

RUSSIAN ECONOMY: TRENDS AND PERSPECTIVES
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Political and Economic Developments in September of 2004

On the 1st of September tragic events took place in North Ossetia where a group of terrorists captured a school in Beslan-city. On the 3d of September the bloody upshot of this situation happened in Beslan school.

A few days later Vladimir Putin made a political statement. He said that the tragic events that took place were of “international terrorists” doing. In his address, the President told nothing of Chechen problem. No actions of the power structures before and during the storm (which, allegedly, was “not prepared” and happened only because of a chain of explosions, following which the high death toll among hostages became inevitable) were also given an assessment. As in 1999, in analysis of reasons causing the acts of terrorism dominated such characteristics as weakness and “disintegration” of the Russian State, but, this time two more were added - “disintegration of the USSR” and “actions of unknown countries” not interested in Russia’s strengthening. Absurdity of any talks with terrorists was ascertained, as well as the need for political and financial isolation of their “emissaries” and the coordinated efforts of the departments. On September 13, on extraordinary session of the RF Government it was announced of an appointment of Dmitry Kozak (Head of the RF Government Office) Representative of the RF President in the South Federal Okrug, and also head of commission combining the power agencies’ efforts in this region. It was also announced that the draft laws will be submitted to the Parliament for consideration, aimed at changing the procedure of governor’s appointment, namely, through their appointment as regional legislatures on recommendation of President, and also draft laws concerning switching to elections in the State Duma only through party lists. Presently acting governors and those from regions where elections have already been announced, will keep their posts until expiration of their terms in office. On 27th of September, the respective draft laws were submitted to the State Duma for consideration. In conformity with the above, appointment will be made by regional legislature on non-alternative basis, and in the case a nominee is twice rejected, the President have the right to dissolve the legislature and must appoint an acting governor. Dismissal of a governor is performed by the President on different occasions, including “loss of President’s confidence”. The draft laws on the election of State Duma deputies have not yet been submitted for consideration, the same is true for the draft laws (assumed by experts) on “liquidation of local governments”.

The foreign countries’ leaders, including the US President George W. Bush, were concerned of tendency to refuse to follow democratic principles in Russia. The same thoughts were also presented in an interview with the first President of Russia Boris Yeltsin.

It is to be noted that no public commitments of Vladimir Putin make sense any longer, as, according to journalists, the attempts to appoint regional leaders, were refuted by him six times at the minimum. Every time he used rather a sharp terminology, such as “contempt of electorate”, “violation of Constitution” etc., last time it took place in December 2003.

The discretionary regulation system, based on nondisclosed notions of what is due and essential, has nothing in common with stability, as stability means not only invariability of a leader, but to a considerably greater extent - invariability and clear vision in taking decisions.

When talking about perspectives of the reform of the election system and that of regional bodies of executive power, strangely enough, but we should note that they are of minor importance for the mid-term and long-term outlook. In absence of guarantees of free elections (the right to recount bulletins, independent (on power) funding sources, non-manipulated television, etc) both forms of voting - majority and proportional – are of minor importance. Though, and it is natural, switching to elections exclusively through party lists (in conditions of strict requirements to Russian retarded parties and total distrust in them of population) leaves better chance for manipulations. As regards governors, in reality, many of them were appointed de-facto by way of withdrawal from elections of disagreeable candidates and falsification of the results of voting. Also, one cannot say that that the overwhelming majority of governors show, in some or other way, even minor self-dependence in federal policy, that they are stable to pressure, etc. In principle, it is natural that the appointed governors will never represent interests of the electorate, and would rather act exclusively in interests of the officials who appointed them, and (in case they lack their own resource) – in interests of their sponsors. However, this is not the matter of next year. More interesting is the fact that most of nominees will hold their posts by the year 2008, when next political reform will apparently be conducted, the essence of which will

be – to prolong the authority of the country chief executive in power. For civil society, of vital importance becomes the future of local government, as guarantee of executive power polyarchy in a region and information source alternative for Moscow. In Boris Yeltsin ruling, the President's representative in a region or the supported from Moscow mayor of the regional center often served as counterbalance to governor. That system was broken even at the first term of Putin's stay in power (for example, his assisting to remove mayors of Omsk, Khabarovsk, Novorossisk, etc.)

No doubt that in the power hierarchy the reform sharply expands the influence of V. Surkov, Deputy Head of the President's Administration, who not only supervises regional policy by function, but is also entrusted to make public (and, most likely, to prepare) the final wording of draft laws' package.

Incidentally, Dmitry Kozak, a politician, who is considered a person being most close to Vladimir Putin, fell a victim of the reorganization being performed. Instead of (very important, but rare in public) post of a Head of the Government Office, he became a Special Envoy in Northern Caucasus – the role being extremely responsible, but without any powers (except for abstract "coordination"). Though, some experts see no big trouble in it, as, a mere absence of big tragedies like that occurred in Beslan will be considered, as they believe, "stabilization of the situation". The following circumstance also supports the above assumption: Dmitry Kozak could promote to the key post of a Head of the Government Office a loyal person – S. Naryshkin.

In our viewpoint, this is not so. It is natural that the situation in Northern Caucasus becomes more complicated. Serious unrests took place in North Ossetia and Kalmykia over the passed month, the situation is not yet solved in Dagestan. At the same time, the coalition of "new malcontents" has nothing in common with islamic extremists, their only intention is to remove the present-day leadership of republics from office or fix a certain status quo. But, like islamic extremists, in case of need, they are ready to use different forms of argumentation. In North Ossetia the head of the Republic Dzasokhov had to resign the Cabinet and, judging by his address to the meeting, he was ready to resign himself. Though the latter did not occur: the analogies might be too obvious. In Kalmykia, the oppositionists, who enjoy serious support of the Federal Agencies, were attacked by the law-enforcement bodies resulted in death toll. It is indicative that D. Kozak, who promised "to punish severely riots that may arise for both sides" (according to official version of Ilyumzhinov supporters, the forces of international terrorism became more active in Kalmykia populated predominantly by Buddhists), in fact, took the opposition's side. Though, it is too early to discard Ilyumzhinov himself, even because of the role of Kalmyk offshore in TNK-BP activities.

Even so (as a rule, the administrative resource of a political and not administrative staff appointee is stronger at the very beginning), nowadays D. Kozak has no real power. The factor of geographic remoteness from Kremlin should also be borne in mind, just as the fact that top executives' posts are unsafe in Northern Caucasus.

In the sphere of economy, bidding has been summed up for the sale of Lookoil public shareholdings. Despite intriguing participation of the alternative contenders, the bidding has been completed quickly and with an insignificant edge of the U.S. Conoco company. At the same time, a forthcoming merger of Gazprom and Rosneft was announced. This is explained by the need of the State to hold the controlling GAZPROM shareholdings through adding a state-held asset to the company. This suggestion has little force – in fact, after the year 2000, at shareholder meetings the State has never voted for less than 50% + 1 vote of the number of shareholders that took part in the voting, besides, the consolidated by Federal Government and Gazprom subsidiaries' shareholdings are under 50% by less than one percent. In our opinion, the two Government-entrusted (to managing their own assets) figures – A. Miller and S. Bogdanchikov - could come into collision, as the executive body of the unified company suggests undivided authority. We believe that Miller's chances are higher. In the mid-term outlook, taking into account the organization of a vertically integrated holding (including oil, petrochemical, electric power, media and other assets) on the basis of Gazprom, possibility is not excluded of partial privatization of the stock of "new Gazprom", in which foreigners will take part as minority shareholders.

In September, the political parties did not show much activity, putting mild blaming on the President's actions. The only fact worth mentioning – is the support of presidential initiatives by the LDPR and Rodina, which once more show that they serve as "bridge-structures" to the executive power.

S. Zhavoronkov

Budgetary and Fiscal Policy

By the end of July 2004, the level of revenues to the federal budget of the Russian Federation increased by 1 percentage point of the GDP as compared to the previous month and accounted for 21.6% of the GDP, while the revenues to the consolidated budget of the Russian Federation accounted for nearly 33.1% of the GDP. The level of expenditures of the federal budget declined as compared to the previous month and accounted for 15.8% of the GDP. The consolidated budget expenditures reached 27% of the GDP in July, which is equal to the figure of the previous month.

According to the estimates of the RF Ministry of Finance, the stabilization fund's volume is expected to reach 574.4 bln rubles by the end of 2004. The stabilization fund's volume is estimated to reach 719.5 bln rubles by the end of 2005, taking into account financing of the Pension Fund's deficit and foreign debt payments from the stabilization fund.

National Budget Status

In the period between January and July of 2004, cash execution of the federal budget revenues accounted for 21.6% of the GDP, while the budget expenditures amounted to 15.8% of the GDP (Table 1). This resulted in budgetary surplus which accounted for 5.8% of the GDP.

Table 1.

Execution of the federal budget of the Russian Federation (in % of the GDP¹ 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
Revenues													
Profit tax .	1.4%	1.3%	1.3%	1.3%	1.3%	1.3%	0.9%	0.7%	1.2%	1.4%	1.3%	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%	2.7%	2.7%	2.6%	2.7%	2.2%	2.6%	2.8%	2.9%	2.9%	2.8%	2.8%
Taxes on goods and services. License and registration dues .	9.1%	8.9%	8.7%	8.6%	8.5%	8.5%	10.2%	8.5%	7.6%	7.6%	7.6%	7.3%	7.4%
VAT	6.9%	6.8%	6.7%	6.6%	6.6%	6.6%	7.9%	6.6%	6.2%	6.4%	6.5%	6.3%	6.5%
Excise taxes	2.2%	2.1%	1.9%	1.9%	1.9%	1.9%	2.3%	1.8%	1.4%	1.2%	1.1%	1.0%	0.9%
Taxes on foreign trade and foreign economic operations .	3.4%	3.4%	3.3%	3.3%	3.4%	3.4%	3.6%	4.2%	4.4%	4.7%	5.0%	4.9%	4.9%
Other taxes .	2.0%	2.0%	2.0%	2.0%	2.0%	2.0%	2.5%	0.1%	-0.2%	-0.2%	-0.2%	-0.2%	0.7%
Tax revenues .	18.7%	18.4%	17.9%	17.9%	17.9%	18.0%	19.4%	16.1%	15.9%	16.4%	16.6%	16.2%	17.2%
Non-tax revenues .	1.5%	1.5%	1.4%	1.4%	1.3%	1.3%	0.9%	0.8%	0.9%	1.0%	1.1%	1.1%	1.4%
Total revenues .	20.4%	20.0%	19.5%	19.4%	19.3%	19.4%	20.4%	19.6%	19.7%	20.4%	20.6%	20.6%	21.6%
Expenditures													
Public administration .	0.4%	0.4%	0.4%	0.4%	0.4%	0.5%	0.2%	0.3%	0.4%	0.4%	0.4%	0.4%	0.4%
National defense .	2.6%	2.6%	2.5%	2.5%	2.5%	2.7%	1.7%	2.2%	2.6%	2.9%	2.7%	2.6%	2.6%
International activity .	0.2%	0.2%	0.2%	0.2%	0.2%	0.2%	-0.1%	0.2%	0.2%	0.3%	0.3%	0.3%	0.3%
Judicial power .	0.2%	0.2%	0.2%	0.2%	0.2%	0.2%	0.1%	0.1%	0.2%	0.2%	0.2%	0.2%	0.2%
Law enforcement and safety measures .	1.7%	1.7%	1.7%	1.7%	1.7%	1.9%	1.0%	1.5%	1.7%	1.9%	1.8%	1.8%	1.8%
Fundamental scientific research and technological development promotion .	0.3%	0.3%	0.3%	0.3%	0.3%	0.3%	0.1%	0.1%	0.2%	0.3%	0.3%	0.3%	0.2%
Public services rendered to national economy, including :	0.8%	0.8%	0.9%	0.9%	0.9%	1.1%	0.2%	0.4%	0.5%	0.6%	0.6%	0.7%	0.7%
Social services .	2.2%	2.2%	2.1%	2.1%	2.1%	2.3%	1.4%	1.7%	1.9%	2.1%	2.1%	2.1%	2.1%
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%	1.4%
Other expenditures	7.1%	7.0%	6.9%	6.8%	6.8%	6.9%	5.2%	5.8%	5.9%	6.5%	6.4%	6.1%	6.1%
Expenditures and loans less repaid loans	17.4%	17.3%	17.1%	16.8%	16.7%	17.7%	10.8%	14.4%	15.8%	16.8%	16.3%	15.9%	15.8%
Surplus	3.0%	2.7%	2.5%	2.6%	2.6%	1.7%	9.6%	5.2%	3.8%	3.6%	4.3%	4.7%	5.8%
Domestic financing	0.0%	0.3%	0.2%	-0.1%	-0.3%	0.5%	-8.6%	-3.1%	-1.2%	-1.3%	-2.4%	-3.1%	-3.2%
External financing	-3.0%	-2.9%	-2.7%	-2.5%	-2.3%	-2.2%	-1.0%	-2.1%	-2.6%	-2.3%	-1.9%	-1.6%	-1.7%
Total financing	-3.0%	-2.7%	-2.5%	-2.6%	-2.6%	-1.7%	-9.6%	-5.2%	-3.8%	-3.6%	-4.3%	-4.7%	-4.9%

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

The budget revenues increased by 1.2 percentage points in 2004 as compared to the comparable period between January and July of 2003, while the expenditures were reduced by 1.6 percentage points of the GDP, which entailed an increase in budgetary surplus by 2.8 percentage points of the GDP. In the same way as before, the VAT revenues – 30.3% of the total tax revenues – remain responsible for

¹ The figures are subject to revision due to evaluative nature of the data on GDP .

the basic share of federal tax revenues, which is virtually by 3.4 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 August of 2004 accounted for 20.6% of the GDP, which exceeds the figures of the comparable period of the previous year by 0.6 percentage points of the GDP. At the same time, cash execution of the budgetary expenditures accounted for 15.9% of the GDP (17.3% of the GDP in the period between January and August of 2003). Thus, according to the preliminary data, the budgetary surplus accounted for 4.6% of the GDP after the total of seven-month period of the current year.

According to the preliminary estimation of the RF Ministry of Finance, in the period between January and August of 2004, by performed financing² the federal budget was executed at the level of 17.1% of the GDP by expenditure (Table 2), while this indicator was 18.6% of the GDP over the comparable period in 2003. The federal budget revenues in the period between January and August of 2004 grew up by 0.6 percentage points of the GDP and accounted for 20.6% 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 2.1 percentage points of the GDP and accounted for 3.4% of the GDP as compared to the corresponding indicator between January and August 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	20.0%	19.5%	19.4%	19.3%	19.5%	20.4%	19.6%	19.7%	20.4%	20.6%	20.6%	20.7%	20.6%
Public administration	0.5%	0.5%	0.5%	0.5%	0.5%	0.5%	0.7%	0.6%	0.6%	0.6%	0.5%	0.6%	0.5%
Judicial power	2.8%	2.7%	2.8%	2.9%	2.7%	2.7%	3.9%	2.9%	3.7%	3.2%	2.8%	3.0%	2.8%
International activity	0.2%	0.2%	0.2%	0.2%	0.2%	0.0%	0.2%	0.2%	0.3%	0.3%	0.2%	0.3%	0.4%
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	1.9%	1.9%	1.9%	1.9%	1.9%	2.1%	2.4%	2.3%	2.4%	2.3%	2.1%	2.1%	2.1%
Fundamental scientific research and technological development promotion	0.3%	0.3%	0.3%	0.3%	0.3%	0.2%	0.3%	0.3%	0.4%	0.3%	0.3%	0.3%	0.3%
Public services rendered to national economy	1.0%	1.0%	1.0%	1.1%	1.1%	0.5%	0.7%	0.8%	0.9%	0.9%	0.8%	0.8%	0.6%
Social services	2.4%	2.3%	2.3%	2.4%	2.3%	2.4%	2.5%	2.4%	3.0%	2.9%	2.5%	2.5%	2.4%
National debt service	2.0%	2.0%	1.8%	1.7%	1.7%	1.0%	2.1%	2.2%	1.7%	1.5%	1.4%	1.3%	1.5%
Other expenditures	7.2%	7.0%	6.9%	6.9%	7.0%	5.6%	6.6%	6.1%	6.6%	6.6%	6.2%	6.3%	6.3%
Total expenditures	18.6%	18.2%	17.9%	18.1%	17.8%	15.2%	19.7%	18.0%	19.7%	18.8%	17.1%	17.4%	17.1%
Budgetary surplus (+) / deficit (-)	1.3%	1.3%	1.5%	1.3%	1.6%	5.2%	0.0%	1.7%	0.7%	1.8%	3.5%	3.3%	3.4%

According to the Ministry of Taxation of the Russian Federation, the federal budget revenues amounted to nearly 122.5 bln rubles (without regard for the unified social tax) in August of 2004. The real tax revenues accounted for 246.0% as compared to the figure of January 1999, while the comparable indicator accounted for 242.6% in August of 2003 and 246.5% in 2002 (Table 3).

² 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)³.**

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%	288.9%					

* Without regard for the unified social tax .

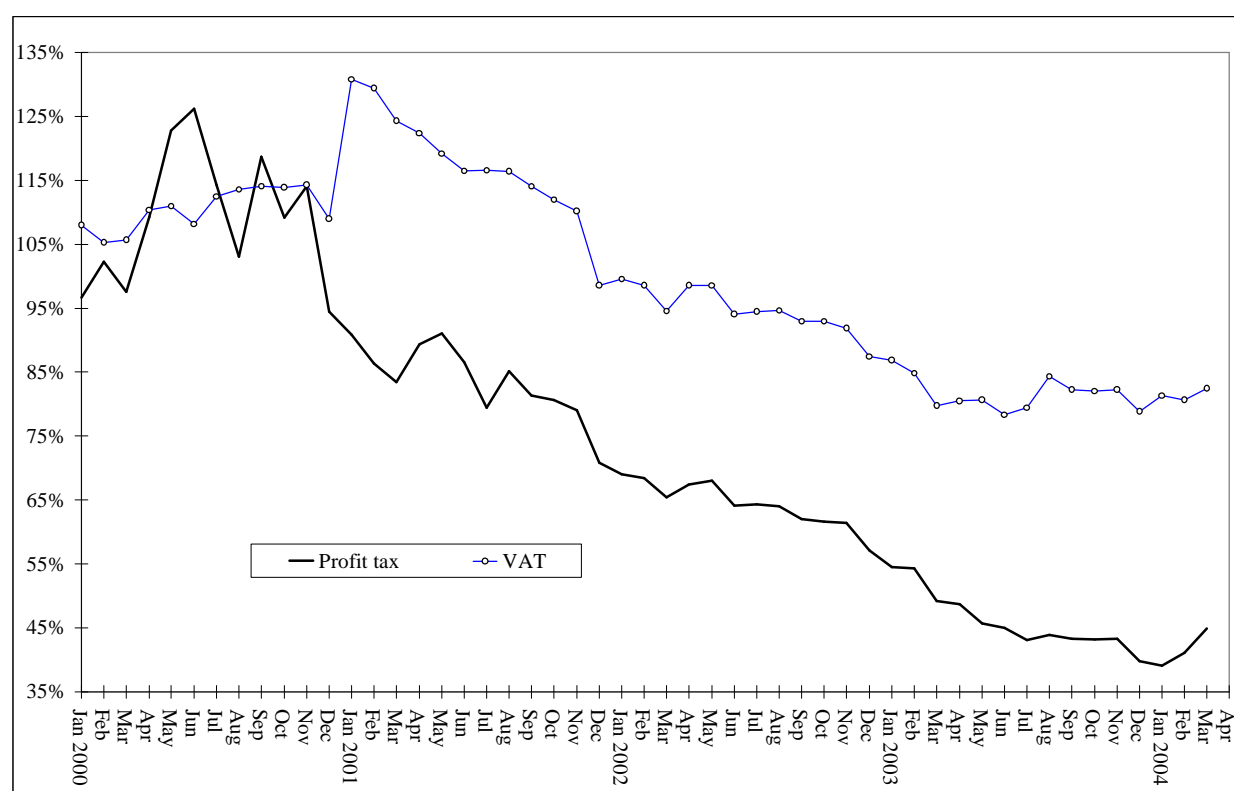


Fig. 1. Real tax arrears to the federal budget (in % to July 1999)

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 both accrued profit tax and VAT arrears.

³ 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%	5.0%	5.0%	5.1%	25.2%
Revenues	32.0%	30.3%	31.5%	33.4%	33.6%	32.2%	32.2%	31.6%	0.9%	0.8%	0.7%	31.1%
Expenditures	20.7%	25.3%	27.7%	28.8%	28.8%	28.6%	28.7%	28.5%	8.2%	7.8%	7.9%	29.7%
Budgetary deficit/surplus	11.3%	5.0%	3.8%	4.5%	4.7%	3.5%	3.6%	3.1%	7%	0%	8%	1.4%
2004												
	I	II	III	IV	V	VI	VII					
Taxes*	25.6%	20.6%	21.8%	27.4%	27.4%	26.6%	27.2%					
Revenues	30.6%	28.2%	29.8%	32.9%	32.9%	32.5%	33.1%					
Expenditures	18.5%	22.8%	25.4%	27.3%	26.9%	27.0%	27.0%					
Budgetary deficit/surplus	12.1%	5.4%	4.4%	5.6%	6.0%	5.5%	6.1%					

* Without regard for the unified social tax

The consolidated budget revenues in the period between January and July of 2004 accounted for 33.1% of the GDP, of which tax revenues (without regard for the unified social tax) are represented by 27.2% of the GDP (Table 4). The consolidated budget expenditures were reduced as compared to the period between January and July, 2003 by 1.7 percentage points of the GDP and accounted for 27.0% of the GDP. The consolidated budget surplus accounted for 6.1% of the GDP as of August 1, 2004, which exceeds the level of the comparable period in 2003 by 2.5 percentage points of the GDP.

Basic Developments in Public Sector .

According to the statement of the RF Minister of Finance, in 2005 the RF Ministry of Finance is ready to allocate 5 -10 bln rubles from the Reserve Fund which totals 30 bln rubles, as part of the aid to the regions during transition to monetization of the benefits. In this regard, from 2005 the RF Ministry of Finance will cease to extend non-interest loans, and the regions will have to enter the capital market when the need in financial resources arises. At the same time, according to the estimates of the RF Ministry of Finance, the regional budgets will be balanced in general in 2005, including adjustment of the aid allocated from the financial aid fund to the regions, the co-financing fund and a number of other funds.

The RF Ministry of Finance is against indexation of salaries of the state-financed employees in 2004, as well as additional indexation of the military pay in 2005, since this move may create problems for poorly financed regions. According to the estimates of the RF Ministry of Finance, a 1,5 increase in military pay requires additional 200 bln rubles with the need to allocate additional funds to increase military pensions due to increase in the military pay. In this case, the funds of the Federal Budget Draft 2005 which are to be allocated in order to increase the labor compensation fund to the military personnel (in terms of replacement of in-kind benefits with monetary benefits), amount to 31 bln rubles .

According to the estimates of the RF Ministry of Finance, the volume of revenues to the stabilization fund in 2004 is predicted to reach 468,4 bln rubles, including receipt of additional revenues from the oil production tax and the oil export duty with oil price being over \$20 per barrel, the revenues will amount to 380,4 bln rubles. In addition, 87,9 bln rubles will be generated from carrying over the balances of budgetary funds to the end of 2004. Given the initial volume of the fund to the amount of 106 bln rubles as of February 1, 2004, its total volume in the current year is estimated 574,4 bln rubles with allowance for the revenues to be generated in the course of the year. According to the Federal Budget Draft, the contributions to the stabilization fund in 2005 are expected to reach 387,7 bln rubles,

with 242,6 bln rubles of the estimated volume of its usage in the next year, including the amount of 74,7 bln rubles which is planned to be allocated to cover the RF Pension Fund's budget deficit, and 167,9 bln rubles to repay the foreign debt of the Russian Federation. Thus, as of January 1, 2006, the stabilization fund's funds volume is estimated to the amount of 719,5 bln rubles .

Within September, the RF Government plans to consider the issue on investment of the stabilization fund's funds. It was previously reported that provisions were made for investment of stabilization fund's funds in securities of foreign countries rated AAA .

S. Ponomarenko

Monetary Policy

In August of the current year, the consumer price index (CPI) accounted for 0.4%, thus exceeding markedly its levels recorded in the same month of the previous years and. The gold and foreign exchange reserves increased insignificantly, while the monetary base continued to decline for the second successive month. The stabilization fund was mainly responsible for sterilization of liquidity after the first seven months.

According to the Statistical Service of the Russian Federation, the consumer price index in August of the current year accounted for 0.4% as compared to the previous month (refer to *Fig. 1*) (the highest value for August since 2001) and 7.6% as compared to December of the previous year (– 0.4% and 8.5% respectively in the previous year). The highest increase in prices within the group of paid services for the population was 1% in August and 13.6% of accumulative total since the beginning of the current year (0.7% and 18.7% in 2003). During the last eight months of the current year, the highest increase (by 21.4%) was noted in the rates of housing and public utilities, which is slightly lower than in the comparable period of the previous year (25.1%).

Prices of food products increased by 0.1% in August, while they were noted declining by 0.4% in the previous year. It was noted in August that prices of the majority of food products increased. It should be noted that substantial decline in prices of fruits and vegetables was mainly responsible for the CPI drop in August of the previous year. In the current year, price reduction has been found to be almost three-time less. In addition, no seasonal decline of prices of granulated sugar occurred.

Totally, the price of non-food products increased slower as compared to the previous year. From January till August 2004, the price growth accounted for 4.6% (0.5% against the previous month). This tendency was noted within all subgroups of non-food products, except for gas. The growth in consumer prices of gas was 1.9% in August, while it was 19.5% as compared to December 2003 (1.2% and 10.4% respectively in 2003).

Basic inflation⁴ grew by 5.8% since the beginning of the year (6.2% in the comparable period of 2003). Basic inflation of the current year is nearly at the same level as that of the previous year. The CPI was increasing slower in the first half of the current year as compared to 2003, while convergence of the figures was noted in August .

According to the preliminary estimates, inflation didn't exceed 0.3 – 0.5% in September.

⁴ The basic consumer price index – the indicator reflecting the level of inflation in the consumer market without taking into account 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 .

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

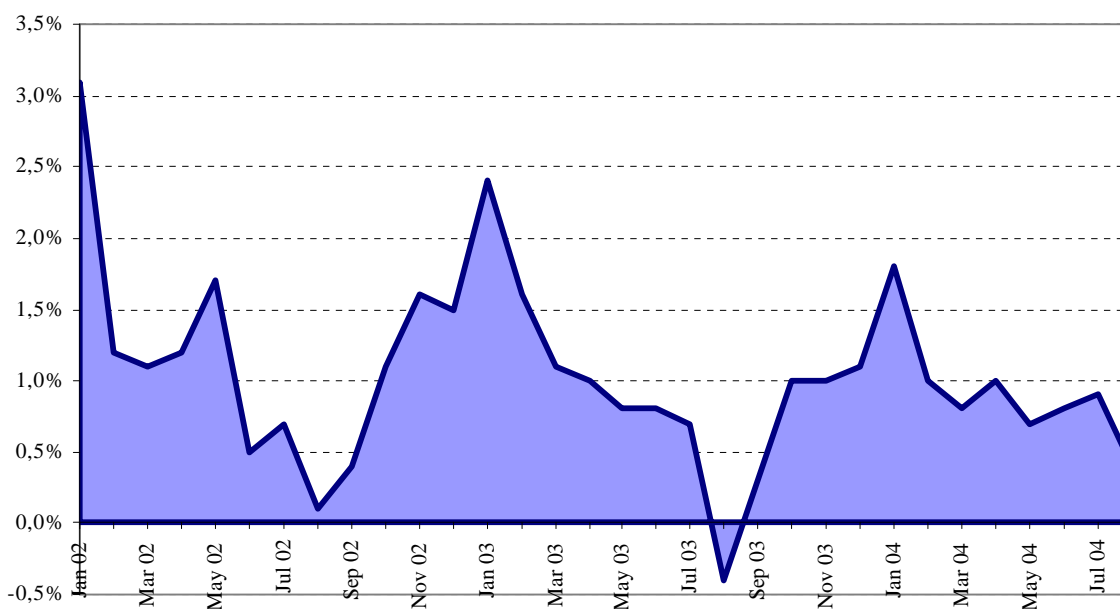


Fig. 1. The CPI Growth Rate in 2002 – 2004 (% per month).

The volume of gold and foreign exchange reserves the RF Central Bank amounted to 88,7 bln US dollars as of September 1, 2004, thus having grown by 15.3% since the beginning of the year and by 0.1% during August (refer to Fig. 2). In addition, this volume is barely by 800 ml US dollars higher than that recorded as early as in July 9, i.e. as far back as three months. In addition, the current volume of gold and foreign exchange reserves exceeds barely by 2 bln US dollars that as of February 13. However, according to the statement of the Bank of Russia, the gold and foreign exchange reserves will reach 100 bln US dollars by the end of the year.

In August, for the second successive year, the monetary base (required reserves + cash) was characterized by a positive movement. In July, this was entirely due to reduction of the required reserves fund (the result of a significant decrease of the required reserves standards since July 1, 2004), whereas in August the decrease was noted by both components comprising the monetary base. The required reserves fund shrank by nearly another 20 bln rubles, while the volume of currency in circulation was reduced by 23 bln rubles or by 1.6%. Thus, the volume of monetary base shrank by 2.9% in total in August (by 2.7% in July).

The broad money⁵ was also reduced in August. In this case the decrease in the required reserves fund's volume (its ruble share) and currency in circulation became the determinant factor. Other components of this aggregate were characterized by upward movement. The broad money during August 2004 shrank by 1.3% and amounted to 1.83 trillion rubles as of September 1. The volume of money supply declined by 4.6% as compared to that as of January 1 of the current year.

⁵ Besides 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 broad money of the Russian Federation takes into account the assets on correspondent accounts of credit organizations and bank deposits with the Bank of Russia.

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

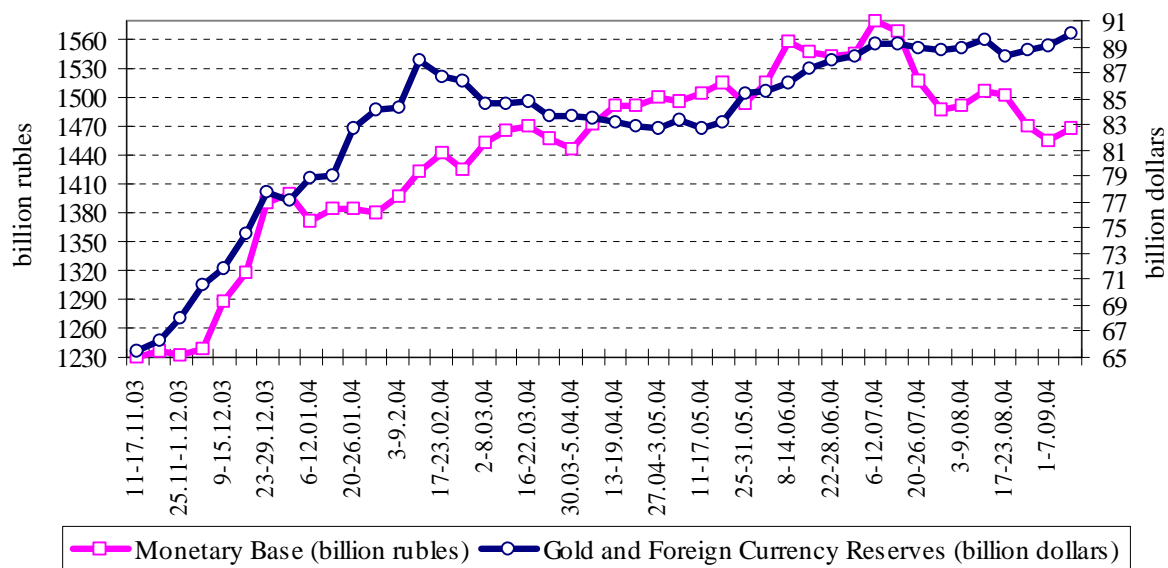


Figure 2. Changes in the Monetary Base and the RF Gold and Foreign Exchange Reserves at the end of 2003 – 2004.

As of August 1, 2004, the volume of national monetary base amounted to 3,63 trillion rubles (– 1.4% as compared to the previous month), thus having increased by 13.1% since the beginning of the year. In addition, the volume of currency in circulation grew by 3% as compared to the previous month and by 14.6% since the beginning of the year and amounted to 1.32 trillion rubles. Non-cash resources represented by balances on call and thrift ruble accounts opened with credit organizations, including the interest, were reduced by 3.8% as compared to the previous month (the growth amounted to 12.3% since the beginning of the year). In this case the basic factor governing a moderate movement of the national monetary base in the current year is build-up of the stabilization fund, its volume by now exceeding 300 bln rubles. On the other hand, double reduction of the contributions to the required reserves fund led to a significant release of the funds of commercial banks.

P. Trunin

Financial Markets

In September, a positive trend was dominating in the financial market. This was caused by high oil prices, absence of negative corporate news, as well as a number of transactions in the corporate sector, namely the purchase of a blocking minority ownership of NovaTek by French Total and the auction on the government equity stake of LUKOIL. Growing interest of foreign investors in Russian assets fostered the growth in shares of Russian companies. The debt market of Russia was also dominated by a falling yield trend of traded instruments.

Government Securities Market

Transactions in the foreign debt market of Russia were open with optimism in the beginning of September: closing of holiday season and relatively favorable situation in the market of US treasury bonds fostered the growth of Russian Eurobonds, which was suspended after the terrorist acts took place in Russia. The market continued to grow in the middle of the month, which reduced spreads on the US Treasury bonds. Towards the end of the month, a fall was noted in the US government bond market despite the 0.25% increase of the US base rate, which fostered the growth of bonds in the Russian segment of the Eurobonds market. It was only in the end of the fourth week that the growth gave way to correction, while the general trend of investors remained positive.

According to the data as of 24 September, yield to maturity of the Russian Eurobonds RUS-30 amounted to 7.10% of annual interest, RUS-18 – 7.59% of annual interest. On the same date the yield on the Russian Eurobonds was 6.68% on Minfin Bonds, tranche 7, 4.00% on Minfin Bonds tranche 6, 5.73% on Minfin Bonds tranche 5, and 5.51% on RUS-07 .

FIGURE 1.

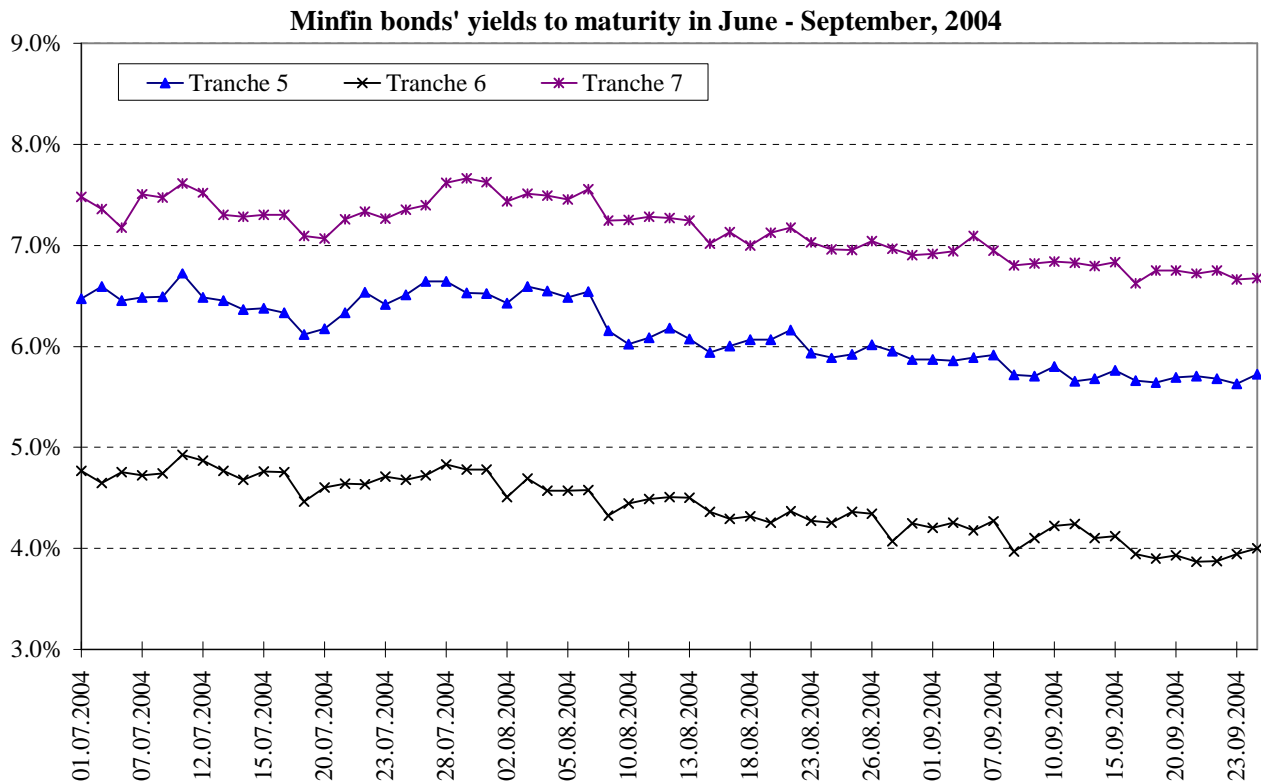
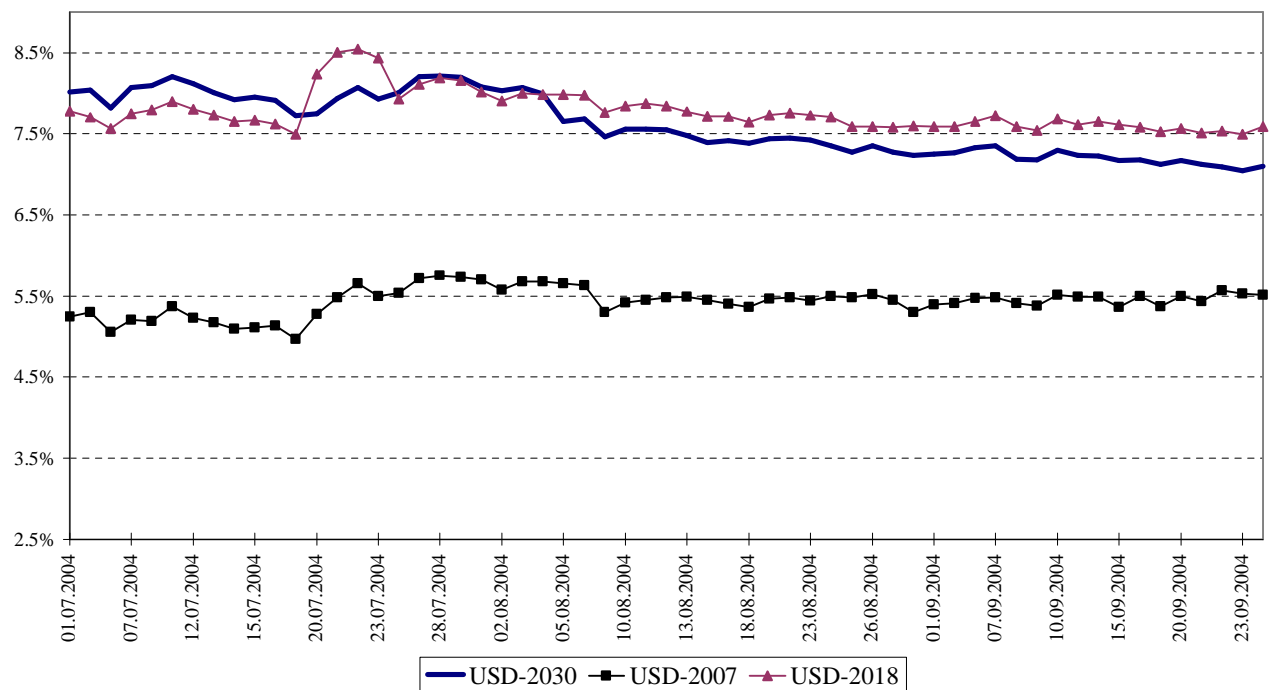


FIGURE 2.

Yields to maturity of the Russian eurobonds with maturity in 2030, 2018 and 2007 in June - September, 2004



A general growth was observed in the market of ruble government bonds market in September. At the beginning of the month the government bonds sector remained at a low level of activity. The government debt market turnover depended largely on direct REPO transactions, which was related to ruble deficit in the banking sector. Interbank loan rates continued to grow. New instruments emerged in the market: the Bank of Russia's bonds were placed, which was followed by growth in all spectrum of government bonds.

In the period between September 1 and 24, total turnover of the GKO-OFZ secondary market amounted to nearly 103 bln rubles with average daily turnover being nearly 5.76 bln rubles, which exceeds significantly the figures of August this year. On September 15, two auctions were held on OFZ-AD, 27026 and 46002 series, at par value of 5.2 and 4.8 bln US rubles, correspondingly. The issue volume amounted to 1.04 and 4.8 bln rubles. Average weighted yield at auctions was 7.52% of annual interest and for OFZ-AD 46002 and 8.05% of annual interest on OFZ-AD 27026 .

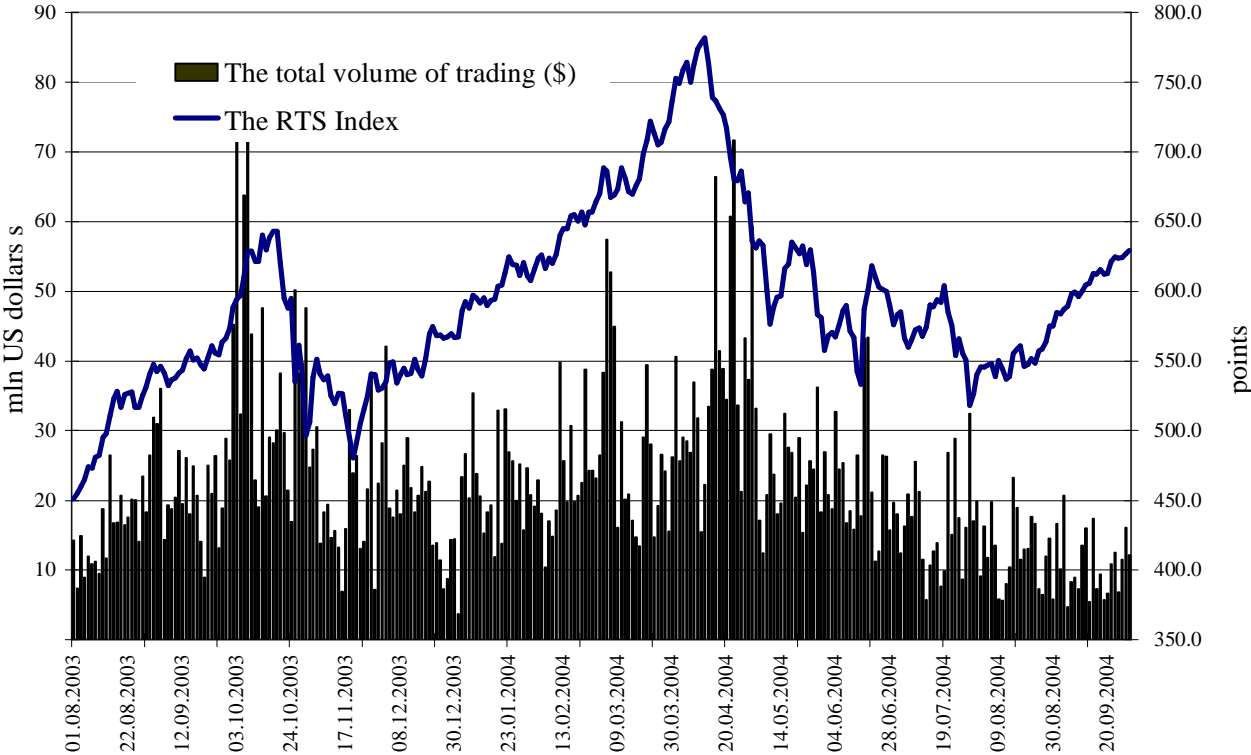
As of September 28, the GKO-OFZ market volume amounted to 474.46 bln rubles at par value and 456.11 bln rubles at market value. Duration of the GKO-OFZ market portfolio was 1701.61 days.

Corporate Securities Market

Stock Market Situation.

In September, the Russian stock market was governed by a stable upward trend for traded securities. Gradual growth rate was observed at the fist half of the month, which was followed by stock growth due to the end of the "summer slack" period. The growth was stimulated by increased investment interest in companies of the Russian electric power industry. Favorable foreign economic situation and high oil prices continued to support the market. The market rates continued to grow towards the middle of the month. Unfavorable corporate news (it concerns mostly YUKOS) did nothing but a short-term downward correction in the market. Neither did the tragic events at the Republic of Northen Osetiya have any significant impact on the market movement, though the news from the Caucasus did result in some market fluctuations.

FIGURE 3.



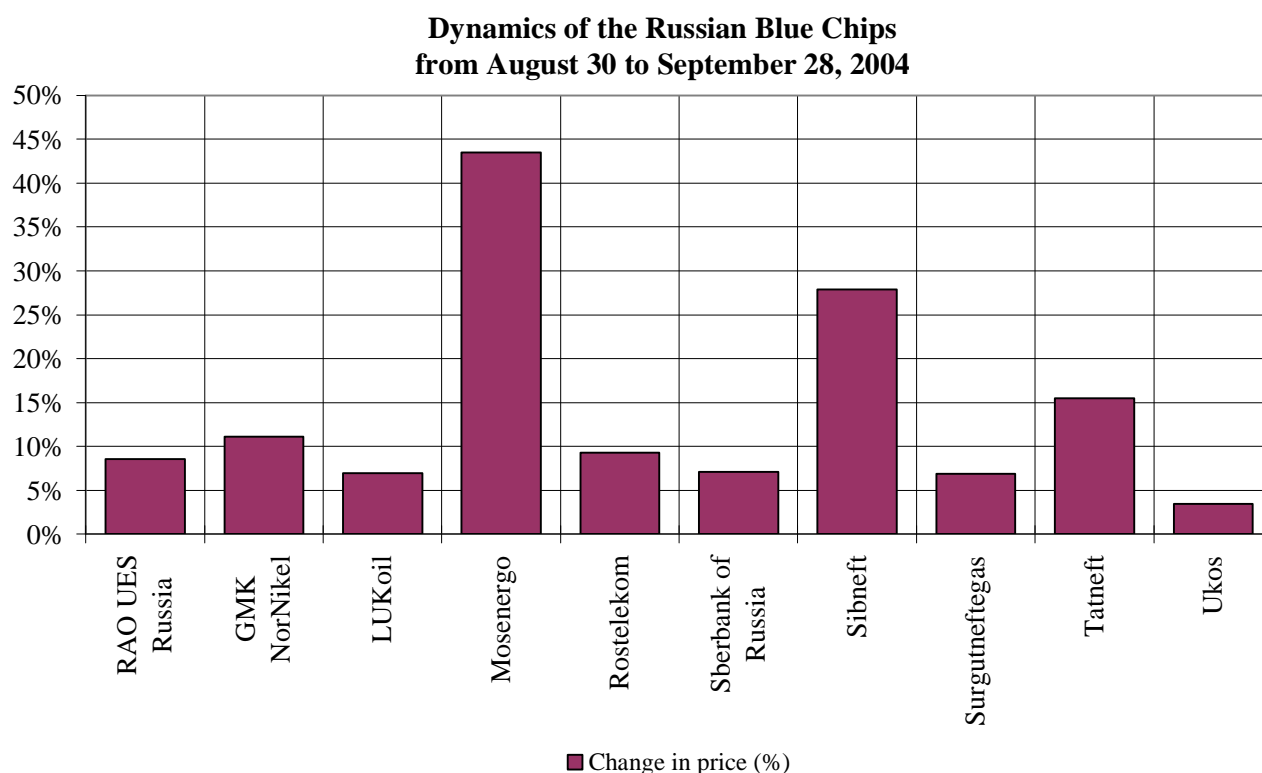
The prices and transaction turnover continued to grow in the second half of the month. At the same time, the lack of new favorable news constrained further growth rates. In addition, the market remained sensitive to political risks. At the end of the month, the market was largely supported by a

favorable foreign economic situation, as well as expectations of a positive outcome at the auction of the government stake of LUKOIL shares and the purchase of a blocking minority ownership of NovaTek by French Total.

All in all, during the period between August 31 and September 28 the RTS index grew by 7.61%, which is 44.49 points in absolute figures. Over the same period, the transaction turnover in the RTS amounted to 211.2 ml US dollars (nearly 260.5 ml US dollars in August) with average daily turnover being nearly 10.5 ml US dollars (12.4 ml US dollars in August). The figures of minimum and maximum transaction in September amounted to 20.68 ml US dollars (on September 2) and 4.7 ml US dollars (on September 3) as compared to \$23.2 и \$5.6 in August, correspondingly.

According to the outcome of the month (from August 30 till September 28), all blue chips showed positive increase in market value. Mosenergo stocks remained the leaders in terms of growth by demonstrating the 43.5% advance over the period under review. Such an expansive growth is most likely to be explained by continued purchase of companies shares by the strategic investor. Shares of Sibneft (27.88%) and Tatneft (15.47%) also grew in rates. These are followed by Norilsky Nickel (11.11%), Rostelekom (9.25%), and RAO Unified Energy System of Russia (8.59%). Shares of Sberbank of Russia (7.1%), LUKOIL (6.94%) Surgutneftegaz (6.91%) и YUKOS (3.5%) grew at a slightly lower rates.

FIGURE 4.



In September, LUKOIL (21.39%), RAO Unified Energy System of Russia (16.31%) and Norilsky Nickel (9.25%) became the three top leaders in terms of turnover in the RTS⁶.

According to the data of 28 September, the five top leaders in capitalization of the domestic stock market are as follows⁷: LUKOIL – 26.7 bln US dollars, Surgutneftegaz – 25.9 bln US dollars, Sibneft – 15.76 bln US dollars, Norilsky Nickel – 12.78 bln US dollars, and RAO Unified Energy System of Russia - 11.75 bln US dollars

Futures market. In September, investors were more active in the futures RTS (FORTS) market than in August. In the period between September 1 and 28, the total turnover of the futures and options market in the RTS amounted to nearly 26.4 bln rubles (112.77 thousand transactions and 3.26 million

⁶ In a classic stock market.

⁷ According to the PTC's data.

contracts), which is slightly higher than in (20 bln rubles turnover, 108.1 thousand transactions and 2.86 million contracts).

Futures still remain in maximum demand: in the period under review, the futures turnover amounted to 23.4 bln rubles (108.35 thousand transactions and 2.89 million contracts). Options were in significantly less demand with turnover being nearly 2.97 ml rubles (4.4 thousand transactions and 370.9 тыс. Контрактов). The maximum turnover in the futures market amounted to 1.98 bln rubles (on September 27), while the minimum one was 807 ml rubles on September 20.

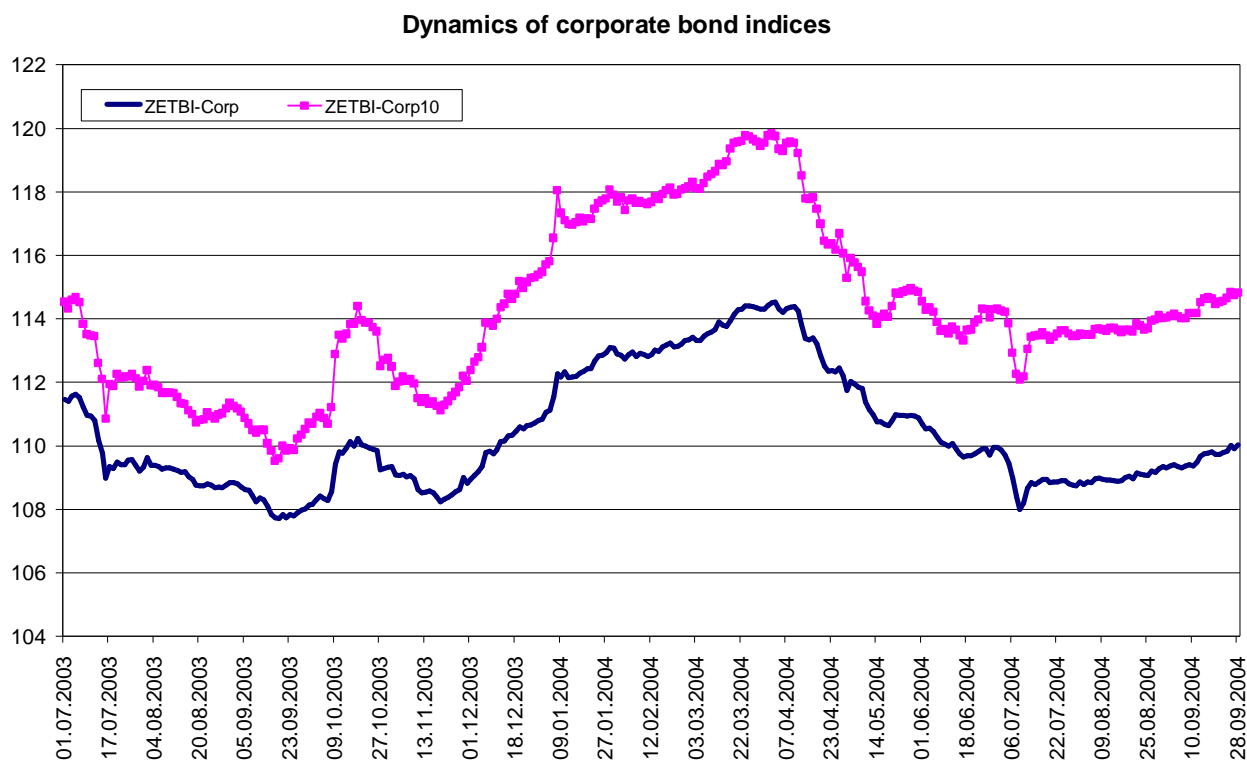
Corporate bond market .

A moderate growth of the most liquid bonds was observed in the corporate bond sector during the first week of the month beside improvements in liquidity in the banking sector. A decrease was noted only due to the fall of Russian Eurobonds against the background of terrorist acts and hostage taking at Beslan. The general picture of the entire secondary market was deteriorated by the outcome of the auctions on Moscow bonds offering. Positive impact could be achieved subject to participation of a great number of investors, thus adding a premium to the market rates. However, the demand of major participants, which almost doubled the supply, led to a discount to the secondary market. Such an aggressive conditions could hardly attract small and medium investors. Then, the situation in the corporate bond market was characterized by a significant decrease in rates due to a notable reduction of new offerings. Interest rates in the sector of corporate and regional debt instruments grew poorly throughout the entire week. The market was supported by (1) a significant growth of the US government bonds, and (2) normalized ruble liquidity in the banking system. In the second half of the month was characterized by correction which started in the previous week and gave way to growth by the end of the month against increased demand for long issues of the leading echelon as well as a number of the second echelon securities. This was due to a new inflation data, whereof it was clear that it would be difficult for the Central Bank of Russia to simultaneously achieve the inflation target (10%) and the stronger ruble goal (7%). Some increase in the USD exchange rate might have been considered by investors as a signal that the Central Bank of Russia had decided in favor of inflation and not to increase the currency rate. This made speculators close positions in the foreign exchange market and switch to long bonds. However, the Central Bank of Russia proceeded maintaining the exchange rate at the level between 29.21 and 22 rubles, which made investors less optimistic and led to correction in the market in the absence of fundamental factors.

In the period between September 1 and 28, the price index of the corporate bonds traded in the MICEX⁸ grew by 0.71 points (0.65%), while the index of the ten most liquid bonds of the corporate sector grew by 0.81 points (0.81%). Over the period between September 1 and 24, the total turnover of the MICEX bond section amounted to nearly 5 bln rubles with the average daily turnover being 279 ml rubles, which is significantly lower than the figures of August this year.

⁸ The calculation was based on the indices of corporate bonds traded in the MICEX, which are computed by Zenit bank.

FIGURE 5



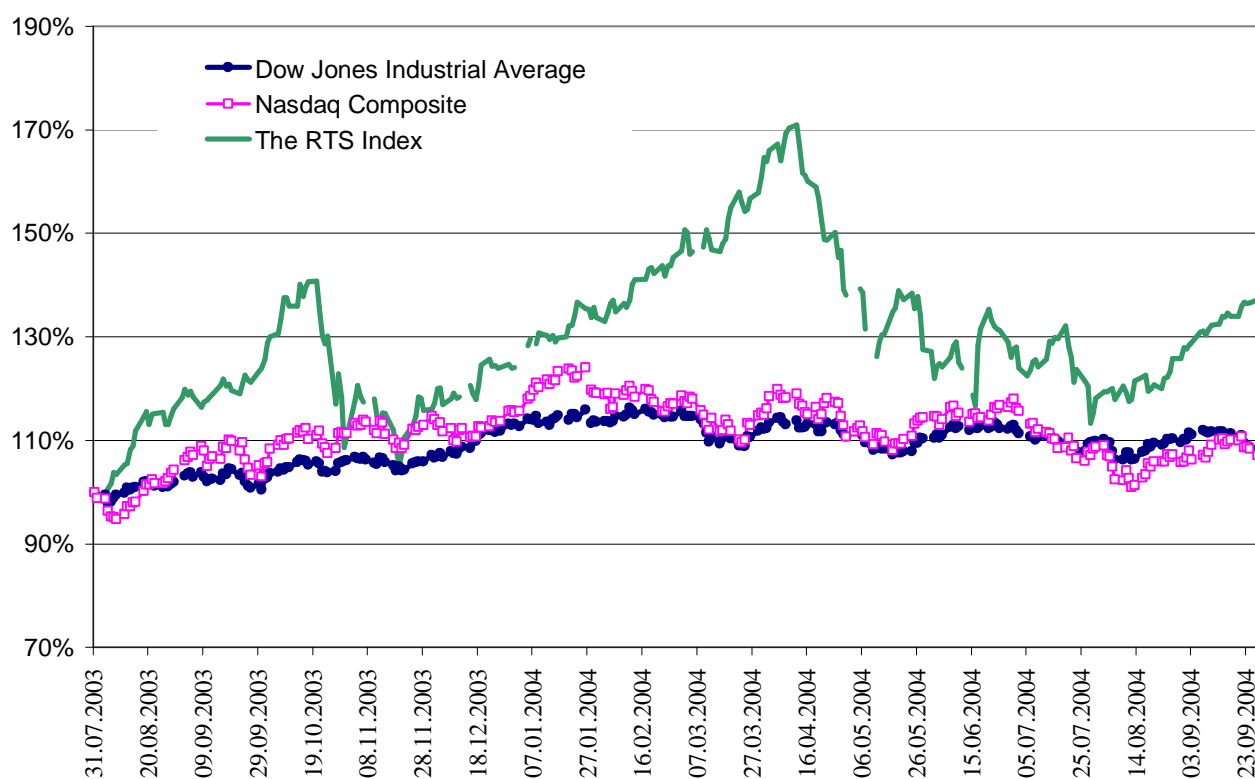
External factors effecting movement in the Russian Stock Market .

In September, the global oil market was dominated by an upward trend with a new absolute historical maximum. At the beginning of the month, the trend was supported by unstable situation in Iraq: hardly had the northern Iraqi oil pipe-line functioned over a few days after repairs when another subversive destruction took place. The market was supported by the data on fuel reserves in the United States, according to which the crude oil reserves of country were reduced significantly. The news about YUKOS continued a positive effect on the prices: again it was most likely that YUKOS would stop its operating activities after its subsidiaries' accounts had been arrested as well as tax claims increased. Another major factor of oil price rise became the Ivan hurricane that took place in the Caribbean zone. In spite of the fact that the aftereffects appeared to be less destructive for the oil industry, several oil refineries at Louisiana and Mississippi were closed. According to the data of the US natural resources service, production of oil products was reduced by 5.2 million barrels due to the protective measures. The tendency for a reduction of oil products reserves continued as well. The increase in OPEC's quotas by 1 million barrels daily up to 27 million barrels had no impact whatsoever on the prices because the current production of the cartel has reached its maximum capacity of over 28 million barrels daily. The market was supported by a decision of YUKOS to reduce export volume to China by railway transportation.

Quite an opposite trends were observed in the global stock markets in September (refer to Table 1). In the beginning of the month, the American stock indices had a differently directed movement against a very small trading volume and high volatility. The prices were supported positively by a relatively low yield of the government bonds and strengthened position of the incumbent president in the electoral campaign, while the negative impact was represented by ceased correction of oil prices, negative forecast for corporate financial performance, cooling of the economy, light trading of stocks and short-term technical outbid. All in all, economic statistical data were of negative character. Then, a slight growth of indices was observed against contradicting corporate and general business news. The speech made by A. Greenspan at the Budgetary Committee of the House of Representatives proved the opinion that the US economy is suffering a decline in growth rates along with other serious current problems (sizeable budget deficit and unemployment problems). Stock indices in the Ameri-

can stock market were falling towards to the end of the month, which was conditioned mainly by high oil prices and prevailing negative outcome in the corporate sector of the economy.

FIGURE 6.



In general, it should be noted that global oil prices, which had reached new historical maximums, had a significant impact on the movement of the Russian stock market against a neutral trend in the global stock markets. The growth of oil companies' stocks was "hauling" the entire market.

Corporate news .

LUKOIL oil company

On September 27, the company published its consolidated financial statement for three and six months of 2004 drawn in accordance with the US GAAP. Net profit in the first half of 2004 amounted to 1696 ml US dollars, which is 594 ml US dollars more than that in the comparable period of the previous year. Operating expenses of the company in the first half of 2004 decreased by 27 ml US dollars (2%) as compared to the similar period of 2003 .

Sibneft

On September 22, the company published its full consolidated financial statement prepared in accordance with US GAAP for the first half of 2004. Total business earnings of the company in the first half of 2004 amounted to 4014 ml US dollars as compared to 3438 ml US dollars in the comparable period of 2003 (17% growth). Net profit in the first half of 2004 amounted to 992 ml US dollars, which is 29% less than the comparable figure of 2003 (1380 ml US dollars) when Sibneft gained income from selling its share in ONAKO/Orenburgneft . Net profit decreased by 2% without regard of this income.

Gazprom

On September 14, it was stated that the Government of Russia had offered an option of increasing the government share in the Gazprom authorized capital. The increase will result from transfer of shares to the state-owned Rosneft, which is going to be a 100% subsidiary of Gazprom.

GMK Norilsky Nickel

GMK Norilsky Nickel appointed investment banks Citigroup and Morgan Stanley as joint lead-managers of the planned debut Eurobonds issue nominated in US dollars, which was placed on September 17 to the amount of 500 ml US dollars with the yield of 7.125% and maturity date on September 30, 2009 . The demand for issue was 4 times higher than the supply. The Eurobonds will be unconditionally and irrevocably secured by GMK Norilsky Nickel .

In September, the company published for the first time its interim financial statement for the first quarter of 2004 prepared in accordance with the International Accounting Standards. According to the financial statement, the sales revenue over the period under review increased by 40% as compared to the similar period of 2003 и amounted to 1583 ml US dollars. Net profit in the first quarter of 2004 amounted to 460 ml US dollars, which corresponds the 322% growth as compared to the similar period of 2003 .

YUKOS

On September 20, the company published a statement saying that from September 28 the company would temporally suspend a part of direct export delivery to the Peoples Republic of China to the amount of 1 million tons till the end of 2004 . The suspension is caused by impossibility of further pre-export financing of oil delivery to the Chinese National Oil Corporation. Under the circumstances YUKOS plans to redirect the current export volumes to other directions of crude sales, rather than reduce oil production.

Table 1.

Global Stock Indices Movement

Data as of September 28, 2004	Value	Changes per month (%)⁹	Changes since the beginning of the year (%)
RTS (Russia)	629.14	9.36%	7.35%
Dow Jones Industrial Average (USA)	10077.4	-0.45%	-3.19%
Nasdaq Composite (USA)	1869.87	1.82%	-6.82%
S&P 500 (USA)	1110.87	0.99%	0.14%
FTSE 100 (Great Britain)	4567.3	1.72%	1.27%
DAX-30 (Germany)	3882.27	1.13%	-3.39%
CAC-40 (France)	3667.47	0.85%	1.96%
Swiss Market (Switzerland)	5499.7	0.93%	-1.49%
Nikkei-225 (Japan)	10815.57	-3.30%	-0.09%
Bovespa (Brasil)	23231.0	1.58%	3.50%
IPC (Mexico)	10843.42	6.31%	33.57%
IPSA (Chile)	1687.82	3.95%	13.69%
Straits Times (Singapore)	1979.1	3.87%	10.48%
Seoul Composite (South Korea)	832.1	3.34%	1.32%
ISE National-100 (Turkey)	22293.78	12.28%	16.43%
Morgan Stanley Emerging Markets Free Index	460.5	4.94%	3.92%

Foreign Exchange Market .

The US dollar got stronger in the beginning of the month. Temporal US dollar growth in the global foreign exchange market played against the ruble. In addition, certain inflation expectations remained

⁹ In respect to the levels of August 30 .

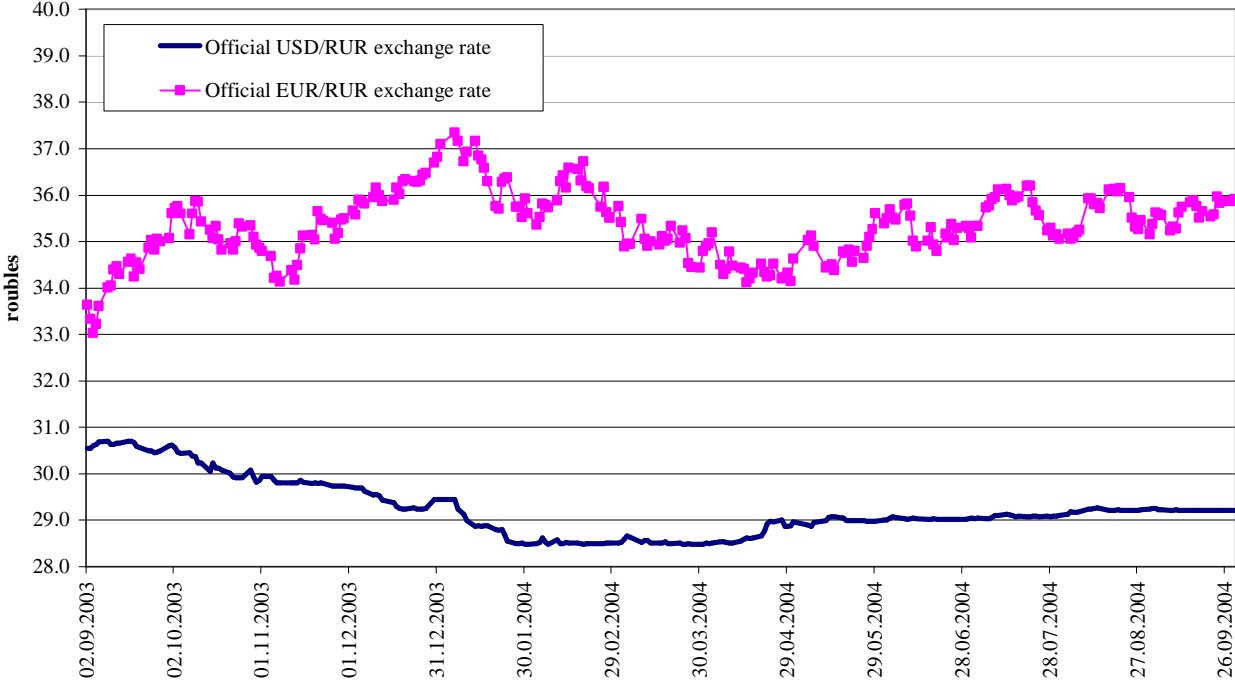
in the Russian market. On the other hand, the Russian currency was supported by stable inflow of currency earnings due to a very high oil prices. Then, the US dollar stabilized at the level of 29.22 rubles for 1 US dollar. The market showed a moderate activity. In the second half of the month, the US dollar remained relatively stable varying at the level of nearly 29.215 rubles for 1 US dollar. Quiet market was governed by the USD/EURO ratio stabilized at 1,21 to 1,22 US dollars for 1 Euro in the global market. At present, the Russian market is receiving export contracts earnings with high oil prices of the summer period. Large-scale sales of export earnings encouraged turnover growth in the foreign exchange market.

In the period between September 1 and 29, the USD exchange rate fell by 0.04 rubles (-0.15%) and amounted to 29.215 rubles for 1 US dollar. Total turnover on the US dollar in the SELT over the period between September 1 and 24 amounted to nearly 13.7 bln US dollars, average daily turnover over this period amounted to 762 ml US dollars, which is comparable with the figures of August this year. The maximum trading volume on the US dollar over the period was recorded on September 13, which amounted to nearly 1828 ml US dollars, while the minimum volume was 285 ml US dollars on September 6.

Ruble liquidity in the banking sector increased slightly in September 2004 as compared to the previous month: average balance in corresponding accounts of credit organizations with the Bank of Russia amounted to 197.5 bln rubles in September against 194.3 bln rubles in August.

FIGURE 7.

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



In the beginning of the month, the EUR/USD exchange rate remained unchanged in the global foreign exchange market, though it jumped due to negative data on industry and consumer uncertainty in the United States, and even slumped after the report on unemployment. Then, the EURO strengthened significantly against the US dollar. The US currency became weaker due to the comments made by A. Greenspan with regard to low inflation, as well as his actual acknowledgment of economic cooling, which reduced the yield of the US government bonds and encouraged the Euro growth. Towards the end of the month, the market experienced a smooth strengthening of the Euro versus the US dollar against the background of investors' confidence in slowed-down economic growth rates in the United States and lower risk of interest rate growth. The all-time high level of deficit of US current accounts doesn't allow for significant changes in the power balance in favor of the US dollar.

In the period between September 1 and 29, Euro exchange rate grew in the global market by \$0.014 (1.15%) and reached 1.2319 US dollars for 1 Euro. The EUR/RUR exchange rate movement depended largely on the global market trend. Over the period between September 1 and 29, EUR/RUR exchange rate grew by 0.53 rubles (1.51%) from 35.37 to 35.90 rubles for 1 Euro. Total turnover on Euro in the SELT from 1 to 24 September amounted to 141.4 ml Euros with average daily figure being nearly 7.86 ml Euros. The maximum trading volume on the Euro over the given period was recorded on September 7, which amounted to 13.76 ml Euros, while the minimum volume was 5.94 ml Euros on September 10.

FIGURE 8.

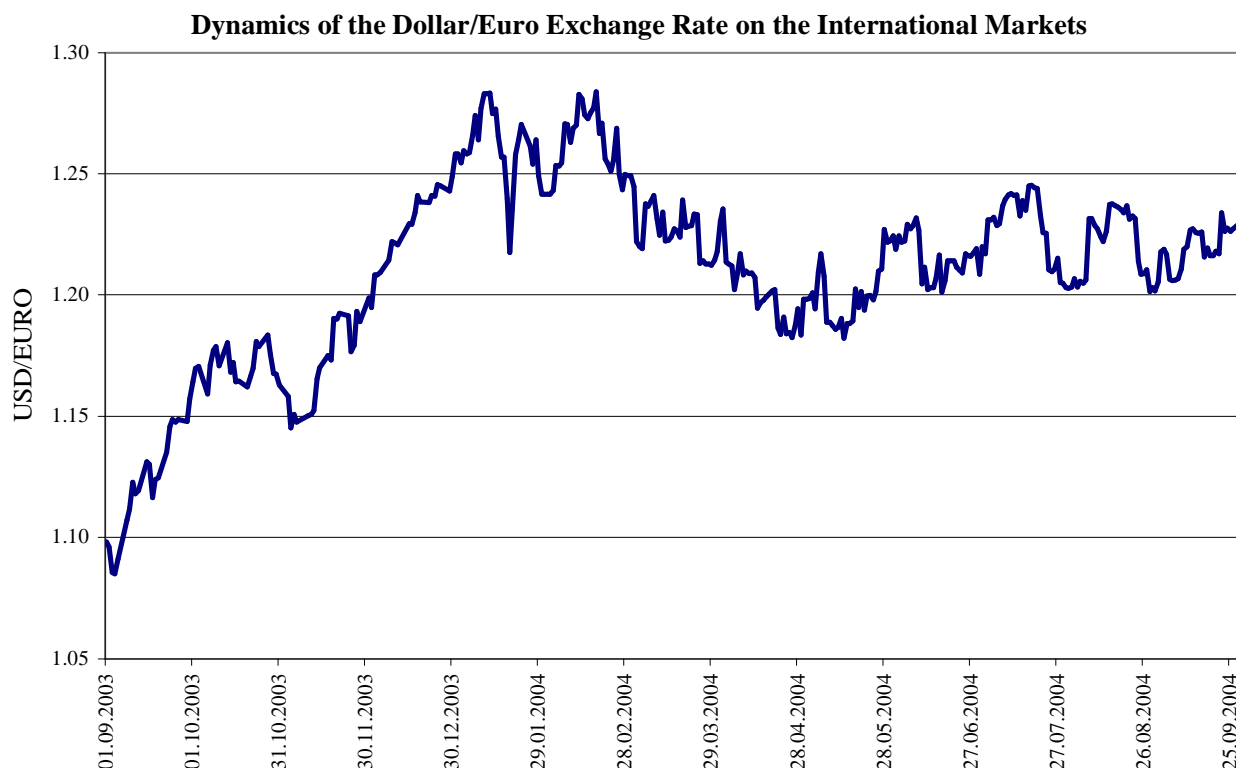


Table 2.

Financial Markets Indices

Month	May	June	July	August	Sep.
Monthly inflation	0,7%	0,8%	0,9%	0,4%	0,4%
Estimated annual inflation according to current month trend	8,73%	10,03%	11,35%	4,91%	4,9%
Refinancing rate of the Central Bank of Russia	14%	13%	13%	13%	13%
OFZ average yield to maturity for all issues (% per year)	7,04%	6,48%	6,45%		%
GKO-OFZ monthly market turnover (bln rubles)	19,67	12,03	6,41		
OBB3 yield to maturity at the end of the month (% per year):					
tranche 5	6,52%	6,71%	6,52%	5,87%	5,7%
tranche 6	4,91%	4,92%	4,78%	4,25%	4,0%
tranche 7	7,31%	7,68%	7,63%	6,90%	6,7%
tranche 8	5,41%	5,49%	5,33%	4,87%	4,5%
Yield to maturity Eurobonds at the end of month (% per year):					
2005	3,35%	3,39%	3,45%	3,92%	4,7%
2007	5,07%	5,28%	5,71%	5,30%	5,5%
2010	6,36%	6,52%	7,94%	6,76%	6,8%
2018	7,81%	7,87%	8,02%	7,60%	7,6%

Month	May	June	July	August	Sep.
2028	8,22%	8,29%	8,53%	8,22%	8,0%
2030	8,00%	8,09%	8,08%	7,23%	7,1%
МБК-МІАСR overnight rate (% per year at month end) .	21,18%	11,38%	4,96%	9,86%	6,0%
Official USD/RUR exchange rate at month end (ruble /US dollar) .	28,9850	29,0274	29,1019	29,2447	29,2171
Official EUR/RUR exchange rate at month end (ruble /Euro) .	35,6052	35,2915	35,0532	35,1463	35,9896
Monthly increase in official USD/RUR exchange rate (%) .	0,35%	0,15%	0,26%	0,49%	-0,09%
Monthly increase in official EUR/RUR exchange rate (%) .	4,28%	-0,88%	-0,68%	0,27%	2,40%
Monthly market turnover of the RTS (ml US dollars, by shares included into the list of the RTS index calculation) .	419,36	482,07	368,25	277,15	240
RTS-1 index value at month end .	581,47	584,63	540,27	584,65	635
Monthly changes in the RTS-1 index (%) .	-8,37%	0,54%	-7,59%	8,21%	8,6%

- Estimation

D. Polevoi

The state of the market of non-state pensions

This year, the pension reform, which has started a few years earlier, enters a new stage: the system of mandatory pension insurance is complemented with non-state pension funds (NSPF). Seventy seven of such funds have been already registered in accordance with the legislation currently in force and started the campaign aimed at the attraction of participants wishing to invest their pension savings in NSPF. This campaign should be completed on October 1. According to the preliminary data, it is expected that this year the activity of the population, as concerns the transfer of pension savings in NSPF, would be even lower than in 2003, when 700 thousand persons submitted applications about the choice of investment portfolios offered by private management companies. Nevertheless, in the future it may be expected that a significant part of the employed population may become clients of NSPF investing their mandatory pension insurance funds in these organizations. In this connection, the present state of the market of NSPF services should be analyzed in more detail.

The present number of NSPF is close to 300 (after this number declined to 257 in 2001 in 2001 due to the cancellation of more than 50 licenses, since 2002 this number has been increasing).

The number of NSPF participants makes 5.6 million persons (8 per cent of the total number of employed), not less than 0.5 million of which receive payments from the funds.

Both employees and employers are eligible to make contributions to NSPF. Accordingly, by this criterion NSPF are classified as so called

- “corporate” funds, where principle contributors are employing enterprises (in this category there are also certain branch funds, for instance those pertaining to electrical power engineering or railroads);

- “regional”, where principal contributors are local administrations;

- “open” funds, which are oriented towards retail businesses and where contributors are primarily individuals.

There are relatively few funds oriented towards operations with individuals. Judging by the amount of contributions registered in the first six months of 2004, three fourths or more of the total amount of contributions were made by individuals in only 51 funds. At the same time, on the average the sizes of these funds are 4 times less than funds oriented towards operations with legal entities.

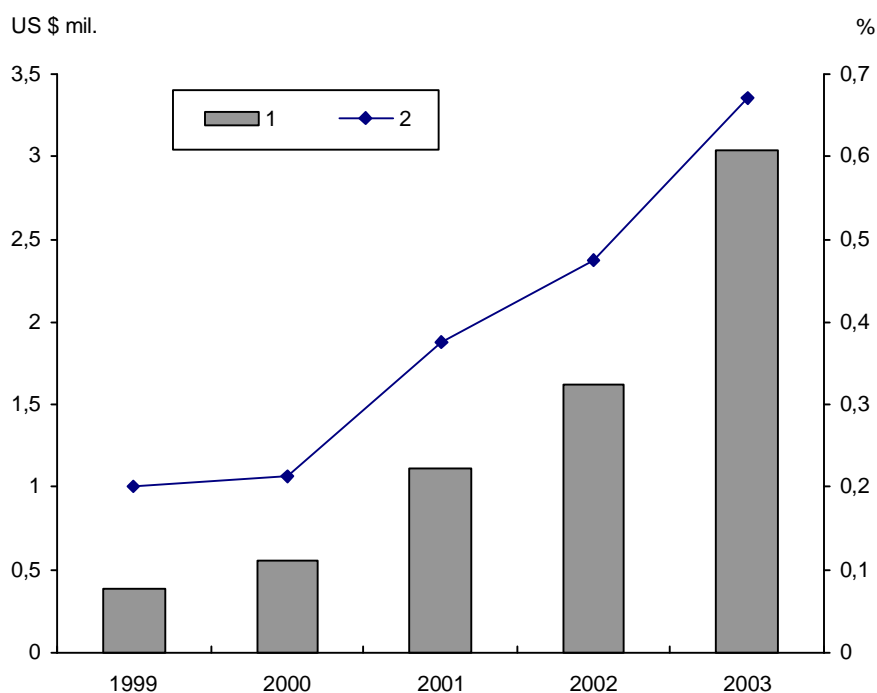
Non-state pension funds offer both schemes based on the principle of fixed payments, and fixed contributions. The state regulation in this sphere is primarily oriented towards the system of fixed payments. Thus, a mandatory condition of implementation of a fund’s pension scheme is that the insured person receives a pension not less than 0.5 of the minimal state old age pension granted in the case the total registered length of service of such a person is equal to the respective number of years required for granting of the full pension set by the legislation of the Russian Federation at the moment the pension agreement is made.

At present, the average amount of the pension paid by NSPF makes 37 per cent of the average state labor pensions paid in the end of 2003. However, in the case it is taken into account that in fact payments were made by less than 200 funds, in 2003 the average amount of payments per one beneficiary made about Rub. 1277 per month, what makes 78 per cent of the average state pension.

By the end of 2003, the aggregate amount of pension reserves of non-state pension funds made Rub. 91.7 billion (US \$ 3 million). As it is shown in Fig. 1, pension reserves have rapidly increased over several years and over 4 years (in 2000 through 2003) their amount in US \$ terms grew almost 8 times. However, this value remains insignificant in comparison with GDP (less than 1 per cent).

The average amount of pension reserves of a fund made Rub. 349 million (less than US \$ 12 million) by the end of 2003. In these terms, funds differ from zero to Rub. 45 billion.

Given the small amount of financial reserves at the disposal of the average NSPF, the structure of the branch market is characterized by a very high level of concentration. As in the end of 2003, the share of the largest NSPF made about the half of the total amount of pension reserves. The next four funds make 19 per cent of the total amount, therefore, 5 largest NSPF concentrated about 70 per cent of voluntary pension contributions. At the same time, the largest NSPF in terms of pension reserves (Gazfond) was five times above the respective indicator of the second largest fund. All five leading NSPF are in the category of corporate funds.



1 – Pension reserves as at the end of the year (left axis)

2 – Pension reserves in per cent of GDP (right axis)

Fig. 1. Pension reserves of NSPF.

Sources: Inspection of Non-State Pension Funds, the Federal Service of State Statistics.

The geographical structure of the market is also characterized by a high level of concentration, what is typical for the Russian financial market. Almost half of all funds, which presented their accounting data for year 2003 in the Inspection of NSPF was registered in Moscow. At the same time, the share of Moscow based funds made more than 80 per cent of the total amount of pension reserves. The picture will remain similar in the case the Gazfond is not taken into account: the share of the funds based in the capital remains very high (more than 70 per cent). At the same time, the branch network of NSPF is underdeveloped. In the case the NSPF of Sberbank, which may use the branch network of its parent bank for promotion of its products, is not taken into account, the NSPF Elektroenergetiki (19 offices) and Blagosostoyaniye (18 offices) are among the leaders.

Besides, in order to assess the real position of non-state pension funds on financial markets, it is necessary to take into account the fact that a significant share of financial resources at their disposal

are not pension reserves, but constitute the property designated for carrying out of authorized activities of the funds. This indicator may be most correctly defined as capital. The funds receive these means from their founders. However, according to the legislation, founders should have no ownership rights as concerns these means, since these rights belong to NSPF.¹⁰

On the average, the indicator of property designated for carrying out of authorized activities makes 25 per cent across funds, and 36 per cent without the NSPF Gazfond. These means should be invested separately from the pension reserves and do not depend on respective restrictions.

By the end of 2003, investment of NSPF made Rub. 116.5 billion (US \$ 4 billion). On the average, this indicator makes Rub. 453 million (US \$ 15.4 million) per fund. According to this criterion, funds vary from zero to Rub. 47 billion. Similarly to the amount of pension reserves, Gazfond was the leader in terms of invested financial resources, however, the gap between the first and second places in terms of this indicator was significantly more narrow than in terms of pension reserves: the share of the leader of the market made 40.6 per cent, while the share of the second fund made 18 per cent; at the same time the share of 5 largest funds in terms of investment made 72.3 per cent. All top five of NSPF are classified as corporate funds, while the level of concentration in terms of the amount of investment is close to the level of concentration in the case of pension reserves.

It has proved impossible to single out and evaluate the assets, where there were invested pension reserves per se; therefore, above are presented the data characterizing the total amount of NSPF investment. The increase in the means invested by NSPF in the few last years occurred at a very high rate, however, only in the last 2 years they outpaced the rates of growth in pension reserves (see Fig. 2).

According to the data presented by the Inspection of NSPF as in the middle of 2003, the investment in shares made 52 per cent, government bonds (Federal and subfederal) made 9 per cent, bank deposits made 15 per cent, promissory notes made 15 per cent, real estate made 1 per cent, and other investments made 8 per cent.

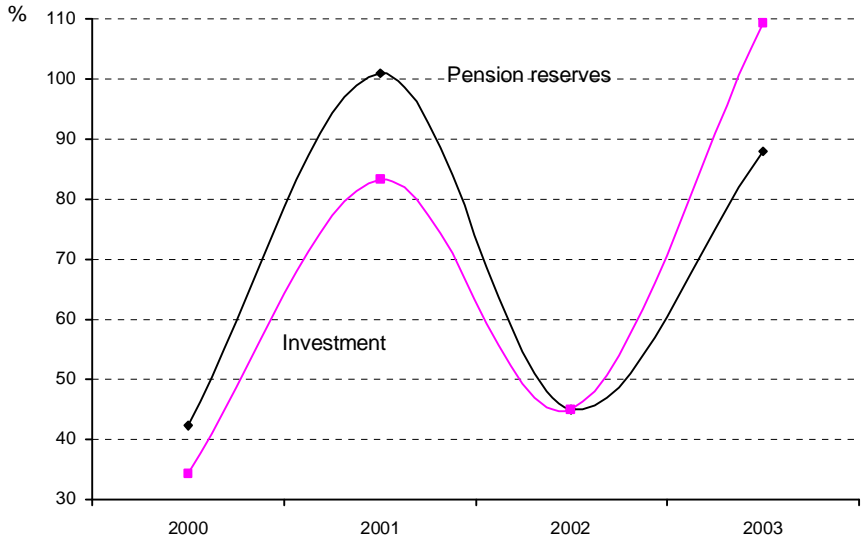


Fig. 2. Growth in pension reserves and investments of NSPF (in US \$ terms)

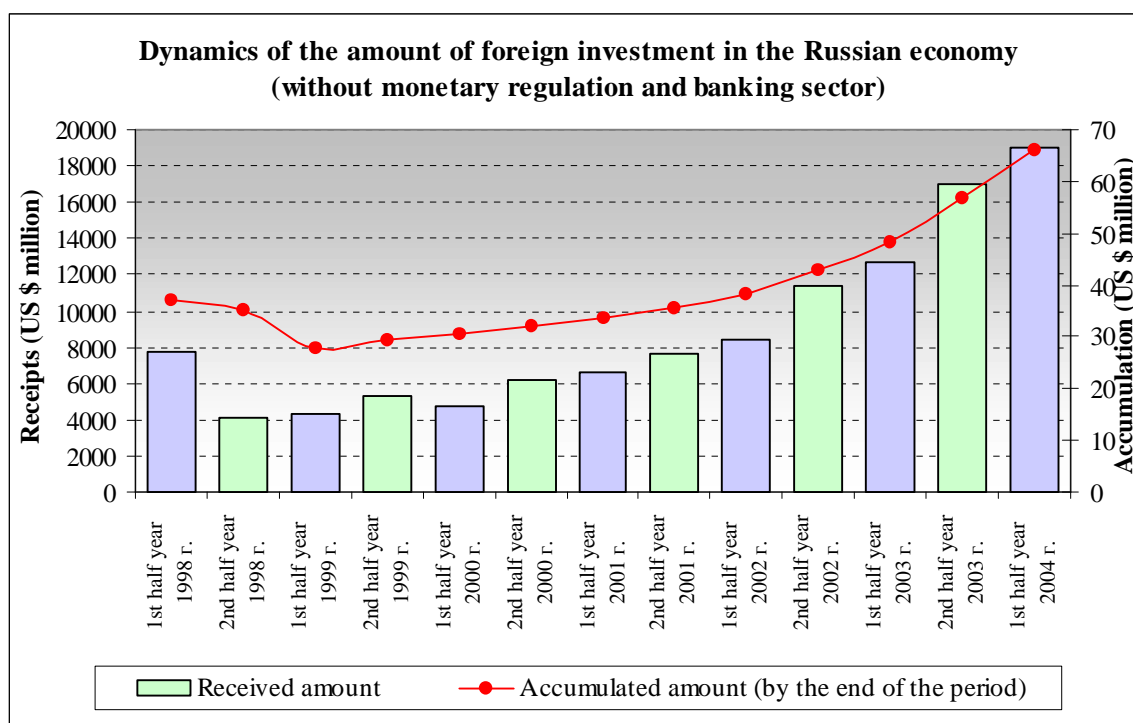
Source: Inspection of Non-State Pension Funds.

L. I. Sychova, L. V. Mikhailov, O. S. Tochikina

¹⁰ The same is true as concerns pension reserves. In accordance to the legislation, they are own property of NSPF.

Foreign investment in the Russia's economy

In the first six months of 2004, the foreign investment in Russian economy increased in comparison with the figures registered in the respective period of the preceding year by 49.9 per cent and made about US \$ 19 billion. As on July 1, 2004, the accumulated amount of foreign investment in Russia, including investment from CIS member countries were at US \$ 66.1 billion.



Source: Federal Service of State Statistics.

In spite of the growth in foreign investment in the Russian economy, in the first six months of this year, an amount exceeding 52 per cent of received foreign investment was withdrawn as transferred abroad earnings of foreign investors, payments pertaining to the interest on credits, and repayment of credits (as compared with 57.3 per cent registered in the first six months of 2003). The most significant outflow of capital, similarly to preceding years, was observed in the 1st quarter.

Table 1

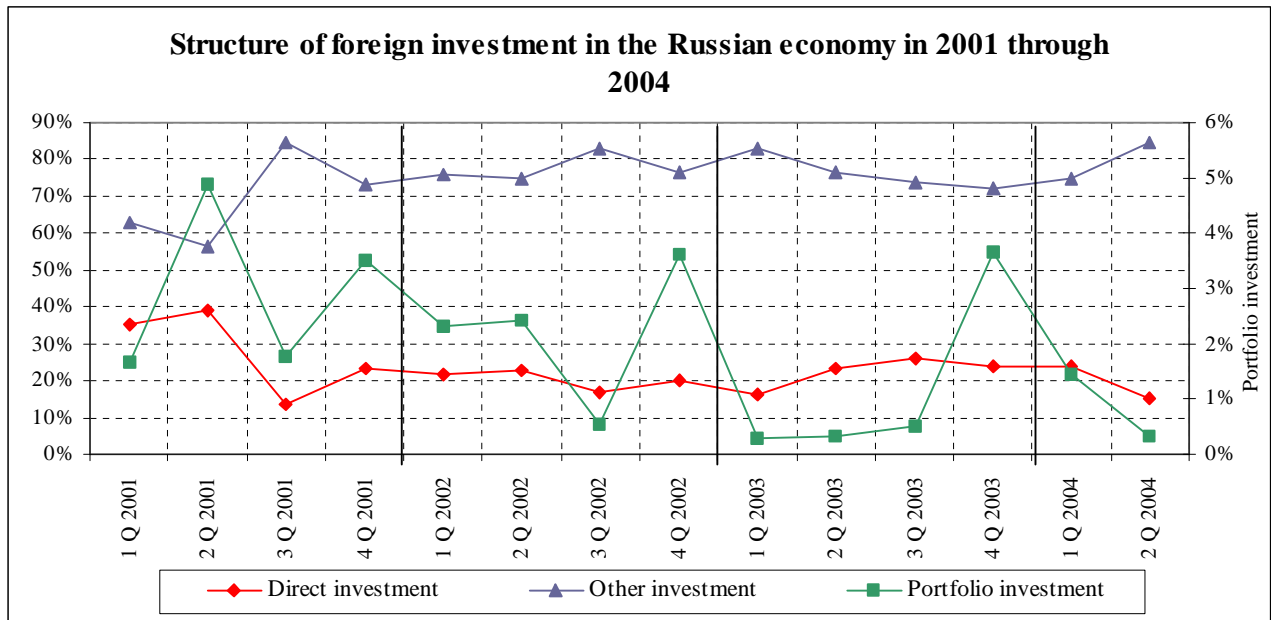
Foreign investment in the Russian economy in 2001 through 2004.

	Foreign investment, received	Foreign investment, withdrawn	Accumulated by the end of the period	Ratio between the received and withdrawn investment
Q 1, 2001	2718	2830	31893	104,1%
Q 2, 2001	3966	2020	33839	50,9%
Q 3, 2001	3037	2060	34816	67,8%
Q 4, 2001	4537	3729	35624	82,2%
Q 1, 2002	3789	4977	34436	131,4%
Q 2, 2002	4579	865	38150	18,9%
Q 3, 2002	4537	2885	39802	63,6%
Q 4, 2002	6875	3749	42928	54,5%
Q 1, 2003	6268	6165	43031	98,4%
Q 2, 2003	6394	1084	48341	17,0%
Q 3, 2003	8237	2983	53595	36,2%
Q 4, 2003	8800	5381	57014	61,1%
Q 1, 2004	6171	6121	57064	99,2%
Q 2, 2004	12812	3781	66095	29,5%

Source: Federal Service of State Statistics.

The increase in the amount of withdrawn capital is a direct consequence of the growth in the amounts of other investments subject to repayment. Over the last few years, "other investment" have made the largest share of investment.

Structure of foreign investment in the Russian economy in 2001 through 2004



Source: Federal Service of State Statistics.

By the end of the six months of 2004, the structure of foreign capital invested in the Russian economy has changed. In spite of the growth in the absolute values of all components, the lower rates of growth in direct investments in comparison with the respective indicator of aggregate foreign investment resulted in the fact that the share of “other” investment in the total amount of investment registered in the first six months of 2004 made 81.3 per cent (first six months of 2003 – 79.7 per cent), while the share of direct investment declined and made 18 per cent (20 per cent in the first six months of 2003).

Table 2

Structure of foreign investment in the Russian economy in the first six months of 2001 through 2004.

	US \$ mil.				In % of the figures registered in the preceding year			
	Total	Direct	Portfolio	Other	Total	Direct	Portfolio	Other
2001	6684	2509	238	3937	39,9	40,5	3,7	33,9
2002	8368	1872	199	6297	25,2	-25,4	-16,4	59,9
2003	12662	2533	38	10091	51,3	35,3	-80,9	60,3
2004	18983	3427	129	15427	49,9	35,3	3,4	52,9

Source: Federal Service of State Statistics.

The high level of oil prices facilitated the attraction of investment in fuel industry, what resulted in an increase in the share of industry in the branch structure of foreign investment by 1.6 times.

Table 3

The branch structure of foreign investment in industry in the Russian economy in the first six months of 2001 through 2004.

	US \$ mil.				In % of the total			
	2001	2002	2003	2004	2001	2002	2003	2004
Industry	2487	3245	4326	10250	37,2	38,8	34,2	54,0
Transport and communications	607	350	741	337	9,1	4,2	5,9	1,8
Trade and public catering	2426	3596	5686	6113	36,3	43,0	44,9	32,2
Commercial activities relating to market servicing	403	533	1072	924	6,0	6,4	8,5	4,9
Finance, credit, insurance, pensions	99	41	112	468	1,5	0,5	0,9	2,5
Other sectors	662	603	725	891	9,9	7,1	5,6	4,6

Source: Federal Service of State Statistics.

Trade and public catering have lost their leading positions in terms of preferences of foreign investors, however, these sectors remain a rather attractive sphere of investment of capital, since these sec-

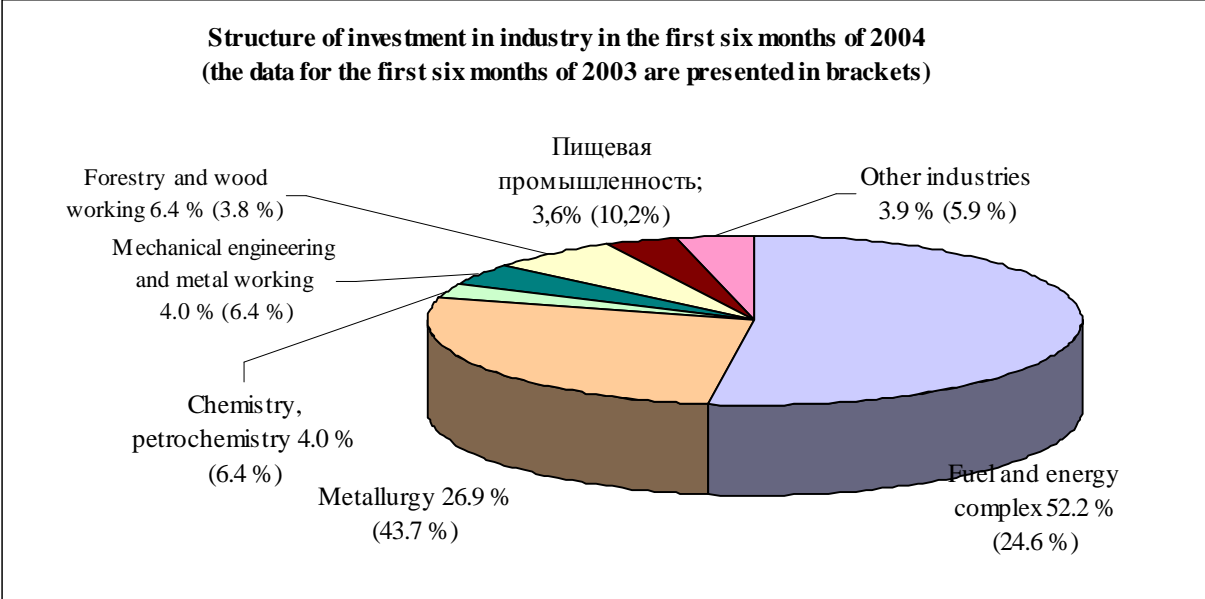
tors demonstrate high rate of turnover of capital and higher profits (from 15 per cent to 40 per cent). Foreign investment in this sphere of the economy increased by 7.5 per cent in the first six months of 2004.

Foreign investors have invested in the sphere of transport and communications less, in the first six months of 2004 the amount of investments was 2.2 times below the figures registered in the respective period of the preceding year.

By the end of the first six months of 2004, the share of the fuel and energy complex in the total foreign investment in industry was the largest (US \$ 5.35 billion), what was 5 times above the respective indicator registered in the first six months of 2003. Over this period, investment in forestry and wood working increased 4 times (up to US \$ 658 million), investment in mechanical engineering and metal working grew 1.5 times (up to US \$ 409 million), while investment in metallurgy also increased and made US \$ 2.76 billion. At the same time, investment in food industry declined by 24.1 per cent and made US \$ 366 million.

A significant increase of investment in the fuel and energy complex resulted in significant changes in the structure of foreign investment in industry.

Structure of investment in industry in the first six months of 2004 (the data for the first six months of 2003 are presented in brackets).



Source: Federal Service of State Statistics.

The trend towards a growth in the specific weight of “other” investment and decline in the share of foreign direct investment is characteristic of both the structure of the total amount of foreign investment and the structure of foreign investment in industry.

The share of foreign direct investment made in the first six months of 2004 in industry made 73.1 per cent (US \$ 2.5 billion) of the total amount of direct investment in the Russian economy (46.0 per cent, or US \$ 1.17 billion in the first six months of 2003). At the same time, the rates of growth in foreign direct investment in industry significantly exceeded the respective indicator pertaining to total foreign direct investment in the Russian economy. While the former indicator increased more than 2 times, the growth in the latter is evaluated to make 35.3 per cent.

The major part of foreign direct investment (67.1 per cent of the total direct investment) flowed in fuel industry (45 per cent, or US \$ 1544 million), forestry complex (11 per cent, or US \$ 378 million), as well as trade and public catering (11 per cent or US \$ 379 million). In the first six months of 2003, foreign direct investment in these industries were evaluated to be at 25.2 per cent, 3.6 per cent, and 16.4 per cent respectively.

Over the same period, “other” investment in industry made 49.8 per cent of the total amount of “other” investment in the Russian industry (31.1 per cent in the first six months of 2003). The share of fuel industry in the total amount of “other” investment made 24.5 per cent (4.1 per cent in the first six months of 2003).

In the first six months of 2004, the major investing countries in the Russian industry were Luxemburg (US \$ 2.79 billion) and the Netherlands (US \$ 1.7 billion). These countries increased their investment 5.5 times and 4.5 times respectively in comparison with the figures registered in the respective period of the preceding year. At the same time, while in the first six months of 2003 foreign investors from Luxemburg made 97.6 per cent of their investment in industry in nonferrous metallurgy, this year 99 per cent of the respective investment were made in fuel industry. Businesspersons from the Netherlands also paid more attention to fuel industry by making 86.1 per cent of their investment in this branch (50.3 per cent in the first six months of 2003).

Table 4

Structure of foreign investment in industry in the first six months of 2004.

	US \$ mil.			In % of the figures registered in 2003		
	Direct	Portfolio	Other	Direct	Portfolio	Other
Industry	2504	61	7685	2,1 times	2,9 times	2,4 times
Including:						
Fuel industry	1544	1	3782	2,4 times	в 5,0 p.	9,1 times
Food industry	95	1	270	-36,7%	в 2,5 p.	-7,8%
Wood working, pulp and paper industry	378	3	277	4,1 times	No investment in the 1 st half year of 2003	3,9 times
Metallurgy	61	3,3	2693	39%	-34,0%	46,1%
Chemistry and petrochemistry	67	17	288	63%	в 170,0 p.	50,8%
Mechanical engineering and metal working	93	11	305	12%	в 11,0 p.	58,9%
Other industries	266	24,7	70	2,3 times	73%	-48,5%

Source: Federal Service of State Statistics.

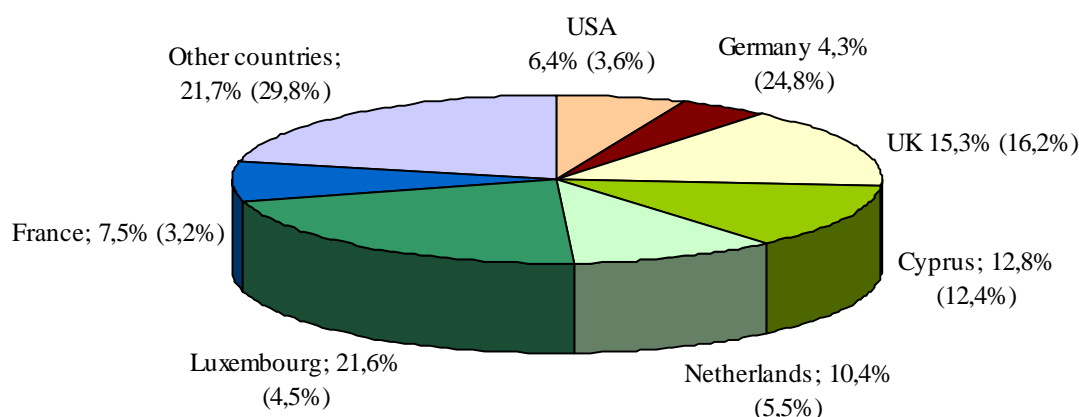
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On the whole, the list of major countries exporting their capitals in the Russian economy in the first six months of 2004 includes Germany, UK, USA, the Netherlands, and France, although the geographical structure of investment in the Russian economy made in the first six months of 2004 has somewhat changed.

Geographical structure of foreign investment in Russia's economy in the first half 2004 (the data on the 1st half 2003 is given in brackets)



Source: Federal Service of State Statistics.

This year, Luxemburg was the leader in terms of invested capital for the first time, the respective investments are evaluated to make US \$ 4.1 billion, what was 7.2 times above the level observed in the first six months of 2003. At the same time, investment from the USA increased 2.7 times and made US \$ 1.2 billion, from the Netherlands – 2.9 times up to US \$ 2 billion, from France – 3.5 times up to US \$ 1.4 billion. Metallurgy and mechanical engineering were most attractive for US investors (66 per cent and 9.9 per cent of the total US investment). Investors from France and UK preferred trade and public catering, the amount of respective investment made US \$ 1.1 billion, or 78.9 per cent for France and 40 per cent for UK. At the same time, 38.1 per cent of investment from UK flowed in metallurgy.

In the first six months of 2004, the activity of German investors somewhat declined, the German investment in the Russian economy decreased by 73.8 per cent in comparison with the figures registered in the first six months of 2003, and made US \$ 823 million. Of this amount, 39.5 per cent (US \$ 325 million) were invested in industry. In the first half year of 2003, 15.3 per cent (US \$ 480 million) of the German investment were made in industry.

At the same time, similarly to the first six months of 2003, the share of the 10 largest investors made more than 80 per cent of the total amount of investment accumulated by July 1.

Table 5

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

	Accumulated by 01.07.2004, US \$ mil.				Change to 01.01.2004, % (*)			
	Total	Direct	Portfolio	Other	Total	Direct	Portfolio	Other
USA	5630	3893	77	1660	6,3 (1,3)	-9,4 (-11,8)	87,8 (108,1)	73,3 (49,7)
Germany	10294	2453	361	7480	0,9 (-3,5)	-3,5 (4,7)	-5,7 (-6,2)	2,8 (-5,8)
France	4555	299	0,1	4256	-4,6 (70,6)	-9,7 (7,6)	0,0 (0,0)	-4,3 (77,9)
UK	6784	1311	107	5366	-6,0 (15,2)	-53,6 (-45,5)	0,0 (-0,9)	25,2 (59,1)
Cyprus	9254	5076	519	3659	14,5 (40,1)	0,8 (14,5)	-5,1 (75,9)	46,3 (94,7)
The Netherlands	8810	6934	43	1833	2,5 times (3 times)	2,5 times (3 times)	8,6 times (7,2 times)	2,4 times (3 times)
Other countries	20768	6912	290,9	13565	16,3 (48,3)	-16,7 (8,6)	-15,9 (-19,2)	47,3 (86,2)
Total	66095	26878	1398	37819	15,9 (36,7)	2,9 (19,1)	-2,2 (17,4)	28,4 (53,8)

* Changes in comparison to 1.07.2003 are in brackets

Source: Federal Service of State Statistics.

The top ten countries exporting capital in Russia account for 82.3 per cent (78.8 per cent in the first six months of 2003) of accumulated foreign direct investment, 83.3 per cent (76.2 per cent) and 88.6 per cent (87.9 per cent) of portfolio and other investment respectively.

E. M. Ilyukhina

The Real Sector of the Economy: Factors and Trends

According to the Regulations governing the elaboration and presentation of the data on the part of the Federal State Statistics Service, there was completed the first assessment of GDP in the first six months of 2004 and update of the indicators registered in the 1st quarter. The amount of GDP in the first six months of 2004 made Rub. 7549.0 billion and increased by 7.4 per cent in comparison with the figures registered in the respective period of the preceding year. The intensive growth in industry and trade, as well as branches of the market infrastructure (communications and trade) had the determining impact on the structure of the produced GDP.

The calculation of forecast values of macroeconomic indicators until end-2004, carried out by IET, demonstrates that the amount of GDP will increase by 7.2 per cent by the end of the year, while investment in fixed assets and exports will be at 111.5 per cent and 121.4 per cent as compared with the figures registered in the preceding year.

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Table 1

Indices of GDP growth across sectors of the economy in the first six months of 2003 through 2004, in per cent of the figures registered in the respective period of the preceding year

	2003			2004		
	1 st Q	2 nd Q	1 st half year	1 st Q	2 nd Q	1 st half year
Gross Domestic Product	107,5	107,9	107,7	107,5	107,4	107,4
including:						
<i>Production of goods</i>	106,9	108,0	107,5	107,6	107,7	107,7
Of which:						
Industry	106,5	107,9	107,2	107,5	107,1	107,3
Construction	113,6	114,7	114,2	113,8	114,6	114,3
Agriculture	101,1	98,9	99,9	98,6	98,8	98,7
<i>Production of services</i>	108,0	107,8	107,9	107,1	107,1	107,1
Market services	109,0	108,8	108,9	107,9	107,9	107,9
Of which:						
Transport	106,4	106,5	106,4	106,8	106,2	106,5
Communications	117,8	122,2	120,2	121,5	123,6	122,7
Trade	112,8	111,2	112,0	108,2	109,2	108,7
Non-market services	102,4	102,3	102,4	102,2	102,5	102,4

Source: Federal Service of State Statistics

The major factors behind structural shifts in the use of GDP remain the positive dynamics of external and internal demand. In the favorable external business situation, the growth in the Russian economy registered in the first six months of 2004 was by more than half determined by the outpacing growth in exports. In January through August of 2004, the increase in the amount of exports made 125.2 per cent in comparison with the figures registered in the respective period of the preceding year.

The level of concentration of domestic exports in a narrow group of raw materials has significantly increased over the recent years and was accompanied by growing dependence of the rates of growth in Russian exports on price fluctuations on the world markets of raw materials. The domination of fuels and raw materials in the Russian exports determined the very low level of diversification of foreign trade ties. The specific weight of machinery and equipment in the total amount of export remained at 7

per cent to 9 per cent, while the share of fuel and energy resources grew up to 54.4 per cent, and the share of metals increased up to 14.8 per cent.

At the background of stable expansion of external demand, export oriented industries have retained their leading positions in the Russian economy. In January through August, the production index in fuel industry made 107.9 per cent, including oil extracting branch – 109.5 per cent. Over the same period, output of ferrous and non-ferrous metallurgy increased by 5.3 per cent and 4.3 per cent respectively. As concerns chemistry, the increase in production there made 8.4 per cent.

Due to high profitability of export operations, in January through July of 2004 the net financial results demonstrated by the export oriented sector exceeded the aggregate indicators of industry by almost 42 p. p. In January through July of this year, the net profit of fuel industry increased 1.98 times, while ferrous and nonferrous metallurgy and chemistry demonstrated growth 2.3 times, 1.5 times, and 1.4 times respectively. The exceptionally good price situation on the world markets of energy resources and metals, as well as the growth in the earnings of exporters, has initiated transformational shifts on the domestic market. While rates of growth in output of manufacturing industries accelerated, this year the balanced financial results demonstrated by mechanical engineering, industry of construction materials, and food industry became positive. The increase in balanced profits in mechanical engineering, food industry, and the industry of construction materials made 7.4 per cent, 20.3 per cent, and 2.3 times respectively.

The dynamic expansion of investment demand had the dominating impact on the structure of the domestic market. In January through August of 2004, the increase in production of products of final demand made 9.1 per cent, while the output of industries belonging to the investment complex grew by 12.9 per cent. At the same time, the output of the consumer complex branches made 3.2 per cent. The character of industrial dynamics were most significantly affected by mechanical engineering (an increase by 113.7 per cent in comparison with the figures registered in January through August of 2003) and the industry of construction materials (106.2 per cent). In spite of the outpacing rates of growth in output of mechanical engineering in comparison with the indicators of investment in fixed assets, the balance of the market of capital goods has been still supported by the outpacing rate of increase in import of machinery and equipment. According to the data presented by the Federal Customs Service, in January through July of 2004 the specific weight of machinery, equipment, and vehicles in the total amount of imports increased up to 44.1 per cent, as compared with 38.2 per cent registered in the respective period of the preceding year. By the end of the first six months of 2004, the share of imported machinery and equipment made 23.5 per cent of the total amount of the respective investment expenditures.

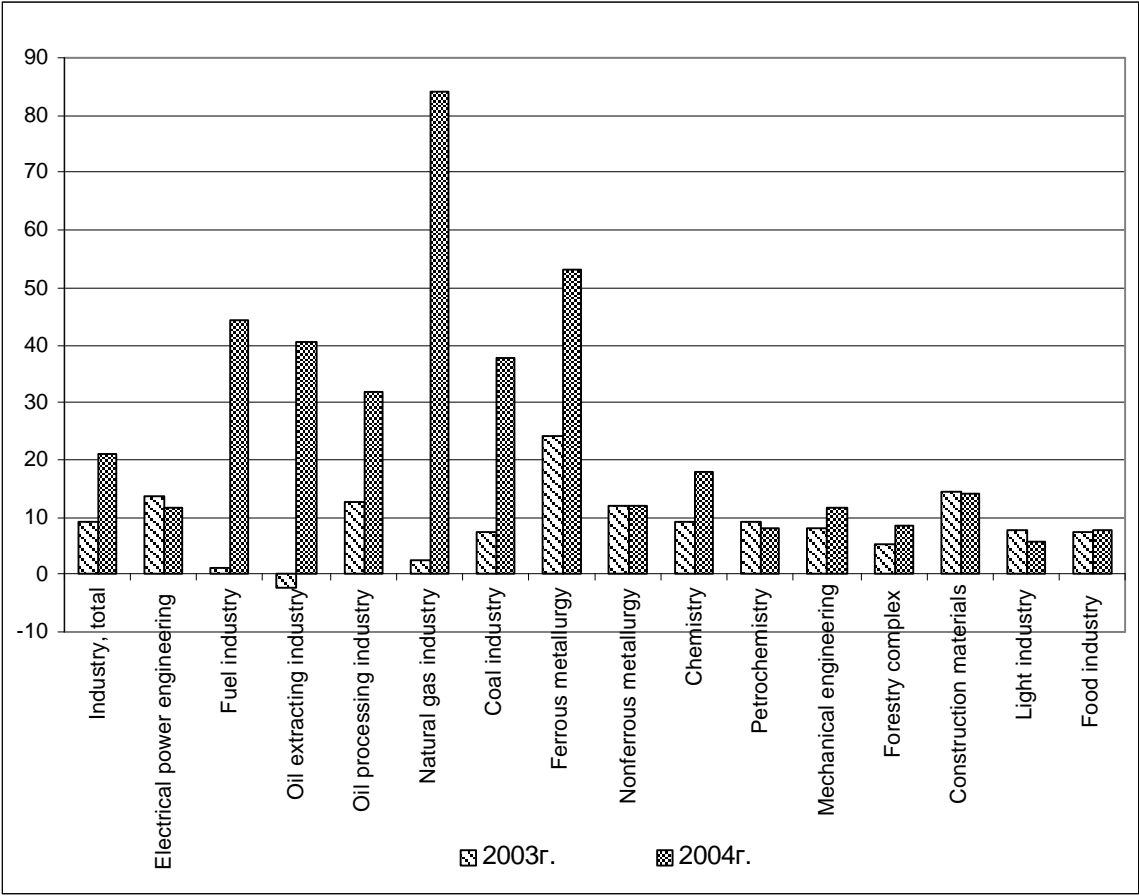
This year, the stable expansion of the final consumption of households was determined by the gradual improvement of the social parameters of economic development. In January through August of 2004, the increase in real household incomes made 9.2 per cent in comparison with the figures registered in the respective period of the preceding year, while real wages and salaries and real gross monthly pensions grew by 13.2 per cent and 6.7 per cent respectively. The increase in the effective household demand determined the intensive growth in the turnover of the retail trade. While the retail trade turnover grew by 11.4 per cent in comparison with the figures observed in January through August of the last year, the growth in sales of food and non-food products made 9.4 per cent and 13.2 per cent respectively. Similarly to the situation observed last year, the increase in the turnover was most significantly determined by the outpacing rates of growth in the market of non-food goods. To a certain degree, this development was determined by lower inflation rates and structural shifts in prices of major commodity groups. While consumer prices increased by 7.6 per cent in the first six months of 2004, the prices of food and nonfood products and services grew by 7.2 per cent, 4.6 per cent, and 13.6 per cent respectively.

Over the few last years, the development of the Russian economy has been dynamics has been characterized by moderate dynamics of output of domestic consumer products in comparison with the dynamic expansion of the retail trade turnover and household incomes. In January through August, the increase of production in food industry made 4.2 per cent as compared with the figures registered in the respective period of the preceding year. In January through August of 2004, the increase in output of food industry made 4.2 per cent, as compared with 4.6 per cent registered in the respective period of the preceding year. The competitive power of Russian food products was determined by the relatively low level of prices and the successful adaptation of production to the traditional structure of consumer

preferences. In the first six months of 2004, the specific weight of food products and raw materials used for their production in the total amount of imports made 19.1 per cent, what was by 4.5 p. p. above the level observed last year. The market of nonfood goods has been negatively affected by the permanent crisis of light industry. The situation was aggravated by the fact that the low activity of domestic business in this sector of the economy at the background of outpacing rates of growth in real household incomes, wages, and salaries in comparison with the dynamics of the retail trade turnover has provoked an aggressive increase in imports. It should be noted that in spite of the fact that this year there became perceptible the trend towards deceleration of the rates of growth and a decline in the share of textile goods in the structure of imports, this development failed to create incentives for enterprises' operations. In January through August of 2004, the decline in production of light industry made 5.8 per cent in comparison with the figures registered in the respective period of the preceding year, including a 4.6 per cent downfall in the output of textile industry and a 12.4 per cent decline in the production of sewing industry.

One of the factors determining the structural specifics of economic development this year is the stable outpacing rates of growth in producers prices in manufacturing industries in comparison with the dynamics of the consumer price index. While in January through August of 2004 inflation on the consumer market made 107.6 per cent, the increase in the producer prices in manufacturing industries made 20.9 per cent. The dynamics of prices significantly differ across the industries oriented towards the domestic and foreign markets.

Figure. Changes in producer prices across industries in August of 2003 and 2004, in per cent of the figures registered in December of the preceding year.



According to the assessment of the Ministry of Economic Development and Trade, the producer prices of manufactured goods increased by 15.3 per cent in January through August of 2004. After the rise in tariffs on electrical power regulated at the federal level, as concerns the power purchased on FOREM, as well as natural gas and railroad freight, which was observed in January through February of 2004, there was registered a slowdown of dynamics of prices of products and services of natural

monopolies. As concerns electrical power engineering, in this industry the tariffs increased by 11.6 per cent since the beginning of the year, since March, the growth in tariffs for final consumers regulated by regional energy commissions, has practically stopped.

In industries of the investment and consumer complexes, the rise in prices has been significantly constrained by high levels of competition, both on the part of imports, and on the part of other domestic producers. This year, the average monthly rates of growth in prices of the products of mechanical engineering (1.4 per cent), construction materials (1.6 per cent), light industry (0.7 per cent), and food industry (0.9 per cent) remained below the level of the aggregate indicator of producer prices in manufacturing industries (2.4 per cent).

As concerns the export oriented branches of industry, the dynamics of domestic prices in these industries was adequate to the changes in world prices. Since 2003, ferrous metallurgy has been characterized by the exceptionally high dynamics of prices at the background of an intensive expansion of demand for metals. After the rise in prices in ferrous metallurgy by 28.8 per cent registered in 2003, in January through August of 2004 the prices increased again by 52.9 per cent. In 2004, the complex of fuel industries was also characterized by growth in prices. Since the beginning of the year, producers prices in oil extracting, oil processing, and natural gas industries increased by 40.4 per cent, 31.7 per cent, and 84.1 per cent.

While assessing the prospects of development, it should be noted that the trends towards the increase in the share of expenditures for raw materials in the structure of production costs, which provokes a rise in prices in related industries are forming at the background of an intensive rise in prices of metals and fuels. The situation is aggravated by the recovery of the negative influence of the out-pacing rates of growth in wages and salaries in comparison with the labor productivity. Besides, the improvement of positions of the oil, natural gas, and metallurgy complexes has determined a sufficient reserve of growth in wages and salaries in these sectors at the background of increasing differentiation in the levels of pay in extracting and manufacturing industries.

O. I. Izryadnova

Oil and Gas Sector

In January-August 2004, the development of oil and gas sector of the economy was characterized by continuation of a trend of oil and gas production growth. As compared to the same period of last year, increase in oil production was 9.5%. The world prices of oil were extremely high, which made possible to considerably increase the export earnings. The current situation in the world oil market allows to expect a continuation, in the near future, of the high level of world oil price and favorable environmental conditions for forming the revenue side of the state budget and the development of oil and gas sector.

Over the last few months the world oil prices, which have a defining impact on the situation in the oil and gas sector of the Russian economy, are extremely high. Because of cuts in oil production in Iraq and restriction of oil production by OPEC countries, the average price of OPEC oil basket considerably exceeded the upper limit of target price range \$22-28 a barrel, established by the organization, while the average price of Russian Urals oil was higher than \$35 a barrel (Table 1), over the last few months.

Table 1

World Prices of Oil in 2000-2004, dollar/barrel.

	2000	2001	2002	2003	2004 I qu.	2004 II qu.	2004 July	2004 August
Brent crude oil price, Great Britain	28.50	24.44	25.02	28.83	31.95	35.36	38.32	43.04
Urals crude oil price, Russia	26.63	22.97	23.73	27.04	28.94	32.54	35.24	38.82

Source: OECD International Energy Agency.

In January-August 2004, the development of oil and gas sector was characterized by continuation of growth tendency in the production of oil and gas (Table 2). As compared to the same period of last year, increase in the volume of oil production was 9,5%, natural gas – 2,6%. At the same time, a drop of investment activity observed in oil sector: as compared to previous year, in January-July 2004, the

volume of development drilling for oil decreased by 4,7%, bringing into service new oil wells – by 5,4%. Decrease continued in the volume of exploration drilling for oil (by 21,5%, as compared to previous year), which can be explained by rather high crude oil supplies. At the same time, a sharp increase in investment activity observed in the gas sector: for six months of 2004, the development and exploration drilling for gas increased by 2,5-2,7 times, as compared to previous year. In January-July 2004, in oil refining industry, degree of crude oil refining increased from 70,1% in 2003 to 71,5%, while the share of high-octane gasoline in the total production of motor gasoline increased from 51,6% to 54,1%.

Table 2

**Production of Oil, Oil Products and Natural Gas in 2000-2004,
% to previous year**

	2000	2001	2002	2003	2004 January- August
Oil	105.9	107.7	108.7	111.1	109.5
Gas condensate	103.8	106.7	112.8	108.7	119.9
Primary crude oil refining	102.7	103.2	103.3	102.7	101.5
Motor gasoline	103.6	100.6	104.9	101.2	102.7
Diesel fuel	104.9	102.0	104.7	102.0	101.2
Fuel oil	98.3	104.2	107.1	100.3	96.8
Natural gas, bln. cub.m.	98.5	99.2	101.9	103.4	102.6
Petroleum, bln. cub.m.	102.5	105.0	110.5	119.3	106.3

Source: Federal State Statistics Service.

This year, a noticeable rise in oil prices is observed in the internal market, which in large measure can be explained by high level of oil price in the world and better opportunity for oil exporting (including the use of rail transport). In July, the average domestic price of oil (producers' price) in US dollars reached \$90.2 per tonne, which is a maximum level of oil price for all the period of reforms (Table 3, Fig. 1, 2). At the same time, considerable gap observed in the level of domestic and world prices of oil. This year a considerable price rise is also observed for natural gas (to \$9.9 per 1 thousand cub.m., which is also a record price not observed before).

Table 3

**Domestic Prices of Oil, Oil products and Natural Gas in 2000-2004, in US dollars
(average producer's prices, dollar/tonne)**

	2000 Decem- ber	2001 Decem- ber	2002 Decem- ber	2003 Decem- ber	2004 January	2004 March	2004 June	2004 July
Oil	54,9	49,9	60,7	70,1	70,1	79,9	87,5	90,2
Motor gasoline	199,3	151,5	168,8	236,9	236,8	234,2	275,1	291,4
Diesel fuel	185,0	158,5	153,8	214,3	224,3	225,5	244,6	248,5
Fuel oil	79,7	47,1	66,1	66,0	66,5	65,4	94,9	88,7
Gas, doll./thou.cub.m.	3,1	4,8	5,9	4,4	8,8	9,4	9,7	9,9

Source: calculated according to the data of Federal State Statistics Service.

The oil export in the first half of 2004, as compared to the same period of last year, increased by 4,2%. The oil export ratio in the total volume of Russian export In January-July 2004 was 28,9%, in the export of power resources – 52,8%. The export of oil products in the first half of 2004, as compared to the same period of previous year, decreased by 3,7%. The export share in the commodity resource of diesel fuel in the first half of the year was 48,3%, fuel oil – 57,6%, motor gasoline – 15,9% (for comparison: in 1999, the export share in production of motor gasoline was only 7,2%). As a result of rise in the domestic prices of oil products and real rouble rate, the import of oil products has been increased considerably (2,5 times compared with the first half of 2003). However, the import ratio in oil products still remains rather low (in relation to motor gasoline, in January-June, it reached only 0,8%). In comparison with previous year, the growth rates of gas export increased (from 2,5% in the first half of 2003 to 4,5% in the first half of this year).

Table 4

**Export of Oil, Oil products and Natural Gas from Russia,
% to the same period of previous year**

	2001 first half year	2002 first half year	2003 first half year	2004 first half year
Oil, total	109,2	114,3	111,4	104,2
Including: to countries – other than CIS	107,2	106,8	111,4	105,5
To CIS countries	125,2	164,3	111,1	98,2
Oil products, total	101,5	114,3	106,9	96,3
Including: to countries – other than CIS	103,5	115,1	106,2	94,6
To CIS countries	67,4	95,4	125,5	137,3
Gas, total	87,0	104,0	102,5	104,5

Source: Federal State Statistics Service.

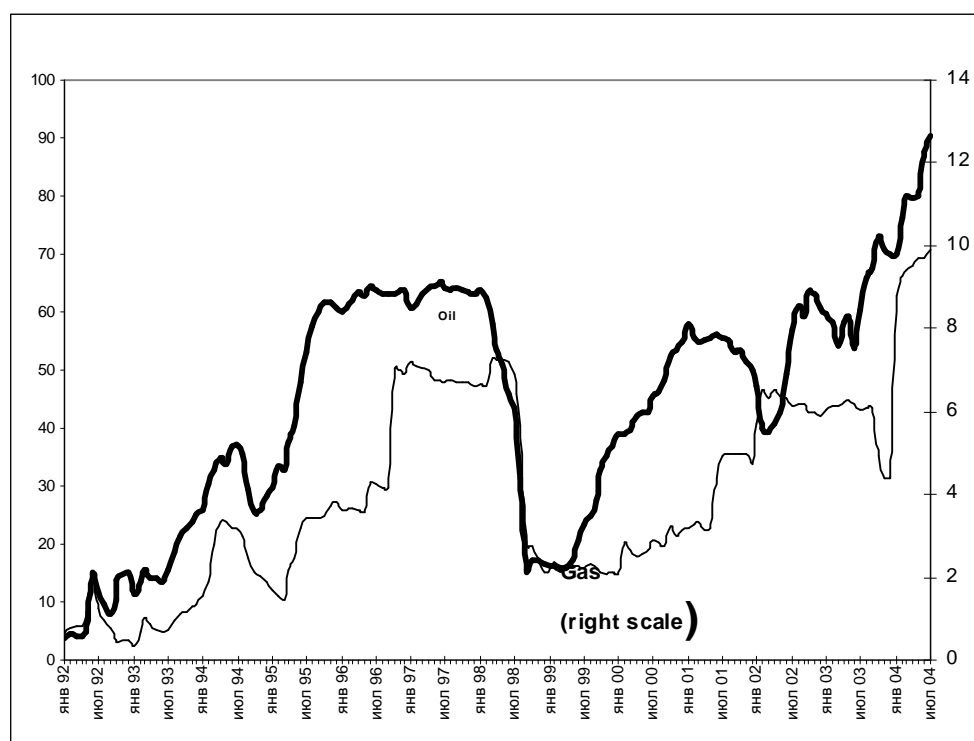
Table 5

Forecast of World Prices of Oil for 2004-2005, dollar/barrel.

	2000	2001	2002	2003	2004 IV qu. (forecast)	2004 (forecast)	2005 (forecast)
Average price of oil imported into U.S.*	27.72	22.01	23.69	27.74	38.16	35.58	35.59

*Acquisition cost of oil purchased from refineries.

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

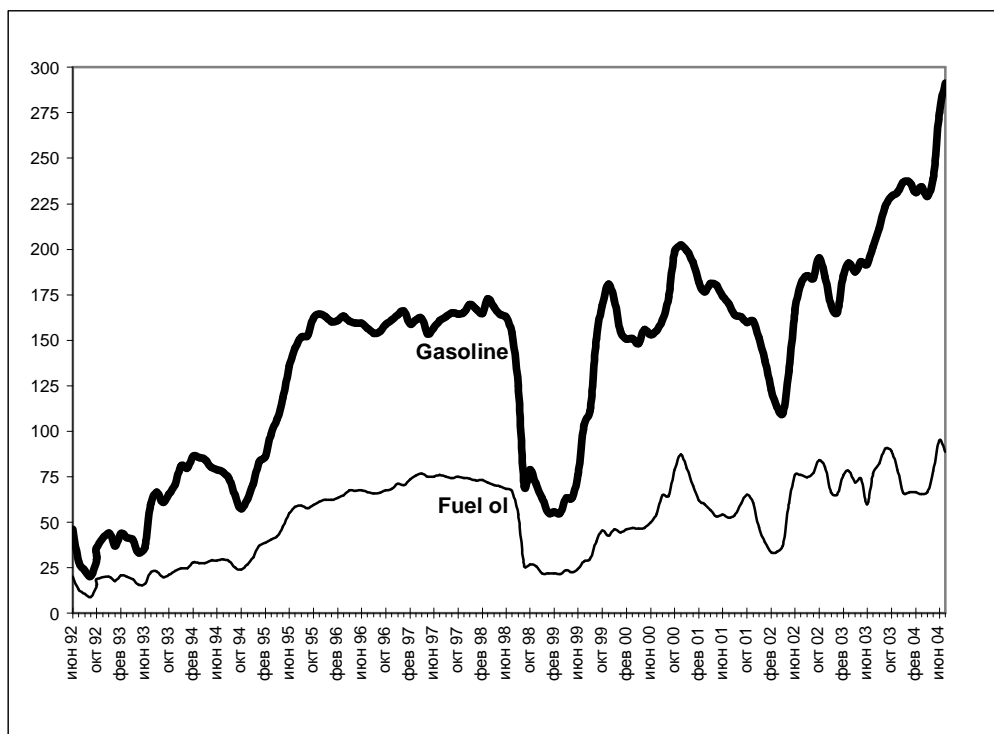


Source: calculated according to the data of Federal State Statistics Service.

Fig.1. Average Producers' Prices of Oil and Gas (in US dollars) in 1992-2004, dollar/tonne, dollar/thou. cub. m.

As analysis of the situation in the world market shows, the continuation of high level of world oil prices may be expected in the near future. According to the base variant of the latest (September 2004) forecast of the U.S. Department of Energy, the world oil price, determined as average price of oil imported into the U.S., will be rather high, and will average, in the 4th quarter of 2004, \$38.2 per barrel (Table 5). In 2005, according to the forecast of U.S. Department of Energy, an average oil price will

make \$35.6 per barrel, in so doing, gradual decrease in the world oil prices (to \$34.3 per barrel by the end of the year) will be observed during the year.



Source: calculated according to the data of Federal State Statistics Service.

Fig.2. Average Producers' Prices of Motor Gasoline and Fuel Oil (in US dollars) in 1992-2004, dollar/tonne

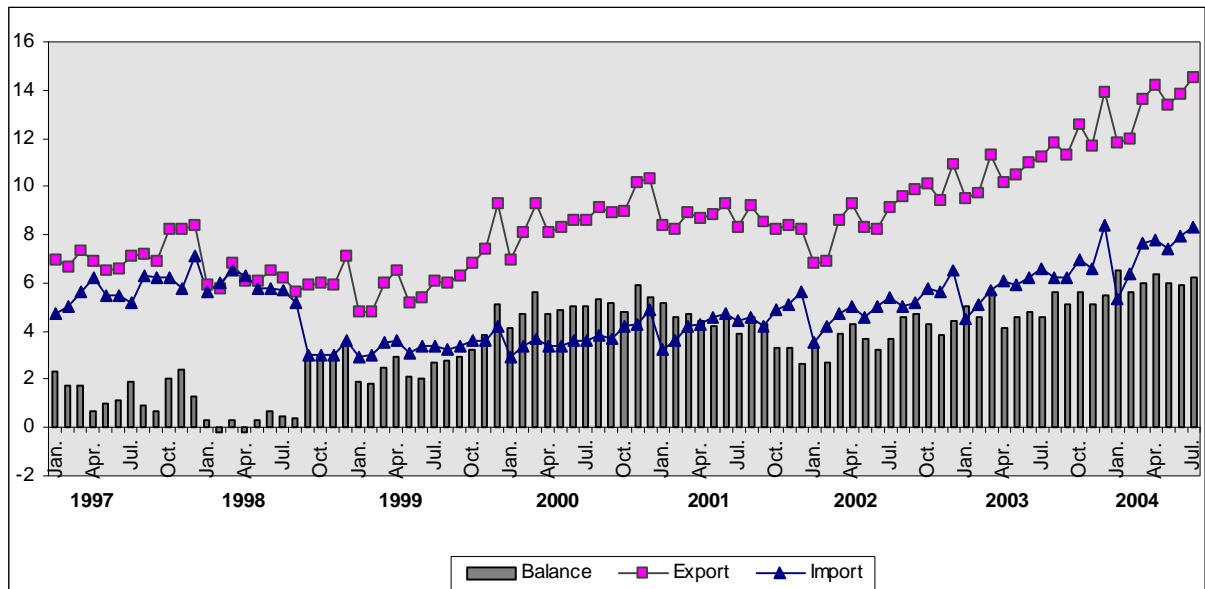
Bobylev Yu.N.

Foreign Trade

In July of 2004, the key indicators of development of the Russian foreign trade again reached record highs in this year. The growth in exports was still facilitated by the favorable price situation as concerns staple export goods and an increase in the volumes of export of goods. The growth in imports may be primarily explained by increasing consumer demand supported by the growth in the real household incomes.

In September, the Russian Federation signed the protocol on the completion of negotiations with the Republic of Korea and China concerning access of goods on the market in the framework of Russia's accession to the World Trade Organization (WTO). The Russian government continued its efforts aimed at the formation of trade policy complying to the rules and regulations set by WTO.

In July of 2004, the Russia's foreign trade turnover (according to the balance of trade methodology) increased by 26.2 per cent in comparison with the figures registered in the respective period of 2003 and made US \$ 22.8 billion. In July of 2004, the amount of export of goods grew by 27.6 per cent in comparison with the figures registered in the respective period of 2003 (up to US \$ 14.5 billion), while imports grew by 23.9 per cent and made US \$ 8.3 billion. The active balance of trade made US \$ 6.2 billion. At the same time, the amount of exports in countries outside NIS increased by 24.5 per cent up to US \$ 11.9 billion. The amount of imports from countries outside NIS made US \$ 6.4 billion in July of 2004, thus increasing by 22.8 per cent in comparison with the figures registered in July of 2003.



Source: RF CB

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

The growth in exports was still facilitated by the favorable price situation on the world markets. Oil prices were at a high level in July. Thus, the average Urals oil price made US \$ 35.4 per barrel (a 9.6 per cent growth in comparison with the figures registered in June of 2004), while the average Brent oil price was at US \$ 38.2 per barrel (a growth by 8.5 per cent).

The major factors behind the continuing increase in oil prices observed in July were the growing instability in the Middle East (in oil extracting regions, such as Iraq and Saudi Arabia). Besides, in spite of official statements that OPEC raised its daily oil extraction quotas in July and August (by 2.5 million barrels a day), no additional supply of oil was registered on world markets. It was expected that after reaching the historic highs the quotations will inevitably go down, however, it did not happen and expectations of shortages of oil on the market increased again, what was the factor facilitating the new price surge.

Over the period under observation, the oil market experienced a decline in Norwegian exports (Norway is the third largest oil exporter in the world). The amount of oil supplies from Norway declined by 10 per cent.

Economic growth in the USA, Europe, and Asia resulted in a record world demand for oil products.

Because of the continuing growth in world prices, the Russian Federation has increased the export custom duties on oil and oil products, since October 1, 2004, this duty shall make US \$ 87.9 per metric ton. The rate of the export duty on oil set on August 1, 2004, made US \$ 69.9 per metric ton. In September, the rate of export duty on oil products made US \$ 45.4 per metric ton, what corresponds to 65 per cent of the marginal export duty on crude oil.

As on April 1, 2004, the rate of the export oil duty made US \$ 37.5 per metric ton. Therefore, over the first six months of 2004, the duty increased more than two times. It should be reminded that the rate of the export duty should be revised once in two months proceeding from the two month monitoring of world oil prices.

In July, there increased world prices of major nonferrous metals. Thus, the average price of nickel made US \$ 15038 per metric ton (a 12.9 per cent increase in comparison with July figures). The major factor behind the rise in nickel prices was the reduction of reserves of this metal at the London Exchange and growing demand for stainless steel on the part of China. The average prices of aluminum made US \$ 1710 per metric ton (a 2.1 per cent growth in comparison with June prices), while the price of copper made US \$ 2813 per metric ton (a 5.4 per cent growth).

Table 1

The average monthly world prices in July of the respective year

	1996	1997	1998	1999	2000	2001	2002	2003	2004
Oil (Brent), USD / metric ton	20,66	18,25	12,96	18,8	28,4	24,62	25,7	28,25	38,2
Natural gas, USD / thous. c. m.	-	2,121	1,983	2,363	4,01	3,15	2,94	5,021	6,034
Gasoline, USD / metric ton	0,634	0,594	0,423	0,6	0,935	0,732	0,804	0,896	1,306
Copper, USD / metric ton	1935,9	2481,7	1754,3	1744,8	1864,2	1541,4	1589,0	1730,3	2813,0
Aluminum, USD / metric ton	1455,4	1563,7	1377,7	1403,5	1565,9	1412,2	1338,4	1434,9	1710,0
Nickel, USD / metric ton	7350	6737,3	4620	5273	8202,0	5956,8	7143,1	8790,6	15038,0

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

The growth in imports in the Russian Federation was determined by the continuing Ruble appreciation, as well as high dynamics of consumer demand, which was supported by the growing real household incomes. In January through July of 2004, these incomes increased by 9.7 per cent in comparison with the figures registered in the respective period of the preceding year (the growth in June made 10.6 per cent).

In July of 2004, the amounts of Russia trade vis-à-vis CIS member countries made US \$ 4.43 billion, exports grew by 43.7 per cent (US \$ 2.63 billion) and imports increased by 27.9 per cent (US \$ 1.80 billion) in comparison with the figures observed in July of 2003.

This September, the Government of the Russian Federation approved the draft agreement with the Government of the Republic of Belarus as concerns the principles of collection of indirect taxes pertaining to export and import of goods, rendering of services, and conduct of works. The draft envisages the setting of the zero rate VAT and exception of excise taxes in the case the fact of export is confirmed by respective documents. In the case of import, indirect taxes should be collected by the importing country.

Besides, another resolution of the RF Government abolished export duties on a number of goods imported from Russia by the countries being the members of the Customs Union (Belorussia, Ukraine, Kazakhstan, and Tadzhikistan) since October 7, 2004. Tin and zirconium ores, oxides of nickel and copper, manganese, bismuth, nickel alloys, pulp, paper, and cardboard, as well as products of light industry, medical tools and sea foods.

At the end of September, in Moscow there was held the congress of member countries of the Eurasian economic community. The congress was aimed to attract investments in the economies of the EvrAzES member countries and development of mutual trade. Representatives of Russia, Belorussia, Kazakhstan, Kyrgyzia, and Tadzhikistan also elaborated joint documents concerning the issues of single customs tariffs and licensing of the export of goods and services.

This September, the Russian Federation signed the protocol on the completion of negotiations with the Republic of Korea and China concerning access of goods on the market in the framework of Russia's accession to the World Trade Organization (WTO). Although 146 countries are members of WTO, exactly the agreements with China, EU, and USA are the key arrangements. An important victory of the Russian diplomacy was the signing of a protocol with the EU in May. It seemed that after concluding agreements with 2 out of 3 major participants, Russia has a short road yet to go before the accession to WTO. However, at the moment the US party criticizes Russian trade policy declaring that Russia increases trade barriers and state support of agriculture, as well as stating that the Russian system of veterinary and fitosanitary certification is too complicated, what checks the world trade.

However, the Russian government continued its efforts aimed at the formation of trade policy complying to the rules and regulations set by WTO. At the meeting of the Interdepartmental Commissions on Protective Measures in Foreign Trade held on September 23, 2004, there was taken a number of important decisions. Thus, in the framework of the policy aimed at the reduction of export duties on the goods with high shares of added value, the Commission recommended to abolish export duties on newspaper paper. In 2003, there were exported 1.175 million metric tons of such paper at the average price US \$ 330 per metric ton. Proceeding from these figures, the potential economic effect of the

abolishment of the respective export duty will make US \$ 19.4 million a year. The producers should use this amount to modernize their equipment and increase the competitive power of Russian paper products.

Protecting the interests of Russian producers, the Commission took the decision to increase the rates of import duties on bleachers, which are produced in Russia in sufficient quantities, from 5 per cent to 10 per cent, and to reduce the import duty on metal fittings for furniture from 15 per cent to 5 per cent.

At the same time, the Commission did not support a proposal about the increase in the rates of import duties on roasted coffee, and agricultural harvesters, as resulting in a worsening of the situation on the Russian consumer market. There was also taken the decision to unify import duties on packed palm oil at the same level as all other vegetable oils (15 per cent), however, these duties should not be below Euro 0.12 per kilogram.

In accordance with federal law No. 165 FZ of December 8, 2003, "On special protective, antidumping, and countervailing measures as concerns import of goods" and basing on the results of review of the application submitted by the Association of illumination engineering "Rossiyski Svet" on behalf of Russian producers, the Ministry of Economic Development took the decision to start an investigation with respect to the increasing import of electric bulbs and the respective serious damages for this industry of the Russian economy.

In the period from 2001 to 2003, the import of light bulbs has significantly increased: for instance, the import of light bulb of general purpose increased 1.8 times, the share of imported light bulbs of general purpose in the total amount of consumption of these goods on the Russian market increased from 14.8 per cent in 2001 to 25.0 per cent in 2003.

Therefore, Russia accumulates the experience of the introduction of protective measures. The legislation in this sphere is relatively new, the first law permitting to introduce protective measures in foreign trade was approved in 1998. At present, protective measures are introduced with respect to the import of refrigerators, ball bearings, and poultry. The protective measures concerning import of starch and caramel were abolished. There is also an agreement with Ukraine limiting imports of pipes from that country, which expires in 2004. There are also antidumping measures with respect to galvanized rolled products from Ukraine and countervailing measures against import of iron rods for concrete constructions. The major objective of the introduction of protective measures is to ensure that domestic producers have competitive power with respect to their Western counterparts.

N. Volovik, N. Leonova

Urgent nature of the military reform problems

This study continues the military and economic comparison of possible variants of stepping up the transition to the contract based system of recruitment and switching to a shorter conscription based service (1 year and 6 to 9 months) in connection to terrorist attacks and the necessity to adequately meet this challenge by simultaneously increasing the military strength of the state and promotion of the readiness of the civil society to parry these terrorist threats.

A series of terrorist attacks, recently carried out in our country by the forces of international terrorism with veiled assistance of shadow political structures was perceived by the society as the beginning of a war. The RF President has officially stated the same thing. He also indicated the main means to fight off this peculiar aggression: "this is the mobilization of the nation against the common threat. The events happening in other countries demonstrate that the terrorists suffer the most resolute rebuff there, where they confront not only the strength of the state, but an organized, united civil society."¹¹ There may be also added another obvious point: in the case we expect that the civil society efficiently rebuffs terrorism, this society, and especially its most active forces, should be in advance prepared for this function.

Therefore, it appears that it would be necessary to overhaul the plans of modernization of the military organization of the Russian Federation, in particular, the new system of recruitment.

As it is well known, in 2003 there was approved the federal target program (FTP) of such transition, envisaging two principally important outcomes::

¹¹ *Rossiyskaya Gazeta* of September 6, 2004. "Interventsiya" (Intervention) Address of the RF President

1) recruitment of about 50 per cent of privates and noncommissioned officers on the contractual basis;

2) reduction of the duration of conscription to 1 year.

Both measures should be introduced in 2008. The complete transition to the contract based recruitment to the regular troops is postponed for an indefinite future.

Both two key parameters of the FTP (the duration of the conscription based service and the term of completion of transition to the contract based recruitment of regular troops) have already been met with questions. Now, there arises a new question: do we have the right to strive for only these objectives in the situation of war? Is the strength of regular troops, i.e. the “strength of the state” according to the President’s definition, sufficient for the task? Is the civil society, especially its section defined as the mobilization resource (MR) sufficiently organized and prepared for the rebuff?

In order to answer these questions, IET has continued to compare different possible variants of switching to the reduced term of military service based on conscription. The IET approach is based on two key scenarios. The first scenario, offered by the Defense Ministry, envisages the reduction of the term of service to 1 year upon the completion of the FTP. The second scenario, proposed by IET, envisages a more rapid completion of the FTP and the use of conscription based service for primary military training of a larger number of citizens, what can help to increase the strength of the MR, as well as select volunteers for contract based military service. In this case, the term of service for the majority of other military specialized fields may be 6 months. According to the *Krasnaya Zvezda* newspaper¹², this variant (more precisely, from 6 to 9 months) was studied as an alternative by the experts of the Administration of the RF President.

The results of comparison of these two variants (and several others) basing on an imitation model were described in the study published in the IET Working Papers series (No. 75, “Challenges and Practice of the Transition of Russia's Military Organization Towards a New Draft System”). In this study, these variants were indicated as B1-2 and B2-2.

The first variant envisages that after the completion of the FTP the transition of military units to the contract based service will be continued in order to achieve the sufficient (in terms of efficient strength and possibilities of selection) strength of contracted servicemen by 2012. Alongside with the variant based on the concept of the RF Defense Ministry (a 1 year service) there was also analyzed the variant envisaging the transition to a six month period of service.

The second variant (B2-2), which envisaged a more rapid switching of troops to the contract based principle of recruitment in order to achieve the sufficient strength of contracted servicemen not by 2012, but by 2008, and a reduced term of draft service (6 months) in this study was supplemented with a variant, where the term of service was 1 year.

Therefore, there were analyzed 4 variants:

- B1-2 – a variant studied earlier;
- B2-2 – a variant also studied earlier;
- B1-2sh – the same variant as B1-2, however, the term of service in this variant is not 1 year, but 6 months starting from 2008;
- B2-2g - the same variant as B2-2, however, the term of service in this variant is not 6 months, but 1 year starting from 2008.

The figures below present some results of the comparison. For instance, Fig. 1 demonstrates the changes in the number of citizens conscripted in these variants.

¹² *Krasnaya Zvezda* of July 10, 2004. D. Barabash “Otsrochek stanet menshe” (There will be less deferments)

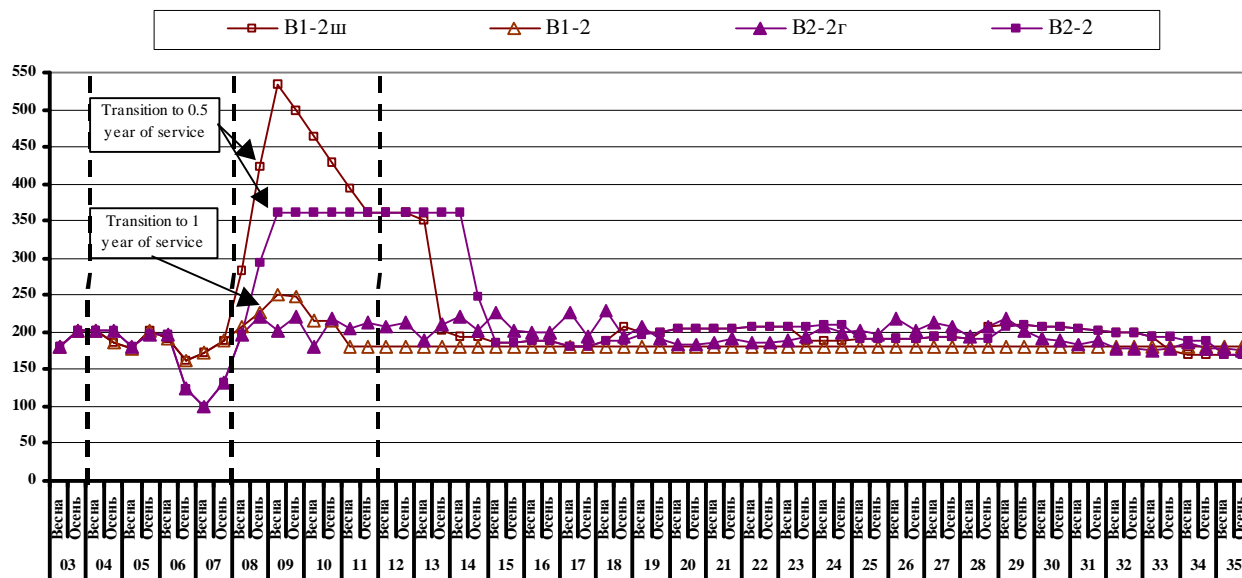


Fig. 1. The number of conscripts to the RF military organization (thousands persons each six month)

It should be reminded that the number of the conscripts is affected by the following factors:

- number of contracted servicemen; it should be at the sufficient level, and latate it should be annually supplemented by the number of contracted servicemen leaving service upon the termination of their contracts;
- the number of conscripts and also the necessity to compensate for the number of those leaving service;
- the number of potential draftees yearly supplemented by the growing young people, this number includes the persons, whose deferments expire in a given year, and diminishes by the number of persons exceeding the conscript age;
- additional conditions relating to the personnel policy, which determine the rate of draft.

The strength of the contingent subject to draft was modeled basing on the available demographic data on the number of young males entering age of 18. in the course of the modeling concerning the rate of draft, especially in the transition period (from 2008 till 2012), there were introduced certain constraints, for instant those relating to the deceleration of the growing required rate of conscription. It permitted to “maintain” for a certain time the contingent subject to draft to the detriment of the maintenance of the total strength. Otherwise, the contingent subject to draft is fast exhausted, thus creating conscription problems after the completion of transition. The graphs in Fig. 1 demonstrate that for switching to the 6 month service period it is necessary to achieve the sufficient number of contracted servicemen as soon as possible. While in the case of variant B2-2 it is required to maintain the strength of conscription at the level of 360 thousand persons in half-year, in the case of variant B1-2sh this strength should be significantly higher, at about 540 thousand persons. Only by 2012 this number will decrease to 360 thousand persons.

A more complete picture may be seen in the course of comparison of the preceding figure with Figure 2.

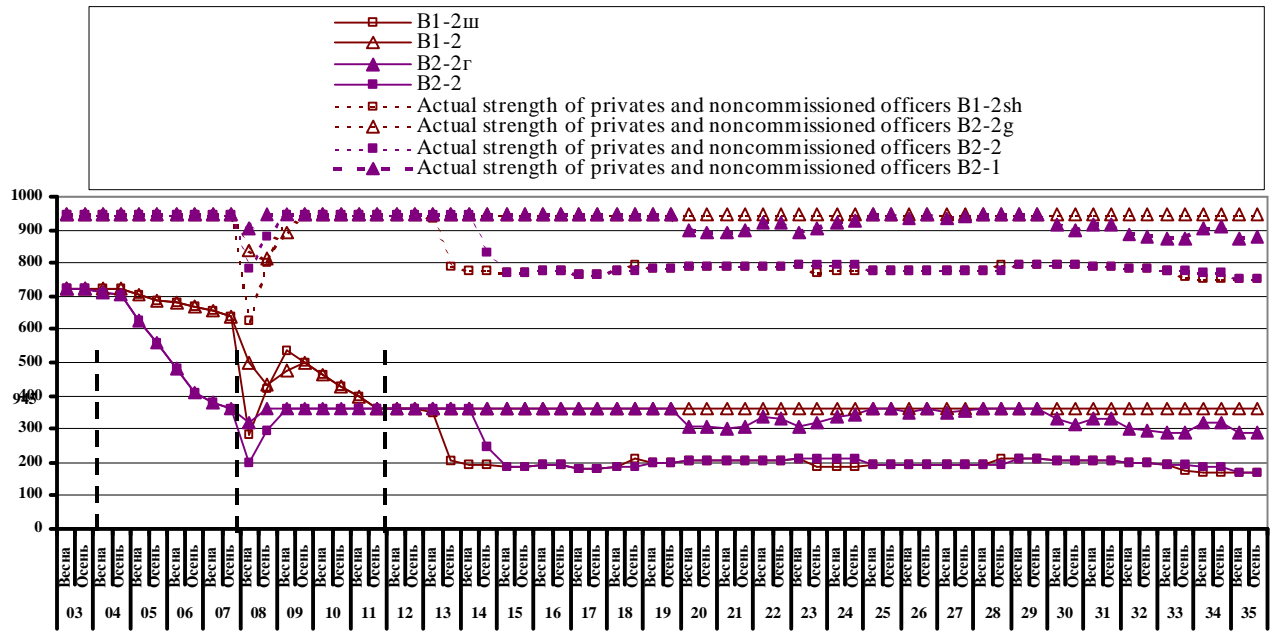


Fig. 2. The total number of conscripts in the RF military organization (thousands persons each six month)

It follows from the comparison that in the first half-years after the transition there is observed a decline in the total number of drafted servicemen, and, therefore, the total strength of the privates and noncommissioned officers. This decline in the strength is also observed after 2015 for variants B2-2 and B1-2 (in the case the term of service is reduced to 6 months). This development is related to the “exhaustion” of the contingent subject to conscription.

However, the maintenance of the total strength can not be the main objective of the reform. First, because the number of draftees is sufficient to ensure contest based selection for contract service. This assumption is confirmed by the graphs presented in Fig. 3.

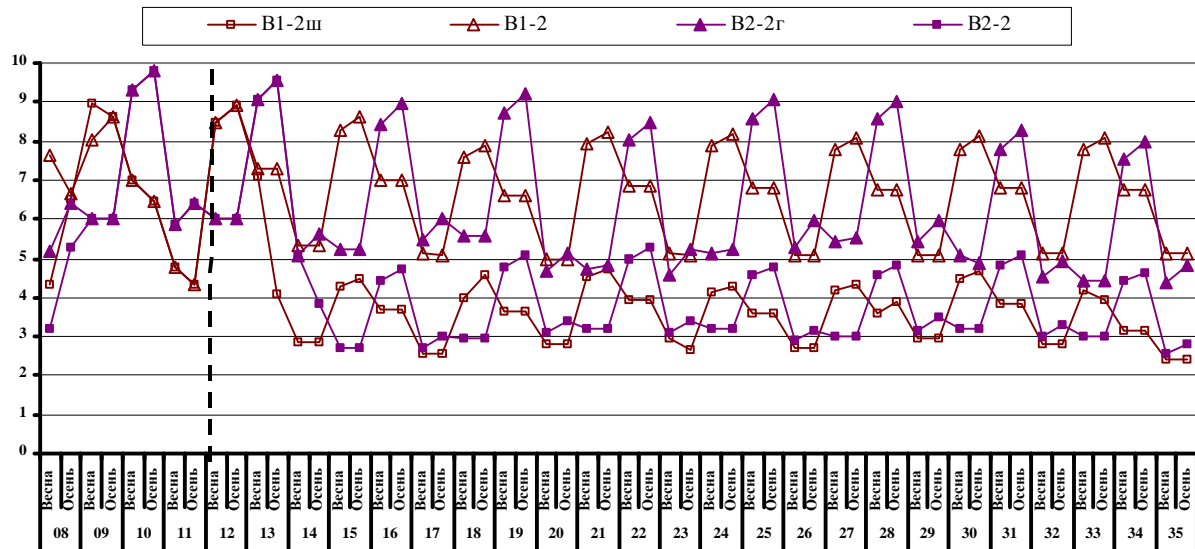


Fig. 3. The ratio between the number of drafted servicemen and the number of persons required to complete regular troops with contracted servicemen.

Figure 3 demonstrates that both in the case of transition to 1 year service and 6 months service it would be possible to organize the contest based selection. Naturally, in the framework of variants B1-2 and B2-2g the contest will be more strict than in the framework of variants B1-2sh and B2-2, since there are taken into account the persons serving 6 months to 1 year, who are less likely to make con-

tracts. In any case, there are people to serve on the basis of contracts, the only thing, which is needed, is moral and material incentives.

And, second, the most important thing is that regular troops will be completed with trained contracted servicemen. From the point of view of the efficient strength expressed as the equivalent number of “professional fighters” (see Figure 4), there is no important difference between the transition to 6 months or 1 year service term. In any case, after 2012 it will be above the present level. At the same time, the impact of more rapid transition to contract based service is apparently indicated in the period from 2008 to 2012. The large number of contracted servicemen will permit to avoid the “dip” of the efficient strength of the military in the period of transition to a reduced term of draft service.

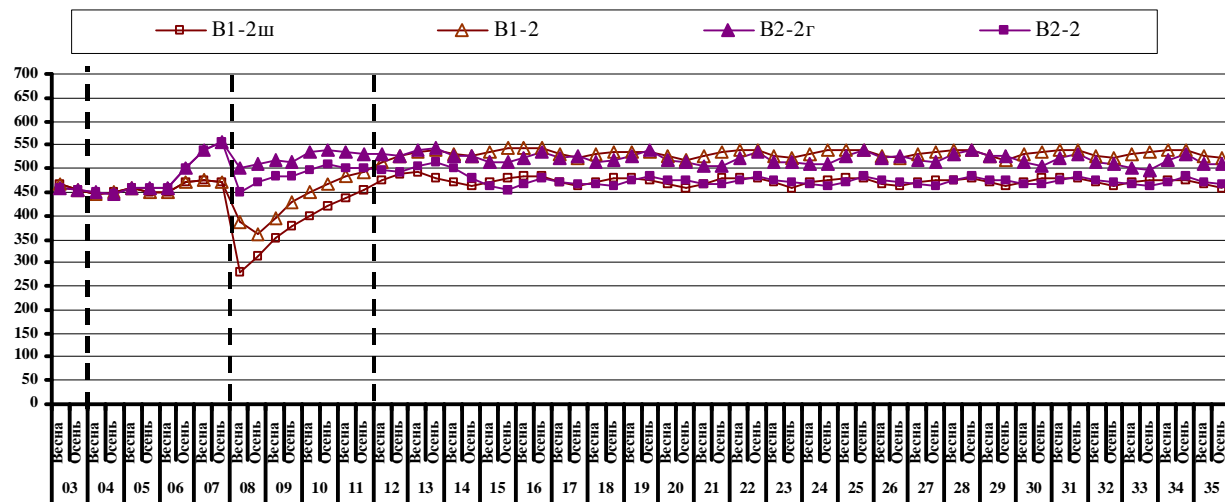


Fig. 4. The efficient strength of privates and noncommissioned officers in the RF military organization. (thousands persons each six month)

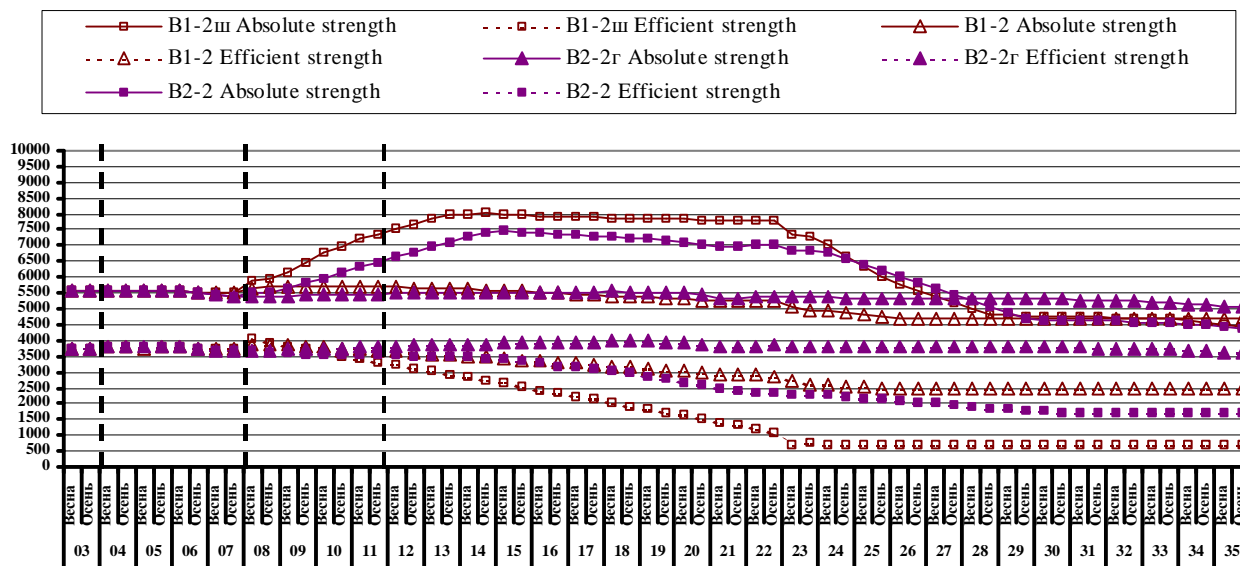


Fig. 5. The absolute and efficient strength of the mobilization resource (1st category) in the RF military organization.

From the point of view of the impact of the mobilization resource on the efficient strength (see Fig. 5), there is also no significant difference between the variants with the exception of certain advantages observed in the case of variant B2-2g in a long term outlook.

However, a significant difference is registered as concerns the largest absolute strength of the mobilization reserve (MR) having served the 6 months term. It should be noted that this difference becomes

apparent immediately after 2007 and should continue for a long period. The intensification of transition to the contract based military service also positively affects the efficient strength of the mobilization reserve (MR).

An economic analysis of expenditures for the realization of the reviewed variants is not of less importance. These expenditures were calculated across a large number of components; however, the graphs in Fig. 6 present only aggregate expenditures.

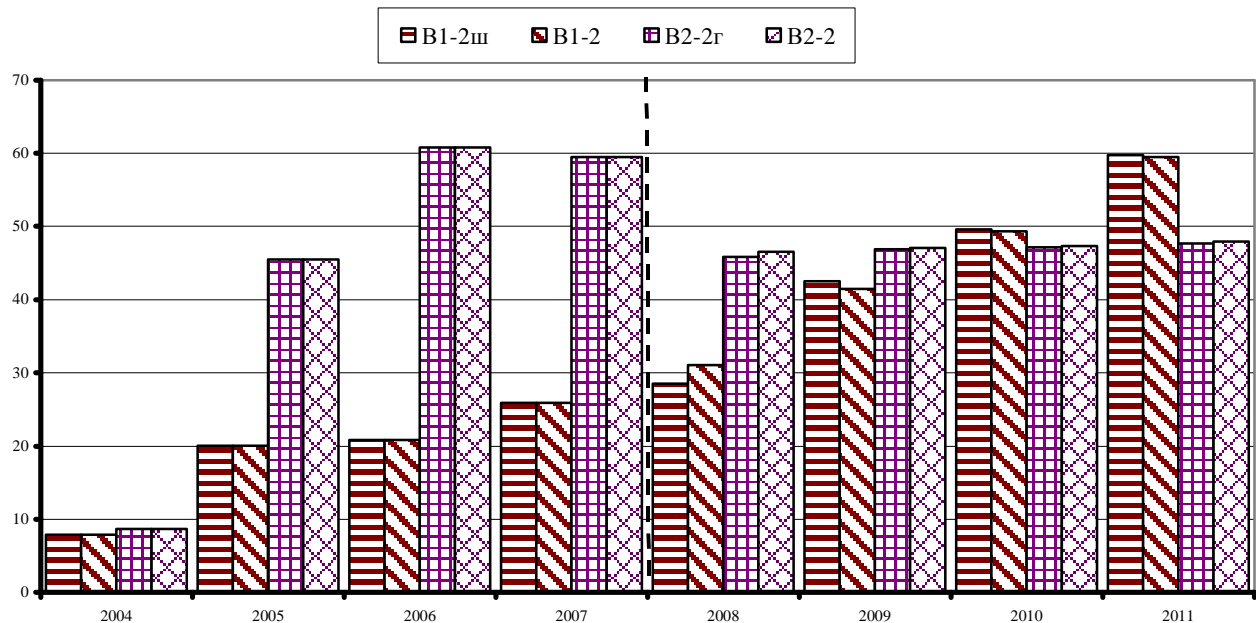


Fig. 6. Expenditures for maintenance of privates and noncommissioned officers across variants (Rub. billion a year)

As concerns these expenditures, there should be noted the following. Naturally, the speeded up variant requires higher expenditures in the period before 2008, however, it permits to reduce future expenditures after 2009.

The difference between expenditures in the case of transition to draft for 6 months or 1 year is insignificant for the state budget. First, this relates to the fact that the significantly higher share of expenditures is allocated for maintenance of contracted servicemen as opposed to drafted servicemen. Second, in the framework of the expenditures borne by the state in order to finance drafted servicemen, the insignificant difference described above concerns transportation expenditures for delivery of draftees to their respective places of service. Other expenditure items are practically similar.

Conclusions:

1. The objective to simultaneously increase the strength of the military organization and consolidate the capacity to rebuff terrorism on the part of the civil society originated by the more severe terrorist attacks may be attained in the case the reform of the system of completion of the RF military organization may be speeded up.

2. from the point of view of military efficiency of regular troops, the more intensive transition to the contract based service is useful, since it may increase this efficiency already at present time, and not in a far future. At the same time, it would be possible to avoid significant “dips” in the total strength. Simultaneously, there are no significant difference between the transition to the 6 months and 1 year term of service as concerns the military efficiency. From the point of view of the combat readiness of the mobilization resource, the transition to the 6 months term of service is better, since a larger number of citizens could have military training, although only primary. In the case the present situation, as concerns international terrorism threats, in the country and in the world is taken into account, the fact that more citizens would have primary military and antiterrorist training would be a useful development.

3. The difference in the expenditures borne by the state as concerns maintenance of servicemen according to different variants of the term of military service (6 months or 1 year) is insignificant. More

rapid transition to the contract based military service will require an increase in the spending in the period till 2008, however, additional expenditures are below several per cent of the planned expenditures for defense and national security, what seems rather reasonable. At the same time, this acceleration of the reform may help to reduce future expenditures.

4. From the point of view of the public support of the variants under observation, the advantages of transition to the 6 months term of military service are undeniable. This term of service will facilitate the prevention of the criminal payoffs as concerns draft. The same may be said about the lost (reduced) revenues of the society arising due to the fact that young people have to serve in the military organization. It may be added that the transition to the 6 months term of service will not negatively affect the system of higher education.

N. Kardashevsky

Scenary Macroeconomic Forecast for 2004 and 2005

This section presents a scenary forecast of basic macroeconomic indicators (GDP, CPI, tax revenues, export, import, RUR/USD exchange rate, gold and foreign exchange reserves, real effective exchange rate of the Ruble, retail turnover, unemployment rate, real value of cash incomes) for 2004 and 2005, which was performed by using a system of structural econometric equations.

The equations were evaluated on the basis of quarterly data over the period between the 1st quarter of 1996 and the 2nd quarter of 2004 inclusively. In some cases a model was evaluated only for the 1st quarter of 2000. The data were based on the official information received from the RF Statistical Service, the Bank of Russia and the International Monetary Fund (International Financial Statistics).

The equation depicting a short-term movement of macroeconomic indicators includes the variables and their lags which have a significant and economically logical impact on the interpretable variable. The equations were also added with dummy variables, thus taking into account quarterly seasonal factor and structural changes. Moving average members were used for the purpose of eliminating autocorrelation of excesses.

Predicted values of macroeconomic indicators were calculated on the basis of the scripted scenarios of exogenous variables movement: Brent oil price, capital investment, M_2 and USD/EUR exchange rate.

TABLE 1

Exogenous Variables Scenarios for 2004 and 2005

	2004	2005		
		Scenario 1	Scenario 2	Scenario 3
USD/EUR exchange rate	1,21	1,18	1,24	1,15
Urals oil price (US dollars per barrel)	31,2	28	31	24
M_2 growth rate, %	35	28	35	20
Capital investment growth rate, %	11,5	9,8	12,0	8,5

Exogenous variables movement over the two latest quarters of 2004 were selected on the basis of assessments of average annual values of the similar variables in 2004, presented in the forecasts of the RF Ministry of Economic Development and Trading (RF MEDT) and the RF Central Bank . Thus, according to the estimates of the Central Bank («Basic Trends of the Unified Public Monetary Policy for 2005 »), M_2 growth rates in 2004 may amount to 32 to 37%. According to the estimates of the RF MEDT, in 2004, the average annual Urals oil price included into the reference conditions of the forecast of socio-economic development of the Russian Federation till 2007 is expected to amount to nearly 31,2 US dollars per barrel. According to the estimates of the RF MEDT, in 2004, the USD/EUR average annual exchange rate and annual growth rates of capital investments должны составить 1,21 US dollars for 1 Euro and 11,5%, respectively.

Our macro forecast for 2005 was calculated on the basis of three basic scenarios of the USD/EUR exchange rate, oil prices, M_2 and capital investments growth. Scenario 1 was drawn according to the reference conditions and forecast output of the RF MEDT for 2005 («socio-economic development forecast in the Russian Federation till 2007 »): the USD/EUR average annual exchange rate is 1,21, Urals oil price is 28 US dollars per barrel, M_2 growth rate is 28%, capital investment growth rate by

year end is 9,8%. Scenario 2 is optimistic and predicts oil prices to remain at the 2004 level (31 US dollars per barrel). In addition, according to Scenario 2, capital investment growth rate is predicted to be at the level of 12%, USD/EUR average annual exchange rate is 1,24, money supply growth rate is 35%. Scenario 3 is pessimistic and predicts a gradual decline in Urals oil prices down to 22 US dollars per barrel by the end of 2005. In addition, Scenario 3 predicts strengthening of the US dollar against the Euro as compared to the previous year (average annual exchange rate in 2005 is 1,18 US dollars for 1 Euro against 1,21 in 2004), decline in investment growth rate down to 8.5% annually and M₂ growth rate is 20% in 2005 .

TABLE 2

Forecast for 2004 and 2005

	2004	2005			
		Scenario 1	Scenario 2	Scenario 3	RF MEDT Scenario
Real GDP growth rate, %	7.2	5.9	6.9	4.0	6.3
GDP (trillion rubles)	16 221	19 280	19 482	18 459	18 720
CPI growth rate, %	11.0	10.1	10.4	8.3	8.5
Tax revenues to the RF consolidated budget (% of the GDP)	25.2	25.9	26.6	25.3	
Gold and foreign exchange reserves (bln US dollars) .	107	120	131	115	
Rate of strengthening of real effective exchange rate of the ruble, %	7.9	6.4	7.8	5.9	4.4
Rate of strengthening of real exchange rate of the ruble to the dollar, %	8.3	4.6	7.9	0.5	4.3
Nominal exchange rate of the ruble to the dollar .	29.2	30.2	29.0	30.5	30.4
Export (bln US dollars)	165	165	174	158	163.2
Импорт (bln US dollars)	90	103	107	99	104.7
Retail turnover growth rate, %	8.1	8.8	9.6	7.1	8.5
ИППИ growth rate (in % against previous quarter)	7.0	5.5	6.5	3.6	5.5
Share of unemployed in total number of the gainfully occupied population, %	7.8	7.2	7.1	7.4	8.5
Growth rates of real value of cash incomes, % .	8.8	8.1	8.7	6.8	9

According to the macroeconomic forecast output (refer to Table 2), GDP growth rate in 2004 will amount to 7.2%. According to the optimistic scenario (Scenario 2), in 2005 growth rates of the GDP will decrease down to 6.9% and 4% under Scenario 3, correspondingly. In 2004, nominal value of GDP volume will amount to nearly 16,2 trillion rubles. In 2005, this figure will reach 19,28 trillion rubles according to Scenario 1, 19,48 trillion rubles according to Scenario 2 and 18,46 trillion rubles according to Scenario 3.

In the case of 35% increase in money supply in 2004 and 7.2% of the predicted GDP growth rate, inflation in 2004 will amount to nearly 11%. Next year inflation rates will reduced down to 8.3 to 10.4% depending on the predicted scenary changes in money supply.

The presented assessment of tax revenues volume to the consolidated budget does not include the unified social tax revenues. The tax revenues forecast was calculated with due consideration of actual and planned (by the RF Government) changes in the tax law in 2004 and 2005 as compared to the previous years.¹³ In particular, taken into consideration were a decrease in the value-added tax rate by 2 percentage points, sales tax abatement, as well as indexation of excises and changes in the base rate

¹³ Since the applied indicator of the revenues volumes to the RF consolidated budget doesn't include the revenues of the unified social tax, no consideration was taken of the planned decline of the unified social tax from 2005, which is expected to reduce tax burden of enterprises by 280 bln rubles, according to the estimates of the RF Government .

of the mineral tax from 2004. At the same time, on the basis of the predicted scenario oil prices, we took into account the consequences of tax burden growth for the oil industry from 2005. According to a new scale of export duties, the duty will be 0% with oil prices being up to \$15 USD per barrel; with oil price of 15 to 20 US dollars per barrel, the export duty will be up to 35% of the difference between actual oil price and \$15 USD; with oil price of 20 to \$25 USD per barrel the export duty will not exceed \$12,78 plus 45% of the difference between actual oil price and \$20; with oil price over \$25 USD per barrel the export duty will not account for more than \$29,2 USD and 65% of the difference between actual oil price and \$25. At the same time, the Mineral Tax equation included the base tax rate raised from 347 rubles up to 400 rubles per ton from 2005, as well as non-taxable threshold of oil price from \$8 to \$9 USD. In addition, the Mineral Tax equation included the RUR/USD exchange rate revised from 31,5 rubles for 1 US dollar up to 29 rubles for 1 US dollar. In addition, calculation of tax revenues for 2005 took into account the introduction of the «country of destination» principle on the value-added tax with regard to hydrocarbons and other goods exported to Belarus as well as the respective growth of the base rate of oil production tax and the base rate of flammable natural gas production tax, which according to the estimates of the RF Ministry of Finance will lead to reduction of tax revenues. Account was also taken of an average reduction by 32% of export duties rates in all groups, except for the fuel and energy group, that also will lead to reduction of tax revenues, according to the estimates of the RF Ministry of Finance.

The corresponding quantitative changes in the amount of tax revenues were calculated on the basis of tax revenues of the previous year with consideration of taxation base growth, presented oil prices scenarios and forecast of the RUR/USD exchange rate. Thus, as a result of changes in the tax legislation, tax revenues of the RF consolidated budget in 2004 will be reduced to 132 bln rubles. According to Scenario 1, tax revenues in 2005 will increase by 65 bln rubles; according to Scenario 2 (with the highest oil prices), tax revenues will increase by 137 bln rubles; according to Scenario 3, revenues of the consolidated budget will barely grow by 16 bln rubles. As a result of adjustment of the predicted values of tax revenues by the amount of discretionary changes, the predicted volume of tax revenues of the RF consolidated budget in 2004 will amount to nearly 25.2% of the GDP; in 2005, 25.9% of the GDP according to Scenario 1; 26.6% of the GDP according to Scenario 2; and 25.3% of the GDP according to Scenario 3.

According to the forecast output, by the end of 2004 the volume of gold and foreign exchange reserves will reach 107 bln US dollars.¹⁴ With the lowest oil prices in 2005 (Scenario 3), gold and foreign exchange reserves will increase by 8 bln US dollars, while if oil prices in 2005 remain at the level of 2004 (Scenario 2), the increase in gold and foreign exchange reserves in 2005 will amount to nearly 24 bln US dollars.

The predicted rates of strengthening of both real effective exchange rate of the ruble and real RUR/USD exchange rate in 2004 will amount to nearly 8%. In 2005, according to the given scenarios, the rates of strengthening of the real effective exchange rate of the ruble will be from 5.9 to 7.8%. The ruble will strengthen at a slightly lower rate against to the US dollar, with only the 0.5% in 2005 according to Scenario 3 (with the strongest US dollar rates against the Euro).

Export volume in 2004 will reach 165 bln US dollars, while in 2005 this indicator will remain unchanged according to Scenario 1. With oil prices remaining at the previous year level (Scenario 2) in 2005, export volume will increase up to 174 bln US dollars, while with a decrease in oil prices to \$22 by the end of 2005, export volume will amount to nearly 158 bln US dollars. In each of the given scenarios the predicted import volume in 2005 will be found bigger than in 2004 by 13 bln US dollars according to Scenario 1; 17 bln US dollars according to Scenario 2; and 9 bln US dollars according to Scenario 3. The forecast of import volume in 2004 shows nearly 90 bln US dollars. Thus, the forecasts demonstrate that export surplus in 2005 will be found lower by more than 8 bln US dollars on the average as compared to the previous year according to each scenario.

The predicted retail turnover growth rates, industrial production index and real value of cash incomes are generally in line with the forecast of GDP growth rates. In the medium-term period, the retail turnover growth rates are comparable by value with growth rates of real available incomes and

¹⁴ The presented predicted estimates of the volume of gold and foreign exchange reserves at the RF Central Bank do not take into account foreign debt repayment.

higher than the GDP growth rates by more than 2 percentage points. On the contrary, growth rates of the industrial production index are lower than the GDP growth rates by 0,4 percentage points on the average .

The predicted the share of unemployed in total number of gainfully occupied population is 7.8% in 2004. In 2005, the share of unemployed will be reduced as compared to the previous year by up to 7.2% according to Scenario 1, up to 7.1% according to the most optimistic Scenario, and up to 7.4% according to the pessimistic Scenario.

Also, it should be noted that our forecast of macro indicators for 2005 (Scenario 1) are generally in line with the comparable forecast made by the RF Ministry of Economic Development and Trading under the similar reference conditions. The largest difference was found for the RUR/USD real exchange rate and inflation. According to the forecast of the RF Ministry of Economic Development and Trading, the real effective exchange rate of the ruble in 2005 was found to be below our forecast by 2 percentage points. Correspondingly, the RF MEDT's predicted growth rates of the consumer price index were found to be below by 1.6 percentage points.

FIGURE 1

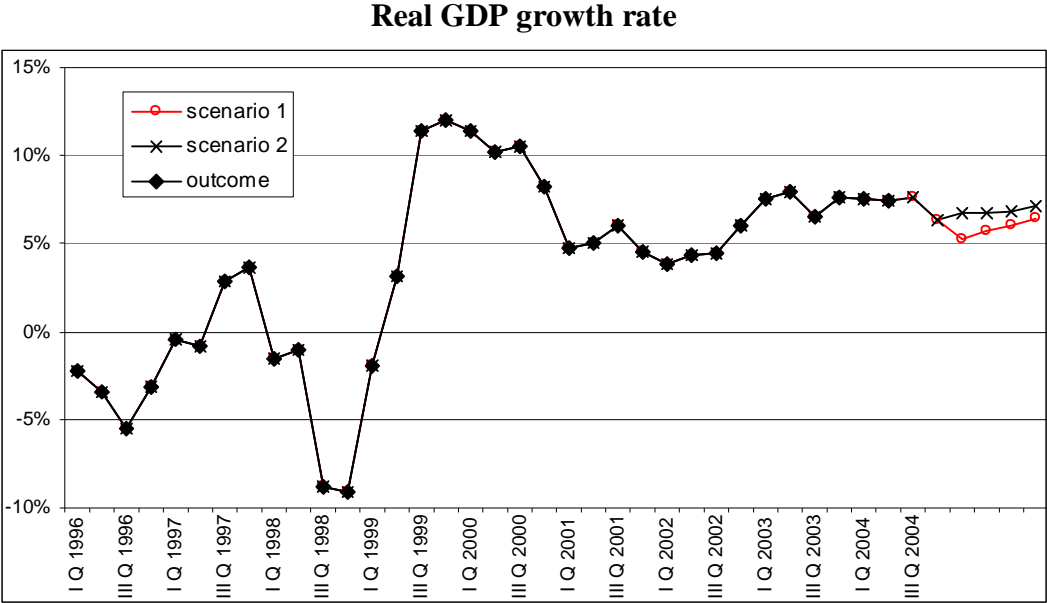


FIGURE 2

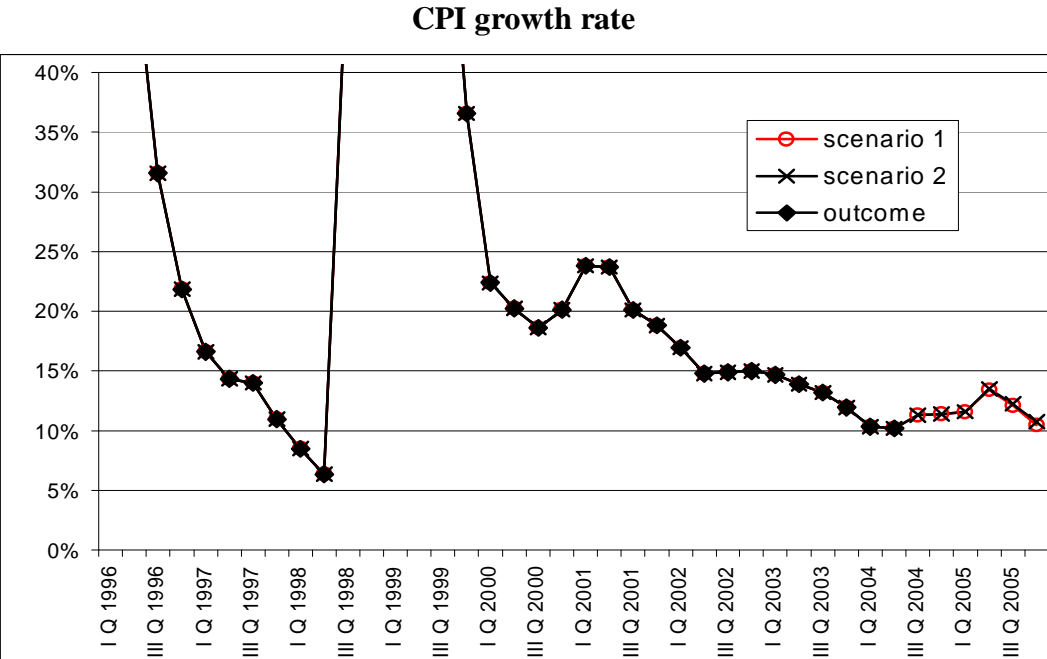


FIGURE 3

Consolidated budget tax revenue (% to 1 Q. 1996)

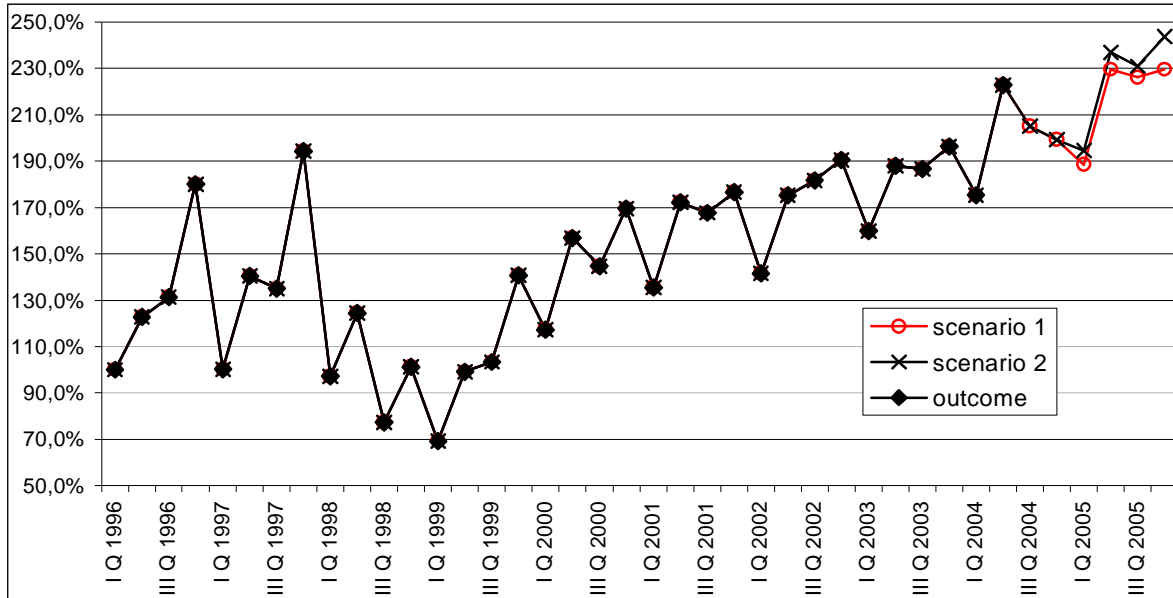


FIGURE 4

Gold and foreign exchange reserves (bln rubles.)

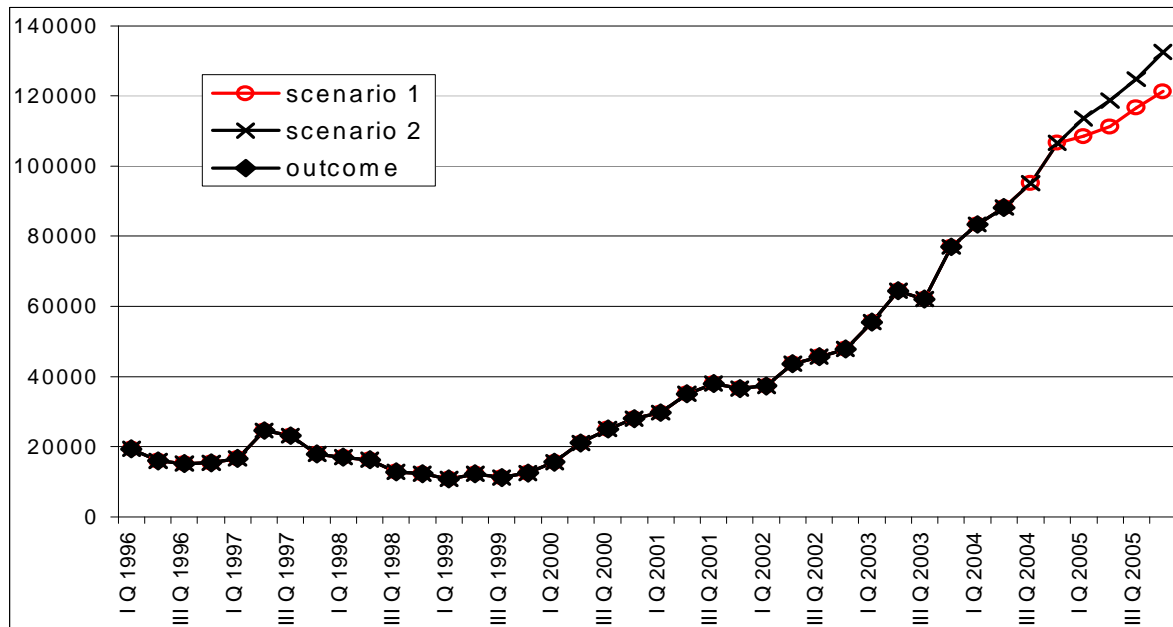


FIGURE 5

Nominal exchange rate (RUR/USD)

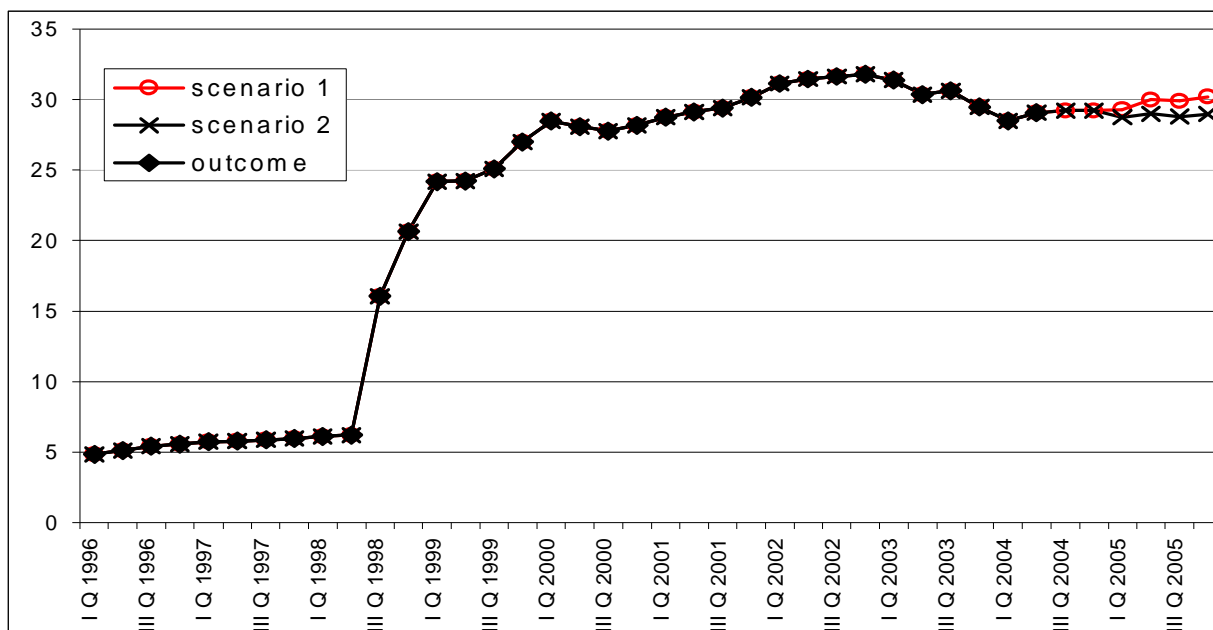


FIGURE 6

Real effective exchange rate (index number)

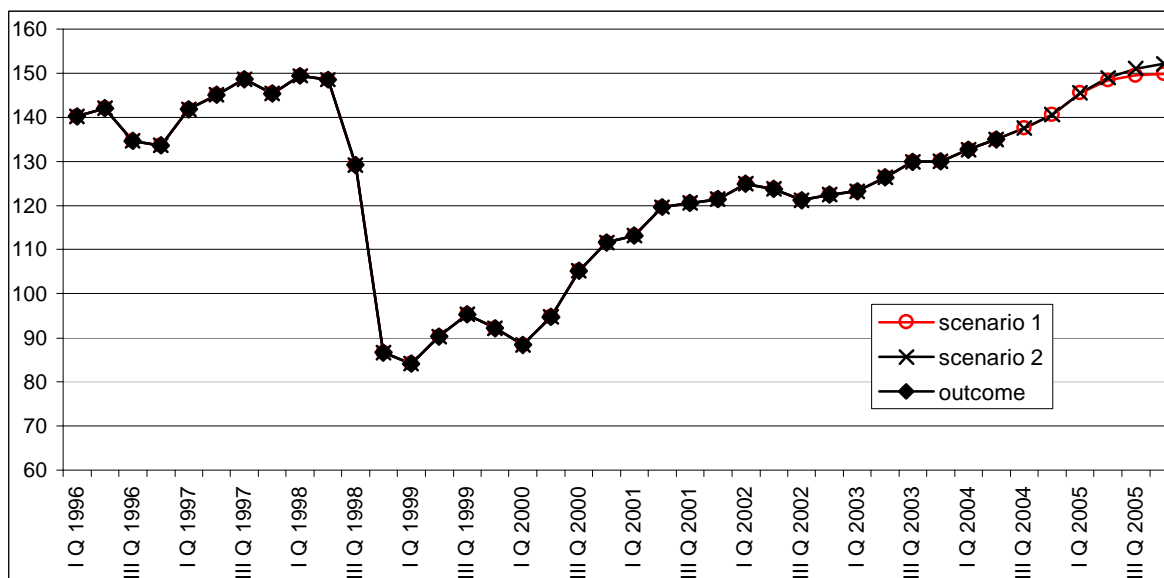


FIGURE 7

Export (ml USD)

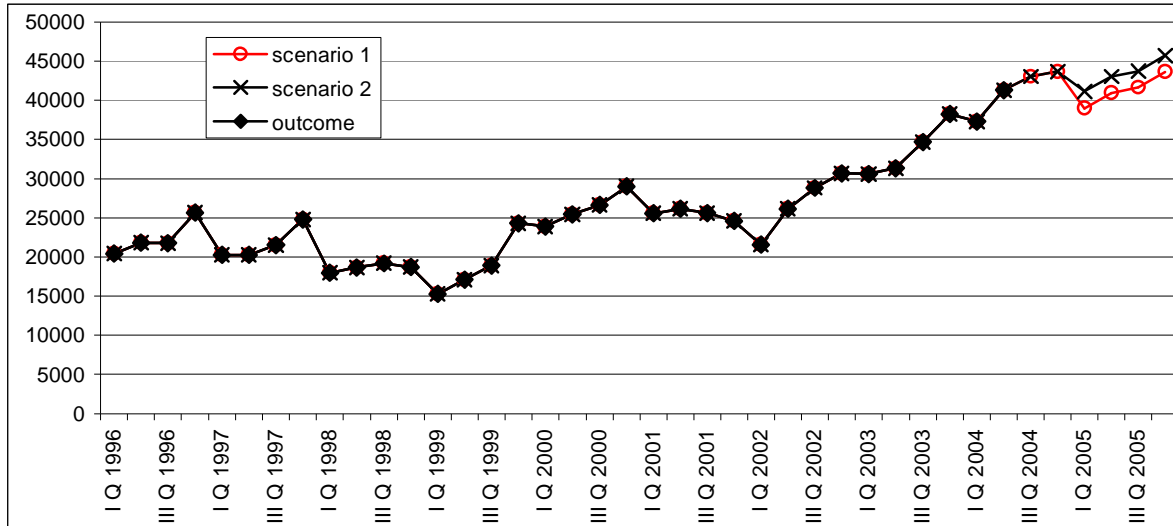


FIGURE 8

Import (ml USD)

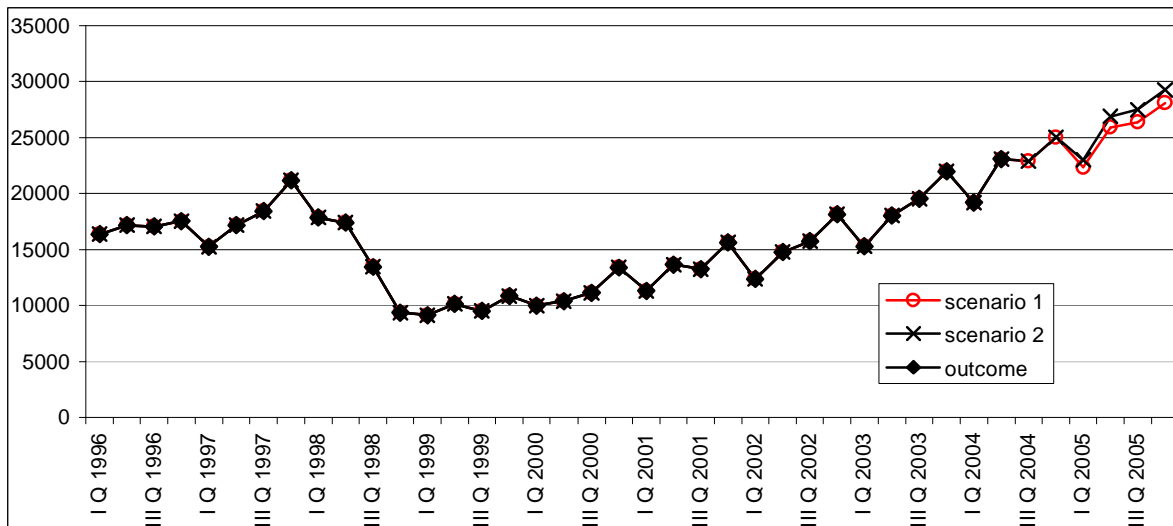


FIGURE 9

Real retail turnover growth rates

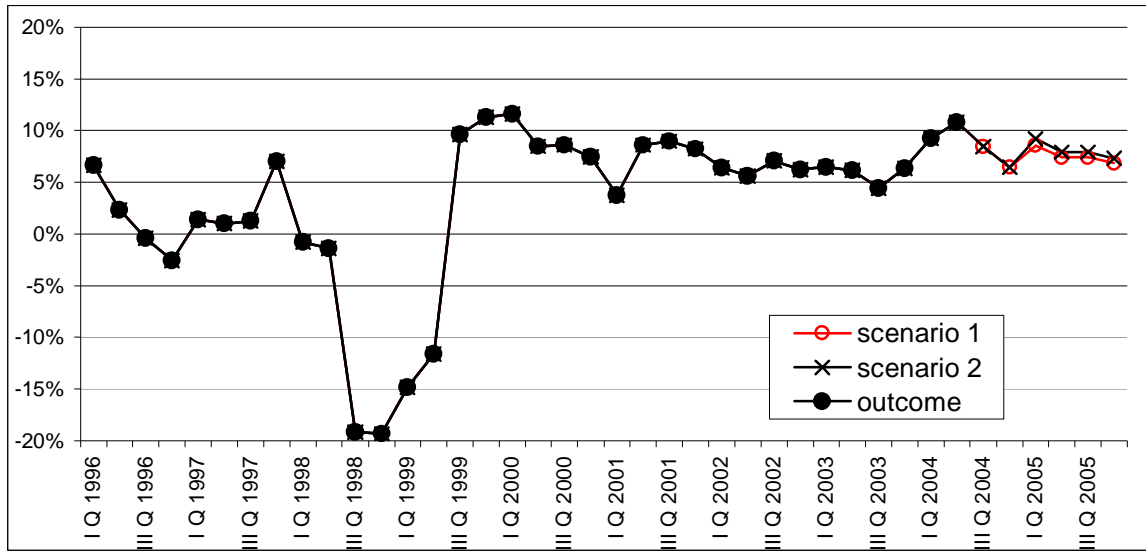


FIGURE 10

Industrial production index growth rates

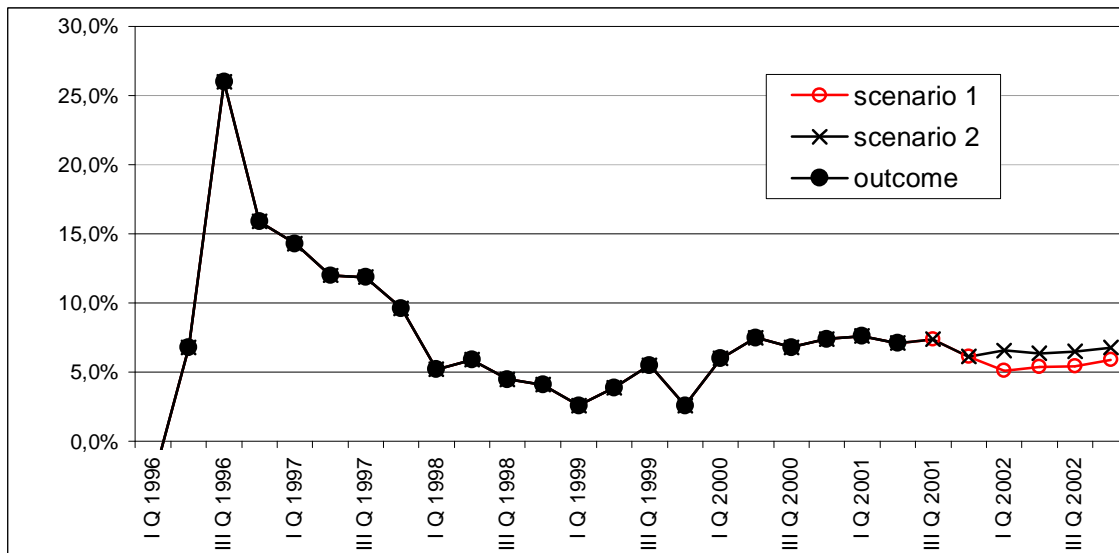


FIGURE 11

Number of unemployed against gainfully occupied population (in %)

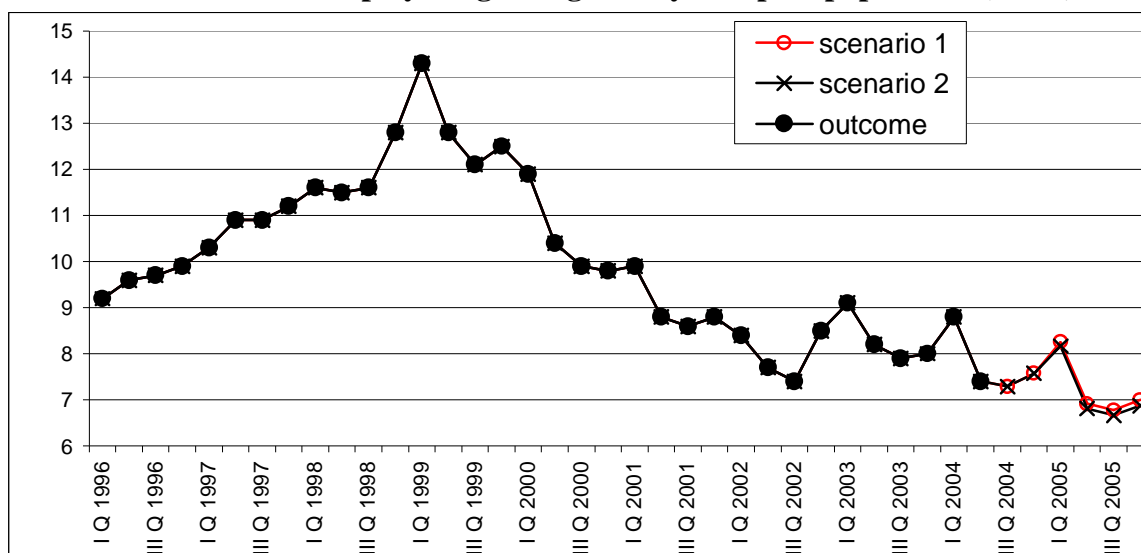
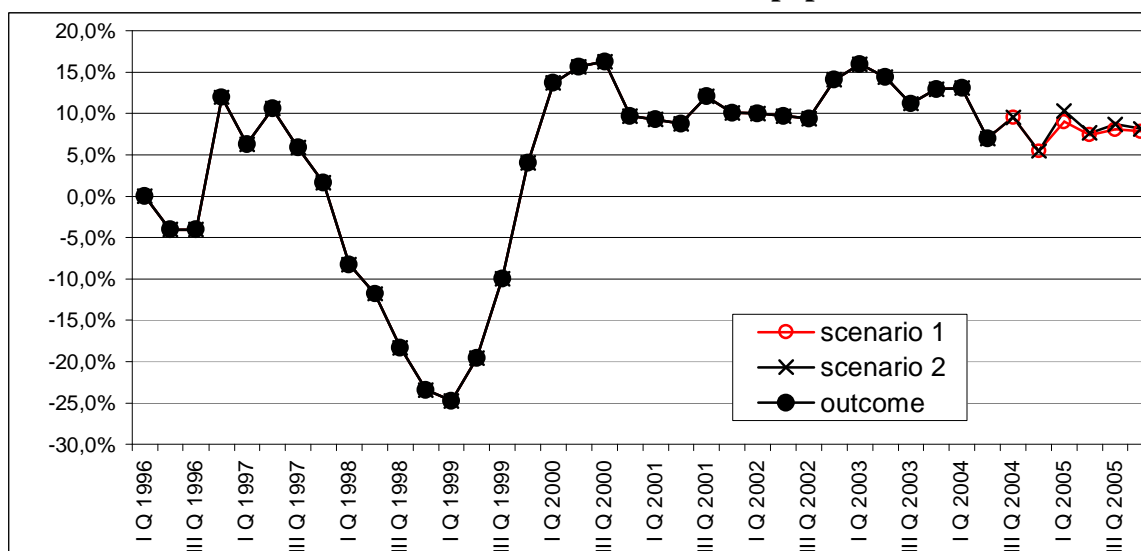


FIGURE 12

Growth rates in real income of the population



Drobyshevsky S., Ponomarenko S.

Issues discussed at the meetings held by the Government of the Russian Federation on September 9 and 22 of 2004

Among the all issues discussed at the meetings held by the Government of the Russian Federation in September, the most interesting ones were the following: at the meeting of the RF Government held on September 9, I. Ye. Levitin, the RF Minister of Transport presented his report “On the measures aimed at the implementation of the structural reform of the railroad transport” describing the results of the first stage of the reform. At the meeting of the Government of the Russian Federation held on September 22, 2004, there was discussed the report presented by G. O. Gref, the RF Minister of Economic Development and Trade, “On the procedures governing the financing of payments relating to the cumulative component of the labor pension and the specifics of investment of pension savings of citizens of pre-pension and pension age” describing the draft federal law. Besides, at the same meeting, there was discussed the issues of informing citizens about the state of personal accounts of the cumulative

component of the labor pension (the report “On the progress of informing citizens about the state of their personal accounts” presented by M. Yu. Zurabov, the RF Minister of Health Care and Social Development).

* * *

At the meeting held on September 9, the Government of the Russian Federation discussed the report of I. Ye. Levitin, the RF Minister of Transport, “On the measures aimed at the implementation of the structural reform of the railroad transport.”

The Minister noted that at the first stage of the reform of the railroad transport (carried out in accordance with the Program of structural reform of the railroad transport approved by the RF Government resolution No. 384 of May 18, 2001), there had been formed the necessary legislative framework of the operation of the railroad transport in the new situation and divided the functions of state and economic management.

The functions relating to the state regulation in the sphere of railroad transport, earlier carried out by the Ministry of Railroad Transport of Russia had been transferred to the Ministry of Transport of Russia and the Federal Service for Supervision in the Sphere of Transport and the Federal Agency for Railroad Transport in its jurisdiction.

In the framework of the reform of the system of railroad transport, in accordance with the RF Government resolution No. 585 of September 18, 2003, there was created the open joint stock company “Russian Railways (Rossiyskiye Zheleznye Dorogi).”

There were elaborated criteria and basic indicators necessary for implementation of the monitoring of the structural reform of the railroad transport permitting to carry out an analysis of intermediate results of the reforming. The obtained results of the analysis indicated the trends towards demopolization of the market in certain segments of the transportation process and increase in the volume indicators, as well as the efficiency of implementation of the reform.

At the second stage of the reform, it is necessary to ensure the following:

- intensification of competition as concerns services relating to freight;
- attraction of private investment for modernization of the railroad infrastructure;
- completion of optimization of the management structure of the JSC RZhD (including the enhancement of the role played by the organization of management across types of activities);
- efficient functioning of the systems of accounting formed at the first stage of the reform;
- reduction of cross-subsidizing of passenger traffic with the use of the mechanism of support of passenger traffic created at the first (preliminary) stage of reform;
- creation of independent legal entities in the sphere of suburban passenger traffic, far distance passenger traffic, repairs of equipment for railroad transport, and production of spare parts, transit, intermodal, and refrigerator freight, auxiliary types of activities not related to transportation..

The most important objective of the further development of the reform is to attract private investment in the infrastructure of railroad transport with the use of mechanisms of state-business cooperation. At the same time, it is necessary to clearly determine the procedures relating to the protection of investors’ interests, the procedures of their interaction with the state and organizations of railroad transport. Concessions might be one of the variants of attraction of private investment.

In order to attain the objectives set by the Program of the structural reform of the railroad transport and to ensure financial stability and efficient functioning of the system, there was elaborated the Strategic program of development of the JSC RZhD until 2010. At the same time, the Program is oriented towards sustained development in the situation of limited growth in tariffs: until 2006, by the rate of inflation, and since 2007 with the coefficient equal to 0.98 per cent of the rate of inflation. The target parameters of the Program are oriented towards the necessity to solve the infrastructure problems relating to the objective of ensuring the rates of growth of the Russian economy until 2010. .

The report noted a number of issues, requiring decisions on the part of the RF Government:

1. Completion of elaboration of draft regulating legal acts necessary to implement the structural reform of the railroad transport.

The most serious problem is the issue of amendment of the legislation embracing the licensing of certain types of activities and preparation of respective resolutions of the RF Government.

2. Implementation of measures aimed to solve financial problems..

An important problem is to amend the legislation as concerns the use of the zero rate VAT in the case of export, import, and transit freight by railroad transport in the new operation environment.

3. Improvement of the state tariff regulation and development of competition in the framework of the railroad transport.

The program of structural reform of the railroad transport envisages a gradual transition to free price determination in competitive sectors of the market of railroad freight.

4. Improvement of the procedures governing the management of the property complex of the JSC RZhD.

5. Gradual cessation of cross-subsidizing of passenger traffic at the expense of financial results of the JSC RZhD.

The liquidation of cross-subsidizing of passenger traffic at the expense of financial results of the JSC RZhD is a necessary prerequisite for the creation of the Federal Passenger Company, what is envisaged by the Program of the structural reform of the railroad transport.

6. Introduction of amendments to the Program of the structural reform of the railroad transport approved by the RF Government Resolution No. 384 of May 18, 2001..

In order to attain the objectives of the structural reform of the railroad transport, the RF Ministry of Transport finds it feasible to amend the Program of the structural reform of the railroad transport approved by the RF Government Resolution No. 384 of May 18, 2001, as concerns the creation of affiliates and subsidiaries of the JSC RZhD.

7. Maintenance of higher education and establishments and colleges in the jurisdiction of the Federal agency for railroad transport..

The report also indicated key principles and target parameters of the Strategic program of development of the JSC RZhD.

* * *

At the meeting of the Government of the Russian Federation held on September 22, 2004, G. O. Gref, the RF Minister of Economic Development and Trade, presented his report “On the procedures governing the financing of payments relating to the cumulative component of the labor pension and the specifics of investment of pension savings of citizens of pre-pension and pension age” concerning the draft federal law “On the procedures governing the financing of payments relating to the cumulative component of the labor pension and the specifics of investment of pension savings formed in favor of the citizens of pension age in the Russian Federation.”

The federal law sets the organizational, legal, financial, and economic principles in the sphere of financing of payments of the cumulative component of the labor pension from the RF Pension Fund. Its main objective is to set the legislative framework determining the procedures pertaining to the financing of the cumulative component of the labor old age pension, to determine the expected period of payment of the cumulative component of the labor old age pension, as well as the specifics of implementation of the right to choose the investment portfolio (management company) and investment of pension savings formed in favor of the insured persons of pension age.

The regulations envisaged by the federal law under observation set the following:

- specifics of formation and control of pension savings formed in favor of the insured persons eligible for the cumulative component of the labor pension taking into account the fact that after granting of the cumulative component of the labor pension, the pension savings formed in favor of such persons, lose their personified nature;

- the procedures governing the actuary assessment of pension savings formed in favor of insured persons eligible for the cumulative component of the labor pension and the requirements pertaining to actuaries as concerns the conduct of the indicated activities;

- a special procedures governing the investment of pension savings formed in favor of insured persons of pension age in order to reduce the risks of volatility of the value of pension savings at the moment of granting of the cumulative component of the labor pension to such persons and in the period of payments of this component of the labor pensions to such persons;

- the isolation of the pension savings formed in favor of insured persons, which were granted the cumulative component of the labor pensions from pension savings formed in favor of insured persons, who were eligible for such component, prior to the start of the respective payments, determination of the specifics of the formation of such pensions, the norms regulating investment of the aforementioned savings, as well as the procedures governing the allocation of pension savings for payment of the cumulative component of the labor pensions.

The approval of this federal law will permit to guarantee that insured persons enjoy the right to receive the cumulative component of the labor pension at the state of its payment.

At the same meeting of the RF Government, there was discussed the report made by M. Yu. Zurabov, the Minister of Health Care and Social Development of the RF, "On the progress of informing citizens about the state of their personal accounts."

In his report, the Minister noted that according to federal laws "On individual (personified) control in the system of mandatory pension insurance" and "On investment of funds for financing of the cumulative component of the labor pension in the Russian Federation." From 2003, the RF Pension Fund informs insured persons about the state of their personal accounts in the system of mandatory pension insurance. For this purpose, the organizations of the RF Pension Fund annually implement a package of measures aimed at the updating of the information database of personified control. The main operations concerning the update of the informational database of personified control include: reception of accounting data from insurers and proceeding thereof, verification of the data pertaining to accounting and personified control, and posting of the data across the personal accounts.

In 2004, in the period of reception of the personal data from insurers for 2003 and proceeding thereof, there was continued the updating of the address database for mailing of notifications to the insured persons.

The report contains proposals aimed at the improvement of certain aspects of the system of informing: the use of less expensive schemes of informing, the use of the existing in the country identification means and terminal networks, combination of documental informing of the insured persons as concerns the state of their personal accounts by mailing special correspondence of the RF Pension Fund and informing of the insured persons residing in localities with respective infrastructure in the electronic form.

E. Bolshakova

Economic Legislation Review, September 2004

The following amendments to the current legislation were made in September 2004. A Federal Law providing for replacement of the bulk of in-kind benefits (except for the benefits in payment for housing and public utilities) with monthly monetary compensations from January 1, 2005 was adopted; the RF Government approved the amount of subsistence minimum, the federal standards of payments for accommodation and public utilities service, the cost of major repairs of residential properties; a provision on terms and procedure of granting subsidies on payment for accommodation and public utilities service was approved; a letter of the RF Ministry of Taxation specified the procedure of taxation of individual income, and compensatory payments due to the public servants.

I. FEDERAL LAWS of the Russian Federation

1. « ON AMENDMENTS TO THE LEGISLATIVE ACTS OF THE RUSSIAN FEDERATION AND CESSATION OF SEVERAL LEGISLATIVE ACTS OF THE RUSSIAN FEDERATION DUE TO ADOPTION OF THE FEDERAL LAWS «ON AMENDMENTS TO THE FEDERAL LAW « ON GENERAL PRINCIPLES OF ORGANIZATION OF LEGISLATIVE BODIES (REPRESENTATIVE) AND EXECUTIVE BODIES OF THE CONSTITUENT ENTITIES OF THE RUSSIAN FEDERATION » AND «ON GENERAL PRINCIPLES OF ORGANIZATION OF LOCAL SELF-GOVERNMENT OF THE RUSSIAN FEDERATION »» of 22.08.2004 , No. 122 -FL .

The law will be effective from January 1, 2005, except for several provisions to be effective from January 1, 2006 .

The law is intended to protect the rights and liberties of the citizens of the Russian Federation on the basis of delimitation of authorities between the federal government bodies and government bodies of the constituent entities of the Russian Federation, optimize functioning of territorial forms of government of the federal executive bodies, as well as with regard to the vicinal issues vested in the Constitution of the Russian Federation and the federal laws. The Law also solves the problems of securing equality of the rights and liberties of man and citizen, improving the living standards of the citizens, providing economic security of the state and bringing the social safety of the citizens, which are entitled to social benefits, safety and compensation, in balance with the principle of delimitation of authorities between the federal government bodies, government bodies of the constituent entities of the Russian

Federation and local self-government bodies, as well as the principles of the rule-of-law state with socially oriented market economy.

Amendments were made to a great number of legislation acts of the Russian Federation. In particular, amendments were made to the legislation acts on the issues of social policy, regulation of payment for labor, education and science, healthcare, sport, and mass media; environmental management, emergency protection; development of infrastructure and industrial sectors support .

From January 1, 2005, the bulk of in-kind benefits (except for the benefits in payment for housing and public utilities) will be replaced with monthly monetary compensations for those individuals whose social protection is within the authority of the federal government bodies. The amounts of compensatory payments by category were specified.

In replacing the in-kind benefits with monetary compensations, the constituent entities of the Russian Federation and municipal government bodies are obliged to introduce effective legal mechanisms providing security and, if possible, improvement of the previously achieved social security level of the citizens with allowance for the specifics of their legal and property status; provide an opportunity for the citizens to adapt within a reasonable period of time to the amendments made to the legislation, in particular, by way of introducing a tentative regulation of social relations .

II. REGULATIONS OF THE GOVERNMENT of the Russian Federation

1. « ON ESTABLISHMENT OF SUBSISTENCE MINIMUM PER CAPITA AND BY BASIC SOCIODEMOGRAPHIC GROUP IN THE RUSSIAN FEDERATION FOR THE 1ST AND 2ND QUARTERS OF 2004 » of 03.09.2004 , No. 456 .

The amount of subsistence minimum was established for the Russian Federation. In particular, the amount of the subsistence minimum per capita for the 2nd quarter of 2004 is 2363 rubles; 2588 rubles for working population; 1793 rubles for pensioners, and 2313 rubles for children.

2. « ON FEDERAL STANDARDS OF PAYMENTS FOR ACCOMMODATION AND PUBLIC UTILITIES AND THE PROCEDURE OF REPAYMENT OF EXPENDITURES ON HOUSING MAJOR REPAIR FOR 2005 » of 26.08.2004 , No. 441 .

Established for 2005 were the federal standard of the marginal monthly cost of housing and public utilities services per 1 square meter of total living space in the Russian Federation in average to the amount of 31,9 rubles and to the amounts specified for every constituent entity of the Russian Federation . Also, established was the federal standard of the monthly cost of major repairs of residential properties per 1 square meter of living space in the Russian Federation in average to the amount of 2,8 rubles and to the amounts specified for the constituent entities of the Russian Federation and the federal standard of the marginal monthly cost of housing and public utilities services per 1 square meter of total living space in closed administrative-territorial entities .

3. «ON GRANTING SUBSIDIES ON PAYMENT FOR ACCOMODATION AND PUBLIC UTILITIES » of 30.08.2004 , No. 444 .

The provision specifies the conditions and the procedure of granting subsidies, determining their size, accounting income and calculating the aggregate family income and single individuals, as well as the average per capita family income for the purpose of granting the given subsidy on a case-by-case basis. Established were the specifics of granting subsidies to various categories of citizens, especially the persons who are doing or did contractual military service outside the Russian Federation at territorial entities, military units, units and organizations of the corresponding federal executive bodies. The procedure of suspension and termination of granting subsidies was approved. In addition, it was established that regulatory and legal acts issued under this Provision by government bodies of the constituent entities of the Russian Federation establishing the procedure and conditions of granting subsidies on their territory and considering the socio-economic development of the constituent entities of the Russian Federation , must not aggravate the situation of the citizens as compared the citizens which are entitled to the subsidies granted pursuant to the given Provision.

The Resolution of the RF Government dated 02.08.1999 , No. 887 « On Improvement of the Plan of Payment for Accommodation and Public Utilities and Social Protection Measures », including amendments, was held inoperative .

III. ORDERS, INSTRUCTIONS and REGULATIONS

1. The letter of the RF Ministry of Taxation dated 03.09.2004 , No. 04 -2 -06/605 « ON INDIVIDUAL INCOME TAX » .

Specified was the procedure of individual income taxation of compensatory payments due to public servants established under the current legislation of the Russian Federation, legislative acts of the constituent entities of the Russian Federation, decisions of the representative bodies of local self-government authorities. In particular, it was stated that the compensatory payments specified in Article 15 of the Federal Law of 31.07.1995 , No. 119 -FL « On the Basics of Public Service in the Russian Federation », are exempted from the tax on individual income pursuant to Paragraph 3, Article 217 of the RF Tax Code. Other additional payments relative to public service, which are unstipulated in the foregoing Federal Law, are not compensatory in themselves and therefore are to be included into the taxation base on the individual income tax. The same is true regarding the issue of taxation of compensatory payments due to municipal government servants, which are effected in accordance with the decisions of local self-government bodies of the constituent entities of the Russian Federation, but being not within the regulations of the Federal Law of 08.01.1998 , No. 8-FL « On the Basics of Municipal Service in the Russian Federation ».

Tolmacheva I.V.