

RUSSIAN ECONOMY: TRENDS AND PERSPECTIVES
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March of 2004: Political and economic outcomes.....	3
On the progress of reforms in March of 2004.....	5
The State of the Federal Budget.....	6
Monetary Policy.....	9
Financial Markets	11
Investment in fixed assets	20
Foreign investment in the Russia's economy	22
The Real Sector: Factors and Trends	25
Oil and natural gas sector.....	27
IET Business Survey: Industry in March of 2004.....	30
Foreign Trade.....	32
Mergers and takeovers in 2003	34
The cumulative mortgage system as a new tool aimed to settle the housing problems of military personnel.....	39
A forecast of certain macroeconomic indicators.....	42
Issues discussed at the meetings held by the Government of the Russian Federation on March 18 and March 25 of 2004	44
Review of economic legislation: March of 2004.....	48

March of 2004: Political and economic outcomes

The major outcomes in March of 2004 include, alongside with the expected results of the Presidential elections and the first round of the regional elections held in 2004, the reshuffling of the RF Government.

According to the data presented by the RF Central Election Commission, the election turn-out was registered at 64.3 per cent, what is by almost 10 per cent above the respective figures observed in the course of the December Parliamentary elections, when the turn-out was close to the critical threshold of 50 per cent. V. Putin received 71.3 per cent of the vote, i.e. by almost 20 per cent more than in 2000. N. Kharitonov was the second with 13.6 per cent of the vote, while S. Glazyev and I. Khakamada lagged behind with 4.1 per cent and 3.8 per cent, 3.4 per cent of the vote was cast against all candidates, while the LDPR candidate O. Malyshkin received 2.2 per cent and S. Mironov, the Speaker of the Federation Council who in fact supported V. Putin got less than 1 per cent of the vote. At the end of March, I. Rybkin announced about the withdrawal of his candidacy. His appeal to boycott the elections was heard only by a narrow group of political scientists, since this candidate did not carry out his election campaign.

The few complaints made by international organizations monitoring the election campaign and the elections were reduced to the disproportional coverage of candidates on the part of state owned, primarily electronic, mass media. OECD observers assessed the Presidential elections as well organized, but failing to comply with the European standards. No complaints were voiced by the candidates. Nevertheless, the indicators of the turn-out and support of the incumbent President in certain North Caucasus Republics and in the Republic of Bashkortostan incompatible with common sense, naturally, aroused suspicion. It is impossible to verify these results, since all “alternative” candidates running for the office of the RF President have delegated no observers to polling stations.

As concerns the party and political spectrum, Communists could hold their ground, while Glazyev, who had lost his sponsors and was cut off the television, suffered a crushing defeat and Khakamada, who expected to attract additional “democratic” vote, received less votes than obtained by her party at the Parliamentary elections. However, serious comments on the actions of the candidates running against the incumbent President would not make sense, since they disposed of negligible resources and could not inform the voters about their positions.

In this context, the results of elections to regional and municipal legislatures, where half of delegates are elected on the basis of party tickets, are of a special interest (Tatarstan, Karachayevo Cherkess Republic, Sverdlovsk and Yaroslavl oblasts, Altai krai, city of Krasnoyarsk). The results demonstrated by the “party of power” in these regions differ dramatically – from more than 70 per cent of the vote in Tatarstan to only second place in the Altai krai (the Altai elections were won by the bloc of left wing parties headed by the KPRF), and the city of Krasnoyarsk, while in the Yaroslavl oblast the United Russia could get only a few more votes than the Rodina election bloc (25 per cent and 20 per cent respectively). Communists are represented in all legislatures, LDPR and Rodina – in three and two legislative assemblies respectively. Opposition blocs not related to any concrete federal parties also obtained seats in some legislatures. Therefore, at the regional level there still exist prerequisites for political competition. In the regions, where opponents of the United Russia organized well designed election campaigns, they could have won.

As concerns parties and politicians, March witnessed the final collapse of the Rodina deputy association, which voted to remove S. Glazyev from his post of the deputy association leader (22 votes out of 38). The Rodina deputies elected D. Rogozin, whose nomination was supported by such Rodina sponsors as A. Babakov, V. Geraschenko, V. Yuzhilin, V. Shestakov, etc. Since no ideological changes on the part of the Rodina leadership have been observed since the completion of the State Duma election campaign, it may be noted that the only ground for the dismissal of S. Glazyev was his nomination for the office of the RF President and critical remarks concerning V. Putin. As yet, S. Glazyev has made no clear statement about his future political plans. At the same time, it is clear that the majority of the Rodina deputies support the present authorities from positions of social demagogy and nationalism and strive to play a more important role in the spectrum earlier represented by G. Raikov, S. Mironov, G. Seleznev, etc.

As concerns other segments of the civil society, in March there have not been observed any noteworthy events.

In March, there was formed the backbone of the RF Government and the Presidential Administration, although some offices still remained vacant. Mikhail Fradkov, the former Presidential envoy to the European Union, the former head of the tax police and deputy Minister of Foreign Economic Relations, was appointed

as the Prime Minister. The new Prime Minister has held various top posts practically since the start of reforms and worked under many administrations. There are expressed mixed opinions about the practices of the tax police in the brief period it was headed by Fradkov (from March of 2001 till July of 2003). While skeptics point out that at that time there were issued several guidelines broadly interpreting the powers vested with tax police officers and that the tax police under Fradkov could detect a negligible number of violations in comparison with other security agencies, optimists assert that exactly in that period tax police abandoned the practices of armed raids of masked police officers widespread under the Fradkov's predecessor V. Soltaganov.

The State Duma readily approved Fradkov's appointment. The forecasts that the United Russia deputy association, which dominates the Parliament, would play a more independent role turned out to be wrong. The Parliamentary majority failed to influence the country's leadership as concerns ideological or personnel decisions. Thus, in spite of the fact that Alexander Zhukov, the State Duma deputy from Moscow, the former head of the Duma Budget Committee, was appointed as the only Vice Premier, the United Russia party representatives failed to obtain any other appointments with the exception of an insignificant office of the Head of the Construction, Housing, and Communal Services Agency. A. Kudrin, G. Gref, and V. Khristenko, whose names are associated with liberal economic reforms, were appointed to run such key Ministries as the Finance Ministry, the Ministry of Economic Development and Trade, and the Ministry of Industry and Power Engineering. Nevertheless, certain persons, whose activities had been dispraised earlier, were also appointed to the Government. Some appointees (for instance, heads of the Ministry of Natural Resources and the Agency for Fishery) have absolutely no previous experience in the respective spheres.

There was signed Presidential decree No. 314 of March 9, 2004, setting forth the new system and structure of the executive authorities. The decree is based on the concept of departmental specialization: Ministries determine state interests, services are vested with supervisory functions, while agencies render services on behalf of the state, manage property, and keep registers. Therefore, the new three tier system is focusing to eliminate the conflict of interests triggered in the case the same body carries out rule-making, enforcement, and supervisory functions, i.e. works out the regulations, renders services in accordance with these regulations, and enforces compliance. The number of Ministries was reduced, at the same time, it should be noted that the right to appoint heads of agencies and services is vested not with the respective Ministers, but with the Prime Minister.

Nevertheless, the total number of federal bureaucratic structures will increase more than 1.5 times, from 54 (including the governmental staff) to 73. Although the number of Ministries is reduced from 23 to 14, 30 departments are replaced with 58 structures (29 services and 29 agencies). It is doubtful that agencies and services will function independently. Federal Ministers will have the right to approve their annual action plans and performance indicators, work out regulations concerning services and agencies, determine the respective amounts of financing, etc. Ministers will nominate candidacy of the directors of services and agencies, which should be approved by the Government. The apparent flaw of the reform is that it is too hurriedly implemented. The Ministers were given time until March 25 to work out respective Regulations¹, and it is not surprising that this deadline was not met. The quality of these decisions was so poor, that for the first time the published (!) Presidential decree had to be redrafted under the pretext of elimination of "technical errors."

Besides, the reform of the Government should have addressed not only the issues of the conflict of interests and overlapping functions, but, more importantly, the powers vested with the governmental structures (for instance, the Interior Ministry, Federal Security Service, the former Revenue Ministry, the State Customs Committee, the Procurator's office), which can in fact suspend operations of any economic agent without turning to courts. It should be noted that the redistribution of powers among the governmental structures did not affect the Interior Ministry, which is often indicated as a major source of administrative pressure on business and civil society.

Similarly to the previous Cabinet, the administrative reform, which was declared as a priority, has no single responsible supervisor. There were given no explanations concerning the dismissal of B. Aleshin, who had for a long time worked on the design of the administrative reform.

¹ In the framework of the preceding Government, there were found out over 5 thousand of functions performed by Ministries.

As concerns the Presidential Administration, there was no expected radical reshuffling. However, similarly to the Government reform, the status of many officials was reduced (from Deputy Head of the Administration to the Assistant to President, etc.).

In March, there were still discussed certain controversial aspects of the economic policy, which had not been agreed upon earlier. For instance, it concerns the rise in and possible differentiation of the mineral extraction tax, introduction of special VAT accounts, the issue of acquisition of shares in the wholesale generating companies (WGC) in the framework of the RAO UES reform via special cash auctions, Gazprom reform. It is not surprising, that the settlement of these problems has been in fact delayed.

S. Zhavoronkov

On the progress of reforms in March of 2004

In formal terms, March proved to be absolutely uneventful as concerns the implementation of economic reforms – over the month, the RF Government approved no significant documents relating to the sphere of economic policy. All materials submitted by Ministries in compliance with the Governmental Action plan for 2004 were rejected under vain pretexts. At the same time, certain important decisions entailing significant consequences were taken at the Presidential level.

The structure of the Government has been radically reshuffled, a number of departments were closed, while others were considerably reformed. At last, there was implemented the principle of a three tier organization of the executive authorities, which has been for a long time discussed by the expert community as the most efficient method of organization of the Government. For the first time over four years, there were made most dramatic personal changes at the federal level of the executive authorities.

At the same time, these decisions signified only the beginning of the administrative reform. The most difficult and onerous work is ahead – the administrative reform shall be implemented with respect to the lower tiers of the government apparatus and settle the problems of radical rise of pay of government officials, what requires the introduction of merit based budgeting mechanisms, a new system of human resources management, a new system of organization of work of public servants basing on the currently worked out administrative regulations, etc.

It is too early to evaluate the efficiency of the new Government. Most probably, about six months will be spent for adaptation of Ministries and agencies to the changed conditions. Yet ahead is the new significant wave of reshuffling at the level of Deputy Ministers and heads of departments in Ministries and agencies, since according to the new concept of the administrative reform each Minister should have only two deputies.

The decision to leave only two Deputy Ministers will be a shock for a number of Ministries, primarily those engaged in the implementation of economic reforms (the RF Ministry of Economic Development and Trade and the RF Finance Ministry) in the next two to three months. As concerns these Ministries, there the whole package of problems was distributed among two dozens of First Deputy Ministers and Deputy Ministers, and the largest number of decisions was taken exactly at this level.

At present, each Ministry should work out a new system of administration focusing on the probable enhancement of the role played by departments, their respective enlargement, the new higher status of departments, as well as selection and placement of the personnel. The reform, no doubt, will entail a significant outflow of trained professionals from offices of Deputy Ministers and heads of departments – the recovery from such losses may take more than a few months. It will also result in a significant “non-voluntary” redundancy of officials due to the reduction of available posts.

March was marked not only by the developments relating to the administrative reform, but also the Presidential elections, which are directly related to economic reforms. As concerns the economy, the fact that V. Putin won the landslide victory already in the first round of elections means that the liberal economic course pursued over the last four years will be continued. Moreover, this course may become even more consistent taking into account the statements Putin made at his meeting with his representatives and the new appointments in the Ministries responsible for economic and social policies.

O. Fomichev

The State of the Federal Budget

In January of 2003, the revenues of the federal budget (cash execution) made 20.9 per cent of GDP, while expenditures made 11.1 per cent of GDP (see Table 1). Therefore, the federal budget surplus made 9.8 per cent of GDP.

Table 1

The monthly execution of the federal budget of the Russian Federation (in % of GDP², cash execution).

	XII'02	I'03	II'03	III'03	IV'03	V'03	VI'03	VII'03	VIII'03	IX'03	X'03	XI'03	XII'03	I'04
Revenues														
Profits tax	1.6%	1.2%	1.1%	1.4%	1.5%	1.4%	1.4%	1.4%	1.3%	1.3%	1.3%	1.3%	1.3%	0.9%
Income tax	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Unified social tax (UST)	3.1%	2.4%	2.7%	2.8%	2.9%	2.9%	2.8%	2.8%	2.8%	2.7%	2.7%	2.6%	2.7%	2.3%
Indirect taxes	8.9%	11.2%	10.1%	9.9%	9.6%	9.6%	9.2%	9.1%	8.9%	8.7%	8.6%	8.5%	8.5%	10.5%
VAT	6.9%	8.5%	7.4%	7.2%	7.2%	7.2%	6.9%	6.9%	6.8%	6.7%	6.6%	6.6%	6.6%	8.1%
Excises	2.0%	2.7%	2.7%	2.6%	2.4%	2.3%	2.2%	2.2%	2.1%	1.9%	1.9%	1.9%	1.9%	2.3%
Taxes on foreign trade and foreign economic transaction	3.0%	3.4%	3.4%	3.4%	3.5%	3.5%	3.4%	3.4%	3.4%	3.3%	3.3%	3.4%	3.4%	3.6%
Other taxes, fees and levies	2.1%	0.5%	1.7%	2.0%	2.2%	2.1%	2.0%	2.0%	2.0%	2.0%	2.0%	2.0%	2.0%	2.5%
Total taxes and other payments **	18.6%	18.8%	19.0%	19.4%	19.6%	19.4%	18.8%	18.7%	18.4%	17.9%	17.9%	17.9%	18.0%	19.9%
Non-tax revenues	1.4%	17.5%	8.5%	1.3%	1.2%	1.7%	1.6%	1.5%	1.5%	1.4%	1.4%	1.3%	1.3%	0.9%
Total revenues	20.1%	20.8%	20.6%	20.9%	21.0%	21.3%	20.6%	20.4%	20.0%	19.5%	19.4%	19.3%	19.4%	20.9%
Expenditures														
State administration	0.5%	0.3%	0.3%	0.4%	0.4%	0.4%	0.4%	0.4%	0.4%	0.4%	0.4%	0.4%	0.5%	0.2%
National defense	2.7%	1.5%	2.1%	2.6%	2.7%	2.7%	2.6%	2.6%	2.6%	2.5%	2.5%	2.5%	2.7%	1.8%
International activity	0.3%	-0.3%	0.0%	0.2%	0.2%	0.3%	0.2%	0.2%	0.2%	0.2%	0.2%	0.2%	0.2%	-0.1%
Judicial authorities	0.2%	0.1%	0.1%	0.1%	0.2%	0.2%	0.2%	0.2%	0.2%	0.2%	0.2%	0.2%	0.2%	0.1%
Legal protection and security	1.7%	1.1%	1.4%	1.7%	1.7%	1.7%	1.8%	1.7%	1.7%	1.7%	1.7%	1.7%	1.9%	1.1%
Fundamental research	0.3%	0.1%	0.2%	0.2%	0.2%	0.3%	0.3%	0.3%	0.3%	0.3%	0.3%	0.3%	0.3%	0.1%
Services to national economy	1.5%	0.2%	0.4%	0.5%	0.6%	0.7%	0.8%	0.8%	0.8%	0.9%	0.9%	0.9%	1.1%	0.2%
Social services	5.6%	1.5%	1.8%	2.0%	2.3%	2.2%	2.2%	2.2%	2.2%	2.1%	2.1%	2.1%	2.3%	1.4%
Government debt servicing	2.0%	1.7%	2.9%	3.0%	2.3%	2.1%	2.0%	1.8%	2.0%	2.0%	1.8%	1.7%	1.7%	1.1%
Other expenditures	3.8%	6.6%	7.1%	7.0%	7.0%	7.1%	7.1%	7.1%	7.0%	6.9%	6.8%	6.8%	6.9%	5.3%
Total expenditures	18.7%	12.7%	16.4%	17.7%	17.7%	17.7%	17.5%	17.4%	17.3%	17.1%	16.8%	16.7%	17.7%	11.1%
Surplus (+) / deficit (-)	1.4%	8.1%	4.2%	3.2%	3.3%	3.6%	3.0%	3.0%	2.7%	2.5%	2.6%	2.6%	1.7%	9.8%
Internal financing	0.6%	-6.6%	-1.7%	-1.0%	-1.0%	-0.5%	0.3%	0.0%	0.3%	0.2%	-0.1%	-0.3%	0.5%	-8.8%
External financing	-2.0%	-1.4%	-2.5%	-2.2%	-2.3%	-3.1%	-3.3%	-3.0%	-2.9%	-2.7%	-2.5%	-2.3%	-2.2%	-1.0%
Overall financing	-1.4%	-8.1%	-4.2%	-3.2%	-3.3%	-3.6%	-3.0%	-3.0%	-2.7%	-2.5%	-2.6%	-2.6%	-1.7%	-9.8%

* в % ВВП; ** ЕСН включен в налоговые доходы

As compared with the figures registered in January of 2003, the budget revenues increased by 0.1 p. p. of GDP in the first month of 2004, while expenditures decreased by 1.6 p. p. and budget surplus respectively increased by 1.7 p. p. of GDP. At the same time, without SST the budgetary revenues decreased by 0.2 p. p. of GDP and made 18.6 per cent of GDP. As before, VAT accounted for the major share of federal tax revenues – 40.7 per cent of the total tax revenues what is practically at the level observed in the respective period of 2002.

² Because of the estimated data on GDP, the indices may be subject to revision.

According to preliminary estimates, the cash execution of federal budget revenues made 20.2 per cent of GDP in January through February of 2004, what was by 0.4 p. p of GDP below the level observed in the respective period of the preceding year. At the same time, the cash execution of expenditures made 17.9 per cent of GDP (16.4 per cent of GDP in January through February of 2004); therefore, in the first two months of this year, according to preliminary data, the surplus made 2.3 per cent of GDP.

According to the preliminary estimates of the Finance Ministry, in terms of fulfilled funding³ the expenditures of the federal budget in January through February of 2004 made 20.2 per cent of GDP (see Table 2), while in January through February of 2003 this indicator was at 20.5 p. p. of GDP. In January through February of 2004, the amount of revenues of the federal budget decreased by 0.4 p. p. of GDP in comparison with the figures registered in the respective months of 2003 and made 20.2 per cent of GDP. Therefore, the surplus of the federal budget in terms of fulfilled funding in January through February of 2004 decreased by 0.2 p. p. of GDP in comparison with the figures registered in January through February of 2003 thus balancing the federal budget in terms of fulfilled funding.

Table 2.

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

	II'03	III'03	IV'03	V'03	VI'03	VII'03	VIII'03	IX'03	X'03	XI'03	XII'03	I'04	II'04
Total expenditures	20.6%	20.9%	21.0%	21.3%	20.6%	20.4%	20.0%	19.6%	19.5%	19.4%	19.4%	20.9%	20.2%
State administration	0.6%	0.6%	0.6%	0.6%	0.5%	0.5%	0.5%	0.5%	0.5%	0.5%	0.5%	0.6%	0.7%
National defense	3.1%	3.3%	3.2%	3.1%	3.0%	2.9%	2.8%	2.7%	2.8%	2.9%	2.7%	2.7%	4.0%
International activity	0.1%	0.2%	0.3%	0.3%	0.3%	0.3%	0.2%	0.2%	0.2%	0.2%	0.2%	0.0%	0.2%
Judicial authority	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%
Legal protection and security	2.2%	2.3%	2.2%	2.2%	2.1%	2.0%	1.9%	1.9%	1.9%	1.9%	1.9%	2.1%	2.5%
Fundamental research	0.3%	0.3%	0.3%	0.3%	0.3%	0.3%	0.3%	0.3%	0.3%	0.3%	0.3%	0.3%	0.3%
Services to national economy	0.8%	0.9%	1.0%	1.0%	1.0%	1.0%	1.0%	1.0%	1.0%	1.1%	1.1%	0.5%	0.7%
Social services	2.7%	2.7%	2.9%	2.7%	2.6%	2.5%	2.4%	2.3%	2.3%	2.4%	2.3%	2.5%	2.6%
Government debt servicing	2.9%	3.0%	2.3%	2.1%	2.0%	1.8%	2.0%	2.0%	1.8%	1.7%	1.7%	1.1%	2.2%
Other expenditures	7.5%	7.3%	7.2%	7.4%	7.3%	7.2%	7.2%	7.0%	6.9%	6.9%	7.0%	5.7%	6.8%
Total expenditures	20.5%	20.9%	20.2%	19.9%	19.2%	18.8%	18.6%	18.3%	18.0%	18.1%	17.8%	15.6%	20.2%
Surplus (+) / deficit (-)	0.2%	0.0%	0.8%	1.4%	1.3%	1.6%	1.3%	1.3%	1.5%	1.3%	1.6%	5.3%	0.0%

According to the estimates of the Revenue Ministry, in February of 2004 tax revenues of the federal budget made about Rb. 97.1 billion (without the single social tax). In real terms the revenues made 204.0 per cent of the level registered in January of 1999, while the respective indicator was at 229.2 per cent in 2003 and 187.1 per cent in 2002 (see Table 3).

³ 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).

Table 3.

**Actual tax revenues to the federal budget, according to the data of the MTC
(in % of the data for January of 1999)⁴.**

1999											
I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII
100,0%	115,1%	122,0%	122,1%	104,5%	112,9%	127,0%	127,5%	124,3%	141,4%	160,8%	213,1%
2000											
I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII
149,3%	160,5%	181,3%	205,8%	233,1%	186,9%	181,0%	186,4%	173,1%	181,1%	201,7%	254,1%
2001											
I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII
204,4%	198,4%	227,6%	267,5%	252,2%	233,3%	231,9%	235,6%	219,4%	237,5%	247,3%	360,6%
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					
230,0%						204,0%					

* Без учета ЕСН.

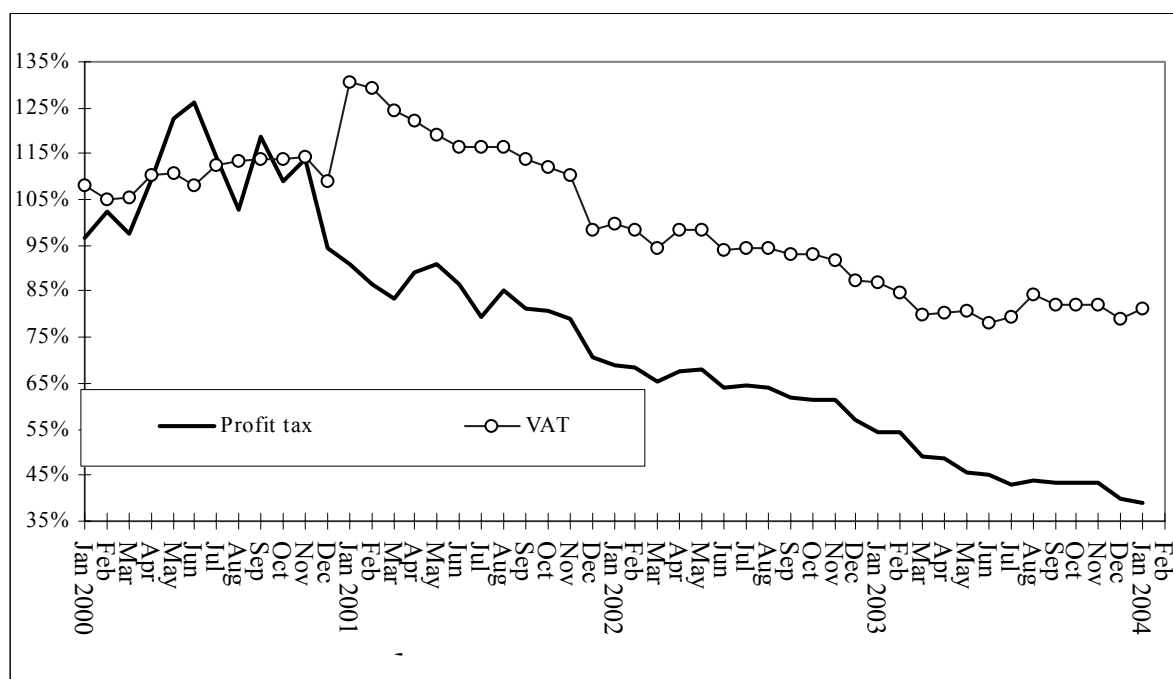


Figure 1. Real tax arrears to the federal budget (in % to July 1999)

The dynamics of real arrears relating to major taxes since January of 2000 are presented in Fig. 1. On the whole, a gradual decrease in the level of accumulated arrears observed since early 2001 to the second half of 2003 was replaced by the stabilization of the level of accumulated indebtedness as concerns both the profit tax, and VAT.

⁴ 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%
Deficit	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%	26,0%	25,0%	25,1%	25,2%
Revenues	32,0%	30,3%	31,5%	33,4%	33,6%	32,2%	32,2%	31,6%	29,9%	30,8%	30,7%	31,1%
Expenditures	20,7%	25,3%	27,7%	28,8%	28,8%	28,6%	28,7%	28,5%	28,2%	27,8%	27,9%	29,7%
Deficit	11,3%	5,0%	3,8%	4,5%	4,7%	3,5%	3,6%	3,1%	7%	0%	8%	1,4%
2004												
	I											
Taxes	25,6%											
Revenues	30,6%											
Expenditures	18,5%											
Deficit	12,1%											

* Без учета ECH

The revenues of the consolidated budget in January of 2004 made 30.6 per cent of GDP, including tax revenues (without SST) at 25.6 per cent of GDP (see Table 4). Expenditures of the consolidated budget decreased by 2.2 p. p. of GDP in comparison with the figures registered in January of 2003 and made 19.5 per cent of GDP. As on February 1, 2004, the surplus of the consolidated budget made 12.1 per cent of GDP, what is by 0.8 p. p. of GDP above the level observed in the respective period of 2003.

A. Razin

Monetary Policy

According to the RF Goskomstat, in February the rise in prices in Russia made 1 per cent as compared with the figures registered in January of 2004 and 2.8 per cent in comparison with the levels observed in December of 2003 (see *Figure 1*). It should be reminded that in February of 2003, prices in Russia grew by 1.6 per cent with respect to the figures registered in January of 2003 and by 4.1 per cent in comparison with the levels observed in December of 2002.

This February, in Moscow and St. Petersburg the consumer price index made 100.3 (102.8 since the beginning of the year) and 100.9 (102.8 since the beginning of the year) respectively. It should be noted that the most significant increase occurred in paid services rendered to households (by 1.6 per cent), while the lowest rates of growth were observed with respect to the group of nonfood products (0.4 per cent), at the same time prices of food products rose by 2.8 per cent⁵.

The base consumer price index (BCPI), which excludes short term volatile changes in prices caused by individual administrative, non-recurrent, and seasonal factors made 100.8 in February (101.7 since the beginning of the year). It should be noted that both in January of 2002 and in January of 2004, base inflation rates were twice below the CPI values.

Therefore, according to the Russian official statistics, in February of this year there was observed a decline in the rates of growth in consumer prices. It should be noted that while in January the most significant increase was observed with respect to prices of food products, in February paid services rendered to households accounted for the largest increment in prices, what may explain the fact that this group demonstrated the highest rates of growth since the beginning of the year.

⁵ However, it should be noted that the official statistics for February of this year without any explanation present only changes in prices of certain housing and public utilities not allowing to assess the changes across the whole group of paid services. Therefore, in February of 2004 the RF Goskomstat in fact failed to present information concerning the dynamics of prices of housing and public utilities services at large.

According to preliminary estimates, in March inflation rates were at or below 0.8 per cent to 1.0 per cent.

As on March 12, 2004, the amount of gold and foreign exchange reserves of the Bank of Russia made US \$ 84.6 billion (see *Figure 2*) and did not change over the week. As a result, the current amount of gold and foreign exchange reserves is practically still at the level registered in early February. In the last month, the amount of gold and foreign exchange reserves decreased by US \$ 3.4 billion (from US \$ 88 billion to US \$ 84.6 billion). This significant decrease may be explained both by the considerable payments related to the external debt, and support of the Ruble exchange rate on the domestic market on the part of the RF Central Bank. According to the estimates, only on March 3 the Bank of Russia sold more than US \$ 1 billion to commercial banks in order to prevent a significant appreciation of the US Dollar exchange rate.

The Growth Rate of the CPI in 2002 - 2004 (% per month).

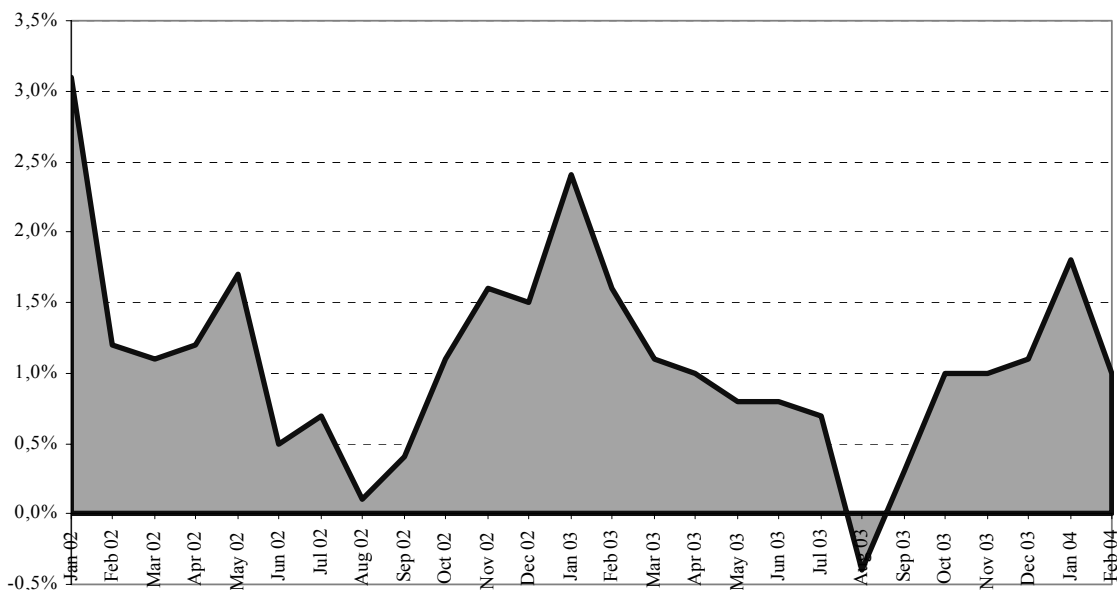


Figure 1.

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

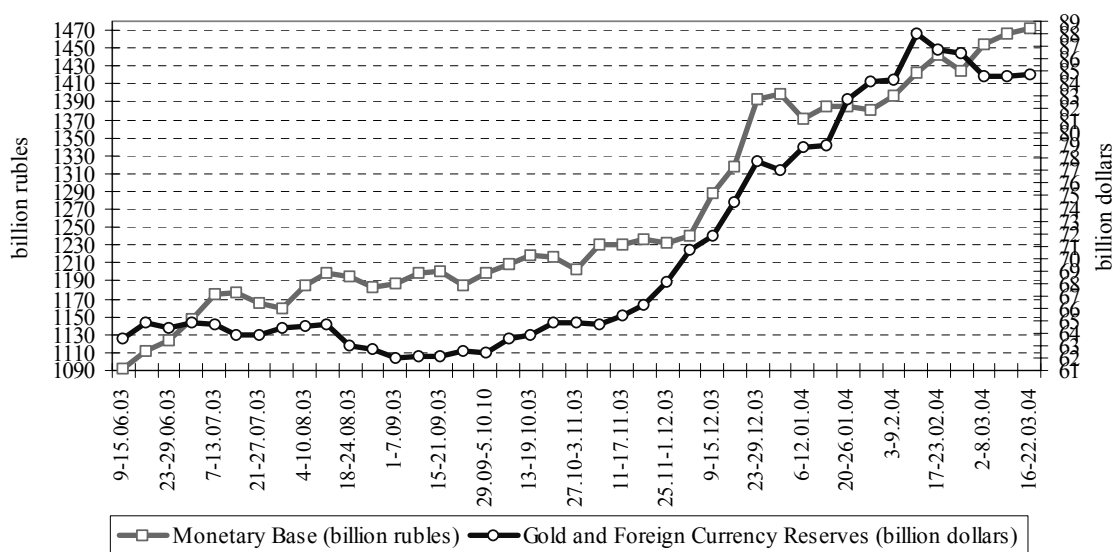


Figure 2.

In February of 2004, the monetary base of the Russian Federation in the broad definition⁶ increased by 1.85 per cent and made RUR 2008.1 billion as on March 1, 2004. At the same time, the amount of cash in circulation (as adjusted for cash balances of crediting organizations) made RUR 1233.5 billion, or was by 3.3 per cent above the level registered at the end of January of 2004. The amount of accounts of crediting organizations with the Central Bank of Russia diminished by 13 per cent (to RUR 232.6 billion) in February, the mandatory reserves reached RUR 280.7 billion (increasing by 1.15 per cent in comparison with the figures registered in January of 2004), while the amount of banks' deposits in the Bank of Russia increased by 3.4 per cent up to RUR 189.8 billion. As on March 1, the amount of the CBR liabilities concerning repurchase of securities was at RUR 71.6 billion, what was by 46.4 per cent above the level observed on February 1 of 2004.

In March, Russia paid about US \$ 2521.1 million as disbursement of its public foreign debt, including US \$ 198.4 million transferred as debt repayment and US \$ 148.6 million as interest payments to the official creditor countries. The payments to international financial institutions made US \$ 253.7 million: 233.1 million as debt repayment and US \$ 20.6 million as interest payments respectively. Besides, in March, US \$ 2069 million were transferred as the payment relating to RF Eurobonds, including US \$ 1273.6 million of debt repayment and US \$ 795.4 million of interest payments respectively.

In February and March, there were observed indications that the Bank of Russia seriously considers to undertake preventive measures if the US \$ depreciation against the Euro would significantly affect the Russian domestic forex market. In particular, the bank may discontinue to quote the Ruble against any single foreign currency and switch to "basket" mechanisms. At the official level, the priority of the RF Central Bank is at the moment is to control the real effective Ruble exchange rate. It is calculated in accordance with the methods made public last October. However, the Bank of Russia reviews the possibility to amend its exchange policies aiming to determine the Ruble exchange rate basing on the basket including both US Dollar and Euro. At the same time, the necessity to mitigate the volatility of the Ruble / Euro exchange rate on the domestic market may be primarily explained by the fact that the importance of the member countries of the Euro zone in the Russian foreign trade is constantly increasing.

P. Trounin

Financial Markets

In March, positive situation was observed on the Russian financial market. The overall dynamics of the sovereign bond market reflected the situation on the US market of government bonds. A certain intensification of activity was observed also on the market of Ruble denominated debt, especially after the reelection of V. Putin for his second Presidential term. Moreover, the favorable external and domestic market situation facilitated an increase in the attractiveness of Russian securities: in March the RTS index reached its next historical high of 72.81 points. As concerns the forex market, there was observed a significant appreciation of the Ruble against the Euro, while the Ruble / US \$ exchange rate remained rather stable.

The Market for Government Securities

In February, there was observed a rather stable situation on the market of government forex denominated bonds characterized by a certain decline in yields. However, it should be noted that in the beginning of the month, the appointment of M. Fradkov positively affected the market dynamics. Later, the quotations somewhat declined and remained at practically the same level reacting only to the dynamics of prices of base assets – the US Treasury bills. It is interesting to note that the results of the Presidential elections in Russia had practically no impact on the market, since they were expected and already reflected by quotations. Towards the end of the month, only one event significantly affected the yields of securities. In the beginning of the third week of March, there was observed a considerable rise in prices of Russian sovereign bonds caused by the information that the Fitch agency may increase its ranking of Russia to the investment level. However, the growth turned out to be short lived: towards the end of the week there was observed a decline in quotations in the Russian segment against the background of decreasing prices of the base assets, as predicted by certain experts.

⁶ The Monetary Base in broad definition includes cash in circulation, the funds in mandatory reserves, and funds in commercial banks' correspondent accounts with the Bank of Russia.

As on March 24, the yield to maturity of Russian Eurobonds RUS-30 was 6.78 per cent p.a. (end of February: 7.08 per cent); RUS-18: 6.52 per cent p.a. (end of January: 6.82 per cent). Besides, on the same date the yield to maturity of the Russian Eurobonds was: Minfin bonds, 7th tranche: 5.90 per cent; Minfin bonds, 6th tranche: 3.61 per cent; Minfin bonds, 5th tranche: 4.98 per cent; RUS-07: 3.89 per cent. Therefore, over February the levels of yields of all Russian Eurobonds have somewhat increased in comparison with the figures registered at end-January of 2004.

FIGURE 1.

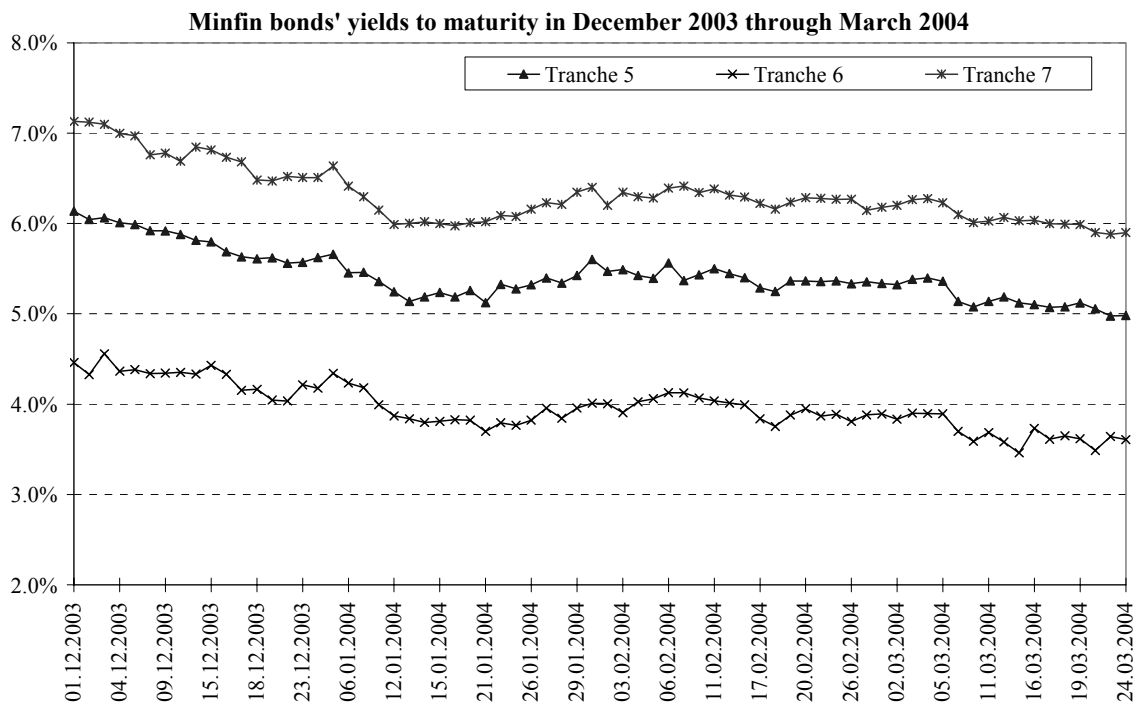
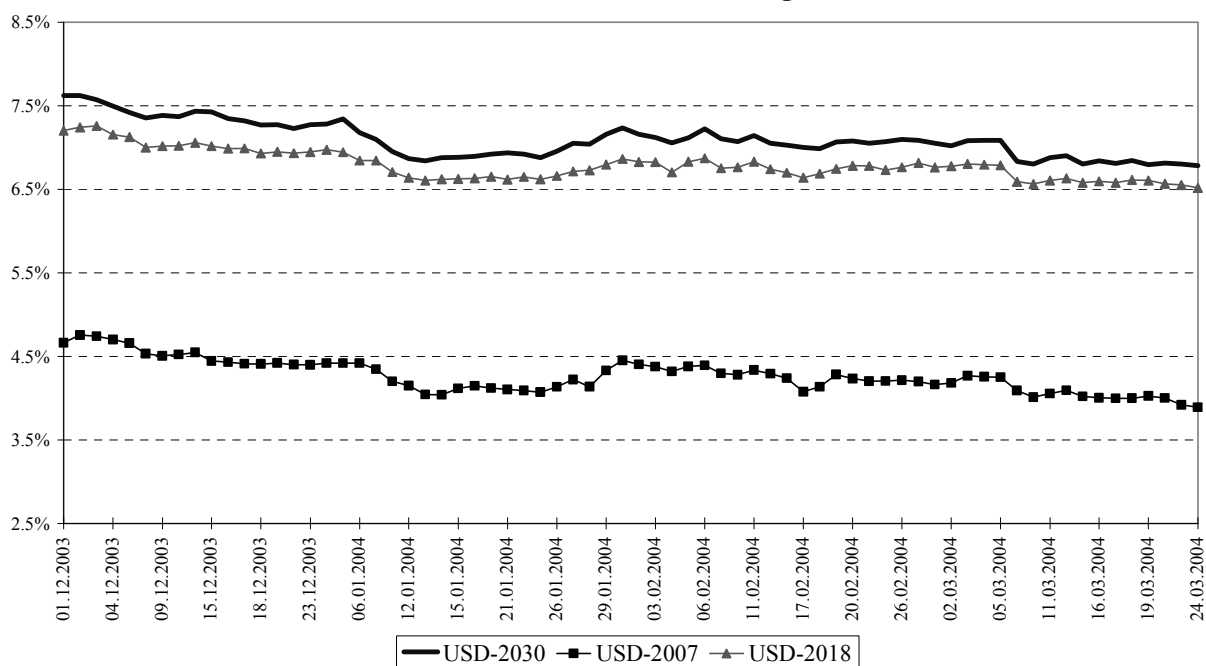


FIGURE 2.

Yields to maturity of the Russian eurobonds with maturity in 2030, 2018 and 2007 in December 2003 through March 2004



Over the month, the situation on the market of Ruble denominated public debt was also rather tranquil. In spite of the fact that in the beginning of the month the rise in prices was constrained by the appreciation of the US \$ exchange rate on the currency market, the latter appreciation of the Ruble had positively affected

the dynamics of prices. Besides, the market was supported by the impact of other factors as well, among which the most important still were the high level of liquidity in the banking sector and high oil prices on the world market. At the same time, the reelection of V. Putin for his second Presidential term entailed an additional demand for Ruble denominated assets on the part of non-residents, who raised the limits on investment in Ruble denominated instruments. At the same time, a certain growth in quotations was observed even at the background of increasing supply on the primary market.

Over the period from March 1 to 24, the aggregate turnover of the secondary GKO OFZ market made about RUR 58.6 billion, while the average daily turnover was at RUR 3.45 billion (in February, the average daily turnover was registered at RUR 4.5 billion). In the same period, there took place several auctions for the placement of OFZ AD. For instance, on March 3 there were held auctions for placement of OFZ AD 46001 and OFZ-AD 46002, the nominal value of which made RUR 4 and 7 billion respectively. The amount of the placements made RUR 3.99 and 1.42 billion, while the weighed average yields of the placements were at 7.08 per cent and 7.91 per cent per annum. On March 17, there were held auctions for the placement of OFZ FD 27025 and OFZ-AD 46003, the par value of the placements made RUR 5 billion each. The amount of the placement made RUR 1.02 and 2.26 billion, while the weighed average yields of the placements were at 6.51 per cent and 7.46 per cent per annum respectively.

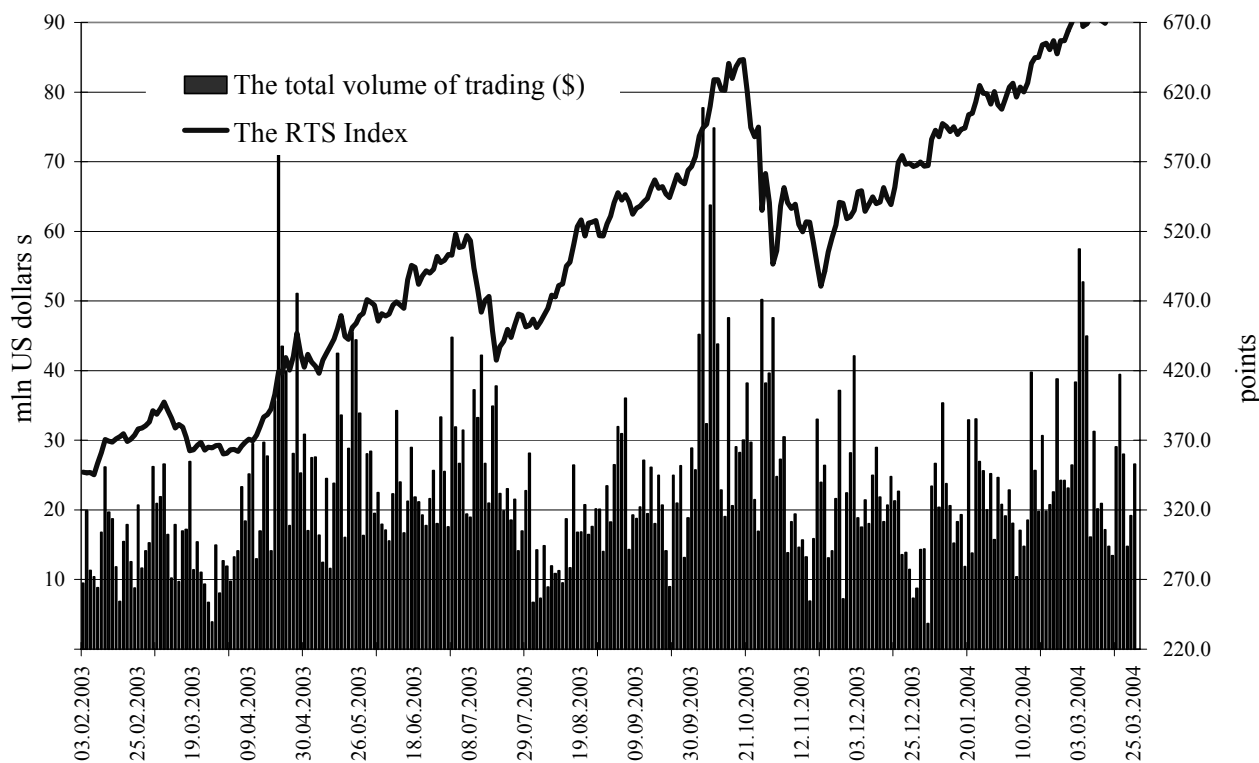
As on March 26, the amount of the GKO – OFZ market made RUR 453 billion at par and RUR 437.62 billion at the market value. The duration of the GKO-OFZ market portfolio was 1670.1 days.

The Market for Corporate Securities

Situation on the stock market.

In March of 2004, on the Russian stock market there was observed a steady increase in quotations. For instance, in the period from March 1 till 26 the RTS index grew by 46.41 points (by 6.93 per cent) and at closure on March 25 it was registered at 706.71 points. At the same time, it should be noted that on March 22 the index reached its historical maximum of 721.81 points. The major factors behind the positive dynamics of quotations were as before high oil prices, stabilization of the Ruble exchange rate, and rather high level of liquidity in the banking sector. At the same time, it should be noted that political factors had practically no impact on the prices of stocks: the market rather calmly reacted both to the news about the reshuffling of the Government and to the results of the Presidential elections. However, both factors facilitated optimism of investors, what resulted in the growth of the market in the second half of the month.

FIGURE 3.

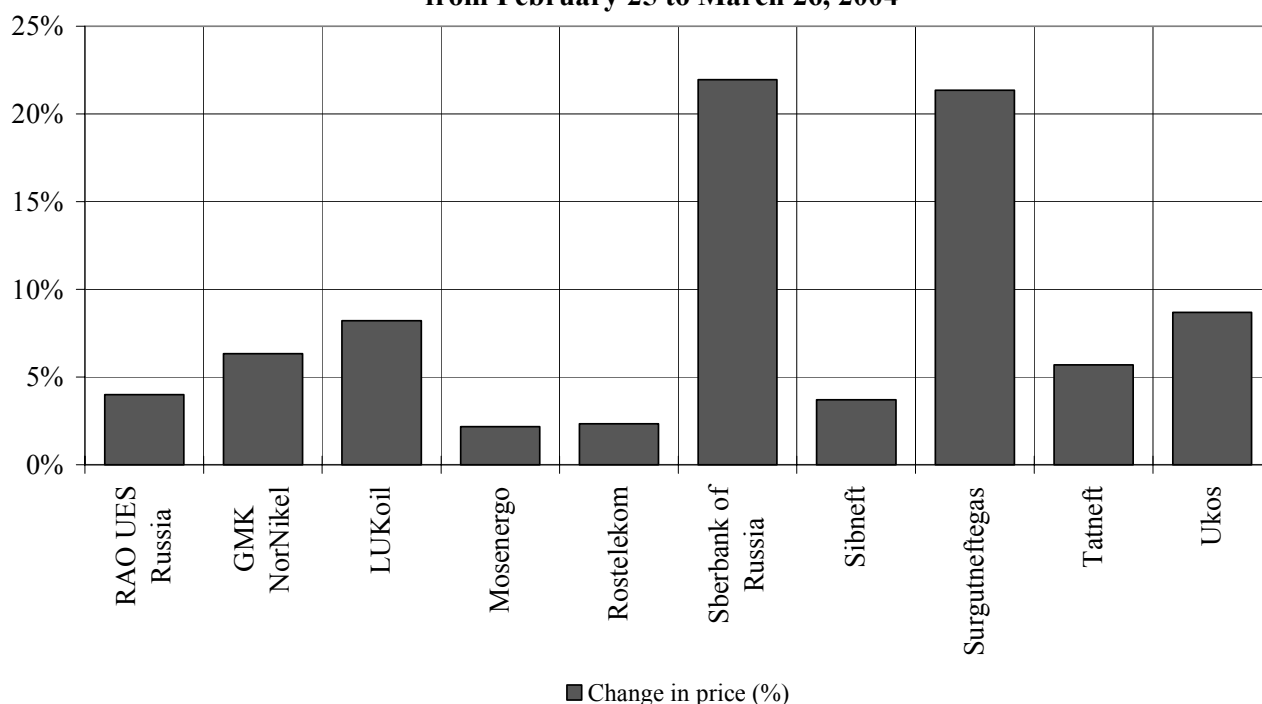


In the period from March 1 till 26, the turnover in the RTS trading amounted to US \$ 534.74 million, while the average daily turnover at the RTS made about US \$ 28.14 million (US \$ 22.7 million in February). The highest volume of trade at the RTS (US \$ 57.5 million) was observed on March 3. The lowest trade volume (US \$ 13.4 million) was observed on March 17.

Over the last month (from February 25 till March 26), all “blue chips” demonstrated a growth in prices. Thus, shares in the RF Sberbank became leaders in terms of growth in prices (a rise by 21.95 per cent). Sberbank stocks were followed by securities of Surgutneftegaz, which gained 21.35 per cent. YUKOS shares grew in price by 8.68 per cent, LUKoil – by 8.2 per cent, Norilsk Nickel – by 6.34 per cent. The most insignificant rates of growth among all “blue chips” demonstrated Mosenergo stocks, which were up by only 2.17 per cent.

FIGURE 4.

**Dynamics of the Russian Blue Chips
from February 25 to March 26, 2004**



In February, the MMC Norilsk Nickel shares took the top position by the volume of turnover in the RTS⁷: the share of respective transactions amounted to about 29.81 per cent of the total turnover. The amount of transactions with the shares in the RAO UES of Russia was somewhat lower (26.41 per cent). The shares of LUKoil and YUKOS followed: the volume of transactions with these companies’ shares made 21.94 percent and 12.42 per cent of the total turnover respectively.

As on March 26, the top five leaders of the national stock market by capitalization looked as follows⁸: YUKOS: US \$ 36.17 billion; Surgutneftegaz: US \$ 26.08 billion; LUKoil: US \$ 25.07 billion; Sibneft: US \$ 16.45 billion; MMC Norilsk Nickel: US \$ 15.67 billion.

The market for fixed term contracts. In March, the activity of investors on the RTS market for fixed term contracts (FORTS) increased in comparison with the preceding month. Thus, in the period from March 1 till March 26 the volume of trade in futures and options at the RTS amounted to about RUR 24.5 billion (110.6 thousand transactions; 3.02 million contracts), what was by far above the respective indicators registered in the preceding month (RUR 18.98 billion, 93.25 thousand transactions; 2.5 million contracts).

As usual, futures contracts account for the greatest percentage of transactions: the volume of trade in these contracts reached RUR 22.97 billion (2.84 million contracts, 107.6 thousand transactions) over the period under observation. As before, options were in a much lower demand: the respective amount of trading made

⁷ On the classical stock market.

⁸ According to the RTS.

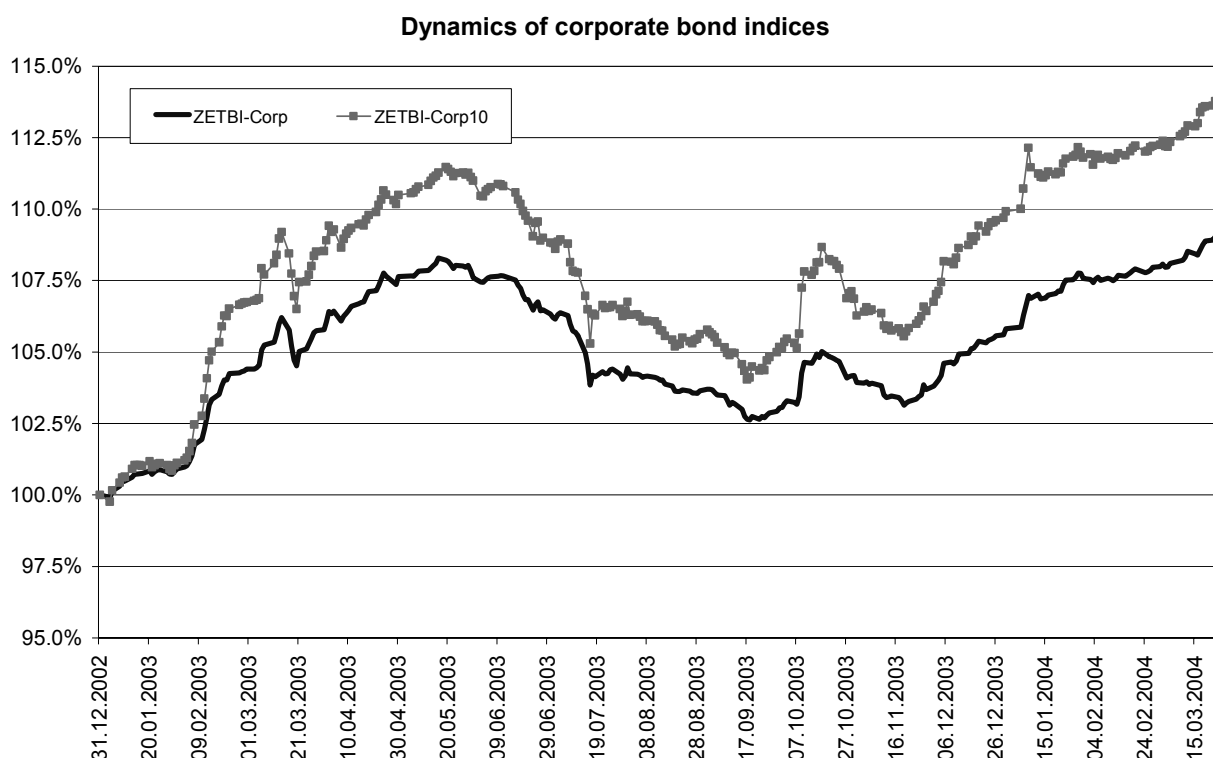
about RUR 1.49 billion. The maximum trading volume was observed on March 1 and made RUR 1.66 billion, while the minimum trading volume (RUR 920.67 million) was registered on March 5.

Corporate bond market. Over the month, overall positive price dynamics were observed on the market of corporate bonds. From February 27 till March 25, the price index of corporate bonds traded at the MICEX⁹ increased by 1.07 points (0.95 per cent) and the index of ten most liquid corporate sector bonds increased by 1.53 points (1.3 per cent).

The major factors behind the dynamics of the RF financial market, including the market of corporate bonds still were the liquidity in the banking sector and the Ruble / US \$ exchange rate dynamics. Besides, more active behavior of non-residents on the market after the Presidential elections had an additional positive effect on prices.

In the period from March 1 till March 24, the total turnover in the bond sector of MICEX made about RUR 11.3 billion, while the average daily turnover was registered at RUR 664.3 billion (RUR 1.78 billion in February). Therefore, in March the activity of investors was significantly below the levels observed in February.

FIGURE 5



External factors affecting the dynamics of the Russian stock market. Throughout March of 2004, the growth in prices continued on the world oil market. Thus, in the period from February 27 till March 26 of 2004, the price of Brent oil on the world market increased by US \$ 0.87 (2.86 per cent) making US \$ 33.31 per barrel. It should be noted that in the period from March 16 till March 22, the world oil price was at or above US \$ 34 per barrel. There were several factors behind these positive dynamics. First, in accordance with the forecast published by the International Energy Agency, the consumption of oil should increase in 2004, what in view of predicted reduction of quotas on the part of OPEC may create prerequisites for emergence¹⁰ of deficit. The Madrid explosions have also facilitated a rise in prices.

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

¹⁰ For details on the oil market situation, see the section "Oil and natural gas sector."

FIGURE 6.

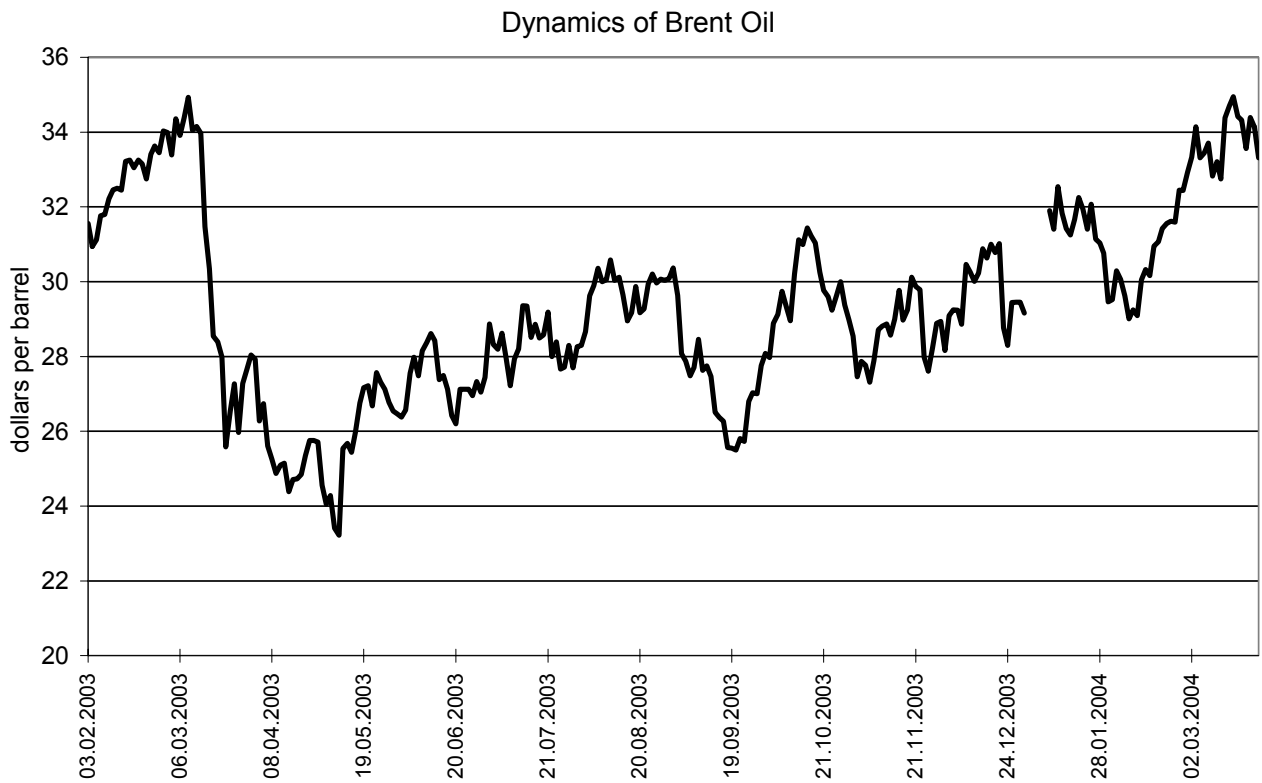
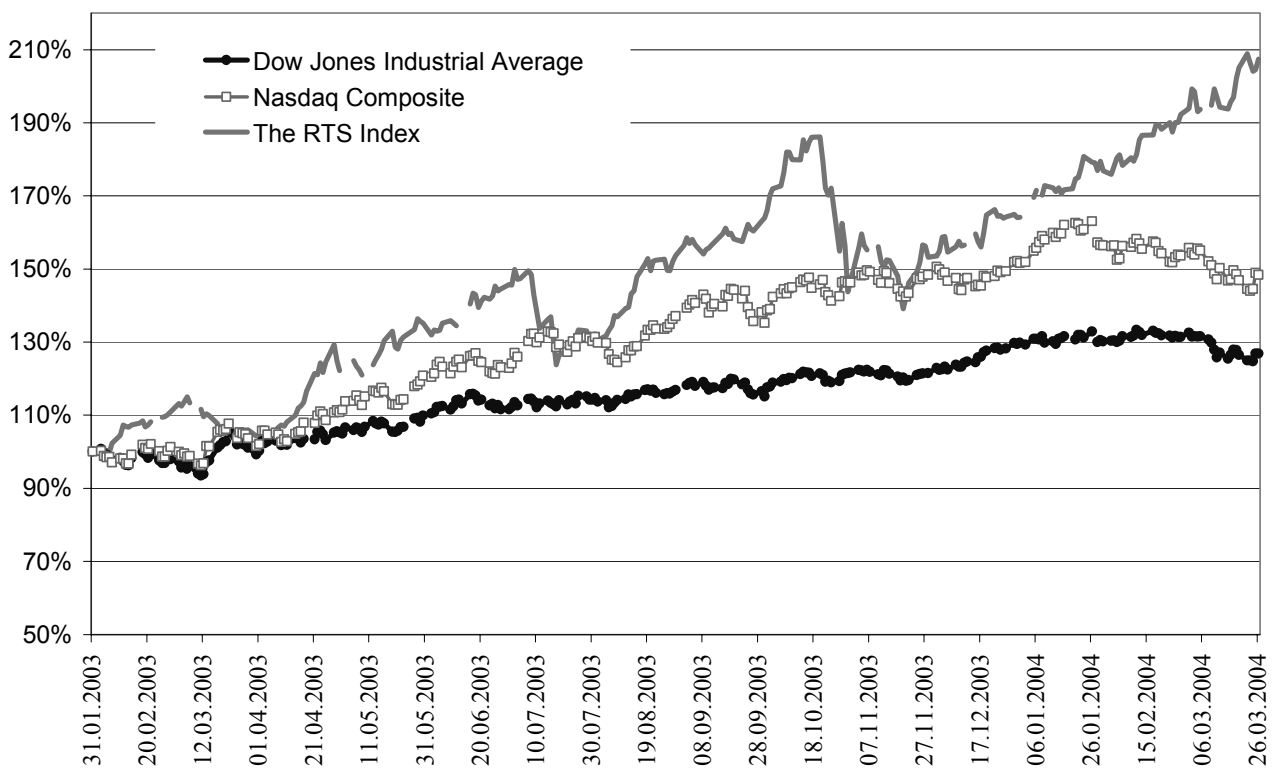


FIGURE 7.



In March, on the world stock markets there was observed an overall worsening of the market situation (see Table 1). The US and European stock indices were characterized by negative rates of growth. The only exception were stock indices of Japan, Mexico, and Turkey, which grew over the month. Besides, the overall

worsening of the market situation affected developing countries, what was reflected by the dynamics of the stock index calculated by the agency MSCI.

In the beginning of the month the US stock indices grew somewhat, however, later there prevailed downward dynamics. The major factors behind the decline in indices were the decelerating rates of economic growth in the USA, in particular, the unfavorable data on the labor market, a rise in the world oil prices, and the political factor of a decline in the popularity of G. Bush, the incumbent US President. Even the meeting of the FRS Open Market Committee, where there was taken the decision not to change the interest rate (at present the rate is at 1 per cent) could not prevent the fall of the stock market. It should be also specifically noted that the Madrid explosions were an additional factor behind the slump on the stock market, since investors perceived them as an evidence of growing threat of terrorism, while the political factor (diminishing popularity of G. Bush) also contributed to these developments.

Summing up the developments analyzed above, it should be noted that as before, the dynamics of the Russian stock market are most considerably affected by the situation on the world raw material markets, while being less prone to the impact of the situation on the world stock markets. An evidence confirming this conclusion is the fact that even at the background of falling stock indices in the USA and Europe, the Russian RTS index grew and even reached its historical maximum.

Corporate news.

The NK LUKoil

In March, the LITASKO company, a 100 per cent affiliate of the NK LUKoil signed a contract for supply of gasoline and diesel fuel in the northern Iraqi provinces. The contract is termed for 3 months, however, it may be prolonged for up to 12 months. The quarterly volumes of gasoline and diesel fuel supply are set at 180 thousand metric tons and 130 thousand metric tons respectively. According to the contract, the shipments should start since April 1, 2004.

Besides, the NK LUKoil Board of Directors took the decision to issue 6 millions of documentary interest bearing inconvertible bearer bonds maturing in 5 years with par value Rub. 1000 each. The period of coupon payments of the bonds is set at 6 months. The interest rate on all coupons is uniform and should be determined basing on the results of the auction on the date of the start of placement. The funded loan envisages a 3 year offer.

The OAO GMK Norilsk Nickel

On March 29, the company announced that it purchased for cash via its 100 per cent affiliate London based company Norimet 98.5 million ordinary shares in the gold mining company Gold Fields Limited. The total amount of purchase has made about Rand 7.6 billion, or Rand 77.5 per one ordinary share. The amount of the transaction in US \$ equivalent made US \$ 1.16 billion, or US \$ 11.79 per one ordinary share.

The OAO NGK Slavneft

On March 15, 2004, the OAO NGK Slavneft completed the repayment of the issue of the bond issue amounting to Rub. 2 billion as stipulated by the terms of the issuance. At the same time, the company paid the coupon income from the fourth coupon of its second tranche of bonds. The coupon rate made 8.89 per cent per annum, or Rub. 44.33 per each share with par value of Rub. 1000. The total amount of payments made Rub. 88.66 million.

Table 1.

Dynamics of International Stock Market Indices

Data as of March 26, 2004	Value	Change within the month (%)¹¹	Change since the beginning of the year (%)
RTS (Russia)	716.55	15.7%	22.26%
Dow Jones Industrial Average (USA)	10212.97	-4.57%	-1.89%
Nasdaq Composite (USA)	1960.02	-9.00%	-2.33%
S&P 500 (USA)	1108.06	-4.09%	-0.04%
FTSE 100 (UK)	4357.5	-1.98%	-3.39%

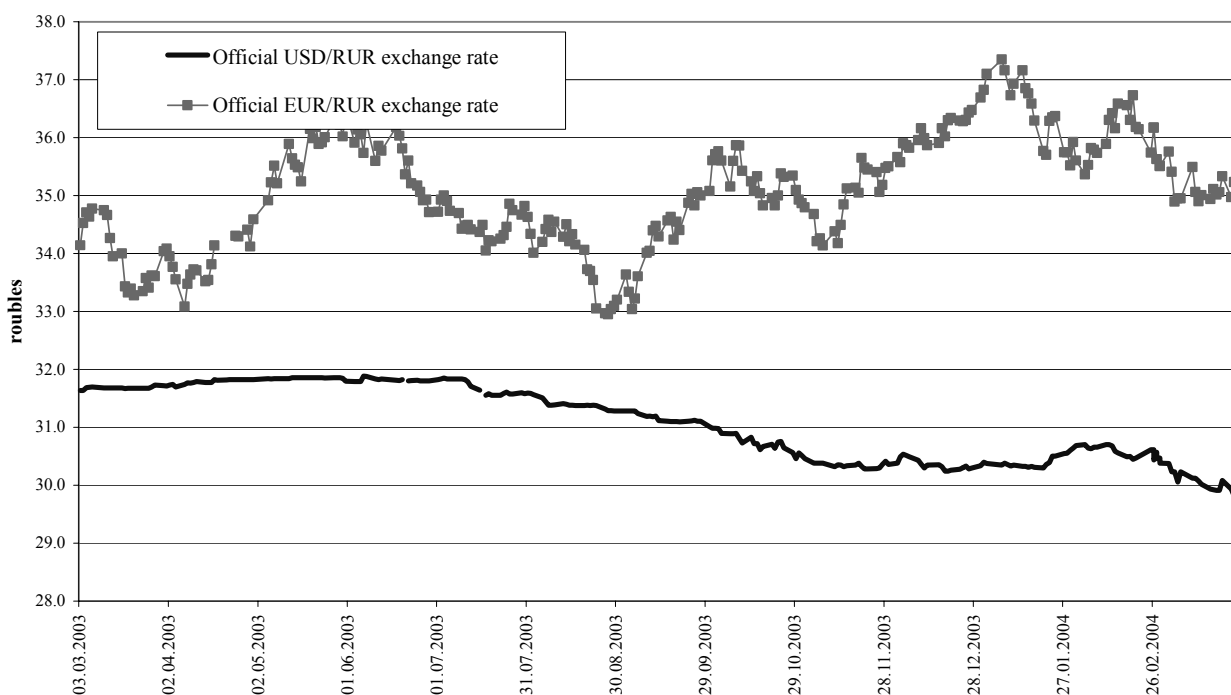
¹¹ As compared to the level registered on February 25.

Data as of March 26, 2004	Value	Change within the month (%) ¹¹	Change since the beginning of the year (%)
DAX-30 (Germany)	3822.33	-7.42%	-4.88%
CAC-40 (France)	3592.39	-2.27%	-0.12%
Swiss Market (Switzerland)	5587	-2.81%	0.08%
Nikkei-225 (Japan)	11770.65	7.27%	8.73%
Bovespa (Brazil)	21541	-11.54%	-4.03%
IPC (Mexico)	10432	9.08%	28.50%
IPSA (Chile)	1433.87	-0.35%	-3.42%
Straits Times (Singapore)	1827.11	-3.84%	2.00%
Seoul Composite (South Korea)	863.95	-0.59%	5.20%
ISE National-100 (Turkey)	20836.12	13.51%	8.82%
Morgan Stanley Emerging Markets Free Index	466.627	-0.67%	5.30%

The Foreign Exchange Market. In the period from February 28 till March 26, the US \$ / RUR exchange rate declined by 2 kopecks to the level of RUR 28.4979 per US \$. In the beginning of the month the dynamics of the Ruble exchange rate were primarily determined by the US \$ exchange rate on the world forex market: a sharp appreciation of the Dollar against Euro resulted in the Ruble depreciation with respect to the US Dollar. However, on the whole the process of exchange rate determination went under impact of two oppositely directed trends, what limited the band of possible fluctuations: the US Dollar appreciation on the world market was compensated by the growth in the world oil prices. Over the next three weeks, the Ruble again somewhat appreciated against the on the US Dollar, what was facilitated by high oil prices and a higher demand for Rubles in relation to the nearing deadline for tax payments.

FIGURE 8.

Dynamics of the Official USD/RUR and EUR/RUR Exchange Rates in 2003-2004



The aggregate volume of trade in the US Dollar at the SELT in the period from March 1 till March 24 made US \$ 12.07 billion. The average daily turnover made US \$ 710.2 million over this period, what was somewhat below the respective indicator registered in February of 2004 (US \$ 889 million). During the pe-

riod under review, the highest volume of trade in the US Dollar, about US \$ 1.9 billion, was observed on March 3 (about US \$ 3.38 billion in February); the lowest volume, US \$ 441.33 million, was observed on March 1.

This March, the Ruble liquidity in the banking sector somewhat decreased in comparison with the figures registered in the preceding month: in March, the average balances of correspondent accounts of credit organizations with the Bank of Russia made RUR 189.86 billion, what was by about RUR 46 billion below the respective indicator registered in February (RUR 236.32 billion).

In the period from February 29 till March 26, on the world forex markets there was observed appreciation of US \$ against Euro. Thus, during this period of time the Euro exchange rate decreased by US \$ 0.035 making US \$ 1.214 per Euro.

The dynamics of the Euro - Ruble rate were mainly determined by the trends on the world market. Following the appreciation of the US Dollar against Euro on the world forex markets, the exchange rate of the European currency against the Ruble also declined. In the period from February 28 till March 26, the European currency depreciated by RUR 0.97 (-2.74 per cent) from RUR 35.5 per Euro and made RUR 34.53 per Euro. The aggregate turnover of trade at the SELT amounted to Euro 163.2 million in the period from March 1 till March 24 (Euro 127.6 million in February). In this period, the highest trade volume of Euro was registered on March 11 at Euro 13.99 million, and the lowest, Euro 6.36 million, on March 1.

FIGURE 9.

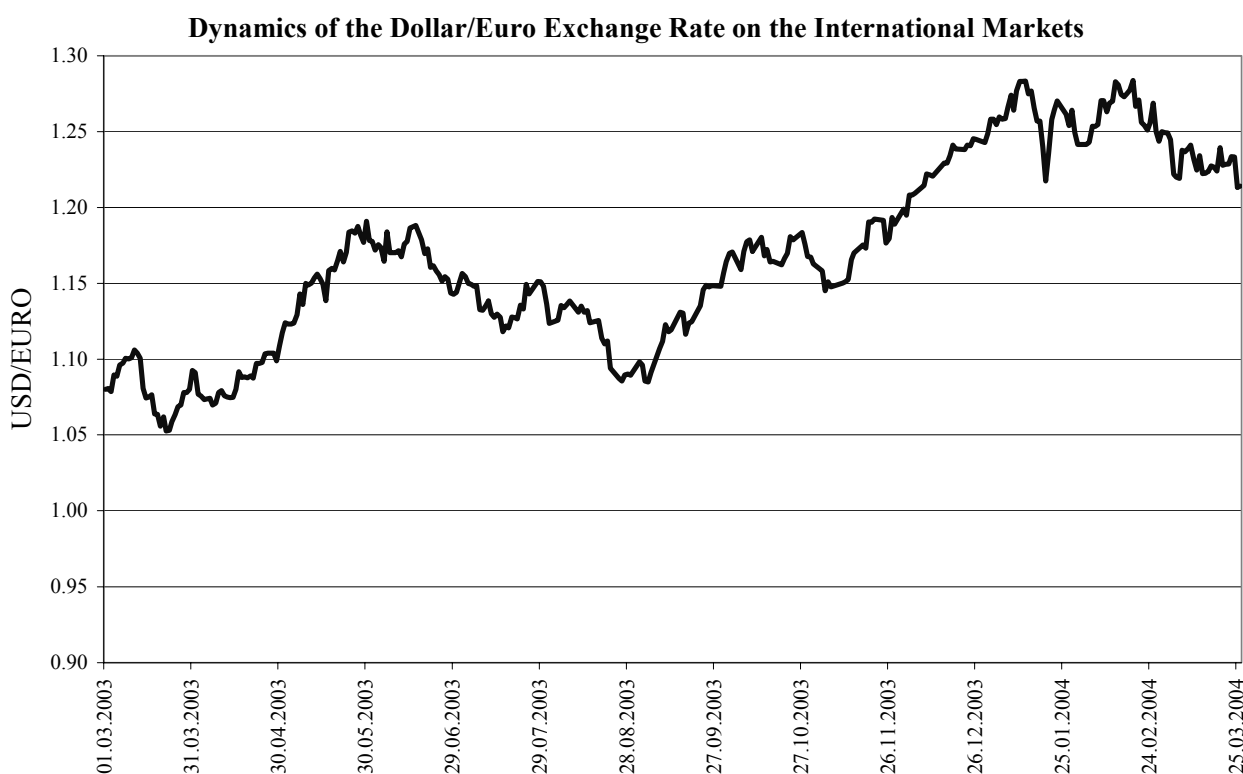


Table 2.

Financial Markets Indicators

Month	November	December	January	February	March*
Monthly inflation rate	1,0%	1,1%	1,8%	1,0%	0,8%
Inflation rate annualized on the basis of this month's trend	12,68%	14,03%	23,87%	12,68%	10%
CB RF refinancing rate	16%	16%	14%	14%	14%
Annualized yield to maturity on OFZ issues (%)	6,74%	7,63%	6,48%	6,15%	6,6%
Volume of trading in the secondary GKO-OFZ market for the month (RUR billion)	5,02	20,58	31,77	25,47	60,0
Yield to maturity on Minfin bonds at the end of the month (% p.a.)					

Month	November	December	January	February	March*
5th tranche	5,99%	5,62%	5,60%	5,36%	5,0%
6th tranche	4,36%	4,18%	4,01%	3,88%	3,6%
7th tranche	7,09%	6,51%	6,40%	6,15%	5,9%
8th tranche	5,09%	5,16%	4,77%	4,56%	4,2%
Yield to maturity of Eurobonds at the end of the month (% p.a.)					
2005	3,16%	3,05%	2,83%	2,77%	2,5%
2007	4,66%	4,42%	4,45%	4,20%	3,9%
2010	5,92%	5,80%	5,79%	5,68%	5,5%
2018	7,19%	6,97%	6,86%	6,82%	6,5%
2028	7,50%	7,34%	7,33%	7,25%	7,0%
2030	7,57%	7,28%	7,24%	7,08%	6,8%
INSTAR-MIACR rate (% p.a.) on interbank overnight loans at the end of the month	7,75%	7,75%	2,15%	1,76%	1,5%
Official RUR / US\$ exchange rate at the end of the month	29,7387	29,4545	28,4916	28,5156	28,485
Official RUR / Euro exchange rate at the end of the month	35,5021	36,8240	35,3635	35,5076	34,45
Average annualized growth in RUR / US\$ exchange rate	-0,40%	-0,96%	-3,27%	0,08%	-0,10
Average annualized growth in RUR / Euro exchange rate	1,83%	3,72%	-3,97%	0,41%	-3,0%
Volume of trading at the stock market in the RTS for the month (US\$ million)	374,55	416,89	432,75	433,12	580
Value of RTS-1 Index at the end of the month	543,84	567,40	611,10	670,14	725
Change in value of RTS-1 Index during the month (%)	5,81%	4,33%	7,70%	9,66%	8,2%

* Estimate

D. Polevoy

Investment in fixed assets

In the beginning of 2004, the investment situation was characterized by a high level of business activity in the construction and investment complex of industries. The rates of growth in investment in fixed assets observed in February of 2004 were the highest since January of 2002. In January through February of this year, the amount of investment in fixed assets increased by 13.4 per cent as compared with the figures registered in the respective period of the preceding year and made Rub. 255.6 billion.

The major factors facilitating the intensification of investment activity were: increasing rates of growth in output of products and services of the base sectors of the economy; increase in the investment resources of households at the expense of growth in real disposable cash incomes; enhancement of investment potential of the export oriented industries resulting from the improving external market situation. As a result, the situation formed in 2003, which is characterized by the recovery of outpacing rates of investment in fixed assets in comparison with the GDP dynamics and final household consumption, persisted.

According to the data published by the RF Goskomstat, in 2003, investment in fixed assets increased by 112.5 per cent and made Rub. 2183.3 billion. Due to the exceptionally favorable combination of factors of high business activity of domestic business and the price situation on the world market of raw materials, the share of gross savings made 28.5 per cent of GDP in 2003. The growth in the revenues of the economy facilitated by positive changes in the business situation on the world market guaranteed the prompt repayment and servicing of the foreign public debt and enabled the state to meet its social obligations. For the first time since the start of reforms, there was registered a net inflow of capital in the private sector. There was observed the recovery of the population confidence in the domestic banking system. At the same time, the growth in earnings and profitability of the economy facilitated an increase in the asymmetry of savings and investment. In the period from 2000 till 2003, the share of investment in fixed assets in GDP remained on the average at 16.5 per cent, what made about a half of savings.

The growth in earnings of enterprises and organizations in the economy, household savings, and growing activity of the banking sector have positively affected the nature of development and permitted to overcome the decline in investment activities formed in 2001 through 2002. The principally new moment of economic growth was the shift from financing of investment in fixed assets at the expense of own funds of enterprises and organizations to the expansion of attraction of borrowings. This is a convincing illustration of quantitative changes in the mechanism of investment development oriented towards the rationalization of flows of investment resources. In 2003, the share of own funds in the structure of the total amount of investment in fixed assets made 45.6 per cent as compared with 47.7 per cent registered in year 2000, when there was observed the peak of investment demand registered in the whole period of recovery growth. The changes in proportions of borrowings was determined by the outpacing rates of growth in bank credits and funds borrowed from other organizations in comparison with budget sources of financing. The decrease in the share of budget resources in financing of investment expenditures by 1.2 p. p. occurred at the background of changes in proportions of the federal budget and the budgets of RF subjects. It should be noted that while over the few last years the gradual decrease in the share of budget resources in financing of investment was accompanied by the increase in the share of funds provided by RF subjects, in 2003, on the contrary, exactly expenditures of the federal budget significantly affected the dynamics of investment activity.

The improvement of efficiency of economic activities was accompanied by the rationalization of flows and formation of additional sources of investment resources. Mobilization of resources both on the domestic and external markets created incentives for acceleration of growth in credits extended to the economy. The amount of loans granted by credit organizations to enterprises, banks, and individuals, including credits extended to foreign countries made Rub. 2910.2 billion as on January 1, 2004 as compared with Rub. 2028.9 billion registered in 2002. At the same time, the amount of resources redistributed via bank credits to non-financial enterprises reached 8.5 per cent of GDP as compared with 4.1 per cent of GDP observed in 2002. In 2003, the share of banks in crediting of investment increased to 5.3 per cent in comparison with 4.8 per cent in 2002 and 2.9 per cent in 2000.

Table

Structure of investment in fixed assets across sources of financing, in % of the total

	1998	1999	2000	2001	2002	2003*)
Investment in fixed assets, total	100	100	100	100	100	100
Including the sources of financing:						
<i>Own funds</i>	53,2	52,4	47,7	49,4	48,0	45,6
Of which:						
Profits	13,2	15,9	23,4	24,0	20,5	18,0
<i>Borrowings</i>	46,8	47,6	52,5	50,6	52,0	54,4
Of which:						
Bank credits	4,8	4,2	2,9	4,4	4,8	5,3
Including credits of foreign banks			0,6	0,9	0,5	0,7
Borrowings from other organizations	4,3	5,6	7,2	4,9	6,0	9,2
Budget resources:	19,1	17,0	22,0	20,4	19,6	18,7
Federal budget	6,5	6,4	6,0	5,8	6,0	6,3
Budgets of RF subjects and local budgets	12,6	10,6	16,0	14,6	13,6	11,4
Foreign investment in the total amount of investment in fixed assets	3,5	6,6	4,7	4,5	4,1	5,7

*) with the exception of small businesses and parameters of informal activities

Source: RF Goskomstat

Among the factors, which had determined the growing role played by banks and borrowings from other organizations, there may be singled out de-dollarization of cash household savings and decrease in the net outflow of capital. The diminishing amounts of foreign exchange held by households and conversion of forex denominated holdings in Rubles was accompanied by a growth in amount of deposits with banking structures. The net inflow of funds to time deposits and banks debentures made about 5.6 per cent of GDP. The low real cost of credit resources at the average level of profitability formed in the economy has determined the expansion of the group of borrowing enterprises oriented towards the domestic market. The reduction of the refinancing rate by the Bank of Russia from 25 per cent in March of 2002 to 18 per cent in February and 16 per cent in June of 2003, as well as the increase in the share of medium and long term resources accumulated by the banking system have increased the attractiveness of the monetary market. At the same

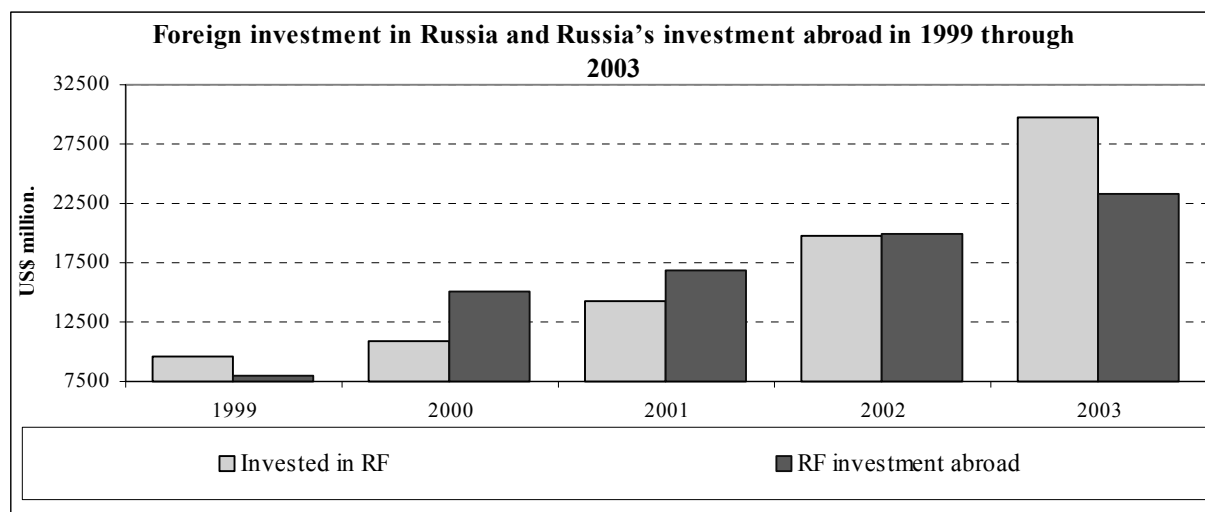
time, in the situation of economic growth it became apparent that the investment management is not coordinated with the dynamic processes of restructuring underway in the Russia's economy. The lack of investment financial institutions, underdevelopment of the stock market, and instability of the legal sphere complicates the process of attraction of credits. For all practical purposes, no mechanisms enabling the intersectoral flow of capitals have been formed in the economy, what complicates the investment operations at the level of enterprises, sectors of the economy, and regions.

O. Izryadnova

Foreign investment in the Russia's economy

In 2003, the RF investment sphere was characterized by growing business activity facilitated by an improvement in the investment climate and stable growth in the Russia's economy, and positive assessments of business prospects in Russia on the part of foreign entrepreneurs and ranking agencies. According to the FDI Confidence Index published by the consulting company Kearny¹² in September of 2003, in 2003 Russia was ranked 8th (in 2002 it was 17th, in 2001 – 32nd). The international ranking agency Moody's increased the ranking of the RF by two grades at once (from speculative Ba2 up to the investment level Baa3¹³) in the early October of 2003. At present, ranking agencies Fitch and Standard & Poor's rank Russia one (- BB+) and two (BB) positions below the investment level respectively.

As on January 1, 2004, the accumulated foreign capital in the Russia's economy, including the investment from CIS member countries, made about US \$ 57 billion, what was by 33.5 per cent above the level registered in 2002. The total amount of foreign investment in the non-financial sector of the Russian economy (not taking into account the monetary and credit regulating authorities, commercial and savings banks, and including Ruble denominated investment in US \$ equivalent made US \$ 29.7 billion in 2003. For the first time in the few last years, the amount of investment in the Russia's economy exceeded Russian investment abroad.



Source: RF Goskomstat

A favorable factor of investment activity in the Russian Federation was that the rates of growth in foreign direct investment outpaced the respective indicator of aggregate foreign investment, what resulted in an increase in the specific weight of direct investment in the total investment. Over the last few years, foreign direct investment practically has not been growing and even declined in 2001.

¹² The ranking characterizes investment attractiveness of countries reflecting not the current amounts of direct investment, but only perceptions and intentions of investors.

¹³ Ranking of Russian forex denominated bonds, Russian Ruble denominated bonds, and all Eurobonds in circulation. Investment rankings according to the Moody's scale start with Baa3 and with BBB- according to the scale offered by Standard & Poor's and Fitch.

Table 1

The structure of foreign investment in the Russia's economy

	US \$ mil.				In % of the preceding year				In % of total		
	Total	Direct	Portf.	Other	Total	Direct	Portf.	Other	Direct	Portf.	Other
1998	11 773	3 361	191	8 221	- 4,2	- 37,0	-72,0	30,9	43,4	5,5	51,1
1999	9 560	4 260	31	5 269	- 18,8	26,7	6,2 times less	- 35,9	44,6	0,3	55,1
2000	10 958	4 429	145	6 384	14,6	4,0	4,7 times more	21,2	40,4	1,3	58,3
2001	14 258	3 980	451	9 827	30,1	- 10,1	3,1 times more	53,9	27,9	3,2	68,9
2002	19 780	4 002	472	15 306	38,7	0,6	4,7	55,8	20,2	2,4	77,4
2003	29 699	6 781	401	22 517	50,5	69,4	- 15,0	47,1	22,8	1,4	75,8

Source: RF Goskomstat.

The major share of foreign investment in the Russia's economy in 2003, similarly to previous years, consisted of "other" investment formed primarily at the expense of credits of international financial organizations. The European Bank of Reconstruction and Development (EBRD) is the largest non-state creditor of Russia. In 2003, EBRD investment in the Russia's economy amounted to Euro 1.1 billion, what made 29.6 per cent of the total EBRD investment in 2003. In 2002, EBRD investment in Russia was assessed at Euro 1.29 billion. Taking into account the fact that the bulk of EBRD credits is denominated in US \$, the US Dollar depreciation observed in 2003 resulted in a decline in the evaluation of the bank's amount of investment by about 20 per cent (in prices of 2002 the amount of credits EBRD extended to Russia makes Euro 1.32 billion). The accumulated amount of EBRD financing of its Russian projects is estimated to be Euro 5.2 billion, or 22.8 per cent of the bank's aggregate investment.

In 2003, the sectoral structure of foreign investment was characterized by a growth in investment in the production sphere, where there was registered a slight increase in absolute terms (about US \$ 5 billion). The investment in general commercial activities relating to market servicing increased by more than US \$ 2 billion.

Table 2

**Sectoral structure of foreign investment in the Russia's economy
in 2000 through 2003.**

	US \$ mil.			Change in comparison with preceding year, %			In % of the total		
	2001	2002	2003	2001	2002	2003	2001	2002	2003
Industry	5 662	7 332	12 330	19,9	29,5	68,2	39,7	37,1	41,5
Transport and communications	1 259	610	1 083	- 35,3	- 51,5	77,5	8,8	3,1	3,6
Trade and public catering	5 290	8 800	10 516	170,7	66,4	19,5	37,1	44,5	35,4
Commercial activities relating to market servicing	792	1 355	3 403	192,3	71,1	151,1	5,6	6,9	11,5
Finance, credit, insurance, pensions	127	130	640	-53,6	2,4	4,9 times	0,9	0,7	2,2
Other sectors	1 128	1 553	1 727	- 37,0	37,7	11,2	7,9	7,9	5,8

Source: RF Goskomstat

More active interest of foreign investors in production resulted in the fact that the sphere of trade and public catering was outpaced by industry as concerns the investment preferences of foreign investors.

Among the industries most popular with foreign investors, there should be noted fuel industry and metallurgy. Thus, in 2003 foreign investment in fuel industry increased 2.7 times as compared with the figures registered in the preceding year and made US \$ 5.3 billion, while investment in metallurgy grew by 41.5 per cent totaling to US \$ 3.5 billion. Investment to forestry, wood working, and pulp and paper industry increased more than 2 times (up to US \$ 600 million). On the whole, in 2003 a growth in amounts of foreign investment as compared with the indicators registered in 2002 was observed across practically all key industries, although the rates of growth somewhat decelerated (by 31.5 per cent in food industry, by 30.8 per cent in mechanical engineering and metal working), what entailed significant changes in the structure of foreign investment made in industry.

In 2003, the structure of foreign investments in industry is characterized by the prevalence of “other” investment, the share of which made 71.8 per cent (US \$ 8.85 billion), what was by 68.8 per cent above the respective indicators observed in 2002. Foreign direct investment in industry increased by 77 per cent in comparison with the figures registered in 2002, the specific weight of this type of investment in total foreign investment in industry is estimated to be 27.7 per cent (US \$ 3.4 billion). The amount of portfolio investment in industry has declined 2.75 times over the period under observation.

The regional distribution of foreign investment observed in 2003 indicates the persistence of concentration of foreign investment in Moscow due to its higher investment attractiveness. In 2003, the amount of investment in Moscow amounted to US \$ 12 billion, what was by 45 per cent above the level registered in 2002. Simultaneously, in the past year there was observed a significant increase in the attention of foreign investors to other Russian regions. For instance, foreign investment in the Novgorod oblast grew 3.5 times (up to US \$ 212.8 million), while the amount of investment in the Rostov oblast, Karelia, the Leningrad and Chelyabinsk oblasts increased 2 times (up to US \$ 225.3 million), 1.7 times (up to US \$ 34.7 million), 1.4 times (up to US \$ 239.7 million), and by 28.9 per cent (up to US \$ 1 billion) respectively. Last year, foreign investment in St. Petersburg remained at the levels registered in 2002 and made US \$ 696 million.

In 2003, five largest investing countries accounted for 62.4 per cent of the total amount of foreign investment accumulated by January 1, 2004, while the respective indicators registered in 2002 and 2003 made 63.8 per cent and 67.7 per cent. Five largest investing countries also account for 57.5 per cent of direct accumulated investment, 75.4 per cent and 66.1 per cent of portfolio and other investment respectively (in 2002 the respective indicators made 60.1 per cent, 67.0 per cent and 55.2 per cent).

Table 4

Accumulated foreign investment as broken down by major investing countries.

	Accumulated by 01.01.2004, US \$ mil.				Change to 01.01.2003, %			
	Total	Direct	Portfolio	Other	Total	Direct	Portfolio	Other
USA	5296	4297	41	958	-4,1	1,8	-39,7	-22,4
Germany	10204	2542	383	7279	25,3	48,3	-0,3	20,4
France	4776	331	0,1	4445	57,5	9,2	0,0	62,8
UK	7220	2828	107	4285	42,9	29,1	-16,4	56,6
Cyprus	8085	5037	547	2501	43,7	28,3	79,3	79,3
The Netherlands	3575	2796	5	774	25,4	16,6	-76,2	79,6
Other countries	17858	8300	345,9	9212	40,7	48,2	-39,0	41,1
Total	57014	26131	1429	29454	32,8	28,4	-3,0	39,6

Source: RF Goskomstat.

At the background of growing investment from other countries, in 2003 Swiss investment declined making US \$ 1.1 billion (-20.8 per cent as compared with the figures registered in 2002), while the amount of investment from the USA practically did not change and also made US \$ 1.1 billion. Last year, the most significant growth (3.1 times up to US \$ 3.7 billion) was registered with respect to investment from France. The investment from UK, Japan, and Cyprus increased 2 times (up to US \$ 4.6 billion), 2.3 times (up to US \$ 1 billion), and by 80 per cent (up to US \$ 4.2 billion) respectively. In 2003, Germany remained the leader as concerns the amount of invested capital, its investment made US \$ 4 billion (+ 7.8 per cent as compared with the level registered in 2002).

The priority sectors for both German and British investors were trade and public catering, where they invested US \$ 2.5 billion (or 59 per cent of the aggregate investment from Germany) and US \$ 1.8 billion (39.6 per cent of the aggregate investment from UK) as compared to 76.6 per cent and 47.2 per cent respectively registered in 2002. The German and British investment in industry were estimated to make 24.5 per cent and 26.7 per cent of the aggregate investment from these countries in the Russian economy made in 2003.

The major part of capitals flowing in the Russia's economy from France (85 per cent), Japan (96,1 per cent), and the Netherlands (72.5 per cent) were invested in industry.

The dynamics observed on the investment market indicate that the interest of foreign investors in Russia is growing, what permits to hope that the amounts of foreign investment in the Russia's economy will increase this year.

E. M. Ilyukhina

The Real Sector: Factors and Trends

The acceleration of the rates of economic growth registered in the beginning of this year was determined by the persistence of trends formed across base sectors in 2003. In January and February of 2004, the increase in output of base sectors of economy made 8.3 per cent in comparison with the figures registered in the respective period of the preceding year. The dynamic development of industry (108.7 per cent), construction (113.5 per cent), and retail trade (110.3 per cent) had the dominating impact on the macroeconomic situation.

The major structural shifts in the real sector of the economy were determined by changes in domestic and external demand. The favorable business situation persisting on world markets still created incentives for growth in output of export oriented branches of fuel industry, ferrous metallurgy, forestry complex, and chemistry. In January and February of 2004, the increase in output of the export oriented sector of economy made 7.7 per cent in comparison with the figures registered in the respective period of the preceding year. It should be noted that in the beginning of 2004 there were registered more moderate dynamics of development of the raw material complex as compared with the rates of growth in output of industry at large and production of final demand products, what is an evidence of the growing role of domestic demand as a factor of economic growth.

As concerns the formation of the dynamics and structure of domestic demand, in the second six months of 2003 it was still most significantly affected by industries of the investment complex. In January and February of 2004, the increase in output of the investment complex made 18.8 per cent in comparison with 2.3 per cent registered in the respective period of 2003 as the output of mechanical engineering and construction materials industry increased by 19.8 per cent and 11.9 per cent respectively. The expansion of demand for investment goods and services had a cumulative effect on the nature of development of related sectors and industries. In comparison to the figures registered in January and February of 2003, output of ferrous metallurgy, chemistry, and forestry complex grew by 8.3 per cent, 10.7 per cent, and 8.7 per cent respectively. A characteristic feature of development of these industries was increasing specific weight of construction materials produced for domestic consumption in the structure of output, as well as growing production of export goods at the background of positive shifts in the world price situation.

The state of investment industries is the major technological factor of settlement of urgent problems of reconstruction and modernization of production on the new technical basis. However, in the course of analysis of the trends in the development of mechanical engineering over the last two years there were noted the following phenomena. First, import of machinery and equipment is growing at a rate outpacing the dynamics demonstrated by domestic mechanical engineering. The growing role of imported machinery and equipment is caused by both insufficient scale of domestic production, and poor competitiveness of many types of technical means in terms of their "price – quality" ratio. Second, the high rates of growth in output of machinery and equipment was primarily facilitated by expanding demand for products of railroad mechanical engineering, instrument making, communications industry at the background of the permanent overproduction crisis in the automotive manufacture. Third, in the situation of growing export revenues of the economy there was observed a contraction of demand for domestic machinery and equipment on the part of the fuel industry.

After the switch to the model of investment development, the conflict between the structure of the sector and the dynamic processes of changes in demand aggravated. Although in the period from 1999 till 2003 the increase in the investment in mechanical engineering made almost 40 per cent in comparison with the level registered in 1998, this circumstance had no significant impact on the technical and economic characteristics of the fixed assets of the industry. The persistence of a long term trend towards downfall of output of machine tool manufacturing was a factor behind the low rates of renewal of fixed assets in mechanical engineering at large. As the average rate of renewal of fixed assets in the industry has persisted at 0.8 per cent over the last three years, the wear and tear was by 2 p. p. above the average level registered in the industry on the whole. Mechanical engineering is in the catastrophic need of skilled labor. Even an increase in the average wages and salaries did not entail higher attractiveness of this branch of industry on the labor market. In the period from 1998 till 2002, the number of employed personnel decreased by almost 8 per cent. The outpacing rates of growth in wages and salaries in comparison with labor productivity entailed the increase in the share of labor remuneration expenditures in the structure of production costs from 15.3 per cent in 2000 to 18.8 per cent in 2002 and 20.1 per cent in 2003. As a result, these developments strengthened the trend towards a decrease in profitability levels from 14.0 per cent in 2000 to 9.8 per cent in 2003. Therefore, in the

situation of intensive growth in investment demand, the standing of mechanical engineering in the structure of the Russian economy do not seem to be good in the near term outlook.

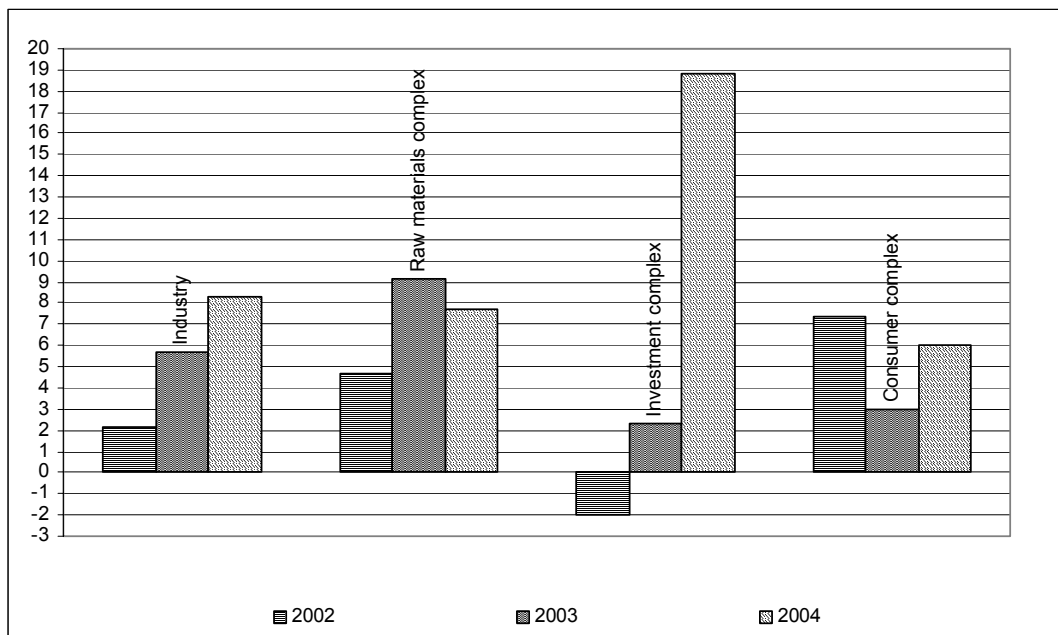


Figure 1. Changes in the dynamics of output across industrial production complexes in January and February of 2001 through 2004, in % of the preceding year.

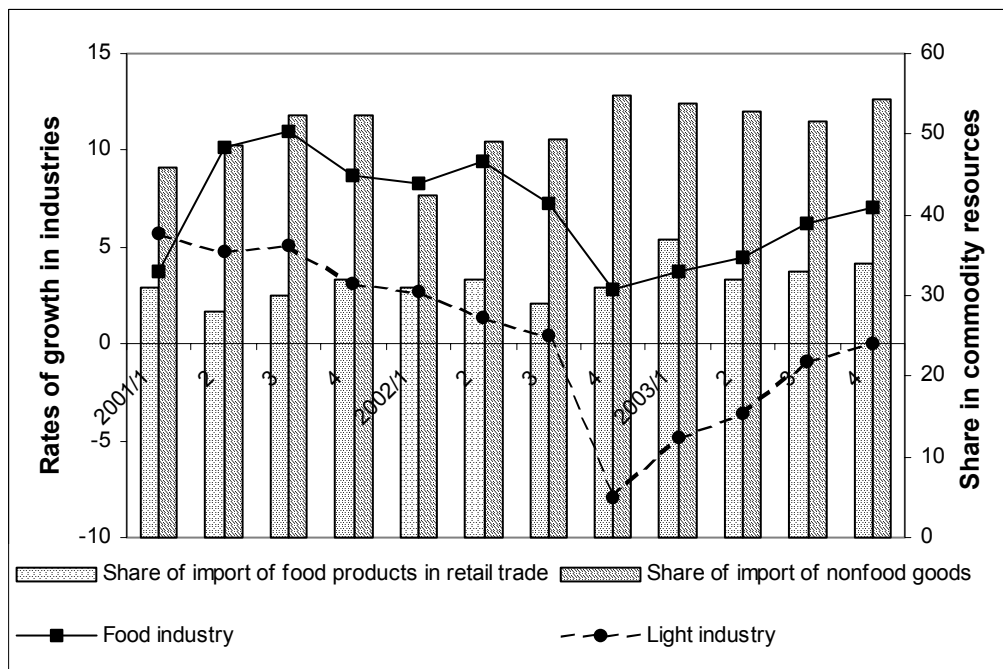


Figure 2. Changes in the dynamics of output of light and food industries and the share of imports in commodity resources of the consumer market in 2001 through 2003, in %

In the beginning of the year, a positive development was the acceleration of the rates of growth in the complex of consumer branches up to 6 per cent as compared with 3 per cent registered in the respective period of 2003. At the same time, an analysis of the post-crisis development of industry reveals that the lack of serious qualitative shifts in the technology and structure of production, the complex of branches manufacturing consumer goods will not be able to support high rates of growth over a long time. The narrowness of the material and production base on the one hand, and lower competitive power of domestic products in com-

parison with imports at the given exchange rate, on the other hand, result in expansion of niches for imported goods. According to the estimates presented by the RF Ministry of Economic Development and Trade, in January and February of 2004 the import of consumer goods increased approximately 1.1 times, while output of food industry grew by 6.9 per cent and production of light industry declined by 2.7 per cent. While in 2003 the share of domestic products in the structure of the food commodity group on the consumer market remained at about 66 per cent, almost 54 per cent of the turnover of retail trade with nonfood goods were formed by imported products.

An analysis of development of the Russian economy in the period from 1999 till 2003 reveals that the specific feature of recovery economic growth was the more important role played by domestic demand. In this connection, the prospects of further growth to a considerable extent depend on the intensity of transformation of the structure of national economy in favor of branches manufacturing final demand goods. Facilitation of this transformation requires to coordinate decision making in the spheres of budget, tax, tariff, customs, and monetary policies. The reform of the tax system and the budget process should create incentives for diversification of the structure of the economy both by increasing investment attractiveness of manufacturing industries, and at the expense of equalization of efficiency via redistribution of the fiscal burden among the sectors of the economy.

O. Izryadnova

Oil and natural gas sector

The price situation on the world oil markets determined the development of the oil and natural gas sector of the Russian economy in 2003 and the first months of 2004. Due to the fact that production of oil in Iraq decreased and OPEC member countries had in place the limitations on oil extraction, the world oil prices were at an exceptionally high level. In 2003 and in January through February of 2004, the average price of the oil basket of OPEC member countries was above the upper target price threshold (US \$ 22 to US \$ 28 per barrel) set by the organization. The average price of Russian Urals oil was close to US \$ 28 per barrel at the end of 2003 and in the beginning of 2004 (see Table 1).

Table 1

World oil prices in 1999 through 2004, US \$ per barrel

	1999	2000	2001	2002	2003	2004 January	2004 February
Brent, UK	17,97	28,50	24,44	25,02	28,83	31,23	30,83
Urals, Russia	17,30	26,63	22,97	23,73	27,04	28,88	27,64
OPEC oil basket	17,47	27,60	23,12	24,34	28,13	30,26	29,67

Source: OECD International Energy Agency.

The development of the oil and natural gas sector of the economy in 2003 and the first months of 2004 was characterized by a persisting trend towards an increase in extraction of oil, oil products, and natural gas (see Table 2). In 2003, the volume of oil output, including gas condensate, exceeded the level registered in 1992 for the first time in the recent years and reached 421.4 million metric tons, while the increase in oil extraction in comparison with the figures registered in the respective period of the preceding year made 11.1 per cent (the record high in the post-reform period). An increase in extraction of natural gas first registered in 2002 continued making 3.4 per cent by the end of 2003. There was observed a certain increase in investment activity, especially in the natural gas sector: in 2003, the volume of oil production drilling grew by 2.7 per cent as compared with the figures registered in the preceding year, while natural gas production drilling increased by 58.6 per cent. At the same time, due to a certain decline in the volume of drilling observed last year, the commissioning of new oil wells was down by 5.0 per cent in 2003. The decline in the volumes of oil surveying drilling continued (oil drilling decreased by 10.7 per cent in comparison with the figures registered last year), what may be explained by sufficient levels of available reserves, while natural gas surveying drilling increased (by 31.2 per cent in comparison with the figures observed in the preceding year). The output of oil products refined with the use of modern processing technologies increased by 13.1 per cent, while the degree of processing grew from 69.6 per cent in 2002 to 70.3 per cent in 2003. The share of high octane gasoline in the total amount of motor gasoline increased from 49.4 per cent in 2002 to 52.0 per cent in 2003.

Table 2

Oil, oil products, and natural gas output in 1999 through 2004, in % of the preceding year

	1999	2000	2001	2002	2003	2004 January - February
Oil	100,3	105,9	107,7	108,7	111,1	111,5
Gas condensate	104,7	103,8	106,7	112,8	108,7	114,1
Primary oil processing	102,9	102,7	103,2	103,3	102,7	101,4
Motor gasoline	102,2	103,6	100,6	104,9	101,2	100,7
Diesel fuel	104,2	104,9	102,0	104,7	102,0	103,7
Furnace fuel oil	94,8	98,3	104,2	107,1	100,3	94,4
Natural gas, cub. m. billion	99,7	98,5	99,2	101,9	103,4	102,2
Oil gas, cub. m. billion	103,2	102,5	105,0	110,5	119,3	111,9

Source: RF Goskomstat.

In 2003, there was observed a significant growth in prices of oil and oil products occurring on the domestic market, what was primarily related to the enhancement of the potential of oil export (first of all, due to the expansion of the Baltic pipeline system). In December, the average domestic oil price (producers' price) in dollar terms increased to US \$ 70.1 per metric ton. The average motor gasoline price has reached US \$ 236.9 per metric ton, what is the record high over the whole post reform period. At the same time, there persisted a significant gap between the levels of domestic and world oil prices: in 2003, this ratio was at or below 45 per cent to 50 per cent. In January and February, there was observed a rise in prices of oil and natural gas, while the domestic prices of oil products stabilized (see Table 3).

Table 3

**Domestic oil, oil products, and natural gas prices (in US \$) in 1999 through 2004
(average wholesale prices of enterprises, US \$ / metric ton)**

	1999 Dec.	2000 Dec.	2001 Dec.	2002 Dec.	2003 Dec.	2004 Jan.	2004 Feb.
Oil	37,0	54,9	49,9	60,7	70,1	70,1	76,3
Motor gasoline	171,9	199,3	151,5	168,8	236,9	236,8	231,0
Diesel fuel	125,0	185,0	158,5	153,8	214,3	224,3	223,4
Furnace fuel oil	46,1	79,7	47,1	66,1	66,0	66,5	66,4
Gas, US \$ / thos. c. m.	2,2	3,1	4,8	5,9	4,4	8,8	9,3

Source: calculated on the basis of RF Goskomstat data.

In 2003, the oil exports increased by 17.8 per cent in comparison with the figures registered in the preceding year, while export of oil products grew by 3.6 per cent. The share of exports in commodity resources of diesel fuel made 56.2 per cent, furnace fuel oil – 55.0 per cent, motor gasoline – 13.2 per cent (memorandum: in 1999 the share of exports in the amount of motor gasoline output made only 7.2 per cent). In 2003, the amount of oil exports increased by 33.2 per cent as compared with the figures registered in the preceding year, what is 2 times above the growth in the volumes of oil exports.

The import of oil products increased as a result of the rise in domestic prices of oil products and real Ruble appreciation. On the whole, the import of oil products increased by 36.4 per cent in comparison with the figures observed in the preceding year. At the same time, imports of motor gasoline grew by 128 per cent, while the share of imports in the gasoline resources increased from 0.1 per cent to 0.3 per cent. However, the specific weight of imports remains rather low. For instance, in the first six months of 1998, i.e. before the Ruble devaluation, the specific weight of imports in the gasoline resources made 8.7 per cent.

At the same time, there was registered a decline in the rates of growth in natural gas exports in comparison with the figures registered last year, what was caused by low effective demand on the part of CIS member countries (in 2003 natural gas exports to these countries fell by 7.7 per cent).

As the analysis of the data on the output and export of oil and oil products reveals (see Table 4), the bulk of oil additionally extracted in 2003 (85 per cent) was exported (either directly, or as refined products). In 2003, the net export of oil and oil products made 291.6 million metric tons, i.e. grew by 35.5 million metric tons in comparison with the figures registered in the preceding year (including an increase in the export of oil

by 32.1 million metric tons and in export of oil products by 3.4 million metric tons). In other words, similarly to the period from 2000 till 2002, exactly the growth in exports determined a significant increase in oil output in 2003. As a result, the specific weight of the net export of oil and oil products in the total oil output made 69.2 per cent, while oil exports exceeded 50 per cent of the total oil output. Due to the growing demand for natural gas both on the world and domestic markets, in 2003 the output of natural gas significantly increased and the specific weight of net exports in the total output of natural gas made 29.4 per cent.

Table 4

The ratios between output, consumption, and export of energy resources in 1999 through 2003

	1999	2000	2001	2002	2003
Oil, mil. metric tons					
Output	305.0	323.2	348.1	379.6	421.4
Export, total	134.5	144.5	159.7	187.5	223.5
Export to countries outside CIS	115.7	127.6	137.1	154.8	186.4
Export to CIS member countries	18.8	16.9	22.7	32.7	37.1
Net exports	128.5	138.7	154.7	181.3	213.4
Domestic consumption	120.5	123.0	122.9	123.5	129.8
Net exports in % of output	42.1	42.9	44.4	47.8	50.6
Oil products, mil. metric tons					
Export, total	56.9	61.9	70.8	75.0	78.4
Export to countries outside CIS	53.9	58.4	68.3	72.5	74.9
Export to CIS member countries	3.0	3.5	2.5	2.6	3.5
Net exports	50.3	61.5	70.5	74.8	78.2
Oil and oil products, mil. metric tons					
Net export of oil and oil products	184.5	200.2	225.2	256.1	291.6
Net export of oil and oil products in % of output of oil	60.5	61.9	64.7	67.5	69.2
Natural gas, billion c. m.					
Output	590.7	584.2	581.5	594.5	620.3
Export, total	205.4	193.8	180.9	185.5	189.3
Export to countries outside CIS	131.1	133.8	131.9	134.2	142.0
Export to CIS member countries	74.3	60.0	48.9	51.3	47.3
Net exports	201.3	189.7	176.8	178.3	182.1
Domestic consumption	389.4	394.5	404.7	416.2	438.2
Net exports in % of output	34.1	32.5	30.4	30.0	29.4
Aggregate indicators					
Output of oil and natural gas, mil. metric tons OE	836.6	849.0	871.5	914.7	979.7
Net export of oil, oil products, and natural gas, mil. metric tons OE.	365.7	370.9	384.3	416.6	455.5
Domestic consumption of oil and natural gas, mil. metric tons OE.	470.9	478.1	487.2	498.1	524.2
Net export of oil, oil products, and natural gas, in % of oil and natural gas output	43.7	43.7	44.1	45.5	46.5

Source: RF Goskomstat, RF Energy Ministry, RF State Customs Committee, author's calculations.

The total volume of export of oil and oil products increased from 262.5 million metric tons in 2002 to 301.9 million metric tons in 2003, or by 15 per cent. The export of crude oil still dominated the structure of oil exports (almost $\frac{3}{4}$ of the total export of oil and oil products). At the same time, the bulk of export of oil products was formed by furnace oil and diesel fuel. Export of natural gas increased by 2.0 per cent. The major part of energy resources (83.4 per cent of oil, 95.5 per cent of oil products, and 75 per cent of natural gas) were exported to countries outside CIS.

As the analysis of the dynamics of the Russian oil exports over a long period reveals, the aggregate net export of oil and oil products in 2003 exceeded the level registered in 1990 (246.3 million metric tons) for the second year running and reached the level observed in 1988, when the volumes of oil exports were maximal (291.6 million metric tons). At the same time, there was observed a growth in the volumes of exports, which have steadily grown since 1996. As a result, the specific weight of refined oil products in the

total oil exports increased from 18.2 per cent registered in 1990 to 26.8 in 2003. After a sharp downfall in domestic consumption of oil (according to our estimates, it declined from 269.9 million metric tons in 1990 to 129.8 million metric tons in 2003, i.e. more than 2 times), the specific weight of export of oil and oil products in oil output has increased from 47.7 per cent to 69.2 per cent over this period. In contradistinction to export of oil and oil products, in the last few years net export of natural gas did not exceed the level observed in the late 1990s and is close to the level registered in the early 1990s, although the specific weight of net export of natural gas in its output remains somewhat above its pre-reform level (29.4 per cent in 2003 as compared with 28 per cent in 1990).

In 2003, the aggregate net export of oil, oil products, and natural gas for the first time exceeded not only the level registered in 1990, but also in 1988. According to our estimates, it increased from 407.6 million metric tons in terms of oil equivalent in 1990 to 455.5 million metric tons in terms of oil equivalent in 2003, or by 11.8 per cent. At the same time, the specific weight of net exports in the aggregate output of oil and natural gas grew from 37.3 per cent to 46.5 per cent. These data indicate that the export orientation of the oil and natural gas sector enhances in comparison with the figures registered in the pre-reform period. Nevertheless, it should be taken into account that export orientation results not only from increase in the volumes of export, but also from contraction of output of hydrocarbons as a reaction to the decline in their domestic consumption and falling export to the NIS countries.

The high level of world oil prices determined a significant growth in proceeds of the oil sector of the economy (see Table 5, Figures 1 and 2). The aggregate proceeds from export of oil and staple oil products (furnace oil, diesel fuel, and motor gasoline) made US \$ 51.13 billion in 2003, while their specific weight in the Russian exports made 37.8 per cent.

Table 5

Oil and oil products export revenues in 1999 through 2003, US \$ billion

	1999	2000	2001	2002	2003
Proceeds from export of oil and staple oil products	18,82	34,89	33,43	38,72	51,13

Source: calculated on the basis of RF Goskomstat data.

The current situation on the world oil market permits to expect that rather high levels of world prices will persist in the near term outlook. According to the base variant of the last (March of 2004) forecast of the Energy Information Administration of the US Department of Energy, a leading organization in the field of analysis and prognostication of the development of world energy sphere, in 2004 the world price of oil, calculated as the average price of the oil basket imported in the USA, will make on the average US \$ 29.1 per barrel, while in 2005 it will be at US \$ 26.4 per barrel. According to a forecast presented by Brunswick UBS, in 2004 on the average the Brent oil price will be observed at US \$ 29.5 per barrel. Therefore, in the short term perspective there may be expected the persistence of the favorable external economic situation both in terms of development of the oil and natural gas industry, and the formation of revenues of the state budget.

Yu. N. Bobylev

IET Business Survey: Industry in March of 2004

The Goskomstat data published in February demonstrated that the recovery of industry continued. According to the evaluations of the Center for Macroeconomic Analysis and Short Term Prognostication (CMASPT), in February the average daily output increased by 0.6 per cent in comparison with the figures registered in January (as adjusted for the seasonality factor). On the average, in the first two months of this year, the growth in the output made 0.6 per cent a month as compared with 0.5 per cent a month registered in the 4th quarter of 2003. In the case the present trend persists, in 2004 the index of industrial output will make 105.5 to 106.5 per cent.

In March, the rates of growth in sales of manufactured goods (as adjusted for the seasonality factor) increased further by several points reaching best values observed in the period from October of 2000. Therefore, after the seasonal downfall registered in January, the balance (rate) of change in this indicator increased by 16 points, what very closely resembles the picture observed in the first months of the preceding year. The only difference is that at preset the absolute decrease in sales was registered only in January, while a year ago a decline (negative balances) were observed from October of 2002 till January of 2003. Across industries, the rates of growth did not accelerate only in power engineering and metallurgy.

The recovery of the growth in sales has positively affected the respective assessments. In March, the balance of evaluations (above norm – below norm) increased by 10 points and reached the best values registered in the second six months of 2003 (the average value observed over this period made –42 per cent). At present, the balance of assessment is at –44 per cent. The share of evaluations of demand as “normal” increased to 49 per cent (as compared with 51 per cent registered in the second half year of 2003). The improvement of balances and increase in the share of “normal” evaluations was observed across all industries with the exception of power engineering and metallurgy. The highest levels of satisfaction with demand was registered in food industry (63 per cent).

In the 1st quarter of 2004, the share of cash sales relating to industrial products made 87 per cent, while barter accounted for 4 per cent and promissory notes and offsets made 8 per cent of the total amount of sales. However, the balance of evaluations on the “above norm – below norm” scale demonstrates that dissatisfaction with the amounts of barter has prevailed among the enterprises involved in this type of transactions since the beginning of 2002. In the cases where enterprises evaluated the amount of their barter operations as normal, the share of barter fluctuated from 7 per cent to 10 per cent over the last four quarters. As concerns promissory notes and offsets, the amount of which is also evaluated as insufficient, this indicator fluctuated in the band from 11 per cent to 14 per cent.

The rates of growth in output (as adjusted for the seasonal factor) reached + 25 per cent in March, what is the historical high not only in 2004, but in the last 48 months. However, this increase in output begins again to outpace the growth in sales. In March, the share of enterprises reporting about the more rapid growth in production (in comparison with demand) increased to 28 per cent, while in February the share of such enterprises made 22 per cent and the share of enterprises closely following demand declined from 67 per cent to 64 per cent. In March, the maximal values of the latter indicator were observed in power engineering (86 per cent), chemistry and petrochemistry (76 per cent), and light industry (76 per cent).

The outpacing rates of growth in output facilitated the replenishment of finished stocks and revision of respective evaluations. In March, the balance of this indicator increased at once by 9 points thus returning to the levels registered at the end of 2001 and in early 2003, when Russian enterprises started to maintain finished stocks sufficient to immediately meet new (not planned) orders.

The key indicators of competition monitored by the IET substantiate the conclusion that in 2003 the progressive development of the Russia’s industry continued in the situation of aggravating competitive struggle. First, the share of competitive markets has increased. According to enterprises’ evaluations, in 2003 the competition was rather perceptible on 91 per cent of domestic markets. It is the historical high registered since the start of monitoring in 1995. In 2003, the most significant increase was observed as concerns the share of markets where domestic products competed with goods imported from countries outside the NIS. Towards the end of the past year, Russian producers experienced this type of competition already on 62 per cent of the markets. The pre-default maximum (registered in July of 1998) was at 60 per cent. Therefore, the presence of imports has already exceeded the levels observed in 1998. However, these developments entailed no catastrophic consequences for the domestic industry. First, on the whole Russian enterprises experience the most strong competition on the part of other Russian enterprises, and the intensity of competition with producers from countries outside the NIS is still below the level of competition among Russian producers.

The forecasts of changes in demand remained very optimistic over the last three months. In March there was reached a new record: the share of reports about expected increase in sales made 40 per cent. Earlier, the maximum value of this indicator was registered only at 37 per cent. At present, the most optimistic expectations relating to an increase in demand are registered in chemistry, petrochemistry, and construction industry. The balance of forecasts (as adjusted for seasonal factors) proved to be the most optimistic since October of 2000.

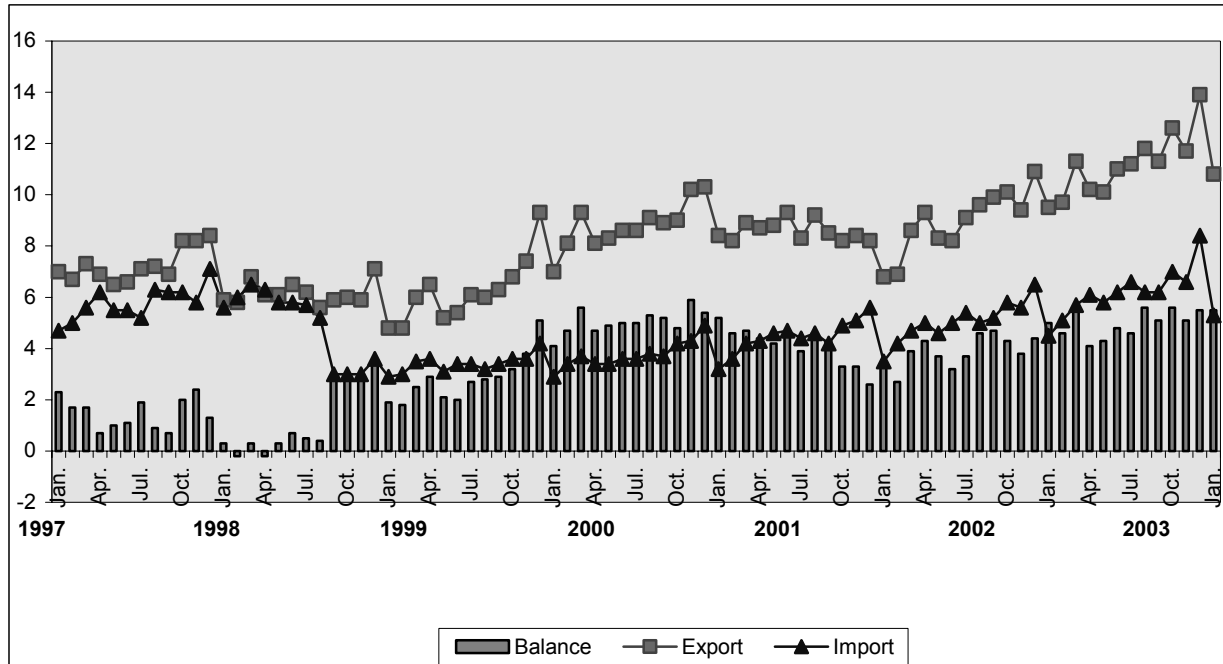
The plans of changes in output, similarly to forecasts of changes in demand, have demonstrated very high rates of optimism since the beginning of the year. The share of reports about the plans to increase output has been above 50 per cent for the third month running (such developments have been never observed before), while the balance (as adjusted for seasonal factors) has been registered at the best level since October of 2001.

S. Tsukhlo

Foreign Trade

In January of 2004, the Russia's foreign trade turnover grew by 12.7 per cent in comparison with the figures registered in the respective month of the preceding year and made US \$ 16.1 (according to the balance of trade methodology, in actual prices of the month).

In January of 2004, Russian exports made US \$ 10.8 billion, what was by 13 per cent above the figures registered in January of 2003 and by 23 per cent below the level observed in December of 2003. Export to countries outside NIS made US \$ 9.1 billion (by 11.2 per cent above the respective indicator of the preceding year).



Source: RF Goskomstat

Figure Main indicators of Russia's foreign trade (in US \$ bln.).

Russia has been actively exporting fuels, metals, lumber, paper, and chemicals. In January of 2004, there increased by 60.5 per cent volumes of export of ferroalloys, while unprocessed aluminum, nitrate mineral fertilizers, and anhydrous ammonia rose by 63.6 per cent, 20.8 per cent, and 53.5 per cent respectively. The amounts of export of machinery and equipment grew by 60.6 per cent. Products of heavy and power mechanical engineering accounted for the bulk of increase. Crude oil exports made 15.1 million metric tons rising by 12.4 per cent in comparison with the figures registered in the respective period of the preceding year.

In January of 2004, world oil prices continued to grow steadily (for more details on the dynamics of world oil prices, see the section "Oil and natural gas sector").

Contract prices of Russian natural gas declined by 0.6 per cent in comparison with the figures observed in December of 2003.

In January of 2004, there was observed a rise in prices on the world market of ferrous metals. European export prices of major types of merchant rolled shapes and flat rolled products grew by 4 per cent and 2.2 per cent respectively.

In January of 2004, at the background of the global economic growth and the resulting increase in demand, the prices of non-ferrous metals continued to rise. The average nickel, copper, and aluminum prices increased in comparison with the figures observed in the December of the preceding year by 6.2 per cent (US \$ 14855 per metric ton), 3. per cent (US \$ 1610 per metric ton), and 11.2 per cent (US \$ 2440 per metric ton) respectively. As compared with the levels registered in January of 2003, the prices of nickel, aluminum, and copper grew 1.9 times, by 24.6 per cent, and 1.5 times respectively.

Table 1.

The average monthly world prices in January of the respective year

	1996	1997	1998	1999	2000	2001	2002	2003	2004
Oil (Brent), USD / metric ton	137,5	170,2	111,6	82,4	185,7	189,6	141,58	204,62	221,0
Natural gas, USD / thous. c. m.	-	88,8	74,9	71,3	86,8	260,7	76,7	180,3	219,8
Gasoline, USD / metric ton	142,5	184,5	133,9	176,5	263,8	308,8	204,5	304,5	354,2
Copper, USD / metric ton	2553	2400	1682	1528,2	1887,9	1849,6	1557,8	1571,3	2441,9
Aluminum, USD / metric ton	1554	1598	1480	1301,4	1695,5	1641,5	1377,9	1291,1	1608,2
Nickel, USD / metric ton	7956	7485	5496	4550,8	8338,1	7091,3	6094,6	7643,9	14855,0

Source: calculated in accordance to the data presented by London Metal Exchange (UK), International Oil Exchange (London)

According to the law "On customs tariff," the Cabinet of Ministers should adjust the rate of the import oil duty every two months proceeding from the respective two month monitoring of the average crude Urals oil price on the world markets. According to the results of the monitoring, in January through February the price of Russia's oil made US \$ 28.3225 per barrel as compared with US \$ 27.86991 per barrel registered in November through December of 2003. On April 1, 2004, there were introduced new rates of export duties on oil and oil products. The rate of the export duty on oil was set at US \$ 35.2 per metric ton (earlier it made US \$ 33.9 per metric ton). The rate of the export duty on light and medium distillates, gas oil, liquid fuels is set at US \$ 31.7 per metric ton (earlier it made US \$ 30.5 per metric ton). Since last December, the rate of the export duty on oil and oil products has been raised by US \$ 2.45 per metric ton on the average. The most significant increase in the rate of the export duty was registered in the autumn of the preceding year (on October 1, it was increased by almost US \$ 9). However, on December 1 the rate was reduced by US \$ 2.6.

In January of 2004, imports to Russia made US \$ 5.3 billion, what was by 12.1 per cent above the figures registered in January of 2003 and by 37 per cent below the levels observed in December of 2003. It should be noted that the import of goods and services from countries outside the NIS made US \$ 3.9 billion (by 3.5 per cent above the figures registered in January of 2003).

Imports of equipment have been growing. This January, the share of equipment in imports was at 45.4 per cent, as compared with 38.5 per cent observed in January of 2003. Imports of cars have grown two times, while there was observed a decline in the import of food products and raw materials necessary for production thereof (18.7 per cent as compared with 24.9 per cent registered in January of 2003).

As compared with the figures observed in the preceding year, Russia increased import of fresh frozen fish by 30.3 per cent, while import of fresh frozen meat, poultry, and sugar declined by 71.5 per cent, 78.1 per cent, and 26.9 per cent respectively. These developments may be explained by the introduction of such protective barriers as quotas set on meat imports and rates of import duties on unrefined sugar pegged to the quotations of the New York Mercantile Exchange. However, the rules governing import of sugar and meat products to Russia may seriously change. Before May, there should be approved the law "On agriculture," which may determine the perspectives of the sugar and meat markets for the next three years.

In January of 2004, Russia had the active balance of trade at US \$ 5.5 billion, what was by 13.8 per cent above the figures registered in January of 2003.

In January of 2004, Russian exports to CIS member countries made US \$ 1.69 billion, increasing by 24 per cent in comparison with the level observed in January of 2003. The export of oil products rose more significantly (2 times), including the growth in diesel fuel and gasoline exports 3 times and 5 times respectively, while oil exports increased by almost 40 per cent.

In the first month of this year, Russia's imports from this region increased by 45 per cent in comparison with the figures registered in January of 2003. The structure of respective Russian imports was dominated by food products and agricultural produce. For instance, import of wheat and barley rose more than 5 times, while milk and condensed cream imports grew 12 times.

In March of this year, the Russian customs authorities detected several instances, when refined cane sugar was imported from Belorussia as sugar produced from beets. According to the legislation currently in force, sugar produced or refined from Belorussian raw materials is exempt from customs duties. However, as concerns sugar produced from raw materials imported to Belorussia, it is subject to the normal customs treatment, i.e. clearing involving the payment of all duties. The total volume of sugar found to be illegally exported from Belarus to Russia made about 435 metric tons. It should be noted that Belorussia produced only 254 thousand metric tons of sugar from the sugar beet crops of 2003, at the same time the volumes of Belorussian sugar exports to Russia exceeded 260 thousand metric tons only in the period from November of

2003 till March of 2004. It should be also noted that import of refined sugar from such CIS member countries as Kazakhstan, the Kyrgyz Republic, Moldavia, and Ukraine made only 89.1 thousand metric tons. Therefore, Russian customs authorities undertook additional measures to control sugar imports from Belarus in order to prevent evasion of customs duties on the part of unscrupulous participants of external economic activities.

In the first two months of the year, the customs authorities transferred to the federal budget more than Rub. 140.54 billion, what was by Rub. 41.5 billion above the figures registered in the respective period of the preceding year. A major factor facilitating these developments was the entry into force of the new Customs Code on January 1, 2004. The new Code meets international standards and seriously simplifies the rules governing the conduct of external economic operations.

The performance of the customs working in accordance with the new Code improved dramatically. For instance, 80 per cent of declarations are processed in one day in stead of three days established by the law, what is the result of the radical reduction in the number of documents and data required by the customs authorities. At present, customs request only the documents necessary for identification of goods and application of tariff and non-tariff regulations. No other documents are required.

There were abolished thousands of instructions regulating relations between participants of external economic activities and the customs authorities. The new law contains practically all requirements the participants of external economic activities should comply with. In the nearest future, the Federal Customs Service is planning to supplement the new Customs Code with about 100 orders and instructions interpreting enforcement of certain provisions of the Code. It should be noted that previously there had been about 4.5 thousand bylaws and regulations in force.

In the first few months, the implementation of the new Customs Code will require a close monitoring of the relevant enforcement practices, detection of flaws and merits of the new customs legislation, and accumulation of positive experience pertaining to the reform of the Russian customs service aimed to improve its performance in the interests of foreign trade and the national economy at large.

N. Volovik, N. Leonova

Mergers and takeovers in 2003

In quantitative terms, it may be asserted that the number of transactions in the sphere of mergers and takeovers has significantly increased (see Table 1). This trend observed in Russia completely corresponds with the international patterns, which demonstrate that waves of mergers and takeovers are traditionally registered in the periods of economic growth. At the same time, in Russia these processes are underway at the background of a decline in mergers and takeovers registered in Western countries (after the peak of mergers and takeovers observed in 2001, the results of 2003 look especially modest).

As Table 1 demonstrates, in comparison with the figures registered in 1999 and 2002, the total amount of transactions observed in 2003 increased 7 times and 2 times (with the exclusion of the TNK – BP deal) respectively. The total number of transactions increased almost 4 time as compared with the figures observed in 1999, while the increment in the number of deals registered in 2003 in comparison with 2002 made about 30 per cent. In 2002 through 2003, the average value of merger and takeover transactions in Russia (without the YUKOS – Sibneft and TNK – BP deals) increased by 47 per cent, from US \$ 17 million to US \$ 25 million. Almost 2/3 of transactions were conducted in Russia. In 1999, the number of takeover of Russian companies on the part of foreign firms exceeded the opposite process 3 times (takeover of foreign companies by Russian entities), while in terms of amounts of transactions the excess made 23 times. In 2003, both these indicators were much more similar: the number of takeovers of Russian companies by foreign firms exceeded the opposite process (takeover of foreign entities by Russian companies) only 1.2 times, while in terms of amounts of transactions the excess made 2.5 times¹⁴. Naturally, as concerns these processes, it is impossible to assess the share of genuine foreign capital in contradistinction to repatriated Russian funds; therefore, any such analysis is rather conventional. Nevertheless, these dynamics may indirectly indicate not only growing expansion of Russian companies abroad, but also the trend towards repatriation of previously exported capitals, which became noticeable in the 2000s. From the point of view of international expansion,

¹⁴ This analysis, basing on the materials presented by the KPMG corporate finance department for mergers and takeovers (see “Analiz obschei situatsii na mirovom rynke sliyanii i pogloschenii,” 2004), was supplemented and adjusted by the author’s calculations in accordance with the data presented by Dealogic.

the bulk of Russian investment was traditionally directed to CIS member countries and countries of Central and East Europe (42 per cent and 21 per cent, respectively, of the total amount of external investment registered in 2002).

Table 1.

**Completed transactions involving mergers and takeovers registered
in Russia in 1999 through 2003***

	1999		2000		2001		2002		2003	
	Amount, US \$ mil.	Number of transactions	Amount, US \$ mil.	Number of transactions	Amount, US \$ mil.	Number of transactions	Amount, US \$ mil.	Number of transactions	Amount, US \$ mil.	Number of transactions
Mergers and takeovers in Russia	1203,8	75	508,3	134	1899,3	199	2578,9	217	6668	308
Russian companies taken over by foreign companies	167,2	33	2111,9	60	1318,6	43	1825,8	41	2455	53
Foreign companies taken over by Russian companies	6,9	11	105,7	17	463,6	25	504,4	33	975	45
Total mergers and takeovers	1377,9	119	2725,9	211	3681,5	267	4909,1	291	10098	406

* Transactions completed by December 2, 2003, with the exception of privatization deals. As concerns 2003 – without the TNK – BP and YUKOS – Sibneft transactions. Taking into account the BP – TNK deal, the amount of transactions in 2003 should be adjusted by US \$ 7.7 billion (or the amount of cash – US \$ 2.6 billion). This methodology is the most proper and comprehensive as concerns the assessment of the dynamics on the market of mergers and takeovers. Other studies do not exclude privatization transactions and equity swaps in the course of evaluation of the amounts of the market (Thomson Financial). According to evaluations published by Ernst&Young (only cash money, including the TNK – BP and YUKOS – Sibneft transactions), the amount of deals made US \$ 4 billion in year 2000, US \$ 5 billion in 2001, US \$ 9 billion in 2002, US \$ 12 billion in 2003 (first 9 months). After the exclusion of US \$ 3 billion (the “contribution” of the canceled YUKOS – Sibneft transaction), the results registered in 2003 coincide with the data presented by Dealogic, although in preceding years the differences in evaluations were significant.

Source: Dealogic 2002-2003; KPMG

As concerns the sectoral structure, the share of transactions involving enterprises engaged in extraction of oil, natural gas, and other mineral resources made 63 per cent of the total amount of merger and takeover transactions in 2003, although the world significance of the extracting sector is less than 5 per cent (see Table 2). Nevertheless, in absolute terms the amounts of transactions increased by 40 per cent as concerns the industrial production and by over 100 per cent in the sectors of telecommunications, transport, and public utilities. In Russia, the sectors of finances and insurance, real estate, chemistry and pharmaceuticals, which are highly developed on the world scale, retain a low attractiveness for investors. The share of merger and takeover transactions in these sectors in Russia makes about 3 per cent, while in the world at large this share constitutes about 42 per cent of the total amount of such deals. According to the RF Ministry of Antimonopoly Policy, in 2003 the most intensive activity was also observed in the block of industries related to the fuel and energy complex, transport, communications, and housing and public utilities, as well as on traditionally attractive markets of oil, oil products, and coal.

In 2003, the most noticeable transactions were the merger of assets owned by the TNK and BP, and the transaction between the Interros group and OMZ, as well as attempt of the Alpha group to establish its control over the Megaphone company. The merger (friendly takeover) of Sibneft and YUKOS announced to take place in 2003, could have been the largest deal in the history of the Russia’s economy, however the financial and economic analysis of a cancelled is not feasible. In February of 2004, the signing of the cancellation protocol, it seems, brought to the end the period of uncertainty as concerns the relations between the largest shareholders of these two companies. For the future, it may be of practical importance to analyze the “divorce” techniques applied to the in fact completed takeover.

As Table 3 demonstrates, in quantitative terms horizontal transaction continued to dominated in 2003. On the contrary, conglomerate mergers and takeovers made about 10 per cent to 15 per cent in the aggregate amount of respective deals and about 20 per cent to 25 per cent in the total number of transactions. Nevertheless, according to the data presented by the RF Ministry of Antimonopoly Policy, in the beginning of 2004 on the commodity markets on the largest scale occurred processes of *creation of ramified structures and vertical integration*, including the formation of large vertically integrated companies striving for control over

enterprises ensuring the whole cycle of production, as well as the consequent sale of the products. These processes determine the growth in the aggregate economic concentration.

Table 2.

Sectoral structure of transactions involving mergers and takeovers registered in 1999 through 2003, %*

Sectors	Russia					World
	1999	2000	2001	2002	2003	2003
Extracting sector	53	4	49	25	63	5
Industrial production	1	55	6	34	14	8
Telecommunications	2	14	9	7	11	12
Transport	0	0	4	1	4	4
Public utilities	27	1	0	3	2	5
Food and light industries, wood working	4	15	2	10	2	4
Finances and insurance	0	0	2	4	2	21
Chemistry and pharmaceutical industry	4	5	20	1	1	12
Mass media and program products	0	2	0	14	0	5
Other	9	5	8	1	2	25
TOTAL	100	100	100	100	100	100

* Transactions completed by December 2, 2003, without privatization deals. As concerns the data for 2003, there was excluded the YUKOS – Sibneft transaction.

Source: Dealogic 2002-2003; KPMG

Table 3.

Mergers and takeovers as broken down by type in January through September of 2003, %

	Conglomerate	Vertical	Horizontal
Share in the total amount of transactions, without the oil sector	10-15	20-25	65-70
Share in the total number of transactions	20-25	25-30	50-55

Source: M&A Appraisal

As concerns the assessment of the quantitative dynamics of mergers and takeovers in the environment existing in modern Russia notwithstanding the stages of economic growth, the most important factors to be taken into account remain such as post-privatization redistribution of property and expansion of large groups. Nevertheless, the *latter factor became less significant*. The “contribution” of the largest groups in the intensification of processes of mergers and takeovers taking place in Russia in 2003 became more important not only due to the intensification of reorganization processes in the groups and enhancement of their expansion abroad. The major factor behind these developments is the *more active behavior of economic agents of the second echelon, large and medium sized companies* disposing of sufficient resources to expand their businesses at the expense of taking over smaller companies.

The general trends in the dynamics of mergers and takeovers are confirmed by the data on the dynamics of applications submitted to the RF Ministry of Antimonopoly Policy (see Table 4). In the last few years, there was observed a growth in the aggregate number of applications submitted in compliance with articles 17 and 18 of the RSFSR law No. 948-1 of March 22, 1991, “On competition and restriction of monopolistic activity on commodity markets.” It should be noted that the majority of applications are submitted in relation to article 18.

In 2002, the number of notifications submitted in accordance to article 18 (9461) was comparable with the number of applications relating to the same article (10198). At the same time, according to the data presented by the RF Ministry of Antimonopoly Policy, about half of transactions (in accordance with article 18) conducted in 2002 through 2003 were related to purchase of shares in the authorized capitals of economic agents operating on different commodity markets and therefore not competing with each other. Therefore, article 18 is “tuned” to the excessive rigidity as concerns the necessity to comply with permission procedures. As a result, a considerable part of economic agents attempts to avoid the approval procedures required by articles 17 and 18 – the number of violations found out by the RF Ministry of Antimonopoly Policy made 4000 in

2000 and more than 5 thousand in 2001 (their actual number is much more considerable), and it should be noted that the increment in the number of violations of exactly these articles of the law “On competition...” was most significant¹⁵. At the same time, the problem of “bureaucratization of violations” (as defined by I. Yuzhakov, the former MAP Minister, in the course of a press conference held on December 25, 2003), in the realm of antimonopoly legislation, i.e. the growing involvement of officials in anti-competition arrangements, is of equal importance.

Table 4.

Dynamics of the number of examined notifications and applications submitted in accordance with the stipulations of articles 17 and 18 of the law “On competition...” *

	Number of notifications and applications		Specific weight in the number of applications submitted in accordance with articles 17 and 18, %	
	Article 17	Article 18	Article 17	Article 18
1998	2485	4417	36,0	64,0
1999	2936	7315	28,6	71,4
2000	3882	12092	24,3	75,7
2001	4827	16165	23,0	77,0
2002	4371	19659	18,2	81,8

* The RSFSR law No. 948-1 of March 22, 1991, “On competition and restriction of monopolistic activity on commodity markets” established state control over the creation, reorganization, and liquidation of commercial organizations and associations thereof (article 17) and over the compliance with antimonopoly legislation in the course of purchase of shares in the authorized capital of commercial organizations (article 18).

Source: the data presented by the RF Ministry of Antimonopoly Policy

In the case there is analyzed only the structure of applications (without notifications), the major trends retain their importance (see Table 5). In 2002 through 2003, in the structure of applications examined by the RF Ministry of Antimonopoly Policy more than 70 per cent constitute applications for purchase of shares (article 18), while the share of applications relating to mergers and affiliation does not exceed 5 per cent. It apparently does not mean that the data collected by the RF Ministry of Antimonopoly Policy contradict to the statistics of mergers and takeovers in Russia presented above. On the contrary, the MAP statistics, although not permitting to single out takeovers (this term is lacking in the Russian legislation), indicate growing scale of this process, especially taking into account the large amounts of respective blocks of shares (over 20 per cent).

Table 5.

Structure of applications examined by the RF Ministry of Antimonopoly Policy in 2002 through 2003

Types of applications	2002		2003	
	Number	Share, %	Number	Share, %
Purchase of shares	7813	71,1	8880	71,0
Procurement of fixed means of production or intangible assets	1901	17,3	2144	17,1
Mergers and affiliations of commercial organizations	500	4,6	539	4,3
Other	763	7	951	7,6
Total	10 977	100	12 514	100

Source: the data presented by the RF Ministry of Antimonopoly Policy, authors’ calculations

The problem is that the term “reorganization” defined in the RF Civil Code (article 57) relates only to the legal aspects of enterprises’ operations as concerns the regulation of possible intermediate transformations of legal entities between their creation and liquidation (although with respect to substantive aspects it includes the latter, since reorganization is also a way of both termination and creation of new legal entities). At the same time, the typical Russian practice is to register transactions, which in fact are mergers (affiliations), in accordance with the requirements pertaining not to “reorganization,” but to purchase of shares and assets.

¹⁵ Simachev Yu. O sovershenstvovanii antimonopolnogo regulirovaniya primenitelno k integratsionnym protsessam v promyshlennosti. Mimeo, 2003.

This situation results from, first, the wish of contracting parties to circumvent the procedures applicable to reorganization (the reorganization agreement, procedure of conversion, transfer deed, calling of the general meeting of shareholders, approval on the part of the RF Ministry of Antimonopoly Policy, etc.), and, second, to deprive the creditors of the right to request the fulfillment of obligations ahead of the schedule¹⁶. The latter norm seems to be excessive, however the fact that it is retained in the legislation is an important incentive to look for possible bypasses.

Yet another objective motive is to preserve the former company in the case it has the stock, credit, and “report” (especially answering international standards) history in the cases the merger requires to create a new company. As Table 5 demonstrates, the number of application for purchase of shares and assets almost 20 times exceeds the number of applications for merger and affiliation. It should be also noted that applications for reorganization (merger, affiliation, etc.) are most often submitted in the cases of enlargement of SUEs in the framework of the reform of this sector implemented over the few last years.

In 2003, there emerged a number of optimistic evaluations of the existing procedures governing mergers and takeovers, according to which “managers more and more often review the idea of merger with other enterprises as a type of business restructuring, a tool from the arsenal of instruments permitting to achieve the qualitative improvement of the business structure and a way to attract investment.”¹⁷ From our point of view, the realities are yet very far from such assessments. Although positive shifts take place, they are rather unique.

However, on the whole, according to the RF Chamber of Trade and Commerce Economic Security department, about ¾ of takeovers are of hostile nature, i.e., taking into account the prevailing techniques, are based on buying up of shares with the use of blackmail, threats, or bribery, unlawful access to registers of shareholders, etc¹⁸. The obvious economic motive to use unlawful methods of takeovers is the comparison of costs borne in the course of a “hostile” (taking into account the specifics indicated above) and “civilized” methods of takeover: for about US \$ 0.5 million (comparable to the annual earnings of the targeted company) spent for legal services, bribery of officials, judges, and bailiffs, the violator may obtain an object worth US \$ 5 million.

Moreover, the problem of hostile takeovers carried out with the use of so called “administrative resource” became so urgent in 2002 and 2003 that it required attention on the part of legislators. Thus, in May of 2003, the State Duma held a special hearing concerning the legislative measures aimed at ensuring ownership rights, including cases of hostile takeovers. Among the recommendations voiced during the hearing is the introduction of more strict responsibility for making the respective court rulings (what will require amendments of the legislation pertaining to the juridical system), introduction of responsibility of minority shareholders for lodging claims initiating hostile takeovers, more precise definition of procedures governing shareholders’ meetings and keeping registers of joint stock companies (definition of grounds on which registers may be transferred to other registrars, prohibition to arrest registers), etc. Nevertheless, even introduction of these amendments in the legislation would fail to render the problem less urgent until there remain the respective economic (comparable cost effectiveness of different methods allowing to establish control) and institutional (systemic corruption) prerequisites.

A. Radygin, N. Shmeleva

¹⁶ See: Pleshanova O. Slitno i bezrazdelno. Kak obyedinyayutsya rossiyskiye kompanii. – Kommersant, 2004, February 6.

¹⁷ Yefimchuk I. Vzryv sliyaniy. – Finans, 2003, No. 35, p. 15.

¹⁸ Interview of A. Makarychev, the director of the RF Chamber of Trade and Commerce Economic Security department – Kommersant, 2004, February 6. In 2002, 76 per cent of 1870 takeovers were defined as hostile in this context. Apparently, this case is different from the classical definition of hostile takeover as an attempt to obtain control over the financial and economic activities or assets of the targeted company by legal means (for instance, via tender bidding or buying up of blocks of shares on the market) in the situation, where the management of the targeted company or its key participants oppose the transaction. According to a number of other assessments, in 2002 the share of *attempted* hostile takeovers in the their total number made 85 per cent to 90 per cent (as compared with 65 per cent to 70 per cent in 2001); however, as concerns all *completed* takeovers, this share was considerably lower – about 55 per cent.

The cumulative mortgage system as a new tool aimed to settle the housing problems of military personnel

Among the numerous problems encountered in the process of the RF military organization switching to the new recruitment system, one of the most urgent issues is that the planned measures are implemented in the situation, where the federal targeted program (FTP) has been already approved by the RF Government (in August of 2003), but the design of the new recruitment system is still unclear. The new conditions of the military service have not been determined as yet. The legislation remains the same. Draft laws (including those worked out by IET) are available, however, their discussion and approval is being delayed.

As it has turned out, it is necessary to change not certain stipulations of certain laws, but the whole system of personnel policy. Until now, this term has been used only in relation to the officer corps. However, in 2003 the President and the RF Government took the decision to staff all regular troops (forces), starting with the military units of constant combat readiness and the military units on permanent combat alert, with servicemen recruited on the contractual voluntary basis, and significantly cut the term of conscription based military service. In this situation, the definition of “personnel policy” should be considerably broadened in order to train and retrain all servicemen and provide them with all types of allowances.

As concerns the economic aspects of the problem, there are two major types of allowances: money and housing ones.

The situation relating to money allowances is clear: in order to create incentives for citizens to enter the voluntary contract based service, the levels of money allowances should be raised and maintained above the amount of the average wages and salaries in the country.

The situation in the sphere of housing is aggravated by two well known factors: the lack of necessary military residential housing and the enormous debt of the state to the citizens still serving in the Armed Forces and military pensioners. The line of servicemen having no apartments and in need of improvement of their housing conditions exceeds 170 thousand persons.

Proceeding from the difficulties related to the contract and conscription based recruitment system of the RF military organization, and possible negative consequences, there were more precisely defined the earlier recommendations aimed at the improvement of the personnel policy to be pursued by the military organization, which were worked out by IET. It is proposed to extend personnel policy not only to the officer corps, but also to privates and non-commissioned officers.

As concerns the personnel policy, there was carried out a number of calculations pertaining to military-economic and socioeconomic efficiency of the new recruitment system¹⁹. In the course of modeling it was found out that from the financial and economic point of view there should be taken into account not only direct expenditures associated with the transition to the new recruitment system, but also indirect outlays. Even in the case there is implemented a rational personnel policy envisaging that half of contracted servicemen, who consequently make three 3 year contracts return to the civilian sphere, the expenditures for their dismissal, pensions, and housing provisions turn out to be rather significant. These expenditures should be taken into account and planned in advance.

Any other policy allowing a contracted military personnel to join the military organization “for life,” i.e. until the retirement, turns out to be a too heavy burden on the state.

Basing on the results of the modeling of personnel policy options and choice of the rational version thereof, there was modeled the cumulative mortgage system (CMS) aimed at provision of housing for all servicemen, including privates and non-commissioned officers serving on the contractual basis.

This model is principally different from the previously analyzed ones, since it not only takes into account the option that privates and non-commissioned officers will be entitled to participate in the cumulative mortgage system, but also in terms of dynamics of the CMS development set forth by the targeted federal program for the period from 2004 till 2007 and is further defined in the “Basic Principles of the State Policies of the Russian Federation Related to Military Development for the Period until 2010.”

Besides, there were more precisely defined certain input data as concerns the numbers and rates of entry of military personnel of different categories to the cumulative mortgage system and disentanglement thereof because of being provided with housing or due to other reasons. In the course of the computation there was taken into account that the rate of recruitment of young officers in the RF military organization will be 25

¹⁹ www.iet.ru/files/text/voennoe/seminar.pdf

thousand persons a year. As concerns warrant officers, it was assumed that until 2008 the respective rate of recruitment will be at 15 thousand persons a year and later will correspond with the rate of transfer of contracted privates and non-commissioned officers to this category of military personnel.

The share of persons entitled to participate in the cumulative mortgage system was assumed to make: in 10 years – 50 per cent; in 20 years – 30 per cent; in 25 years – 15 per cent; and in 30 years – 5 per cent. These data should be further verified. As a matter of fact, the military organization is not interested in too early “rooting” of military personnel in concrete localities and garrisons, since this would render new transfers and appointments more difficult. Therefore, there should be created incentives for servicemen to obtain housing via the mortgage system as late as possible. This policy may be implemented, for instance, by making the military personnel to pay interest on the mortgage credit in the case of an early purchase of housing, while the persons using temporary accommodation facilities at the place of service should be granted substantial bonuses over the time of participation in the cumulative system and obtain better housing after discharge.

As concerns contracted privates and non-commissioned officers, the specifics of respective personnel policy (see above) should be designed with the aim to ensure that the average term of service were about 6 years and therefore only a small portion of contacted military personnel (about 1/8) could serve until retirement, therefore, the model recommends a two tier structure of the cumulative system.

All contracted servicemen should be entitled to participate in the first tier of this system (the single cumulative system for military personnel, SCSMP). The second tier (the cumulative mortgage system *per se*, CMS) should be applicable to the persons whom the law entitles to the right for own housing or an equivalent cash compensation.

The SCSMP should be **financed from the budget** in proportion to the number of participants in the system, at the same time the savings should be personified. The probable high initial rate of entry in the system of contracted military personnel is not an obstacle, since the respective funds upon facilitating the fast start of the SCSMP operation will be returned to the budget having created the incentives to enlist in the military organization on the contractual basis and thus enabling the military organization to select servicemen deserving the second contract term.

It is assumed that all servicemen, including privates and non-commissioned officers, who made contracts entitling them to participate in the SCSMP, should be entitled to participate in the SCSMP after January 1, 2005. The question if the military personnel serving their first 3 year contract terms should be entitled to participate in the system is still open. In the course of modeling, this option was taken into account.

According to the results of modeling, it has proved more feasible to choose the option, where only privates and non-commissioned officers serving their second contract terms should be entitled to participate in the SCSMP, what permits to include in the system in 2005 many privates and non-commissioned officers, serving their first contract term at present.

In the future, the term of participation in the SCSMP and accumulation of funds should be prolonged if the servicemen make next contracts without intermission. In the case the contract is terminated and no new contract is made (either on the initiative of the serviceman or the Defense Ministry) before the length of service made 10 years, the serviceman should be discharged from the military organization and disentitled from participation in the SCSMP. The amount accumulated in the serviceman’s personal account should be **returned to the budget**.

As concerns the military personnel with the length of service exceeding 10 years, these servicemen become entitled to participate in the second tier of the system – CMS. Such servicemen should be granted the right to either transfer the respective savings to a mortgage company, or continue participation in the CMS.

Servicemen should have the right to independently choose the option most suitable for them: either purchase housing using the savings accumulated over 20 years, or prolong participation in the CMS and purchase better housing later. Neither commanders, nor the CMS administration should have the right to influence this choice.

While practically all officers have the right to participate in the CMS on condition that they perform their duties and meet status requirements, privates and non-commissioned officers will know that that they face contest barriers and may expect to be entitled for housing only in the case they develop their skills and become warrant officers or ensigns. Therefore, the personnel policy will create incentives for military training and thus facilitate the development of national defense capability.

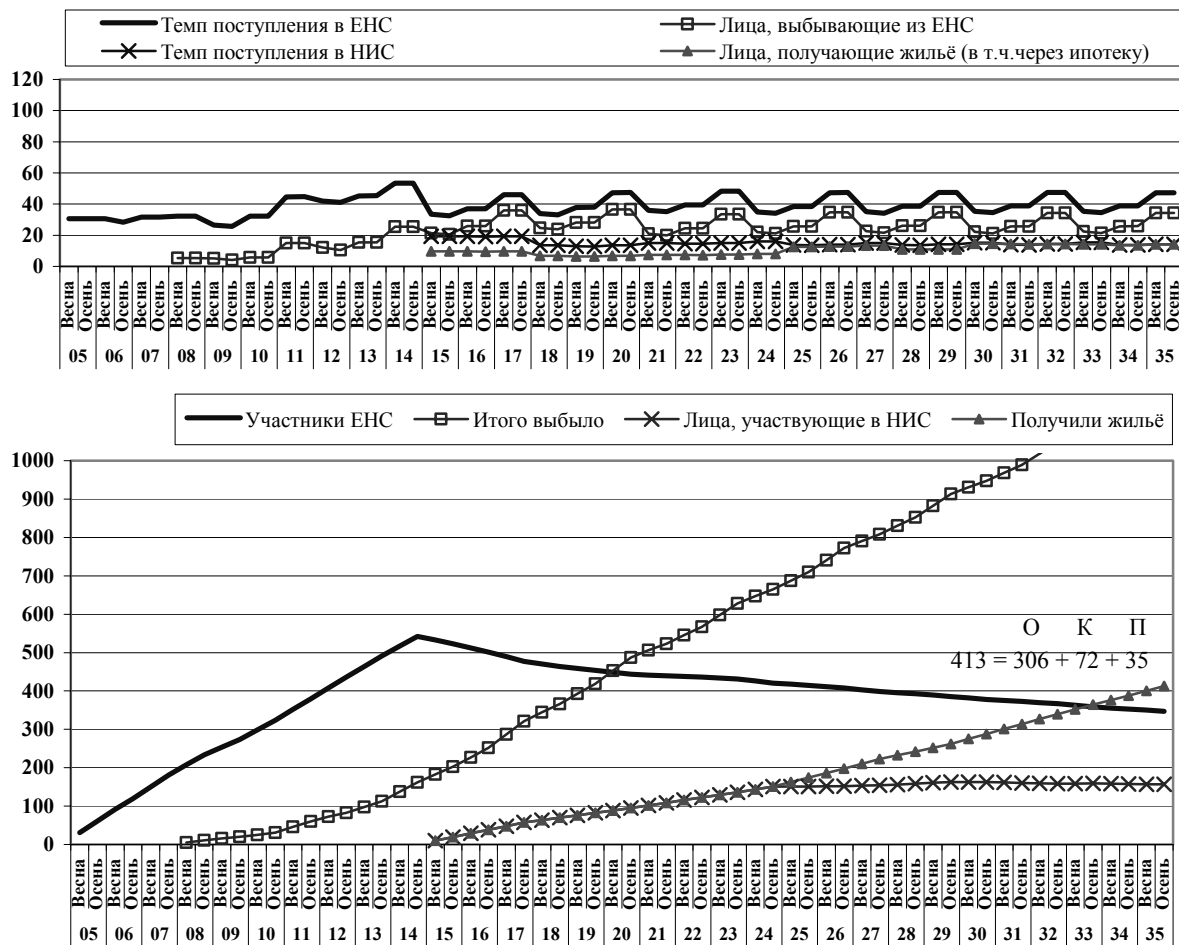
It is important to note that the company vested with the management of the single cumulative system for military personnel should take into account the necessity to return to the budget the funds made available after servicemen are discharged from the military organization in the way discussed above.

The personnel and accumulation policies described above should create a number of incentives important for the military personnel, the CMS, and the state:

- as concerns persons without higher education, they would be interested to enter military service on the contractual basis as privates or non-commissioned officers and develop their skills, since after 45 years of military service they would be entitled to military pensions and savings sufficient for purchase of housing;
- as concerns servicemen, they would be interested to prolong their contracts and participation in the CMS and at the same time retaining mobility and readiness for redeployment;
- the inflow of budget funds in the CMS would facilitate the its fast launch, later these funds would be returned to the budget at a minimum cost;
- elimination of uncertainty concerning service perspectives of the contracted military personnel: the servicemen willing and deserving to remain in the military organization would switch from SCSMP to CMS thus accumulating funds sufficient for purchase of housing, while the citizens serving one term would return to the civilian sphere without at a low budget costs.

A separate issue is the problem of compensation for the decline in receipts of the Pension Fund as concerns the citizens serving less than 10 years and returning to the civilian sphere, since in contradistinction to other employers, the Defense Ministry does not make contributions to the Pension Fund. It would be wrong to disadvantage such citizens.

However, the model under observation offers the possibility to resolve this problem. It would suffice to transfer to the Pension Fund a portion of the funds accumulated by the CMS management company in the personal accounts of citizens discharged from the military organization.



The results of the modeling are attached as graphs indicating the semiannual dynamics of the number of participants in the SCSMP and CMS (thousands persons) and the dynamics of housing provision to the military personnel (thousands persons). According to this version, by year 2035 housing will be provided to 413

thousand persons, including 306 thousand officers, 72 thousand contracted privates and non-commissioned officers, and 35 thousand of warrant officers (ensigns). By that time, only officers and contracted privates and non-commissioned officers will remain entitled to participate in the CMS. The processes of their joining and withdrawal from the system (upon being provided with own housing) will stabilize.

The dynamics discussed above will also determine the flows of budget resources, since it was assumed that each participant in the system will be entitled for a stable amount of about Rub. 30 thousand a year in prices of 2004.

A recent Defense Ministry conference held on the initiative of the RF President has approved the plan of the cumulative mortgage system aimed at provision of the military personnel with housing.

In conclusion, there should be noted yet another advantage of entitlement of all servicemen making their second contracts in 2005 to participate in the new cumulative system of housing provision. After the launch of this system the inflow of new servicemen in the line for housing will stop. For a certain time, the military personnel serving for sufficiently long terms and preparing to retire from the military organization will continue to join this line, however, this flow will stop soon and the state will have the opportunity to settle its accumulated obligations.

N. Kardashevsky, V. Tsymbal

A forecast of certain macroeconomic indicators²⁰

Below are presented the results of forecasting of the tax revenues of the consolidated (singling out profit tax, VAT, and the income tax) budget and revenues of the federal budget generated by the profit tax in April through June of 2004. The estimated values were calculated basing on the data pertaining to the time interval from January of 1999 till January of 2004 according to the data presented by the RF Finance Ministry and basing on REM models²¹. It should be noted that since November of 2003 IET has monthly published the bulletin of model based calculations of short term forecasts of social and economic indicators observed in the Russian Federation (see www.iet.ru), which presents estimates of more than 40 indicators.

Table 1

Forecast of tax revenues of the consolidated budget

Month	Indicator			
	Amount of the aggregate tax revenues	Amount of the profit tax revenues	Amount of VAT revenues	Amount of income tax revenues
REM model based forecasts (Rub. billion)²²				
April 2004	401.6	74.4	84.8	45.8
May 2004	327.2	44.3	81.6	40.5
June 2004	309.5	35.9	82.7	45.9
ARIMA model based forecasts (Rub. billion)				
April 2004	366.1	61.6	84.8	43.0
May 2004	301.2	42.4	82.3	43.4
June 2004	279.3	41.9	82.4	45.8

²⁰ For the purposes of this presentation, a forecast is defined as an estimate of the future values of the indicator obtained basing on a model with the best statistical qualities. For more details of the modeling of time series see, for instance: S. Sinelnikov-Murylev, R. Entov, S. Drobyshevski, V. Nosko, A. Yudin (2001) "Econometric Analysis of Time Series of Key Macroeconomic Indicators," Moscow, IET.

²¹ REM model principles were worked out by Robert Conrad and Morgan Smith of the Duke University, USA, in order to forecast tax revenues. With the authors' permission, we use this model for plotting our forecasts.

²² Here forecasted values of (nominal) tax revenues are presented in terms of Rub. Billions or increments of real values in comparison with the figures registered in the respective periods of preceding years and not in percentage of GDP, since the reliable monthly data on the RF GDP are not available in the official statistical records.

Memorandum: actual values in respective periods of 2003 (Rub. billion)				
April 2003	332.0	68.7	74.6	37.1
May 2003	270.8	41.0	71.9	32.9
June 2003	255.9	33.2	72.8	37.2
Increment in tax revenues in comparison with the respective month of the preceding year (in prices of this month) according to REM model				
April 2004	10%	-2%	3%	12%
May 2004	10%	-2%	3%	12%
June 2004	10%	-2%	3%	12%
Increment in tax revenues in comparison with the respective month of the preceding year (in prices of this month) according to ARIMA model				
April 2004	0%	-19%	3%	5%
May 2004	1%	-6%	4%	20%
June 2004	-1%	14%	3%	12%

Table 1a

Forecast of tax revenues of the federal budget

Month	Amount of the aggregate tax revenues				Amount of the profit tax revenues			
	REM model based forecasts (Rub. billion)	Increment in tax revenues in comparison with the respective month of the preceding year (in prices of this month) according to REM model	ARIMA model based forecasts (Rub. billion)	Increment in tax revenues in comparison with the respective month of the preceding year (in prices of this month) according to ARIMA model	REM model based forecasts (Rub. billion)	Increment in tax revenues in comparison with the respective month of the preceding year (in prices of this month) according to REM model	ARIMA model based forecasts (Rub. billion)	Increment in tax revenues in comparison with the respective month of the preceding year (in prices of this month) according to ARIMA model
April 2004	227.8	15%	211.4	6%	11.5	-44%	11.2	-45%
May 2004	201.3	15%	190.6	8%	7.2	-44%	9.1	-29%
June 2004	210.2	15%	184.0	0%	7.8	-44%	17.1	22%
Memorandum: actual values in respective periods of 2003 (Rub. billion)								
April 2003	180.2				18.7			
May 2003	159.4				11.7			
June 2003	166.3				12.7			

On the average, the forecasted rates of growth in the income tax revenues²³ in April, May, and June of 2004 in comparison with the figures registered in the respective periods of the preceding year will make about 12 per cent (see Tables 1 and 1a) in real terms. The average rates of increase in the amount of VAT revenues will make slightly above 3 per cent in real terms. As concerns the profit tax generated revenues of the RF consolidated budget, they will decline on the average by 3 per cent in real terms.

²³ Average rates of increment are calculated as the arithmetic mean of the forecasts based on two models over a 3 month period. At the same time, it should be noted that forecasted rates of increment in revenues over three months based on REM models demonstrate higher stability than ARIMA based estimates, what may be directly explained by the technology of forecasting. According to the REM model, the coefficient of growth in forecasted revenues in comparison with the respective indicators registered in the preceding year insignificantly changes month on month, since the obtained fluctuations result either from changes in the tax rates across individual months, or from the increment in the amount of revenues accumulated since the beginning of the year. At the same time, fluctuations in the rates of growth in ARIMA based forecasts are explained by unstable dynamics of time series under observation and the characteristics of forecasts of econometric models of time series.

The profit tax revenues of the federal budget will decline by more than 30 per cent. As concerns the aggregate tax revenues of the RF consolidated budget in April, May, and June of 2004, the respective forecasted average growth in real terms will make about 5 per cent in comparison with the figures registered in the respective periods of the preceding year, while the total revenues of the federal budget will increase by 10 per cent over the same period.

M. Turuntseva, S. Ponomarenko

Issues discussed at the meetings held by the Government of the Russian Federation on March 18 and March 25 of 2004

In the period from March 1 to March 29 of 2004, the RF Government held three meetings, in the course of which there were examined various issues.

In particular, it was decided to provide additional financing for the RF State Duma and the Federal Security Service from the reserve fund of the RF Government. Besides, the Government discussed the results of the social and economic development of the Russian Federation in 2003, scenario based forecasts of Russia's social and economic development in 2005 through 2007, and parameters of projections with respect to prices (tariffs) on products (services) of natural monopolies for year 2005, based on the respective report of the RF Ministry of Economic Development, there were approved the principles underlying the draft RF Forestry Code presented by the RF Ministry of Economic Development, there was approved the draft federal law "On amendments to articles 34 and 41 of the federal law "On investment of funds for financing of the cumulative part of the retirement pension in the Russian Federation," it was decided to submit it to the State Duma according to the established procedure, there was discussed the issue concerning the measures necessary for implementation of the RF President's decree No. 314 of March 9, 2004, "On the system and structure of the federal executive authorities" and taken respective decisions.

Below, there will be discussed such important issues as the draft federal law "On amendments to articles 34 and 41 of the federal law "On investment of funds for financing of the cumulative part of the retirement pension in the Russian Federation," as well as the problems the results of the social and economic development of the Russian Federation in 2003, scenario based forecasts of Russia's social and economic development in 2005 through 2007, and parameters of projections with respect to prices (tariffs) on products (services) of natural monopolies for year 2005 reviewed at the meeting held on March 25, 2004.

Meeting of the RF Government of March 18, 2004.

At this meeting, there was discussed the draft federal law "On amendments to articles 34 and 41 of the federal law "On investment of funds for financing of the cumulative part of the retirement pension in the Russian Federation."

Articles 10 and 32 of the federal law "On investment of funds for financing of the cumulative part of the retirement pension in the Russian Federation" set forth that the RF Pension Fund is responsible for informing of the insured persons not only about the state of their individual personal accounts, but also about the results of investment of respective pension savings entrusted with management companies. Therefore, the draft law amends article 41 of the federal law "On investment of funds for financing of the cumulative part of the retirement pension in the Russian Federation" to the effect that in the period from January 1, 2003 till March 31, 2004, the RF Government establishes procedures and terms applicable to the informing of the insured persons about the state of their individual personal accounts and the results of investment of respective pension savings entrusted with management companies on the part of the Pension Fund.

At the same time, the draft law under observation eliminates another discrepancy in the text of this law.

Federal law No. 135-FZ of November 10, 2003, "On amendments to article 41 of the federal law "On investment of funds for financing of the cumulative part of the retirement pension in the Russian Federation" sets forth that in the period from January 1, 2003 till March 31, 2004, the RF Government should determine the terms of transfer of pension savings to the management companies chosen by the insured persons or state management company by the RF Pension Fund in accordance with article 34 of the federal law "On investment of funds for financing of the cumulative part of the retirement pension in the Russian Federation." However, article 34 of the federal law "On investment of funds for financing of the cumulative part of the retirement pension in the Russian Federation" concerns only the terms of transfer of pension savings to the management companies chosen by the insured persons and does not determine the terms of transfer of pension savings to the state management company. The amendments to article 34 of the federal law "On investment of funds for financing of the cumulative part of the retirement pension in the Russian Federation" es-

establish the terms of transfer of pension savings to the state management company and eliminate the discrepancies between articles 34 and 41 of the federal law "On investment of funds for financing of the cumulative part of the retirement pension in the Russian Federation."

The meeting of the RF Government approved the draft federal law "On amendments to articles 34 and 41 of the federal law "On investment of funds for financing of the cumulative part of the retirement pension in the Russian Federation" and took the decision to submit it to the State Duma according to the established procedure.

The draft law under observation is aimed to bridge the present gaps in the legislation and eliminate the discrepancies in the regulations set forth by the RF pension legislation. It is necessary to approve the draft law in order to ensure smooth financing of the of the cumulative part of the retirement pension in the Russian Federation.

At the **meeting of the RF Government of March 25, 2004**, there were reviewed the results of the social and economic development of the Russian Federation in 2003, scenario based forecasts of Russia's social and economic development in 2005 through 2007, and parameters of projections with respect to prices (tariffs) on products (services) of natural monopolies for year 2005. The RF Government made a note as concerns the respective report presented by the RF Ministry of Economic Development.

In the course of elaboration of the guidelines of social and economic development of the Russian Federation in 2005 through 2007 and the projections of the federal budget in 2005 through 2007, the RF Government will proceed from the scenario based forecasts of Russia's social and economic development in 2005 through 2007 and parameters of projections with respect to prices (tariffs) on products (services) of natural monopolies for year 2005 worked out by the RF Ministry of Economic Development in collaboration with interested federal executive authorities.

The medium term forecast of Russia's social and economic development was elaborated proceeding from the evaluation of the economic development of the country in 2003 and hypotheses about expected changes in domestic and external conditions of development over this period.

Growth of the world economy

The assessments of the rates of growth of the world economy across world regions in the few next years permits to formulate the following hypotheses about growth of the world economy: moderate conservative scenario is based on the assumption that the average annual rates of growth will be at 2.8 per cent, the favorable scenario is based on the growth rates making 3.8 per cent to 4.4 per cent.

Euro / US \$ exchange rate dynamics

In the medium term outlook, the average annual Euro exchange rate may decline from US \$ 1.25 per Euro in 2004 to US \$ 1.12 per Euro in 2007.

Oil prices

According to the forecast concerning the changes in demand for oil presented by the International Energy Agency (IEA), the overall demand for hydrocarbon raw materials may increase at 2 per cent to 4 per cent rate a year, while in Europe this rate will be at 1.5 per cent to 2.5 per cent.

The forecast is based on the following scenarios of changes in the Urals oil prices.

Scenario I proceeds from the assumption that there will take place the transition to moderate rates of changes in prices of Russian oil, while the average annual Urals oil price in 2005 through 2007 will make US \$ 20 per barrel.

Scenario II proceeds from more favorable dynamics of oil prices (US \$ 24 per barrel in 2006 and 2007 and their moderate growth in the few next years).

Export of oil and natural gas

The forecasts of export of oil and natural gas across all scenarios proceed from the assumption that demand for oil on the part of all major consumers will be increasing until 2007 and are basically similar to the targets set forth by the Energy Strategy of the Russian Federation for the Long Term Perspective. According to Scenario I, the volumes of oil exports will grow from 188.4 million metric tons in 2002 to 235 million metric tons in 2007, while Scenario II sets the target at 259.8 million metric tons.

On the whole, the forecasts envisage that export of natural gas will increase from 185.5 billion cubic meters in 2002 to 231 billion cubic meters (according to Scenario I) or to 248 billion cubic meters (according to Scenario II) in 2007. The dynamics of natural gas prices are forecasted basing on the dynamics of prices of oil and oil products taking into account a 5 to 6 months lag.

Foreign debt

According to both scenarios, the dynamics of payments relating to the foreign debt will correspond to the schedule, no debt restructuring is envisaged. The same relates also to the debt servicing.

In this period, the Russia's expenditures for repayment and servicing of its foreign debt will make from US \$ 16.3 billion in 2004 and US \$ 18.9 billion in 2005 to US \$ 14.9 billion in 2007.

Slowdown of inflation

According to both scenarios, inflation will decline from 12 per cent in 2003 to 4 per cent to 6 per cent in 2007 and will further decrease to 2 per cent to 4 per cent by 2010.

Levels of prices (tariffs) of goods (services) of natural monopolies

According to the estimates, in order to ensure that inflation is at the target level in 2004 through 2007, the contribution of increase in prices of products (services) of natural monopolies should be at or below 2.5 percentage points to 3.5 percentage points a year.

It is recommended to retain the real level of tariffs on electrical power and railroad freight at the level registered in 2005.

It is recommended to raise the real level of natural gas prices until 2009, what, according to preliminary estimates, will permit to ensure competition of natural gas with alternative types of fuel and will create incentives for more rational use of natural gas as a fuel.

Reform of the tax system

In 2005, it is planned to increase taxes on the oil extracting industry by amending the procedures governing the calculation of the mineral extraction tax with respect to oil and raise oil export duty in the case high oil prices persist.

Besides, it is envisaged to reduce the effective rate of the single social tax (SST) in 2005. It should result in a decrease in SST generated revenues in 2005 as compared with the figures registered in 2004, however, in the future, as the share of wages and salaries in GDP increases, it is expected that the respective SST revenues will increase.

The expansion of the tax base relating to the growth in gross payroll will entail a growth in revenues generated by the income tax.

Besides, the monetization of a number of social benefits accompanying the reduction of SST will result in a growth in household incomes by Rub. 150 billion a year.

Ruble exchange rate dynamics

The dynamics of the Ruble exchange rate will be primarily determined by the scale of supply of foreign exchange earned in the course of trade operations, therefore, they will to a considerable extent depend on the world prices of Russia's energy resources and the conditions envisaged in the framework of the scenarios under observation.

According to the scenario envisaging less favorable market situation of Russian exports, average annual rates of Ruble appreciation against foreign currencies will be at or below 3 per cent since 2005.

Creation of the potential for enhancement of investment activity

According to preliminary estimates, foreign direct investment should make about US \$ 20 billion according to the optimistic forecast and about US \$ 11.3 billion according to the pessimistic forecast by 2010.

Macroeconomic forecast for 2004 through 2007.

Macroeconomic indicators of the forecast were elaborated in accordance with two scenarios taking into account the impact of the future conditions and factors.

In 2004, the contribution of external economic factors in the growth in GDP will remain at approximately the level registered in 2003. For instance, in the case oil prices will be higher than the average level observed over the decade, it will contribute 2.0 percentage points in the growth of GDP. Internal factors (an increase in real household incomes and investment in fixed assets) account for an increase of GDP by 4.4 percentage points.

The structure of external demand will differ significantly depending on the scenario. According to Scenario I, in the situation of moderately low world prices of energy goods and a lower Ruble exchange rate, in the value structure of *exports* there will continue to increase the share of products of the manufacturing sector, in particular, of machinery and equipment. The second scenario envisages the continuation of a growth in the share of the energy sector and, as concerns other industries, of the share of export of machinery and equipment. In the short term outlook, the dynamics of *imports* will be determined by a gradual Ruble appreciation, needs of technological modernization of the growing economy, increase in the disposable earnings of enterprises and households. At the same time, Scenario II envisages that in the more favorable export situa-

tion the Ruble will appreciate at a faster rate, what, in combination with a significant growth in consumer and investment demand will result in an increase in demand for imports.

On the whole, in the medium term perspective, the active balance of goods and services will be declining, although in the situation envisaged in Scenario II this decline will be more smooth.

The positive dynamics of final consumption will be primarily determined by the growth in *final household consumption*, what is related to the growth in real disposable household incomes. At the same time, the distorted structure of the income distribution will persist, therefore, the objective to reduce the scale of poverty remains a priority. The calculations based on the potential of the economy demonstrate that the *real household incomes* may increase at rates outpacing growth in GDP by 2 to 4 percentage points in the framework of both scenarios.

A decrease in the tax burden on the economy will also facilitate the development of processes of legalization of wages and salaries. According to estimates, in 2007 the share of gross payroll in GDP may increase to 30.4 per cent as compared with 24.5 per cent registered in 2003.

The outpacing growth in real incomes should ensure an increase in the share of consumption in GDP in the medium term outlook. At the same time, the trend towards changes in the consumer household expenditures will persist. In the structure of consumer spending, there will increase the share of consumption of non-food goods and services, while the share of food products will decline. By 2007, the final household consumption is expected to grow by 106 per cent to 107.1 per cent depending on the scenario.

By 2007, the real disposable household incomes should increase by 36 per cent to 42 per cent as compared with the figures registered in 2003.

As concerns the *sources of investment*, borrowings will play a more important role. The growth in borrowings will primarily occur at the expense of bank credits and foreign investment, which compensate for the decline in the share of budget funds.

According to the forecast, in the period until 2007 the amount of own funds remaining at the disposal of enterprises will increase in nominal terms approximately 1.5 times by 2003, at the same time the disposable profits will grow 1.33 times, and the amount of amortization will increase 1.6 times. It is also expected that the share of profits allocated for investment in the total amount of profits will increase (up to 85 per cent in 2007), while amortization will also grow (up to 45 per cent to 46 per cent by 2007).

As a result, the nominal amount of resources allocated for investment in fixed assets from all sources of financing will increase 1.9 to 2.1 times in the period from 2004 till 2007, what corresponds to the real growth 1.38 to 1.46 times, taking into account the index deflator of investment.

The growth in investment and consumer demand will ensure stable rates of growth in *industry*. Industrial output will increase in 2007 by 4.6 per cent to 5.7 per cent in comparison with the figures registered in the preceding year, while growing by 19.2 per cent to 23.8 per cent in comparison with the levels observed in 2003.

Output of agricultural produce will increase by 16 per cent to 17 per cent as compared with the figures registered in 2003.

Level of prices and tariffs on products and services of natural monopolies

The analysis of the impact of rise in regulated prices and tariffs on products and services of natural monopolies on the economy in 2000 through 2003 confirms that the high level of energy consumption of industrial production, especially as concerns industry, has a constraining effect on the rates of economic growth. According to the conducted studies, the contribution of the increase in prices of products and services of natural monopolies in the total rise in the consumer prices made from 3.7 percentage points to 4.3 percentage points in 2000 through 2003, what made about one third of the annual inflation rates in the respective years. The RF Ministry of Economic Development and Trade believes that it would be feasible to set the parameters of growth in consumer prices resulting from the increase in prices and tariffs on products and services of natural monopolies at a level at or below 30 per cent to 35 per cent of the projected target inflation rates.

Taking into account the fact that in 2005 inflation should decline to 6.5 per cent to 8.5 per cent (as compared with 10 per cent registered in 2004), the contribution of the rise in regulated prices and tariffs in inflation will be at or below 2.6 p. p. to 2.7 p. p. in 2005, 2.3 p. p. to 2.4 p. p. in 2006, and 1.9 p. p. to 2 p. p. in 2007 respectively.

The RF Ministry of Economic Development and Trade, the RF Finance Ministry, the Ministry of Industry and Power Engineering, the Ministry of Social Development and Public Health with participation of other interested federal executive authorities and the Bank of Russia were charged to elaborate the presented draft scenarios taking into account the results of the discussion, focusing on such issues as:

- implementation of measures aimed at acceleration of the rates of growth in gross domestic product;
- impact of planned changes in the tax legislation on the key macroeconomic indicators;
- substantiation of maximal levels of prices (tariffs) of products (services) of natural monopolies, including natural gas;
- more precisely define oil prices and amounts of oil exports;
- etc.

At the meeting, it was decided that elaborated scenario based forecast should be submitted to the RF executive authorities so they could work out the respective recommendations with respect to key parameters of the forecast of social and economic development of the Russian Federation in 2005 through 2007, before April 1, 2004.

In the course of the meeting, it was pointed out that in order to accelerate the rates of economic growth and reduce the level of poverty, in 2004 the RF executive authorities should base their activities on the following priorities:

- implementation of the administrative reform;
- completion of the tax reform, including the reduction of the effective rate of the single social tax, changes in the procedures governing the calculation of the mineral extraction tax, improvement of the administration of the profit tax and the value added tax;
- creation of an efficient system of medical, social, and pension insurance of Russian citizens;
- creation of conditions stimulating innovative activities in the sphere of science, technology, and production;
- reform of the housing and public utilities sector, including the development of the mortgage credit lending system;
- enhancement of the efficiency of utilization of natural resources and improvement of environment protection system.

The RF Ministry of Economic Development and Trade was charged to further review and submit recommendations concerning the adjustment of the RF Government action plan proceeding from the necessity to attain the objectives determined by scenario based conditions of the social and economic development of the Russian Federation in the few next years.

E. A. Bolshakova

Review of economic legislation: March of 2004

I. FEDERAL LAWS of the Russian Federation

1. "ON AMENDMENTS TO ARTICLE 16 OF THE LAW OF THE RUSSIAN FEDERATION "ON EDUCATION" No. 9-FZ of March 5, 2004.

Enters into force on the day of promulgation.

According to the amendments to the law, persons who were orphaned or left without parents' guardianship aged below 23 should be entitled to the privilege to enter state and municipal educational establishments providing secondary professional education and higher professional education without contest. Earlier, the right to enter the said educational establishments had been granted only to persons aged below 18.

2. "ON AMENDMENTS TO THE FEDERAL LAW "ON JOINT STOCK COMPANIES" No. 5-FZ of March 24, 2004.

Enters into force on the day of promulgation.

Federal law No. 208-FZ of December 26, 1995, "On joint stock companies" was amended with respect to its stipulations concerning the procedures governing the use of cumulative voting in the course of election of members of the board of directors (supervisory board) and termination of the membership in the board of directors. The law establishes that cumulative voting should be used in the course of election of members of the board of directors of joint stock companies with any number of shareholders. It is envisaged that the number of members of the board of directors should be not less than 5 persons. Membership of all members of the board of directors (supervisory board) may be terminated before the expiration by the decision of the general shareholders meeting.

II. RESOLUTIONS OF THE GOVERNMENT of the Russian Federation

1. "ON APPROVAL OF RULES GOVERNING THE GRANTING OF STATE GUARANTEES OF THE RUSSIAN FEDERATION WITH RESPECT TO BORROWINGS OF THE OPEN JOINT STOCK COM-

PANY “ROSSIYSKIY BANK RAZVITIYA” MADE ON THE DOMESTIC FINANCIAL MARKET FOR FINANCING OF SMALL BUSINESSES, INCLUDING FARMS, IN 2004” No. 118 of March 1, 2004.

The approved Rules establish the procedure governing the granting by the Government of the Russian Federation of state guarantees of the Russian Federation with respect to the borrowings of the open joint stock company “Rossiyskiy Bank Razvitiya” made on the domestic financial market for financing of small businesses, including farms, in 2004, and maintenance of state guarantees.

The state guarantees are granted to the bank within the amount of funds provided for these purposes in the federal budget for year 2004 and should ensure the fulfillment of the bank’s obligations relating to its borrowings made on the domestic market of the Russian Federation via the placement of the bank’s bonds and attraction of credits. The Russian Federation should be subsidiary liable to the holders of bonds (creditors) with respect to the bank’s obligations covered by the state guarantees. The term of the state guarantee is determined by the term of execution of the respective obligations covered by the state guarantee. The obligations covered by the state guarantees should be executed at the expense of the federal budget. In the case the state guarantee is granted, the RF Finance Ministry and the bank should make an agreement stipulating the substantial terms of provision of the state guarantee, as well as rights and obligations of the parties. The RF Finance Ministry should be vested with the power to control the designated use of the bank’s borrowings covered by the state guarantees by analyzing quarterly reports submitted by the bank.

2. “ON PRICE DETERMINATION WITH RESPECT TO ELECTRICAL AND HEAT ENERGY IN THE RUSSIAN FEDERATION” No. 109 of March 26, 2004.

The resolution approves the principles of price determination with respect to electrical and heat energy in the Russian Federation, which determine key principles and methods of regulation of tariffs (prices) of electrical and heat energy and respective services, the system of said tariffs, the procedure governing price determination on the wholesale and retail markets of electrical power and heat energy. The resolution also approves the Rules of state regulation and implementation of tariffs on electrical and heat energy in the Russian Federation, which envisage the principles and procedures governing the determination of tariffs on electrical and heat energy established by the said Principles of price determination.

Resolution of the Government of the Russian Federation No. 226 of April 2, 2002, “On price determination with respect to electrical and heat energy in the Russian Federation” was abolished.

3. “ON APPROVAL OF THE COEFFICIENT OF INDEXATION OF THE RATED PENSION CAPITALS” No. 141 of March 15, 2004.

Enters into force on April 1, 2004.

The resolution approves the coefficient of indexation of the rated pension capitals of insured persons. As on January 1, 2003, this coefficient makes 1.177.

4. “ON DETERMINATION OF AMOUNTS OF BASE PARTS OF LABOR PENSIONS AND APPROVAL OF THE COEFFICIENT OF ADDITIONAL INCREASE IN THE INSURANCE PART OF LABOR PENSION SINCE APRIL 1, 2004.” No. 142 of March 15, 2004.

Enters into force on April 1, 2004.

Since April 1, 2004, the amount of base part of the labor old age pension, labor disability pension, and labor survivor’s pension envisaged by the federal law “On labor pensions in the Russian Federation,” as well as respective pensions granted in accordance with the federal law “On state pensions in the Russian Federation” should be calculated proceeding from the amount of the base part of the labor old age pension determined by item 1 of article 14 of the federal law “On state pensions in the Russian Federation” as indexed in accordance with inflation rates, which since April 1, 2004, has been set at Rub. 621 a month. Besides, on April 1, 2004, there was approved the coefficient of additional increase in the insurance part of the labor pension (1.09) as per items 5 and 7 of article 17 of the federal law “On state pensions in the Russian Federation.”

III. INSTRUCTIONS AND ORDERS

1. Telegram of the RF Central Bank “ON CHANGES IN THE RATES OF MANDATORY RESERVES OF CREDITING ORGANIZATIONS” No. 1395-U of March 19, 2004.

The rates of mandatory reserves of crediting organizations relating to the Ruble denominated funds borrowed from legal entities and the forex denominated funds borrowed from legal entities and individuals were reduced from 10 to 9 per cent proceeding from the respective amounts as of April 1, 2004. The rate of mandatory reserves pertaining to Ruble denominated household deposits was retained at 7 per cent.

2. Letter of the RF Tax Ministry “ON THE STAMP TAX” No. SA-6-04/88@ of February 27, 2004.

The letter informs about the amendments to RF law No. 2005-1 of December 9, 1991, “On the stamp tax” made in relation to the changes made in federal law No. 129 – FZ of August 8, 2001, “On the state registration of legal entities” with respect to the state registration of individual entrepreneurs. Article 3 of the RF law “On the stamp tax” envisages that the stamp tax should be charged for state registration of citizens as individual entrepreneurs and for state registration of discontinuation of the status of individual entrepreneurs on their initiative. The stamp tax for state registration of discontinuation of the status of individual entrepreneurs is set at Rub. 400. The stamp tax for state registration of citizens as individual entrepreneurs on their initiative is set at Rub. 80. The stamp tax charged in relation to the conduct of actions relevant in law should be paid prior to submission of the respective application.

3. Informational letter of the RF Tax Ministry “ON CALCULATION OF THE MINERAL EXTRACTION TAX RATE IN DECEMBER OF 2003” No NA-6-21/40@ of January 16, 2004.

The letter informs about the data used for the calculation of the mineral extraction tax with respect to oil and gas condensate extracted from oil and gas condensate deposits in December of 2003:

The average level of Urals oil prices on the Mediterranean and Rotterdam markets (US \$ 28.35 per barrel);

Official Ruble / US \$ exchange rate; the average value of the Ruble / US \$ exchange rate determined by the RF Central Bank across all days of the tax period (Rub. 29.4331;

Value of the Kts coefficient (2.3768);

Tax rate adjusted for the Kts coefficient (Rub. 808.1120 per metric ton).

I. V. Tolmacheva