

RUSSIAN ECONOMY: TRENDS AND PERSPECTIVES
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5 Gazetny pereulok, Moscow 103918, Russian Federation
Phone: (095) 203-88-16 Fax: (095) 202-42-24 E-Mail: todorov@iet.ru

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Politico-economical developments of January 2005

The major event of January 2004 became an absolutely unpredictable for powers social activity of the population because of coming into force “monetization of benefits”. As is known, the surprising peaceful behavior of population in the passed year, in passing by the Parliament of such an unpopular measure, caused many analysts to make far-reaching conclusions – from suggestions of a social apathy of citizens to speculations of giving the total support to Vladimir Putin who, in conditions of controlled television, will be excused anything. (In June – August 2004, even communists and other dissatisfied groups of population in Moscow could “bring out into the streets” only some hundreds of people, though, It is fair to say that at this particular time actions were conducted to split the KPRF, by conducting parallel congresses, etc.). It worth noting that the January troubles had not been marked in the time-schedules of most radical political forces.

However, it turned out that seemed peace and order in the country is deceitful. Waves of protest triggered in Russia on January 10, – by the end of holidays, when the earlier used their benefits citizens had to make use of transportation services, and they clearly realized during their holidays that absence of benefits is a “new reality”. Of course, there were some additional factors that “added fuel to the flame”. It turned out during analysis of what happened, that only one (!) region – Yakutia – provided delivery to homes’ of the beneficiaries of federal level their monthly payments in cash (for January) before the New Year holidays.

In the city Khimki of the Moscow region pensioners blocked Leningradskoye highway, and in St.-Petersburg, where the protesters’ actions were most large-scale (to 10 thousand), — Nevsky Prospect. The started wave of meetings is continuing, gathering, depending on the size of city, from hundreds to thousands of people. The forms and style of behavior are different - from pickets to capture of administrative buildings (for example, in Izhevsk, on Sakhalin etc.). In Bashkiria, where after 2003 there formed a strong infrastructure, opposing Rakhimov’s regime, the meetings were conducted in imitation to Ukrainian, with the use of orange symbols. The dynamics and specifics of the process come under notice – blocking of Leningradskoye highway happened at the time when the meeting near the city administration’s building produced no effect. And only a large jamming on Leningradskoye highway forced to draw attention to those gathered at the meeting. Quite clear that the situation became most acute just in the Moscow region – the possibility of free transportation of pensioners in Khimki remains only in the city transport, but almost all existing transport routes in Khimki district are suburban. So, most of pensioners have no travel privilege. Besides, the displeasure of the protesters caused by the fact that the right for free traveling in Moscow had only Moscow pensions, and other pensioners who pretended to passage in Moscow metro had to undergo the humiliating procedure of checking registration of passports. According to Finance Minister Kudrin, about 1% of the country’s inhabitants (1.5 million)) took to the streets.

It is indicative that in most cases the protest actions led to positive results for those who took to the streets. In Udmurtia, for example, where the crowd numbering 5 thousand participants carried out on January 12 an assault of the Government House, the working group of the republic government had been formed of the protesters, who decided to retain free traveling on public transport for pensioners. By the decision of the Moscow government the Moscow region inhabitants will also have the right to free passes in the Moscow metro. After blocking for 4 hours, on January 15 and 16, in St.-Petersburg the crossing of the two central streets of the city – Sadovaya and Nevsky Prospect - Valentina Matviyenko stated that she will bring to the notice of Putin and the government an opinion of people about the necessity of cancellation of the bill on monetization of benefits, and also will supply the pensioners with travel cards. In Kemerovo region A. Tuleev promised to work with entrepreneurs so that to enter such a new budget line as “non-repayable transfers”.

An interesting characteristic feature of protests, which cannot be concealed even by federal TV channels, is a radical anti-president agenda. The protesters blamed in their misfortunes not the government, certainly not its left wing (despite the communists’ efforts to narrow the problem to “Kudrin and Gref”), not governors (who, it is true, might well, but did not mitigate the outcome of monetization, probably, because of cancellation of electivity and losing incentives for dialogue with the electorate), but, personally, V. Putin. Another interesting detail is a rather a good-natured behavior of militia, though, as is known, during the last few years the normal practice became arrests, beating the

participants of peaceful unauthorized mass actions. And this is may well be explained – as pensioners, the militiamen themselves lost benefits.

Because of this situation, the country's leadership had to, first, repent "some omissions" (A. Kudrin and M. Zurabov did so), and, second, offer certain measures to reduce social tension. As basic requirements of the protesters concern traveling on the public transport, the RF Government offered to governors a pattern of joint financing of the travel privilege. Its essence is in the following. Regions are offered to conclude an agreement with the center, according to which, a territory shall introduce on its territory a social travel card for federal and regional beneficiaries. This card should not be more expensive than the size of most low for this region cash compensation. Having sent to the Center an information of how many beneficiaries bought out their travel cards following the results of the quarter, regional administrations may count on 30% compensation of their price from the federal budget. Those regions, which preserved free travel in kind, cannot pretend to receive compensation. Though, much is left unclear concerning pensioners, lots of which, according to the new law, do not fall within either of categories.

No doubt, one should not overestimate the events that happened. In the present-day situation the RF Government is capable, at least partly, again to grant benefits or increase the size of compensations, and after January 20-21 the protest actions receded. Though there is another information. According to the data of the Federal Agency on Tariffs, in 20 regions the services of the housing and utilities infrastructure went up by 40-70%, and, for example in Tatarstan – more than two times (which is concerned with the necessity of introducing 100% paying the services of the housing and utilities infrastructure, which in many regions stood over to the bitter end). Knowing with this circumstance is still in prospect for the population. Also important is another thing. In January 2005 there were the first anti presidential mass actions for Putin's period of being in office. The fact that they were not organized by a certain political force only means big potential of protest moods.

To the point, KPRF and Yabloko tried to join the protesters' actions, but wee not a success. Contrary to their former position, SPS voiced severe criticism concerning not the principle of benefits' monetization, but its haste and that the whole situation had not been worked out properly in advance. But most striking public effect produced the four deputies, members of the Motherland faction, headed by its leader D. Rogozin, who went on hunger-strike in the State Duma for political reasons and demanded cancellation a package of draft laws on benefits' monetization and resignation of the government.

Violent protests against the benefits' monetization had also some ulterior motives. This month both V. Putin and S. Ivanov disproved the information on overall draft of students to the army. Though, Putin's considerations on higher education institutions with "senior divisions", all the same distress for the fate of students as, now, a draft deferment is granted to students regardless of the availability of a senior division in the higher education establishment.

An interesting development received business with the sale of the so-called Yuganskneftegaz. It became evident that the established by the "well-known" to V. Putin powermen the LLC Baikal Finance Group received money for a huge pledge (USD \$1.7 bn) from Surgutneftegas, which, in turn, obtained a credit in Sberbank of the RF. Soon after, Baikal Finance Group was sold to Rosneft. Allegedly Rosneft on 31.12.2004, on the last working day paid the remaining sum. But, the source of financing is not clear for the transaction. It is not improbable that is "the same" Sberbank. However, most likely, it will become clear basing on reporting that no real movement of funds did occur – otherwise it would be difficult to explain to Gazprom shareholders the loss of the bail stood by it. Therefore, the situation with Yuganskneftegaz demonstrated that the power not only departs from the right In the broad sense of the word, but, on the whole – from "lex scripta". It is obvious that there is no other way for writing-off the company "debts". So, no wonder that broadcasting announce about the sale of part of Yuganskneftegaz shares either to Chinese or to Indian government company was not a success. At the same time, it becomes more and more difficult to introduce the managers of Yuganskneftegaz (chairman of the board of Rosneft, I. Sechin) into Gazprom system, controlled by competing St.-Petersburg group of A Miller.

The sale of Yuganskneftegaz led to an activation of M. Khodorkovsky. It was announced that now his shares of the management company Group Menatep are passed into the ownership of his historical assistant and team-mate L. Nevzlin, departed to Israel, who, in turn, promised to litigate with the Russian Government. Though, nothing new had been demonstrated as yet, which makes an impression

that Khodorkovsky again count on some trade-off alternative with Kremlin, though it is clear that there are less chances now for this than before. The indicator of such a strange position is denial of massive setting up claims to the structures relating to the history of bashing YUKOS, in particular, to R. Abramovich, that for more than a year hold USD \$3 bn, transferred under the project of merger of YUKOS into Sibneft.

At the session of the Competition Council under the RF Government a number of business representatives – A. Mordashev, A. Shokhin and, especially, A. Chubais criticized hard the investment climate in Russia and warned of possible negative implications of “tax terrorism”, touching more and more companies. Their initiatives were supported by A. Zhukov and A. Kudrin, who proposed to specify the authorities of tax services, What is meant here is possibility to “suspend” checking of (in fact, allowing to check a company the year-round, with intervals for 1-2 days), repeated checks for the same period (formalized under the pretence of supervision over the actions of the first controllers), arbitrary fine and penalty and charging, possibility of irrefutable writing-off means of the taxpayer and suppression of any documents of the company etc. The available information allows to suppose that, it is true, in spring of 2005 an information campaign will be conducted for working out the very same “understood, light for taxpayers” rules of game, to which V. Putin called for in his Message of 2004. At the same time, the taxation bodies and courts will continue confiscation of the employers’ assets in accordance with the instructions available, and sometimes – without them (most evident targets are the subsidiaries of YUKOS, Bashneft and Volgotanker). Standardizing of law-enforcement practice in tax sphere cannot but mean reducing the authority of the executive power, including the President of Russia, so, now it is impossible.

In January a “regular” information campaign was conducted concerning “struggle against extremism”, confined to a meeting of the leaders of the leading nations of the world on the occasion of 60-year anniversary of release of concentration camp Oswiecim. On January 25, the two tens of deputies from KPRF and Motherland factions made an appeal to the Prosecutor-General’s Office requesting to set a veto on Jewish organizations, because, as the authors believe, Zionism is a misanthropical religion, which allegedly admits human sacrifice etc. Besides the traditional supporters of such views (N. Kondratenko, A. Makashov), most part of those who put a signature – the members of Motherland faction, just those who expelled from the post the leader of faction, S. Glaziev for unauthorized advancing to the position of the RF President, among them, the well-known representatives of “chekist Orthodoxy” - the former chairman of KGB of the USSR, N. Leonov, the former presenter of the television show “Russian House” A. Krutov, etc. Naturally, that letter was condemned by officials, including V. Putin. Thus, further demonstrations of anti-Semitism may be expected in the near future, on the one hand, and calls on civil society to concentrate on counteraction against this dangerous phenomena, on the other.

On January 3, 2005, A. Illarionov was relieved of his post a special representative of the RF President for negotiations with the “Big Eight”, with preservation of his post an adviser of the RF President. In the past year Illarionov publicly opposed the two principled positions (at a minimum) of the country’s – these are ratification of Kyoto Protocol and the sale of YUKOS assets, that is why his further functioning in the presidential administration looked a plain absurd. On the other hand, Illarionov’s experience and contacts made not easy a decision on his dismissal after almost the three years of working on the problems of Russia’s participation in G-8, including also that he, like not many, is well aware of all the arguments against Russia’s participation in this club, and, the more so, - planned for 2006 presidency. I. Shuvalov has been assigned a new special representative, and it looks like it will take long time for him to master this new (for him) line of activity.

S. Zhavoronkov

Budgetary and Fiscal Policy

In accordance with the preliminary results of 2004, the level of revenues of the RF federal budget has increased by 0.2 p. p. of GDP in comparison with the figures registered in the preceding month and made 20.7 per cent of GDP. The level of expenditures of the federal budget decreased by 0.4 p. p. in comparison with the figures registered last month and made 16.5 per cent of GDP in 2004. In January through November of 2004, the revenues of the RF consolidated budget made about 32.3 per cent

of GDP, while the expenditures of the RF consolidated budget over the respective period made 26.1 per cent of GDP.

In the framework of implementation of the law on the substitution of allowances with money payments, the RF Finance Ministry is planning to assign additional Rub. 8.5 billion from the federal budget as subsidies to the regions to be used for transport privileges of federal allowance recipients.

The State of the Federal Budget

In January through November of 2004, the revenues of the federal budget (cash execution) made 20.5 per cent of GDP, while expenditures made 15.2 per cent of GDP (see Table 1). Therefore, the federal budget surplus made 5.2 per cent of GDP.

Table 1

The monthly execution of the federal budget of the Russian Federation (in % of GDP¹, cash execution).

	XI'03	XII'03	I'04	II'04	III'04	IV'04	V'04	VI'04	VII'04	VIII'04	IX'04	X'04	XI'04
Revenues	1.3%	1.3%	0.9%	0.7%	1.2%	1.4%	1.3%	1.3%	1.3%	1.3%	1.2%	1.2%	1.2%
Profit tax .	2.6%	2.7%	2.2%	2.6%	2.8%	2.9%	2.9%	2.8%	2.8%	2.8%	2.7%	2.6%	2.6%
Income tax .	6.6%	6.6%	7.9%	6.6%	6.2%	6.4%	6.5%	6.3%	6.5%	6.5%	6.4%	6.4%	6.4%
Unified social tax .	1.9%	1.9%	2.3%	1.8%	1.4%	1.2%	1.1%	1.0%	0.9%	0.8%	0.8%	0.8%	0.7%
Taxes on goods and services. License and registration dues .	3.4%	3.4%	3.6%	4.2%	4.4%	4.7%	5.0%	4.9%	4.9%	5.0%	4.9%	5.0%	5.1%
VAT	1.9%	1.9%	2.4%	2.6%	2.4%	2.5%	2.5%	2.5%	2.5%	2.5%	2.5%	2.5%	2.6%
Excise taxes	2.9%	3.0%	2.3%	0.1%	0.2%	0.2%	0.1%	0.1%	1.0%	0.2%	0.2%	0.2%	0.2%
Taxes on foreign trade and foreign economic operations .	20.5%	20.7%	21.6%	18.7%	18.6%	19.3%	19.5%	19.0%	20.1%	19.1%	18.7%	18.6%	18.8%
Other taxes .	1.3%	1.3%	0.9%	0.8%	0.9%	1.0%	1.1%	1.5%	1.4%	1.5%	1.4%	1.6%	1.7%
Tax revenues .	19.3%	19.4%	20.4%	19.6%	19.7%	20.4%	20.6%	20.6%	21.6%	20.6%	20.1%	20.2%	20.5%
Non-tax revenues .	0.4%	0.5%	0.2%	0.3%	0.4%	0.4%	0.4%	0.4%	0.4%	0.4%	0.4%	0.4%	0.4%
Total revenues .	2.5%	2.7%	1.7%	2.2%	2.6%	2.9%	2.7%	2.6%	2.6%	2.5%	2.4%	2.4%	2.4%
Expenditures	0.2%	0.2%	-0.1%	0.2%	0.2%	0.3%	0.3%	0.3%	0.3%	0.3%	0.2%	0.3%	0.3%
Public administration .	0.2%	0.2%	0.1%	0.1%	0.2%	0.2%	0.2%	0.2%	0.2%	0.2%	0.2%	0.2%	0.2%
National defense .	1.7%	1.9%	1.0%	1.5%	1.7%	1.9%	1.8%	1.8%	1.8%	1.8%	1.8%	1.7%	1.8%
International activity .	0.3%	0.3%	0.1%	0.1%	0.2%	0.3%	0.3%	0.3%	0.2%	0.2%	0.2%	0.3%	0.3%
Judicial power .	0.9%	1.1%	0.2%	0.4%	0.5%	0.6%	0.6%	0.7%	0.7%	0.7%	0.7%	0.7%	0.8%
Law enforcement and safety measures .	2.1%	2.3%	1.4%	1.7%	1.9%	2.1%	2.1%	2.1%	2.1%	2.0%	2.0%	2.0%	1.7%
Fundamental scientific research and technological development promotion .	1.7%	1.7%	1.0%	2.1%	2.2%	1.7%	1.5%	1.4%	1.4%	0.3%	1.5%	1.4%	1.2%
Public services rendered to national economy, including :	6.8%	6.9%	5.2%	5.8%	5.9%	6.5%	6.4%	6.1%	6.1%	7.4%	5.8%	5.8%	6.2%
Social services .	16.7%	17.7%	10.8%	14.4%	15.8%	16.8%	16.3%	15.9%	15.8%	15.9%	15.2%	15.1%	15.2%
National debt service	2.6%	1.7%	9.6%	5.2%	3.8%	3.6%	4.3%	4.7%	5.8%	4.7%	4.9%	5.1%	5.2%
Other expenditures	-0.3%	0.5%	-8.6%	-3.1%	-1.2%	-1.3%	-2.4%	-3.1%	-3.2%	-2.9%	-3.3%	-3.3%	-3.8%
Expenditures and loans less repaid loans	-2.3%	-2.2%	-1.0%	-2.1%	-2.6%	-2.3%	-1.9%	-1.6%	-1.7%	-1.8%	-1.6%	-1.5%	-1.4%
Surplus	-2.6%	-1.7%	-9.6%	-5.2%	-3.8%	-3.6%	-4.3%	-4.7%	-4.9%	-4.7%	-4.9%	-4.8%	-5.2%

в % ВВП; ** ECH включен в налоговые доходы

As compared with the figures registered in January through November of 2003, the budget revenues increased by 1.2 p. p. of GDP in the respective period of 2004, while expenditures decreased by 1.5 p. p. of GDP and budget surplus respectively increased by 2.6 p. p. of GDP. As before, VAT accounted for the major share of federal tax revenues – 34.1 per cent of the total tax revenues, what was by 1.8 p. p. above the level observed in the respective period of 2003. At the same time, in 2004 the share of taxes on foreign trade in the total amount of tax generated revenues of the federal budget significantly increased in comparison with the figures registered in the preceding year (from 16.5 per cent observed in the first 11 months of 2003 to 26.9 per cent registered in the respective period of 2004).

According to preliminary estimates, the cash execution of federal budget revenues made 20.7 per cent of GDP in 2004, what was by 1.3 p. p of GDP above the level of revenues observed in the respective period of the preceding year. At the same time, the cash execution of expenditures made 16.5 per

¹ Because of the estimated data on GDP, the indices may be subject to revision.

cent of GDP (17.7 per cent of GDP in 2003); therefore, this year, according to preliminary data, the surplus of the federal budget made 4.2 per cent of GDP.

According to the preliminary estimates of the Finance Ministry, in terms of fulfilled funding² the expenditures of the federal budget in 2004 made 16.5 per cent of GDP (see Table 2), while in 2003 this indicator was at 17.8 per cent of GDP. In 2004, the amount of revenues of the federal budget increased by 1.2 p. p. of GDP in comparison with the figures registered in 2003 and made 20.7 per cent of GDP. Therefore, the surplus of the federal budget in terms of fulfilled funding in 2004 increased by 2.5 p. p. in comparison with the figures registered in 2003 and made 4.1 per cent of GDP.

Table 2

**The monthly execution of the federal budget of the Russian Federation
(in % GDP, fulfilled funding)**

	XII'03	I'04	II'04	III'04	IV'04	V'04	VI'04	VII'04	VIII'04	IX'04	X'04	XI'04	XII'04
Total revenues	19.5%	20.4%	19.6%	19.7%	20.4%	20.6%	20.6%	20.7%	20.6%	20.1%	20.2%	20.5%	20.7%
Public administration	0.5%	0.5%	0.7%	0.6%	0.6%	0.6%	0.5%	0.6%	0.5%	0.5%	0.5%	0.5%	0.5%
Judicial power	2.7%	2.7%	3.9%	2.9%	3.7%	3.2%	2.8%	3.0%	2.8%	2.6%	2.9%	2.8%	2.6%
International activity	0.2%	0.0%	0.2%	0.2%	0.3%	0.3%	0.2%	0.3%	0.4%	0.4%	0.3%	0.5%	0.5%
National defense	0.2%	0.2%	0.2%	0.2%	0.2%	0.2%	0.2%	0.2%	0.2%	0.2%	0.2%	0.2%	0.2%
Law enforcement and safety measures	1.9%	2.1%	2.4%	2.3%	2.4%	2.3%	2.1%	2.1%	2.1%	2.0%	2.0%	2.1%	1.9%
Fundamental scientific research and technological development promotion	0.3%	0.2%	0.3%	0.3%	0.4%	0.3%	0.3%	0.3%	0.3%	0.2%	0.3%	0.3%	0.3%
Public services rendered to national economy	1.1%	0.5%	0.7%	0.8%	0.9%	0.9%	0.8%	0.8%	0.6%	0.7%	0.9%	0.9%	1.0%
Social services	2.3%	2.4%	2.5%	2.4%	3.0%	2.9%	2.5%	2.5%	2.4%	2.2%	2.2%	2.3%	2.2%
National debt service	1.7%	1.0%	2.1%	2.2%	1.7%	1.5%	1.4%	1.3%	1.5%	1.5%	1.4%	1.3%	1.2%
Other expenditures	7.0%	5.6%	6.6%	6.1%	6.6%	6.6%	6.2%	6.3%	6.3%	5.9%	5.9%	6.0%	6.1%
Total expenditures	17.8%	15.2%	19.7%	18.0%	19.7%	18.8%	17.1%	17.4%	17.1%	16.2%	16.5%	16.9%	16.5%
Budgetary surplus (+) / deficit (-)	1.6%	5.2%	0.0%	1.7%	0.7%	1.8%	3.5%	3.3%	3.4%	4.0%	3.7%	3.6%	4.1%

According to the estimates of the Tax Ministry, in December of 2004 the tax revenues of the federal budget made about Rub. 149.58 billion (without the single social tax). In real terms the revenues made 289.5 per cent of the level registered in January of 1999, while the respective indicator was at 247.9 per cent in December of 2003 and 250.2 per cent in December of 2002 (see Table 3).

Table 3

**Actual tax revenues to the federal budget, according to the data of the MTC
(in % of the data for January of 1999)³.**

2002*											
I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII
218,7%	187,1%	234,8%	277,8%	239,6%	218,0%	284,4%	246,5%	254,8%	299,7%	241,0%	250,2%
2003*											
I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII
230,0%	229,2%	265,5%	280,4%	233,2%	240,0%	260,4%	242,6%	248,7%	265,6%	231,0%	247,9%
2004*											
I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII
266,5%	204,4%	238,0%	261,4%	241,0%	243,6%	288,9%	246,0%	288,4%	314,7%	220,2%	289,5%

* Без учета ECH.

The revenues of the consolidated budget in January through November of 2004 made 32.3 per cent of GDP, including tax revenues (without SST) at 26.9 per cent of GDP (see Table 4). The expenditures of the consolidated budget decreased by 1.8 p. p. of GDP in comparison with the figures registered in January through November of 2003 and made 26.1 per cent of GDP. As on December 1, 2004, the surplus of the consolidated budget made 6.2 per cent of GDP, what is by 3.4 p. p. of GDP above the level observed in the respective period of 2003.

² The execution of the budget in terms of fulfilled (actual) financing is equal to the sum of the funds transferred to managers of budget funds, while the cash execution of the budget is equal to the sum of funds spent by managers of funds (i.e. without account of funds remained on their accounts).

³ It was decided to choose January of 1999 as the benchmark in order to render the comparison more reliable. January of 1999 is not a remarkable date in terms of tax revenues.

Table 4

Execution of the RF consolidated budget (in % of GDP)

2002												
	I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII
Taxes*	28,7%	23,6%	24,3%	26,5%	26,6%	25,9%	26,4%	25,9%	25,2%	25,4%	25,4%	25,5%
Revenues	32,9%	31,3%	31,4%	33,6%	33,6%	32,7%	33,3%	32,5%	31,7%	32,0%	32,1%	32,1%
Expenditures	18,3%	23,7%	26,0%	28,4%	28,4%	28,8%	29,1%	28,9%	28,4%	29,3%	29,7%	31,1%
Budgetary deficit/surplus	14,6%	7,7%	5,4%	5,3%	5,2%	3,8%	4,2%	3,7%	3,3%	2,7%	2,4%	1,0%
2003												
	I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII
Taxes*	25,6%	24,4%	25,6%	27,4%	27,1%	26,0%	26,1%	25,7%	5,0%	5,0%	5,1%	25,2%
Revenues	32,0%	30,3%	31,5%	33,4%	33,6%	32,2%	32,2%	31,6%	0,9%	0,8%	0,7%	31,1%
Expenditures	20,7%	25,3%	27,7%	28,8%	28,8%	28,6%	28,7%	28,5%	8,2%	7,8%	7,9%	29,7%
Budgetary deficit/surplus	11,3%	5,0%	3,8%	4,5%	4,7%	3,5%	3,6%	3,1%	7,7%	5,0%	7,8%	1,4%
2004												
	I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII
Taxes*	6,1%		21,8%	27,4%	27,4%	26,6%	27,2%	27,1%	26,4%	26,5%	26,9%	26,9%
Revenues	30,6%	28,2%	29,8%	32,9%	32,9%	32,5%	33,1%	32,9%	31,9%	32,0%	32,3%	32,3%
Expenditures	18,5%	22,8%	25,4%	27,3%	26,9%	27,0%	27,0%	26,9%	26,0%	25,9%	26,1%	26,1%
Budgetary deficit/surplus	12,1%	5,4%	4,4%	5,6%	6,0%	5,5%	6,1%	6,0%	5,9%	6,1%	6,2%	6,2%

* Без учета ЕСН

Main Developments in the Public Sector

The RF Finance Ministry is planning to submit to the RF Government its proposals concerning the reduction of the VAT rate from present 18 per cent to 16 per cent. The Finance Ministry plans also include the switching to accrual basis, abolishment of the preferential 10 per cent rate of the tax, improvements related to the return of VAT payments to exporters and compensation of VAT paid in the course of capital transactions. It should be noted that the reduction of the base VAT rate from 20 per cent to 18 per cent in 2004 did not result in a significant decline in the revenues of the budgetary system generated by the Value Added Tax. Thus, in the first 11 months of 2004, VAT generated revenues made 6.4 per cent of GDP and 6.6 per cent of GDP in the respective period of 2003, while the expected reduction of VAT revenues should make more than 0.6 per cent of GDP.

On January 1, 2005, there were enacted the amendments to article 26 of the RF Tax Code "Mineral extraction tax." In accordance to the amendments, the MET rate was increased from Rub. 347 per metric ton to Rub. 419 per metric ton. At the same time, the oil price threshold not subject to the MET was increased from US \$ 8 to US \$ 9. Besides, the Ruble exchange rate used in the course of calculation of MET was changed from Rub. 31.5 per US \$ to Rub. 29 per US \$, what took into account the trend towards the Ruble appreciation. According to the estimates presented by the RF Government, due to the appreciation of the national currency the fixed Ruble / US \$ exchange rate used in the MET formula resulted in additional revenues of the oil industry at US \$ 1 billion.

Since mid-March of 2004, there has been introduced the new scale of export duties on oil, which increased withdrawals from the oil sector at higher levels of oil prices. At the same time, the RF Finance Ministry plans to reduce the export duty on oil from US \$ 101 per metric ton introduced on December 1, 2004, to US \$ 83 per metric ton since February 1, 2005.

On January 1 of 2005, there was enacted federal law No. 122 envisaging the supplement of allowances with cash payments. In particular, the law envisages that such privileges as free conveyance by city, suburban, and intercity transport, allowances related to the payment for public utilities and telephone, etc. should be supplemented with cash subsidies. The aggregate amount of annual expenditures of the federal budget envisaged by this law makes about Rub. 171.2 billion. The rest of the financing should be made from the budgets of RF subjects; the RF subjects should have the right to set forth the measures of social support at their discretion. However, after an analysis of the implementation of this law in the first month of the year, the RF Finance Ministry is planning to assign additional Rub. 8.5 billion from the federal budget as subsidies to the regions to be used for transport privileges of federal allowance recipients.

S. S. Ponomarenko

Monetary Policy

In 2004, the rates of inflation in the RF exceeded the upper limit of the official forecast (10 per cent) and made 11.7 per cent. In 2004, there was observed a more moderate increase in the monetary base as compared with the figures registered in 2003. However, in the 4th quarter it grew at a faster rate than in the respective quarter of the last year. By the end of 2004, the amount of the national gold and foreign exchange reserves exceeded US \$ 125 billion. In 2004, there were made payments relating to the external debt amounting to RUR 574 billion.

In December of 2004, the increase in the consumer price index made 1.1 per cent (1.1 per cent in December of 2003), and 11.7 per cent since the beginning of the year (12 per cent in January through December of the preceding year, see *Fig. 1*). The most significant rise was observed in the group of food products (1.7 per cent as compared with 1.5 per cent registered in the respective month of 2003). The increment as compared with the figures observed in December of 2003 made 12.3 per cent, what is significantly above the increase observed in the respective period of the preceding year (10.2 per cent). In the first seven months of this year, there were registered more moderate rates of growth in consumer prices of food products as compared with the figures observed in the respective period of the last years. However, after a relatively insignificant seasonal decline in prices of fruits and vegetables observed in August and September, the CPI characterizing this group of products began to exceed the value of this indicator registered over the preceding years. As concerns the period from January till December of 2004, over this time the pasta products, meat, poultry, fish, sea products, and sugar have increased in prices more significantly than in the respective period of the preceding year. Besides, in 2004 the prices of fruits and vegetables grew by 3.3 per cent, while in 2003 the respective prices went down by 4.2 per cent.

In 2004, the most significant rise in prices was observed in the group of paid consumer services (by 17.7 per cent as compared with 22.3 per cent registered in the preceding year). The increase in December made 1 per cent (as compared with 0.9 per cent observed in the respective month of 2003). It should be noted that in January through October of 2004 the increase in the consumer prices of paid services to the population was below the indicators registered in the last two years; however, in December the prices of paid services grew more significantly than in 2003, what is an alarming trend. Over the last month the services of passenger transport demonstrated the most considerable growth (+ 3.8 per cent), while the most significant rise of prices in 2004 was observed with respect to HPU services (+ 23.5 per cent).

This year, the prices of nonfood goods also grew at lower rates as compared with the indicators registered last year. Thus, in December the increase made 0.4 per cent (as compared with 0.6 per cent registered in December of 2003), while in the 12 months of this year the prices of nonfood products grew by 7.4 per cent (by 9.2 per cent in the respective period of the preceding year). In December, the prices of gasoline at last decreased by 1.7 per cent. On the whole, in 2004 the respective prices grew by 31.3 per cent what was practically twice above the indicators registered in 2003 (+ 16.8 per cent).

In November, the growth in the Base Consumer Price Index (BCPI)⁴ made 1 per cent. Therefore, since the beginning of the year the increase in the BCPI made 10.5 per cent (the total increase in the BCPI in 2003 made 11.2 per cent).

According to preliminary estimates, in January of 2005 inflation in the RF will make about 2.5 per cent.

⁴ The Base Consumer Price Index (BCPI) is an indicator reflecting the inflation rate on the consumer market. It leaves out of account the seasonal (prices of fruits and vegetables) and administrative (tariffs on regulated types of services etc.) factors, calculated by the Statistics Service of the RF.

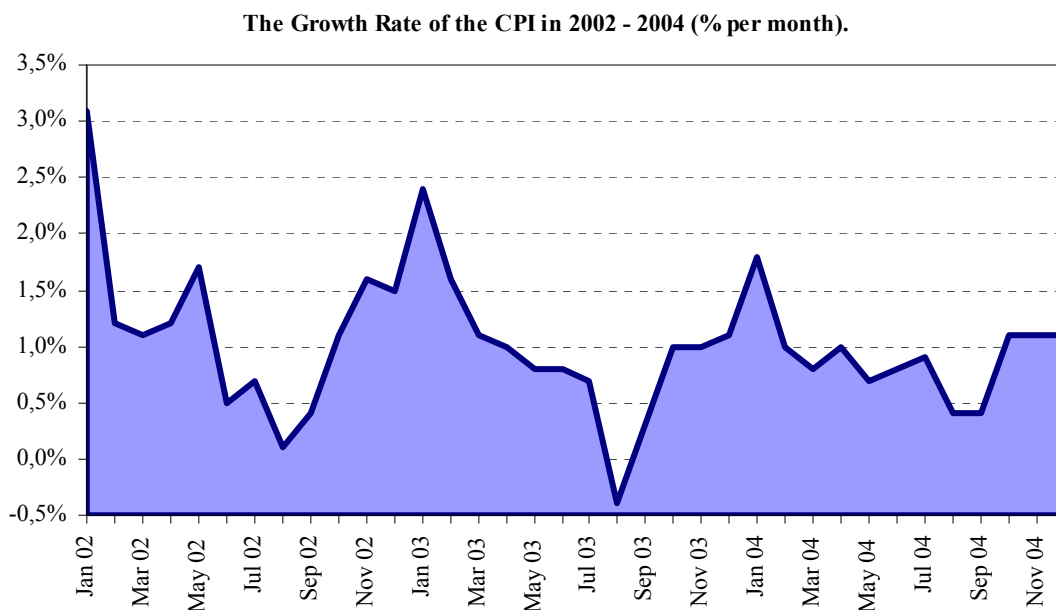


Figure 1

In December of this year, the monetary base of the Russian Federation (in the broad definition⁵) increased by RUR 303 billion and made RUR 2.39 trillion. As on December 1, 2004, the amount of the monetary base of the Russian Federation (in the broad definition) was at RUR 2.08 trillion. Therefore, in December the growth in the monetary base made 14.5 per cent. Therefore, in 2004 the monetary base increased by 24.7 per cent. In the respective period of the preceding year the growth made 55.3 per cent. Below, the dynamics of the monetary base will be analyzed across its components.

The amount of cash in circulation (as adjusted for cash balances of crediting organizations) made RUR 1.67 trillion as on January 1 (+ 17.8 per cent as compared with the level registered on December 1 of this year). On the same date, the amount of accounts of crediting organizations with the Central Bank of Russia made RUR 486.4 billion (+ 74.4 per cent), the amount of mandatory reserves was at RUR 121.7 billion (+ 2.3 per cent), the amount of banks' deposits in the Bank of Russia made RUR 91.4 billion (- 52.6 per cent), the amount of the Bank of Russia bonds held by crediting organizations made RUR 9.7 billion (- 63.8 per cent), the amount of the Central Bank's liabilities related to the reverse repurchase of securities was at RUR 2.5 billion (-93.8 per cent), and the funds transferred to the Bank of Russia as the reserves related to foreign exchange operations made RUR 4.7 billion (- 37.3 per cent).

In December of 2004, there was registered a simultaneous growth in the amount of cash in circulation (+ 17.8 per cent) and mandatory reserves (+ 2.3 per cent), what resulted in an increase in the narrowly defined monetary based (cash plus mandatory reserves) by 16.6 per cent (see *Fig. 2*). This growth was determined by a significant amounts of purchase of foreign exchange on the part of the Bank of Russia: in December the gold and foreign exchange reserves of the Bank of Russia grew by 6.1 per cent and made US \$ 124.5 billion. In the first weeks of January, the amount of gold and foreign exchange reserves declined to the level of US \$ 120.1 billion (- 3.5 per cent).

On the whole, in 2004 there was observed a more moderate growth in the monetary base than in 2003. However, in the 4th quarter the monetary base increased at a more rapid rate than a year ago. It should be noted that until September the gold and foreign exchange reserves grew at a slower rate than in 2003. On the other hand, after the summer reduction of the requirements concerning the mandatory reserves, the amount of reserves of commercial banks has significantly declined; however, the impact

⁵ The RF Monetary Base in broad definition includes cash in circulation, the Ruble denominated funds in mandatory reserves relating to the borrowings of credit organizations, and funds in credit organizations' correspondent accounts and commercial banks' deposits with the Bank of Russia.

of this factor ceased in the autumn. It should be also noted that in 2004 there was continued the policy of active sterilization of the forex denominated export proceeds via the Stabilization Fund, the amount of which made more than RUR 500 billion by the end of 2004.

Changes in the Monetary Base and in the Gold and Foreign Currency Reserves in 2003 - 2004.

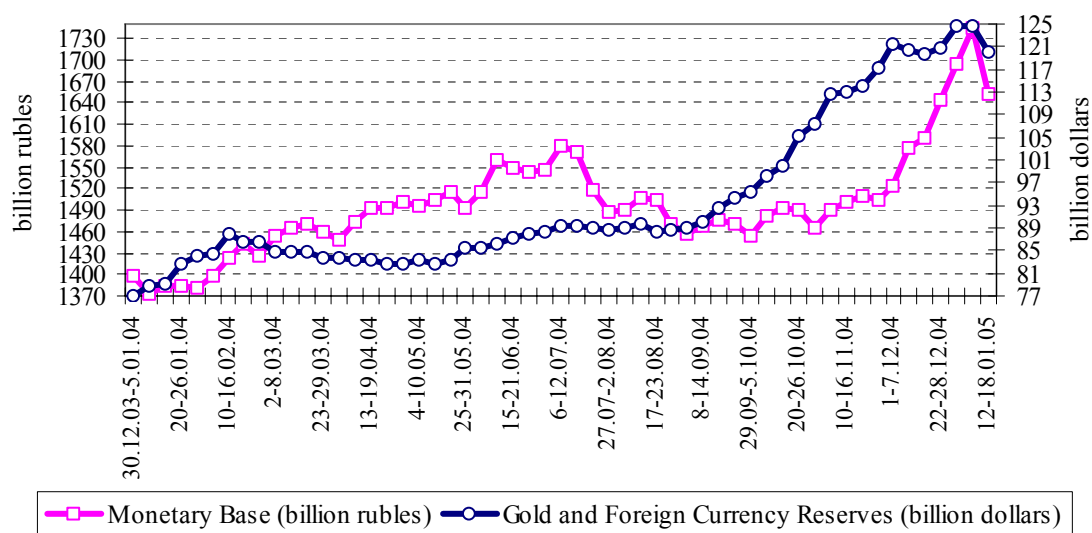


Figure 2

According to the preliminary estimates presented by the RF Finance Ministry, in January through November of 2004 the payments pertaining to the RF foreign debt amounted to RUR 574 billion. The payments associated with the servicing of the foreign debt made RUR 164.7 billion, while the repayment of the principal debt amounted to RUR 409.3 billion. At the same time, new borrowings were registered at RUR 41.3 billion.

According to information provided by the RF Finance Ministry, in 2005 the Russian Federation may make anticipatory repayment of US \$ 10 billion of the external debt in the case this step is approved by the creditor countries and the Government.

P. Trounin

Financial Markets⁶

In January, the situation on the Russian financial market remained relatively calm. Forex denominated bonds demonstrated a slight growth, while the market of Ruble denominated debt was in the phase of decline in quotations, what was primarily determined by the US \$ appreciation with respect to the Ruble on the forex market and growing inflationary expectations in the Russian economy. On the stock market, the activity of investors enhanced gradually and reached average indicators only by the end of the month. At this background, over the most part of the month the Russian stock indices demonstrated mixed trends due to speculative operations carried out by the market participants and grew only in the last week of January at the background of an inflow of large foreign investments to the Russian stock market.

The Market for Government Securities

By the end of January, the majority of issues of Russian Eurobonds were characterized by a growth in value. However, over the month the dynamics of prices were mixed. Thus, in the beginning of the month the Russian segment of the Eurobond market demonstrated a decline in quotations at the back-

⁶ In the course of preparation of the survey, there were used analytical materials and surveys published by the Zenith Bank, investment company ATON, MICEX, and the materials presented at web sites of Russian issuing companies.

ground of a decline in base assets. However, this trend was replaced by an adjustment, which occurred at the end of the first trade week of the month. Later, the downward trends again prevailed on the market. The factor behind these developments could be the news that the agreement between Russia and the Paris Club on the anticipatory repayment of the debt amounting to US \$ 10 billion had not been reached yet. However, the further growth of base assets (US government bonds), as well as the statements made by the FRS representatives to the effect that the authority control inflation, facilitated the recovery of quotations of Russian Eurobonds. The market was also supported by the statement issued by Lehman Brothers that the credit rankings presented by the Fitch ranking agency would be taken into account on the equal basis with the rankings published by Moody's and Standard & Poor's as concerns the inclusion of bonds in the stock indices. Therefore, Russian securities should be included in the index published by Lehman Brothers (Lehman US Credit/Aggregate), which is an indicator for US funds with aggregate assets amounting to US \$ 1.5 to 2 billion. The end of the month was marked by a certain decline in activity after a phase of a rather rapid growth, at that time the quotations of securities stabilized at the levels they reached during the month.

As on January 28, the yield to maturity of Russian Eurobonds RUS-30 was 6.50 per cent p.a.; RUS-18: 6.45 per cent p.a. Besides, on the same date the yield to maturity of the Russian Eurobonds was: Minfin bonds, 7th tranche: 5.79 per cent; Minfin bonds, 6th tranche: 4.41 per cent; Minfin bonds, 5th tranche: 5.21 per cent; RUS-07: 4.95 per cent.

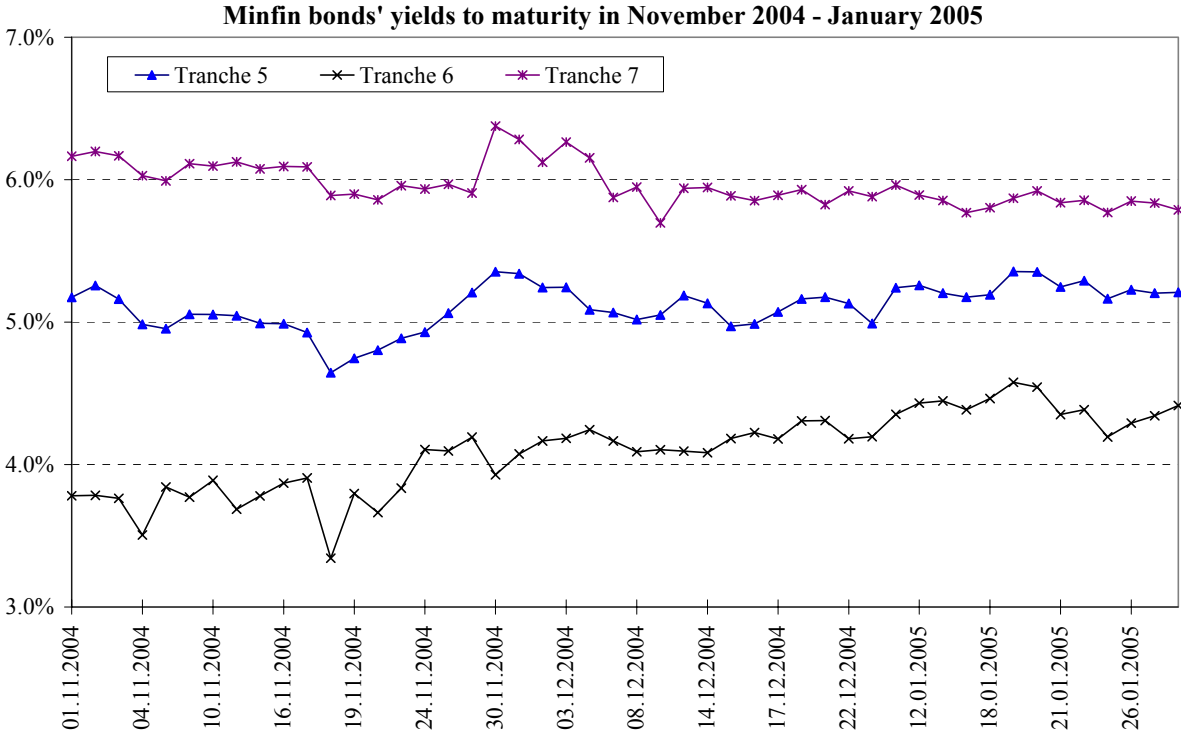


Figure 1

**Yields to maturity of the Russian eurobonds with maturity in
2030, 2018 and 2007 in November 2004 - January 2005**

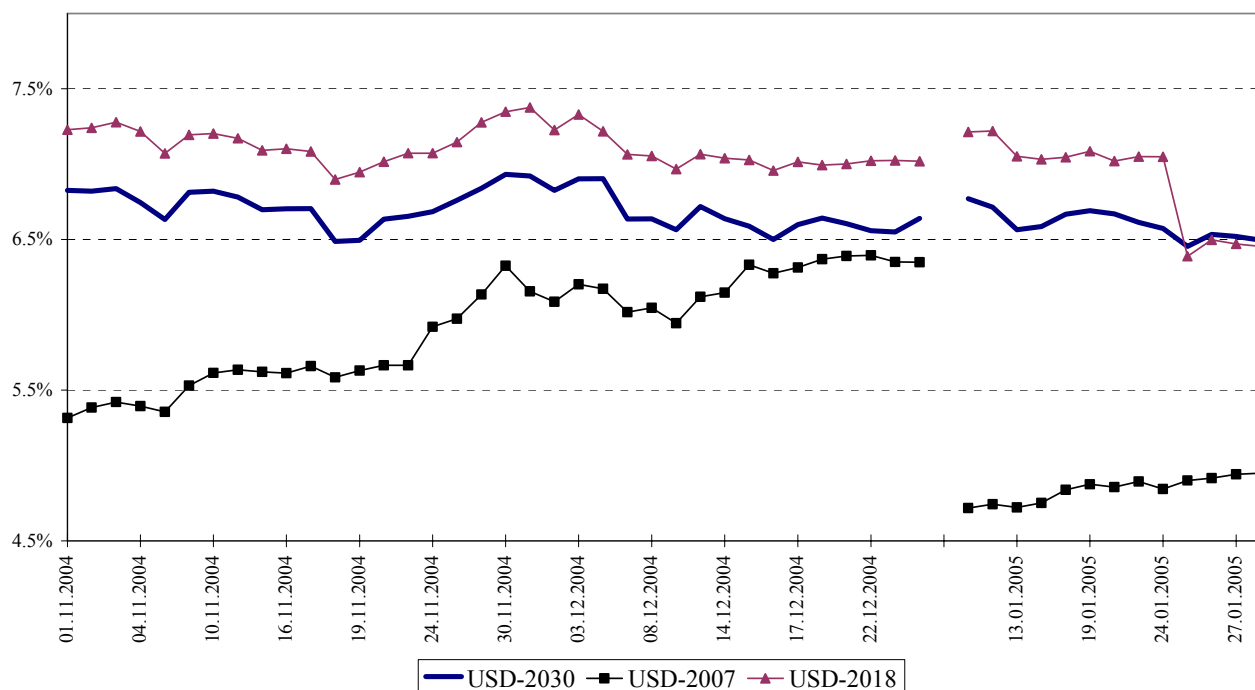


Figure 2

In January, the dynamics of the Ruble denominated government debt was primarily affected by the situation observed on the forex market. On the whole, the quotations of securities demonstrated a decline. An additional factor behind the rise in yields was, as it seems, growing inflationary expectations in the Russian economy and the probability of the rise of the base interest rate in the US.

Over the period from January 11 to 27, the aggregate turnover of the secondary GKO OFZ market made about RUR 32.2 billion, while the average daily turnover was at RUR 2.48 billion (RUR 2.54 in December). Therefore, the activity of the market was at the level observed in the preceding month. In this period, there took place only one auction for the placement of OFZ PD 25057 due for repayment in 2010. The amount of the issue made RUR 8 billion, while the actual amount of placement made RUR 2.17 billion. The weighted average yield of the placement made 7.84 per cent p. a.

As on January 27, the amount of the GKO – OFZ market made RUR 570.73 billion at par and RUR 556.06 billion at the market value. The duration of the GKO-OFZ market portfolio was 1726.01 days.

The Market for Corporate Securities

The business situation on the stock market. In January, the business situation on the Russian stock market somewhat improved in comparison with the preceding month. However, during the month the situation on the market fluctuated. In the first two trade weeks of the first month of the new year the trading demonstrated no significant fluctuations, since investors were rather inactive, what was in part determined by a small number of participants taking part in the operations after the long holidays. The major operations on the market were exceptionally of the speculative nature, what determined the dynamics of quotations. The RTS index was at about 600 points. The statement made by A. Miller to the effect that in the course of liberalization of the Gazprom stock market the quotas relating to the holdings of the company’s stocks by nonresidents might be abolished had a short term positive impact on the market of securities.

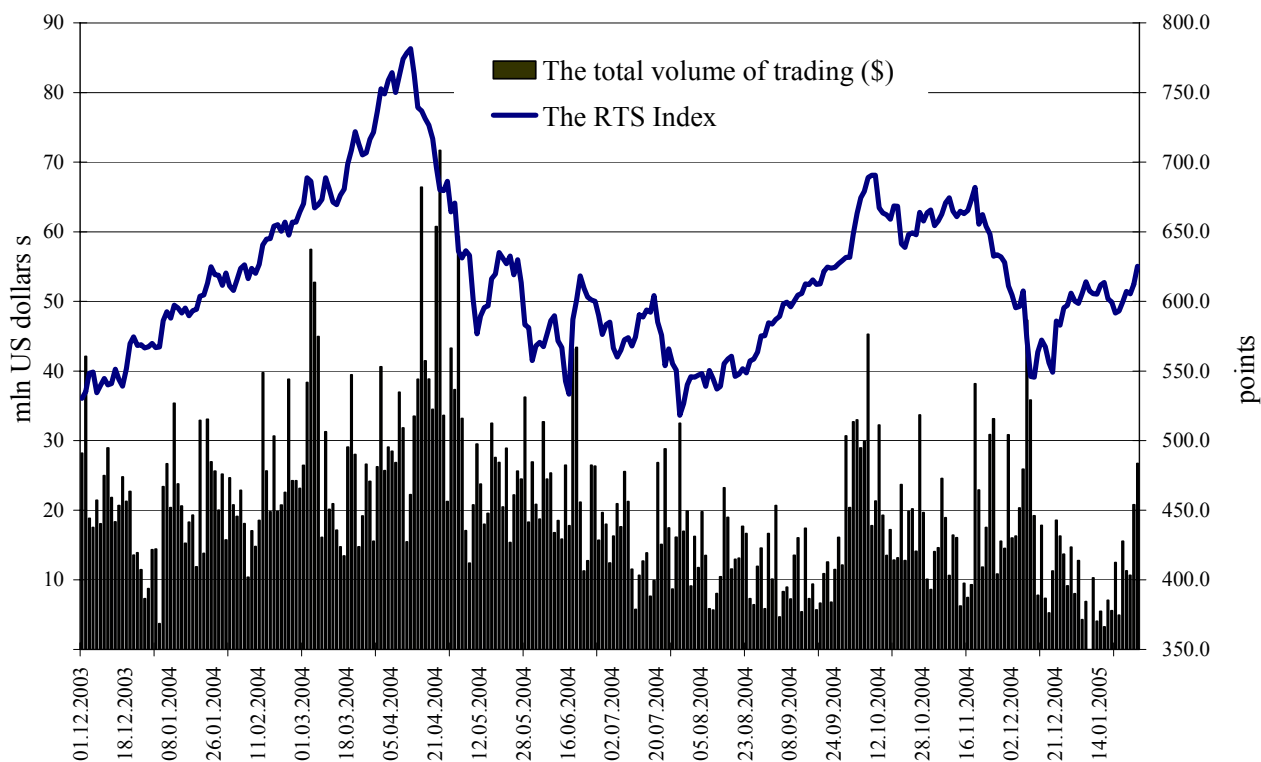


Figure 3.

At the same time, by the end of the month the activity of investors increased, what determined a growth of the market. It seems that the factor behind the growth in quotations was the fact that large foreign investors came to the market and formed a significant demand for Russian blue chips, since the domestic and foreign news remained on the whole neutral.

On the whole, in the period from January 11 till January 28, the RTS index increased by 2.89 per cent or by 17.6 points in absolute terms. Over the same period, the turnover of the RTS trading amounted to about US \$ 138.1 million, while the average daily turnover at the RTS made about US \$ 10.6 million (US \$ 18.7 million in December of 2004). Therefore, in comparison with the data collected in the preceding month, the activity of investors has significantly declined in January of 2005. The highest and the lowest volumes of trade at the RTS made US \$ 26.7 million (on January 28) and US \$ 3.2 million (on January 17) as compared with US \$ 47.3 million and US \$ 4.3 million respectively in December.

Over the last month (from December 11 till January 28), the majority of “blue chips” demonstrated an increase in prices. The leaders in terms of the upward movement of prices were the shares in Norilsk Nickel, which gained 8.43 per cent in January. The Norilsk Nickel stocks were followed by the shares in Tatneft (+ 8.01 per cent), RAO UES of Russia (+ 3.25 per cent), NK LUKoil (2.36 per cent), and OAO Surgutneftegaz (+ 2.05 per cent). The shares in Mosenergo and Sberbank demonstrated practically zero dynamics (the prices of these securities increased by mere 0.34 per cent and 0.1 per cent). At the same time, the shares in YUKOS, Rostelekom, and Sibneft demonstrated the negative dynamics of prices (- 19.78 per cent, -2.98 per cent, and -0.34 per cent respectively).

**Dynamics of the Russian Blue Chips
from 11 to 28 of January, 2005**

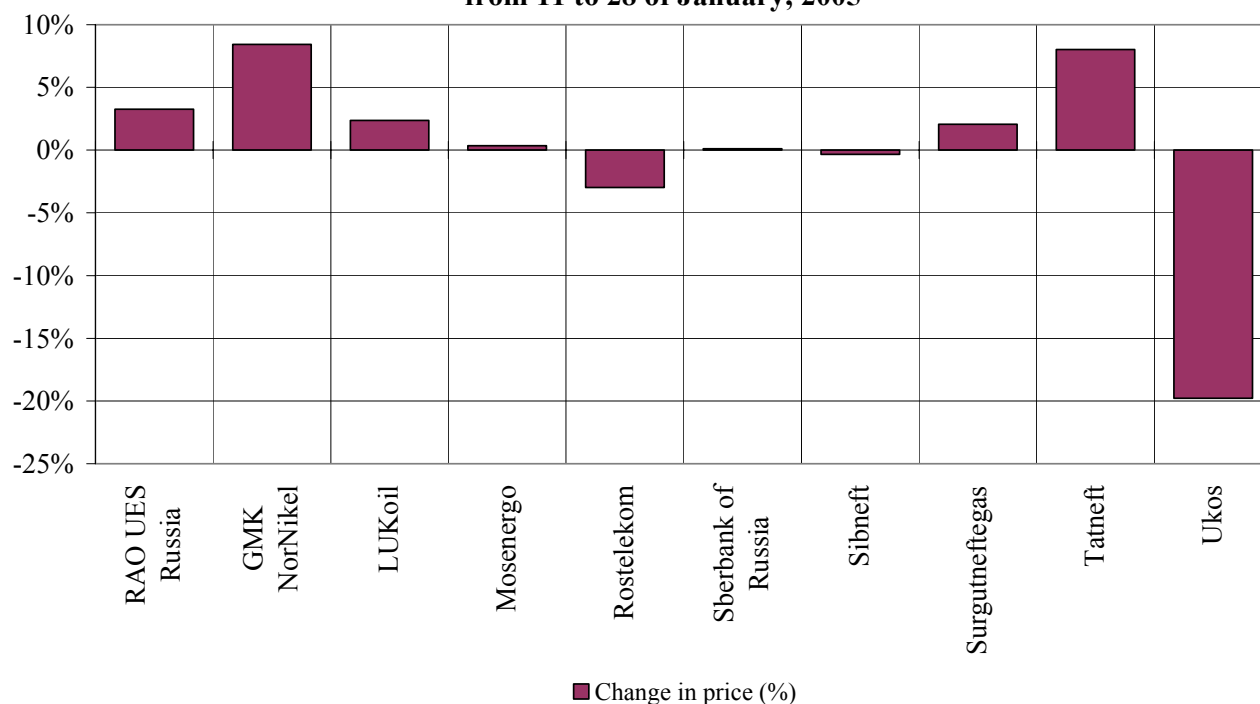


Figure 4

In January, the list of leaders in terms of the volume of turnover at the RTS⁷ looked as follows: the shares in the RAO UES of Russia (30.51 per cent), LUKoil (21.81 per cent), and Sberbank of Russia (5.49 per cent). Besides, according to the results of weekly trade, among the leaders in terms of the volume of turnover were also the securities of Norilsk Nickel and Rostelekom.

As on January 28, the top five leaders of the national stock market by capitalization looked as follows⁸: Surgutneftegaz: US \$ 26.28 billion; LUKoil: US \$ 25.35 billion; Sibneft: US \$ 14.01 billion; the RAO UES of Russia: US \$ 11.62 billion; and GMK Norilsk Nickel: US \$ 12.17 billion.

The market for fixed term contracts. In January, the activity of investors on the RTS market for fixed term contracts (FORTS) was at a rather low level in comparison with the December indicators, what may be partially explained by the long holidays. Thus, in the period from January 11 till January 28, the aggregate volume of trade in futures and options at the RTS amounted to about RUR 18.2 billion (87.6 thousand transactions; 2.4 million contracts).

Futures contracts accounted for the greatest percentage of transactions: the volume of trade in these contracts made RUR 15.97 billion (2.05 million contracts, 83.65 thousand transactions) over the period under observation. As before, options were in a much lower demand: the respective amount of trading made about RUR 2.2 billion (279.9 thousand contracts, 3.9 thousand transactions). The maximum trading volume was observed on January 28 and made RUR 1.99 billion, while the minimum trading volume (RUR 639.4 million) was registered on January 11.

Corporate bond market. In January, the quotations of the bonds issued in the corporate sector changed insignificantly. Similarly to the market of Ruble denominated public debt, the corporate sector of the debt market was affected by the news incoming from the forex market. The US \$ appreciation started immediately after the New Year holidays decreased the attractiveness of Ruble denominated debt instruments. Growing inflationary expectations caused by the publication of the official data on inflation rates registered in 2004, which significantly exceeded the target indicators, also facilitated a growth in yields. By the end of the month, the decline of the market has somewhat decelerated in spite of unfavorable dynamics of the US \$ exchange rate. It seems that the market has

⁷ On the classical stock market.

⁸ According to the RTS.

ated in spite of unfavorable dynamics of the US \$ exchange rate. It seems that the market has formed a certain immunity to the fluctuations of the exchange rate: in spite of the US \$ appreciation, the quotations of certain liquid issues increased.

From January 11 till January 27, the price index of corporate bonds traded at the MICEX⁹ decreased by only 0.03 points (by 0.03 per cent), while the index of ten most liquid corporate sector bonds decreased by 0.16 points (by 0.14 per cent). In the period from January 11 till January 27, the total turnover in the bond sector of MICEX made about RUR 5.6 billion and the average daily turnover was at the level of about RUR 430.8 million (RUR 2.42 billion in December). Therefore, the activity of participants of the market of corporate debt instruments remained at an extremely low level.

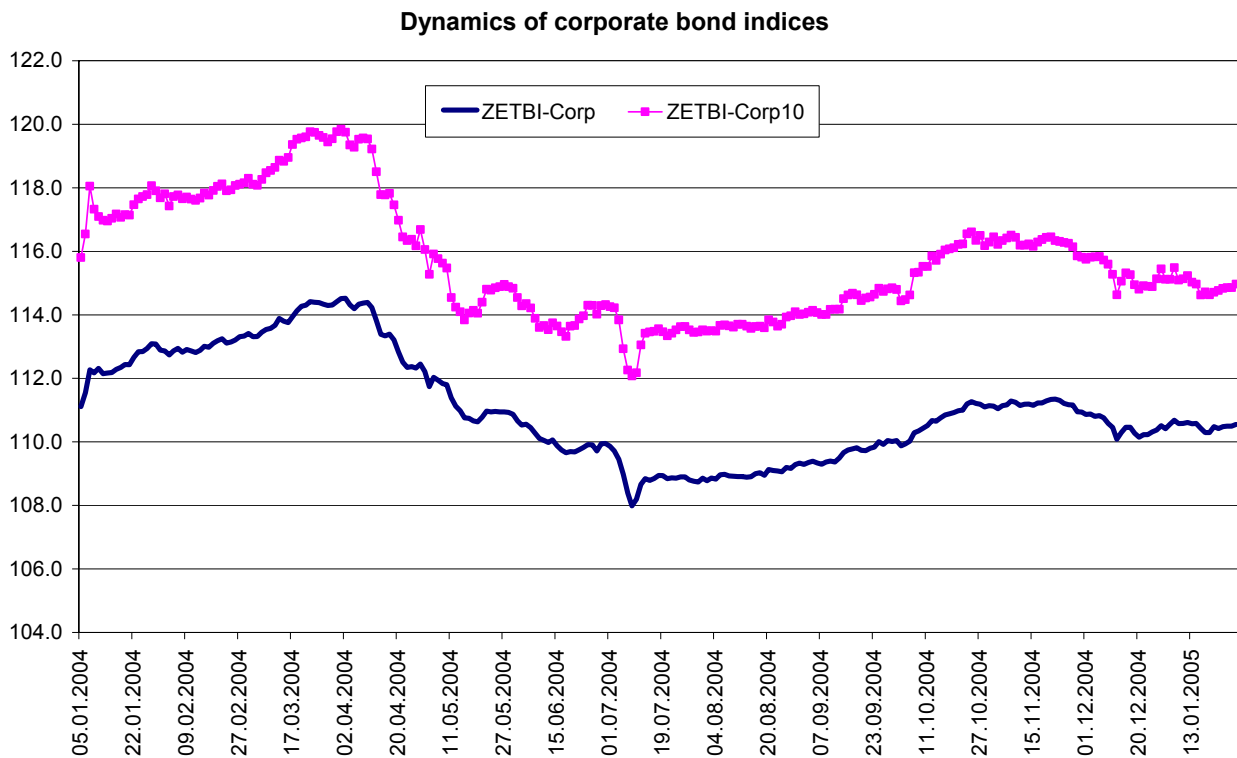


Figure 5

External factors affecting the dynamics of the Russian stock market. Immediately after the New Year holidays, the world oil market demonstrated a growth in spite of insufficiently optimistic data on the fuel reserves in the USA. Cold weather in the USA (the temperatures were by 8 to 10 centigrade below the yearly average) had a certain impact on prices. In January, the oil quotations were also supported by the comments of OPEC member countries representatives made in favor of a decrease in official quotas in relation to the observed overproduction at the OPEC summit planned for January 30.

In January, the situation on world stock markets remained unfavorable (see Table 1). The majority of stock indices of developed countries were characterized by a decline in stock indices. A somewhat better situation was observed on the markets of a number of developing countries.

As concerns the USA, in this country January became a month of decline in stock quotations; the factors behind these developments were the rise of the world oil prices, depreciation of US currency, deceleration of the rates of growth in the proceeds of US corporations. The data presented by the US FRS also had a significant impact on the market. According to the presented data, in the US economy there was observed an increase in inflationary expectations, what made more probable a further raise of interest rates. Such factors as a relatively low growth in yields of government bonds prevented a more significant decline of the market.

⁹ The indices of corporate bonds traded at the MICEX that have been used for the calculations are calculated by Zenit Bank.

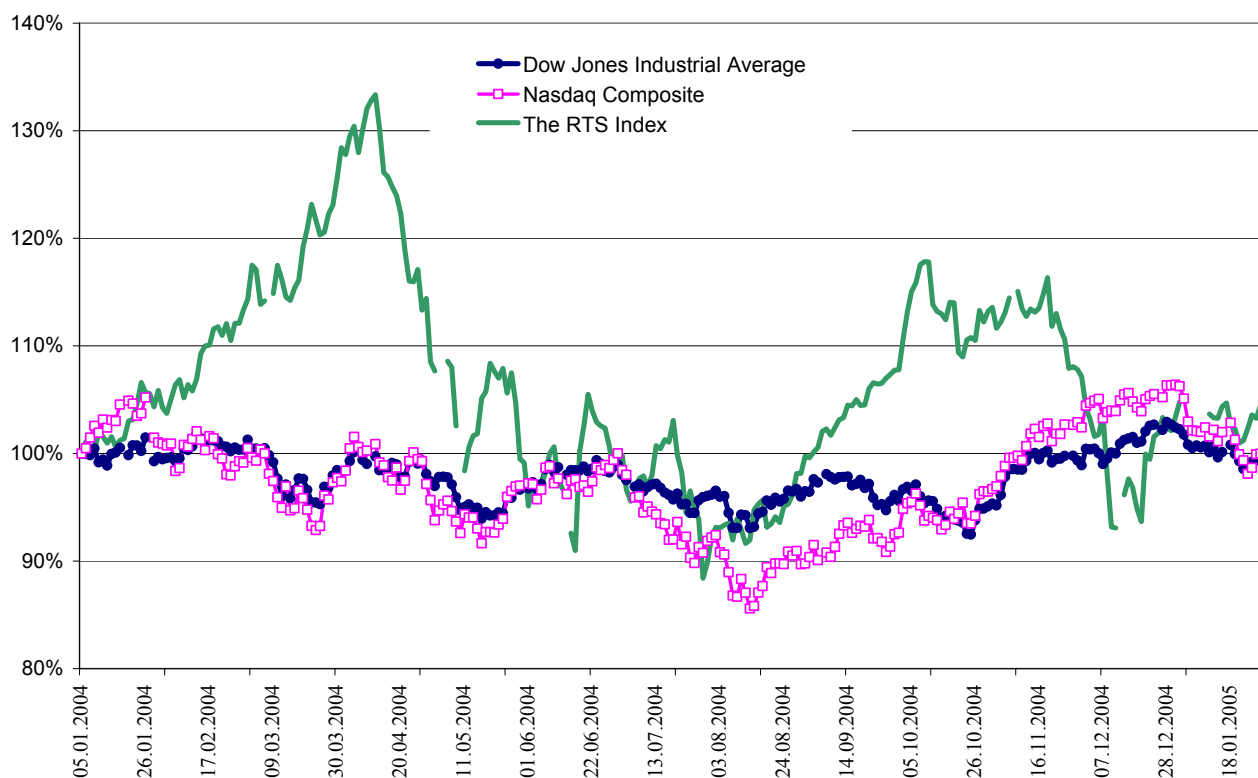


Figure 6

Corporate news.

The OAO LUKoil

On the first trading day of the month, the company published its consolidated financial statement for the first 9 months of 2004 prepared in accordance with the US GAAP.

According to the presented data, in the first 9 months of 2004, the company's net profits made US \$ 3 095 million, what was by US \$ 1 292 million above the figures registered in the respective period of the preceding year (not adjusted for the influence of the accumulated effect of changes in accounting policies and the results of the sale of the company's share in the Azeri Chirag Guneshli project amounting to US \$ 1 262 million). Besides, the amount of taxes (without the profit tax) paid to the RF budget made US \$ 2.46 billion, what was by more than 40 per cent above the level registered in the respective period of 2003. The growth in net profits was caused by the favorable price situation on the world raw materials market and better control over expenditures. At the same time, the increase in profits was checked by the growth in the tax burden, Ruble appreciation, and the continuing growth in transport costs.

The OAO Sibneft

On January 24, the company announced the changes in the number of own shares per one American Depositary Receipt (ADR). Since January 24, one ADR should be equal to 5 ordinary shares of Sibneft. Previously, one ADR was equal to 10 ordinary shares of Sibneft. Therefore, the number of issued ADR should be doubled and their owners would receive one additional receipt for each ADR held by them. This step was taken in order to increase the liquidity of Sibneft own shares traded on international markets. At present, the Sibneft first level ADR are traded at the Frankfurt and Berlin stock exchanges.

OAO GMK Norilsk Nickel

At the end of January, the company informed the public about the results of examination of the applications submitted by its shareholders in relation to the purchase by the company of its own placed shares, as it was decided by the Board of Directors of the GMK Norilsk Nickel at its meeting held on December 2, 2004. On December 3, 2004, the company announced that it was ready to purchase up to 12.5 million its shares (5.8 per cent of the authorized capital) at the price of RUR 1 680 per share, to

the total amount of RUR 21 billion. The total number of properly made applications with respect to the sale of shares submitted by the shareholders to the ZAO "National registration company" reached 372, of which 207 were submitted by legal entities and 165 by individuals. The total number of shares offered for sale by the shareholders made 59 761 360 pieces, of which 57 965 450 were offered for sale by legal entities and 1 795 910 shares were offered by individuals. Since the total number of shares offered for sale made 59 761 360 pieces and exceeded the number of 12 500 000 shares offered for purchase, the company should determine the final number of shares purchased from shareholders on the proportional basis.

Table 1

Dynamics of international stock market indices

Data as on January 28, 2005	Value	Change within the month (%) ¹⁰	Change since the beginning of the year (%)
RTS (Russia)	625.15	2.89%	2.89%
Dow Jones Industrial Average (USA)	10427.20	-2.82%	-2.82%
Nasdaq Composite (USA)	2035.83	-5.40%	-5.40%
S&P 500 (USA)	1171.36	-2.56%	-2.56%
FTSE 100 (UK)	4832.80	-0.29%	-0.29%
DAX-30 (Germany)	4201.81	-2.09%	-2.09%
CAC-40 (France)	3870.35	0.38%	0.38%
Swiss Market (Switzerland)	5750.70	-0.31%	-0.31%
Nikkei-225 (Japan)	11320.58	-1.71%	-1.71%
Bovespa (Brazil)	23968.00	-6.82%	-6.82%
IPC (Mexico)	13040.53	0.14%	0.14%
IPSA (Chile)	1799.67	0.21%	0.21%
Straits Times (Singapore)	2089.51	0.94%	0.94%
Seoul Composite (South Korea)	921.59	3.12%	3.12%
ISE National-100 (Turkey)	27074.09	6.40%	6.40%
Morgan Stanley Emerging Markets Free Index	535.71	-1.20%	-1.20%

The Foreign Exchange Market. In January, on the forex market there prevailed the trend towards the US \$ appreciation against the Ruble. Due to the long national holidays, the first trading week of 2005 was marked by the key segments of the Russian financial market reflected the developments observed over that time on the world markets. First of all, this concerned the foreign exchange market: in the beginning of the month the US \$ / Ruble exchange rate significantly increased, what was the reaction of the market to the dynamics of the US \$ / Euro exchange rate. Therefore, the trend towards the Ruble appreciation observed over the last two months of 2004 had significantly slowed down. By the end of the month, the sharp increase stopped and the exchange rate stabilized at the level of Rub. 28.0 per US \$.

In the period from January 1 till January 27, the US \$ appreciated by RUR 0.34 (by 1.21 per cent) and made RUR 28.085 per US \$. The aggregate volume of trade in the US Dollar at the SELT in the period from January 1 till January 27 made about US \$ 27.3 billion. Over this period, the average daily turnover made US \$ 2.09 billion (as compared with US \$ 2.09 registered in December), what was somewhat below the respective indicator registered in December. During the period under review, the highest volume of trade in the US Dollar, about US \$ 4.18 billion, was observed on January 21; the lowest volume, US \$ 863 million, was observed on January 17.

This January, the Ruble liquidity in the banking sector demonstrated a certain decrease in comparison with the figures registered in December of 2004: the average balances of correspondent accounts of credit organizations with the Bank of Russia made about RUR 321.4 billion as compared with RUR 371.8 billion registered in December of 2004. In spite of these developments, the amount of liquidity is still at a rather high level.

¹⁰ In relation to the levels registered on January 11.

Dynamics of the Official USD/RUR and EUR/RUR Exchange Rates in 2004-2005

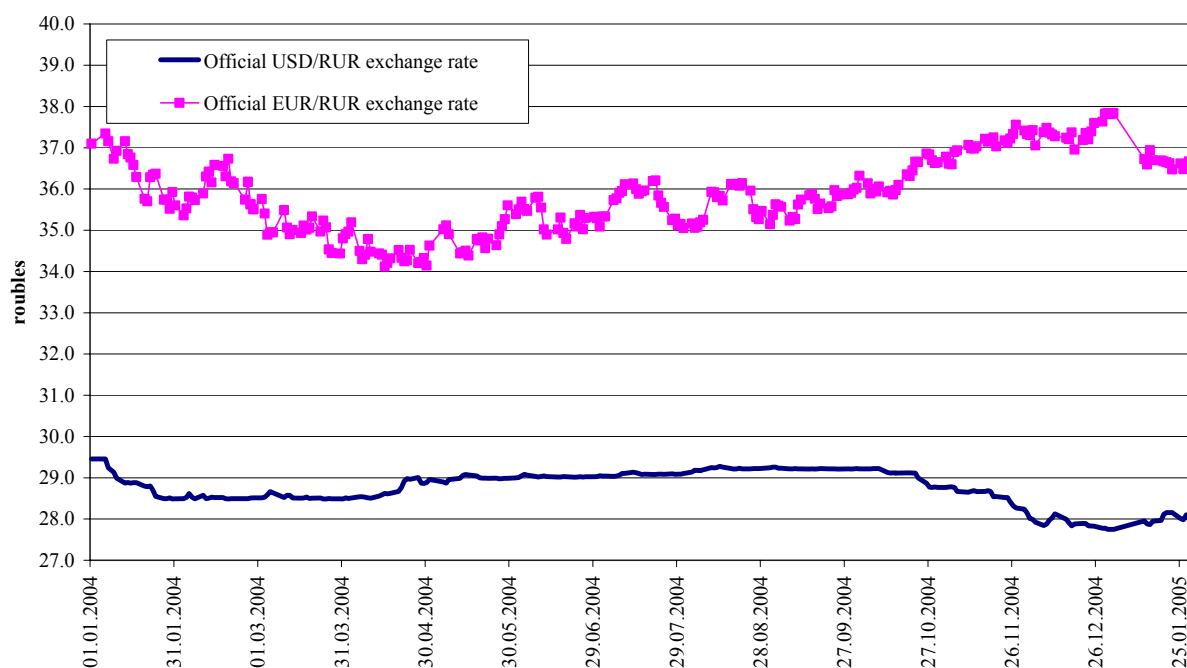


Figure 7

Dynamics of the Dollar/Euro Exchange Rate on the International Markets

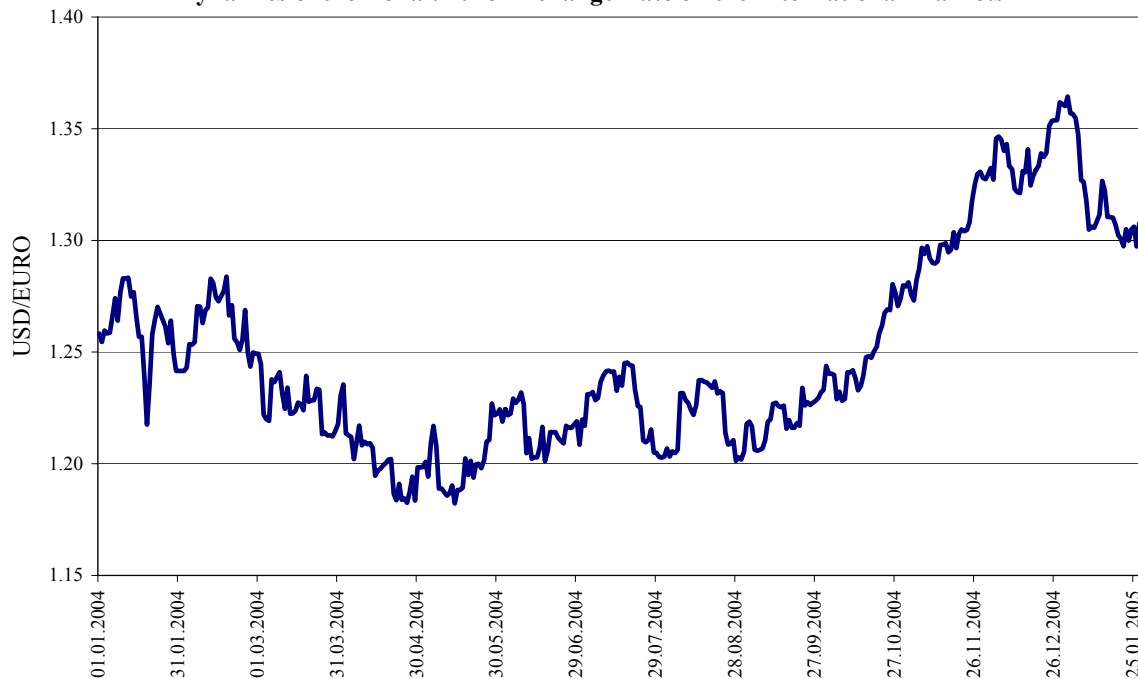


Figure 8

The US \$ continued to appreciate against the Euro on the FOREX market. The major positive factor for the US currency was the statistics of net purchases of US securities by foreign investors, which were significantly above the forecasts. Therefore, the Euro depreciated in January and remained at the level of US \$ 1.3 per Euro practically during all month.

In the period from January 1 till January 30, the exchange rate of Euro on the world market depreciated by US \$ 0.05 (by 3.86 per cent) and reached US \$ 1.3045 per Euro. At this background, there was

also observed a significant appreciation of the Ruble against the Euro. In the period from January 11 till January 27, the European currency depreciated against the Ruble by RUR 1.22 (by 3.21 per cent) from RUR 37.841 per Euro to RUR 36.625 per Euro. The aggregate turnover of trade at the SELT amounted to Euro 155.9 million in the period from January 11 till January 27, while the average daily turnover was registered at about Euro 12 million (Euro 8.98 in December). These indicators were significantly above their respective levels observed in December. In this period, the highest volume of trade with Euro was registered on January 14 at Euro 27.6 million, and the lowest, Euro 4.53 million, was observed on January 11.

Table 2

Financial Markets Indicators

Month	September	October	November	December	January*
Monthly inflation rate	0,4%	1,1%	1,1%	1,1%	2,5%
Inflation rate annualized on the basis of this month's trend	4,91%	14,03%	14,03%	14,03%	34,5%
CB RF refinancing rate	13%	13%	13%	13%	13%
Annualized yield to maturity on OFZ issues (%)	7,13%	6,15%	7,97%	6,11%	7,2%
Volume of trading in the secondary GKO-OFZ market for the month (RUR billion)	33,59	30,57	18,07	66,54	28,0
Yield to maturity on Minfin bonds at the end of the month (% p.a.)					
5th tranche	5,84%	5,28%	5,35%	4,99%	5,2%
6th tranche	4,25%	3,80%	3,93%	4,20%	4,4%
7th tranche	6,86%	6,27%	6,38%	5,88%	5,8%
8th tranche	4,76%	4,28%	4,46%	4,49%	4,6%
Yield to maturity of Eurobonds at the end of the month (% p.a.)					
2005	5,14%	6,26%	8,43%	10,17%	3,8%
2007	5,86%	5,39%	6,33%	6,35%	5,0%
2010	7,01%	6,66%	7,03%	6,95%	7,3%
2018	7,61%	7,21%	7,35%	7,02%	6,5%
2028	8,20%	7,83%	7,86%	7,57%	7,1%
2030	7,24%	6,84%	6,93%	6,64%	6,5%
INSTAR-MIACR rate (% p.a.) on interbank overnight loans at the end of the month	3,13%	2,93%	1,26%	1,03%	1,5%
Official RUR / US\$ exchange rate at the end of the month	29,2171	28,7655	28,2367	27,7487	28,0845
Official RUR / Euro exchange rate at the end of the month	35,9896	36,6472	37,4165	37,8104	36,625
Average annualized growth in RUR / US\$ exchange rate	-0,09%	-1,55%	-1,84%	-1,73%	1,21%
Average annualized growth in RUR / Euro exchange rate	2,40%	1,83%	2,10%	1,05%	-3,14%
Volume of trading at the stock market in the RTS for the month (US\$ million)	262,27	470,87	351,53	365,31	165
Value of RTS-1 Index at the end of the month	635,57	663,67	633,34	614,11	640
Change in value of RTS-1 Index during the month (%)	8,71%	4,42%	-4,57%	-3,04%	4,2%

* Estimate

D. Polevoy

The Real Sector of the Economy: Factors and Trends

In January of 2004, the increase in GDP made 6.9 per cent, while the rates of growth in investment in fixed assets accelerated to 10.9 per cent and the rates of increase in the gross volume of industrial made 6.1 per cent. The outpacing rates of growth in investment demand have significantly affected the nature of structural shifts in final demand, as well as the changes in the contribution of base sectors of the economy in the dynamics of GDP production.

In 2004, the increase in the output of the investment complex made 9.8 per cent, what was by 1 p. p. above the level registered in the preceding year, while the production of the export oriented sector made 5.7 per cent as compared with 7.7 per cent registered in 2003. Without serious qualitative changes in the technology and structure of production, the complex of industries manufacturing consumer goods failed to maintain high rates of growth. In spite of the increasing role of the investment complex in the dynamics of industrial growth, in 2004 the contribution of internal demand for domestic products remained at the average level of the indicators observed in 1999 through 2003.

The period of 1999 through 2004 was characterized by dynamic development registered across practically all sectors and industries of the economy. The economic recovery occurred at the back-

ground of favorable external economic situation and internal social and political stability. The specific feature of functioning and structural shifts in the economy was the expanding domestic market occurring at the background of a dynamic growth in the consumer and investment demand. Over the last 6 years, GDP increased by 47.0 per cent, the actual final consumption of households grew by 45.2 per cent, while investment in fixed assets increased by 72.0 per cent. The enhancement of business activity based on the outpacing rates of growth in investment in comparison with the dynamics of production and consumption had the decisive effect on the nature of structural shifts in produced and utilized GDP in the period of recovery growth. In 2004, the volumes of industrial output increased by 53.4 per cent and agricultural produce – by 26.4 per cent as compared with the figures registered in 1998. The growth in production of goods was supported by the infrastructure of the market of services formed in the years of reforms. The commercial freight turnover increased by 37.8 per cent, the amount of communication services – by 238.7 per cent, and retail trade – by 49.3 per cent as compared with the respective indicators registered in 1998.

Apparently, the nature of economic development observed over the last years was positively affected by the exceptionally favorable situation on the world markets of fuel, mineral, and raw material resources. In 2004, as compared with the situation of 2003, the terms of Russia's trade vis-à-vis foreign countries improved both as a result of outpacing rates of growth in prices of exported goods, and due to the expansion of demand for staple Russian export products (see the section "Foreign Trade"). In 2004, as compared with the situation observed in the preceding year, in the commodity structure of exports there were registered an increase in the share of energy goods, ferrous and nonferrous metals at the background of a decline in the share of machinery, equipment, and vehicles. The cumulative effect of the growth in prices and volumes of output in the raw material export oriented sector initiated the acceleration of the dynamics of production in related sectors and had the dominating effect on the changes in the conditions and factors of economic development.

The simultaneous expansion of both domestic and external markets was a specific feature of the recovery growth. At the same time, it should be noted that under the conditions of the recovery growth there was observed a gradual increase in the influence of the factors of internal demand on GDP dynamics. For instance, the deceleration of the rates of growth observed in 2001 and 2002 occurred at the background of a significant lagging of the rates of growth in internal demand behind external demand. Since the 2nd quarter of 2003, the recovery of the outpacing rates of growth in the domestic market at the expense of expansion of investment and consumer demand was the dominating factor facilitating the overcoming of the trend towards the deceleration of the rates of economic development. The favorable external economic situation observed in 2003 and 2004 positively affected the financial standing of exporters and transformed in the increase in the domestic demand. A stable increase in the influence of domestic demand on economic growth was registered across all quarters of 2004. The contribution of internal demand in the increase in GDP grew from 35.4 per cent in 2003 to 50 per cent in 2004. The external factor related to both high oil and metal prices, and the capacity of a significant increment in the volumes of export of energy resources explains more than a half of economic growth. The volume of Russia's export of goods registered in January through November of 2004 has increased by 32.1 per cent as compared with the figures registered in the respective period of the preceding year, while the import of goods grew by 24.3 per cent.

In 2004, there were also observed significant volumes of imports. In January through November of 2004, according to the estimates presented by the RF Ministry of Economic Development and Trade, the amount of import of goods increased by 24.6 per cent. The relative decline in the costs of import of raw materials, material and technical resources occurring at the background of gradual Ruble appreciation has in the end been a significant factor behind the changes in the competitive environment and revealed the problem zones of growth. In particular, while the dynamics of consumer imports were checked by the rather strong competitive positions of Russian producers of food goods, the increase in investment imports was accompanied by the squeezing of Russian producers from the respective markets. As a result, the general competitive positions of Russian producers adjusted for the negative effect of changes in internal prices and imports have practically returned to the level observed in the pre-crisis 1997. These developments have sharply enhanced competition between domestic goods and imports and shifted the center of gravity of competition to non-price factors.

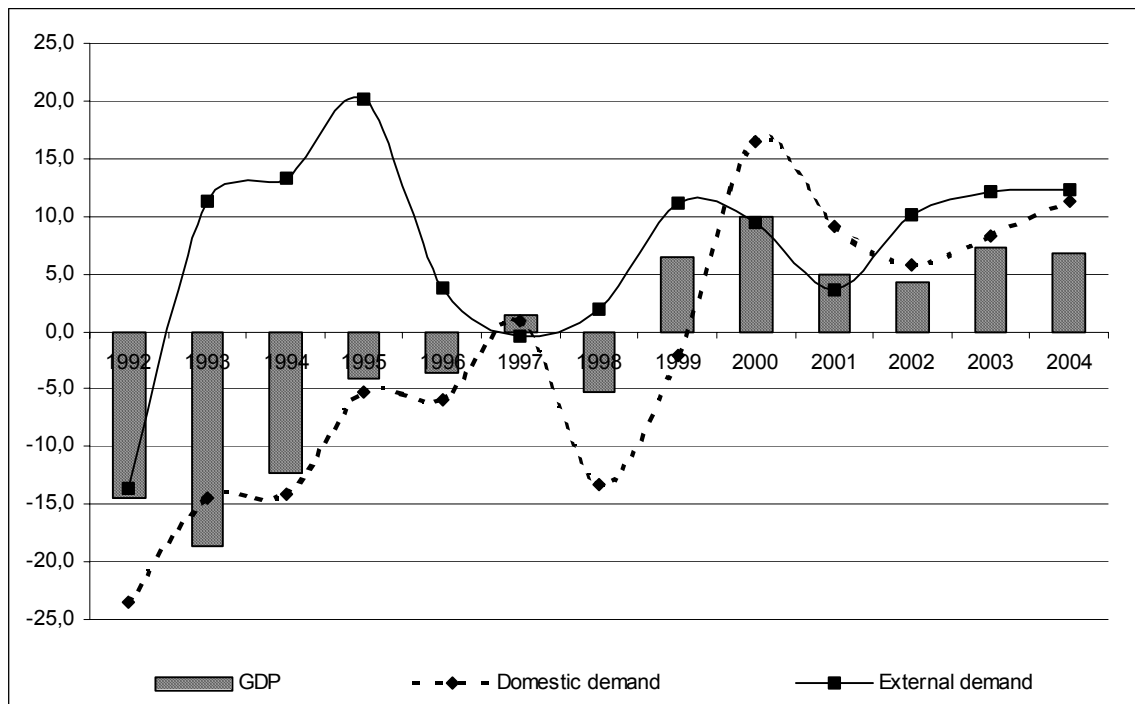


Figure 1. Rates of growth in domestic and external demand in 1992 through 2004, in per cent of the figures registered in the preceding year

In 2004, a specific feature of economic growth was the growing scale of gross savings. In the exceptionally favorable situation combining the factors of high business activity of domestic business and the price situation observed on the world market of raw materials, the share of gross savings has been in the interval from 28.6 per cent to 36.7 per cent of GDP in the last 5 years. This circumstance permitted to completely service the public external debt and finance social programs. In 2004, the gross national savings increased from 32.3 per cent of GDP in 2003 to 33.5 per cent of GDP under the impact of growing revenues of the economy from exports and the increase in the inflow of foreign investment on the one hand, and the deceleration of the growth in final consumption of households at the increasing propensity to save, on the other hand. The share of investment in fixed assets in GDP observed in 2000 through 2004 persisted at 16.5 per cent on the average, what made about one half of the saved funds. The low level of transformation of savings in investments remains a factor checking the rates of growth of domestic businesses.

As it is demonstrated by the experience accumulated over the last 5 years, exactly the ratio between investment demand and final consumption most acutely react to the changes in the export revenues and determines the specifics of functioning of the domestic market. Sharp fluctuations of investment expenditures for the reproduction of fixed assets were compensated by smooth changes in the dynamics of final consumption. After the recovery of the parameters of social development, there were registered significant shifts in the structure of household incomes and expenditures. As concerns the structure of employment, employees make 92.1 per cent of the total working population, while only 7.9 per cent of working population is outside the hired labor group. Accordingly, this ratio determines the specifics of formation of the structure of household incomes and GDP. Remuneration of hired labor accounts for more than 65 per cent of household incomes and 46.8 per cent of GDP.

Taking into account the fact that the dominating share of household incomes is formed at the expense of wages and salaries, the priority problems are those of employment. In the period of recovery growth (in 1999 through 2004), the specific feature was the trend towards an increase in demand for working force. In 2004, the average annual share of the employed made 67.6 million persons as compared with 65.8 million persons registered in 2003 and 63.8 million persons in 1998, while the unemployment declined to 5.6 million persons in comparison with 6.2 million persons and 8.9 million persons respectively. As the situation on the domestic market changed, the real household incomes, real wages and salaries, and the real gross pensions entered the trajectory of dynamic growth. In 2001, the

final household consumption recovered and was at the pre-crisis level of 1997, while in the last three years it increased by 30.5 per cent. The growth in real incomes resulted in a significant decline in the level of poverty of the population. The share of persons with cash incomes below the subsistence minimum declined to 24.9 million persons, what makes 17.3 per cent of the total size of the national population as compared with 35.8 million persons (25 per cent) in 2002.

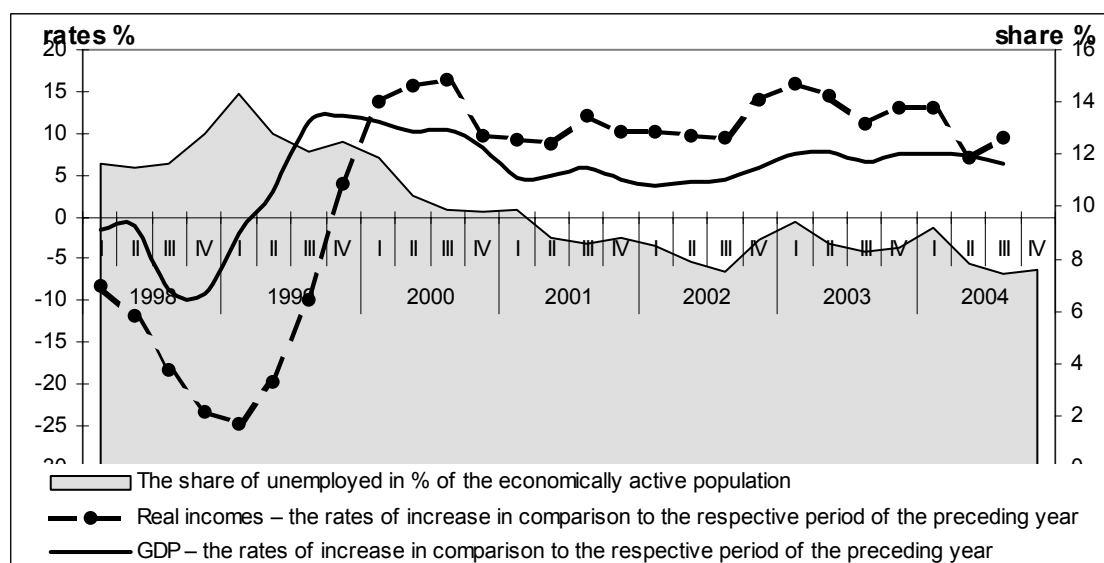


Figure 2. Changes in the rates of growth in GDP, real household incomes, and the share of unemployed in the period of 1998 through 2004, in %

An analysis of the dynamics of real incomes in the period of recovery growth demonstrates that the outpacing rates of growth in wages and salaries had the dominating influence on the nature of changes in social parameters. The rise of the share of remuneration of hired labor in the structure of GDP was related to the persisting trend towards the outpacing rates of growth in wages and salaries in comparison with the productivity of labor. These developments in the sphere of labor remuneration was accompanied by a decline in the gross revenues of the economy from 43 per cent in 2000 to 40.5 per cent in 2004.

Table 1

**Structure of GDP formation as broken down by revenue sources
in 1999 through 2003, in % of the total**

	1999	2000	2001	2002	2003	2004*
Gross Domestic Product	100	100	100	100	100	100
Including:						
Wages and salaries, including concealed wages and salaries	40,1	40,2	43,0	46,6	46,0	46,8
Net taxes on production and imports	15,7	17,1	15,7	14,1	13,7	12,7
Gross profit of the economy and gross mixed revenues	44,2	42,7	41,3	39,3	40,3	40,5

*) preliminary data

Source: Federal Service of State Statistics

The persistence of the dynamics of internal demand was based on the growth in real wages and salaries and household incomes, and was accompanied by the redistribution of incomes from enterprises to the population. These developments resulted in the end in an increase in production costs and a decline in the profitability of production. In 2004, the growth in real household incomes made 7.8 per cent, while real wages and salaries increased by 10.8 per cent. Although in 2003 at the background of an intensive growth in production there were observed more similar dynamics of increase in labor productivity and wages and salaries, the impact of this process on the changes in the indicators of efficiency of operations conducted by enterprises and organizations remained extremely weak and unstable. In 2004, the gap between the rates of growth in labor productivity and wages and salaries grew in favor of the latter, what had a negative impact on the qualitative indicators of economic dynamics.

O. I. Izryadnova

Oil and Gas Sector

Development of the oil and gas sector of economy in 2004 was characterized by maintaining the production growth trend. In comparison with previous year, an increase of oil production, including gas condensate made 8,9%, which chiefly can be explained by growth in exports. The world oil prices were at extra high level, which allowed to considerably increase the export revenues. The current situation on the world oil market allows to count on maintaining in the near future the high level of world's oil price and favorable external conditions for the development of the oil and gas sector.

The determining influence on the situation in the oil and gas sector of the Russian economy is made by price situation on the world oil market. Because of high growth rates of the world economy, limitation of oil production by OPEC countries during the first half of the year and drop in oil production in Iraq, the world oil prices were, in 2004, extra high. Reduction of oil production in the Gulf of Mexico as a result of September hurricane, disorders in the river Niger estuary, and also strikes in Nigeria, Norway and Brazil made for high price maintenance. As a result, the oil price of Brent reached, in October 2004, USD 49.6/barrel, while the price of Russian oil Urals - USD 42.3/barrel. In 2004, an average price of OPEC oil basket considerably exceeded the targeted pricing marginal rate USD 22-28/barrel, set by the organization, and on average made USD 36.1/barrel. In 2004, an average price of Russian oil Urals reached on the world (European) market USD 34.4/barrel, or by 27,2% exceeded the average level of previous year (Table 1).

Table 1

World Oil Prices in 2003-2004, \$/barrel

	2003	2004 1 qu.	2004 2 qu.	2004 3 qu.	2004 4 qu.
Brent oil price, Great Britain	28.83	31.95	35.36	41.54	44.0
Urals oil price, Russia	27.04	28.94	32.54	37.41	38.6
Price of OPEC oil basket	28.13	30.80	34.41	38.97	40.0

Source: OECD International Energy Agency, OPEC.

The development of the oil and gas sector of economy in 2004 was characterized by maintaining the growth trend of oil and oil products production, existing in 2000-2003. In 2004, as compared to previous year, an increase in the volume of oil production, including gas condensate, made up 8,9%, while an increase in the volume of primary oil refining – 2,6%. Continuation of the growth of natural gas production (started in 2002) is observed, which reached in 2004 1,6% (Table 2). In so doing, some drop had been observed in investment activity in the oil sector: in January-November 2004, the volume of exploitation drilling decreased by 1,3% vs the same period of previous year, oil prospecting drilling - by 18,9%, which may be explained by rather high crude reserves, putting into service new oil wells reduced by 3,1%. In the oil refining industry the production of oil products with the use of intensifying technologies increased in January-November by 1,0%, while the refining intensity rate increased from 70,2% in January-November 2003 to 71,5% in January-November 2004. The share of high-octane gasoline in the automobile fuel output increased from 52,9% in January-November 2003 to 55,5% in 2004.

Table 2

**Production of Oil, Oil Products and Natural Gas in 2000-2004,
in % to previous year**

	2000	2001	2002	2003	2004
Oil, including gas condensate	106.0	107.7	109.0	111.0	108.9
Oil	105.9	107.7	108.7	111.1	108.6
Gas condensate	103.8	106.7	112.8	108.7	116.9
Primary oil refining	102.7	103.2	103.3	102.7	102.6
Automobile fuel	103.6	100.6	104.9	101.2	103.8
Diesel fuel	104.9	102.0	104.7	102.0	102.7
Fuel oil	98.3	104.2	107.1	100.3	97.8
Natural gas, billion cub. m.	98.5	99.2	101.9	103.4	101.6
Oil gas, billion cub. m	102.5	105.0	110.5	119.3	106.4

Source: Federal State Statistics Service.

In 2004, a noticeable rise in prices of oil and oil products had been observed in the domestic market largely explained by enhancement of oil export. Thanks to high world prices of oil, in oil exportation the transport schemes became effective that use rail and river. In November, an average domestic oil price (producer's price) in dollars reached USD 121.2 per ton, while an average price of automobile fuel - USD 353.9 per ton, which is a maximum price level of oil and automobile fuel for all the period of reforms. Over the last few months, gas prices noticeably exceeded those existed before devaluation period, and reached USD 10 per 1 thou. cub.m. (Table 3, Fig. 1, 2).

Table 3

**Domestic Prices of Oil, Oil Products and Natural Gas in 2000-2004,
(average producer's prices, \$/t)**

	2000 December	2001 December	2002 December	2003 December	2004 June	2004 November
Oil	54.9	49.9	60.7	70.1	87.5	121.2
Automobile fuel	199.3	151.5	168.8	236.9	275.1	353.9
Diesel fuel	185.0	158.5	153.8	214.3	244.6	359.1
Fuel oil	79.7	47.1	66.1	66.0	94.9	79.7
Gas, \$/ thou. cub.m	3.1	4.8	5.9	4.4	9.7	10.2

Source: calculated according to the data of the Federal State Statistics Service.

In January-October, the oil exports increased, vs the same period of last year, by 13,0%, oil products – by 4,4% (Table 4). The export share of diesel fuel was 54,1 %, fuel oil - 64,3%, automobile fuel - 14,1% (for comparison: in 1999 the export share in automobile fuel production made up only 7,2%). The high world prices of oil determined the considerable growth of revenues from export. In value terms, the oil exports in January-October 2004 increased by 45,2%, as compared to the same period of previous year, which more than three times exceeds an increase of the volume of export. The share of oil export in the total volume of Russian export in January-November 2004 made 32,6% (in January-November 2003 – 29,7%). The total cost of oil exports of basic types of oil products in January-October 2004 reached USD 52.5 bn. The growth of export revenues of the oil sector of economy provided considerable increase of tax revenues to the government budget and allowed oil companies to keep low level of payables.

As a result of growth of domestic prices of oil products and raising the real ruble rate of exchange, the imports of oil products increased. On the whole, the imports of oil products in January-October 2004 increased 3,2 times in comparison with the same period of last year. At that, the automobile fuel imports increased 7,6 times vs previous year, and the import share of automobile fuel went up from 0,2% to 1,6%. Still, the import share remains very low (for comparison: in the first half of 1998, that is, before ruble devaluation, the import share of automobile fuel constituted 8,7%).

In comparison with previous year, the growth rates of gas exportation went ahead, which largely was caused by an increase of gas deliveries to CIS (in January-October 2004, of gas deliveries to those countries increased by 15,8%).

Table 4

**Exportation of Oil, Oil Products and Natural Gas from Russia,
in % to relevant period of previous year**

	2002	2003	January-October 2004
Oil, total	113.9	117.8	113.0
including:			
to not CIS countries	109.9	118.9	114.2
to CIS countries	137.3	112.4	106.9
Oil products, total	118.5	103.6	104.4
including:			
to not CIS countries	119.1	102.6	103.3
to CIS countries	102.8	132.3	132.6
Gas, total	102.4	102.0	106.4

Source: Federal State Statistics Service.

As an analysis of the situation on the world oil market shows, in the short term one may expect maintaining the high level of oil prices of oil. According to the base variant of the last (January 2005) forecast of the Department of Energy, the world oil price, defined as an average oil price imported into

the U.S. in 2005 will constitute 36,6 \$/barrel With account of the actual, for the end of 2004, ratios between the price of oil Brent, Urals and an average price of oil imported into the U.S., the price of oil Brent this year will constitute, in this case, around USD 40 \$/barrel, and the price of Urals – USD 35.5 \$/barrel (Table 5).

Table 5

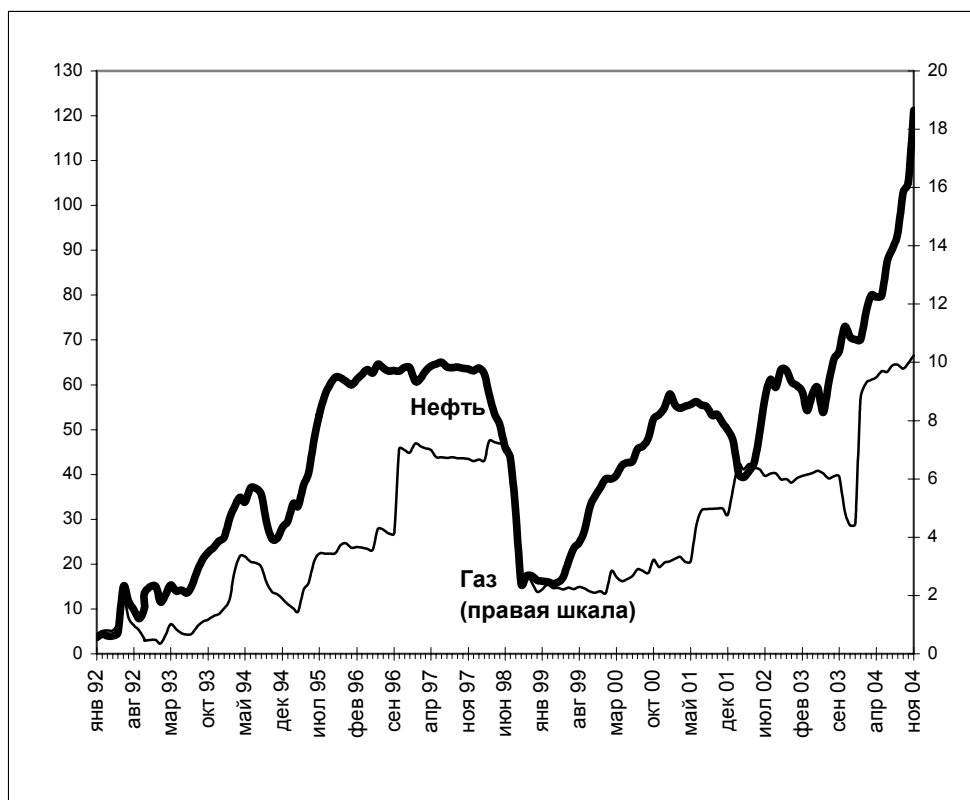
Forecast of the World Oil Price in 2005, \$/barrel

	2000	2001	2002	2003	2004	2005 (forecast)
Average price of oil imported into the U.S.*	27.72	22.01	23.69	27.74	36.1	36.6
Price of oil Brent	28.50	24.44	25.02	28.83	38.2	40.0
Price of oil Urals	26.63	22.97	23.73	27.04	34.4	35.5

*Producer's prices in deals with oil refineries.

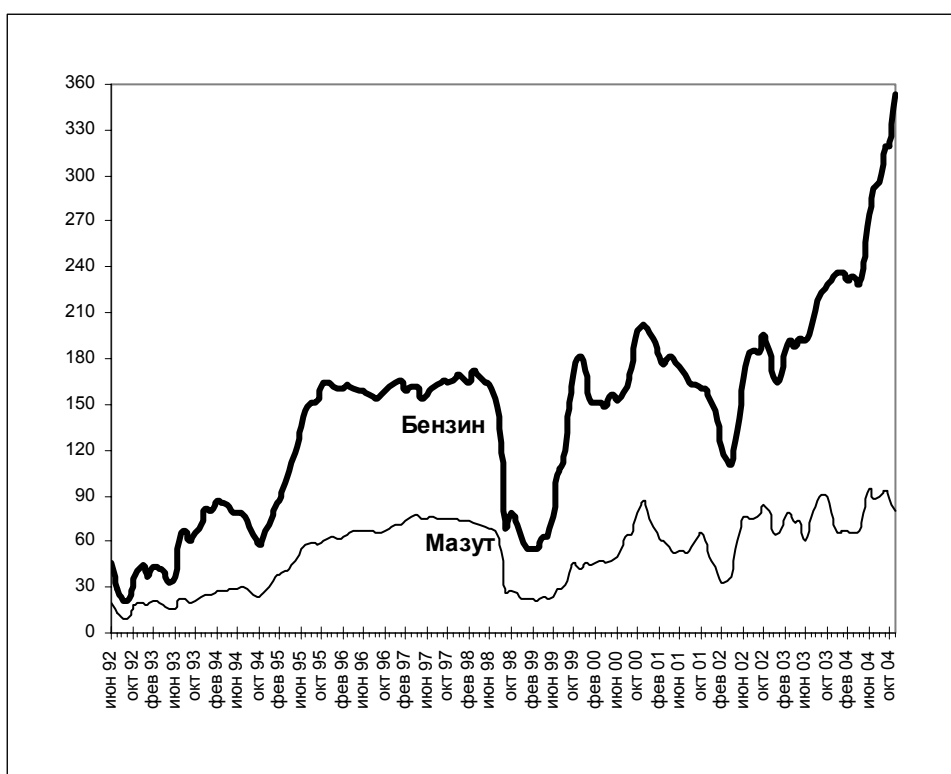
Source: U.S. Department of Energy/Energy Information Administration, IEA, author's estimates.

According to the latest forecasts of the leading foreign and some Russian organizations, the world price of oil Brent in 2005 will be kept at a very high level and will constitute about 35-40 \$/barrel, which will meet the world price of Russian oil Urals at USD 31.5-35.5 \$/barrel This makes possible to expect maintaining in the short run of favorable external conditions for forming the revenue side of the state budget and development of the oil and gas sector.



Source: calculated according to the data of the Federal State Statistics Service.

Fig.1. Average Producer's Prices of Oil and Gas in 1992-2004, \$/t, \$/thou. cub. m



Source: calculated according to the data of the Federal State Statistics Service.

Fig.2. Average Producer's Prices of Automobile and Fuel Oil in 1992-2004, \$/t

Yu.N. Bobylev

IET Business Survey: Industry in January of 2005

A slight acceleration of the rates of growth in industrial output registered in December by IET surveys and confirmed by the official statistics three weeks later has failed to become the beginning of a period of recovery of the previous dynamics of output. Long national holidays have negatively affected the situation in the Russian industry. While in January of 2005 the growth in demand indicated by the enterprises' evaluations decelerated at a slower rates than those registered a year ago, the rates of growth in output slowed down much more than at that time.

The data published by the Rosstat indicate that the trend towards the recovery of industry observed at the end of 2004 persisted. According to the appraisals presented by the the Center for Macroeconomic Analysis and Short Term Prognostication (CMASTP), in December the increase in the average daily volumes of output made 0.2 per cent similarly to the average monthly increases registered in the 4th quarter (as adjusted for the seasonal factor). In December, in individual industries there were registered the following most important positive trends: the persistence of recovery processes in mechanical engineering, acceleration of the rates of growth in output in timber and paper industries, continuing moderate growth in output of food industry. Among the negative trends there may be indicated the following: the continuing decline in oil extraction, the end of recovery in ferrous metallurgy, a decline in the volumes of output of construction materials. On the whole, according to the data presented by the Rosstat in 2004 the industrial output index made 106.1 per cent as compared with 107.0 per cent registered in 2003.

An absolute decline in demand, which, similarly to the situation observed a year ago, started in December made 26 p. p. in January (the data is not adjusted for the seasonal factor). Sales diminished across all industries. A most intensive decline was registered in light and construction industries. After the adjustment for the seasonal factor, the balance of changes in demand made -1 p. p., what is comparable with the figures registered in January, July, and September of 2004. The dynamics of sales registered in January of 2005 were, therefore, not the worst as compared with the data observed last year.

However, the appraisals of demand indicate that the dissatisfaction with the volumes of sales increases. After the 60 per cent satisfaction with the volumes of sales registered in October of 2004, the share of answers “normal” declined to 48 per cent. At the moment, the level of satisfaction with the volume of sales makes only 28 per cent in electrical power engineering, light industry, and construction industry. An opposite situation is observed in ferrous (72 per cent) and nonferrous (96 per cent) metallurgy. Along with the obvious dependency of the level of satisfaction with demand on its dynamics, evaluations of finished stocks (the less are these stocks, the better), and dynamics of profits, this indicator also rises depending on the lack of excessive production capacities (but not the personnel), increase in employment and the size of enterprises (larger enterprises are more often satisfied with demand than smaller ones). It should be noted that the dynamics of output and the dynamics of finished stocks do not affect the formation of “normal” evaluations of demand.

In January of 2005, there was also registered an absolute decline in output. The balance of changes in output (prior to the adjustment for the seasonal factor) decreased from + 13 per cent to -26 per cent. A year ago the balance declined only to -8 per cent. After the adjustment for the seasonal factor the balance makes + 7 per cent (i.e. a growth in production persisted); however, the results observed in January of 2004 were better (+ 23 per cent). Such slow rates of growth in output as in January of 2005 were registered for the first time in 25 months. This conclusion is supported by the data on utilization of production capacities. For the first time since January of 2003 this indicator has stopped to increase: after 67.2 per cent observed in October, the respective level declined to 65.7 per cent. A decrease in utilization of production capacities was registered across all industries.

Enterprises still consider low demand (48 per cent as compared with 38 per cent registered in October of 2004) and the lack of working capital (46 per cent as compared with 42 per cent) as the major hindrances to growth in output. Other hindrances were mentioned twice less often. The third most important hindrance to production was the competing imports (22 per cent as compared with 17 per cent), followed by the lack of skilled personnel (20 per cent as compared with 28 per cent), payment arrears of consumers (18 per cent as compared with 16 per cent), and the lack of equipment (18 per cent as compared with 19 per cent). However, not all factors indicated by enterprises really hindered them to increase production. In 2004, only the lack of skilled personnel increased the probability of decline in output. The influence of other factors was either insignificant, or did not result in a real decrease in output.

In January, the balance of evaluations of finished stocks declined by 6 points as excessive hoarding decreased. The decline in excessive finished stocks became possible due to a rise in the number of the share of enterprises where the rates of changes in demand outpaced the rates of changes in output (this share made 21 per cent as compared with 12 per cent registered in December) and a rise in the optimism of forecasts. The decline in excessive finished stocks did not occur only in nonferrous metallurgy (in this industry, there persisted the lack of finished stocks), the forestry complex and food industry (after 10 months of the lack of finished stocks there was observed a minimal excess).

Although the forecasts of changes in demand became more optimistic (the balance was the best since November of 2000), enterprises still did not believe that the probability of these forecasts to turn out true was as high as earlier. This fact was indicated by the evaluations of excess or lack of production capacities in relation to the expected demand. The balance of such appraisals remained positive and increased at once by 7 p. p. in January of 2005. In other words, the “overhang” of excessive production capacities in relation to expected demand persisted in the Russian industry and this “overhang” even increased.

After a nine months period of stabilization, the balances of plans of changes in output increased by 6 points in January (the growth not adjusted for the seasonal factor made 31 p. p.) Forecasts improved across all industries with the exception (due to the seasonal factor) of electrical power engineering. The most intensive increase in production was planned in fuel industry and mechanical engineering. However, the production plans of enterprises only in 64 per cent of cases were based on forecasts of demand. At the moment, the share of enterprises where output would increase at the rates outpacing demand makes 30 per cent. Such outpacing rates of growth in production in comparison with demand have not been registered since July of 2002. This fact makes doubtful the feasibility of production plans of enterprises.

S. V. Tsukhlo

Russia: budget support to farm production in 2004

In 2004 the nominal amount of budget support to farm producers continued to decrease while trade protectionism, on the contrary, strengthened. In January-November 2004 allocations to subsidizing agriculture from the federal, regional and local budgets totaled 52.4 billion rubles. The budget discipline in financing agriculture becomes better with every passing year: in 11 months the sector has received 84% of the annual agricultural budget appropriations while the budget at large was executed by only 78%. However, the strengthening of budget discipline goes in line with the decrease in total amounts of financing (Picture 1): in 2004 the respective consolidated budget expenditures are to reduce by 2% in nominal terms. The share of agriculture in the overall consolidated budget expenditures is down from 1.6% in 2003 to 1.4% in 2004. Still, the aggregate support estimated by PSE¹¹ is growing rather rapidly (Picture 2) evidencing larger contribution of regulation tools designed to directly influence prices and markets.

After two years of federal component's expansion, the share of regional and local budgets in the consolidated agricultural budget started to grow again (Picture 3): in 11 months 2004 they accounted for 64% of the total budget expenditures.

Moreover, beginning from January 1, 2005 the subsidizing of farm producers is transferred to the competence of regional and local administrations. This decision will have the most destructive effect on the sector. First of all, regions-donors able to finance support to agriculture on their territories are primarily located in the climatic zones that are least fit for farming. Thus the shifting of farm support's gravity center from the federal to regional level implies encouraging of non-efficient resource utilization in agricultural production. Second, for already many years regional support results in "trade wars" between regions, attempts to oust neighbors from the all-Russia market by means of direct subsidies to local producers, bans on agricultural and food products' transit, etc. In other words, this decision of the RF Government brings in the domestic market all the negative sequences of protectionism on the world agricultural markets that the WTO Agricultural Agreement strives to eliminate (by the way, Russia wants to join this organization with its anti-protectionism principles).

Already in 2004 financing of agrifood sector from the federal budget decreased notably. In January-November it amounted to 20.4 billion rubles that is 11% less in real terms as compared with 2003. The annual expenditures on agriculture in 2004 are planned to reach 38.6 billion rubles, or are 3% below the previous year level.

The plan for 2005 envisages further reduction of expenditures on agriculture by 3% in nominal terms. Budget appropriations for the agrifood sector in 2005 Federal Budget account for 1.3% of the overall federal budget expenditures while in 2004 their share reached 1.5%.

A positive trend is the shift in structure of federal budget financing: while direct subsidizing of farm producers reduces (by 17% in 2005), general services (science, education) get more funds (Table 1). In 2004 expenditures on agricultural education and training increased by 20%, in 2005 - are planned to increase by 9%. Growth of expenditures on science accelerated markedly. So, allocations are gradually redistributed in favor of general services which is a positive trend in budget structure evolution.

The structure of budget expenditures on subsidizing agriculture remains constant throughout the recent decade (Table 2). The reform of budget classifier in the process of drafting 2005 budget has actually skipped agricultural articles and failed to solve the problems that accumulated due to the inadequacy of the effective budget classifier of expenditures on the agrifood sector.

Plenty of subsidy programs are preserved in the budget year after year only because they are included in the budget classifier. Though many of them have long been found non-efficient, the respective expenditures are not revised remaining constant in nominal terms.

One of the most successful farm support programs was the subsidizing of interest on credits. It helped agriculture to get over 40 billion rubles annually.

Beginning from 2002 the program envisages subsidizing of interest on investment credits as well. In 2002-2004 the amount of subsidized investment credits totaled about 10 billion rubles.

¹¹ This indicator summarizes the effect of both budget support to farm producers and measures leading to higher prices for agricultural commodities (including trade protectionism tools).

In March 2004 the rules in force for several years have been radically revised. First, the subsidizing of interest on credits to processing enterprises was abolished which is a very serious limitation for agricultural crediting. Due to the high credit indebtedness and small available collateral of farm producers banks are not disposed to credit them directly. At the same time processors used to take credits for contracting farm input suppliers. In other words, credits reached agriculture through processors. In 2004 this scheme became impossible.

Second, interest subsidies are now tied not to the repaid but to the granted credits. Probably, this somewhat simplifies the subsidy application procedure but the amendment opens an opportunity to get subsidies for farms that do not pay back their debts. In other words, while earlier the program helped to improve agricultural producers' access to bank credit, from now on it will become one of the forms of non-repayable subsidizing. Such an amendment completely alters the initial concept of the program.

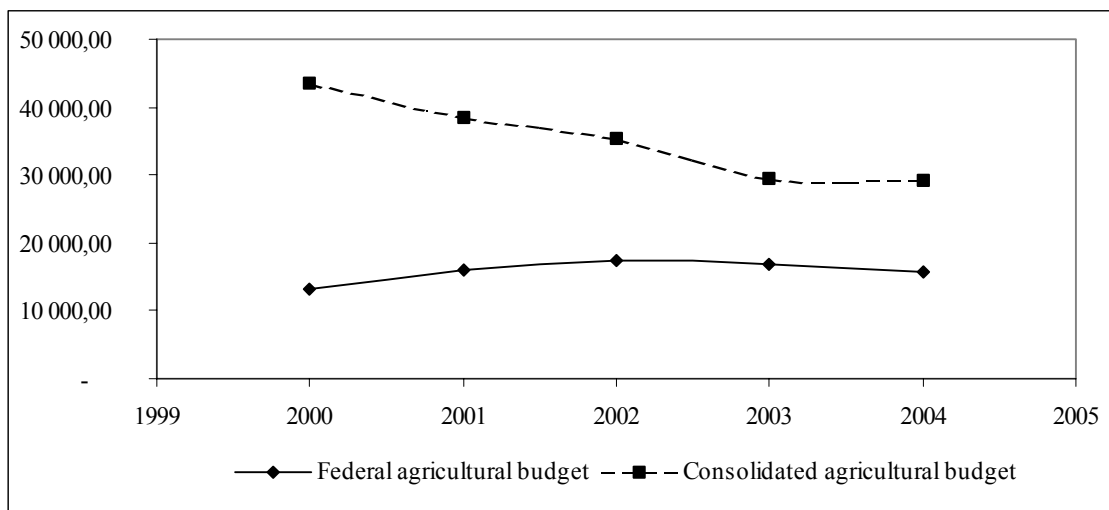
The largest by the amount of allocated funds program of farm support is the program of leasing. From January 2002 to July 2004 1500 contracts were signed on leasing of farm machinery and pedigree stock to the total amount of 22.2 billion rubles (Table 3).

Before 2002 leasing was the only program for supporting technical modernization of agriculture. The existence of a single leasing company receiving large donations from the federal budget monopolizes the market, resulting in higher cost of leased machinery for farm producers and closing access to agricultural leasing programs for private companies.

In 2001 5.5 billion rubles were allocated from the federal budget to forming of the leasing fund and authorized capital of "Rosagroleasing"; in 2002 this amount reduced two fold, in 2003 – down to 870 thousand rubles, but in 2004 it again more than doubled. The overall investments in "Rosagroleasing" authorized capital in the previous years total 11.3 billion rubles (Table 3). The creation of man-made monopoly on the market with the help of government funds leads to non-efficiency of the leasing program. The program of subsidizing interest on investment credits is much more beneficial for producers.

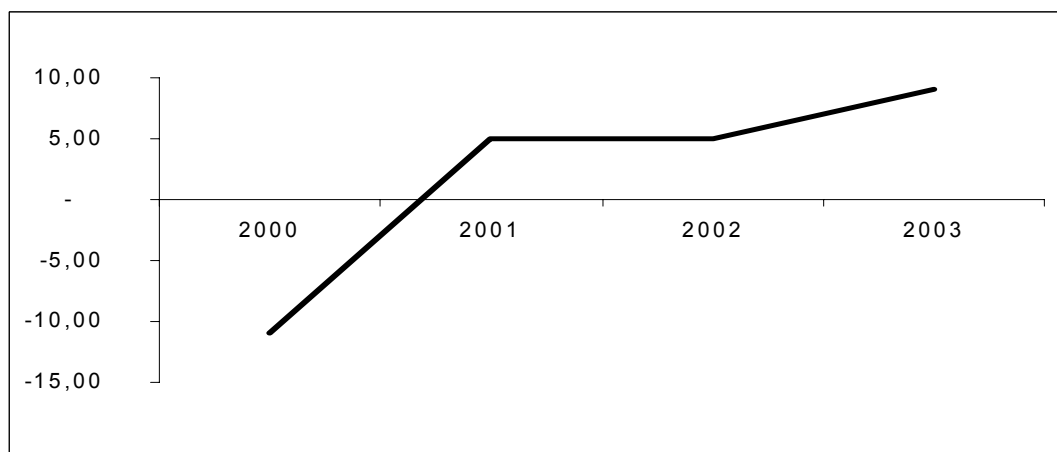
In 2004 the financing of program for partial compensation of farm producers' expenditures on crop insurance notably grew (Table 2). The compensation equals 50% of the insurance premium paid to insurer that has a license on insuring farm crops. Few insurers in regions get such a license; the 50% discount from the cost of insurance contract multiplies their clientele among farm producers and, respectively, the amount of received premiums. This seems to make such companies more disposed to pay the insurance. In 2004 we carried out a sample survey of 49 farms in Perm oblast. It showed that in insured farms the incidence of insured events is very high and they are much more frequent than in non-insured farms (Table 4) though both the former and the latter are located in the same regions. In 2002 amounts received by insured farms (payment from the insurer plus partial compensation of insurance premium) averaged 0.93 rubles per each ruble spent on insurance, in 2003 – 1.34 rubles. In 2002 8 farms got under the insurance contract more than they had spent, in 2003 – already 14 farms (out of 28 farms that answered the questions about the size of insurance premium and insurance payment). Given that one can assume that apart from its original objective insurance has become a form of direct subsidizing of farm producers.

The regulation of prices on the domestic market was primarily effected by means of trade protectionism. The only exception is grain interventions. They were carried out in February-June 2004 with the aim to lower prices for food grain and thus to constrain growth of prices for bread. Overall, about 1.5 million tons of soft wheat #3 and #4 and rye #A were sold – the volume almost equaling monthly consumption of food grain in the country. This means that each month the market received additionally from 20 to 25% of grain. Such an intervention could well influence prices and be a cause of lower rates of bread and bakery retail prices' growth in the first half of the year (Picture 4). The Picture shows that in 2004 the ratio of bread and food price indices from January to July fell while in the two preceding years it grew. Still, it's questionable whether there was a need to constrain bread prices at such a cost. At the same time the experiment with interventions showed that a single grain market has formed in the country.



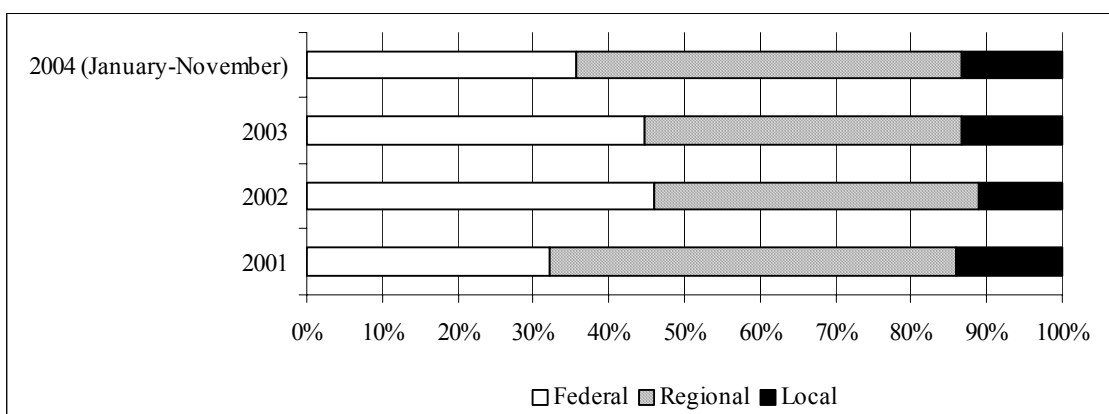
Source: RF Ministry of Finance.

Picture 1. Consolidated and federal budget expenditures on agriculture, million rubles in constant 1999 prices (2004 - estimate)



Source: own calculations.

Picture 2. Producer support estimate (PSE), %



Source: RF Ministry of Finance.

Picture 3. Structure of consolidated budget support to agriculture

Table 1

Structure of federal budget expenditures on agriculture in 2001-2005, thousand rubles

	2000	2001	2002	2003	2004	2005	2005	2005
	execu- tion	execu- tion	execu- tion	execu- tion	plan	draft	as % of 2004	struc- ture
Agricultural production (subsidies)	6608	12468	20281	22365	24689	22602	92%	53%
Land resources	6 699	6 959	1 347	1401	1 985	2209	111%	5%
State support of grain inspection institutions	41	57	98	138	153	0	0%	0%
Investments in authorized capital of the leasing company				870	2 000	0	0%	0%
Forming of authorized capital of Rosselkhozbank (Russian Agricultural Bank)		2 000	1 420	850	0	0		0%
Science	113	187	172	200	213	301	142%	1%
Russian Academy of Agricultural Sciences	739	1 056	1 496	1747	1 991	2319	116%	5%
Education	2 929	3 751	5 350	6461	7 817	8548	109%	20%
Fixed capital investments (from 2002 – in agricultural production, 2005 – non-program investments and construction)	711	347	247	1146	0	2435		6%
Fixed capital investments / Special federal program “Soil fertility improvement in Russia in 2002-2005”						1884		4%
Ministry staff	99	129	142	167	266	378	142%	1%
International activities		16	0	365	713	10	1%	0%
Healthcare				12	13	14	107%	0%
Social policies		4		5	5	0	0%	0%
Financial assistance to regional and local budgets		374	2	1634	67	0	0%	0%
including: Special federal program “Rural social development till 2010”						2172		5%
Other expenditures	96	33		0,4	0	0		0%
Total expenditures on agriculture	18 036	27 349	30 555	37 361	39 911	42 872	107%	100%

Source: RF Ministry of Finance.

Table 2

Subsidies to agriculture in 2000-2005, million rubles

	2000	2001	2002	2003	2004	2005	2005	2005
	execu- tion	execu- tion	execu- tion	execu- tion	plan	draft	as % of 2004	struc- ture
Support to livestock production	603	945	1 100	1 194	1 195	745	62%	3%
including:					0			
Pedigree stock-breeding	298	619	703	744	745	745	100%	3%
Subsidies to wool producers	142	256	327	350	350		0%	0%
Reindeer breeding		70	70	100	100		0%	0%
Purchase of formula feeds	162							0%
Support to crop production	223	554	622	1 170	2 270	2670	118%	12%
including:								
Elite seed growing	68	248	270	270	270	770	285%	3%
Subsidies to producers of flax and hemp	72	85	67	100	100		0%	0%
Partial compensation of expenditures on crop insurance	-	222	285	800	1 900	1900	100%	8%
Other expenditures	2 998	686	5 530	2 153	2 733	1754	64%	8%
including:								
Building of federal reserve of veterinary drugs								0%
Subsidies to waste disposal plants	3	39	40	45				0%
Centralized delivery of seeds to northern and mountain regions			140	200				0%

	2000	2001	2002	2003	2004	2005	2005	2005
	execu- tion	execu- tion	execu- tion	execu- tion	plan	draft	as % of 2004	struc- ture
Subsidies to horticulture and grape growing			300	400				0%
Building of pesticide reserve			300	300				0%
Creation of leasing fund	2 624	5 500	2 780					0%
Building of federal seed reserve	100	150	150			80		0%
Fixed capital expenditures			865	864				0%
Other	275	647	955	344				0%
Maintenance of subordinate institutions	2 505	2 888	6 144	8 964	9 291	9 531	103%	42%
Environment protection		59	100					0%
Subsidizing of interest on credits		1 627	2 017	3 200	3 200	5 370	168%	24%
Including: short-term credits			1 400	2 000	0			0%
Long-term credits			617	1 200	0			0%
out of them: credits on construction of port elevators				130	0			0%
Seasonal crediting	-37				0			0%
Program "Soil fertility improvement"	-		4 767	4 531	4 530	1 683	37%	7%
including:					0			0%
Partial compensation of mineral fertilizers' cost	83*		237	2 100	0			0%
Special federal program "Rural social development"***				1 470	1 470	1	0%	0%
Subventions for financing food grain purchase interventions				1 152	0	250		1%
State administration expenditures						518		
Support to individual farmers	2				0			0%
Total	6 297	12 468	20 281	22 365	24 689	22 602	92%	100%

* in 2000 purchase of mineral fertilizers was subsidized outside the program "Soil fertility improvement".

** in 2005 this item includes only direct subsidies in the framework of this program while investment expenditures are presented in Table 1.

Source: RF Ministry of Finance.

Table 3

**Investments in Leasing fund from the federal budget
(prior to 1997 – billion rubles, after 1998 – million rubles)**

	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
Plan	1000	1351	2700	2400	2000	2280	2624	3000	0	870	2000
Actual allocations	1053.6	1080.6	1928.9	736.6	1007	2241	2624	5 500	0	870	n.a.

Source: RF Ministry of Finance.

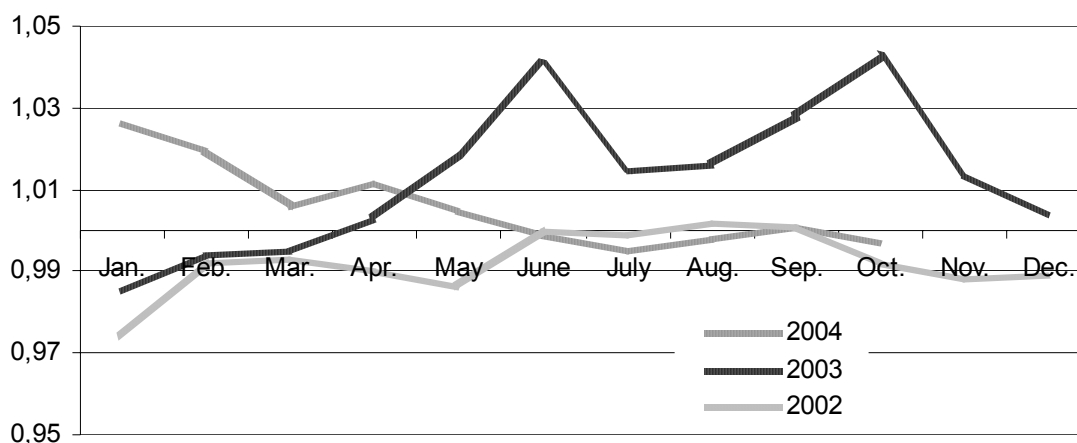
Table 4

The incidence of insured events in the sampled farms

	2002	2003
Number of positive responses	23	33
as % of the total number of insured farms	79	83
Number of negative responses	14	10
including given by insured farms	6	5*
as % of the total number of insured farms	21	12*
including given by non-insured farms	8	5
as % of the total number of non-insured farms	57	83

* 4 of the insured farms did not answer this question.

Source: results of the sample survey conducted by the AFE Centre in Perm oblast in 2004, 49 agricultural enterprises.



Source: calculated using data of the Federal service of state statistics.

Picture 4. Ratio of monthly price indices for bread and bakery products and for food products at large

O. Shick, E. Serova

Foreign trade

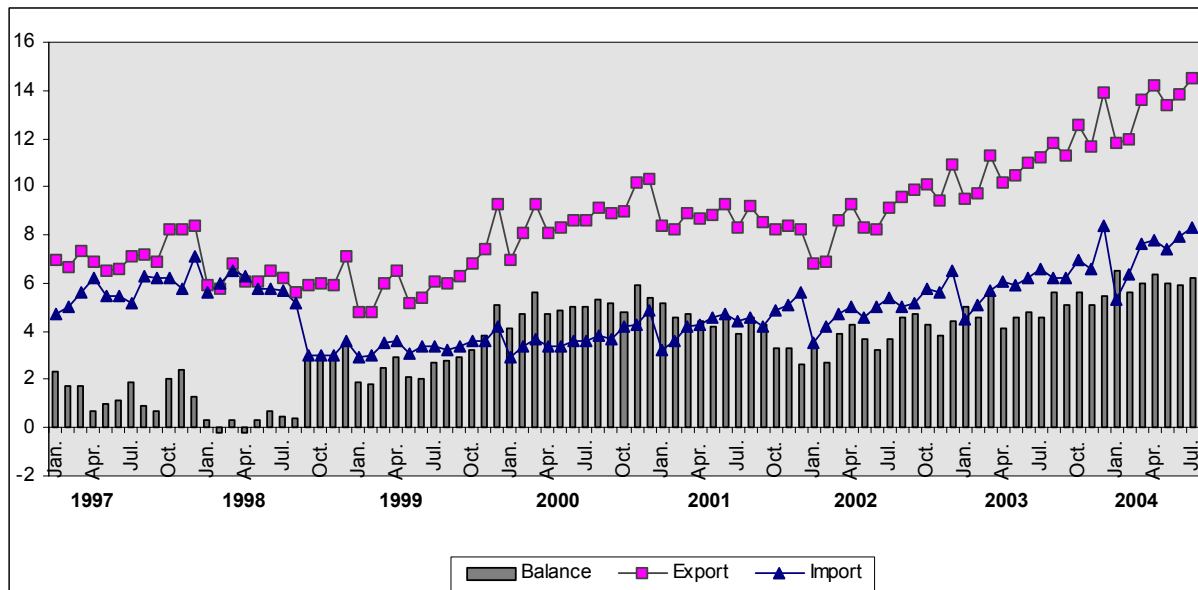
Still favorable, the world market conjuncture, and also growth of the effective demand for both population and domestic enterprises exerted positive influence on the development of the foreign economic activity throughout 2004. In November 2004, the Russia's major foreign trade indices reached its maximum for all observation period since 1994.

In January 2005, a new procedure of goods carriage had been introduced, as well as new rates of customs collections implemented for clearance, accompanying, and goods storage at warehouses.

In November 2004, the Russia's foreign trade turnover, calculated according to the balance of payment methodology, made up USD 26.8 bn, which is by 47,3% higher than in November of previous year. In so doing, considerable growth had been observed of both export and import. The export value volume had grown by 54%, in comparison with the same indicator of previous year, and made up USD 17.8 bn. Import deliveries had grown to USD 9 bn, which is by 33% higher than the level of November 2003.

As a result of priority rates of export dynamics throughout 2004, very high growth rates of the balance of trade had been observed, which in November 2004 made USD 8.8 bn vs USD 4.8 bn in November 2003.

For all the period of observations since 1994 Russia had not seen such high indices of foreign trade.



Source: Goskomstat of the RF

Figure 1. Major Indices of the Russian Foreign Trade (bn dollars)

The record growth of Russian export had been achieved basically due to continued utterly favorable world market conjuncture. Despite the reduction of prices of some of goods of the Russian export in November 2004, they are still at a very high level. According to the Bank of Russia estimates, in November 2004 vs previous month, the world prices with account of the export structure by aggregate of goods, including about 65% of its value, reduced on average by 7.2%. But vs November 2003 they were higher by 28,1%.

On average, in November vs October 2004, the price of oil Brent reduced by 13,5% (to USD 43.1 bn per barrel), while Urals - by 12,4% (to USD 37.3 bn per barrel). In comparison with November 2003, an average oil price of Brent was higher by 50,7%, while Urals - by 35%.

According to monitoring of the RF Government, an average oil price of Russian oil Urals became, in November-December, about USD 35,76 bn per barrel. Proceeding from the marginal rates of dues established by the law "On the Customs Tariff", the oil export duty rate is reduced since February 1, 2005 from USD 101 to USD 83 dollars per ton.

The foreign exchange revenues from export of Russian oil in January-November 2004 made up USD 52.9 bn, which by 47,7% exceed the revenues for the same period of last year. The oil production for 11 months reached in the country 419.3 mln t., which by 9,2% exceeds oil production in the same period of previous year. The oil sales on the domestic market increased by 2,1% (to 177.6 mln t.), export deliveries – by 13,3% (to 234.4 mln t.).

The share of oil export deliveries in the volume of Russia's export in January-November 2004 constituted 32,6%, in the export of fuel and energy products – 56,6% (in January-November 2003, such indicators constituted 29,7% and 51,7% correspondingly).

In November Russia ranked next to Saudi Arabia by production of oil. According to OPEC data, Russia extracted in November 9 mln barrels per day, Saudi Arabia - 9,475 mln barrels.

In November 2004, the prices of oil products also went down. As compared to previous month, the price of diesel fuel lowered by 8,7%, gasoline - by 8%, fuel oil - by 20,5%. On average, oil products went down by 12,8%. In comparison with November 2003, the prices of oil products were, on average, 1,3 times higher (the price of became 1.5 times higher, diesel fuel - 1,6 times, fuel oil became cheaper by 8,8%).

In November of 2004, vs previous month, the prices of natural gas became higher by 2,7% in Europe, in the U.S. they went down by 5%. In comparison with November 2003, the price of natural gas in Europe became higher by 27%, while in the U.S. - by 34%.

In November 2004, the world prices for products of the Russian fuel and energy complex went down, vs previous month, on average by 8,7%, and in comparison with November 2003, they were higher 1.3 times.

Reduction of aluminum prices in November 2004 could be explained basically by growth of demand for this metal.

The rise in copper prices, which continued since July 2004, had been caused by existing shortage of this non-ferrous metal on the world market. As before, rising of copper shortfall on the world market is made for by an increase of consumption of this metal. In January-August 2004, the demand for copper increased by 5,9%, vs the same period of previous year, and reached 10.9 mln tons.

Changes in the world prices of nickel in 2004 to a large extent depend on the rates of China's economic growth. The demand for it on the part of PRC is increased by the rates surpassing growth of demand of other countries.

In November 2004, vs October, the prices of non-ferrous metals went down on average by 0,6%, with aluminum to be made cheaper by 0,3%, nickel – by 2,7%, copper got up by 3,7%. Relative to November 2003, the prices of non-ferrous metals were on average 1,2 times higher (aluminum went up by 20%, copper - by 52%, nickel - by 16%).

TABLE 1.

Monthly Average World Prices in November of Corresponding Year

	1996	1997	1998	1999	2000	2001	2002	2003	2004
Oil (Brent), USD/barrel	22.8	17.8	11.5	24.1	25.6	19.35	24.4	28.6	43.1
Natural gas, USD/1 mln. BTU	3.093	2.393	2.251	2.558	5.767	2.843	4.11	4.876	6.533
Gasoline, USD/gallon	0.6691	0.5648	0.3739	0.6986	0.7649	0.5454	0.7203	0.845	1.289
Copper, USD/t	2273.3	1834.7	1601.6	1748.1	1914.4	1481.0	1610.0	2052.0	3123.0
Aluminum, USD/t	1459.9	1535.5	1305.0	1470.7	1562.5	1326.6	1373.4	1507.0	1814.0
Nickel, USD/t	6920.0	6099.0	4202.0	7984.2	7315.4	5159.7	7316.7	12090.0	14026.0

Source: based on the data of the London Metal Exchange, International Oil Exchange (London)

Serious obstacle to further increase of export is control of access of Russian goods to foreign markets. As of December 24, 2004, in relation to Russian goods are in effect 113 restrictive measures, including 52 antidumping duties, 2 protective duties, 10 quotas, 4 restrictions on prices, 1 restriction on nomenclature of goods, 4 bans on imports, 2 additional taxes, 1 tariff quota, 1 technical barrier, 1 phytosanitary measure, 1 excise. Also, the Byelorussian party uses 15 restrictive measures. In addition, Russian commodities are subjected to 8 antidumping and 11 special protective investigations. Main countries where there are restrictions with regard to Russian export are European Union countries (17 restrictive measures), Byelorussia (15), the Ukraine (12), USA (10), India (8).

At the end of December of 2004 the RF Federation Government approved the new rates of customs collections to be paid by citizens and entrepreneurs for customs services concerning clearance, accompanying and goods storage at warehouses.

In accordance with the rules being in effect before the beginning of 2005, payment for goods clearance was established in percentage from the cost of shipped cargo – 0,15%. Now, clearance value is expressed as fixed sums and varied from Rb 500 to Rb 100 000, depending on commodity value. For example, if the cargo value does not exceed Rb 200000, the size of tariff rate will be Rb 500. To clear a commodity which value is not more than Rb 450000, it will be needed Rb 1 000., while the cargo that costs Rb 1.2 million, may be cleared for Rb 2 000. For the most expensive cargoes, which value is over Rb 30 million, clearance will cost Rb 100 000. In practice, those figures mean 1,5 times increase of the cost of clearing at a minimum. For inexpensive cargo carriers, the rates will rise on average more than two times.

The conditions of car imports became more severe: rates of charges increased twice as much and constitute now from Rb 500 to 100 thousand, depending on the cost of the car. In this case, new rules are effective for both - juridical and natural persons.

To clear a car priced to Rb 200 thousand, one has to pay now Rb 500. At the cost of a car from Rb 200 to Rb 450 thousand, the charge rate will make Rb 1000. If a car is crossing the border and it's cost is from Rb 450 thousand to Rb 1.2 million, one will have to pay Rb 2000. If the car's value does not exceed Rb 2.5 million, the charge rate will constitute Rb 5500. A person who owns a car priced no more than Rb 5 million, will have to clear it for Rb 7500. For carriage of a car that cost from Rb 10 to RB 30 million, one will have to pay for clearing Rb 50 thousand. The highest rate (Rb 100000) has been established for "rare" cars, which cost is over Rb 30 million.

In addition, on the first days of the new year there had been signed the government regulation, establishing the list of equipment to be imported without special permission. These, in particular are cellular phones, videophones, fax machines, teleprinters, machine answering devices, satellite and radio-telegraph antennas.

Since January 15, 2005 a new scheme of goods transportation has been introduced, which basically concerns those foreign trade participants who carry out importation of goods by small batches. As a rule, these are so-called “shuttler traders” and cargo companies. Principally, the requirements are as follows. The customs bodies’ managers must require to provide them data on the transported goods for each package, through “presentation in the packing list of specifications, sheets, or other commercial, shipping (carriage) documents”. Compulsory attributes of such sheets are the data on the name (description) of goods contained in a package, their number and markings.

More than that, all goods must be separated and packed by their type and name. For each package it is necessary to provide a full list with description of the names, markings and quantity of goods contained in it. Otherwise, an importer will have to unpack sacks and boxes right at the temporary storage warehouse. Then goods will have to be graded and repacked. In this case, the customs clearing term will be prolonged until all is performed properly.

N.Volovik

The third law on insolvency: the first results and prospects

An analysis of the results of enforcement of bankruptcy procedures in 2003 and 2004 revealed that due to the lack of formed court practices of enforcement of the provisions of the third law on insolvency, it may be considered that its potential is far from being exhausted; however, even now it is possible to form a judgment on the most noticeable miscalculations relating to the evaluation of the situation in the sphere of enforcement of insolvency procedures and certain flaws in the provisions of the new law.

While in the period in which the first law on insolvency was in force (1992 through 1998) the institution of bankruptcy was rather of the imitation nature, the second law (1998 through 2002) had even more distorted the situation turning the institute of bankruptcy from a method to instill financial discipline into a tool of redistribution of property and withdrawal of assets.¹² The new (third) law on bankruptcy has been in force since 2003 and it envisages a number of positive innovations: lower risks of misuse of the rights on the part of creditors, granting of equal rights to the state and bankruptcy commissioners, consolidations of state claims, expansion of the mechanisms aimed at the protection of bona fide owners, introduction of the procedure of financial rehabilitation, greater control over the actions of bankruptcy commissioners, etc.

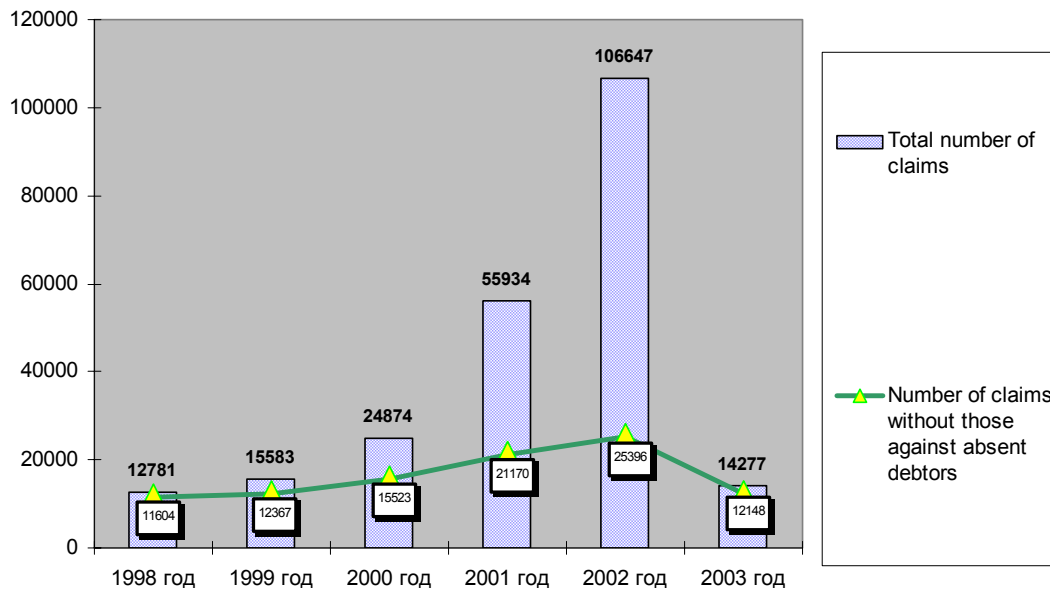
In March of 2004, the alignment of forces of the respective authorities engaged in the regulation and practical enforcement of bankruptcy procedures principally changed. Accordingly, the problem of further division (coordination) of the functions performed by different authorities in the sphere of insolvency became more urgent. In 2004 and 2005, there were observed two most pronounced trends: first, the trend towards a reduction in the number of “poles” of regulation in this sphere after their “atomization” in the course of the liquidation of the Federal Service of Financial Rehabilitation (Russ. abbr. FSFO), and, second, towards an enhancement of Federal Tax Service (Russ. abbr. FNS) powers.

The approval of a new law on bankruptcy, which has significantly modified the institution of insolvency, determined the necessity to revise the regulatory bylaws in this sphere. In 2002 through 2005, different state authorities issued more than 20 bylaws pertaining to the sphere of bankruptcy, however, the “tuning” of the new legislative mechanisms continues. At the same time, after the enactment of the new bankruptcy law there is required a period for formation of the respective infrastructure and its adaptation to new legislative regulations. It is also apparent that such “tuning” requires to take into account the specifics of real demand for institutional innovations, which would be adequate to the existing economic realities. However, the practices of 2003 and 2004 indicate significant changes in the dynamics of respective cases, appearance of new important trends in the sphere of bankruptcy, revision of the significance of certain problems observed in the preceding period.

¹² See: Radygin A., Simachev Yu. Bankrotstva (Bankruptcies). – In: *Ekonomika perekhodnogo perioda. Ocherki ekonomicheskoi politiki postkommunisticheskoi Rossii 1998 – 2002. M., Delo, 2003, pp. 498 – 512.*

Yet in 2003, the scale of application of bankruptcy proceedings sharply declined: the number of bankruptcy claims against debtors declined 7.5 times from 106647 cases in 2002 to 14277 cases in 2003 (see Diagram 1). Even a more dramatic decline was observed with respect to the claims resulted in initiation of bankruptcy proceedings – the number of such claims decreased 9.8 times from 94531 in 2002 to 9695 in 2003 (see Diagram 2).

Diagram 1. The dynamics of bankruptcy claims against debtors



The fact that tax authorities have practically stopped to accept bankruptcy claims against absent debtors accounts for about 85 per cent of this radical reduction in the number of bankruptcy claims. In 2003, there were registered only 2129 claims against absent debtors as compared with 81251 claims registered in 2002. It is an illustrative demonstration of the enforcement of the provisions of the third law on insolvency, which stipulates that bankruptcy procedures with respect to absent debtors should be applied only in the case budgets have the respective funds; however, as it should be expected, no such funds were provided in the budget for year 2003. On the whole, this result may be positively appraised, since it reduced the irrational burden on the system of arbitration courts. However, the problem of absent debtors has not been resolved by a legislation envisaging methods other than bankruptcy procedures.

At the background of such a massive reduction of claims against absent debtors, the decline in the number of claims against “substantive” debtors does not look very significant; however, in reality the number of such claims decreased about two times. The number of initiated bankruptcy cases involving monitoring made 5351 in 2003 as compared with 10739 cases registered in 2002. It seems that these developments resulted from more strict conditions of the registration of claims concerning insolvency. However, it is expected that this would be a rather short term effect as it is probable that many creditors have not yet subjected their debtors to executive proceedings.

On the face of it, a more sharp reduction of the number of initiated bankruptcy cases in comparison with the decline in the number of bankruptcy claims against debtors may be interpreted as a more strict approach of courts to the submitted claims (see Diagram 3). However, the growth in the number of initiated bankruptcy proceedings observed in 1999 through 2002 was related to the increase in the specific weight of the number of claims against absent debtors; therefore, in 2003 the activity related to the initiation of cases governed by simplified procedures sharply declined, while the share of rejected claims increased. On the whole, the “exclusiveness” of the application of bankruptcy procedures has significantly increased. On the face of it (judging by the number of submitted claims and the share of claims against absent debtors in this number), the scale of application of bankruptcy procedures in 2003 reminds of the situation existing in 1998 and 1999.

Diagram 2. The dynamics of initiated bankruptcy cases

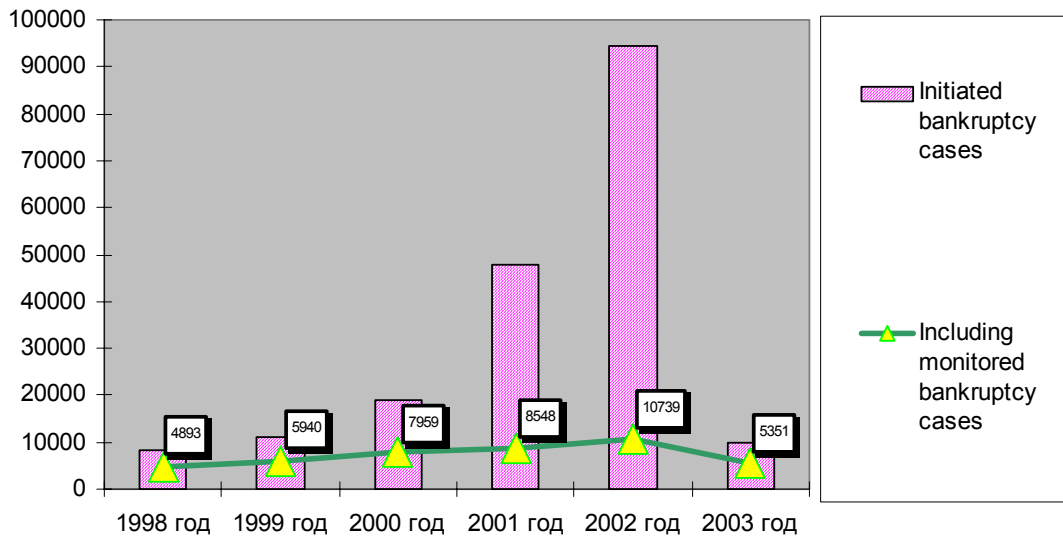
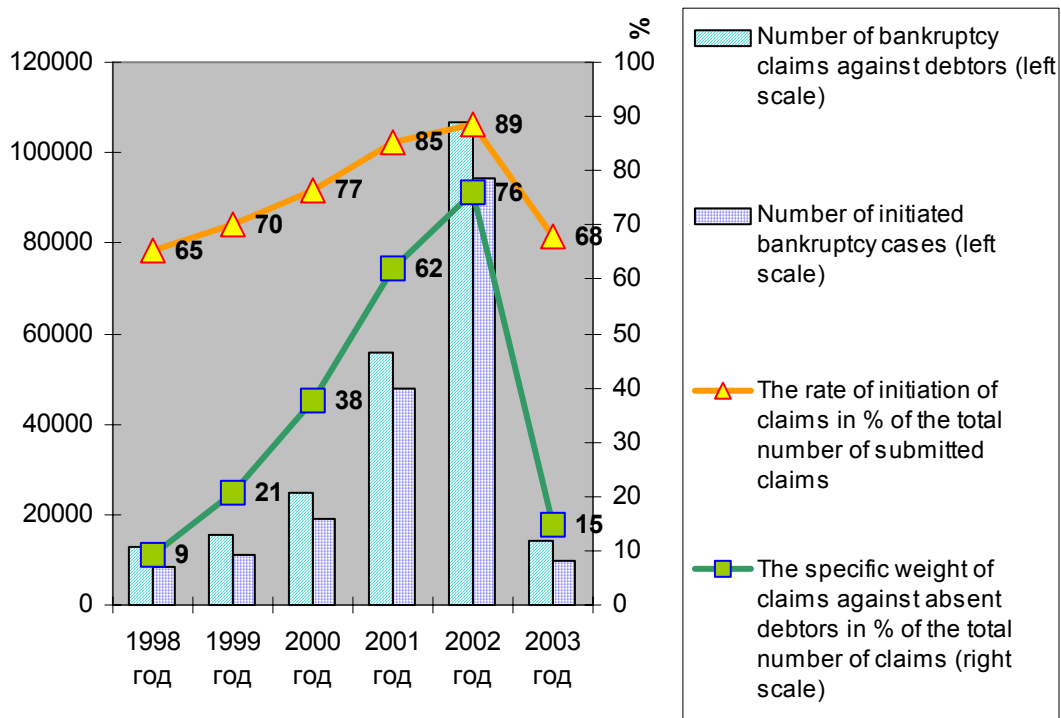


Diagram 3. The rate of initiation of bankruptcy proceedings against debtors



The practices of enforcement of the third law on insolvency in 2003 do not permit to indicate any positive shifts in the solution of reorganization and rehabilitation problems in the course of implementation of bankruptcy procedures. In about 70 per cent of cases, the monitoring procedures resulted in the initiation of bankruptcy proceedings. The trend towards a decline in the both the number, and the share of rulings initiating external administration persisted (547 cases in 2003 as compared with 931 cases in 2002). There was observed a significant decline in the number of approved amicable settlements: from 145 in 2002 to 54 in 2003. At the same time, there was observed a significant increase in the share of rulings rejecting bankruptcy claims against debtors and the share of rulings ceasing bank-

ruptcy proceedings, what is an evidence of a growing role played by arbitration courts as concerns the protection of interests of potentially solvent enterprises. Only due to these factors the bankruptcy bias of monitoring procedures has somewhat decreased. The procedures of external administration proved to be even less suitable both for the achievement of amicable settlements, and for recovery of enterprises' paying capacities. In 2003, more than 90 per cent of external administration procedures resulted in rulings initiating bankruptcy proceedings. The trend towards a decline in the number of amicable settlements persisted (53 cases in 2003 as compared with 121 cases in 2002), while financial rehabilitation of enterprises was achieved only in few cases (only 28 cases). On the whole, taking into account all "stages" of bankruptcy procedures, in 2003 there were registered about 230 cases where businesses were "rehabilitated": 170 proceedings were ceased after the conclusion of amicable settlements and 56 bankruptcy proceedings resulted in the rehabilitation of debtors and satisfaction of debtors' claims. The practice of enforcement of insolvency procedures indicates that the bankruptcy bias persists and even grows; it is apparent that in the course of elaboration of the provisions of the third law on bankruptcy the wish of owners to rehabilitate and develop debtors' businesses was overestimated.

The trends noted above were also characteristic in 2004.¹³ According to the data presented by the RF Ministry of Economic Development and Trade, as on September 1, 2004, the number of bankruptcy cases examined by Russian arbitration courts declined two times (to 48833) as compared with the respective figure registered in 2002. As it has been noted above, a sharp decline (including the data for year 2004) of the number of bankruptcy claims against debtors was to a significant extent related to the "freezing" of the state activity as concerns the initiation of bankruptcy procedures since March of 2004 because of the administrative reform and the necessity to provide budgetary funds for the payment of bankruptcy procedures related costs. At the same time, about 50 per cent to 60 per cent of the consolidated debts of enterprises undergoing the bankruptcy procedures are due to the state. The changes in this situation (including the solution of administrative, legal, and financial issues) will result in a sharp increase in the number of bankruptcies. In particular, this also means that in the near future the state will become the major "contractor" of bankruptcies and the issues relating to the criteria of initiation of such cases become extremely urgent at present.

The problem of fraudulent and deliberate bankruptcies remained urgent in 2003 and 2004. According to the data presented by FSFO, in 2002 there were revealed 457 cases of deliberate and fraudulent bankruptcies and 417 such cases in 2003. It should be noted that in 2002 through 2004 there were initiated about 300 respective criminal cases, however, only 20 were examined in courts and only 12 of them resulted in convictions. Due to the introduction of more complicated procedures governing the initiation of bankruptcy proceedings and restriction of the discretion of bankruptcy commissioners, since 2003 the number of "contracted" bankruptcies (according to the FSFO estimates) has significantly declined in 2003 and 2004¹⁴; however, there were implemented corporate procedures (withdrawal of assets is carried out prior to bankruptcy). This problem is rather urgent as concerns state unitary enterprises, especially those included in yearly privatization plans. According to certain estimates, up to 10 per cent of such state unitary enterprises (included in privatization plans) go bankrupt within a year, while 70 per cent to 80 per cent of assets of such enterprises are withdrawn prior to bankruptcies.¹⁵

As a result, as it is demonstrated by the practices of 2003 and 2004, since the enactment of the provisions of the new law on bankruptcy the role of this institution in the sphere of seizure of assets has significantly declined. However, it means only that the respective "burden" was transferred to the traditional market of corporate control (hostile takeovers via purchase of shares or other actions related to the company's shares) and the sphere of executive proceedings. According to the provisions of the

¹³ At the moment the work with this material was completed, the official statistics for year 2004 (VAS RF etc) was not available.

¹⁴ According to the FSFO data for year 2001, after the "sifting" of the cases of absent debtors there remained about 21 000 "substantive" cases, one third of which (i.e. 7 000) were of "contracted" nature. (An interview with T. Trefilova – Kommersant, 2004, February 13).

¹⁵ Pervyi god deistviya novogo zakona o bankrotstve: rezultaty i perspektivy. (The first year of enforcement of the new law on bankruptcy: results and perspectives). The materials of the conference of the RF Commerce Chamber, the RF VAS, and the RF State Duma, February 24, 2004.

new law, the creditor has the right to submit the bankruptcy claim against the debtor only in the case the law enforcement officers failed to exact the debt. There is formed a situation, where all assets of a company may be purchased via bailiffs without initiation of the bankruptcy proceedings.¹⁶

Below, there are presented certain *general evaluations of the impact of the insolvency institution on the demography of organizations* (see Table 1)¹⁷. On the whole, about 145 thousand of organizations ceased their operations in the period from July 1, 2002 till July 1, 2004; at the same period there were created almost 600 thousand of organizations. In 77 per cent of these cases, the cessation of operations of legal entities related to their liquidation and only in 20 per cent of cases – to reorganization. In the majority of cases, the liquidation of organizations (72 per cent of the total number of such organizations) was related to bankruptcy procedures. *On the whole, in 2 years 4.7 per cent of the total number of organizations as on July 1, 2002, was liquidated via bankruptcy procedures.*

Table 1

Liquidations involving bankruptcy procedures

	Legal entities liquidated via bankruptcy procedures in the period:		The share of organizations liquidated via bankruptcy procedures in % of the number of organizations at the beginning of the period:	
	July 1, 2002 – September 30, 2003	October 1, 2003 – July 1, 2004	July 1, 2002 – September 30, 2003	October 1, 2003 – July 1, 2004
<i>All legal entities</i>	47 531	32 729	2,8	1,6
Limited liability companies	14 035	9 575	1,6	0,8
Joint stock companies (open, closed)	3 760	3 223	2,5	1,9
Production cooperatives	1 346	1 302	5,5	5,1
Unitary enterprises	241	228	1,7	1,4

The significance of bankruptcy procedures in the course of liquidation of organizations depend on their *organizational and legal forms*: the bankruptcy processes were more intensive among production cooperatives and joint stock companies. The observed decline in the significance of bankruptcy procedures and liquidation of enterprises in the period from October 1, 2003 till July 1, 2004, is related to both a lesser duration of the observation period, and the fact that in this period (in contradistinction to the first period) there was in force the third law on bankruptcy. Accordingly, in this period there was most clearly indicated the sharp reduction of practices of submission of bankruptcy claims against absent debtors. It should be noted that this decline of the role played by bankruptcy procedures and liquidation of enterprises were not proportional across the groups of legal entities depending on their organizational and legal forms. The less intensive use of bankruptcy procedures became the most significant for limited liability companies (in this group there were observed much more “abandoned” firms and ephemerid companies) and least significant for production cooperatives and unitary enterprises.

In about one year after the enactment of the new law on bankruptcy there was started a work on its improvement and, what is equally important, the harmonization of other legal acts with this law.¹⁸ For instance, in 2003 and 2004, the RF Government approved on the whole the following areas of modification of the bankruptcy law presented by the RF Ministry of Economic Development and Trade and the RF Justice Ministry:

- improvement of the criminal and administrative legislation and bankruptcy legislation as concerns the responsibility for offences and crimes related to bankruptcy;
- determination of the procedures and terms of participation of the authorized agencies in the procedures of financial rehabilitation and amicable settlement of bankruptcy cases;

¹⁶ See: Vyshegorodtsev I. Chto budet s bankrotstvami. Sliyaniya i Pogloshcheniya, 2005, No. 1, p. 59.

¹⁷ For evaluations, there were used the data on the state registration of legal entities in the Single State Registry of Legal Entities carried out in 2002 through 2004 presented by the Russian Tax Ministry.

¹⁸ For details see: Radygin A., Swain H., Simachev Yu., Entov R., et al. Institut bankrotstva: stanovleniye, problema, napravleniya reformirovaniya (The institution of bankruptcy: formation, problems, reforming). M., IET – CEPRA, 2005.

- modification of the law on bankruptcy as concerns the more clear definition of current payments, requirements pertaining to the bankruptcy commissioner, consequences of the dismissal of the bankruptcy commissioner, the status of compensatory funds and mutual insurance societies, the procedures governing the sale of property in the framework of financial rehabilitation or external administration, development of self-regulation;

- creation of the legal basis of the procedures of bankruptcy, financial rehabilitation, and amicable settlements;

- introduction of the option of the amicable settlement in bankruptcy cases where the Russian Federation is the major creditor;

- expansion of the circle of legal entities subject to bankruptcy procedures;

- harmonization of the issues of priority of satisfaction of creditors' claims with the bankruptcy legislation currently in force;

- protection of property from criminal offences, prevention of crimes and offences via the improvement of provisions of the RF Criminal Code and RF Code of Administrative Offences setting forth the responsibility for offences related to bankruptcy procedures and pre-bankruptcy operations.

The same guidelines were indicated in the Program of social and economic development of the RF in a medium term outlook (2005 through 2008) worked out by the RF Ministry of Economic Development and Trade and being elaborated in November of 2004 through January of 2005. In January of 2005, the RF Government approved a package of draft laws aimed at the improvement of the legislation on bankruptcy and introducing amendments to the law "On insolvency (bankruptcy)," the RF Criminal Code, the RF Code of Administrative Offences, the RF Tax and Budget Codes. The planned changes embrace a rather wide range of flaws and gaps of the law on bankruptcy and in the case these amendments are approved, they may significantly improve the quality of the new law. However, there remain significant possibilities for further modification of the law.

Simachev Yu. V., Radygin A. D.

Most Important Issues Considered at the Sessions of the RF Government on January 13 and 27, 2005

Of the RF Government sessions held in January 2005, of special interest are those dated January 13 and 27. On January 13, the RF Government adopted a draft Decree of the RF Government, presented by Russian Finance Minister Alexey Kudrin, on volumes of issuing the government papers in 2005. At the session of the RF Government of January 27 a draft Federal Law had been approved "On Introducing Changes to the Federal Law "On Labor Pensions in the Russian Federation" concerned with setting sizes of the base part of labor pension and a procedure of indexation of the base and insurance parts of labor pensions in 2005" and decision had been taken to introduce it into the State Duma of the RF. At that very session a draft Decree of the RF Government had been adopted by the Government concerning allocation of funds to the budgets of the Russian Federation's subjects to make available the transportation services for the population on the territory of the RF.

* * *

At the session of the RF Government of **January 13, 2005** the Finance Minister Alexey Kudrin provided, in execution of the Federal Law "On the Federal Budget for 2005", a draft Decree of the RF Government on volumes of issuing the government papers in 2005. To observe the law, the Finance Ministry offered the following volumes of issuing the government papers:

- state short-term zero coupon bonds (GKO) - to Rb 6.0 mlrd, federal loan bonds (OFZ) - to Rb 213.0 mlrd,
- state savings bonds (GSO) - to Rb 60.0 mlrd.

As it had been stressed in the report, in 2005 borrowings on the domestic market will predominantly be short-term- or long-term. Herewith, the Ministry of Finance of Russia, as an issuer of government papers will place indicative issues of state bonds with repayment dates of 3, 5 and 10 years, moreover, it will continue to replace "long" issues - 15-year state bonds.

Taking into account considerable volumes of pension accruals, that will be invested in the near future in the government papers, investing these means only in circulating papers will negatively affect the GKO/OFZ market because of accumulation of the government papers by "passive" investors and

reducing the market liquidity. To avoid such a situation, the Ministry of Finance of Russia offers to use for investing the means of state savings bonds (GSO) for financing the funded part of the labor pension in the RF. Thus, issuing GSO in the size of Rb 60 mlrd is planned to carry out basically for placing the funds of the Pension Fund of the RF and the government managing company - Bank for Foreign Economic Activity – for placement of pension accruals.

The RF Government adopted a draft decree on this issue.

At the session of the RF Government of **January 27, 2005** the Social and Healthcare minister Mikhail Zurabov presented in his report “On Raising the Base Part of the Labor Pension and Procedure of Indexation of Pensions in 2005” a draft law, prepared for the support of population’s financial condition, with account of measures being conducted currently for reforming the system of benefits, “On Introducing Changes to the Federal Law “On Labor Pensions in the Russian Federation” concerned with establishing sizes of the base part of the labor pension and a procedure for indexation of the base and insurance parts of labor pensions in 2005”. The draft law was adopted by the RF Government and decision had been taken to introduce it into the State Duma.

The provided draft law within the frame of the third paragraph of point 6, Article 17 of the Federal Law “On Labor Pensions in the Russian Federation” provides for single-stage increase, since March 1, 2005, of the size of all base parts of labor pensions (old-age pension, disablement pension, survivor's pension).

At present, the base part of the old-age pension, specified by the above law (after all carried out indexations following coming into force of the law since 01.01.2002) is Rb 660 per month¹⁹. The law offers to establish it Rb 900 per month, that is to raise it by 240 rubles. Concurrently, the size of all other base parts of the labor pension (old-age pension, disablement pension, survivor's pension) is increased in proportion correspondingly.

It had been emphasized in the report of the minister that for considerable part of pensioners the base parts of labor pensions (and the total amount of labor pension, correspondingly) will be raised for more than 240 rubles. For example, if an old-age pensioner has one dependent, his base part of the labor pension will make up 1200 rubles per month, that is will be increased by 320 rubles (at present, the base part of pension in such a case - 880 rubles). The base part of disablement pension, at the 3d degree of limitation of ability to work will make up 1800 per month and will be increased by 480 rubles (currently, it is 1320 rubles). For some categories of pensioners (we mean here the disabled with the 1st degree of limitation of ability to work, which is established in case a person retains no less than 50 % of working ability, and ordinary survivor's pensioners) an increase will make 240 rubles.

More than that, considering that pensions are calculated proceeding from the size of base parts of labor pensions, the size of pensions themselves will also be increased. Thus, for example, disabled, as a result of war trauma, with the 2d degree of limitation of ability to work will receive, since March 1, 2250 rubles per month, they will have an increase amounting to 600 rubles (at present their pension makes up 1650 rubles), while Chernobyl veterans, with the 3d degree of limitation of ability to work will have an increase amounting to 1200 rubles (4500 instead of 3300 rubles).

The suggested increase of the base part of the labor pension had not been provided for by the Federal Law “On the Budget of the Pension Fund of the Russian Federation for 2005”, in which connection it is necessary to change the dates of indexation of the base and insurance parts of the pension, as well as additional increase of the insurance part of pension and indexation (increase) coefficients.

With due account for this, the draft bill establishes for 2005 a partial changing of points 6 and 7 of Article 17 of the Federal Law “On Labor Pensions in the Russian Federation” and Article 7 of the Federal Law “On the Budget of the Pension Fund of the Russian Federation for 2005”, reading that indexation of the base and insurance parts of the labor pension and an additional increase of the size of insurance part of the labor pension will be made since August 1, 2005 basing on indexation (increase) coefficients determined by the RF Government.

To implement the draft law it will be additionally needed Rb 115.04 mlrd funds from the RF Pension Fund, which are to be compensated from the Federal Budget.

¹⁹ Decree of the RF Government of 21.07.2004 No. 363 “On Establishing the Sizes of the Base Parts of the Labor Pensions and Approval of the Indexation Coefficient since August 1, 2004, of the Insurance Part of the Labor Pension”.

The above draft law was approved by the RF Government.

At that very session of the RF Government the Finance Minister Alexey Kudrin proposed a draft Decree of the RF Government concerning allocation of funds to the budgets of the Russian Federation's subjects to make affordable the transportation services for the population on the territory of the RF. The draft Decree had been approved by the RF Government, with account of its specification according to the results of discussions at the session.

The draft provides for (in order that transportation services were equally provided to population in all regions, in which case the social support measures are within the purview of the RF and Russian Federation's subjects) allocation, in the first quarter of 2005, of Rb 2 mlrd as subsidies to support measures on ensuring balance of the RF budgets. The above funds are suggested to be sent to the Russian Federation's subjects for settlements with transportation organizations for provision of social passage tickers – one for federal and regional beneficiaries, or other forms of ensuring availability of transportation services.

According to the data of the Ministry of Finance of Russia, a total Rb 8.5 mlrd will be needed this year for these purposes. It is planned that shortage of funds will be provided to regions from the fund balance stipulated in Article 43 of the Federal Law "On the Federal Budget for 2005", and also be found during execution of the current year Federal Budget, and introducing appropriate changes to the said Federal Law.

Bolshakova E.A.

A review of regulatory documents concerning taxation, which were made public in January of 2005

In accordance with articles 21 and 34.2 of the RF Tax Code, taxpayers should have the right to be informed in writing by the RF Finance Ministry, financial authorities of RF subjects, tax agencies in the jurisdiction of which the taxpayers are registered about the problems of enforcement of the RF legislation on taxes and charges and respective regulatory acts, the procedures governing the calculation and payment of taxes and charges, etc.

According to article 111 of the RF Tax Code, in the case a taxpayer or a tax agent acted in compliance with the written explanations concerning the tax legislation issued by the authorized state authorities or competent officials thereof, such a taxpayer or a tax agent should be considered not guilty in tax offences. In such circumstances, the person is not responsible for tax offences.

In this connection, alongside with monitoring of innovations introduced in the texts of regulatory and legal acts, there should be paid attention to the formation of databases of written explanations sent by the authorized authorities to taxpayers. In many cases, taxation is determined by concrete contents and rules of registration of transactions based on civil law; it is affected by the regulations set forth by specific branch legislation regulating the issues of conduct of economic operations in different branches and spheres of activities. Therefore, the written explanations issued by the authorized authorities with respect to specific issues of enforcement of tax legislation are the necessary condition of a flexible tying of the tax legislation to the changing conditions of activities of economic agents. Taking into account the aforementioned facts, the written explanations of the authorized authorities with respect to tax legislation should be included in monthly surveys alongside with legislative acts, judicial rulings, and bylaws issued by the federal executive authorities.

Below, there will be analyzed certain explanations issued by the authorized bodies, which were published at the end of 2004 and in the beginning of 2005 in relation to the changes in the tax legislation entering into force since January 1, 2005.

1. In relation to the enactment of certain provisions of the RF Tax Code concerning the privileges relating to taxation of property owned by legal entities, the RF Tax Service requested the RF Finance Ministry to explain the procedures governing the application of tax privileges concerning the tax on the property owned by organizations with respect to the objects of social and cultural sphere used for the needs of culture, arts, education, physical culture and sports, health care, and social security.

As concerns the aforementioned request, the RF Finance Ministry issued its explanation as its letter No. 03.-06-01-04/65 of October 20, 2004, which, as FTS letter No. 21-4-04/9 of January 11, 2005, was sent to the tax authorities for the use in their work.

In particular, the RF Finance Ministry explained the following issues. In article 30 “Tax on property of organizations” of the RF Tax Code there is no concept of objects of social and cultural sphere used for the needs of education, physical culture, health care, and social security.

In spite of the fact that in the same document (the RF Tax Code), although in another article concerning the profit tax, the objects of health care, culture, objects of preschool education, summer camps for children, sanatoriums, boarding houses, tourist centers, objects of physical culture and sports (including tracks, hippodromes, stables, tennis courts, golf fields, badminton courts, rehabilitation centers), objects of non-production types of consumer services rendered to the population (bath houses and saunas) are defined as the objects of social and cultural sphere, the RF Finance Ministry referring to the absence of direct indications in other branches of the legislation (on health care, physical culture and sports in the Russian Federation, the principles of social servicing of the population of the Russian Federation) that the tourist centers, boarding houses, camps for children, etc. are objects used for the needs of culture, arts, education, physical culture, sports, health care, and social security explains that the privileges related to the tax on the profit of organizations may be granted only in the case the respective organizations use these properties for the purposes indicated in their bylaws.

It should be noted that this position of the RF Financial Ministry and the RF Tax Service allows different interpretations of the same term in the framework of the same law (the RF Tax Code). Codification of the tax legislation in the framework of one document was carried out with an aim to exclude different interpretation of the same term for the calculation of different taxes, what earlier created technical problems and complications.

The clearly pronounced trend towards domination of budget legislation over the tax legislation in the sphere of taxation results in the fact that budget organizations have unjustified heavy tax burden in comparison with commercial organizations involved in entrepreneurial activities. This situation is at variance with the principle of equal tax burden not depending on the organizational and legal form of the taxpayer set forth by the RF Tax Code. Thus, in accordance with the aforementioned explanation of the RF Finance Ministry, the object of property tax as concerns budget organizations is the initial value of the property, while commercial organizations pay the tax calculated on the basis of depreciated value of their properties. Different tax bases (and respective tax burden) is explained by the consideration that the property granted for free should not be the subject of depreciation. However, it should be reminded that wear and tear are taken into account in other cases, for instance, in the course of determination of the tax base of the profit tax. Commercial organizations (in contradistinction to budget organizations) have the right to deduct the amount of depreciation from the profit tax base; therefore they can recover the means spent by them earlier and equalize the tax burden. At the same time, too high property tax burden on budget organizations has no economic justification whatsoever.

2. Letter of the FTS No. 09-0-10/5985 of December 27, 2004, was issued in relation to the enactment of article 366 of the second section of the RF Tax Code on January 1, 2005, and in relation to the amendments made to article 29 of the RF Tax Code. The letter explains the issues of registration of taxpayers paying the tax on gambling at the location of the object of taxation. The RF Tax Service prepared its draft order concerning the registration of the payers of the tax on gambling in the respective tax agencies. After the approval of the draft order by the respective structural units of the RF Tax Service, this order will be submitted for approval of the RF Finance Ministry.

Until the order is approved, since January 1, 2005, the registration of the taxpayer should be carried out on the basis of the taxpayer application for registration of the object (objects) of taxation submitted in accordance with the procedures set forth in paragraph 2 of article 366 of the RF Tax Code supplemented with the documents indicated in the draft order (if such documents are available).

3. Federal law No. 198 FZ of December 9, 2004, amends article 1 of federal law No. 82 FZ of June 19, 2000, “On minimal wage” to the effect that the minimal monthly wages and salaries should be set at:

- Rub. 720 per month since January 1, 2005;
- Rub. 800 per month since September 1, 2005;
- Rub. 1 100 per month since May 1, 2006.

4. Federal law No. 207 FZ of December 29, 2004, sets forth the insurance tariffs related to the mandatory social insurance as concerns accidents at work and professional illnesses.

5. Letter of the RF Tax Service No. 04-4-09/1273 of December 29, 2004, explains the procedures governing the registration of payment documents as concerns the payment of the stamp tax, which in 2005 should be entered in the accounts of the Federal Treasury agencies in its full amount.

6. Resolution of the RF Government No. 857 of December 27, 2004, abolishes the minimal and maximal rates of payments for the use of water objects set forth by Resolution of the RF Government No. 826 of November 28, 2001, due to the enactment of article 25.2 of the RF Tax Code “Water Tax.” The tax rates should be directly set forth by the RF Tax Code.

7. Letter of the RF Tax Service No. ShS-6-10/8 of January 14, 2005, explains the procedures governing the transfer of tax related payments made by bank customers to the budget system of the Russian Federation on the part of crediting organizations. The letter concerns the transfer of taxes, charges, and other payments registered prior to January 1, 2005, and entered in the database of the documents not executed within the established terms. In accordance with letter No. 08-17/5677 of December 31, 2004, of the Central Bank of the Russian Federation, the aforementioned payment documents should be executed by the crediting organizations in accordance with the stipulations of the Bank of Russia Rules No. 2-P of October 3, 2002, “On non-cash payments in the Russian Federation” being in force at the moment of registration of the payment documents and should not be reregistered by crediting organizations.

The issue of the possibility for banks to introduce changes in the payment documents of taxpayers is very urgent, since, on the one hand, the RF Tax Code includes a direct stipulation (article 45) that the tax should be considered as paid on the date of submission of the respective payment document to the bank on condition that the taxpayer has sufficient funds on its bank account. At the same time, the Constitutional Court explained (No. 138-O of April 25, 2001) that this stipulation should be applicable only to conscientious taxpayers. Since in each concrete case only the court may establish if the taxpayer is conscientious, the failures of banks to execute such documents often result in tax offences and respective fines imposed on the taxpayers. In fact, the explanation issued by the RF Constitutional Court has returned the situation existing prior to the banking crisis of 1998, when taxpayers had no means of protection against the actions of tax authorities.

As concerns the establishment of the date of the payment of the tax by the customer, in accordance with the banking legislation, the transfer of money from the corresponding account of the payer’s bank to the corresponding account of the beneficiary’s bank is executed by a payment document issued by the bank on the date of actual transfer of the funds from its account. At the same time, the original tax payment document filled in by the customer is supplemented to the bank payment document. Banks have no right to make changes in the customer’s document. The real problem is that tax authorities still can not switch to control over the movement of payment documents in bank databases. Therefore, tax authorities, (infringing on the tax legislation stipulations) register the tax payments on the basis of notifications from the Federal Treasury that the necessary amount was entered in the account of budget revenues, and until that moment continue to hold the taxpayer responsible for delay of tax payments. The failure of tax authorities to organize proper monitoring of the movement of payment documents in the framework of in the bank – taxpayer system results in unjustifiable high administrative costs borne by taxpayers with respect to the payment of taxes, while the risks associated with unjustified actions on the part of tax authorities turn out to be too high. It seems probable that exactly this factor had the key impact on the worsening of the investment climate in the Russian Federation.

L. Anisimova

A review of economic legislation: January of 2005

In late December and January there were introduced the following changes in the legislation currently in force: enactment of the new Housing Code of the Russian Federation; the minimal wage was set at Rub. 720 since January 1, 2005; the tax deduction for each child was increased from Rub. 300 to Rub. 600; there were approved the Provisional Rules governing the investigation of deliberate and fraudulent bankruptcy by the bankruptcy commissioner; the Tax Service brought to the notice of all concerned parties the data used for the calculation of the mineral extraction tax rate on oil in December of 2004; the Tax Service brought to the notice of all concerned parties the rates of excise taxes on excisable goods imported to the customs territory of the Russian Federation applicable since January 1, 2005.

I. FEDERAL LAWS of the Russian Federation

1. “ON ENACTMENT OF THE HOUSING CODE OF THE RUSSIAN FEDERATION” No. 189 FZ of December 29, 2004

The RF Housing Code enters into force on March 1, 2005. At that time, there should be abolished the Housing Code of the RSFSR, regulatory legal acts introducing amendments to the Housing Code of the RSFSR, and there should be introduced the respective amendments to certain normative legal acts regulating the legal relations in the housing sphere.

The law set forth that prior to the harmonization of the respective laws and other regulatory legal acts in force on the territory of the Russian Federation with the RF Housing Code, the provisions of these laws and other regulatory legal acts should be enforced in the case they are not at variance with the RF Housing Code and this federal law.

The law stipulated that the citizens registered as the applicants for housing provided on the basis of contracts for social renting prior to March 1, 2005, should retain their right for such a registration until they receive housing on the basis of the social renting contracts.

The housing granted to the citizens on the basis of contracts for social renting after March 1 of 2005 should not be subject to privatization.

2. “ON AMENDMENTS TO THE FIRST SECTION OF THE CIVIL CODE OF THE RUSSIAN FEDERATION” No. 213 FZ of December 30, 2004

The law enters into force on January 1, 2005.

The law sets forth that the uncompleted construction objects should be defined as immovable things (immovable property, real estate).

The law introduces the norm in accordance to which the right of use of housing by the members of the family of the previous owner in the case the right of ownership of a residential house, an apartment, or other residential premises is transferred to a new owner should be terminated. Besides, the law stipulates that in the case of the sale of residential premises, the preliminary permission (consent) of the guardian authorities with relation to such a transaction is required only in the case such premises are occupied by the members of the family of the previous owner of such residential premises being under the guardianship, or underage members of the family of the previous owner without parental custody (what is known to the guardian authorities) and the said transaction infringes on the rights or interests of the said persons protected by the law.

The law excluded from the Code the norm in accordance with which the mortgage contract should be certified by a notary.

The law sets forth that in the case a plot of land is mortgaged, the right of mortgage should be applied to the buildings or structures located or constructed on this plot of land by the mortgager in the case the respective contract does not stipulate other conditions.

3. “ON AMENDMENTS TO THE FEDERAL LAW ‘ON MORTGAGE (PLEDGE OF REAL ESTATE)’” No. 216 FZ of December 30, 2004

The law sets forth that the mortgage should concern all inseparable improvements of the object of mortgage in the case the respective contract or this federal law does not set forth other conditions.

The amendments to the law abolish the requirement of notary certification of mortgage contracts.

Article 31, which regulates the insurance of mortgaged property, was supplemented with the norms concerning the insurance of borrowers’ obligations to creditors as concerns the failure to execute or improper execution of debt repayment obligations.

The federal law was supplemented with Article 64.1 “Mortgage of plots of land purchased at the expense of borrowings from banks or other credit organizations or target loans” and Article 64.2 “Mortgage of plots of land, where there are located buildings or structures purchased or constructed at the expense of borrowings from banks or other credit organizations or target loans.” In the case the federal law or a contract do not stipulate other conditions, the plot of land purchased at the expense of borrowings from banks or other credit organizations or target loans granted by another legal entity with the purpose of purchase of this plot of land should be considered as being mortgaged since the moment of the state registration of the right of ownership of the borrower with respect to the said plot of land. In the case the federal law or a contract do not stipulate other conditions, the plot of land where there are located buildings or structures constructed or being in the process of construction at the expense of borrowings from banks or other credit organizations or target loans granted by another legal entity with the purpose of construction of a building or a structure, or the right of rent of such a

plot of land is considered to be mortgaged since the moment of the state registration of the right of ownership of the borrower with respect to the said commissioned or noncommissioned buildings or structures; or since the moment the authority responsible for the state registration of the rights of receives the notification from the mortgager and mortgagee as concerns the conclusion of the credit agreement (target loan agreement).

4. "ON AMENDMENTS TO ARTICLE 1 OF THE FEDERAL LAW 'ON MINIMAL WAGE'" No. 198 FZ of December 29, 2004

The amendments to the law concern an increase in the minimal wages and salaries. Thus, since January 1, 2005, the minimal wages and salaries should make Rub. 720 per month, Rub. 800 per month since September 1, 2005, and Rub. 1100 per month since May 1, 2006.

5. "ON AMENDMENTS TO THE SECOND PART OF THE TAX CODE OF THE RUSSIAN FEDERATION" No. 203 FZ of December 29, 2004

The law enters into force after one month since the date of its promulgation.

The law introduced amendments to Article 218 of the RF Tax Code, which determines the procedures governing the granting of social tax deduction. In particular, the tax deduction for each child of taxpayers caring for the children and who are parents or spouses of parents was increased from Rub. 300 to Rub. 600. Besides, this tax deduction should be granted for each child of the taxpayers who are custodians, guardians, or foster parents. The total amount of income making a family eligible for this tax deduction was raised from Rub. 20000 to Rub. 40000. The amount of tax deduction should be doubled in the case a child under 18 years of age is disabled and in the case a full time pupil, post-graduate student, resident physician, or student under 24 years of age is an invalid of the first or second group.

This federal law should be applicable to the legal relations originated since January 1 of 2005.

II. RESOLUTIONS OF THE GOVERNMENT of the Russian Federation

1. "ON THE APPROVAL OF THE PROVISIONAL RULES GOVERNING THE INVESTIGATION OF DELIBERATE AND FRAUDULENT BANKRUPTCY BY THE BANKRUPTCY COMMISSIONER" NO. 855 of December 27, 2004

The approved Rules regulate the procedures governing the determination of indications of deliberate and fraudulent bankruptcy.

The detection of indications of deliberate bankruptcy is carried out in two stages. At the first stage, there are analyzed the values and dynamics of coefficients characterizing the solvency of the debtor. In the case at the first stage there is established a considerable worsening of values of 2 and more coefficients, there should be carried out the second stage of detection of indications of deliberate bankruptcy of the debtor, i.e. an analysis of transactions made by the debtor and the actions of managing bodies of the debtor over the period under observation, which could cause such a worsening of indicator values.

In the course of the analysis of transactions conducted by the debtor, there should be established the compliance of the transactions and actions (failures to act) of the managing bodies of the debtor with the legislation of the Russian Federation, and there should be detected transactions conducted or carried out on terms not corresponding to the respective market conditions resulting in origination or increase in insolvency or real money losses of the debtor. In particular, the Rules define as the transactions concluded on the terms not corresponding to market conditions the following: transactions concerning the sale of debtor's property, which can not be defined as purchase and sales transactions and aimed at the replacement of the debtor's property with less liquid property; purchase and sales transactions with respect to debtor's property, which were concluded on the terms definitely unfavorable to the debtor, as well as the transactions involving the property necessary for the core activities of the debtor; the transactions causing debtor's obligations not covered by its property, as well as those resulting in purchase of non-liquid property; the transactions aimed at the replacement of obligations with other obligations concluded on the terms definitely unfavorable for the debtor. The definitely unfavorable terms of transactions for the debtor may concern, in particular, the price of property, works, and services, as well as the types and terms of the payments related to such transactions.

Investigation of indications of fraudulent bankruptcy should be carried out in the case of initiation of bankruptcy proceedings on the basis of the debtor's claim. In order to establish the indications (absence of indications) of fraudulent bankruptcy, there should be carried out the analysis of values and dynamics of coefficients characterizing the solvency of the debtor.

The resolution determines the indications of deliberate or fraudulent bankruptcy and the procedures governing the preparation of the report as concerns the revelation of the indications (absence of indications) of fraudulent or deliberate bankruptcy.

2. "ON THE APPROVAL OF THE RULES GOVERNING THE ELABORATION, APPROVAL, AND ENACTMENT OF STATE EDUCATION STANDARDS OF PRIMARY, SECONDARY PROFESSIONAL, HIGHER PROFESSIONAL, AND POSTGRADUATE PROFESSIONAL EDUCATION" No. 36 of January 21, 2005

The resolution sets forth the procedures governing the elaboration, approval, and enactment of state professional education standards, which include the federal and regional (national regional) components, as well as the component of the educational institution (organization).

The state education standards of professional education should be approved at least once each 10 years.

The resolution determines the powers of the RF Ministry of Education and Science as concerns the elaboration, approval, and enactment of the said education standards.

The resolution abolishes a number of resolutions of the RF Government regulating this sphere of legal relations.

III. INSTRUCTIONS, REGULATIONS, AND ORDERS

1. Letter of the RF Federal Tax Service "ON THE ENACTMENT OF THE AGREEMENT BETWEEN THE GOVERNMENT OF THE RUSSIAN FEDERATION AND THE GOVERNMENT OF THE REPUBLIC OF BELARUS 'ON THE PRINCIPLES OF COLLECTION OF INDIRECT TAXES IN THE COURSE OF EXPORT AND IMPORT OF GOODS, EXECUTION OF WORKS, AND RENDERING OF SERVICES'" No. MM-6-26/4@

The FTS letter informs that the agreement between the Government of the Russian Federation and the Government of the Republic of Belarus "On the principles of collection of indirect taxes in the course of export and import of goods, execution of works, and rendering of services" signed on September 15, 2004, was enacted on January 1, 2005 and should be applied with respect to the goods shipped since January 1 of 2005.

2. Informational letter of the RF Tax Ministry No. MM-6-21/36@ of January 20, 2005 "ON CALCULATION OF THE MINERAL EXTRACTION TAX RATE IN DECEMBER OF 2004"

The letter informs about the data used for the calculation of the mineral extraction tax with respect to oil in December of 2004:

- the average level of Urals oil prices on the Mediterranean and Rotterdam markets (US \$ 34.99 per barrel);
- value of the Kts coefficient (2,9904);
- tax rate adjusted for the Kts coefficient (Rub. 1037,6688 per metric ton).

3. Order of the RF FTS "ON COLLECTION OF EXCISE TAXES" No. 438 of December 27, 2004

The order informs about the rates of excise taxes imposed on excisable goods imported to the customs territory of the Russian Federation (in particular, ethyl alcohol, alcohol beverages, alcohol containing products, vines, tobacco, cigarettes, cars, gasoline) applicable since January 1 of 2005.

I. V. Tolmacheva