



INSTITUTE FOR THE ECONOMY IN TRANSITION

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July 2001

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RUSSIAN ECONOMY: TRENDS AND PERSPECTIVES

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The economic and political situation in Russia in July 2001

Last July continued to demonstrate the intensification of the unity and coordination of actions between the legislature and the executive branch of power. The recent spring Duma session was likely to become the most efficient one in the history of the post-communist Russia. During the seven months of its work the government introduced and Duma approved a number of crucial socio-economic bills that form the frame of the current stage of reform aimed at the establishment of the institutional structure of the national economy. The government has obtained Duma's support to the first deregulation package, while the new corporate profit tax mechanism and the mineral tax were passed rather rapidly. The legislature supported the Labor Code and the Land Code, and the initial step was made in regard to pension reform. The bill on lowering the margin of compulsory sales of foreign exchange-denominated proceeds passed three readings at once. Though the debates around some of the noted bills were sometimes accompanied by scandals in the Duma and around it (that is especially true with respect to the Labor Code and the Land Code), nonetheless, that could not alleviate the visible effect of the growing consolidation of elites.

The Federation Council has also continued to show its loyalty to the executive power. In July the Chamber even approved the bill that many politicians unanimously believed had no chances: that is, the bill that seriously limits the current governors' chances to be reelected for the third term. However the document received the Chamber's support, mostly thanks to the pro-presidential faction "Federation" emerging in the Upper Chamber. The Chamber has also approved the Chapter of the Tax Code that regulates the taxation of profit, though the new procedures should substantially limit the powers of the Subjects of the Federation (until that, the regional authorities have had a right to decrease their part of the tax to zero).

Such a development of the situation may imply dual interpretation: on the one hand, it may be regarded as the legislators' growing realization of their responsibility for the state of affairs in the country (indeed, the passed legislation is very important and can substantially improve the investment and entrepreneurial climate in the country). However, on the other hand one can conclude that the executive power is taking over the legislature.

It is likely that the both processes are in place. The experiences of the last decade could not help but tell on the views of the new national elite, thus helping it raise its maturity and responsibility. At the same time one cannot help but seeing a certain pragmatism in the voting outcomes: both the problem of the third term and the regions' right to decrease their share of corporate profit tax appeared to be an immediate concern of the minority

of Subjects, and at this point a political calculation was quite in place.

Such a development of the situation sometimes faces a harsh criticism, both among general public and mass-media (including foreign ones), because of the legislature's excessively vigorous support of the government activity. This criticism is unlikely to be fair: first, the majority of bills generate serious discussions in the Duma, and substantial amendments are introduced to them. Secondly, the noted bills, indeed, are crucial for the promotion of economic reform in the country; finally, thirdly, in the majority of democratic countries the parliamentary majority practically automatically passes proposals submitted by the government they support.

The last fact appears especially interesting. In fact, last months witnessed new important processes in the domestic political life: the pro-government majority is emerging in the Duma. The process, however, takes an inverse path: the majority rather consolidates itself around the government than the majority has formed the government. However, despite some artificiality of such compositions, the political process has increasingly gained a considerable stability, which, in turn, helps retain and strengthen a certain inertia in the economic policy area.

The problem of creation of a single legal zone, ensuring the equal possibilities in the area of relationship between the federal center and regions retains its urgency, even despite a serious work on bringing the regional law in consistency with the federal law. While making steps towards each other, the parties clearly focus on dialogue. On the one hand, in June the Commission on the federate relations reform held its inaugural meeting, while on the other hand, four regions of the Volga Federal Supreregion declared they would quit the agreements on division of powers concluded between 1995 to 1996. The convergence of the center's and regions' positions on the problem of unification of the economic regime testifies to the Russian elites' growing self-consciousness.

All the aforementioned processes, along with a non-deficit budget and fulfillment of foreign debt obligations, help raise the investment attractiveness of the national economy. According to international rating agencies, Russia is one of the most promising emerging markets, though still the country is far from investment prosperity.

It is the strengthening of the pro-Western orientation potentially appears a very promising direction of the country's development. In July the work was activated on realization of Prodi-Putin's idea of formation a single European economic zone, and this direction should become the crucial long-term priority for the national economy. From the tactical perspective, the focus on Europe might become an important factor helping Russia's accession to WTO (which poses certain problems in July).

The state of the federal budget

TABLE 1. THE MONTHLY EXECUTION OF THE FEDERAL BUDGET OF THE RUSSIAN FEDERATION (IN COMPARABLE PRICES)

	I`00	II`00	III`00	IV`00	00	I`01	II`01	III`01	IV`01	V`00
Revenues										
Corporate profit tax	1,6%	1,6%	2,0%	2,3%	2,6%	1,4%	1,5%	1,9%	2,4%	2,6%
Personal income tax	0,3%	0,3%	0,3%	0,3%	0,4%	0,0%	0,0%	0,0%	0,0%	0,0%
VAT, special tax and excises	8,2%	8,3%	8,0%	8,1%	7,3%	9,1%	9,4%	9,0%	9,2%	9,3%
Tax on foreign trade and foreign trade operations	3,1%	3,4%	3,5%	3,5%	3,3%	3,6%	4,2%	4,1%	4,0%	3,9%
Other taxes, duties and payments	0,3%	0,3%	0,3%	0,3%	0,4%	1,1%	0,9%	0,8%	0,8%	0,7%
Total- taxes and charges	13,6%	14,0%	14,1%	14,6%	13,9%	15,3%	16,0%	15,8%	16,3%	16,6%
Non- tax revenues	1,9%	1,8%	1,8%	2,0%	2,3%	1,0%	1,2%	1,1%	1,2%	1,2%
Revenues, total	15,5%	15,8%	16,0%	16,6%	16,2%	16,0%	17,1%	16,9%	17,5%	17,8%
Expenditure										
Public administration	0,1%	0,2%	0,3%	0,3%	0,4%	0,1%	0,2%	0,3%	0,4%	0,4%
National defense	0,0%	2,5%	3,0%	3,0%	2,7%	1,3%	2,0%	2,2%	2,5%	2,7%
International activities	0,7%	0,9%	0,8%	0,8%	0,3%	0,3%	0,3%	0,2%	0,2%	0,2%
Judicial power	2,8%	0,1%	0,1%	0,1%	0,1%	0,0%	0,1%	0,1%	0,1%	0,1%
Law enforcement and security activities	0,8%	1,2%	1,3%	1,3%	1,5%	0,7%	1,1%	1,3%	1,4%	1,4%
Fundamental research	0,0%	0,1%	0,1%	0,2%	0,3%	0,0%	0,1%	0,2%	0,2%	0,2%
Services provided for the national economy	0,3%	0,4%	0,5%	0,6%	0,9%	0,1%	0,3%	0,6%	0,7%	0,8%
Social services	1,3%	1,5%	1,8%	1,9%	1,9%	1,2%	1,7%	1,9%	2,1%	2,0%
Servicing of public debt	3,8%	3,1%	2,9%	2,8%	2,5%	3,2%	5,6%	4,7%	3,7%	3,4%
Other expenditure	5,6%	2,7%	3,0%	2,8%	3,1%	3,3%	3,2%	2,9%	3,0%	3,1%
Expenditure, total	12,6%	12,7%	13,8%	13,8%	13,7%	10,4%	14,6%	14,3%	14,2%	14,2%
Loans, redemption exclusive	2,9%	3,1%	2,2%	2,8%	2,5%	5,8%	2,5%	2,6%	3,4%	3,7%
Expenditure and loans, redemption exclusive	-0,5%	-1,5%	-0,3%	-0,3%	0,0%	-3,7%	-0,8%	-0,6%	-1,1%	-1,7%
Budget deficit (-)	-2,4%	-1,6%	-1,9%	-2,5%	-2,5%	-2,1%	-1,7%	-2,1%	-2,3%	-2,0%
Domestic financing	-2,9%	-3,1%	-2,2%	-2,8%	-2,5%	-5,7%	-2,5%	-2,6%	-3,4%	-3,7%

TABLE 2. THE MONTHLY EXECUTION OF THE FEDERAL BUDGET OF THE RUSSIAN FEDERATION (IN % GDP, ACTUAL FINANCING).

	I`01	II`01	III`01	IV`01	V`01	VI`01
Total	16,2%	17,1%	16,9%	17,5%	17,9%	17,6%
Public administration	0,5%	0,5%	0,5%	0,5%	0,5%	0,5%
National defense	2,4%	2,5%	2,8%	2,8%	2,9%	2,9%
International activities	0,5%	0,4%	0,2%	0,2%	0,2%	0,2%
Judicial power	0,2%	0,2%	0,1%	0,1%	0,1%	0,1%
Law enforcement and security activities	1,7%	2,0%	1,9%	1,8%	1,8%	1,8%
Fundamental research	0,3%	0,3%	0,3%	0,3%	0,3%	0,3%
Services provided for the national economy	0,5%	0,9%	1,0%	1,0%	1,1%	1,3%
Social services	2,4%	2,6%	2,5%	2,7%	2,6%	2,6%
Servicing of public debt	3,2%	5,6%	4,7%	4,3%	3,9%	3,2%
Other expenditure	3,7%	3,5%	3,2%	2,5%	2,7%	3,3%
Total expenditure	15,3%	18,5%	17,2%	16,4%	16,2%	16,1%
Profit (+) / deficit (-)	0,9%	-1,4%	-0,3%	1,1%	1,7%	1,5%

The data on the execution of the federal budget in the 1st quarter 2001 is given in Table 1¹. As of June 1, the revenues to the federal budget 2001 accounted for 17.8% of GDP, including tax revenues – 16.6%, while expenditure made up 14.2% of GDP (16.1% of GDP in terms of fulfilled funding), including non- interest ones

10.8% of GDP (12.3% in terms of fulfilled financing. The level of budget profit accounted for 3.7% of GDOP (1.7% of GDP in terms of fulfilled funding).

Between January through May 2001 the execution of the federal budget was characterized with the 1.5 per cent points excess of the level of tax revenues over the

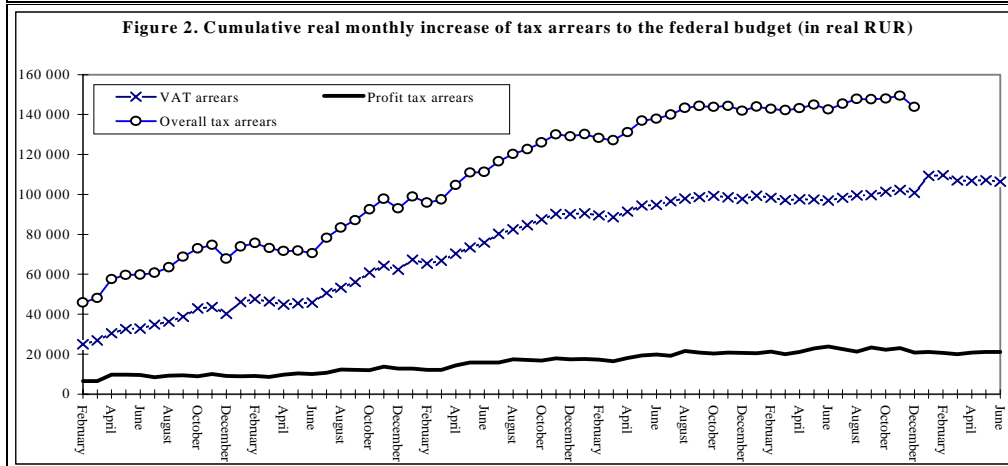
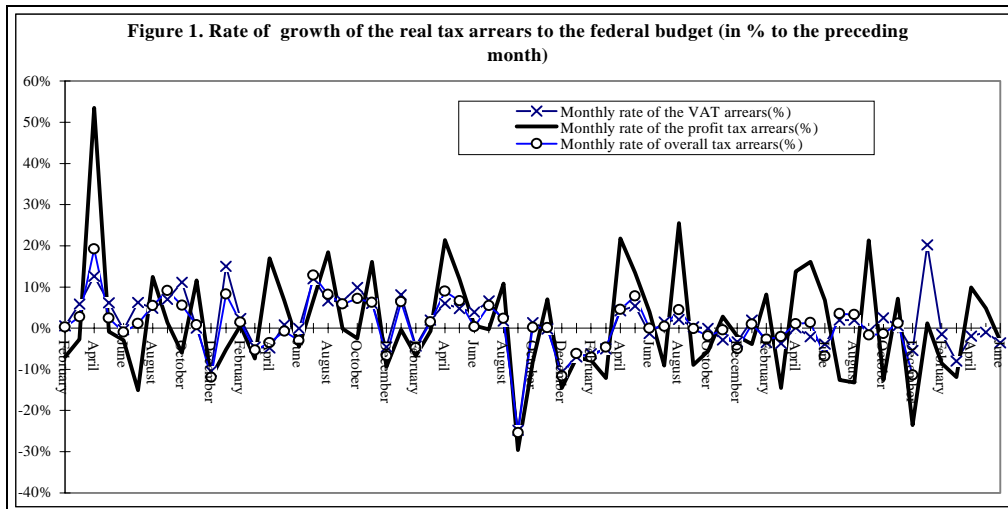
¹ Because of the estimated data on GDP, the indices may be subject to revision

respective index of 2000, which again can be attributed to the rise in collection of indirect taxes, primarily VAT and taxes on foreign trade.

The estimate of the execution of the expenditure part of the federal budget over the period concerned varies due to the methodology of the accounting of operations-

GDP), and the contraction in spending on defense (from 2.9 to 2.7% of GDP) and international activity (from 0.6 to 0.2% of GDP).

The main difference between the cash execution of expenditure and the fulfilled funding falls under such outlays as “national defense” (0.2 p.p.), “law enforcement” (0.4 p.p.), “social services to the population” (0.5 p.p.).



whether it is calculated in terms of fulfilled funding or cash execution. In the former case the volume of expenditure accounted for 14.2% of GDP, while in the latter-16.1% of GDP.

According to the official data on cash execution of the federal budget over the 1st five month of the year, one can note the growth in expenditure on servicing the public debt compared with the prior year (from 2.9% to 3.4% of

all, since early 2001 the aforementioned funds (including the moneys of the Road and Ecological Funds) grew by Rb. 2.8 bln.

The dynamics of actual tax debts to the federal budget is given in Fig. 1. Since 2001 the form of the MTC's presentation of the respective statistical data has been changed, and the debts to the federal budget by all the taxes is no longer singled out.

TABLE 3. ACTUAL TAX REVENUES TO THE FEDERAL BUDGET, ACCORDING TO THE DATA OF THE MTC (IN PRICES OF JANUARY 1998).

1999											
I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII
10067	11586	12281	12287	10524	11369	12785	12838	12514	14238	16190	21455
2000											
I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII
15030	16161	18247	20714	23469	18817	18219	18762	17422	18232	20306	25579
2001											
I	II	III	IV	V	VI						
20580	19978	22917	26959	25311	23491						

TABLE 4. THE EXECUTION OF THE CONSOLIDATED BUDGET BETWEEN 1998 THROUGH 2001 IS REPRESENTED IN TABLE 4.

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								
Taxes	22,7%	23,6%	23,9%	25,4%								
Revenues	25,9%	27,1%	27,4%	29,3%								
Expenditures	16,8%	22,8%	23,7%	24,7%								
Deficit	9,1%	4,2%	3,7%	5,4%								

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Monetary Policy

In June 2001 the CPI growth rate accounted for 1.6%. That has become the lowest value since December 2000. It was food stuffs that demonstrated the highest rise rate on – 1.9% (including a 9.3% growth rate in prices for fruits and vegetables), and services – 2.5% (including 5.1% growth rate in prices for recreation services and 4.1% – for public transport¹, while prices for housing grew by 3.1%). The non-food goods price index increased by 0.6%.

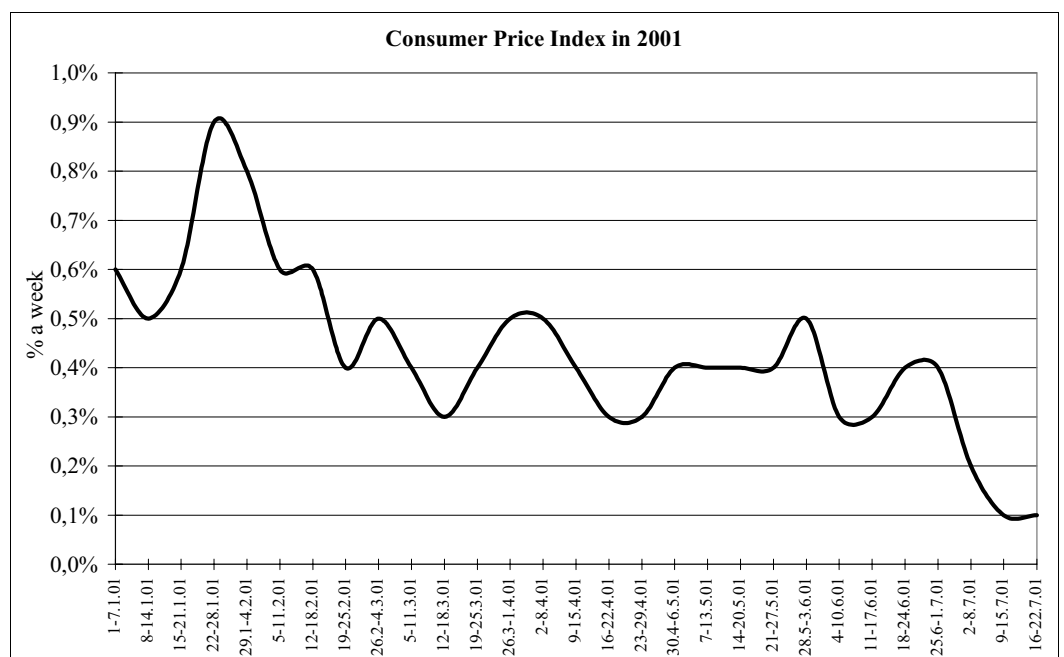
Therefore, for the first half of 2001 the inflation rate made up 12.7% (27% in annual terms). Input of single price indices was 14.1% for prices for food stuffs, 6.4% – for prices for non-food goods and 21.1% – for prices for services. It is worth noting that in 2001 the ratio between single indices was practically the same as in 2000, but inflation was higher in absolute term².

In July 2001 the consumer prices growth rates slowed down (see Fig. 1). According to preliminary estimates, in July the inflation rate did

not exceed 0.9% (11.35% in annual terms). However the level of 14%, which was set in the 2001 Federal Budget Law, will be reached as early as in July or August, and the final index for 2001 may exceed the respective value of 2000 and reach 22–24%.

In June and July 2001 the Bank of Russia proceeded with accumulation of its foreign reserves (see Fig. 2). The latter made up \$36 billion. Thus, since the beginning of 2001 the foreign reserves have grown by \$8 billion, or by

FIGURE 1.



¹ Primarily First of all, due to the increase in tariffs for passenger railway transport at 15%.

² In the first half of 2000 the inflation rate was 9.5%.

28.6%. The rate of money supply growth sped up correspondingly. In June 2001 the narrow monetary base rose by 6.0% and by 2.34% – for the first three weeks of July.

The evaluation of money supply structure ('reserve

FIGURE 2.

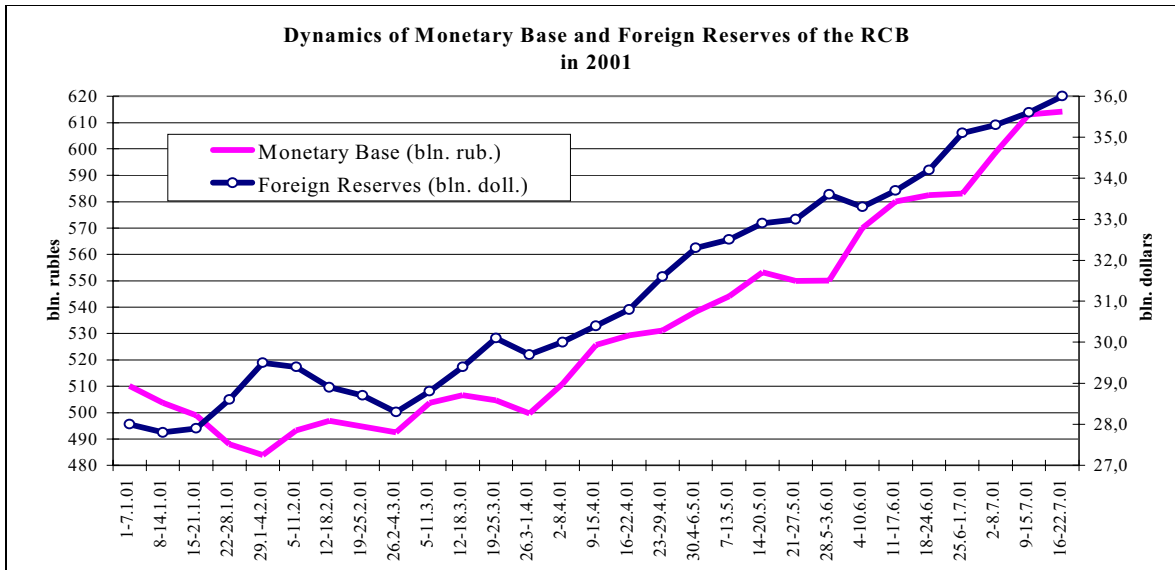
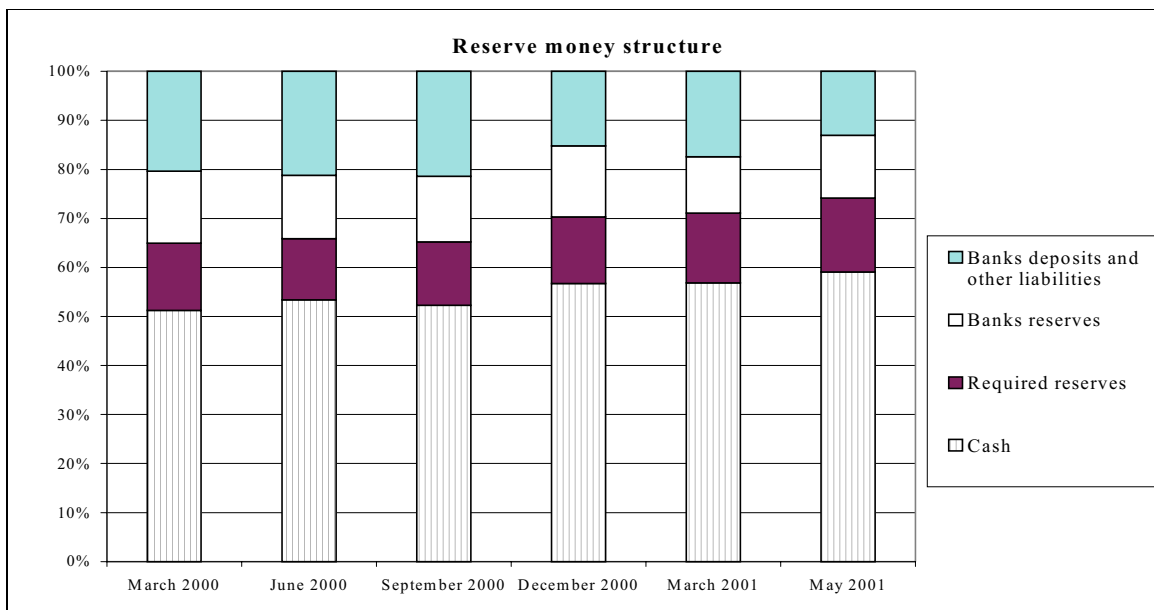


FIGURE 3.



spondent an deposit accounts of commercial banks in the Bank of Russia) reduced to 25–26% against 35% in 2000. At the same time, there was a growth in the shares of both cash and required reserves (from 51–53% to 59%, and from 12–13% to 15%, respectively). This means that the commercial banks expand their credit portfolios, thus increasing money supply in the economy. In addition, bearing in mind an accumulation of foreign reserves, we assume a higher effectiveness of sterilisation policy pursued by the monetary authorities. Among possible sterilisation tools of the Central Bank of Russia it is worth noting a more active open market operations in the GKO/OFZ market as well as the encouragement of demand for foreign currency through negative real rate on the majority of rouble-denominated financial assets.

money') in the first half of 2001 (see Fig. 3) shows that there is a tendency to overcoming the negative patterns noted in 2000. By end of May, 2001, the share of non-borrowed reserves (we consider balances on both corre-

In July 2001 the Russian Government published its medium run projections on main macroeconomic indicators (2002–2004), which will be included in the Federal Budget 2002 draft law. There are two scenarios of the Russian economy's development depending on the dynamics of international oil prices, while another important point is the assumption of the full pre-scheduled servicing and redemption of the Foreign Debt.

The first scenario ('conservative') suggests a decrease in oil prices from 24 \$/bbl (in 2002) to 17 \$/bbl in 2004. Should this be the case, the RF Government estimates real GDP growth rate at 3.5% in 2002, 2.6% in 2003 and 4% in 2004. The inflation rate in 2002–2003 is assumed to be stable within the range of 10–13%, but in 2004 it would fall to 8–10%.

The second ('favourite') scenario is based on the as-

sumption that the oil prices would be staying at the level of 22–23 \$/bbl. Therefore, the Government projects the real GDP growth rate at 4.3% in 2002, 4% in 2003 and 4.7% in 2004, while inflation would decline gradually, and in 2002–2003 it amount to 9–12%, while in 2004 – 7–9%.

Our view on these projections is that overall the following points should be emphasized. First, the Government's forecast bears no expectations (or targets) in regard to the nominal and real exchange rates. Sec-

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Financial Markets

The government securities market.

In July 2001 the market for the Russian foreign liabilities was extremely volatile (see Figs. 1 and 2). That was primarily related to external factors. The main one was the further worsening of the situation in Argentina, where the threat of default on both sovereign and municipal debt became more apparent. This provoked a capital outflow from all the emerging markets, though the macroeconomic situation in Russia and its foreign financial position have been the most successful and stable. Therefore, the fall in quotations of securities in mid-July (the Minfin bonds fell by 4–6 percentage points, eurobonds – up to 10 percentage points) was short-term, and the prices of the bonds grew by 4–6 percentage points as early as by the end of the month. Nevertheless, we

ond, the Government assumes a decline in the economy's growth rate in 2003, because of larger payments on the foreign debt, but in 2004 some acceleration is expected. However, mechanisms of the recession and acceleration are unclear; namely, the envisaged tax reforms do not impose any additional fiscal burden on the economy in 2003. On the other hand, the probable faster devaluation of rouble in 2003 may encourage a decrease in imports and a growth in the import-substituting sector.

assess the Russian securities being underestimated now, and a growth of their quotations up to the level of late-June 2001 is very likely in the near future.

In July, the prices of domestic debt securities fell slightly, and the average-weighted yield to maturity rose from 16–16.5% to 17.5–18% per annum. The real yield to maturity on GKO/OFZ remains negative, and the demand for these securities is very limited. On latest auctions on placement of new bonds (June 27, July 11 and 25) the RF Ministry of Finance was compelled to accept a premium to the yield in the secondary market, but it was only the placements of short-term (four- or five-month) GKO that were rather successful, while merely one fourth of the total issue of three-year OFZ was placed.

FIGURE 1.

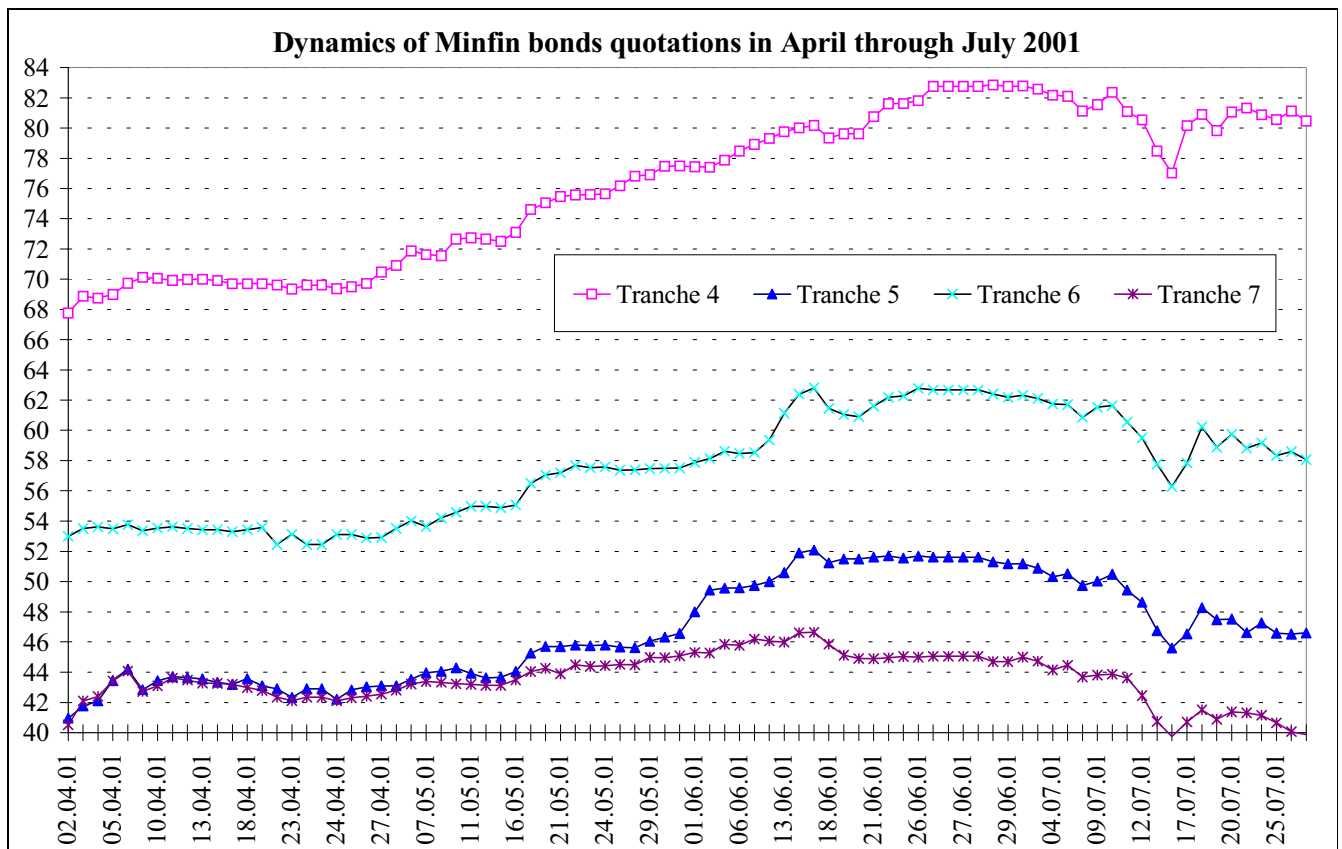


FIGURE 2.

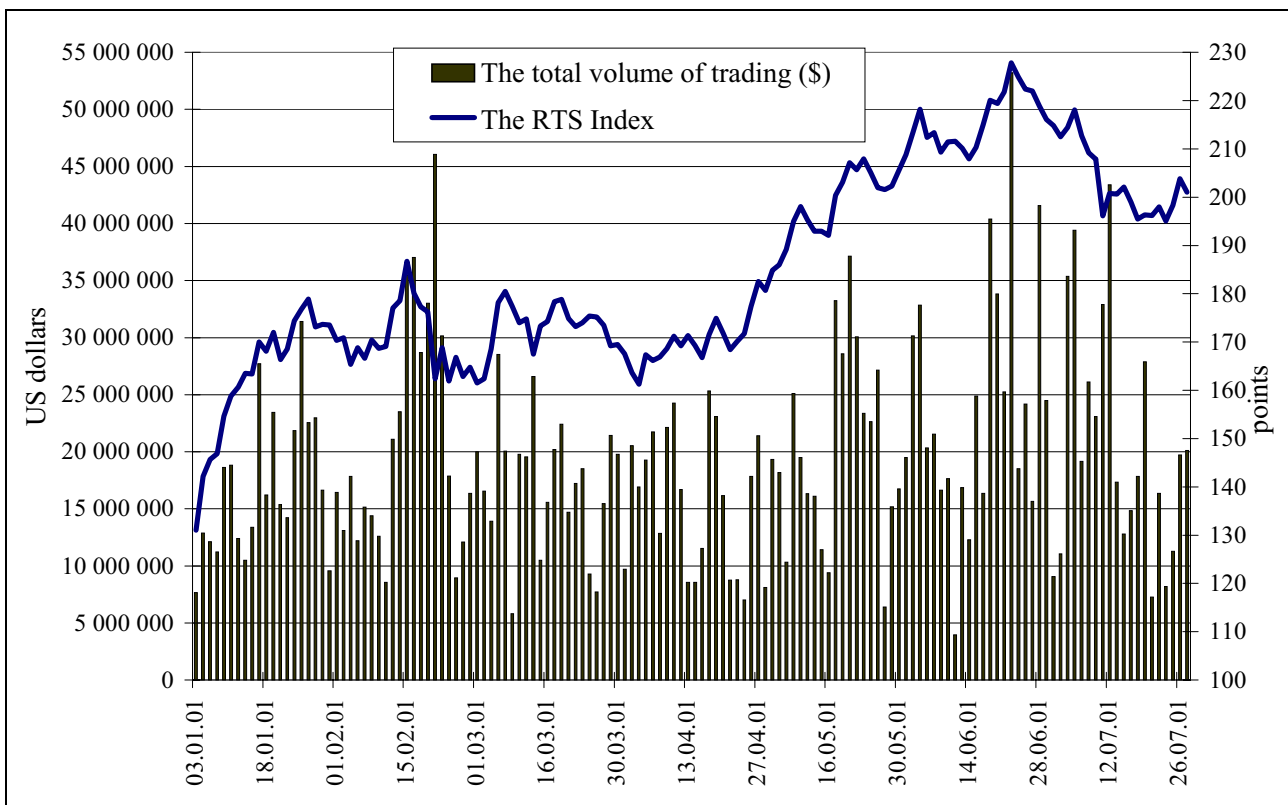


Stock market.

In July 2001 the growth in the Russian stock market, which started in spring 2001, stopped, and the quotations fell. The change in the pattern was caused mainly by

unfavourable external factors, such as the downfall in oil prices and the unstable situation in the financial markets both in the USA and some developing countries.

FIGURE 3.



For the month (29.06.01–27.07.01) the RTS Index slid by 15.06 points (6.97%), the total trade volume totalled more than \$413 ml., the average daily turnover exceeded \$20 ml. The RTS Index declined during the first three weeks of July (by 1.56%, 5.69% and 2.2% correspondingly, while the trade volume amounted to the maximum value – \$142 ml. on the second week). The quotations grew over the last week only (by 2.47%), with

the average daily trade volume accounted for \$15 ml. (–6.11% compared to the prior week).

In July the prices for all Russian *blue chips* fell, but the price change was not uniform. It was common stocks of ‘Rostelecom’ (-17.7%) and ‘Mosenergo’ (-14.5%) the quotations of which dropped most significantly among blue chips. At the same time, quotations of other blue chips declined slightly: RAO ‘UES Russia’ (-0.3%), ‘Aeroflot’ (-0.5%).

FIGURE 4.

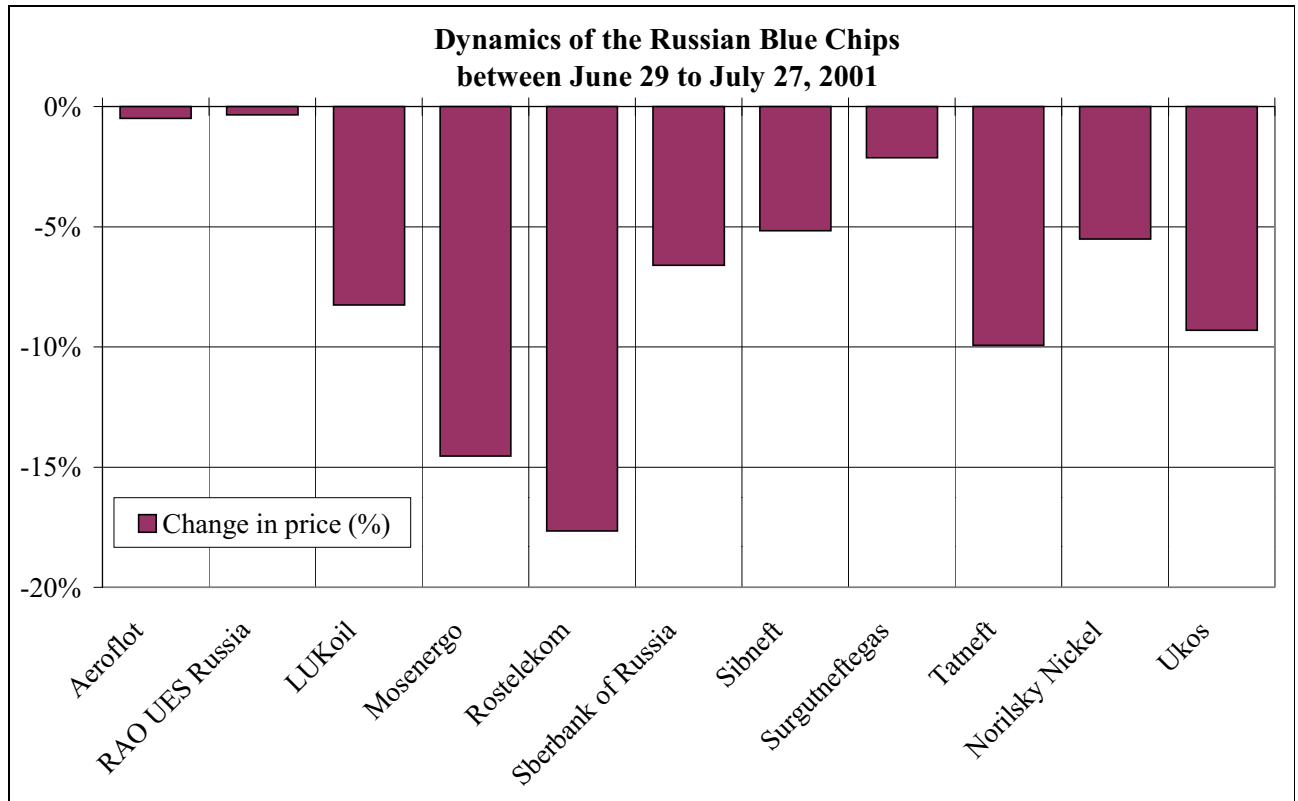
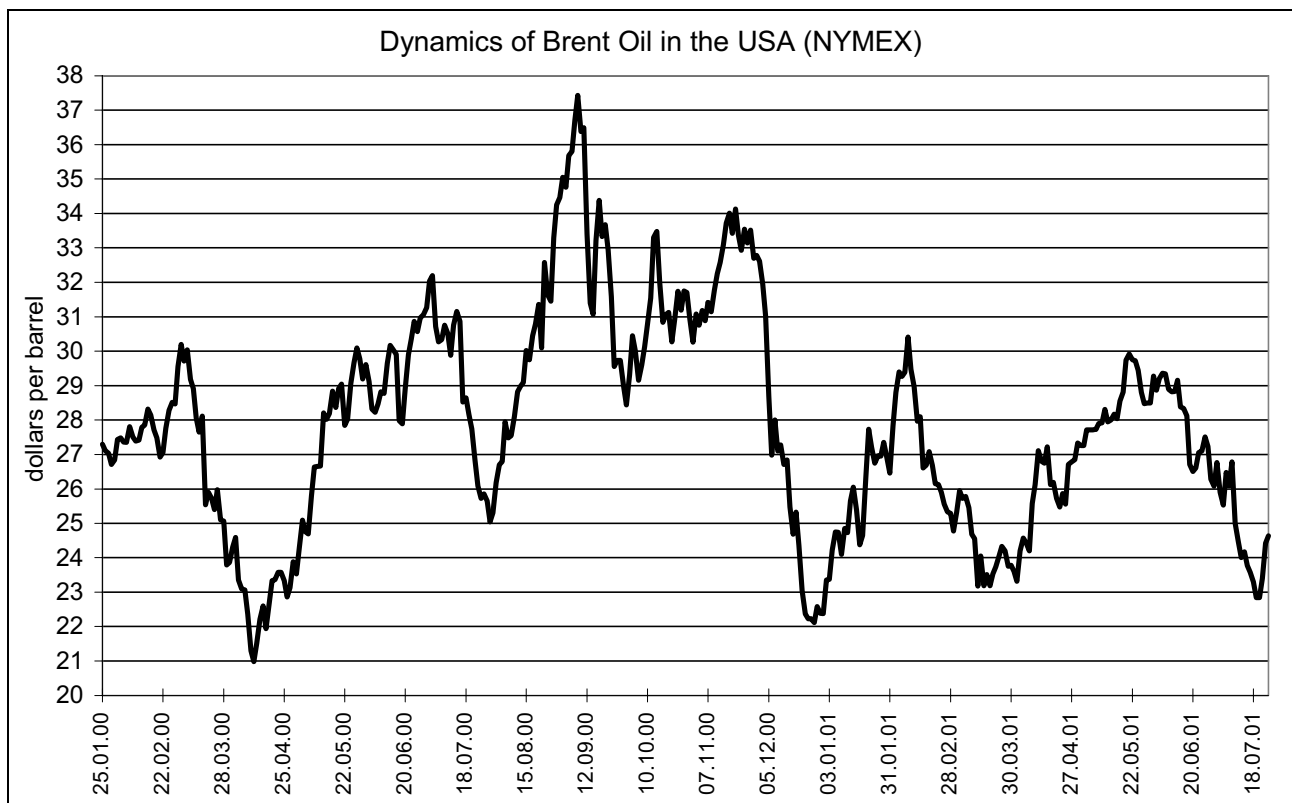


FIGURE 5.



The share of common stocks of RAO 'UES Russia' in the total trade volume in the RTS was 28.8% (27.0% in June), the share of 'YUKOS' – 23.3% (13.1%), 'LUKoil' stocks – 12.4% (17.7%), 'Norilsky Nickel' – 8.5% (15.1%). 'Surgutneftegaz' – 8.1% (7.3%), Thus, in July the total share of the five most liquid stocks in the RTS was 81.2% (in June – 80.2%).

According to the Merrill Lynch's estimate of the Russian stock market, it was the second among the most successful in the world in the second quarter of 2001 (it was the Turkish one that was the first). Thus, the Russian stock market entered the top-three markets for the second time running.

The recognition of economic growth and the growing political stability in the country manifested themselves in the increase in the RF's international credit rating. After the S&P raised the long-term and short-term sovereign credit ratings from 'B-' to 'B' and from 'C' to 'B', correspondingly, in late-June, on July 17 Fitch IBCA decided on shifting the Russian long-term foreign currency rating and the eurobonds rating (which are 'B' now) to the advancement list.

Among *political news* in July, we would like to highlight the following ones.

The State Duma passed in the last reading the chapter of the Tax Code on profit tax that suggests the reduction in the tax rate from 35% to 24%. This bill (after approving by the Federation Council and signing by the President) will come into force on the 1st of January, 2002 (see details in the section *Tax policy*).

The Land Code passed the second reading. The third reading is scheduled after the Duma's summer recess.

The Federation Council approved the Law on the decline in the rate of required sale of export receipts from 75% to 50% and the law package on taxation of oil and gas industry.

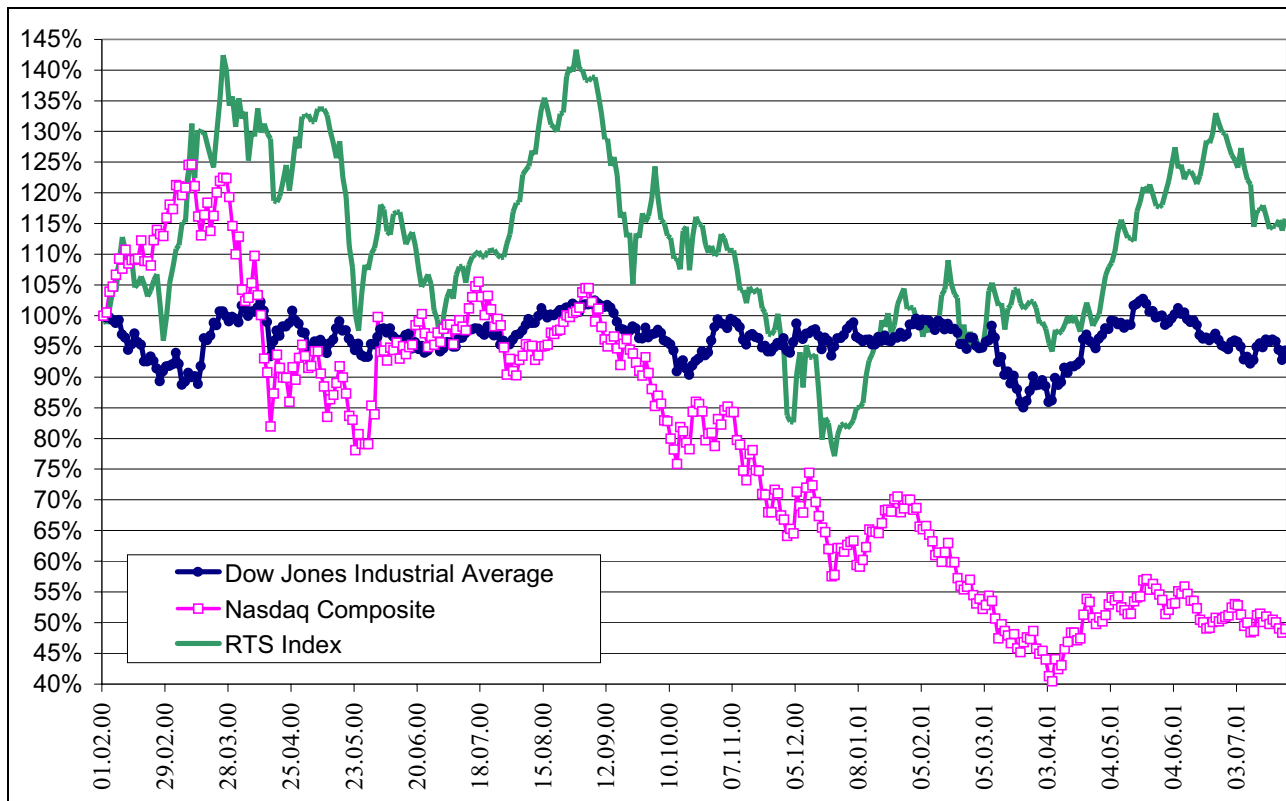
The *external factors*, which influence the Russian market were the follows. Iraq renewed its oil supplies (about 2 million barrels per day). On July 10, the American Petroleum Institute reported the increase in the crude oil reserves at 18 million barrels and petrol reserves at 13 million barrels. The recession in the world economy contributed to a decline in the demand for energy resources.

The latter led to the drop in oil prices to 22.84 \$/bbl on July 19. However, after the OPEC announced a new reduction in oil delivery at one million barrels per day effective as of the 1st September, the oil prices rose once again and by July 25 reached 24.64 \$/bbl.

The unstable situation in the financial markets of Argentina and Turkey induced a decline in the confidence in all emerging markets and the capital outflow from the markets to developed countries.

The continuous uncertainty in regard to the future of the US economy also hindered investors' activity in the stock market. On July 10, the main US stock indices fell to the minimum values since mid-April: NASDAQ dropped to 1962.79, and the DJIA – to 10175.64.

FIGURE 6.



Corporate news.

The Task Force on liberalisation of the market for Gazprom shares, which was organised in April 2001, finished its work and is preparing its report to the President.

The forthcoming liberalisation of the gas industry, elimination of restrictions on the access to the Gazprom transport system encouraged the interest in gas extraction on the part of the biggest oil companies. LUKoil declared its intention to acquire a stock of shares in Yamalneftegazdobycha and to invest in development of oil and gas fields in Yamal-Nenetsk autonomous district up to one billion dollars over five years. This deal is the first attempt of acquisition and development of gas fields by a big Russian oil company. Recently, LUKoil has announced its plans on participation in development of oil and gas fields in Uzbekistan. However the development of gas fields is its primary objective. YUKOS also advertised its plans on the increase in gas extraction up to 20–30 billion cubic meters by 2005.

The conflict between Gazprom and the Moscow Stock Exchange made the trades on Gazprom shares (80% of shares circulating in the domestic market and registered in the Gazprombank depository) move to the stock exchange in Saint-Petersburg. The trades on the MSE continue only with the shares that are registered in the Depository and Settlement Union.

On June 29, the annual meeting of Sibneft shareholders took place. Shareholders decided on cancellation of 12.23 billion common stocks, which had been recorded in the corporation's Charter and amounted three times more than the number of placed shares. Two representatives of minor shareholders entered the Board of Directors. In addition,

amendments to the Charter aimed at protection of minor shareholders interests, were approved. Thus, the results of the meeting showed intention of company's managers to bring the corporation management into line with international standards. The market reacted positively to these changes, and Sibneft's shares grew by 4.5%.

The news (on July 12) about the forthcoming purchase of Sibneft by Surgutneftegaz induced an 14.6% rise in prices of Sibneft share. However the both companies rejected the information during the day.

LUKoil stocks were badly affected by the information on the regular delay with the publication of company's financial results in US GAAP format. The LUKoil Board decided on selling 2.2% of shares by the means of open subscription, which started since July 20, 2001. Placement will take place at a market price plus 15 cents.

On July 4, Gazprom published financial reports drafted in compliance with international accounting standards. According to the report, the net profit amounted to \$286.15 billion roubles (\$10.17 billion.). However the major part of the profit is accounted for temporary non-cash items, which have nothing to do with the company's real activity.

On July 10 Aeroflot announced that its net profit in 2000 (in compliance with international accounting standards) made up \$8.6 million.

On July 19 YUKOS published results of the first quarter of 2001 (in compliance with US GAAP). Net receipts amounted to \$1.9 billion, while the net profit – \$596 million.

Tyumenaviatrans advertised the first flight from international terminal of Surgut airport. The opening of the international terminal should bring a wider range of chances to develop company's international activity.

TABLE 1. DYNAMICS OF THE FOREIGN STOCK INDEXES

as of July 25, 2001	Value	change for last week (%)	change for last month (%)
RTS (Russia)	198.35	-11.83%	51.39%
Dow Jones Industrial Average (USA)	10405.67	-0.94%	-2.26%
Nasdaq Composite (USA)	1984.32	-3.24%	-13.42%
S&P 500 (USA)	1190.49	-2.31%	-7.23%
FTSE 100 (UK)	5275.7	-6.82%	-14.56%
DAX-30 (Germany)	5582.76	-5.41%	-11.24%
CAC-40 (France)	4773.17	-8.45%	-17.69%
Swiss Market (Switzerland)	6667.3	-6.94%	-17.88%
Nikkei-225 (Japan)	11891.61	-7.79%	-13.15%
Bovespa (Brazil)	13956	-4.02%	-9.52%
IPC (Mexico)	6411.53	-2.30%	15.38%
IPSA (Chile)	109.28	0.64%	9.96%
Straits Times (Singapore)	1632.51	-4.40%	-15.01%
Seoul Composite (South Korea)	526.08	-12.03%	0.98%
ISE National-100 (Turkey)	9535.23	-11.76%	0.72%

Interbank credit market.

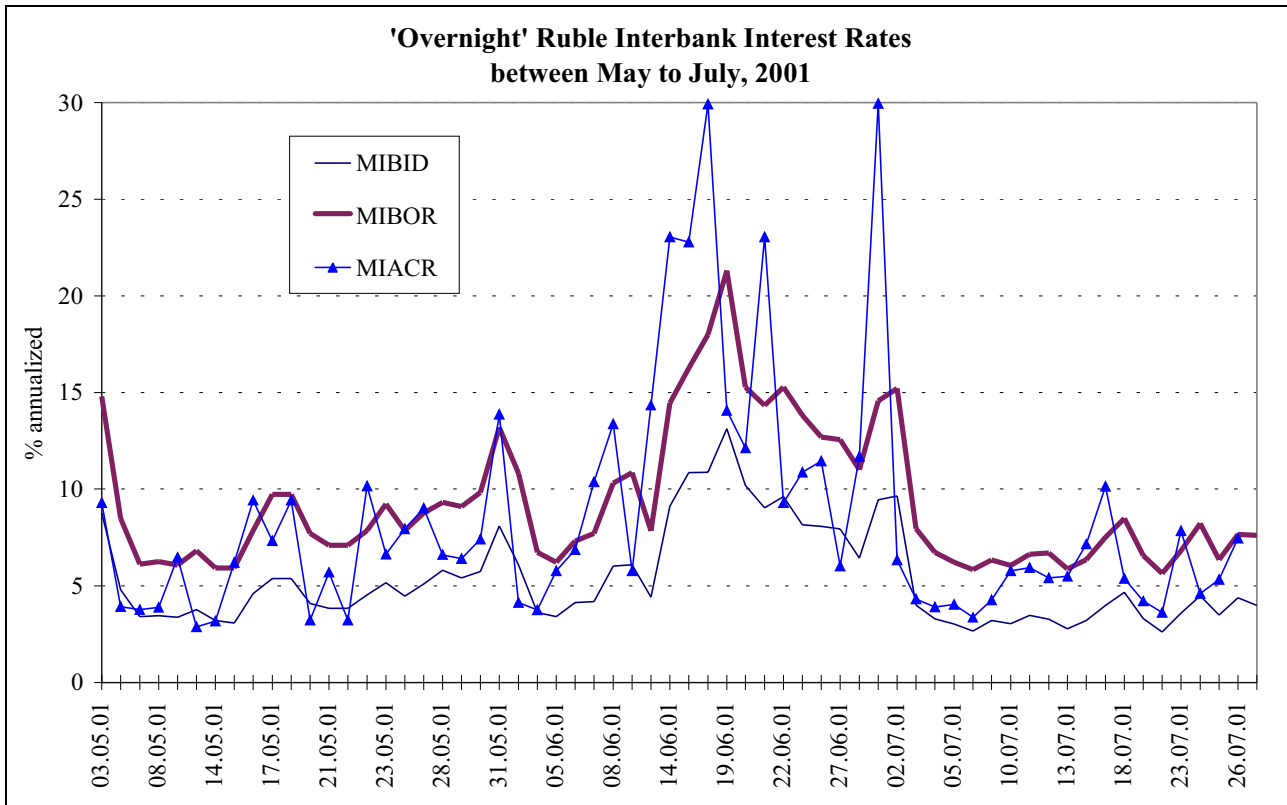
The dynamics of interest rates in the market for rouble interbank credits in June and July 2001 could be clearly divided into two periods, which coincide with calendar months (see Fig. 7). In June, the rates on credits rose up

to 30% per annum, and that was related to a decline in non-borrowed reserves of commercial banks. During the substantial part of the month the balances on correspondent accounts of commercial banks in the Bank of Russia did not exceed 70 billion roubles. That roughly

was one fourth less than the level of end of May or early-June (from 95 billion roubles).

In July 2001 non-borrowed reserves increased (up to 75–85 billion roubles), and interest rates fell to the level of 5–7% per annum once again.

FIGURE 7.

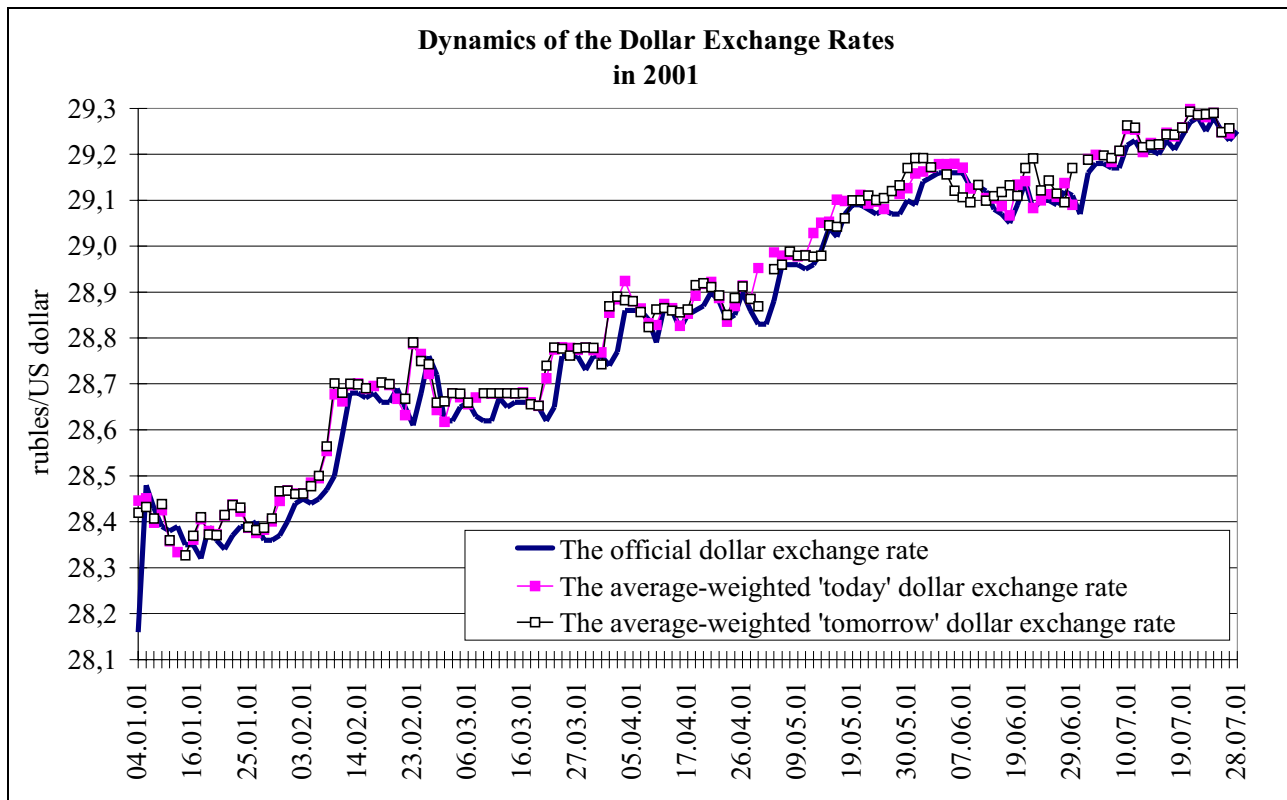


Foreign exchange market.

In July 2001 the dollar exchange rate rose once again. In our view, the main factors contributing to the rouble devaluation over the month were the increase in liquidity in the banking sector (balances on correspondent accounts

of commercial banks in the Bank of Russia) and the active Central Bank's policy aimed at accumulation of its foreign reserves. In addition, one should take into account expectations of changes in exchange rate and informa-

FIGURE 8.



tion effects: namely, in July the RF State Duma passed the decision on the decline in the rate of export receipts sale from 75% to 50%. In our view, this measure would not have any serious impact on exchange rate dynamics, since presently the actual share of export receipts sold on exchanges does not exceed 50%, and under current oil

prices the supply of foreign exchange outperforms the demand (minus demand on the part of the monetary authorities). Nevertheless, in the short run the information is likely to induce an attempt of speculations on exchange rate. Thus, in July the Bank of Russia intervened to smooth the exchange rate dynamics.

FIGURE 9.

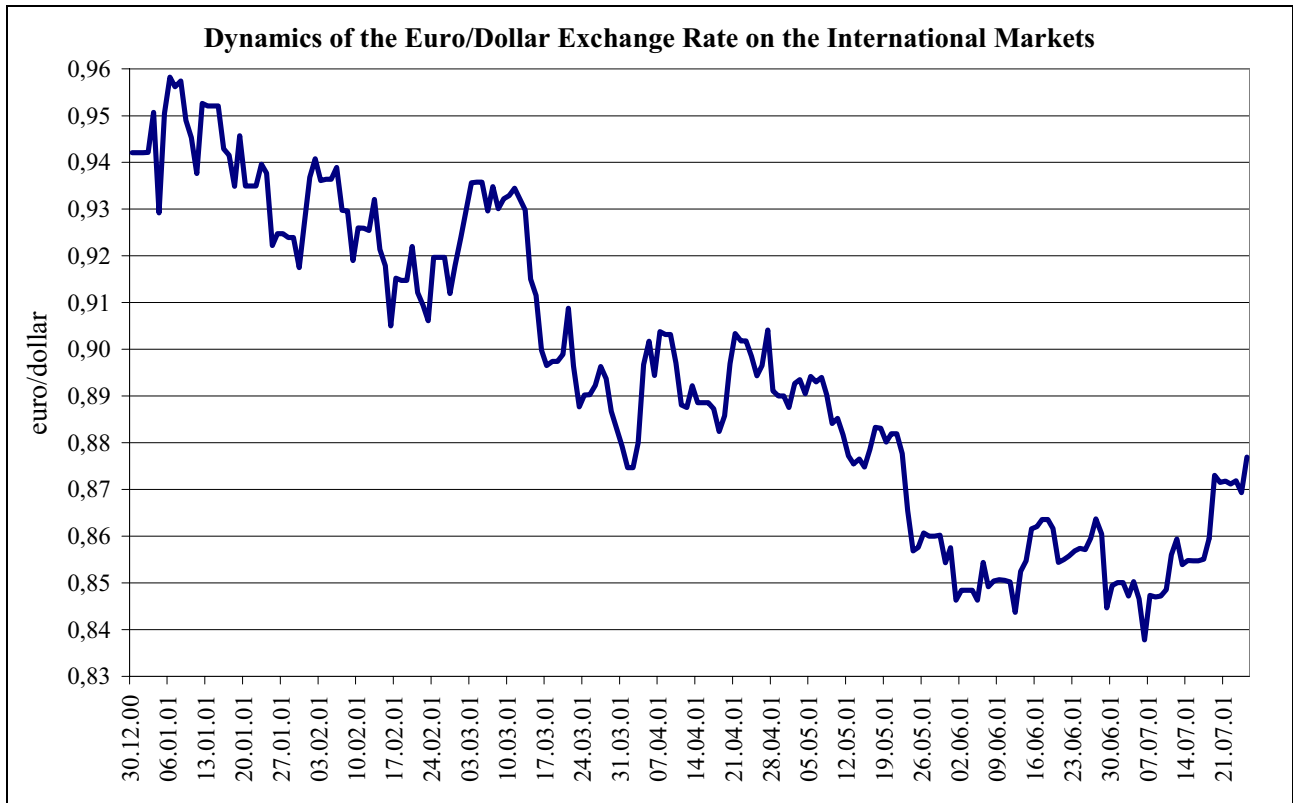
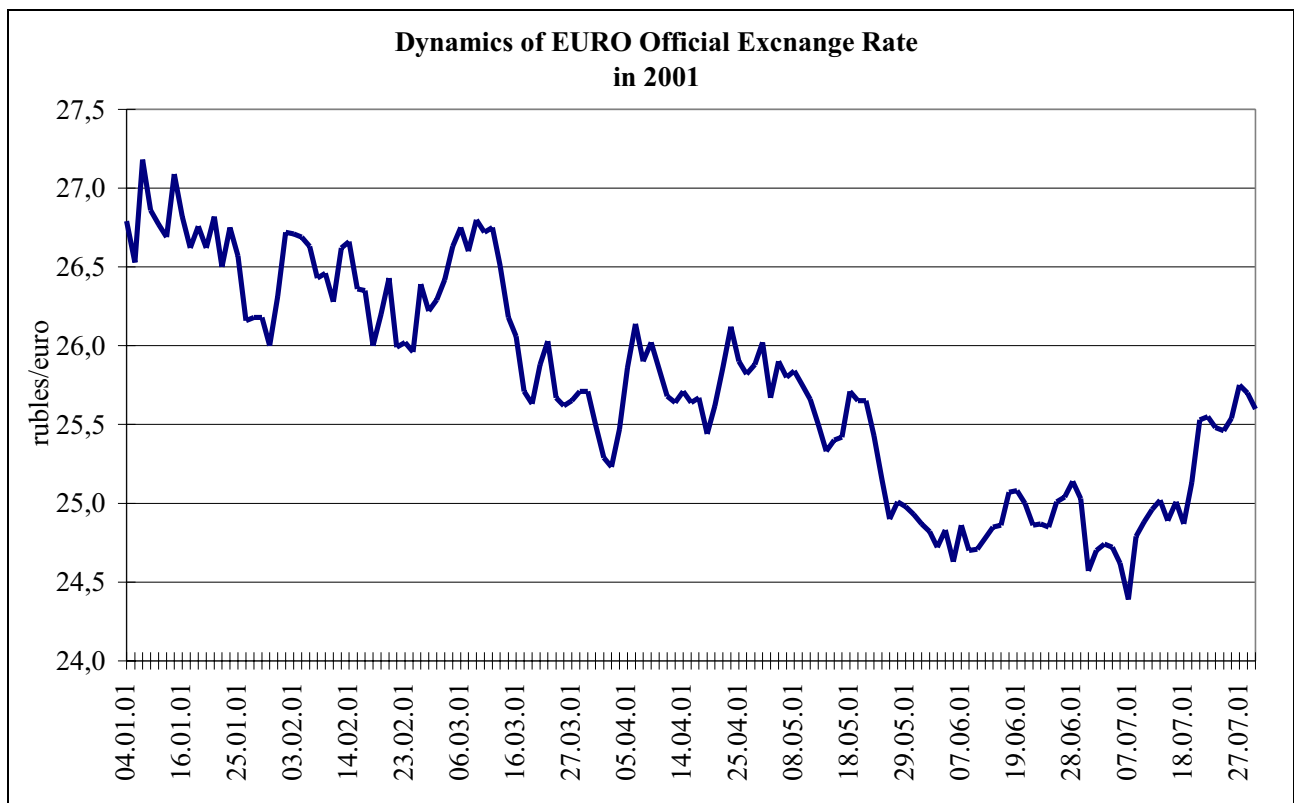


FIGURE 10.



In July 2001, the official dollar exchange rate grew from 29.07 rubles/\$ to 29.27 rubles/\$, i.e. by 0.69% (8.58% annualised, see Fig. 8). The 'today' dollar exchange rate

in the SELT grew from 29.1125 rubles/\$ to 29.2450 rubles/\$ (as of July 26), i.e. by 0.46%. The 'tomorrow' dollar exchange rate grew from 29.1505 rubles/\$ to 29.2567

rubles/\$ (as of July 26), i.e. by 0.36%. In July the trading volumes by dollar in the SELT remains at the June's level and amounted to about 150 billion and 157.5 billion roubles, respectively.

In July 2001 the bearish tendency in the 'euro/dollar' exchange rate was broken (see Fig. 9). Between July 6 and July 25 the 'euro/dollar' exchange rate grew by 4.67%, from 0.8378 to 0.8769 \$/euro. Therefore, the euro exchange rate came back to the level of mid-May 2001. The main factors contributing to the strengthening of the European currency were the crisis in Argentina, whose

economy is linked to the US dollar (in particular, the national currency, peso, is fixed against US dollar under currency board regime) as well as rather positive results of economic performance in the EC countries in May 2001 compared to the USA.

Following the increase in euro exchange rate in the world foreign exchange market, in July the rouble/euro official exchange rate decreased from 24.57 roubles/euro to 25.6 roubles/euro, i.e. by 4.19% (see Fig. 10). According to preliminary estimations, in July 2001, the total trading volume on euro in the SELT made up about 3.5 billion roubles contrary 3.79 billion roubles in June.

TABLE 2. INDICATORS OF FINANCIAL MARKETS.

	March	April	May	June	July*
inflation rate (monthly)	1.9%	1.8%	1.8%	1.6%	0.9%
annualised inflation rate by the month's tendency	25.34%	23.87%	23.87%	20.98%	11.35%
the RCB refinancing rate	25%	25%	25%	25%	25%
annualized yield to maturity on OFZ issues	20.38%	16.33%	17.11%	17.03%	17.4%
volume of trading in the secondary GKO-OFZ market a month (billion roubles)	10.83	15.14	7.98	7.92	11.0
yield to maturity on Minfin bonds by the end of the month (% a year):					
4th tranche	25.39%	22.12%	17.37%	13.91%	16.2%
5th tranche	18.37%	17.55%	16.34%	14.59%	16.6%
6th tranche	17.58%	17.71%	15.88%	14.01%	16.0%
7th tranche	14.52%	13.83%	13.09%	13.26%	15.0%
8th tranche	17.84%	17.57%	15.71%	13.93%	15.1%
INSTAR – MIACR rate (annual %) on interbank loans by the end of the month:					
overnight	15.20%	24.50%	13.87%	29.95%	7.5%
1 week	11.65%	28.06%	8.52%	29.49%	12%
official exchange rate of ruble per US dollar by the end of the month	28.74	28.83	29.09	29.07	29.27
official exchange rate of ruble per Euro by the end of the month	25.29	25.67	24.87	24.57	25.6
average annualized exchange rate of ruble per US dollar growth	0.07%	0.31%	0.90%	-0.07%	0.69%
average annualized exchange rate of ruble per euro growth	-3.55%	1.50%	-3.12%	-1.21%	4.19%
volume of trading at the stock market in the RTS for the month (millions of USD)	363.5	329.1	405.7	490.4	430
the value of the RTS Index by the end of the month	169.46	180.68	208.80	216.11	200
growth in the RTS Index (% a month)	2.85%	6.62%	15.56%	3.50%	-4.2%

* Estimates

O. Izryadnova.

The real sector: factors and trends

According to the preliminary results of the first half 2001, the increment in GDP accounted for 5.4% relative to its respective period of the prior year. The positive dynamics of the development of the basic industry branches of the real sector, along with a favorable situation in foreign markets for Russian exports have determined the nature of structural shifts in GDP. In the second quarter 2001 the acceleration of growth rates was noted practically across all the sectors and industries of the national economy: the increment in industrial output accounted for 5.5% vs. the first half 2000, while the increment in the construction sector made up 6.4%. The growth in output of goods was taking place against the background of

an intensive increase in output in the sectors centered on the domestic market. When compared with the 1st half 2000, the increment in output in the machine engineering accounted for 10.5%, in the food sector- 6.7%, and in the light industry - 5.2%. As concerns the sector for services, it was trade and communication that demonstrated an intense growth there.

This year, the national economy retains the trend to the advanced growth in domestic demand vs. external one. The increment in the former in the first half 2001 relative to its respective period of the prior year accounted for 9.3% and fully determined economic growth this year. Given that exports grew by as much as 4.8%, according-

ly, the proportion of net exports in the structure of GDP dropped from 19.0% in the first quarter to 14.1% in the second quarter. With the current price situation in the markets for minerals and raw materials, it is the processes of the fall in the domestic products' competitiveness caused by the gradual appreciation of the Rb. that have a substantial impact on the dynamics of net exports. During the first half 2001 import grew by 17.9%, an its proportion in the overall volume of resources to be used in the domestic market rose roughly by 3.4 per cent points compared with the respective period of the prior year. The advance growth in imports compared with the domestic output appears the factor inhibiting the output of goods of final demand.

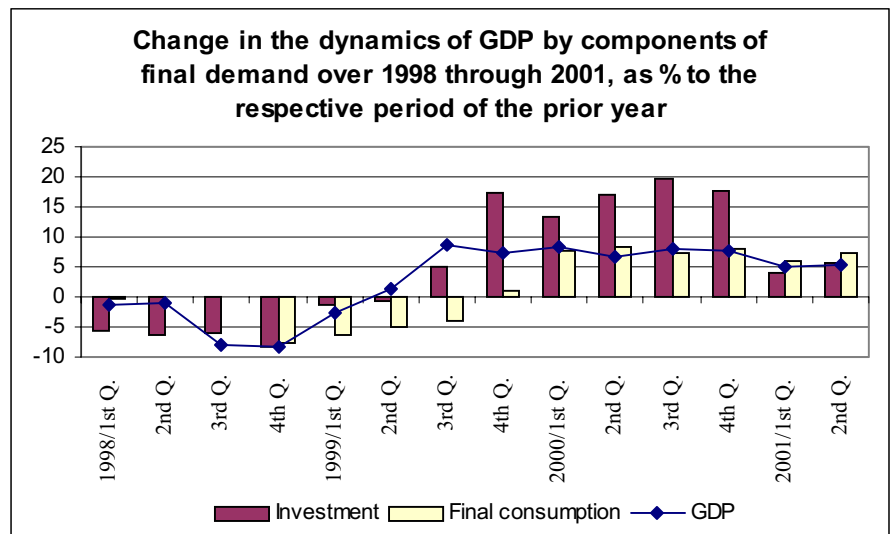
Whilst in 2000 economic growth was determined by an intense increase in investment, this year the structure of final demand experiences changes under the impact of the households' final demand. According to preliminary estimates, the noted index grew roughly by 9.9% vs. the first half 2000, provided that the growth rate in investment in capital assets accounted for 4.2%

It should be noted that the growth in the noted indicator takes place against the backdrop of the growing inflation and the slowdown in the growth rate in the population's growth rate. Overall, in the first half 2001 consumer prices grew by 12.8% vs. 9.5% noted in the respective period of the prior year. In June the inflation rate showed some slowdown: consumer prices grew just by 1.6% vs. 1.8% in May this year.

In contrast to 2000, in the first half 2001 the population's real income showed a considerably slower growth rate (104.4%) than the retail trade turnover (110.0%). The intense growth in retail trade was accompanied by the shifts in the structure of the population's demand: practically all the rise in the goods turnover was ensured by the growth in sales of non-food goods. When compared with the first half 2000, the increment in sales of non-food goods accounted for 12.8%, while the one in food stuffs made up 6.9%. The change in the consumers' behavior was determined by the lowering relative prices for non-food goods compared to food stuffs: between January to June the prices for food stuffs grew by 14.1%, while for non-food goods- by 6.4%. When compared with the period between January to June 2000, the proportion of savings in the population's spending fell by 1.3 per cent points. In such a situation, the renewal of consumer demand can be considered to be the factor compensating

for the slowdown in the growth rate in gross accumulation in capital assets.

The investment sphere also demonstrated new processes. Given that in 2000 the growth in investments was accompanied by a substantial increase in the production profitability rate, this year the fall in the profitability rate



is accompanied by the convergence of sectors by this indicator. The proportion of gross profit in GDP fell by 1 per cent point compared to the first quarter 2000. In the export-oriented sector, the reduction in the profit rates is related to the growth in proportional costs caused by the rising tariffs for energy sources as well as the Rb. appreciation. At the same time with a steadily low profit rate in the majority of processing industries, there has not been any emerging trend to contraction in funds on enterprises' accounts, which allows optimistic estimates of this particular sector.

The maintenance of positive dynamics of investment is determined by diversification of directions of activities. The specifics of investment process this year is a slower growth rate in construction services compared with the dynamics of costs for machinery and equipment. The investments in machinery and equipment support the demand for the output of domestic machine engineering and the related sectors. At the same time the enterprises' lowering incomes lead to fairly moderate estimates of the investment activity level in the economy through the end of the year. The prospects for further growth are attributed to a growth in the population's income as well as the rise in profits of enterprises of the manufacturing sector. As well, one of the crucial conditions for the continuation of the growth is the maintenance of the balance between demand and offer under the ongoing process of a large-scale foreign exchange inflow and the inflationary threats.

IET monthly trend survey: July 2001

The first results of July testify to the ongoing unstable situation in the national industrial sector. The discontinuation of effective demand along with the growth in excessive stocks make the prospects of further growth doubtful, though both enterprises and the government still hope for that.

In July, the dynamics of demand variables did not experience changes compared with June, which means

products bought did not change in July and accounted (similar to June) for 75-76%.

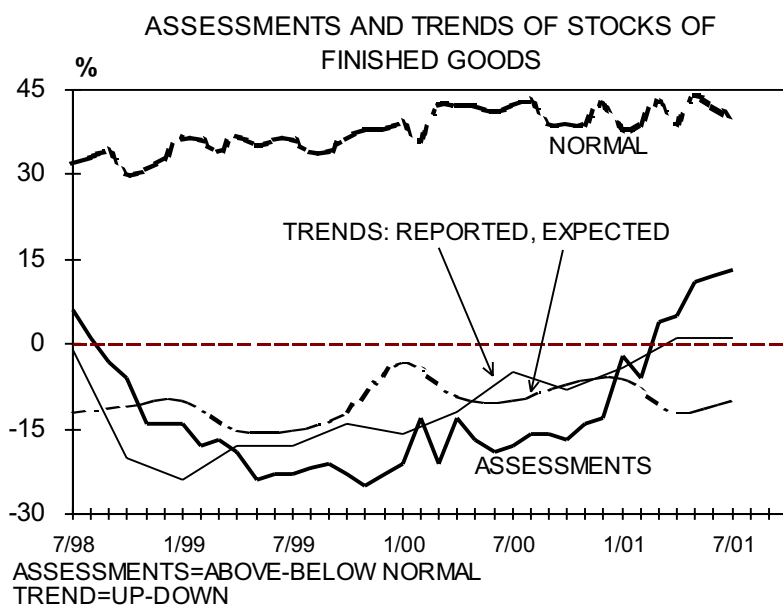
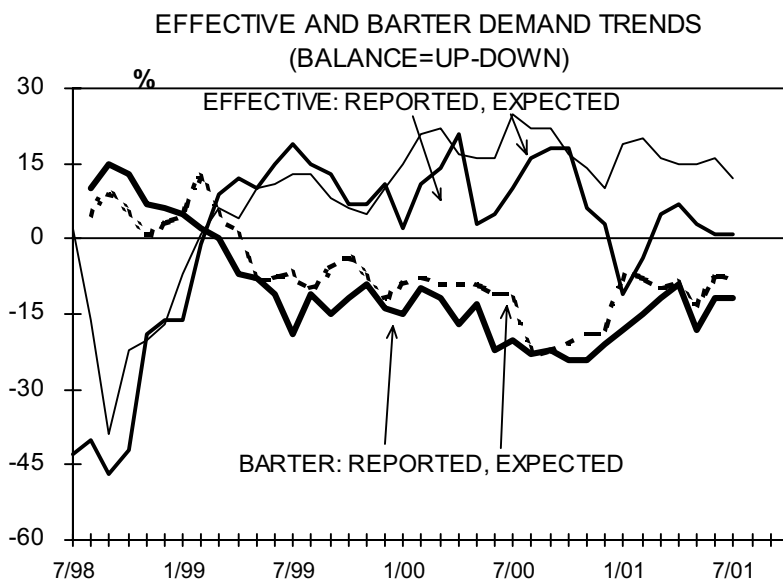
Despite the discontinuation of the growth in effective demand, the enterprises still prefer to contract their volumes of non-monetary deals. Similar to June, the number of reports on decline of barter, promissory note and off-set transactions proved to be bigger than the number of reports on their growth. Such a situation is

noted in all the sectors, but the industry of construction materials which showed a slight growth in barter in July. However, the enterprises began to change their attitude towards non-monetary transactions: given that while estimating the volume of barter in the industrial sector, until January the responses "above" norm would prevail steadily, the respective balance has become zero since April 2001. The volumes of promissory note and off-set deals considered insufficient since April 2000 (the start of the monitoring of the index), while in July 2001 the insufficiency in terms of the volume of such deals reached its maximum value. It is only metallurgical plants that consider their volumes insufficient.

The problems with sales have led to the growth in the volume of stocks of finished produce. For the second quarter running the reports on the growth in the index prevailed in the industrial sector. So far, the prevalence is not serious and it would be more correct to state the discontinuation of the decrease in the volume of stocks of finished produce. However, the alarming sign is that there has not been a balance of responses (up-down) for five years, with such a balance registered in 1996. Meanwhile, an absolute growth in the stock of finished goods was reported by the ferrous metallurgy, chemicals, and machine building. The enterprise's estimates of their stocks of finished produce appeared yet more alarming: the excessive stock of finished goods has been registered for the fifth month running, which has not been noted since summer 1998. At the time the enterprises also reported the excess for 5 months, but it was the default in August 1998

that allowed the national producers to get rid of excessive stocks within a few weeks.

In July the intensity in growth in output rose by another several points and reached the level registered in February 2001. The contraction in the output was registered only in the sector for electric power, metallurgy, light and food



that for the second month running enterprises report the discontinuation of the growth in monetary sales across the industrial sector on the whole. On the sectoral level, the absolute decline in monetary sales continues in the ferrous metallurgy, forestry, wood-working, light and food sectors, and it appeared in the sector for electric power. As a result, the proportion of monetary settlements for

industries. In 2001, the loading rate of production capacities roughly accounted for 55%.

The forecasts of the change in effective demand dropped by 4 points in July and became the worst values over 2001. Nonetheless, the growth in sales is expected in all the sectors except the one for electric power. The forecasts of barter, promissory note and off-set operations remained unchanged. On the whole enterprises expect the slowest decline in barter for the last two years and practically a full stop of the decline in the volume of promissory note and off-set deals. The growth in barter may become possible only in the food sector, while the rise in promissory notes and off-sets - in the metallurgy, light and food sectors.

V. Tsymbal, E. Luboshits, E. Khrustalev

The economic aspects and concepts for the transition to professional Armed Forces in Russia

Recent years and even the first four months of 2001 proved that detente had not become a global process, while the development of ways and means of military struggle continued. According to the concept for prevention and restricting a possible aggression, different branches of armed forces permanently are on guard, while military actions and special operations of different structures of the military organization in Chechnya. The national troops also participate in peace-making missions arranged by international organizations.

In such conditions an effective resolution of military tasks requires the relevant skills which can be mastered by pros only. That is why it is the problem of the transition of the national military organization towards professional one, which is one of the most urgent problems in the area of the military reform in modern Russia.

Below, there are brief findings of the economic analysis of some options for reforming the system of the manning of the military organization in RF.

There are three variants considered to be most popular:

1. The postponement of the transition towards professional army over 2004;
2. An immediate refusal from any conscription starting from 2002; and
3. Specially selected military and economic characteristics of a new in principle mixed manning of the military organization.

The third variant put forward by experts of IET somewhat a year ago provides a retaining of the principle of mixed stuffing, however, in a substantially modified form. The regular armed forces and Navy that provide for the country's military security should be manned only on the professional grounds; at the same time the conscription whose length should make up 6 to 8 months would be used only to train the military reserve, including for the purpose of manning the regular army with professionals who voluntarily opted for the military career. Naturally,

The forecasts of changes in output improved for the second month running. The balance in July became the best over the last five months. The growth in output is forecasted by all the industries except the food sector, with the most optimistic expectations registered in the construction sector, electric power, metallurgy and machine building. After the decline in the forecasts of the change in employment registered for three quarters, they improved in July: it is only the ferrous metallurgy, chemicals, petrochemicals and construction sector that may experience downsizing within the forthcoming months, though an excessive (due to the envisaged growing demand) employment was also registered in the sector for electric power, forestry, wood-working, and paper and pulp sector.

the transition to the professional army, along with economic constraints to be imposed on military expenditure would require considerable "downsizing" in the military organization, and such a decision has been already made.

The practical problem (which is, in a sense a research one) is the selection of a sound program for the transition from one system of manning to another, given that such a program should be implemented with a certain schedule of contraction in the overall number of military personnel.

To compare variants in terms of economic indices and optimization of the program of transition to the new principle of manning, the experts of IET accomplished the respective calculations of military expenditure. At the same time the experts considered additional payments due to privates and junior officers that are on the military service under contracts and those who should complete their service under the current conscription terms (2 years) until 2003.

The results were as follows:

Variant 1 requires minimal expenses, however it does not solve the problem of transition to professional army.

Variant 2 requires maximal expenditure and does not solve the problem of training the mobilization reserve of the required quantity.

Variant 3 (the proposed one), though requiring an insignificant increase in expenditure compared with Variant 1, ensures the solution of the both problems of the military build-up. Furthermore, it ensures the possibility of bonus payments to those troops that under their conscripted services should ensure the transition to the new system of manning the Russian army.

The evaluation of main kinds of expenditure and overall expenditure on implementation of the proposed concept is provided in three tables below, along with some references in the text.

The comparison of expenditure required for the implementation of the reform according to the proposed concept with the current level of expenditure on national defense showed that the annual rise in overall expenses should not exceed 4% of the noted level.

Considering the envisaged annual growth in GDP roughly at 4%, one can argue that the implementation of the proposed concept should not require additional allocations (in prices of 2001), provided that, of course, the present proportion of military spending in the federal budget is retained.

The regulation of the non-financing indices of the reform options showed that the proposed variant has indisputable advantages in terms of the majority of aspects, though it bears the only deficiency: it appears more

complicated in terms of organization. It would require the organization of a simultaneous service of conscripted military personnel for 24 months (such personnel would have to stay in the army for the transitional period) and of those who would be serving for between 6 to 8 months (such personnel would be conscripted to the training centers for reservists), as well as the development of the network of training centers, the priority training of warrant officers (sergeants) and those who will be serving under contracts.

The cumulative program of changes in the number and composition of the national armed forces, and direct expenditure on realization of the proposed concept are given in Table 1:

TABLE 1

Parameters/years	2001	2002	2003	2004
<i>Spending on privates and junior officers (conscripted)</i>				
1.1. Spending on military personnel to serve for 2 years				
The number of military personnel, Thos.	650	480	325	0
<i>The average spending on every military man during his service, Rb./year</i>	16800	16800	16800	-
The overall spending on this purpose, Rb. mln.	10920	8064	5460	0
<i>The average additional payments due in the course of demobilization from the army (in the first/second half year), Rb.</i>	0	3180 / 6360	12540 / 18720	0
Payments due in the course of dismissal, Rb. mln.	0	1550	5080	0
The dynamics of overall spending on military personnel that will have served for 2 years, with account for the demobilization payments, Rb. mln.	10920	9614	10540	0
1.2. Spending on military personnel to be conscripted for 6 months				
The number of military personnel, Thos	0	100	150	200
<i>The average spending on every military man during his service, Rb./year</i>	-	16800	16800	16800
The overall spending on this purpose, Rb. mln.	0	1680	2520	3360
The dynamics of overall spending on military personnel that will have served for 2 years, without regard to/ with the account for he demobilization payments, Rb. Mln	10920	9744 / 11294	7980 / 13060	3360
2. Spending on privates and junior officers who volunteered for the contractual service				
The number of military personnel, Thos	150	150	185	400
<i>The average spending on every military man during his service, Rb./year</i>	40400	46800	52800	60000
The dynamics of overall spending on military personnel that will be serving under contract, Rb. Mln	6060	7020	9768	24000
3. Overall spending on all the privates and junior officers				
The dynamics of overall spending on military personnel, without regard to/ with the account for he demobilization payments, Rb. mln	16980	16764 / 18314	17748 / 22828	27360
The dynamics of overall spending on military personnel relative to the spending in 2001, without regard to/ with the account for he demobilization payments, Rb. Mln	0	- 216 / 1334	768 / 5848	10380

Note: the presence of 2 estimated values (without regard to/ with the account for he demobilization payments) is determined by the fact that though there are no formal grounds for such payments, however from the moral perspective, there must be a reward for those who would ensure the implementation of the military reform with their conscripted service.

The acceptance of the proposed variant will be complicated with a simultaneous implementation of the decision of the Security Council of May 11, 2001 that provided for a substantial increase in monetary allowances for officers, warrant officers, privates and junior officers that served under contracts, as well as military pensions. In compliance with the Security Council's ruling, the monthly monetary allowance for junior officer corps should be increased almost twice, while for senior and high officers- 1.7 and 1.4 times, respectively. To implement the decision, the additional allocations from the federal budget should make up: in 2002- Rb. 21.8 bln., in 2003- 45 bln., in 2004- 55.8 bln. In all it is envisaged that over the three years these additional allocations should account for Rb. 122.6 bln.

To implement the proposed system of manning with privates and junior officers in 2002, there is no need in additional expenses from the federal budget, while in 2003 they should grow just, and it will be only 2004 when it would require as much as Rb. 10.4 bln. (Table 1).

Overall, the implementation of the proposal in question will require as much as Rb.11.2 bln. over the three years, or 9.1% of the total spending on the increase of monetary allowance for the military personnel.

With the envisaged annual growth in GDP at 4% in years to come, one can assume that in 2004 the federal budget expenditure should grow by Rb. 125- 130 bln. compared with 2001. In this case, the change in the system of manning of the national armed forces with privates and junior officers would require just 8.2% of the noted amount.

Should the additional allocations on the change in the system of manning of the national armed forces account for Rb.0.08 bln. in 2003 and Rb. 10.4 bln. in 2004, it will become possible to carry out a comprehensive military reform, to raise promptly the fighting efficiency of the privates and junior officers and, consequently, of the whole army, and to eliminate the tension in the society caused by the current hard, dangerous and, in a number of cases, humiliating conditions determined by the conscription system.

The expenses on household conditions. At the initial stage of the reform, it would be sufficient to reconstruct the current military barracks into hostels for single military staff (and those with small families) that serve by contracts. It can be accomplished partly by the means of so-called "economic way" and partly at the expense of funds that could be accumulated thanks to sales of the spare military property, including real estate.

In the period following 2004 there should be the building up of ministerial houses and the respective infrastructure, while for those military staff that would express their desire to proceed with their military career and will be duly attested by their seniors it would be expedient to start a saving account designated for the purchase of a flat in the European part of Russia upon 20 years of accumulation of the respective moneys. With the account for capitalization of the savings over the initial period, the volume of contributions to such accounts may make up roughly as much as 50% of the respective volume of contributions over the final period, which should alleviate the financial pressure on the budget during the initial stage of existence of such accounts.

Then, with an annual stable pace of graduation from military schools accounting for up to 20 Thos. and roughly the same number of other military personnel for whom such saving accounts should be started, the estimated pressure on the budget should account for up to Rb. 5 bln. a year, which does not appear a very heavy burden on the budget. Note that at present roughly as much as 8 bln. Rb. is spent annually on the house building for military personnel. In this connection, it would be possible to redistribute the expenditure (to contract the house building designated immediately for the military personnel, the increase in the fund of the ministerial housing, and the increase in the volume of the provision of the funds accumulated on the saving accounts for purchasing flats), which would allow the solution of the housing problem facing the military personnel to become a natural process.

As well, it is important to stress that since 2005 it is envisaged that the number of military pensioners would tend to fall. That can be attributed to the fact that the majority of the current military pensioners have left the army during the period of their gradual, though constant contraction, and the respective dynamics reflects, with some time lag though, the dynamics of the transition from the unbearably huge number of military staff characteristic of the Soviet military organization to the substantially small number of them in the military organization of RF.

The provision of benefits to proceed with education. The provision of benefits for enrollment to military high and secondary schools to the military personnel that would complete their training in the training centers for reservists and, furthermore, to those who will have served a certain number of years by contract appears a natural process of the military staff's circulation within the military system of RF that would not require new expenses.

At the same time, should upon his demobilization, a military man would like to enroll to a civilian state higher school, the situation may appear more complicated. The problem may be solved through the introduction of a certain "bonus" score added either to the one stated in the certificate completion of secondary school, or to the higher school enrollment examination score.

As long as the enrollment to a non-state higher school that charges for its services is concerned, the problem may appear yet more complicated. In our view this problem seems non-resolvable until 2005. After that, there might be various options, one of which, for example, may be as follows: upon 3 years of military service, a military man advises his seniors of his intention to enroll to such a higher school, and should his commanders acknowledge the expediency of his service in a military institution, a saving account is started under his name. Such a saving account is analogous to the one designated for the purchase of housing, however the purpose of this is different—namely, for the higher education. In this case, the length of his military service is to be set by the military man upon the agreement with his commanders. To implement this proposal, every year in the course of drafting the federal budget an ultimate amount of contributions to the saving accounts should be set. Within the limits of the amount the opening of new accounts is allowed.

The expenditure on the building up of the centers for training of the military-trained reservists. That should not imply any additional funding until 2005, provided that there will be a sound use of the network of existing military training units and a re-orientation of some military schools for that purpose. At the same time it is understood there may not be any contraction in monetary allowances, manning and other parameters of the services carried out by the permanent personnel of such schools.

After 2005, there should be a well-planned process of improvement of the training equipment, manuals, and other modern educational means throughout the whole training centers network. The volume of funding required for this purpose appears slightly dependent upon the concept of manning the military organization of RF. The improvement of the means and methods of education is determined by scientific and technical progress and particularly by the development of arms and military equipment.

The above concept of changing the system of manning of the national military organization bears certain consequences for the non-military sector of the national economy. First, the procedures and the length of

scription concern every citizen, because they are related to their as well as their relatives' constitutional duty - to be ready to defend their Fatherland. Secondly, we believe all the sectors for production and services

that somehow are related to satisfying the needs of the military personnel and their families should develop their long-term planning with the account for the forthcoming transformations in the military sphere.

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Foreign trade

In May 2001 Russia's foreign trade grew by 10.2% (up to USD 12.9 bln. compared to its respective period of the prior year, including exports accounted for USD 8.5 bln. vs. 8.3 bln. in May last year (a 1.8% growth) and imports USD 4.4 bln. vs. 3.4 bln. in May 2000 (a 30.7% growth). The volume of Russia's foreign trade in May 2001

the whole between January to May the exports to non-CIS countries grew by 4.5% and accounted for USD 36.5 bln.).

The main share in the export increment over the first five months 2001 relative to the respective period of 2000 was ensured mostly by the growth in the export supplies

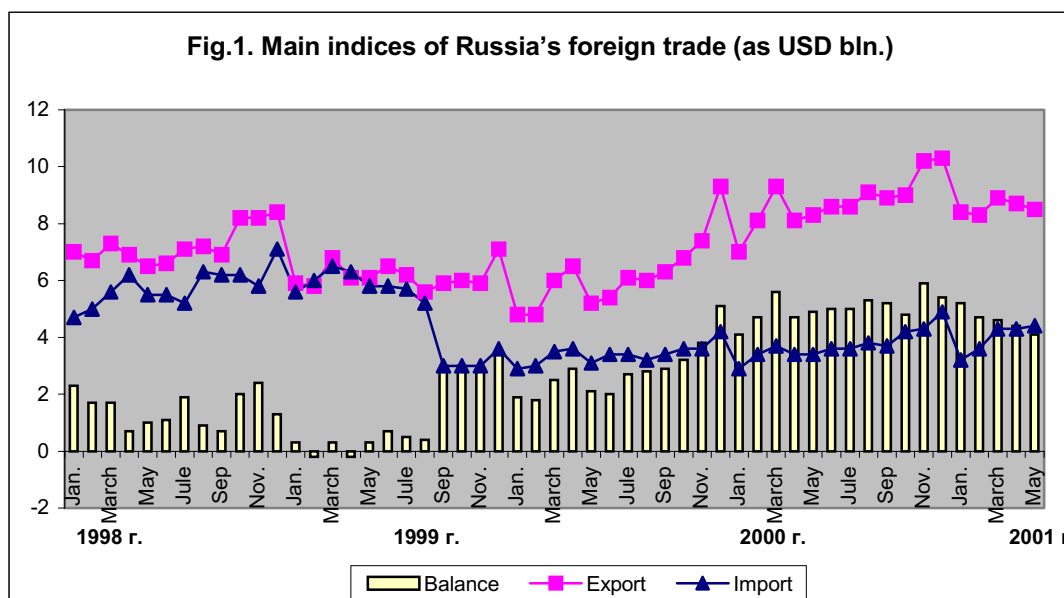
of natural gas, due to the noted price rise for that, despite the contraction in physical volume of the respective export to all the countries. During the period in question Russia supplied 80.67 bln. cub.m. of natural gas to the world market, or at 6% down compared with the respective index of the prior year. At the same time the value volume of export supplies of natural gas grew by 28%

compared with the respective period of the prior year and reached USD 8,877.9 bln. The export of natural gas to Far Abroad countries and the Baltic states during the period in question accounted for 6,2307.5 mln. cub.m. and was worth a total of USD 7,951.8 mln., while the gas supplies to the CIS countries accounted for 18366.04 mln. cub.m. (926.26 bln. USD).

The increment in oil exports can be attributed to the growth in physical volume of oil supplies abroad. The national exporters also increased export supplies of machinery and equipment, round timber, and mineral fertilizers, while the export supplies of ferrous and non-ferrous metals fell.

There was an excessive offer of steel products in the world market. In 2000, the world steel output broke the record value- 843 mln.t., while the US steel imports grew up to 34.5 mln.t. However, the world market for non-ferrous products began to experience a decline since late 2000. At the same time over 50 anti-dumping procedures were initiated against the Russia metallurgical products. During recent years, the US have sharply reduced the accession of the Russian steel produce to their market. According to the RF Ministry for Economic Development and Trade, given that in 1998 Russia supplied 6.6 mln. t.

Fig.1. Main indices of Russia's foreign trade (as USD bln.)



practically remained unchanged: the 2.7% contraction in exports was compensated by the 3.3% rise in imports. The balance of Russia's foreign trade remained high and accounted for USD 4.1 bln. (4.9 mln. in May last year).

During the first five months 2001 the situation in the world markets for minerals was more favorable for Russian exporters than the one between January through May 2000. That can be attributed mostly to high prices for natural gas. In Europe, the prices for natural gas grew by 88% compared with the period between January to May 2000. As well, the prices grew for petrol, diesel fuel, timber and sawed materials, commercial paper, cellulose and mineral fertilizers. During the first five months of 2001 the average price for the standard rent oil in the European markets was equal to the price level noted in the period between January to May 2000- USD 25-26/ barrel, while Urals quoted at 4.6% lower - USD 23.8/ barrel. The prices for black oil, nickel and caoutchouk slid substantially - by 17.4%, 30%, and 11.1%, respectively, while aluminum prices dropped by 1, and copper - by 2.2%.

In May 2001 Russia's exports to the non-CIS countries accounted for USD 7.2 bln., or at 0.7% down compared with the respective index of the prior year. However, on

of metal products to the US market worth a total of USD 1.41 bln., in 2000 the respective supplies (in the framework of the quota agreement concluded in 1999) accounted just for 3 mln. t. (worth USD 0.63 bln.). At the same time, because of the minimal price for the hot-rolled metal products increased by the US side, the Russian enterprises have stopped their supplies of them for almost a year.

At the meeting on the US- Russia trade and economic relations held in late July the Novolipetsky Metallurgical Plant has submitted to the US side a package of documents that contained the justification of the fact that the discriminative measures against Russian exports in the US market were incorrect. The measures did not take into account the current situation in Russia. At the same time the documents prove that Russian enterprises currently operate in market conditions. Should the US side make a

positive decision on the issue, the whole export from Russia would be considered an export from the market economy and there would not be any exceptional conditions and special regimes for Russia..

In May 2001 import supplies from the Non-CIS countries grew by 36.1% and accounted for USD 3.2 bln. In all between January through Mat 2001 the import supplies were worth a total of USD 14.2 bln., or at 20.3% up compared with their respective index of the prior year.

The acceleration in growth in import supplies over the five months 2001 was related to the growth in raw materials and products needed to ensure the needs of the growing economy. The purchases of the latter products grew by 23%, while the importation of machinery an equipment rose by 10.8% and the import of investment goods- by 13.3%.

TABLE 1 THE AVERAGE WORLD PRICES IN MAY OF THE RESPECTIVE YEAR

	1996	1997	1998	1999	2000	2001
Oil (brent), USD/t	140,4	138,3	105,6	115,8	200,2	209,0
Natural gas, USD/mln.m ³	-	81,1	78,1	83,9	133,0	150,7
Petrol, USD/t	242,3	226,3	183,1	188,9	341,9	391,1
Copper USD/t	2756,7	2480,4	1736,2	1539,9	1834,7	1708,2
Aluminum, UDS/t	1623,0	1618,9	1370,6	1317,9	1464,7	1536,7
Nickel, USD/t.	8135,2	7468,1	5058,3	5239,5	10141,4	7115,7

The growth in imports was also determined by the rise in consumer demand caused by the growing incomes of the population. In the period between January to May 2001 relative to the respective period of 2000 the purchases of food stuffs and food raw materials grew by 18.5%, while the ones of non-food goods- by 46.2%. The growth in imports of medicines was especially substantial (42.1%).

The imports of the goods on which customs duties were lowered since January 1, 2001, grew by 65%. For example, according to the SCS data, upon the 10% lowering of the effective duty rate for TV=s with diagonal size over 42 cm., the import supplies of TV=s grew by 638%, while the respective proceeds from them- by 432%. In all, over the four months the customs office collected at 48% more in proceeds from the goods, the customs duty rates on which were lowered, than during the respective period of the prior year.

In the first five months 2001 the volume of Russia's foreign trade with the CIS countries accounted for USD 11.9 bln. and grew by 9.% compared with the respective period of the prior year. In May 2001, exports to the CIS countries accounted for USD 1.3 bln., while imports- 1.2 bln.

The trend to a positive mutual impact of economic growth in the CIS countries and to a growth in foreign trade continues to have its effect this year. Thus, particularly thanks to the growth in Russia's economy and the growing demand on the part of national producers, last year the import supplies from the CIS countries to Russia grew over 40%.

In 2001, the rise in mutual trade, in turn, was generated by the growth in industrial output in the neighboring countries that accounted, on average, for 8.5% over the period between January to May (in 2000, the respective index was 9.7%). During the period in question it was Tadjikistan, Kazakhstan and Moldova that showed the highest growth rate in output this year (13.5%, 11.6%, and 9.9%, respectively).

At the meeting of the Task Force on Russia's joining WTO held in June the countries- members of WTO raised a number of requirements to Russia that automatically delayed the start of the final round of the talks for minimum six months. The Russian delegation's proposal to begin drafting the Protocol on Accession was declined on the grounds of an insufficient adjustment of the Russian law to the WTO standards. A number of WTO members, particularly Australia, Canada and the US believe that "so far, Russia did not pass the necessary border line in regard to amending its law for joining WTO". At the same time the partners demand both the passing of new (or amending of existing) laws and putting them in effect and the proofs that they really work. There are even proposals to discuss the WTO-related bills in the frame of the Task Force, i.e. with the participation of over 50 "parties concerned" in such a discussion. The main pretensions raised by the WTO members concerned the law in the area of customs regulation, standartization, and certification. There have not ever been such rigid requirements to other countries joining WTO, and they would amend their law to bring it into consistency with WTO standards after becoming members of the Organization. Russian and WTO should

resume the discussion in late 2001. However, even if the decision is positive, the six-month delay should be fairly painful for the country. In autumn 2001 there will be a round of global negotiations between the WTO members, the preparation to which will require mobilization of our partners' full negotiation capacity. Therefore they may

physically have no time to tackle the Russian problems. At the same time in the frame of the global round scheduled for late 2002 the members of WTO will start discussing new agreements between them, and it may well happen that Russia will face the renovated Organization and will have to begin anew all the negotiations.