

RUSSIAN ECONOMY: TRENDS AND PERSPECTIVES
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The State of the Federal Budget

In February of 2003, the revenues of the state budget (cash execution) made 20.6 % of GDP, while expenditures made 16.4 % of GDP (see Table 1). Therefore, the federal budget surplus made 4.2 % of GDP.

Table 1

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

	I'02	II'02	III'02	IV'02	V'02	VI'02	VII'02	VIII'02	IX'02	X'02	XI'02	XII'02	I'03	II'03	III'03
Revenues															
Corporate profit tax	1,4%	1,4%	1,5%	1,9%	1,9%	1,7%	1,7%	1,7%	1,6%	1,7%	1,6%	1,6%	1,2%	1,1%	
Personal 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%	
VAT, special tax and excises	4,9%	4,4%	4,0%	3,9%	3,6%	3,5%	3,5%	3,3%	3,2%	3,1%	3,1%	3,1%	2,4%	2,7%	
Tax on foreign trade and foreign trade operations	9,3%	9,1%	9,3%	9,3%	9,3%	9,3%	9,3%	9,1%	9,0%	8,9%	8,9%	8,9%	11,2%	10,1%	
Other taxes, duties and payments	6,9%	6,4%	6,8%	6,9%	7,0%	7,0%	7,0%	7,0%	6,9%	6,9%	6,9%	6,9%	8,5%	7,4%	
Total- taxes and charges	2,4%	2,6%	2,5%	2,4%	2,3%	2,3%	2,2%	2,1%	2,0%	2,0%	1,9%	2,0%	2,7%	2,7%	
Non- tax revenues	3,2%	3,3%	3,2%	3,0%	2,9%	2,9%	2,9%	2,8%	2,8%	2,8%	2,9%	3,0%	3,4%	3,4%	
Revenues, total	9,7%	9,1%	8,7%	8,7%	8,4%	1,8%	2,0%	2,0%	2,0%	2,1%	2,1%	2,1%	0,5%	1,7%	
Expenditure	20,4%	19,6%	19,6%	19,9%	19,6%	19,3%	19,4%	18,9%	18,5%	18,6%	18,5%	18,6%	18,8%	19,0%	
Public administration	2,1%	1,6%	1,4%	1,3%	1,2%	1,3%	1,4%	1,4%	1,4%	1,6%	1,4%	1,4%	17,5%	8,5%	
National defense	22,4%	21,2%	20,9%	21,2%	20,9%	20,6%	20,9%	20,4%	20,0%	20,2%	20,1%	20,1%	20,8%	20,6%	20,9%
International activities															
Judicial power	0,1%	0,2%	0,3%	0,4%	0,4%	0,4%	0,4%	0,4%	0,4%	0,4%	0,4%	0,5%	0,3%	0,3%	
Law enforcement and security activities	1,0%	1,5%	1,9%	2,3%	2,4%	2,5%	2,5%	2,5%	2,4%	2,4%	2,5%	2,7%	1,5%	2,1%	
Fundamental research	0,4%	0,4%	0,4%	0,4%	0,4%	0,4%	0,4%	0,3%	0,3%	0,3%	0,3%	0,3%	-0,3%	0,0%	
Services provided for the national economy	0,0%	0,1%	0,1%	0,1%	0,1%	0,1%	0,1%	0,1%	0,1%	0,2%	0,2%	0,2%	0,1%	0,1%	
Social services	0,6%	0,9%	1,0%	1,2%	1,2%	1,3%	1,4%	1,4%	1,4%	1,4%	1,5%	1,7%	1,1%	1,4%	
Servicing of public debt	0,0%	0,1%	0,2%	0,2%	0,2%	0,2%	0,2%	0,2%	0,2%	0,2%	0,3%	0,3%	0,1%	0,2%	
Other expenditure	0,1%	0,3%	0,4%	0,5%	0,6%	0,7%	0,8%	0,8%	0,8%	1,2%	1,3%	1,5%	0,2%	0,4%	
Expenditure, total	3,7%	4,8%	4,8%	5,3%	5,2%	5,2%	5,2%	5,1%	4,9%	5,5%	5,6%	5,6%	1,5%	4,7%	
Loans, redemption exclusive	2,0%	3,4%	3,4%	2,6%	2,5%	2,4%	2,3%	2,4%	2,4%	2,2%	2,0%	2,0%	1,7%	2,9%	0,3%
Expenditure and loans, redemption exclusive	2,9%	3,3%	3,6%	3,9%	4,0%	4,0%	4,0%	3,9%	3,8%	3,9%	3,9%	3,8%	6,6%	4,2%	
Budget deficit (-)	10,9%	15,0%	16,1%	16,9%	17,1%	17,2%	17,2%	17,1%	16,9%	17,8%	18,0%	18,7%	12,7%	16,4%	18,0%
Domestic financing	11,5%	6,2%	4,8%	4,3%	3,8%	3,4%	3,7%	3,3%	3,1%	2,4%	2,1%	1,4%	8,1%	4,2%	2,9%
Other taxes, duties and payments	-11,2%	-4,6%	-2,7%	-2,0%	-1,8%	-1,6%	-1,8%	-1,3%	-1,2%	-0,5%	-0,2%	0,6%	-6,6%	-1,7%	-2,9%
Total- taxes and charges	-0,4%	-1,6%	-2,1%	-2,3%	-1,9%	-1,8%	-1,9%	-1,9%	-1,9%	-1,9%	-1,9%	-2,0%	-1,4%	-2,5%	-2,2%
Non- tax revenues	-11,5%	-6,2%	-4,8%	-4,3%	-3,8%	-3,4%	-3,7%	-3,3%	-3,1%	-2,4%	-2,1%	-1,4%	-8,1%	-4,2%	-5,1%

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

As compared with the figures registered in February of 2002, the budget revenues decreased by 0.6 p.p., while expenditures increased by 1.4 p.p. and budget surplus decreased by 2.0 p.p. At the same time, without SST the budgetary revenues increased by almost 1.1 p.p. of GDP and made 17.9 % of GDP.

In February of 2003, VAT accounted for the major share of federal tax revenues – 36 % of the total tax revenues what is by about 6 p.p. above the level observed in the respective period of 2002.

According to preliminary estimates, the cash execution of federal budget revenues made 20.9 % of GDP in January through March of 2003, what is at the respective level observed in January through March of 2002. At the same time the cash execution of expenditures made 18.0 % of GDP (16.1 % of GDP in 2002); therefore, the surplus made 2.9 % of GDP (4.8 % of GDP in 2002).

According to the preliminary estimates of the Finance Ministry, in terms of fulfilled funding² the expenditures of the federal budget in January through March of 2003 made 20.8 % of GDP (see Table 2), while on April 1 of 2002 this indicator was at 18.6 % of GDP. As a result, the surplus of the federal budget

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

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

in terms of fulfilled funding in the first three months of 2003 has also decreased by 2.2 p.p. in comparison with the figures registered in the respective period of 2002 and made 0.1 % of GDP.

Table 2

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

	Г02	II02	III02	IV02	V02	VI02	VII02	VIII02	IX02	XII02	Г03	II03	III03
Total	22,2%	21,0%	20,9%	21,2%	20,8%	20,5%	20,5%	20,5%	20,0%	20,1%	21,4%	21,2%	20,9%
Public administration	0,5%	0,5%	0,5%	0,5%	0,5%	0,5%	0,5%	0,5%	0,5%	0,5%	0,5%	0,6%	0,6%
National defense	1,7%	2,4%	2,4%	2,7%	2,7%	2,7%	2,7%	2,7%	2,6%	2,6%	2,5%	3,2%	3,3%
International activities	0,4%	0,2%	0,4%	0,5%	0,4%	0,4%	0,4%	0,3%	0,3%	0,3%	-0,4%	0,1%	0,1%
Judicial power	0,2%	0,2%	0,2%	0,2%	0,2%	0,2%	0,2%	0,2%	0,2%	0,2%	0,2%	0,2%	0,2%
Law enforcement and security activities	1,6%	1,4%	1,4%	1,5%	1,5%	1,6%	1,9%	1,6%	1,6%	1,7%	1,9%	2,3%	2,3%
Fundamental research	0,3%	0,3%	0,2%	0,3%	0,3%	0,3%	0,2%	0,3%	0,3%	0,3%	0,3%	0,3%	0,3%
Services provided for the national economy	0,3%	0,6%	0,8%	0,9%	1,0%	1,0%	1,1%	1,1%	1,0%	1,5%	0,6%	0,8%	0,9%
Social services	5,0%	5,7%	5,3%	5,9%	5,7%	5,5%	5,6%	5,4%	5,2%	5,7%	2,6%	2,8%	2,7%
Servicing of public debt	1,9%	3,4%	3,4%	2,7%	2,5%	2,4%	2,6%	2,4%	2,4%	2,0%	1,7%	3,0%	3,0%
Other expenditure	3,5%	4,0%	3,9%	4,0%	4,6%	4,2%	4,0%	4,0%	4,0%	3,8%	7,0%	7,8%	7,3%
Total expenditure	15,5%	18,7%	18,6%	19,1%	19,4%	18,9%	19,1%	18,6%	18,2%	18,7%	16,9%	21,1%	20,8%
Профицит (+) дефицит (-)	6,8%	2,3%	2,3%	2,1%	1,4%	1,6%	1,4%	1,8%	1,7%	1,4%	4,5%	0,1%	0,1%

According to the estimates of the Revenue Ministry, in March of 2003 tax revenues of the federal budget made Rb. 115.3 billion (without the single social tax). In real terms the revenues made 265.5 % of the level registered in January of 1999, while the respective indicator was at 234.8 % in 2002 and 227.6 % in 2001 (see Table 3).

Table 3

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

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			
230,0%				229,2%				265,5%			

* Без учета ЕСН.

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

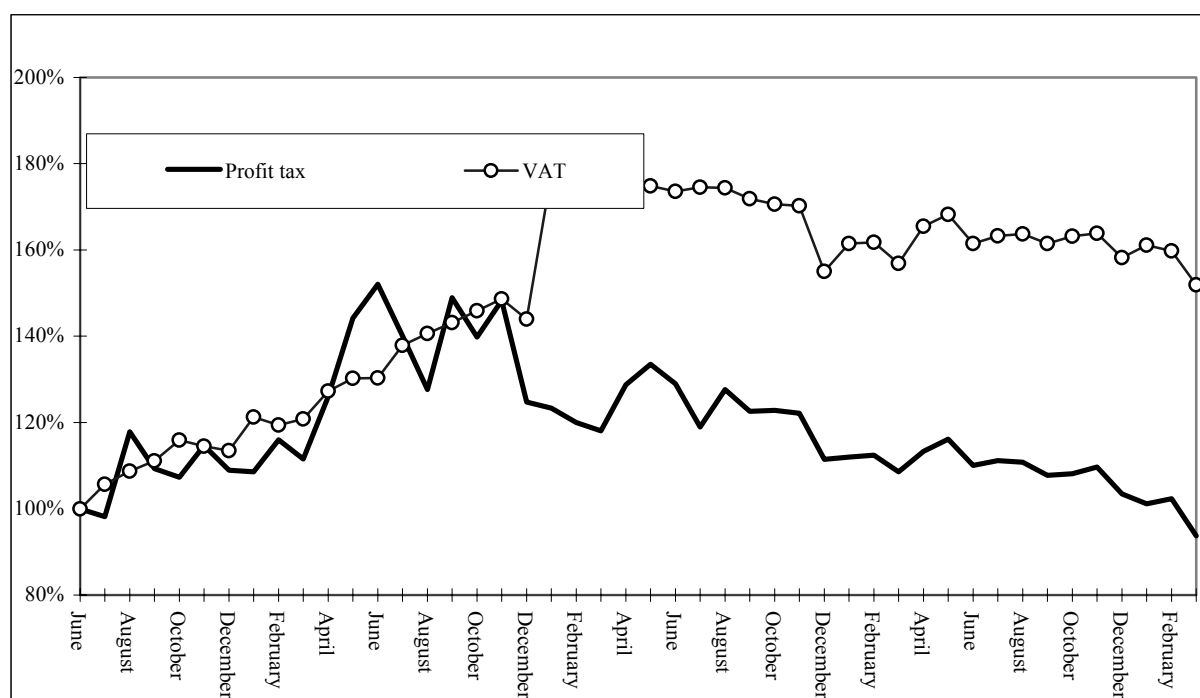


Fig 1. Rate of growth of the real tax arrears to the federal budget (in % to June of 1999)

Table 4

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

1998												
	I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII
Taxes	16,2%	17,4%	18,1%	19,3%	19,7%	19,8%	19,8%	19,4%	18,8%	18,5%	18,6%	19,6%
Revenues	18,8%	20,1%	21,2%	22,4%	23,0%	23,2%	23,2%	22,9%	22,3%	22,0%	22,0%	24,5%
Expenditures	25,3%	23,8%	27,0%	28,1%	28,6%	29,5%	29,4%	28,6%	27,4%	26,9%	27,1%	29,5%
Deficit	-6,5%	-3,7%	-5,8%	-5,7%	-5,7%	-6,3%	-6,2%	-5,7%	-5,2%	-5,0%	-5,0%	-5,1%
1999												
	I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII
Taxes	16,8%	16,6%	18,1%	19,9%	20,1%	20,5%	20,8%	20,8%	20,3%	20,2%	20,9%	22,1%
Revenues	19,2%	18,9%	20,6%	22,7%	23,2%	23,9%	24,3%	24,5%	24,1%	24,0%	24,8%	26,3%
Expenditures	18,6%	20,3%	23,6%	25,6%	26,6%	27,3%	27,4%	27,4%	26,7%	26,3%	26,7%	29,2%
Deficit	0,6%	-1,5%	-3,1%	-3,0%	-3,4%	-3,4%	-3,1%	-2,9%	-2,7%	-2,3%	-1,9%	-2,9%
2000												
	I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII
Taxes	20,8%	21,4%	22,6%	24,2%	25,5%	25,4%	24,9%	24,8%	24,1%	23,7%	24,0%	24,6%
Revenues	24,4%	24,8%	26,4%	28,2%	29,7%	29,7%	29,3%	29,2%	28,4%	28,0%	28,6%	30,0%
Expenditures	19,6%	21,1%	23,8%	24,8%	25,2%	25,5%	22,3%	25,1%	24,5%	24,2%	24,6%	27,0%
Deficit	4,7%	3,7%	2,6%	3,4%	4,5%	4,3%	7,0%	4,1%	3,9%	3,8%	4,0%	3,0%
2001												
	I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII
Taxes	22,7%	23,6%	23,9%	25,4%	26,4%	26,0%	26,1%	25,9%	25,0%	24,8%	25,4%	27,1%
Revenues	25,9%	27,1%	27,4%	29,3%	30,5%	29,8%	29,9%	29,7%	28,3%	28,2%	28,8%	29,5%
Expenditures	16,8%	22,8%	23,7%	24,7%	25,1%	25,3%	25,5%	25,6%	24,9%	24,7%	25,0%	25,6%
Deficit	9,1%	4,2%	3,7%	4,7%	5,4%	4,4%	4,4%	4,1%	3,5%	3,5%	3,8%	3,9%
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					
Taxes	25,6%						24,4%					
Revenues	32,0%						30,3%					
Expenditures	20,7%						25,3%					
Deficit	11,3%						5,0%					

* Без учета ЕЧВ

The debts related to the payments due to the federal budget made for VAT Rb. 231.6 billion as on April 1, 2003, the arrears of the profit tax made Rb. 30.6 billion. The dynamics of real arrears relating to major debts since June of 1999 is presented in Fig. 1. On the whole, the dynamics and the latest data still demonstrate a gradual decrease in the level of accumulated arrears as concerns the profit tax and a certain trend towards a decline in VAT arrears.

The revenues of the consolidated budget in February of 2003 made 32.3 % of GDP, including tax revenues (without SST) at 24.4 % of GDP (see Table 4). Expenditures of the consolidated budget increased by 1.6 p.p. in comparison with the figures registered in February of 2002 and made 25.3 % of GDP. The surplus of the consolidated budget in February of 2003 made 5.0 % of GDP, what is below the level observed in January of 2002 (7.7 % of GDP).

S. Batkibekov

Monetary Policy

Inflation in Russia stabilised at the level of 1.1 percent per month. The Central Bank of RF introduced a new procedure for the establishment of the official RUR - US\$ rate; from now on the rate will be established based on the results of the special SELT session with settlements 'tomorrow'.

In March 2003 inflation in Russia fell to 1.1 percent (see Fig. 1). The average daily price growth in March did not exceed 0.034 percent; this is lower than in the corresponding period of 2002 (0.035 percent) and in the previous month (0.058 percent). In March the index of foodstuff prices was 101 percent (104.8 percent since the beginning of the year); for non-foods: 100.8 percent (102.8 percent); for payable services to the population: 101.7 percent (110.6 percent). The base consumer price index (BCPI) (that does not take into account "short-term irregular price changes under the influence of individual factors of administrative, occasional or seasonal nature") grew 0.7 percent in the course of the past month or 2.8 percent since the beginning of the year. Thus, in Quarter 1, 2003, consumer prices grew 5.2 percent as against 5.4 percent in the corresponding period of 2002, slightly exceeding the upper five percent limit set in the forecast by the Ministry for Economic Development. It should be reminded that the official inflation forecast for the year is 12 percent.

According to preliminary estimates, the CPI did not change in April as compared to March, remaining at the level of 101.1 points.

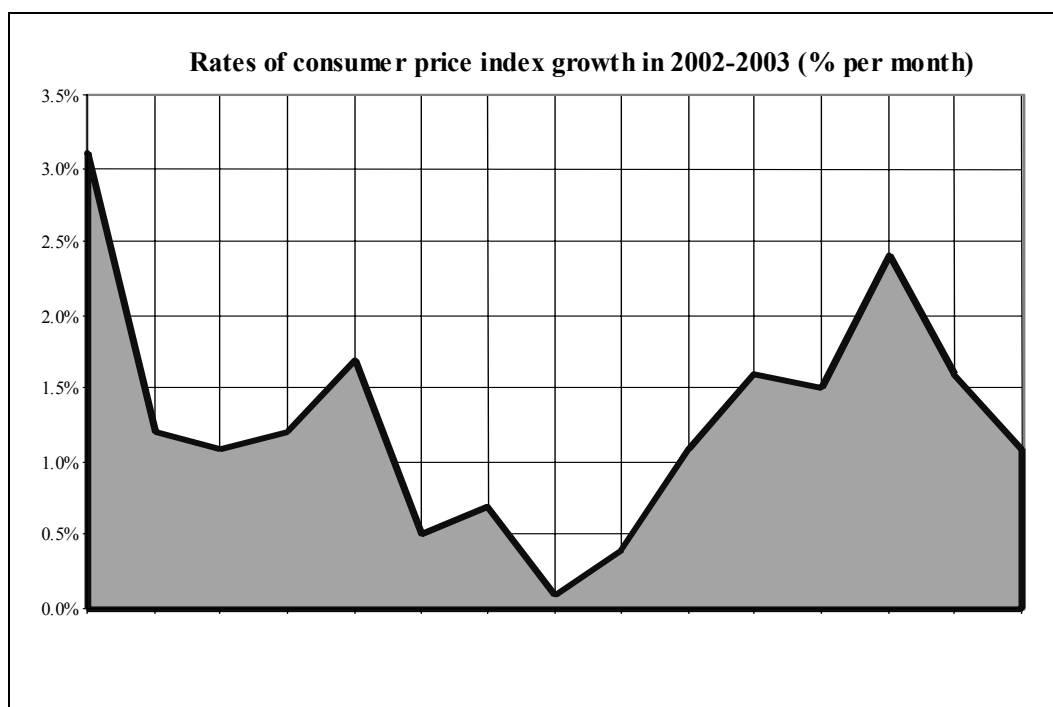


Fig. 1.

In March and April of 2003 foreign reserves of the Bank of Russia continued to grow (see Fig. 2). As at 1 April, 2003, they reached US\$ 55.4 billion or 16.1 percent more than at the beginning of 2003. At the same time, the rate of foreign reserve growth fell in March to 4.3 percent (February: 7.7 percent). During the first three weeks of April foreign reserves increased US\$ 2.3 billion, reaching the level of US\$ 57.7 billion on 20 April.

Dynamics of money supply (limited indicator) and foreign reserves in the second half of 2002 - 2003



Fig. 2.

In March the limited money supply indicator grew 3.2 percent, or from RUR 901.3 billion to 930.4 billion (See Fig. 2). In the first three weeks of April the money supply grew another 5.6 percent; this may have resulted mainly from the accumulation of the Central Bank's foreign reserves. The broad money supply indicator grew 3.5 percent (from RUR 1240.7 billion to 1284.5 billion) in March. Thus, in Quarter 1, 2003, the limited indicator of money supply remained practically unchanged in comparison with early January, and the broad indicator of money supply grew 4.2 percent (in the corresponding period of the previous year: fell 7 percent).

According to the State Internal Debt Management Department of the RF Ministry of Finance, the Russian Federation's internal debt grew 3.32 percent, reaching RUR 674.39 billion in March. This is a 3.04 percent growth in comparison with the beginning of 2003, when this indicator was RUR 654.51 billion. The debt growth was brought about by the issuance of OFZs with depreciation of the principal amount of debt (+ RUR 13.8 billion) and OFZs with a fixed coupon rate (+ RUR 10.66 billion). As at 1 April, 2003, the share of these securities was 52.72 percent (RUR 355.58 billion) and 31.75 percent (RUR 214.13 billion), correspondingly.

According to the data supplied by the External Debt Department of the RF Ministry of Finance, in April 2003 the Ministry allocated altogether cca. US\$ 1017.6 million for the purposes of external debt payments. This amount was distributed as follows: US\$ 168.363 million were transferred to official creditor countries, banks and companies, including US\$ 147.207 million for repayment of the principal amount and US\$ 21.156 million for repayment of interest; US\$ 393.27 million were repaid to international financial organisations. In addition, cca. 464 million were directed for repayment both of the last coupon of the Russian five-year eurobond the issue and of the issue itself, including US\$ 418.349 million for repayment of the principal amount and US\$ 37.651 million for repayment of interest. These eurobonds were issued on 30 April, 1998; the total issue amount was Italian Lira 750 billion. In 2003 Russia must repay a total of cca. US\$ 17.3 billion to foreign creditors.

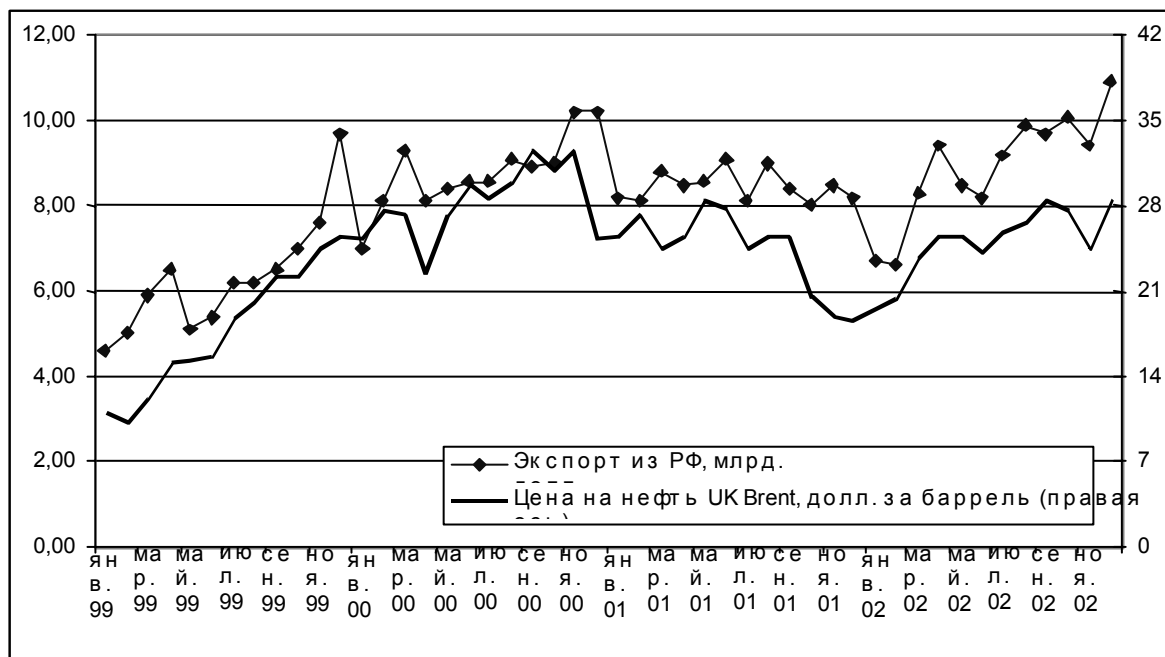
In April 2003 the Central Bank of the Russian Federation changed the procedure for the establishment of the official RUR - US\$ rate. Starting from 15 April, 2003, interbank currency exchanges introduced sales of

US Dollars for Russian Roubles with the settlement 'to-morrow'. In doing so, the exchanges have retained the existing risk management system and the equal access for trade participants from various Russian regions. In the opinion of the Bank of Russia, this new segment is bound to become the most liquid segment of the exchange currency market due to the considerable duration of the trade session and lower operational risks as compared to conversion deals on conditions 'today'. In addition, the rate formed in the course of a trade session with the settlements 'tomorrow' is more representational as it is less affected by short-term factors, in particular changes in the current liquidity of authorised banks. In this connection the Bank of Russia is going to establish the official RUR - US\$ rate based on the results of the SELT trade session with settlements 'today' and, to this end, use the weighted-average value of the US Dollar at the SELT with settlements 'tomorrow' reached at 11.30 a.m. of the day of the trade session.

P. Trounin

External factors of monetary policies in the Russian Federation

The paper deals with analysis of interventionist policy options, testing some hypotheses on dynamics of foreign trade, forex and monetary and credit policy indicators, and evaluation of possibilities for sterilization of money supply. The paper also contains a review of literature on the Central Bank's interventionist policy and channels of its impact on the economy. One of the most important exogenous factors significantly affecting Russia's monetary policy is the dynamics of world oil prices. Growing oil prices result in increases in exports, which primarily consist of mineral raw materials (the share of oil and mineral fuels makes more than half of the total amount of exports). In the situation, where prices of natural gas, ferrous, and non-ferrous metals change less than oil prices, fluctuations of world oil prices are the major source of fluctuations of the amounts of exports from the Russian Federation (see Fig. 1).



Exports from RF, US \$ billion

Oil price: UK Brent, US \$ / barrel (right axis)

Jan. 99 Mar. 99 May 99 Jul. 99 Sep. 99 Nov. 99 Jan. 00 Mar. 00 May 00 Jul. 00 Sep. 00 Nov. 00 Jan. 01 Mar. 01 May 01 Jul. 01 Sep. 01 Nov. 01 Jan. 02 Mar. 02 May 02 Jul. 02 Sep. 02 Nov. 02

Source: RF Central Bank, IMF Financial statistics.

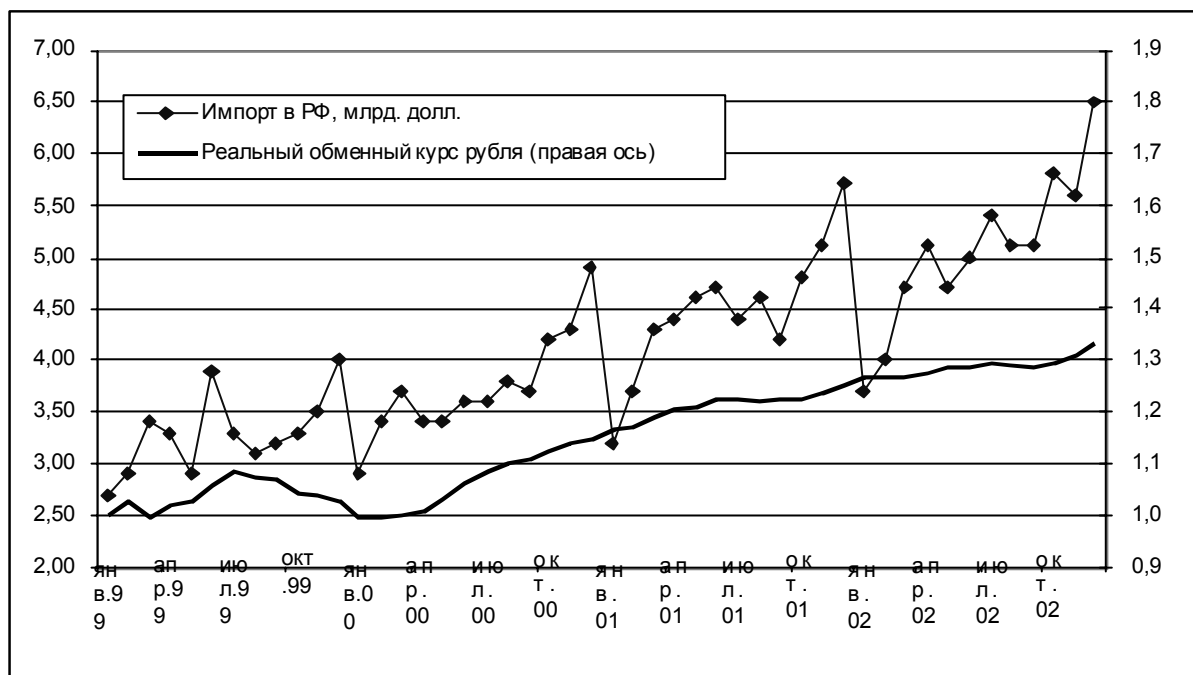
Fig. 1. Dynamics of export from the Russian Federation and world Brent oil prices in 1999 through 2002

Increases in exports occurring at the periods of high oil prices (2000 – 2002) result in inflow of foreign currency in the country, what, taking into account the rate of mandatory sales of forex denominated proceeds, in turn increases the supply of foreign currency on the forex market. At the same time, it is necessary to note low price elasticity of volumes of exports – the volumes of exported oil are to a considerable degree determined by export capacity of the transport and pipe systems which put natural

(binding) constraints on volumes of a considerable part of exports. The inflow of foreign currency in the country generated by exports is distributed among the following major avenues.

Import of goods and services in the RF. In 2000 through 2002 there occurred real Ruble appreciation. Simultaneously, imports grew (see Fig. 2), what may be explained by the following factors:

- real Ruble appreciation means a relative decrease in the value of imported goods, and, therefore, substitution of imported goods for consumption of some Russian goods;
- real Ruble appreciation in the situation of not diminishing real Ruble cash household incomes results in growing welfare of consumers and profits derived by firms due to availability of a wide range of imported goods;
- the economic growth started in 1999 facilitated an increase in real cash household and enterprise incomes, what, on an assumption of a not too fast increase in the savings rate also brought about a growth in demand for all types of goods, including imported ones.



Imports to RF, US \$ billion

Real Ruble exchange rate (right axis)

Jan. 99 Apr. 99 Jul. 99 Oct. 99 Jan. 00 Apr. 00 Jul. 00 Oct. 00 Jan. 01 Apr. 01 Jul. 01 Oct. 01 Jan. 02 Apr. 02 Jul. 02 Oct. 02

Source: RF Central Bank, RF Goskomstat, author's calculations.

Fig. 2. Dynamics of the index of real Ruble exchange rate and import to the Russian Federation in 1999 through 2002

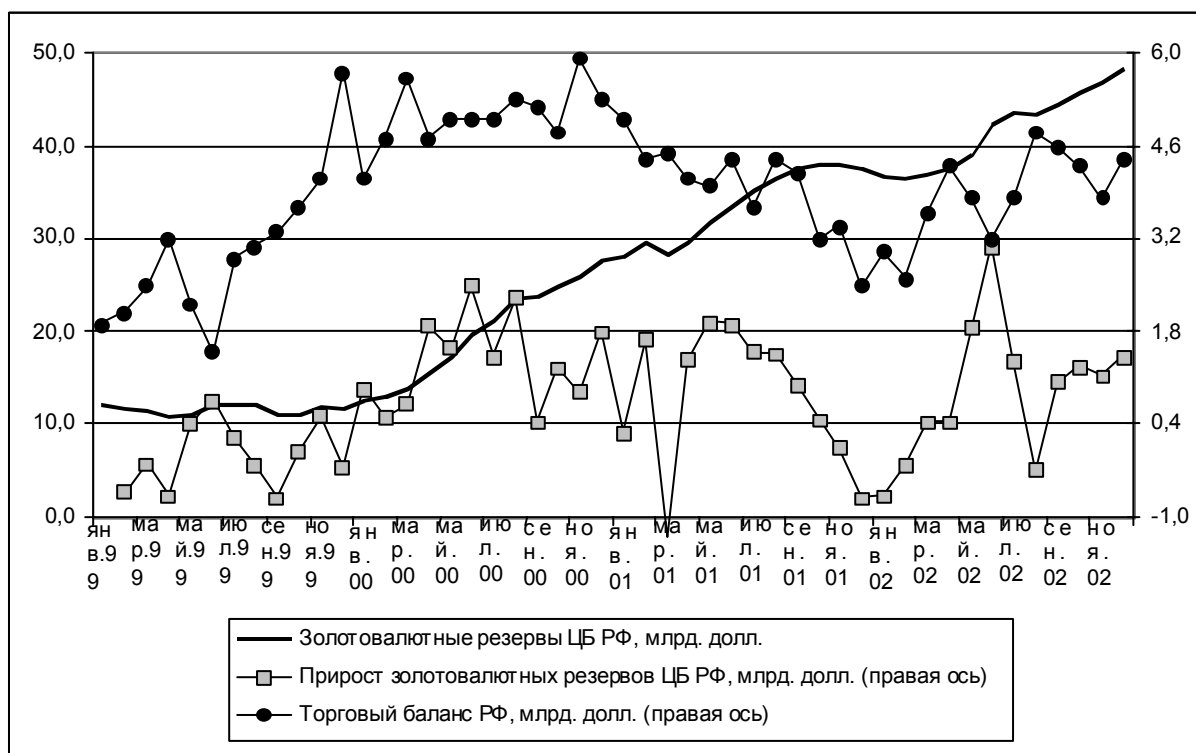
An increase in imports at the background of relatively high, but falling, world oil prices resulted in a decline in the balance of trade, by decreasing the balance of inflow of foreign currency in the country at the expense of trade operations.

Repayment of the foreign debt and the RF balance of payments on capital account. The next important avenue of utilization of foreign currency flowing in the country at the expense of export is the repayment of foreign debt. The resulting outflow of capital conditioning stable adverse balance of the account of capital operations and financial instruments, which partially compensates the active balance of the RF balance of trade.

Changes in household forex denominated savings. It may be assumed that a portion of foreign currency flowing in the RF was accumulated as household savings in foreign cash. An indirect evidence of this phenomenon is the accumulation of Ruble and forex denominated deposits (in this period there were attracted more than US \$ 10 billion were attracted as forex denominated deposits) over the period under observation.

Accumulation of gold and foreign exchange reserves of the RF Central Bank. The next important avenue of utilization of foreign currency flowing in the RF at the expense of export contracts is the

accumulation of gold and foreign exchange reserves of the RF Central Bank. As the dynamics of gold and foreign exchange reserves of the RF Central Bank in 1999 through 2002 demonstrate (see Fig. 3), the trend of increase in reserves on the whole corresponded to the trend of the trade balance. Early 2002 was an exception, since at that time reserves were accumulated at a more rapid rate in spite of moderate fluctuations of the trade balance. The most probable explanation of this phenomenon is a decline in the outflow of capital and repatriation of previously exported capital to Russia in relation to growing stability and improvement of the macroeconomic situation.



Jan.

99 Mar. 99 May 99 Jul. 99 Sep. 99 Nov. 99 Jan. 00 Mar. 00 May 00 Jul. 00 Sep. 00 Nov. 00 Jan. 01 Mar. 01 May 01 Jul. 01 Sep. 01 Nov. 01 Jan. 02 Mar. 02 May 02 Jul. 02 Sep. 02 Nov. 02

Gold and foreign exchange reserves of RF Central Bank, US \$ billion

Increase in gold and foreign exchange reserves of RF Central Bank, US \$ billion (right axis)

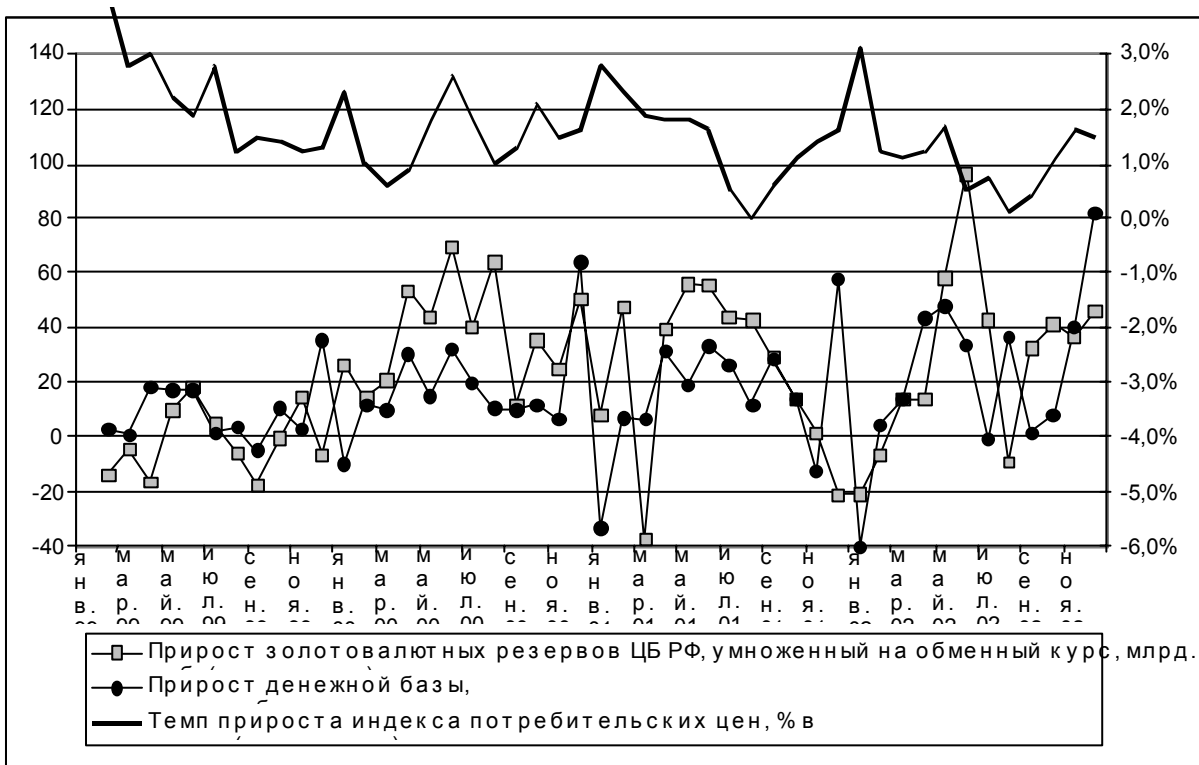
RF balance of trade, US \$ billion (right axis)

Source: RF Central Bank, author's calculations.

Fig. 3. Dynamics of the trade balance of the Russian Federation and gold and foreign exchange reserves of the RF Central Bank in 1999 through 2002

In 1999 through 2002, in certain periods the growth in gold and foreign exchange reserves was accompanied by comparable increase in the amount of money supply, what in turn created monetary prerequisites for inflation. The purchase of foreign currency on the forex market by the Central Bank may be viewed as an intervention to prevent nominal Ruble appreciation. Accordingly, from the viewpoint of monetary policy, the situation formed on the market presented for the public authorities the problem of sterilization of the increase in money supply either via reduction of other (than reserves) assets of the Central Bank, or substitution of other types of liabilities for monetary base. An additional incentive for restraint on growth in money supply is the fact that the RF Government proclaimed easing of inflation (down to 6 to 8 per cent a year by 2005) as its priority for the next few years.

For the dynamics of growth in gold and foreign exchange reserves of the RF Central Bank (in Rubles), increase in the monetary base, and inflation (rates of growth in the consumer price index) see Fig. 4.



Jan.

99 Mar. 99 May 99 Jul. 99 Sep. 99 Nov. 99 Jan. 00 Mar. 00 May 00 Jul. 00 Sep. 00 Nov. 00 Jan. 01 Mar. 01 May 01 Jul. 01 Sep. 01 Nov. 01 Jan. 02 Mar. 02 May 02 Jul. 02 Sep. 02 Nov. 02

Increase in gold and foreign exchange reserves of the RF Central Bank multiplied by the exchange rate, Rub. billion (right axis)

Increase in the monetary base, Rub. billion

Rate of increase in consumer price index, % a month (right axis)

Source: RF Central Bank, RF Goskomstat, author's calculations.

Fig. 4. Dynamics of growth in gold and foreign exchange reserves of the RF Central Bank, the monetary base, and the consumer price index in the RF in 1999 through 2002

As Fig. 4 demonstrates, the increase in gold and foreign exchange reserves of the Central Bank converted into Rubles in accordance with the exchange rate of the month of purchase was significantly above the increase in the monetary base in certain months.

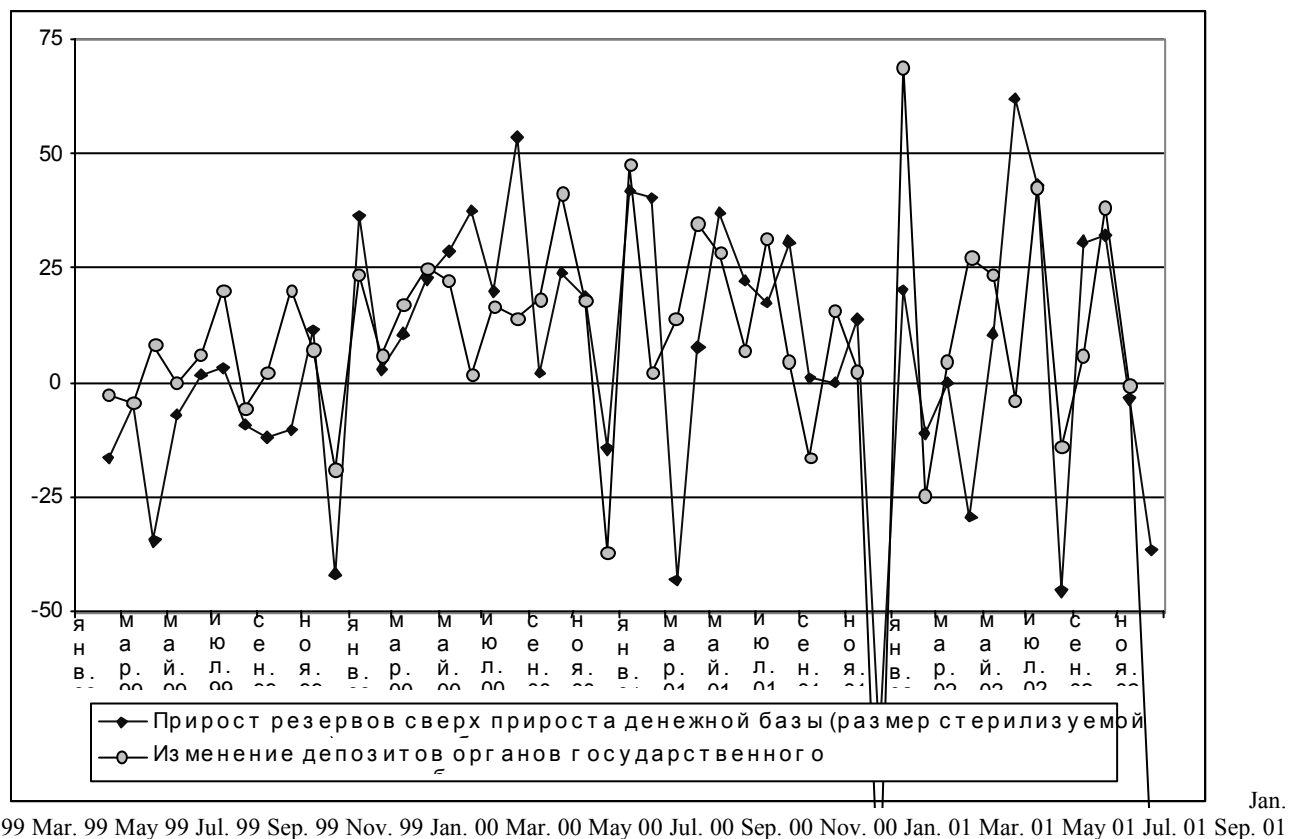
Specifics of tax revenue accounting in the RF are that tax payments are entered not to the Finance Ministry accounts with commercial banks, as is the practice in the majority of countries, but to the accounts with the Federal Treasury. It means that these funds are not taken into account in the monetary base statistics, i.e. each tax payment results in a decrease in the monetary base. In the case the budget is balanced, i.e. there occurs even receipt and expenditure of funds, no changes in the monetary base occur on average over the respective period. In the situation where a part of surplus is accumulated on the accounts of the RF Government (the Finance Ministry of the RF) with the Federal Treasury, there occurs a decrease in the monetary base.

Growing inflow of foreign currency in the RF at the expense of increases in exports would result in the nominal Ruble appreciation in the case the Central Bank did not participate in trade on the forex market. However, regular purchases of foreign currency checked the nominal Ruble appreciation, at the same time, rather high inflation rates (18.8 % in 2001 and 15.1 % in 2002) resulted in the real Ruble appreciation thus creating incentives for increases in imports and respectively decreasing the balance of trade.

A growth in oil prices, beside increasing export proceeds, also results in increasing revenues of budgets at all levels of the budgetary system. This growth in revenues includes both the increase in export duties rates *per se*, and increases in the revenues generated by major taxes due to the general revival of business activity initiated by increases in proceeds and profits of export oriented industries. On the one hand, taking into account the considerations discussed above, accumulation of surplus on the accounts of the RF Finance Ministry with the Federal Treasury may be used as a means of sterilization of purchases of foreign currency on the part of the Central Bank. On the other hand, a portion of the budget surplus is converted into foreign

currency, thus creating additional demand for foreign exchange on the forex market, and may be used for repayment or repurchase of the foreign debt, thus increasing the adverse current balance of capital flows.

Fig. 5 presents the dynamics of the scale of sterilization, i.e. an increase in reserves not followed by an increase in the monetary base, and changes in the balances on accounts of the government with monetary authorities.



99 Mar. 99 May 99 Jul. 99 Sep. 99 Nov. 99 Jan. 00 Mar. 00 May 00 Jul. 00 Sep. 00 Nov. 00 Jan. 01 Mar. 01 May 01 Jul. 01 Sep. 01
 Nov. 01 Jan. 02 Mar. 02 May 02 Jul. 02 Sep. 02 Nov. 02
 Increase in reserves exceeding increase in the monetary base (size of the sterilized intervention), Rub. billion
 Changes in deposits of the Government, Rub. billion
 Source: RF Central Bank, author's calculations.

Fig. 5. Dynamics of sterilization of purchase of foreign exchange on the part of the RF Central Bank, changes in deposits of the Government with monetary authorities in 1999 through 2002

The above Figure in fact points out that the sterilized portion of interventions, i.e. that not resulting in an increase in the monetary base significantly corresponds to fluctuations of balances on accounts of the budgetary system. This means that the growth in exports observed simultaneously with the growth in oil prices and the increase in gold and foreign exchange reserves were accompanied by growing revenues of the budgetary system and accumulation of surplus, which to a considerable degree permitted to sterilize purchases of foreign currency carried out by the RF Central Bank. The not sterilized portion of interventions resulted in the increase in the monetary base thus creating monetary prerequisites for inflation, what in turn (in the case of slowly changing nominal exchange rate) resulted in real Ruble appreciation thus creating incentives for growth in imports and decline in the net inflow of foreign currency in the country at the expense of foreign trade.

The results of the empirical analysis. In the framework of the study conducted by IET, there were obtained the following results of the empirical analysis of the aforesaid relationships:

1. There exists a stable relationship between the amount of exports and world oil prices both in the long term (cointegration relationship) and short term (relationship in increases) perspectives. An increase in world oil prices by 1 US \$ per barrel results in an increase in exports by about US \$ 200 million.
2. There exists a rather stable relationship between imports and the real exchange rate both in the long term and short term periods (growth in the index of real appreciation by 20 % in

comparison with the values registered in early 1999 results in an increase in imports by about US \$ 1 billion). At the same time, besides the real exchange rate, the increase in industrial output (as a factor characterizing demand) also affects the increase in imports – as the index of industrial output increases by 1 (January of 1993 = 100), the growth in imports makes about US \$ 87 million.

3. A key factor of increase in the monetary base is the growth in gold and foreign exchange reserves, at the same time, in spite of partial sterilization of interventions, the growth in the monetary base in the case of purchase of foreign currency makes on the average about 28 % of the increase in reserves (in Rubles).
4. Interventions are sterilized in the course of purchase of reserves by the Central bank, the major instrument of sterilization is the accumulation of a portion of funds on accounts with the Federal Treasury. Correlation between changes in deposits and reserves indicates some coordination of actions of the Central Bank and the RF Finance Ministry. Operations with securities in the Central Bank assets are not used for sterilization.
5. An avenue of utilization of funds on accounts with the Federal Treasury is the servicing and repayment of the foreign debt. Authorized agents of the RF Finance Ministry in the course of purchase of foreign currency necessary to payments relating to the foreign debt increase the monetary base and demand for foreign exchange on the currency market in addition to the RF Central Bank actions.
6. The results of the test for cointegration indicate a relationship between the nominal exchange rate and gold and foreign exchange reserves, at the same time, the increase in the nominal exchange rate by 1 Ruble per US \$ (Ruble depreciation) results in the increase in international reserves by US \$ 5 to US \$ 5.5 billion. It is also necessary to point out that this relationship exists across the whole range of world oil prices affecting the inflow of foreign currency in the RF over the whole period under observation.
7. In the short term period (monthly data) there is observed a negative relationship between the increase in gold and foreign exchange reserves of the RF Central Bank and increase in the exchange rate, while as concerns daily data, the relationship is insignificant. It appears to indicate that the Central Bank increased the reserves in the case there was observed a trend towards the nominal Ruble appreciation, at the same time seeking to stabilize the nominal exchange rate and not allow it to significantly appreciate or depreciate, probably compensating excessive demand for or supply of foreign exchange and the daily rate fluctuations, although not causing additional fluctuations of the rate resulting from interventions.
8. The test of profitability of interventions also fits the hypothesis about the gradual accumulation of reserves in the framework of relatively stable nominal exchange rate – the hypothesis that interventions were not intended to derive speculative profits because of rate fluctuations is not refuted.

On the whole, this analysis of the dynamics of key indicators of the balance of payments, forex market, and monetary policy demonstrated that in spite of limited capacity to sterilize the increase in money supply in the case of accumulation of gold and foreign exchange reserves, the RF Central Bank carried out significant sterilization – the increase in reserves (in Rubles) was significantly above the increase in the monetary base. At the same time, the sterilized portion of interventions, i.e. that not resulting in the increase in the monetary base, significantly corresponded to the fluctuations of the balances on accounts of the budgetary system with the monetary authorities. It means that the growth in exports observed simultaneously with the growth in oil prices and the increase in gold and foreign exchange reserves were accompanied by growing revenues of the budgetary system and accumulation of surplus, which to a considerable degree permitted to sterilize purchases of foreign currency carried out by the RF Central Bank. The not sterilized portion of interventions resulted in the increase in the monetary base thus creating monetary prerequisites for inflation, what in turn (in the case of slowly changing nominal exchange rate) resulted in real Ruble appreciation thus creating incentives for growth in imports and decline in the net inflow of foreign currency in the country at the expense of foreign trade.

P. A. Kadochnikov

The Real Sector: Factors and Trends

In the 1st quarter of 2003, according to the preliminary estimates, the increase in gross domestic product made 6.4 %. Economic growth was supported by persisting positive dynamics of production across practically all sectors of the economy. The output of products and services of the base industries increased by 6.7 % in comparison with the figures registered in January through March of 2002. The accumulated potential of development determined successful adaptation to changing conditions of the external economic situation, dynamics of the real Ruble exchange rate, costs relating to wages and salaries and payments for products and services of natural monopolies.

A specific feature of the 1st quarter of 2003 was the changes in proportions of final consumption and the investment component. In 2001 through 2003 there are observed indications of a socially oriented growth determined by the outpacing growth in consumption in comparison with GDP. The persisting intensive dynamics of growth in final household consumption were supported by increasing household incomes. In the 1st quarter, the growth in real disposable household incomes made 116.0 % as compared with the figures registered in the respective period of the preceding year, while real wages and salaries increased by 110 %. The real amount of gross pensions was maintained at the same level, since the rise in pensions in Russia has started since April 1, 2003.

The major factor behind the growth in real incomes and consumption was the intensive increase in real wages and salaries. A specific feature of this process is the widening gap between the dynamics of real wages and salaries and productivity of labor. This development results in redistribution of added value from enterprises to the population. The problem is aggravated by increasing differentiation of the sectors of the economy and extracting and manufacturing industries in terms of remuneration of labor. As a result, there is observed a decrease in the factor remuneration of labor in manufacturing industries and the sector of services. Taking into account the fact that almost 90 % of the economically active population is employed in the manufacturing industry and the sector of services, while wages and salaries of employees form over 75 % of the cash household incomes, the low effective demand on the part of these citizens is a serious factor constraining the rates of economic growth. In the economy, there is observed a growth in production costs and, accordingly, decreasing profitability of the real sector of the economy. The reaction of supply to this situation is reflected via decelerating growth of domestic production of consumer goods in comparison with final demand and accelerated increase in imports. These developments confirm the conclusion about deterioration of the generating influence of consumer demand on the dynamics of production in comparison with the levels registered in the respective period of the preceding year.

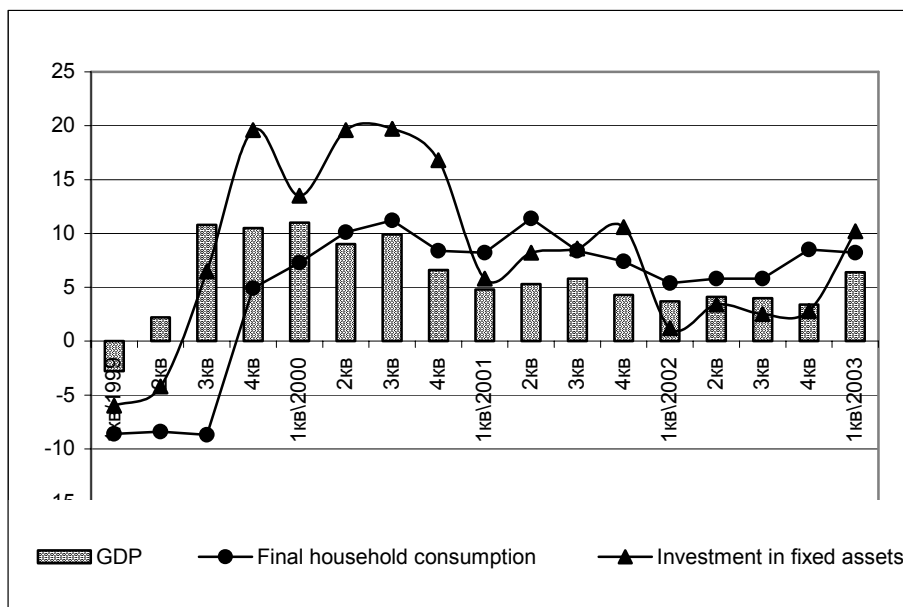


Fig. 1. Changes in GDP dynamics as broken down by the components in 1999 through 2003, in % of the respective period of the preceding year

The determining factor of the increase in GDP was the renewed growth in industrial output. In February through March of this year, the trend towards a decline in industrial output registered in the 4th quarter of 2002 and in January of 2003 was overcome. In the 1st quarter of 2003, the increase in industrial output made 6.0 % in comparison with this indicator registered in the respective period of the preceding year.

The dynamics of industrial output in the 1st quarter of 2003 were determined by the widening gap between the rates of growth in extracting and manufacturing industries. Favorable changes of the business situation on the world markets of hydrocarbon and raw materials further accelerated industrial growth. The rates of increase in production of export oriented industries in the 1st quarter of 2003 made 109.9 % in comparison with 103.8 % registered in the respective period of the preceding year. This year, among the most dynamically developing industries were fuel industry (109.9 %), ferrous (111.1 %) and non-ferrous (109.5 %) metallurgy. The growing role of extracting industries and industries engaged in the initial processing of raw materials has determined the nature of structural shifts.

While in the first six months of 2002 the dynamics of industrial growth were determined by the outpacing rates of production of consumer goods in comparison with export oriented and investment complexes, in the beginning of this year the situation changed. In January through March of 2003, the index of production across industries of the consumer complex made 102.2 % as compared with 106 % registered in the respective period of 2002. The investment industries are also characterized by rather moderate dynamics: the increase in production of mechanical engineering made 3.9 %, while in the industry of construction materials it made 3.5 %. As compared with the figures registered in the 1st quarter of 2002, the increase in production in the consumer complex at large grew by almost 2.5 p.p. and made 3.7 %. In February through March of this year, in mechanical engineering and the industry of construction materials there was registered an intensive growth in production, which fully corresponds to the recovery of positive dynamics of increase in investment in fixed assets. However, at the same time the dynamics of output of capital goods significantly lagged behind the growth in investment in fixed assets. The share of imports on the market of investment goods expands. While in 2002, according to the data provided by the State Customs Committee, the Russia's imports of technological equipment increased by 30 %, in the first months of this year this increase made already 27.3 %.

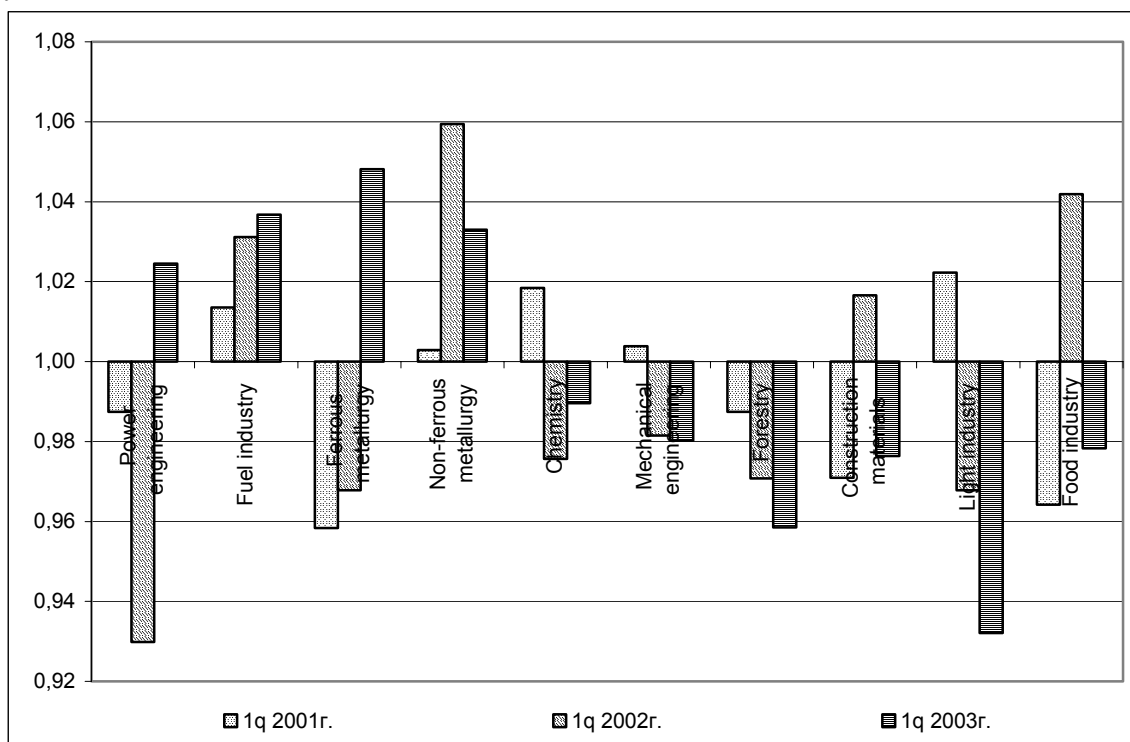


Fig. 2. Changes in output dynamics across industries in the 1st quarter of 2001 through 2003, industry = 1

The acceleration of growth in the export oriented raw materials sector was reflected via changes in the macrostructure of the economy. A specific feature of 2002 and early 2003 was the outpacing rate of growth in exports in comparison with the dynamics of domestic demand and imports in comparison with domestic production of goods. These developments are an evidence of changing roles of domestic demand and export as factors of economic growth.

While in 2001 and 2002 the growth in final household consumption determined the dynamics of domestic demand, in the beginning of this year there increased the role of the investment component. In the 1st quarter of 2003, the investment in fixed assets increased by 10.2 % as compared with 1.2 % registered in the respective period of the preceding year. The enhancement of investment activity was positively affected by the trend towards a gradual increase in profitability of production under the influence of growing proceeds of the export oriented sector of the economy, which had been registered since the second half of 2002. While in the first six months of 2002 profitability of production of industry made 13.7 %, by the end of the year it was estimated to make up to 16.3 %. As concerns oil extracting industry forming about ¼ of the aggregate profits of industry, there the profitability increased from 17.3 % in the first six months to 24.0 % registered in the second half of 2002. The surge of investment demand was primarily caused by export oriented industries and aimed to compensate for the lag in formation of finished stocks occurred in 2002.

The economic situation in the 1st quarter of 2003 formed under the impact of the favorable combination of internal and external factors of development. However, making estimates of further economic development there shall be taken into account a wide range of possible changes in the world economic situation.

O. Izryadnova

IET Business Survey: Industry

The “new economic upsurge” formed in early 2003 appears to abate. The first April results demonstrate that the Russia’s industry starts to brake its acceleration. The decelerating rates of growth in sales forces enterprises to check output, adjust assessments of finished stocks, and moderate optimism of forecasts.

The official Goskomstat data on the results of operations in the Russia’s industry in the first quarter of 2003 confirmed the operative data obtained in the course of surveys. The volume of industrial output grew by 6.0 %, while GDP increased by 6.4 %. Oil industry has been the locomotive of recovery (since the world oil prices were 1.5 times above the level registered in early 2002). The favorable price situation creates incentives for a growth in exports, and, correspondingly, output of ferrous metallurgy. These two industries form investment demand, which has revived mechanical engineering, where growth is evaluated to make 3.9 % in January through March of 2003. Goskomstat has registered growth in output across all industries with the exception of light, microbiological, and printing industries.

However, the first April results demonstrate that the Russia’s industry starts to brake its acceleration. The index of industrial optimism calculated by IET basing on the results of surveys lost in April almost all increase accumulated over two preceding months (see the Fig. below). The decrease occurred across all three indicators: changes in effective demand, evaluations of finished stocks, and expected changes in output.



RUSSIAN INDICES OF INDUSTRIAL OPTIMISM
IET METHODS
EUROPEAN METHODS

The intensity of changes in effective demand diminished by 10 balance points over the month. Only non-ferrous metallurgy, chemistry, petrochemistry, and industry of construction materials could increase the rates of growth in cash sales. Across other industries the rates decelerated, while in forestry, woodworking, pulp and paper industry, and light industry, where there was registered a decline effective demand in absolute terms, the rates became negative.



Production has reacted to decelerating rates of growth in sales. In April, the intensity of growth in output decreased on the whole by 7 points. Similar trends were observed across the majority of industries. Only in industry of construction materials (seasonal factors!) and food industry surveys registered an acceleration of rates of growth in output.

However, more numerous reports about excessive accumulation of finished stocks demonstrate that deceleration of rates of growth in output was insufficient. Over the month, the balance of evaluations (above the norm – below the norm) increased by 4 points reaching the record highs since May of 2002. The growth in balance occurred across all industries with the exception of metallurgy, although volumes of finished stocks diminished. The balance of changes in this indicator decreased from + 2 % to –8 % over the first quarter. In other words, enterprises could diminish finished stocks accumulated by the beginning of the year over the 1st quarter of 2003. However, the prospects of sales in the 2nd quarter do not look very hopeful, what resulted in growing number of reports “above the norm.”

Deceleration of rates of growth in sales has also stopped positive trends observed in the profit dynamics. The deceleration of the rates of decrease in profits stopped shortly after it had started. At present this indicator decreases at the same rate as in October through December of 2002. Real profits grew only in industry of construction materials.

However, on the whole enterprises could improve their financial and economic standing in comparison with the three preceding quarters. In April, the share of evaluations “satisfactory” grew up to 68 %, what is the historical maximum (see the Fig. Below). The historical minimum of this indicator (July of 1998) makes 19 %.

The forecasts of changes in demand lost at once 17 points in April. However, the positive balance was retained – on the whole enterprises hope for a growth in cash sales even in May – the month of massive vacations. An absolute decrease in sales is expected only in ferrous metallurgy, forestry complex, and light industry.

The plans relating to output have been similarly revised. In April, the optimism of respective forecasts dropped by 12 balance points. However, hopes for a growth in output prevail in the industry at large and across the majority of industries. An absolute decrease in output (because of the seasonal factors) is planned only in power engineering and forestry complex.



CHANGES IN EVALUATIONS OF ECONOMIC STANDING OF ENTERPRISES
 SATISFACTORY
 BAD
 GOOD
 EXTREMELY BAD

The forecasts of changes in employment in the Russia's industry improved by 6 points over the quarter and showed practically zero balance. The share of reports about planned layoffs became equal to the share of reports about hiring of new employees. Previously, the plans of layoffs has prevailed over four quarters. A significant growth in employment is expected to occur in short time in chemistry, petrochemistry, mechanical engineering, and construction industry. In other industries, expectations of a decrease in employment prevail.

It is also expected that amounts of profits will continue to decline in the next few months. The balance of forecasts relating to this indicator was negative for the industry at large and across the majority of individual industries. An increase in profits may occur only in non-ferrous metallurgy and industry of construction materials. At the same time, it shall be noted that forecasts relating to such indicators are, as a rule, too optimistic.

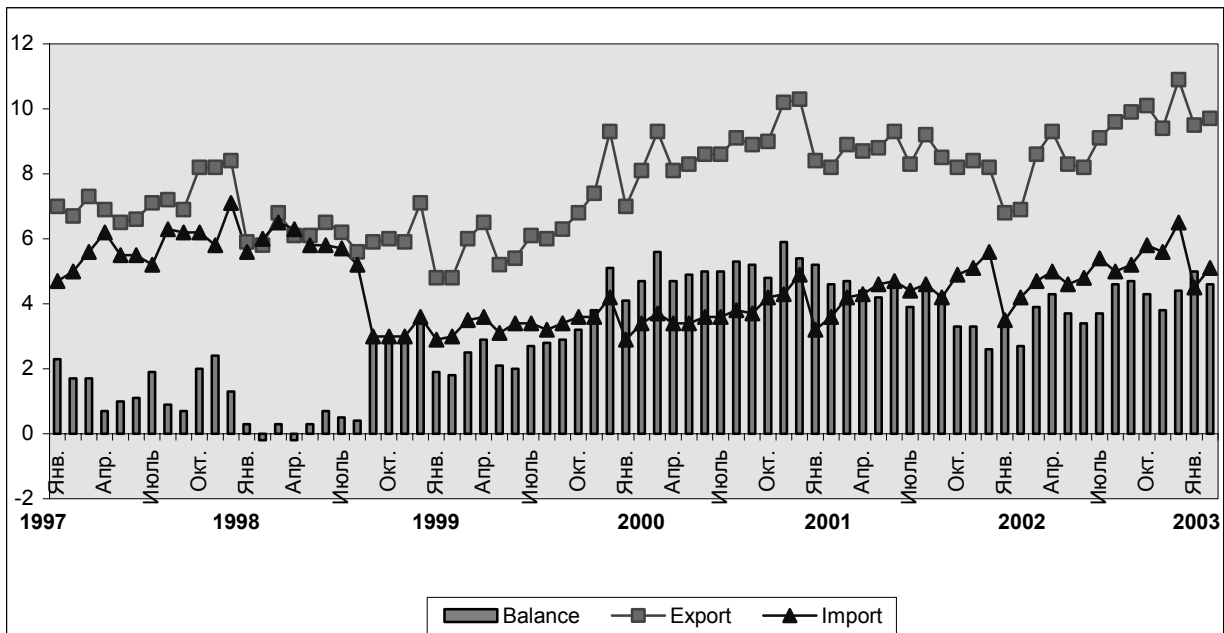
S. Tsukhlo

Foreign Trade

According to the Central Bank of Russia, in February of 2003 the foreign trade turnover made US \$ 14.7 billion, what is by 33.3 % above the figures registered in the preceding year. In February, the amount of export of goods grew by 40.6 % in comparison with the figures registered in February of 2002 up to US \$ 9.686 billion, while imports grew by 21.4 % up to US \$ 5.053 billion.

The significant increase in exports is determined by two factors: first, high export prices of staple fuel and energy commodities. Second, due to the growth in export prices there increased amounts of export of ferrous metals, primarily at the expense of rolled iron and unalloyed steel products. On the whole, the export of products of the fuel and energy complex increased almost 1.5 times in comparison with the figures registered in January through March of the preceding year, while export of metals and metal products increased by 20.9 %. The aggregate share of these commodity groups in the total exports to countries outside NIS made 78.7 % in the first two months of 2003.

In February of 2003, the situation on the world commodity markets continued to improve for Russian exporters. By the end of the month, oil prices have reached the record high in the last 12 years: prices of futures contracts on the New York stock exchange made up to US \$ 38.7 per barrel. The average price of Brent oil made US \$ 32.1 per barrel (an increase by 57.9 % and 14.1 % in comparison with the figures registered in February of 2002 and January respectively), the average price of Urals oil – US \$ 30.6 per barrel (an increase by 62.8 % and 3.7 % respectively).



Source: RF Goskomstat

Fig. 1. Main indicators of Russia's foreign trade (in Rub. bln.)

Natural gas prices grew considerably.

The situation on the market of ferrous metals was rather favorable in February of 2003. There was observed a growth in average prices of major types of rolled products. On the majority of key markets of non-ferrous metals, prices also grew. A factor behind the rise of prices was a decline in exchange stocks. By the end of February, the stocks of all metals made 2.93 million metric tons, as compared with 2.98 million metric tons registered in the beginning of the year and 3.09 million metric tons in mid-2002. There shall be noted that demand for non-ferrous metals grew in Asian countries, especially in China.

Table 1.

The average monthly world prices in February of the respective year

	1996	1997	1998	1999	2000	2001	2002	2003
Oil (Brent), USD / metric ton	126,1	155,8	109,2	78,3	195,9	198,0	147,8	233,41
Natural gas, USD / thous. m3		78,7	71,2	72,7	101,0	201,5	80,7	227,4
Gasoline, USD / metric ton	192,6	233,0	181,3	187,3	333,5	315,1	220,0	373,1
Copper, USD / metric ton	2552,9	2392,0	1673,3	1414,8	1779,1	1811,4	1601,5	1705,9
Aluminum, USD / metric ton	1597,8	1567,7	1479	1188,1	1584,2	1602,1	1370,8	1428,04
Nickel, USD / metric ton	8091,5	7670,8	5462,2	4629,4	10269,6	6544,6	6042,7	8619,64

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

Imports are still influenced by opposite factors. Ruble appreciation in relation to US dollar, which made, according to the Bank of Russia, 3.8 % in January through February (the maximum since July of 2000), stimulates Russia's imports, while Ruble depreciation in relation to Euro (1.6 %) renders the purchase of goods in the EU less profitable. At the same time, the growth in effective demand of households and enterprises facilitates increase in imports.

In February of 2003, the rates of growth in export outpaced imports, what resulted in a considerable increase in the active balance of trade, which grew by 70.4 % up to US \$ 4.6 billion in comparison with the figures registered in February of 2002.

In February of 2003, the amount of Russia's trade vis-à-vis CIS member countries made US \$ 2.46 billion. Imports grew by 18.1 % in comparison with the figures registered in February of 2002 and made US \$ 0.98 billion, while exports increased by 41.3 % and made US \$ 1.48 billion.

According to the data concerning two first months of this year, the most considerable growth in industrial output among the CIS member countries in comparison with the figures registered in February of 2002 was observed in Tadzhikistan, where it made 13.4 %, in Ukrain the production grew by 10.8 %, while in

Kazakhstan the increase in output made 9.2 %. The amounts of Russia's trade vis-à-vis these countries increased by 3 %, 41.7 %, and 23.1 % respectively.

Therefore, the tendency of the dependence of growth in amounts of foreign trade on positive dynamics of economic growth in CIS member countries was indirectly confirmed.

As concerns the sphere of bilateral relations between Russia and neighboring countries, this year there shall be noted the fact that Belorussia introduced special tax regimes of control over import of beer produced in Russia aimed to curb the respective exports. According to the new regulations, beer may be sold only from warehouses authorized by the tax authorities. In 2002, Russia increased the volumes of exported beer 1.5 times and imported about 3.5 decaliters.

Ukraine has again come out for the lifting of restrictions on the export of about 150 types of Ukrainian goods to Russia.

Besides, the Ukrainian party takes the view that profits from the growth in volumes of Russian exports may exceed losses suffered in relation to the abolishment of VAT on energy resources supplied by Russia.

At the same time Ukraine, trying to guarantee the future volumes of meet exports, came out for quotation of this product in spite of the fact that the Russia's quotation of beef and pork imports did not concern CIS member countries. In 2002, Ukraine exported to Russia about 115 thousand metric tons of beef and its share in the Russian imports structure made 24 %.

Ukrainian beef is sold on the Russian market at prices close to those of domestic producers and the quota for 2003 is planned to make 315 thousand metric tons. The almost threefold increase in respective imports may prejudice the interests of Russia's national producers.

In April of 2003, almost four years after the first reading, the State Duma approved the new Customs Code.

The major controversy was caused by Article 182, which defined the temporary import arrangements for goods transferred to the Russia's territory. There was offered an amendment stipulating the payment of export customs duties on products of processing transferred outside the Russia's territory in the case of "change in the classification code of the commodity classification of the external economic activities at the level of any of the four first digits." In fact, the amendment abolished the concessional taxation of tolling schemes actively used by aluminum and textile enterprises, typographies, etc.

The amendment was approved by the respective Duma committee, however, the reaction on the part of the Duma at large and businesspersons was sharply negative. In the result of the discussion, the amendment failed and tolling was retained.

The stipulations and terms used in the Customs Code has been brought in conformity with Russia's legislative acts adopted in 1994 through 2001. The major objective of the new Customs Code is to regulate the customs functions in the RF, therefore, the stipulations concerning administrative offences and responsibility for infringement upon customs regulations have been removed from the draft Code. Administrative offences are regulated only by the RF Code of Administrative Offences, while customs crimes are subject to the Penal Code. The stipulations concerning service in customs agencies have been excluded from the draft Code, since they are reflected in the federal law "On service in tax agencies of the Russian Federation."

In compliance with the Kyoto Convention, the new Customs Code has revised the economic substance of a number of customs regimes, in particular, of processing, free warehouse, re-export, and re-import procedures. The new Code sets forth shorter terms of customs formalities and defines procedures permitting to simplify and accelerate customs clearance. The time of customs clearance becomes three times shorter. For instance, the term of registration of the customs declaration may be decreased from 10 to 3 days. Besides, the Code envisages clearance of goods before they enter the customs due to the introduction of modern systems and technologies. Necessary procedures should be carried out while the shipment is on the way to the border.

Besides, the Code stipulates the procedure governing the application of technologies of analysis and risk management in the course of customs clearance of excisable goods and goods subject to high customs duties (for instance, household appliances, cars, foodstuffs, etc.) by the RF customs authorities. According to the Code, there shall be monitored primarily the "budget-forming" goods.

A key WTO requirement implemented in the Code is a more fair system of collection of customs fees, the amount of which shall correspond to the services actually rendered by the customs. At present, the customs fee still makes uniform 0.15 % of the value of goods thus forming inadequately high customs profits. The new Code stipulates that the Government shall be vested with the right to determine concrete amounts of

fees, however, these fees may not exceed the estimated costs borne by customs authorities in relation to conduct of customs operations.

Yet another principal novation is that numerous references to departmental bylaws issued by the RF State Customs Committee, which permitted customs officers to act at their discretion. The new RF Customs Code includes a maximal number of direct action articles, what is of the principal importance. From the draft Customs Code there were removed all formulations like “to discretion of customs authorities,” however, there are several references to the “discretion of the Government.” Nevertheless, the Customs Code provides a wide field for departmental rule-making. 146 articles vest the settlement of various issues with the RF State Customs Committee.

The Code in detail defines relations between the RF State Customs Committee and companies engaged in customs operations, i.e. customs brokers and, for instance, expert organizations. At present, as these relations are regulated by the RF State Customs Committee, it results in the fact that certain companies are in the privileged situation in comparison with others.

In the period when the Customs Code was elaborated, its articles dedicated to the customs control became more detailed. Now the Customs Code includes an exhaustive list of the forms of the customs control. Certain novations were included in the list, for instance, control based on audit methods or clearly defined mechanisms of expert examination and research.

Besides, new articles and sections have been introduced in the Customs Code. For instance, there was introduced a section stipulating the protection of intellectual property rights by customs agencies, what has always been a sphere of WTO interest. According to this novation, customs shall keep a register of objects of intellectual property and apply a special regime of clearance and control in relation to such objects thus facilitating detection of contrafact counterfeit products. The new Code also sets forth more strict measures as concerns responsibility of customs agencies for their actions. Therefore, the new Customs Code shall significantly decrease the corruption component in the regulatory acts of the customs legislation.

The new Customs Code shall be enacted on January 1, 2004. The terms of previously issued licenses and permits concerning application of customs regimes of processing in the customs territory, under customs control, outside of the customs territory, temporary import arrangements shall remain in force until their respective dates of expiration in the case these terms do not contradict the requirements set forth in the Code. The licenses for establishment of duty free shops shall be terminated on January 1, 2004.

N. Volovik N. Leonova

On the progress of reforms in March and april of 2003

In March and April of 2003, the Government of the Russian Federation discussed, alongside with the new key guidelines of the tax reform, issues relating to the development of the natural gas market, and other problems, the draft of the new medium term program worked out by the Ministry of Economic Development. The draft was submitted to the Government on April 16 of this year. The draft is the further elaboration of the initial “mix” of a brief conceptual document prepared by the Ministry of Economic Development in November of 2002 and the current medium term program for 2002 - 2004, for the first time discussed at the meeting of the Government, which took place on February 20, 2003. The program has considerably changed since that time, what appears to be a result of its March discussion at the Center of Strategic Research. There were discussed both individual sections of the program (financial markets, HPU, new economy, AIC, etc.), and the program at large (joint discussions with representatives of business circles conducted by G. O. Gref, the Minister of Economic Development and Trade).

As a result, several new sections (“Implementation mechanisms,” “Policies concerning tariffs on services of natural monopolies,” and a number of others) were introduced in the draft, what has seriously changed the program. The provisions of the sections became more concrete (what had already resulted in a number of differences of opinion with executive authorities). A significant novation was the introduction of indicators intended to demonstrate if the policies implemented in different spheres were successful. A serious stride towards the improvement of the program was that responsible executors (ministries and agencies) were designated to control the implementation of each measure set forth by the program, what should result in its better implementation. At the same time, the ideology of the program was maintained without change. The draft is primarily focused on the implementation of the “accelerated diversification” policy aimed at the changing of the structure of the economy in order to overcome its dependence on raw materials. The program formulates a package of measures (grouped as “horizontal” and “vertical”) allowing to achieve the

desired outcomes. The most important novation of the program, as compared with the current one, is the introduction of an additional section dealing with the administrative reform. Exactly the lack of progress in this sphere significantly constrains the potential progress of reforms and prevents the development of business activity.

It is already clear that the draft will give rise to heated debates. First, as it has already been noted, it already is opposed by a number of ministries and agencies referring to the fact that it is too concretized. Second, the time of its discussion is not very suitable, since the draft was submitted before the annual Presidential Address and long before the start of the Presidential election campaign. This means that, first, the program should be at least once adjusted (after the Presidential Address), and, second, a new program meeting the requirements of the pre-election period will probably have to be worked out in the end of the year.

Alongside with the most important item submitted for Governmental discussion – the draft of the new medium term program, there may be also singled out a number of measures being of importance for the progress of economic reforms.

Modernization of economy

In the framework of the reform of public service, in April of 2003 the State Duma of the Federal Assembly of the Russian Federation passed in the third reading the draft federal law “On the system of public service in the Russian Federation.” The bill sets forth the legal and organizational principles of the system of public service in the Russian Federation.

There was carried out active work on enhancement of effectiveness of management of state property, including elaboration of measures aimed at classification of federal state owned unitary enterprises and organizations in those necessary for exercise of state powers and those having ceased to perform such functions (these measures are aimed to diminish the number of such enterprises and organizations). The respective draft Resolution of the Government of the Russian Federation was submitted for approval of federal executive authorities in March of 2003.

In April of 2003, the Government of the Russian Federation issued its Resolution approving the Principles of state policy in the sphere of utilization of mineral raw materials and development of mineral wealth setting forth the measures, principles, and objectives of state regulation of respective types of activities, as well as guidelines for improvement of the system of management of the mineral and raw materials complex and the state fund of mineral wealth of Russia.

As concerns the sphere of the reform of the taxation system, in April of 2003 the Government of the Russian Federation submitted to the State Duma of the Federal Assembly of the Russian Federation the draft federal laws “On the abolishment of provisions of RF legislative acts concerning tax control over expenditures of individuals” and “On amendments to Article 220 of the RF Tax Code.”

The Government of the Russian Federation submitted to the State Duma of the Federal Assembly of the Russian Federation the draft federal law “On transfer of property owned by citizens and legal entities into ownership of the Russian Federation (nationalization)” aimed to guarantee the interests of the owners, clearly define the cases where property may be nationalized, ensure advance and adequate compensation of the value of the property and other losses of the owners inflicted as the result of nationalization.

The Interdepartmental Commission on the accounting and financial reporting reform approved the action plan for 2003 aimed to prepare the economy to the transition to international standards of financial reporting at its meeting, which took place in March of 2003.

The successful implementation of reforms in other spheres of the economy in many aspects depends on the pace and outcomes of the reform of infrastructure monopolies. A significant progress has been achieved in the formation of the legislative base of the reform of power engineering and railroad transport.

In April of 2003, the Government of the Russian Federation submitted to the State Duma of the Federal Assembly of the Russian Federation the draft federal law “On railroad transport in the Russian Federation” and “On amendments to the RF federal law ‘On the transport charter of the railroad transport of the Russian Federation.’” The bills are aimed to eliminate unjustified expenditures of the federal budget and ensure the interests of the Russian Federation as concerns national defense and security of the state, as well as to define more precisely certain stipulations of these federal laws.

In April of 2003, the Federation Council of the Federal Assembly of the Russian Federation approved the draft federal law “On amendments to the law of the Russian Federation ‘On the basic principles of federal housing policy’ and other legislative acts of the Russian Federation as concerns the improvement of the system of payments for housing and public utility services.”

In March of 2003, the Concept of creation and development of the guarantee system for support of the export of industrial products was submitted to the Government of the Russian Federation.

In April of 2003, the State Duma of the Federal Assembly of the Russian Federation in the third reading the draft Customs Code of the Russian Federation.

In March of 2003, the State Duma of the Federal Assembly of the Russian Federation in the third reading the draft federal laws submitted by the Government of the Russian Federation: “On foreign currency regulation and foreign currency control” (new version), aimed at further liberalization of this sphere; “On special protective, anti-dumping, and countervailing measures concerning commodity imports,” which fully harmonized measures protecting Russia’s producers from imports to WTO rules and regulations.

In March of 2003, the Government of the Russian Federation submitted to the State Duma of the Federal Assembly of the Russian Federation the draft federal law “On the principles of state regulation of foreign trade operations” aimed at determination of the principles of the state regulation of foreign trade operations, powers vested with the Russian Federation and subjects of the Russian Federation in the sphere of foreign trade operations and protection of the economic and political interests of the Russian Federation.

Social sphere

In March of 2003, the State Duma of the Federal Assembly of the Russian Federation in the first reading the draft federal law “On amendments to certain RF legislative acts as concerns financing of the general education establishments.” The bill, in particular, stipulates that local authorities should be vested with state powers in order to ensure the state guarantees of citizens’ rights for generally accessible and free general education in accordance with key non-specialized programs implemented by general education establishments within their jurisdiction.

There is continued the work on formation of the legislative base of the pension reform. In March of 2003, the President of the Russian Federation signed the federal law “On amendments to the federal law ‘On licensing of certain types of activities’” concerning the licensing of activities relating to pension provision and pension insurance.

In April of 2003, the Government of the Russian Federation approved a resolution designating the Finance Ministry of the Russian Federation as empowered executive authority to regulate, control, and oversee the sphere of formation and investment of pension savings.

One of the most important objectives in the sphere of labor relations is the transition to the efficient employment of the population, meeting of developing demand of the economy for skilled labor, and ensuring of operative reaction to changes in the situation on the labor market. The elaborated draft Concept of actions on the labor market in 2003 through 2005 aimed at the resolution of these issues was submitted to the Government of the Russian Federation.

The problem of migration is a key issue as concerns the resolution of the problem of ensuring the country with necessary labor resources. In March of 2003, the Government of the Russian Federation issued a resolution approving the Concept of regulation of migration flows in the Russian Federation, which presents a system of approaches to the substance and key guidelines of activities carried out by state authorities of the Russian Federation in the sphere of management of migration processes.

O. Fomichev