RUSSIAN ECONOMIC REPORT

November 2005

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RUSSIAN ECONOMIC REPORT – NOVEMBER 2005

I. RECENT ECONOMIC DEVELOPMENTS

Russian economic growth in 2005 has been influenced by three primary factors: a continuing rapid expansion of domestic incomes and demand, improvements in the expectations of investors, and growing competitive pressures from the real appreciation of the ruble. In this context, Russian economic growth remains strong, although the slowdown in many sectors since the second half of 2004 continues. Recent data provides more evidence of growing competitive pressures from a stronger ruble. Higher oil prices have brought even greater windfall revenues to the federal budget. Core consumer price inflation remains roughly at the same level as in 2003 and 2004. Debates surrounding the management of mounting surplus state revenues have intensified, and these debates find reflection in the 2006 federal budget. President Putin and the government have taken a number of initiatives to reassure private investors of a political commitment to improving the investment climate. The government has continued the implementation of previously launched reforms, but appears to have postponed any new major initiatives until after the elections in 2008. Nevertheless, many regions plan to launch the very ambitious and far-reaching reform of local self-government as scheduled in 2006. The government has placed a political priority on increasing the activity of the state in the economy in partnership with private investors through PPPs, special economic zones, and concession agreements. The planned purchase of Sibneft by Gazprom could represent another step in the consolidation of governance in the oil industry within state-controlled firms.

GDP and Industrial Production

Aggregate GDP growth in Russia is still strong, and preliminary numbers suggest that it may have strengthened somewhat in the second half of the year. GDP grew by an estimated 5.7 percent in the first half of 2005, as compared to 7.4 percent growth during the same period of 2004 (Table 1). Growth received a boost from new increases in oil and gas prices, and from the rapid expansion of domestic demand. Income and wage growth continues to outstrip the expansion of GDP, and the retail trade boom shows no signs of abating. But the slowdown in many sectors of the economy since the second half of 2004 remains visible, and 2005 has brought even stronger evidence that this slowdown is related to increasing competitive pressures from the rapid real appreciation of the ruble. Much of the recent growth in Russia appears to be concentrated in non-tradable sectors. Table 1 presents the breakdown in GDP growth according to the so-called “old classification” of Rosstat which is comparable with previous years. Despite double digit growth in retail trade, other sectors show a measurable slowdown compared to the same period of the previous year.

Table 1: Russian Economic Growth: 2002-2005

	2002	2003	2004	2004-9m	2005-9m
GDP	4.7	7.3	7.1	7.4*	5.7 *
Industry	3.7	7.0	7.3	7.4	4.0
Agriculture	1.5	1.3	1.6	1.2	2.6
Retail trade	9.3	8.4	12.1	11.9	11.7
Construction	3.9	12.8	10.1	11.1	8.3
Transport	5.9	7.7	6.3	7.1	2.4

*Source: Rosstat, * first half of the year*

Table 2 contains data according to the new classification of Rosstat. While these numbers are inconsistent with the old classification shown in Table 1, they show essentially the same trends in the main sectors of the economy. The most significant slowdowns were registered in the extraction industries and manufacturing. Part of the former decline is related to the disruptive effects of the Yukos affair on the oil industry. But the decline in growth in value added from manufacturing in the first half of 2005 was equally notable: estimated at 1.4 percent as compared to almost 9 percent in the first half of 2004. Transportation and construction also exhibited slower growth.

Table 2: Growth Rates of Value Added by Main Sectors (% to period of previous year)

	Q1-04	Q2-04	Q1-05	Q2-05
GDP growth rates	7.6	7.7	5.2	6.1
of which:				
Extraction of mineral resources	7.9	8.2	3.0	1.2
Manufacturing	9.6	8.4	-0.4	2.8
Electricity, gas and water	-0.4	3.5	0.6	0.7
Construction	13.9	14.7	4.6	6.6
Transport and communication	9.4	11.7	6.2	6.8
Trade (wholesale and retail)	9.5	10.5	9.4	10.8
Hotel and catering business	7.7	8.6	11.6	10.9

Source: Rosstat,

GDP and industrial output growth have picked up somewhat in the second half of 2005. Growth in output from manufacturing industries reached an estimated 6.1 percent for the first 9 months of the year (Table 3).[1] Aggregate industrial growth remained lower (4.0 percent), due primarily to much slower growth in the extraction industries. This decline in growth concerns not only oil and gas, but also the extraction of non-energy resources.

Table 3: Growth of Industrial Production

	Jan-Sep 04	Jan-Sep 05
Industrial growth total	**7.4**	**4,0**
Extraction of mineral resources	7.2	1.0
o/w energy resources	*8.3*	*1.7*
Non-energy resources	*1.7*	*-3.2*
Manufacturing	8.9	6.1
Electricity, gas and water	0.1	1.9

Sources: Rosstat

Eight out of thirteen main manufacturing industries surveyed by Rosstat reported a substantial decline in their growth rates. On a positive note, following two years of declining growth rates, the food industry appears to be faring relatively well in 2005, as productivity increases from new investment and management may have so far kept pace will growing competition from imports:

[1] The State Statistical Service, Rosstat, recalculated industrial statistics according to a new classification system at the end of 2004. The new classification is closer to common world practice, and moves from defining sectors as groups of enterprises to sectors as product groups.

Figure 1: Growth Rates in Machine Building (%)

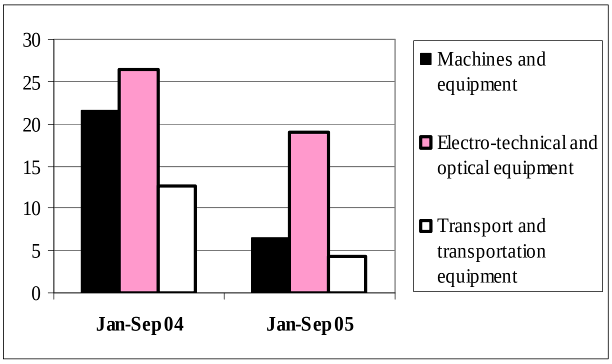


Figure 2: Growth Rates in Chemicals and Metallurgy (%)

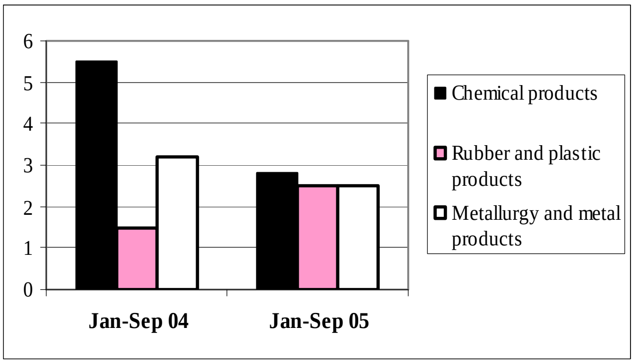


Figure 3: Growth rates in food and light industry (%)

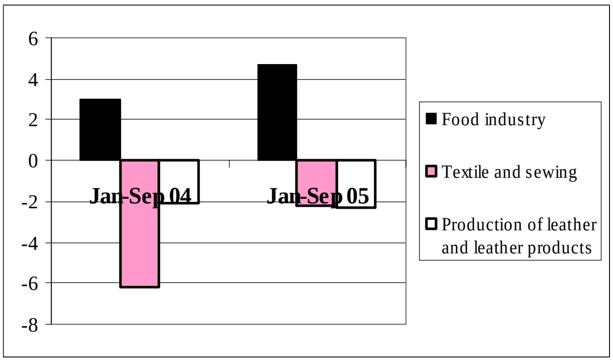
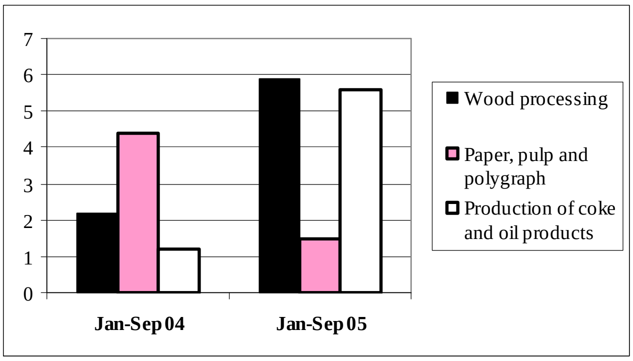


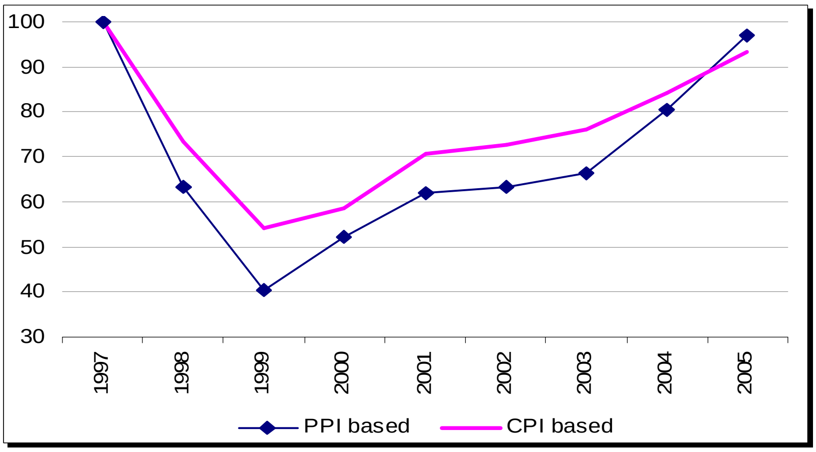
Figure 4: Growth rates in wood and oil processing (%)



Sources: Rosstat

Slower growth in many areas of manufacturing is related to a combination of the rapid real appreciation of the ruble, more significant capacity constraints, rapid real wage growth, and rather low investment levels in previous years. Data from 2005 provide even stronger evidence that many industries are struggling due to the real appreciation of the ruble. By the official index of the Central Bank, the ruble appreciated by 7.3 percent in the first nine months of 2005 against the basket of currencies of its main trading partners, while real wages increased by 8.7 percent. Yet, if measured in producer rather than consumer prices, the real appreciation has been much more rapid both in 2004 (21 percent) and 2005 (another projected 20 percent) (Figure 5). The ruble has now virtually reached its pre-crisis level of 1997. Thus, the special advantage in competitiveness from a weak ruble following the 1998 crisis no longer exists.

Figure 5: Real Effective Exchange Rate Index *



*Source: CBR, * 2005 estimate is projected on the basis of 9 months data*

Evidence of the effects of ruble appreciation on economic growth can be found in both trade and production data. Import growth continues at a very rapid pace (28 percent in dollar terms for the first 9 months of 2005), while most of the growth in exports is due to price effects. As an example, imports of machines and equipment to Russia increased by over 40 percent in the first seven months of 2005 (40.4 percent in January-July 2004), while exports of machines and equipment decreased by almost 11 percent. In fact, downward trends in quantity terms are visible for a number of Russia's main exports (Table 4).

Table 4: Export growth of Russia's main exported goods (quantity terms)

	7m-2004	7m-2005
Crude oil	16.2	-0.6
Natural gas	7.2	6.8
Electricity	-7.3	17.3
Ferrous metals	60.3	35.8
Machines, equipment, transport	21.0	-10.9
Fertilizers	8.9	6.8
Synthetic caoutchouc	22.0	7.3
Ammonia	7.2	-5.8
Cellulose	-7.6	5.8
Processed timber	18.9	14.8

Source: Rosstat

The breakdown of industrial growth suggests that much of the recent growth has been concentrated in sub-industries that may be *de facto* non-tradables (table 5). For example, the estimated 6.6 percent growth for the first nine months of 2005 in machines and equipment is due entirely to a surge in mechanical equipment (37.4 percent), which in turn was mostly driven by an increase in the production of hydraulic turbines (by 120 percent). The other five sub-industries in this sector reported either very small or negative growth for the period. Exactly the same picture can be observed in the production of transport and transportation equipment, where estimated growth of 4.3 percent (first nine months of 2005) was achieved due to the increased production of diesel and electric locomotives by 61 and 100 percent, respectively. At the same time, the production of cars, trucks and trailers decreased by 4.1 percent, compared to a 12.9 percent growth reported for the same period in 2004.

Table 5: Growth Rates in Manufacturing

	Jan-Sep 04	Jan-Sep 05
Production of coke and oil products	1.2	5.6
Food industry	3.0	4.7
Textile and sewing	-6.2	-2.2
Production of leather and leather products	-2.1	-2.3
Wood processing	2.2	5.9
Paper, pulp and polygraph	4.4	1.5
Chemical products	5.5	2.8
Metallurgy and metal products	3.2	2.5
Electro-technical equipment	26.5	19.0
tele-, radio- and communication equipment	*n/a*	*30.8*
Machines and equipment (aggregate)	21.7	6.6
o/w *Machines for agriculture an forestry*	*n/a*	*-1.8*
General purpose equipment	*n/a*	*-2.2*
Processing machines	*n/a*	*-4.0*
Households appliances	*n/a*	*-1.4*
Production of special mechanical equipment	*n/a*	*37.4*
steam turbines	n/a	37.1
hydraulic turbines	n/a	120
Transport and transportation equipment (aggregate)	12.7	4.3
Production of ships, air/spacecrafts and other transportation devices	*n/a*	*8.8*
diesel locomotives	12.5	57.1
electric locomotives	120	100
railways building machines	-22.7	120
Production of cars, trucks and trailers	***12.9***	***-4.1***

Source: Rosstat, staff estimates

A handful of tradable sectors did exhibit relatively high growth rates in the first three quarters of 2005, however. This includes the food industry, as discussed earlier, and petroleum products. In addition, some tradable sectors in Russia may actually be using the stronger ruble to their advantage for importing component parts for assembly and sale to the domestic market. In this regard, it is notable that quite strong growth is coming from electro-technical equipment (19 percent for the first three quarters of the year), especially, tele-, radio- and communication equipment (31 percent growth). Five-ten percent lower tariffs on imports of electronic components than on final household appliances may be an important reason why assembly in Russia is profitable.

In sum, the observed changes in the structure of industrial growth (especially manufacturing), accompanied by a continuing boom in the retail trade, construction, communication, hotel and catering, suggest strong effects from the real appreciation of the ruble. The primary concentration of growth in non-tradable sectors of the economy is consistent with symptoms of so-called Dutch Disease: booming domestic demand, strong growth in non-tradables, and declining growth in tradables.

Investment growth in many sectors of the economy has been picking up, despite a marginal decline in aggregate fixed capital investment for the first three quarters of the year (9.9 percent versus 11.5 percent for the same period in 2004). The aggregate slowdown is due primarily to lower investment in the oil sector which is quite ironic given potential high returns and expectations of high oil prices.[2] However, the oil sector is currently in need of large fixed investments, and is still suffering from fallout over the Yukos affair, uncertainty surrounding state-private relations in oil, and very high marginal tax rates that weaken the link between oil profits and world market prices.

Despite the trend in the oil sector, the overall news on investment is positive. A combination of explicit efforts by the government to calm private investors and even higher expectations of oil prices have made the Russian market more attractive. After the difficult years of 2003 and 2004, attitudes of foreign and domestic investors have unquestionably improved. In this context, Russia received credit rating upgrades for Fitch (August) and Moody's (October). Inflows of foreign direct investment increased by an estimated 30 percent (to USD 4.5 billion) in the first half of 2005, although relatively little FDI in 2005 has been going to non-energy tradables.[3] The strong majority of foreign inflows remain in the category of "other investment (USD 11.8 billion in H1-05)," primarily in the form of debt. Investment activity, including foreign investment, appears to be picking up in the second half of 2005, and a genuine investment boom could be possible in Russia in the near future. This would be critical to Russia, as overall low fixed capital investment rates (less than 20 percent of GDP) still jeopardize the sustainability of strong growth in the country, given the challenges to competitiveness outlined above.

[2] Fixed capital investment in resource extraction industries declined by an estimated 6.3 percent in the first half of the year, as compared to the corresponding period of 2004. This sector accounted for 15.6 percent of total investment in the economy (17.8 percent in 2004), as opposed to a 19.2 percent share of the manufacturing sector).

[3] Roughly 40 percent of this sum, however, can be associated with Dutch investment in the Sakhalin II project. Another 22 percent of FDI in the first half of 2005 can be associated with trade, the financial sector, and real estate. Among tradable manufacturing sectors, the food industry continues to attract the most foreign direct investment (6 percent in H1-05).

The Balance of Payments and Capital Flows

As could be expected, record high oil prices once again widened considerably Russia's trade, current account, and balance of payments surpluses. Russia's trade surplus reached an estimated USD 93 billion during the first 9 months of 2005, as compared to USD 62 billion for the same period in 2004 (table 6). Despite the repayment of USD 19 billion in foreign debt, gross foreign reserves accumulated by more than USD 40 billion between January-September. By early October, gross foreign reserves reached USD 159.5 billion or 20 percent of GDP. By preliminary data, the current account registered at a record USD 69 billion for the first nine months of the year.

Table 6: Balance of Payments (USD billions)

	2003	2004	9m-05*	9m-04
Current Account Balance	35.4	58.2	69.1	41.6
Trade Balance	59.9	87.1	92.8	61.9
Capital and Financial Account	-0.8	-5.4	-17.7	-19.4
Errors and Omissions	-8.2	-5.2	-11.0	-3.8
Change in Reserves	26.4	47.6	40.5	18.3

*Source: CBR, * preliminary estimates*

Russia may be experiencing important changes in its capital account. Although the aggregate number on net capital outflows from the country (the difference between the current account and accumulation of reserves) remains close to that registered in 2004, USD 17 billion of outflows in 2005 represent prepayment of foreign debt. Thus, excluding payments of debt principle, net outflows from Russia declined from USD 23.3 billion in the first nine months of 2004 to USD 12.0 billion in the same period in 2005 (table 7). The decline in net capital outflows from the private sector is even more striking in preliminary figures: USD 2.8 billion in the first nine months of 2005 as opposed to USD 17.4 billion in the same period of 2004. The biggest reduction in capital outflows was reported in the non-banking sector (from USD 11.9 billion to USD 3.5 billion). Short-term capital flows in the banking sector continue to be highly volatile, and appear tied to currency speculation (see previous RER of March 2005). Significant outflows from the banking sector in the first half of 2005 (USD 5.2 billion) shifted to strong inflows (USD 5.9 billion by preliminary data) in the third quarter of the year.

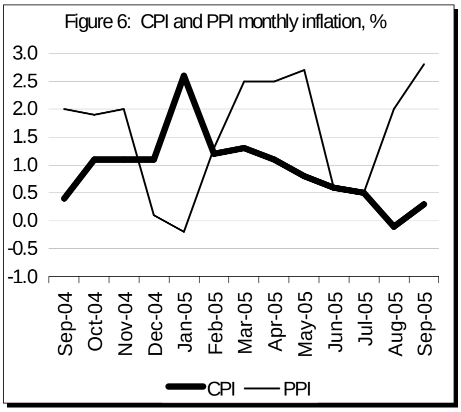


Figure 6: CPI and PPI monthly inflation, %

Source :Rosstat

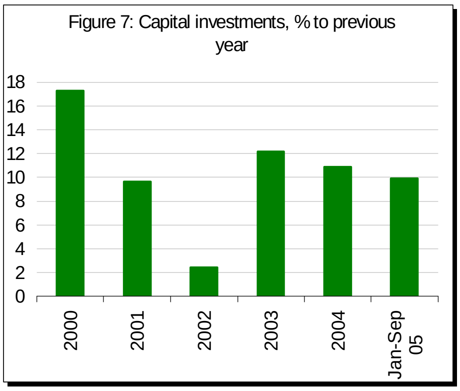


Figure 7: Capital investments, % to previous year

Source :Rosstat

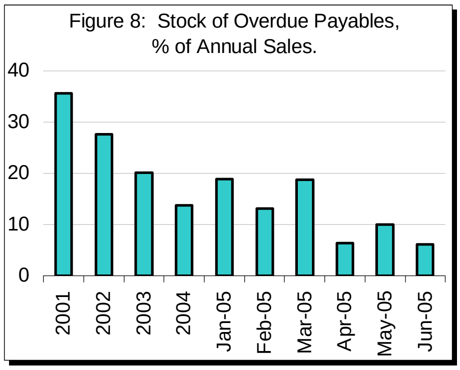


Figure 8: Stock of Overdue Payables, % of Annual Sales.

Source: Rosstat

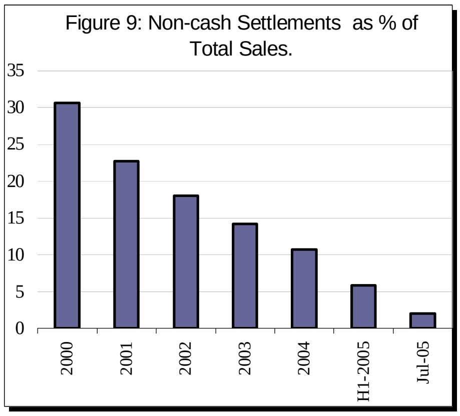


Figure 9: Non-cash Settlements as % of Total Sales.

Source: Rosstat

Table 7: Net Capital Outflows (USD billion)

	2004-9M	2005-9M
Total net capital outflows from Russia	23.3	28.6
Net capital outflows excluding early debt repayment	23.3	12.0
Total net capital outflows from the private sector	17.4	2.8
Net capital outflows from the banking sector	*5.5*	*-0.7*
Net capital outflows from non-banking sector	*11.9*	*3.5*

Source: CBR, staff estimates

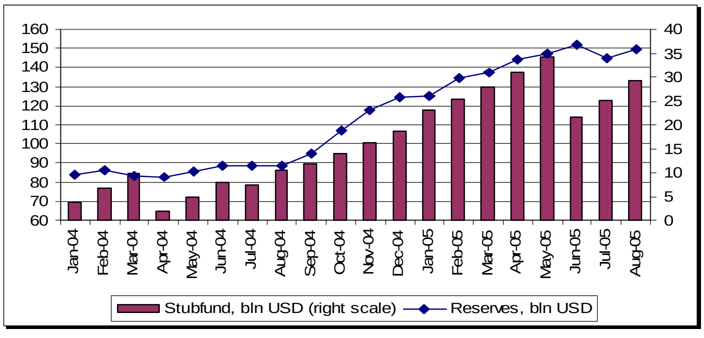
Inflation and Monetary Policy

CPI inflation amounted to 8.6 percent in January-September 2005, already reaching the initial annual target of the government. CPI inflation in 2005 will most likely exceed 12 percent. Higher inflation in 2005 than in 2004 is due in large part to increases in administered utilities prices early in the year.[4] In fact, core consumer price inflation has actually declined somewhat, from 6.8 percent in the first nine months of 2004 to 6.3 percent in the same period of this year. Producer price inflation in 2005 (15.7 percent in the first nine months) was higher than CPI inflation, due in large part to higher prices on energy resources. Energy prices for producers increased by almost 53.1 percent in the first nine months of 2005, while producer prices on manufacturing goods rose by only 7.2 percent.

Monetary policy in Russia continues to revolve around managing the nominal exchange rate. The Central Bank now follows a policy of maintaining a high degree of exchange rate stability, while still allowing the ruble to move gradually against the dollar or Euro based on market pressures. The Central Bank has announced its intention to introduce gradually more exchange rate flexibility over the medium term. It realizes, however, that any sudden change in monetary policy in this direction, given the market pressures for appreciation, could lead to large scale speculation, bubbles, and instability. Indeed, unstable short-term capital flows in 2004 and 2005 appear related to currency market speculation.

The primary source of inflationary pressures in Russia remains the huge balance of payments surplus. As oil prices grow, so do the potential pressures for inflation or nominal currency appreciation. The Stabilization Fund continues to be far and away the most important economic policy instrument for limiting these pressures. The very high marginal taxation of oil revenues into the Stabilization Fund is certainly the reason why inflationary pressures in 2005 do not exceed those in 2004. The Stabilization Fund reached 832 billion rubles (4.0 percent of GDP) by the end of August 2005.

Figure 10: Accumulation of Reserves and the Stabilization Fund



Source: CBR, Minfin

[4] CPI Inflation was especially high in January (2.6 percent) which was due to administered increases in housing and utilities prices (24.1 percent increase).

Fiscal policy and the Federal Budget

Exceptionally high world oil prices once again brought higher than expected revenues to the federal government in 2005, generating a budgetary surplus of an estimated 1.17 billion rubles (cash basis), or 8.9 percent of GDP, in the first eight months of the year. This can be compared to only 201 billion rubles (1.1 percent of GDP) targeted in the 2005 budget law. Despite windfall revenues, federal government spending in recent years has remained in the range of 16-18 percent of GDP.

The Federal Budget for 2006 was passed into law in August 2005. The outcome of the budgetary process reflected heated debates on the share of expected surplus revenues that could be spent in the current budget. In a compromise solution, planned nominal federal expenditures were increased by roughly 30 percent over the currently planned figures for 2005 (an additional projected 1.3 percent of GDP). The additional money will be spent primarily on government investment and social programs. Planned federal expenditures for 2006 amount to 17.5 percent of GDP, while revenues are planned at 20.7 percent (table 8).

Table 8: The Federal Budget (% of GDP)

	2003	2004	2005 Budget Law, revised *	2006 Draft Budget Law
Revenues	**19.6**	**20.4**	**23.7**	**20.7**
Expenditures	**17.9**	**16.1**	**16.2**	**17.5**
Of which:				
General state management (without debt service)			1.18	1.82
National defense			2.62	2.74
National security, law enforcement			2.11	2.22
National economy			1.21	1.38
Housing and utility			0.05	0.13
Environment			0.02	0.03
Education			0.78	0.85
Culture, mass media			0.22	0.21
Health and sport			0.42	0.60
Social policy			0.85	0.86
Interbudgetary transfers			5.57	5.85

Sources: , Minfin, EEG, World Bank staff calculations
** According to the revisions introduced on July 5, 2005*

While the additional spending in the 2006 budget may increase somewhat inflationary pressures, levels of spending are still generally consistent with the overall maintenance of macroeconomic financial control. As might be expected, however, debates on how to make use of windfall revenues continue to mount along with the rapid accumulation of fiscal reserves. If oil prices are above 60 dollars a barrel, the Stabilization Fund could even reach as much as 1.5 trillion rubles (USD 52 billion) by the end of 2005.

Russia still suffers greatly from poor infrastructure and significant social distress, implying a high potential value of these funds. Yet Russia also still lacks an articulated strategy for making use of these resources in a manner that trades off the expected costs and benefits in stabilization policy, infrastructure, structural reforms, other state investment programs, social policy, tax relief, investment tax credits, early foreign debt retirement, the capitalization of the Pension Fund, and other potential uses. There is a perceived danger that Russia could fall victim to the common syndrome in resource-abundant countries that experience commodity price booms: an accumulation of bloated inefficient state investment programs and populist social spending that destabilizes the economy without compensating economic or social benefits. The above warnings concerning the affects of the appreciation of the ruble on growth and diversification should be heeded in any strategy that expands government spending. Given the importance of sterilization for slowing the pace of ruble appreciation, as well as the particular demographic situation in Russia, a "Fund for Future Generations" would appear to make sense.

A recent related government initiative seeks to reduce the VAT rate from 18 to 13 percent, which could be viewed as an attempt to channel part of the surplus to the private sector and business. In general, making use of surplus resources through lower taxes appears to be a promising direction for Russia, as a lower average tax burden could enhance competitiveness and compensate somewhat for the stronger ruble. Yet this particular initiative is very controversial, as the VAT represents the only major source of revenue for the federal government that is not highly sensitive to oil and gas price fluctuations.

Income, Employment, and Poverty

Aggregate social indicators continue to show signs of progress. Growth in real wages may have slowed from the double digit annual expansion of the previous five years. But wages are still growing faster than the economy as a whole. By preliminary estimates, average real wages grew by 8.7 percent in January-September 2005. Real disposable income of the population also increased by an estimated 9.3 percent in the first nine months of 2005 relative to the same period of 2004. The rate of unemployment (ILO definition) in the Russian economy is still declining. According to preliminary estimates, 5.1 million people (6.8 percent of economically active population) were unemployed at the end of September 2005. On average the unemployment rate fell from 8.1 percent in January-September 2004 to an estimated 7.4 percent in the same period of 2005. The statistics on the number of people living below the subsistence level indicate that Russia’s growth since 2000 has been strongly pro-poor. According to the latest official statistics, only 17.8 percent of population was living below the subsistence level in 2004, as compared to 24.2 percent in 2002 and 20.3 percent in 2003.

Government-Business Relations and Reforms

While the investment climate in Russia continues to suffer from a high degree of uncertainty, particularly in relations between the government and business in so-called “strategic sectors” of the economy, the first three quarters of 2005 can be associated with some positive changes relative to the regrettable years of 2003 and 2004. First, the Kremlin and government have publicly acknowledged the problem and the need to solve it. They have been quite active in meeting with, and reassuring, major business figures in the country and abroad of the protection of their interests. A number of measures were proposed by the President himself as a demonstration of his resolve to improve the investment climate. This includes a proposed decrease in the number of years after privatization that deals can be contested, several changes in the operation of the state tax administration to protect businesses, and an amnesty for the repatriation of Russian capital from abroad. While none of these measures in isolation would probably have had a significant impact on business confidence, their combination may have been important in at least communicating a new sense of concern about conditions for private investors. If the government can further develop a reputation for upholding stable and consistent rules that are conducive to the successful operation of private business, investment rates in Russia are bound to accelerate. This is a critical question for the sustainability of rapid growth.

2005 has also witnessed at least some implicit progress in the articulation of a vision for business-government relations in Russia. For large strategic sectors, this vision is one of partnership, co-investment, and cooperation. Most new government initiatives fall into this category, including a new concessions law, priorities for the development of private-government partnerships (PPPs) in many areas, and special economic zones for joint state-private projects. The government is also in the process of developing a list of areas in the economy that would be closed to foreign-dominated ownership, including the exploitation of large resource deposits. While this initiative has given rise to very mixed feelings among foreign investors, it is consistent with the proposed overall goal of reducing uncertainty. The initiative to consolidate state control in the oil and gas industries has carried into 2005. The government plans to obtain an outright controlling stake in the gas monopoly, Gazprom, and Gazprom itself is in the process of acquiring the privately held oil giant, Sibneft.

The political climate in Russia has become increasingly focused on the parliamentary elections in 2007 and, especially, the presidential elections of 2008. The coming elections, combined with a favorable overall macroeconomic situation and the difficult experience with social reform (the monetization of in kind social benefits) early in the year, can be associated with an increasingly cautious attitude toward reform in Moscow. Although the government is continuing to implement a number of previously launched reforms, including those in the banking sector and government administration, the appetite for launching new reforms at the federal level has weakened considerably.

Nevertheless, 2006 may turn out to be a particularly significant year for economic reform at the subnational level in Russia. Most Russian regions have been working very hard in 2005 in preparation for the implementation of a major planned reform in local-self government. This reform creates thousands of new municipalities, establishes a two-level municipal system, and delegates to the municipal level explicit sources of budgetary income, expenditure autonomy, and property management. It also creates a potential foundation for the development of grass roots institutions of democracy and civil society. Although a recent law was passed that delays the implementation of the actual Law on Local Self-Government to 2009, the many regions that prepared for the law are being encouraged to move ahead with implementation in 2006 or, in some cases, 2007. Experts agree that creating genuine budgetary capacity at the lowest municipal level will be a difficult process over the next few years. Yet the implications for Russia’s economic, political, and social future could be very important.

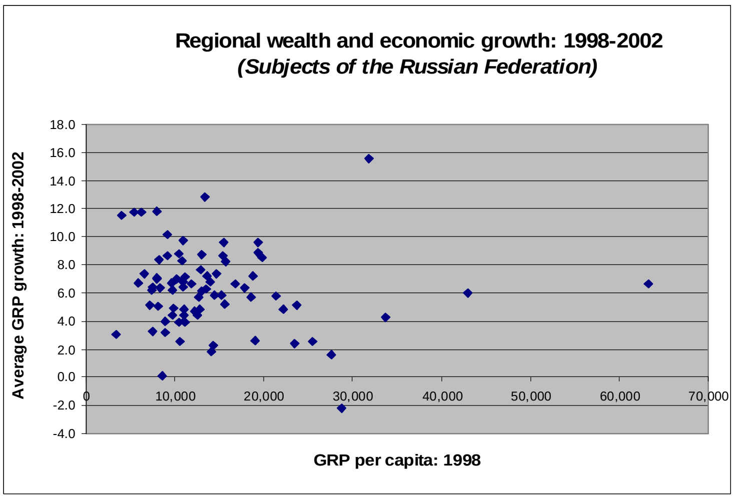
II. Regional Development and Policy in Russia

Social and economic problems in depressed Russian regions are likely to become more serious in the near future and medium term. Thus, the Russian government has chosen an opportune time to develop a National Regional Strategy. An effective Strategy will need to address complicated tradeoffs in equalization, active support for the development of growth points, and the reallocation of labor and capital to areas of greater economic potential. In this light, recent international experience in regional policy should be of interest for Russia.

At the outset of economic transition, Russian regions differed radically in advantages and opportunities for developing competitive local economies. Consequently, the transition period has witnessed growing regional inequalities, and significant budgetary resources have been spent on sustaining economic activity and minimal living standards in depressed areas. As Russia now struggles to sustain rapid economic growth and develop competitive industries outside of the resource sectors, the basic premise for regional policy is undergoing a reassessment. The Ministry of Regional Development has been working on a new “Strategy for the Socio-Economic Development of Regions or the Russian Federation” that could signal a new policy orientation. The draft Strategy and several recent publications in Russian economics journals and newspapers propose shifting away from regional “equalization (vyravnivanie)” and towards promoting the development of areas of concentrated economic growth. The idea is that Russia should come to terms with the fact that rapid economic development in the country should and will be geographically quite uneven. Such a possible reorientation in policy comes at a time when surplus government revenues have opened up new potential opportunities for infrastructure and other investments. This note considers a few basic issues pertaining to Russian regional development and the current discussions on regional development strategies.

The development of a national strategy for regional development comes at a critical time in Russia. The initial period of economic recovery from the 1998 crisis brought rapid growth and poverty reduction to many poorer Russian regions. A depreciated ruble, huge excess capacity, and cheap labor supported broad-based economic growth, particularly in many regions that had experienced very rapid decline in the 1990s. Loss-making industrial firms suddenly became profitable. Quite a number of poorer regions achieved average GRP growth of over 6 percent between 1998 and 2002 (Figure 11). A similar picture exists for progress in poverty reduction.

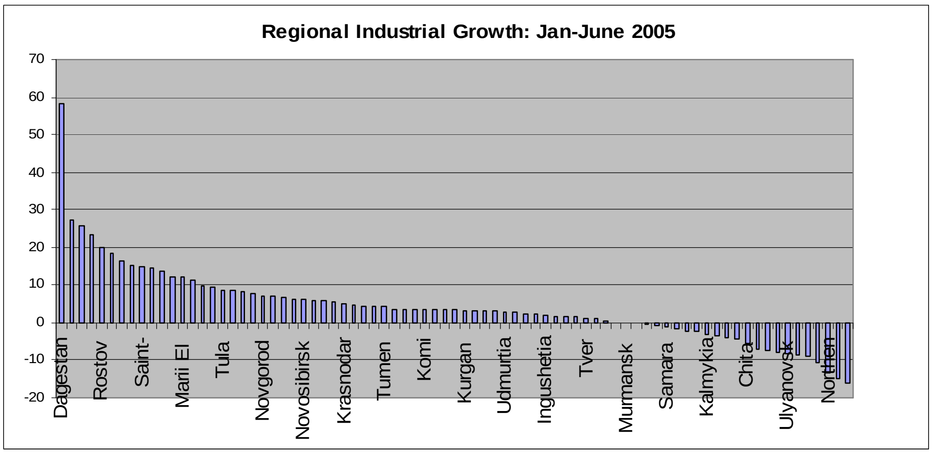
Figure 11:



But the factors that supported broad-based growth in the post-crisis period have now been practically exhausted. The ruble has appreciated back to its pre-crisis level, capacity constraints are increasingly binding, and Russian labor is now relatively expensive compared to most other countries of the region. Under these conditions, Russian producers have come under increasing competitive pressures, and only those sectors and firms that achieved the most rapid productivity growth since the late 1990s are proving themselves equipped to meet these pressures.

The implications for regional development are serious. Future growth in Russia should be concentrated in particular areas where there exist genuine comparative advantages on world markets. These comparative advantages and developmental potential are distributed highly unevenly across the Russian Federation. Thus, there exists strong potential for a very rapid divergence in regional development in coming years. As much Russian regional data becomes available only with a lag, it is difficult to test this hypothesis at the present time. Yet recent industrial production data are consistent with possible growing regional disparities. While almost all regions experienced strong industrial growth during the period of economic recovery, 19 of 88 regions experienced industrial growth of less than 3 percent in 2004, and 9 regions showed negative industrial growth. In the first half of 2005, 37 regions reported industrial growth of less that 3 percent, and 23 Subjects of the Federation experienced industrial declines relative to the same period of 2004 (Figure 12).

Figure 12:



Relative to the same period in 2004. Data source: Rosstat

A national strategy will be important for addressing the social and economic implications of growing regional disparities. An effective national strategy for regional development will need to balance and coordinate three pillars of economic policy: *equalization policy, active regional policy,* and *spatial policy.* Equalization policy addresses the social consequences of regional disparities, active regional policy seeks to promote growth in particular geographic areas, and spatial policy concerns the mobility and rational territorial allocation of labor and capital.

Despite the recent calls for a shift away from equalization to supporting points of growth, the social implications of highly unequal regional development and the imperfect mobility of the population nevertheless necessitate measures to ensure a minimal standard of living and public services in poverty-stricken areas. As some public services and assistance are more effectively administrated at the subnational level, this naturally takes the partial form of transfers to relatively depressed regions or localities. But the overarching goal of equalization policy should be the welfare of the population and poverty reduction, as opposed to the equalization of economic growth or development across regions. In many cases, the former goal might be best achieved by facilitating rapid, although regionally unequal, economic growth, while providing social assistance to lagging areas and encouraging migration to places of higher growth and potential (spatial policy). This is the sense in which the call for a shift away from "equalization" makes sense for Russia, which still suffers from an inherited geographic misallocation of much labor and capital. Ironically, however, a strategy that recognizes and even promotes uneven regional economic development actually increases the importance of equalization policy for addressing inevitable social distress in less fortunate regions.

Russia made important progress since the mid-1990s in the allocation of equalization transfers through the Fund for Financial Support of Subjects of the Federation. The establishment of a formula-based transfer system increased transparency, weakened the dependency of transfers on recent past performance, and concentrated a greater share of assistance in the poorest regions. Current reforms seek to expand these principles to transfers between regions and municipalities. Nevertheless, some studies have raised doubts to the degree to which changes in transfer methodologies have improved incentives in poorer regions to develop their own tax base.[5] Serious problems remain. Yet the declaration in some studies that equalization policies in Russia have been an unqualified failure appears to be rooted in a misconception. Equalization policy is sometimes evaluated according to the degree to which it has decreased interregional differences in budgetary capacity or incomes over time. As long as economic growth is distributed highly unevenly among Russian regions, however, there is no reason to expect convergence in regional budgetary capacity or income levels. The proper goal of equalization policy should not be understood as convergence, but as the provision of minimal levels of basic social services and assistance to poorer areas of the countries.

Two options for confronting the longer-term problems of depressed regions are strategies that either "bring investment and business to the people" (active regional policy) or "bring people and capital to the business and investment (spatial policy)." The former consists of measures to ignite economic growth in designated regions, while the latter addresses barriers to the mobility of labor and capital to areas of higher return. Expert opinions differ on the optimal balance of these two objectives in a national regional policy.

While the achievement of robust growth in backward regions may be preferable to migration from the geo-political and social points of view, world experience suggests that effective active regional policy is quite difficult to design and implement, particularly at the central level of government. Among larger countries, Brazil has a particularly interesting long experience with active regional policy aimed at promoting growth in the relatively poor North-Eastern regions of the country. Extensive programs since the 1950s include infrastructure projects, tax breaks, preferential credits, and special economic zones. During the time of these programs, differentials in GDP per capita between the North and South declined, and the special economic zone of Manaus became a focal point of economic growth as planned. Yet some recent studies raise serious challenges about the efficacy of these policies. The primary factor behind the trend toward convergence in GDP per capita appears to be migration from North to South that would have occurred, maybe even at a faster pace, in the absence of the expensive regional policies. The special economic zone of Manaus imposed high opportunity costs on the country in the form of billions of dollars in foregone tax revenues and the attraction of labor, capital and other inputs that could have been engaged elsewhere in the country.[6] In contrast to Brazil, regional policy in China focused first on the relatively more advanced Southern provinces, allowing for the development of markets through regional initiatives and competition. The economic success in the South

[5] For example, B. Lavrovskii and E. Postinikova (2005), "Transfertnyi mekhanizm: preodelen li krizis?" *Voprosy ekonomiki*, #8,

[6] This is described and analyzed in Ferreira, Pedro Cavalcanti (2005), "Regional Policy in Brazil: A Review," mimeo

subsequently spilled over to much of the rest of the country, although following a period of growing differentiation.

The effectiveness of active regional policy for addressing developmental problems in backward regions is inherently limited by a number of problems. First, large subsidies can breed a dependency relationship that has an adverse effect on local incentives for growth, efficiency, and the development of a local tax base. Second, the national government has only limited information on local conditions and the growth potential of various localities. Third, decisions surrounding active regional policy are often highly politicized and may therefore depend more on political lobbying than on economic and social considerations. Two areas of potential high returns in regional policy are infrastructure, particularly transportation, and education (human capital). Yet investments in both of these areas can have a very ambiguous effect on the development of backward regions. As suggested by the experience of the European Union, lowing transportation costs can actually encourage more firms to set up in larger, more affluent cities. In this case, they can exploit advantages from agglomeration in the larger cities and access remote markets (backward regions) through lower transportation costs. Similarly, higher levels of education and training can encourage the movement of human capital to more affluent regions. In both cases, while the effects on overall growth and development are positive, the local impact on backward regions can be ambiguous.

Given the Soviet legacy of labor and capital misallocation, demographic trends, and highly imperfect capital and labor mobility, spatial policy deserves a very prominent place in Russia regional policy, even more so to the degree that a new national strategy will emphasize supporting growth poles at the expense of aid to lagging regions. Under these circumstances, both social welfare and economic growth will be very closely tied to the migration of people and capital from peripheral depressed areas to clusters of growth. The attraction of foreign migrants will also be critical to sustaining growth in many regions. Section three of this RER outlines the basic problems pertaining to migration policy in Russia. Areas of importance include the housing market, infrastructure, and regulations on migration. The United States is an example of a large country that has managed to reduce regional inequalities through very flexible labor and capital mobility between States, and with very little intervention in the form of active regional or equalization policy.

Lessons from international experience in regional policy are supporting a consensus among some specialists and practitioners around a so-called “new regional policy.” The new regional policy includes three particular points of emphasis. First, there is a more integrated effort to exploit areas of potential competitiveness or the promotion of growth clusters within a region. There is a greater emphasis on investment in human capital, given the evidence from some studies of high potential returns. In addition, there is much more reliance on decentralized initiatives at the regional and local levels of government. After disappointing experiences with top-down state subsidy and sector-based regional policies, a number of countries, including Brazil and Italy, have recently shifted the emphasis toward the active support of subnational initiatives, and initial results appear to be positive. China’s success has been primarily rooted in decentralized initiatives.

Since 1999, the trend in Russia has been toward greater centralization, and support for subnational initiatives has received rather little attention in Moscow in recent years. Yet the year 2005 may represent a turning point in this regard. The difficult experience with the centrally-designed reform in the monetization of social benefits early in the year has increased interest in some Moscow circles for the possible use of pilot regions or decentralized initiatives for the realization of key social reforms. The major reform in local self-government will most likely be realized during 2006-2009 on the basis of regional and local programs. Further opportunities for expanding the autonomy and responsibility of subnational administrations might be explored, particularly on the revenue side of their budgets and regional debt markets. On the potential importance of decentralized initiatives, it can be noted that:

- Unless regional and local administrations are themselves strongly motivated to create conditions conducive to markets, investment, and growth, the effectiveness of national regional policy will be quite limited. The experience of the period of Soviet stagnation in the 1970s and 1980s offers ample evidence of the consequences of stifling lower level initiatives in a modern industrial economy.
- To the degree that active regional policy at the national level is used to support potential growth points, it will be much more effective in the context of regions and localities that seek energetically to reveal and develop their true potential.
- Decentralized initiatives have often played a significant role in experiences of rapid growth and development in large countries, beginning from Great Britain in the 17th century and including the United States and, more recently, China.
- The high degree of variance in Russian regions implies that a uniform approach to economic policy and reform is not always optimal. Regional and local initiatives can exploit specific local factors and conditions.
- The combination of various decentralized initiatives will provide valuable information on best practices under specific local conditions that can be used to spread successes to more problematic regions at a later date.
- Competition between regions for business, investment can support strong incentives for local initiatives at promoting economic growth.
- Decentralized approaches present the opportunity for delegating genuine responsibility for outcomes to lower levels of government.

Now is an ideal time for Russia to develop a national strategy to cope with the formidable challenges in regional development in the medium and longer term.

III. MIGRATION AND RUSSIAN ECONOMIC DEVELOPMENT[7]

Both external immigration and internal migration are crucial for economic growth and welfare in Russia. The country is in the middle of a severe demographic crisis. Ageing and depopulation will most likely continue for decades. In the near future, Russia will also face a particular shortage of working age population. To compensate for this, Russia would need an annual inflow of 1 million immigrants, which is three times as the average official annual flow over the last 15 years, and five times the official flow in recent years. Fortunately, there is a huge potential migrant pool of millions of skilled Russian-speaking residents in former Soviet countries. A legacy of the Soviet period is an irrational geographic allocation of labor and a shortage of larger cities that could be the focal point for diversified growth and development. Social welfare and economic development in Russia depend on fluid and substantial internal migration flows. Policies related to international and internal migration deserve serious attention.

International migration

International migration is a major prerequisite for Russia's sustainable economic development. The Russian population is both ageing and shrinking, and should continue to do so for decades. Mortality rates are exceptionally high in Russia, particularly among working age males. While many European countries currently face challenges in ageing and depopulation, trends in the Russian Federation are particularly acute. According to the World Population Data Sheet (WPDS), the rate of natural increase in Russia is the world's second lowest: -0.6 percent after -0.8 percent in Ukraine.[8] The WPDS projects population change in Russia in 2004-2050 to be -17 percent (declining from 144 to 119 million), which is slightly higher than -19 percent in Eastern Europe, but lower than in Russia's neighbors in Northern Europe (8 percent), Western Asia (60 percent), and South Central Asia (89 percent). The United Nations provides an even lower estimate for Russia's population in 2050: 112 million.[9] While the population in Russia has been gradually falling since 1992, the decline in *working age* population will be especially severe after 2007, especially in central regions, as a long-term consequence of birth rate behavior in 1980s.[10] In order to fully compensate for this drop, there would need to be an annual inflow of about 1 million working age migrants, a number which is three times the average net inflow in the years between the Censuses of 1989 and 2002.

Does the demographic crisis imply that Russia needs migrants? As Russia's comparative advantage is in natural resources, it is not immediately obvious that a decrease in population implies lower economic growth. In a pure natural resource economy, income per capita would be simply natural resource rents divided by the number of citizens. Hence, a decline in population can actually result in per-capita growth.

For the case of Russia, however, the need for migration to sustain growth is arguably very strong. Russia's population is not only declining, but aging, and the ratio of dependents to working age population is steadily growing. Furthermore, Russia has understandably made diversification a major developmental priority, due to risks from the exhaustion of oil reserves and vulnerability to oil price fluctuations. A large population brings economies of

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[7] This section is based mostly on a paper prepared for the World Bank by Yuri Andrienko and Sergei Guriev (2005), "Understanding Migration in Russia."

[8] 2004 World Population Data Sheet (Population Reference Bureau)

[9] World Population Prospects (2004 Revision) United Nations

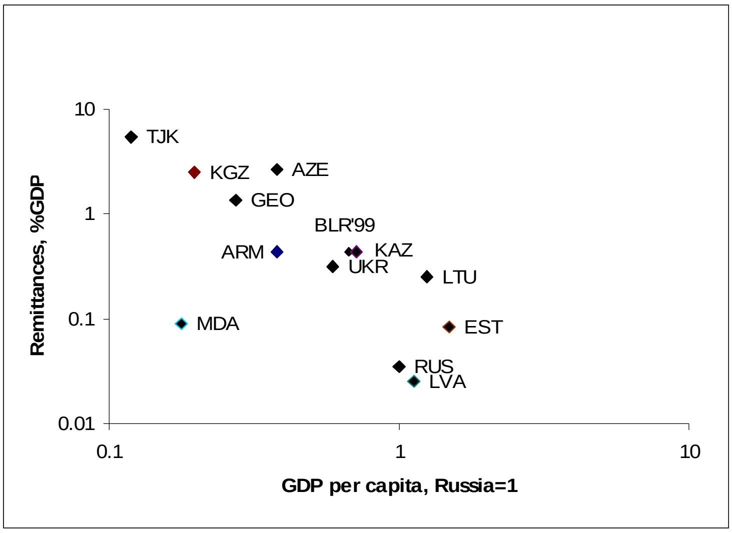
[10] Mkrtchian, N.V., Zubarevitch, N.V. (2005) " Typology of Russian regions by migration and socio-economic development" ["Tipologiia regionov Rossii po pokazateliam migratsii I sotsialno-economitcheskogo razvitia"], Tsentr strategitcheskikh razrabotok, Moscow, Mimeo, April

scale, agglomeration, and the benefits of large market size. In addition, it is possible that international migrants to Russia are more productive than average Russians due to skill and, especially, age profiles.

Strong potential flows of migrants can be expected under two conditions: (a) skills are highly transferable from the home country to Russia, and (b) the returns to skills and relative wage dispersion are higher than those at home.[11] Both assumptions appear applicable to Russia for the case of neighboring FSU countries. These countries share a similar economic and social background, and have also gone through an even more serious transformational decline. A relatively small welfare state in Russia also implies lower social costs from international migrants than in countries of the European Union. For all of these reasons, international migration is an even more attractive option for Russia than it is for EU countries.

Although Russia's demographic problems are more serious than those in the European Union, there has been no consistent policy to attract foreign labor, especially high-skilled workers. Instead, the regulatory framework in recent years has become increasingly restrictive towards immigrants. As these regulations are not perfectly enforced and there is no visa regime within the FSU, immigration flows have nevertheless been quite substantial, especially migration from Central Asia (Kazakhstan, Uzbekistan, Tajikistan, Turkmenistan, and Kyrgyzstan) and the Slavic CIS countries (Belarus, Ukraine, and Moldova). The returns to migration from these countries remain large. Although undocumented labor flows are not directly observable, data on remittances can be used as s a proxy. Even though the balance-of-payments-based IMF data most likely underestimate the magnitude of remittances, they are still very large, especially for the poorest former Soviet countries (Figure 13). The pattern in Figure 3.1 is consistent with the view that CIS-Russia migration is driven primarily by huge income differentials.

Figure 13: Income differentials between CIS countries and Russia and remittances in 2002* (logarithmic scale)



** For Belarus 1999 data source: IMF*

According to the Census data between 1989 and 2002, the majority of the natural decline in the Russian population (5 percent) was compensated by a net migration of 3.8 percent. Given that some migration is most likely not picked up in the Census, migration may have come close to compensating fully for the population decline during this period. The skill profile on in-migrants also appears quite favorable.[12]

[11] On this, see Borjas, G.J. (1994) "The Economics of Immigration", Journal of Economic Literature, vol. 32(4), Dec., pp.1667-1717.
[12] See World Bank (2005) *Russia Country Economic Memorandum*, chapter CI.

Given that Russia's restrictive migration policy has failed to stem the tide of immigrants, does policy matter at all? There are at least three reasons to believe that it does. First, it may well be the case that the intensity of migration flows would be different under a different regime. The prevalence of bribes and harassment deters migrants. Second, the existing policy affects the skill composition of migration. There are reasons to expect that repressive policies encourage low-skilled relative to high-skilled informal migration.[13] Third, repressive policies push many otherwise legal migrants into clandestine migration.[14] Thus, Russia could most likely profit from a serious reexamination of international migration policy. Explicit regulations should become more lenient, yet more meaningful, and a point-based system for the evaluation of migrants could be developed. There is also the question of an amnesty for the many of the large number of existing illegal migrants. In fact, some selective amnesties were already granted in 2005.[15]

Internal migration

The previous section of this Report outlined some of the challenges that stem from the problematic geographic allocation of capital and labor in the Russian Federation, and how internal migration to areas of higher productivity will be a key factor both in creating urban growth points and in alleviating social distress in geographic areas of economic decline. While such migration is occurring today in Russia, the pace appears slow relative to the degree of interregional disparities.

The transition to a market economy and the liberalization of foreign trade in Russia can be associated with a large increase in wage inequality across industries. As Soviet industry structure was geographically concentrated, such inequality also implied huge income differentials between regions. So far, migration has been insufficient to counter these trends. There has been very limited interregional convergence in income (price adjusted) and no convergence in the unemployment rate across Russian regions.[16] Figure 14 verifies the absence of any trend between 1992 and 2003 toward a greater reduction in unemployment in those regions that experience the highest unemployment. The interregional dispersion of real incomes continues to be high, and interregional differentials in unemployment are even increasing. A standard econometric convergence analysis shows that there is either no convergence, or that the convergence process is very slow. Especially in light of the projections in section 2 of this Report of growing regional dispersion in economic development, the seriousness of this issue is bound to grow.

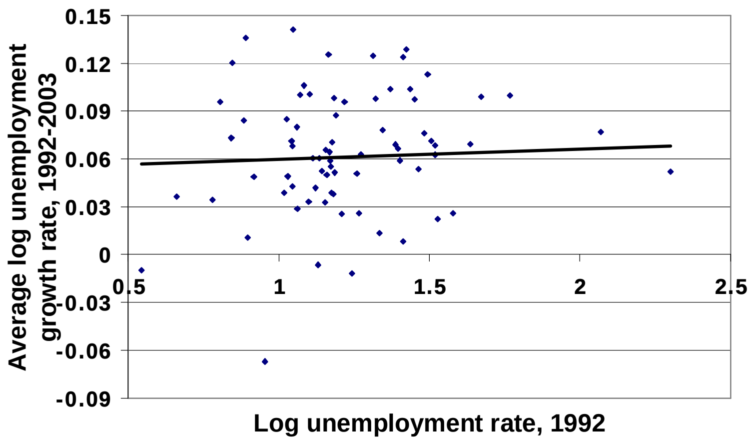
[13] Friebel, G., Guriev, S. (2004) "Smuggling Humans: A Theory of Debt-Financed Migration." CEPR Discussion Paper 4305, London

[14] Research on illegal immigrants in the US suggests that (a) repressive policy measures create substantial illegal immigration (Donato et al., 1992, Massey and Espinoza, 1997); (b) those who enter the country illegally are trapped in low-skilled jobs, do not invest in their human capital, and eventually lag behind in productivity, relative to native workers with the same initial levels of human capital.] See Donato, K., Durand, J., Massey, D. (1992) "Stemming the Tide? Assessing the Effects of the Immigration Reform and Control Act.," *Demography* 29: 138-57, and Massey, D., Espinoza, K. (1997). "What's driving Mexico-US migration? A theoretical, empirical, and policy analysis." *American Journal of Sociology* 102, pp. 939-99

[15] Federal Migration Service officials visited construction sights in Moscow, Moscow oblast, and Krasnyarsk, and handed out legal documents to irregular migrants, thus allowing for a relatively easy and inexpensive official registration. Similar experiments are planned for Ekaterkinburg, Samara, and Novosibirsk (See www.fmsrf.ru and http://www.mirtv.ru/rubrics/history/history-archive-16-9-2005.htm)

[16] On low convergence in Russia see also analysis in Bornhorst, F., Commander, S. (2004) "Regional Unemployment and its Persistence in Transition Countries", IZA Discussion Paper No. 1074, March
and Kwon, G., Spilimbergo, A. (2004) "Russia's Regions: Income Volatility, Labor Mobility and Fiscal Policy." International Monetary Fund.

Figure 14: Lack of convergence in unemployment, 1992-2003



As for the case of international migration, official data underestimate the extent of internal migration flows in Russia. But a numbers of studies have examined the question of internal migration that use a combination of official data, census data, and survey data. On the one hand, internal migration flows in Russia do appear rational in their response to differences in economic conditions. The main trend has been a substantial flow of migrants from colder and more isolated regions to cities in warmer regions. The latest Census revealed that a number of warmer European regions experienced population growth of over 10 percent during 1999-2002, while quite a few Northern and Eastern regions experienced population declines of the same magnitude or greater.[17] Economic factors such as real incomes, unemployment, and public goods provision appear to affect migration in an intuitive way. On the other hand, interregional migration flows appear to be rather slow by international standards, and have apparently not picked up in recent years in response to greater regional differences in wages and standard of living.[18]

Important barriers to internal migration that have been identified in existing studies include the underdevelopment of housing and financial markets. Given the nature of the privatization process for apartments, the virtual lack of a competitive housing market and the poor state of housing infrastructure, families in poorer and isolated regions typically cannot afford to rent or buy housing in more prosperous areas. Andrienko and Guriev find evidence to the effect that internal migration in Russia may actually be an increasing function of income in the poorer regions, i.e. it appears that many potential migrants may be trapped in certain areas due to insufficient liquidity or funds needed to move.[19] In other cases, the presence of high government subsidies in maintaining social and economic infrastructure in geographic areas without comparative advantages for the market can decrease incentives for the population to move.

Russia can facilitate more fluid migration through a combination of policies that

- remove internal administrative controls, including the registration system, that still exist for some cities.
- provide information to the population on jobs and housing in different regions.

[17] See World Bank (2005*) Russia Country Economic Memorandum*, chapter C1

[18] See Gerber, T.P. (2005) “Individual and Contextual Determinants of Internal Migration in Russia, 1985-2001”, Universty of Wisconsin, mimeo, and Andrienko, Y., Guriev, S. (2004). “Determinants of Interregional Labor Mobility in Russia.” *Economics of Transition* 12(1), 1-27.

[19] Andrienko, Y., Guriev, S. (2004). “Determinants of Interregional Labor Mobility in Russia.” *Economics of Transition* 12(1), 1-27.

- gradually phase out subsidies to depressed regions, thereby increasing incentives to move.
- develop programs aimed at directly facilitating migration, including support for private sector lending to internal migrants.
- pursue reforms in the housing sector to promote the development of infrastructure and competitive markets in low cost housing, including rental markets.
- develop more sophisticated instruments for spatial demographic and labor market forecasting.

The ability of Russia to address effectively problems in international and internal migration will be a crucial determinant of prospects for the country's long-term development.

Table 9: Main Macroeconomic Indicators

	2001	2002	2003	2004	2005								
Output Indicators	**Yr**	**Yr**	**Yr**	**Yr**	**Jan**	**Feb**	**Mar**	**Apr**	**May**	**June**	**July**	**Aug**	**Sept**
GDP, % change, y-o-y 1/	**5.1**	**4.7**	**7.3**	**7.1**	-	-	5.2	-	-	5.7	-	-	
Industrial production, % change, y-o-y	**4.9**	**3.7**	**7.0**	**7.3**	2.1	5.1	4.0	5.0	1.4	6.9	4.9	3.4	5.2
Fixed capital investment, % change, y-o-y	**8.7**	**2.6**	**12.5**	**10.9**	7.0	7.8	8.0	10.8	6.8	11.0	11.2	9.8	10.7
Fiscal and Monetary Indicators													
Federal government balance, % GDP 1/	**3.0**	**2.3**	**1.7**	**4.2**	13.8	8.3	12.4	10.6	10.3	10.2	9.4	8.9	
Primary balance, % of GDP 1/	**5.5**	**4.4**	**3.4**	**5.4**	30.6	10.2	14.2	12.0	11.5	11.3	0.0	10.1	
M2, % change, p-o-p	**44.6**	**34.1**	**44.8**	**42.5**	-4.0	2.9	3.8	2.5	2.2	5.1	1.2	3.0	
Inflation (CPI), % change, p-o-p	**18.6**	**15.1**	**12.0**	**11.7**	2.6	1.2	1.3	1.1	0.8	0.6	0.5	-0.1	0.3
Nominal exchange rate, % change, p-o-p / (-) appreciat/	**7.0**	**5.4**	**-7.3**	**-5.8**	1.2	-1.1	0.2	-0.2	1.1	2.1	-0.1	-0.3	-0.2
Real effective exchange rate, July 1998=100 (IMF)	**79.4**	**82.0**	**84.9**	**91.6**	95.0	96.3	96.9	98.6	99.4	100.1	100.2		
Real effective exchange rate, % change, p-o-p (IMF)	**18.7**	**3.3**	**3.5**	**7.9**	3.2	1.3	0.6	1.7	0.8	0.7	0.1		
Reserves (including gold) billion $, end-o-p	**36.6**	**47.8**	**76.9**	**124.5**	124.9	134.2	137.4	144.3	147.4	151.6	144.6	149.7	159.6
Balance of Payment Indicators													
Current Account, billion $	**35.1**	**32.8**	**35.9**	**60.1**	-	-	22.4	-	-	46.4	-	-	69.1
Trade Balance, billion $	**48.1**	**46.3**	**59.9**	**86.9**	8.3	8.4	10.2	10.5	10.8	9.7	10.9	11.5	12.5
Exports, billion $	**101.9**	**107.3**	**135.9**	**183.2**	15.0	16.6	20.1	20.2	20.4	19.8	21.5	22.0	23.0
Imports, billion $	**53.8**	**61.0**	**76.1**	**96.3**	6.7	8.2	9.9	9.7	9.6	10.1	10.6	10.5	10.5
Average export price of Russia's oil, $/bbl	**20.9**	**21.0**	**23.9**	**34.1**	32.1	35.2	39.3	42.1	41.7	44.5	48.9		
Financial Market Indicators													
CBR refinancing rate, %, end-o-p	**25**	**21**	**16**	**13**	13	13	13	13	13	13	13	13	13
Average deposit rate for enterprises, %	**8.5**	**6.9**	**4.4**	**4.2**	2.6	2.6	2.5	2.2	2.9	3.4	3.1		
Average lending rate for enterprises, %	**17.9**	**15.8**	**13.1**	**11.5**	10.9	10.8	10.7	10.4	11.0	11.2	10.3		
Real average rate for Ruble loans, % (deflated by PPI)	**-1.1**	**3.9**	**-2.2**	**-10.1**	-9.8	-8.0	-8.8	-8.9	-8.9	-6.6	-6.7		
Net credits to real sector, R billion	**486**	**479**	**898**	**1210**	44	7	132	148	109	173	130		
Share of long-term credits to entrepr. in total, %	**21**	**25**	**30**	**30**	30	30	30	30	31	30	30		
Stock market index (RTS, ruble term)	**260**	**359**	**567**	**614**	637	716	699	670	674	706	779	882	1007
Enterprises Finances													
Share of loss-making companies 1/	**38**	**43**	**41**	**36**	39	39	42	41	39	38			
Profitability (net profit/paid sales), % 1/	**26**	**17**	**21**	**25**	52	41	48	30	29	25			
Non-cash settlements (% of total sales)	**22**	**18**	**14**	**11**	8	9	10	7	7	6			
Income, Poverty and Labor Market													
Net change in gov't wage arrears, %, p-o-p	**-26**	**-5**	**-34**	**-56**	24	12	-17	-26	8	-11	10		
Real disposable income, 99 = 100	**122**	**136**	**154**	**167**	139	168	185	193	179	191	190	184	196
Average dollar wage, US $	**112**	**139**	**179**	**237**	262	269	291	288	288	301	303	300	308
Share of people living below subsistence, % 1/	**27.3**	**24.2**	**20.6**	**17.8**	-	-		-	-		-	-	
Unemployment (%, ILO definition)	**8.7**	**7.9**	**8.4**	**8.3**	8.3	8.2	7.9	7.6	7.3	7.0	6.7	6.4	6.8

1/ Cumulative from the year beginning

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