

RUSSIAN ECONOMIC REPORT

March 2005

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INTRODUCTION

This issue of the RER combines an analysis of recent developments in the Russian economy with discussions of two critical issues for economic policy: achieving diversified growth and accession to the World Trade Organization. The conclusions are rather optimistic. There is much that the Russian government can do to ensure sustainable and diversified growth, and this would not require a substantial change in course from the basic reform and policy strategy that has been pursued by the government since 2000. The draft Medium Term Social and Economic Program of the Government appears to be a promising document in this regard. An analysis based on a computable general equilibrium model of the Russian economy confirms that WTO accession should benefit the vast majority of households in the country, including the poor.

I. RECENT ECONOMIC DEVELOPMENTS

The Russian economy continues to grow at a rapid pace. Official figures for growth in GDP and industrial production for 2004 (7.1 and 7.3 percent, respectively) were higher than widely expected. Real incomes increased by an estimated 7.8 percent in 2004, and poverty rates have declined further. Inflows of foreign direct investment reached record levels of USD 9.4 billion for the year. Foreign inflows also contributed to higher inflationary pressures since the second half of 2004; CPI inflation (11.7 percent) exceeded its planned annual target of 10 percent. The federal budget ran a record surplus in 2004 of 4.2 percent of GDP. The performance of the economy in early 2005 remains strong. In the light of the positive macroeconomic trends, responsible macroeconomic policy, and a rapidly improving debt position, Standard and Poor's recently joined Fitch and Moody's in granting Russia an investment rating.

Although recent data on industrial production has been difficult to interpret, the slowdown in economic growth in many sectors noted in the previous Russian Economic Report (RER 9) apparently continued in the fourth quarter of 2004, and has carried into 2005. This slowdown appears linked to more rapid increases in production costs than productivity in 2004, as well as to capacity constraints and remaining high uncertainty in relations between government and business. Some declarations by the Kremlin in 2005 indicate possible growing concern for improving the investment climate in the economy, although business expectations will depend critically on the government building a more positive reputation in practice. Debates within the Russian government continue over alternative uses for surplus revenues that are accumulating in the Stabilization Fund. The draft Medium Term Economic Program of the government gives high priority to structural reforms in the social sphere, although fallout from problems in the monetization of social benefits in early 2005 may complicate the realization of these measures.

Table 1: Growth in the Russian Economy

	2002	2003	2004
GDP	4.7	7.3	7.1
Industry	3.7	7.0	7.3
Agriculture	1.5	1.3	1.6
Retail trade	9.3	8.4	12.1
Construction	3.9	12.8	10.1
Transport	5.9	7.7	6.3

Source: Rosstat

GDP and Industrial Production

The previous Russian Economic Report of November 2004 noted a marked slowdown in industrial growth in the third quarter of 2004, and suggested that a rapid rise in production costs in the first half of the year may have been partly responsible for this trend. Preliminary figures showed a continuation of the industrial slowdown in the fourth quarter of 2004. Yet the announced annual official figures for growth in GDP and industrial production (7.1 and 7.3 percent) were higher than widely expected. Furthermore, the State Statistical Service, Rosstat, has recalculated industrial statistics according to a new classification system under which the previously documented aggregate industrial slowdown in the second half of 2004 virtually disappears.¹ The breakdown of the new industrial data actually show an acceleration in growth in manufacturing in the second half of 2004, in stark contrast to previous figures, while resource extraction exhibited a slowdown (Table 2)

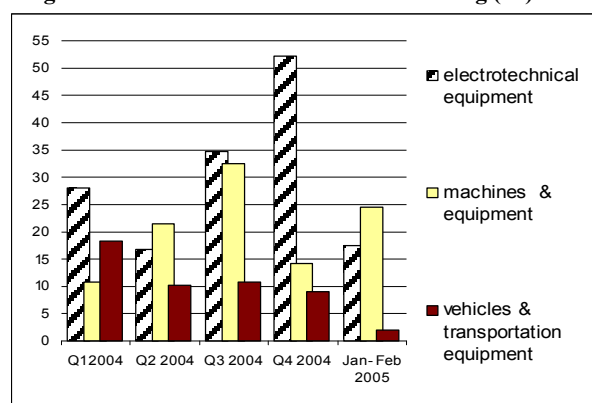
Table 2. Growth Rates in Industry (% to the same period of previous year)

	Q1 2004	Q2 2004	Q3 2004	Q4 2004	2004	Jan-Feb 2005
Total industrial production:						
“Old” data	7.6	7.1	4.8	4.8	6.1	
“New” data	7.4	7.2	7.5	7.1	7.3	3.9
of which:						
Extraction of mineral resources	8.4	8.1	5.3	4.6	6.5	2.3
Manufacturing	9.6	7.6	9.6	9.8	9.2	5.9
Electricity, gas and water	-1.4	2.5	0.1	0.2	0.1	0.9

Source: Rosstat

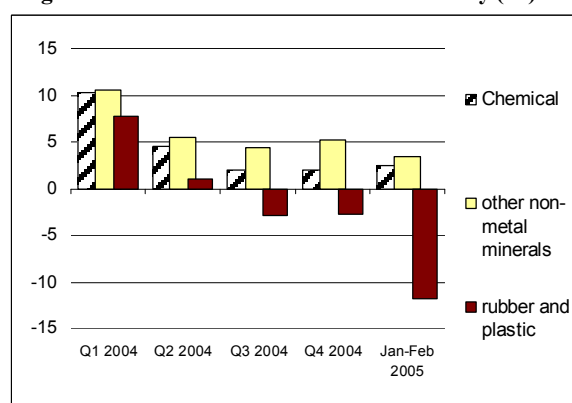
A closer examination of the new Rosstat data on industrial production reveals that the exceptional growth in manufacturing in the second half of 2004 is due entirely to machine-building. Figures 1-4 below illustrate the growth dynamics in the machine building, chemical, metallurgy, and food industries, which account for the vast majority of industrial value added outside of the resource sectors. Accelerating growth in the second half of 2004 was documented only in the production of machines, equipment, and (especially) electro-technical equipment. This reported growth was rapid enough to offset in aggregate statistics negative growth trends elsewhere in manufacturing. Chemicals and metallurgy continue to show declining trends during 2004 according to the new data, while annual growth in the food industry (3.0 percent) was considerably lower than in 2003 (5.1 percent).

Figure 1: Growth Rates in Machine Building (%)



Source: Rosstat (new numbers)

Figure 2: Growth Rates In Chemical Industry (%)



¹ The new classification is closer to common world practice and moves from defining sectors as groups of enterprises to sectors as product groups.

Outside of manufacturing, construction and transportation also exhibited measurably slower growth in the second half of 2004 relative to the same period of the previous year (Figure 4). Consistent with these trends, fixed capital investment growth in the economy also showed a declining growth trend in 2004, and registered at 10.9 growth for the year relative to 12.5 percent in 2003. By contrast, retail trade gathered increasing momentum throughout 2004 along with incomes, and imports comprised an increasing share of sales.

Figure 3: Growth Rates in Selected Industries (%)

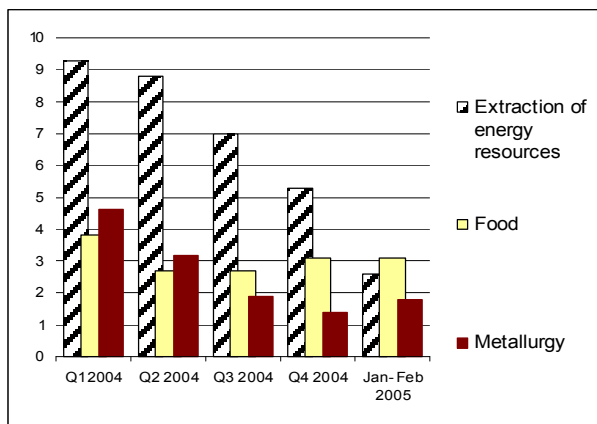
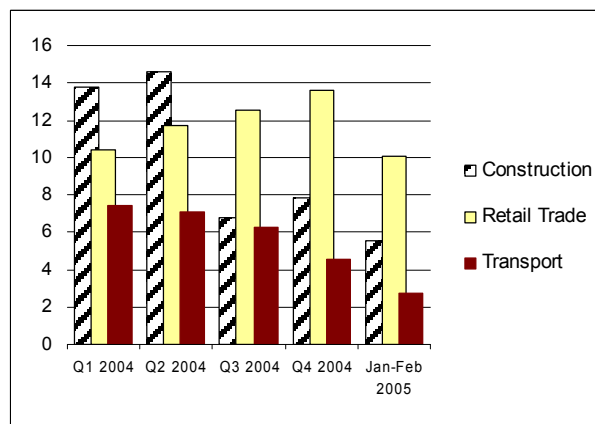


Figure 4: Growth Rates in Non-industrial Sectors (%)



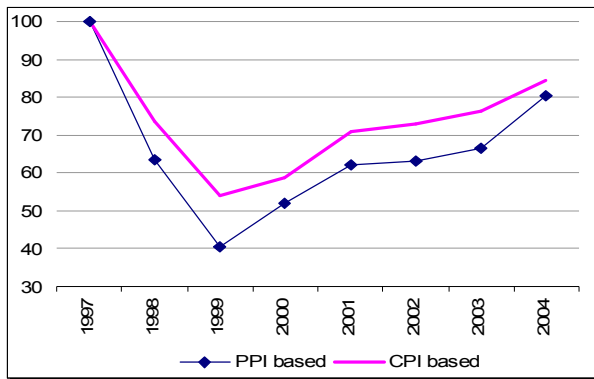
Source: Rosstat (new numbers)

Figures for January-February 2005 indicate what could be a continuation of slower growth, although the sharp decline relative to the same period in 2004 is at least partly explained by the newly-introduced extended holidays in January. Yet industrial output in February was only 5.1 percent higher than its level in the same month of 2004. Resource extracting industry grew by 2.3 percent in January-February 2005 compared to an 8.8 percent growth during the same period of 2004. Manufacturing industries increased their production by 5.9 percent compared to a 9.6 percent growth a year ago. Aggregate industrial production grew at 3.9 percent for January-February 2005, as compared to a 7.5 percent growth during the same period of 2004.

The much higher growth in machine-building in the new figures in the second half of 2004 is rather puzzling, given declines in growth reported in previous figures. Machine-building also experienced much higher costs for metals in 2004 along with other cost increases that have affected all of Russian manufacturing. It is quite possible that these Rosstat figures for industrial output will undergo subsequent revisions before being finalized. Qualitative trends in the remaining sectors of the economy did not change substantially in the new data, however, and the balance of evidence suggests a slowdown in growth in most sectors in the second half of 2004 and early 2005.

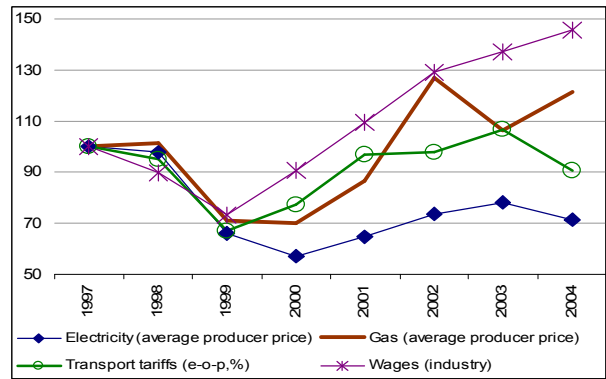
The causes of slower growth in most sectors of the economy are still not entirely clear. As argued in the previous Russian Economic Report, evidence does not support the hypothesis that the slowdown is due to a liquidity shortfall. 2004 witnessed rapid commercial credit expansion, substantial declines in payable arrears (Figure 11), and increases in correspondent accounts held by commercial banks in the CBR. It is much more likely that the slowdown in growth in a number of sectors is related to substantial recent increases in production costs due to the appreciation of the ruble, higher energy prices, rapid wage growth (Figures 5 and 6), and increasingly binding capacity constraints. According to the official index of the Central Bank, the ruble appreciated by 6.1 percent in 2004 against the basket of currencies of its main trading partners, and by another 4.3 percent in January-February 2005 alone. Yet the real appreciation measured in producer, rather than consumer, prices was much more rapid in 2004, reaching an estimated 21 percent (Figure 5).

Figure 5: Real Effective Exchange Rate Index



Source: Rosstat

Figure 6: Real Input Prices Index (1997=100)



Following the collapse of real incomes during the inflation of 1998-1999, both wages and labor productivity have exhibited rapid growth in industry. The pace of industrial wage growth has been consistently more rapid than that of productivity growth, however (Figure 7). The dynamics of industrial wage growth in 2004 indicate that the pace may have finally started to slow (Figure 8). Slower industrial wage growth is also consistent with the notion that many parts of Russian manufacturing faced declining profit margins in the second half of the year. Preliminary figures indicate that slower wage growth has carried into 2005.

Figure 7: Productivity and real wage growth in industry

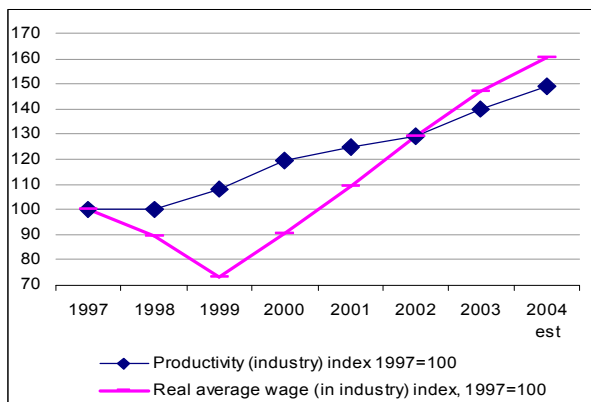
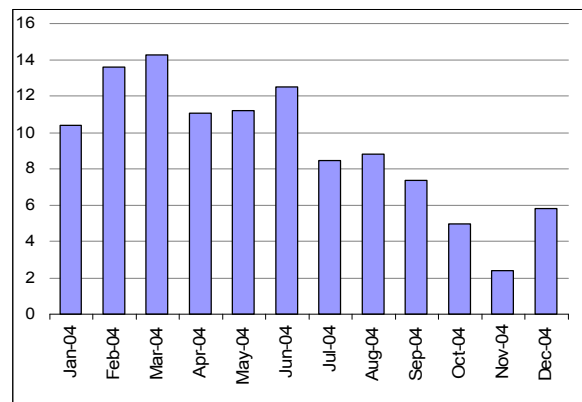


Figure 8: Growth rates of real wages in industry (% to the same month of the previous year)



Source: Rosstat

While growing production costs, and a corresponding loss in competitiveness, appear to have affected some sectors of the Russian economy, they cannot alone explain the slowdown in economic growth. For example, metallurgy has profited from sharp increases in world prices on metals that have likely more than compensated for cost increases in most cases. While profitability data by sector for 2004 is not yet available, preliminary related figures suggest that net unit profits for manufacturing on aggregate may not have declined in 2004 relative to 2003. Much higher profitability for metals producers is most likely a primary reason. Most analysts conclude that the metals industry has become increasingly capacity constrained in recent years, although a loss of competitiveness in metal pipe production relative to Ukraine may also be important.

A slowdown in growth and investment is also visible in the oil sector, despite exceptionally high world market prices. In the oil sector, very high marginal taxation has weakened significantly the link between higher prices and profits. In addition, the growth slowdown in the oil sector and some other parts of the economy is quite likely connected to fallout from the prolonged Yukos affair and perceptions of greater discretionary state intervention in economic affairs to the disadvantage of private business, as discussed below.

The Balance of Payments and Capital Flows

High prices for Russia’s commodity exports pushed the trade balance to an estimated record USD 87.2 billion in 2004 by preliminary figures. The corresponding foreign inflows almost doubled the pace of foreign reserve accumulation relative to 2003. Gross foreign reserves of the Central Bank (CBR) soared from USD 76.9 billion to 124.5 billion during 2004. The trade surplus amounted to an estimated USD 8.6 billion in January 2005, and the figure for February may be even higher following further oil price increases.

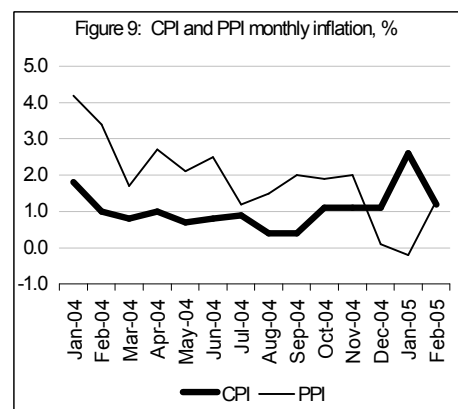
Table 3. Balance of Payments (USD billions)

	2003	2004
Current Account Balance	35.4	58.2
Trade Balance (GNFS)	59.9	87.2
Capital and Financial Account	-0.8	-5.4
Errors and Omissions	-8.2	-5.2
Change in Reserves	26.4	47.6

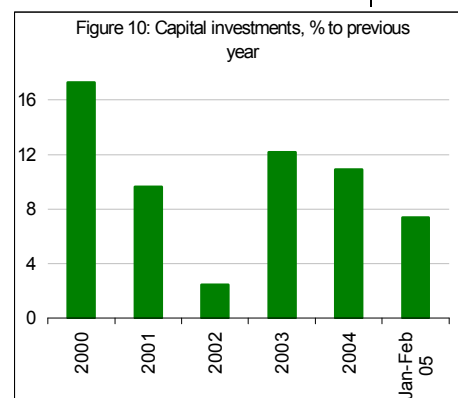
Source: CBR

The capital account weakened in 2004 relative to 2003. Despite the apparent inflow of USD 6 billion in the fourth quarter of 2004 in association with financing the purchase of Uganskneftgaz by Rosneft, net outflows (capital account plus errors and omissions) amounted to over USD 10 billion. The CBR estimates that USD 7.8 billion of this sum corresponds to net capital outflows from the private sector, as compared to USD 1.9 billion in 2003 (Table 4). Most of this difference is due to short-term capital flows in the banking sector, which have mirrored closely changes in monetary policy since 2003. Aggregate inflows to the banking sector declined from 10.3 billion in 2003 to 3 billion in 2004. This was due to significant outflows in the first half of 2004 at a time when the ruble exchange rate was held virtually fixed relative to the dollar. Short-term capital flows became positive in the second half of the year following a tightening of monetary policy. Net outflows from the non-banking sector remain significant, although they declined slightly from USD 12.2 billion in 2003 to USD 10.8 billion in 2004. Preliminary figures from January-February indicate that the positive net capital flows to Russia in the fourth quarter of 2004 have most likely carried into early 2005.

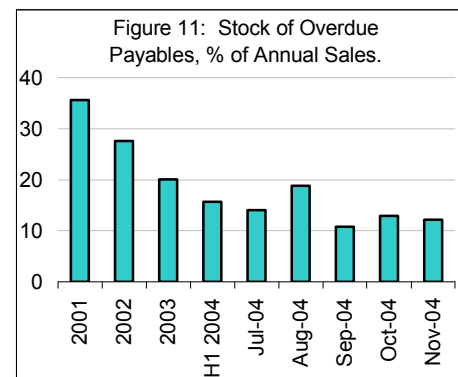
Despite high political uncertainty, foreign direct investment continues to flow to Russia in the current favorable macroeconomic environment. Inflows of FDI increased to an estimated record USD 9.4 billion in 2004, relative to USD 6.8 billion in 2003. Nevertheless, cumulative per capita foreign investment inflows to Russia (about USD 260) are quite low relative to most other transition countries. The vast majority of foreign inflows to Russian firms consist not of direct investment, but bank credit (USD 26.4 billion in 2004).



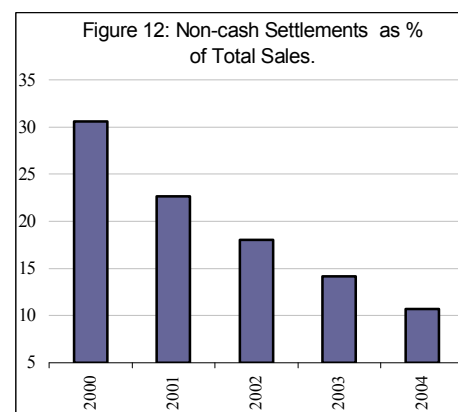
Source: Rosstat



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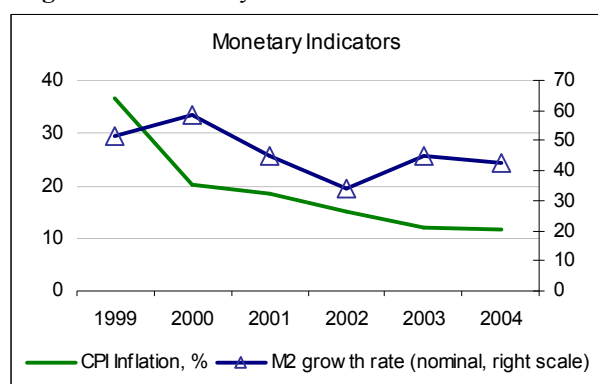
Table 4. Net Private Sector Capital Flows and the Ruble/USD Exchange Rate

	Q1-04	Q2-04	Q3-04	Q4-04
Net capital outflows from banking sector, USD bln.	-3.2	-3.3	0.9	8.6
Net capital outflows from non-banking sector, USD bln.	-0.8	-2.9	-8.9	1.7
Average Ruble/USD exchange rate	28.5	29.0	29.2	27.7

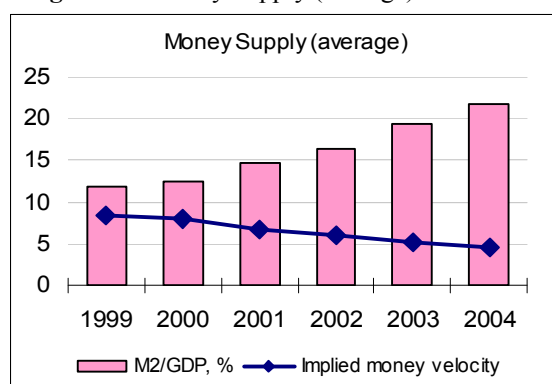
Source: CBR

Inflation and Monetary Policy

CPI inflation amounted to 11.7 percent in 2004, thus exceeding a planned target of 10 percent. Inflationary pressures increased in the second half of 2004 in the context of stronger balance of payment inflows. After increasing by only 9.8 percent in the first half of 2004, ruble money growth (M2) soared in the second half of the year, bringing annual M2 growth to 35.8 percent. Fortunately, most of the ruble expansion owing to higher oil prices was sterilized through an accumulation of the fiscal Stabilization Fund. If not for this strong sterilization, CPI inflation would have most likely been significantly higher in 2004, and especially in early 2005 (M2 grew by 11 percent in December 2004 alone). Producer price inflation in 2004 (28.8 percent) was much higher than CPI inflation due primarily to higher energy and, to some degree, metals prices. Commercial credit to the non-financial sector also continued to expand at a rapid rate in 2004 (44.6 percent), including long-term loans that increased the estimated share of credit in investment finance from 6.4 percent in 2003 to 7.3 percent in 2004.

Figure 13: Monetary Indicators

Source: CBR

Figure 14: Money Supply (average)

Source: CBR, WB staff estimates

Inflationary pressures have remained similar in early 2005. Monthly inflation in January was exceptionally high (2.6 percent), although this was due to administered increases in housing and utilities prices (24.1 percent increase). February CPI inflation registered at 1.2 percent, and January-February base inflation, adjusted for seasonality and excluding administrated prices, amounted to 1.6 percent. PPI inflation was actually marginally negative in January 2005 (-0.2 percent), although this was due to temporary declines in oil and gasoline prices. PPI inflation for the month of February amounted to 1.3 percent.

Since the second half of 2004, the Central Bank has moved to a somewhat more flexible exchange rate policy, although the preservation of basic exchange rate stability still serves as the primary anchor. In early 2005, the CBR announced a shift from a former exclusive orientation on the US dollar for exchange rate policy to a euro/dollar currency basket. This basket initially placed 10 and 90 percent weights on the euro and dollar, respectively. These weights were revised in March to 20 and 80 percent. As the US dollar has weakened against

most world currencies, the CBR has allowed the ruble to appreciate steadily against the dollar from 29.2 Rbl/USD in August 2004 to under 28 Rbl/USD by February 2005.

Fiscal policy and the budget

Exceptionally high world oil prices once again brought about higher than expected revenues to the federal government in 2004, generating a budgetary surplus of an estimated 687 billion rubles, or 4.2 percent of GDP (cash basis), as compared to only 83 billion rubles (0.5 percent of GDP) targeted in the 2004 budget law. In this context, the Stabilization Fund reached 522 billion rubles (3.1 percent of GDP) by the end of the year.

The federal budget continued to accumulate record levels of revenues in January 2005, even excluding the windfall of 138 billion rubles in back taxes that followed the sale of Yuganskneftgaz. The Stabilization Fund mushroomed to 708 billion rubles by March 2005, primarily due to a transfer of surplus funds at the end of the year that had been designated for (unrealized) early debt retirement in 2004. The government reached an agreement in early 2005 on the retirement of its debt to the IMF in full (93.5 billion rubles), and continues to negotiate with the Paris Club on realizing further early foreign debt retirement this year.

Despite the increase in federal revenues, the government has maintained generally conservative fiscal policy in recent years that has not allowed expenditures to rise along with revenues. Federal expenditures in 2004 amounted to only about 16 percent of GDP, and a similar estimate for 2005 was embedded in the budget law. The lower revenue figure in the 2005 budget law reflects a conservative oil price assumption of 28 dollars a barrel. The final figures in Table 5 represent our expectation for a revision of the 2005 budget law, which includes an additional commitment of 200 billion rubles in social spending in the wake of monetization and additional revenues from a higher oil price assumption (USD 39 a barrel) and back taxes received from Yukos. This pushes estimated federal revenues to record levels of 23 percent of GDP. On the other hand, even after this increase, projected expenditures remain close to the average of 17.6 percent of GDP from 2002-2004.

Table 5. The Federal Budget

	2003	2004	2005 budget law	2005 revised
Expenditures, % of GDP	17.9	16.1	16.3	17.4
Revenues, % of GDP	19.6	20.4	17.8	22.9
<i>Memo:</i>				
<i>GDP, bln Rub</i>	<i>13201.1</i>	<i>16778.8</i>	<i>18720.0*</i>	<i>18720.0*</i>

Sources: Rosstat, Minfin, World Bank staff calculations

*GDP forecast is in accordance with the Law on Federal Budget in 2005.

As could be expected, the recent windfall in federal revenues has created strong social and political pressures for either increases in state expenditures or tax relief to Russian firms. Debates within the government have focused on state investment programs, lower tax rates, investment credits, and increases in social expenditures. Some of these issues are addressed in section 2 of this Report. Preliminary discussions surrounding the 2006 federal budget indicate plans to increase social spending significantly over the medium term, including the doubling of salaries in the budgetary sphere and pensions over a three year period. To meet higher needs in expenditures, a larger share of excess oil profits are to be channeled into the budget beginning in 2006. Currently, all state revenues due to an oil price of over 20 dollars a barrel accumulate in the Stabilization Fund. It is expected that this price will be increased

to 27 dollars 2006. This would cover planned government expenditures at roughly the same level as in 2004 in the event (as assumed in budgetary calculations) that the price of oil declines to 34 dollars a barrel. If the cut off price for the Stabilization Fund is raised in this manner and oil prices end up considerably higher than 34 dollars a barrel, the federal budget would accumulate surplus revenues, which would hopefully still be transferred to the Stabilization Fund at the end of the year. Under the current macroeconomic situation, any sharp increase in government expenditures could have a significant negative impact on inflation and the real appreciation of the ruble.

Income, Employment, and Poverty

Incomes and wages grew quite rapidly in 2004, and this growth has carried into 2005. Real disposable income of the population increased by an estimated 7.8 percent in 2004, while real average wages surged by 10.8 percent. In this context, final consumer demand strengthened, and retail trade volume accelerated during the year, registering at 12.1 percent growth for 2004 as a whole. The combination of income growth and ruble appreciation is fueling quite rapid import growth (24.6 percent growth in dollar value in 2004). The rate of unemployment (ILO definition) in the Russian economy also fell from 8.4 percent in 2003 to 8.0 percent in 2004. Russia's growth since 2000 has been strongly pro-poor. According to the latest official statistics, the number of people living below the subsistence level decreased from 25 percent in 2002 to 20.4 percent in 2003, and to about 19 percent (estimate) in 2004.

Economic strategy of the government and future prospects

The investment climate in Russia still suffers from increased uncertainty since mid-2003 in business-government relations, including expectations of more probable discretionary state intervention in the economy. The protracted Yukos affair has been the center of attention in this regard, but many other companies have also apparently experienced increased harassment, often from the tax administration under the guise of exposing and collecting unpaid taxes from previous years. In 2004, the tax administration apparently collected an estimated 470 billion rubles in back taxes, as opposed to less than 150 billion in 2003. This uncertainty was magnified by initial signals that the new Russian government might initiate important changes in basic economic strategy.

Given the extremely favorable macroeconomic conditions and huge business opportunities in Russia, these political problems are quite unfortunate. Although fixed capital investment has recently exhibited double digit growth in Russia, it began from a very low base level. Fixed capital investment as a share of GDP (18 percent in 2004) is quite low relative to most dynamic emerging market economies. Competitiveness in the Russian economy will depend on sustaining productivity growth to compensate for real appreciation and rising production costs. This in turn will require higher rates of private investment. While some problems in the business climate can be solved only through a long process of institutional development and structural reform (lack of independent judiciary, high corruption, low corporate culture), the government still has the capacity, even in the short run, to exert a major positive impact on the investment climate through building a reputation for upholding strong commitments to property rights, a stable regulatory climate, and the absence of discretionary state interventions.

Early 2005 witnessed at least a few positive signals in this regard. The Kremlin appears to have acknowledged concerns over the business climate, and has given indications of supporting measures that would limit the discretionary authority of the tax administration and decrease the period of contestability for privatization deals from 10 to 3 years. If the final

government Medium Term Program for the Social-Economic Development of the Russian Federation (2005-2008) resembles recent circulated drafts, it may also have a positive impact on the expectations of investors. The draft Program reiterates the basic commitment of the government for improving conditions for the private sector as the primary engine of growth and investment. The fact that the Program has still not been approved reflects some remaining disagreements within the government, however.

Relative to previous government programs, the draft Medium Term Program places more emphasis on issues of diversification and competitiveness outside of the resource sector. An ambitious agenda for structural reform gives particular focus to the government and social sectors. This includes the reform of health, education, housing and utilities, social protection, pensions, the state administration, the budgetary sphere, and the development of private public partnerships. For institutional development, the program stresses property rights, the financial sector, land markets, competition policy, and privatization.

A major reform in the social sphere, the monetization of in kind social benefits, was carried out in early 2005. The manner in which monetization was carried out led to widespread social protests among pensioners and other groups that lost former in kind benefits. This was followed by various modifications in the programs implemented at the federal, regional, and municipal levels, including measures to restore options for in kind benefits in certain cases and a commitment by the federal government to raise pension levels at a faster rate. It is feared that the shaky start in the realization of social reforms in 2005 may increase political obstacles to the realization of the ambitious medium-term agenda in the social sphere. For example, the particularly regressive in kind benefits in housing and utilities are scheduled for monetization in 2006, yet the status of this reform is now unclear.

While there is room for greater financial commitments by the government to the social sphere, these commitments could be accompanied by measures to restructure state expenditures toward greater efficiency. Russia currently suffers from an exceedingly poorly-targeted system of social support. While, in principle, the monetization of social benefits represents a step toward increasing the efficiency of the social benefit system, the short term impact may have been just the opposite. At the regional level, it appears that obligations associated with monetization and the subsequent social unrest may have diverted attention away from the development of other social programs that give a larger share of benefits to the poor. While relative salaries in the budgetary sphere in Russian are indeed unacceptably low, measures to increase salaries for medical practitioners, teachers, and other public servants would ideally be accompanied by substantial restructuring in this sphere. Russia currently has an oversupply of public employees in the budgetary sphere (6 percent of the population) relative to other countries, and the recent expansion of the employment in this sphere, despite relatively low salaries, raises suspicions that it includes a large share of hidden unemployment.

II. ACHIEVING DIVERSIFIED GROWTH IN RUSSIA

An increasing number of voices in Russia are calling for major corrective measures by the government to counteract market forces that appear to be pushing the country down a path of increasing resource dependence and unbalanced growth. Yet the most effective policies to promote growth and diversification in Russia are consistent with market forces and the development of market institutions. Recent Russian growth already owes much to the active pursuit of market reform and responsible macroeconomic policy. Comparative advantages outside of the resource sector do exist in Russia, and these advantages can be harnessed. World experience and the particular macroeconomic situation in Russia suggest caution in the expansion of budgetary expenditures and state investment programs in the interest of diversification. Diversified growth can be achieved without a radical change in policy course.

Russia has experienced impressive growth, stabilization, and poverty reduction for five consecutive years. Yet policy debates continue to echo major concerns over the sustainability, or even the desirability, of recent macroeconomic developments. The accelerated growth since 2003 is linked to sharp increases in prices for commodity exports, particularly oil and gas. On the other hand, the competitiveness of Russian manufacturing appears fragile, and could be suffering further due to the real appreciation of the ruble, higher resource prices, rapid wage growth and the steady exhaustion of excess industrial capacity. An increasing number of voices in Russia are calling for the government to take major corrective measures to promote competitiveness. These proposals range from granting the government a dominant role in much of the production sphere to measures for increasing the private returns to investors outside of the resource sectors (lower taxes, investment credits, structural reforms, innovation funds, etc.). The issues and tradeoffs in these debates are complicated and controversial. This section presents reflections on a few central issues.

Resource abundance and the development of competitive manufacturing industries in Russia.

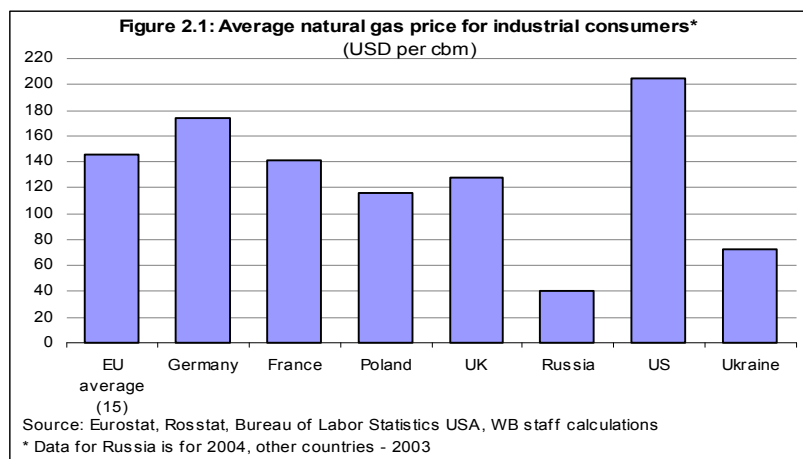
A number of recent economic studies suggest that resource abundance need not necessarily be an advantage in economic development. Indeed, a number of the recent successes in economic development have been concentrated in resource-poor countries, including those of East Asia, while many relatively resource-rich countries in Latin America have performed less impressively. In addition to vulnerability to declines in commodity prices and the possible diversion of effort to rent-seeking activities, a potential disadvantage of resource abundance is so-called “Dutch Disease,” whereby large foreign inflows from resource exports exert upward pressure on the real exchange, possibly undercutting the international competitiveness of manufacturing (tradable) sectors. The economic losses from Dutch Disease are related to possible foregone economies of scale or learning-by-doing that may characterize the development of some areas of manufacturing.

The recent performance of the Russian economy has cast increasing attention on these potential problems. In the context of the current commodity boom, the ruble continues to appreciate in real terms, thereby increasing competitive pressures on the tradable goods sectors of the economy. As discussed in the first section of this report, a decline in growth rates in a number of sectors of the economy since the second half of 2004 may be partly associated with a particularly rapid rise in production costs during the first half of the year.

Nevertheless, there is far from a consensus among economists that resource abundance should be a major liability for the diversified economic development of a large country like Russia. On the contrary, particularly if the government can maintain responsible economic

policy and realize key reforms, resource abundance should be an advantage for some areas of manufacturing. For example, in the case of the United States, some studies present evidence to the effect that a high resource component contributed strongly to the competitiveness of US exports in the late 19th and early 20th century, a time when the USA became the world leader in factor productivity.²

There could be many examples of advantages for manufacturing industries in Russia from resource abundance. Among these examples, the natural gas sector deserves particular attention. Russia's advantages in natural gas production and distribution dwarf those of any other country, and ample reserves exist to maintain these advantages well into the future. Cheaper gas also implies cheaper thermal electricity generation. Relative gas and electricity prices fell to extremely low rates following the financial crisis of 1998. Subsequent measures to raise these prices steadily toward cost recovery levels have elicited many complaints about the possible erosion of industrial competitiveness. But there is finally some very good news for Russian industry on this front. World Bank experts believe that natural gas tariffs for commercial enterprises are now finally approaching cost recovery levels, including long-run (investment) costs. This rate is much less than half of current world market prices in Europe or Asia, and is significantly lower than in other CIS countries (Figure 2.1). This is a potential strong comparative advantage for Russian manufacturing firms that can be sustained in the medium and longer term. In addition, the reduction of current substantial inefficiencies in the gas industry through reforms and more effective regulation would decrease unit costs, much of which could be passed on to industrial consumers in lower prices for still greater economic advantage. The natural gas sector is a "goose that lays golden eggs" in Russia, which speaks for the importance of measures to ensure the successful development of this sector in the medium and longer run. This includes further measures to rationalize regulation, reduce cross-subsidies, and attract sizeable private investment for the development of new gas fields.



An additional advantage from resource abundance, and the associated state budgetary revenues from resource exports, can be passed on to Russian firms in the form of a lower average tax burden than in competing resource-poor countries. High and heavily-taxed resource exports allow maintaining equivalent government expenditures under lower average tax rates. Thus, although Russian firms may be compelled to operate with higher labor and some other input costs relative to competing firms in other countries, they can potentially enjoy compensating advantages of lower taxes, lower energy costs, and more affordable access to foreign capital goods and technology. While different relative prices for producers in Russia may favor different areas of manufacturing than in some other countries, there is no

² Wright, Gavin (1990), "The Origins of American Industrial Success, 1879-1940," *American Economic Review*, 80: 651-668,

reason to conclude that, due to resource abundance, Russian manufacturing should chronically suffer from low competitiveness in general. In addition, the positive flip side of higher labor costs in Russia is a higher standard of living for Russian citizens. After all, that is the ultimate goal of economic development.

Oil, institutions and economic growth: Russia and Ukraine in comparative perspective

Russia has already accomplished much in providing a foundation for diversified growth. Some of these accomplishments have been masked somewhat in recent years by the commodity price boom that has understandably favored a shift of emphasis toward the resource-oriented sectors of the economy. Higher oil and gas prices have increased the returns for hydrocarbon exporters, while also exerting upward pressure on the real exchange and thereby increasing competitive pressures in the manufacturing (tradable) sectors of the economy. The recent rapid expansion of output and exports in resource-oriented and related sectors has supported a common perception that current growth in Russia is almost entirely due to high oil and gas prices.

In this regard, the comparison of Russia with Ukraine is instructive. The growth patterns in Ukraine during the period of economic transition have been quite similar to those of Russia. Ukraine also experienced a strong industrial decline in the first decade of transition, a demonetized “virtual economy” in the late 1990s, a financial crisis in 1998, and subsequent rapid monetization and growth, which slowed in 2001 and 2002, but accelerated since 2003. Recently, Ukrainian growth rates have exceeded those of Russia. Yet Ukraine does not have oil or large-scale domestic gas production.

Given these strong similarities in economic performance and the significant degree of economic integration between Ukraine and Russia, some observers assume that Ukrainian growth has been driven by spillovers from the Russian economic expansion. But a recent World Bank Country Economic Memorandum of Ukraine challenges this view,³ noting that, for various reasons, trade volume between the two countries did not increase much before 2004, despite the economic growth, and that capital inflows to Ukraine have been quite low over the period in question. It is true that worker remittances from Russia to Ukraine have been significant, Ukrainian control of the gas pipeline from Russia to Europe is a source of rents, and certain Russian investments in Ukraine have been important, particularly in oil processing and metals. Yet none of these effects are of sufficient magnitude to explain the strong recent growth in the Ukrainian economy.

What has driven the economic growth in Ukraine? As is the case for Russia, world market prices, in this case for steel, explain a part of the recent accelerated growth, but only a part. A strong majority of increased production in Ukraine since 2000 has been for the domestic market, and capital goods from the far abroad have been the fastest growing component of imports. An examination of all the evidence supports the conclusion that changes in incentives and the business climate have altered fundamentally the orientation and activities of Ukrainian firms. As in Russia, these changes began with the sharp depreciation of the currency in the late 1990s, and active policies since 2000 to enforce financial discipline, maintain stable and responsible macroeconomic policy, reduce and rationalize subsidies, and implement key structural reforms in taxation, agriculture, and the removal of administrative barriers to business. In this context, Ukraine has been experiencing a period of rapid

³ Ukraine: Country Economic Memorandum (2004), World Bank
http://siteresources.worldbank.org/INTUKRAINE/147271-1089983407712/20280269/CEM1_e.pdf

institutional development in areas such as corporate governance, restructuring, banking and financial markets, and the development of small and medium-sized businesses.

The interesting point is that these policy and institutional changes in Ukraine closely parallel similar developments in Russia. In fact, between 1999 and 2003, Russia played a leading role in many areas relative to Ukraine in articulating and implementing a comprehensive economic program aimed at facilitating the development of market institutions and the private sector. A recent publication of the Higher School of Economics, *Structural Change in Russian Industry*, and recent business surveys demonstrate that a very similar process of rapid institutional development has been occurring in Russia.⁴ In both countries, corporate structure has shifted radically in favor of outside ownership, and active markets for corporate control and managerial services have emerged. From trivial levels in the late 1990s, monetization and financial intermediation have shown very rapid growth, competition has increased, and the administrative costs of doing business have declined. In these conditions, Russian, as well as Ukrainian, businesses have reoriented a good share of their energies to profitable activities in the formal economy.

Given these strong parallels in policy and institutional development, why haven't high oil prices supported even stronger growth in Russia than that in Ukraine? Several factors can be noted here. One is simple geography. In addition to much more favorable conditions for agriculture, Ukraine does not have to contend the same magnitude of spatial misallocations of people and capital across many regions with severe climatic conditions. Second, lower balance of payment inflows have kept the Ukrainian hryvnia weak relative to the ruble, which has afforded one strong competitive advantage to Ukrainian companies. Average labor costs in Ukraine, for example, are only half of those in the Russian Federation. Finally, in 2003-2004, the investment climate in Ukraine did not suffer from the same sort of political uncertainty in the economic sphere that has plagued Russia since mid-2003. This is ironic, as Russia experienced an unprecedented degree of political stability during the period in question, while Ukraine changed governments continually. Nevertheless, the basic course in economic policy remained remarkably stable in Ukraine, which created both heightened competition and opportunities for Ukrainian corporations. Yet the recent similarities between Russia and Ukraine are even stronger than the differences, and speak for the importance of incentives and institutions for economic growth.

Policies to promote growth and diversification

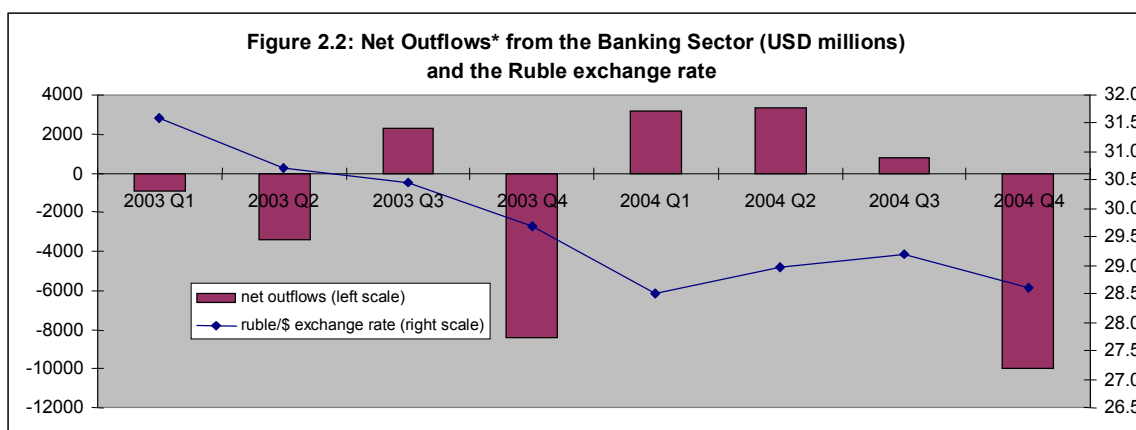
Russian economic growth began a half decade ago in the context of an exceptionally weak ruble, cheap labor, repressed energy prices, and huge excess capacity. Given that relative prices have changed so dramatically in subsequent years, it is natural that many sectors and firms may be experiencing increasing difficulties. The absence of stable economic conditions makes it difficult to speak at present of revealed comparative advantages for Russian firms outside of a few obvious resource-oriented sectors. In the future, however, given that wholesale energy prices are reaching rational levels, the balance of payments should move closer to equilibrium, and tax reductions and structural reforms hopefully improve the overall business environment, we should witness the increasing emergence of genuine "winners" in the market that successfully exploit comparative advantages in the Russian context of a more permanent nature. This can provide the foundation for diversified growth in the future. Special government programs to facilitate or speed this development may be of value to Russia. Yet world experience indicates that such programs will most likely be more effective if they focus on strengths already identified in the market (for example, export promotion) as well as on general sources of competitiveness (for example, education and human capital), as

⁴ Yasin, E., ed., *Structural Change in Russian Industry* (in Russian), Higher School of Economics, Moscow, 2004

opposed to rescuing failing, or fostering entirely new, industries. This is of particularly relevance to the Russian context, where corruption is a major problem and developing a highly competitive manufacturing sector still requires substantial macro-restructuring in the form of the reallocation of labor and capital from inefficient industries, regions, or firms to areas that will be the engines of future diversified growth.

Debates within the government on strategies to promote growth and diversification have focused on rapidly accumulating resources in the fiscal Stabilization Fund. By the end of February 2004, the Stabilization Fund had accumulated to an estimated 707 billion rubles, or 4 percent of GDP. To what degree should Russia continue to accumulate resources in this Fund, as opposed to increasing government expenditures, including investment outlays, lowering the tax burden for private investors, or financing key structural reforms?

The tradeoffs for Russia in this area are complicated. The opportunity costs associated with the Stabilization Fund relate to two of its important functions. The first function is to insure the budget against fluctuations in energy prices. Given the strong dependence of federal budgetary revenues on oil and gas prices, the Stabilization Fund can support stability in government expenditures in the presence of energy price fluctuations, as well as decrease the risks of financial crisis from a period of prolonged low energy prices. Yet the Stabilization Fund also plays a second very important role in the current Russian economic context. Given the strong current account inflows due to high oil and gas prices, combined with highly unstable short-term capital flows, the Stabilization Fund has played a central role in maintaining macroeconomic stability and moderating the effect of foreign inflows on inflation and the real exchange rate. Due to current weaknesses in domestic financial markets and the banking system, the Central Bank alone lacks sufficient instruments to manage liquidity in the context of such large and volatile inflows. In fact, attempts by the Central Bank to control inflation in 2003-2004 through tightening monetary policy and allowing the ruble to appreciate have been largely negated by speculative capital account inflows that reacted to these measures (Chart 2.2). To preserve a context for diversified growth, it is imperative that the process of real ruble appreciation due to high energy prices be kept at moderate levels that do not overwhelm productivity growth in promising sectors of the economy. Maintaining and strengthening recent accomplishments in macroeconomic stability and the control of inflation are also central to the business environment. Consequently, to the degree that the Russian government moves to channel part of the oil revenue surplus to alternative uses other than the Stabilization Fund, it should take a very cautious and gradual approach so as to avoid sharp unfavorable macroeconomic movements.



Source: CBR * "+" - outflows

Certainly, there are areas in infrastructure and the social sector that would profit greatly from additional state resources. Yet, the central importance of the Stabilization Fund for macroeconomic policy and world experience suggest caution. Irresponsible increases in

government spending during commodity price booms have plagued a number of resource rich countries in recent history. The experience of Mexico, another relatively large oil exporting country, may be particularly relevant for Russia. The oil price boom in the 1970s led to a mushrooming of government investment spending, including outlays on projects to select and foster special infant industries. These investment projects had notoriously low returns and the government budget became highly vulnerable to oil price shocks, thereby setting the stage for the financial crisis of the early 1980s.⁵ Government investment as a share of GDP in Russia (about 4 percent) is already not low by international standards, and the efficiency of government investment in many areas remains low.

A second key question concerns the basic economic strategy of the government. As argued above, improved economic incentives and rapid institutional change have been key sources of growth in Russia. They reflect effective macroeconomic policy and a well-articulated comprehensive government economic program since 2000 that embodies a basic commitment to improving conditions for private business and investment. Since mid-2003, the investment climate in Russia has nevertheless suffered from heightened uncertainty about government-business relations, and corresponding greater worries about possible discretionary state interventions. This is unfortunate for Russia, as the highly favorable macroeconomic conditions afford the opportunity for the government to generate much higher rates of private investment. An effort by the government to declare and uphold clear commitments to stable and favorable economic conditions for private business, together with the realization of some key structural reforms, could have a dramatic effect on private investment rates in the economy. This is a key to the realization of diversified growth, as private investment under these conditions will flow not only to the resource sectors (where it is also desperately needed) but to points of emerging comparative advantage in manufacturing and services about which the government may have only limited information. In addition, the successful diversified development of Russia will depend on the continued energetic pursuit of structural reforms to strengthen market institutions in areas such as the judiciary, state administration, fiscal federalism, tax administration, and competition policy.

The accomplishments of the Russian government since the 1990s in improving conditions for private business in the country are sometimes underestimated. The achievement of diversified growth in Russia will depend, first and foremost, on a determined continuation of the policies and reform initiatives embodied in the government strategy since 2000. Together with selective state programs that complement, rather than substitute for, markets, this remains the most promising recipe for achieving sustainable diversified growth in Russia.

⁵ Richard M. Auty, "Large Resource-Abundant Countries Squander Their Size Advantage: Mexico and Argentina" in Auty ed., *Resource Abundance and Economic Development*, Oxford U Press, 2002.

III. RUSSIA'S WTO ACCESSION: WHAT ARE THE MACROECONOMIC, SECTOR, LABOR MARKET AND HOUSEHOLD EFFECTS?

Accession to the WTO is likely to generate substantial macroeconomic and household benefits for Russia - the medium-term benefits will be about USD 19 billion a year (about 3.3 percent of 2004 Russian GDP). The main export sectors are likely to experience the greatest expansion. This is good for the economy as the internationally competitive exporting sectors will bid up wages overall and attract labor from less competitive. In the long term, an improvement in the investment climate should boost incomes by an estimated US\$64 billion per year (11 percent of 2004 GDP). We estimate that 99 percent of households will gain from WTO accession in the medium and long term, and the poor will gain as least as much as the average household. Despite gains in the medium to long term, many households may lose during a transition period. Thus, government safety nets are crucial for helping with the short-run adverse impact from the accession, especially for the poorest members of society.

Introduction

It is widely believed that WTO accession will have important effects on the Russian economy, and a growing majority of Russians believe that WTO accession will benefit the country. But many questions about the impact of WTO accession remain, including the nature of the macro-economic impact; how different sectors and regions of the economy will be affected; the impact on incomes of the population and poverty. Some observers are also asking for clearer explanations of why WTO will bring about any of the claimed impacts. In this section, we reflect on the probable sources of gains and losses for the Russian economy.⁶

To analyze the impact of WTO accession, we construct a 35 sector computable general equilibrium comparative static model of the Russian economy, based on the Russian input-output table. Primary factors include capital, skilled and unskilled labor, and sector-specific workers. The model contains the 49,000 households of the Russian Household Budget Survey. The principal changes from WTO membership that we model are the following: (1) significant liberalization of barriers to foreign direct investment (FDI) in business services sectors; (2) an across the board reduction in tariff barriers by 50 percent (exact cuts are unknown); and (3) reduced application of antidumping duties against Russian exporters.⁷

WTO Accession Will Have Significant Aggregate Benefits

Liberalization of the barriers to FDI in the services sectors is the most important source of gains from WTO accession. About 73 percent of the gains follow from liberalization of the barriers to multinational providers of services. Examples of the barriers that are under negotiation as part of the WTO accession are: the Rostelekom monopoly on long distance telephone services; the restraints on multinational banks opening affiliates in Russia; and the quotas on multinational providers of insurance services. Russian commitments to multinational service providers would encourage more FDI in Russia. This would give Russian businesses improved access to the services of multinational service providers in such sectors as telecommunications, banking, insurance, and transportation. This should lower the cost of doing business and should also lead to productivity gains for firms using these services. It should also encourage Russian exports in a wide variety of sectors.

⁶ Unless otherwise stated, the gains we report are annual gains from our medium-term model, where in the medium term the economy has adjusted to the new incentives and reached equilibrium. We also occasionally report results from a long-run version of the model where we allow for the capital stock to adjust to an improved investment climate; these results are called long-term gains. The detailed papers may be found on www.worldbank.org/trade/russia-wto.

⁷ Tariff data and trade data are taken from the Customs Committee. Barriers to foreign direct investment in key sectors have been estimated based on data provided by Russian experts.

Tariff reduction will lead to significant gains (18 percent of all gains) but is not the most important source of benefits from WTO accession. Tariff reduction should lead to improved allocation of resources in Russia, as resources will shift to sectors where they are more highly valued at world prices. More important, tariff reduction would more readily permit Russian businesses to import products that contain new and diverse technologies. This would lead to productivity gains and is likely to expand exports. But the Russian tariff rate is at present not very high (1.6 percent of GDP, or about 7 percent of the value of imports).⁸ Therefore, this would not yield the largest macroeconomic effect, although it would be important for a few sectors.

Improved market access is valuable but is the least important of the three key changes that would result from WTO accession. Improved market access accounts for only 9 percent of the gains. Russia has already attained either bilateral (Most Favored Nation) MFN status or preferential status (in the CIS) from almost all of its trading partners. Hence, the MFN status accorded to WTO members will not significantly help Russian exporters to obtain better market access. Russian exporters subject to antidumping cases, however, will obtain improved legal status to challenge the application of duties. Yet this is not likely to lower duties significantly on average.

The potential long-term growth effects resulting from improvements in the investment climate could result in much larger gains, but estimates are subject to a large margin of error. Although we don't use an explicit dynamic model, we do conduct a long-term analysis that allows the capital stock to change. The improvement of the investment climate in the long-term should expand the capital stock. Hence, we estimate that the long-term gains could be three or four times larger than the medium term gains.

Aspects of WTO accession that we do not model are likely to provide additional gains to Russia. WTO accession will encourage modernization of standards and customs clearance, and requires implementation of intellectual property law. As a member of the WTO, Russia will also have a voice in establishing the rules of the WTO in the future. We assess that these other aspects will, on balance, be positive for Russia. Consequently, we believe that we do not overestimate the gains to Russia from WTO accession.

Impact on the Sectors and Employment

Export-intensive manufacturing sectors are likely to experience the largest expansion. Outside of services, the sectors that will experience the greatest expansion in employment are non-ferrous metals, ferrous metals and chemicals. These sectors are among those that export the highest percentage of their output, and thus they will benefit most from a lower real value of the ruble that should accompany the tariff reduction. In addition, these sectors are among the seven sectors that will benefit from improved treatment in antidumping cases. The expansion of these sectors is good for the economy, since these sectors will attract labor from the less internationally competitive sectors of the economy and this will push up wages overall.

Overall employment will not change. International experience indicates that there is no aggregate change in employment in the medium term from trade liberalization, and this is what we believe will occur in the Russian economy following WTO accession. Labor market institutions and other structural factors determine the long run level of unemployment, and macroeconomic policy are most relevant for unemployment in the short to medium term.

⁸ Seven percent is an effective tariff rate (i.e., value of collected import duties divided by imports) which is different from an average statutory rate of 11 percent, owing to application of various preferential customs regimes

Protected manufacturing sectors that export little are likely to contract. Despite overall gains to the economy, some productive and services sectors will contract in the medium run. In manufacturing, we estimate that the greatest fall in employment will be in the food industry, in light industry, in construction materials and in machinery and equipment. Exports as a share of output are quite low in these sectors, and the first three sectors are the only ones with tariff rates at about 10 percent. In the longer run, however, many of these sectors will expand due to the expansion of the capital stock.

Wage Payments and the Returns to Capital

We estimate that the wage rate of skilled labor will rise by 5.5 percent, the wage rate of unskilled labor will rise by 3.8 percent and the rate of return on capital will increase by 1.7 percent. Although the returns to all factors of production should increase, the impact on Russian “specific” capital owners in sectors that compete with FDI will depend on their ability to participate in joint ventures. We estimate that there would be a significant increase in FDI and an increase in multinational firms operating in the business services sectors in Russia, which would result in a more competitive environment for Russian capital owners in these sectors. The Russian firms that become part of a joint venture with foreign investors are likely to increase the value of their investments. Russian capital owners in business services who remain wholly independent of multinational firms, either because they avoid joint ventures or because they are not desired as joint venture partners, are likely to see the value of their investments decline. The concentration of losers in a few sectors could create significant political lobbying against measures associated with WTO accession, despite the fact that gains will be widespread throughout the economy.

Distribution of Gains at the Household Level

The vast majority of households are expected to gain from WTO accession. 99 percent of households fall within a range of gaining 2 to 18 percent of household consumption in the medium term. In the long run, when the positive impact on the investment climate and productivity materializes, the gains will be larger.

Government safety nets are very important in helping with the transition, and especially for the poorest members of society that can ill afford a harsh transition. Despite gains in the medium to long term, it is possible that many households will be worse off during a short run transition period during which the economy is adjusting to the new incentives. There will be unskilled workers who will suffer losses from transitional unemployment and are likely to incur expenses related to retraining or relocation. Thus, despite a likely substantial improvement in the standard of living for almost all households after accession to the WTO (and after adjustment to a new equilibrium), there is a strong role for public policy especially in helping the poorest members of society to adjust to the transition.

Broader impact

WTO accession is an important step toward an open economy model of development. Our results are consistent with international experience of the past 20-30 years that shows that rapid and sustained economic growth has occurred only in countries that progressively liberalized import protection, and who provided incentives to exporters that offset the tax that import protection imposes on exports. This is true for Chile, Hong Kong and Singapore who pursued classical free market principles; it is true for Mauritius, which used export processing zones to encourage exports and provide exporters with equivalent incentives as importers; and it is even true for South Korea and Taiwan, who started with significant import protection, but progressively lowered protection. Moreover, since import protection implicitly

imposes a tax on exports, South Korea and Taiwan implemented complicated programs (like indirect duty drawback) to provide exporters with incentives equivalent to sectors that received import protection. Their programs required a very competent and non-corrupt government bureaucracy to administer, something that most developing and transition countries do not possess. Diverse and rapid export growth characterized the experience of all these countries, and appears crucial for sustained rapid economic growth. Since import protection penalizes exporters, it appears that lowering protection is a crucial necessary (but not sufficient) condition for sustained rapid economic development in transition countries.

WTO accession can galvanize domestic support for liberalization of trade and foreign direct investment, and represents an opportunity to “lock-in” reforms of the trade and foreign direct investment regimes in the direction of an open economy model of economic development. Lobbying and political economy considerations often allow special interests to strongly influence policy of a particular ministry, thereby slowing reforms.. WTO accession, however, requires across the board reform in many sectors, and the pressure of WTO negotiations engage policy-makers at the highest levels of government. As a result, WTO accession provides an opportunity for a quicker realization of key reforms. Moreover, commitments at the WTO “lock-in” reforms under international treaty. Consequently, unlike reforms unilaterally undertaken, WTO commitments can not easily be reversed by a later government that is less inclined to offer a liberal trade and foreign direct investment regime.

Table 6. Main Macroeconomic Indicators

	2001	2002	2003	2004												2004	2005	
	Yr	Yr	Yr	Jan	Feb	Mar	Apr	May	June	July	Aug	Sep	Oct	Nov	Dec	Yr	Jan	Feb
Output Indicators																		
GDP, % change, y-o-y 1/	5.1	4.7	7.3	-	-	7.5	-	-	7.4	-	-	7.0	-	-	7.1	7.1	-	-
Industrial production, % change, y-o-y	4.9	3.7	7.0	6.4	8.5	7.4	5.4	6.9	9.3	6.9	9.7	6.1	4.6	12.5	4.6	7.3	2.1	5.1
Fixed capital investment, % change, y-o-y	8.7	2.6	12.5	12.7	13.8	12.8.	11.6	11.3	13.2	10.0	10.8	9.4	7.8	11.1	10.0	10.9	7.0	7.8
Fiscal and Monetary Indicators																		
Federal government balance, % GDP 1/	3.0	2.3	1.7	9.6	2.1	3.6	3.2	3.8	4.4	4.9	4.6	4.8	4.7	5.2	4.2	4.2	13.8	
Primary balance, % of GDP 1/	5.5	4.4	3.4	10.6	4.3	5.9	4.9	5.3	5.8	6.3	6.1	6.3	6.1	6.5	5.4	5.4	30.6	
M2, % change, p-o-p	44.6	34.1	44.8	0.0	3.8	2.6	1.8	1.2	4.6	-1.4	0.6	1.9	1.9	3.7	10.7	42.5	-4.0	
Inflation (CPI), % change, p-o-p	18.6	15.1	12.0	1.8	1.0	0.8	1.0	0.7	0.8	0.9	0.4	0.4	1.1	1.1	1.1	11.7	1.0	1.0
Nominal exchange rate, % change, p-o-p / (-) appreciat/	7.0	5.4	-7.3	-3.2	0.1	-0.1	1.4	0.4	0.1	0.3	0.5	-0.1	-1.5	-1.8	-1.7	-5.8	1.2	-1.1
Real effective exchange rate, July 1998=100	79.4	82.0	84.9	88.0	89.7	91.4	92.2	91.9	91.4	91.3	91.6	91.5	91.5					
Real effective exchange rate, % change, p-o-p	18.7	3.3	3.5	1.4	1.9	1.9	0.9	-0.3	-0.6	0.0	0.3	-0.1	0.0					
Reserves (including gold) billion \$, end-o-p	36.6	47.8	76.9	84.0	86.3	83.4	82.7	85.6	88.2	88.6	88.7	95.1	107.3	117.4	124.5	124.5	124.9	134.2
Balance of Payment Indicators																		
Current Account, billion \$	35.1	32.8	35.9	-	-	12.6	-	-	26.1	-	-	40.8	-	-	58.2	58.2	-	-
Trade Balance, billion \$	48.1	46.3	59.9	5.8	5.6	6.3	7.1	6.3	7.0	7.2	8.5	8.1	8.7	8.7	9.0	88.4	8.6	
Exports, billion \$	101.9	107.3	135.9	11.3	12.1	14.0	14.7	13.6	14.9	15.4	16.8	16.3	17.2	17.8	19.3	183.2	15.2	
Imports, billion \$	53.8	61.0	76.1	5.5	6.5	7.7	7.6	7.3	7.8	8.3	8.2	8.2	8.5	9.0	10.3	94.8	6.7	
Average export price of Russia's oil, \$/bbl	20.9	21.0	23.9	25.0	24.8	26.1	27.0	29.7	30.5	31.4	35.0	35.8	37.6	36.2	32.2	30.9	37.8	38.5
Financial Market Indicators																		
CBR refinancing rate, %, end-o-p	25.0	21.0	16.0	14.0	14.0	14.0	14.0	14.0	13.0	13.0	13.0	3.4	3.2	2.5	4.1	4.2		
Average deposit rate for enterprises, %	8.5	6.9	4.4	3.9	3.6	4.5	4.1	5.4	9.2	3.4	3.3	11.5	11.0	10.2	10.1	11.5		
Average lending rate for enterprises, %	17.9	15.8	13.1	12.4	12.2	11.8	12.1	12.9	11.7	11.1	11.5	13.0	13.0	13.0	13.0	13.0	13.0	13.0
Real average rate for Ruble loans, % (deflated by PPI)	-1.1	3.9	-2.2	-4.2	-6.2	-6.9	-7.8	-9.2	-11.8	-11.4	-11.2	-11.7	-12.7	-14.5	-14.2	-10.1		
Net credits to real sector, R billion	486	479	898	-14	70	123	158	52	116	103	105	111.9	56.1	129.7	197.9	1210.2		
Share of long-term credits to entrepr. in total, %	21	25	30	29	29	29	28	28	28	28	28	29.2	29.1	30.0	29.9	29.9		
Stock market index (RTS, ruble term)	260.1	359.1	567.3	611.1	670.1	752.7	631.1	581.1	583.3	540.3	584.7	631.4	663.7	628.0	614.1	614.1	637.2	716.4
Enterprises Finances																		
Share of loss-making companies 1/	38.4	43.4	41.3	38.6	39.5	42.9	42.7	41.3	40.2	40.7	39.4	37.5	39.2					
Profitability (net profit/sales), % 1/	25.6	17.4	20.7	41.5	32.8	28.9	27.5	27.2	25.2	25.0	27.1	27.0	26.7					
Non-cash settlements (% of total sales)	22.3	18.0	14.2	11.0	8.8	11.7	10.5	10.7	11.0	10.0	24.2	5.7	11.5	11.0	11.4	11.1		
Income, Poverty and Labor Market																		
Net change in gov't wage arrears, %, p-o-p	-26.5	-5.2	-34.4	20.8	15.1	-15.6	-9.2	12.3	8.1	7.5	-10.3	-5.8	-5.4	-12.9	-54.0	-55.5	23.8	12.1
Real disposable income, 99 = 100	121.7	135.5	154.1	155.3	159.5	169.1	175.4	159.6	179.7	183.6	180.2	188.8	192.6	196.2	249.6	166.1	143.3	171.6
Average dollar wage, US \$	112.4	138.6	179.4	208.2	210.1	230.7	227.0	226.9	211.1	216.0	207.3	221.0	247.7	249.5	314.8	237.2	250.6	271.6
Share of people living below subsistence, % 1/	27.3	24.2	20.6	-	-	22.1	-	-	21.5	-	-	20.2	-	-	17.8	17.8	-	-
Unemployment (% , ILO definition)	8.7	7.9	8.4	9.1	9.5	8.9	8.2	7.6	7.5	7.4	7.3	7.7	8.0	8.3	8.5	8.3	8.6	

1/ Cumulative from the year beginning

Source: Rosstat, CBR, EEG, IMF, staff estimates.