

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

**MONTHLY BULLETIN**

**Moscow**  
**2004**

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## The Political and Economic Results of July 2004

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The month has proved to be poor with decisions taken by the federal executive power and legislature.

The work on passing the package of bills on "monetization of benefits" was underway. These voluminous documents passed the first reading with an amazing speed, and the second and third readings are scheduled for 3 and 5 August 2004, respectively. It is well known that the second reading is crucial for most of provisions of a document. Meanwhile, it is hard to predict which else categories of '*lgotniki*' (individuals entitled for benefits) would complement the group of those who will further enjoy the benefits as per the agreement between the Government and the "United Russia" faction that controls the Parliament. It is stated in the agreement that the following categories will keep their benefits: liquidators of the Chernobyl disaster, inhabitants of the Far North, Heroes of the Socialist Labor, etc. It is equally hard to analyze the final version of the bill<sup>1</sup>. It is also worth noting the approval by the Federation Council of the bill submitted by Pres. Putin and entitled "On civil service...". The bill happily escaped most of experts' notice. In compliance with the bill, civil servants and their immediate relatives will retain the right for free medical, resort and rehabilitation services, increased wages rates (depending on a region of residence), reimbursement of travel expenses in the event of their transfer to a new location, increased pensions, etc. Plus, they would be entitled for a single housing subsidy. It is evident, nonetheless, there have been problems with the style of designing and drafting the bills. And if it was not enough, the state-owned media have turned the promotion of the rightly supposed unpopular bill into a large-scale PR-campaign. As a result, the government has missed the ideological target (that is, the monetization, at least except for some minor groups with special merits before the society). Second, the trend to fixing and even expansion of the civil servants' natural benefits raises serious doubts concerning a convincing economic effect of the said measures (as the cuts are going to concern poorly funded mandates of a broad public, rather than those for bureaucrats). Third, there occurred an unexpected rise of governors. On July 22, 2004, 10 governors of 13 in the Far-East federal super-region signed an appeal to Pres. Putin in which they declared the "social package" anti-constitutional. The Subcommittee for Budget of the Duma made the likewise statement concerning the upcoming set of amendments to the Budget Code (more specifically, its Chapter 215) that are to deprive the regions of the right to service their accounts with their own treasury systems. The documents also cite the intended lever to exercise an additional pressure: that is, in particular, the convention of the Supreme Council of United Russia party (that is one of numerous bodies dominated by regional representatives). Mr. Gryzlov's signing an agreement on interaction with the Federation of Independent Trade-Unions of Russia which focuses on the problem of monetization of benefits, in turn, shows that the party is quite susceptible to such a pressure.

The last Government meetings and other official gatherings (such as the first meeting of the Council on competitiveness) displayed no fundamental developments. The fashion all the events were held has been routine, as usual. At their meeting on 8 July 2004, the Cabinet commissioned a task force to refine "Main Operational Guidelines of the RF Government". However, as it could be expected, they failed to meet the deadline for their approval (16 July 2004). Interestingly, draft documents that media succeed to get hold of bore a peculiar terminology (such as, for instance "private-state partnership", "rent", "rental payments", "designing Russia's space", etc.) with no specific mechanisms of their implementation. Plus, the documents displayed clumsy compilation of different papers into a single one. So it looks like the drafting of "Main Guidelines" has become an arena for the struggle between the government staff, who, however, have not displayed their genuine intentions. Hence, judging the above, it is premature to discuss a new (or old) strategy. In the earlier drafted Russia's Transport Strategy and EBRD documents the private-state partnership was viewed as concrete joint infrastructure programs basing on legal principles of the contract law, which could be analogous, say, to the institution of concession. So it is impossible even to discuss final contours of any single term.

On July 17, 2004, Prime-Minister Fradkov signed a new draft of the electricity reform plan for the period 2004-05. Despite the fact the document bears nothing new and certain, the mere fact it has been

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<sup>1</sup> Without that, it will be impossible, in turn, to understand how the genuine 2005 draft budget law will be amended

signed appeared very positive after some statements of some Russian officials in June that seemed to bring the discussion back to its 2000 level.

In July 2004 President Putin dismissed # 3 in the national army: that is, General A. Kvashnin, the Head of the General Staff. He was the sole *protege* of the former Defense Minister P. Grachev who not only survived after 1996, but retained numerous leading positions in the Army. His conflict with the previous Defense Minister I. Sergeev resulted in the latter's dismissal. Mr. Kvashnin was replaced by a general with a similar record who had served in the Leningrad Military District, Gen. Yu. Balyuevsky, the staffer of the General Staff. Compelled to choose the lesser of two evils, Russian analysts expressed different views on the reshuffle. While some of them believed Mr. Kvashin was a symbol of the "Grachev's epoche", which means corruption and disgraceful losses of the first Chechen War (at the time he was the Commander-in-Chief of the Caucasian Military District), and cronyism, inner conflicts and the absence of a conceptual, strategic vision of the future of the Army, the others, on the contrary, regarded him as one of the very few professionals who, albeit on his own mistakes, had acquired a considerable experience in the military building area and was such appeared opposite to Mr. S. Ivanov, a philologist from St. Petersburg. Both assessments appear inaccurate, for they both demonstrated the same approach, which is persistent requirements to increase financing unreformed and inefficient army deprive of any doctrine. Hence the continuous collapse of Russia's armed forces (mass malfunctions of the military equipment, mass conscripts' escapes, homicides and suicides in the barracks) are the personal merit of all Russia's military leadership.

July 2004 was signified by an important twist in the YUKOS case. Following some forecasts, the government declarations of not being interested in bankruptcy of the company have failed to match the reality, which, with account of the level of their authors, by itself formed negative news for the market. The PR Center under the Ministry of Justice broke the news that a stake in Yuganskneftegas, which is a major oil division of OAO NK YUKOS would be appraised by independent appraisers and transferred to a specialized company to be sold in the frame of a bankruptcy procedure. YUKOS's representatives suggested that Yuganskneftegas might be "sold" by means of a direct sale and expressed their eagerness to sue any of its buyers.

July 2004 saw conventions of two leftist parties: that is, CPRF and "Motherland". Despite analysts credited Mr. Zyuganov with a majority of supporters at the congress, he failed. That can be explained by the archaic Party's Charter that provides a sophisticated management structure (the Central Committee of over 100 members elected at the convention consequently elect the Party Chairman and his deputies). In a few days before the convention (scheduled for 3 July) there occurred 2 Plenums of the central Committee of CPRF. It cannot be excluded that there was quorum at both of them (for Mr. Zuganov's enemies had entrenched mostly among the party leadership rather than in its regional branches, and many of them were likely to attend both events). The anti-Zyuganov plenum deprived him of Chairmanship and elected Mr. V. Tikhonov, the Governor of Ivanovo oblast (incidentally, Mr. Zyuganov would cite his mission as a success of the "red governor", despite an obvious impoverishment of the oblast) and changed the Convention venue. As for the pro-Zyuganov's plenum, it naturally voted for Zyuganov and expelled the "dissidents" from the party. The events were accompanied with the whole classical set of actions characteristic of corporate wars: hackers attacking the CPRF Home-page on the Internet, fist-fighting, the use of fake stunts instead of actual delegates, etc. Both parties eventually began to apply to the Ministry of Justice to prove the legitimacy of either convention. As by the date of the convention most delegates were likely to get convinced in the power of the pro-Zyuganov majority, they ran to the victorious camp. Pres. Putin received the communist boss and assured him that his Administration had had nothing to do with the scandal. It seems that the challenger, Mr. G. Semigin, and his allies made a radical false start beyond the party's Charter and miscalculated their chances. They disclosed their supportive structures thus facilitating the crusade against them, up to their expulsion from the party. Mr. Semigin's failure can also be attributed to the fact that the conflict was too personalized, for both parties were represented by figures belonging to the "right-wing" and "leftist" quasi-factions. It should also be noted that the inner conflict seriously mitigated the protest actions against passing the "social package" in the first reading. In reality, no one is keen to crash CPRF, for a lesser, but more independent of the authorities and radicalized group could be much more troublesome. Thus, CPRF is undergoing a guided conflict that derails both the party and the leftist opposition as a whole.

As concerns the Motherland convention, it was the "Congress of Winners". Mr. Rogozin was elected the party Chairman, while Mr. Babakov, the head of TSKA soccer club and allegedly close ally to Messrs. A. Mamut and R. Abramovitch now presides over the party Executive Council. It is easy to guess that shaped as such, Motherland clearly has become an affiliate to the Presidential Administration whose profile will be hence "fighting for social just and against bad oligarkhs" (and, behind the scene, "Mr. Putin's struggle against extremism"), and the party will be enjoying an unlimited access to main information channels. It is noteworthy though that the new leader's egocentrism has already provoked inner conflicts among the party allies, which can be further fueled by the growing rebellion mood in the new faction. In the nearest future a group of MPs from Narodnaya Volya party (led by Mr. S. Baburin) should hold a separate convention to found their own party. So far they indignantly have accused Mr. Rogozin of "seizing on the general victory".

*S. Zhavoronkov*

## Budget and tax policies

In May of 2004, the revenues of the federal budget increased to 20.6 per cent of GDP, while revenues of the consolidated budget remained at practically the same level as compared with the figures registered in the preceding month and made about 32.8 per cent of GDP. The level of expenditures of both federal and consolidated budgets declined in comparison with the figures registered in the preceding month and made 16.3 per cent of GDP as concerns the federal budget and 26.95 per cent of GDP as concerns the consolidated budget.

At the same time, the RF Finance Ministry is planning to complete the tax reform in the course of the two next years. The main outcomes of the reform may be a decline in the tax burden and streamlining of the RF tax system. In the case the average annual oil prices decrease and make US \$ 20 to US \$ 22 per barrel, the tax burden in 2004 could be below 30 per cent of GDP.

### The State of the Federal Budget

In January through May of 2004, the revenues of the federal budget (cash execution) made 20.6 per cent of GDP, while expenditures made 16.3 per cent of GDP (see Table 1). Therefore, the federal budget surplus made 4.3 per cent of GDP.

*Table 1*

**The monthly execution of the federal budget of the Russian Federation  
(in % of GDP<sup>2</sup>, cash execution).**

	V'03	VI'03	VII'03	VIII'03	IX'03	X'03	XI'03	XII'03	I'04	II'04	III'04	IV'04	V'04
Revenues													
Profits tax	1,4%	1,4%	1,4%	1,3%	1,3%	1,3%	1,3%	1,3%	0,9%	0,7%	1,2%	1,4%	1,3%
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%
Unified social tax (UST)	2,9%	2,8%	2,8%	2,8%	2,7%	2,7%	2,6%	2,7%	2,2%	2,6%	2,8%	2,9%	2,9%
Indirect taxes	9,6%	9,2%	9,1%	8,9%	8,7%	8,6%	8,5%	8,5%	10,2%	8,5%	7,6%	7,6%	7,6%
VAT	7,2%	6,9%	6,9%	6,8%	6,7%	6,6%	6,6%	6,6%	7,9%	6,6%	6,2%	6,4%	6,5%
Excises	2,3%	2,2%	2,2%	2,1%	1,9%	1,9%	1,9%	1,9%	2,3%	1,8%	1,4%	1,2%	1,1%
Taxes on foreign trade and foreign economic transaction	3,5%	3,4%	3,4%	3,4%	3,3%	3,3%	3,4%	3,4%	3,6%	4,2%	4,4%	4,7%	5,0%
Other taxes, fees and levies	2,1%	2,0%	2,0%	2,0%	2,0%	2,0%	2,0%	2,0%	2,5%	0,1%	-0,2%	-0,2%	-0,2%
Total taxes and other payments **	19,4%	18,8%	18,7%	18,4%	17,9%	17,9%	17,9%	18,0%	19,4%	16,1%	15,9%	16,4%	16,6%
Non-tax revenues	1,7%	1,6%	1,5%	1,5%	1,4%	1,4%	1,3%	1,3%	0,9%	0,8%	0,9%	1,0%	1,1%
Total revenues	21,3%	20,6%	20,4%	20,0%	19,5%	19,4%	19,3%	19,4%	20,4%	19,6%	19,7%	20,4%	20,6%
Expenditures													
State administration	0,4%	0,4%	0,4%	0,4%	0,4%	0,4%	0,4%	0,5%	0,2%	0,3%	0,4%	0,4%	0,4%
National defense	2,7%	2,6%	2,6%	2,6%	2,5%	2,5%	2,5%	2,7%	1,7%	2,2%	2,6%	2,9%	2,7%

<sup>2</sup> Because of the estimated data on GDP, the indices may be subject to revision.

International activity	0,3%	0,2%	0,2%	0,2%	0,2%	0,2%	0,2%	0,2%	-0,1%	0,2%	0,2%	0,3%	0,3%
Judicial authorities	0,2%	0,2%	0,2%	0,2%	0,2%	0,2%	0,2%	0,2%	0,1%	0,1%	0,2%	0,2%	0,2%
Legal protection and security	1,7%	1,8%	1,7%	1,7%	1,7%	1,7%	1,7%	1,9%	1,0%	1,5%	1,7%	1,9%	1,8%
Fundamental research	0,3%	0,3%	0,3%	0,3%	0,3%	0,3%	0,3%	0,3%	0,1%	0,1%	0,2%	0,3%	0,3%
Services to national economy	0,7%	0,8%	0,8%	0,8%	0,9%	0,9%	0,9%	1,1%	0,2%	0,4%	0,5%	0,6%	0,6%
Social services	2,2%	2,2%	2,2%	2,2%	2,1%	2,1%	2,1%	2,3%	1,4%	1,7%	1,9%	2,1%	2,1%
Government debt servicing	2,1%	2,0%	1,8%	2,0%	2,0%	1,8%	1,7%	1,7%	1,0%	2,1%	2,2%	1,7%	1,5%
Other expenditures	7,1%	7,1%	7,1%	7,0%	6,9%	6,8%	6,8%	6,9%	5,2%	5,8%	5,9%	6,5%	6,4%
Total expenditures	17,7%	17,5%	17,4%	17,3%	17,1%	16,8%	16,7%	17,7%	10,8%	14,4%	15,8%	16,8%	16,3%
Surplus (+) / deficit (-)	3,6%	3,0%	3,0%	2,7%	2,5%	2,6%	2,6%	1,7%	9,6%	5,2%	3,8%	3,6%	4,3%
Internal financing	-0,5%	0,3%	0,0%	0,3%	0,2%	-0,1%	-0,3%	0,5%	-8,6%	-3,1%	-1,2%	-1,3%	-2,4%
External financing	-3,1%	-3,3%	-3,0%	-2,9%	-2,7%	-2,5%	-2,3%	-2,2%	-1,0%	-2,1%	-2,6%	-2,3%	-1,9%
Overall financing	-3,6%	-3,0%	-3,0%	-2,7%	-2,5%	-2,6%	-2,6%	-1,7%	-9,6%	-5,2%	-3,8%	-3,6%	-4,3%

As compared with the figures registered in January through May of 2003, the budget revenues decreased by 0.7 p. p. of GDP in the respective period of 2004, while expenditures decreased by 1.4 p. p. and budget surplus respectively increased by 0.7 p. p. of GDP. As before, VAT accounted for the major share of federal tax revenues – 31.7 per cent of the total tax revenues, what is by 0.2 p. p. below the level observed in the respective period of 2003.

According to preliminary estimates, the cash execution of federal budget revenues made 21.2 per cent of GDP in January through June of 2004, what was by 0.6 p. p of GDP above the level observed in the respective period of the preceding year. At the same time, the cash execution of expenditures made 16.7 per cent of GDP (17.5 per cent of GDP in January through June of 2004); therefore, in the first five months of this year, according to preliminary data, the surplus made 4.5 per cent of GDP.

According to the preliminary estimates of the Finance Ministry, in terms of fulfilled funding<sup>3</sup> the expenditures of the federal budget in January through June of 2004 made 17.7 per cent of GDP (see Table 2), while in the respective period of 2003 this indicator was at 19.2 per cent of GDP. In January through June of 2004, the amount of revenues of the federal budget increased by 0.7 p. p. of GDP in comparison with the figures registered in the respective months of 2003 and made 21.3 per cent of GDP. Therefore, the surplus of the federal budget in terms of fulfilled funding in January through June of 2004 increased by 2.3 p. p. in comparison with the figures registered in January through June of 2003 and made 3.6 per cent of GDP.

Table 2

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

	VI03	VII03	VIII03	IX'03	X'03	XI'03	XII'03	I'04	II'04	III'04	IV04	V04	VI04
Total expenditures	20,6%	20,4%	20,0%	19,5%	19,4%	19,3%	19,5%	20,4%	19,6%	19,7%	20,4%	20,6%	21,3%
State administration	0,5%	0,5%	0,5%	0,5%	0,5%	0,5%	0,5%	0,5%	0,7%	0,6%	0,6%	0,6%	0,5%
National defense	3,0%	2,9%	2,8%	2,7%	2,8%	2,9%	2,7%	2,7%	3,9%	2,9%	3,7%	3,2%	2,9%
International activity	0,3%	0,3%	0,2%	0,2%	0,2%	0,2%	0,2%	0,0%	0,2%	0,2%	0,3%	0,3%	0,3%
Judicial authority	0,2%	0,2%	0,2%	0,2%	0,2%	0,2%	0,2%	0,2%	0,2%	0,2%	0,2%	0,2%	0,2%
Legal protection and security	2,1%	2,0%	1,9%	1,9%	1,9%	1,9%	1,9%	2,1%	2,4%	2,3%	2,4%	2,3%	2,2%
Fundamental research	0,3%	0,3%	0,3%	0,3%	0,3%	0,3%	0,3%	0,2%	0,3%	0,3%	0,4%	0,3%	0,3%
Services to national economy	1,0%	1,0%	1,0%	1,0%	1,0%	1,1%	1,1%	0,5%	0,7%	0,8%	0,9%	0,9%	0,9%
Social services	2,6%	2,5%	2,4%	2,3%	2,3%	2,4%	2,3%	2,4%	2,5%	2,4%	3,0%	2,9%	2,6%
Government debt servicing	2,0%	1,8%	2,0%	2,0%	1,8%	1,7%	1,7%	1,0%	2,1%	2,2%	1,7%	1,5%	1,4%
Other expenditures	7,3%	7,2%	7,2%	7,0%	6,9%	6,9%	7,0%	5,6%	6,6%	6,1%	6,6%	6,6%	6,4%
Total expenditures	19,2%	18,8%	18,6%	18,2%	17,9%	18,1%	17,8%	15,2%	19,7%	18,0%	19,7%	18,8%	17,7%
Surplus (+) / deficit (-)	1,3%	1,6%	1,3%	1,3%	1,5%	1,3%	1,6%	5,2%	0,0%	1,7%	0,7%	1,8%	3,6%

According to the estimates of the Tax Ministry, in June of 2004 tax revenues of the federal budget made about Rub. 119.8 billion (without the single social tax). In real terms the revenues made 243.6

<sup>3</sup> The execution of the budget in terms of fulfilled (actual) financing is equal to the sum of the funds transferred to managers of budget funds, while the cash execution of the budget is equal to the sum of funds spent by managers of funds (i.e. without account of funds remained on their accounts).

per cent of the level registered in January of 1999, while the respective indicator was at 240 per cent in June of 2003 and 218 per cent in June of 2002 (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)<sup>4</sup>.**

2002*											
I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII
218,7%	187,1%	234,8%	277,8%	239,6%	218,0%	284,4%	246,5%	254,8%	299,7%	241,0%	250,2%
2003*											
I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII
230,0%	229,2%	265,5%	280,4%	233,2%	240,0%	260,4%	242,6%	248,7%	265,6%	231,0%	247,9%
2004*											
I	II	III	IV	V	VI						
266,5%	204,4%	238,0%	261,4%	241,0%	243,6%						

\* Без учета ЕЧН.

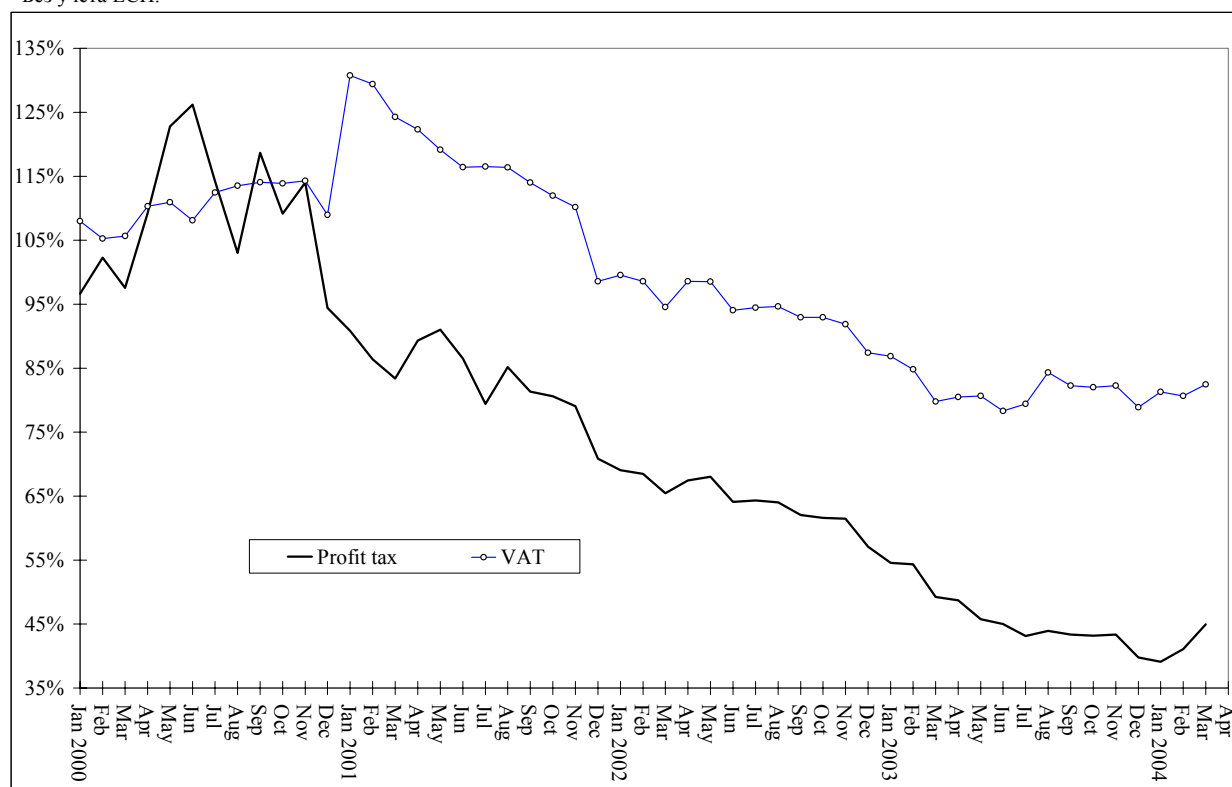


Figure 1. Real tax arrears to the federal budget (in % to June of 1999)

The dynamics of real arrears relating to major taxes since January of 2000 are presented in Fig. 1. The debts related to the payments due to the federal budget made for VAT Rub. 264.1 billion as on April 1, 2004, increasing by Rub. 7.8 billion in March of 2004, while the arrears of the profit tax similarly increased by Rub. 2.9 billion and made about Rub. 30.8 billion. On the whole, a gradual decrease in the level of accumulated arrears observed since early 2001 to the second half of 2003 was replaced by the stabilization of the level of accumulated indebtedness as concerns both the profit tax, and VAT.

<sup>4</sup> It was decided to choose January of 1999 as the benchmark in order to render the comparison more reliable. January of 1999 is not a remarkable date in terms of tax revenues.

Table 4

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

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

\* Без учета ECH

The revenues of the consolidated budget in January through May of 2004 made 32.9 per cent of GDP, including tax revenues (without SST) at 27.4 per cent of GDP (see Table 4). Expenditures of the consolidated budget decreased by 1.9 p. p. of GDP in comparison with the figures registered in January through May of 2003 and made 26.9 per cent of GDP. As on June 1, 2004, the surplus of the consolidated budget made 6.0 per cent of GDP, what is by 1.3 p. p. of GDP above the level observed in the respective period of 2003.

S. Ponomarenko

**Monetary Policy**

In June, for the first time in the course of this year, the rate of growth in consumer prices became equal to the respective inflation figures registered last year (0.8 per cent). Also for the first time since February of 2004, there has recommenced a growth in the monetary base. An increase in the amount of excessive reserves of commercial banks indicated that crisis phenomena in the banking sector have been overcome. National gold and foreign exchange reserves continued to grow and made a new record high of US \$ 89.2 billion.

According to the data published by the RF Statistics Service, in June of 2004 the consumer price index made 0.8 per cent (these figures are at the level registered in June of 2003). Therefore, in the first six months of 2004 the inflation rate was at 6.1 per cent (as compared with 7.9 per cent observed in 2003).

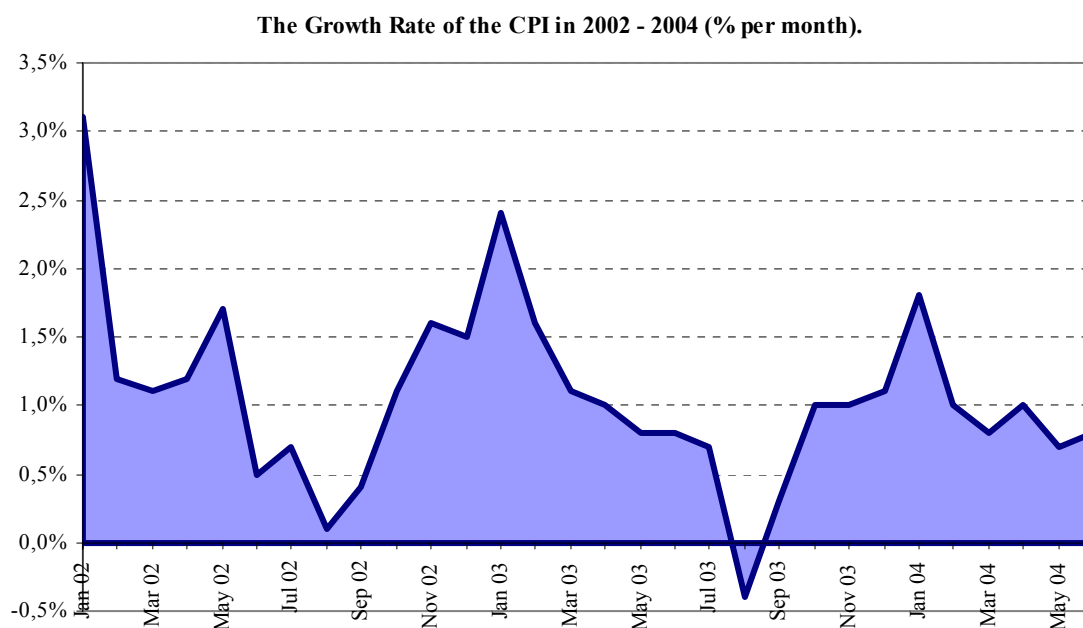
The most significant rise in prices has been as before observed in the group of paid consumer services (0.9 per cent in June and 11 per cent in the first six months of 2004 as compared with 1.2 per cent and 15.6 per cent respectively in 2003). In June, the increase in the group of paid services rendered to households was below the figures registered last June across all positions (with the exception of cultural organizations). On the whole, in the first six months of this year a more moderate growth of prices of paid services in comparison with the figures registered last year was observed across all groups with the exception of prices of services relating to preschool education and those rendered by cultural organizations. In terms of inflation rates, these groups was followed by food products, where for the first time since the beginning of 2004 the price dynamics came up to the last year level (0.8 per cent). On the whole, since the beginning of this year the increase in this group made 6 per cent (as compared with 7.3 per cent registered in the first six months of 2003). In June of 2004, the least increase in inflation in comparison with the figures observed in December of the preceding year was registered in the group of prices of nonfood goods (3.4 per cent as compared with 4.6 per cent registered in the respective period of 2003).



Base inflation<sup>5</sup> continued to slow down. In June, its level made 0.5 per cent as compared with 0.6 per cent and 0.8 per cent registered in May and April of this year respectively. Therefore, in the 2<sup>nd</sup> quarter base inflation made 1.9 per cent. The major factor behind the progressing decline in the base inflation was a diminishing monetary pressure on prices. At the moment, the price dynamics become to be affected by a growth in the M2 money supply observed in the 1<sup>st</sup> quarter of 2004, which slowed down significantly in comparison with the figures observed in October through December of the preceding year (2.1 per cent a month on the average as compared with 5.4 per cent).

According to preliminary estimates, in July inflation rates were at 0.4 per cent to 0.8 per cent.

Figure 1



In the 2<sup>nd</sup> quarter of this year, the monetary base of the Russian Federation (in the broad definition<sup>6</sup>) decreased by 0.9 per cent (the process of decline was observed for the third month running), and as on July 1 of 2004 made RUR 1.92 trillion. In comparison with the indicator's value observed as on January 1, 2004, the amount of the monetary base increased by 0.3 per cent. It should be noted that in April through May the amount of the monetary base diminished by 3.5 per cent and only in June there was registered a 2.7 per cent growth. It should be reminded that in the 2<sup>nd</sup> quarter of the last year the monetary base increased by 19.4 per cent. Below, the dynamics of the monetary base will be analyzed across its components.

The amount of cash in circulation (as adjusted for cash balances of crediting organizations) made RUR 1.35 trillion as on July 1 (by 9.5 per cent above the level registered on April 1 of this year). Over the 2<sup>nd</sup> quarter of 2004, the amount of accounts of crediting organizations with the Central Bank of Russia diminished by 3.9 per cent to RUR 223.1 billion. In April through June, the amount of mandatory reserves also declined by 12.7 per cent and made RUR 251.7 billion. The amount of banks' deposits in the Bank of Russia in the 1<sup>st</sup> quarter of 2004 decreased 65 per cent to RUR 38.4 billion. As on July 1, the amount of the Central Bank's liabilities related to the reverse repurchase of securities was by 22.9 per cent below the respective figures registered as on April 1 and made RUR 56 billion. Therefore, the structure of the monetary base reflected the consequences of crisis phenomena in the

<sup>5</sup> The Base Consumer Price Index (BCPI) is an indicator reflecting the inflation rate on the consumer market. It leaves out of account the seasonal (prices of fruits and vegetables) and administrative (tariffs on regulated types of services etc.) factors, calculated by the Statistics Service of the RF.

<sup>6</sup> The RF Monetary Base in broad definition includes cash in circulation, the Ruble denominated funds in mandatory reserves relating to the borrowings of credit organizations, and funds in credit organizations' correspondent accounts and commercial banks' deposits with the Bank of Russia.

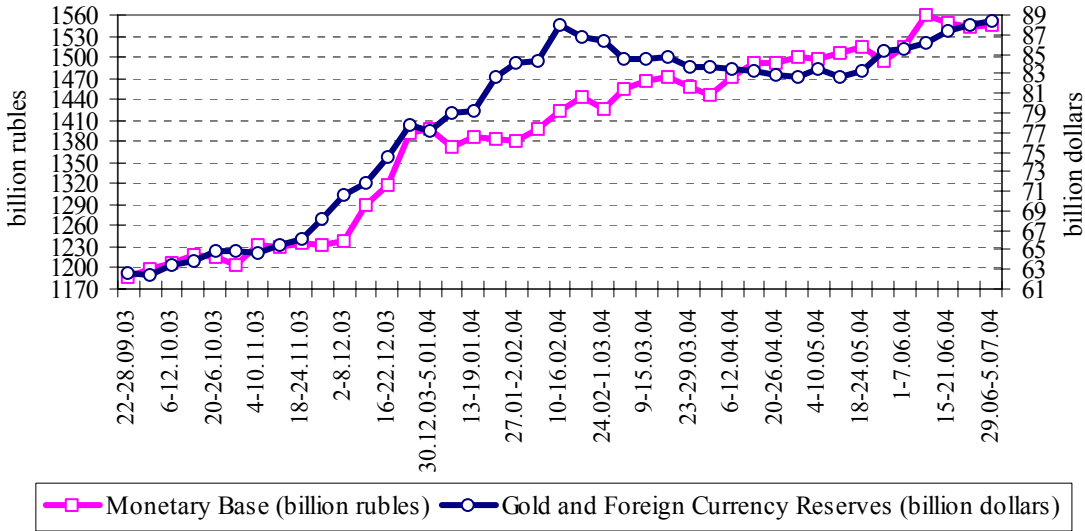
RF banking sector: a sharp decline in the liquidity of the market of interbank crediting resulted in the contraction of deposits and banks' accounts with the RF Central Bank, the outflow of deposits and lowering of the mandatory reserve standards was followed by a decline in mandatory reserves, while a consequence of the Central Bank's attempts to increase the liquidity of the market of interbank crediting was diminishing of its liabilities related to the reverse repurchase of securities with respect to banks. At the same time, in July the overall situation as concerns liquidity somewhat improved, what was followed by an increase in the amount of deposits of crediting organizations in the RF Central Bank.

A significant growth in the amount of cash in circulation registered in the 2<sup>nd</sup> quarter (+ 9.5 per cent) even in spite of a decline in mandatory reserves resulted in an increase in the narrowly defined monetary base (cash and mandatory reserves) by 5.9 per cent (see *Figure 2*). This growth was to a considerable extent a consequence of the significant amount of purchases of foreign exchange on the part of the Central Bank – in April through June, the gold and foreign exchange reserves of the Russian Central Bank increased by 5 per cent and made US \$ 87.9 billion. It should be reminded that the maximal registered amount of gold and foreign exchange reserves was accumulated in the middle of last February and made at that time US \$ 88 billion.

In June, the amount of gold and foreign exchange reserves increased by almost 3 per cent and made US \$ 88.2 billion as on July 1, 2004. In the first six months of this year, the gold and foreign exchange reserves grew by 14.7 per cent (from US \$ 76.9 billion as on January 1). At the same time, in July the amount of foreign exchange reserves increased by 3.2 per cent to US \$ 84.5 billion, while the gold reserves have not change and remained at the levels observed in the beginning of this year (US \$ 3.8 billion). In the first three weeks of July, the gold and foreign exchange reserves grew further by 1.1 per cent and made US \$ 89.2 billion.

Figure 2.

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



During the first three months of this year, the total amount of the external public debt increased by US \$ 2.7 billion (or by 1.5 per cent) and made US \$ 186.9 billion<sup>7</sup>. Over the period under observation, the amount of the governmental debt declined and made US \$ 95.5 billion, what was by US \$ 2.4 bil-

<sup>7</sup> It should be reminded that according to the international methodology used by the RF Central Bank for the determination of the amount of the foreign debt, this debt includes liabilities to nonresidents across all sectors of the economy notwithstanding the currency they are denominated in. Besides, a key characteristic of the debt is the debtor's obligation to make payments relating either to the principal or interest, i.e., the amount of the debt does not include conditional obligations, loan commitments, and guarantees, as well as participation in capital.

lion, or 2.5 per cent below the figures registered as on January 1, 2004. As concerns the structure of this category of liabilities, the amount of the new Russian debt continued to increase (by 4.4 per cent over the 1<sup>st</sup> quarter) and made US \$ 40.3 billion, while the liabilities relating to the foreign liabilities of the former Soviet Union diminished (by 7.4 per cent) and made US \$ 53.8 billion. As on April 1, 2004, the share of liabilities of the government in the total amount owned by the Russian national economy made 51 per cent, what was by 2.1 p. p. below the level registered in the beginning of 2004.

The specific weight of non-financial enterprises in the total amount of the RF debt makes 31 per cent. In the 1<sup>st</sup> quarter, the amount of this debt increased by US \$ 4.3 billion, or 8 per cent, and made US \$ 57.9 billion. Besides, a certain growth in the amount of external debt resulted from an increase in the amount of liabilities of the monetary authorities (+ US \$ 0.6 billion) up to US \$ 8.4 billion. In the first three months of the year, the amount of foreign debt of the Russian banking system (participation in capital excluding) increased by US \$ 0.2 billion and made US \$ 25.1 billion. Therefore, there occurs a steady decline in the external debt as concerns the government, while liabilities of non-financial enterprises continue to grow.

On June 15, 2004, the RF Central Bank introduced certain amendments to its instruction "On formation and amounts of reserves pertaining to operations of crediting organizations vis-à-vis residents of offshore zones." The amendments more precisely define the approaches to the formation of reserves pertaining to operations of Russian crediting organizations vis-à-vis residents of offshore zones. For instance, an operation concerning broking contracts with residents of offshore zones was included in the list of operations requiring crediting organizations to form the reserves. The instruction also determines the amount of reserve payments pertaining to operations vis-à-vis residents of offshore zones as concerns brokering contracts. Besides, there were more precisely defined the approaches to the formation of reserves pertaining to guarantees and securities given to residents of offshore zones on the part of crediting organizations.

The RF Central Bank is going to simplify the procedures governing the operations of non-residents of the RF on the market of domestic public debt. The planned measures will include either lowering of the reserve ratio (at present it makes 20 per cent), or shorter term of reserving. According to the estimates made by the RF Central Bank, the present 20 per cent reserving ratio results in a 1 p. p. to 1.5 p. p. increase in the operational costs borne by nonresidents..

Since August 16, 2004, the Bank of Russia starts to issue modified banknotes of the Bank of Russia (version of 1997 as modified in 2004) denominated RUR 10, 50, 100, 500, and 1000. This measure is aimed to improve the protection complex of the banknotes and make the control of their authenticity on the part of the population more easy. The modified banknotes follow the composition of the banknotes of the 1997 standard series. No exchange of banknotes is planned. The newly issued banknotes should be in circulation in parallel with the 1997 standard banknotes.

*P. Trounin*

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## **Financial Markets**

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In July of 2004, the situation on the Russia's financial market continued to worsen on the impact of a number of factors. First, in the beginning of the month there were observed serious problems in the banking sector. Second, a significant impact on all segment of the Russian financial market, primarily the market of corporate securities had the development of the YUKOS affair: in the beginning of the month the RF Tax Ministry put forward additional claims against the oil company as concerns taxes due in 2001, while later in the month there was published information alleging the sale of the YUKOS major asset, the Yuganskneftegaz company. However, it should be noted that in spite of a significant decline in quotations of practically all blue chips, the impact of the YUKOS affair on the market gradually diminishes.

### **The Market for Government Securities**

In July, on the market of Russian forex denominated bonds at large there were observed trends towards a decline in quotations of traded securities. In the beginning of the month, the quotations of Russian forex denominated securities grew at the background of falling yields of US treasury bills, which are the benchmark for the world debt market. However, after the publication of US macroeconomic data, in particular, about the employment situation, yields of US treasury bills began to in-

crease, what affected the quotations of Russian securities. Yet another factor unfavorably affecting the Russian Eurobond segment was the decision of Germany to issue credit notes denominated in US \$ and Euro pegged to the Russian debt payments to Germany. Although in formal terms the new bonds are not Russian securities, investors saw them as increasing supply on the market of Russian bonds. A temporary decline in quotations was registered only after the S&P agency confirmed the sovereign ranking of Russia at the BB- level. It appears that diminishing uncertainty with respect to the Russian credit ranking played its role. However, later in the month downward trends prevailed on the market, what was caused by the publication of negative corporate news about YUKOS affair; bailiffs made public their decision to start the sale of the major YUKOS asset, Yuganskneftegaz company. Besides, an additional external negative factor was the statement made by A. Greenspan, which gave rise to expectations of a further increase in the US interest rates already in August.

According to the data as on July 23, the yield to maturity of Russian Eurobonds RUS-30 was 7.93 per cent p.a.; RUS-18 - 8.43 per cent p.a. Besides, on the same date the yield to maturity of the Russian Eurobonds was: Minfin bonds, 7<sup>th</sup> tranche: 7.27 per cent; Minfin bonds, 6<sup>th</sup> tranche: 4.71 per cent; Minfin bonds, 5<sup>th</sup> tranche: 6.42 per cent; RUS-07: 5.50 per cent.

FIGURE 1.

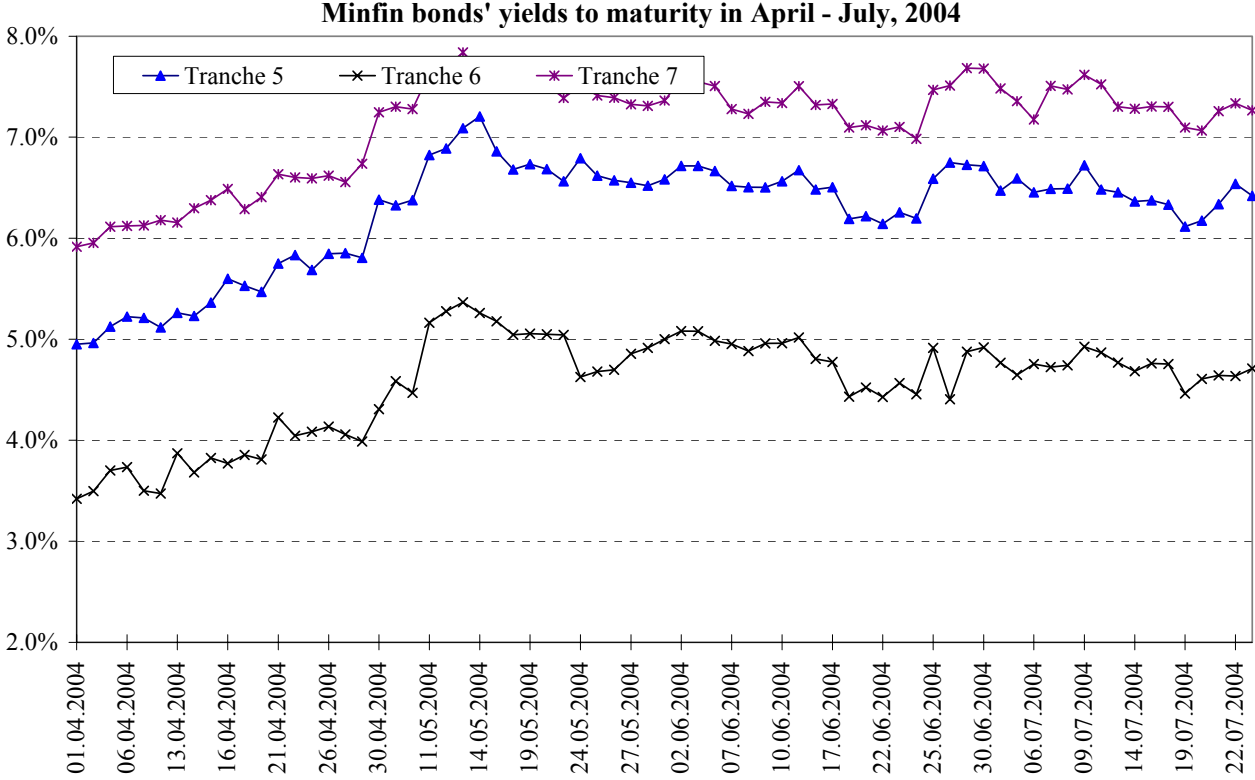
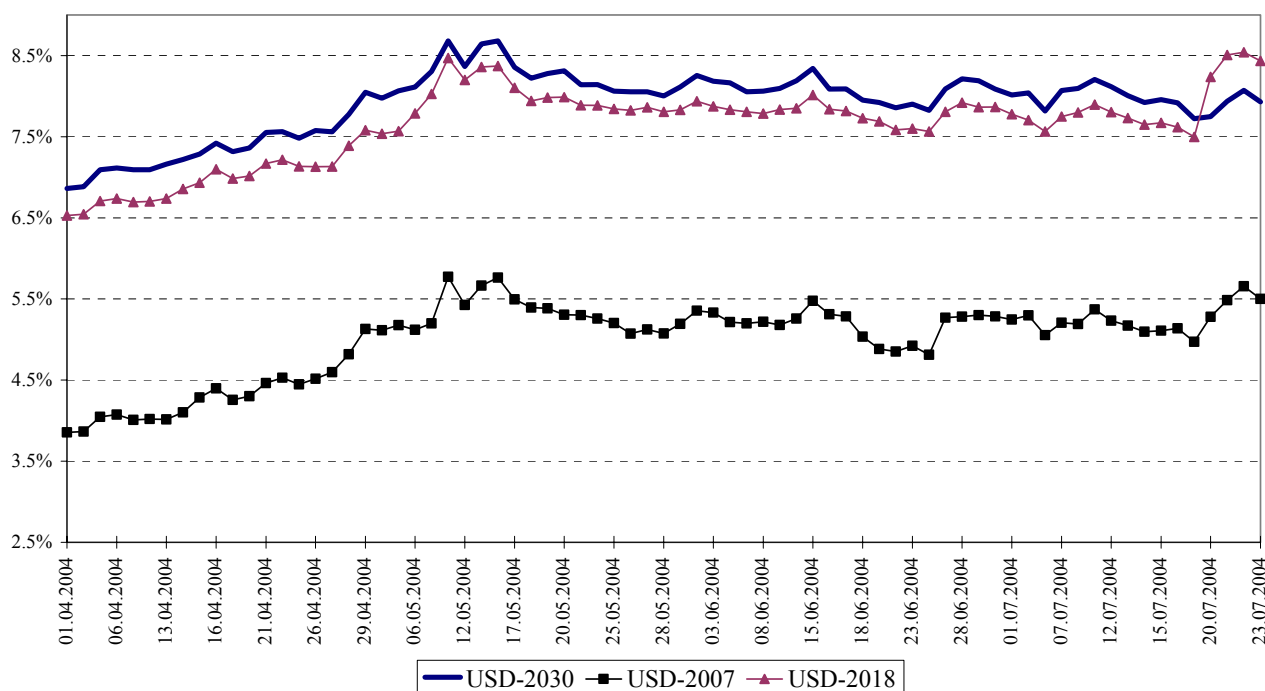


FIGURE 2.

**Yields to maturity of the Russian eurobonds with maturity in 2030, 2018 and 2007 in April - July, 2004**



As concerns the market of Ruble denominated public bonds, in July there was observed a noticeable growth in activity of investors, what was reflected by an increase in the demand for most liquid issues. These developments seem to be a result of growing risks in the corporate sector and, as a consequence, transfer of funds in less risky instruments. A significant growth of the market was checked by the US \$ appreciation, which market operators saw as an alternative to investment in government bonds. Nevertheless, a rise in prices registered over the first week of the month stopped and there began a decline: on the secondary market the increase in yields reached in certain cases 2.5 p. p. and the activity of investors abated. Later, there was observed an adjustment of prices caused by technical factors (excessive sales of securities), absence of negative news about YUKOS affair, and normalization of the situation in the banking sector, which had a significant impact on the whole Russian financial market in the beginning of the month. Later in the month, the situation on the market of Ruble denominated bonds worsened in the wake of negative news concerning YUKOS affair; however, by the end of the month quotations began to recover somewhat.

Over the period under observation, there took place several auctions for the placement of OFZ. On July 7, there was held an auction for additional placement of OFZ AD 45001, the nominal value of which made RUR 6 billion. The amount of the placement made RUR 1.3 billion, while the weighed average yield of the placement was at 6.63 per cent per annum. On July 21, there were held auctions for additional placement of OFZ AD 46003, the nominal value of which made RUR 6 billion each. The amount of the placements made RUR 1.21 billion, while the weighed average yields of the placements were at 7.59 per cent per annum. As on July 26, the amount of the GKO – OFZ market made RUR 463.33 billion at par and RUR 443.95 billion at the market value. The duration of the GKO-OFZ market portfolio was 1621.84 days.

## The Market for Corporate Securities

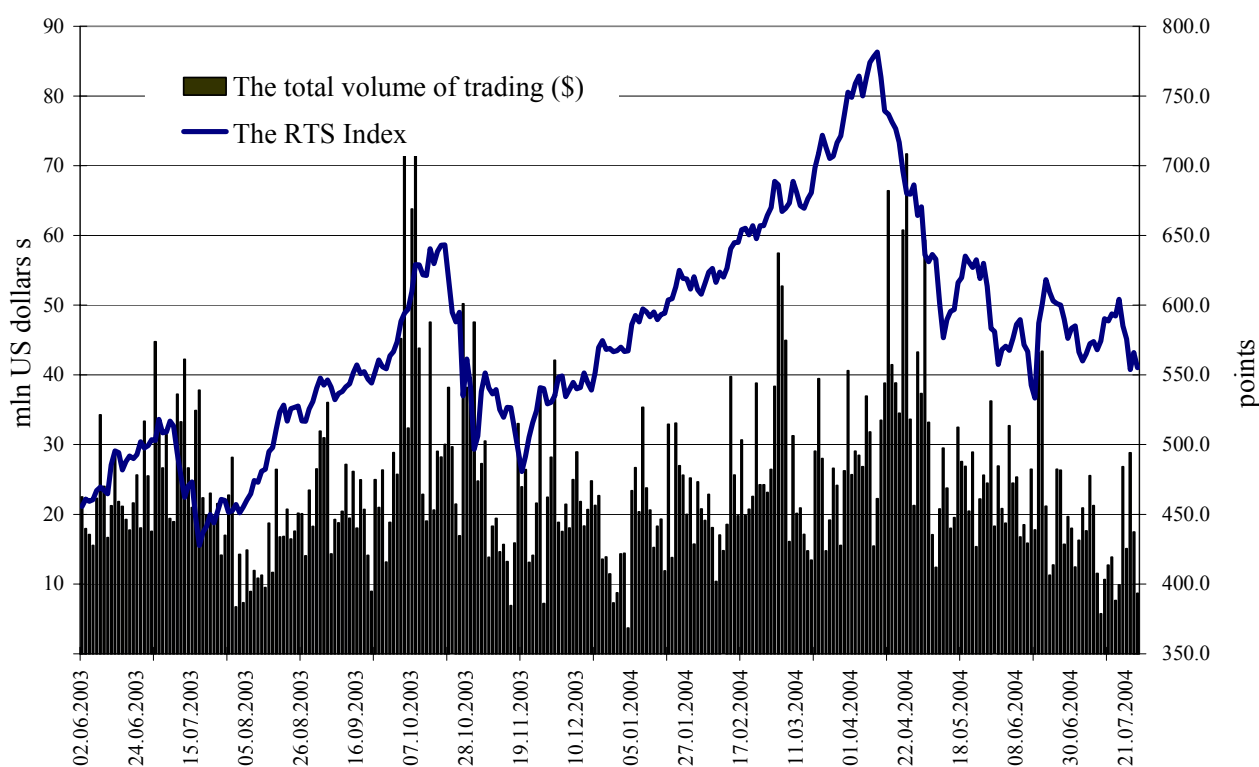
### Situation on the stock market.

In July, on the Russian stock market there was registered a decline in quotations. At the same time, there should be singled out several period over which the dynamics of the RTS index differed. Thus, early in the month there was observed a decline in prices of securities on the market, what was caused by the delay in the finalization of the electrical power engineering reform and liberalization of Gaz-

prom stocks, as well as new tax claims against YUKOS put forward by the RF Tax Ministry on the basis of tax audit with respect to the company's operations in 2001. Over the next week, the market experienced a further decline in prices at the background of high volatility of all blue chips and decreasing amount of trade. Any news about YUKOS caused either a sharp increase or decline in quotations. At the same time, the potential systemic risks relating to the problems experienced by a number of large Russian banks forced investors to take a wait and see position.

However, throughout the third week of the month there were no news which could seriously affect the market situation: no new information concerning YUKOS affair was published at that time, while the tensions in the banking sector gradually abated. On the whole, on the market there was observed the traditional summer lull. At this background, the market experienced an upward adjustment, and on July 19 the RTS index was registered at the level of 604.13 points. However, on July 20 the market prices sharply fell as the news that YUKOS should pay more than RUR 5 billion and the company's major extraction enterprise, Yuganskneftegaz, might be sold. After the publication of this information the trade with the YUKOS shares had to be suspended for 1 hour because of a decline in their market value by 11.7 per cent in comparison with the beginning of trade. The downfall of blue chips was also caused by the fact that one week earlier many investors took long positions expecting that the RTS index might break the 600 point level and could grow further.

FIGURE 3.

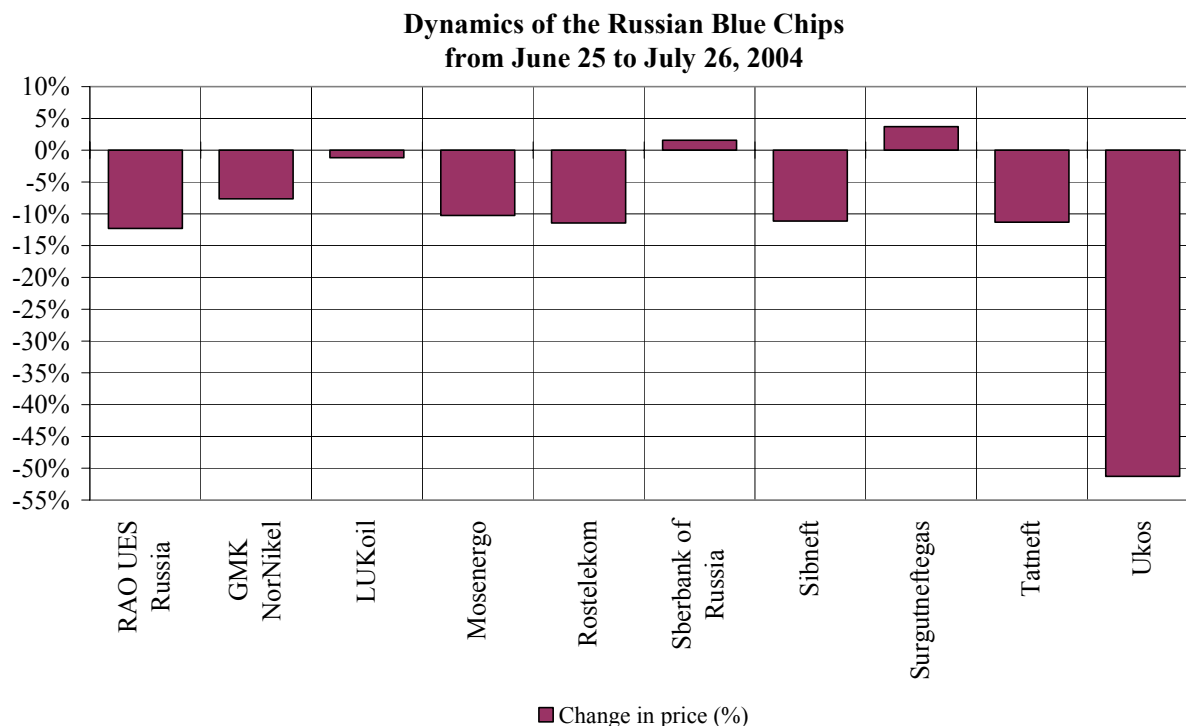


On the whole, in the period from June 25 till July 26, the RTS index decreased by 7.47 per cent, or by 40.84 points in absolute terms. Over the same period, the turnover of the RTS trading amounted to about US \$ 363.46 million (about US \$ 533 in June), while the average daily turnover at the RTS made about US \$ 16.48 million (US \$ 23.8 million in June). The highest and the lowest volumes of trade at the RTS made US \$ 28.8 million (on July 22) and US \$ 5.7 million (on July 12) as compared with US \$ 43.3 million and US \$ 11.3 million respectively in June.

Over the last month (from June 25 till July 26), practically all "blue chips" with the exception of the Sberbank of Russia (a 1.54 per cent growth) and Surgutneftegaz (a 3.7 per cent growth) demonstrated a downfall in prices. Thus, shares in the NK YUKOS (-51.29 per cent) and the RAO UES of Russia (-12.32 per cent) became leaders in terms of decrease in prices. These shares were followed by the stocks of the Rostelekom (-11.47 per cent), the Tatneft (-11.39 per cent), and shares in Sibneft (-11.15

per cent). At the same time, the shares in Surgutneftegaz fell by 4.85 per cent, while prices of Sibneft and Sberbank of Russia also declined (by 0.6 per cent and 0.34 per cent respectively).

FIGURE 4.



As on July 26, the four leaders in terms of the volume of turnover at the RTS<sup>8</sup> were as follows: the RAO UES of Russia retained its top position as the share of respective transactions amounted to 34.6 per cent of the total RTS turnover. The amount of transactions with the shares in the LUKoil was somewhat lower (21.98 per cent). The shares of YUKOS followed: the volume of transactions with this company's shares made 13.67 per cent of the total turnover. The last in top four was the NK Norilsk Nickel with 7.26 per cent of the volume of transactions at RTS. Thus, the aggregate percentage of transactions with the shares of only these four companies made about 77.5 per cent of the total turnover of trade at RTS over the period from June 28 till July 23.

As on July 26, the top five leaders of the national stock market by capitalization looked as follows<sup>9</sup>: Surgutneftegaz: US \$ 24.23 billion; LUKoil: US \$ 23.14 billion; Sibneft: US \$ 12.47 billion; MMC Norilsk Nickel: US \$ 11.02 billion; the RAO UES of Russia: US \$ 10.17 billion. It should be noted that for the first time in a long time shares in NK YUKOS were absent in the list of top five companies in terms of capitalization; the YUKOS capitalization decreased by about US \$ 10 billion over the month and made only US \$ 9.57 billion as on July 26.

**The market for fixed term contracts.** In July, the activity of investors on the RTS market for fixed term contracts (FORTS) decreased in comparison with the preceding month. Thus, in the period from July 1 till 26 the aggregate volume of trade in futures and options at the RTS amounted to about RUR 21 billion (103.5 thousand transactions; 2.83 million contracts), what was significantly below the respective indicators registered in the preceding month (turnover - RUR 32.1 billion, 127.1 thousand transactions; 4.25 million contracts).

As usual, futures contracts account for the greatest percentage of transactions: the volume of trade in these contracts made RUR 19.7 billion (2.66 million contracts, 101.24 thousand transactions) over the period under observation. As before, options were in a much lower demand: the respective amount of trading made about RUR 1.3 billion (167 thousand contracts, 2.27 thousand transactions). The

<sup>8</sup> On the classical stock market.

<sup>9</sup> According to the RTS.

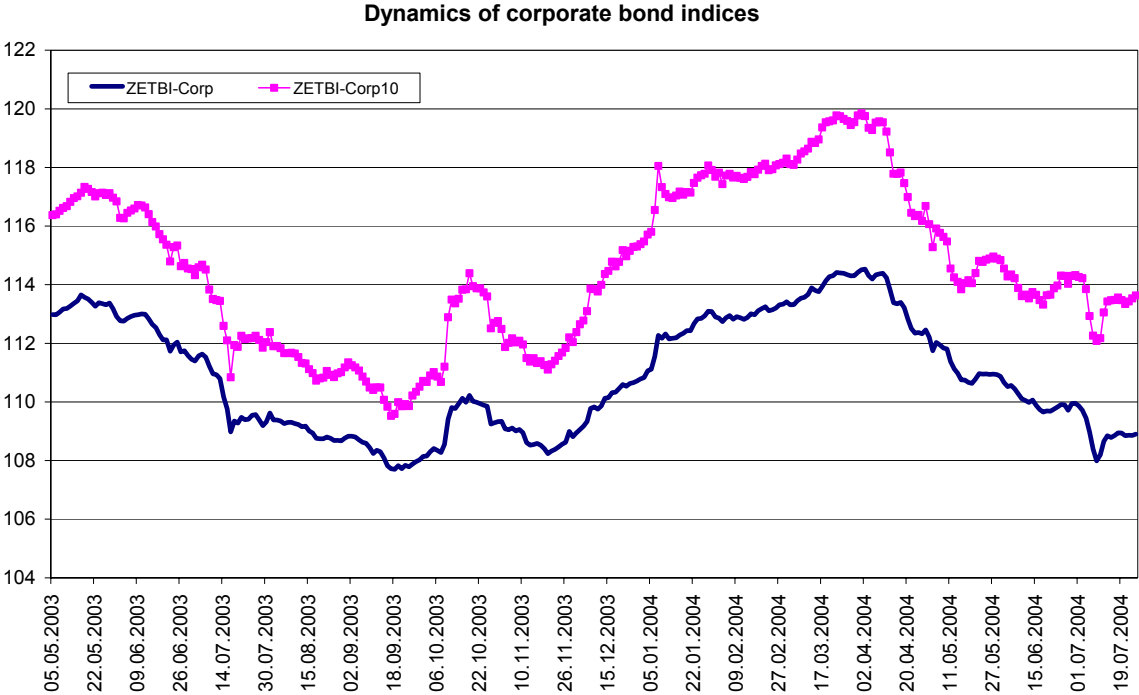
maximum trading volume was observed on July 1 and made RUR 2.21 billion, while the minimum trading volume (RUR 631.4 million) was registered on July 9.

**Corporate bond market.** Over the month, on the market of corporate bonds at large there was observed a downfall in prices. From July 1 till July 26, the price index of corporate bonds traded at the MICEX<sup>10</sup> decreased by 0.06 points (-0.88 per cent) and the index of ten most liquid corporate sector bonds decreased by 0.63 points ( by 0.63 per cent).

Over the first two weeks of the month, on the market there was observed a rapid decline in quotations of corporate securities caused by a number of negative factors: as concerns the YUKOS affair, in the beginning of the month the RF Tax Ministry put forward additional claims against the oil company as concerns taxes due in 2001, while the banking sector experienced a confidence crisis resulted in serious problems of a number of largest national banks. As depositors strived to withdraw their deposits, banks had to sell their highly liquid assets, including corporate bonds. Besides, the statement made by a representative of the S&P agency, which implied that Russia has poor perspectives as concerns an increase in its sovereign ranking because of the YUKOS affair, problems experienced by the banking sector, and a delay in the finalization of the electrical power engineering reform were among the factors negatively affected growth in yields. A certain negative impact had the decision of the Moody's agency to include almost two dozens of Russian banks in the list of organizations expecting a decrease in rankings.

The absence of new negative information about the YUKOS affair and stabilization of the liquidity situation in the banking sector after the standard rate of mandatory reserves was reduced 2 times permitted the quotations of blue chips somewhat rise at the background of growing demand on the part of large investors. However, after publication of the information about possible sale of Yuganskneftgaz company, on the market of corporate bonds, as well as across other segments of the financial market, there was observed an increase in sales resulted in a significant decline in quotations to the levels, which persisted on the market until the beginning of the last week of the month.

FIGURE 5



<sup>10</sup> The indices of corporate bonds traded at the MICEX that have been used for the calculations are calculated by Zenit Bank.



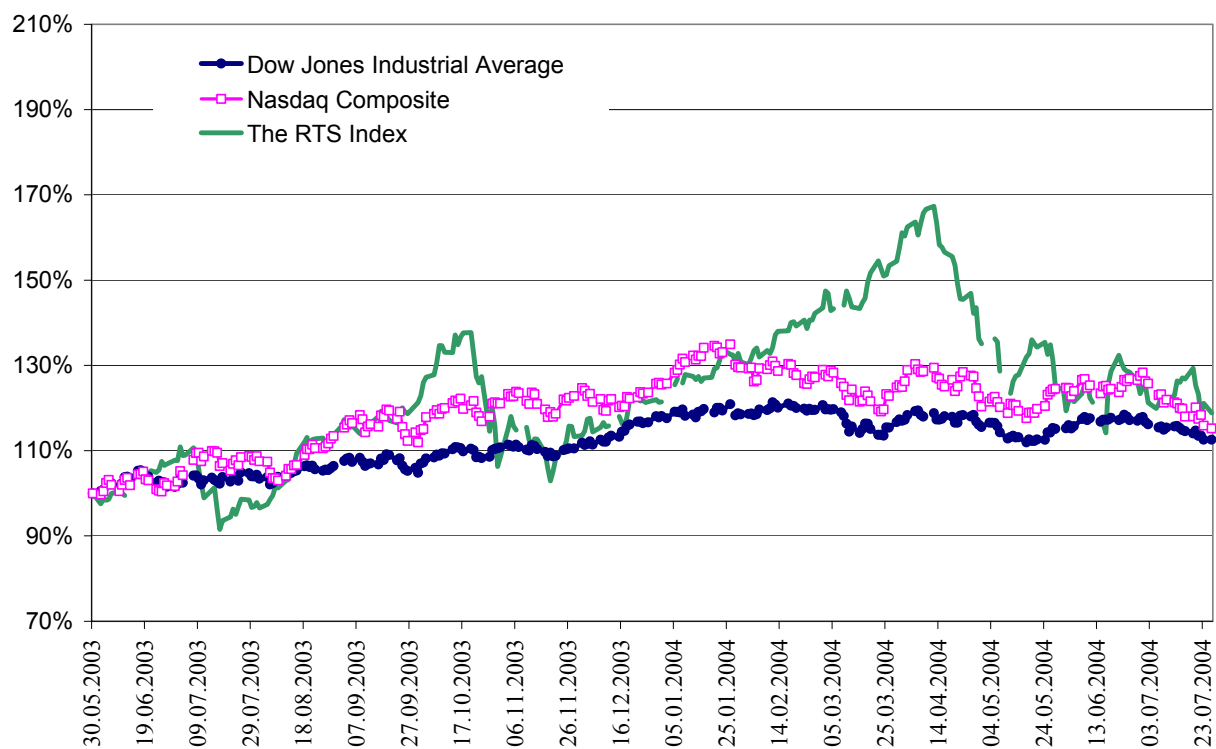
### External factors affecting the dynamics of the Russian stock market.

Throughout the month, the prices on the world oil markets remained at a high level. There should be noted several factors behind a rise in oil prices. First, the situation related to the US oil and oil products reserves still facilitates persistence of high oil prices. Besides, in July there were observed more active operations on the part of the funds, which had taken a wait and see position earlier. For instance, the quotations of the US WTI reached the six week maximum by the middle of the month (US \$ 41.8 per barrel). Besides, the unfolding of the YUKOS affair has also affected the world oil market: operators apprehended that the company might stop oil deliveries on the market. By the end of the month, the situation has somewhat stabilized and the prices persisted at the levels they had reached by that time.

Throughout the month, on the world stock markets there dominated a trend towards a worsening of the market situation. At the end of the month, stock indicators of many countries with the exception of Brazil, Chili, Singapore, and Turkey were registered at negative values (see Table 1).

In July, the leading US stock indices somewhat declined. In the beginning of the month, the US stock indices went down at the background of dominating negative economic statistics and corporate news. The most important news affecting the stock market was the rise of interest rates by 0.25 per cent to 1.25 per cent, as well as the formal transition of power in Iraq to the national government. As concerns the macroeconomic statistics, there should be noted lower than expected values of the indicators characterizing a growth of employment in the economy and persisting high oil prices on the world market. The decline of the market continued later in the month even in spite of decreasing yields of government bonds. There prevailed negative factors: high oil prices, negative forecasts of corporate results in the 2<sup>nd</sup> quarter, and the dynamics of the election campaign unfavorable for the incumbent US President.

FIGURE 6.



Therefore, summing up the developments analyzed above, it should be noted that on the whole the external environment in July remained rather neutral as concerns its impact on the Russian stock market. On the one hand, high oil prices and the favorable business situation in the Russian economy supported the markets. On the other hand, a decline of the markets in developed and developing economies facilitated a certain deterioration of the business situation. At the same time, in July internal fac-

tors had the most significant impact on the dynamics of the market of corporate securities and to a somewhat lesser degree on the dynamics of the government bond market, i.e. the further unfavorable unfolding of the YUKOS affair. In spite of the fact that each next month the stock market reacts more and more calmly to this conflict, its further escalation affects current quotations.

**Corporate news.**

*The NK LUKoil*

In the beginning of the month, the company published its consolidated financial statement for the three months of 2004 prepared in accordance with the US GAAP requirements. According to the presented reports, in the 1<sup>st</sup> quarter of 2004 the company's profits made US \$ 819 million, what was by US \$ 131 million above the figures registered in the respective period of the preceding year. The sales proceeds of the company increased by US \$ 1456 million in comparison with the figures observed in the 1<sup>st</sup> quarter of the preceding year and made US \$ 6512 million.

*The OAO NK Sibneft*

In 2003, the net consolidated profit of the company defined in accordance with the US GAAP standards increased by 96 per cent in comparison with the figures registered in 2002 and made US \$ 2.278 billion. The Sibneft proceeds increased by 41 per cent and made US \$ 6.717 billion. The company also could achieve an increase in the indicator characterizing its profit before the payment of interest, taxes, depreciation, and amortization (EBITDA) by 30 per cent.

*The RAO UES of Russia*

On July 20, the company published the financial statement of the RAO UES of Russia Group for 2003 prepared in accordance with IAS. As on December 31, 2003, the aggregate assets of the Group made RUR 1087.5 billion, fixed assets – RUR 872.2 billion. The debtor indebtedness of the Group as on December 31, 2003, made RUR 105.3 billion, what was by RUR 12.4 billion above the figures registered in 2002. In 2003, the profits of the RAO UES of Russia Group from core activities made RUR 64.5 billion, what was approximately 3.5 times above the level registered in 2002. The indicator of net profits of the Group made RUR 27 billion, what was by RUR 8 billion below the respective figures observed in 2002.

*The NK YUKOS*

On July 5, the company received the default notification forwarded by the agent of the pre-export credit amounting to US \$ 1 billion on behalf of the participants of this credit facility in connection to the latest events relating to the company and their impact on its business and assets. The notification was issued after the appeals instance of the Moscow Arbitration Court confirmed the ruling, which required YUKOS to pay RUR 99.4 billion and initiation of the respective execution proceedings on the part of bailiffs.

On July 22, the RF Ministry of Justice announced that in the framework of the initiated execution proceedings there is prepared assessment and sale of shares in the JSC Yuganskneftegaz, which is the major extraction assets of YUKOS.

Table 1.

**Dynamics of International Stock Market Indices**

<b>Data as of July 26, 2004</b>	<b>Value</b>	<b>Change within the month (%)<sup>11</sup></b>	<b>Change since the beginning of the year (%)</b>
RTS (Russia)	555.13	-7.47%	-5.28%
Dow Jones Industrial Average (USA)	9961.92	-3.95%	-4.30%
Nasdaq Composite (USA)	1839.02	-9.21%	-8.36%
S&P 500 (USA)	1084.07	-4.44%	-2.20%
FTSE 100 (UK)	4287.00	-4.61%	-4.95%
DAX-30 (Germany)	3752.61	-6.50%	-6.62%
CAC-40 (France)	3532.61	-5.61%	-1.78%
Swiss Market (Switzerland)	5444.00	-4.18%	-2.48%
Nikkei-225 (Japan)	11159.55	-5.27%	3.09%
Bovespa (Brazil)	21318.00	2.74%	-5.02%
IPC (Mexico)	9921.40	-2.62%	22.21%
IPSA (Chile)	1495.02	1.22%	0.70%
Straits Times (Singapore)	1855.98	2.79%	3.61%
Seoul Composite (South Korea)	736.21	-5.50%	-10.36%
ISE National-100 (Turkey)	18645.38	7.43%	-2.62%
Morgan Stanley Emerging Markets Free Index	418.514	-2.94%	-5.56%

**The Foreign Exchange Market.**

Throughout the month, the situation on the domestic forex market was primarily determined by high oil prices and the situation in the banking sector. In the beginning of the month, the events in the corporate sphere practically did not affect the forex market. In early July, on the market there was observed a certain appreciation of the national currency facilitated by a significant increase in the supply of forex denominated proceeds. The following development of the situation in the banking sphere resulted in a growth in the amount of trade on the foreign exchange market in spite of the vacation season, which is traditionally characterized by lower activity of market operators. However, by the end of the month the liquidity problem in the banking sector was successfully settled, what resulted in a decline in demand for US dollars and respective depreciation of the US dollar. Thus, in the period from July 1 till July 26, the US \$ / RUR exchange rate increased by about 0.046 Rubles to the level of RUR 29.09 per US \$, what made circa 0.16 per cent.

This July, the Ruble liquidity in the banking sector significantly increased in comparison with the figures registered in the preceding month: in July, the average balances of correspondent accounts of credit organizations with the Bank of Russia made RUR 204.7 billion as compared with RUR 171.3 billion registered in June of 2004.

<sup>11</sup> As compared to the level registered on June 25.

FIGURE 7.

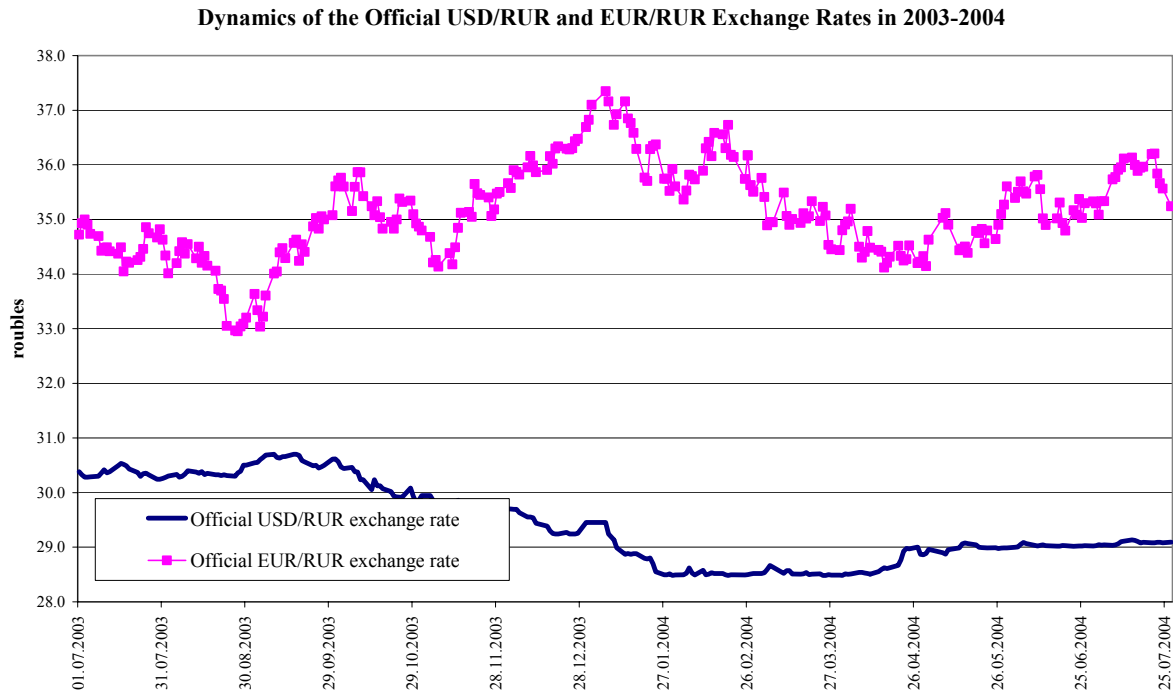
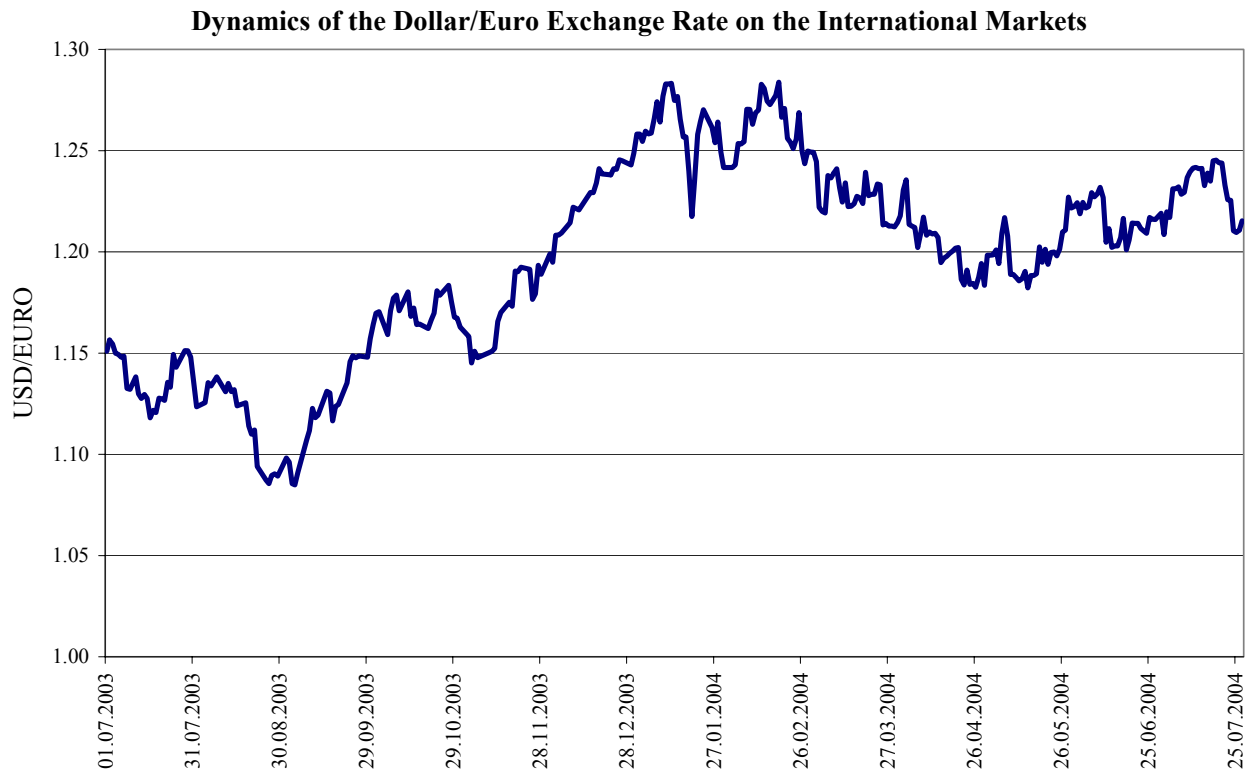


FIGURE 8.



In July, on the world forex market the US dollar appreciated in spite of slower rates of economic growth and declining foreign investment in the US economy. The major factor behind these dynamics was the statement made by A. Greenspan, the Chairman of the US FRS, which gave rise to expectations of a further increase in the US interest rates already in August. As a result, in the period from

July 1 till July 26 the Euro exchange rate decreased by US \$ 0.0045 (-0.27 per cent) making US \$ 1.215 per Euro.

The dynamics of the Euro / Ruble rate were mainly determined by the trends on the world market. In the period from July 1 till July 27, the European currency appreciated by RUR 0.15 (0.43 per cent) from RUR 35.09 per Euro and made RUR 35.24 per Euro.

Table 2

### Financial Markets Indicators

Month	March	April	May	June	July*
Monthly inflation rate	0,8%	1,0%	0,7%	0,8%	0,5
Inflation rate annualized on the basis of this month's trend	10,03%	12,68%	8,73%	10,03%	6,2%
CB RF refinancing rate	14%	14%	14%	13%	13%
Annualized yield to maturity on OFZ issues (%)	6,78%	6,78%	7,04		
Volume of trading in the secondary GKO-OFZ market for the month (RUR billion)	50,55	21,72	19,67		
Yield to maturity on Minfin bonds at the end of the month (% p.a.)					
5th tranche	4,99%	6,38%	6,52%	6,71%	6,5%
6th tranche	3,54%	4,31%	4,91%	4,92%	4,7%
7th tranche	5,93%	7,25%	7,31%	7,68%	7,3%
8th tranche	4,22%	4,58%	5,41%	5,49%	5,3%
Yield to maturity of Eurobonds at the end of the month (% p.a.)					
2005	2,40%	3,00%	3,35%	3,39%	7,7%
2007	3,90%	5,11%	5,07%	5,28%	5,6%
2010	5,51%	6,34%	6,36%	6,52%	7,9%
2018	6,56%	7,53%	7,81%	7,87%	8,5%
2028	7,07%	8,10%	8,22%	8,29%	8,5%
2030	6,88%	7,97%	8,00%	8,09%	8,1%
INSTAR-MIACR rate (% p.a.) on interbank overnight loans at the end of the month	6,19%	17,54%	21,18%	11,38%	4,0%
Official RUR / US\$ exchange rate at the end of the month	28,4853	28,8834	28,9850	29,0274	29,09
Official RUR / Euro exchange rate at the end of the month	34,8005	34,1431	35,6052	35,2915	35,10
Average annualized growth in RUR / US\$ exchange rate	-0,11%	1,40%	0,35%	0,15%	0,22%
Average annualized growth in RUR / Euro exchange rate	-1,99%	-1,89%	4,28%	-0,88%	-0,54%
Volume of trading at the stock market in the RTS for the month (US\$ million)	613,91	830,27	419,36	482,07	350
Value of RTS-1 Index at the end of the month	755,43	634,61	581,47	583,32	520
Change in value of RTS-1 Index during the month (%)	12,73%	-15,99%	-8,37%	0,32%	-11%

\* Estimate

D. Polevoy

## The Real Sector of the Economy: Factors and Trends

According to the preliminary results of the first six months of 2004, the amount of GDP increased by 7.4 per cent in comparison with the figures registered in the respective period of the preceding year. This year, the structure of the final demand changes on the impact of the outpacing growth in gross accumulation as compared with the final consumption of households. In the first six months of 2004, the increase in investment in fixed assets made 12.6 per cent in comparison with the figures observed in the respective period of the last year and completely determined the dynamics of economic growth.

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

According to the preliminary results of the first six months of 2004, the amount of GDP increased by 7.4 per cent in comparison with the figures registered in the respective period of the preceding year. The increasing rates of growth were observed across practically all sectors of the economy and branches of industry. In comparison with the figures registered in the first six month of 2003, the volume of industrial output increased by 7.4 per cent, while construction grew by 14.2 per cent. As concerns the sector of services, the most intensive growth was observed in the infrastructure sectors: the increase in the amount of communication services made 28.8 per cent, retail trade turnover – 11.0 per cent, freight turnover – 7.8 per cent as compared with the figures registered in the first six months of 2004. The positive dynamics of development of the base sectors of the economy was supported by the exceptionally favorable business situation on world markets of energy resources and metals. In January through June of 2004, the amount of exports increased by 22.3 per cent as compared with the figures registered in the respective period of the preceding year.

The level of concentration in the narrow group of raw commodities and materials has significantly over the last years and was accompanied by growing dependence of the rates of growth in Russian exports on the price fluctuations on world raw materials markets. In the exceptionally favorable external economic situation, in January through May of 2004 the increase in export of crude oil was by 9.3 p. p. above the figures registered in the respective period of the preceding year, while over the same period export of ferrous metals grew by 38.3 per cent, aluminum – by 30.8 per cent, mineral fertilizers – by 12.1 per cent, timber – by 21.5 per cent. The domination of fuel and raw material commodities in the structure of Russian exports has determined the extremely small degree of diversification of foreign economic ties. The specific weight of machinery and equipment in the total amount of exports persisted in the band from 7 per cent to 9 per cent, while the share of fuel and energy resources and metals increased to 57.4 per cent and 19.5 per cent respectively.

At the background of stable expansion of external demand, export oriented industries have retained their leading positions in the Russian economy. In the first six months of this year, the production index in fuel industry made 108.2 per cent, including oil extracting branch – 110 per cent. Over the same period, output of ferrous and non-ferrous metallurgy increased by 5.5 per cent and 3.9 per cent respectively, while output of chemistry grew by 9.1 per cent.

Due to high profitability of export operations, by the end of the period from January till May of 2004 the net financial results demonstrated by the export oriented sector by almost 35 p. p. exceeded the aggregate industrial indicators. In January through May of this year, the net profit of fuel industry increased 1.8 times, while ferrous and nonferrous metallurgy demonstrated growth 2.1 times and 1.5 times respectively. At the same time, the respective indicator in chemistry grew 1.4 times. The exceptionally favorable price situation on the world markets of energy resources and metals, as well as a growth in proceeds of exporters have initiated transformational shifts on the domestic market. As the rates of growth in production across manufacturing industries, the net financial results of mechanical engineering, industry of construction materials, and food industry became positive. The increase in net profits of mechanical engineering made 7.4 per cent, food industry – 20.3 per cent, and industry of construction materials – 2.3 times.

In January through June of 2004, the increase in production of goods of final demand reached 12.8 per cent, while the output of industries within the investment complex made 13.7 per cent, and consumer complex grew by 5.3 per cent. Mechanical engineering (114.9 per cent in comparison with the figures registered in January through June of 2003) and the industry of construction materials (108.5 per cent) have most significantly affected the structural changes in industry. In spite of the fact that output of mechanical engineering outpaced investment in fixed assets, the balance of the market of capital goods was supported due to the outpacing rates of growth in the import of machinery and equipment. According to the data presented by the Federal Customs Service, in January through May of 2004, the specific weight of machinery, equipment, and vehicles in the total amount of imports made 47.3 per cent as compared with 38.9 per cent registered in the respective period of the preceding

year. By the end of the 1<sup>st</sup> quarter of 2004, the share of imported machinery and equipment made 23.5 per cent of the total amount of respective investment expenditures.

The moderate dynamics of domestic production of consumer goods have been a specific feature of the development of the Russian economy over the last two years. In the first six months of 2004, there were registered accelerating rates of growth in food industry (up to 6.1 per cent as compared with 4.3 per cent observed in the respective period of the preceding year). These developments resulted in an increase of the share of domestic products in the structure of the commodity resources of the food market. The high competitive capacity of Russian food products was determined by both relatively low price levels and the successful adaptation of production to the traditional structure of consumer preferences, and an active investment policy aimed at modernization and reconstruction the industry has been pursuing since the start of the economic reforms in 1992. As concerns the rates of renewal of production capacities, the food industry is leading among other industries. Over the last five years, the rate of renewal of fixed assets in the food industry made 2.9 per cent, while the average rate across industries made 1.5 per cent. The expansion of competitive production capacities of the food industries on the modern technological basis was a factor checking growth in imports. In the first six months of 2004, the specific weight of foods and respective raw produce in the total amount of imports was at 19.1 per cent, what was by 4.5 per cent below the level registered in the preceding year. Besides, it should be noted such principal aspects as changes in the structure of turnover of both retail trade and imports in favor of organized forms of these activities, as well as formation of structures promoting domestic products on the Russian domestic market.

The market of nonfood goods is negatively affected by the permanent crisis of the domestic light industry. The situation is aggravated by the fact that the low activity of Russian businesses in this sector of the economy at the background of outpacing rates of growth in real household incomes, wages, and salaries provokes aggressive import. Although this year there appeared a trend towards deceleration of the rates of growth and even decline in the share of textile goods in the structure of imports, this development failed to create incentives for the way the enterprises in this segment operated. In the first six months of 2004, the decline in output in light industry made 3.9 per cent in comparison with the figures registered in the respective period of the preceding year, as the downfall of production of textile industry and clothing industry made 3.7 per cent and 12.5 per cent respectively.

This year, the stable expansion of final household consumption was determined by a gradual improvement of the social parameters of economic development. In the first six months of 2004, the increase in real household incomes made 9.8 per cent in comparison with the figures observed in the respective period of the last year, while real wages and salaries and real gross pensions grew by 14.1 per cent and 6.8 per cent respectively.

The increasing effective demand on the part of households resulted in an intensive growth in the retail trade turnover. Similarly to the situation observed last year, the dominating impact on the retail trade had the outpacing rates of growth of the market of nonfood goods. While the turnover of retail trade increased in comparison with the figures registered in the first six months of 2004 by 11.1 per cent, the growth in sales of food products and nonfood goods made 9.5 per cent and 12.5 per cent respectively. To a certain extent, these developments were determined by abating inflation rates and structural changes across major commodity groups. As consumer prices increased by 6.1 per cent in the first six months of 2004, over the same period the prices of food products and nonfood goods grew by 6.0 per cent and 3.4 per cent respectively. It should be noted that at the existing level of incomes statistical surveys reveal changes in the structure of sales of food products in favor of more expensive goods. The share of consumer expenditures in the structure of utilization of cash incomes made 71.3 per cent in the first six months of 2004 and somewhat increased in comparison with the figures registered in the respective period of the preceding year. However, these developments have not affected the trend towards an increase in the higher household propensity to save. In the first six months of 2004, the share of savings in the structure of household expenditures made 12.9 per cent increasing by 1.0 p. p. in comparison with the level observed in the respective period of the last year.

The structural shifts in utilization of household financial resources were accompanied by changes in the distribution of the population across average per capita incomes. At the same time, there was noted a trend towards a decline in the share of poor households. The size of the population with cash incomes below the subsistence level made 29.8 million in the 2<sup>nd</sup> quarter of 2004 (20.8 per cent of the total size of the population) as compared with 33.7 million (23.5 per cent) registered in the respective

period of 2003. The stable growth in real household incomes observed since 2000 was a factor positively affecting the decline in the level of poverty.

Since wages and salaries account for almost 70 per cent of the aggregate household incomes, a key factor determining the parameters of social development is the level of employment. According to the data of a sample employment survey published by the RF Goskomstat, in January through June of 2004 the size of employment in the economy increased by 1.8 per cent in comparison with the levels observed a year ago and made 66.6 million. The total number of unemployed calculated in accordance with the ILO methodology has declined by 211 thousand since January of 2004 and made 6.1 million by the end of June (7.9 per cent of the economically active population). The coefficient of tension (the number of unemployed citizens registered with employment agencies per vacancy) decreased from 2.3 in January of 2004 to 1.7 this June. The changes on the labor market resulted from increasing rates of economic growth.

*O. I. Izryadnova*

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## **The Situation in the Industrial Sector in July 2004**

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High growth rates of demand and output through the first half year led to a considerable improvement of the enterprises' state. However, the stop of growth of their sales in July can impede the take-off of the national economy. It has already resulted in the dynamics of sales greatly lagging behind the dynamics of output and in an overestimation of capacities and personnel.

According to the Center for Macroeconomic Analysis and Short-term Forecasting, the national economy retain an intense rise. The dynamics of GDP in the 2<sup>nd</sup> quarter averaged 0.5% a month, which is just slightly lower than the respective index of the 1<sup>st</sup> quarter. Some slowdown of the rise can be explained by a deceleration of the growth in market services and primarily the contraction in the volumes of paid services delivered to the population. The transportation services still remain stagnant. By contrast, the output in the industrial sector accelerated drastically. The dynamics of daily output averaged 0.7% a month vs. 0.4% reported in the 1<sup>st</sup> quarter. The structure of the industrial rise in the 2<sup>nd</sup> quarter testifies to a notable intensification of influence on economic growth on the part of domestic demand, while the one of mineral exports was weakening. The processing industries ensured nearly half of the increment in the industrial output between April through June, while in the 1<sup>st</sup> quarter their contribution to that accounted just for 17%. These structural changes mirror a key specificity of the 2<sup>nd</sup> quarter: that is, the change of factors of economic growth. Those are: a considerable slowdown of the dynamics of the physical volume of export vis-a-vis the growth in exporters' nominal revenues; the growing salaries and wages fueled by the rise in the companies' revenues; the growing turnover in the retail trade sector; an over-intensive rise in investment in capital assets under the pressure of competing imports and favorable opportunities for borrowing overseas.

However, against the above background the first data on the state of the national industrial sector in July also highlighted negative trends.

First, after the five-month period of fairly intense growth, effective demand discontinued to grow further in July. The balance (after exclusion of seasonality) became negative – for the first time since January the proportion of reports on lowering cash sales has become greater than the one of reports on growing sales. Negative trends (an absolute fall or slowdown of growth) were registered nearly in all the sectors. It was only the fuel industry and ferrous metallurgy whose pace of sales showed growth.

Second, the proportions of enterprises with excessive capacities and personnel have grown. After a steady decline (capacity excess) and stabilization at a low level (personnel excess) these indices grew by 5 points each immediately at the start of the new quarter. The rise in the proportion of enterprises with excessive capacities appeared especially drastic in the machine-engineering sector and forestry, while that of enterprises with excessive personnel – in the sector for electricity and machine engineering. Noteworthy is that the assessment of the excessive parameters is linked to envisaged changes in demand.

Third, while speaking of the structure of impediments to a rise in industrial output, for the second quarter straight the enterprises increasingly cite the shortage of liquid assets, while the share of references to competing imports has grown for the fourth quarter straight. As a result, the latter indicator has now reached its absolute maximum, which is 26%, while in July 1998 it accounted only for 12%. In July 2004 the sectors that suffered the most from imports were: the light industry (39% vs. 27% in



July 1998), machine engineering (30 and 13%, respectively), and the food-processing industry (28 and 25%).

Still, the enterprises give more positive than negative signals.

Despite the decline in sales, enterprises have not yet revised their assessments of demand. Furthermore, in July the proportion of normal assessments hit 57%, which is an absolute maximum value. All the sectors but the light industry report a high satisfaction with demand. In the light industry, the proportion of normal estimates made up only 26%. The balance of assessments (above- below norm) across the industrial sector as a whole made up the best value over 11 past years of observations.

The optimistic assessments of demand enable enterprises to maintain high output growth rates. However, under the volumes of demand declining, this results in output increasingly advancing vis-a-vis sales. In July, such a phenomenon was registered at 32% of enterprises (which has not been noted since November 2001) vs. 24% reported in June. An absolute decline in output was noted only in the light industry. Interestingly, once the pest for the national industrial sector, non-payments play an increasingly lesser part among the impediments to output. At present they hamper operations only at 15% of enterprises, and they sank to the bottom of their list of impediments to output.

The stock of finished goods has not yet reacted to the discontinuation of growth in July. The balance of assessments grew by 4 points, but has failed to overshoot the maximum values reported this and over the prior years. The share of normal assessments remained unchanged. Most of industries maintain their reserves of finished goods at the normal level, except for the forestry complex that has reported a drastic rise in excessive stock. By contrast, the food-processing sector reported their shortage.

The high rates of growth and output in 2004 enabled enterprises to considerably improve their financial and economic situation. In July, the proportion of assessments "bad" sank to its absolute minimum (16%), while the share of assessments "very bad" has been 1-2% over the past two quarters. Most enterprises (70%) view their situation as satisfactory. As a result the balance of assessments of their economic situation hit -8%. It had not ever been up to -70% prior to August 1008, while the share of the respective assessments did not exceed 30%.

The forecasts of change in demand have stayed nearly still over last months, with not less than 60% of enterprises forecasting maintenance of their levels of sales, while three others hoped for boosting them. Such hopes are particularly great in the light, fuel and food-processing industries.

The plans of changing output have been just as the same- they stabilized within the range +31...+34%. The July balance (after exclusion seasonality) accounts for +33%, and traditionally it appears more optimistic than the one of forecasts of sales. The most intense rise in output is envisaged in the light industry, the sector for chemicals and petrochemicals, and machine-engineering.

The high pace of output and stable forecasts of sales fuel the enterprises' plans to employ new personnel. In July, the balance of the plans has become positive once again, meaning that there are more industrial enterprises planning to take in new employees than those that are keen to carry out downsizing. Enterprise heads in the building sector, food-processing and machine-engineering appeared particularly optimistic in this respect. nearly one-fourth of industrial enterprises report that the shortage of qualified personnel forms a major impediment to their production rise.

*S. Tsukhlo*

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## **Reform of sugar market regime in the EU**

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The EU announced liberalization of its most regulated agrifood sub-sector – the sugar one. The reform is to come into force in July 2005 and be implemented in two stages within three years. For Russia its aftereffects may be double-sided and affecting not only and not so much sugar production as production of grain, sunflower seeds and meat. Besides, the new EU sugar regime can weaken Russia's position when negotiating respective issues with WTO.

In July the European Commission proposed for discussion an unprecedented document – suggestions on reforming sugar regime in the EU.

The effective EU sugar regime (CMO) had been for long excluded from the process of reforming Common agricultural policies (CAP). It was established in 1968 and since then remained almost unchanged.

In compliance with this regime an intervention price is set (beginning from 1993/1994 it equals 631.9 EUR per ton of white sugar and 523.7 EUR per ton of raw sugar<sup>12</sup>). However, the level of protection against import is such that domestic sugar prices haven't fallen to the intervention boundary for a long time. Production quotas of two types – A and B – are distributed between countries, and, respectively, producers. They indicate the maximum sugar output that is eligible for support. Their purpose is: 1) to limit supply on the domestic market; 2) to reduce the Union's expenditures on supporting the regime; 3) to ensure each country-member access to the domestic market. Production in excess of these quotas (sometimes called quota C) is not supported; sugar is to be exported from the EU. The total quota (A+B) for 25 countries is 17.4 million tons of which 82% is quota A and 18% is quota B. When producing sugar within quota A processors pay farmers 46.72 EUR per ton of sugar beets, within quota B – 32.42 EUR. Besides, quotas are set for sugar substitutes: isoglucose and inulin syrup.

The mechanism of quotas is supplemented with foreign trade regulation. Import tariff is composed of two duties: permanent and variable. At present permanent duty equals 419 EUR per ton of white sugar and 329 EUR per ton of raw sugar. Variable duty is to mitigate the world market volatility and therefore it varies (in 2003 it averaged 115 EUR, in 2002 – 87 EUR). Such a regime obviously requires export compensations since domestic price becomes higher than the world one (e.g. in 2003 export price averaged 223 EUR, and export compensation equaled 485 EUR). Besides, the EU has trade agreements with certain groups of countries (first of all, with ACP – African, Caribbean and Pacific countries) envisaging preferential import quotas.

As a result profits of the EU farmers growing sugar beets are 1.7 fold higher than in agriculture in general. Sugar beets are produced in all countries except Luxemburg, i.e. even in marginal areas. The EU is not only the largest producer of sugar but also its net exporter: exports exceed 5 million tons which is one third of gross output and three fold above imports. Sugar production is rather intensely concentrating in the largest enterprises – after the regime was introduced the number of plants dropped from 340 to 135 and the number of their employees almost halved. Although reducing in recent years, net expenditures (market operators pay a certain tax on production) on sugar regime in the EU amount to 1.5-2 billion EUR per annum. Domestic sugar price is well above the world prices (retail prices for sugar in the EU are approximately 1.5 fold higher than in the US and 2 fold higher than in Canada and Australia). Finally, according to expert judgment the balance of favourable and adverse effects of sugar beets growing on ecology is rather negative than positive.

It's obvious that the regime entails notable redistribution of subsidies in favour of sugar sector at the expense of other agricultural producers and consumers, standing aside from the general process of agricultural markets' liberalization initiated by WTO Agricultural agreement in 1994. It enables marginal producers in the EU to remain on the market constraining growth of more efficient ones. The procedure of quotas' distribution by countries disrupts the common market space and prevents producers' benefiting from their areas' comparative advantages.

This regime has long been severely criticized by industrial sugar consumers and by developing countries whose cheap cane sugar has no access to the European market (surely, except for countries having preferential quotas). Already in 2003 preparatory works were underway, 4 variants of reform were discussed (ranging from an actual preservation of the effective regime to the complete liberalization of the market). At last, the agricultural commissioner Mr. Fishler declared introduction of a new regime beginning from July 2005 that will be effected in two stages giving market operators time to adjust.

The reform essentials are as follows:

- lowering of intervention price down to 421 EUR within 3 years;
- lowering of minimal purchase price for sugar beets down to 27.4 EUR in two stages within three years;
- discontinuation of government purchases for supporting intervention price, their substitution with storage by private entities;
- reduction of annual production quota to 14.6 million tons within 4 years;
- reduction of subsidized exports from current 2.4 million tons to 0.4 million tons;

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<sup>12</sup> For instance, in Russia the effective support price for white sugar is 500 USD per ton.

- compensatory (about 60% of the lost revenue) payments to farmers not tied to production volumes (an already familiar mechanism earlier used in other sectors);
- permission to transfer quota to producers in other EU countries;
- compensations to plants quitting the sector amounting to 350 EUR per ton of produced sugar.

These suggestions are so far brought up for discussion and thus it's still difficult to assume their consequences for the Russian agricultural sector. Since no changes are envisaged in the import regime, domestic sugar producers will hardly get a chance to export sugar to the EU. On the contrary, in the medium term the comparative advantages of European sugar industry will grow due to supply of cheaper raw sugar from the southern hemisphere. This, in turn, can result in bigger imports of white sugar to Russia.

At the same time the obviously following reduction of sugar beets production in the West and East European countries will entail larger production of grains, legumes and oilseeds resulting in lower prices and consequently in weakening of the Russia's export potential.

It's not yet clear how will the decrease of sugar beets production influence the European livestock breeding that is complementary for this sector. In case production of pork gets smaller, the dumping pressure on the Russian market may lessen.

Finally, the liberalization of sugar regime in the EU can strengthen positions of proponents of smaller support to the sector during the new WTO round. Then it will more difficult for Russia to "sell" the variable duty on sugar introduced at the end of 2003 (see the previous survey).

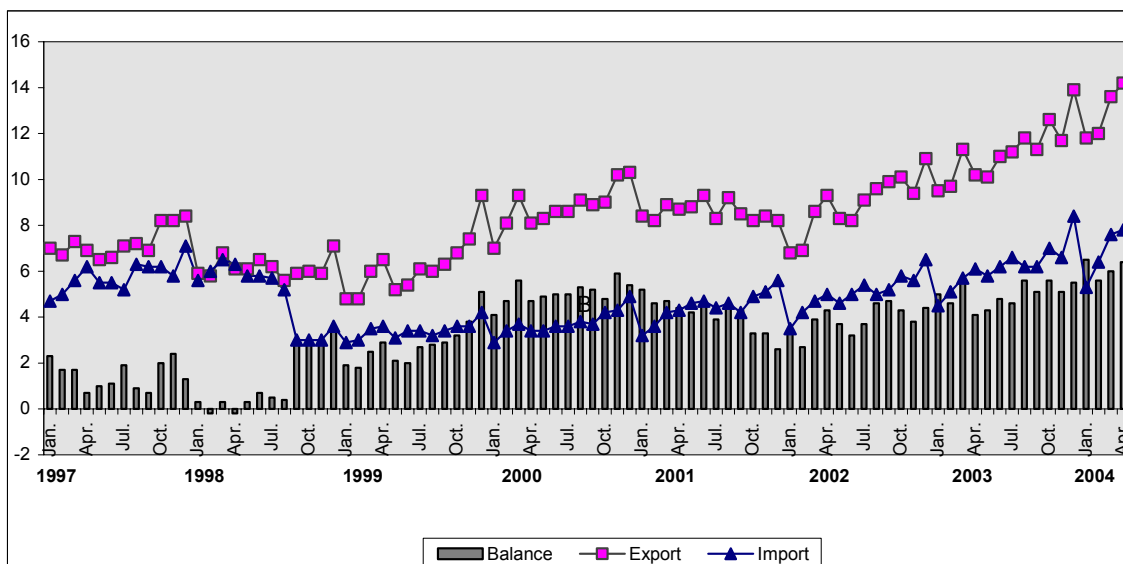
*E. Serova*

## Foreign Trade

The favorable state of affairs in the world markets and the rising population's and enterprises' effective demand fuel the maintenance of positive dynamics of development of the nation's foreign trade. Both export and import supplies continue to grow.

The regular round of the talks on Russia's accession to WTO caused new problems for the country, for it complicated negotiations with China, USA and Brazil.

The comprehensive Russia-US steel trade agreement expired on July 12, which means that Russian metal producers now can supply their produce to the US without any quotas.



Source: Goskomstat of RF, CB of RF

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

The favorable state of affairs in the world markets and the growing effective demand contribute to a steady rise in main indices of Russia's foreign trade. Though dropped slightly in May 2004 vs. April, the foreign trade growth rates remained fairly high vis-a-vis the respective indices of the prior year. In May 2004 Russia's foreign trade turnover accounted for SD 20.8 bln., or at 26.8% more than in May

2003. Export supplies grew by 27.9% and made up USD 13.4 bln., while imports soared by 26.4% and made a total of USD 7.4 bln.

The rise in the value volume of exports became possible primarily thanks to an outstanding price situation for energy sources and non-ferrous metals in the world markets.

*Table 1*

**Averaged World Prices in May of the Respective Year**

	1996	1997	1998	1999	2000	2001	2002	2003	2004
Oil (Brent), USD/barrel	19,29	19,00	14,51	15,91	27,50	28,71	25,21	25,34	37,9
Natural gas, USD/1 mln. BTE		2,271	2,187	2,349	3,724	4,220	3,254	5,984	6,465
Motor gasoline, USD/gallon	0,678	0,634	0,513	0,529	0,957	1,095	0,767	0,835	1,342
Copper, USD/t	2756,7	2480,4	1736,2	1539,9	1834,7	1708,2	1596,2	1667,5	2720,0
Aluminum, USD/t	1623,0	1618,9	1370,6	1317,9	1464,7	1536,7	1344,3	1397,6	1615,7
Nickel, USD/t	8135,2	7468,1	5058,3	5239,5	10141,4	7115,7	6764,0	8351,9	11068

Source: computed basing on the data of London Metal Exchange (UK), the International Oil Exchange (London, UK)

In May 2004 the oil prices were at an unprecedentedly high level, with the Urals prices averaged USD 35.3/barrel (+17.6% vs. April 2004), while Brent prices hit USD 37.9/barrel (+13.1%). The price rise for oil was fueled particularly by an unusually high demand for gas in the US and the growing instability in the oil-producing countries.

As a result, since August 1, 2004, the RF Government raised the export customs duty on crude oil up to USD 69.9/t. and the one on oil products – up to USD 45.4/t., which is equivalent 65% of the upper marginal export customs duty on crude oil. Prior to August 1, the export customs duties on the noted commodities were USD 41.6/t. The customs duty rates on light distillates and products, medium distillates, gasoil, liquid fuel, propane and butane were set at the level of USD 37.4/t.

The contractual prices for natural gas grew in May 2004 at 11.7% vs. the prior month.

By contrast, the markets for non-ferrous metals underwent some price downfalls: more specifically, in May 2004 the average price for nickel was USD 11,068/t. (less 14% vs. April 2004), aluminum – 1,615/t. (minus 6.8%), copper- 2,270 (minus 7.8%).

The rise in import supplies is fueled by intense dynamics of the consumer demand, which is fueled by a rapid growth in the population's real disposable incomes. Between January through May 2004 they grew by 9.9% vs. their respective period of 2003.

According to the official statistics, in May the Russia-CIS trade turnover accounted for USD 3.83 bln., with Russia's exports showing a 41.9% growth vs. May 2003 and worth a total of USD 2.15 bln., while imports soared by 53.85 and made up USD 1.68 bln.

At their July meeting Heads of customs agencies of the Union State of Russia and Belarus discussed problems of operations in the single customs zone under the cancellation of the customs administrative border between the two countries. They agreed that a uniform customs tariff might be introduced by the end of 2004.

In July the Government approved methodological recommendations for designing drafts of international legal documents in the frame of the Agreement of September 19, 2003 on formation of a single economic zone (SEZ) embracing Russia, Ukraine, Kazakhstan, and Belarus. The methodological recommendations would allow to unify the format of documents to be drafted to cover such problems as the customs and tariff regulation, public procurements, forex regulation, capital and workforce mobility.

In July, the RF Ministry for Economic Development and Trade issued an official notification of the commencement of an investigation into the dumping Ukrainian import of some kinds of steel pipes. More specifically, that concerns boiler, pumping and compressor, bearing, oil- and gas- pipeline pipes, to name a few. For example, the Ukrainian boiler pipes are sold at a price being at 10% lower than Russian ones, while the prices for bearing pipes are twice lower than the Russian. The overall 2004 quota for the Ukrainian producers was set at the level of 620,000 t. of pipe products. Let us remember that, despite the introduction of quotas, between 2002-2003, because of the Ukrainian dumping supplies, Russian producers lost orders for 710,000 t. of pipes.

In July, Russia entered into the regular round of its accession to WTO. After Russia and the EU signed the protocol on completion of negotiations on the issue, Russia was to clear last disagreements

with the US (on the state support of the aircraft industry and protection of intellectual property), Japan (on customs duties on automobiles), and China (mostly on customs duties on light industry produce).

But all of a sudden China resumed already seemingly agreed upon issue: that is, the Chinese demanded to raise domestic prices for gas and electricity up to the world ones, though China has never raised the issue before – their demands were: one day – to ensure a free accession of the Chinese workforce to Russia's labor market, while on the other day – either registration procedures for Chinese companies in Russia's territory, or lowering customs duties on textile, leather and footwear.

Ultimately China dismissed its demand to increase domestic gas prices, but it is still too premature to believe the final protocol with the Chinese will be signed shortly. Nonetheless, it has become clear that Beijing expects Moscow to be more tractable with respect to the export of Russian carbohydrates to China. A representative of the Chinese oil corporation argued that China hoped that its more moderate stance with respect to Russia's joining WTO and particularly the problem of tariffs for natural gas would help to sign the agreement on Russian gas supplies to China at a beneficial price.

Equally unexpectedly, Russia was challenged by the US and Brazil. The latter insists that the RF Government has inaccurately computed meat tariff quotas. Let us remember that because of prohibitive duties effective as of January 1, 2003, it became practically impossible to supply over 500,000 t. of pork and beef into Russia. The importer nations received their quotas basing on the data on the meat import over the period between 1999 through 2001 (in compliance with the WTO procedures, the country quota should be computed basing on the data for the three year period prior to the decision on introduction of a tariff quota). Most of importers did not protest, but the Brazilians argue that they started their meat supplies to Russia only in 2002, that is why their part of the quota appeared unjustly lowered (some 26,000 t.).

Moscow has also rejected the US' s demand concerning the protection of intellectual property: that is, to liquidate both the contrafact products and the equipment with which they were produced. This particular case concerns undertaking obligations that are not subject to the WTO procedures, for they do not imply elimination of any equipment.

On 12 July the US-Russia Comprehensive Agreement on Steel came to its end. The Agreement was signed in summer 1999 and allowed the Russian producers to get back to the US market, as it cancelled then effective customs duties. The Agreement quoted supplies of the major part of ferrous metal produce, including cast iron, cold-rolled steel, etc. The size of the quota was revised several times.

From the above date on the Russian metal producers can export their products to the US without any limitations. But currently supplies to the US market do not appear very attractive. For instance, in February 2003 the US allowed the Russians to supply annually extra 1 mln. t. of cast iron and 125,000 t. square pipe intermediates (before that 600,000 t. and 75,000 t., respectively). As a result, the volume of Russian supplies grew by nearly \$ 190 mln. But the market situation changed drastically last summer, and all Russia's export supplies were re-oriented towards the South- East Asian market.

It was in the late 1990s that the US were a major export market for the national metal producers, and thee metal supplies there broke a record volume in 1998 when until September they accounted for 5 mln.t. However, that month the US government initiated a series of anti-dumping investigations against the Russian producers and consequently introduced increased duties on their exports. That was followed by the signing of the Comprehensive Agreement, and the US cancelled the duties and introduced the quotas instead.

Five years after, productions costs in Russia grew substantially, and the Russian metal plants even failed to meet the existing quotas. Their supplies accounted for 0...40% of those. The Russian metal producers' comeback would happen following the further downfall of prices in China. Since April 2004 the average price fall there was 15% and currently account for \$ 425 for 1 t. of hot-rolled and \$520 for 1 t. of cold-rolled produce, which is much lower than in Europe (\$570 and 660) and the US (\$605 and 665, respectively).

*N. Volovik, N. Leonova*

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## **The Agenda of the Government Meetings of 1, 15 and 22 July 2004**

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The text below highlights the most interesting documents of all those considered at the Government meetings in July. At the meeting on July 1, the RF MinFin presented a new draft Strategy of Development of the Banking Sector of RF (hereinafter referred to as "Strategy") for 2004 and further up to

2008. The document sets main objectives and guidelines for the development of the national banking sector and the envisaged outcomes from the Strategy implementation. At the meeting of 15 July, the MinFin presented a report entitled "On results of implementation of the domestic and foreign borrowing programs of the Russian Federation in 2003 and draft domestic and foreign borrowing programs of the Russian Federation for 2005". On July 22, the RF Minister of Finance A. Kudrin presented a report entitled "On the draft federal law "On introduction of changes into Chapter 25 of the Tax Code of the Russian Federation" (in the part of exemption from the corporate profit tax of the compulsory medical insurance funds that insurance medical companies spend on forming a reserve of funding preventive measures)". The document contains a proposal to exempt the funds that insurance organizations that deal with the compulsory medical insurance forward to the reserve of preventive measures. As well, the document proposes not to include the value of assets medical organizations receive from insurance medical organizations and procured at the expense of the noted reserve in the medical organizations' revenues.

#### The Government Meeting of July 1, 2004

At the Government meeting on July 1, 2004, the RF MinFin presented the said Strategy.

According to the Ministry, the main objectives for further development of the national banking sector are: boosting the general economic efficiency of the banking sector's functions associated with the accumulation of monetary means, the national credit institutions' competitiveness on the domestic market vis-a-vis overseas ones, prevention of using credit institutions in unscrupulous and illicit commercial operations, among others.

The objectives can be achieved by means of improvement of the legal provisions for the sector, fostering the banking regulation and supervision system, promoting a competitive environment, transparency of their operations, discipline in the sector, securing equal conditions for the competition, introduction of stricter requirements to the quality of corporate governance for credit institutions.

The report accentuates the need in amending the effective banking law with direct provisions and specifying provisions associated with the participation of overseas capital in the banking sphere.

As concerns promoting the banks' role in the financial mediation system, it requires measures on promoting the openness of economic agents' operations on the basis of disclosure of information of their financial state and economic operations according to the international financial accounting standards, development of instruments for refinancing and banks' liquid assets management. As well, it is important to ensure all the banks can enjoy more complete opportunities to take part in operations and deals performed on financial markets.

In the banking regulation and supervision area, the focus should be made on development of conceptual approaches, particularly the risk-oriented supervision, or the identification of a banking supervision mode and application, when needed, of supervision reaction measures proceeding primarily from the nature of risks a credit institution undertakes, and the quality of risk management. As well, the document cites the provision for an efficient early reaction system and an introduction of a comprehensive evaluation of credit institutions' operations, and enhancement of the quality and efficiency of operative decisions made in the banking supervision frame as equally priority measures.

According to the Strategy, to develop a competitive environment and ensure the credit institutions' transparency, and solidify the market discipline requires creation of more favorable conditions for the development of the infrastructure of the market for banking services, which is particularly important for regions. Plus, it is necessary to ensure the credit institutions' transparency and enhance the efficiency and quality of auditors' operations which can be made basing on introduction of international auditing and financial reporting standards.

In the area of corporate governance in credit institutions, the emphasis should be made on ensuring an efficient risk management, development and increasing efficiency of inner control systems and a due level of transparency of the corporate governance system.

As concerns the participation in developing the banking business infrastructure, the RF Government and the Central Bank will center on the establishment and functioning of a deposit insurance system, including operations of the Agency For Deposits Insurance and assigning the functions of the corporate liquidator of banks to it, founding a corporate record bureau, a body dealing with registration of collateral assets, and establishment of an online interbanking settlements system.

Speaking of subjects associated with the public finance area, the RF Government is going to hold additional hearings on problems of taxation of credit institutions and to take measures on improving the governance in the banks in whose capital it participates, given the requirements to develop competition in the market for banking services are honored.

A special focus will be made on establishment and functioning of the deposits insurance system, to comply with the RF law "On insurance of private individuals' deposits in banks of the Russian Federation". The Bank of Russia and the RF Government are keen to undertake additional measures on a comprehensive assessment of the credit institutions' financial stability, including the quality of their assets and capital, liquidity and profitability levels, the state of their management system and strategic management aspects in particular.

The envisaged Strategy results should become: a substantial rise in the banking sector's functional role in the economy, its greater financial sustainability and transparency. It is projected that should the Strategy become a success, by January 1, 2009, the banking sector's performance indicators should be: assets to GDP- 56 to 60%; capital to GDP- 7.0-8.0%; credits to GDP – 26-28%.

The Government and CBR proceed from the assumption that the future will see such a structure of the sector that will be represented mostly by a limited circle of large multi-branch banks, which would be capable of delivering to all categories of clients a universal set of banking services. Such banks would be doing business in the territories of most of the RF Subjects, as well as the Near- Abroad countries. They would also provide banking services to Russia's economic interests in the global economy. At the same time, medium- and small-size banks would keep on servicing their regional clients, while there would also emerge specialized banks dealing with consumer credits, mortgage, and loans to small businesses), coupled with settlements and deposit and credit non-banking institutions.

The Government Meeting on July 15, 2004

At the meeting, the Min Fin presented a report entitled " On results of implementation of the 2003 programs of public domestic and foreign borrowings of the Russian Federation and the draft programs of public domestic and foreign borrowings of the Russian Federation for 2005".

The Ministry noted that in 2003 the actual attraction of monetary means by means of placement of T-bonds under market conditions accounted for Rb. 132.36 bln. The market has been improving its qualitative characteristics through 2003: the GKO-OFZ yields rates continued to decline; a favorable for the MinFin macroeconomic situation enabled to significantly prolong the maturity dates of the domestic public borrowing and continue the work on improvement of the repayment schedule on the public domestic debt, particularly with respect to preclude the emergence of peaks of payments vis-a-vis the growing volume of borrowing. The liquidity of the market has grown considerably, along with the daily turnover with respect to T-bonds.

In 2003, Russia issued the Rb. 33.3 bn.- worth government guarantees, or 94% of the volume set by the program of the domestic public borrowing (35.3 bln.).

The positive changes in the market for the public domestic borrowing in 2002-2003 created prerequisites for a considerable rise in the domestic public debt (vs. a simultaneous decline in Russia's foreign debt). This became possible thanks to the prolonged term of borrowings in the domestic market and prevention of peak debt repayment loading on the federal budget.

Between January to May 2004, in pursuit of the policy of prolongation of the term of public borrowings, the MinFin went on placing early OFZ issues. As a result, the duration of the market GKO-OFZ portfolio has grown considerably. As of June 1, 2004, it made up 1,514 days (vs. 984 days, as of January 5, 2004).

In addition, the MinFin has centered on boosting the volume of turnover of the existing most liquid issues of government securities. That was done in the frame of the course towards creating basic issues. The first quarter 2004 has witnessed a decline in yields rates of the government securities traded on the organized securities market. The effective portfolio indicator that characterizes the yields rates of all the government securities in circulation slid from 7.83% as of January 5, 2004 to 6.58% as of March 24, 2004.

In the 2<sup>nd</sup> quarter 2004, the dynamics of yields rates of the government papers was fueled by the situation in the domestic forex market. A vigorous demand for forex led to the fall in investment attractiveness of government papers. During the period in question, the banking sector saw the volume of its free funds falling. The re-orientation of financial flows towards the forex market has generated soaring rates on the domestic public debt instruments. During the first five months of 2004, the gov-

ernment expenditures on servicing the domestic public debt denominated in the government papers accounted for Rb. 10.75 bln.

The 2005 domestic public borrowing program was designed with a due account of the governmental 2003 Debt Strategy that provides for lowering the aggregate public debt of RF and the replacement of external sources of financing with domestic ones. As long as the latter are concerned, one of priorities is to increase the level of market liquidity and expand the circle of investors on the market for government securities.

In the 2005 program of public domestic borrowing of RF it is suggested to allocate Rb. 35.72 bn. to repay other debt obligations, including R. 3.37 bln. – to repay the MinFin promissory notes; 1.0 bln. to repay the public debt commodity obligations (to citizens who, due to various reasons, had failed to get their obligations under targeted interest-free loans and targeted automobile vouchers), while 0.05 bln. is intended to be spent on other debts repayment, and 1.3 bln. - to honor the public guarantees.

The 2003 external borrowing program of RF was implemented in compliance with the national law and with account of provisions of the presidential budget addresses "On the budgetary policy for 2001 and the medium term" and "On the budgetary policy for 2003". In 2003, Russia received from the EBRD two tranches of a loan on development of budget federalism and the regional finance reform. The tranches made up a total of SD 40.0 mln. In 2003, the use of the EBRD and the IBRD non-financial loans accounted for 306.804 mln. USD ( 115.38 mln. and 191.46 mln., respectively).

The federal law "On the 2004 federal budget" approved the total volume of targeted foreign borrowing – up to USD 612 mln. The sum includes the use of loans from international financial institutions – 346 mln. and loans disbursed by foreign governments, banks and firms – up to 266 mln.

However, at the moment a number of the national ministries, organizations, government agencies and companies applied to the Government for an increase in the use of loans, as per the Program. The analysis of the Program implementation with respect to targeted loans over the period between January through May 2004 shows that the use of credits accounted for USD 132.8 mln., which is at 30% greater vis-a-vis the initially planned budget indicators. On the threshold of the envisaged rise of the Federal Reserve 's refinancing rate, since the 2<sup>nd</sup> quarter 2004 the emerging market have witnessed the trend to capital outflow. That predetermined, among other effects, a high volatility and growing yields rates on the market for Russia's Eurobond loans, which affected terms and conditions of new borrowings. At such a juncture it seems inappropriate to attract obligation loans in 2004.

In the frame of implementation of the 2005 RF borrowing policy the draft 2005 program of the RF public external borrowing has taken into account constraints imposed by the current macroeconomic and budgetary situation and the mission to tame the non-interest expenditure growth rates, contract the volume of the nation's foreign debt and the budget expenditures on its servicing. The current macroeconomic situation and the state of the budget compels the government to refuse considerable foreign borrowing, which would allow to lower the pressure on the Ruble. Plus, the existence of sufficient domestic resources allows to argue that it would be inappropriate to attract foreign borrowings at a rate that would exceed Russia's capacity to place its temporarily idle resources on the market.

The report also cites the appropriateness of limiting in 2005 the total volume of issuance of external bonds for the sake of refinancing repayment of the principal debt with the amount of USD 2.25 bln.

#### The Government Meeting of July 22, 2004

At the meeting, the minister of Finance, Alexey Kudrin, presented a report entitled "On the draft federal law "On introduction of amendments to Chapter 25 of the Tax Code of the Russian Federation" (in the part of exemption the corporate profit tax of the compulsory medical insurance funds that insurance medical companies spend on forming a reserve of funding preventive measures").

It was noted in the report that upon enactment of Part II of the Tax Code of RF (effective as of January 1, 2002), which did not take into consideration the specifics of operations and financing of the compulsory medical insurance system as per the RF law "On medical insurance of citizens in the Russian Federation", there emerged collisions associated with the application of legal acts on CMI.

In compliance with procedures stipulated in Chapter 25 of the Tax Code, the funds of the reserve for funding preventive measures (hereinafter referred as "the reserve") that insurance medical institutions that deal with CMI form are subject to the 24% tax rate.



Besides, the medical institutions that receive free of cost from insurance medical institutions assets procured at the expense of the reserve are bound to pay a tax at a rate of 24% of the value of the said assets.

To eliminate the defects of the effective taxation procedures that result in a considerable withdrawal of the CMI funds, it is proposed to exempt from the tax that the medical institutions that deliver CMI accumulate as the reserve. As well, it is proposed not to consider in their revenues the value of the assets they receive from the insurance medical institutions and procured at the expense of the noted reserve.

Keeping in the CMI system financial resources designated to pay for medical assistance and lower risks of diseases will allow to solidify the financial position of the CMI system.

*E. Bolshakova*

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

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In July, there were introduced changes in Chapter 29 “Tax on gambling business”; there was prolonged the experiment concerning the switching to the financing of certain higher professional education institutions via state personal financial obligations (SPFO); there were approved the rules governing the payment of compensations to certain categories of RF citizens as concerns their deposits with the RF Sberbank and deposits (contributions) with state insurance organizations in 2004; there was also approved that since August 1 of 2004 the amount of the base component of the indexed labor retirement pension should be Rub. 660 a month.

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

1. “ON AMENDMENTS TO CHAPTER 29 OF SECTION TWO OF THE TAX CODE OF THE RUSSIAN FEDERATION” of June 30, 2004, No. 60 - FZ

Enters into force on January 1, 2005, with the exception of the stipulations which shall enter into force at other times.

The amendments pertain to the Chapter “Tax on gambling business” and concern in particular the procedures governing the registration of such businesses by the respective tax authorities. Thus, since January 1, 2005, each object, on which the gambling tax is imposed (i.e. gambling table, slot machine, sweepstake cash register, bookmaker office cash register) are subject to registration with the tax authorities of the jurisdiction, where such object of taxation is located, while at present the taxpayers register their objects of taxation in their respective jurisdictions, where they are registered as taxpayers. The taxpayers not registered with the tax authorities in the RF subjects, where they create their objects of gambling taxation, should register with the tax authorities responsible for the locations, where such objects will be established since January 1 of 2005. In the tax jurisdictions, where such objects of taxation are registered, there should be monitored all changes in the number of the objects of taxation, and the taxpayers must submit tax declarations and pay taxes to the respective tax authorities.

There were also amended the procedures governing the calculation of the tax due in the case of establishment of new additional objects of gambling taxation or liquidation thereof prior to the expiration of the respective tax period (as concerns the tax on gambling, such a period is one calendar month). In the case new objects of taxation are established on or after 15 of a month and in the case of the liquidation of such an object prior to or on 15 of a month, the amount of the respective tax should be calculated basing of the half of its usual rate. Prior to the introduction of the amendments, in the aforesaid cases the amount of the tax due had been calculated basing on the half of the usual tax rate as concerns the total number of respective objects of taxation, i.e. the amount of tax had been less. The amendments shall enter into force after one month since the date of the official promulgation of this federal law, however, not prior to the 1<sup>st</sup> day of the next tax period applicable to the gambling business.

2. “ON AMENDMENTS TO ARTICLE 217 OF SECTION 2 OF THE TAX CODE OF THE RUSSIAN FEDERATION” of June 30, 2004, No. 62 – FZ

Enters into force in one month since the day of promulgation.

The amendments exempt pecuniary and (or) in kind prizes received by athletes with disabilities taking part in the Paralympic and Surdoolympic Games, world and European championships, and cham-

pionships and contests taking place in the territory of the Russian Federation. These stipulations concerns also prizes received by athletes at the World Chess Olympic Games.

## **II. REGULATIONS OF THE GOVERNMENT of the Russian Federation**

1. “ON PLACEMENT AND PUBLIC CIRCULATION OF SECURITIES ISSUED BY THE INTERNATIONAL FINANCIAL CORPORATION IN THE TERRITORY OF THE RUSSIAN FEDERATION” of July 2, 2004, No. 908-r

It was decreed that the International Financial Corporation within the World Bank group is an international financial organization entitled to place and publicly circulate its securities in the Russian Federation.

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

1. “ON THE PROLONGATION OF THE DURATION OF THE EXPERIMENT CONCERNING THE SWITCHING TO THE FINANCING OF CERTAIN HIGHER PROFESSIONAL EDUCATION INSTITUTIONS VIA STATE PERSONAL FINANCIAL OBLIGATIONS FOR 2004” of June 26, 2004, No. 313

The duration of the experiment concerning the switching to the financing of certain higher professional education institutions via state personal financial obligations (SPFO) approved by the RF Government resolution No. 6 of January 14, 2004, was prolonged for year 2004. At the same time, the new resolution set forth certain amendments to the stipulations envisaged by the preceding resolution as concerns the conditions and terms of the experiment for participating higher education institutions. For instance, higher education establishments should determine and announce the cost, scope, and form of education across the respective profession lines not later than a month prior to the beginning of registration of applications (as compared to 3 months envisaged by the preceding resolution). Besides, there was made an amendment pertaining to the obligation to enroll first year students only on the basis of financial obligations for all professional lines. The participating higher education establishments were instructed to exclude from their lists of professional lines those requiring special creative or physical abilities included in the list approved by the RF Ministry of Education and Science.

2. “ON PAYMENT OF PRELIMINARY COMPENSATIONS (COMPENSATIONS) TO CERTAIN CATEGORIES OF RF CITIZENS AS CONCERNS THEIR DEPOSITS WITH THE RF SBERBANK AND DEPOSITS (CONTRIBUTIONS) WITH STATE INSURANCE ORGANIZATIONS (PUBLIC JOINT STOCK COMPANY ‘RUSSIAN STATE INSURANCE COMPANY’ AND SOCIETIES WITHIN THE ROSGOSSTRAKH SYSTEM) IN 2004” of July 9, 2004, No. 343

The resolution approves the rules for year 2004, which should govern the payment of preliminary compensations to certain categories of RF citizens as concerns their deposits with the Sberbank of the Russian Federation as on June 20, 1991, and deposits (contributions) with state insurance organizations (public joint stock company Russian State Insurance Company and societies within the Rosgosstrakh system) as on January 1, 1992. According to federal law No. 73 – FZ of May 10, 1995 “On restoration and protection of savings of citizens of the Russian Federation” these savings are guaranteed savings. The resolution sets forth that in accordance with the Rules the financing of expenditures relating to the payment of the preliminary compensation with respect to deposits (contributions) should be within the amount of financial resources allocated for these purposes by federal law No. 186 – FZ of December 23, 2003 “On the federal budget for year 2004.” The expenditures borne by the joint stock company “Russian State Insurance Company” relating to the payment of the preliminary compensation (compensation) should be covered at the expense of the federal budget targeted for the servicing of the public debt and make 10 per cent of the amount of actual payments.

3. “ON DETERMINATION OF THE AMOUNT OF BASE COMPONENTS OF LABOR RETIREMENT PENSIONS AND APPROVAL OF THE INDEXATION COEFFICIENT PERTAINING TO THE INSURANCE COMPONENT OF LABOR RETIREMENT PENSIONS SINCE AUGUST 1, 2004” of July 21, 2004, No. 363

Enters into force on August 1, 2004

The resolution sets forth that since August 1, 2004, the amount of the base component of the indexed labor retirement pension should be Rub. 660 a month. Proceeding from this amount, there should be calculated the amounts of base components of the labor retirement pension, disability pen-

sions, and survivors' pensions envisaged by the federal law "On the labor pension in the Russian Federation", as well as respective pensions paid in accordance with the federal law "On the state pensions in the Russian Federation." The indexation coefficient pertaining to the insurance component of the labor pension was set at 1.0628.

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

1. Instruction of the Central Bank of the Russian Federation "ON AMENDMENTS TO REGULATIONS OF THE BANK OF RUSSIA NO. 2-P OF OCTOBER 3, 2002, 'ON NONCASH PAYMENTS IN THE RUSSIAN FEDERATION'" of June 11, 2004, No. 1442 – U

Enters into force in 10 days since the promulgation in "*Vestnik Banka Rossii*."

The instruction contains the new version of Articles 4 – 6 of Section 1 of the Regulations setting forth the procedures governing payments relating to letters of credit and respective operations at the banks issuing and making available the credit. In particular, the instruction notes that the issuing bank, bank of the beneficiary, or any other bank may act as a bank making credit available. The instruction points out that the letter of credit is separate and independent of the basic agreement. In the case of change in conditions or withdrawal of the revocable letter of credit, the issuing bank must forward the respective notification to the recipient of funds not later than the working day next to the date, on which the conditions were altered or the revocable letter of credit was withdrawn. Partial acceptance of changes in conditions of irrevocable letter of credit on the part of the beneficiary should not be permissible. There was also altered the procedure governing the operations pertaining to letters of credit at issuing banks. The term of examination of the documents and information presented by the beneficiary bank by the issuing bank should be seven working days or less if no other conditions had been agreed upon by the beneficiary bank and the issuing bank.

2. Telegram of the Central Bank of the Russian Federation "ON THE RUBLE EQUIVALENT OF THE MINIMAL AMOUNT OF AUTHORIZED CAPITALS OF NEWLY CREATED BANKS AND NON-BANKING CREDITING ORGANIZATIONS APPLYING FOR GENERAL LICENSES AND NON-BANKING CREDITING ORGANIZATIONS APPLYING FOR THE BANK STATUS FOR THE 3<sup>RD</sup> QUARTER OF 2004" of July 2, 2004, No. 75 – T

In the 3<sup>rd</sup> quarter of 2004, the Ruble equivalent of the minimal amount of authorized capitals of the newly created banks notwithstanding the share of participating foreign capital, as well as the amount of own funds (capital) of operating crediting organizations applying for general licenses and non-banking organizations applying for bank status should make Rub. 176 457 500. The Ruble equivalent of the authorized capital of newly created non-banking crediting organizations should make Rub. 17 645 750.

3. Letter of the RF Tax Ministry "ON REGISTRATION OF REAL ESTATE LOCATED IN THE TERRITORIES OF SEVERAL SUBJECTS OF THE RUSSIAN FEDERATION WITH THE TAX AUTHORITIES" of May 25, 2004, No. 09-0-10/2162@

The letter sets forth the procedures governing the registration with the tax authorities of the organization owning, controlling, or managing the real estate object located in the territories of several subjects of the Russian Federation. The letter points out that in accordance with the Instruction on the state registration of titles and transactions concerning real estate located in the territories of several registration districts as approved by the RF Justice Ministry No. 193, RF Property Ministry No. 17, RF Gosstroj No. 2, Roszemkadastr No. 169 of June 3, 2000, the state registration of the title of such real estate should be conducted at any title registering agency chosen by the title owner in any RF subject on the territory of which the real estate is located.

Therefore, the registration of the organization owning the real estate located in the territories of several subjects of the Russian Federation may be conducted at any tax agency of the respective RF subjects basing on the information presented by the title registration agency.

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