RUSSIAN ECONOMY: TRENDS AND PERSPECTIVES
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On progress in reforms (July 2003)

President Putin signed a decree on main administrative reform measures, and the government created the respective commission. The Government has so far failed to adopt a new medium-term program. The Government abolished control over private individuals' large spending and passed the law on lowering the VAT rate effective as of 2004.

The existing civil service system is characterized by a low efficiency and insufficient flexibility. Should it be retained, the implementation of other reforms may slowdown or even cease. The administrative reform guidelines in 2003 are the civil service reform, enhancement of efficiency of state property management, promotion of debureaucratization processes, and the environmental management reform.

In June 2003, President Putin signed a Decree that sets guidelines for civil service reform in 2003-04. According to the Decree, the Government established a high-level commission on civil service reform chaired by Vice Prime-Minister B. Aleshin.

The division of powers between different tiers of government forms one of the key challenges in the administrative reform area. In July, President Putin signed the federal law 'On amending the Federal Law " On fundamentals of organization of legislative (representative) and executive bodies of state power of Subjects of the Russian Federation'.

Promotion of the tax reform forms one of the major missions of the Government. In late July, President signed the federal law 'On amendments to Section Two of the tax Code of the Russian Federation, amending some other statutes of the Russian Federation and recognizing invalid some other statutes of the Russian Federation' submitted by the RF Government. The bill supplements the Tax Code of RF with a chapter ' The taxation system under implementation of production sharing agreements'.

One of the key guidelines of the tax reform is refusal from an inefficient system of control over private individuals' expenses. In July, President Putin signed the federal law 'On recognizing invalid of provisions of statutes of he Russian Federation in the part of tax control over private individuals' expenses'.

As well, in July President signed the federal law that provides a decrease in the VAT rate form the current 20 to 18% and indexation of excise rates, both effective as of 2004.

In July, the work on the property tax system reform was underway. In June 2003 the State Duma passed in the second reading the bill that provide amending the Tax Code with a chapter on corporate property tax, while a chapter of the Tax Code on inheritance and gift tax was passed in the first reading. The suggested principles of collection of the noted taxes should encourage an efficient property use.

The state of market infrastructure appears important for the state of the investment and business climate, which makes **institutional and infrastructural reforms** a priority. In 2003 the reformers' focus has been on the national financial system and natural monopolies.

The work on the railway transportation reform was underway. In June, President signed two federal laws aimed at preventing unjustified federal budget expenditures and ensuring interests of the Russian Federation in the area of defense and security, as well as specification of single provisions of federal statutes.

In June 003, the governmental Resolution approved an action plan on reforming the electricity sector for 2003-2005.

In June 2003, the governmental Resolution approved a concept for development of the market for liquid gas for household needs; the concept is aimed at furthering liberalization of this particular market.

In June 2003, President Putin signed anew version of the federal law 'On communication'. The new statute introduces provisions of direct effect that should ensure an openness of procedures of granting and cancellation of licenses in the communication area, operators' accession to the general use network and their interaction.

In July, President Putin signed a Decree on organization of alternative military service.

The Government puts a strong emphasis on securing the economy's openness and is keen to bring the national law in line with WTO procedures and standards as well as to promote liberalization in the foreign trade are, among other priorities.

In June, the State Duma passed in the second reading the bill 'On special protective, antidumping and compensatory measures in the course of importation of goods' whose protective measures stipulated therein have been completely brought in line with the WTO procedures and standards.

The Government paid a serious attention to the social sphere, with major objectives for 2003 being the healthcare and educational reforms that at most determine the quality of human capital, and furthering the pension reform.

In the sphere of education, one of priorities is creation of conditions to ensure students' conscious choice of their future profession and account of needs on the labor market: this should be accomplished particularly by introduction of a profile education in educational institutions that provide comprehensive secondary education. In June 2003 the Government passed a resolution on conducting such an experiment, whose purpose is to establish a system of a specialized training (profile education) in senior forms, testing new contents and forms of organization of the educational process.

As well, the work on development and adoption of statutes and other legal acts needed to further the pension reform was underway.

In June 003, the Government adopted a resolution regarding the insured person's eligibility for the choice of an investment portfolio (management company) in compliance with the federal law 'on investing funds to finance the savings part of the labor pension in RF'. The Resolution sets, among other things, procedures of information of insured persons on the state of a special part of their individual account and their submission of applications on the choice of an investment portfolio (investment company).

The Government continued its work on organization of pension savings management. The respective Resolution passed in June 2003 approves a standard trust agreement between the Pension Fund of RF and a management company selected basing on tender procedures, among other legal acts.

O. Fomichev

The State of the Federal Budget

In the first five months of 2003, the revenues of the state budget (cash execution) made 21.3 % of GDP, while expenditures made 17.7 % of GDP (see Table 1). Therefore, the federal budget surplus made 3.6 % of GDP.

Table 1

The monthly execution of the federal budget of the Russian Federation (in % of GDP[1[1]], in comparable prices).

	IV`02	V`02	VI`02	VII`02	VIII`02	IX`02	X`02	XI`02	XII`02	I`03	II`03	III`03	IV03	V03
Revenues														
Corporate profit tax	1,9%	1,9%	1,7%	1,7%	1,7%	1,6%	1,7%	1,6%	1,6%	1,2%	1,1%	1,4%	1,5%	1,4%
Personal income tax	0,0%	0,0%	0,0%	0,0%	0,0%	0,0%	0,0%	0,0%	0,0%	0,0%	0,0%	0,0%	0,0%	0,0%
VAT, special tax and excises	3,9%	3,6%	3,5%	3,5%	3,3%	3,2%	3,1%	3,1%	3,1%	2,4%	2,7%	2,8%	2,9%	2,9%
Tax on foreign trade and foreign trade operations	9,3%	9,3%	9,3%	9,3%	9,1%	9,0%	8,9%	8,9%	8,9%	11,2%	10,1%	9,9%	9,6%	9,6%
Other taxes, duties and payments	6,9%	7,0%	7,0%	7,0%	7,0%	6,9%	6,9%	6,9%	6,9%	8,5%	7,4%	7,2%	7,2%	7,2%
Total- taxes and charges	2,4%	2,3%	2,3%	2,2%	2,1%	2,0%	2,0%	1,9%	2,0%	2,7%	2,7%	2,6%	2,4%	2,3%
Non- tax revenues	3,0%	2,9%	2,9%	2,9%	2,8%	2,8%	2,8%	2,9%	3,0%	3,4%	3,4%	3,4%	3,5%	3,5%
Revenues, total	8,7%	8,4%	1,8%	2,0%	2,0%	2,0%	2,1%	2,1%	2,1%	0,5%	1,7%	2,0%	2,2%	2,1%
Expenditure	19,9%	19,6%	19,3%	19,4%	18,9%	18,5%	18,6%	18,5%	18,6%	18,8%	19,0%	19,4%	19,6%	19,4%
Public administration	1,3%	1,2%	1,3%	1,4%	1,4%	1,4%	1,6%	1,4%	1,4%	17,5%	8,5%	1,3%	1,2%	1,7%
National defense	21,2%	20,9%	20,6%	20,9%	20,4%	20,0%	20,2%	20,1%	20,1%	20,8%	20,6%	20,9%	21,0%	21,3%
International activities														
Judicial power	0,4%	0,4%	0,4%	0,4%	0,4%	0,4%	0,4%	0,4%	0,5%	0,3%	0,3%	0,4%	0,4%	0,4%
Law enforcement and security activities	2,3%	2,4%	2,5%	2,5%	2,5%	2,4%	2,4%	2,5%	2,7%	1,5%	2,1%	2,6%	2,7%	2,7%

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

	IV`02	V`02	VI`02	VII`02	VIII`02	IX`02	X`02	XI`02	XII`02	I`03	II`03	III`03	IV03	V03
Fundamental research	0,4%	0,4%	0,4%	0,4%	0,3%	0,3%	0,3%	0,3%	0,3%	-0,3%	0,0%	0,2%	0,2%	0,3%
Services provided for the national economy	0,1%	0,1%	0,1%	0,1%	0,1%	0,1%	0,2%	0,2%	0,2%	0,1%	0,1%	0,1%	0,2%	0,2%
Social services	1,2%	1,2%	1,3%	1,4%	1,4%	1,4%	1,4%	1,5%	1,7%	1,1%	1,4%	1,7%	1,7%	1,7%
Servicing of public debt	0,2%	0,2%	0,2%	0,2%	0,2%	0,2%	0,2%	0,3%	0,3%	0,1%	0,2%	0,2%	0,2%	0,3%
Other expenditure	0,5%	0,6%	0,7%	0,8%	0,8%	0,8%	1,2%	1,3%	1,5%	0,2%	0,4%	0,5%	0,6%	0,7%
Expenditure, total	5,3%	5,2%	5,2%	5,2%	5,1%	4,9%	5,5%	5,6%	5,6%	1,5%	1,8%	2,0%	2,3%	2,2%
Loans, redemption exclusive	2,6%	2,5%	2,4%	2,3%	2,4%	2,4%	2,2%	2,0%	2,0%	1,7%	2,9%	3,0%	2,3%	2,1%
Expenditure and loans, redemption exclusive	3,9%	4,0%	4,0%	4,0%	3,9%	3,8%	3,9%	3,9%	3,8%	6,6%	7,1%	7,0%	7,0%	7,1%
Budget deficit (-)	16,9%	17,1%	17,2%	17,2%	17,1%	16,9%	17,8%	18,0%	18,7%	12,7%	16,4%	17,7%	17,7%	17,7%
Domestic financing	4,3%	3,8%	3,4%	3,7%	3,3%	3,1%	2,4%	2,1%	1,4%	8,1%	4,2%	3,2%	3,3%	3,6%
Other taxes, duties and payments	-2,0%	-1,8%	-1,6%	-1,8%	-1,3%	-1,2%	-0,5%	-0,2%	0,6%	-6,6%	-1,7%	-1,0%	-1,0%	-0,5%
Total- taxes and charges	-2,3%	-1,9%	-1,8%	-1,9%	-1,9%	-1,9%	-1,9%	-1,9%	-2,0%	-1,4%	-2,5%	-2,2%	-2,3%	-3,1%
Non- tax revenues	-4,3%	-3,8%	-3,4%	-3,7%	-3,3%	-3,1%	-2,4%	-2,1%	-1,4%	-8,1%	-4,2%	-3,2%	-3,3%	-3,6%

as % of GDP; ** the Unified Social Tax is included in tax revenues

As compared with the figures registered in January through May of 2002, the budget revenues decreased by 0.4 p. p. of GDP in January through May of 2003, while expenditures increased by 0.6 p. p. and budget surplus respectively decreased by 0.2 p. p. At the same time, without UST the budgetary revenues increased by 0.8 p. p. of GDP and made 18.4 % of GDP.

VAT accounted for the major share of federal tax revenues – 33.8 % of the total tax revenues what is by about 0.3 p.p. above the level observed in the respective period of 2002.

According to preliminary estimates, the cash execution of federal budget revenues made 20.5 % of GDP in January through May of 2003, what is by 0.1 p. p below the respective level observed in January through May of 2002. At the same time the cash execution of expenditures made 17.6 % of GDP (17.2 % of GDP in 2002); therefore, the surplus made up 2.9 % of GDP (3.4 % of GDP in 2002).

According to the preliminary estimates of the Finance Ministry, in terms of fulfilled funding[2[2]] the expenditures of the federal budget in January through May of 2003 made 19.2 % of GDP (see Table 2), while on June 1 of 2002 this indicator was at 18.9 % of GDP. As a result, the surplus of the federal budget in terms of fulfilled funding in the first four months of 2003 has also decreased by 0.3 p.p. in comparison with the figures registered in the respective period of 2002 and made 1.3 % of GDP.

Table 2.

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

	IV`02	V`02	VI`02	VII`02	VIII`02	IX`02	X`02	XI`02	XII`02	I`03	II`03	III`03	IV03
Total	21,2%	20,8%	20,5%	20,5%	20,5%	20,0%	20,1%	21,4%	21,2%	20,9%	21,0%	21,3%	20,5%
Public administration	0,5%	0,5%	0,5%	0,5%	0,5%	0,5%	0,5%	0,5%	0,6%	0,6%	0,6%	0,6%	0,5%
National defense	2,7%	2,7%	2,7%	2,7%	2,7%	2,6%	2,6%	2,5%	3,2%	3,3%	3,2%	3,1%	3,0%
International activities	0,5%	0,4%	0,4%	0,4%	0,3%	0,3%	0,3%	-0,4%	0,1%	0,1%	0,3%	0,3%	0,3%
Judicial power	0,2%	0,2%	0,2%	0,2%	0,2%	0,2%	0,2%	0,2%	0,2%	0,2%	0,2%	0,2%	0,2%
Law enforcement and security activities	1,5%	1,5%	1,6%	1,9%	1,6%	1,6%	1,7%	1,9%	2,3%	2,3%	2,2%	2,2%	2,0%

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

	IV`02	V`02	VI`02	VII`02	VIII`02	IX`02	X`02	XI`02	XII`02	I`03	II`03	III`03	IV03
Fundamental research	0,3%	0,3%	0,3%	0,2%	0,3%	0,3%	0,3%	0,3%	0,3%	0,3%	0,3%	0,3%	0,3%
Services provided for the national economy	0,9%	1,0%	1,0%	1,1%	1,1%	1,0%	1,5%	0,6%	0,8%	0,9%	0,9%	1,0%	1,0%
Social services	5,9%	5,7%	5,5%	5,6%	5,4%	5,2%	5,7%	2,6%	2,8%	2,7%	2,9%	2,7%	2,6%
Servicing of public debt	2,7%	2,5%	2,4%	2,6%	2,4%	2,4%	2,0%	1,7%	3,0%	3,0%	2,3%	2,1%	2,0%
Other expenditure	4,0%	4,6%	4,2%	4,0%	4,0%	4,0%	3,8%	7,0%	7,8%	7,3%	7,3%	7,4%	7,3%
Total expenditure	19,1%	19,4%	18,9%	19,1%	18,6%	18,2%	18,7%	16,9%	21,1%	20,8%	20,2%	19,9%	19,2%
Профицит (+) / дефицит (-)	2,1%	1,4%	1,6%	1,4%	1,8%	1,7%	1,4%	4,5%	0,1%	0,1%	0,8%	1,3%	1,3%

According to the estimates of the Ministry of Taxes and Levies, in April of 2003 tax revenues of the federal budget made Rb. 106.2 billion (without the unified social tax). In real terms the revenues made 240.0 % of the level registered in January of 1999, while the respective indicator was at 218.0 % in 2002 and 233.3 % in 2001 (see Table 3).

Table 3

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

1999											
I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII
100,0%	115,1%	122,0%	122,1%	104,5%	112,9%	127,0%	127,5%	124,3%	141,4%	160,8%	213,1%
2000											
I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII
149,3%	160,5%	181,3%	205,8%	233,1%	186,9%	181,0%	186,4%	173,1%	181,1%	201,7%	254,1%
2001											
I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII
204,4%	198,4%	227,6%	267,5%	252,2%	233,3%	231,9%	235,6%	219,4%	237,5%	247,3%	360,6%
2002*											
I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII
218,7%	187,1%	234,8%	277,8%	239,6%	218,0%	284,4%	246,5%	254,8%	299,7%	241,0%	250,2%
2003*											
I		II		III		IV		V		VI	
230,0%		229,2%		265,5%		280.4%		233.2%		240.0%	

Without regard to UST.

The dynamics of real arrears relating to major debts since June of 1999 is presented in Fig. 1. The debts related to the payments due to the federal budget made for VAT Rb. 233.4 billion as on June 1, 2003, showing almost a Rub. 5.1 billion contraction as compared with the figures registered in the preceding month, while the arrears of the corporate profit tax reduced by 240 mln. made Rb. 28.7 billion. On the whole, the dynamics observed over the past 2 years demonstrate a gradual decrease in the level of accumulated arrears as concerns not only the corporate profit tax, but VAT as well.

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

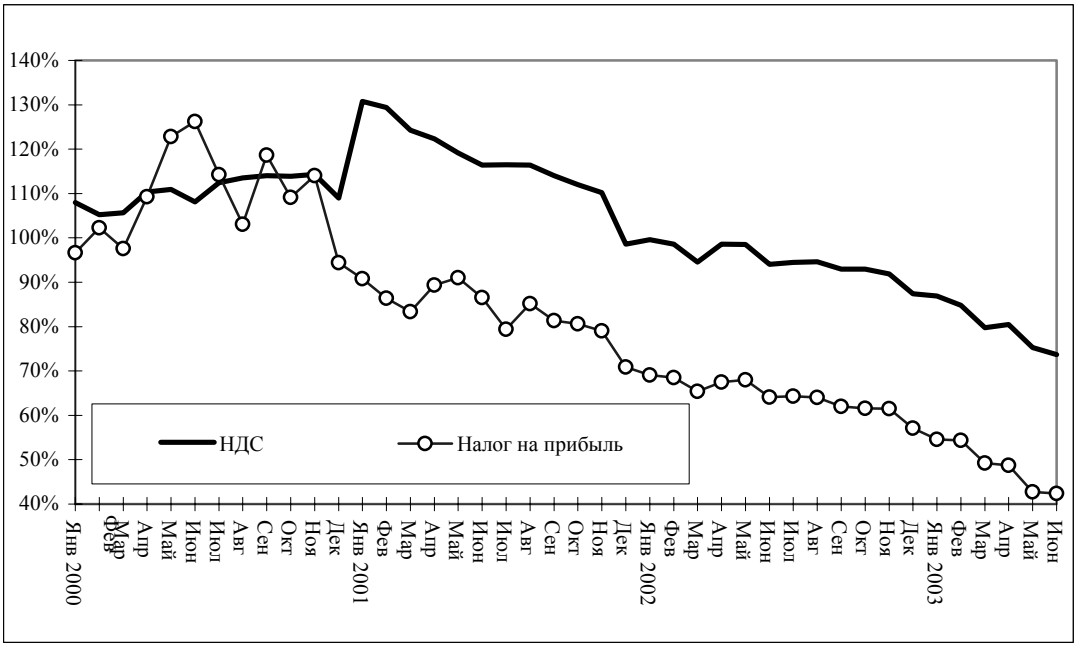


Fig. 1.

Real tax arrears to the federal budget (in % to July 1999)

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**		
Taxes	25,6%			24,4%			25,6%			27,4%		
Revenues	32,0%			30,3%			31,5%			33,4%		
Expenditures	20,7%			25,3%			27,7%			28,8%		
Deficit	11,3%			5,0%			3,8%			4,5%		

* Without account of the Unified Social Tax

The revenues of the consolidated budget between January through May 2003 made 33.6 % of GDP, including tax revenues (without UST) at 27.1 % of GDP (see Table 4). Expenditures of the consolidated budget increased by 0.4 p. p. in comparison with the figures registered between January-April 2002 and made 28.8 % of GDP. The surplus of the consolidated budget in March of 2003 made 4.7 % of GDP, which is below the level observed over the respective period last year (5.2 % of GDP).

S. Ponomarenko

Monetary and credit policy

The slowdown of inflation rate discontinued between June to July. Because of considerable amount of payments due on foreign debt Russia's foreign reserves underwent the fourth decrease over the past two months. Against such a background the Bank of Russia lowered the compulsory forex revenue sales rate to 25%.

In June, inflation rate in Russia acounted for 0.8% (while in June 2002 it was o.5%, see *Fig.1)*. According to Goskomstat of RF, similar to May 2003, the greatest price increment was noted for paid services delivered to the population (+1.) and food stuffs (+0.8%). It is worthwhile to note that a seasonal price drop for fruits and vegetables is fairly insignificant this year, which is likely to contribute to a higher CPI value vs. June last year. Nonetheless, considering the interim results of the period between January through June 2003, inflation rates dropped to 7.9% vs. their respective values in the same period of the prior year. In June 2003, 8 RF Subjects saw the price rise for goods and services being over 2%, with Astrakhan oblast breaking a record 3.9%, while tariffs for paid services grew by 12.9% there. In Moscow, consumer prices rose by 1.3%, against 0.6% in St. Petersburg, while the respective indices computed starting from January 2003 account for 8.7 and 9.3%, respectively.

Our forecasts show a 0.8...1.0% increment in consumer prices in July, so over the first seven months 2003 inflation rate in RF may hit 9.0% (for reference: according to the RF government's forecasts the rise in CPI should be within 12%).

In June 2003 Russia's foreign reserves fell by USD 0.3 bln. vs. the prior month (at -0.5%) (see: *Fig.2*), and as of July 1, 2003, they made up USD 64.4 bln. The contraction in foreign reserves continued in July, and by 18 July they accounted for USD 63.8 bln. We believe such fluctuations in foreign reserves should be attributed primarily to considerable amounts of payments on foreign debt.

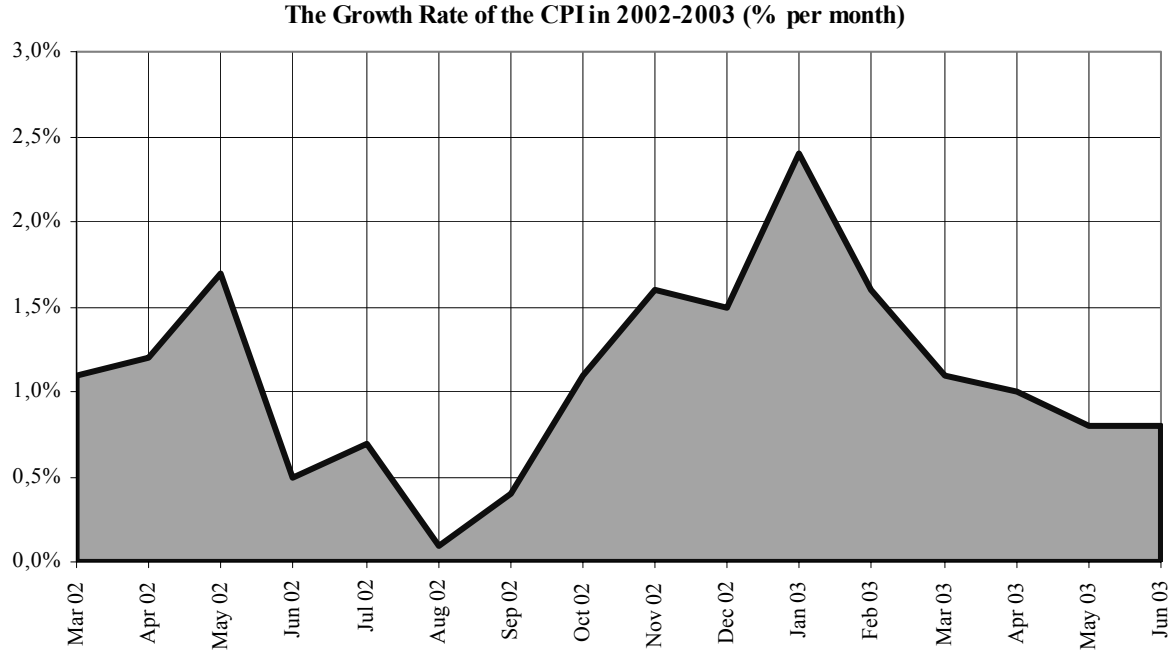


Fig. 1
Consumer price index increment rates in 2002-03 (as % per month)

The Changes in the Monetary Base and in the Gold and Foreign Currency Reserves in 2002-2003.

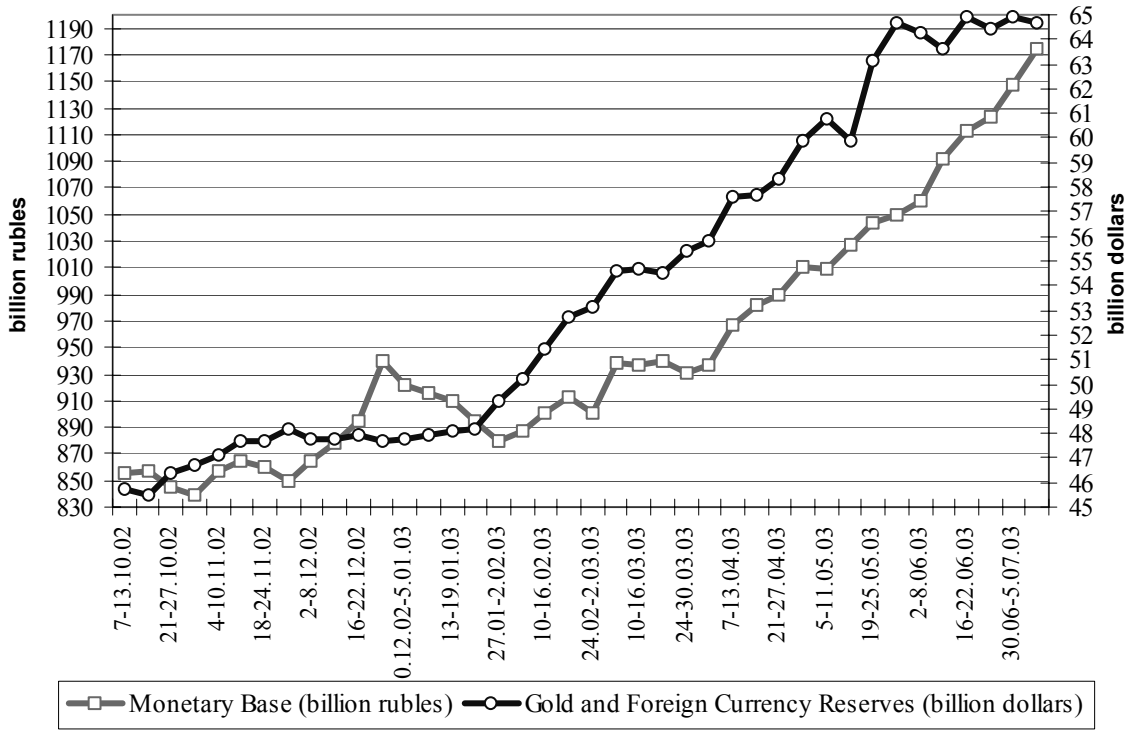


Fig. 2

The dynamics of monetary base (in narrow terms) and foreign reserves
in the second half 2002 through 2003)

According to results of July 2003, the volume of monetary base in narrow terms grew from 1,049.5 up to 1,123.6 bln. RUR (+7.1%) (see *Fig.2*). Despite the noted contraction in foreign reserves, for the first two weeks of July the volume of monetary base added up another 4.5%. So, the monetary base in narrow terms grew by 15.9% over the first half 2003 (vs. 11.3% noted over the respective period of the prior year).

As concerns the monetary base in broad terms, in June it grew at 1.88% - from RUR 1506 bln. up to 1,534 as of July 1: more specifically, the volume of cash in circulation, with the account of credit institutions' cash balances, soared from 904.3 bln. up to 971.9 bln., or by 7.48%. The amount of cash accumulated on credit institutions correspondent accounts in the Bank of Russia made up Rb. 165.4 bln. vs. 180.2 bln. as of early June this year.

Monetary base in narrow terms (as RUR bln.) Foreign reserves (as USD bln.)

In July, the volume of Russia's payments on foreign debt accounted for USD 969, 485 mln., including 580.742 mln. on debt repayment and 388.743 on debt servicing. More specifically, the volume of debt repayment to the countries- official creditors, banks and firms accounted for USD 210.49 mln., including 153.411 mln. on debt repayments and 57.079 mln. on interest payments, while international financial institutions received USD 438.463 mln. due, including 427.331 mln. as debt repayment and 11.132- interest payments. Russia also paid USD 320.532 mln. as coupon payments on its eurobonds.

The volume of placements in the frame of the stock modified REPO in June accounted for USD 23.14 bln., or three times less than in the prior month. More specifically, at SMR auctions the Central Bank placed OFZ-PD 26198 and OFZ-AD 46006 issues, while three auctions of six announced by the Bank of Russia did not take place. The reason for that was either the lack of applications, or too low investors' bids.

In June the federal law 'On amendments to Art. 6 of the Law of the Russian Federation 'On foreign exchange regulation and foreign exchange control' was enacted. The law sets the volume of sales of compulsory export revenues at the level of 30% and delegates the mandate to set this particular standard to

the Bank of Russia. In light of this, the Bank of Russia decided to set the rate of compulsory sale of foreign exchange revenues from export of goods (services and intellectual activity output) at the level of 25% of the total amount of forex revenues effective as of July 10. But we believe this measure did not affect the market, as an actual share of forex revenues exporters have sold over past months accounted for not less than 50-60%.

P. Trunin

Financial markets

The market for government securities

July 2003 saw the continuation of fall in quotations on the market for government forex-denominated bonds: the prices of Eurobonds reached the level noted in April last year. For instance on 23 June the yield to maturity of RUS-30 hot 7.7% annualized, while RUS-28- soared up to 7.71%. Such a fall was caused by several factors: first, a decline in the volume of the Pension Fund's investment, which now is bound to place on the market for government papers the saving part of the population's pension funds. Second, the situation with YUKOS compelled Western investors to recall political risks associated with investment in Russian securities. In addition, in summer 2003 all the quotations on the emerging financial markets have become more volatile. As of 23 July, maturity yields by Russian bonds accounted: the 7th tranche OVVZ (6.25%), the 6th trance OVVZ (4.52%), the 5th tranche OVVZ (5.90%), and RUS-07 (4.56%).

Доходность к погашению ОВВЗ в апреле - июле 2003 года

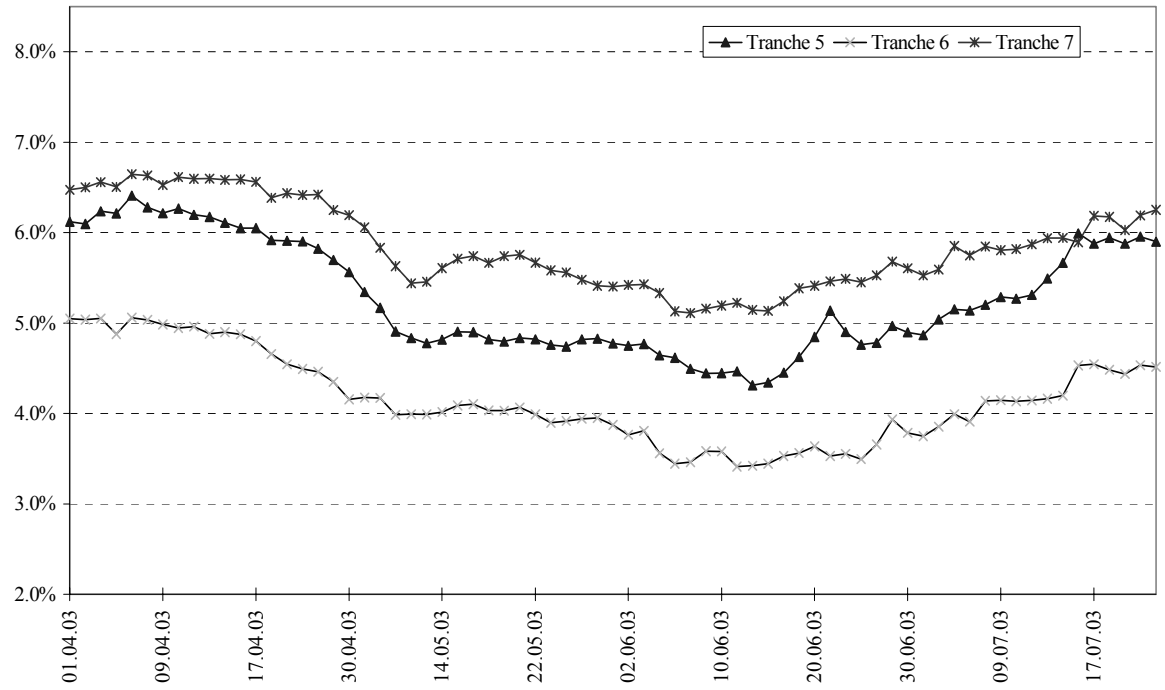


Fig.1

Yields to maturity of OVVZ in April-June 2003

Between 30 June to 18 July the market for GKO-OFZ also saw the fall in quotations of RUR-denominated government bonds. The overall volume of trading on the market for the first three weeks of July accounted for Rb. 22.1 bln., which was considerably lower vs. the prior month. The fall in the market for government bonds can also be caused by the rising USD and, consequently, an increasing attractiveness of operations in the forex market.

In July two auctions were held on placement of GKO-OFZ. More specifically, on July 9 OFZ-FD issue 27024 with the maturity date on 19 April 2006 was placed worth a total of RUR 5. bln. (face value). The face-value demand was 4.3 bln., while the volume of placement- 4.03 bln. The cut-off price was set at the level of 100.431% (yields rate 7.7% annualized). On 23 July, an action on an additional placement of OFZ-FD issue 27024 worth a total of RUR. 6 bln was held, with the face-value demand accounting for RUR. 6.7

bln., while the volume of placement by face-value- 1.3 bln. The cut-off price was set at the level of 0.98.887 of the face value, equal to a 8.36% yields rate in annualized terms.

Доходности к погашению российских евробондов со сроками погашения в 2003, 2007 и 2028 гг. в апреле - июле 2003 года

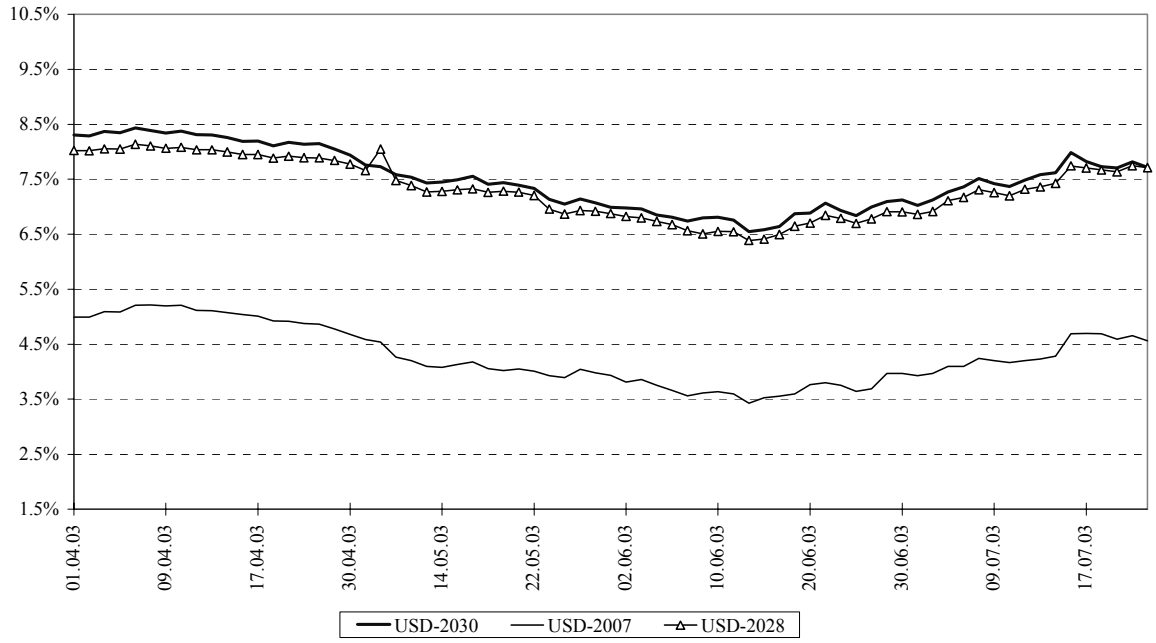


Fig.2

Yields to maturity of Russian Eurobonds with maturity due in 2003, 2007 and 2008 in April-June 2003

As of July 2004, the face-value volume of GKO-OFZ market accounted for RUR 303.2 bln. and 322.5 bln. in market prices, with the duration of the market GKO-OFZ portfolio being 832.38 days.

In July, the RUR liquidity in the banking sector dropped slightly vs. the prior month: as of 25 July, credit institutions' balances on correspondent accounts with the Bank of Russia were RUR 126.4 bln. The MIACR rte made up 1.91% annualized as of 24 July.

The corporate securities market

The state of affairs in the stock market. In July, the national stock market witnessed a substantial fall in quotations vs. the prior month. More specifically, between 30 June to 25 July the RTS index fell by 4.83 points, or at 8.25%. During the first week of the month the Index hit the next post-crisis maximum and made up 518.07 points[4] (the closing session on 2 July). Between June 30 to July 25 the turnover of trades in RTS accounted for USD 543.09 mln., while its daily turnover averaged 27.2 mln., or at 4.9 mln. more than the respective index reported in the prior month. The record-breaking daily volume of trades was registered on July 1 (USD 44.753 mln.) while the lowest on- on June 5 (14.126 mln.). The Index grew over the first one and a half week, and by 8 July it hit 513.33 points. The consequent period of time saw a rapid fall of the index to the bottom line of 427.64 points (on 17 July), which corresponds to the level reached during the first week of May 2003. Then Index's rebound by the closing session on 25 July made up 460.48 points. Such a considerable fall in the Index was fueled, among other factors, by the situation with YUKOs, as the majority of Western investors perceived that as a rise in political risks of investment in Russian securities, which could not help affecting the securities market.

[4] Last time a greater value was reported on 24 October 1997

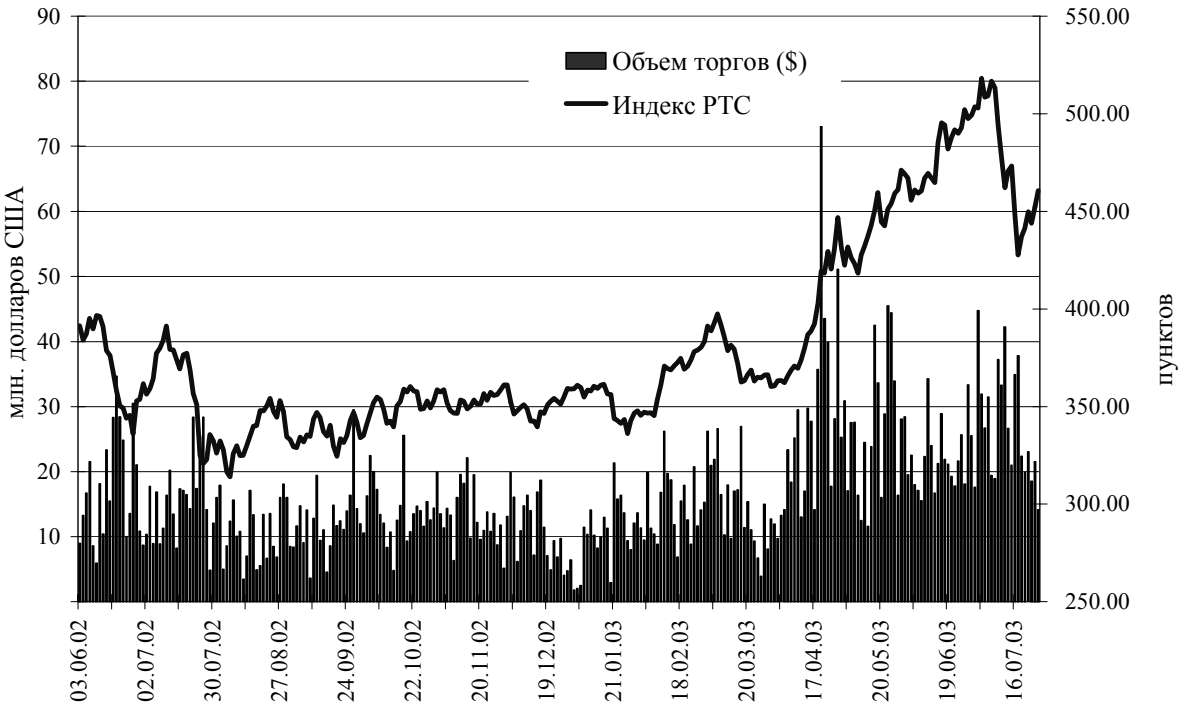


Fig.3

So, between June 30 through July 25 practically all the national blue chips were falling: YUKOS's stock lost 17.66%, thus breaking the record among the most liquid stock, while Mosenergo lost 12.89%, followed by Rostelekom (-11.65%), Sibneft (-9.65), Surgutneftegaz (-8.24%), and LUKoil (-8.25%). The least volatile were Tatneft's stock that fell just by 1.73% as of July 25. Against such a background, RAO UES Russia and Norilsky Nickel's Stock formed an exception, as they were on the rise between 30 June to 25 July - at 2.32 and 6.77%, respectively. So, it is Norilsky Nickel's stock that proved to be a leader of the national stock market for the second month running.

Between June 30 through July 25 the aggregate turnover made up USD 543.1 mln. vs. 424.5 mln. reported on June, or at 27.9%. The average daily trade volume grew by 21.5% vs. June and reached USD 27.2 mln. (vs. 22.3 mln. in June). Most likely, such a rise in the trade volume was driven by investors' eagerness to fix profit after a long growth in quotations and the situation around YUKOS.

As of July 25, the Top Five (by capitalization) national companies comprised: YUKOS- USD 25.7 bln., LUKoil- 15.4 bln., Surgutneftegas-14.02, Sibneft-11.5, and RAO UES Russia-USD 11.1 bln.

The market for futures. The period in question witnessed a slight rise in the volume of trades on FORTS market vs. the prior month, with the aggregate turnover of the futures market accounting for RUR 21.2 bln (72,400 transactions, 3.06 mln. contracts) of which on futures- RUR 19.4 mln. (67,800 transactions, 2.8 mln. contracts). The maximal volume of trades was reported on 17 July and accounted for Rb. 1.659 bln., while the minimal one-488,12 mln. was noted on 25 July.

The market for corporate bonds. In July this particular market as a whole was characterized by a notable rise in yields of the majority of papers, while frightened by falling quotations and the overall instability, the majority of investors preferred to fix profits and for some time to restrain themselves from active operations. At the same time the fall in quotations was noted against the background formed by lowering trade volumes. More specifically, during the first three weeks of July the turnover of the corporate securities section at MICEX accounted for RUR 16.06 bln. Plus, by July 18 the yield rates on the most durable obligations (with a 3-5 year maturity) reached the level of 12-13% annualized, while the yields on some issues hit 14-16% (+3-5 p.p. against the government bonds with a comparable maturity). So, during last three weeks the market for corporate bonds basically found itself in the mainstream of the general trend to a gradually soaring yields noted on the market for government bonds.

During the month in question, a few new placements took place: on July 2, Tatneft placed its 3-year bonds worth a total of RUR 1.5 bln., followed on 3 July by Severstal with 4-year obligations with the face-value of

RUR 3 bln. and yields to maturity about 9.7%. On July 10 Pervaya Ipotechnaya Kompania (PIK) placed its 2-year obligations with the face-value of RUR 750 mln. The third week of July saw rather an intense activity on the primary market, with 3-year obligations placed by OAO LOMO, ZAO Severo-Zapadnaya Lesopromyshlennaya Kompania and OAO Sibirtelekom whose respective volumes of placement made up RUR 700, 300 and 1,530 mln.

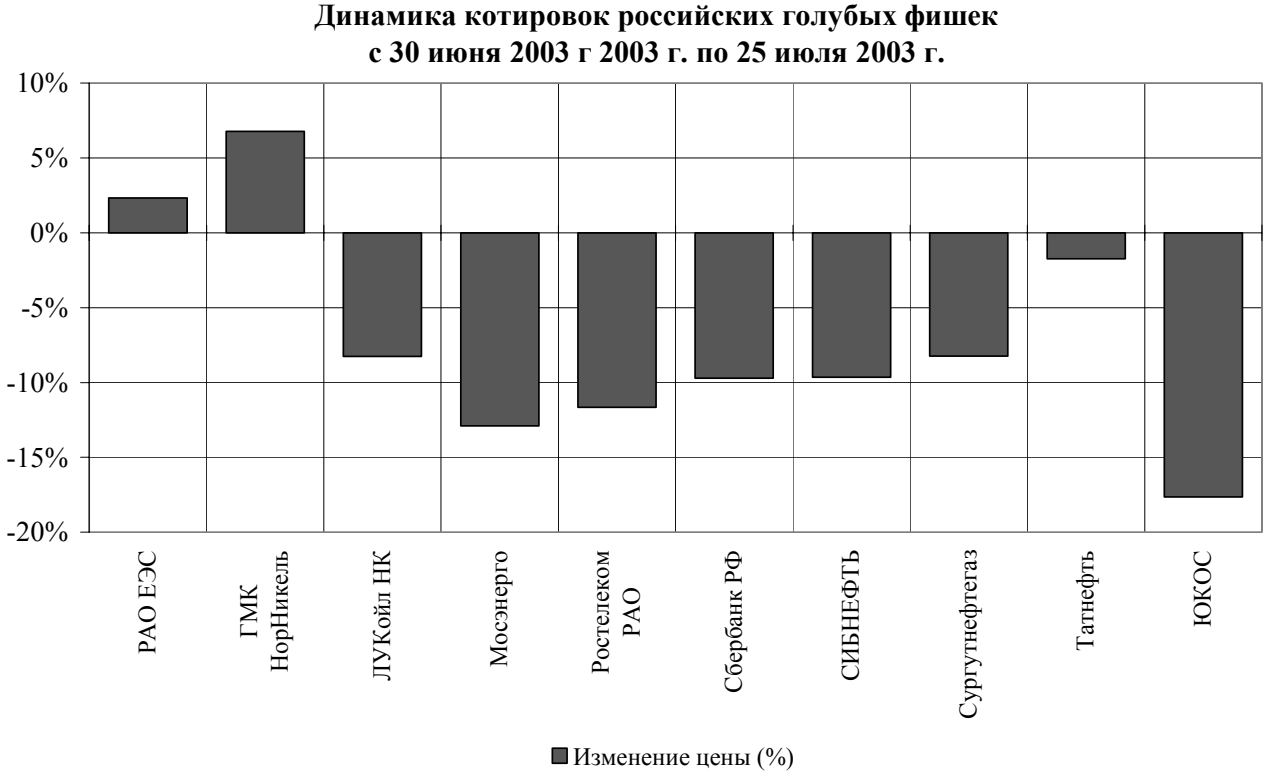


Fig. 4

Dynamics of quotations of Russian blue chips between June 30, 2003-July 25, 2003

External factors of dynamics of the national securities market. In July, the bullish trend was prevailing the world markets. In the first week of the month Brent overshot USD 28/barrel and on 4 July hit USD 28.6/barrel. The price rise for oil was fueled primarily by the continuos strike in Nigeria and a hurricane in the Mexican Bay. Later, the next week, the conflict between the Nigerian government and trade-unions was resolved, which immediately resulted in a price adjustment that continued until 9 July. Nonetheless, the price rise renewed shortly afterwards, particularly due to a storm in the Mexican Bay and the cease of operations at two oil refineries in Texas and Louisiana. In addition, a representative of the US Military Engineering Corps in Iraq reckoned that it would take the country not less than a year to re-establish the pre-war oil output (some 2 mln. barrel a day). Eventually, on July 14 Brent soared up to USD 29.35/barrel, while favorable reports on the US oil products reserves the International Energy Agency and the US Oil Institute published in the middle of the month led to some price adjustments, which, however, proved to be rather short-living: on 21 July, Brent cost 29.19/barrel.

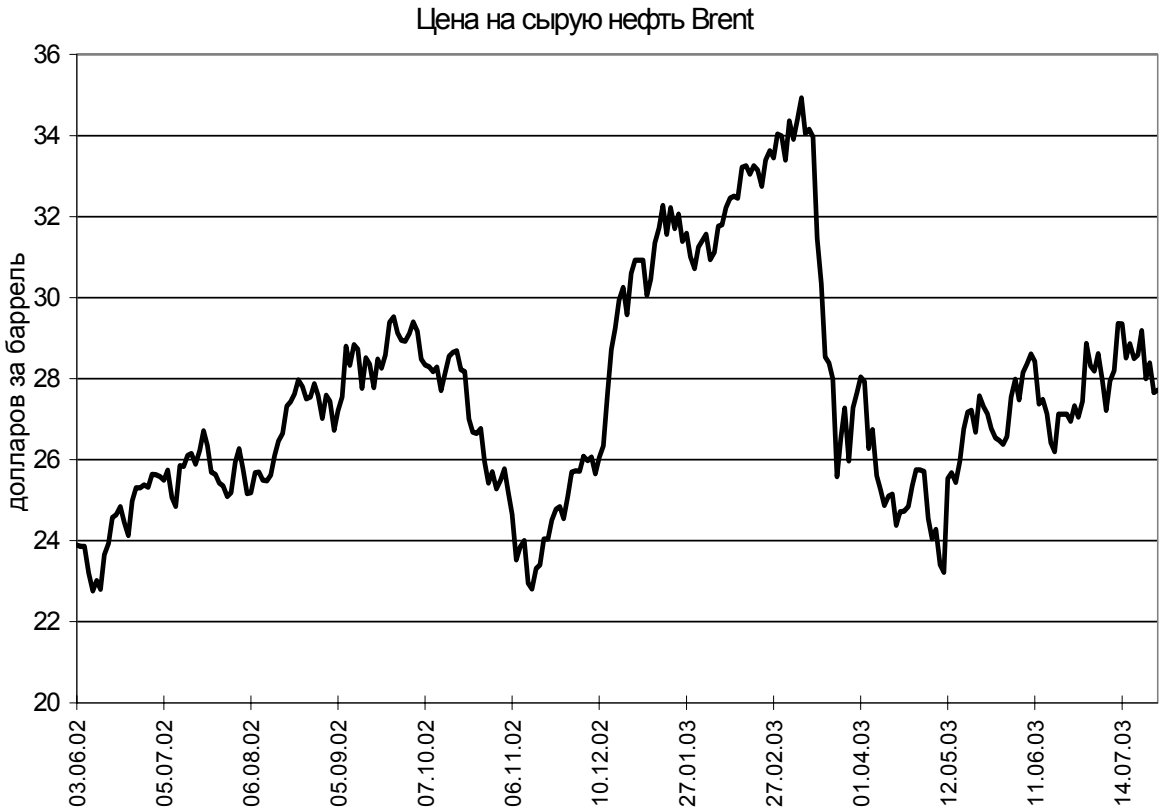


Fig.5

Crude oil (Brent) prices (USD/barrel)

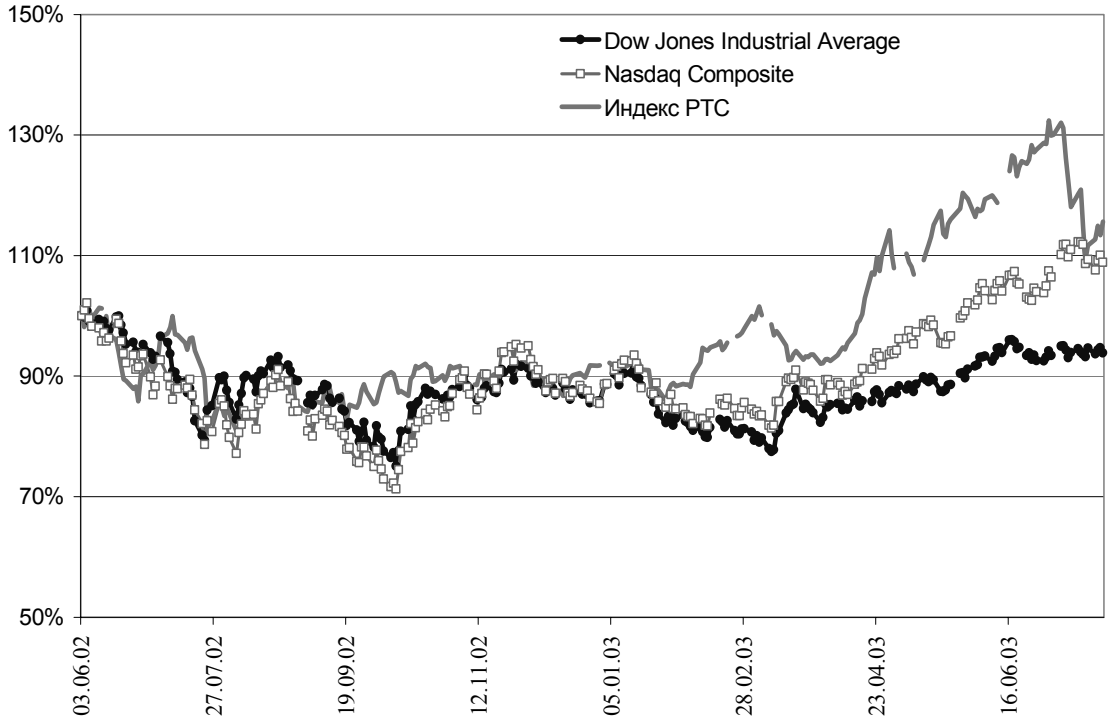


Fig.6

During he period in question, international securities markets still showed a moderate growth: more specifically, since early July (the early 2003) the US DJIA and NASDAQ grew by 24 July by 1.42% (5.87%) and 4.84% (22.85%), along with FTSE 100 in UK rose by 2.94% (3.49), German DAX 30- by

4.79% (8.69%), French CAC-40 - by 2.36% (-1.19%). This trend was also noted across Asian markets: Nikkei grew by 6.47% (10.99%), Seoul Composite- by 4.39% (10.67%), Straits Time- by 7.00% (15.96%). Positive dynamics were also noted in some emerging markets: in Brazil, Bovespa soared at 6.07%, while the emerging economies index increment computed y MSCI made up 4.08% in July. The only economy with negative change rates in the stock market in July was Turkey, whose ISE National-100 as lost 3.76% (1.16%) since early July (early 2003).

The dynamics of the US securities market over the first two weeks of July was mostly determined by favorable corporate news, while economic statistics was mostly negative. It was expectations of relatively positive financial results of the US corporations' performance over the past quarter that served as an additional positive factor that supported high prices in the market. During the consequent two weeks positive dynamics was supported mostly by favorable economic news. More specifically, for the first time over several past months the US saw a decline in the level of primary unemployment, while in June there occurred a rise in industrial output, retail services and permits for new construction. The optimistic mood was also fueled by Mr. Greenspan's statement about another decrease of the Federal Reserve rate.

Despite negative macroeconomic indices noted in EU and generally loose financial performance of a number of EU companies, in July there was noted a rise in financial indicators, though it still is the US securities market that propels the rise in the European stock markets.

Corporate news.

LUKoil

On July 1, the company signs a Founding Agreement with Gasprom on establishment an open-end joint-stock company CentrKaspneftegas. The purpose of its creation is to participate as an RF authorized agent in the development of Centralnaya geological structure in the Caspian sea along with Kazakh authorized agent-KazMunaiGas. The authorized capital of the newly created company is RUR 10 mln., and each participant in this joint venture holds 50% of its stock. LUKoil experts reckon the carbohydrate reserves of Centralnaya account for 512 mln. t. of conditional fuel.

In addition, in July the Board of Directors of LUKoil was convened: they approved the composition of the Board and plan of their operations for 2003-2004.

Sibneft

In late June, Moody's confirmed Ba2 index with respect to the company's main rating and Ba3- on its rating of unsecured obligations. That became possible thanks to a lower level of the company's borrowing since the start of the year and the envisaged merger with YUKOS.

The company's Board Meeting in mid-July ruled to convene an early shareholder meeting on 18 August, 2003. Shareholders ill be proposed to approve a new version of the company's charter: more specifically, one of the key changes should be the withdrawal of p.2 Article 80 of the federal law 'n joint-stock companies' which suggests that any party acquiring over 30% of the company's stock is bound to redeem minority shareholders' share. Such changes are needed o optimize the planned merger with YUKOS.

OAO Tatneft

In late June, there happened a shareholder meeting at which the company management reported on its performance in 2002: it became known that the volume of output remained unchanged vs. the prior year and stood at 24 mln. t. In addition, the company has repaid its USD 300 mln.- worth debt on Eurobonds and a USD 112 mln.-worth debt to the Paris club. The meeting ruled that shareholders will be entitled for dividends of 100% of the face-value of privileged and 10% -on ordinary shares.

Norilsky Nickel

In July, the company made its investment performance public: in 2002, it proceeded with enhancing the efficiency of its existing production and invested as much as some USD 351 mln., of which 117 mln. - in maintenance and development of its mining production, 20 mln. in refining facilities, 45 mln. -in metallurgy, and 20 mln. - in the energy sector.

It is worthwhile noting that in July the Trade and Economic Council under the RF Ministry of Economic Development and Trade selected the best exporters in 2002, and the company once again became exporter #1 in the non-ferrous metal sector.

OAO Slavneft

The company's net consolidated profit in 2002 run up to RUR 13.43 bln. and grew by 26.4% vs. 2001. The company's sales amounted to RUR 85.26 bln., thus showing a 3.4% drop vs. the prior year, while the pre-tax profit grew from RUR 14.2 bln. up to 19.61 bln., or at 38%.

OAO Sberbank of Russia

Ernst and Young Vneshaudit issues an indisputably positive auditor conclusion on the 2002 Sberbank's financial accounting in compliance with International Financial Reporting Standards. The Bank's net profit amounted to RUR 30.5 bln, while the balance- sheet currency grew by 22% vs. 2001 and made up RUR 1 trln. The percent of reserves on possible bad loans dropped from 9.21% in 2001 to 9.12%.

The sufficiency of main capital computed in compliance with the Basel Agreement made up 14.7%, while the sufficiency rate of the overall capital reached 16.0% (with the minimally allowed level of 8%).

YUKOS

In early July, the company published its consolidated financial report over the 1st quarter made in compliance with the US GAAP that was examined by Price Waterhouse Coopers.

In the 1st quarter 2003 the volume of proceeds from sales and other revenues generated from main operations grew up to USD 3.898 bln. or at 94% up compared with the respective period of 2002. That became possible thanks to the rise in output and price rise for oil in the domestic and international markets. The company's net profit in the 1st quarter 2003 accounted for USD 1.267 bln. vs. USD 462 mln. EBITDA for the first quarter 003 made up USD 1.664 bln. vs. 667 mln. reported over the respective period of the prior year, while the volume of oil output accounted for 19.2 mln. t. (140.5 mln. barrel), or at 22.6% more tan in the 1st quarter 2002, while the volume of oil refining grew by 21.7% vs. the same period of time. As Maizeikiu Nafta oil refinery's performance was included in YUKOS's consolidated report, it boosted the volume of the company's oil refinery.

RAO UES Russia

The company published its fully consolidated financial report over 2002 made in compliance with IFAS. According to the report, gains grew by 16.1% and accounted for USD 15.2 bln., while operational costs rose by 15% and reached USD 14.6 bln. As a result, EBITDA grew by 10.5% and made up USD 2.3 bln., while the reported net profit accounted for some USD 1 bln., thus showing a 22% decline vs. the prior year.

Table 1

Dynamics of international stock indexes

Данные на 24 июля 2003 года	Значение	Изменение за месяц (%)	Изменение с начала года (%)
РТС (Россия)			
Dow Jones Industrial Average (США)	9112.98	1.42%	5.87%
Nasdaq Composite (США)	1701.29	4.84%	22.85%
S&P 500 (США)	981.6	0.73%	7.98%
FTSE 100 (Великобритания)	4149.6	2.94%	3.49%
DAX-30 (Германия)	3374.82	4.79%	8.69%
CAC-40 (Франция)	3156.86	2.36%	-1.19%
Swiss Market (Швейцария)	4970.6	3.26%	1.45%
Nikkei-225 (Япония)	9671.0	6.47%	10.99%
Bovespa (Бразилия)	13761.0	6.07%	18.6%
IPC (Мексика)	7309.41	3.61%	17.41%
IPSA (Чили)	1278.98	4.14%	24.15%
Straits Times (Сингапур)	1549.25	7.00%	15.96%
Seoul Composite (Южная Корея)	702.94	4.93%	10.67%
ISE National-100 (Турция)	10475.16	-3.76%	-1.16%
Morgan Stanley Emerging Markets Free Index	347.598	4.48%	18.96%

The forex market

With the strengthening USD on international markets in early July and a slightly decline in domestic exporters' offer, it appreciated slightly vs. RUR and between June 28 through July 25 showed a 0.74 (0.02%) kopeck growth - from 30.348 up to 30.356 RUR/USD. The overall amount of trades on USD in

SELT system made up USD 7.01 bln., with the maximal level of daily transactions registered on July 15 - USD 766 mln.

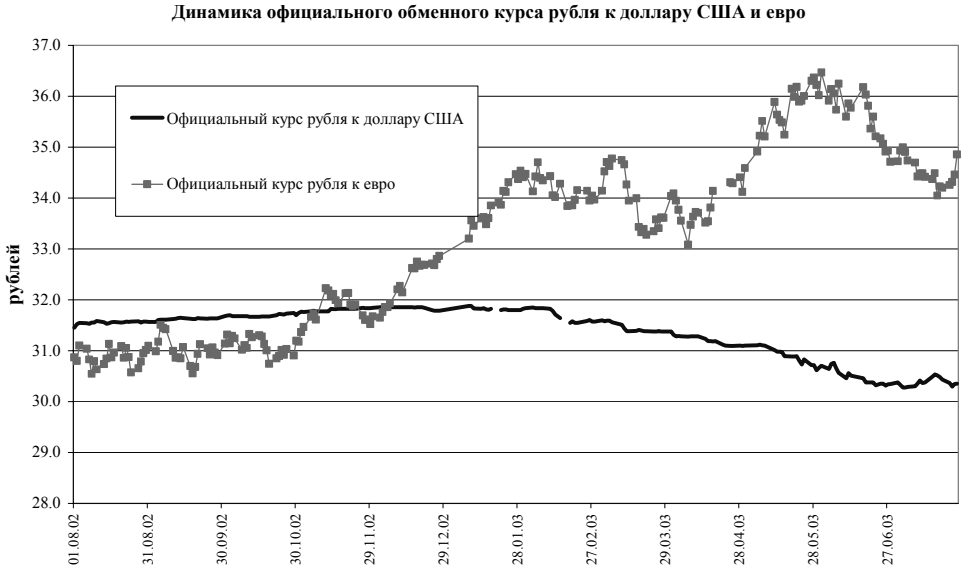


Fig. 7

Dynamics of the official exchange rate of RUR to USD and EURO

On international forex markets USD plunged vs. EURO by 0.1 cent (-0.09%) and hit the level of USD 1.143/EURO. So, after a slight drop in the middle of the month to USD 1.118/EURO (on July 16), the rate practically got back to the level registered in late June 2003.

EURO appreciated by 14 kopeck (0.41%) vs. RUR over the period in question- from the level of 34.71 to 34.85 RUR/EURO. The overall amount if trades on EURO in SELT between June 30 through July 23 accounted for EURO 160.256 mln. The maximal volume of transactions was registered on July 17 and made up EURO 14.931 mln., while the lowest level was noted on July 22 - 5.77 mln.

Fig.8

The dynamics of EURO/USD rate on international financial markets

Table 2

Indicators of financial markets

Month	March	April	May	June	July *
Monthly inflation	1,1%	1,0%	0,8%	0,8%	0,9%
Inflation rate for the year estimated on the basis of inflation rate in the month	14,02%	12,68%	10,03%	10,03%	11,35%
Rate of refinancing of the Central Bank of Russia	18%	18%	18%	16%	16%
Average yield to maturity on all issues of OFZ securities (% per annum)	8,85%	8,03%	6,44%	5,31%	–
Volume of the GKO-OFZ securities market per month (billion rubles.)	33,45	20,83	20,68	40,12	–
Yield to maturity of OFZ securities as of the end of the month (% per annum):					
5 tranche	6,23%	5,57%	4,78%	4,90%	5,9%
6 tranche	5,19%	4,18%	3,87%	3,79%	4,5%
7 tranche	6,45%	6,19%	5,40%	5,61%	6,3%
8 tranche	5,25%	4,78%	4,17%	4,20%	5,2%
Yield to maturity of eurobonds as of the end of the month (% per annum):					
2003	*3,68%*	*3,22%*	*2,74%*	*2,74%*	*3,2%*
2005	*5,09%*	*4,68%*	*3,93%*	*3,97%*	*4,6%*
2007	*6,27%*	*5,85%*	*5,27%*	*5,37%*	*6,0%*
2010	*7,33%*	*7,20%*	*6,43%*	*6,35%*	*7,3%*
2018	*8,08%*	*7,78%*	*6,88%*	*6,91%*	*7,8%*
2028	*8,41%*	*7,94%*	*6,99%*	*7,13%*	*7,8%*
2030	*3,71%*	*3,46%*	*1,81%*	*3,17%*	*5%*
Inter-Bank Lending-MIACR rate (% per annum as of the end of the month) on overnight loans	*31,3805*	*31,1000*	*30,7090*	*30,3483*	*30,20*
Official USD exchange rate as of the end of the month (RUR/USD)	*33,5865*	*34,1447*	*36,4669*	*34,7124*	*34,40*
Official EURO exchange rate as of the end of the month (RUR/EURO)	*-0,62%*	*-0,89%*	*-1,26%*	*-1,17%*	*-0,49%*
Gain of the official USD exchange rate in the month (%)	*-1,38%*	*1,66%*	*6,80%*	*-4,81%*	*-0,9%*
Gain of the official EURO exchange rate in the month (%)	*304,35*	*601,40*	*497,74*	*442,12*	*600*
Stock market volume in RTS in the month (mil USD):	*363,68*	*429,16*	*467,1*	*500,1*	*465*
Value of the RTS-1 Index as of the end of the month	*-5,10%*	*18,00%*	*8,84%*	*6,41%*	*-7%*
Change in the RTS-1 Index in the month (%)	*1,1%*	*1,0%*	*0,8%*	*0,8%*	*0,9%*

*Estimation

D. Polevoi

The real sector: factors and trends

According to preliminary results of the 1st half 2003, Russia's GDP grew by 7.2% relative to its respective index of the prior year. The increment in domestic demand over the 1st half 2003 made up 8.5% as compared with the 1st half of 00 and fully determined the dynamics of economy growth. This year the structure of final demand was changing under the impact of an advanced rise in gross accumulation vs. households' final consumption.

Preliminary results of the 1st half 2003 show a 7.2% increment in Russia's GDP vs. the 1st half of the prior year. The year of 2003 sees an acceleration of growth rate across practically all the sectors and industry branches. The volume of industrial output rose by 6.8% and that of construction- by 14.3% s. their respective indices of the 1st half 2002. In the sector for services it was trade and communication sectors whose development was most intense. The positive dynamics of development of basic sectors of the economy and a favorable state of affairs in the area of foreign trade have determined the nature of structural shifts in GDP.

An intense rise in the value volume of export of goods fueled both by an increase in its physical volume and the price factor has resulted in the renewal of positive dynamics of net export. According to estimates of the RF Ministry of Economic development and trade, in the 1st half 2003 export of goods made up USD 61.2 bln. and grew by 28.3% vs. the respective period of the prior year, while importation of goods grew at 20.7%. In the first half 2003, the foreign trade balance averaged USD 5 bln. a month, which is comparable to the record values reported in 2000.

This year, the national economy retains the trend to an advanced growth in domestic demand vs. external demand, which has been in place since the 4th quarter 2000. Very favorable international prices for energy sources and non-ferrous metals and the ongoing intense external demand and a rise in exporters' revenues generate transformational processes of expansion of the domestic market for consumer and investment goods.

It was export-oriented industries that contributed at most to the increment in industrial output over the period in question. With the 9.% rise in the fuel and energy complex's output (including a 10.0% growth in output in the fuel industry), the growth rates in the sectors producing intermediary goods accounted for 106.3% and final goods- 105.9%.

The growth in investment activity has resulted in an intensification of output in the machine-engineering sector (at 7.6%) and the sector for building materials (at 5.6%) vs. their respective indices of the prior year. The overall progress was darkened by a deceleration of growth rates in output in the food sector to 104.3% vs. 108.2% reported in the first half 2002 and a 0.8% decline in the light industry's output caused by the ongoing crisis in the sector for textiles. Moderate dynamics of production of domestic goods designated for final demand was compensated by an intense expansion of imports, which has also undergone serious changes this year which became dominated by the importation of machinery and equipment, rather than consumer goods, as it had been noted last year.

The new wave of investment rise in the industrial sector is ensured by fuel and food-processing enterprises, while the complex of industries servicing to investment demand retains the trend to contraction of spending on capital assets reproduction. That boosts the share of imports on the investment market. In the 1st quarter 2003, domestic enterprises invested as much as RUR 22.5 bln., or 26.7% of the overall investment in machinery and equipment vs. 22.7% reported on the respective period of the prior year.

The increment in domestic demand in the 1st half 003 vs. its respective index of the prior year accounted for 8.5% and fully determined the dynamics of economic growth. It should be noted that given that in the 1st half 2002 the country's economic development was determined by the expanding final consumption on the part of households, this year, the structure of final demand experiences changes caused by an intense rise in investment in capital assets. Some preliminary estimates show that while the household consumption grew by some 6.8% vs. the 1st half 2002, the growth rates in investment in capital assets soared by 11.9%.

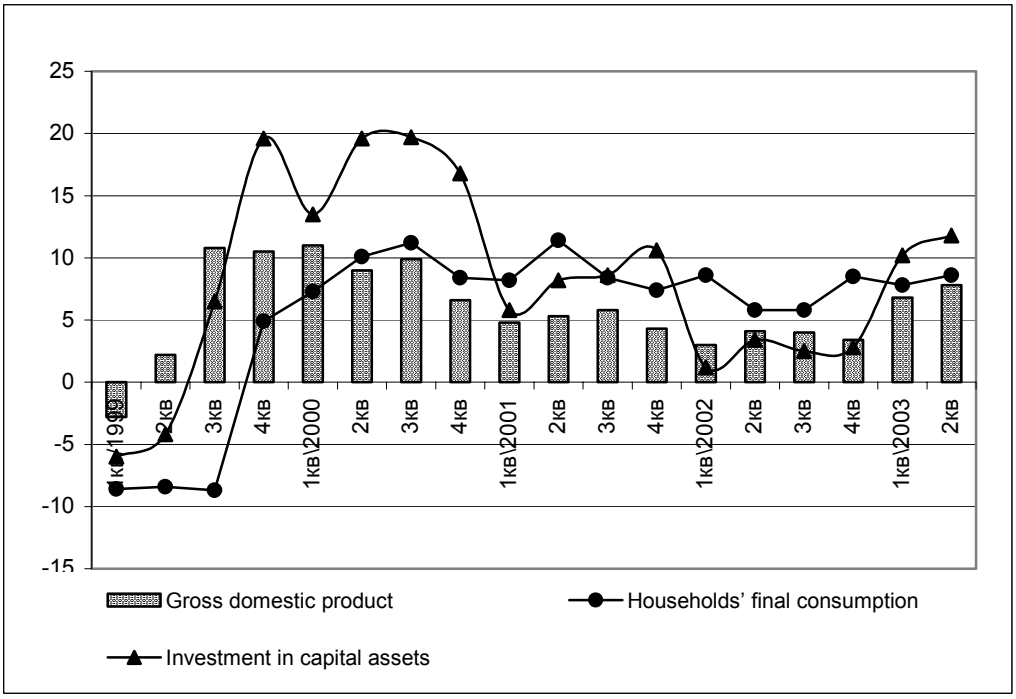


Fig.1

Change in dynamics of GDP across components of final demand in 1999-2003, as % to the respective period of the prior year.

The expansion of final consumption is fueled by a gradual improvement of social parameters of economic development. The development of this particular trend appears a logical consequence of a strategy aimed at the renewal of the population's pre-crisis level of living standards. In the 1st half 2003 relative to the respective period of the prior year the population's real incomes grew by 14.6%, while real salaries and wages showed a 9.7% and a real amount of monthly pensions due - a 2.4% rise. The population's rising effective demand causes an intense growth in the retail trade turnover. In contrast to the prior year when practically all the increase in goods turnover was ensured by the expansion of food stuffs sales, the 1st half 2003 shows a reverse correlation: with the 8.9% rise in the retail trade turnover vs. the 1st half 2002, the increment in food stuffs sales accounted for 7.3%, while non-food goods- for 10.3%. The change in consumer behavior is explained by the slowdown in inflation rates ad structural shifts in prices across main groups of tradables. Overall, in the 1st half 2003 consumer prices rose by 7.9% vs. 9.0% reported in the 1st half 2002, with prices for food stuffs showing a 7.4%, while those for non-food goods- a 4.6% rise since the start of the year. Interestingly, under the current income level statistical observations register changes in the assortment structure of sales of food stuffs in favor of more expensive ones.

The share of consumer spending in the structure of use of monetary incomes dropped and accounted for 70.5% in the 1st half 2003 vs. 74.2% in the respective period of 2002. With the population's income growing, domestic consumers gradually lower their share of spending on goods and are becoming increasingly keen to save more. It is not accidental then that saving institutions are regaining their attractiveness in the population's eyes: the share of savings in the form of deposits and securities in the structure of the population's pending grew by 1.6 percent point over the period in question vs. the 1st half 2002.

The noted structural shifts in the population's use of their monetary means are accompanied by changes in the population's distribution in terms of per capita income. Despite the remaining high income differentiation rate, there emerges a trend to contraction in the share of the needy, who in the 2nd quarter 2003 accounted for some 33 mln. (2-23% of the overall Russian population) vs. 37.2 mln. reported in the 1st quarter 2002 and 39.1 mln. in the first half 2002. This process was also affected by the ongoing increase in population's real incomes that has been in place since 2000.

While nearly 70% of the population's aggregate incomes fall on employees' salaries and wages, it necessitates an increase in the employment level. According to some selective employment surveys, in the 1st half 2003 the share of those employed in the economy grew from 64.7 to 65.2 mln., while the overall number of unemployed computed according to ITO has fallen by 375,000 since January 2003 and now accounts for 6.1 mln. (8.5% of the economically active population). The tension rate (computed as the number of unemployed registered with public employment agencies per 1 vacancy) dropped from 2.2 in January 2003 to 1.7 in June 2003. The change in the labor market has thus become a result of the acceleration of economic growth rates.

O. Izryadnova

The IET business survey: July 2003

The first results of the July survey prove the strengthening of positive trends in dynamics of main indicators of the national industrial sector. rather an intense rise in sales allows enterprises to maintain high growth rates of output without overloading their storage facilities with finished products, increase their production capacity's loading rate and employ new personnel.

As estimated by the Center of macroeconomics analysis and short-term forecast, he growth of the national economy in the 2nd quarter was taking place under the sharp deceleration of industrial growth to 0.5% in the 2nd quarter vs. 1.1% reported in the 1st quarter. One of the reasons underlying the process is lowering dynamics of output in export-oriented industries. In the fuel and energy complex, the average monthly growth rates fell to 0.1% vs. 0.8% in the 1st quarter, while mineral industries reported a 0.5% fall- from 1.1% down to 0.6%. An accelerated expansion of domestic final demand coupled with a simultaneous slowdown in growth of imports encouraged output in the sectors focused on the domestic market, which formed the very cornerstone that allowed to maintain the overall economic dynamics and avoid sliding into stagnation. The industrial sector is loosing its role in ensuring the growth in GDP, while positive dynamics of the latter was secured by the construction sector (investment boom), trade (rising consumer spending) and output o other market services.

The first data on the 3rd quarter that IET received in July showed the strengthening of positive trends in dynamics of main indicators of the national industrial sector.

First, monetary sales of industrial produce have sustained their fairly high growth rates for the second month running, except the light industry and (due to seasonality) the electricity sector. The most intense rise in sales was noted in metallurgy, chemicals, petrochemicals and the industry of building materials. The balance of estimates of demand volumes (above-below normal) improved by 12 points at once in July and broke a record value ever noted since July 1993 (see Fig.). The share of enterprises that consider the volume of effective demand for their output to be normal grew up to 84%, which is an absolute peak value ever registered by our surveys since March 1992.

Second, the growth rates in output have remained high: the indicators of the past two months proved to be the best ones since September 2001. The rise in output continued in all the industries, except electricity, with the best performance being demonstrated by the industry of building materials, forestry, chemicals, petrochemicals, and machine-engineering sectors. Third, the loading rate of production capacities has grown by 5 percent points since the start of the year and reached the best value across the industrial sector as a whole over the past 10 years (62%). The leaders in this respect are: the non-ferrous metallurgy (83%), the fuel sector (81%), and forestry (78%), while in the machine-engineering sector this indicator accounted for 58%.

The main obstacles to boosting the output still are a low domestic demand and shortages of liquid capital, but the frequency of citing these particular factors has fallen substantially. While currently the low demand still affects operations of 51% of the national enterprises, the respective rate was 63% in the beginning of the year. The lack of liquid capital in July was referred to just by 44% of enterprises, which forms a historic minimum, while non-payments inhibit operations of 21% of those, which has also became a historic minimum. At the same time, the constraining effect of imports, on the contrary reached its maximum, with 21% of enterprises considering import products to constrain the rise in their output. In the ferrous metallurgy, the share of such responses made out 51%, in the sector for chemicals and petrochemicals-35%, in the light industry- 29%, and 25% in the machine-engineering sector. Interestingly in early 1998 the share of such enterprises accounted for just 13%.

Fourth, a more intensively boosted output vs. demand has led to a rise in the volume of finished goods in stock, which became especially notable in metallurgy, machine engineering and the food sector, while other industries did not reported rise in their stock of finished goods. However, there was no growth in excessive stock: the balance of responses (above-below normal) dropped by several points, while the share of normal estimates reached 54%, which formed yet another record-breaking value for all our 135 surveys. So, enterprises hope for steady sales over the upcoming months and to cover a part of demand with their produce in stock.

Fifth, though profit decline rates showed a slight growth over the month, the overall estimates of enterprises' financial and economic state reached an absolute maximum: 73% of them believe their situation satisfactory, while in specific sectors the respective rate is even high: in the ferrous metallurgy -91% and in the electricity sector- 82. The worst rates were registered in the constriction sector and forestry (62%), while the proportions of 'bad' and 'very bad' estimates fell to a minimum rate.

In July, forecasts of changes in demand became at 3% less optimistic compared to June, but retained their positive values. The industrial sector still holds high expectations of a rise in effective demand, with the greatest sales rates forecasted by the sectors for chemicals and petrochemicals, the light industry and forestry.

Forecasts of change in output continued to gain optimism in July. While compared with April 2003 (the bottom line) the balance (growth-decline) improved by 14 points, with all the sectors planning to boost their output, while those for electricity, non-ferrous metallurgy and forestry predicting its most intense rise. That allowed enterprises to revise their employment forecasts that once again became positive, which means a greater number of enterprises in the industrial sector that plan to increase their staff. During the past five quarters our surveys registered the prevalence of the plans to lower the number of staff, while now its is only the sector for electricity, non-ferrous metallurgy and forestry that still view job cuts as a possible option.

Enterprises' price forecasts in July proved to be most moderate over the whole post-default period, with the majority of producers (74%) not intending to change their prices over the coming months.

S. Tsoukhlo

Import substitution in Russian Federation between 1998-2002

A rapid and intense, more than three-fold, depreciation of Ruble between August to September 1998 has resulted in a drastic fall in the real exchange rate. At the same time, the population's and enterprises' incomes declined considerably, followed a shortly by the emergence of a trend to production growth. This trend has been steady through sevarl past years. The fall in the RUR real exchange rate led to a relative price rise for import goods. That is why, perhaps, one of the reasons for the noted production growth is that such a price rise boosted demand for domestic goods that began to substitute for import ones. This assumption suggests there should be seen a decline in the domestic consumption of import goods and, accordingly, in the volume of their importation, and a rise in the domestic consumption of domestic goods. Naturally, this assumption proves to be correct only with regard to the goods for which such substitution is possible, otherwise, given other conditions equal, this particular effect is noted only with respect to tradables. Interestingly, in different industries it can manifest itself in different ways, which depends on elasticity of demand, inclination to import and a possibility of a prompt adjustment of import purchases and domestic output. In such a situation, we understand the process of import substitution as a rise in output and domestic consumption of domestic goods against the background of a declining consumption of import goods (in physical equivalent).

Table 1 illustrates dynamics of industrial output, import and export indexes (in USD, in prices of 2000) and the RUR real exchange rate indexes.

While explaining the ongoing economic growth, one also needs to consider a vast array of other factors that affect demand for import and domestic goods. In addition to the noted depreciation of the RUR real exchange rate in autumn 1998, there also occurred a decline in enterprises and population's incomes that resulted in the overall fall in demand for all kinds of goods. In such a situation, the price rise for import goods due to depreciation should result in an asymmetric change in demand for domestic and import goods.

Rising consumption of domestic goods in parallel with declining consumption of import goods can be generated not only by a change in relative prices, but also by a change in the structure of import, export and domestic output, as well as due to a change in consumers' preferences.

Table 1

Dynamics of indexes of industrial output, RUR real exchange rate, import and export (in USD, in prices of 2000)

For all indexes 2000=100	1997	1998				1999				2000	2001	2002
		I	II	III	IV	I	II	III	IV			
RUR real effective exchange rate index	142,6	146,8	145,9	127,1	85,3	82,8	88,9	93,8	90,8	100	118,7	124,7
Industrial output index	88,7	87,9	83,1	79,3	87,9	87,9	89,2	93,8	99,1	100	105,2	104,6
Export, index	93,6	70,5	70,1	69,8	75,2	60,7	65,9	70,9	91,9	100	97,8	93,2
Import, index	183,0	166,1	161,4	128,7	82,8	86,1	93,3	89,0	101,8	100	127,4	132,1

Note: quarterly import and export indexes were computed as the ratio of export and import over the respective quarter to their value in the basic year multiplied by 4.
Source: Goskomstat RF, IMF Financial Statistics.

The transformational slump in Russian economy in the wake of the price liberalization in 1998 has been replaced by a steady economic growth, that was spearheaded by structural shifts and transformational processes in the economy, among others[5]. Accordingly, key growth factors became enterprises' rising efficiency and investment activity, change in the structure of investment, adaptation of labor resources to new conditions, etc. It can be assumed that a drastic real depreciation of RUR formed a protective shield for domestic producers, as for quite a long time it weakened competition on the part of import goods and boosted domestic output.

The dynamics of consumption of domestic and import goods can also depend on changes in the inclination to consumption of the latter. A rapid loosening of restrictions on importation of goods and their expanding assortment that became available for consumers in the early 1990's together with the appreciating real exchange rate of RUR have resulted in a growing inclination to consumption of import goods even if there existed their domestic analogues. It can be assumed that the 1998 RUR depreciation generated a shift of consumption towards domestic goods without consequent reverse move towards import ones under the noted recent real appreciation of RUR (hysteresis effect). There also may occur another effect, that is, the rise in demand for import driven by an imperative need to maintain earlier imported equipment.

As already noted, the 1998 RUR depreciation and the respective shock proved to be drastic and concentrated in time, while the period between 1999-2002 saw an appreciation of the RUR real exchange rate accom-anied by a relative price fall for import and increase in its physical volumes. At the same time, the growth in import took a greater pace vs. the rise in domestic output, which means, in the frame of the terminology we use in this paper, a counter-import substitution process, i.e. the substitution for domestic goods by cheaper import analogues.

The formal analysis of import substitution necessitates understanding of the fact that the two factors, that is, change in relative prices for import goods and change in real incomes may not by themselves be identified with substitution effect and income effect in the frame of the traditional macroeconomic model of choosing between domestic and import goods. In addition to the substitution effect, the relative price rise for import goods as a result of the RUR depreciation has also created a negative effect of income generated by the contraction in the set of goods available for purchasing. In addition, consumer demand was lowering due to the income decline generatd by the the crisis.

Evaluation of demand for domestic goods and imports. To compute income and substitution effects, one needs to evaluate elasticities of compensated demand for those in terms of prices and elasticities of non-compensated demand in terms of income. Then, basing upon Slutsky's equation one needs to divide the overall effect from a price change into (import) substitution effect and income effect. In this paper, to evaluate the system of functions of demand for domestic goods and imports, we use Rotterdam model[6].

[5] See: Gaidar, Ye. (2003) Sovremenny ekonomicheskyi rost i strategicheskie perspectivy sotsialno-ekonomicheskogo razvitia Rossii. M.: IEPP.

[6] For more details, see: Theil, H. (1965). The Information Approach to Demand Analysis. Econometrica. Vol. 33. Is. 1. P. 67–87., Marquez, J. (1994). The Econometrics of Elasticities or the Elasticity of Econometrics: an Empirical Analysis of the Behavior of U.S. Imports, The Review of Economics and Statistics. Vol. 76. Issue 3., Deaton, A. (1986). Demand Analysis. Handbook of Econometrics. Vol. III. 1764–1829.

The model describes demand for domestic goods and imports in the form of a system of two functions from consumers' demand and prices for domestic goods and imports and can be presented in the following form:

$$\Delta \log X_{it} = c^1_{0i} + c^1_{1i}\left(\Delta \log I_t - w_1 \Delta \log p^X_{it} - w_2 \Delta \log p^{\mathrm{Im}}_t\right) + c^1_{2i}\Delta \log p^X_{it} + c^1_{3i}\Delta \log p^{\mathrm{Im}}_t + \varepsilon^1_{it} \quad (1)$$

$$\Delta \log Im_{it} = c^2_{0i} + c^2_{1i}\left(\Delta \log I_t - w_1 \Delta \log p^X_{it} - w_2 \Delta \log p^{\mathrm{Im}}_t\right) + c^2_{2i}\Delta \log p^X_{it} + c^2_{3i}\Delta \log p^{\mathrm{Im}}_t + \varepsilon^2_{it} \quad (2)$$

where:

$\Delta \log X_{it}$ – the industrial output growth rate in *i*-sector in RUR-equivalent prices as of 2000 ã.;

$\Delta \log Im_t$ – the growth rate in the volume of imports analogue to produce of *i*-sector in RUR terms as of late 2000;

$\Delta \log I_t$ – the population income growth rate;

$\Delta \log p^X_{it}$ – the price rise rate for domestic produce of *i*-sector;

$\Delta \log p^{\mathrm{Im}}_t$ – the price rise rate for imports;

w_1 and w_2 – the share of spending on domestic goods and imports, respectively.

In terms of the variables used herein, main hypotheses tested in the course of an econometric analysis of consumer demand can be formulated as follows:

· c^1_{0i} и c^2_{0i} – are insignificant(i.e. there were no structural shifts of consumer demand, while the overall effect of change in demand is determined by the change in relative prices and consumer incomes);

· c^1_{1i} и c^2_{1i} – elasticities of the non-compensated demand for domestic goods and imports appear positive in terms of income, given other conditions equal, as the population's growing incomes boost demand for domestic goods and imports;

· c^1_{2i} – elasticity of the compensated demand for domestic goods at a price for domestic goods appears negative, as soaring prices for goods lead to a lower demand for them;

· c^1_{3i} – elasticity of the compensated demand for domestic goods at a price for imports is positive, as once prices for such goods soar, the substitute goods enjoy a greater demand;

· c^2_{2i} – elasticity of the compensated demand for imports at a price for domestic goods is positive, as once prices for such goods soar, the substitute goods enjoy a greater demand;

· c^2_{3i} – elasticity of the compensated demand for domestic goods at a price for domestic goods appears negative, as soaring prices for goods lead to a lower demand for them.

In the frame of the Rotterdam model, the separate evaluation of equations of demand for imports and domestic goods is not quite accurate. That is why such equations were evaluated in the form of the Seemingly Unrelated Regression, using a one-step method of the least squares with the use of weighting co-variation matrix.

To conduct evaluations in the frame of the present research, we used the monthly data of Goskomstat of RF on dynamics of the population's monetary income and volume of industrial output across sectors, quarterly data of the RF Customs Committee on dynamics of the volume of importation across groups of goods, the IMF's monthly data on dynamics of the RUR effective real exchange rate, the monthly data of the Central Bank of RF on dynamics of nominal exchange rate, and the monthly data of the Center of Economic Conjuncture on indexes of industrial output across industrial sectors within the period between January 1994 through September 2002.

Results of the evaluation. The system of equations (1)-(2) was evaluated with regard to domestic output and volume of import both in the industrial sector on the whole and across its single industries. The results of the overall evaluation of the industrial sector are given in Table 2[7].

[7] The respective indices across industries will be presented in an unabridged version of this paper.

Table 2

Results of evaluation of the models of demand for domestic and import goods

price increment rate for goods	Domestic		Import	
	Coefficient	P-value	Coefficient	P-value
Constant	–0,002	0,621	0,002	0,860
The population's income increment rate	0,217	0,000	0,735	0,000
Price increment rate for domestic goods	–0,001	0,990	0,536	0,006
price increment rate for imports	0,073	0,326	–0, 651	0,000
R-square	0,347		0,598	

As it can be seen from the results of evaluation of the model of demand for domestic goods, the demand increment rates for them find themselves affected just by the population's income increment rate, with the respective coefficient accounting for 0.217. As concerns the coefficients under the price increment rates for domestic and import goods, they proved to be insignificant. This can be attributed to the fact that at this point we used the index of the volume of industrial output, rather than the volume of consumption. Obviously, due to technological constraints, the volume of industrial output cannot fluctuate considerably under price fluctuations for domestic and import goods, and consequently the volume of industrial output proves to be less elastic in terms of prices compared with the volume of actually consumed goods. At the same time, under insignificant changes in the volume of industrial output under price fluctuations volumes of consumption can change greater thanks to changes in reserves[8].

The results of the evaluation of the model of demand for imports testify to its relatively good explanatory characteristics, with determination coefficient accounting for 0.6. We estimate elasticity of the non-compensated demand for imports by incomes at the level of 0.735, while elasticity of the compensated demand for imports by prices makes up 0.536 for domestic goods and -0.651 for imports.

Computation of income and (import) substitution effects. Using results of assessments of the import demand equation, it becomes possible to compute income and substitution effects related both to changes in population's incomes and in relative prices[9]. Assessments of elasticities of non-compensated demand for import in terms of prices are presented in *Table 3.*

Table 3

Computation of elasticity of non-compensated demand for imports in terms of price

Imports	Total	Light	Food	machine engineering	Chemicals	Forestry
Elasticity of compensated demand for imports in terms of prices	–0,647	–0,314	–0,781	–0,634	–0,646	–0,763
The share of spending on imports	0,160	0,347	0,297	0,274	0,303	0,140
Elasticity of demand by income	0,735	0,848	0,600	0,717	0,730	0,691
Elasticity of non-compensated demand for imports by prices	–0,765	–0,608	–0,959	–0,831	–0,868	–0,860

According to our estimates, the elasticity of non-compensated demand for aggregate imports accounts for -0.765, i.e. in the event the price for imports (which in the present research is computed by multiplying the nominal rate by the US price index) changes by 1%, the demand for the import would drop by 0.765, given that at 0.647% the decline is determined by the substitution effect and at 0.118- by the income effect. While compared with other research in his area, our price elasticity estimates prove to be slightly greater: more specifically, according to those of O. Dynnikova[10], the elasticity of imports in terms of real exchange rate accounts for -0.5. The least elasticity of non-compensated demand in terms of prices is noted among light industry imports (-0.608), while the greatest price effect is noted in the case of importation of food stuffs (-

[8] Unfortunately, the statistical data o resesrves is unavaialble, that is why in the frame of the present evaluation we limit ed ourselves with the evaluation of the equation on the volume of output, while focusing mostly on the analysis of the equation of demand for imports.

[9] The aggregate effect of the impact of prices on the volume of demand (whose indicator can be formed by the value of elasticity of non-compensated demand in terms of prices) can be computed basing on the Slutsky equation in elasticities.

[10] See: *Dynnikova, O. (2001). Plusy i minusy slaboy elastichnosti import v Rossii*

0.959). In the machine-engineering, chemicals and forestry sectors, price elasticities of non-compensated demand for import account for -0.831,- 0.868 and -0.860, respectively.

By multiplying elasticities by the respective percent changes it becomes possible to compute income and substitution effects associated with changes in relative prices for domestic and import goods, as well as income effect related to changes in the population's income. Results of such computations are given in Table 4. The sum of substitution and income effects associated with changes in prices and an income effect not associated with those is equal to the explained rise in demand for import. The difference between actual and explained growth rates of demand for import forms inaccuracy of the evaluation and can be explained by some other factors not included in the model.

Table 4

Computation of substitution and income effects in the equation of demand for import

	1997	**1998**				**1999**	**2000**	**2001**	**2002**
		I	**II**	**III**	**IV**				
Elasticity of compensated demand for imports at a price for domestic goods	0,533	0,533	0,533	0,533	0,533	0,533	0,533	0,533	0,533
An actual percent change in the volume of demand for import due to price change for domestic goods	1,3%	–0,4%	2,0%	1,5%	4,5%	10,8%	5,9%	2,3%	3,2%
Elasticity of compensated demand for imports at a price for imports	–0,647	–0,647	–0,647	–0,647	–0,647	–0,647	–0,647	–0,647	–0,647
An actual percent change in the volume of demand for import due to price change for imports	–2,6%	–0,6%	–0,7%	–18,7%	–13,4%	–9,9%	–2,3%	–2,4%	–2,2%
Elasticity of non-compensated demand for imports by income	0,735	0,735	0,735	0,735	0,735	0,735	0,735	0,735	0,735
An actual percent change of consumer demand for import under the effect from changes in consumers' real incomes due to price change for domestic goods	–1,5%	0,4%	–2,3%	–1,7%	–5,2%	–12,5%	–6,8%	–2,7%	–3,7%
An actual percent change of consumer demand for import under the effect from changes in consumers' real incomes due to price change for imports	–0,5%	–0,1%	–0,1%	–3,4%	–2,4%	–1,8%	–0,4%	–0,4%	–0,4%
Actual per cent change in consumer demand for import due to change in their nominal incomes	6,4%	–12,1%	0,2%	4,7%	16,1%	13,7%	7,8%	8,3%	6,7%
Explained demand growth rate	**3,3%**	**-12,6%**	**-0,7%**	**-17,5%**	**-0,3%**	**0,5%**	**4,4%**	**5,2%**	**3,7%**
Actual demand growth rate	18,2%	–15,8%	–4,4%	–26,6%	5,5%	8,3%	5,6%	7,4%	5,3%

The above results allow a number of conclusions. Overall, the model of demand for import provides a satisfactory explanation of import volume growth rates. In some moments of time, a certain backwardness of actual import dynamics from those forecasted in the model becomes notable. That means that the change in explanatory variables affects with some time lag the change in the explained variable. More specifically, the fall in import volumes in the majority of industries in question in the 3rd quarter 1998 can be explained fairly well, but in the 4th quarter, with inflation rates overrunning devaluation rates, the model foretells a soaring demand for imports, while the volume of import continues to decline.

The aggregate substitution effect that can be computed as a sum of substitution effects associetd with the price change for domestic goods and imports had a diminishing effect on the demand for import until the end of 1998, with the decline in the volume of import due to the aggregate substitution effect reaching 17.2% in the 3rd quarter 1998. Since 1999 the aggregate substitution effect across the industries in question has generally driven them towards boosting import volumes.

The aggregate income effect associated with the price change for domestic and import goods drives the demand for imports towards its decline, as the prices are growing within the whole period of time in question, except those for the national light, chemical, food and machine-engineering sectors' output in 1997 and the food sector in the 2nd quarter 1998.

The inome effect, which appears not associated with price change for domestic goods and imports acts towards a rise in the demand for import, as the population's nominal incomes were growing within the whole time period in question except the 1st quarter 1998.

The evaluation of the Rotterdam modelbasing on Russian data has led to the following results: demand for domestic goods proves to be elastic in terms of the population's incomes. Price rise rates for both domestic goods and imports do not show significant effect on production growth rates in any sector of the national economy. One of explanations of this conclusion can be the fact that the available statistical data enabled evaluation of the equation of demand for domestic goods basing on output data without regard to reserves and export.

In all the industries in question but the light industry, demand for import proves to be elastic both in terms of the population's incomes and pricing for domestic and import goods. As far as incomes are concerned, it is demand for import food stuffs that proves to be the least elastic, while that for light- industry imports proves to be the most elastic. In terms of prices for import goods, demand for import appears less elastic than for domestic goods. As well, as it was demonstrated with the above calculations, the nature of demand for imported food stuffs and light industry goods has undergone changes in the wake of the crisis. Prior to that, the demand for import in both sectors was highly elastic by incomes and non-elastic by prices, while after the crisis elasticity by incomes lowered, while that by prices showed a reverse trend.

We estimate the aggregate price effect, which is described by elasticity of non-compensated demand by price, on demand for imports at the level of -0.765. Our price elasticity estimates thus prove to be a little greater vs. other researchers' data. The least elasticity of non-compensated demand by price is noted with import of the light industry's output, while the greatest effect is noted in the event of importation of food stuffs.

Overall, the present research allowed two main outcomes: first, the evaluation of demand for domestic and import goods: the respective results demonstrated that such demand appeared elastic in terms of the population's incomes. In addition, it was found out that a substitution between domestic and import goods was possible, and it proved to be dependent upon relative prices, or in other words, on the real exchange rate: an appreciation of th real rate at 1% leads to a substitution for domestic goods by imports and boosts imports at 0.77% across the economy on average and up to 0.96% in the food sector alone. Second, the evaluation of substitution and income effects allows to reckon that in 1998 and hence the dynamics of import and output might have been to a significant extent driven by the substitution effect, i.e. changes in the proportion of consumption of domestic goods and imports affected by the change in the real exchange rate.

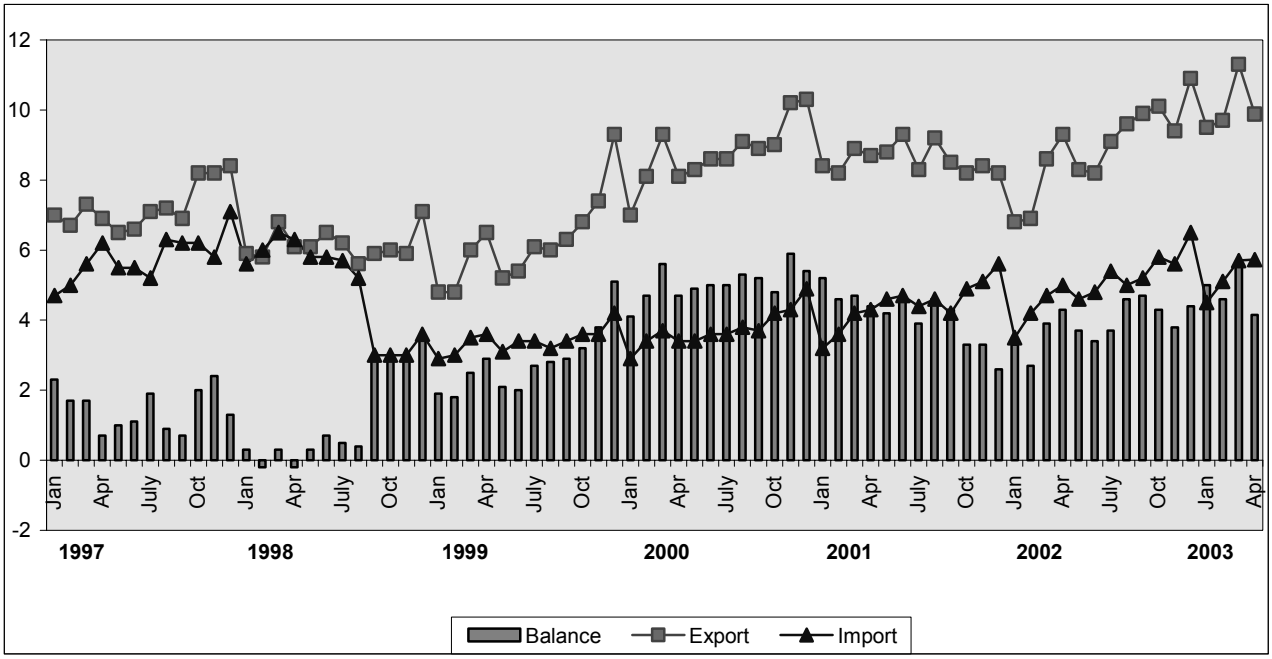
P. Kadochnikov, S. Chetverikov

Foreign trade

A favorable state of affairs in international markets allows stable positive dynamics of development of Russia's foreign trade, and its export and import supplies grwo considerably.

The process of Russia's acesssion to WTO decelerated, while discrimination of national exporters has recently intensified, and the only way to protect them is country's joining WTO.

With the state of affairs on international markets remaining favorable for the country, its ain trade indicators continue their steady rise. In May 2003 Russia's foreign trade turnover peaked USD 15.9 bln., or at 23.5% higher than in may last year. The stucture of the national foreign trade turnover is dominated by exports that account for neraly 2/3 of it an made up USD 10.1 bln. in May 2003 (at 21.7% up vs. May 002), while import supplies grew by 26.1% vs. May 2002 and acccounted for USD 5.8 bln.



Source: Goskomstat of RF

Fig.1

Main indicators of Russia's foreign trade (as USD bln.)

The rise in thevalue volume of exports was ensured primarily thanks to a favorable world prices for energy sources and non-ferrous metals.

As major consumers were keen to increase their oil reserves and because of a new automobile season, May 2003 saw the rise in oil demand that boosted oil prices. The uncertainty with the renewal of Iraqi supplies also had a certain effect on the markets, which resulted in the average quotations of Urals being USD 24.9/barrel (8.7% up vs. April 2003), while Brent was traded at USD 25.4 (2.2% up).

Against such a background, contractual prices for Russian natural gas soared by 11% v. April 2002.

The state of affairs in the markets for non-ferrou metals has also encouraged national producers' spirit, with aluminum traded at USD 1,397.*6/t. (up at 4.9% vs. April 2003), copper - 1,667.5 (4.3%), and nickel-8.351,9 (5.5%).*

Table 1

The average world prices in May of the respective year

	1996	**1997**	**1998**	**1999**	**2000**	**2001**	**2002**	**2003**
Oil (Brent), USD / metric ton	155,2	125,38	101,36	114,43	167,2	191,2	187,9	180,5
Natural gas, USD / thous. m^3	-	70,2	91,0	78,1	109,0	185,7	121,7	192,5
Gasoline, USD / metric ton	252,5	162,4	135,1	139,7	288,5	356,9	290,9	305,4
Copper, USD / metric ton	2574,9	2369,7	1775,3	1539,9	1710,1	1689,4	1620,8	1598,5
Aluminum, USD / metric ton	1590,2	1554,0	1413,5	1318,0	1448,0	1493,7	1370,3	1332,8
Nickel, USD / metric ton	8053,9	7312,.4	5352,5	5239,5	9657,1	6303,1	6940,6	7915,3

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

Imports were boosted primarily thanks to rising contractual prices and more specifically the increased purchases of machinery, equipment and means of transportation, while there was also noted a parallel increase in import supplies of food stuffs, chemicals, ferrous metals, and light industry produce.

In July, the 20th session of the task force on Russia's accession to WTO has finished its work in Genev. Despite a considerable progress in discussions, the task force so far has failed to solve key problems blocking Russia's joining WTO.

More specifically, WTO still retains its stance with regard a compulsory condition for Russia's membership in the Organization: namely, the WTO's requirement to raise domestic tariffs for energy sources up to the international level. At this point, the discussion did not focus on equalizing domestic and export

prices, but rather on transparency of pricing in the energy sector, while concrete figures associated with oil and gas prices were not debated at all.The Russian delegation's stand on this particula matter remained unchanged: as energy issues do not fall within the WTO's purview, Russia is not going to commit itself to any obligations in this area.

In addition to the bove, there remains unsolved the problem of customs tariffs on number of goods- cars, airplanes, furniture, pharmaceuticals, and subisidies to the agrarian sector: notbly enough, some WTO member nations demand to lower import duties for automobiles from the current 25 to 5% of their value.

The Russian side is hoping to complete negotiations on foreign companies' accession to the national marjet for goods and services by 2003. Should it happen, Russia may join WTO as eraly as in 2004. So far, the task force should meet for the next round in October 2003.

It should be noted that Russia's membership in WTO becomes an increasingly pressing matter. As in July WTO recognized illegal the US protective import duties imposed on steel in March 2002 (up to 30% applied to steel exports from a big group of nations, including Russia), the EU countries as memebers of the organization filed a claim against the US and promised to impose USD 2.2 bln. -worth duties on th US exports to EU.

Since the imposition of the noted protective duties, the US steel prices soared at more than 50%, which saved from bankruptcy many local companies nd enabled them to re-conquer up to 89% of thelocal steel market. Then the US made series of compromises to some countries, including Russia and crossed certain kinds of steel out of their 'black list', and since March 2003 the duties were consequently lowered to 24%.

Now, once the anti-dumping investigation is over, the WTO member nation can hope for a borader access to the US market. It is worth noting that the US metal consumers, more specifically, car manufacturers, are keen to have them on this market, as they are disssatisfied by a rapid price rise or metals. Nonetheless, the White House representatives have already stated that they, first, would appeal against the WTO's ruling and, second, are not goin to lift the customs barriers until late 2003.

If WTO can successfully retain its official verdict, the US companies will prolongue the 'steel prohibition', aiming particularly att Russian exports, among others. In July, the US metal companies submitted to te Commission on International Trade their request to keep the respective protective measures for another 5 years. Should it be satisfied, some steel exporters, including Russia, would keep just a 1.5% share in the IS steel market. Contrast to China that has also fallen victum of the noted measures and holds its membership in WTO, Russia does not have any counter-measures and appeal to WTO.

The situation is aggravated by the very likely opening of the 'second front' against Russia in Europe, where a 25% customs duty on Russian metallurgical silicon exports became effective as of 12 July for the period of consequent 6 months. The national siliconproducers' losses will amount to USD 20 mln., and that happened against the background of the US decision to close their silicon market for Russia in autumn 2002. Clearly, these moves demostrate Russia's discrimination, and it is only membership in WTO that will help the country protect itself.

In July, Moscow hosted a meeting of the CIS nations' customs agencies. The customs representatives discussed an agreement on customs procedures of, and control over electricity supplies through customs borders within the CIS. As well, they greed on amendments o the Procedures of Identification of the Country of Origin of Goods approved yet in 2000 and discussed problems of interaction between the CIS customs agencies.

At its meeting in July, the Integration Committee of the Eurasian Economic Community (EEC) announced creation by 008 the Single Customs Zone. Such a union implies a unified customs territory and unification, or, at least, closeness of customs tariffs on external borders of the Commonwealth. In addition, under such a unified zone, imports from the third countries will be subject to a unified tariff rate. At present, the EEC members ave already introduced a free trade regime that embraces only the goods produced in its membership countries. As well, the Customs Union suggests to establish a single dministrative agency and budget basing on contributions from customs revenues.

In July, Russia's Customs Committee decided to strengthen the customs control oer goods shipped by Belorussian cargo companies. In spring, the RF Customs Committee ruled an order 'On delivery under the customs control of goods transported by Belorussian cargo companies' that identified only 8 customs clearance and temporary cargo deposit points for cargo recipients located in central Russia. To fix certain terminals for certain cargo companies will allow a a stricter control over shipment of goods. Meanwhile, belorussian cargo delivery companies find themselves in a privileged position. It is not a secret that they try dumping and charge for a shipment of goods from Finland just USD 700 against 1,000 quoted by Russian

companies, while their cargo delivery services from Germany to Moscow are at one-third cheaper than Russian ones. The Associateion of International Carriers believes that Belorussian companies hold a 48% share in the market of cargo transportation from the third countries to Russia.

As it was not enough, they also break record in terms of criminal activities: for instance, in 2002 alone over 30% of cargo delivery failires to Russia fell on Belorussioan companies, and RF customs authorities initiated over 200 investigations in this respect. They found it difficult to identify the Belorussian companies' debt record, but proceeding from the average USD 20,000 in cutoms duties due from a truck, the overall debt would run up to some USD 400,000.

N. Volovik, N. Leonova

The government policy in the area of renewal of the research staff structure.

The present review deals ith main challenges in the area of provision of science with staff and the governmental approaches to their solution that were noted in the first half 2003. The analysis was conducted in a comparative context with policies pursued by the nations that experience simialr problems related associated with a broken reproduction structure and 'brain drain'. A special attention is paid to the draft federal targeted program 'Research staff in RF'. In conclusion, the paper

suggests guidlines of the government regulation of the situation with research staff.

The present problems of shortages of research staff in Russia are not formed just by their outflow but both by the ruined reproduction structure and a drastic aging of he research staff. While research institutions now serve mostly as 'transit terminals' for young staff, their average length of work there does not exceed 6-7 years. As a result, the proportional weightof middle-age researhesrs (between 30 to 40 years) declines, while the respective share of the staff aged over 60 tends to grow. Nowadays, the average researcher age is 49 years, PhD=s - 53, and doctors of science-61 year, respectively.

The specificity of the brain-drain process is that the main group there is formed by young researcgers, which makes both the maintenance of the noted staff imbalance and 'washing away' the most gifted and promising researchers from the resecrh area. The survey on graduates form the Moscow Lomonosov Unersity conducted by the Center of Research and Statistics of Science in Octiber-November 002 showed that 35% of them were keen to proceed with research, however slightly 50% of the graduates planned to pursue their career in the country.

Yet another specificity of the current brain drain is an actual absence of the reverse flow. The most optimistic estimates show 10-15% of returned staff of the overall umber of emigrants, but, as a rule, they come back to pursue their career outside research area.

Recent research show that tody there are two main reasons undelying research emigration: low wages in the area andthe mismatch between obsolete research equipment and devices and modern research tasks; interestingly, the significance of the latter factor has grown considerably when compared with the eraly amd mid-1990s. Indeed the current age of research equipment in Russia averages 17 years, hile in the developed countries- 7 years. Practically all researchers who happened to work abroad recognize a much higher technical level of foreign research centers[11]. it is not accidental then that the staff mobility in the Russin variant does not constitute organizational element of research when travels are determined by the logic of development of the given research underway. Rather, it is a recation to inadequate working conditions. This also forms the reason for maintenance of the same scope of so-called 'pendilium' migration. A poor technical provision of research both encourages brain drain and lower the competitiveness of those staying at home.

At the government level, the support of renewal of th equipmen research base is very poor, and today research institutions use mostly grants (primarily received from foreign sponsors) and contracts to purchase equipment. It was planned to allocate not less than 5% of the budget under item 06 'Fundamental research and promotion of the research and technical progress' to develop the reseearch equipment base in 2003, however, the approved amount made up just 1.76%.

As concerns the staff policy of the state, the numer of initiatives grows constantly, however they embrace mostly ypung researchers (aged 33-35 years) and exist in the fomr of various small extra grants, bonuses, stipendia, etc. (usually not more than RUR 3,000 a month), which does not allow change of the overall

[11] See: Kugel, S. Mezhdunarodnaya migratsia uchenykh kak mechanism globalizatsii nauki i vysokikh tekhnologiy//Problemy deyatelnosti uchenogo i nauchnykh kollektivov. Spb, Gydrometeoizdat, 2002, p. 66.

situation. At the same time in 2003 the biggest bonuses and extra payments were allocated to full members and members by correspondence of the Russian Academy of Sciences (RUR 20,000 and 10,000, respectively). The respective funds were found in the cuntry's budget for research and science. which cannot be reckoned about funding bonuse due for degrees, which were intended to grow as much as thrice fr researchers mployed in the public sector. Some research institutions suggest to their staff an alternative: to ensure the increased extra payments due, they would need either downsizing (and fire one-third of their research staff), or compel all the staff to work part-time.

Low basic salaries in the research area are pregnant both with undermining of the staff balance and more intense and systemic consequences. More specifically, it gives rise to so-called 'research day-labor',- that is, the situation when a researcher has to simultaneously contribute to several short-term (up to 1 year) projects, as it can ensure their wages. Such a work entails a lower research productivity, for he looses conditions for conducting a serious research. One of manifestations of this situation is the rise in the number of researchers that leave fundamental research in favor of one-day applied projects. An execssive focus on the latter appears dangerous, as it breaks the balance of reseearch on stages of the innovation cycle.

Meanwhile, the government developes a Concept of measures on maintaining staff capacity of the research complex and a draft Federal Targeted Program 'Research Staff of the Russian Federation' aimed at 2004-2009 and designated for laying down fundamentals for a unified staff reproduction system in th research area. It is intended to complete both documents by the end of 2003. The draft available today provides a formulation of a tactical task of the government staff policy in terms of 'maintenance' of the most productive staff, meeting young researchers' needs and 'reduction of their emigration or leving' research for other areas. Hoever, certain forms and means of maintenance and reproduction of the research capacity sometimes appear prohibitive and restricting. For example, in order to fix research staff in Russia, it is proposed to ' strengthen conrol over implementation of international agreements on cooperation in the research and expert exchange area' and 'ensure a stage-by-stage introduction of a free post-graduate or doctorate education only in the event of the compulsory employment in the public sector of the economy for 5 years'[12]. The draft document suggests numerous forms of incentive payments, grants and bonuses for young researchers, as well as support of leading research institution and research stuff dealing with priority science and technical issues. It is also suggested a mortgage system for public science and technicl complex employees and an introduction of a civil servant status for researchers. At the same time, the document contains just a slight hint on the necessity of developing the material and technical base to be available only for the 'leading national universities', while it provides no criteria for identification of those, at least, at the onceptual level.

At the same time, experiences of some countries facing similar challenges show the nececcity of pursuing a comprehensive policy on stabilization of the staff structure and brain drain prevention, and such a policy should be based on openness, rather than restrictions. Interestingly, there are both success stories in this respect and failures, and the latter occur whenever there is no such policy in place. For instance, China, currently one of the biggest donors of research staff for the US science and technology sector has now been very successful in promoting a 'repatriation' program by means of the following mechanisms: high wages, especially for those holding Doctor degrees, an accelerated establishment of experimental bases and laboratories in the best national research centers, encouragement of high-tech enterprises, support of emergence of the innovational infrastructure (innovational and incubator centers), and incentives for development of research structures from aborad. They enjoy land tax benefits and can import research equipment free from customs duties. As a result, now China has become home for over 200 transnational corporations' research centers, and the country sees a considerable inflow of researchers who once left abroad.

Another example is Canada, whose research institutions were facing growing pressures because of the bran drain to the US. To return national researchers and prevent a nw wave of brain drain, in 1997 the government established the Canadian Innovation Fund, one of whose main tasks became support to the creation of research infrastructure, including renewal of the experimental base. The idea was that having got a chance to work on a new equipment, researchers would favor th idea to stay in the country. At the ame time, funding was based on co-financing principles, with the Fund contributing with 40%, local budgets and the industrial sector together with 60% of the overall budget. In addition, in 2000 the government initiated

[12] Mery po sokhraneniyu kadrovogo potentsiala nauchno-tekhnicheskogo komplexa. Kontseptsia. proekt. Sovet pri Presidente RF po nauke i vysokim yekhnologiyam. Moscow, April 2000.

the program of support to high research positions in the frame of hich until 2005 the gornment will be funding 2,000 such posiions in the Canadian institutions and universities. All the above should help get back earlier left researchers.

So, the correction of the sittuation with research staff in both countries is made both by means of higher salariei and creation of the respective infrastructure.

There also is an opposite example, namely, France. The country also suffers a mass brain drain, whose major reasons are relatively low salaries and innumerous bureaucratic constraints in the scientific sector. More specifically, researchers employed in the public sector enjoy tthe status of civil servants, while in universities science and edication often appear split, which makes the French and Russian systems o organization of science very similar. In France, there is anotable stagnation in the area of funding research: for several years government expenditure on science remain unchanged and amounted to 2.1% of GDP[13] There is an ongoing debate on the public sector reform and some steps were made (for instance, establishment of joint university research laboratories and the National Research Center (CNRS), which was established yet in 1939 following the Soviet Academy of Science model and is a recepient of one-fourth of all the allocations for research[14]), but they are fragmentary ones.

At the same time since 1996 Russia has implemented a federal targeted program which since 2002 is known as 'Integration of Research and the Higher Education in Russia for the Period between 2002-2006'. The program focuses both on supporting young researchers through the integration of academic insitutions and universities' research and educational activities an contributes to optimization of the institutional structure of science and a 'smooth' reform of its public sector. In 2003 the program was funded at the level of the prior year, i.e. its actual funding diminished. In addition, because of constraints imposed by the Budget Code, it becomes impossible to extend support to integration structures themsrlves, the majority of which are not legal entitis, while they form fundamental elements of the modern organization of science. The same problem faces public research funds, which results in their awarding grants to institutions as a whole, rather then winner teams. One of the areas he program embraced also provided support to renewal of research and educational centers' device base, however, that particular activity as not promoted due to lack of funds. The Program also suffers certain drawbacks: an excessive and growing from year to year number of participants (s of today, hose are 247 public universities, 320 research centers under the Russian Academy of Sciences, and 168 secoral public research centers), lack of strict criteria for support, and complex reporting procedures. But its concept remain up-to-date, and should its deficiencies be eliminated, in couple with a rise in governmental allocations on its implementation, the Program could become instrumental for th systemic solution of th staff problem in science, while there ould be no need in introducing another federal targeted program.

Overall, the renewal of the staff balance in the national silence will be happening simultaneously with the improvement of the material base of research, development of the industrial sector in science, and restructuring of the research center network.

That is why the government should view among its priorities the support to establishment and renewal of the research infrastructure and encouragement of ties between research and industry. As a first step, one need to substantially raise financing under the program 'Development of the device ase of research organizations and the higher schools' by adjusting it to the current scope and rate of aging of the research equipment, so that its share would account for at least 10% of the whol budget for science. Under this particular program the allocation of funds should be based upon tender procedures and linked to the implementation of targeted programs. The other possible mechanism is funding centers of collective usage of equipment through the Russian Fund of Fundamental Research (RFFR).

The device base of the national science could also b renewed by purchasing equipment (with the length of service up to 3 years) on the secondary market. But there is a hole range of factors associated with the imperefection of the customs law that block the use of this particular channel: the problem is research equipment is not singled out in the customs classification of goods, that is why it is classified arbitrarily and there are no standart customs procedures. Furthermore, as the majority of research devices are unique, every

[13] OECD Science, Technology, and Industry Outlook- 002. OECD, 2003, p.89

[14] R. Lallement, S. Paillard. The Position of France in the Knowledge-Based Economy: an Assessment. Pper presented at the international onference 'innovation in Europe: Dynamics, Institutions, and Values". Rockslide University, Denmark, May 8-9, 2003

time it should be certified, which appears labor- intensive and substantiallyslows down their shipment across Russian borders.

On the other hand, the national research instrument-making sector has always been quite advanced, and it continues to develop thatnsk to small innovation firms. In light if this, it would be expedient to extend the governmental support to smallmanufacturers selling their produce to Russian research centers and higher schools. In the first half 2003 there appeared the first precedent of using such a scheme: the Fund for Support of Development of Small Forms of Businsses in the Scientific and Technical Sphere signed an agreement with the Siberian Branch of the Russian Academy of Sciences, according to which small businesses supported by the Fund wuld produce research equipment for institutions of SB RAS. It is stipulated in the areement that the Fund provides 50% of funding, while SB RAS-40%, and research centers's funds would form the remaining 10% of funding.

The staff situation can also be partly resolved, if the government creates conditions to encourage an inflow of research staff form other countries and primarily from the CIS states. But there is no government policy in this particular area, despite President Putin in his 2003 Address to the Federal Assembly emphasized the importance of shaping an efficient immigration policy, especially with respect to the CIS countries.

There also is a growing need in the development of a program to attract talented young an qualified staff from the CIS countries, which would include, among others, such components as an introduction of special, 'green-light' procedures to ensure work permits for research staff. To prevent abuses in this are, it would be expedient to introduce a core-based system of assessment of potential immigrants' capacities in the given research area with account of other countries' respective success records. The following elements can form criteria for such an assessment: the MA degree for young researchers and work record and degree for lder ones, the level of command in Russian, and an invitation of from a concrete Russian organization or a university. In addition, the government needs to develop the list of research areas for which the country needs qualified researchers and which can hardly be met at the expense of domestic reserves. This would allow an introduction of a flexible and more neatly built system of immigrant selection criteria. In addition to the above, while pursuing the policy of attraction of youngsters to research, one should also introduce age restrictions. As well, there should be provided an opportunity to receive the RF citiznship for those immigrants from the CIS countries who have successfully worked during a certain period of time (5 and more years) in the national research sector.

The country has alredy witnessed success stories of integration of reseachers from the CIS countries into Russian institutions and universities. For instance, an inflow of Middle-Asian Russian-speaking researchers provided an impetus to the development of humanitarian sciences in Great Novgorod and Severodvinsk, while biological scinece in Omsk also benefited greatly from the same exodus. It should be noted that local universities helped the newcomers with appartments there. Such an experience showed that the inflow of qualified resarch staff both contributes to progress in science and has a positive effect on the social environment in small cities.

As concerns Russian staff leaving the country, there must not be any prohibitive or restrictive measures,- on the contrary, Russian resarch community should develop cooperation programs with our compatriots abroad (joint research, invitations to visit Russia and delier seminars here, joint innovation projects together with small businesses).

I. Dezhina

The YUKOS case: an attempt of interpretation.

The papers suggests the most acceptable, from the author's point of view, interpretation of the events around YUKOS/Menatep happened in July 2003. Though paradoxically, but the author believes that the main cause of the pressure on the group appears a notably grown level of legal protection (legalization) of the company's assets and its owners' possible strategic vision of its future.

The YUKOS/Menatep case was likely to form the most notable case in Russia in July 2003. Several formally separate cases simultaneously imitated by the Attorney General's office both gave rise to numerous versions and speculations and, as it often happens, left genuine motives of the situation aside of the general public's notice. At the same time, none of the versions highlighted by mass media (with a natural absence of official ones) appear satisfactory.

Purely political interpretations associated with the start of the pre-election struggle, conflicting groups in the presidential Administration and their financial sources (the remains of 'the Family' and YUKOS-Sibneft,

the St. Petersburg representatives of enforcement agencies-Rosneft), Mr. Khodorkovsky's political ambitions, etc. are unlikely to provide a satisfactory explanation, though they could well form an additional impulse to a solution by means of enforcement. Nevertheless, the political component of the situation is indirectly proved by the typical fact tat authors of even relatively minor political intrigues do not often seriously consider global economic consequences for the country as a whole.

It is equally hard to consider purely economic, property redistribution, motivations. The existing legal instruments are not sufficient to ensure a non-market takeover of share in YUKOS[15]. As far as withdrawal of disputable stock packages in other companies (such as the de-privatization of 20% of OAO Apatit or the assignment of a 19% stake in Eniseyneftegas to Rosneft) is concerned, the forces involved are too great, while judicial prospects (providing impartiality of the court of law) are too loose.

In all likelihood, the context of this particular case appears ore fundamental. There have recently appeared an increasing number of research addressing the problem of a rising demand for independent institutions in Russia[16]. More specifically, such papers note a rise since 2002 in the interest in the economic institutions that are not associated with a certain social group, i.e. those that are designated to ensure protection of all economic agents (the universal support of the idea of the state machinery reform, the idea of independence of the court of law, etc.) Clearly, such an interest does not rise by itself. According to available estimates, at a certain stage, the biggest Russian corporations' costs of interaction with the domestic bureaucracy (in the framework of a protective mechanism built in the 1990s, which is based on utilizing the 'administrative resources', i.e. 'connections' with federal and regional civil servants and courts of law, financing politicians, among others) have proved to be too high, which called for a revision of the protective mechanism system[17].

One should also take into account yet another - not less important- factor that stimulates such demand. As Mr. Shvidler, President of Sibneft, put it, in the course of their development, each oil company had obtained a share of administrative resources and it was the factor that determined a real competition in the oil market[18]. At the same time, the standardization and mass application of 'administrative resource' procedures resulted in the conflicting parties' use of the same methods (equal supportive figures), which makes either party's victory illusory. In such a situation, the costs associated with such a corporate conflict become comparable to the actual value of the parties' assets, which makes civilized negotiations more cost-saving from the economic perspective. That in turn demands for a greater level of protection of property of the parties involved in the given deal and a greater level of economic agents' transparency (including actual owners of Russian companies, among others).

Finally, there may also exist the third factor of the demand for independent institutions. Many Russian groups (holdings) were actively pursuing reorganization in the 2000, which was caused, apart from other factors, mostly by a fundamental dilemma emerged by 2001: as the completion of 'partnerships' in the frame of every large group had been over by that time, it necessitated the legal purity or, at least, a greater legalization of the property and income structure. The obvious logical step became creation of offshore holdings (to avoid an additional taxation in Russia), while owners ('partners', beneficiaries) ensured control over and protection of their assets through the groups of complex legal structures. All organizational schemes became to formally comply with the law[19]. The lowered level of the legal risk allowed to make the problem of civilized (genuinely independent) economic institutions a more applied one.

In such a context, (apart form the political one, which is likely to have its own significance) one should perhaps consider the YUKOS/Menatep case, and there are several aspects in it worth noting:

Given that in 2001 (the data of SCREEN Emitent) the OAO YUKOS's register contained only nominal holders: OAO Doveritelny i investitsionny bank (controlled by Group Menatep Ltd.) - 59.21%, ZAO

[15] Unless one admits ultimately wild options associated with personal threats: for instance a change of the Special Trust Arrangement in favor of *other* beneficiaries. Under 'non-market' takeover we understand any methods different from a classical hostile takeover or a market deal involving the given company's certain stock.

[16] For more details, see: razvitie sprosa na pravooye regulirovanie corporativnogo upravlenia v chastnom sectore. Nauchnye doklady, # 148. M., MONF, 2003; Radygin A., Entov R., Mezheraups I. Problemy pravoprimemenia (enforcementa) v sfere zaschity prav aktsionerov. M., IEPP, 2002, among others.

[17] See: Guriev S., Sonin K. Bogatstvo i rost. Expert, 003, # 24, 30 June, p. 40-47

[18] Kommersant-Vlast, 2003, 2026 January, p.25

[19] With two exceptions, though: the permanent violation of the anti-monopoly law (according to some estimates, not less than 20% of deals) and transfer pricing (particularly for the purpose of capital export, though practically there is no legal regulation in this particular area).

Brunswick UBS Warburg Nominees - 13.52%, OOO Deutsche Bank- 12.99%, in 2002 (as of June 10), the Group Menatep's Homepage on the Internet disclosed practically complete data on the company's control structure.

According to the data, Group Menatep Ltd. registered in Gibraltar controls 100% of YUKOS Universal Ltd. registered on the Isle of Man, which in turn owns 3.54% of oil company YUKOS. Another 57.47% of oil company YUKOS are controlled by Hulley Enterprise Ltd. (a daughter company of YUKOS Uniersal Ltd., Cyprus). Group Menatep Ltd. is co-owned by 6 private individuals (of which four hold 7% each, while another two- 8 and 9. 65%, respectively), while Special Trust Arrangement (the only beneficiary is the head of YUKOS Mr. Khodorkovsky) holds a 50% stock, and some minority shareholders' aggregate stock accounts for 4.5%. Obviously, it is Mr. Khodorkovsky who exercises the dominant influence in the company (with account of the trust, his share runs up to 59.65%), however, the idea of trust is that formally decisions are made by the Director of Group Menatep Ltd. and trustees, rather than the beneficiary himself. It is provided that, should Mr. Khodorkovsky be deprived of the possibility to exercise his beneficiary functions (once kidnapped, detained or forced to vote against his will), the voting right is to be assigned to a co-owner of Group Menatep Ltd. appointed beforehand.

Naturally, such motives as the access to the capital market (issuance of ADR) or the Western banks' pressure in the framework of the global campaign against money laundering (FATF, OECD, EU's activities, Wolfsberg Principles, etc.) appear insufficient to ensure a complete transparency in the area of beneficiary ownership. Most likely, there is some 'time' factor associated with the completion of reorganization of groups (in the wake of privatization and consequent takeovers), building fully legal (protected) asset ownership arrangements and a legal optimization of taxation of benefits. In other words, there should be some period of time after which the risk of loosing acquired (often with abusing civil or criminal law) assets become minimal[20]. The impossibility until a certain moment to demonstrate sources of the acquired property, including facts of tax dodging, is also fundamentally important, and the majority of Russian groups and companies still are not ready for that. *Having competed this stage of corporate development, YUKOS became a pioneer company in Russia in this respect.*

Clearly, taking the whole property scheme out of shadow (while tax and financial arrangements are not considered at this point) and creation of a fully legal mechanism of asset protection imply both a *lower need in specific friendly relations with bureaucracy and a notable rise in a company's (its owners and beneficiaries' independence) of the state and its enforcement agencies*. There practically are no such huge private companies and so legally protected company owners in Russia as YUKOS. Hence, the question is to what extent such a strong company fits in the Russian interpretation of the 'strong state' ideology.

The qualitative progress in the transparency level (even in the aforementioned context) could not form the cause for concrete enforcement operations against Mr. Khodorkovsky's group. Rather, it may well happen that the concrete reason should be associated with the whole logic of development of the 'model company' YUKOS in the 2000s.

The policy of promotion of a favorable corporate image and an artificial 'rise' in the company's capitalization may testify particularly to the preparation of its sale or a parity international merger[21]. Given other conditions being equal, many experts believe that the arrival of new, including foreign, co-owners in some Russian companies is just a matter of time, which is determined, first, by the moment when the latter reach a certain value matching their foreign analogues, and, second, by availability of options for investing

[20] A completely vulgar interpretation is that there still is a great volume of illegally acquired property that needs to be laundered.

[21] The task of selling a company or a parity merger can be pursued in a different way: for instance, to merge its Russian assets with BP, TNK did not at all need to increase its capitalization and create a corporate image. On the contrary, TNK was known for its negative stand with respect to entering the domestic stock market upon completion of its capitalization. The company's actual closeness and refusal to allow the public circulation of its stock were proved by a small number of its shareholders, concerns about scandals and corporate blackmail which could endanger its reputation, and unwillingness to use 'cheaper' domestic quotations for the purpose of benchmarking. As long as the establishment of a multinational corporation is concerned, one is likely to consider an international industrial group by SUAL-International, Access Industries' coal assets in Russia and Kazakhstan and tantalum production in Mosambique and Cubam ferronickel production owned by Flemina Family and Partners (UK).

the respective proceeds (for instance, a football team in UK?). Some experts believe that already in 2002 at the level of declarations YUKOS has no longer positioned itself as Russian company[22].

The YUKOS-Sibneft merger (essentially, the takeover of the latter) announced in 2003 would ensure for the newly established company the 4th...6th place among oil companies worldwide.

At the same time, the task of becoming a' global leader in the energy sector' the owners of the new company set before their new company appears hardly achievable without transforming it into a multinational corporation. Most likely, the level of the company's influence on, and independence of the Russian government (providing its oil output and refinery are located in Russia) become unacceptable. At this point it is worth noting that, according to some sources, despite his protocol positive comments, President Putin was informed of the TNK-BP merger after it actually happened, while his actual attitude to that might not be quite positive. It may be quite possible that it was decided not to create such precedents in the future.

If this version is accurate, the blow at YUKOS and Sibneft's capitalization makes sense: the national enforcement agencies' operations (despite of legal grounds, names and prescription of cases) are designated both to teach YUKOS's owners a lesson on what may not be done under any circumstance and to show to the world that it is not worth dealing with such a 'dirty' company. The fall in capitalization in turn lowers the company owners' interest in selling a part of its stock (needless to say, one can arrange for as many such falls as needed).

It has also become evident that the YUKOS case could not be initiated without President's informal approval, which can be proved by nearly zero support (protection) of YUKOS on the part of other biggest group (entrepreneurs). The situation also allows a clear understanding of a real value of the so-called Charter of Business Ethics the Russian Union of Entrepreneurs and Industrialists approved on 25 October 2002, which united proponents of 'universally recognized moral rules and standards'.

All the above, of course, is just an attempt to build some acceptable version of the ongoing events, and time will show ho accurate it is. The first lesson is evident nonetheless: the company that pioneered the public disclosure area, with the most complete (vs. others) and open data on its structure, stockholders and beneficiaries fell the first victim to such a legalization.

At the same time, one should not forget those who, together with other advocates of 'universally recognized moral rules and standards', fostered 'trustworthy' relations with the national bureaucracy at the federal and regional levels over the whole period of Russian reforms: at all he stages of privatization, capitalizing on GKO pyramid in 1993-98, loans-for shares auctions, allocation of budget resources, and in the credit and finance, banking and foreign trade areas; those who, basing on court's rulings stripped off enterprises' assets to the detriment of other stockholders and creditors; those who broke 'wars of compromises' by means of 'submissions' to the Attorney general's office, etc. 'He that leadeth into captivity shall go into captivity: he that killeth with the sword must be killed wih the sword' (The St. John's Revelation, 13-10).

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[22] Tremasov K. Promyshlennaya politika. Pochemu net investitsiy. -Vestnik NAUFOR, 2002, # 3, p.9