

LISTING PARTICULARS



Russian Federation

**Russian Federation U.S.\$426,793,154 Bonds due 31 March 2007 to 31 March 2030 (“2030 Bonds”) and
Russian Federation U.S.\$64,284,650 Bonds due 31 March 2006 to 31 March 2010 (“2010 Bonds” and,
together with the 2030 Bonds, the “Bonds”)**

These Listing Particulars relate to an offering of Bonds by the Ministry of Finance of the Russian Federation acting on behalf of the Russian Federation (the “Offering”). The Offering implements an exchange offer described in greater detail in “Terms of the Offering—Background to the Offering” herein.

The Bonds will be direct, unconditional and unsecured obligations of the Russian Federation and will be fungible in all respects with Bonds previously issued in connection with the Russian Federation’s March 2004 IBEC/IIB restructuring, the Russian Federation’s December 2002 FTO Debt restructuring and the Russian Federation’s August 2000 London Club restructuring. U.S.\$354,679,295 aggregate principal amount of 2030 Bonds and U.S.\$54,063,620 aggregate principal amount of 2010 Bonds were issued in connection with the IBEC/IIB restructuring, U.S.\$1,192,710,277 aggregate principal amount of 2030 Bonds and U.S.\$183,842,536 aggregate principal amount of 2010 Bonds were issued in connection with the FTO Debt restructuring and U.S.\$18,336,205,144 aggregate principal amount of 2030 Bonds and U.S.\$2,820,041,044 aggregate principal amount of 2010 Bonds were issued in connection with the London Club restructuring. U.S.\$19,883,594,716 aggregate principal amount of 2030 Bonds and U.S.\$2,767,442,247 aggregate principal amount of 2010 Bonds are currently outstanding. The aggregate principal amount of 2010 Bonds to be issued on the Settlement Date will be U.S.\$64,284,650, of which U.S.\$ 58,177,609 will be outstanding after payment on the Settlement Date of 9.5% of the principal amount of such 2010 Bonds, as more fully discussed below. Subsequent to the Offering, U.S.\$20,310,387,870 aggregate principal amount of 2030 Bonds and U.S.\$2,825,619,855 aggregate principal amount of 2010 Bonds will be outstanding.

Interest on the 2030 Bonds is payable semi-annually in arrear on 31 March and 30 September in each year, commencing on 30 September 2000, at the rates set out in “Terms and Conditions of the 2030 Bonds—5. Interest” herein. Interest on 2030 Bonds accruing from 31 March 2000, but excluding interest that would otherwise be due for payment from and including 14 June 2002 and to but excluding 16 March 2004 (the “Settlement Date”) will be paid on the Settlement Date to the holders of 2030 Bonds issued in the Offering. See “Terms of the Offering—Cash Payments” herein. Interest will be paid thereafter on 31 March and 30 September of each year, commencing on 31 March 2004. Unless previously redeemed, or purchased and cancelled, 2030 Bonds will be redeemed on 31 March and 30 September in each year, commencing on 31 March 2007, in 47 semi-annual instalments in the respective amounts set forth in the terms and conditions of the 2030 Bonds. See “Terms and Conditions of the 2030 Bonds—6. Redemption, Purchase and Cancellation” herein.

Interest on the 2010 Bonds is payable (except as noted below) semi-annually in arrear on 31 March and 30 September in each year, commencing on 30 September 2000, at the rates set out in “Terms and Conditions of the 2010 Bonds—5. Interest” herein. Interest on 2010 Bonds accruing from 31 March 2000, but excluding interest that would otherwise be due for payment from and including 14 June 2002 and to but excluding the Settlement Date will be paid on the Settlement Date to the holders of 2010 Bonds issued in the Offering, together with 9.5% of the principal amount of the 2010 Bonds. See “Terms of the Offering—Cash Payments” herein. Interest will be paid thereafter on 31 March and 30 September of each year, commencing on 31 March 2004. Unless previously redeemed, or purchased and cancelled, 2010 Bonds will be redeemed on 31 March and 30 September in each year, commencing on 31 March 2006, in nine semi-annual instalments in the respective amounts set forth in the terms and conditions of the 2010 Bonds. The initial holders of 2010 Bonds issued on the Settlement Date will be required to waive the right to receive a portion of the initial interest payment. See “Terms of the Offering—Cash Payments” and “Terms and Conditions of the 2010 Bonds—6. Redemption, Purchase and Cancellation” herein.

The Bonds have not been and will not be registered under the United States Securities Act of 1933 (the “Securities Act”) or any other securities laws and may be offered and sold only in transactions that are exempt from, or are not subject to, the registration requirements of the Securities Act. The Bonds are being offered in the United States only to Qualified Institutional Buyers (as defined in Rule 144A under the Securities Act) and outside the United States in offshore transactions in reliance on Regulation S under the Securities Act.

The Bonds will be issued in the form of one or more permanent global bonds in registered form without interest coupons attached. On the Settlement Date, global bonds representing Bonds offered and sold in the United States will be deposited with the custodian, and registered in the name of the nominee, for The Depository Trust Company and global bonds representing Bonds offered and sold outside the United States will be registered in the name of, and deposited with, the sub-common depository for the common depository for Euroclear and Clearstream. See “Form and Transfer of Bonds” herein.

Application has been made to list the Bonds on the Luxembourg Stock Exchange.

The date of these Listing Particulars is 12 March 2004.

The Russian Federation, having made all reasonable enquiries, confirms that these Listing Particulars contain all information with respect to the Russian Federation and the Bonds which is material in the context of the issue and offering of the Bonds, that such information is true and accurate in every material respect and is not misleading in any material respect and that these Listing Particulars do not omit to state any material fact necessary to make such information not misleading. The opinions, assumptions and intentions expressed in these Listing Particulars with regard to the Russian Federation are honestly held, have been reached after considering all relevant circumstances and are based on reasonable assumptions. The Russian Federation accepts responsibility for the information contained in these Listing Particulars.

Information contained herein that is identified as being derived from a publication of the Russian Federation or one of its agencies or instrumentalities is included herein on the authority of such publication as an official public document of the Russian Federation. All other information contained herein is included as an official public statement made on the authority of the Minister of Finance of the Russian Federation.

No person has been authorised to make or provide any representation or information regarding the Russian Federation or the Bonds other than as contained in these Listing Particulars and in the related offering circular. Any such representation or information should not be relied upon as having been authorised by the Russian Federation or any agency thereof. The delivery of these Listing Particulars at any time does not imply that the information contained herein is correct as at any time subsequent to their date. Unless otherwise indicated, all information in these Listing Particulars is given as of its date.

The Fiscal Agent, the Registrar, the Paying Agent and the Transfer Agents referred to herein make no representation regarding these Listing Particulars or the Bonds.

These Listing Particulars do not constitute an offer of, or an invitation by or on behalf of, the Russian Federation or any agency thereof in any jurisdiction where an offer or invitation by or on behalf of the Russian Federation or any agency thereof is not permitted by the laws of such jurisdiction. The distribution of these Listing Particulars and the offering of the Bonds in certain jurisdictions may be restricted by law. Persons into whose possession these Listing Particulars come should inform themselves of and observe all such restrictions.

With effect from 1 January 1998, the rouble was redenominated, with one new rouble being set equal to one thousand old roubles. All references herein to amounts in “roubles” are references to new roubles, and any rouble amounts relating to the period prior to 1 January 1998 have been restated in new roubles. The rouble/dollar exchange rate as reported by the Central Bank of the Russian Federation (the “Central Bank”) on 1 January 2004 was 29.45 roubles to the dollar.

In these Listing Particulars, all references to “dollar,” “U.S.\$” and “\$,” are to the lawful currency of the United States of America, all references to “ECU” are to European Currency Units, all references to “euro” and “€” are to the currency introduced at the start of the third stage of European economic and monetary union pursuant to the Treaty establishing the European Community, as amended, and all references to interest accruing from a specified date or to a specified date are to interest accruing from and including the first specified date to but excluding the second specified date.

Except as otherwise provided, translations of amounts from one currency into another currency are solely for the convenience of the reader and are made at various exchange rates. No representation is made that amounts referred to herein could have been, or could be, converted into another currency at any particular exchange rate or, in the case of rouble and dollar amounts, at all.

Prior to the dissolution of the Soviet Union, the collection of data and production of official statistical information with respect to the Russian economy was geared to the needs of central planning. Since that time, the means employed in collecting data and methodologies used in the production of statistics have evolved significantly from year to year. Statistical information reported herein has been derived from official publications of, and information supplied by, a number of agencies of the Russian Federation, including the State Committee on Statistics (“Goskomstat”), the Central Bank, the Ministry of Finance of the Russian Federation (the “Ministry of Finance”) and the State Customs Committee of the Russian Federation (the “Customs Committee”), and by The Bank for Foreign Economic Affairs of the USSR (“Vnesheconombank”). In certain cases, the Ministry of Finance has performed arithmetic calculations or otherwise determined the form in which information is classified or presented herein. Unless otherwise stated, all annual information, including budget information, is based on calendar years, and interim statistical information has not been annualised. Data included in these Listing Particulars has been subject to rounding adjustments; accordingly, data shown for the same item of information may vary, and total figures may not be arithmetical sums of their components. In addition, certain data presented herein differ from data made public previously due to regular revisions conducted by Goskomstat, the Central Bank, the Ministry of Finance, the Customs Committee, Vnesheconombank and other Russian authorities.

Except as otherwise provided herein, any reference in these Listing Particulars to an action being taken by the Russian Federation should be construed as a reference to such action being taken by the Ministry of Finance acting on behalf of the Russian Federation.

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TERMS OF THE OFFERING

Background to the Offering

On 2 December 1997, Vnesheconombank agreed to assume responsibility for certain unpaid Soviet-era debt originally owed to foreign banks and other financial institutions organised as the London Club, and the holders of this debt agreed to exchange their existing claims for new obligations of Vnesheconombank. On 25 August 2000, the Russian Federation agreed to assume responsibility for Vnesheconombank's London Club debt, and Vnesheconombank's London Club creditors agreed to exchange their existing claims on Vnesheconombank for Bonds.

On 7 September 2001, representatives of the Russian Federation, the International Bank for Economic Co-operation ("IBEC"), the International Investment Bank ("IIB") and Lloyds TSB Bank, as chair of the consultative working groups of IBEC and IIB creditors, agreed in principle to restructure the debt of IBEC ("IBEC Debt") and the debt of IIB ("IIB Debt") owed to foreign creditors on the terms set out in the IBEC/IIB Debt Exchange Term Sheet. The term sheet, as subsequently amended, provides that the foreign holders of IBEC Debt and IIB Debt will be deemed to have received in exchange for their IBEC Debt and IIB Debt, pursuant to an exchange offer to be made by IBEC and IIB, a like principal amount of indebtedness of the former USSR owed by Vnesheconombank to IBEC and IIB ("Former USSR Debt"), and to have immediately and automatically tendered such Former USSR Debt in a simultaneous offer to exchange Bonds for such Former USSR Debt to be made by the Ministry of Finance of the Russian Federation on behalf of the Russian Federation. This series of transactions was effected on 16 March 2004.

The present Offering is made pursuant to Resolution No. 770 of the Government of the Russian Federation dated December 23, 2003 that provides for the exchange of indebtedness of the former USSR owed by Vnesheconombank to IIB ("Eligible Debt") for Bonds and certain cash payments due in respect of the Bonds. The Bonds now being listed under these Listing Particulars are issued pursuant to the exchange offer to be made by the Ministry of Finance of the Russian Federation on behalf of the Russian Federation.

Cash Payments

Holders of Bonds issued in the Offering will receive on the Settlement Date 9.5% of the initial principal amount of their 2010 Bonds and (except as noted below) all of the interest payments on their 2030 Bonds and 2010 Bonds that would have been made if their 2030 Bonds and 2010 Bonds had been issued on 25 August 2000 in connection with the Russian Federation's London Club restructuring, but excluding all interest in respect of the Bonds that would otherwise be due for payment from and including 14 June 2002 and to but excluding the Settlement Date, as follows:

Cash Payment in Respect of 2030 Bonds

- \$73.75 in cash in respect of each \$1,000 principal amount of such Holder's 2030 Bonds, subject to the rounding rule referred to below

This payment will comprise, with respect to each \$1,000 principal amount of such Holder's 2030 Bonds, all of the interest payments (in the case of each interest payment, rounded down to the nearest cent) that would have been made on such 2030 Bonds if such 2030 Bonds had been issued on 25 August 2000 in connection with the Russian Federation's London Club restructuring, but excluding all interest in respect of the 2030 Bonds that would otherwise be due for payment from and including 14 June 2002 and to but excluding the Settlement Date, set forth below.

Interest Payments Due on Each \$1,000 Principal Amount of 2030 Bonds

<u>Interest Payment Date</u>	<u>Amount (before rounding)</u>
30 September 2000.....	\$11.25
31 March 2001.....	\$12.50
30 September 2001.....	\$25.00
31 March 2002.....	\$25.00
Total=	\$73.75

Due to the rounding of individual interest payments referred to above, the amount of cash that will be received by a participating Holder in respect of its 2030 Bonds may not be exactly proportionate to the total amount of the cash payment, noted above, that will be received in respect of each \$1,000 principal amount of 2030 Bonds.

The terms and conditions of the 2030 Bonds are set out in the “Terms and Conditions of the 2030 Bonds” (and, together with the “Terms and Conditions of the 2010 Bonds”, the “Terms and Conditions of the Bonds”) below.

Cash Payment in Respect of 2010 Bonds

- \$244.32 in cash in respect of each \$1,000 principal amount of such Holder's 2010 Bonds, subject to the rounding rule referred to below.

This payment will comprise, with respect to each \$1,000 principal amount of 2010 Bonds:

- 9.5% of the initial principal amount of such 2010 Bonds (the “Initial Principal Payment”); and
- all of the other interest payments (in each case, rounded down to the nearest cent) that would have been made on such 2010 Bonds if such 2010 Bonds had been issued on 25 August 2000 in connection with the Russian Federation's London Club restructuring, but excluding all interest in respect of the 2010 Bonds that would otherwise be due for payment from and including 14 June 2002 and to but excluding the Settlement Date, set forth below.

A breakdown of the cash payments that will be made in respect of each \$1,000 principal amount of 2010 Bonds is set out below.

Cash Payments Due on Each \$1,000 Principal Amount of 2010 Bonds

<u>Cash Payment</u>	<u>Amount (before rounding)</u>
Initial Principal Payment.....	\$95.00
Interest Payment on:	
30 September 2000.....	\$37.33125
31 March 2001.....	\$37.33125
30 September 2001.....	\$37.33125
31 March 2002.....	\$37.33125
Total Cash Payment=	\$244.32

Due to the rounding of individual interest payments referred to above, the amount of cash that will be received by a participating Holder in respect of its 2010 Bonds may not be exactly proportionate to the total amount of the cash payment, noted above, that will be received in respect of each \$1,000 principal amount of 2010 Bonds.

The terms and conditions of the 2010 Bonds are set out in the “Terms and Conditions of the 2010 Bonds” below.

Waiver of Specified Amount of Initial Interest Payment

IIB will be required to irrevocably waive the right to receive (a) the interest that would otherwise be due on the Settlement Date in respect of the Initial Principal Payment on their 2010 Bonds and (b) all interest in respect of the Bonds that would otherwise be due for payment from and including 14 June 2002 and to but excluding the Settlement Date.

Further Issuances of Bonds

The Russian Federation will be at liberty from time to time, without the consent of the Holders of the Bonds, to create and issue further Bonds ranking equally in all respects (or in all respects save for, in the case of the 2010 Bonds, the date and amount of the first payment of principal thereon and, in the case of all Bonds, the date and amount of the first payment of interest thereon) so that such further Bonds will be consolidated and form a single series with the Bonds.

Cross-Acceleration of Russian Federation Eurobonds

Each series of Russian Federation Eurobonds issued during the life of the 2030 Bonds or the 2010 Bonds will include a provision that treats an acceleration of the 2030 Bonds or the 2010 Bonds on the same basis as an acceleration of the Russian Federation's then-existing Eurobonds for the purpose of determining whether a cross-acceleration Event of Default has occurred (an "Expanded Cross-Acceleration Clause"). For the avoidance of doubt, an Expanded Cross-Acceleration Clause will not treat the Bonds as Excluded Indebtedness (as defined in the terms and conditions of the Eurobonds issued by the Russian Federation prior to August 1998, referred to below as "Existing Eurobonds") or as any other category of indebtedness having a similar effect.

If the 2030 Bonds or the 2010 Bonds become due and payable prior to their stated maturity (or the Russian Federation fails to make the final payment of principal on the 2030 Bonds or the 2010 Bonds in accordance with their terms), and the principal amount of the affected bonds is at least equal to U.S.\$75 million (or its equivalent in other currencies), then holders representing at least 25% in aggregate outstanding principal amount of any series of Existing Eurobonds may, by delivering a written notice to the Russian Federation (a "Repurchase Notice") no later than twelve months following the date on which the 2030 Bonds or the 2010 Bonds became due and payable prior to their stated maturity (or the date on which the Russian Federation failed to make the final payment of principal on such bonds in accordance with their terms), require the Russian Federation to purchase the Eurobonds of such series held by such holders at their principal amount, together with accrued interest to the date of purchase (the "Repurchase Date"), not later than 90 days following the date of delivery (the "Repurchase Notice Delivery Date") of Repurchase Notices representing at least 25% in aggregate principal amount of such series of Existing Eurobonds (the "Repurchase Right"). The remaining holders of such series of Existing Eurobonds may require the Russian Federation to purchase their Existing Eurobonds of such series on the same terms by delivering a Repurchase Notice to the Russian Federation within 30 days of the Repurchase Notice Delivery Date.

Notwithstanding the foregoing, holders of any series of Existing Eurobonds will not have any Repurchase Rights for so long as any Russian Federation Eurobonds which contain an Expanded Cross-Acceleration Clause (other than Bonds) are outstanding in an aggregate principal amount in excess of U.S.\$1 billion (or its equivalent in other currencies). Repurchase Rights will be reinstated if the Russian Federation issues a series of Eurobonds during the life of the 2030 Bonds or the 2010 Bonds that does not contain an Expanded Cross-Acceleration Clause.

A holder wishing to exercise its Repurchase Right must deliver a Repurchase Notice to the Russian Federation, in care of the Ministry of Finance, by letter or facsimile at the following address, with copies to the Fiscal Agent or the Luxembourg Paying Agent for the Bonds and the clearing system in which such holder's Existing Eurobonds are held:

Ministry of Finance of the Russian Federation
9 Ilyinka Street
Moscow 103097
Russia
Tel.: ++ 7 095 298 9093
Fax: ++ 7 095 913 4542
Attention: Head of Department of International Co-operation and External Debt

Such notice may only be provided by or through persons that are direct accountholders or participants in the applicable clearing system. If a person wishing to exercise its Repurchase Right holds its Existing Eurobonds through an accountholder or participant in a clearing system, it must make appropriate arrangements for such accountholder or participant to deliver a Repurchase Notice to the Ministry of Finance on its behalf.

The Russian Federation will provide written notice of any Repurchase Notice Delivery Date to the applicable clearing systems, issue a press release to the Dow Jones News Service and Reuters News Service no later than 5:00 p.m., London time, on the next Business Day immediately following such Repurchase Notice Delivery Date and (so long as the Bonds are listed on the Luxembourg Stock Exchange and the rules of the Luxembourg Stock Exchange so require) publish a notice in a leading newspaper having general circulation in Luxembourg (which is expected to be the *Luxemburger Wort*). For these purposes, “Business Day” means a day other than a Saturday, a Sunday or a day on which banks in London are not open for domestic and foreign exchange business, banks in New York City are required or authorised to close, the Luxembourg Stock Exchange is not open for trading, or Euroclear, Clearstream or DTC are not open. The Russian Federation will give notice of any Repurchase Date in the manner specified above no later than 5:00 p.m., London time, on the thirty-fifth day prior to such Repurchase Date.

The Repurchase Right was implemented in connection with the Russian Federation’s 2000 London Club restructuring by means of a deed of covenant (the “Deed of Covenant”) executed by the Russian Federation in favour of all holders from time to time of any series of Existing Eurobonds. The Deed of Covenant is held by the Fiscal Agent and is available for inspection at the offices of the Fiscal Agent.

Any reference under this heading to any action being taken by the Russian Federation shall be construed as a reference to such action being taken by the Ministry of Finance acting on behalf of the Russian Federation or, in the case of the reference to the Russian Federation’s issuance of Eurobonds during the life of the 2030 Bonds or the 2010 Bonds, to such action being taken by the Ministry of Finance or another such body of executive authority whose functions, pursuant to a decision of the Government of the Russian Federation, include the preparation and/or implementation of the federal budget and which is hereafter authorised under the laws of the Russian Federation to issue Eurobonds on behalf of the Russian Federation during the life of the 2030 Bonds or the 2010 Bonds.

TERMS AND CONDITIONS OF 2030 BONDS

The following, save for the paragraphs in italics, is the text of the terms and conditions of the 2030 Bonds which, subject to amendment, will be endorsed on each Bond Certificate and will be attached and (subject to the provisions thereof) apply to each Global Bond:

The U.S. Dollar Denominated Bonds due 2007 to 2030 (the “Bonds”) (which expression includes any further Bonds issued pursuant to Condition 13 and forming a single series with the Bonds) of the Ministry of Finance of the Russian Federation (the “Ministry of Finance”) acting on behalf of the Russian Federation were authorised pursuant to the provisions of Federal Law No. 136-FZ of 29 July 1998, Government Resolution No. 478 of 23 June 2000, and Government Resolution No. 426 of 14 June 2002 and Government Resolution No. 764 of 19 December 2003. A fiscal agency agreement dated 24 August 2000, as amended on 17 December 2002, 15 March 2004 and 15 March 2004 (the “Fiscal Agency Agreement”) has been entered into in relation to the Bonds by the Russian Federation, The Chase Manhattan Bank (now JPMorgan Chase Bank), London branch, as fiscal and principal paying agent (the “Fiscal Agent”) and as registrar (the “Registrar”), the other paying agents named therein (together with the Fiscal Agent and the Registrar, the “Paying Agents”) and the transfer agents named therein (the “Transfer Agents”).

In these Conditions, “Fiscal Agent,” “Registrar,” “Paying Agent” and “Transfer Agent” shall include any successors appointed from time to time in accordance with the provisions of the Fiscal Agency Agreement for the Bonds, and any reference to an “Agent” or “Agents” shall mean any or all (as applicable) of such persons.

Copies of the Fiscal Agency Agreement are available for inspection during usual business hours at the principal office of the Fiscal Agent (currently at 9 Thomas More Street, London E1W 1YT, England) and at the specified offices of each of the other Agents. The Bondholders (as defined in Condition 1(b)) are bound by, and are deemed to have notice of, the provisions of the Fiscal Agency Agreement for the Bonds.

1. Form, Denomination and Title

(a) Form and Denomination

The Bonds are in definitive fully registered form, without interest coupons attached, in a minimum denomination of U.S.\$1.00 and any amount in excess thereof which is an integral multiple of U.S.\$1.00 (each an “authorised denomination”). A certificate (each a “Bond Certificate”) will be issued to each Bondholder in respect of its registered holding or holdings of Bonds. Each Bond Certificate will be numbered serially with an identifying number which will be recorded in the register (the “Register”) which the Russian Federation shall procure to be kept by the Registrar.

(b) Title

Title to the Bonds will pass by and upon registration in the Register. In these Conditions, “Bondholder” and “holder” mean the person in whose name a Bond is registered in the Register (or, in the case of joint holders, the first-named thereof). The holder of any Bond will (except as otherwise requested by such holder in writing, or as otherwise ordered by a court of competent jurisdiction or required by law) be treated as its absolute owner for all purposes, whether or not it is overdue and regardless of any notice of ownership, trust or any interest therein, any writing thereon by any person (other than a duly executed transfer thereof in the form endorsed thereon) or any notice of any previous theft or loss thereof, and no person will be liable for so treating the holder.

2. Transfer of Bonds and Issue of Bonds

(a) Transfer

Subject to Condition 2(d), a Bond may be transferred in whole or in part in an authorised denomination upon the surrender of the Bond Certificate representing that Bond, together with the form of transfer (including any certification as to compliance with restrictions on transfer included in such form of transfer) endorsed thereon (the “Transfer Form”) duly completed and executed, at the specified office of the Registrar or any Transfer Agent, together with such evidence as the Registrar or, as the case may be, such Transfer Agent may reasonably require to prove the title of the transferor and the authority of the persons who have executed the Transfer Form. In the case of a transfer of part only of the Bonds represented by a Bond Certificate, neither the part transferred nor the balance not transferred

may be less than the applicable authorised denomination and a new Bond Certificate in respect of the balance not so transferred will be issued to the transferor.

(b) Delivery

Each new Bond Certificate to be issued upon a transfer of any Bonds will, within five business days of the request for transfer being duly made, be delivered at the specified office of the Registrar or, as the case may be, any Transfer Agent or (at the request and the risk of such transferee) be mailed by uninsured post to such address as the transferee entitled to the Bonds represented by such Bond Certificate may have specified. In this Condition 2(b), “business day” means a day (other than a Saturday or Sunday) on which commercial banks are open for business (including dealings in foreign currencies) in the cities in which the Registrar and any such Transfer Agent have their respective specified offices.

(c) No Charge

Registration or transfer of Bonds will be effected without charge to the holder or transferee thereof, but upon payment (or against such indemnity from the holder or the transferee thereof as the Registrar or the relevant Transfer Agent may reasonably require) in respect of any tax or other duty of whatever nature which may be levied or imposed in connection with such registration or transfer.

(d) Closed Periods

No Bondholder may require the transfer of a Bond to be registered during the period of 15 calendar days ending on the due date for any payment of principal in respect of such Bond.

(e) Regulations Concerning Transfer and Registration

All transfers of Bonds and entries on the Register will be made subject to the detailed regulations concerning transfer of Bonds scheduled to the Fiscal Agency Agreement. The regulations may be changed by the Russian Federation in a manner which is reasonably required by the Russian Federation (after consultation with the Registrar) to reflect changes in legal requirements or in any other manner which is not prejudicial to the interests of the Bondholders. A copy of the current regulations will be sent by the Registrar to any Bondholder who so requests.

3. Status

The Bonds constitute direct, unconditional, unsecured and unsubordinated obligations of the Russian Federation and the full faith and credit of the Russian Federation is pledged for the due and punctual payment of principal of, and interest on, the Bonds and for the performance of all other obligations of the Russian Federation pursuant to the Bonds. The Bonds shall at all times rank *pari passu* without any preference among themselves and at least *pari passu* in all respects with all other present and future unsecured and unsubordinated obligations of the Russian Federation.

Under the Constitution and laws of the Russian Federation, certain of the Russian Federation's assets are not available to satisfy the claims of creditors, including Bondholders. In particular, Article 126 of the Civil Code, as amended, provides that assets which have been transferred to state-owned entities under “economic management” or “operational management” are not available for such purpose. The laws of the Russian Federation do not restrict the Russian Federation from transferring any of its assets to such state-owned entities. In addition, Article 126 provides that certain other assets which may only be owned by the state (for example, subsoil, federal transportation systems and nuclear power installations) are not available to satisfy the claims of creditors.

4. Negative Pledge and Covenant

(a) Negative Pledge

So long as any of the Bonds remains outstanding (as defined in the Fiscal Agency Agreement) the Russian Federation will not create or permit to subsist any Lien upon the whole or any part of the International Monetary Assets to secure any Public External Indebtedness unless, at the same time or prior thereto, the obligations of the Russian Federation under the Bonds are secured equally and rateably therewith.

(b) Covenant

So long as any Bond remains outstanding the Russian Federation shall obtain, and do or cause to be done all things necessary to ensure the continuance of, all consents, licences, approvals and authorisations, and make or cause to be made all registrations, recordings and filings, which may at any time be required to be obtained or made in the Russian Federation for the execution, delivery or performance of the Bonds or for the validity or enforceability thereof.

(c) Definitions

In these Conditions:

“Excluded Indebtedness” means any obligation of the Russian Federation, the Government of the Russian Federation, the Ministry of Finance, Vnesheconombank of the U.S.S.R. or any other person that may arise from time to time representing restructured indebtedness originally incurred prior to 1 January 1992 by the government of the former Soviet Union or any of its legally authorised entities, other than the Bonds and the Russian Federation U.S. Dollar Denominated Bonds due 2006 to 2010.

“External Indebtedness” means Indebtedness (i) which is not Excluded Indebtedness, (ii) which is denominated or payable, or at the option of the relevant creditor or holder thereof may be payable, in a currency other than the lawful currency of the Russian Federation and (iii) which was not originally incurred or assumed under an agreement or instrument made with or issued to creditors substantially all of whom were residents of the Russian Federation or entities having their head office or principal place of business within the territory of the Russian Federation. For the avoidance of doubt, External Indebtedness does not include Internal Government Hard Currency Bonds known as “OVVZs,” “Taiga” bonds or “MinFins” or any bonds representing restructured internal hard currency bonds of the Government of the Russian Federation.

“Government of the Russian Federation” means the Government of the Russian Federation as provided in Article 110 of the Constitution of the Russian Federation, or any successor article, from time to time.

“IMF” means the International Monetary Fund.

“Indebtedness” means any legal obligation or any obligation intended by its terms to be a legal obligation (whether present or future, actual or contingent, secured or unsecured, incurred as principal, surety, guarantor or otherwise) for the payment or repayment of borrowed money created (or intended by its terms to have been created) under an agreement or instrument in which the Russian Federation, the Government of the Russian Federation or the Ministry of Finance is designated as the obligor, or which by operation of Russian law constitutes a legal obligation of the Russian Federation, the Government of the Russian Federation or the Ministry of Finance (it being understood that neither the Central Bank of the Russian Federation, nor any political subdivision, regional or municipal government, ministry (other than the Ministry of Finance), department, authority or statutory corporation of the Russian Federation nor any joint stock company, enterprise or other entity organised or existing under the laws or regulations of the Russian Federation or any of the above, is considered to be part of the Russian Federation, the Government of the Russian Federation or the Ministry of Finance for purposes hereof).

“International Monetary Assets” means all official holdings of gold, Special Drawing Rights, Reserve Positions in the Fund and Foreign Exchange of the Ministry of Finance or the Government of the Russian Federation from time to time (but not, for the avoidance of doubt, any such assets of the Central Bank of the Russian Federation at any time), and the terms “Special Drawing Rights,” “Reserve Positions in the Fund” and “Foreign Exchange” have, as to the types of assets included, the meanings given to them in the IMF's publication entitled “International Financial Statistics” or such other meanings as shall be formally adopted by the IMF from time to time.

“Lien” means any lien, pledge, hypothecation, mortgage, security interest, deed of trust, charge or any other encumbrance arising under a security agreement or arrangement.

“Public External Indebtedness” means External Indebtedness which (i) is in the form of, or represented by, bonds, notes or other securities or any guarantee thereof and (ii) is, or may be, quoted, listed or ordinarily purchased and sold on any stock exchange, automated trading system or over-the-counter or other securities market (including,

without prejudice to the generality of the foregoing, the market for securities eligible for resale pursuant to Rule 144A under the United States Securities Act of 1933, as amended (the “Securities Act”).

5. Interest

Each Bond bears interest on its outstanding principal amount from 31 March 2000 at the rates set forth below, payable semi-annually in arrear on 31 March and 30 September in each year until maturity, commencing on 30 September 2000. Interest will be paid subject to and in accordance with the provisions of Condition 7.

Interest Period

**(from and including the first indicated date to
but excluding the second indicated date)**

Interest Rate

31 March 2000 to 30 September 2000	2.25 per cent. per annum
30 September 2000 to 31 March 2001	2.50 per cent. per annum
31 March 2001 to 31 March 2007	5.00 per cent. per annum
Thereafter	7.50 per cent. per annum

Each Bond will cease to bear interest from each Principal Payment Date (as defined in Condition 6) on the portion of the outstanding principal amount of such Bond scheduled to be paid on such Principal Payment Date unless, after presentation and (in the case of the Final Principal Payment Date) surrender of such Bond, payment of principal is improperly withheld or refused, in which case the outstanding principal amount of such Bond will continue to bear interest in accordance with this Condition 5 (after as well as before judgement) until whichever is the earlier of (i) the day on which all sums due in respect of such Bond up to such day are received by or on behalf of the relevant Bondholder and (ii) the day which is seven days after notice has been given to the Bondholders that the Fiscal Agent has received all sums due in respect of the Bonds up to such seventh day (except, in the case of payment to the Fiscal Agent, to the extent that there is any subsequent default in payment in accordance with these Conditions).

If interest is required to be calculated for a period of less than 12 months, it will be calculated on the basis of a year of 360 days consisting of 12 months of 30 days each and, in the case of an incomplete month, the actual number of days elapsed.

6. Redemption, Purchase and Cancellation

(a) Redemption

Unless previously redeemed, or purchased and cancelled, each Bond will be redeemed in 47 semi-annual instalments on the dates set forth below (each a “Principal Payment Date”) commencing on 31 March 2007 in the amount (expressed as a percentage of the outstanding principal amount of each Bond on the date of issue) set forth below opposite such Principal Payment Date. Principal will be paid subject to and in accordance with the provisions of Condition 7.

Principal Payment Date

Percentage

31 March 2007	0.5 per cent.
30 September 2007	0.5 per cent.
31 March 2008	0.5 per cent.
30 September 2008	0.5 per cent.
31 March 2009	2.0 per cent.
30 September 2009	2.0 per cent.
31 March 2010	2.0 per cent.
30 September 2010	2.5 per cent.
31 March 2011	3.0 per cent.
30 September 2011	3.0 per cent.
31 March 2012	3.0 per cent.
30 September 2012	3.0 per cent.
31 March 2013	3.0 per cent.

30 September 2013.....	3.0 per cent.
31 March 2014.....	3.0 per cent.
30 September 2014.....	3.0 per cent.
31 March 2015.....	3.0 per cent.
30 September 2015.....	3.0 per cent.
31 March 2016.....	3.0 per cent.
30 September 2016.....	3.0 per cent.
31 March 2017.....	3.0 per cent.
30 September 2017.....	3.0 per cent.
31 March 2018.....	3.0 per cent.
30 September 2018.....	3.0 per cent.
31 March 2019.....	4.0 per cent.
30 September 2019.....	4.0 per cent.
31 March 2020.....	4.0 per cent.
30 September 2020.....	4.0 per cent.
31 March 2021.....	3.0 per cent.
30 September 2021.....	3.0 per cent.
31 March 2022.....	3.0 per cent.
30 September 2022.....	3.0 per cent.
31 March 2023.....	2.0 per cent.
30 September 2023.....	2.0 per cent.
31 March 2024.....	2.0 per cent.
30 September 2024.....	2.0 per cent.
31 March 2025.....	0.5 per cent.
30 September 2025.....	0.5 per cent.
31 March 2026.....	0.5 per cent.
30 September 2026.....	0.5 per cent.
31 March 2027.....	0.5 per cent.
30 September 2027.....	0.5 per cent.
31 March 2028.....	0.5 per cent.
30 September 2028.....	0.5 per cent.
31 March 2029.....	0.5 per cent.
30 September 2029.....	0.5 per cent.
31 March 2030.....	remainder

(b) Purchase and Cancellation

The Russian Federation and its affiliates may at any time purchase Bonds in the open market or otherwise at any price. Any Bonds so purchased may be cancelled or held and resold (provided that such resale is outside the United States, as defined in Regulation S under the Securities Act). Any Bonds so cancelled will not be reissued.

7. Payments

(a) Principal

Payments of principal in respect of each Bond will be made by transfer to a U.S. dollar account maintained by the Bondholder with a bank in New York City or (i) if it does not have such a U.S. dollar account or (ii) the principal amount of Bonds held by such person is less than U.S.\$250,000, by a U.S. dollar cheque drawn on a bank in New York City mailed to the registered address of the Bondholder by uninsured mail at the risk of the Bondholder. Such payment will be made only upon presentation and (in the case of final redemption) surrender of the relevant Bond Certificate at the specified office of any of the Paying Agents and will be rounded downwards, if necessary, to the nearest cent. For the purposes of this Condition 7(a) the holder of such Bond will be deemed to be the person shown as the holder (or the first-named of joint holders) on the Register at the Registrar's close of business on the fifteenth day before the due date for such payment of principal and the outstanding amount of each Bondholder's registered holding will be deemed to be the amount shown as such on the Register for such Bondholder at the same time on that date.

(b) Interest

Payments of interest (other than interest due on a Principal Payment Date) in respect of each Bond will be made by U.S. dollar cheque drawn on a bank in New York City and mailed to the holder (or to the first-named of joint holders) of such Bond at the address appearing in the Register not later than the due date for such payment and will be rounded downwards, if necessary, to the nearest cent. For the purposes of this Condition 7(b) the holder of such Bond will be deemed to be the person shown as the holder (or the first-named of joint holders) on the Register on the fifteenth day before the due date for such payment of interest.

Upon application by a Bondholder with respect to Bonds having a principal amount of U.S.\$250,000 or more to the specified office of the Registrar not less than fifteen days before the due date for the payment of any interest (other than interest due on a Principal Payment Date) in respect of such Bonds, such payment will be made by transfer to a U.S. dollar account maintained by the payee with a bank in New York City. Any such application for transfer to a U.S. dollar account shall be deemed to relate to all future payments of interest (other than interest due on a Principal Payment Date) in respect of the Bonds which become payable to the Bondholder who has made the initial application until such time as the Registrar is notified in writing to the contrary by such Bondholder.

Payment of interest due on a Principal Payment Date will be made in the same manner as payment of the principal of a Bond.

(c) Payments Subject to Fiscal Laws

All payments of principal and interest in respect of the Bonds are subject in all cases to any applicable fiscal or other laws and regulations, but without prejudice to the provisions of Condition 8.

Consistent with the terms of Regulation No. BG-4-06/14 of 12 July 2000 approved by the Ministry of Taxes and Duties of the Russian Federation and agreed by the Ministry of Finance, Russian residents, other than physical persons, may not receive interest on the Bonds in any form.

The Regulations do not contain a definition of "Russian residents." Accordingly, it is unclear whether, for example, Russian branches and representative offices of foreign entities would be considered to be Russian residents for this purpose. See "Russian Taxation."

(d) Commissions

No commissions or expenses shall be charged to the Bondholders in respect of any payments of principal or interest in respect of the Bonds.

(e) Payments on Business Days

Where payment is to be made by transfer to a U.S. dollar account, payment instructions (for value the due date or, if that is not a business day, for value the first following day which is a business day) will be initiated on the due date for payment or, if later, in the case of principal and interest due on redemption in whole or in part, on the business day on which the relevant Bond Certificate is presented and, in the case of a Final Principal Payment Date, surrendered at the specified office of any of the Paying Agents.

Where payment is to be made by cheque, the cheque will be mailed on the due date for payment or, if later, in the case of principal and interest due on redemption in whole or in part, on the business day on which the relevant Bond Certificate is presented and, in the case of a Final Principal Payment Date, surrendered at the specified office of any of the Paying Agents.

In these Conditions, "business day" means a day (other than a Saturday or Sunday) on which commercial banks are open for business in New York City and, in the case of the surrender of a Bond Certificate, in the place where the Bond Certificate is surrendered.

(f) Delay in Payments

Bondholders will not be entitled to any interest or other payment for any delay after the due date in receiving any amount due in respect of any Bond as a result of (i) the due date not being a business day, (ii) the Bondholder being late in presenting or surrendering its Bond Certificate (if required to do so) or (iii) a cheque mailed in accordance with this Condition 7 arriving after the due date for payment or being lost in the mail.

(g) Partial Payments

If at any time a partial payment is made in respect of any Bond, the Registrar shall endorse the Register with a statement indicating the amount and date of such payment.

(h) Agents

The initial Agents and their initial specified offices are listed below. Any of the Agents may resign in accordance with the provisions of the Fiscal Agency Agreement and the Russian Federation reserves the right at any time to vary or terminate the appointment of any Agent and appoint additional or other Agents, provided that while the Bonds are outstanding it will maintain (i) a Fiscal Agent, (ii) a Registrar and (iii) a Paying Agent and a Transfer Agent having a specified office in a major European city which will be in Luxembourg, so long as the Bonds are listed on the Luxembourg Stock Exchange and the rules of the Luxembourg Stock Exchange so require. Notice of any change in the Agents or their specified offices will promptly be given to the Bondholders in accordance with Condition 14.

8. Taxation

All payments of principal and interest in respect of the Bonds by the Russian Federation shall be made free and clear of, and without withholding or deduction for, any taxes, duties, assessments or governmental charges of whatever nature imposed, levied, collected, withheld or assessed by the Russian Federation or any political subdivision or any authority thereof or therein having power to tax (together, "Taxes"), unless such withholding or deduction is required by law. If at any time any Taxes are withheld or deducted, the Russian Federation shall increase the payment of principal or interest, as the case may be, to such amount as will result in the receipt by the Bondholders of such amounts as would have been received by them had no such withholding or deduction been required, except that no such increased amount shall be payable:

- (a) to a holder, or to a third party on behalf of a holder, if such holder is liable to such Taxes by reason of having some connection with the Russian Federation other than the mere holding of a Bond or the receipt of payments thereunder; or
- (b) if the Bond Certificate representing a Bond is presented and (in the case of final redemption) surrendered for payment more than 30 days after the Relevant Date, except to the extent that the holder would have been entitled to such additional amounts on presentation and (in the case of final redemption) surrender of such Bond Certificate for payment on the last day of such period of 30 days.

If, in relation to any payment under the Bonds (a "Payment") any Bondholder has received any increased amount as provided in this Condition 8, the Russian Federation shall have the right to retain any refund of any amount withheld or deducted in respect of such Payment, which refund may be available under a tax treaty or otherwise to such Bondholder. Notwithstanding the foregoing, no Bondholder makes any representation or warranty that the Russian Federation will be entitled to any such refund (or to make any claim in respect thereof) and no Bondholder shall incur any obligation with respect thereto (including, without limitation, incurring any expense or liability in connection therewith).

For the avoidance of doubt, the Russian Federation acknowledges that it shall have no right to make any deduction or withholding in respect of (nor will it purport to set off any amount equal to) any such refund from any payment in respect of any Bond.

In these Conditions, "Relevant Date" means whichever is the later of (i) the date on which the payment in question first becomes due and (ii) if the full amount payable has not been received in New York City by the Fiscal

Agent on or prior to such due date, the date on which (the full amount having been so received) notice to that effect has been given to the Bondholders.

Any reference in these Conditions to principal or interest in respect of the Bonds shall be deemed to include any increased amounts which may be payable under this Condition 8.

9. Events of Default

If any of the following occurs and is continuing (each an “Event of Default”) in respect of the Bonds, as applicable:

(a) Non-payment

The Russian Federation fails to pay any amount of principal or interest in respect of the Bonds, as the case may be, when due and such failure continues for a period of fifteen business days, provided, however, that it shall not constitute an Event of Default if interest is not paid to a Bondholder which is a Russian resident (other than a physical person) as contemplated in Condition 7(c); or

(b) Breach of other obligations or undertakings

The Russian Federation defaults in performance or observance of or compliance with any of its other obligations or undertakings in respect of the Bonds, as the case may be, which default (if capable of remedy) is not remedied within sixty days after written notice of such default shall have been given to the Russian Federation by any holder of the Bonds, as the case may be, it being understood that a default in respect of the undertaking set forth in Condition 4(a) shall be deemed capable of remedy for purposes hereof; or

(c) Cross-acceleration

Any other Public External Indebtedness shall become due and payable prior to the stated maturity thereof otherwise than at the option of the debtor following a default or the Russian Federation, the Government of the Russian Federation or the Ministry of Finance shall fail to make the final payment of principal in respect of any Public External Indebtedness on the date on which such final payment is due and payable or at the expiration of any grace period originally applicable thereto or, in the case of any guarantee which constitutes Public External Indebtedness, the underlying obligation in respect of which such guarantee has been given shall have become due and payable prior to the stated maturity thereof otherwise than at the option of the debtor following a default or the debtor shall have failed to make the final payment of principal in respect of such underlying obligation on the date on which such final payment is due and payable or at the expiration of any grace period originally applicable thereto and the guarantee shall not be honoured when due and called upon; provided that the aggregate amount of the relevant Public External Indebtedness in respect of which one or more of the events mentioned in this Condition 9(c) shall have occurred equals or exceeds U.S.\$75,000,000 (or its equivalent in any other currency or currencies); and provided, further, that any secured Public External Indebtedness that by its terms is fully non-recourse to the Russian Federation, the Government of the Russian Federation or the Ministry of Finance shall not be counted as Public External Indebtedness for purposes of this Condition 9(c); or

(d) Moratorium

A moratorium on the payment of principal of, or interest on, all or any part of Public External Indebtedness; or

(e) Unlawfulness or Invalidity

The validity of the Bonds is contested by the Russian Federation or any agency or entity acting on behalf of the Russian Federation or the Russian Federation or any agency or entity acting on behalf of the Russian Federation shall deny any of the Russian Federation's obligations under the Bonds or it is or will become unlawful for the Russian Federation to perform or comply with any of its obligations under or in respect of the Bonds or under or in respect of the Fiscal Agency Agreement or any of such obligations shall be or become unenforceable or invalid; or

(f) IMF

The Russian Federation ceases to be a member of the IMF or eligible to use the general resources of the IMF pursuant to Article 26 of the IMF Articles of Agreement; or

(g) Consents etc.

Any regulation, decree, consent, approval, licence or other authority necessary to enable the Russian Federation to enter into or perform its obligations under the Bonds or under the Fiscal Agency Agreement or for the validity or enforceability thereof shall expire or be withheld, revoked or terminated or otherwise cease to remain in full force and effect or shall be modified in a manner which adversely affects any rights or claims of any of the holders of the Bonds, as the case may be, then holders of 25 per cent. or more in aggregate outstanding principal amount of the Bonds may declare the Bonds to be immediately due and payable whereupon the Bonds shall become immediately due and payable at their principal amount, together with accrued interest, without any further formality.

10. Prescription

Claims against the Russian Federation in respect of principal and interest shall become void unless made within a period of ten years, in the case of principal, and five years, in the case of interest, from the appropriate Relevant Date (as defined in Condition 8).

11. Replacement of Bond Certificates

If any Bond Certificate is lost, stolen, mutilated, defaced or destroyed, it may be replaced at the specified office of the Registrar or the Transfer Agent with its specified office in Luxembourg subject to all applicable laws and stock exchange requirements, upon payment by the claimant of the expenses incurred in connection with such replacement and on such terms as to evidence, security, indemnity and otherwise as the Russian Federation may reasonably require. Mutilated or defaced Bond Certificates must be surrendered before replacements will be issued.

12. Meetings of Bondholders, Modification and Waiver

(a) Meetings of Bondholders

The Fiscal Agency Agreement contains provisions for convening meetings of holders of Bonds to consider any matter affecting their interests, including the modification by Extraordinary Resolution of these Conditions. The quorum at any such meeting for passing an Extraordinary Resolution shall (subject as provided in the Fiscal Agency Agreement in the event that all Bonds for the time being outstanding are held by one person) be two or more persons holding or representing a clear majority of the principal amount of the Bonds for the time being outstanding, or at any adjourned meeting two or more persons being or representing holders of the Bonds whatever the principal amount for the time being outstanding so held or represented, except that at any meeting the business of which includes consideration of proposals, *inter alia*, (i) to modify the maturity of the Bonds, (ii) to reduce or cancel the principal amount of, or interest on, the Bonds, (iii) to change the currency of payment of the Bonds, (iv) to modify the provisions concerning the quorum required at any meeting of holders of the Bonds or the majority required to pass an Extraordinary Resolution or (v) to modify the percentage required to pass any resolution, the necessary quorum for passing an Extraordinary Resolution shall (subject as provided in the applicable Fiscal Agency Agreement in the event that all Bonds for the time being outstanding are held by one person) be two or more persons holding or representing not less than three-quarters, or at any adjourned such meeting not less than one-quarter, of the principal amount of the Bonds for the time being outstanding. An Extraordinary Resolution duly passed at any meeting of holders of the Bonds will be binding on all holders of the Bonds whether or not they are present at the meeting.

(b) Modification and waiver

The parties to the Fiscal Agency Agreement may agree, without the consent of the holders of the Bonds, to any modification of any provision of the Fiscal Agency Agreement or the Bonds which is of a formal, minor or technical nature or is made to correct a manifest error.

13. Further Issues

The Russian Federation shall be at liberty from time to time, without the consent of the holders of the Bonds, to create and issue further Bonds ranking equally in all respects (or in all respects save for payments made prior to the issuance of such further Bonds and, if applicable, the date and amount of the first payment on such further Bonds) so that the same shall be consolidated and form a single series with the Bonds.

14. Notices

Notices to the Bondholders will be sent to them by first class mail (airmail if overseas) at their respective addresses on the Register, and will be deemed to have been given on the fourth day after the date of mailing. So long as the Bonds are listed on the Luxembourg Stock Exchange and the rules of the Luxembourg Stock Exchange so require, notices with respect to the Bonds will also be published in a leading newspaper having general circulation in Luxembourg (which is expected to be the *Luxemburger Wort*) or, if such publication is not practicable, in an English language newspaper having general circulation in Europe, and each such notice shall be deemed to have been given on the date of such publication, or if published more than once or on different dates, on the first date on which publication is made.

A copy of all notices provided pursuant to this Condition 14 shall also be given to Euroclear and Clearstream.

15. Currency Indemnity

The U.S. dollar is the sole currency of account and payment for all sums payable by the Russian Federation under or in connection with the Bonds, including damages. Any amount received or recovered in a currency other than the U.S. dollar (whether as a result of, or the enforcement of, a judgement or order of a court of any jurisdiction or otherwise) by any Bondholder in respect of any sum expressed to be due to it from the Russian Federation shall only constitute a discharge to the Russian Federation to the extent of the U.S. dollar amount which the recipient is able to purchase with the amount so received or recovered in that other currency on the date of that receipt or recovery (or, if it is not practicable to make that purchase on that date, on the first date on which it is practicable to do so). If that U.S. dollar amount is less than the U.S. dollar amount expressed to be due to the recipient under any Bond, the Russian Federation shall indemnify such recipient against any loss sustained by it as a result. In any event, the Russian Federation shall indemnify the recipient against the cost of making any such purchase. These indemnities constitute separate and independent obligations from the Russian Federation's other obligations, shall give rise to a separate and independent cause of action, shall apply irrespective of any indulgence granted by any Bondholder and shall continue in full force and effect despite any judgement, order, claim or proof for a liquidated amount in respect of any sum due under any Bond or any judgement or order.

16. Governing Law

The Bonds and the Fiscal Agency Agreement shall be governed by and construed in accordance with the laws of England.

TERMS AND CONDITIONS OF 2010 BONDS

The following, save for the paragraphs in italics, is the text of the terms and conditions of the 2010 Bonds which, subject to amendment, will be endorsed on each Bond Certificate and will be attached and (subject to the provisions thereof) apply to each Global Bond:

The U.S. Dollar Denominated Bonds due 2006 to 2010 (the “Bonds”) (which expression includes any further Bonds issued pursuant to Condition 13 and forming a single series with the Bonds) of the Ministry of Finance of the Russian Federation (the “Ministry of Finance”) acting on behalf of the Russian Federation were authorised pursuant to the provisions of Federal Law No.136-FZ of 29 July 1998, Government Resolution No. 478 of 23 June 2000, and Government Resolution No. 426 of 14 June 2002 and Government Resolution No. 764 of 19 December 2003. A fiscal agency agreement dated 24 August 2000, as amended on 17 December 2002, 15 March 2004 and 15 March 2004 (the “Fiscal Agency Agreement”) has been entered into in relation to the Bonds by the Russian Federation, The Chase Manhattan Bank (now JPMorgan Chase Bank), London branch, as fiscal and principal paying agent (the “Fiscal Agent”) and as registrar (the “Registrar”), the other paying agents named therein (together with the Fiscal Agent and the Registrar, the “Paying Agents”) and the transfer agents named therein (the “Transfer Agents”).

In these Conditions, “Fiscal Agent,” “Registrar,” “Paying Agent” and “Transfer Agent” shall include any successors appointed from time to time in accordance with the provisions of the Fiscal Agency Agreement for the Bonds, and any reference to an “Agent” or “Agents” shall mean any or all (as applicable) of such persons.

Copies of the Fiscal Agency Agreement are available for inspection during usual business hours at the principal office of the Fiscal Agent (currently at 9 Thomas More Street, London E1W 1YT, England) and at the specified offices of each of the other Agents. The Bondholders (as defined in Condition 1(b)) are bound by, and are deemed to have notice of, the provisions of the Fiscal Agency Agreement for the Bonds.

1. Form, Denomination and Title

(a) Form and Denomination

The Bonds are in definitive fully registered form, without interest coupons attached, in a minimum denomination of U.S.\$1.00 and any amount in excess thereof which is an integral multiple of U.S.\$1.00 (each an “authorised denomination”). A certificate (each a “Bond Certificate”) will be issued to each Bondholder in respect of its registered holding or holdings of Bonds. Each Bond Certificate will be numbered serially with an identifying number which will be recorded in the register (the “Register”) which the Russian Federation shall procure to be kept by the Registrar.

(b) Title

Title to the Bonds will pass by and upon registration in the Register. In these Conditions, “Bondholder” and “holder” mean the person in whose name a Bond is registered in the Register (or, in the case of joint holders, the first-named thereof). The holder of any Bond will (except as otherwise requested by such holder in writing, or as otherwise ordered by a court of competent jurisdiction or required by law) be treated as its absolute owner for all purposes, whether or not it is overdue and regardless of any notice of ownership, trust or any interest therein, any writing thereon by any person (other than a duly executed transfer thereof in the form endorsed thereon) or any notice of any previous theft or loss thereof, and no person will be liable for so treating the holder.

2. Transfer of Bonds and Issue of Bonds

(a) Transfer

Subject to Condition 2(d), a Bond may be transferred in whole or in part in an authorised denomination upon the surrender of the Bond Certificate representing that Bond, together with the form of transfer (including any certification as to compliance with restrictions on transfer included in such form of transfer) endorsed thereon (the “Transfer Form”) duly completed and executed, at the specified office of the Registrar or any Transfer Agent, together with such evidence as the Registrar or, as the case may be, such Transfer Agent may reasonably require to prove the title of the transferor and the authority of the persons who have executed the Transfer Form. In the case of a transfer of

part only of the Bonds represented by a Bond Certificate, neither the part transferred nor the balance not transferred may be less than the applicable authorised denomination and a new Bond Certificate in respect of the balance not so transferred will be issued to the transferor.

(b) Delivery

Each new Bond Certificate to be issued upon a transfer of any Bonds will, within five business days of the request for transfer being duly made, be delivered at the specified office of the Registrar or, as the case may be, any Transfer Agent or (at the request and the risk of such transferee) be mailed by uninsured post to such address as the transferee entitled to the Bonds represented by such Bond Certificate may have specified. In this Condition 2(b), “business day” means a day (other than a Saturday or Sunday) on which commercial banks are open for business (including dealings in foreign currencies) in the cities in which the Registrar and any such Transfer Agent have their respective specified offices.

(c) No Charge

Registration or transfer of Bonds will be effected without charge to the holder or transferee thereof, but upon payment (or against such indemnity from the holder or the transferee thereof as the Registrar or the relevant Transfer Agent may reasonably require) in respect of any tax or other duty of whatever nature which may be levied or imposed in connection with such registration or transfer.

(d) Closed Periods

No Bondholder may require the transfer of a Bond to be registered during the period of 15 calendar days ending on the due date for any payment of principal in respect of such Bond.

(e) Regulations Concerning Transfer and Registration

All transfers of Bonds and entries on the Register will be made subject to the detailed regulations concerning transfer of Bonds scheduled to the Fiscal Agency Agreement. The regulations may be changed by the Russian Federation in a manner which is reasonably required by the Russian Federation (after consultation with the Registrar) to reflect changes in legal requirements or in any other manner which is not prejudicial to the interests of the Bondholders. A copy of the current regulations will be sent by the Registrar to any Bondholder who so requests.

3. Status

The Bonds constitute direct, unconditional, unsecured and unsubordinated obligations of the Russian Federation and the full faith and credit of the Russian Federation is pledged for the due and punctual payment of principal of, and interest on, the Bonds and for the performance of all other obligations of the Russian Federation pursuant to the Bonds. The Bonds shall at all times rank *pari passu* without any preference among themselves and at least *pari passu* in all respects with all other present and future unsecured and unsubordinated obligations of the Russian Federation.

Under the Constitution and laws of the Russian Federation, certain of the Russian Federation's assets are not available to satisfy the claims of creditors, including Bondholders. In particular, Article 126 of the Civil Code, as amended, provides that assets which have been transferred to state-owned entities under “economic management” or “operational management” are not available for such purpose. The laws of the Russian Federation do not restrict the Russian Federation from transferring any of its assets to such state-owned entities. In addition, Article 126 provides that certain other assets which may only be owned by the state (for example, subsoil, federal transportation systems and nuclear power installations) are not available to satisfy the claims of creditors.

4. Negative Pledge and Covenant

(a) Negative Pledge

So long as any of the Bonds remains outstanding (as defined in the Fiscal Agency Agreement) the Russian Federation will not create or permit to subsist any Lien upon the whole or any part of the International Monetary Assets

to secure any Public External Indebtedness unless, at the same time or prior thereto, the obligations of the Russian Federation under the Bonds are secured equally and rateably therewith.

(b) Covenant

So long as any Bond remains outstanding the Russian Federation shall obtain, and do or cause to be done all things necessary to ensure the continuance of, all consents, licences, approvals and authorisations, and make or cause to be made all registrations, recordings and filings, which may at any time be required to be obtained or made in the Russian Federation for the execution, delivery or performance of the Bonds or for the validity or enforceability thereof.

(c) Definitions

In these Conditions:

“Excluded Indebtedness” means any obligation of the Russian Federation, the Government of the Russian Federation, the Ministry of Finance, Vnesheconombank of the U.S.S.R. or any other person that may arise from time to time representing restructured indebtedness originally incurred prior to 1 January 1992 by the government of the former Soviet Union or any of its legally authorised entities, other than the Bonds and the Russian Federation U.S. Dollar Denominated Bonds due 2007 to 2030.

“External Indebtedness” means Indebtedness (i) which is not Excluded Indebtedness, (ii) which is denominated or payable, or at the option of the relevant creditor or holder thereof may be payable, in a currency other than the lawful currency of the Russian Federation and (iii) which was not originally incurred or assumed under an agreement or instrument made with or issued to creditors substantially all of whom were residents of the Russian Federation or entities having their head office or principal place of business within the territory of the Russian Federation. For the avoidance of doubt, External Indebtedness does not include Internal Government Hard Currency Bonds known as “OVVZs,” “Taiga” bonds or “MinFins” or any bonds representing restructured internal hard currency bonds of the Government of the Russian Federation.

“Government of the Russian Federation” means the Government of the Russian Federation as provided in Article 110 of the Constitution of the Russian Federation, or any successor article, from time to time.

“IMF” means the International Monetary Fund.

“Indebtedness” means any legal obligation or any obligation intended by its terms to be a legal obligation (whether present or future, actual or contingent, secured or unsecured, incurred as principal, surety, guarantor or otherwise) for the payment or repayment of borrowed money created (or intended by its terms to have been created) under an agreement or instrument in which the Russian Federation, the Government of the Russian Federation or the Ministry of Finance is designated as the obligor, or which by operation of Russian law constitutes a legal obligation of the Russian Federation, the Government of the Russian Federation or the Ministry of Finance (it being understood that neither the Central Bank of the Russian Federation, nor any political subdivision, regional or municipal government, ministry (other than the Ministry of Finance), department, authority or statutory corporation of the Russian Federation nor any joint stock company, enterprise or other entity organised or existing under the laws or regulations of the Russian Federation or any of the above, is considered to be part of the Russian Federation, the Government of the Russian Federation or the Ministry of Finance for purposes hereof).

“International Monetary Assets” means all official holdings of gold, Special Drawing Rights, Reserve Positions in the Fund and Foreign Exchange of the Ministry of Finance or the Government of the Russian Federation from time to time (but not, for the avoidance of doubt, any such assets of the Central Bank of the Russian Federation at any time), and the terms “Special Drawing Rights,” “Reserve Positions in the Fund” and “Foreign Exchange” have, as to the types of assets included, the meanings given to them in the IMF's publication entitled “International Financial Statistics” or such other meanings as shall be formally adopted by the IMF from time to time.

“Lien” means any lien, pledge, hypothecation, mortgage, security interest, deed of trust, charge or any other encumbrance arising under a security agreement or arrangement.

“Public External Indebtedness” means External Indebtedness which (i) is in the form of, or represented by, bonds, notes or other securities or any guarantee thereof and (ii) is, or may be, quoted, listed or ordinarily purchased

and sold on any stock exchange, automated trading system or over-the-counter or other securities market (including, without prejudice to the generality of the foregoing, the market for securities eligible for resale pursuant to Rule 144A under the United States Securities Act of 1933, as amended (the “Securities Act”).

5. Interest

Each Bond bears interest from 31 March 2000 at the rate of 8.25 per cent. per annum. On the date of issue of each Bond (the “First Payment Date”), interest accrued on 9.5% of the outstanding principal amount of each Bond, from and including 31 March 2000 to but excluding the First Payment Date will be payable. Thereafter, interest on the outstanding principal amount of each Bond will be payable semi-annually in arrear on 31 March and 30 September in each year until maturity, commencing on 30 September 2000. Interest will be paid subject to and in accordance with the provisions of Condition 7.

Each Bond will cease to bear interest from each Principal Payment Date (as defined in Condition 6) on the portion of the outstanding principal amount of such Bond scheduled to be paid on such Principal Payment Date unless, after presentation and (in the case of the Final Principal Payment Date) surrender of such Bond, payment of principal is improperly withheld or refused, in which case the outstanding principal amount of such Bond will continue to bear interest in accordance with this Condition 5 (after as well as before judgement) until whichever is the earlier of (i) the day on which all sums due in respect of such Bond up to that day are received by or on behalf of the relevant Bondholder and (ii) the day which is seven days after notice has been given to the Bondholders that the Fiscal Agent has received all sums due in respect of the Bonds up to such seventh day (except, in the case of payment to the Fiscal Agent, to the extent that there is any subsequent default in payment in accordance with these Conditions).

If interest is required to be calculated for a period of less than 12 months, it will be calculated on the basis of a year of 360 days consisting of 12 months of 30 days each and, in the case of an incomplete month, the actual number of days elapsed.

6. Redemption, Purchase and Cancellation

(a) Redemption

Unless previously redeemed, or purchased and cancelled, each Bond will be redeemed on the First Payment Date and in nine subsequent semi-annual instalments on the dates set forth below (each, together with the First Payment Date, a “Principal Payment Date”) commencing on 31 March 2006 in the amount (expressed as a percentage of the outstanding principal amount of each Bond on the date of issue without giving effect to the payment of principal made on that date) set forth below opposite such Principal Payment Date. Principal will be paid subject to and in accordance with Condition 7.

<u>Principal Payment Date</u>	<u>Percentage</u>
First Payment Date	9.500 per cent
31 March 2006	10.055 per cent.
30 September 2006	10.055 per cent.
31 March 2007	10.055 per cent.
30 September 2007	10.055 per cent.
31 March 2008	10.055 per cent.
30 September 2008	10.055 per cent.
31 March 2009	10.055 per cent.
30 September 2009	10.055 per cent.
31 March 2010	remainder

(b) Purchase and Cancellation

The Russian Federation and its affiliates may at any time purchase Bonds in the open market or otherwise at any price. Any Bonds so purchased may be cancelled or held and resold (provided that such resale is outside the United States, as defined in Regulation S under the Securities Act). Any Bonds so cancelled will not be reissued.

7. Payments

(a) Principal

Payments of principal in respect of each Bond will be made by transfer to a U.S. dollar account maintained by the Bondholder with a bank in New York City or (i) if it does not have such a U.S. dollar account or (ii) the principal amount of Bonds held by such person is less than U.S.\$250,000, by a U.S. dollar cheque drawn on a bank in New York City mailed to the registered address of the Bondholder by uninsured mail at the risk of the Bondholder. Such payment will be made only upon presentation and (in the case of final redemption) surrender of the relevant Bond Certificate at the specified office of any of the Paying Agents and will be rounded downwards, if necessary, to the nearest cent. For the purposes of this Condition 7(a) the holder of such Bond will be deemed to be the person shown as the holder (or the first-named of joint holders) on the Register at the Registrar's close of business on the fifteenth day before the due date for such payment of principal and the outstanding amount of each Bondholder's registered holding will be deemed to be the amount shown as such on the Register for such Bondholder at the same time on that date.

(b) Interest

Payments of interest (other than interest due on a Principal Payment Date) in respect of each Bond will be made by U.S. dollar cheque drawn on a bank in New York City and mailed to the holder (or to the first-named of joint holders) of such Bond at the address appearing in the Register not later than the due date for such payment and will be rounded downwards, if necessary, to the nearest cent. For the purposes of this Condition 7(b) the holder of such Bond will be deemed to be the person shown as the holder (or the first-named of joint holders) on the Register on the fifteenth day before the due date for such payment of interest.

Upon application by a Bondholder with respect to Bonds having a principal amount of U.S.\$250,000 or more to the specified office of the Registrar not less than fifteen days before the due date for the payment of any interest (other than interest due on a Principal Payment Date) in respect of such Bonds, such payment will be made by transfer to a U.S. dollar account maintained by the payee with a bank in New York City. Any such application for transfer to a U.S. dollar account shall be deemed to relate to all future payments of interest (other than interest due on a Principal Payment Date) in respect of the Bonds which become payable to the Bondholder who has made the initial application until such time as the Registrar is notified in writing to the contrary by such Bondholder.

Payment of interest due on a Principal Payment Date will be made in the same manner as payment of the principal of a Bond.

(c) Payments Subject to Fiscal Laws

All payments of principal and interest in respect of the Bonds are subject in all cases to any applicable fiscal or other laws and regulations, but without prejudice to the provisions of Condition 8.

Consistent with the terms of Regulation No. BG-4-06/14 of 12 July 2000 approved by the Ministry of Taxes and Duties of the Russian Federation and agreed by the Ministry of Finance, Russian residents, other than physical persons, may not receive interest on the Bonds in any form.

The Regulations do not contain a definition of "Russian residents." Accordingly, it is unclear whether, for example, Russian branches and representative offices of foreign entities would be considered to be Russian residents for this purpose. See "Russian Taxation."

(d) Commissions

No commissions or expenses shall be charged to the Bondholders in respect of any payments of principal or interest in respect of the Bonds.

(e) Payments on Business Days

Where payment is to be made by transfer to a U.S. dollar account, payment instructions (for value the due date or, if that is not a business day, for value the first following day which is a business day) will be initiated on the due

date for payment or, if later, in the case of principal and interest due on redemption in whole or in part, on the business day on which the relevant Bond Certificate is presented and, in the case of a Final Principal Payment Date, surrendered at the specified office of any of the Paying Agents.

Where payment is to be made by cheque, the cheque will be mailed on the due date for payment or, if later, in the case of principal and interest due on redemption in whole or in part, on the business day on which the relevant Bond Certificate is presented and, in the case of a Final Principal Payment Date, surrendered at the specified office of any of the Paying Agents.

In these Conditions, “business day” means a day (other than a Saturday or Sunday) on which commercial banks are open for business in New York City and, in the case of the surrender of a Bond Certificate, in the place where the Bond Certificate is surrendered.

(f) Delay in Payments

Bondholders will not be entitled to any interest or other payment for any delay after the due date in receiving any amount due in respect of any Bond as a result of (i) the due date not being a business day, (ii) the Bondholder being late in presenting or surrendering its Bond Certificate (if required to do so) or (iii) a cheque mailed in accordance with this Condition 7 arriving after the due date for payment or being lost in the mail.

(g) Partial Payments

If at any time a partial payment is made in respect of any Bond, the Registrar shall endorse the Register with a statement indicating the amount and date of such payment.

(h) Agents

The initial Agents and their initial specified offices are listed below. Any of the Agents may resign in accordance with the provisions of the Fiscal Agency Agreement and the Russian Federation reserves the right at any time to vary or terminate the appointment of any Agent and appoint additional or other Agents, provided that while the Bonds are outstanding it will maintain (i) a Fiscal Agent, (ii) a Registrar and (iii) a Paying Agent and a Transfer Agent having a specified office in a major European city which will be in Luxembourg, so long as the Bonds are listed on the Luxembourg Stock Exchange and the rules of the Luxembourg Stock Exchange so require. Notice of any change in the Agents or their specified offices will promptly be given to the Bondholders in accordance with Condition 14.

8. Taxation

All payments of principal and interest in respect of the Bonds by the Russian Federation shall be made free and clear of, and without withholding or deduction for, any taxes, duties, assessments or governmental charges of whatever nature imposed, levied, collected, withheld or assessed by the Russian Federation or any political subdivision or any authority thereof or therein having power to tax (together, “Taxes”), unless such withholding or deduction is required by law. If at any time any Taxes are withheld or deducted, the Russian Federation shall increase the payment of principal or interest, as the case may be, to such amount as will result in the receipt by the Bondholders of such amounts as would have been received by them had no such withholding or deduction been required, except that no such increased amount shall be payable:

- (a) to a holder, or to a third party on behalf of a holder, if such holder is liable to such Taxes by reason of having some connection with the Russian Federation other than the mere holding of a Bond or the receipt of payments thereunder; or
- (b) if the Bond Certificate representing a Bond is presented and (in the case of final redemption) surrendered for payment more than 30 days after the Relevant Date, except to the extent that the holder would have been entitled to such additional amounts on presentation and (in the case of final redemption) surrender of such Bond Certificate for payment on the last day of such period of 30 days.

If, in relation to any payment under the Bonds (a “Payment”) any Bondholder has received any increased amount as provided in this Condition 8, the Russian Federation shall have the right to retain any refund of any amount withheld or deducted in respect of such Payment, which refund may be available under a tax treaty or otherwise to such

Bondholder. Notwithstanding the foregoing, no Bondholder makes any representation or warranty that the Russian Federation will be entitled to any such refund (or to make any claim in respect thereof) and no Bondholder shall incur any obligation with respect thereto (including, without limitation, incurring any expense or liability in connection therewith).

For the avoidance of doubt, the Russian Federation acknowledges that it shall have no right to make any deduction or withholding in respect of (nor will it purport to set off any amount equal to) any such refund from any payment in respect of any Bond.

In these Conditions, “Relevant Date” means whichever is the later of (i) the date on which the payment in question first becomes due and (ii) if the full amount payable has not been received in New York City by the Fiscal Agent on or prior to such due date, the date on which (the full amount having been so received) notice to that effect has been given to the Bondholders.

Any reference in these Conditions to principal or interest in respect of the Bonds shall be deemed to include any increased amounts which may be payable under this Condition 8.

9. Events of Default

If any of the following occurs and is continuing (each an “Event of Default”) in respect of the Bonds, as applicable:

(a) Non-payment

The Russian Federation fails to pay any amount of principal or interest in respect of the Bonds, as the case may be, when due and such failure continues for a period of fifteen business days, provided, however, that it shall not constitute an Event of Default if interest is not paid to a Bondholder which is a Russian resident (other than a physical person) as contemplated in Condition 7(c); or

(b) Breach of other obligations or undertakings

The Russian Federation defaults in performance or observance of or compliance with any of its other obligations or undertakings in respect of the Bonds, as the case may be, which default (if capable of remedy) is not remedied within sixty days after written notice of such default shall have been given to the Russian Federation by any holder of the Bonds, as the case may be, it being understood that a default in respect of the undertaking set forth in Condition 4(a) shall be deemed capable of remedy for purposes hereof; or

(c) Cross-acceleration

Any other Public External Indebtedness shall become due and payable prior to the stated maturity thereof otherwise than at the option of the debtor following a default or the Russian Federation, the Government of the Russian Federation or the Ministry of Finance shall fail to make the final payment of principal in respect of any Public External Indebtedness on the date on which such final payment is due and payable or at the expiration of any grace period originally applicable thereto or, in the case of any guarantee which constitutes Public External Indebtedness, the underlying obligation in respect of which such guarantee has been given shall have become due and payable prior to the stated maturity thereof otherwise than at the option of the debtor following a default or the debtor shall have failed to make the final payment of principal in respect of such underlying obligation on the date on which such final payment is due and payable or at the expiration of any grace period originally applicable thereto and the guarantee shall not be honoured when due and called upon; provided that the aggregate amount of the relevant Public External Indebtedness in respect of which one or more of the events mentioned in this Condition 9(c) shall have occurred equals or exceeds U.S.\$75,000,000 (or its equivalent in any other currency or currencies); and provided, further, that any secured Public External Indebtedness that by its terms is fully non-recourse to the Russian Federation, the Government of the Russian Federation or the Ministry of Finance shall not be counted as Public External Indebtedness for purposes of this Condition 9(c); or

(d) Moratorium

A moratorium on the payment of principal of, or interest on, all or any part of Public External Indebtedness; or

(e) Unlawfulness or Invalidity

The validity of the Bonds is contested by the Russian Federation or any agency or entity acting on behalf of the Russian Federation or the Russian Federation or any agency or entity acting on behalf of the Russian Federation shall deny any of the Russian Federation's obligations under the Bonds or it is or will become unlawful for the Russian Federation to perform or comply with any of its obligations under or in respect of the Bonds or under or in respect of the Fiscal Agency Agreement or any of such obligations shall be or become unenforceable or invalid; or

(f) IMF

The Russian Federation ceases to be a member of the IMF or eligible to use the general resources of the IMF pursuant to Article 26 of the IMF Articles of Agreement; or

(g) Consents etc.

Any regulation, decree, consent, approval, licence or other authority necessary to enable the Russian Federation to enter into or perform its obligations under the Bonds or under the Fiscal Agency Agreement or for the validity or enforceability thereof shall expire or be withheld, revoked or terminated or otherwise cease to remain in full force and effect or shall be modified in a manner which adversely affects any rights or claims of any of the holders of the Bonds, as the case may be, then holders of 25 per cent. or more in aggregate outstanding principal amount of the Bonds may declare the Bonds to be immediately due and payable whereupon the Bonds shall become immediately due and payable at their principal amount, together with accrued interest, without any further formality.

10. Prescription

Claims against the Russian Federation in respect of principal and interest shall become void unless made within a period of ten years, in the case of principal, and five years, in the case of interest, from the appropriate Relevant Date (as defined in Condition 8).

11. Replacement of Bond Certificates

If any Bond Certificate is lost, stolen, mutilated, defaced or destroyed, it may be replaced at the specified office of the Registrar or the Transfer Agent with its specified office in Luxembourg subject to all applicable laws and stock exchange requirements, upon payment by the claimant of the expenses incurred in connection with such replacement and on such terms as to evidence, security, indemnity and otherwise as the Russian Federation may reasonably require. Mutilated or defaced Bond Certificates must be surrendered before replacements will be issued.

12. Meetings of Bondholders, Modification and Waiver

(a) Meetings of Bondholders

The Fiscal Agency Agreement contains provisions for convening meetings of holders of Bonds to consider any matter affecting their interests, including the modification by Extraordinary Resolution of these Conditions. The quorum at any such meeting for passing an Extraordinary Resolution shall (subject as provided in the Fiscal Agency Agreement in the event that all Bonds for the time being outstanding are held by one person) be two or more persons holding or representing a clear majority of the principal amount of the Bonds for the time being outstanding, or at any adjourned meeting two or more persons being or representing holders of the Bonds whatever the principal amount for the time being outstanding so held or represented, except that at any meeting the business of which includes consideration of proposals, *inter alia*, (i) to modify the maturity of the Bonds, (ii) to reduce or cancel the principal amount of, or interest on, the Bonds, (iii) to change the currency of payment of the Bonds, (iv) to modify the provisions concerning the quorum required at any meeting of holders of the Bonds or the majority required to pass an Extraordinary Resolution or (v) to modify the percentage required to pass any resolution, the necessary quorum for passing an Extraordinary Resolution shall (subject as provided in the applicable Fiscal Agency Agreement in the event that all Bonds for the time being outstanding are held by one person) be two or more persons holding or representing not less than three-quarters, or at any adjourned such meeting not less than one-quarter, of the principal amount of the Bonds for the time being outstanding. An Extraordinary Resolution duly passed at any meeting of holders of the Bonds will be binding on all holders of the Bonds whether or not they are present at the meeting.

(b) Modification and waiver

The parties to the Fiscal Agency Agreement may agree, without the consent of the holders of the Bonds, to any modification of any provision of the Fiscal Agency Agreement or the Bonds which is of a formal, minor or technical nature or is made to correct a manifest error.

13. Further Issues

The Russian Federation shall be at liberty from time to time, without the consent of the holders of the Bonds, to create and issue further Bonds ranking equally in all respects (or in all respects save for payments made prior to the issuance of such further Bonds and, if applicable, the date and amount of the first payment on such further Bonds) so that the same shall be consolidated and form a single series with the Bonds.

14. Notices

Notices to the Bondholders will be sent to them by first class mail (airmail if overseas) at their respective addresses on the Register, and will be deemed to have been given on the fourth day after the date of mailing. So long as the Bonds are listed on the Luxembourg Stock Exchange and the rules of the Luxembourg Stock Exchange so require, notices with respect to the Bonds will also be published in a leading newspaper having general circulation in Luxembourg (which is expected to be the *Luxemburger Wort*) or, if such publication is not practicable, in an English language newspaper having general circulation in Europe, and each such notice shall be deemed to have been given on the date of such publication, or if published more than once or on different dates, on the first date on which publication is made.

A copy of all notices provided pursuant to this Condition 14 shall also be given to Euroclear and Clearstream.

15. Currency Indemnity

The U.S. dollar is the sole currency of account and payment for all sums payable by the Russian Federation under or in connection with the Bonds, including damages. Any amount received or recovered in a currency other than the U.S. dollar (whether as a result of, or the enforcement of, a judgement or order of a court of any jurisdiction or otherwise) by any Bondholder in respect of any sum expressed to be due to it from the Russian Federation shall only constitute a discharge to the Russian Federation to the extent of the U.S. dollar amount which the recipient is able to purchase with the amount so received or recovered in that other currency on the date of that receipt or recovery (or, if it is not practicable to make that purchase on that date, on the first date on which it is practicable to do so). If that U.S. dollar amount is less than the U.S. dollar amount expressed to be due to the recipient under any Bond, the Russian Federation shall indemnify such recipient against any loss sustained by it as a result. In any event, the Russian Federation shall indemnify the recipient against the cost of making any such purchase. These indemnities constitute separate and independent obligations from the Russian Federation's other obligations, shall give rise to a separate and independent cause of action, shall apply irrespective of any indulgence granted by any Bondholder and shall continue in full force and effect despite any judgement, order, claim or proof for a liquidated amount in respect of any sum due under any Bond or any judgement or order.

16. Governing Law

The Bonds and the Fiscal Agency Agreement shall be governed by and construed in accordance with the laws of England.

RUSSIAN FEDERATION

Territory, Population and Natural Resources

The Russian Federation, or Russia (*Rossiya*), is a sovereign and democratic federal state, consisting of 89 sub-federal political units, the “Federation subjects.” It is the largest country in the world, covering 17.1 million square kilometres, approximately one-eighth of the earth’s land area. Russia borders 16 countries and spans 11 time zones, extending some 9,000 kilometres from the Baltic Sea in the west to the Pacific Ocean in the east and some 4,000 kilometres from its southern border on the Black and Caspian Seas to its northern limits on the Arctic Ocean. The European part of the country consists of a large plain west of the Ural Mountains, while the Asian portion is divided into Siberia, occupying the vast central region of the country, and the Russian Far East, which borders on the Pacific. Russia has the tallest mountain in Europe (Elbrus, in the Caucasus, at 5,642 metres), the largest lake in Europe (Ladoga, near St. Petersburg) and the world’s deepest lake (Baikal, near Irkutsk).

Russia is home to approximately 145 million people (2.3% of the world’s population at the beginning of 2003) and ranks seventh in the world by population size. Overall population density is approximately 8.5 persons per square kilometre, although most of the population (72%) lives in European Russia. Approximately 73% of Russia’s population lives in cities. Russia’s capital and largest city is Moscow (10.4 million inhabitants). Other major cities include St. Petersburg, Novosibirsk, Nizhny Novgorod, Ekaterinburg and Samara. In all, 13 Russian cities have a population of more than one million, including four in the Urals and two in Siberia.

According to the most recent general census in 2002, ethnic Russians accounted for 80% of the population. There are more than 100 other ethnic groups in Russia, the largest being Tatars (approximately 3.8% of the total population), Ukrainians (2.0%), Bashkirs (1.2%) and Chuvashs (1.1%). No other ethnic group accounts for more than 1% of Russia’s total population.

Russia has a well-developed system of education and the literacy rate exceeds 99%. Education is compulsory for those between the ages of seven and 15. The country has approximately 1,039 institutions of higher education, with 5.9 million students. Russia’s labour force numbered approximately 71 million at the end of 2003, of which over 99% had at least eight years of schooling, 81% had at least ten years, 22% had received higher education and 43% had received professional training.

Russia is rich in natural resources. It is the world’s leading producer of natural gas, the second-largest producer of oil and a significant producer of coal, uranium, nickel, palladium and platinum. The country also has substantial gold deposits (located mainly in Eastern Siberia and the Russian Far East) as well as significant deposits of zinc, lead, tin, silver, rare metals and precious and semiprecious stones. Russia is also among the world’s leading producers of electricity, steel, fertilisers, cotton textiles and other goods. Forests cover over 51% of Russia’s total land area and Russia’s timber reserves are estimated at 81.9 billion cubic metres, more than those of any other country.

Russia and the Dissolution of the Soviet Union

From 1922 to 1991, Russia was the largest republic in the Union of Soviet Socialist Republics (the “Soviet Union”). For most of this period, the politics and economy of the Soviet Union were centralised under Communist rule. Beginning in 1985, Mikhail Gorbachev, the General Secretary of the Communist Party of the Soviet Union, led a movement to reform the Soviet political and economic system through policies of openness (*glasnost*) and restructuring (*perestroika*).

General Secretary Gorbachev sought to make Soviet social and political life more democratic, open and decentralised. As a result of his policies, the Soviet Union greatly improved its relations with the West, effectively ending the Cold War, the Soviet press gained greater independence and public discussion became increasingly open and informed. At the same time, the leading role of the Communist Party as a matter of law was abolished.

General Secretary Gorbachev’s economic reforms were mostly unsuccessful, however. The aim of *perestroika* was to revive economic growth through the introduction of market incentives within the framework of a planned economy. Despite a number of initiatives, the economy continued to decline and economic conditions deteriorated significantly in 1990 and 1991. The main reasons for the decline were large increases in social

expenditures enacted by the Supreme Soviet, the Soviet Union's legislative body, and a jurisdictional dispute between Soviet and Russian authorities over the collection of taxes, which caused central government revenues to decline. The resulting budget deficit reached approximately 20% of GDP in 1991. To cover this deficit, the Soviet Union resorted to short-term and uncoordinated foreign borrowing, the sale of virtually all its gold and foreign exchange reserves and the printing of roubles in large quantities. The increase in the money supply, combined with price controls on most products, led to excess money holdings, acute shortages of consumer goods and significant inflationary pressure (prices rose by 160% in 1991). Over the same period, output contracted and the Soviet Union fell into recession.

In 1990, Russia declared its sovereignty (though not its independence) and began to challenge the central Soviet government's authority. On 17 June 1991, Boris Yeltsin became Russia's first popularly elected president. In that same year, President Yeltsin and the leaders of eight other Soviet Republics reached agreement with the central authorities on a new power sharing arrangement. In August 1991, the imminent signing of this new Union Treaty provoked a coup attempt by Soviet hardliners. In the wake of the coup's failure, President Yeltsin banned the Communist Party of the Soviet Union within Russia.

On 8 December 1991, the Soviet Union was formally dissolved by the leaders of Russia, Ukraine and Belarus, the original signatories of the 1922 Union Treaty that had constituted the Soviet Union, and Russia became a fully independent state.

For some time after the dissolution of the Soviet Union, the division of authority between Russia's federal executive and legislative branches was unclear. Beginning in the summer of 1992, the Supreme Soviet, which had been elected during the Soviet period, sought to assert its authority over Russia's economic policy, in opposition to the reform programme of the Government. Support for the Government's programme was demonstrated in a national referendum in April 1993, in which a majority of voters voted in favour of continuing the reform process. In September 1993, relations between the Government and the Supreme Soviet reached an impasse. That month, President Yeltsin issued a decree dissolving the Supreme Soviet, prompting several of its members to occupy the Russian parliament building and call for an armed uprising. Within a short time, the occupation was ended with the assistance of Interior Ministry troops. A new Constitution was subsequently drafted by the office of the President, approved by a specially convened Constitutional Assembly and, in December 1993, adopted by a 58% majority vote in a national referendum in which 55% of eligible voters participated. On the same day, the first elections to the State Duma (the "Duma"), the lower house of Russia's new legislative body, the Federal Assembly, were held.

Political System

Constitution

The Constitution of Russia provides for a tripartite governmental structure in which the power of the state is divided between the executive, legislative and judicial branches, each independent of the others. The Constitution also establishes a federal system, allocating responsibilities between federal, sub-federal and local authorities.

The Constitution protects certain fundamental "rights and freedoms of the person and the citizen," and charges the state with guaranteeing the equal treatment of people of all races, nationalities and beliefs. In contrast to the Soviet Union's constitution, which emphasised state property and the one-party system, under the Russian Constitution all forms of property (including private property) are equal before the law and ideological diversity and a multi-party system are expressly recognised.

In general, the Constitution may be amended through passage of a special federal constitutional law, and its ratification by the legislatures of at least two-thirds of the Federation subjects. Passage of such a special law requires the vote of a two-thirds majority of the Duma, a three-fourths majority of the Federation Council (the upper house of the Federal Assembly) and signature by the President. Those provisions of the Constitution that govern the nature of the constitutional system, individual rights and the amendment process, however, can be changed only by convening a Constitutional Assembly. A proposed new constitution may be adopted either by the vote of a two-thirds majority of the Constitutional Assembly or by a simple majority in a national referendum in which more than half the eligible voters participate.

Executive Branch

President

The President of Russia has broad powers. The President is Head of State and Supreme Commander of the Armed Forces, with authority to declare a state of military emergency and other states of emergency, subject to approval by the Federation Council, and the ability to commence military engagements, subject to immediate notification to the Duma and Federation Council. The President also bears responsibility for foreign policy and national defence. The President has the power to issue decrees and orders that have the force of law (although these may not contravene the Constitution or federal legislation), to suspend acts of sub-federal and local executive authorities and to call national referenda on matters of special importance. In addition, the President is empowered to arbitrate disputes between the federal authorities and the Federation subjects.

The President has the power to veto bills passed by the Federal Assembly and, under certain circumstances, to dissolve the Duma. The President may dissolve the Duma if (i) the Duma fails to accept the President's proposed candidate for Prime Minister in three successive votes, (ii) the Duma twice within three months passes a motion of no confidence in the Government or (iii) the Government loses a confidence motion put before the Duma by the Prime Minister. The Duma may not, however, be dissolved at any time during the last six months of a presidential term, during the period between passage by the Duma of an accusation initiating impeachment proceedings against the President and action by the Federation Council on such accusation, while a state of emergency covering all of Russia is in effect, or, in the case of (ii) or (iii) above, within the first year after Duma elections. In the event the Duma is dissolved, the President must schedule elections and a newly-elected Duma must be convened within four months.

The President also enjoys significant appointment powers, including the power to appoint the Prime Minister (with the consent of the Duma) and the other members of the Government (who are nominated by the Prime Minister). The President may also dismiss deputy prime ministers and federal ministers at any time and may dismiss the Prime Minister, which would simultaneously lead to a dismissal of the Government. In addition, the President nominates candidates for Governor of the Central Bank (for appointment by the Duma), Prosecutor General (for appointment by the Federation Council) and Constitutional Court, Supreme Court and Supreme Arbitration Court judges (for appointment by the Federation Council).

The President is elected in a national election for a term of four years. The Constitution provides for the early termination of the President's term of office in the event of the President's death, resignation or impeachment, or if the President is persistently unable to exercise his powers for health reasons. New presidential elections must be held within three months of any early termination. Impeachment of the President requires an accusation supported by the vote of a two-thirds majority of the Duma, followed by a vote in favour of impeachment by a two-thirds majority of the Federation Council, with subsequent confirmation by the Supreme Court of the legality of the accusation and by the Constitutional Court of the observance of due process. Under the Constitution, whenever the President is incapable for any reason of carrying out his duties, the obligations of the office are temporarily assumed by the Prime Minister, except that the Prime Minister, as acting President, may not dissolve the Duma or propose any national referendum or change to the Constitution.

Government

The Government consists of the Prime Minister, deputy prime ministers and federal ministers, all of whom are appointed by the President as described above. The Government is automatically dissolved after each presidential election in order to permit the President to form a new Government.

The Government is responsible for implementing federal laws, presidential decrees and international agreements. In particular, the Government is responsible for preparing and implementing the federal budget, establishing a unified financial, credit and monetary policy, carrying out social policy, preserving public order and defending the rights and freedom of citizens.

Legislative Branch

The legislative branch is the Federal Assembly, which consists of a lower chamber, the Duma, and an upper chamber, the Federation Council.

The Duma consists of 450 deputies, elected by a mixed system of majority vote and proportional representation. Half the deputies are elected by majority vote in individual electoral districts. The other half are chosen from “party lists” on the basis of a nationwide election, with seats being allocated in proportion to the number of votes received by the party. Only parties receiving more than 5% of the vote qualify for these “party list” seats. “Party list” deputies are free to change their party affiliations during their terms of office without the need for a new election. The Duma sits for a four-year term. No person may simultaneously serve as a Duma deputy and hold a position in the Government.

The Federation Council, with 178 deputies, represents Russia’s 89 Federation subjects. See “Federal Structure and Regional Issues.” Each Federation subject appoints two members of the Federation Council, one chosen by the legislative body of the Federation subject and the other by its executive body. The members of the Federation Council have to work on a full-time basis and cannot occupy any other office.

For a bill to become federal law, it generally must first be passed by a majority vote in the Duma, be approved by a majority vote in the Federation Council and finally be signed by the President. Rejection of a bill by the Federation Council can be overridden by a two-thirds majority of the Duma. Rejection of a bill by the President can be overridden by a two-thirds majority of each of the Federation Council and the Duma.

Judicial Branch

Russia has a Constitutional Court, which has jurisdiction over matters relating to the interpretation of the Constitution, including the constitutionality of federal laws, decrees of the President, resolutions of the Government, resolutions of the Duma and the Federation Council, laws and legal documents of the Federation subjects and agreements between federal and sub-federal authorities. Judicial authority is otherwise vested in a Supreme Court and lower courts of general jurisdiction in civil, criminal, administrative and other matters. Jurisdiction over economic disputes is vested in a Supreme Arbitration Court and lower arbitration courts.

Judges on the Constitutional Court, Supreme Court and Supreme Arbitration Court are nominated by the President and appointed by the Federation Council. Judges on lower federal courts are appointed by the President in accordance with procedures established by federal legislation.

Political Parties, Most Recent Elections and Political Developments

Under federal law, all Russian citizens who are at least 18 years old have the right to vote in presidential elections, Duma elections and national referenda.

The Constitution contains a number of provisions designed to encourage the development of a stable party system. First, candidates must collect a specified number of signatures to qualify for elections. In the case of the presidential election, a candidate must collect at least one million signatures in order to be placed on the presidential ballot. Second, the allocation of half the Duma seats to parties receiving 5% or more of the “party list” votes tends to discourage parties that cannot command significant electoral support. Only six parties received 5% or more of the “party list” votes in the most recent Duma elections, held in December 1999. Third, the rules for presidential elections, which call for a run-off election between the two top finishers if no candidate wins a majority in the initial round of voting, discourage fragmentation of the vote.

In the December 2003 Duma election, the pro-Kremlin party, *Edinaya Rossiya* (United Russia), the product of the 2001 merger of two large centrist parties – *Yedinstvo* (Unity) and *Otechestvo – Vsyaya Rossiya* (Fatherland – All Russia), received a plurality of the party-list votes cast (37.6%) and currently holds 306 Duma seats. The Communist Party received only 12.6% of the party-list votes cast in 2003 (down from 24.3% in 1999) and holds 52 Duma seats. Two other parties are also represented in the Duma: the Liberal Democratic Party (11.5% of the party-list votes cast and a total of 36 seats) and the National-Patriotic Union *Rodina* (Homeland) (9.0% of the party-list votes cast and a total of 38 seats).

From March 1998 through early 2000, the Government underwent a number of significant changes. On 23 March 1998, President Yeltsin dismissed the Government, including Prime Minister Victor Chernomyrdin, who had been in office since 1993. President Yeltsin nominated Sergei Kiriyenko to replace Mr. Chernomyrdin. Mr. Kiriyenko was rejected twice by the Duma and then approved on the third and final vote.

On 17 August 1998, the Government led by Mr. Kiriyenko announced that it would not be able to meet its obligations under its short-term rouble denominated treasury bills and certain other rouble denominated securities. The Government also announced a relaxation of its exchange rate policy and a 90-day moratorium on certain hard currency payments. The actions of the Government led to a severe economic crisis. See “The Russian Economy—Overview of Economic Reforms” for a more detailed discussion of the events of 17 August 1998 and their consequences.

On 23 August 1998, President Yeltsin dismissed the Government headed by Prime Minister Kiriyenko and sought to reappoint Mr. Chernomyrdin. When Mr. Chernomyrdin’s nomination was rejected twice by the Duma, President Yeltsin nominated Mr. Evgeny Primakov, who had been serving as Foreign Minister. Mr. Primakov was approved as Prime Minister by the Duma on 11 September 1998.

The Government formed by Mr. Primakov restored a certain degree of political and economic stability to the country before it was dismissed by President Yeltsin on 12 May 1999. Soon thereafter the Duma sought but failed to initiate impeachment proceedings against President Yeltsin. On 19 May 1999, the Duma voted to approve President Yeltsin’s nominee, Mr. Sergei Stepashin, as the new Prime Minister.

On 9 August 1999, less than three months after Mr. Stepashin’s approval as Prime Minister, President Yeltsin again dismissed the Government and nominated Mr. Vladimir Putin to become the new Prime Minister. Before his nomination, Mr. Putin had been Director of the Federal Security Service and Secretary of the Security Council of the Russian Federation. The Duma approved Mr. Putin’s appointment as Prime Minister on 16 August 1999.

President Yeltsin resigned on 31 December 1999 and, in accordance with the Constitution, Mr. Putin became Acting President, retaining his position as Prime Minister. On 26 March 2000, Mr. Putin was elected President in the first round of elections, receiving approximately 53% of the vote in which 68.7% of eligible Russian voters participated. The next candidate, the leader of the Communist Party, Gennadi Zyuganov, received 29% of the vote, and no other candidate received more than 6% of the vote. As a result of Mr. Putin’s first-round majority, no run-off election was required. Following his election, President V. Putin nominated Mikhail M. Kasyanov to serve as Prime Minister. The Duma approved Mr. Kasyanov’s appointment on 17 May 2000. On 24 February 2004, President V. Putin dismissed the Government headed by M. Kasyanov and appointed Deputy Prime Minister Viktor Khristenko as Acting Prime Minister. On 1 March 2004, President V. Putin appointed Mikhail Fradkov as Prime Minister. The Duma approved Mr. Fradkov’s appointment as Prime Minister on 5 March 2004.

Presidential elections are scheduled to be held on 14 March 2004.

Federal Structure and Regional Issues

Russia consists of 89 Federation subjects, consisting of 21 republics, ten autonomous regions, six *krais*, 49 *oblasts*, one autonomous *oblast* and two cities of federal importance (Moscow and St. Petersburg). In December 2003, the merger of Perm oblast and Komi-Permyazki Autonomous Krai was approved in a referendum. Each of the republics and autonomous regions contains a substantial group of ethnic non-Russians and some are named after these ethnic groups, although in most Federation subjects ethnic Russians constitute the majority. The Federation subjects form the intermediate level of government. Lower-level governments at the county (*raion*), city and village levels are subordinate to their respective Federation subjects.

Throughout its history, Russia has generally been a unitary state with centralised governance. Since the dissolution of the Soviet Union, however, Federation subjects have obtained greater decision-making authority and financial autonomy.

The Federation Treaty of 31 March 1992, signed by 88 Federation subjects (all but the Chechen Republic), initially granted each Federation subject a measure of control over budgetary and external policy as well as over the

natural resources of its territory. The Constitution subsequently confirmed and refined the terms of the division of authority between Russia and its subjects, expressly incorporating the provisions of the Federation Treaty to the extent they were not inconsistent with other provisions of the Constitution. Certain areas of governance are reserved by the Constitution exclusively to the federal authorities, including management of federal property, the issuance of currency, foreign relations, military defence and the nation's continental shelves. Joint federal-regional authority is prescribed in a number of other areas, including tax administration, ownership and use of land and natural resources and the selection of certain court and law enforcement officials. Responsibility for all matters not reserved to the federal authorities or to joint federal-regional competence is assigned to the Federation subjects. The Constitution also provides for the free movement of goods, capital and labour throughout Russia and explicitly prohibits any sub-federal barriers to such movement.

Within this Constitutional framework, bilateral agreements have been concluded between the federal authorities and most of the Federation subjects, allocating powers between the two. A number of these agreements provide for an even greater degree of regional autonomy than expressly provided by the Constitution.

In May 2000, President V. Putin signed a presidential decree creating seven federal circuits, each comprising several Federation subjects, and authorising the President to appoint a representative to each. The representatives' responsibilities include facilitating the implementation of the President's domestic and foreign policies, supervising the implementation of federal decisions in the Federation subjects and reporting to the President on the state of affairs in the Federation subjects.

In August 2000, a law aimed at improving management of the Federation subjects and lower-level authorities came into effect. The law grants the President the power to dismiss the chief legislative and executive authorities of the Federation subjects in circumstances in which such authorities have declined to repeal local legislation held by a court to be (i) contrary to the Constitution or federal law and harmful to the fundamental rights and freedoms of Russian citizens or (ii) preventing bodies of federal authority from performing their statutory functions.

In general, disputes between the federal authorities and Federation subjects have been resolved peacefully through the political process. The military confrontation in the Chechen Republic has been a notable exception. Before the intervention of Russian forces in Chechnya, in December 1994, and the declaration of a state of emergency, the authorities in the Chechen Republic openly defied the legal authority of the Government. In August 1996, the Government signed an agreement on the cessation of the military confrontation and withdrew its troops from Chechnya. In May 1997, the Government and the Chechen Republic signed a peace treaty. One-year agreements were also concluded between the Government, the Central Bank and the Chechen Republic, stipulating basic principles of economic and financial cooperation. Following the execution of these agreements, however, orderly administration of the Chechen Republic was not restored and the Chechen authorities failed to prosecute numerous instances of illegal activities, including kidnapping and misappropriation of federal funds. Despite the peace treaty, in August 1999, Chechen armed groups attempted to capture by force territory in the neighbouring Republic of Dagestan, a Federation subject. Russian interior and military troops repelled the attacks and continued to pursue the retreating forces into the territory of Chechnya through major ground and air operations. By April 2000, Russian forces had regained control over the territory of the Chechen Republic. In March 2003, a referendum was held in Chechnya on draft laws dealing with the Constitution, presidential elections and parliamentary elections. Approximately 88% of all eligible voters participated in the referendum, and more than 95% of the voters supported the draft laws. In October 2003, Presidential elections were held in Chechnya, with 88% of all registered voters participating. Mr. Akhmad Kadyrov was elected President with 83% of the votes cast.

International Relations

Russia's Position in the International Community

Russia has been recognised by the international community as the successor to the Soviet Union and maintains diplomatic relations with 178 countries. Russia is currently a member of many international organisations, including the United Nations, where it is a permanent member of the Security Council. Russia accordingly plays an active role in maintaining international peace and security.

Russia regularly participates in political discussions during meetings of heads of state and governments, as well as in discussions of finance ministers and central bank governors of the "G-7" group of industrial nations.

Since 1992, Russia has been a member of the International Monetary Fund (“IMF”) and the International Bank for Reconstruction and Development (the “World Bank”). See “Public Debt—Relations with International Financial Institutions.” Russia is also a member of the International Finance Corporation and participates as a donor in the International Development Association. In December 1996, the Central Bank became a member of the Bank for International Settlements, and in September 1997, Russia became a member of the Paris Club of creditor nations.

In December 1994, Russia applied for membership in the World Trade Organisation (the “WTO”). The Government has placed a high priority on joining the WTO, in part because entry into the WTO would allow Russia to use the organisation’s procedures to combat discrimination against Russian producers and exporters, which the Government believes has a negative effect on Russian exports. A Government commission has been established to ensure that Russia’s trade policy is in line with WTO rules, and discussions on Russia’s accession to WTO membership are proceeding. In 2002, both the European Union (the “EU”) and the United States recognised Russia as a “market economy,” an important step toward WTO membership.

Since 1993, Russia has had working contacts with the Organisation for Economic Cooperation and Development (the “OECD”). In 1994, a Declaration on Cooperation was signed with the OECD, on the basis of which an annual programme of cooperation now exists. Russia has been granted observer status with the 13 working groups and 11 committees of the OECD and formally applied for membership in May 1996. A committee on relations between Russia and the OECD was established in 1997.

In 1997, President Yeltsin and the leaders of 16 NATO nations signed the “Founding Act on Mutual Cooperation,” establishing new principles to govern their relationship and providing for consultation between Russia and NATO. After the actions taken by NATO in Yugoslavia in the first half of 1999, Russia temporarily froze its relations with NATO and recalled its official representative from NATO headquarters. Russia resumed its participation in the NATO Permanent Council in July 1999 and in the NATO Permanent Military Committee in September 1999, in order to discuss the practical issues of the peacekeeping operation in Yugoslavia. In December 2001, Russia and NATO agreed upon a process aimed at enhancing future cooperation and in May 2002 agreed to work together to fight terrorism and to curtail the spread of nuclear, chemical and biological weapons. Russia and NATO have also agreed to cooperate in the areas of missile defence, arms control, peacekeeping, civil defence and maritime search-and-rescue.

Russia and Regional Cooperation

Russia has wide-ranging contacts with the EU, its most significant trading partner. An interim customs, trade and standardisation agreement is now in force, pending ratification by EU member states of the full Agreement on Partnership and Cooperation, which was signed by President Yeltsin and the heads of governments of the EU countries in 1994. The Agreement became effective for Russia on 1 December 1997.

Russia is a member of the European Bank for Reconstruction and Development (the “EBRD”), the Soviet Union having been one of its founders. Russia also participates in a number of regional cooperation forums, including the Council of Barents/Euroarctic Regions, the Council of Baltic Sea States and the Black Sea Economic Cooperation Council, and is a member of the Black Sea Bank for Trade and Development.

Russia participates in working meetings of the Association of South-East Asian Nations and participates as an observer in working meetings of the Asian Development Bank. Russia became a member of the Council on Pacific Economic Cooperation in 1992, the Pacific Economic Council in 1994 and the Asian Pacific Economic Cooperation Forum in 1976.

Russia, the Former Soviet Union and the CIS

After the dissolution of the Soviet Union, Russia concluded separate agreements (“zero-option agreements”) with all of the other republics of the former Soviet Union, except the Baltic republics. All of the zero-option agreements have been ratified by both parties, except the agreement with Ukraine, which has not yet been ratified by Ukraine. Each zero-option agreement provides that, as between Russia and the other former Soviet republic, Russia will be responsible for virtually all the external debt contracted on behalf of the authorities of the former Soviet Union and will receive in return all claims on former Soviet Union assets located outside the territory of the other former republic. The Government has since regularized its relations with virtually all the external

creditors of the former Soviet Union, and has agreed a schedule for the repayment of former Soviet Union debt that is consistent with the Government's capacity to service that debt.

In April 1996, the Government entered into an agreement rescheduling approximately U.S.\$33 billion of indebtedness to the Paris Club of official creditors. In August 1999, the Government concluded a further rescheduling agreement providing for the deferral of approximately U.S.\$8.3 billion of indebtedness to Paris Club creditors.

In December 1997, Vnesheconombank restructured the Soviet-era debt owed to the London Club of commercial creditors. In the wake of the events of 17 August 1998, Russia, Vnesheconombank and a committee of London Club creditors agreed, in February 2000, on terms for the further restructuring of Vnesheconombank's London Club debt. The agreed restructuring terms were implemented through an exchange offer in August 2000. In December 2002, Russia restructured most of the Soviet-era debt owed to uninsured trade creditors. See "Public Debt—External Debt Restructuring" for a further discussion of indebtedness owing to the Paris Club, the London Club and uninsured trade suppliers.

Twelve of the former Soviet Union republics—all but the Baltic republics—constitute the Commonwealth of Independent States (the "CIS"), which promotes mutual cooperation among its members. In September 1993, an Agreement on the Establishment of an Economic Union was signed by all the CIS countries. In 1993, the governments and central banks of the CIS countries founded the CIS Interstate Bank. Its main goals include facilitating multilateral settlements among the national central banks and providing financing for interstate projects.

In 1995, an agreement on the creation of a customs union was concluded between Russia, Belarus and Kazakhstan. Kyrgyzstan joined this customs union in 1996 and Tajikistan in 1999. In 1999, all of the member countries signed a treaty creating a customs union and a common economic territory, and in 2000 signed a treaty concerning the creation of a Euroasian economic community. In September 2003, Russia, Belarus, Kazakhstan and Ukraine signed an agreement on the creation of a common economic zone.

In March 1996, Russia and Belarus signed an agreement calling for the mutual convertibility of their currencies and the stabilisation of exchange rates. In April 1997, President Yeltsin and President Lukashenko of Belarus signed a treaty calling for a union of Russia and Belarus and declaring their intent to strengthen political, economic and military cooperation. On 23 May 1997, the two Presidents signed the union's charter, which declares the equality and sovereignty of its members, calls for the coordination of policies in the political, economic and military spheres, creates supranational authorities to be staffed by the representatives of the legislative and executive bodies of the member states and introduces the concept of union citizenship in addition to national citizenship. The union is open for other countries to join.

In December 1999, Russia and Belarus signed a treaty on the creation of a unified state and a programme for its implementation. Under the treaty and the programme, Russia and Belarus are to preserve their independence and sovereignty, while developing a single economic space, joint social policies and coordinated foreign and defence policies. Although the treaty does not interfere with the constitutions of either country, amendments to the laws of Russia or Belarus may be necessary in the future. A draft constitution for the two countries was approved in April 2003. It envisages unifying Belarus and Russia's tax and social welfare systems, as well as Belarus' adoption of the Russian rouble in 2005.

In June 1997, Russia and Ukraine entered into agreements which, among other things, resolved questions relating to the division of the Black Sea fleet and the status of the city of Sevastopol on the Crimean peninsula. In October 2001, Russia and Ukraine entered into a separate agreement providing for the settlement of the indebtedness of NAK Naftogaz Ukrainy, the Ukrainian state-owned oil and gas company, to Gazprom, the Russian state-owned gas company, for previously delivered natural gas. The agreement also contains provisions governing the transit of Russian natural gas through Ukrainian territory.

THE RUSSIAN ECONOMY

Overview of Economic Reforms

Russia's economic reform programme, first outlined by President Yeltsin in October 1991, set out to achieve three principal goals: liberalisation, privatisation and financial stabilisation.

Liberalisation of the Russian economy required a fundamental redefinition of the role of the state, which had previously regulated virtually all economic and financial activities. The subsequent liberalisation of most prices has permitted market forces to determine prices to a significant extent and to play an increased role in the allocation of resources and output. At present, only certain public services and legislatively defined "natural monopolies" (for example, pipeline transport of oil and gas, household and industrial natural gas supply, electricity transmission and supply, railway transport, terminal, port and airport services and postal services) are subject to price regulation. Internationally, liberalisation of Russia's trade regime has helped redirect trade flows away from historically important former socialist markets towards OECD countries and developing nations and contributed to an overall rise in exports. See "Balance of Payments and Foreign Trade—Foreign Trade."

Beginning in January 1992, the Government implemented a privatisation programme, which was made possible by the legal recognition of private property and the creation of an economic and legal environment more conducive to the development of private economic activity. By 2001, wholly state-owned or municipal enterprises accounted for only a small portion of output in the major sectors of the economy: 9% of industrial output, 10% of construction and 4% of retail trade.

Financial stabilisation, essential as a foundation for sustainable economic growth, was pursued through a commitment to fiscal restraint, the development of non-inflationary means of deficit financing and management of exchange rate fluctuations. See "Public Finance—Deficit Financing" and "Monetary and Financial System—Monetary Policy."

Russia's financial stabilisation programme, agreed with and monitored by the IMF, came under severe pressure in the second half of 1997 and the first half of 1998, when the repercussions of the Asian currency and financial crisis and a sharp fall in world prices for oil and other commodities adversely affected the Government's ability to continue to finance its budget deficit and to maintain the value of the rouble against the U.S. dollar. On 17 August 1998, the Government and Central Bank announced a three-part programme intended to address these pressures. First, the corridor within which the rouble was permitted to trade against the U.S. dollar was revised from 5.25-7.15 roubles for one U.S. dollar to 6.00-9.50 roubles for one U.S. dollar. This corridor was subsequently abandoned. Second, short-term rouble denominated treasury bonds (GKO and OFZs) issued prior to 17 August 1998 and maturing before 31 December 1999 were restructured into new longer-term instruments. Finally, for a period of 90 days, Russian private individuals were restricted from conducting certain foreign exchange operations of a capital nature, including making payments of foreign currency under forward contracts and repurchase agreements and making principal payments on long-term credits.

The events of 17 August 1998 led to a severe devaluation of the rouble; a sharp increase in the rate of inflation; the near collapse of the country's banking system; significant defaults by Russian public and private borrowers on their hard currency obligations; dramatic declines in the prices of Russian debt and equity securities (including Russian Federation Eurobonds); and an inability of Russian borrowers to raise funds internationally.

The situation stabilised rapidly, however, and subsequently improved dramatically. Noteworthy developments included significant GDP growth, resulting in part from the devaluation of the rouble; a slow-down in the decline in the value of the rouble against the U.S. dollar (the rouble actually appreciated against the U.S. dollar in real terms through 2002 and in both real and nominal terms in 2003); a decline in consumer price inflation; an improved trade balance, resulting in part from the devaluation of the rouble and a significant increase in oil prices; improved fiscal conditions (involving both improved tax collection and lower Government spending), resulting in a significant primary fiscal surplus (and an overall fiscal surplus from 2000 through 2003); a marked reduction in net private capital outflow; increasing prices for Russian debt and equity securities; a decrease in barter and arrears, both in inter-enterprise transactions and in the execution of regional budgets; and the restructuring of a significant portion of Russia's rouble denominated domestic indebtedness, the rescheduling of a portion of Russia's Paris Club indebtedness and a reduction and restructuring of its London Club and uninsured trade indebtedness. Despite these

positive developments, Russia continues to experience certain economic difficulties, including a high level of capital flight in relation to GDP and a relatively high, although gradually declining, level of inflation.

In June 2000, the Government approved a Long-Term Strategy for the Development of the Russian Federation (the “2010 Strategy”). The 2010 Strategy is aimed at ensuring sustainable economic growth by further deregulating the economy, reinforcing market institutions and creating a more favourable business environment. Key elements of the strategy include enhancing protection of ownership rights and the rights of minority shareholders, eliminating sources of unfair competition, removing administrative obstacles to business activities, increasing the openness of the economy and implementing responsible monetary and fiscal policies.

The top priorities of the 2010 Strategy are to reform the tax system (this has been substantially completed), reduce the Government’s obligations with a view to maintaining a balanced budget, focus the social security programme on the most vulnerable sectors of society, reform the pension system and rehabilitate the banking sector. The 2010 Strategy also envisages further structural reforms including the removal of barriers to market entry for new businesses; implementing restrictions on excessive control of local administration over business; eliminating the remaining budgetary subsidies for communal services; restructuring loss-making subsidised enterprises; further developing market infrastructure; facilitating the mobility of labour and capital; and reforming Russia’s natural monopolies (electricity, gas and railroads). The Government’s 2010 Strategy generally contemplates the elimination of internal cross-subsidies, limiting the areas subject to government control, fostering competition where appropriate and feasible, and liberalising prices in competitive sub-sectors.

In 2003, the Government adopted a new Medium Term Program for the period 2003-2005. The principal priorities of the program are economic diversification (increasing the contribution of the manufacturing sector to production and exports and fostering development of the high-tech sector); restructuring public services (through performance budgeting); and improving administration (by restricting and more precisely defining the functions and responsibilities of government agencies and improving the recruitment and remuneration of civil servants).

Civil and Commercial Law

Since 1992, Russia has sought to establish a legal framework for economic relations between independent legal persons and entities. This legal framework includes a new civil code, a new joint-stock company law and a new bankruptcy law. The rule of law in Russia nonetheless continues to be undermined by the recent nature of much Russian legislation, persistent gaps in that legislation, inconsistencies between legal norms at the federal level as well as between norms at the federal and regional levels, the significant degree of discretion given to state officials in many areas and the inexperience of some Russian judges and their susceptibility to outside influences, especially at the regional and local levels.

The Constitution protects the right of Russian citizens to hold private property. Property rights and basic rules for commercial relations are set out in Russia’s Civil Code (the “Civil Code”). Part I of the Civil Code, passed in 1994, establishes the principles of contract and property law. The Land Code, which entered into force in 2001, regulates the ownership of non-agricultural real estate and establishes general principles of private land ownership. Federal law in this area remains incomplete, however, and there are many local rules and standards that limit the purchase and ownership of land. These uncertainties have meant that private ownership of land is not widespread in Russia and an active land market has not yet developed.

The Land Code does not cover agricultural land, whose status is instead regulated by the law on the circulation of agricultural land, which was enacted in 2002 and came into effect in January 2003. This law creates a unified market framework at the federal level for the purchase and sale of farmland. Under the agricultural law, foreigners are not allowed to purchase farmland.

The Civil Code also specifies the forms that private enterprises may take, including corporations, partnerships and limited liability companies. Part II of the Civil Code, passed in 1996, regulates particular types of contractual relationships, including sales contracts, leases, credit agreements and insurance policies. The third and final part of the Civil Code came into effect in 2002 and covers, among other matters, trademarks and copyrights.

The law on joint-stock companies came into effect in 1996, replacing old regulations adopted in 1990, and was subsequently amended in 2001. The joint-stock law sets forth the basic framework for corporate organisation

and corporate governance, covering the formation of companies, shareholder rights and liabilities, the role of directors, interested party transactions, mergers and acquisitions and share capital and dividends. The Law on the Securities Market, adopted in 1996, regulates the issuance and circulation of securities. Pursuant to the law, companies that issue securities must, with limited exceptions, register the issue by filing a prospectus and must publicly report information on a quarterly basis. The law also regulates the activities of professional participants in the securities market and aims to strengthen the protection of investors by imposing rules on market professionals.

A new bankruptcy law came into effect in December 2002, replacing the prior law adopted in 1998. The new bankruptcy law provides basic rules for declaring an enterprise bankrupt, for managing and liquidating an enterprise after it has been declared bankrupt, for satisfying creditors' claims and for the bankruptcy process generally. The bankruptcy law permits an enterprise to be declared bankrupt if it is unable to make payments due to its creditors (including tax authorities) within three months of such payments becoming due. The new law expands the types of legal entities that are subject to the bankruptcy law and clarifies the procedure for appointing managers of bankrupt enterprises and, in an attempt to prevent "custom made" bankruptcies, for initiating insolvency proceedings.

The legislative framework for the restructuring of banks was established in the Law on Insolvency (Bankruptcy) of Credit Institutions, adopted in February 1999 and amended in 2001. This legislation details the standards for the appointment of temporary bank administrators by the Central Bank, provides an expedited liquidation procedure for banks and gives the Central Bank the power to licence the receivers of bankrupt banks and to propose receivers for approval by arbitration courts.

Under Russia's Foreign Investment Law, foreign investors are ensured equal treatment with domestic investors (with some exceptions in the area of land ownership and leasing, access to natural resources and participation in privatisation). The law provides a guarantee against nationalisation or expropriation without compensation, ensures the free transfer of investment proceeds in foreign currency and reinvestment of profits in local currency, and provides recourse to Russian courts.

Russia has also adopted laws governing competition. Before 1991, the Soviet government encouraged specialisation in an attempt to minimise what was regarded as unnecessary duplication of production. Russia's economic reform programme has instead sought to foster the development of competitive markets. Russia has a competition and anti-monopoly law under which enterprises with a market share exceeding 35% may be, and enterprises with a share exceeding 65% are, entered in a register of monopolistic enterprises maintained by the Ministry for Antimonopoly Policy (the "MAP"). The MAP is authorised to employ a variety of means to restrain the anti-competitive behaviour of these enterprises, and can in extreme cases compel their break-up. MAP consent is required for any acquisition of 20% or more of the voting stock of any commercial entity with a size above a certain threshold and for any merger or acquisition that would lead to the creation of a monopoly enterprise.

Gross Domestic Product

The following table sets forth certain information regarding Russia's GDP for the years 1998 to 2002 and for the first half each of 2002 and 2003:

	Gross Domestic Product⁽¹⁾						
	1998	1999	2000	2001	2002	H1 2002	H1 2003⁽²⁾
Nominal GDP (billions of roubles)	2,630	4,823	7,306	9,039	10,863	4,791	6,028
At official exchange rate (U.S.\$ billions)	268.9	196.0	259.7	309.9	346.5	154.5	192.8
Real GDP as compared to 1997 (%)	94.7	100.8	110.8	116.4	121.4	—	—
Nominal GDP per capita (roubles)	17,971	33,136	50,446	62,794	74,817	33,135	41,716
At official exchange rate (U.S.\$)	1,837	1,346	1,793	2,153	2,387	1,069	1,334
Real GDP per capita as compared to 1997 (%)	95.0	101.6	112.3	118.6	122.7	—	—
GDP deflator (%)	18.6	72.5	37.6	17.8	15.2	14.4 ⁽³⁾	17.6 ⁽³⁾
Memo:							
Official exchange rate, rouble/U.S.\$, average	9.8	24.6	28.1	29.2	31.4	31.0	31.3
Total population, millions (end of period) ⁽⁴⁾	146.3	145.6	144.8	144.0	145.2	144.6	144.5

Notes:

(1) Certain data presented in this table differ from previously published data due to regular revisions by Goskomstat.

(2) Preliminary estimate.

(3) Compared to the same period in the previous year.

(4) Estimated. Data for 2002 is without regard to the general census conducted in October 2002; data for 2003 is estimated based on the 2002 census.

Source: Goskomstat, Central Bank.

After a steep decline in Russia's real GDP in the period between 1992 and 1996, GDP increased by 1.4% in real terms in 1997. The modest real GDP growth in 1997 was primarily attributable to rising consumer demand fuelled by increased household income. This recovery was interrupted in 1998, when GDP declined by 5.3% in real terms, by the economic crisis in Russia and the sharp decline in world commodity prices.

The devaluation of the rouble following the events of 17 August 1998 improved the competitiveness of Russian products, led to a rise in export volumes and promoted import substitution. These factors led to an increase in production, as real GDP grew by 6.4% in 1999, exceeding the level of real GDP recorded in 1997.

Economic recovery was also supported by a decrease in barter and other non-monetary transactions. The main reasons for the decrease of barter included increased liquidity due to increased payment of the Government's obligations to commercial enterprises (itself made possible by improved tax collection), the 1999 rise in profits of Russian commercial enterprises in rouble terms (due in significant part to a fall in real wages) and the decline in attractive alternative uses of free funds resulting from the contraction of the GKO/OFZ market and the decline in interest rates on bank time deposits. Barter currently accounts for only a small fraction of transactions.

Significant economic growth was recorded in 2000, when real GDP increased by 10.0%. This growth was aided significantly by increases in international commodity prices. Increased proceeds from exports contributed to expanding domestic demand (both consumer and investment), which in turn became the major vehicle of growth. However, a sustained real appreciation of the rouble from 2000 through 2002 resulted in a rapid recovery of imports, and this slowed the rate of growth, as did a fall in commodity prices in 2001, particularly crude oil prices. GDP nonetheless grew 5.0% in real terms in 2001 and 4.3% in 2002, despite a weakening of external demand due to the general slowdown of the world economy. GDP increased in the first half of 2003 by 7.0% compared to the first half of 2002, primarily as a result of increased labour productivity (which increased by 8.1% in the first half of 2003, as

compared to 2002) due to increased investment and improved management. The average rate of productivity growth over the period 1999 to 2002 was 5.4% per year.

The devaluation of the rouble following the events of 17 August 1998 resulted in a sharp decline in the U.S. dollar value of Russia's GDP in 1998 and 1999. See "Monetary and Financial System—Monetary Policy—Exchange Rates." Strong real appreciation of the rouble and production growth led to an aggregate increase in the U.S. dollar value of Russia's GDP by 77% in 2000 through 2002. This trend continued in the first half of 2003, when GDP grew by 25% in dollar terms compared to the first half of 2002.

GDP by Source

The following table illustrates Russia's GDP by source for the years 1998 to 2002 and for the first half each of 2002 and 2003:

Gross Domestic Product by Source

	1998		1999		2000		2001		2002		H1 2002		H1 2003 ⁽¹⁾	
	(%)	% change ⁽²⁾	(%)	% change ⁽²⁾	(%)	% change ⁽²⁾	(%)	% change ⁽²⁾	(%)	% change ⁽²⁾	(%)	% change ⁽²⁾	(%)	% change ⁽²⁾
GDP total	100.0	(5.3)	100.0	6.3	100.0	10.0	100.0	5.0	100.0	4.3	100.0	3.6	100.0	7.0
Non-service sector	43.8	(7.4)	45.2	10.4	45.0	12.4	42.9	6.5	40.3	3.3	37.8	3.3	37.2	7.2
Industry	30.0	(4.8)	31.1	10.2	31.4	11.1	28.1	4.9	26.5	3.7	27.4	3.4	27.2	6.8
Agriculture	5.6	(18.8)	7.3	17.1	6.4	12.7	6.5	11.2	5.8	1.6	3.0	2.9	2.4	(0.2)
Construction	7.4	(6.3)	6.1	5.9	6.6	17.4	7.5	9.9	7.3	2.7	6.5	2.8	6.7	14.3
Services	56.2	(3.4)	54.8	2.3	55.0	6.9	57.1	3.5	59.7	5.3	62.2	3.9	62.8	6.9
Market services	44.4	(4.6)	46.0	2.3	46.6	8.3	48.0	4.2	50.0	5.8	51.5	4.2	51.1	7.7
Transportation and Communications	10.9	(3.4)	9.5	9.6	9.0	6.1	9.3	5.4	9.9	6.0	10.4	5.9	10.3	10.2
Trade, distribution and Catering	20.5	(6.7)	23.2	(2.0)	23.7	12.1	22.4	3.9	22.8	8.1	23.3	5.8	23.4	9.6
Housing and communal Services	3.4	(3.6)	2.4	(8.0)	2.2	(1.1)	2.3	(0.7)	2.8	(0.5)	2.9	5.4	3.2	(0.8)
Financial sector	0.4	(8.3)	1.0	5.4	1.4	(2.1)	2.4	27.4	2.7	(7.2)	2.9	(9.2)	2.7	12.0
Public services	11.8	1.3	8.9	1.9	8.4	1.4	9.1	(0.6)	9.7	2.3	10.8	1.8	11.7	2.1
Health care and social security	2.1	1.7	1.4	1.0	1.4	(0.3)	1.5	(0.8)	1.8	2.4	2.0	1.9	1.8	1.1
Education and culture	3.1	(1.0)	2.2	(0.2)	2.1	(0.5)	2.2	(0.3)	2.6	1.9	2.9	1.3	2.6	1.5
Fundamental sciences	0.3	(9.6)	0.1	(5.9)	0.1	2.7	0.1	0.1	0.1	(0.8)	0.1	(0.8)	0.1	0.0
Public administration and defence	5.3	2.1	4.4	2.3	4.3	2.5	4.6	(1.2)	4.6	2.4	5.0	1.8	6.5	3.0

Notes:

- (1) Preliminary estimate.
- (2) In constant prices.

Source: Goskomstat.

In 1999, the contribution of non-service sectors increased (from 43.8% of GDP in 1998 to 45.2% in 1999) and the contribution of service sectors declined (from 56.2% of GDP in 1998 to 54.8% in 1999). In 2000, these trends reversed due to the real appreciation of the rouble. In 2002, the share of services (most of which are provided domestically and paid for in roubles) reached 59.7% of GDP, while the share of non-service sectors (where a portion of production is exported and paid for in foreign currency) declined to 40.3%.

Between 1998 and 2002, the contribution of public services to GDP decreased substantially (from 11.8% of GDP in 1998 to 9.7% in 2002), reflecting changing patterns of Government expenditure. At the same time, the share of market services increased from 44.4% of GDP in 1998 to 50.0% in 2002 due primarily to the increase in trade, distribution and catering (from 20.5% of GDP in 1998 to 22.8% in 2002) and in the financial sector (from 0.4% of GDP in 1998 to 2.7% of GDP in 2002).

These shifts in the composition of Russia's GDP resulted from changes in performance in real terms and from changes in relative prices. Between 1998 and 2002, the fastest growing sectors were the non-service (36.5%) and market service (22.2%) sectors, while public services increased by only 5.1% in real terms. During the same period, significant growth in real terms was recorded in all major non-service sectors: industry increased by 33.3%, agriculture by 49.1% and construction by 40.4%. Growth in real terms in market services was slightly smaller, with transportation and communications increasing by 29.9% and trade, distribution and catering by 23.4%. As these rates are close to the overall GDP growth rate, the increase in the share of trade and decrease in the share of transportation are attributable to changes in relative prices. In the first half of 2003, the highest growth rates year-on-year were recorded in construction (14.3%), transportation and communications (10.2%) and trade (9.6%).

GDP by Use

The following table illustrates Russia's GDP by use for the years 1998 to 2002 and for the first half each of 2002 and 2003:

Gross Domestic Product by Use⁽¹⁾

	1998		1999		2000		2001		2002 ⁽⁴⁾		H1 2002		H1 2003 ⁽⁴⁾	
	%	% change ⁽²⁾	%	% change ⁽²⁾	%	% change ⁽²⁾	%	% change ⁽²⁾	%	% change ⁽²⁾	%	% change ⁽²⁾	%	% change ⁽²⁾
GDP	100.0	(5.3)	100.0	6.4	100.0	10.0	100.0	5.0	100.0	4.3	100.0	3.6	100.0	7.0
Domestic demand	93.2	(11.9)	83.0	(2.0)	80.0	15.0	87.2	9.2	89.2	5.8	89.2	4.6	87.4	8.8
Consumption	77.9	(2.1)	68.1	(1.2)	61.3	5.6	65.2	6.9	68.2	7.1	71.9	6.8	70.4	6.5
Public	19.1	0.9	14.6	3.1	15.1	2.1	16.3	(1.7)	16.9	2.4	18.7	1.8	18.3	2.3
Private	58.7	(3.2)	53.5	(2.9)	46.2	7.1	48.9	9.7	51.2	8.5	53.2	8.3	52.1	7.6
Investment	15.3	(45.2)	14.8	(6.6)	18.7	75.2	22.0	16.5	21.1	1.7	17.3	(3.9)	17.0	19.1
Fixed assets	16.5	(12.4)	14.4	6.3	16.9	18.1	18.6	10.5	17.9	3.0	15.3	2.7	15.3	11.6
Inventory														
Accumulation	(1.2)	⁽³⁾	0.4	⁽³⁾	1.8	⁽³⁾	3.4	72.0	3.1	(5.9)	2.1	(56.7)	1.7	161.0
Net exports	6.8	131.5	17.0	79.3	20.0	(15.9)	12.8	(13.6)	10.8	(4.5)	10.8	(1.9)	12.6	(1.9)
Exports	31.9	1.9	43.2	11.3	44.1	9.5	36.3	3.6	34.7	10.2	34.7	9.0	35.9	11.6
Imports	25.1	(17.4)	26.2	(17.1)	24.0	32.4	23.5	18.0	24.0	19.1	23.9	16.8	23.3	19.8

Notes:

- (1) Certain data presented in this table differ from previously published data due to regular revisions by Goskomstat.
- (2) In constant prices.
- (3) Change in inventory stock in 1998 and 1999 was negative in constant prices.
- (4) Preliminary estimate.

Source: Goskomstat.

GDP composition by use did not display a clear trend over the period 1998 to 2003. The events of 17 August 1998 adversely affected consumption and investment, while a sharp fall in imports positively affected net exports. These trends changed, however, beginning in 2001. Consumption grew as a percentage of GDP in both 2001 and 2002, but still accounted for only 68.2% of GDP in 2002, as compared with 77.9% in 1998.

Private consumption was adversely affected by the contraction of household disposable income resulting from the devaluation of the rouble in 1998, but recovered gradually beginning in 2001. Overall private consumption grew in real terms between 1998 and 2002 by 23.8%, while public consumption was kept by the Government at a relatively stable level in real terms during this period. As a result, public consumption in real terms lagged far behind overall GDP growth, growing between 1998 and 2002 by only 5.8%, while the share of public consumption in GDP decreased from 19.1% in 1998 to 16.9% in 2002.

The share of net exports in GDP increased due to the sharp devaluation of the rouble in 1998 and 1999, the resulting contraction of imports and an increase in commodity prices in the international markets in 2000. Though both exports and net exports decreased in 2001 and 2002 as a percentage of GDP due to the real appreciation of the rouble, they still contributed significantly to GDP. Imports remained relatively constant over the period from 2000 to 2003 at approximately 24% of GDP. In 2002, exports accounted for 34.7% of GDP (as compared to 31.9% in 1998) and net exports accounted for 10.8% of GDP (as compared to 6.8% in 1998). The real value of net exports grew sharply in 1998 and 1999, but has declined since 2000 due to the real appreciation of the rouble.

Between 1998 and 2002, the growth of investment in real terms was higher than any other component of GDP by use. Investment grew by 93.7% between 1998 and 2002, more than three times the overall growth of GDP over the same period. Gross investment as a percentage of GDP, after declining in 1999, increased to 21.1% of GDP in 2002. The contribution of fixed assets to gross investment rose from 16.5% of GDP to 17.9% of GDP, from 1998 to 2002, while the contribution of inventory accumulation increased from -1.2% of GDP to 3.1% of GDP during the same period. Preliminary estimates for the first half of 2003 show further rapid growth in private consumption and a slower contraction of net exports in real terms.

Principal Sectors of the Economy

Industry

Russia is highly industrialised, with a large share of industrial activity in heavy industry and chemicals. Russia is the world leader in natural gas extraction, is second in oil extraction, and holds an important place in the production of electricity, iron, steel, rolled products, mineral fertilisers and coal. Manufacturing activity is heavily concentrated in the traditional defence industries, which now produce both for military use (arms, anti-aircraft missiles, fighters and submarines) and for civilian use (power equipment, space technology and aeroplanes).

The following table illustrates the structure of industrial output and period-on-period changes in real industrial output by sector for the years 1998 to 2002 and for the first nine months of each of 2002 and 2003:

Industrial Output by Sector⁽¹⁾

	1998		1999		2000		2001		2002		January to September 2002		January to September 2003	
	%	change ⁽²⁾	%	change ⁽²⁾	%	change ⁽²⁾	%	change ⁽²⁾	%	change ⁽²⁾	%	change ⁽²⁾	%	change ⁽²⁾
Total	100.0	(5.2)	100.0	11.0	100.0	11.9	100.0	4.9	100.0	3.7	100.0	4.0	100.0	6.8
Electricity	17.0	(2.3)	10.1	(1.2)	9.1	2.3	10.4	1.6	12.0	(0.7)	11.1	(1.2)	12.1	4.3
Fuel	15.5	(2.6)	16.7	2.5	20.3	4.9	19.8	6.1	20.0	7.0	19.3	6.3	18.9	9.6
Ferrous metallurgy	7.7	(7.6)	8.3	16.8	8.9	15.7	7.9	(0.2)	8.1	3.0	8.1	1.8	9.9	9.3
Non-ferrous metallurgy	7.6	(4.3)	10.1	10.1	10.1	15.2	8.4	4.9	7.8	6.0	8.0	8.9	7.5	4.8
Chemicals and petrochemicals	7.3	(6.0)	7.3	24.1	7.2	13.1	6.4	6.5	5.8	1.6	6.0	3.6	5.6	3.4
Machine building	18.0	(8.7)	19.2	17.2	19.0	20.0	20.2	7.2	20.0	2.0	19.7	3.1	19.5	8.1
Wood processing	3.9	0.4	4.8	17.8	4.6	13.4	4.4	2.6	4.4	2.4	4.4	2.8	4.2	1.0
Construction materials	3.8	(6.3)	2.9	10.2	2.8	13.1	3.1	5.5	3.1	3.0	3.2	4.7	3.2	5.4
Textiles	1.6	(10.3)	1.7	12.3	1.6	20.9	1.6	5.0	1.6	(3.4)	1.5	0.3	1.4	(2.8)
Food-processing	13.7	0.8	14.7	3.6	12.8	14.4	13.8	8.4	14.0	6.5	14.7	7.8	14.1	4.7
Other	3.9	—	4.2	—	3.6	—	3.8	—	3.3	—	3.9	—	3.6	—

Notes:

- (1) Certain data presented in this table differ from previously published data due to regular revisions by Goskomstat.
(2) In constant prices.

Source: Goskomstat.

Following a steep decline in production output between 1992 and 1996 and a modest increase in industrial output in 1997, industrial output declined in 1998 by 5.2% in real terms, due to the economic crisis in Russia and the sharp decline in world commodity prices. Industrial output recovered rapidly, however, in the following years.

Overall, industrial output increased by 35.1% in real terms from 1998 to 2002. This increase was due to the improved competitiveness of Russian products both in the domestic and in international markets after the devaluation of the rouble in 1998, a recovery of world commodity prices and growth in private investment, which was supported by a movement of capital away from the public GKO market after 1998.

Growth from 1998 through 2002 was recorded in all major industries. The largest overall growth was in machine building (53.8%), chemicals and petrochemicals (51.9%), non-ferrous metallurgy (41.0%) and wood processing (40.3%), all of which benefited from strong external and investment demand and falling imports. The smallest output growth was recorded in electricity, reflecting energy saving practices and the disconnection of electricity supplies to users with payment arrears.

In 2002, Russia's total industrial output increased by 3.7% in real terms as compared to 2001. Growth was recorded in most major industries, with fuels and food processing experiencing the highest growth. Output declined in 2002 in only two sectors: electricity and textiles (in the latter case due to a shift of demand to higher quality imported textiles).

In the first nine months of 2003, industrial output grew by 6.8% in real terms as compared to the same period in 2002. The largest growth by industry was recorded in fuels (9.6% year-on-year), ferrous metals (9.3% year-on-year), and machine building (8.1% year-on-year). This growth was fuelled by expansion of both external and domestic demand.

Energy

In 2002, energy accounted for about 31% of Russia's industrial output and 54% of its exports. About 36% of Russia's energy production is exported. In 2002, oil and petroleum products accounted for 36.8% of total exports, while natural gas accounted for 15.5%, coal for 1.1% and electricity for 0.3%.

Domestic energy prices were heavily subsidised in the Soviet Union and amounted to only 10% to 20% of world market prices in 1992. By 1996, however, domestic energy prices had risen relative to other prices as a result of export liberalisation and the real appreciation of the rouble against foreign currencies. The devaluation of the rouble in 1998 led to a sharp fall in domestic energy prices in dollar terms. Despite a recovery in prices in subsequent years (from January 2000 to September 2003, producer prices in the gas industry grew approximately 1.7 times faster than industrial prices generally), domestic prices for gas, electricity and crude oil remain lower than international prices, though domestic prices for petroleum products are close to international prices, after deductions for export duties and transportation costs. Federal budget revenues and Russia's balance of payments are affected to a significant extent by world prices for oil and gas.

Oil and Natural Gas

Russian methodologies for calculating oil and gas reserves and Russian reserves classifications differ from standard international methodologies and classifications, in particular with respect to the manner in which and the extent to which commercial factors affecting exploration, development and production are taken into account. Generally, Russian methodologies classify oil and gas deposits as reserves if such deposits are technically recoverable, even if the recovery of a portion of such reserves using currently available technology is uneconomic. In contrast, most international methodologies classify oil and gas deposits as reserves only if such deposits are economically extractable on the basis of existing technologies, prices and costs. Accordingly, the oil and gas reserves information contained herein is not comparable, and cannot be made comparable, to oil and gas reserves information provided on the basis of standard international methodologies and classifications. The oil and gas reserves information contained herein represents total "explored" reserves, consisting of oil and gas reserves in categories A, B and C1 of the Russian classification system.

Oil

Oil output has declined significantly since the dissolution of the Soviet Union. Output in 2002 was 366 million tonnes (about 10.7% of world output), 35.8% off the peak of 570 million tonnes in 1988, but 8.6% above the level of output in 2001. Overall oil output increased by 24.7% between 1998 and 2002. Oil exports to non-CIS countries were 155 million tonnes in 2002, while exports to the CIS were 33 million tonnes. Oil output for the first nine months of 2003 was 301 million tonnes, of which approximately 137 million tonnes were exported to non-CIS and 28 million tonnes to CIS countries.

Starting in 1993, the state oil industry was split into several holding companies and operating subsidiaries. This resulted in the creation of a number of large vertically integrated oil groups, with each holding company managing and controlling a stake in many operating subsidiaries. Only one of the oil groups, Rosneft, currently remains wholly state-owned. The first privatisation auction of Rosneft, in May 1998, was unsuccessful and the Government is still considering the possible privatisation of the company.

Natural Gas

Russia's A, B and C1 natural gas reserves are estimated at 47.2 trillion cubic metres. Natural gas output has stabilised in recent years after declining immediately after the dissolution of the Soviet Union, increasing by 1.8% in 2002 as compared to 2001 and falling by 0.5% overall in the period from 1998 to 2002. In 2002, total natural gas output was 561 billion cubic metres and total oil gas output was 34 billion cubic metres. Approximately 186 billion cubic metres of natural gas and oil gas were exported, with approximately 72% of exports going to non-CIS countries and the remainder to CIS countries. During the first nine months of 2003, 427 billion cubic metres of natural gas and oil gas were produced, of which approximately 138 billion cubic metres was exported.

Russia's natural gas industry is dominated by Gazprom, which has an effective monopoly on gas transmission, storage and export and accounts for most of Russia's natural gas reserves and production. Approximately 38.4% of Gazprom's shares are owned by the state and a further 16.2% are owned by Gazprom subsidiaries. Gazprom holds production licences with respect to almost two-thirds of Russia's natural gas reserves, accounts for 93% of Russia's gas production (88% including oil gas) and owns and operates the Unified Gas Supply System, which includes approximately 149,000 kilometres of high pressure pipelines,

Coal

Russia has approximately 200 billion tonnes of coal reserves. Since the dissolution of the Soviet Union, coal production has been negatively affected by both a decrease in overall demand and a reduction in budgetary subsidies. The decline in production also reflected under-investment in the industry over an extended period. As a result, many mines are currently inefficient. Russia has adopted a four-stage rationalisation plan, supported by World Bank lending, for the restructuring of the coal industry and the gradual closure of inefficient and subsidised mines. These measures, together with growing demand, resulted in growth of coal production between 1998 and 2002. Some 253 million tonnes of coal were produced in Russia in 2002, up approximately 3.7% from 1997, but 5.9% less than 2001. In the first nine months of 2003, coal production increased 9.6% over the same period of 2002. Coal exports, over half of which go to Japan, Turkey and Ukraine, amounted to some 43.3 million tonnes in 2002. The Government owns a substantial portion of the coal sector (non-privatised enterprises account for 40% of output in the coal industry). The Government also holds stakes in a number of privatised coal companies and is currently considering selling its stakes in several of these companies.

Electricity

Russia's electricity output was 889 billion kWh in 2002, representing an increase of 6.6% compared with 1997 and growth of 0.1% compared with 2001. In the first nine months of 2003, electricity output amounted to 661 billion kWh, an increase of 4.2% as compared to the same period in 2002. Total Russian generating capacity is 214,900 MW. Approximately 11% of this amount is attributable to nuclear power plants. Electricity is exported to CIS countries (Georgia and Kazakhstan), Finland, Latvia, Mongolia and Norway, among others.

The Russian electricity industry was restructured in 1992 and split into RAO Unified Energy Systems (“UES”), 73 regional energy companies (*energoes*), and a separate nuclear power industry run by the Ministry of Atomic Energy. UES is the largest single producer of electricity in Russia, owning 72% of Russia’s generating capacity, and is also the monopoly high voltage distributor and wholesale purchaser and seller of electricity. UES owns at least a 49% equity stake in 61 of the 73 *energoes*. UES is currently 52% state-owned.

A legislative program was adopted in 2003 to further reform the electricity sector and to promote competition in the electricity market. The new legislation provides for the restructuring of UES and for the separation of UES’ generation, transmission and distribution businesses. The legislation also mandates the creation of a number of Government-controlled electricity companies responsible for managing the uniform electric network and distribution system, subject to the requirement to provide other electricity producers with equal access to the uniform network. The liberalization of the electricity market, introduced in October 2003, is eventually expected to account for the sale of between 5% and 15% of electricity generated in Russia. The legislation contemplates that reform of the electric power industry will be completed by 2006.

Agriculture

Russia’s agricultural sector has faced significant challenges in recent years, as major structural changes have been implemented under difficult conditions and agricultural commodity prices have fallen steeply. Agricultural output grew by 22.6% between 1998 and 2002. In 2002, agricultural output grew by 1.7% in real terms, compared to 2001. In the first nine months of 2003, agricultural sector output fell by 1.7% compared to the same period in 2002, due to less favourable weather conditions. Russia still imports substantial amounts of food and agricultural products. However, foodstuffs and agricultural products as a percentage of total exports increased from 1.9% in 2001 to 2.6% in 2002, and remained above 2% in the first nine months of 2003. See “Balance of Payments and Foreign Trade—Foreign Trade—Composition of Trade.”

The agricultural sector consists primarily of large collective farms (estimated to account for about 79% of land under cultivation and 42% of agricultural output) and private plots, both urban and rural, worked by people who are not full-time farmers (estimated to account for 5.6% of land under cultivation and 54% of agricultural output). Family farms account for the remainder of agricultural production. Less than 5% of Russia’s agricultural land is state-owned. The law on the circulation of agricultural land, which was adopted in 2002 and came into effect in January 2003, creates a unified market framework at the federal level for the purchase and sale of farmland. It also prohibits the non-agricultural use of farmland, regulates the amount of farmland any one owner may hold and prohibits foreign ownership of farmland.

In the Soviet Union, state authorities exercised significant influence over almost all aspects of the production and sale of foodstuffs and enjoyed a virtual monopoly on food purchases. Since the dissolution of the Soviet Union, Government subsidies to the agricultural sector have decreased significantly, the state food purchasing monopoly has been replaced by a decentralised market system and the share of agricultural output purchased by the state has fallen steadily.

Construction

The construction sector accounted for approximately 7.3% of GDP in 2002. Following a steep decline after the dissolution of the Soviet Union through 1998, output in the construction industry has grown significantly in recent years. The construction sector grew 2.7% in 2002, with overall growth of 40.4% between 1998 and 2002. New housing construction amounted to 33.8 million square metres in 2002, approximately 6.5% more than in 2001.

Transport and Communications

Russia has a well-developed railway network, a large merchant fleet, a large number of airports, well-developed municipal transport systems, a reasonably comprehensive road network and a major space industry. The market for the provision of transport and communication services has been liberalised and restructured, particularly in air transport, water transport and communications. Although investment in transport and communications has fallen in real terms since the dissolution of the Soviet Union, its share in total fixed investment has increased.

Railways

There are approximately 139,000 kilometres of railways in Russia, of which 62% are used for general passenger and freight transportation. Railways accounted for 81% of all freight transport in tonne-kilometres (excluding pipeline transport) and 40% of all passenger journeys in passenger-kilometres in 2002, making it the country's most important form of transport. In the first nine months of 2003, railway freight transportation (in tonne-kilometres) increased by 10.9% and passenger transportation (in passenger kilometres) increased by 1.8% as compared to the first nine months of 2002.

Tariffs for passenger transport are currently subsidised from railway freight revenues and are insufficient to cover total capital and operating costs. In the future, the railways will require a significant increase in investment to maintain track and replace rolling stock.

The Government has developed a three-stage programme of structural reforms in the railways sector. The key points of the first two stages, to be completed by 2005, include separating control and management functions through the establishment of a joint-stock company, fostering the emergence of new independent companies to enhance competition, liberalising prices in competitive sub-sectors and prohibiting cross-subsidies. The third stage envisages the privatisation of state-owned companies in the railway sector, by 2010.

Roads

There are approximately 891,000 kilometres of roads in Russia, 84% with a hard surface. Some 72% of the hard-surface roads are in public use, 6% under federal and 66% under regional supervision. The rest of Russia's roads are supervised by particular agencies and generally link enterprises with the public road network. Prior to 2001, roads were financed by taxes earmarked for the Federal Road Fund and for road funds of the Federation subjects. The Federal Road Fund was abolished in 2001.

Ports and Shipping

Russia had 43 commercial seaports and 323 freight complexes with a total capacity of 217.5 million tonnes per year in 2002. In 2002, 93 billion tonne-kilometres of freight were transported by sea from Russian ports (5.5% of Russia's total freight transport, excluding pipeline transport). More than 80% of freight loaded at Russian ports was transported to international destinations in 2001. In addition, Russia has over 2,000 river ports, providing access to Russia's 102,000 kilometres of navigable rivers. Because Russia lacks deep water ports, commercial shipments of oil to the United States and other distant locations are not currently economically attractive. Domestic water transport (via rivers, canals, lakes and combined river and sea navigation) accounted for 73 billion tonne-kilometres (4.3% of all freight, excluding pipeline transport) in 2002. Rivers play a particularly important role in northern and eastern Siberia, where in some areas they are the dominant means of freight transport. In the first nine months of 2003, freight transportation (in tonne-kilometres) decreased by 30% as compared to the first nine months of 2002.

Prior to 1991, each of Russia's commercial seaports was run by a particular shipping line, while ports were under central state control. The ports and shipping lines were organisationally separated in 1991. By the end of 1995, the state had disposed of its controlling interest in the majority of ports and shipping companies.

Air Transport

Russia has 845 airports, 52 of which are international. The largest international airports are located in Moscow and St. Petersburg. Air transport in 2002 accounted for 16.6% of total intercity domestic passenger traffic in passenger-kilometres.

The national airline, Aeroflot, was the monopoly carrier until 1991. Following the dissolution of the Soviet Union, Aeroflot was split into over 140 regional airlines and an international carrier, Aeroflot International Airlines. Most of the regional airlines were subsequently privatised. In 1995, Aeroflot International Airlines was partially privatised, although the state continues to own 51% of the shares. A number of new private Russian carriers have commenced domestic and international operations since 1991.

Pipelines

As of the end of 2002, Russia had 216,000 kilometres of trunk pipelines, consisting of 153,000 kilometres of natural gas pipelines, 48,000 kilometres of oil pipelines and 15,000 kilometres of oil product pipelines. In 2002, a total of 2,100 billion tonne-kilometres of commodities were transported by pipeline, an increase of 7% compared with the previous year. The transmission capacity of Russia's pipelines to non-CIS countries is approximately 140 million tonnes of crude oil and 145 billion cubic meters of natural gas per year.

Pipelines from major oil- and gas-producing areas in Russia are generally connected to pipelines in the CIS and former Soviet bloc countries. A number of significant new pipeline projects are planned or under construction. Gazprom is currently building new trunk pipelines (the "Yamal-Europe project") that will extend nearly 6,000 kilometres from the northern part of the Tyumen region of Russia through Belarus and Poland to Germany. Gazprom is also currently involved in the large-scale construction of a trunk pipeline to Turkey (the "Blue Stream project"), a portion of which crosses the Black Sea. The Blue Stream project is expected to enhance significantly Russia's gas export capacity. Initial gas flow through the undersea portion of the pipeline commenced in December 2002, with the first commercial delivery to Turkey in February 2003 and an estimated annual capacity of 16 billion cubic metres from 2010.

New pipeline-related projects intended to increase the export capacity of the oil industry are also being implemented or planned in Europe and Asia, including the Baltic pipeline system now under construction, connecting West Siberia with a major new harbour at St. Petersburg, where inadequate tanker facilities have resulted in reduced pipeline through-put. The first two stages of the project have already increased annual pipeline capacity by 30 million tons of crude oil. The next stage is expected to increase annual capacity up to 42 million tons. Another programme currently under way will upgrade the Druzhba oil pipeline through Eastern Europe by constructing by-passes and extensions. New oil pipelines to the Asia-Pacific region are also under consideration, including a pipeline to the Nakhodka port in the Far East and a pipeline connecting West and East Siberia with China.

Over 50% of Russia's existing oil pipeline network has been in operation for at least 20 years and over 20% for more than 33 years, and the gas pipeline network is also aging. Repair and maintenance costs are accordingly high.

The crude oil and oil product trunk pipeline networks are owned and managed by state-owned monopolies, Transneft and Transneftproduct. The gas trunk pipeline network is owned and managed by Gazprom.

Telecommunications

In 2002, there were 40 million telephone lines in Russia. It is estimated that the capacity of long distance (intercity) telephone lines increased by 21% (from 654,400 to 792,100 zonal communication lines and channels) from 1998 to 2002. There are separate telecommunications systems for the Government, law enforcement agencies, the military, the railways and others. By the end of 2002, there were approximately 17.6 million mobile telephone subscribers throughout 76 regions of Russia, a more than two-fold increase over the number of subscribers at the end of 2001. Moscow and St. Petersburg account for 53% of all mobile telephone registrations.

Russia's telecommunications industry was restructured in the early 1990s through the creation of Rostelekom and Svyazinvest. Rostelekom, founded in 1992 through the merger of 20 independent enterprises, is the monopoly provider of long distance (intercity) telecommunications in Russia, providing international services as well. The company was privatised in 1993, with 38% of its shares (representing the majority of the voting stock) subsequently being transferred to Svyazinvest. Svyazinvest was established in 1994 as the holding company for majority voting interests in all of Russia's 85 regional telecommunications companies, and provides local telephone services. In August 1997, a group of Russian and international investors acquired Svyazinvest shares representing 25% of its charter capital plus one vote. The Government is planning further privatisation of Svyazinvest, including, in the near-term, a sale of a further 25% of the company's charter capital minus two votes. The Government will, however, still hold a majority of the shares after the sale.

In 2002, 13% of all telecommunications services were provided by public sector entities and 87% by private privatised operators. There are currently more than 2,500 domestic operators and several international operators active in Russia.

Environment

Environmental protection in Russia is primarily the responsibility of the State Environment Committee. Environmental regulations require enterprises to pay fees for emissions or discharges of most pollutants. These fees, which are low by international standards, may be used to fund investment to improve the environment. Russia's environmental protection programme has focused on replanting forests, constructing spent gas treatment plants, installing water recycling systems and constructing sewage purification plants. Total public and private sector investment in environmental protection in Russia during 2002 amounted to 0.2% of GDP. Federal expenditure to protect the environment and to address the effects of environmental catastrophes and natural disasters in 2002 amounted to an additional approximately 0.2% of GDP and 1.0% of total non-interest expenditure for the year.

Employment

Overall employment declined in Russia from the dissolution of the Soviet Union through 1998. The rise in export volumes and import substitution, beginning in 1999, led to a rise in employment. The rate of increase in employment was less than the rate of increase in real GDP, however, due to gains in productivity. The number of unemployed fell 34% between 1998 and 2002, and by 10% between 2000 and 2002. In 2002, 36.9% of all employees worked in the state sector, 49.1% in the private sector and 10.7% in enterprises with a mixed form of ownership.

The following table sets forth quarterly information regarding unemployment in Russia for the period from 1998 through the end of the third quarter of 2003:

Unemployment at the End of Period⁽¹⁾

	Official (ILO) definition unemployed ⁽²⁾		Registered unemployed ⁽³⁾		Registered jobseekers ⁽⁴⁾	
	Million	% of labour force	Million	% of labour force	Million	% of labour force
1998						
First Quarter.....	8.5	11.8	2.0	2.7	2.2	3.0
Second Quarter	8.1	11.3	1.8	2.5	2.0	2.8
Third Quarter	8.6	11.9	1.8	2.4	2.0	2.8
Fourth Quarter	9.6	13.2	1.9	2.6	2.1	2.9
1999						
First Quarter.....	10.0	14.0	1.9	2.7	2.1	3.0
Second Quarter	8.8	12.3	1.6	2.2	1.8	2.5
Third Quarter	8.8	12.2	1.3	1.9	1.5	2.1
Fourth Quarter	8.9	12.4	1.3	1.8	1.4	2.0
2000						
First Quarter.....	8.2	11.5	1.2	1.7	1.4	2.0
Second Quarter	7.3	10.1	1.0	1.4	1.2	1.6
Third Quarter	7.1	9.9	1.0	1.3	1.2	1.6
Fourth Quarter	7.0	9.9	1.0	1.5	1.2	1.7
2001						
First Quarter.....	6.8	9.7	1.1	1.6	1.3	1.8
Second Quarter	6.1	8.6	1.0	1.4	1.2	1.7
Third Quarter	6.2	8.7	1.0	1.4	1.2	1.7
Fourth Quarter	6.2	8.7	1.1	1.6	1.3	1.8
2002						
First Quarter.....	5.8	8.2	1.3	1.9	1.6	2.2
Second Quarter	5.4	7.5	1.3	1.8	1.5	2.1
Third Quarter	5.5	7.6	1.3	1.8	1.6	2.2
Fourth Quarter	6.3	8.8	1.5	2.1	1.7	2.3
2003						
First Quarter.....	6.3	8.9	1.6	2.3	1.9	2.6
Second Quarter	5.7	8.0	1.5	2.1	1.7	2.4
Third Quarter	5.7	7.9	1.5	2.1	1.7	2.4

Notes:

- (1) Certain data presented in this table differ from data previously made public due to regular revisions by Goskomstat.
- (2) Based on survey data. Persons not working, looking for a job and ready to start work are counted as unemployed.
- (3) Based on number of individuals who choose to register as unemployed with the Federal Employment Agency; registration is required as a condition of receiving unemployment benefits.
- (4) Based on number of individuals who choose to register as seeking employment with the Federal Employment Agency.

Source: Goskomstat.

On the basis of International Labour Organisation (“ILO”) definitions, there were 6.3 million unemployed in Russia at the end of 2002 (8.8% of the labour force), slightly more than at the end of 2001 (6.2 million, or 8.7% of the labour force), but less than at the end of 2000 (7.0 million, or 9.9% of the labour force). Unemployment peaked at 10.0 million (14.0% of the labour force) in the first quarter of 1999, up from 8.5 million (11.8% of the labour force) in the first quarter of 1998. The total numbers of unemployed and of workers officially registered as unemployed by the Employment Service increased at the end of 1998 and at the beginning of 1999 as a result of the August 1998 financial crisis. The number of officially registered unemployed, as well as with the number of unemployed according to ILO definitions, subsequently declined. In the period from the fourth quarter of 2002 to the third quarter of 2003, unemployment rose slightly due to business restructuring. The ILO unemployment figures do not take into account certain “hidden unemployment.” For example, in 2002, 3.0% of the Russian labour force was on shortened workdays and 4.7% had been temporarily laid off. In 2002, the total number of lay-off days for these two categories represented an additional 0.2 million unemployed workers (0.4% of the labour force). The average number of officially registered unemployed decreased by 22% from 1998 to 2002. As of 30 September 2003, ILO unemployment stood at 5.7 million (7.9% of the labour force).

Wages and Income

The sharp increase in consumer prices following the devaluation of the rouble in the second half of 1998 led to a significant decline in real wages. Wages decreased in real terms by 13.4% in 1998 and by 22.0% in 1999. This trend has since reversed, with real wages increasing by 19.9% in 2001 and by 16.2% in 2002. Overall, real wages grew by 31.4% between 1998 and 2002, even though compensation to employees (including wages and social contributions) remained below the pre-financial crisis level.

The minimum wage has remained relatively low, amounting to just 8% of the average wage in September 2003. The minimum wage, established by the Duma, serves as a benchmark in setting the level of federal benefits, and also plays a role in determining certain types of budget expenditures.

The share of the population with income below the official subsistence level increased from 23% in 1998 to 28% in 1999. A modification in 2000 to official subsistence calculations (which raised the subsistence level by approximately 15%) resulted in a further increase in 2000 in the share of the population with income below the subsistence level, to 29%. This share fell by the end of 2002 to 22%.

In recent years, a significant portion of wages has not been paid when due as a result of the generally difficult economic conditions in Russia. Wage arrears have given rise to sporadic strikes and protests. At the start of 1999, the total stock of wage arrears in the Russian economy amounted to 77 billion roubles, up from 49 billion roubles at the beginning of 1998. Wage arrears then declined rapidly from 1999 through 2001, with the total stock amounting to 30 billion roubles at the end of 2001 and subsequently remained relatively stable in nominal terms while decreasing gradually in real terms. Federal budget arrears were fully paid off in the beginning of 2000 and the federal budget has remained current since then. The stock of regional budget wage arrears in September 2003 amounted to 2.7 billion roubles.

Organised labour has played a relatively minor role in setting wages in Russia. The percentage of organised workers in the national economy, close to 100% in the Soviet Union, has since fallen significantly. Traditional trade unions founded during the Soviet era now function essentially as welfare organisations providing social services, while new trade unions have yet to build up significant membership.

Social Benefits and Expenditure

Social security reforms were introduced in Russia beginning in 1991. New institutions were founded to deliver social benefits, including unemployment insurance and benefits for the very poor. Social benefits amounted to 9.1% of GDP in 1999, 7.9% of GDP in 2000, 9.4% of GDP in 2001, 10.3% of GDP in 2002 and 9.1% of GDP in the first nine months of 2003. Total social expenditure (excluding housing subsidies) amounted to 14.8% of GDP in 1999, 13.3% of GDP in 2000, 14.9% of GDP in 2001, 17.1% of GDP in 2002 and 15.9% of GDP in the first nine months of 2003.

Prior to 2002, most social expenditure was provided through either extra-budgetary funds or sub-federal authorities. In 2001, 47% of social expenditure was provided by extra-budgetary funds and 39% was provided by sub-federal authorities. Direct payments from the federal budget accounted for approximately 14% of social expenditure in 2001. The extra-budgetary funds finance expenditure on health, other social benefits and, prior to 2002, financed most pensions. Sub-federal budgets finance housing and transportation subsidies, most education and health expenditure and certain social benefits. The federal budget is also responsible for a portion of the expenditure on education, health, culture and social benefits. In 2001, the federal budget began providing unemployment benefits in connection with the liquidation of the extra-budgetary Employment Fund. See “Public Finance—Extra-budgetary Funds.” Starting in 2002, the federal budget is also responsible for financing the basic component of pensions, which accounts for more than one half of pension payments. See “Public Finance—2004 Federal Budget Law” and “—Pension Reform” below.

Pension Reform

Pension reform legislation was enacted in 2001 and a new social security system came into effect on 1 January 2002. Under the new system, a retiree's pension consists of a basic pension, an insurance pension and a funded pension. The basic pension and the insurance pension are paid from current pension contributions on a 'pay-as-you-go' basis. The basic pension is funded from the federal budget and its size does not depend on past social security contributions. The insurance pension is funded from the State Pension Fund and varies depending on past contributions by the pensioner. The funded pension is based on the amount of funds accumulated in a pensioner's individual pension investment account. One half of overall pension contributions are transferred to the federal budget and are earmarked to fund basic pensions. The other half goes to the State Pension Fund, and is split between insurance and funded pensions based on birth year. For men born before 1953 and women born before 1957, no funded pension accumulates; for men born from 1953 to 1966 and women born from 1957 to 1966, 14% of contributions to the State Pension Fund are used for funded pensions; for men and women born after 1966, the share of contributions accumulated in personal accounts will increase gradually over the 2002 to 2005 transition period, and starting in 2006 will equal 43% of contributions to the State Pension Fund. The Pension Law envisages that the size of the basic pension will be revised by the Government to account for inflation within the amount earmarked in the budget for basic pension. Payments to pensioners from the funded pension will start in 2012. Prior to 2012, the funds allocated to the funded pension will be accumulated in personal accounts.

Contributions to the funded pension system are collected by the State Pension Fund and will be managed by state and private trust companies. According to the Law On Investments for Financing the Funded Part of Pensions, enacted in 2002, individuals may choose a private trust manager from those selected on the basis of a public tender. The tender was held in September 2003 and 55 private trust companies were selected. Individuals were required to choose a trust manager by 31 December 2003, and funds will be transferred to private trust companies in the beginning of 2004. Vnesheconombank was appointed as the State Trust Management Company, responsible for the management of funds held by individuals who did not choose a private trust company. Private trust companies may invest pension funds in securities of Russian private and public companies, rouble and foreign currency bank deposits and shares in foreign securities index funds. Vnesheconombank, as the State Trust Management Company, may invest pension funds in rouble and foreign currency government bonds, mortgage bonds and bank deposits. These reforms are expected to give rise to a new category of institutional investors in the Russian capital market.

BALANCE OF PAYMENTS AND FOREIGN TRADE

Balance of Payments

The following table sets forth Russia's consolidated balance of payments for the years 1998 to 2002 and for the first half of 2002 and 2003:

Consolidated Balance of Payments⁽¹⁾

	1998	1999	2000	2001	2002	H1 2002	H1 2003
	(millions of U.S.\$)						
Current account	219	24,616	46,839	33,572	29,905	14,141	20,381
Goods and non-factor services (nfs)	12,346	31,730	53,506	38,290	36,027	16,153	23,669
Export of goods & nfs.....	86,816	84,618	114,598	113,302	121,214	54,027	68,921
Import of goods & nfs.....	(74,471)	(52,887)	(61,091)	(75,012)	(85,188)	(37,874)	(45,252)
Trade balance.....	16,429	36,014	60,172	48,121	46,635	20,943	28,595
Exports of goods (fob).....	74,444	75,551	105,033	101,884	107,601	48,058	61,898
Imports of goods (fob).....	(58,015)	(39,537)	(44,862)	(53,764)	(60,966)	(27,115)	(33,303)
Non-factor services.....	(4,083)	(4,284)	(6,665)	(9,831)	(10,609)	(4,790)	(4,927)
Exports of services.....	12,372	9,067	9,565	11,417	13,613	5,969	7,023
Imports of services.....	(16,456)	(13,351)	(16,230)	(21,248)	(24,222)	(10,759)	(11,949)
Income.....	(11,790)	(7,716)	(6,736)	(3,959)	(6,117)	(1,737)	(3,339)
Employee compensation.....	(164)	221	268	130	197	110	9
Investment income.....	(11,626)	(7,937)	(7,004)	(4,089)	(6,314)	(1,848)	(3,348)
Received.....	4,000	3,456	4,253	6,176	4,951	3,059	2,986
Paid.....	(15,626)	(11,393)	(11,257)	(10,265)	(11,264)	(4,907)	(6,334)
Current transfers.....	(337)	601	69	(759)	(5)	(275)	51
Capital and financial account	9,598	(16,058)	(37,683)	(24,733)	(23,790)	(12,290)	(16,874)
Capital account.....	(382)	(328)	10,955	(9,356)	(12,388)	(1,234)	(520)
Capital transfers credit.....	1,704	885	11,822	2,147	7,536	6,111	335
Capital transfers debit.....	(2,086)	(1,213)	(867)	(11,503)	(19,924)	(7,345)	(855)
Financial account.....	9,981	(15,730)	(48,638)	(15,377)	(11,402)	(11,056)	(16,354)
Direct investment.....	1,492	1,102	(463)	(63)	(481)	(202)	1,143
Abroad.....	(1,270)	(2,208)	(3,177)	(2,533)	(3,490)	(1,599)	(1,676)
In Russia.....	2,761	3,309	2,714	2,469	3,009	1,395	2,819
Portfolio investments, net.....	8,618	(946)	(10,334)	(653)	2,500	237	(5,904)
Financial derivatives, net.....	24	6	161
Other investments.....	(5,434)	(14,108)	(21,831)	(6,449)	(2,070)	(4,503)	3,887
Assets.....	(14,463)	(13,219)	(17,659)	80	1,803	(324)	(3,352)
Cash foreign currency.....	824	921	(888)	(1,123)	(1,080)	(258)	3,764
Demand and time deposits ⁽³⁾	1,150	(4,084)	(3,649)	293	2,267	924	1,850
Trade credits and advances ⁽⁴⁾	(5,323)	(3,276)	(4,245)	827	248	89	980
Loans extended, net.....	5,345	4,855	5,365	(739)	(2,816)	1,187	1,421
Arrears.....	(7,285)	(5,759)	(7,350)	9,120	15,992	3,167	(2,460)
Indebtedness on supplies according to inter-governmental agreements.....	(877)	(355)	(650)	(365)	(197)	(20)	126
Non-repatriation of export proceeds and import advances not repaid in time ⁽⁵⁾	(7,959)	(5,051)	(5,293)	(6,388)	(12,224)	(5,116)	(7,335)
Other assets, net.....	(339)	(471)	(950)	(1,544)	(367)	(296)	(1,697)
Liabilities.....	9,029	(889)	(4,172)	(6,528)	(3,874)	(4,179)	7,239
Cash national currency.....	65	3	155	49	11	(22)	29
Demand and time deposits.....	(3,050)	162	725	1,480	489	241	1,286
Loans received, net.....	7,325	(2,880)	(3,603)	(6,339)	(1,747)	(4,045)	5,863
Arrears.....	5,342	2,027	(1,637)	(1,036)	(2,790)	(428)	(196)
Other liabilities, net.....	(654)	(201)	187	(682)	163	73	257
Reserve assets ⁽⁶⁾	5,305	(1,778)	(16,010)	(8,212)	(11,375)	(6,594)	(15,641)
Errors and omissions, net	(9,817)	(8,558)	(9,156)	(8,840)	(6,115)	(1,851)	(3,507)

Notes:

- (1) Certain data presented in this table differ from previously published data due to regular revisions by the Central Bank.
- (2) At current rouble/U.S. dollar exchange rates. Precise information on the volume of Russia's foreign trade with neighbouring CIS countries is difficult to obtain due to the lack of customs posts. The creation of a customs union with Belarus, Kazakhstan, Kyrgyzstan and Tajikistan adds to the difficulty of tracking regional trade flows. Statistical problems are particularly severe in the case of imports from CIS and non-CIS countries, because of the importance of so-called "unregistered trade," consisting of commercial (in contrast to private) transactions that escape customs records or are undervalued by customs authorities. Value adjustments for unregistered trade are made in the official balance of payments accounts. These adjustments added approximately U.S.\$14 billion to import values in 1998, U.S.\$9 billion in 1999, U.S.\$11 billion in 2000, U.S.\$12 billion in 2001 and U.S.\$15 billion in 2002.
- (3) Includes adjustment of reserve assets (previously shown as a separate line item) made to avoid double counting of official reserves deposited

- in resident banks.
- (4) Includes received trade credits and advances in export and import of non-factor services.
 - (5) Beginning with the third quarter of 2001, includes the estimated value of import of services advances not repaid on time. Since the fourth quarter of 2002, includes the estimated value of fictitious transactions in securities.
 - (6) Changes in reserve assets that arise as a result of transactions with reserve assets, i.e., excluding monetisation of gold and valuation changes. This definition differs from that employed in the calculation of official international reserves. See "Official International Reserves."

Source: Central Bank.

Current Account

In 1997 and 1998, the current account balance was close to zero. The U.S.\$3.1 billion increase in the deficit in income payments from 1997 to 1998 was offset by a U.S.\$3.4 billion improvement in the balance of trade in goods and non-factor services. The deterioration in the income balance was mainly due to higher debt service brought about by a significant increase in the amount of GKO and OFZs held by non-residents (part of these obligations were incurred in 1997 but came due in 1998) and to an increase in yields on these bonds at the end of 1997 and in 1998. See "Public Debt—Domestic Debt—Government Domestic Debt Policy."

Both exports and imports of goods decreased in 1998 (by 14% and 19%, respectively). Because the rate of decrease was higher for imports than for exports, the trade balance increased to U.S.\$16.4 billion in 1998 as compared to U.S.\$14.9 billion in 1997. The fall in exports was attributable to a fall in commodity prices rather than to changes in export volume. In 1998, the physical volume of exports increased by 2%, while export prices fell by 16% in U.S. dollar terms, mainly as a result of a decline in world oil prices.

During the first six months of 1998, imports of goods to Russia grew by 9% compared with the first six months of 1997. Growth in imports of machinery and equipment amounted to 11% during that period. As a result of the severe financial and banking crisis in August 1998, which led to a crippling of the payments system, a sharp decline in the value of the rouble, a correspondingly sharp rise in the rouble prices of imports and a sharp fall in household real income, import growth in the first half of 1998 was offset by a 42% contraction in imports during the second half of 1998, as compared with the second half of 1997. The trade surplus accordingly increased by U.S.\$8.3 billion during the second half of 1998 as compared with the second half of 1997, despite an 18% fall in exports of goods in the period, due to the even faster fall in imports.

In 1998, the negative balance of trade in services declined by U.S.\$1.9 billion compared with 1997. As in the case of goods, the reason for this change was that imports decreased at a higher rate than the exports.

In 1999, Russia had a current account surplus of U.S.\$24.6 billion (12.6% of GDP), a significant improvement from 1998, when the current account surplus was only U.S.\$0.2 billion. This improvement was mainly due to a U.S.\$19.6 billion increase in Russia's trade surplus. In 1999, imports of goods fell by 32%, compared with 1998, while exports of goods increased slightly. The improvement in exports resulted mainly from increases in export volumes, offset in part by a decrease in the U.S. dollar prices of certain goods. In 1999, the volume of exports increased by 10% compared with 1998, while average export prices fell by 9% despite the rise in the price of crude oil. The principal reasons for the steep decline in imports were the rise in import prices in rouble terms and the decline in real incomes due to the devaluation of the rouble and the general financial crisis resulting from the events of 17 August 1998.

The income balance also improved in 1999, with the negative balance of investment income payments declining to U.S.\$7.9 billion from U.S.\$11.6 billion in 1998. This reduction was due to the significant decrease in scheduled interest payments on GKO and OFZs held by non-residents as a result of the restructuring of those bonds effected in the first half of 1999, the devaluation of the rouble and the imposition of additional exchange controls on non-resident holders of restructured domestic debt. See "Public Debt—Domestic Debt—Government Domestic Debt." In 1999, the negative balance of services remained stable; both exports and imports of services decreased significantly (by 27% and 19%, respectively), compared with the previous year.

In 2000, the current account balance increased by U.S.\$22.2 billion as compared with 1999, reaching U.S.\$46.8 billion (18.0% of GDP). The primary reason for this improvement was a significant increase in the trade surplus (from U.S.\$36.0 billion in 1999 to U.S.\$60.2 billion in 2000). The increase in the trade surplus resulted

from a 39% increase in exports, compared with 13% growth in imports. The export growth was due mostly to increases in the price of oil, oil products and natural gas. During 2000, average prices for these products increased by 66% as compared with 1999, while the physical volumes of exports of these products grew by 3%. Higher growth in physical volumes was precluded by administrative restrictions on exports and by the low payment capacity of trade counter-parties located in CIS countries. In 2000, non-energy export price increases were much weaker and physical volume growth was stronger. In 2000, export volumes (excluding oil, oil products and natural gas) increased by 15%. At the same time, the average price of non-energy exports increased by just 2%. The increase in imports was mainly due to general economic growth, while the real exchange rate remained stable.

The investment income deficit decreased from U.S.\$7.9 billion in 1999 to U.S.\$7.0 billion in 2000. The negative balance of non-factor services increased in 2000 (from U.S.\$4.3 billion to U.S.\$6.7 billion), primarily due to an increase in imports (mainly travel) caused by growth in disposable income.

In 2001, the current account balance was U.S.\$33.6 billion, a U.S.\$13.3 billion decrease as compared with 2000. The decrease was caused predominantly by a lower trade surplus, as well as by deterioration in the balance of trade in non-factor services. In 2001, imports of goods increased 20%, compared to 2000. This growth was caused by the real appreciation of the rouble and 5% GDP growth, resulting in increased domestic demand. An important factor in the growth of overall imports in 2001 was the increase in imports of machinery and equipment (by 32%) as compared with 2000. Despite the increase in imports and decline in world oil prices (by 14%), the current account balance of U.S.\$33.6 billion (10.8% of GDP) and trade surplus of U.S.\$48.1 billion remained high in 2001, though below their levels in 2000. The high positive trade balance in 2001 was attributable to higher world prices for natural gas (14% price increase over 2000), higher physical volumes of crude oil exports (14% volume increase over 2000) and non-energy exports (4% volume increase over 2000). Due to the positive influence of these factors, the value of exports declined just 3% in 2001 as compared with 2000. Overall physical volumes of Russian exports increased by 4% and export prices decreased by 7% on average over 2000.

The negative balance of non-factor services increased to U.S.\$9.8 billion in 2001, as compared with U.S.\$6.7 billion in 2000, mainly due to an increase in imports. The negative investment income balance decreased from U.S.\$7.0 billion in 2000 to U.S.\$4.1 billion in 2001.

In 2002, the current account balance declined to U.S.\$29.9 billion (8.6% of GDP) due to decreases in both trade and income payment balances. In 2002, the value of Russian exports increased by 6% as compared with 2001 due to a significant increase in volumes shipped, which was partially offset by lower average export prices (mainly due to the delayed adjustment of gas prices to oil price increases). In 2002, export volumes exceeded 2001 volumes by 10%, while average export prices decreased by 4%. A significant real appreciation of the rouble and increased economic activity led to a 13% rise in imported goods. Because the rate of increase was higher for imports than for exports, the trade surplus decreased in 2002 to U.S.\$46.6 billion. The balance of services deteriorated as well.

The negative balance of non-factor services increased to U.S.\$10.6 billion in 2002 as compared with U.S.\$9.8 billion in 2001, due to an increase in imports that exceeded the increase in exports. The investment income deficit also increased from U.S.\$4.1 billion in 2001 to U.S.\$6.3 billion in 2002, due to a decline in the investment balance of the private sector.

In the first half of 2003, the value of exported goods increased by 29% compared with the first half of 2002. This increase resulted from substantial increases in both export prices and volumes shipped. In the first half of 2003, export volumes increased by 12% over the first half of 2002, while average export prices increased by 15%, due primarily to higher world energy prices resulting from instability in the Middle East and war in Iraq. Strong appreciation of the euro versus the US dollar, which increased the competitiveness of Russian goods in comparison with European goods, contributed significantly to the increase in volumes shipped.

Real appreciation of the rouble and an increase in economic activity led to a 23% increase in imports of goods in the first six months of 2003. The appreciation of the euro versus the U.S. dollar restrained further growth of import volumes, due to the increased competitiveness of Russian producers, but also made imported goods more expensive in dollar terms. The effects on volumes and prices effectively offset one another. The net effect was that changes in the euro/dollar exchange rate did not materially affect the value of Russian imports.

As a result of faster export growth, the trade surplus increased to U.S.\$28.6 billion in the first half of 2003, a significant increase over the first half of 2002. The balance of trade in non-factor services amounted to U.S.\$4.9 billion in the first half of 2003, largely unchanged as compared with the first half of 2002.

The increase in the trade surplus led to a higher current account surplus in the first half of 2003 despite an increase in the income payments deficit, which amounted to U.S.\$3.3 billion for the first six months of 2003, an increase of U.S.\$1.5 billion over the same period of 2002. The main reason for this increase was an increase in external debt of non-financial enterprises. In the first half of 2003, the current account surplus nonetheless increased by U.S.\$6.2 billion in comparison with the first half of 2002, and amounted to U.S.\$20.4 billion (10.6% of GDP).

Capital and Financial Account

In 1998, the capital and financial account surplus increased by U.S.\$0.7 billion in comparison with 1997, to U.S.\$9.6 billion, largely due to changes in foreign currency holdings in cash. Whereas the stock of foreign currency cash holdings increased by U.S.\$13.4 billion in 1997, it declined in 1998 by U.S.\$0.8 billion. The decline resulted from the need to support living standards following the 1998 financial crisis and the reduction in unregistered trade (where foreign currency is used as the means of payment). Reserve assets also decreased in 1998, by U.S.\$5.3 billion (net of valuation changes), due to the Central Bank's support of the rouble, which positively affected Russia's capital and financial account. At the same time, inflows of direct and portfolio investment weakened. Net foreign direct investment decreased from U.S.\$1.7 billion to U.S.\$1.5 billion due to the domestic financial crisis, which diminished the interest of foreign investors in the Russian real sector. Gross direct investment (total foreign direct investment to Russia without taking account of Russian investment abroad) decreased substantially (from U.S.\$4.9 billion in 1997 to U.S.\$2.8 billion in 1998). Net portfolio investment decreased in 1997 from U.S.\$17.8 billion (without taking into account U.S.\$27.9 billion of London Club debt) to U.S.\$8.6 billion, reflecting the change in attitude of foreign investors to the GKO/OFZ market following the Asian financial crisis, the Government's budgetary problems and the events of 17 August 1998, which effectively closed the GKO/OFZ market.

In 1999, the capital and financial account showed a deficit of U.S.\$16.1 billion, compared with a surplus of U.S.\$9.6 during 1998. The main cause of the deterioration was the domestic financial crisis that resulted from the events of 17 August 1998, which precluded external borrowings by both the public and the private sectors. Net direct investment in 1999 was U.S.\$1.1 billion, a decrease of U.S.\$0.4 billion compared with 1998. On the other hand, gross direct investment (total foreign direct investment to Russia without taking account of Russian investment abroad) increased from U.S.\$2.8 billion in 1998 to U.S.\$3.3 billion in 1999. The investment (mainly from the United States and Germany) was channelled to the fuel sector, food industry, transportation and retail trade. These positive investment flows were offset by growth of Russian investment abroad (from U.S.\$1.3 billion during 1998 to U.S.\$2.2 billion during 1999) after contracting sharply in 1998, mainly due to Russian companies investing in the oil and gas sector and in joint ventures abroad. Reserve assets increased in 1999 by U.S.\$1.8 billion, after decreasing by U.S.\$5.3 billion in 1998. The increase in 1999 was mainly due to the limited capacity and decreased willingness of the Central Bank to support the rouble. Portfolio and other investment balances significantly deteriorated compared with 1998. Net portfolio investments were negative by U.S.\$0.9 billion, as compared to the strongly positive balance of portfolio investments in 1998 of U.S.\$8.6 billion. This deterioration was mainly due to the inability of Russian issuers to raise funds in the Eurobond market. The negative other investment balance increased from U.S.\$5.4 billion in 1998 to U.S.\$14.1 billion in 1999 as a result of the very low disbursements of loans and credits to both the public and private sectors.

In 2000, the capital and financial account deficit increased significantly, to U.S.\$37.7 billion compared with U.S.\$16.1 billion in 1999. The increase was mainly due to a U.S.\$16.0 billion increase in Central Bank reserves during 2000, whereas in 1999 reserves had increased by only U.S.\$1.8 billion. In 2000, the other investments deficit increased by U.S.\$7.7 billion as compared to 1999, reaching U.S.\$21.8 billion. The deterioration was mainly attributable to increased investment outside of Russia as a result of GDP growth in U.S. dollar terms in 2000. The foreign direct investment balance also deteriorated in 2000, from a positive balance of U.S.\$1.1 billion in 1999 to a deficit of U.S.\$0.5 billion, reflecting foreign perception of the high risk of long-term investment in Russia. The net portfolio investment deficit was U.S.\$10.3 billion in 2000, reflecting the exchange of London Club debt for Eurobonds, which reduced debt by U.S.\$11.0 billion. The debt reduction was also shown as a capital transfer to Russia. Net of the 2000 London Club restructuring, the portfolio investment deficit in 1999 turned into a surplus of U.S.\$0.7 billion.

In 2001, the capital and financial account improved despite the increase in official external debt payments. The deficit decreased by U.S.\$13.0 billion compared with 2000, declining to U.S.\$24.7 billion. The improvement was mainly due to reduced demand by the Central Bank for foreign currency. Net capital outflows from the private sector also decreased due to both higher short-term foreign capital inflows into the banking and corporate sector and lower Russian capital outflows. In 2001, the deficit of other investments decreased by U.S.\$15.4 billion to U.S.\$6.4 billion, primarily reflecting a decrease in foreign assets due to U.S.\$11 billion in debt relief provided by Russia to the poorest Paris Club debtors. This debt relief also appeared as an offsetting amount in the balance of payments as a capital transfers debit. Net of the decrease in foreign assets due to the debt relief provided by Russia, the balance of other investments improved by U.S.\$4.4 billion because of increased short-term foreign investment in Russia's private sector and a decline in Russian capital outflows. The net portfolio investment deficit decreased from U.S.\$10.3 billion in 2000 to U.S.\$0.7 billion in 2001. The higher deficit in 2000 reflected the U.S.\$11.0 billion debt reduction granted to Russia by the London Club of commercial creditors in August 2000. This reduction was reflected in the balance of payments as a decrease in foreign liabilities. However, this decrease was not accompanied by foreign capital outflows since it was compensated by a capital transfer to Russia. Net of this debt reduction, the net portfolio investment balance remained unchanged. In 2001, net foreign direct investment deficit improved only slightly, to U.S.\$0.1 billion.

In 2002, the capital and financial account deficit declined slightly, to U.S.\$23.8 billion, compared with U.S.\$24.7 billion in 2001. This improvement was due to an increased balance of portfolio and other investment, despite a larger increase in official foreign currency reserves, as compared to 2001. The other investments deficit also declined in 2002, by U.S.\$4.4 billion, as compared to 2001, amounting to U.S.\$2.1 billion, while the balance of capital transfers connected with debt forgiveness was U.S.\$3 billion lower than in 2001 due to greater debt relief provided by Russia to the poorest Paris Club debtors. On the other hand, the exchange of Russian Federation Eurobonds for a portion of the uninsured Soviet-era trade indebtedness for which Russia has agreed to be responsible ("FTO Debt") resulted in a U.S.\$1.4 billion decline in foreign liabilities in the form of other investments in 2002. Net of the FTO Exchange, the improvement in the other investment balance amounted to U.S.\$2.7 billion. This improvement was mainly attributable to increased disbursements of foreign loans and credits to the corporate sector. The foreign direct investment deficit increased from U.S.\$0.1 billion in 2001 to U.S.\$0.5 billion in 2002, principally due to the higher rate of Russian investment abroad as compared to foreign direct investment in Russia. The portfolio investment balance improved from a deficit of U.S.\$0.7 billion in 2001 to a surplus of U.S.\$2.5 billion in 2002. The main reasons for the improvement were increased purchases of corporate shares by non-residents and the exchange of U.S.\$1.4 billion of newly issued Russian Federation Eurobonds for a portion of Russia's FTO Debt. In 2002, reserve assets increased by U.S.\$11.4 billion, or U.S.\$3.2 billion more than in 2001.

In the first half of 2003, the capital and financial account deficit amounted to U.S.\$16.9 billion, an increase of U.S.\$4.6 billion compared with the first half of 2002. This increase reflected growth in official foreign currency reserves, as the Central Bank sought to prevent excessive real appreciation of the rouble, and a decline in the portfolio investment balance. In the first half of 2003, reserves increased by U.S.\$15.6 billion, compared to a U.S.\$6.6 billion increase in the first half of 2002. The portfolio investment deficit reached U.S.\$5.9 billion in the first half of 2003, a significant decrease from the U.S.\$0.2 billion surplus recorded in the first half of 2002. The main reasons for this deterioration was the repayment of two series of Russian Federation Eurobonds and the Series IV Ministry of Finance Hard Currency Bonds ("MinFins"), as well as declining demand on the part of non-residents for investments in shares and other securities issued by Russian banks and corporations. The other investments balance, which was in U.S.\$4.5 billion deficit in the first half of 2002 turned into a surplus of U.S.\$3.9 billion in the first half of 2003. The improvement was primarily attributable to increasing foreign capital inflows to the banking and corporate sectors and the reduced interest of Russian individuals and small businesses in cash foreign currency as a form of short-term savings. In the first half of 2003, the balance of foreign direct investments showed a surplus of U.S.\$1.1 billion, as compared to a deficit of U.S.\$0.2 billion in the first half of 2002. The cause of this change was strong growth in foreign direct investment to Russia backed by a relatively stable macroeconomic situation, as Russian investment abroad remained largely unchanged.

Since 1992, increasingly liberal foreign exchange regulations, economic uncertainty and exchange rate fluctuations have prompted Russian banks, enterprises and households to convert their current holdings and savings into foreign currency (particularly U.S. dollar-denominated) assets. Though the impact of these factors has declined in recent years, capital flight has nevertheless been significant in Russia, including both legal outflows through shifts by residents from rouble to foreign currency holdings and illegal outflows through non-repatriation of export

proceeds and unrefunded import advances. The high level of unaccounted transactions may also reflect significant capital flight.

In 1997, net cash foreign currency purchases were significant due largely to uncertainty surrounding the Asian financial crisis and the redenomination of the rouble. In 1998 and 1999, the stock of cash foreign currency held by Russian residents decreased slightly, but recovered in 2000 and 2001 and grew further in 2002. However, the nominal appreciation of the dollar during the first half of 2003 caused Russian individuals and small businesses to convert cash dollars into roubles and resulted in a decline in the stock of cash foreign currency by U.S.\$3.8 billion. Capital outflows in the form of non-repatriation of export proceeds and unrefunded import advances were U.S.\$11.6 billion in 1997. In 1998 and 1999, illegal outflows related to foreign trade (non-repatriation of export proceeds and unrefunded import advances) decreased significantly due to both the contraction of trade turnover and the tightening of foreign exchange controls by the Central Bank. A sharp increase in 2002 to 2003 reflects better recording of transactions by the Central Bank due to improved methodology. Non-repatriation of export proceeds and unrefunded import advances amounted to U.S.\$8.0 billion in 1998, U.S.\$5.1 billion in 1999, U.S.\$5.3 billion in 2000, U.S.\$6.4 billion in 2001, U.S.\$12.2 billion in 2002 and U.S.\$7.3 billion in the first half of 2003 (compared to U.S.\$5.1 billion in the first half of 2002).

Russia's balance of payments accounts include a high level of unaccounted transactions, which have been subject to significant fluctuation, amounting to U.S.\$9.8 billion in 1998, U.S.\$8.6 billion in 1999, U.S.\$9.2 billion in 2000, U.S.\$8.8 billion in 2001, U.S.\$6.1 billion in 2002 and U.S.\$3.5 billion in the first half of 2003 (compared to U.S.\$1.8 billion in the first half of 2002). Net errors and omissions declined in 2002 and 2003 due to better recording of transactions by the Central Bank.

Foreign Trade

Foreign Trade Regime

Until 1992, exports and imports were fully centralised. One of the first post-Soviet economic reforms was to abolish the state monopoly on external trade.

Because of severe goods shortages and the need to ensure the importation of vital supplies, most restrictions on imports were abolished in early 1992. Import tariffs were subsequently introduced for a broad range of goods as of 1 July 1992. In 1995, Russia adopted a 30% tariff ceiling on most imports and announced a schedule of gradual reductions in import tariffs. The weighted average of Russia's import tariffs, which stood at 14.5% in 1996, was reduced to 11.4% in 2000. In 2001, the Government further decreased the maximum import tariff rates and worked to unify rates within commodity groups, bringing Russia's external trade regime more closely in line with WTO standards. Although the maximum rate of import tariffs continues to be 20% (with the exception of five commodity groups, which are levied at various rates, reaching 100% for spirits), the weighted average import tariff rate was 11.9% in 2001 and 12.1% in 2002. The increase over 2000 occurred due to a higher weighting of relatively heavily taxed goods, reflecting better customs administration and decreasing tax evasion.

In 1998, Russia adopted the Trade Remedies Law. This law is based on general WTO principles and covers various issues relating to import safeguards, anti-dumping and compensation measures.

From 1992 to 1994, exports were an important source of foreign exchange earnings for the federal budget and remained controlled even as imports were being liberalised. By the second half of 1996, all export quotas, export tariffs and other export restrictions were abolished. Excise taxes were subsequently introduced on oil, gas, petroleum, automobiles, alcohol and certain other goods, and voluntary export restraints continue to exist on a list of goods agreed between Russia and the EU (for some steel products) and between Russia and the United States (for some steel products and certain consumer goods).

In 1999, the Government reintroduced export tariffs on certain natural resources in order to increase federal budget revenues and restrain growth in domestic prices. The export tariff on crude oil, which generally varies depending upon crude oil export prices, was initially set at €2.5 per metric tonne, increased to €48 at the beginning of 2001 and declined after that in line with fluctuations in world prices of oil. The Law on Customs Tariffs was

amended in 2002. Export tariffs on oil are now based on world oil prices, increasing their predictability. A new Customs Code became effective on 1 January 2004 and is intended to facilitate and accelerate customs clearance procedures, further liberalising Russia's foreign trade regime.

In order to ensure adequate supplies of oil and oil products within Russia, in mid-1999 the Government introduced non-tariff export limitations requiring oil producers to supply certain amounts of oil and oil products to the domestic market prior to receiving access to export facilities. These measures were gradually relaxed and finally eliminated by the end of 2001. At the beginning of 2002, Russian oil companies decreased oil exports through oil pipelines (but not other means) in order to support the attempt by the Organisation of Petroleum Exporting Countries to prevent a sharp decline in world crude oil prices. In May 2002, Russia announced that it would no longer limit exports of crude oil in this manner.

Composition of Trade

The following table illustrates the composition of Russia's exports and imports on a customs basis (excluding unregistered trade adjustments) for the years 1998 to 2002 and for the first half of 2002 and 2003:

	Structure of Trade ⁽¹⁾⁽²⁾⁽³⁾ (excluding unregistered trade)									
	1998		1999		2000		2001		2002	
	U.S.\$ billion	%	U.S.\$ billion	%	U.S.\$ billion	%	U.S.\$ billion	%	U.S.\$ billion	%
Exports										
Machinery, equipment and transport	8.1	11.4	8.0	10.9	9.2	8.9	10.5	10.5	10.0	9.5
Metals, precious stones and their products	19.7	27.6	19.0	26.1	22.4	21.6	18.8	18.8	19.7	18.6
Mineral products ⁽⁴⁾	30.5	42.8	32.7	44.9	55.5	53.8	54.5	54.7	58.4	55.2
Chemical products and rubber ...	6.2	8.7	6.2	8.5	7.4	7.2	7.5	7.5	7.4	7.0
Timber, woodpulp and paper										
Products	3.5	4.9	3.7	5.1	4.5	4.3	4.4	4.4	4.9	4.6
Textiles	0.8	1.1	0.8	1.1	0.8	0.8	0.8	0.8	0.9	0.8
Leather and fur products	0.4	0.6	0.2	0.3	0.2	0.3	0.2	0.2	0.3	0.3
Foodstuffs and agricultural products (excluding textiles)	1.5	2.1	1.0	1.3	1.6	1.6	1.9	1.9	2.7	2.6
Other	0.6	0.8	1.3	1.8	1.5	1.5	1.2	1.2	1.5	1.5
Total trade	<u>71.3</u>	<u>100.0</u>	<u>72.9</u>	<u>100.0</u>	<u>103.1</u>	<u>100.0</u>	<u>99.8</u>	<u>100.0</u>	<u>105.8</u>	<u>100.0</u>
									<u>47.2</u>	<u>100.0</u>
									<u>61.1</u>	<u>100.0</u>
Imports										
Machinery, equipment and Transport	15.5	35.6	10.0	33.3	10.6	31.4	14.3	34.1	16.7	36.2
Metals, precious stones and their products	3.2	7.2	2.2	7.3	2.9	8.6	3.1	7.4	3.0	6.4
Mineral products ⁽⁴⁾	2.3	5.4	1.2	4.0	2.1	6.3	1.7	4.1	1.7	3.7
Chemical products and rubber ...	6.6	15.1	4.9	16.0	6.1	17.9	7.6	18.2	7.7	16.7
Timber, woodpulp and paper										
Products	1.7	3.8	1.1	3.6	1.3	3.8	1.7	4.0	2.0	4.3
Textiles	1.8	4.1	1.6	5.2	2.0	5.9	2.3	5.5	2.4	5.3
Leather and fur products	0.1	0.3	0.1	0.3	0.1	0.4	0.2	0.5	0.2	0.4
Foodstuffs and agricultural products (excluding textiles)	10.8	24.8	8.1	26.7	7.4	21.8	9.2	22.0	10.3	22.5
Other	1.6	3.7	1.1	3.6	1.3	3.9	4.8	4.3	2.0	4.4
Total trade	<u>43.6</u>	<u>100.0</u>	<u>30.3</u>	<u>100.0</u>	<u>33.8</u>	<u>100.0</u>	<u>41.8</u>	<u>100.0</u>	<u>46.0</u>	<u>100.0</u>
									<u>20.8</u>	<u>100.0</u>
									<u>25.0</u>	<u>100.0</u>

Exports of mineral products (including oil, gas and coal) and metals and precious stones account for the vast majority of Russia's total exports, representing 73.5% of exports in 2001 and 73.8% in 2002. Other significant exports include chemical products and rubber (7.0% of total exports in 2002) and machinery and other equipment (9.5% in the same period).

Imports of machinery, equipment and transport accounted for some 34.1% of total imports in 2001 and 36.2% in 2002. Russia also imports significant amounts of raw and processed foodstuffs and agricultural products. In the aggregate, these products accounted for 22.0% of total imports in 2001 and 22.5% in 2002.

Direction of Trade

The following tables illustrate the geographic distribution of Russia's trade on a customs basis (excluding unregistered trade adjustments) for the years 1998 to 2002 and for the first half of 2002 and 2003:

	Exports ⁽¹⁾⁽²⁾⁽³⁾ (excluding unregistered trade)											
	1998		1999		2000		2001		2002		H1 2002	
	U.S.\$	%	U.S.\$	%	U.S.\$	%	U.S.\$	%	U.S.\$	%	U.S.\$	%
	million	change	million	change	million	change	million	change	million	change	million	change
Exports to non-CIS countries	57,614	(15.8)	62,179	7.9	89,269	43.6	85,352	(4.4)	90,546	6.1	40,407	28.5
OECD countries.....	41,497	(14.3)	43,300	4.3	61,172	41.3	58,635	(4.1)	61,199	4.4	27,493	26.2
Germany.....	5,719	(12.4)	6,205	8.5	9,232	48.8	9,194	(0.4)	8,035	(12.6)	3,817	33.1
Great Britain	2,960	3.9	2,886	(2.5)	4,670	61.8	4,283	(8.3)	3,803	(11.2)	1,677	26.4
Switzerland	3,118	(12.0)	3,351	7.5	3,857	15.1	2,309	(40.1)	5,367	132.4	1,680	54.4
Japan.....	2,176	(25.9)	2,125	(2.3)	2,764	30.1	2,427	(12.2)	1,803	(25.7)	858	25.4
USA.....	5,100	13.8	4,709	(7.7)	4,644	(1.4)	4,198	(9.6)	3,983	(5.1)	1,813	13.6
Italy.....	3,219	(9.7)	3,755	16.7	7,254	93.2	7,401	2.0	7,432	0.4	3,501	13.8
Other OECD	19,205	(21.6)	20,270	5.5	28,750	41.8	28,823	0.3	30,775	6.8	14,146	25.7
Transition economies ⁽⁴⁾	6,230	(24.2)	6,298	1.1	9,345	48.4	9,617	2.9	10,979	14.2	4,661	32.1
Other non-CIS countries.....	9,888	(16.2)	12,581	27.2	18,753	49.1	17,101	(8.8)	18,367	7.4	8,253	34.1
Exports to CIS countries	13,699	(17.6)	10,707	(21.8)	13,824	29.1	14,617	5.7	15,609	6.8	6,817	34.1
Ukraine.....	5,560	(23.2)	4,792	(13.8)	5,024	4.8	5,282	5.1	5,853	10.8	2,549	32.3
Belarus.....	4,670	0.1	3,767	(19.3)	5,572	47.9	5,348	(4.0)	5,842	9.3	2,512	39.6
Kazakhstan.....	1,893	(23.4)	1,226	(35.3)	2,247	83.4	2,778	23.6	2,412	(13.2)	1,080	29.9
Kyrgyzstan	132	(21.0)	85	(36.2)	103	21.7	83	(19.0)	104	24.8	48	32.0
Other CIS	1,443	(30.4)	837	(42.0)	877	4.7	1,126	28.4	1,396	24.0	628	27.1
Total exports	71,314	(16.1)	72,885	2.2	103,093	41.4	99,970	(3.0)	106,154	6.2	47,224	29.3

Notes:

(1) Certain data presented in this table differ from previously published data due to regular revisions by the Customs Committee.

(2) Figures differ from the presentation in "—Balance of Payments" due to classification, coverage and other adjustments.

(3) At current rouble/U.S. dollar exchange rates.

(4) Bulgaria, China, Cuba, Mongolia, North Korea, Romania, Slovakia and Vietnam.

Source: Customs Committee statistics.

Imports⁽¹⁾⁽²⁾⁽³⁾
(excluding unregistered trade)

	1998		1999		2000		2001		2002		H1 2002		H1 2003	
	U.S.\$ million	% change	U.S.\$ million	% change	U.S.\$ million	% change	U.S.\$ million	% change	U.S.\$ million	% change	U.S.\$ million	% change	U.S.\$ million	% change
Imports from non-														
IS countries														
OECD countries	32,266	(16.8)	21,935	(32.0)	22,274	1.5	30,680	37.7	35,921	17.1	16,224	19,362	19.3	19.3
Germany	25,560	(16.9)	16,711	(34.6)	17,473	4.6	23,746	35.9	27,398	15.4	12,224	14,561	19.1	19.1
USA	5,486	(17.4)	4,202	(23.4)	3,898	(7.2)	5,808	49.0	6,586	13.4	2,898	3,477	20.0	20.0
Italy	4,114	1.4	2,388	(42.0)	2,694	12.8	3,253	20.7	2,972	(8.6)	1,390	1,320	(5.0)	(5.0)
Finland	1,819	(31.1)	1,160	(36.2)	1,212	4.5	1,715	41.4	2,222	29.6	1,051	1,074	2.1	2.1
Netherlands	1,440	(23.1)	947	(34.2)	958	1.1	1,285	34.1	1,515	17.9	672	777	15.6	15.6
France	914	(24.2)	689	(24.7)	740	7.4	846	14.4	1,056	24.8	466	572	22.5	22.5
Other OECD	1,595	0.1	1,233	(22.7)	1,187	(3.7)	1,538	29.5	1,892	23.0	827	1024	23.9	23.9
Transition economies ⁽⁴⁾	10,192	(20.0)	6,092	(40.2)	6,783	11.3	9,301	37.1	11,156	19.9	4,920	6318	28.4	28.4
Other non-CIS countries	2,156	(13.8)	1,594	(26.1)	1,638	2.8	2,577	57.3	3,178	23.3	1,494	1,860	24.5	24.5
Imports from CIS countries	4,550	(18.1)	3,630	(20.2)	3,164	(12.8)	4,357	37.7	5,344	22.7	2,506	2,941	17.3	17.3
Ukraine	11,313	(20.5)	8,343	(26.3)	11,604	39.1	11,202	(3.5)	10,233	(8.7)	4,623	5,661	22.5	22.5
Belarus	3,267	(17.9)	2,528	(22.6)	3,651	44.4	3,845	5.3	3,226	(16.1)	1,424	1,842	29.3	29.3
Kazakhstan	4,608	(3.6)	3,222	(30.1)	3,710	15.4	3,960	6.7	4,054	2.4	1,807	2,148	18.9	18.9
Kyrgyzstan	1,884	(31.3)	1,398	(25.8)	2,200	57.4	2,018	(8.3)	1,945	(3.6)	926	1,129	21.9	21.9
Other CIS	132	(10.7)	95	(28.2)	89	(6.6)	62	(30.2)	74	19.8	36	46	26.3	26.3
total imports	1,422	(44.9)	1,100	(22.6)	1,954	77.7	1,317	(32.6)	933	(29.1)	429	497	15.8	15.8
	43,579	(17.8)	30,278	(30.5)	33,879	11.9	41,881	23.6	46,153	10.2	20,846	25,023	20.0	20.0

Notes:

(1) Certain data presented in this table differ from previously published data due to regular revisions by the Customs Committee.

(2) Figures differ from the presentation in "—Balance of Payments—" due to classification, coverage and other adjustments.

(3) At current rouble/U.S. dollar exchange rates.

(4) Bulgaria, China, Cuba, Mongolia, North Korea, Romania, Slovakia and Vietnam.

Source: Customs Committee statistics.

Between 1998 and 2002, Russia's exports to OECD countries moved in accordance with the general tendency in Russian exports, improving in 1999 after a significant decline in 1998, increasing substantially in 2000 and remaining relatively stable afterwards. The total increase in exports to OECD countries between 1998 and 2002 was almost 50%. In relative terms, exports to OECD countries remained stable, accounting for from 58% to 59% of Russia's total exports in each year from 1998 through 2002.

In 1998, exports to CIS countries accounted for 19% of total exports. In 1999, prices of goods exported to CIS countries decreased significantly as a consequence of the devaluation of the rouble and the financial crises in certain CIS countries, and as a result, the share of exports to CIS countries dropped to 15% in 1999. After the sharp decrease in 1999, exports to CIS countries rose by 29% in 2000 compared with 1999, due to a rise in both prices of goods exported to the CIS as well as an increase in export volumes, though the overall share of CIS exports declined to 13% as a result of an increase in non-CIS exports. CIS exports increased by a further 5.7% and 6.9% in 2001 and 2002, and accounted for approximately 15% of total exports in both 2001 and 2002.

From 1998 to 2000, movements in exports to transition economies tracked movements in total exports, while the share of exports to transition economies remained stable. In 2001 and 2002, the share of transition countries increased to 10% from 9% in 1998-2000, due to the higher rate of increase in exports to these countries as compared to the rate of increase in total exports. The share of other non-CIS and non-OECD countries increased from 14% of Russia's total exports in 1998 to 17% in 2002.

The events of 17 August 1998 resulted in lower household disposable income, increased imports of lower-priced goods and a consequent decrease in the share of generally higher-priced goods from OECD countries in total imports, from 58% to 59% in 1997 to 1998, to 55% in 1999 and 52% in 2000. Russia's increasing GDP thereafter resulted in increased levels of imports from OECD countries—57% in 2001 and 59% in 2002—returning to their 1998 level.

As a result of the 1998 crisis, which made inexpensive but low-quality goods produced in CIS countries relatively less expensive and therefore more attractive to Russian consumers, the share of CIS countries in total imports increased from 26% in 1998 to 34% in 2000. Russia's increasing GDP thereafter led to a decline in the share of imports from CIS countries to 27% of total imports in 2001 and 22% in 2002.

The share of transition economies in total imports remained stable between 1998 and 2000, at approximately 5% of total imports, but increased thereafter to 6% in 2001 and 7% in 2002. The share of other non-CIS countries and non-OECD countries in Russia's total imports varied between 9% and 12% from 1998 to 2002.

Germany, Belarus, Italy, China, Ukraine and the United States are Russia's leading trading partners. The role of Belarus in Russia's foreign trade has increased significantly since 1995 due to intensified political and economic links between the two countries. The largest importers of Russian goods in 2002 were Germany (8% of Russian exports), Italy (7%), China, Belarus and Ukraine (6% each). The most important exporters to Russia were Germany (14% of Russian imports), Belarus (9%), Ukraine (7%) and the United States (6%). Three countries (Ukraine, Belarus and Kazakhstan) account for 90% of Russia's exports and imports to and from CIS countries.

Official International Reserves

The following table sets forth information with respect to the official international reserves of the Russian Federation as at 1 January of each year from 1999 to 2003 and as at 1 October 2003:

Official International Reserves⁽¹⁾

	As at 1 January					As at 1 October
	1999	2000	2001	2002	2003	2003
	(U.S.\$ million) ⁽²⁾					
Official foreign exchange reserves	7,801	8,457	24,264	32,542	44,054	58,330
Special Drawing Rights.....	0.1	0.6	0.5	2.9	1.2	4.4
Reserve position in IMF.....	1.3	1.3	1.2	1.3	1.6	1.7
Other foreign exchange	7,800	8,455	24,263	32,538	44,051	58,324
Official gold reserves						
(fine troy ounces, million).....	14.7	13.3	12.4	13.6	12.5	12.5
U.S.\$ million (national valuation) ⁽³⁾	<u>4,422</u>	<u>3,998</u>	<u>3,708</u>	<u>4,080</u>	<u>3,739</u>	<u>3,743</u>
Total official international reserves						
(including gold)	<u>12,223</u>	<u>12,456</u>	<u>27,972</u>	<u>36,622</u>	<u>47,793</u>	<u>62,073</u>
Net official international reserves						
(including gold) ⁽⁴⁾	(7,197)	(2,832)	16,258	27,115	41,312	56,725

Notes:

(1) Since the third quarter of 2002, short-term liabilities of the Central Bank have been excluded from both assets and liabilities in the calculation of official international reserves.

(2) At current rouble/U.S. dollar exchange rates.

(3) At U.S.\$300 per troy ounce.

(4) Total official reserves less gross international reserve liabilities (the latter being defined and calculated in accordance with IMF requirements).

Source: Central Bank, Ministry of Finance.

During 1998, the decrease in Russia's exports, outflows of private foreign capital and the Central Bank's efforts to support the rouble led to a U.S.\$5.6 billion decline in official international reserves (including gold). The decline in reserves occurred despite almost U.S.\$15 billion in external borrowings by the Government and the Central Bank in 1998 (excluding the Government's exchange of Eurobonds for GKO's in July 1998). As at 1 January 1999, official international reserves (including gold) stood at U.S.\$12.2 billion, of which U.S.\$7.8 billion was in foreign currency and U.S.\$4.4 billion was in gold. These reserves represented 2.0 months of import coverage. Net official international reserves (including gold) were negative U.S.\$7.2 billion as at 1 January 1999.

In 1999, the Central Bank was unable to increase significantly the level of official international reserves despite strong improvement in the current account. While foreign capital inflows in 1999 were low, the large current account surplus was used mostly for the accumulation of foreign assets by Russian residents rather than to increase official international reserves. In line with its agreement with the IMF, the Central Bank in 1999 gradually excluded assets held with its subsidiary foreign banks from official international reserves.

As at 1 January 2000, official international reserves (including gold) stood at U.S.\$12.5 billion, of which U.S.\$8.5 billion was in foreign currency and U.S.\$4.0 billion was in gold. These reserves represented 2.8 months of import coverage. Compared with 1998, the improvement in import coverage was due mainly to the sharp decrease in the volume of imports. Net official international reserves (including gold) were negative U.S.\$2.8 billion as at 1 January 2000. The improvement in net international reserves was mainly due to the reduction of the Government's and the Central Bank's debt to the IMF from U.S.\$19.4 billion at the end of 1998 to U.S.\$15.3 billion at the end of 1999, resulting from significant amortisation in excess of new IMF disbursements.

In 2000, the improved situation in world commodity markets and the Central Bank's policy of preventing sharp real appreciation of the rouble by buying dollars led to an increase in Russia's reserves. As at 1 January 2001, official international reserves (including gold) stood at U.S.\$28.0 billion, of which approximately U.S.\$24.3 billion

was in foreign currency and approximately U.S.\$3.7 billion was in gold. These reserves represented 5.5 months of import coverage. Net international reserves stood at U.S.\$16.3 billion as at 1 January 2001.

Russia's reserve position improved further in 2001. As at 1 January 2002, gross international reserves (including gold) stood at U.S.\$36.6 billion, representing 5.9 months of import coverage. Foreign currency reserves amounted to U.S.\$32.5 billion and gold reserves stood at U.S.\$4.1 billion. In 2001, net official international reserves increased by U.S.\$10.9 billion, amounting to U.S.\$27.1 billion at 1 January 2002. This improvement was due to both an increase in gross reserves (backed by Russia's large trade surplus) and significant principal payments on the Government's and Central Bank's debt to the IMF, including voluntary early repayments.

The growth of international reserves continued in 2002 and the first nine months of 2003 due to favourable world commodity prices and a strong inflow of foreign capital. As at 1 January 2003, gross international reserves (including gold) stood at U.S.\$47.8 billion, representing approximately 6.7 months of import coverage. Foreign currency reserves amounted to U.S.\$44.1 billion and gold reserves stood at U.S.\$3.7 billion. Net international reserves stood at U.S.\$41.3 billion as at 1 January 2003.

As at 1 October 2003, official international reserves (including gold) stood at U.S.\$62.1 billion of which approximately U.S.\$58.3 billion was in foreign currency and approximately U.S.\$3.7 billion was in gold. These reserves represented approximately seven months of import coverage. Net international reserves stood at U.S.\$56.7 billion as at 1 October 2003.

The Government strictly regulates Russia's output, sale and export of precious metals and stones, including gold, platinum and diamonds. As part of this regulatory regime, the Government licences and has a right of first refusal to purchase Russia's precious metals output. The Government may add to its reserves any purchased output or any proceeds from sales and exports of its precious metals.

Both the Central Bank and the Ministry of Finance currently have official foreign exchange and gold reserves. Reserves of the Ministry of Finance, however, make up only a small portion of Russia's total official international reserves. There is no constitutional or federal legislative requirement that the Ministry of Finance maintain foreign currency reserves.

PUBLIC FINANCE

The information presented herein with respect to the federal budget has been prepared, with limited exceptions, substantially in accordance with the guidelines and definitions set forth in the IMF's publication "Government Finance Statistics" (GFS-1986). The differences between the historical presentation of federal budget information and the GFS guidelines and definitions relate mainly to (i) sales of gold and precious metals and privatisation proceeds, which are treated as positive elements of deficit financing in the presentation herein but as revenue items under GFS, and (ii) purchases of gold and precious metals, which are treated as negative elements of deficit financing in the presentation herein but as expenditure items under GFS.

The federal budget information presented herein differs in significant respects from budget information prepared in accordance with federal budgetary laws and published in other official sources. For example, the 1997 federal budget law for technical and operational reasons did not include non-coupon debt service costs (for instance, payment of original issue discount) as an element of expenditure. These costs are included in the federal budget information presented herein. Unlike the budgets for 1997 and previous years, the subsequent budget laws were prepared in accordance with the GFS guidelines and the methodologies used to present budget information herein. The only exception is the budget for 2002, in which official reports include the Government's purchase of Vneshtorgbank stock in October 2002 (0.4% of GDP) in non-interest expenditure. In the budget information presented herein, this purchase is characterized as a reverse privatisation and therefore as a financing item. The 2003 and 2004 budget laws were prepared in accordance with the GFS guidelines and the methodologies used to present the budget information herein, and it is expected that all federal budget information published in the future will be prepared in accordance with these methodologies.

Overview

Russia has significantly improved its fiscal position over the last several years, transforming a federal budget deficit of 7.4% of GDP in 1997 into a federal budget surplus of 1.4% of GDP in 2002. Russia has, in particular, managed to capitalise on the positive effects of the 1998 financial crisis. Starting in 1999, the federal budget has continuously run a primary surplus, reaching 3.5% of GDP in 2002. This improvement is attributable in part to improvements in the federal budgetary process, which allow for greater control over expenditure, and more efficient tax policy.

The following table sets forth certain summary information regarding Russia's public finances for the years 1997 to 2002 and for the first half of 2003:

Enlarged Budget⁽¹⁾							
	1997	1998⁽²⁾	1999⁽³⁾	2000⁽⁴⁾	2001	2002⁽⁵⁾	H1 2003
(millions of roubles)							
Enlarged Budget							
Revenue.....	911,023	890,123	1,630,587	2,727,001	3,349,983	4,021,783	2,343,525
Expenditure.....	1,098,686	1,033,365	1,679,830	2,498,587	3,058,834	3,864,655	2,095,871
Surplus (deficit).....	(187,663)	(143,242)	(49,243)	228,414	291,149	157,128	247,654
Federal budget							
Revenue	310,728	290,421	615,532	1,132,083	1,593,978	2,204,726	1,243,960
Expenditure	484,034	422,732	678,440	1,045,661	1,320,012	2,012,151	1,059,722
Surplus (deficit)	(173,306)	(132,311)	(62,908)	86,421	273,966	192,575	184,238
Primary surplus (deficit) ⁽⁶⁾ ...	(55,519)	(25,739)	99,953	344,274	505,070	422,242	302,577
Local (sub-federal and municipal) budgets ⁽⁷⁾							
Revenue	360,479	352,404	598,111	964,648	1,092,444	1,315,375	702,678
Expenditure	389,076	364,082	591,093	930,890	1,100,196	1,368,927	672,612
Surplus (deficit)	(28,596)	(11,679)	7,019	33,759	(7,752)	(53,552)	30,066
Extra-budgetary funds ⁽⁸⁾							
Revenue	254,745	263,883	455,662	730,343	757,786	616,697	397,136
Expenditure	257,243	261,322	434,266	611,112	746,446	613,135	366,215
Surplus (deficit)	(2,498)	2,561	21,396	119,231	11,339	3,562	30,921
(% of GDP)							
Enlarged Budget							
Revenue.....	36.7	32.5	34.2	37.3	37.1	37.0	39.0
Expenditure.....	44.3	37.7	35.2	34.2	33.8	35.6	34.9
Surplus (deficit).....	(7.6)	(5.2)	(1.0)	3.1	3.2	1.4	4.1
Federal budget							
Revenue	12.5	10.6	12.9	15.5	17.6	20.3	20.7
Expenditure	19.5	15.4	14.2	14.3	14.6	18.5	17.7
Surplus (deficit)	(7.0)	(4.8)	(1.3)	1.2	3.0	1.8	3.1
Primary surplus (deficit) ⁽⁶⁾ ...	(2.2)	(0.9)	2.1	4.7	5.6	3.9	5.0
Local (sub-federal and municipal) budgets ⁽⁷⁾							
Revenue	14.5	12.9	12.5	13.2	12.1	12.1	11.7
Expenditure	15.7	13.3	12.4	12.7	12.2	12.6	11.2
Surplus (deficit)	(1.2)	(0.4)	0.1	0.5	(0.1)	(0.5)	0.5
Extra-budgetary funds ⁽⁸⁾							
Revenue	10.3	9.6	9.6	10.0	8.4	5.7	6.6
Expenditure	10.4	9.5	9.1	8.4	8.3	5.6	6.1
Surplus (deficit)	(0.1)	0.1	0.4	1.6	0.1	0.0	0.5
Memo:							
Nominal GDP, billions of roubles)	2,479	2,630	4,823	7,306	9,039	10,863	6,004

Notes:

- (1) Calculated on the basis of cash or other items of value actually collected or spent. Certain data presented in this table differ from data made public previously due to regular revisions made by the Ministry of Finance.
- (2) Includes monetary offsets recorded in January and February 1998 but attributable to 1997 (18.4 billion roubles).
- (3) Includes monetary offsets recorded in January to March 1999 but attributable to 1998 (18.0 billion roubles).
- (4) Includes monetary offsets recorded in 1999 (6.2 billion roubles).
- (5) Expenditure for the purchase of a stake in Vneshtorgbank in October 2002 is characterized as a reverse privatisation, i.e., a financing item, rather than as non-interest expenditure.

- (6) Federal budget revenues less non-interest expenditure.
 - (7) Excluding transfers from the federal budget.
 - (8) Excluding transfers from the federal and local budgets and among extra-budgetary funds.
- Source: Ministry of Finance.

Federal Budgetary Process

The Ministry of Finance is centrally involved in each stage of the federal budgetary process, including establishing fiscal policy objectives, developing macroeconomic forecasts, preparation of the budget, adoption of the budget by the Federal Assembly, executing the budget (including later amendments) and auditing the budget's execution.

Budget Preparation and Adoption

Under the Budget Code, the draft budget is prepared by the Ministry of Finance and presented to the Government. It is then presented to the Duma, where it proceeds through four readings. In the first reading, the budget's overall macroeconomic framework and the budgeted revenue, deficit and expenditure are established. The Duma may not increase revenues or the deficit ceiling without the approval of the Government. The second reading is devoted to allocating total authorised expenditure to specific purposes according to functional classifications within limits defined after the first reading. The third reading involves allocating the expenditure among government institutions, lending and borrowing programmes, and other items. In the fourth reading, the budget as a whole is adopted and no further amendments are permitted. After the Duma's fourth reading, the Federation Council votes on the bill. After its adoption, the bill is sent to the President for consideration. The bill becomes law following signature by the President and publication in the appropriate print media. During the course of the fiscal year, the Government may submit to the Duma amendments to the budget law for consideration in accordance with the normal legislative process.

The Government submitted the draft budget law for 2004 to the Duma on 26 August 2003. The President signed the budget into law on 23 December 2003. See "—2004 Federal Budget Law."

Budget Execution

Once the budget law has been enacted, the Ministry of Finance is responsible for its execution.

The budget law sets overall nominal levels for revenue, expenditure and deficit, as well as caps for domestic and foreign borrowing and other sources of deficit financing. Approval of the Duma is required if the budget plan exceeds the nominal level of expenditure or borrowing. In each year since 1992, the Ministry of Finance has executed the budget using only revenue actually collected and without violating the deficit ceiling established in the budget law, with the exception of 1998, when the deficit was 14 billion roubles higher than the budgeted amount due to the financial crisis following the events of 17 August 1998.

The expenditure levels established in the budget law are annual spending limits with a breakdown for each line item. Upon adoption of the budget law, the Government establishes indicative (*i.e.*, non-binding) quarterly allocation targets for each line item in order to enhance operational control over budgetary performance. The Government can choose how to allocate expenditure on an item over the course of the year so long as it does not exceed by year-end the expenditure figure set forth in the budget law for that item. According to the Budget Code, the Government may reduce expenditure proportionally up to 10% for each line item if revenues and sources of financing do not reach prescribed targets. The Government may execute expenditure cuts by more than 10% only after corresponding amendments are made to the budget law.

Due to the financial crisis in August 1998, the Government did not service GKO and OFZs with maturity dates between 17 August 1998 and 31 December 1999 and certain categories of former Soviet Union debt for which the Government had agreed to be responsible. Following consultations between the Government and various groups of investors, GKO and affected OFZs were exchanged for new rouble denominated securities with longer maturities.

During 1999, the Government financed in full only the expenditure that had been explicitly provided for in the 1999 budget law. The service of Soviet-era debt was not provided for in the budget law and thus was not financed. See “—Federal Budget Expenditure” below. Unlike the previous budgets, the 1999 budget law did not contain any provisions for sequestration (or withholding) of expenditure in the event revenues were not sufficient. It also provided that any additional revenue realized during the year due to higher inflation, depreciation of the rouble or other factors should be allocated evenly between non-interest expenditure and interest and principal debt payments.

In 2000, budget execution improved significantly. See “—Federal Budget Revenue—Revenue Performance” below. Although the 2000 budget law envisaged a deficit of 1.1% of GDP, the federal budget ended the year with a surplus of 1.2% of GDP after meeting all budget obligations, including debt service on former Soviet-era debt. The Government also concluded an agreement with the London Club of commercial creditors to restructure and reduce its indebtedness to those creditors. See “Public Debt—External Debt.” Additional revenues that appeared during the year due to higher economic growth and better tax compliance were used to fund additional non-interest expenditure and debt service, including principal debt repayments.

The 2001 budget law was the first zero-deficit budget law since the end of the Soviet Union. In 2001, budget performance further improved, with the surplus reaching 3.0% of GDP. In accordance with the 2001 budget law, a significant portion of this additional revenue (approximately 3.0% of GDP out of an additional 4.6% of GDP) was spent on debt reduction.

The budget law adopted in 2002 provided for a budgetary surplus of 1.6% of GDP. Actual revenue exceeded budgeted revenue by 0.4% of GDP, 0.1% out of which was spent on debt reduction. In addition, foreign borrowing was partially replaced by domestic borrowing and amounted to only 0.2% of GDP, compared to 0.8% of GDP as contemplated in the budget law.

2004 Federal Budget Law⁽¹⁾

	(billions of roubles, unless otherwise noted)	(% of GDP)
Total revenue	2,742.9	17.9
Total revenue without social tax.....	2,304.6	15.1
Tax revenue.....	2,071.4	13.5
Profit tax.....	164.6	1.1
Personal income tax.....	0.0	0.0
VAT.....	988.4	6.5
Excise taxes.....	98.5	0.6
Natural resources taxes.....	279.4	1.8
Customs duties.....	532.5	3.5
Other tax revenue.....	8.0	0.1
Non-tax revenue.....	219.2	1.4
Central Bank profit transfer.....	9.0	0.1
Non-tax revenue from foreign economic activity.....	55.9	0.4
Budgetary Fund.....	14.1	0.1
Social tax (to be transferred to the Pension Fund)	438.2	2.9
Total expenditure	2,659.4	17.4
Total expenditure excluding transfer of social tax to the Pension Fund.....	2,221.2	14.5
Debt service.....	287.6	1.9
Interest on domestic debt.....	64.4	0.4
Interest on external debt.....	223.2	1.5
Non-interest expenditure.....	1,933.7	12.6
National economy.....	241.9	1.6
Social and cultural sphere.....	354.0	2.3
State administration.....	76.9	0.5

	(billions of roubles, unless otherwise noted)	(% of GDP)
Law and order	343.8	2.2
Defence	411.5	2.7
Expenditure on foreign economic activity	45.1	0.3
Financial aid to regions	311.0	2.0
Budgetary Fund	14.1	0.1
Other expenditure	135.4	0.9
Transfer of social tax to the Pension Fund.....	438.2	2.9
Fiscal surplus	83.4	0.5
Total Financing	(83.4)	(0.5)
External financing (including disbursements from the IMF)	(166.8)	(1.1)
Borrowing	113.7	0.7
Tied credits	0.0	0.0
Financial credits.....	0.0	0.0
Of which Eurobonds	93.9	0.6
Principal repayment.....	(280.4)	(1.8)
Domestic financing.....	83.4	0.5
Borrowing	258.9	1.7
Principal repayment.....	150.4	1.0
Privatisation	45.5	0.3
Net gold sales.....	12.8	0.1
Financial Reserve (accumulation)	(384.3)	(2.5)
Primary Surplus	371.0	2.4
<i>Memo:</i>		
GDP	15,300	
CPI growth (December on December, %)	5.2	
Average exchange rate (U.S.\$/rouble)	31.3	
Average oil price, Urals (U.S.\$/barrel)	22.0	

Notes:

(1) In accordance with the definition used throughout this section.

Source: Ministry of Finance.

The 2004 federal budget was prepared in accordance with the changes in the tax system and new budgetary policies adopted in 2003. The budget law provided for a fiscal surplus of 72.2 billion roubles (0.6% of GDP) and external debt repayments of 280.4 billion roubles, a significant portion of which (108.5 billion roubles) is to be borrowed on domestic markets.

Since 2002, the federal budget includes one-half of the revenues and payments of the Pension Fund, totalling 438.2 billion roubles (2.9% of GDP) in 2004. These amounts are added to federal revenues and expenditure and therefore do not affect the budget balance. They are excluded from the discussion that follows.

The 2004 budget law envisages revenue of 2,304.6 billion roubles, or 15.1% of GDP, with value added tax representing 6.5% of GDP, profit tax 1.1% of GDP, excise taxes 0.6% of GDP and natural resource extraction tax 1.8% of GDP. Planned expenditure is 2,221.1 billion roubles (14.5% of GDP), with debt service accounting for only 13% of total expenditure. A budgeted surplus of 83.4 billion roubles (0.5% of GDP) and a budgeted surplus of 371.0 billion roubles (2.4% of GDP), combined with anticipated privatisation and net gold receipts, are intended to limit new borrowings.

Federal budget tax revenue has been, and continue to be, highly sensitive to world prices for commodities exported from Russia, particularly oil and gas.

Federal Budget Revenue

The following table sets forth information regarding federal budget revenue for the years 1998 to 2002 and the first nine months of 2003, including information on cash operations:

	Federal Budget Revenue					Total Revenue ⁽¹⁾				As at 30 September 2003
	Cash Revenue ⁽²⁾		(millions of roubles)			1999	2000	2001	2002	
	1998 ⁽³⁾	1999	2000	1998	1999	2000	2001	2002	2003	
Total Revenue	290,421	615,532	1,132,083	243,084	609,312	1,132,083	1,593,978	2,204,726	1,896,283	
Total Revenue net of social tax	290,421	615,532	1,132,083	243,084	609,312	1,132,083	1,593,978	1,865,265	1,635,315	
Tax revenue	253,654	509,697	964,782	206,644	503,477	964,782	1,460,398	1,696,137	1,482,614	
Profit taxes	37,166	81,143	178,283	29,953	80,495	178,283	213,777	172,212	123,196	
Personal income tax	90	19,951	27,368	90	19,951	27,368	2,750	(1)	79	
VAT	115,915	221,064	371,511	91,028	216,589	371,511	638,966	752,655	650,456	
Excise taxes	56,636	84,230	131,092	42,152	83,213	131,092	203,124	214,865	190,200	
Natural resources taxes	3,309	10,577	18,569	2,887	10,577	18,569	49,693	214,237	180,831	
Taxes on foreign economic activity	36,544	86,196	229,224	36,544	86,196	229,224	331,340	323,369	322,109	
Import duties	27,401	47,377	64,378	27,401	47,377	64,378	104,161	128,695	113,482	
Export duties	4	38,819	164,813	4	38,819	164,813	227,174	194,674	208,628	
Property tax	365	749	1,290	365	749	1,290	2,817	1,441	1,450	
Other tax revenue	3,628	5,787	7,446	3,624	5,707	7,446	20,747	17,359	14,294	
Social Tax	—	—	—	—	—	—	—	339,461	260,969	
Non-tax revenue	12,705	49,202	74,385	12,705	49,202	74,385	119,069	153,998	141,105	
Central Bank profit transfer	1,394	0	593	1,394	0	593	2,090	9,042	9,042	
Non-tax revenue from foreign economic activity	2,854	36,457	37,393	2,854	36,457	37,393	51,506	65,559	65,559	
Revenues of Budgetary Funds	24,063	56,633	92,915	23,735	56,633	92,915	14,512	15,130	11,595	
(% of GDP)										
Total Revenue	10.6	12.9	15.5	8.9	12.8	15.5	17.6	20.3	19.6	
Total Revenue net of social tax	10.6	12.9	15.5	8.9	12.8	15.5	17.6	17.2	16.9	
Tax revenue	9.3	10.7	13.2	7.5	10.6	13.2	16.2	15.6	15.3	
Profit taxes	1.4	1.7	2.4	1.1	1.7	2.4	2.4	1.6	1.3	
Personal income tax	0.0	0.4	0.4	0.0	0.4	0.4	0.0	0.0	0.0	
VAT	4.2	4.6	5.1	3.3	4.6	5.1	7.1	6.9	6.7	
Excise taxes	2.1	1.8	1.8	1.5	1.7	1.8	2.2	2.0	2.0	
Natural resources taxes	0.1	0.2	0.3	0.1	0.2	0.3	0.5	2.0	1.9	

Taxes on foreign economic activity	1.3	1.8	3.1	1.3	1.8	3.1	3.7	3.0	3.3
Import duties.....	1.0	1.0	0.9	1.0	1.0	0.9	1.2	1.2	1.2
Export duties.....	0.0	0.8	2.3	0.0	0.8	2.3	2.5	1.8	2.2
Property tax	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other tax revenue	0.1	0.1	0.1	0.1	0.1	0.1	0.2	0.2	0.1
Social tax	—	—	—	—	—	—	—	3.1	2.7
Non-tax revenue.....	0.5	1.0	1.0	0.5	1.0	1.0	1.3	1.4	1.5
Central Bank profit transfer ..	0.1	0.0	0.0	0.1	0.0	0.0	0.0	0.1	0.1
Non-tax revenue from foreign economic activity	0.1	0.8	0.5	0.1	0.8	0.5	0.6	0.6	0.7
Revenue of Budgetary Funds	0.9	1.2	1.3	0.9	1.2	1.3	0.2	0.1	0.1
	(% of total revenue not including social tax)								
Total Revenue	100.0	100.0	100.0	100.0	100.0	100.0	100.0	118.2	116.0
Total Revenue net of social tax	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Tax revenue	87.3	82.8	85.2	85.0	82.6	85.2	91.6	90.9	90.7
Profit taxes	12.8	13.2	15.7	12.3	13.2	15.7	13.4	9.2	7.5
Personal income tax.....	0.0	3.2	2.4	0.0	3.3	2.4	0.2	0.0	0.0
VAT	39.9	35.9	32.8	37.4	35.5	32.8	40.1	40.4	39.8
Excise taxes.....	19.5	13.7	11.6	17.3	13.7	11.6	12.7	11.5	11.6
Natural resources taxes	1.1	1.7	1.6	1.2	1.7	1.6	3.1	11.5	11.1
Taxes on foreign economic activity	12.6	14.0	20.2	15.0	14.1	20.2	20.8	17.3	19.7
Import duties.....	9.4	7.7	5.7	11.3	7.8	5.7	6.5	6.9	6.9
Export duties.....	0.0	6.3	14.6	0.0	6.4	14.6	14.3	10.4	12.8
Property tax	0.1	0.1	0.1	0.2	0.1	0.1	0.2	0.1	0.1
Other tax revenue	1.2	0.9	0.7	1.5	0.9	0.7	1.3	0.9	0.9
Social tax	—	—	—	—	—	—	—	18.2	16.0
Non-tax revenue	4.4	8.0	6.6	5.2	8.1	6.6	7.5	8.3	8.6
Central Bank profit transfer ..	0.5	0.0	0.1	0.6	0.0	0.1	0.1	0.5	0.6
Non-tax revenue from foreign economic activity	1.0	5.9	3.3	1.2	6.0	3.3	3.2	3.5	4.0
Revenue of Budgetary Funds	8.3	9.2	8.2	9.8	9.3	8.2	0.9	0.8	0.7
GDP (billions of roubles).....	2,630	4,823	7,306	2,630	4,823	7,306	9,039	10,863	9,690

Notes:

- (1) Based on cash or other items of value actually collected, subject to adjustment in respect of certain items of revenues. Since 2000, the federal budget has received all revenue in cash.
- (2) Excludes all types of offsets. Since 2000, the federal budget has received all revenue in cash.
- (3) Subject to adjustments in respect of certain items of expenditure incurred after 31 December 1998 but appropriate to record in respect of 1998. Includes monetary offsets recorded in January to March 1999 but attributable to 1998 (18.0 billion roubles).

Source: Ministry of Finance.

Sources of Federal Revenue

The main elements of Russia's tax system are a value-added tax ("VAT"), a system of excise taxes, an enterprise profits tax, duties on foreign economic activities, a natural resources extraction tax and a personal income tax. Following tax reforms that came into force in 2001, the total number of taxes and tax exemptions have been reduced together with the overall tax burden, and income tax collection has been improved. Sub-federal governments may impose only those taxes that are contemplated by the tax code. Following the second stage of tax reforms which took effect in 2002, a new modified royalty tax on resource extraction has replaced three previous taxes: royalty, tax for replenishment of natural resources and oil excise. In the case of crude oil, the modified royalty tax on resource extraction is calculated at a specific rate (in roubles per tonne) depending on the current international oil price. For natural gas, the tax was calculated as a percentage of the price of gas produced through 2003, and from 1 January 2004 has been set at a specified rate per unit volume of gas produced.

VAT, charged at a general rate of 18% (20% prior to 1 January 2004), and reduced to 10% for certain items and to 0% for exports and other limited items, has been the largest source of federal budget revenue since 1992, accounting for more than 40% of total cash revenue during 2001 and 2002. Since 2001, all VAT payments for domestically-produced goods and services have been transferred to the federal budget.

The federal portion of the profit tax is now set at a uniform rate of 5%, down from 6% in 2003 and 7.5% in 2002. The total profit tax rate is currently 24% (it was 35% prior to 1 January 2002). In connection with the 2001 tax reform, the profit tax was made more market-oriented, with enhanced accelerated depreciation and loss carry-forward mechanisms, while limits on many cost deductions and certain tax exemptions were eliminated.

Revenue from foreign economic activity consists mainly of taxes and fees on exports and imports and interest payments on loans abroad. In 1996, significant steps were taken towards the abolition of centralised exports and the gradual replacement of export duties by domestic excise taxes. Between 1 July 1996 and 1 January 1999, export duties did not exist in Russia. The 1998 devaluation of the rouble and the subsequent increase in world commodity prices made Russian exports more profitable, and the Government has since imposed export duties on most exported goods. Export duties accounted for almost 15% of federal revenues in 2000 and more than 14% in 2001, but declined to 10% in 2002, primarily due to the decline in international oil prices at the beginning of the year. In the first half of 2003, the share of export duties rose to 13%. Although the share of federal revenue represented by import duties declined from 11.3% in 1998 to 7% in 2002 and the first half of 2003, import duties remain an important source of federal budget revenue. Import tariff rates are expected to be reduced gradually over the next three years. See "Balance of Payments and Foreign Trade—Foreign Trade—Foreign Trade Regime."

Under the 1997 and 1998 budget laws, all personal income tax revenue was allocated to sub-federal budgets. Effective 1 April 1999, revenues from a 3% component of the personal income tax rate were allocated to the federal budget. The 2000 budget law allocated 16% of personal income tax revenues to the federal budget, while the 2001, 2002 and 2003 budget laws allocated all income tax revenue to sub-federal budgets. The personal income tax rate is currently a flat rate of 13%.

Natural resource taxation is an important issue in Russia. Until 2001, resource extraction in Russia was taxed by royalties and contributions to the Mineral Resources' Replenishment Fund, in addition to excise taxes. Approximately 40% of natural resource tax revenue went to the federal budget. Since 2002, those taxes have been replaced by a modified tax on resource extraction. Since the federal share of this tax revenue has increased to approximately 75%, this tax has become an important source of federal revenue, representing more than 10% of federal revenue in the first half of 2003.

Russia's tax system also includes a number of other taxes, though their significance for the federal budget is relatively low. In 2002, the total contribution of these taxes to federal budget revenue was less than 1%.

Federal budget revenue also includes non-tax revenue. The role of proceeds from the use of state property is increasing, reflecting improvement in the control over state property. In addition, federal legislation provides for the transfer of 50% of all Central Bank profits to the federal budget, with the other 50% being retained by the Central Bank.

Prior to 2001, so-called budgetary funds (former extra-budgetary funds that were previously consolidated in the budget) were an important part of federal budget revenue. Starting with 2001, most of the federal budgetary funds were liquidated, except for the fund of the Ministry of Atomic Power. The oil and gas sectors accounted for approximately 38% of federal budget revenue in 2002.

Revenue Performance

Revenue performance in years prior to 1999 was poor, undermined both by low cash tax collection and by extensive use of “tax offsets” (tax credits issued by Government ministries in payment for their purchases of goods and services) and “monetary offsets” (*ad hoc* arrangements involving the crediting and debiting of cash to enterprises that are owed amounts from and owe amounts to the federal budget). Poor revenue performance was among the reasons cited for the delays in drawdowns under Russia’s Extended Funds Facility (“EFF”) with the IMF in 1997 and 1998. See “Public Debt—Relations with International Financial Institutions” below. Beginning in 1999, revenue performance improved significantly, following macroeconomic and structural changes in the Russian economy.

Federal budget tax revenue (cash and non-cash) was 10.6% of GDP in 1997, while cash tax revenue (excluding offsets) was 8.2% of GDP. As part of the Government’s efforts to enhance revenue collection, a November 1997 presidential decree abolished all forms of monetary offsets in lieu of cash payments to the federal budget.

Total federal (cash and non-cash) tax revenue in 1998 was only 83% of budgeted levels, due in large part to the financial crisis following the events of 17 August 1998. In 1999, federal budget tax revenues reached 126.4% of the established budgetary target. Improved revenue performance made it possible to reduce the budget deficit by almost 60%, even though expenditure amounted to 116.8% of budget.

At the beginning of 1998, tax revenue performance improved slightly, but then declined in the second quarter following deterioration in the financial markets. The events of 17 August 1998 further undermined revenue performance. The devaluation of the rouble led to an almost twofold reduction in the value of imports (and thus adversely affected revenues from import tariffs), and the resulting banking crisis delayed transfers of tax payments to the budget, causing a sharp reduction in tax collection. As a result, total federal cash revenue declined to 8.9% of GDP in 1998.

In 1999, federal budget revenue performance improved due to several measures aimed at improving revenue collection and changes in revenue sharing legislation. Cash revenues to the federal budget reached 14.8% of GDP in the fourth quarter of 1999, resulting in cash revenues for the year of 12.8% of GDP.

Starting in 2000, federal budget revenue has been higher than budgeted amounts. In 2000, federal budget revenue amounted to 15.5% of GDP, 42% higher than the budget target. The increase was attributable to better tax collection, with federal budget tax revenues reaching 13.2% of GDP in 2000, compared to 10.6% of GDP in 1999. One of the reasons for better tax compliance was an increase in international prices of crude oil and other raw materials. This affected tax revenue both directly (through an increase in export tariffs and profits of exporters) and indirectly (through increased taxpayer ability to pay taxes in cash). In 2000, tax collection improved further, partly due to more effective restructuring of tax arrears. Prior to 1999, tax arrears grew consistently, representing 18% of GDP in 1999. Following the Government’s adoption of a resolution allowing enterprises to reschedule their tax arrears in exchange for the full and orderly payment of current tax payments, tax arrears were reduced to 15% of GDP in 2000, 13% of GDP in 2001, 5% of GDP in 2002 and 8% of GDP in the first half of 2003.

In 2001, federal budget revenue amounted to 17.6% of GDP, 33% higher than the budget target. The increase was attributable to better tax collection, with federal budget tax revenues increasing to 16.2% of GDP in 2001 compared to 13.2% of GDP in 2000. Additional revenue comprised 4.4% of GDP and was divided between non-interest expenditure and debt service in accordance with the 2001 budget.

In 2002, federal budget revenues amounted to 17.2% of GDP, 1% higher than the budget target. The better-than-budgeted revenues were attributable to additional revenues from customs duties due to increased oil

prices and higher non-tax revenues. Federal budget tax revenues decreased to 15.6% of GDP in 2002, as a result of the reduction in profit tax base that became effective in 2002. In the first nine months of 2003, tax revenue amounted to 15.3% of GDP, with the decrease primarily attributable to a reduction in the profit tax and VAT base, as compared to total federal budget revenue in the first nine months of 2002 of 16.9% of GDP.

Federal Budget Expenditure

The following table sets forth information regarding federal budget expenditure for the years 1998 to 2002 and the first nine months of 2003, including information on cash operations:

	Federal Budget Expenditure					
	Expenditure (including offsets and other monetary surrogates) (1)			Cash Expenditure ⁽²⁾		
	1998 ⁽³⁾	1999	2000	1998	1999	2000 ⁽⁴⁾ 2001 2002 2003 ⁽⁵⁾
				(millions of roubles)		
Total expenditure	422,732	678,440	1,045,661	375,395	672,221	1,045,661 1,324,307 2,012,151 1,657,385
Total expenditure net of the social tax transfer to the Pension Fund	422,732	678,440	1,045,661	375,395	672,221	1,045,661 1,324,307 1,680,547 1,385,856
Debt service	106,571	162,862	257,853	106,571	162,862	257,853 231,104 229,667 193,966
<i>of which</i>						
Domestic debt service	65,706	73,882	54,949	65,706	73,882	54,949 46,410 37,385 31,924
Foreign debt service	40,865	88,980	202,904	40,865	88,980	202,904 184,694 192,282 162,042
Non-interest expenditure	316,161	515,579	787,808	268,823	509,359	787,808 1,093,202 1,450,881 1,191,890
State administration	10,924	14,846	25,004	7,707	14,846	25,004 41,971 56,168 42,131
International activity	14,888	59,077	10,874	14,871	59,077	10,874 23,766 34,202 14,931
Law and order	37,235	60,573	113,671	32,281	59,505	113,671 160,716 209,906 177,465
Defence	65,062	115,594	191,728	47,233	112,206	191,728 247,703 295,394 242,921
National economy	27,614	41,110	71,901	20,500	40,460	71,901 134,063 178,355 128,347
Social and cultural sphere	61,682	85,139	134,288	59,196	84,702	134,288 204,129 286,720 207,250
Net credit operations	11,053	(12,487)	(53,937)	10,788	(12,487)	(53,937) (47,601) 9,863 2,262
Other expenditure	87,704	151,726	41,456	76,247	151,050	294,281 328,455 380,273 376,583
<i>of which</i>						
Budgetary funds	26,373	56,209	97,680	26,071	56,209	97,680 14,527 15,075 10,763
Transfers from federal budget	49,909	62,735	101,208	42,044	62,735	101,208 230,007 318,253 307,047
Social tax transfer to the Pension Fund	—	—	—	—	—	— 331,603 271,529
				(% of GDP)		
Total expenditure	15.4	14.3	14.3	13.7	14.1	14.3 14.6 18.5 17.1
Total expenditure not including social tax transfer to the Pension Fund	15.4	14.3	14.3	13.7	14.1	14.3 14.6 15.5 14.3
Debt service	3.9	3.4	3.5	3.9	3.4	3.5 2.6 2.1 2.0

Notes:

- (1) Based on cash or other items of value actually spent, subject to adjustment in respect of certain items of expenditure. Since 2000, the federal budget has financed all expenditure in cash.
- (2) Excludes all types of offsets. Since 2000, the federal budget has financed all expenditure in cash.
- (3) Includes monetary offsets recorded in January to March 1999 but attributable to 1998 (18.0 billion roubles).
- (4) Includes London Club restructuring.
- (5) Includes social tax transfer to the Pension Fund.

Source: Ministry of Finance.

Total federal expenditure decreased from 15.4% of GDP in 1998 to 14.6% of GDP in 2001, but then increased to 15.5% of GDP in 2002. Total expenditure amounted to 14.3% of GDP in the first nine months of 2003. These amounts reflect a gradual reduction in debt service expenditure and structural changes in non-interest expenditure. Debt service (which includes only payments in respect of discount and interest on Government debt) declined between 1998 and 2002, both in terms of GDP (3.9% of GDP in 1998 to 2.1% in 2002 and 2.0% in the first nine months of 2003) and total expenditure (25% of total expenditure in 1998 to 14% in 2002 and 14% in the first nine months of 2003). The decline in debt service is to a certain extent attributable to the Government's conservative debt and fiscal policies following the 1998 financial crisis. See "—Deficit Financing" below. Prior to 1999, non-interest expenditure reduction was pursued primarily through sequestration and accumulation of arrears. Although measures addressing the reduction of budget obligations were undertaken at that time as well, they did not have a significant effect.

In 1997, non-interest expenditure was heavily sequestered, reflecting both poor revenue performance (see "—Federal Budget Revenue") and high debt service payments attributable to the high yields prevailing in the GKO/OFZ market. See "—Deficit Financing" below. As a result of the Government's sequestering policies, overall non-interest federal budget expenditure was 14.8% of GDP in 1997 (as compared with 16.3% of GDP envisaged in the 1997 federal budget law).

At the end of 1997, the Government adopted a programme aimed at reducing the expenditure commitments of federal agencies and improving its control over their spending of budgetary funds. Under this programme, which was implemented in 1998, the Government imposed ceilings on energy and utilities expenditures, brought a number of federal agencies within the federal treasury system, carried out a full accounting of arrears owed by federal agencies and completed a census of all federal employees. Overall, the Government reduced expenditure commitments by approximately 22 billion roubles in 1998.

From 1999 to 2003, substantial progress was achieved in preparing and implementing other expenditure reforms. In 1999, the Government cleared all wage arrears of the federal budget and since that time has paid wages on time. Budgetary control has also been enhanced by the expansion of the treasury system. All federal revenues and almost all federal expenditure, together with the operations of a number of regions and extra-budgetary funds, have been included in the treasury system since the beginning of 2002.

The share of non-interest spending in federal expenditure increased from almost 76% of total cash spending in 1999 to 86% in 2002 and to 86% in the first nine months of 2003. Spending on "power" ministries (Defence and Interior) increased from 4.2% of GDP in 2000 to 4.7% of GDP in 2002 and declined to 4.3% of GDP in the first nine months of 2003. Socially related expenditure from the federal budget (such as health, education and social policy) grew from 1.8% of GDP in 2000 to 2.6% of GDP in 2002 and to 2.1% of GDP in the first nine months of 2003. Federal spending on the national economy increased from 0.8% of GDP in 1998 to 1.6% of GDP in 2002, mainly as a result of the inclusion of the expenditure of liquidated budgetary funds, which had previously been categorised as other expenditure in the form of budgetary funds. The growth of non-interest expenditure in 2002 and the first nine months of 2003 was attributable to the increase in the volume of financial aid to sub-federal budgets, including transfers from the federal budget (from 2.5% of GDP in 2001 to 2.9% of GDP in 2002 and 3.2% of GDP in the first nine months of 2003) due to higher centralisation of the budget system. See "—Federal-Local Fiscal Relations" below.

Deficit Financing

Russia inherited a significant budget deficit from the Soviet Union. In 1992, the enlarged budget deficit (comprising deficits associated with federal, sub-federal and local budgets and extra-budgetary funds) amounted to over 40% of GDP. A reduction in the enlarged budget deficit was the essential precondition for financial stabilisation, a key objective of Russia's initial economic reform programme. The enlarged budget deficit was 7.6% of GDP in 1997, 5.2% of GDP in 1998 and 1.1% of GDP in 1999. Starting in 2000, the enlarged budget has had a surplus: 3.1% of GDP in 2000 and in 2001. The federal budget surplus stood at 1.2% of GDP in 2000, up from a deficit of 1.3% of GDP in 1999. In 2001 the federal budget ran a surplus of 3.0% of GDP. In 2002, the federal budget surplus, including social tax operations, reached 1.8% of GDP. The federal primary surplus was 2.1% of GDP in 1999, 4.7% of GDP in 2000, 5.5% of GDP in 2001, 3.9% of GDP in 2002 and 4.5% of GDP in the first nine months of 2003.

Prior to 1995, non-inflationary alternatives to monetary financing of the budget deficit were not well-developed and the deficit was largely financed through inflationary means. See “Monetary and Financial System—Monetary Policy—Money Supply and Inflation.” Significant sources of non-inflationary finance were available in the period between 1995 and 1998 with the emergence of the market for state treasury bills (GKO and OFZs). As a result, monetary financing dropped to 1.6% of GDP in 1995, from 9.1% of GDP in 1994. By 1997, the Government’s stabilisation policy achieved a certain degree of success. Yields on GKO/OFZ bonds declined from more than 200% in June 1996 (when they were adversely affected by the presidential election) to 18% in September 1997. However, the Asian financial crisis and the general decline in world commodity prices at the end of 1997 caused a fall in the prices of all domestic debt instruments. Despite attempts by the monetary authorities to stabilise the situation between November 1997 and July 1998, investors gradually lost confidence in the domestic Government securities market, and following the events of 17 August 1998, the state treasury bill market closed and the value of the rouble fell.

The August 1998 financial crisis caused a significant change in the structure of the Government’s deficit financing. Prior to June 1998, GKOs and OFZs were the main sources of deficit financing. Between January and May 1998, these securities were issued only to roll over debt coming due. During the same period, GKO/OFZ issuances (net of Central Bank purchases) accounted for more than 80% of gross deficit financing, and repayment of GKO/OFZ debt held by the Central Bank exceeded by 0.7% of GDP purchases of GKOs and OFZs by the Central Bank. In June and July 1998, the Government attempted to replace domestic financing by external borrowings through Eurobond issuances and an offer to exchange new Russian Federation Eurobonds for certain short-dated GKOs. During those two months, external sources (including IMF credits) accounted for more than 60% of gross deficit financing. After August 1998, both domestic and foreign market borrowing became unavailable and monetary financing became the most important source of deficit financing, with the Central Bank financing the deficit through purchases of Government short-term debt and the extension of foreign currency credits to finance external debt payments. Between September and December 1998, monetary financing amounted to more than 80 billion roubles, accounting for 70% of gross deficit financing. Privatisation and gold sales were also important sources of financing during this period, accounting for about 17% of gross deficit financing.

The share of monetary financing in the first six months of 1999 declined from 90% of gross deficit financing in January to 75% (8.5% of GDP) in June 1999. The balance was financed through tied credits and gold sales. Monetary financing was reduced in 1999 in fulfilment of the targets set by the financial programme for 1999 as negotiated with the IMF. Starting in July 1999, the Government began to repay Central Bank credits, with gross repayments of approximately 1.4% of GDP in the second half of 1999. As a result of tight fiscal discipline in 1999, the federal budget deficit was 1.3% of GDP, while the primary surplus was 2.1% of GDP.

In 2000, the Government made significant changes in its financing structure, contributing to a surplus of 1.2% of GDP and a primary budget surplus of 4.7% of GDP, the first surplus since the break-up of the Soviet Union. Unlike the previous year, domestic financing consisted of non-monetary borrowing (short-term credits from large commercial banks and government securities issues) and sales of state assets. Declining interest rates and investor optimism enabled the Ministry of Finance to reissue GKOs, though for the purpose of creating liquidity in the banking sector, rather than as a means of deficit financing. Gross proceeds from GKO issuances in 2000 totalled 0.3% of GDP, while repayment of domestic debt exceeded borrowing by 0.4% of GDP. Increased revenue allowed the Government to finance external debt amortisation of U.S.\$7.3 billion without significant foreign borrowings. Total foreign borrowings in 2000 were only U.S.\$1.1 billion, compared to U.S.\$5.9 billion envisaged by the budget law. Proceeds from gold sales and privatisation amounted to 1.0% of GDP and comprised 27% of gross financing.

The structure of financing adopted in 2000 was maintained in 2001, when the federal surplus reached 3.0% of GDP. The 2001 budget law envisaged U.S.\$4.8 billion in foreign borrowing, mainly from international financial institutions. However, better than expected revenue performance allowed the Government to finance foreign principal debt amortisation of U.S.\$8.4 billion with only U.S.\$0.7 billion of foreign borrowing. Domestic debt policy continued to be conservative in 2001, with domestic debt amortisation exceeding borrowing by 0.3% of GDP.

Government cash balances with the Central Bank have become an important item in the financing structure. As of 1 January 2001, government discretionary cash balances were approximately U.S.\$1.2 billion. By the end of 2001 these balances had increased to approximately U.S.\$2.7 billion, creating a financial reserve for debt repayment.

In 2002, the federal surplus amounted to 1.8% of GDP, and the structure of deficit financing sources remained largely unchanged from 2001. Proceeds from privatisation amounted to only U.S.\$0.3 billion, as compared with U.S.\$1.1 billion planned in the 2002 budget. However, proceeds from privatisation for 2002 did not include approximately \$2.5 billion from the sale of part of the Government's stake in LUKoil and Slavneft, which were booked in 2003. In addition, the sale of state reserves of precious metals and stones produced net gains of 14.6 billion roubles, while foreign borrowing consisted almost entirely of tied credits (U.S.\$0.6 billion). Although the 2002 budget law provided for the issuance of up to U.S.\$2 billion of Eurobonds, none were in fact issued due to better-than-planned budget performance, with a portion of the contemplated Eurobond proceeds replaced by domestic borrowing.

In the first nine months of 2003, domestic borrowing represented an increased share of the sources of deficit financing. Net domestic borrowing amounted to 0.3% of GDP, and a substantial amount of foreign debt (equivalent to 2.8% of GDP) was redeemed. Net foreign financing represented 2.7% of GDP in the first nine months of 2003, while proceeds from privatisation amounted to 86.2 billion roubles (0.9% of GDP) and included approximately 76.7 billion roubles from the privatisation of a portion of the Government's stake in LUKoil and Slavneft, which were booked in January and May 2003, respectively. The balance of the net redemption of foreign debt was financed from the financial reserve. During the first nine months of 2003, the balance of the financial reserve declined from 228.6 billion roubles at the start of the year to approximately 141.5 billion roubles.

Privatisation revenue is classified as "deficit financing" under the international accounting methodology used herein. Prior to 1997, privatisation proceeds were of limited significance as a source of deficit financing. During 1997, however, the Government sold significant stakes in large companies at commercial auctions generating substantial proceeds. In 1997, privatisation proceeds accounted for approximately 3.4% of gross federal budget deficit financing (0.7% of GDP) and for approximately 3.5% of gross federal budget deficit financing (0.6% of GDP) in 1998. Privatisation proceeds declined sharply in 1999, to 1.8% of gross federal budget deficit financing (0.2% of GDP). In 2000, the Government's privatisation proceeds increased to 9.8% of gross federal budget deficit financing (0.4% of GDP) before declining modestly to 8.8% in 2001 (0.1% of GDP).

Foreign disbursements, including tied and untied credits but excluding IMF disbursements, were as high as 12.0% of GDP in 1992, but have since declined significantly. Foreign disbursements dropped substantially in 1993 and since then have remained low, representing only 3.4% of GDP in 1998, 1.2% in 1999, 0.4% in 2000, 0.2% in 2001, 0.6% in 2002 and 0.2% in the first nine months of 2003. Net of cash principal repayments to foreign lenders, foreign financing was 0.2% of GDP in 1999, 1.3% of GDP in 2000 (excluding London Club restructuring operations) and 2.2% of GDP in 2001 (including debt operations with the Czech Republic in December 2001).

Federal-Local Fiscal Relations

The political and economic reforms initiated at the end of 1991 established a new distribution of revenues and expenditures among the federal, sub-federal and local governments. Under this legislation, sub-federal authorities were required to set budgets based on the existing tax system, taking into account the distribution of expenditure responsibilities and revenue transfers laid down in the federal budget.

Sub-federal governments are directly assigned a specified portion of the revenue from certain taxes collected in their jurisdictions. Sub-federal governments currently receive 100% of personal income tax, 100% of property taxes, 100% of land taxes (from 2003), 50% of excise taxes on alcohol, 60% of excise taxes on gasoline, diesel fuel and motor oil (from 2003) and 100% of all other excise taxes (with the exception of excise tax on cars, and natural gas) and approximately 30% of natural resource taxes. Federation subjects do not, however, enjoy the statutory right to alter the tax base or to increase the marginal rate of these taxes. Prior to April 1999, Federation subjects were able to impose their own profit taxes at rates up to 22 percentage points above the federal rate of 13%, and were directly assigned 25% of domestic VAT revenues. The share of domestic VAT transferable to the regions was reduced to zero by 2001. As of April 1999, the upper limit of the regional profit tax was reduced to 19% (with the federal portion of the tax rate now equal to 11%) and then increased up to 24% in 2001 to compensate for the abolition of a turnover housing tax. In 2002, the federal profit tax rate was 7.5% and the maximum subfederal (regional and local) rate was 16.5%. In 2003, the federal rate was 6% and the maximum subfederal rate was 18%. In 2003, the turnover tax on road users was abolished, and regions received in exchange a portion of the excise tax on car fuel and motor oil, revenue from the new transport tax and the 1.5% increase in the share of profit tax.

The Government allocates a portion of its tax revenues to various regional support funds for redistribution to the regions. The Fund for Regional Support was established in 1994 as the primary source of federal transfers to regional governments. The revenue received by the Fund is set forth in the budget law. In 1998, actual allocations to the Fund for Regional Support were 30.1 billion roubles, representing 14.4% of total federal tax receipts, excluding import and export duties. In 1999, the Fund received 44.3 billion roubles, representing less than 10.6% of federal tax receipts, excluding import and export duties. In 2000 and 2001, the Fund received 68.0 and 103.2 billion roubles, respectively, representing slightly more than 9% of federal tax receipts, excluding import and export duties. Although federal Government transfers to the regions in 2000 and 2001 were higher than envisaged in the relevant budget laws, a reduction of the share of the Fund in additional federal tax revenue resulted in a reduction in the overall percentage of federal tax revenue transferred to the Fund in 2000 and 2001. In 2002, the Fund for Regional Support received 147.5 billion roubles, as contemplated in the 2002 budget law, representing 10.7% of federal tax receipts excluding custom duties. The 2003 budget law provided for a transfer of 173.2 billion roubles, or 11% of budgeted federal tax receipts excluding custom duties.

In 2001, a new regional support fund, the Compensation Fund, was established. The Compensation Fund provides federal subsidies to regional budgets to finance obligations under the Law On Social Protection of the Handicapped and the Law On Childhood Benefits. In 2001 and 2002, the Compensation Fund received 33.4 and 41.0 billion roubles, respectively. The 2003 budget law allocated 47.0 billion roubles to this fund. Another new fund for regional support, the Fund for Co-Financing Social Expenditure, was established in 2002. The primary aim of this fund is to improve the financing of basic public services by regional governments. This fund received 16.2 billion roubles in 2002 and 5 billion roubles in 2003.

Local budget expenditure (including expenditure financed by federal transfers and federal budget loans) was approximately 15.4% of GDP in 2002. Social expenditure by local authorities is substantial (approximately 6.9% of GDP), reflecting the transfer of social expenses from enterprises to local authorities since 1992. In 2002, local governments paid for about 71% of total public expenditure on the national economy (excluding extra-budgetary funds), 80% of education expenditure, 88% of health expenditure and 73% of all social expenditure.

Significant progress has been made in Russia in the area of federal-regional fiscal relations. All special fiscal arrangements between the regions and the federal Government were eliminated by 2001. The transfer of federal funds to the regions has become more transparent and more efficient through the creation of new funds and a reconfiguring of existing funds. In 2003, the Law on General Principles of Regional Government Organisation was amended and a new law on local self-governance was adopted. The two laws establish a clear division of spending powers among the various levels of the budgetary system. They also introduced a mechanism for transferring authority from one budgetary level to another, intended to prevent non-financed mandates and impose temporary restrictions on the budgetary powers of insolvent regional and local authorities.

Extra-Budgetary Funds

Russia had more than 60 extra-budgetary funds in 1992 and 1993, which significantly complicated fiscal management. Since that time, most of these funds have been consolidated in the federal budget. At present there are only three federal extra-budgetary funds: the Pension Fund, the Social Insurance Fund and the Medical Insurance Fund. There are also extra-budgetary funds of federal state agencies (for example, the Russian Fund for Technological Development and the Fund for the Financing of Research and Development) and regional extra-budgetary funds (for example, road funds, ecology funds and medical insurance funds). In the future, the Government plans to consolidate in the federal budget all remaining extra-budgetary funds other than the Pension Fund, the Social Insurance Fund and the Medical Insurance Fund.

The four largest extra-budgetary funds are the Pension Fund (expenditure of 789.6 billion roubles in 2002), the local road funds (expenditure of 110.1 billion roubles in 2002), the regional medical insurance funds (expenditure of 129.6 billion roubles in 2002) and the Social Insurance Fund (expenditure of 125.6 billion roubles in 2002). Together, these funds account for more than 90% of total estimated extra-budgetary expenditure. In 2002, the Pension Fund, the Social Insurance Fund and the federal Medical Insurance Fund raised approximately 30% of their revenue from a 35.6% payroll tax paid by employers. The Pension Fund also receives transfers from the federal budget, while the regional medical insurance funds receive transfers from corresponding regional budgets

and the federal Medical Insurance Fund. Revenue for the local road funds is provided by certain corporate and household taxes, as well as transfers from the regional budgets.

In general, the current extra-budgetary funds have remained broadly balanced since their creation in 1992, reflecting the stable revenue base from which they are supported. In 1995 and 1996, the Pension Fund recorded significant deficits as a result of a shortfall in revenues (due to rising unemployment and a lack of contributions from the informal private sector), a rise in the number of persons qualifying for benefits and an increase in the level of pension benefits, which are determined by reference to the minimum pension set by the Duma. The deficit was covered by loans from the federal budget and from banks. The Pension Fund surplus for 1998 was 2.4 billion roubles (0.1% of GDP).

Extra-budgetary funds ran surpluses of 1.6% of GDP in 2000 and 0.1% of GDP in 2001, were balanced in 2002 and ran a deficit of 0.5% of GDP in the first nine months of 2003. The Pension Fund ran a surplus of 1.2% of GDP in 2000, 0.2% of GDP in 2001, a deficit of 0.1% of GDP in 2002 and a surplus of 0.4% in the first nine months of 2003.

Since 2001, all social contributions have been consolidated into a single 35.6% payroll tax, referred to as the social tax. Following the adoption of pension reform measures that became effective in 2002, revenues from 14% of the social tax rate are directed to the federal budget and then transferred to the Pension Fund to finance the “basic part” of pensions. See “The Russian Economy—Pension Reform” above. As a result, a substantial portion of the obligation for pension expenditure has been transferred from the Pension Fund to the federal budget.

Tax Reform

Prior to 1999, the federal tax system consisted of a number of unconsolidated tax laws and regulations. In 1999, the general part of a new tax code, dealing with the framework of the tax system, general definitions and administrative aspects of taxation, came into force. The second part of the new tax code, dealing with VAT, excise duties, social tax, personal income tax, profit tax, resource extraction tax, sales tax and the taxation of agricultural producers, came into force in stages in 2001 and 2002. In 2003 and 2004, chapters dealing with transport tax, a simplified tax system, a unified tax on imputed income on certain types of activities and property tax came into force.

The main objectives of the Government’s tax reform programme are to reduce the total number of taxes, to improve the stability, transparency and fairness of the system through the elimination of tax exemptions, to reduce the overall tax burden and to improve tax collection.

The tax changes made effective in 2001 included the adoption of a flat personal income tax rate (13%) in place of the previous progressive scale of between 12% and 30%, although certain types of income, such as income from bank deposits with interest rates above the Central Bank’s discount rate, remain subject to tax at 35%. The tax rate for income in the form of dividends was set at 6% and the personal income tax rate for non-residents is now 30%. The introduction of a flat income tax was accompanied by the abolition of certain exemptions. The 2001 measures also unified various social contributions (38.5% of payroll for the employer, plus 1% of payroll for the employee) into one social tax at a rate of 35.6% of payroll, declining on a regressive scale to 5% (2% since 2002) of payroll for higher wages. Turnover taxes were also reduced in 2001, from 4% to 1%, and were abolished in 2003. A transport tax was introduced in 2003. Other reforms adopted in 2002 included indexing specific rates of excise taxes, replacing the fuel sales tax with excise taxes on diesel and motor oil and exempting certain items from profit tax and VAT.

Since January 2002, profit tax has been imposed at a unified rate of 24%, down from 35% generally and 43% for banks and certain types of enterprises, and the tax base and related procedures have become closer to those of market-oriented economies. In 2003 and 2004, the allocation of the profit tax was redistributed. The regional rate was raised from 14.5% to 16% in 2003 and to 17% in 2004, while the federal rate was reduced from 7.5% to 6% in 2003 and to 5% for 2004. Municipalities continue to receive 2%.

Since 2002, a resource extraction tax has replaced three taxes on natural resources, including the royalty and excise taxes on crude oil. The resource extraction tax on oil is calculated according to a formula that takes international oil prices and the rouble exchange rate into account. In 2002, certain exemptions from the profit tax and VAT (*e.g.*, medicine) were also abolished.

From 1 January 2003, a simplified tax regime was introduced for small businesses, replacing most existing taxes with a single, easily calculated tax. Under the new regime, small firms may elect to pay either 6% of sales or 15% of profits. A 1% foreign currency purchase tax was abolished from January 2003.

From 1 January 2004, the sales tax was eliminated, VAT was reduced (from 20% to 18%, though some goods retained their preferential 10% rate) and excise duties were indexed or, in the case of natural gas, abolished. Changes to the law governing Production Sharing Agreements also took effect at the start of 2004.

MONETARY AND FINANCIAL SYSTEM

The Central Bank of the Russian Federation

The Central Bank of the Russian Federation is Russia's central bank, established by the Constitution and federal law as an independent entity with specific powers and responsibilities. The primary objective of the Central Bank, specified in the Constitution, is to protect and maintain rouble stability.

Pursuant to the revised Central Bank Law enacted in April 1995, the Central Bank is charged with responsibility for protecting and ensuring the stability of the rouble, developing and strengthening Russia's banking system and ensuring the efficient and uninterrupted functioning of the settlement system. The Central Bank Law prohibits any government authority, federal or local, from interfering with activities undertaken by the Central Bank in furtherance of its constitutionally and legislatively determined responsibilities, permits the Central Bank to issue resolutions having the force of law within its area of competence and subjects all federal laws and federal executive actions that would affect the activities of the Central Bank to review by the Central Bank. The Central Bank is accountable to the Duma insofar as it is required to present an annual report of its activities to the Duma and to solicit commentary regarding its monetary policy from the Duma.

The Central Bank is also responsible for acting as the Government's banker, acting as lender of last resort to Russian credit institutions, holding most of Russia's official reserves, issuing banking licences and overseeing the bankruptcy and liquidation proceedings of credit institutions.

The Central Bank's governor, who also heads its 12-member board of directors, is nominated by the President and confirmed by the Duma. The governor is appointed for a four-year term, and under the Central Bank Law may not be dismissed except for violation of a federal law relating to the activities of the Central Bank or violation of a criminal law. Sergei Ignatiev is the current governor of the Central Bank. His term began on 20 March 2002. Members of the board of directors of the Central Bank are nominated by the Central Bank governor and confirmed by the Duma for four year terms and may be dismissed only with the approval of the governor. Board members may not be officers of the Government or members of the Federal Assembly.

The Central Bank registers and licences all credit institutions, regulates their banking activities and establishes accounting and record-keeping standards. The Central Bank also sets standards for banks with respect to minimum capital requirements, capital adequacy, loan loss provisions and exposure to individual creditors and shareholders. Compliance by commercial banks with Central Bank regulations is monitored through a reporting system, periodic inspections and requests for information. The Central Bank has a variety of sanctions at its disposal to enforce its regulations, including the power to issue warnings, demand changes in a bank's operations, impose temporary restrictions on a bank's activities, appoint a temporary administrator, impose fines and revoke banking licences.

The Central Bank also supervises acquisitions in the banking sector. Any acquisition of more than 5% of the charter capital of a credit institution requires notice to the Central Bank, and any acquisition of more than 20% requires Central Bank approval.

A new federal law on the Central Bank was enacted in 2002. The law, while preserving the independent status of the Central Bank, expanded the functions and adjusted the composition of the National Banking Committee, a supervisory board through which the Government is expected to increase its influence over the Central Bank. The Committee consists of representatives of the Government, the Federal Council, the Duma, the Presidential Administration and the Central Bank's Governor. The Central Bank's accounting rules and staff salaries are subject to the Committee's approval. As of 1 January 2003, the statutory capital of the Central Bank was increased to 3 billion roubles from 3 million roubles.

Monetary Policy

Money Supply and Inflation

The following table sets forth information concerning Russia's money supply for 1998 to 2002 and for the first eleven months of 2003:

Monetary Survey⁽¹⁾

	As of 1 January						As of 1 December
	1998	1999	2000	2001	2002	2003	2003 ⁽²⁾
	(millions of roubles, except ratio)						
Net foreign assets	10,724	(104,401)	95,349	724,014	1,092,955	1,577,804	1,969,634
Monetary authorities	43,601	(115,226)	(40,301)	511,389	876,437	1,380,486	1,929,511
Banking system	(32,877)	10,824	135,650	212,625	216,518	197,318	40,123
Domestic credit extended by the Central Bank and the banking system	690,753	1,181,360	1,607,645	1,801,980	2,288,168	2,895,063	3,481,786
Net claims on enlarged government	380,528	724,482	910,208	737,860	708,352	821,797	536,496
Claims on non-financial public enterprises	51,733	38,248	52,245	79,065	83,318	122,996	147,000
Claims on private sector	250,416	411,104	631,454	969,677	1,473,265	1,917,289	2,746,537
Claims on other financial institutions	8,077	7,526	13,738	15,378	23,232	32,980	51,753
Broad money	457,178	628,476	984,476	1,559,574	2,122,244	2,842,411	3,617,702
Money ⁽³⁾	298,223	342,653	526,373	878,920	1,192,137	1,498,005	1,898,956
Quasi-money ⁽⁴⁾	158,955	285,824	458,103	680,654	930,106	1,344,406	1,718,747
Restricted Deposits	20,605	70,720	107,865	97,682	87,357	57,842	78,556
Money market instruments	31,485	42,062	113,089	199,081	263,885	399,866	528,531
Capital accounts (capital of banking system)	216,179	276,845	423,996	547,246	751,105	1,035,180	1,253,767
Other items, net	(23,971)	58,856	73,569	122,412	156,533	137,569	(27,137)
<i>Memo:</i> ⁽⁵⁾							
Base money (national definition) ⁽⁶⁾	164,500	210,400	324,300	519,500	717,200	935,200	1,232,600
Rouble broad money (M2) (national definition) ⁽⁷⁾	374,100	448,300	704,700	1,144,300	1,602,600	2,119,600	2,821,300
Velocity of M2 ⁽⁸⁾	7.6	7.2	8.4	8.2	7.0	6.2	5.3

Notes:

(1) Certain data presented in this table differ from previously published data due to regular revisions by the Central Bank.

(2) Preliminary estimate.

(3) Comprises cash outside banks and demand deposits (other than deposits of the enlarged government) within the banking system (M1).

(4) Comprises time and savings deposits and foreign currency deposits within the banking system.

(5) Only aggregates denominated in roubles.

(6) Comprises cash outside the Central Bank and reserves of commercial banks maintained at the Central Bank.

(7) Comprises M1 and time and savings deposits in the banking sector, including deposits with credit organisations with revoked licences (M2).

(8) Average velocity based on monthly series of nominal GDP and M2.

Source: Central Bank.

The principal aim of the Central Bank's monetary policy since 1992 has been to restrain the growth of the money supply in order to curb inflation and achieve financial stabilisation. Between 1992 and 1994, achievement of this aim was hampered by the Government's lack of substantial non-inflationary sources of financing, resulting in significant monetary financing of the deficit and contributing to high levels of inflation. See "Public Finance—Deficit Financing."

After October 1994, in the wake of "Black Tuesday" (see "—Exchange Rates" below), the Central Bank succeeded in slowing the growth of the money supply. Underlying this success was the emergence in 1993 of the GKO/OFZ market as a source of non-inflationary financing (reflected in net claims on enlarged government),

followed by the enactment of amendments to the Central Bank Law in April 1995, which prohibited direct monetary financing of the budget deficit. As a result, money supply growth was relatively modest in 1995, 1996 and 1997, as reflected, among other things, in the limited growth of M2 over this period.

In the last quarter of 1997, the Asian financial crisis severely tested the stability of Russia's financial markets and the sustainability of the Central Bank's policy. Like most emerging market economies, Russia experienced significant capital outflows. These outflows caused a sharp decline in the prices of Government securities and a consequent increase in demand for U.S. dollars, while the unfavourable situation in key export markets produced a deterioration in the balance of payments, which also contributed to difficulties in the foreign exchange market.

The Central Bank responded to this pressure on both the Government securities market and the rouble by increasing the refinancing rate and the lombard rate in November 1997 and by increasing the reserve requirements for foreign currency deposits with Russian banks. When these measures proved insufficient, the Central Bank elected not to raise rates further out of concern for the stability of the banking sector and the impact on the federal budget, and instead engaged in open-market purchases of GKO's. During this period, the Central Bank also depleted its reserves in an effort to prevent the devaluation of the rouble.

The simultaneous support of both the GKO/OFZ market and the rouble soon proved to be unsustainable. The Central Bank ultimately chose to pursue exchange rate stability, tightening its monetary policy through a gradual increase in the refinancing rate, limiting the liquidity available to banks and growth in the money supply. Between January and August 1998, M2 fell by 8.2%.

The Central Bank managed to keep control over the exchange rate and inflation until July 1998. During this period, the exchange rate remained within the trading corridor set by the Central Bank and a stable rouble produced low inflationary expectations, with inflation slightly exceeding 4% in the first half of 1998.

The rouble liquidity shortage maintained by the Central Bank to suppress demand for foreign exchange inevitably had a negative effect on the interbank credit market. Starting in May 1998, interbank credit rates increased to 150% to 200%. Despite the increase in interest rates, private deposits were withdrawn from commercial banks, declining by 12.2% between June and August 1998, and savings were increasingly held in foreign currency, increasing the share of income allocated by households to foreign currency purchases from 14.1% in May 1998 to 19.2% in July 1998.

On 20 July 1998, the IMF approved an additional U.S.\$11.2 billion financing to Russia in support of its economic programme. See "Public Debt—Relations with International Financial Institutions" below. Approval of this additional financing did not, however, restore confidence in financial markets, and Russia's international reserves, as well as prices of Government securities, continued to fall. Servicing of the Government's domestic debt during this period was aggravated by the deterioration in Russian financial markets and unsatisfactory federal budget revenues. Massive interventions in the foreign exchange market in August 1998 resulted in a sharp reduction of gross international reserves, notwithstanding a U.S.\$4.8 billion drawing of IMF funds at the end of July. In mid-August, these problems became especially acute. On 17 August 1998, the Government announced that it would not meet its obligations on GKO's and certain OFZ's. The Government and the Central Bank also announced on 17 August a widening of the rouble trading corridor (which was subsequently abandoned) and a 90-day moratorium on certain hard currency payments. See "The Russian Economy—Overview of Economic Reforms."

Following the events of 17 August 1998, the Central Bank relaxed its monetary policy with a view to supporting the federal budget, as well as resolving the liquidity crunch and the crisis of the payment system. Between September and December 1998, M2 grew by 30.5%, resulting in overall growth of 19.8% at the end of 1998 as compared to year-end 1997. Beginning in the second half of 1999, monetary policy was affected by the large current account surplus. See "Balance of Payments and Foreign Trade—Balance of Payments." A massive inflow of foreign exchange associated with high export prices for oil and other commodities, combined with a devaluation-related drop in imports, created upward pressure on the rouble. During this period, the Central Bank pursued a policy of building reserves while resisting excessive real appreciation of the rouble, based on its view that high oil prices were a temporary phenomenon and its commitment to long-term rouble stability.

Large purchases of U.S. dollars by the Central Bank were a driving force behind the growth of monetary aggregates in the post-crisis period. During 1999 and 2000, M2 grew by 57.2% and 62.4%, respectively, with the rate of growth declining gradually in subsequent years. In 2003, the favourable situation on Russia's main export markets and growing confidence in the Russian economy, as well as the high profitability of the oil extracting sector, resulted in a significant inflow of foreign exchange from both export earnings and foreign investment. The general decline of the U.S. dollar against other major currencies in 2002 and 2003 also contributed to this exchange inflow. As a result of these developments, Russia experienced substantial reserve accumulation during the first nine months of 2003, as international reserves increased by U.S.\$16.6 billion. Despite the efforts of the Government and the Central Bank to sterilise excess liquidity associated with this rapid accumulation of reserves, the money supply increased by 33% from 1 January 2003 to 1 December 2003.

The upsurge in monetary aggregates had only a limited effect on inflation, as the increasing monetisation of the economy, due to rising economic activity and heightened confidence in the rouble, allowed money supply growth well above the rate of inflation.

The following table illustrates the rise in consumer and producer prices from 31 December 1997 to 31 December 2003:

Inflation: Consumer and Producer Prices

	Consumer Price Inflation (annual)	Producer Price Inflation (annual)
	(% change, end of period)	
1997.....	11.0	7.4
1998.....	84.4	23.2
1999.....	36.5	67.3
2000.....	20.2	31.6
2001.....	18.6	10.7
2002.....	15.1	17.1
2003.....	12.0	12.4

Source: Goskomstat.

In 1997, overall consumer price inflation totalled 11.0%, down significantly from the 1996 level of 21.8%. Producer price inflation was also substantially reduced, from 25.9% in 1996 to only 7.4% in 1997. Price stability was maintained in the first half of 1998 as consumer price inflation was held at slightly above 4% during the period. The decline in the value of the rouble and the increase in the money supply following the events of 17 August 1998 intensified inflationary pressures, however, and the consumer price index increased by 80% between September and December 1998, resulting in a total increase of 84.4% for the year. In early 1999, inflationary pressures were effectively reduced, and inflation fell from 8.5% per month in January to 1.2% to 1.5% per month in the last months of 1999. The inflation rate for 1999 as a whole was 36.5%.

Inflation fell further to 20.2% in 2000, to 18.6% in 2001, to 15.1% in 2002 and to 12.0% in 2003. The expansion of monetary aggregates, coupled with the gradual adjustment of prices for communal services, electricity and transport, prevented a further reduction of inflation or inflationary expectations. During 2001 and 2002, annual increases in tariffs for regulated services of 35% to 40%, as part of the Government's policy to reduce subsidies in the housing sector, was a significant factor in overall inflation. The increase in tariffs for regulated services declined to 22% in 2003, helping to reduce consumer price inflation to 12.0%, meeting the Central Bank's inflation target for the year.

Instruments of Monetary Policy

The primary instruments of monetary policy employed by the Central Bank are interest rate policy, commercial banks, open-market operations (including the purchase and sale of government securities in the secondary market), bank reserve requirements and bond issuances.

The Central Bank principally influences interest rates through its official refinancing rate and a standing Lombard-credit facility. Since it was established in 1992, the refinancing rate has generally remained above the rate available on the interbank market, and most borrowing by commercial banks has accordingly been conducted on the interbank market. The Central Bank's refinancing rate thus has not been used extensively for the financing of commercial banks and has been of importance primarily for statistical purposes and for tax, penalty and other calculations.

The Central Bank also maintains a standing lombard-credit facility under which commercial banks are permitted to borrow funds at the published discount rate against appropriate collateral. In addition to these lending facilities, the Central Bank provides overnight credits and conducts repurchase operations with GKO and OFZs, holds periodic deposit auctions to absorb excess liquidity, conducts open market operations and maintains reserve requirements.

The financial crisis of 1998 and the ensuing collapse of the GKO and OFZ markets substantially limited the range of monetary instruments available to the Central Bank. The refinancing rate was widely used as an instrument of monetary policy in the first half of 1998. Following the events of 17 August 1998, the Central Bank also employed bank reserve requirements as an important instrument of monetary policy. During the last four months of 1998, the Central Bank relaxed these reserve requirements in order to improve bank liquidity and to restore operation of the payment system. In the beginning of 1999 and again in the beginning of 2000, the Central Bank gradually raised the required reserve ratios. In both instances, the move was aimed at absorbing excess liquidity and easing pressure on the foreign exchange market and the rouble. Currently, the general reserve requirement for both hard currency and rouble deposits is 10% irrespective of the maturity of the deposit and 7% for funds borrowed from individuals in roubles. Banks that fail to meet their reserve requirements face escalating cash penalties for each day that reserves are inadequate. No interest is paid on reserve requirements or on excess reserves (correspondent accounts) held by commercial banks at the Central Bank.

In mid-1999, the Central Bank adjusted the refinancing rate in light of improving economic conditions, lowering it from 60% to 55%. During 2000, the refinancing rate was reduced from 55% to 25%, and further reduced in 2003 to 16%. From 15 January 2004, the refinancing rate was set at 14%, in line with the overnight credit and currency swap rates.

Since late 1999, large and growing current account surpluses generated strong upward pressure on the rouble and required the Central Bank to intervene heavily to prevent a large appreciation of the rouble. The Central Bank sought to offset the monetary impact of foreign exchange purchases through sterilisation mechanisms. Due to the lack of market-based instruments, the Central Bank relied mostly on a direct deposit facility. During the first half of 2000, interest rates on Central Bank deposits were comparable with inflation and commercial banks actively used these deposits to improve their returns on rouble assets, particularly in light of the lack of other rouble instruments. The gradual reduction of deposit rates in the course of 2000, as well as slightly increased inflation in the first half of 2001, made these facilities unprofitable. As a result, deposit operations did not play a significant sterilisation role in this period. Deposit operations were again used for sterilisation at the end of 2001, following a significant increase in the Central Bank's deposit rate. In 2002, the interest rate policy of the Central Bank underwent a major modification. The profitability of deposit operations was substantially reduced, while the time structure of deposits was shifted from short-term towards longer-term deposits. Excess liquidity and lack of rouble instruments forced commercial banks actively to employ deposit facilities despite a significant reduction in deposit rates.

In 2002, the Central Bank increased the range of available monetary policy tools. Currency swaps were introduced with the aim of improving short-term liquidity management and money market stability. At the same time, the Central Bank resumed repurchase agreement auctions for GKO and OFZs and launched a reverse repurchase agreement program (in which the Central Bank auctions GKO and OFZs on the basis of the terms offered for their repurchase on a date and at a price fixed in advance).

Exchange Rates

Exchange rate policy is formulated by the Government in consultation with the Central Bank and is implemented by the Central Bank.

The following table sets forth information with respect to rouble/U.S. dollar exchange rates for the years 1997 to 2003:

Official Rouble/U.S. Dollar Exchange Rates

	Average⁽¹⁾	End of Period
1997	5.79	5.96
1998	9.85	20.65
1999	24.67	27.00
2000	28.13	28.16
2001	29.17	30.14
2002	31.35	31.78
2003	30.69	29.45

Notes:

(1) Simple average.

Source: Goskomstat.

Following the dissolution of the Soviet Union, high inflation caused the value of the rouble to decline in nominal terms. From 1992 to 1995, the rouble fell in value relative to the U.S. dollar at a rate slower than the rate of inflation, thus appreciating in real terms against the U.S. dollar. This real appreciation amounted to 206% in 1993, 3.2% in 1994 and 72.2% in 1995. Although the rouble depreciated by 1.2% in real terms against the U.S. dollar in 1996, reflecting the relatively low rate of inflation for the year, in 1997 the rouble appreciated by 1.2% against the U.S. dollar in real terms, primarily due to the Central Bank's support of the rouble through market intervention and monetary policy tightening. As a result of the events of 17 August 1998, the rouble depreciated against the U.S. dollar by 246.5% in nominal terms and by 47.6% in real terms. Following a substantial depreciation during 1998 and the Central Bank's tightening of exchange rate controls, the rouble remained relatively stable in 1999, appreciating against the U.S. dollar in real terms by 2.2% while depreciating against the U.S. dollar in nominal terms by 30.8%. The strengthening of the rouble by 11.4% in real terms in 2000 and by 7.6% in real terms in 2001 was to a large extent due to the strong balance of payments and massive inflow of foreign currency during this period. In 2002, the rate of rouble appreciation slowed, and the rouble gained 6.2% in real terms. In 2003, the Central Bank revised its exchange rate policy and let the rouble appreciate against the dollar in nominal as well as in real terms. This decision reversed the Central Bank's prior policy of allowing a steady nominal depreciation, averaging around 0.5% a month, to slow the real appreciation of the rouble. As a result, during 2003, the rouble appreciated against the dollar by 19.1% in real terms, while the trade-weighted real exchange rate of the rouble increased by 4.1%.

Between 1992 and 1994, periodic fluctuations in the value of the rouble increased the uncertainty of the overall economic environment and fuelled inflationary expectations, undermining progress towards financial stabilisation. The most extreme example of these fluctuations came on 11 October 1994 (so-called "Black Tuesday"), when the rouble lost more than 25% of its value against the U.S. dollar in a single day, before rebounding to its original level in the days that followed. These events led to renewed support for a commitment to a policy of fiscal and monetary restraint. The consistent implementation of this policy, particularly after the first quarter of 1995, succeeded in stabilising the value of the rouble. From July 1995 to August 1998, the Central Bank successfully maintained the exchange value of the rouble against the U.S. dollar within a specified corridor.

The events of August 1998 forced the Central Bank to adopt a floating exchange rate regime. By sharply reducing the size of its interventions, the Central Bank effectively relied upon the market's supply and demand equilibrium to determine exchange rates. To reduce speculative demand and massive capital flight, exchange regulations were severely tightened and additional controls introduced.

Beginning in September 1998, the Central Bank undertook a series of measures aimed at restricting foreign exchange speculation and preventing capital outflow. The obligatory sale of a portion of export revenue, originally introduced in 1992, was centralised at the Moscow Interbank Currency Exchange ("MICEX"), where trading was split into two sessions: a morning session for the sale of a portion of export revenue and an afternoon session for ordinary transactions with foreign currency for banks' needs and import contracts not confirmed by the required

documentation. The Central Bank also required a 100% prepayment for any purchase of foreign exchange at the morning session. At the same time, additional restrictions were imposed on commercial banks. Foreign exchange could be purchased only for execution of clients' orders or fulfilment of foreign currency liabilities to counterparties, and banks were prohibited from having open positions in foreign currency at the end of a day.

Separation of the trading sessions on MICEX and the other currency control measures strengthened the Central Bank's regulatory function and helped to reduce demand for foreign currency. The situation, however, remained far from stable. Relatively relaxed monetary policy and lack of control over capital flows created substantial additional pressure on the foreign exchange market, while insufficient reserves forced the Central Bank to rely mostly on administrative mechanisms.

The floating exchange rate policy continued in 1999, with the Central Bank's presence in the market limited to smoothing excessive short-term fluctuations and preventing speculative attacks. At the same time, to prevent high capital outflow, the Central Bank undertook a number of measures to strengthen foreign exchange regulations. Beginning in January 1999, Russian residents were required to convert 75% of their export revenues into roubles, an increase from the 50% required previously. Strict controls also were established over purchases of foreign currency by Russian banks, and foreign banks were prohibited from purchasing hard currency with roubles in their correspondent accounts with Russian banks. In addition, Russian importers prepaying import contracts were required to create rouble security deposits with Russian banks in an amount equivalent to the value of the prepayment. These security deposits bear interest and are returnable to the importers only after delivery of the imported goods is confirmed.

As a result of these measures, the Central Bank managed to restore relative calm to the foreign exchange market. Following the devaluation of the rouble by 47% in real terms between August and December of 1998, the real value of the rouble against the U.S. dollar stabilised. Following the rouble's stabilisation and as part of the economic programme agreed with the IMF, the Central Bank took steps to liberalise the foreign exchange market. At the end of June 1999, MICEX returned to a single trading session and foreign banks were allowed to purchase hard currency with roubles in their correspondent accounts with Russian banks.

From 2000 through 2003, the U.S. dollar-rouble exchange rate was determined by supply and demand in the foreign exchange market. The Central Bank set the official exchange rate on the basis of the market exchange rate, and its efforts continued to be aimed at smoothing excessive short-term fluctuations in the U.S. dollar-rouble exchange rate and supporting Russia's international reserves. The favourable macroeconomic situation and the continued inflow of foreign exchange from export earnings allowed the Central Bank to reduce the mandatory conversion requirement from 75% to 50% of export revenue in 2001. In 2003, the upper limit of the mandatory conversion requirement was fixed by law at 30%, and the Central Bank set the mandatory conversion requirement at 25% of export revenue.

Banking

Structure of the Banking Industry

All credit institutions are required to be licensed by the Central Bank. The most comprehensive licence available is a licence for general banking, which allows a credit institution to engage in all types of banking operations in a range of prescribed currencies. Under Russian law, commercial banks holding general licences are allowed to own, underwrite and deal in all types of securities. Banks without a general licence require a separate licence to conduct foreign exchange operations.

As of 1 October 2003, there were 1,279 licensed banks and 51 non-bank credit organisations in Russia, 304 of which held general licences and 843 of which held foreign exchange licences. Licensed banks included 29 wholly foreign-owned banks and 10 banks with majority foreign ownership. Licensed foreign banks are subject to the general banking laws and regulations and are entitled to participate in the same range of banking activities as their Russian counterparts. As of 1 October 2003, there were 15 representative offices of foreign banks in Russia. The Central Bank controls Sberbank and, as a result of a transfer of ownership effected in 2003, the Government now controls Vneshtorgbank.

As of 1 October 2003, there were 3,234 branches of operating domestic banks in Russia, of which 33% are branches of Sberbank, the successor of the former state savings bank in the Soviet Union. As of the same date, Sberbank held approximately 64% of all household deposits and itself accounted for about a quarter of total banking assets. Prior to 2003, household deposits, other than deposits with Sberbank, were not guaranteed by the state. In 2003, Russia enacted a federal deposit insurance law. Under the new law, banks are required to make annual contributions to a federal deposit insurance fund in an amount equal to 0.15% of the bank's deposits. The fund will insure the full repayment of deposits up to 100,000 roubles. The state's guarantee of Sberbank's deposits will end in 2007, or earlier, if the bank's share of the retail market drops below 50%. Under the deposit insurance law, the Central Bank will confirm a bank's eligibility to participate in the deposit insurance program. The deposit insurance law is expected to enable other banks to compete more effectively with Sberbank for private household deposits.

Banking Supervision and Regulation

The Central Bank operates an early warning system under which it analyses the most significant prudential ratios for all banks on a monthly basis. Banks that fail to comply with their reporting obligations can be forced to close their correspondent accounts with other banks and make all settlements exclusively through the Central Bank. The ratios reviewed by the Central Bank include ratios relating to capital, overdue loans, open foreign exchange positions and loans to insiders. On the basis of these ratios, banks are placed in one of four groups, according to the level of risk of failure. As of 1 October 2003, there were two banks in the highest risk group and 37 in the second highest risk group, indicating a likelihood of closure without the injection of new capital. These banks are generally small and borrow in the interbank market only to a limited extent. The risk that their closure would trigger systemic failure is considered low.

Russian banks (other than Sberbank) are subject to prudential regulations intended to move the Russian banking industry toward compliance with the capital adequacy standards established by the Basel Committee on Banking Supervision. These regulations impose requirements with respect to minimum capital, capital adequacy, exposure to individual borrowers and shareholders, deposit taking and equity investments in other companies. As at 1 October 2003, five banks did not meet the applicable capital adequacy requirements, representing 0.4% of Russia's banks. These banks will be required to increase their capital, to merge or to liquidate.

The Law on Insolvency (Bankruptcy) of Credit Institutions, adopted in February 1999, established the legislative framework for the restructuring of banks. This law details standards to be used by the Central Bank in appointing temporary bank administrators, provides an expedited liquidation procedure for banks, gives the Central Bank the power to licence the receivers of bankrupt banks and to propose receivers to arbitration courts for their approval. Certain amendments were made to the Civil Code and the Central Bank Law in 1999 to help ensure the efficiency and transparency of the bank restructuring process.

The events of 17 August 1998 led to the near collapse of Russia's banking system. The decision by the Government to cease servicing its GKO and certain OFZs and to restrict GKO and OFZ trading had a significant adverse effect on the balance sheets and liquidity of Russia's most important banks. The devaluation of the rouble also made it difficult, and in many cases impossible, for Russian banks to service their hard-currency debt obligations or to meet their obligations under forward currency contracts. A number of Russia's banks were ultimately unable to honour their obligations to depositors. The economic crisis also increased the portfolio of bad debts held by Russia's banks. As a result, many of Russia's banks became insolvent, a number had their banking licences revoked and some eventually were declared bankrupt and are in the process of being liquidated.

In November 1998, the Government and the Central Bank adopted new policies with respect to the restructuring of the banking system, including the creation, in early 1999, of the Agency for Restructuring of Credit Organisations ("ARCO"). ARCO's objectives are to restore the banking system's ability to make settlements, provide credit to the economy and ensure the safety of client deposits. Under the Law on Restructuring of Credit Organisations, the Central Bank makes the initial proposal to refer particular banks to ARCO's management. The Central Bank can only select core banks with a strong regional presence that hold sizeable amounts of household deposits (at least 1% of total household deposits within Russia and 20% of household deposits within a Federation subject) and carry out extensive credit activities (at least 1% of total banking assets within Russia in the form of loans to legal persons, excluding banks, and 20% of total banking assets within a Federation subject).

Under the Law on Restructuring of Credit Organisations, the Central Bank must appoint a temporary administrator simultaneously with the Central Bank's referral of a bank to ARCO. Within a 90-day period, ARCO conducts a diagnostic examination to determine whether to accept or reject the referral. Upon acceptance, ARCO assumes legal and management control over the credit institution and may pursue various restructuring measures with a view to overcoming the institution's financial instability and restoring its solvency. These measures include the sale of assets and businesses, the negotiation of settlement arrangements with creditors, the commencement of new operations and the raising of external finance.

In 2001, the Government and the Central Bank agreed on a restructuring programme for the banking sector. The "Strategy of the Russian Federation Banking Sector Development" envisages gradual changes to the banking system. It imposes no strict deadlines and the timeframe of reforms will depend upon Russia's economic situation. The strategy contemplates that the Government will withdraw from capital ownership of commercial banks where its share is less than 25%. The remaining state-owned banks will keep their general licences. The minimum capital requirement will be increased to €5 million for new banks. Existing banks will have to increase their capital to €5 million by 2007. As of 2005, banks with a capital adequacy ratio of less than 10% (currently, the required ratio is 2%) will lose their licences. The restructuring scheme aims to preserve the status quo, postponing radical changes for several years. In 2002, the Government and the Central Bank initiated legislation aimed at improving the banking system, including action to establish a deposit insurance system, to create more favourable conditions for foreign banks and to improve the existing bankruptcy legislation. The introduction of international accounting standards in 2004 is expected to improve the overall transparency in the banking sector.

In 2002 and 2003, the Central Bank adopted regulations tightening its control over banking capital. Under the new regulations, all prudential ratios will be recommended rather than mandatory, but the adequacy of a bank's capital will be determined by the Central Bank by reference to all of the bank's prudential ratios, rather than by the mechanical application of fixed ratios, which were sometimes subject to manipulation in the past.

Foreign Exchange Regulations

As of 1 July 1996, Russia adopted Article 8 of the IMF's Articles of Agreement with respect to current account convertibility and since that time has met all obligations imposed by Article 8.

Russian currency exchange laws regulate the convertibility of the rouble. Russian residents (including Russian legal entities and organisations formed under Russian law, Russian citizens and permanent residents) may freely convert foreign currency into roubles through authorised banks. Russian residents may similarly convert roubles into foreign currency, but only if the purpose of the conversion is to settle a "current" transaction or to repay principal on a loan denominated in hard currency in circumstances where the hard-currency loan either did not require a Central Bank licence or was made on the basis of a Central Bank licence. The conversion of roubles into foreign currency in other circumstances requires a Central Bank licence. "Current" transactions include payments for imported or exported goods within 90 days of the date of sale, lending or borrowing money for terms of up to 180 days and payments of interest, dividends and certain other amounts in respect of loans, investments or securities.

Legal entities that are not Russian residents may convert foreign currency into roubles through type "N" or type "K" accounts at authorised Russian banks. Type "N" and type "K" accounts may be opened for the purposes of conducting export-import transactions, for maintaining representative offices in Russia and for the purposes of investing or reinvesting in Russia. Non-resident legal entities may also convert roubles into foreign currency for repatriation through type "K" accounts. The rules are less strict for non-residents who are natural persons.

Roubles may not be exported except with the approval of the Central Bank, the Ministry of Finance and the Customs Committee.

In July 2001, Russia relaxed its foreign exchange regulations. The currency repatriation period for proceeds from exports by machinery and construction firms' exports was extended from three months to three and five years, respectively. Individuals were allowed to transfer up to U.S.\$75,000 each year abroad without Central Bank approval for the purpose of investment in foreign equities. The range of operations that does not require any special permit from the Central Bank was expanded to include payments made by residents outside Russia for

construction, insurance and reinsurance contracts, as well as the extension of loans by non-residents to Russian residents in excess of 180 days. The process of currency operations licensing through the CBR was also simplified.

In December 2003, Russia enacted a new currency law that will significantly liberalize the existing currency regime when it comes into force in June 2004. Under the new law, only enumerated currency operations of residents and non-residents will be subject to regulation, and neither the Central Bank nor the Government may adopt currency regulations except in cases expressly prescribed by the new law. In particular, in the absence of a prescribed procedure, residents and non-residents may open bank accounts and conduct currency operations without limitation. The law further provides that all irresolvable doubts, contradictions and ambiguities in the new currency law or in any currency regulation are to be resolved in favour of residents and non-residents conducting currency operations.

The new law distinguishes between two types of capital operations, those that are regulated by the Government (principally commercial credits granted by residents to non-residents) and those regulated by the Central Bank (loans, cash transfers and securities transactions). The instruments of currency regulation include reserve requirements, use of special accounts and (as described below) the pre-registration of accounts. In general, the Government may require the deposit of up to 50% of the total amount of a covered currency transaction in a non-interest bearing account for a term of up to two years. The Central Bank may also require the deposit of capital intended to be exported from Russia for a period of up to two months, and the deposit of up to 20% of capital being repatriated to Russia for a term of up to one year. The Central Bank may also require a Russian resident or non-resident to open and maintain a special account with a Russian authorized bank (or depositary, if the settlement involves securities) for the settlement of certain enumerated transactions. All restrictions on capital operations are to be lifted in 2007.

The new law does not impose any restrictions on an individual resident's investment in foreign securities up to a maximum of U.S.\$150,000 per year. Starting in January 2005, individual Russian residents may also open accounts in foreign banks in any country that is a member of the Organization for Economic Cooperation and Development and a party to the Financial Action Task Force on Money Laundering, subject only to notification of the Russian tax authorities. Legal entities will obtain similar rights in June 2005. Russian residents desiring to open accounts in other countries will be required to pre-register their account with the tax authorities. The new law preserves until 2007 the existing obligation to convert up to 30% of export revenues into roubles.

Foreign Exchange Market

Russia's foreign exchange trading takes place in the over-the-counter interbank currency market and MICEX, with the biggest share of currency trading taking place in the over-the-counter interbank currency market.

The Central Bank buys and sells currencies through MICEX when it acts to influence exchange rates. MICEX was established in 1991 as a department of the Central Bank's Soviet Union predecessor, and was transformed in January 1992 into a closed joint-stock company. MICEX's largest shareholder is the Central Bank. Commercial banks and the Association of Russian Banks are also shareholders. Only MICEX members, which include commercial banks, financial institutions and certain other investment institutions, may participate in currency exchange trading on MICEX.

The major currency traded on MICEX is the U.S. dollar, with a trading volume of U.S.\$143 billion in 2003, accounting for more than 98% of total turnover. MICEX also trades euro and, as a result of Russia's economic re-integration with the CIS countries, CIS currencies. The CIS currencies can be converted only in countries that have a special agreement on mutual currency convertibility.

The Central Bank and MICEX have supported the establishment of a system of regional currency exchanges within Russia. There are currently seven regional exchanges. The largest regional currency exchanges are the St. Petersburg Currency Exchange ("SPCEX") and the Ural Regional Currency Exchange.

Capital Markets

Government Securities

The government rouble securities market comprises federal government rouble bonds (the largest part) and sub-federal rouble bonds. The Government's rouble securities include short-term bills ("GKOs") and medium-term bonds ("OFZs"). GKOs and OFZs are initially issued through MICEX. See "—Foreign Exchange Market" above. Secondary trading of GKOs and OFZs takes place on MICEX and its representative exchanges in the regions. GKOs and OFZs are held in book entry form, which minimizes transaction risks.

GKOs were first issued in May 1993. By mid-1998, the GKO/OFZ market was the most active and largest financial market in Russia. After the 1998 financial crisis, the market for rouble Government bonds declined and other financial markets became more important. Average daily turnover in GKOs and OFZs at MICEX was U.S.\$36 million from January to September 2003, compared to U.S.\$18 million in the comparable period in 2002. As of 1 October 2003, the par value of marketable federal government bonds was approximately U.S.\$9.6 billion.

For a detailed description of the various Government domestic debt instruments, see "Public Debt—Domestic Debt—Government Domestic Debt."

The market for sub-federal rouble bonds prior to 2002 consisted mainly of City of Moscow bonds placed and traded at MICEX and City of St. Petersburg bonds placed and traded at SPCEX, amounting to approximately 31 billion roubles (U.S.\$1.0 billion) at 1 October 2003. In 2002 and 2003, 46 of the 89 Federation subjects issued rouble bonds, with an aggregate outstanding principal amount of approximately 54 billion roubles (U.S.\$1.8 billion) at 1 October 2003.

Corporate Securities

The trading of privatisation vouchers issued in connection with Russia's mass privatisation programme, implemented between 1992 and 1994, played an important role in the development of the equity securities market in Russia. A certificateless securities system was subsequently adopted, largely in response to voucher fraud encountered in the trading of vouchers. As a result, virtually all common and preferred stock in Russia is held in book entry form, with ownership recorded in the issuer's share register.

The Russian stock market was originally based on an electronic over-the-counter trading system, the Russian Trading System ("RTS"), introduced in 1995 and managed by the National Association of Stock Market Participants, a self-regulatory body responsible for the development of rules for trading on the RTS. There are 23 licensed stock exchanges in Russia, and the share of exchange-based trading is increasing. In the first nine months of 2003, the average daily stock turnover was approximately U.S.\$260 million on MICEX, the largest Russian exchange, and roughly U.S.\$20 million on the RTS.

During the 1998 financial crisis the capitalisation of the Russian stock market declined dramatically. At the end of 1998, the market capitalisation of the RTS was U.S.\$11.1 billion. The stock market's subsequent revival increased RTS's capitalisation to U.S.\$60.6 billion by the end of 2001, to U.S.\$85.2 billion by the end of 2002 and to U.S.\$138.8 billion as of 1 October 2003. Of the largest Russian companies, only Gazprom does not have an RTS listing. In September 2003, Gazprom's market capitalisation was approximately U.S.\$30.2 billion.

The Russian corporate bond market is a fast-growing segment of the Russian financial market, but remains relatively small compared to the stock market. In 2001, 2002 and 2003, the corporate bond market broadened substantially in terms of both the number of bond issues and their tenor. New corporate bond issues typically have a tenor of from two to four years, and include an annual put back to the issuer. As at 1 October 2003, the outstanding volume of corporate bonds amounted to 151 billion roubles (U.S.\$4.9 billion). For the nine-month period ended 30 September 2003, the average daily turnover in the Russian corporate bond market (both the exchange market and over-the-counter market) was approximately U.S.\$60 million.

Regulation of the Capital Markets

The Federal Commission for the Securities Markets (the “Securities Commission”) has the primary responsibility for regulating the Russian securities market. The Securities Commission has ministerial status and is composed of an eleven-member board. The Central Bank oversees Government securities transactions (as an instrument of monetary policy), foreign investment (as a matter of currency exchange control) and securities transactions and offerings by banks (as the primary regulator of banks and pursuant to the authority granted to it by the Securities Commission).

PUBLIC DEBT

External Debt

As at 30 June 2003, the total outstanding external debt of the Government, or for which the Government has agreed to be responsible, amounted to approximately U.S.\$114.6 billion. This amount included all loans contracted or guaranteed by the Government, loans contracted or guaranteed by Vnesheconombank and debt contracted or guaranteed by other entities legally authorised to borrow on behalf of the government of the former Soviet Union, as well as outstanding arrears unpaid as at the end of June 2003. Undisbursed commitments and public or private sector borrowings not guaranteed by the Government are excluded from the U.S.\$114.6 billion outstanding at the end of June 2003. The Government incurred additional external debt of U.S.\$126 million under multilateral facilities and U.S.\$94 million from bilateral sources from July to October 2003.

The following table sets forth information with respect to the Government's external debt at period end for the years 1997 through 2002 and as at 30 June 2003:

External Debt Stock of the Government of the Russian Federation by Creditor⁽¹⁾

	As at 31 December						As at 30
	1997	1998	1999	2000	2001	2002	June
				(U.S.\$ billion)			2003
Total external debt	134.6	158.1	155.0	139.7	127.4	119.3	114.6
External debt of the Government of the Russian Federation ...	35.6	55.4	51.4	46.4	39.2	37.9	34.3
Multilateral creditors ⁽²⁾	18.7	26.0	22.4	18.9	14.9	14.0	12.5
Bonds	4.5	16.0	15.6	15.5	14.4	14.7	13.3
Official creditors ⁽³⁾	7.6	9.7	9.8	8.5	6.4	5.7	5.1
Ministry of Finance Hard Currency Bonds ⁽⁴⁾	3.5	3.5	3.5	3.5	3.5	3.5	3.5
Commercial creditors	1.3	0.2	0.1	0.0	0.0	0.0	0.0
External debt of the former Soviet Union for which the Government of the Russian Federation has agreed to be responsible	99.0	102.7	103.6	93.2	88.2	81.4	80.3
Multilateral creditors	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Bonds ⁽⁵⁾	0.1	0.0	0.0	20.9	20.9	22.3	22.3
Official creditors ⁽³⁾	56.9	59.4	58.3	58.5	53.2	48.9	49.7
Ministry of Finance Hard Currency Bonds ⁽⁶⁾	7.6	7.6	7.6	7.3	7.3	5.8	3.8
Commercial creditors ⁽⁷⁾⁽⁸⁾	34.4	35.7	37.7	6.6	6.8	4.5	4.5
<i>Memo Item:</i>							
Ministry of Finance obligations owed indirectly to the Central Bank	0.0	2.3	6.4	6.4	6.4	6.2	6.2

Notes:

- (1) Foreign currency values of outstanding external debt have been converted into U.S. dollars at the relevant market exchange rates prevailing at the end of the indicated period.
- (2) Excludes contingent liabilities amounting to approximately \$0.4 billion in the form of guarantees and counter-guarantees.
- (3) Includes government-to-government credits and official export credits.
- (4) Ministry of Finance Hard Currency Bonds, Series VI and VII (MinFins), representing Russian debt issued in 1996.
- (5) Represents outstanding 2010 Bonds and 2030 Bonds issued in exchange for London Club debt in 2000 and FTO debt in 2002.
- (6) Ministry of Finance Hard Currency Bonds, Series III, V and VIII (MinFins), representing restructured former Soviet debt. At 1 July 2003, U.S.\$349 million of MinFin IIIs had been exchanged for rouble-denominated OFZs, which are classified as internal debt and are therefore not included in the U.S.\$3.8 billion amount shown as at 30 June 2003.
- (7) Includes uninsured trade suppliers of the former Soviet Union not exchanged for 2010 and 2030 Bonds in the FTO Exchange and claims owed to IBEC and IIB.
- (8) Subject to reconciliation.

Source: Ministry of Finance, Vnesheconombank.

Of the U.S.\$114.6 billion outstanding at 30 June 2003, U.S.\$34.3 billion represents loans and bonds contracted or guaranteed by the Government since 1 January 1992. These obligations have been honoured in full.

The remaining U.S.\$80.3 billion represents external debt obligations of the former Soviet Union for which the Government has agreed to be responsible. In view of the short maturity of most of these obligations (approximately two-thirds fell due between 1992 and 1995, with more than half falling due in 1992 and 1993) and in the absence of sufficient foreign exchange to service them as scheduled, the Government was forced to restructure these obligations beginning in December 1991. Comprehensive rescheduling agreements in respect of virtually all the Soviet-era debt for which the Government has agreed to be responsible were agreed by the Government in 1996 and 1997, with the exception of the Eurobonds issued by Vnesheconombank prior to the dissolution of the former Soviet Union, which were honoured in full on their due dates.

An additional U.S.\$6.2 billion was outstanding at the end of June 2003 in respect of Ministry of Finance obligations owed indirectly to the Central Bank. These obligations arose in the absence of external sources of hard currency funding following the events of 17 August 1998.

Following the events of August 1998 and the subsequent build up of arrears on Soviet-era obligations, the objectives of the Government's external debt policy were to regularise relations with the external creditors of the former Soviet Union as rapidly as possible and to secure new restructuring agreements on terms consistent with the Government's capacity to service those obligations.

External Debt Restructuring

Paris Club

In January 1992, the Government concluded an initial annual rescheduling agreement with the Paris Club of official creditors, followed by three further annual reschedulings in 1993, 1994 and 1995, covering debt service falling due during the period from December 1991 to the end of 1995.

In April 1996, a comprehensive rescheduling was agreed with the Paris Club covering approximately U.S.\$33 billion of debt owed to Paris Club creditors, including debt service falling due between the beginning of January 1996 and the end of March 1999 and virtually all the debt rescheduled under the previous agreements. Of this amount, 45% is scheduled to be repaid over a period ending in 2020, while the remaining 55% (which includes all short-term debt owed to these creditors) will be repaid over a period ending in 2016, in gradually increasing semi-annual instalments.

In August 1999, the Government concluded a further rescheduling agreement with the Paris Club. This agreement provided for the deferral of approximately U.S.\$8.3 billion of debts owed to Paris Club creditors, including payment arrears outstanding at the end of June 1999 and debt service falling due between the beginning of July 1999 and the end of December 2000 in respect of both previously rescheduled and non-previously rescheduled Soviet-era obligations. The rescheduled principal is to be repaid in gradually increasing instalments commencing in 2002, with approximately 30% to be repaid over a period ending in 2020 and approximately 58% to be repaid over a period ending in 2016. The remaining approximately 12% was reprofiled over a period ending in 2005.

U.S.\$1.6 billion of Soviet-era obligations owed to Paris Club creditors were never rescheduled under any agreement with the Paris Club. These obligations have been almost entirely repaid.

London Club

A comprehensive restructuring agreement in respect of Soviet-era debt owed to Vnesheconombank's London Club (commercial bank and other financial) creditors was closed in December 1997. Under the terms of this agreement, the entire stock of outstanding principal owed to London Club creditors, amounting to approximately U.S.\$22.2 billion, was restructured as PRINs and the interest regarded as having accrued on this debt (net of a cash down-payment) was restructured into U.S.\$6.0 billion principal amount of IANs.

In July 2000, the Russian Federation offered to exchange Vnesheconombank's PRINs and IANs for 2030 Bonds and the interest arrears on PRINs and IANs for a combination of 2010 Bonds and cash. For each U.S.\$1,000 principal amount of PRINs tendered, a creditor received U.S.\$625 principal amount of 2030 Bonds, and for each U.S.\$1,000 principal amount of IANs tendered, a creditor received U.S.\$670 of 2030 Bonds. In August 2000, U.S.\$18.2 billion of 2030 Bonds and U.S.\$2.5 billion of 2010 Bonds were issued in exchange for PRINs and IANs, and U.S.\$275 million was paid in cash in exchange for PRIN and IAN interest arrears. A further U.S.\$129 million of 2030 Bonds and U.S.\$18 million of 2010 Bonds have been issued in subsequent re-openings of this exchange. At 1 July 2003, U.S.\$0.5 million of PRINs and U.S.\$33.5 million of IANs have not been tendered for exchange and remain outstanding.

FTO Debt

In November 2002, the Russian Federation offered to exchange 2030 Bonds and 2010 Bonds for eligible uninsured trade debt of the former Soviet Union for which the Government has agreed to be responsible ("FTO claims") on terms broadly comparable to the terms previously offered to PRIN and IAN holders. In December 2002, U.S.\$1.19 billion principal amount of 2030 Bonds and U.S.\$183.8 million principal amount of 2010 Bonds were issued in exchange for FTO claims and U.S.\$171.5 million was paid in cash. It is anticipated that the Russian Federation will in 2004 offer to exchange 2030 Bonds and 2010 Bonds on the same terms for up to approximately U.S.\$800 million of further FTO claims, following their reconciliation.

Other Former Soviet Union Debt

Following the dissolution of the former Soviet Union, the Government assumed liability for Soviet-era debts owed to the former member countries of the Council for Mutual Economic Assistance ("CMEA"). These debts relate to the CMEA trade settlement systems that were in place between CMEA member countries. Most of these debts were incurred as a result of an imbalance in the settlements in favour of the creditor country at the time of the dissolution of the CMEA and the Soviet Union. As of the end of June 2003, CMEA debt amounted to U.S.\$3.8 billion. A substantial portion of this debt will be repaid in the form of equipment, goods and services, with the balance to be repaid in cash.

The Government has also concluded negotiations with a number of non-Paris Club official creditors under which repayment is partly in the form of equipment, goods and services. The Government intends to conclude negotiations with the remaining non-Paris Club official creditors on similar terms by the end of 2004.

In 1993, the Government issued U.S. dollar denominated Internal Government Hard Currency Bonds ("OVVZs," known as "Taiga" bonds or "MinFins") to compensate Russian legal entities whose funds had been frozen in 1991 in foreign currency accounts at Vnesheconombank. MinFins were initially issued in five series, with maturities ranging between one and 15 years. Two additional series were issued in May 1996 with maturities of 10 and 15 years, respectively. All of the MinFins pay a 3% coupon annually until redemption. OVVZs trade in the over-the-counter market. The principal amount of outstanding OVVZs stood at U.S.\$7.3 billion at the end of June 2003. Historically, OVVZs were regarded as domestic public debt. Starting in 2000, they were reclassified as external debt for budgetary purposes.

On 11 May 1999, the Ministry of Finance requested the holders of U.S.\$1.3 billion aggregate principal amount of Series III MinFins maturing on 14 May 1999 not to present their bonds for redemption, pending the development of a restructuring proposal. On 14 May 1999, the Ministry of Finance paid all of the interest accrued as of that date on Series III MinFins and announced that interest on these bonds would continue to accrue at the original rate of 3% until they were restructured into new instruments. Following consultations with representative investor groups, the Government made a proposal in November 1999 to exchange all Series III MinFins for (i) new U.S. dollar denominated Government bonds with an average life of seven and a half years and bearing interest at 3% payable semi-annually or (ii) rouble denominated OFZs with maturities of four years, paying interest semi-annually at 15% in the first year, declining to 10% in subsequent periods. Under the Government's proposal, Series III MinFins were exchanged for new U.S. dollar denominated bonds at par, and for new rouble denominated bonds at par at the rate of 26.2 roubles per U.S. dollar, that being the average official exchange rate for the first week of November 1999. As of 1 July 2003, the Ministry of Finance had received applications for the exchange of

approximately U.S.\$1.235 billion face value of Series III MinFins, of which approximately U.S.\$887 million was exchanged for U.S. dollar instruments and the remaining U.S.\$349 million was exchanged for OFZs.

During 1996 and 1997, allegations were made that certain of the outstanding MinFins had been stolen. Pending determination of their ownership, interest payments on these securities were temporarily frozen. At 1 January 2004, interest payments in respect of MinFins with a face value of U.S.\$19.8 million were still frozen.

External Debt Service Projection

The following table sets forth a projection of the Government's contractual external debt service by type of creditor from 2004 to 2009, including principal and interest payable on all external debt outstanding at the end of June 2003, on the basis of the exchange rates and interest rates prevailing at that time. This table includes the contractual payments that will be due on 2010 Bonds and 2030 Bonds expected to be issued to foreign holders of IBEC Debt and IIB Debt pursuant to the exchange offer to be made by the Ministry of Finance of the Russian Federation on behalf of the Russian Federation.

This table does not reflect the external debt service (i) on any borrowings by or on behalf of the Government since 30 June 2003, which have not been significant, or (ii) on any new drawdowns on existing borrowings by or on behalf of the Government during the period covered by the table, which are expected to be significant.

External Debt Service Projections by Type of Creditor⁽¹⁾

	2004	2005	2006	2007	2008	2009
	U.S.\$billion					
Principal	6.65	8.85	7.23	7.70	9.90	4.96
External debt of the Government of the Russian Federation.....	4.65	6.56	4.02	4.14	3.74	0.81
Multilateral creditors.....	2.34	1.97	1.76	1.32	0.90	0.60
Bonds ⁽²⁾	1.18	3.71	0.00	2.40	2.50	0.00
Official creditors.....	1.13	0.88	0.50	0.43	0.34	0.22
Ministry of Finance Hard Currency Bonds ⁽³⁾	0.00	0.00	1.75	0.00	0.00	0.00
Commercial creditors.....	0.00	0.00	0.00	0.00	0.00	0.00
External debt of the former Soviet Union for which the Government of the Russian Federation has agreed to be responsible.....	2.00	2.29	3.21	3.56	6.16	4.15
Multilateral creditors.....	0.00	0.00	0.00	0.00	0.00	0.00
Bonds.....	0.01	0.00	0.62	0.81	0.81	1.41
Official creditors.....	2.00	2.29	2.16	2.30	2.50	2.74
Ministry of Finance Hard Currency Bonds ⁽⁴⁾	0.00	0.00	0.44	0.44	2.84	0.00
Commercial creditors.....	0.00	0.00	0.00	0.00	0.00	0.00
<i>Memo Item:</i>						
Ministry of Finance obligations owed indirectly to the Central Bank.....	0.70	1.20	1.70	2.60	0.00	0.00
Interest	5.35	4.98	4.45	4.29	4.01	3.53
External debt of the Government of the Russian Federation.....	1.93	1.71	1.29	1.06	0.73	0.54
Multilateral creditors.....	0.28	0.23	0.18	0.13	0.10	0.08
Bonds ⁽²⁾	1.37	1.27	0.94	0.82	0.54	0.38
Official creditors.....	0.17	0.11	0.07	0.05	0.04	0.03
Ministry of Finance Hard Currency Bonds ⁽³⁾	0.11	0.11	0.11	0.05	0.05	0.05
Commercial creditors.....	0.00	0.00	0.00	0.00	0.00	0.00
External debt of the former Soviet Union for which the Government of the Russian Federation has agreed to be responsible.....	3.41	3.28	3.16	3.23	3.28	2.99
Multilateral creditors.....	0.00	0.00	0.00	0.00	0.00	0.00
Bonds.....	1.28	1.22	1.21	1.40	1.59	1.51
Official creditors.....	2.02	1.94	1.83	1.73	1.61	1.48
Ministry of Finance Hard Currency Bonds ⁽⁴⁾	0.11	0.11	0.11	0.10	0.09	0.00
Commercial creditors.....	0.00	0.00	0.00	0.00	0.00	0.00
<i>Memo Item:</i>						
Ministry of Finance obligations owed indirectly to the Central Bank.....	0.07	0.06	0.05	0.03	0.00	0.00
Total	12.00	13.83	11.68	11.99	13.91	8.49
<i>Memo Item:</i>						
Ministry of Finance obligations owed indirectly to the Central Bank.....	0.77	1.26	1.75	2.63	0.00	0.00

Notes:

- (1) Includes contractual payments of existing obligations, as well as contractual payments of 2010 Bonds and 2030 Bonds expected to be issued to foreign holders of IBEC and IBEC Debt. Excludes payments to be made in the form of equipment, goods and services, which are likely to be significant.
- (2) Assumes that the put option on the U.S.\$2.5 billion Russian Federation Eurobond maturing in 2028 is exercised in 2008.
- (3) Ministry of Finance Hard Currency Bonds, Series VI and VII (MinFins), representing Russian debt issued in 1996.
- (4) Ministry of Finance Hard Currency Bonds, Series III, V and VIII (MinFins), representing restructured former Soviet Union debt.

Source: Ministry of Finance, Vnesheconombank.

External Borrowings

Since the dissolution of the former Soviet Union, the Ministry of Finance has borrowed externally on behalf of Russia only in respect of certain multilateral facilities, through bond issues and through certain medium and short-term financings. All other external borrowings of the Government have been implemented through Vnesheconombank, Vneshtorgbank (Russia's foreign trade bank), or Roseximbank (Russia's export-import bank), which are all authorised on a case-by-case basis to borrow externally under the guarantee of the Government and are responsible for recording and monitoring these borrowings. Borrowings by these banks under the Government's guarantee are included in the external debt statistics of the Government.

Apart from guarantees of obligations of these banks, the Government has not provided external guarantees for public or private sector entities, with the exception of certain contingent liabilities to the World Bank and EBRD amounting to approximately U.S.\$0.4 billion in the form of guarantees and counter-guarantees. No ministry, regional authority or public sector entity is authorised to borrow in its own name under a Government guarantee.

The Government has provided letters of comfort to creditors in respect of certain borrowings by the public and private sectors. These letters commit the Government to take (or refrain from taking) certain actions but do not require it to pay any funds. The Government is not the obligor in respect of such borrowings, and they are not included in the Government's external debt statistics.

The Government has paid in full all of the debt service due on borrowings contracted by the Government since 1 January 1992, including payments on the approximately U.S.\$36.9 billion aggregate principal amount of Eurobonds issued by Russia since November 1996.

Current External Debt Policy

The prime objective of the Government's external debt policy is to further reduce its outstanding stock of external debt and its external debt service to lower levels. The Government has also announced a programme to adopt the best international practices in debt management, to ensure appropriate management of its risk exposure and to reduce its debt-servicing costs while meeting the Government's fund raising targets.

Domestic Debt

The following table sets forth information with respect to Russia's domestic debt at period-end for the years 1998 to 2002 and as at 1 October 2003:

Domestic Debt of the Federal Government ⁽¹⁾

	As at 31 December					As at 1 October
	1998	1999	2000	2001	2002	2003
	(billions of roubles)					
Total	529.9	578.2	557.4	533.5	680.3	701.0
GKO.....	16.8	7.4	3.1	19.5	18.8	9.5
OFZs with variable coupon.....	0.1	0.0	24.1	24.1	24.1	24.1
OFZs with fixed rates	346.8	402.2	359.2	307.8	350.7	50.6
OFZs with fixed coupon.....	112.6	112.4	122.8	138.5	207.1	217.6
Amortising OFZs ⁽²⁾	—	—	—	—	42.3	368.8
Other	53.6	56.1	48.3	43.5	37.3	30.3
	(% of total)					
Total	100.0	100.0	100.0	100.0	100.0	100.0
GKO.....	3.2	1.3	0.5	3.7	2.8	1.4
OFZs with variable coupon.....	0.0	0.0	4.3	4.5	3.5	3.4
OFZs with fixed rates	65.4	69.6	64.4	57.7	51.6	7.2
OFZs with fixed coupon.....	21.2	19.4	22.0	26.0	30.4	31.0
Amortising OFZs ⁽²⁾	—	—	—	—	6.2	52.6
Other	10.1	9.7	8.7	8.2	5.5	4.3
	(% of GDP)					
Total	19.33	12.13	7.63	5.90	6.26	5.29
GKO.....	0.61	0.16	0.04	0.22	0.17	0.07
OFZs with variable coupon.....	0.00	0.00	0.33	0.27	0.22	0.18
OFZs with fixed rates	12.65	8.44	4.92	3.40	3.23	0.38
OFZs with fixed coupon.....	4.11	2.36	1.68	1.53	1.91	1.64
Amortising OFZs ⁽²⁾	—	—	—	—	0.39	2.78
Other	1.95	1.18	0.66	0.48	0.34	0.23
<i>Memo:</i>						
Exchange rate, rouble/U.S.\$, end of period ..	20.65	27.00	28.16	30.14	31.78	30.61
GDP (billions of roubles)	2,741	4,767	7,302	9,041	10,863	13,250
Total domestic debt of the Government						
(U.S.\$ billion)	25.7	21.4	19.8	17.7	21.4	22.9

Notes:

- (1) Certain data presented in this table differ from previously published data due to changes in the accounting methodology of the Ministry of Finance.
- (2) In accordance with the federal budget law for 2003, non-marketable rouble government bonds (fixed rate OFZs) held by the Central Bank were exchanged for amortizing OFZs with a total face value of 282.5 billion roubles in February 2003. The goal of this exchange operation was to reinforce liquidity management by the Central Bank.

Source: Ministry of Finance.

Government Domestic Debt

The Government's domestic indebtedness consists principally of GKOs and OFZs. As of 1 October 2003, the Government's domestic debt amounted to 701.0 billion roubles (U.S.\$22.9 billion), or 5.3% of estimated GDP for 2003.

GKOs are rouble denominated zero-coupon instruments with a maturity of less than one year. GKOs were first issued in May 1993 and are sold at a discount and redeemed at par. The aggregate amount of GKOs

outstanding increased steadily until the middle of 1997. A shift to medium-term borrowing and the subsequent restructuring of certain GKO and OFZ reduced the amount of GKOs outstanding. At 1 October 2003, GKOs represented about 1.4% of outstanding Government domestic debt (less than 0.1% of projected GDP for 2003).

OFZs are rouble denominated obligations with a maturity of over one year, and pay interest quarterly, semi-annually or annually. Initially issued in June 1995, OFZs (including OFZs issued in the GKO/OFZ restructuring discussed below) represented 86.7% of the Government's domestic debt (16.8% of GDP) at the end of 1998 and 94.3% of domestic debt (5.0% of projected GDP) at the end of September 2003.

OFZs were initially issued with floating coupons pegged to the average market yields of GKOs redeemable during the period beginning 30 days before and ending 30 days after the coupon payment. Floating rate OFZs represented 9.7% of total Government domestic debt at the end of 1997 and declined in importance thereafter.

In July 1997, fixed rate OFZs were introduced and have subsequently replaced floating rate OFZs. The Government issued two- and three-year fixed rate OFZs until the middle of 1998, paying annual or semi-annual interest at rates between 12% and 20% per annum. As of 1 October 2003, fixed rate OFZs represented 7.2% of the Government's domestic debt (0.4% of projected GDP).

As part of the restructuring of GKOs and certain OFZs following the events of 17 August 1998, the Ministry of Finance issued OFZs with maturities of four and five years and fixed declining coupons. Fixed coupon OFZs have since been issued with maturities varying from two to four years. As of 1 October 2003, fixed coupon OFZs comprised 31.0% of the Government's domestic debt (1.6% of projected GDP).

In May 2002, the Government issued fixed coupon amortizing OFZs (serial bonds) with maturities of 4.5 and 6 years. As of 1 October 2003, fixed coupon amortizing OFZs represented 52.6% of the Government's domestic debt (2.8% of projected GDP).

The restructuring of GKOs and certain OFZs that took place following the events of 17 August 1998 radically changed the structure of the Government's domestic debt. The restructured GKOs and OFZs were converted into medium-term bonds with fixed declining coupons, and the Government did not issue new GKOs or OFZs until December 1999. As a result, the maturity of the Government's domestic debt substantially increased.

In 2000 and 2001, net domestic borrowing was negative, contributing to a rapid decline in interest rates. As a result of subsequent improvement in market conditions, in 2002 and 2003 the Government increased the average term of its borrowing, and in 2002 and 2003 issued 10-year and 15-year amortizing bonds. As at 1 October 2003, the average maturity of the Government's marketable domestic debt was 858 days, as compared to 375 days as at 31 December 2001. GKOs and OFZs with a maturity in excess of one year represented 73% of the total stock of GKOs and OFZs as of 1 October 2003, as compared to 28% as at 31 December 1997.

Annualised yields on GKOs and OFZs were generally high from 1993 through 1996, largely due to macroeconomic and political risks. Reductions in inflation and greater control over the exchange rate reduced yields on GKOs and OFZs to approximately 19% in August 1997, though due in part to the Asian financial crisis rates subsequently increased, reaching 80% in late July 1998. Since January 1999, when secondary market trading in GKOs and OFZs resumed, yields have generally declined, to approximately 8% by October 2003.

Non-Residents' Access to Local Bond Market

Following the events of 17 August 1998 and the adoption of the restructuring scheme for GKOs and certain OFZs in early 1999, the Central Bank reintroduced additional restrictions on non-resident holders of GKOs and OFZs. Conversion of rouble investments in GKOs and OFZs was limited to foreign exchange auctions held by the Central Bank, special currency conversion GKO issues offered by the Ministry of Finance and transfers of funds from investment "S" accounts to conversion "S" accounts. The latter required funds to be deposited in non-interest bearing "transit" accounts for 365 days before repatriation.

The restrictions on repatriation of money from “S” accounts by non-residents were subsequently liberalised. Effective 15 September 2003, non-residents are allowed to transfer money from investment S accounts to conversion S accounts freely for subsequent repatriation. Certain restrictions on new foreign investment in the Government’s domestic rouble bonds were retained, however, to avoid the adverse effect of short-term capital inflows on the balance of payments and securities market.

Government Domestic Debt Service

Payments in respect of discount and interest on Government domestic debt declined from 2.4% of GDP in 1998 to 1.6% of GDP in 1999. The decrease in domestic debt service in 1998 and 1999 was attributable mainly to the restructuring of GKO and certain OFZs. In 2000, 2001 and 2002, domestic debt service declined to 0.8% of GDP, 0.5% of GDP and 0.3% of GDP, respectively, as a result of a reduction in the amount of domestic debt outstanding, GDP growth and a decline in interest rates.

Government Domestic Debt Policy

After the 1998 financial crisis, the Government’s domestic debt policy was principally aimed at restoring the domestic debt market. The Government has subsequently been able to increase the number of available domestic debt instruments and to improve their liquidity and lengthen their maturity.

Going forward, the Government intends in the medium-term to borrow domestically to repay domestic and external debt. This will lead to a moderate increase in the domestic debt stock. The Ministry of Finance also anticipates issuing new domestic debt instruments to facilitate the development of the domestic debt market. Demand for medium- and long-term debt instruments is expected to increase following the pension reforms enacted in 2001, which should lead to increased investment by pension funds and other institutional investors.

Other Public Sector Domestic Debt

Russia’s total domestic public debt includes debt of sub-federal and local governments in the form of municipal bonds and bank credits. The Government is not legally responsible for the debts of sub-federal and local governments in the absence of a Government guarantee. An estimated 232.3 billion roubles (approximately U.S.\$7.6 billion) aggregate amount of consolidated debt of Federation subjects and local authorities was outstanding at 1 October 2003 (1.8% of projected GDP). This debt consisted of guarantees (31%), loans and credits from the federal budget (24%), securities (23%) and bank credits (22%).

External Assets

Following the dissolution of the Soviet Union, the Government assumed responsibility for virtually all the external debts contracted on behalf of the government of the former USSR pursuant to agreements signed with 11 of the other former Soviet republics. In return, Russia received the right to the republics’ claims on the external assets of the former Soviet Union. These assets included claims on other countries, the majority of which are claims on less-developed countries. It has been estimated that the face value of the official credits provided to these countries amounted to less than U.S.\$100 billion. In most cases, the loans are non-performing.

In September 1997, Russia became a member of the Paris Club of official creditors. As a result, the Government now pursues its claims against debtor governments within the Paris Club framework. In connection with Russia’s joining the Paris Club, the Government agreed to reduce its claims on Paris Club debtors with the understanding that claims denominated in Gosbank roubles and transferable roubles would be converted into U.S. dollars at the rate of 0.6 Gosbank rouble and one transferable rouble per U.S. dollar, respectively. In 2001, the amount received by Russia from its government debtors totalled approximately U.S.\$2.37 billion, of which U.S.\$829 million was paid in cash and the balance in-kind. In 2002 and 2003, payments on debt owed to Russia amounted to U.S.\$806 million and U.S.\$766 million, respectively.

Relations with International Financial Institutions

The Government has in the past received financial and technical assistance from various international financial institutions, including the IMF, the World Bank and the EBRD.

In 1992, the IMF approved a stand-by arrangement amounting to approximately U.S.\$1.0 billion. This was followed by a systemic transformation facility under which drawings were made in the approximate amount of U.S.\$1.5 billion in 1993 and in roughly the same amount in 1994. A U.S.\$6.2 billion standby arrangement was approved by the IMF in 1995. In March 1996, the IMF approved a three-year EFF totalling U.S.\$10.2 billion. Drawdowns under this facility were generally conditional on Russia meeting targets with respect to certain key indicators ("performance criteria").

Significant delays in Russia's drawdowns under the EFF occurred in 1996 and 1997, caused mainly by the IMF's concerns about the Government's poor revenue performance. In February 1998, the Government and the IMF agreed on the extension of the EFF through early 2000. On 20 July 1998, the IMF Executive Board approved an additional U.S.\$11.2 billion facility in support of Russia's economic programme, of which U.S.\$4.8 billion was disbursed immediately. Despite this disbursement, Russia's financial situation could not be stabilised and the Central Bank's reserves continued to fall. After the actions taken by the Government and the Central Bank on 17 August 1998, the IMF temporarily froze its lending to Russia. Following consultations between the Government and the IMF, on 28 July 1999, the IMF approved a 17-month stand-by facility in the amount of U.S.\$4.5 billion to support the Government's economic programme in 1999 and 2000. Only one drawdown was made under this arrangement, which expired on 27 December 2000. Russia and the IMF subsequently discussed a new stand-by facility covering 2001 and a precautionary stand-by facility. After agreement had been reached on most aspects of a policy package, the Russian authorities ultimately decided not to request the precautionary stand-by facility. The IMF is currently monitoring the implementation of Russia's macroeconomic and structural policies as part of its post-programme monitoring procedure.

In June 2002, the World Bank's Board of Executive Directors approved its Country Assistance Strategy Progress Report in the Russian Federation for 2002-2004. The World Bank's assistance programme focuses on systemic and institutional reforms (including reform of public administration, tax administration, fiscal federalism, and the judicial system), while pursuing related efforts at the regional and local levels. Most of the structural reforms agreed in negotiations with the World Bank have already been incorporated into the Government's own reform programme. Implementation of structural reform is monitored by the World Bank and may be supported by future adjustment lending, depending on Russia's financing needs. Through September 2003, the World Bank had approved 58 loans in Russia, 33 of which had been implemented, directed primarily to infrastructure development and industrial restructuring. The World Bank loans represent current commitments of U.S.\$13.1 billion, of which approximately U.S.\$8.3 billion has been drawn. Disbursements of up to U.S.\$600 million per year are envisaged for 2004 and 2005, aimed at improving the business environment and enhancing competition, improving public sector management and mitigating social and environmental risks.

The EBRD has committed to 152 projects in Russia, largely in the private sector, including projects relating to the financial sector, industry, agriculture and infrastructure development, with a total investment of €4.8 billion.

FORM AND TRANSFER OF THE BONDS

Form of Bonds

All Bonds will be in definitive registered form, without interest coupons attached. Each series of Bonds offered and sold outside the United States in reliance on Regulation S will be represented by interests in one or more permanent global bonds in definitive fully registered form, without interest coupons attached (the “Unrestricted Global Bonds”), which will be deposited on or before the Settlement Date with, and registered in the name of, J.P. Morgan Bank Luxembourg S.A., as sub-common depositary for the common depositary in respect of interests held through the facilities of Euroclear Bank, S.A./N.V. (“Euroclear”) and Clearstream Banking, S.A. (“Clearstream”). A beneficial interest in an Unrestricted Global Bond may at all times be held only through Euroclear and Clearstream.

Each series of Bonds offered and sold to Qualified Institutional Buyers within the meaning of Rule 144A under the Securities Act (“QIBs”) will be represented by interests in one or more permanent global bonds in definitive fully registered form, without interest coupons attached (the “Restricted Global Bonds”), which will be registered in the name of Cede & Co., as nominee for The Depository Trust Company (“DTC”), and which will be deposited on or before the Settlement Date with JPMorgan Chase Bank, New York office, as custodian (the “Custodian”) for DTC. The Restricted Global Bonds and any Bond Certificate issued in exchange therefore (a “Restricted Bond Certificate”) will be subject to certain restrictions on transfer contained in a legend appearing on the face of such Bond set forth below.

The Unrestricted Global Bonds and the Restricted Global Bonds (each a “Global Bond” and together, the “Global Bonds”) of each series will have separate CUSIP and ISIN numbers and separate Common Codes.

All Bonds will initially be in the form of Unrestricted Global Bonds and/or Restricted Global Bonds. Bond Certificates (as defined below) will only be available in certain limited circumstances described below.

Exchange of Interests in Global Bonds for Bond Certificates

Registration of title to Bonds initially represented by a Restricted Global Bond in a name other than DTC or a successor depositary or one of their respective nominees will not be permitted in respect of a series of Bonds unless (a) such depositary notifies the Russian Federation that it is no longer willing or able to discharge properly its responsibilities as depositary with respect to the Global Bonds of that series or ceases to be a “clearing agency” registered under the United States Securities Exchange Act of 1934 (the “Exchange Act”), or is at any time no longer eligible to act as such, and the Russian Federation is unable to locate a qualified successor within 90 days of receiving notice of such ineligibility on the part of such depositary, or (b) following a failure to pay principal in respect of any Bonds of that series that is due and payable, the Fiscal Agent has received notice from the registered holder of any Global Bond of that series requesting the exchange of such Global Bond in full for individual Restricted Bond Certificates.

Registration of title to Bonds initially represented by an Unrestricted Global Bond in a name other than the sub-common depositary for the common depositary for Euroclear and Clearstream or any nominee of such sub-common depositary will not be permitted in respect of a series of Bonds unless (a) Euroclear or Clearstream is closed for business for a continuous period of 14 days (other than by reason of legal holidays) or announces an intention permanently to cease business or (b) following a failure to pay principal in respect of any Bonds of that series that is due and payable, the Fiscal Agent has received a notice from the registered holder of the Unrestricted Global Bond of that series requesting the exchange of a specified amount of the Unrestricted Global Bond of that series for individual bond certificates (the “Unrestricted Bond Certificates” and, together with the Restricted Bond Certificates, the “Bond Certificates”).

In such circumstances, the relevant Global Bond will be exchanged in full or in part, as the case may be, for Bond Certificates and the Russian Federation will, at the cost of the Russian Federation (but against such indemnity as the Registrar or any relevant Transfer Agent may require in respect of any tax or other duty of whatever nature which

may be levied or imposed in connection with such exchange), cause sufficient Bond Certificates to be executed and delivered to the Registrar for completion, authentication and dispatch to the relevant holders of the Bonds. A person having an interest in a Global Bond of the relevant series must provide the Registrar with (a) a written order containing instructions and such other information as the Russian Federation and the Registrar may require to complete, execute and deliver such Bond Certificates and (b) in the case of a Restricted Global Bond only, a fully completed, signed certificate substantially to the effect that the exchanging holder is not transferring its interest at the time of such exchange or, in the case of a simultaneous sale pursuant to Rule 144A, that the transfer is being made in compliance with the provisions of Rule 144A. Bond Certificates issued in exchange for a beneficial interest in a Restricted Global Bond will bear the legends applicable to transfers pursuant to Rule 144A, as set out under “Transfer Restrictions” herein. Such transfer restrictions will terminate with respect to each series of Bonds two years (or such other period as provided by Rule 144) after the date on which Bonds of that series which are represented by an interest in a Restricted Global Bond are last issued, assuming compliance with Condition 6(b) of the Terms and Conditions of the Bonds.

If interests in Global Bonds are exchanged for Bond Certificates in the limited circumstances where this is permitted, there will be a 15% withholding tax on interest received by holders of the Bond Certificates which are legal persons, subject to any available double tax treaty relief, and the redemption proceeds paid on Bond Certificates may be subject to taxation. See “Russian Taxation” below.

The holder of a Bond may transfer such Bond in accordance with the provisions of Condition 2 of the Terms and Conditions of the Bonds. Bond Certificates may not be eligible for trading in the DTC, Euroclear or Clearstream systems.

If principal in respect of any Bonds represented by an Unrestricted Global Bond is not paid when due and payable (but subject as provided below), the registered holder of the Unrestricted Global Bond may from time to time elect that direct enforcement rights (“Direct Rights”) against the Russian Federation will come into effect. Thereupon, each relevant holder of an account with Euroclear or Clearstream, as the case may be, shall, at the relevant time, acquire against the Russian Federation all rights (including the right to receive payments due on the Bonds) that such accountholder would have received if it had been the holder of Unrestricted Bond Certificates. Such election shall be made by the holder of the Unrestricted Global Bond by notice to the Registrar and presentation of the Unrestricted Global Bond to or to the order of the Registrar whereupon the Registrar shall reduce the principal amount of Bonds represented by the Unrestricted Global Bond entered on the Register and shall make the appropriate entry or entries on the Register to reflect that such Direct Rights have come into effect. Such Direct Rights may not be eligible for trading in the Euroclear or Clearstream systems.

No Direct Rights election may be made on or before an Exchange Date (as defined in each Unrestricted Global Bond) unless the registered holder elects in such notice that the exchange in question shall no longer take place.

Upon the transfer, exchange or replacement of a Restricted Bond Certificate bearing the legend referred to under “Transfer Restrictions,” or upon specific request for removal of the legend on a Restricted Bond Certificate, the Russian Federation will deliver only Restricted Bond Certificates that bear such legend, or will refuse to remove such legend, as the case may be, unless there is delivered to the Russian Federation and the Registrar such satisfactory evidence, which may include an opinion of counsel, as may reasonably be required by the Russian Federation that neither the legend nor the restrictions on transfer set forth therein are required to ensure compliance with the provisions of the Securities Act. Such transfer restrictions will terminate with respect to each series of Bonds two years (or such other period as provided by Rule 144) after the date on which Bonds of that series which are represented by an interest in a Restricted Global Bond are last issued, assuming compliance with Condition 6(b) of the Terms and Conditions of the Bonds.

The Registrar will not register the transfer of or exchange of interests in a Global Bond for Bond Certificates during the three Business Days ending on the due date for any payment of principal of the Bonds.

DTC, Euroclear and Clearstream Arrangements

So long as DTC or its nominee or Euroclear, Clearstream or the sub-common depositary for the common depositary or any nominee of such sub-common depositary is the registered holder of a Global Bond, DTC, Euroclear or Clearstream, the sub-common depositary or such nominee, as the case may be, will be considered the sole owner or

holder of the Bonds represented by such Global Bond for the purposes of the Fiscal Agency Agreement and the Bonds. Payments of principal, interest and additional amounts, if any, in respect of a Global Bond will be made to DTC, Euroclear, Clearstream or such sub-common depositary or nominee, as the case may be, as the registered holder thereof. None of the Russian Federation, the Exchange Agent, the Sub-Exchange Agent or any affiliate of any of them or any person by whom any of them is controlled for the purposes of the Securities Act will have any responsibility or liability for any aspect of the records relating to or payments made on account of beneficial ownership interests in a Global Bond or for maintaining, supervising or reviewing any records relating to such beneficial ownership interests.

Holders of book-entry interests in Bonds held through DTC will receive from the Fiscal Agent through DTC, to the extent received by DTC from the Fiscal Agent, all distributions of principal and interest made with respect to book-entry interests in such Bonds.

Distributions of principal and interest with respect to book-entry interests in Bonds held through Euroclear or Clearstream will be credited, to the extent received by Euroclear or Clearstream from the Fiscal Agent, to the cash accounts of Euroclear or Clearstream customers in accordance with the relevant system's rules and procedures.

Interest on the Bonds (other than interest on redemption) will be paid to the holder shown on the register maintained by the Registrar on the third Business Day before the due date for such payment so long as the Bonds are represented by a Global Bond, and on the fifteenth day before the due date for such payment if the Bonds are in the form of Bond Certificates (the "Record Date"). Trading of Bonds will therefore be net of accrued interest from the relevant Record Date to the relevant interest payment date.

The laws of some states of the United States require that certain persons take physical delivery of securities in definitive form. Consequently, the ability to transfer interests in a Global Bond to such persons may be limited. Because DTC, Euroclear and Clearstream can only act on behalf of direct and indirect participants, the ability of a person having an interest in a Global Bond to pledge such interest to persons or entities which do not participate in the relevant clearing system, or otherwise take actions in respect of such interest, may be affected by the lack of a physical certificate in respect of such interest.

The holdings of book-entry interests in the Bonds through DTC, Euroclear and Clearstream will be reflected in the book-entry accounts of each institution. The Registrar will adjust the amounts of Bonds on the Register as necessary for the accounts of (a) Cede & Co. and (b) J.P. Morgan Bank Luxembourg S.A. to reflect the amounts of Bonds held through DTC, Euroclear and Clearstream, respectively. Beneficial ownership in Bonds will be held through financial institutions as direct and indirect participants in DTC, Euroclear and Clearstream.

Interests in the Global Bonds will be in uncertificated book-entry form.

Trading between Euroclear and/or Clearstream Accountholders

Secondary market sales of book-entry interests in Bonds held through Euroclear or Clearstream to purchasers of book-entry interests in Bonds through Euroclear or Clearstream will be conducted in accordance with the normal rules and operating procedures of Euroclear and Clearstream and will be settled using the procedures applicable to conventional eurobonds.

Trading between DTC Participants

Secondary market sales of book-entry interests in Bonds between DTC participants will occur in the ordinary way in accordance with DTC rules and will be settled using the procedures applicable to U.S. corporate debt obligations in DTC's Same Day Funds Settlement System.

Trading between DTC Seller and Euroclear/Clearstream Purchaser

When a book-entry interest in Bonds is to be transferred from the account of a DTC participant holding a beneficial interest in a Restricted Global Bond to the account of a Euroclear or Clearstream accountholder wishing to purchase a beneficial interest in an Unrestricted Global Bond (subject to such certification procedures as are provided in the Fiscal Agency Agreement), the purchaser must send instructions to Euroclear or Clearstream at least one

business day prior to the settlement date. Euroclear or Clearstream, as the case may be, will instruct the common depositary to receive the beneficial interest and make payment for it. On the settlement date, the common depositary will make payment to the DTC participant's account against delivery of the beneficial interest. After settlement has been completed, the beneficial interest will be credited to the respective clearing system, and by the clearing system, in accordance with its usual procedures, to the Euroclear or Clearstream accountholder's account. The securities credit will appear the next day, European time. The cash debit will be back-valued to, and interest on the Unrestricted Global Bond will accrue from, the value date, which will be the preceding day when settlement occurs in New York. If settlement is not completed on the intended value date, that is, if the trade fails, the Euroclear or Clearstream cash debit will be valued instead as of the actual settlement date, whenever that may be.

The Euroclear or Clearstream accountholder will need to make available to its clearing system the funds necessary to process same-day funds settlement. The most direct means of doing so is to pre-position funds for settlement, either from cash on hand or existing lines of credit, as it would for any pre-settlement occurring within Euroclear or Clearstream. Under this approach, the purchasing accountholder may take on credit exposure to Euroclear or Clearstream until the beneficial interest in the Unrestricted Global Bond is credited to its account one day later. As an alternative, if Euroclear or Clearstream has extended a line of credit to the purchasing accountholder, it can elect not to pre-position funds and allow that credit line to be drawn upon to finance settlement. Under this procedure, the Euroclear or Clearstream accountholder purchasing the beneficial interest in the Unrestricted Global Bond would incur overdraft charges for one day, assuming it cleared the overdraft when the beneficial interest was credited to its account. However, interest on the Unrestricted Global Bond would accrue from the value date. Therefore, in many cases, the investment income on the Unrestricted Global Bond earned during that one-day period may substantially reduce or offset the amount of such overdraft charges, although this result will depend on each accountholder's particular cost of funds.

Because the settlement is taking place during New York business hours, the DTC participant can use its usual procedures for transferring a beneficial interest in the Global Bond to the common depositary for the benefit of the Euroclear or Clearstream accountholder. The sale proceeds will be available to the DTC seller on the settlement date. Thus, to the DTC participant, a cross-market transaction will settle no differently than a trade between two DTC participants.

Trading between Euroclear/Clearstream Seller and DTC Purchaser

Due to time zone differences in its favour, a Euroclear or Clearstream accountholder may employ customary transfer procedures when transferring a book-entry interest in an Unrestricted Global Bond to the account of a DTC participant wishing to purchase a beneficial interest in a Restricted Global Bond (subject to such certification procedures as are provided in the Fiscal Agency Agreement). The seller must send instructions to Euroclear or Clearstream at least one business day prior to the settlement date. Euroclear or Clearstream will instruct the common depositary to credit the beneficial interest in the Global Bond to the DTC participant's account and receive payment. Payment will be reflected in the account of the Euroclear or Clearstream accountholder the following day. Receipt of cash proceeds in the Euroclear or Clearstream accountholder's account will be back-valued to the value date, which will be the preceding day, when settlement occurs in New York. If the Euroclear or Clearstream accountholder has a line of credit with its clearing system and elects to draw on such line of credit in anticipation of receipt of sale proceeds in its account, the back-valuation may substantially reduce or offset any overdraft charges incurred over that one-day period. If settlement is not completed on the intended value date, that is, if the trade fails, receipt of the cash proceeds in the Euroclear or Clearstream accountholder's account will instead be valued as of the actual settlement date, whenever that may be.

For a further description of restrictions on the transfer of Bonds, see "Transfer Restrictions" below.

DTC has advised the Russian Federation that it will take any action permitted to be taken by a holder of Bonds (including, without limitation, the presentation of a Global Bond for exchange as described above) only at the direction of one or more participants in whose account with DTC interests in Global Bonds are credited and only in respect of such portion of the aggregate principal amount of the relevant Global Bonds as to which such participant or participants has or have given such direction. In the circumstances described above, DTC will surrender the Global Bonds for exchange for individual Bond Certificates, which will, in the case of Restricted Bond Certificates, bear the legend applicable to transfers pursuant to Rule 144A.

DTC has advised the Russian Federation as follows: DTC is a limited-purpose trust company organised under the laws of the State of New York, a member of the United States Federal Reserve System, a “clearing corporation” within the meaning of the New York Uniform Commercial Code and a “clearing agency” registered pursuant to the provisions of Section 17A of the Exchange Act. DTC was created to hold securities for its participants and to facilitate the clearance settlement of transactions between its participants through electronic book-entry changes in accounts of its participants, thereby eliminating the need for physical movement of certificates. DTC participants include securities brokers and dealers, banks, trust companies and clearing corporations and may in the future include certain other organisations. DTC is partially owned by some of these participants or their representatives. Indirect access to the DTC system is also available to banks, brokers, dealers and trust companies that clear through, or maintain a custodial relationship with, a participant, either directly or indirectly.

Euroclear and Clearstream have advised the Russian Federation as follows: Euroclear and Clearstream hold securities for participating organisations and facilitate the clearance and settlement of securities between their respective accountholders through electronic book-entry changes in accounts of such accountholders. Euroclear and Clearstream provide to their accountholders, among other things, services for safekeeping, administration, clearance and settlement of internationally traded securities and securities lending and borrowing. Euroclear and Clearstream interface with domestic securities markets. Euroclear and Clearstream accountholders are financial institutions such as underwriters, securities brokers and dealers, banks, trust companies and certain other organisations. Indirect access to Euroclear or Clearstream is also available to others such as banks, brokers, dealers and trust companies that clear through or maintain a custodian relationship with a Euroclear or Clearstream accountholders, either directly or indirectly.

Although the foregoing sets out the procedures of DTC, Euroclear and Clearstream to facilitate transfers of beneficial interests in Global Bonds among participants and accountholders of DTC, Euroclear and Clearstream, none of DTC, Euroclear or Clearstream is under any obligation to perform or continue to perform such procedures, and such procedures may be discontinued at any time. Neither the Russian Federation nor any agent of the Russian Federation nor any person by whom any of them is controlled for purposes of the Securities Act will have any responsibility for the performance by DTC, Euroclear or Clearstream or their respective direct or indirect participants or accountholders of their respective obligations under the rules and procedures governing their operations or the sufficiency for any purpose of the arrangements described above.

While a Global Bond is lodged with DTC or the Custodian, Bonds represented by individual Bond Certificates will not be eligible for clearing or settlement through DTC. While a Global Bond is lodged with Euroclear or Clearstream or the sub-common depository for the common depository for Euroclear or Clearstream, Bonds represented by individual Bond Certificates will not be eligible for clearing or settlement through Euroclear or Clearstream.

TRANSFER RESTRICTIONS

Transfers of interests in Global Bonds within DTC, Euroclear and Clearstream will be in accordance with the usual rules and operating procedures of the relevant system.

A beneficial interest in a Restricted Global Bond may be transferred to a person who wishes to take delivery of such beneficial interest through an Unrestricted Global Bond only upon receipt by the Registrar of a written certification from the transferor (in the applicable form provided in the Fiscal Agency Agreement) to the effect that such transfer is being made to the Russian Federation or an affiliate of the Russian Federation or in accordance with Regulation S or Rule 144 (if available) under the Securities Act.

In respect of any such transfer as is referred to above, the transferee must give details of the accounts at Euroclear and Clearstream, as the case may be, and DTC to be credited or debited, as the case may be, with an interest in the relevant Global Bond.

With respect to each series of Bonds, transfer restrictions will terminate two years (or such other periods as provided by Rule 144) after the date on which Bonds of that series which are represented by an interest in a Restricted Global Bond are last issued, assuming compliance with Condition 6(b) of the Terms and Conditions of the Bonds.

Any beneficial interest in either a Restricted Global Bond or an Unrestricted Global Bond that is transferred to a person who takes delivery in the form of a beneficial interest in the other Global Bond will, upon transfer, cease to be a beneficial interest in such Global Bond and become a beneficial interest in the other Global Bond and, accordingly, will thereafter be subject to all transfer restrictions and other procedures applicable to a beneficial interest in such other Global Bond for so long as such person retains such an interest.

The Bonds are being offered and sold in the United States only to QIBs. Because of the following restrictions, purchasers of Bonds offered in the United States are advised to consult legal counsel prior to making any offer, resale, pledge or transfer of such Bonds.

Each purchaser of Bonds offered hereby other than in reliance on Regulation S will be deemed to have represented, agreed and acknowledged as follows (terms used herein that are defined in Rule 144A are used herein as defined therein):

- (a) The purchaser is (1) a QIB and (2) acquiring the Bonds for its own account or for the account of a QIB.
- (b) The purchaser understands that the Bonds have not been and will not be registered under the Securities Act and may not be offered, resold, pledged or otherwise transferred except in accordance with the legend set forth below.
- (c) Each Restricted Global Bond and any Restricted Bond Certificates offered hereby will bear a legend to the following effect, unless the Russian Federation determines otherwise in accordance with applicable law:

THIS BOND HAS NOT BEEN AND WILL NOT BE REGISTERED UNDER THE U.S. SECURITIES ACT OF 1933, AS AMENDED (THE "SECURITIES ACT"), OR WITH ANY SECURITIES REGULATORY AUTHORITY OF ANY STATE OR OTHER JURISDICTION OF THE UNITED STATES AND MAY NOT BE OFFERED, RESOLD, PLEDGED OR OTHERWISE TRANSFERRED EXCEPT (1) TO THE RUSSIAN FEDERATION OR AN AFFILIATE OF THE RUSSIAN FEDERATION, (2) IN ACCORDANCE WITH RULE 144A UNDER THE SECURITIES ACT TO A PERSON THAT THE HOLDER REASONABLY BELIEVES IS A QUALIFIED INSTITUTIONAL BUYER WITHIN THE MEANING OF RULE 144A PURCHASING FOR ITS OWN ACCOUNT OR FOR THE ACCOUNT OF A QUALIFIED INSTITUTIONAL BUYER, (3) IN AN OFFSHORE TRANSACTION IN ACCORDANCE WITH RULE 903 OR RULE 904 OF REGULATION S OR (4) PURSUANT TO AN EXEMPTION FROM REGISTRATION UNDER THE SECURITIES ACT PROVIDED BY RULE 144

THEREUNDER (IF AVAILABLE), IN EACH CASE IN ACCORDANCE WITH ANY APPLICABLE SECURITIES LAWS OF ANY STATE OF THE UNITED STATES. NO REPRESENTATION CAN BE MADE AS TO THE AVAILABILITY OF THE EXEMPTION PROVIDED BY RULE 144 UNDER THE SECURITIES ACT FOR RESALES OF THIS BOND.

The Russian Federation and its affiliates and others will rely upon the truth and accuracy of the foregoing acknowledgements, representation and agreements.

No Bonds will be offered, sold or delivered, and no copies of these Listing Particulars or any other document relating to the Bonds will be distributed, in Italy other than to professional investors (*investitori professionali*), as defined in Article 31, paragraph 2 of *Commissione Nazionale per le Società e la Borsa* (“CONSOB”) Regulation No. 11522 of 1 July 1998, and in accordance with Italian securities, banking, tax and exchange control and all other applicable laws and regulations. The Bonds may not be placed, sold or offered in the primary or the secondary market to individuals resident in Italy.

RUSSIAN TAXATION

General

The following is a summary of certain Russian tax considerations relevant to the ownership and disposition of Bonds. This summary is based on the laws of the Russian Federation, including administrative regulations and interpretations, in effect on the date of these Listing Particulars.

Unless specifically indicated otherwise, this summary is limited to the tax treatment of “non-resident holders” of Bonds. For these purposes, “a non-resident holder” is a legal person or organisation that is not organised under Russian law and holds and disposes of Bonds otherwise than through a permanent establishment in the Russian Federation. Generally, a legal person or organisation will not have a permanent establishment in the Russian Federation if it does not have a branch, representative office, division, office, bureau, agency or other separate division or place of economic activity through which it conducts business on a regular basis within the Russian Federation. A holder of a Bond will not be deemed to have a permanent establishment in Russia solely by virtue of having acquired a Bond.

This summary does not address the availability of, or procedures for claiming, double tax treaty relief, the practical difficulties involved in claiming such relief, or the applicability of, or procedures in relation to, taxes levied by regions, municipalities or other non-federal level authorities of the Russian Federation. Prospective investors should consult their own tax advisors regarding an investment in Bonds.

The substantive provisions of Russian tax law are subject to more rapid and unpredictable change and to greater inconsistency than is generally the case in jurisdictions with more developed capital markets. The tax system of the Russian Federation has recently been fundamentally reorganised. As a result of this reorganisation, a substantial portion of the tax legislation of the Russian Federation has been changed and the prior array of tax laws has been unified into a single Tax Code. As discussed below, these changes have affected the tax treatment of Bonds and the ownership and disposition of Bonds.

Many aspects of current Russian tax law applicable to the ownership and disposition of Bonds are subject to significant uncertainty. Prior to the adoption of the Tax Code, certain of these issues were addressed by Regulation No. BG-4-06/1n of 12 July 2000, approved by the Ministry of Taxes and Duties of the Russian Federation and agreed by the Ministry of Finance (the “Tax Regulations”). Although the Tax Regulations were issued and approved by the Federal authorities now responsible for the administration of the Tax Code, and have not been withdrawn, the Tax Regulations have not been updated since the passage of the Tax Code and would not in any event be regarded by a Russian court as having the status of law. By letter dated 8 July 2003, the Ministry of Finance requested, and by letter dated 22 December 2003, the Ministry of Taxes and Duties of the Russian Federation confirmed, that the Tax Regulations will apply to the Bonds to be issued in the Offering, except to the extent the Tax Regulations contradict provisions of the Tax Code that have taken effect after the Tax Regulations were issued. The Tax Code does not contradict the provisions of the Tax Regulations described herein.

Interest on Bonds

The Tax Regulations describe the treatment of interest payments made in respect of Bonds that are held in global form. Although the Tax Regulations have not been updated following the adoption of the Tax Code, the Tax Regulations should continue to apply to the payment of interest in respect of the Bonds that are held in global form.

The Tax Regulations state that if (i) the Bonds are evidenced by a global certificate held by a clearing or depositary organisation which is a resident of a state that is a party to a treaty with the Russian Federation on the avoidance of double taxation and (ii) the treaty provides that residents of that other state are exempt from Russian tax on interest income, then the clearing or depositary organisation will be treated as a qualifying resident of that other state and will be the beneficial owner of the interest payments made on such Bonds for purposes of such treaty. Under these circumstances, the Tax Regulations further provide that no income tax will be withheld from the interest payments made on such Bonds if, prior to the first interest payment on the Bonds, a certification is filed with the Russian tax authorities confirming that the clearing or depositary organisation is a resident of that other state and the terms of the Bonds provide that organisations resident in the Russian Federation may not receive interest on the Bonds in any form.

The Tax Regulations do not contain a definition of “clearing or depositary organisation” or “Russian resident” or any guidance on the form of confirmation which will be regarded as satisfactory by the relevant tax authorities in the Russian Federation. The Tax Regulations also do not contemplate that Bonds will be evidenced by two or more global bonds or that interest payments that would have been due on Bonds prior to the Settlement Date if the Bonds had been then outstanding will be made on the Settlement Date.

The Bonds will be represented by two or more Global Bonds as described above in “Form and Transfer of Bonds.” The Global Bonds will be registered in the name of Cede & Co. (as nominee for DTC) and J.P. Morgan Bank Luxembourg S.A. (as sub-common depositary for the common depositary). Condition 7(c) of the Terms and Conditions of the Bonds provides that Russian residents, other than individuals, are not permitted to receive interest payments on the Bonds. On or prior to the first interest payment in respect of the Bonds, the Ministry of Finance will certify to the appropriate tax authorities (based on a certification made to it by DTC and the sub-common depositary) that the Global Bonds are being held by DTC and the sub-common depositary as clearing or depositary organisations and that DTC and the sub-common depositary are residents of a state that is party to a double taxation treaty of the type referred to above.

Based on the Tax Regulations, interest on the Bonds should not be subject to Russian profits tax or, under the circumstance described above, income tax, whether imposed directly or by withholding so long as the Bonds are represented by Global Bonds in the manner described above.

If the Bonds cease to be held in the form of a global certificate by a clearing or depositary organisation at any time, the exemption from withholding tax referred to in the Tax Regulations will not be available. Accordingly, if interests in the Global Bonds are exchanged for Bond Certificates in the limited circumstances where this is permitted (see “Form and Transfer of Bonds—Exchange of Interests in Global Bonds for Bond Certificates”), there will be a 15 percent withholding tax on interest received by non-resident holders, subject to any available double tax treaty relief.

Interest payments on Bonds will also be subject to a 15 percent withholding tax if the Regulations were held not to apply to Bonds in the manner described above, or if the Tax Regulations were to be repealed.

Condition 8 of the Terms and Conditions of the Bonds contains a provision requiring the Russian Federation to increase the payment of principal or interest in respect of the Bonds if in certain cases Taxes (as defined therein) are withheld or deducted from such payment. Contractual provisions for the payment by one party of a tax levied on another party may generally not be enforced in the Russian Federation. The Tax Regulations, however, state that an agreement may include provisions relating to the increase of amounts payable, including interest, by one party in the event additional tax obligations are imposed after the date of the agreement.

If Bonds are sold or disposed of by a non-resident holder between coupon payment dates to (i) a legal person or organisation organised under Russian law, (ii) a foreign legal entity’s permanent establishment within the Russian Federation, or (iii) an individual entrepreneur resident in the Russian Federation for tax purposes, then the sale proceeds attributable to accrued but unpaid interest will be treated as an interest payment to the seller and will not be eligible for the beneficial treatment provided by the Tax Regulations for interest payments made to the nominee for DTC or the nominee for the sub-common depositary. Under these circumstances, the purchaser of the Bond would be required to withhold 15 per cent of the purchase price attributable to accrued but unpaid interest from the proceeds payable to the seller, subject to applicable double tax treaty relief.

Disposal or Redemption of Bonds

Under the Profits Tax Chapter of the Tax Code, a foreign legal entity is subject to profits tax on income from the sale of Bonds only if the sale is effectively connected with a permanent establishment of the seller in the Russian Federation. Therefore, no Russian tax will be due on a sale of Bonds by a non-resident holder.

Other Taxes

Payments made in respect of Bonds will not be subject to value added tax.

Securities tax, if any, on the issue of Bonds will be payable by the Russian Federation. No securities tax will be payable on a sale or other disposal of Bonds.

The housing fund maintenance tax and road users' tax previously applicable in the Russian Federation have been abolished.

No property tax will be payable in respect of Bonds.

Except as described in these Listing Particulars, including as set forth below under "General Information" (i) no federal stamp, registration, documentary or similar federal taxes are payable in the Russian Federation by reason of the issue of the Bonds or in relation to any enforcement proceedings in respect of Bonds brought in Russian courts, (ii) non-resident holders of Bonds will not incur any federal tax on income or capital gain, stamp duty, registration, transfer or other similar federal taxes by reason only of the acquisition, ownership or disposal of Bonds and (iii) all payments by the Russian Federation of principal and interest on Bonds to non-resident holders may be made without withholding or deduction for or on account of any other federal taxes, duties, assessments or governmental charges in the Russian Federation.

GENERAL INFORMATION

1. The Bonds will be accepted for clearance through DTC, Euroclear and Clearstream. The CUSIP numbers, ISIN numbers and Common Codes of the Bonds are as follows:

	<u>2030 Bonds</u>		<u>2010 Bonds</u>	
	<u>Restricted Global Bonds</u>	<u>Unrestricted Global Bonds</u>	<u>Restricted Global Bonds</u>	<u>Unrestricted Global Bonds</u>
CUSIP	78307ACZ4	X74344DM5	78307ACY7	X74344DL7
ISIN.....	US78307ACZ49	XS0114288789	US78307ACY73	XS0114295560
Common Code.....		11428878		11429556

The Bonds represented by interests in the Restricted Global Bonds have been accepted for trading in PORTAL. The PORTAL reference numbers are RUSFNP30 for the 2030 Bonds and RUSFNP10 for the 2010 Bonds. The 2010 Bonds and the 2030 Bonds will be fully fungible with the bonds currently outstanding as of the Settlement Date.

2. Application has been made to list the Bonds issued in the Offering on the Luxembourg Stock Exchange. So long as either series of Bonds is listed on the Luxembourg Stock Exchange and the rules of the Luxembourg Stock Exchange so require, the Russian Federation will maintain a paying agent and transfer agent in Luxembourg with respect to that series. Copies (and English translations where the documents in question are not in English) of the following documents with respect to each series of Bonds may be inspected during usual business hours on any weekday (Saturdays, Sundays and public holidays excepted) at the offices of the Paying Agent in Luxembourg so long as any Bonds of that series are listed on the Luxembourg Stock Exchange:

- 2.1 The Fiscal Agency Agreement, which includes the forms of the Global Bond and the Bond Certificate;
- 2.2 The authorisations referred to in item 4 below; and
- 2.3 The Deed of Covenant.

3. The Russian Federation will obtain prior to the Settlement Date all necessary consents, approvals and authorisations in the Russian Federation (other than annual budget appropriations for years subsequent to 2004) in connection with the issue of, and performance of its obligations under, the Bonds and the Deed of Covenant.

4. The issue of the Bonds and the execution of the Deed of Covenant were authorised pursuant to Federal Law No. 136-FZ of 29 July 1998, Government Resolution No. 478 of 23 June 2000, Government Resolution No. 426 of 14 June 2002 and Government Resolution No. 764 of 19 December 2003.

5. The Central Bank has confirmed by letter No. 09-39/2993 of 6 July 2000 that (i) the Ministry of Finance may issue the Bonds in foreign currency without the consent of the Central Bank, (ii) it will not impose any limitations on the making of payments on the Bonds to non-Russian residents outside of the Russian Federation, (iii) it does not object to the fulfilment in foreign currency by the Ministry of Finance of its payment obligations to the Fiscal Agent and (iv) with the consent of the Customs Committee, it does not object to the export by the Ministry of Finance of the Global Bonds representing the Bonds.

6. The Russian Federation is not involved in any litigation or arbitration proceedings relating to claims or amounts which are material in the context of the issue of the Bonds nor so far as the Russian Federation is aware is any such litigation or arbitration pending or threatened.

7. Article 1210 of the Civil Code provides that the parties to any foreign economic transaction may choose the governing law of the relevant transaction. Article 1210 will apply with respect to the choice of English law to

govern rights and obligations in respect of the Bonds in the case of any Bond held by a foreign person. There is no express provision of Russian law that permits a choice of governing law for a transaction to which all the parties are Russian persons. Accordingly, it is uncertain whether the choice of English law to govern rights and obligations in respect of the Bonds would be given effect by a court of the Russian Federation in the case of a Bond held by a Russian person.

8. Under current Russian Federal law, state duty may be payable upon the initiation of any action or proceeding arising out of the Bonds in any court of the Russian Federation. In the case of an action or proceeding initiated in a court of general jurisdiction such duty may be a proportion of the amount of the relevant claim. State duty will also be payable upon an action or proceeding initiated in an arbitration court.

9. The Russian Federation has not waived any rights to sovereign immunity it may have in any jurisdiction. Accordingly, the Russian Federation may be entitled to immunity from suit in any action or proceeding arising out of the Bonds and the Russian Federation and its assets, properties and revenues may be entitled to immunity in any enforcement action. In addition, the Russian Federation has not submitted to the jurisdiction of any court, agreed that disputes may be resolved in any forum or appointed any agent for service of process in any jurisdiction in connection with any action or proceeding arising out of the Bonds. Accordingly, holders of Bonds may have difficulty obtaining effective redress in connection with the Russian Federation's obligations under the Bonds.

10. Enforceability in the Russian Federation of a final judgement for the payment of a sum of money rendered by a court in any jurisdiction other than the Russian Federation will be recognised by a court of the Russian Federation as a basis upon which to approve enforcement of a judgement against the Russian Federation or its assets, properties or revenues in the Russian Federation provided that there exists an international treaty between the Russian Federation and the country where the foreign judgement was rendered concerning the recognition and enforcement of judgements in civil cases and, unless such international treaty otherwise provides, provided that the relevant requirements set forth in Article 409 of the Civil Procedure Code, dated 14 November 2002, and any other relevant law, decree or regulation of the Russian Federation are met. No international treaty exists between the Russian Federation and the United Kingdom or the United States of America concerning the recognition and enforcement of judgements in civil cases. Accordingly, it is unlikely that a court of the Russian Federation would recognise or enforce such a judgement without re-examination of the issues. Moreover, a court of the Russian Federation may refuse or limit enforcement of a foreign judgement, *inter alia*, on public policy grounds and may seek to decline jurisdiction over a dispute arising out of an agreement governed by foreign law.

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