

[3] Aerospace & Defence 2010 year in review and 2011 forecast. PwC, 2011. http://www.pwc.com/aerospaceanddefence/.

including the regulations/manuals (Internal Service Regulations, Combat Manual, Disciplinary regulations) and various instructions. The participation of the Defense Ministry specialists in the development of draft laws on money allowances (MA) for servicemen and on retirement pays became a most important area of activity. The IEP experts also took part in this effort[1].

The main comments to the MA draft law developed by the Ministry of Finance and Ministry of Defense were as follows: the new MA system will deepen the gap between military and civil officers, and between the military officers who serve in different departments inside the power block. The MA is not linked to the average national wage and to the budget process, if done, this could align the MA indexation. Corruption-biased wordings are used in certain law provisions. The key thing is that for lower ranks of the servicemen the MA level is inappropriate, and this would make the army recruitment even more difficult.

There are numerous comments to the provisions setting retirement pays. These provisions are very unfair in treating the old age pensioners, and may cause a lot of complaints immediately after the new pensions are paid.

Unfortunately, the justified comments caused no reaction, and the drawbacks in the draft laws have been incorporated in the laws.

6.7.4. Changes in the military staffing policy

Early 2011, the first theoretical and practical conference of the Ministry of Defense was arranged on the topic "The formation of the innovative educational environment in the system of educational institutions of the RF Ministry of Defense". As per the established tradition, that meant training of the officers only with simultaneous reduction of the number of academies and colleges, and this approach caused strong dissatisfaction among the servicemen. Nevertheless, the changes have been implemented as planned. Now in the RF Armed Forces there are three scientific and training centers, 11 military academies under the Joint Chief Academy, and two universities (Military University and Military Aviation Engineering University). The Academies train staff for such troops as missile strategic forces, army signals, army troops, NBC defense troops, engineering troops, artillery troops, battlefield air defense troops, military space troops, combined service forces. The focus was also made on the training of troops in advanced combat training centers where in addition to individual training, units will be trained.

However, the attention to training of ranks and files and junior command personnel was not appropriate. The major part of the military personnel continues to be conscripted. The Armed Forces Commanders, namely the Commanders of the ground troops acknowledged that the current practice of a five-month training of the called-up specialists does not meet the modern requirements. Note that the reduction of the service term to one year was provided in the federal Government Regulations adopted back in 2003, and the respective amendments were made in the legal framework in 2007. However, "the tests of the new training program

[1] See, e.g. V. Tsymbal, A. Privetkin. A failure of the strategy for social development at the financial front // Independent Military Review. 2011. June 3–9 (No. 20); V. Tsymbal, A. Privetkin. The servicemen are promised a worthy pension in a quarter of a century. Independent Military Review 2011. June 10–16 (No. 21); E. Trofimova Certain achievements and issues of the social development of the RF Armed Forces//Economic and political situation in Russia, 2011. No. 2; A. Privetkin, E. Trofimova. On the fund of money allowance of the RF servicemen// Economic and political situation in Russia, 2011. No. 7.

for junior specialists" designed for 3 months "in connection with the transition to one year of service" began in 2011 only[1].

The need to refuse from the call-up principle was hushed up (in autumn 2010, the Joint Staff Commander announced 700,000 positions for conscript servicemen) early this year though full enlisting was clearly impossible. The Border Guards and the Federal Penal Service abandoned the call-up principle long before. Recently, the Interior Ministry Troops being aware of the conscription difficulties have decided to contract the staff and tried to improve the attractiveness of such service[2].

By March 2011, the Ministry of Defense had matured to be aware of the true situation with enlisting. The report at the meeting in the RF Academy of Military Sciences can give some evidence to that[3]. It was said that the number of the conscripted servicemen should be reduced by 10–15% of the total membership. And the report also focused on the attractiveness of the contract enlisting. Some NATO country-members, Poland, in particular, were mentioned as an example. It appeared that by 2017 the number of rank and files and junior command officers serving under the contract should be 425,000 instead of current 184,000.

Activities on "humanization" of the military service have been carried out in the troops: a new plan of the day (with an after-lunch rest) and a five-day service week with possible week-end leaves was introduced; to use rank and files in fatigue duties was limited or even forbidden; the food ration and quality were improved; mobile phones were allowed. The principle of "service close to home" was implemented where possible. Nevertheless, there is still no contest for the military service, and there are many draft evaders.

The institutions of priests and military police have been promised recently for implementation. However, in 2011, the promises remained unfinished.

The necessity to abandon the call-up enlisting seems obvious, but the top commanders hesitate to acknowledge this though President Dmitry Medvedev did recognize this necessity but for a faraway perspective. There is no political will yet to do this.

6.7.5. Social support to the servicemen and their family members

Housing is an obvious example of how the Armed Forces deal with social and economic issues. There is a tremendous burden of such issues in this sector since the national leaders used to put off them for a number of years. Once there was an attempt to re-shift this burden from the federal to the regional authorities. Eventually, the military and political leaders of Russia elected to stop pushing aside this problem. After all the housing needs were registered in 2009 it became clear that 175,600 servicemen and military retirees had to be provided with housing.

Early 2011, the Ministry of Defense while talking about the house provision plans announced their ambitious target "to do away with the waiting list of the servicemen in need of housing by 2012"[4]. This announcement was very challenging since in that year there was no properly functioning Unified Register of the Servicemen in need of housing accessible via Internet, i.e. the system of recording and control was still in the process of development.

[1] A. Gerasimov. Special courses for junior specialists//Red Star, 2011 February 3, (No. 17).
[2] Interior troops invite//Red Star 2011.February 4 February (No. 18).
[3] N. Makarov. Up to date//Red Star. 2011. March 29 (No. 51).
[4] D. Semenov, V. Mokhov. No waiting lists should remain // Red Star. 2011. January 14 (No. 2).

However, by October 2011, the list reduced down to 63,800 families and by the year end further to 41,600, according to the report of the Joint Staff Commander to the Public Chamber.

Nevertheless, the problems are still there: there are corrupt officials and bribetakers involved, the files of the servicemen on the demand list was lost, the computerized recording and control system does not function properly, apartments are provided in locations where people do not want to reside.

The second important area of solving social issues is the increase of the money allowance from January 2012. Let us talk about the MA amounts. The main MA components, namely the basic salary for the service position (SSP) and for the military rank (SMR) are given in *Table 34.*

Table 34

Comparison of the military ranks, positions and money allowances of the RF AF servicemen after January 1, 2012

Grade	Proposed position*	Proposed SSP*	Approv. SSP**	Standard military position (Regulation 922)**	Proposed military ranks	proposed SMR*	Appr. SMR**
1	2	3	4	5	6	7	8
50	First Deputy Minister	45000	45000	First Deputy, RF Minster of Defense	Army General		27000
49	Deputy Minister	44000	44000	Deputy, RF Minster of Defense	Army General		27000
48		42000	42000	Commander-in-Chief, AF type	General-Colonel	20000	↑25000
47	Military District (MD) Commander	40000	40000	Director-General, Central Office (CO) Department Director, Commander-in-Chief , Corps; MD Commander-in-Chief	General-Colonel	20000	↑25000
46		38000			General-Lieutenant	17000	↑22000
45	Deputy, MD Commander	37500			General-Lieutenant	17000	↑22000
44	Army Commander	37000	37000	Deputy to: CO Director-General, Department Director Army Commander-in-Chief	General-Lieutenant	17000	↑22000
43		36500			General-Lieutenant	17000	↑22000
42		36000	36000	Director-General: CO, MoD Department :	General-Lieutenant	17000	↑22000
41		35500			General-Lieutenant	17000	↑22000
40		35000			General-Lieutenant	17000	↑22000
39		34500			General-Lieutenant	17000	↑22000
38		34000	34000	Deputy Director-General: CO, Department :	General-Lieutenant	17000	↑22000
37	Deputy Army Commander	33500			General-Lieutenant	17000	↑22000
36		33000			General-Lieutenant	17000	↑22000
35	Corps Commander	32500	32500	Commander, motorized rifle corps, Director-General, Department in USC, MD	General-Lieutenant	17000	↑22000
34		32000			General-Major		20000
33		31500			General-Major		20000
32	Deputy Corps Commander	31500	31500	Section Head: CO, Department	General-Major		20000

cont'd

1	2	3	4	5	6	7	8
31	Division Commander	30500	30500	Commander, motorized rifle (tank) division	General-Major		20000
30		30000	30000	Deputy Section Head: CO, Department	Colonel	13000	13000
29	Deputy Division Commander	29500	29500	Section H in USC /MD Department	Colonel	13000	13000
28	Brigade Commander	29000	29000	Commander, motorized rifle (tank) brigade, Section Head, Army	Colonel	13000	13000
27		28500	29000	Group Head in Central Office/Department Section, MoD of Russia	Colonel	13000	13000
26		28000	28000	Senior Officer (CO Section, Department)	Colonel	13000	13000
25	Deputy Brigade Commander	27500			Colonel	13000	13000
24		27000	26500	Officer (CO Section, Department)	Colonel	13000	13000
23	Regiment Commander	26500	26500	Commander, motorized rifle (tank) regiment	Colonel	13000	13000
22		26000	26000	Senior Officer, USC Department. MD	Sub-colonel		12000
21		25500	25500	Senior Officer, All-arms army administration	Sub-colonel		12000
20	Deputy Regiment Commander	25000	25000	Officer, USC Department, MD	Sub-colonel		12000
19		24500	24500	Officer, all arms army administration	Sub-colonel		12000
18	Battalion Commanding Officer	24000	24000	Commander: motorized rifle (tank) battalion, missile/artillery division	Major	11500	11500
17		23500			Major	11500	11500
16	Deputy Battalion Commanding Officer	23000			Major	11500	11500
15		22500			Captain		11000
14	Squadron Commander	22000	22000	Commander: motorized rifle (tank) squadron, anti-air missile battery	Captain		11000
13		21500			Senior lieutenant		10500
12	Deputy Squadron Commander	21000			Senior lieutenant		10500
11		20500			Lieutenant		10000
10	Platoon Commander	20000	20000	Commander, motorized rifle (tank) platoon	Lieutenant***	10000	10000
9		17000			Senior Warrant Officer		8500
8		16500			Senior Warrant Officer		8500
7	Deputy Platoon Commander	16000			Warrant officer		8000
6		15000			Sergeant		7500
5	Squad Commander	14500	↑15000	Commander, motorized rifle (tank) squad	Senior Sergeant		7000
4		12500			Sergeant	6500	6500
3		11500			Junior Sergeant		6000
2		10500			Private First Class		5500
1	Rifleman	10000	10000	Rank and file positions of soldiers and seamen under contracts	Soldier	5000	5000

* The military ranks, position grades and salaries related to ranks and positions: see "the State defined the price of the military service// Military and industrial courier. 2011. April 13 (No. 14).

** RF Government Resolution of December 5, 2011 No 992 "On the establishment of base salaries of the cash allowance of the servicemen who serve under the contract".
*** There is no "junior lieutenant" rank in the table since it is very rare and assigned only in exceptional cases(e.g. to sergeants who graduated from short-term qualification courses or to lieutenants who are reduced to a lower rank).

Let us do the following comment to the data in *Table 34*. MA for high-ranking military officials and commanders was increased even above the level that had been discussed when the MA draft laws were reviewed. But the lower ranks of the military hierarchy "lost the game". The gap between the rank-related salaries of the Colonel and General Major was Rb 7,000; this is actually the amount that makes the difference between the rank-related salaries of the Junior Sergeant and the Colonel - how's that?

The situation with promises given to contracted soldiers is even worse. In 2012, at the start of the service, the soldier will get not the promised Rb 28,000 but less: Rb 15,00 – Rb 20,000 per month. The soldier will have to wait for two to three years to get the promised allowance, and this will depend on the attitude of his commanding officer. For reference: by the end of 2011, in Russia the average wage went up to Rb 22,000. Thus the voluntary military service has not become attractive on the employment market.

So far the Russian military leaders feel optimistic by declaring the contracting plans (and the contest selection) up to 50,000 people annually (in reality with account of the replacement of those who retire this figure must go up to 70,000) but they hardly take into account the situation on the employment market and the current demographic trends.

6.7.6. Military and financial policy

Through 2011, the Ministry of Finance was an ongoing supporter of reduction of the military expense. In May, at the meeting in the RF Government with the agenda on the RF budget for 2012-2014, Minister of Finance made proposals[1] to cut down the key additional expenses related to the pre-election obligations of the Kremlin and the White House regarding budget military costs. The key proposal was not to step up the number of officers and contractors of the Ministry of Defense with the consequent saving about Rb 160bn annually up to 2014 inclusively. The Ministry of Finance also proposed not to increase the army but to reduce it further by 15% over next three years and to cut down the budget costs for the state military order during this period by Rb100bn per year. There was another proposal not to increase the financial provision of the saving-and-mortgage system for the servicemen thus saving up to Rb78.2bn in 2012. Besides the Ministry of Finance suggested to cut down costs for the Ministry of Internal Affairs: by Rb 97 bn in 2012 and by Rb 99.1 bn in each of the following two years.

However, the MinFin initiatives were not accepted by the military and political leadership of the country.

As for the federal budget that has been adopted by that time the practice of its execution in 2011 turned back to the pre-crisis scheme with two annual corrections of the initial version[2] – in summer[3] and in autumn[1], but with an additional correction in July[2] when mainly secret and

[1] P. Netreba. The budget gets rid of expenditure units// Commersant, 2011 May 25 (No. 92).
[2] Federal Law of December 13, 2010 No. 357-FZ "On the federal budget for 2011 and the planning period of 2012 and 2013".
[3] Federal law of June 1, 2011 No. 105-FZ On amendments in the Federal Law "On the federal budget for 2011 and the planning period of 2012 and 2013".

top-secret applications related to the state military order were changed with no modification of the overall federal budget expenditures. The July correction may be viewed as another demonstration of the unusual boom in the Russia military and technical policy during 2011.

As a result of all the said changes, by the year end the federal budget allocations for "National Defense" increased by 1.3% from Rb1 trillion 517bn 91mn to Rb 1 trillion 537bn 444mn in 2011 with the total growth of budget expenditures by 4.3%. In real terms, these allocations increased by 4.2% (nominal growth – 20.3%) vs 2010, while their size remained at 2.8% of the GDP.

The above mentioned figures of military expenditures cannot be drawn from the published Budget Law given that after 2007 the non-transparency of the Russian federal budget has sharply increased, and the analysis of the Budget Law should be supplemented with additional sources; thus in preparation of the review we used the materials of the government version of the federal budget, the monthly report of the Federal Treasury on the execution of the budget in January 2011 and the documents of the State Duma[3]. Such an indirect approach cannot but influence the accuracy of the evaluations.

In 2011, the degree of secrecy of federal budget expenditures increased by 1.4 vs 2010 (*Table 35*), and its secret allocations reached Rb1 trillion 302 bn 839mn. Secret/classified allocations were returned to subsection "Intermediate vocational education" and to section on inter-budgetary transfers. The secrecy level remained in such sections as "Physical culture and sports" and "Mass media" (these have been independent sections since 2011), and the share of secret expenditures in the overall expenditures for physical culture was more than half (53.31%, according to our estimates) surpassing the section "National defense" and getting closer to the level of secrecy traditional for the security authorities. Also secret are some allocations for "Preschool education" and "Culture", by tradition. The share of secret allocations to "National economics" is reaching 2%, and to sub-section "Housing" goes above 25.03%.

Table 35

The share (%) of secret allocations in the federal budget expenditures in 2005–2011

Code and the title of section (sub-section) with secret expenditures	2005	2006	2007	2008	2009	2010	2011
1	2	3	4	5	6	7	8
Overall federal budget expenditures	11,33	11,80	10,33	11,92	10,01	10,46	11,82
0100 GENERAL GOVERNMENT ISSUES	3,67	6,28	5,52	8,66	5,05	4,75	*8,56*
0108 International relations and international cooperation	–	0,01	< 0,01	3,66	–	–	–
0109 State material reserve	82,86	89,23	92,18	90,17	85,01	85,08	*88,15*
0110 Fundamental research	2,13	1,22	1,12	0,97	0,78	0,32	*0,66*
0114 Other general government issues	0,05	0,72	0,28	4,42	1,56	1,05	*0,27*
0200 NATIONAL DEFENSE	42,06	42,77	45,33	46,14	48,09	46,42	47,56
0201 Armed Forces of the Russian Federation	33,07	35,59	37,11	39,04	40,21	39,03	41,41
0204 Mobilization of the economy	100,0	100,0	100,0	100,0	100,0	100,0	100,0
0205 Preparation for and participation in assurance of collective security and peace-making efforts	100,0	100,0	100,0	–	–	–	–

[1] Federal Law of November 6, 2011 No. 302-FZ On amendments in the Federal Law "On the federal budget for 2011 and the planning period of 2012 and 2013".

[2] Federal Law of July 20, 2011 No. 251-FZ On amendments in the Federal Law "On the federal budget for 2011 and the planning period of 2012 and 2013".

[3] Decision of the State Duma Commission on the review of the federal budget expenditures to support defense and state security of the Russian Federation, in draft federal law No. 607158-5 "On the federal budget for 2011 and the planning period of 2012 and 2013", M., October 19, 2011.

cont'd

1	2	3	4	5	6	7	8
0206 Nuclear arms	100,0	100,0	100,0	100,0	100,0	100,0	100,0
0207 Implementation of international obligations in the area of military and technical cooperation	45,22	46,90	50,65	100,0	100,0	100,0	100,0
0208 Applied research in the area of national defense	98,37	93,94	93,69	93,20	92,85	91,32	92,47
0209 Other issues of national defense	2,49	8,79	24,38	29,21	34,64	42,03	37,64
0300 NATIONAL SECURITY AND LAW-ENFORCEMENT	28,52	31,64	31,07	31,84	30,82	32,12	31,91
0302 Internal Affairs agencies	4,76	6,31	5,16	4,97	3,70	4,30	3,39
0303 Internal troops	11,76	10,31	9,80	10,25	8,19	8,28	5,58
0306 Security agencies	97,80	95,49	97,31	99,05	99,61	97,05	99,57
0307 Border service agencies	100,00	98,97	97,62	100,00	99,47	98,61	99,15
0309 Protection of the population and territories in emergencies of natural and technogenic nature, civil defense	59,02	62,39	50,65	51,39	51,00	51,28	49,08
0313 Applied research in the area of national security and law-enforcement efforts	73,95	66,41	64,43	75,49	79,35	92,09	87,20
0314 Other issues in the area of national security and law-enforcement efforts	8,26	50,71	39,95	56,32	68,37	67,94	88,40
0400 NATIONAL ECONOMY	0,05	0,02	0,44	0,64	0,55	1,56	*1,96*
0411 Applied research in the area of national economy	–	–	5,23	5,84	4,49	5,61	*12,07*
0412 Other issues in the area of national economy	0,12	0,06	< 0,01	0,31	0,72	4,47	*2,18*
0500 HOUSING AND UTILITIES	–	3,42	0,85	6,96	10,09	19,26	*17,87*
0501 Housing	–	4,22	5,69	15,97	12,91	20,79	*25,03*
0700 EDUCATION	2,76	2,69	2,39	2,55	3,06	3,59	*4,33*
0701 Pre-school education	2,03	2,17	2,44	2,48	2,45	3,91	*5,34*
0702 general education	1,51	1,91	2,14	2,00	2,75	3,45	*0,70*
0704 Intermediate vocational education	1,06	1,03	1,02	0,86	0,99	–	*0,01*
0705 Professional training, re-training and qualifications improvement	16,85	15,78	17,22	1,80	2,54	9,40	*18,16*
0706 Higher and post-higher education	3,15	2,93	2,53	3,08	3,64	4,08	*5,34*
0709 Other issues of education	0,30	0,33	0,28	0,29	0,48	0,61	*0,27*
0800 CULTURE, CINEMATOGRAPPHY, MASS MEDIA	0,17	0,17	0,21	0,17	0,18	0,17	–
0800 CULTURE AND CINEMATOGRAPHY	–	–	–	–	–	–	*0,12*
0801 Culture	0,14	0,10	0,16	0,10	0,14	0,09	*0,14*
0804 Periodic press and publications	13,46	7,45	2,57	2,62	3,14	3,59	–
0806 Other issues of culture, cinematography and mass media	0,02	0,15	–	–	–	–	–
0900 HEALTHCARE, PHYSICAL CULTURE AND SPORTS	4,30	3,99	2,57	4,14	3,54	3,01	–
0900 HEALTHCARE	–	–	–	–	–	–	*8,29*
0901 Stationary medical help	5,61	4,66	2,94	3,24	2,77	2,41	*2,71*
0902 Outpatient care	n/a[1]	n/a	n/a	13,94	4,34	3,75	*21,38*
0905 Health-building care	n/a	n/a	n/a	14,07	15,88	10,73	*11,98*
0907 Sanitary and epidemiological health	n/a	n/a	n/a	2,09	0,63	0,64	*0,73*
0908 Physical culture and sports	0,28	0,26	0,24	0,42	0,32	0,62	–
0910 Other issues of healthcare, physical culture and sports	–	–	–	1,74	1,07	1,01	–
0910 Other issues of healthcare	–	–	–	–	–	–	*0,43*
1000 SOCIAL POLICY	–	–	–	0,01	0,01	–	–
1003 Social security	–	–	–	0,02	0,02	–	–
1100 PHYSICAL CULTURE AND SPORTS	–	–	–	–	–	–	*0,26*
1101 Physical culture	–	–	–	–	–	–	*53,31*
1200 MASS MEDIA	–	–	–	–	–	–	*0,27*
1202 periodical press and publications	–	–	–	–	–	–	*3,38*
1400 INTER-BUDGET TRANSFERS TO THE BUDGETS OF THE RF SUBJECTS AND MUNICIPAL ESTABLISHMENTS OF GENERAL NATURE	–	–	0,16	–	–	–	*0,14*
1401 Subsidies to align budget cover of the RF subjects and municipal establishments	–	–	0,50	–	–	–	–
1403 Other inter-budget transfers to the budgets of the RF subjects and municipal establishments of general nature	–	–	–	–	–	–	*1,74*

Source: the IEP estimates based on the federal budgets data for 2005–2011 (2003–2007 data linked to the respective sections and sub-sections of the budget classification effected since January 2008.) The classification that has been out of the effect since 2011 and preliminary estimates are shown in italics.

[1] Non-applicable due to the changes in the budget classification.

Absolute and relative values of the main components of direct military allocations in the federal budget and their changes vs 2010 according to the final, November version of the Federal Budget Law for 2011 are shown in *Table 36.* The 2010 prices have been recalculated by using the first estimate[1] of the GDP index-deflator for 2011 (115.4%) used by Rosstat.

Table 36

Direct military allocations of the federal budget under section "National defense"

Section/subsection title	2011 in Rb mn / same in prices of 2010	Changes in 2011 vs 2010, Rb mn / growth, %	Allocation share % / change vs 2010 in points	
			2011 federal budget	GDP
1	2	3	4	5
NATIONAL DEFENSE	1 537 444 1 332 274	54 247 4,24	13,82 1,36	2,83 –
Armed Forces, Russian Federation	1 140 915 988 661	29 098 3,03	10,26 0,90	2,10 –0,03
Mobilization and paramilitary training	6 700 5 806	3 199 122,73	0,06 0,03	0,01 0,01
Mobilization preparation of the economy	4 895 4 242	–653 –13,34	0,04 –	0,01 –
Preparation for and participation in collective security and peace-making efforts	421 365	–10 722 –96,71	<0,01 –0,10	<0,01 –0,02
Nuclear arms	29 968 23 369	4 614 24,60	0,24 0,06	0,05 0,01
Implementation of international obligations on military and technical cooperation	4 447 3 854	–357 –8,47	0,04 –	0,01 –
Applied research in the area of national defense	161 346 139 815	–8 866 –5,96	1,45 –	0,30 –0,03
Other issues of national defense	191 752 166 163	37 934 29,58	1,72 0,47	0,35 0,07

Source: the IEP estimates.

Military allocations from other sections of the federal budget are given in *Table 37* (by italics, secret allocations are shown on the basis of the draft law on the federal budget). Note that to improve comparability of the data of the Russian military expenditures according to the international practice, since 2011 expenditures on security agencies have not been accounted for as military, and the respective amendments have been made in our published perennial dynamic rows.

Table 37

Direct and indirect military allocations under other sections of the federal budget

Section title or *allocations for*	2011 in Rb mn / same in prices of 2010.	Changes in 2011 vs 2010, Rb mn / growth, %	Allocation share % / change vs 2010 in points	
			2011 federal budget	GDP
1	2	3	4	5
in section "National security and law-enforcement efforts"				
Internal troops	73 225 63 454	–2 980 –4,49	0,66 0,01	0,13 –0,01
Border service	82 153 71 190	–6 237 –8,06	0,74 –0,02	0,15 –0,02
EMERCOM troops and civil defense	51 018 44 210	–1 930 –4,18	0,46 0,01	0,09 –0,01

[1] On the production and use of GDP for 2011 M.: Rosstat, February 21, 2011 See.: http://www.gks.ru/bgd/free/b04_03/Isswww.exe/Stg/d03/20vvp31.htm.

cont'd

1	2	3	4	5
In section "National economy"				
Alternative civil service	6 5	–1 –13,34	<0,01 –	<0,01 –
President Program "Destruction of chemical weapons in the RF"	768 666	–404 –37,74	0,01 –	<0,01 –
Subsidies to transportation companies that purchase motor vehicles for military convoys	55 48	–7 –13,34	<0,01 –	<0,01 –
Subsidies to functioning of Russia-NATO Center	33 28	7 34,85	<0,01 –	<0,01 –
Construction of special and military facilities	11 433 9 907	–5 224 –34,53	0,10 –0,04	0,02 –0,01
Federal target program "Industrial utilization of weapons and military equipment (2005–2010)"	91 79	42 116,91	<0,01 –	<0,01 –
Contributions to charter capitals and subsidies to organizations of defense-industrial complex	31 328 27 147	3 962 17,09	0,28 0,06	0,06 0,01
Stipends to young employees of the defense-industrial complex	234 221	– –	– –	– –
Secret/classified expenditures	*33 998* *29 461*	*7 179* *32,22*	*0,31* *0,09*	*0,06* *0,01*
In section "Housing and utilities"				
President Program "Destruction of chemical weapons in the RF"	659 571	–847 –59,70	0,01 –0,01	– –
Provision of office and permanent housing accommodations too servicemen	126 344 109 483	–16 433 –13,05	1,14 –0,09	0,23 –0,05
Secret/classified expenditures	*42 749* *37 044*	*1 335* *3,74*	*0,38* *0,04*	*0,08* –
In section "Education"				
MoD expenditures	47 798 41 419	–3 092 –6,95	0,43 –	0,09 –0,01
Secret/classified expenditures	*22 465* *19 468*	*4 891* *33,56*	*0,20* *0,06*	*0,04* *0,01*
In section "Culture and cinematography"				
MoD expenditures	2 491 2 158	–1 535 –41,56	0,02 –0,01	<0,01 –
Secret/classified expenditures	*208* *189*	*–28* *–13,34*	*<0,01* –	*<0,01* –
In section "Healthcare"				
MoD expenditures	38 940 33 744	922 2,81	0,35 0,03	0,07 –
Secret/classified expenditures	*40 993* *35 523*	*25 337* *248,74*	*0,37* *0,27*	*0,08* *0,05*
In section "Social policy"				
MoD pension provision	149 598 140 998	15 090 11,98	1,35 0,12	0,28 –
Pension provision to Border troops, Internal troops and EMERCOM troops	*28 143* *26 525*	*3 861* *17,03*	*0,25* *0,03*	*0,05* –
Material security to specialists of the RF nuclear weapons complex	5 095 4 802	637 15,29	0,05 0,01	0,01 –
Acquisition of housing for retired servicemen	19 770 17 132	–916 –5,08	0,18 –	0,04 –
Additional monthly material security to disabled after a service-related trauma	1 041 981	336 52,04	0,01 –	<0,01 –
Repairs of individual housing units owned by servicemen family members who lost their bred-winner	307 266	–135 –33,72	<0,01 –	<0,01 –

cont'd

1	2	3	4	5
Compensatory payments to the family members of the deceased servicemen	1 245 1 174	198 20,35	0,01 –	<0,01 –
Allowances and compensatory payments to servicemen, persons equivalent to servicemen, and retired servicemen	8 644 8 147	–3 079 –27,43	0,08 –0,03	0,02 –0,01
On-off allowance to a pregnant wife of a convicted serviceman under call-up liability, and a monthly allowance for the called-up serviceman's child	2 238 2 109	133 6,72	0,02 –	<0,01 –
In section "Mass media"				
MoD expenditures	1 500 1 300	100 8,32	0,01 –	<0,01 –
Secret/classified expenditures	*168* *146*	– –	– –	– –
In section "Inter-budget transfers to the budgets of the RF subjects and municipal establishments of general nature"				
Transfers to the budgets of Closed Administrative territorial Units (ZATO)	8 876 7 692	–1 185 –13,34	0,08 –0,01	0,02 –
Development and support to ZATO social and engineering infrastructure	2 690 2 331	–359 –13,34	0,02 –	>0,01 –
Migration from ZATO	527 457	–70 –13,34	>0,01 –	<0,01 –
Secret/classified expenditures	*820* *711*	– –	– –	– –

Source: the IEP estimates. Pensions, allowances, compensations and stipends are deflated for CPI.

Let us analyze the dynamic trend of the federal budget and its corrections in the course of the year.

In 2011, the allocations for MoD housing construction in the section "National defense" (Rb 17bn 639 mn) increased vs the previous year by 140 % (in real terms) also as a result of re-allocation of Rb 12bn in the budget year from the target item expenditures "Construction of military and special facilities", while in section "housing and utilities" (Rb 95bn 82mn) the allocations fell down by 23%. The federal budget allocations for the savings and mortgage system of housing provision to the MoD servicemen went up by 21% (in real terms) reaching Rb 29bn 740mn.

In 2011, allocations to motor fuels/lubs reduced by 10% (in real terms) down to Rb 51bn 57mn vs 2010 as a result of considerable carry-overs of the motor fuels. Thus, according to the Accounts Chamber[1], the cost of the surplus stock of motor fuels was evaluated at Rb 13bn 287mn as of June 1, 2011; during the last three years 15% up to 20% of the motor fuels (vs the established annual limits) have not been used. The shortage of motor fuels is no more a cause of low combat training since the actual average flying hours in the military aviation was about 90 hours against the 100 planned hours in 2011[2].

The federal budget allocations to MoD subsistence support continued growing by 27% in real terms vs 2010. Unlike the previous year, in 2011, allocations to MoD material support grew up by 12.4% in real terms. The MoD healthcare allocations demonstrated an interesting trend having reduced by Rb 2bn 901mn in June and increased again in November by Rb2bn 991mn (about 7.7% of their total).

In 2011, the MoD allocations to MA and additional incentives reduced in real terms by 12.5% vs 2010 down to Rb 262bn 578mn in spite of the actual increase of the money allow-

[1] Conclusive statement of the Accounts Chamber regarding draft federal law "On the federal budget for 2012 and the planning period 2013 and 2014". No. ZAM-23/1. M., October 7, 2011. P. 129–130.
[2] Independent Military Review. 2012. 16–23 March (No 8).

ances by 6.5% since April 1st. Simultaneously, the military personnel allocations to the MoD healthcare system reduced by 58% in nominal value during the year.

In 2011, allocations to MoD pension provision went up by 12% vs 2010 (in real terms) thus ensuring the 6.5% increase of the military pensions since April 1st, and pension provision to newly retired servicemen.

As a result, in 2011, direct military allocations from the Russian federal budget (*Table 38*) calculated according to the UN standard for military expenditures amounted to 4% of GDP while general military allocations with account of costs related to previous military functions (retirement pensions, destruction of chemical weapons, etc.) made 4.4% of GDP.

Table 38

Total military and military-related allocations from the federal budget

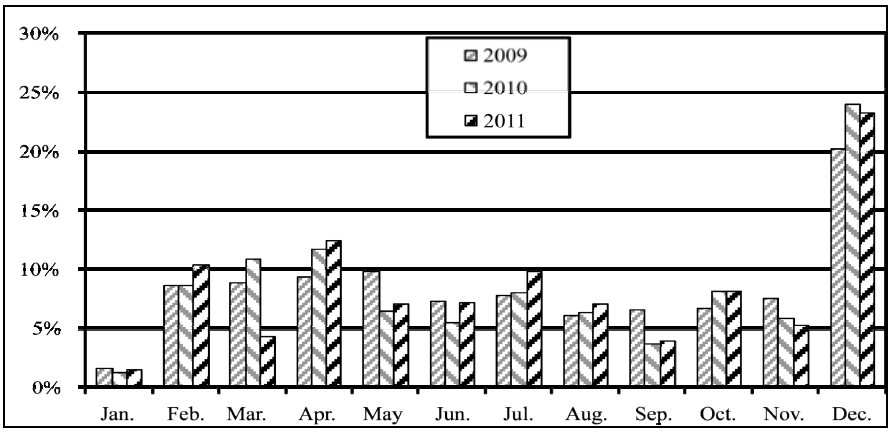
Allocation items	Allocation amount, in Rb mn,	Allocation share in % /its change vs 2010	
		in 2011 federal budget.	in GDP
Total direct military allocations	2 157 078	19,40 1,70	3,97 –0,05
Cumulative direct & indirect military allocations related to the previous and current military activities	2 375 205	21,36 1,82	4,37 –0,07
Total allocations for sections “National defense” and “national security and law-enforcement efforts”	2 779 552	24,99 1,92	5,11 –0,13

Source: the IEP estimates.

The 2011 federal budget implementation with regards to the military spend was more uniform than in 2010. According to our estimates, the excess over the limit of expenditure under “National defense” item reached its maximum of Rb5bn 866mn in July but did not exceed the limit of Rb 7bn 58mn established by part 7 Article 24 of the Law on federal budget for 2011, for the growth of military allocations at the expense of above plan budget revenues according to the consolidated budget plan.

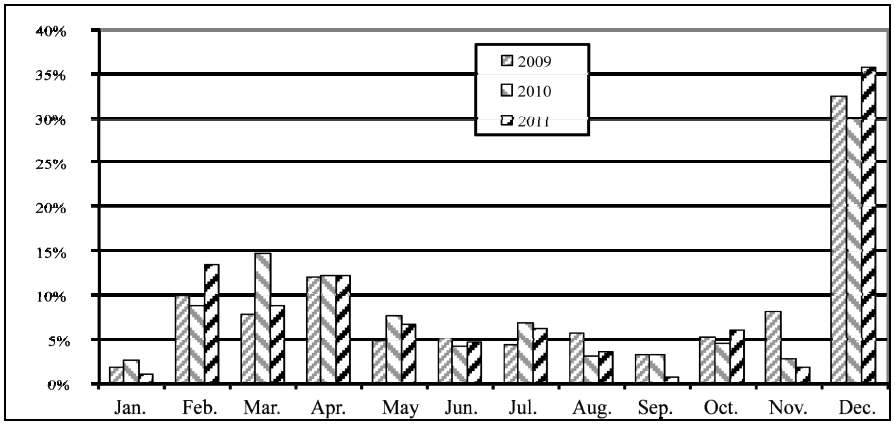
After this the said excess went to zero in November, and by the year end the consolidated plan envisaged Rb13bn of savings in section “National defense” as compared to the allocation amount sated in the budget law.

The dynamic trend of monthly execution of expenditures for major subsections of section “National Defense” in 2009-2011 is shown on *Fig. 37–39*. The expenditures of subsection “Armed Forces of the Russian Federation” that are used to fund the greater part of the MoD state military order failed to meet the two-month standard in 2011 while the December budget “tent” decreased but slightly (*Fig. 37*). The situation with expenditures in two other sections (*Fig 38, 39*) probed to be even worse and quite considerably in the last case.



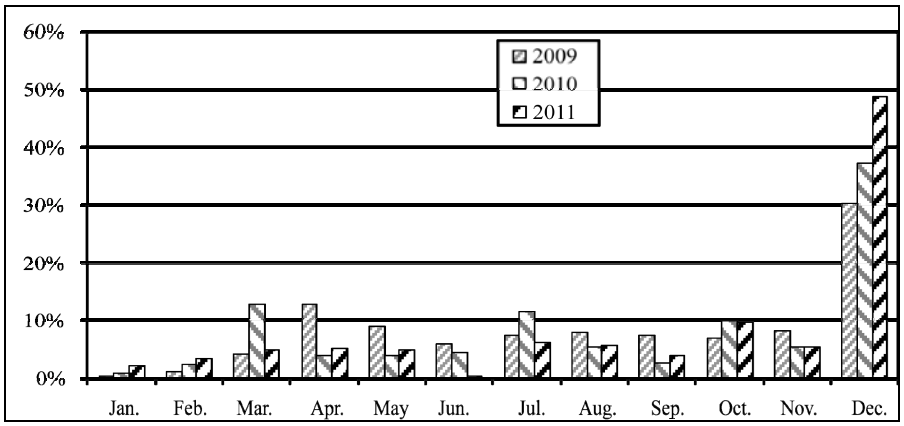
Source: the IEP estimates based on the Federal Treasury data.

Fig. 37. Implementation of federal budget expenditures under subsection "Armed Forces of the Russian Federation" in 2009–2011



Source: the IEP estimates based on the Federal Treasury data.

Fig. 38. Implementation of federal budget expenditures under subsection "Applied research in the area of national defense" in 2009–2011



Source: the IEP estimates based on the Federal Treasury data.

Fig 39. Implementation of federal budget expenditures under subsection "Other issues of the national defense" in 2009–2011

Table 39 shows military expenditures of the governments of the RF subjects that maintain long-term trends.

Table 39

Military expenditures of the consolidated budgets of the RF subjects in 2004–2011, in Rb mn*

Subsection of expenditure classification	2004	2005	2006	2007	2008	2009	2010	2011
Armed Forces of the Russian Federation	–	–	3,5 0,1	0,5 0,3	0,3 0,3	–	–	–
Modernization of the Armed Forces of the Russian Federation and military units	–	–	–	–	1,0 0,5	–	–	–
Mobilization and paramilitary training	–	65,6 65,6	899,3 808,6	1 351,9 1 245,6	1 797,9 1 702,2	2 116,0 2 021,6	2 003,7 1 958,4	2 250,0 2 187,3
Mobilization preparation of the economy **	532,4 500,6	485,4 468,6	708,3 692,8	861,2 840,9	1 137,2 1 063,9	1 045,4 989,7	1 298,4 1 247,8	1 351,2 1 266,3
Other issues of the national defense	–	109,6 97,5	32,8 32,1	5,5 5,7	0,7 0,5	4,4 4,4	<0,1 <0,1	2,7 2,7
Internal troops	12,4 12,2	9,9 9,9	3,5 1,4	1,0 1,0	0,3 0,3	–	–	–
Security units	6,7 6,5	0,3 0,3	16,5 16,5	0,1 0,1	0,0 0,0	60,0 60,0	<0,1 <0,1	14,5 14,4
Border service units	–	0,1 0,1	–	–	–	–	–	–
Protection of population and territory from emergencies of natural and technogenic nature, civil defense	7 968,2 7 281,3	11 184,6 10 958,9	15 636,4 14 367,0	19 118,4 18 292,6	23 895,8 21 456,7	23 865,0 21 712,6	27 218,0 25 527,4	34 678,1 32 122,9

*Numerator – allocated, denominator – actually spent.
** Before 2005, the subsection was not included in "National defense".
Source: Federal Treasury.

Table 40 presents Russian military expenditures in the period 1999–2011 that do not include (to avoid duplication) military expenditures of the consolidated budgets of the RF subjects shown in *Table 39.*

Table 40

Main parameters of the Russian Federation military expenditures in 1999–2011

	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
1	2	3	4	5	6	7	8	9	10	11	12	13	14
1. In nominal terms (current prices) Rb bn													
Implementation of FB expenditures under section "National defense" in the current budget classification [a]	115,6	191,7	247,7	295,4	355,7	430,0	581,1	681,8	831,9	1 040,8	1 188,2	1 276,5	1 516,0
FB allocations to "National defense": current budget classification	93,7	209,4	214,7	284,2	354,9	427,4	578,4	686,1	839,1	1 031,6	1 192,9	1 278,0	1 537,4
moved to other sections of the budget classification [b]	–	–	–	–	–	–	44,3	77,7	91,3	126,5	202,4	270,8	324,4
in comparable budget classification	93,7	209,4	214,7	284,2	354,9	427,4	622,6	763,9	930,4	1 158,1	1 395,3	1 548,8	1 861,9
Military expenditures, UN data[c]	–	202,6	294,4	325,9	447,0	499,0	665,0	822,1	850,2	1 127,2	1 176,4	1 179,3	–
Total direct military allocations[d]	120,9	256,1	262,2	321,3	408,4	490,9	692,1	899,7	1 085,4	1 356,5	1 652,7	1 819,1	2 157,1
Cumulative direct and indirect military allocations related to current and previous military activities[e]	137,5	294,3	313,4	429,1	556,2	586,6	788,2	1 000,1	1 263,3	1 502,4	1 822,3	2 006,7	2 375,2
2. In real terms (in 2011 prices)[f], Rb bn													
Implementation of FB expenditures under section "National defense" in the current budget classification	1 202,9	1 285,6	1 247,9	1 265,4	1 250,0	1 289,3	1 413,2	1 343,6	1 407,2	1 434,9	1 491,9	1 517,8	1 516,0
FB allocations to "National defense": current budget classification	975,1	1 404,4	1 081,5	1 217,3	1 247,3	1 281,5	1 406,5	1 352,2	1 419,4	1 422,1	1 497,7	1 519,6	1 537,4
moved to other sections of the budget classification	–	–	–	–	–	–	107,6	153,2	154,5	174,4	254,1	321,9	324,4

cont'd

1	2	3	4	5	6	7	8	9	10	11	12	13	14
in comparable budget classification	975,1	1 404,4	1 081,5	1 217,3	1 247,3	1 281,5	1 514,1	1 505,4	1 573,9	1 596,5	1 751,9	1 841,5	1 861,9
Military expenditures, UN data	–	1 358,8	1 483,3	1 396,2	1 570,9	1 496,1	1 617,1	1 620,1	1 438,2	1 554,0	1 477,1	1 402,1	–
Total direct military allocations	1 257,6	1 717,0	1 320,9	1 376,5	1 435,1	1 471,9	1 683,0	1 773,1	1 836,1	1 870,1	2 075,1	2 162,9	2 157,1
Cumulative direct and indirect military allocations related to current and previous military activities	1 431,0	1 973,4	1 578,9	1 838,3	1 954,7	1 758,8	1 916,7	1 970,8	2 137,0	2 071,3	2 288,0	2 385,9	2 375,2
3. In real terms (in 1999 prices), Rb bn													
Implementation of FB expenditures under section "National defense" in the current budget classification	115,6	123,5	119,9	121,6	120,1	123,9	135,8	129,1	135,2	137,9	143,4	145,8	145,7
FB allocations to "National defense": current budget classification	93,7	135,0	103,9	117,0	119,8	123,1	135,2	129,9	136,4	136,7	143,9	146,0	147,7
moved to other sections of the budget classification	–	–	–	–	–	–	10,3	14,7	14,8	16,8	24,4	30,9	31,2
in comparable budget classification	93,7	135,0	103,9	117,0	119,8	123,1	145,5	144,7	151,2	153,4	168,3	177,0	178,9
Military expenditures, UN data	–	130,6	142,5	134,2	151,0	143,8	155,4	155,7	138,2	149,3	141,9	134,7	–
Total direct military allocations	120,9	165,0	126,9	132,3	137,9	141,4	161,7	170,4	176,4	179,7	199,4	207,8	207,3
Cumulative direct and indirect military allocations related to current and previous military activities	137,5	189,6	151,7	176,6	187,8	169,0	184,2	189,4	205,4	199,0	219,9	229,3	228,2
4. Military burden on the economy, % of GDP													
Implementation of FB expenditures under section "National defense" in the current budget classification	2,40	2,62	2,77	2,73	2,69	2,53	2,69	2,53	2,50	2,52	3,06	2,87	2,79
FB allocations to "National defense": current budget classification	1,94	2,87	2,40	2,63	2,69	2,51	2,68	2,55	2,52	2, 50	3,06	2,83	2,79
moved to other sections of the budget classification	–	–	–	–	–	–	0,20	0,29	0,27	0,31	0,52	0,60	0,60
in comparable budget classification	1,94	2,87	2,40	2,63	2,69	2,51	2,88	2,84	2,80	2,81	3,60	3,43	3,42
Military expenditures, UN data	–	2,77	3,29	3,01	3,38	2,93	3,08	3,05	2,56	2,73	3,03	2,61	–
Total direct military allocations	2,51	3,51	2,93	2,97	3,09	2,88	3,20	3,34	3,26	3,29	4,26	4,03	3,97
Cumulative direct and indirect military allocations related to current and previous military activities	2,85	4,03	3,50	3,97	4,21	3,44	3,65	3,72	3,80	3,64	4,70	4,44	4,37
5. Purchasing power parity (in current prices), Rb bn													
Implementation of FB expenditures under section "National defense" in the current budget classification	21,9	26,8	30,2	31,9	34,2	36,2	45,6	54,0	59,5	72,6	82,0	79,9	93,3
FB allocations to "National defense": current budget classification	17,7	29,3	26,2	30,7	34,1	35,9	45,4	54,3	60,1	71,9	82,3	80,0	94,7
moved to other sections of the budget classification	–	–	–	–	–	–	3,5	6,2	6,5	8,8	14,0	16,9	20,0
in comparable budget classification	17,7	29,3	26,2	30,7	34,1	35,9	48,9	60,5	66,6	80,8	96,3	96,9	114,6
Military expenditures, UN data	–	28,3	35,9	35,2	42,9	42,0	52,2	65,1	60,9	78,6	81,2	73,8	–
Total direct military allocations	22,8	35,8	32,0	34,7	39,2	41,3	54,3	71,2	77,7	94,6	114,1	113,8	132,8
Cumulative direct and indirect military allocations related to current and previous military activities	26,0	41,2	38,3	46,3	53,4	49,3	61,9	79,2	90,4	104,8	125,8	125,6	146,3
For reference													
GDP deflator, % to the previous year	172,5	137,6	116,5	115,5	113,8	120,3	119,3	115,2	113,8	118,0	101,9	111,4	115,4
Expenditures deflator on end consumption of collective services of public administration[g], % to the previous year	140,1	155,2	133,1	117,6	121,9	117,2	123,3	123,4	116,5	122,7	109,8	105,6	*118,9*
Purchasing power parity[h], Rb/$	5,29	7,15	8,19	9,27	10,41	11,89	12,74	12,63	13,97	14,34	14,49	15,98	*16,24*

[a] For 2011. – preliminary data on federal budget implementation of Federal Treasury.

[b] Total expenditures of MoD and secret/classified expenditures under sections 05–09 and 11 of 2005–2011 federal budgets for 2011 – additionally for section 12.

[c] For 2011 – RF government will provide the data to UN in 2012; these will include expenditures for maintenance of the internal, border troops and civil defense

[d] Including maintenance of the internal, border troops and civil defense troops.

[e] With servicemen retirement pays.

[f] Deflated by the deflator of expenditures on end consumption of collective services of public administration.

[g, h] For 2011 – the IEP estimates.

Source: Federal laws on the federal budgets of 1999–2011 and on the implementation of the federal budgets of 2000–2010.; Russia's national accounts in 1997–2010 Statistical collection/Rosstat M., 2005–2011; Objective information on the military issues including transparency of the military expenditures. UN General Secretary reports of 2001–2011.; Rosstat; Federal Treasury.

* * *

The objectives of the 2011–2020 state arms program to raise the share of state-of-the art arms in the current force up to 70% by 2020 and in the strategic nuclear force – up to 100% are non-realistic and counterproductive since, firstly, these objectives are unreachable given the potential of the national industry, and this has been confirmed by the results of the first year implementation of the said program, and secondly, they doom the national industry to a more than two-fold reduction of the strategic nuclear weapons production after 2020, and of the conventional weapons for the national Armed Forces, after 2025. If these reductions take place, one should not rely on a considerable compensation of the reduced weapons at the expense of growing weapon exports, specifically with respect to the strategic nuclear weapons.

According to the Russia's Ministry of Defense data[1], the share of state-of-the art weapons in the armies of the leading foreign countries makes 30% to 50%; this apparently sets up a necessary pace for development of their defense industries that supply products to the domestic markets.

Therefore, assuming that the optimal value of the said target indicator would be in the same range for Russia as for other countries with sufficiently developed military production and following the declared value of the state arms program worth Rb 20 trillion for 2011-2020, we can estimate possible saving of the budget at the expense of the arms program till 2020 inclusively within the range Rb5.3 trillion – Rb14.8 trillion (with account of the attained, by early 2012, target indicator of the arms program at 25% and 16% for strategic and conventional weapons, respectively).

To overcome the current bureaucratic stupor caused by the fight between the Ministry of Defense and the Russian defense and industrial complex may be possible only if the military and technical policy returns to the route pointed out by V. Putin back in 2004 in his President message to the Federal Council in the form of a statement on "the transparent military economy" as an absolutely necessary condition of the successful reform. This for sure will require abandoning the latest practice of thoughtless pumping of budget funds into the defense and industrial complex, improving discipline at all the tiers of the public administration and doing away with the administration irresponsibility. The directive and financial methods of managing the defense and industrial complex in the existing context of the vertical power model proved to be ineffective and inefficient both in a short-term and long-term perspective; and the 12-year long experience is a good evidence of this.

Indeed it is impossible to improve the efficiency of expenditures including the military expenditures unless accurate statistics is published, federal budget gets transparent, a policy of openness (glasnost) on the issues of defense is carried out and corruption is fought with effectively. *Table 35* gives you an idea of what a long way Russia will have to go.

The irrational institution of the program-based planning of weapons that is outdated in terms of the format and the content still remains the only tool of blackmailing politicians and

[1] Interview of V. Popovkin, Deputy Minister of Defense//National Defense, 2011, March.

the community forcing them to satisfy, every five years, the ever growing appetite of the Russian defense and industrial complex with no responsibility for the outcomes. This may create a *dangerous* effect that feeds up not only the ongoing growth of military expenditures but also leads to militarization of the community backed up with the statement about increasing defenselessness of Russia.

The modern Armed Forces of Russia have not been among the top five world leading armies, and so far there is no opportunity for them to reach this target set by the MoD leadership. Among the G8 states, Russia remains the only country with the army which by over one half is formed involuntary, by the call-up principle. Given the established total numerical force of one million, the efforts to staff all the military units at 100% failed due to erroneous notions about the number of conscripts and low attractiveness of the military service. The ongoing "humanization" of the call-up military service is useful, no doubt, but it is not going to resolve the problems of the service effectiveness.

The program of transition of the constant readiness military units to the contract enlisting during 2004–2007 failed for the sake of keeping the conscription and the "feeding trough" for corrupt officials engaged in conscription. Up to now, the persons at fault have not been punished, no lessons have been drawn from the situation and the intentions to increase the number of enlisted by contract continue running into old corruption factors and the absence of understanding by the government officials of the needs of the servicemen and their family members, and the real difficulties of the military service. As a result of this policy, the initial money allowance of the soldiers (rank and files) is going to be lower than the average wage across the country even after the latest increase of this allowance, though the Strategy of social development approved by the RF MoD fixed the 25% excess of MA over the average wage. It may be expected that the competitiveness of the army at the employment market would remain low. The attempt to equip the army with volunteers from the CIS countries who wish to become citizens of Russia seems to be totally inefficient.

Economic incentives are needed to support the declared annual increase of the numerical force of the army by 50,000 of the enlisted by contract, these incentives could ensure manning of new positions and replacement of the retired, and this would set the annual enlisting requirement up to 70,000. To reach this level would be hard if the initial amount of the rank-and file money allowance is not increased in the near future.

The announced by the Joint Staff Commander proposals for implementation of the system of continuous military training of the servicemen that so far covers officership only, should also include soldiers and the junior command personnel.

6.8. Strategy of Socio-Economic Development of the North-Caucasian Federal Okrug: the First Steps

Strategy of the socio-economic development of the North-Caucasian Federal Okrug through 2025 was approved more than a year ago, and its implementation has already kick-started. But already at the onset there arose risks which experts had long forewarned of: specifically, the Strategy implementation mechanisms may exacerbate typical of the North-Caucasian regions problems and fuel new ones. Hence an integral component of the NCFO Strategy should become a policy comprising strictly defined rules and procedures and aiming at prevention of conflicts.

Strategy in a Nutshell

Strategy of the socio-economic development of the North-Caucasian Federal Okrug through 2025 was approved by Resolution of the RF Government No 1485-p of 6 September 2010. The mission of the strategy is "to ensure conditions for advanced development of the real sector of the regions in the Okrug, generation of job opportunities, raising the residents' living standards". In the frame of an optimal scenario of development of NCFO by 2025 it is planned to:

- create no less than 400,000 jobs and bring unemployment from 16% down to 5%;
- reduce the proportion of the population with incomes under the subsistence level from 16.5% to 9.2%;
- raise average salaries and wages from Rb 9,600 to 23,800;
- ensure the annual GRP increase rate at a level of 7.7% (with its cumulative growth over the period in question accounting for 2.7 times) and the annual increase rate in the industrial sector at a level of 10.1%;
- quadruple consolidated regional budget revenues per capita.

It is envisaged to ensure such a breakthrough by encouraging advancement of the real sector, including the agro-industrial complex, tourist-recreational one, energy, mining and processing industries, and transit functions. It is also envisaged to bolster innovation-educational activities and establish a federal university.

During most of the period of 2010-2011, the Strategy was largely "appended" with necessary paraphernalia, such as the normative base, organizational structure, etc. There began functioning the Commission of the RF Government for the North Caucasus led by PM V. Putin as its Chair. To implement the Strategy, there were established JSC "the North Caucasus Development Corporation", a subsidiary to Vensheconombank, with the authorized capital of Rb 500mn, and JSC "Resorts of the North Caucasus", a subsidiary to JSC 'Special Economic Zones" with participation of Vnesheconombank and Sberbank of Russia, with the authorized capital of Rb 5,35bn. The RF Ministry of Regional Development, regional agencies in charge of economic development became engaged in projects selection. A range of public advisory bodies were created: the Council under the Envoy, the Public Council of the Okrug, The Anti-Corruption Council, the Council of Elders, the Council for Youth Policy, the Council of Alims, the Okrug Commission for Cossack Affairs, the Expert Council, to name a few.

That said, not all the problems were solved even on the organizational level. Specifically, the widely publicized federal target program "Development of the North-Caucasian Federal Okrug through 2025" was not adopted. In accordance with the FTP, it was planned to allocate Rb 3.9 trillion, including 2.6 trillion out of the federal budget, for development of the North Caucasus. Devised in July 2011 by the RF Ministry of Regional Development, the FTP consists of 10 sub-programs and over 8,300 measures. It is envisaged that three currently implemented federal target programs which concern the NCFO regions, namely, "The Socio-Economic Development of the Republic of Ingushetia for 2010-2016", "The Socio-Economic Development of the Republic of Chechnya for 2008-2013", "South of Russia (2008-2013)" (with regard to RF Subjects within NCFO), should form structural components of the Program. It is planned to allocate, on the annual basis, some Rb 400 bn to implement this program in years to come.

However, the program has not been adopted as yet, particularly because of significant controversies with the RF Ministry of Economy and Ministry of Finance with respect to its funding. The program is to be approved by May 2012, but it is not clear how to combine a gargantuan increase in the federal spending on the North Caucasus with the task to ensure a sustained balancing of the budget and ensuring a budget maneuver in favor of sectors of the social sphere which the nation faces today in connection with the imperative of attaining its strategic development objectives on the whole.

Prospects and Risks Facing the Tourist Cluster

It was the work on shaping the tourist cluster that proved particularly active. With its Resolution No. 833 of 14 October 2010 "On creation of the tourist cluster in the North-Caucasian Federal Okrug, Krasnodar krai and Republic of Adygeya", the RF Government ruled to establish 5 tourist-recreational special mountain skiing economic zones, of which 4 ones – in the North-Caucasian federal okrug (Matlas in Dagestan, Elbrus-Bezengi – in Kabardino-Balkaria, Arkhyz – in Karachaevo-Cherkessia and Mamison – in North Ossetia – Alania). It was envisaged that the Government would invest, through JSC "RNC", Rb 60 bn in the transport and communal infrastructure of these projects, with the private businesses financing construction of resort infrastructure objects against the RF Government's guarantee to return up to 70% of their investment in the event of force majeure and vows to grant tax and customs benefits. More specifically, tax benefits include exemption from the federal component of the corporate profit tax (2%) coupled with a possible slashing to 0% of the current 18% regional component thereof, and exemption for the term of up to 10 years from land and property, and transport taxes.

The year of 2011 saw vigorous efforts to attract foreign investment into the project. The Russia-France summit in Dauville in May 2011 resulted in a joint declaration on inclusion of the project of development of a tourist cluster in the North Caucasus in the list of priority directions under the aegis of the nations' strategic partnership. At the St. Petersburg Economic Forum, JSC "RNC" signed a memorandum of intention with the French state-owned holding Caisse des Dépôts et Consignation with regard to a joint venture to contribute to the tourist cluster development project. In late 2011, a joint Russian-French venture "The International Development of the Caucasus" was incorporated, which is to commence its operation in February 2012. In compliance with the Incorporation Agreement signed by the parties thereto, the newly established joint venture plans to attract up to Euro 1 bn in investments in the project.

The work on building a mountain skiing cluster has just kicked off (construction *de facto* is in progress only in Arkhyz), but with its Resolution of 29 December 2011 No. 1195 "On special economic zones in the North-Caucasian Federal Okrug", the RF Government has already doubled in size the territory of the North-Caucasian tourist-recreational complex. More specifically, special economic zones of tourist-recreational type are established in the Republic of Ingushetia (in the territory of Jeirakh and Sunzhen districts), along the Caspian shore in the Republic of Dagestan and in a number of other territories. At this point, it should be noted that peaceful environment, the absence of ethnic and confessional conflicts and acts of terror are not typical of all those territories. There also exist plans to have the company's operations spread across other territories, including those beyond the North Caucasus. In parallel there intensify demands for public funding to build the infrastructure. It has been announced recently that it is imperative to build four new airports and reconstruct two existing ones in the region.

The envisaged deliverables indeed pursue the goal of a substantial transformation of the economic basis to bolster the region's advancement and include creation of over 1,000 km of pists, over 200 cable tramways, erection of hotels, apart-hotels and private cabins of different categories with the overall capacity of some 85,000 beds. It is envisaged that the project implementation will generate over 330,000 jobs in the region. It is planned to have local resorts in the North Caucasus and along the Caspian shore be able to accommodate up to 250,000 tourists a day. In accordance with the publicly voiced estimates, once the project gets into top gear, the tourist inflow in the region will account for 10 mn people. The peak of construction works will fall on 2013-17 and the program is scheduled for completion in 2019.

Meanwhile, a series of fundamental questions raised a year ago regarding development of the tourist cluster in the region still remain unanswered. Let us cite three of them.

First, the *occupancy rate.* At the existing resorts in the North Caucasus, the high-season occupancy is 10-15,000 alpine skiers a day. The season lasts for 100-120 days. Besides, even prior to the 2011 developments which battered the local ski industry (see below), the number of tourists there had been dwindling[1]. There has been no in-depth examination of demand for services of those tourist giants which are supposed to be created in the region or, at least, respective findings were not made public.

Second, *what is going to happen to the existing tourist centers?* There are at least two large ski centers in the region: at the vicinity of Mt. Elbrus (Kabardino-Balkaria) and Dombai (Karachaevo-Cherkessia). Given development of the tourist cluster, their prospects remain murky. They will obviously prove undesirable rivals to the ski cluster under construction which lower their chances for survival. That said, it is worth noting they both are holders of a real brand, with the Elbrus one boasting an internationally recognized brand of both ski and mountaineering center. They secure quite a number of job opportunities for both locals and seasonal staff and it is not guaranteed they would be able to find their niche in the frame of the new tourist industry with its greater, and somewhat different, requirements. It is not at all granted, either, that residents of once long-standing tourist industry leaders which subsequently fell prey to the state would necessarily welcome new privileged rivals. It is more likely that such a development would fuel new intense conflicts in the region and no one is insured against such conflicts growing violent.

This compels posing the third and, perhaps, the most thorny – at the moment – question*: how can development a tourist cluster* receiving 250,000 visitors a day, including women and children (as it is also planned to develop family tourism), *combine with the threat of acts of terror*? The act of terror in Kabardino-Balkaria on 18 February 2011, which left three tourists dead and another three wounded[2], is a perfect demonstration of the gravity of the threat in question. The fact that the first act of terror against tourists took place after making public the gargantuan plans to develop a tourist complex in the region, thus increasing the political and economic significance[3] of security issues, cannot help but compel contemplating the urgency

[1] See: North Caucasus –Modernization challenge.-M.: Delo Publishers, 2011, p. 222-223.

[2] Actually, the killing of the tourists on 18 February was just the first link the in the chain of terrorist attacks in the territory which aim at derailing the local tourist business. The next night, a pillar of a local cable tramway was blown, and a mine-strewn car was found at a local alpine place popular with tourists.

[3] Experts differ on the issue. Thus, Islam Tekushev, Director of medium Orient news agency suggests that behind the acts of terror were forces striving to topple Arsen Kanokov, the incumbent President of Republic of Kabardino-Balkaria: "It is not known when clans and local thugs represented by the Kabardino-Balkar underground began to systematically work on destabilization of the situation for the sake of their common objective,

of creation of efficient anti-terrorist mechanisms. This problem is a genuine life-and-death one for the future tourist cluster. That said, while discussing respective plans in this sphere, these problems have not even been made public.

In practice, it is the forceful option that still remains predominant in this regard, with the sole response to the rise of terrorism in the Republic being a counterterrorist operation regime (CTO) since 20 February 2011. In Elbrus district and in a part of Baksan district the CTO regime was canceled only on 5 November 2011, thus having lasted for over 8 months. From the perspective of forceful action, its results were positive and the militant underground suffered a serious blow. According to the local Ministry of Interior, 95 illegal militants were killed and another 97 detained during the CTO period. That said, a longer-range success of such a policy does not seem that granted.

First, like many other actions of this sort, the one in question was accompanied with abuses of human rights, including killing innocent individuals who were taken for militants and inflicting damage on non-combatants' property. Specifically, once again the crackdown on the regular "mosque-goers" was on the upswing. During the CTO, mosques stayed empty in Elbrus district as local residents were afraid of dropping by. NGO "Memorial" cites an example of the local authorities' failure to engage militants' families to get their children out of the "woods". A month and half after airing their mothers' video with an appeal to put an end to the civil war there was broadcast another one which evidenced that sons of two women who had recorded the video in the summer were killed literally in their presence during a "special operation" in the town of Baksan[1]. It is this kind of situation that gives rise to the "vicious cycle of violence" when suffering and deaths of the innocent, often relatives, friends and mates, in the course of combat against terrorism bolsters the desire to revenge and result in augmentation, rather than fading, of the armed struggle.

Second, the territories concerned saw the local economic activity in ruins. The influx of tourists in the locality has fully discontinued since the moment of imposition of the anti-terrorist operation regime there. Hoteliers and other operators and owners of the local tourist infrastructure objects faced a grave challenge, as they had already taken loans in the hope to expand their businesses. Employees, too, found themselves on the verge of hunger, and so did small-sized businesses, including, in particular, craftsmen and artisans (there even was a probability of not sending children to school on 1 September, as there was nothing to wear). Unknown structures were vehemently buying land at giveaway prices[2]. While the CTO regime was canceled in early November 2011, it goes without saying it will be fairly hard to avoid its long-term adverse effects.

For one part, the residents' growing discontent is centered both on militants and the authorities, which manifested itself even on the official level. While meeting with residents of

that is, toppling Kanokov… Customers realized very well that killing tourists within the zone of a federal ski resort popular with mountaineers, rock-climbers and skiers throughout Russia and European states does not fit in the framework of permissible risks set by Russian elites in the Caucasus" (Islam in the North Caucasus: history and modernity. Prague, Medium Orient, 2011, p. 178-179). In the Republic, a widespread opinion is that the spike of violence is directly associated with the struggle for control over the tourist business.

[1] Bulletin of the Memorial human rights watchdog. Situation in the zone of conflict in the North Caucasus: the human rights activists' assessment. The summer of 2011. Source: the human rights advocacy center "Memorial"//"Caucasian knot". http://www.kavkaz-uzel.ru/articles/194174. 18 October 2011.

[2] We visited this locality during the ATO period. Even on the surface the picture was terrifying: packs of hungry dogs, rags of billboards flying in the wind, and not a single human being around.

settlement Elbrus, President A.Kanokov of Kabardino-Balkaria enunciated that, "Nobody was going to impinge upon the local residents' interests, despite the dearth of talks about that". However, in private conversations the local residents cited a comment made by a high-ranked federal bureaucrat: "You are going to starve till the last Wahhabi!" Such an automatic labeling of local residents as terrorists' accomplices does not help ensure a social harmony in the Republic, either, and contributes to the said "vicious circle of violence".

On the other hand, development prospects for tourism in the region and, perhaps, throughout the North Caucasus have been jeopardized. While it is yet premature to assess prospective losses, some short-term results have become already known. Since mid-December the local resort's occupancy rate has been just 15%, while during the high season (New Year holidays) it received twice as little tourists than a year before. According to information available, local businesses' economic losses are further exacerbated by the need to invest in security and no possibility for even an inflation-adjusted price rise. Meanwhile, compensations payable to local residents for damages inflicted by ACT are preposterous: according to information available, the Elbrus district residents are entitled for a total of Rb. 1.5mn in compensations, while the neediest households received a Rb. 15,000-worth compensation each.

Apart from ACT, the official reason for a meager tourist inflow in the region is the snowless winter. Future will show which factor plays a greater role; however, it is already clear that restoration of the Elbrus district and the North Caucasus on the whole as an appealing ski resort can take a lot of time and costs.

At this juncture it is evident that a successful development of the local tourist cluster is up in the air without fundamentally new approaches to security challenges in the region. Most North-Caucasian Republics already rejected the credibility of the purely forceful solution.

Some efforts were made, albeit with a different level of consistency and success, in Dagestan, Ingushetia and Kabardino-Balkaria to mitigate the standoff and return former militants to peaceful life, but federal structures did not contribute to the process, thus drastically lowering its efficiency. Should such a policy be pursued further on, it may seriously torpedo the Strategy implementation.

Project Financing

The possibility to obtain guarantees or other forms of backing to investment projects aroused much interest in the region, primarily with the medium-sized business community. Practically all its representatives we interviewed last year were preparing projects to apply for the support. Meanwhile, those entrepreneurs who have already faced the selection procedure sounded ambiguous. Thus, it was noted that structures engaged in the selection process are keen to pick large, rather than small, projects and explicitly encourage the entrepreneurs to extend their projects and increase volume of investment. But the process is at its onset, and it is too early to assess its efficacy. Thus, Rb 50bn allocated in the 2011 budget for provision of state guarantees against loans attracted by legal entities to implement investment projects in the North Caucasus was carried forward to the 2012 budget (accordingly, the latter now provides for Rb 100bn in allocations for the said purpose).

Main technical problems exposed by now were quite predictable. Those were: an insufficiently high quality of projects and a low level of their development. This factor might become one of the reasons behind the decision to transfer implementation of most projects to Stavropol krai, with its lower risks and a relatively higher culture of project implementation, as evidenced by Mr. A. Khloponin, the presidential Envoy in NCFO: "For next year

Rb. 6.6bn from the Investment Fund was planned in the budget, and all the allocations are for projects in NCFO, infrastructure development. But it is only Stavropol krai which is ready and already in receipt of Rb 3bn. The rest of the money has not been assigned as yet, as there are no concrete projects and documentation in accordance with which the projects need to be funded"[1].

Meanwhile, conflicts engendered by implementation of state-sponsored investment projects were not long in coming. A particularly explosive situation emerged in Nogaysky district of Dagestan, where it was planned to build a sugar-processing plant.

The fuel for the future conflict had been there even before the respective decision was made and it was the land. The district in question is a territory where most lands (over 60%) fall under the category of the so called distant-pasture cattle rearing ones and as such are used by settlers from mountainous regions (the Dargin and Avar peoples), rather than the local Nogays. Ex-highlanders have also staked out most pastures in the district that did not fall under the above category, thus de-facto leaving the Nogays with a meager fraction of arable land in their hands. It is most of these lands (some 100,000 hectares) claimed by the sugar-processing plant development project. The locals conceived of the project as a threat from different perspectives.

First, in the absence of formal land titles, the disputable lands *de facto* prove to have been fixed with the locals. Informal property rights are widespread in Dagestan and the residents therein regard them as legitimate ones. Thus, the investor's arrival was *de facto* perceived of as a way to strip the residents off their last land plots. Besides, the Nogay *vox populi* is that sugar beet cannot be cultivated in the local climatic conditions.

Second, the construction of the prospective plant was perceived of as a means to ensure the highlanders' further migration into the territory of the district. Such conclusions were made basing on the fact that the project provided for 15,000 new jobs. But the local residents cannot supply workforce in such quantities. Besides, there practically is no qualified staff among them, as the Nogays have never been engaged in planting sugar beet. The need to attract extra workforce into the region was voiced by the Republic's leadership too.

More fat into the fire was added by the fact that the project was initiated by an Avar from Khasavyurt district of Dagestan.

The local residents' protests were ultimately a success and the project was transferred to a neighboring district. But a fragile equilibrium in the district was broken, the residents grown politically mobilized and the conflict started living its own life which was independent of the investment project which had triggered it. At the congress of the Nogay people[2] held in the capital of Nogay district, the settlement of Terekli-Meleb, in late May 2011, in addition to the problem of the sugar-processing plant, the residents raised more general political issues: the need to unite all the Nogays in the frame of an administrative-territorial entity, transition to direct elections of the district Head, etc. Even after the decision was made to relocate the construction project in question, the Nogays' activity did not subside, the conflict with the district authorities escalated and the range of political demands was expanding (the opposition now is

[1] Yuri Goverdovsky. The North Caucasus have a Development Strategy// The Parliament Gazette, No. 48 (2464). http://www.pnp.ru/newspaper/20101001/4614.html. 1 October 2010.

[2] Main territories of the Nogays's compact residence; Dagestan, Chechnya, Karachaevo-Cherkessia and Stavropol krai, and Astrakhan oblast. There are Nogay national districts in Dagestan and Karachaevo-Cherkessia.

against election of the local legislature on party ticket). According to mass media, "the region itself is growing into a full-fledged zone of conflict"[1].

The risks emerged already at the onset of the Strategy implementation, which proved associated with escalation of the conflict potential in the North-Caucasian regions, require an additional development, in the frame of the NCFO Strategy, of a policy aiming at prevention of the rise of additional conflicts. This can be at least partly ensured through devising a set of rules and procedures which would secure a sound awareness campaign, taking into account the residents' opinion and refusal of projects that may have an adverse effect on social stability in the region.

The latter is in need for a more detailed explanation. The previous record of launching investment programs in the North Caucasus exposed an extreme danger of implementation of projects that provided for withdrawal from the economic turnover of sizeable arable land sites (eg., as a result of their impounding). By destroying traditional livelihoods without offering a credible alternative, such projects can provoke the rise of extremism in the territories concerned. It seems appropriate either to shelve such projects at all, or to secure a maximum possible account of the popular opinion and get the projects implemented only upon mobilization of a broad public consensus. As in the conditions of the North Caucasus monitoring of genuineness of such a consensus may pose certain problems and be associated with sizeable costs, the former option (a ban on projects associated with a large-scale land withdrawal) may prove the most sound one.

The policy in question should also encompass anti-terrorist activity and provide for abandonment of a purely forceful solution to the problem and engagement of mechanisms securing public consent with participation of the federal center which should become a guarantor behind agreements reached and coordinator of law enforcement agencies and other "*siloviki*"'s contribution to the process in question.

[1] Ivan Sukhov. The Nogay Riot. The biggest district in Dagestan demands for non-party elections. Moscow news. http://mn.ru/blog_caucasus/20110905/304671811.html. 5 September 2011. 17:12.