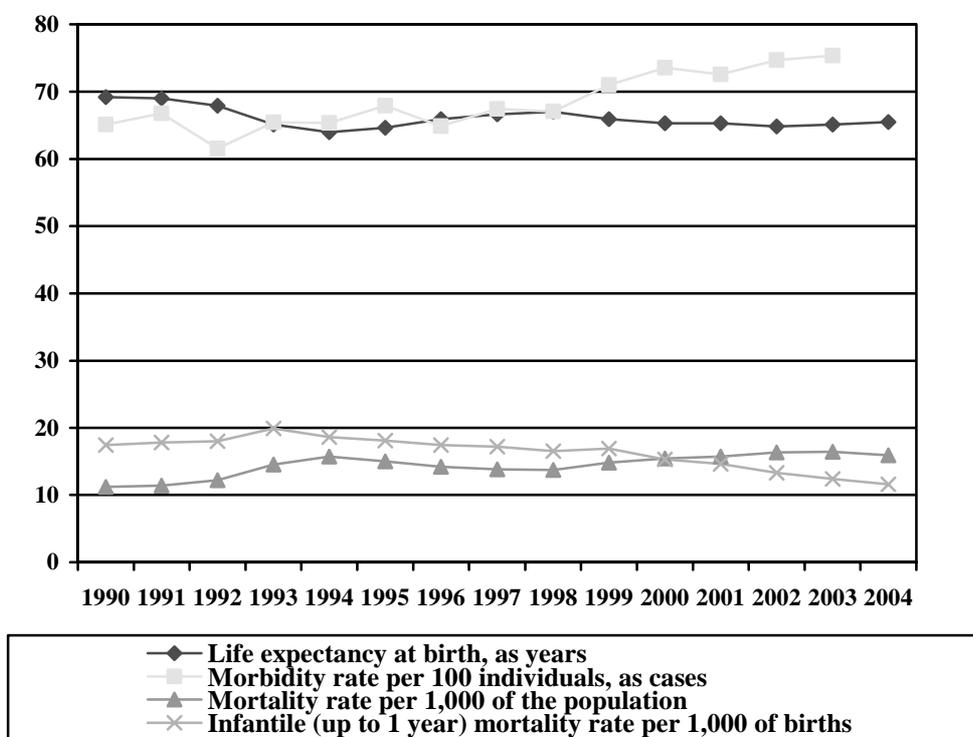


3.6. Sub-sectors of the Socio-Cultural Sphere

3.6.1. Health Care

Main Indicators of the Health Care Institutions' Performance

The Russian population's morbidity and mortality rates tend to grow (Fig. 70). However, in 2004, it was the first time over the last five years the mortality rate per 1,000 reduced (from 16.4 in 2003 to 15.9 in 2004). Besides, infantile mortality rate decreased essentially over the last five years: from 16.9 in 1999 to 11.6 with per 1,000 births. Life expectancy indicators at birth have stabilized, albeit on an extremely low level. In 2003, this value equaled 65.5 years, for men – 59.1 years and for women – 72.5 years.



Source: according to the Russian Statistics Agency data.

Fig. 70. Indicators of the State of Russia's Populations Health

So far as fundamental principles of provision of medical assistance are concerned, the Russian health care system has not much changed vis-avis the Soviet times. Nowadays it comprises a countrywide medical-preventive institutions network, a great number of hospital beds, and a great number of medical doctors. Over the last 15 years volume indicators of the hospital system were declining (Table 39). The number of beds per 10,000 of the population in 2003 accounted for 81% vis-a-vis 1990. The number of medical institutions has fallen by 21% since 1990, but the number of polyclinic institutions did not change that much. By contrast, the number of medical doctors was steadily growing: in 2003 it at 7% exceeded the respective 1990 level and accounted for 48 medical doctors per 10,000

of the population. By contrast to that, the number of the nurses per 10,000 residents fell approximately by 13% during the 1999–2003.

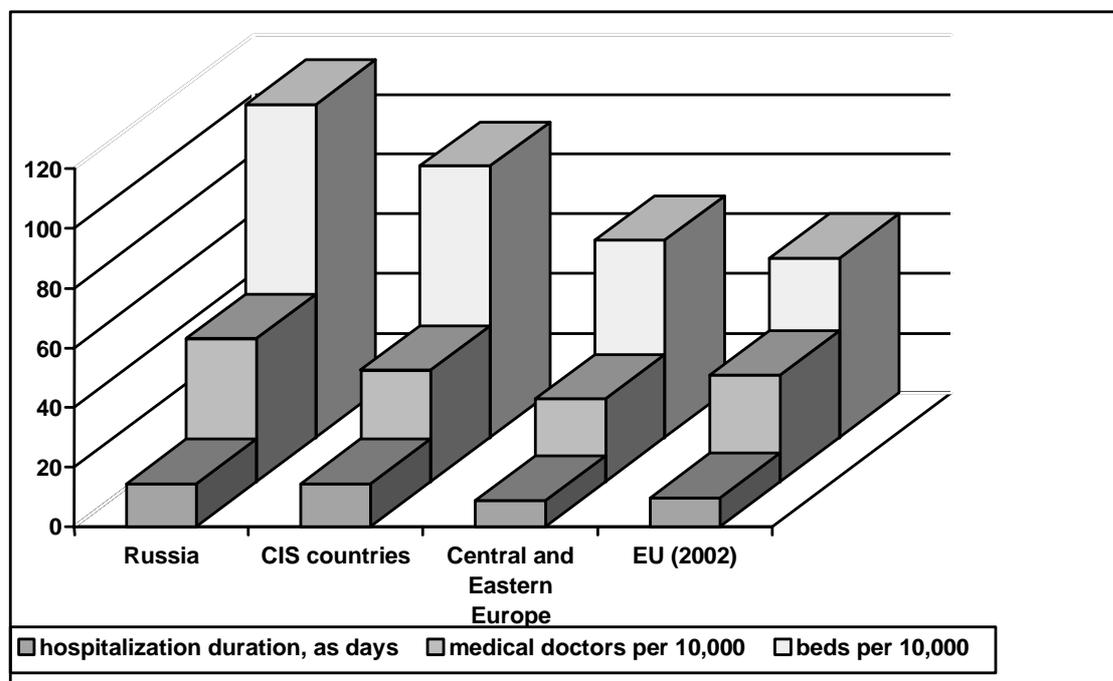
Table 39

The Medical-Preventive Institutions Network in Russia

| | 1990 | 1995 | 2000 | 2001 | 2002 | 2003 |
|---|-------|-------|-------|-------|-------|-------|
| The number of polyclinic institutions, as Thos. | 12,8 | 12,1 | 10,7 | 10,6 | 10,3 | 10,1 |
| The number of hospital beds per 10,000 residents (as of the end of the year) | 137,5 | 126,1 | 115,9 | 115,4 | 113,7 | 111,6 |
| The number of polyclinic institutions (independent and belonged to other institutions), as Thos. | 21,5 | 21,1 | 21,3 | 21,3 | 21,4 | 21,5 |
| Capacity of medical polyclinic institutions per 10,000 residents (as of the end of the year), as visits per shift | 217,4 | 235,6 | 245,0 | 247,6 | 250,2 | 248,7 |
| The number of doctors per 10,000 residents (as of the end of the year), as persons | 45,0 | 44,5 | 47,2 | 47,3 | 47,9 | 48,0 |
| The number of nurses per 10,000 residents (as of the end of the year), as persons | 124,5 | 111,0 | 108,4 | 107,8 | 109,3 | 108,5 |

Sources: Rossiysky Statistichesky Yezhegodnik. M.: Rosstat, 2004; WHO Regional Office for Europe health for all database.

In spite of the above-mentioned reductions, the Russian health care vis-à-vis European countries and even CIS countries still enjoys greater indicators of provision of the population with doctors and hospital beds. But the efficiency of the use of the available resource potential is low. A great sufficiency of beds goes in pair with a longer duration of hospitalization (Fig. 71).



Sources: Rossiysky Statistichesky Yezhegodnik. M.: Rosstat, 2004; WHO Regional Office for Europe health for all database.

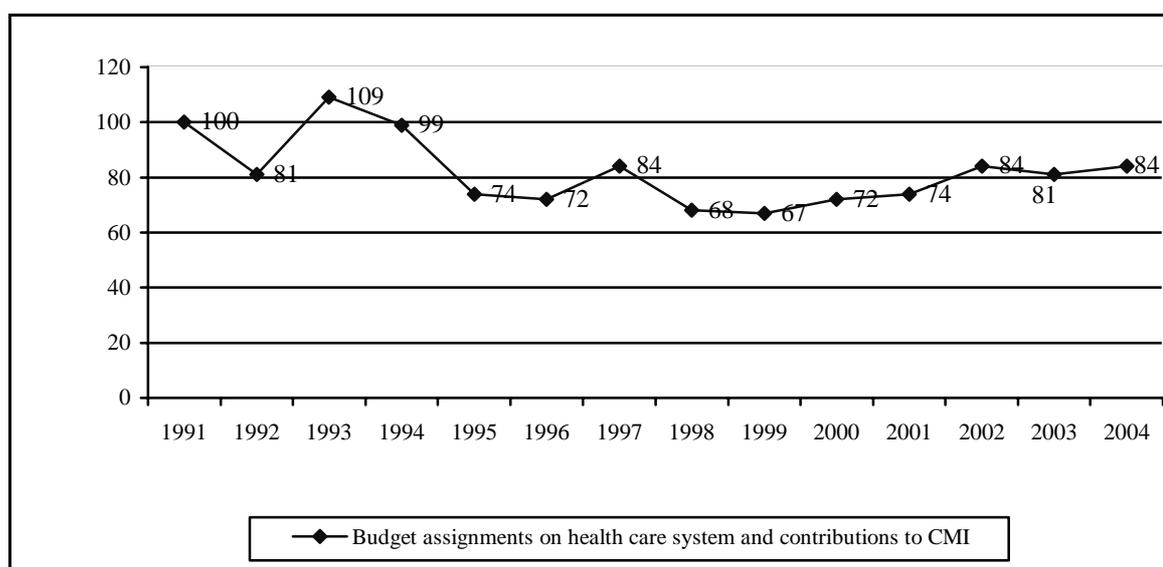
Fig. 71. Indicators of Health Care Systems, 2003

Stationary medical assistance prevails over the system of medical services in the country. Meanwhile, according to the assessments of the RF Ministry of Health Care, more than 30% of hospital patients could receive an effective medical assistance on the outpatient basis. According to insurance company “ROSNO-MS”, 24% of hospital patients as a minimum had diagnoses that did not require a stationary treatment. When checking the validity of the medical bills submitted by hospitals, the insurance company exposed shortcomings of the organization of medical assistance in 10% of stationary treatment cases. The main causes underlying the inefficiency of medical services are extension of treatment term and hospitalization without sufficient medical diagnoses.

The health care system comprises a complex of fundamental economic problems that reproduced themselves over the last 10 years:

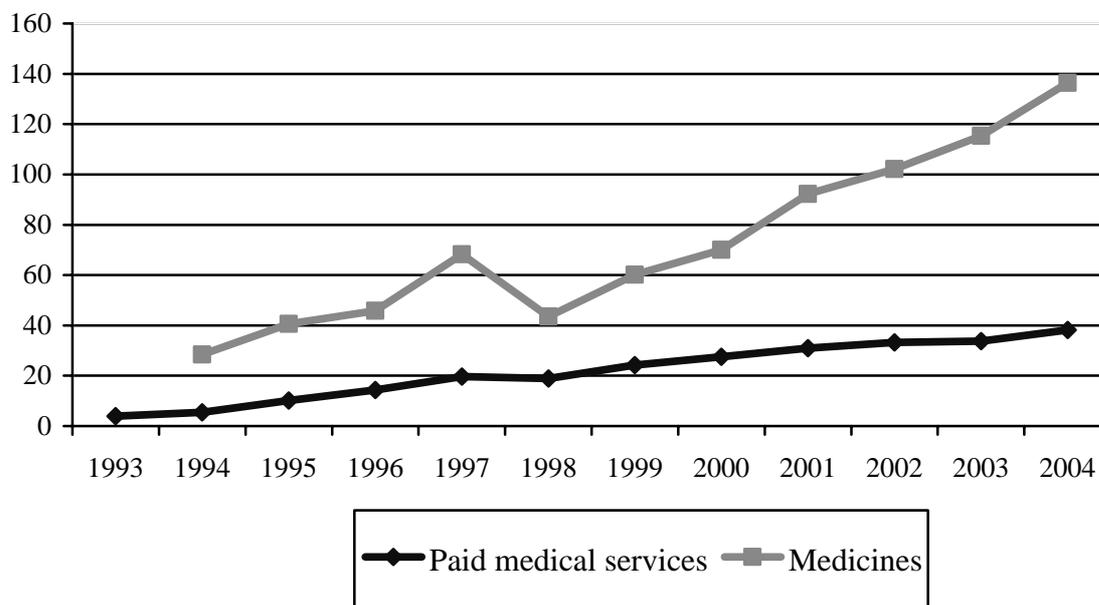
- financial insufficiency of the state guarantees of medical assistance to the population;
- unregulated replacement of the state expenses by private ones without revision of guarantees;
- incompleteness of introduction of the compulsory medical insurance system;
- considerable differentiation of the amounts of the state financing across regions;
- absence of economic mechanisms that encourage participants in the health care system to increase the effectiveness of the use of public resources.

The volume of the government financing of the health care system that had reduced by more than one-third in the 90-s began increasing since 2000, but has still failed to reach the level registered 15 years ago (*Fig. 72*). In addition to that, the public guarantees, as in the Soviet times, provide for medical assistance being free for the population at the public and municipal health care institutions, albeit the volume of such guarantees for single individual has not been defined as yet. The divergence between the population’s expected volumes of their provision and real capabilities of the state is immanent for such guarantees. Given the reduced government financing, this divergence transforms into the gap between the declared and real economic conditions of receiving medical assistance.



Source: Calculated basing on the Russia’s Rosstat data

Fig. 72. The Dynamics of the Government Expenses on the Health Care System (1991=100%)



Source: Calculated basing on the Russia's Rosstat data

Fig. 73. The Population's Expenses on Health Care System, as Rb. billion in the 2000 prices

Financing of the medical assistance to a greater extent is shifted onto households and employers. The population's spending on medicines and medical services grows steadily at a high pace, which has not reduced over the last years, in spite of the growth of the government financing, but outstrip it (Fig. 72 and 73). The replacement of the government expenses by private spending is a spontaneous process. The attempts to regulate the process are undertaken on the micro, rather than macrolevel. A high real level of the population's contribution to paying for medical assistance does not go together with a revision of inadequately fulfilled guarantees.

Compulsory Medical Insurance

The existing system of compulsory medical insurance (CMI) suffers a number of serious shortcomings that need to be overcome through changing the CMI model itself.

There is no coordination between the CMI programs and the amounts of insurance premiums. This is the fundamental shortcoming. The CMI system accumulates 46% of the aggregate volume of the public health care insurance, while the value of the basic CMI program accounts for 63% of the value of the government guarantees program on free medical assistance to the population. This problem is mainly associated with the breach of obligations with regard to insurance contributions for the non-working population by RF Subjects and local authorities.

In 2004, the government proceeded with its 2003 experiment on the Pension Fund's participation in co-financing of the CMI contributions on behalf of the unemployed pensioners. The amount of resources allocated from the Pension Fund's budget for these purposes has grown from 1.5 billion rubles in 2003 up to 6 billion in 2004. It is intended to increase the amount up to 10 billion in 2005. The experiment and the process of intensifi-

cation of governors' dependence on the federal center have recently contributed to a considerable growth of the amount of contributions for the non-working population, but that does not fundamentally change the situation in the CMI area.

The current CMI model has failed to exert an essential influence on the efficiency of the use of health care resources. The original expectations of the emergence of a competition between the insurers, which was envisaged to have a stimulating effect on their proactive stance in regard to protection of insurants' rights and optimization of placement of orders among suppliers of the medical services, have vanished. The population can hardly choose an insurer. In addition to that, insurers are not subjected to any financial risks in regard to the payment of medical assistance. So they are not interested in selecting more efficient options of organization of provision of medical assistance for insurants.

The basic rate of the social tax that is directed in part to CMI was reduced from 3.6% to 2.8% but its centralized part was simultaneously increased from 0.2% to 0.8%. The 2005 federal budget provides for subventions at the amount of 3 Rb. bln. that are envisaged to be forwarded to the CMI Federal Fund to co-finance insurance contributions on compulsory medical assistance for the non-working population (children). In fact, this forms a compensation for the revenue losses of the CMI system resulting from the reduction of the social tax rate. So, the CMI Federal Fund receives considerable resources to equalize the financial sufficiency of the territorial CMI programs.

The economic mechanisms presently existing in the health care system do not create incentives for its participants to enhance the efficiency of use of public resources. The duality of sources and methods of the public and municipal health care institutions' financing for provision of medical assistance to the population that are envisaged by the basic CMI program pose a main problem, so long as procedures of their financing are concerned. According to the CMI system's design, such kinds of assistance should have been paid only at the expense of the CMI funds, but in practice they continue to be financed both from the CMI system and from the budget. Public and municipal medical-preventive institutions (MPI) receive approximately 50-60% of their resources in the form of the budget financing of maintenance of the institution, about 30-50% from the CMI system in the form of payment for the provided medical assistance and from 5 to 15% in the form of incomes from provision of the population with paid medical services. According to the federal recommendations, the budget and insurance resources should be employed for reimbursement of different expenditure items. In practice, however, some single expenditure items of the MPI are simultaneously covered from the two above-mentioned sources of financing. This creates the institutions' eagerness to spend more, rather than to use the resources in a more efficient manner.

Development of the Health Care Reform Guidelines

The discussion on the guidelines of the much-needed health care reform has been under way in the government since 1997. Between the 2000-2003 the Ministry for Economic Development played a leading role in designing of the respective proposals. The bill on CMI had been developed by March, 2004. It was coordinated with all the agencies concerned⁴⁸. The consequent government reform has changed the configuration of positions. The new leadership of the RF Ministry for Health Care and Social Development began to play a principal role in the preparation of the health care reform proposals.

In 2004, the preparation of the health care reform developed into a new phase. It is worthwhile noting that in official documents the wording "health care reform" was substi-

⁴⁸ For the Concept of this bill see: Rossiyskaya Ekonomika v 2003 godu. Tendentsii i perspektivy. M.: IET, 2004. P. 282-283

tuted by “health care modernization”. In 2004, the Presidential Address highlighted some key avenues of the health care modernization:

- specification of guarantees of free medical assistance basing on development of standards of medical services, which include an array of medical-diagnostic procedures and medicines, and minimal requirements to conditions of provisions of medical assistance;
- transition from the estimate-based principle of maintenance of medical institutions to the payment for the provided volume and quality of medical assistance produced in compliance with the principles of the compulsory insurance;
- fostering incentives for voluntary insurance.

During 2004 the RF Ministry for Health Care and Social Development with the assistance of experts of the Center of Strategic Development was working on the preparation of two bills designated to form a legal base of the health care modernization:⁴⁹

- “On state guaranties of medical assistance”;
- “On compulsory medical insurance”.

The first bill sets kinds of the guaranteed medical assistance. Their current array that should be provided at no cost remains almost invariable. In contrast to the current system of state guarantees of medical assistance, the bill provides for specification of these guarantees across volumes, conditions and procedures of provision of medical services at different stages of medical assistance.

The guaranteed volumes of medical assistance are specified on the basis of standardization of medical technologies. Clinical protocols (sectoral standards) are designed for every kind of morbidity on the federal level. They comprise lists of medical services suggested (doses and application recurrence, levels of provision of medical assistance, etc.). In the framework of the respective list and algorithms of fulfillment of the protocols are common for the whole country.

Basing on the clinical protocols the RF Subjects design clinical-economic standards (CES=s), which specify requirements of clinical protocols and comprise an assessment of the value of the pre-set “package”. CES=s determine actual volumes of medical assistance across every illness with account of peculiarities of the employed medical technologies (both what to do and how to do) and prices of resources. Every RF Subject adopts and employs its own clinical-economic standards.

Clinical protocols and CES=s comprise two parts. The fixed part is formed by a set of medical services and medicines that is compulsory for all patients with a given illness. A volume of services of the fixed part is equal for all patients with the same illness. The variable part is formed by a set of medical services needed for the part of patients with a given illness, depending on peculiarities of its anamnesis. The volume of services of the variable part is computed on account of an aggregate of patients (for example, 60 ultrasonic examinations are required per 100 patients with the diagnosis “Cholecystitis”).

The fixed part of services is guaranteed to every patient, while the variable one is delivered according to medical diagnoses. So far the variable part is concerned, the medical doctor takes a decision in an order that is set by a head of a given medical organization. In case of medical contra-indications to the use of services and medicines included in CES, medical assistance, which is not envisaged by the standard, is guaranteed. But this implies a higher level of decision-making – by a clinical-expert commission under the medical institution.

⁴⁹ Slepnev A.A., Shevskiy V.I., Sheiman I.M., Shishkin S.V. Modernizatsiya sistemy zdravookhraneniya: poisk resheniy//Manager zdravookhraneniya. 2004. №11.

Such a structure of the standard, on the one hand, provides for a specification of the set of medical services and medicines its patients receive, while on the other, it ensures a medical doctor freedom necessary to take decision under conditions of the variety of manifestation of the same illness by different patients.

The procedures of provision for medical assistance in the framework of the public guarantees are based on the following principle: the provision of medical assistance is guaranteed, providing there exists a pre-set “route” of the patient across the levels of provision of medical assistance. A local medical doctor and a general-practice doctor play the roles of an organizer and coordinator, respectively, of provision of medical assistance on other stages. The planned particularized medical assistance on an outpatient basis and in hospital conditions is delivered according to their prescriptions. In case of the absence of the respective prescriptions, the planned medical assistance provides for a direct payment by the patient.

The procedures set a “queue” of the planned particularized medical assistance and maintenance of a list of patients. The queue is to be kept under control.

The bill envisages setting quotas on high-tech kinds of medical assistance delivered both at the federal medical institutions (for the RF Subjects) and at the RF Subjects’ medical institutions of the tertiary level (for municipal institutions). The RF Subjects can introduce additional guaranties in regard to such kinds of assistance – on the basis of direct agreements with federal medical organizations at tariffs that are set for the medical assistance subject to quotas. The lists and amounts of quotas of the respective kinds of provided medical assistance and lists of medical organizations are set annually, according to the federal and territorial programs of state guaranties.

The government agencies of the RF Subjects set the guaranteed conditions of provision of medical assistance on the level not lower than the one set by the federal program of state guarantees of medical assistance. The latter sets requirements to standards of patients’ length of stay and provision with food in hospitals, as well as to the marginal term of waiting for the planned medical assistance.

The state guaranties of medical assistance should be implemented through the compulsory medical insurance system. The bill “On compulsory medical insurance” envisages its modernization.

In order to increase the manageability of the CMI system and the state control over targeted and rational employment of the CMI funds, the bill establishes the principle of subordination of the municipal CMI funds to the Federal CMI Fund. The head of a territorial CMI fund is appointed by the head of the Federal CMI Fund upon consent of the supreme executive body of the RF Subject. Thus created vertical is to ensure the integrity of the system and its financial stability.

In addition to this, the proposed structural modifications ensure that the RF Subjects’ administrative bodies preserve control over the functioning of municipal CMI funds. The representative body of the RF Subject approves of the municipal CMI fund’s budget. The municipal CMI fund sets the standards of the per capita financing of insurers upon consent with the executive body of the RF Subject.

The bill provides for an introduction of social partnership institutions to the CMI system’s administration. The RF agencies, associations of Russian trade unions and employers form the territorial CMI Fund’s supervisory board. The Supervisory boards control the performance of such Funds’ budgets.

The executive body of the respective RF Subject, basing on an agreement with the municipal CMI fund, as well as associations of medical organizations, professional unions

of employers and insurance medical organizations set tariffs on medical assistance of the medical institutions provide to the insureds.

The bill sets a number of requirements and mechanisms that ensure a balance between the CMI programs and financial resources. Insurance premiums of the RF Subject on CMI on behalf of the non-working population should be set at an amount not lesser than that, which provides the balance of the amount formed by all sources designated for financing the basic CMI program and its value. The procedure of calculation of the value of the basic CMI program in the RF Subjects and the methodology of calculation of amount of premiums on CMI on behalf of the non-working population are approved by the RF Government.

The CMI tariffs that are pre-set in the calculation of the price of the basic CMI program cannot be lower than the values computed according to the methodology of computation of minimal tariffs on the guaranteed medical assistance approved by the federal executive agency in compliance with the law on public guarantees of medical assistance, providing the said agency conducts legal regulation in the health care area. As a result, this should increase requirements to the resource-based provision of medical assistance and on this basis help overcome the regions' eagerness to synthetically lower the value of the CMI program and, consequently, the amount of the CMI premiums on behalf of the non-working population.

The equalization of conditions of financing of the basic CMI program in the RF Subjects is made at the expense of both Federal CMI Fund and subsidies and subventions from the federal budget. The CMI financial resources are distributed at the expense of subsidies from the Federal CMI Fund in favor of regions that are unable to collect funds sufficient for the provision of the basic value of the CMI program due to objective social and economic reasons. One calculates the amount of subsidies with a due account of levels of the RF Subjects' budget sufficiency and sets it in the structure of the RF Federal CMI Fund's budget expenditures across single regions.

The subsidies from the Federal CMI Fund are earmarked under the following conditions:

- compliance of a CMI program in a given RF Subject with the requirements to its formation;
- absence of unsettled debts of the RF Subject on insurance premiums on CMI on behalf of the non-working population.

The bill reads that it is insurance medical institutions (IMI) can serve as the CMI insurers. But at the same time the conditions of their functioning are subject to substantial modifications.

1. The bill grants insureds with the right to select an insurer company by themselves, rather than by their employer, as it *de-facto* happens today. This right is fixed in the current legislation on medical insurance and it is secured by the current procedures of change of the insurer, as well as by personified accounting in the compulsory medical insurance system. As a result, the intensifying competition between IMI=s should encourage them to re-galvanize their operations on protection of patients' rights and control over the quality of medical assistance.
2. The bill increases IMI's responsibility for organization of provision of medical assistance: in the event the insured finds it impossible to receive the necessary medical assistance at a selected medical institution (in the frame of a territorial IMI program), the insurer is bound to immediately undertake steps on securing the provision of the insured with the required medical assistance.

3. The bill sets the IMI's obligation to plan volumes of medical assistance delivered as per contract on provision of the medical assistance by CMI, to ensure the consistency of overall volumes of medical assistance to insureds with indicators of volumes stipulated in the territorial CMI program. The insurers are accountable to the territorial office with respect to fulfillment of their contract on provision of medical assistance. These requirements are aimed at an increase of efficiency of the use of CMI funds. Accordingly, the insured's operations are evaluated on the basis of his contribution to the increase of the efficiency of the use of CMI funds.
4. The bill introduces a system of division of financial risks between the territorial IMI's fund and insureds: the latter will undertake the part of risks associated with the bias in actual spending on provision of insureds with medical assistance from the planned ones. Accordingly, while interacting with medical institutions, IMI=s will not be able to limit their respective functions with the "cashier" one. This should increase their motivation to search for a more efficient structure of provision of insureds with medical assistance.

The bill provides for a possibility of a targeted setting of additional guarantees in the CMI system. The basic CMI program can be complemented with federal and territorial programs of additional medical insurance funded at the expense of additional insureds premiums payable by the RF and/or the RF Subjects, as well as by other entities.

The framework of the effective law bears the problem of duplication of funding the compulsory and voluntary medical insurance and the departmental medical services. At many enterprises, the employers have to arrange a parallel system of medical assistance for their employees, either by using their own medical treatment basis and funding it out of the enterprise' proceeds or by applying the voluntary medical insurance (VMI), thus paying twice for the same risks.

For the purpose of liquidation of the above-mentioned duplication, the bill suggests an introduction of a mechanism of compensations for the part of insurance premium from the CMI funds payable by insurers according to medical insurance contracts.⁵⁰ The provision of premium is conditioned by the conformity between CMI and insurance programs to a medical insurance contract. The premium is provided at the amount of the per capita financing standard per 1 insured in CMI system. The provision of the premium in such an amount and the simultaneous reassignment of obligations to an insurer, who has entered in a medical insurance contract on financing medical assistance in the volume as per the basic CMI program, will not result in a financial destabilization of the CMI system and will not infringe upon the rights of other insureds under the CMI system. Moreover, the availability of VMI should rise considerably thanks to compensating for a part of the insurance premium as per the medical insurance contract. This will secure additional proceeds in the health care system and foster the transition to more solidary and legal forms of the population's participation in paying for medical assistance.

The CMI requirements, particularly, an introduction of the system of personified accounting of insureds, control over the volume, quality, terms, conditions and validity of provision of medical assistance to insureds, protection of their rights, etc. apply to insurers that exercise their mission in compliance with such medical assurance contract.

According to the noted medical insurance contract, an insured has the right to resort to the CMI system in emergency cases, which require an urgent interference, while being

⁵⁰ IET introduced and developed this approach over years. (see: Shishkin S.V. Reforma finansirovaniya rossiyskogo zdra-vookhraneniya. M.: IET; Teis, 2000 // www.iet.ru. P. 316-318; Gudkov A.A., Popovich L.D., Shishkin S.V. Perspektivy sochet-aniya obyazatel'nogo i dobrovol'nogo meditsinskogo i sotsialnogo strakhovaniya v Rossii. Sotsial'noye obespecheniye eko-nomicheskikh reform M.: Institute for the Economy in Transition, 2002. P. 128-150.

away from their permanent residence, in the event they are in need for provision of a specialized high-tech medical assistance and impossibility to receive the much-needed medical assistance in medical institutions, with which the insurer has contractual relations as per to the respective medical insurance contract. In these cases medical services delivered in the CMI system are payable for to the given medical institution by territorial departments with the consequent reimbursement for these sums by an insurer as per the respective medical insurance contract.

The designing of the bills has been underway until the late 2004. They have not been presented to the Government for consideration. So, disagreements between the Ministry of Health Care and Social Development, the Ministry of Finance and the Ministry of Economic Development across single positions were not removed.

A New Mechanism of Provision of Medicines to “Beneficiaries’

The design of mechanisms of implementation of provisions of Federal Law No. 122 of August, 22, 2004, which envisaged the modification of social benefits delivered in kind for an array of categories of the population (war invalids and participants, veterans; members of families of the deceased war veterans, survivors of the Leningrad blockade, disabled, etc.) became a priority task of the Ministry for Health Care and Social Development (MHCS D) in late 2004. Such benefits also comprise a beneficial provision of medicines (free or with the 50% discount) and the sanatorium and rehabilitation treatment. Since 2005 the mechanism of delivery of medicines, the sanatorium and rehabilitation treatment and traveling to the treatment spots has changed for the respective categories of the population. These kinds of services account for an independent set of social services (the so-called “social package”) that is equal across all the above-mentioned categories and amounts to 450 rubles per month. Expenses associated with provision of the given social package are compensated from the Federal Budget. In 2006, citizens will be able to opt for either compensation in cash, equivalent of the cost of the social package or receipt of services included therein.

The main part of the social package is the provision of medicines equivalent of 350 rubles per month. Free medicines are provided for all the respective categories of “beneficiaries” (earlier just a part of the recipients of benefits enjoyed only the 50% discount for the purchased medicines). MHCS D approved a list of medicines that can be delivered to beneficiaries. It comprises 352 international unlicensed brands, or over 2,000 commercial brands. Basing on the method of qualified selection without tender, the Federal Service for supervision in the sphere of health care and social development under the Ministry selected distributor pharmaceutical institutions that were assigned to supply medicines to distribution centers (drugstores) for the individuals entitled for benefits. The Federal Service made the ability to supply all kinds of medicines included in the list the principal selection criterion. As many as 5 distributor companies matched the given criterion. Each of them has monopolized a given federal district and regional market and become a sole supplier of medicines to the recipients of benefits there. “Proteck” supplies medicines to the Central and North-Western federal districts, “SIA – International” – to the Southern and Ural districts, “Biotech” – to Volga district, and ZAO ROSTA – to the Far-Eastern and Siberian districts. “Farmimeks” company supplies medicines to Ingushetia and Chechnya’s drugstores. In late February 2005, ZAO “Apteka-Holding”, the sixth distributor, was permitted to participate in supplying medicines to beneficiaries.

The network of drugstores provides medicines to the beneficiary categories of the population. The networks are selected by the RF Subjects and local agencies. Medicines

provided to beneficiary categories of the population should be paid for through the CMI system. The Federal Budget funds are forwarded to the Federal CMI Fund, which distributes them across territorial CMI funds as per their requests.

The federal agencies failed to explain to all participants the new mechanism of financing the provision of medicines to beneficiaries. It is worthwhile noting that until November 2004 MHCS D mainly focused on designing the set of medicines, negotiations with their manufacturers and selection of suppliers. The procedures of interaction between all participants in the system have been quickly worked out over the two last months of the year. Legal acts that regulate the procedures of contracts on supply of medicines to individuals entitled for benefits and conduct of the respective calculations arrived in regions only in the last decade 2004.

Originally, it was intended to include insurers who participated in the CMI system in the system of payments. The insurers were to receive resources from territorial CMI. Insurers were to sign contracts on supply of medicines to beneficiaries with the distributors and exercise control over validity of the respective prescriptions by medical institutions. The participation of insurers in provision of medicines to beneficiaries was conditioned by MHCS D. The Ministry demanded that they should obtain a special license on the provision of the respective insurance services. Using the insider information, 12 out of 348 medical insurance institutions that participated in CMI, succeeded in getting such licenses until early 2005. The list of such organizations comprises Alfastrakhovaniye-MS, Gazprommedstrakh-M, Ingosstrakh-M, Maks-M, Kapital, Meditsinskoye strakhovaniye, Krasnyy Krest, ROSNO-MS, Soglaskiye-Vita, Solidarnost' dlya zhizni.

Under control on the part of the Ministry for Health Care and Social Development, insurers identified regions for their further operations and started to conclude contracts with pharmaceutical distributors. The insurers' attempts to intrude into regions where they had not ever operated caused conflicts with local governors, who desired to reassign rights of payment for medicine supplies to the regional insurance companies. The Mayor of Moscow was the strongest opponent and he objected the insurers' participation in this program. As a result, in early February 2005, it was decided to exclude insurers from participation in the payment arrangements for medicines and to use for this purpose solely the Federal and territorial CMI funds. However, 8 insurance companies opposed this ruling in their joint statement.

Distributors started supplying medicines to beneficiaries without a fore-payment, i.e. in the form of commodity credit. The procedural arrangements envisaged that the payment was to be effected upon the end of the first quarter against bills for medicines de facto supplied to beneficiaries. This particular arrangement emerged because the absence of accurate data on real volumes of needs in securing for those entitled for benefits with medicines and, consequently, the impossibility to hold tenders on their supply. Such a decision gave a rise to high risks of emergence of problems with price levels and ensuring the general match between the assortment and volumes of supplies of medicines and the respective demand for them.

The above-mentioned procedure quite naturally gives incentives to distributors to include risk premiums in the prices set by them. According to the Ministry for Health Care and Social Development, it agreed with the manufacturers of medicines on marginal levels of registered prices for medicines that are included in the list at the level lower than the producer prices sales of medicines. The amounts of price caps set by distributors producers and importers' prices were not subject to regulation. Meanwhile, January and February saw numerous cases when the amounts of the pre-set prices on the medicines for beneficiaries were higher than those for the same medicines sold on the commercial basis. In

response to that, MHCS D proposed to conclude agreements with manufacturers (importers) of medicines on additional obligations to exercise control over prices and quality of medicines. By late February 2005, 170 out of 324 manufacturers of medicines included in the list signed such agreements.

Lack of maturity of regulation of the volume of demand for the respective medicines is Achilles' heel of the new mechanism. Medical doctors independently determine the volumes of the prescribed medicines. Insurers were supposed to exercise control over the accuracy and validity in respect to prescriptions medical institutions produced for beneficiaries. But they failed to start this work. MHCS D deliberately refused to impose any restrictions on the volumes of the prescribed medicines during the first months of implementation of the new system. This can be easily explained by the fact that it was keen to exhaust the delayed demand of the individuals entitled for benefits for much-needed medicines and by means of an experiment to find a real volume of the beneficiaries' needs for their provision. According to the Ministry of Health Care and Social Development, the 50.8 Rb. bln allocated in the 2005 Federal Budget in for these purposes (which is much greater than the respective 2004 budget allocations) and honoring agreements with suppliers about the price levels for medicines for beneficiaries will allow to cope with the rise in the delayed demand for the medicines that had earlier been in short supply to the benefit recipients due to regional budgets falling short of funds to pay for them. It was suggested to work out mechanisms of adjustment of the volumes of the prescribed medicines upon the first months of the attempt to implement the new provision arrangement.

During the first two months of the year, the number of medical prescriptions for beneficiaries grew more than 2.5 times vis-a-vis the analogous period of 2004.

There immediately began to arise with benefit recipients failing to get prescribed medicines. However, that was a countrywide phenomenon. MHCS D, along with subordinated institutions, had to fine-tune the procedures of provision of medicines and to intensify administrative efforts to ensure their effectiveness. The Federal Fund formed a centralized pool of resources, which were going to be earmarked between regions in an immediate-reaction mode, once an emergency associated with payment for medicines arose. Mr. M. Zyrabov happened to move from one region to other investigating into causes of the faults with supplies of medicines. According to the Ministry's data, until mid-February beneficiaries received 6.6 mln. prescriptions. About 88% of them were fulfilled.

The new procedures of provision of medicines to beneficiaries made the federal agencies responsible for paying for all the volume of the prescribed medicines, which they do not control. The beginning of payment to suppliers for the sold medicines will form the X-hour. If the government fails to design mechanisms of adjustment of prescription and there remains the procedure of payment against the actual amount of sales of medicines, this would entail either the necessity for the Federal Budget to further raise in its expenditures on these purposes, or in a rise in social tensions fueled by the impossibility to deliver the prescribed medicines in full.

3.6.2. Education

The development of Russian educational system has recently been conditioned by changes in the demographic situation, the dynamics of demands of the labor market, processes of redistribution of powers between government levels, as well as attempts to pursue reforms in this sphere. As concerns considerable changes in this sector, one should note, first of all, the rise in the number of university and secondary polytechnic insti-

tutions students (*Table 40*). The higher education has actually become broadly available in this country.⁵¹

Table 40

Educational Institutions Network in Russia

| No | Indicators | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 |
|----|--|-------|-------|-------|-------|-------|-------|
| 1 | Quantity of pre-school institutions, as thousand | 56,6 | 53,9 | 51,3 | 50,0 | 48,9 | 47,8 |
| | A number of children, as thousands | 4379 | 4225 | 4263 | 4246 | 4267 | 4321 |
| | – as % of children of the respective age | 53,9 | 54,9 | 56,0 | 57,2 | 58,1 | 57,6 |
| 2 | Quantity of institutions of general education, as thousand. Including: | 67,9 | 67,5 | 67,0 | 66,9 | 65,7 | 64,5 |
| | – in public and municipal | 67,3 | 66,9 | 66,4 | 66,2 | 65,0 | 63,8 |
| | – in non-government | 0,6 | 0,6 | 0,6 | 0,7 | 0,7 | 0,7 |
| 3 | Quantity of students of institutions of general education, as thousand | 21479 | 20879 | 20074 | 19429 | 18440 | 17323 |
| | – in public and municipal | 21429 | 20826 | 20013 | 19363 | 18372 | 17254 |
| | – in non-government | 50 | 53 | 61 | 66 | 68 | 69 |
| 4 | Quantity of elementary polytechnic institutions. Quantity of students, as thousand | 3954 | 3911 | 3893 | 3872 | 3843 | 3798 |
| | | 1676 | 1694 | 1679 | 1649 | 1651 | 1649 |
| 5 | Quantity of secondary polytechnic institutions | 2631 | 2649 | 2703 | 2684 | 2816 | 2809 |
| 6 | Quantity of students in secondary polytechnic institutions, as thousand | 2069 | 2175 | 2361 | 2470 | 2586 | 2613 |
| | – total quantity on public and municipal institutions, as thousand | 2052 | 2147 | 2309 | 2410 | 2489 | 2502 |
| | – per 10.000 of the population | 141 | 148 | 160 | 167 | 173 | 174 |
| 7 | Quantity of higher educational institutions | 914 | 939 | 965 | 1008 | 1039 | 1046 |
| | – public and municipal | 580 | 590 | 607 | 621 | 655 | 654 |
| | – non-government | 334 | 349 | 358 | 387 | 384 | 392 |
| 8 | Quantity of students in the higher educational institutions, as thousand | 3598 | 4073 | 4742 | 5427 | 5948 | 6456 |
| | – per 10.000 of the population | 229 | 256 | 294 | 332 | 364 | 388 |
| | – in non-government institutions | 251 | 345 | 471 | 630 | 719 | 860 |

Source: Rossiyskiy Statisticheskiy Yezhegodnik. 2004: Stat. sb. M.: Rosstat, 2004. p.227.

The analysis of financing of the system of education shows that the Federal Budget has maintained a fairly high growth rate of spending on education. Between 1999 and 2002 the spending was not lower than 43% annually in nominal terms. In 2003, growth rates reduced, with the rise in expenditures on education accounting 24.6% vis-a-vis 2002, while in 2004 – 21.5% vis-a-vis 2003 (*Table 41*). But the 2003–2004 budgets did not take into account the recommendation of the RF State Council to increase the amount of financing of education by not less than 25% annually. Nevertheless, the share of expenditures on education is growing in the structure of the Federal Budget as well as in Gross Domestic Product (GDP) from 0.73% in 2002 to 0.76% in 2004.

⁵¹ Dostupnost' vysshego obrazovaniya v Rossii / Otv. red. S.V. Shishkin. M.: Independent Institute for Social Policy, 2004.

Table 41

Expenditures on Education in the Federal Budget

| | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 |
|---|-------|-------|--------|--------|--------|--------|--------|
| The Federal Budget, as Rb. bln. | 388,9 | 664,7 | 1029,2 | 1325,7 | 1947,4 | 2354,9 | 2659,4 |
| Expenditures on education: | | | | | | | |
| – Rb. bln. | 14,6 | 20,9 | 38,1 | 54,5 | 80,1 | 99,8 | 121,3 |
| – as % to the prior year | | 143,1 | 182,2 | 143,0 | 147,0 | 124,6 | 121,5 |
| The share of expenditures one education in the Federal Budget, as % | 3,7 | 3,1 | 3,7 | 4,11 | 4,11 | 4,24 | 4,56 |

Source: Calculated basing on the Rosstat data.

According to the 2004 results, the level of the average monthly wages of employees in the sphere of education remains lower vis-avis the health care and culture spheres (4,824 and 4,747, respectively). Moreover, during the year one noted a slight decline in the level of average monthly wages in the sphere of education relative to the nation-wide average level of wages. The same tendency is typical of the health care and culture spheres (Table 42). The volume of budgetary wages arrears in the social-cultural sub-sectors plunged as much as 2.8 times by late 2004, with the greatest volume of the arrears falling on the educational sphere (Table 42).

Table 42

The Average Monthly Wages Due in the Social-Cultural Sub-Sectors (Less Social Contributions) per 1 Employee, as Rubles

| | January | March | June | September | December |
|---|-------------|-------------|-------------|-------------|-------------|
| Total | 5932 | 6428 | 7003 | 6918 | 7344 |
| Education | 3832 | 4126 | 4885 | 4231 | 4614 |
| – To the nationwide average wages level, as % | 65 | 64 | 70 | 61 | 63 |
| Health Care | 4254 | 4485 | 5259 | 4700 | 4824 |
| – To the nationwide average wages level, as % | 72 | 70 | 75 | 68 | 66 |
| Culture | 3927 | 4132 | 4595 | 4265 | 4747 |
| – To the nationwide average wages level, as % | 66 | 64 | 66 | 62 | 65 |

Source: Calculated basing on the Russian Rosstat data.

The 2004 educational policy involved the continuation of an experimental refining of an instrument of the combined assessment of the final and enrollment examination, *alias* The Uniform State Examination (USE), mechanisms of funding of the higher education on the basis of State Individual Financial Obligations (SIFO). In addition to the above, the government adopts a series of strategic documents and legal statutes that substantially affect the essence and vector of the Russian educational reform efforts.

Table 43

**The Outstanding Budget Wages Arrears in the Social-Cultural Sub-Sectors
(Except for Small Businesses), as Rb. Mln.**

| | 01.02.04 | 01.04.04 | 01.07.04 | 01.10.04 | 01.01.05 |
|---|-------------|-------------|-------------|-------------|-------------|
| Total | 2730 | 2652 | 2924 | 2654 | 1005 |
| Of which: | | | | | |
| Social Sub-sectors – total | 1741 | 1601 | 1821 | 1602 | 618 |
| Including: | | | | | |
| – from the Federal Budget | 10 | 9,5 | 12 | 10 | 5 |
| – from the budgets of the RF Subjects and local budgets | 1731 | 1591 | 1809 | 1592 | 613 |
| Education – total | 308 | 263 | 384 | 326 | 94 |
| Including: | | | | | |
| – from the Federal Budget | 7 | 7 | 9 | 8 | 4 |
| – from the budgets of the RF Subjects and local budgets | 301 | 256 | 375 | 318 | 90 |
| Health Care - total | 174 | 177 | 225 | 249 | 49 |
| Including: | | | | | |
| – from the Federal Budget | 0,3 | 1 | 0,3 | 0,3 | 0,1 |
| – from the budgets of the RF Subjects and local budgets | 174 | 176 | 224 | 249 | 49 |
| Culture - total | 64 | 66 | 96 | 72 | 19 |
| Including: | | | | | |
| – from the Federal Budget | 0,0 | 0,0 | – | – | – |
| – from the budgets of the RF Subjects and local budgets | 64 | 66 | 96 | 72 | 19 |

Source: According to the Russian Rosstat data.

**Outcomes of, and Prospects for the Nationwide
Transition to USE**

In 2004, in compliance with government Resolution of 16 January 2004 No. 725 “On Prolongation for 2004 of the Term of Conduct of the Experiment on Introduction of the Uniform State Examination”, the Russian educational system proceeded with the given experiment. Last year, the accent was put on probation of a few technologies of its conduct and enhancement of the quality of control measuring materials by expanding the participation of representatives of the polytechnic education in their design and evaluation. In addition to that, the government stressed the need for improvement of informational orientation available to those enrolling to the higher education and secondary specialized educational institutions.

As many as 65 RF Subjects voluntarily took part in the USE experiment, with some regions holding it by all 14 subjects. Notably, the number of participants in the experiment hit the record-breaking 982,000, or at 1.3 times more than in the prior year. As many as 29 federal ministries and agencies that have subordinated higher education and secondary polytechnic education institutions have expressed their consent to participate in USE. When compared with 2003, the number of universities accepting students by their USE scores more than doubled, while the number of secondary polytechnic educational institutions recognizing the USE scores accounted for 1,530 (*Table 44*).

Table 44

The Progress in the USE Experiment

| | 2001 | 2002 | 2003 | 2004 |
|--|------|------|------|------|
| The number of the RF Subjects taking part in the USE experiment | 5 | 16 | 47 | 65 |
| The number of students that passed USE, as thousand | 30 | 300 | 752 | 982 |
| The number of USE subjects | 8 | 9 | 12 | 14 |
| The number of universities and their branches participating in the USE experiment | 16 | 117 | 464 | 946 |
| The number of secondary polytechnic educational institutions participating in the USE experiment | – | 79 | 928 | 1530 |

Source: Basing on the data of the RF Ministry for education and Science.

The rise in the number of participants in the experiment evidences that regions and universities are keen to benefit from its results. That said the progress with the experiment owes its success to order of 10 February 2004 No. 560 of the RF Ministry for education and Science on the mandatory account of the USE scores by the universities of the federal subordination (except for the Moscow Lomonosov University) located in Moscow and Moscow oblast. They were ordered to identify, as a rule, not less than 50% of the overall specialties across which the 2004 enrollment with account of the USE scores was consequently conducted.

Single regional educational agencies (the Moscow City Department of Education among them) were not in a position to ensure a full-scale conduct of the experiment. That created certain complexities with regard to securing the quality of rights of graduates from the public secondary institutions in Moscow and those of other Subjects in the course of enrollment to the Moscow-based universities. To overcome this contradiction, upon a submission by the Moscow City Department of Education, on 11 February 2004 the RF Ministry for Education and Science issued its order No. 584. The order reads that for graduates from the 11th (12th) forms of public secondary educational institutions based in the city of Moscow that their participation in the USE is voluntary, while the examination is conducted by 5 subjects.

In 2004, the Ministry of Education specified methodological documents that regulated the procedure and the content of USE, the procedure of functioning of the state examination and arbitration commissions of the RF Subjects, the procedure of enrollment to higher educational and secondary polytechnic institutions. In addition to that, the Ministry created an informational infrastructure on the basis of the federal and 63 regional information processing centers. The higher education and secondary polytechnic institutions were allowed to check evidences of the USE outcomes in the Federal Base of Evidences.

In October 2004, IV Russian Conference on the experiment outcomes and setting tasks for the 2005 experiment was held. The conference positively assessed the USE experiment.

In 2005–2006, it is intended to complete the approbation of the procedure and technology of USE in all the RF Subjects, while reserving the right for them to select patterns of participation (quantity of subjects, obligatory/voluntary participation in USE by graduates and institutions). In 2005, it is planned to introduce USE in full across 16 regions where the USE experiment lasted not less than 3 years. In 2005, as many as 78 regions expressed

their intention to participate in the USE experiment. So, about 83% of Russian secondary school graduates are going to take USE next year.

It is planned to ensure a step-by-step transformation of USE into a sole examination instrument throughout Russia in 2006–2008. So, the deadline for the compulsory introduction of USE across the country is postponed from the originally scheduled 2006 to 2008.

Meanwhile, the RF Ministry of Education and Science's stand is that USE should not be considered the only instrument of examination for the graduates enrolling for universities. The Ministry calls for alternative forms of the entrance examinations. According to the head of the Federal Service for Supervision in the sphere of education, universities will undoubtedly maintain the right to carry out competitions, whose results allow graduates to enroll for the leading universities. The competitions presently exist in the pyramidal form: school – city – oblast – okrug – the federation. It is intended to somewhat modify this arrangement to ensure the winners of regional competitions are accepted by all Russian universities on a non-competition basis. Besides, universities will be able to hold additional examinations for graduates with USE certificates.

Approbation of New Mechanisms of University Financing

In compliance with RF government Resolution of 26 June 2004 No 313, the experiment on transition to the financing of single universities by means of state nominal financial obligations (SNFO) was prolonged through 2004. The structure of universities participating in the experiment approved by order of 30 June 2004 No. 37 of the Federal Agency for Education under the RF Ministry for Education and Science remained unchanged vis-avis 2003. It comprises 6 universities: Mari State University, Mari State Polytechnic University, Chuvash State University, Yakut State University, Mari State Teachers' Training University, Chuvash State Teachers' Training University. The overall number of students using SNFO accounts for 12,548 in 2004 of which 11,657 had a SNFO of a regular amount, while the remaining 891 enjoyed an increased amount of SNFO.

Those were the students whose specialties are especially significant for social and economic development of regions, albeit not demonstrating a sufficient demand for them on the part of the population.

The methodological basis of the experiment that determines conditions and procedures of its implementation remained practically unchanged in 2004, albeit in the late 2003, according to the outcomes of the first stage of the experiment, the RF Ministry for Education prepared a number of proposals on its improvement.

In 2004, the value of the budget funds earmarked for the SNFO purposes as per order of the RF Ministry for Education of 22 July 2004 No. 26 remained unchanged vis-avis 2003. The average proportional costs across the SNFO items in universities accounted for 11,800 rubles. Such an approach against the background of the overall growth of costs for university education essentially means a reduction in the budgetary financing of the universities' current spending. The dynamics of distribution across SNFO categories in universities testifies to the growth in 2004 of the share of the 3rd and 4th SNFO categories and some drop in the share of the 1st – 2nd SNFO categories.

It is worthwhile noting that in the universities that participate in the experiment the correlation between the first-year students whose education was paid for from the federal budget and those who co-financed their education has slightly changed in favor of the former group over the past three years (*Table 45*).

Table 45

**Distribution by SNFO Categories in the Universities Participating
in the Experiment (Across All the Forms of Education), as %**

| | 2002 | 2003 | 2004 |
|--------------------------|------|------|------|
| 1 st category | 8,0 | 11,6 | 8,8 |
| 2 nd category | 39,0 | 27,5 | 27,4 |
| 3 rd category | 37,6 | 42,7 | 46,9 |
| 4th category | 10,8 | 12,5 | 12,7 |
| 5th category | 4,7 | 5,7 | 4,4 |

Source: Basing on the data of the State University – the Higher School of Economics.

Table 46

**The Share of the First-Year Students in the Universities Participating
in the Experiment at the Expense of the Federal Budget
and Co-Funding Their Education, as %**

| | 2002 | 2003 | 2004 |
|--|------|------|------|
| Across all the forms of tuition: | | | |
| – at the expense of the federal budget ^{3a} | 58,7 | 59,7 | 61,7 |
| – co-funding | 41,3 | 40,3 | 38,3 |
| Regular tuition: | | | |
| – at the expense of the federal budget ^a | 58,8 | 58,6 | 60,0 |
| – co-funding | 41,2 | 41,4 | 40,0 |
| By correspondence: | | | |
| – at the expense of the federal budget ^a | 58,6 | 64,0 | 66,5 |
| – co-funding | 41,3 | 36,0 | 33,5 |

Source: Basing on the data of the State University – the Higher School of Economics.

To extend the information base of the SNFO experiment with its order of 13 August 2004 No. 51 the Federal Agency for Education bound a number of universities that were not participating in the experiment to submit data necessary for conducting model computations of the SNFO functioning. Notwithstanding the above, 2004 did not witness any real steps on the experiment modification, while all the above deficiencies of the approved new mechanism of university funding⁵² essentially were still there. That concerns, primarily, an increase of the SNFO amount across all the categories, reduction in their number from 5 to 3, awarding the winners of the nationwide school competitions and participants in international school competitions with the highest SNFO category to ensure the possibility for them to enroll for the respective departments of the public universities, introducing a greater amount of SNFO for the specialties that objectively appear more costly than the others. As well, one should ensure the possibility for changing the originally granted SNFO category according to the student's performance and examination results.

Given the scope of the experiments underway, they address single avenues of the education system reform and do not form an integral complex strategy of modernization of all elements of the Russian education system. This has not allowed for a much-needed mass support of the reforms underway and making their goals clear and shared by the majority of the educational community and society on the whole.

⁵² Rossiyskaya Ekonomika v 2003. Tendentsii i perspektivy. M.: IET, 2004. P. 289–290.

Modifications in the Education Legislation

In compliance with Federal Law No. 122-FZ of summer 2004, the education legislation underwent substantial modifications. Consequently, a number of provisions of the Law "On Education" that envisaged public guarantees of priority of education, particularly, the higher education (on issues of financing the education system including the universities' social sphere, provision of tax and other benefits, etc.) was abolished.

As per the Law, the provisions that regulated the standardized financing of educational institutions were modified. The Law formulates a new content of the concepts of the federal, regional and local standards of financing educational institutions. Thus, the federal standard concerns financing institutions of the federal subordination, the regional standard - those of the regional subordination. So far the local standard is concerned, it is related to institutions of the local subordination. In addition to that, item 41 of the Law "On Education" reads that the financing of public educational institutions under the RF Subjects and municipal educational institutions is exercised basing on the federal standards and those of the RF Subjects. However, the Law does not stipulate the procedure of approving of the respective federal standards.

Meanwhile, the Law maintained the provision, which provides for the setting of standards of financial costs for small rural and considered as such by government and educational agencies institutions. These costs do not depend on the quantity of students therein.

Hence, in compliance with the Law the procedure of regulation of issues associated with organization of control and financing of the education system was fundamentally modified. This primarily concerns assignment of competence in the education sphere between levels of government and exclusion of the possibility for an additional financial support from the budgets of other levels. Division of powers between the levels of government is chiefly made basing on the principle of a strict tying to the level of financing of educational institutions. This would result in a restriction of possibilities for an additional financial support of institutions, their employees and student as well.

The Law has lifted restrictions on the paid-for enrollment of students for their training in the sphere of jurisprudence, economics, management (the share of students who paid for educational services could not earlier exceed 50% of their respective number at a given department). The abolition of this restriction, on the one hand, allows to meet the population's effective demand for educational services and solidify the financial state of universities, while, on the other, to intensify the urgency of the task of provision of a proper control over the quality of education.

The legal modifications also concerned the practice of co-founding of educational institutions. The Law "On Education" had earlier permitted the co-founding, but now such possibility is excluded, because it contradicted to the Civil Code. The system of co-founding of educational institutions was rather efficiently employed in Samara oblast in the course of organization of a two-level financing of schools, with educational expenses being covered from the regional budget, while communal expenses and those on the real estate maintenance from the municipal budget. The removal of this provision intensifies the urgency of the task of development of new integration forms of provision of educational institutions with resources.

In compliance with the new legislation, the procedure of provision of social protection to students from the budget funds is replaced by a mechanism of implementation of social support measures. It is provided that this particular mission will fall under the competence of educational institutions themselves. Given the above, the current legislation cancels the students' meals and transportation benefits, particularly, for those trained at the publicly

accredited non-government educational institutions that are deprived of the right for benefits that the RF law set for students of public and municipal educational institutions.

The Law substantially modified labor compensations to the budget employees and, particularly, those in the education sphere. The minimal amount of tariff rate (wages) of the budget employees is no longer recognized as a uniform and mandatory one nationwide. Besides, it became the differentiated (depending on the level of the budget financing and residence) instrument of regulation of labor compensations in the regions, which considerably lowered the level of employees' labor rights. Moreover, the Law abolished the government obligations on adjustment of the level of teachers' wages by means of setting labor compensation standards in the form of the labor compensations in the educational sector to those in the industrial sector ratio.

Resulting from the abolishment of RSFSR Law of 21 December 1990 No 438-1 "On Social Development of the Countryside", rural teachers have lost their right for the extra 25% wages and tariff rates vis-avis their urban colleagues. The abolishment of the given benefit substantially deteriorates their economic state of and will have an extremely negative effect on the staffing capacity of the sector. As well, this will derail the teachers' professional prestige, which presently has already sunk considerably.

It is worth noting that in the course of debates of legislative innovations associated with changes in the teachers' social status the trade unions have succeeded in keeping the provision on the pedagogical staff's right for a free housing with heating and lighting in the countryside and settlements of urban type, and for a priority provision of housing to them. But the amount, conditions and procedure of compensation for the costs associated with provision of the noted social support measures have to be set by the RF Subjects' legal statutes, which raises doubts about the actual provision of these rights.

The aforementioned amendments to the educational law have formally brought it in a due consistence with the Civil and Budget Codes of RF, Federal Law of 4 July 2003 No 95-FZ "On Introducing Amendments to the Federal Law "On General Principles of Organization of Legislative (Representative) and Executive Bodies of State Power of Subjects of the Russian Federation, Federal Law of 6 October 2003 No 131-FZ "On General Principles of Organization of Local Self-Governance in the Russian Federation". Notwithstanding this, the priority of education declared by numerous program documents has failed to find the respective legislative fundamentals in the new version of the law "On Education".

Identification of the Future Government Policy Priorities

At its meeting on December 9, 2004, the RF Government considered the present educational reform priority avenues until 2010 for the purpose of securing the country's socio-economic development on the basis of the capacity and by means of the educational sphere. As well, the Government concluded interim results of the 2001 Concept for Modernization⁵³. It was noted that the implementation of the Concept for Modernization through 2001–2004 has allowed:

- to secure the growth of budget expenditures on educational needs;
- to intensify the work on the legislative and legal provision of development of the education system;
- to conduct a number of large-scale experiments on introduction of new mechanisms of financing, assessment of students' progress, provision of accessibility of the higher education.

⁵³ The 2001 Concept for Modernization of Russian Education through 2010 identified enhancement of the quality, accessibility and efficiency of education as principal objectives of its development.

At the government meeting it was also noted that the Russian education system does not meet the respective requirements due to the following reasons:

- an insufficient orientation of vocational training to labor market demands;
- lack of consistency education;
- absence of due connection between education and science;
- an insufficient level of public and government control over the quality of education;
- a low level of teachers' labor compensations;
- an insufficient participation of the general public in the educational reform underway;
- a poor integration of Russian education into the international educational community.

The Government also identified priorities of the present government educational policy, which would allow to successfully find solutions to the objectives set by the Concept for Modernization of the Russian education, as follows:

- development of a modern system of the consistent vocational training;
- improvement of quality of vocational training;
- provision of accessibility of a qualitative general education;
- increasing investment attractiveness of the sphere of education.

It was also noted that one of the most promising avenues of creation of conditions of increasing of economic independence of educational institutions is to encourage the variety of their organizational and legal forms.

Transformation of financial-economic mechanisms that provide for conditions of implementation of the noted priorities, is primarily associated with the attempt to refuse the estimate-based procedure of the budget financing of educational institutions, because this procedure hamper incentives to improve the quality and efficiency of educational services. In the budget reform framework, it is proposed to finance the education system basing on the "performance-oriented management" principle. Such an approach requires from any education development program funded from the budget to comprise a strict list of performance indicators, which would allow to increase the efficiency of the budget spending.

The strategy of the government implies the development and employment of various mechanisms of financing educational institutions from the budget, particularly: 1) standardized per capita financing that allows to secure transparency of allocation of budget funds and to tie the volume of financing directly with the consumer of a given educational service; 2) universities financing on the basis of state nominal financial obligations (SNFO).

A complete transition to the standardized per capita financing is mainly impeded by the absence of the much-needed legislative basis, practical methodologies of calculation of standards across educational levels, types and kinds of educational institutions. In addition to that, some Russian regions' (Samara oblast, Chuvash Republic, Yroslavl oblast) positive experience in this sphere allows to argue about the efficiency of application of the given financing mechanism and the necessity of its further extension to other regions.

In compliance with the government recommendations that were discussed at the government meeting in December 2004, it is proposed to approve the system of differentiated standards of budget financing within the framework of application of standardized per capita budget financing: according to the USE results, international, nationwide, regional competitions; across training avenues, with account of regional specifics.

Due to its complexity and scathing criticism on the part of some rectors of leading universities, the ongoing experiment on universities financing on the SNFO basis requires further specification and suggests inclusion of a greater number of participating universities.

The fundamental institutional modifications in the area of regulation of organizational-legal and financial-economic relations in the sphere of education that were approved by the strategic government documents compel this particular sphere to focus on a

more pro-active integration in market relations. This requires a thorough monitoring of on-going changes and evaluation of socio-economic risks associated with the planned reforms.

3.6.3. The Start of Restructuring the Budgetary Institutions Network

The task of reforming the budgetary institutions network was formulated in the RF Presidential Address to the RF Federal Assembly of RF in May 2003. It was further specified in "Principles of the Budget Sector Restructuring in the Russian Federation in 2003-2004 and for the period until 2006", drafted by the RF Ministry of Finance and approved by the RF Government in September 2003.

In 2004, the Government made attempts to implement this mission by starting with the federal institutions network.

Since July 2004 the RF Government has initiated an intense discussion on measures on optimization of the federal budgetary institutions network and reorganization of budget institutions. The Government worked out proposals on two new organizational-legal forms: autonomous institution and public (municipal) autonomous non-profit organization.

In July 2004, the Government Commission on administrative reform approved the procedure of organization of work on optimization of the network of federal state unitary enterprises and federal public institutions subordinated to federal executive agencies.⁵⁴ The Government Commission suggested to break the noted organizations into groups and prepare, accordingly, four arrays of organizations subjected to: 1) remaining in the federal property; 2) transfer to the RF Subjects' and municipal property; 3) step-by-step privatization; 4) an additional consideration after adoption of legal acts on the procedure of privatization of federal public institutions or their transformation into other organizational-legal forms.

The Government Commission paid a special attention to public educational institutions. It also emphasized appropriateness of a transfer of educational institutions that currently remain in the federal property, as a rule, to the purview of the Federal Agency for Education. However, the RF Ministry of Health Care and Social Development and the RF Ministry of Culture have succeeded to save medical universities and universities of culture and arts from this lot.

The Government Commission suggested to include in list (3) organizations that managed real estate and other property fixed with the federal agencies, in list (4) – organizations exercised functions on the material-technical and social-household provision of civil servants' operations and institutions whose operations were funded from the budget, albeit these funds appeared extrabudgetary, as they result from contracts between such institutions and public agencies.

Overall, the government has demonstrated rather modest progress in this particular reform area. The majority of federal public institutions fell under list (1), while the main part of institutions of elementary and secondary vocational education that had earlier belonged to the federal property is currently included in list (2).

In late October 2004, the RF Government approved the list of institutions of elementary and secondary vocational education (EVE and SVE, respectively) assigned under the regions' competence. Consequently, the Government started the process of assignment of these institutions to the regional level. By 1 January 2005 as many as 2,517 institutions of elementary and 299 ones of secondary vocational education were assigned to the RF Subjects. In all likelihood, the assignment process would result in the restructuring of the

⁵⁴ Minutes of the meeting of the RF Government Commission on administrative reform of 13 July 2004. No 18.

EVE and SVE institutions network with account of budget capacity of the RF Subject and actual needs in the respective qualified staff demonstrated by regional labor markets.

Basing on the experiences of Nizhniy Novgorod oblast, Novgorod oblast, Samara oblast and the city of St. Petersburg that had taken EVE and SVE institutions under their competence in late 90-s, the RF Ministry of Education and Science expects positive changes the given innovation should generate nationwide. The experience of Nizhniy Novgorod oblast exemplifies such a model of the EVE and SVE regional system, under which regional enterprises by themselves select the needed specialists, provide for a production base and tutors, set regional increments to their labor compensations and, consequently, have qualified workers. In addition to that, the oblast has preserved the vocational colleges network, implemented their partial optimization by means of their integration with NVE institutions and regional universities. As a result, during their training students already receive labor compensations up to 5,000 Rubles.

Design of Forms of New Public Organizations

The design of proposals on transformation of budgetary institutions into other organizational-legal forms became an independent critical avenue of the preparation for the budgetary sector reform.

In the 90-s, prior to the implementation of the new Budget Code, budget institutions *de-facto* had enjoyed a high degree of independence in exercising their economic operations, capital attraction and spending budgetary and extrabudgetary resources. The situation has started to change recently. With the government pursuing the policy aimed at strengthening the financial discipline in planning and spending budget funds, the implacable logic compels it to restrict the independence of public institutions. The government has consistently attempted to bring this array of rights in conformity to the model of budget organization laid down in the organizational-legal form of a given institution. The milestones of this process became: the transition to the treasury execution of operations with the budget funds of public institutions; the adoption of a new, detailed, classification of budget expenditures, in compliance with which the budget financing of institutions and approval of their expenditure estimate are executed; and, finally, the likewise transition of institutions' extrabudgetary revenue and expenditure operations to the treasury execution, which implies a strict control over every item of the institution's revenue and expenditure estimate on the part of its founder.

For the majority of budgetary institutions such the above will lead to the gap between the volume of rights they will enjoy and requirements to their efficiency caused by actual conditions of their functioning. This concerns the institutions whose revenues are formed by compensations from the budgetary and extrabudgetary sources for the services they provide. The array of such institutions comprises health care institutions that participate in the compulsory medical insurance system and receive funds from it according to the volume and quality of the medical assistance delivered; vocational education institutions and institutions of culture and arts, whose revenues to a significant extent are formed by extrabudgetary receipts, etc.

Excessive restrictions of such institutions' operations will result in a weaker motivation to adequate accounting of demands of consumers of their services and efficient utilization of their capacity. That is why there exists an actual need in the public sector having both administratively controlled budget institutions and those that enjoy the legislatively set right for independent economic operations.

The document entitled “Principles of restructuring of the RF budget sector” presents two variants of transformation of budget institutions:

- 1) into a specialized public or municipal non-profit organization;
- 2) into a public or municipal autonomous non-profit organization.

The RF Ministry of Economic Development, the State University-the Higher School of Economics, Institute for the Economy in Transition⁵⁵ designed the above variants. Each of the latter grants a public organization with a broader range of powers versus public institution, while at the same time, discharge a part of obligations from the state with regard to the economic provision of its operations.

In spring 2004, on the basis of earlier drafts, the Center of Private Law designed the following bills:

- “On autonomous institutions”;
- “On public (municipal) non-profit organizations”;
- “On setting the procedure, conditions and criteria of reorganization of public and municipal institutions in the form of transformation”;
- on amendments to the Civil and Budget Codes of RF, the Federal Law “On non-profit organizations”.

Since summer the revision of these bills has been conducted under the aegis of the RF Ministry of Economic Development. These draft laws envisage a special kind of the right for operative property management, which the founder of the public (municipal) autonomous institution fixes with that. By contrast to the existing institutional form, the owner does not bear subsidiary responsibility for the autonomous institution’s obligations. As concerns the autonomous institution itself, it is liable by all its obligations with the property it has under its operative control, except for real estate and particularly valuable movables. The power to identify particularly valuable movables falls under the RF Government’s competence.

The autonomous institution independently controls other property (including real estate) that it purchased for revenues from its operations.

The noted revenues are subject to the institution’s independent control and are used to fulfill its principal mission.

The owner of the autonomous institution has a right to assign tasks to autonomous institutions, the fulfillment of which he is bound to finance. While granting a broader independence to the autonomous institution, the state should have more transparent mechanisms of control over its operations. A form of control alternative to the administrative control over the organization on the part of a superior government agency is the establishment of the board of trustees with the autonomous institution. It should comprise individuals appointed by the founder, albeit not employed and receiving compensations for their contribution to the board’s activity. The board will oversee the consistency of the organization’s operations to its mission as per its Charter, particularly, review its plans and reports, approve of large deals, etc.

The form of a public (municipal) autonomous non-profit organization suggests that its property, particularly, that the founder transfer to it upon its establishment belongs to the organization in question. Should the public (municipal) autonomous non-profit organization have any revenues and spend those particularly to acquire any property, the said revenues and property become subject to its independent control.

⁵⁵ Povysheniye effektivnosti bjudgetnogo finansirovaniya gosudarstvennykh uchrejeniy i upravleniya gosudarstvennymi unitarnymi predpriyatiyami T. I. M.: IET, 2003. C. 151–250.

The government maintains control over operations of such an organization by means of the board of trustees, established in a manner analogous to the board of trustees of the autonomous institution. But this particular case this collective board is granted with both supervisory powers and the rights to make certain decision: approval of organization's annual financial plans and the respective reports; consideration of the organization's financial performance over shorter periods of time (half year, quarter); making decisions as to whether or not these or those kinds of its commercial operations other than the principal ones are in consistency with its statutory objectives.

It is suggested that these forms should complement, rather than replace, the current form of the institution. While some existing public budgetary organizations are going to remain in their current form, the others will be transformed into new forms. Economic conditions of various kinds of operations of social institutions, the correlation between their various revenue sources, the extent to which the institutions find themselves dependable on budget appropriations appear substantially different across the sectors of the social sphere and within single sectors.

Decision-making with respect to the appropriateness of the transformation of the institutions into new forms should be exercised with account of economic conditions of their operations (revenue and expenditure structure, presence of an actual and potential competition, etc.).

Transformation from the current form of an institution into the one of the autonomous institution poses an urgent challenge to pre-school institutions and schools in medium-size towns and big cities as well as most public vocational education organizations, and urban outpatient-policlinic and hospital institutions. As their operations combine the provision of free and paid services to consumers, or insurers pay for these services, the consumers or insurers have a right to exert economic influence on their operations.

Some public vocational education and health care organizations find themselves under an intense competition and pressure on the part of consumers. This primarily concerns economic, law, linguistic universities, computer and communication training centers, primary and secondary vocational training institutions, medical institutions of the same profile located in the same city, among others. These organizations face an urgent challenge of transformation into public autonomous non-profit organizations.

However, the coordination of the above bills with the agencies concerned has been delayed. The property regime proposed for an autonomous institution has formed the major sticking point. While the RF Ministry of Economic Development and Trade advocate the stand formulated by the Center of Private Law: that is, the property regime in question is a kind of the right for operative control, the stance of the Chief Legal Department of the presidential Administration is that the respective volume of powers falls beyond the operative control framework, which is why it may not be considered as a kind of it.

In November 2004, the debate on the bills in question gained a new hue. More specifically, the leadership of the All-Russia Theatre Union speculated that the above proposals were an attempt to impose an administrative control over Russian theatres' creative and economic operations. They undertook a number of actions highlighted by the national media. The numerous appeals to the government cited the collapse of the Russian repertoire theatre, should theatres be transformed into the aforementioned new forms and demanded to protect the national treasure. In reality, however, theatre directors propone the existing practice, which grants them with an uncontrollable right to manage the property fixed with the theatre and the respective revenues, along with a minimum economic responsibility for their independent economic performance.

3.7. Foreign Economic Activity

3.7.1. Main Trends in Russia's Foreign Trade

Growth rates of the world economy were boosted in 2004 to account for 4%, according to the World Bank. The general global economic situation was animated mainly by a substantial growth in Chinese economy (8%) as well as improved economic situation in Japan and the United States. GDP growth rates in these countries exceeded 4%. The US economic growth was caused mainly by increased investments and consumer spendings. European countries showed slower economic growth rates. Economic growth in Western Europe and Japan was caused mainly by export growth due to increased demand in developing countries.

According to the World Bank, the world trade volume increased by 10.2% in 2004 due to a rapid growth in industrial output. China accounted for over 20% of the world trade volume of goods. Considerable growth in foreign trade turnover in China was caused by a positive impact from its accession to the World Trade Organization, as well as high growth in investments and consumer demand .

Raw goods trade demonstrated the fastest growth rates due to a great demand in such goods, which served as a material incentive for expanding commercial business at a variety of developing countries. In addition, investment goods trade was growing rapidly thus promoting export expansion in Germany and Japan which are specializing in manufacturing machinery and equipment.

In 2005, production growth is expected to slow down due to a price rise of fuel and raw materials. Export volumes have been declining. According to the forecast of the World Bank , the world economic growth is estimated to drop to 3.2%, and the world trade is expected to decline to 8.5% in 2005. World trade flows will be governed by, besides prices of raw goods, the size of budget deficit in the United States affecting the USD exchange rate, as well as a likelihood of economic decline in China.

In 2003, the Russian Federation was ranked 17th in the world on export volumes with a share accounting for 1.8% in the world export. Russia may come 15th on goods export volumes according to the results achieved in 2004. Last year, the Russian Federation was ranked 23rd in import volume in the world with a share accounting for nearly 1% of the total world import. Russia is included in the list of top forty leading countries in terms of sales turnover.

Russian growth rates in foreign trade turnover is by more than 4 times ahead of its economic growth rates. In 2004, sales turnover grew by 31.1%, and GDP – by 7.1%.

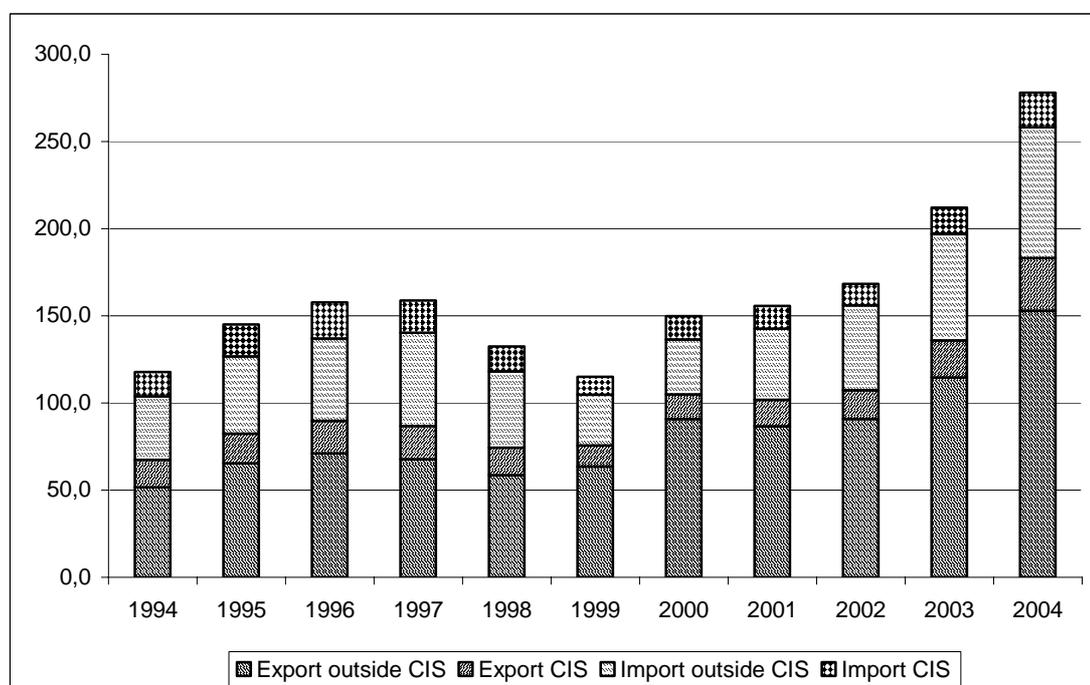
At the same time, Russia is falling behind in service trade. For example, it is 29th in the world in terms of service trade with a share accounting for less than 1% of the world volume. Russia comes 22nd in the world in terms of service import, its share accounting for slightly more than 1%.

In regard to foreign trade, in 2004 the Russian Federation showed record-breaking growth ever achieved over the last 15 years in terms of monetary volumes of both export and import of goods, with export supply growing faster thus promoting together with foreign trade turnover growth a substantial growth in positive trade balance .

Favorable world market situation for Russian exporters, RUR strengthening, as well as expanding domestic consumer and investment demand had a basic positive impact on foreign trade turnover growth in the Russian Federation in 2004.

In 2004, the Russian foreign trade turnover amounted to \$278,0 billion as calculated by using the method of balance of payments, which exceeds by 31.1% that of the previous

year (Fig. 71). Sales turnover with CIS countries grew faster to reach \$49,99 billion, which is by 37.2% higher than that in 2003. Russian sales turnover with foreign countries other than CIS countries increased by 29.9% to amount to \$228,03 billion.



Source: the RF Central Bank .

Fig. 71. Russian Foreign Trade Turnover (USD billion)

It was primarily the price factor that had an impact on import growth of Russian goods in 2004 (Table 71). According to the Bank of Russia, incremental growth of world prices of basic Russian export goods accounted for 20% on the average in 2004 as compared to 2003, while volume export index was 111.1% (correspondingly 114.6 and 110.5% in 2003).

Table 47

| | Average Annual Prices | | | | | | | | |
|----------------------------------|-----------------------|--------|--------|--------|--------|--------|--------|--------|---------|
| | 1996 | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 |
| Oil (Brent), USD per barrel | 21.33 | 17.4 | 14.1 | 15.9 | 28.19 | 24.84 | 25.02 | 28.83 | 37.4 |
| Natural gas, USD/1 million . BTU | - | 1.9642 | 2.5469 | 2.1876 | 4.3442 | 3.9764 | 3.3857 | 5.461 | 5.993 |
| Gas, USD per gallon | 0.71 | 0.615 | 0.511 | 0.529 | 0.887 | 0.7922 | 0.755 | 0.891 | 1.197 |
| Copper, USD per ton | 2574.9 | 2369.7 | 1775.3 | 1539.9 | 1863.9 | 1613.6 | 1592.9 | 1785.6 | 2808.2 |
| Aluminum, USD per ton | 1590.2 | 1554.0 | 1413.5 | 1318.0 | 1550.0 | 1444.7 | 1350.7 | 1424.7 | 1693.2 |
| Nikel, USD per ton | 8053.9 | 7312.4 | 5352.5 | 5239.5 | 8624.0 | 5966.0 | 6175.1 | 9580.8 | 13756.8 |

Source: calculated on the basis of the data of London Metal Exchange (Great Britain, London), International Oil Stock Exchange (London).

World oil prices were maintained at a record level in 2004, which was caused by slightly increased demand for oil over the last 24 year at the background of geopolitical instability in oil producing countries. For example, the average world price of Urals oil was \$ 28,86 per barrel in January, \$ 38,11 per barrel (growth by 32.1%) in September, and \$ 42,26 per barrel in October (growth by 46.4% as compared to January and by 10.9% as compared to September 2004).

Average monthly oil price of the same oil in 2004 was \$ 34,4 per barrel (growth by 25.9% as compared to 2003). In October 2004, oil prices at the New York Stock Exchange reached \$55 per barrel .

The OPEC decreased substantially oil production in accordance with the decision approved at its meeting held in September: from 27,69 million barrels daily in September to 30,61 million barrels daily in October , which reduced tension in the world oil market along with oil prices. However, OPEC's oil production reached its maximum over the last 25 years. Saudi Arabia showed the highest oil production as compared to other oil producers, and it still has reserves to further increase its capacity. Other OPEC countries are very close to reach their full oil-production capacity.

Natural gas prices in Europe increased by 9.7% against the previous year, gasoline prices grew by 34.3%, diesel fuel increased by 26.6%, fuel oil by 2.8%. The average price of energy resources increased by 15% and non-energy goods by 23% in 2004.

Non-ferrous metals were in great demand in 2004. Price rise on plumb, zinc, copper, tin and aluminum was found to be substantial as compared to that in 2003. The price explosion was caused basically, besides general factors, by a growing demand for these products in rapidly developing Asian countries. In addition, metal supply to the world market was reduced due to increased metal consumption in metal producing countries. There was a marked downward trend in reserves of several groups of metals (aluminum, tin, copper, plumb) at warehouses of the leading world commodity exchanges. The majority of metals reached their price maximum in fall. Non-ferrous metals were more expensive by average of 34% in 2004 against 2003 (aluminum by 18.8%, copper by 57.3%, nickel by 43.6%), iron ore by 19%, price index of steel production increased by 54%.

Prices of aluminum remain high mainly due to growing demand for aluminum in China, as well as deficit in alumina and electric power. According to Metal Bulletin Research, deficit in aluminum in the world market was 460 to 550 thousand tons by the end of 2004 . Aluminum consumption in China increased by 16 to 17%.

In last January, price of nickel reached its maximum over the last 14 years. World nickel production volumes do not meet the demand yet, primarily in Asian countries. The world nickel supply will not be able equal the demand until 2006–2007, provided that major nickel mines are put into operation in Canada и Australia.

The world copper market situation was quite favorable for copper producers in 2004. Prices of cooper have steadily been growing over the last three years. the world market prices copper prices grew by merely 8.4% in 2002, by 38% in 2003 , and by 42.9% more in 2004 .

Copper prices were changed due to a variety of factors :

- first, deficit in copper in the world market. Though the copper supply met and even exceeded the growing demand in the market in 2002, there was a deficit of 376 thousand tons in 2003 and 701 thousand tons in 2004, which resulted in price rise ;
- second, growing copper production costs (mainly due to increasing prices of raw materials) ;
- third, transition of product markets to new price levels that was under way throughout a period between 2003 and 2004.

In 2005, the copper market situation will become more attractive than in 2004. In particular, copper production is expected to increase by 7.7% (up to 17 094 thousand tons) with simultaneous growth in demand by 4.1% (up to 17 146 thousand tons). This is expected to improve the balance of the world copper market and reduce substantially the deficit in copper in the market.

With this situation in mind, one can forecast in 2005 a growth in prices of the metals traded at stock exchanges due to growing demand in several countries, primarily in the United States and China. There is no reason, however, for expecting growth rates similar to those of the previous year, because the growing demand resulted in boosted production of the metals being in shortage, which provides no stability whatsoever for the world market in general.

As a result of unfavorable world market situation, unprecedented high growth rates in Russian exports was noted during 2004, its monetary volume being increased by 34.8% against 2003 to break the record over the last decade – \$183.2 billion (*Table 48*).

Table 48

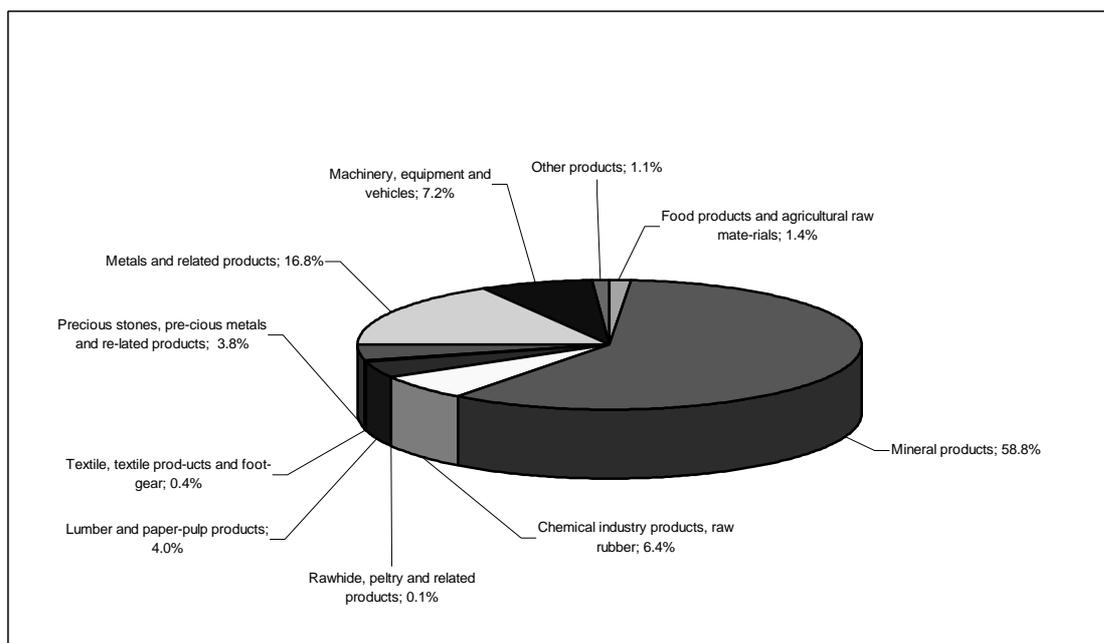
| Russian Exports Movement | | | | | | | | | |
|--|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|
| | 1996 | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 |
| Export, USD billion . | 89.7 | 86.9 | 74.4 | 75.6 | 105.0 | 101.9 | 107.2 | 135.4 | 183.2 |
| Including : | | | | | | | | | |
| Foreign countries other than CIS countries . | 71.1 | 67.8 | 58.7 | 63.6 | 90.8 | 86.6 | 91.0 | 113.9 | 152.9 |
| Growth rates, % of the previous year | | | | | | | | | |
| Volume of exports index . | 100.1 | 101.8 | 99.7 | 109.4 | 110.2 | 104.2 | 115.0 | 109.5 | 111.1 |
| Price Index . | 108.6 | 98.1 | 84.2 | 92.1 | 128.2 | 93.8 | 86.0 | 113.4 | 120.5 |

Source: the RF Central Bank.

However, the quantitative growth had no impact whatsoever on the quality of Russian exports still facing a major problem of inefficient structure of goods. Though several mature economies (for example, Canada and Norway) have a substantial share of raw materials in their export, they also export end products, including high technology products. A share of processed goods in Russian exports is miserable. Furthermore, this share is getting smaller (according to the corresponding parameter calculated for Russia by using the World Bank's method, the share is not over 30% over the last few years). The share of Russia in the world sales volume of machinery and technological equipment accounts for 0.3%, vehicles – 0.1%, electronic goods – 0.04%.

Thus, Russian specialization in raw materials trade, which can be deemed applicable at a certain period of time and under certain conditions, is not evolving into more developed forms related to raw materials processing thus interfering with increasing Russia's share in the world market.

Russian export growth still remain based mainly on the two product groups: fuel and energy products whose export increased by 34.9% in value terms in 2004 as compared to 2003, as well as metals and metal-based products which grew to 64.8% (*Fig. 72*).



Source: the RF Federal Customs Service .

Fig. 72. Russian Export Structure in 2004 (%)

In 2004, a share of fuel and energy products accounted for 58.2% of the total Russian export structure, which is slightly bigger than that in the previous year (57.8%).

Foreign exchange proceeding from exports of Russian oil amounted to \$55,0 billion in 2004 and exceeded by 49.3% that in 2003. Total oil production in Russia in 2004 amounted to 459,0 million tons and exceeded by 8.9% that in the previous year. Oil sales in the domestic market increased by 2.1% up to 177,6 million tons; export supplies increased by 13.3% up to 239,6 million tons.

A share of export in total oil export volume in Russia in 2004 accounted for 32.3%, and 55.5% in export of fuel and energy products (in 2003, the figures were 29.2 and 50.5% correspondingly).

A share of supply volume in export of oil-products grew by 4.5%, from 77,4 million tons up to 80,9 million tons. Export volume in money terms increased by 35.4%, up to \$19,0 billion against \$14,03 billion in 2003.

2004 saw the highest growth rates in prices of metals since 1992 . This was responsible for an increase from 14 up to 16.8% in a share of the group of goods (metals and related products) which is the second one in order of importance in Russian export (mainly through export of ferrous metals to foreign countries other than CIS countries, which grew by 82.1%).

A share of exports of machinery and equipment (7.2%), chemical products (6.4%), and lumber (4%) in total export volume of products in the Russian Federation remained the same as in the previous year.

Negative effect in the Russian export movement was caused by a 16% decrease in value of food products and related raw materials which resulted mainly from reduction in export supplies of grains.

High prices in the world market fostered growth in contract prices almost of all basic range of Russian export products (*Table 49*).

Table 49

**Average Contractual Prices of Basic Russian Export Products
(supplies to foreign countries other than CIS countries, USD/ton)**

| | 1996 | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 |
|------------------------------------|-------|-------|-------|-------|-------|--------|--------|--------|--------|
| Crude oil | 133,5 | 118,5 | 74,4 | 110,9 | 179,9 | 156,4 | 162,4 | 181,2 | 231,4 |
| Oil products | 129,9 | 115,7 | 75,7 | 94,5 | 171,9 | 145,2 | 147,9 | 180,2 | 230,3 |
| Natural gas, thousand cubic meters | 84,2 | 88,6 | 72,2 | 55,31 | 85,91 | 105,21 | 91,4 | 112,3 | 113,6 |
| Hydrogen nitride | 125,6 | 113,0 | 83,1 | 53,0 | 97,5 | 81,7 | 72,4 | 118,5 | 158,3 |
| Nitrogen manure | 128,0 | 90,3 | 58,3 | 36,8 | 57,9 | 61,8 | 60,6 | 76,0 | 103,1 |
| Potassic menure | 7,2 | 79,7 | 87,4 | 86,4 | 86,6 | 76,8 | 74,9 | 77,8 | 94,3 |
| Lumber, cubic meters | 59,4 | 57,5 | 46,9 | 43,5 | 43,4 | 45,6 | 44,8 | 47,8 | 56,2 |
| Cellulose | 407,3 | 373,5 | 342,9 | 274,0 | 352,2 | 293,4 | 300,0 | 321,7 | 371,9 |
| Newsprint paper | 473,7 | 383,4 | 394,0 | 349,5 | 386,6 | 421,7 | 332,2 | 338,3 | 387,9 |
| Cast iron | 136,8 | 124,2 | 104,3 | 66,8 | 80,7 | 86,2 | 91,1 | 126,8 | 242,7 |
| Ferrous-based alloys | 1114 | 819,2 | 740,8 | 548,2 | 625,6 | 601,7 | 625,7 | 634,6 | 1097,8 |
| Copper | 2143 | 2099 | 1655 | 1495 | 1675 | 1465,3 | 1371,4 | 1564,9 | 2587,6 |
| Nickel | 7272 | 6733 | 5140 | 5761 | 8629 | 5730,9 | 6143,9 | 8584,0 | 1266,0 |
| Aluminum | 1500 | 1401 | 1352 | 1157 | 1296 | 1176,3 | 1036,9 | 1050,0 | 1162,1 |

Source: Customs statistical data .

A share of export is nearly 1/3 of total sales volume of industrial products (considering transportation costs and trade markup). The share of export is exceeding substantially the average figure in a variety of industries.

Raw materials industry and primary process industries, primarily fuel industry, metallurgical industry and timber-and-paper industry, as well as in production of special types of basic chemical products and mineral fertilizers, are most oriented at and dependant on export.

A share of export in industries of high-level processing is normally smaller due to poor competitiveness of the manufactured products (Table 50).

Table 50

Export Share in Production of Essential Goods (%)

| | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 |
|-------------------------------------|------|------|------|------|------|------|------|------|------|------|
| Crude oil | 41,5 | 41,7 | 41,6 | 45,2 | 44,2 | 44,7 | 45,9 | 50,3 | 53,0 | 53,9 |
| Oil products | 25,8 | 32,4 | 34,7 | 32,9 | 33,6 | 36,0 | 39,8 | 40,9 | 41,3 | 52,4 |
| Natural gas | 32,2 | 33,1 | 35,2 | 34,5 | 34,6 | 33,2 | 32,8 | 33,1 | 32,6 | 34,4 |
| Coal | 17,1 | 15,8 | 14,5 | 15,7 | 16,7 | 25,7 | 39,7 | 37,2 | 48,9 | 25,0 |
| Mineral fertilizers | 83,9 | 85,9 | 80,6 | 86,5 | 83,2 | 82,9 | 81,8 | 78,1 | 75,2 | |
| Raw wood | 22,3 | 23,2 | 29,3 | 34,1 | 40,1 | 42,4 | 53,4 | 51,0 | 50,9 | 42,1 |
| Wood pulp | 74,8 | 85,7 | 82,8 | 77,6 | 79,1 | 82,4 | 83,7 | 85,1 | 83,3 | 74,9 |
| Newsprint paper | 71,1 | 72,2 | 70,1 | 74,6 | 70,6 | 69,0 | 67,4 | 68,6 | 66,6 | 63,9 |
| Plywood | 71,4 | 63,2 | 67,0 | 67,2 | 69,2 | 65,8 | 64,5 | 64,2 | 61,4 | 61,8 |
| Flat-rolled steel and iron products | 53,1 | 59,7 | 58,6 | 63,5 | 60,6 | 55,3 | 43,0 | 50,5 | 47,1 | 44,7 |
| Cars | 16,7 | 10,4 | 4,9 | 8,3 | 7,3 | 12,2 | 10,1 | 12,3 | 11,7 | 11,5 |
| Trucks | 25,4 | 17,4 | 10,7 | 9,6 | 8,3 | 7,0 | 12,3 | 20,8 | 19,2 | 21,2 |

Source: the RF State Statistics Committee; Customs statistical data.

Restricted access of Russian goods to foreign markets constitutes is a serious obstacle for export growth.

Russia is ranked second after China in the list of countries on which antidumping measures were imposed by the WTO countries in the first half of. As of October 1, 2004, 107 restrictions were imposed on Russian goods, including 53 antidumping duties, 10 quota restrictions, 6 price restrictions, 1 product range restriction, 3 import prohibitions, 2 additional taxes, and 1 protective duty.

According to the Central Bank of Russia, the export transitions efficiency index (ETEI) for an aggregate of goods including nearly 65% of the Russian export value, was estimated as 1,11 in January – October 2004 (in was 1,12 in January thru October 2003). The decrease in the index was mostly caused by growth in prices of goods exported in the domestic market, which ran ahead of contact prices, as well as increased duties on oil and oil products.

Import movement was characterized by growing rates. Volumes import supplies increased by 24.7%, up to \$94,8 billion, which a record-breaking figure over the last decade.

Growth in import volumes were basically responsible for import growth in 2004 (*Table 51*), which reached 120.8% against a moderate growth in prices, 103.1%.

Table 51

| Russian Import (USD billion) | | | | | | | | | |
|--|--------------------------------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|
| | 1996 | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 |
| Total import | 68.1 | 72.0 | 58.0 | 39.5 | 44.9 | 53.8 | 60.5 | 75.4 | 94.8 |
| Including : | | | | | | | | | |
| Foreign countries other than CIS countries | 47.3 | 53.4 | 43.7 | 29.2 | 31.4 | 40.3 | 48.2 | 60.0 | 75.1 |
| | Growth rates, % of the previous year | | | | | | | | |
| Import volume index | 98.1 | 121.1 | 89.0 | 84.4 | 129.2 | 129.1 | 117.6 | 119.2 | 120.8 |
| Price index | 100.2 | 94.8 | 92.3 | 82.1 | 86.7 | 94.3 | 93.4 | 98.7 | 103.1 |

Data source: Bank of Russia.

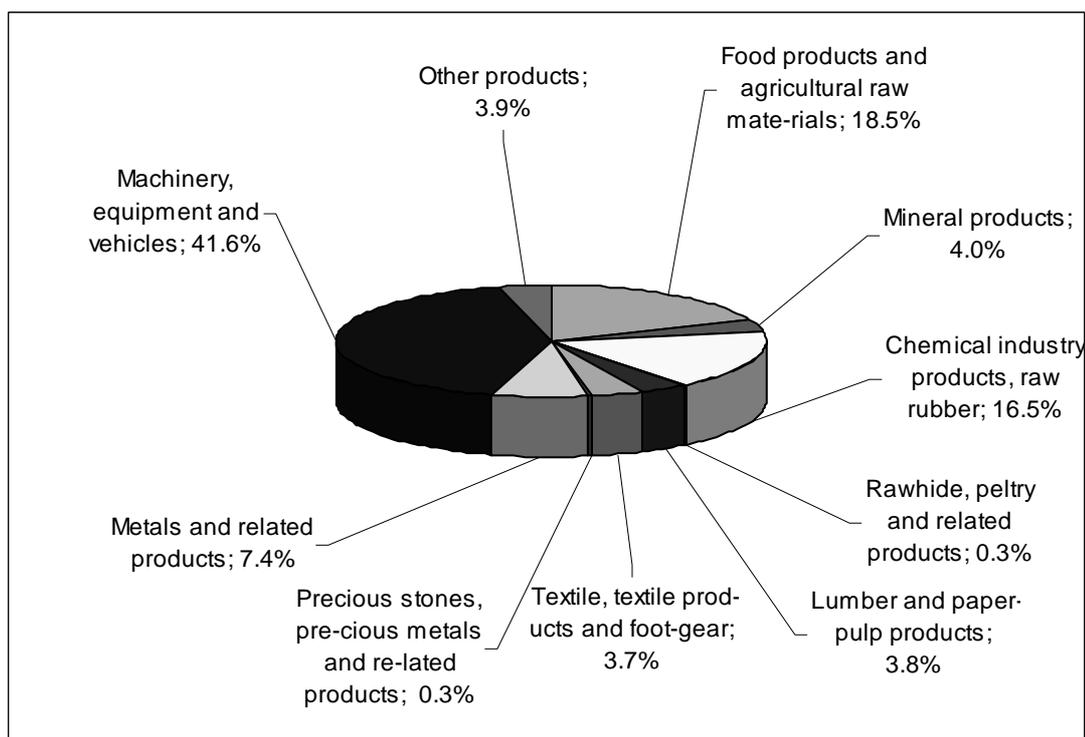
The Russian import growth was mainly based on real RUR strengthening and good figures of economic growth which slowed down by the end of the year though. According tot the Bank of Russia, in 2004, the RUR became stronger by 15.0% against the USD (4.2% were achieved in quarter IV), by 5.6% against the EURO and by 6.1% against the currency basket. By comparison, in 2003 a real strengthening of the RUR against the USD accounted for 13.6%, while by 0.8% to the currency basket.

The ongoing economic growth and relatively low inflation fostered real monetary personal income, which increased by 9% (by 13.6% in 2003) in 2004 against 2003. This results in consumer demand by individuals and industrial enterprises.

Growth in import of goods was mainly based on increased number of machinery and equipment (by 47.8%). Their share in total import of products increased from 37% in 2003 up to 41.6% in 2004, and from 40.8 up to 45.7% in the volume of goods imported from foreign countries other than CIS countries. Increased volumes of land transportation means (their value increased by 1,9 times) was responsible for a half of the growth achieved.

Reduction in volumes of purchases of meet products and sugar and consequent decrease in monetary volumes (by 9 and 25% correspondingly) had an effect on the decrease in a share of food products and related raw materials in total volume of foreign imported goods from 21.2 to 18.5%.

A share of products of chemical industry and related industries accounted for 16.5%, which is almost equal to that in the previous year (*Fig. 73*). This item is ranked 3rd in the Russian import structure.



Source: the RF Federal Customs Service .

Fig.73. Russian Import Structure in 2004 (%)

Growth in import supplies has most adverse affect on Russian motorcar factories. They have been suffering from the consequences of RUR strengthening and competition improvement. The demand for Russian motor vehicles has gradually been declining since the middle of 2003 against growing demand for imported motor. In 2004, import of light motor vehicles to Russia grew by 2,3 times as compared to 2003, its volume reached \$5 163,5 million.

The policy aimed at protecting domestic manufacturers by way of introducing import duties on foreign motor vehicles failed to achieve the expected efficiency. Neither quality of Russian vehicles nor output volumes have been improved over a period of two years of the customs duties imposed. Consequently, the RF Government plans to rely on using imported auto parts to assemble vehicles in Russia .

The Interdepartmental Commission for Protection Measures in Foreign Trade and Tariff Policy made a decision on its meeting held on January 27, 2005 to recommend the RF Government to abolish the import duty on a part of the auto parts imported to the Russian Federation for car assembly, as well as reduce it for several types of auto parts by 3 to 5%. Auto parts imported for free trading in the secondary market would be subject to the applicable rates of duties.

Reducing import duties on auto parts has a direct relationship with integration of the Russian automobile industry into the world automobile industry. This is an objective process which will help to improve quality of motor vehicles. At the same time, domestic manufacturers will not suffer from a decrease in duties on auto parts. At present, almost all modern car assembly enterprises enter into investment agreements with the RF Govern-

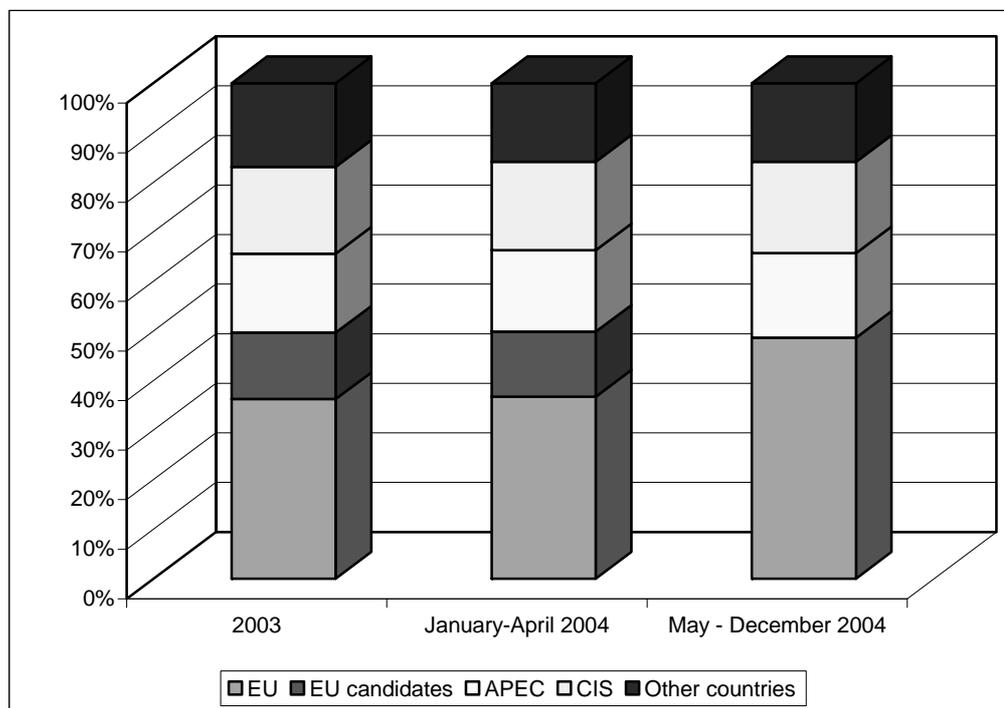
ment , which specify zero rates of customs duties on all auto parts. Thus, the new decision will create equal conditions for all automobile manufacturers.

At the same time, the duties on imported foreign cars will remain high enough. Russia has achieved agreements with almost all countries with advanced automobile industries (except for Japan) on supply of motor vehicles to Russia after its accession to the WTO . The duties imposed on import of second-hand light motor vehicles, trucks, auto-buses being in service more than 7 years will remain unchanged, i.e. banned in fact. Duties on new vehicles will be reduced from 25 to 15%. The decrease, however, will continue within a period of 7 years. The rates will remain the same over the first 4 years out of the 7 ones. Customs duties on import of foreign light cars being in service from 3 to 7 years from the production date will be reduced insignificantly, however, they must not exceed the duties on import of new motor vehicles by a least 5%.

Foreign trade conditions improved for the Russian Federation on the majority of product lines in 2004. Average growth in export prices exceeded the growth in import ones by 12 percentage points.

Export surplus was positive in 2004, \$88,3 billion (\$59,9 billion in 2003).

Geographical structure of Russian foreign trade was slightly changed in 2004 (Fig. 74). Due to the accession of 10 new countries to the European Union in May 2004, a share of this group in the gross volume of Russian foreign trade increased from 36.7% in January thru April up to 48.8% in May thru December 2004. Thus, in analyzing foreign trade transactions of Russia with the European Union, we will consider new EU countries apart from the old ones.



Source: the RF Federal Customs Service .

Fig. 74. Geographical structure of Russian foreign trade

In 2004, Russian foreign trade turnover with the old EU members increased by 36.6% as compared to the previous years, including export by 40.5% and import by 28.4%. For-

foreign trade turnover with the new EU countries increased by 21.7%, including export by 20.6% and import by 26.8%.

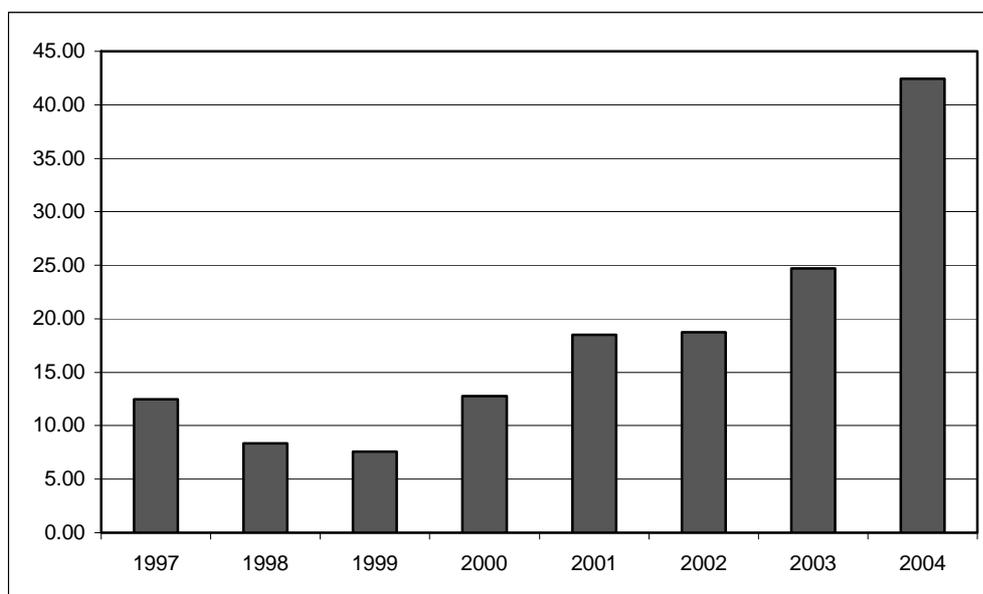
It should be noted that a share of the old EU countries in the foreign trade turnover structure increased by 0,5 percentage points in 2004 as compared to that in 2003. At the same time, a share of this group of countries increased by 1,2 percentage points in the Russian export structure, and decreased by 1,1 percentage points in the import structure. A share of the countries newly accessed to the European Union decreased by 1 percentage point, a share in the export structure decreased by 1,2 percentage points, and by 0,3 percentage points in the import structure.

CIS countries remain second in the structure of foreign trade turnover volume and import. Other countries come second in export volumes, export to the APEC (Asian Pacific Economic Cooperation) countries and the new members of the European Union is nearly equal in volume.

Analysis of the foreign trade turnover structure revealed the following trends: a share of the old EU countries and CIS countries is increasing in the geographical structure of Russian export, while a share of the countries accessed to the European Union in May 2004 and a group of other countries is decreasing.

A share of the APEC and CIS countries increased in the geographical structure of Russian import at the background of decreasing share of the old and new members of the European Union .

Russian foreign trade represents an important factor in financial stabilization of the national economy. Revenues from foreign economic activity have a substantial impact on the revenues of the Russian budget. In 2004, the federal budget received RUR1 219,5 billion in revenues, which is by 61% more than that received in 2003 (*Fig. 75*). Customs payments accounted for 5.65% of GDP in 2003, and nearly 8% of GDP in 2004. The increase in federal budget revenues was caused mainly by growth in prices of energy sources as well as increased import volume.



Source: the RF Federal Customs Service .

Fig. 75. Customs Revenues Inflow to the RF Budget (USD billion)

A share of revenues from export of goods increased in 2004 against the previous year. In 2003 a share of export revenues accounted for 39% against 54% in 2004. However, though a share of import revenues (import duties, VAT, excises, customs duties) decreased, there was an upward movement in import revenues.

Basic import revenues are received from goods imported from foreign countries other than CIS countries. Transportation means come first (group 87). In 2004, import of these goods accounted for 19% of import revenues (12% in 2003), primarily motor vehicles. Other types of equipment come second (groups 84 and 85). Meat products come third (group 2) whose import volumes remain substantial in spite of the introduced quotas. Plastic materials and related products come forth (group 39). Such goods as sugar (group 17) and pharmaceutical products (group 30) are also considered as basic goods generating import revenues.

3.7.2. Establishing a Single Economic Zone for Russia, Ukraine, Byelorussia and Kazakhstan

Creating a Single Economic Zone (SEZ) for Russia, Byelorussia, Kazakhstan and Ukraine is one of the top priorities for Russia for the time being. A search for new and optimal ways of economic integration resulted in an Agreement and Concepts of Establishing a Single Economic Zone signed on September 19, 2003 in Yalta.

The Single Economic Zone means an economic zone which is integrating customs zones of the member-countries for the purpose of ensuring free movement of goods, services, cash and labor force and pursuing a single foreign trade, financial and foreign exchange policies.

In the long term, the four countries are expected to use a single currency. Most importantly, the SEZ is nothing but economic organization meeting the vital interests of all its members.

It was agreed that the SEZ would be created on a stage-by-stage basis, each stage including fulfillment of certain obligations on achievement of a particular stage of integration. A new stage can not be approved until obligations of the previous stage are fulfilled.

The primary goals are to establish a free-trade regime for imported goods of the SEZ members, create conditions for establishing a customs union and a single competitive environment, take measures on harmonization of national laws. Next step is to create a free-trade zone without exceptions and restrictions, conduct a coordinated competition policy, and establish the customs union providing a single tariff. Finally, to ensure a free movement of goods, services, cash and labor force as a result of joints efforts of all the members.

It is proposed to establish a single regulatory body which could assume some powers from the SEZ countries. Decisions of the body would be approved by a weighted voting and mandatory for all the four members. A Council of Heads of States would be a supreme body of the organization. Decisions of the Council would be taken on a consensus basis.

At present, there is a High-Level Group acting as working body of the SEZ, which is represented by Deputies Prime Minister of the member countries. Russia is represented by V.B. Khristenko, Minister of Industry and Power Industry and a special representative of the RF President on integration cooperation issues with CIS countries. The High-Level Group includes 7 task groups working in various segments:

1. Customs and tariff regulation, non-tariff regulation, customs administration ;
2. Competition policy, natural monopolies, subsidies, government purchases, privatization ;
3. Technical regulations, intellectual property ;

4. Tax, budget and monetary policy. Foreign exchange regulation and control, macroeconomic performances ;
5. Services ;
6. Cash flow, investments ;
7. Labor force movement.

A meeting of the heads of the SEZ countries that was held on September 15, 2004 in Astana (Kazakhstan) actually initiated a practical implementation of the provisions of the Agreement and Concepts of Establishing a Single Economic Zone. In particular, a list of 25 top-priority international regulatory documents aimed at substantial liberalization of mutual trade and creating conditions for further advance towards the customs union and a single competition environment as drafted by the High-Level Group was approved. These agreements are scheduled for signing before July 2005.

Humanitarian issues are also among the vital ones. A series of agreements were developed for the purpose of simplifying formalities in crossing state borders by citizens of the SEZ countries.

The experience gained as part of the bilateral relations established between our countries is widely used in creating the SEZ. For example, a series of bilateral agreements were signed in Astana to ensure that VAT is collected on the "country of destination" principle without exceptions as early as January 1, 2005 in the member countries. To date, the High-Level Group has developed a draft basic set of international agreements (more than 80 ones) which represent a legal and regulatory basis of the SEZ has been drafted by .

The Agreement and Concepts of Establishing a Single Economic Zone is open for accession of other countries sharing its principles, provided that they meet the established macroeconomic and institutional criteria. It should be borne in mind, however, that it is the Single Economic Zone that should be established first, primarily its contractual and legal basis, to ensure that every SEZ membership-seeker be able to measure its compliance and capacity provided for by the aforementioned documents.

Accession to the WTO of all the four countries is evidently one of the key issues effecting the entire process of SEZ establishment. The SEZ countries have already established a mechanism of coordination in regard to their accession to the WTO.

3.7.3. Regulating Foreign Trade

In 2004, measures on improvement of tariff and non-tariff regulation in the Russian foreign trade were continued to develop.

In regard to tariff regulation in 2004, a wide range of issues was considered on adjusting export (in particular, asbestos and bleached sulfate pulp) and import (for example, various types of meat, cheese, sodium sulfite, digital audio and video equipment) customs duties.

Rates of export duties on oil and oil products were changed several times due to a price growth of energy resources. A new regulation took effect in February 2002 specifying that the rate of export duty on Russian oil must be determined on the basis of its price in the world markets. The oil export duty was revised once on a two-month basis (*Table 52*). The rate of duty on oil products was adopted together with the rate of duty on oil. It accounted for 90% of the export duty on oil until 1 August 2004, and 65% after 1 August.

Table 52

Rates of Export Duties on Oil and Oil Products in 2004 (USD/tons)

| | Oil | Oil products |
|-------------------|------------|---------------------|
| January | 31.2 | 28.1 |
| since February 1 | 33.9 | 30.5 |
| since April 1 | 35.2 | 31.7 |
| since June 1 | 41.6 | 37.5 |
| since August 1 | 69.9 | 45.4 |
| since October 1 | 87.9 | |
| since November 20 | | 57.0 |
| since December 1 | 101.0 | |

Data source: regulations issued by the RF Government

Rates of export duty on oil products became differentiated from November 2004. Now they are calculated on the basis of world oil prices and will average nearly 65% of the oil export tariff. Inside the “oil products basket”, however, export of fuel oil will be twice as cheap as export of refined oil products. For example, with general rate of duty on the “oil products basket” is 15% of export value, the duty on fuel oil is 10%, while that on other oil-based products is 20%.

On the basis of the foregoing, the RF Government approved on October 18 a new rate of customs duties to be imposed on oil-based products exported from the Russian Federation to countries other than the customs union’s member countries. Benzol, toluene, xylol, lubrication oils, oil product residues , propane, butane and other condensed gazes are subject to the rate of duty of \$57 per ton. Since November 20, the same rate was applied to export from Russia of xylols, distillates, gas oils, residues from refining of oil and oil products produced from bituminous rocks. Crude oil products and calcined oil char are exempted from export duty.

The Interdepartmental Commission for Protection Measures in Foreign Trade and Customs and Tariff Policy approved in general the new procedure of export duties on oil products at its meeting held on January 27, 2005 . Export duties on oil products will be calculated concurrently with oil duties for a period of 2 months on the basis of monitoring of oil prices in the world market. The following equation will be used :

For oil products (except for fuel oil):

- $0,416 * (P \text{ is } 109,5)$

for fuel oil:

- $0,224 * (P \text{ is } 109,5),$

where P is oil price , according to the conducted monitoring; 109,5 is oil price per ton, tax exempted.

New export duties on oil products will be determined on April 1, 2005 .

In 2004, measures of protection of domestic manufacturers were based on two guidelines as follows.

First guideline: improving and developing a legal and regulatory basis regulating application of protective measures in the internal market:

- a concept and terms of reference for the Federal Draft Law “On Amendments to the Customs Code the Russian Federation” was developed. The documents were submitted to federal executive agencies for coordination. The Draft Law provides for updating a procedure of declaring various names of goods contained in a single shipment as specified in Clause 128 of the RF Customs Code, as well as a procedure of paying and refunding preliminary special , antidumping and compensatory duties ;

- Regulation No. 546 “On Approval of Rules of Calculation of Specific Subsidy of Foreign Country (Union of Foreign Countries) and On Invalidity of Various Laws of the RF Government Regulating Application of Special Protection, Antidumping and Compensatory Measures in Import of Goods” was prepared and adopted by the RF Government.

Second guideline: providing protection of domestic manufacturers by applying special protection, antidumping or compensatory measures.

The following measures and duties were applied in 2004 on the basis of findings of the previous studies: special protective measures were applied against growing import to the Russian Federation of potato and corn starch, caramel, refrigerating compressors, poultry meat, as well as a compensatory duty was imposed on subsidized import of reinforced concrete rounds from Ukraine.

The effect of the Agreement On Regulation of Black Pipes Supply concluded on April 10, 2001 between the Ministry of Economic Development and Trade of Russia and the Ministry of Economy of Ukraine was extended for the period of 2004 for the purpose of regulating black pipes supply from Ukraine to the Russian Federation.

As a result of negotiations, an Agreement on Regulation of Galvanized Rolled Iron Supply from Ukraine to the Russian Federation was concluded on January 23, 2004 between the Ministry of Economic Development and Trade of Russia and the Ministry of Economy of Ukraine.

Monitoring of effectiveness of special protective measures against import of potato and corn starch, caramel, refrigerating compressors, poultry meat to the Russian Federation and the compensatory duty on import of reinforced concrete rounds to the Russian Federation from Ukraine were monitored throughout 2004. Furthermore, the situation of the Russian caramel market was analyzed.

The monitoring resulted in decisions aimed at reducing the applicable duty on potato starch import and updating the rate of import customs duties on native and modified starches by introducing combined duty rates with a specific component in order to prevent understatement of the customs value.

Growth of imported dried yeasts in the Russian market as well as dumping import of channel beams to Russia from Ukraine were investigated into.

Investigations into dumping import of asynchronous motors to the Russian Federation from the Republic of Belarus and Ukraine and various types of pipes from Ukraine, flat-rolled products from the European Union, as well as increased import of white sugar and electric bulbs to the Russian market were commenced.

Negotiations on conditions of Russia’s accession to the World Trade Organization (WTO) were animated in 2004.

The Task Group held its 22nd meeting on February 5, 2004 in Geneva. The meeting was dedicated to further consideration of the Final Report made by the Task Group, which represents a basic element of the final package of documents for the accession. The meeting resulted in consideration of another 10 sections of the Final Report, including collection of excises and import VAT, export duties, government purchases, regulation of trade in cases of transit, etc.

In addition, two-day bilateral negotiations were held on the subject matter of market access of goods and services. As a result, agreements on tariffs were finalized with 13 countries, however, 1 to 2 items remain to be agreed with 10 countries; agreements on services are expected to be achieved with 11–12 countries. In addition, multilateral consultations on the new RF Customs Code, agricultural issues and tariff quotas were held. The consultations covered mostly technical issues.

The Task Group held its 23rd meeting on March 29 thru April 2, 2004. Ten updated sections of the draft report were considered and coordinated during the meeting. In addition, a series of bilateral arrangements were conducted, including representatives of foreign business communities.

The Task Group held its 24th meeting on Russia's accession to the WTO on July 15 thru 16, 2004 in Geneva. Sections of the Final Report dedicated to customs clearance, foreign trade licensing and intellectual property protection in Russia were considered.

The meeting was dedicated to the issues related to customs. Most of the WTO members express their concern about the new RF Customs Code, especially in regard to shipment clearance at customs stations and customs value determination.

The Task Group held its 25th official meeting dedicated to Russia's accession to the WTO on November 18, 2004 in Geneva. The third revision of the Final Report on Russia's accession to the WTO which was substantially updated as compared to the previous one, was considered.

Customs service is one of the most delicate issues at the negotiations, especially customs value determination, law enforcement, several agricultural problems, sanitary and phytosanitary control and technical regulation in general, as well as intellectual property protection.

Furthermore, the United States and Canada continue express their high concern of the issue related to double pricing of energy sources. Russia, however, is not ready to offer substantial concessions in this field.

The progress is as follows. Russia finalized negotiations on terms and conditions of mutual access to product markets with 14 countries (in particular, major trade partners of Russia : nearly 50% of trade turnover with the European Union, 10% with China, 4% with South Korea). A total of 46 countries (in addition, over 10 countries have been negotiating on services only, other WTO members have no claims whatsoever to Russia as they have no economic relationship) expressed their desire to negotiate with Russia. It is important that all of them should agree on Russia's accession to the WTO, because decisions on accession of a new member to the WTO must be made by common consent of the existing WTO members. Russian negotiators expect to finalize negotiations with Australia in spring of 2005.

The hardest part upon achieving an agreement with the European Union and China is to do the same with the United States. Prospects of the Russian aircraft industry is the issue that still remains unresolved. Accession to the WTO has various impact on various industrial sectors . Some of them (telecommunications, banking, insurance services, etc.) has an up-to-date institutional and technological base, but anticipate a sever competition upon opening of the market, though they are competitive and even have an advantage over their competitors in the Russian market. Others, above all processing industries, recognize their poor competitiveness against importers and consequently tend to a harder protective policy. Aircraft industry is the "hardest" one: it needs huge investments, secured leasing treatment and more to make it catch up with the contemporary market of passenger air jets. This industry must continue for strategic purposes.

Copyright is the second complicated problem in the negotiations with the United States. Russia is ranked second in the world in production of illegal copies (software, video and audio products). At a press conference held recently in Moscow, the US party has demonstrated DVD movies that haven't been released in the United States yet.

Thus, the Russian Federation has reached the final stage in accession to the WTO, when most complicated issues are to be resolved. Potential obligations on all parameters of the accession (tariffs, agricultural obligations, service market access, system-based

issues) will be based on current and future economic situation and ensure the required protection of domestic manufacturers and adequate competitive environment.

Construction of legal and regulatory framework regulating foreign economic activity is expected to be finalized soon. A lot of work has been performed to bring the Russian customs legislation in compliance with the WTO's regulations. A total of fifteen laws and draft laws were considered in the previous year. The RF Customs Code took effect on January 1, 2004; RF Law "On Regulation in Foreign Trade" came into force on July 15, 2004. RF Antidumping Law and Law on Technical Regulation regulating a minimum set of standards and reducing the number of required licenses were adopted. A foundation of legal protection of intellectual property was laid.

The applicable legal base regulating Russian foreign trade includes the new RF Customs Code, 12 regulations and 2 instructions issued by the RF Government, more than 80 regulations of the RF Federal Customs Service issued in elaboration of the RF Customs Code.

However, the initial year of operation under the new the RF Customs Code revealed that several of the RF Customs Code need to be more clear-cut, certain and legally elaborated. The same is true with the regulations issued on the basis of the RF Customs Code and orders of the RF Government, as well as law enforcement. In addition, nearly 30% of more than 10 000 different regulations, orders and instructions issued on the basis of the RF Customs Code of 1993 are still effective. RF Law "On Customs Tariff" needs to be brought in compliance with the new RF Customs Code and the requirements of the World Trade Organization . No amendments were made to the RF Tax Code the Russian Federation in regard to value added tax refund, in particular processing products exported from the customs territory of Russia. Provisions of the RF Customs Code and the RF Tax Law remain to be correlated . Altogether this is evident of the fact that legal basis of customs regulation still remains to be finalized.

Application of simplified customs clearance mechanisms to special types of entities is one of the essential new developments of the RF Customs Code. Such mechanisms provide for faster customs clearance for the entities which respect customs regulations in good faith.

However, special simplified procedures of customs clearance came to be applied only in May 2004 pursuant to Federal Law "On Amendments to Various Regulations of the Russian Federation and Invalidation of Various Regulations of the Russian Federation Due To Application of Measures on Public Administration" of June 29, 2004 No. 58-FL. This is caused by the fact that the RF Customs Code neither specifies clear application mechanisms of such procedures nor authorizes departments to establish such procedures. So, amendments were made to the RF Customs Code authorizing the Ministry of Economic Development and Trade of the Russian Federation to establish such procedures.

There is another new and essential development provided for by the RF Customs Code – computer-based declaring of goods – that needs to be finalized too. The RF Customs Code permits provision of electronic documents. However, neither list of electronic documents which may be submitted nor their forms have been specified to date. The required software and hardware are not available yet.

Foreign trade operators are facing serious economic, legal and administrative problems caused by expanding practice of the RF Federal Customs Service aimed at restricting the number of customs clearance stations for declaring certain categories of goods.

There were 34 regulations restricting the number of customs clearance stations for declaring certain categories of goods before the new the RF Customs Code came into effect. Such measures allowed declared goods to become legal in trade and increased in

number: electronic household appliances by 1,5 to 2 times and meat by 2,5 times, with insignificant changes in export of such goods to the Russian Federation .

Article 125 of the RF Customs Code provides for submission of customs declarations to any customs clearance station. However, practical application of this Clause by agencies under the RF Federal Customs Service makes this provision ineffective in regard to numerous categories of goods by underlying a new category: "goods related to frequent violations of the RF Customs Law". Such practice is governed by Clause 2(3), Article 125 of the RF Customs Code which is uncertain and referential in essence, thus allowing the RF Federal Customs Service to restrict by internal regulations the number of customs clearance stations for declaring numerous categories of goods. Such practice of application of Article 125 of the RF Customs Code received a fairly negative response from the Task Group on Russia's accession the WTO as being considered a form of non-tariff protectionism.

At the same time, maintaining such authorities of federal government agencies complies with the international practice (standard rule 3.20 of the General Schedule attached to the Kyoto Convention 1999) and is aimed at improving control efficiency. Unlike the former regulation, the new RF Customs Code Russia provides for clear-cut criteria for restricting the number of customs clearance stations. Such measures must be justified and based on risk analysis, and abolished if they prove inefficient and have an adverse effect on operation of foreign trade participants. The number of customs clearance stations for certain categories of goods will gradually be increasing under liberalized customs regulations and due to a wide use of IT-based customs clearance and supervision procedures, as well as introduction of a system of risk assessment and management. At present, the RF Federal Customs Service has prepared proposals on reduction of restrictions imposed on the number of customs clearance stations for declaring goods imported to the customs territory in accordance with the plan coordinated with the Ministry of Economic Development and Trade Russia .

The new RF Customs Code resulted in substantial changes in composition of the so-called customs-related organizations (customs brokers, customs carriers, owners of interim storage facilities).

Establishing large amounts of security for entities which run the customs-related business, has already ousted small and medium-size companies from the market, which are unable to secure their responsibility to customs authorities. For example, 1469 organizations provided services on interim storage of goods before the RF Customs Code came into force, while 1116 companies appeared to be listed in the corresponding Register of owners of interim storage facilities at the end of 2004. The number of companies operating as owners of customs warehouses and providing storage services at these warehouse was reduced from 219 (including 4 organizations established by customs authorities), as of January 1, 2004, to 168 (including 3 warehouses established by customs authorities).

A monitoring conducted late in 2004 of the changes in the market of services provided by customs brokers (representatives) showed that such services were rendered by 278 organizations listed in the Customs Broker Register (representatives) and qualified for being included in such Register, as well as 122 organizations operating as customs brokers with licenses (prior to the end of license period) issued by customs authorities prior to January 1, 2004. Thus, total number of customs brokers was 400. Prior to the new RF Customs Code took effect, 843 customs brokerage licenses were issued, while the number of customs brokers was reduced by 2,1 in 2004.

There is a threat of monopolization of broker services by a dozen of large brokers. This may entail monopolized prices of brokerage services, encourage corruption trends in this environment, increase costs incurred by trade operators and boost up prices of imported consumer goods. The same is true with the market of customs carriers and storage services.

Thus, a series of problems were revealed during the initial year under the new RF Customs Code, which could be resolved by making amendments to the regulatory documents and, in special cases, updating corresponding provisions of the RF Customs Code .

The following problems are worth mentioning:

- to date, no amendments were made to the customs-related laws and regulations of the Russian Federation ;
- RF Law “On Customs Tariff” was neither brought in compliance with the new RF Customs Code nor the requirements of the World Trade Organization ;
- no amendments were made to the RF Tax Code in regard to VAT refund, in particular on processing products exported from the customs territory of Russia ;
- problems still can be found in incompliance of provisions of the RF Customs Code Russia with the Tax Law the Russian Federation in regard to tax base determination for assessing customs duties and taxes, as well as in incompliance of limitation periods of customs payments enforcement with integrity checks of data provided for customs clearance after products are manufactured.

Invoice processing rules established pursuant to RF Law On Taxes and Duties, make no allowance for the fact that goods may be produced prior to submission of a customs declaration, when a state customs number is not yet assigned and consequently can not be indicated in an invoice so that the goods can be sold in the domestic market.

Tax authorities may face problems after January 1, 2005 in applying the provisions of the RF Customs Code referring to the Law On Taxes and Duties, due to the amendments made by the Federal Law of July 29, 2004 to Article 13 of the RF Tax Code under which the customs duty is excluded from the list of federal taxes .

At the same time, it should be noted that some amendments to the RF Customs Code were already made. RF Law “On Amendments to the RF Customs Code” was adopted, which added a new Chapter (“Customs Duties”) to the RF Customs Code. This was done for the purpose of ensuring a legal support in collecting customs duties.

Article 33.1 (“Customs Duties”) provides definition of the “customs duties” term and specifies a list limiting their categories: customs duties on customs clearance, carrying and storage. The Draft Law specifies the maximum rate of customs clearance duty: RUR100 thousand. It also specifies fixed rates of customs carrying and storage of goods at interim storage facility or customs warehouses owned by customs authorities. The Draft Law specifies fixed rates of special categories of customs duties thus making it a direct-effect law.

For example, customs duty for escort of goods is RUR2000 per each vehicle and each unit of rolling stock at a carrying distance of up to 50 km and RUR3 000 for that at a distance of 51 to 100 km. However, customs duty for escort of goods at a distance more than 200 km is RUR1000 per every 100 km of the road, but not less than RUR6000. The amount of customs escort duty is RUR20 000 per every sea vessel, river craft or aircraft regardless of carrying distance.

Making amendments to the Code will help Russia to meet its commitments in the field of customs duty at the negotiations on its accession to the WTO : pursuant to Article VIII of the General Agreement on Tariffs and Trade (GATT), customs duties must be collected as compensation for customs costs rather than for fiscal purposes.

Federal Laws "On Basic Principles of Public Regulation in Foreign Trade" and "On Foreign Exchange Regulation and Control" took effect in June 2004, which play an important role in regulating foreign economic activity. These laws underwent expertise confirming their compliance with the corresponding WTO regulations .

RF Law "On Basic Principles of Public Regulation in Foreign Trade" provides updated definitions of basic terms (foreign trade, import, export, etc.) and introduces a series of new terms and definitions (transit, free trade zone, customs union). The Law contains provisions on separate public regulation of foreign trade in goods, services and intellectual property. It also includes new provisions on regulation of foreign barter trade and on pre-shipment inspection. A new procedure on counter measures is introduced.

The Law specifies basic principles of public regulation of foreign trade on the basis customs-tariff and non-tariff methods, including the following ones measures: establishing and abolishing import and export customs duties and dues; imposing and withdrawing restrictions and limitations in international trade in products, services and intellectual property; arranging and withdrawing economic and administrative measures promoting development of foreign trade; concluding international trade agreements as well as agreements on customs unions, free trade zones or regional economic integration.

The Law ensures that the Russian legislation meet the provisions of Articles I, III, V, XI, XIII, and XXIV of the GAAT of 1994 as well as the WTO Agreements on import licensing and pre-shipment inspection.

Furthermore, the Law specifies regulations on imposing restrictions and limitations provided for by Articles XX and XXI of the GAAT of 1994. Special provisions of the Law are intended to ensure transparency in accordance with Article X of the GAAT of 1994.

Developing new regulations and making amendments to the applicable ones is one of the basic tasks of the present period in implementing provisions of Federal Law "On Basic Principles of Public Regulation in Foreign Trade", in particular measures of non-tariff regulations.

FR Law "On Foreign Exchange Regulation and Control" excludes precious metals and precious stones from the list of currency valuables, which provides for liberalization in this field and makes the Russian legislation compliant with Article XX of the GAAT of 1994 in this respect.

The Law also specifies the term for abolishing the existing restrictions, as well as reduces the number of capital transactions requiring permission of the Bank of Russia, with consideration of international agreements of the Russian Federation, including Article. VIII of the Agreement with the IMF.

The list of non-commercial operations classified as current exchange transactions is largely expanded. The list is open, which provides for further liberalization of foreign exchange regulations.

In November 2002 , when a new revision of RF Law "On Foreign Exchange Regulation and Control" was prepared, RF Minister of Finance A. Kudrin pointed out that the standard of compulsory disposal by exporters of a share of foreign exchange earnings might range from 0 to 30% subject to the RF Central Bank. This standard should be reduced on a regular basis, while it also may be increased provided that Urals oil price drop to \$12 USD per barrel. In last July, the RF Central Bank already used its right to change the standard by reducing it half as much, down to 25%.

At the end of November 2004, the RF Central Bank made a decision to sharply reduce the standard of compulsory disposal of a share of foreign exchange export earnings from 25 to 10%. This is a decision of major importance, because it was this standard that

the Russian Government was using for a long period a tool to influence inflation and USD/RUR exchange rate.

The standard of compulsory disposal by exporters of a share of foreign exchange earnings came into force on January 1, 1992 pursuant to a Regulation On Liberalization of Foreign Economic Activity issued by President B. Yeltsin. The mechanism worked as follows: a republican foreign exchange reserve received 40% of foreign exchange earnings at a special exchange rate, and a foreign exchange stabilization fund of the RF Central Bank was built up on the basis of 10%. The foreign exchange reserve and special exchange rate were abolished on 1 July 1992 : the entire 50% of foreign exchange earnings was supposed to be sold in the domestic foreign exchange market according to the procedure established by the RF Central Bank: 20% in the domestic foreign exchange market and 30% directly to the RF Central Bank to replenish its foreign exchange reserves. It was only a year after, on July 1, 1993, when the RF Central Bank allowed the entire 50% of earnings to be sold in the foreign exchange market. Economic situation of that time was undoubtedly complex: downward trend in RUR exchange rate, huge inflation and short supply of consumer goods.

The RF Government again brought up the issue after the post-crisis period in 1998. The State Duma approved a decision to increase the standard from 50 to 75% in December of the same year.

In 2001 the standard was reduced from 75 to 50% due to high oil prices. In 2004 the standard was reduced to 10% as result of ultra high oil prices in the world market .

Thus, in 2004, the Russian Government continued to bring the RF law in compliance with the WTO requirements, which above all meets the Russian national interests and is conditioned by intensive expansion of foreign trade relationships with other countries, Russia's integration into the world economy and consequently the need to develop an up-to-date and adequate mechanism of trade policy as based on the principles and rules of international trade.

3.8. Military Security of Russia under Present Conditions: Economic Problems

3.8.1. Military policies and military-economic activities in the Russian Federation

The bases of the RF state policies in the field of military organization for the period of up to the year of 2010 were determined by the Supreme Commander- in-Chief, the RF President, as far back as 2002 and such policies are further specified by the President in his annual addresses to the Federal Assembly. Jointly with the National Security Concept and the RF Military Doctrine, these documents define objectives and tasks of both military organization and military activities in general. Concrete programs, the Federal Target-Oriented Program (FTP) for transition to a new system of army recruitment in particular, were respectively approved by the RF Government.

Adoption of the federal budget by the early 2004 permitted timely approval of the state defense order as well.

Thus, positive solution of the RF military security tasks, it would seem, was to be supported with all the necessary resources which did not augur any faults in functioning of the respective "power bodies".

However, analysis of the Defense Ministry activities in 2004 construes an impression that its governing bodies proceeded basically from their own understanding of the objectives and tasks of the said activities as stated in the "Development the RF Armed Forces:

Topical Tasks” (the so called “White Book” of the Defense Ministry, October, 2003). This is mostly attributable to a strong wish of the Defense Ministry governing bodies to close down the question of the Russian military reform as though it has already been fully, successfully and finally completed.

Yet, even if double failure of the submarines’ strategic missiles during the exemplary 2004 naval maneuvers, attended also by V.V. Putin, RF president, was indeed quite accidental but at that accidental rather demonstrative. It once again graphically showed that with their *de facto* results being neither compared against the respective costs nor estimated with regard to the economic expediency, the administration system of the “power bodies” is simply liable to have low efficiency. Another significant factor was lack of due civilian control.

A number of facts are leading to a conclusion that the military-political leadership of Russia began at last to understand this situation which in turn brought about the appearance of political will to overcome such. So it is not by any chance that early last year a group of top ranking Defense Ministry officials, for the first time during many years, made a special trip to visit their colleagues in Great Britain just in order to study their practical experience in the area of defense financing. However, there was something more important here – the RF administrative reform which started in April, did not pass the “power bodies” by. So the necessity of their participation in this reform once again graphically demonstrated unlikeness of the defense ministry’s thesis that the military reform had already been fully, successfully and finally completed.

Results of ensuring RF military security on the international arena in the last year do not at all seem to be unambiguous. On the whole, these may be considered as successful with regard to foreign countries. For instance, Russia was able to preserve its principle position in the Iraqi question and rejected insistent invitations to join the US military effort in this country. At the same time, however, because of its own national interests, Russia continued to support international forces in Afghanistan by providing for transit of military and other respective cargo through its territory. Stronger became its cooperation with the NATO: 34 joint actions took place during the year, including military games in the headquarters of NATO in Brussels, joint naval maneuvers in the Ionian Sea and the Northern Atlantic Ocean, the first entry of a Russian A-submarine into the French sea port of Brest and maneuvers simulating defense of nuclear objectives on the Kola Peninsula.

Steadily maintained is a sufficiently high level of Russia’s military and technical cooperation with foreign countries. As officially declared, the volume of military exports for the said year exceeded 6 (six) bln US dollars. In the same period, however, claims were for the first time openly made to Russia in connection with her inability to complement all the supplied armaments with the necessary spare parts. Besides, there still remains the problem of money deductions for the intellectual property in the Indians-made Russian armaments models.

Quite positive results were also achieved in both military and military and technical cooperation with the former Soviet republics. Successful were the “Border 2004” anti-terrorist maneuvers conducted in Kirghizia within the framework of the Agreement on the CIS Collective Security. At the same time, however, a number of observers openly expressed their opinion that Russian peace-keeping forces did not at all act in the best way during the aggravation stage of the July 2004 international conflict in the Southern Ossetia.

In the Russian Federation itself, in 2004, its armed forces were used in Chechnya, Ingushetia and the Northern Ossetia. The special forces and anti-mine engineering units combat operations in Chechnya are considered as sufficiently efficient. The troops own

losses somewhat decreased as compared with the previous years. Yet, any attempts to free the territory of this republic from the terrorist bands and catch their leaders were rather unsuccessful. And although withdrawal of the airborne units from Chechnya by the end of November basically completed the reduction process of the troops strength on its territory, almost simultaneously plans were published to form two mountaineering-rifle brigades in the Northern Caucasus. It is noteworthy that stationing one of them on the territory of the mountainous Daghestan was confronted with active protestations of the local population caused, as reported, by plans of the military to alienate certain agricultural lands.

Of particular significance is the fact that actions of all “power bodies” during the criminal sally of the terrorist fighters in Ingushetia on June 22 and the Beslan tragedy on September 1–3 were extremely unsuccessful. The latter were in both cases able to take initiative at least for a certain period of time.

Last year, the composition, organization and functions of the Defense Ministry were significantly changed – the General Staff of the RF Armed Forces lost a number of administrative functions as regards direct control of troops and was placed under the authority of the Defense Minister which, as expected, should enable him to concentrate on matters of strategic planning and perspective development of the RF Armed Forces.

Practically completed is the change-over to a unified inter-departmental supply system under which the Armed Forces Logistics Services were made responsible for supplying the troops of all the “power bodies” with the Defense Minister controlling financing of the nuclear defense system.

In July, 2004, the system of military education experienced another change of names which, on the one hand, to some extent returned it to its former state (with military academies and military schools) but, on the other, it was accompanied with the lowest graduation rate of officers from the respective military institutions for the recent years. In the course of three years alone, this graduation rate decreased from 24 thousand down to 14 thousand military servicemen. Accordingly, plans were worked out to draft 15 thousand graduates of civilian higher educational institutions to serve as officers. At that, the Defense Ministry considers the resultant full strength of officers in the RF Armed Forces to be about 88% of the “optimum”. The Defense Ministry also started a three-year experiment on the competitive distribution of the respective funding between civilian educational establishments intended for training officers with humanitarian specialization. Although the main funds of the Federal Target-Oriented Program (FTP) for reforming the system of military education in 2004 were allocated to certification of the military educational institutions, their connection to Internet and renewing the stock of the respective libraries’ educational materials.

One of really significant events in the area of military and technical policies and purchases of armaments was the document: “Main Development Directions of Armaments, Military and Special Machinery for the Period of up to the Year of 2020” adopted at the Defense Ministry Collegium in late March, 2004.

According to the “Red Star” newspaper, more than 300 armaments and military machinery models were added to the RF armory in the period from 2001 which somewhat contradicts frequent complaints about insufficient financing of the R&D by the state. But the situation, possibly, is rather reverse. The said R&D problems, it seems, are primarily caused by exceptional privacy of R&D, poor connection with requirements of different army branches, flourishing corruption and excessive abuses.

In the year of 2004, there still was no positive solution of the defense industry problems. To somewhat facilitate its reforming process, the list of strategic industrial enter-

prises was cut down from 3 thousand to 1059. Attempts were also continued to administratively introduce vertical structures: for example, the end of the year saw setting up of a helicopter-construction corporation headed by the "OPK Oboronprom" Open Joint Stock Society and consisting of the Mil Moscow Helicopter Plant, the Ulan-Ude and Kazan aviation plants which "Rosvertola" (with 51% federal share in the corporation) is expected to join in future. However, a number of observers have strong doubts that such measures are capable of positively solving of the so called "disproportion" problem. Besides, of major significance is becoming the quality of the armaments and military machinery produced – the number of claims for product replacement has grown 10 times on the domestic and 20 times on the foreign markets.

Not everything is going well enough with transition of the RF military organization to the new system of recruitment for the army.

The previous year of 2004 was the first to see the start of implementing the "Transition to Recruiting Contracted Servicemen for a Number of Military Units and Formations" FTP for the period from 2004 to 2007. Besides, an attempt was made to attract the CIS citizenry to contract servicing but so far with little positive results.

Fully contracted in the Defense Ministry already is the 76th Guards Airborne Division (the city of Pskov). Intensively being re-equipped are the barracks and hostels where the military units and formations are stationed which are preparing for transition to the new recruitment system for the army in 2005.

As has been officially declared, there are no more drafted RF Defense Ministry servicemen in Chechnya. Yet, there still remain in Chechnya 3.8 thousand Ministry of Internal Affairs Forces (MIAF) drafted servicemen and that contributes neither to better efficiency of the troops nor to decreasing negative attitudes of the public as concerns the draft system of recruitment for the army.

As different either from the RF Armed Forces top officials who do not intend to give up draft recruitment in full, or the MIA Internal troops which have not yet determined their position on this matter, the Frontier Troops have already firmly decided in favor of such transition to contracted service of all their servicemen by the year of 2008 and in 2004 even rejected 6 thousand of drafted servicemen.

On the whole, the situation with compulsory drafting in the Russian Federation does remain rather problematic. Abundant is corruption which fact is graphically evidenced by bringing to criminal account of a number of functionaries from the military registration and enlistment offices: all in all, 27 men were brought to criminal account during the year of 2004 alone.

No more joyful were the social results of 2004 for professional military servicemen. Not everybody was quite happy with regard to abolition of privileges. Attitudes towards the mortgage system to provide living accommodations for military servicemen remains rather suspicious since such a system does not directly concern most of those with no living accommodations. There is a lot of criticism regarding indexation of servicemen's money allowances and wages of the civilian personnel.

It is quite difficult for military servicemen to understand the Defense Ministry policy in this respect – it is neither sufficiently transparent nor any logically consistent. Which is, in particular, evident from analyzing the situation concerning practical implementation of the above said FTP. Appearing in the mass media means, Yu. N. Baluevsky, the new Head of the RF DM General Staff, frequently noted the low quality of the citizenry who agree to serve on the contract basis, explaining it by the fact that "*most of our countrymen consider payment for military labor as definitely insufficient*" – 6200 roubles a month (outside Chechnya) including all the due bonuses. Obviously, this is too little, particularly so if ac-

count is taken of the fact that the average monthly wages/salaries in the country already comprise something about 7000 roubles. However, fully in accordance with Article 13, Clause 9, "On the Status of Military Servicemen" of the Federal Law, any increments to the basic money allowance are determined by none else than the "Defense Minister of the Russian Federation (Head of another federal body of executive power in which the federal law provides for military service)". As stated in the said law, "within the limits of the funds allocated" but nevertheless by these very persons. It is their direct duty to strive for allocation of such funding.

However, actions of the Defense Ministry during the last two years insistently demonstrate quite a different policy. As far back as early 2003, when the inter-departmental Working Group was set up to prepare the FTP, all members of the Group were given a document signed by the Defense Minister. This document set up the calculated level of the money allowance for the contracted servicemen – 4000 roubles a month. Any reasonable objections of some Group members that this level does not correspond to the results of the respective sociologic polls and is grossly understated were simply ignored. Moreover, while the RF Government were preparing a Resolution on the FTP (the formal approval took place on August 25) the Defense Minister signed Order No 245, dated 9.07.03, on establishing monthly extra pay "to certain categories of military servicemen for the importance degree of the tasks performed". Such "*certain categories*" included officers of the DM central bodies of administration and the said extra pay comprised 75% of their basic salaries.

It was only in December 2003 that the same minister, on the same grounds and fully in accordance with the approved FTP that Order No 450 was finally signed introducing extra pay "for special conditions of combat training" to contracted servicemen in military units and formations to be transferred to the new system of recruitment for the army. The Order instructs to introduce significant extra pay to those serving in the 42nd Guards Division, stationed in Chechnya, and extra pay in the amount from 2700 roubles to 3300 roubles in other military units and formations to be transferred to the new system of recruitment for the army, the guiding principle being: the higher the rank, the higher the extra pay. Yet, the respective payments started not right away but only "beginning from the day of assumption of an office but not earlier than the date when the commander of the respective military unit by his order officially declared transition of such unit to the new system of recruitment for the army". In the result, the money allowance level of contracted privates and junior rank officers in the permanent alert military units and formations turned out to be lower than the average wages/salaries in the country. Moreover, totally forgotten were contracted servicemen in other military units and formations not being transferred to the new system of recruitment for the army. Such turned out to be market motivation for joining the army on the contract basis!

A year later, when it became clear that with this level of payment RF citizenry are not very willing to become contracted servicemen on a voluntary basis and that such level indeed needs to be raised, functionaries of the Defense Ministry just repeated the approach efficiently tested in the previous year: they just prepared a new Order - No 346, dated 30.10.04, which increased the said extra payment up to 120% of the basic money allowance but... only to military servicemen in the central administration.

It is also noteworthy that the said extra payments in the military units and formations are eventually determined by the commanding officers thus opening the way for possible arbitrariness with regard to military servicemen.

3.8.2. Military expenditures of the federal budget

Since the federal budget for the year of 2004, military expenditures of the state included, was approved in due time it enabled all the executive bodies to practically immediately start its implementation. And although growth of prices on fuels and lubricants, electrical energy and housing and communal services during the year required that the corresponding expenditure articles be increased, profit of the federal budget permitted such increases which was practically done in November 2004.

Due to changes in the law on the Federal Budget, its expenditures were increased up to 2 768.1 bln roubles (or by 4.1%) which allowed to increase military expenditures as well. Finally, the defense expenditures grew by 3.9% on the whole; at that, the military program of Minatom (Ministry of Atomic Energy) went up by 8.9% and expenditures on the military reform grew by 16.5%. Expenditures on pensions to military servicemen remained at the same level and on pensions in the law enforcement bodies even went down by 7.7%. Thus, growth of the military budget turned out to be less than such of the federal budget on the whole. No indexation of the money allowance for the military servicemen or of salaries for the civilian personnel were provided. In view of the regular indexation of salaries for the federal state employees, it was understood in the military servicemen community as intention of the state's military and political elite to solve macroeconomic stabilization problems at the expense of worsening the social status of families of military servicemen, military pensioners and civilian personnel of the "power bodies".

Absolute and relative indicators of the basic military expenses in accordance with the final version of the federal budget are represented in *Tables 53 and 54*.

Table 53

Direct military expenditures of the federal budget for "National defense"

| # | Name of the section and subsections | 2004, mln roub./the same in prices of 2003 | Changes in 2004 as com- pared against 2003, mln roub/ growth rates % | Share of expenditures/its changes as compared against 2003, % | |
|-----|---|---|---|---|-------|
| | | | | in Fed. Budget 2004 | GNP |
| 1 | National defense | 427 376 | 27 704 | 15.44 | 2.65 |
| | | 382 610 | 7.24 | 0.74 | -0.03 |
| 1.1 | Building and maintaining of RF Armed Forces | 403 376 | 25 026 | 14.59 | 2.50 |
| | | 361 504 | 6.92 | 0.65 | -0.04 |
| 1.2 | Military program of Minatom | 18 326 | 3 395 | 0.66 | 0.11 |
| | | 16 407 | 20.69 | 0.12 | 0.02 |
| 1.3 | Mobilization and military training for civilians | 4 696 | 34 | 0.17 | 0.03 |
| | | 4 204 | 0.82 | 0.00 | 0.00 |
| 1.4 | Collective security and peace keep- ing (preparation 189 and participa- tion) | 211 | -706 | 0.01 | 0.00 |
| | | 189 | -373.43 | -0.03 | -0.01 |
| 1.5 | Branches for the national de- fense | 343 | -46 | 0.01 | 0.00 |
| | | 307 | -14.93 | 0.00 | 0.00 |

Table 54

Direct and indirect military expenditures for other federal budget sections

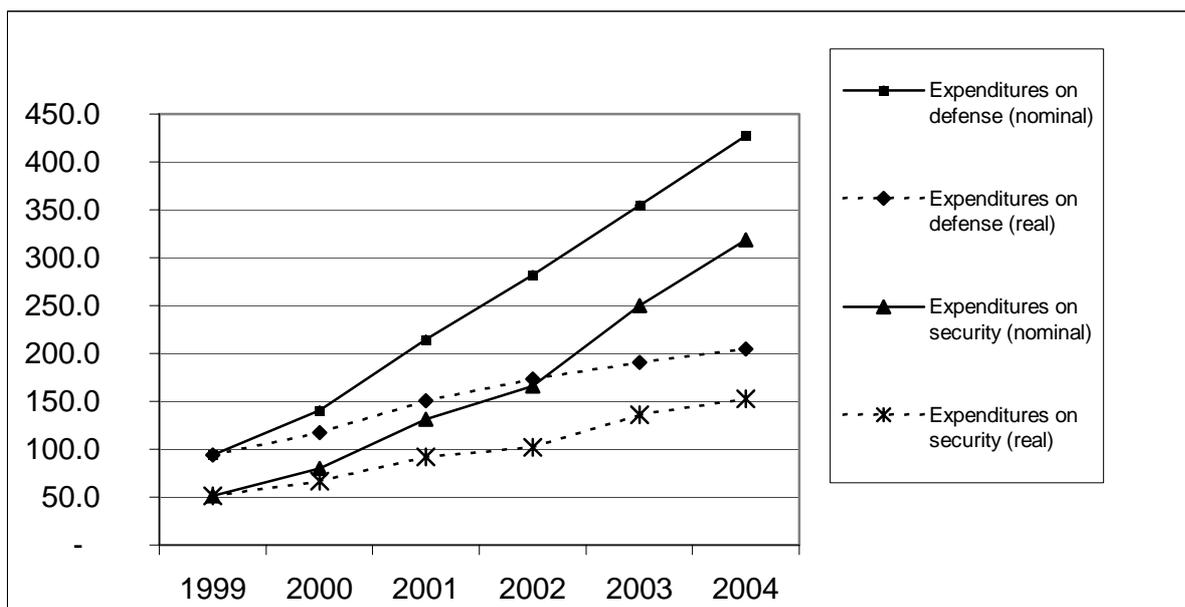
| No | Name of the section and subsections | 2004, mln rouble/the same in prices of | Changes in 2004 as compared against 2003 mln rouble | Share of expenditures/its changes as compared against 2003,% | |
|----------|---|--|---|--|-------------|
| | | | | in Fed. Budget | GNP |
| 2 | Expenditures on military organization in "Law enforcement and state security" | | | | |
| | | <u>23 347</u> | <u>1 680</u> | <u>0.84</u> | <u>0.14</u> |
| 2.1 | Internal troops of RF MIA | 20 902 | 8.04 | 0.05 | 0.00 |
| | | <u>53 571</u> | <u>-216</u> | <u>1.94</u> | <u>0.33</u> |
| 2.2 | State security bodies | 47 960 | -0.45 | -0.06 | -0.03 |
| | | <u>31 272</u> | <u>1 797</u> | <u>1.13</u> | <u>0.19</u> |
| 2.3 | Bodies of border services | 27 996 | 6.42 | 0.04 | 0.00 |
| 3 | Military and related expenditures provided for in other sections of the federal budget | | | | |
| | | <u>6 630</u> | <u>422</u> | <u>0.24</u> | <u>0.04</u> |
| 3.1 | Men, combat training, material and technical supply of MES forces (without fire service) | 5 935 | 7.11 | 0.01 | 0.00 |
| | | <u>1 093</u> | <u>-49</u> | <u>0.04</u> | <u>0.01</u> |
| 3.2 | Maintenance of special construction bodies | 979 | -4.99 | 0.00 | 0.00 |
| | | <u>1 100</u> | <u>500</u> | <u>0.04</u> | <u>0.01</u> |
| 3.3 | Mobilization preparation of economy | 985 | 49.23 | 0.02 | 0.00 |
| | | <u>67</u> | <u>-7</u> | <u>0.00</u> | <u>0.00</u> |
| 3.4 | Civil defense | 60 | -11.70 | 0.00 | 0.00 |
| | | <u>8 438</u> | <u>-10 100</u> | <u>0.30</u> | <u>0.05</u> |
| 3.5 | Military reform | 7 554 | -133.70 | -0.43 | -0.08 |
| | | <u>18</u> | <u>-43</u> | <u>0.00</u> | <u>0.00</u> |
| 3.6 | Russian defensive sports-technical organization | 16 | -266.55 | 0.00 | 0.00 |

It is noteworthy that growth of military expenditures of the Russian Federation after the 1998 crisis is of a stable character. However, as shown in *Table 55* and *Fig. 76*, in constant prices of 1999 this growth is of a fading character.

Table 55

Dynamics of expenditures on defense and security in 1999–2004

| Sections of the federal budget | Years | | | | | |
|---|---------------|----------------|----------------|----------------|----------------|----------------|
| | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 |
| Expenditures on "National defense" in prices of the budget year (1999, mln roubles) | <u>93 702</u> | <u>140 852</u> | <u>214 688</u> | <u>281 970</u> | <u>354 907</u> | <u>427 376</u> |
| Increment as compared against the previous year, % | – | 25.1 | 28.5 | 15.2 | 10.1 | 7.2 |
| Increment as compared against 1999, % | – | 25.1 | 60.7 | 85.2 | 103.8 | 118.6 |
| Expenditures on "Law enforcement and state security" In prices of the budget year (1999, mln roubles) | <u>51 324</u> | <u>79 802</u> | <u>131 621</u> | <u>165 999</u> | <u>249 799</u> | <u>318 543</u> |
| Increment as compared against the previous year, % | – | 29.4 | 39.1 | 10.6 | 32.8 | 12.4 |
| Increment as compared against 1999, % | – | 29.4 | 79.9 | 99.0 | 164.2 | 197.0 |



Source: Calculations of IET

Fig. 76. Dynamics of expenditures on defense and state security, bln roubles

As to indirect military expenditures (*Table 56*), noteworthy is their stabilization which is determined by completion of the main processes of transition of Russia's military organization to a new system. There also took place further decrease of the real (5%) expenditures on pensions to military servicemen which is stimulating loss of the military service prestige.

Table 56

Indirect military expenditures connected with previous military service

| № | Name of the section and subsections | 2004, mln roub./the same in prices of 2003 | Changes in 2004 as compared against 2003 mln roub/growth rates % | Share of expenditures/its changes as compared against 2003, % | |
|-----|---|--|--|---|-------|
| | | | | in Fed. Budget 2004 | GNP |
| 4.1 | Pensions to military servicemen | 66 606 | -2 969 | 2.41 | 0.41 |
| | | 59 629 | -4.98 | -0.19 | -0.06 |
| 4.2 | Utilization and liquidation of armaments, including performance of international agreements | 10 944 | -962 | 0.40 | 0.07 |
| | | 9 797 | -9.82 | -0.05 | -0.01 |
| 4.3 | Conversion of defense industry | 190 | -80 | 0.01 | 0.00 |
| | | 170 | -46.97 | 0.00 | 0.00 |

Table 57

**Summary indicators of military
and related expenditures**

| No | Name of expenditures | Expenditures (mln roubles) | Share of expenditures/its changes as compared against 2003, % | |
|----|--|-------------------------------|--|-------------|
| | | | In federal budget 2004 | GNP |
| 1 | Summary direct military expenditures | 544 474 | <u>19.67</u> | <u>3.38</u> |
| | | | 0.80 | -0.06 |
| 2 | Summary direct and indirect military expenditures connected with the present and past military service | 630 651 | <u>22.78</u> | <u>3.91</u> |
| | | | 0.13 | -0.22 |
| 3 | Total expenditures on national defense, law enforcement and national security | 745 919 | <u>26.95</u> | <u>4.62</u> |
| | | | 1.90 | 0.06 |
| 4 | Summary direct and indirect federal expenditures connected with the present and past military and law enforcement and state security | 881 768 | <u>31.85</u> | <u>5.47</u> |
| | | | 1.20 | -0.12 |

Data on performance of the military and related expenditures, based on Ministry of Finance monthly reports concerning performance of the consolidated budget, are represented in *Table 58* and *Fig. 77*. When analyzing them, account should be taken of the fact that in 2004, the Ministry of Finance turned to quarterly allocation of expenditure quotas whereas in 2003, such quotas were determined on a monthly basis. Effect of such innovation seems to be rather doubtful because, for example, with the general excess of the planned level of expenditures on "Building and maintenance of the Armed Forces" in the amount of 3.2 bln roubles, indebtedness to the Defense Ministry's suppliers comprised in the end of the year more than 5 bln roubles. Accordingly, it seems somewhat paradoxical that significant financial effect was achieved with regard to articles "State security bodies", "Pensions to servicemen of the RF Defense Ministry" and "Military reform" where savings comprised 1.7, 1.7 and 2.2 bln roubles, respectively.

Table 58

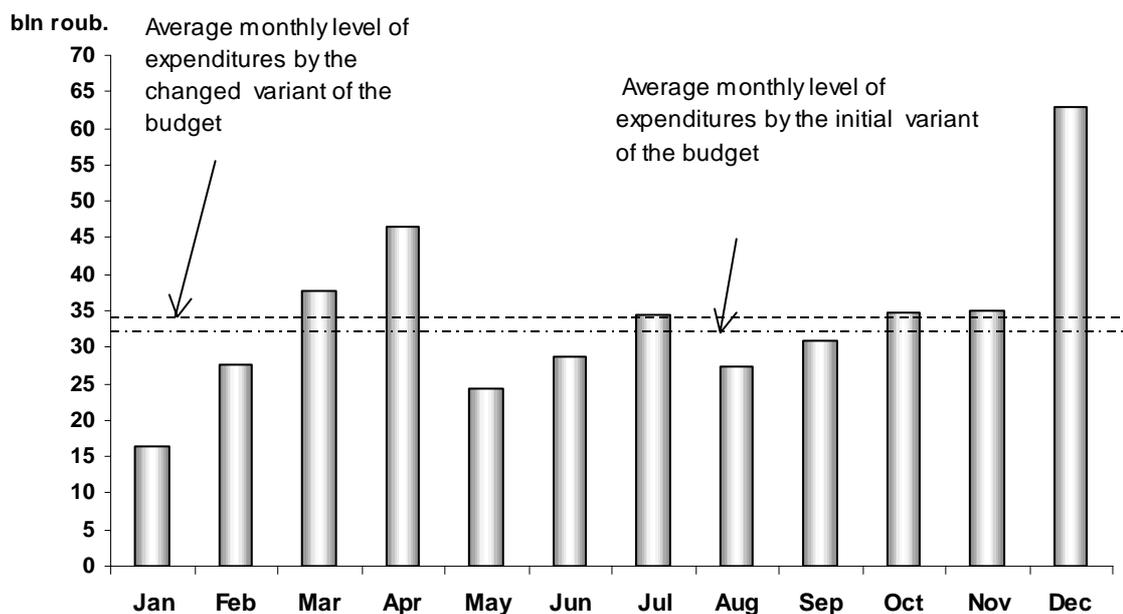
**Performance of military and related expenditures in the federal budget
by months, mln roubles**

| No | Expenditures | Plan/Plan with corrections | January | February | March | April | May | June | July | August | September | October | November | December | Saving (over-expenditure) |
|-----|---|----------------------------|---------|----------|--------|--------|--------|--------|--------|--------|-----------|---------|----------|----------|---------------------------|
| 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 | 11 | 12 | 13 | 14 | 15 | 16 |
| 1 | National defense | <u>411</u> | 18 432 | 30 310 | 40 597 | 96 218 | 22 084 | 29 158 | 37 042 | 28 888 | 32 511 | 36 217 | 36 868 | 65 806 | (2 586) |
| | | <u>473</u> | | | | | | | | | | | | | |
| 1.1 | Building and maintaining of RF Armed Forces | <u>427</u> | 16 467 | 27 670 | 37 610 | 46 581 | 24 457 | 28 727 | 34 479 | 27 424 | 31 026 | 34 795 | 34 984 | 62 801 | (3 222) |
| | | <u>376</u> | | | | | | | | | | | | | |
| 1.2 | Military program of Minatom | <u>389</u> | 1 842 | 2 346 | 2 539 | 1 092 | 1 122 | - | 2 189 | 1 148 | 1 157 | 1 097 | 1 519 | 2 275 | |
| | | <u>402</u> | | | | | | | | | | | | | |
| 1.3 | Mobilization and military training of civilians | <u>403</u> | 119 | 254 | 397 | 398 | 330 | 413 | 356 | 308 | 317 | 301 | 298 | 591 | 614 |
| | | <u>800</u> | | | | | | | | | | | | | |
| | | <u>16 826</u> | | | | | | | | | | | | | |
| | | <u>18 326</u> | | | | | | | | | | | | | |
| | | <u>4 687</u> | | | | | | | | | | | | | |
| | | <u>4 696</u> | | | | | | | | | | | | | |

RUSSIAN ECONOMY in 2004
trends and outlooks

| No | Expenditures | Plan/Plan with corrections | January | February | March | April | May | June | July | August | September | October | November | December | Saving (over-expenditure) |
|-----|---|---------------------------------------|---------|----------|--------|------------|------------|--------|--------|--------|-----------|---------|----------|----------|---------------------------|
| 1.4 | Collective security and peace keeping (preparation and participation) | 215 211 | 2 | 16 | 15 | 17 | 25 | 18 | 18 | 8 | 10 | 25 | 22 | 16 | 21 |
| 1.5 | Branches for the national defense | 343 343 310 | 2 | 24 | 36 | 43 | 68 | - | - | - | - | - | 45 | 341 | 1 |
| 2 | Law enforcement and internal troops | 577 318 543 21 531 23 347 | 11 189 | 22 435 | 26 656 | 27 650 | 20 970 | 27 870 | 25 085 | 22 409 | 27 344 | 25 688 | 28 246 | 49 809 | 3 192 |
| 2.1 | Internal troops | 21 531 23 347 | 720 | 1 397 | 1 868 | 1 927 | 1 725 | 2 206 | 1 888 | 1 836 | 1 990 | 1 981 | 2 467 | 3 575 | (233) |
| 2.2 | State security bodies | 49 737 53 571 | 2 536 | 3 634 | 3 915 | 4 258 | 3 498 | 4 045 | 4 558 | 3 391 | 4 170 | 4 001 | 3 710 | 10 146 | 1 709 |
| 2.3 | Bodies of border services | 29 993 31 272 | 803 | 1 355 | 2 035 | 2 683 | 1 896 | 2 538 | 2 028 | 2 768 | 2 586 | 2 626 | 3 016 | 6 377 | 561 |
| 3.1 | Conversion of defense | 190 190 | 15 | 19 | - | 56 | 16 | - | - | - | - | - | 81 | 4 | |
| 3.2 | Maintenance of special construction bodies | 1 089 1 093 | 19 | 89 | 84 | 101 | 82 | 95 | 93 | 69 | 74 | 62 | 64 | 142 | 119 |
| 4.1 | Prevention and liquidation of consequences of | 15 705 15 977 | 713 | 1 054 | 1 250 | 1 708 | 1 005 | 1 429 | 1 343 | 1 302 | 1 285 | 1 304 | 1 393 | 2 083 | 106 |
| 4.2 | Civil defense | 67 67 | - | - | 13 | 3 | 8 | 3 | 5 | 14 | - | 10 | 2 | 8 | |
| 5 | Pensions to military servicemen | 66 606 66 606 | 5 225 | 5 253 | 5 381 | 8 127 | 2 676 | 5 382 | 5 396 | 5 515 | 5 475 | 5 500 | 5 448 | 5 480 | 1 747 |
| 6 | Utilization and liquidation of armaments, including performance of international agreements | 10 365 10 944 | 457 | 844 | 1 453 | 310 | 1 653 | 79 | 588 | 1 201 | 528 | 1 075 | 1 106 | 1 632 | 17 |
| 7 | Mobilization of economy | 1 100 1 100 | 17 | 36 | 124 | 258 067 | 257 860 | 7 | 37 | 13 | 45 | 103 | 252 | 252 | 8 |
| 8 | Military reform | 7 246 8 458 | 328 | 594 | 713 | 561 | 379 | 586 | 546 | 325 | 743 | 393 | 364 | 739 | 2 185 |

As can be seen from the comparative analysis of the defense expenditures structure of a number of foreign countries (*Fig. 78*), a rather popular opinion about an insufficient level of the investment component in Russia's military expenditures is most likely just a habitually wrong understanding. Should the decision of the RF Security Council on the "optimum" share of expenditures on the respective development equaling 40%, be implemented, then Russia will be among the top in this indicator category leaving behind the USA, the Great Britain and Germany. Whether this is really needed and what the effect of such "optimality" will be, to a considerable extent still remains a question with no answer. Neither the criterion of optimization nor its methodology are yet known to the Russian scientific community. So far, the funding of the investment component, for instance, in the Defense Ministry are to a considerable extent formed at the expense of expenditures on the money allowances and salaries what its governing bodies are absolutely not shy to officially and regularly declare in different mass media means.



Source: Calculations of IET based on the RF Ministry of Finance data.

Fig. 77 Expenditures on building and maintenance of RF Armed Forces in 2004.

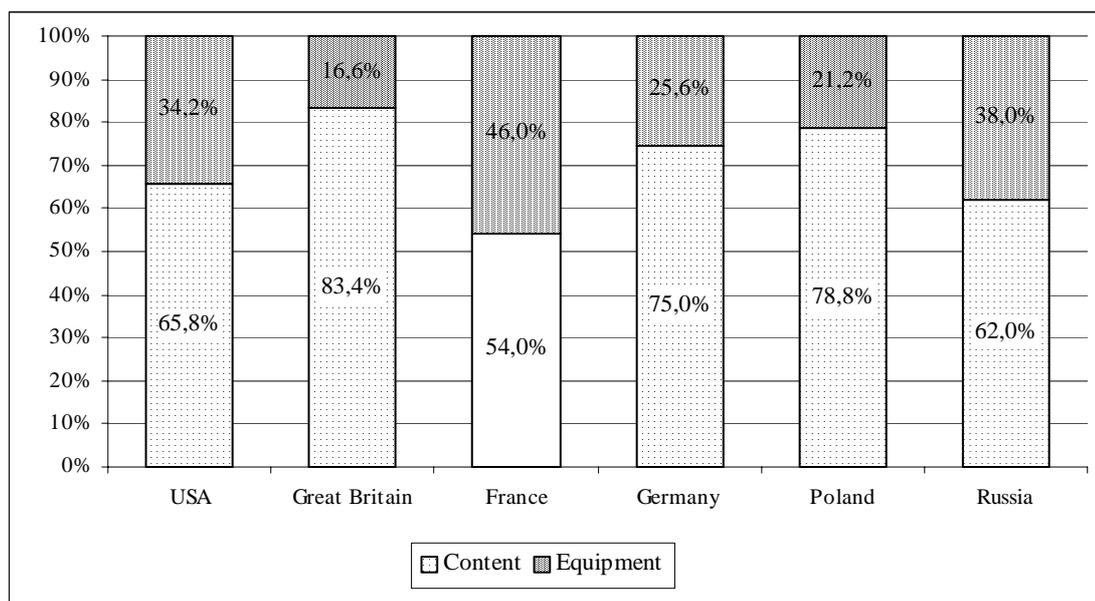


Fig. 78 Structure of expenditures on equipment and maintenance of armed forces of a number of countries in 2004.

Sources: 1. Der Verteidigungsetat 2004. Einzelplan 14/2004 im Vergleich zum Haushalt 2003 (in der vom Parlament verabschiedeten Fassung, Stand 28.11.2003);
 2. UK Defence Statistics Factsheet 2003 Edition. – London: The Stationery Office, 2003;
 3. Budget of the United States Government Fiscal Year 2006;
 4. Budget de la defense pour 2004. Novembre 2003;
 5. Podstawowe informacje o budziecie MON na 2004 rok. – Warszawa: Ministerstwo obrony narodowej, 2004.

3.8.3. Problems of further modernization of Russia's military organization

Within the executive power reform which started in the year of 2004, a principally new, the main and a priority element in the activities of the RF Defense Ministry and other "power bodies", as the respective state government organs, in 2005 will most likely be restructuring the budget planning activity, the routine activity itself and the respective accounting procedures. To be put to good order are to be the following activity parameters of all subjects of planning, the "power block" included:

1. Objectives and tasks of activities;
2. Obligations with regard to expenditures and formation of returns;
3. Results of activities;
4. Distribution of expenditures by objectives, tasks and programs;
5. Results of the budget expenditures.

Accordingly, these parameters determine the section names of a special document called: "Report on the Results and the Main Directions of Activities of the Budget Planning Subjects". Actually, some of the above parameters were also formulated in such documents as: "The National Security Concept" (NSC), "The Military Doctrine" (MD), "The Fundamentals of the RF State Policies in the Field of the Military Organization" (Fundamentals) and others. Distribution of expenditures by objectives, tasks and programs as well as estimating the results of the respective activities in close coordination with expenditures for the RF Defense Ministry on the whole is a principally new task, which is but only partially familiar to the RF Defense Ministry administration officers, for example, from the experience they gained when working out the State Program of Armaments" (SPA).

If we take the first group of the above parameters of activities alone, even then close coordination of *strategic objectives*, *tactical tasks*, and *targeted programs*, as required by the Government, will nevertheless turn out to be quite problematic. No less problematic seems to be coordination of a number of indicators in time.

The published methodological recommendations (MR) do contain an approximate list of Russia's strategic objectives to be used in working out the said Reports but it is neither exhaustively full nor sufficiently enough satisfies the requirements to formulating such objectives by the MR themselves. Besides, the corresponding objectives of the budget planning subjects, in particular such for the Defense Ministry's activities, are to be worked out for each strategic objective of the country. This approximate list does have certain notional faults as well, such as, for example, division of threats into external and internal ones although the difference between them consists only in the fact that aggression is initiated not by foreign states but by transnational centers which usually tend to operate in secret and under cover.

Noteworthy is also one more requirement with regard to the objectives and tasks which determine activities of the budget planning subjects. This is conditioned by a simple fact that one of the most important sections of the Report, namely "Distribution of expenditures by objectives, tasks and programs" (see above, p. 4, in the list of parameters and sections), must be first worked out and then practically used. However, in accordance with both the Budget Code and the Law on the Budget Classification, expenditures must be distributed according to the officially approved classification groupings of expenditures, primarily so by sections, subsections, specialized articles and expenditure types of the budget functional classification.

The structure of two expenditure sections and their subsections in the Federal Budget for the year of 2005 (FB – 2005), to such or other extent connected with ensuring the national military security, is presented in *Table 59*. This *table* also contains the ap-

proved values of respective expenditures as well as shares of expenditures by subsections in each section.

Values of future military expenditures permit to make the following conclusion: Expenditures on the “national defense” have grown in the absolute value and are expected to comprise the figure of 533.1 bln roubles or about 16% of the FB expenditures. In relation to the GNP, the level of expenditures will change rather insignificantly.

The structure of expenditures does not clearly show what part of such will be allocated to the technical equipping of the RF Armed Forces although, according to official declarations of the Defense Minister, it equals 186.9 bln roubles (35.2% of the total expenditures). The said structure includes expenditures on R&D (33.7%), on purchasing new and modernized models of MAT (60%) and on repairing MAT (6.3%). Any proof as to how optimal such expenditures distribution is, or may be, is not yet known either.

The social component of the military expenditures still continues to be criticized by both military servicemen and civilian personnel. No indexation of the basic pay is provided for in the budget, nor many people seem to be very happy about the increasing special allowances. To avoid social protests, early in 2005, the RF President instructed the RF Government to find a positive solution for these social problems of all those connected with the country’s military security at the expense of the expected additional revenues.

Comparison of the budget expenditure groupings, as represented in *Table 59*, with the strategic aims (both shown in the said methodological recommendations and those mentioned earlier in the approved conceptual documents) inevitably leads to a conclusion that *they do not correspond with each other*.

Moreover, such classification structure of the military expenditures in the RF was different in the earlier years (it is changed almost every year) which will make analysis of expenditures for the period of six years, including the previous years, undoubtedly much more difficult. Suggestions contained in the said methodological recommendations, i.e. to group expenditures of the functional and economic classification by objectives and tasks, are actually rather hard to practically implement. Sufficiently accurate in this case can only be presentation of such expenditures by objectives and by the budget classification groups simultaneously.

Little doubt causes something else: if all the state spending is to be put under control then the same should be extended to the so called “non budget returns” of the RF Defense Ministry and other “power bodies” as well. These must become sufficiently obvious for the budget and be put under control.

Moreover, the problem of inconsistencies is not at all exhausted with that. For, there is a number of by-laws setting aims and objectives of the budgetary planning subjects. This primarily concerns the so called “power bodies” – subjects of the budgetary planning.

For instance, in the Regulations on the RF Defense Ministry, by the Decree of the President of the Russian Federation, dated 16.08.04, functions of this ministry are set as consisting of:

1. working out and implementing state policy in the field of defense;
2. normative and legislative regulation in the field of defense;
3. performing other functions in the same area as established by the respective RF laws, presidential Acts and the Government of the Russian Federation.

Table 59

**Structure of budget expenditures connected with
ensuring the national security**

| Name of section and subsection | Amount (mln rouble). | Share in summary expendi- tures % |
|---|-------------------------|--|
| National defense | 531 139.2 | 100 |
| Armed Forces of the Russian Federation | 388 028.8 | 73.1 |
| Mobilization and military training of civilians | 1 895.4 | 0.4 |
| Mobilization preparation of economy | 3 500.0 | 0.7 |
| Collective security and peace keeping (preparation and participation) | 61.1 | 0.0 |
| Nuclear and weapons complex | 8 693.1 | 1.6 |
| International obligations in the area of military and technical cooperation | 6 231.0 | 1.2 |
| Applied scientific research in the field of national defense | 79 189.9 | 14.9 |
| Other matters in the area of national defense | 43 539.9 | 8.2 |
| National security and law enforcement | 398 889.5 | 100 |
| Internal troops | 23 893.8 | 6.0 |
| Security bodies | 62 315.8 | 15.6 |
| Border services | 31 685.0 | 7.9 |
| Prevention and liquidation of consequences of emergencies and natural calamities, civil defense | 22 054.7 | 5.5 |
| Applied scientific research in the field of national security and law enforcement | 2 654.3 | 0.7 |
| Other matters in the area of national security and law enforcement | 19 100.1 | 4.8 |

The said Regulations contain neither directions nor formulations of the objectives to be reached which needs implementing of the said functions. So, on the face of it, there can be no contradictions with any suggestions concerning activities of the RF Defense Ministry. However, further on, the Regulations explicitly state the tasks of the Defense Ministry and if these are considered as tasks of the budgetary planning subject, then, due to the absence of respective objectives, these tasks turn out to be, figuratively speaking, pointless. Of the ten tasks, enumerated in the Regulations on the RF Defense Ministry, the first three and the tenth one apply to working out the policy and the respective normative and legislative regulation but in the most general form. Accordingly, estimating the solution of these tasks can be only strictly formal. Hence, there will be no practical possibility either to evaluate the degree of solving such tasks or to make workable conclusions as to rationality of the respective military expenditures.

Very much the same can be said about tasks of the Defense Ministry in the field of coordination. The said formulation of the tasks make it practically impossible to understand the exact purpose of such coordination or where it is actually leading to. To give an account of their performance is indeed possible but again – in a strictly formal form. Which will undoubtedly contradict the very idea of the said reforming the system of state governance.

The above analysis results of documents which do not sufficiently enough coincide with each other, permit at this stage to work out but only some *proposals of conceptual nature* which are connected with the reform of the state governance in the RF and relate to the sphere of activities of the RF Defense Ministry.

1. First of all, in our opinion, we must change our understanding as to the practical use of the RF Armed Forces in the present, relatively peaceful time. This relates, for example, to the intelligence and analytical activities of the Main Intelligence Department of the

General Staff and other departments of the RF Defense Ministry aimed mainly at timely revealing of military threats and ways to efficiently parry them back. Novelty of the present situation lies in the transnational nature of military threats and their merging with the terrorist separatism in the Russian Federation.

2. The objective of technically equipping the RF Armed Forces must be made and kept contentually adequate and fully in accordance with the changes in the tactical and technical parameters (TTP) of the armed struggle means and principally new features of the contemporary period in the economic development of humanity.
3. Content of the task connected with solving social problems of military servicemen, must be tied up with ensuring a high social status for all categories of such servicemen and full exclusion of the compulsory military service in regular military forces in peaceful time.
4. The most radical changes must be made in the content of the basic military tasks in peaceful time. For, the main for many combat branches now is not combat readiness for possible hypothetical military actions but combat watch, force determent of aggression and solution of other concrete military tasks aimed at preventing any aggression. *Later on, these kinds of activities must become main for all kinds and branches of the Armed Forces.*

Analysis of the Regulations on the RF Ministry of Internal Affairs (MIA), approved by the RF President in his Decree, dated 19.07.04, resulted in the following conclusions: the established functions of this ministry consist in working out and practically implementing the state policy as well as in the normative and legislative regulation in the sphere of internal affairs, matters of migration included.

One of the MIA tasks is that of controlling its internal troops (IT MIA) and organizing their practical functioning. But the nature of such activities is not at all specified in the said Regulations. Nor there is any confirmation of the task which was posed to the troops in the previous version of the "Fundamentals of the State Policy in the Field of Military Organization", namely "suppression, localization and neutralization of internal armed conflicts on the territory of the Russian Federation". There is only one clause of authorities determining participation of the RF MIA in "securing the wartime regime" as well as in "conducting measures of the wartime regime".

Accordingly, to plan the budget spending on the MIA internal troops as well as to estimate the efficiency of their activities on the basis of such task setting can hardly be deemed possible.

Such situation with determining the role of *other troops and military formations* in other bodies having them at their command, is quite similar.