

RUSSIAN ECONOMY: TRENDS AND PERSPECTIVES
December 2002

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The State of the Federal Budget

The federal budget in January through October of 2002 was executed as follows: revenues – Rb. 1803.4 billion (or 20.2 % of GDP), expenditures (actual financing) – Rb. 1589.5 billion (or 17.8 % of GDP). (see Table 1). The federal budget surplus made Rb. 213.9 billion, or 2.4 % of GDP.

Table 1.

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

	XII'01	I'02	II'02	III'02	IV'02	V'02	VI'02	VII'02	VIII'02	IX'02	X'02
Revenues											
Corporate profit tax	2,4%	1,4%	1,4%	1,5%	1,9%	1,9%	1,7%	1,7%	1,7%	1,6%	1,7%
Personal income tax	0,0%	0,0%	0,0%	0,0%	0,0%	0,0%	0,0%	0,0%	0,0%	0,0%	0,0%
VAT, special tax and excises	0,0%	4,9%	4,4%	4,0%	3,9%	3,6%	3,5%	3,5%	3,3%	3,2%	3,1%
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%	9,0%	8,9%
Other taxes, duties and payments	7,1%	6,9%	6,4%	6,8%	6,9%	7,0%	7,0%	7,0%	7,0%	6,9%	6,9%
Total- taxes and charges	2,2%	2,4%	2,6%	2,5%	2,4%	2,3%	2,3%	2,2%	2,1%	2,0%	2,0%
Non- tax revenues	3,7%	3,2%	3,3%	3,2%	3,0%	2,9%	2,9%	2,9%	2,8%	2,8%	2,8%
Revenues, total	0,6%	9,7%	9,1%	8,7%	8,7%	8,4%	1,8%	2,0%	2,0%	2,0%	2,1%
Expenditure	16,2%	20,4%	19,6%	19,6%	19,9%	19,6%	19,3%	19,4%	18,9%	18,5%	18,6%
Public administration	1,4%	2,1%	1,6%	1,4%	1,3%	1,2%	1,3%	1,4%	1,4%	1,4%	1,6%
National defense	17,6%	22,4%	21,2%	20,9%	21,2%	20,9%	20,6%	20,9%	20,4%	20,0%	20,2%
International activities											
Judicial power	0,5%	0,1%	0,2%	0,3%	0,4%	0,4%	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%	2,4%	2,4%
Fundamental research	0,3%	0,4%	0,4%	0,4%	0,4%	0,4%	0,4%	0,4%	0,3%	0,3%	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%	0,1%	0,2%
Social services	1,6%	0,6%	0,9%	1,0%	1,2%	1,2%	1,3%	1,4%	1,4%	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%	0,2%	0,2%
Other expenditure	1,3%	0,1%	0,3%	0,4%	0,5%	0,6%	0,7%	0,8%	0,8%	0,8%	1,2%
Expenditure, total	2,3%	3,7%	4,8%	4,8%	5,3%	5,2%	5,2%	5,2%	5,1%	4,9%	5,5%
Loans, redemption exclusive	2,6%	2,0%	3,4%	3,4%	2,6%	2,5%	2,4%	2,3%	2,4%	2,4%	2,2%
Expenditure and loans, redemption exclusive	3,0%	2,9%	3,3%	3,6%	3,9%	4,0%	4,0%	4,0%	3,9%	3,8%	3,9%
Budget deficit (-)	14,7%	10,9%	15,0%	16,1%	16,9%	17,1%	17,2%	17,2%	17,1%	16,9%	17,8%
Domestic financing	2,9%	11,5%	6,2%	4,8%	4,3%	3,8%	3,4%	3,7%	3,3%	3,1%	2,4%
Other taxes, duties and payments	-0,1%	-11,2%	-4,6%	-2,7%	-2,0%	-1,8%	-1,6%	-1,8%	-1,3%	-1,2%	-0,5%
Total- taxes and charges	-2,8%	-0,4%	-1,6%	-2,1%	-2,3%	-1,9%	-1,8%	-1,9%	-1,9%	-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%	-3,1%	-2,4%

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

As compared with the figures registered in the respective period of 2001, the budget revenues increased by 3.4 p.p., while expenditures grew by 3.9 p.p. and budget surplus decreased by 0.5.

VAT accounted for the major share of federal tax revenues – 37 % of the total tax revenues, what is somewhat below the respective indicator observed in January through October of the preceding year (42 %).

Social services accounted for the major part of the expenditures of the federal budget – 5.5 % of GDP, or 31 % of the total expenditures. As of November 1, the expenditures for the servicing of the public debt made 2.2 % of GDP, while in the respective period of the preceding year they made 2.9 % of GDP.

According to the preliminary estimates of the Finance Ministry, as concerns the fulfilled funding² the federal budget in January through November of 2002 was executed as follows: revenues – Rb. 1991.0 billion (20.1 % of GDP), expenditures – Rb. 1920.1 billion (19.4 % of GDP) (see Table 2).

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

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

Table 2.

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

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

According to preliminary estimates, in November of 2002 tax revenues of the federal budget decreased to Rb. 98 billion (without the single social tax). In real terms the revenues made 241.0 % of the level registered in January of 1999, while the same indicator was at 299.7 % in October of this year (see Table 3).

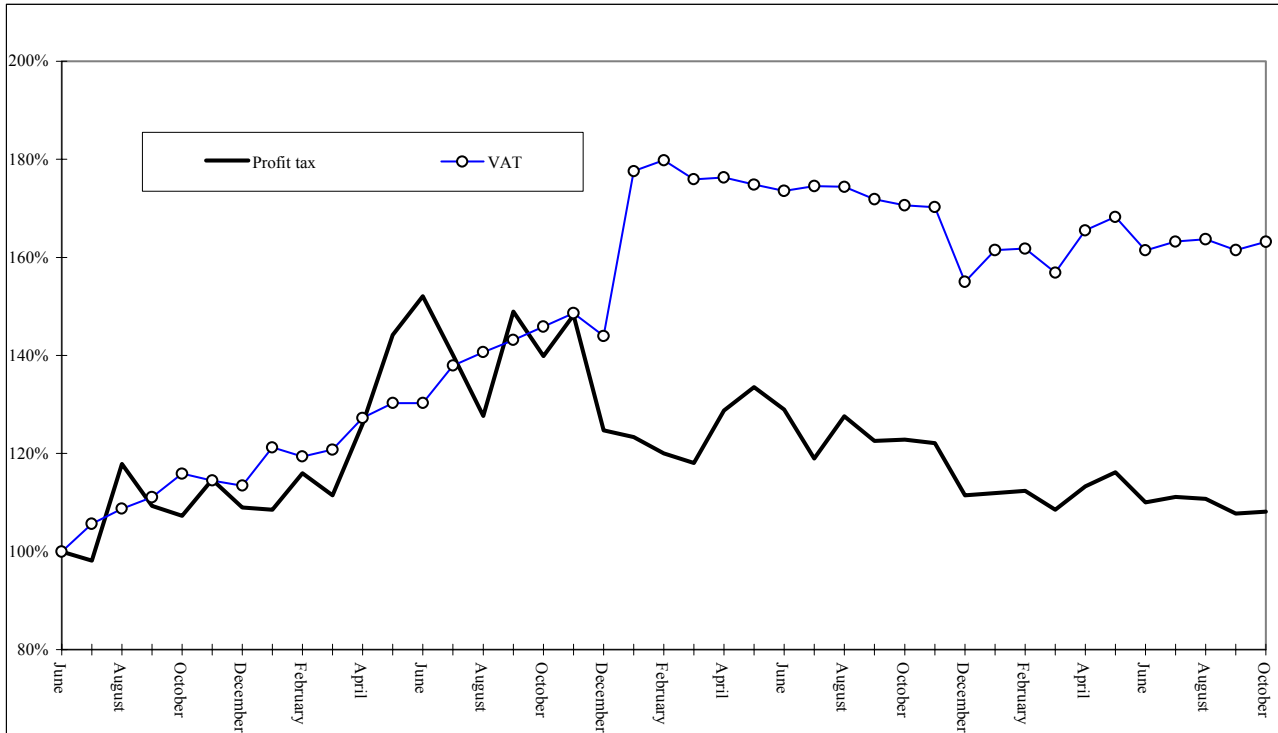
Table 3.

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

1999											
I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII
100,0%	115,1%	122,0%	122,1%	104,5%	112,9%	127,0%	127,5%	124,3%	141,4%	160,8%	213,1%
2000											
I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII
149,3%	160,5%	181,3%	205,8%	233,1%	186,9%	181,0%	186,4%	173,1%	181,1%	201,7%	254,1%
2001											
I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII
204,4%	198,4%	227,6%	267,5%	252,2%	233,3%	231,9%	235,6%	219,4%	237,5%	247,3%	360,6%
2002											
I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII
218,7%	187,1%	234,8%	277,8%	239,6%	218,0%	284,4%	246,5%	254,8%	299,7%	241,0%	

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.

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



The debts related to the payments due to the federal budget made Rb. 248.8 billion as on November 1, 2002, the arrears of the profit tax made Rb. 35.3 billion. For the dynamics of actual tax debts as broken down by key taxes since June of 1999 see Figure 1⁴.

The revenues of the consolidated budget in the first 10 months of 2002 made 32.0 % of GDP, including tax revenues at 25.4 % of GDP (see Table 4). Expenditures of the consolidated budget somewhat increased and made 29.3 % of GDP. The surplus of the consolidated budget in January through October of 2002 was 2.7 % of GDP, what is the record low in the last two years.

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%

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.

2001												
	I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII
Taxes	22,7%	23,6%	23,9%	25,4%	26,4%	26,0%	26,1%	25,9%	25,0%	24,8%	25,4%	27,1%
Revenues	25,9%	27,1%	27,4%	29,3%	30,5%	29,8%	29,9%	29,7%	28,3%	28,2%	28,8%	29,5%
Expenditures	16,8%	22,8%	23,7%	24,7%	25,1%	25,3%	25,5%	25,6%	24,9%	24,7%	25,0%	25,6%
Deficit	9,1%	4,2%	3,7%	4,7%	5,4%	4,4%	4,4%	4,1%	3,5%	3,5%	3,8%	3,9%
2002												
	I	II	III	IV	V	VI	VII	VIII	IX	X		
Taxes	28,7%	23,6%	24,3%	26,5%	26,6%	25,9%	26,4%	25,9%	25,2%	25,4%		
Revenues	32,9%	31,3%	31,4%	33,6%	33,6%	32,7%	33,3%	32,5%	31,7%	32,0%		
Expenditures	18,3%	23,7%	26,0%	28,4%	28,4%	28,8%	29,1%	28,9%	28,4%	29,3%		
Deficit	14,6%	7,7%	5,4%	5,3%	5,2%	3,8%	4,2%	3,7%	3,3%	2,7%		

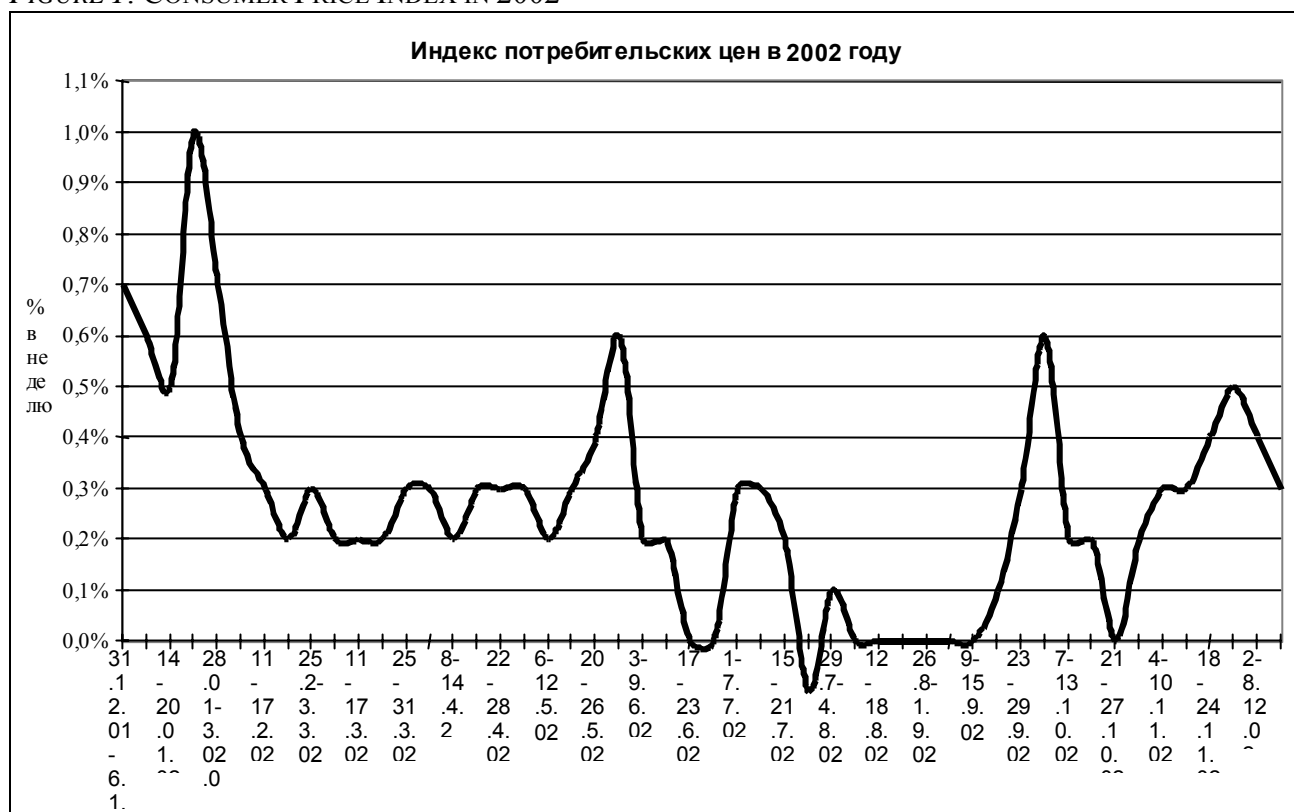
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Monetary Policy

In November of 2002, the consumer price index increased by 1.6 %. The greatest rise in this group was registered for food products (+ 2.0 %), while prices of non-food goods increased only by 0.9 %, and prices of services grew by 1.9 %. The commodity structure of the increase in consumer prices is an evidence in favor of the hypothesis about the domination of seasonal factors. For instance, the growth in prices of fruits and vegetables made 6.2 %, while prices of groats and legumes increased by 11.1 % and of granulated sugar and butter – by 5.1 %.

In December, relatively high rates of inflation persisted (see Figure 1). According to our preliminary estimates, the monthly increase in CPI was over 1.8 %, what makes 24 % per annum. Therefore, the annualized inflation may be at 15.5 %. This value is below the respective indicator observed in 2001 (18.8 %), however, in annualized terms, it exceeds the upper limit of the range of targeted inflation for year 2002 (12 % to 14 %) by 1.5 p.p.

FIGURE I. CONSUMER PRICE INDEX IN 2002

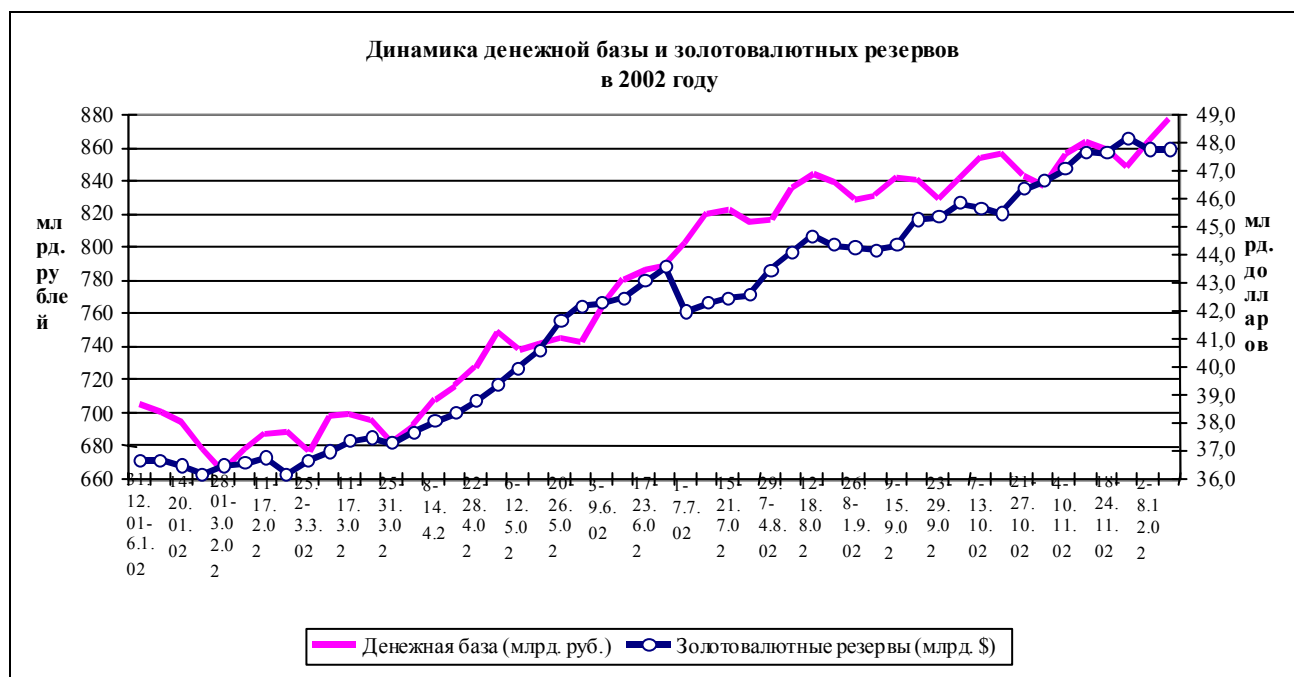


In December of 2002, the rapid growth in the gold and currency reserves of the Bank of Russia ceased (see Figure 2). We suppose that it is primarily due to the fact that the Finance Ministry of the RF purchased currency in order to repay external debt (in the last month the amount of debt payments made over US \$ 900 million). At the same time, the accumulated amount of reserves (Rub. 48 billion) has reached the historic

high for Russia and exceeds different estimates of “safe” (i.e. sufficient to cover three-months imports and ensure the stability of forex market) level (US \$ 40 to 45 million).

In December, the dynamics of monetary base were determined by seasonal factors. A rapid growth in monetary aggregates resulting from demand for liquidity on the part of households (in relation to increasing expenditures) and firms (payments to the budget and completing of annual balances), as well as growth in budgetary expenditures, is traditionally observed in the end of the year. For instance, in the first two weeks of December, the increase in the narrow monetary base made 3.4 % (see Figure 2).

Figure 2. DYNAMICS OF THE MONETARY BASE AND GOLD AND CURRENCY RESERVES IN 2002



S. Drobyshevski.

Financial Markets

The Market for Government Securities

In December, a side trend prevailed on the market Russian forex-denominated bonds (see Figures 1 and 2). The quotations of both short and long term bonds practically did not change. The maximal growth was registered for bonds of the 7th tranche of Minfin bonds (+ 2.81 %), RUS-18 (1.2%), and RUS-30 (+1.09%). It shall be also noted that on December 4 the prices of the most liquid Russian securities – (RUS-30 maturing in 30 years) exceeded an important level – 80 % of the nominal value. However, by the end-month the quotations of bonds declined again. Instability on the markets of other developing countries, in particular, Brazil and Argentina, played a negative role. Higher rankings of the Russian Federation by the leading international ranking agencies have been already taken into account in prices and had practically no impact on the yields of bonds.

In December, the RF Finance Ministry transferred US \$ 352.8 million as the payment of interest on Eurobonds. On December 18, the RF Finance Ministry announced the completion of the first tranche of exchange of commercial debt of the former USSR into Russian Eurobonds. The total amount of claims of the creditors of the former USSR made US \$ 1.28 billion. According to the estimates of the Finance Ministry, the amount of the commercial debt of the former USSR makes over US \$ 3 billion taking into account the accumulated interest.

Figure 1. Yield to Maturity of Minfin Bonds in September through December of 2002.

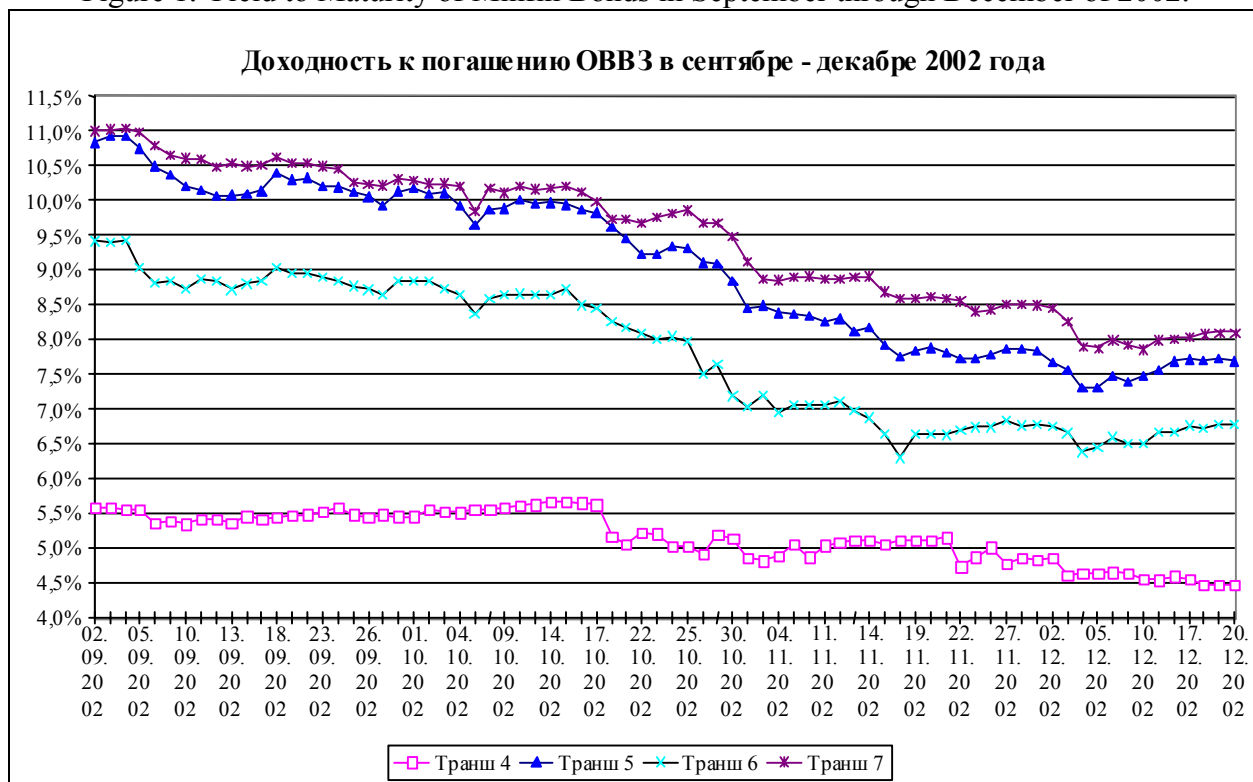
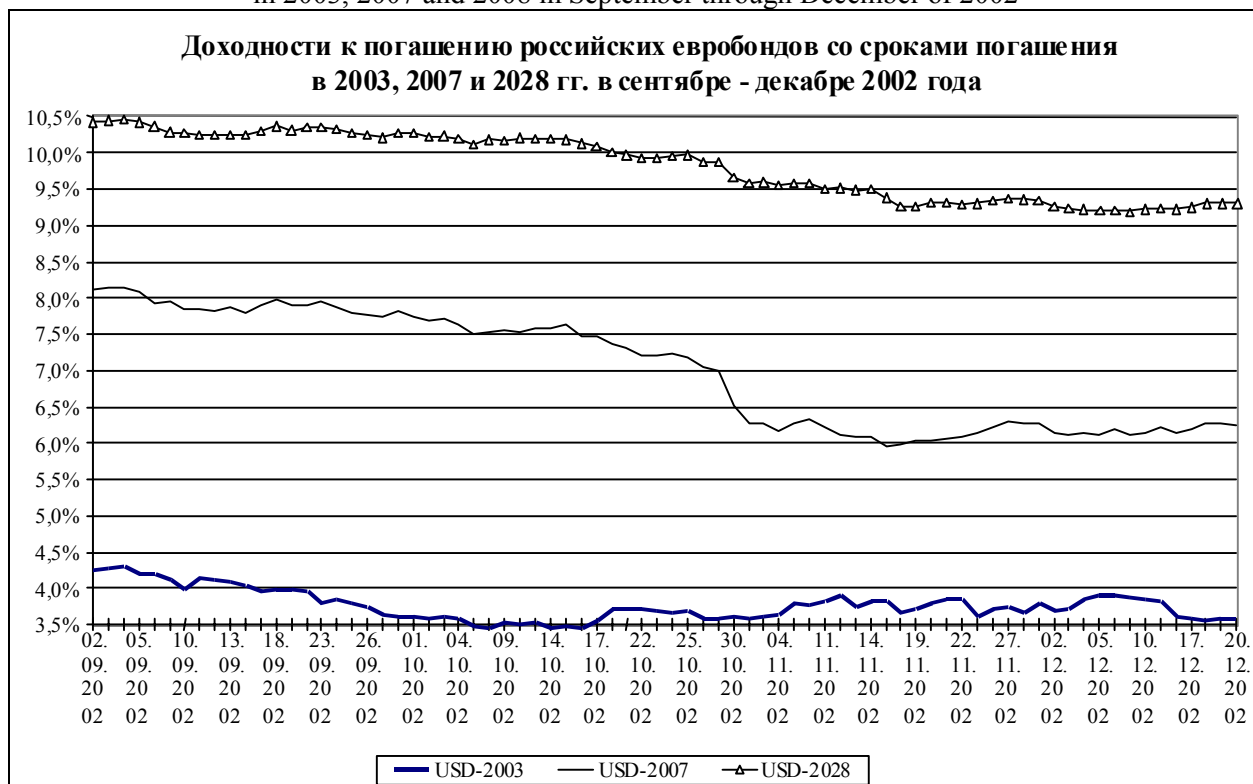


Figure 2. Yield to Maturity of Russian Eurobonds with Maturities in 2003, 2007 and 2008 in September through December of 2002

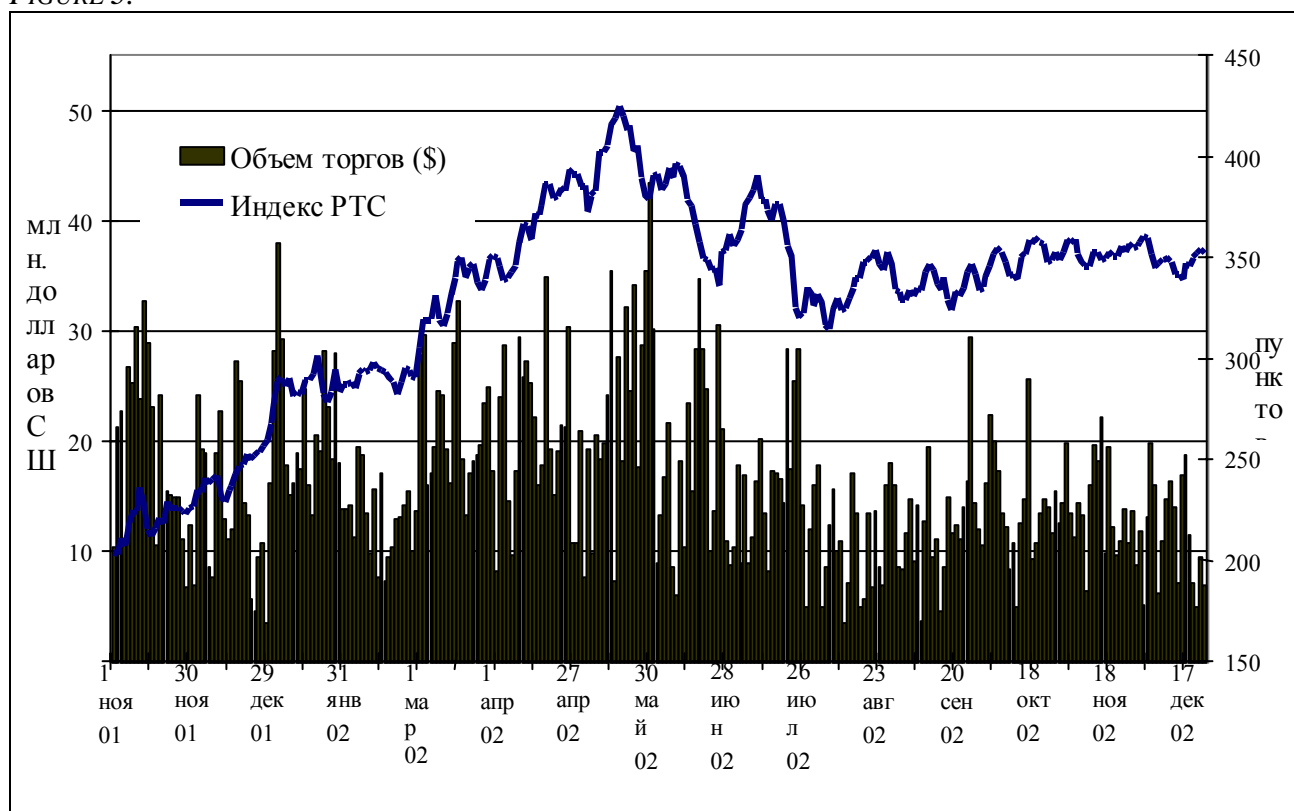


In the first three weeks of the month, the annualized yield of securities on the domestic debt market made 13.18 %. In December, there took place three auctions for the placement of government bonds amounting to the nominal value of RUR 20 billion, the actual placed amount made RUR 8.13 billion, the amount of demand being RUR 9.37 billion.

The Market for Corporate Securities.

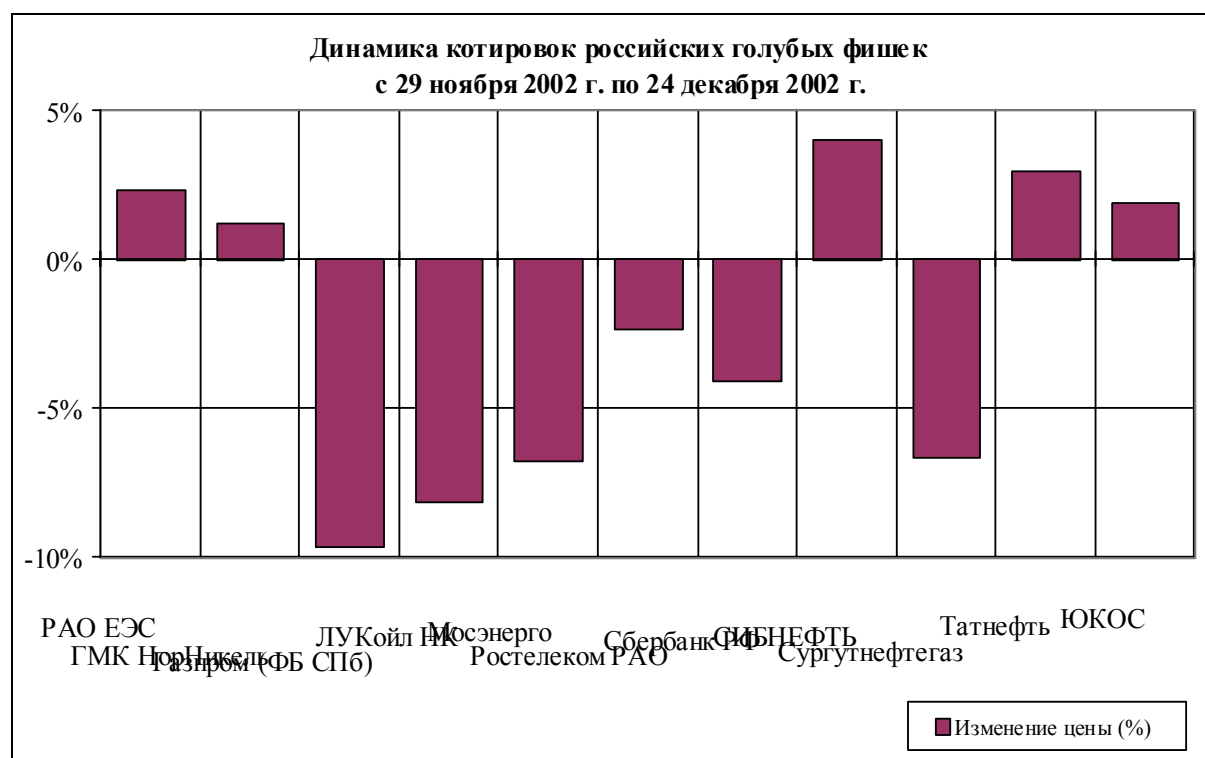
The stock market. In December, the side trend continued on the Russia's market of shares, the market was fairly quiet. From November 29 till December 24, the RTS index decreased by 8.56 points (- 2.37 %). In this period, the volume of trade made US \$ 193 million. The average daily volume was US \$ 12 million. In the first half of the month there was observed a decrease in the index. Since the end of November till December 16, the stock market indicator fell by 21.59 points (- 5.98 %). The dynamics of the index in the middle of the month were determined by the "long" weekend. By the end of the month the stock market indicator increased and made 352.29 points on December 24. In the last 4 days of the month there was observed a very low daily trade volume – less than US \$ 10 million. The minimal trade volume was registered on December 20, what made US \$ 4.9 million, while the maximum made US \$ 19.8 million (December 3). From our point of view, in December there were observed interesting specifics: a sharp increase in the world oil prices did not adequately affect the prices of domestic oil giants. These market dynamics may result in a rapid growth in the beginning of the next year.

FIGURE 3.



Since December 1 till December 24, the maximal growth was registered for shares of Sibneft (+ 3.98 %) followed by shares of Tatneft (2.91 %), and RAO UES. A lesser growth was demonstrated by the shares of Yukos (1.96 %) and MMC Norilsk Nickel (1.16 %). Shares of Rostelecom and Sberbank fell in price by 2.34 % and 4.06 % respectively. At the same time, the prices of certain shares decreased even more: Surgutneftegas (- 6.64 %), Mosenergo (- 6.76 %), Lukoil (- 8.09 %), and Gazprom (- 9.59 %). The delay of the discussion of the key laws related to the reform of the Russia's power engineering was a factor behind a more pronounced growth in quotations of RAO UES securities. The sharp drop in the prices of the shares in the gas concern occurred due to its low financial results in the first 6 months of 2002 and alarming rumors concerning the ability of the company to service its tremendous debt. The growth in quotations of Sibneft early in the month was brought about by the purchase of a block of shares in Slavneft owned by the Belorussian government and the expectations that the company would win the auction for the sale of the Russia-owned share in Slavneft.

Figure 4. The dynamics of Russian blue chip quotations from 29 November till 24 December of 2002.



Ordinary shares of RAO UES traditionally accounted for the greatest proportion in the total volume of RTS turnover from December 01 till 24 – 27.47 % (29.64 % respectively in the last month). Ordinary shares of Lukoil were at the second place – 18.29 % (17.97 %). The turnover of Yukos shares increased up to 14.56 % (10.51 %), while the share of Surgutneftegas in the RTS turnover made 13.27 % (13.12 %). The share of Sibneft increased more than 1.5 times up to 7.02 % (4.14 %). This month, the aggregate share of five most liquid stocks in the total RTS turnover decreased somewhat making 80.6 % (77.55 % in November).

In the period from December 1 to 24 of 2002, the volume of trade with Gazprom shares through RTS terminals made US \$ 46.5 million (about 60.5 mil. of shares), the total number of transactions with the securities of the concern was 7.4 thousand.

In the end of the year, the list of the top five Russian companies by capitalization was as follows: Yukos, US \$ 20.6 billion; Gazprom, US \$ 17.2 billion; Lukoil, US \$ 13 billion; Surgutneftegas, US \$ 11.1 billion; Sibneft, US \$ 9.9 billion (according to RTS data).

The Market for Term Contracts. On December 15, 2002, there were executed December futures contracts in amount of RUR 209 million. The futures contract for the price of RAO UES shares (EESI-12.02) accounted for the maximal number of contracts for execution (20896 contracts amounting to RUR 88 million)

On the whole, the volume of trade on the market for term contracts made RUR 8.25 billion (42.3 thousand transactions, 1.86 million contracts), of which futures contracts accounted for RUR 8.06 billion (40.9 thousand transactions, 1.81 thousand contracts). The maximal daily turnover was registered on December 3 and made RUR 784.7 million. On the average, the daily turnover was RUR 515 million, the number of transactions made 2646.

External factors behind the dynamics of the Russia's stock market. An upward trend was observed on the oil market: from November 29 till December 24 the rise in prices made more than 20 % (US \$ 5.21/barrel). The major factors determining the dynamics of quotations on world markets were the news from Venezuela, where oil exports were practically paralyzed, and growing tensions in the relations between USA and Iraq. On December 12, OPEC took the decision to increase export oil quotas from January 1, 2003, by 1.3 million barrels a day up to 23 million barrels a day. These measures were aimed at the restoration of confidence in the quota system and maintaining the prices of the "black gold" at the level acceptable for the cartel member countries (US \$ 22 to 28 per barrel). On December 16, there was registered a significant

growth in the prices of oil and oil products (+ 4 %), what reflected the reaction of the world market to the growing tension in Venezuela. Prices reached the maximal level registered since the beginning of October (US \$ 28.6 per barrel). Venezuela is a major supplier of crude oil to the USA, where a decrease in industrial reserves of oil made about 7 % in comparison with the figures registered in the preceding year.

In the absence of positive news, the quotations of oil exceeded the level of US \$ 30 per barrel by the end of the month and on December 24 made US \$ 30.93 per barrel.

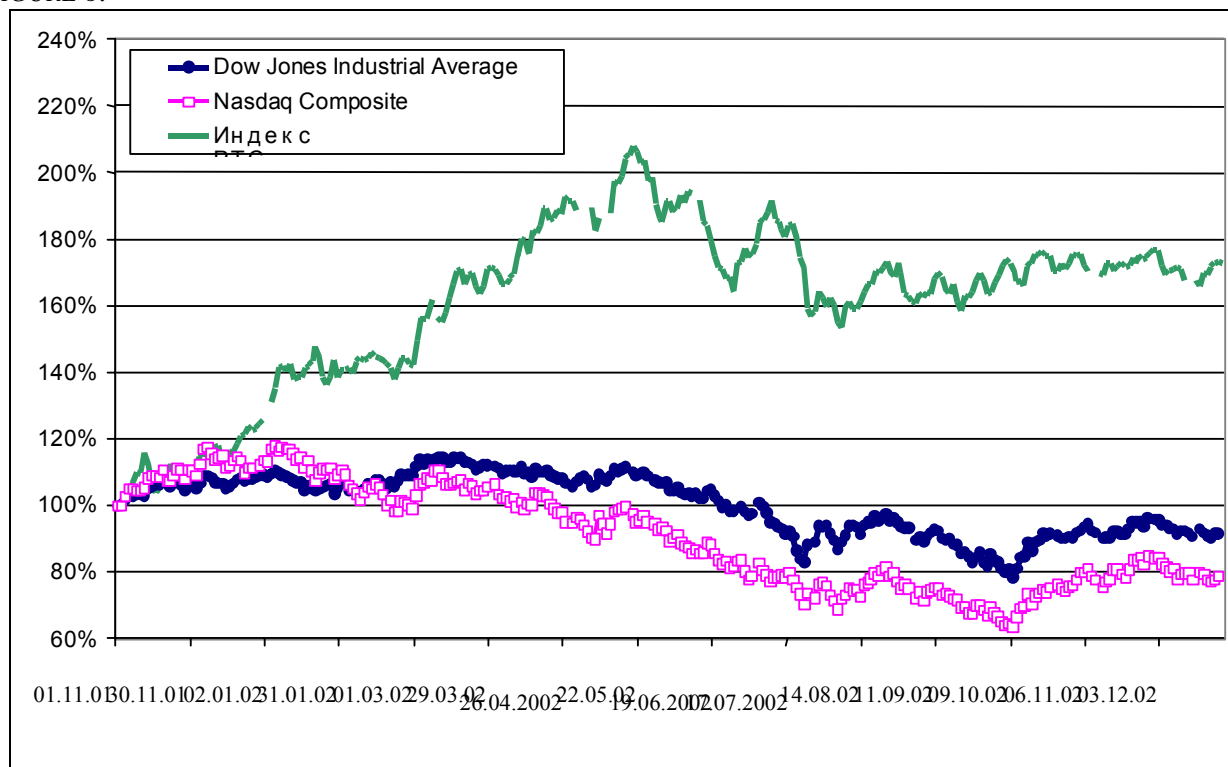
Figure 5. Price for Brent crude oil, USA (NYMEX)



In December, international ranking agencies upgraded sovereign rankings of the Russian Federation. On December 5, Standard & Poors announced the increase in long term sovereign rankings of Russia from BB- to BB+ as concerns liabilities denominated in domestic currency and from BB- to BB as concerns forex denominated liabilities according to the international scale. Therefore, assessments of the Russia's economy are getting closer to the investment evaluations, which, according to the S&P scale, start from BBB category. As concerns the national scale, the ranking of Russia was confirmed at the ruAA+ level. The agency's analysts point out that the reasonable tax policies and improved system of the debt management excludes the return to a significant budget deficit even in the case oil prices decrease. The new management of the Bank of Russia facilitated a progress of the banking reform. However, in 2003, S&P does not plan a further increase in Russia's standing because of the Parliamentary elections in the end of the next year and related deceleration of structural economic reform. On December 17, Moody's Investors Service also increased the ranking of Russian liabilities denominated in foreign currency from Ba3 to Ba2.

The European Central Bank has decreased the discount rate by 0.5 % down to 2.75 % for the first time since November of 2001. The US FRS left the key interest rate at the minimal level in 41 years (1.25 %). In its statement, FOMC noted that the risk of a further increase in inflation rates and the risk of a further weakening of the economy have equal weights. The Bank of England also took the decision not to change the interest rate at the level of 4 %.

FIGURE 6.



Corporate News.

ОАО ОС Yukos.

According to the company's press service, the Board of Directors of the oil company recommended the extraordinary shareholder meeting to take the decision about the payment of intermediate dividends for 9 months of this year in amount of RUR 12.75 billion (about US \$ 400 million), what makes RUR 5.70 per an ordinary share. It shall be noted that in spite of a decrease in the company's net profits registered in the first six months of the year in comparison with the figures observed in the respective period of the preceding year, the recommended annualized amount of dividends per share was increased.

The ranking agency Standard & Poors upgraded the ranking of OC Yukos in national and foreign currency up to BB level according to the international scale and ruAA+ according to the national scale. The S&P comments note that the ranking of Yukos reflects the low level of debt and its significant amount of liquid assets. The company demonstrates a high level of profitability and cash flows, as well as high effectiveness of investment. Among negative factors the agency's analysts note instability of world oil prices, general risks of Russia's oil industry, ambitious investment policy, and concentrated structure of the joint stock capital.

ОАО Lukoil.

The government of Iraq revoked the contract for the development of a large oil deposit West Kurna it had concluded earlier with Lukoil. The West Kurna deposit with estimated oil reserves at 7.3 billion barrels is the largest deposit offered for development by a foreign oil company. The formal pretext of the repudiation of the contract was the failure to meet its obligations on the part of the Russian company, what, allegedly, damaged the Iraqi economic interests.

S&P upgraded the long term credit rankings of the oil company from B+ to BB-. The increase in ranking is related to the leading position of Lukoil as concerns the reserves, extraction, and exports among other Russian oil companies. The constraining factors include high level of average costs and a significant amount of debt.

OGC Slavneft.

A key event of December was the auction for the sale of the block of shares in OGC Slavneft owned by the Russian government. Before the auction, the representatives of the RF Accounting Chamber evaluated the price of the 74.95 % shares in Slavneft at US \$ 3 to 3.2 billion. However, the oil company was sold to TNK and Sibneft for a much lower amount of US \$ 1.86 billion. According to A. Kudrin, the RF Finance

Minister, privatization of state owned blocks of shares in Lukoil and Slavneft allowed to form the necessary amount of financial reserves.

However, the purchase worsened the financial standing of both companies, what was reflected by a decrease in their rankings by leading agencies. For instance, S&P reviewed the forecast of the change in the standing of Sibneft from “developing” to “negative” and excluded TNK from the CreditWatch list (the company was included on December 6, 2002 with a positive forecast). The ranking of Sibneft according to the national scale was decreased from ruAA to ruA+.

OAO MTS.

A largest operator of cellular phone networks, OAO MTS published the US GAAP financial report for the first 9 months of 2002. MTS net profits increased by more than 30 % in comparison with the figures registered in the respective period of the preceding year and made US \$ 191.9 million. In the same period, the proceeds of the company increased 1.5 times and made US \$ 634.8 million, while profits before taxes made US \$ 491.4 million, what is 1.6 times over the indicators of 2001, EBITDA made 52 %.

Table 1.

Dynamics of Foreign Stock Indexes

As of December 23, 2002	Value	Change during the month (%)	Change since the beginning of the year (%)
RTS (Russia)	354.22	-1.92%	36.21%
Dow Jones Industrial Average (USA)	8493.29	-4.53%	-16.21%
NASDAQ Composite (USA)	1381.69	-6.57%	-30.47%
S&P 500 (USA)	897.38	-4.16%	-22.71%
FTSE 100 (UK)	3936.9	-5.58%	-24.90%
DAX-30 (Germany)	3000.84	-9.62%	-41.85%
CAC-40 (France)	3087.62	-7.19%	-33.23%
Swiss Market (Switzerland)	4731.3	-7.55%	-26.28%
Nikkei-225 (Japan)	8406.88	-8.78%	-20.26%
Bovespa (Brazil)	11470	9.14%	-15.53%
IPC (Mexico)	6153.22	-0.06%	-4.85%
IPSA (Chile)	85.14	4.89%	-21.96%
Strait Times (Singapore)	1335.09	-4.06%	-17.89%
Seoul Composite (Korea)	691.38	-4.61%	-0.33%
ISE National-100 (Turkey)	10702.46	-19.53%	-22.35%
Morgan Stanley Emerging Markets Free Index	299.242	-1.03%	-5.72%

Foreign Exchange Market.

In December of 2002, no significant fluctuations were observed on the RF foreign exchange market. The exchange rate fluctuated in a narrow corridor between RUR / US \$ 31.84 to 31.86. The overall growth in the US \$ exchange rate was 0.26 kop. (0.0082 %) from RUR / US \$ 31.8424 (on 29.11.2002) to RUR / US \$ 31.845 (on 20.12.2002). According to preliminary estimates, the volume of trade in US \$ in the SELT amounted to circa RUR 90 billion.

The demand for US \$ stabilized in December due to the measures taken by the RF Central Bank. The supply of foreign exchange somewhat increased because exporters do not have to sell foreign exchange directly to the RF CBR (since the beginning of December). A certain increase in activity of trade in the SELT occurred due to the decrease in commission for currency transactions and the abolishment of the mandatory 100 % cash deposit.

Figure 7. Dynamics of official Ruble exchange rate (US \$ and Euro) in 2002

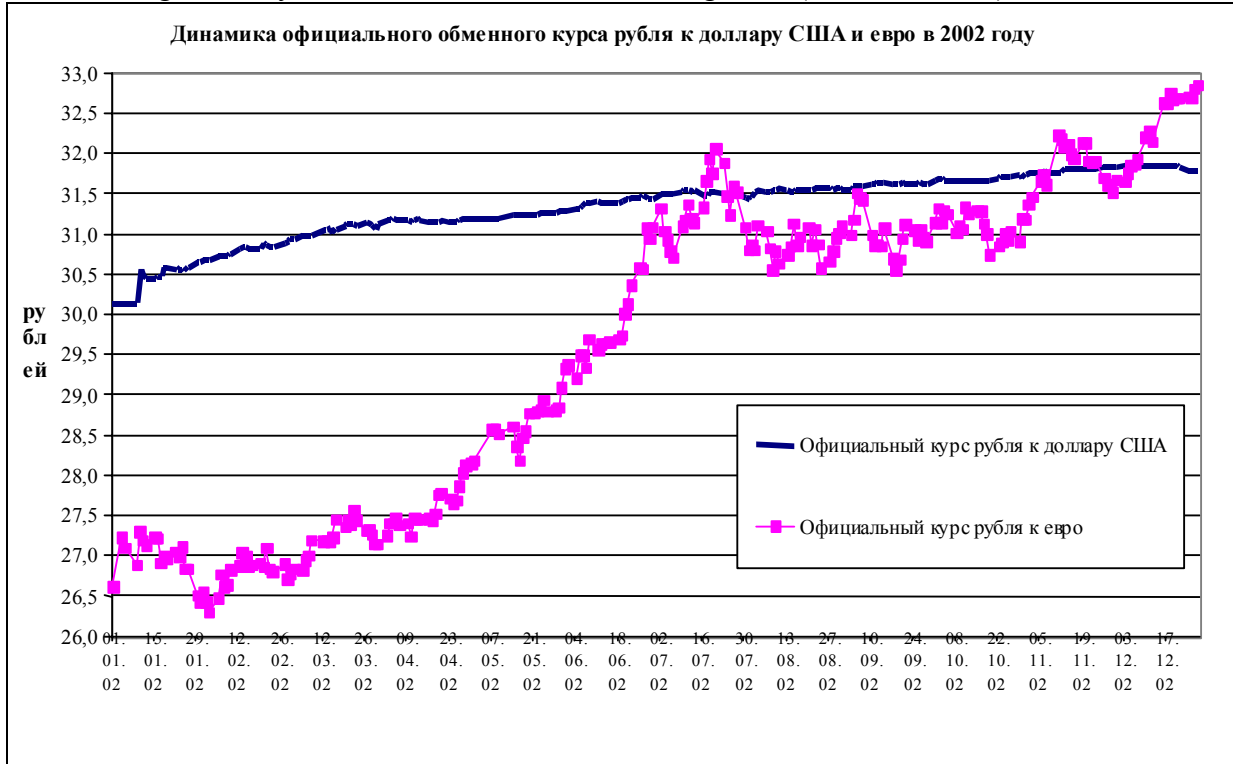


Figure 7. Dynamics of Euro/Dollar Exchange rate on the world forex markets



In the very beginning of December, Euro rate again exceeded the parity mark, and in the second half of the month its rate was above US \$ / Euro 1.02. The maximal value of the rate (US \$ / Euro 1.0288) was registered on December 18. The resignation of the US Secretary of the department of the Treasury and the uncertainty about the continuation of the “strong dollar” policy by the new Treasury administration were

behind these dynamics of the exchange rate. The publication of the new macroeconomic indicators also did not facilitate an improvement in the exchange rate of the US currency.

The changes in RUR / Euro exchange rate followed the trends on the global market. The maximum value in December made RUR / Euro 32.8355 (the historical high) on December 17, 2002, the lowest value was RUR / Euro 31.621 on December 2, 2002. During the month, the RUR / Euro exchange rate changed from 31.6417 on November 11, 2002, to RUR / Euro 32.695 on December 20, 2002, i.e. by 3.33 %.

Table 2.

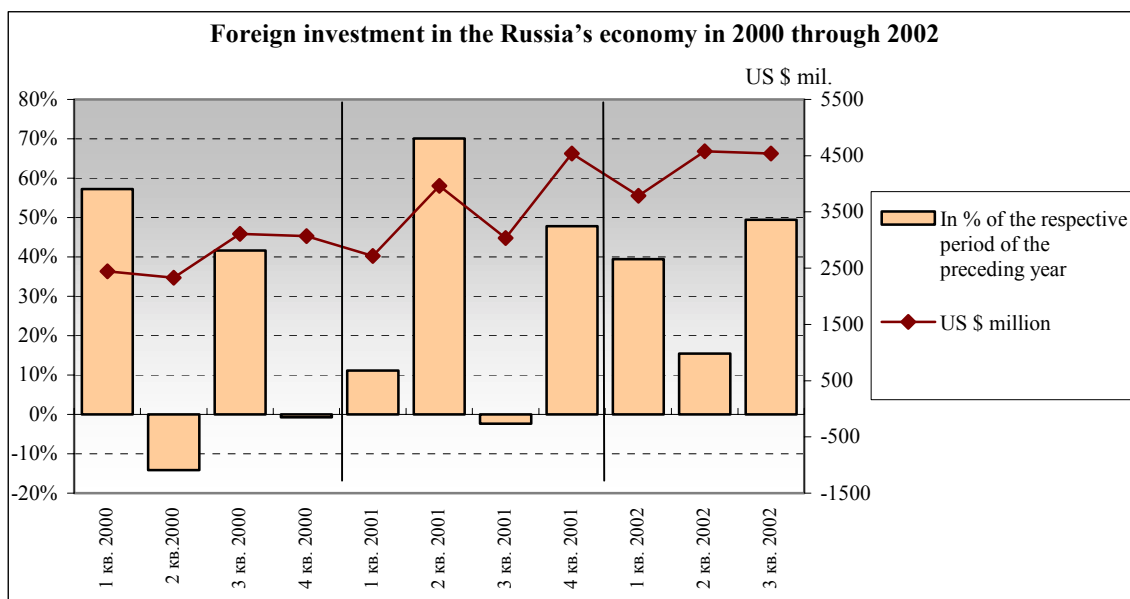
Financial Market Indicators					
Month	August	September	October	November	December *
Monthly inflation rate	0,1%	0,4%	1,1%	1,6%	1,8%
Inflation rate annualized on the basis of this month's trend	1,21%	4,91%	14,03%	20,98%	24%
CB RF refinancing rate	21%	21%	21%	21%	21%
Annualized yield to maturity on OFZ issues	14,45%	15,25%	14,98%	14,02%	13,5%
Volume of trading in the secondary GKO-OFZ market for the month (RUR billion)	6,95	15,97	18,73	11,15	16,0
Yield to maturity on Minfin bonds at the end of the month (% p.a.)					
4th tranche	5,60%	5,46%	4,86%	4,83%	4,5%
5th tranche	10,88%	10,13%	8,46%	7,83%	7,7%
6th tranche	9,52%	8,84%	7,04%	6,78%	6,8%
7th tranche	11,05%	10,31%	9,13%	8,50%	8,1%
8th tranche	9,81%	9,24%	7,68%	6,81%	6,6%
INSTAR-MIACR rate (% p.a.) on interbank loans at the end of the month: Overnight	5,74%	17,79%	14,89%	4,68%	2,5%
Official RUR / US\$ exchange rate at the end of the month	31,5673	31,6358	31,7408	31,8424	31,80
Official RUR / Euro exchange rate at the end of the month	31,0938	30,9082	31,1790	31,6736	32,75
Average annualized growth in RUR / US\$ exchange rate	0,40%	0,22%	0,33%	0,32%	-0,13%
Average annualized growth in RUR / Euro exchange rate	0,95%	-0,37%	0,88%	1,59%	3,4%
Volume of trading at the stock market in the RTS for the month (US\$ million)	239,10	263,17	324,38	260,20	230
Value of RTS Index at the end of the month	337,02	340,06	358,65	361,15	355
Change in value of RTS Index during the month (%)	3,31%	0,90%	5,47%	0,70%	-1,7%

* Estimates

D. Skripkin

Foreign investment in the Russia's economy.

As of October 1, 2002, the accumulated foreign capital in the Russia's economy, including the investment from CIS member countries, made US \$ 39.8 billion. In the first 9 months of 2002, the inflow of foreign investment in the RF economy is estimated at US \$ 12 905 million, what is by 32.8 % above the respective indicator registered in 2001 (in the first 9 months of 2001 investment grew by 23.2 % as compared with the figures registered in the respective period of 2000).



Source: RF Goskomstat.

A decline in the amounts of foreign direct investment is a negative factor in the Russia's economy. In comparison with the pre-crisis level, the absolute values of this indicator decreased almost twofold. The major share of foreign investment in the Russia's economy in 2002, similarly to previous years, consisted of "other" investment formed primarily at the expense of credits of international financial organizations and funds investors assign for purchase of state securities.

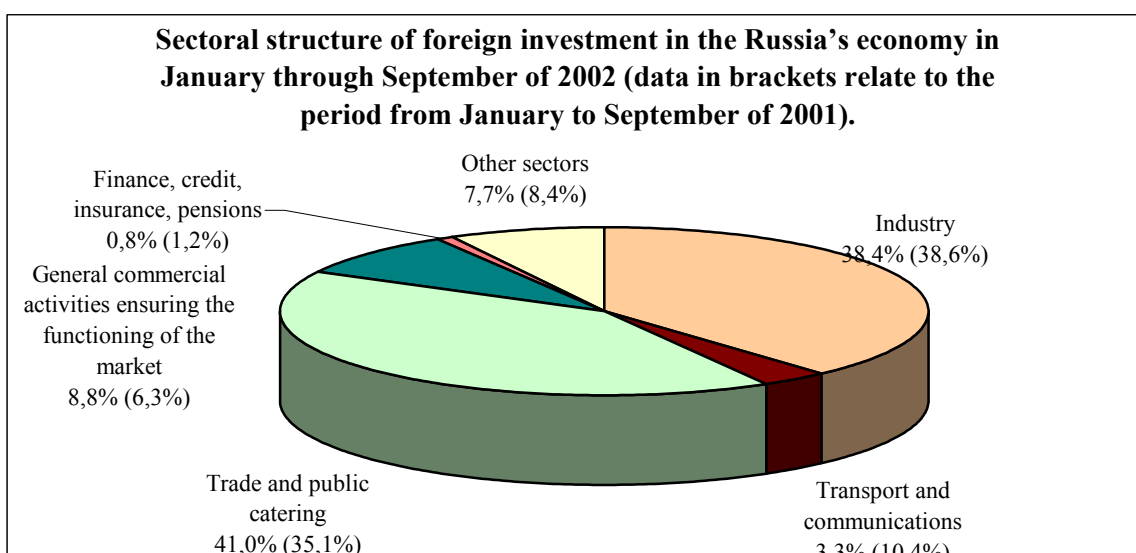
The structure of foreign investment in the Russia's economy in the first 9 months of the respective year.

	Total, US \$ mil.	Direct		Portfolio		Other	
		US \$ mil.	in % of total	US \$ mil.	in % of total	US \$ mil.	in % of total
1998	9 286	2014	21,7	192	2,1	7 080	76,2
1999	6 467	3 132	48,4	9	0,1	3 326	51,4
2000	7 888	3 154	40,0	59	0,7	4 675	59,3
2001	9 721	2 920	30,0	292	3,0	6 509	67,0
2002	12 905	2 631	20,4	224	1,7	10 050	77,9

Source: RF Goskomstat.

The sectoral structure of foreign investment in Russia is still characterized by the leading role played by trade and industry. The investment in these two sectors made US \$ 5292 million and US \$ 4950 million respectively in the first 9 months of this year.

Sectoral structure of foreign investment in the Russia's economy in January through September of 2002 (data in brackets relate to the period from January to September of 2001).



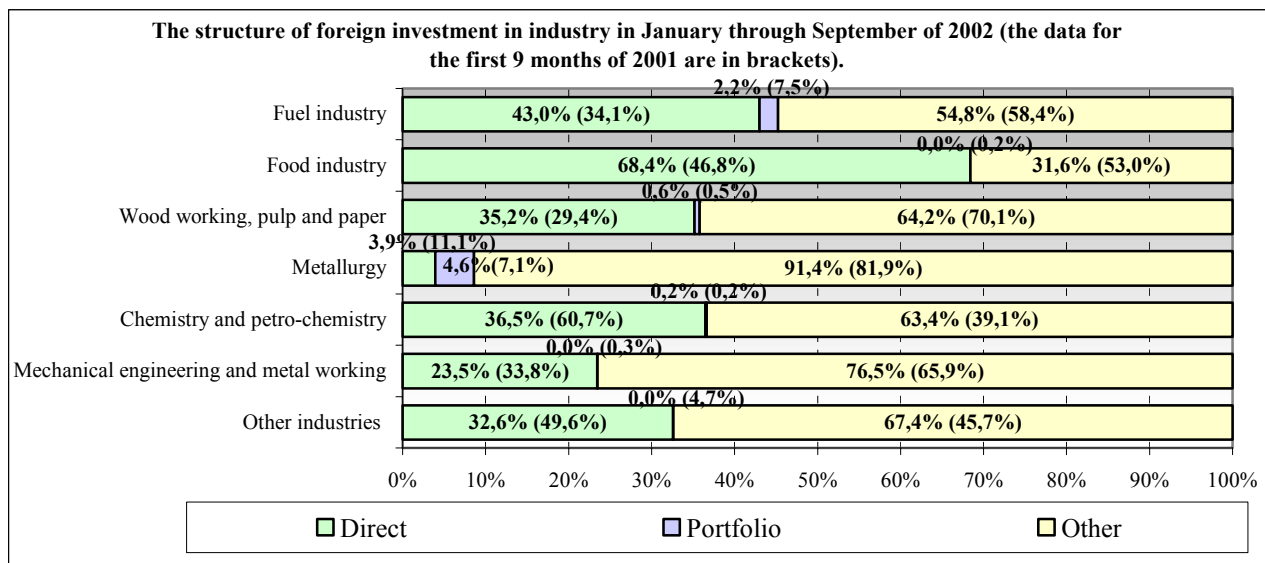
In the sphere of industry, foreign investors are still interested in fuel industry and metallurgy. The amount of investment in these branches made 61.2 % of the aggregate foreign investment in industry in the first 9 months of 2002. At the same time, the growth in foreign capital invested in these branches in January through September of 2002 made 52.3 % in metallurgy and increased 2.2 times in fuel energy in comparison with the figures registered in the respective period of 2001. Over the same period, the investment in mechanical engineering and food industry declined by 24.8 % and 19.9 % respectively. For the distribution of foreign investors by the base industries, see the Table below:

The structure of foreign investment in industry as broken down by branches in January through September of 2000 through 2002.

	US \$ mil.			In % of the total			Change in comparison with the figures registered in the respective period of the preceding year (%)		
	2000	2001	2002	2000	2001	2002	2000	2001	2002
Industry, total, including:	3 324	3 755	4 950	100	100	100	-3,2	13,0	31,8
Fuel industry	424	591	1 282	12,7	15,7	25,9	-73	39,4	116,9
Metallurgy	747	1 148	1 748	22,5	30,6	35,3	65,6	53,7	52,3
Mechanical engineering and metal working	360	404	304	10,8	10,8	6,1	88,5	12,2	- 24,8
Food industry	1 259	1 038	831	37,9	27,6	16,8	51,7	-17,6	- 19,9
Woodworking, pulp and paper industry	183	176	197	5,5	4,7	4,0	41,9	-3,8	11,9
Other industries	351	398	588	10,6	10,6	11,9	114	13,4	47,7

Source: RF Goskomstat.

Changes in the structure of foreign investment in industry made in the first 9 months of 2002 correspond to the changes in the structure of aggregate foreign investment in the Russia's economy: the specific weight of direct investment decreased from 31.8 % registered in January through September of 2001 to 24.3 % in January through September of 2002, while the similar indicator for other investment increased from 64.8 % to 73.8 % respectively over the same period.



The major part of foreign direct investment in industry (45.7 % of the aggregate foreign direct investment in the national economy at large) was made in fuel industry (US \$ 418 million, or 34.8 % of direct investment in industry), mechanical engineering (US \$ 208 million, or 17.3 %), and food industry (US \$ 195 million, or 16.2 %).

Switzerland and USA, which accounted for the major part of foreign investment in industry (about 40 %) in January through September of 2001, have considerably diminished their investment in this sector of the economy: industrial investment from Switzerland decreased from 36.7 %, from USA – by 37.4 %. At the same time, the specific weight of these two countries in the total investment in industry in 2002 decreased to 16.2 %.

In 2002, investment from 93 countries exporting capitals flowed in the Russia's economy (in 2001 – 107 countries). Five largest investing countries accounted for 64.5 % of the total amount of foreign investment accumulated by October 1, 2002, 60.8 % of direct accumulated investment, 65.8 % and 68.2 % of portfolio and other investment respectively.

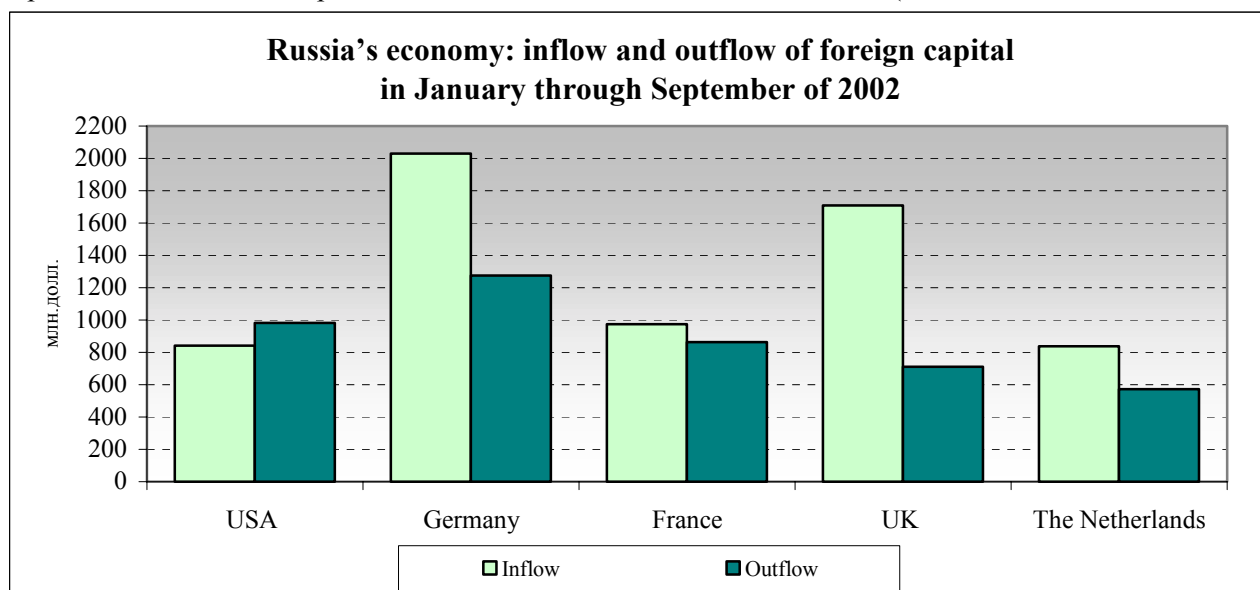
The structure of accumulated foreign investment as broken down by major investing countries.

	Accumulated by 01.10.2002 r., US \$ mil.				Change to 01.01.2002 r., % (*)			
	Total	Direct	Portfolio	Other	Total	Direct	Portfolio	Other
USA	5 483	4 132	68	83	- 2,5 (-1,2)	1,2 (2,1)	- 24,4 (- 1,4)	- 11,6 (- 10,4)
Germany	6 839	1 579	384	4 876	12,4 (14,9)	4,4 (4,9)	by 13,7 times (by 13,7 times)	7,3 (10,4)
France	3 393	268	0,1	3 125	3,4 (- 9,5)	- 24,3 (- 24,7)	0,0 (-90,0)	6,7 (-7,9)
UK	4 810	2 100	140	2 570	26,2 (42,9)	10,6 (15,6)	11,1 (by 3,8 times)	43,7 (69,7)
Cyprus	5 158	3 709	320	1 129	- 2,8 (- 5,4)	- 0,5 (- 0,4)	- 31,6 (- 30,0)	1,7 (- 11,2)
The Netherlands	2 807	2 419	21	367	10,4 (15,8)	12,6 (16,1)	- 4,5 (10,5)	- 1,3 (14,7)
Other countries	11 312	5 181	452,9	5 678	26,1 (42,7)	16,6 (22,9)	- 8,7 (- 1,1)	40,9 (74,3)
Total	39 802	19 388	1 386	19 028	11,7 (15,6)	6,7 (9,3)	12,7 (29,7)	17,3 (21,9)

* changes (as compared with the data registered on 1.10.2001) are in brackets

Source: RF Goskomstat.

In the first 9 months of this year, the inflow of capital from USA declined by 31.4 % (down to US \$ 841 million), while investment from Cyprus fell by 9.3 % (US \$ 1.7 billion), while the inflow of investment from the Netherlands decreased by 8.3 % (US \$ 838 million). In January through September of 2002, the amount of German investment made US \$ 1.7 billion, what is 2.6 times above the level registered in January through September of 2001. The respective indicators for UK made US \$ 906 million (2 times above the level of 2001).



In 2002, the major part of investment from Germany (US \$ 1318 million, or 65 % of the aggregate German investment in the first 9 months of 2002) was made in trade and public catering. US investors preferred to invest in industry (34 % of the US investment). UK investors are most interested in such sectors of the Russia's economy as trade and public catering (US \$ 739 million, or 43.2 % of the total UK investment made in January through September of 2002), industry (US \$ 494 million, or 28.9 %), and the general commercial activities ensuring the functioning of the market (US \$ 410 million, or 24 %). The operations of joint Russian-French ventures is primarily oriented towards to provision of trade, mediation, consulting, financial, and other services.

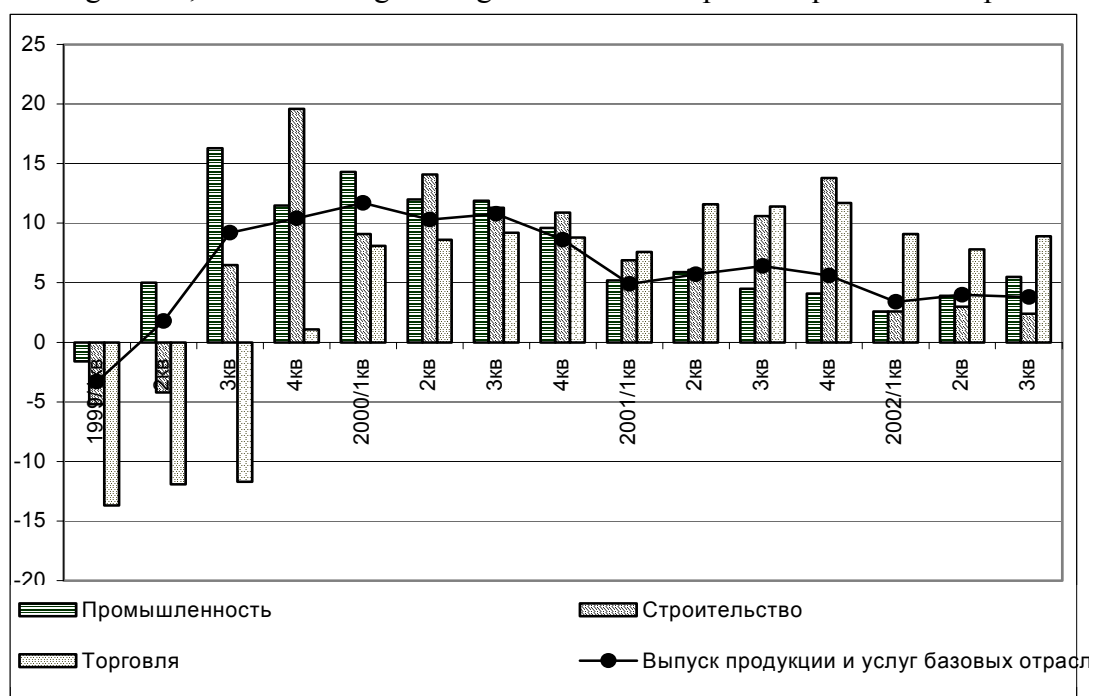
A positive factor behind the investment activity in Russia is improving credit ranking of Russia by largest world rating agencies Moody's and Standard & Poor's.

E. Ilyukhina

The Real Sector: Factors and Trends

The positive dynamics of GDP are supported by the growth of production in industry, construction, and agriculture. At the same time, a comparative analysis of the year's dynamics of macroeconomic indicators demonstrate that the rates of growth gradually decelerate. While in 1999 through 2002 the average annual rate of increase in GDP made 7.2 %, in 2001 through 2002 it made only 4.5 %, at the same time, the respective indicator of industry made 11.4 % and 4.6 %. For the first time in the last decade, in 2000 through 2001 construction developed at rates outpacing the growth in the volumes of output in industry and GDP. However, in 2002 there is detected a decelerating rate of investment demand. The increase in investment in the real sector of the economy made 2.5 % in January through November of 2002, as compared with 8.3 % registered in the respective period of 2001.

Dynamics of output of products and services of base economic sectors in 1999 through 2002, in % of the figures registered in the respective quarter of the preceding year



In the course of analysis of the stability of the Russia's economy, it shall be stressed that outpacing growth in internal demand in comparison with the external demand is a key specific factor of the economic development in 2000 through 2002. The share of internal demand in the GDP structure according to the estimates of the Ministry of Economic Development has increased up to 90.0 % as compared with 87.1 % registered in 2001.

The trend toward an expansion of demand on the consumer and investment markets persists at the background of decelerating rates of industrial development and determines an acceleration of the rates of growth in import of goods of final consumption in comparison with the dynamics of domestic production. As output of light industry stagnated, the increase in import of jersey and textile clothes made 72.2 % as compared to the figures registered in January through September of 2001, while production of footwear made 29.5 %. The growing gap in the rates of growth in domestic production of consumer goods and imports resulted in a change of the situation on the retail market. The share of imported goods in the resources of goods of the food and non-food markets made 33.3 % and 47.8 % respectively over the first 3 quarters of 2002.

An increase in the share of imports in the structure of resources of material and technical production has been also observed since mid-2000. While the output of industry increased by 3.7 % in comparison with the figures registered in January through November of 2001, the imports grew by 12.1 %. The increasing influence of competing imports significantly affected the dynamics of development of industries oriented towards the domestic market. The ratio between rates of demand for domestically produced and imported types of machinery and equipment were most seriously affected by the changes in the situation on the domestic market. The production of mechanical engineering increased by 2.2 % in comparison with the figures observed in January through November of 2001, while the imports grew by 23.2 %. As concerns the commodity resources of certain types of products of chemistry and pulp and paper industry, there the share of imports increased almost twofold in 2002.

By the end-year the situation was aggravated by the fact that at the background of persisting general trend towards decelerating rates of output in the mechanical engineering complex, the negative impact of the overproduction crisis in the motor industry became more profound. An analysis of the functioning of the domestic motor industry reveals that overproduction crises occur with a certain regularity. In the present situation, the increase in prices of cars anticipating the introduction of new customs duties on used imported cars has sharply changed the situation on the domestic market. As a result of falling demand for domestically produced vehicles, the output of cars declined almost by 1/3 in November as compared with the figures registered in October, while output of trucks fell by 12.6 %.

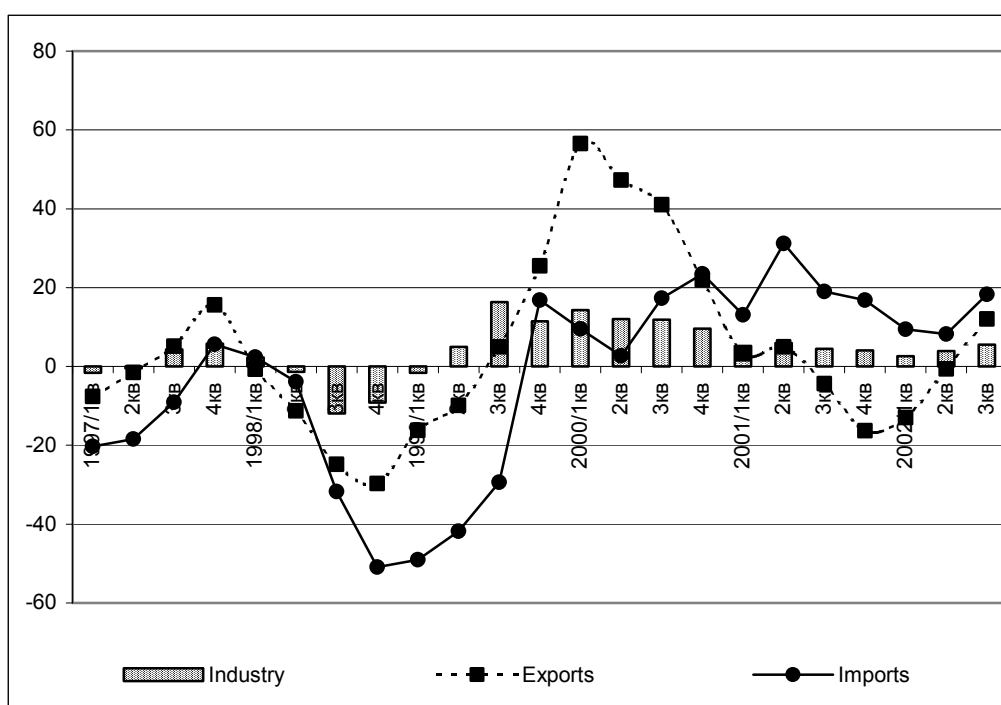
Although the decline in production of motor industry made 0.7 % in comparison with the levels observed in January through November of 2001, it shall be taken into account that under the developed system of inter-branch links and high concentration of production the sales crisis in the motor industry negatively affects the results of operations of related enterprises and industries producing construction materials and completing parts.

The sluggishness of industrial growth occurring in the last two years is, on the one hand, an evidence of the exhaustion of the residual potential of import substitution and devaluation, and, on the other hand, of the absence of processes of restructuring of domestic business aimed at the formation of new competitive markets of domestic products. The orientation towards traditional positions on world markets of raw materials and fuel and the lack of a prospective strategy of development of manufacturing industries of the economy determine the restrained policy of participation of financial and crediting institutions in the financing of the real sector of the economy.

While the dynamics of the volumes of export may be explained by conjecture factors on the world markets of raw materials, the intensive growth in imports registered in 2001 through 2002 is related to purely internal problems. The specifics of the 3rd quarter of 2002 were favorable changes in the world business situation, which stimulated exports and supported the economy at large. As the external business situation gradually improved, the rates of growth in production of the fuel complex made 106.7 %, in non-ferrous metallurgy – 107.7 %, in ferrous metallurgy – 102.3 % in January through November of 2002.

As export revenues grew and profitability of production in extracting industries improved, the share of profits in GDP in the first three quarters of 2002 stabilized at the level registered in the preceding year. These developments allowed to maintain investment activity of enterprises and meet the state obligations relating to foreign debt. In the case the present tendencies persist, the increase in GDP will make 4.1 % in 2002, what corresponds to the parameters of the estimates, on which the budget of this year is basing.

Changes in the rates of growth in exports, imports and industrial output in 1995 through 2002, in % of the respective quarter of the preceding year.



O. Izryadnova

IET Business Survey: Industry

The closing months of 2002 have been not so good for Russia's industry: for the second month running amounts of cash sales are diminishing, while the growth in production has nearly stopped, finished stocks are increasing, and profits are falling down. Estimates of enterprises for early 2003 are mostly pessimistic. For

the first time in the post-default period there is expected a decrease in sales and very modest growth in output.

Changes in cash sales occurring in December did not confirm the forecasts made in the preceding month when estimates of enterprises gathered a few points of optimism. The rates of decline in effective demand increased from -4 % to -15 % (in terms of balance) and exceeded the figures registered in December of 2001 when this indicator made -10 %. In 1999 through 2002, the IET surveys registered the most intensive decline of sales in January of 2002 (- 20 %). At present, a growth in effective demand is registered only in power engineering (+ 58 %) and food industry (+ 4 %).

Negative trends of sales dynamics have at last affected estimates of amounts of sales by enterprises. The share of responses evaluating amounts of sales as "normal" decreased by 6 points over the last month and makes 32 % on the average across industries, what is the worst value registered in the second half of 2002. Minimal values were observed in mechanical engineering (22 %), chemistry and petrochemistry (26 %).

Non-cash types of demand also continue to decline. In December, the rates of decrease in barter, promissory notes, and offset payments did not change significantly. A growth in barter transactions was registered only in non-ferrous metallurgy, promissory notes and offsets payments grew in power engineering and food industry. Therefore, at the moment all types of demand are declining across Russia's industries. At the same time, the decline in cash sales (- 15 %) is more intensive than the decrease both in barter transactions (- 9 %), and promissory notes and offsets (- 4 %). However, positive values of the substitution index (see the Figure) show that the substitution of non-cash types of demand for effective demand persists. At the same time, it shall be noted that since September (when there was registered the year's maximum) the value of the index has dropped practically to zero. Negative values of the index were observed twice in 2002: in January and May. Seasonal downturns in sales at that time were so pronounced that non-cash demand supplanted effective demand in industry. It is rather probable that similar developments will take place in January of 2003.

In the situation of the absolute decrease in cash sales enterprises have to keep a check on the growth in production. In the 4th quarter, the intensity of output decreased by 22 balance points. Reports about an increase in output prevailed only in power engineering (+ 100 %), forestry complex (+ 49 %), and food industry (+ 26 %).

However, it seems that the adjustment of production turned out to be insufficient. The balance of assessments of finished stocks remains positive (i.e. there are still excessive stocks) and increased by 10 points across all industries over the last month. A decrease in excessive stocks was registered only in chemistry, petrochemistry, and food industry. A constant lack of stocks was observed only in the forestry complex.

Real profits of industrial enterprises continue to decline. In the 4th quarter, the balance of change in this indicator remained practically at the same level – the level of intensive decline. In December, surveys registered an absolute increase in profits only in power engineering and metallurgy.

The balance of estimates of changes in effective demand has become negative for the first time since the beginning of 1999. Therefore, expectations of a decline in cash sales have prevailed in the Russia's industry for the first time since the default. Most probably, these expectations are of seasonal nature and take into account the experience of the last year when an absolute decrease in demand started in December, peaked in January, and persisted in the first half of 2002. The minimal balance of estimates in 2001 was also registered in December, however, it made + 5 %, while the minimum of 2000, which occurred in December was at + 10 %. On the other hand, the negative balance of assessments seems to reflect also the fact that enterprises realize that the period of the rapid post-default growth has ended. Only enterprises in power engineering are expecting a growth in cash demand.

The balances of estimates of non-cash types of demand remain negative. Enterprises do not expect any increase in the amounts of barter, promissory note, and offset transactions either in the industry at large, or in individual branches. A growth in barter is probable only in the forestry complex, while amounts of promissory notes and offsets may increase in power engineering. At the moment enterprises barter about 9 % of their output, while promissory notes and offsets account for 11 %.

Estimates of changes in output fully correspond to the pessimism concerning cash sales. Since August, the balance of enterprises' plans with regard to changes in output has dropped from + 38 % to + 9 %. Russian enterprises have not planned such a modest growth in output since the beginning of 1999. The conformity between the planned changes in output and expected changes in effective demand is at the moment registered for 71 % of enterprises. Such a conformity prevails in construction industry (84 %) and light industry (80 %).

At the same time, 21 % of enterprises in the Russia's industry are going to change volumes of their output "anticipating" the expected dynamics of sales, what most probably will result in a growth in their excessive finished stocks.

S. Tsukhlo

The effect of changes in electric power tariffs on prices and volumes of output in the RF economy⁵.

An estimate of the effect an increase in tariffs of natural monopolies, including tariffs on electric power and prices of energy resources and consumer prices is a serious problem both for natural monopolies themselves, and the governmental agencies, which by indexing tariffs at rates outpacing inflation declare the obligation to keep the rise of prices within the limits determined by the indicators set forth in the federal budget. In the course of the analysis of the impact of an increase in tariffs on prices and volumes of output, the study will focus on the search for answers to three following questions:

- In what way an increase in tariffs may affect consumer prices, in particular, prices of goods being components of the standard consumer basket and prices of public utilities and housing services.
- In what way an increase in tariffs on electric power may affect producers' prices in industry at large and in individual branches.
- In what way an increase in tariffs on electric power may affect the volumes of output in the economy or industry at large (an estimate of the impact on economic growth), and an estimate of the impact of the probable increase in tariffs on the volumes of output across individual branches.

The review and analysis of the literature on the topic show that the bulk of the studies concerning the prognostication of increases in tariffs of natural monopolies is based on the works published in the 1960s and 1970s, which focused on the research of sectoral price dynamics. A major outcome of these studies, first of all *Nordhaus (1970)* (see also *Arrow (1964) Stigler, Kindahl (1970)*)⁶, was the delimitation of the long and short term factors determining the price behavior of enterprises, as well as specification of price equations and demonstration of differences in price behavior of enterprises of monopoly, oligopoly, and competition types. The main idea used in these studies was the construction of a price model basing on the classical microeconomic model including the prerequisites concerning the type of production function. In the course of price modeling with the use of price equations with specifics basing on the hypotheses proceed from the microeconomic analysis, it is usually assumed that final prices are determined as the sum of costs and a certain margin. Therefore, it may be assumed that the margin depends on the indicators characterizing demand. Accordingly, the factors of price determination used in the course of modeling may be classified in two groups: cost variables and demand variables. The first group includes the costs of labor and materials – expenses for supplies and capital costs. Variables reflecting the influence of demand on behavior of firms belong to the second group of factors. These variables include the rate of utilization of production capacities, the ratio between the levels of stocks and sales, the ratio between new or uncompleted orders and sales, etc. (for econometric evaluations of equations see, for instance, *Eckstein, Wyss, (1972), Straszheim, Straszheim, (1976)*)⁷.

The studies published in the last years (see, for instance, *Hope, Singh (1995)*) use similar equations for the evaluation of the impact of increases in tariffs on energy resources on economic growth and inflation. The general result of these studies is an evidence indicating that increases in tariffs have an impact on inflation. As concerns the impact of an increase in tariffs, there shall be noted studies by *Wolak (2001)*,

⁵ This article summarizes in brief the results of the IET study concerning the assessment of the impact of changes in tariffs of natural monopolies and prices of energy resources on prices and volumes of output in the RF economy.

⁶ Nordhaus W. D., (1970), "The Econometrics of Price Determination: Recent Development in Price Dynamics" // Cowles Foundation Paper 377, Oct. 1970, Arrow K. J., (1964), "The Role of Securities in the Optimal Allocation of Risk-Bearing" // The Review of Economic Studies, Apr. 1964, Stigler, G.J., Kindahl J., (1970), "The Behavior of Industrial Prices", NY: NBER, 1970.

⁷ Eckstein, O., Wyss D., (1972), "The Econometrics of Price Determination", Washington D.C., Board of Governors of Federal Reserve System and Social Science Research Council, 1972; Straszheim, D. H., Straszheim, M. R., (1976), "An Econometric Analysis of the Determination of Prices in Manufacturing Industries" // The Review of Economics and Statistics, May 1976, 58(2).

Wolak, Patrick (2001)⁸, which discuss the price elasticity of demand for electric power and note that the assumption about the non-elasticity of demand not always proves true – for instance, in the case there are introduced different tariffs for households depending on the time of the day, demand shifts to the hours when tariffs are lower.

Econometric modeling of the consumer price index. In order to correctly specify a model of inflation (rates of increase in consumer prices), it is necessary to take into account a number of other factors alongside with tariffs, such as inflationary expectations (inflation with respective lags), rates of increase in money supply, nominal exchange rate (as an indicator reflecting changes in the cost of imported goods and yields of forex denominated savings). Accordingly, taking into account the results of test for stationarity, there were evaluated the model of relationship between inflation rates and rates of increase in indicators mentioned above and rates of increase in producers' prices in power engineering, natural gas industry, tariffs on freight and producers' prices of gasoline. The model was evaluated for the period from 1995/01 to 2001/07 and sub-periods from 1995/01 to 1998/07 and 1999/01 to 2001/12. For the purpose of evaluation there were used RF Goskomstat and RF Central Bank data. The econometric evaluations of the rates of increase in the producer price index demonstrate that the impact of tariffs on electric power is statistically significant (at about 10 % of the significance level) in the first sub-period and in the whole period under observation. The elasticity of influence of tariffs on electric power on consumer price index makes 0.05 to 0.08. The major factors affecting the dynamics of inflation are rates of increase in nominal USD exchange rate and values of inflation and the rate of increase in money supply taken with a lag.

Econometric modeling of prices of housing and public utility services. In the course of modeling prices of housing and public utilities (HPU) services it is necessary to take into account the fact that regional prices of HPU services directly include tariffs on electric power and natural gas supply. Besides, costs related to these factors are taken into account in other HPU components, provision of which requires consumption of electric power and natural gas. At the same time, HPU prices may be affected by tariffs on rail freight (Ministry of Railroads), since the heating of residential housing and industrial facilities as a rule requires coal and fuel oil transported by railroads. Similarly, costs of garbage disposal and provision of utilities include costs of gasoline, therefore in the course of comparison of the impact of prices of energy resources on prices of HPU services this indicator should be included in the respective equation. In contradistinction to consumer price index (CPI), the tariffs on HPU services are determined by local authorities and municipalities (not including tariffs on electric power, which should be approved by Regional Energy Commissions). Therefore, prices of HPU services less depend on inflationary expectations, dynamics of money supply, and dynamics of exchange rate due to the specifics of services costs of which is taken into account in the course of calculation of prices of such services. However, in the case a rise in prices is significant, it may be expected that prices of HPU services would be indexed more, therefore, beside the evaluation of the model in terms of the increase in the prices of HPU services there was also carried out evaluations of similar models as concerns excess of rates of increase in indexes under observation over the rates of increase in the CPI.

On the whole, the results of evaluations demonstrated that tariffs on electric power, gas supply, and rail freight had statistically significant impact on prices of HPU services. It shall be noted that tariffs on electric power had the most profound influence on the HPU services price dynamics: the elasticity of respective relationship makes 0.24. The elasticity of tariffs on natural gas supply and rail freight made 0.046 and 0.064 respectively.

In the course of evaluation of the period from January of 1995 to July of 1998, there were obtained similar results: tariffs on electric power, rail freight, and prices of gasoline has a statistically significant positive impact on the dynamics of prices of HPU services. The most significant influence exert tariffs on electric power: a 1 % increase in tariffs results in about 0.58 % increase in prices of HPU services, while for tariffs on rail freight and gasoline prices the elasticity makes 0.16 and 0.5 respectively. In the second period (January of 1999 to December of 2001) a statistically significant impact on prices of HPU services was detected only as concerns tariffs on electric power: a 1 % increase in electric power tariffs results in an increase in prices of HPU services by 0.55 %. Proceeding from the obtained evaluations, it may be

⁸ Wolak F., (2001), "Identification and Estimation of Cost Functions Using Observed Bid Data: An Application to Electricity Markets", NBER, Working Paper 8191; Wolak, F.A., Patrick, R.H., (2001), "The Impact of Market Rules And Market Structure On Price Determination Process In The England And Wales Electricity.

concluded that the influence of electric power tariffs on prices of HPU services remain relatively stable over the period under observation.

Evaluations of models concerning the relationship between the rates of outpacing increase in HPU services prices with regard to the rates of increase in CPI and the respective excess of rates of increase in tariffs over consumer and producers' prices demonstrated that the 1 p.p. excess of the rates of increase in tariffs on electric power, natural gas, and rail freight (Ministry of Railroads) over the rate of increase in CPI determines the excess of the rate of increase in prices of HPU services over the rates of increase in CPI by 0.72, 0.03, and 0.07 respectively. The results of evaluations concerning the relationship between the excess of tariffs over producers' prices in the industry on the average showed that only the excess of electric power tariffs over average producers' prices has a statistically significant impact on the excess of the rates of increase in prices of HPU services over the rates of increase in CPI. The elasticity of this relationship makes about 0.795. The results of evaluation of these models carried out for the sub-periods demonstrate that the elasticity of the dependence of HPU services prices on electric power tariffs in the model (as concerns the excess over the general increase in prices) makes about 0.26 to 0.34 for the first sub-period and 0.55 to 0.59 for the second sub-period (depending on the model), i.e. in the framework of the model of relative increase in the prices of HPU services in relation to the relative increase in tariffs there is observed an increase in elasticity of HPU services prices with regard to tariffs on electric power.

Econometric modeling of producers' prices across industries. In addition to the evaluation of the impact of tariffs on consumer prices and prices of HPU services, there were also made evaluations of the influence of tariffs on producers' prices and output volumes across major industries. Electric power is a key factor of production in industry, especially in such energy-intensive branches as ferrous and non-ferrous metallurgy. Respectively, the share of electric power costs in these industries is especially high. In the course of analysis of the relationship between the factors of production and branch-specific producers' prices, it shall be taken into account that certain factors of production may be substituted by others. However, taking into account the fact that a considerable share of Russia's enterprises are equipped with obsolete machinery and limited as concerns investment resources necessary to introduce modern energy-saving technologies, it may be assumed that demand for electric power is low-elastic, i.e. that changes in tariffs only insignificantly affect consumption of electricity. As tariffs increase, there occurs an increase in costs of enterprises, what results in increases in prices. Similarly to costs of electric power supply, costs of enterprises may also include costs of other energy resources, for instance, costs of natural gas, fuel oil, and costs relating to freight of goods – rail freight, gasoline, and other oil products. Besides, we assume that increases in the prices of these resources results in immediate or somewhat lagged increases in producers' prices.

At the same time, producers' prices may be affected by other factors. Among such factors, there shall be noted exchange rate characterizing the competitive capacity of import-substituting and profitability of export-oriented industries, as well as world prices of products of export-oriented industries, an increase in which may result in an increase in domestic prices due to the price leveling in the course of increase in the share of exported products. Taking into account these considerations and the results of tests for stationarity, the evaluation of increases in tariffs on electric power, natural gas, and rail freight, as well as prices of gasoline were carried out in terms of rates of increase and respective variables for individual industries were included in the equation.

Evaluations related to fuel industry are in favor of a positive impact of the rates of increase in electric power tariffs on the rates of increase in producers' prices in this industry, the respective coefficient makes about 0.17 for the whole period (a 1 % increase in tariffs on electric power results in a 0.17 % increase in producers' prices in fuel industry), as concerns the sub-periods (1995/01-1998/07 and 1999/01-2001/12), it makes 0.26 % to 0.28 %. Besides, there is observed a stable positive relationship to prices of natural gas and gasoline (coefficients for the whole period of evaluations make 0.10 and 0.21 respectively). It is necessary to note that the results of evaluations indicate the presence of a stable relationship of internal producers' prices in fuel industry and external factors, primarily, world oil prices (UK Brent) and the nominal USD exchange rate. In the period under observation, the rates of increase in these indicators were statistically significant and positively affected the rates of increase in producers' prices in fuel industry.

The modeling of the rates of increase in producers' prices in ferrous metallurgy demonstrated that a significant positive relationship exists only as concerns rates of increase in prices of rail freight (the coefficient makes 0.03), and rates of increase in prices of gasoline (the coefficient is 0.02). The respective coefficients for the sub-periods (1995/01-1998/07 and 1999/01-2001/12) are insignificant, what indicates

low level of their influence and significant variance of analyzed variables preventing the detection of a statistically significant relationship.

As concerns non-ferrous metallurgy, the evaluations over the whole period indicate a positive relationship between producers' prices and tariffs on natural gas supply and rail freight, as well as prices of gasoline (the coefficients make about 0.011, 0.03, and 0.02 respectively). Evaluation of similar models for sub-periods demonstrates that significant relationships are observed only for tariffs on rail freight and gasoline prices in the first sub-period – respective coefficients make 0.09 and 0.15. Tariffs on electric power were statistically insignificant with regard to producers' prices in non-ferrous metallurgy, as in the case of ferrous metallurgy. On the whole, the significance of tariffs on rail freight for producers' prices in ferrous and non-ferrous metallurgy indicates the importance of this type of expenditures in the structure of production costs.

External factors (world prices of metals and exchange rate) also have a statistically significant impact on producers' prices in non-ferrous metallurgy – the respective rates of increase in the indicators are statistically significant in the equation for the rates of increase of producers' prices in non-ferrous metallurgy. As concerns chemical industry, the only stable significant positive relationship is that of producers' prices to tariffs on electric power (the coefficient makes 0.23 to 0.39 for the whole period and sub-periods). In the case of the second sub-period (and the whole period) there is observed also a significant positive dependence of producers' prices on the prices of gasoline (the coefficient makes about 0.08).

The evaluation of models concerning the rates of increase in producers' prices in mechanical engineering show that there is a significant positive relationship to the rates of increase in tariffs on electric power (according to the model, a 1 % increase in tariffs results in an increase in producers' prices in mechanical engineering by 0.06 %), and the rate of increase in prices of gasoline (the coefficient makes 0.013). Evaluations for the first sub-period demonstrate that the coefficient of the tariffs on electric power makes about 0.32. In the same sub-period, the coefficient of rail freight, which makes 0.19, is also significant and positive. In the second sub-period, no significant positive dependence of producers' prices on the respective tariffs in mechanical engineering could be detected.

On the whole, it may be noted that statistically significant impact of electric power tariffs on producers' prices was observed in fuel industry, chemistry, and mechanical engineering. It may be also noted that coefficients of tariffs on electricity are higher in comparison with coefficients of tariffs on natural gas, rail freight, and gasoline prices. This fact reflects the considerable share of electricity costs in the structure of expenditures in these industries and characterizes the degree of influence of changes in tariffs on producers' prices – a 1 % growth in tariffs results in an increase in producers' prices from 0.06 % in mechanical engineering to 0.36 % in chemical industry.

Econometric modeling of industrial output indices across industries. Indicators characterizing changes in costs resulting from growth in prices of utilized resources, beside affecting producers' prices across industries, may also result in changes in production due to decline in demand for products of industries because of price hikes. Accordingly, an increase in tariffs on electric power, products of other natural monopolies, and prices of fuel may result in decline in output of certain industries, primarily those where a considerable share of costs in the expenditures structure is related to these factors.

Another group of variables able to influence the volumes of output are variables characterizing internal and external demand. In order to model the influence internal demand, in this study we will use real household incomes changes in which may characterize changes in the aggregate demand in the economy at large. Accordingly, an increase in internal demand may result in a growth in the volumes of output. In order to evaluate the impact of factors of external demand, in the model of production indices broken down by individual industries there was also used real exchange rate as a parameter characterizing the competitive power of products of Russia's enterprises with regard to imported goods or products of competitors on world markets, as well as world prices of products of exporting industries, under the assumption that an increase in world prices may stimulated an increase in supply on the world market and, accordingly, an increase in output. Besides, in the equation there was added net exports, which indirectly reflect the value of demand for Russia's products on the part of other countries⁹.

The results of evaluations of the model of rates of increase in indices of industrial output including the factors mentioned above demonstrate that only electric power tariffs have a significant (negative) impact on the rates of increase in the index of industrial output (a 1 % increase in tariffs, according to the model

⁹ In practice, taking into account the specifics of the Russia's exports, which mainly consist of mineral resources, there are certain constraints on the transport capacity, i.e. the possibility to increase certain exports in a short time period.

evaluations, result in a decline in output by 0.18 %). The results of the model evaluations for sub-periods demonstrated that a significant negative relationship between rates of increase in industrial output and the rates of increase in tariffs on electric power is observed only in the first sub-period (1995/01-1998/07). In the same sub-period, there is observed a significant positive relationship to the rates of increase in real household incomes (a factor of demand). In the second sub-period (1999/01-2001/12), all coefficients were statistically insignificant.

The results of evaluations across industries demonstrate that the rates of increase in household incomes have a significant positive impact on the rates of increase in indices of industrial output across industries (as concerns fuel industry, chemistry, and mechanical engineering). In the period under observation, electric power tariffs have a significant negative impact on the rates of growth in production in non-ferrous metallurgy and mechanical engineering (coefficients make -0.39 and -0.58 respectively). Evaluations of the model in two sub-periods (1995/01-1998/07 and 1999/01-2001/12) demonstrate similar results with the exception of the second sub-period, where a significant negative dependence of the rates of increase in tariffs on electric power is observed only in fuel industry (the coefficient makes -0.17 %).

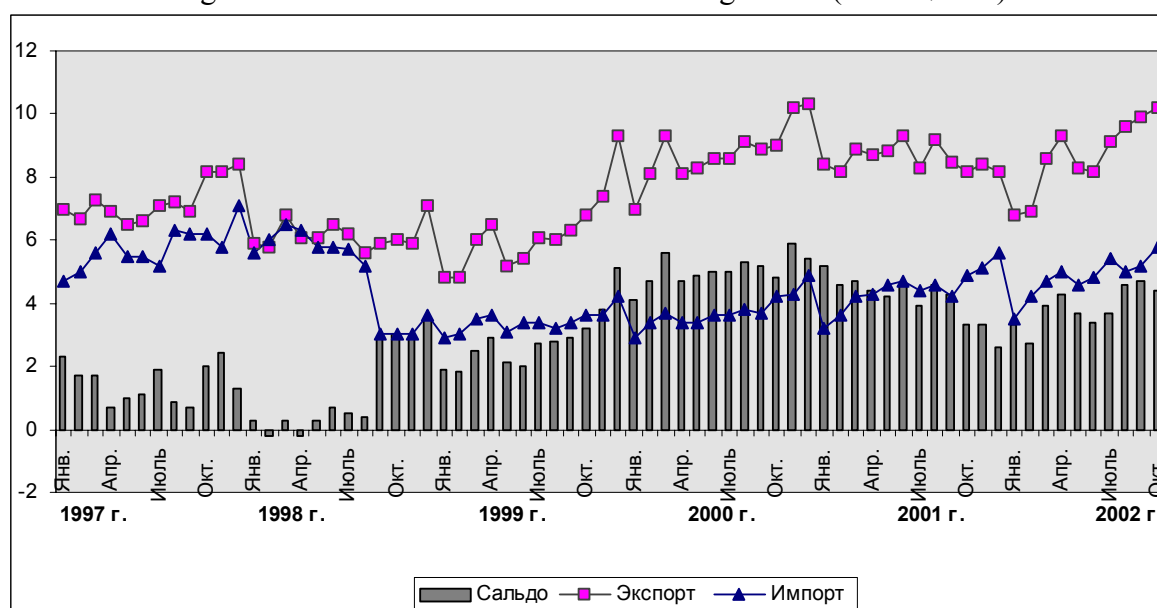
Additionally, in the framework of the study there was carried out an analysis of the impact of effective electric power tariffs on prices and output in the economy at large, i.e. tariffs taking into account the balance of debtor and creditor indebtedness of power engineering per kilowatt-hour of energy supplied to consumers. The analysis of dynamics of mutual indebtedness indicates that, as it seems, since about the spring of 1999, the UES became a net debtor credited at the expense of other sectors of the economy. It means that in the case the total amount of outstanding creditor and debtor indebtedness is taken into account, since 1999 the effective price of electric power on the average has exceeded the nominal price. It also means that in the last years the payments for electrical power have been rapidly growing: by increasing the balance of indebtedness to the economy and simultaneously decreasing the share of barter in payments, UES tried not only to establish discipline of contractual payments, but also mobilize necessary funds to settle the sectoral problems in the situation of lagging behind indexation of tariffs.

P. Kadochnikov

Foreign Trade.

In October of 2002, the Russia's foreign trade turnover increased by 25 % in comparison with the figures registered in the respective period of the preceding year and made US R 15.96 billion. Such a significant growth may be explained by the increase in the amounts of both exports and imports. As compared with the indicators of the preceding month, the foreign trade turnover increased by 6 %.

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



Source: RF Goskomstat

In October, exports made US \$ 10.21 billion, what is by 27.7 % above the level registered in the respective month of 2001. At the same time, the share of countries outside CIS was at about the level of October of 2001 (83.8 %).

The growth in exports may be explained both by the continuing increase in volumes of export, and the favorable business situation of the world market. According to IMF, in October of 2002 world prices of staple Russian exports were by 6 % above the level registered in the same month of the preceding year.

The situation on the world oil market was unstable in October. In the first 2 weeks of the month oil prices remained rather high. However, since the third week of the month there was observed a downfall in prices, resulting from the oil deliveries exceeding established quotas on the part of certain OPEC member countries. According to the International Energy Agency, 10 OPEC member countries exceeded their respective daily quota of oil extraction (21.7 million barrels) by 2.5 million barrels in October. Besides, the indicators published in the weekly report of the US Oil Institute had a negative impact on prices. According to the report, the reserves of crude oil in the USA increased by 6.8 million barrels by the end of the month making 286.2 million barrels. This indicator is rather significant taking into account the beginning of the heating season, when oil reserves in consuming countries traditionally decline. As a result of the influence of the factors mentioned above, in October the average price of BRENT oil decreased by 3.8 % in comparison with the figures registered in September, while the price of URALS fell by 4.1 %. However, as compared with the last October figures, the price of BRENT oil increased by 26.8 % and made US \$ 27.2 per barrel, while URALS price grew by 31.3 % and made US \$ 26 per barrel.

It shall be noted that natural gas prices demonstrated an upward trend in the last three months of this year. In October, import prices of Russian natural gas on West European markets increased by 14.3 % as compared with the figures observed in September, while in comparison with the level registered in October of 2001 the prices grew by 56.4 %.

In October of 2002, there were registered no significant changes in prices on the majority of key markets of non-ferrous metals as compared with the September figures. At the same time, in comparison with the levels observed in October of 2001, there was registered a considerable growth: aluminum prices increased by 8.1 %, nickel prices grew by 41.4 %, while price of copper increased by 2.5 %.

Table 1

The average monthly world prices in October of the respective year

	1996	1997	1998	1999	2000	2001	2002
Oil (Brent), USD / metric ton	24,08	17,9	12,8	24,1	32,14	21,45	27,19
Natural gas, USD / thous. m ³	2,742	2,346	2,205	2,558	5,767	2,649	4,144
Gasoline, USD / metric ton	0,6704	0,5695	0,4205	0,6986	0,8945	0,603	0,8013
Copper, USD / metric ton	1968,5	1900,7	1659,2	1748,1	1838,6	1405,1	1519,0
Aluminum, USD / metric ton	1341,1	1538,5	1354,2	1470,7	1473,5	1280,8	1313,2
Nickel, USD / metric ton	7060,9	6240,5	4262,4	7984,2	7353,2	4836,8	6840,9

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

The average weighted rate of customs duties declined from 10 % to 6.5 % in 2002. More than 200 rates of export duties were decreased and about 500 abolished. In 2002, the damages of domestic exporters resulting from protective measures introduced on external markets could be minimized – the total amount of damages declined by US \$ 150 million. For instance, in the USA there was suspended the antidumping investigation concerning Russian exports of plate steel due to the fact that US recognized the market status of the Russia's economy.

In October of 2002, the export of all types of steel products from Russia to USA increased by 68 % in comparison with the figures registered in the preceding month – from 132 thousand metric tons to 221 thousand metric tons (according to the US Department of Trade). As concerns the results of the period from January till October, Russia was ranked 4th among the largest exporters of steel to the US market after Canada (4.5 million metric tons), Brazil (3 million metric tons), and Mexico (2.88 million metric tons). For the first time in the first 10 months of this year, 1.37 million metric tons of steel were exported from the RF to the USA.

In October of 2002, the real Ruble / US \$ exchange rate exceeded the level registered in the respective month of 2001 by 5 %. Besides, the level of GDP increased by 4.0 % in comparison with the figures observed in October of 2001. A stronger national currency and a growth of incomes in the economy were objective factors behind higher levels of imports. On the other hand, as Euro became by 9 % stronger in

relation to US \$, prices of Europe-made goods increased and, accordingly, constrained a growth in the volume of Russian imports from the European zone.

As a result of impact of these and other factors, in October of 2002 the amount of imported goods increased by 19.6 % in comparison with the level registered in the same month of 2001 and made US \$ 5.75 billion. At the same time the growth in imports from countries outside CIS was even higher and made 23.6 %. The share of these countries in imports grew from 78 % in October of 2001 to 81 % in October of 2002.

The active balance of trade made US \$ 4.46 billion as compared with US \$ 3.19 billion registered in October of 2001 and US \$ 4.72 billion in the preceding month.

In December of 2002, the next round of talks concerning the accession of Russia to the World Trade Organization (WTO) was held in Geneva. No compromise could be reached concerning a number of issues. The main barriers on the way of accession remain the discrepancy between domestic and external prices of electric energy and natural gas, inconsistencies of the Russian legislation and WTO rules, restraints on the participation of foreign capital in the financial and telecommunication sectors, and tariffs on import of certain goods. No progress could be achieved during the talks on these problems.

There are also other unsettled disagreements with other WTO member countries. For instance, the USA, among other issues, is disturbed by the high level of protection of the Russian aviation industry, Canada - by restraints on foreign participation in the mining industry of the RF, Japan – by high customs duties on imported cars, the “Kern group” – by expanding practices of quotation of imports, auctions for quotas, etc.

At the same time, the Russian delegation could achieve an important tactical concession on the part of its partners, who agreed to intensify the process of negotiations. In January through April there shall be held three official meetings of the working group on Russia’s accession to WTO, each meeting shall take about a week. It may be noted that in 2002 there were held only 4 such meetings taking 2 to 3 days each.

In October, Russia’s exports to CIS member countries increased by 26.6 % in comparison with the figures registered in October of 2001 and made US \$ 1.66 billion, while imports grew by 23.6 % and made US \$ 1.1 billion. Therefore, Russia maintains the active balance of trade at about US \$ 0.56 billion.

In December, there was held a regular meeting of the Council of Heads of customs services of the Eurasian Economic Community. The meeting was attended by the representatives of customs of Belarusia, Kazakhstan, Kirghyzia, Russia, and Tadzhikistan, which discussed the problems of further unification of customs rules in these states.

There was also discussed a complex of issues related to the transfer of intellectual property goods, what is a mandatory prerequisite for the accession to the World Trade Organization. It was decided to organize the exchange of the registers of objects of intellectual property among the customs services of the member states. Customs services constantly comply such registers in order to prevent illegal traffic in intellectual property.

In December, there was also held the meeting of the Customs Committee of the Russia – Belorussia Union State. The participants discussed the problem of formation of conditions necessary to create the common customs space.

The participants of the meeting focused on the problem of transit. In the case this problem is solved, it would facilitate the further liberalization of customs procedures.

There were worked out recommendations aimed to protect the interests of Russia and Belorussia on the external border of the Union State, as concerns both imported and transited goods. Besides, there were discussed additional measures aimed to consolidate control over the import and transit of goods transferred in accordance with the convention on international road transportation. This year, 53 of 160 forwarding companies, which submitted respective applications, were rejected due to infringements on the convention. In October of 2002, the Belorussian customs implemented the system of operative reaction as concerns forwarding agencies failing to deliver goods to the destination customs authority, including Russian customs. The meeting was concluded by a report about the development of the customs infrastructure of the check points at the Belorussian border.

N. Volovik N. Leonova

Foreign financing of Russia's science: new priorities.

In the last six months the topic of foreign support of Russia’s science became more popular than ever. It is not excluded, that a factor behind this development is a peculiar anniversary – the reform in Russia and in Russian science (where foreign support was of considerable importance, and not only in material terms) has

been in progress for a decade. This anniversary requires to summarize the experience and objectively answer the following questions about the results of this support, its importance for Russia and donor countries, the scale of further financing, the most suitable mechanisms of support, necessary changes (if any) as concerns the priorities (areas of support and eligible categories of grant recipients). At present, foreign organizations and foundations are ready to cooperate closer and share their experience in the assessment of the effectiveness of implementation of programs. At the same time, the grounds for cooperation have also changed as a number of foundations implement joint programs.

Official statistics reveal that the share of financing of science from foreign sources is diminishing – at present it makes slightly over 10 %. At the same time, a decrease in the specific weight does not mean that financing is declining in absolute terms. Russian science demonstrates a positive trend towards a constant growth in orders on the part of industry. This development accounts for the decrease in the specific weight of foreign sources. At the same time, in certain areas of research, especially prospective and rapidly developing spheres (for instance, medical and biological studies, chemical physics), the share of foreign sources (in the form of grants and contracts) makes up to 80 %. Yet another indicator is that according to expert estimates, at present about one third of all fundamental studies in Russia is carried out in the form of joint research projects with foreign partners. Foreign support is directed to clearly defined recipients, as a rule, is assigned via tenders, projects are assessed with participation of foreign experts, what, in view of the Russia's academic community, ensures that Western donors take more fair decisions. Therefore, foreign financing retains its importance, which in reality is greater than in "statistical" terms.

May it be expected that foreign financing of Russian science will diminish? The answer to this question in part depends on the achievement of goals, for which the funds were assigned. Foundations and programs aimed at the support of Russian science have many different missions, and often one donor organization pursues several goals at the same time. Summarizing, the following dominating goals of the support of Russia's science may be singled out: to keep the best researchers involved in fundamental and applied studies, to prevent "brain drain," to re-orient former defense research establishments towards the implementation of civilian projects, assistance in the adaptation of the sphere of science to the market economy via participation in its institutional and structural reform and support of science in regions, assistance and cooperation in commercialization of the results of research. Apparently, most of these goals remain urgent. For instance, the "brain drain" continues, although on a lesser scale. At the same time, more young researchers give up science and it may be said that young researchers "flow through" the sphere of science (especially hard science) in no time. The problem of conversion of defense establishments is also far from settlement, although Western organizations made large investments in the process of conversion: for instance, only the budget of the International Scientific and Technical Center (ISTC), which finances civilian projects of former defense scientists six times exceeds annual budgets of two leading domestic scientific foundations – the Russian Fund of Fundamental Studies (RFFS) and the Russian Humanitarian Scientific Fund (RHFS). Receiving grants for the implementation of civilian projects, defense scientists re-orient their studies, however, only for a time, and return to military projects as soon as there are state orders for respective researches. There were no massive evaluation of "conversion" of defense scientists, while sample surveys demonstrate that complete re-orientation is possible only in case organizations do not receive defense-related orders. It shall be hardly expected that the full reorientation towards civilian projects pursued by Western donors will be achieved in the nearest future" in the last year the amount of defense order in science increased, as per expert estimates, 2 or 3 times.

The structural and institutional reforms in the sphere of science are far from completion, while many problems remain unsettled in terms of commercialization of the results of studies and researches. Therefore, there are no grounds to expect a decline in foreign financing in relation to the achievement of specified goals. At the same time, the prospects of growth or decline in the market of foreign support of science depend not only on goals and priorities of sponsor organizations, but also on the conditions of their work in Russia. An urgent problem often confusing foreign donors is frequent changes in the Russian tax legislation. While, for instance, the rules governing the single social tax and VAT were in the end adjusted in favor of organizations providing technical assistance, this problem still rises questions about the feasibility to maintain the scope of support of Russian science on the part of foreign organizations. At the same time, taking into account the variety of factors, it may be expected that foreign sponsors will maintain the present level of financing of Russia's science.

Even in the case certain goals set forth by the terms of support were not achieved, it does not mean that financing was inefficient. To the contrary, there is a number of positive effects. Among such effects are the

introduction of new mechanisms of financing, like tenders, basing on independent expertise and targeted support of research teams, lessons of grant management, introduction of the term “conflict of interests” to the Russia’s scientific community, promotion of the idea of support of science in higher education establishments, where research is effective two times, since it involves young scientists and simultaneously achieves both scientific and educational goals. At last, programs and foundations contributed to the popularization of foreign experience of distribution and protection of intellectual property rights.

Summarizing various discussions and meetings organized over the last few months by Western donors, it may be concluded that the donors are also in the dark concerning the effects of the Western assistance to Russian science, and if these effects are favorable for the donors themselves. Most donors adhere to the idea that “the situation is not what it seems to be at the first glance” fearing that the goals and priorities were not always set correctly. Such sentiment is not accidental: assessment of a number of initiatives implemented in Russia revealed that these initiatives did not bring expected results. A factor behind this development is that programs were worked out by Western donors without consultations with Russian experts proceeding from their understanding what Russia needs and what facilitates its transition to the market economy. Ideas realized in such programs not always answered the interests and views of Russian organizations responsible for scientific and technical development, as well as requirements of regional authorities and the scientific community, what resulted in failures in implementation of projects. At present, the approaches to such issues (assist to whom, how, and on which terms) are reviewed. The following ideas in this sphere begin to dominate.

First, the majority of organizations tend to a stricter selection of priorities of assistance, and a closer cooperation with the Russian partners before they start to implement their initiatives. This is especially characteristic of US foundations, the budgets of which are in part financed at the expense of the federal sources, and international European organizations. The general trend demonstrated by European donors is to assign less but larger grants concentrating them in selected areas, in particular those conforming to the priorities of the 6th framework EU program.

Second, it is necessary to strive for joint (better – parity) financing on the part of the Russian investors, which may include not only federal agencies (they have been the most active participants of joint initiatives), but also regional authorities, as well as Russian and Western industrialists. Exactly this logic is implemented by G. Soros in the course of reorganization of the Open Society Institute (OSI). OSI shall be replaced by a number of organizations with the status of Russian legal entities. Among such organizations is “Internet Sotsium” representing the association of 33 Universities, where were established Internet centers. A largest successor of OSI shall become the Fund “New Russia” with the budget financed from two to three sources (the Eurasia Fund, Soros, and, most probable, a large Russian corporation). Fund New Russia will implement educational programs, programs of support of small and medium-sized innovative businesses, initiatives related to the development of civil society, and a number of others. In the case the situation develops in the favorable direction, organizations succeeding OSI will be more and more supported by the Russian capital. At the same time, representatives of INTAS – a well known and popular among Russian researchers EU initiative – announced that they are ready to invite Western companies to finance their projects (November meeting in Brussels). On the one hand, it will allow to increase the budgets of programs, on the other hand, participating firms will have a relatively inexpensive way to pay for the researches they are interested in and a favorable PR action.

Third, it is recognized that it is important to better coordinate programs among Western organizations themselves in order to work out common approaches, elimination of redundancies, and more effective utilization of financial resources. It was also recognized that at present different donors disagree about such basic terms as cooperation, institutional reforms, civil society. Besides, the coordinated activities may facilitate that reforms in one sector of the economy (scientific and technological) will positively affect other sectors of the economy (for instance, education or industry). At the same time, the elaboration of programs shall become more operative, since the object of assistance (spheres of science) changes very rapidly. The operative character of programs shall be combined with more thorough strategic planning.

Fourth, there is observed a trend towards the actualization of delayed in time assessment in order to analyze long term effects of programs implemented by foundations. At present this aspect of work of foreign organizations and foundations is still underdeveloped, and foundations often operate by indicators of short term results and achievements.

Fifth, Western organizations plan to develop more deep and integrated forms of cooperation with Russian organizations and research teams, continuing the transition from support and assistance to equal cooperation.

Ideally, the development of cooperation shall go through the following stages: exchange of information, mutual visits and exchange of experience - grants for joint research – joint projects including whole organizations – standing institutional partnerships basing on the first three types of cooperation¹⁰.

Sixth, more attention is paid to spheres, where support could bring tangible practical results. Accordingly, more organizations are involved in such areas as assistance to commercialization of the results of scientific researches and projects, development of assistance programs relating to the establishment of partner ties between Russian and Western scientific organizations and Russian scientists and Western small businesses and industrial companies. INTAS, for instance, demonstrates its interest in these avenues of cooperation, similar steps are taken by the US Civilian Research and Development Fund (CRDF), which in December announced the start of its new initiative to establish offices of transfer of technologies in Russia's Universities, where in the framework of the program "Fundamental Research and Higher Education" were created scientific and educational centers (SEC) in the sphere of natural sciences. While initially it was planned to concentrate assistance in the sphere of fundamental research (what is reflected in the name of the Fund's program), as centers developed it became clear that it is necessary to make the next step and assist Universities to acquire the experience of commercialization of the products and technologies they developed. Many problems and doubts exist in this area. Problems are related to the certain gaps in the Russian legislation (for instance those concerning objects of intellectual property), while doubts exist if the stimulating of the commercialization of the results of Russian researches abroad may facilitate the economic development of the country, or such support is primarily in the interests of donor countries. No clear answer to these questions exists at the moment, however, it is apparent that representatives of the Russian federal authorities shall participate in working out the "rules of the game" for such initiatives.

At last, seventh, a priority of foundations is the support of certain categories (demographic groups) of researchers. First of all, such groups and categories include young scientists, programs of support of which are initiated by the growing number of organizations and foundations. Eligibility priorities also always concern women and scientists working in regional centers. The effectiveness of implementation of such targeted programs has not had clear confirmation, and their urgency is primarily related to the political choice of foundations and their understanding of the characteristics of democratic organization of the sphere of science.

Two answers may be given to the question of results of the assistance to Russia's science for donor countries themselves. First, this assistance facilitates economic stability, and in some degree the development of civil society in Russia via the support of the intellectual elite of the country. Second, there are obvious benefits for Western scientists, who engage in the joint projects with their Russian counterparts. Opinions of participants of programs run by such foundations as CRDF, INTAS, ISTC are an evidence that Western scientists learn about new ideas and, accordingly, obtain new scientific results with the help of their Russian colleagues. Benefits for the West are also apparent as concerns co-financing of commercialization of the results of Russian studies and research by foundations and foreign companies.

On the whole, the foreign support of Russia's science is developing in accordance with the major trends observed at present on the international market of philanthropy, i.e. it becomes more targeted and oriented towards the final result.

Therefore, foreign programs and foundations do not curb their activities in Russia, but just change the form of their presence by joining resources, attracting Russian capital for the financing of science, improving the selectivity, and setting priorities in order to support certain disciplines, spheres, and areas of scientific and technological activities.

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¹⁰ - Temmes M., Salminen A. Transformation and Transition: An Introduction in East-West Cooperation in Public Sector Reform. IISA/EGPA, IOS Press Amsterdam, 2002.