

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

**MONTHLY BULLETIN**

**Moscow**  
**2004**

---

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

August of 2004: Political and economic outcomes .....	3
Reforms Progress in the Period Between June and August, 2004.....	6
Budgetary and Fiscal Policy.....	7
Monetary Policy .....	11
Financial Markets .....	14
Investment in the real sector of the economy .....	24
The Real Sector of the Economy: Factors and Trends .....	27
Regions: Dynamics of Industrial Output.....	30
Industrial situation in August 2004. ....	32
Foreign Trade .....	33
Issues discussed at the meetings held by the Government of the Russian Federation on August 5, 12, and 23 of 2004.....	36
Economic legislation review over the period between August and late July 2004 .....	41

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

---

In August, there were relatively few events in the structures of executive and legislative authorities, however, similarly to the developments observed in 1996, the month witnessed a sharp aggravation of the situation in the North Caucasus. This trend became clear yet in the spring of 2004. As a result of the raid of a large group of guerillas and ensuing fighting in the city of Grozny (August 21 and 22), several dozens of Russian servicemen were killed in action (traditionally, the exact number of casualties had to be guessed, as Russian sources had as always failed to publish the figures and there is no reason to believe the information dissimilated by separatists). A few days earlier, in Kabardino-Balkaria a large group of fighters could broke out of encirclement with minimal casualties in spite of the fact that the military operation was controlled by the top leadership of the Republic.

On August 24, two passenger planes, TU 134 and TU 154, crashed on their flights from Moscow with a few minutes difference. Ninety people died in the catastrophes. It should be mentioned that in the first few days after the crashes, the officials of the RF FSS Public Relations Center denied the obvious fact of a terrorist attack and changed their mind only after the statement made by President Vladimir Putin. On August 31, in Moscow there was registered yet another terrorist attack by a suicide female bomber, while after a large gang of terrorist took 300 hostages in the town of Beslan (North Ossetia) the Russian leadership demanded an extra meeting of the UN Security Council.

Many commentators link the wave of Islamic terrorists activities with the “election” of the new Chechen President A. Alkhanov. However, these elections could hardly bring about a radical change in the situation – it was apparent that the Russia’s leadership took the decision to maintain the structure of the pro-Russian Chechen administration without changes after the death of Akhmat Kadyrov promising to enhance its powers and financing. Therefore, the election of A. Alkhanov was not a symbolic event for separatists and they did not need either prevent or to take revenge for it.

The factors behind this surge of terrorist activity seem to be quite different. As it has been noted in the May and June publications, there had not been eliminated the fundamental causes of the conflict, i.e. collapse of the legal framework, the lack of the single administrative and military authority vertical in Chechnya, loose control over the activities of officers of armed structures, and non-transparency of the situation in the Republic for human rights activists and general public. At the same time, it is apparent that in a civil society the influence of structures of special services, mass media, and human rights organizations should be balanced. Lack of transparency results in the lack of confidence. At the same time, the decisions taken by the RF Supreme Court also do not seem adequate enough<sup>1</sup>.

There should be also noted two other factors. First, there is observed the lack of sufficiently efficient propaganda of Russian policy in the North Caucasus, or any attempts to influence the large Muslim community with the purpose to make it take a friendly attitude to the base values of the Russia’s Constitution. The leadership of major Islamic spiritual centers, such as the Central Spiritual Administration of Russia’s Muslims, or the Spiritual Administration of the Asian Russia do not hesitate to make public appeals neighboring to the propaganda of religious hatred and exclusiveness, although seemingly aimed primarily against the USA and Israel. Naturally, their listeners make the right conclusions from these appeals.

The current situation in the North Caucasus calls for Russia to find allies. In stead of using the mechanisms of national and clan ties in the interests of Russian authorities, the federal center provides considerable financial aid to the republics of the North Caucasus. However, the real or imaginary past services should not be viewed as an indulgence. Otherwise, in the specific conditions of the North Caucasus, it is possible that there will emerge an extremely narrow cleptocratic regime, already not strong enough, but in opposition to the majority of population, what is extremely dangerous in this armed region. In this relation, illustrative are the events, which took place in the town of Khasavyurt (a large district center in Dagestan populated primarily by Avars, which form the majority of the Dagestan population). After the impeachment of the head of administration of the Khasavyurt district, his political ally, S. P. Ukhmanov (the Khasavyurt Mayor and a rather influential political figure in the

---

<sup>1</sup> For instance, the fact that the RF Supreme Court left in force almost maximum sentence (20 years in prison) for Z. Muzhikhoyeva, the suicide female bomber, whose evidence, according to FSS officers, helped to prevent a few terrorist attacks, while E. Ulman, a GRU captain, who murdered 8 people, was acquitted.

region, some experts think him to be an ally of Suleiman Kerimov) took part in a meeting, the participants of which (although not S. P. Ukhmanov personally) accused the Head of the Dagestan State Council M. Magomedov of inability to maintain law and order in the Republic, corruption, and organization of contract murders. The current leadership of the Republic took countermeasures: the head of the local office of the Interior Ministry was removed from his post, there was initiated a criminal case against S. P. Ukhmanov, federal TV channels accused him of being a fighter in stead of the fact that S. P. Ukhmanov personally participated in holding off the attack of Islamic guerillas against Dagestan in 1999, and so on.

It remains unclear who of the politicians mentioned above is right. Not having other mechanisms of protest, the officers of the Khasavyurt office of the Interior Ministry refused to recognize their new head. It is a violation of regulatory acts and the legislation. However, the blame for the aggravation of the situation should be laid on the leadership of Dagestan, who attempted to use the available administrative resource against the political competitor taking the advantage of the surge of “anti-separatist” rhetoric on the part of the Russian authorities.

It seems that the probability of settlement of the Caucasus crisis via the optimal methods, such as inventory of policies and personnel while maintaining the strict measures against terrorists is rather low.

At the meeting of the RF Government held on August 18, the appeal of the Prime Minister M. Fradkov to the Ministers to take personal responsibility for attaining the objective of twofold increase in GDP, as well as his criticism of the report made by G. Gref were opposed by some participants. A. Kudrin, the RF Finance Minister, offered the Prime Minister to assume personal responsibility for the progress of key reforms, for instance, the reform of HPU, transformations in the natural gas and power engineering industries, administrative reform, and so on, what, according to A. Kudrin, could facilitate the attainment of respective objectives. M. Fradkov noted that his is thinking over personal changes in the Cabinet. However, the mass media failed to note a very interesting issue, i.e. the fact that the Prime Minister publicly required to set in the forecast the figures he needed to carry out the instructions given by the President, with the only justification that the figures of economic growth (7.5 per cent) will permit to increase GDP twofold by year 2010. However, A. Kudrin and G. Gref gained a tactical victory, and shortly afterwards were received by the President. It seems that the experts who believe that the Prime Minister had too early engaged in re-division of the recently approved structure of the Cabinet and begun to make too much ill-wishers (for instance, by organizing closed briefings for journalists).

The decisions concerning the medium term program of the Cabinet, as well as not less voluminous issue of evaluation of performance of Ministries was delayed at least until September<sup>2</sup>.

The new developments relating to the YUKOS affair, which has already resulted in a significant capital flight from the country<sup>3</sup>, were mixed as courts and bailiffs took contradictory decisions, sometimes even during one day. However, there was observed a rather important event: the investment bank Dresdner Kleinwort Wasserstein (DrKW) was hired (without tender) to carry out the assessment of the key YUKOS asset, the OAO Yuganskneftegaz. In accordance with the agreement made between the bank and the RF Justice Ministry, the evaluation should be completed in September. To a certain extent, it is a positive news, since the Dresdner Bank would hardly sign the certificate containing false figures. On the other hand, the DrKW can hardly be defined as an independent assessor. Last year, this bank was a leading manager of attraction of borrowings for Gazprom, Rosneft, and Transneft. Therefore, it may be assumed that in the framework of the bankruptcy procedure the major YUKOS assets will be sold and not gifted, but at a friendly price..

In August, there was announced the sale of a single lot (7.59 per cent) of shares owned by the state in LUKOIL. It is believed that it was arranged with Vladimir Putin that this block of shares will be sold to the American company Conoco. Most probably, the auction will be a formality in spite of its rather simply conditions. An evidence of this is the starting price (US \$ 19.5 per share), which, according to experts, is 1.5 times below the market price. At the same time, the rumors that Conoco is ready

---

<sup>2</sup> Among proposals is to evaluate the work of Ministries in accordance with sociological surveys.

<sup>3</sup> According to the preliminary estimates published by the RF Central Bank, in the first six months of 2004 the capital flight made US \$ 5.5 billion, what is four times above the levels registered in the respective period of the preceding year.

to purchase a large (up to the blocking interest) lot of shares seem to be unsubstantiated at the moment. First, the negotiations about the purchase were complicated (there was information that the Russian party was hastily mobilizing alternative offers, including an offer from D. Gugenheim and so on). Second, the LUKOIL management has not been ready to sell the controlling interest, while minority shareholders of the company (similarly to the BP case in 2001) had to sell their shares failing to obtain real access to the management of the company's operations. Third, the influence of possible political reasons making the Russian authorities to sell the blocking interest in the company to a non-resident may cease after November of 2004, while the transaction can not be completed earlier than this date. On the whole, in spite of all minuses (losses of the budget and so on), the decision to sell shares in LUKOIL is a positive step, since it is not in line with the clear general trend towards concentration of property at state owned enterprises.

The political parties and movements did not demonstrate significant activity in August in spite of the promises to organize mass protests against monetization of social benefits. The respective meetings, even in large cities, failed to attract more than 1 to 2 thousand of participants, what confirmed political analysts opinions that even such political parties as KPRF to organize mass political events not related to important dates. It seems that one of the factors behind this failure was the internal fragmentation of the opposition. At this background, the most significant event was the action organized by the left populist National Bolshevik party resulting in non-violent capture of the office of M. Zurabov, the RF Health Care Minister. It should be noted that the persons, who threw out of the window the portrait of Vladimir Putin are still in custody and the charges brought against these persons are not adequate to the gravity of the offence.

In August of 2004, the RF Central Election Commission (TsIK RF) formalized the initiatives of the Head of the Commission to reform the electoral legislation. At the moment this document exists in the form of an analytical report supported by all Election Commission members with the exception of the KPRF representative. However, it is apparent that this document containing certain absolutely exotic ideas (like a 30 per cent quotas for women) had not been agreed with the Presidential Administration and the United Russia leadership.

Although in formal terms this document is aimed to strengthen the party system weakened by the tremendous success of the United Russia in comparison to its political competitors and the mass joining of independent deputies to this party, on the whole it facilitates the use of administrative resource in the course of elections. The key problem is not that the United Russia due to its victory over the KPRF has accumulated the majority of the votes cast for the parties failed to pass the electoral threshold (similarly to the case of the KPRF in 1995). The major issue is the existing system of coverage of the United Russia activities by state owned mass media, coercive fund rising, administrative pressure on competitors, and, certain cases of direct falsification. However, the analytical report fails to propose any measures aimed at the improvement of this situation.

According to the document, single seat electoral district should be abolished, i.e. in the framework of the existing system of formation of the Federation Council the regions in fact will have no real representation in the Parliament at all. The current system should be replaced by an extremely complicated and intricate system of distribution of mandates as concerns the parties overcoming the electoral threshold. Parties have to form one federal list (no more than three candidates) and no less than 73 regional lists. It should be noted that the votes for regional lists should be taken into account in relative terms, i.e. in the case, for instance, one million votes were cast for the list in Moscow (a 13 per cent equivalent), and one thousand in the Evenk AO (14 per cent), the deputy will be the candidate running in the Evenk district. These provisions create no difficulties for the "party of power," which has rather even distribution of votes across regions, but forms unprecedented opportunities for pushing through of "friendly" candidates from the lists of opposition parties.

As a "carrot", the document recommends to lower the barrier at the Parliamentary and regional elections to 5 per cent, however, this measure has not significance in the situation, where it is proposed that the party membership should make not less than 100 thousand persons (it is hard to find so many citizens independent of the authorities in a political system dominated by one "right" political party). Moreover, under pretext of care about observers, it is proposed that they should have no right to make out copies of election protocols (election commissions would issue ready copies), what renders monitoring of the elections senseless.

*S. Zhavoronkov*

## **Reforms Progress in the Period Between June and August, 2004**

---

The Federal Government has been working on the program documents – a three-year socio-economic development program is under revision in the anniversary of adoption of the previous program. The three recent summer months have provided a great deal of food for reflection regarding the future economic policy and methods of its implementation.

A clear profile of the socio-economic policy pursued by the new Head of the Cabinet of Ministers has been shaped up during the summer months after a spring “stagnation” in the socio-economic policy resulted from continuous adaptation of the new Prime Minister, his deputies, ministers and a great deal of public officers at lower levels to the altered framework of government and various ministries and public agencies.

A concise conceptual document, «Basic Trends in Government Activity», has been drafted at first. The struggle around the «Basic Trends » has revealed all the sources of influence emerged after the administrative reform, which have an impact on policy making in the Federal Government. Among the sources are the RF Ministry of Economic Development, a sectoral department within the Federal Government’s office; the secretariat of the Prime Minister deputies responsible for the economic issues; and the group of consultants of the Prime Minister himself. This has resulted in ideological inconsistency of the «Basic Trends» which is reflected by a conflict of the principles and measures with the liberal wording written by the RF Ministry of Economic Development.

The recent events have demonstrated that the Prime Minister has no intention whatsoever to dodge the work on the concept and ideology of socio-economic policy. A decision has been made to develop a new medium-term program, which is expected to include the principles specified in the «Basic Trends». The head of the program development working group will be the Prime Minister in his own person.

On the basis of the «Basic Trends», some of these principles should, for instance, be as follows :

- introducing a «target prediction», i.e. a plan to achieve certain macroeconomic figures even if these figures are not under control of the Federal Government ( GDP, for instance ) ;
- developing sectoral development strategies by ministries and government agencies ;
- implementing major projects governed by «breakthrough development trends» .

The original version of the new medium-term program is expected to be issued at the end of September. Initially, the program will be developed by the RF Ministry of Economic Development .

Another key innovation which has been noted this summer is the so called «budgetary reports» of the ministries, which are designed in an effort to measure not only public officers performance on the basis of the established performance measures system ( which is employed in most countries, and it was expected to be introduced in Russia a part of the administrative reform ), but also the input of every ministry and every public officer in achieving the goals of the Federal Government as a whole. An hierarchy of goals of the Federal Government has been developed.

The task which initially seems to be correct and ambitious, doesn’t look so good at closer examination: the goals of the Federal Government have been defined as goals of socio-economic development of the country, which suggests that the Federal Government can have a direct impact upon all economic processes ( which is not the case for the market economy ). Furthermore, an attempt is being made to measure the input of one or another ministry in achieving these goals ( i.e. macroeconomic indicators ), for defining priorities of budgetary financing. Such a task setting completely misrepresents the original idea of measuring public officers performance, because it is absolutely impossible to measure the most substantial input in «GDP doubling» - education or health service. Neither is it possible to change financing of the ministries on the basis of such measurements.

Methodology and ideology of the budgetary reports still remain to be improved and updated, and it is not the time to say that a wrong decision has already been made.

A notorious set of laws on «monetization of benefits», which has been heavily covered by the mass media, has been adopted. The laws are good in terms of ideology, but their further practical implementation seems to be problematic enough.

In summer, no advance has been noted with regard to the previously key reforms launched by the Federal Government : the Forestry Code and Water Code have not been submitted to the State Duma yet ; the Law on «Mineral Wealth» is still under development; the set of laws on creation of a market of affordable housing has finally passed the third reading without the two key components, Housing Code and Zoning Regulation Code, which have not passed the second reading yet.

*Fomichov O.V.*

## Budgetary and Fiscal Policy

By the end of June 2004, the level of revenues inflow to the federal budget of the Russian Federation remained unchanged as compared to the previous month and accounted for 20.6% of the GDP, while the revenues to the consolidated budget of the Russian Federation accounted for nearly 32.5% of the GDP. The level of expenditures of the federal budget declined as compared to the previous month and accounted for 15.9% of the GDP. Consequently, the consolidated budget expenditures reached 27% of the GDP in June.

On August 19, the RF Ministry of Finance submitted a federal draft budget for 2005 to the Government of the Russian Federation.

### National Budget Status

In the period between January and June of 2004, cash execution of the federal budget revenues accounted for 20.6% of the GDP, while the budget expenditures amounted to 15.9% of the GDP ( Table 1 ). This resulted in budgetary surplus which accounted for 4.7% of the GDP.

*Table 1*

### Execution of the federal budget of the Russian Federation (in % of the GDP<sup>4</sup> by cash execution) .

	VI'03	VII'03	VIII'03	IX'03	X'03	XI'03	XII'03	I'04	II'04	III'04	IV'04	V'04	VI'04
<b>Revenues</b>													
Profit tax .	1.4%	1.4%	1.3%	1.3%	1.3%	1.3%	1.3%	0.9%	0.7%	1.2%	1.4%	1.3%	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 .	2.8%	2.8%	2.8%	2.7%	2.7%	2.6%	2.7%	2.2%	2.6%	2.8%	2.9%	2.9%	2.8%
Taxes on goods and services. License and registration dues .	9.2%	9.1%	8.9%	8.7%	8.6%	8.5%	8.5%	10.2%	8.5%	7.6%	7.6%	7.6%	7.3%
VAT	6.9%	6.9%	6.8%	6.7%	6.6%	6.6%	6.6%	7.9%	6.6%	6.2%	6.4%	6.5%	6.3%
Excise taxes	2.2%	2.2%	2.1%	1.9%	1.9%	1.9%	1.9%	2.3%	1.8%	1.4%	1.2%	1.1%	1.0%
Taxes on foreign trade and foreign economic operations .	3.4%	3.4%	3.4%	3.3%	3.3%	3.4%	3.4%	3.6%	4.2%	4.4%	4.7%	5.0%	4.9%
Other taxes .	2.0%	2.0%	2.0%	2.0%	2.0%	2.0%	2.0%	2.5%	0.1%	-0.2%	-0.2%	-0.2%	-0.2%
Tax revenues .	18.8%	18.7%	18.4%	17.9%	17.9%	17.9%	18.0%	19.4%	16.1%	15.9%	16.4%	16.6%	16.2%
Non-tax revenues .	1.6%	1.5%	1.5%	1.4%	1.4%	1.3%	1.3%	0.9%	0.8%	0.9%	1.0%	1.1%	1.5%
Total revenues .	20.6%	20.4%	20.0%	19.5%	19.4%	19.3%	19.4%	20.4%	19.6%	19.7%	20.4%	20.6%	20.6%
<b>Expenditures</b>													
Public administration .	0.4%	0.4%	0.4%	0.4%	0.4%	0.4%	0.5%	0.2%	0.3%	0.4%	0.4%	0.4%	0.4%
National defense .	2.6%	2.6%	2.6%	2.5%	2.5%	2.5%	2.7%	1.7%	2.2%	2.6%	2.9%	2.7%	2.6%
International activity .	0.2%	0.2%	0.2%	0.2%	0.2%	0.2%	0.2%	-0.1%	0.2%	0.2%	0.3%	0.3%	0.3%
Judicial power .	0.2%	0.2%	0.2%	0.2%	0.2%	0.2%	0.2%	0.1%	0.1%	0.2%	0.2%	0.2%	0.2%
Law enforcement and safety measures .	1.8%	1.7%	1.7%	1.7%	1.7%	1.7%	1.9%	1.0%	1.5%	1.7%	1.9%	1.8%	1.8%
Fundamental scientific research and technological development promotion .	0.3%	0.3%	0.3%	0.3%	0.3%	0.3%	0.3%	0.1%	0.1%	0.2%	0.3%	0.3%	0.3%
Public services rendered to national economy, including :	0.8%	0.8%	0.8%	0.9%	0.9%	0.9%	1.1%	0.2%	0.4%	0.5%	0.6%	0.6%	0.7%
Social services .	2.2%	2.2%	2.2%	2.1%	2.1%	2.1%	2.3%	1.4%	1.7%	1.9%	2.1%	2.1%	2.1%
National debt service	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	7.1%	7.1%	7.0%	6.9%	6.8%	6.8%	6.9%	5.2%	5.8%	5.9%	6.5%	6.4%	6.1%
Expenditures and loans less repaid loans	17.5%	17.4%	17.3%	17.1%	16.8%	16.7%	17.7%	10.8%	14.4%	15.8%	16.8%	16.3%	15.9%
<b>Surplus</b>	3.0%	3.0%	2.7%	2.5%	2.6%	2.6%	1.7%	9.6%	5.2%	3.8%	3.6%	4.3%	4.7%
Domestic financing	0.3%	0.0%	0.3%	0.2%	-0.1%	-0.3%	0.5%	-8.6%	-3.1%	-1.2%	-1.3%	-2.4%	-3.1%
External financing	-3.3%	-3.0%	-2.9%	-2.7%	-2.5%	-2.3%	-2.2%	-1.0%	-2.1%	-2.6%	-2.3%	-1.9%	-1.6%
Total financing	-3.0%	-3.0%	-2.7%	-2.5%	-2.6%	-2.6%	-1.7%	-9.6%	-5.2%	-3.8%	-3.6%	-4.3%	-4.7%

in % of the GDP; \*\* the unified social tax is included into tax revenues .

<sup>4</sup> The figures are subject to revision due to evaluative nature of the data on GDP .

The budget revenues remained unchanged in 2004 as compared to the comparable period between January and June of 2003, while the expenditures were reduced by 1.6 percentage points of the GDP, which entailed an increase in budgetary surplus by 1.7 percentage points of the GDP. The VAT revenues, 30.8% of the total tax revenues, remain responsible for the basic share of federal tax revenues, which is virtually by 3 percentage points less than the comparable figure in 2003 .

According to the preliminary information, cash execution of the federal budget revenues in the period between January and July of 2004 accounted for 20.7% of the GDP, which exceeds the figures of the comparable period of the previous year by 0.3 percentage points of the GDP. At the same time, cash execution of the budgetary expenditures accounted for 16.3% of the GDP ( 17.4% of the GDP in the period between January and July of 2003). Thus, according to the preliminary data, the budgetary surplus accounted for 4.4% of the GDP after the seven-month period of the current year.

According to the preliminary estimation of the Ministry of Finance, in the period between January and July of 2004, by performed financing<sup>5</sup> the federal budget was executed at the level of 17.4% of the GDP by expenditure ( Table 2 ), while this indicator was 18.8% of the GDP over the comparable period in 2003. The federal budget revenues in the period between January and July of 2004 grew up by 0.3 percentage points of the GDP and accounted for 20.7% of the GDP as compared to the corresponding months of 2003. Thus, the budgetary surplus by performed financing in the period between January and July of 2004 grew up by 1.7 percentage points of the GDP and accounted for 3.3% of the GDP as compared to the corresponding indicator between January and July of 2003.

Table 2

**Execution of the federal budget of the Russian Federation  
( in % of the GDP, by performed financing ).**

	VII03	VIII03	IX03	X03	XI03	XII03	I04	II04	III04	IV04	V04	VI04	VII04
Total revenues	20.4%	20.0%	19.5%	19.4%	19.3%	19.5%	20.4%	19.6%	19.7%	20.4%	20.6%	20.6%	20.7%
Public administration	0.5%	0.5%	0.5%	0.5%	0.5%	0.5%	0.5%	0.7%	0.6%	0.6%	0.6%	0.5%	0.6%
Judicial power	2.9%	2.8%	2.7%	2.8%	2.9%	2.7%	2.7%	3.9%	2.9%	3.7%	3.2%	2.8%	3.0%
International activity	0.3%	0.2%	0.2%	0.2%	0.2%	0.2%	0.0%	0.2%	0.2%	0.3%	0.3%	0.2%	0.3%
National defense	0.2%	0.2%	0.2%	0.2%	0.2%	0.2%	0.2%	0.2%	0.2%	0.2%	0.2%	0.2%	0.2%
Law enforcement and safety measures	2.0%	1.9%	1.9%	1.9%	1.9%	1.9%	2.1%	2.4%	2.3%	2.4%	2.3%	2.1%	2.1%
Fundamental scientific research and technological development promotion	0.3%	0.3%	0.3%	0.3%	0.3%	0.3%	0.2%	0.3%	0.3%	0.4%	0.3%	0.3%	0.3%
Public services rendered to national economy	1.0%	1.0%	1.0%	1.0%	1.1%	1.1%	0.5%	0.7%	0.8%	0.9%	0.9%	0.8%	0.8%
Social services	2.5%	2.4%	2.3%	2.3%	2.4%	2.3%	2.4%	2.5%	2.4%	3.0%	2.9%	2.5%	2.5%
National debt service	1.8%	2.0%	2.0%	1.8%	1.7%	1.7%	1.0%	2.1%	2.2%	1.7%	1.5%	1.4%	1.3%
Other expenditures	7.2%	7.2%	7.0%	6.9%	6.9%	7.0%	5.6%	6.6%	6.1%	6.6%	6.6%	6.2%	6.3%
Total expenditures	18.8%	18.6%	18.2%	17.9%	18.1%	17.8%	15.2%	19.7%	18.0%	19.7%	18.8%	17.1%	17.4%
Budgetary surplus (+) / deficit (-)	1.6%	1.3%	1.3%	1.5%	1.3%	1.6%	5.2%	0.0%	1.7%	0.7%	1.8%	3.5%	3.3%

According to the Ministry of Taxation of the Russian Federation, the federal budget revenues amounted to nearly 149.2 bln rubles (without regard for the unified social tax ) in June of 2004. The real tax revenues accounted for 300.8% as compared to January 1999, while the comparable indicator accounted for 260.4% in July of 2003 and 284.4% in 2002 ( Table 3 ).

<sup>5</sup> Budget execution by performed financing is equal to the amount of funds transferred by the Federal Treasury to the accounts of budget funds recipients. Cash execution of the budget is equal to the amount of funds consumed by budget funds recipients from their accounts.



Table 3.

**Real tax revenues to the federal budget according to the RF Ministry of Taxation  
( in % of the data obtained in January, 1999 )<sup>6</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	VII					
266.5%	204.4%	238.0%	261.4%	241.0%	243.6%	300.8%					

\* Without regard for the unified social tax .

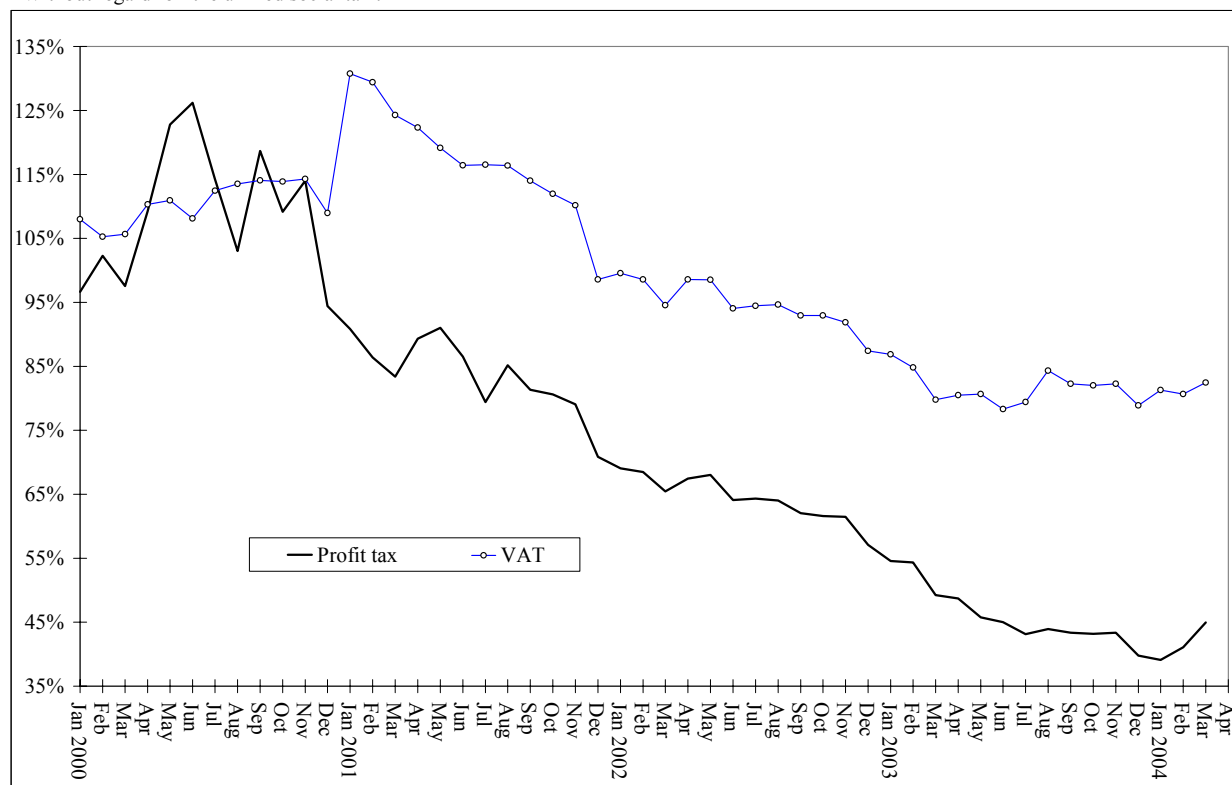


Fig. 1. Real tax arrears to the federal budget ( in % to July 1999 )

The movement in real basic taxes arrears since January 2000 is presented in Figure 1. VAT arrears to the federal budget increased by 7.8 bln rubles in March 2004 and amounted to 264.1 bln rubles as of April 1, 2004 . Respectively, profit tax arrears increased by 2.9 bln rubles and amounted to nearly 30.8 bln rubles. All in all, the downward trend of tax arrears, which was observed from the beginning of 2001 till the second half of 2003, gave way to a stabilized level of the accrued profit tax and VAT arrears.

<sup>6</sup> Comparison with January 1999 has been selected to complete the data presented. January 1999 is not a representative data in terms of tax revenues.

Table 4

**Execution of the consolidated budget of the Russian Federation ( in % of the 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%
Budgetary deficit/surplus	14.6%	7.7%	5.4%	5.3%	5.2%	3.8%	4.2%	3.7%	3.3%	2.7%	2.4%	1.0%
2003												
	I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII
Taxes*	25.6%	24.4%	25.6%	27.4%	27.1%	26.0%	26.1%	25.7%	25.0%	25.0%	25.1%	25.2%
Revenues	32.0%	30.3%	31.5%	33.4%	33.6%	32.2%	32.2%	31.6%	30.9%	30.8%	30.7%	31.1%
Expenditures	20.7%	25.3%	27.7%	28.8%	28.8%	28.6%	28.7%	28.5%	28.2%	27.8%	27.9%	29.7%
Budgetary deficit/surplus	11.3%	5.0%	3.8%	4.5%	4.7%	3.5%	3.6%	3.1%	2.7%	3.0%	2.8%	1.4%
2004												
	I	II	III	IV	V	VI						
Taxes*	25.6%	20.6%	21.8%	27.4%	27.4%	26.6%						
Revenues	30.6%	28.2%	29.8%	32.9%	32.9%	32.5%						
Expenditures	18.5%	22.8%	25.4%	27.3%	26.9%	27.0%						
Budgetary deficit/surplus	12.1%	5.4%	4.4%	5.6%	6.0%	5.5%						

\* Without regard for the unified social tax

The consolidated budget revenues in the period between January and June of 2004 accounted for 32.5% of the GDP, of which tax revenues (without regard for the unified social tax) are represented by 26.6% of the GDP ( Table 4 ). The consolidated budget expenditures were reduced as compared to the period between January and June, 2003 by 1.6 percentage points of the GDP and accounted for 27.0% of the GDP. The consolidated budget surplus accounted for 5.5% of the GDP as of July 1, 2004, which exceeds the level of the comparable period in 2003 by 2 percentage points of the GDP.

**Basic Developments in Public Sector .**

On August 19, the RF Ministry of Finance submitted a federal draft budget for 2005 to the Government of the Russian Federation. Upon consideration at a meeting of the RF Government, the federal budget draft was submitted to the State Duma in accordance with the RF Budget Code. According to the RF Ministry of Finance, the draft budget was developed on the basis of the figures specified in the RF socio-economic development forecast for the period between 2005 and 2007 submitted by the RF Ministry of Economic Development at a meeting of the RF Government which was held on August 19. Basic parameters of the budget were calculated on the basis of the mean price of Urals oil, 28 dollars US per barrel, in 2005 .

The federal budget revenues in 2005 are expected to reach 3 trillion 326 billion rubles (17.77% of the GDP ), of which tax revenues are estimated to reach 2 trillion 232,7 billion rubles ( 11.93% of the GDP ). As compared to the expected execution of the federal budget in 2004, the estimated revenues in 2005 will increase by 35.6 bln rubles. However, the share of revenues in the gross domestic product will decrease from 20.4% to 17.77%. The federal budget expenditures are expected to reach nearly 3 trillion 47,9 billion rubles ( 16.3% of the GDP ), while the budgetary surplus is estimated to reach 278,1 bln rubles or 1,5% of the GDP respectively. In addition, the profit tax revenues of organizations to the federal budget will amount to 259 bln rubles, while the value-added tax revenues to 713,2 bln rubles, and the unified social tax revenues to the federal budget will amount to 266,5 bln rubles

According to the data specified in the federal draft budget for 2005, total volume of the Stabilization Fund, considering surplus balances of the federal budget early in 2005, will exceed 500 bln rubles, thus allowing a share of the funds to be used to repay the foreign national debt ( to the amount of 167,99 bln rubles ) and finance the budget deficit of the RF Pension Fund in its execution, which is caused by reduced rate of the unified social tax ( to the amount of up to 74,7 bln rubles ). On the basis of the estimated average annual price ( 28 US dollars per barrel ) of Urals oil in 2005, the amount of

operating revenues to the Stabilization Fund is estimated 387,8 bln rubles in 2005, and 719,5 bln rubles as of January 1, 2006 .

The RF Ministry of Finance plans to complete the tax reform in the nearest two years, which is basically expected to result in reduced tax burden and simplified taxation system. While prior to the tax reform ( prior to 1998 ), tax burden accounted for nearly 35% of the GDP and the number of taxes was 52, today the RF Ministry of Finance estimates tax burden to be decreased down to 31.5% of the GDP, as well as the number of taxes to be reduced down to 15 by 2006. At the same time, according to the RF Ministry of Finance, transfer pricing and development of differentiation mechanism of the mineral tax with regard to oil remain a key issue of the upcoming reform.

*S. Ponomarenko*

---

## **Monetary Policy**

---

No growth retardation of the consumer price index ( CPI ) was noted in July despite the downward tendency that was observed in the previous periods. Moreover, the CPI level went beyond the June level and accounted for 0.9%. In July, the monetary base decreased by 3.7%, thus demonstrating the most significant reduction of this indicator in the Russian Federation since January 2003. In August, the Bank of Russia presented a project, «The Basic Trends in Monetary Policy for 2005».

In July, the consumer price growth rate slightly increased, which is unrepresentative of the common seasonal movement over the last few years ( refer to *Figure 1* )<sup>7</sup>. It accounted for 0.9% in July as compared to 0,8% in June, although a seasonal growth rate retardation in consumer prices normally begins in July. Such movement can be explained by several reasons as follows :

- strengthening of the dollar in nominal terms, which increased slightly dollarization of the economy and boosted the rate of the ruble cash turnover against the background of the problems occurred in the banking sector ;
- explosion of the rates of utility and municipal transportation services which are regulated on an administrative basis ;
- notable price-rise of fruits and vegetables, which is unrepresentative of the common seasonal movement of this indicator ( it seems to be associated with adverse weather conditions at the beginning of summer, which resulted in delayed new harvest ; in this case prices of fruits and vegetables should be cheaper in August <sup>8</sup>).

In July, prices of food products grew up by 1.0% as compared to 0.8% in the previous month (by 7.1% since the beginning of the year ), while prices of non-food products grew up by 0.6% as compared to 0.7% (4%). Prices of fee-based services delivered to the population grew up by 1.3% in July, while in June this indicator grew up by 0.9% ( by 12.5% since the beginning of the year ).

Basic inflation<sup>9</sup> also increased in July. It accounted for 0.8% as compared to 0.5% of the pervious month. Therefore, the gradual downward trend of the underlying inflation dominating in the second quarter of the year was disrupted.

Considering the developing tendency, there are few odds to meet the inflation dead point (10%), because in order to meet this point the average monthly consumer price index should not go beyond 0.5% over the period between August and December.

The CPI growth rate accounted for nearly 0.5% in August, according to the preliminary estimates.

The prices of industrial products grew up by 1.2% in Russia in July, according the data presented by the RF Statistical Service. In the period between January and July the prices of industrial products grew up by 19.1% ( the growth accounted for 2.5% in June, 2.1% in May, 2.7% in April, 1.7% in

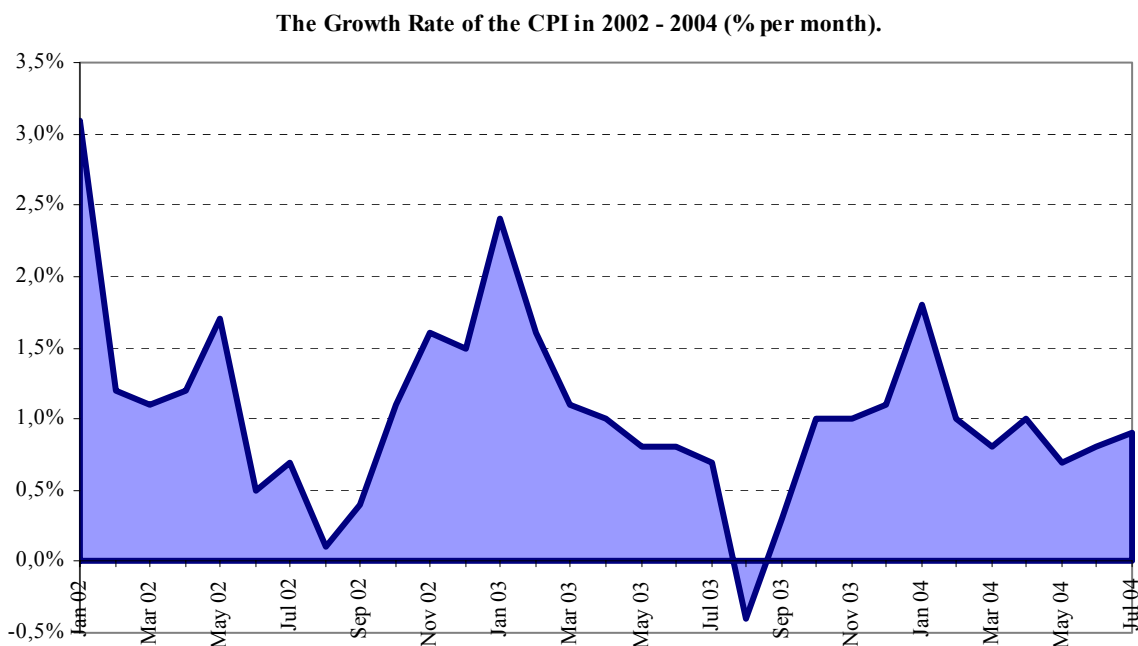
---

<sup>7</sup> Due to the fact that the Statistical Service of the Russian Federation publishes the data on consumer prices movement with a certain lag, the data on inflation in August were not available while the author was writing this paper .

<sup>8</sup> New data on the CPI movement that is to be published in August will allow us to test the given hypothesis .

<sup>9</sup> The basic consumer price index – an indicator reflecting the level of inflation in the consumer market with omission of seasonal ( prices of fruits and vegetables ) and administrative ( rates of regulated types of services, etc. ) factors – is calculated by the Statistical Service of the Russian Federation .

March, 3.4% in February, and 4.2% in January ). It should be noted that the prices of industrial products grew up by 7.5% in the period between January and July 2003.



*Fig. 1.* The Growth Rate the CPI in the period between 2002 and 2004 ( % per month ).

According to the data of the Bank of Russia, the broad money<sup>10</sup> in Russia decreased by 3.7% in July and accounted for 1.85 trillion rubles as of August 1. The size of the monetary base shrank by 3.4% as compared to the indicator as of January 1.

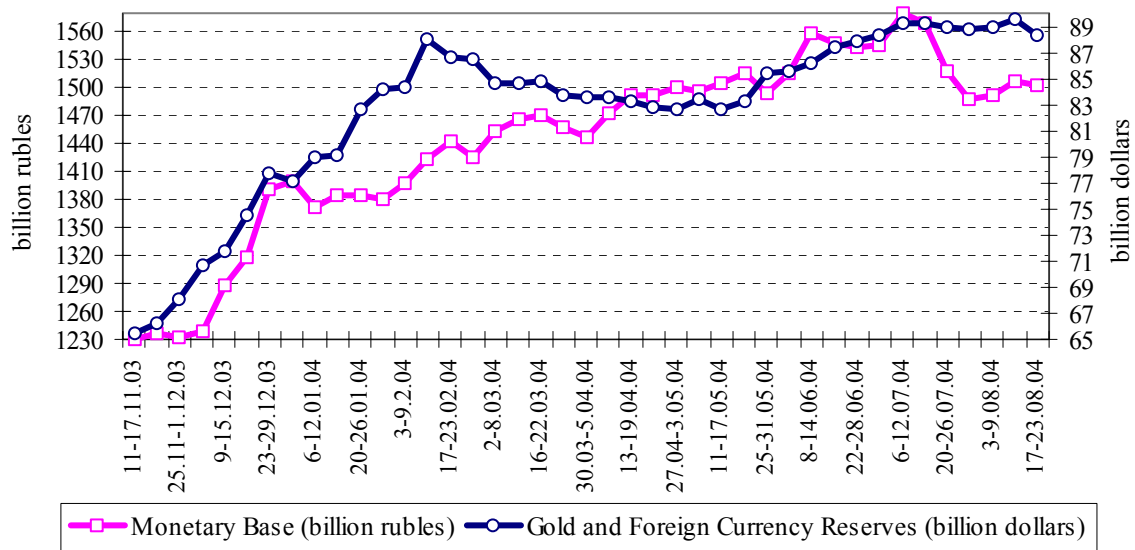
Let us consider the monetary base movement by components. The value of cash in circulation with provision for cash balance at credit organizations accounted for 1.4 trillion rubles as of August 1 ( more than 3.3% as compared to July 1 of the current year). In July, the value of credit organizations' accounts with the Bank of Russia decreased by 6.3% down to 209 bln rubles. The required reserves decreased by 47.2% down to 132.6 bln rubles in July. The value of bank deposits with the Bank of Russia decreased down to 32.4 bln rubles (– 15.6%) in July. The value of liabilities of the Bank of Russia on repurchase of securities increased by 42% as of August 1 as compared to July 1, and accounted for 79.5 bln rubles. This means that the previously noted tendency remained unchanged in July at the background of a gradual growth of cash in circulation: shrinking of the required reserves and bank accounts with the Bank of Russia. It seems to have been resulted from the banking crisis and outflow of funds from the banking system.

With the growth in cash quantity the significant reduction of the required reserves entailed a reduction of the monetary base in its narrow definition<sup>11</sup>: in July this indicator shows a reduction by 3.6% ( refer to *Figure 2* ). Consequently, in July the gold and foreign exchange reserves grew up insignificantly: from \$88.2 bln USD up to \$88.6 bln USD (+ 0,4% ). However, they were reduced by 0,3% ( down to \$88,3 bln USD ) as early as the first three weeks of August.

<sup>10</sup> Apart from the cash funds issued by the Bank of Russia and balance of the required reserves accounts on the funds borrowed by credit organizations in national currency to be deposited with the Bank of Russia, the monetary base of the Russian Federation in its enlarged definition takes into account the assets on correspondent accounts of credit organizations and bank deposits with the Bank of Russia.

<sup>11</sup> It will be recalled that this indicator is subject to the ultimate control by the Bank of Russia.

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



*Fig. 2. The Monetary Base Movement and the Gold and Foreign Exchange Reserves of the Russian Federation late in 2003 and 2004 .*

A document, «The Basic Trends of the Unified State Monetary Policy for 2005», was presented at a meeting of the Government of the Russian Federation held on August 19 of the current year. This document is intended to define the role of the Bank of Russia in providing economic growth in the country, which places «The Basic Trends of the Unified State Monetary Policy for 2005» on the same shelf as the Federal Budget and other policy documents.

The key task of the Central Bank is to maintain such an exchange rate of the national currency that can allow the best possible conditions for the economic development. For the time being, the Bank of Russia is viewing its current role in the foreign exchange market only in mitigating the ruble exchange rate's fluctuations with maximum deregulation in the market in prospect.

With regard to inflation, the targeted parameters on the consumer price index are not in line with those specified in the document "The Socio-Economic Development Forecast of the Russian Federation for 2005" ( 6.5 to 8.5% against 8 to 9% ) prepared by the Ministry of Economic Development of the Russian Federation, while the targeted parameters on the underlying inflation are contradictory. The Bank of Russia estimates that inflation in the consumer's market at the level between 6.5 and 8.5% in 2005 is corresponding to the basic inflation at the level between 6 and 8%. It appears from this that monetary inflation will account for more than 90% of the total growth of consumer prices, while the factors related to regulated prices and rates will account for not more than 0.5 percentage points of inflation in the consumer market<sup>12</sup>. However, it is practically impossible to achieve this level given the inflation movement of the current year and planned indexing of the natural monopolies' rates.

« The Basic Trends of the Unified State Monetary Policy for 2005 » contains no efficiency estimation of the Bank of Russia during the banking crisis that took place in period between May and July of the current year. In addition, the wording of the document actually contradict the existence of banking crisis. The Bank of Russia confines itself to mentions about «problems with several banks», «failure of trust in several banks by several creditors», «money market segmentation», and considers its activity

<sup>12</sup> It will be recalled that among the key factors which have impact upon inflation development are monetary factor; increase in rates of products and services of natural monopolies and other factors ( inflationary expectations; ruble exchange rate movement, etc. ).

mainly from the point of view of financial supervision (mainly by recalling licenses from banks) rather than liquidity management.

Even worse, in its policy document the Bank of Russia proposes no meaningful measures to ensure stability and development of the banking system in the future. At the same time the summer banking crisis proved once again that any banking system is unstable internally in the absence of the institute ( it is often the Central Bank ) which effectively plays the role of the ultimate authority creditor.

In August 2004, the Bank of Russia extended the list of collateral papers on which it extends loans to commercial banks. At present, the lombard list also includes bonds of the constituent entities of the Russian Federation, as well as state secured bonds of mortgage agencies and credit organizations in addition to GKO and OFZ, external bonds of the Russian Federation and the Bank of Russia bonds. In theory, the extension of the lombard list is obviously a positive move, because it will increase the volume of the Bank of Russia's borrowings to commercial banks and facilitate to resolve the liquidity problem for the banks, primarily medium-size and small-size ones. Moreover, inclusion of securities into the lombard list will facilitate liquidity growth of the securities themselves and bring more potential clients. However, the number of new papers to be accepted as collateral by the Bank of Russia is insufficient in the market. In addition, there are certain restrictions imposed for the new papers included into the lombard list, according to which they can not be used for REPO transactions which are most cost-effective for banks. Finally, the Bank of Russia has made no changes in the limits of refunding banks. Therefore, the foregoing circumstances can actually nullify the efficiency resulted from enlargement of the lombard list.

*P. Trunin*

---

---

## **Financial Markets**

---

---

In August, on the Russian financial market there was observed a decline in activity of investors. Over the most part of the month, the behavior of quotations of assets in all segments of the financial market was mixed at the background of the general tend towards a gradual improvement of the market situation. The major positive factors behind the dynamics of assets were the growth in oil prices, which have reached their historical maximums once more, as well as positive macroeconomic data registered in the Russian Federation. The events relating to the YUKOS affair had a negative impact on the market in the beginning of the month. On the whole, the situation on the financial market in August remained stable.

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

In August, on the market of forex denominated bonds there prevailed the trends towards a decline in the yields of traded instruments. In the first half of the month, the quotations of bonds moved in different directions. On the one hand, any negative news concerning the YUKOS affair facilitated downward movements of quotations. Even the increase in the base interest rate in the USA failed to significantly affect the quotations. However, in the second half of the month, positive sentiments of investors prevailed across all segments of the foreign exchange denominated debt market, including the Russian market, what facilitated a growth in quotations of Russian bonds. Yet another factor behind the growth was the intent of Russia to start consultations with the Paris Club concerning the repayment or exchange for market instruments of the debt amounting to US \$ 47.7 billion.

As on August 27 the yield to maturity of Russian Eurobonds RUS-30 was 7.27 per cent p.a.; RUS-18: 7.58 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: 6.97 per cent; Minfin bonds, 6<sup>th</sup> tranche: 4.07 per cent; Minfin bonds, 5<sup>th</sup> tranche: 5.96 per cent; RUS-07: 5.45 per cent.

FIGURE 1.

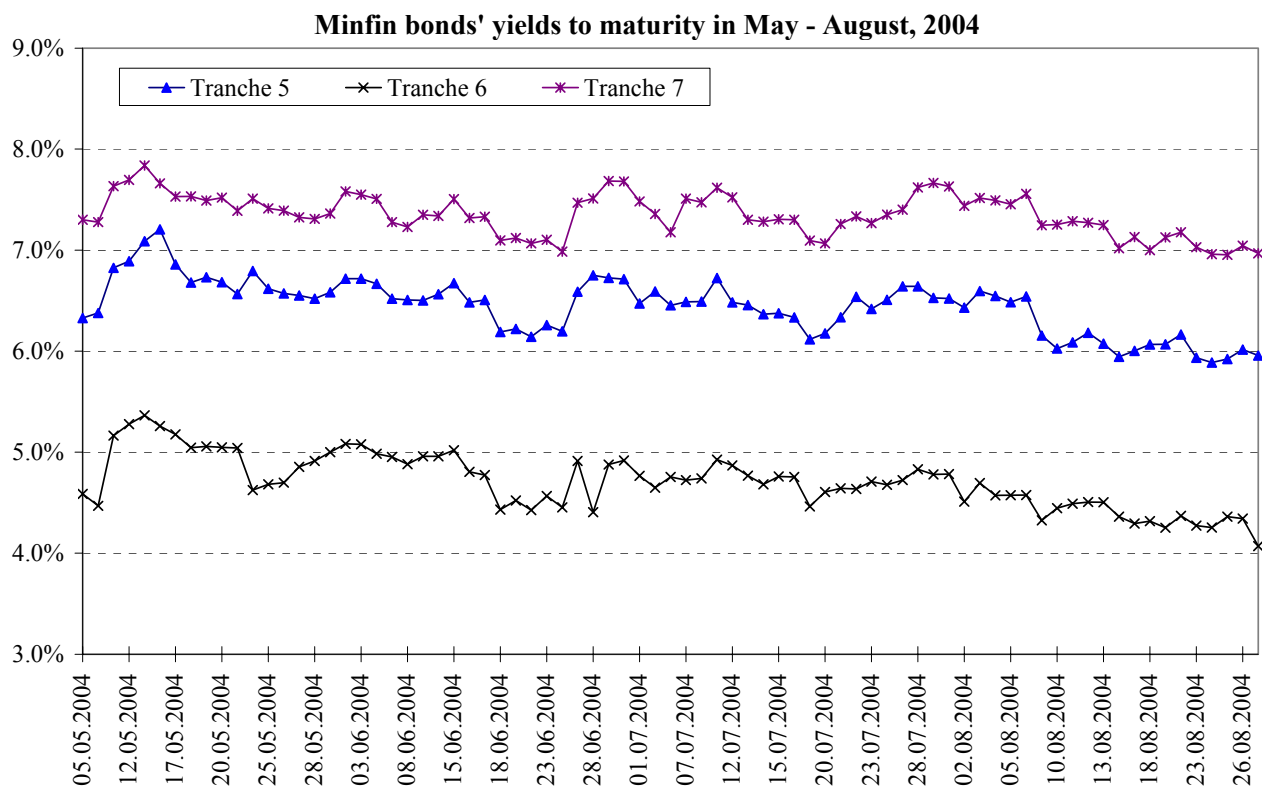
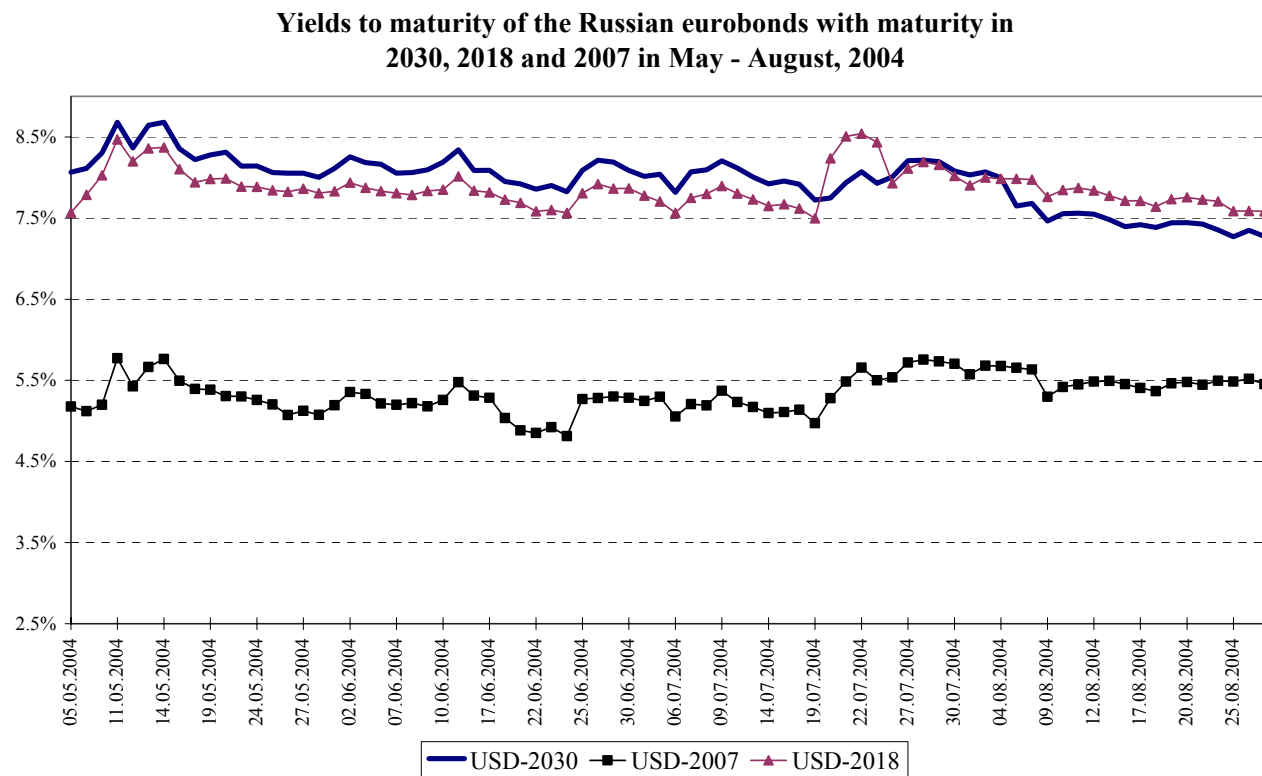


FIGURE 2.



As concerns the segment of Ruble denominated public bonds, in August there persisted a relative stability. On the one hand, the insignificant changes in quotations could be caused by the seasonal lull

on the market. On the other hand, the low volatility of quotations may be an evidence of the high stability of the existing price levels.

Over the period from August 2 to 27, the aggregate turnover of the secondary GKO OFZ market made about RUR 37 billion, while the average daily turnover was at RUR 1.76 billion. In the same period, there took place several auctions for the placement of GKO – OFZ. On August 4, there took place the auction for the additional placement of OFZ AD 46001 and two auctions for the additional placement of OFZ AD 46003 and OFZ AD 46014, the nominal value of which made RUR 4.5, 3, and 2.5 billion each. The amount of these placements made RUR 2.1 billion, 35 million, and 1.7 billion respectively, while the weighed average yields of the placements were at 7.02 per cent p. a. for OFZ AD 46001, 7.55 per cent p. a. for OFZ AD 46003, and 8.18 per cent per annum for OFZ AD 46014. At the auction for the placement of OFZ AD 46001 (which took place on August 25), the amount of placement made RUR 249 million, while the weighed average yields of this placement was at 7.1 per cent. On the same day, there took place the auction for the additional placement of OFZ AD 46002, the nominal value of which made RUR 1 billion. The amount of this placement made RUR 755 million, while the weighed average yield of the placement was at 8.08 per cent per annum.

As on August 31, the amount of the GKO – OFZ market made RUR 455.05 billion at par and RUR 433.41 billion at the market value. The duration of the GKO-OFZ market portfolio was 1667.83 days.

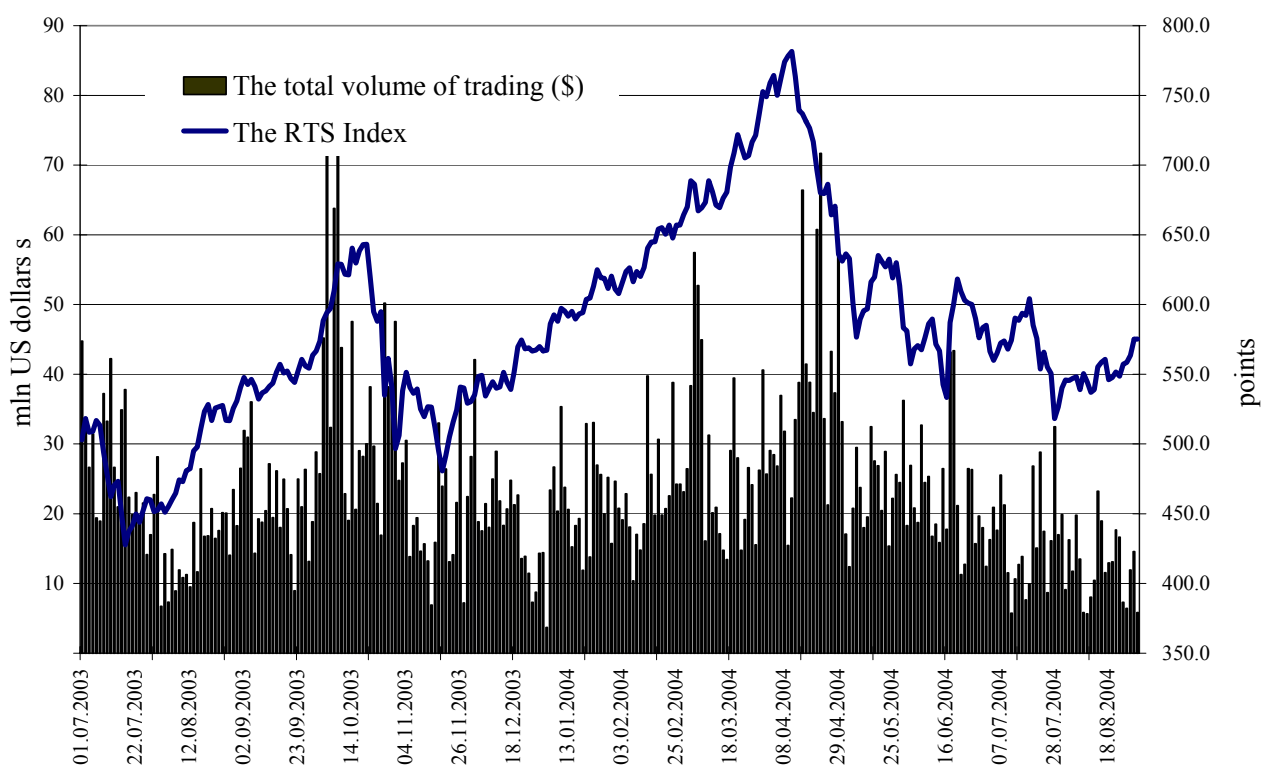
## **The Market for Corporate Securities**

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

Over the first two weeks of August, the situation on the Russian stock market was to a significant degree determined by the developments relating to the YUKOS affair. The fluctuations of prices of the company's stocks during a trade session reached 15 per cent to 20 per cent, so the trade relating to these securities had to be suspended. At the same time, at the background of the price surge on the oil world market, the securities issued by oil companies were in the favorable position. The third week of the month was characterized by a sharp decline in quotations of blue chips, for instance, as concerns Gazprom shares, this process was initiated by the news about the deputy appeal to the General Procurator's office to investigate the "gray" schemes used by non-residents for purchase of ordinary shares in this company. Besides, ING and Societe Generale declined their participation in the syndicated credit for TNK – BP explaining this by the deterioration of the business climate in the country. At the background of continuing court proceedings concerning the YUKOS affair, this and other events are an evidence that investors still extremely seriously apprehend political risks and these risks prevent a fast recovery of the Russian stock market. However, the situation changed in the last week of the month. The positive sentiments of operators prevailed on the market resulting in a growth in quotations of the most liquid securities. The market was also supported by a number of factors, especially significant of which was the favorable external business situation and positive macroeconomic statistics. In spite of the low activity of operators due to the seasonal factor and uncertainty relating to the YUKOS affair, the absence of negative corporate news facilitated a rise in quotations of blue chips. Other factors behind the positive market dynamics were the announcement of the terms of the auction for the sale of the state owned block of shares in the oil company LUKoil and the information that the company ConocoPhillips intends to increase its share in the oil giant up to 25 per cent.



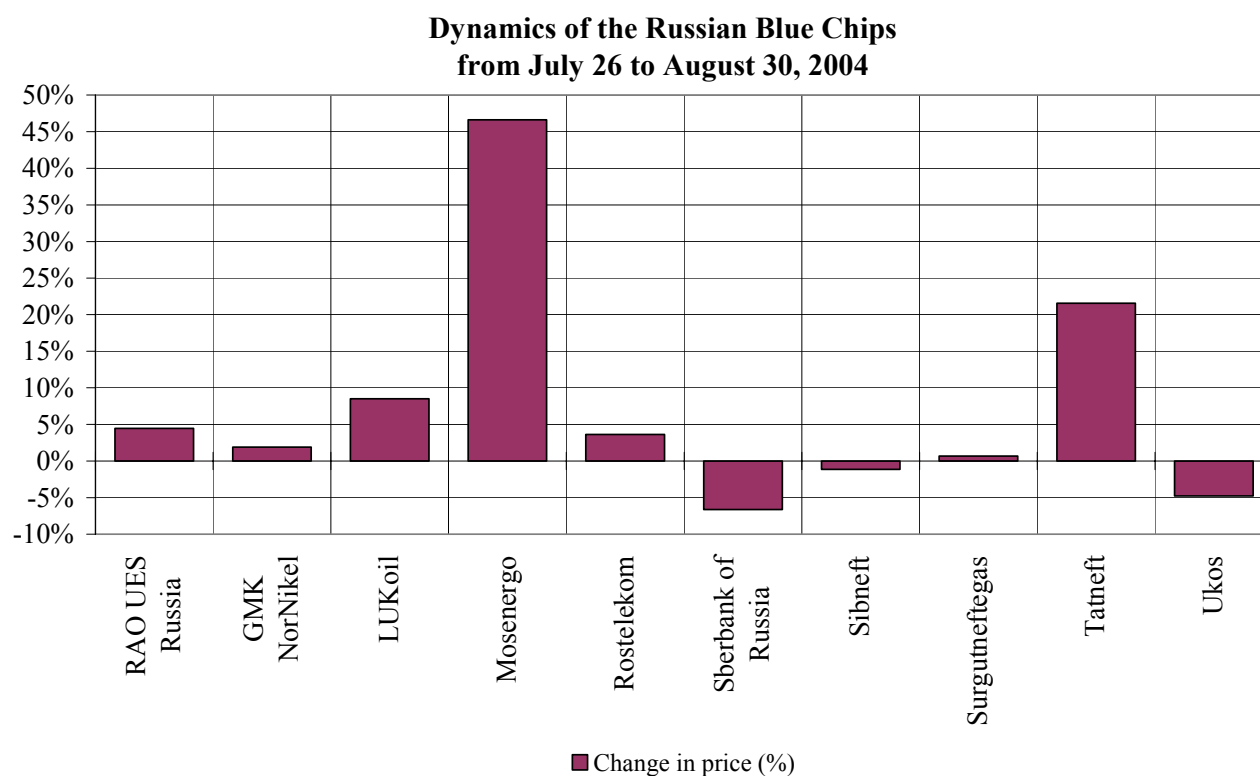
FIGURE 3.



On the whole, in the period from July 30 till August 30, the RTS index increased by 6.48 per cent, or by 35.01 points in absolute terms. Over the same period, the turnover of the RTS trading amounted to about US \$ 260.5 million (about US \$ 368 million in July), while the average daily turnover at the RTS made about US \$ 12.4 million (US \$ 16.7 million in July). The highest and the lowest volumes of trade at the RTS made US \$ 23.2 million (on August 13) and US \$ 5.6 million (on August 10) as compared with US \$ 28.8 million and US \$ 5.7 million respectively in July.

Over the last month (from July 26 till August 30), practically all “blue chips” with the exception of the Sberbank of Russia (a 6.63 per cent decline), Sibneft (a 1.14 per cent decline), and YUKOS (a 4.76 per cent decline) demonstrated a growth in prices. Thus, shares in Mosenergo, the price of which increased by 46.63 per cent over the period under observation, became the leaders. Most probably, the factor behind such a sharp rise in quotations was the purchase of the respective shares by a strategic investor. These shares were followed by the stocks of the Tatneft (21.56 per cent), shares in LUKoil (8.49 per cent), RAO UES of Russia (4.44 per cent), and Rostelekom (3.63 per cent). At the same time, the stocks of the GMK Norilsk Nickel and Surgutneftegaz demonstrated the lowest rates of growth among all blue chips – 1.89 per cent and 0.67 per cent respectively.

FIGURE 4.



In August, the list of leaders in terms of the volume of turnover at the RTS<sup>13</sup> periodically changed. The shares in the RAO UES of Russia and LUKoil were traditionally among the 5 leaders of the market in terms of turnover the share of which in the weekly amount of trade fluctuated from 15 per cent to 55 per cent. Over several weeks, among the leaders there were stocks of YUKOS, Surgutneftegaz, Rostelekom, and the RF Sberbank.

As on August 30, the top five leaders of the national stock market by capitalization looked as follows<sup>14</sup>: LUKoil: US \$ 24.98 billion; Surgutneftegaz: US \$ 24.47 billion; Sibneft: US \$ 12.23 billion; MMC Norilsk Nickel: US \$ 11.55 billion, and the RAO UES of Russia: US \$ 10.59 billion.

**The market for fixed term contracts.** In August, the activity of investors on the RTS market for fixed term contracts (FORTS), as well as other segments of the Russian financial market, was at a low level. Thus, in the period from August 2 till 30 the aggregate volume of trade in futures and options at the RTS amounted to about RUR 20 billion (108.1 thousand transactions; 2.86 million contracts), what was somewhat below the respective indicators registered in the preceding month (turnover - RUR 21 billion, 103.5 thousand transactions; 2.83 million contracts).

As usual, futures contracts account for the greatest percentage of transactions: the volume of trade in these contracts made RUR 18.6 billion (2.66 million contracts, 104.9 thousand transactions) over the period under observation. As before, options were in a much lower demand: the respective amount of trading made about RUR 1.48 billion (206 thousand contracts, 3.18 thousand transactions). The maximum trading volume was observed on August 18 and made RUR 1.69 billion, while the minimum trading volume (RUR 429.9 million) was registered on August 9.

**Corporate bond market.** On the whole, over the month on the market of corporate bonds there was observed a certain growth in quotations. From August 2 till August 30, the price index of corporate bonds traded at the MICEX<sup>15</sup> increased by 0.51 points (0.47 per cent) and the index of ten most liquid corporate sector bonds increased by 0.6` points ( by 0.54 per cent).

<sup>13</sup> On the classical stock market.

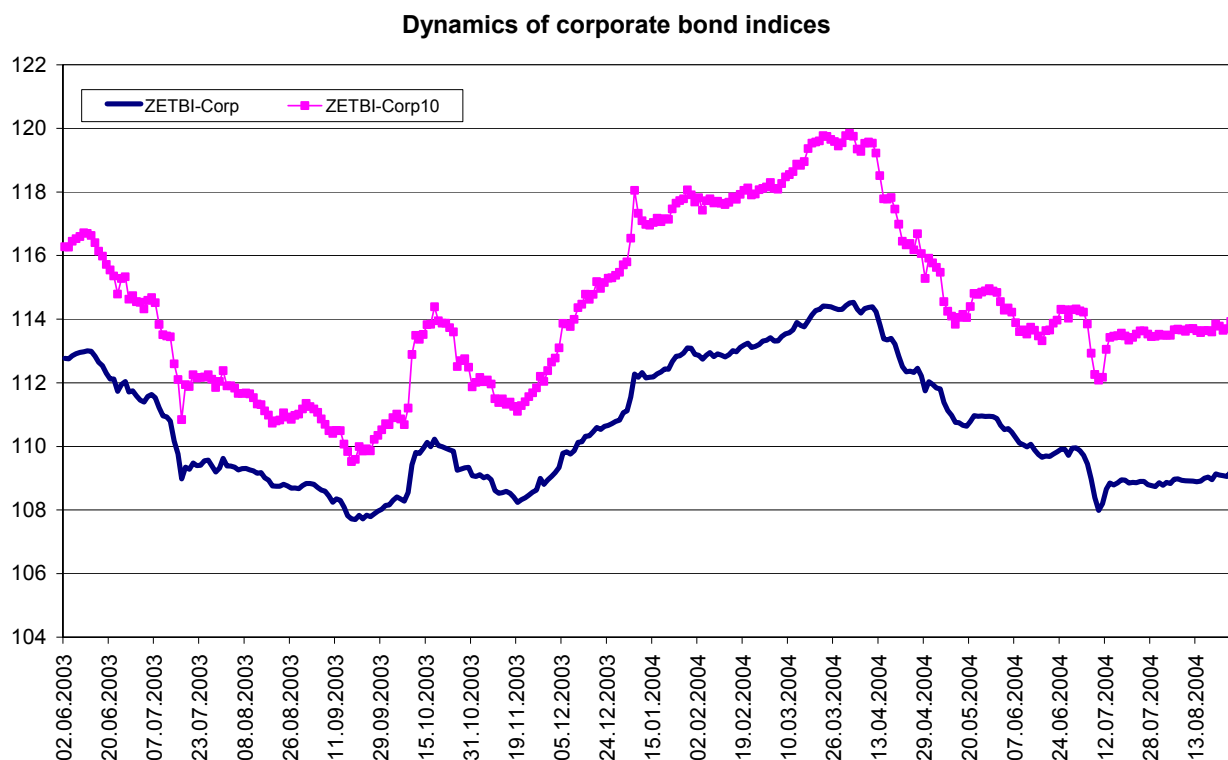
<sup>14</sup> According to the RTS.

<sup>15</sup> The indices of corporate bonds traded at the MICEX that have been used for the calculations are calculated by Zenit Bank.

Throughout the month, the situation on the corporate debt market remained stable at the background of a smooth upward trend demonstrated by quotations. The stability of the market was supported by the high level of liquidity in the banking sector. On the one hand, the market was affected by the Ruble devaluation, on the other hand, the quotations were supported by the external situation characterized by the positive dynamics of base assets and Russian Eurobonds. Only by the end of the month the market recovered: the prices of the “first echelon” issues increased, while the amount of trade was sufficiently high.

In the period from August 2 till August 27, the total turnover in the bond sector of MICEX made about RUR 12.6 billion, while the average daily turnover was registered at RUR 632 million.

FIGURE 5



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

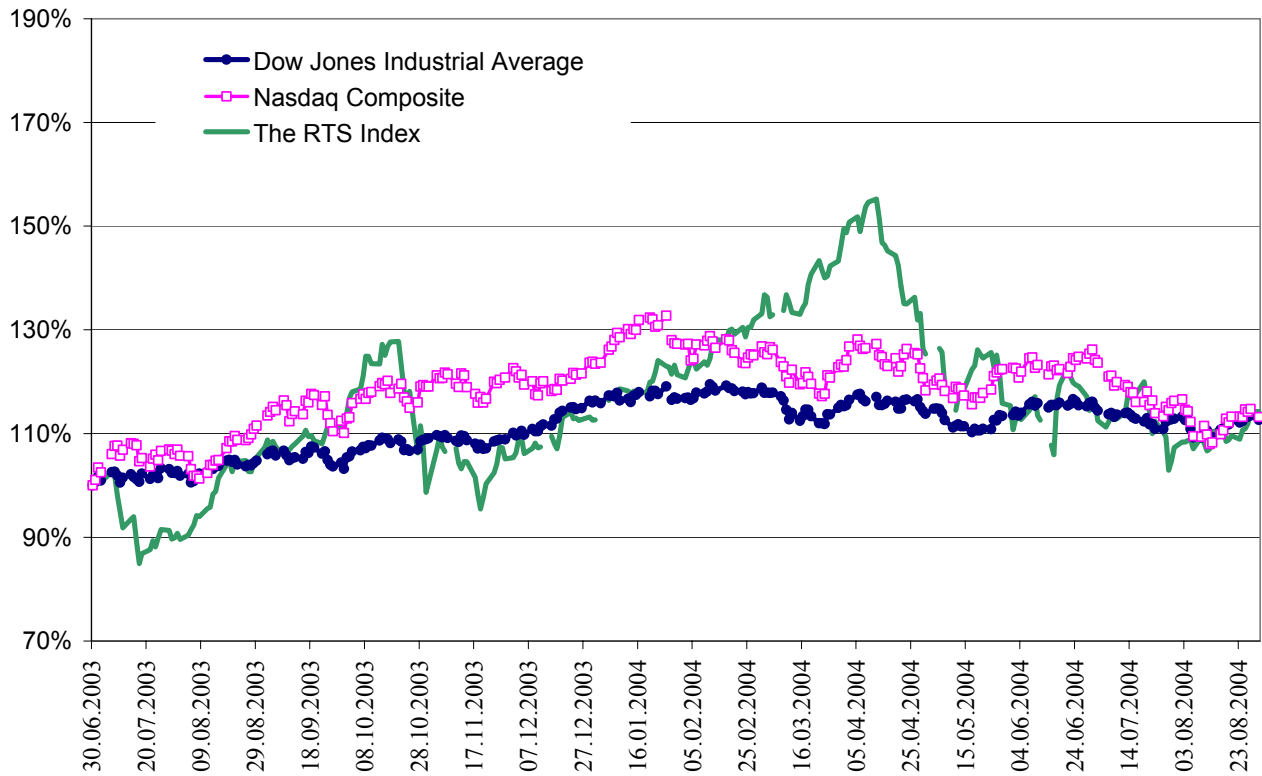
The oil prices on the world market continued to reach new historical maximums and remained at a high level. In the beginning of the month, the upward trend in oil prices was provoked by the news about the announcement of a higher level of the treat of terrorist attacks in the USA. Besides, the YUKOS affair still facilitated a fall in quotations: a decrease in supply of oil to the world market could create additional prerequisites for a further increase in prices of the “black gold”. In the situation, where the OPEC capacity to increase oil extraction in order to move prices down has been practically exhausted, this factor may significantly support the market. At the moment, only Saudi Arabia has a reserve amounting to about 1 million barrels a day. The instability in Iraq also is one of the factors pushing the oil prices up. By the end of the month, the prices were somewhat adjusted downward after the publication of the data on a growth in reserves of oil and oil products in the USA.

In August, on the world stock markets there prevailed trends towards a growth in the leading stock indices. Practically all stock indices of developed and developing countries grew by the end of the month (see Table 1). The only exception was the US index NASDAQ, which declined by 0.14 per cent by the end of the month.

In the first two weeks of the month, on the US trading floors there was observed a deterioration of the market situation, occurring at the background of prevailing negative macroeconomic statistics and

corporate news, as well as high prices of oil. Corporations continued to publish negative forecasts for the current quarter, while the data about the labor market were also pessimistic. The tremendous trade deficit also did not facilitate investors' optimism. A positive factor for the stock market remained only the low yields of government bonds. Starting from the middle of the month, stock indices began to recover. The factors behind the recovery were the technical "oversale" of stocks, as well as a significant fall of the world oil prices.

FIGURE 6.



### Corporate news.

#### *The OAO Mosenergo*

In the beginning of the month, the company published the results of its operations in the first six months of 2004. According to the statement, in the first six months of the year the loss borne by the OAO Mosenergo made RUR 285 million after the profit tax and other mandatory payments as compared with RUR 1.3 billion profit registered in the respective period of 2003. The decline in profits is related to the growth in payments relating to the property tax, since the list of property subject to privileged taxation has not been approved as yet.

#### *The OAO GMK Norilsk Nickel*

On August 9, international ranking agencies Moody's and Standard&Poor's announced that the company was granted the credit ranking. The agency Moody's granted Norilsk Nickel the long term credit ranking denominated in foreign exchange at the "Ba1" level, the forecast of changes was "stable." At the same time, the agency Standard&Poor's granted the company the long term credit ranking denominated in foreign exchange at the "BB" level, the forecast of changes was "stable." The credit ranking at the national scale was granted at the "ruAA" level.

#### *The RAO UES of Russia*

On August 4, the company published the financial statement of the RAO UES of Russia Group for the first six months of 2004 prepared in accordance with the Russian Accounting Standards (RAS). Over this period, the operating revenues of the Group declined from RUR 30.496 billion to RUR

17.059 billion. In the first six months of 2004, the net profits of the RAO UES of Russia Group from core activities made RUR 10.615 billion, what was by about RUR 0.799 billion below the level registered in the preceding year.

*The NK YUKOS*

On August 6, the NK YUKOS received from its agent bank for the pre-export credit amounting to US \$ 1.6 billion the default notification caused by the YUKOS affair and its impact on the company's business and assets. The notification sent by the agent bank points out that due to the default, the credit should be repaid in accordance with the instructions of the agent bank. The NK YUKOS was also informed by the both groups of participants in pre-export credits that in accordance with the terms of the credit documentation the banks have the right to use funds relating to proceeds from sales of export oil shipments being the credit collateral for full or partial repayment of the debt.

*Table 1.*

**Dynamics of International Stock Market Indices**

<b>Data as of August 30, 2004</b>	<b>Value</b>	<b>Change within the month (%)<sup>16</sup></b>	<b>Change since the beginning of the year (%)</b>
RTS (Russia)	575.28	3.63%	-1.84%
Dow Jones Industrial Average (USA)	10122.52	1.61%	-2.67%
Nasdaq Composite (USA)	1836.49	-0.14%	-8.48%
S&P 500 (USA)	1099.15	1.39%	-0.84%
FTSE 100 (UK)	4490.1	4.74%	-0.45%
DAX-30 (Germany)	3838.85	2.30%	-4.47%
CAC-40 (France)	3636.71	2.95%	1.11%
Swiss Market (Switzerland)	5448.8	0.09%	-2.40%
Nikkei-225 (Japan)	11184.53	0.22%	3.32%
Bovespa (Brazil)	22869.00	7.28%	1.89%
IPC (Mexico)	10199.54	2.80%	25.64%
IPSA (Chile)	1623.72	8.61%	9.37%
Straits Times (Singapore)	1905.45	2.67%	6.37%
Seoul Composite (South Korea)	805.19	9.37%	-1.96%
ISE National-100 (Turkey)	19855.25	6.49%	3.70%
Morgan Stanley Emerging Markets Free Index	438.84	4.86%	-0.97%

**The Foreign Exchange Market.**

In the beginning of the month, the situation on the foreign exchange market was determined by two factors: the start of the new reporting period in the banking sector stimulating a growth in demand for foreign exchange and the extremely high oil prices on the world market. The increase of the interest rate in the USA by 0.25 per cent on August 10 facilitated the appreciation of the US dollar on the Russian forex market, however, the large amounts of sales of forex denominated proceeds and a certain weakening of the dollar on the FOREX market made dollar to return to the level of RUR 29.25 per US \$. Later, the Ruble had somewhat appreciated at the background of sales of forex denominated proceeds and the growing demand for Rubles on the part of banks caused by the period of the payment of taxes. The Ruble appreciation was also caused by the depreciation of the US dollar on the world market at the background of the growing deficit of the US balance of trade and decline in the consumer confidence indices. By the end of the final week of the month, the growing demand for Ruble denomi-

<sup>16</sup> As compared to the level registered on April 23.

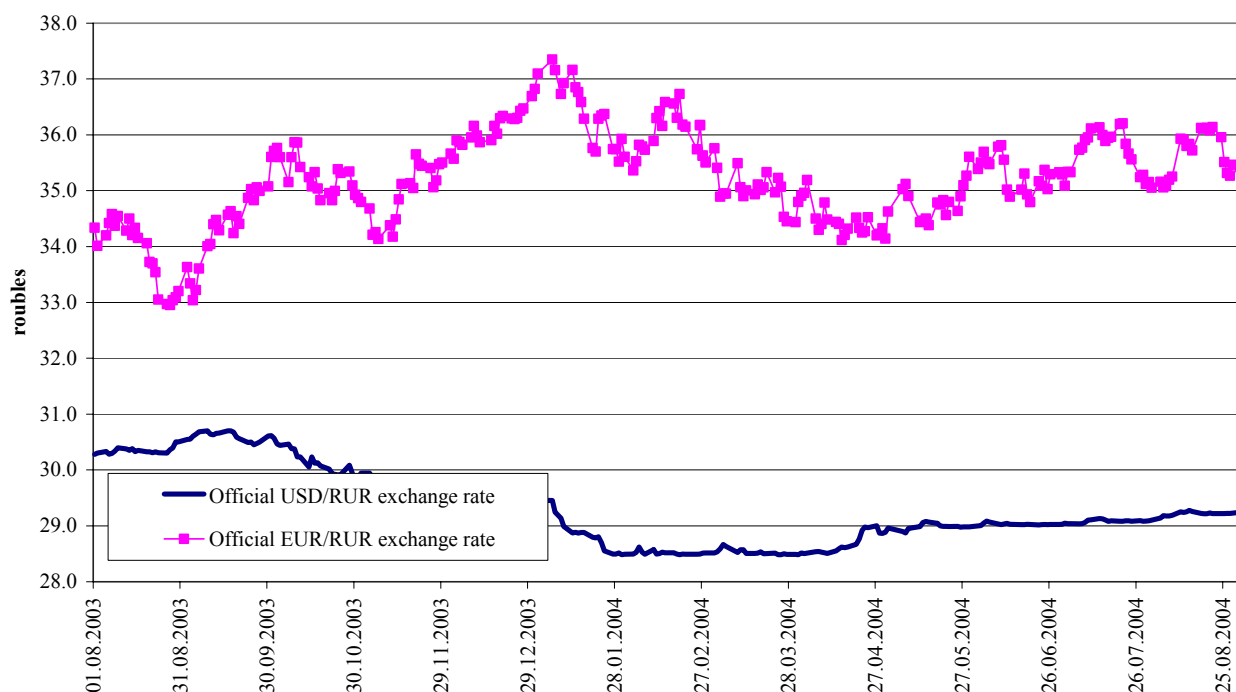
nated resources on the part of the banking system supported the Ruble exchange rate. In the situation, where the interest rates on overnight credits grew and the balances of correspondent accounts diminished to RUR 173 billion, the forex market actively used banks as a mechanism of management of liquidity..

Thus, from August 3 till August 31, the US \$ appreciated by RUR 0.104 (by 0.36 per cent) and made RUR 29.245 per US \$. The aggregate volume of trade in the US Dollar at the SELT in the period from August 2 till August 27 made about US \$ 13.2 billion. Over this period, the average daily turnover made US \$ 659 million. During the period under review, the highest volume of trade in the US Dollar, about US \$ 957 million, was observed on August 19; the lowest volume, US \$ 353.8 million, was observed on August 5.

This August, the Ruble liquidity in the banking sector somewhat decreased in comparison with the figures registered in the preceding month: in August, the average balances of correspondent accounts of credit organizations with the Bank of Russia made RUR 193.5 billion as compared with RUR 202.1 billion registered in July of 2004.

FIGURE 7.

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



On the world forex market, the US dollar / Euro exchange rate practically did not change by the end of the month, although it was characterized by significant volatility. In the beginning of the month, the publication of the negative data on the US labor market resulted in a sharp increase in the Euro / US \$ exchange rate up to US \$ 1.23 per Euro after a short period of consolidation at the level of US \$ 1.2 per Euro. The appreciation of Euro was also facilitated by the growth in the deficit of the US balance of trade, which was significantly above the forecasts. In the second half of the month, there were published statistical data on purchase of US securities by foreigners, which was favorable for the US \$ exchange rate. This factor, as well as the low inflation rate in the USA prevented the European currency from strengthening its positions on the world forex market. By the end of the month, the Euro depreciation occurred at the background of falling oil prices and under the impact of other technical factors. As a result, in the period from August 1 till August 31 the Euro exchange rate increased by US \$ 0.002 (0.17 per cent) on the world market making US \$ 1.205 per Euro.

The dynamics of the Euro / Ruble rate were mainly determined by the trends on the world market. In the period from August 3 till August 31, the European currency depreciated by RUR 0.015 (-0.04

per cent) from RUR 35.16 per Euro to RUR 35.14 per Euro. The aggregate turnover of trade at the SELT amounted to Euro 146.6 million in the period from August 2 till August 27, while the average daily turnover was registered at Euro 7.33 million. In this period, the highest trade volume of Euro was registered on August 11 at Euro 11.79 million, and the lowest, Euro 4.88 million, was observed on August 12.

According to the IET estimates<sup>17</sup>, in September and October of 2004 the Ruble / US \$ exchange rate is forecasted to be at RUR 29.35 and RUR 29.26 per US \$ respectively. At the same time, in these two months the US \$ / Euro exchange rate will be at US \$ 1.23 and 1.24 per Euro.

FIGURE 8.

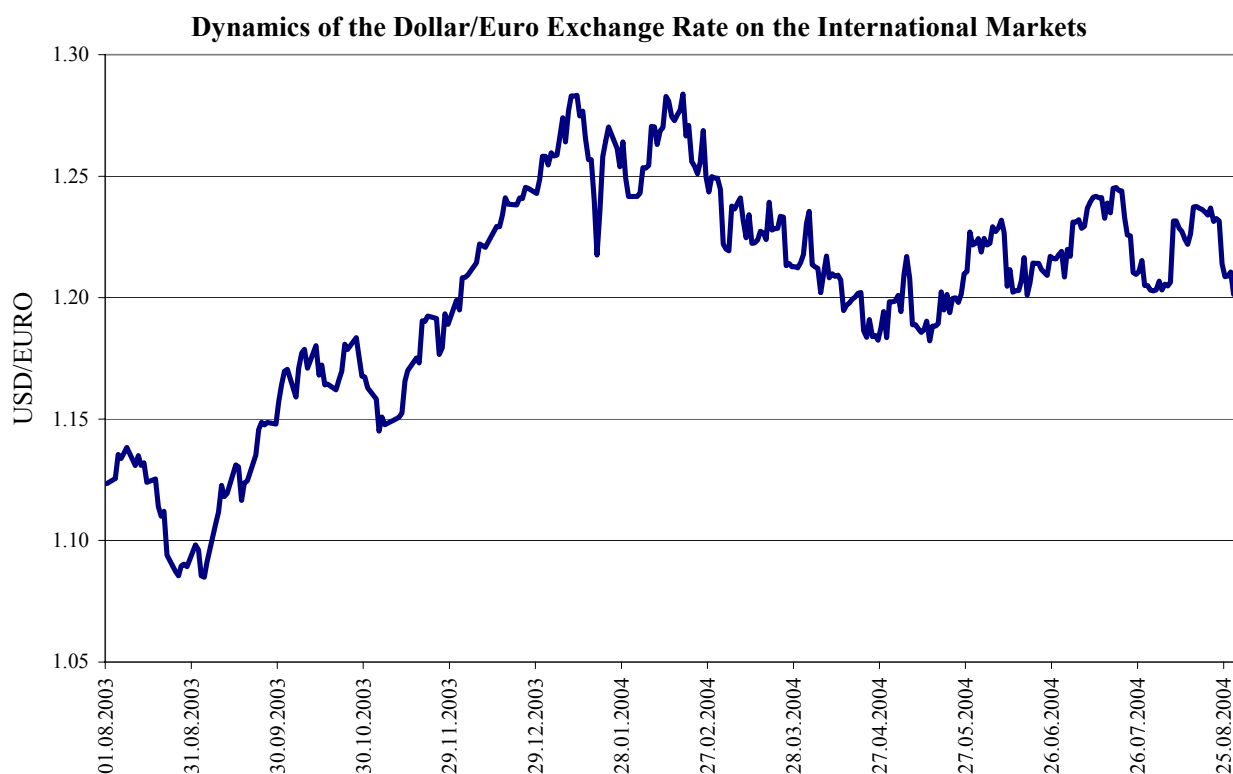


Table 2.

**Financial Markets Indicators**

Month	April	May	June	July	August*
Monthly inflation rate	1,0%	0,7%	0,8%	0,9%	0,5%
Inflation rate annualized on the basis of this month's trend	12,68%	8,73%	10,03%	11,35%	6,2%
CB RF refinancing rate	14%	14%	13%	13%	13%
Annualized yield to maturity on OFZ issues (%)	6,78%	7,04%		6,45%	6,6%
Volume of trading in the secondary GKO-OFZ market for the month (RUR billion)	21,72	19,67		6,41	21,5
Yield to maturity on Minfin bonds at the end of the month (% p.a.)					
5th tranche	6,38%	6,52%	6,71%	6,52%	5,9%
6th tranche	4,31%	4,91%	4,92%	4,78%	4,0%
7th tranche	7,25%	7,31%	7,68%	7,63%	6,9%
8th tranche	4,58%	5,41%	5,49%	5,33%	4,8%
Yield to maturity of Eurobonds at the end of the month (% p.a.)					

<sup>17</sup> See: The Bulletin of modeling calculations for short term forecasts of the RF's social and economic indices: July through August, 2004," IET, 2004.

Month	April	May	June	July	August*
2005	3,00%	3,35%	3,39%	3,45%	3,8%
2007	5,11%	5,07%	5,28%	5,71%	5,4%
2010	6,34%	6,36%	6,52%	7,94%	6,8%
2018	7,53%	7,81%	7,87%	8,02%	7,5%
2028	8,10%	8,22%	8,29%	8,53%	8,2%
2030	7,97%	8,00%	8,09%	8,08%	7,3%
INSTAR-MIACR rate (% p.a.) on interbank overnight loans at the end of the month	17,54%	21,18%	11,38%	4,96%	6,89%
Official RUR / US\$ exchange rate at the end of the month	28,8834	28,9850	29,0274	29,1019	29,2447
Official RUR / Euro exchange rate at the end of the month	34,1431	35,6052	35,2915	35,0532	35,1463
Average annualized growth in RUR / US\$ exchange rate	1,40%	0,35%	0,15%	0,26%	0,49%
Average annualized growth in RUR / Euro exchange rate	-1,89%	4,28%	-0,88%	-0,68%	0,27%
Volume of trading at the stock market in the RTS for the month (US\$ million)	830,27	419,36	482,07	368,25	277,15
Value of RTS-1 Index at the end of the month	634,61	581,47	584,63	540,27	584,65
Change in value of RTS-1 Index during the month (%)	-15,99%	-8,37%	0,54%	-7,59%	8,21%

\* Estimate

*D. Polevoy*

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

In the first six months of 2004, the share of investment in fixed assets made 13.3 per cent of GDP and persisted at about the level registered in the respective period of the preceding year. The amount of investment in fixed assets from all sources of financing increased by 12.3 per cent in the period from January through July of 2004.

In the first six months of 2004, there was observed a number of significant shifts in the structure of investment across the sources of financing. There was registered a significant increase in the share of the banking sector in crediting of the investment complex. At the background of the stable economic growth, there increased the intensity of inflow of foreign investment in the Russian economy.

This year, a specific feature of the Russian economy is a high level of business activity in construction. The progressive trend towards a growth in investment in fixed assets was positively affected by the gradual decrease in risks resulting from the stable improvement of the legislative and regulatory base. In January through July of 2004, investment in fixed assets made Rub. 1230.6 billion and were by 12.3 per cent above the figures registered in the respective period of the preceding year.

In the first six months of 2004, there was observed a number of significant shifts in the structure of investment across the sources of financing. The amount of credits and other lending granted by crediting organizations to non-financial enterprises and organizations increased by 15.1 per cent and made Rub. 2646.7 billion, while the share of these credits in the assets of the banking sector has increased by 2 p. p. since the beginning of the year. The share of bank credits in the financing of investment programs increased by 2.5 p. p. in comparison with the figures registered in the respective period of the preceding year, while credits granted by foreign banks grew by 0.3 p. p. The aggregate share of bank credits and borrowings of other organizations (insurance and investment companies, industrial and trade enterprises, etc.) made 17.9 per cent in the first six months of 2004 and was by almost 4.2 p. p. above the level observed in the last year.

At the background of economic growth, there increased the interest of foreign investors in the Russian economy. In the first six months of 2004, the Russia's economy received foreign investment amounting to US \$ 19.0 billion, what was by 49.9 per cent above the figures observed in the first six months of 2003. Over the same period, foreign direct investment increased 1.35 times and made US \$ 3.4 billion. According to the preliminary estimates, the share of foreign investment in the structure of



the sources of financing has increased by 3.2 p. p. The decline in profitability of alternative Ruble and forex denominated financial instruments, more active operations of banks, other crediting organizations, and private investors relating to investment in the real sector of the economy was a factor compensating for the decline in the share of budget funds.

In comparison with the figures registered in the first six months of 2003, the share of budget resources in the financing of investment in fixed assets has decreased by 2.2 p. p. This process developed at the background of the changes occurring in ratios between budgets of different levels. As a result, the investment burden on the budgets of RF subjects increased, while the share of federal funds declined. In January through July of 2004, according to the data presented by the RF Finance Ministry, the state capital investment were financed in the amount of Rub. 23.9 billion, what makes 35.3 per cent of the annual limit. The amount of funds of the federal budget allocated for financing of state capital investment has declined by Rub. 8.1 billion in comparison with the figures registered in the January through July of 2003.

*Table 1*

**Structure of investment in fixed assets across sources of financing in the first six months of 2002 through 2004, in % of the total**

	2002	2003	2004
Investment in fixed assets, total	100	100	100
Including			
1. <i>Own funds</i>	51,6	46,5	48,6
of which			
Profits	21,6	17,5	17,3
2. <i>Borrowings</i>	48,4	53,5	51,4
of which			
Budget resources	18,9	18,4	16,2
including:			
Federal budget	5,2	5,7	4,2
Budgets of RF subjects	12,4	11,8	11,2
Bank credits	4,3	4,8	7,3
Including credits of foreign banks	0,5	0,8	1,1
Borrowings form other organizations	5,7	7,9	6,0
Extra-budgetary funds	2,8	0,9	0,7
Other	16,7	21,5	21,2
Foreign investment in the total amount of investment in fixed assets		5,6	4,5

Source: Federal Service of State Statistics

The own funds of enterprises continued to play the most significant role in the structure of the sources of financing of investment. In the first six months of 2004, the share of such funds made 48.5 per cent of the total amount of investment in fixed assets. Although in comparison with the figures registered in 2003 there was observed a certain increase in the share of own funds, the analysis of the dynamics of investment across the sources of financing in the post-crisis period demonstrates that as the rates of economic growth recovered, enterprises primarily orient towards attraction of other sources of financing of investment activities. These developments are determined by both the stability and predictability of the macroeconomic situation and behavior of the authorities, and the expansion of the range of services and opportunities of participation of the banking sector in the financing of the real sector of the economy.

There were observed certain signs of diversification of the investment process. At the background of enhancing business activity in the sector of services, the dynamic development of communications, transport, and trade was supported by the stable increase in the scale of investment. At the same time, the specific weight of investment in fixed assets in the sector of goods was significantly affected by the decline in the share of industry from 44.1 per cent in comparison with 46.1 per cent registered in the first six months of 2003 and, respectively, the share of construction from 3.1 per cent to 2.9 per cent.

Table 2

**The structure of investment in fixed assets across sectors of the economy in the first six months of 2002 through 2004, in per cent of the total**

	2002	2003	2004
Investment in fixed assets	100	100	100
Including:			
Sectors manufacturing goods	50,4	51,8	50,1
Sectors rendering services	49,6	48,2	49,9
From the total amount of investment:			
Industry	44,9	46,1	44,0
Construction	2,5	3,1	2,9
Agriculture	2,9	2,6	3,0
Transport	18,6	16,8	17,6
Communications	4,0	3,4	6,7
Trade	1,8	2,1	2,7
Housing and public utilities	14,7	15,9	12,5

Source: Federal Service of State Statistics

As concerns the sectoral structure of investment in fixed assets, this year there persisted the domination of the fuel sector. However, in comparison with the figures registered in the first six months of 2003, the decline in the share of investment in fixed assets of fuel industry in the total amount of investment in the development of industry made 6.0 p. p. In spite of the fact that there was observed a growth in export proceeds and an intensive increase in output, the share of investment in oil extracting industry has declined from 32.2 per cent registered in the first six months of 2003 to 25.9 per cent, and natural gas industry – from 12.8 per cent to 11.0 per cent.

As concerns the metallurgy complex, at the background of falling investment in nonferrous metallurgy by 0.6 p. p. the specific weight of ferrous metallurgy increased by 4.0 p. p. A negative feature of changes in the structure of investment in industry is the low investment activity observed across the branches of manufacturing industry. The specific weight of food industry in the total investment in fixed assets in the first six months of 2004 made 7.4 per cent, what is by 1.7 p. p. below the figures registered in the respective period of the preceding year. As concerns light industry and mechanical engineering, in these industries the share of investment remained at the levels observed in the first six months of 2003.

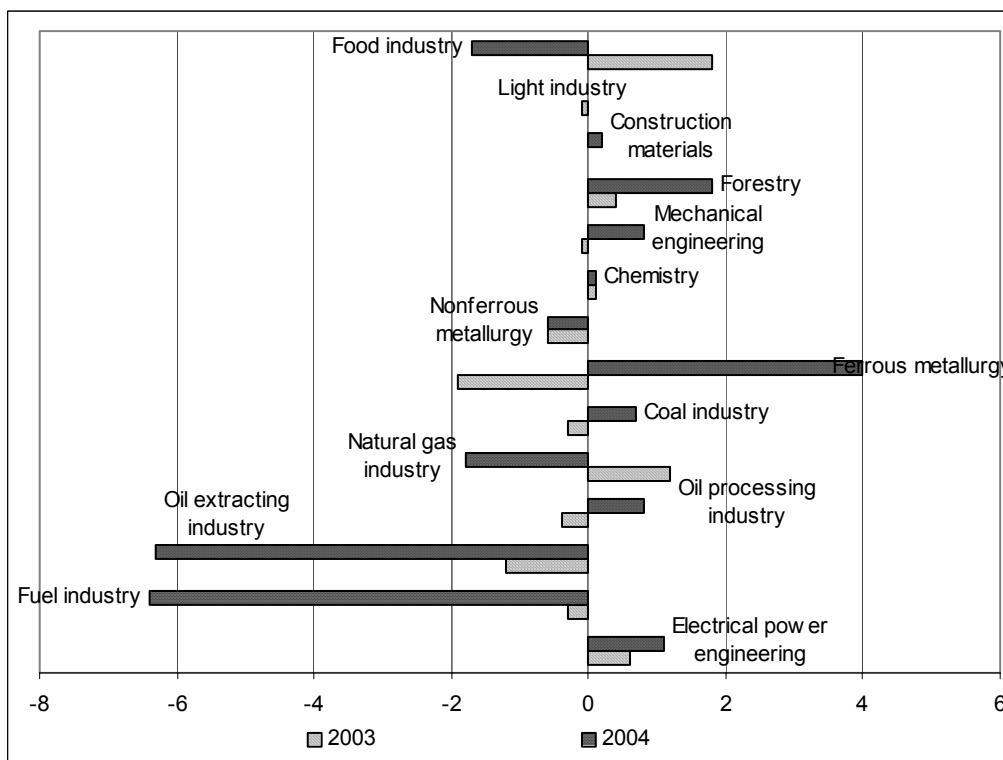
Table

**The type structure of investment in fixed assets in the first six months of 2002 through 2004, in per cent of the total**

	2002	2003	2004
Investment in fixed assets	100	100	100
Including:			
Residential housing	7,6	8,6	9,3
Buildings (with the exception of residential housing) and structures	47,3	49,7	44,6
Machinery, equipment, vehicles	36,8	34,0	38,4
Other	8,3	7,7	7,7

Source: Federal Service of State Statistics

This year, in mechanical engineering there was observed an increase in investment activity. However, at the current technological and age structure of the production apparatus of the industry, the economy experiences an intensive lack of modern equipment and machinery. The domestic mechanical engineering was not adequate to the growing investment demand both in terms of the amount and the structure of supply of capital goods. In the situation of the existing trends towards an increase in the share of machinery and equipment in the technological structure of investment, the greater role has been played by the import of foreign equipment. Investments for purchase of foreign equipment made by organizations in the first six months of 2004 made Rub. 69.8 billion, or 23.5 per cent of the total investment in machinery and equipment. Import of investment equipment has made almost 40 per cent of the total amount of imports, and increased by 45 per cent in this year.



*Fig. 1* Changes in the structure of investment in fixed assets across industries in the first six months of 2003 through 2004 in comparison with the figures registered in the respective period of the preceding year, in %

By the end of the first six months of 2004, the share of investment in fixed assets made 13.3 per cent of GDP and remained at about the level registered in the preceding year. In the situation characterized by the exceptionally favorable business situation on the world market of raw materials and dynamic increase in proceeds of exporters there may be expected the acceleration of processes of transformation of savings into investment.

*O. I. Izryadnova*

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

According to the 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 major factors of growth remain the intensive dynamics of domestic and external demand. 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. According to the estimates, 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, while the rate of unemployment in the size of economically active population is 7.9 per cent, in 2004 GDP may grow by 6.6 per cent in comparison with the figures registered in the preceding year.

According to the 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. In the conditions of persisting favorable external business situation, the growth in the Russia's economy was to a significant extent determined by an intensive increase in exports. The dynamic increase in the gap between the rates of growth in exports and domestic demand has been registered since the 2<sup>nd</sup> quarter of 2002. In the first six months of 2004, the export of goods increased by 25.2 per cent in comparison with the figures registered in the respective period of the preceding year. The growing proceeds relating to the external economic activities had the dominating impact on the structure of GDP utilization.

The qualitative specifics of the economic growth observed in 2004 were also reflected in the acceleration of the rates of increase in domestic demand in comparison with the figures registered in the preceding year both on the investment and consumer markets. At the same time, it should be noted that in spite of persistence of high dynamics of imports at the background of the real Ruble appreciation, the contribution of Russian producers of goods and services in the satisfaction of domestic demand has increased. As compared with the figures registered in the first six months of 2003, the share of domestic production in the structure of resources of the domestic market grew by 2.6 p. p. A relative improvement of positions of domestic producers was caused by the growth in the share of services and works relating to construction in the structure of final demand, as well as improving standing of competitive industries, for instance, food industry, certain branches of mechanical engineering, chemical industry, and the industry of construction materials. For instance, according to the estimates published by the Federal State Statistical Service, in the 1<sup>st</sup> and 2<sup>nd</sup> quarters of 2004 the share of imports in the amount of commodity resources (as concerns food products) decreased to 34.0 per cent as compared with the figures registered in the 1<sup>st</sup> and 2<sup>nd</sup> quarters of 2003 (37.0 per cent and 32 per cent respectively). It should be stressed that the attractiveness of Russian goods in terms of their prices has been gradually closing the constraints relating to the increasing production costs and falling efficiency of production. In particular, the quality and intensity of the economic growth are negatively affected by the outpacing rates of growth in wages and salaries in comparison with labor productivity, an increase in electrical power and energy intensity of production and the low efficiency of use of fixed production assets.

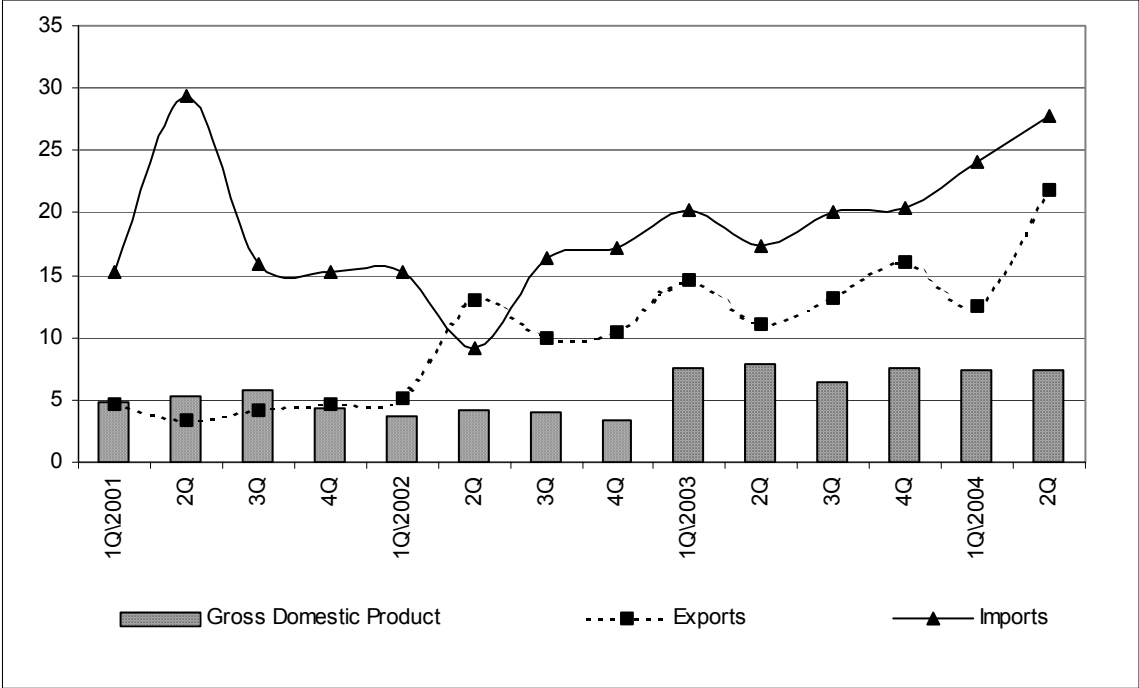


Fig. 1. Rates of growth in GDP, exports and imports in 2001 through 2004, in % of the figures registered in the respective quarter of the preceding year.

The structural shifts in GDP are characterized by the outpacing growth in gross accumulation and investment in fixed assets as compared with the dynamics of final consumption. In January through July of 2004, the increase in investment in fixed assets made 12.3 per cent, what is by 0.6 p. p. above the level observed in the respective period of the preceding year. It should be noted that at the background of persistence of stable rates of economic growth (as compared with the situation existing in the first six months of 2003) there is also observed an increase in the contribution of final consumption of households.

The acceleration of the dynamics observed in the consumer sector based on the growth in real disposable household incomes. In January through July of 2004, real household incomes increased by 9.7 per cent in comparison with the figures registered in the respective period of the last year. It should be

noted that this year the rates of growth in the real household incomes were most significantly affected by the outpacing rates of increase in wages and salaries. In January through July of 2004, wages and salaries grew by 14.2 per cent as compared with 9.7 per cent registered in the respective period of the preceding year at the background of extremely moderate dynamics of growth in the amounts of real gross pensions (106.7 per cent) and other sources of household incomes.

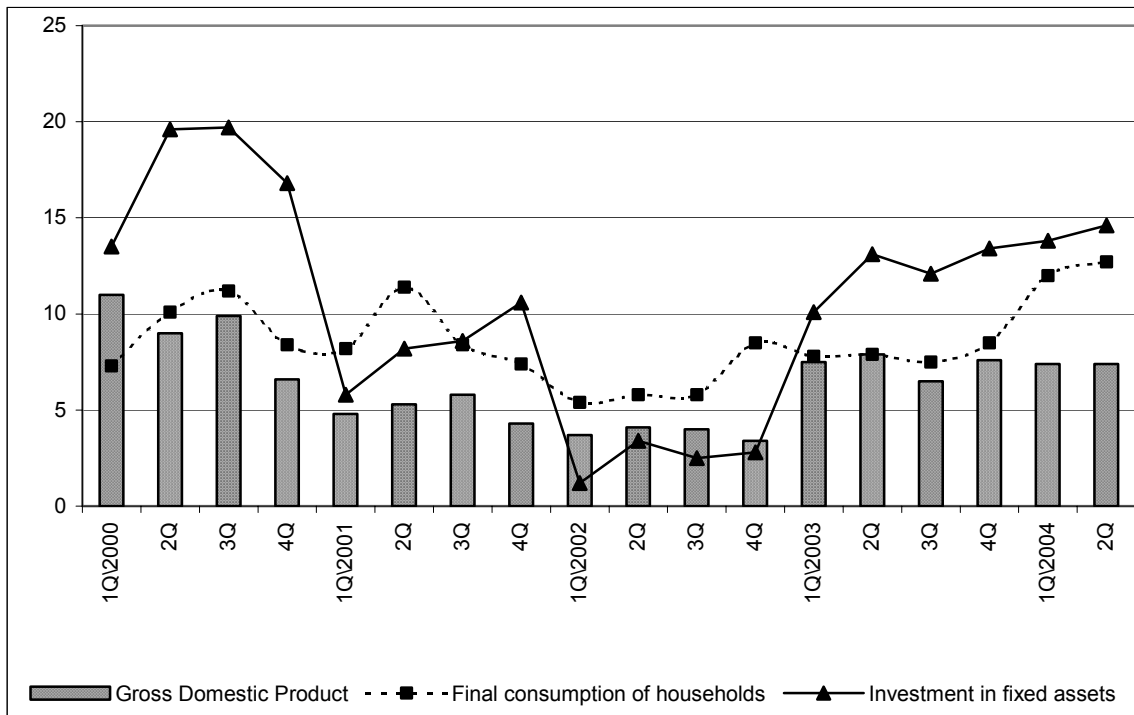


Fig. 2. Changes in the dynamics of GDP growth across the components of final consumption in 2000 through 2004, in % of the figures registered in the respective quarter of the preceding year.

The growing purchasing power of households facilitated the persistence of high rates of increase in the retail trade turnover. In January through July of 2004, households spent Rub. 4071.7 billion for purchase of goods and services, what was by 22.7 per cent above the indicators observed in the respective period of the last year. As concerns the structure of retail trade turnover, there was observed that the rates of increase in sales of non-food goods have constantly outpaced the rates of growth in the sales of foodstuffs, while the share of sales carried out via trading organizations increased and the assortment structure of sales changed in favor of more expensive food products.

The shifts in the structure of household demand and the growing share of sales of non-food durable goods and household appliances have facilitated the development of consumer crediting. In January through July of 2004, the amount of credits granted to individuals increased by 46.6 per cent and made Rub. 439.3 billion as on July 1, 2004. The share of retail credits in the assets of the banking sector made 7.1 per cent as on July 1, 2004, and 11.9 per cent of the total amount of credits granted by the banking sector.

Yet another specific feature of the changes in the consumer behavior of households was the increasing propensity to save. In January through July of 2004, the amount of cash household incomes made Rub. 5715.7 billion, savings made Rub. 1078.5 billion, what was by 19.3 per cent above the level registered in the preceding year. The amount of household deposits with crediting organizations on Ruble and foreign exchange denominated accounts made Rub. 1797.5 billion as on July 1, 2004, and increased by 16.7 per cent in comparison with the figures registered in the beginning of 2004 (the growth in Ruble and foreign exchange denominated accounts made 22.1 per cent and 4.0 per cent respectively).

In January through July of 2004, the structure of production was dominated by the outpacing rates of growth in trade, construction, and communications. While in January through July of 2004 the output of base sectors of the economy increased by 7.6 per cent, the amount of construction works, retail

trade turnover, and communications grew by 13.0 per cent, 11.3 per cent, and 26.3 per cent respectively.

As concerns the structure of industrial output, there was observed a shift in favor of industries manufacturing final goods, at the same time, in the 2<sup>nd</sup> quarter of 2004 the impact of these industries increased due to the enhancing investment activity. In January through July of 2004, the rates of growth in output of final industries made 109.5 per cent, while the respective indicator of mechanical engineering made 113.8 per cent. The industries of the consumer complex were characterized by extremely moderate rates of development (103.9 per cent): in January through July of 2004, in food industry the increment of production made 4.9 per cent, while in light industry there was observed a fall by 4.5 per cent.

This year, there was observed a decline in the contribution of industries manufacturing intermediate goods. The rates of growth in the industries belonging to the fuel and energy complex made 106.1 per cent, while output of industries engaged in production of raw materials increased by 5.3 per cent, what was respectively by 0.8 p. p. and 1.7 p. p. below the aggregate indicator of industrial growth registered in January through July of 2004.

According to the available data, the balanced financial results of the operations conducted by large and medium sized organizations across all sectors of the economy made Rub. 922.2 billion and was by 44.4 per cent above the level registered in the respective period of the last year. The increase in the balanced financial results is characteristic of the majority of the sectors of the economy, however, over the period under observation it grew at the most rapid rate in industry (165.5 per cent) and transport (198.5 per cent). In fuel industry the balanced financial results grew by 83.9 per cent, in ferrous metallurgy – 2.3 times, in nonferrous metallurgy – by 44.1 per cent, in chemistry and petrochemistry – by 70.8 per cent. As concerns the industries of the investment complex, the industry of construction materials took the leading positions (a 2 times growth). In mechanical engineering and metal working the balanced financial result increased by 11.3 per cent, while in construction it made 81.5 per cent of the level registered in the preceding year.

Taking into account the fact that the industries of the investment complex have the dominating impact on the dynamics of industrial development, it should be noted that in mechanical engineering and metal working there was observed a decline in output (by 8.3 per cent in comparison with the figures registered in June of 2004). The July decrease may be viewed as a factor compensating for a sharp increase in production observed in June (118.1 per cent). Besides, a significant impact had the wave-like process of production of technological equipment, the weight of which in the structure of mechanical engineering has significantly increased over the last 18 months. Taking into account the high degree of influence of inter-branch ties between mechanical engineering and industries producing construction materials, this aspect requires close attention.

*O. I. Izryadnova*

## **Regions: Dynamics of Industrial Output**

---

In the first six months of 2004, the differences among regions in terms of dynamics of industrial output were very significant yet. While the national industrial output index made 107.4 per cent, its value varied across RF subjects from 153.6 per cent in the Nenets AO to 74.0 per cent in the Chukotka AO.

In all federal okrugs (with the exception of the Ural federal okrug embracing few RF subjects) there were registered regions demonstrating very high rates of growth or decline in industrial output. Both the lists of leading and outsider regions, as concerns the dynamics of industrial production, include RF subjects with very different economic specializations. The Archangelsk oblast maintained its leading positions due to the persisting high rates of growth in the fuel industry of the Nenets AO (where in 2003 there were also registered the maximal values of the industrial output index). Apparently, the positive effect of the special economic zone regime in the Kaliningrad oblast persisted this year. The regions oriented towards the most capacious sales markets could maintain their attractiveness (the Moscow oblast, the Tver, Ivanovo, and Tula oblasts, as well as the city of St. Petersburg and the Leningrad oblast).

Table 1

**Regions demonstrating the most and least favorable industrial output dynamics in the first six months of 2004\***

Regions demonstrating most significant rates of growth in industrial output	IOI, first six months of 2004 in % of first six months of 2003	Regions demonstrating a decline in industrial output	IOI, first six months of 2004 in % of first six months of 2003
Arkhangelsk oblast	132,9	Krasnoyarsk krai	99,7
Kaliningrad oblast	124,2	Astrakhan oblast	99,2
Republic of Adygeya	120,2	Khabarovsk krai	99,2
Republic of Mordovia	120,0	Republic of Ingushetia	97,7
Chuvash Republic	119,6	Smolensk oblast	95,4
Rostov oblast	118,6	Chita oblast	95,2
Moscow oblast	117,3	Ulyanovsk oblast	94,6
Tomsk oblast	117,2	Kamchatka oblast	92,2
City of St. Petersburg	116,4		
Republic of Sakha (Yakutia)	116,1		
Republic of Dagestan	115,6		

\* without autonomous okrugs

IOI – industrial output index

The most significant changes in the distribution of leading regions in terms of their shares in the national amount of industrial output in the first six months of 2004 in comparison with the figures registered in the respective period of 2003 were the noticeable increase in the role played by the Tyumen oblast, or more exactly the oil extracting Khanty Mansi AO, naturally, due to high rates of growth in oil prices (see Table 2).

Table 2

**Regions leading in terms of their share in the national volume of industrial output in the first six months of 2003 and 2004\***

Regions	Share in industrial output, the first six months of 2004, in %	Regions	Share in industrial output, the first six months of 2003, in %
Tyumen oblast	12,19	Tyumen oblast	11,26
City of Moscow	5,28	City of Moscow	5,51
Sverdlovsk oblast	4,28	Sverdlovsk oblast	4,51
Moscow oblast	4,16	Moscow oblast	4,09
Samara oblast	4,05	Samara oblast	3,97
Chelyabinsk oblast	3,96	Chelyabinsk oblast	3,74
City of St. Petersburg	3,79	City of St. Petersburg	3,73
Republic of Tatarstan	3,61	Republic of Tatarstan	3,43
Krasnoyarsk krai	3,39	Krasnoyarsk krai	3,30
Kemerovo oblast	3,11	Republic of Bashkortostan	2,86
<i>Total top 10</i>	<i>47,82</i>	<i>Total top 10</i>	<i>46,40</i>
Republic of Bashkortostan	3,08	Kemerovo oblast	2,75
Nizhni Novgorod oblast	2,59	Perm oblast	2,59
Perm oblast	2,47	Nizhni Novgorod oblast	2,42
Vologda oblast	2,10	Vologda oblast	2,01
Lipetsk oblast	1,92	Irkutsk oblast	1,98
<i>Total top 15</i>	<i>59,99</i>	<i>Total top 15</i>	<i>58,16</i>

\* without autonomous okrugs

As concerns the federal okrugs, the most unusual recent development was the relatively high rates of growth in industrial output in the Far East federal okrug (see Table 3). In the last few years, the

situation in this okrug was the worst, in 2003 its characteristic feature was the minimal rates of growth in industrial output. It should be noted that the North West federal okrug and the Central federal okrug have maintained their leading positions in terms of industrial output growth for several years running.

Table 3

### Characteristics of industrial output across federal okrugs

Federal okrugs	IOI, first six months of 2004 in % of first six months of 2003	Share in the national industrial output (in %)	
		First six months of 2004	First six months of 2003
Central federal okrug	109,2	21,51	22,27
North West federal okrug	114,3	12,47	12,16
Southern federal okrug	108,0	6,14	6,36
Privolzhski federal okrug	107,6	22,31	22,20
Ural federal okrug	108,6	20,73	19,81
Siberian federal okrug	103,5	12,69	12,36
Far East federal okrug	108,4	4,15	4,83
<b>Russian Federation</b>	<b>107,4</b>	<b>100,00</b>	<b>100,00</b>

It should be noted that as concerns federal okrugs there is observed a certain discrepancy between the dynamics of industrial output in terms of volumes and amounts of production. Thus, in spite of rather high values of the industrial output index registered in the Far East federal okrug, its share in the national amount of industrial output has decreased somewhat. The maximal rate of growth in output in terms of amount was registered in the Ural federal okrug, what may be explained by the aforementioned factor of high rates of increase in oil prices.

*O. V. Kuznetsova*

### Industrial situation in August 2004.

The first data on situation in the Russian industry in August are characterized by a combination of stabilized figures and positive movement of various parameters. The Russian industry was able to reach a positive profit-earning capacity due to satisfied demand and recovered normal growth rates in sales. However, the industrial output and reserve estimates of manufactured finished goods remained almost unchanged. The later is nevertheless indicative of the fact that the Russian manufacturers have been successful in balancing the demand and the output.

The data on July provided by the Federal Statistic Service is indicative of a continuous upward tendency in the industrial production, with some retardation though. The average daily production output increased by 0.5% as compared to 0.7% of the monthly average figure recorded in the second quarter. The Center for Macroeconomic Analysis and Short-Term Forecast (CMASF) underlines the following specific features in the industrial movement in July 2004 : growth retardation in oil production ( down to 0.3% as compared to 0.8% of the monthly average figure recorded in the second quarter ); decline in production of nonferrous metals; continuous expansion of production at the civil machine engineering industry mainly due to production of vehicles and production equipment; rapid growth in production of timber and paper; and continuous growth in food industry. The industrial production growth accounted for 107% over the period between January and July. The CMASF's estimates of industrial production index range between 107.1 and 107.3% in 2004, provided that the current tendency remains the same.

According to the forecast of the Ministry of Economic Development and Trade, the average monthly growth in industrial production is expected to be nearly 0.5% in the second half of the year, while in the first half of the next year it is estimated to reach 0.7%. The Ministry also reported that in 2004 the average monthly growth in industrial production is expected to be nearly 0.6% (except for seasonal fluctuation).

The current data on the Russian basic industrial indicators in August show no significant changes as compared to the previous month. Notwithstanding this fact, positive tendencies were registered as well.



The normal growth rate in effective demand has been reestablished. After the dip in July (down to +2% according to the initial data and 0% without regard for seasonal fluctuations), in August the balance reached 16% and 7% respectively. Improvement was registered in all industries except for forestry industry and wood-working industry. Negative balance (i.e. absolute sales drop) was recorded only in light industry, but the industry demonstrated a retardation in sales growth rates from -33% to -5% (according to the balance).

Assessments of the demand by the above-below-standard scale remain at record levels over the last eleven years. By now, from 57 to 58% of enterprises consider the current sales volumes as normal. In August 1998, such assessments only could be given by 6% of manufacturers. The absolute minimum of this indicator was recorded in the period between March and April 1996 and accounted for 4%. At that period, 94% of the Russian enterprises considered the demand for their products as "below the standard". However, the balance of demand assessments remains negative: the "below-the-standard" answers keep prevailing among those enterprises which consider the demand for their products as abnormal. Nevertheless, the differences in assessment have reached -39..-38% over the last months, while in 2002 it accounted for (annual average) -64%.

A positive record was recorded in enterprises' assessment of real profit: for the first time since the beginning of monitoring in February 2002, the share of enterprises which reported growth in profits exceeded definitely that of the enterprises which reported profit decline. Positive balances in movement of this indicator were obtained in metallurgy industry, machine-building industry and light industry. Other industries keep providing the profit-decline answers.

No significant movements in the output were recorded in August. An enviable stability has been recorded over the last three months after refining the balance value from seasonal fluctuation (movement rate). However, it comes short of the figures recorded over the previous 12 months. At the same time, the initial (unrefined) data showed growth in the balance up to +27% after +19% in July. The balance grew in all industries, except for non-ferrous metallurgy and construction industry. Growth in output was also recorded in light industry after 4 months of declining (negative balance).

Also stable are the recent months as well as the balances of finished goods reserves assessment. This indicator remains stable within the range of +12% and +14%, which seems to have been normal for the Russian industry over the last few years. Thus, the enterprises are able to successfully manage the balance the sales and the output on the basis of the expected changes. Lack of reserves (i.e. negative balance) was recorded in August in fuel industry, metallurgy and food industry. This may entail delays in completing new orders in the nearest months.

The August balance of demand forecasts grew by 7 points and became the best for the last five months. The seasonal refining adjusted its value towards decline, but retained its advantage as compared to the previous months. More intensive growth in sales is expected in the nearest future in all industries, except for construction industry.

The plans to change the output at 74% of the enterprises in the period between September and October will be corresponding to the demand forecasts in the industry. The value obtained is the highest for this calculation indicator. Advanced production growth against the demand is likely to take place only for 19% of the manufacturers, which is less than the traditional values of the last few months (from 21 to 24%). Thus, enterprises are focused more on sales in developing their production plans. In the nearest future, the output rate is likely to grow for the industry as a whole as well as the majority of industries. Absolute production decline is only expected in non-ferrous metallurgy and construction materials industry.

*S.V. Tsukhlo*

---

## **Foreign Trade**

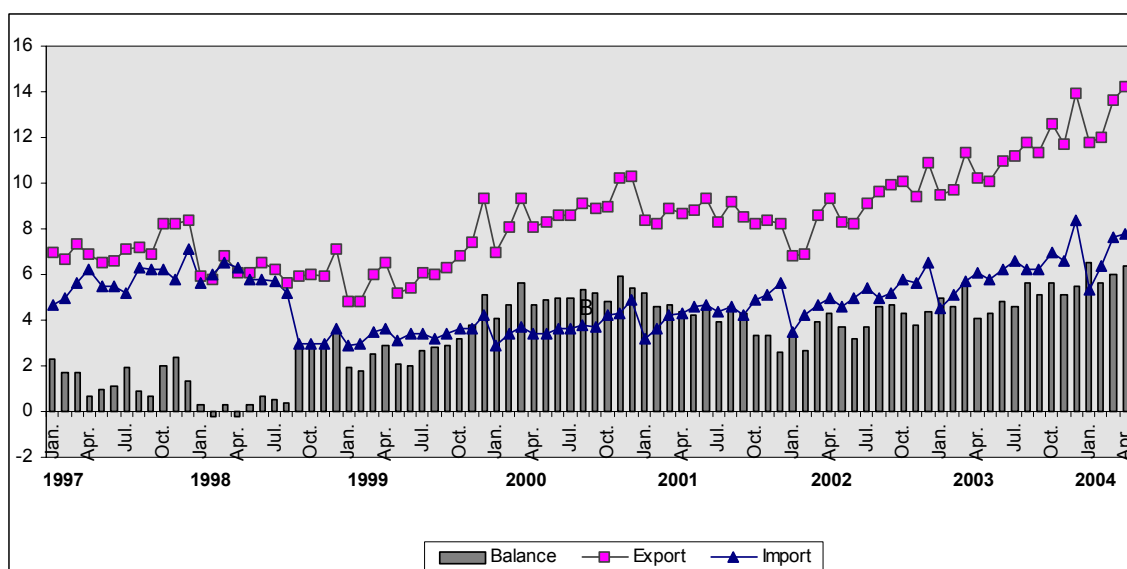
---

In June, Russia continued to increase its foreign trade turnover. The further growth in the amount of exports may be explained by the persistence of the favorable external economic situation, in particular, high levels of the world prices of oil, non-ferrous and ferrous metals. The expansion of imports was caused by the growth in the economy and the persisting appreciation of the national currency.

The Interdepartmental Commission of the RF Government on customs and tariff policies has proposed a package of measures aimed at the increase in the share of manufactured goods in the total amount of Russian exports.

In June of 2004, the Russia's foreign trade turnover (according to the balance of trade methodology) made US \$ 21.7 billion, what is by 26.2 per cent above the figures registered in June of 2003. This high rate of growth in the turnover was almost equally determined by the increase in the amounts of both exports and imports.

This June, Russia exported goods worth US \$ 13.8 billion, what was by 23.9 per cent above the figure registered in June of 2003. Imports made US \$ 7.9 billion exceeding the indicators observed last year by 30.7 per cent. The higher amounts of imports are explained by the increasing purchasing power of the Ruble in comparison with the US dollar and the general growth of revenues in the economy. Thus, according to the RF Central Bank, by the end of June the real Ruble / US \$ exchange rate was by 4.7 per cent above the figures registered in December of 2003 and by 21.1 per cent above the indicators observed in the respective period of the preceding year. at the same time, in January through June the level of GDP grew by 7.4 per cent in comparison with the figures registered in the respective period of 2003. The active balance of trade increased by 22.9 per cent as compared with the figures registered in June of 2003 and made US \$ 5.9 billion.



Source: RF Goskomstat, RF CB

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

For the long time, the major factor behind the rapid growth in exports has been the favorable market situation as concerns staple Russian exports.

In June of 2004, the world oil prices remained at a high level. Thus, the average Urals price made US \$ 32.1 per barrel, while the average Brent price was at US \$ 35.2 per barrel.

The contract prices of the Russian natural gas demonstrated an upward trend. In the first six months of 2004, the average monthly contract price of natural gas increased by 8.8 per cent in comparison with the figures registered in the respective period of 2003.

On the market of nonferrous metals, after a short period of growth in prices observed in the first half of May, by the end of the month there was registered a significant decline in prices. In June, the downward trend of prices persisted on the markets of copper, tin, and zinc. At the same time, a certain rise in prices was registered on the markets of aluminum, nickel, and lead. In June of 2004, the prices of copper, tin, and zinc declined in comparison with the figures observed in May by 0.6 per cent, 3.3 per cent, and 0.6 per cent respectively, while the prices of aluminum, nickel, and lead grew by 3.7 per cent, 29.4 per cent, and 10 per cent respectively. This June, the index of prices of nonferrous metals reached 171.8 points increasing by 3.4 per cent in comparison with the May figures.

Table 1

**The average monthly world prices in June of the respective year**

	1996	1997	1998	1999	2000	2001	2002	2003	2004
Oil (Brent), USD / metric ton	17,95	18,28	13,83	15,99	29,41	27,14	24,66	27,06	35,2
Natural gas, USD / thous. c. m.	-	2,136	2,159	2,358	4,245	3,704	3,254	5,891	6,409
Gasoline, USD / metric ton	0,440	0,441	0,359	0,485	0,970	0,820	0,767	0,858	1,228
Copper, USD / metric ton	2202	2543	1665	1552,1	1752,0	1615,3	1686,2	1703,2	2669,3
Aluminum, USD / metric ton	1490	1575	1316	1327,3	1510,2	1467,7	1354,9	1410,2	1675,6
Nickel, USD / metric ton	7153,8	7054,6	4540	5241	8384,3	6629,2	7110,0	8761,1	13322,5

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

In August of this year, the exports to the CIS member countries made US \$ 2.48 billion and increased by 46.3 per cent in comparison with the figures registered in August of 2003; at the same time imports made US \$ 1.76 billion and grew by 43.9 per cent.

The products of the fuel and energy complex remained the staple Russian exports to the CIS member countries. This year, there was registered an increase in the export of oil products, including motor gasoline and diesel fuel, while export of crude oil declined.

As concerns the commodity structure of imports from the CIS member countries, the share of food products and respective raw materials exceeded 20 per cent and was equal to the share of machinery and equipment. This year, there was observed an increase in imports of ferrous metals, wheat, and corn, while on the contrary the import of pipes and meat declined.

In August, in the course of negotiations conducted by the Russian and Ukrainian Presidents, there were made agreements with respect to the collection of VAT on the country of destination principle as concerns the export of energy resources, while in Russia these commodities should be taxed at the zero rate. It is planned that the estimated losses of the Russian budget amounting to about US \$ 800 million will be covered at the expense of the growth in the turnover of trade between the two parties.

Besides, in order to improve the situation of the Russian exporters, there was signed a long term (15 years) agreement pertaining to the oil and natural gas sphere. The agreement fixes the volumes of transit of Russian natural gas via the Ukrainian territory (85 million metric tons a year); in the case this volume is exceeded, the parties should find additional transport capacities. Ukraine assumes the obligation to impose nondiscriminatory tariffs on the transit of Russian natural gas and notify Russia about any changes in tariffs not later than 3 months prior to the date of enactment of such tariffs.

In spite of the intensive dynamics of development of the Russian exports, there are negative factors checking the respective growth. Among these factors is the raw material structure of exports. Manufactured goods make only 30 per cent of the total amount of Russian exports. The share of machinery and equipment in the total amount of Russian exports makes only about 9 per cent, while the share of such goods in the world exports makes already 40 per cent, USA – 48 per cent, Germany – 50 per cent, and Japan – 70 per cent.

In July of 2004, there was held a meeting of the Interdepartmental Commission of the RF Government on customs and tariff policies. At the meeting there was discussed a package of measures aimed at the improvement of the structure of Russian exports and imports.

The Commission recommended to abolish export duties on products of high degree of processing of raw materials. There was also proposed to introduce duty privileges with respect to the import of equipment in the case the domestic production of such equipment can not satisfy the respective domestic demand as yet. The Commission took the decision to abolish export duties on more than 90 commodities characterized by the high degree of processing and low volumes of export. On the whole, it makes about one fourth of the total amount of Russian exports, however, after the abolishment of these customs duties this indicator may increase and make up to one third in the next 3 to 5 years.

It was also decided to abolish the export duty on potash fertilizers and asbestos (which at present is at 5 and 3 per cent respectively); this decision was substantiated by the fact that about one third of the

output of Russian potash fertilizers and asbestos are not in demand on the domestic market (due to the satisfaction of effective demand and comparatively high prices on these domestic products), and that the world prices of these commodities are rather high. The aggregate annual export of potash fertilizers and asbestos from the RF should increase almost 1.5 times after the abolishment of the export duties.

Besides, in order to create incentives for export of foliate and long fibered hydrated cellulose (products of deep processing of forestry raw materials) it was recommended to reduce the export duty on these products two times: from 10 and 15 per cent to 5 per cent. About 65 per cent of the domestic demand for these commodities is satisfied by internal production, the rest is covered by imports from Scandinavia. However, the aforementioned types of Russian cellulose are more expensive than imported ones, what causes the risk of overstocking the market, while due to the 10 per cent duty on these products their export prices are higher than the average world levels. Therefore, the reduction of export duties would increase the profitability of production and export of these products.

In principle, the preferential export regime with respect to the aforementioned goods may result in more broad antidumping procedures against Russian manufactured goods. At present, there are 9 antidumping investigations involving Russian commodities underway, and there are 11 special protective measures in place. However, recently the RF Government has succeeded as concerns the abolishment or prevention of the introduction of about 20 such measures against many domestic producers: such measures were planned by China, Hungary, Poland, Latvia, Slovakia, Turkey, Iran, Kazakhstan, Indonesia, Ukraine, USA, and the EU.

The Commission also recommended to abolish import duties on technological equipment for pulp and paper, furniture, and textile industries, as well as import of goods and services aimed at implementation of strategic investment projects in the RF with participation of foreign capital.

At present, the level of satisfaction of demand in the aforementioned industries as concerns equipment is at 40 per cent on the average, and it should be mentioned that more than one half of this demand is related to imports. A fast reorientation of these industries to domestic equipment is impossible due to the insufficient production. As concerns the strategic investment projects with foreign participation, the final list of such projects eligible for the abolition of import duties should be approved by the RF Government in the 3<sup>rd</sup> quarter of 2004. It should be noted that according to the estimates of the European Economic Commission of the UN, implementation of such projects after the abolition of investment import duties may accelerate 1.5 times. Besides, there will be created an incentive to elaborate new similar projects.

The Commission also recommended to stabilize import duties on dried fruits and margarine at 10 per cent and 15 per cent respectively, reduce the duty on imported digital audio and video equipment from 15 – 20 per cent to 10 per cent (the domestic production of such equipment meets only about 20 per cent of respective demand). It has been also recommended to abolish duties on the import of about one third of the range of medical equipment (also due to the lack of domestic products and the wear and tear of almost two thirds of fixed assets in this sphere).

In August of 2004, there was reduced the import duty on the cane unrefined sugar (set proceeding from the dynamics of the average world prices and the availability of respective raw materials for Russian sugar factories): from US \$ 206 to US \$ 194 per metric ton. The reduction of this duty is substantiated by the unfavorable forecast of the next yield of sugar beets, what may result in probable rise in prices of this raw material and, therefore, the final product. However, almost 80 per cent of the Russian sugar processing factories operate in November through June using the unrefined sugar and accumulate respective stocks in August through September. Therefore, the lower prices on the imported unrefined sugar will permit to balance domestic prices of raw sugar and products of sugar processing.

*N. Volovik, N. Leonova*

## **Issues discussed at the meetings held by the Government of the Russian Federation on August 5, 12, and 23 of 2004**

---

Among the all issues discussed at the meetings held by the Government of the Russian Federation in August, the most interesting ones were the following: at the meeting of the RF Government held on August 5, G. O. Gref, the RF Minister of Economic Development and Trade, presented the report “On the results of social and economic development of the Russian Federation in the first six months of

2004,” which focused on an analysis of the current economic situation in the Russian Federation. At the meeting held on August 12, the RF Government discussed the Consolidated Report “Plans and indicators of budget planning agents (federal Ministries, federal services, and federal agencies managed by the Government of the Russian Federation for year 2005 and the period until year 2007” presented by A. D. Zhukov, the deputy Chairman of the Government. At the meeting held on August 23, 2004, the RF Government discussed the draft Federal Budget for year 2005 and the draft federal law of the Russian Federation “On amendments to the federal law “On budget classification of the Russian Federation” and the draft federal law “On amendments to the federal law “On minimum wages and salaries.”

\* \* \*

At the meeting held on August 5, 2004, the Government of the Russian Federation discussed the report “On the results of social and economic development of the Russian Federation in the first six months of 2004” presented by G. O. Gref, the RF Minister of Economic Development and Trade.

The key conclusions made by the RF Minister of Economic Development are as follows:

According to the estimates presented by the RF Ministry of Economic Development and Trade, in the first six months of 2004, GDP increased by 7.4 per cent in comparison with the figure registered in the respective period of 2003.

In the first six months of 2004, more than one half of the growth in GDP was determined by the persisting increase in exports, at the same time, there grew the contribution of household consumption in the amount GDP. In spite of the real Ruble appreciation, the contribution of domestic producers in the satisfaction of internal demand for goods and services increased from 2.9 p. p. of GDP registered in 2003 to 3.3 p. p. (an estimate) in the first six months of 2004, what is an evidence of a certain improvement of competitive power of goods produced in Russia. However, in the 2<sup>nd</sup> quarter the structure of domestic demand somewhat changed in favor of imported goods in comparison with the figures observed in the beginning of the year, although the Ruble appreciation in that period had practically ceased.

According to the estimates presented by the Ministry of Economic Development and Trade, in January through June of 2004, the average Urals oil price made US \$ 30.8 per barrel and increased by 15.2 per cent in comparison with the prices registered in the respective period of the preceding year.

As concerns the industrial production, there was observed a shift in favor of industries producing final goods. In the first six months of 2004, their share in the increment in output made 44.7 per cent as compared with 30 per cent observed in the first six months of 2003. the rate of growth across these industries made 110.6 per cent as compared with 107.4 per cent registered in industry on the whole. The most significant contribution (about 36 per cent) in the growth in the industrial output registered in the first six months of 2004 was made by mechanical engineering and metal working (the rate of growth in these industries made 114.9 per cent).

This year, the rate of inflation decelerated in comparison with the figures registered in the preceding year. In the first six months of 2004, inflation rate was at 6.1 per cent, as compared with 7.9 per cent observed in January through June of 2003.

**At the meeting of the RF Government held on August 12 of 2004**, A. D. Zhukov, the deputy Chairman of the Government, presented the Consolidated Report “Plans and indicators of budget planning agents (federal Ministries, federal services, and federal agencies managed by the Government of the Russian Federation for year 2005 and the period until year 2007.”

According to the key points of the Consolidated Report, the Concept of the reform of the budget process in 2004 through 2006 (approved at the RF Government meeting of April 15, 2004), envisaged the creation of conditions ensuring the maximally efficient management of public finances in accordance with the priorities of the state policy..

It is envisaged to shift accents of the budget process from “management of budget resources (expenditures)” to “performance management” via the enhancement of responsibility and independency of participants of the budget process and administrators of budget funds in the framework of clear medium term targets, as well as switch to, for the most part, program based and target oriented methods of budget planning ensuring the direct relationship between allocation of budget resources and actual or targeted results of their utilization set proceeding from the priorities of the policies pursued by the state.

**At the meeting of the Government of the Russian Federation held on August 23, 2004**, A. L. Kudirn, the RF Minister of Finance presented the draft Federal Budget for year 2005.

The budget policy for year 2005 and the medium term perspective is aimed at the support of the general macroeconomic stability. The key objective of the budget and tax policies for year 2005 and the medium term outlook is to form priorities of budget policy for the medium term and long term perspective on the basis of a qualitative change in approaches to the formation of the budget, which should envisage the following:

- an enhanced role of the long term financial plan in the budget process;
- the use of new mechanisms of program based target oriented budgeting;
- optimization of the network of budget organizations proceeding from the state functions and tasks performed by these organizations;
- allocation of budget resources among the administrators of budget funds and (or) budget programs implemented by such administrators depending on the planned targets in accordance with the priorities of the social and economic policies;
- formation of the budget basin on division of existing and new expenditure obligations;
- improvement of methods and forms of social support of the population, including conversion of social benefits in the monetary form;
- turning of federal targeted programs (FTP) into an efficient mechanism of implementation of structural reforms;;
- improvement of the state procurement mechanisms;
- the completion of the tax reform in general;
- the ensuring of the balance of budgets at all levels of the budget system basing on the division of expenditure obligations and revenue sources on the long term basis.

The parameters of the federal budget for year 2005 and the medium term outlook were calculated basing on the forecast of key indicators of social and economic development of the RF and scenario based conditions of economic development until year 2007, which assumed that the favorable external (high levels of oil prices) and internal conditions of economic development would persist.

Next year and in the medium term perspective, consumption of the public sector will be determined, on the one hand, by restraints on non-interest expenditures and maintenance of its surplus, and, on the other hand, the necessity to make expenditures for implementation of structural transformations in the economy relating to the financial backing of social reforms, modernization of the defense complex, and development of the public infrastructure.

The draft federal budget for year 2005 was formed (taking into account SST) as follows: revenues at Rub. 3326.1 billion, or 17.8 per cent of GDP; expenditures at Rub. 3048.0 billion, or 16.3 per cent of GDP, the surplus of the federal budget is planned to make Rub. 278.1 billion, or 1.5 per cent of GDP.

The revenues of the enlarged budget (taking into account SST) will decline from 36.2 per cent of GDP in 2004 to 34.0 per cent of GDP in 2005, while the respective indicators of the consolidated budget will decrease from 31.9 per cent of GDP to 29.3 per cent of GDP. The revenues of the federal budget will decline from 20.2 per cent of GDP to 17.8 per cent of GDP. In real terms, the revenues of the federal budget will decrease by 5.4 per cent in 2005.

The factors affecting the formation of budget revenues in the medium term outlook are as follows:

- 1) A decline in tax burden (primarily on manufacturing industries and the sphere of services).
- 2) The forecasted decrease in world prices on the oil market from US \$ 31.2 per barrel to US \$ 28 per barrel in 2005 through 2007.
- 3) The real effective Ruble appreciation (from 3 per cent to 5 per cent a year).

In the course of elaboration of the draft federal budget for year 2005, there were taken into account the following changes in the tax legislation:

- The reduction of the base SST rate from 35.6 per cent to 26 per cent, the descending tax scale should be maintained;
- The raise of the base mineral extraction tax rate from Rub. 347 to Rub. 419 per metric ton and the change in the formula pertaining to the calculation of the base rate; introduction of a new differentiated scale of relationship between the rate of the export customs duty and the world oil prices; reduction of export customs duties on all goods (with the exception of oil and oil products) by 20 per cent on the average;
- The indexation of all specific excise rates depending on the forecasted inflation rates.

Besides, in 2005 there should be completed the reform of the system of property taxes, improved the mechanism of collection of the water tax, introduced changes in the land tax regime, gift and inheritance taxes, the regime of imposition of the stamp duty, taken measures aimed at the improvement of the mechanism of VAT collection.

In the framework of the tax and budget reform, there will be changed the distribution of tax revenues among the levels of the budget system: the rate of the profit tax revenues due to regional budgets will be reduced by 1.5 p. p. (to 17.5 per cent); at the same time, 95 per cent of the mineral extraction tax on oil and gas condensate, payments for the use of water objects, and water tax generated revenues are due to the federal budget. In 2005, the revenues of the federal budget (without SST) in real terms will be at about the level registered this year.

The reduction of the amount of resources redistributed via the budget in the medium term outlook will result in a decline in expenditures of the enlarged budget – from 34.4 per cent of GDP in 2004 to 32.9 per cent of GDP in 2005; while respective indicators of the consolidated budget will diminish from 25.6 per cent of GDP to 23.4 per cent of GDP (without the amount of repayment of the public debt and contributions to the Stabilization Fund). In 2005, the expenditures of the federal budget (taking into account the subsidies for payment of pensions at the expense of the SST resources) will make 16.3 per cent of GDP as compared with 16.8 per cent of GDP observed this year.

The expenditures of the federal budget for year 2005 and the medium term outlook are formed taking into account the phased transition from management of budget expenditures to performance management based on the system of evaluation of plans and indicators of work of all executive authorities.

A specific feature of the federal budget for year 2005 is the fixation of priorities of budget policies for the medium and long term outlook. Starting from the next year, the budget obligations will be classified in the budget of existing and new obligations.

The most important priority of the budget policy for the next year remains the social sphere. In 2005, it is envisaged to expand program based target oriented methods of financing of education. Significant funds will be allocated for the implementation of federal targeted programs in the sphere of health care.

In 2005, the expenditures related to the national defense, national security and law enforcement will increase by 17.5 per cent in real terms and will make almost 5 per cent of GDP. Besides, the federal budget for year 2005 envisages expenditures for conversion of in kind allowances for servicemen in the monetary form, as well as the switching of Armed Forces to the contract based system of recruitment, fight against terrorism, implementation of the cumulative mortgage system aimed at provision of housing for servicemen, utilization of the armaments and military equipment.

As a result of changes in the legislation governing interbudgetary relations, the fiscal powers of the executive authorities of RF subjects and local governments pertaining to the formation of expenditures of respective budgets will significantly increase, since both the amount and procedures governing the payment will be determined by regional and municipal legal acts. The distribution of tax revenues among the tiers of the budget system will be fixed in the Budget and Tax Codes, what creates conditions for introduction of medium and long term budget planning, increases stability and predictability of revenues of territorial budgets.

In 2005, there will be implemented changes concerning the forms and methods of financial support of regions from the federal budget. According to the new budget legislation, the resources of the Federal fund of financial support of RF subjects (FFFS) will be allocated only as grants for equalization of the levels of budgetary security. In 2005, there will be formed the Fund of reforming of regional and municipal finances, which is the successor of the Fund of reforming of regional finances existing in 2002 through 2004. The new fund regulations envisage the increase in the number of participants up to 8 RF subjects from year 2005, and from year 2006 the right to participate in the fund will be granted to 8 municipal entities.

Next year, it is envisaged to devolve a number of federal powers to the regional and local levels of the budgetary system. It primarily concerns the transfer of responsibilities relating to provision of benefits relating to the payments for housing and public utilities for certain categories of citizens.

In 2005 and in the medium term perspective, the policy concerning the sphere of public debt is aimed at reduction of the aggregate public debt of the RF and substitution of the external sources of financing with domestic borrowings.

The amount of borrowings on the foreign market is estimated to be US \$ 3.65 billion. In 2005, there will be repaid US \$ 11.5 billion of the foreign debt, what is by US \$ 2.5 billion above the amount of payments relating to the foreign debt registered in 2004. In the medium term outlook, the amount of placement of government bonds on the domestic market (and attraction of other sources of domestic financing). The priority will be given to the issuance of medium term and long term instruments, including those financed at the expense of pension savings.

The amount of the public debt will decrease from 26.5 per cent of GDP (as registered at the end of 2004) to 23.1 per cent of GDP at the end of 2005.

In 2005, it is envisaged to privatize property not used for the execution of state functions.

At the same meeting, A. L. Kudrin, the RF Finance Minister presented the draft federal law "On amendments to the federal law "On budget classification of the Russian Federation."

All changes reflected in the draft law presented at the meeting are related to the current reform of the budgetary sphere, meet the requirements set by the Concept of the reform of the budget process in 2004 through 2006 (approved by the RF Government resolution "On measures aimed at the improvement of effectiveness of budget expenditures") as concerns the reform of the RF budget classification and budget accounting.

The formation of draft RF budgets for 2005 is carried out in the situation, where there are implemented a number of fundamental structural reforms: division of powers and jurisdictions among the federal authorities, authorities of RF subjects, and local governments, the reform of the system of federal executive authorities, changes in the system of provision of social benefits, continuing transformations in the tax sphere, restructuring of the budgetary sector, and so on. The bringing of the structure and contents of the budget classification in accordance with objectives of the current reforms since January 1, 2005, is a necessary condition of successful implementation of these reforms.

The draft budget also envisages more close conformity of the structure and contents of the budget classification with the requirements set by the international standards and creation of prerequisites for the introduction of the Single chart of account based on the accrual method and ensuring the evaluation of the financial results of the state administration sector.

The introduction of changes in the federal law "On budget classification of the Russian Federation" (before the RF Budget Code is respectively amended), is aimed at:

- reorientation of budget funds towards achievement of final results;
- adjustment of the structure of functional classification of expenditure to the major functions performed by state authorities (local governments);
- adjustment of the budget classification to the international accounting standards and public finance statistics;
- adjustment of the structure of budget classification to the economic substance of operations carried out in the state administration sector;
- application of the feature of the (head) administrator of budget funds to all operations carried out in the framework of budget execution (revenues, expenditures, sources of financing of the budget deficit).

The proposed changes are in accordance with the provisions of the RF Budget Code currently in force. Certain amendments envisaged in the draft law are in compliance with the version of the RF Budget Code to be enacted on January 1, 2005.

At the current stage, the draft law envisages the introduction of the uniform 20-digit code for classification of revenues, expenditures, and sources of financing of deficits of RF budgets in order to ensure uniform principles of formation and execution of budgets at all levels of the RF budget system.

The new procedure of codification in the framework of budget classification, as well as other amendments envisaged in the draft law, concern the majority of annexes to the federal law "On budget classification of the Russian Federation" including: classification of the RF budget revenues, functional classification of the RF budget expenditures, economic classification of the RF budget expenditures; classification of domestic sources of financing of deficits of RF budgets, classification of external sources of financing of deficits of the RF federal budget and budgets of RF subjects, departmental classification of expenditures of the federal budget.

Also at the meeting of the RF government held at August 23, there was discussed the draft federal law "On amendments to the federal law "On minimum wages and salaries." According to this draft law, the minimum wages and salaries shall be set at Rub. 720 per month since January 1, 2005.

*E. A. Bolshakova*



## **Economic legislation review over the period between August and late July 2004**

---

The amendments to the current legislation in August were as follows: the duration of copyright was extended to 70 years; rates of single social tax were reduced for all categories of taxpayers; a new chapter 25.2, "Water Tax", was added to the RF Tax Code; tax rates of excisable goods were increased; percentage ratio of the profit tax by type of budget was changed; changes were made in the procedure of granting a property charge-off during income taxation of physical persons in cases of purchase of dwelling; presented were the data for June of 2004 used to calculate mineral tax with regard to oil.

### **I. FEDERAL LAWS OF THE Russian Federation**

1. «ON AMENDMENTS TO THE LAW OF THE RUSSIAN FEDERATION «ON COPYRIGHT AND ALLIED RIGHTS» of 20.07.2004 , No. 72-FL .

The key amendments in the field of copyright and allied rights are as follows: the duration of copyright was extended from 50 to 70 years; the list of the rights of the author of a work and audio record producers is added with the right to present the work or audio record so that any person can have an interactive access to them from any place and at any time at his/ her discretion (public notification right ). The law was also amended with the articles regarding protection of the copyright and allied rights . In particular, it was established that the owners of exclusive rights have a right to hold at their own discretion the violator to pay a compensation instead of indemnifying losses to the amount of 10 thousand to 5 million ruble in accordance to a decision of the court or arbitration court made on the basis of the nature of violation; twice the cost of works or objects of allied rights, or twice the cost of the rights of use of works or objects of allied rights to be determined on the basis of the price which is normally payable under comparable circumstances for legal use of works or objects of allied rights . Compensation shall be paid in cases the fact of violation is proved regardless of existence or non-existence of the losses incurred.

2. «ON AMENDMENTS TO SECTION 2 OF THE TAX CODE OF THE RUSSIAN FEDERATION» of 20.07.2004 , No. 65-FL .

The law will come into force in a month upon its publication, but not earlier than the 1<sup>st</sup> date of the next fiscal period on the unified tax on imputed income for various types of activity.

Amendments were made to Chapter 26.3, « Taxation System as a unified tax on imputed income for various types of activity », of the RF Tax Code. The list of business activities which are subject to taxation as a unified tax on imputed income, was amended with a new type of activity, delivery of services regarding security of vehicles at attendant parking zones. The table of physical parameters specific for a certain type of business activity was updated.

3. «ON AMENDMENTS TO CHAPTER 24 , SECTION 2, OF THE TAX CODE OF THE RUSSIAN FEDERATION, TO THE FEDERAL LAW «ON COMPULSORY PENSION INSURANCE IN THE RUSSIAN FEDERATION » of 20.07.2004 , No. 70-FL .

To come into force from January 1, 2005 .

Amendments were made to Chapter 24, «The Unified Social Tax», of the RF Tax Code. The UST rates were reduced for all categories of taxpayers, including self-employed entrepreneurs and lawyers. At the same time, excluded from the list of incomes exempt from the UST were the amounts payable from the membership dues at horticultural, fruit-and-vegetable, garage-construction and housing societies (associations) to persons providing works ( services ) for the aforementioned organizations; payments in cash and in kind payable from the trade union dues to every trade union member provided that such payments are effected not often than quarterly and do not exceed 10 000 rubles annually; payments in kind with the in-house production goods – agricultural products and /or goods for children – to the amount of up to 1000 rubles (inclusively) on a per physical person basis, employee over a calendar month; payments to employees of budgetary organizations to the amounts not exceeding 2000 rubles per physical person according to each of the following grounds: the amounts of material assistance paid by employers to their employees as well as former employees retired due to disability or old age, amounts of compensation (payment) paid by employers to their former employees (retirement and/ or disablement pensioners) and/ or to their family members the cost of the medicaments prescribed by the attending medical doctor and purchased by them (for them).

Exempted from the UST will be the amounts of material assistance payable to physical persons from budget sources by budgetary organizations, which do not exclude 3 000 rubles per physical person during a taxation period. Ceased to be in force is the regulation on exemption from the UST for the Russian Science and Education funds with regard to the amounts paid to the citizens of the Russian Federation as grants (non-payable aid) paid to teachers, professors, pupils, students and/ or graduate students of state and/ or municipal educational establishments. In addition, the UST payment procedure by taxpayers, self-employed entrepreneurs, was established for the case of cessation of such activity.

In particular, the amendments made to the Federal Law of 15.12.2001 No. 167-FL «On Compulsory Pension Insurance in the Russian Federation» specify that the scheme of financing the saving share of labor pension will not be applicable to the persons born in 1966 and earlier.

4. «ON AMENDMENTS TO SECTION 2 OF THE TAX CODE OF THE RUSSIAN FEDERATION, EMENDMENTS TO ARTICLE 19 OF THE LAW OF THE RUSSIAN FEDERATION «ON THE PRINCIPLES OF TAX SYSTEM IN THE RUSSIAN FEDERATION», AS WELL AS ON WITHDRAWAL OF SEVERAL ACTS OF LAW OF THE RUSSIAN FEDERATION» of 28.07.2004, No. 83-FL.

To come into force from January 1, 2005.

Section VIII, Chapter 2 of the RF Tax Code is complemented with Chapter 25.2, «Water Tax». Defined is a circle of water taxpayers, as well as object of taxation and the calculation procedure for taxation base, tax period, tax rates, tax calculation procedure, terms and procedure of tax payment, and tax return submission procedure. It was established that 0,85 coefficient is to be applied to the tax rates specified in this Federal Law for water extraction from surface aquatic objects for technical purposes within the established limits with regard to taxpayers operating objects of heat-power engineering and nuclear-power engineering with the use of a direct-flow water supply plan, for the period from January 1 to December 31, 2005 inclusively.

Federal Laws and other normative legal acts regulating the issues of payment for the use of bodies of water are effective in the part which is not in conflict with this the Federal Law, and are subject to be brought in balance with it. The Federal Law of 06.05.1998 No. 71-FL «On Payments for the Use of Water Objects» will cease to be in force from January 1, 2005.

5. «ON AMENDMENTS TO CHAPTER 22, SECTION 2, OF THE TAX CODE OF THE RUSSIAN FEDERATION» of 28.07.2004, No. 86-FL.

To come into force from January 1, 2005, except for several provisions.

Tax rates for all types of excisable goods will be raised from January 1, 2005, except for those of Champaign and natural wines. Excise rates will be raised as follows: of ethyl alcohol from 18 to 19,5 rubles, while the rates of beer with 0.5 to 8.6% alc. from 1,55 to 1,75 rubles; of filter cigarettes 65 rubles per 1000 pieces plus 8% of their wholesale factory price, but not less than 20% of the wholesale factory price (currently 60 rubles + 5%); of non-filter cigarettes and mouthpiece cigarettes up to 28 rubles per 1000 pieces + 8%, but not less than 20% of the wholesale factory price (currently 23 rubles + 5%). According to the law, the wholesale factory price is deemed to be the value of sold cigarettes calculated on the basis of the market price without regard for the excise and VAT.

The tax warehouse regulations will be applied to alcoholic products from the moment of their production and/ or arrival to a warehouse till the moment of their shipment (transfer) to customers or taxpayer's organization department performing both retail and wholesale sales. The tax warehouse regulations will be applied to storage, transportation and supply (transfer) to buyers or taxpayer's organization department performing both wholesale and retail sales (at present, only retail sales) of alcoholic products with volume ratio of ethyl alcohol over 9 percent, except for natural wines, including Champaign, sparkling and carbonated wines produced in the Russian Federation.

From January 1, 2006, excisable goods will mean cosmetics registered at the authorized federal executive agencies and bottled in vials of no more than 100 ml with volume concentration of ethyl alcohol up to 80 percent inclusively (at present, excisable goods are cosmetics bottled in vials of not more than 270 ml).

6. «ON AMENDMENTS TO SECTIONS ONE AND TWO OF THE TAX CODE OF THE RUSSIAN FEDERATION AND WITHDRAWAL OF SEVERAL ACTS OF LAW OF THE RUSSIAN FEDERATION ON TAXES AND DUES» of 29.07.2004, No. 95-FL.

To come into force from January 1, 2005, except for several provisions.

The redrafted version specifies the norms of chapter 1 of the RF Tax Code with regard to types of taxes and dues in the Russian Federation, federal taxes and dues, regional taxes, local taxes, special tax regulations. Amendments were made to the chapter on profit tax of organizations. Changes were made to percentage ratio of profit tax allocation by budget type: the federal budget will include the tax amount calculated according to the rate of 6.5 percent ( currently 5 percent ); the budgets of the constituent entities of the Russian Federation will include the tax amount calculated according to the rate of 17.5 percent ( currently 17 percent ); no entries are provided for local budgets ( currently 2 percent ). Increased from 6 to 9 percent will be the profit tax rate with regard to the tax base defined on the basis of earnings generated as dividends from Russian organizations to Russian organizations and physical bodies, tax residents of the Russian Federation. Amendments were also made to Chapter 26.3, «System of Taxation as unified tax on imputed income for various types of activity». The list of types of activity subject to this system of taxation is complemented with a new type «distribution and/ or positioning of outdoor advertisements». The redrafted version includes a table of physical parameters specifying a certain type of business activity and basic monthly earning capacity. It was established that before bringing the laws of constituent entities of the Russian Federation and regulatory and legal acts of representative bodies of municipalities in accordance with the Federal Law, the foregoing laws, regulatory and legal acts shall be effective in the part which is not in conflict with this Federal Law .

7. «ON AMENDMENTS TO SECTION 2 OF THE TAX CODE OF THE RUSSIAN FEDERATION AND OTHER ACTS OF LAW OF THE RUSSIAN FEDERATION » of 18.08.2004 , No. 102-FL .

To come into force from January 1, 2005 .

In accordance with the amendments from January 1, taxation of the added value of oil, including gas condensate, natural gas, which are exported on the territory of the CIS countries, shall be executed according to the tax rate of 0 percent. At the same time, the amounts of tax rates for non-renewal exploitation will be increased: oil, from 347 to 419 rubles per tone; natural gas, from 107 to 135 rubles per 1000 cubic meters.

In addition, the provisions of the Federal Law of 05.08.2000 No. 118-FL establishing a special procedure of execution of the value-added tax with regard to oil and natural gas exported on the territory of the CIS countries, as well as the goods which are exported to and imported from the Republic of Byelorussia, will cease to be in force.

8. «ON AMENDMENTS TO CHAPTER 217 , SECTION 2, OF THE TAX CODE OF THE RUSSIAN FEDERATION» of 20.08.2004 , No. 103-FL .

To come into force from January 1, 2005 .

Extended was the list of earnings to be exempt from physical persons' income tax by adding the amounts of material assistance, including payment for medical treatment and medical service, delivered by non-government organizations to disabled persons from their own funds.

9. «ON AMENDMENTS TO CHAPTERS 146 AND 149 , SECTION 2, OF THE TAX CODE OF THE RUSSIAN FEDERATION» of 20.08.2004 , No. 109-FL .

To come into force from January 1, 2005 .

The list of transactions which are not deemed to be taxation objects during calculation of the value-added tax is complemented with transactions on residential buildings and properties sales, their shares; assignment of the interest in the right to common property in apartment house during sales of apartments; and transactions on land areas (their shares) sales. Therefore, from January 1, 2005, all transactions relating to dwelling sales by property developers as well as transactions in the secondary housing market will not be subject to the value-added tax.

10. «ON AMENDMENTS TO CHAPTERS 220 AND 224 , SECTION 2, OF THE TAX CODE OF THE RUSSIAN FEDERATION» of 20.08.2004 , No. 112-FL .

To come into force from January 1, 2005 .

Amendments were made to the existing procedure of granting a property charge-off in taxation of physical persons in the case of purchase of dwelling, including the use of credits (loans), as well as during its further sales. In particular, the new procedure allows for a charge-off in the case when taxpayers purchase and sell a residential building, apartment, including repayment of the interest on special-purpose loans extended for construction or purchase of dwelling, not only by tax authorities at the end of taxation period, but also by a fiscal agent ( employer at the principal place of business ) prior to termination of taxation period, provided that tax authorities prove the taxpayer's right to property

charge-off. A 9-percent tax rate was established with regard to the earnings generated as interest on mortgage-backed bonds issued prior to January 1, 2007, as well as the earnings of mortgage trust settlors generated by purchasing mortgage participation certificates issued by a mortgage manager before January 1, 2007 .

## **II. ORDERS, INSTRUCTIONS and REGULATIONS**

1. The Letter of the RF Ministry of Taxation «ON CALCULATION OF THE MINERAL TAX RATE IN JUNE 2004 » of 21.07.2004 , No. 21-2-05/82 .

Provided are the data on June 2004 used for mineral tax assessment with regard to oil, specifically :

- average price of the Urals oil in the Mediterranean and Rotterdam oil stock markets, 32,06 US dollars per barrel ;
- Kc coefficient value is 2,7718 ;
- tax rate with regard for Kc coefficient is 961,8146 rubles per ton.

*Tolmacheva I.V.*