



QUARTERLY REPORT JANUARY –MARCH 2010

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1. INTRODUCTION

The first quarter of 2010 saw the continued consolidation of political structures in Russia with regional elections less criticised than those in October 2009 but still flawed. However on 29 March Moscow was violently reminded of the continuing conflict in the North Caucasus by the explosion of two bombs in the metro set off by women suicide bombers killing 40 people and injuring over 100.

Relations with Ukraine began to improve following the election of President Yanukovich while new difficulties emerged with Belarus. President Medvedev and the Government continued to emphasise the need for modernisation of Russia and a number of activities in the economic, industrial and educational/research sectors were linked to this.

The post-crisis economic recovery continued although the pace remained slow and some indicators actually fell back. However with the price of oil remaining relatively high the prospects for growth are good. The formation of the customs union with Belarus and Kazakhstan has become a key external trade priority, consolidating the tariff increases introduced by Russia in 2009.

2. POLITICAL DEVELOPMENTS

2.1. Domestic politics

In February 2010, Levada Center published opinion polls indicating that the popularity of President Medvedev (75%) gets closer to that of Prime Minister Putin (78%).

During the reported period, number of street protests took place across Russia, the most significant in Kaliningrad and Vladivostok to show discontent with Prime Minister Vladimir Putin, his Government and United Russia.

Local and regional elections of 14 March 2010 can also be interpreted as an expression of dissatisfaction with the Government. As expected, the United Russia (UR) won the regional elections. However, its overall result was lower than anticipated (10% less than in October 2009 elections). The UR maintained the majority but in some regions the percentage of votes was far below 50% and as a consequence, UR dismissed the UR party secretaries of these four regions and nominated a new UR campaign manager for the October 2010 elections. The Communist Party (CPRF), Liberal Democratic Party (LDPR) and Fair Russia (FR), performed better than anticipated by pre-election polls and all passed the electoral threshold. Just Cause and Patriots of Russia failed to pass the threshold in the few regions where they participated. As a result, the number of active political parties is now limited to four: UR, CPRF, LDPR and FR. Despite the shortcomings (notably related to registration of political parties), the elections took place in a less tense atmosphere compared to October 2009 and the leaders of the main political parties accepted the election results.

On 29 March 2010, two bomb explosions were set off by women suicide bombers at the Moscow metro stations "Park Kultury" and "Lubyanka", claiming the lives of 40 people with over 100 injured. The Chechen militant leader Doku Umarov declared responsibility for the attacks saying the bombings were staged in retaliation to the killing of several civilians in an operation carried out by the FSB against militants in February in Ingushetia, and promised that the attacks would continue. The Russian authorities responded by a number of measures aimed at enhancing the security and fight against terrorism.

President Medvedev continued his campaign for the modernisation of Russia, putting an emphasis on economic diversification, need for new technologies and innovation. Modernisation was the leitmotiv of the Krasnoyarsk Economic Forum (12-13 Feb 2010) where political liberalisation and state reform were raised as an issue and condition of economic modernization.

Northern Caucasus

Armed conflict continues throughout the North Caucasus. Paramilitary groups set up by illegal combatants are well organised and coordinated and managed in 2010 to carry out attacks in Russia's core regions – Moscow and St. Petersburg.

Interior Troops Commander Nikolai Rogozhkin said in March 2010 that up to 500 militants are active in the Northern Caucasus. He described the situation in the region as "complicated, but controllable". Despite the official statistics, several senior officials including President Medvedev, acknowledge that the earlier impression that the North Caucasus was becoming more peaceful, was wrong. The leaders of the Russian federal authorities realize how inefficient the current anti-terrorism policies in the region are. President Medvedev has singled out three reasons for this failure, namely corruption, the clan system and the inefficiency of the state authorities, in particular the security forces.

On 19 January 2010, President Medvedev made the unexpected decision to establish a North Caucasus Federal District, while also appointing the Krasnoyarsk regional governor, Alexander Khloponin, as Presidential Plenipotentiary Envoy to the new district as well as Deputy Prime Minister of Russia. President Medvedev stressed that problems in the Caucasus such as unemployment, economic crime, cronyism and bribery cannot be resolved simply by law enforcement procedures - economic methods are necessary as well.

Said Buryatsky , chief ideologist of the North Caucasus rebels, and seven other rebels were killed in an operation led by the FSB in the Ingush village Ekazhevo in March 2010. Allegedly Buryatsky was at the time training 30 potential suicide bombers in the Northern Caucasus. FSB director Alexander Bortnikov told President Medvedev that investigators believe that the rebels were behind the November's 2009 Nevsky Express bombing that killed 28 passengers and injured 90 others.

Two days after the Moscow terrorist acts, suicide bombers attacked Kizlyar (Dagestan), killing 12.

Alexander Bastrykin, the head of the Investigative Committee within the Russian prosecution system, proposed to efficiently combat crime in the North Caucasus with a databank of gene samples and fingerprints of North Caucasian citizens. Due to public outcry, the idea was widened to include all Russian citizens, but since then has not materialised despite the Moscow metro bombings.

A 2010 report of the Centre for Strategic and International Studies shows that the number of suicide bombings in the North Caucasus in 2009 nearly quadrupled compared to 2008. Most of the attacks occurred in Chechnya. Ambushes, shootings and roadside bombings are also increasing across the North Caucasus: in 2009, more than 900 people were killed, almost the double compared to 2008.

2.2 Justice and Home Affairs

Interior Ministry Reform

The ambitious plan for police reform, demanded by Medvedev in December 2009 is being progressively rolled out. In January 2010, new methods of assessing policemen's work were introduced, based on citizens' opinions. The authorities are considering to triple police salaries (to 1.000-1,500 Euros per month) while cutting 20% of personnel. Other proposals include requiring recruits to obtain

recommendations and pass drug and psychological tests, and giving municipal, regional and federal agencies (the latter would be led by the Public Chamber) oversight of police activities.

Criminal code amendments

In March 2010, President Medvedev submitted to the Duma a bill containing several amendments to the Criminal and Criminal Procedural Code to liberalize the way economic crimes are punished. The new bill will remove the article on false entrepreneurship (article 173 of the Criminal Code), will reduce prison terms for money laundering and increase the threshold for economic crimes to be treated as major.

Penitentiary system

President Medvedev declared at the end of December 2009 that there is no order in the Russian penitentiary institutions, new staff need to be attracted and forms of alternative imprisonment are necessary. The same day he signed two decrees regarding the penitentiary system: on house arrest and on the extension of judiciary decisions on parole for economic crimes. In January 2010, amendments to the Penal Code and the Code on Execution of Sentences entered into force relating to 'house arrest' for convicted persons. This punishment will be used only for less serious crimes, and as an additional penalty to those who have committed more serious offences. It is expected that the new alternative punishment could considerably reduce the prison population. FSIN has calculated that around 110.000 convicted persons could be subject to alternative punishment. The Head of FSIN declared in February 2010 that a reform strategy of the penitentiary system is about to be published – the reform will be in three stages and fully implemented by 2020.

Judiciary

In February 2010, the Duma passed at first reading a package of draft bills which provide for reforming the country's judicial system.

The first jury trial began in Chechnya's Supreme Court in April 2010. Chechnya has become the last Russian region to introduce jury trials as of 1 January 2010.

FSB

In April 2010, human rights activists expressed concern over the Government-submitted draft bill which would broaden powers of the Federal Security Service (FSB). The bill inter alia would allow the FSB to warn citizens or legal entities that their behaviour creates conditions that could lead to crime, and would target media reporting unfavourably about the state's actions.

Border crossings

The construction works of the € 13,3 Million EU-funded project "Design and Build of Mamonovo–Grzechotki Border Crossing Point, Kaliningrad Oblast" were successfully completed in 2009. A final visit to the site with the participation of the Commission, relevant Russian Authorities, the Contractor (Badprim) and the supervisor (Arup), took place in January 2010. The Final Acceptance Certificate will be issued after the successful completion of one-year maintenance period.

The project covers the construction of a new border crossing point at Mamonovo, close to the Polish border. The new border crossing will have the capacity of a traffic flow of 4000 vehicles (2600 cars, 150 buses and 1250 tracks) per day.

2.3 Democracy and Human Rights

Russia ratified in February 2010 the Protocol 14 to the European Convention of Human Rights, which is designed to help the Strasbourg court cope with the growing backlog of complaints from individuals, nearly one-third of them filed from Russia. Russia has lost the majority of cases brought against it in the Strasbourg-based court. A large number of suits are related to abductions of people in the country's volatile North Caucasus. In addition, the Constitutional Court will consider whether civil cases should be revised in line with ECHR judgements.

The freedom of assembly, peaceful demonstrations are selectively allowed or forbidden. Opposition parties and other organisations have encountered problems when trying to organise street demonstrations. In January 2010, a draft bill was submitted to the Duma by Moscow region deputies, which provides for obligatory notification of the authorities of planned one-person pickets.

In March 2010, the members of the Moscow City Duma rejected an initiative by Moscow city police Chief Vladimir Kolokoltsev suggesting introduction of administrative arrest for up to 15 days for violation of the rules on holding rallies.

Vadim Karastelev, a human rights defender from Novorossiysk (Krasnodar region), was attacked and beaten by unknown persons on February 27th 2010 at the entrance to his apartment building, a day after his release from seven days' administrative detention. He suffered severe injuries and was hospitalized. Karastelev represents the interests of the ex-police major and whistleblower Aleksey Dymovsky. One of the attackers has been detained.

In February 2010, the Moscow City Court convicted nine members of the 'White Wolves' skinhead group of committing a series of racist murders and sentenced them to prison terms up to 23 years.

In March 2010, a group of members of United Russia, led by Speaker Boris Gryzlov, submitted an updated edition of the bill on liability for approving or denying Nazi crimes. The bill would amend the Penal Code and the Criminal Proceedings Code and envisage criminal liability for approving or denying Nazi crimes.

In March 2010, the Prosecutor General's Office recognised 'Mein Kampf' as extremist. The book had been "freely available on several websites and was also sold semi-legally by booksellers, since it was not banned", according to the Prosecutor General's Office.

In March 2010, the Russian Constitutional Court dismissed a complaint that the laws of Ryazan region, prohibiting "propaganda of homosexuality" directed at minors, are in contradiction to the Constitution.

In January 2010, Russia's highest court upheld an unprecedented ruling halting the activities of a regional branch of Jehovah's Witnesses and banning dozens of its publications. This followed a 2004 ruling by the Moscow City Court prohibiting a branch in the Russian capital from engaging in religious activity. The ruling substantially increased the likelihood of a total ban of the JHW activities in Russia and will most likely influence upcoming court cases against Jehovah's Witnesses at regional courts.

In February 2010, Moscow OMON riot police officers filed a libel lawsuit against the New Times magazine over a publication which reported on complaints by a group of OMON riot police officers that they are being forced to make false arrests and to work with fellow officers who held illegal jobs as bodyguards for mafia bosses.

In February 2010, Russia's Moscow Arbitration Court partially upheld real estate tycoon Yelena Baturina's 200,000 rouble libel lawsuit against opposition leader Boris Nemtsov. The court required Nemtsov to retract the statement that Baturina's business was not performing well anywhere except Moscow and to pay 40,000 roubles in damages.

In February 2010, a Russian court opened a libel case filed by Chechen leader Ramzan Kadyrov against opposition newspaper Novaya Gazeta. During the court hearings, much attention was focused on the "Murder in Vienna" article linking Kadyrov to the murder of Umar Israilov.

At the end of March 2010, Yevgeny Dzhugashvili decided to seek \$330,000 and a retraction from the radio station Ekho Moskvyy over a claim that Stalin sanctioned the execution of children as young as 12 during the purges of the 1930s.

In February 2010, the Government prepared a draft Law on insider information which was sharply criticised by the media for holding the mass media responsible for divulging insider information. President Medvedev asked the Government to coordinate the draft with the media by 1 May.

European Instrument for Democracy and Human Rights (EIDHR)

The Delegation hosted its annual human rights conference in the context of EIDHR on 23 March 2010. This year's conference was dedicated to the security of human rights defenders. Around 200 participants took part in the conference, including over 40 Russian leading human rights NGOs, representatives of Ministries and Agencies of the Russian Federation, international organisations, European Parliament and Member-States' Embassies. The conference was highly appreciated by the Russian NGO community as it provided an opportunity to speak out about urgent and acute challenges of human rights defenders.

The Delegation, together with the Irish NGO FrontLine Defenders, organised the following day a security training for Russian human rights defenders, including those working in the most insecure Russian region, notably the Northern Caucasus.

Institutional Building Partnership Programme (IBPP)

The final conference of the project "Social workers in extreme situations" preventing professional burnout", financed with the IBPP Civil Society grant instrument, was held in Moscow on 24 March 2010. The event brought together over one hundred representatives of social services Administration from Moscow and 20 regions of Russia, as well as representatives of the Russian Public Chamber, the Ministry of Extreme Situations, the Ministry of Defense, the Federal penitentiary service and Russian and European non-governmental organizations.

Given the increasing frequency of mass emergencies, especially with the rise of terrorism in Russia (and Europe) the conference explored the necessity of emergency preparedness and looked at the diverse and important roles of social workers in emergency response. The project utilized and adapted valuable European experience in this area, by working very closely with the emergency and social services in the UK. As a result of the project a system of support to mitigate the risks to social work professionals and improved extreme situation response management was put in place in several regions of the Russian Federation, including the Moscow city, Kemerova and Beslan.

2.4 Foreign Policy

De facto Abkhaz Leadership Visits Moscow

On 16-18 February 2010, the de facto Abkhaz President paid a working visit to Moscow. Bagapsh met with President Medvedev, Deputy Prime Minister Ivanov, as well as the Moscow Patriarch Kirill. The Russian MFA noted that Bagapsh's visit was timed to commemorate the 200th anniversary of Russia's union with the Kingdom of Abkhazia under Tsar Alexander I. Bagapsh's meeting with Medvedev covered the whole scope of the Russian-Abkhaz bilateral relationship. President Medvedev placed

special emphasis on the need for the new Abkhaz government to maintain its unity and the maintenance of a strong team around the President. The culmination of the visit was the signing of 10 documents between Russia and Abkhazia, formalising co-operation in the military, economic and transport sphere. Bagapsh's visit allowed Russia and Abkhazia to address several key issues in the bilateral relationship, including clarification of the legal status of Abkhaz private real estate. Bagapsh's visit to Moscow marked the next step in Abkhazia's increased dependency, both political and economic, on Russia as well as exposing key sectors of the Abkhaz economy to further Russian control.

Visit of Ukrainian Foreign Minister to Moscow

The March 2010 visits of Ukrainian President Viktor Yanukovich on 5 March 2010 and Foreign Minister Konstantin Grishchenko on 16-17 March 2010 marked the first official contacts between Yanukovich's government and Moscow. While the visits were not accompanied by any breakthroughs in the bilateral relationship, they did mark the normalisation of relations between Moscow and Kiev through the reactivation of the Russian-Ukrainian Intergovernmental Commission.

Putin's Visit to Belarus

Following the March 2010 visit of Prime Minister Putin to Belarus, Moscow and Minsk remain at loggerheads regarding the imposition of export duties for Russian oil supplies that are in excess of the demands of the Belarusian internal market. Tension has led to the recent Belarus decision to take Russia to the CIS Economic Court. The Russian MFA stated that Russia hopes to solve the issue bilaterally before the 2012 formation of the Single Economic Space (SES). The Russian MFA does not view Belarusian attempts to diversify its oil supply as hindering the overall bilateral relationship. Russia has been presented with further requests from Belarus for USD \$2 billion in credit, however, Russia will not accord further economic credit without firm repayment guarantees from the Belarusian side. Recent human rights developments in Belarus are viewed in Moscow as potentially harming Belarus' relations with the West. The Russian stance seems to utilise Lukashenko's increasingly smaller room for manoeuvre to further Russian-Belarusian economic integration, on Moscow's terms.

iv. Middle East

The Quartet met in Moscow on 19 March 2010 to discuss the Middle East peace Process. A joint statement reiterating the Quartet's commitment to two-state solution was issued.

3. ECONOMY

3.1 Macroeconomic performance

The Russian economy demonstrates signs of gradual post-crisis recovery. Economic activity continued to recover in the first quarter 2010, but the pace of recovery remains rather slow.

Preliminary results for the first quarter 2010 reported by the Ministry of Economic Development show that the rate of economic growth slowed down to 0.6% despite the effect of a low base as the Russian economy severely contracted at the end 2008 and in the beginning of 2009.

Indicators such as transport (up 9.3%, y-o-y, in February), retail trade (up 1.3% in February, y-o-y), real disposable income (up 2.4% in February, y-o-y) show an improvement in the economy. On the other hand, recovery in the manufacturing sector is rather slow. Rosstat data indicate an increase in industrial output (5.8%, y-o-y, in the first quarter of 2010), while data derived by the Higher School of Economics from statistics on the production of 730 manufactured goods indicate a zero-rate growth in February. The growth in processing industries decelerated for a third month in a row. Production and distribution

of electricity, gas and water has been increasing, but this could be largely attributed to the quite cold winter in Russia.

According to estimates of the Centre for macroeconomic analysis and forecasting, industrial output stabilized at 11% below of the pre-crisis peak reached in September 2008, which is half-way to the point of full recovery in output.

Major sectors of the Russian economy showed different trends in the first quarter of 2010. Growth was recorded in the mineral resources sector, electricity generation and consumer goods industries, while the production of semi-finished goods and machinery was declining. However, with the price of oil hovering around \$85 per barrel, the economy is set to receive a boost through greater pass-through effects from the oil price and demand for machinery and equipment from the energy sector could grow.

Dynamics of industrial output taking into account seasonal factors, m-o-m (%)

	4 th quarter 2009	1 st quarter 2010	Jan 2010	Feb 2010	Mar 2010	Mar 2010 with respect to Sep 2008
Total industrial output, m-o-m	0.5	0.2	0.4	0.2	0.0	-11.1
Production of mineral resources	0.5	0.8	0.8	-0.3	1.2	2.5
Processing industries	0.2	0.0	0.0	0.4	-0.5	-18.3
Production and distribution of electricity, gas and water	1.9	0.5	1.7	0.2	-0.3	-3.1

Source: Estimates of the Centre of Macroeconomic analysis and forecasting

Fixed capital investment remains quite sluggish. Rosstat reported about an 8.7% decline y-o-y in fixed capital investment in January 2010.

However, the negative impact of sluggish investment on the economy is partially offset by rising domestic consumption and government spending. As a result, the government is going to revise upwards its forecast of economic growth in Russia in 2010 from 3.1% to 4.0%. The IMF projects the same rate of growth for the Russian economy this year, while the World Bank forecasts growth in the range of 5.0-5.5%. Meanwhile, the Centre of Economic Policy Analysis of the Higher School of Economics forecasts that the economy would contract by 0.7% this year due to the negative impact of the rouble's appreciation and an increase in unit labour costs.

3.2 Monetary and exchange rate policy

M2 money supply grew 1.5% m-o-m in February to 15.6 trillion roubles (€392 billion). In y-o-y terms, the growth in money supply totalled 29.5%. The increase in money supply reflects some improvement in the economic environment.

Inflation has been decelerating in the first months of the year. Annualized inflation (average inflation over the last six months) has remained at 5.0-6.0% since the fourth quarter of 2009. The deceleration of inflation allowed the Central Bank to cut its basic refinancing rate by another 25 basis points to a record low of 8.25%.

On 2nd April, the rouble reached its new maximum in relation to the bi-currency basket (55% of USD and 45% of EUR) at 33.9 roubles to the basket. The Central Bank tried to restrain the pace of rouble appreciation by intervening in the currency market and increasing its forex reserves. The Central Bank's gold and forex reserves reached \$447 billion.

The overall effect of the rouble appreciation on the economy is ambiguous. The rouble appreciation worsens competitiveness in the tradable (export-oriented) sector. At the same time, the rouble appreciation encourages imports of investment equipment and machinery and decreases the costs of servicing debts denominated in foreign currencies. The rouble appreciation also encourages capital inflow to Russia.

Dynamics of the USD/Rouble exchange rate over the last six months



Dynamics of the EUR/Rouble exchange rate over the last six months



Balance of payments data for the first quarter of 2010 published by the Central Bank show a quite volatile picture of capital flows. Following net private capital inflows of \$8.3 billion in the fourth quarter of 2009, the Central Bank estimated net private capital outflows from Russia at \$12.9 billion in

the first quarter of 2010. In fact, the figure for net private capital outflows in the first quarter 2010 could be much higher taking into account the figures of \$11.8 billion under the item “errors and omissions” and \$5.5 billion under the item “non-repatriated currency proceeds” in the balance of payments. Usually these items mask capital flight using “grey” schemes.

Russia’s external debt amounted to \$473.7 billion as of 1st April 2010 compared to \$471.6 billion as of 1st January 2010. Public external debt declined by 1.3% in the first quarter of 2010 to \$30.9 billion.

Russia’s equity market did very well last year when it gained 120% in 2009. The market has also outperformed emerging markets since January 2010 (9% compared to 4% for EM markets)

Dynamics of the RTS index over the last 12 months



Fiscal policy

Results of the first three months of 2010 in the area of public finances can be considered as quite successful. Federal budget revenues amounted to 1.95 trillion roubles (28.1% of the total planned revenues in 2010), while expenditures amounted to 2.26 trillion roubles (22.9% of the total planned spending in 2010). The federal budget deficit was 307.6 billion roubles or about 10% of the federal budget deficit for the whole year 2010. The federal budget for 2010 foresees a deficit of 2.936 trillion roubles, but experts believe that the actual budget deficit in 2010 could be lower than this projection. The budget deficit could be lower due to higher oil prices which hover around \$85 per barrel. The budget for 2010 is based on an average oil price of \$59 per barrel. Experts argue that the actual budget deficit in 2010 could total 2.2 trillion roubles.

Meanwhile, the current system of budget planning and execution comes under increased criticism. The idea of radical reform of the budgetary system has been widely discussed within the government over the last six months. The Cabinet plans to approve a programme for increasing efficiency of budget spending until the year 2012. In a nutshell, the programme envisages a deep budgetary reform and modernization in the area of public finances. PM Putin said in his recent speech to the Duma that 90%

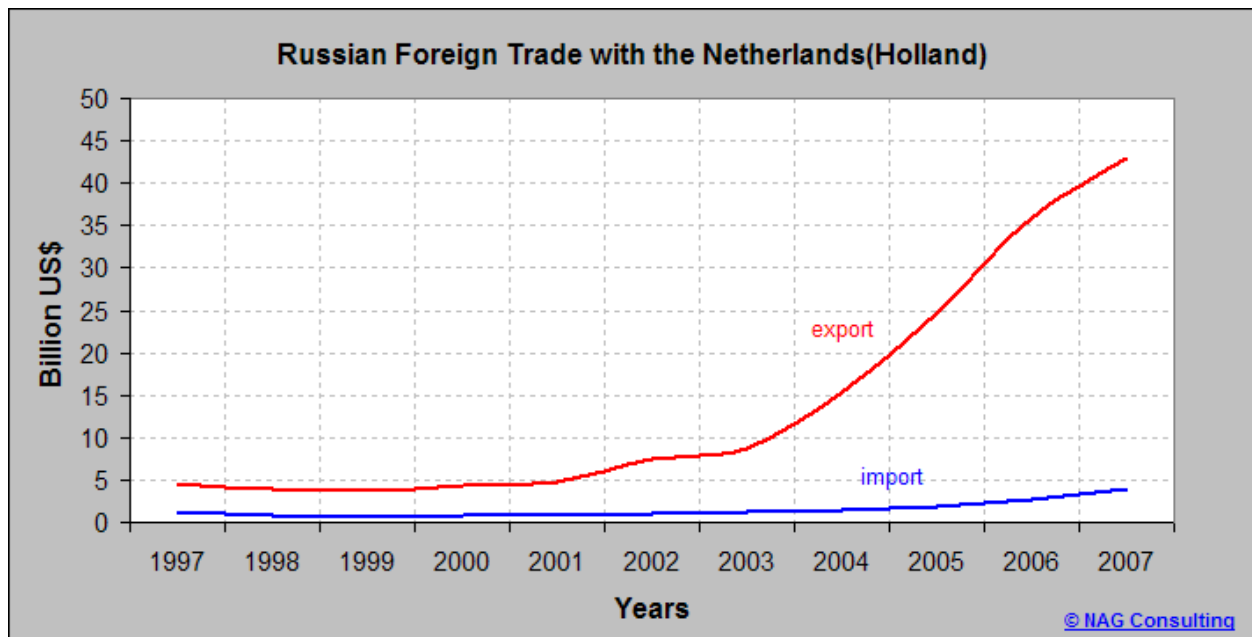
of the federal budget funds will be allocated to state targeted programs which concentrate resources of different government agencies.

3.3 External trade and foreign investment

According to estimates by the Ministry of Economic Development, Russia's foreign trade turnover between January–March 2010 totalled \$136.6bn. The figure is 42.7% higher than between January–March 2009. This sharp increase can be explained by a start of the post-crisis recovery of the Russian economy and the global economy as a whole. The demand for Russian export commodities on the world market significantly increased. There has been a continuing growth in the world oil price. This steep growth in Russia's foreign trade turnover is also due to the base effect – Russia's trade turnover in the first quarter of 2009 dropped due to the global economic crisis to \$95.7bn. Exports accounted for 66.6% of Russia's trade turnover in the 1st quarter of 2010, and imports accounted for 33.2%.

The EU remained Russia's largest trade partner, accounting for 53.2% of Russia's total trade turnover in January-February 2010. According to the Federal Customs Service, while Russia's exports in January-February 2010 grew by 60.3% to total \$58.0, Russia's exports to the EU grew more rapidly, by 73.6%. Exports to Poland increased by 2.8 times, to Spain by 2.2 times, to Germany and Belgium by 2 times each, to the Netherlands by 1.2 times, to Hungary by 1.6 times, and to Italy and France by 1.5 times each.

Among the EU Member States, Russia's largest trade partners were the Netherlands (10.3% of Russia's total trade turnover, up from 8.0%); followed by Germany (8.3%), Italy (6.7%), Poland (4.5%), France (3.3%), Finland (3.0%) and the UK (2.6%).



Russia's trade turnover with major partners (mio. USD), January - February 2010

	Turnover (mio. USD)	In percentage points vs. total turnover in Jan-Feb 2010	In percentage points vs. total turnover in Jan-Feb 2009, %
Whole world	81,599	100%	143.5%
EU-27	43,374	53.2%	152.6%
USA	2,002	2.5%	95.1%
Japan	2,264	2.8%	105.7%
CIS	11,173	13.7%	144.2%
EURASEC	6,147	7.5%	125.4%
China	7,172	8.8%	139.6%

The formation of the Customs Union with Belarus and Kazakhstan became a major priority of Russia's external trade policy. On 1st January 2010, Russia adopted the Single Customs Tariff of the Customs Union. Compared to Russian Customs Tariffs in 2009, the Single Customs Tariff of Russia, Belarus and Kazakhstan left unchanged 9,300 tariff lines (82% of all tariff lines). Tariff rates were reduced for 1,500 lines (e.g. some pharmaceuticals, photo products, some types of electrical equipment, clothing, medical equipment, video cameras, sound recording equipment). Tariff rates were increased for 350 lines (certain food products). On the other hand, the tariff rate increases that Russia originally introduced for a limited period to counteract the crisis have now become institutionalised.

According to Rosstat, accumulated foreign investments in Russia amounted to \$268.2 billion as of the end of 2009, up 1.4% y-o-y. Other investments (loans, trade credits, etc.) accounted for 55.5% of this amount, FDI – 40.7% and portfolio investment – 3.8%.

The inflow of foreign investment amounted to \$81.9 billion in 2009, down 21% y-o-y. Foreign direct investment plunged to 41.1% in 2009, y-o-y.

Inflow of foreign investment in 2009

	2009		
	Mio USD	In % with regard to	
		2008	total
Total investment	81,927	79.0	100
<i>including:</i>			
Direct investment	15,906	58.9	19.4
Portfolio investment	882	62.3	1.1
Other investment	65,139	86.5	79.5

Accumulated foreign investment from major investing countries, mio. USD

	Accumulated as of the end of 2009		Including			Inflow in 2009
	Total	In % with regard to total	direct	portfolio	other	
Total investments	268,226	100	109,022	10,258	148,946	81,927
Investment from major countries	222,118	82.8	84,394	9,338	128,386	63,244
including:						
Cyprus	49,128	18.3	33,547	1,835	13,746	8,286
The Netherlands	48,619	18.1	29,065	4,280	15,274	11,640
Luxembourg	37,157	13.9	1,185	273	35,699	11,723
The UK	23,585	8.8	3,625	2,327	17,633	6,421
Germany	19,226	7.2	7,834	14	11,378	7,366
China	10,343	3.9	939	0,0	9,404	9,757
Ireland	9,212	3.4	415	5	8,792	748
France	8,622	3.2	2,182	29	6,411	2,491
Japan	8,301	3.1	875	3	7,423	3,020
Virgin Islands	7,925	2.9	4,727	572	2,626	1,792

Anti-crisis measures and industrial policy

While reporting to the Duma on the Government's activities in 2009 and the Government's economic policy in 2010, PM Putin declared that the economic recession was over. The Government would continue its support only to the sectors which were mostly affected by the crisis – automobile production and the construction industry.

The Government was able last year to carry out large-scale anti-crisis measures without cuts in social spending. Instead of cutting budget expenditures, the Government opted for redistributing funds with an emphasis on social programs. Despite a 29% drop in budget revenues, social spending increased by 27.4% in 2009 compared to the previous year.

Social spending remains an important policy priority among the anti-crisis measures. Putin promised to implement another increase in wages of public employees by the end of the year. Some additional support to pensioners helping to pay for medical insurance is also on the government's policy agenda.

The Government argues that they did not assist specific businesses during the crisis, but supported crucial sectors and key enterprises that employ tens of thousands of citizens. Russian companies used state guarantees to raise loans totalling RUR374 billion. The federal budget earned RUR 19.2 billion from placing temporarily budget funds on deposits in commercial banks. A total of RUR 687 billion in budget funds was placed in banks. "

Putin reported that Russia earned RUR397 billion from investing in the National Welfare Fund (NWF) and the Reserve Fund in 2008-2009. Total earnings from investing in the Reserve Fund and NWF in

2008-2009 were almost RUR397 billion (about \$20 billion), which was a 3.9% return in foreign currency terms.

Agriculture is the other sector which benefits from government support. The support is primarily provided via state guarantees on loans given to agricultural producers. President Medvedev recently called to expand the support to agricultural producers as the sector is considered to be strategically important for Russia. State support to the agricultural sector financed from the budgets of all levels totalled RUR300bn in 2009. The sector also attracted credits of RUR776bn, of which RUR 453bn were lax credits on government subsidized interest rates.

The largest Russian carmaker AvtoVAZ recently unveiled the company's business development strategy until 2020. The strategy foresees that AvtoVAZ will remain the largest producer of cars in Russia by 2020 with a market share of 25%. The total cost of projects foreseen in the strategy amounts to 180 billion roubles. AvtoVAZ is majority-owned by the state corporation Russian Technologies and expects that most funding for the company's investment projects would come from the budget. The government-funded "cash-for-clunkers" programme is claimed to be a big success. About 55,000 certificates valid for the purchases of new cars have been issued since the start of the programme on 9 March 2010. The government is considering an extension of the programme to buses and trucks.

4. SECTORS

4.1 Energy

An official ceremony to celebrate the successful implementation of the EU-funded project "Construction of the Sludge Incineration Plant at the Southwest Wastewater Treatment Plant in St. Petersburg" took place on 4 March 2010 with the participation of representatives of the EU Delegation, the city government, Vodokanal St. Petersburg, the Contractor (Bamag) and the Project Supervision Unit (Arup).

The European Union contributed € 24.9 Million to the construction of the plant (approximately 80% of the total construction budget), representing the largest and the most complex investment project ever financed under the EU-Russian cooperation programme. The new plant will help to solve the important problem of the utilisation of sewage sludge in St. Petersburg, thereby guaranteeing the preservation of the green belt around the city and the resort zone of the Finish Gulf coast. Its daily capacity is 68 tons of dry solid content a day, which increases the total capacity of the existing facilities in St. Petersburg to 440 tons a day.

Tenders for two projects under the Common Space Facility were launched during the first quarter of 2010:

- "Introducing Environmental Monitoring Results into the Russian Economic Processes" (budget: € 1 Million). The project is aimed at the use of the environmental monitoring results, including the information on climate change, in order to improve the country's economy;
- "Support to the development of new models to compile long-term projections of GHG emissions in Russia and evaluate the effectiveness of Russian climate change mitigation policies and measures" (budget: € 1 Million). The project will focus on the development of comprehensive projections of GHG emissions by sources and their sequestration by sinks for the period up to 2050 with and without climate policies in order to assist the Russian authorities with negotiating new climate change international agreements and taking steps towards low carbon society in Russia.

Gas

Naftogaz Ukrainy paid each month in full and on time for the Russian gas supplied in the preceding month. Ukraine's new leadership worked towards lowering the gas price. Russia said that it could be interested in proposals on setting up a consortium to manage and reconstruct the Ukrainian gas transportation system. Russia would not impose penalties on Ukraine for buying less gas than was agreed upon in the contract.

A number of Gazprom's European customers obtained modifications to their long-term contracts. Some companies could receive 10-15% of Russia's gas at spot market prices instead of long-term contract prices for the next three years. Minimum take-or-pay volumes were lowered. Contract prices were discussed. Gazprom maintained the principle of having long-term contracts linked to oil prices.

Gazprom made promises to allow extended access to the gas transportation system in 2014. Gazprom prepared a draft government decree with a transition period from 2011 to 2013 for reaching full net-back parity between the domestic and export gas prices by 2014.

The Nord Stream consortium received the last permit to start building the pipeline and was in the process of receiving the necessary bank loans.

Greece was prepared to sign an agreement on a joint project company with Gazprom for South Stream. Romania confirmed its interest in participating in the project. An agreement was signed on Croatia's participation in the project. The constituent documents were signed of a joint company to implement South Stream in Hungary. CEO of Eni Paolo Scaroni's suggestion to merge the South Stream and Nabucco projects was rejected by Russian Energy Minister Shmatko.

Discussion was going on in Russia about a possible 3-year delay in the Shtokman gas field project. According to Gazprom, only the timetable concerning the financing decisions was postponed until 2011.

Rosprirodnadzor (Federal Service for Supervising Natural Resources) carried out an investigation of the Kovykta gas field (where the main shareholder is TNK-BP) and concluded that the licence conditions of the field had not been fulfilled. Rosprirodnadzor recommended to Rosnedra (Federal Agency for Subsoil Use) to withdraw the field licence. TNK-BP discussed with Gazprom and state-owned Rosneftgaz selling its stake in the Kovykta gas field.

Gas supply from Turkmenistan to Russia was restored in January 2010 at lower levels. The supply was cut in April 2009 following an incident on the gas pipeline. Gazprom started to receive gas from Azerbaijan in January 2010.

Belarus asked for the Russian gas price to stay at the 2009 level in 2010 (i.e. \$150 instead of \$168 for 1000 cm). Gazprom claimed that Belarus had paid too little for the gas supplied in the first quarter of 2010. Gazprom raised its stake in the Belarusian gas infrastructure and pipeline company Beltransgaz to 50%.

Gazprom, Polish PGNiG and Polish pipeline operator EuroPolGas signed an agreement in January 2010 on Russian gas supplies to Poland until 2037 and on transit until 2045.

Volga Resources (controlled by Gennady Timchenko) increased its share of Novatek to 20,77%. Gazprom and Novatek agreed on the principles of gas sales from the Yuzhno-Tambeyskoe field in Yamal.

The € 3 Million EU-funded project “Promoting investments into energy savings projects in Russia’s regions” deals with energy efficiency projects under the Kyoto Joint Implementation mechanism. The project aims at supporting the Russian government in the development of policy proposals connected with the formation of targets for the reduction of GHGs in three pilot regions in Russia (Rostov, Sverdlovsk and Tver). Three important seminars were held in the regions on regional energy balances in January 2010. The project started in September 2008 and will be completed at the end of 2010.

A small project aiming to support the creation of an energy efficiency management system in Russia was successfully completed in January 2010. The final report of another study on addressing impacts of the financial crisis to the EU – Russia energy cooperation is currently being finalised.

Oil

The Russian oil export duty for crude oil was \$267 a tonne in January, \$270,7 in February and \$253,6 in March 2010. The corresponding export duties for light oil products were \$192,2, \$194,7 and \$183,2 a tonne, and for dark oil products \$103,5, \$104,9 and \$98,7 a tonne. Zero export duty applied to a number of oil fields in Western Siberia.

The establishment of a single export schedule for the supply of oil and oil products by all means of transportation in the framework of creating a system of “oil control” was discussed among government agencies.

An oil dispute between Russia and Belarus occurred in January 2010. Belarus gave an early warning of the dispute to the European Commission on 1.1.2010. The parties reached an agreement on 27.1.2010 with Russia supplying 6,3 mln tn of duty-free oil to Belarus in 2010 for domestic consumption and the oil transit tariff growing by 11%. Russia and Belarus made a joint statement on guaranteed stable conditions of oil transit to the EU. In March Belarus filed a suit with the Economic Court of the CIS against Russia concerning the lawfulness under the customs union of Russia levying export customs duties on petroleum products shipped to Belarus.

Acting CEO of TNK-BP Mikhail Fridman announced that he, Viktor Vekselberg and German Khan could be leaving their top-management positions in TNK-BP when the new CEO Maxim Barsky would take over the leadership of the company in January 2011.

Rosneft received, without competition, a licence for the exploration and production of hydrocarbons on the shelf (Astrakhonovskoye more – Nekrasovskiy) close to Sakhalin-1.

Electricity

An electricity dispute occurred in January 2010 between Russia and Belarus which threatened to cut the supply of Russian electricity via Belarus to Kaliningrad and Lithuania. The parties reached agreement soon after their oil dispute was settled (see above).

An amendment to the law on electrical energy was adopted in March allowing electricity produced from associated petroleum gas to have second-priority access onto the wholesale electricity market.

The basic decree on the principles of the long-term capacity market was adopted in February 2010. An agreement seemed to emerge later on the price parameters.

Nuclear

The Russian government approved in January 2010 the Federal Target Programme concerning a new generation of nuclear energy technologies for the period 2010-2015 and in the perspective of 2020.

PM Putin signed a decree in February 2010 authorising the construction of the Kaliningrad nuclear power plant.

Russia and the IAEA signed an agreement in March 2010 on the creation of the world's first reserve ('fuel bank') for nuclear fuel in Angarsk in the Irkutsk region (Siberia).

Russian energy activities abroad

Stroytransgaz carried out negotiations in Turkey concerning the construction of an underground gas storage facility, and the privatisation of the Istanbul gas distribution network. Gazprom and China reached an initial agreement on the price formation and supply for natural gas from Russia to China. Gazprom was negotiating with Tullow Oil for receiving a share of the development of the Kuda field in Nigeria. Gazprom and Indian ONGC signed an addition to their MoU of 2005. Gazprom and Serbia established a joint venture for the underground gas storage Banatski Dvor in Serbia.

Lukoil signed a service contract with Iraq on the development of the West Qurna-2 field. Russian National Oil Consortium (consisting of Lukoil, Rosneft, TNK-BP, Gazprom Neft and Surgutneftegaz) signed a deal with the Venezuelan state company PdVSA on the establishment of a joint venture for the exploration of the Junin-6 block in Venezuela's Orinoco Belt. Russia and Qatar met at PM level on gas coordination.

Negotiations on Russian participation in the construction of a nuclear power station in Turkey continued. Russia and China agreed on the construction of the second stage of the Tianwan nuclear power plant. Russia and India signed agreements on the construction of the third and fourth reactors at the Kudankulam nuclear power plant.

Energy Efficiency

Sweden and Russia signed an intergovernmental memorandum on areas of energy cooperation, such as energy efficiency and renewable energy sources.

Strategic Sectors' Law – the Shelf

The Ministry of Natural Resources suggested extending the rules for the use of subsoil resources on the shelf to Gazprom's daughter companies and to all Russian oil companies, with a possibility for foreign participation of up to 50%.

Modernisation of Russia's economy

President Dmitry Medvedev gave instructions to the Russian Government in March 2010 on the Modernisation and Technological Development of Russia's Economy. The energy sector was prominent in the instructions.

4.2 Environment

Climate change

On 29 January Roshydromet (Russian Hydro Meteorological Service) submitted to UNFCCC Russia's statement confirming association with the **Copenhagen Accord**. The submission states Russia's GHG emission target 2020 as 15-25% below 1990 but depending on two conditions: consideration of Russia's forestry potential and undertaking by all major emitters of legally binding obligations.

The **Russian Security Council** met on 17 March and acknowledged global warming as a threat to national security, especially in the Far North. President Medvedev issued instructions for implementation measures within the framework of the Climate Doctrine (endorsed in December 2009) to be adopted by 1 October 2010, including stimuli for the environmental modernization of industry, to approve a hydrometeorology strategy up to 2030, to assess the impact of permafrost thawing, and to consider the creation of a 'multipurpose space system Arctic'.

On 16 February Roshydromet released a Report on Climate Specifics in the Russian Federation, according to which **2009 was colder than expected**, with a high precipitation rate, up to 20% lower thawing in the Arctic region than in the past 10 years and 5.2 mln km² pack ice in the Arctic Ocean as compared to 4.7 in 2008. However, droughts led to the deterioration of agricultural conditions.

On January 25 the Russian Presidential Advisor **Alexander Bedritsky** was nominated Russian **Presidential Envoy on Climate**.

On 15 January Roshydromet published a report "On Strategic Assessments of the Climate Change Impact for the Next 10-20 Years on the Environment and Economy of the Union State of Russia and Byelorussia". It foresees temperature increases (highest in Siberia and Arctic Region), increase of precipitation, changes in the structure of energy consumption (reduction of the heating season by an average of 10 days) and development of solar and wind energy. In 2010 in addition to the 2 existing satellites Roshydromet will obtain 3 new satellites for meteorological observation (1 in cooperation with Belarus). Further, modern PCs, 900 observation stations, 100 automatic hydrologic units (mainly on rivers) will be installed.

On 15 March Sberbank closed the **JI tender** launched on 17 February. It received 44 applications (SUEK, OGC-5, TNK-BP, Evraz etc). Out of bids for 75 mln ERUs (each=1 tonne CO₂) only 30 will be auctioned. Earlier, on 3 February the Ministry of Justice registered the document describing new JI procedures (JI projects criteria: energy efficiency, economic viability, economic and social impact) including the role of Sberbank.

On 18 March Sberbank announced it seeks 10% of the global trade in carbon credits within 3-5 years of its first tender under a United Nations programme to reduce greenhouse-gas emissions. It may hold two or three more tenders in 2010 allotting 50 to 60 million tons of credits.

On March 24 Japan's Sumitomo Corp. signed a memorandum of understanding with Sberbank to jointly develop projects to reduce greenhouse gas emissions in Russia and sell the resulting carbon credits to Japanese businesses (no numeric targets cited).

Various issues

On 29 March Russia participated in **Earth Hour 2010** (Moscow saved 2850 MW of energy).

On 12 January the Minister of Natural Resources and Environment signed an order to implement measures in accordance with the **Water Strategy until 2020** (financing: 662.4 bln rubles or 15.5 bln euro from the federal budget, 480.9 bln rubles / 11 bln euro regional budgets, 66.9 bln rubles /1.5 bln euro non-budget funds).

On 15 March PM Putin addressed the **National Geographic Society** speaking of the need to turn it into "an intellectual venue and an organising centre for research in all related spheres", the need to preserve the Lake Baikal ecosystem, to protect Arctic fauna and educate young professionals and the public.

On March 25 at a round-table in the **Public Chamber** a decision was made to establish a public movement called "Green Energy of Russia" which is to serve as an information exchange and shareholders' platform to focus on issues as utilization of associated gas, natural gas in transport and other energy-saving technologies.

On 17 March the Ministry of Natural Resources approved standards for maximum admissible impacts on the environmental system of **Lake Baikal**, including hazardous substances and fishing limits.

On 21 January Minister of Foreign Affairs Lavrov said an international warning mechanism in case of **natural disasters** needed to be created as Russia had suggested in 2006.

On 10 January the Ministry of Natural Resources adopted criteria for voluntary environmental certification of real estate to ensure minimisation of environmental impact during **construction** and utilisation in line with international standards.

On 23 March the **Moscow City** government adopted a decision limiting access of trucks non-compliant with **Euro-3 standard** from 2011 (Euro-4 from 2012). It is expected to decrease annual hazardous emissions by 5%. The number of compressed gas-powered cars will increase. Besides, the City plans to create increased environmental responsibility zones from 1 October 2010 (facilities of social significance such as schools, kindergartens and hospitals).

On 25 January Greenpeace's attempt to stop the delivery of spent **uranium** (650 tons) from France to Russia failed. In 2009 Russian environmentalists called on the French company "Areva", which processes nuclear fuel for Electricite de France (EDF), to stop spent uranium delivery to Seversk.

On 16 February WWF/Russia announced that it ended its participation in the **Sochi Olympic** preparations, saying that Olimpstroy, the organization in charge of construction, did not consider NGOs' advice, construction was of poor quality and inflicted vast damage on the environment.

4.3 Science & Technology, Education, Space

Russia's R&D, innovation and education landscape in January-March 2010 was marked by several institutional and policy changes undertaken as part of the Government's "modernization effort". PM Vladimir Putin assigned research and innovation a central role in his and his Cabinet's activities, while President Medvedev launched an ambitious initiative to build from scratch a Russian high-tech hub. The Government was particularly active trying to link R&D with business and to boost the research component at Russian universities – funding allocated to universities for their research activities was increased, while the Russian Academy of Sciences, whose institutes still implement the bulk of Russia's research, has remained outside the Government's action.

Research and Development

Institutional and staff changes

Several initiatives, re-organisations and personnel reshuffles in R&D-related areas occurred in the first quarter of 2010, as part of the Government's attempt to boost its "modernization agenda" and to ensure its effective implementation. (i) PM Vladimir Putin took the lead in the *Government Commission for High Technologies and Innovation*, a high-level decision-making body parallel to the President-led *Commission for Modernization and Technological Development*. At the first meeting under his chairmanship, PM Putin announced the expansion of the Commission's powers and decisions and making them binding for all government agencies. Putin said the Government would spend in 2010 up

to roubles 1.1 trillion (~€28 billion at the current exchange rate), or more than 10 percent of its budget, on fundamental and applied science, higher education, high-tech medicine and federal targeted programmes in aviation, space and nuclear energy, stressing that funding for major scientific projects would be allocated on a competitive basis. Putin also created a new Department for Science, High Technologies and Education within the Government's Executive Office, led by ex-Vice Minister for Science and Education, Alexander Khlunov. (ii) The Russian Federal Agency for Science & Innovation (Rosnauka), the European Commission's counterpart in several EU-Russia Research Working Groups, and the Russian Federal Agency for Education were dissolved by President Medvedev; their functions were transferred to the Ministry of Education and Science. Rosnauka's ex-Head, Sergei Mazurenko, was appointed Vice-Minister for Education and Science responsible for the Federal Targeted R&D Programmes. Other management and staff changes are expected at the Ministry to accommodate the duties and personnel of the abolished agencies.

Research & education: international cooperation actions

At an annual ministerial meeting in March, Minister of Education and Science Andrei Fursenko stressed, in the context of Russia's integration into global scientific processes, the importance of Russia's ongoing efforts towards an accession to the EU R&D Framework Programmes, its participation in large-scale international projects, and a more active involvement of foreign researchers and scientists of Russian origin in Russian programmes as project participants, lecturers, and independent evaluators. Several corresponding initiatives have been launched or prepared in the first quarter of 2010. In March Rosnauka published, under the Federal Targeted Programme "Scientific and Scientific-Pedagogical Human Resources for an Innovative Russia", *a tender to support scientific research by teams from scientific-educational centres which take part in the EU's Seventh Framework Programme* in the technical and natural sciences. A total of 525 million roubles (~€13 million at the current exchange rate) will be allocated to 35 projects in 2010-2012 to carry out research, enhance staff training, team building and international S&T cooperation. In addition, three more initiatives, in line with the Government's efforts to better integrate scientific research and education, were announced in February. Overall, 12 billion roubles (~€300 million at the current exchange rate) will be allocated for calls to support the *integration of universities and industry*, whereby industry may obtain subsidies for R&D works ordered from universities; to *develop an innovation infrastructure at universities* (e.g. technoparks and incubators; intellectual property rights protection; staff training) and to provide *grants for top-level foreign and Russian scientists and lecturers* (including but not limited to Russian "scientific diaspora" abroad) who wish to work at universities' research labs. Conceptually, this last initiative is similar to EU researchers' mobility schemes, such as grants of the European Research Council and Marie Curie fellowships.

President Medvedev ordered to draft *a law simplifying visa and migration procedures for highly qualified foreign specialists participating in Russian R&D, innovation and education projects*, as one of the measures to improve the country's investment climate.

In January, the Presidium of the Russian Academy of Sciences identified five priority areas of research for 2010. 193 million roubles and 185.6 million (~€5 and €4.75 million) will be allocated on a competitive basis for basic research in molecular biology and nano-materials. Other priority areas include fundamental medicine (74.3 million roubles /~€2 million), biodiversity and environment & climate change (66.9 million roubles /~€1.7 million).

Sector overview

In March, Rusnano announced the results of its call for proposals to develop *nanotechnology centers* in Russia. Four projects, submitted by centres in Kazan, Dubna, Zelenograd and Tomsk/Novosibirsk, were awarded the right to enter into an investment agreement with Rusnano on the implementation of a project for the creation of a nanotechnology centre. Rusnano's nano-centers combine technological

capacities with innovation incubator expertise. Overall, 19 billion roubles (~€500 million) will be invested by Rusnano in the development of its nanotechnology centres.

Innovation

President Dmitry Medvedev presented a project of a Russian version of Silicon Valley, a high-tech town for young, creative scientists and entrepreneurs that is to be built in the Moscow region town Skolkovo which hosts a premier business school, the Moscow School of Management Skolkovo. The work on the project, to be led by Russian billionaire Viktor Vekselberg and to be overseen scientifically by Nobel Laureate Zhores Alferov, could start already in 2010, with most of funding coming from the Government's modernization and innovation budget. The new town will follow five "presidential" priorities for modernization: energy, IT, telecommunications, biotechnology and nuclear technology. Experts criticized the building from scratch of a new facility which would cost up to \$4 billion, as many existing technology centres (such as those located in Tomsk, Novosibirsk, St. Petersburg, Obninsk and Dubna) already have the necessary infrastructure in place. It is also pointed out that other attempts to create high-tech innovation centers under "hothouse conditions" (e.g. in the form of special economic zones) have proved to be largely unsuccessful.

The Economic Development Ministry has developed a plan to reform the country's state corporations, based on the President's order to dismantle them in their current legal form by 2015. Unlike 100 percent state-owned companies, state corporations combine both commercial and regulatory functions. Rusnano and Rosavtodor would be transformed into joint stock companies by the end of 2010; Russian Technologies – by 2014; while a decision on Rosatom will be made after 2011. Vneshekonombank may also adopt this new legal status or become a joint stock company in 2012, after its commercial activities are transferred to subsidiaries. A draft law that would increase oversight, monitoring and regulation of state corporations and companies may be reviewed at the State Duma spring session.

The Government plans to stimulate the development of innovative clusters which so far have been developed primarily at the initiative of local authorities. In addition to support provided through programmes for SMEs, subsidies will also be allocated to regions to enable them to offer grants of up to 500,000 roubles (~€ 12,000) to entrepreneurs to start an innovative company, while subsidies of up to 5 million roubles (~€ 128,000) will be given for R&D, production planning, equipment, patents and technical audits. Support will also be intensified through Russia's "development institutions" - Vneshekonombank, state corporation Rusnano and the Russian Venture Company (RVC). Rusnano, RVC and the Foundation for Assistance to Small Innovative Enterprises ("Bortnik Foundation") will work as a so-called "innovation elevator", a partnership of several public funding bodies providing support to R&D and industrial innovation at all levels. In particular, the Bortnik Foundation would invest tens of thousands of dollars in individual innovative SMEs, RVC – up to a million dollars in large-scale projects, and Rusnano would fund large-scale production processes. RVC also plans to start a number of specialized venture funds for biotechnology and microelectronics in 2010.

Swiss-based technology conglomerate Oerlikon has launched Russia's first facility for covering machinery with a nanotech durability coating, a technology used by car and plane makers. The plant opening came after President Dmitry Medvedev asked billionaire Viktor Vekselberg, whose Renova Group is now Oerlikon's largest shareholder, to lead the development of the planned "Skolkovo innovation hub". Oerlikon invested 3 million Swiss francs in the project and expects to build several more.

Onexim Group chief Mikhail Prokhorov presented a project to build hybrid cars at a new facility to be built in AvtoVAZ's hometown of Tolyatti. The plant, with the capacity to produce 10,000 cars annually, is to start production in mid-2012. Production investment will reach €150 million.

Higher Education

The main developments in higher education during the reporting report include efforts to further strengthen the research component at Russian universities, to expand the network of Federal Universities, to establish the Shanghai Cooperation Organisation (SCO) University, and the discussion around the mutual recognition of higher education diplomas between Russia and India.

As part of its policy to better integrate scientific research into the higher education system, the Ministry of Education and Science in February launched the *second call for proposals to select new “national research universities”*, higher education entities in which research and education are closely interlinked. In 2009, twelve Russian universities had obtained such a status, together with 1.8 billion roubles (~€45 million) each for the implementation of ten-year development programmes. Under the recent call, ten winners will be selected in April, out of 128 applicants. In a related initiative, the Government prepared amendments to the Russian Budget and Tax Codes in order to overcome weaknesses in the federal law which allows Russian universities to establish spin-offs. Also, President Medvedev increased the amount of presidential scholarships for the best undergraduate and postgraduate students at Russian universities.

The SCO University, an idea launched by then President Putin in 2007, is meant to be a “network university” created by 53 universities from the participating countries (China, Kazakhstan, Kirgystan and Russia) among which 16 are from Russia (Moscow Institute of International Relations of the Ministry of Foreign Affairs, Moscow State University, Moscow State Linguistic University, Ural State University, etc.). A MoU to formally establish the SCO University is to be signed in Moscow at the end of April 2010. In March, the Russian Education and Science Ministry indicated as September 2010 the date of the first intake of students at SCO University, studying masters’ programmes in 5 different areas - environment, energy, nanotechnology, regional studies and information technology. Masters’ programmes should last two years, during which each student should study at least one semester in a host university of a participating country in addition to his/her home university. At the end, students shall receive diplomas from the home university and the SCO University.

In March, during a visit to India, Russian Prime Minister Putin discussed the issue of mutual recognition of diplomas between Russia and India. According to PM Putin, 4,000 Indian students are currently studying in Russia. The recognition of Russian diplomas is one of the major problems faced by these students.

The establishment of federal universities continues to be in the news. At present, five federal universities are being established: the North (Arctic) Federal University in Arkhangelsk, Kazan (Tatarstan), Ural (Yekaterinburg, Sverdlovsk region), Far East (Vladivostok) and North-Eastern Federal University (Yakutia). PM Putin was quoted as saying that each of them will receive not less than 400 million roubles (approx. € 1,050,000) per year for development costs from now to 2013. The new universities will join two federal universities already existing - Siberia Federal University in Krasnoyarsk and South Federal University in Rostov; while according to First Deputy PM Zhukov in the coming years two additional federal universities are to be established, in Kaliningrad and the North Caucasus. Federal universities are expected to improve the quality of higher education and to help reduce the high number of universities currently delivering higher education degrees (about 1,200, half of which are privately established since 1994). An important reason for reducing the number of higher education institutions is the expected decrease of HE students due to demographic decline. Minister Fursenko has indicated that instead of the current 7,5 million students, the total number of HE students may be between 5,5 million (optimist scenario) and 4,5 million (more realistic one) in coming years.

Space

(i) Three new satellites for the Russian global navigation system Glonass entered orbit in March after being launched by a Proton-M rocket from the Baikonur Cosmodrome. The latest additions have

increased the number of Glonass satellites in space to 20, with 19 active and one suspended for maintenance. The Federal Space Agency Roscosmos plans to send six more satellites into orbit in two launches in 2010, giving the system the needed 24 working satellites and three in reserve. (ii) The Head of the Federal Space Agency (Roscosmos), Anatoly Perminov, said at a press conference at Baikonur that Russia was the world's fifth largest spender on space programmes. Roscosmos had earlier reported that the United States spent \$18.8 billion on space programmes in 2009, the European Space Agency \$5.3 billion, China \$3.1 billion, Russia \$2.7 billion, Japan \$2.2 billion and India \$1.2 billion.

Culture

A third call for proposals under the IBPP-Culture took place. Around 80 concept notes were received and 8 projects were finally selected for a total amount of € 2 Million. The selected projects will be implemented in 2010-2011 in Moscow, Perm, Pskov, Tver and other Russian regions in cooperation with the EU cultural institutions. They cover different areas: contemporary dance and music, heritage preservation, documentary cinema, museum cooperation, cultural tourism, etc. The projects will be officially presented at the IBPP-Culture kick-off meeting in September 2010.

4.4 Transport

Air

On 13 January, due to financial difficulties, German operator Blue Wings, 48% owned by Alexander Lebedev's private Russian bank National Reserve Corporation, ceased passenger transportation. United Aircraft Corporation said sales of domestically-produced airplanes increased twofold in 2009.

On 2 February PM Putin approved the decision of the Ministry of Transport to convert seven regional airlines currently managed by Rostekhnologii (Russian Technologies) into joint-stock companies only to transfer them in a second step to **Aeroflot**. On 15 March the Government approved the procedure for this transfer.

Road

On 9 February AEB reported that sales of new cars in Russia declined by 37% in January 2010 as compared with January 2009, to 74,000 cars. The leaders of sales are AvtoVAZ's economy-class cars. Less expensive Korean cars from Hyundai and Kia replaced Chevrolet and Ford from the first and second places. The Renault Logan model is third among foreign cars. AvtoVAZ sales year-on-year dropped by 41% in January and by 31% in February. Renault, which owns 25% of AvtoVAZ, has promised to invest €240m of technology into the company to develop new models and improve efficiency.

PM Putin signed a Decree on the implementation of the “**cash-for-clunkers**” programme between March and 1st November 2010. The budget allocation for it amounts to 11 billion roubles. AvtoVAZ will be its major beneficiary with 20,000 applications already received, and sales of 100,000 new cars expected.

On 27 January state **requirements for industrial assembly** of cars in Russia were tightened. Foreign corporations will no longer enjoy preferential import tax conditions on components for their models assembled in Russia unless they commit to switch to full-cycle production in Russia and limit their share of imported parts to a third within 4.5 years. The new order also requires foreign producers to declare investments once every six months (previously once a year).

On 23 March Deputy Economic Minister Andrey Slepnev called on the Government to cancel the increase of **car import duties** (introduced for nine months in January 2009 and then extended in October 2009 until July 2010) because high import duties lower incentives for domestic car producers to make competitive cars, and because such duties contradict Russia's G20 obligations.

The Government approved the **Automotive Industry Development Strategy until 2020** submitted by the Ministry of Industry and Trade. It paints a dire picture of Russian car-makers but expresses hope that by 2015 the crisis will be overcome and production of cars in Russia will grow fivefold. To achieve this, 584 bln roubles (14 bln euro) of investment by the industry are said to be needed, but also state guarantees and 180 bln roubles (4 bln euro) of state subsidies. The Ministry suggested that the purchase of new technologies abroad was essential but car-makers deny such a necessity.

In February, **Daimler and EBRD** expanded their stake in truck producer KamAZ by 5%, from 10% to 15%. The price of the deal was not revealed. Rostekhnologii owns 37.8% of KamAZ, and a consortium of shareholders led by Troika Dialogue bank owns 39.4%. Troika said it was ready to sell its 25% stake.

On 4 March major shareholder of Onexim Group Mikhail Prokhorov told the Government High-Tech and Innovations Commission that Onexim would organize the production of **hybrid cars powered by LNG and electricity**. The plant for new hybrid cars would be launched in early 2011 and start massive production in mid-2012. Onexim will provide financing, while the Russian-Belarusian Yarovit holding will be responsible for production. There will be three models of hybrids: a sports car, a town car and a lorry. The price of a car will be about \$10,000. By 2013 Yarovit plans to launch production of **trucks with gas engines** in St. Petersburg and produce 10,000 -12,000 trucks per year.

On 9 March the Ministry of Transport prepared a draft law that obliges Russian heavy goods vehicles weighing more than 12 tons to pay for the use of Russian roads. So far only foreign carriers from certain EU countries, Switzerland and Turkmenistan pay **road user charges**. The ministry did not specify the amount of payment due. According to media, the fee for the use of Russian roads collected from foreign carriers would be 60,000 roubles a year.

On 25 February the State Road Inspection said **Russian road regulations would be harmonized with European regulations** (banning spiked tires in summer, amending regulations on entering opposite lanes etc.).

On 16 March PM Putin signed a Decree to facilitate **Public Private Partnerships** (minimum private share – 25%) by granting state guarantees to companies working on state construction projects, namely the bypass of Odintsovo in Moscow Region, Moscow-St. Petersburg highway and the Western High Speed Diameter.

Rosavtodor (**Russian Roads**) adopted a **Programme for 2010-2015** whose priority is modernisation and reconstruction of Federal roads, as well as a financial plan. It recognises that 28% of Federal roads (13 000 km) are used beyond their capacity.

In 2009 the Moscow City government cut **road construction projects** by almost 70%. The initial plan was to spend 110 bln rubles or 2.5 bln euro, an amount equal to allocations from the Federal budget for the same purpose for the entire country.

Rail

According to Russian Railways' (RZD) performance report, freight volumes declined by 15% in 2009, while passenger transportation declined by 17.8%.

RZD costs for pre-construction works in the Sochi Olympics 2014 area (Adler-Krasnaya Polyana) already reached \$2 bln. No tender was held among subcontractors. Construction is to be carried out by SK-Most and Transyuzhstroy. On 29 January RZDstroy (Russian Railways Construction) and Alpine Bau GmbH (Austria) set up a joint venture. Among its projects is construction of two tunnels in Sochi.

The Ministry of Transport approved rail reforms including the creation of the Second Freight Company to which RZD will gradually transfer its rolling stock. In addition, RZD will sell its major stake of shares in the First Freight Company and by 2012 also in the Second Freight Company. RZD plans to sell its stakes in more than 30 companies by 2012. Among the biggest deals will be the sale of 50% minus 2 shares of each First Freight Company and TransTelecom and 35% minus two shares of TransContainer.

4.5 Agriculture, Veterinary and Phytosanitary, Fisheries, Forestry, Public Health

Agriculture

- President Medvedev signed a Decree on 30 January 2010 adopting the Food Security Doctrine of the Russian Federation.

The Decree foresees an implementation plan to be drafted by the government and annual reports.

The doctrine is linked to the National Security Strategy, refers inter alia to FAO recommendations on food security and foresees, as a criterion to evaluate food security, shares of domestic production in the main agriculture sectors and in fisheries ranging between 80% to 95%, depending on the sectors.

It refers i.a. to food safety, GMOs, tariff regulations and protective measures, SPS measures taking into account international standards.

- In February, PM Putin signed a Decree - **Decree N 68 of 20 February 2010 - allocating 5.038 billion roubles in 2010 to stimulate the exports of grain from Russia's state reserves.** The money will be spent to cover the difference between domestic and international prices for grain. Putin's spokesman, Dmitry Peskov, said that the measure will make it possible to enlarge the share of Russian grain on the international market.

- **BRIC countries (Brazil, Russia, India and China) meeting at the level of Agriculture ministers in Moscow on 26 March, signed a declaration on food security,** agreeing inter alia to combat hunger and boost efforts to promote food security.

The BRIC countries agreed to establish an agricultural information database that would help countries compute supply, demand and establish grain reserves.

In addition, the ministers agreed to reduce the effects of global climate change on food security and cooperate in the field of agricultural technology and innovation. An expert working group was set up to implement these measures, and it will meet on a regular basis.

Statistical overview of latest trends in agriculture

In his April speech to the Duma, PM Putin gave a positive assessment of the situation in the agricultural sector. Agricultural output increased by 1.2% in 2009 despite the economic crisis which hit Russia in the end of 2008. The total volume of agricultural output amounted to 2,600 billion roubles in current prices (about €67 billion).

The Ministry of Agriculture forecasts that the grain harvest in 2010 will total 97 million tonnes (the same level as in 2009); while the Russian Grain Union President, Arkady Zlochevsky, said that the grain harvest could exceed 100 million tonnes this year.

Russia's exports of grain in the period July 2009 – February 2010 amounted to 13.7 million tonnes (increasing with 6.1%, y-o-y).

The Russian government supported the domestic grain prices via interventions on the grain market. The stock of grain in the intervention fund exceeded 4 million tonnes at the beginning of the year. Agriculture Minister Skrynnik said that one million tonnes of grain from the intervention fund could be shipped abroad and a part of this amount could be supplied as humanitarian aid.

Cattle farming

As of 1st January 2010 the total number of cattle in Russia was 20.6 million heads (98.2% compared with the same date last year). The number of cows totalled 8.9 million (down 2.1%, y-o-y), the number of pigs – 17.3 million (up 7.0%, y-o-y), the number of sheep and goats – 22.5 million (up 4.5%, y-o-y).

State support to agriculture

First Deputy PM Zubkov acknowledged that the financial situation in the agricultural sector deteriorated last year despite the increase in state support and the program of anti-crisis measures. Agricultural producers can not expect an increase in state support this year due to the difficult economic situation, he said.

Veterinary and Phytosanitary issues

- Usual very intense correspondence and contacts between DG SANCO and the Russian Veterinary and Phytosanitary Service (Rosselkhoznadzor), as well as the Russian Consumer Protection Service (Rospotrebnadzor)

- A meeting between DG SANCO with Member States and Rosselkhoznadzor took place in the margins of the **Green Week in Berlin on 14-15 January**.

Main issues discussed:

- Implementation of the governmental resolution of September 28, 2009 №761 about harmonization of Russian sanitary epidemiological requirements, veterinary and sanitary and phytosanitary sanitary measures with international standards
 - Results of meat establishments' inspections in 2009 in the EU Member-States
 - Results of monitoring of banned and hazardous residues in animal products imported into Russia from the EU
 - State-of-play of the lists of EU establishments that produce milk, dairy products and animal products and intend to export to the RF
 - BSE requirements
 - Veterinary certificates
 - Bluetongue and composite products
 - Pesticides residues
 - Plant nurseries and grains
- On 19 January 2010 PM Putin announced a reform of Rosselkhoznadzor during his chairing session of the Government Commission for Administrative Reform.** The Veterinary and Phytosanitary Control Service under the Ministry of Agriculture will simplify the administrative burden, redundant controls and consequent corruption and further clarified the relation between the federal and regional veterinary and phytosanitary controls.

The **Government's Decree of 9 March 2009 N 299-p** and the attached **Action Plan of measures to be adopted in the coming months** implement the reform of Rosselkhoznadzor.

Health

- The first meeting of the Dialogue on Public health working group foreseen for March has been postponed by the RF Ministry of Health.
- The “Law on the Turnover of Medicines” was passed in third reading by the Duma on March 24.
- **On 12 February 2010, Roszdravnadzor** – Russia Surveillance Service for Healthcare and Social Development, under the Ministry of Health - hosted a meeting in Moscow with the Chair of the **Pharmaceuticals Inspection Convention and Pharmaceuticals Inspection Cooperation Scheme - PIC/S**, to sign a **Memorandum of Understanding between Roszdravnadzor and PIC/S to begin formally the accession process of RF to PIC/S**, a process which can last up to 6 years.

Roszdravnadzor has asked for EU technical support for Russia accession to PIC/S.

Fisheries

- **On 19 February 2010**, following completion by RF of the necessary procedures, **Russia has been included in the list of flag State notifications under the EC IUU Regulation** and has therefore resumed fish exports to the EU, with the catch certification.
- **The first meeting of the EU-RF Joint Baltic Sea Fisheries committee took place in Kaliningrad on 10-12 March.**
- A meeting between DG MARE and Fisheries Agency on the implementation of the EU IUU Regulation took place in Moscow on 24 March.

Forestry

- DG ENV participated in a workshop organized by WWF-Russia to discuss Russian and European Union Legislative Initiatives to Combat Trade in Illegally Harvested Timber and its Processing Products, which took place in Moscow on 26 March 2010.

5. TRENDS IN PUBLIC OPINION

In line with the Delegation's policy to make full use of Internet instruments, a press conference was organised in cooperation with the RIA Novosti press agency informing about the launch of a competition amongst bloggers and Internet media journalists, associated with the 20th Anniversary of the fall of the Berlin Wall. All competition entries as well as rules and information on jury members are available at www.europlanet.ru . The website also includes a blogmedia, a Wiki section and an entertainment corner for teenagers.

On 27 March 2010, Europe Day took place in Kazan for the second time. Just two days after the inauguration of the new President of Tatarstan and with participation of the Head of EU Delegation and the Minister of Education of Tatarstan, a series of events, attracting at least 3,000 local residents, took place at different places throughout the city. Good promotion and support from local partners provided excellent media coverage and enhanced the visibility of the EU.