

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

According to the preliminary estimates of the Finance Ministry, the federal budget in January through August of 2002 was executed as follows: revenues – Rb. 1572.2 billion, expenditures (actual financing) – Rb. 1436.0 billion.

*Table 1*

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

	XII'01	I'02	II'02	III'02	IV'02	V'02	VI'02	VII'02	VIII'02
Revenues									
Corporate profit tax	2,4%	1,4%	1,4%	1,5%	1,9%	1,9%	1,7%	1,7%	1,7%
Personal income tax	0,0%	0,0%	0,0%	0,0%	0,0%	0,0%	0,0%	0,0%	0,0%
VAT, special tax and excises	0,0%	4,9%	4,4%	4,0%	3,9%	3,6%	3,5%	3,5%	3,3%
Tax on foreign trade and foreign trade operations	9,4%	9,3%	9,1%	9,3%	9,3%	9,3%	9,3%	9,3%	9,1%
Other taxes, duties and payments	7,1%	6,9%	6,4%	6,8%	6,9%	7,0%	7,0%	7,0%	7,0%
Total- taxes and charges	2,2%	2,4%	2,6%	2,5%	2,4%	2,3%	2,3%	2,2%	2,1%
Non- tax revenues	3,7%	3,2%	3,3%	3,2%	3,0%	2,9%	2,9%	2,9%	2,8%
Revenues, total	0,6%	9,7%	9,1%	8,7%	8,7%	8,4%	1,8%	2,0%	2,0%
Expenditure	16,2%	20,4%	19,6%	19,6%	19,9%	19,6%	19,3%	19,4%	18,9%
Public administration	1,4%	2,1%	1,6%	1,4%	1,3%	1,2%	1,3%	1,4%	1,4%
National defense	17,6%	22,4%	21,2%	20,9%	21,2%	20,9%	20,6%	20,9%	20,4%
International activities									
Judicial power	0,5%	0,1%	0,2%	0,3%	0,4%	0,4%	0,4%	0,4%	0,4%
Law enforcement and security activities	2,7%	1,0%	1,5%	1,9%	2,3%	2,4%	2,5%	2,5%	2,5%
Fundamental research	0,3%	0,4%	0,4%	0,4%	0,4%	0,4%	0,4%	0,4%	0,3%
Services provided for the national economy	0,1%	0,0%	0,1%	0,1%	0,1%	0,1%	0,1%	0,1%	0,1%
Social services	1,6%	0,6%	0,9%	1,0%	1,2%	1,2%	1,3%	1,4%	1,4%
Servicing of public debt	0,3%	0,0%	0,1%	0,2%	0,2%	0,2%	0,2%	0,2%	0,2%
Other expenditure	1,3%	0,1%	0,3%	0,4%	0,5%	0,6%	0,7%	0,8%	0,8%
Expenditure, total	2,3%	3,7%	4,8%	4,8%	5,3%	5,2%	5,2%	5,2%	5,1%
Loans, redemption exclusive	2,6%	2,0%	3,4%	3,4%	2,6%	2,5%	2,4%	2,3%	2,4%
Expenditure and loans, redemption exclusive	3,0%	2,9%	3,3%	3,6%	3,9%	4,0%	4,0%	4,0%	3,9%
Budget deficit (-)	14,7%	10,9%	15,0%	16,1%	16,9%	17,1%	17,2%	17,2%	17,1%
Domestic financing	2,9%	11,5%	6,2%	4,8%	4,3%	3,8%	3,4%	3,7%	3,3%
Other taxes, duties and payments	-0,1%	-11,2%	-4,6%	-2,7%	-2,0%	-1,8%	-1,6%	-1,8%	-1,3%
Total- taxes and charges	-2,8%	-0,4%	-1,6%	-2,1%	-2,3%	-1,9%	-1,8%	-1,9%	-1,9%
Non- tax revenues	-2,9%	-11,5%	-6,2%	-4,8%	-4,3%	-3,8%	-3,4%	-3,7%	-3,3%

*Table 2*

### The monthly execution of the federal budget of the Russian Federation (in % GDP, actual financing).

	I'02	II'02	III'02	IV'02	V'02	VI'02	VII'02	VIII'02	IX'02
Total	22,2%	21,0%	20,9%	21,2%	20,8%	20,5%	20,5%	20,5%	20,0%
Public administration	0,5%	0,5%	0,5%	0,5%	0,5%	0,5%	0,5%	0,5%	0,5%
National defense	1,7%	2,4%	2,4%	2,7%	2,7%	2,7%	2,7%	2,7%	2,6%
International activities	0,4%	0,2%	0,4%	0,5%	0,4%	0,4%	0,4%	0,3%	0,3%
Judicial power	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%
Fundamental research	0,3%	0,3%	0,2%	0,3%	0,3%	0,3%	0,2%	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%
Social services	5,0%	5,7%	5,3%	5,9%	5,7%	5,5%	5,6%	5,4%	5,2%
Servicing of public debt	1,9%	3,4%	3,4%	2,7%	2,5%	2,4%	2,6%	2,4%	2,4%
Other expenditure	3,5%	4,0%	3,9%	4,0%	4,6%	4,2%	4,0%	4,0%	4,0%
Total expenditure	15,5%	18,7%	18,6%	19,1%	19,4%	18,9%	19,1%	18,6%	18,2%
Профицит (+) / дефицит (-)	6,8%	2,3%	2,3%	2,1%	1,4%	1,6%	1,4%	1,8%	1,7%

The data on the execution of the federal budget up to August of 2002 are presented in Table 1<sup>1</sup> and 2. As of September 1, 2002, the revenues of the federal budget accounted for 20.4 % of GDP, including tax

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

revenues at 18.9 %, while expenditures made 17.1 % of GDP (18.6 % of GDP in terms of fulfilled funding<sup>2</sup>), including non-interest ones – 14.7 % of GDP (16.2 % of GDP in terms of fulfilled funding). The level of budget surplus accounted for 3.3 % of GDP (1.8 % of GDP in terms of fulfilled funding).

The indicators of revenues collected in January through August of 2002 somewhat decreased as compared with the figures registered in January through July. The tax revenues in January through August of 2002 made 15.6 % of GDP (without the single social tax).

The expenditures for the servicing of the public debt in January through August of 2002 made 2.4 % of GDP. As concerns the fulfilled funding, the expenditures in the first nine months of 2002 made 18.2 % of GDP.

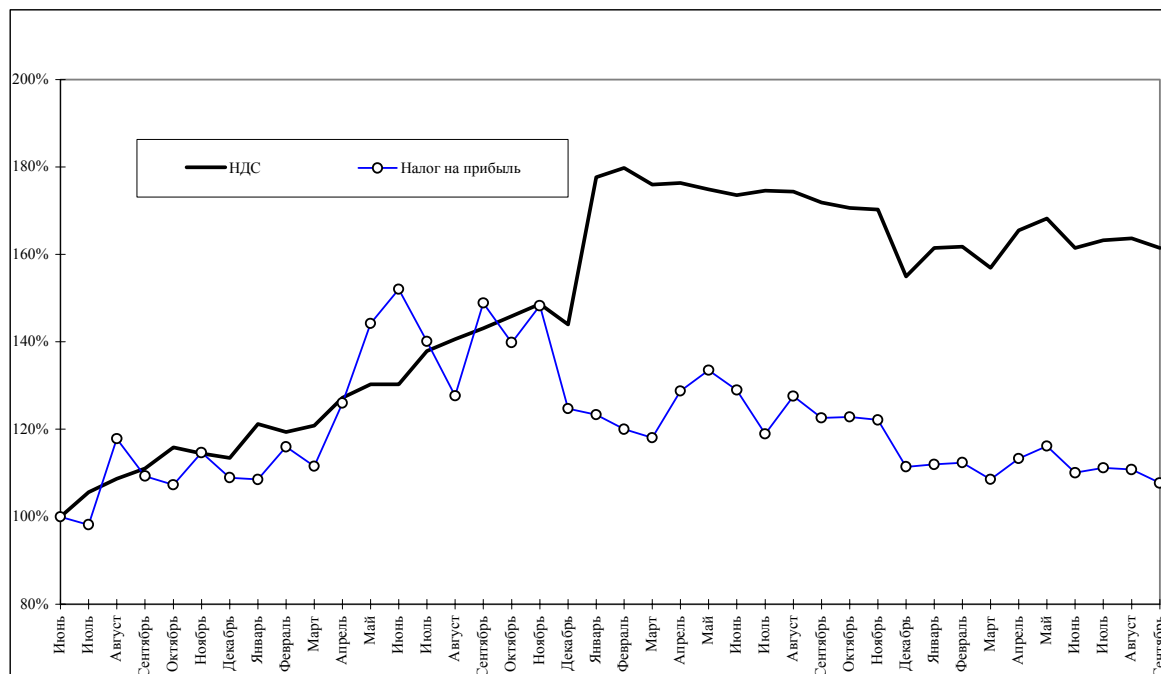
As of October 1, according to the preliminary estimates, the balances of accounts on accounting the federal budget funds (without regard to the funds accumulated on personal accounts of recipients of budget funds) grew up by Rb. 65 bln. since the beginning of the year.

Table 3

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

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			
218,7%	187,1%	234,8%	277,8%	240,9%	218,0%	283,6%	243,5%	250%			

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



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

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

The dynamics of actual tax debts to the federal budget is presented in Figure 1<sup>4</sup>. In October, no significant changes were registered.

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				
Taxes	28,7%	23,6%	24,3%	26,5%	26,6%	25,9%	26,4%	25,9%				
Revenues	32,9%	31,3%	31,4%	33,6%	33,6%	32,7%	33,3%	32,5%				
Expenditures	18,3%	23,7%	26,0%	28,4%	28,4%	28,8%	29,1%	28,9%				
Deficit	14,6%	7,7%	5,4%	5,3%	5,2%	3,8%	4,2%	3,7%				

\* Без учета ECH

Table 5.

	Всего налоговых поступлений в консолидированный бюджет РФ	Всего поступлений налога на прибыль в консолидированный бюджет РФ	Всего поступлений НДС	Всего поступлений подоходного налога в консолидированный бюджет РФ	Всего налоговых поступлений в федеральный бюджет РФ	Всего поступлений налога на прибыль в федеральный бюджет РФ
ARIMA						
Сентябрь	25,2%	4,4%	6,9%	3,1%	15,2%	1,6%
Октябрь	24,4%	4,3%	6,7%	3,1%	15,2%	1,6%
Ноябрь	24,9%	4,4%	6,8%	3,1%	15,3%	1,6%
Декабрь	25,3%	4,3%	7,2%	3,2%	15,7%	1,6%
REM						
Сентябрь	24,9%	4,4%	7,0%	3,2%	15,2%	1,6%
Октябрь	24,3%	4,2%	7,0%	3,2%	14,9%	1,5%
Ноябрь	23,8%	4,2%	6,9%	3,2%	15,0%	1,4%
Декабрь	24,0%	4,3%	7,0%	3,2%	15,0%	1,4%

4 Since 2001 the form of the MTC's presentation of the respective statistical data has been changed, and the data on debts to the federal budget across all the taxes are no longer available. Since January of 2002 the practice of balancing the data on the arrears against the amount of tax surplus has been ceased. In this relation the figure presents the data on the gross unbalanced tax arrears for comparability purposes.

The level of tax revenues of the consolidated budget in January through August of 2002 somewhat decreased in comparison to the indicators observed in the period from January to July. The surplus of the consolidated budget was by 0.4 % of GDP below the level registered in the preceding year.

The estimate of tax revenues of the consolidated and federal budgets is presented in the table<sup>5</sup>. The estimate was revised as compared to the indicators presented in the preceding bulletin basing on the new data on the execution of the consolidated and federal budgets.

S. Batkibekov

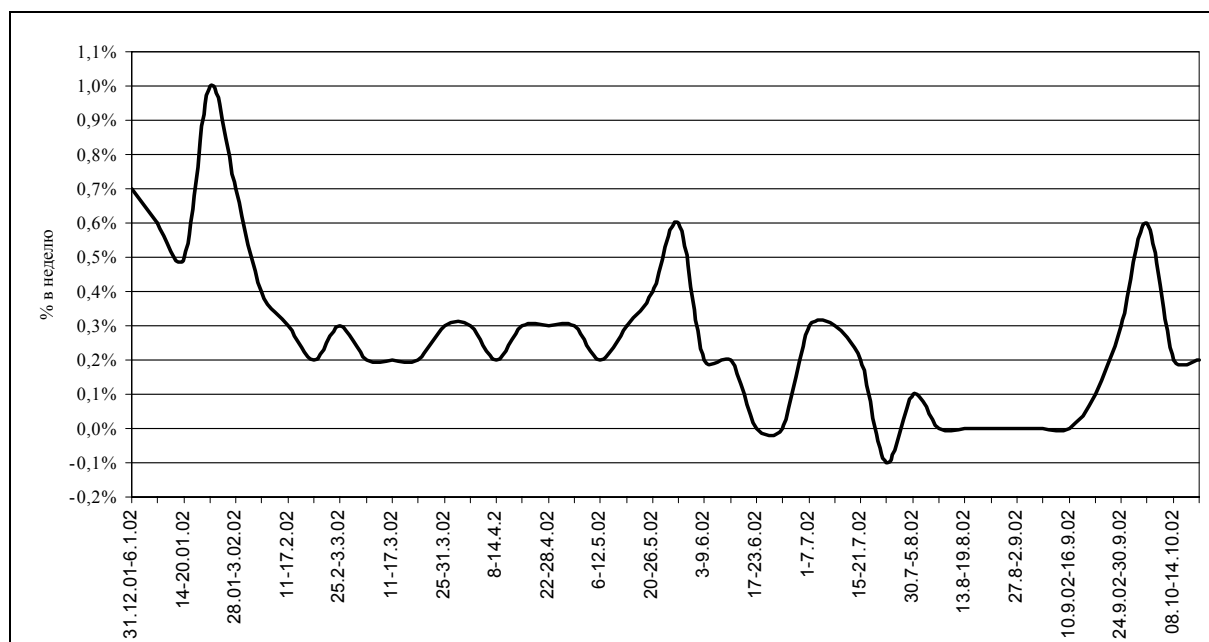
## Monetary Policy

According to the State Committee for Statistics of the RF, in September the consumer price index amounted to 100.4 percent; the main rise, 0.3 percent, occurred during the last week of the month. Prices for fruits and vegetables continued to decline: in September the price index for this commodity group was 90.1 percent.

Service price index grew 2.8 percent. In this group the greatest rise of 10.9 percent was marked in the sector of educational services, which is related to the beginning of the academic year. Prices for housing and communal services continue to grow as before: the rise was 2.6 percent, or 40.2 percent as compared to December 2001. Prices for non-foods were up 0.9 percent.

During the first nine months of 2002 inflation in Russian (measured by the CPI) was 10.3 percent (13.9 percent in the respective period of 2001). According to preliminary estimates, in October the increase in consumer prices was significantly greater than during the previous month: during the first week prices grew 0.6 percent, and the overall growth for the month is estimated to be 1.3 - 1.6 percent. In this connection it would be quite problematical for the Government to remain within the 12 - 14 percent range it had originally planned.

*Figure 1. Consumer Price Index in 2002*

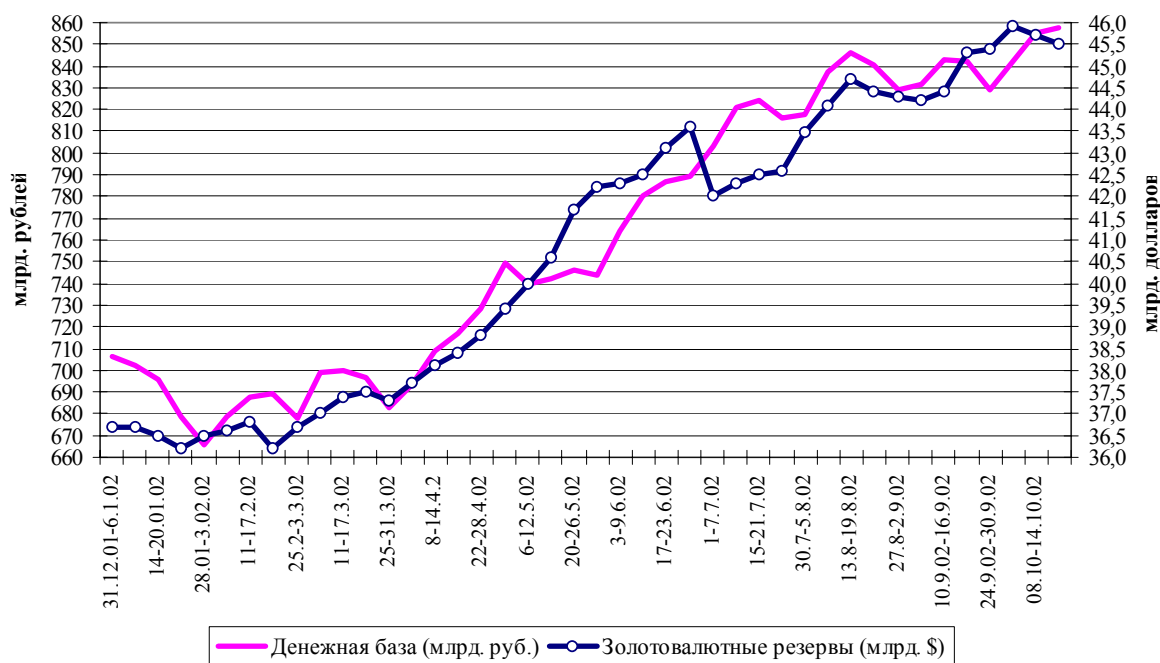


In October the gold and currency reserves continued to grow, reaching US\$ 45.5 billion on 18 October 2002 as compared to US\$ 45.4 billion on 27 September 2002. This growth was observed only in the period before 04 October 2002 when the reserves reached another historic high of US\$ 45.9 billion. As regards the subsequent decrease, one might assume that this occurred due to the Central Bank's reaction to an inflation upsurge in the beginning of the month. From the viewpoint of external debt payments October is a quiet month: plan payments did not exceed US\$ 660.9 million, which is significantly lower than during the previous months.

<sup>5</sup> For the description of models see the preceding bulletins.

No important occurrences were observed in the area of monetary policy in October. The Government did not take up the issue of improving the currency legislation that had been put on the agenda.

Figure 2. Dynamics of the Monetary Base and Gold and Currency Reserves in 2002



D. Levchenko

## Financial Markets

### The Market for Government Securities

In October 2002, the trend towards a slight decrease in yields observed in the Russian market for foreign debt during previous months, continued. The negative expectations potential related to the elections in Brazil has been obviously exhausted. As had been expected, on 27 October 2002 Luis Ignacio Lula Da Silva, nominated by the opposition Labor Party, was elected President of Brazil. A few days before the elections Brazilian securities and the Real even demonstrated a slight rise, however, then they decreased again. Now investors wait for the President to appoint the Cabinet. As far as Russian proper is concerned, one might note that Moody's intends to upgrade the country's credit rating. The yield on all series fell below 10 percent p.a. On 30 October 2002 the greatest yield of 9.93 percent was marked for Euro-28. The decision by the US Federal Reserve System to decrease the refinance rate can also result in a further rise in quotations.

Figure 1. Yield to Maturity of Minfin Bonds in May to October 2002.

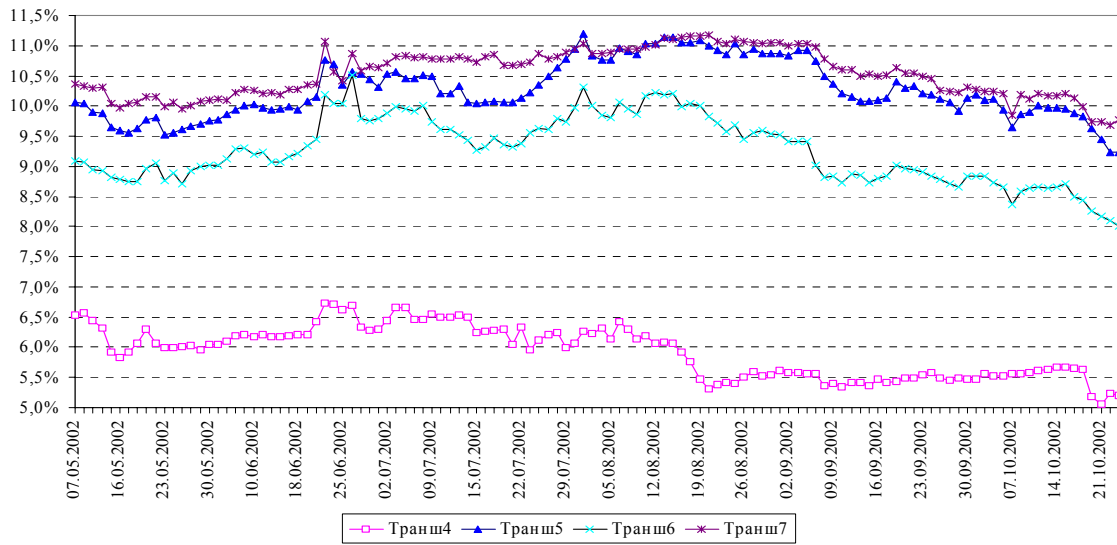
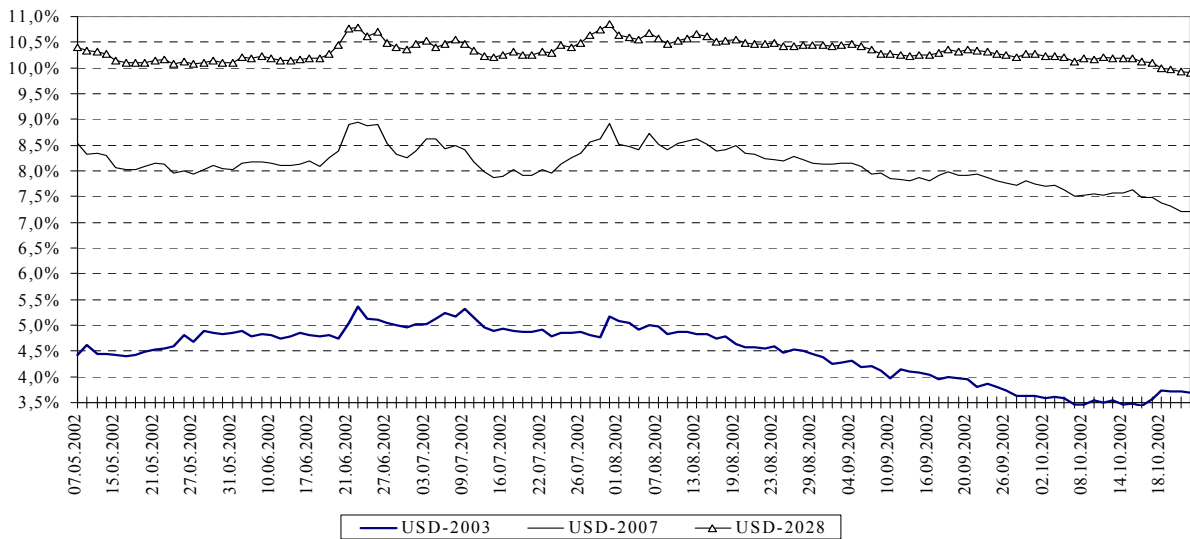


Figure 2 Yield to Maturity of Russian Eurobonds with Maturities in 2003, 2007 and 2008 in May to October 2002



In September the annualized yield of securities in the market for domestic debt was 15 percent. Based on preliminary data, the estimated turnover is expected to be RUR 17.5 billion.

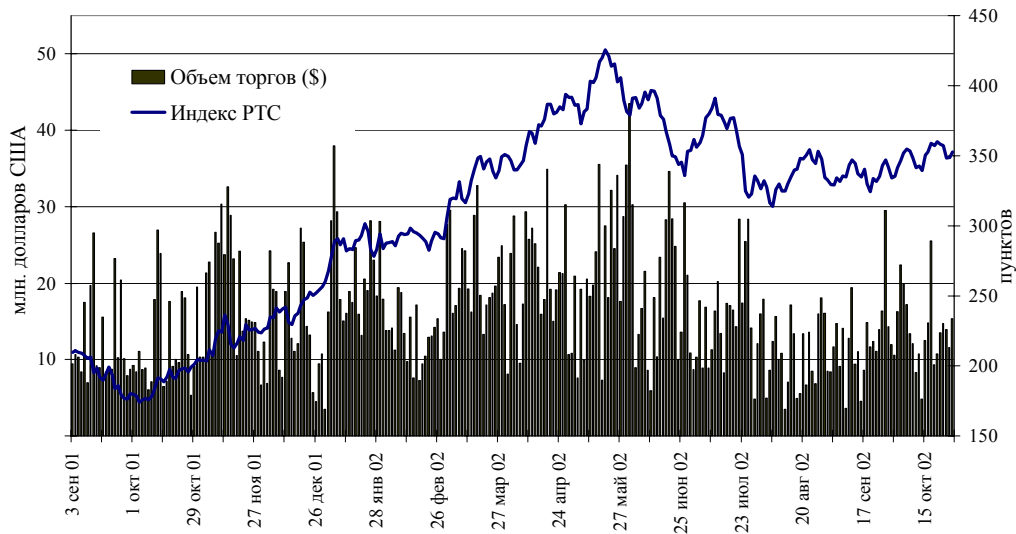
**The Market for Corporate Securities**

In October the RTS index passed the psychological barrier of 350 points. In accordance with the existing tradition, security quotations have developed under the influence of positive factors (positive macroindicators of the Russian economy and high oil prices) and negative factors (lack of stability in international financial markets).



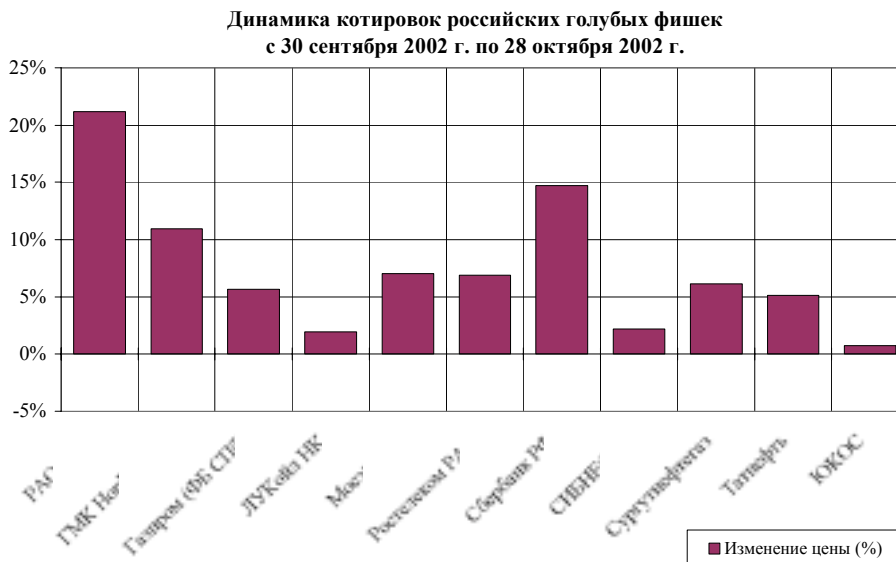
## The Stock Market

Figure 3.



From 01 to 28 October the RTS index grew 18.74 points (5.61 percent), reaching 352.8 points as on 28 October, which is twice as high as the similar indicator for the previous period. It should be noted that during October the index reached a three-month high of 360.23 points. The greatest intra-day index growth was 10.77 points (+3.17 percent). The greatest intra-day drop of 9 points (-2.51 percent) was observed on 24 October, which was caused by the tragedy in Moscow. The trade volume grew US\$ 26.4 million (+10.50 percent) as compared to the respective period of the previous month, reaching US\$ 277.6 million. The average daily turnover grew as well, reaching US\$ 13.9 million. The greatest activity was marked on 17 October when the trade volume reached a three-month high of US\$ 25,52 million; the lowest turnover was marked on 14 October at the level of US\$ 4.8 million.

Figure 4.



Price for almost all of liquid securities grew during the period in question; however, the growth was uneven. Shares of RAO UES demonstrated the greatest growth (21.20 percent); Sberbank shares come second with 14.69 percent and the shares of MMC Norilsk Nickel come third with 10.92 percent. The growth in quotations of Sberbank shares is related to the possible approval of the proposal by the RF Ministry for

Economic Development and Trade to loosen up the existing limitations on participation of non-residents in the capital of Russian banks, which would, without doubt, positively affect the development of the Russian banking system. The increase in quotations of Norilsk Nickel shares has been brought about chiefly by the information that it has entered into a long-term agreement with General Motors on deliveries of metals of the platinum group. Prices for the securities of the following companies changed to a smaller extent: Mosenergo (7.04 percent), Rostelecom (6.90 percent) and Surgutneftegas (6.15 percent). The last places in the growth list are filled by Sibneft (2.18 percent), Lukoil (1.9 percent) and Yukos (0.73 percent). Among the "second tier" shares we would like to note the securities of Slavneft-Megionneftegas (+89,68 percent), whose sudden growth is a result of the RF Government's decision to sell 75 percent of Slavneft's shares in December 2002, and Uralsviazinform (+30,61 percent), whose share prices grew due to good financial results for 2001 and a transfer to a single share.

In October ordinary shares of RAO UES took the top position in the trade volume in the total turnover at RTS with 29.22 percent as compared with 29.41 percent in the previous month. The proportion of ordinary Lukoil shares was 23.31 percent (15.07 percent), Yukos: 12.02 percent (16.13 percent), Surgutneftegas: 11.03 percent (10.68 percent). The proportion of Sibneft shares almost doubled, reaching 5,21 percent (2.48 percent). On the whole, in October the total proportion of five most liquid shares in the overall RTS turnover grew up to 80,79 percent (in September: 79.12 percent).

In the period from 01 till 28 October 2002 the volume of trade in Gazprom shares conducted via RTS terminals decreased as compared to the previous period, reaching US\$ 54.7 million (ca. 74.6 million shares); a total of 8.7 deals were concluded with Gazprom securities.

In October the top five Russian companies by capitalization were as follows (RTS data): Yukos, US\$ 20.4 billion; Gazprom, US\$ 17.7 billion; LUKoil, US\$ 13.6 billion; Surgutneftegas, US\$ 12.8 billion; Sibneft, US\$ 9.5 billion.

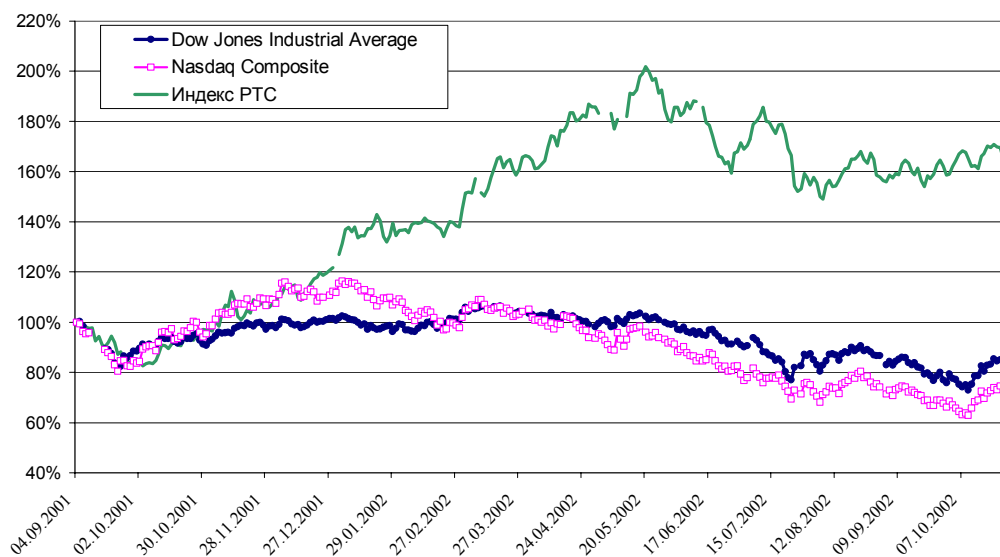
### The Market for Term Contracts

Market participants continue to take an interest in the FORTS market for term contracts. In the period from 01 till 28 October the total trade volume in the market for term contracts exceeded RUR 6.9 billion (49.5 thousand deals, 2.08 million contracts). Futures contracts accounted for RUR 6.87 billion (48.2 thousand deals, 2.04 million contracts) in this amount.

The greatest activity was marked in the end of the month: on 28 October the turnover reached RUR 479 million. The average daily turnover was RUR 349.6 million, the number of deals: 2475.

### Factors Affecting the Pricing

Figure 5.

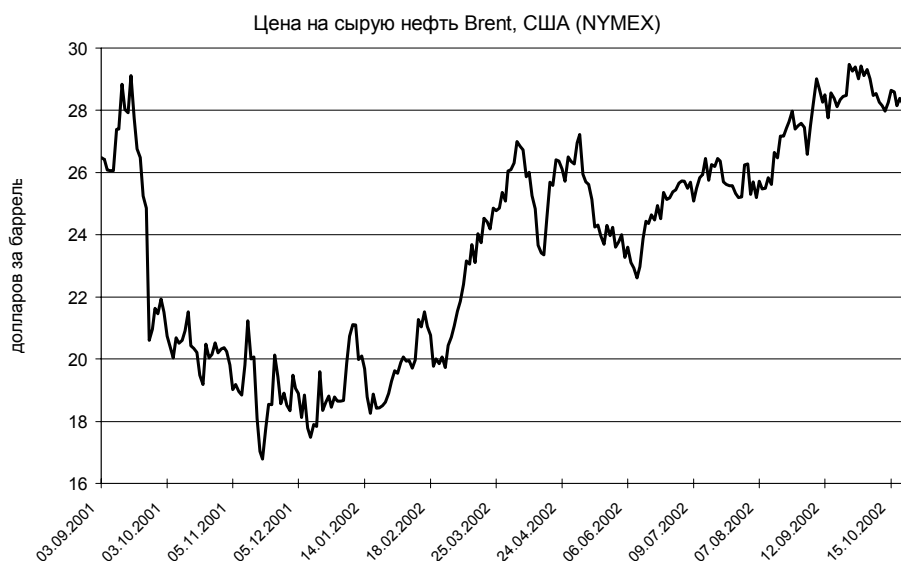


A recession in the world's largest exchanges continued in the first half of October. In Quarter 3 the Dow demonstrated the weakest results since 1987 (-17 percent), NASDAQ declined ca. 20 percent. As a result of the trade session on 9 October the Dow fell to the level of November 1997 (7286.27), NASDAQ - down to

October 1996 (1114.11). These dynamics have been caused by negative corporate news: shutdowns of ports at the US West Coast and lack of clarity in respect to military action against Iraq. In other developed countries the situation also far from excellent. In Japan, Nikkei-225 hit the 19-year low.

However, in the end of the month US stock indexes partially managed to recover. By 23 October Dow Jones and NASDAQ had grown up to 8494.27 (+16.6 percent up from the lowest level) and 1320.23 (+18.5 percent), respectively. On the whole, in the course of October DJ grew 11.89 percent and NASDAQ grew 12.64 percent. The chief reason for the increase in share prices was positive financial reports by largest corporations: the performance of Yahoo!, Aetna, IBM, Microsoft and Citicorp exceeded expert estimates, and the performance of General Electric, the world's largest company by capitalization, was in accordance with the expectations. The performance of the largest companies was higher than predicted, which allows to assume that the period of recession in corporate profits is coming to an end.

*Figure 6. Price for Brent Crude Oil, USA*



The main factor affecting the level of oil prices was the possibility of a war in the Persian Gulf. While the probability of a military conflict between the USA and Iraq was high, oil prices remained at a high level: US\$ 28-29/ barrel. However, following a statement by the Bush Administration that it was possible to find a peaceful settlement, the prices for crude oil fell below US\$ 27/ barrel.

According to the statement by the Oil Minister of Qatar, OPEC does not intend to increase crude oil production in the foreseeable future.

It is important to note favorable domestic news. The State Duma has passed the package of laws on reforms in the electroenergetics sector at the first reading. FATF has taken Russian out from its blacklist. Moody's has declared it could upgrade the sovereign rating of the RF in foreign currency for bonds and bank loans. The possible revision of ratings would be based on an assessment of Russia's financial and macroeconomic indicators and the data on the course of structural reforms, in particular in the field of natural monopolies.

### **Corporate News**

#### **ОАО Lukoil**

LUKoil has published its GAAP financial statements for the first six months of 2002. From January till June 2002 the proceeds from oil sales in the territory of RF were US\$ 235 million, or US\$ 183 million less than in the respective period of 2001. Oil exports and oil sales by foreign subsidiaries brought LUKoil US\$ 1.983 billion in proceeds (2001: US\$ 1,977 billion). In the reporting period LUKoil's revenues from operations outside the RF grew from US\$ 4.641 billion to US\$ 4.924 billion; their proportion in the company's total revenues increased to 74.14 percent (68.1 percent in the respective period of 2001).

#### **ОАО Sberbank**

The Supervisory Board has decided to pay RUR 1.907 billion in dividends for 2002, which is 7 percent of the expected net income. Both the absolute and the relative amount of planned dividend payments will

exceed last year's figure. The Bank management expects that the amount of payment per one ordinary share with par value of RUR 50 would be RUR 95, and per one privileged share with par value of RUR 1 it would amount to RUR 2. Let us remind that last year the amount paid on one ordinary share was RUR 52.9 and on one privileged share, RUR 1.1.

#### **OAD MMC Norilsk Nickel**

The trading company Norinmet, Ltd., a 100-percent subsidiary of the MMC, has entered into a long-term contract with the General Motors for deliveries of platinum group metals. Norilsk Nickel has not been delivering platinoids to international markets since the beginning of 2002, and the conclusion of a contract with one of the largest US corporations allows to hope for stable revenues from sales of the platinum group metals and better performance of the metallurgical holding on the whole.

#### **OAD Sviazinvest**

According to the press service of this telecom holding, in the first half of 2002 profits from sales of telecommunication companies grew 59 percent, reaching RUR 15.6 billion. Gross income of Sviazinvest operators grew 28 percent up to RUR 54.2 billion in the period under review, and expenses on the main operations grew 19 percent, amounting to RUR 38.6 billion.

#### **OAD Tatneft**

Standard & Poor's has changed its forecast for Tatneft from stable to positive and confirmed the company's long-term "B-" rating. The company's rating reflects the significant amount of exports, reasonable financial policy, considerable assets as well as insufficient diversification of operations, insufficient processing facilities, long periods of time required for the development of the main deposits, high level of short-term debts and an influence that the Government of the Tatar Republic has on the company.

*Table 1*

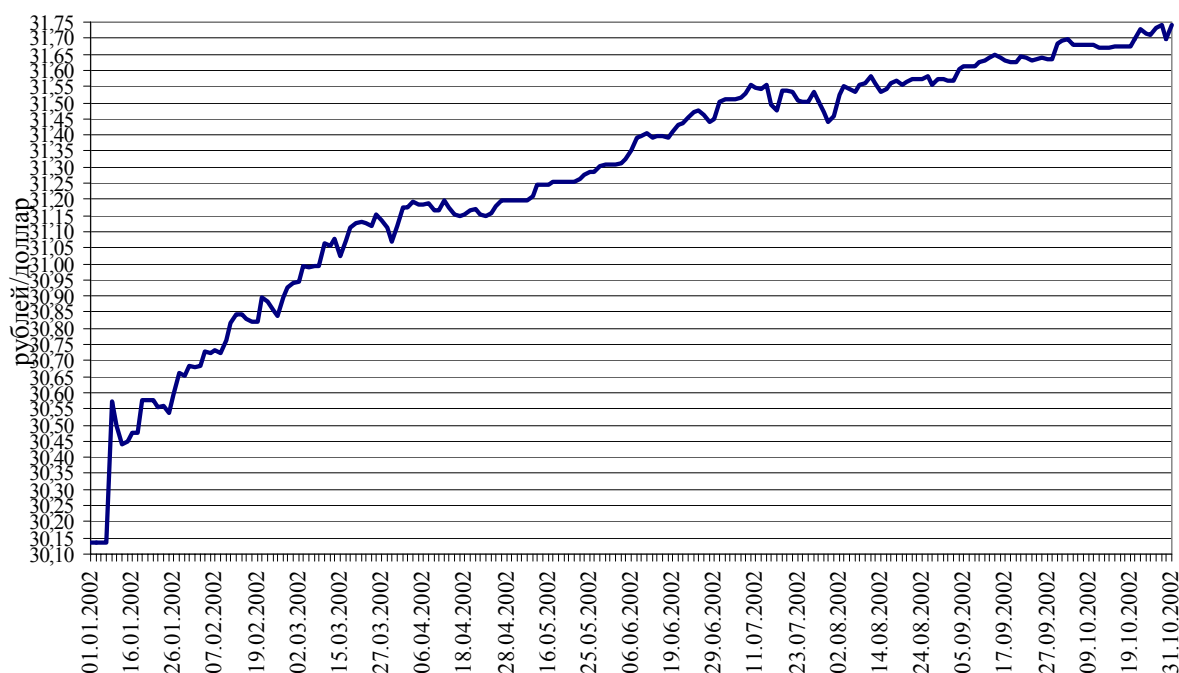
#### **Dynamics of Foreign Stock Indexes**

As of 23 October 2002	Value	Change During the Month (%)	Change Since the Beginning of the Year
RTS (Russia)	357.53	7.03%	37.49%
Dow Jones Industrial Average (USA)	8494.27	11.89%	-16.21%
NASDAQ Composite (USA)	896.14	9.92%	-22.81%
S&P 500 (USA)	819.29	-10.56%	-29.43%
FTSE 100 (UK)	4006.9	7.66%	-23.57%
DAX-30 (Germany)	3015.42	8.90%	-41.56%
CAC-40 (France)	2992.23	7.73%	-35.30%
Swiss Market (Switzerland)	4761.3	-0.45%	-25.81%
Nikkei-225 (Japan)	8714.52	-7.13%	-17.34%
Bovespa (Brazil)	9840	14.11%	-27.53%
IPC (Mexico)	6000.62	4.75%	-7.21%
IPSA (Chile)	78.86	-8.74%	-27.72%
Strait Times (Singapore)	1463.33	8.21%	-10.00%
Seoul Composite (Korea)	657.43	1.70%	-5.23%
ISE National-100 (Turkey)	9943.62	12.46%	-27.85%
Morgan Stanley Emerging Markets Free Index	280.033	5.23%	-11.77%

#### **Foreign Exchange Market**

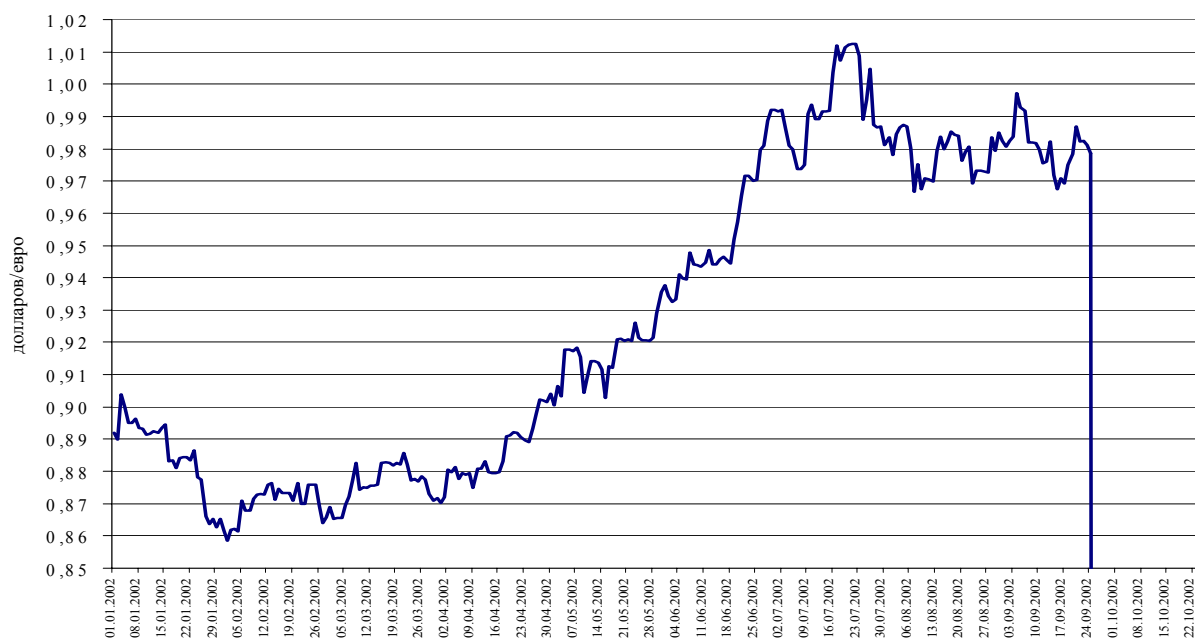
In October 2002 no significant fluctuations were observed in the RF foreign exchange market. The exchange rate passed the RUR/ US\$ 31.70 mark, but this occurred at the end of the month, instead of the beginning as expected. These moderate dynamics were accompanied by CB RF currency interventions in the second half of October. Relatively sharp fluctuations were marked at the very end of the month, when the exchange rate grew from 31.7411 on 26 October 2002 up to 31.6977 on 30 October 2002 and returned to the 31.7408 level on 31 October 2002. Based on preliminary estimates, the trade volume in the SELT was RUR 150 billion. In the previous bulletin we noted already that this value will lose its analytical sense once a new procedure for the mandatory sales of a part of foreign currency export revenues by legal entities is introduced by the Central Bank on 1 December 2002.

Figure 7.



In October, like in September, the Euro / US\$ exchange rate remained in the range 0.97-0.99 US\$ / Euro. No new trends were observed. US markets demonstrated a certain growth trend due to the influence of stable expectations that in early November the Federal Reserve would decrease its refinance rate.

Figure 8.



In the Russian market the Euro hovers around the RUR/ Euro 31 mark. The highest value in October was RUR/ Euro 31.3179 on 02 October 2002, the lowest value was 30.7447 on 19 October 2002. In the course of October the official RUR-Euro exchange rate grew from 30.9082 on 28 September 2002 to 31.179 on 31 October 2002, i.e. 0.88 percent.

Figure 9.



Table 2

**Financial Market Indicators**

Month	June	July	August	September	October*
Monthly inflation rate	0,5%	0,7%	0,1%	0,4%	1,5%
Inflation rate annualized on the basis of this month's trend	6,17%	8,7%	1,2%	4,9%	19,6%
CB RF refinancing rate	23%	23%	21%	21%	21%
Annualized yield to maturity on OFZ issues	14,86%	14,42%	14,45%	15,25%	15%
Volume of trading in the secondary GKO-OFZ market for the month (RUR billion)	12,99	9,34	6,95	15,97	17,5
Yield to maturity on Minfin bonds at the end of the month (% p.a.)					
4 <sup>th</sup> tranche	6,29%	6,27%	5,6%	5,46%	5,2%
5 <sup>th</sup> tranche	10,43%	11,19%	10,88%	10,13%	9,24%
6 <sup>th</sup> tranche	9,75%	10,3%	9,52%	8,84%	8,01%
7 <sup>th</sup> tranche	10,65%	11,03%	11,05%	10,31%	9,77%
8 <sup>th</sup> tranche	9,55%	9,72%	9,81%	9,24%	8,43%
INSTAR-MIACR rate (% p.a.) on interbank loans at the end of the month:					
Overnight	14,81%	29,06%	5,74%	17,79%	5%
One week	22,26%	8,08%	8,25%	2,85%	7%
Official RUR / US\$ exchange rate at the end of the month	31,4471	31,4401	31,5673	31,6358	31,7408
Official RUR / Euro exchange rate at the end of the month	31,0792	30,8019	31,0938	30,9082	31,1790
Average annualized growth in RUR / US\$ exchange rate	0,45%	-0,02%	0,4%	0,2%	0,33%
Average annualized growth in RUR / Euro exchange rate	6,81%	-0,89%	0,72%	-0,6%	0,88%
Volume of trading at the stock market in the RTS for the month (US\$ million)	344,3	407	276,04	304,19	
Value of RTS Index at the end of the month	353,79	326,23	332,9	334,06	349
Change in value of RTS Index during the month (%)	-9,58%	-9,22%	2,7%	0,35%	4,47%

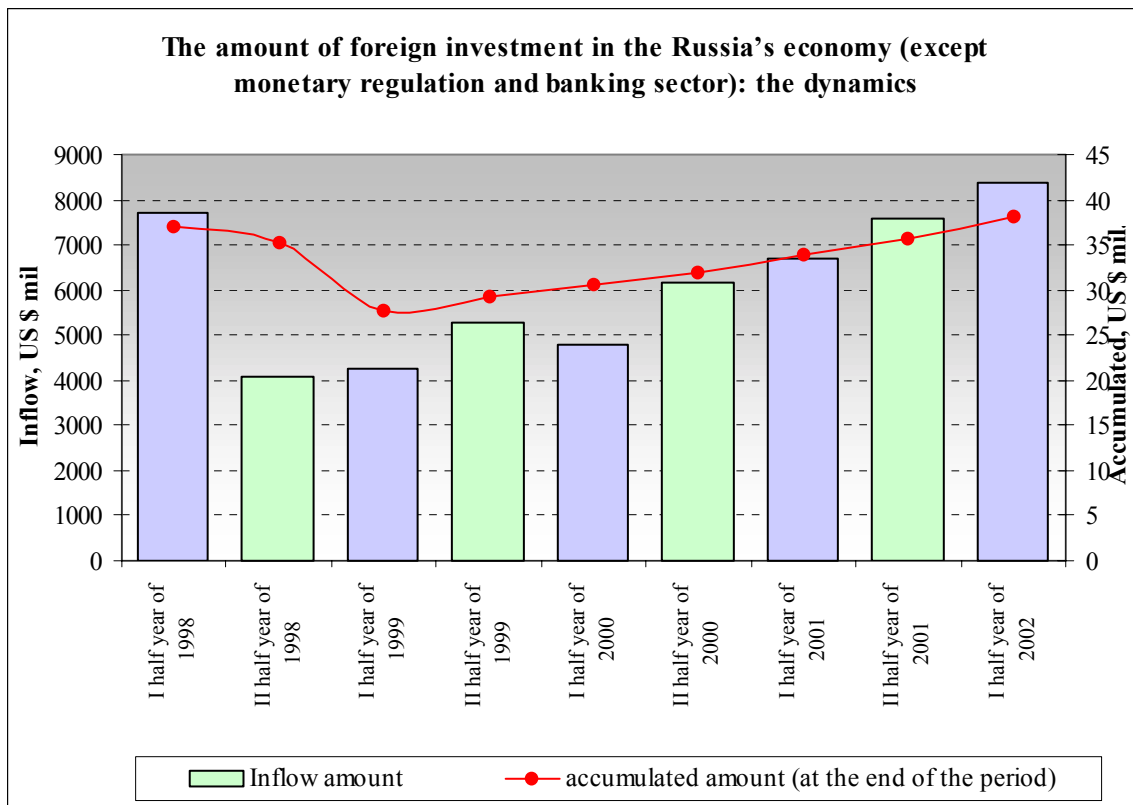
\* Estimates

*D. Levchenko, D. Skripkin*

## Foreign investment in the Russia's economy.

In spite of the problems experienced by the world economy, foreign investors have not decreased their activity in Russia. According to the FDI Confidence Index, which characterizes investment attractiveness of different countries (the ranking reflects the sentiments and intents of investors rather than the current amount of direct investment) published in September of 2002 by the consulting company Kearney, for the first time since the crisis of 1998 Russia has been ranked 17<sup>th</sup> among 25 countries most attractive for investors (above such countries as Hong Kong, the Netherlands, Thailand, South Korea, Singapore, Belgium, Taiwan, and Austria).

In the first six months of 2002, the inflow of foreign investment in the RF economy increased by 25.2 % as compared with the figures registered in the respective period of the preceding year and by estimation made about US \$ 8.4 billion. As of July 1, 2002, the accumulated foreign capital in the Russia's economy, including the investment from CIS member countries, made US \$ 38.2 billion.



Source: RF Goskomstat.

The highest rates of growth were registered in “other” investment, which in the first six months of 2002 increased by 60 % as compared with the figures registered in the respective period of the preceding year and made US \$ 6.3 billion. The amounts of direct and portfolio investment are estimated to be at US \$ 1.87 billion and US \$ 199 million respectively, what is by 25.4 % and 16.7 % below the respective indicators registered in the first six months of 2001. Therefore, serious changes have occurred in the structure of investment capital: in the first six months of this year the specific weight of direct investment declined to 22.4 % (as compared with 37.5 % registered in the first six months of 2001), while portfolio investment declined to 2.4 % (as compared with 3.6 % registered in the first six months of 2001), and other foreign investment grew up to 75.2 % (as compared with 58.9 % registered in the first six months of 2001). The excess of other investment as compared to the amount of direct and portfolio investment is a negative factor, since borrowings prevailing in this type of resources have to be returned and paid for, while the state is responsible for these resources in economic and political terms.

An analysis of the situation of the investment market demonstrates that foreign investors are still interested in fuel and food industries, metallurgy, the sphere of trade and public catering. For the distribution of foreign investment by base sectors of the Russia's economy see the Table below:

**Sectoral structure of foreign investment in the Russia's economy in the first six months (in 2000 through 2002)**

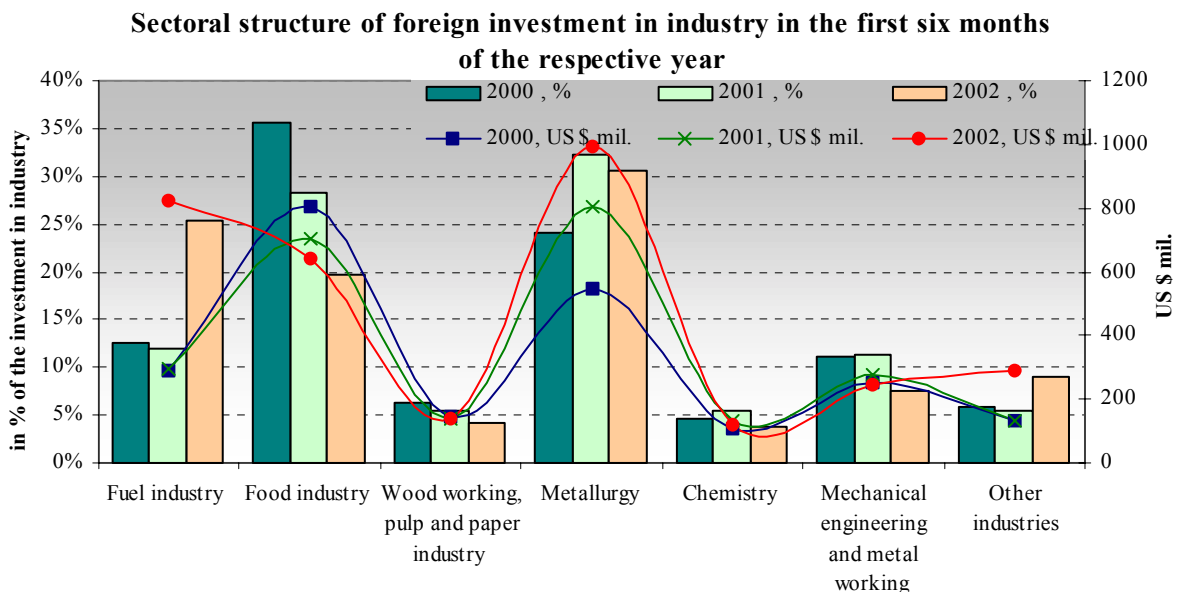
	2000		2001		2002	
	US \$ mil.	% of total	US \$ mil.	% of total	US \$ mil.	% of total
Industry	2273	47,57	2487	37,2	3245	38,8
Transport and communications	666	13,94	607	9,1	350	4,2
Trade and public catering	766	16,04	2426	36,3	3596	43,0
Commercial activities relating to market servicing	98	2,05	403	6,0	533	6,4
Finance, credit, insurance, pensions	154	3,22	99	1,5	41	0,5
Other sectors	821	17,18	662	9,9	603	7,1

Source: RF Goskomstat

The sectoral structure of foreign investment is characterized by a growth in investment in industry at the background of declining investment in other spheres of economy. In the first six months of this year, the rates of growth in foreign investment in industry (+ 30.5 %) exceeded the similar indicators of growth of aggregate amounts of foreign investment in the Russia's economy. At the same time, the direct investment in industry increased by 6.7 % as compared with the figures registered in the first six months of 2001 and made US \$ 887 million (47.4 % of the aggregate foreign direct investment in the RF economy). Other investment in industry made in this period increased by 48.1 % and reached US \$ 2.26 billion (36 % of the aggregate foreign direct investment in the RF economy). The decline in the amount of portfolio investment made 26 %.

In the last years, in the investment preferences of foreign investors there persists the stable growth of the specific weight of trade and public catering, since this sector is characterized by short payback periods. At the same time, about 83 % of the total investment in this sphere made in the first six months of this year were formed by other investment, which mostly comprise credits.

In the first six months of 2002, a decline in the amounts of investment in base industries as compared with figures registered in the respective period of the preceding year was observed in chemistry and petrochemistry (- 11.9 %), mechanical engineering and metal working (- 12.5 %), and food industry (- 8.4 %). Foreign investment in the Russia's fuel and energy complex increased 2.75 times in the period under observation, what resulted in an increase of the FEC share in the total amount of foreign investment in industry from 12 % in 2001 to 25.3 % in 2002. The specific weight of metallurgy in foreign investment has decreased from 32.2 % to 30.5 %. This decrease was determined by the fact that the rates of growth in foreign investment in metallurgy was outpaced by similar indicators characterizing the growth of foreign investment in industry at large.



Source: RF Goskomstat.



The structure of foreign investment in industry does not differ from the respective structure of its total amount and is characterized by a decline in foreign direct investment at the background of other investment. However, some changes were registered as compared with the figures registered in 2001.

**The structure of foreign investment in industry in the first six months of 2002.**

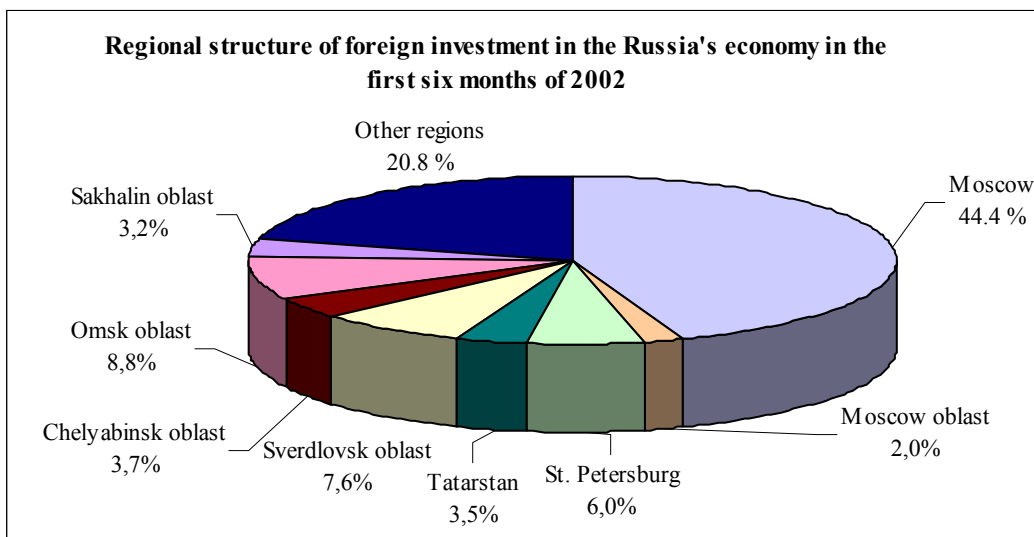
	US \$ million			Change as compared with the first six months of 2001		
	Direct	Portfolio	Other	Direct	Portfolio	Other
<b>Industry</b>	887	94	2264	+6,7%	-26,0%	48,1%
Including:						
Fuel	243	0,1	578	+32,8%	-99,6%	By 6,6 times
Food	166	0,1	476	-39,0%	-96,7%	+11,7%
Wood working, pulp and paper	39	7	92	-55,7%	By 17,5 times	+87,8%
Metallurgy	59	78	854	-46,4%	-3,7%	+39,8%
Chemistry and petro-chemistry	53	1	65	By 2,5 times	0	-42,3%
Mechanical engineering and metal working	184	0,1	60	+55,9%	-90%	-62,5%
Other industries	143	7,7	139	By 3,7 times	-38,9%	-90,4%

\* No portfolio foreign investment was registered in the first six months of 1999.

Source: RF Goskomstat.

In the first six months of 2002, the major part of foreign direct investment was made in fuel and food industries (12.3 % and 8.9 % respectively), mechanical engineering (9.8 %), and trade and public catering (33.2 %).

In spite of the development of investment attractiveness of regions, the regional structure of foreign investment in 2002 was characterized by the persisting concentration of investment in a limited number of RF subjects.



The persisting attractiveness of the Moscow market is related to the stable growth of household incomes in the city and high rates of growth in the amount of sales. In the total amount of foreign investment flowing in Moscow in the first six months of 2002 (US \$ 2.72 billion), direct investment accounted for US \$ 780 million (21 %), portfolio investment made US \$ 92.6 million, and other investment made US \$ 2.85 billion.

In the first six months of 2002, investment from 93 countries exporting capitals flowed in the Russia's economy (first six months of 2001 – 100 countries). At the same time, in the first six months of this year, 10 largest investing countries accounted for 83 % of the total amount of foreign investment accumulated by July 1, 2002. These indicators pertaining to the results of the first six months of 2000 and 2001 made 87.5 % and 86.2 % respectively.

At the same time, top ten exporters of capital accounted for 79.4 % of accumulated direct investment in the Russia's economy, and 68.4 % and 87.9 % of portfolio and other investment respectively.

**The structure of accumulated foreign investment as broken down by major investing countries.**

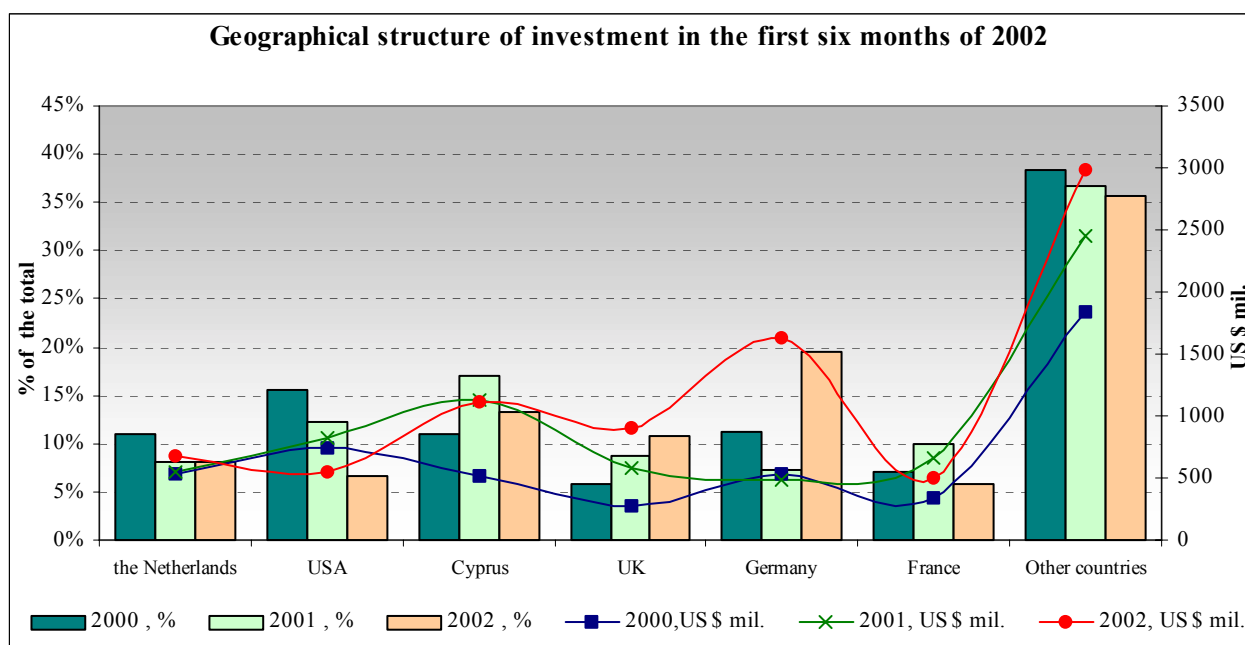
	Accumulated by 01.07.2002, US \$ mil.				Change to 01.01.2002, % (*)			
	Total	Direct	Portfolio	Other	Total	Direct	Portfolio	Other
USA	5356	4096	68	1192	-4,8 (-0,2)	3,2 (5,9)	-24,4 (-1,4)	-17,9 (-16,6)
Germany	7164	1524	384	5256	17,7 (17,7)	0,8 (5,9)	by 13,7 times (by 13,7 times)	15,6 (13,8)
France	3364	276	0,1	3088	2,5 (-4,9)	-22,0 (-24,6)	0 (-90,0)	5,5 (-2,6)
UK	4189	1973	143	2073	9,9 (29,4)	4,0 (11,5)	13,5 (by 3,7 times)	15,9 (45,0)
Cyprus	4807	3594	335	878	-9,4 (-6,7)	-3,6 (-2,6)	-28,4 (-21,5)	-20,9 (-14,9)
The Netherlands	2637	2244	21	372	3,7 (18,4)	4,5 (14,3)	-4,5 (10,5)	0 (51,2)
Other countries	10633	4872	490,9	5270	18,5 (29,1)	9,6 (8,8)	-1,0 (17,4)	30,8 (57,8)
Total	38150	18579	1442	18129	7,1 (12,7)	2,3 (5,7)	17,2 (44,1)	27,1 (18,8)

\* changes (as compared with the data registered on 1.07.2001) are in brackets

Source: RF Goskomstat.

In the first six months of this year, the inflow of capital from USA declined by 32.4 % in comparison with the respective period of the preceding year (the first six months of 2002 – US \$ 554 million), and French investment decreased by 26 % (the first six months of 2002 – US \$ 492 million), while investment from other countries grew. For instance, in the first six months of this year, German investment made US \$ 1.63 billion (3.4 times above the respective indicator in the first six months of 2001), and UK investment made US \$ 906 million (+ 54.6 % as compared with the figures registered in the first six months of 2001).

**Geographical structure of investment in the first six months of 2002**



Source: RF Goskomstat.

In the first six months of 2002, investment from USA were primarily invested in trade and public catering (49.3 % of the total US investment), and industry (35.2 %). As concerns industry, American investors were most interested in mechanical engineering (46.7 % of the total US investment in industry) and food industry

(33.3 %). As concerns the structure of accumulated capital, US investment in the Russia's economy were dominated by direct investment, which made about US \$ 4.1 billion (76.5 % of the total amount of accumulated investment from USA).

The major part of investment from Germany (US \$ 1.48 billion, or 91.1 % of the total German investment) was made in trade and public catering (68.3 %) and industry (22.9 %). As concerns the industrial sector, German investors preferred metallurgy, which received US \$ 194 million, or 52.2 % of the total German investment in the Russia's industry in the first six months of 2002.

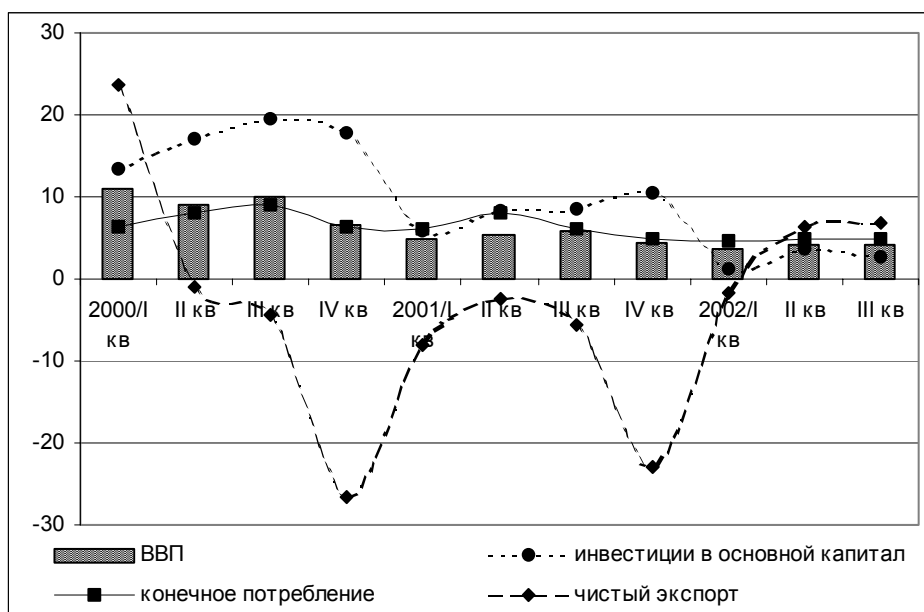
An alarming fact at the background of growing investment in the Russian economy in the first six months of 2002 is that in the same period Russian investments abroad made US \$ 10 billion, what is by 20.1 % above the amount of foreign investment in Russia. In the first six months of 2001, the Russian investment in other countries made US \$ 6.48 billion, while foreign investment in RF made US \$ 6.68 billion.

*E. Ilyukhina*

## The Real Sector: Factors and Trends

According to the preliminary data collected in January through September of 2002, GDP increased by 4.0 % in comparison with the figures registered in the respective period of the preceding year. The macroeconomic situation was characterized by the persisting trends towards the expansion of internal and external demand. The amount of industrial output has increased by 4.0 % in comparison with the figures registered in January through February of 2001, while construction increased by 2.7 %. As concerns the sector of services, trade and communications developed most intensively. The index of growth in retail trade turnover made 108.9 %, while for communications this indicator made 113.2 % in comparison with the level observed in January through September of 2001. The positive dynamics of development of base economic sectors and the favorable external economic situation determined the nature of shifts in the real sector.

*Figure 1* Changes in GDP dynamics as broken down by the components of final consumption in 2000 through 2002, in % of the respective period of the preceding year



GDP investment in fixed assets inal consumption Net exports

This year, the trend towards the expansion of internal demand fixed since the 4th quarter of 1999 persists. This year, the Russia's economy maintains the trend towards the outpacing growth of internal demand as compared with external demand, what was first observed in the 4th quarter of 2000. It shall be noted that while in the first six months of 2001 economic growth was determined by the intensive increase in investment, this year the structure of final demand changes on the impact of the outpacing growth in final household consumption. In the GDP structure, the share of investment in fixed assets declined by 2.1 p.p. in comparison with the figures registered in January through September of 2001 and made 13.6 %.

The final household consumption increased by 4.8 % in comparison with the first half-year of 2001, while rates of growth in investment in fixed assets were at 2.5 %. A factor behind the expansion of final consumption was a gradual improvement of the social parameters of economic development. There is observed accelerated rates of growth in real household incomes as compared with figures registered in January through September of 2001. The development of this trend is a logical result of the continuing strategy aimed at the recovery of pre-crisis living standards. In January through September, the increase in real household incomes made 7.1 %, real wages and salaries grew by 17.9 %, while real gross monthly pensions increased by 18.9 % as compared with the figures registered in the respective period of the preceding year.

An additional factor behind the growth in final consumption was the trend towards abating inflation rates. In January through September of 2002, inflation on the consumer market made 10.3 % as compared with 13.9 % in the respective period of 2001. At the same time, in August prices grew by 0.4 %. The decline in inflation rates was determined by the implementation of balanced fiscal and monetary policies, surplus of the federal budget, and decelerating growth of money supply in 2002 as compared with indicators of 2001.

An important factor facilitating lower inflationary expectations was the predictability of the situation related to the measures aimed at the curbing of growth in prices and tariffs set by the subjects of natural monopolies, which were made public by the government.

This year, another significant aspect of economic policy is the outpacing rates of growth in net exports as compared with the dynamics of GDP and internal demand. In the 2<sup>nd</sup> quarter of this year, the increase in net exports made 6.4 % as compared with the figures registered in the respective period of the preceding year. An analysis of internal and external factors and conditions of economic growth in the 3<sup>rd</sup> quarter of 2002 reveals that the recovery of favorable business situation on world markets of fuel and raw materials was a factor facilitating the acceleration of the rates of economic growth. The increase in industrial output in the 3<sup>rd</sup> quarter as compared with the 2<sup>nd</sup> quarter made 5.5 % and was by 1 p.p. above the level registered in the respective period of the preceding year. Accelerating growth in industry was initiated by both increasing output in export oriented industries, and persisting high rates of growth in the sectors of the consumption complex primarily oriented towards the domestic market.

The output of fuel energy increased by 6.1 %, non-ferrous metallurgy – by 8.9 %, consumption complex – by 7.3 % in comparison with the figures registered in the respective period of the preceding year. As concerns the investment complex, there the index of production made 103.3 % as compared to January through September of 2001. While in January through September of 2001 the increase in the output mechanical engineering made 7.7 %, outpacing the rates of industrial growth by 2.5 p.p., in the respective period of 2002 the situation is opposite. Output of mechanical engineering increased by 3.1 %, while the output of industry on the whole grew by 4.0 %.

The dynamics of output across branches of mechanical engineering are volatile. This year, the trend towards an outpacing rate of growth in automobile manufacturing in comparison with the output of mechanical engineering recovered again.

*Table 1*

**The dynamics of output across branches of mechanical engineering in January through September of 2000 – 2002, in % of the respective period of the preceding year.**

	2000	2001	2002
Mechanical engineering and metal working	116,0	107,7	103,1
Including by branch:			
Metallurgical engineering	144,1	90,8	70,1
Chemical and oil engineering	123,0	125,6	87,8
Hoisting and transport engineering	148,1	123,5	92,3
Railroad engineering	105,2	121,1	123,4
Electrical engineering	139,3	113,7	94,4
Machine tool and tool manufacturing	117,3	98,0	85,0
Instrument making	136,1	100,6	92,8
Automobile industry	104,0	98,6	103,3
Tractor and agricultural machinery industry	153,8	134,9	82,2
Mechanical engineering for light and food industries and the industry of household appliances	108,9	104,3	115,7
Communications engineering	430	85,6	169,2

Source: RF Goskomstat

It shall be noted that this year mechanical engineering is growing at an outpacing rate in comparison with the general dynamics of investment, what enhances the possibility of transformational shifts in the reproduction of fixed capital. However, the lack of significant changes in the sectoral structure of investment activity has a strong negative effect on the dynamics of the investment process. In the Russia's economy, fuel industry maintains its dominating positions in the structure of investment, its share makes 15 % of the total investment in the fixed assets of the economy at large and 51.2 % of the total investment in industry; at the same time, more than 1/3 of investment flows in oil extracting industry. Taking into account the traditionally high concentration of profits in the export oriented industries of the oil and raw materials sectors and the lack of mechanisms of inter-sectoral flow of capitals, it may be hardly expected that the rate of investment would increase and radical changes would occur in the nature of the reproduction of fixed capital. The share of investment industries makes 8.5 %, while the consumer complex branches account for 7.7 % of the total amount of investment in industry.

In 2002, at the background of decelerating rates of investment in fuel industry, there deteriorated practically all aggregate characteristics of reproduction of fixed capital. Shrinking investment demand on the part of export-oriented fuel and raw materials industries determined by falling export revenues negatively affected the character of business activity in the investment complex. As a result, in January through September of 2002, investments in fixed assets grew only by 2.5 % as compared with 7.8 % registered in the respective period of the preceding year. Given the current trends of investment demand and the level of enterprises' profits, there are no grounds to expect that rates of investment will accelerate by the end of the year. Even taking into account the traditional surge in investment in the 4<sup>th</sup> quarter, determined by the completion of the yearly construction cycle, the expected growth in investment will make 103.0 % to 103.5 % as compared with the levels observed in the preceding year.

*O. Izryadnova*

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## **IET Business Survey: Industry**

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In October, the growth of cash sales in industry stopped. The balance of responses (growth – decrease) dropped by 11 points; however, the positive value of balance was kept as the growth in effective demand continued. In October, negative balances (absolute decrease in sales) were registered in ferrous metallurgy, mechanical engineering, and construction. Therefore, the September surge in sales (+ 15 % after + 3 % observed in August) became the best value registered over the last 24 months.

However, the slowing down growth in sales does not trouble industrial enterprises as yet. Moreover, the share of responses evaluating cash demand as “normal” increased from 38 % in August and September to 43 %. The maximal values of this indicator are registered in non-ferrous metallurgy (86 %), power engineering (74 %), and the forestry complex (69 %). This fact may be confirmed by the results of the quarterly monitoring of evaluations of barter and other non-cash sales. In the beginning of 4th quarter, the balance of evaluations of non-cash types of demand (“above” – “below the norm”) increased from –4 % to –2 % for barter and from –8 % to –3 % for promissory notes and offsets. I.e., although the opinion that amounts of non-cash transactions is insufficient prevails across the Russia's industries, the respective evaluations increased by 2 and 5 points over the quarter.

The dynamics of barter did not change in October. The decline in direct barter operations was relatively stable in the last seven months. In the last months, about 9 % of industrial output were sold via barter operations. The forestry complex (16 %) and construction industry (14 %) account for the largest numbers of such transactions. The intensity of decrease in promissory note and offset transactions declines for the second month running. At present the balance makes –1 %, i.e. the decrease in these types of operations has practically stopped. About 12 % of industrial output is sold via promissory notes and offsets.

The very recent deceleration of the decrease in profits stopped in October. The balance again became significantly negative. Profits continued to grow only in power engineering. The most intensive decline was registered in chemistry, petro-chemistry, non-ferrous metallurgy, and the forestry complex.

The output has been also affected by the slowing down growth in sales. The rates of increase in output rose for four months, however, in October, the balance decreased by 9 points. Decelerating rates of growth were registered across all industries with the exception of power engineering, while in metallurgy and food industry there was observed an absolute decline in output.

The overall finished stocks accumulated by industry have not changed recently (the balance has stabilized at zero). This development allowed to maintain stable evaluations of finished stocks (above – below the

norm). However, across individual industries the picture is rather diverse. A growth in finished stocks was registered in chemistry, petro-chemistry, and mechanical engineering. In other industries, the reports on a decline in stocks were more numerous, especially many such responses were registered in light industry and the forestry complex. However, the scarcity of finished stocks prevails only in the forestry complex.

Competition in the Russia's industry has not changed significantly in the last years, an evidence of which is the dynamics of evaluations of the level of competition on competitive markets, i.e. markets where it exists and where its level is not equal zero. The only evident change is the increasing level of major types of competition (inside Russia and with countries outside the former Soviet Union). However, the proportion of these two types of competition has not changed. On the whole, Russian enterprises directly affected by competition evaluate the internal Russian competition to be at the similar level as competition with imported products. The level of competition inside Russia equal to or even higher than competition with imported goods is reported by the majority of industries. Only mechanical engineering demonstrates a stable evaluation of the level of competition with imports as higher, although only slightly, than the level of competition inside Russia.

At the same time, it shall be taken into account that the share of markets where effects of competition are clearly felt principally differs in terms of two types of competition mentioned above. In the case all sales markets are represented as 100 %, the internal Russian competition in October of 2002 is registered on 87 % of markets, while 13 % of markets are free of competition among Russian products. At the same time, according to reports of enterprises, the competition with imported products has place on only 55 % of markets, while on 45 % of markets Russia-made products do not compete with imports.

Estimates of changes in effective demand continue to lose points in terms of optimism. In October of 2002, the balance of estimates (will increase – will decrease) declined further by 11 points and turned out to be at the record low since the start of post-default growth. Estimates of an absolute decrease in cash sales prevail across the majority of industries. Only power engineering, mechanical engineering, and food industry still expect a growth in effective demand. However, in this situation barter transactions will be hardly used to compensate the declining cash sales. Enterprises expect a most intensive decrease in amounts of barter in the last 22 months. A growth in barter is possible only in food industry. At the same time, it seems most probable that amounts of promissory note and offset transactions will not change till the end of 2002. The overall balance of forecasts with regard to changes of this indicator for the second half-year is at zero.

Estimates of changes in output also loose optimism. Although in September and October the respective balance dropped by 12 points, it remains positive, and a growth in industrial output in Russia will continue. A decline in this indicator is possible only in non-ferrous metallurgy, chemistry, petro-chemistry, and construction industry. The changes in demand and output affect the employment plans of enterprises. The October survey registered the most pessimistic estimations of this indicator (in 1999 through 2002) for industry at large and across the majority of industries. New employment is probable only in the forestry complex.

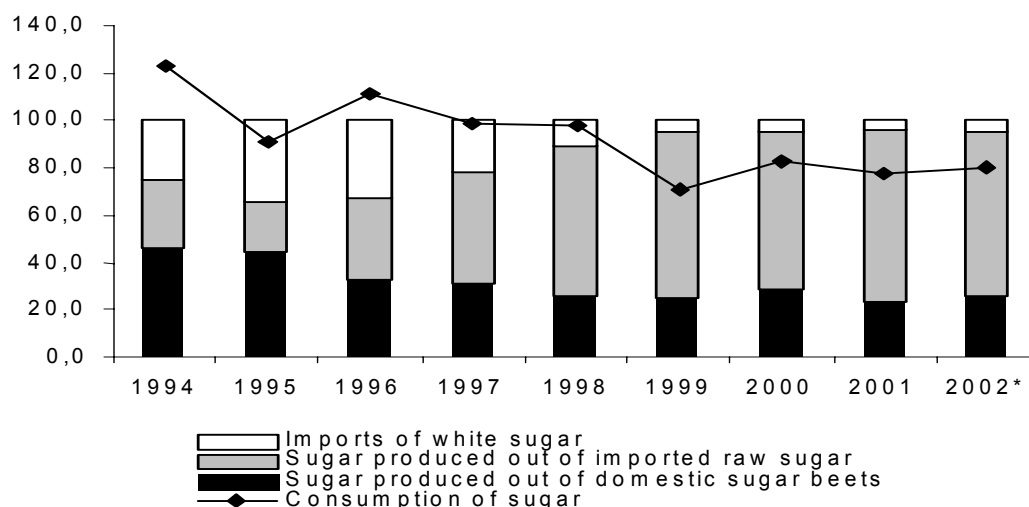
*S. Tsukhlo*

## **Russian Sugar Market in 2002: Outcomes of Three Years of State Regulation**

Seasonal fluctuations are an immanent feature of the Russian sugar market both from the point of view of technological cycle (production of raw inputs, their processing, import of raw sugar for further processing in case of lacking domestic supply of sugar beets) and the state regulation of this market.

The basic problem of national sugar market being the primary concern of state regulation in the past few years is the continuous shrinking of share of white sugar produced out of domestic inputs and the growing dependence on import of cheap raw sugar for processing. The substitution of import for domestic production (Picture 1) results in regress of a traditional industry of the Russian economy and consequently in deteriorating performance of domestic sugar beets producers and heavier dependence of domestic market on the world market fluctuations.

Picture 1. Russian sugar market: consumption and structure of raw inputs supply, %



\* - 2002 - estimate.

\*\* - consumption as percent of total supply.

Source: Bulletin of Russian Sugar Producers' Union, Customs Statistics of Foreign Trade, corresponding years.

To solve the problem the state has chosen protective strategy of market regulation aimed at attaining two goals: halting of uncontrolled import of sugar (both white sugar ready for consumption, and raw sugar being an input for domestic processors) and favouring of domestic sugar beets production, recovery of domestic resource base, support of domestic agricultural producers. Two regulation tools were applied: import tariffs and quotas (in the past three years sold at autumn tenders).

What are the outcomes of this regulation in 2002 and what is the current market situation? On the whole we can say that in 2002 the latter remained actually the same as in the past two years both from the point of view of demand/supply and the state market regulation.

The white sugar import is constrained at the level of about 0.3 million tons due to high import tariffs (in 2002 - 40% but not less than 140 EUR per ton and seasonal duty - 45% but not less than 160 EUR per ton). For this item the tariff regulation turned out to be rather efficient.

Although in addition to import tariffs the supply of raw sugar is regulated by quotas, the effect of regulating this market segment is less vivid. While import quota for the whole 2002 is 3.65 million tons, 3.3 million tons have already been imported under it in the first half of the year. The remaining 0.3 million tons will be supplied in October-December. At the same time by the second half of September (i.e. the time when domestic-grown sugar beets start to be delivered to processing plants) 4.2 million tons of raw sugar have already been imported, i.e. the volume of supplies in excess of the quota reached 0.8 million tons.

Thus, the only meaningful result of market regulation is that quotas and import tariffs helped to separate the periods when processors get imported inputs (raw sugar) and sugar beets from domestic producers. On the whole the scheme of seasonal supplies works: almost all raw sugar imports are delivered in the first half of the year while in its second half sugar plants process primarily domestic sugar beets. At the same time two objectives of regulation remain unattained: first, deliveries of sugar in excess of quotas are beyond domestic regulation, world prices being their major determinants. In case world prices go down, the non-quota sugar is supplied to the Russian market despite all ordinary, seasonal and even special elevated import tariffs as low prices for raw sugar make up for suppliers' losses from paying duties. For example, in 2001 (i.e. already after the introduction of quota mechanism) raw sugar imports grew by 18% as compared to 2000 (although then no quotas existed) including over 1.5 million tons imported in excess of the quota. Second, no radical changes occurred in domestic production of sugar beets. The state has no idea of how to support domestic producers while private investments in this segment have not yet altered the existing market trends and, besides, negatively correlate with supply of imported inputs. One can hardly expect that investments in domestic production of sugar beets will grow despite excessive imports of cheap raw sugar.

In the current year the expansion of areas planted to sugar beets was minor, but yields grew by about 5% most likely due to larger fertilizer application and renovation of agricultural machinery inventories (being the

effect of investments). Still, processing of new crop showed that the output of sugar per ton of sugar beets is 2% less than in the previous year and thus the production of domestic sugar will hardly exceed (or will only slightly exceed) the 2001 level.

It's hard to expect any improvements in 2003 since the approaches to state regulation remain the same. The resolution on regulating sugar market in the coming year<sup>6</sup> adopted in mid-July doesn't alter the support mechanisms introducing only quantitative amendments: the quota is increased up to 3.95 million tons and tariffs are notably elevated: the duty on raw sugar - up to 0.2-0.23 (beginning from July 1) EUR, the duty on white sugar - up to 0.24-0.27 EUR per kilogram. The results of import quota tender held in late September prove the invariability of selected market support strategy.

Summing up the results of the tender we'd like to underline several facts.

First, the activity of tender participants was rather high resulting in rapid price rise during trading sessions. A year before an average purchase price was 50-51 USD per ton, in 2000 - 60 USD per ton while this September - 100-105 USD per ton.

The number of tender participants didn't grow much since principal players on the domestic sugar market are already known. In 2001 they played rather cautiously and actual prices remained far below the upper limit. This year the quota prices didn't fall below 100 USD per ton. There is nothing strange about it. By the time the tender was held market operators already knew that the 2003 import duties on sugar supplied in excess of the quota will be record high - 200 EUR per ton in the first half of the year and 230 EUR - in the second. This fact explains high activity of tender participants: given the new tariff level import of non-quota sugar becomes unprofitable and thus the focus is shifted to getting quotas.

According to "RusAgro" (one of the largest market operators and buyer of the biggest quota at the recent tender - 19 lots) the prices were pushed up by Western companies - for them Russia is a strategic market and they can afford to inflate prices given low world prices for raw sugar. To our mind, the price rise was provoked by high demand for sugar quotas conditioned by high import tariffs.

Second, the sale of quotas becomes a good source of federal budget receipts. The first quota tender brought to it 214 million dollars, the second - 185 million dollars and the recent one - 397 million dollars. Probably, the key answer to the question of why state policies of regulating sugar market remain unchanged are these 800 million dollars "earned" by the budget during three years.

Third, it becomes obvious that 2003 can repeat the 2001 pattern when prices for quota and non-quota sugar levelled off due to low prices on the world market and thus the effect of tariff regulation was brought to nought. Companies that participated in the tender and paid for quotas can then incur losses. Such a situation is quite possible given over-production of sugar in the world and the forecast price drop throughout 2002/2003 marketing year<sup>7</sup>. Having made losses, these companies will again start to lobby their interests insisting on elevation of import duties on non-quota sugar.

Fourth, the tender results are a clear indication of forthcoming domestic sugar prices' rise already in the first months of 2003, i.e. by the time quota sugar will start to be supplied to Russia. Personal consumption will hardly go down in response to it due to the enormous market inertia, the population's non-readiness to substitute alternative sweeteners for sugar. The overall drop of demand will most likely be an outcome of smaller use by large consumers: producers of confectionery and beverages. Their shifting to alternative imported sweeteners and the deliberate maintaining of high sugar prices by companies that paid for quotas may result in domestic sugar market collapse.

*Khramova I.*

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## **Foreign Trade.**

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According to the latest WTO estimates, in the first six months of this year the total amount of Russian import increased by 7 % as compared with the figures registered in the respective period of the preceding year. As concerns this development, as well as imports from China, which grew by 10 %, it is an exception from the general trend observed on many leading world markets, where was registered a significant decline in the amounts of import. According to WTO, in January through June of 2002, the imports from USA and Western Europe decreased by 6 % as compared with the figures registered in the first six months of 2001. At

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<sup>6</sup> Government Resolution № 536 "On tariff regulation of raw and white sugar imports in 2003", July 15, 2002.

<sup>7</sup> Forecast of the International Sugar Organization (ISO), Bulletin of Russian Sugar Producers' Union № 37 (264), September 26, 2002.



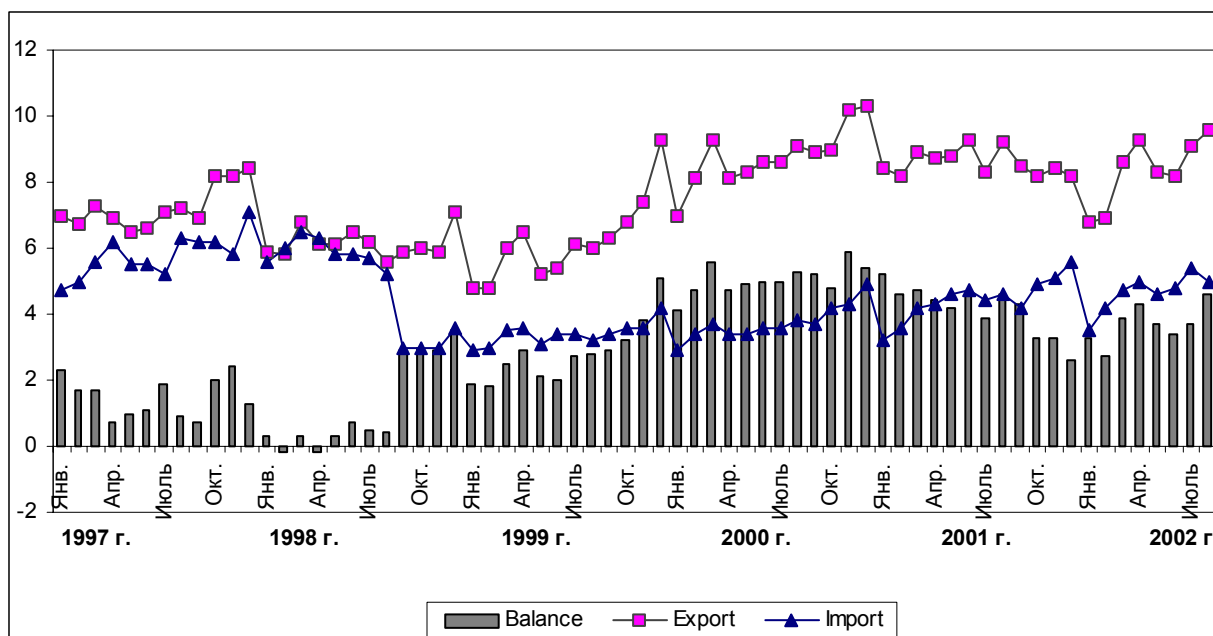
the same time, it shall be noted that in 2001 imports on US and European markets were by 3.5 % and 3 % respectively lower than in the preceding year.

In Japan and Latin American countries, the decrease in imports was most pronounced than on any other world market and made 10 %. According to WTO experts, this trend is related to the fact that the “investment bubble in information and communications sectors burst, the general economic activity abated and the rates on stock markets went down.”

In August of 2002, the Russia’s foreign trade turnover made US \$ 14.6 billion and grew by 5.8 % in comparison with the figures registered in the respective period of the preceding year. As compared with last August figures, both exports and imports increased (by 6.4 % and 9.4 % respectively). Exports made US \$ 9.6 billion (the record high since January of 2001) and imports made US \$ 5.0 billion.

As compared with this July figures, in August exports grew by 4.9 %. This increase in exports was mostly related to growing deliveries of machinery and equipment, as well as energy resources. As compared with this July figures, in August imports fell by 7.5 %, i.e. after a sharp July surge imports practically returned to the June level. The active balance of trade increased up to US \$ 4.5 billion and was at its maximum in the period from August of 2001.

Figure 1. Main indicators of Russia’s foreign trade (in US \$ bln.)



Source: RF Goskomstat

In August, the price situation on world markets continued to improve – world prices of the staple Russia’s exports increased by 2.0 % on the average in comparison with the July figures. For instance, at the end of the month oil prices at the New York commodity exchange exceeded the level of US \$ 30 per barrel, thus reaching the record high in the last 15 months. URALS prices increased by 3.8 % up to US \$ 25.7 per barrel, oil products also went up by 3.8 %, while European prices of natural gas grew by 2 %.

The business situation on the world market of ferrous metals was stable this August. Export prices of reinforcing steel, commercial steel, hot and cold rolled steel exported from EU member states to third countries did not change in comparison with July figures and made US \$ 200 – 230, 215 – 250, 270 – 290, and 310 – 340 per metric ton respectively by the end of the month.

In the situation of low demand and large finished stocks, the trend towards a decrease in prices prevailed on the majority of key markets of non-ferrous metals.

On October 1, the seasonal duty on imported unrefined sugar were increased from Euro 0.15 per kilogram to Euro 0.2 per kilogram. This duty will be in effect till December 31, 2002.

By increasing duties, the government establishes the most favored treatment for domestic producers. Seasonal import duties on unrefined and refined sugar are annually set by the government. For instance, in

2001, the rate of the duty on unrefined sugar was set at Euro 0.15 per kilogram and on refined sugar at Euro 0.18 per kilogram for the period from July 1 to December 31, 2001.

*Table*

**The average monthly world prices in August of the respective year**

	1996	1997	1998	1999	2000	2001	2002
Oil (Brent), USD / metric ton	21,04	18,25	12,5	20,2	29,4	25,7	27,2
Natural gas, USD / thous. m <sup>3</sup>	2,856	2,121	1,858	2,8	4,437	2,91	2,999
Gasoline, USD / metric ton	0,6299	0,5941	0,4128	0,6476	0,9021	0,776	0,834
Copper, USD / metric ton	2001,4	2481,7	1627,4	1646,6	1941,7	1499,4	1480,0
Aluminum, USD / metric ton	1480,1	1563,7	1345,4	1421,1	1546,4	1374,9	1292,0
Nickel, USD / metric ton	7100,4	6737,3	4137,1	6430,8	8092,9	5554	6720,0

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

On October 1, the government resolution “On the amendment of rules governing the transfer of goods across the customs border by individuals” was enacted. It is a regular attempt to minimize “gray” imports on the part of the government. According to the estimates of the RF Ministry for economic development, in 2000 “shadow” import of footwear and other products of light industry made US \$ 10.8 billion and US \$ 12.4 billion in 2001.

After the enactment of this regulation, individuals may import free of duty goods worth up to US \$ 1000 and weighing up to 50 kilograms, but only in case the owner is personally present at the customs office. All goods exceeding these standards shall be subject to the common duty and VAT collection. On a temporary basis, until January 1, 2003, the goods weighing 50 to 100 kilograms and worth US \$ 100 to 5000 will be exempted from VAT.

The recently abolished rules were established for individuals; however, on practice they were used by legal entities, so called cargo firms, which based their businesses on duty free imports fraudulently pretending to be individuals. The scheme used by cargo firms was rather simple. The carriers divided shipments in small lots, obtained a power of attorney from an individual for each lot and imported goods free of duty. Previously, the shipments weighing from 50 to 200 kilograms and worth up to US \$ 10000 were subject to a 30 % duty and were exempted from VAT. Smaller shipments were absolutely free of duty. Now, it is impossible to avoid paying the duty, however small the shipment is.

Since October 4, the radically increased duties on import of cars manufactured seven and more years ago are in effect. According to the government resolution No. 643 of August 30, 2002, the following duties are introduced with regard to such cars imported by individuals: 2 Euro per 1 cubic cm of motor capacity for cars with motors below 2.5 thousand cubic cm and 3 Euro per 1 cubic cm of motor capacity for cars with motors above 2.5 thousand cubic cm (as compared to previously effective duties of 1.4 Euro).

The duties on cars manufactured 3 to 7 years ago remained without change (0.85 Euro per 1 cubic cm of motor capacity for cars with motors below 2.5 thousand cubic cm and 1.4 Euro per 1 cubic cm of motor capacity for cars with motors above 2.5 thousand cubic cm).

The new customs duties result in similar prices of cars manufactured 3 to 7 years ago and older cars. This development shall shift preferences in favor of newer cars.

Resolution No. 642 of August 30, 2002, introduces higher rates of duties on cars manufactured 7 and more years ago imported by legal entities (it shall be noted that legal entities import significantly fewer old cars than individuals).

For instance, in 2001, legal entities imported 29 000 cars used for 3 or more years by the moment of customs clearance) as compared with 23.5 thousand cars imported in 2000. Individuals imported 352.5 thousand of used cars in 2001, as compared with 131.9 thousand cars imported in 2000.

According to the August data (2002), the amounts of both imports and exports related to CIS countries exceeded the figures registered in the respective period of the preceding year by 6 %. Russia maintains the active balance of trade vis-à-vis these countries, its exports to CIS countries made US \$ 1.39 billion (US \$ 0.33 above the amount of imports).

In October, the government abolished the resolution “On the procedure governing the introduction of a special duty on ferrous pipes imported from Ukraine” in effect since May of 2001. At the same time, the previously approved Agreement (of April 10, 2001) regulating import of ferrous pipes from Ukraine was prolonged. This decision may negatively affect the interests of domestic producers of pipes in Russia, since now Ukraine has no reasons to conclude of prolong any agreements on self-restriction of respective imports.

Earlier, the special duties were the main means forcing Ukraine to maintain the system of quotation of its imports.

A most important aim of EvrAzES is also to solve the problem of import customs duties. In the course of the October meeting of EvrAzES representatives, it was noted that at present the levels of customs duties on almost 60 per cent of the total nomenclature of goods traded among Russia, Byelorussia, and Kazakhstan have been harmonized, while an efficient common system of customs tariffs may be created when 80 % of customs duties would be adjusted.

N. Volovik N. Leonova

## **Unification of corporate governance rules in Russia and EU: formal and real criteria<sup>8</sup>**

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The use of unified EU rules in the course of improvement of the Russian model of corporate governance became an actual issue in 2001, when the idea of feasibility of formation of the “common European economic space” was approved at the Russia – EU summit.

Certainly, a considerable number of English and American mechanisms for *protection* of shareholders’ rights was adopted by the Russian legislation on companies (or, more exactly, corporate law). Nevertheless, the common traditions of the continental European law dominate, what determines the closeness of the Russian company law to the standards set for EU acts in terms of formal criteria reflected in the directives and regulations of the Council of European Union (Table 1). It is also true for standards worked out by different European associations representing the private sector<sup>9</sup>.

Probably, no serious problems would be encountered in the case there arises the need to **formally** harmonize the Russian company law with EU rules (if the use of certain formal pretexts by political opposition in Russia and EU is not taken into account). It would be possible not only because of the state of the Russian legislation, but also because of a number of factors related to EU. For instance, the eighties and the nineties were characterized by a slowdown of the harmonization of EU legislation on companies. This development was most clearly reflected in the course of discussion of draft 5<sup>th</sup> (concerning the structure of public limited companies and the powers and obligations of their organs) and 13<sup>th</sup> (concerning takeover bids) directives, and in the fact that the elaboration of the Statute for a European Company took too much time, i.e. it was related to the areas where national approaches were most different. The resulting compromise (i.e. compiling all major national approaches) decisions and documents (drafts) are so multi-variant that they would allow Russia to “fit” in this European format without much effort. For instance, the adaptation to the standards relating to the model of “European company” adopted in 2001 after a 30 year discussion would not present a problem for the corporate law of Russia. At the same time, the first and second, relatively “tight” Council directives concerning the areas where legal regulations at the national levels were already rather similar, do not present serious problems for Russia, since the Russian legislation has many similar standards. At last, many issues are still regulated exceptionally by national legislation (for instance, liquidation), have different levels of legal regulation (for instance, groups of companies), or are strikingly different across countries (for instant, self-regulation).

**Real** economic constraints and internal contradictions of the model of corporate governance forming presently in Russia present a more serious problem in the context of potential harmonization.

On the whole, taking into account a number of empirical and legal data, it may be stated that there is a *stable and fundamental contradiction in the forming system of corporate governance*. Its essence is the fact that two principally different approaches exist in the present system. On the one hand, concentration of joint stock capital, which requires a minimum of legal means of protection of shareholders. On the other hand, the Anglo Saxon legal tradition, which is characterized by maximization of means of legal protection of minority shareholders.

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<sup>8</sup> The article is based on the materials of IET and RECEP researches conducted in 2001 through 2002.

<sup>9</sup> See: Corporate Governance Principles and Recommendations. European Association of Securities Dealers (EASD), May 2000; Corporate Governance Guidelines 2000. The European Shareholders Group. Brussels, February 2000. For a detailed comparative review of pan-European codes of corporate governance and codes of EU member countries see: Comparative Study Of Corporate Governance Codes Relevant to the European Union And Its Member States. Final Report and Annexes I-III. On behalf of the European Commission (In consultations with EASD and ECGN). Weil, Gotshal and Manges LLP, January 2002.

Table 1.

**Availability and level of elaboration of key legislative regulations concerning companies in the Russian law and EU acts (basing on the level of elaboration in EU acts)**

Regulation	Russia *	EU**
Strict and thorough procedures governing the formation of joint stock companies	Present (CC, JSC)	Present (D 1, D 2 Д 1, Д 2), as well as R on EEIG 1985 and R on SE 2001
Strict and thorough elaborated procedure for the maintenance of the size of joint stock capital	Present (JSC, SM)	Present (D 2)
Regulation of establishment of branch offices, representation agencies, and other separate units	Present (CC, JSC)	Minimally (D 11 as concerns accounting)
Key issues of reorganization	Present (CC, JSC), however, further elaboration is necessary as concerns: forms of reorganization Methods of protection of shareholders' and creditors' rights	present (D 3, D 6, draft D 10 on cross border mergers)
Control of "economic concentration"	Present (AMR), although ineffective	"R on mergers", 1989
Single member companies	Present (JSC)	Present (D 12) for close / private companies
Shareholders' preemptive right as concerns shares	Present (JSC, as amended in 2001)	Present (D 2)
Choice between one and two tier systems	Present (JSC)	Present as a compromise of national models (draft D 5, R and D of October 8, 2001, on SE)
Participation of employees in management	No	Present as a compromise of national models (draft D 5, R and D of October 8, 2001, on SE)
Strict requirements with regard to accounting and audit	Present (SM, JSC, etc.), however, it is necessary to introduce levels of tightness depending on the company size; create real conditions for transition to international standards	Present (D 1, D 4, D 7 aimed at harmonizing financial information published by limited companies, D 8 on audit, D 11)
Takeovers and protection of minority shareholders' rights	Present (JSC), however, it shall be elaborated in more detail	Common principles are at the stage of discussion (draft D 13) because of conflicting national approaches
Group of companies (enterprises)	Minimally and inconsistently on subsidiary and dependent companies (CC, JSC), "groups of persons" and affiliated persons (AMR)	Minimally (D 7 on consolidated accounts, social aspects, draft D 9 on "group behavior")
Bankruptcy	Present, however, a radical modification of legislation is necessary	Minimally (C, 1985) mainly regulation of inter-country conflicts
Insider transactions	Minimally, although a special law is necessary	Direct prohibition and minimal standards (D)
Liquidation	Present (CC, JSC)	No

\* JSC is for the law "On joint stock companies", CC is the Civil Code, SM is for the law "On securities market", AMR is for the law "On competition and restriction of monopolistic activities on commodity markets"; \*\* D is for directive, R is for regulation, C is for convention, SE is for "Societas Europae" (European company), EEIG is for European Economic Interest Grouping.

The combination of these approaches resulted in a unique situation of their *mutual neutralization*. Concentration of joint stock capital and gradual "squeezing out" of minority shareholders in principle deteriorates the importance of a broad legal tool kit of protection of minority shareholders from the viewpoint of the corporate sector at large, while the tools of protection of minority shareholders per se transform in tools of corporate blackmail. At the same time, the creation of an extended system of means of legal protection of shareholders' rights constraints the further process of concentration of joint stock capital (as a factor of reverse influence of the law).

Is it possible to discuss the prospects of formation of either classic model in Russia (as adjusted for the processes of convergence of national rules) in this situation? It seems that it is possible to state that in Russia, in spite of the contradiction of approaches described above, takes place the objective (in terms of its economic principles) *gravitation to the continental European model of the company law (corporate governance)*. This conclusion is based on the similarity of the key problems encountered by both Russia and continental EU member countries.

According to K. Hopt, the initial conflict in terms of “principal – agent” in the European company law is rather the conflict between *majority and minority shareholders* than the conflict between shareholders and the board of directors (which, due to the dominance of the American tradition, has been most often discussed in the modern economic theory since the thirties<sup>10</sup>). This situation is based on the differences between continental Europe and USA – UK as concerns joint stock ownership and control structure, what allows to single out two different types of corporate governance systems – insider and outsider systems. Both in US and UK, neither private shareholders, nor institutions have significant shares in companies, while on the continent, shareholdings are highly concentrated in families, other companies, or universal banks (the phenomenon of “groups”). Mutual and cross ownership is frequent. In such companies, boards of directors are often only marionettes in the hands of the controlling shareholder or the parent company. The reaction of the European legislation on companies (if any) to this phenomenon is different safeguards relating to the protection of minority shareholders’ rights<sup>11</sup>.

Russia clearly fits in the typical continental model characterized by puppet boards of directors. The trend towards a superficial reformation of their role noted above is sometimes viewed as a new panacea for efficient corporate governance in Russia. Nevertheless, as concerns the discussion of policies with regard to boards of directors, it is necessary first to settle the apparent problem: is it necessary to legislatively strengthen the role of this management body in the situation, where the controlling shareholder (group), top managers, and the board of directors are most often *identical* in terms of personal composition and / or their interests? In a somewhat different context, it is referred to the possibility to use US – UK prescriptions for the settlement of the continental European problem.

Another problem is related to the traditional requirement to improve the transparency of companies and is similarly complicated. It is well known that strict standards of financial reporting and audit in the system of corporate governance are necessary for portfolio outside investors, i.e. in the cases where a company relays on a considerable inflow of funds from outside joint stock financing. A legitimate question arises: should the state pursue a policy in favor of strict transparency standards in the situation of concentration of joint stock property (or, similarly in this context, reduction of minority joint stock ownership)?<sup>12</sup>

However, the situation is even more complex. For instance, on the one hand, the most serious problem in Russia is the conflict between majority (controlling) shareholders and minority shareholders due to the specifics of the Russian corporate landscape. In fact, the importance of this conflict is based not on its absolute significance, but on the absence of equivalent conflicts in the system of Russian corporate governance<sup>13</sup>. On the other hand, there is no apparent economic necessity and possibility to further tighten measures aimed to protect minority shareholders (such as monitoring of boards of directors, transparency, etc.). Similarly, there are no legislative tools in place, which would protect major shareholders’ (issuers’) rights from corporate blackmail, since this issue shall be settled in the framework of the problem of efficient judicial system. Implementation of a policy in favor of either group of subjects of the system of corporate governance requires a radical economic reform of the existing relations and would result in the upsetting of the balance of interests of all other subjects, who have equal rights to be protected from the viewpoint of general principles of protection of ownership rights. What are *possible solutions*?

1) First of all, it is necessary to take into account the *global trend toward the convergence of models* of corporate governance and formation of generally accepted principles of the “corporation of the 21<sup>st</sup> century.” On the whole, it seems that the most suitable approach is the recognition of the fact that responsibility, accountability, integrity (lawfulness), and transparency are really universal standards for all regimes of corporate governance<sup>14</sup>. At the same time, the opinion that the more fully principles of national entrepreneurship are taken into account, the more efficient will be the functioning of the “corporation of the 21<sup>st</sup> century,” still remains widespread.

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<sup>10</sup> See also: Hopt K.J. et al., eds. *Comparative Corporate Governance – The State of the Art and Emerging Research*. Oxford, 1998).

<sup>11</sup> Hopt K. *Modern Company Law Problems: A European Perspective*. In: *Company Law Reform in OECD Countries. A Comparative Outlook of Current Trends*. Stockholm, Sweden, 7-8 December 2000.

<sup>12</sup> Of course, it concerns only the feasibility of enforceable rules (i.e. those set by the law). Nothing prevents a *close circle* of interested Russian companies to use international accounting principles voluntary. Nothing also prevents these companies to invite “independent managers” and carry out other measures aimed at the improvement of their corporate image.

<sup>13</sup> In the case the separate problem of hostile takeovers is not taken into account.

<sup>14</sup> Fremond O., Capaul M. *Corporate Governance: One Size Fits All?* (2002). [http://rru.worldbank.org/Hot\\_Topics\\_Fremond\\_Capaul.asp](http://rru.worldbank.org/Hot_Topics_Fremond_Capaul.asp)

2) In the long term perspective, it is necessary to move in the direction of a *mixed model*, which, on the one hand, would take into account the balance of interests of all shareholders, or, in more broad terms, all “co-participants.” In practical terms, this approach (at this moment of time) presupposes unfeasibility (impossibility) of the legal fixation of the “national model” of corporate governance corresponding to either classical pattern (it shall be noted that these patterns become more and more eroded). From the viewpoint of the state, the fundamental task is to review corporate governance in the context of protection of and guarantees for ownership rights (both investors and shareholders) and maintenance of the balance of interests (rights) of all participants of corporate relations. Exactly in this context, corporate governance shall be reviewed as the most important institutional condition of economic growth.

3) *Enforcement* of legislation is the principle aspect of the problem. Although significant differences exists across Western countries, in Russia the reform in this sphere is most urgent<sup>15</sup>. In the context of potential harmonization of rules relating to corporate governance in Russia and EU, it is important to take into account the differences across judicial systems of EU member countries, or more exactly, the prospects and frameworks of functioning of the “European legal space” mentioned in the Amsterdam treaty (implementation of conventions on civil and criminal proceedings, equal rights of legal recourse, fast and efficient implementation of legal procedures).

4) As concerns the urgent reforms relating to the company law in Russia, in many aspects they are also similar to the current tasks of the respective reform in the EU. *In Russia, the practical priorities* include such areas as takeovers and mergers, monitoring of large transactions, affiliated structures, beneficiary ownership and responsibilities of owners, collision “management on trust – trust,” groups of companies, bankruptcies, existing size of the state in corporations (for instance, the problem of “golden share”). It is apparent that any progress will be meaningless in case there is no efficient infrastructure and political will in the enforcement of legislation.

Apparently, even in the case Russia is admitted in EU, there would be required a significant *transition period* for the adaptation and harmonization of legal regulations and standards. However, even outside the problem of accession to EU, at present it would be feasible to discuss a number of *positive innovations* (at reception level) present in EU acts, some of which are listed below:

- public approval of new legal regulations concerning companies by all parties (proceeding from the procedure adopted for the elaboration of Directives);
- dependence of the level of disclosure of information (transparency) on economic conditions: size of a company, organizational and legal form of a company, concentration of ownership (the fourth and other Directives);
- protection of creditors’ rights and the requirement of independent evaluation in the course of mergers and divisions of companies (the third and sixth Directives);
- regulation of employees’ rights in the course of reorganization (Directive 77/197);
- elaboration of circumstances in which consolidated accounts are to be drawn up (the seventh Directive), although difficulties are apparent (the Directive is not implemented in some EU member countries);
- transparent and understandable requirements concerning individuals and legal entities performing audit functions (the eighth Directive), although the problems of efficient audit are apparent both in Russia (merger of ownership and management) and “puppet” boards of directors (some EU member countries);
- incentives for single member private limited liability companies (the twelfth Directive), what is especially important in Russia, taking into account the traditional trend towards the closeness of companies and problems relating to the responsibility of owners;
- use of the proposals for the draft fifth directive as concerns the cooperation with employees as recommendations for companies, although in this case it would be more acceptable to use approaches employed by countries where the tradition of cooperation is more weak (for instance, UK approach excludes such provisions from the corporate law);
- proposals drawn up by the group of top experts in 2001 as concerns regulation of takeovers (elaboration of bidders’ rights with regard to replacement of members of boards of directors and top managers, acquisition of residual shares, guarantees of “fair price” for minority shareholders, etc.);
- transparency of legal procedures at the EU level and control of implementation of requirements set by Directives and other EU acts by the European Court of Justice.

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<sup>15</sup> See: Radygin A. D., Entov R. M. *Zaschita prav aktsionerov: teoriya i praktika pravoprimereniya* [Protecting shareholders’ rights: theory and practice of enforcement]. M., IET, 2002.

