Russian State Policies in Current Foreign Trade

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List of Abbreviations

GATT	General Agreement on Tariffs and Trade
WTO	World Trade Organisation
GDP	Gross Domestic Product
CBR	Central bank of Russia
CIA	Central Intelligence Agency
FDI	Foreign Direct Investment
UNCTAD	United Nations Conference on Trade and Development
USSR	Union of Soviet Socialist Republics
RSFSR	Russian Soviet Federal Socialist Republic
CIS	Commonwealth of Independent States
IMF	International Monetary Fund
BOFIT	The Bank of Finland Institute for Economies in Transition
FSU	Former Soviet Union
OECD	Organisation of Economic Cooperation and Development
OPEC	Organisation of the Petroleum Exporting Countries
RCA	Revealed Comparative Advantage
RF	Russian Federation
SEZ	Single Economic Zone
VAT	Value Added Tax
RAO UES	Russian Joint-Stock Company Unified Energy System of Russia
EU	European Union
OGK	Wholesale Electricity Company
FGC	Federal Grid Company
IDC	Interregional Distribution Grid Company
FIG	Financial-Industrial Group
TNK-BP	Tyumen Oil Company – British Petroleum
FSB	Federal Security Service
IT	Informational Technology
UK	United Kingdom
USA	United States of America
SELA	Latin American Economic System
UN	United Nations
RSPP	Russian Union of Industry and Entrepreneurs
MBK	Michail Borisovitch Khodorkovskiy
EBRD	European Bank for Reconstruction and Development
R&D	Research and Development
SME	Small and Middle Enterprises

Introduction

Foreign economic relations of all countries in the world play an important role in world economic development – they can produce positive circumstances for every nation. Russia is not an exception. Russian foreign trade has a thousand-year old history. The beginnings of Russian foreign trade involved famous trading practices "from the Varangian to the Greek". Throughout of all Russian history foreign trade its regulation was of paramount importance to the state: from the collection of duties in the times of first Russian principalities up to the period when the Duma decided upon the questions of foreign relations including foreign trade.

Trade policy at that time included custom duties: for example, the Customs Charter of 1653 replaced various customs charges, with one uniform rate of 5%. The 1755 Customs Charter abolished some inter-regional trading barriers so that Russian foreign trade could further flourish. Russian foreign trade witnessed softening and toughening changes according to the state's interests and needs. In 1891, a principle of the escalation of duties (depending on the degree of goods processing) was introduced. Thus the foreign trade of Russia always served the purposes of national interests (Vneshnaja Torgovlja Rossii… Undated).

The decisive influence on regulation of foreign trade activities in Russia was shaped by the reforms in the 1860s. During the course of those years, tariff measures were used to protect home producers and to promote the export of capital-intensive goods with the aim to develop and support the home machine-building and defensive industries.

In the first decade of the twentieth century, Russia was the first exporter of grain (more than 30% of world exports). The country had a surplus trading balance and its share in world trade was equal to 3,6%. Russia exported wood, flax, sugar, oil, furs, and manganese ore among other resources. It is interesting to notice that the main trading partner of Russia was Germany (38% of trade turnover in the year 1913) though Russia had trading contacts with 31 countries around the globe (Vneshnaja Torgovlja Rossii… Undated).

A key role in assistance to foreign trade development and its regulation in view of the state's objectives was played by state departmental structures. In the sixteenth century, the Ambassadorial Order for overseas traders was created and a century later the need "to unite all the tradespeople in one decent Order to let trade multiply without difficulty and red tape, to replenish the great sovereign's treasury", was fully recognized. This helped duties and tariffs flow into the state treasury in considerable quantities. Since the time of Peter the Great, a new stage in development of foreign trade was reached: Peter made a decree to establish the new Board of Trading and since 1720, Russia had its own Commercial Board which in the beginning of the twentieth century was transformed into the Ministry of Industry and Trade.

In the first decade of the twentieth century, Russia fully integrated into the world capitalist economy but its exports were mainly grain and other agricultural goods while imports consisted of industrial goods. The outbreak of the First World War meant Russia's loss of its main trading partner, Germany. During the Soviet epoch, foreign trade was strictly monopolised: only the Ministry of Foreign Trade and later the Ministry of Foreign Economic Relations had the right to carry out trade operations, aspiring to achieve the best results for the sake of the country's welfare and prosperity in the given trade conditions. The refusal of the young Soviet republic to pay Russia's foreign debts and the chaos of the civil war in the country kept foreign trade volumes minimal. With the creation of the People's Commissariat of Foreign Trade these activities were nevertheless considered to be a separate branch in the country's economic complex. This Ministry (de facto) collected all the currency from the trade and redistributed it according to the state's plans. Continuity and change of the country's leaders and the world situation now brought about new various trade agreements and treaties including their dissolution. At the middle of the eighties, the country's political leaders started complex reforms in the field of foreign trade activities. They were initiated in the face of Russia's partially opened borders customs, a critical exhaustion of currency reserves of the Central Bank, the actual disorganization of the state bank system, the sharply increased foreign debt and the drastic recession of industrial production in the country. Gorbachev granted direct trading rights to a few Russian enterprises (Burmistrov, Dvortsov 2001:15-17). It was a blessed hour for future exporters who exploited domestic and foreign price discrepancies, allowing them to accumulate vast private fortunes.

In the late eighties, Russia tried to pursue the policy of partial self-efficiency to lower its hard-currency debt while increasing oil and gas exports. As a result of political and economic changes in the country there were real changes that could be described as a transition from central planning to a market system and the liberalization of conditions for foreign trade activities (Burmistrov, Dvortsov 2001:19). At the present time a new mechanism of foreign trade regulation is being created. Its effectiveness and stability will depend on its adequacy to the conditions of the current transition period, its ability to maintain progressive changes in the structure of production and consumption of the Russian society and the responsiveness to a varying situation in the world and internal markets (Berglöf, Kunov 2003:140).

Russia has been seeking improvement in participation in international markets. In 1987, it asked for an observer status in GATT and the following year signed a preliminary agreement with the EEC. Since 1997, it has been taking part as observer in G-7 meetings, and became a full member in 1998. The country's present economic policies aim at establishing a free-trade zone throughout the CIS. Russia also aspires to join the WTO but before this, much work and many changes should be implemented (Commanding Heights 2004).

As seen from the aforesaid, foreign trade is a part of economic relations. It raises the standard of living, alleviates many ills of society, increases people's free time and influences the country's role in global economical and political life. Moreover, it has spill-over effects as well: pursuing certain goals of a welfare state in which policy-makers try to find a compromise between four main macroeconomic goals: stable price levels, high employment rates, sustainable and adequate growth rates and foreign trade balance (Majer 2001:38-39).

Processes developing in the world economy between the end of the 20th and beginning of the 21st century (in the real sector, communications, trade, flow of direct or portfolio investments as well as in the world financial system) determine the transformation of the world economic system into an integrated organism: the world economy with a capacity for self-development, self-reproduction and sustainability. A common objective of the world economy as a system is a consistent long-term development aimed at satisfying human needs implemented on the level of each nation-state. In these changing conditions and facing huge challenges Russia presents an interesting example to explore. A scope of issues concerning the participation of the country in the international division of labour and resources together with the unsatisfactory description of the state policies in foreign trade proves to be a challenging task. This Bachelor thesis is about the Russian state policies on current foreign trade.

Usually, the impact made by the state on other countries is assessed by the extent of expansion of its foreign economic policy, which finds its expression in terms of impact on size, dynamic behaviour, industry-based structure of foreign investments; influence on size and structure of import of commodities, services or intellectual property rights; attempts or effective actions in terms of regulation of export flows; involvement in forming volumes of external debts of countries recipient of foreign investments and impact on national currency exchange rates (Perskaya Undated:6-7).

The purpose of this Bachelor thesis is to explore and describe the main implications and possible perspectives of Russian state policies in the current foreign trade, not only against the background of the current economic situation in the country but also including political processes in the world to the extent that is necessary to understand their implications. Foreign trade is understood to be a part of trading activities of a country. The current definition of state policies in foreign trade in this thesis reads as follows: a plan or course of authorities' actions (in interaction with other actors: political parties, business, public, etc.) intended to influence and determine development of the country's foreign trade by way of influencing decisions and actions of economic agents (domestic and foreign) of foreign trade. It should be noted that only one aspect of the Russian foreign trade could be laid down in detail, namely Russian foreign trade of goods and services as it is beyond the scope of this thesis to cover these issues. The aspects of investments or effects of monetary or fiscal policies in the country are only sketched briefly so that the logic of the discussion would be clear.

This study traces the development of Russian foreign trade up to the present day in the context of the country's general goals and tactics of development laid down in the first part of this thesis. With the help of the analysis in the first section, the basics for the stable development in the country could be deduced and highlighted at the beginning of the second section. Following the leading role of foreign economic relations for Russia, the role of the state today in shaping its foreign trade activities in the form of policies is described. Implementation of national policy in the areas of the country's economic openness and international competitiveness is based on statutory measures related to state regulation of foreign trade activities, including support of Russian producers and exporters, thus creating conditions for non-discriminatory access of commodities to external markets, protection of home market and domestic commodity producers and applying rules generally accepted in world practice.

Thriving international commerce has long served Russian interests by promoting the country's prosperity, job-creation and peaceful foreign relations. This is mostly true in respect to the Russian energy sector as it plays the leading role in expanding Russian exports. Though, a narrative sketch at the end of the second part of three main branches of the Russian energy sector: oil, gas and electricity, depicts certain peculiarities and problems connected with state policies. The narration allows us to deduce the main risks and tendencies that are intrinsic to current state policies in respect to the country's foreign trade. To illustrate some of them more clearly, three land-specific examples are designated and analyzed through a diachronic as well as synchronic comparison. This allows a broad view on multiple possible developments of state policies in numerous contexts and with numerous outcomes. In short, some recommendations for state policies development and implementations are collected at the final stage of the work. Generally, the aim of this thesis is not to necessarily provide exhaustive explanations about the effects of Russian state policies in current foreign trade, but rather it is an exploratory study that seeks to discover general tendencies and their intrinsic risks.

This work draws on primary and secondary literature in English, Russian, German and French on the subject of state policies in trade is growing constantly and has made major advances in the last few years. This research is based primarily on a critical examination of existing accounts in order to be able to cope with the abundance of economic data on the one hand and the complex economic problems and political sinuosity on the other. This Bachelor thesis aims to contribute to the discussion of Russian state policies in its current foreign trade, their implications on the country's development, their chances and hazards, the advantages and disadvantages both obvious and hidden.

1. Current Economic Situation in the Russian Federation

1.1 Strategies and Tactics of the Country’s Development

One of the most important functions of state leaders is to establish strategic goals for the country’s future development. In the Soviet times in Russia, such goals were set in the five-year plans that were abolished in the 1980’s. Thereafter, some efforts to find sober and reasonable substitutions or solutions were crowned with the president’s „Conception of Transition to the Sustainable Development of the Russian Federation” in 1996. The latter was elaborated in the government’s “Program on Structural Re-Structurization and Economic Growth in 1997-2000” along with “Strategy of State Development to the Year 2010” (Ishaev, Belousov *et al.* 2000). The Strategy elaboration can be defined as a basis of purposive guidelines for the current and medium-termed macroeconomic program in the country. The Strategy defines the main objectives of the country’s development up to the year 2010. “The aim [...] is to qualitatively raise living standards on the basis of self-fulfilment of every citizen, to preserve Russia’s independence and cultural values, to restore the country’s economic and political role in the world community”. ” [...] Advancement to these aims should be monitored by society proceeding from such quantitative and qualitative criteria as a rapid growth of the population's living standards (more than doubling of average per capita incomes, radical reduction of the level of poverty) and increase in the percentage of people who have assumed responsibility for their own well-being; appearance of a cult of the education, self-value and independence of the individual (at least a doubling of national spending on education); growth of the Russian economy's competitiveness (increase in the share of the non-raw materials export); progressive changes in the structure of the economy in line with world trends; maintenance of a socially acceptable level and structure of employment; unconditional maintenance of the state's solvency; emergence and development of social institutes (including self - regulating organizations); enhancement of the effectiveness of local governments; strengthening of the independence of the judiciary and unconditional observance of laws; withdrawal of the authorities (including regional ones) from economic activities (Russia’s Development Strategy… 2000).

The Strategy takes aim at growing economically faster than the world on the basis of capital accumulation (a growth of the GDP at an average annual rate of at least 5-6% over the ten-year period), greater efficiency of labour resources, and greater efficiency of their utilization and the awakening of business enterprise.

These set aims stir up hopes that changing prices will substantially transform the nominal structure of the GDP and the dynamics of private consumption may start exceeding the growth of investments, net exports will drop and it is possible that it will become negative if Russia becomes a reliable recipient of capital. It is important that the strengthening of the rouble in its real expression and its market exchange rate will approach parity with purchasing power. Thus, “the strategy's basic elements are an economic policy directed at ensuring equal conditions of competition, protecting the rights of ownership, removing administrative barriers to entrepreneurship, making the economy more open and carrying out a tax reform; as well as the creation of an effective state performing the function of a guarantor of external and internal security and also of social, political and economic stability. A new social contract between the more active sections of Russian society and the reformed government should ensure broad support for and the implementation of the suggested strategy” (Russia’s Development Strategy 2000; Pisarev 1999).

The very next year, almost the same think-tank published a more radical version of the Strategy for the general public discussion where the necessity of long-term goals and social consolidation as the basic elements for future development was recognized. “The measures proposed [...] can serve as a useful supplement to the program developed and implemented by the government” (Strategy for the Development… 2000). This concept of the Russian development was based on the idea that this can be achieved only on condition of the re-creation of a growth economy. It admitted that the primary sector, namely the extractive industry and especially the export-oriented sectors, are an important material resource for economic growth, and in order for the primary sector to provide a material basis for sustainable economic growth in Russia and to maintain a net export surplus in the medium term, it is also necessary to develop complex raw-materials processing in the framework of the extractive industries, and to increase the share of the processed goods in export. According to this version, the country’s economy possesses the main preconditions for a continued economic upswing, namely available production capacities, “soft” resource constraints and “free” financial resources. The main task of the economic policy is seen by the authors in bringing these growth factors together.

The authors pointed out that the greater part of the potential supplemental demand was based on the revenues of the export-oriented sector, which are enhanced by devaluation. They assert with reason that in real terms this sector is not prepared to initiate demand, neither through the compensation of its operatives' labour, nor through stepped up investments, and especially not on the domestic market, on a scale corresponding to the growth of its revenues. Therefore, the additional revenues of the export-oriented sector, received as a result of the devaluation of the rouble (as well as the improvement of the price conjuncture on world markets), effectively become a resource only for capital flight. As a result, the set strategic prospects will largely be shaped by the question whether or not the supplemental revenues will be directed into the domestic market, and above all into investment (Strategy for the Development 2000).

As the title of the Strategy suggests, one cannot ignore the role of the state in the implementation of these changes. The Supplement to the Strategy speaks of a strong state, “which can manage its property, which fulfils its obligations, and which can harshly punish both those operators in the markets who violate the rules of the game, and its own apparatus, which distorts those rules by means of bureaucratic interference.” The authors are taking into account the period of transition and peculiarities of the Russian economy and believe that the state ought to expand substantially the sphere of its responsibility in the economy, in such spheres as its military-industrial, agro-industrial complexes and infrastructure where its responsibility should be exclusive (Strategy for the Development 2000).

It seems quite clear to the authors that huge amounts of the available financial flows into the economy may increase the rates of inflation, but the authors consider it the natural task of the government to channel financial flows in such a way as to achieve the maximum effect for economic growth, while keeping inflationary processes under control. They imply ensuring the flow of financial resources into the real sector of the economy. The top priority of the state in this situation is to eliminate systemic risks and ensure the continuous functioning of the entire financial sphere. In this respect creation of new institutions and instruments to raise and structure the quality of real-sector obligations and to simultaneously organize the proper registration and structuring of the relevant debt obligations and ensure that their quality is guaranteed appears to be on the agenda.

Unsatisfactory volumes of investment in-flux into the real sector of the economy and the drastic wear-and-tear of fixed capital became evident long ago (Broadman 1999). Considering the modern level of technology development in the world it is unquestionable that the substantial part of new fixed capital will consist of imported equipment, but the state's current foreign trade and customs policies hinder the import of production capital, providing incentives rather for the export of raw materials and import of finished consumer goods. Thus, the list of state priorities includes the task of changing the tax and customs ideology, orienting now toward freeing imported equipment. On the whole, customs policy should be oriented toward a shift of duties from imported production equipment, onto exported raw materials and imported consumer goods. This ought to provide for a growth in domestic demand for domestically produced consumer goods, and facilitate an expansion of the supply of such products on the domestic market. “The growth of the Russian Federation's foreign trade turnover could be substantially higher, if a mechanism were created for utilizing excess and effectively frozen currency reserves. The persistent growth of foreign currency reserves in the hands of the monetary authorities, brought about by the superfluous positive trade balance, which government draft plans intend to maintain, creates conditions for a significant jump in manufacturing exports, and a substantial renovation of the technological base of the economy, through expanded import of technology. This requires activating the "surplus" foreign currency reserves through the banking system of the Russian Federation, first by allowing the Central Bank and the Ministry of Finance to deposit a certain portion of foreign currency reserves in essentially state commercial banks [...]. At the same time, these banks would be extending credit to export-import operations [...]. These actions, according to the most conservative estimates, could increase exports by $4-6 bln, and imports by $8-12 bln [per annum], while the growth of imports would be directed, in its overwhelming majority, into investment in fixed capital. This, in turn, would mean an approximate 20% increase in investment activity in the country as a whole [...]” (Strategy for the Development 2000). As to the revenue allocation it would be proper to use it for an expansion of state demand and support for the development of credit for production.

Events of the recent period have shown that Russia's extremely high dependence on the situation in the world energy markets. Moreover, a long-term sustained economic growth is impossible without the stable functioning and development of such life-support systems as the electric power supply, the natural gas supply, and so forth. Under current conditions, the acute problems of supplies to Northern regions, supplies of fuel and lubricants for planting and harvesting in agriculture and cut-offs of energy in the recent years made the energy security of the country extremely important. Based on these considerations, some steps to reform certain braches in the Russian energy sector have been taken recently.

Well thought-out measures to promote sustained economic growth in the near term are a necessary precondition for achieving the nation's strategic development goals. Economists and analytics describe the ongoing discussions as a quarrel between the market-oriented and the state-oriented economists. Some analytics are divided over the ambitious plans for national development outlined in President Vladimir Putin's state of the federation speech in 2004, but they agree that realizing them will take some doing.

Possible scenarios for the Russian economy up to the year 2008 stay at the core of the present macroeconomic discussion as they are dedicated to be an ongoing issue for the next three budgets (2006, 2007 and 2008). The turning point is the threshold level of oil price and the volume of revenues that could flow into the stabilization fund without prejudice to the country's economy. Most of the government is under the pressure of the president's goal of doubling the GDP. Some economists express fears that the state's massive intervention into the economy (in the face of the coming elections in 2008 and the goals set by the president the high-blown Stabilization Fund implies ambitious investments into some infrastructure projects or into some "winner" sectors) could lead to negative results or at least to certain losses in efficiency. Others critique the government's plans by tabbing them as „purely political documents" and point out that though threshold oil prices for the Fund are exogenous, they are arbitrarily chosen and some possible aims for investment are not chosen at all (Pravitelstvo Utverdilo Stsenarij… 2005).

Currently, the prospects of doubling the GDP stay relatively bleak. The interdependence and interplay of thousands of factors, internal and external, can only help answer the question in the future. But the necessary preconditions for this are being created.

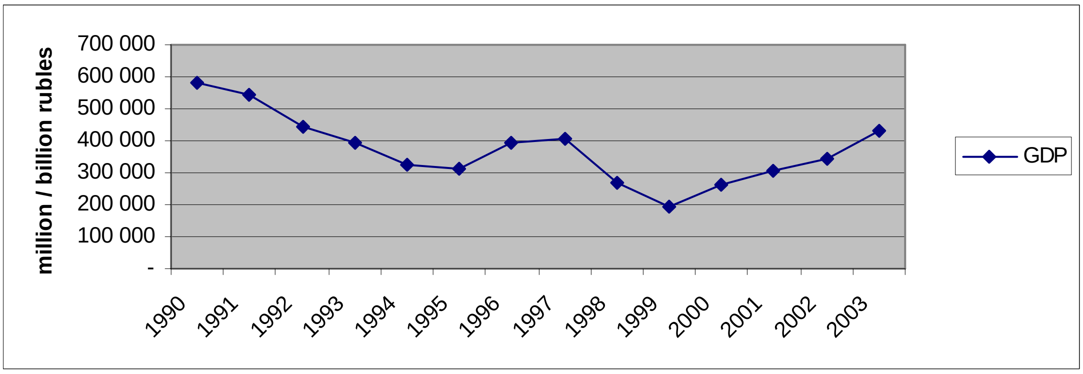
To understand the economic situation in the country and application of state policies and their effect on the economic growth of Russia, one must examine the breakdown of processes that influence the Russian economy.

1.2 An Analysis of Basic Economic Indices - the Face of the Coin

While analyzing the main macroeconomic indicators of a certain country, there are always a number of obstacles. It is first two are usually reliable statistical data and the choice of the most sources. A possible result of this difficult choice could be "reviewing the past"; for example, the presentation of Russian economic history since 1999 by the Ministry of Finance in 2004. The economic data was divided into two sets which conveyed the main idea to the public; namely, that the Russian economy experienced a deep crisis up to 1999, but with the change of the president it "rejoiced" implacably (Pravitelstvo Peresmotrelo Proshloje… 2004). Hence one must additionally consider the country's peculiarities, its political-economic and social state. In the case of Russia, it is a process of transition and all the economic consequences that affected or still affects the country's economic growth at the moment: e.g. the rouble crisis of 1998, the bank crisis of 2004 Q3, etc.

To re-start its economic growth Russia needed to overcome its depression and stagnation in the 1990's which accompanied transition from a centrally planned economy to a system similar to a market economy. Putting aside the grounds for the crisis (discussing it could probably be a thesis in itself) one should note that the period of transition up to the present moment can be roughly broken up into four sub-periods: first, the years of 1991-1995: a steep fall in both the GDP and industrial production by about 50%; the second period of 1996-1997: stagnation and slow growth from the low level reached in1996; the third period of 1998-1999: new recession in output followed by a recovery to the 1997 levels in output (Menshikov 1999) and the final period of a renewed growth up to the present day. It should be noted that the country has not reached the GDP level of 1990 (Graph 1.2.1). Thus, Russia still lags behind in the international GDP comparisons (Rossija Otstajet v Mezhdunarodnih Sopostavlenijah 2005; Rezultati Mezhdunarodnih Sopostavlenij VVP… 2005).

Graph 1.2.1 Dynamics of GDP in Russia



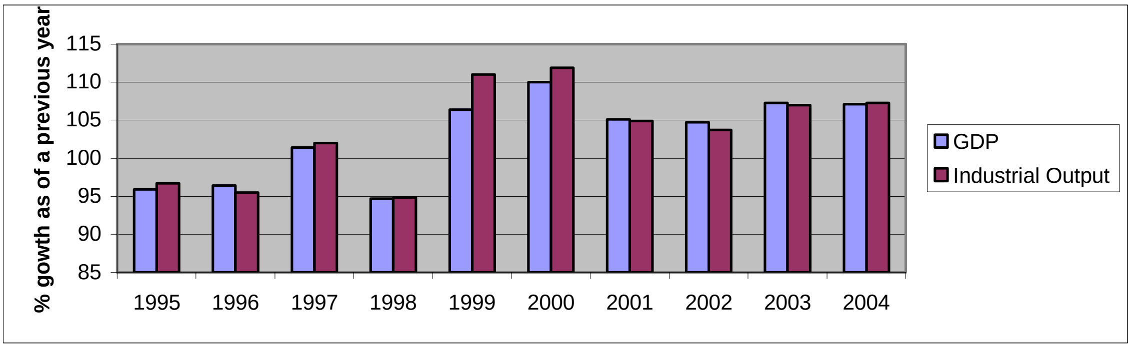
Source: CBR; own presentation.

Overcoming a long-time period of depression, stagnation and recurrent crises is much more difficult than resuming growth after a relatively short-lived downturn. It involves escaping from an extremely unfavourable behavioural pattern that is implanted in the economy and has created a "no-growth trap". But to understand fully the whole range of problems connected with countries in "transition", one should remember Lech Walensa's metaphor of "transmogrifying the fish soup into the aquarium" (Gaidar, Sinelnikov-Mouriylev *et al.* 2005a).

There are three main viewpoints in discussions about the present Russian economic growth. There is an opinion that the reason for the growth is a change of President and that "the menu of options available to Russia [...] is to a large extent determined by the choices made by its own political leaders" (Gavrilenkov, Schrettl 2002:2). Others believe that the main reason is a high level of oil prices and the rouble devaluation in 1998. Still, a minority of voices support the idea of a combination of many different factors, the aforesaid among them, but they are not exhaustive enough to claim the survey complete. This minority considers the whole set of reforms implemented in the country to be one of the major factors of the present economic success. They express the opinion that Russia is still in the phase of restorative growth (just like at the beginning of the century: certain parallels can be surely drawn) and there is a real danger of these outstanding indicators to give wrong goals for the economy in the long run. The exhaustion of reserves in the economy inevitably leads to the slowdown in the growth rates (Groman 1927:15-16; Gaidar 2005b).

Nevertheless, Russia ended its sixth year of growth in 2004, having annually 6,7% growth on the average since the financial crisis of 1998. Its main macroeconomic indicators are obviously good, even compared with the developed countries: growth in the output of goods and services, investment and household real money income increased at a rapid rate (Vazhnejshije Economicheskije Pokazateli 2004) (Graph 1.2.2). After the publication of the results by OECD, the Russian State Federal Service of Statistics presented the final results of the regular GDP comparison between 42 countries of the world in 2002. The Russian GDP per capita (PPP) allowed the country to reach 38th place (Resultati Mezhdunarodnih Sopostavlenij 2005).

Graph 1.2.2 Dynamics of GDP and Industrial Output (as % of a previous year)

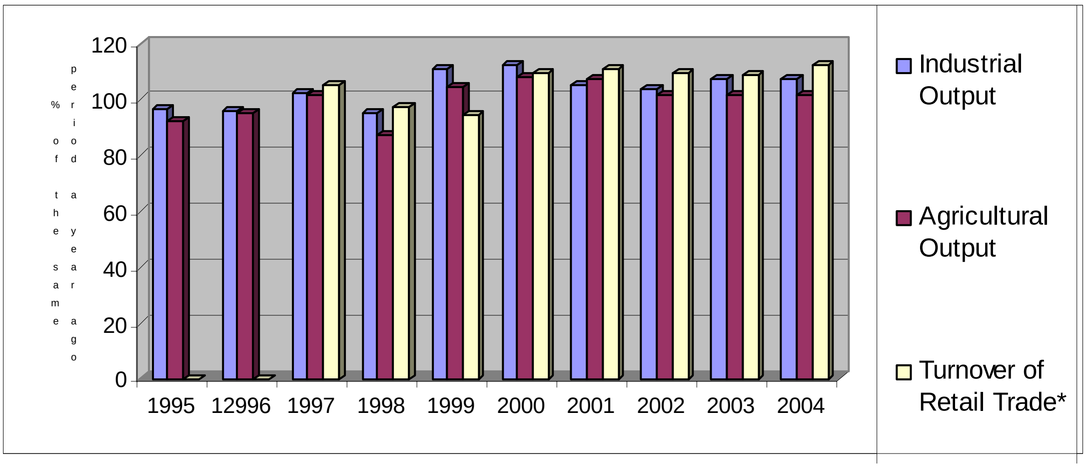


Source: CBR; own presentation.

There was a significant expansion in turnover of retail trade: it increases 3,7 percentage points in 2004 in comparison with 2003. The Russian agricultural output maintained a level of about 101,5% growth in the course of the last three years.

Measured without taking into account seasonal and random factors, the average rate of industrial output growth increased slightly in 2004 as compared with 2003 (Graph 1.2.3).

Graph 1.2.3 Industrial Output, Agricultural Output and Turnover of Retail Trade Turnover Dynamics



* Data for 1995-1996 not available

Source: CBR; own presentation.

The present growth is represented by various inputs of different industries as is seen from Graph 1.2.4.

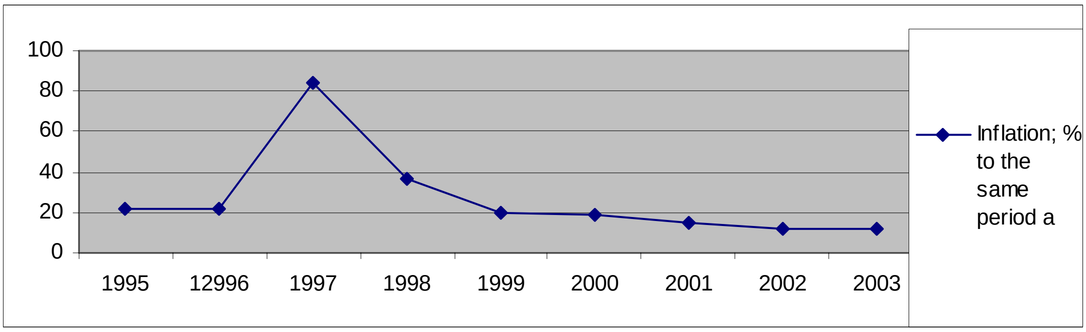
Graph 1.2.4 Production Growth in Individual Industries

Source: Social and Economic Situation… 2005.

The favourable macroeconomic situation and monetary policy of the Central Bank conditioned this economic upswing, investment and consumer-driven demand have played a noticeably increasing role since 2000. Fixed capital investments have averaged gains greater than 10,7% over the last five years as well as 10,8% gains of real disposable personal incomes.

Regarding to inflation, according to the experts' estimations, it fluctuates about 13% on the average in the course of the three last years on the background of the rouble's nominal strengthening and further decrease of its monetary base. Although, inflation exceeded the target set for 2004 of 10% and reached the level of 11,7% (Social and Economic Situation… 2005) (Graph 1.2.5).

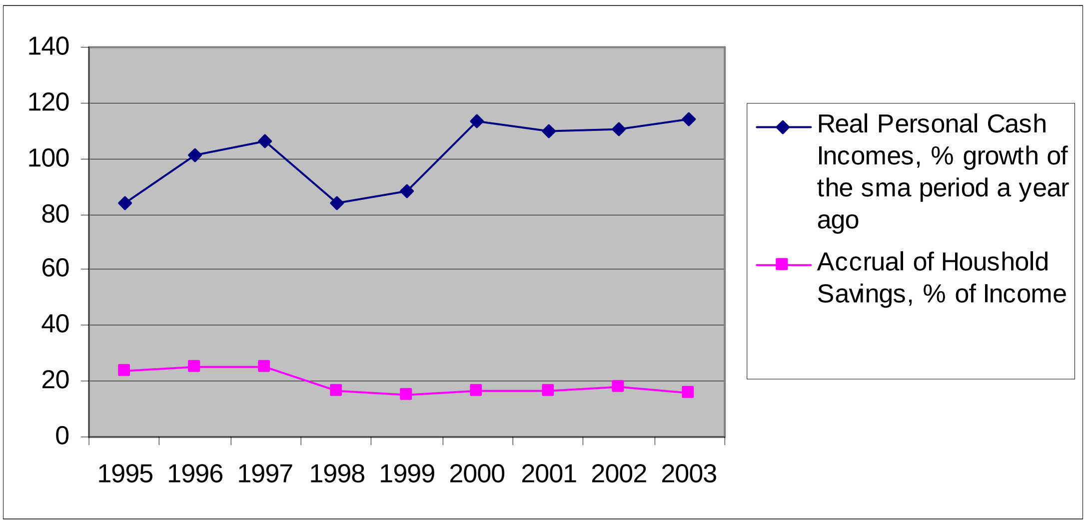
Graph 1.2.5 Inflation Dynamics



Source: CBR; own presentation.

In the market of consumer goods, the rapid growth of population demand exceeded all the previous achievements of the period (Graph 1.2.6). Consumer activities of the population have led to further growth in the share of consumer spending.

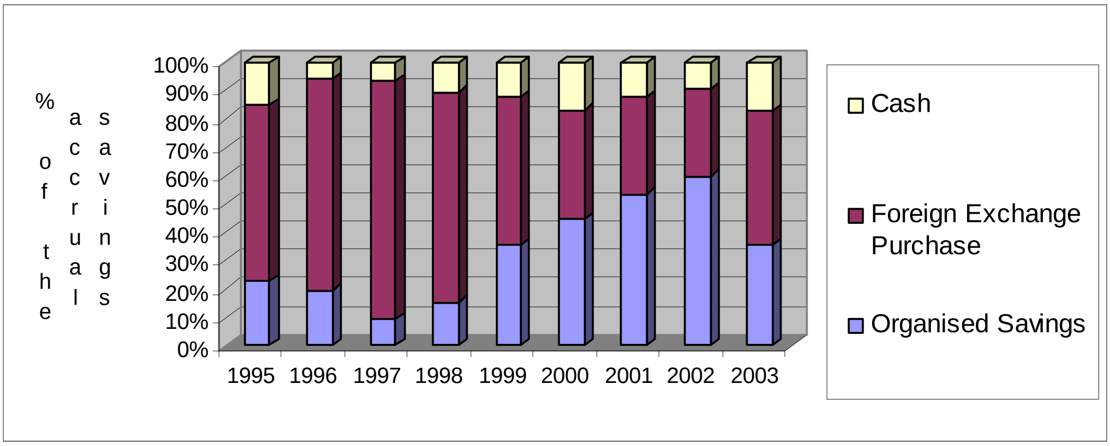
Graph 1.2.6 Real Personal Cash Incomes and Savings Dynamics



Source: CBR; own presentation.

In addition, the bank crisis in the autumn of 2004 has lowered the propensity of the population to the savings, thus "having warmed up" consumer demand (Graph 1.2.7). Advancements in the improvement of consumer crediting schemes have supported the trend of the consumer boom, thus lowering the propensity to save.

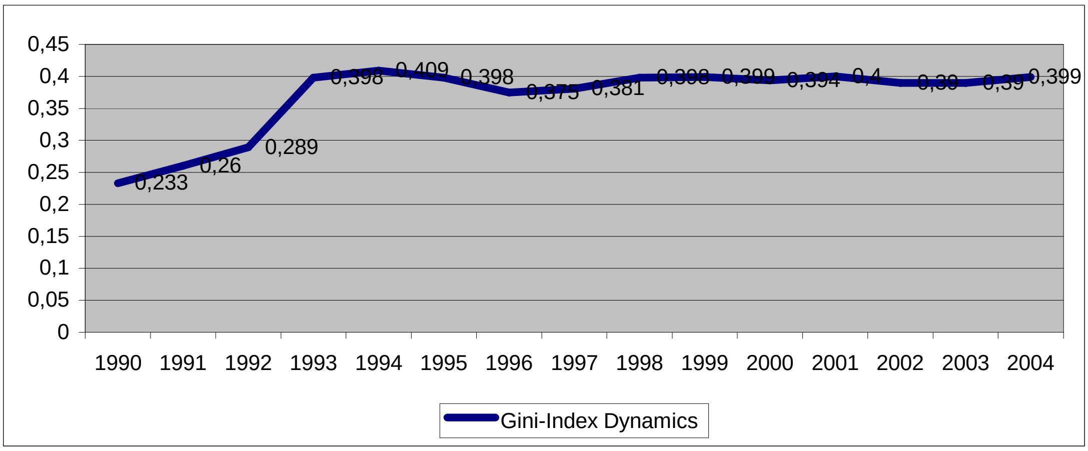
Graph 1.2.7 Types of Household Savings



Source: CBR; own presentation.

On the other hand, one must not forget that according to the estimations of various international organizations the amount of people living in poverty was about 25% in 2003 (CIA World Factbook 2005). Krassilchtchikov, the researcher at the Centre for Development and Modernization Studies, Institute of World Economy and International Relations in Moscow asserts that if "one looks at poverty based on the share of food in total household expenditures, whereby people who spend half or more of their incomes on food are considered to be below the poverty line, in 2000 almost 50% of Russia's population would have been below the poverty line" (Krassilchtchikov 2003). Accordingly the distribution of family income in terms of Gini-Index is still drastic – 39,9 in 2001- 2004 (Distribution of Family Income 2005). It is striking that during the period from 1992 to 1994, namely in the course of two years Gini coefficient increased practically 1,5 times: from 0,29 to 0,41 in 2001 and 39,9 in January 2001 (Kislitsyna 2003:38) (Graph 1.2.8). In 2001 Russia ranked 51st according to its result of the survey among 113 countries. Compared with Mozambique and Morocco, Russia has greater inequality of family income (Distribution of Family Income 2005).

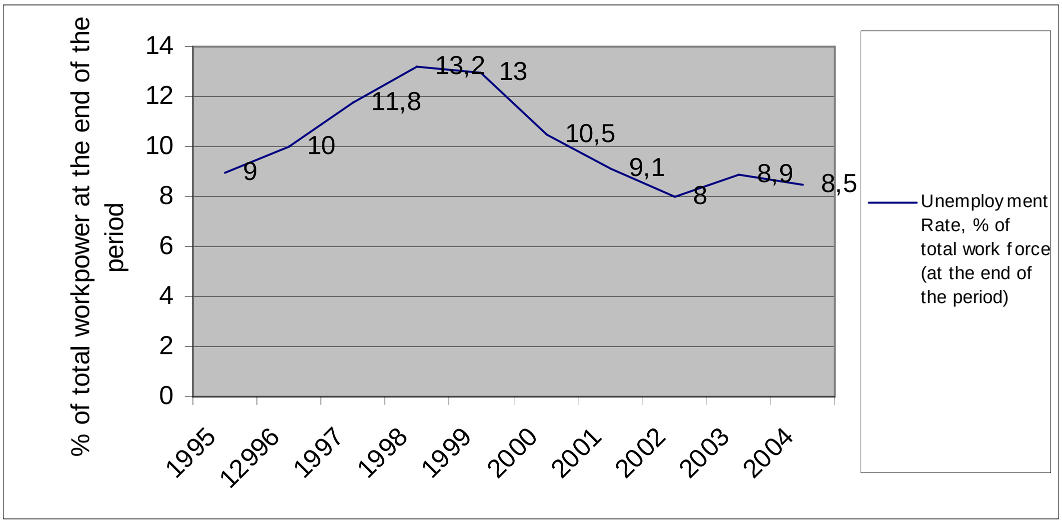
Graph 1.2.8 Gini Index Dynamics in the Russian Federation



Source: Kislitsyna 2003:38; own presentation.

General possible causes of such disproportions are inflation and unemployment (Hishow 2001: 281-282). The Central Bank estimated the unemployment in 2004 in the country with 8,5% plus additional considerable underemployment. This indicator has fluctuated around the figure of 8,45% in the course of the last 3 years (Graph 1.2.9).

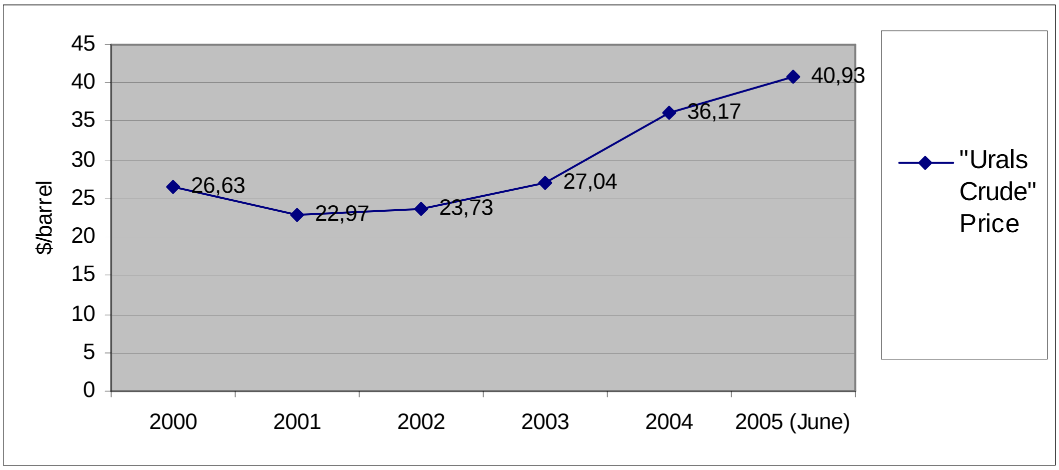
Graph 1.2.9 Unemployment Rate Dynamics



Source: CBR; own presentation.

On the other hand, the favourable external economic situation stimulated some Russian export-stimulated industries. Year by year the situation on the commodity markets gets better for the Russian exporters as the prices for major export Russian commodities rise. For example, the price for "Urals" oil climbs up uncompromisingly according to the world trend and it seems that a new record will be achieved this year (Graph 1.2.10).

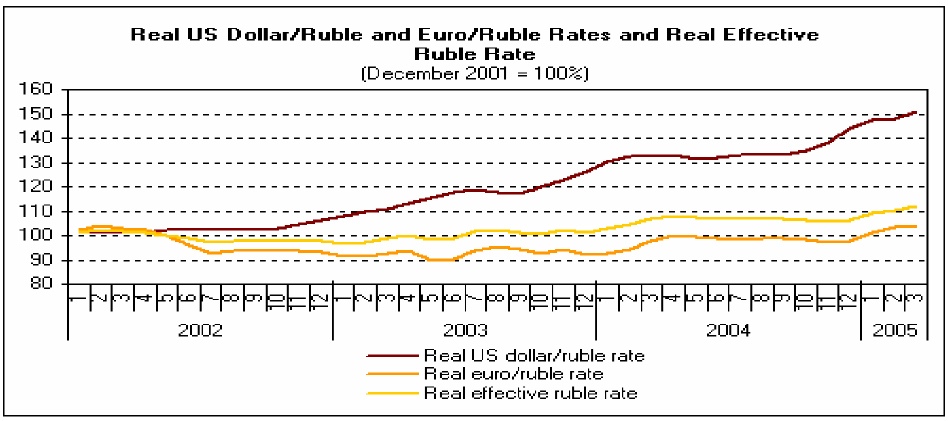
Graph 1.2.10 "Urals Crude" Oil - World Market Price Dynamics



Source: Vneshneekonomitcheskij Kompleks Rossii 2004:153; own presentation.

By the end of 2004, the economy has actually exhausted the price stock created by the rouble devaluation in 1998. The price level of December 1997 (in dollar expression) has been reached, but there are still opportunities for some further rouble strengthening: first of all, due to foreign trade conditions. In real terms, the rouble gains gradually both against the dollar and against the euro month after month. As a result, the real effective rouble rate gains against the currencies of Russia's major trading partners increases too (Graph 1.2.11).

Graph 1.2.11 US Dollar / Rouble and Euro / Rouble Exchange Rates and Real Effective Rouble Rate



Source: Social and Economic Situation… 2005.

The budgetary policy in 2004 remained extremely rigid and focused on the accumulation of reserves. The macro accounts are all in the black, with the federal budget running a surplus in 2004 for the 5th year in a row and another surplus is forecast for fiscal 2005. The current favourable external conjuncture together with some improvements in taxation policy, helped increase the inflow of the export rent and have secured huge volumes of additional incomes.

In 2004 the Russian currency reserves increased by 50% and the country ranks now the 9th in the list of countries with the largest reserves of currency (without taking account of gold reserves). It explains the creation of the Stabilization Fund. This rapid accumulation of means has surpassed all expectations. The target volume that had been planned to be reached in the course of five years was surpassed in the course of this year. It made the question of spending the "superfluous" money actual, though the basic conception of spending is still not developed (Zakljutchenije Cshetnoj Palati… 2004). In " The Basic Directions of a Monetary and Credit Policy in 2005 " the Bank of Russia has specified that it will be guided by the strengthening of a real effective rouble exchange rate no more than on 8% so that it would not damage the country's exports activities. Additionally, it used this money to repay a part of the Russian external debt (Russia Has World's 9th Largest Currency Reserves 2004).

Thus, a developing macroeconomic situation remains favourable enough for the Russian economy; thereby, some risks of uncertainty in the model of economic policy remain significant. There is an opinion that the influence of exports as "the locomotive" of economy would be considerably limited in future. Instead, an increase of competitiveness of Russian manufacturers and the growth of internal and foreign investments would become the motive power of economic growth. But these factors in union with the current favourable external economic conditions could not guarantee the preservation of the current rates of growth: in the most probable scenario (in which the price for the Russian oil is $31/barrel), the rate of growth of gross national product in 2005 is estimated at be 5,8-6,0%, while the bottom level of rate of growth of gross national product in the pessimistic scenario with the price of $22/barrel is 3,7% or 4,3% (at $28/barrel) (Razvitije Ekonomiki Rossii 2005). But the year of 2004 saw growth of 7,1%. This was possible due to the further increase of the oil prices up to 40 $/barrel on the background of the relative invariance in export volumes. The fact is explained by transportation restrictions in escalating physical volumes of export.

The place of Russia in the world market of capital is defined by its social and economic position and its national investment climate. Following substantial increases during 1995-1997 (mostly speculative capital), the FDI flows to the Russian Federation levelled off. Given the size of the Russian economy, and compared with the volume of flows to other countries in the Central and Eastern Europe such as Poland or the Czech Republic, this level is relatively low. On the other hand, the Russian Federation is by far the leading investor country in the CEE region, accounting on average for more than 75% of the regional annual outflows. The most part of the FDI (about 70%) is currently received from the developed countries, the greatest part from the USA and Cyprus in spite of the obvious decline in 2001-2002 (FDI in Brief… 2002:9).The Inward FDI Performance Index of the UNCTAD for the years 2000-2002 places Russia at 111th place (0,317) among 140 world economies, the Outward FDI Performance Index for the years 2001-2003 places it at the 38th place (0,484) (Inward FDI Performance Index 2004). Deep economic crisis and instability of the situation on internal financial and currency markets have generated unregistered massive outflows of capital from the country.

In the world capital market during the 90's, Russia was considered basically as an extremely unreliable partner, incapable to provide a comprehensible degree of protection for investors. Rating estimations have sharply worsened after the August, 1998 financial crisis. During the course of the last few years, the situation improved. Recently, Standard and Poor's Ratings Group increased Russia's sovereign debt rating to investment grade by upping its rating from BBB- to BB+ (Standard&Poor's Raises… 2004). It was a long-awaited move driven by Russia's oil-fueled budget surplus and soaring hard currency reserves. Still, legal (without mentioning illegal flight) capital flight from Russia quadrupled during last year (compared to the previous year) and equaled to $7,9 bln (Capital Flight from Russia Quadrupled… 2005). In 2003, Russia recorded legal capital flight of $1.9 bln. After showing net inflows in the second quarter of the year, capital flight leapt in the third quarter as the legal campaign against "Yukos" and its owners gathered pace. "Apparently, investors interpreted "Yukos"' events as a signal about the possible propagation of the prosecution scenario to other companies" (Goriaev, Sonin 2005:16)

From the sector point of view, the most favourable situation can be registered in respect to the tertiary sector, especially transport and telecommunications. By 2001, the tertiary sector received about 50% of the total FDI inflows. In the secondary sector the food industry is a prominent FDI recipient, but on the whole this sector saw a slight decrease. Finally, the primary sector reflects the erratic FDI flows in the petroleum sector. "Altogether transport, communications, mining and food account for about half of total FDI stock in the Russian Federation. The relative modest importance of the inward FDI in the Russian economy is reflected in the low level of its FDI flows as a percentage of gross fixed capital formation, which stands at 6% during 1996-2001, one of the lowest of the region (together with those of Bosnia Herzegovina or Slovenia for instance). Conversely, its prominence as an investor is reflected in its relatively high ratios of the FDI flows to gross fixed capital formation and the FDI stock to the GDP, clearly the highest ones of the region" (FDI in Brief 2002:4).

International ratings of competitiveness published by the authoritative foreign organizations annually reveal that Russia stands at the lowest positions in the world and its prospects are gloomy. For example, according to the World Competitiveness Scoreboard 2005 its rating was 54 out of 60 (The World Competitiveness Scoreboard 2005).

According to the Kurtzman Group, the Opacity Index of Russia (this Index presents the degree to which the country lacks clear, accurate, easily discernable and widely accepted practices governing the relationships among businesses, investors, and governments) is 46. Russia stands at the same level of opacity as Saudi Arabia – evidently, it is rather high. Evidently, the higher this Index, the higher the losses in per capita income, net foreign direct investment and inflation (Kurtzman, Yago *et al.* 2004:13). Corruption and lack of intransperency still present a significant problem for Russia, rendering a sharply negative influence on every aspect of life. Published in 2002 by Transparency International Global Corruption Report ranks Russia after Romania, Turkey and Sri Lanka, its Corruption Perceptions Index

2002 score being equal to 2,7 (Transparency International Corruption Perceptions Index 2002).

According to the analysis above, it is clear that it is a question of time and reasoning if Russian economy could take advantage of this respite and whether it will be able to compete on equal with import goods share of which has essentially grown in cumulative internal demand due to the gradual income growth of the population. The major problems of the real sector during the last years were the issues of low competitiveness of Russian industrial goods together with the process of strengthening the real rouble exchange rate and exhaustion of potentials in growth due to the "old" fixed capital and the flight of capital that could be invested in the country. Russia needs the knowledge of sustainable development in the situation of constantly changing post-industrial world, it should not get into wars, it should evade internal havoc, and should think of the long-term implications instead of characteristic of the country “stop-and-go” development. Russia must learn how to use not only the state intervention and regulation, but also initiative and private enterprise guidance. Of course, this is much more difficult than to spur up the tempo of economic growth as it needs constant, consistent work but this knowledge and such policies lead to a sustainable development.

1.3 Current Foreign Trade of the Russian Federation – the Flip Side of the Coin

Foreign trade traditionally plays an important and sometimes crucial role as it is evident in the current development of Russia. From the historical standpoint imports and exports can explain the role of the country in the world division of labour. Trade with other countries is based on natural comparative advantages. For Russia these advantages are manifested in its vast natural resources, its well qualified and rather inexpensive labour potential and many creative opportunities of its domestic science research and development (R&D). Nevertheless, these opportunities must be explored further and new advantages must be created if Russia wants to achieve the set goals.

Up to the end of the sixteenth century Russian exports were mainly agriculturally-oriented, though in the epoch of Peter the Great, deliveries of raw material and materials abroad grew in numbers. It was the time when manufacturing and industry in countries of Western Europe were emerging and the main exports were iron, sailing cloth, linen, and a number of other industrial semi-finished items. Such wares made up approximately 40% of Russian exports to Europe in the seventeenth century. On the brink of the Industrial Revolution when young industries were withdrawing capital and labour force from the agricultural sector of the economy the Russian exports became once again mainly agricultural. In the last decade of the nineteenth century the sales of the agrarian products abroad provided for about 80% of exports, a share of grain breads being about 40%. As a result, Russia became the granary of Europe and ranked the sixth or the seventh in the list of the largest world exporters (Vneshnaja Torgovlja Rossii… Undated).

With the development of mass production in Europe there was an acute need for new sources of energy and the offer was once again made by Russia: at the turn of the twentieth century, Russia ensured half of the world's oil extraction, not without the participation of foreign capital. It must be noted that oil was the most effective source of energy at that time. The more recent history witnessed Russian specialization on energy and primary resources in the world trade. This became evident when the world experienced the two oil shocks in which Russia helped to overcome the crises. 8% of oil and natural gas in the Russian exports in 1970 became about 31% by 1980 and has reached its peak - more than 37% in 1985 (Vneshnaja Torgovlja Rossii Undated).

The most urgent problem of the current Russian trade has been and still is the fact that neither the USSR nor the Russian Federation had any luck in converting its energy and raw materials-based exports specialization into one with improved and more refined processing of a high quality and the modernization of adjacent and serving branches. The mass exports of grain and raw materials did not lead to the technological re-equipment of agrarian / mining sectors thus undermining their manufacturing capacities. The same is valid for modern energy and the primary branches of industry in the Russian Federation.

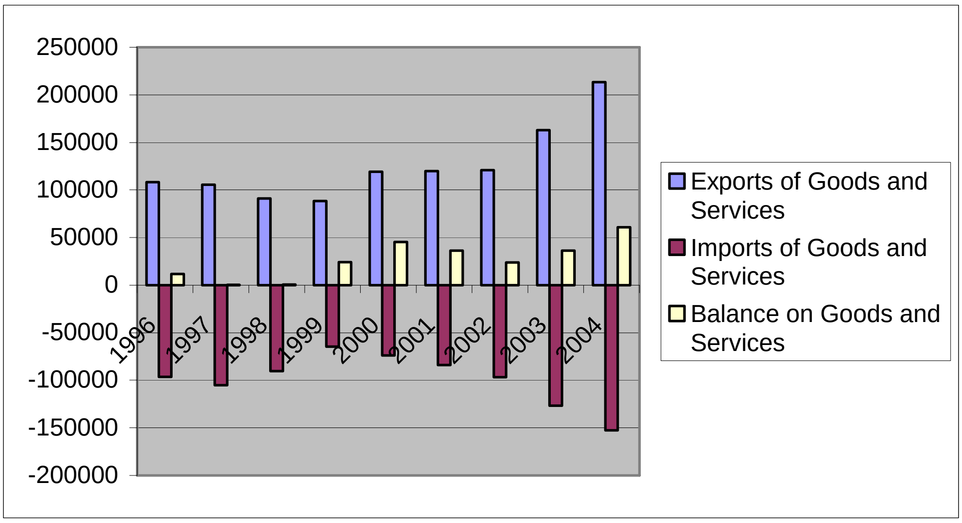
As an unavoidable consequence of the deep economic recession during the 1990's in the USSR, the decline in productivity and quality of production and the growth of internal costs led to the significant deterioration in quantitative and qualitative indicators of the country's participation in the international labour division. During 1984-1991, exports from the territory of the former USSR diminished by more than one-third. A further dramatic slide of exports took place in 1991; during that year exports dropped by 24%. From that background a gradual decentralization of decision making took place. The main features of the centrally planned economy are: the absolute dominance of state ownership, the non-convertibility of the currency, huge military expenditures, and the regulation of almost all prices, had to be changed into the features complying with the market economy (Aven 1997:81-82). The process began officially with the enactment of Presidential Edict No.213 of November 15, 1991, "On Liberalizing Foreign Economic Activities within RSFSR Territory". Since then, many important steps have been made in this direction (Dulatov 2004; Economic and Foreign Trade Regime 1996)

The current results are seen in the statistics concerning foreign trade. The Russian share in world merchandise was 1,8% in 2003. Thus, Russia ranked seventeenth in the list of the leading exporters in merchandise trade and 23 th in the list of the leading importers in world merchandise trade. Correspondingly, it ranked 27th as exporter and 18th as importer in the world trade in commercial services in 2003 (World Trade 2004a:19, 21).

According to the world trends in the international trade, the Russian shares both in exports and imports grow constantly, but it should be noted that the Russian trade balance profits mostly due to high world prices for the main groups of the Russian exports, and only marginally due to other factors. Thereby export revenues stay high, the dynamics of export development did not look so bright on the background of the world trends (Graph 1.3.1).

Graph 1.3.1 Dynamics of International Transactions of Russia

(mln USD; minus sigh indicates debit)



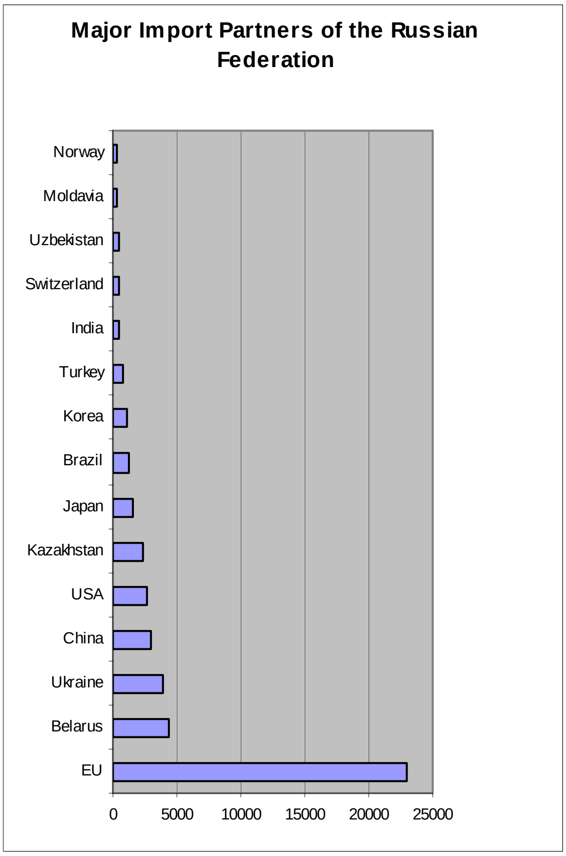
Source: Vneshneekonomitcheskij Kompleks Rossii 2005:137; own presentation.

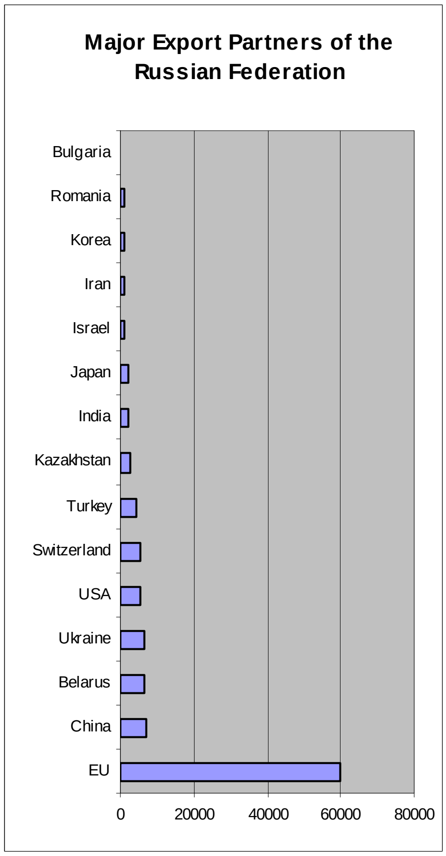
The Russian share of the total trade in the region of the Eastern Europe, the Baltic States and CIS sank considerably in the course of time: as merchandise exporter in 1995 Russia has a share of 41,1% in the region as against 33,5% in 2003; as merchandise importer its share sank from 30,9% down to 19,9% in the regional trade (Götz 2002:74-77). Regionally, as exporter of services it had a share of 23,4% in 1995 in the region, this share sank slightly down to 22,9% in 2003; as an importer of services it has a share of 44,2% in 1995 and only 34,0% in 2003 (World Trade 2004b:69, 75).

The main Russian partner in foreign trade remains the EU. For the most part, its imports are mineral fuels, lubricants, and crude materials, it exports to Russia machinery and transport equipment, chemicals, manufactured goods. It corresponds to the general composition of Russian foreign trade (Götz 2003:218) (Graphs1.3.2 (1), 1.3.2 (2)).

Graph 1.3.2 (1) Russian Main Trade Partners

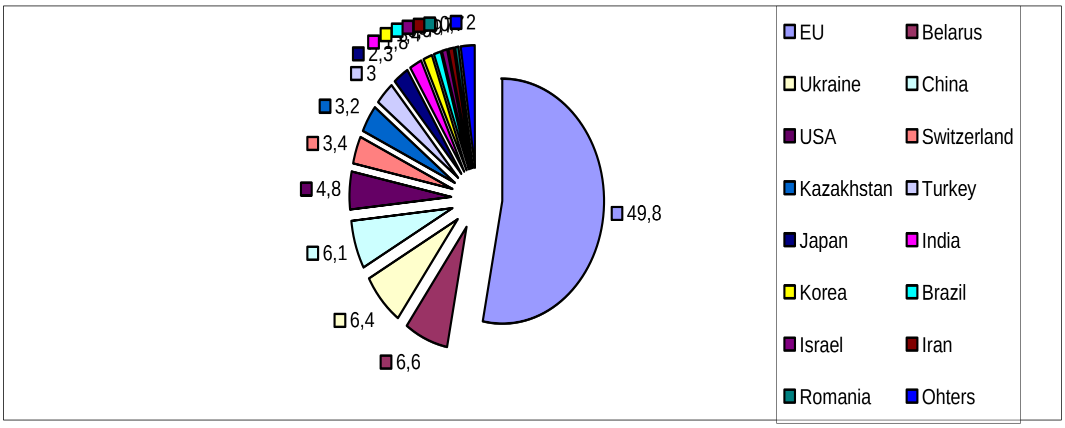
(according to the balance of payments 2003, mln Euros)





Source: IMF (Direction of Trade Statistics); own presentation.

Graph 1.3.2(2) Russian Main Trade Partners, % Shares

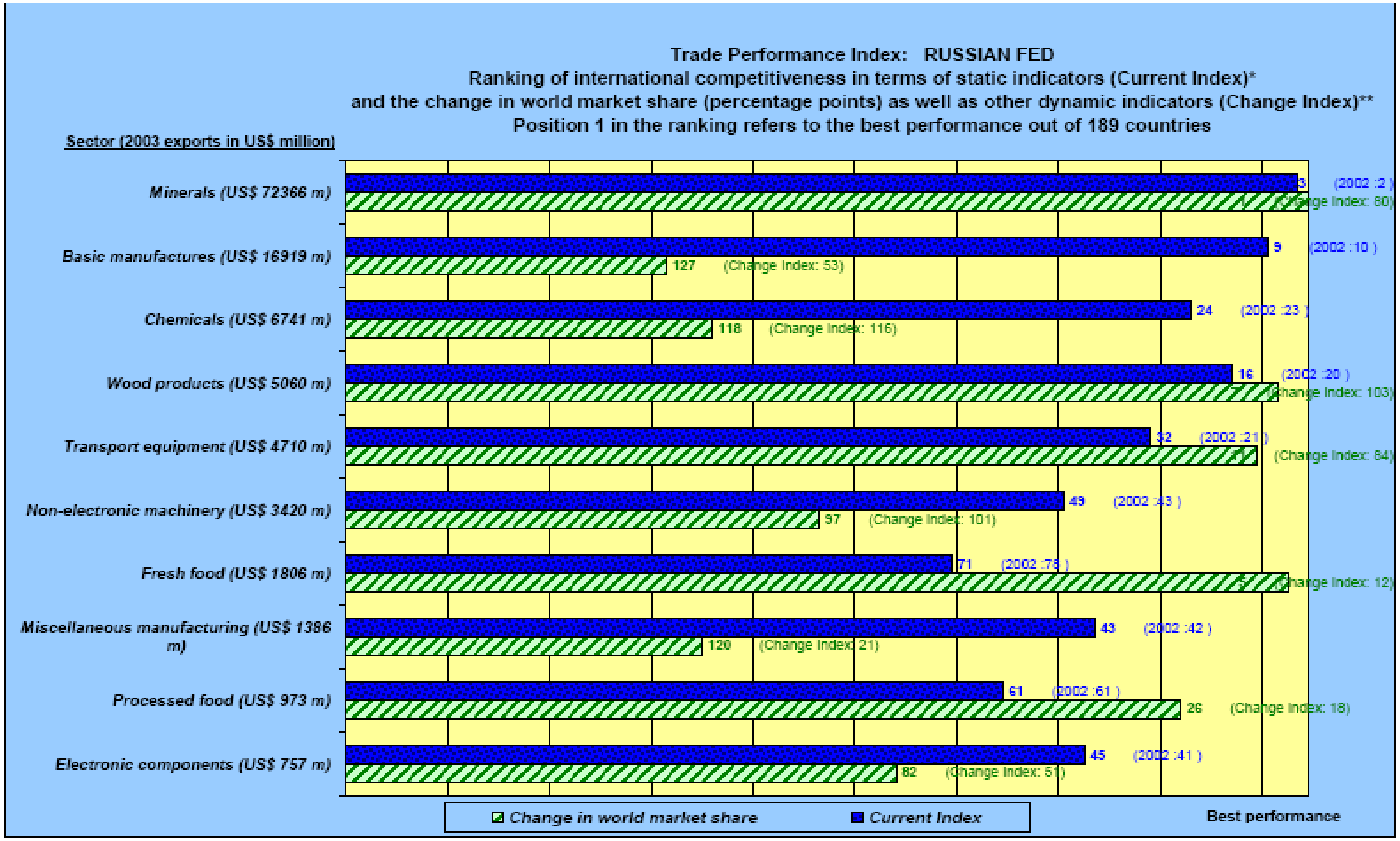


Source: IMF (Direction of Trade Statistics); own presentation

Evidently and traditionally, Russia has stable positions in energy and raw materials exports. In the particular, it takes the lead in exporting natural gas, oil and mineral oil, electric power, wood, ferrous and non-ferrous metals and products, nitric fertilizers, etc. But there are an extremely limited number of positions where the importance of Russia as an exporter is great. Following the recent study of Valentine Piana, Russia belongs to the semi-periphery if one takes into account its "strength", its "potential" for influencing and being influenced in trade with its partners. This means that Russia is dominant with respect to one or more countries but that are dominated by one or more other countries (Piana 2004) (Graph 1.3.3).

On the export side, the share of machinery and equipment in total exports fell from almost 20% at the end of the Soviet period to under 8% in 2003. This decline could have been partially offset only due to the recovery in arms exports after the mid-1990s. Moreover, an increasing share of Russia's exports consists of mineral products and semi-finished goods whose production is highly energy intensive and also involves significant environmental externalities. Examples include base metals and chemicals. This is explained by relatively cheap energy inputs. Rising domestic energy prices would reduce the competitiveness of many of these exports, as well as any serious efforts to raise environmental standards (Graph 1.3.4). On the import side, the most visible shifts include a sharp increase in the shares of food and consumer goods in the total imports. As the share of machinery and transportation equipment remains quite large, it now consists largely of consumer electronics and passenger autos rather than investment goods (Graph 1.3.4).

Graph 1.3.3 Trade Performance Index of the Russian Federation

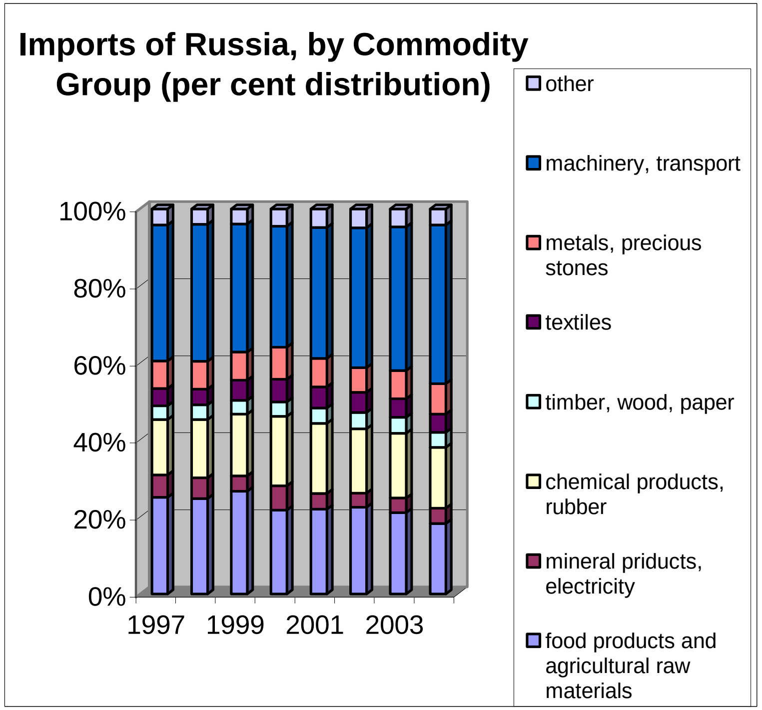


* Net exports, per capita exports, share in world market, product diversification, market diversification.

** Change in: world market share, export/import coverage, product and market diversification, correlation with dynamics of international demand.

Source: International Trade Center1997-2003.

Graph 1.3.4 Russian Exports and Imports of Main Product Groups in 2003



Source: Vneshneekonomitcheskij Kompleks Rossii 2005:143; own presentation.

Only a tiny share of Russian civil finished goods and high-tech products and technologies in the world trade can be explained due to their poor competitiveness. Russian share in the world exports of machines, equipment and vehicles does not exceed 0,3-0,4%, and Russian cost parameters are much worse compared with those of the industrial countries and are absolutely non-comparable with volumes of exports of the leading developed states. If one does not take into account the exports of special equipment, machines and according to the agreements of technical cooperation (the CIS) there is only a small part of the Russian machines and equipment which is really competitive in the world market, its value is estimated approximately in terms of $2-3 bln, which is equal to 0,0001% of the world exports in this branch (Podberezkin, Korobnikov 2003:78-91).

The Russian participation in trade in services is analogically oriented to traditional and low-tech sectors, tourism and transportation among them. Now the role of the country in the market of services is rather insignificant and defined as 0,7-0,8% of their total world export. Tourism and transportation accounted for 75-80% of all Russian services exports in the second half of the 90's. The same types of services accounted for about 67% in the developing states, for 53% in the developed countries (Vneshneekonomitcheskij Kompleks Rossii 2004:9). The weakest positions of Russia in this area are represented by modern business and enterprise consulting, services in the field of development of new technologies and "know-how", computer science, communication, financial activities and insurance.

In the current world conjuncture and world labour division the priority is given to the branches or industries of high technology products or high technologies, but unfortunately Russia falls behind in them. In 2004 the Russian exports of high-tech products ranked the seventeenth in the listing of 25 developing countries (let alone the developed countries) with its high-tech share in exports of 9,1%. It lagged behind Poland, Hong Kong and Brazil in the specified sector (The Global Production Scoreboard 2005). Russia sells mostly nuclear technologies, arms, military equipment and machinery, rocket engines, the techniques of shooting rockets-carriers and satellites, telecommunications and navigation techniques and equipment. Another important reason for Russian integration into the world market of high technologies is a lack of internal demand for it in the country, that leads to the aging of the advanced technological base (aircraft, rockets, radio electronics, biotechnology) and its non-renovation (Abramova 2003: 121-122).

Liberalization of foreign trade activities and a greater degree of the country's openness for the rest of the world played an important positive role in overcoming the economic crisis and going through the transformation process. Russian export activities helped maintain the level of manufacturing and employment in the country on the background of reduction of internal solvent demand, they allowed to carry out the minimal level of investments into development of exports-oriented and related branches and they provided significant budgetary revenues (Ziener 2002:124-128). At the same time, the excessive export orientation becomes a "curse" for the economy and the sustainable development of the country (Korhonen 2004:31-32). The phenomenon of the excessive, sometimes disproportional development of the export-oriented sector, extractive / primary industries due to high rates of return in these markets as a consequence of high world prices and shrinking of non-primary, that is secondary and tertiary industries is used to be defined as "the Dutch disease". "[...] In the 1960s, the Netherlands experienced a vast increase in its wealth after discovering large natural gas deposits in the North Sea. Unexpectedly, this ostensibly positive development had serious repercussions on important segments of the country's economy, as the Dutch guilder became stronger, making Dutch non-oil exports less competitive. [...] Although the disease is generally associated with a natural resource discovery, it can occur from any development that results in a large inflow of foreign currency, including a sharp surge in natural resource prices, foreign assistance, and foreign direct investment" (Ebrahim-Zadeh 2003).

In the case of Russia, the surge of oil prices together with export-orientation of the primary sector could be defined as the germ of the disease. Though, the Russian active trading balance allows to solve a number of the important economic problems, namely: to increase the currency reserves of the country necessary for regulation of the internal currency market-financial, realization of interventions in the world market of the capital and service of an external duty; to finance critical import maintenance of economic safety of the country, and also the purchase of goods and services in the interest of the state. During 2000-2001 currency reserves of Russia continuously grew and were approximating \$34 bln. As of November, 1st, 2001 (it has increased four times in comparison with the beginning 2000), such developments could not be described as optimal. The ongoing growth of the extracting sectors is based on a significant difference in internal and world prices.

The Dutch disease means as well a partial de-industrialisation of the economy. The lack of solvent demand or only a low internal demand has generated a phenomenon of so-called "ruining growth". There is always a risk (sometimes a very sound risk) of the situation when each new increase in deliveries in real expression conducts to an even more significant fall of prices and general costs of export.

Additionally, this defines the country's high vulnerability to fluctuations in world markets and commodity conjuncture. In a number of extracting branches such dependence on deliveries to a foreign market has reached critical levels. Oil, natural gas, metals, and timber account for more than 80% of exports, leaving the country vulnerable to swings in world prices. Russia's manufacturing base is dilapidated and must be replaced or modernized if the country is to achieve broad-based economic growth (CIA World Factbook 2005).

Thus, if specialization on the exports of energy and raw mineral material is a logical consequence of the Russian natural competitive advantages, then high export-orientation of such branches as ferrous and non-ferrous metals, pulp, etc. is dictated by ecology reasons on part of the Western countries, namely, their desire to deduce "dirty" manufactures in their territories, be it even to the prejudice of the country's economy. They pursue long-term environmental goals. Russia specializes more and more in exports of the most harmful branches as it possesses its significant ecological "durability" owing to the huge size of the territory. Such pattern of specialization can take place only during a limited period of time and upon condition of rigid public control. However, this pattern is insolvent and dangerous to the country in long-term prospects (Gaidar, Sinelnikov-Mourylev *et al.* 2005a:57-60).

From the point of view of national economy the exports of non-renewable resources means only transition of national riches from substantiated into a monetary (liquid) form, but some substantial real increment of the country's riches does not occur or there is only an insignificant increase. At the same time exports of the processed goods using cheap import raw materials provides the greatest contribution to the increment of national riches. Excellent examples are the economy of the USA, Japan, Switzerland, and also such small countries and territories as Singapore, Luxembourg, Hong Kong, Taiwan and of some others. As a result Russia actually voluntary transfers a part of the national income to foreign countries.

As to imports, they naturally solve a number of problems of security and provision to the deficit and scarce goods in crisis periods. But at a certain stage their share, by virtue of domestic manufacturers' weakness, experienced a hypertrophied development. Together with a significant increase in internal consumption the Russian domestic manufacturers for the home market have almost lost in the competitive struggle in a wide range of positions, first of all consumer assortments, including many products of consumer durables. Import activities have gotten a strongly pronounced offensive, and in some cases simply aggressive in character. The basic difficulty does not consist in total volumes of import - on the contrary, they can even be insufficient from the economic point of view, if one considers the needs of the modernization of technical base in manufacture, the problem is the purchase of directly competing production. The last circumstance has generated the sharpest problems for the weak in the financial and marketing aspects domestic industry. It is characteristic that about two thirds of all imports in the 90's from the EU presented branches serving the final consumer demand, with high expenditures on R&D and advertising. Such a high concentration of imports of advanced, branded goods and services that appeal powerfully to quality, together with the Russian custom duties which were in most cases only nominal barriers, have created unequal conditions for a competition and have led to a significant deterioration of the Russian manufacturers' position of many, sometimes even to bankruptcy.

It is important to notice that being inconsistent, incomplete, insufficiently controllable and complicated by internal problems the liberalization of foreign trade activities stimulated a significant outflow of the capital from the country, including its illegal forms.

Thus, foreign trade activities have rendered double influence on development of a transitional economy. Without its intensive export-import activities, active international investment and currency-credit cooperation the national economy of the country in a deep economic crisis could not solve practically any urgent social and economic problems. It is not only the maintenance of manufacture, employment, social standards, but also the maintenance of a national currency rate and so on. At the same time, wide liberalization of foreign trade activities lead to many structural problems in economy, low competitiveness of the majority of domestic goods, generated serious negative consequences, including a phenomenon of de-industrialisation, the Russian excessive dependence on a world conjuncture, resurgence of struggle with importers in a home market, huge outflow of the capital from the country and unreasonable growth of external debts.

Further integration of the country into the system of the world economy is an objective goal; it is a strategic interest of the Russian society. But the other side of the coin is the costs which Russia should pay for its integration. This cannot happen at any cost. Only a successive increase in efficiency of foreign trade activities due to increase in exports of a share of production of a high degree of the processing, new technologies and progressive kinds of services could reduce these costs, no less than the rationalization of import composition, expansion of modern process equipment imports; growth of direct foreign investments into the real sector of economy, first of all into the manufacture and reductions in capital flights from the country. Solving these specified problems is important to the long-term development of the country, its future perspectives and achievements, and the state plays frequently the leading role in it.

2. State Policy in Current Russian FT

2.1 Factors of Development, the Role of Foreign Trade in Sustaining the Growth

While analyzing the Russian transformation to the market structures and processes it is crucial to understand the situation facing the Russian Federation when it emerged as a newly independent state and embarked on radical economic reforms in the wake of the Soviet collapse. It must be noted that the crisis of the Soviet system had its roots in the long-term secular decline in growth rates experienced by the USSR from the 1950s onwards. Among other factors precipitating the final breakdown of the Soviet command economy were external shocks, ill conceived reforms and growing political unrest (Arbatov, Feygin *et al.* 2005). The year of 1991 saw the polity fragmenting and the economy in free-fall, whereas the real GDP that year declined by about between 8 and 21% – owing to the chaotic economic and political situation of the time. The statistics vary widely (See Leppänen 2004; BOFIT Russia Review 2005; Goskomstat, etc). Nevertheless, the fact is that the Russian GDP started to decline dramatically.

According to Ahrend, the Soviet state budget deficit was pushed from 20% in 1992 to 9% of the GDP by the second half of 1992 and to 3% of the GDP by 1993 by rising subsidies to back controlled prices, falling production and collapsing tax discipline. As the easiest way to finance the deficit was printing money, its supply swelled and wrecked the remnants of the system of price controls. The combination of price-controls and monetary incontinence meant that very high inflation coexisted with the shortages produced by price controls (Ahrend 2005:6).

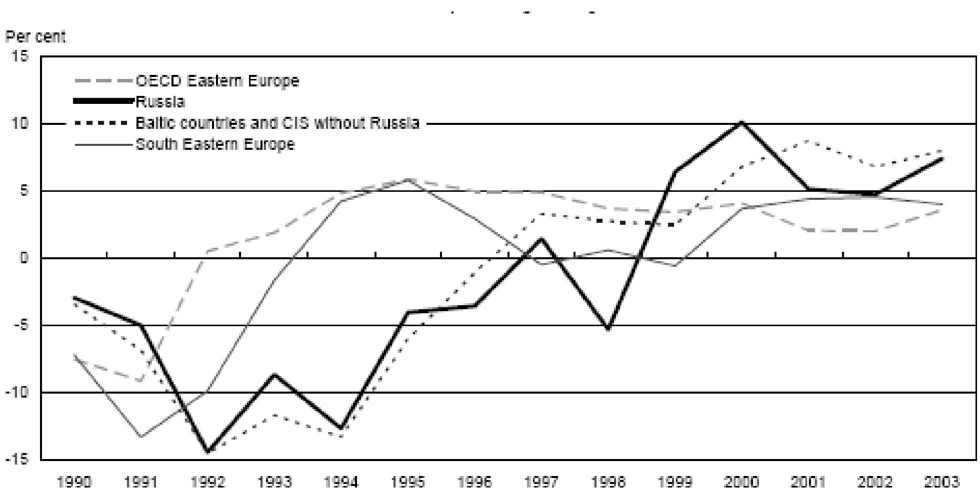
Faced with such an acute crisis at the end of 1991, the Russian authorities opted for a “big bang” program of economic transformation, involving the rapid liberalisation of prices and trade, as well as large-scale privatisation. Some researchers suggest that it would have been better to choose a more gradualist approach at that time. However, as others rightfully note, in regard of the erosion of central authority and the decay of the Soviet economic institutions, it was not at all clear if such an approach would be feasible, let alone desirable due to the collapse of the system of fixed prices. On 2 January 1992 some 90% of retail and 80% of producer prices were freed. The main exceptions were energy, some raw materials and some basic foodstuffs. At the same time, external liberalization was under way (Ahrend 2005:7).

Soon thereafter the rapid privatization of state property was undertaken, initially via a voucher scheme. One of the government's chief priorities in this sphere was to gain a measure of control over that process. After granting special privileges to enterprise insiders, thereby ensuring that most enterprises would emerge from the process with a dispersed and insider-oriented ownership structure the authorities were able to proceed with voucher privatisation. As a part of the industry was privatized via the voucher scheme in 1992-94, the state still kept substantial stakes in the allegedly most valuable large enterprises. These were to be sold for cash in a second phase of privatization during 1995–97 by means of "loans for shares" auctions. A handful of well-connected financial-industrial groups (FIGs) accepted state shares in the companies as collateral for loans extended to the government provided that the lenders could realize the stakes if the loans were not repaid by September 1996. It was clear that the state would not repay the loans as the 1996 budget didn't contain any provision for this. It was equally clear that the stakes would not be realized in a manner advantageous to the government. Political circumstances also shaped the pace of the reforms. Simultaneously, fiscal tightening was planned to be accompanied by tight monetary policies (Ahrend 2005:7).

The immediate results of the initial reform package were a surge of inflation and a continuous drop in the GDP in 1992 that lasted until 1999 with the exception of a weak pick-up in 1997. On the background of other countries in the Eastern Europe the Russian downturn was deep and dramatic (Graph 2.1.1).

Graph 2.1.1 Annual GDP Growth Dynamics by Country,

annual percentage change



Source: Ahrend 2005:14.

Initially inflation fell sharply after the shock, but in 1992 it surged again as a result of looser policies. After some futile efforts in 1992-1994 the government chose a strategy of stabilisation based on the exchange rate ("corridor") which brought a very rapid real appreciation (Ahrend 2005:12).

As an immediate result, the competitiveness of Russian industry together with its output continued to fall. But though in the face of great social costs and pressures only a few industrial agents were bankrupt as the greatest part was kept afloat via subsidies. As the direct subsidies from the budget and soft credits from the CBR had largely been eliminated by the mid-nineties, subsidization took form of an unpenalized arrears to the state-controlled gas and electricity monopolies, debts to workers, the state and to suppliers (correspondingly via wage, tax and payment arrears) (Tompson 1999:9,11).

The picture of external relations was equally dismal. According to Ahrend (2005) the Russian export volumes fell by 40% in dollar terms in 1991 and imports by 80%. The Soviet external debt reached $67 bln – roughly 566% of the rouble GDP at the market exchange rate, its foreign exchange reserves fell to $60mln, around ten hours' import cover . This precipitous situation is assumed to be a result of western insistence that Russia service its debts until a restructuring could be agreed (Ahrend

2005:8). In 1992 the state monopoly in foreign trade was abolished, quantitative controls on imports were scrapped and a flat import tariff was adopted. Exports of many commodities (most notably oil) were subject to quotas or very high export duties in an effort to hold down domestic prices. Numerous controls on imports remained, alongside with subsidized imports of some necessities. Such controls created lucrative opportunities for those in charge.

Additionally, the period was marked by a re-orientation of trade flows away from the former Soviet Union (FSU) to non-FSU countries (Perdikis, Read 2005:39).

By early 1998 the economic situation and the fixed exchange rate regime had become critical as the consumption (in association with a strong growth in imports) boomed in 1997, and the oil price dropped in the aftermath of the Asian crisis. All this had contributed to deterioration in Russia's external balance. When the current account was about to turn negative in mid-1997, it became clear that the exchange rate was not only too high for a significant part of the Russian industry, but also, with regard to the constant capital flight, too high to achieve the external balance. In August 1998, there was no choice but a devaluation accompanied by an effective default. Though the devaluation was meant to be limited it was eventually impossible to stabilise the rouble around a moderately devalued exchange rate, and "the rouble soon followed the stock market into free fall" (Ahrend 2005:15). As the prices of imported goods quadrupled in rouble terms the volumes of imported goods and services fell sharply, so that the current account had again surpluses.

After the crisis, the pace of the reform accelerated while the process of privatization slowed down markedly. The most attractive assets had been privatized by then. The remaining prime assets were fought over and there was little demand for residual state shareholdings in otherwise attractive companies that were already controlled by a private owner or group of owners. A large number of less attractive assets were still in the hands of the state. The process slowed but after 2000 there were certain improvements in both investor sentiment and the state's performance in the field of privatization, but these changes were limited.

Russia's privatization policies have attracted much criticism: the evidence suggests that privatization has improved enterprise performance, especially in the case when a strong outside owner had emerged, though it was seldom the case in Russia due to the schemes applied. A good deal of research on privatization demonstrates its interaction with such factors as competition and market structures or privatisation and firm performance (e.g. Guriev, Rachinsky 2004; Goldman 2004; Ackerman 2004; Rosefielde 2005, etc.).

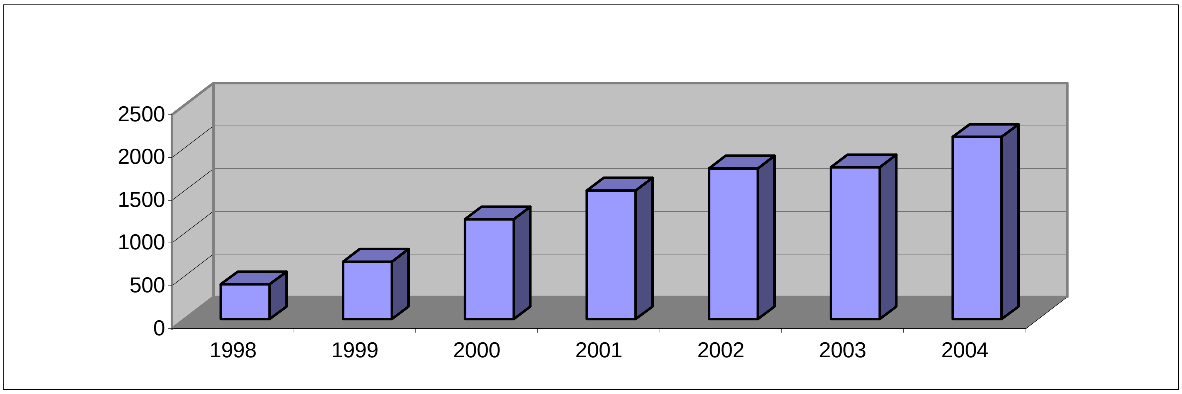
As an immediate social consequence of the implemented reforms and external shocks, on the background of sharp fall in real wages and large cuts in real social spending and in the immediate aftermath of the financial collapse, when the economy virtually came to a standstill poverty increased significantly (See graph 1.2.8). Nevertheless, slowly but surely the economy started to recover. The large initial decline in input costs allowed a significant share of Russian industry to become competitive and profitable again, while the sharp rise in the rouble prices of imports facilitated import substitution on a large scale. The levels of barter, arrears and non-payments declined as the process of re-monetarisation took place. The early post-crisis years also saw a wave of sometimes very aggressive ownership consolidation. Many of the large financial groups were also extremely adept at 'restructuring' failed banks (Chowdhury 2003:9).

Not only prudent fiscal policies but also reasonable monetary policy helped to sustain the recovery. The improved terms of trade did play a positive role in the recovery. Since 2000 the oil price cycle was taken into consideration while drafting the balance, the government resisted the temptation to spend the windfalls from the oil exports as it used a significant part of it to repay the Russian debt and accumulate some reserves. Parts of these reserves have been used to set up the Stabilisation Fund in 2004. The government also took advantage of the favourable fiscal situation to implement a reform in the tax system. Though the financial sector of the economy did play a positive role in the development of the country, Russia still needs stronger competition policy. Some authors argue there is a competition blockade in Russia (Gavrilenkov, Welfens *et al.* 2004: 39-41).

The set of reforms implemented, e.g. reforms in the banking or judicial systems should not be forgotten. Notwithstanding the latest developments property rights became sufficiently secure so that the level of investment is stated to rise substantially in 2001 (Graph 2.1.2). Particularly the oil sector profited from this surge, while high oil prices were another major factor (Antonov 2001). Still, further structural reforms will also have to play a role.

Graph 2.1.2 Dynamics of Gross Fixed Investments, Total

(mln RUB, less VAT)



Source: CBR; own presentation.

The Russian legal framework can be improved and enforcement of the laws is the critical task that needs to be undertaken. Predictability of the “rules of the game” is key for this competition to produce desirable outcomes. Sustainable growth requires sustainable outcomes. Thus, key priorities for realizing sustainable growth and investment in Russia are judicial, administrative, social, and banking-sector reforms. The priority areas include increased protection of property rights (and associated with this, judicial reform, as mentioned above), reduction in government intervention in the private sector, including regulation and taxation, etc.

The weight of natural resources in the economy increased; there was a significant shift from goods production towards the service sector. Russia began its transition with an extraordinarily open import regime but heavily regulated exports. As the rouble strengthened, Russia went over to an increasingly complex import tariff structure that gave rise to extensive corruption – by the mid-1990’s; it included tariff definitions for around 3.500 product categories (Ahrend 2005:24). Those exploiting this over-regulation did not tend to further liberalization and there was an apparent slow-down in improving the situation. Still, the process has been advancing in the course of the years, given a necessity to join the WTO - exports were gradually liberalized while import-competing sectors secured a degree of protection from foreign competition (Economic Overview of Russia 2001).

The complex tariff structure that had evolved in the 1990s underwent a fundamental overhaul at the end of 2000. At the start of 2001, over 30% of products were classified into just four categories with tariff rates of 5%, 10%, 15% and 20%. Although a few products, including cars, sugar, alcohol and tobacco, continued to be taxed at rates well above 20%, these changes brought the average rate down to 11-12%. Over time, the number of 'peaks' in the tariff schedule has declined; there are relatively few tariffs now above 15% (Ahrend 2005:29)

Now the Russian tariffs are relatively low by international standards and its tariff structure is being brought in accordance with systems of most OECD countries. As Russia aspires to join the WTO, its tariff and non-tariff barriers approach the standard levels.

The openness of the country together with some obvious advantages entails certain risks. While a more diversified export composition is preferable, Russia revealed comparative advantages in natural resources which have been increasing, especially in oil due to the rapid surge in exports in this sector. There is a possibility that other trade partners would implement protectionist measures if the tempo of export growth is supported in the future. In this respect the issue of transportation should not be forgotten - in all probability Russia will need new pipelines. Additionally, increases in other mineral (and especially hydrocarbon) exports are doubtful, though possible as Russian reserves of oil are comparatively limited. In the short and medium term new oil fields could be explored. Externally, the risk of price war with the OPEC could stop the export increases (Ahrend 2004a:33). Internally, it is important to ensure that Russian fiscal and regulatory policies (especially the enforcement and clarity of property rights), administrative reforms, etc. will be favourable for development of new oil fields.

In the long run, the leading candidate to take the place of the leading export commodity is gas as Russia has the world's largest proven gas reserves. The world's tendency of increasing gas consumption will let Russia increase this kind of exports without any threat of a price war. But one should remember that this sector of economy is highly monopolised and regulated and it shows the signs of productivity decline (OECD Economic Survey… 2004). Analytics proposed reforms which have been partially implemented.

As the riches of the country will grow the service sector could become another driver of long-term growth. Heavily underdeveloped, it has a great potential for catch-up, its growth may well outpace the overall GDP growth but it must be accompanied by increases in goods production and exports.

The Russian external vulnerability manifests itself in its industrial and export structure. The crucial importance of good fiscal and monetary policy for the Russian economy can hardly be overstated. A good example can be the Stabilisation Fund, which establishment was approved by the most part of economic agents. By accounts of some foreign economic analytics, it could strengthen Russia’s bargaining position *vis-à-vis* the OPEC and indemnify it against future oil-price drops. Thereto, it helps to keep sovereign external debt down and reduces the external vulnerability (See BOFIT 2004:4).

Ahrend argues that additional sustainability could be achieved as a result of Russian de-dollarisation / de-euroisation on the basis of avoidable exchange-rate fluctuations. Only prudent fiscal and monetary policy could bolster the confidence in the home currency. He insists the CBR should become further sterilisation instruments (Ahrend 2005:18)

Apparently unavoidable, further increase of the mineral sector in the economy also increases the risks connected with “the Dutch disease”**.** Those risks are the deindustrialization of a nation's economy that occurs when the discovery of a natural resource raises the value of that nation's currency, making manufactured goods less competitive with other nations. The term originated in Holland after the discovery of North Sea gas. Highly competitive and profitable export-oriented sectors of the Russian industry won’t run the risk of losing their competitiveness even if relative prices of main raw material climb further but the rest of the Russian industry, especially manufacturing, is faced with the problem of competitiveness decline - the tendency to differentiate between world and home prices for primary raw materials promote their ineffective use and exposes large differences in productivity between sectors.

The current windfalls impel Russia to have a relatively strong exchange rate. On the other hand, relatively high wages in the resource-sector put pressures on wages in other sectors and raise living standards of the part of the population who work there.

The production in the non-tradable sectors in its turn is boosted thus slowing the production of other tradable goods. In this situation, the non-resource tradable sector must therefore increase its productivity and restrain unit labour costs sufficiently to stay competitive in order either to export or at least to face effectively the home import competition. In this context, positive developments with respect to productivity in most sectors, and to some degree also unit labour costs are encouraging (OECD Economic Survey 2004).

Lately, the Russian industry has tried to solve the problems by means of “passive” restructuring (labour-shedding) (OECD Economic Survey 2004:6). Further *active* industrial restructuring (including private investment for modernisation) is appointed by the situation. In this respect one should also mention a probable shift from the industrial to the service sector employment. Given the low productivity in the latter sector one may only hope for comparatively low wages. But to a degree that large wage inequality may be socially and politically unacceptable, these potential employment opportunities in services may not arise if the authorities pay due attention to the situation and prevent this inequality.

The potential negative impact of the natural resource sector on the economy could be alleviated through proper policy measures. They could ease the adjustment process for the tradable non-resource sector and try to avoid a low employment trap.

While Russian monetary policy should avoid sharp rouble appreciation through a wider range of monetary sterilization mechanisms the Russian fiscal policy could try be countercyclical to the oil price measures with the help of the Stabilisation Fund and tax structure. Among the proposed changes is increased direct taxation of the natural resource sector (not only the oil sector) via excise, extraction or export taxes while cutting the unified social tax (OECD Economic Survey 2004:7). Though, the increased taxation should not affect the profitability so gravely that it would not stop the development of the raw materials sectors. Simultaneously, taxing a larger part of the resource rent away (by corruption-proof means, to reinforce the reduced general tax levels and introduce additional targeted social transfers) will probably lead to relatively lower wages in the resource sector and hence diminish the pressure on wages in other sectors. To the degree that this would allow the paying of lower wages for activities with lower productivity, it would help to preserve employment that would otherwise be lost (or facilitate the creation of jobs that might not otherwise exist).

While denouncing Russian dependence on natural resource exports some proper and sound state measures, activities and institutions can help to keep employment at acceptable levels, promote the diversification of the economy and favour the production of more sophisticated products. One must admit that the goals of the diversification are long-run prospects and the near future will probably be marked by growth in service sector with as well as some increase in import substitution.

Russia's large share of natural resources in its exports can cause a number of risks described profusely in the literature: corruption, hence slower long-term growth; greater inequality of incomes; bias of talent allocation towards natural resource sector. Additionally there is a great risk that political and economic institutions may evolve to favour rent-seeking over entrepreneurship. Along with the changes in taxation the proposed ways to outweigh the risks are de-monopolisation of the monopolized sectors in the economy.

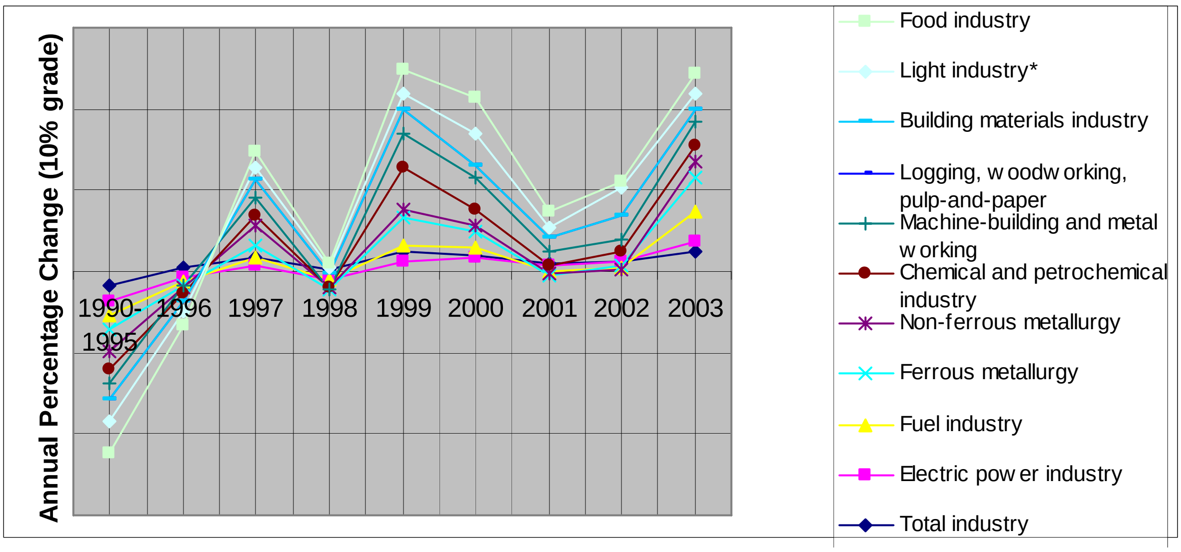
Nowadays the corruption levels of Russia confirm the idea that those levels and the efficiency of the rule of law and the development of civil society are strongly and negatively correlated (Lambsdorff 1999). Ahrend suggests that a lack of press freedom causes corruption (Ahrend 2002:3). Thus, one of the main difficulties lies in creating an efficient and non-corrupt administration, which applies clear-cut rules and taxes discretely and interferes minimally in commercial activity and which is adequately checked and monitored as well. Thus while creating such administration and institutions in Russia its main priorities could be strengthening the judicial system, fostering the development of civil society and press freedom and increasing the accountability of officialdom.

Interestingly, all resource-based economies that have developed successfully had strong civil societies, relatively well functioning and independent judicial systems, high levels of press freedom and relatively low levels of corruption, whereas resource economies that failed to achieve adequate economic progress usually lacked most of these features (Korhonen 2004:12).

Along with the structural reforms the country's economic growth could exploit economies of scale and enhance competition, particularly by diffusing technological progress though foreign trade. The significance of the last factor cannot be underestimated as Akhmedov and Bessonova find that the increased availability of imported inputs helped improve the productivity of domestic firms during 1995–2001 and that competition with foreign imports and with goods produced by foreign-owned firms in Russia does lead to faster restructuring of domestic enterprises (Akhmedov, Bessonova *et al*. 2003:15). However, this group of authors simultaneously argue that the benefits of trade and FDI liberalization depend on other policies as well, for example on financial sector reform, measures to improve labour mobility and reductions in regional bureaucracy. These conclusions confirm the analysis of industrial competitiveness presented in OECD Economic Survey – Russian Federation (OECD Economic Survey 2004).

Despite the pressures from the rouble appreciating steadily in real terms since early 2000 and wages rising rapidly, while energy and transport tariffs were frozen, a great part of Russian industry did relatively well in maintaining competitiveness. While industrial production growth slowed down to 4% in 2001-2002, it recovered to around 7% in 2003–2004. The main reason for this resilience – apart from the dominant role of the oil sector – appears to be significant labour productivity increases in a large majority of sectors (Graph 2.1.2).

Graph 2.1.3 Labour Productivity Dynamics

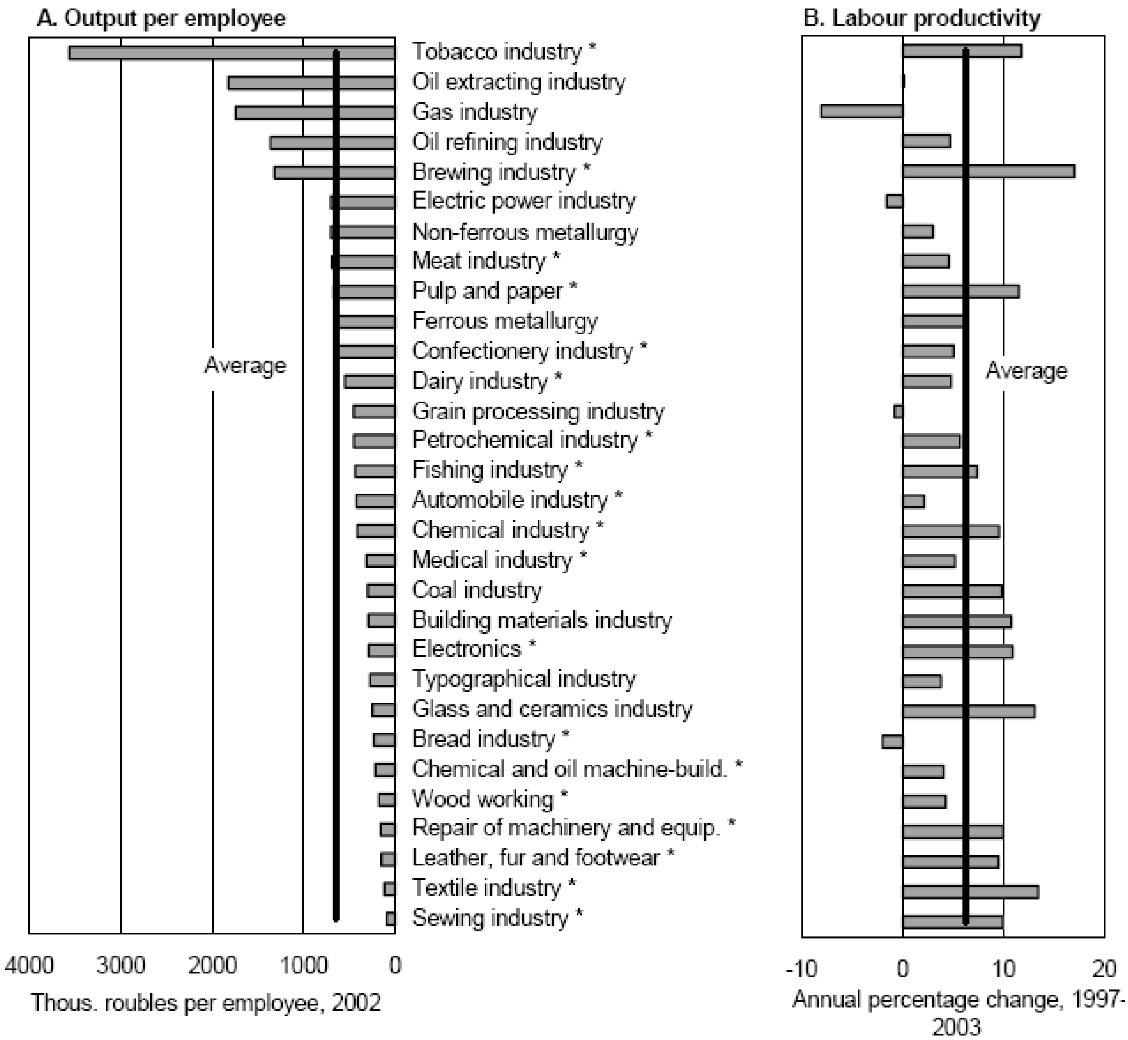


Source: Goskomstat and OECD calculations; own presentation.

The performances of different sectors have varied widely, but there have been improvements in almost all of them. The few inglorious exceptions turn out to be sectors in which there is still significant direct state control over enterprises or extensive state interference in economic activity. The productivity performance of the grain-processing and bread sectors, as well as oil (before 2001) and electricity (until 2002), is deplorable (OECD Economic Survey 2004). But on the background of improvements of labour productivity and positive trends in unit labour costs in 1992-2003 there are some grounds for cautious optimism (Ahrend 2004b:14) (Graph 2.1.3).

Graph 2.1.4 Labour Productivity: Changes in the 30 most important industrial sectors

(annual percentage change, 1997-2003)



Source: Ahrend 2004b:5.

Though evident advancements in efficiency and competitiveness are obvious, still only a few sectors have reached the level to sale goods on the world markets. Russia's revealed comparative advantage (RCA) (following Neven's definition (Neven, Roller 1991:1296-1297) reveals those goods: hydrocarbons (oil, oil products and gas), some other resource-based (*e.g.* wood, pulp and paper) and energy-intensive products (non-ferrous metals, steel, and fertiliser). Moreover, the number of sectors in which Russia has some RCA, is surprisingly short (See Table App1 in Appendix). Probably, Russia also has an RCA in arms, but detailed official data are unavailable. This short list suggests that the authorities' concern for economic diversification is well founded but at the same time it highlights how difficult reducing Russia's reliance on natural resource exports will be (See Table App3 in Appendix). It must be noted that the transition to cost-reflective domestic energy prices will to some degree erode the comparative advantages enjoyed nowadays by energy-intensive export sectors. In the long run, it will reward more energy-efficient production and thus lead to a more efficient allocation of productive resources.

As to Russian competitive disadvantages, they are mostly in such manufactured products as industrial machinery and equipment, electronic consumer goods, cars, and medicinal and pharmaceutical products together with meat production (See Table App2 in Appendix).

One may hope that continued investment growth will lead gradually to the development of comparative advantage in areas other than mineral exports, but this will happen only if the economy will remain open and levels of FDI will grow. A good example could be a more active development of joint ventures in sectors like the automobile industry where they can facilitate the transfer of technology and managerial expertise to former state enterprises. Vast additional advances in productivity could be achieved simply by introducing better business organisation into Russian firms. Simultaneously, poor protection of property rights and weak enforcement of laws undermine the incentives of investors and managers to improve efficiency. But the productivity performance of sectors characterised by a high degree of state intervention in enterprise affairs presents a reminder of the past dirigiste industrial policies while attempting to diversification the industry. And generally, the entire political and legal context, the so called "business climate" matters for investments.

Ralf Wiegert, a German economist specialized in Russia and generally on transitive economies, argues that there is a link between the introduction of competition and market-oriented institutions on the one side and growth of investment and of new private enterprises on the other side (Wiegert 2003:272-274; Ziener 2004:158).

On the other hand currently the concentration of power at the federal level and within the executive branch has come at the expense of the legislative and the regions. Although this constellation has brought an unprecedented opportunity to implement critical structural reforms, it has also created a commitment problem. Experience shows that when a country's rules and laws are unclear or when the power of a country's ruler is unchecked, the country's economic growth may suffer (Korhonen 2004:11). Now the major problem of the situation is the establishment of checks and balances necessary for the Russian government to commit to stable institutional rules that are conductive to sustainable economic growth in the country. Russian and foreign entrepreneurs must perceive a strong protection of property rights. In particular, the results of privatisation, as controversial as they are, should be accepted once and for all. Allowing the business to own land and streamlining the regulatory environment are important steps in reducing the scope for bureaucratic arbitrariness and corruption.

Russian industry desperately needs strategic investment and thorough restructuring to increase productivity and finally maintain its tempo of growth. New investments, especially foreign direct investments are important for improvements in productivity and their spill over effects, but the size and impact of these depend critically on the quality of the human capital and the extent of the economic reforms in the country. At this point, the high quality if Russia's human capital can no longer be taken for granted. Recent numbers show that although the number of university graduates is increasing, the quality of education in the country is deteriorating as a result of the partial "brain drain" and the exclusion of young talents from the university system for financial reasons. Thus, developments that promote improvements in productivity also generate investments – investments in the country's educational system are critical for sustaining productivity and increasing spill-overs (Korhonen 2004:32).

Thanks to accumulating experience and data from more that a decade of transition, as well as new conceptual insights, the researches are now much better equipped to analyze these issues that they were when the process began. Most of the researches summarize that the impressive rebound since 1998 is due to four broad factors (excluding structural change):

✓ external factors, such as price increases for Russia's main commodity exports;

- ✓ endogenous adjustments triggered by the 1998 crisis, mostly relative price adjustments such as a massive real exchange rate devaluation, and real wage decline;
- ✓ changes in the behaviour of economic agents (including economic policy makers);
- ✓ underutilized productive capacity of capital and labour, use of which was very important in the early post-crisis years, but had run its course by mid-2002. (Structural Changes Needed in Russia… 2003-2004).

Thus, one can assume that the foreign trade of Russia plays the leading role in reinforcing the growth nowadays but important shifts should be made to help create the basis of factors for further sustainable growth.

2.2 Role of the State in Current Russian FT

2.2.1 Law Regulation of Foreign Trade[1]

The purpose of the regulation of foreign trade activity is the protection of economic sovereignty, economic safety of the Russian Federation, stimulation of the development of national economy and provision of effective integration of Russia's economy in the global economy.

The applicable legal base regulating Russian foreign trade includes the new RF Customs Code, 12 regulations and 2 instructions issued by the RF Government, more than 80 regulations of the RF Federal Customs Service issued in elaboration of the RF Customs Code. However, the initial year of operation under the new the RF Customs Code revealed that several of the RF Customs Code need to be more clear-cut, certain and legally elaborated. The same is true with the regulations issued on the basis of the RF Customs Code and orders of the RF Government, as well as law enforcement. In addition, nearly 30% of more than 10 000 different regulations, orders and instructions issued on the basis of the RF Customs Code of 1993 are still effective. RF Law "On Customs Tariff" needs to be brought in compliance with the new RF Customs Code and the requirements of the World Trade Organization. Provisions of the RF Customs Code and the RF Tax Law remain to be correlated. Altogether this is evident of the fact that legal basis of customs regulation still remains to be finalized.

Application of simplified customs clearance mechanisms to special types of entities is one of the essential new developments of the RF Customs Code. Such mechanisms provide for faster customs clearance for the entities which respect customs regulations in good faith.

There is another new and essential development provided for by the RF Customs Code – computer-based declaring of goods – that needs to be finalized too. The RF Customs Code permits provision of electronic documents. However, neither list of electronic documents that were to be submitted nor their forms have been specified to date. The required software and hardware are not available yet. Foreign trade

[1] See also Appendix 1. Basics of State Regulation of Foreign Trade

operators are facing serious economic, legal and administrative problems caused by expanding practice of the RF Federal Customs Service aimed at restricting the number of customs clearance stations for declaring certain categories of goods.

There were 34 regulations restricting the number of customs clearance stations for declaring certain categories of goods before the new the RF Customs Code came into effect. Such measures allowed declared goods to become legal in trade and increased in number: electronic household appliances by 1,5 to 2 times and meat by 2,5 times, with insignificant changes in the export of such goods to the Russian Federation.

Unlike the former regulation, the new RF Customs Code Russia provides for clear-cut criteria for restricting the number of customs clearance stations. Such measures must be justified and based on risk analysis, and abolished if they prove inefficient and have an adverse effect on operation of foreign trade participants. The number of customs clearance stations for certain categories of goods will gradually be increasing under liberalized customs regulations and due to a wide use of IT-based customs clearance and supervision procedures, as well as introduction of a system of risk assessment and management. At present, the RF Federal Customs Service has prepared proposals on reduction of restrictions imposed on the number of customs clearance stations for declaring goods imported to the customs territory in accordance with the plan coordinated with the Ministry of Economic Development and Trade in Russia. The new RF Customs Code resulted in substantial changes in composition of the so-called customs-related organizations (customs brokers, customs carriers, owners of interim storage facilities).

Establishing large amounts of security for entities which run the customs-related business, has already ousted small and medium-size companies from the market, which are unable to secure their responsibility to customs authorities. There is a threat of monopolization of broker services by a dozen of large brokers. This may entail monopolized prices of brokerage services, encourage corruption trends in this environment, increase costs incurred by trade operators and boost up prices of imported consumer goods. The same is true with the market of customs carriers and storage services.

Thus, a series of problems were revealed during the initial year under the new RF Customs Code, which could be resolved by making amendments to the regulatory documents and, in special cases, updating corresponding provisions of the RF Customs Code.

The following problems are worth mentioning:

- ✓ to date, no amendments were made to the customs-related laws and regulations of the Russian Federation;
- ✓ RF Law “On Customs Tariff” was neither brought in compliance with the new RF Customs Code nor the requirements of the World Trade Organization ;
- ✓ no amendments were made to the RF Tax Code in regard to VAT refund, in particular on processing products exported from the customs territory of Russia ;
- ✓ problems still can be found in incompliance of provisions of the RF Customs Code Russia with the Tax Law the Russian Federation in regard to tax base determination for assessing customs duties and taxes, as well as in incompliance of limitation periods of customs payments enforcement with integrity checks of data provided for customs clearance after products are manufactured.

Invoice processing rules established pursuant to RF Law on Taxes and Duties make no allowance for the fact that goods may be produced prior to submission of a customs declaration, when a state customs number is not yet assigned and consequently can not be indicated in an invoice so that the goods can be sold in the domestic market.

Tax authorities may face problems after January 1, 2005 in applying the provisions of the RF Customs Code referring to the Law on Taxes and Duties, due to the amendments made by the Federal Law of July 29, 2004 to Article 13 of the RF Tax Code under which the customs duty is excluded from the list of federal taxes.

At the same time, it should be noted that some amendments to the RF Customs Code were already made. Making amendments to the Code will help Russia to meet its commitments in the field of customs duty at the negotiations on its accession to the WTO: pursuant to Article VIII of the General Agreement on Tariffs and Trade (GATT), customs duties must be collected as compensation for customs costs rather than for fiscal purposes.

Federal Laws “On Basic Principles of Public Regulation in Foreign Trade” and “On Foreign Exchange Regulation and Control” took effect in June 2004, which play an important role in regulating foreign economic activity. These laws underwent expertise confirming their compliance with the corresponding WTO regulations. RF Law “On Basic Principles of Public Regulation in Foreign Trade” provides updated definitions of basic terms (foreign trade, import, export, etc.) and introduces a series of new terms and definitions (transit, free trade zone, customs union). The Law contains provisions on separate public regulation of foreign trade in goods, services and intellectual property. It also includes new provisions on regulation of foreign barter trade and on pre-shipment inspection. A new procedure on counter measures is introduced.

The Law specifies basic principles of public regulation of foreign trade on the basis customs-tariff and non-tariff methods, including the following measures: establishing and abolishing import and export customs duties and dues; imposing and withdrawing restrictions and limitations in international trade in products, services and intellectual property; arranging and withdrawing economic and administrative measures promoting development of foreign trade; concluding international trade agreements as well as agreements on customs unions, free trade zones or regional economic integration.

The Law ensures that the Russian legislation meet the provisions of Articles I, III, V, XI, XIII, and XXIV of the GAAT of 1994 as well as the WTO Agreements on import licensing and pre-shipment inspection. Furthermore, the Law specifies regulations on imposing restrictions and limitations provided for by Articles XX and XXI of the GAAT of 1994. Special provisions of the Law are intended to ensure transparency in accordance with Article X of the GAAT of 1994. Developing new regulations and making amendments to the applicable ones is one of the basic tasks of the present period in implementing provisions of Federal Law ”On Basic Principles of Public Regulation in Foreign Trade“, in particular measures of non-tariff regulations. [2]

[2] FR Law “On Foreign Exchange Regulation and Control” is of a secondary importance, therefore not regarded here in detail.

2.2.2 WTO Accession

It is obvious that the goal of integration of Russia into the international economic relation and improving the standard of living for its citizen requires a strong, dynamically developing economy, based on greater production efficiency, the creation of qualitatively different economic and social structures, and many other reforms. Most importantly, it must encompass a progressive opening up of the country, since historical experience (in particular Russia's own experience) demonstrates that a cultural and economic isolation is a sure path towards degradation of economy, state, and society as a whole.

The main priority in the foreign policy of the Russian Federation in international economic relations is to promote the development of the national economy, which, in conditions of globalization, is unthinkable without broad integration of Russia in the system of world economic ties. Russia applied for membership to the WTO in 1993. In 2000, Russia's newly elected president Vladimir Putin designated WTO membership a priority for his government, a goal that was bolstered by renewed Russian cooperation with the United States after September 11th. Now it is evident, that the country faces the challenge of opening its economy radically. The embodiment of this integration into the world economy is Russian accession to the WTO. "Accession to the WTO, in case it takes place in 2006, will provide a most powerful impulse to the rise of the country's investment appeal and the growth of its economy. It will be a serious contribution to that very redoubling of the GDP that we are talking about," asserted German Gref, the Russian Minister for Economic Development and Trade (Quote of the Day 2005).

Back in 1993 the authorities faced the acute problems of economy in the country, and they had to choose between two strategies: state support of exports or import-substitution (thus, protection of domestic industry). Both examples would be easily found in the economic history of the 20th century. It must be noted that the strategy of import-substitution was followed only by those countries that had to industrialize first (India, Pakistan, etc.) Other chose the orientation to export increases (China). The cross-country analysis and comparison of these two groups show that the second group outpaced the first and it reached the industrialization levels of the developed countries in relatively short time.

Logically, there are 2 groups among those concerned in Russia: for and against. At the initial phases of negotiation the opposition in the country mobilized more quickly and effectively than supporters. This increased attention to negotiations, instead of leading to greater openness, has resulted in protectionism on the part of the Russian government, particularly with regard to agriculture over the initial phase of negotiations. Since, the zeal of Russian authorities was fluctuating as well - whereas Russia previously pursued accession as a top priority and seemed willing to accept attendant sacrifices, it now demands clearly defined terms and desires accession less urgently, having recently acquired market economy status (O'Donnell 2003; Berkowitz, DeJong 2001:11). Two thirds of the way behind, Russia is in the third round of negotiations. Maxim Medvedkov, Russia's Deputy Economy Minister and lead WTO negotiator, recently stated that he expects accession sometime in 2007 (O'Donnell 2003). Up to that time, Russian products remain subject to various forms of discrimination (e.g. antidumping measures) and they do not enjoy advantages granted to products of WTO-member countries, examples being standardization and technical objectives notifications, product-proof tests, the right to take legal recourse within the framework of the WTO in case of other countries' improper activities, etc.

Negotiations on conditions of Russia's accession to the World Trade Organization (WTO) were animated in 2004. The Task Group held its 25th official meeting dedicated to Russia's accession to the WTO on November 18, 2004 in Geneva. The third revision of the Final Report on Russia's accession to the WTO which was substantially updated as compared to the previous one, was considered.

Customs service is one of the most delicate issues at the negotiations, especially customs value determination, law enforcement, several agricultural problems, sanitary and phyto-sanitary control and technical regulation in general, as well as intellectual property protection.

Furthermore, the United States and Canada continue to express their high concern of the issue related to double pricing of energy sources. Russia, however, is not ready to offer substantial concessions in this field.

The progress is as follows: Russia finalized negotiations on terms and conditions of mutual access to product markets with 14 countries (in particular, major trade partners of Russia: nearly 50% of trade turnover with the European Union, 10% with

China, 4% with South Korea). A total of 46 countries (in addition, over 10 countries have been negotiating on services only, other WTO members have no claims whatsoever to Russia as they have no economic relationship) expressed their desire to negotiate with Russia. It is important that all of them should agree on Russia's accession to the WTO, because decisions on accession of a new member to the WTO must be made by common consent of the existing WTO members. Russian negotiators expect to finalize negotiations with Australia in spring of 2005.

The hardest part in achieving an agreement with the European Union and China is to do the same with the United States. Prospects of the Russian aircraft industry still remain unresolved. Accession to the WTO has varying impact on various industrial sectors. Some of them have an up-to-date institutional and technological base, but anticipate a severe competition upon opening of the market, though they are competitive and even have an advantage over their competitors in the Russian market. Others, above all processing industries, recognize their poor competitiveness against importers and consequently tend to have a harder protective policy. Aircraft industry is the "hardest" one: it needs huge investments, secured leasing treatment and more to make it catch up with the contemporary market of passenger air jets. This industry must continue for strategic purposes.

Copyright is the second complicated problem in the negotiations with the United States. Russia is ranked second in the world in production of illegal copies (software, video and audio products).

Thus, the Russian Federation has reached the final stage in accession to the WTO, when most complicated issues are to be resolved. Potential obligations on all parameters of the accession (tariffs, agricultural obligations, service market access, system-based issues) will be based on the current and future economic situation and ensure the required protection of domestic manufacturers and adequate competitive environment.

Construction of legal and regulatory framework regulating foreign economic activity is expected to be finalized soon. A lot of work has been performed to bring the Russian customs legislation in compliance with the WTO's regulations. A total of fifteen laws and draft laws were considered in the previous year. The RF Customs Code took effect on January 1, 2004; RF Law "On Regulation in Foreign Trade" came into force on July 15, 2004. RF Antidumping Law and Law on Technical Regulation regulating a minimum set of standards and reducing the number of required licenses were adopted. A foundation of legal protection of intellectual property was laid.

As it is precisely calculated by foreign and Russian analytics the Russian accession to the WTO is likely to generate substantial benefits for Russia: for example, about 7% of the value of consumption in the medium term and considerably more in the long term. These benefits would come from increased FDI by multinational service providers, due to commitments to liberalize the services sectors to foreign investors; from increased productivity due to an inflow of imported technology as the result of a reduction in Russian tariff barriers; and from the improved treatment of Russian exporters in antidumping cases (Yudaeva, Bessonova *et al.* 2000). The main export sectors are likely to experience the greatest expansion. Sectors that export little and that have relatively high import protection are likely to contract in the medium term. In the long term, an improvement in the return to investment should expand the capital stock and incomes considerably more than 7% of consumption. Liberalizing the services sector, according to a different study, could result in medium-run gains of 6,8% of consumption (Yudaeva 2003a). Some needed changes in legislation were under discussion earlier but the efforts were abandoned as the Ministry of Finance stipulated that it would not help obtain concessions from the WTO while negotiating.

Additionally, the process of the WTO accession accelerates the speed of domestic reforms, which otherwise could be slow and half-way only. The principal changes will imply significant liberalization of barriers to FDI in business services sectors, further across the board reduction in tariff barriers by 50% and some reduced application of antidumping duties against Russian exporters in sectors subject to antidumping (Rutherford, Tarr 2004b:1).

All in all, WTO accession is an important step towards an open economy model of development. This claim is consistent with international experience of the past 20-30 years that shows that rapid and sustained economic growth in countries that progressively liberalize import protection and provided incentives to exporters that offset the tax that import protection imposes on exports.

The argument used the most often against WTO accession and trade liberalization is a potential increase in unemployment. Studies of the issue concluded that employment and output in some sectors will expand and contract in others, but overall unemployment will not change. Protected manufacturing sectors that export little are likely to contract. Although more sectors will expand than contract, and export-intensive manufacturing sectors are likely to experience the largest expansion. The World Bank estimates that the wage rate of skilled labour will rise by 5,5%, the wage rate of unskilled labour will rise by 3,8% and the rate of return on capital will increase by 1,7% (Tarr, Rutherford *et al.* 2004a:6).

Though in the short term the negative effects from the accession (e.g.: surge of unemployment of the unskilled workers) might outweigh the positive ones it must be remembered that government safety nets are crucial in helping with the short-run adverse impact from the accession, especially for the poorest members of society. Thus, despite the improvement in the standard of living for almost all Russians after accession to the WTO and after adjustment process, a strong role for public policy is required, especially with regards to the poorest members of the society (World Bank Poverty Assessment Report… 2005:77).

From an economic point of view another major difficulty is the reform of the energy sector where the state is still the major stakeholder. In the meantime, Kremlin policy makers continue to exhibit an inclination to advance the state's influence in the energy sector, not to reduce it and energy reform is one of the main real obstacles to accession from the economic perspective (Yudaeva 2003b).

2.2.3 Establishing a Single Economic Zone for Russia, Ukraine, Byelorussia and Kazakhstan

Creating a Single Economic Zone (SEZ) for Russia, Byelorussia, Kazakhstan and Ukraine is one of the top priorities for Russia for the time being. A search for new and optimal ways of economic integration resulted in an Agreement and Concepts of Establishing a Single Economic Zone signed on September 19, 2003 in Yalta (Russia – Countries of the Commonwealth of Independent States 2005).

The Single Economic Zone means an economic zone which is integrating customs zones of the member-countries for the purpose of ensuring free movement of goods, services, cash and labour force and pursuing a single foreign trade, financial and foreign exchange policies.

It was agreed that the SEZ would be created on a stage-by-stage basis, each stage including fulfilment of certain obligations on achievement of a particular stage of integration. A new stage can not be approved until obligations of the previous stage are fulfilled.

The primary goals are to establish a free-trade regime for imported goods of the SEZ members, create conditions for establishing a customs union and a single competitive environment, take measures on harmonization of national laws. Next step is to create a free-trade zone without exceptions and restrictions, conduct a coordinated competition policy, and establish the customs union providing a single tariff. Finally, to ensure a free movement of goods, services, cash and labour force as a result of the joint efforts of all the members.

It is proposed to establish a single regulatory body which could assume some powers from the SEZ countries. Decisions of the body would be approved by a weighted voting and mandatory for all the four members. A Council of Heads of States would be a supreme body of the organization. Decisions of the Council would be taken on a consensus basis.

At present, there is a High-Level Group acting as working body of the SEZ, which is represented by Deputy Prime Minister of the member countries. Russia is represented by V. B. Khristenko, Minister of Industry and Power Industry and a special representative of the RF President on integration cooperation issues with CIS countries. The High-Level Group includes 7 task groups working in various segments:

1. Customs and tariff regulation, non-tariff regulation, customs administration;

2. Competition policy, natural monopolies, subsidies, government purchases, privatization;

3. Technical regulations, intellectual property;

4. Tax, budget and monetary policy. Foreign exchange regulation and control, macroeconomic performances;

5. Services;

6. Cash flow, investments;

7. Labour force movement.

A meeting of the heads of the SEZ countries that was held on September 15, 2004 in Astana (Kazakhstan) actually initiated a practical implementation of the provisions of the Agreement and Concepts of Establishing a Single Economic Zone. In particular, a list of 25 top-priority international regulatory documents aimed at substantial liberalization of mutual trade and creating conditions for further advance towards the customs union and a single competition environment as drafted by the High-Level Group was approved. These agreements are scheduled for signing before July 2005. Humanitarian issues are also among the vital ones. A series of agreements were developed for the purpose of simplifying formalities in crossing state borders by citizens of the SEZ countries.

The experience gained as part of the bilateral relations established between our countries is widely used in creating the SEZ. For example, a series of bilateral agreements were signed in Astana to ensure that VAT in is collected on the "country of destination" principle without exceptions as early as January 1, 2005 in the member countries. To date, the High-Level Group has developed a draft basic set of international agreements (more than 80 ones) which represents a legal and regulatory basis of the SEZ.

The Agreement and Concepts of Establishing a Single Economic Zone is open for accession of other countries sharing its principles, provided that they meet the established macroeconomic and institutional criteria. It should be borne in mind, however, that it is the Single Economic Zone that should be established first, primarily its contractual and legal basis, to ensure that every SEZ membership-seeker be able to measure its compliance and capacity provided for by the aforementioned documents.

Accession to the WTO of all the four countries is evidently one of the key issues affecting the entire process of SEZ establishment. The SEZ countries have already established a mechanism of coordination in regard to their accession to the WTO (Vneshneekonomitcheskij Kompleks Rossii 2005:67).

2. 3 Revolution Transformation and Consequences in the Russian Foreign Trade

Vladimir Mau, Professor of Economics in Russia, asserts in his writings that in the course of the last fifteen years Russia has witnessed revolution transformation. Among multiple interesting remarks and hypotheses he states that every revolution is accompanied by an acute economic crisis and newly established authorities are faced with two main questions, precisely: how to establish a stable base of socio-political forces in society and from where to get money? (Mau 1998). Putting aside the former question the latter can be answered with the help of printing money and property manipulations. Both opportunities were used in Russia on the brink of the epoch, namely in 1990-1992 (Mankiew 2001:241). Again, putting aside the first, property manipulations were called “privatization” and had their immediate and far-reaching results. Though, Russia’s privatization policies have been widely criticized but the evidence suggests that privatization has improved enterprise performance, especially in the case when a strong outside owner had emerged. On the other hand, many economic entities are still “in the hands of the state”. The Soviet legacy is still perceived through the presence of thousands of more or less ‘accidental’ holdings on the state accounts – these are residual stakes in enterprises that have not been sold for various reasons. The privatization of this residual “legacy” is a tremendously difficult task. Further adjustments to existing privatization legislation could help accelerate the process of selling off small, illiquid blocs of shares and the large numbers of small unitary enterprises.

The scope of the problem is clearly reflected in the gas, oil and electricity sectors. Their importance should not be overestimated as the Russian energy complex is important to domestic and world energy markets because Russia has the world's largest natural gas reserves, the second largest coal reserves, and the eighth largest oil reserves. Russia is also the world's largest exporter of natural gas, the second largest oil exporter, and the third largest energy consumer. Besides, it produces and exports huge amounts of electricity. Russian strategic commodities have always been energy and metals (Lejonhielm, Larsson 2004:141)

The Russian energy complex is interesting in many aspects, not least in respect of the Russian foreign trade. But first and foremost, the issue of ownership strikes the eye. While the gas sector is monopolized by the state and the Russian electricity sector is under reform, in the oil sector there are private and state-controlled companies operating side by side. Ahrend asserts that "the Russian state has proved to be an extremely inefficient owner of those assets" (Ahrend, Tompson 2004:2). Being the regulator and the owner the state is eager to make the entities be more competitive simultaneously imposing unprofitable social obligations on them (though, generally "compensated" via fiscal or regulatory privileges). This duality implies a possible decision of the problem – separation of regulatory and ownership functions. In each case, resource allocation could be made more efficient by putting an end to the provision of implicit subsidies and cross-subsidies via tariffs which are below long-run cost-recovery levels. Even after the reforms, these sectors will require some degree of regulation, thus sharpening the problem of institutional quality (especially regulation quality of institutions) in Russia.

The issue of efficient competition policies is also at the agenda of such qualities. In some cases there was ample evidence that the behaviour of insider managers was characterized by "informal profit-seeking" at the expense of the state. In some cases, state assets have been alienated to persons or entities affiliated with insider managers; in other instances, cash flows are diverted or concessionary terms are offered to related private entities. This raises the question of transparency which has been improving in some entities - Sberbank, Gazprom and RAO UES – but not in all cases and not promptly, the most evident example being Gazprom. By drafting the reforms many different facettes characteristic to specific sectors and outlined above come together to build the right decision. Though all the reforms are interconnected and they could all have some spill-over effects (e.g. establishing precedents and building state capacities).

In the following the consequences and effects of the reforms in implementation and the Russian state policies in this sector are described and analyzed.

2.3.1 State as Property Owner

Historically, the Russian state remains an extremely important player in the economy. The "residual" bias towards state's ownership has been analyzed and described by many. Thus, the issue of the state ownership and the governance of state-owned companies are of prime importance. Still, this ownership is not without problems – for example, the conflict of interest in the case where the state plays the role of regulator with its role of owner distorts the competition. Some analytics assert that state-owned companies are generally less efficient than their privately owned rivals and that enterprise insiders in large state companies are able to extract significant rents for themselves (Ahrend 2005:51).

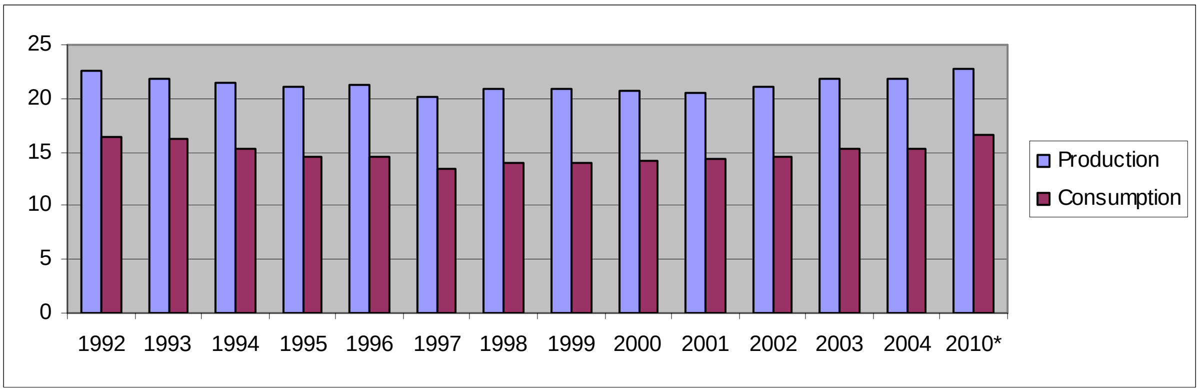
The government has committed itself to a wide range of reforms in this area, including substantial further privatization and an ambitious restructuring of the electricity sector. It has also expressed an intention to increase transparency and level the competitive playing field in sectors such as natural gas, where state-owned concerns will continue to play a dominant role. However, actual progress in recent years has generally been relatively slow, and there have recently been signs that the state is now inclined to extend its asset holdings in some key sectors rather than reduce them. Certainly, there has been a tendency for it to intervene more directly in industrial sectors that are regarded as "strategic", thought these strategic sectors are not defined precisely and seem to change from time to time according to various political interests.

Gas and Monopoly of Russia: Gazprom

Gazprom, Russia's state-run natural gas monopoly, holds nearly one-third of the world's natural gas reserves, produces nearly 90% of Russia's natural gas, and operates the country's natural gas pipeline network. The company's tax payments account for around 25% of federal tax revenues. Together with the world's largest natural gas reserves Russia has been the world's largest natural gas producer in 2004, as well as the world's largest exporter of gas (Country Analysis Briefs 2005). However, Russia's natural gas production and consumption remained relatively flat since 1992 (Graph 2.1.3.1).

Graph 2.3.1.1 Dynamics of Natural Gas Consumption and Production in Russia,

trln cubic feet per year



* 2010 – estimates

Source: Country Analysis Briefs 2005; own presentation.

Moreover, Russia’s Energy Strategy, released in May 2003 but developed still in 2000 at the order of the government of the Russian Federation, calls for only modest natural gas production growth (about 1,3%) by 2010 (Russia’s Energy Strategy 2003:4). The Energy Strategy hints at possible growth of gas prices up to $64 in the optimistic scenario (Development of Gas Industry… 2004).

About two-thirds of the company's revenues come from its export sales to Europe, where natural gas is much more expensive. Roughly a quarter of the European demand is satisfied by the Russian gas, thereafter Gazprom remains one of Moscow's main foreign policy tools.

Being an economic entity Gazprom is to make profit, but simultaneously it is heavily regulated by the state. It must supply the natural gas to the domestic market at government-regulated prices, regardless of profitability.

The problems of export diversification brushed the gas sector in view of export flows diversification: the flows of export gas shifted to serve the rising demand in countries of the EU, as well as Turkey, Japan, and other Asian countries. As Gasport’s trade relationship with European consumers is sure to develop and Russia aspires to access the WTO, some contentious issues have been under discussion recently: the European economists criticized the monopolistic position of Gazprom and difference between domestic and export prices (two-tiered pricing system) (Country Analysis Briefs

2005). A compromise was reached when the Russian authorities agreed to grant independent natural gas producers access to Gasport's pipelines and started to increased prices for industrial consumers. Still, there is a two-tiered pricing system. While gas tariffs have risen rapidly since 2000 they still have some way to go up to reach long-term sustainable levels.

Being a joint-stock company, Gazprom's vertically-integrated structure of monopoly maintains tight control over the sector's infrastructure and over information flows within it. Gazprom's control over information is particularly problematic, as it stays unclear what happens in the sector. The two-tier pricing is in fact a subsidy from the gas sector (the state) to the rest of the economy. If one considers that Russia enjoys some market power in the world market of gas it has its interest in price-discriminating (Hare, Schaffer *et al.* 2004:16).

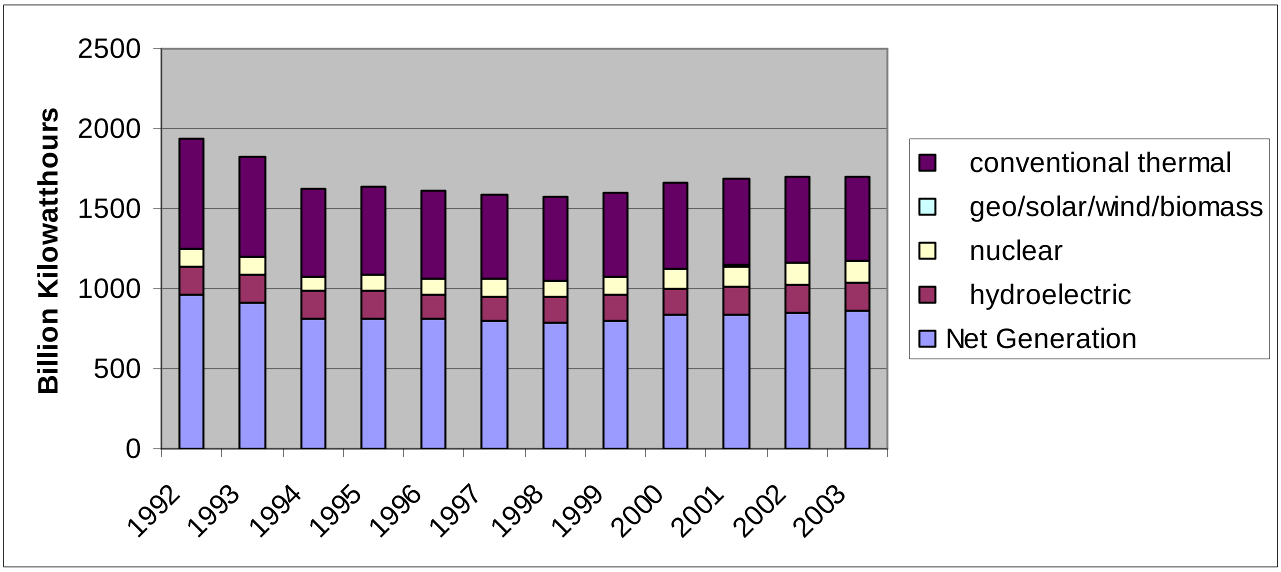
Despite its enormous importance, the natural gas industry of Russia can be the least reformed major sector in Russia. The structure of the sector impedes the growth and risks to meet rising domestic demand and growing export commitments. On more than one occasion, Gazprom has actively and publicly lobbied to prevent even most moderate proposals concerning its re-structurisation or transparency (OECD Economic Survey 2004:5). There one can see a huge potential but not unless Gazprom's controls over information flows and its infrastructure reformed. The solution of the problem can be found in an effective regulated third-party access regime for the sector's infrastructure, an increased transparency and a clear-cut division of its regulatory and economic functions. Various drafts of the government's energy strategy and other official documents have outlined medium-term targets for gas prices, but price increases have reached the targets. In this respect, the talks of Russia's WTO accession present the Russian commitment to solve the problem.

Recently, the public attention was drawn to Gazprom's acquisition all manner of assets, many of them unrelated to its core functions. It is recommended by some specialists that the rents be directed towards the development of the gas sector (e.g.: Ahrend, Tompson 2004:12-14).

Electricity: Monopoly Revised?

The Russian power sector is of no less importance – it includes about 440 thermal and hydropower plants plus 31 nuclear reactors. A few generators in the far-eastern part of the country are not connected to the power grid. Since the collapse of the Soviet Union, electricity generation showed both a dramatic decline up to 1999, followed by a gradual recovery (Country Analysis Briefs 2005) (Graph 2.3.1.2).

Graph 2.3.1.2 Electricity Generation Dynamics in Russia

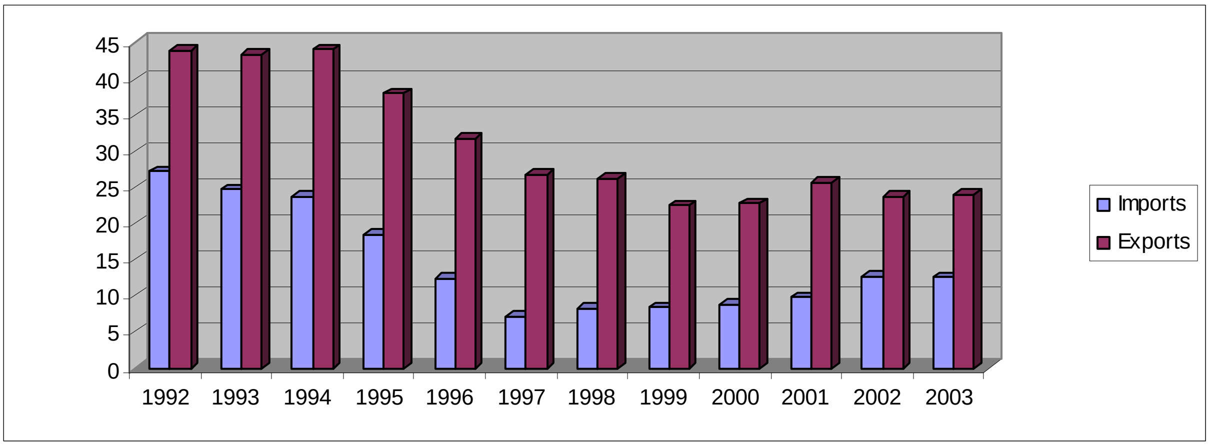


Source: Country Analysis Briefs 2005, EIA; own presentation.

Thermal power (oil, natural gas, and coal-fired) accounts for roughly 63% of Russia's electricity generation, followed by hydropower (21%) and nuclear (16%). The Russian government has stated its intention to expand the role of nuclear and hydropower generation in the future to allow for greater export of fossil fuels (Country Analysis Briefs 2005). Electricity export and import activities are of great importance to Russia (Graph 2.3.1.3).

Graph 2.3.1.3 Exports and Imports of Electricity of Russia,

bln Kilowatts



Source: Country Analysis Briefs 2005, EIA; own presentation.

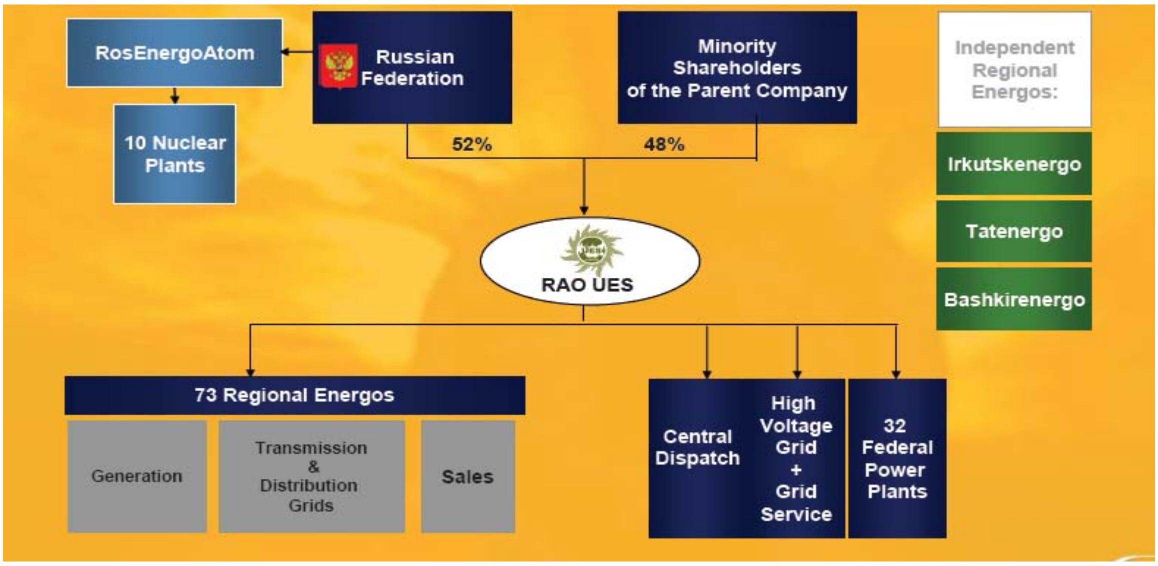
The country's largest generation owner, Unified Energy System of Russia (UES) which is 52% owned by the Russian government (Gazprom has a considerable stake), controls most of the transmission and distribution in Russia. There are seven separate regional power systems in the Russian electricity sector. UES owns 96% of the transmission and distribution system, the central dispatch unit, and the federal wholesale electricity market. Currently, wholesale competition and choice of electricity supplier are nonexistent for consumers in Russia, but this will change under the new plan when implementation begins in 2006. In December of the last year there was delay by twelve months in the first sale of electricity generation assets was announced. This increased the public's and investors' concerns of sluggish reforms (Proskurnina, Simakov *et al.* 2005)

In March 2004 the first part of the reform was enacted by Presidential bills. This involved new tariff rates on the domestic market that were to be made more universal instead of geographically-specific by July 1, 2005, the liquidation of RAO UES (through partial privatisation) in 2006.

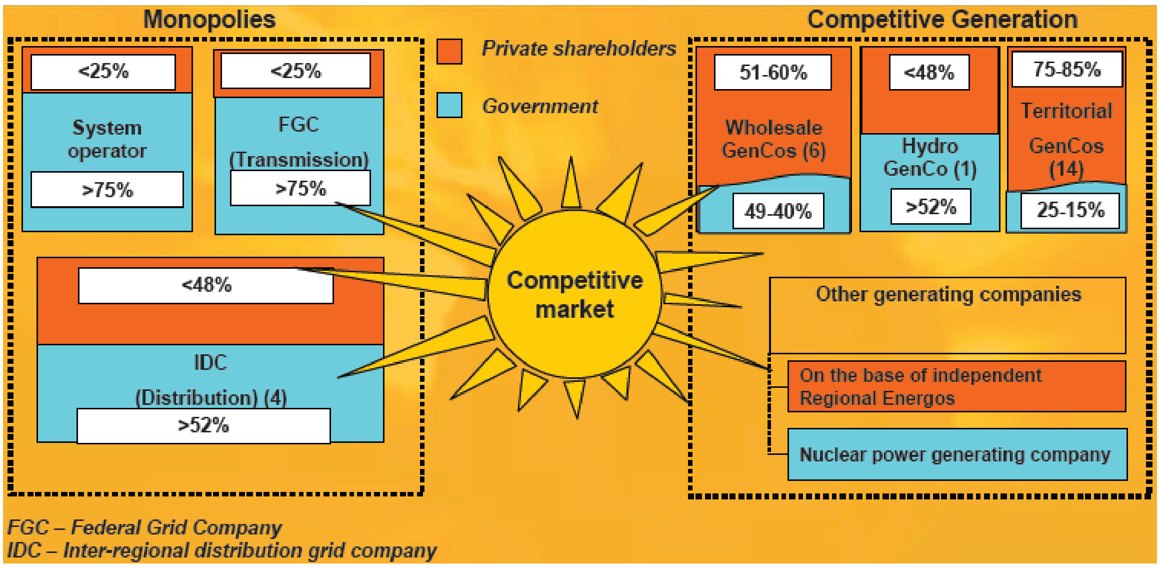
The aim of the electricity reform is to create a generating sector consisting of multiple wholesale electricity companies (commonly called "OGKs"), that would participate in a new competitive wholesale market. In November 2003 Russia officially introduced a "5-15" model (5-15% of the country's electricity sector) of market deregulation which serves as a trading centre mostly for UES regional entities. The creation of 10

OGKs, each of which will own portions of the Russian generation sector, is the foundation for the sector's privatization. Still there is no privatization strategy for the OGK and the reform is postponed till sometime in 2005-2006. There is some progress in auctioning off some wholesale generation companies though it is mostly Gazprom that bought the assets. Its share being 10,3% in UES and a 25% share in Mosenergo (another generation company, situated in Moscow region) (Russia Country Analysis Briefs 2005) (Figure 2.3.1.3).

Figure 2.3.1.3 Pre-Reform Structure of RAO UES and…



…Target Sector Model



Source: Chubais 2005:13-14.

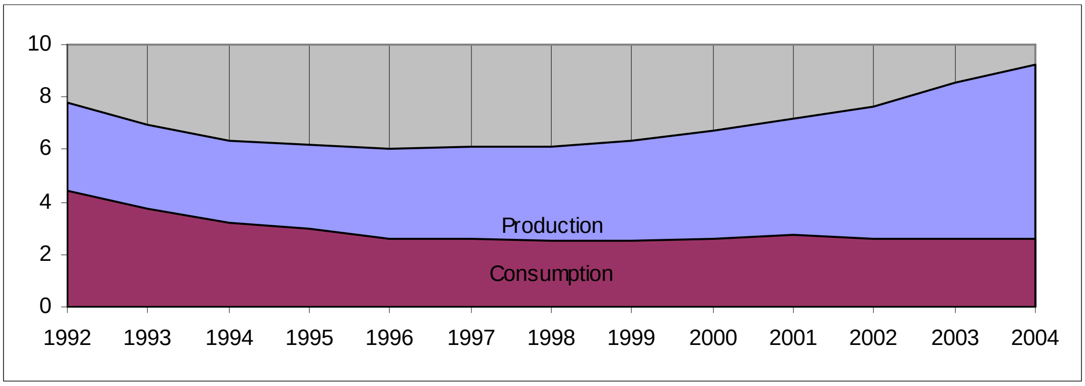
The implementation of the reforms is somewhat torpid and one-sided. According to the reform plans the new regional distribution companies will have to function as guaranteed suppliers to all customers and bilateral contracts between generators and customer will continue to be mandatory at fixed prices set by the government (Götz 2003:217-219). In this respect, the same problem of regulatory and economic functions being in conflict is present.

2.3.2 Privatization and its Children - Russian Oil Tycoons – Oligarchs

Though the ways of the Russian privatization are being criticized constantly and not without reason (and unfortunately, there is still a possibility to structure the privatization requirements so as to favour specific bidders, e.g. Slavneft), its results are reflected in the structure of ownership in the oil sector of Russia. Generally, according to the World Bank research on ownership and control, the Russian ownership concentration within industries and across the economy is dominated by a group of 23 largest private owners and their business groups. Ownership concentration is uneven across sectors as these financial-industrial groups (FIGs) tend to control enterprises in a number of "strategic" sub-sectors: oil and raw materials, automobiles, and chemicals. In other sectors the phenomenon is absent. These firms in the oil sector are invested by 30% more than others (Guriev, Rachinsky 2004:2; Executive Summary 2005:6). Concentrated ownership proved to be beneficial in individual firms, but not at the national level.

As to the oil sector in Russia, its potential is tremendous. Russia has proven oil reserves of 60 bln barrels. In the 1980s, the production of the Soviet Union peaked with 12.5 mln barrels per day in 1988 (mostly from Russia). After the fall of the Soviet Union in 1991, oil production fell precipitously, reaching a low of roughly 6 mln bbl/d, or around one-half of the Soviet-era peak but in 1999 a turnaround in the Russian oil output began. This was spurred by privatization in the sector and successive use of newest technologies, higher world oil price, and partially after-effects of the 1998 financial crisis and rouble devaluation. The rebound has continued since 1999. Accordingly, in 2003, Russia was the world's second largest producer of crude oil, behind only Saudi Arabia (Country Analysis Briefs 2005). More recently, there is a slight decline in production growth which is attributed to re-nationalisation of some oil-producing firms. The incentives for improving techniques therefore improving current production become less clear (Graph 2.1.2.3). Most of the literature indicates this tendency as "the Yukos affair" (e.g.: Goriaev, Sonin 2005).

Graph 2.3.2.1 Dynamics of Total Liquids Production and Consumption in Russia (Oil and Oil Products), th bbl/d



Source: Country Analysis Briefs 2005; own presentation.

The largest part of the Russian oil is sent abroad, about two-thirds of its exports to Central and Eastern Europe, along Russia's major export pipeline, Druzhba, and its multiple branches.

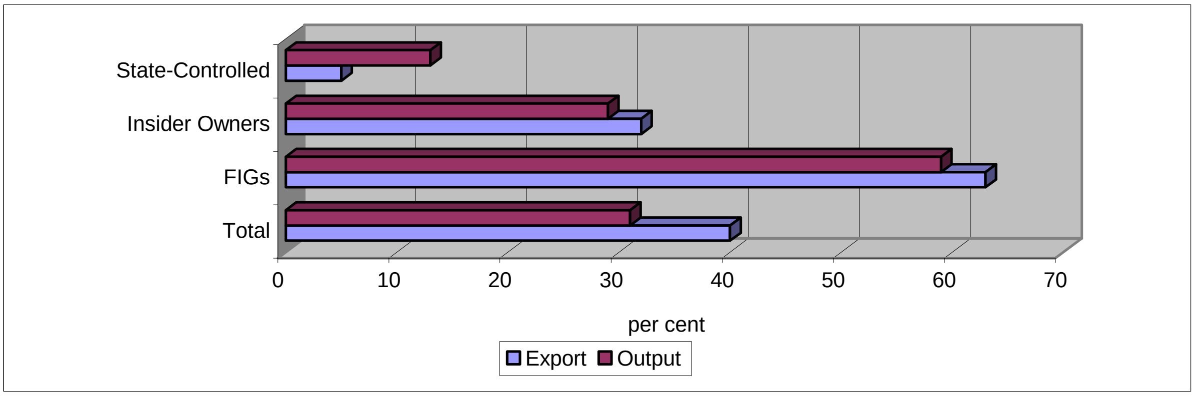
Kremlin policy-makers and Russia's oil companies aspire to increase oil exports but sometimes these two sides are at odds over how best to boost the country's export capacity. Crude oil exports via pipeline fall under the exclusive jurisdiction of Russia's state-owned pipeline monopoly, Transneft. Only about 4 mln bbl/d can be transported in major trunk pipelines of Transneft; the rest must be shipped by rail and river routes which make them more expensive and less viable if world oil prices fall. The bottlenecks in the Transneft system make the company's export capacity incapable of meeting oil producers' export ambitions. The problem has been recognised and some steps to improve the situation taken but is the potential role of private firms and investors (who may play a role) is at stake, presumably at the expense of state-owned Transneft (Country Analysis Briefs 2005).

As stated above, the effectiveness of privately owned companies are much higher then of state-owned firms. According to the sector specifics and peculiarities of Russian privatisation one cannot but fail to see that in term of ownership concentration the oil sector is dominated by the so called oligarchs, Russian oil tycoons. “In contemporary Russia, the term denotes a large-scale businessman who controls resources sufficiently vast to influence national politics" (Guriev, Rachinsky 2004:3).

A common belief is that the oligarchs owe their fortunes to the "loans-for-shares" auctions is only half true. The only fact that unites all the head of the FIGs is connections on the governmental levels and financial capital available to purchase ownership in privatization auctions at the right time (Guriev, Rachinsky 2004:11).

The same study reveals that the concentration of ownership in contemporary Russia is higher than in other countries. Micro-level data suggest that oligarchs run their assets better than other Russian private owners. Total factor productivity growth was 8% greater by oligarch-owned firms compared with other private Russian firms. Only foreign-owned firms were better than oligarch-owned in these terms (by 12%). Interestingly, fast productivity growth was associated with greater output growth rather than a decrease in employment (Guriev, Rachinsky 2004:15) (Graph 2.3.2.2).

Graph 2.3.2.2 Oil Sector Companies in Russia: Relative Performance of Average Growth in 2001-2003



Source: Country Analysis Briefs 2005; own presentation.

Many of these differences between different types of firms in terms of ownership could be explained by industry specifics. Oligarchs usually operate in industries where the average enterprise is large. But if one compares the productivity levels of firms in the same industry, there are hardly differences in productivity between oligarch-owned and other private firms (Guriev, Rachinsky 2004:14).

While the relative weight of oligarchs' firms in the Russian economy is tremendous, the firms themselves do not appear excessively large by the standards of the global markets in which most of them operate. Historical experience from other countries, meanwhile, suggests that such a high level of ownership concentration can create considerable problems in building sustainable democracy in Russia.

Quite a few countries have gone through a period of high ownership concentration, but they have eventually moved on and have achieved high levels of economic growth. Not surprisingly, many of these dominant owners were at some point considered illegitimate by public opinion. Though, the high concentration of ownership has in all cases slowed down the development of an effective democratic system. Oligarchs present a feasible counterweight to the corrupt Russian bureaucracy and when on their behalf they lobby actively for the development of market institutions. They are also the only Russian owners who can afford to invest and restructure Russian businesses in a very hostile business climate. On the other hand, they stripped assets from Russian firms and send money abroad, they discredit the ideas of private property and corporation among the public at large, though indirectly. By efforts, sometimes successful, of capturing of federal and state agencies they weaken Russia's democratic institutions. But the most serious difficulty created by Russia's oligarchic capitalism is that privatization has not led to secure property rights. This has created a conflict between the core free market values (private property rights), on the one hand, and crucial democratic values (majority rule), on the other. All in all, their role in the Russian development is far from being obvious.

Recently, in accordance with the political reinforcement of the vertical branch of the executive, one can witness a shift towards expanding the state's role in 'strategic' sectors, the oil sector being apparently one of these (Kulikova 2004). In September 2004, Gazprom acquired a state-owned oil company, Rosneft but the deal was postponed because of connections between Rosneft and Yugansneftgas (Russia Calls off Gazprom Merger… 2005). With the help of the deal, the Russian authorities will acquire more control over the development of the country's natural resources. Gazprom plans to establish an equity share in the wholesale power generating sector and in the nuclear realm though partial purchases of soon-to-be-separated wholesale power producers and by obtaining a majority stake in Russia's only nuclear technology exporter, Atomstroieksport.

Less efficiency, more rent-seeking and slower growth in the very sectors that have been driving growth in recent years hang together with the extension of state control over resource-exporting industries.

The state has also demonstrated a particular knack in “reorganizing” the energy sector evident in “the Yukos affair”. On charges of fraud and tax evasion the Russian government arrested numerous shareholders and top-level executives in the company and auctioned off about 80% of the company’s prime asset, Yuganskneftegaz, for far less than the company's fair market value in late 2004. A week after the auction the company was sold to Rosneft, the state oil company.

The Russian government was forced to make concessions to foreigners and two major mergers in the Russian energy industry took place: in September 2004, ConocoPhillips announced a strategic alliance with OAO Lukoil, (ConocoPhillips Annual Report 2005:8) and in 2003 British Petroleum (BP) completed its merger with the Russian oil company, Tyumen Oil Company, creating a new company called TNK-BP (Central and Eastern Europe Energy News 2003:8).

But recently, there were some announcements that the Russian authorities intend to exclude companies or groups that are not majority Russian-owned from bidding for natural resource development licences, together with the plan to prioritize the building of a $15 bln pipeline to Nakhodka on the Pacific (Weafer 2005). That means that the state is moving to restore greater direct and regulatory control over the oil and gas industry. The authorities not only intend to use greater export volumes to encourage the country’s economic growth. The aim of the GDP-doubling and was to help push for faster integration into the global economy. More energy exports will also mean broader geopolitical gains, including a possible push for WTO access.

The need to restore state control over the energy sector of the economy goes a long way to explain such events as the “Yukos” case and the authorities’ desire to consolidate ownership and control under one holding, Gazprom.

3. Perspectives

3.1 Risks and Tendencies of the Present Development

Not long ago a dramatic century for Russia came to an end. Since 1917 the state and the people have been trying to catch up with the European countries to reach their structural, institutional, technological and cultural levels. They have failed so far, but while there is life there is hope. So one wishes it would be possible in the near future.

Now there is a wide range of opinions in respect of the opportunities Russia has. There is an opinion that there are necessary preconditions for the accelerated modernisation: the predictable authorities with wide political support, the basics of the democratic and market institutions, the relations with the rest of the world on the basis of partnership and common values, additionally, such potentially favourable factors as access to the Internet, the economic rise of the recent years, etc.

One can agree that there is a chance for Russia. Still, there is a further opinion warning of some unfavourable tendencies. In spite of the economic revival of the country they say that the country is still in the state of mired in hyper-depression as the GDP in 2003 officially acknowledged to be approximately 25% below the level of 1989 (Rosefielde 2004:8), and unemployment in the vicinity of 25% during the nineties, though officially underreported. (Rosefielde 2000:8). The support of the authorities is sinking continuously.

It is evident that there are some dangerous tendencies for the newly-born Russian democracy and some authors confirm that Russia's feeble democratization has misfired as the state has reasserted control over the media, the security services (especially the FSB) have become the dominant force in the government, the process of de-privatisation in certain most profitable sectors under way while there is no clear-cut and feasible strategy for the rest of the sectors (Hale 2005:39-41; Ostrovsky 2004). They say that Russia tries to re-establish hegemony in the CIS while ramping up for “a major military modernization drive” (Rosefielde 2005:9) and developing new ballistic missiles to outmanoeuvre America's national missile defence, and maintains 40,000 re-targetable nuclear weapons (Miles 2004).

Grigory Yavlinski, Chairman of the Russian Democratic Party "Yabloko," speaks of six major features of Russia which must be taken into account today. First, Russia does not have independent judicial system. Second, Russia does not have elements of an independent parliament. Third, Russia does not have parliamentary control or oversight of the secret services and law enforcement agencies. Fourth, Russia does not have politically important independent media. Fifth, elections in Russia are manipulated by the government. Sixth, the Russian economy is an instrument of the state (Yavlinsky 2004). Moreover, Russian is accused of authoritarianism (Fak 2004)

This scroll of the alleged tendencies influences directly or indirectly the Russian foreign trade, be they internal or external. Some risks (unfortunately not all of them) are evident to the authorities of the Russian Federation. On the basis of the Security Law a National Security Concept and after that a renewed version of the Concept in 1992 and 2000 respectively were approved by Russian presidents. The recent Concept defines threats (internal and external, active and passive) for the country. To them one can attribute uncontrolled outflow of capital from the state, low investment activities, external debt of the former Soviet Union, imperfection of the tax and customs policies, low volumes of raw materials processing in the country, extravagant technologies in the country's agriculture and industry, wear and tear of fixed assets / decline of the production capacities potential, low competitiveness of the Russian goods, a large share of portfolio investments in the most important sectors of the economy, decay of the scientific and technical (research and technology) potential of the country, a decline in the human resources potential, a brain drain, annual catastrophes and human losses due to industrial disasters, poverty of the population, to name several.

One of the most dangerous "external" threats is the current Russian specialization in the international division of labour and foreign trade as it has the highest degree of dependency upon the world conjuncture in the raw materials prices on the background of the poor diversification of the exports. In the case of Russia, the bias towards the export-oriented sectors implies the change in the direction of low-tech goods.

In this connection there are discussions as to what course of action should be adopted by the state. Rescinding such vital issues as budgetary, monetary and fiscal policies, it is possible to speak of two mainstreams: the first is dirigiste approach. Its opponents try to persuade the public that the authorities should collect for the most part of the rent from the export-oriented sectors and redistribute it administratively in favour of industrial sectors, e.g. machine-building, aviation, automotive industry (according to one's tastes and interests). Some adherents label the approach as normative and aspire to the public spirit while flaunting their desire to live in the country launching its own spacecrafts and flying domestically-made planes.

The second approach could be called liberally-institutional as it is opposed to excessive state intervention and regulation, and its champions point out that institutional, juridical, and administrative and other reforms, are of prime importance to the country at the present moment (Montefiore 2004). The supporters of this approach propose to reduce the non-market share of the economy in the country by reform and privatize the most part of the state ownership as well as to reform natural monopolies and to reshape the budgetary spending.

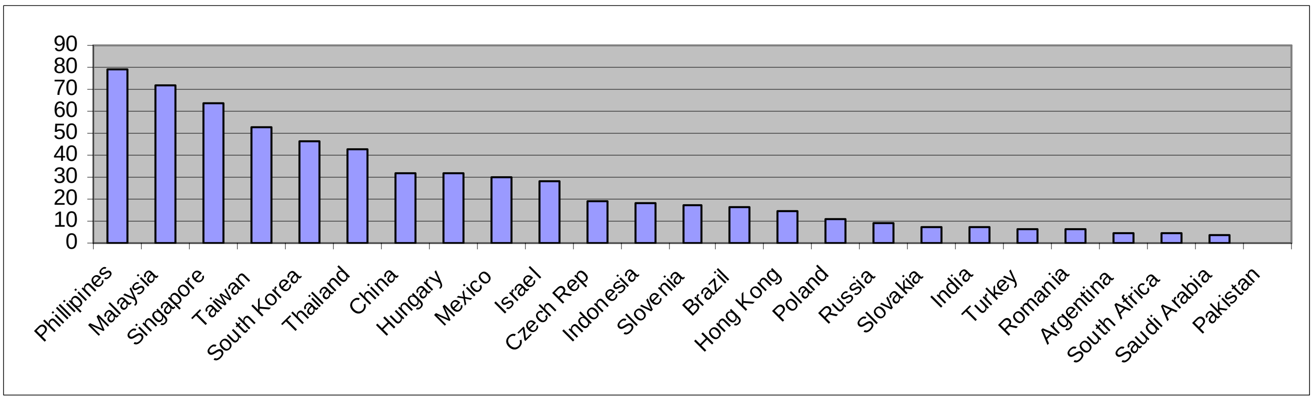
It is revealing that the situation in the sectors as such aviation (however, with some exceptions) and automotive appeal to the state support while telecommunications and spacecraft building industries and missile construction sites have chosen the strategy of full integration into the world economic cooperation and show the considerable signs of world competitiveness (Hishow 2003:12-14; Enhancing Market Openness… 2005:41, 51). One may remark that the military and the arms sectors of the Russian industry have always supported high standards. It is impossible to shut the eyes to the fact that this cooperation has brought considerable advantages and opportunities to both sides.

Constant lobbying of interests in the government hinders the final choice but the second approach seems to gather momentum nowadays. The choice of approach to the problems of the foreign trade is complicated by constant disputes over minor problems of trade with the Russian trading partners. That speaks of urgent need to gain access to the WTO and settle disputes on this level. While discussing the problems of the American chicken, the Russian flat-rolled metallic products and the European second-hand cars Russia neglects the fact that the world has not stopped moving forward. Meanwhile in 1997 the world trade volumes of IT-trade have surpassed the volumes of car, food and metal trade taken together. India has achieved a phenomenal success in exports of software while Thailand and Malaysia have been exporting information technologies (Information Technology to Malaysia 2005, Information Technology to India 2005). The export of software from Russia runs currently into a mere $500 mln but its market is estimated at $4,5-5 bln (Production of Information Technologies… 2004:9).

The world tendency shows distinctly that IT-trade determines the difference between the standard of living of the rich and the poor countries. High technologies and products define the parameters of competitiveness of the country in the whole. The beginning of the twenty-first century sees a birth of new paradigm of technical and scientific development. Its components have a more interdependence between capital and new technologies, a rapid evolution of the so-called economy based on knowledge or "new economy".

In the foreseeable future there will surely be a rise in innovation growth rates in the developed and some developing countries (Russia among them) as there will be inevitable shortages of labour force due to demographic problems (Cervantes, Malkin 2001). There is an urgent need to spend more and more to support the aging population, prevent the aggravating of environmental problems and climate change. It is innovative activities that shape and will shape the economic prospects of the developed and the developing countries. The majority of the developing countries tries to boost the share of high-tech products in their exports (Graph 3.1.1).

Graph 3.1.1 High-Tech % Share in Exports by Country



Source: The Global Production Scoreboard 2005; own presentation.

So far, globalization has touched Russia only marginally, though not in the most perspective sectors. Historically, in 1987 only 18% of Soviet manufactured goods met world technical standards, and the greatest part of the currency was received by purchasing oil, steel, gas, crude iron, gold and arms. Additionally the USSR purchased several kinds of primary commodities (e.g. grain). That structure of the Soviet foreign trade shaped the composition of the goods and services going abroad in the 90's.

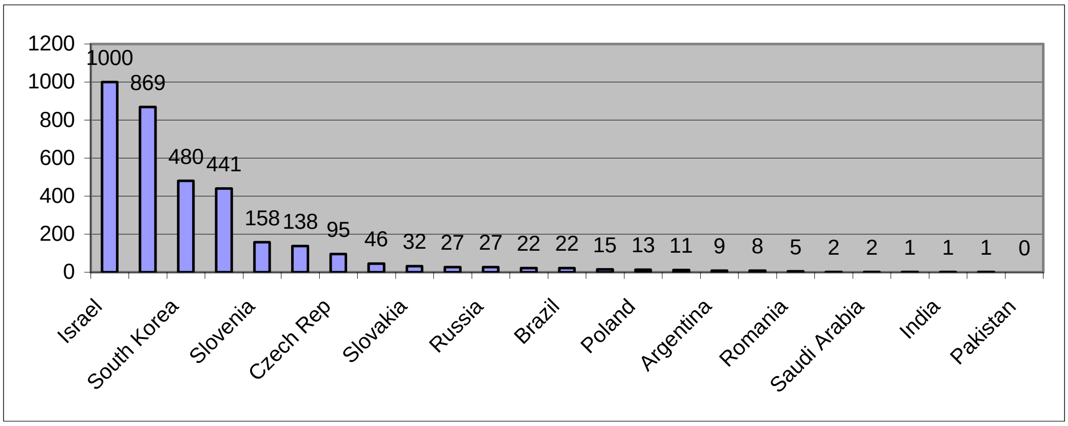
Modern Russia is not an economic power of the world, its share in the world GDP was 2,6% in 1995 (World GDP and Population Date 1995). Its economic partnership and the structure of its trade with the rest of the world is based upon the Soviet legacy of the manufacture and services structure and their more recent developments: the hypertrophy of the heavy industry together with underdevelopment of the agriculture, food and light industries. In the course of the last years the industry had a tendency of a further hypertrophy bearing up for its expanding fuel and energy complexes, metallurgy and shrinking of the machinery as well as import-substituting industries. Partly it is connected with external demand for the above mentioned expanding sectors and disability of the home producers to compete on even with foreign rivals in their own country. In this situation it is no wonder that in the structure of the manufacturing new modern sectors (microelectronics, informatics, biotechnology, IT among them) have an insignificant share. The new progressive sectors have enclave character.

Russia has great potential to harness its IT strengths and overcome its weaknesses due to a well-educated, well-trained, and dynamic workforce focused on science, engineering and technology. Though this workforce potential declines steadily as well. Russia's IT spending has outperformed the global averages for the last three years running at about 20%. Spending in the IT market is projected to reach almost $20bln by 2005. Major factors preventing Russia from fully capitalizing on its human capital strengths are software piracy, poor infrastructure, and poor image. Piracy rates have decreased significantly since the 1990s, Russia is still among the worst rated countries in the world with a rate of 79%. Some legal reforms have been enacted to significantly decrease this number but enforcement is key (Waylett 2004).

Another number of major factors negatively influencing the development of the country and its foreign trade is the state of the Russian science, R&D activities and the process of brain-drain. In the international perspective, Russia does not show good results even among the developing countries mostly due to financial crisis

(Graph 3.1.2). However, it must be realized that international competitiveness increasingly depends on innovation. Among high-income countries, differences in prosperity are closely related to differences in the intensity of innovation. For developing nations, low-cost inputs by themselves are no longer sufficient to maintain competitiveness. Companies must increasingly be able to access and ultimately develop global technology.

Graph 3.1.2 R&D Capacity Index by Country

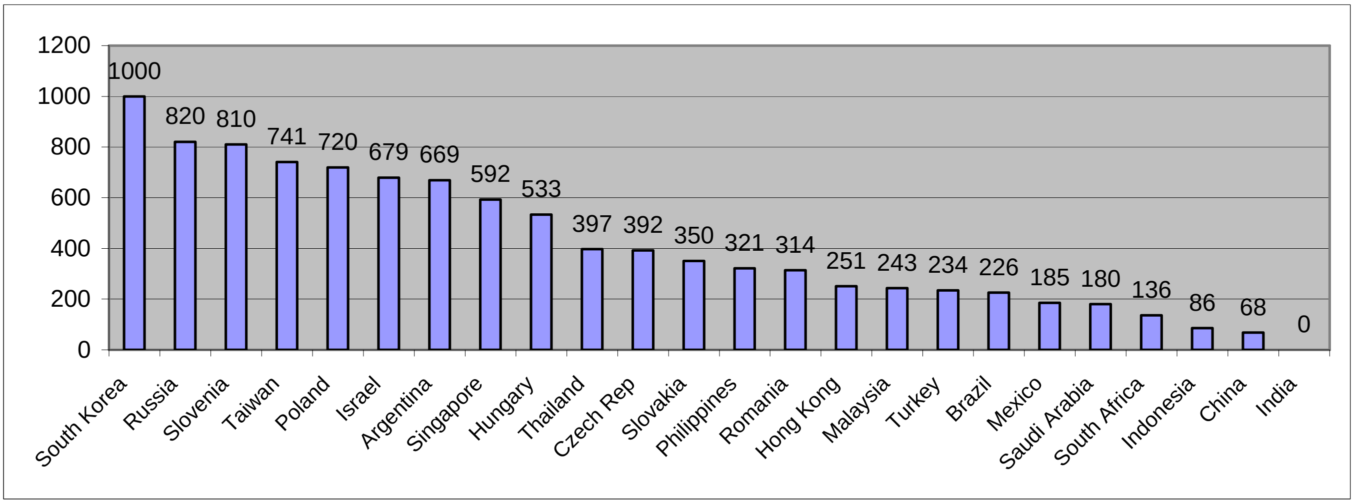


Source: The Global Production Scoreboard 2005; own presentation.

According to Potter's classification Russia is still in the first stage of the competition development, which implies the major importance of factors of production. The place taken by the country in the international division of labour is based mostly on the availability of the natural resources and fixed assets. This path of development cannot be long as these advantages are of relatively short duration (Porter's Five Forces 2004).

At the same time such possible competitive advantages as labour force and progressive technologies stay relatively intact. As to labour resources, the qualification of the Russian labour power is still impressive compared to some developing countries (Graph 3.1.3).

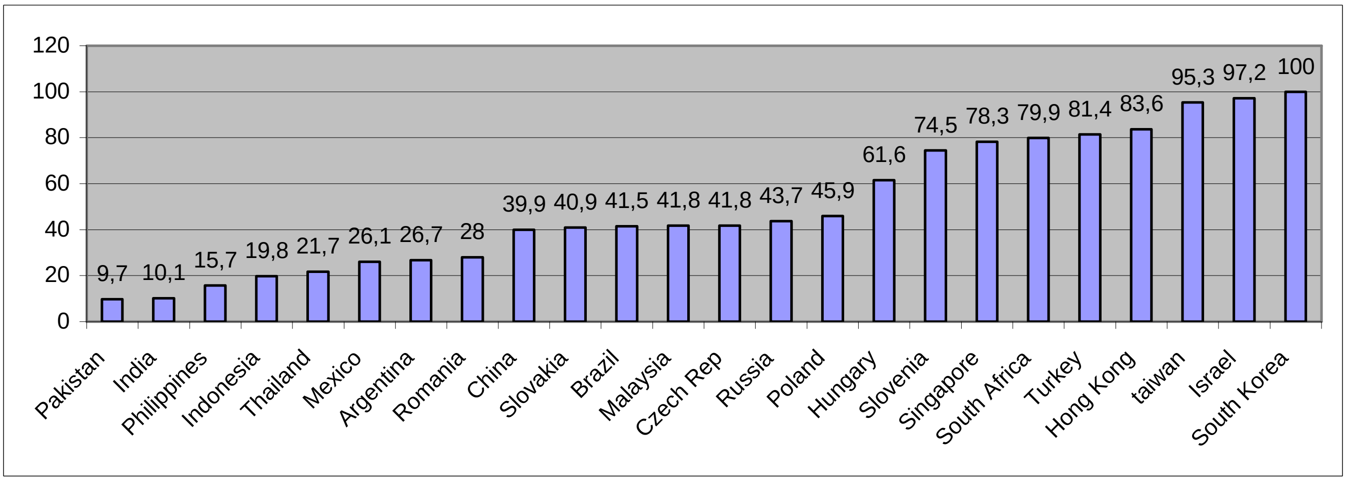
Graph 3.1.3 Availability of Skilled manpower in a Country's Labour Force Index



Source: The Global Production Scoreboard 2005; own presentation.

There is an opinion that the Russian labour is very cheap but in comparison with other developing countries and the countries in transition it proves to be a myth (Graph 3.1.4).

Graph 3.1.4 Wage Cost Index by Country



Source: The Global Production Scoreboard. 2005; own presentation.

In comparison with other countries, the Russian Wage Cost Index could give some hints of possible Russian competitive advantages at the present stage. All the discussed facts contribute to the discussion of the Russian overall competitiveness**.**

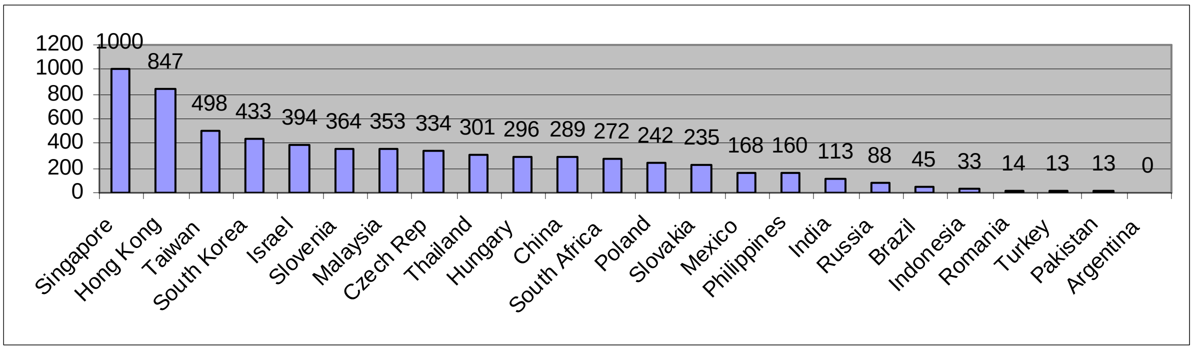
According to the opinion of some Russian researches (e.g. Obolenskij 2002:649-651) the bias of Russian foreign economic relations could be partly explained by some mistakes of Russian politicians of the recent years. They assume that the state concentrated on liberalization, fraternized with the world economic organizations without taking into account some issues connected with optimization of such involvement. One could see a primary fiscal interest in this. Thereby, strategic aims of development (export support and import rationalization) remain virtually neglected.

Currently, the problems are aggravated by wear-and-tear of equipment – the best example is the recent black-out in Moscow (We All Have to Pay for Black-Out 2004). Wearing of equipment and machinery in the manufacture is about 70%, and its average age is twice as high the world common average of any equipment and machinery (Hishow 2002:259-270).

All the difficulties sketched above do not contribute to the competitiveness of Russia on international markets. Competitiveness could be defined as an ability of a state to create proportionally more wealth than its rivalries on the world markets. The Russian competitive advantages are not improved while many countries are seriously worried about the problem and take serious measures to enlarge the number of their competitive advantages. According to the forecasts of the specialists, at the beginning of the 21st century the list of the most competitive countries will begin the USA and the Asian states. In the year of 2030 the most competitive states will probably be the USA, Japan and China, after them Germany, Singapore, South Korea, India. Taiwan, Malaysia and Switzerland. The developing countries remain mostly the exporters of the raw materials, food and goods of a lower degree of processing (Podberezkin, Korobnikov 2003:101).

It is quite logical that almost all the developing countries try to diversify their exports. In this respect the adequate role of the government in the issue of competitiveness is very controversial. There is an opinion that it should support some strategic and basic for the country sectors of the economy or at least help them to keep afloat. There is a lot of opponents of this view, who argue that free market is the best alternative and there is no place for regulation and intervention. Some suppose that the adequate role of the authorities and the state consists in catalyzing activities, in searching for the new and perspective, it should let and make economic entities to reach higher levels of competitiveness, even if it means an abatement of subsidization and so on (Abramova 2003:107). The argument given is that the state cannot create competitive sectors or enterprises. The state's role in the process is important by implication and it helps to reach the success only if the state's activities work out with favourable mainframe conditions. The policy of the state that could lead to success is the "field creation" (or "rules of the game") and not the state's involvement in the process. In the most of the cases the role of the state is rather indirect. Taken as a comparison with other developing states and states in transition the Russian authorities seem to be quite unsuccessful in creating conditions for international business activities till now (Graph 3.1.5).

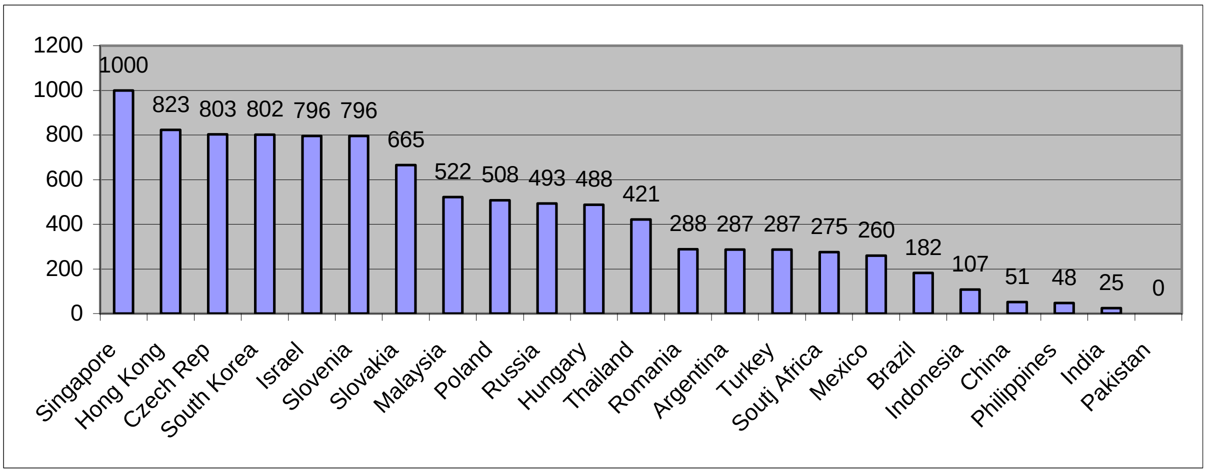
Graph 3.1.5 Government Contribution for International Business Activities Index by Country



Source: The Global Production Scoreboard. 2005; own presentation.

Evidently, the role of the authorities in the improvement of the competitive policy was becoming momentous. States work out strategies and programs to improve the country's competitiveness, the competitiveness of its goods; they play an active part in building the necessary infrastructure for that – ranging from communication, informational technologies, to scientific research and taxation systems. According to the same data, the Russian performance could and should be much better as it is. Taken as an example, the availability of infrastructure in the country is fairly good thanks to the Soviet system but could still be improved further (Graph 3.1.6).

Graph 3.1.6 Availability of "Basic" and "Modern" Infrastructure Index by Country



Source: The Global Production Scoreboard. 2005; own presentation.

In this respect it is also of prime importance to speak of the investment climate in the country and investment risks specific for the country (Suhinova 2004:74-75). As mentioned above, the country's ratings are gradually improving but the money outflow of the country seems to ignore this fact. Political developments in the country contribute massively to the process.

There are two major groups of handicaps to the development of the Russian economic model: its institutional and structural drawbacks. One of the necessary steps to improve the situation would be correction of policy approaches and elimination of inequality of competitive conditions in the country (e.g. abolition of hidden subsidies, preferences equal of import-substitution in food, light and automotive industries). Modernization of three fourths of old but viable enterprises could give 5% growth of the GDP in the course of the next five years (Podberezkin, Korobnikov 2003:113). Next steps could be related to functioning of common market mechanisms and institutions and structural re-organization of the economy. On the basis of the fact that one third of productive capacities is not viable any more, another third urgently needs modernization and the rest has a chance in a world economy restructuring of the economic potential of the country (including agriculture, transport, baking system, etc.) is the priority of the modern generation and in all probability of the next generation as well.

Some authors point out that the analysis of the macroeconomic tendencies in Russian trade could not be accomplished without taking into account the development of the Russian realities, in particular, big business, or FIGs, as discussed above (e.g. Dynkin 2002:43-44; Dynkin is First Deputy Director of the Institute of the World Economy and International Relations, President of the Foundation for Prospective Studies and Initiatives and a Corresponding Member of the Russian Academy of Sciences). They stress the positive role of such groups in re-structuring and maintenance of the employment levels. Informal relations and links help to overcome the shocks of the transitional period and they may evaluate into the stable elements of the system. Formal institutions of Russia do not function automatically thus implying the market segmentation and temporal restrictions of decisions. It means that economic transactions with relatively low transaction costs are possible only among those economic entities which maintain confidential relations. One kind of these relations was implemented in the FIGs. Their share in overall investments is impressive (for example, in the oil sector, but a slight decrease due to insecurity of property rights). It is these groups that could be pioneers in attracting foreign investment in the country (e.g. in the form of joint companies). At the same time there is a tendency of regional expansion of those groups (e.g. in 1993 LUKoiL operated in five regions , in 2000 – in 21 regions) which necessitate the integrity of the entity of the RF, its economic, administrative and juridical aspects as well as its stability (Dynkin 2003).

However, there is an understanding that the concentration of ownership is superfluous. Taken into account all the disadvantages connected with such business-groups one cannot but see that Russia is doomed to use these diversified holdings. These groups are more resistant to external shocks due to their structure which consists of industrial, financial, insurance and non-state pension fund elements. There is a risk of building casts in the society but the creation of proper state institutions to substitute those of FIGs for the general public will take many years.

Thereby, Russia is integrating into the world economic community with its biased structure of economy by leaps and bounds, aging fixed assets, impoverished population, difficulties in spheres of science and education, its exports based on raw materials and minerals, imperfect tax and customs policies, mostly. Quite a low level of the Russian technical development, low competitiveness of most goods and "excess" of natural resources on the background of "catching-up" growth (Burtsev

2001). One can deduce that the structure of the Russian foreign trade correlates with its current potential.

The importance of the foreign trade promoting economic growth was underestimated. In 1996 the government passed a bill “On Additional Support of Domestic Export of Goods And Services” which foresaw the increase of goods of high levels of processing in exports. In particular it was planned to create credit opportunities with the help of state guarantees, state insurances of such projects and schemes, tax preferences, informational and consultation services, promotion on the basis of international fairs and exhibitions and even state shares in capital. But this program remained only a happy declaration as in the year of its enforcement it was spent only RUB 100 mln instead of $900 mln, and during the few next years there was no spending at all. In this respect one should note the marginal meaning of “Roseksimbank” that was created to support exports and imports pf the Russian producers. The bank has a margin of crediting equal to $2,5 mln that logically limits the possibility of any large-scale project. The idea of creating consortiums for such projects saw no implementation.

The years of 2003-2005 saw the development of universal mechanisms for state support of export suppliers. A centre of technical, informational and legal support for SME was created (Resursnij Tsentr Malogo Predprinimatelstva Undated). In 2003 the concept for the development of state financial (guarantee) support of export of Russian industrial products was approved. “State Specialized Russian Export-Import Bank (“Roseximbank”) was appointed again the agent of the Russian Government and is responsible for provision of state support to the exports of industrial products. This time it is stipulated that all expenses on state guarantees will be financed from the budget. In particular, the 2005 federal budget stipulates granting $600 mln for this purpose (Vneshneekonomitcheskij Kompleks Rossii 2004:ii).

The next stage was about adaptation of normative legal acts of the Russian Government that were to set the order and terms of state guarantee provision of national exporters. Federal legislation “About hard currency regulation and currency board” provides for conditions under which exporters can increase their revenue streams and can keep more of these revenues to themselves. Today the state support of exporters has a solid legal frame work which includes both national normative acts and international agreements and legislation.

The country's financial infrastructure received a big boost in 2004 after Russian "Vneshekonombank" and "Roseksimbank" had linked cooperation agreements with financial institutions of major Russian trade partners such as the USA, Germany, France, the UK, Italy; Mexico, India, Brazil, etc. The indicated agreements are expected to promote Russian value-added products (mainly high-tech ones) on the international markets. Information, consulting, marketing and organizational measures of state export support are the most labour and resource-consuming segment of the state export policy. Hopefully, the above described measures will be especially useful for small and medium exporting enterprises.

Still, it is evident that in the near future Russia has no alternative to the mass exports of minerals and raw materials. This direction of export development is laid down in the "Russian Energy Strategy", which foresees the exports of 630 mln tonn of the derived fuels according to the optimistic scenario. On the other hand, Russia is by no means richer in raw materials and minerals than the rest of the world. It means that the question of rational using of its riches should be considered carefully. The Russian riches are not yet depleted, far from it, but it is not the best alternative of their use (Russia's Energy Strategy 2003).

Simultaneously, a large range of questions in respect of future exports is of no less importance as well: issues of market sharing (the increase in export volumes means new market sharing, which is at least dubious), of limited capacities and growth of the internal demand as a consequence of the internal growth dynamics.

It is clear that the economy of Russia is spurred nowadays mostly by its natural resources exports. This direction of the country's development leads it away from the path of the scientific-technological progress. Such bias of the economy is connected in the long run with certain risks and threats. One of them is the imminent depletion of the resources, deterioration of mining operation conditions what brings the increase of expenses and decline in competitive position. The informational revolution and 21st century technologies, development of substitutes and sparing technologies will finally lead to uncertainty of raw materials and fuel prices which will unavoidably impact the

Russian exports as well as the overall competitiveness of the country. To evade the critical situation the country urgently needs a well thought-out industrial policy.

3.2 Experiences around the Globe

A thoughtful and critical approach to the problems in the Russian Federation should not neglect the experiences of other countries. A careful examination of other countries' historical case-studies and an analysis of its positive and negative aspects could only help contribute to the best practices or provide a good / bad example for Russia. It is high time one stopped learning exclusively from one's own mistakes, looked around and saw the world as it is.

3.2.1 Lessons from Venezuela – Corruption, Weak Institutions and Nationalisation[3]

Some economists warn that the Russian government is making some of the same mistakes that prevented growth in Latin America, particularly in Venezuela (Fak 2005). One should take into account all the dissimilarities of the two countries but there are still some similar features that could be traced in both counties – e.g. corruption, high inflation and weak institutions that might really damage the country's development prospects.

Venezuela (just like Russia) is rich in oil. Albeit the first commercial drilling of petroleum took place in 1917, already in 1934 91% of the Venezuelan exports consisted of oil. The industry proved extremely lucrative to the scores of foreign companies that drilled the Venezuelan crude because of the country's low wages, nominal taxes and the policies supported by corrupt relations between foreign oil companies and various military dictatorships. During the next forty years the government and foreign oil companies in Venezuela engaged in a tug-of-war over taxation, regulation, and ultimately, ownership. Although Venezuela reaped substantial benefits from its generous oil endowment, corruption and deceit on the part of the foreign companies and avaricious caudillos still limited their scope.

The Russian corruption record is far from being ideal - Russia is at the bottom of the ranking in Transparency International Corruption Watchdog and it is tied with Tanzania, India, Zimbabwe, Cote d'Ivoire and Honduras for 71st place out of 102

[3] The basic facts are taken from: Venezuela. Country Studies Undated.

countries included in the annual Corruption Perceptions Index (Transparency International Corruption Perceptions Index 2002).

In 1936 on the background of general strikes because of poor labour conditions and wages the Venezuelan authorities concentrated efforts on economic modernization. A central bank, as well as some state-controlled industrial and agricultural development banks, was established. Employing the slogan of “sowing the oil” a program for developing the national economic and social infrastructure was launched and new oil fields to exploitation were opened. The next years saw several political leaders who succeeded in implementing some changes in the country’s democracy along with the 1943 Petroleum Law which assured the government a 50% tax on the oil industry's profits. Though the initial changes in the Venezuelan democratic developments were not to stay long (deplorably, just as in Russia – a surge of democratic processes was changed by fading interest and decline in implementation of changes) as the next five years a brutal dictatorship of Perez and his inner circle of six colonels concentrated political power in their hands. They revived the old idea of “Democratic Caesarism” doctrine and gave it a new name, the "New National Ideal," under which politics would be de-emphasized in favour of material progress (dubbed the "conquest of the physical environment" by apologists for the dictatorship). According to this idea, much of the nation's ever-increasing petroleum revenues were used for ostentatious construction projects. These included a replica of New York's Rockefeller Centre, a luxurious mountaintop hotel, and the world's most expensive officers' club. An even larger share of the state treasury was squandered or simply stolen.

In January 1958 the political pendulum swayed in the other direction when the resurrection of the democracy rudiments had already started. A group of army officers, fearful for their own lives, forced Perez to resign. The dictator alone had accumulated a fortune estimated at $250 mln. He fled to Miami carrying most of what remained of the national treasury. The five-man provisional military junta at first tried to rule without civilian participation. The junta began a valiant effort to deal with the grim realities of an empty treasury and some $500 mln in foreign debt. It immediately stopped work on most of the dictator's public works projects, and later decreed a sharp increase in income taxes. Most importantly, the junta increased the government's share of the profits on petroleum extraction from 50% to 60%.

At the time the Venezuelan authorities tried to control profit-making industries. Deplorably, the Russian authorities try to do the same at the time when they should be attracting foreign capital into the country. The Venezuelan economy was characterized by underinvestment, high inflation and weak institutions. The Russian poor rates of investment reflected the government's efforts to consolidate and control the oil a sector.

In the course of the next few years under Betancourt's rule, the Venezuelan government had no choice but to improve salaries and housing. In what amounted to guarantees to the foreign and local business communities, the parties agreed to respect the principles of capital accumulation and the sanctity of private property. Local industry, furthermore, was guaranteed the government's measures to protect it from foreign competition as well as subsidies through the state. This stark break with the past was inspired by the "Spirit of the 23rd of January," after the date of Perez's fall from power. Having inherited an empty treasury and enormous unpaid foreign debts, Betancourt nevertheless managed to return the state to fiscal solvency despite the persistence of rock-bottom petroleum prices throughout his presidency. He also managed to continue the effort, of "sowing the oil" by initiating a variety of reform programs, the most important of which was agrarian reform. Vastly enlarged state subsidies benefited the poor in such areas as food, housing, and health care.

Interestingly, the "Spirit of the 23rd of January" informed the 1961 constitution and created a weak bicameral legislature, where partisan political conflict could be aired but would cause a minimum of damage. The president was given considerable power just like in Russia where the bias towards executive and the strong presidency is clearly-cut. Due to this fact the democracy of Russia is tabbed as "illiberal" or "defect" (Mommsen 2004: 423).

During 1960 in Venezuela two institutions were founded: the Venezuelan Petroleum Corporation, conceived to oversee the national petroleum industry, and the Organization of the Petroleum Exporting Countries (OPEC). Both organizations were the creations of Juan Pablo Perez Alfonso, who, for the second time, served as Betancourt's Minister of Energy. During his term, Perez Alfonso had earned the wrath of the foreign oil firms with his proposition to re-nationalize the petroleum industry; this idea once again became government policy. Meanwhile, a recovery in petroleum prices and the relative political tranquillity spurred robust economic growth. Reform programs kept their course and some impressive infrastructure projects designed to open up the nation's interior to agricultural and industrial development were introduced. In 1971 a first step in the direction of nationalization, the Hydrocarbons Reversion Law stipulating that all of the oil companies' Venezuelan assets would revert to the state when their concessions expired, was made and the lay went into effect. In the Russia of today, first tentative attempts of re-nationalization of the oil industry are obvious.

Another similar feature between two countries is the Venezuelan Investment Fund (FIV). In February 1974 when Perez assumed the presidency, he was immediately faced with the seemingly enviable task of managing a windfall of unprecedented proportions as in October 1973 Arab-Israeli War triggered a quadrupling of crude oil prices in a period of only two months. To combat the inflationary pressures he set up the FIV, with the objective of exporting 35% of this unexpected income as loans to Caribbean, Central American, and Andean neighbours. The rest of the "excess capital" went to various multilateral lending institutions. This loan program engendered considerable international goodwill on behalf of Venezuela. Building on that prestige, Perez and the Mexican president Luis Alvarez (1970-76) founded the Latin American Economic System (SELA). SELA had twenty-three Latin American nations as its initial members in 1975 and it was formed to promote Latin American cooperation in international economic matters. The idea of creating a "new international economic order," in which the developing nations of the southern hemisphere would challenge the economic hegemony of the developed nations of the north was in the air (In Russia the creation of the Stabilization Fund pursues other aims currently).

The Venezuelan policy of "managing abundance with the mentality of scarcity" had no success in the long run as the authorities embarked on a spending spree designed to distribute Venezuela's oil wealth among the citizenry. Price controls that subsidized the public consumption of food and other commodities were introduced, government-authorized wages increased, combined with foreign exchange controls that subsidized imports. All that led to high consumption rates by the population – e.g. per capita consumption of Scotch whiskey soared to a level among the world’s highest, German cars and American clothing were no more a rarity. Though the Perez administration initiated various programs to spur employment, income distribution was less equitable in 1976 than it had been in 1960. The government continued to put a large portion of its petroleum revenues into building an industrial base, with the objective of generating future income after the nation's oil reserves had been depleted.

Well aware of the fact that the volume of bureaucratic entanglement of fiscal responsibilities would be increasing continuously the Venezuelan funding was vested in autonomous and semi-autonomous entities. The four years following the 1973-74 oil boom saw the creation of no less than 163 such entities, ranging from textile and lumber companies, a hydroelectric consortium, to an airline and a national steamship company. By 1978 the budget outlay for state-owned enterprises and decentralized agencies was 50% higher than the federal budget. In January 1975 the nationalization of iron ore industry took place and in 1975 a bill on nationalization of the petroleum industry was approved.

This craze with nationalization could be mostly responsible for the ills of life throughout the 70s in Venezuela. The Perez administration had devised its grandiose Fifth National Plan under the assumption that rising oil prices would boost government revenue throughout the 1970's. Instead, Venezuela's oil income levelled off in 1976, and then began to decline in 1978. Foreign commercial banks, awash with petrodollars deposited by other OPEC nations, provided loans to make up the shortfall so that Venezuela's development program could proceed on schedule. On the one hand, the banks saw oil-rich Venezuela as an excellent credit risk, while on the other hand, the autonomy of Venezuela's state firms allowed them to borrow excessively, independent of central government accounting. They chose mostly short-term loans, which carried higher rates of interest. As a result, by 1978 the public-sector foreign debt had grown to nearly $12 bln, a five-fold increase in only four years where an estimated 70 to 80% of this new debt had been contracted by the decentralized public administration. The Perez administration spent more money (in absolute terms) in five years than had all the other Venezuelan governments during the previous 143 years combined. Perhaps inevitably, a lot of money was squandered in mismanagement and corruption. Despite expansive overseas programs to train managers in the new public entities, the lack of competent personnel to execute the government's many sophisticated endeavours became painfully evident. The delays and myriad cost overruns formed the backdrop of frequent malfeasance by public officials. Overpayment of contractors, with kickbacks to the contracting officers, was perhaps the most rampant form of graft. Featherbedding and the padding of payrolls with nonworking or nonexistent employees also became common practices (These types of activities are well-known and widely used in Russia nowadays).

The period of 1984-89 saw devaluations of the currency, a multi-tier exchange-rate system, greater import protection, increased attention to agriculture and food self-sufficiency, and generous use of producer and consumer subsidies. From 1985 to 1988 the country experienced a sustained modest growth but by 1989 the economy could no longer support the high rates of subsidies and the increasing foreign debt burden, particularly in light of the nearly 50% reduction of the price of oil during 1986. In 1989 the second Perez administration launched profound policy reforms with the support of structural adjustment loans from the IMF and the World Bank. In February 1989, prices were increased. The reforms sparked several days of rioting and looting in the country. It was the worst violence since the country's return to democracy in 1958.

Ironically, Perez, who oversaw much of the government's expansion beginning in the 1970's, spearheaded the structural reforms of 1989 with the goal of reducing the role of government in the economy, orienting economic activities toward the free market, and stimulating foreign investment. The most fundamental of the 1989 adjustments, however, was the massive devaluation of the bolivar. By 1991, some related policies sought to eliminate budget deficits through the sale of state-owned enterprises, to restructure the financial sector, to liberalize trade through tariff reduction and exchange-rate adjustment, and to abolish most subsidies and price controls. The government also aggressively pursued debt reduction schemes with its commercial creditors in an effort to lower its enervating foreign debt repayments.

Most of the events that had happened in Venezuela were almost immediately repeated in Russia. The symptoms of "the Dutch disease" noticed in Russia could possibly turn out to be the Venezuelan disease in its worst form. It suggests that the state's policy is aimed at heavy taxation and bureaucratic regulation of financial flows in the extracting sector, the nationalization of successful companies there, maintenance of the state monopoly over the infrastructure of the sector, abolition of property rights with regard to the riches of the soil, forcing out foreign investors from the exploration of fields or deposits with the help of political uncertainty, protectionism, which was to cover the rest of the sectors in the economy in the long run.

3.2.2 Lessons from Norway – Stabilisation Fund and Strong Civil Society Institutions[4]

Norway is also rich in oil as it has approximately half of the remaining reserves of oil and gas in Europe. The Norwegian authorities chose to ensure the welfare of future generations while extracting oil and gas on a long-term perspective and converting these riches into financial riches in the shape of an oil fund. The Norwegian State Petroleum Fund provides short-term fiscal stabilization across the oil price cycle and acts as a mechanism for transferring wealth from current resource exploitation to future generations. The idea proved to be successful as Norwegians are 60% richer now than they were in 1980. Evidently, the petroleum revenues have contributed to more equal distribution of income (The Norwegian Experience… 2003:2).

Generally, the typical purpose of a non-renewable natural-resource - based stabilization fund is to help a government deal with its large, fluctuating income from natural resource use. The history of oil-based stabilization funds has so far been mainly disappointing. During the 1980s, when oil prices fluctuated severely, many countries got rid of their oil funds because governments found it hard to differentiate between temporary and permanent price changes and therefore when to ease up or crack down on collections. As stabilization funds are usually outside existing budget systems, the misuse of the funds by insiders has also been a common problem. In 2001 the IMF researchers found that the creation of a fund did not stabilize government income over fluctuations in most countries with oil-based stabilization funds. Instead, these funds complicated fiscal policy (Davis, Ossowski *et al.* 2001). The study suggests that governments should concentrate on fiscal policy in a long-run context, focusing on maintaining a sustainable non-oil fiscal balance and restraining expenditures when oil prices rise. The study's notable exception was Norway. The State Petroleum Fund in Norway was considered successful precisely because it was actually large enough to absorb fiscal fluctuations and transparently administrated without rent-seeking.

[4] The basic facts are taken from: Hagland 2000.

The Norwegian fund is by far the largest of all such funds and it is clearly designed for long-term stabilization. Thus, the Norway counterpart could teach its youngster (the Russian Stabilization Fund) some useful lessons. The Russian Fund was created in February 2004 with the transfer of a share of RUB 106 bln in budget revenues from 2003 to initially capitalize the fund. The Fund is financed from the natural resource extraction tax and crude oil duties when the price of Urals-grade oil exceeds $20 a barrel, after 2004 - $23. During 2004, the Fund grew faster than expected due to the rapid rise in world oil prices. By the end of 2004, the Fund's value was RUB 522 bln ($18bln), which was equal to 3% of the Russian GDP (BOFIT Russia Review 2005:2). Under the Budget Code, the first RUB 500 bln accumulated in the Fund may only be spent on financing federal deficits that occur when the Urals oil price falls below $20/barrel / $23/barrel. That initial RUB 500 bln represented the projected deficit that would be caused by two consecutive years of low oil price (around $15/bbl). Above this ceiling, the government is free to spend revenues for purposes agreed with the Federal Assembly. Such purposes presently include early repayment of foreign debt and spending on certain structural reforms.

Like the funds in Norway and Kazakhstan, the central bank manages the Fund according to the rules set down by the Ministry of Finance. According to the current plan, revenues from the fund may only be invested in foreign securities defined by the government. A beneficial side effect of the arrangement is that investments from the stabilization fund tend to stabilize the exchange rate, by helping to curb excessive money supply and, hence, inflation.

A quick comparison of the Russian Stabilization Fund with other funds reveals that the Russian fund is both younger and smaller than its counterparts. Russia's original plan was a modest fund of RUB 500 bln, but it has so far continued to collect it beyond that limit. As it is managed by the central bank and used only according to political decisions, the risk of misuse is lower than in most oil-rich states (BOFIT Russia Review 2004:4), however, the pressure to ease up on collections grows constantly. The plans to invest in foreign securities is healthy, since investing in domestic markets carries the risk that volatility of resource revenues could spill over into the economy.

The lessons of the IMF study on stabilization funds are that such funds cannot be a substitute for effective fiscal policy. Instead, funds should be seen as tools for stabilizing fiscal policy over time. Because size matters here, the Russian government should strive to continue building the fund during periods of high oil prices and acknowledge the goal of long-term stabilization. For Russia, the creation of a substantial stabilization fund during this “window of opportunity” may prove more valuable than gold down the road.

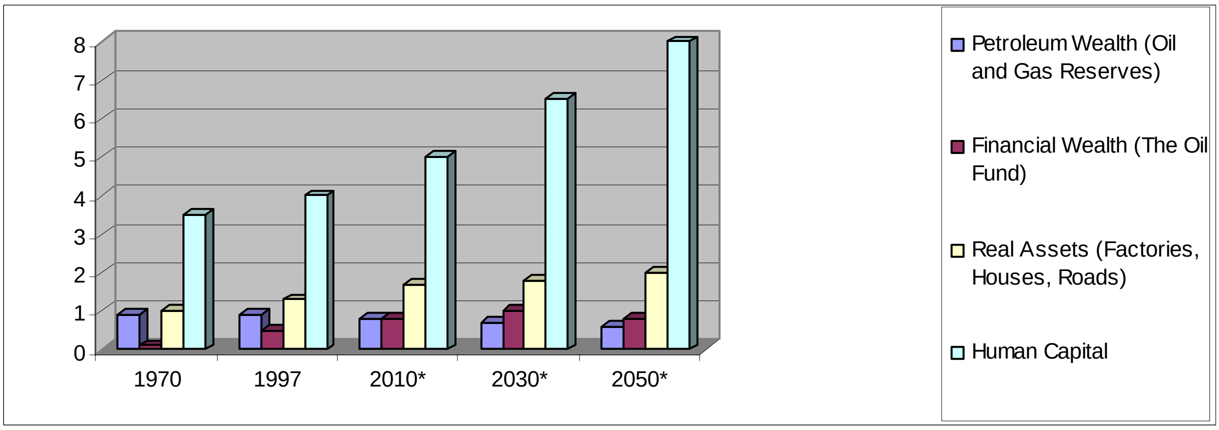
One should learn and aspire to establish a stable democracy with traditions of transparency and solid institutions, strong anti-corruption mentality, especially among bureaucracy, unrestricted media attention and accountable political leadership as it is in Norway. This country seems to be in a better position to deal with resource wealth than many other nations with similar access to valuable non-renewable resources, however, there is no guarantee against bad strategic decisions. Indeed, it’s probably true that the transferability of one country’s experience to another is limited, even when that experience is not location- or resource-dependent; things like an entrepreneurial culture, honest public institutions, or a willingness to sacrifice resources today for greater resources tomorrow can’t be replanted like flowers. But the example is set and it works. Furthermore, the ways to reach the state are quite clear.

Interestingly, Norway has always encouraged participation from overseas oil and gas companies (Hagland 2000). The world's biggest oil companies operate today on the Norwegian shelf. In this way Norway procures the widest possible professional basis for the extraction of its oil reserves.

Moreover, the national wealth per capita grouped by its components shows the tendency of growing human capital in the country. Considerable investment in human capital has always been the country’s key priority and it has been paid off as Norway is currently ranked the first in the UN Human Development Report (Human Development Reports 2003:237, 2004:139) (Graph 3.2.1).

Graph 3.2.1 Norwegian National Wealth Per Capita Dynamics,

Mln 1997-NOK



Source: The Norwegian Experience 2003; own presentation.

Interestingly, Gylfason and Zoega argue that a country's dependence on its natural resources influences both inequality and growth. More and better education is associated with less inequality and more rapid growth. The data also bear out an inverse relationship between economic growth and the share of natural capital in national wealth. Norway is the best example (Gylfason, Zoega 2002:32).

Moreover, Norway also has ambitious environmental goals for the development of its energy. Simultaneously, it wants to be a front-liner in environmental issues. The authorities and the oil industry are working together on the development of new, environment- friendly technology for petroleum activities.

It is quite clear that there is no escape from "the Dutch disease" for Russia and the cleverest thing to do is to limit the damage of it wisely. It presents the challenges to political and economic prudence and culture for any country. The destructive quest for "my share" could lead only to political populism as well as economic suicide.

3.2.3 Lessons from South Korea – Chaebols and Catch-up Development[5]

The concentration of the Russian ownership is often compared with the South Korean chaebols. A closer look at the problem can give some useful hints in this respect.

[5] The basic facts are taken from: The Lessons of the Chinese and South-Korean Reforms for Russia (2) 1997.

The economic environment of South Korea could be described by such key-words as centrally-led capitalism (Economic Planning Board) justified by the idea of the national security, ”growth first” and five-year plans at that time. As the pioneering force behind South Korea’s economic growth large business groups consisting of large companies enjoyed various privileges from the state. These groups, called chaebols, were owned and managed by family members or relatives and operated in many diversified business areas. The 1960’s and 1970’s saw the successful implementation of the Korean choice in favour of export-promotion and import-substitution. For 20 years, since the mid-1960’s, the average annual index of economic growth was 6,6%, one of the highest in the world. The GNP rose steadily as South Korea turned from an agrarian into an industrialized country. In the beginning of the 1960s light industry developed rapidly. In the 1970s the emphasis was shifted to heavy industry (chemical, steel, motor-car, shipbuilding and industrial equipment). The share of the manufacturing industry in the country's exports rose from 22% in 1968 to 88,2% in 1973.

At the end of the 1970s the crisis of social structures in South Korea came to a head. Initially the state and business were generally satisfied with each other in spite of strict control by the government and harsh punitive measures for the violation of its instructions and the model of rapid extensive industrialization suited both sides. But as the economy made progress, the chaebols (monopolies) grew strong and tended to become independent (provided they retained all the benefits and privileges granted by the government). The imbalances between the monopoly of big business, on the one hand, and small and medium-size businesses, on the other, became too great. The economy grew mostly at the expense of the available resources and accumulations rather than due to growth of the productivity of labour. On the background of careful and phased liberalization and "opening" of the South-Korean economy there were evident changes in the relation between the state and big business.

In Russia, the stronger the oligarchs grow, the more they influence the politics in the country. A few of them served in government in 1990’s (two as high up as deputy prime ministers in charge of economic policy), many have been members of parliament. In 2000, the oligarchs took over the Russian Union of Industrial and Entrepreneurs (RSPP), which was converted from an association of middle-size manufacturing enterprise managers into a leading lobby of big business (Guriev, Rachinsky 2004:21). This is comparable to the initial stage of chaebolisation in South Korea. The Korean chaebols could work successfully only on the domestic market where they were protected against interference from outside, but they were non-competitive on the world market. The Russian counterparts are mostly competitive on the foreign markets.

The incompetitiveness of the Korean chaebols made the governments of Chung Doo Hwon and of two following presidents, wage a continuous struggle against them, trying to break them up and make them agree to more narrow specialization and to concentrate on some three major industries. In 1991, the government promised to lift all bans and restrictions on their activity (which had existed since 1984), and to grant tax cuts and other benefits if they agreed to limit their specialization. Those who disagreed were threatened with the withdrawal of bank credits and loans on easy terms for buying land and creating new companies.

In Russia the main task seems to curb the oligarchs' political influence. In 2000, in Mr. Putin's open letter to voters, he promised to treat the oligarchs in the same way as other entrepreneurs. Later he announced that all interest groups would be kept at an "equal distance" from his government. On becoming President Mr. Putin offered them the following pact: as long as the oligarchs paid taxes and did not use their political power (at least not against Putin), he would respect their property rights and refrain from revisiting privatization. This pact defined the ground rules of oligarchs' interaction with central and regional government for Putin's first term (2000-2004). Although the pact could never have been written down, even the general public was well aware of its existence. A poll by an independent non-profit Russian polling organization a week after the meeting showed that 57% Russians knew about it (Petrova 2000).

Putin's threat to prosecute any oligarch was implemented in 2003 when the prominent oligarch Mikhail Khodorkovsky, the major owner of the "Yukos" oil company, deviated from the pact by openly criticizing corruption in Putin's administration and supporting opposition parties and independent media (Comments on MBK's Arrest 2003). He and his partners were soon arrested or forced into exile. It is not clear why Khodorkovsky did not stick to the pact, however, Putin has clearly demonstrated that his priority was to establish his credibility even if this damaged his economic agenda.

“The Yukos affair” is supposed to clarify the rules of the game between oligarchs and the Kremlin (Schröder 2003). Oligarchs have learned the risks related to violating the pact and so, in the future, they will be presumably less likely to interfere in national politics.

Ironically, by crushing Russia’s most transparent company, Putin has pursued the “political antitrust” policy that was crucial in building the U.S. democracy and economy in the beginning of the twentieth century (Rajan, Zingales, 2003:9). Even though oligarchs remain economically powerful they no longer have any weight in politics.

As to South Korea, it took almost 15 years before the struggle by the succeeding Korean governments against the chaebols, bore fruit. In spite of some head-on collisions the Samsung Corporation was the first to establish good relations with the government. It specialized in electronics, chemicals and heavy engineering. The others followed the example. In Russia, the outcome of the struggle is not yet clear as the struggle has just commenced.

Just like in Russia nowadays, the Korean government was well aware of the need to modify its relations with business circles as the economy became developed into a complex system. Initially, consultations at a semi-official level were held up, thereafter the institution of twenty Private Sector Consultative committees were made responsible for the respective sectors of public production. The main function of these committees was to draw up recommendations for the government on formulating macroeconomic, industrial and technical policies. The acme of these initiatives was the creation of the Committee for Industrial Development, a private sector organization responsible for the review of industrial policy as a whole. Under the law of 1986, the Ministry of Trade, Industry and Power had to receive a preliminary endorsement by this committee for its recommendations on the regulation and development of industry. Gradually, business became more rights formulating economic policy and the state dropped its direct intervention in the economy and restricted itself to regulation at the macro level.

In Russia, the Russian Union of Industrialists and Entrepreneurs was established in 1995 to resolve practical problems of promotion of business and enterprises in Russia. After securing control over the RSPP’s governance the oligarchs created and led multiple taskforces, each responsible for a specific avenue of reform: tax reform, industrial policy, foreign trade, land reform, judiciary reform, railroad reform, international relations, and many others. Since 2000, active lobbying activities were quite apparent (Mommsen 2004:405). In many cases, they have been conducive to Russia's long term economic prosperity. However, the intensity and outcomes vary widely across specific activities. The best example is the attitudes to the Russian WTO accession (Cottrell, Wagstyl 2002).

During the second half of the 1980s two main directions of development gained momentum: first, industrialization and shaping the post-industrial productive forces. To stimulate the creation of flexible manufacturing industries putting out durable goods and engineering products based on skilled labour and high technologies, the government began to encourage, on the one hand, the importation of the relevant technologies and stimulated investments in R&D, on the other. In this respect the aspirations of the government and the chaebols coincided as large corporations manufacturing electronic equipment discovered soon that the license fees constituted a larger share of the cost of production than the cost of the work force. A similar situation prevailed in the motor-vehicle and other high-technology industries. About 2% of the Korean GDP was invested in R&D in the second half of the 1980's and the plans saw an increase in expenditure to 5% by the year 2001. The chaebols paid three-fourths of the expenditure. It is obvious that South Korea made extensive preparations for completing the process of shaping its modern national economy and its full integration into the world economy on an equal basis.

In this respect, another lesson that could be learnt from South Korea is the process of catch-up development. During three and a half decades South Korea has covered more than half the distance and closely approached the developed capitalist countries of the West and Japan. Faced with the same problems in different periods of the history, Russia and South Korea chose two different models, two different paths to follow. The Russian authorities picked as its guiding star the modern model of developed Western (i.e. American) capitalism and adopted the conception of the EBRD and IMF which lays excessive stress on macroeconomic stabilization and structural (financial) adaptation and which has been tried out in many developing countries without any success. As far back as 1991, the Japanese government officially criticized this approach and insisted that to reach the goal of self-supporting economic growth, governments should pursue a policy of stimulating investments, that the leading branches of production should be clearly identified, and that target - oriented and subsidized credits should play the key role in promoting industrialization.

South Korea has chosen Japan's experience of economic development as the model to emulate. South Korea first laid the foundation of the future edifice of its economy and raised the walls (i.e. implemented the strategy of dualistic industrialization), covered it with the roof (macro stabilization and structural financial adaptation) and only then began to invite "guests" (liberalization of foreign trade and foreign financial activity), doing it very cautiously and selectively. As to Russia, it built the roof on flimsy supports and invited the "guests" right away.

Last but not least, a few words about democracy and economic development should be said. The process of democratization in South Korea began as a consequence of successful economic development leading to major changes in the social structure and political consciousness of society and a long, difficult and even bloody struggle of working people, middle classes and radical student militants. Democracy was born by the Korean people by painful labour, and the peaceful transition in 1987 to the process of democratization on the basis of a compromise between the ruling circles and the opposition. It speaks volumes about the political culture of the two countries.

Mr. Putin’s task is difficult but not impossible. It is insightful to look back at Park Chung-hee’s first years in power in Korea. While there are many differences between Korea in the 1960s and Russia at the turn of the century, it is certainly not true that corruption was initially low in Korea. Nor did Korea possess developed democratic institutions. General Park came to power in 1961 after Korean public was deeply disappointed in the corrupt regime of Syngman Rhee, the first president of independent Korea. At that time the chaebol owners had already built their initial wealth; the public deemed their wealth illegitimate as it was related to corrupt deals and misuse of U.S. aid (Gall 2003) just like the Russian public deems oligarchs for their illegal acquisitions. General Park started off with a crackdown on these “oligarchs.” He even made them promise to donate large parts of their wealth to charities or return to the state. Korea’s richest individual, Lee Byung-chol of Samsung who supposedly held 19% of all national wealth (Graham 2003:19) was in opposition to Park and eventually had to pay fines to government in 1963. Yet no chaebol lost any serious part of its wealth and no chaebol leader was prosecuted; even though Park's new laws certainly allowed that and 24 arrests were initially made to establish credibility. In Park's later years, chaebols have received substantial support from the state in the form of subsidized loans. The support was awarded mostly to those who succeeded in the export markets. Apparently, Park's administration was happy with chaebols as long as they led Korea's industrialization and economic growth.

There are two important problems with the Korean scenario for Russian voters and Russian rulers. First, it illustrates that democracy may take a very long time to emerge along this path. After losing popularity, Park Chung-hee first rigged an election, and then cancelled presidential elections altogether, appointing himself a president for life. He was assassinated by his own intelligence chief in 1979. Second, against all odds and economists' advice he promoted specific industries where Korea did manage to establish a market niche. It is hard to reproduce this strategy now, because Russia is no longer in the industrialization stage and global competition is much tougher, however, this may be less of a problem because oligarchs should be capable of choosing profitable market strategies themselves.

There is some speculation on resolving the problem of illegitimacy of property rights. There appear to be two possible solutions: either to confiscate the oligarchs or to legitimize their wealth via some sort of an amnesty. Confiscation of oligarchs' property and prosecution of oligarchs is certainly the most popular option with Russian public. There seems to be little doubt that in modern Russia government can expropriate and prosecute oligarchs. It is less clear though what would happen with the assets after confiscation. There can be two approaches: one is to simply renationalize them and manage as a public company, the other one is to auction them off again. Both rise many questions and thereafter problematic.

If one mediates the problem from another standpoint, it becomes clear that the property rights should be clearly defined and awarded to a party that is willing to pay the most. Since the current oligarchs seem to be a good match for the assets and they are also the only ones who are financial unconstrained, they should keep their assets but compensate others. This solution is known as a privatization amnesty and it has been advocated by both critics of the reform (Goldman 2004) and oligarchs themselves (e.g. by Deripaska) (Ackerman 2004). There are many possible versions of the amnesty as well as many technical problems that nevertheless could be resolved.

Currently, the outcome of the dilemma is not clear and the strategy of the government could not be deduced from the first moves. Even if one assumes a certain commitment on the part of the President in office, the new President can again appeal to public's negative attitude and return to confiscatory policies – it can be simple tax rises for natural resource industries.

Hence, it is not clear how the government and the public can commit to the amnesty. Yet, there are examples of similar deals that did succeed. In 1938, the Swedish social-democratic government introduced a new tax code. Higher income taxes for the Swedish tycoons were compensated by tax breaks on investments. This loophole gave large firms an advantage over new entrants (Hogfeldt 2004:21). The deal was effective until 1990s.

3.3 Outlook

The recent years were brilliantly successful for Russia. It was possible not only to overcome the decline of growth observed in 2001-2002, but also to get onto the trajectory of doubling the GDP in ten years. The GDP achievements look brilliant, investments in fixed assets are also optimistic, consumer consumption is growing steadily, inflation climbs down slowly but continuously, etc. Deutsche Bank Research reports that there are four pivotal factors which determine the Russian development. They are domestic politics, international integration, institutional reforms and economic diversification and investment (Lanzeni, Schularick 2003:12).

The year of 2004 could be tabbed as a year of economic paradoxes. The first of them is the acceleration of economic growth on the background of gradual rouble strengthening and expansion of imports. The second is a tendency of reduction of employment together with acceleration of economic growth. The third paradox presents a simultaneous increase in real incomes of the population and investments, and greater than the growth rate of the GDP. The fourth is the interplay of declining inflation and the expansion of the monetary base in the country.

There are three main causes of such stunning successes: the first is high growth rates in value terms as exports have reached record values – $103 bln that is three times more that in 1995 ($32 bln) (Vneshneekonomitcheskij Kompleks Rossii 2005:89). According to the Customs Service the Russian export volumes in 2004 increased in value terms by 30,8% against 2003 as well as in 2003 they grew by 34,8% compared to 2002 (Vneshneekonomitcheskij Kompleks Rossii 2005:137) The growth of THE GDP is based primarily on favourable external conjuncture (increase in exports volumes and high oil prices) (Belousov 2004:4). The second cause is positive microeconomic changes in the country that took place in 2000-2004. During the post-crisis period there was “a microeconomic revolution”: this period witnessed an emergence of a layer of middle-size companies (in food-processing industry, manufacture of home appliances, services) that expended on a wave of import-substitution. They modernized successfully their fixed assets, improved corporate management and organization that allowed them to resist to expansion of import volumes while the rouble was strengthening. Thirdly there was an increase of investment demand based on demand of the Russian natural monopolies and other export-oriented sectors expanding to the Russian manufacturers in specific sectors connected with monopolies (machines and (transport) equipment). Generally direct investment proved to be positive unlike two previous years (Vneshneekonomitcheskij Kompleks Rossii 2005:137)

In the course of the last three years the internal sources in the country were responsible for approximately 3,5% of the GDP growth potentially (Belousov 2004: 4). Nevertheless, Belousov (a member of the Russian Academy of Natural Sciences, a member in the Ministry of economic development and trade of the Russian Federation, a member of Advisory Council of the Government of the Russian Federation) asserts that 1% was lost due to the outpaced increase in imports of the ready goods (mostly investment-intensive) on a home market. So, the quantity of the positive changes has not become quality as yet. Thus, the acceleration of growth rates has been reached mostly due to the model of exports where fuels and minerals dominated.

On the whole the scheme of the achieved results is as follows: firstly, the external demand on minerals and fuels creates an impulse for growth in these branches; logically there is an increase in incomes of export-oriented industries which stimulates an internal final demand where the growth of exports is accompanied by strengthening of the rouble. It decreases competitiveness of the Russian goods in home markets that leads to increases in imports. At the same time, the strengthening of the rouble stimulates inflows of the capital and it promotes a kind of automatism of growth in the real exchange rate. It creates "a window of opportunities" for modernization of domestic manufactures and improvement of their competitiveness (Fedortsov, Jakovlev 2004:42-44).

The main difficulty lays in the fact that this economic success is limited by its own dynamics of raw exports. If a reduction in rates of export growth in the energy sector happens (e.g. as a result of price conjuncture, the so called “price shock”) the probability of recession becomes rather high. The country’s economic growth is based on a myriad of external and internal factors, policies of the government, positive trends in behaviour of economic subjects, external demand, etc. They have in many respects defined the economic processes which were finally embodied in the positive results of the year. The external factors basically consist of three groups: the first is the improvement of investment conditions and improving of the Russian investment rankings. Despite of the essential political risks connected with the change of mutual relations of the state and large business in Russia the above described tendencies have considerably expanded opportunities for attraction of foreign capitals. On the other hand, the world low rates of growth made interest rates in the world markets decrease.

The second is the tendency of dollar depreciation against the world basic currencies. It was induced by growth of imports in the USA on the background of a revival of internal demand. It led to a deficit in the trade balance and respectively to press on the American currency down in the direction of its depreciation. Additionally, falling interest rates did also play a role. The decrease in the dollar exchange rate against the euro conditioned some appreciation of the rouble against the dollar but not against the European currency thus leaving almost intact the links between Russian main trading partners.

The third is a favourable conjuncture in the world markets of minerals and fuels. The incremental growth of world prices of basic Russian export goods accounted for 20% on the average in 2004 as compared to 2003. World oil prices were maintained at a record level in 2004 which was caused by a slightly increased demand for oil over the last 24 years against the background of geopolitical instability in oil producing countries.

As a result of the improvement of trade conditions one could see some shifts in the country's balance of payments - up to $60 bln in comparison about $36 bln in 2003. Constraining superfluous strengthening of the rouble, the monetary authorities set to purchases of currency for the official reserves – as reasonable amounts of reserves have been reached to new record levels. The rouble appreciation against the dollar has affected the economy in several ways. It spurred the growth of imports, hampered collecting the producer's rent for the exporters in Russia, speeded up the process of de-dollarisation of the Russian economy, stimulated productivity growth due to restructuring and reduction of budget revenues. Furthermore, the rouble appreciation and some additional external factors became favourable for reducing capital outflows. Within a background of money supply increases there was a decline of inflation thanks to the sterilization mechanisms (Fedortsov, Jakovlev 2004:38).

Certain improvements in labour productivity and growth of real incomes of the Russian population were based partially on the reduction of the employed. It presented a new tendency in the Russian economy as it mirrored the deficit of the high-skilled labour on the one hand (this deficit made companies maintain the high rates of real wage growth. It was possible due to the effects of the rouble devaluation in 1998 that still gave some space for real wage growth though this wage growth was not sustained by growth of labour productivity) and on the other hand the rouble appreciation caused a tougher competition of the imported goods and limited the opportunities of further growth of labour costs. As a result, these two tendencies created the economic scissors of scarcity of high-skilled labour and tough competition. Against this background in 2004 there was a chain of factors. The rouble appreciation caused indirectly improvement of labour productivity though there was a slightly decreased number of unemployed (Belousov 2004:13)

Another important tendency is a rise in investment and a change of investment model took place: from the model where the internal funds were used to a model of the borrowed funds. This change is a turning point in the economic development of the country as it indicates new qualitative changes in the model of investment – in the middle-term it could be a stable basis for solving the investment problem in Russia (Vercueil 2004). Unfortunately, this model is used only in the frame of the export-oriented sectors and the Russian natural monopolies but there is a hope that it will be spread onto the other Russian sectors as well (Belousov 2004:15).

The consumer boom was defined by the dynamics of wage growth and social transfers. The growth of labour wages (in the course of the last 4-5 years) and social transfers became a stimulus for enlarged production. It must be noted however that the de-dollarisation of the Russian economy and the following surge of the rouble cash in the hands of the population should not be taken as an income increase as it may appear in the statistical data. The tax cuts of the previous years were counterbalanced by cuts in budget spending. The decrease of budget incomes could be explained by the rouble appreciation, the immediate results of the taxation reform and mass profit tax evasion.

The peculiarity of the coming period will be changed by ever varying conditions in the economy of the country and by some external factors as well. The transformation will presumably shape three main concerns. The first concern is the deterioration of a macroeconomic situation caused by a possible fall in world oil prices and fall in export volumes. Though improbable but if it happens it will cause a delay in growth of the final demand and manufacture. On the one hand, it will lead to deterioration in the Russian export-oriented sectors. One must not forget that incomes from these sectors define the current tax base of the budget, the country's investments dynamics and consumption. Accordingly, the distribution side of the budget will be reduced. On the other hand, the rouble appreciation may possibly speed up the opening of the Russian market; as a result the borders between countries (at least between Russia and its trading partners and primarily in imports) will be blurred substantially. Correspondingly, the character and the conditions of the competition will be changed radically: the role of the price will possibly sink and such factors as the quality of goods, their delivery and purchase conditions, after-sales services, etc. will determine the situation. This will mean a real challenge for the Russian domestic companies.

The second concern is the asynchrony of globalization processes. Such spheres as trade and financial intermediation are the most globalized, but the production and manufacturing are still lagging behind due to their deficient competitiveness, low capitalisation levels, low velocity of capital (e.g. in comparison with trade), etc. As the capital circulation determines the production, the prospective growth of network companies can be a driving force of the modernization in the consumer sector. In this respect there is a risk of "an institutional gap" when the consumer's demands could not be fulfilled by the manufacturer (at least, not by the Russian manufacturer).

Adaptation of the Russian companies to open markets and changed conditions of competition will lead to the deepening contradiction of the company's economic efficiency and its social functions (e.g. support of employment). It will inevitably lead to the surge of the unemployed and escalation of social problems in the country.

The adaptation to the changing conditions may take a form of the company's capitalisation. Its forms (e.g. direct investments or lending) may stimulate positive changes in the Russian economy, but simultaneously may lead to "overheating" of the financial markets in the country and accumulating of financial risks.

The third issue is the aggravation of social problems due to high levels of poverty in the country and degradation of the country's social infrastructure. In the course of last few years there was a tendency to further decrease in life expectancy and the surge of mortality in the employable age, increase in morbidity of professional diseases and surge of crimes (Volkov, Denenberg 2005).

The configuration of the defined problems spreads certain risks of the coming period:

- the fall in the growth rates (presumably 2006-2007) down to 2-3% a year (defined by the growth of exports);
- there is a risk of exchange rate correction (if there is a fall in the payment balance of the country and it is not compensated by net inflow of capital);
- possible overheating of the financial markets in the country (a default on some corporate bonds, chain non-payments on bank credits, etc.).

Additionally, the model of economic growth based on export-oriented sectors caused active payment balances over the last years. The external conditions specified the change in the importance of the internal factors for the growth in the country: in 2001 the contribution of the internal factor was about 3,9 though in 2000-2003 it sank down to 2,4-2,8 per cent points (Belousov 2004:18). These dynamics make it clear that there is a layer of Russian firms that are quite competitive on the world markets (the quickest development is seen in trade, construction and services) but on the other hand the dynamics of their development is insufficient in respect to the world trends and the rouble appreciation. Optimistically, there is still a possibility that the importance of the internal factors will gain momentum, both for the achievement of the president's aim as well as preventing a social catastrophe, "acceptable" growth rates should be no less than 5%.

There are some new opportunities (creating "a window of opportunity") for the future development:

- improvement of the investment potential in the country (due to "the long money industry" increase and foreign capital inflow);
- growth of capitalization of the Russian companies and the international technological cooperation;
- expansion of investment demand in the Russian natural monopolies;

- expansion of investment and consumer demand of the population due to hypothec and consumer crediting, etc.

The current economic trends, expected changes of external factors, the declared political aims and priorities define a possible economic "agenda" for the most recent four years. The first issue is the improvement and development of the Russian competitive advantages determining its place in the world economic relations. In particular, it could be energy and transportation which potential could allow Russia to be firmly established as a connecting-link and an important trading partner of China, the USA, some Asian countries, and the EU. A favourable step in the future development would be further and more rapid capitalisation of the Russian production assets, land, natural resources. In perspective, it could attract more investments and positively influence the rouble exchange rate (under certain conditions). The list of the Russian competitive advantages on the global markets is not long and comprises mostly mineral resources. Unfortunately, the agricultural potential of the country is hardly tapped as in the course of the twentieth century Russia lost its leading positions in selling grains in the world markets. Still, Russia has every chance of competing on par with its peers in at least 20 areas of output of science-intensive products (e.g. engineering equipment, electronics, electro-techniques, etc.).

The country's huge potential of R&D activities is gradually deteriorating. Nevertheless, the country's innovative potential can allow to develop cooperation with the advanced countries. It must be noted that Russia should develop its economic relations more intensively with their immediate neighbours as well. It could be considered as a possible comeback of the leading role on the post-Soviet space but the geographical position of the country preconditions more close relations with its neighbours. With higher levels of investments into R&D the share of Russia in the market of hi-tech production could be evidently much higher. Luckily, the indices of R&D effectiveness in Russia are still high compared to OECD, but if inputs were higher, it could lead to even higher outputs. There is a huge potential in such sectors as military machine-building, civil mechanical engineering, etc. the current situation appeals to a change in the state policy in the educational and R&D spheres. There is much heated discussion now about the developmental tendencies, directions and even number of educational and R&D institutions in Russia (Nauchit Uchenogo 2005).

The second important issue is the change in the human resources of the country where currently tendencies to deterioration are gaining momentum. The most important task is the creation of favourable conditions for increase in “the human capital” competitiveness by means of decrease in levels of poverty, especially its stagnant forms, improvement of territorial social mobility; availability of qualitative resources of human development for the population, not only for the socially-privileged, formation of a more fair system of income re-distribution which could be the stable social basis for supporting governmental reforms and actions.

The third issue is improvement of strategic stability of the Russian economy in conditions of globalisation and interdependence. The key aspect of this is the choice of the “engine” for the future development. Among possible candidates (there are possible candidates at the moment, the state, the large export-oriented groups and the new layer of the middle-sized entrepreneurship) there is only one that has the greatest chances in completing the task of increasing competitiveness – it is the national “new business”, those developing economic entities of the second wave which are oriented to expansion, further capitalisation, investments, etc. In this respect the following issues will be determinant for future modernization:

- creation of infrastructure that could provide access to personnel, innovative and financial infrastructure for middle-size and small entrepreneurship;
- quality of the governing;
- reinforcement of some strategic aspects;
- reduction of corruption;
- creating of a communication system between the state and the Russian business while achieving strategic goals of the country;
- unification of the institutional environment, its harmonization with system of the international law, rules and standards.

The fourth issue concerns overcoming the degradation of the social infrastructure (housing and communal services, education, medical services among them). In the course of the last few years this system has been falling into “a resource trap”: insufficient resources caused degradation of the infrastructure which caused decrease in efficiency of resource use which superinduced more acute insufficiency of resources and so on. In this situation a possible solution will be segmentation of the system into separate parts. There will be segments provided for which maintain high standards of quality and there are “weak” elements, not sufficiently provided for, they are doomed to degrade.

The tendency of degradation of the social structures will imply sharp differentiation of the population in respect of access to human capital development resources. If the tendency won’t be stopped it will lead to ever increasing immobility of the population and expansion of “poverty traps” which are to be noticed in some Russian regions. The breakthrough could be achieved only on the basis of reforms and investments (The Investment Environment… 2001:31). It is vital to expand financing of the structures to improve conditions while recruiting the skilled labour and improving quality of services.

Only an increase in terms of real incomes of the population no less than 5-6% a year could help improve the situation. Capital investments in a social infrastructure should increase for four years at least in 1,4 times that corresponds to the general growth of investments into economy on 1,6% annually (Belousov 2004:24). Considering all these issues it could be concluded that there are some demands for the economic development in the country. This development should improve real cash incomes for the population substantially as well as investment volumes should be raised.

The next, fifth issue is modernization of industrial infrastructure. The Russian economy faces the urgent call for improving its functioning and investment attractiveness while investing massively in the industrial infrastructure – energy complex, transportation, communication, etc. One of the major risks in this respect is achieving a balance whilst raising the prices for infrastructural monopolies and increasing their investment potential.

The analysis of the current situation and main challenges for the Russian economy shows that the task is multifaceted: the current potential of growth due to external factors will probably be dampened in the middle and long-term perspective, as high oil prices and export volumes remain the same or even decrease (though, as seen in the past the oil prices are impossible to predict); there will probable be worsening of conditions for home industrial development as the market borders will be further blurred; there will be an acute need for scale investments into the social and industrial infrastructure.

If the model of raw materials and fuel exports be preserved (which seems to be a tendency, quite in line with the scenario of "sluggish Russian bear" in Deutsche Bank Research (Lanzeni, Schularick 2003:4), the country's growth rates will sink inevitably and these dynamics won't allow to solve the above-discussed problems. But the potential of the country and a change of the export model will help maintain and even improve the country's performance in the long run. Available reserves and present opportunities (increase in investment potential, growth of cooperation opportunities, etc.) should not be missed as well all the risks connected with this should be taken into account.

The adequate economic policy should be aimed at realization of global competitive advantages of the Russian economy, regulation of opening for the world markets (including the exchange rate) in respect of adaptation changes in the Russian economy; creation of the infrastructure which will provide access to financial, innovative, labour resources for the SME, responsible social policy aimed at a decrease in poverty levels, income re-distribution and access to resources of human development for all layers of the population; maintenance and development of the industrial and social infrastructure; capitalization of innovative system of the Russian economy; improvement and maintenance of favourable macroeconomic and institutional conditions for investment growth, creation of system which could define and improve strategic development of the Russian economy and finally find a formulae of the relationship and interaction between the Russian middle class, Russian businessmen and the authorities.

From foreign experience it is clear that there are two main possibilities: first, the co-operation between the business and the state, though not always idyllic (like in America and Hong Kong) or second, the predominance of the government over the business, (like in Europe or in Japan). In the second case the government provides and supports the "rules of the game" and re-distributes the resources. More generally, it is the high time to choose the strategy and national idea for the whole of the country, its long-term development and define the goals (Chto Delat? Kto Vinovat?... 2005). It will certainly be a painstaking, mundane task of building a new capitalist market society, transforming the Russian economy and middle-size business. But the tendency towards authoritarianism, a single-centre model with a single party reinforced by bureaucracy suggests only blatant government racketing in the future and none of the goals set in the country's Strategy (Skugorev 1997; Shmarov 2005).

Conclusion

A variety of approaches are used by political scientists and economists in analyzing foreign economic policies. This thesis is based on the framework proposed by Robert Baldwin which identifies four major sets of actors whose interactions determine a country's international economic policies, foreign trade being one of them. These actors are individual citizens, common interest groups, the domestic government, and foreign governments along with other foreign groups, such as international organizations, foreign private interest groups or organizations, etc. This thesis analyzes the domestic government as the key participant in the process of forming foreign trade policies of the state since it makes the final policy decisions and implements or (indirectly but decisively) influences them. However, the other three actors or groups of actors also influence the nature of these decisions by exerting various forms of political or economical pressure on the domestic government (Baldwin 1996:156-167).

In the case of Russia, a whole number of different actors (government, interest groups, etc.) are involved in determining Russian foreign policies in trade on such issues as the accession to the WTO or priority directions of development of certain sectors in respect of foreign trade, etc. The historical legacy of the Soviet Union and the current development of the institutions in Russia could explain to a certain degree why President Putin (and his successors presumably) have a major stake in determining Russian economic policy in foreign trade.

Against the background of the economic revival in the country and booming foreign trade its importance cannot be overestimated on the path of the country's development, integration into the world community and achievement of the goals which are laid out in the "Strategy of State Development to the Year 2010". But taking a closer look at the composition of foreign trade it becomes clear that Russia is extremely dependant on the situation in the world energy markets and the major parts of its economic successes could be explained by high world prices for its basic export commodities, oil among them. The aim of exports diversification acknowledges this high level of dependence. There are only moderate rates of growth for exports of gas and oil in the "Energy Strategy" but on the other hand, further measures for export diversification seem to be middle-of-the-road, especially in their implementation.

Some initial steps to support the Russian exporters of high-tech goods have been taken but their implementation and success is not yet evident.

There are additional groups in the government and around President which have competing foreign policy agendas (respectively foreign economic policies and foreign trade policies). First, there are politicians who present a liberal economic agenda and support the Russian integration into the global economy. The group is headed by the Russian Minister of Economic Development and Trade, German Gref. His ministry has been the major driving force in accelerating Russian WTO accession. Lately, the progress on the accession has been somewhat sluggish as the country reached the most difficult phase of the negotiations where most sensitive questions should be regulated with the rest of 13 countries. Therefore, one speaks of 13 steps up to the WTO accession (Rossija v 13 Shagah ot WTO 2005). The bargaining proceeds.

The Finance Ministry is another champion of the liberal reforms in economy. The major achievements of this Ministry are the establishment of the Stabilization Fund, a huge federal fiscal surplus, and constantly augmenting foreign exchange reserves which exceed the country's external debt. Externally, it means a lesser grade of dependence on foreign lending institutions such as the Paris Club, etc. as growing reserves are equal to opportunities of debt redemption which is best seen in the Russian pre-term debt redemptions to the members of this institution.

The Ministry of Foreign Relations also promotes Russian economic interest in trade but unfortunately it cannot boast of such stunning and evident successes as its counterparts. Other administrative bodies ranging from local authorities up to the Duma can influence the economic policy agenda of Russia.

The second prominent group is the so-called “family” members (the former Yeltsin team, their followers, or simply people who could make use of changes in the country at that time) who used to have influence on the government and President but faces difficult times now. It is this group that presents the main rival to the state now. This second prominent group is presented now mainly by oligarchs. They work in different sectors of the Russian economy so it is impossible to define their economic policies as a single agenda as their interests diverge depending on the sector.

Though, there is a matter common for all the oligarchs. With the change of President in 2000 and the backroom pact between the Russian oligarchs and President Putin in 2004 the situation is fraught with dangers and unexpected complications. “The Yukos affair” delineated the borders of the state’s influence and competences but the outcome and implications of the delineation are not yet clear at all. What is really clear is that this event endangers one of the basic values of the market economy – the private property right and confirms the lack of democracy in Russia. Consequently, capital flight and low rates of investment directly and negatively influence the outcome of these policies and worsen foreign trade results. Nobody can calculate the losses as History does not know the subjunctive mood. Low competitiveness of Russian industrial goods cannot be helped by the “strong hand of the state”, it can be helped only by respecting market values and following “rules of the games”. In fact, the priority of every state is to set these rules and not to entangle them. In any case, the stable and relatively high level of inflation, low levels of investment which go arm in arm with high levels of capital flight, the real rouble strengthening and sinking of manufacturing levels could not help achieve the presidential goals.

Though, on several occasions throughout this thesis the importance of the state’s role in improving competitiveness has been ascertained. The difficulties of the transitional period called for an active participation of the state in the economy but the functions and means of this participation were not clear as well as the legitimacy of the State institutions had deteriorated during the Soviet period. There was no tradition of a transparent State and the boarders and limits of its participation or involvement in the economy were not clear.

The whole range of problems could be clearly seen in the most important sector for Russia’s exports – the energy complex. Here, the state is represented by the monopoly of Gazprom, its influential stake in RAO UES and its current efforts to consolidate the oil sector. The energy sector of the country seems to become a playground for future policy definitions where the state will maintain or gain considerable control levers over the processes in the complex. On the other hand, the effectiveness (putting aside the question of rationing) and economic justification of the dirigiste approach is far from being obvious.

The task of the GDP doubling became political as well as economic. Current Russian benefits from an extraordinary favourable situation in international markets for its exports cause a certain risk of adopting populist decisions. However, it is impossible to run the economy steadily without efficient civil service, incorrupt courts of law and a credible law enforcement system. But these elements are still not to find in the Russia of the present day. It is still difficult to enforce law and the court of law may as well turn an abused citizen or company adrift. In this situation any law that regulates economic life and any economic decision the government makes is useless. Clearly, the Russian judicial and law enforcement systems are far from being excellent. In this case, the expansion of the state economic influence turns out to be an inefficient and rather dangerous enterprise.

According to the sketch in this thesis the large share of natural resources in the country's exports causes a number of risks. As everything new is old, the Russian situation is similar with the so called "Dutch disease" with the Venezuelan complications where the state played the leading role in a varying degree (by choosing different foreign trade policies or taking different decisions, etc.). Three sketches of different lands in a diachronically perspective illustrate the possible outcomes of different *facettes* of the current situation in Russia. Other nations' experiences at best allow one to avoid grave errors (not always, though) and to foster conditions necessary (unfortunately, not sufficient, though) for sustainable development. Though, specifically Russian complications could be cured by specifically Russian advantages and opportunities of the country, may be unorthodox vis-à-vis the "correct" ones. Indeed, it's probably true that the transferability of one country's experience to another is limited, but the examples are set.

It is not clear how the described conglomeration of policy agendas will play out in Russian trade policy in the future. It seems that the liberal opponents are getting ahead quite well, but simultaneously the opposition to the WTO accession gains momentum among the population as well. Truly, there is a group that opposed to liberal reforms. It could be explained by a number of factors ranging from the obvious lack of information (especially, about the WTO), or some negative short-term outcomes of the accession up to the difficulty to through up the familiar idea of the state as the leading economic agent and protector. On the other hand, given the lack of experience and channels to express this opposition, it is highly improbable that the opinion of the population would be taken into account.

Thus, a somewhat paradoxical situation takes place in Russia. Striving to be a full member of the WTO and implement its liberal principles does not impede taking first steps in the direction of the dirigisme. That is why it is very difficult to forecast any outlooks in this situation and define future policies in the Russian foreign trade as the political pendulum could swing to either side. It remains to hope that the political and economic extremes would not be achieved.

It will be exciting to see how Russia will integrate into the world economy following the same rules as any other country. It is obvious that this internationalization would reduce the ability of the State to control the economy. Any authoritarian government would not tolerate the invisible hand of the market as it is clearly beyond its control. Moreover, the strengthening of the international position cannot be conducted by the State alone. The State can promote the process but it requires competent public-private co-operation. Competing in the world economy is a task that enterprises should conduct. So far, however, the record of internationalization by private enterprises has been modest in respect with the size and potential hidden in the country. True, even State-owned enterprises could expand abroad, but their record in succeeding in competition, even in the domestic market, has been more than modest.

Today, the challenges of the world demand from Russia to urgently design a strategy and tactics for socio-economic breakthrough. The country should secure an appropriate place in the global economy of the 21st century. Interestingly, it is not "right" macroeconomic policy or "right" political institutions that matter nowadays. These are now only necessary steps up to the most important improvements which are associated with the human personality and factors directly related to human vital functions (education, health care, housing, infrastructure, and stable democracy) it is these factors that five a country its competitive advantage. It is by supporting a human being that the state could achieve something, and not by promoting sectors or branches. The stress lies with the institutions associated with human development. Luckily, this change found its reflection in the Strategy of Development of the State.

Additionally, a more diversified economy is required there. It can only be based on development of the SME sector and innovativeness. In their turn, they both require stability and long-term thinking. The main function of the state here is an industrial policy. It will bear its fruits only in the long-term and the state should restore the trust of its citizens its success in implementing its industrial policy. However, diversification would mean loosing of control for the state. The question now is if the state ready for that, if the ideology of the state Almighty is in the past or still lingers on.

Unfortunately, the interest of the public to the foreign trade is limited only by the levels of revenues flowing into the country. Expansion of foreign trade is predominantly perceived as a dependency to be avoided rather than a win-win concept. Maybe, in the current situation it is partly true in respect to Russian foreign trade composition. Historically, all the export revenues have been controlled by a small number of people and the natural resources have been controlled by a limited number of people. The benefits of foreign trade have not spilled over. The current structure of Russia's export continues this tradition. The concentrated ownership in the export-oriented sectors and the state's inability to re-distribute the incomes more equally undermine the legitimacy of an open economy. The banking system fails to effectively re-allocate the export revenues to other sectors. Furthermore, the deteriorating education standards and scarce investments undermine the possibilities of increasing labour productivity. According to the competitiveness ranking, some of the major weaknesses of Russia's competitiveness are rooted in the poorly functioning public sector.

As clearly seen from the aforesaid, there are things that the state can and should do to strengthen Russia's position in the world and also at home. But first of all, to be able to implement the whole range of changes and reforms, the State should become a partner, neither a tool in the hands of vested interests nor the master of a power hierarchy.

Appendix 1. Basics of State Regulation of Foreign Trade

The principles of the state regulation of the foreign trade activity are established by the Law are: equality of the participants and non-discrimination; protection by the state of the rights and lawful interests of participants of the foreign trade activity and priority of economic measures of the state regulation of such activity.

According to the Law, state regulation of foreign trade activity (including financial, currency, credit, customs tariff and non-tariff regulation; export control; policy in certification of exported and imported goods) are in exclusive power of the Russian Federation. The powers of the subjects of the Russian Federation include the right to give additional financial guarantees to participants of foreign trade activity located in the Russian Federation.

National customs policy of the Russian Federation is an integral part of foreign and domestic policy of the Russian state. The Russian Federation under the Constitution of the Russian Federation is vested with powers to put in place its concepts. Underlying provisions for the customs policy are defined in the Customs Code of the Russian Federation, Federal Law "On state regulations of foreign trade activity." They are further interpreted in other statutory enactments of the Russian Federation.

The Federal Law "On state regulations of foreign trade activity" provides in-depth interpretation of different components of the foreign economic policy. In particular, the Law defines notions of export and import, basics of state regulations of foreign trade activity, procedure of its implementation by Russian and foreign parties, etc.

In particular, the Law establishes that a foreign trade activity in the Russian Federation is regulated by:

1. generally accepted principles and standards of international law and international agreements of the Russian Federation;
2. Constitution of the Russian Federation;
3. Law "On state regulations of foreign trade activity," other federal laws;
4. other enactments of the Russian Federation.

Basic principles of state regulations of foreign trade activity in the Russian Federation are:

1. Consistency of foreign trade policy as an integral part of foreign policy of the Russian Federation;
2. Consistency of system of state regulations of foreign trade activity and control of its implementation;
3. Consistency of export control policy to meet state objectives aimed at national security, political, economic and military interests as well as international commitments of the Russian Federation to prevent export of mass destruction weapons and other most lethal types of weapons;
4. Integrity of the customs territory of the Russian Federation;
5. Priority of economic efforts of state regulations of foreign trade activity;
6. Equality and non-discrimination of foreign trade players;
7. State protection of rights and lawful interests of foreign trade players;

8. Ruling out of unjustified interference of the state and its bodies in foreign trade activity, infliction of damage to its players and economy of the Russian Federation in whole.

State foreign trade policy is pursued through customs tariff regulations (application of import and export customs tariffs) and non-tariff regulations (in particular, through quotas and licenses) of foreign trade activity under the present Federal law, other federal laws and other enactments of the Russian Federation. Other methods of state regulations of foreign trade activity through interference and various restrictions on the part of state bodies of the Russian Federation and state bodies of entities of the Russian Federation are not permissible. Other types of foreign trade activity, in particular international investment cooperation, production cooperation, currency and financial and credit operations are regulated by respective federal laws and other enactments of the Russian Federation.

At present, legislative and executive bodies of the Russian Federation address issues of further development of a state customs policy. The new version of the Customs Code outlines the main directions of improving customs policy, and according to the World Customs Organizations, it fully complies with standards laid down in the WTO's underlying documents and is compatible with current customs law applied by customs services of other states, members of the World Customs Organization.

In practice, governmental restrictions operate as non-tariff measures of state regulations of foreign economic activity that are instruments of administrative regulation of foreign economic activity of the Russian Federation. These measures are legalized as norms and include:

- licensing;
- certification;
- allocation of quotas;
- export control system;
- system of permits;
- other restrictions on imports to the RF and exports from the RF.

A number of experts refer customs blockades and embargoes to non-tariff measures.

Quelle: Burmistrov, Dvortsov 2001:17-25; own translation.

Table App1. Revealed comparative advantage (RCA)

Title	RCA							Export share	
	1997	1998	1999	2000	2001	2002	2003	2003	Cumul.
Petroleum, petroleum products and related materials	23.8	16.5	23.9	31.7	32.6	36.9	38.9	40.4	40.4
Gas, natural and manufactured	18.3	17.9	15.3	15.3	17.9	15.1	13.7	14.0	54.4
Special transactions and commodities not classified	-14.7	-21.8	-17.7	-22.9	1.6	8.8	7.9	8.5	62.8
Non-ferrous metals	8.3	11.5	8.4	6.9	5.9	5.7	5.2	6.0	68.8
Iron and steel	5.7	5.0	3.6	2.8	2.1	3.6	3.0	6.5	75.3
Cork and wood	2.0	2.0	2.5	2.0	2.1	2.5	2.4	2.4	77.7
Fertilizers	1.8	2.0	1.9	1.5	1.7	1.6	1.5	1.6	79.3
Coal, coke and briquettes	0.7	0.6	0.5	0.9	0.9	1.0	1.1	1.6	80.8
Other transport equipment	-1.3	-0.4	0.0	0.6	-0.4	-0.9	1.1	2.8	83.7
Pulp and waste paper	0.4	0.4	0.4	0.5	0.5	0.5	0.4	0.5	84.2
Organic chemicals	0.7	0.4	0.3	0.6	0.4	0.4	0.4	1.2	85.4
Crude rubber (including synthetic and reclaimed)	0.4	0.3	0.3	0.2	0.2	0.3	0.3	0.4	85.8
Electric current	0.6	0.5	0.2	0.1	0.1	0.1	0.2	0.3	86.1
Cereals and cereal preparations	-1.4	-0.8	-1.9	-1.5	-0.8	0.1	0.1	1.0	87.1
Leather, leather manufactures and dressed fur skins	0.0	0.0	0.0	0.0	0.0	0.0	0.1	0.1	87.2
Hides, skins and fur skins, raw	0.4	0.4	0.2	0.1	0.1	0.1	0.04	0.1	87.3
Power-generating machinery and equipment	0.0	0.6	0.8	0.3	0.3	0.1	0.03	1.5	88.8

Source: United Nations, Commodity Trade Statistics Database (COMTRADE).

Table App2. Revealed comparative advantage (RCA) (continued)

Title	RCA							Import share	
	1997	1998	1999	2000	2001	2002	2003	2003	Cumul.
Road vehicles	-2.5	-2.0	-1.2	-1.5	-3.7	-4.4	-6.6	7.5	7.5
General industrial machinery and equipment, and machine parts	-4.5	-3.7	-3.6	-2.9	-4.6	-6.0	-5.9	6.6	14.2
Electrical machinery, apparatus and appliances, and electrical parts thereof	-2.2	-2.1	-1.7	-1.7	-3.5	-4.7	-5.3	5.9	20.0
Machinery specialized for particular industries	-3.4	-3.3	-3.5	-3.3	-4.1	-4.8	-4.8	5.2	25.2
Medicinal and pharmaceutical products	-2.5	-2.2	-2.1	-2.8	-4.4	-3.7	-4.4	4.5	29.7
Meat and meat preparations	-4.1	-3.5	-3.1	-2.3	-4.2	-5.4	-4.1	4.2	33.9
Vegetables and fruit	-2.7	-2.4	-2.5	-2.6	-2.9	-3.5	-3.9	4.0	37.9
Telecommunications, sound-recording, reproducing apparatus and equipment	-2.1	-1.8	-1.6	-1.8	-3.3	-4.1	-3.4	3.6	41.5
Miscellaneous manufactured articles	-1.2	-1.2	-0.2	-0.5	-2.3	-2.6	-2.7	3.2	44.6
Paper, paperboard and articles thereof	-0.6	-0.3	-0.5	-0.7	-1.4	-1.9	-2.0	2.8	47.4
Essential oils and resinoids and perfume materials; toilet, polishing and cleansing preparations	-1.1	-1.0	-0.7	-0.8	-1.4	-1.9	-2.0	2.2	49.6
Sugars, sugar preparations and	-1.9	-2.2	-3.1	-1.9	-3.2	-2.3	-1.9	2.0	51.6

honey									
Coffee, tea, cocoa, spices, and manufactures thereof	-1.2	-1.2	-1.4	-1.3	-1.7	-2.0	-1.8	1.9	53.5
Professional, scientific and controlling instruments and apparatus	-1.3	-1.1	-0.9	-1.1	-1.2	-1.5	-1.8	2.3	55.8
Manufactures of metals	-0.9	-0.5	0.7	0.5	-0.9	-1.7	-1.8	2.5	58.3
Beverages	-1.3	-1.3	-0.7	-0.8	-1.2	-1.4	-1.6	1.7	60.0
Textile yarn, fabrics, made-up articles, and related products	-0.7	-0.6	-1.0	-1.2	-1.6	-1.4	-1.6	1.9	61.9
Metalloferous ores and metal scrap	0.0	0.9	-0.9	-2.5	-2.8	-2.1	-1.6	2.5	64.4
Office machines and automatic data-processing machines	-0.7	-0.5	-0.6	-0.6	-1.2	-1.5	-1.5	1.5	65.9
Non-metallic mineral manufactures	-0.7	1.4	-0.6	-0.7	-1.1	-1.4	-1.4	1.7	67.6

Source: United Nations, Commodity Trade Statistics Database (COMTRADE).

Table App3. Changes in revealed comparative advantage, 1997-2003

Title	RCA		Difference
	2003	1997	
10 largest positive changes			
Petroleum, petroleum products and related materials	38.90	23.76	15.14
Other transport equipment	1.07	-1.30	2.37
Cereals and cereal preparations	0.06	-1.42	1.48
Coal, coke and briquettes	1.14	0.68	0.45
Cork and wood	2.38	1.96	0.42
Tobacco and tobacco manufactures	-1.34	-1.64	0.30
Miscellaneous edible products and preparations	-0.82	-1.00	0.17
Leather, leather manufactures, n.e.s., and dressed fur skins	0.05	-0.02	0.07
Pulp and waste paper	0.44	0.39	0.06
Furniture, and parts thereof; bedding, mattresses, mattress supports, cushions and similar stuffed furnishings	-0.66	-0.72	0.06
10 largest negative changes			
Gas, natural and manufactured	13.68	18.27	-4.59
Road vehicles (including air-cushion vehicles)	-6.63	-2.49	-4.14
Electrical machinery, apparatus and appliances, n.e.s., and electrical parts thereof (including non-electrical counterparts, n.e.s., of electrical household-type equipment)	-5.25	-2.20	-3.05
Non-ferrous metals	5.21	8.26	-3.05
Iron and steel	3.00	5.67	-2.67
Medicinal and pharmaceutical products	-4.36	-2.53	-1.83
Metalloferous ores and metal scrap	-1.57	-0.05	-1.52
Machinery specialized for particular industries	-4.85	-3.40	-1.45
Miscellaneous manufactured articles, n.e.s.	-2.69	-1.25	-1.44
Paper, paperboard and articles of paper pulp, of paper or of paperboard	-2.02	-0.64	-1.39

Note: RCA changes of the "non-classified" items category are not reported in this table.

Source: United Nations, Commodity Trade Statistics Database (COMTRADE).

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Table Basic Indicators of Russia 1995-2005

	1995	12996	1997	1998	1999	2000	2001	2002	2003	2004
Output Indicators and Investment										
GDP										
GDP, bn roubles, before 1998 - trln roubles	1429	2008	2343	2629,6	4823,2	7305,6	8943,6	10817,5	13201,1	16778,8
GDP, % of the same period a year ago	95,9	96,4	101,4	94,7	106,4	110	105,1	104,7	107,3	107,1
Industrial Output										
% of the same period a year ago	96,7	95,5	102	94,8	111	111,9	104,9	103,7	107	107,3
Agricultural Output										
% of the same period a year ago	92	94,9	101,5	86,8	104,1	107,7	107,5	101,5	101,5	101,6
Turnover of Retail Trade*										
% of the same period a year ago	--	--	104,9	96,8	94,2	109	111	109,3	108,4	112,1
Fixed Capital Investment										
% of the same period a year ago	--	113,5	119,6	88	105,3	117,4	110	102,8	112,5	110,9
Fiscal and Monetary Indicators										
Inflation (CPI, % p-o-p)	--	22	22	84,4	36,5	20,2	18,6	15,1	12	11,7
Official Exchange Rate (by the end of the period)										
RUB/US$	4649	5560	5960	20,65	27	28,16	30,14	31,78	29,45	27,75
RUB/EURO					27,23	26,14	26,49	33,11	36,82	27,81
CBR Reserves, including gold $ bln, cumulative)	--	--	--	--	--	28	36,6	47,8	76,9	124,5
Consumer Price Index										
% of the same period a year ago	--	--	11	84,4	36,5	20,2	18,6	15,1	12	11,7
Producer Price Index										
% of the same period a year ago	--	--	78,5	23,2	67,3	31,6	10,7	17,1	13,1	28,3
Unemployment Rate, % of total work force (at the end of the period)	9	10	11,8	13,2	13	10,5	9,1	8	8,9	8,5
Real Disposable Personal Incomes, % of the same period a year ago	84	101	105,8	84,1	87,6	112	108,7	111	114,6	107,8