

**RUSSIAN ECONOMY: TRENDS AND PERSPECTIVES**  
**June 2004**

**MONTHLY BULLETIN**

**Moscow**  
**2004**

---

© Institute for the Economy in Transition, 1996. Licence, ИД № 02079 от 19 июня 2000 г.  
5 Gazetny pereulok, Moscow 103918, Russian Federation  
Phone: (095) 203-88-16 Fax: (095) 202-42-24 E-Mail: [todorov@iet.ru](mailto:todorov@iet.ru)

June of 2004: Political and economic outcomes .....	3
The State of the Federal Budget.....	5
Taxation of organizations' proceeds: key changes in the first six months of 2004.....	9
Monetary policy .....	11
Financial Markets.....	13
The Market for Corporate Securities.....	15
Investment in the real sector of the economy.....	23
Choice of instruments meant for investing pension savings funds .....	25
Foreign investment in the Russia's economy .....	30
The Real Sector: Factors and Trends.....	34
Oil-and-gas sector .....	37
IET Business Survey: Industry in June of 2004 .....	40
Foreign trade .....	41
Outcomes of applying variable import tariff on sugar market .....	44
Russia and the Bologna Process: the current state of the problem.....	47
Scenario based macroeconomic forecast for 2004 and 2005 .....	50
Issues discussed at the meetings held by the Government of the Russian Federation held on June 10 and 17 of 2004.....	59
Review of economic legislation: June of 2004.....	63

## **June of 2004: Political and economic outcomes**

---

June of 2004 witnessed the second tragedy in the North Caucasus in two months. On June 22, a large group of guerillas (up to 200 fighters) suddenly attacked checkpoints and the building of the Republican office of the Internal Ministry in the Ingush Republic. Guerillas posted at the captured checkpoints their masked sentries (due to the fact that masks are a constant attribute of the Russian troops, this trick had worked and there were numerous casualties). The fighters shot all officers of military and paramilitary units with the exception of officers of traffic police and the Ministry of Emergencies, as well as people they suspected to support Ingush President Zyazikov. The number of casualties made not less than 80 people, the building of the regional office of the Internal Ministry was burnt down; the guerillas disappeared without trace and practically without casualties. It should be noted that the terrorists used a principally different approach – in stead of attacking military units on the territory of the Chechen Republic and neighboring regions and civilian population in Russia, the attack on Ingushetia was primarily aimed at officials of the Republican administration loyal to the federal center. The “official” propaganda materials of fighters declared this attack to be a punitive action carried out in revenge for persecution of Chechen refugees and mass disappearances of people in the Republic of Ingushetia.

The Ingush tragedy demonstrated both the overall weakness of the Russian law enforcement system, and the persistence of a serious terrorist threat in the North Caucasus. The objectives of this terrorist raid, as well as the recent terrorist attack in the town of Grozny clearly demonstrate that guerillas see local police and military officers loyal to Russia as the major threat and use the abuses conducted by different Russian military and paramilitary units as a pretext for declaring local officers to be collaborationists. The illusion that the “Constitutional field” exists in the North Caucasus prevents the implementation of efficient measures aimed at the legislative imposition of the state of emergency, which may include certain components of the martial law. These measures might be tough, but they will create a predictable and clearly defined situation in the North Caucasus.

In June, the situation in the neighboring Chechnya somewhat stabilized. Different groups of the pro-Russian administration could nominate A. Alkhanov, the head of the Republican office of the Interior Ministry as the single Presidential candidate. Alkhanov, who presumably fought on the side of federal troops during the first Chechen war, became a key figure in the Kadyrov’s administration during the second war. Therefore, there could be prevented a potential split, which could become inevitable in the case of appointment of an official not connected to the pro-Russian Chechen administration. Naturally, it is too early to judge about policy changes in the Chechen Republic before the official elections of the new President of Chechnya.

As concerns the federal political developments, in June the key events were the unfolding YUKOS affair and the statement made by the former Prime Minister M. Kasyanov about his plans for the future.

At the background of the started trial of M. Khodorkovsky and his colleagues, the emigrated shareholders of YUKOS stated that they have no information about terms and conditions offered by the official authorities, however, they were ready to negotiate, what Russian officials had earlier indicated as an alternative to the court proceedings.

On June 17, 2004, V. Putin in his speech held in Tashkent pointed out that “the official authorities of the RF and the economic authorities of the country are not interested in the bankruptcy of a company like YUKOS.” “Debt is the issue to be considered by courts and another issue is how they are being assessed. While these activities are unfolding, the government will try to prevent the company from collapsing,” the Russian President emphasized. However, the enthusiastic response on the part of the stock market seems to be not substantiated – V. Putin had made similar statements earlier (for instance, he expressed his doubts in the feasibility of the arrest of the company’s assets in November of 2003), but these statements had no real consequences. Other facts are of greater importance: first, the court proceedings were practically suspended under pretexts, which courts earlier refused to take into account, like the illness of the Khodorkovsky’s lawyer, his necessity to familiarize himself with the facts of the case, etc.), and, second, the statement made by V. Rusakova, the head of the Gazprom department of strategic development, which was disavowed the next day, that Gazprom is ready to participate in a tender for YUKOS property in the case the company went bankrupt, third, the personal

changes in the top management of the company (S. Kukes was replaced by V. Gerashchenko as the Chairman of YUKOS, what was a logical consequence of the statements made by the former, including hostile remarks addressed to the company's shareholders, involvement of B. Jordan in the affair, etc.), as well as probable personal changes in the Gazprom management. It can not be excluded that there is prepared a large deal aimed at the creation of a new "super-company" on the basis of Gazprom, which already owns chemical, metallurgical, and growing energy assets. It is still unclear what form of squeezing major YUKOS shareholders out of Russia may be chosen and what are the limits of their possible resistance.

At the end of June, Mikhail Kasyanov made public his proposals to create a bank on the basis of the International Investment Bank (IIB) and the International Bank for economic cooperation (IBEC) and increase their authorized capitals at the expense of Euro 2 billion to be allocated from the reserves of the Russian Central Bank. Mr. Kasyanov announced that he was ready to head such a bank and, according to Kasyanov, he had discussed this issue with President Putin. The new bank should invest in infrastructure projects, which could help to meet growing EU demand for Russian energy resources and, according to M. Kasyanov, the necessary amount of investment was at about Euro 30 to 40 billion. It should be reminded that all suggestions about the new job for the former Prime Minister published earlier were not confirmed. Observers surmised that M. Kasyanov might be really going to engage in public activities as he hinted in February. Nevertheless, the former Prime Minister did not exclude this possibility, although not earlier than in 2007 (the year of the next Parliamentary elections). These intentions of M. Kasyanov may be related to the numerous problems faced by his new project, since neither EU, nor CIS seem to be ready to finance it, and there exist a number of legal and international difficulties. However, a successful implementation of this process does not preclude future political activities.

On June 25, 2004, the Board of Directors of the RAO UES of Russia failed to take the expected decision concerning the key issue of the reform in the sphere of electrical power engineering, i.e. the method of sale of shares in the wholesale generating companies (WGC). According to M. Fradkov, the settlement of this problem is delayed till the end of the year. Earlier, M. Fradkov had promised to resolve the issue personally before July 1, 2004. It should be noted that Gazprom failed to fulfill its numerous promises (made not only by the company managers, but also by President Putin) to liberalize the stock market in the nearest future. Therefore, it may be asserted that the reform of natural monopolies has been fully stopped and there were renewed "consultations for the purposes of consultation" often accompanied by buying up of falling shares, what was the case of the securities of the RAO UES in 2001 and 2002.

As it had been predicted by many experts, in June there occurred the first open conflict between the governmental officials and the United Russia party controlling the Duma in relation to the draft law on monetization of allowances. It was envisaged that the federal budget should pay compensations in stead of allowances (this measure should concern 14.27 million disabled persons, participants of wars, people participated in the liquidation of the Chernobyl catastrophe consequences, etc.), while certain cash expenditures would be devolved to the regional level (i.e. the respective compensations would depend on the financial well-being of regions). At the same time, certain benefits and privileges mostly related to non-funded mandates should be abolished. In fact, the reform envisages not only overall diminishing of the social burden on the state, but also redistribution of resources in favor of allowance recipients residing in rural areas and small towns at the expense of the beneficiaries living in large cities (monetization of privileges is unfavorable for residents of large cities, while population of rural areas and small towns, where benefits can not be used or their costs are low will be the better for it). As a result, the Duma group of the United Russia party approved the general principles including the maintenance of in kind allowances with respect to public transport tickets, free medicines, and medical treatment at resorts, as well as not to exclude the concept of the minimal wage as the basis of calculation of the unified tariff schedule from the Labor Code. In fact, these decisions mean the rejection of the key principles of the reform. Experts also predict that due to the first serious failure of the Government the influence of A. Zhukov, who formally represents the United Russia party in the Government, delegated for negotiations with deputies.

As concerns parties' activities, an important event in June was the SPS congress. The congress not only failed to elect a new leader, but even set the date of such elections (it should be noted that the SPS congress deputies could not agree on other issues as well, including the agenda and counting of

the votes). It seems that SPS becomes a classical non-Parliamentary party, the influence of which is in inverse ratio to the internal struggle for leadership and control over the party machinery.

The preparation of the KPRF congress to be held in early July also encountered difficulties. At present, the group of G. Zyuganov's supporters (it should be noted that it is a rather mixed group) intensifies its activities in regions aimed at the condemnation of the positions taken by G. Semigin, who was expelled from the party as a dissenter under the pretext of his participation in the new project "Patriots of Russia." In the course of political struggle, the Zyuganov's group could consolidate support of regions. At the same time, there may be observed surprising developments, since G. Semigin has the possibility to invest in the party. On the whole, it is expected that G. Zyuganov will retain his post as the KPRF Chairman; however, the "Semigin's opposition" will also survive.

As concerns the sphere of good governance development, the RF President has signed the new law "On referendum." It should be reminded that referendums (although not held since 1993) are a rather powerful tool for both influencing the authorities and carrying out political advertising campaigns. The key stipulation of the law is the requirements concerning the collection of signatures: 4.5 thousand people, about 100 campaigners in each region (not less than 45 regions) should after certifying their own signatures with public notaries collect about 2 million signatures in support of a referendum. No other persons will have the right to collect signatures. In fact, this decision is aimed at the liquidation of any possibility to held referendums in Russia, since the bureaucratic barriers introduced by the new law effectively prevent it. The new law, as well as approved earlier amendments to the law "On meetings..." are an evidence that the authorities seriously apprehend popular discontent about the currently pursued policies, since no preceding Government considered such measures necessary.

*S. Zhavoronkov*

---

## **The State of the Federal Budget**

---

In April of 2004, the revenues of the federal budget increased to 20.4 per cent of GDP, while revenues of the consolidated budget grew by about 3 p. p. in comparison with the figures registered in the preceding month and made about 32.8 per cent of GDP. To a considerable degree, the growth of the budget revenues was determined by high level of revenues generated by the profit tax both in the federal budget, and in the budgets of RF subjects. For instance, in April of 2004, profit tax revenues of the RF consolidated budget in real terms exceeded the figures observed in the respective period of the preceding year almost 1.5 times.

According to the estimates made by the RF Government, in 2005 the amount of the stabilization fund shall make Rub. 500 billion. The RF Government is planning to utilize all additional receipts of the stabilization fund for financing of interest expenditures relating to the foreign public debt and of the RF Pension Fund, what could permit to reduce the deficit, which emerged in the result of the reduction of the SST rate in 2005. The Government is also planning to introduce a number of amendments to article 25 of the RF Tax Code more clearly defining the issues pertaining to the profit tax application. Besides, as concerns VAT it is planned to switch from taxation treatment based on the "country of origin" principle to the "country of destination" principle with respect to trade with oil and natural gas vis-à-vis the CIS member countries.

In January through April of 2004, the revenues of the federal budget (cash execution) made 20.4 per cent of GDP, while expenditures made 16.8 per cent of GDP (see Table 1). Therefore, the federal budget surplus made 3.6 per cent of GDP.

Table 1

**The monthly execution of the federal budget of the Russian Federation  
(in % of GDP<sup>1</sup>, cash execution).**

	III'03	IV'03	V'03	VI'03	VII'03	VIII'03	IX'03	X'03	XI'03	XII'03	I'04	II'04	III'04	IV'04
Revenues														
Profits tax	1.4%	1.5%	1.4%	1.4%	1.4%	1.3%	1.3%	1.3%	1.3%	1.3%	0.9%	0.7%	1.2%	1.4%
Income tax	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Unified social tax (UST)	2.8%	2.9%	2.9%	2.8%	2.8%	2.8%	2.7%	2.7%	2.6%	2.7%	2.3%	2.6%	2.8%	2.9%
Indirect taxes	9.9%	9.6%	9.6%	9.2%	9.1%	8.9%	8.7%	8.6%	8.5%	8.5%	10.5%	8.5%	7.6%	7.6%
VAT	7.2%	7.2%	7.2%	6.9%	6.9%	6.8%	6.7%	6.6%	6.6%	6.6%	8.1%	6.6%	6.2%	6.4%
Excises	2.6%	2.4%	2.3%	2.2%	2.2%	2.1%	1.9%	1.9%	1.9%	1.9%	2.3%	1.8%	1.4%	1.2%
Taxes on foreign trade and foreign economic transaction	3.4%	3.5%	3.5%	3.4%	3.4%	3.4%	3.3%	3.3%	3.4%	3.4%	3.6%	4.2%	4.4%	4.7%
Other taxes, fees and levies	2.0%	2.2%	2.1%	2.0%	2.0%	2.0%	2.0%	2.0%	2.0%	2.0%	2.5%	0.1%	-0.2%	-0.2%
Total taxes and other payments **	19.4%	19.6%	19.4%	18.8%	18.7%	18.4%	17.9%	17.9%	17.9%	18.0%	19.9%	16.1%	15.9%	16.4%
Non-tax revenues	1.3%	1.2%	1.7%	1.6%	1.5%	1.5%	1.4%	1.4%	1.3%	1.3%	0.9%	0.8%	0.9%	1.0%
Total revenues	20.9%	21.0%	21.3%	20.6%	20.4%	20.0%	19.5%	19.4%	19.3%	19.4%	20.9%	19.6%	19.7%	20.4%
Expenditures														
State administration	0.4%	0.4%	0.4%	0.4%	0.4%	0.4%	0.4%	0.4%	0.4%	0.5%	0.2%	0.3%	0.4%	0.4%
National defense	2.6%	2.7%	2.7%	2.6%	2.6%	2.6%	2.5%	2.5%	2.5%	2.7%	1.8%	2.2%	2.6%	2.9%
International activity	0.2%	0.2%	0.3%	0.2%	0.2%	0.2%	0.2%	0.2%	0.2%	0.2%	-0.1%	0.2%	0.2%	0.3%
Judicial authorities	0.1%	0.2%	0.2%	0.2%	0.2%	0.2%	0.2%	0.2%	0.2%	0.2%	0.1%	0.1%	0.2%	0.2%
Legal protection and security	1.7%	1.7%	1.7%	1.8%	1.7%	1.7%	1.7%	1.7%	1.7%	1.9%	1.1%	1.5%	1.7%	1.9%
Fundamental research	0.2%	0.2%	0.3%	0.3%	0.3%	0.3%	0.3%	0.3%	0.3%	0.3%	0.1%	0.1%	0.2%	0.3%
Services to national economy	0.5%	0.6%	0.7%	0.8%	0.8%	0.8%	0.9%	0.9%	0.9%	1.1%	0.2%	0.4%	0.5%	0.6%
Social services	2.0%	2.3%	2.2%	2.2%	2.2%	2.2%	2.1%	2.1%	2.1%	2.3%	1.4%	1.7%	1.9%	2.1%
Government debt servicing	3.0%	2.3%	2.1%	2.0%	1.8%	2.0%	2.0%	1.8%	1.7%	1.7%	1.1%	2.1%	2.2%	1.7%
Other expenditures	7.0%	7.0%	7.1%	7.1%	7.1%	7.0%	6.9%	6.8%	6.8%	6.9%	5.3%	5.8%	5.9%	6.5%
Total expenditures	17.7%	17.7%	17.7%	17.5%	17.4%	17.3%	17.1%	16.8%	16.7%	17.7%	11.1%	14.4%	15.8%	16.8%
Surplus (+) / deficit (-)	3.2%	3.3%	3.6%	3.0%	3.0%	2.7%	2.5%	2.6%	2.6%	1.7%	9.8%	5.2%	3.8%	3.6%
Internal financing	-1.0%	-1.0%	-0.5%	0.3%	0.0%	0.3%	0.2%	-0.1%	-0.3%	0.5%	-8.8%	-3.1%	-1.2%	-1.3%
External financing	-2.2%	-2.3%	-3.1%	-3.3%	-3.0%	-2.9%	-2.7%	-2.5%	-2.3%	-2.2%	-1.0%	-2.1%	-2.6%	-2.3%
Overall financing	-3.2%	-3.3%	-3.6%	-3.0%	-3.0%	-2.7%	-2.5%	-2.6%	-2.6%	-1.7%	-9.8%	-5.2%	-3.8%	-3.6%

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

As compared with the figures registered in January through April of 2003, the budget revenues decreased by 0.6 p. p. of GDP in the respective period of 2004, while expenditures decreased by 0.9 p. p. and budget surplus respectively increased by 0.3 p. p. of GDP. At the same time, without SST the budgetary revenues decreased by 0.6 p. p. of GDP and made 17.5 per cent of GDP. As before, VAT accounted for the major share of federal tax revenues – 38.8 per cent of the total tax revenues, what is practically at the level observed in the respective period of 2003.

According to preliminary estimates, the cash execution of federal budget revenues made 20.6 per cent of GDP in January through May of 2004, what was by 0.7 p. p of GDP below the level observed

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

in the respective period of the preceding year. At the same time, the cash execution of expenditures made 16.8 per cent of GDP (17.7 per cent of GDP in January through May of 2004); therefore, in the first five months of this year, according to preliminary data, the surplus made 3.8 per cent of GDP.

According to the preliminary estimates of the Finance Ministry, in terms of fulfilled funding<sup>2</sup> the expenditures of the federal budget in January through May of 2004 made 18.8 per cent of GDP (see Table 2), while in the respective period of 2003 this indicator was at 29.9 per cent of GDP. In January through May of 2004, the amount of revenues of the federal budget decreased by 0.7 p. p. of GDP in comparison with the figures registered in the respective months of 2003 and made 20.6 per cent of GDP. Therefore, the surplus of the federal budget in terms of fulfilled funding in January through May of 2004 increased by 0.4 p. p. in comparison with the figures registered in January through May of 2003 and made 1.8 per cent of GDP.

Table 2

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

	V03	VI03	VII03	VIII03	IX03	X03	XI03	XII03	I04	II04	III04	IV04	V04
Total expenditures	21.3%	20.6%	20.4%	20.0%	19.6%	19.5%	19.4%	19.4%	20.9%	20.2%	19.8%	20.4%	20.6%
State administration	0.6%	0.5%	0.5%	0.5%	0.5%	0.5%	0.5%	0.5%	0.6%	0.7%	0.6%	0.6%	0.6%
National defense	3.1%	3.0%	2.9%	2.8%	2.7%	2.8%	2.9%	2.7%	2.7%	4.0%	2.9%	3.7%	3.2%
International activity	0.3%	0.3%	0.3%	0.2%	0.2%	0.2%	0.2%	0.2%	0.0%	0.2%	0.2%	0.3%	0.3%
Judicial authority	0.2%	0.2%	0.2%	0.2%	0.2%	0.2%	0.2%	0.2%	0.2%	0.2%	0.2%	0.2%	0.2%
Legal protection and security	2.2%	2.1%	2.0%	1.9%	1.9%	1.9%	1.9%	1.9%	2.1%	2.5%	2.3%	2.4%	2.3%
Fundamental research	0.3%	0.3%	0.3%	0.3%	0.3%	0.3%	0.3%	0.3%	0.3%	0.3%	0.3%	0.4%	0.3%
Services to national economy	1.0%	1.0%	1.0%	1.0%	1.0%	1.0%	1.1%	1.1%	0.5%	0.7%	0.8%	0.9%	0.9%
Social services	2.7%	2.6%	2.5%	2.4%	2.3%	2.3%	2.4%	2.3%	2.5%	2.6%	2.4%	3.0%	2.9%
Government debt servicing	2.1%	2.0%	1.8%	2.0%	2.0%	1.8%	1.7%	1.7%	1.1%	2.2%	2.2%	1.7%	1.5%
Other expenditures	7.4%	7.3%	7.2%	7.2%	7.0%	6.9%	6.9%	7.0%	5.7%	6.8%	6.1%	6.6%	6.6%
Total expenditures	19.9%	19.2%	18.8%	18.6%	18.3%	18.0%	18.1%	17.8%	15.6%	20.2%	18.0%	19.7%	18.8%
Surplus (+) / deficit (-)	1.4%	1.3%	1.6%	1.3%	1.3%	1.5%	1.3%	1.6%	5.3%	0.0%	1.8%	0.7%	1.8%

Table 3

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

2002*											
I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII
218,7%	187,1%	234,8%	277,8%	239,6%	218,0%	284,4%	246,5%	254,8%	299,7%	241,0%	250,2%
2003*											
I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII
230,0%	229,2%	265,5%	280,4%	233,2%	240,0%	260,4%	242,6%	248,7%	265,6%	231,0%	247,9%
2004*											
I		II		III		IV		V			
266,5%		204,4%		238,0%		261,4%		241,0%			

\* Без учета ECH.

According to the estimates of the Tax Ministry, in May of 2004 tax revenues of the federal budget made about Rb. 117.5 billion (without the single social tax). In real terms the revenues made 241.0 per cent of the level registered in January of 1999, while the respective indicator was at 233.2 per cent in April of 2003 and 239.6 per cent in April of 2002 (see Table 3).

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

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

At the same time, in May of 2004 the revenues generated by the single social tax made Rb. 34.9 billion. Thus, in April of 2004 the RF Tax Ministry transferred to the federal budget taxes and fees amounting to about Rb. 152.4 billion.

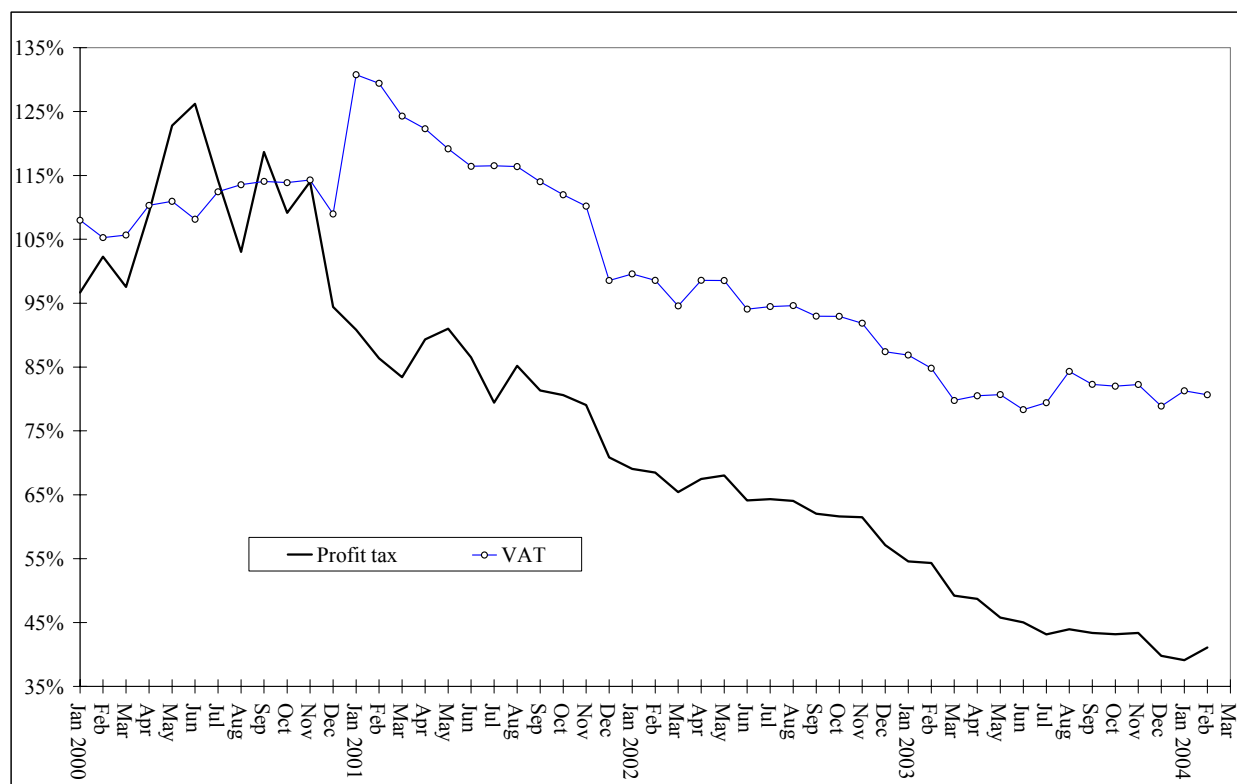


Fig. 1. Real tax arrears to the federal budget (in % to June of 1999)

The dynamics of real arrears relating to major taxes since January of 2000 are presented in Fig. 1. On the whole, the trend towards a gradual decrease in the level of accumulated arrears observed since early 2001 to the second half of 2003 was replaced by the stabilization of the level of accumulated indebtedness as concerns both the profit tax, and VAT.

Table 4

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

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



2001												
	I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII
Taxes	22,7%	23,6%	23,9%	25,4%	26,4%	26,0%	26,1%	25,9%	25,0%	24,8%	25,4%	27,1%
Revenues	25,9%	27,1%	27,4%	29,3%	30,5%	29,8%	29,9%	29,7%	28,3%	28,2%	28,8%	29,5%
Expenditures	16,8%	22,8%	23,7%	24,7%	25,1%	25,3%	25,5%	25,6%	24,9%	24,7%	25,0%	25,6%
Deficit	9,1%	4,2%	3,7%	4,7%	5,4%	4,4%	4,4%	4,1%	3,5%	3,5%	3,8%	3,9%
2002												
	I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII
Taxes	28,7%	23,6%	24,3%	26,5%	26,6%	25,9%	26,4%	25,9%	25,2%	25,4%	25,4%	25,5%
Revenues	32,9%	31,3%	31,4%	33,6%	33,6%	32,7%	33,3%	32,5%	31,7%	32,0%	32,1%	32,1%
Expenditures	18,3%	23,7%	26,0%	28,4%	28,4%	28,8%	29,1%	28,9%	28,4%	29,3%	29,7%	31,1%
Deficit	14,6%	7,7%	5,4%	5,3%	5,2%	3,8%	4,2%	3,7%	3,3%	2,7%	2,4%	1,0%
2003												
	I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII
Taxes	25,6%	24,4%	25,6%	27,4%	27,1%	26,0%	26,1%	25,7%	25,0%	25,0%	25,1%	25,2%
Revenues	32,0%	30,3%	31,5%	33,4%	33,6%	32,2%	32,2%	31,6%	30,9%	30,8%	30,7%	31,1%
Expenditures	20,7%	25,3%	27,7%	28,8%	28,8%	28,6%	28,7%	28,5%	28,2%	27,8%	27,9%	29,7%
Deficit	11,3%	5,0%	3,8%	4,5%	4,7%	3,5%	3,6%	3,1%	2,7%	2,0%	1,8%	1,4%
2004												
	I	II	III	IV								
Taxes	25,6%	20,6%	21,8%	27,4%								
Revenues	30,6%	28,2%	29,8%	32,9%								
Expenditures	18,5%	22,8%	25,4%	27,3%								
Deficit	12,1%	5,4%	4,4%	5,6%								

\* Без учета ECH

The revenues of the consolidated budget in January through April of 2004 made 32.9 per cent of GDP, including tax revenues (without SST) at 27.4 per cent of GDP (see Table 4). Expenditures of the consolidated budget decreased by 1.5 p. p. of GDP in comparison with the figures registered in January through April of 2003 and made 27.2 per cent of GDP. As on May 1, 2004, the surplus of the consolidated budget made 5.6 per cent of GDP, what is by 1.1 p. p. of GDP above the level observed in the respective period of 2003.

*S. Ponomarenko*

### **Taxation of organizations' proceeds: key changes in the first six months of 2004**

Taxation of proceeds of enterprises set forth by Article 25 of the RF Tax Code (Tax on profits of organizations") and certain articles of Section VII "Special taxation treatments" has underwent serious changes since 2004 (including the laws entering into force in 2004), especially as concerns taxation of agricultural producers. IET surveys discuss this issue separately, therefore, this paper should include only an analysis of changes relating to Articles 25, 26.2, and 26.3.

One of the key amendments to Article 25 of the RF Tax Code "Tax on profits of organizations" is the change in the shares of taxes due to the federal and regional budgets. On January 1, 2004, there entered into force federal law No. 117 FZ of July 7, 2003, "On amendments to Section 2 of the RF Tax Code and certain other legislative acts of the Russian Federation, as well as on invalidation of certain legislative acts (provisions of legislative acts) of the Russian Federation," which set forth that the amount of tax calculated at the rate of 5 per cent (in stead of previously used rate of 6 per cent) is due to the federal budget. Accordingly, the tax due to RF subjects' budgets should be calculated at the rate of 17 per cent (in stead of previously used rate of 16 per cent). The rate of taxes due to local budgets is 2 per cent, this provision has not been changed. However, at present there is discussed the issue of an increase in the share of the federal budget in the respective tax revenues since the next year in connection to the transformation of certain social allowances in monetary form and probable assignment of obligations concerning the payment of these funds to the federal budget.

The same law envisages that the resources received for the formation of the Russian fund of technological development, as well as other branch and interbranch funds for financing of R & D registered

in accordance with the procedures envisaged by the federal law “On science and state science and technological policy” in the form of not for profit organizations should be treated as targeted funds and not be included in the tax base. Targeted receipts of the said funds should be also excluded from the respective tax base. As concerns the budget item “Expenditures for R & D” it is permitted to diminish the tax base by the expenditures for formation of funds for R & D financing registered in accordance with the procedures envisaged by the federal law “On science and state science and technological policy.” Previously, the tax base could be diminished only as concerned the expenditures relating to the formation of funds for financing of R & D included in the list approved by the RF Government in accordance with the said law. On condition of adequate control over the expenditure of financial resources accumulated in the said funds, this measure may facilitate voluntary financing of scientific research. It should be noted that it is of utmost importance to switch to identification of funds entitled for this financing privilege basing on the provisions of the law from arbitrary decisions of officials. Later, law No. 163 FZ of December 8, 2003, established that the said rules of determination of the tax base should be applicable to the Russian fund of technological development and funds for financing R & D created at the federal executive authorities in 2003.

Law No. 117 FZ of July 7, 2003, introduced very important amendments to the RF Budget Code. These changes concern the distribution of tax revenues generated by small businesses entitled to the simplified taxation system: 30 per cent of the single tax previously received by the federal budget should now be entered in the budgets of RF subjects. This procedure may stimulate regional authorities to create conditions for development of small businesses. However, it would be more feasible to assign a larger part of revenues generated by small businesses to local budgets. In the absence of an adequate evaluation of the real estate tax base, taxes collected from small businesses could become an independent revenue source of local budgets with more evenly distributed tax base in comparison with, for instance, the tax on profits, since small businesses may be more developed both in large cities and localities without large enterprises and with predominately residential housing. Moreover, the respective tax base depends on the efforts of local authorities aimed at creation of conditions favorable for small businesses and the assignment of a larger part of these tax revenues to local authorities could create incentives for such effort.

Law No. 163 FZ of December 8, 2003, “On amendments to certain legislative acts of the Russian Federation concerning taxes and fees,” which also entered into force on January 1, 2004, introduces changes in the terms of privileges granted to regional and local authorities in accordance with the law “On profit tax” (this law permitted regional and local authorities to grant certain privileges to taxpayers in addition to those set forth by the law). These privileges were abolished since January 1, 2004.

Law No. 178 FZ of December 23, 2003, “On amendments to Articles 251 and 291 of the RF Tax Code” (this law should enter into force in one month after its promulgation on December 27, 2003, but not before the beginning of the next tax period) envisages that insurance contributions made by banks in the deposit insurance fund in accordance with the federal law on insurance of household deposits at banks of the Russian Federation should be excluded from the respective tax base, and that banks should have the right to determine such contributions as expenditures for taxation purposes.

A number of changes in the procedures governing taxation of organizations’ proceeds is currently discussed at the RF State Duma. In particular, the Finance Ministry introduced proposals aimed to amend the current procedure of tax accounting, which envisage harmonization of tax and general accounting across a number of positions. Besides, there is discussed the proposal to decrease tax rates on profits of organizations as concerns proceeds from mortgage securities (the tax rate should be at 6 per cent for proceeds from securities issued prior to January 1, 2007, and 15 per cent for securities issued after 2007). At present RF laws do not set forth any special treatment of proceeds from such securities as concerns the profit tax. It is also proposed to set a 6 per cent rate with respect to proceeds from municipal securities issued prior to January 1, 2007 (for securities issued later the profit tax rate should be set at the current 15 per cent). The latter draft envisages a significant decrease in tax rates alongside with a package of other measures to be in force for a limited term (i.e. the period of formation of the mortgage crediting market). In the case these measures could facilitate the said development process, there may be achieved advantages associated with the economy of scale, which could compensate possible losses. Probably, it would be also feasible to limit the period of validity of the privileges relating to the interest yields of mortgage securities issued after January 1, 2007, which should be taxed at 15 per cent. The arguments for such a decision are as follows: after a certain time mortgage may loose

its priority, while the abolition of an earlier introduced privilege has always been a complicated political problem, and not only in Russia. Therefore, in the case such a limitation is absent, it is possible that such privileges might be extended to other types of activities (there will be always certain arguments for such an extension, for instance, by comparing between social advantages of activities already entitled for the privilege and those with respect to which such privileges are recommended). These developments will inevitably result in distortions, losses of the budget, and tax evasion. In the case by the date of expiration of the privilege the effect of the economy of scale is not exhausted yet, the privilege may be prolonged by a new law.

*E. V. Shkrebel*

---

## **Monetary policy**

---

Growth rates of consumer price index (CPI) in RF recorded in May slowed down to 0.7 percent per month. Gold and foreign currency reserves resumed growing and in May they went up by 3.6 percent. In response to reduced liquidity in banking sector, the Bank of Russia cut down the rate of mandatory reservation and refinancing rate as well as widened the list of stock, which are accepted as collateral in signing repo contracts with commercial banks.

According to data published by Goskomstat of RF, consumer price index recorded in May 2004 amounted to 0.7 percent (see Graph 1). In such a way, Aggregate inflation rate for the period between the beginning of the year through May constitutes 5.4 percent (7.1 percent in the corresponding period of 2003).

Highest price growth as before was recorded in the sphere of paid consumer services population and amounted to 1.4 percent in May and 10 percent for the period between January through May of the current year (1.5 percent and 14.2 percent correspondingly in the year 2003). On the whole, except prices charged for preschool education and charged by organizations of culture, paid consumer services record lower growth rate in comparison with previous year in all other price groups.

Lowest inflation growth rate in May in comparison with December 2003 is recorded in the category of nonfood products and constituted 2.8 percent (4.1 percent in corresponding period of 2003). This growth rate in comparison with previous month amounted to 0.8 percent. Prices on all without exception groups of products, which fall into this category, grew slower between January and May 2004 than in the same period of last year. However, increased price growth on gasoline became a distinctive feature in the period of April through May. If in the period between January through March this growth constitutes only 0.6 percent then in the period between January through May price growth surpassed 7 percent. It is necessary to note a small increase in price growth on tobacco products recorded in May.

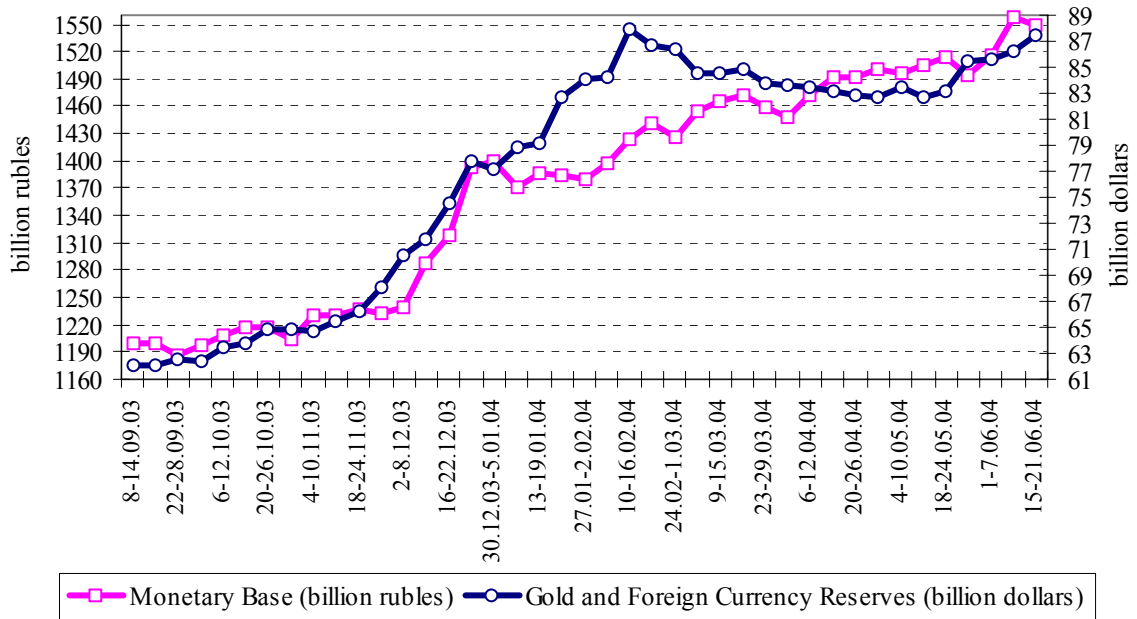
Basic inflation<sup>4</sup> recorded in May noticeably went down: in April—0.8 percent, in May—0.6 percent. This reduction is linked both with decreased pressure of money supply and dedollarization of the economy. On the one hand, considerably lower, than in October-December, cash growth rate recorded in the first quarter of current year (0.5 percent against 6.2 percent) starts influencing the consumer price index. On the other hand, due to stable nominal ruble exchange rate to the dollar preserves incentives to dedollarization of the population's assets. This, in its turn, leads to the reduction in velocity of cash circulation. This results in the reduction of sensitivity of consumer prices to the dynamics of the monetary base.

According to preliminary estimates, consumer price growth rate recorded in June will not surpass 1 percent and, thus, inflation rate in Russia will amount to 6.2-6.5 percent for the first six months of 2004.

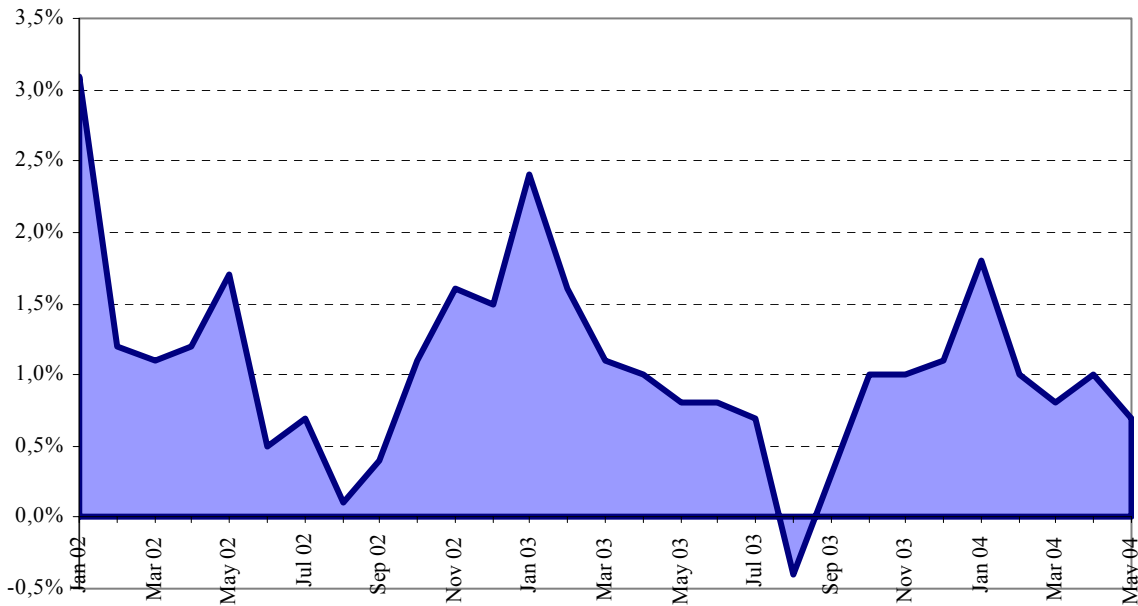
---

<sup>4</sup> The Base Consumer Price Index (BCPI) is an indicator reflecting the inflation rate on the consumer market. It leaves out of account the seasonal (prices of fruits and vegetables) and administrative (tariffs on regulated types of services etc.) factors, calculated by the Statistics Service of the RF.

**Changes in the Monetary Base and in the Gold and Foreign Currency Reserves in  
2003 - 2004.**



**The Growth Rate of the CPI in 2002 - 2004 (% per month).**



Gold and foreign currency reserves of RF grew in May by 3.6 percent (plus 2.9 billion dollars, see Graph 2). In the beginning of June gold and foreign currency reserves continued growing: for the first three weeks they increased by 3.7 percent. However, the volume of monetary base (in broad definition)<sup>5</sup> fell in May by 1.3 percent and from the start of the year—by 2.3 percent. Reduction in the volume of monetary base is linked, first of all, with the decrease of such its components as bank deposits with the Bank of Russia and credit organizations' corresponding accounts with the Bank of Russia.

<sup>5</sup> The RF Monetary Base in broad definition includes cash in circulation, the Ruble denominated funds in mandatory reserves relating to the borrowings of credit organizations, and funds in credit organizations' correspondent accounts and commercial banks' deposits with the Bank of Russia.

Evidently, this is explained by serious problems related to liquidity, which were recorded in the inter-bank market in May.

Money supply in Russia (according to methodology of monetary overview) increased for the period of 4 months of current year by 9.5 percent and amounted by 1 May the sum of 4.34 trillion rubles. In particular, in April money supply increased by 3.4 percent. The volume of money, which represent all funds in the economy that can be used as means of payment (aggregate  $M_1$ ) increased by 3.7 percent for four months and amounted to 2.26 trillion rubles as of 1 May 2004 (growth in April—0.4 percent). Net foreign assets of monetary regulation bodies (CB of RF and Ministry of finance of RF) and credit organizations amounted according to preliminary estimates to the sum of 2.34 trillion rubles as of 1 May. Net assets increased by 16 percent (growth in April—5.9 percent) in comparison with this indicator as of 1 January of current year.

On June 11 of current year the Bank of Russia announced a reduction in assignments norm for banks to the Fund of mandatory reservation on attracted funds of legal entities in domestic currency and attracted funds of legal and physical persons in foreign currency from 9 percent down to 7 percent. This decision followed a reduction of refinancing rate from 14 percent down to 13 percent annualized as well as widening of securities list accepted as collateral in signing with banks direct repo contracts.

In all probability, adoption of these measures was stipulated by lack of liquidity in short-term funds in the Russian market. At the same time, it should be noted that change in the refinancing rate does not have such a significant influence in financial markets and in the real sector of the economy as it does in the majority of the developed countries. However, by increasing the list of securities, on which security banks can obtain funds from CB, thereby the Bank of Russia broadened the base for liquidity management in the banking system

*P. Trunin*

---

## Financial Markets

---

In June of 2004, the situation on the Russia's financial market was characterized by mixed trends. In the beginning of the month, across all segments of the financial market there was observed a deterioration of market situation at the background of liquidity problems in the banking sector, as well as mounting tensions relating to the YUKOS affair. However, after V. V. Putin made a statement that the government was not interested in the bankruptcy of the company, the stock market reacted with a rise in quotations, which compensated for a significant part of the preceding decline. A growth in quotations was also observed on the market of debt instruments. By the end of the month, negative trends again dominated the market, what resulted in a decline in stock indices. It should be noted that in spite of official statements favorable for YUKOS, high political risks still persist on the Russia's markets.

### The Market for Government Securities

In June, on the market of Russian forex denominated bonds at large there was observed a decline in yields of traded securities. As before, the market of Russian forex denominated debt reacted to the changes in the benchmark of all debt markets, i.e. yields of US treasury bills. Over the whole month, there was observed positive dynamics of quotations, which followed a certain decline due to the uncertainty concerning the YUKOS affair, as demand for Russian bonds on the part of nonresidents grew.

Thus, as on May 25 the yield to maturity of Russian Eurobonds RUS-30 was 8.09 per cent p.a.; RUS-18: 7.81 per cent p.a. Besides, on the same date the yield to maturity of the Russian Eurobonds was: Minfin bonds, 7<sup>th</sup> tranche: 7.47 per cent; Minfin bonds, 6<sup>th</sup> tranche: 4.91 per cent; Minfin bonds, 5<sup>th</sup> tranche: 6.59 per cent; RUS-07: 5.27 per cent.

FIGURE 1.

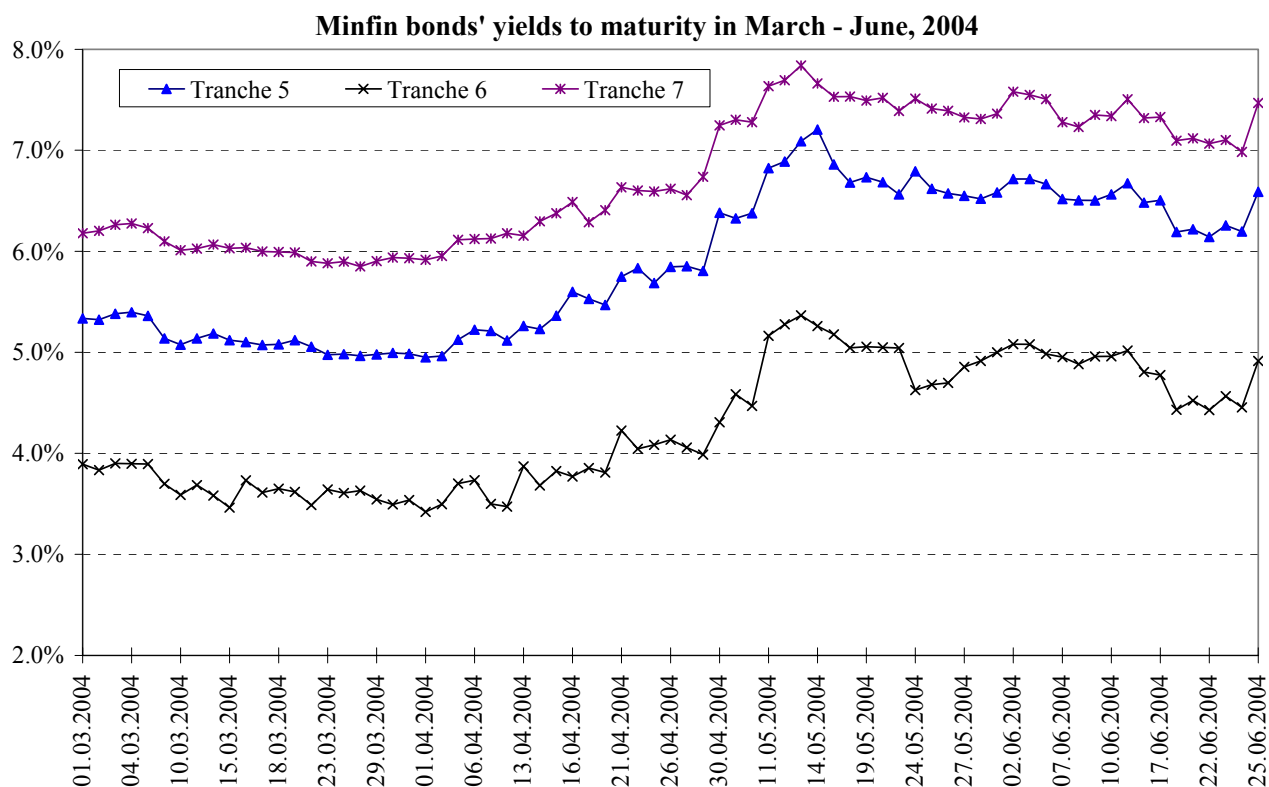
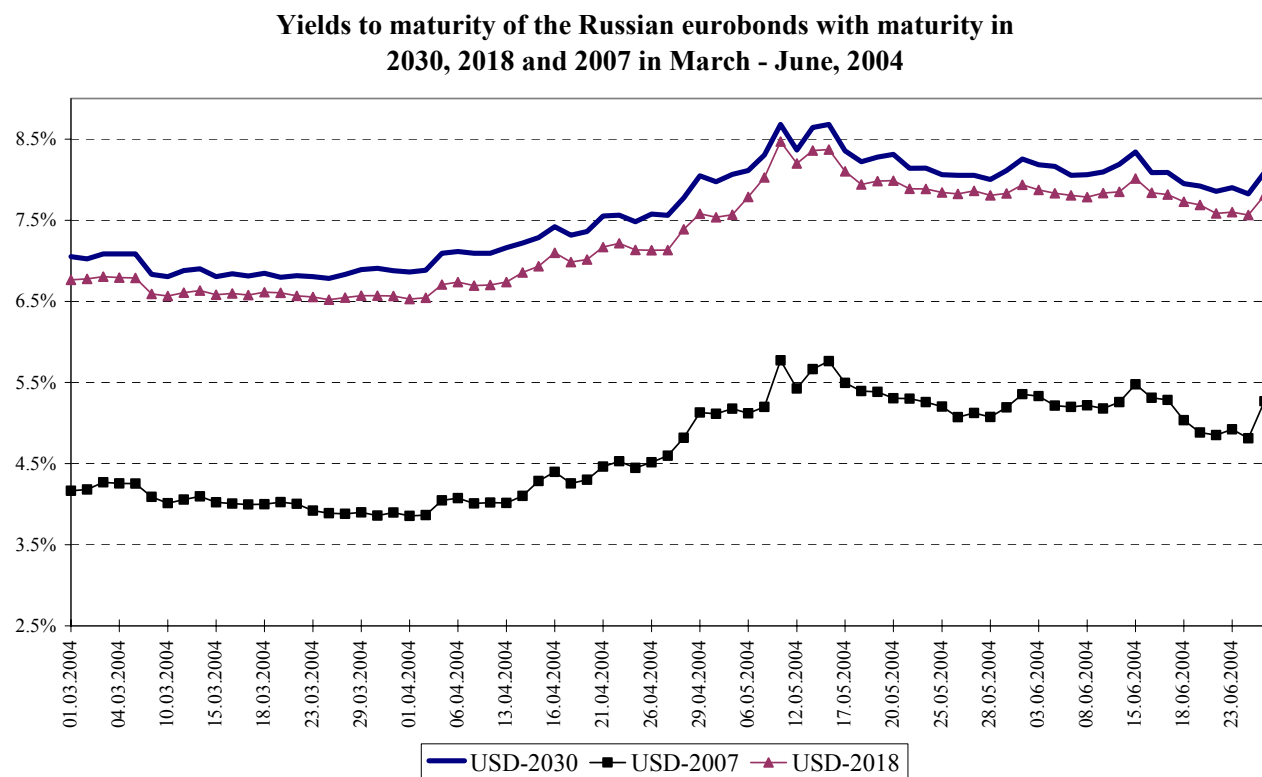


FIGURE 2.



As concerns the segment of Ruble denominated public bonds, in June there also prevailed downward trends in quotations. Yields of securities increased at the background of extremely low activity of investors in comparison with the market of corporate debt and limited liquidity in the banking sector.

Over the period from June 1 to 24, the aggregate turnover of the secondary GKO OFZ market made about RUR 26.85 billion, while the average daily turnover was at RUR 1.58 billion (in May, the respective indicator was registered at about RUR 1.67 billion). In the same period, there took place several auctions for the placement of GKO – OFZ. On June 2, there took place the auction for the placement of OFZ FD 27025 the nominal value of which made RUR 4 billion. The amount of the placements made RUR 868 million, while the weighed average yields of the placements were at 6.71 per cent per annum. On June 3, there were held auctions for additional placement of OFZ AD 46003 and OFZ FK 27025, the nominal value of which made RUR 1.5 billion each. The amount of the placements made RUR 224.5 and 938.7 million respectively, while the weighed average yields of the placements were at 7.58 per cent and 6.66 per cent per annum. As on June 25, the amount of the GKO – OFZ market made RUR 459.48 billion at par and RUR 438.2 billion at the market value. The duration of the GKO-OFZ market portfolio was 1650.76 days.

---

## **The Market for Corporate Securities**

---

### **Situation on the stock market**

Early in the month, on the market there continued a decline in quotations. Pessimism of investors based primarily on the further deterioration of the YUKOS situation, as well as a significant decline in liquidity in the banking sector. “The crisis of confidence” on the market of inter-bank credits was caused by the events relating to “Sodbusinessbank” and “Credittrust”. The situation somewhat improved after the Central Bank reduced the standard rate of mandatory reserves with respect to Ruble denominated deposits of legal entities and forex denominated deposits of legal entities and individuals from 9 per cent to 7 per cent, as well as the refinancing rate – from 14 per cent to 13 per cent. However, the influence of this decision on the stock market was minimal in comparison with other segments of the financial market, since the situation there is significantly affected by broker companies and private investors whose financial standing does not primarily depend on the situation in the banking sector. As a result, the stock index fell and at the close of the trading at RTS on June 16 was at 533.26 points.

However, on June 17 there took place the event, which gave a “sign” to the stock market. The RF President Putin in his speech in Tashkent noted that the Government of Russia was not interested in the bankruptcy of YUKOS. After this statement had been published by news agencies, the demand for shares of YUKOS and other blue chips immediately increased. In one hour the price of YUKOS shares rose by 16.8 per cent and the trade with these shares was in fact stopped (the trading session at RTS is closed at 6 p. m., therefore the suspension of trade at about 5 p. m. was effectively the closure of trading), while MICEX suspended trading for about an hour. Nevertheless, this measure did not significantly influence market operators: after trading was resumed, the rush buying up of all blue chips continued, what resulted in the fact that in one hour the technical MICEX index exceeded its maximal prescribed value and therefore the session had to be closed early.

Over the next week, the market experienced a technical adjustment caused by the fixing of operators’ profits. The decline in the RTS index below 600 points was determined not only by technical factors (on June 25, at the close of the trading at RTS, the index was at 599.97 points), but also by court rulings concerning the YUKOS, as well as delayed decision concerning OGC.

FIGURE 3.

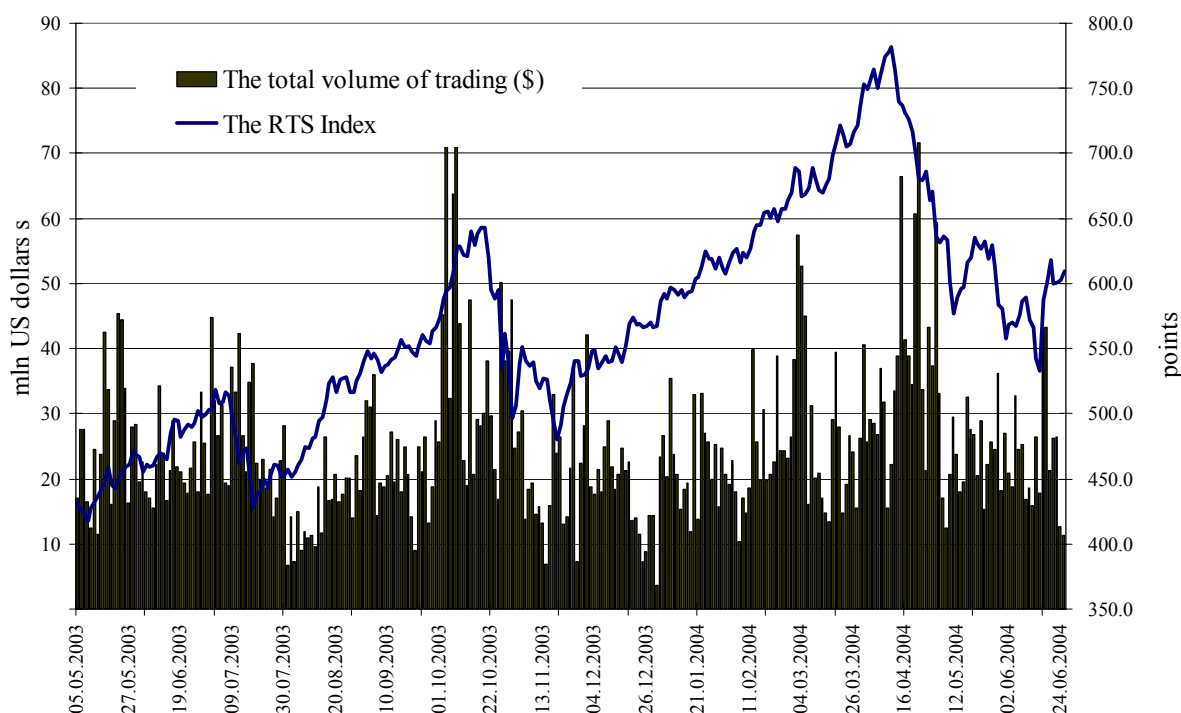
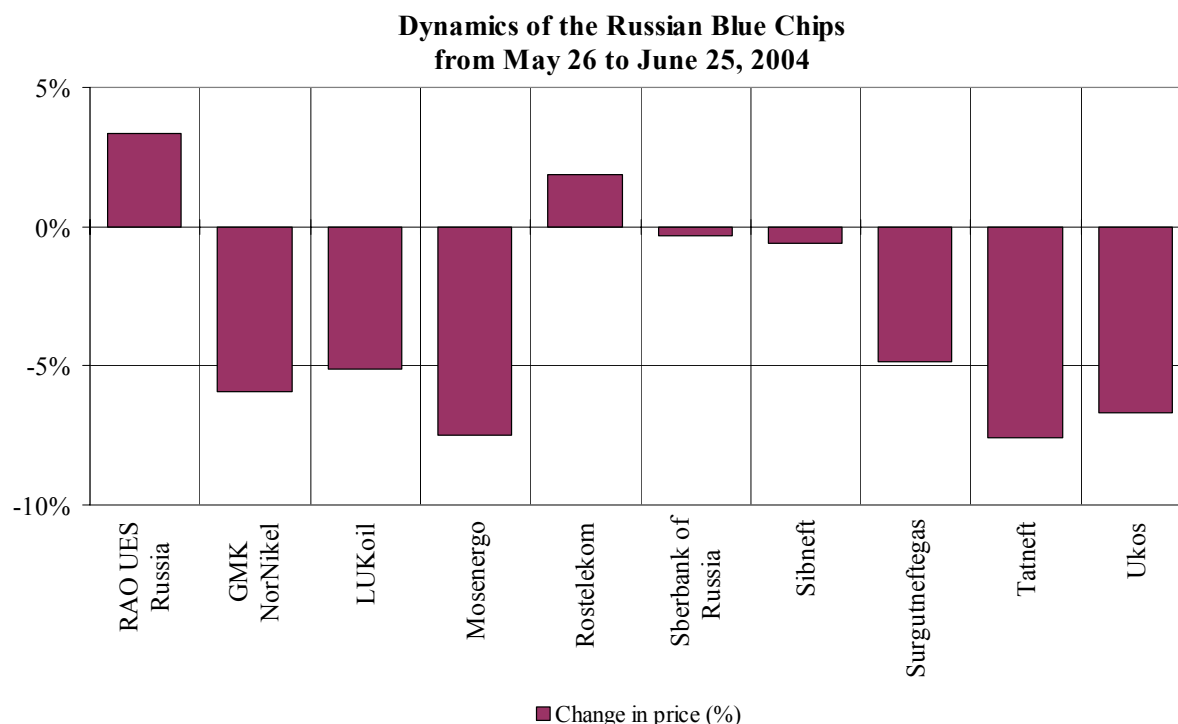


FIGURE 4.



On the whole, in the period from May 26 till June 25, the RTS index decreased by 4.77 per cent, or by 30.02 points in absolute terms. Over the same period, the turnover of the RTS trading amounted to about US \$ 533 million (about US \$ 428.7 million excluding last days of May), while the average daily turnover at the RTS made about US \$ 23.8 million (US \$ 340 million and US \$ 37 million respectively in May). The highest and the lowest volumes of trade at the RTS made US \$ 43.4 million (on June 18) and US \$ 11.3 million (on June 22) as compared with US \$ 32.5 million and US \$ 12.4 million respectively in May.



Over the last month (from May 26 till June 25), all “blue chips” with the exception of the RAO UES of Russia (a 3.35 per cent growth) and Rostelekom (a 1.87 per cent growth) demonstrated a downfall in prices. Thus, shares in Tatneft (-7.59 per cent) and Mosenergo (-7.51 per cent) became leaders in terms of decrease in prices. These shares were followed by the stocks of the NK YUKOS (-6.68 per cent), the GMK Norilsk Nickel (-5.91 per cent), and shares in LUKoil (-5.10 per cent). At the same time, the shares in Surgutneftegaz fell by 4.85 per cent, while prices of Sibneft and Sberbank of Russia also declined (by 0.6 per cent and 0.34 per cent respectively).

As on June 25, the three leaders in terms of the volume of turnover at the RTS<sup>6</sup> were as follows: the RAO UES of Russia retained its top position as the share of respective transactions amounted to 37.68 per cent of the total RTS turnover. The amount of transactions with the shares in the LUKoil was somewhat lower (22.01 per cent). The shares of YUKOS followed: the volume of transactions with this company’s shares made 10.75 per cent of the total turnover. Thus, the aggregate percentage of transactions with the shares of only these three companies made about 70.44 per cent of the total turnover of trade at RTS over the period of time under observation.

As on June 25, the top five leaders of the national stock market by capitalization looked as follows<sup>7</sup>: LUKoil: US \$ 23.35 billion; Surgutneftegaz: US \$ 23.28 billion; YUKOS: US \$ 19.24 billion; Sibneft: US \$ 14.03 billion; MMC Norilsk Nickel: US \$ 12.21 billion.

**The market for fixed term contracts.** In June, the activity of investors on the RTS market for fixed term contracts (FORTS) significantly increased in comparison with the preceding month. Thus, in the period from June 1 till 25 the aggregate volume of trade in futures and options at the RTS amounted to about RUR 32.1 billion (127.1 thousand transactions; 4.25 million contracts), what was significantly above the respective indicators registered in the preceding month (turnover - RUR 20.6 billion, 102.1 thousand transactions; 2.77 million contracts).

As usual, futures contracts account for the greatest percentage of transactions: the volume of trade in these contracts made RUR 29.98 billion (3.97 million contracts, 123.87 thousand transactions) over the period under observation. As before, options were in a much lower demand: the respective amount of trading made about RUR 2.14 billion (278 thousand contracts, 3.16 thousand transactions). The maximum trading volume was observed on June 8 and made RUR 2.35 billion, while the minimum trading volume (RUR 1.33 billion) was registered on June 7.

**Corporate bond market.** Over the month, the downfall in prices on the market of corporate bonds continued. From June 1 till June 25, the price index of corporate bonds traded at the MICEX<sup>8</sup> decreased by 0.75 points (-0.68 per cent) and the index of ten most liquid corporate sector bonds decreased by 0.24 points (by 0.21 per cent).

These negative dynamics were primarily caused by the liquidity crisis in the banking sector. Extremely high rates on the market of inter-bank credits forced banks to close out a part of positions with respect to most liquid securities at the background of low demand, what facilitated a decline in quotations. The external situation also remained negative, since the growth in inflationary expectations in the USA facilitated a growth in yields of US treasury bills, which are a benchmark of the world debt market.

In the period from June 1 till 23, the total turnover in the bond sector of MICEX made about RUR 7.5 billion, while the average daily turnover was registered at RUR 468 million, what was significantly above the indicators registered in May of this year.

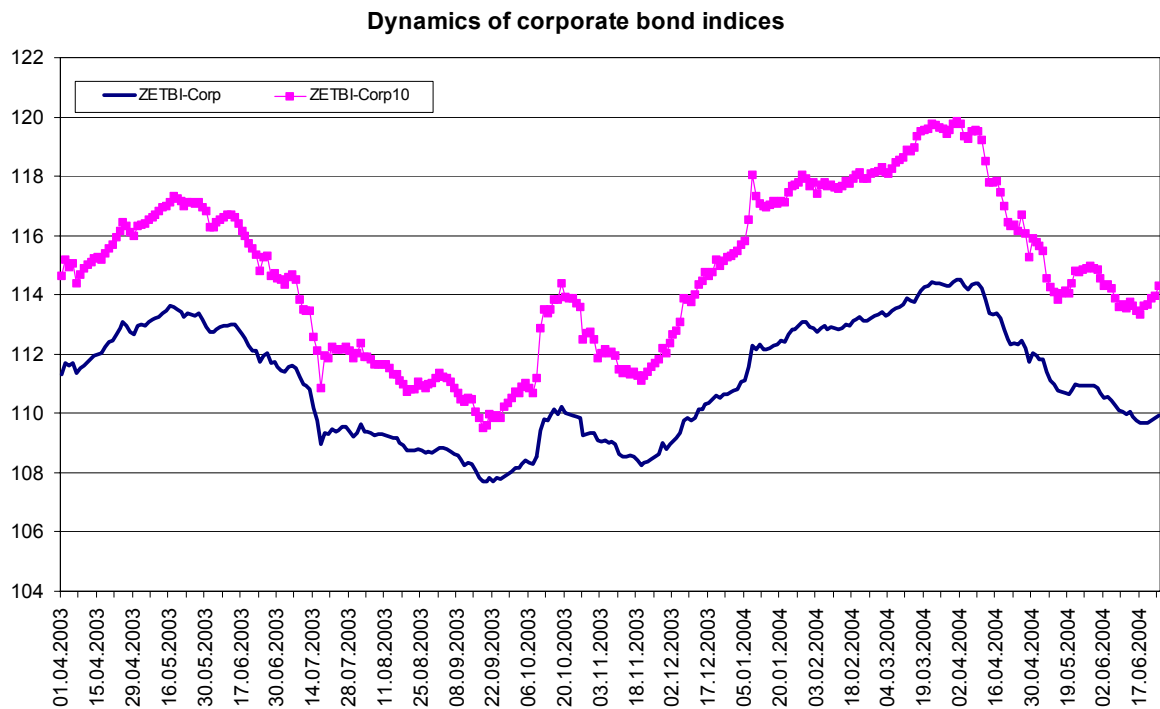
---

<sup>6</sup> On the classical stock market.

<sup>7</sup> According to the RTS.

<sup>8</sup> The indices of corporate bonds traded at the MICEX that have been used for the calculations are calculated by Zenit Bank.

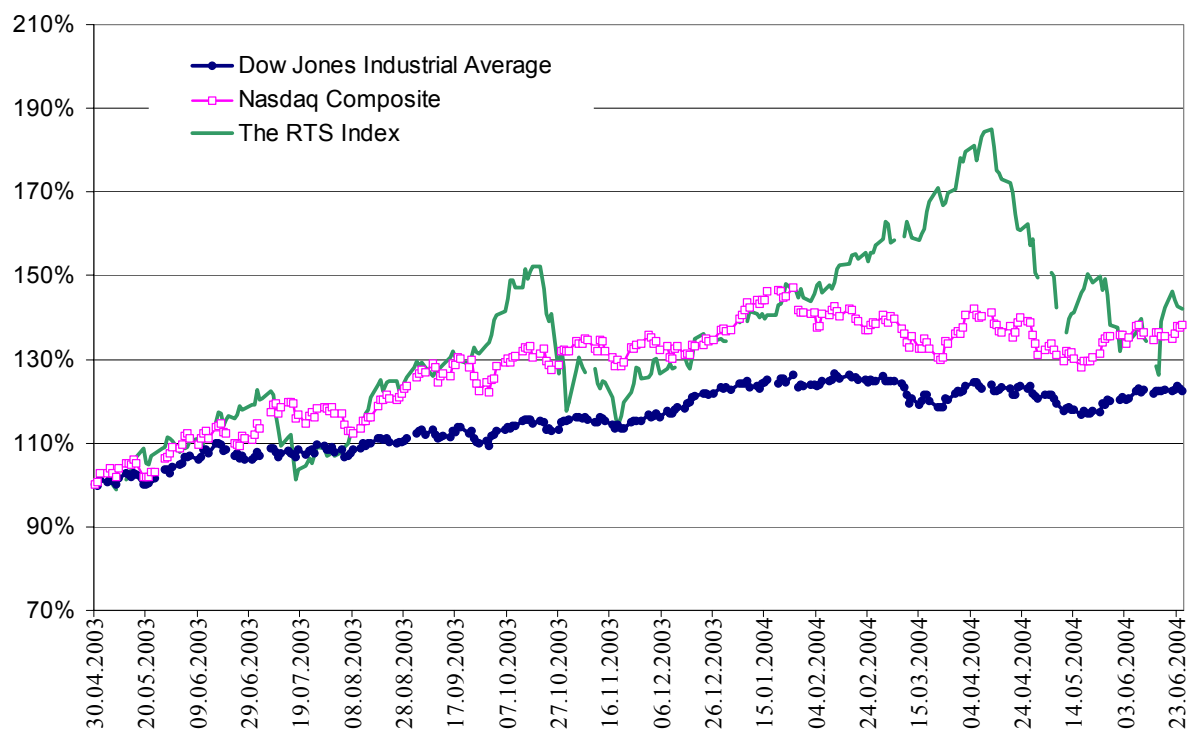
FIGURE 5



**External factors affecting the dynamics of the Russian stock market.**

Throughout the month, the prices on the world oil markets remained at a high level and were not observed to decline below US \$ 30 per barrel in spite of the OPEC decision to increase the official oil extraction quotas by 2 million barrels a day from July 1 and by additional 500 thousand barrels a day since August 1. However, it should be noted that this decision will hardly significantly affect the market in the nearest future, since it only legalized the current surplus of oil on the market. Taking into account the fact that at the moment the potential increase in oil extraction makes 2.67 million barrels a day, while the rise in quotas by August may make 2.5 million barrels a day, the 170 thousand barrels surplus can hardly significantly affect the market in the future. Yet another factor facilitating a certain decline in world prices was an improvement of the situation concerning the oil and oil products in the USA. On the contrary, in June high oil prices were supported by the instability observed in the Middle East (attacks of terrorists in Basra and Saudi Arabia), as well as strikes in Norway, which is a largest independent supplier of oil on the world market alongside with Russia and Mexico.

FIGURE 6.



Throughout the month, on the world stock markets there was observed an improvement of the market situation accompanied by a growth in stock indices. The only exception was the stock index of South Korea, which declined by 0.64 per cent by the end of the month. On the whole, over the month positive trends prevailed across developing markets, what was reflected by the dynamics of the stock index calculated by the agency MSCI (see Table 1).

In June, the US stock indices somewhat grew. In the beginning of the month, the activity of investors on the stock market remained at a relatively low level. A negative factor behind the stock market dynamics was the expectation of a raise in the interest rates: the Alen Greenspen's statement indicated that the FRS is ready to raise interest rates depending on the rates of inflation. On the contrary, a certain decline in oil prices observed in the beginning of the month resulted in an increase in the market value of US stocks. However, in the second half of the month, Alen Greenspen somewhat softened his position, since, according to his statement, inflation was not a serious cause for concern. Publication of favorable macroeconomic statistical data, as well as a certain decline in yields of US government bonds also facilitated a growth in quotations. However, significant growth was checked by the end of decrease in oil prices on world markets, as well as new terrorist attacks in Iraq.

Summing up the developments analyzed above, it should be noted that on the whole the external environment remained neutral as concerns its impact on the Russian stock market. On the one hand, the business situation on the oil market facilitates a growth in the stock market. At the same time, it should be noted that high oil prices not only favorably affect the profits of oil corporations, the share of which among blue chips is high, but also the overall macroeconomic situation in the country, since they increase the attractiveness of investment in the national economy.

#### Corporate news.

##### *The NK LUKoil*

In May, the amount of trade with the company's securities at the London Stock Exchange reached its next historical maximum and made US \$ 2.41 billion. The dynamics of the amount of trade demonstrates a constantly growing interest of investors in the company's stocks. Thus, in 2003 the average monthly amount of trade made US \$ 801 million, while in the first four months of 2004 it made US \$ 1.52 billion.

On June 24, there was held the annual meeting of LUKoil shareholders, which approved the corporate report for year 2003, as well as the accounting documents with respect to the results of the finan-

cial year. Thus, according to the presented reports, in 2003 the company gained the record net profit amounting to US \$ 3.701 billion as compared with US \$ 1.843 billion registered in 2002.

*The OAO Gazprom*

On June 22, the company presented the audited consolidated accounting documents of the Gazprom group for year 2003 prepared in accordance with the requirements set forth by the Russian legislation.

According to the results registered in 2003, the sales proceeds made RUR 844.56 billion, what was by 38 per cent above the respective indicator observed in 2002. The group's net profits in 2003 made RUR 170.877 billion, what was by RUR 66.9 billion(64 per cent) above the figures registered a year ago.

At the meeting of the Board of Directors held in June, there was approved the amount of dividends to be paid according to the operating results in 2003. The total amount of dividend payments should make RUR 16.3 billion, or 11.5 per cent of the net profit of the company.

*The OAO GMK Norilsk Nickel*

On June 2, the company's Board of Directors approved the accounting documents for year 2003 prepared in accordance with International Accounting Standards (IAS). Thus, in 2003 the company's proceeds from sales of metals increased by 68 per cent in comparison with the figures registered in 2002 and made US \$ 5.19 million. The net profits made US \$ 861 million, what was by 47 per cent above the level observed in 2002 (US \$ 564 million).

*The NK YUKOS*

On June 24, there was held a meeting of YUKOS shareholders, which elected the new composition of the company's Board of Directors. Victor Gerashchenko was elected as the Chairman of the Board of Directors, while Steven Tidy replaced S. Kukes as the company's CEO.

*Table 1*

**Dynamics of International Stock Market Indices**

<b>Data as of June 25, 2004</b>	<b>Value</b>	<b>Change within the month (%)<sup>9</sup></b>	<b>Change since the beginning of the year (%)</b>
RTS (Russia)	559.97	-4.77%	2.37
Dow Jones Industrial Average (USA)	10371.84	2.59%	-0.37
Nasdaq Composite (USA)	2025.47	2.50%	0.94
S&P 500 (USA)	1134.43	1.75%	2.34
FTSE 100 (UK)	4494.1	1.26%	-0.36
DAX-30 (Germany)	4013.35	3.77%	-0.13
CAC-40 (France)	3742.38	2.25%	4.05
Swiss Market (Switzerland)	5681.5	0.17%	1.77
Nikkei-225 (Japan)	11780.4	5.63%	8.82
Bovespa (Brazil)	20750	8.82%	-7.55
IPC (Mexico)	10187.92	1.25%	25.49
IPSA (Chile)	1477.01	4.16%	-0.51
Straits Times (Singapore)	1805.54	1.62%	0.79
Seoul Composite (South Korea)	779.03	-0.64%	-5.14
ISE National-100 (Turkey)	17335.16	0.69%	-9.36
Morgan Stanley Emerging Markets Free Index	431.174	1.17%	-2.70%

<sup>9</sup> As compared to the level registered on May 26.

### The Foreign Exchange Market.

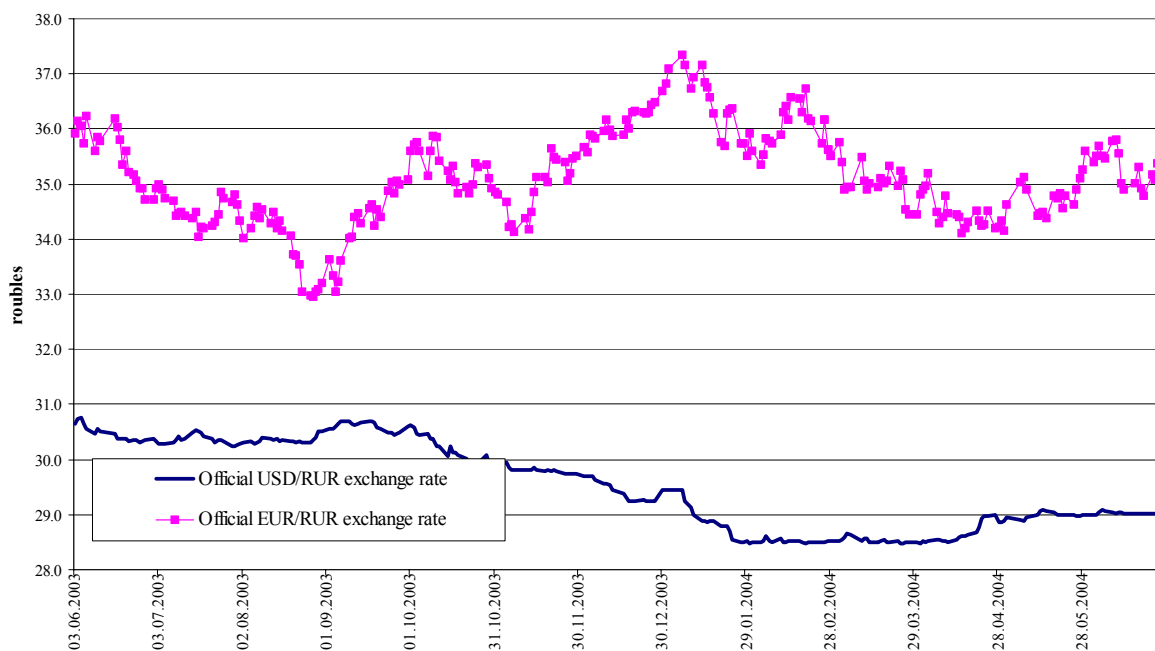
Throughout the month, the situation on the domestic forex market remained rather stable. In early June, there was observed a certain depreciation of the national currency facilitated by an increase in demand for US dollars on the part of investors. These developments were in part caused by their wish to switch from securities to US dollars at the background of mounting political risks. However, later the US \$ / Ruble exchange rate somewhat decreased. In part, this was caused by the fact that for maintenance of the necessary liquidity level banks had to sell the US currency. Thus, in the period from June 1 till June 26, the US \$ / RUR exchange rate increased by about 0.026 Rubles to the level of RUR 29.02 per US \$, what made circa 0.09 per cent.

The aggregate volume of trade in the US Dollar at the SELT in the period from June 1 till June 24 made US \$ 12.4 billion, what was significantly above the figures registered in the respective period of May (about US \$ 8 billion). The average daily turnover made US \$ 728.6 million over this period as compared with US \$ 618.33 million observed in May. During the period under review, the highest volume of trade in the US Dollar, about US \$ 1 billion, was observed on June 16; the lowest volume, US \$ 396.5 million, was observed on June 22.

This June, the Ruble liquidity in the banking sector somewhat increased in comparison with the figures registered in the preceding month: in June, the average balances of correspondent accounts of credit organizations with the Bank of Russia made RUR 170.6 billion as compared with RUR 153.5 billion registered in May of 2004.

FIGURE 7.

Dynamics of the Official USD/RUR and EUR/RUR Exchange Rates in 2003-2004



On the world forex market, the dynamics of US dollar / Euro exchange rate were determined by two opposite trends. On the one hand, expectations of an increase in interest rate exerted downward pressure on Euro. On the other hand, the record high trade deficit in the USA influenced the exchange rate in the opposite direction. As a result, in the period from June 1 till June 26 the Euro exchange rate decreased by US \$ 0.003 (-0.22 per cent) making US \$ 1.126 per Euro.

The dynamics of the Euro / Ruble rate were mainly determined by the trends on the world market. In the period from June 1 till June 24, the European currency appreciated by RUR 0.096 (0.27 per cent) from RUR 35.39 per Euro and made RUR 35.29 per Euro. The aggregate turnover of trade at the SELT amounted to Euro 115.3 million in the period from June 1 till June 24, while the average daily turnover was registered at Euro 6.78 million (Euro 115.6 million and Euro 8.9 million respectively in May). In this period, the highest trade volume of Euro was registered on June 24 at Euro 8.76 million, and the lowest, Euro 4.4 million, on June 21.

FIGURE 8.

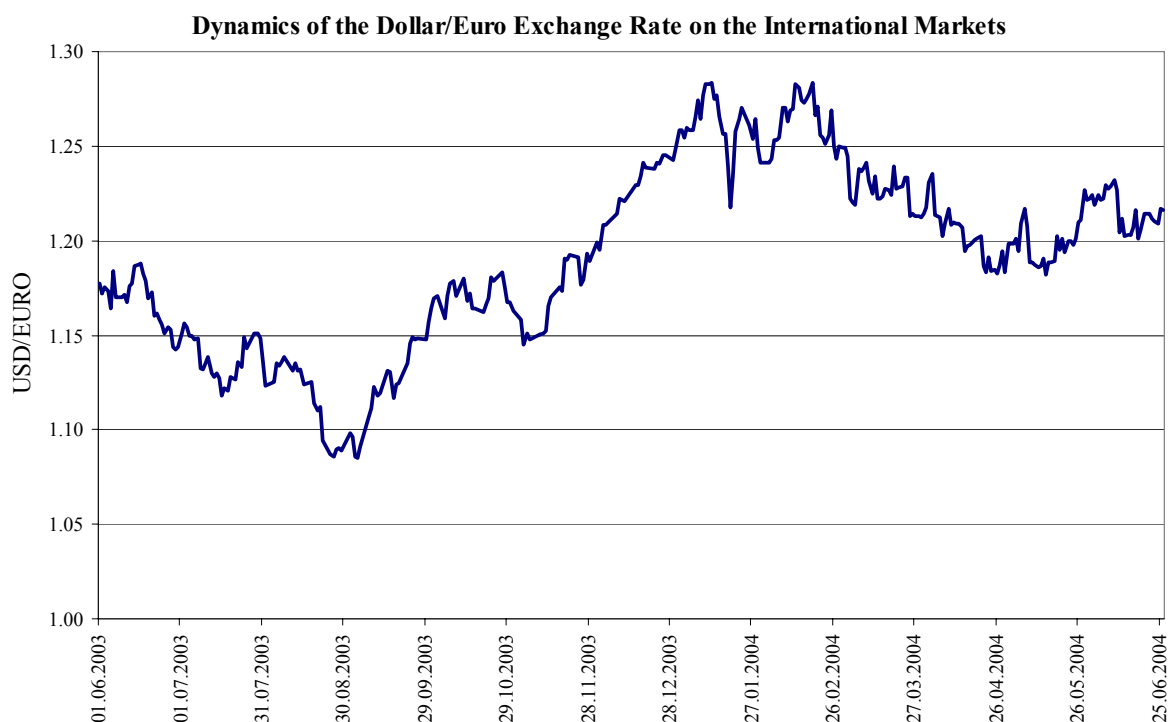


Table 2

**Financial Markets Indicators**

Month	February	March	April	May	June*
Monthly inflation rate	1,0%	0,8%	1,0%	0,7%	0,8%
Inflation rate annualized on the basis of this month's trend	12,68%	10,03%	12,68%	8,73%	10%
CB RF refinancing rate	14%	14%	14%	14%	13%
Annualized yield to maturity on OFZ issues (%)	6,15%	6,78%	6,78%	7,04%	5,5%
Volume of trading in the secondary GKO-OFZ market for the month (RUR billion)	25,47	50,55	21,72	19,67	25,0
Yield to maturity on Minfin bonds at the end of the month (% p.a.)					
5th tranche	5,36%	4,99%	6,38%	6,52%	6,6%
6th tranche	3,88%	3,54%	4,31%	4,91%	5,0%
7th tranche	6,15%	5,93%	7,25%	7,31%	7,5%
8th tranche	4,56%	4,22%	4,58%	5,41%	5,5%
Yield to maturity of Eurobonds at the end of the month (% p.a.)					
2005	2,77%	2,40%	3,00%	3,35%	3,2%
2007	4,20%	3,90%	5,11%	5,07%	5,3%
2010	5,68%	5,51%	6,34%	6,36%	6,5%
2018	6,82%	6,56%	7,53%	7,81%	7,9%
2028	7,25%	7,07%	8,10%	8,22%	8,3%
2030	7,08%	6,88%	7,97%	8,00%	8,1%
INSTAR-MIACR rate (% p.a.) on interbank overnight loans at the end of the month	1,76%	6,19%	17,54%	21,18%	12%
Official RUR / US\$ exchange rate at the end of the month	28,5156	28,4853	28,8834	28,9850	29,025
Official RUR / Euro exchange rate at the end of the month	35,5076	34,8005	34,1431	35,6052	35,35
Average annualized growth in RUR / US\$ ex-	0,08%	-0,11%	1,40%	0,35%	0,14%

change rate					
Average annualized growth in RUR / Euro exchange rate	0,41%	-1,99%	-1,89%	4,28%	-0,72%
Volume of trading at the stock market in the RTS for the month (US\$ million)	433,12	613,91	830,27	419,36	480
Value of RTS-1 Index at the end of the month	670,14	755,43	634,61	581,47	590
Change in value of RTS-1 Index during the month (%)	8,78%	12,73%	-15,99%	-8,37%	1,5%

\* Estimate

*D. Polevoy*

## **Investment in the real sector of the economy**

In January through May of 2004, investment in fixed assets made Rub. 773.5 billion and were by 12.8 per cent above the figures registered in the respective period of the preceding year. In the 1<sup>st</sup> quarter of 2004, the share of investment in fixed assets made 11.4 per cent of GDP and remained at about the level observed in the preceding year.

In the beginning of 2004, there was observed a number of significant shifts in the structure of investment across the sources of financing. There was registered a significant increase in the share of the banking sector in crediting of the investment complex. In the 1<sup>st</sup> quarter of 2004, the aggregate share of bank credits and borrowings of insurance and investment companies, industrial and trade enterprises made 18.9 per cent. It should be also noted that the share of foreign investment in the structure of sources of financing increased to 9.0 per cent.

This year, a specific feature of the Russian economy is a high level of business activity in construction. The progressive trend towards a growth in investment in fixed assets was positively affected by the gradual decrease in risks resulting from the stable improvement of the legislative and regulatory base. In January through May of 2004, investment in fixed assets made Rub. 773.5 billion and were by 12.8 per cent above the figures registered in the respective period of the preceding year.

In the beginning of 2004, there was observed a number of significant shifts in the structure of investment across the sources of financing due to an increase of the share of borrowed resources by 4.3 p. p. in comparison with the figures registered in the 1<sup>st</sup> quarter of 2003. The decline in profitability of alternative Ruble and forex denominated financial instruments created for private investors incentives to invest funds in the real sector of the economy. There is observed a significant increase in the share of the banking sector in crediting of the investment process, the specific weight of which in the structure of investment in fixed assets grew from 4.3 per cent observed in the 1<sup>st</sup> quarter of 2003 to 8.0 per cent in the 1<sup>st</sup> quarter of 2004. The aggregate share of bank credits and borrowings of other organizations (insurance and investment companies, industrial and trade enterprises, etc.) made 18.9 per cent in the 1<sup>st</sup> quarter of 2004. It should be also noted that the share of foreign investment in the structure of sources of financing increased to 9.0 per cent.

The increasing intensity of investment inflows in the real sector of the economy was observed at the background of significant shifts in the sectoral structure of investment. The share of investment in fixed assets of manufacturing industries declined from 3.0 p. p. in comparison with the figures registered in the 1<sup>st</sup> quarter of 2003 and made 53.6 per cent. As concerns the sector of goods, the decline in investment was registered both in industry and construction. As concerns the sector of services, there was observed the most significant increase in investment: from 3.1 per cent in the 1<sup>st</sup> quarter of 2003 to 6.6 per cent in the respective period of 2004. The specific weight of transport and trade in the total amount of investment has increased by about 1 p. p., what permitted to overcome the trend towards deceleration of the rates of investment in these sectors formed over the last two years.

The international consulting company A. T. Kearney ranked Russia as the most attractive country for investment in retail trade. In the present situation where the lack of civilized trade objects is acute, all operating trade networks intensively develop and increase the number of their outlets. As concerns the structure of foreign investment in the Russian economy, since the beginning of the period of reforms it is characterized by a stable growth in the share of investment in the development of trade. Judging by the results of the 1<sup>st</sup> quarter of 2004, the share of trade in the total amount of foreign investment received this year makes 31.3 per cent. The development of the retail market characterized

by the introduction of foreign trade formats changes the competitive environment and the strategy of development used by domestic businesses in this sector of the economy and related industries.

*Table 1*

**Structure of investment in fixed assets across sources of financing in the 1<sup>st</sup> quarter of 2002 through 2004, in % of the total**

	2002	2003	2004
Investment in fixed assets, total	100,0	100,0	
Including			
1. <i>Own funds</i>	53,6	49,1	44,8
of which			
Profits	21,4	19,0	15,5
Amortization	27,3	25,6	25,5
2. <i>Borrowings</i>	46,4	50,9	55,2
of which			
Budget resources	20,4	17,3	14,9
including:			
Federal budget	5,8	5,0	3,5
Budgets of RF subjects	12,2	11,6	10,7
Bank credits	3,8	4,3-	8,0
Borrowed resources	4,0	6,6	10,9
Extra-budgetary funds	1,9	1,0	0,6
Other	18,6	21,2	20,9
Foreign investment in the total amount of investment in fixed assets	2,7	5,8	9,0

Source: Federal Service of State Statistics

*Table 2*

**Structure of investment in fixed assets across sectors of economy in the 1<sup>st</sup> quarter of 2002 through 2004, in % of the total**

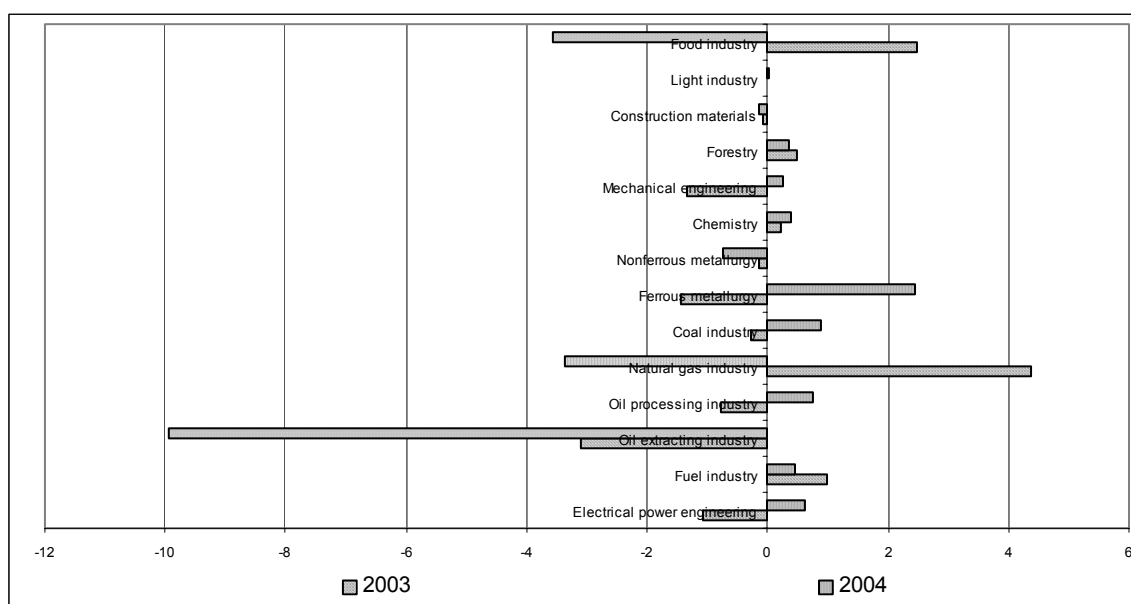
	2002	2003	2004
Industry	47,9	50,2	48,1
Agriculture	3,0	2,4	2,5
Transport	15,8	15,1	16,4
Communications	3,6	3,1	6,6
Construction	3,2	3,8	2,8
Trade	1,6	1,8	2,7

Source: Federal Service of State Statistics

In comparison with the figures registered in the 1<sup>st</sup> quarter of 2003, in industry there was observed a decline in the share of investment in fixed assets in fuel industry from 26.7 per cent to 25.8 per cent, including a decrease in investment in oil extracting industry from 17.1 per cent to 11.6 per cent and in natural gas industry from 6.8 per cent to 4.9 per cent.

As concerns the metallurgy complex, at the background of falling investment in nonferrous metallurgy by 0.5 p. p. the specific weight of ferrous metallurgy increased by 1.1 p. p. A negative feature of changes in the structure of investment in industry is the low investment activity observed across the branches of manufacturing industry. An insignificant amount of investment in industries producing final goods at the background of the current age structure of fixed assets and their physical depreciation and moral obsolescence is insufficient for pursuit of an efficient structural policy and renewal of fixed assets. The specific weight of food industry in the total investment in fixed assets in the 1<sup>st</sup> quarter of 2004 made 2.7 per cent, what is by almost 2 p. p. below the figures registered in the respective period of the preceding year. As concerns light industry and mechanical engineering, in these industries the share of investment remained at the levels observed in the 1<sup>st</sup> quarter of 2003.





*Fig. 1.* Changes in the structure of investment in fixed assets across industries in the 1<sup>st</sup> quarter of 2003 through 2004 in comparison with the figures registered in the respective quarter of the preceding year, in %

As concerns the technological structure of investment, there persisted the trend towards an increase in the share of machinery and equipment. In comparison with the figures registered in the 1<sup>st</sup> quarter of 2003, the share of machinery and equipment in the structure of investment in fixed assets increased by 2.4 p. p. and made 34.7 per cent. The domestic mechanical engineering was not adequate to the growing investment demand both in terms of the amount and the structure of supply of capital goods. In the 1<sup>st</sup> quarter of 2004, investment in purchase of foreign equipment made 23.5 per cent of the total amount of investment in machinery, equipment, and transport vehicles.

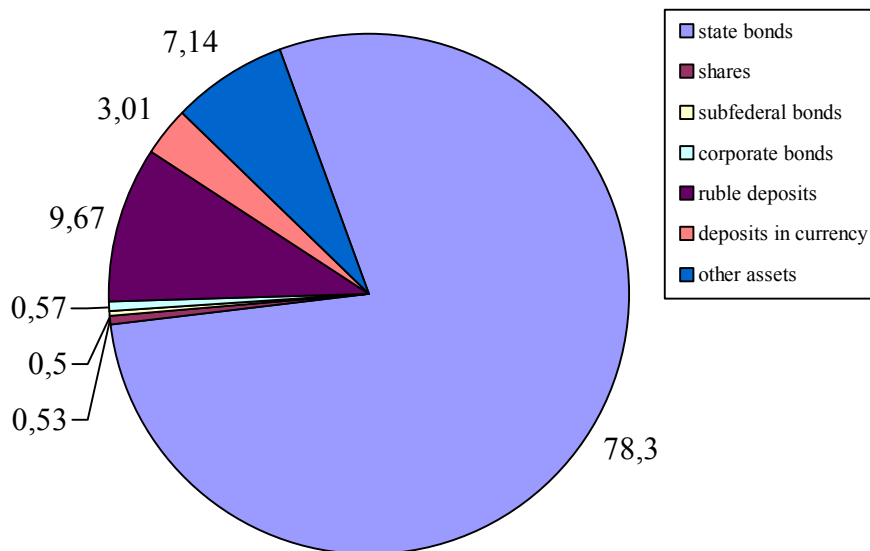
By the end of the 1<sup>st</sup> quarter of 2004, the share of investment in fixed assets made 11.4 per cent of GDP and remained at about the level registered in the preceding year. In the situation characterized by the exceptionally favorable business situation on the world market of raw materials, dynamic increase in proceeds of exporters, as well as growing profitability of production of domestic goods and services due to an increase in the respective volumes of output, expansion of zones of profitable production and decline in the tax burden caused by the current tax reforms there might be expected higher indicators.

*O. I. Izryadnova*

### **Choice of instruments meant for investing pension savings funds**

In April management companies, which successfully passed competition for signing agreements of trust management of pension savings funds, started investing the funds transferred to them by the Pension Fund of Russia according to applications submitted by insured people.

Aggregate structure of the investment portfolios of private management companies by the end of May is given in Graph 1. According to the data as of May 25, management companies invested in state bonds 78.3 percent of personal savings transferred to them. In shares of Russian companies they invested 0.53 percent, in securities issued by subjects of the Federation they invested 0.5 percent, in corporate bonds—0.57 percent. In cash assets and on deposits there are 12.9 percent of the amount of pension savings including 9.67 percent are in rubles, 3.01 percent—in foreign currency. Still 7.14 percent are in other assets.

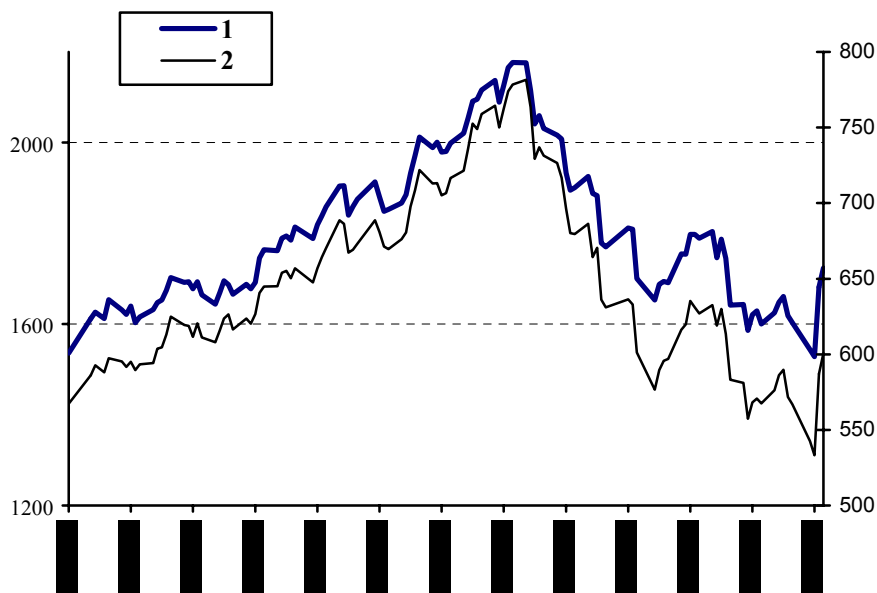


Source: "New Izvestia" 31.05.2004

Graph. 1 Investment of pension savings funds by management companies as of 25 May 2004

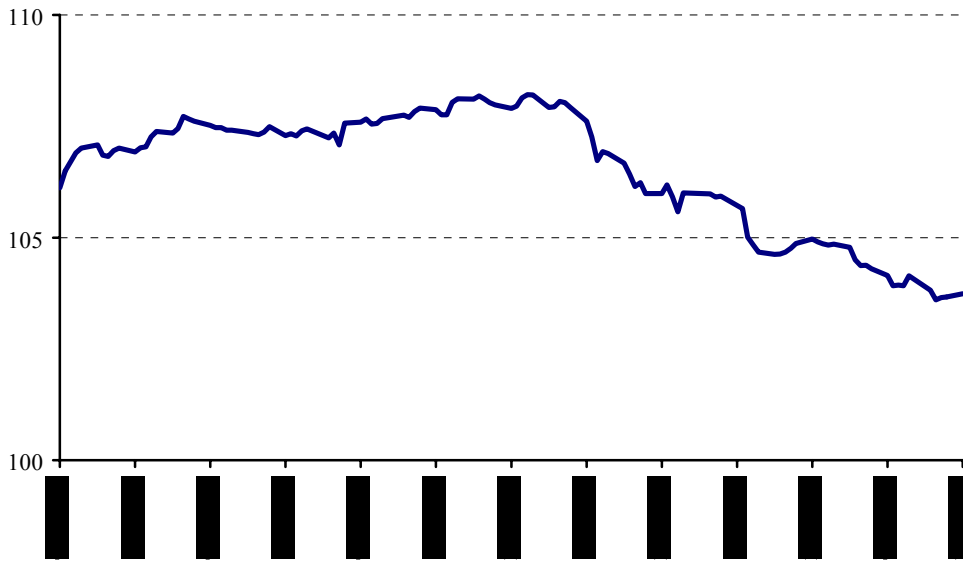
In such a way the share of corporate bonds and shares is considerably lower maximum allowed level.

Of course, negative situation on the securities market (see Graph 2 and 3) resulted in a cautious behavior of management companies regarding these instruments. At the beginning of April the marker looked overheated and then recession began, which continued in May. "Blue chips" and the most liquid issues of corporate bonds and subfederal bonds suffered the biggest fall. A low level of ruble liquidity recorded in the banking system negatively influenced the price dynamics on the stock market. The shortage of ruble liquidity was a result of reduction of balances on correspondent accounts and high rates of inter-bank loans.



1 - RusIndex Titans 10 (USD) (left axis)  
 2 - Index RTS (USD) (right axis)  
 Sources: www.rts.ru, www.djindexes.com

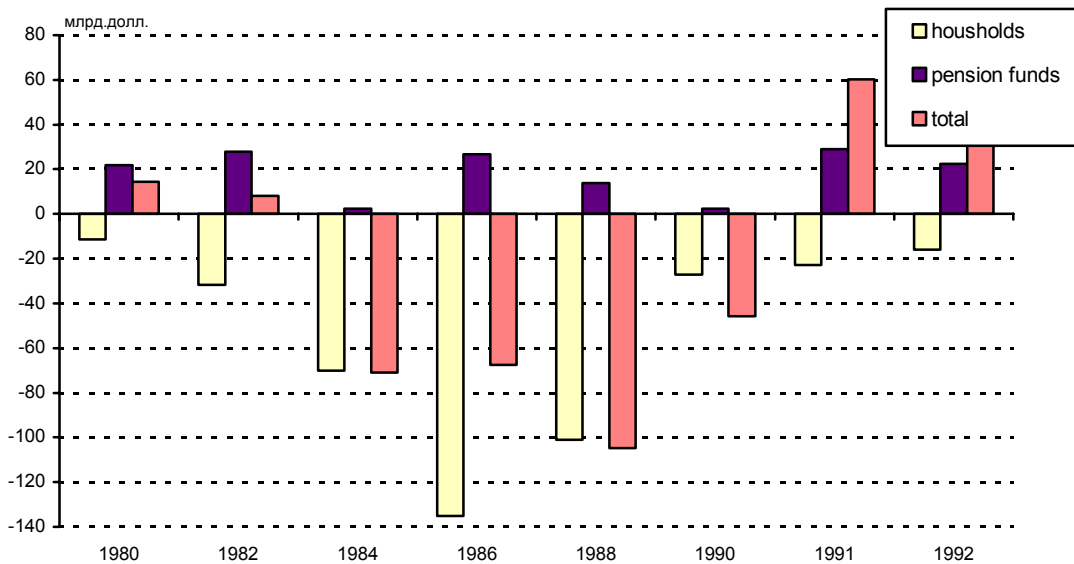
Graph 2. Dynamics of dollar RTS indicators and RusIndex Titans 10



Source: www.micex.ru

*Graph 3.* Dynamics of indicator of corporate bonds on MICEX

In the countries that have long traditions of collective investment pension funds as well as investment funds in such situations pay stabilizing role because their investment horizons are oriented for long-term perspective. For example, in the United States in 1980s—the beginning of 1990s when physical persons actively sold shares and net purchases of the households recorded negative index, net purchases of the pension funds during the whole period recorded positive indices and had a leveling influence on the overall dynamics of the stock market. (see Graph 4).



Source: Federal Reserve Bulletin, November 1993

*Graph 4.* Net purchases of shares in US in 1980-1992

Russian management companies so far are more market oriented, which to a certain extent is provoked by the proper model of the savings pension system, according to which once a year insured person can transfer his savings to another management company or private pension fund and uncertainty of the future of these funds in view of announced by the Government measures on financing forecasted deficit of Pension fund of Russia. Overall amount of funds transferred to private manage-

ment companies could not significantly influence the dynamics of market indicators. Overall volume of shares auction at the stock exchange of RTS and MICEX amounted to 353.4 billion rubles in April and 211.5 billion rubles in May (data published by MICEX and RTS). In that way the sum of pension savings transferred to the management companies in the volume of 1.6 billion rubles even been totally invested in shares in April would have constituted 0.4 percent of the turnover. In May this indicator would have constituted 0.7 percent of the overall auction volume.

Resolution of the Government of RF №379 dates 30.06.2003<sup>10</sup> determines that not more than 40 percent of pension savings can be invested in shares. Due to this fact indicators fall by more than half. Similar situation is being formed with regard to bonds. In April 2004 overall bond auction volume at MICEX and RTS amounted to 15.4 billion rubles out of which 6.2 billion rubles were in corporate bonds, 9.1 billion rubles were in subfederal bonds and 0.1 billion rubles were in municipal bonds. In May 2004 overall volume of bond auction at MICEX and RTS amounted to 8.2 billion rubles out of which 2.3 billion rubles were in corporate bonds, 5.8 billion rubles were in subfederal bonds and 0.1 billion rubles were in municipal bonds. Thus, parting from a premise that private management companies would have placed in bonds maximum allowed volume of pension savings (50 percent), then they would have constituted in April 2004 the amount of 5.2 percent and in May – 9.8 percent. Because the chance for investing pension savings funds in maximum limits is small then shares of pension savings in the volume of shares and binds auction will be less and they will not significantly influence shares and corporate bond markets.

At the same time, the analysis of publications related to the initial stage of investing pension savings by private management companies by far not all of them turned out to be ready to work in the new segment of the market. For example, part of the management companies confronted the problem of independent selection of instruments for investment taking into consideration the restrictions established by the Federal Law "On investing funds for financing the savings component of the retirement pension in the Russian Federation", investment declaration and additional quantitative restrictions for the issuers of bonds fixed by the Government Resolution N379. First of all, this is related to issues of information backup of investment in securities issued by private issuers.

Some of the requirements formulated to securities for the investment of pension savings funds and mentioned in the above-cited Resolution do not seem to be successful. As management companies note<sup>11</sup> selection of securities is very time and labor consuming.

According to the Resolution investment of pension savings funds that are in the trust of management companies into shares is restricted by those issuers whose shares are listed in exchange quotations. Market value of shares must amount to no less than 300 million rubles, value of net assets of the issuers of securities must amount in case of shares to no less than 500 million rubles, average monthly amount of market transactions with stock of OAO (open-end joint-stock company) calculated as of last six months must constitute no less than 2 million rubles. Besides the issuer must have no less than 1000 shareholders and record no losses as minimum during last two years.

Several issues appear, which are not dealt by the Government Resolution N379. For example, how frequently should management companies keep recording the compliance of the issuers, whose shares they have purchased into their portfolios, with set forth requirements. Also information about the value of net assets is not freely accessible and its evaluation is difficult for management companies. Besides this, the process of collecting such necessary information on issuers, in whose shares private management companies place pension savings, as the number of shareholders, frequency of publication and accounting composition is rather labor consuming.

On the whole, requirements set forth in the Government Resolution N379 are very close to the requirements given for including securities into quotation listing "A" of the first level. For example, according to Resolution of the Federal Securities Commission dated 4 January 2002 N1-ps "On adopt-

---

<sup>10</sup> Furthermore, the Ministry of finance of RF issued order № 27H dated 5 March 2004 г. "On determining criteria for placement of pension savings funds into assets indicated in subparagraph 2-4 and b paragraph 1 Article 26 of the Federal law dated 24 July 2004 N 111-FZ "On investing funds for financing the savings component of the retirement pension in the Russian Federation," however it does not contain additions to the requirements mentioned in Government Resolution №379

<sup>11</sup> See: Delovoy Peterburg. 9.04.2004, Vedomosty 2.04.2004

ing provision on requirements put to the organizers of auction at the securities market”<sup>12</sup>, market value of shares must constitute no less than 300 million rubles, value of net assets of the issuer of the securities must constitute in case of shares no less than 500 million rubles, calculated as of last six months average monthly amount of transactions with securities must be no less than 2 million rubles in case of shares. List of shares, which are allowed for the investment of pension funds can be wider than the quotation listing “A” of first level because the issuer can comply with the requirements set for the quotation listing “A” of first level but not be in the list. Among shares that got into this category according to the lists compiled by management companies on the basis of their own analytical research are shares of major companies, such as Aeroflot, Norilskiy nickel, Severstal, Sibirtelecom, Surgutneftegaz. Cumulative capitalization of these issuers as of March 31 amounted to about 53 billion dollars. On the other hand, ordinary shares of Stoilenskiy GOK are in the quotation listing “A” of the first level in MICEX, however, the volume of their trading is below the fixed average monthly volume of market transactions with OAO as it is determined by the Government Resolution N379. However, they are not taken out of listing.

According to our estimates, as of March 31, 2004 capitalization of the issuers, whose shares are allowed for the investment of pension savings funds, amounted to 208 billion US dollars, which represented about 83 percent of the aggregate capitalization (according to data Red-Stars/Financial, capitalization of Russian issuers as of March 30 constituted 250.2 billion US dollars). Overall volume of stock trading listed in the quotation listing “A” of first level for five months of 2004 amounted to 85 percent of the total volume of stock trading at MICEX for this period.

Requirements contained in the Government Resolution N379 regarding bonds coincide with the requirements designed for including bonds in quotation listing “A” of first level according to the Federal Securities Commission Resolution N1-ps. For example, market value of bonds, which are allowed for the investment of pension savings funds, must constitute no less than 30 million rubles. Average monthly volume of market transactions with state bonds of the subject of RF, municipal bonds and bonds of Russian economic entities calculated as of last six months is no less than 400 thousand rubles.

At MICEX bonds of nine issuers were part of quotation listing “A” of first level as of the beginning of April. However, the volume of bond trading of OAO “MMK”, which are included in the highest listing does not satisfy restriction determined by the Government Resolution N379 for the average amount of transactions with bonds of Russian economic entities. Aggregate volume of circulating issues of corporate bonds, into which private management companies can place part of pension savings funds, constituted, according to our estimate, by the end of the first quarter 2004 about 14 percent of the overall volume of corporate bonds in circulation at face-value. Volume of trading in January-March of these issues at MICEX constituted about 30 percent of the cumulative volume of secondary trading in the segment of corporate bonds at MICEX.<sup>13</sup>

Subfederal and municipal bonds are traded mainly in two stock exchanges—MICEX and StPCEX. MICEX quotation listing of the first level comprises bonds issued by 11 subject of RF, whose overall volume constitutes 88.7 billion rubles and municipal bonds of an issuer (issuance volume—0.7 billion rubles). Bonds issued by the Government of Moscow dominate. StPCEX quotation listing of first level includes only bonds issued by the Finance Committee of the Administration of St. Petersburg (number of issues of the overall volume in circulation as of March 1, 2004 amount to 10.6 billion rubles). However, management companies participating in the discussion of investment issues that took place in mass media ignored them.

Among subfederal bonds, which were marked by management companies as complying criteria set by the Government Resolution N379, but which are not in quotation listing “A” of first level are bonds issued by Irkutsk, Kostroma, Tomsk, Yaroslavl oblasts and Chuvash republic. Management companies also noted municipal bonds of Novosibirsk as valid for investment. Overall issuance volume of these

---

<sup>12</sup> was enacted on July 1 by the Resolution of the Federal Securities Commission dated 26 December 2003 N 03-54/ps

<sup>13</sup> List of issuers of corporate bonds that do not enter quotation list of the highest level but purchase of their bonds private management companies do not exclude, include Bashkirenergo, Bashinformsviaz, Mechel, Tsenttelecom. Cumulative volume of bonds issued by them constitutes 2.25 billion rubles.

bonds constitutes 4.1 billion rubles. These bonds meet requirements put to the volume of issuance and trading turnover for placement of pension savings into them. However, they are included in MICEX quotation listing “B”.

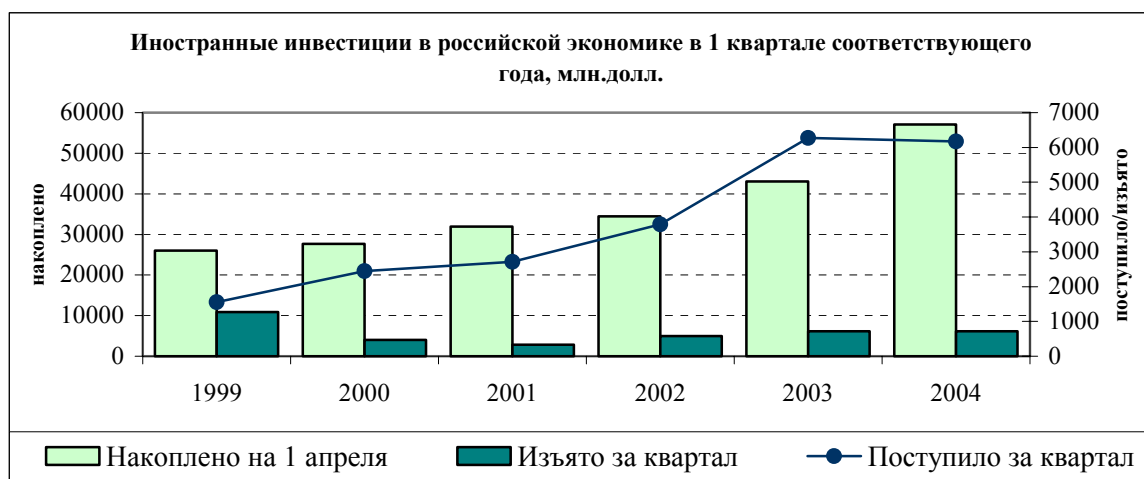
On the whole, even taking into account additional requirements the list of permitted instruments designed for investing provides management companies with a sufficient choice of instruments for investing those amounts, which they received in their trust. Prospects for a considerable increase of this amount in the near future are vague due to approved by the State Duma amendments to the Federal law “On compulsory pension insurance in the Russian Federation,” according to which citizens born before 1967 are excluded from the savings pension system, which leads to a reduction in contributions to the pension system by about 23 percent in the year 2005.<sup>14</sup>

*Marushkina E.V., Sycheva L.I., Tochilkina O.S., Mikhailov L.V.*

## Foreign investment in the Russia's economy

The beginning of this year is characterized by the persisting attractiveness of the Russian market for foreign investors. According to the results of a study carried out by the Ernst & Young agency, Russia was included in the top ten most attractive countries in terms of investment and was recognized as one of the most prospective country for investment in the world (the study based on the survey of top managers of 513 companies in February and March of 2004).

The total amount of foreign investment in the non-financial sector of the Russian economy (not taking into account the monetary and credit regulating authorities, commercial and savings banks, and including Ruble denominated investment in US \$ equivalent made US \$ 6171 million in the 1<sup>st</sup> quarter of 2004 and practically has not changed in comparison with the figures registered in the respective period of the preceding year (US \$ 6268 million in the 1<sup>st</sup> quarter of 2003).



Source: RF Goskomstat

In comparison with the developments observed last year, there have been registered significant changes as concerns the types of foreign investment. Thus, direct investment and portfolio investment increased 1.5 times and 5 times respectively, while “other” investment declined by 11.7 per cent.

In spite of a significant growth in portfolio investment in the 1st quarter of this year, their specific weight in the aggregate foreign investment in the Russian economy remained at a very low level (1.4 per cent). “Other” investment still account for the major share of foreign investment.

As concerns direct investments, it should be noted that there was observed positive developments as contributions to authorized capitals of enterprises located in the Russian territory grew 3.4 times (up to US \$ 1.06 billion). At the same time, the credit component of direct investment somewhat decreased.

<sup>14</sup> Calculation on the basis of forecast



Source: RF Goskomstat

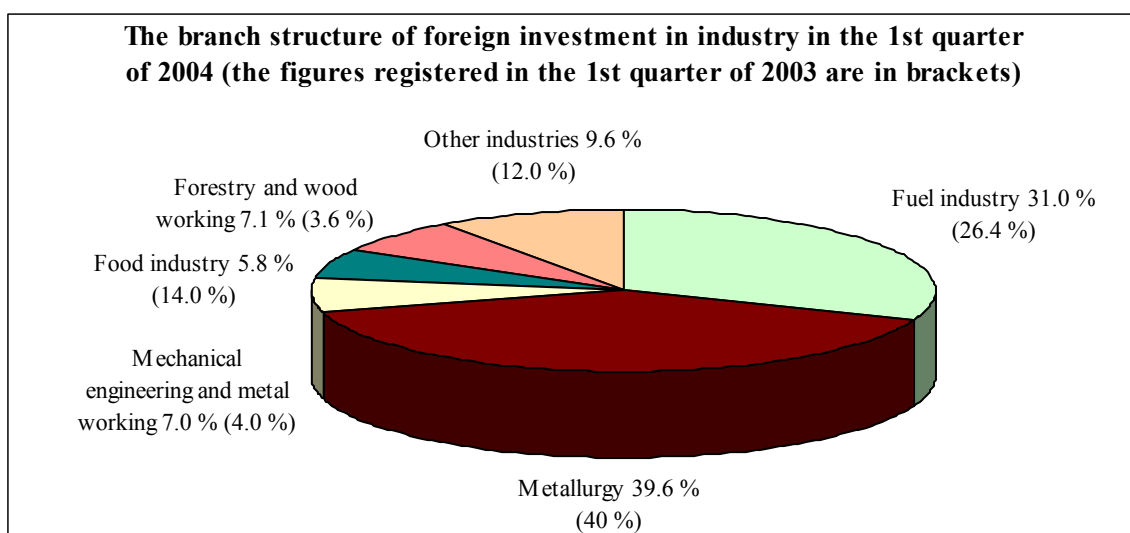
The sectoral structure of foreign investment also underwent significant changes. The amount of foreign investment in non-production sectors has significantly diminished. This year, foreign investors prefer to invest in industry (47 per cent of the total foreign investment in the Russian economy in the 1<sup>st</sup> quarter of 2004), trade, and public catering (31.3 per cent). The amount of foreign investment in different industries made US \$ 2.9 billion, what is by 67.9 per cent above the figures registered in the 1<sup>st</sup> quarter of 2003.

**Sectoral structure of foreign investment in the Russia's economy  
in the 1st quarter of 2002 through 2004**

	US \$ mil.			Change in comparison with the figures registered in the 1 <sup>st</sup> quarter of the preceding year			In % of the total		
	2002	2003	2004	2002	2003	2004	2002	2003	2004
Industry	1755	1727	2900	48,5%	-1,6%	67,9%	46,3	27,6	47,0
Construction	8	30	55	-42,9%	3,75 times	83,3%	0,2	0,5	0,9
Transport and communications	234	506	163	-18,8%	2,16 times	-67,8%	6,2	8,1	2,6
Trade and public catering	1302	3282	1934	в 3,54 p.	2,52 times	-41,1%	34,4	52,4	31,3
Commercial activities relating to market servicing	208	243	541	98,1%	16,8%	122,6%	5,5	3,9	8,8
Finance, credit, insurance, pensions	11	59	236	-76,6%	5,36 times	4 times	0,3	0,9	3,8
Other sectors	271	421	342	-62,0%	55,4%	-18,8%	7,2	6,7	5,5

Source: RF Goskomstat

In the 1<sup>st</sup> quarter of 2004, there was observed a decline in the concentration of investment in a group of certain industries. Although foreign investors still demonstrate interest in fuel industry and metallurgy, they pay more attention to the Russian manufacturing sector. Thus, in the 1<sup>st</sup> quarter of this year investment in mechanical engineering increased almost 3 times in comparison with the figures registered in the respective period of 2003 and made US \$ 204 million, while investment in forestry, wood working and pulp and paper industry grew 3.3 times (up to US \$ 206 million) and exceeded the level of foreign investment in food industry accounting for US \$ 197 million of investments, what is by 31 per cent below the figures observed in the 1<sup>st</sup> quarter of 2003.



Source: RF Goskomstat

The structure of foreign investment made in industry in the 1<sup>st</sup> quarter of 2004 significantly differs from the similar structure of aggregate foreign investment in the Russian economy. Thus, direct investments make 35.5 per cent of the total foreign investment in industry (the share of direct foreign investment in the aggregate indicators made 23.9 per cent). Similar indicators relating to portfolio and “other” investment in industry are evaluated to be at 0.3 per cent (1.4 per cent) and 64.2 per cent (74.7 per cent) respectively.

#### Foreign investment in industry in the 1<sup>st</sup> quarter of 2002 through 2004

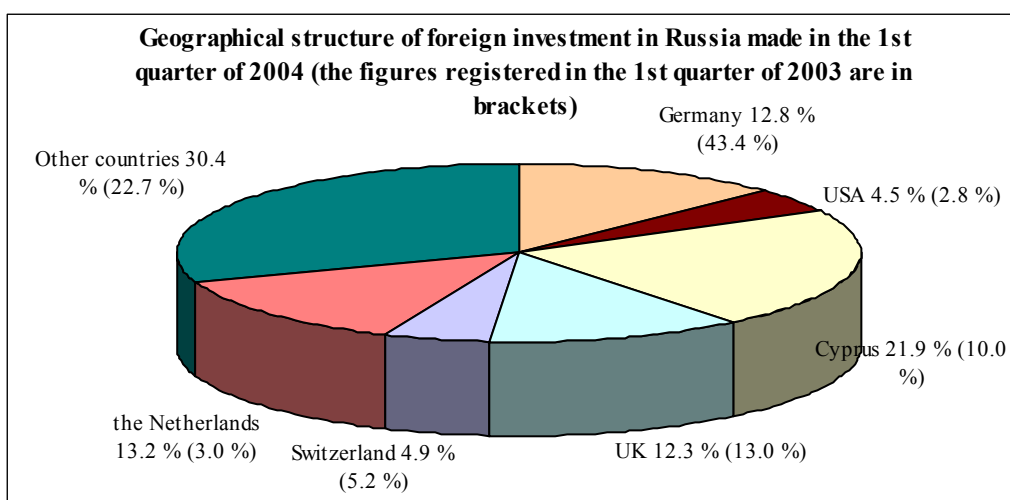
	US \$ mil.			Change in comparison with the figures registered in the 1 <sup>st</sup> quarter of the preceding year			Specific weight (in %) in the respective aggregate indicators		
	2002	2003	2004	2002	2003	2004	2002	2003	2004
Direct investment	407	460	1030	4,9%	13,0%	в 2,2 р.	49,1	44,5	69,7
Portfolio investment	8	14	8	5 times less	75%	- 42,9%	9,1	77,8	8,9
Other investment	1340	1253	1862	77,7%	-6,5%	48,6%	46,6	24,0	40,4

Source: RF Goskomstat

A rather significant growth in investment in industry may be in part explained by the fact that a number of Russian regions grants foreign investors subsidies from regional budgets permitting them to pay the profit tax at reduced rates.

In the 1<sup>st</sup> quarter of 2004, there were observed significant changes in the geographical structure of foreign investment in the Russian economy, primarily related to an almost 3.5 times decline in the amount of investment from Germany, which was the leader among investing countries according to the data for the 1<sup>st</sup> quarter of 2003. Thus, while in the 1<sup>st</sup> quarter of 2003 German investment made US \$ 2.7 billion, this year they are evaluated to be at US \$ 790 million. Traditionally, “other” investment prevailed in the investment to the Russian Federation made by German investors (the share of such investment makes about 90 per cent of the German investment in Russia).





Source: RF Goskomstat

In the 1<sup>st</sup> quarter of 2004, the most significant growth in investment in the RF was registered with respect to the Netherlands (the amount of investment increased 4.3 times and made US \$ 815 million).

The five largest investing countries accounted for 65 per cent of the total amount of foreign investment accumulated in the 1<sup>st</sup> quarter of 2004.

In the 1<sup>st</sup> quarter of this year, German entrepreneurs demonstrated their interest in the sphere of metallurgy (US \$ 362 million, or 45.8 per cent of the aggregate German investment in the RF), as well as trade and public catering (US \$ 259 million, or 32.8 per cent). It should be noted that German investment in trade and public catering declined 7.4 times in comparison with the figures registered in the 1<sup>st</sup> quarter of 2003, primarily due to a more than 8 times decline in the amounts of crediting of this sphere.

Investors from the Netherlands invested US \$ 660 million, or 81 per cent of their total investment in the Russian economy in the 1<sup>st</sup> quarter of 2004 in fuel industry. Direct investment accounted for 99.7 per cent of the total Dutch investment in fuel industry. At the same time, this year the Netherlands became the largest foreign investor in fuel industry.

This year, British investors preferred to invest in metallurgy (US \$ 216 million, or 28.5 per cent of the total investment in the RF from UK made in the 1<sup>st</sup> quarter of 2004), as well as trade (US \$ 225 million or 29.7 per cent), as compared with US \$ 105 million (12.9 per cent) and US \$ 457 million (56.3 per cent) of British investment in Russian metallurgy and trade registered in the 1<sup>st</sup> quarter of 2003.

Although according to the results of the 1<sup>st</sup> quarter of this year Germany lost its leading positions, it still is the leader as concerns the structure of foreign investment accumulated by April 1, 2004. By the end of March of 2004, the amount of accumulated investment in the economy of the Russian Federation made US \$ 57 billion, what was by 32.6 per cent above the indicators registered by the end of March of 2003.

#### Structure of accumulated foreign investment as broken down by major investing countries.

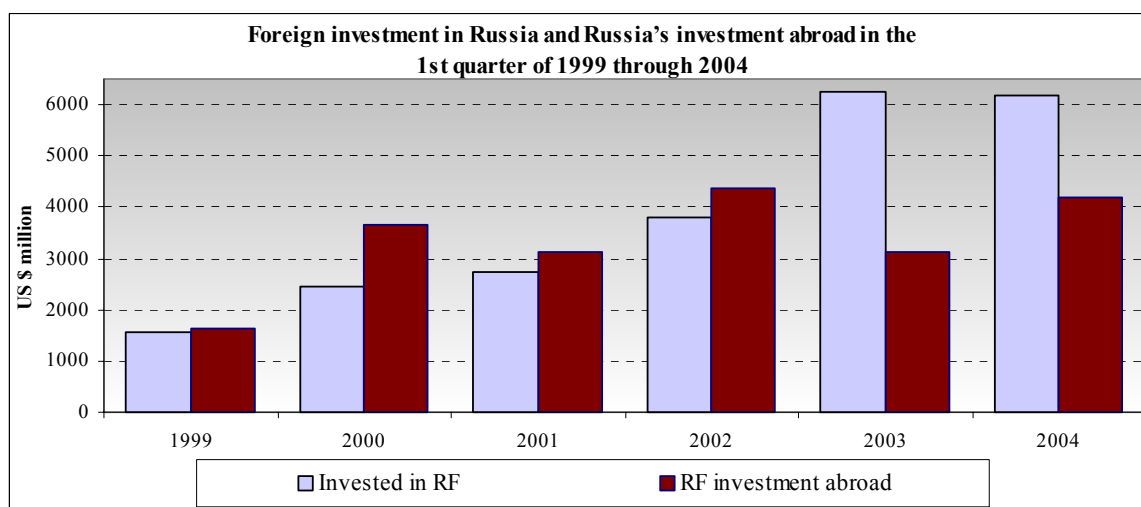
	Accumulated by 01.04.2004, US \$ mil.				Change to 01.01.2004, %			
	Total	Direct	Portfolio	Other	Total	Direct	Portfolio	Other
USA	4807	3778	36	993	-9,2	-12,1	-12,2	3,7
Germany	10524	2308	361	7855	3,1	-9,2	-5,7	7,9
France	4903	299	0,1	4604	2,7	-9,7	0	3,6
UK	5071	1277	108	3686	-29,8	-54,8	0,9	-14,0
Cyprus	8447	4676	580	3191	4,5	-7,2	6,0	27,6

	Accumulated by 01.04.2004, US \$ mil.				Change to 01.01.2004, %			
	Total	Direct	Portfolio	Other	Total	Direct	Portfolio	Other
The Netherlands	7568	6060	16	1492	111,7	116,7	220	92,8
Other countries	15744	6119	327,9	9297	-11,8	-26,3	-5,2	0,9
Total	57064	24517	1429	31118	0,09	-6,2	0	5,6

Source: RF Goskomstat.

It is a favorable circumstance that this year the amount of foreign investment in the Russian economy still exceeds the amount of Russian investment abroad.

Foreign investment in Russia and Russia's investment abroad in the 1<sup>st</sup> quarter of 1999 through 2004



Source: RF Goskomstat.

*E. M. Ilyukhina*

## The Real Sector: Factors and Trends

In the 1<sup>st</sup> quarter of 2004, the amount of GDP increased by 7.4 per cent in comparison with the figures registered in the 1<sup>st</sup> quarter of 2003 and made Rub. 3598.9 billion in current prices terms. The high level of business activity was observed across practically all sectors of the economy. At the background of stable expansion of external demand, export oriented industries have retained their leading positions in the Russian economy. On the domestic market, the situation was determined by the expansion of both investment and consumer demand. In January through May of 2004, the increase in output of goods of final demand made 10.8 per cent, while the growth in output of industries of the investment complex and consumer complex increased by 13.4 per cent and 6.3 per cent respectively.

The estimates of macroeconomic indicators calculated by IET for the end of 2004 demonstrate that in the case the current trends and scenario based changes in conditions of functioning of the economy the persistence of intensive dynamics of external and investment demand remain the major factors of growth. In the case the increase in investment in fixed assets and exports as expected is at 111.5 per cent and 118.1 per cent respectively, in 2004 GDP may grow by 6.6 per cent in comparison with the figures registered in the preceding year.

The Federal Service of State Statistics has for the first time evaluated GDP of this year. The amount of GDP increased by 7.4 per cent in comparison with the figures registered in the 1<sup>st</sup> quarter of 2003 and made Rub. 3598.9 billion in current prices terms. The official evaluation of GDP was by 0.6 p. p. below the expected level because of the adjustment of calculations relating to the external trade.

The intensive growth in industry and amount of works in construction, which compensated the negative influence of decline in output of agriculture, had the decisive effect on the structure of pro-

duced GDP. As a result, the share of the commodities sector made 38.3 per cent of GDP increasing by 0.9 p. p. in comparison with the figures registered in the 1<sup>st</sup> quarter of 2003. The dynamic growth in production of goods was supported by expanding demand for services. The outpacing rates of growth in market services in comparison with the dynamics demonstrated by production of goods and non-market services was a key factor behind the changes in the structure of the economy, since exactly this economic sector demonstrated growing demand for investment and labor resources. In comparison with the figures observed in the 1<sup>st</sup> quarter of 2003, the share of industries rendering market and non-market services in the total amount of investment in fixed assets increased by 3.0 p. p., while the average annual number of employed grew by about 1.2 p. p.

*Table 1*

**Rates of growth in the amounts of real GDP produced in the 1<sup>st</sup> quarter of 2001 through 2004, in % of the figures registered in the respective period of the preceding year**

	1 <sup>st</sup> quarter			
	2001	2002	2003	2004
Gross Domestic Product in market prices	104,7	103,8	107,5	107,4
including:				
Production of goods	105,6	103,2	106,9	107,6
industry	105,4	102,8	106,5	107,5
construction	105,6	109,6	113,6	113,8
agriculture	107,0	102,5	101,1	98,6
Production of services	103,7	103,9	108,0	107,0
market services	104,7	104,3	109,0	107,8
including:				
transport	103,0	104,4	106,4	106,8
communications			117,8	123,9
trade	104,4	106,5	112,8	108,1
non-market services	98,5	101	102,4	102,2

Source: Federal Service of State Statistics

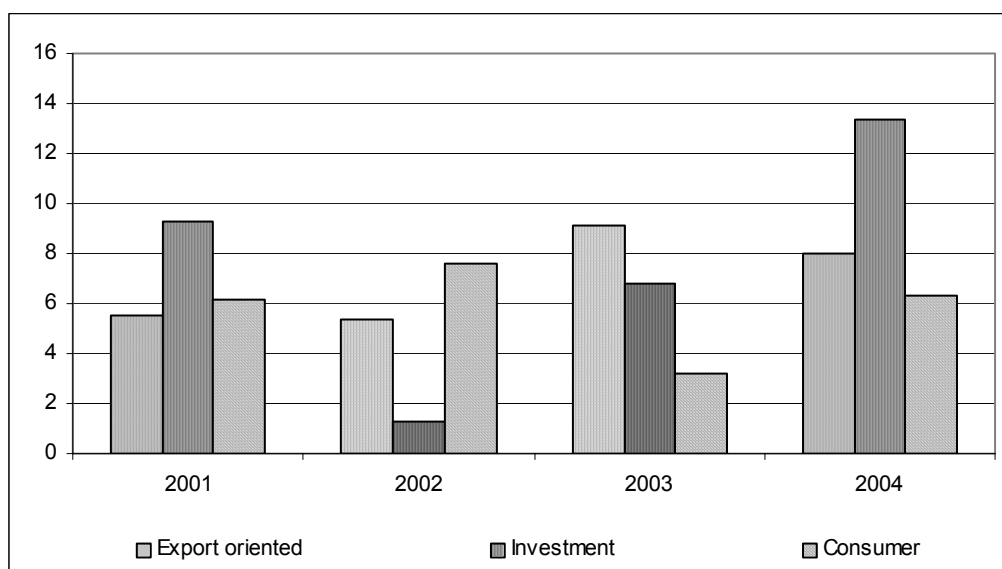
Over the first five months of 2004, the increase in output of production and services of base sectors of the economy made 7.7 per cent as compared with 7.1 per cent registered in the respective period of the preceding year. The high level of business activity was observed across practically all sectors of the economy: the amount of industrial output increased by 7.0 per cent, while the amount of retail trade and the construction grew by 11.0 per cent and 14.9 per cent respectively. The exceptionally favorable business situation on world markets of energy resources and metals had a positive effect on the acceleration of rates of economic development. In January through May of 2004, the amount of exports increased by 26.1 per cent as compared with the figures registered in the respective period of the preceding year. In the 1<sup>st</sup> quarter of 2004, the increase in export of crude oil made 15.6 per cent as compared with 8.4 per cent registered in the respective period of the preceding year, while export of ferrous metals grew by 38.3 per cent (as compared with 30.8 per cent in the same period of the last year). This ratio between rates of development across sectors reflects the specifics of economic dynamics this year.

At the background of stable expansion of external demand, export oriented industries have retained their leading positions in the Russian economy. In January through May, the production index in fuel industry made 108.3 per cent, including oil extracting branch – 110.1 per cent and oil processing sector – 100.7 per cent. Over the same period, output of ferrous and non-ferrous metallurgy increased by 5.9 per cent and 4.2 per cent respectively.

Due to high profitability of export operations, in January through April of 2004 the net financial results demonstrated by the export oriented sector increased by 73.0 per cent as compared with the average 62.9 per cent across industries. In January through April of this year, the net profit of oil extracting industry increased 2.4 times, while ferrous and nonferrous metallurgy demonstrated growth 1.9 times and 1.6 times respectively. The results of economic operations in manufacturing industries are characterized by more modest dynamics. This year, the net financial results of mechanical engineering became positive and made 137.6 per cent as compared with a 7.5 per cent decline registered in January

through April of 2003, while in food industry the increase in net profits made 17.2 per cent in comparison with 9.6 per cent observed a year ago.

On the domestic market, the situation was determined by the expansion of both investment and consumer demand. In January through May of 2004, the increase in output of goods of final demand made 10.8 per cent, while the growth in output of industries of the investment complex and consumer complex increased by 13.4 per cent and 6.3 per cent respectively. Mechanical engineering (114.2 per cent in comparison with the figures registered in January through May of 2003) and food industry (107.5 per cent) have most significantly affected the structural changes in industry. Light industry is in the situation of a permanent crisis: the decline in its output in comparison with the figures observed in January through May of 2003 made 2.3 per cent.



*Figure 1.* Changes in the rates of growth across industrial and production complexes in January – May in 2001 through 2004, in % of the figures registered in the respective period of the preceding year

The moderate dynamics of production of consumer goods were observed at the background of expanding effective household demand. In early 2004, there was again restored the trend towards outpacing rates of growth in wages and salaries in comparison with labor productivity. The growth in real household incomes and changes in the structure of their utilization were additional characteristics of economic growth. In January through May of 2004, the real disposable household incomes increased by 9.9 per cent, while real wages and salaries grew by 14.4 per cent in comparison with the figures registered in the respective period of the preceding year. As compared with the data collected in January through May of 2003, the increase in sales on nonfood goods made 12.5 per cent, while sales of foodstuffs grew by 9.5 per cent. The increasing gap between rates of growth in domestic production and increasing household demand was bridged at the expense of imports. However, in comparison with the figures registered in the 1<sup>st</sup> quarter of the preceding year, the share of imports in the formation of commodity resources of retail trade has declined by 2.0 p. p. and made 44 per cent. Among the factors explaining this situation, there are should be first of all pointed out, first, the development of competitive sector of domestically produced food products for the domestic market, and, second, the changes in the structure of the retail trade turnover and imports in favor of organized trade, as well as, third, gradual formation of the systems facilitating sales of domestically produced goods.

At the same time, the high share of imported goods in retail trade with nonfood goods, as well as in investment resources demonstrates that in the post-crisis period the processes of restructuring and diversification of branches of light industry and mechanical engineering were not adequate to the dynamic changes in effective demand. In the Russian economy there persists the trend towards an outpacing rate of growth in imports in comparison with the dynamics of domestic production. As concerns the results of the 1<sup>st</sup> quarter of 2004, imports grew by 21.3 per cent, while the growth in household consumption increased by 8.2 per cent, investment demand grew by 13.1 per cent, and production of intermediate goods increased by 6.8 per cent. The gradual decline in the prices of imports at the

background of gradual Ruble appreciation facilitated the persistence of high import dynamics. However, according to the IET data (see *S. Tsukhlo IET business survey: industry*), the major factor affecting the competitive capacity of Russian products is the technological backwardness of production and obsolete equipment. In this situation, the expansion of imports rather compensates for the low business activity of Russian businesses in the manufacturing sector of the economy than is a factor checking the development of domestic production. An analysis of changes in the structure of imports demonstrates a stable increase in the share of machinery and equipment. In the 1<sup>st</sup> quarter of 2004, the specific weight of import of machinery and equipment in the commodity structure of imports made 43.4 per cent and by 5.5 p. p. exceeded the respective indicators observed in 2003 and 2003. Apparently, the measures aimed at reduction of import duties on certain types of technological equipment and completing parts for assembly production facilitated higher intensity of this process.

The estimates of macroeconomic indicators made by IET for the end of 2004 demonstrate that in the case the current trends and scenario based changes in conditions of functioning of the economy the persistence of intensive dynamics of external and investment demand remain the major factors of growth. In the case the increase in investment in fixed assets and exports as expected is at 111.5 per cent and 118.1 per cent respectively, in 2004 GDP may grow by 6.6 per cent in comparison with the figures registered in the preceding year.

*O. I. Izryadnova*

## **Oil-and-gas sector**

The state of development of the oil-and-gas sector of the economy in January-May 2004 was characterized by the same tendency of oil and gas production growth. Oil production growth came to 10.2 percent in comparison with the respective period of last year, which was specified mainly by an increase in export volume. World prices on crude oil remained at the very high level, which allowed to considerably increase export revenue. Current situation in the world oil market permits to count on preservation in the near future of high world prices on oil and favorable external conditions for the development of the oil-and-gas-sector.

World prices on oil that determine the state of Russian oil-and-gas sector remained at an exceptionally high level in recent months. Due to a reduction in oil production in Iraq and restriction in oil production introduced by the OPEC countries, the average price of OPEC oil basket considerably surpassed the upper limit of targeted price band of \$US22-28 per barrel set by the organization and average price of Russian Urals for the last three months and came to \$US31.8 per barrel (Table 1).

*Table 1*

**World oil prices in 2000-2004 \$US/barrel**

	2000	2001	2002	2003	2004 January	2004 February	2004 March	2004 April	2004 May
Oil prices Brent, Great Britain	28,5 0	24,4 4	25,0 2	28,83	31,2 3	30,8 3	33,7 9	33,2 5	37,8 0
Oil prices Urals, Russia	26,6 3	22,9 7	23,7 3	27,04	28,8 8	27,6 4	30,3 1	30,13	35,07

Source: OECD International Energy Agency.

State of development of the oil-and-gas sector of the economy in January-May 2004 was characterized by the same tendency of oil and gas production growth (Table 2). Growth of oil production volume in comparison with the respective period of past year came to 10.2 percent, growth of gas production amounted to 2.8 percent. At the same time, there was recorded a certain reduction in investment activity: the volume of oil production drilling in January-April 2004 went down by 8.5 percent in comparison with the previous year, the number of new wells put into operation went down by 3.6 percent. Exploration drilling for oil continued to decline (by 15 percent in comparison with the previous year), which can be explained by a rather high level of current oil reserves. At the same time, a sharp growth of investment activity was recorded in gas sector: volumes of production and exploration drilling on gas in the first quarter of 2004 went up in 2.5-3 times in comparison with the previous year. Grade of oil processing in January-April 2004 in petroleum refining industry grew from 63 percent up to 70.2 percent and the share of high-octane petrol in the overall production volume of motor gasoline grew from 48.3 percent up to 52.7 percent.

Table 2

**Production of oil, oil products and natural gas in 2000-2004 in % to previous period**

	2000	2001	2002	2003	2004 January- May
Oil	105,9	107,7	108,7	111,1	110,2
Gas condensate	103,8	106,7	112,8	108,7	118,9
Primary oil refining	102,7	103,2	103,3	102,7	100,1
Motor gasoline	103,6	100,6	104,9	101,2	102,3
Diesel oil	104,9	102,0	104,7	102,0	101,3
Heating oil	98,3	104,2	107,1	100,3	94,4
Natural gas, bln cub. M	98,5	99,2	101,9	103,4	102,8
Gas condensate, bln. Cub. M.	102,5	105,0	110,5	119,3	108,1

Source: Goskomstat of Russia

Considerable price growth is recorded in the current year on domestic market. To a considerable extent, it is connected with high level of world oil prices and enhancement of oil export (including transportation by rail). In April average domestic oil price (producers' price) in dollar terms reached \$US79.6 per ton, which represents the maximum price level on crude oil recorded for the whole post-reform period (Table3, Graph 1). At the same time, considerable gap in the levels of domestic and world oil prices remained. Considerable price growth on natural gas was recorded in the first months of the year (to \$US9.5 per thousand cubic meters, which is also a historic maximum).

Table 3

**Domestic prices on oil, oil products and natural gas in dollar terms in 2000-2004  
(average producers' prices, dollars/ton)**

	2000 г. Decem- ber	2001 г. Decem- ber	2002 г. Decem- ber	2003 г. Decem- ber	2004 г. January	2004 г. Febru- ary	2004 г. March	2004 г. April
Crude oil	54,9	49,9	60,7	70,1	70,1	76,3	79,9	79,6
Motor gasoline	199,3	151,5	168,8	236,9	236,8	231,0	234,2	229,1
Diesel oil	185,0	158,5	153,8	214,3	224,3	223,4	225,5	227,0
Heating oil	79,7	47,1	66,1	66,0	66,5	66,4	65,4	66,7
Gas, dol- lars/thousand cub m	3,1	4,8	5,9	4,4	8,8	9,3	9,4	9,5

Source: calculated on Goskomstat of Russia data.

Oil export in the first quarter of 2004 in comparison with corresponding period of the previous year increased by 15.6 percent, oil products – by 6.0 percent. The export share in commodity resources of diesel oil amounted to 52.7 percent, heating oil – 40 percent, motor gasoline – 17 percent. (for comparison, in the year 1999 the export share in production of motor gasoline amounted only to 7.2 percent). As a result of growth on the domestic prices of oil products and increase of real value of the ruble import of oil products considerably went up (by 82 percent in comparison with first quarter of 2003). Growth rates of gas export decreased in comparison with previous year (from 2.1 percent in first quarter 2003 down to 1 percent in first quarter of current year).

Analysis of the world oil market demonstrates that one can expect high levels of world oil prices to continue in the near future. According to basic variant of the latest (June 2004) U.S. Department of Energy forecast world oil price, determined as an average price of oil imported in the United States will remain at a rather high level and will constitute on average for 2004 a sum of \$US32.3 per barrel. In addition, maximum price level (\$US34.6 per barrel) will remain in the second quarter of 2004 and in starting with the second half of 2004 a gradual decrease of world oil prices will be recorded. According to the U.S. Department of Energy forest average oil price in the year 2005 will come to \$US29.8 per barrel (Table 4).

Table 4

**World oil price forecast for 2004-2005 dollars/barrel**

	2000 г.	2001 г.	2002 г.	2003 г.	2004 г. (forecast)	2005 г. (forecast)
Average price of oil, imported to US*	27,72	22,01	23,69	27,74	32,30	29,84

\*Price of oil purchased by oil refineries.

Source: U.S. Department of Energy/Energy Information Administration.

At the same time, in the future dynamics of the world oil prices there is a considerable uncertainty linked with a possible presence of a number of hardly forecasted factors. For example, considerable increase in the world oil production due to an increase in OPEC production quotas (or considerable surplus in fixed quotas) as well as a considerable increase in oil exports by Russia, Iraq and other producers (high oil prices stimulate oil extraction in high production cost regions, i.e. beyond OPEC borders) will lead to a price reduction. Weakening of world demand on oil due to a reduction of economic growth rates in major oil importing countries or, for instance, exceptionally warm winter in Northern hemisphere can result in oil price cut.

Forecasts of world oil prices for long term developed by a number of leading international organization in 2003-2004 are given in Table 5. As can be seen from the given data all forecasts differ considerably depending on basic assumptions adopted by the developer in assessing a long-term dynamics of world prices. At the same time, practically all forecasts except high price scenario forecast developed by the U.S. Department of Energy envisage in the future a considerably lower world oil price level in comparison with the current level. For example, forecasts for the year 2010 including basic scenario of the U.S. Department of Energy forecast and International Energy Agency forecast prices do not surpass \$US25 per barrel (in 2002 prices) and according to some forecasts world oil price in the long-term on average will be below \$US20 per barrel.

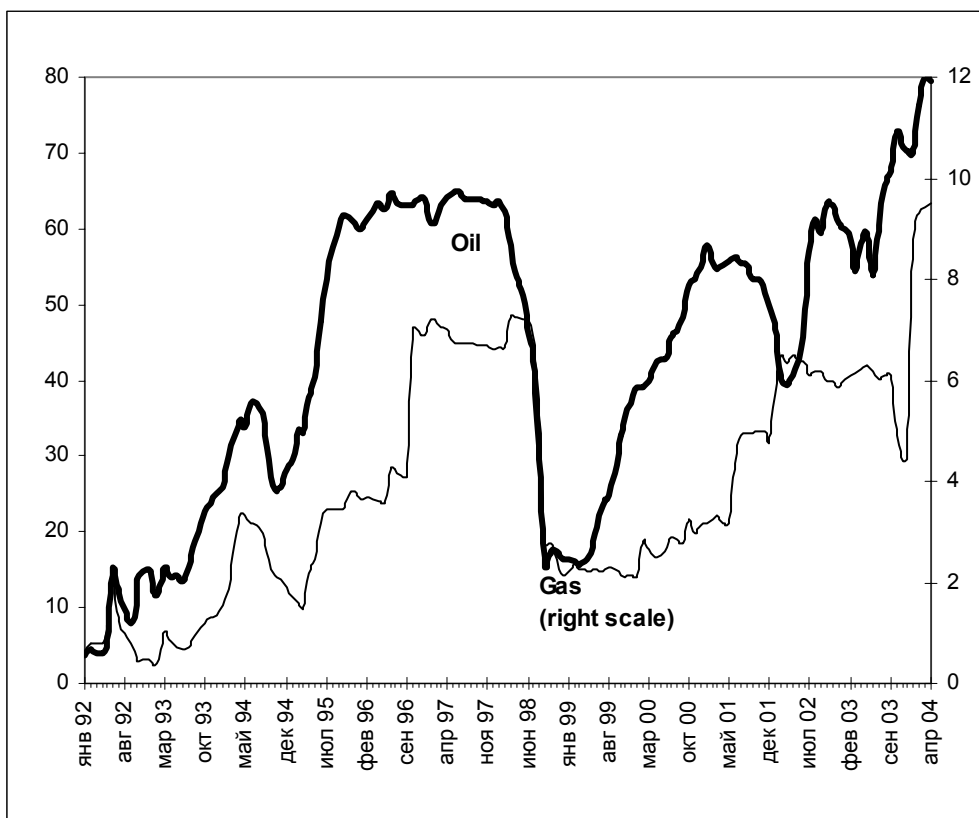
Table 5

**Forecasts of long-term world oil prices dollars/barrel (in 2002 prices)**

Organization	2010	2015	2020
U.S. Department of Energy/ Energy Information Agency (EIA)			
Basic scenario	24,17	25,07	26,02
High price scenario	33,27	34,23	34,63
Low price scenario	16,98	16,98	16,98
International Energy Agency (IEA)	21,75	23,82	25,89
Global Insight, Inc. (GII)	22,26	22,93	23,85
Petroleum Economics, Ltd. (PEL)	21,27	18,41	15,60
PIRA Energy Group (PIRA)	23,90	26,70	-
Natural Resources Canada (NRCan)	22,57	22,57	22,57
Deutsche Banc AG (DB)	18,43	18,41	18,16
Energy and Environmental Analysis, Inc. (EEA)	20,33	19,84	19,36
National Petroleum Council (NPC)	18,00	18,00	18,00
Strategic Energy & Economic Research, Inc. (SEER)	19,86	20,88	22,49
Centre for Global Energy Studies (CGES)	21,27	18,41	15,60

Note. Forecasts EIA – for average oil price, imported to US CIIIA; PIRA, NRCan, SEER и NPC – for the price on west-Texas oil; GII, DB и EEA – for average price purchased by oil refineries; IEA – for average price of imported oil basket IEA; PEL – for price on Brent oil.

Thereby, in the new future one can expect high level of world oil prices and favorable external conditions for the development of the oil-and-gas sector. In future, however, a considerable reduction in oil prices is possible. According to forecasts developed by leading foreign organizations actual world oil prices will tend to the mark of 22-25 dollars per barrel. In this connection one should not exclude a possibility of rather sharp changes in oil prices, which dynamics, as retrospective analysis demonstrates, is subject to considerable fluctuations.



Source: calculated on Goskomstat of Russia data.

*Graph.1.* Average prices of oil and gas in dollar terms in 1992-2004 гг., dollars/ton, dollars/thousand cubic meter

*Yu. N. Bobylev*

## IET Business Survey: Industry in June of 2004

Positive trends observed in the dynamics of the Russian industry continue to consolidate. The rates of growth in sales have stabilized at a very high level. An insignificant downfall in the intensity of increase in output resulted in its higher quality: enterprises have achieved a closer correlation between the dynamics of demand and production. An unprecedented share of products is being sold for money.

According to the data presented by the State Statistical Service (Gosstatluzhba), in May the growth in industrial output continued. The average daily output increased by 0.4 per cent. The estimates made by the Center for Macroeconomic Analysis and Short Term Prognostication (CMASTP) demonstrated that the average monthly rate of increase in the volumes of production made 0.6 per cent over two months of the 2<sup>nd</sup> quarter.

The results of the June survey of enterprises demonstrated that the positive trends registered in the preceding months persisted. As before, in industry there are observed high rates of growth in sales of products for money. The data not adjusted for the seasonality factors demonstrated a growth in this indicator by 4 points in comparison with the figures registered in the preceding month, when there were registered the highest May results ever. After the adjustment of the data for the seasonal and calendar component, it became obvious that sales have stabilized at the level not seen in the Russian industry since year 2000. Especially high rates of sales were observed in the industry of construction materials, mechanical engineering, fuel, and food industries. In light industry, a decrease in demand (negative balance values) persisted.

Evaluations of effective demand has again exceeded the 50 per cent level: more than a half of enterprises in the Russian industry are on the whole satisfied with the amounts of sales of their products for money. However, among other enterprises there prevail appraisals “below norm” and as a result, the



balance remains negative. The lowest level of satisfaction has been traditionally registered in light industry. In the last months, the share of “normal” evaluations made about 30 per cent in this industry.

In spite of a rather high growth in effective demand, the generalized data of surveys demonstrate a decline in the intensity of increase in the volumes of output. On the whole, in industry the balance of actual changes in production has further decreased (after the adjustment for seasonal factors) by additional 3 p. p. in June. This, however, did not result in a growth in the share of enterprises, where sales increased at rates outpacing the rates of growth in output. The microlevel calculations demonstrated that in June there occurred a decline in this indicator to 13 per cent as compared with 22 per cent registered in May, while the share of reports about equal changes in output and demand increased up to 63 per cent (as compared in 58 per cent registered a month before). Therefore, enterprises bring into line the dynamics of output and dynamics of sales.

At present, enterprises sell about 87 per cent of their output for money. This is the best value registered over the whole period of monitoring. Only 4 per cent of products are bartered. As concerns electrical power engineering and fuel industry, there was registered no barter transactions. However, in construction industry and glass production the share of barter makes 11 per cent and 13 per cent respectively. A year ago the shares of barter in these industries were at 12 per cent and 10 per cent. In the 2<sup>nd</sup> quarter of 2004, the share of promissory notes and offsets sales in the overall production made 8 per cent, the maximum of such transactions were registered in chemistry, petrochemistry, and mechanical engineering (10 per cent in each industry).

Good rates of growth and a high share of cash payments permit enterprises to improve the dynamics of profits. Although the values of the balance of changes in profits remain negative, i.e. in the industry there prevail enterprises, which consider that their real profits decrease, the results of the last months demonstrate decelerating rates of decline in profits. In June, the absolute decrease in profits was registered only in electrical power engineering, nonferrous metallurgy, and light industry. Across other industries there were registered positive balances of changes in profits. .

Among the reports about actual changes in prices there begin to grow the share of answers “no changes.” In June, this indicator made 75 per cent increasing by 13 points over two months as the traditional wave of New Year growth in prices starts to ebb. In 2003, the share of reports about stabilization of producers’ prices have not been below 70 per cent since May. By the end of the preceding year, this indicator made 80 per cent. At present, the largest number of answers indicating stabilization of prices are being received from chemistry and petrochemistry (94 per cent), forestry and paper (85 per cent), and light (77 per cent) industries.

Over the last three years, the situation concerning the availability of credits for industrial enterprises has changed dramatically. The share of answers characterizing this availability as “normal” has increased from 45 per cent in 2001 to 62 per cent. In 2004, the highest level of availability of borrowed funds was registered in chemistry and petrochemistry (80 per cent), electrical power engineering, forestry, and paper industry (75 per cent), fuel industry (73 per cent). In the 2<sup>nd</sup> quarter of 2004, the most intensive growth in the use of credits was registered in electrical power engineering (the balance is + 26 per cent), ferrous metallurgy (+ 20 per cent), and light industry (+ 16 per cent).

The forecasts of changes in demand continue to become more optimistic. In May, the balance (as adjusted for seasonal factors) further increased by 3 p. p. an increase in the rates of sales is expected across all industries.

In June, the plans for changes in output across the Russian industry practically did not change. Since it is expected that the rates of sales would increase, this situation permitted to achieve a closer correlation between the dynamics of demand and production. Similar changes in demand and output are expected by 75 per cent of enterprises, what is the absolute maximum.

*S. V. Tsukhlo*

---

## Foreign trade

---

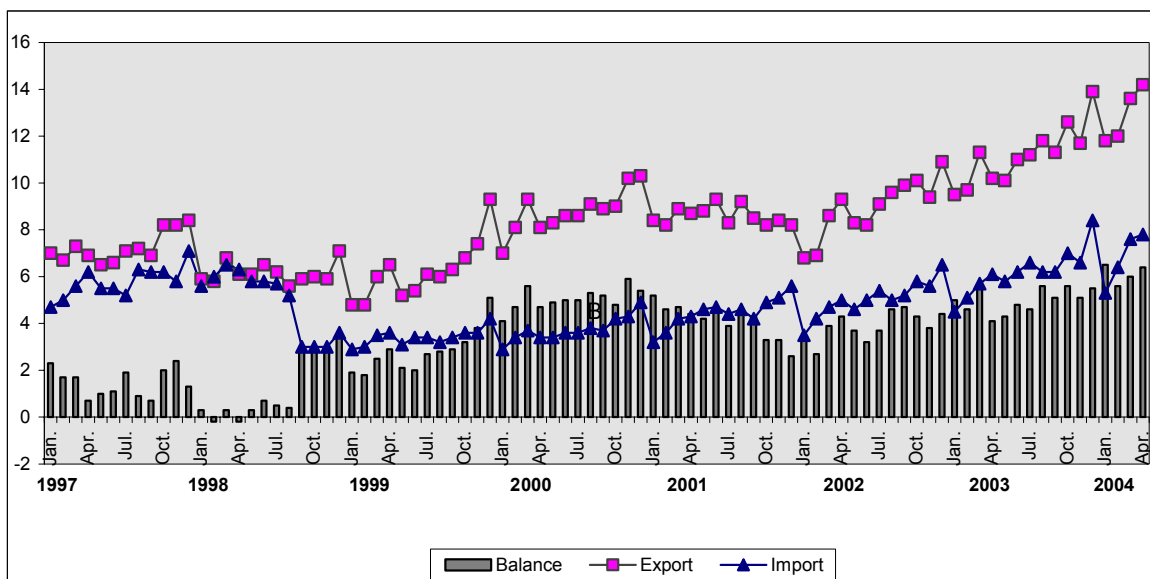
Russian foreign trade main indicators demonstrate constant high rate of growth. Favorable situation in the world market as well as high dynamics of the customer demand contribute to a considerable increase in both export and import supplies.

In June 2004 Federal laws were enacted that play an important role in regulation of foreign economic activity: “On Foundations of State Regulation of Foreign Economic Activity” and “On Currency Regulation and Currency Control.”

In April 2004 Russia’s foreign economic turnover calculated, using balance of payments methodology, amounted to 22 billion dollars, which surpasses the same index of the last year by 35 percent. In addition, Russian export reached a record level for the last fifteen years, which amounted to 14.2 billion dollars, which is by 4.7 percent more than in March of current year and by 39.5 percent more than in April of the last year. Export volume to the countries of the far abroad amounted to 11.9 billion dollars (by 41.9 percent more than a year before.)

The volume of import to the Russian Federation in April 2004 amounted to 7.8 billion dollars, which is 2.6 percent more than in the previous month and by 26.1 percent more than in April 2003. Import from the countries of the far abroad constituted the sum of 6.1 billion dollars (by 21.5 percent more than in April 2003.)

The fact that export was increasing by higher rates resulted in the fact that considerably increased the debit balance of foreign trade, which in April 2004 constituted 6.4 billion dollars, which is by 7.3 percent more than in March 2004 and by 60.2 percent more than in April 2003.



Source: Goskomstat of RF, CB of RF

*Graph 1. Main indicators of Russian foreign trade (billion of dollars)*

Extremely favorable state of the world market for Russian exporters remains the main reason for a sharp growth of export supplies.

Despite an insignificant reduction in oil prices recorded in April 2004 in comparison with previous month, oil prices continued remaining at the high level. For example, average oil price of Urals amounted to \$US30.1 per barrel (reduction in comparison with March 2004 by 2.6 percent) and of Brent - \$US33.5 per barrel (reduction by 0.3 percent.)

OPEC decision to cut down oil production by 1 million barrels per day from 1 April 2004, as well as continued growth of oil demand by oil importing countries and unstable political situation in the Middle East represented main factors that were behind the high oil prices.

Contractual prices of the Russian natural gas in April of current year in comparison with March have not practically changed and in comparison with April 2003 increased by 7.3 percent.

Moreover, in April 2004 London Metal Exchange recorded price fall on base metals (except aluminum). If at the beginning of 2004 world prices on non-ferrous metals constantly went up then in the second quarter quotations of non-ferrous metals started falling and by the end of April price of nickel reached its minimum level starting with the beginning of 2004. Price fall of nickel and copper was stipulated by a weakened demand on these metals on part of China.

Average monthly prices on nickel and copper in April decreased in comparison with March 2004 by 6.2 percent and 3.3. percent correspondingly and the price of aluminum went up by 4.5 percent. In comparison with December 2003 prices on copper and aluminum grew up by 34.4 percent and 11.6 percent correspondingly and the price of nickel went down by 8 percent.

*Table 1.*

**Average world prices in April of a corresponding year**

	1996	1997	1998	1999	2000	2001	2002	2003	2004
Oil (Brent), USD/barrel	21,32	17,22	13,92	15,72	22,97	26,26	25,81	24,79	33,5
Natural gas, USD/1 mln. BTE		1,966	2,548	2,187	3,052	5,200	3,408	5,390	5,785
Motor gasoline, USD/gallon	0,707	0,455	0,378	0,391	0,808	0,999	0,814	0,855	1,152
Copper, USD/t	2574,9	2369,7	1775,3	1539,9	1710,1	1689,4	1620,8	1598,5	2950,0
Aluminum, USD/t	1590,2	1554,0	1413,5	1318,0	1448,0	1493,7	1370,3	1332,8	1734,0
Nickel, USD/t	8053,9	7312,4	5352,5	5239,5	9657,1	6303,1	6940,6	7915,3	12872,0

Source: calculated using data of London Metal Exchange (Great Britain, London), International Oil Exchange (London)

By the end of April the real ruble exchange rate to the US dollar surpassed the level of December 2003 by 5.3 percent and surpassed the same indicator of the previous year by 17.4 percent. In this connection GDP in January-April increased by 8 percent in comparison with the corresponding period of 2003. High purchasing power of the ruble in relation to the dollar and revenue growth in the economy objectively contributed to higher imports level.

Trade volumes between Russia and CIS countries constituted in April of the current year a sum of 3.97 billion dollars. Distinctive feature of April was excess in one and a half times of import growth rates (growth rates in comparison with April 2003 constituted 127.9 percent) over the export growth rates (growth rates constituted 145.6 percent). However, Russia maintains debit balance in foreign trade, which amounted to 0.45 billion dollars.

In June “Gazprom” announced plans of reducing its export supplies to CIS countries due to outstanding liabilities for deliveries on preferential terms. As before Byelorussia is leading on liability volume. Deliveries to Byelorussia were stopped this year and were renewed on the basis of short-term agreements and at the price of \$US50 per cubic meter. This price surpasses the domestic price level, which equals \$US30 per cubic meter. Note that the price of Russian natural gas on the European market surpasses \$US120 per cubic meter. Only in June an agreement was finally reached on conditions for gas deliveries till the end of 2004.

Ukraine also will receive less amount of natural gas this year due to the fact that gas transportation consortium of the two countries does not function so far, which highly impedes the deliveries. It is also planned to reduce gas deliveries to Georgia. Gas export to this country is wholly loss making.

In the course of the June negotiations between heads of governments of Russia and Ukraine issues related to the creation of the single economic space by four largest CIS countries was discussed. Besides, for the first time an agreement was reached on transition to collecting VAT in the country of destination in export of oil products to Ukraine (at present VAT is collected in Russia as well) a year earlier than was planned—from January 2005.

Recently a regular meeting of representatives of customs organizations of Russia and Kazakhstan took place. For the first five months of 2004 mutual goods turnover grew by 45 percent, which was the result of a constructive cooperation of customs organizations of the two countries. At the meeting issues of unification of customs control were analyzed as well as attention was paid to the development of a model customs code for CIS countries and basic Eurasian customs legislation.

In June 2004 were enacted Federal laws, which play an important role in regulating foreign economic activity: “On Foundations of State Regulation of Foreign Economic Activity” and “On Currency Regulation and Currency Control.” These laws passed expert evaluation and were acknowledged as corresponding WTO norms.

The law “On Foundations of State Regulation of Foreign Economic Activity” specifies definitions of main concepts (foreign economic activity, import, export, etc.), introduces a number of new (transit, free trade zone, customs union). The law contains provisions relating to the division of state regulation

of foreign economic activity in the sphere of foreign trade of goods, services and intellectual property. The law contains new provisions on regulation of foreign trade barter deal and on before shipping inspection. The law introduces new order for applying retaliatory measures.

This law establishes foundations of state regulation of the foreign economic activity on the basis of customs-tariff and non-tariff methods, which include the following measures: set and revoke import and export customs dues and duties; set and cancel bans and limitations of international trade of goods, services and intellectual property; set and cancel measures of economic and administrative character, which contribute the development of foreign economic activity; signing international trade agreements and agreements on customs unions, free trade zones, regional economic integration, stimulation and protection of investments.

The law brings Russian legislation in this sphere in compliance with provisions of Articles I, III, V, XI, XIII, XXIV GATT-94, as well as with WTO Agreements on procedures related to import licensing and prior shipping inspection.

The law also contains norms related to bans and limitations envisaged in Articles XX и XXI GATT-94. Special provisions of the law are directed at securing transparency according to Article X GATT-94.

One of principal tasks of the present period dedicated to the realization of provisions of the Federal Law “On Foundations of State Regulation of Foreign Economic Activity” in part of application of measures of non-tariff regulation became the development of new normative legal acts and introduction of changes and amendments to the acting legal acts.

The law “On Currency Regulation and Currency Control” excludes precious metals out of the list of currency values, which envisages liberalization in this sphere and brings legislation in this sphere in compliance with Article XX GATT-94.

The law also determines the period for canceling current restrictions, a list of capital transactions was cut that require permission of the Bank of Russia taking into account international agreements signed by the Russian Federation including Article VIII of an agreement with IMF.

The list of non-commercial transactions attributed to current currency operations was considerably widened. This list is an open one, which represents a possibility for further liberalization of currency legislation and securing its transparency.

*N. Volovik, N. Leonova*

---

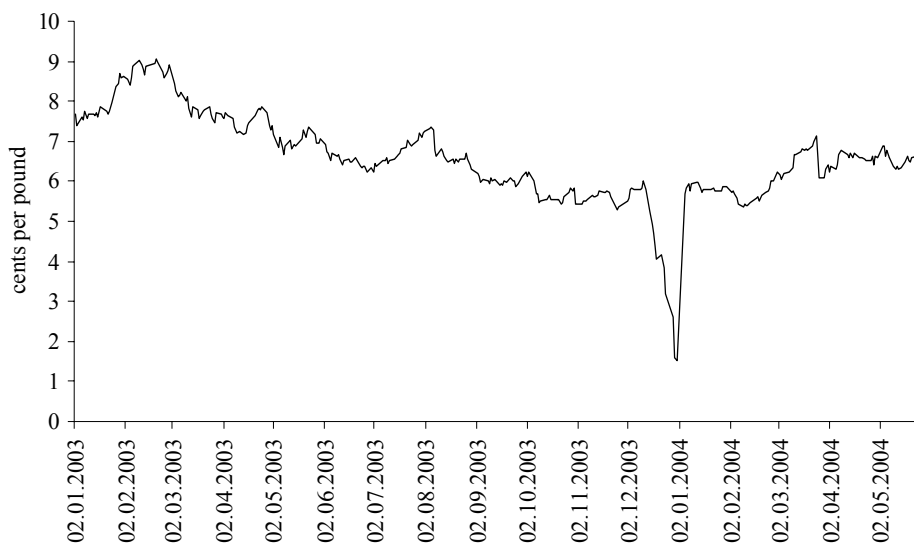
## **Outcomes of applying variable import tariff on sugar market**

---

Variable import tariff is a relatively new tool of customs regulation in Russia. This year it was applied for the first time for regulating import of raw sugar. From now on the import duty on raw sugar depends on the price set at the New York Board of Trade. The objective for applying this mechanism was to mitigate world market fluctuations on the domestic market: the higher is the world price – the lower is the duty, and *vice versa* – lower world prices are leveled off by higher import duty. Such an import constraint scheme has been effective for over 6 months and some conclusions can already be made about its efficiency.

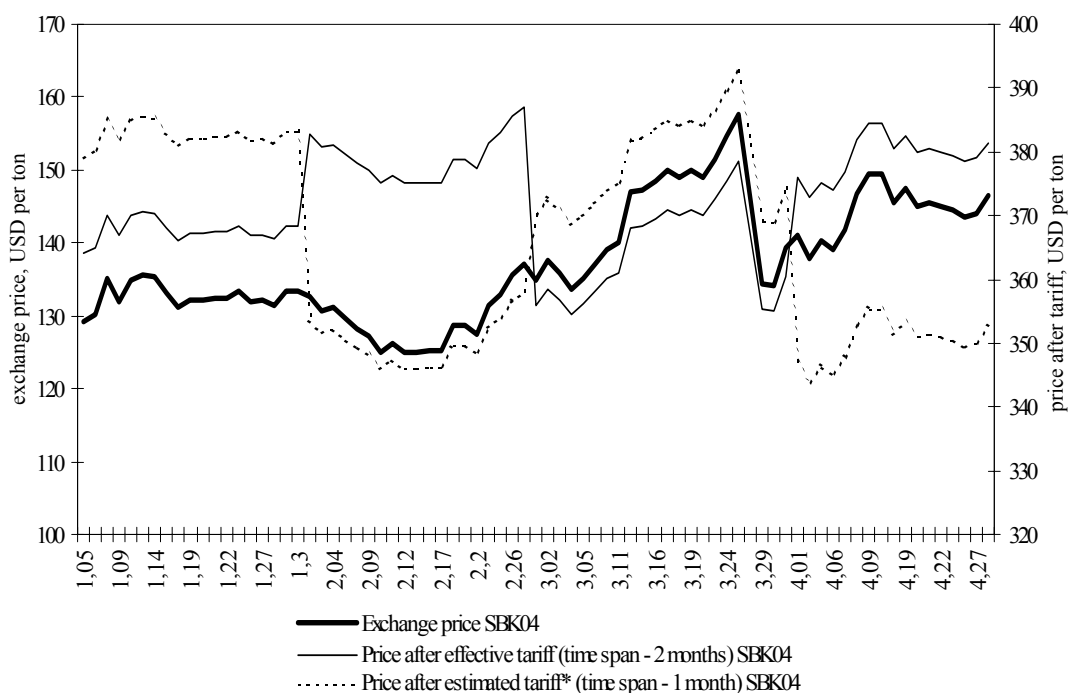
Beginning from 2003 the world prices for raw sugar were sliding down. In last December the exchange price fell to the record low level: after equaling 6 cents per pound at the beginning of the month it dropped to 1.52 cents per pound at its end (Picture 1). Such a sharp fall was due to exchange speculations. This didn't wait to affect the Russian sugar market protection. According to the Russian law the average exchange price in a certain month determines the size of import duty on raw sugar two months later. Thus the low price for it in December shaped quite a high customs tariff in February. The troublesome situation was mitigated only by the fact that an upper trend became obvious as late as March while in February exchange price for raw sugar remained still relatively low (Picture 2). Otherwise the high import tariff combined with the growing world prices (which was the case in March) would have made import of raw sugar unduly costly.

So, the result of 2-month span in calculating import duty on raw sugar is that its size (based on the world price that established 2 months ago) cannot correspond to the current price situation on the world market. Two months is quite a long period for the exchange price trend to change radically.



Source: <http://www.nybot.com/>.

Picture 1. Prices for raw sugar at the New York Board of Trade in 2003-2004



\* - an estimated tariff is the one calculated on the basis of price for raw sugar that established at the New York Board of Trade in the preceding month.

Source: data of Russian Sugar Information, own calculations.

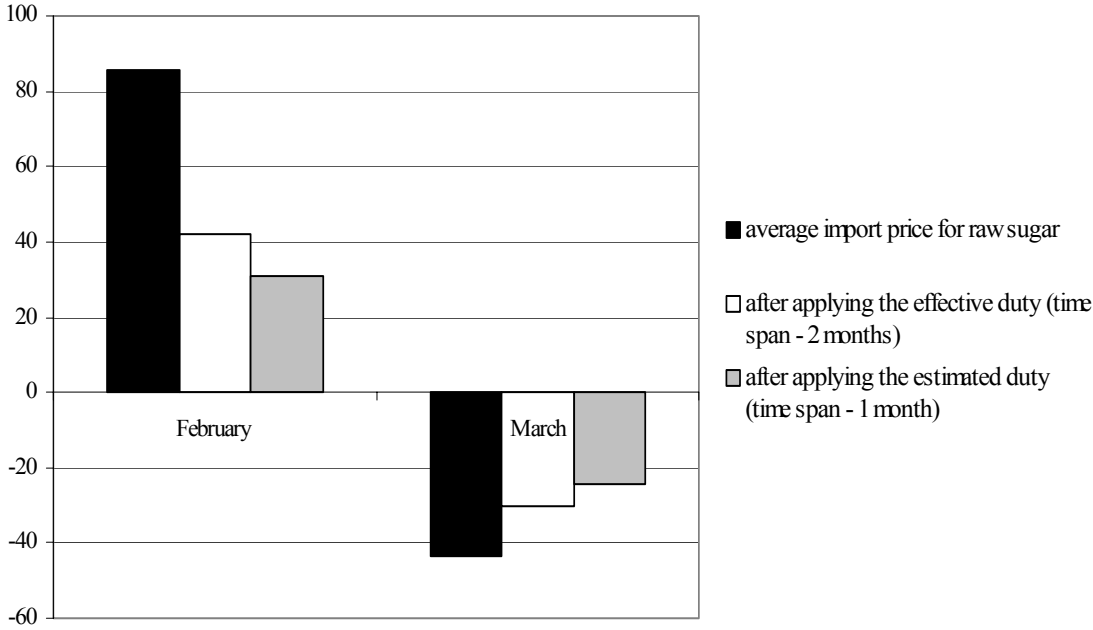
Picture 2. Variable import duty on raw sugar

The new lever does not attain its main goal – it does not protect the domestic market from unstable world market situation. Initially, it was targeted at maintaining the raw sugar support price at a fixed level (470 USD per ton) resulting from correlation between the exchange price and the import tariff. If we follow this scheme and draw a graph of theoretically estimated import price for raw sugar, being a sum of exchange price and import duty (for simplifying the calculation the supply basis is considered constant and equaling 0), we'll see that, on the opposite, the use of variable import tariff intensifies the effect of world market fluctuations on the Russian market. Within a month they grow by the size of import duty, but as a following month begins and a new size of duty is set, the price changes dramati-

cally (Picture 2). Duties calculated on the basis of exchange price for raw sugar in the preceding month (as different from the legally specified 2-month span) are also unable to cope with the task. The point is that intervals set for establishing the import tariff and the average monthly price at the commodity exchange do not coincide: tariff may grow faster or slower than the exchange price. The result are leaps of import price for raw sugar.

More positive conclusions can be made if one examines the effect of variable duty not on the theoretically estimated but on the actual average import price on the Russian market. As mentioned above, theoretically it is a sum of the world price and the supply basis. But in fact the price for imported raw sugar is shaped somewhat differently. While the exchange price in January-February did not exceed 140 USD per ton, the actual import price for raw sugar in February was as high as 361 USD per ton. It was this high import price and not higher duty that served the basic cause of the sharp drop (by 92% as compared with February 2003) of raw sugar import supplies in February.

The lack of statistical data forbids ultimate conclusions but the 3-month foreign trade indicators still demonstrate some smoothening of import price month after month given the effective import duty. However, better result could be achieved if applying a duty calculated on the basis of exchange price in the preceding month. In this case the effect could be almost double (Picture 3).



Source: data of the State Customs Committee, own calculations.

Picture 3. Change of the average import price for raw sugar, as % of the previous month

It should be pointed out that the different sugar trade regime for the CIS countries undermines the effect of import constraints. In January-February imports of sugar from these countries (that account for 90% of the total sugar supplies to Russia) were 53% above the corresponding previous year indicator.

Besides, similarly to any other mechanism of foreign trade regulation the new scheme won't be efficient unless two key problems are solved: 1) stopping of "grey" imports from the CIS countries and 2) simultaneous regulation of import of substituting sugar products. So far, neither the first nor the second problem is solved at the government level. This led to the building of large stocks of sugar in the country and, consequently, to the sharp drop of price for it. As a result the gross output of sugar industry is decreasing despite growth in all other industries including the food one. In January-May 2004 production of granulated sugar was down 27% while the average industrial growth rate amounted to 7% and the output of food industry expanded by 9.1%. It's worth noting that sugar industry declines for the third successive year – beginning from 2002 its output falls by 5-6% annually.

The non-stability of trade regime in 2003 also resulted in smaller areas planted in sugar beets – an almost 10% decrease according to the data of RF State Committee for Statistics.

The outcome of all these negative trends in the sector and the imperfection of applied variable duty mechanism was that market agents again started to demand import quotas for raw sugar. Similar to the previous years, the stumbling stone is the principle of distributing quotas between market operators. Their auction sale led to higher prices (see our previous surveys). At the same time distribution of quotas according to the historic or production principle violates interests of either one or another group of companies (some companies are primarily importers and do not have their own sugar beets production – they lose in case of applying the production principle; other companies are engaged in growing of beets but do not have an import “history” – they lose in case of applying the historic principle). The compromise hasn’t been reached as yet<sup>15</sup>.

However, irrespective of the applied quota distribution mechanism there is a need for bureaucratic control over it that is fraught with corruption and, consequently, is not optimal. Besides, distribution of quotas instead of variable duty also does not solve the key problems of sugar market: non-regulated import of syrup and other sugar products, “grey” supplies from the CIS countries and excessive stocks. In this situation it seems rational to perfect the effective mechanism in three basic ways:

- 1) to introduce simultaneous tariff protection measures for all sugar products;
- 2) to constrain import of sugar and sugar products from countries-members of the Customs Union by quantitative quotas until their trade regimes are harmonized;
- 3) to shorten the time span between the period when a certain rate of variable import duty is applied and the period, the NYBOT price wherein is taken as the basis for its calculation.

*Karlova N., Serova E.*

## **Russia and the Bologna Process: the current state of the problem**

The development of the Russian higher education system takes into account the general guidelines of the Bologna Process. Since recently, there have been put forward many mixed opinions concerning the necessity and the nature of Russia’s participation in the Bologna Process, primarily in connection with the intensifying dynamism of this process and cooperation between EU and Russia. Formulation of the national position with respect to this issue first of all requires the development of a clear understanding of the total variety of phenomena constituting the Bologna Process, which has been implemented by EU since 1984, when the European Commission initiated the creation of a number of tools aimed at the facilitation of mobility of human capital on the European labor market.

The first instrument from this toolkit is the network of national information centers for academic recognition and mobility existing in all EU member countries. The network provides competent information to citizens and universities as concerns the possibilities and requirements pertaining to the academic recognition of degrees and individual courses of studies at foreign universities.

The second tool is the European credit transfer system, which ensures transparency and comparability of the studies, and, accordingly, the academic recognition of qualifications and competences. It was initially created in the framework of the European “Erasmus” program in 1988, at present it includes more than 1100 universities and a network of ECTS Helplines. Compatibility of learning plans permits students to choose programs answering their qualification and later these studies are recognized by other universities.

The third tool is the Diploma Supplement, which universities prepare in accordance with the model (standard) worked out by the joint task force including experts of the European Commission, Council of Europe, and UNESCO. The standard exists in 11 languages and presents a full description of the subject, level, context, and contents of education. The Diploma Supplement facilitates academic mobility and mobility of graduates on the labor market. At the same time, while protecting independency of universities, the Diploma Supplement offers the general framework of cooperation, provides to

---

<sup>15</sup> An indirect sign of lacking compromise is the shift of Russia’s Sugar Union management.

partner educational organizations and citizens with important information about university programs, and facilitates students' promotion abroad.

The fourth instrument is the EURYDICE information network, in the framework of which there is prepared and distributed reliable and comparable information about national systems of education in the EU member countries. EURYDICE was established in 1980 on the basis of the Resolution of the council of ministers of education signed in 1976, which set forth the first cooperation program in the sphere of education. At present the network embraces 30 countries. The offices in Brussels and member countries carry out comparative analysis of policies and organization of national education systems, publish surveys and statistical indicators across specific issues.

Therefore, the process of formation of the European area of higher education has a 20 years long history. The legal basis of the process is constituted by articles 149 and 150 of the EU treaty, it is a part of the general integration process, accompanies and fixes this process. However, this process is far from its completion, it encounters serious problems, public discussions of related risks and quality problems, preservation of national values, formation of confidence environment, autonomy and role played by universities as concerns the attainment of objectives of creation of the European area of education.

In June of 1999, in Bologna, the ministers of education from 29 European countries signed the Declaration about the European area of higher education (the Bologna Declaration). The key objectives to be achieved by 2010 include:

1. Adoption of a system of easily readable and comparable degrees, also through the implementation of the Diploma Supplement.
2. Adoption of a system essentially based on two main cycles, undergraduate and graduate. Access to the second cycle shall require successful completion of first cycle studies, lasting a minimum of three years. The second cycle should lead to the master and/or doctorate degree as in many European countries.
3. Establishment of a system of credits - such as in the European Credit Transfer System (ECTS) system - as a proper means of promoting the mobility of students and academic and administrative staff. Adoption of the general framework approach to qualifications of bachelors and masters, ensuring of "compatibility" of degrees, separate courses and credits. Creation of a system promoting co-operation in quality assurance (on the basis of the European Network of Quality Assurance in Higher Education and organization of information and exchange programs.
4. Promotion of mobility of students and academic and research staff.
5. Promotion of European co-operation in quality assurance with a view to developing comparable criteria and methodologies.
6. Promotion of the necessary European dimensions in higher education.

Following the broad discussions held in the course of conferences and meetings organized by the RF Ministry of Education in 2002 through 2003, there was taken the decision to start the preparation for implementation of the Bologna Process in Russia, there was worked out a special action plan aimed at implementation of the provisions of the Bologna Declaration in the system of higher education in the Russian Federation.

Russia began to develop certain aspects of the Bologna Process even before the signing of the Bologna Declaration. For instance, yet in the early 1990s Russia took steps aimed at the introduction of a system of higher education based on two main cycles: bachelor and master. In 1994, there was approved the introduction in Russia of the system of education envisaging bachelor and master degrees alongside with the traditional system of education.

According to the federal law of the Russian Federation "On higher and postgraduate education" (adopted in 1996), the autonomy of higher education establishments was enhanced, what permitted to introduce the system of credits such as in the European Credit Transfer System (ECTS) system as a means of promoting the mobility of students.

In the period from 2002 till 2004, the Ministry of Education of the Russian Federation carried out an experiment concerning the introduction of the credit system in higher education institutions. The experiment was conducted on the voluntary basis, and in present the number of institutions of higher education participating (fully or partially) in the experiment concerning the introduction of the system of credits reached 31 state and private establishments. In 2002, there was elaborated and distributed among higher education institutions the Methodology of calculation of credits for Russian higher edu-



cation establishments. This methodology is adapted for the specifics of the Russian education system and recommends higher education institutions to use certain procedures governing the calculation of credits compatible with the ECTS. Therefore, the higher education institutions taking part in the experiment should:

- Master the said methods; determine possible forms of organization of the educational process on the basis of credits;
- Work out mechanisms permitting students to form their individual educational trajectories basing on the selection of individual courses;
- Assure rational planning of the amount of work of students and academic staff;
- Introduce modern forms of organization of the educational process, including the rank based system of assessment of students' progress.

It should be noted that the experiment aimed at the introduction of the system of credits was not financed from the federal budget, while the expenditures relating to the organization, methodological, and technological support of the experiment were rather significant.

The federal law of the Russian Federation "On higher and postgraduate education" promotes mobility of students and academic staff. Autonomy of higher education institutions permits them to work out and implement student exchange programs and on-the-job training of students and academics at other higher education establishments in Russia and other countries. At present, the preparation for the introduction of a diploma supplement compatible to the European standards on the whole territory of the Russian Federation is underway, the issue should be settled by 2006. In order to assure high quality of education, Russia started elaboration of compatible criteria and methods of evaluation of the quality of education, this work should be completed by the end of 2005.

On the initiative of the Duma Committee for Education and Science, in June of 2003 the State Duma of the Russian Federation appealed to M. Kasyanov, the head of the Government stating that it was necessary for Russia to sign the Bologna Declaration about higher education. At the Berlin conference of the Ministers of education of European countries held on September 19, 2003, there was taken the decision to include Russia in the group of European countries developing the European area of higher education. Alongside Russia, the document was signed by Andorra, Bosnia and Herzegovina, Albania, Serbia, Montenegro, Macedonia, and Vatican. By now, the Declaration about the European area of higher education has been signed by 40 ministers of education from different countries, and Russia will participate as an official partner of the Bologna club.

The official inclusion of Russia in the Bologna Process had mixed responses on the part of the educational community. In the course of the ongoing discussion, there were detected both problems and difficulties, and positive consequences of the accession to the European area of higher education. The negative responses may be in essence reduced to the following arguments: (a) Russian education is at risk to lose its original character and accumulated positive academic traditions; (b) Russia will experience an intensive brain drain after introducing compatible diplomas; (c) difficulties of the transition period require significant expenditures on the part of higher education institutions, while perspectives of compensation are not apparent.

The said negative assessments to a greater degree result from differences existing among Russian higher education establishments. While certain higher education institutions have already been working on the European level and even exceeds it as concerns some profession lines, so the switching to the use of the aforesaid tools for them will be easy<sup>16</sup>, for many other higher education institutions the costs of reorganization may be prohibitively high. A significant increase in the amount of time academics staff will have to dedicate to the educational process not supported by an adequate raise in salaries may result in deteriorating quality of the academic staff and general deterioration of quality of higher education.

---

<sup>16</sup> However, this transition will incur costs relating to the mass mastering of the new forms of work with students in the framework of a sharply increased amount of independent, but controlled by the educators, studies on the part of students. The major consequence of these developments will be a sharp reduction of the academic staff possibilities to earn money outside higher education institutions. At present, at the "advanced" higher education establishments such additional earnings significantly exceed official salaries of academic staff.

At the same time, the systemic inclusion in the Bologna Process requiring adjustment of methods, organization, and financing of the higher education system will benefit the Russian education by:

- (a) an increase in its efficiency;
- (b) equal status of Russian education establishments and Russian citizens in the world community;
- (c) settlement of the problems of recognition of Russian diplomas in other countries;
- (d) consolidation of the position of the Russian education system on the world market of educational services.

The integration of the Russian education system in European structures will permit to improve the standing of different sectors of the Russian economy on the world market due to higher culture and better organization of economic activities, increase the conductivity for technological progress across a broad range of different areas.

It should be noted that participation in the Bologna Process not in the least requires the unification of higher education systems. This participation is an evidence of the striving for compatibility of educational systems, enhancement of their dynamism and adequacy to the needs of individuals and labor markets. The only alternative for Russia in the case it rejects participation in the Bologna Process is parochialism of the Russian higher education system, deterioration of its competitive capacity, voluntary rejection of an efficient use of advantages and achievements enjoyed by the domestic higher education system.

*I. A. Rozhdestvenskaya*

---

### **Scenario based macroeconomic forecast for 2004 and 2005**

---

The scenario based forecast of key macroeconomic indicators in 2004 and 2005 was made on the basis of a medium term forecast model elaborated in the framework of an USAID project<sup>17</sup> and continues the series of quarterly forecasts of social and economic development of Russia in the medium term outlook carried out by IET<sup>18</sup>. Among the forecasted indicators are: GDP, CPI, tax revenues, export, import, Ruble / US \$ exchange rate, gold and foreign exchange reserves, real effective Ruble exchange rate, retail trade turnover, level of unemployment, IPI, real cash household incomes.

The model used for the medium term forecasting is a system of structural econometric equations. For the purposes of evaluation of the equations there were used quarterly data relating to the period from the 1<sup>st</sup> quarter of 1996, including the data registered in the 1<sup>st</sup> quarter of 2004, however, in certain cases the model was evaluated only basing on the data pertaining to the period from the 1<sup>st</sup> quarter of year 2000. The data were obtained basing on such sources as official information published by the RF Goskomstat, Bank of Russia, and the International Financial Statistics presented by the International Monetary Fund.

The equations describing the medium term dynamics of macroeconomic indicators include variables and respective lags, which have a significant and answering economic logic impact on the explained variable. Respective dummy variables permitting to take into account the quarterly seasonality of the used variables and structural shifts in their dynamics were also added to the equations. There were also used moving average terms permitting to eliminate the autocorrelation of residuals.

The calculation of forecasted values of the macroeconomic indicators was carried out proceeding from the set scenarios of the dynamics of exogenous variables: Brent oil prices, investment in fixed assets, money aggregate M2, and the US \$ / Euro exchange rate.

---

<sup>17</sup> At present, the study is being prepared for publication.

<sup>18</sup> See: Russian economy in 2003. Trends and perspectives. IET. (Issue No. 25).

Table 1

**Scenarios of quarterly dynamics of exogenous variables in 2004 and 2005**

	Scenario 1				Scenario 2			
	US \$ / Euro exchange rate	Oil price (US \$ per barrel)	M2 (Rub. billion)	Investment (in % of the figures registered in the respective period of the preceding year)	US \$ / Euro exchange rate	Oil price (US \$ per barrel)	M2 (Rub. billion)	Investment (in % of the figures registered in the respective period of the preceding year)
<b>2 Q of 2004</b>	1.24	33.0	3 673	112.0	1.24	33.0	3 673	112.0
<b>3 Q of 2004</b>	1.23	29.0	3 978	111.0	1.23	29.0	3 978	111.0
<b>4 Q of 2004</b>	1.22	28.0	4 337	110.0	1.22	28.0	4 337	110.0
<b>1 Q of 2005</b>	1.21	25.0	4 554	108.0	1.21	28.0	4 662	110.0
<b>2 Q of 2005</b>	1.20	24.0	4 771	108.0	1.20	28.0	4 988	110.0
<b>3 Q of 2005</b>	1.20	24.0	4 988	108.0	1.20	28.0	5 313	110.0
<b>4 Q of 2005</b>	1.20	23.0	5 205	108.0	1.20	28.0	5 638	110.0

Starting from the 2<sup>nd</sup> quarter and till the end of 2004, the dynamics of exogenous variables were assumed to be equal in the framework of both scenarios: the average annual Brent oil price is US \$ 30 per barrel, in 2004 the rate of growth in money aggregate M2 makes 35 per cent, the rate of increase in investment in fixed assets is at 11.5 per cent in comparison with the figures registered in the respective period of the preceding year, the average annual US \$ / Euro exchange rate is 1.24. At the same time, it is assumed that Euro will gradually appreciate against the US dollar, while oil prices and investment in fixed assets will decline by the end of 2004.

Scenarios for year 2005 were designed proceeding from different levels of oil prices, investment in fixed assets and growth in the money aggregate M2. Thus, according to the pessimistic scenario (Scenario 1), the average annual Brent oil price is US \$ 24 per barrel, in 2005 the rate of growth in money aggregate M2 will make 20 per cent, the rate of increase in investment in fixed assets will make 8 per cent. According to the optimistic scenario (Scenario 2), the average annual Brent oil price is US \$ 28 per barrel, in 2005 the rate of growth in money aggregate M2 will make 30 per cent, the rate of increase in investment in fixed assets will make about 10 per cent. In the framework of both scenarios the average annual US \$ / Euro exchange rate in 2005 is assumed to be 1.20.

Table 2

**Scenarios for 2004 and 2005 in annualized terms**

	2004	2005	
		Scenario 1	Scenario 2
US \$ / Euro exchange rate	1.24	1.20	1.20
Urals oil price (US \$ per barrel)	30	24	28
Rate of growth in M2, %	35	20	30
Rate of increase in investment in fixed assets, %	11.5	8.0	10.0

Table 3

**Forecast for 2004 and 2005**

	2004	2005	
		Scenario 1	Scenario 2
Rate of growth in real GDP, %	6.6	3.4	5.0
GDP (Rub. trillion)	15.79	17.55	17.88
Rate of increase in CPI, %	9.2	6.6	7.1
Tax revenues of the RF consolidated budget (Rub. tril-	3.86	4.24	4.53

	2004	2005	
		Scenario 1	Scenario 2
lion)			
Tax revenues of the RF consolidated budget (% of GDP)	24.4	24.2	25.3
Gold and foreign exchange reserves (US \$ billion)	102	112	124
Rates of the real effective Ruble appreciation, %	10.6	1.2	5.3
Rates of the real Ruble appreciation against US \$, %	10.3	3.9	5.8
Export (US \$ billion)	158	155	161
Import (US \$ billion)	89	98	102
Rate of increase in retail trade turnover, %	7.2	5.9	7.0
Rate of increase in the industrial production index (in % of the figures registered in the preceding quarter)	6.5	2.7	4.4
Share of unemployed in the total economically active population, %	7.9	7.3	7.1
Rates of growth in real cash household incomes, %	12.6	10.7	11.9

According to the results of the macroeconomic forecasting (see Table 3), in 2004 the rate of growth in GDP will make 6.6 per cent. In 2005, respectively, the rates of growth in GDP may decline to 3.4 per cent in accordance with Scenario 1 and to 5 per cent according to Scenario 2. In the case the money supply increases by 35 per cent in 2004 and at the estimated rates of growth in GDP (6.6 per cent), in 2004 inflation rate will make about 9.2 per cent. Next year, depending on the scenario based changes in the money supply the rates of inflation may decrease to 6.6 per cent to 7.1 per cent in the annualized terms.

The forecast of tax revenues of the RF consolidated budget was made taking into account the actual and planned by the RF Government changes in the tax legislation for 2004 and 2005<sup>19</sup>. In particular, as concerns the data for year 2004 it was taken into account the reduction in the rate of the value added tax by 2 p. p., the abolishment of the sales tax, and changes in the base rate of the mineral extraction tax. At the same time, in accordance with the scenarios of changes in the levels of oil prices there were taken into account the consequences of a growth in the tax burden on the oil industry in 2005. Thus, according to the new scale of export duties: at the oil price up to US \$ 15 per barrel the duty should make 0 per cent; at the oil price from US \$ 15 to US \$ 20 per barrel the duty should make up to 35 per cent of the difference between the actual oil price and US \$ 15; at the oil price from US \$ 20 to US \$ 25 per barrel the duty should be at or below US \$ 29.2 and 65 per cent of the difference between the actual oil price and US \$ 25. As concerns the tax on extraction of mineral resources, its base rate in 2005 should be increased from Rub. 347 per metric ton to Rub. 400 per metric ton, there was also increased the nontaxable oil price threshold from US \$ 8 to US \$ 9. Besides, the new formula of calculation of the mineral extraction tax included the revised Ruble / US dollar exchange rate: from Rub. 31.5 per US \$ to Rub. 29 per US \$ taking into account the trend towards the Ruble appreciation against the US dollar.

The respective quantitative changes in the amount of tax generated revenues were calculated basing on the data on tax revenues received in the preceding year as adjusted for a growth in the tax base, presented scenarios of changes in oil prices, and the forecast of changes in the Ruble / US dollar exchange rate. Therefore, as a result of amendments to the tax legislation, in 2004 the reduction of tax revenues of the RF consolidated budget will make Rub. 132 billion. According to Scenario 1, in 2005 the revenues should decline by Rub. 133 billion, while in the framework of Scenario 2 (at a higher level of oil prices) tax revenues should increase by Rub. 70 billion. As a result of adjustment of the forecasted data on tax revenues for the value of discretionary changes, the amount of tax generated revenues of the RF consolidated budget in 2004 will make about 24.4 per cent of GDP, while in 2005

<sup>19</sup> The indicator of the amount of revenues received by the RF consolidated budget does not include revenues generated by the SST. Therefore, the planned for year 2005 reduction of the single social tax, which according to the RF Government estimates should diminish the tax burden on enterprises by Rub. 280 billion, was not taken into account.

this indicator will be at 24.2 per cent of GDP in the framework of Scenario 1 and 25.3 per cent of GDP according to Scenario 2.

According to the forecasts, the amount of gold and foreign exchange reserves should make US \$ 102 billion by the end of 2004. At a lower level of prices in 2005 (Scenario 1), the gold and foreign exchange reserves should increase by US \$ 10 billion, while at the level of oil prices exceeding this figure by about US \$ 4 the growth in gold and foreign exchange reserves in 2005 should make US \$ 22 billion, i.e. be US \$ 124 billion by the end of 2005.

The forecasted rates of real effective Ruble appreciation in 2004 will make slightly above 10 per cent, a similar value characterizes the Ruble appreciation against the US dollar. However, in 2005 the Ruble will more appreciate against the US dollar than the currency basket. Thus, according to Scenario 1 the real effective Ruble exchange rate should increase by 1 per cent, i.e. the Ruble appreciates by 3.9 per cent against the US dollar in terms of the real exchange rate. According to Scenario 2, similar rates of the Ruble appreciation will make 5.3 per cent and 5.8 per cent respectively.

By the end of 2004, the amount of exports should make US \$ 158 billion, while in 2005 at a lower level of oil prices it will make US \$ 155 billion, or US \$ 161 billion in the framework of Scenario 2. The estimated amount of imports in 2005 will exceed the data for year 2004 in the framework of both scenarios and increase by US \$ 9 billion (Scenario 1) or by US \$ 13 billion in accordance with Scenario 2. The forecast of amount of imports in 2004 is US \$ 102 billion. Therefore, proceeding from the forecasts in 2005 the active balance of trade will be by US \$ 10 billion below the figures registered in the preceding year.

The estimates of the rates of growth in the retail trade turnover, index of industrial production, and real cash household incomes on the whole correlate to the forecasted increase in GDP. At the same time, in the medium term outlook the real rates of growth in the retail trade turnover are on the average by 1 p. p. above the rates of increase in GDP, while the rates of growth in real cash household incomes are by 7 p. p. above and the rates of increase in IPI are, on the contrary, by 0.5 p. p. on the average below this value.

The forecast of the share of unemployed in the total economically active population in 2004 is at 7.9 per cent. In 2005, the share of unemployed will decline in comparison with the figures registered in the preceding year to 7.3 per cent in the framework of the pessimistic scenario and to 7.1 per cent in accordance with the optimistic scenario.

*Table 4*

**Forecast of the RF Ministry of Economic Development for 2004 and 2005**

	2004	2005	
		Scenario 1	Scenario 2
Rate of growth in real GDP (in % of the figures registered in the preceding year)	6.4	4.8	6.2
Rate of increase in CPI (in % of the figures registered in the preceding year)	10	6.5-8.5	6.5-8.5
Rates of the real effective Ruble appreciation (in % of the figures registered in the preceding year)	7.9	0.4	5.2
Rates of the real Ruble appreciation against US \$ (in % of the figures registered in the preceding year)	8.7	-0.6	2.8
Export (US \$ billion)	146.7	130.4	148.2
Import (US \$ billion)	89.8	96.6	101.5
Rate of increase in retail trade turnover (in % of the figures registered in the preceding year)	8.6	6.5	8.6
Rate of increase in the industrial production index (in % of the figures registered in the preceding year)	5.9	3.8	5.8
Rates of growth in real cash household incomes (in % of the figures registered in the preceding year)	10.5	7.3	9.3

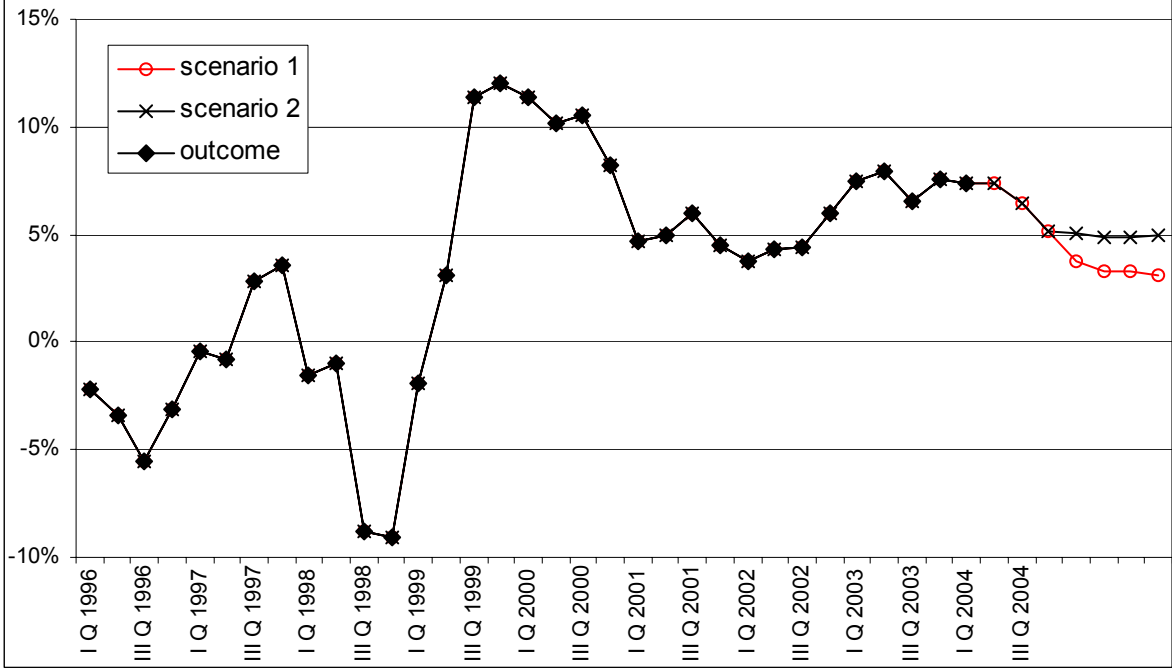
As it is indicated by the data presented in Tables 3 and 4 (see above), the forecasts of base macro-economic indicators on the whole match the similar estimates presented by the RF Ministry of Economic Development. The most significant discrepancy between the IET and Ministry forecasts was

registered with respect to the real Ruble / US dollar exchange rate, the real effective Ruble exchange rate, and exports. Thus, according to the estimates of the RF Ministry of Economic Development, the Ruble appreciation against the US dollar is on the average by 2 p. p. below the figures predicted in the framework of IET forecasts. Similarly, the appreciation of the real effective Ruble exchange rate is on the average by 1 p. p. below the aforementioned figures. At the same time, the forecasted amount of exports (IET) is by more than US \$ 10 billion above the respective estimates made by the Government. This discrepancy in the external economic indicators may be primarily explained by a lower level of oil prices (on the average, by US \$ 2 per barrel) set forth in the initial assumptions of the RF Ministry of Economic Development used as the basis of its forecast.

**Annex**

*FIGURE 1*

**Real rates of growth in GDP**



*FIGURE 2*

**Rates of increase in consumer price index**

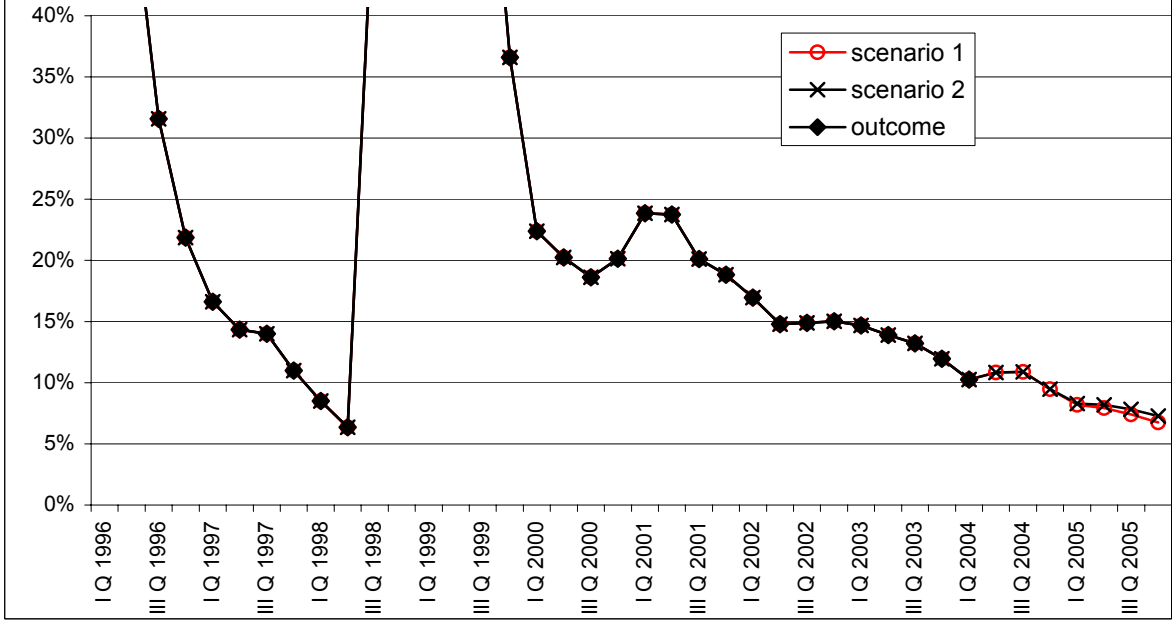


FIGURE 3

**Tax revenues of the RF consolidated budget (in % to the figures registered in the 1<sup>st</sup> quarter 1996) Налоговые поступления в консолидированный бюджет РФ (в % к I кварт. 1996 г.)**

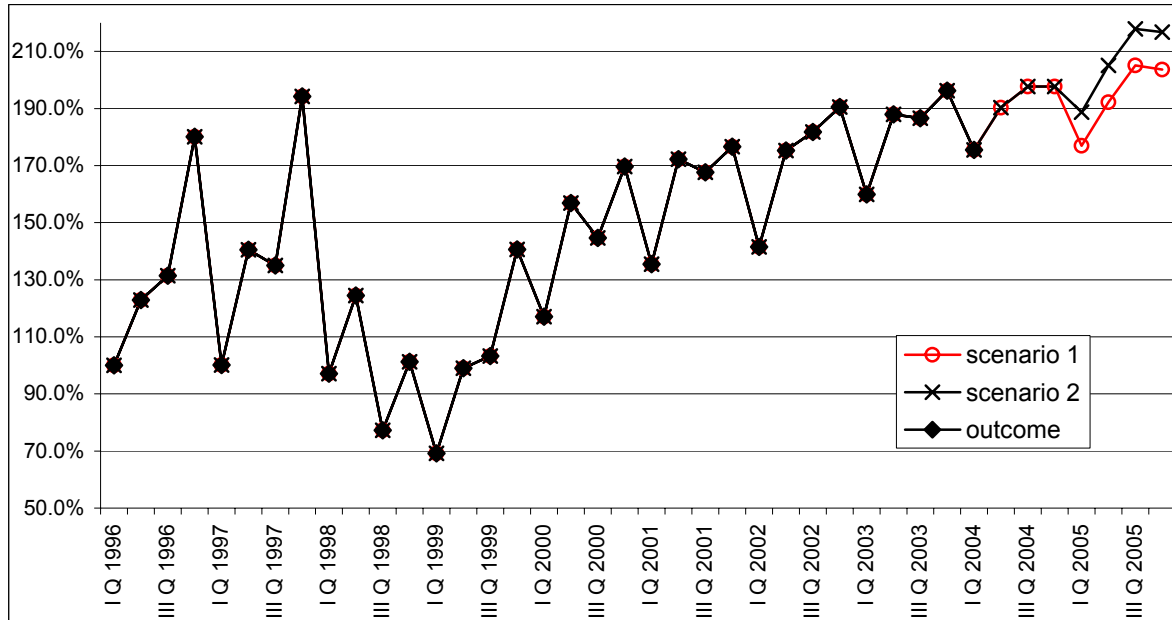


FIGURE 4

**Gold and foreign exchange reserves (Rub. Billion) Золотовалютные резервы (млрд. руб.)**

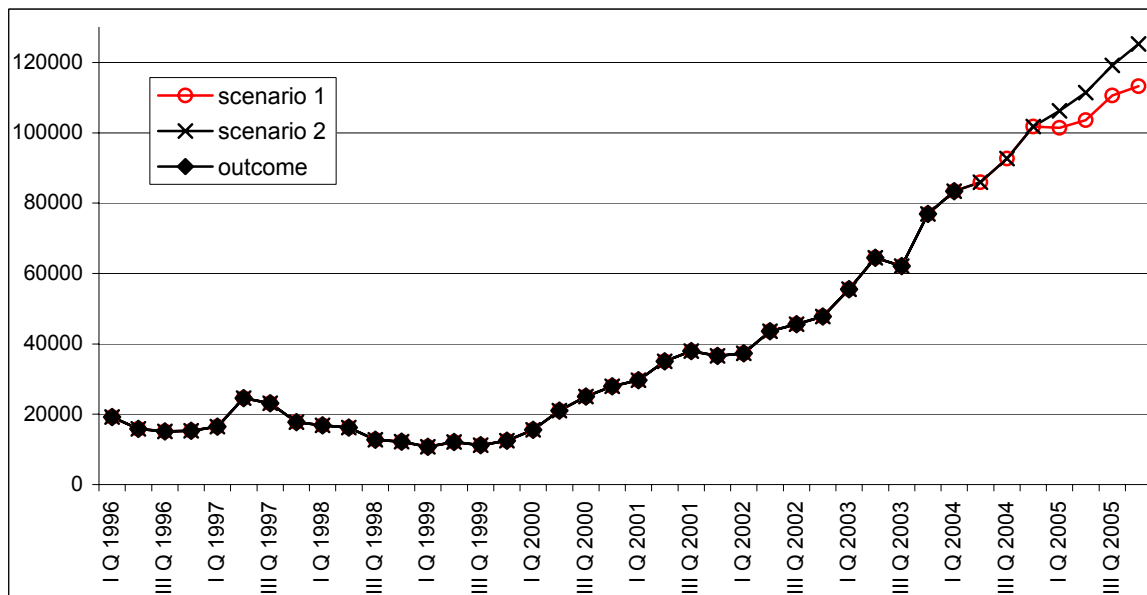


FIGURE 5

Nominal exchange rate (Rub. / US \$)

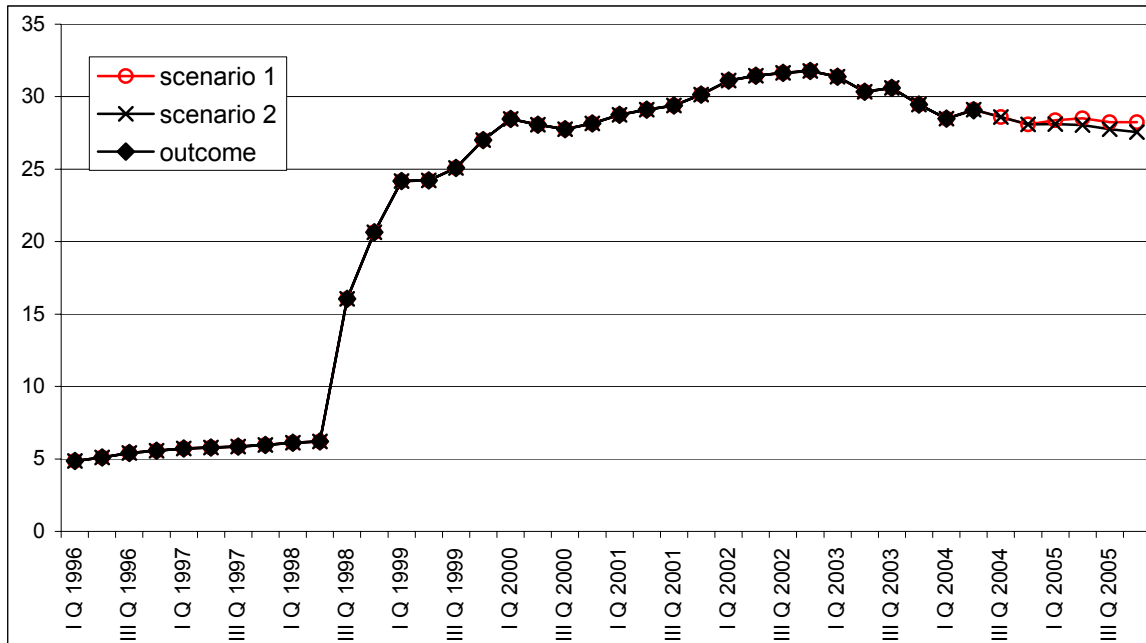


FIGURE 6

Real effective exchange rate (base index)

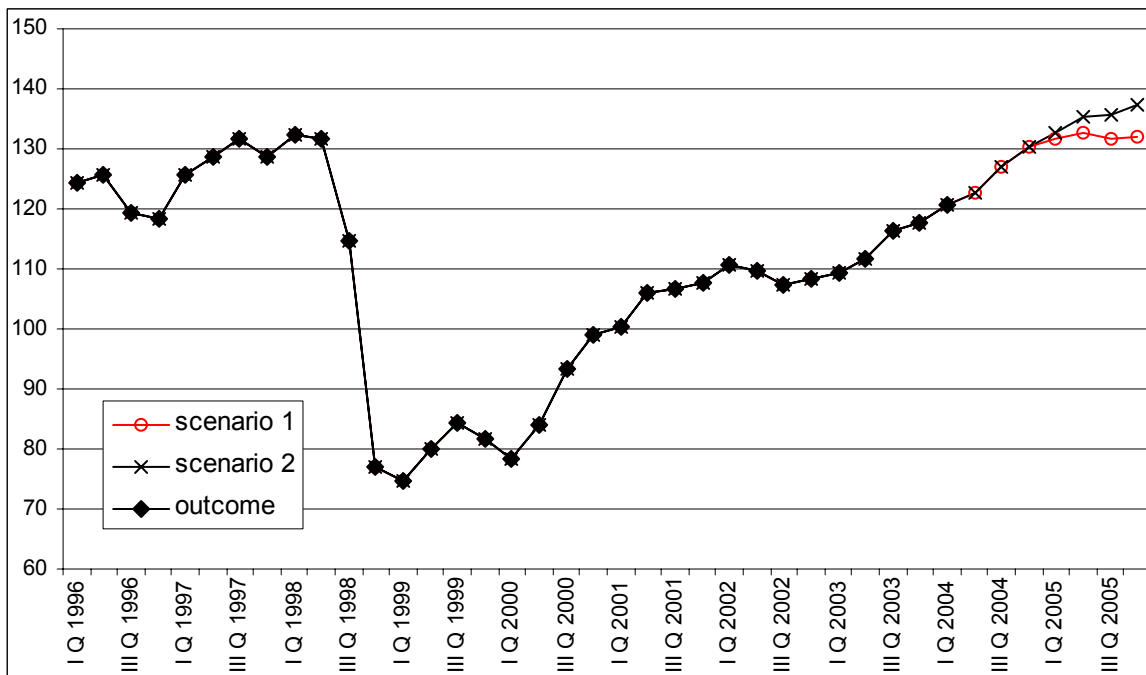




FIGURE 7

Export (US \$ million)

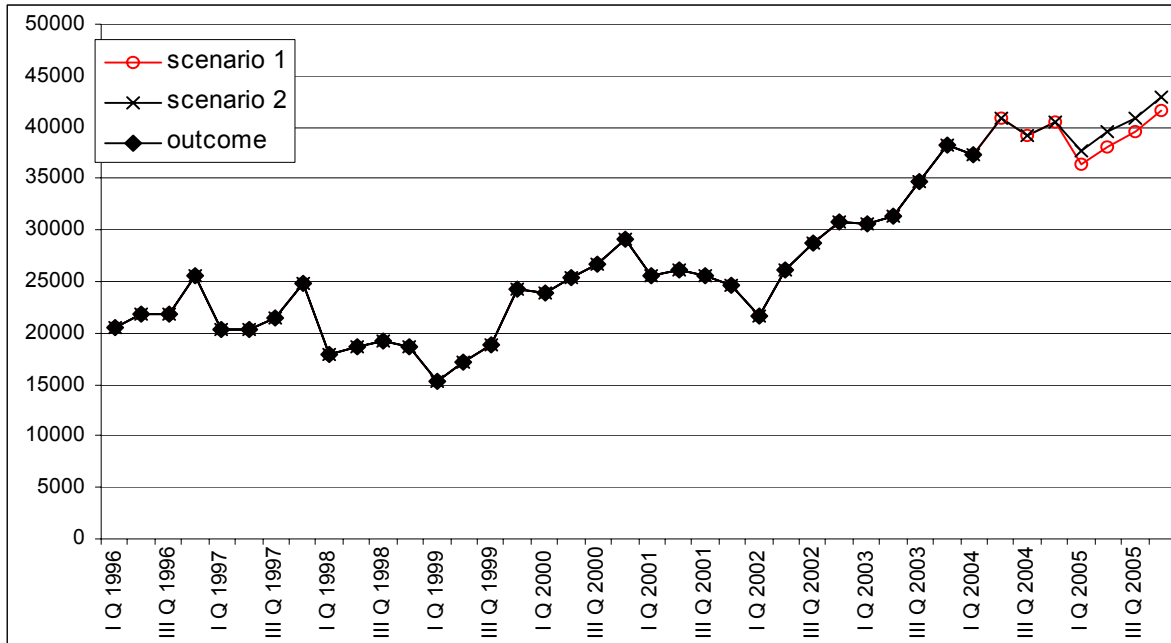


FIGURE 8

Import (US \$ million)

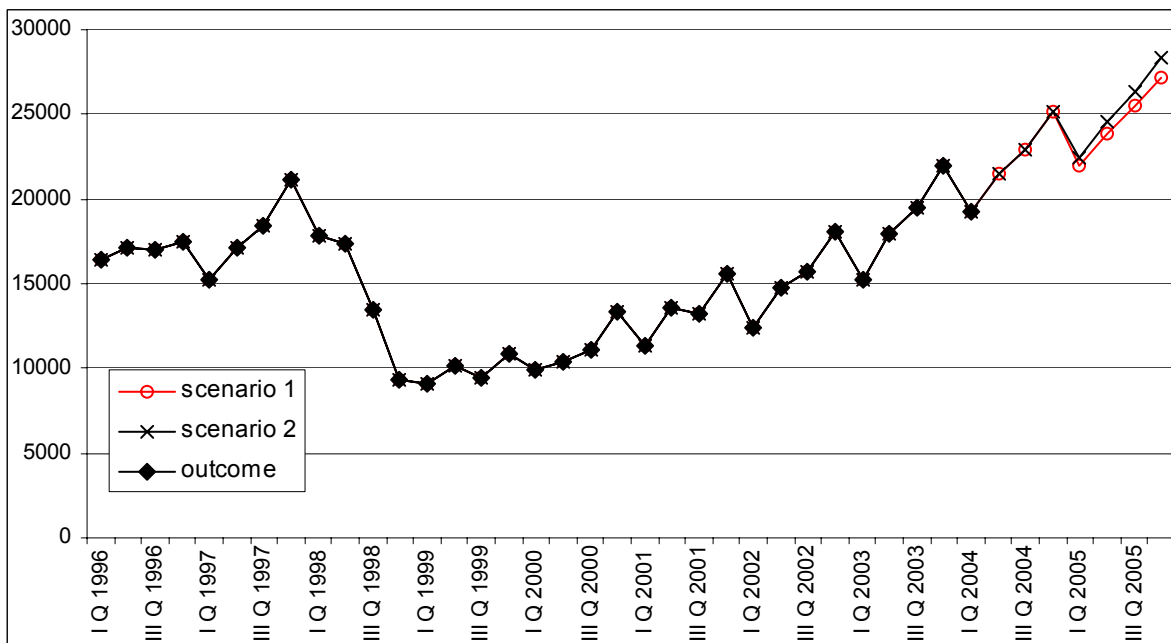


FIGURE 9

Real rates of growth in the retail trade turnover

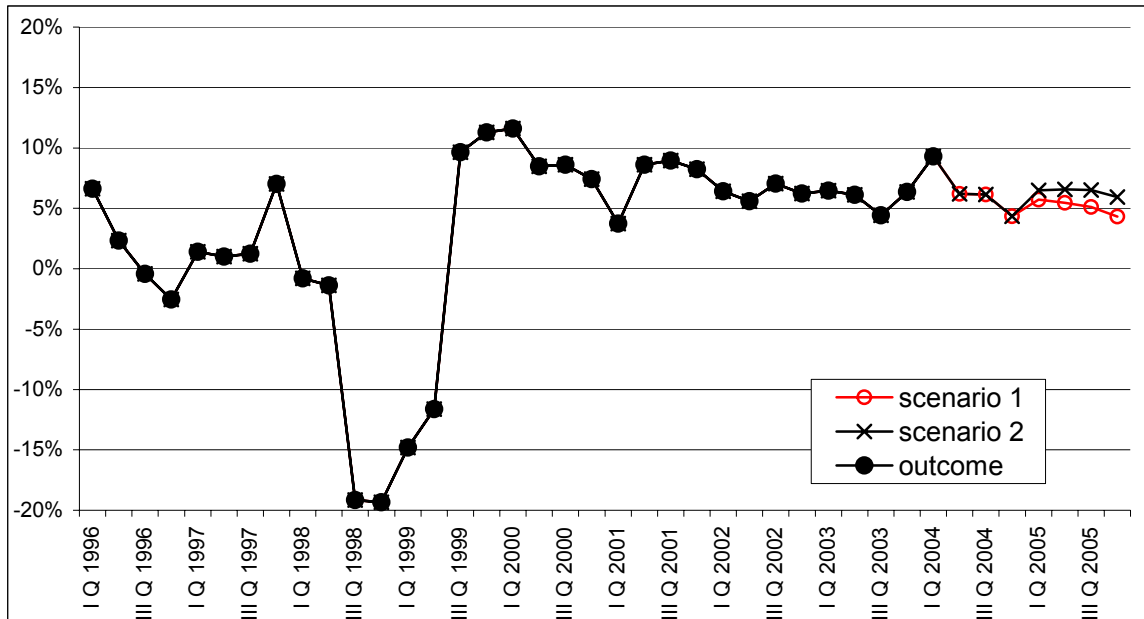


FIGURE 10

Rates of increase in the industrial production index

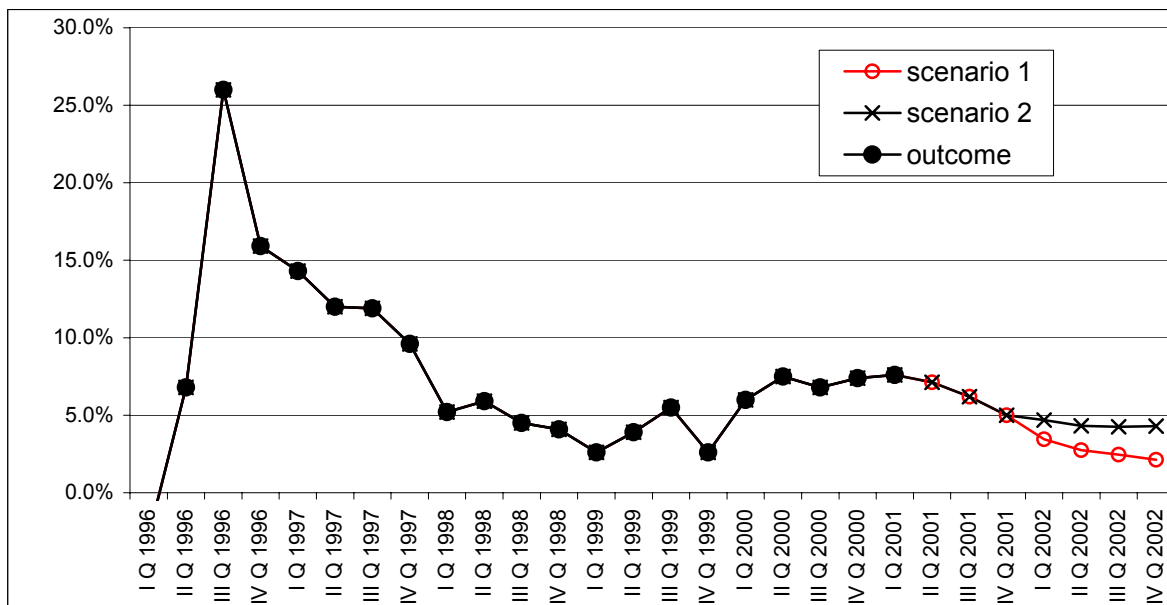


FIGURE 11

Percentage of unemployed in the economically active population

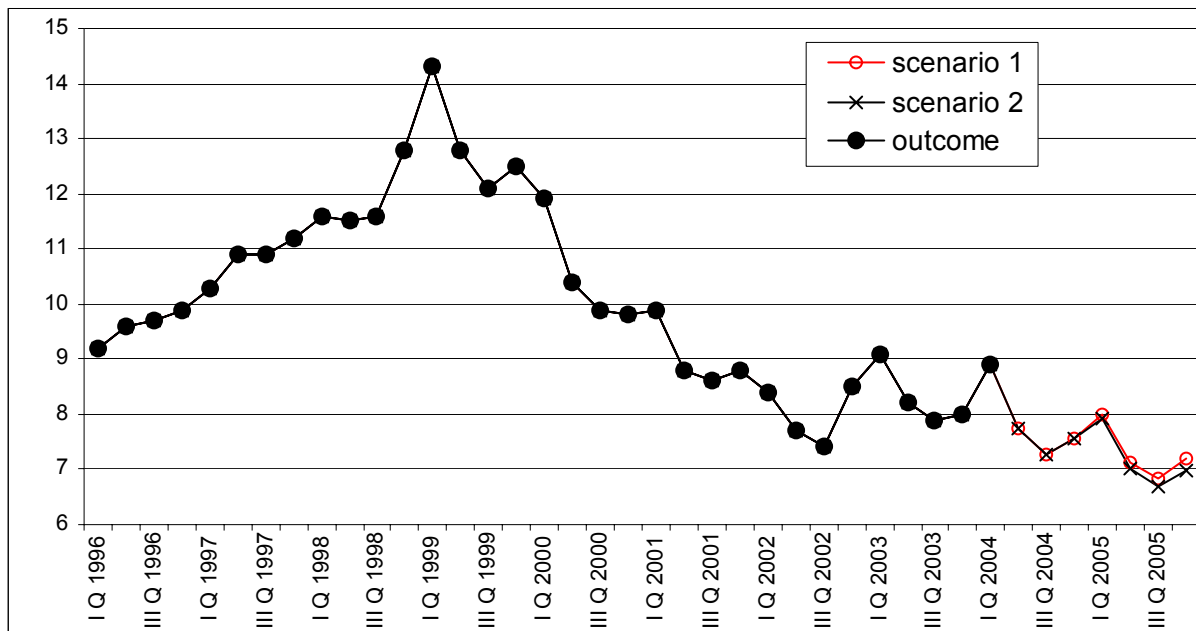
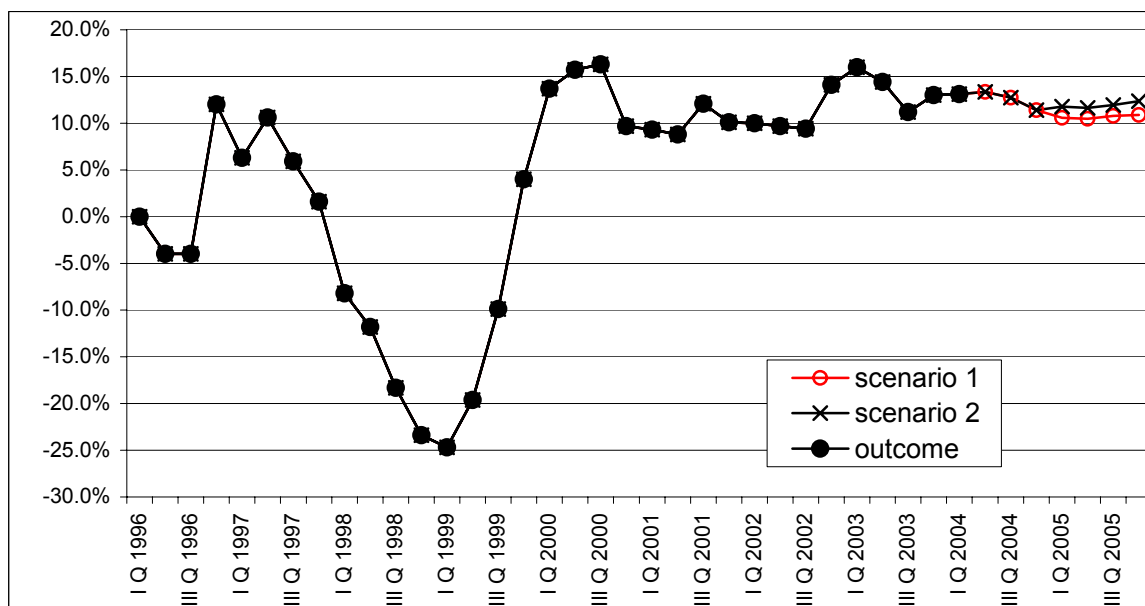


FIGURE 12

Rates of growth in real cash household incomes



S. Drobyshevsky, S. Ponomarenko

Issues discussed at the meetings held by the Government of the Russian Federation held on June 10 and 17 of 2004

The most interesting documents reviewed in the course of the meetings held by the RF Government in June were the following: the report of the RF Finance Minister A. L. Kudrin “On the results of the execution of the RF federal budget in the 1<sup>st</sup> quarter of 2004” presented at the RF Government meeting held on June 10, 2004, which reflected the macroeconomic environment of the execution of the federal budget. At the meeting of the RF Government held on June 17, 2004, there were presented the report of the RF Minister of Economic Development and Trade German Gref and the RF Finance Minister A.

L. Kudrin “On the key parameters of the forecast of the social and economic development of the Russian Federation in 2005 through 2007 and key characteristics of the draft federal budget for 2005 through 2007,” as well as the report made by the RF Minister of Economic Development and Trade German Gref “On the progress of development of the list of federal targeted programs entitled to financing from the federal budget in 2005,” where the Minister pointed out the necessity to modernize federal targeted programs and enhance their efficiency. In the course of the report, there were also noted the steps already made in this direction.

*The meeting of the RF Government held on June 10 of 2004*

The report pointed out that in the 1<sup>st</sup> quarter of 2004, the economy of Russia was characterized by the forming favorable situation facilitating acceleration of the rates of economic growth.

According to the preliminary estimates, the amount of GDP in the 1<sup>st</sup> quarter of 2004 increased by 8 per cent in comparison with the figures registered in the respective period of 2003, while the growth in output of base sectors of the economy in January through March of 2004 made 7.9 per cent as compared with the figures observed in the respective period of the preceding year.

By the end of the 1<sup>st</sup> quarter of 2004, the rate of inflation (3.6 per cent) was significantly below the level registered last year (5.2 per cent).

In the 1<sup>st</sup> quarter of 2004, the revenues of the federal budget made Rub. 688.6 billion, or:

The preliminary evaluation of the amount of GDP in the 1st quarter of 2004 (further – the amount of GDP) was exceeded by 19.7 per cent;

The amount of actual expenditures in comparison with the target figures for the 1st quarter of 2004 made 107.7 per cent.

In the 1<sup>st</sup> quarter of 2004, the expenditures borne by the federal budget made:

- Rub. 629.3 billion in terms of fulfilled *financing* of expenditures of the federal budget, or 94.1 per cent of the budget expenditure targets and 92.3 per cent of the adjusted consolidated budget revenues and expenditures for the 1<sup>st</sup> quarter of 2004;

- Rub. 553.9 billion in terms of the amounts of *cash expenditures* of the federal budget or 82.8 per cent of the budget expenditure targets and 81.2 per cent of the adjusted consolidated budget revenues and expenditures for the 1<sup>st</sup> quarter of 2004;

The surplus in terms of *financing* (excess of revenues over amounts of financing) made Rub. 59.2 billion (1.7 per cent of the amount of GDP), while in terms of *cash execution* of the federal budget is amounted to Rub. 134.7 billion (3.8 per cent of the amount of GDP).

The primary surplus of the federal budget (excess of revenues over amounts of financing not taking into account the amount of payments related to the servicing of the public debt) made Rub. 137.1 billion (3.9 per cent of the amount of GDP), while in terms of *cash execution* of the federal budget is amounted to Rub. 212.5 billion (6.1 per cent of the amount of GDP).

*The meeting of the RF Government held on June 17 of 2004*

At the meeting of the RF Government held on June 17, 2004, there were presented the report of the RF Minister of Economic Development and Trade German Gref and the RF Finance Minister A. L. Kudrin “On the key parameters of the forecast of the social and economic development of the Russian Federation in 2005 through 2007 and key characteristics of the draft federal budget for 2005 through 2007.”

The forecast has been developed proceeding from the evaluation of the economic development in 2003 and projected changes in the domestic and external conditions of development over this period.

In the report, there were pointed out the following issues.

There exists a significant probability that high oil prices will persist in 2004 (the average annualized oil price will make US \$ 29 per barrel).

As concerns the further analysis, the second version of the forecast proceeds from the persistence of the favorable oil price dynamics in the band from US \$ 24 to US \$ 26 per barrel in 2005 through 2003 and a gradual moderate growth of oil prices in the next years. At the same time, the first version of the forecast envisages less intense dynamics of prices of Russian oil and a decrease in Urals prices to the level of US \$ 22.5 per barrel in 2005, while the estimated average price of Urals oil in 2006 through 2008 should make US \$ 20 per barrel.

The forecast of the volumes of *oil exports* on the whole corresponds to the Energy strategy of RF for a long term perspective. It is envisaged that the *export of natural gas* will increase up to 195 bil-

lion cubic meters in 2004 through 2007 in the framework of the first scenario and up to 250 billion cubic meters according to the second version.

Neither scenario envisages any restructuring of the debt as concerns the dynamics of payments relating to the *external public debt*. The state debt policy will be aimed at a gradual reduction of the amounts of external borrowings and simultaneous observance of the set schedule of payments relating to the external debt on the part of the Russian Federation.

*Internal conditions of development* include the creation of favorable environment for business activities, growth in the material well being of the population, expansion of domestic demand and capacity of the domestic market.

As concerns the demographic situation, the report points out that the trend towards a decrease in the average annual size of the resident population will cease in the medium term perspective. The size of the economically active population will increase from 71.6 million people in 2003 to 71.7 million in 2007.

According to the both versions of the forecast, *inflation rate* should decline to 4 per cent to 6 per cent in 2007 and will further decrease to 2 per cent to 4 per cent by 2010.

*The dynamics of the Ruble exchange rate* will significantly depend on the world prices of Russian energy resources and on the conditions envisaged by both forecasts respectively. The rates of the real appreciation of the national currency will gradually decline and make 3 per cent in 2010.

*Macroeconomic indicators* of the forecast were elaborated in two versions taking into account the impact of estimated conditions and factors.

In 2004, the contribution of external factors in the growth of GDP will diminish and make about 1.5 p. p., while the impact of domestic factors will remain on the level observed in 2004. The average rate of growth in GDP is estimated to be at the level of 6 per cent in 2005 through 2007.

In the medium term outlook, the dynamics of *imports* will be determined by the gradual Ruble appreciation, requirements of the technological re-equipment of the growing economy, and increasing disposable incomes of enterprises and households.

The rates of growth of the Russian economy in 2004 through 2007 will be primarily related to the high dynamics of domestic demand. It should be noted that the growth in investment will outpace the rate of increase in consumption.

Among the *sources of investment*, borrowings will play a more and more important role, the share of borrowings in the total amount of investment will increase from 55 per cent in 2002 to 59.6 per cent in 2007 in the framework of the second scenario and to 58.4 per cent in accordance with the first version of the forecast.

Growth in investment and consumer demand should ensure stable rates of growth in *industry*. In 2005 through 2007, the rates of increase in industrial output (in the framework of the second version) will make on the average from 5.3 per cent to 5.7 per cent in comparison with the figures registered in each preceding year.

*The industries manufacturing products of final demand* will develop at the highest rates and by 2007 should ensure about 62 per cent of the total growth.

In 2007, the real disposable household incomes will increase by 33 per cent to 38 per cent in comparison with the figures registered in 2003.

The rates of growth in consumption on the part of the public sector will remain below 2.5 per cent a year.

The formation of budgets being the components of the RF budget system is carried out in the conditions of ongoing reforms in the tax sphere, implementation of a number of fundamental structural reforms in the sector of government aimed at the attainment of strategic goals. In the medium term outlook, the budget policy pursued in the sphere of revenues is aimed at the reduction of the amount of financial resources redistributed via the budget system.

In the course of elaboration of the projections of the key parameters of the budget system of the Russian Federation for year 2005, there were taken into account the most important changes in the tax legislation (the reduction of the rate of SST due to the federal budget and the budgets of state extrabudgetary funds to 26 per cent, changes in the rates of the profit tax, an increase in the base rate of the tax on extraction of mineral resources with respect to oil, the introduction of the new differentiated scale of export duty on oil, a reduction in the rates of export customs duties on all goods, etc.).

The calculations concerning revenues of the federal budgets and consolidated budgets of the RF subjects also take into account the important changes in the standards of distributions of financial resources across the levels of the budget system.

*Sources of domestic financing*

Revenues generated by privatization are one of the sources of financing of the deficit of the federal budget. In 2004 through 2006, all federal property not used for ensuring the execution of functions and objectives of the state will be offered for privatization.

*Sources of external financing*

One of the methods of covering the risks relating to unfavorable developments on the market of domestic and external borrowings and maintenance of non-interest expenditures at the necessary levels is the use of the resources accumulated in the Stabilization fund for repayment of the external public debt exceeding the reserve amount of Rub. 500 billion.

*Budget policy concerning the sphere of expenditures*

In the medium term perspective, the expenditures of the enlarged Government demonstrate a stable downward trend from 34.4 per cent of GDP in 2004 to 31.3 per cent of GDP in 2007, while non-interest expenditures will respectively decrease from 32.3 per cent of GDP to 30 per cent of GDP.

The projections of expenditures borne by the federal budget in 2005 and the next years proceed from the necessity to ensure the balance of the RF Pension Fund at the expense of the federal budgetary funds. In this connection, it is envisaged that a certain part of the Stabilization fund should be utilized for the purposes of increase in expenditures of the federal budget aimed at the covering of the deficit of the budget of the RF Pension Fund.

Yet another significant factor affecting the internal structure of expenditures is the implementation of key principles of the Concept of reforming of the budget process in the Russian Federation in 2004 through 2006, in the framework of which a special attention is paid to the switching from management of budget resources (expenditures) to performance management.

Besides, at the meeting of the RF Government held on June 17, 2004, there were presented the report of the RF Minister of Economic Development and Trade German Gref "On the progress of development of the list of federal targeted programs entitled to financing from the federal budget in 2005."

In his report, the Minister pointed out the necessity to modernize federal targeted programs (hereinafter referred to as FTP) and enhance their efficiency.

The report also points out that at present the existing mechanism of medium term planning represented by FTP in fact is not linked to the budget process of medium term planning: the mechanism of selection of problems solved via FTP in accordance with the priorities of the social and economic development of the country is underdeveloped. As a result, the number of programs is too large, while certain programs are insignificant in terms of their respective sizes and are aimed at the settlement of insignificant specific problems not requiring introduction of the performance budgeting approach.

It was noted in the report that the importance of reorientation and development of the programming framework, first of all, of FTP, is the key area of implementation of the concept of performance oriented budgeting.

According to the priorities and criteria of selection of programs approved by the RF Government proposed to be financed from the federal budget, the implementation of FTP approved by the RF Government according to the established procedures was aimed primarily at the development of social infrastructure, a rational system of economic regulation, ensuring of internal and external security, and more active development of tools creating incentives for enhancement of innovation activities.

The limitation of the number of current and future FTP permitted to bridge the gap between the demand for program financing and the possibilities of the federal budget and to begin the practical implementation of the principle of full and timely financing of programs. There was optimized the structure of FTP and respective subprograms, there were excluded the programs not answering the priorities set forth by the RF Government, what permitted to concentrate the budget allocations for the settlement of urgent problems.

*E. A. Bolshakova*

## **Review of economic legislation: June of 2004**

---

In June, there were introduced the following changes in the legislation currently in force: there was suspended the regulation stipulating that insurers having licenses for life insurance should have no right to reinsurance risks relating to property insurance assumed by the insurers until July of 2007; there was approved the amended version of "General principles of issuance and circulation of state savings bonds"; the RF Government approved the regulations with respect to protection of interests of the Russian Federation as a creditor in the course of reviewing of bankruptcy cases and implementation of bankruptcy procedures; since June 15, there was reduced the discount rate of the Bank of Russia (from 14 per cent to 13 per cent per annum). The RF President presented his annual statement about situation in the country and the key guidelines of the state policy.

### **I. Address of the President of the Russian Federation**

Address of the President of the Russian Federation to the Federal Assembly of May 26, 2004

In accordance with article 84 of the RF Constitution, the President of the Russian Federation made an annual statement about the situation in the country and the key guidelines of the state policy addressed to the Federal Assembly of the Russian Federation. The statement determined the most urgent problems, first of all, the improvement of quality and availability of housing, modernization of the public health care system, and development of education, as well as the problems of poverty and unemployment. The President outlined the package of measures necessary to settle these problems.

Thus, according to the President, in order to settle the housing problem it was necessary to form financial mechanisms permitting to improve housing conditions not only at the expense of wages, salaries, and available savings, but also at the expense of future incomes of citizens. Mortgage should become an available means to settle the problems encountered by people with medium level incomes, eliminate monopoly on construction markets, establish guarantees of property rights of bona fide purchasers of housing. It was also noted that obtainment of housing via social rent agreements should become available for those who is really in need of social housing.

The major objective of modernization of health care is to improve availability and quality of medical aid provided to the broad sectors of the population. The guarantees of free medical aid should be generally known and understandable. Standards of medical services should be worked out and approved for each illness and include a mandatory list of medical and diagnostic procedures and medicines, as well as minimal requirements concerning the conditions of provision of medical aid.

In the address, there were pointed out the following target benchmarks in the sphere of education. Graduates of schools independently of status of their parents should have the possibility to enter higher education establishments in accordance with the level of their knowledge, for these purposes there is needed a transparent and objective system of evaluation of the level of knowledge. There should be set the objective that the majority of graduates of educational institutions worked in accordance with their area of expertise. However, it does not mean that the system of directive distribution of graduates should be restored, it is necessary to prognosticate the need of the state in certain specialists. It was also pointed out that a system of modern educational standards should be put in place.

There were outlined the most important national objectives faced by the country: in particular, there was stressed the need for streamlining of interbudgetary relations and budget planning, implementation of reforms in the tax sphere, reasonable utilization of mineral resources and development of the transport infrastructure, modernization of the armed forces, integration of the Russian economy in the world economy.

### **II. FEDERAL LAWS of the Russian Federation**

1. "ON AMENDMENTS TO ARTICLES 4, 14, AND 21 OF THE FEDERAL LAW 'ON VETERANS'" No. 49 FZ of June 19, 2004

Privates and officers of establishments and bodies of the penal system, who were disabled due to wounds, concussions, or deceases resulting from execution of their official duties in the areas of combat operations should be granted the status of invalids of the Great Patriotic War. The said persons should be entitled for privileges granted to the war disabled, at the same time benefits granted to the family members of killed (deceased) war disabled, participants of the Great Patriotic War and veterans of combat operations should be extended to their family members.

2. “ON SUSPENSION OF ITEM 3 OF ARTICLE 13 OF THE LAW OF THE RUSSIAN FEDERATION ‘ON ORGANIZATION OF INSURANCE BUSINESS IN THE RUSSIAN FEDERATION’” No. 57 FZ of June 21, 2004

Enters into force on the day of promulgation.

Item 3 of article 13 of the RF law No. 4015-1 of November 27, 1992, “On organization of insurance business in the Russian Federation” was suspended until July 1, 2007, with respect to insurance organizations founded prior to the entry into force of federal law No. 172 FZ of December 10, 2003, “On amendments to the law of the Russian Federation ‘On organization of insurance business in the Russian Federation and invalidation of certain legislative acts of the Russian Federation.’” The new law stipulates that insurers having licenses for life insurance should have no right to reinsurance risks relating to property insurance assumed by the insurers. Therefore, there was introduced the “transition period” until July 1, 2007, so the insurers could divide these two types of operations.

This federal law should concern the legal relations originated since the date of entry into force of federal law No. 172 FZ of December 10, 2003.

### **III. RESOLUTIONS OF THE GOVERNMENT of the Russian Federation**

1. “GENERAL PRINCIPLES OF ISSUANCE AND CIRCULATION OF STATE SAVINGS BONDS” No. 262 of June 2, 2004

There were approved the new version of the “General principles of issuance and circulation of state savings bonds” earlier approved by Resolution of the RF Government No. 771 of November 6, 2001.

The general principles of issuance and circulation of state savings bonds (which are a type of federal securities) are subject to approval by the RF Government on the basis of the federal law “On specifics of issuance and circulation of state and municipal securities.” The amendments made to the “General principles of issuance and circulation of state savings bonds” concern certain conditions envisaged by the law and mandatory included in this regulatory act: a) fixed terms of this type of securities; b) specifics of execution of obligations envisaging the right to receive non-cash property equivalent; c) limited group of persons having the right to own these securities on terms of title or other property law.

Alongside with medium and long term state savings bonds, from now on there may be issued also short term savings bonds maturing in the period up to one year. Only certain legal entities, residents of the Russian Federation, are entitled to own such bonds. The general principles contain the closed list of such entities which does not include management companies of unit investment funds, but includes the RF Pension Fund and “other state extra-budgetary funds of the Russian Federation” with the clause that investing of the financial reserves of these funds in state securities should be envisaged in the legislation of the Russian Federation. The law introduces the stipulation directly granting management companies of non-state pension funds of the Russian Federation and the RF Pension Fund carrying out the management of the financial resources of joint stock investment funds the right to purchase bonds in the case these funds answer the requirements to the composition and the structure of assets of joint stock investment funds stipulated by the legislation of the Russian Federation. It should be noted that the Finance Ministry is granted the right to place the bonds not only via auctions by the way of conclusion of respective agreements with organizers of trade on the stock market, but also on the terms of closed subscription at the prices set by the Ministry via organizers of trade on the stock market. Owners and management companies should have the right to exchange for other federal securities in accordance with the procedures envisaged by the terms of issuance and circulation of the said bonds.

2. “ON PROTECTION OF INTERESTS OF THE RUSSIAN FEDERATION AS A CREDITOR IN THE COURSE OF REVIEWING OF BANKRUPTCY CASES AND IMPLEMENTATION OF BANKRUPTCY PROCEDURES” No. 257 of May 29, 2004

There were approved the Regulations determining the procedures which govern the putting forward and consolidation of claims for making mandatory payments to budgets of all levels, as well as state extra-budgetary funds and claims concerning monetary liabilities to the Russian Federation in relation to bankruptcy cases and implementation of bankruptcy procedures.

According to the Resolution, in the case the debtor fails to comply with the claims put forward by the Russian Federation in the amount set forth by the federal law “On insolvency (bankruptcy),” the authorized body should take a decision to submit an application requiring an arbitration court to declare the debtor bankrupt.



It was established that until its transformation in the Federal Tax Service, the RF Ministry of Taxes and Fees should be the body authorized to represent the interests of the Russian Federation as concerns claims related to mandatory payments and monetary liabilities to the Russian Federation and in bankruptcy cases and in the course of implementation of bankruptcy procedures. After the establishment of the Federal Tax Service, this agency should be the body authorized to carry out these activities.

There were invalidated resolutions of the RF Government No. 218 of April 15, 2003, "On the procedures governing putting forward claims concerning liabilities to the Russian Federation with respect to bankruptcy cases and implementation of bankruptcy procedures" and No. 688 of November 14, 2003, "On the Interdepartmental commission for determination of the feasibility to put forward applications for declaring debtors bankrupt."

#### **IV. INSTRUCTIONS, REGULATIONS, AND ORDERS**

1. Telegram of the RF Central Bank No. 1443-U of June 11, 2004, "ON THE RATE OF REFINANCING SET SINCE JUNE 15, 2004"

Since June 15, 2004, the refinancing rate of the Bank of Russia has been reduced from 14 per cent to 13 per cent per annum.

2. Telegram of the RF Central Bank No. 1444-U of June 11, 2004, "ON THE RATE OF INTEREST ON OVERNIGHT CREDITS ESTABLISHED SINCE June 15, 2004"

Since June 15, 2004, the rate of interest of the Bank of Russia on overnight credits has been reduced from 14 per cent to 13 per cent per annum.

3. Telegram of the RF Central Bank No. 1445-U of June 11, 2004, "ON CHANGES IN NORMS OF MANDATORY RESERVES OF CREDITING ORGANIZATIONS AND CARRYING OUT OF EXTRAORDINARY REGULATION OF THE AMOUNT OF MANDATORY RESERVES"

Since June 15, 2004, the norm of mandatory reserves pertaining to borrowings of legal entities denominated in Russian currency and borrowings of legal entities and individuals denominated in foreign exchange have been reduced from 9 per cent to 7 per cent.

The norm of mandatory reserves pertaining to Ruble denominated deposits of individuals shall remain at the rate of 7 per cent. There were determined the specifics of extraordinary regulations of the amounts of mandatory reserves of crediting organizations and the Sberbank of Russia by the territorial offices of the Bank of Russia.

4. Letter of the RF Tax Ministry No. 14-3-03/1712-6 "ON RULING NO. 4243/03 OF OCTOBER 7, 2003, OF THE PRESIDUM OF THE SUPREME ARBITRATION COURT"

The letter was published to inform and instruct tax authorities that according to ruling No. 4243/03 of October 7, 2003, of the Presidium of the RF Supreme Arbitration Court the tax card for registration of incomes and the amount of tax on incomes of individuals approved by order No. BG-3-08/379 of November 1, 2000, is a basic document of tax accounting; however, due to the fact that article 120 of the RF Tax Code, which stipulates responsibility for gross violations of the rules governing registration of incomes and expenditures, as well as objects of taxation does not definitely stipulate that the definition of basic documents should include basic documents of tax accounting, it is inadmissible to call tax agents to account for the absence of tax cards.

In connection to the arguments stated above, it was stipulated that paragraphs 5 – 13 of item 2 of letter of the RF Tax Ministry No. Sh-6-14/734 of September 28, 2001, explaining the procedures governing the calling of tax agents to account for the absence of the said tax cards in accordance with article 120 of the RF Tax Code.

5. Letter of the RF Tax Ministry No. 01-2-03/555 "ON TAXATION OF FORWARDING SERVICES"

The Ministry explains that the services relating to the forwarding of goods, the sale of which is subject to taxation at the rate of 10 per cent, by own transport means is not included in the list of goods (works, services) subject to the added value tax at the rate of 10 per cent, therefore these services should be subject to the general tax treatment, i.e. be assessed at the rate of 18 per cent. According to item 1 of article 153 of the RF Tax Code, in the case the taxpayer's goods (works, services) are subject to taxation at different rates, the tax base should be determined separately for each type of goods (works, services) subject to taxation at different rates. Therefore, in the case the tax base is determined on the basis of separate accounting, the amount of VAT should be calculated as the sum of amounts of

taxes calculated separately as percentage shares of respective tax bases in accordance with the respective tax rates.

6. Letter of the RF Tax Ministry No. 21-2-05/71@ of June 17, 2004 “ON CALCULATION OF THE MINERAL EXTRACTION TAX RATE IN MAY OF 2004”

The letter informs about the data used for the calculation of the mineral extraction tax with respect to oil in May of 2004:

- the average level of Urals oil prices on the Mediterranean and Rotterdam markets (US \$ 35.39 per barrel);
- value of the Kts coefficient (3.1506);
- tax rate adjusted for the Kts coefficient (Rub. 1093.2582 per metric ton).

*I. V. Tolmacheva*