



EUROPEAN UNION
DELEGATION OF THE EUROPEAN UNION TO RUSSIA

QUARTERLY REPORT APRIL-JUNE 2010

Table of contents

1. INTRODUCTION	2
2. POLITICAL DEVELOPMENTS	2
3. ECONOMY	7
4. SECTORS	14
5. TRENDS IN PUBLIC OPINION	28

1. INTRODUCTION

For EU/Russia relations the quarter was dominated by the summit in Rostov-on-Don on 1/2 June. This was the first under the Lisbon Treaty attended by Presidents van Rompuy, Barroso and Medvedev, The atmosphere again reflected the improved EU/Russia relations with the main outcome being a Joint Statement launching the EU/Russia Partnership for Modernisation.

Modernisation is an important theme in many sections of the current report, notably external relations, the economy and science and technology. The policy is clearly a priority for the leadership; however much still remains to be done to put the theory into practice, and there are differences of view on how much emphasis to place on improving the rule of law as a means to attract much-needed investment in modern technology and innovation.

The Russian economy continued to recover from the crisis with economic growth running at 4.2% even if there were signs that this slowed down in June. The WTO process gained momentum following Medvedev's visit to Washington where the deadline of 30 September was set for Russia to adopt necessary outstanding legislation. At the same time there was much focus on the preparations for the customs union with Kazakhstan and Belarus with the common customs code to enter into force at the beginning of July.

On the political scene there were no major developments but the situation in the North Caucasus continued to be marked by violence, conflict and a lack of respect for the rule of law. President Medvedev has sought to identify ways to improve both the security and the socio-economic situation of the region.

In foreign policy relations continued on an even keel with the EU and the US while Russia also sought to develop regional integration processes in its neighbourhood.

2. POLITICAL DEVELOPMENTS

2.1. Domestic politics

Medvedev and Putin on several occasions both declined to exclude seeking re-election in 2012. According to a Levada Centre poll, the number of Russians who believe that Medvedev acts under Putin's control has declined over the last year, from 68% to 44%. At the same time, 58% of respondents expressed the view that Medvedev 'in general continues Putin's policies'. 65% said they in general support Medvedev's actions, compared to 58% in May 2009.

At a meeting in mid-June, the leadership of the ruling United Russia Party proclaimed that improving living standards should be the key goal of modernization and stressed that United Russia should become the driving force of Russia's modernization.

Medvedev has continued his campaign to replace old-guard regional governors.

At the end of May Medvedev ordered that all nominations of Government officials to the steering boards of strategic enterprises should be subject to prior agreement by the Presidential Administration. Medvedev wants to promote officials considered 'fit' for modernization.

Murmansk lawmakers voted unanimously at the beginning of June to dismiss Murmansk mayor Sergey Subbotin for 'improper performance of his duties'. Murmansk governor Dmitry Dmitriyenko backed the move. Subbotin had won the March 2009 mayoral elections as an independent, against the United Russia candidate.

Communist Party-backed candidate Alexander Serov was victorious at the end-May mayoral elections in Bratsk (in the Irkutsk region), winning around 45% of the vote. United Russia candidates won only 22-23%. The victory suggested that when United Russia does not use 'administrative resources' it can lose elections. Several officials of the Irkutsk region administration resigned in the wake of the victory of the Communist Party candidate.

Up to 1,500 people took part in an unauthorised protest action in the town of Mezhdurechensk (the Kemerovo region) where at least 66 people were killed and 24 others were missing as a result of twin blasts at the Rapsadskaya coalmine. OMON riot police detained 28 protestors.

Northern Caucasus

The situation in the North Caucasus remains tense, unstable, dangerous and unpredictable. Attacks on law enforcement agents and on civilians continued, and have expanded now to the traditionally quieter Republics of Kabardino-Balkaria and Karachevo-Cherkessia. The situation has deteriorated in Chechnya, Ingushetia and Dagestan, marred by suicide bombings during the period. The forecast of the FSB of an 'intensification of extremist activity' over the Summer has indeed materialized.

A blast in Stavropol killed five people and injured at least 46 minutes before a Chechen folk dance concert at the end of May. Six policemen were wounded in a blast aimed at the Ingush Deputy Interior Minister on 20th April 20 in Nazran. An adviser to President of the Republic of Karachayevo-Cherkessia was killed in mid-May. Several FSB officers were killed and wounded on 1st June in Dagestan during an operation against the terrorist group suspected of involvement in the 29th March Moscow metro bombings. The FSB claimed to possess information that terrorists 'continue attempts to gain access to nuclear materials and chemical components', and warned of terrorist plots to foil the 2014 Winter Olympic Games in Sochi.

Violence is not decreasing in spite of the increasing effectiveness of the security services to eliminate or detain militants. In May the press service of the Ingushetian press service reported that 33 persons had been killed in the republic since the beginning of the year, while there had been 39 attacks on members of the security forces. In Chechnya, the Ministry of the Interior reports 20 militants killed, 54 detained and 11 who have voluntarily surrendered for the same period. The Ministry claims that most of the accomplices of the Moscow bombings have been identified, some detained and some killed.

Past contract killings continue to be linked to Chechen President Kadyrov. A court in Dubai sentenced an Iranian citizen and a Tajik national to 25 years imprisonment each for their role in the presumed killing of former commander of the Russian Defence Ministry's Vostok ('East') battalion Sulim Yamadayev. A Moscow district court in the beginning of May sentenced

Chechen native Khavazhi Yusupov to eight and half years for attempting to murder Sulim's brother.

A spokesman for the Vienna Prosecutor's Office said at the end of April that a probe into the killing in January 2009 in Vienna of a Chechen man has revealed a connection to an advisor to Chechen President Ramzan Kadyrov. Austrian investigators suspect Kadyrov as having played a role in the abduction and murder of Chechen refugee Umar Israilov in January 2009 in Vienna. The Chechen authorities have denied the allegations.

On 19th May Medvedev held an unprecedented meeting with selected NGOs and Russian civil society activists on the North Caucasus, during which the President sought ideas on how to resolve the region's most important problems (corruption, unemployment, youth involvement in terrorist activities). The main outcome was a promise to create a public chamber (a Council of Elders) in the North Caucasus Federal District, and to look into the problem of numerous police checkpoints in the North Caucasus, which often contribute to the spread of corruption rather than solving security problems. Medvedev warned that corruption in the North Caucasus region threatens national security and 'directly aids separatists and militants'.

President Medvedev during a visit to Chechnya on 14th June praised the fight against militants in Chechnya, but highlighted the need to focus on socio-economic development. He recalled that a targeted programme for Chechnya's socio-economic development for 2008-2011 provides for financing of RUR120 billion.

A draft resolution adopted by the Committee on Legal Affairs and Human Rights of the Council of Europe's Parliamentary Assembly (PACE) was adopted at the beginning of June on the basis of a report prepared by Dick Marty, PACE rapporteur on the human rights situation in the North Caucasus. The resolution called the North Caucasus the region with 'the most serious and most delicate' human rights situation in the whole of Europe and adjacent territories. It spoke of disappearances of opposition activists and human rights defenders going unpunished. The draft expressed concern over 'an alarming upsurge of violence since 2009' in Ingushetia and 'the outbreak of terrorist acts in Dagestan' that leads to 'cruel police responses'. For the first time in 14 years the Russian delegation backed the resolution. Russian Parliamentarians and Ingush leader Yunus-Bek Yevkurov, who addressed the session, called the report 'balanced'. Russia's permanent representation in Strasbourg nevertheless sent a protest to the Council of Europe's Secretary-General Thorbjorn Jagland over the presence at the PACE session of Chechen separatist emissary Akhmed Zakayev.

Humanitarian developments and ECHO partners

According to the data from Danish Refugee Council the number of IDPs registered in Ingushetia at the end of June is 7,551, 284 less than in May. The figure of IDPs in temporary settlements has decreased in the same period from 1583 to 1465.

On the case of the missing DRC staff (Zalema Gaisanova), DRC received a letter from the Chechen Ministry of Interior alleging that Zalema was married to the militant that was killed in her house on that day (which according to her family and DRC is not true) and informing them that a criminal case had been opened on her disappearance. This is contradictory to the initial information given to the family that she had been detained and indicates that, sadly, most likely she is dead.

Memorial is again considering closing down its office in Grozny after President Kadyrov stated publicly that everybody working in the organization is considered an 'enemy' of the Chechen Republic.

2.2 Democracy and Human Rights

Ombudsman for Human Rights Vladimir Lukin presented his 2009 annual report on 26th May. The report concluded that 'there is the beginning of a system of feedback between society and the state', but that 'this cannot be said with any certainty, since the accumulated burden of mutual misunderstanding is still very high, and, moreover, there are still many examples of demonstrative disregard by the authorities both of the law and of the opinion of the citizens of their own country'.

Some 50 activists were detained during the (unauthorized) 31st March Strategy 31 rally on Moscow's Triumfalnaya Square. Police detained both protesters and independent observers for taking part in the unsanctioned event, reportedly employing brutality against both detainees and journalists. More than 150 people were detained by police at the following Strategy 31 rally on 31st May, also unauthorised. About two dozen people claimed that they were beaten or attacked. In St. Petersburg up to 60 opposition activists were detained by police for attempts to hold a rally in support of Article 31. Actions were held in a number of other (more than 40) Russian regions.

On 10th June, Lukin presented a report to Medvedev on the dispersal of the 31st May rally stating that the police had broken the law in many respects.

On 9th June the Tver district court in Moscow sentenced Sergei Makhnatkin, accused of assaulting a police officer during the rally, to two and a half years in a penal colony.

On 16th June about 300 people (including about 80 journalists) participated in a sanctioned opposition rally on Triumfalnaya Square, an initiative of the Solidarity Movement. Speakers called for a profound reform of the Interior Ministry and the release of Makhnatkin.

Aleksei Sokolov, founder and the head of the Russian human rights organization Pravovaia Osnova (Legal Base), was sentenced on 13th May to five years in a high security prison colony for theft, allegedly committed in 2001, and for robbery, allegedly committed in 2004. There is suspicion that the charges were fabricated.

About 30 LGBT activists held a small, unsanctioned Gay Pride march on 29th May in Moscow. It was the first march in five years which passed off peacefully. On 26th June five gay rights activists were arrested at an unsanctioned gay pride protest in Saint Petersburg.

For the first time in the Khodorkovsky II trial, high Russian officials took to the witness stand, testifying broadly in support of the defence, including Viktor Khristenko, Minister for Industry and Trade, German Gref, Sberbank CEO and former Minister of Economic Development and Trade, and former Russian Central Bank chief Viktor Gerashchenko.

Khodorkovsky went on a two day hunger strike in May over a court decision to extend the term of pre-trial detention for him and his business associate Platon Lebedev in the framework of the second case against them. Khodorkovsky said the decision violated an order by President

Dmitry Medvedev that people accused of economic crimes should not be held in pre-trial detention. Khodorkovsky ended his hunger strike on the second day after a spokesperson for Russian Medvedev indicated that Medvedev was familiar with Khodorkovsky's complaint.

A Moscow district court dropped charges against Yukos' former Vice President Vasily Aleksanyan as the statute of limitations had expired.

Moscow City Court judge Eduard Chuvashov was shot dead in Moscow on 12th April. Chuvashov had been involved in a number of high-profile cases and he was known for being tough on perpetrators of nationalist crimes.

2.3 Justice and Home Affairs

The Visa Facilitation Agreement Steering Group met in Brussels and agreed on a number of measures which could be taken to extend the scope of the Agreement to a wider category of beneficiaries and in general to ensure that the smoother implementation of the Agreement.

At the EU-Russia Summit in Rostov-on-Don at the beginning of June Medvedev handed over a draft visa waiver agreement, on the basis of which the Russian side signalled its desire to begin negotiations towards a visa free regime.

2.4 Foreign relations

Russia continued its bid to improve relations with the West in general, in search of modernisation alliances. The New START nuclear arms treaty was signed with the US in Prague at the beginning of April in the biggest success yet of the US-Russia reset. During the reporting period Moscow has made a notable effort to step up ties with a number of EU capitals, most notably Berlin and Paris. Russia also made visible attempts to take forward its relations with Poland following the disaster of 10th April, when a plane carrying Polish President [Lech Kaczyński](#) with [his wife](#) and 87 other politicians and high-ranking army officers [crashed near Smolensk](#), killing all 96 aboard the plane. The passengers were to attend a ceremony marking the 70th anniversary of the Katyn massacre. As far as concerns the EU, the Ministry of Foreign Affairs has pressed the case for the establishment of an EU-Russia 'political and security committee'.

At the same time Moscow continued its bid to maximise its economic influence in the post-Soviet space: a gas deal was signed with Ukraine (in exchange for an extension of the lease on the Russian naval base at Sebastopol) and, following intensive negotiations with Belarus, the Customs Union with Kazakhstan finally looked set to get off the ground by the beginning of the third quarter (see below). However, relations with Belarus President Lukashenka have remained as awkward as ever. Russia made a declaration with Ukraine on how to handle the Transnistria issue, but broadly maintains its support for the 5+2 conflict resolution process. Progress has however slowed on the Geneva Consultations on Georgia.

Russia notably forebore any overt attempt to exert a direct influence on the events in Kyrgyzstan following the ethnic riots which took place in the South of the country in June. Russia has not opposed the interim government following the swearing in of Rosa Otunbaeva at the beginning of April.

3. ECONOMY

3.1 WTO accession process

The Russian WTO-accession process has gained momentum since the recent visit of President Medvedev to the US and the talks with President Obama on the subject. A deadline of 30 September has been agreed upon with the US by which Russia would adopt outstanding legislation and a compromise has been found on state-trading enterprises and poultry.

3.2 Regional integration and trade policy

At the Evrasec-Summit in Astana, the Presidents of Russia, Belarus and Kazakhstan confirmed the Customs Code of the Customs Union entering into force in trilateral format on **6 July**. One of the major disagreements in bilateral Russia-Belarus relations was solved following an agreement on gas prices and transit fees. Belarus, however, could not convince Russia to eliminate export duties on crude oil and petroleum products.

Numerous **exceptions** from the Single Customs Tariff will permit Belarus and Kazakhstan to use lower import duties during a transitional period of one year. The *Protocol on temporary exemptions* from the regime of the single customs territory lists exemptions for different products, including cars imported by physical persons.

The **Single Economic Space** would become operational starting from **1st January 2012** and Belarus could expect the elimination of export duties only from this date. Moscow retains the right to impose a 30% export duty on gas supplied to Belarus. A lot of work still remains to be done: The federal draft law “On customs regulation”, which is supposed to bring Russian legislation in line with the Customs Code of the Customs Union is expected to be passed by the Duma only in **autumn**.

The Customs Union Commission website also published a **report of the Customs Union Commission** on establishing a single customs territory in the Customs Union. According to this report, the second stage of establishing a single customs territory will last until 1st July 2011. During this stage, the members of the Customs Union will maintain customs controls at internal borders of the Customs Union. Temporary exemptions will be eliminated when the formation of the Single Economic Space is approved. Export duties on trade within the Customs Union will be abolished when Belarus ratifies all international agreements listed in the action plan on establishing the Single Economic Space between Belarus, Kazakhstan and Russia.

Kyrgyzstan and Tajikistan have also expressed their interest in joining the Customs Union and asked Russia to abolish export duties on petrol (re-introduced in April this year).

As of 1st July 2010 the Customs Union Commission became responsible for the introduction and application of **anti-dumping and safeguard duties** against third countries.

Technical regulations will be adopted by the decision of the Customs Union Commission. Following the establishment of the Customs Union, the Federal Anti-Monopoly Service (FAS) started a recalculation of company market shares in the common market of Russia, Kazakhstan and Belarus. A single **supranational** agency responsible for **competition policy** in the Customs Union should be established in 2012.

3.3 Industrial policy/ protectionism

In parallel to Russia's enhanced WTO-accession efforts, the government has also been active on industrial policy, state aids and efforts to increase localisation and relocation of foreign investors to Russia.

At the same time, the use of outright protectionist measures such as the adoption of increased import duties has slowed down as Russia can no more increase import duties unilaterally under the customs union.

The most recent initiative by MED concerning localisation of foreign production in Russia concerns a number of sectors subject to localisation (electronics, pharmaceuticals, timber processing and other). Questionnaires have been sent out by MED to collect data from foreign companies in order to design incentive packages (optimal customs duties, tax policy measures, legislative measures, infrastructure and state support) for specific companies and sectors.

Foreign firms' local production has expanded. Examples include the German producer of agricultural equipment and machinery (incl. harvesters), *Claas*, who wants to double the capacity of its plant in Krasnodar and *Hyundai*, who for the first time in assembly practice of foreign carmakers in Russia, set up a costly press-forming unit and invested €25m in this unit.

The government's import substitution strategy is also progressing. Recently, the Government approved a list of 57 critically important pharmaceuticals which will be manufactured domestically within the next five years and which should replace imports.

Also incentive schemes are actively employed by the government: In April, the government granted automobiles produced in Russia's Far East free transportation by rail to other Russian regions RUR500m. Interest-free loans have also been provided by the government (RUR28bn to AvtoVAZ, f.ex.). The cash-for-clunkers scheme has also been very popular and an extension to trucks and busses is imminent, and an inclusion of agricultural machines including combines has also been discussed recently.

3.4 Latest legislative developments

The Duma adopted a record number of 249 laws in the economic, trade, financial, budgetary and social spheres. However, numerous provisions of the Retail Trade Law, Pharmaceuticals Law, Strategic Sectors Law and the Antimonopoly Law are unclear or inconsistent with other Russian laws. The business community, including the AEB, are currently taking part in a campaign for their rectification.

The Duma is in the process of considering a draft law on the Skolkovo innovation centre (a Russian Silicon Valley). Skolkovo would provide conditions for research and development in

energy, information technologies, communications, biomedical sphere and nuclear technologies. Its inhabitants, both individual persons and business entities, would get many tax reliefs. Skolkovo would have its own police department, tax and customs services and patent authority.

On 7 April, President Medvedev signed a bill which protects businessmen from criminal prosecution. The new law contains a provision, whereby persons accused of economic crimes can only be held in custody in exceptional cases.

The Amendments to the Federal Law 'On legal status of foreign citizens in the Russian Federation' (#86-FZ of 19.05.2010) entered into force on 1 July. The Amendments streamlined migration rules for highly-skilled specialists. The migration quota was abolished. The relevant work permit should be issued within 14 working days. Following that a full residence permit could be issued to the specialist and his/her family members. The work permit is granted for 3 years (originally 1 year), with a possibility of extending it several times by 3 years. The highly-skilled specialist will pay a 13% income tax in Russia (down from the current 30%). The Amendments abolish as well the requirement to deregister when a foreigner travels within the country, but not on leaving.

The two packages of amendments to the Strategic Sectors Law (SSL) are currently under discussion by the Government. They aim at reducing unjustified restrictions on foreign investment.

3.5 Recent legislation on banking and financial markets

The Duma passed a draft federal law “On insider trading and market manipulation” in a final third reading. The draft law is expected to be approved by the Federation Council by the end of July and will then be submitted to President Medvedev.

The Fund of Medical Insurance issued decree N 73 establishing a methodology for calculating discounts or premiums on mandatory medical insurance payments depending on the type of economic activity. The amount of discounts or premiums on mandatory insurance payments depends primarily on the conditions of labour safety.

Federal law N 148-FZ introduces changes to the federal law “On banks and banking activities”, which require to inform owners of banking cards about the amount of commission fees charged by automated banking machines for withdrawing cash before a transaction is made. The Central Bank issued Regulation N 2459 “On assessment of credit risks for certain types of loans”. The regulation clarifies an application of the classification of debt-servicing by borrowers as “good”, “average” or “unsatisfactory”, according to specific criteria.

The Central Bank issued letter N 83-T “On processing shipping documents sent by consignors from Belarus by authorized banks”. The Central Bank recommends banks to check the validity of shipping documents from consignors in Belarus using an electronic database of issued shipping documents. Banks are also recommended to ask for a copy of the authorization by the Central Bank of Belarus to transfer funds on external trade transactions with residents of Belarus to accounts in non-resident banks.

3.6 Macroeconomic performance

The process of economic recovery was quite dynamic in the first half of 2010. According to the Ministry of Economy, GDP grew by 4.2%, y-o-y in the first half of 2010. Industrial output increased by more than 10%, y-o-y, in the same period. These statistics could lead to a revision of the official governmental forecasts for economic growth in 2010 (currently from 4% to 4.5-5.0%). The IMF has recently revised its economic growth forecast for Russia from 4.0% to 4.25%. The World Bank projects a 4.5% growth this year. These projections certainly reflect improvements in many sectors of the Russian economy.

Net exports were the major driver of GDP growth in the first months of the year. Exports in monetary terms grew by more than 50% in the first half of 2010, attributed largely to an increase in oil prices.

Recent statistical data suggest that economic growth somewhat slowed down in June. The rate of growth in June was 0.3%, m-o-m, while growth in May was 0.4%, m-o-m, and in April 0.7%, m-o-m.

Investment demand remains quite fragile, but there are signs of gradual recovery. According to the latest Rosstat report, fixed capital investments increased by 7.4% in June 2010, y-o-y, while in March 2010 the increase in fixed capital investment was estimated at 0.9%, y-o-y. Some recovery in the construction sector could be observed in June as the volume of construction increased for the first time in 2010.

As international prices for major Russia's export products stabilized, the contribution of net exports to growth fell and economic growth now has to rely to a larger extent on domestic demand. There are certain indications that consumer demand has been gradually recovering. The volume of retail sales increased by 3.4%, y-o-y in the first half of 2010 and by 5.8% in June. Real disposable income grew by 4.8%, y-o-y in the first half of 2010. Growth in consumer lending also supports domestic demand.

The unemployment rate fell from 7.3% in May 2010 to 6.8% in June 2010.

Rosstat revised its historical economic series in mid-June, as part of the process of recalculating the whole System of National Accounts (SNA) to a new base year (2008 instead of 2003). Industrial output data for the period January 2006 to March 2010 were changed quite significantly.

3.7 Monetary and exchange rate policies

The annual rate of consumer price inflation reached 4.4% by the end of June 2010. This slowdown prompted the Central Bank to cut its refinancing rate by 0.25% to the historic low of 7.75%. The rouble exchange rate stopped appreciating in relation to the bi-currency basket in June, following a period of protracted appreciation since February last year. Gold and Forex reserves of the Central bank increased by €33.3 billion in the first half of 2010 and reached €360 billion.

The Central Bank reported that Russia had a net private capital inflow of €3.5 billion in the second quarter of 2010. In the first quarter 2010 Russia had a negative capital outflow of €3.6 billion.

3.8 Fiscal policy

The federal budget deficit in the first half of 2010 amounted to 2.3% of GDP, or 439.9 billion roubles (€11.2 billion). Federal budget revenues for the period were higher than expected and totalled 3,995 billion roubles (€101.9 billion) or 20.1% of GDP, while federal budget expenditures in the same period amounted to 4,435 billion roubles (€113 billion) or 23.2% of GDP.

3.9 External trade and investments

Russian exports between January-June 2010 stood at €147 billion (up by more than 50% compared to the same period last year); imports totalled €81 billion (up 26%, y-o-y).

According to Central Bank balance of payments estimates for the first half of 2010, foreign direct investment totalled €15.4 billion in the first half of 2010 compared to €12 billion in the same period last year. Russian direct and portfolio investments abroad were €14.8 billion in the first half of 2010 compared to €20.6 billion in the same period last year.

The EU remains by far the largest trade partner of Russia accounting for 50.3% of its total trade turnover in the first half of 2010 up from 49.9% in the same period last year. Among the EU Member States, the Netherlands is currently the largest trade partner of Russia accounting for 10.2% of total Russian trade turnover (up from 7.9% in the same period last year). Germany, in second place, has a steady share of 8.3%. The share of Italy declined from 6.9% to 6.4%; the share of France remained stable at 3.5%.

The APEC countries accounted for 21.4% of total Russian trade turnover and the CIS countries 14.3%. The US accounted for 3.2% of total Russian trade in the same period.

4. SECTORS

4.1 Energy

Gas supplies to the EU were reduced for three days on 21-23 June when **Gazprom cut supplies to Belarus** by 15%, 30% and 60% successively over payment discussions. Lithuania suffered reductions of up to 50%, and Poland of about 18% temporarily. The EU-RU Early Warning Mechanism was activated by Deputy PM Sechin but his letter to Commissioner Oettinger was only delivered after the first cut. Gazprom and Beltransgaz had disagreements over the gas price, the transit tariff and the wholesale mark-up applied by Beltransgaz (50% owned by Gazprom) in Belarus. Discussions were further complicated by the trilateral Customs Union with Kazakhstan, whose 2nd stage was launched in July. Belarus strongly disagrees with Russia's position that energy export duties are not covered by the Customs Union.

Russia and Ukraine found an agreement on **lower gas prices for Ukraine in exchange for an extension of the Russian Black Sea Fleet's lease** on the Crimea till 2042. Through amendments to the existing contracts until 2019, the gas price will be lowered by \$100/mcm but no more than 30%. In other words, the Russian export tax was waived. Roughly calculated, this amounts to a rebate of \$4bn each year over the next 10 years. Negotiations between Gazprom and Naftogaz Ukrainy about a **joint venture**, asset swaps and **eventual merger** of the two companies continued, so far without success, and seemed to become more complicated when the Ukrainian parliament adopted a gas market liberalisation law in 1st reading which would contain unbundling obligations on Naftogaz in line with EU directives. Nuclear, aeronautics and shipbuilding cooperation was also deepened or discussed.

Russia and **Norway** reached a historic understanding on the demarcation of their contested hydrocarbon-rich sea border and energy cooperation. Construction of the **Nord Stream** gas pipeline was launched near St. Petersburg in the presence of President Medvedev and Commissioner Oettinger. GdF Suez joined the Nord Stream consortium. Austria and EdF joined the **South Stream** consortium. **Turkmenistan** started to build the East-West pipeline. Domestic gas demand **production remained low**. The share of Russian gas supplies on the EU market remained considerably below pre-crisis levels. **Gazprom's export monopoly** was circumvented through an agency agreement with Novatek for the Yamal LNG plant.

Russia remained the world's **biggest oil producer** at above 10.1 mio bpd. The government planned to introduce strengthened "oil control".

Nuclear power cooperation agreements including construction of power plants were reached with Turkey and Bangladesh, as well as Ukraine.

4.2 Environment

On 22 June PM Putin addressed 17 instructions to various Government bodies aimed at **improving state regulation in the field of environmental protection**. State-owned firms and state corporations are to regularly submit sustainability reports. On 7 June the President instructed the Government: by 1 November to elaborate provisions to create federal and regional environmental funds; by 1 December to submit to the State Duma draft federal laws on developing the required legal and economic mechanisms; and by 31 December to develop together with public stakeholders principles of Russia's environmental policy until 2030. Other instructions concern renewable energy sources, state support for innovation projects that can reduce emissions of pollutants and greenhouse gases, conservation of forests, and promotion of environmental education and awareness.

The Ministry of Natural Resources by 2012 will develop a **federal targeted programme "Environmental Safety of Russia"** (also to tackle hot spots) with an estimated budget of 3 bln roubles or 75 mln euro. Fees for negative environmental impacts will be differentiated by industry and will increase 2.6 times (2011) and 3.4 times (2016). Introduction of **BATs based on EU BREFs** is expected within the next 10 years.

4.3 Science & Technology, Education, Space

In April, the Ministry of Education and Science granted 23 secondary vocational education schools (colleges) and 7 universities the right to develop specific bachelor programmes oriented to the labour markets (IT, machine & machine-building, etc.). Schools and universities will cooperate closely with employers to develop the new curricula. Following the adoption of the law on two-cycle system (bachelor-masters), the first cycle (bachelor level) is further divided into programmes granting direct access to the labour markets (bachelor professionally oriented) and programmes facilitating students' access to masters' programmes.

New Deputy Minister of education and science appointed

On 16 June Putin, appointed Ivan V. Lobanov as new Deputy Minister of education and science. Lobanov will be responsible for steering the bills of law of the Ministry through the State Duma and Senate (in a number of areas including modernisation of education and science).

The administrative streamlining of governmental bodies in charge of science and technology continued, with the reorganization of the Ministry of Education and Science, following the dissolution of the Federal Agency for Science and Innovation and the Federal Agency for Education in March, still ongoing. Seven Deputy Ministers of Education and Science have been appointed, the number of Directorates in the Ministry increased from 7 to 18, and its staff has almost doubled to 850 employees.

The Russian Government put forward more initiatives aimed at strengthening scientific research in Russian universities, at developing an innovation infrastructure around Russian universities, and at attracting leading scientists to Russian higher education institutions. More than 36 billion roubles is being made available for these initiatives. Importantly, the active participation of scientists and organisations from abroad, especially from Europe and the U.S., is particularly encouraged, which almost amounts to a paradigm shift in the attitude of the Russian authorities and reflects President Medvedev's calls for a "more open Russia".

Following President Medvedev's repeated criticism of the inadequacy of the legal form of the State Corporations which had been created in technologically important areas, Rusnano became the next State Corporation to be transformed into an open joint stock company by the end of 2010, initially with 100% state control. Some analysts point out that this may in effect amount to a second distribution of assets which had already been privatized once in the 1990s, for the benefit of persons in or close to government circles.

In the Space sector, Russia signed separate agreements with Belarus and Ukraine on the creation of common navigation areas and for the coordinated application of space technologies. The Russian space agency Roscosmos and French Arianespace signed a contract to launch ten additional Soyuz-ST boosters by 2016, partly intended for the EU Galileo programme.

4.4 Transport

The Antimonopoly Service's report on Competition in the Russian Federation-2009 noted that **Russian Railways maintains a monopoly** and avoids state regulation of its rolling stock; private property on locomotives is not developing; special (transit, intermodal, refrigerator) transport operators have not been established as planned.

On 26 April Vnesheconombank and Sberbank allocated 29.2 bln roubles or 800 000 euro to build a 43-km **toll road** in the Moscow region, a part of Moscow - St. Petersburg highway. The Government will provide another 20 bln roubles or 500 000 euro for the project. **EBRD's decision** to invest USD 400 mln is still not taken. On 16 April Sberbank announced it would spend 33.5 bln roubles or 840 500 euro on construction (by Vinci company) of the Moscow – St. Petersburg toll highway.

The Ministry of Industry and Trade launched a second stage of the “cash-for-clunkers” programme until 2011 (additional 250 000 euro from the federal budget). Deputy PM Sechin ordered the government to develop a **cash-for-clunkers programme for trucks** to be launched in 2011. Expected reimbursement is 60-350 000 roubles or 1200-9500 euro.

On 22 April the Ministry of Industry and Trade approved the **Strategy for Russian Car Industry Development Until 2020** that envisages state allocations between 1.5-4.5 bln euro, total state investment into the industry is to reach 14.6 bln euro.

Russian Technologies State Corporation agreed with Boeing to **purchase 50 Boeing 737** (to be leased to Aeroflot) for an estimated USD 4 bln.

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

Agricultural production trends

Agricultural output increased by 3.5%, y-o-y, in the period January-May 2010, according to Rosstat.

Domestic production and sales of meat, poultry, milk and eggs increased in the first five months of the year. However, the number of cattle fell by 1.7%, y-o-y, to 21.7 million head.

Farmers complain to President Medvedev

Farmers from Samara region sent an open letter to President Medvedev, concerning the disastrous state of agriculture and low efficiency of state measures to support the agricultural sector. The letter also blames Agriculture Minister Skrynnik for incurring multimillion losses to agricultural producers and casts doubts on her statements about the support to agriculture.

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) continued.**

- A meeting between DG SANCO with Member States and Rosselkhoznadzor took place in **Paris on 26 May in the margins of the OIE Annual Session** on the main outstanding issues in EU/Russia relations in this field.

- **Important obstacles to the trade of fruit and vegetables between the European Union and Russia have been removed, after Rospotrebnadzor aligned some of its maximum levels for pesticide residues (MRLs) with the EU and international standards.** This development provides more favourable conditions for EU exporters of vegetables and fruit, such as apples and pears, grapes, citrus fruits and stone fruits (peaches, apricots, etc.). Following specific EU requests, supported by scientific evidence, the Russian Federation amended its MRLs concerning fruit and vegetables in early June.

Ban on US poultry lifted

Russia lifted a seven-month ban on poultry, Russia has agreed to import poultry meat disinfected with hydrogen peroxide, cetylpyridinium chloride or peroxyacetic acid, instead of chlorine, which remains banned according to the USDA.

Russia's chief sanitary officer, Gennady Onischenko, said that Rospotrebnadzor had been waiting for a list of US establishments which adopted new methods for treating poultry to be exported to Russia. He also confirmed that the Russian side retains the right to inspect these establishments. The Russian side proposed 12 different substitutes for chlorine to treat poultry, he said.

Moldovan wine could be banned again

Russia's chief sanitary official, Gennady Onischenko, said in a live interview that Moldovan wine should not be consumed and could be used to paint fences. Dangerous ingredients were found in 18 batches of Moldovan wine on 30th June – 2nd July 2010.

Health

- The Russian federation registered its first polio cases in 15 years, following a polio outbreak in Tajikistan.

- The EU contributed through the WHO Moscow Office to the work of the session of the Council for Disabled Persons under the Chairman of the Federation Council devoted to ensuring equal access to medical drug care for **patients with** rare diseases, which took place in Moscow on 23 April.

Fisheries

- **A meeting between DG MARE and the RF Federal Fisheries Agency took place in Brussels on 28 April 2010, in the margins of SEAFOOD Expo 2010.**

- **The second meeting of the EU-RF Joint Baltic Sea Fisheries committee took place in Brussels on 21-22 June 2010.**

Forestry

- **The State Duma Committee on Natural Resources, Environment and Ecology held a hearing on 20 May 2010 on the topic: "Legal basis of voluntary forest certification to ensure the legality of export and import of timber products and their recycling".** The EU Delegation gave a presentation prepared by DG ENV on the EU "Due Diligence" Regulation.
- A meeting of the **Working Group on options for a Legally Binding Instrument under Ministerial Conference for the Protection of Forests in Europe (MCPFE) took place in St Petersburg on 1-2 July 2010.**

The level of forestry products following a decline in 2009.

The government has abolished export duties on forestry products with high value-added. The import duties and the VAT on equipment for the forestry sector not produced in Russia were eliminated. The schedule of gradual increase in the export duties on timber was adopted. Investors in the domestic forestry industry are offered beneficial terms of access to forest resources.

The government adopted a number of measures to support the domestic forestry sector. Exporters of forestry products are entitled to receive budget subsidies covering a certain share of interest rate payments on loans taken from Russia banks (in 2009 – 184.2 million roubles). Subsidies on interest rate payments for loans taken to finance the modernization of production capacities amounted 10.1 million roubles in 2010.

Priority investment projects remain to be one of the major policy tools for developing timber processing. New regulations were issued offering investors an easy access to forest resources in exchange for investments in the timber processing. Currently 92 priority investment projects are being implemented in Russia. Total investments in the projects amount to 463 billion roubles. The projects' capacity is to process 75 million cubic meters of timber.

The government is set to establish the nation-wide system of voluntary forestry certification. It is foreseen that all timber and forestry products exported from Russia as well as timber purchased for government procurement needs will have a certificate confirming its legality. The government adopted an inter-agency plan for counteracting illegal logging for 2009-2011 and set up an inter-agency group with the participation of the Ministry of Agriculture, Ministry of Interior, Ministry of Industry and Trade, Rosleskhoz, Rosselkhoznadzor and Federal Tax Service.

The national system for inventory of forests is planned to be established by 2017.

5. TRENDS IN PUBLIC OPINION

On April 26-27, a regional press seminar was organised by the Delegation in Svetlogorsk, Kaliningrad Oblast, for journalists from the European part of Russia with particular emphasis on media from Rostov (venue for the EU-Russia Summit) and the North West. An intensive, interactive programme combining speakers from Moscow and Kaliningrad, diplomats, thinkers,

journalists presented the hottest issues on the EU and EU-Russian relations. A visit to an EU-funded project was also included in the programme and was very much appreciated.

The first Europe Day in Rostov took place on May 22 with very good attendance levels exceeding 4.000 people and a very successful agenda of meetings of the Head of Delegation, including visits to leading political personalities in the region. Europe Day was also accompanied by an EU study week which benefited from the presence of high ranking diplomats and other experts. The first Europe Day also provided the opportunity to set up an EU discussion club among students and professors at the Southern Federal University, which wants to regularly host informal meetings inviting the Delegation to attend. One such event was held in the form of a video conference between the Deputy Head of Delegation and students in Rostov. The events have been highly appreciated by EU Member States.

Visibility of Rostov Europe Day was very instrumental for the subsequent EU-Russia Summit which took place in Rostov on June 1st-2. On that occasion, some 400 journalists were accredited and the Delegation used the opportunity to offer a large number of interviews to Russian and international media. A post event press conference was also organised for the federal media at Komsomolskaya Pravda premises, in which the Deputy Head of Delegation explained the key achievements of the summit.

The bloggers/internet media competition was also brought to an end in June with the jury evaluating the entries. In cooperation with RIA Novosti press agency, the competition positions the Delegation in a new, booming field in Russia, the blogosphere. The feedback to the delegation's initiative has been impressive and the number of competing entries very satisfactory, with the largest numbers coming from the regions, even the remotest ones.