November 2000
IMF Staff Country Report No. 00/145

Russian Federation: Staff Report for the 2000 Article IV Consultation and Public Information Notice Following Consultation

As required under Article IV of its Articles of Agreement, the International Monetary Fund conducts periodic consultations with its member countries. In the context of the 2000 Article IV consultation with the Russian Federation, the following documents have been released and are included in this package:

- the staff report for the 2000 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on **July 18, 2000,** with the officials of the Russian Federation on economic developments and policies. **Based on information available at the time of these discussions, the staff report was completed on August 23, 2000.** The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- the Public Information Notice (PIN), which summarizes the **views of the Executive Board as expressed during the September 15, 2000, Executive Board discussion** of the staff report that concluded the Article IV consultation.

Further background documentation prepared by IMF staff for the consultation may be published separately at a later date. The policy of publication of Article IV staff reports and PINS allows for the deletion of market-sensitive information.

The Article IV staff report is published—both in hard copy and on the IMF's website (http://www.imf.org)—as part of a pilot project.

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International Monetary Fund
Washington, D.C.

INTERNATIONAL MONETARY FUND

RUSSIAN FEDERATION

Staff Report for the 2000 Article IV Consultation

Prepared by the Staff Representatives for the 2000 Consultation
with the Russian Federation

Approved by Gérard Bélanger and John Hicklin

August 23, 2000

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I. Introduction

1. Missions visited Moscow from May 15–31 and from July 11–18, 2000 to hold discussions for the 2000 Article IV consultation. They met with Prime Minister Kasyanov; Mr. Kudrin, Deputy Prime Minister and Minister of Finance; Mr. Bukaev, Minister of Taxation; Mr. Pochinok, Minister of Labor and Social Affairs; CBR Governor Gerashchenko; and a large number of senior officials.[1]

2. The Executive Board completed the last Article IV consultation on July 28, 1999, at which time it also approved a 17-month Stand-By Arrangement for SDR 3.3 billion (55.5 percent of quota). At that meeting, noting that the economic crisis that had erupted in 1998 had been due mainly to the failure to come to grips with longstanding fiscal problems and to implement structural reforms, Directors endorsed the focus in the authorities' economic program on fiscal consolidation and the acceleration of structural reforms. They warned that meeting program objectives would require enforcing tax compliance and advancing bank restructuring in the face of the likely fierce opposition from vested interests. Directors also noted that political resolve in addressing the problems of the banking sector would, in particular, be a key test of the authorities' commitment to structural reform in general. They expressed strong disapproval of the findings that the CBR had in the past given a misleading impression of the true state of reserves and urged the authorities to take immediate steps to prevent a recurrence of these problems.

3. Russia has made only one purchase under the Stand-By Arrangement, upon approval of the arrangement. Performance criteria for end-July, end-September, and end-December 1999 were observed, many with a large margin (Table 6), but there were considerable shortfalls relative to structural benchmarks for both September and December 1999. No program reviews were concluded, preventing further purchases. The authorities have indicated that they intend to request a cancellation of this arrangement and to seek further Fund support under a new Stand-By Arrangement. Discussions on a program that could be supported by such an arrangement have taken place in tandem with discussions on the 2000 Article IV consultation. The authorities hope that the program discussions can be brought to a conclusion in time for Board

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[1] The missions included Messrs. Bélanger (head), Thomsen, Laursen, Panth, Roaf, Robinson, Spatafora (all EU2), Santos (PDR), McDonald (FAD), and Ms. Potter and Ms. van de Ven (assistants, EU2). The missions were assisted by Messrs. Gilman, Anderson, and Barnard of the Fund's Moscow Office. Mr. Mozhin, Executive Director for Russia, and Mr. Palei (Advisor to the Executive Director) participated in the discussions. A conference was held in Moscow during April 5–7, 2000, focusing on structural policy reform options for Russia. The conference was organized by the State University Higher School of Economics, with the support of the IMF and the World Bank, and was attended by a large number of representatives from the government, the Duma, business, and academic institutions, as well as from international financial institutions, including the EBRD and OECD, and foreign experts. Conference papers can be found on the IMF website: http://www.imf.org/external/pubs/ft/seminar/2000/invest/index.htm.

consideration of a new arrangement before end-2000. Relations with the Fund are summarized in Appendix I.

4. As to relations with the World Bank, there have been no disbursements under the third Structural Adjustment Loan since a tranche of $100 million was released at the time the loan was restructured in August 1999. This loan is now likely to be canceled, and may be replaced with a number of sector-specific loans. Discussions on these loans are underway. Two $50 million tranches of the Coal Sector Adjustment Loan were released in late 1999 and a $100 million tranche in March 2000, and the final $250 million tranche of the Social Protection Adjustment Loan was released in August 2000. Relations with the World Bank are summarized in Appendix II.

5. Russia has accepted the obligations of Article VIII, sections 2, 3, and 4, of the Fund's Articles of Agreement, but maintains restrictions that are subject to Fund approval, as described below.

6. While a number of data weaknesses remain, particularly in the real sector, data are generally adequate for surveillance purposes (Appendix III). The authorities have indicated that they would like to subscribe to the Fund's Special Data Dissemination Standard.

7. President Putin was inaugurated on May 7, 2000, having received an absolute majority outright in the first round of the elections. The Duma approved the new cabinet under the leadership of Prime Minister Kasyanov on May 17, 2000. Most of the key economic ministers of the new government held positions in the previous government. There have been no changes in the management team at the CBR.

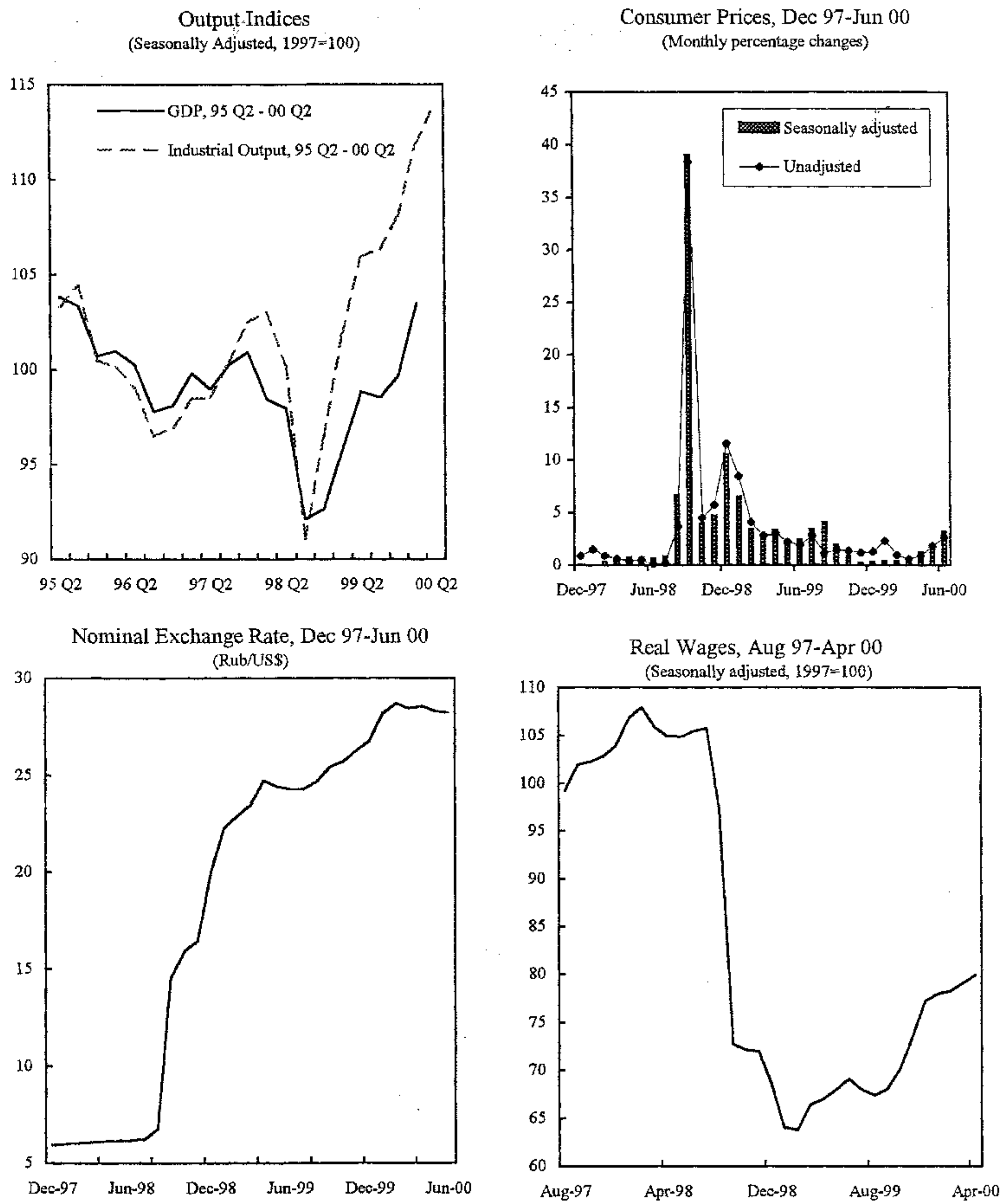
II. Recent Developments

Overview

8. Macroeconomic developments have been very favorable since early 1999, strengthening in important areas lately. Real GDP has more than recovered from the recession that followed the 1998 crisis and the recovery is gaining momentum, with recent data suggesting that real GDP is growing at an annual rate of 6–7 percent. A considerable measure of financial stability has also taken hold. On the strength of an exceptionally large current account surplus—and despite a capital account deficit for the government sector—foreign reserves are now close to the pre-crisis high and the ruble has appreciated in real terms, although it remains well below its pre-crisis level: in recent months, foreign reserves have been increasing by $2 billion per month while the ruble has been appreciating slowly in nominal terms. Inflation fell to a monthly (seasonally adjusted) rate of less than 1 percent by early 2000, but there has been some uptick recently (Figure 1).

9. The strong macroeconomic performance reflects mainly the large real ruble depreciation in 1998, but also the increase in oil prices in world markets and a significant strengthening of fiscal and monetary policies. A sharp recovery in tax revenues, accompanied by expenditure compression, has been reflected in a very strong improvement in the overall balance at all levels

Figure 1. Russian Federation: Macroeconomic Developments



Source: Russian Statistical Agency; and Fund staff estimates.

of government. This has allowed the CBR to undertake large foreign exchange market interventions—to prevent the strong balance of payments from causing a rapid real appreciation that could jeopardize the recovery—without losing control over inflation. However, while the stance of macroeconomic policies has been good, progress in structural reforms has been mixed, with little or no progress in some key areas since the 1998 crisis.

Output and employment

10. Output began to recover in the last quarter of 1998 when large-scale import substitution—spurred by a real depreciation of the ruble by 40 percent—more than offset the contraction in domestic demand that followed in the wake of the August crisis.[2] By early 1999, imports had dropped to about half of their pre-crisis level.

11. The impetus from import substitution gradually waned during 1999, but output continued to grow—with some temporary weakening in mid-year—in particular because non-energy exports began to respond to the ruble depreciation, but also due to a recovery in domestic demand, notably investment. Non-energy export volumes rose by an estimated 12 percent from the first quarter of 1999 to the first quarter of 2000. Export volumes in the energy sector increased only marginally, despite the sustained increase in oil prices in world markets, due to capacity constraints and restrictions placed on oil product exports. As to investment, there has been a relatively broad-based recovery, in particular within the manufacturing sector. The sharp increase in enterprise profitability and the reduction in barter and arrears accumulation suggest considerable positive ripple effects throughout the economy of the ruble depreciation as well as higher oil prices (Figure 2).[3] Such effects were strengthened by the fact that the potential negative impact on energy-intensive sectors was blocked by decisions to limit increases in domestic energy prices, which fell significantly in terms of both international energy prices and domestic producer prices.[4] By end-1999, when household consumption also began to increase as real wages rose from very compressed levels, output growth accelerated (Figure 1).

12. The recovery has continued to gain momentum during the first half of 2000, and preliminary data indicate that real GDP grew at an annualized rate of 6 percent (year-on-year) at

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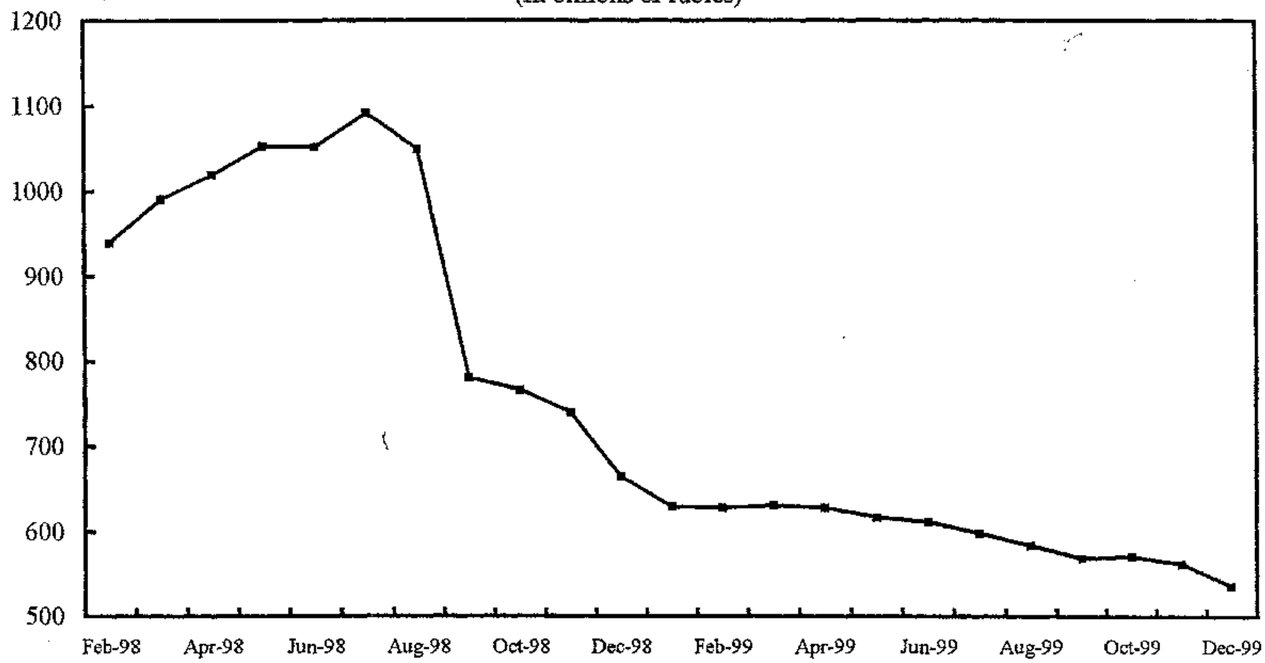
[2] The analysis of real sector developments is complicated by severe data limitations. Key macroeconomic time series are unavailable, internally inconsistent, or of only limited reliability. This applies especially to quarterly data on the main components of demand and data on import and export volumes. In addition, the short data series and the significant changes in the structure of the economy make seasonal adjustment particularly difficult.

[3] Overdue payables of large- and medium-sized enterprises fell from nearly 50 percent of GDP in mid-1998 to 30 percent of GDP at the end of 1999.

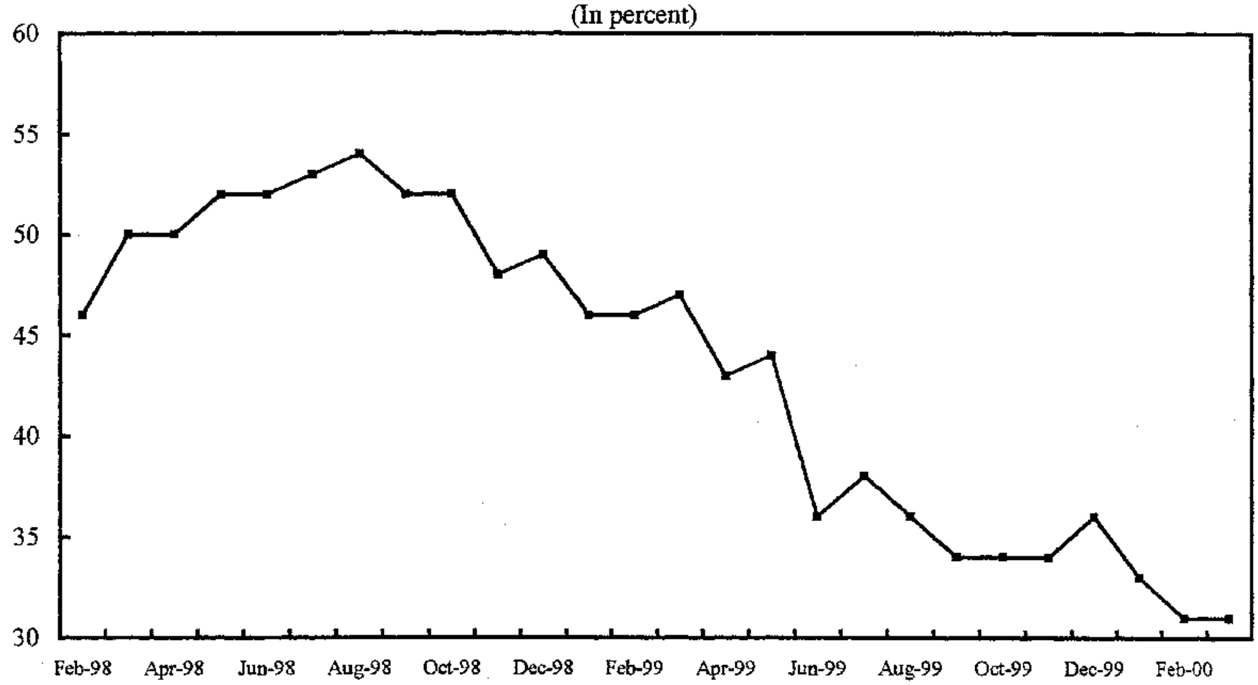
[4] Deflated by producer prices, the price of electricity was 24 percent below its pre-crisis level by March 2000. In U.S. dollar terms, the price has declined by 60 percent over this period.

Figure 2. Russian Federation: Enterprise Financing, 1998-2000

Overdue payables in January 1998 prices 1/
(In billions of rubles)



Share of noncash transactions in total sales in industry
(In percent)



Source: Goskomstat; The Russian Economic Barometer, Vol. 9, No 2.

1/ Relative to GDP, overdue payables were equivalent to 30 percent of GDP at the end of 1999, down from 46 percent in mid-1998.

Q:/data/.../Strep2000/July/charts.xlsPanel3 mid-year. Data for the first quarter show that growth in non-energy exports and household consumption remains strong. While official data on investment are inconclusive, other information suggests that the further increase in oil prices, and possibly also the generally positive sentiments about economic prospects that have taken hold after the Duma and presidential elections, could have provided additional impetus to investment. The strengthening of the recovery is particularly noteworthy in light of the fact that the increase in import volumes—since late 1999—suggests some reversal of the import substitution that was the main source of growth during the early phase of the recovery.

13. While the unemployment rate has fallen as output has recovered—from 14.1 percent in February 1999 to 11.4 percent in June 2000—it remains above the pre-crisis level of 11 percent, notwithstanding the fact that GDP is now well above its pre-crisis level. Industry, in particular, shed labor rapidly in the aftermath of the crisis and has increased output with only a small increase in employment, implying an increase in labor productivity, by March 2000, of 15 percent relative to the pre-crisis level. Unit labor cost in industry—calculated by deflating wages by producer prices—has fallen by some 18 percent over the same period. As the ruble has depreciated by 44 percent in terms of producer prices as of April 2000, export competitiveness has clearly improved significantly.

Fiscal policy

14. The fiscal position has been improving steadily since the beginning of 1999. The primary balance of the federal government has swung from a deficit of about 1½ percent of GDP in 1998 to a surplus of 1½ percent of GDP in 1999 and 6½ percent of GDP during the first half of 2000. The overall balance of the federal government has improved similarly. Other levels of government have also seen notable improvements.

15. The improved position of the federal government since 1998 primarily reflects a sharp rise in revenues, from less than 11 percent of GDP immediately before the crisis to 17½ percent of GDP during the first half of 2000. This performance is particularly noteworthy in light of the fact that all revenues at the federal level have been collected in cash since early 1999. The improvement reflects a combination of factors: (i) the growth in the tax base as a result of the economic recovery, the rise in profitability, and the increase in world market energy prices; (ii) discretionary tax changes, notably higher export taxes, which have captured an estimated 20 percent of the windfall revenue gains accruing to the energy sector, and a shift of VAT, profit, and income tax revenues from local to the federal level; and (iii) a more determined effort to enforce compliance with statutory obligations by large taxpayers, especially oil companies and Gazprom. The relative importance of these factors is difficult to disentangle because of considerable interdependency, but staff analysis suggests that more than half of the increase in revenues relative to GDP since 1995–97—about 4 percent of GDP—is accounted for by discretionary policy changes, see Box 1.

Box 1. Russian Federation: Fiscal Developments Since the August 1998 Crisis

There has been a strong improvement in the fiscal position at all levels of government since the 1998 crisis. In the three years prior to the crisis, the overall balance of the federal government averaged a deficit of 7 percent of GDP. By 2000, this is projected to have turned around to a surplus of 1½ percent of GDP.[1] The improvement in the enlarged government balance is even more dramatic, from an average deficit of 7½ percent of GDP over 1995–97 to a projected surplus of 3 percent of GDP in 2000. At the federal level, increased revenues and lower expenditures contributed more or less equally to the improvement in the overall balance. The contribution of taxes is greater after taking into account the ending of federal offset operations since early 1999: federal cash revenues are up by 6 percent of GDP. Expenditure compression has been much the more important factor in the fiscal adjustment at other levels of government, and the improvement in the enlarged government position is accounted for by an increase in revenues of 4 percent of GDP and a fall in spending of 7 percent of GDP.

A number of interrelated factors lie behind the increase in revenues since the pre-crisis period. Analysis by the staff suggests that changes in tax policy have been responsible for the bulk of the increase in revenues at the federal level. The reintroduction of export taxes in early 1999, and their expansion since, has added over 2 percent of GDP to revenues. The other main policy change, worth around 1 percent of GDP, has been the centralization of tax receipts, both through statutory increases in federal shares of VAT and income tax in 1999 and through the introduction of new tax-sharing rules in 2000. The direct effects on federal revenues of the macroeconomic changes since the 1998 crisis—including the real exchange rate depreciation and higher world energy prices, and associated increases in profitability—are estimated to be relatively small, at well under 1 percent of GDP. This in part reflects the fact that profit tax accrues mainly to local budgets, but also that revenues have been reduced by the very strong import compression. However, the reintroduction of export taxes can also be seen as related to macroeconomic developments, since they have been justified on the grounds of capturing windfall revenues due to the exchange rate depreciation.[2] Residual factors, including compliance, are also estimated to have had a modest effect, of less than 1 percent of GDP, on federal revenues. The contribution of compliance is stronger when considering the increase in cash revenues, since the elimination of noncash receipts (worth 2½ percent of GDP on average over 1995–97) is essentially a compliance effect. Improved compliance, too, is clearly likely to be related to an improved macroeconomic environment, as well as to increased tax collection efforts.

Revenues, net of transfers, at the other levels of government have changed relatively little overall compared to the pre-crisis period. Local government revenue losses due to the centralization of taxes discussed above, and due to the contraction of the domestic tax base (on which local governments are predominantly dependent) relative to GDP, were offset by higher profit tax receipts, the introduction of sales and imputed taxes, and some apparent increase in tax compliance. Extrabudgetary fund revenues stayed fairly constant relative to GDP in the aftermath of the crisis, although Pension Fund receipts are projected to increase modestly in 2000, reflecting real wage growth and compliance effects.

A significant contraction in federal expenditures was already under way at the time of the August 1998 crisis. Noninterest spending in 1998 as a whole was 2½ percent of GDP lower than the 1995–97 average. The original budget for 1999 envisaged a further reduction, although this was moderated later in the year by a supplementary budget on the basis of higher-than-expected revenues. The 2000 budget was again based on conservative revenue assumptions and foresaw a slight further decline in spending relative to GDP. The largest declines in noninterest spending compared to the pre-crisis years have been in transfers to regions and capital expenditures, but wages, social transfers, and defense spending have also been cut. Although the government has not resorted to arbitrary expenditure sequestration in 1999 and 2000, unlike in earlier years, the reductions in spending have still been largely ad hoc in nature, and not based on an expenditure review to determine appropriate spending allocations. Lacking such a review, staff have been unable to assess the sustainability of the expenditure compression. Interest costs, measured in rubles on a commitments basis, rose with the depreciation of the ruble after August 1998. However, after taking account of rescheduling, cash interest spending fell, from over 4½ percent of GDP in 1995–97 to 3 percent of GDP projected for 2000.

Expenditure reductions at the local government level have followed from the falls in federal transfers and the reduction in opportunities for deficit financing. Local governments ran a zero deficit in 1999, and are projected to run a slight surplus in 2000.[3] Projections for 2000 suggest local spending has fallen by about 2½ percent of GDP compared to the pre-crisis years. This decline has been concentrated in housing, education, and health spending, although absent an expenditure review, it is difficult to assess the extent to which service provision has been compromised. Pension Fund expenditures fell by about a third in real terms between 1995–97 and 1999, but are projected to recover to about 15 percent below pre-crisis levels in 2000.

[1] Staff projections, based on preliminary data for the first half of the year.

[2] The contribution of energy exports to the improvement in enlarged government revenues since the pre-crisis period is estimated to be 2 percent of GDP, mostly due to the reintroduction of export taxes. Cash tax collections from energy exporters rose by 4 percent of GDP. These figures compare to estimated windfall revenue gains to energy exporters since the pre-crisis period of about 4 percent of GDP due to higher world energy prices and about 5 percent of GDP due to exchange rate depreciation. Windfall gains to non-energy exporters are estimated at about 5 percent of GDP, of which nearly 1 percent of GDP was captured by export taxes.

[3] Local governments built up balances of approximately Rub 40 billion in the first half of 2000. This surplus may have been concentrated among the regions that benefit strongly from high world energy prices.

16. The higher-than-expected revenues in 1999 were matched by increased expenditures relative to the original budget, allowing the government to alleviate somewhat the sharp expenditure compression that had been built into the budget. In 2000 so far, continued higher-than-expected revenues have, however, been mostly reflected in a higher surplus as expenditures have been mostly kept in line with budgetary appropriations; the overall balance amounted to a surplus of 1 percent of GDP during the first half of 2000, compared to the target of a deficit of 3.3 percent of GDP assumed in the budget and a deficit during the same period of last year of 7.5 percent of GDP. The decision to forgo expenditure increases and ensure a sharp increase in the surplus has provided crucial support for the effort to resist a major nominal appreciation without losing control over inflation. This fiscal support is particularly noteworthy in light of the fact that important expenditure categories—including health, education, and wage expenditures—remain compressed.

Table 1. Russian Federation: Federal Government Operations
(In percent of GDP)

	1998				1999				2000	
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2
Revenues 1/	10.7	10.3	7.0	8.5	10.6	13.1	12.6	16.0	16.0	18.5
Noninterest expenditures 1/	11.5	11.7	9.7	9.1	12.2	11.7	10.0	13.2	10.4	11.4 2/
Primary balance (accrued)	-0.8	-1.3	-2.7	-0.6	-1.6	1.5	2.6	2.8	5.5	7.1 2/
Increase in noninterest arrears	0.5	1.3	3.2	-2.5	0.6	0.7	0.6	0.3	0.3	0.0 2/
Primary balance (cash)	-0.3	-0.1	0.5	-3.1	-1.0	2.2	3.2	3.0	5.8	7.1
Interest payments (cash)	5.0	5.5	3.5	2.6	3.7	4.8	2.9	3.2	2.9	3.5
Overall balance (cash)	-5.3	-5.6	-3.0	-5.6	-4.7	-2.6	0.2	-0.2	3.0	3.5

Sources: Russian authorities; and Fund staff estimates.

1/ Excluding tax collections, and corresponding expenditures, in the form of offsets of tax arrears against expenditures.
2/ Staff estimates. Data on arrears for the second quarter of 2000 are not yet available.

17. The overall balance of extrabudgetary funds and local governments improved by 3 percent of GDP in 1999, and there has been a further strengthening in the first quarter of 2000. Whereas much of the adjustment at the federal level was accounted for by higher revenues, the adjustment at the level of extrabudgetary funds and local governments has been almost entirely on the expenditure side.[5] The reallocation of VAT, profit, and income tax revenues from local governments to the federal government was mostly offset by improved tax compliance at local levels, including reduced recourse to tax offsets.

[5] The arrears of the Pension Fund, which had grown sharply in 1998, were cleared by September 1999.

Table 2. Russian Federation: Enlarged Government Operations
(In percent of GDP)

	1998				1999				2000
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1
Revenues	31.6	33.4	27.6	39.5	29.9	36.1	32.8	41.3	36.9
Expenditures	41.8	44.1	37.7	42.1	37.5	41.4	34.0	44.1	33.2
Primary balance (accrued)	-5.2	-5.2	-5.6	0.9	-0.8	2.8	4.3	2.7	9.1
Overall balance (accrued)	-10.2	-10.7	-10.2	-2.6	-7.6	-5.3	-1.3	-2.8	3.8

Sources: Russian authorities; and Fund staff estimates.

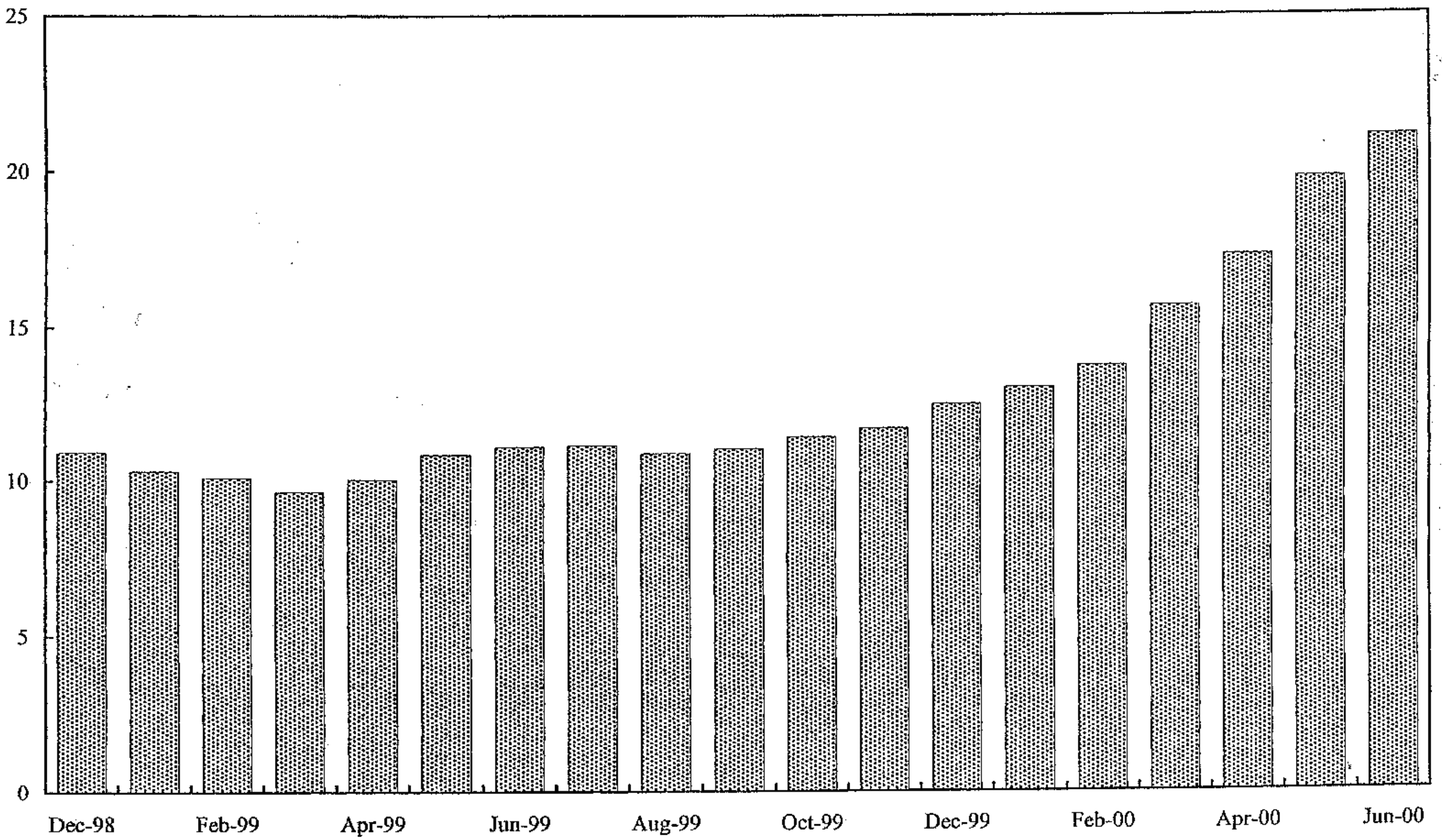
18. The authorities explained that additional costs associated with the conflict in Chechnya had been met within the revised defense budget for 1999, which was increased in a supplementary budget by 0.3 percent of GDP to 2.6 percent of GDP. However, recent information indicates that arrears in the defense sector had increased by 0.5 percent of GDP during 1999. The authorities stated that they intend to allocate approximately Rub 40 billion in excess of the existing defense allocation of 2.5 percent of GDP in the 2000 budget for military arrears clearance.

Monetary and exchange rate policies

19. Faced with a large and growing balance of payments surplus, the CBR has had to deal with difficult issues of monetary and exchange rate management. A nominal exchange rate appreciation would lead to a real appreciation, which could tend to jeopardize the recovery. Offsetting the tendency to real appreciation by monetary expansion would risk increasing inflation, unless money demand is increasing at the same time. The foreign exchange purchases required to stem the appreciation have grown precipitously since mid-1999, from 8 percent of base money in the third quarter of 1999, to 28 percent in the fourth quarter of 1999, 37 percent in the first quarter of 2000, and almost 65 percent in the second quarter of 2000, with a further increase in July.[6]

[6] While the CBR has intervened heavily to prevent a large appreciation, the interventions have been guided by different implicit exchange rate targets: between April and September 1999, interventions were such as to keep the ruble mostly constant against the dollar; between September 1999 and January 2000, the ruble depreciated by 1–2 percent per month; between January and May 2000, the ruble was again largely constant; since then, it has been appreciating slowly.

Figure 3. Russian Federation: Foreign Reserves, December 1998-June 2000
(In billions of U.S. dollars)



Source: Russian authorities.

20. In 1999, inflation was kept on a downward path despite the large foreign exchange interventions, falling to a seasonally adjusted rate of less than 1 percent per month at end-year.[7] A number of factors facilitated reserve money management: (i) there was a significant increase in demand for real money balances as the output recovery triggered a rise in the transactions demand (Figure 4); (ii) commercial banks' holdings of (unremunerated) free reserves at the CBR increased to the equivalent of more than 10 percent of ruble broad money, well above their pre-1998 crisis level. This increase, which had mostly run its course by end-1999, reflected the fact that the collapse of the GKO market had deprived banks of alternative liquid instruments and that the interbank market remained mostly dormant, as well as a reluctance among banks to increase credit to the economy; and (iii), most importantly, there was a sharp increase in the overall balance of all levels of government, reducing government recourse to the CBR as well as to foreign borrowing and other forms of domestic financing.[8]

21. During the first half of 2000, the CBR continued to rely in particular on a steady rise in net deposits by the public sector, including social funds, to effectively sterilize a large part of its foreign exchange market interventions. The increase in such deposits absorbed about half of the liquidity injected through the foreign exchange market operations during this period. However, the interventions required to stem the appreciation have begun to significantly outpace the increase in government deposits with the CBR in recent months, and money growth has accelerated. Following a notable uptick in inflation in May–June, which can only be partly explained by administered price increases, the CBR has allowed a slow gradual nominal appreciation of the ruble (Figure 5). This change in policy has not, however, reduced the inflows so far, and the CBR's foreign exchange market interventions in the first half of July reached a record $2 billion.

22. A notable feature of monetary policy has been the CBR's reluctance to use market-based instruments. According to the CBR, this reluctance reflects the fact that the government's default on GKOs has weakened the CBR's income position; to avoid further exacerbating this weak position, the CBR has relied on increases in (unremunerated) reserve requirements as an alternative to market-based instruments when the increase in public sector (and commercial bank) deposits has been insufficient to control liquidity. Since late 1998, reserve requirements were raised on four occasions from 5 percent (for both ruble and foreign currency deposits) to 10 percent on foreign currency deposits and corporate ruble deposits, and to 7 percent on

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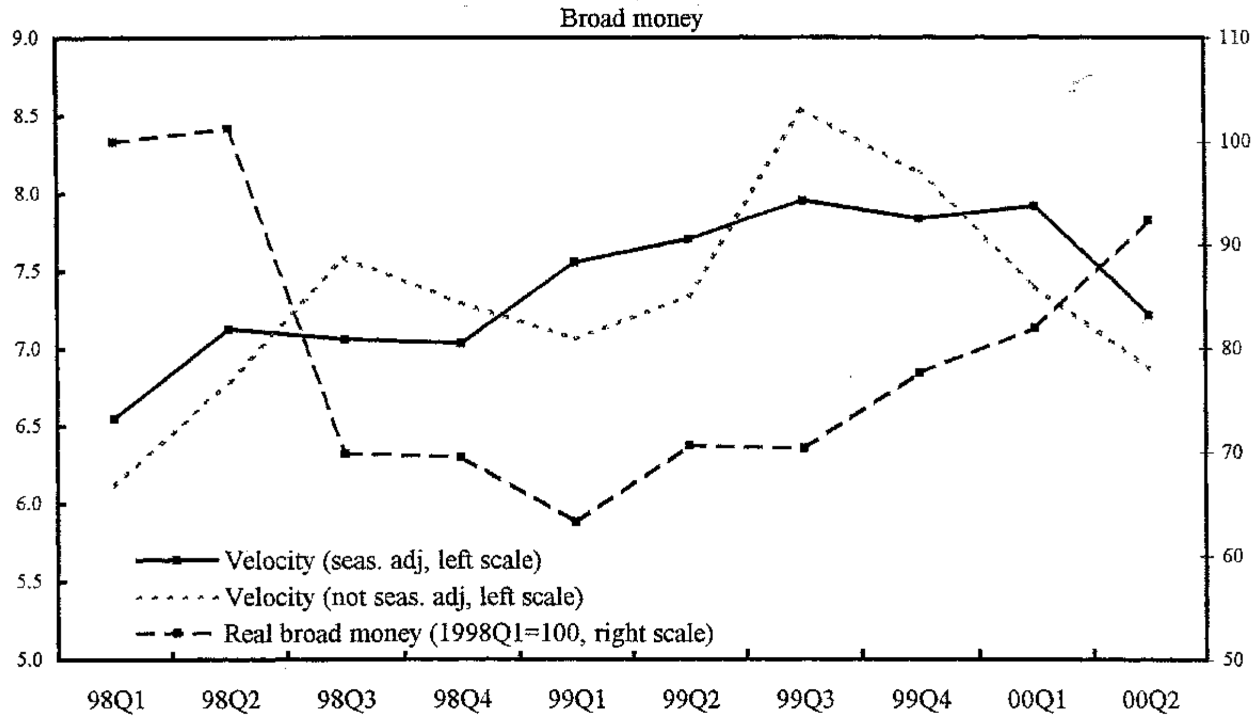
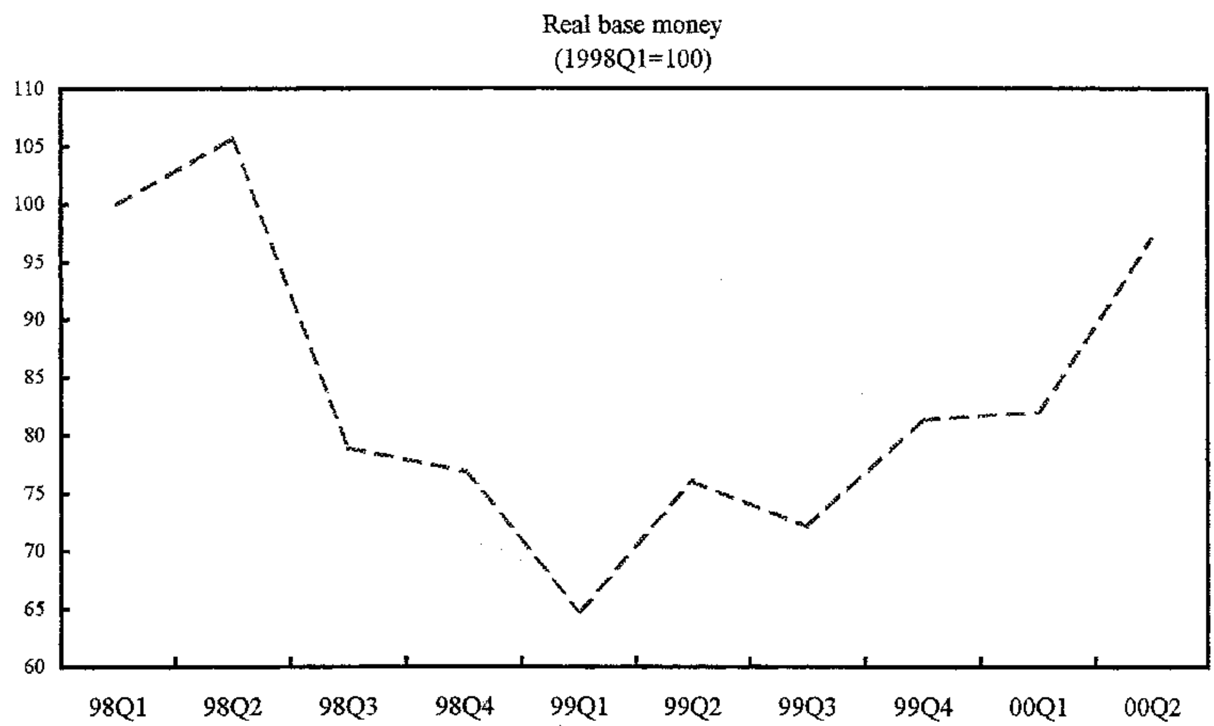
[7] There has been a sharp divergence between developments in inflation as measured by the CPI and inflation as measured by the GDP deflator or the PPI. The divergence reflects the different weights in the indices assigned to imports and energy prices.

[8] While the CBR had to purchase large amounts of foreign exchange during most of 1999, net foreign inflows intermittently fell substantially, typically as private capital outflows increased following periods of very sharp growth in money, occasionally requiring the CBR to sell foreign exchange to support the ruble.

Figure 4. Russian Federation: Money Demand, 1998-2000Q2 1/

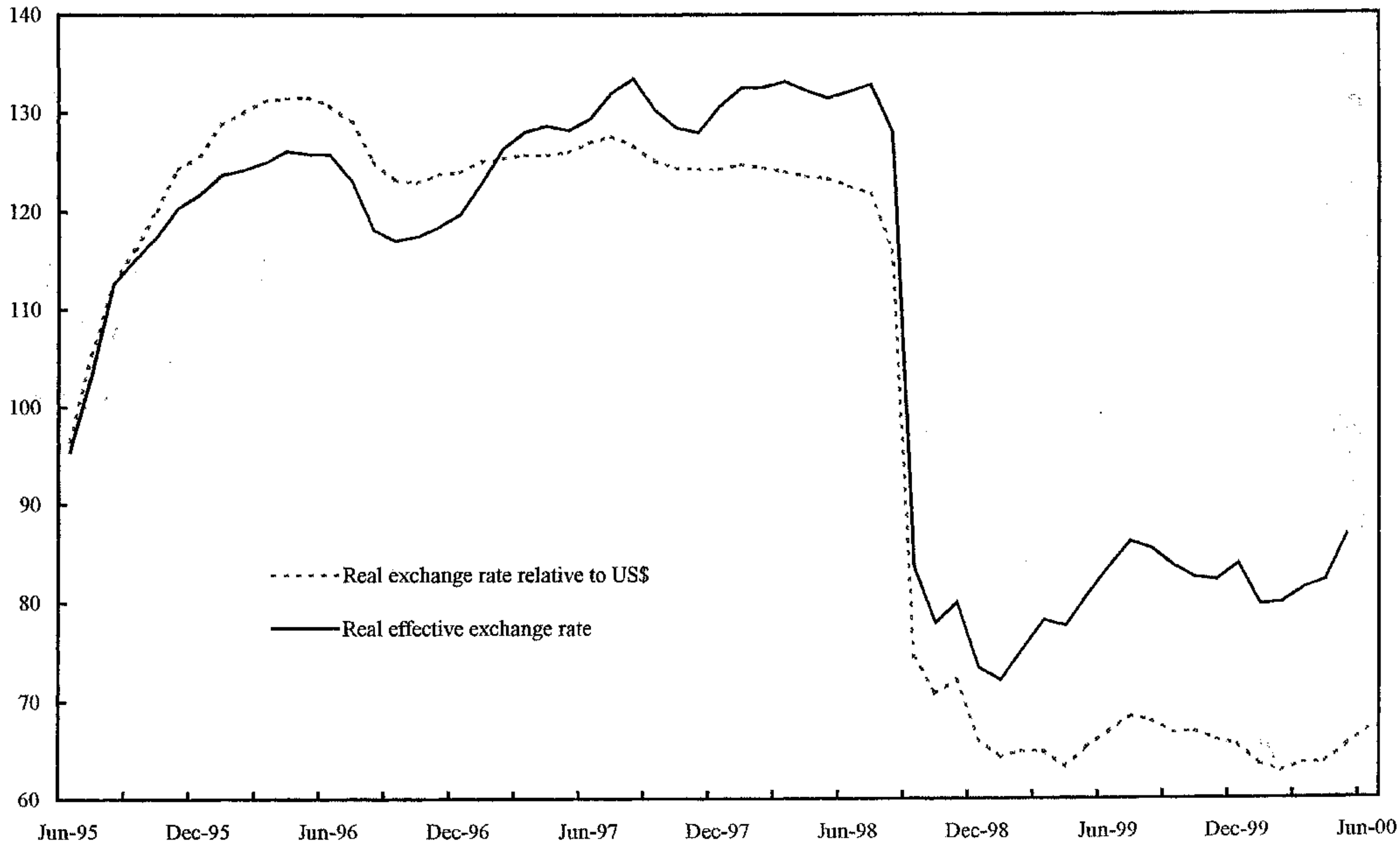




Source: CBR and Fund staff estimates.

1/ Data for Q2 2000 are preliminary estimates. Data for Q4 1999 exclude Rub 20 billion from both broad and base money as an estimate of a temporary increase in liquidity associated with Y2K.

Figure 5. Russian Federation: Real Exchange Rates, June 1995-June 2000
(1995=100)



Source: INS, IFS, Fund staff calculations.

Q:/data/.../Strep2000/July/charts.xlsPanel7 household ruble deposits.[9] Following the renewed rise in inflation recently, the CBR has made increased use of its market-based instruments, principally its deposit facility. With private capital flows still negative and large, sterilized intervention has been effective in limiting the monetary impact of large external surpluses.

Table 3. Russian Federation: The Sources of Base Money Growth 1/
(In percent of beginning of period base money)

	1999				2000	
	Q1	Q2	Q3	Q4	Q1	Q2
Base money	-2.1	25.9	0.2	24.9	-1.7	24.6
NIR of monetary authorities	-6.3	26.6	6.9	30.4	36.0	56.2
NDA	4.1	-0.8	-6.8	-5.5	-37.7	-31.6
Monetary authorities net credit to federal budget	17.8	11.2	-3.7	-5.9	-9.7	-11.6
CBR ruble credit to the federal budget	4.8	-3.0	-2.3	6.3	-3.0	-3.4
CBR foreign exchange credit for debt service	21.4	23.4	3.9	-2.2	0.0	0.0
Ruble counterpart	-8.5	-9.2	-5.3	-10.0	-6.7	-8.2
CBR net credit to local govt and EBFs	-1.9	-1.9	-3.2	-0.2	-11.5	-10.2
Net credit to banks 2/	-5.8	-11.2	-0.4	-5.2	-17.2	-10.5
Other items (net)	-6.0	1.1	0.6	5.8	0.8	0.7

Sources: CBR; and Fund staff estimates.

1/ Calculated at current exchange rates.

2/ Includes foreign exchange credits and required reserves on foreign currency deposits.

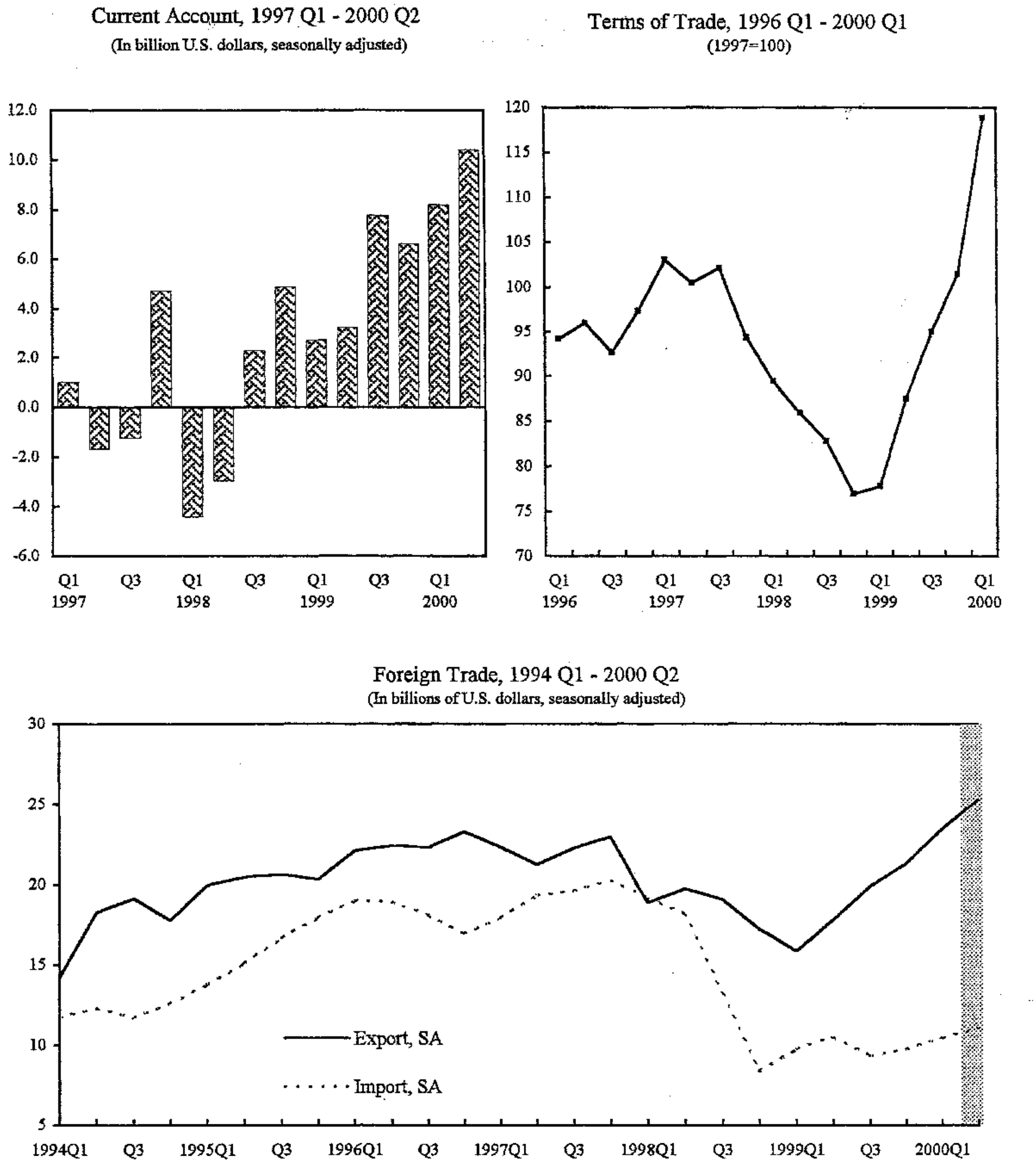
Balance of payments

23. The external current account surplus amounted to about 18 percent of GDP during the first half of 2000, compared to a deficit of 3 percent of GDP during the first half of 1998, before the August crisis (Figure 6). This improvement reflects mainly the dramatic import compression following the ruble depreciation in 1998, but also the sharp rise in energy prices on world markets.[10] The increase in the current account surplus in 2000 relative to 1999 reflects in part the

[9] The CBR absorbed limited amounts through market-based instruments during 1999 by accepting some deposits. It mostly terminated its deposit facility in December, but reactivated it in early 2000.

[10] The fact that imports are running at about 60 percent of the pre-crisis level in dollar terms overstates the extent to which import compression has occurred as the increase in import volumes since the last quarter of 1999 has been masked by the depreciation of the Euro against the dollar. The impact of this depreciation is less on the export side because of the large share of dollar- denominated energy exports.

Figure 6. Russian Federation: External Current Account



Source: Russian authorities, and Fund staff estimates.

fact that prices for natural gas are adjusted to world market prices with a lag of about six months in accordance with the terms of long-standing contracts.

Table 4. Russian Federation: Balance of Payments, Cash Basis
(In billions of U.S. dollars)

	1998				1999				2000
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1
Current account	-2.5	-2.1	2.6	8.2	4.3	5.4	7.8	9.2	10.2
Of which: Exports	18.6	18.9	18.1	19.3	15.6	17.0	18.8	24.0	23.3
Imports	-17.8	-17.3	-13.4	-9.3	-9.1	-10.1	-9.5	-10.9	-9.7
Capital account	1.1	1.2	-9.9	-8.7	-4.8	-3.1	-7.2	-6.2	-6.1
Federal government, net	3.6	3.7	1.7	-1.2	-0.4	0.7	-0.1	0.2	-0.4
Other sectors, including errors and omissions	-2.5	-2.5	-11.6	-7.5	-4.4	-3.8	-7.2	-6.4	-5.8
NIR (minus indicates increase)	1.4	0.9	7.3	0.5	0.5	-2.3	-0.6	-3.0	-4.1
Memorandum item: IMF	0.6	0.7	4.7	-0.6	-0.7	-0.9	-0.7	-1.3	-0.9

Sources: Data provided by the Russian authorities; and Fund staff estimates.

24. About two-thirds of the increase in the external current account surplus in the second half of 1999 relative to the first half was reflected in private capital outflows (including errors and omissions), while one-third was absorbed by higher foreign reserves. Private capital outflows intensified at the height of the crisis in 1998; eased somewhat in early 1999; only to continue at a high rate in the second half of 1999 and early 2000, remaining marginally below the pre-crisis levels (see Box 2 for a discussion of developments in capital flight). However, the recent strengthening of the overall balance of payments—as reflected in larger CBR foreign exchange market interventions—might reflect some further reduction in capital outflows as a result of the aforementioned positive sentiments that appear to have taken hold after the elections.

25. Official net capital inflows have remained compressed; they were close to zero in 1999 on a cash basis, compared to $14 billion during the 12-month period preceding the 1998 crisis. Virtually all payments on Soviet-era debt remain suspended, subject to rescheduling negotiations already completed or ongoing. The status of debt rescheduling negotiations is summarized in Box 3.

Structural reform

26. Progress in structural reform has been mixed. The broad structural agenda agreed with the World Bank in the context of SAL3 has been subject to significant delays in key areas, including accounting reform, privatization, debt management, labor law, and procurement legislation. There has been more progress under the more narrowly focused structural reform agenda under the Fund-supported program, although there have been important delays with regard to these reforms as well. Appendix IV describes the status of the structural benchmarks under the Stand-By Arrangement; most of the benchmarks were missed or only met with considerable delays. Box 4 describes the relatively slow progress in bank restructuring.

Box 2. Russian Federation: Capital Flight

In recent years, the flight of capital has been one of the endemic features of the Russian economy and curbing it has become a cornerstone of the authorities' recent economic policies.[1] The issue of capital flight received renewed attention last year because of investigations into possible Russian money laundering operations involving Western banks. Apart from portfolio diversification, a number of factors including macroeconomic instability, weaknesses in the enforcement of property rights, pervasive tax evasion, and inadequate supervision and regulation of the banking sector have contributed to the outflow of capital from Russia. Definitions and estimates of capital flight vary significantly, and any measure is only indicative, at best. Identifying three components of capital flight in the financial account of the balance of payments and combining the total with part of net errors and omissions (Indicator A), the CBR has tentatively estimated capital flight to have amounted to $66 billion during 1994–99, or about $11 billion annually. A somewhat broader measure, defined as the sum of the errors and omissions in the balance of payments and other net short-term nongovernment outflows (Indicator B), suggests that capital flight might have averaged as much as $19 billion annually during the same period. Similar trends are evident from alternative calculations, e.g., using data from the Direction of Trade Statistics.

	1994	1995	1996	1997	1998	1999	Total	Average 1994–99
	(In billions of U.S. dollars)							
Indicator A: 1/	4.1	8.9	14.3	15.5	13.8	9.0	65.5	10.9
Nonreceipt of export earnings	3.9	4.9	4.2	3.7	4.6	2.3	23.6	3.9
Unredeemed import advances	0.0	0.0	4.3	6.9	4.3	3.1	18.5	3.1
Nonequivalent barter	0.0	0.0	1.3	0.8	0.4	0.1	2.6	0.4
50 percent of errors and omissions	0.2	4.0	4.5	4.1	4.5	3.5	20.8	3.5
Indicator B: 2/	16.7	4.0	25.0	22.3	26.8	22.0	116.2	19.4

1/ Defined as the sum of nonreceipts of export earnings, unredeemed import advances, nonequivalent barter, and 50 percent of errors and omissions on CBR's balance of payments estimates. Including 100 percent of errors and omissions would raise the average annual figure of $10.9 billion to $14.4 billion.

2/ Defined as the sum of errors and omissions and other outflows (Table 12).

The channels of illegal capital flight are well recognized. These have included: (i) under-reporting of export earnings, including through transfer pricing schemes; (ii) overstatement of import payments, including through fake import contracts for goods and services; (iii) fake advance import payments; and (iv) a variety of capital account transactions, often effected through the correspondent accounts of nonresident banks with Russian banks.

Since the August 1998 crisis, the authorities have been seeking to stem capital flight through a number of restrictions on both current and capital transactions, and intensified regulation of foreign exchange transactions through the banking system.[2] These have included a deposit requirement on some advance import payments, strengthened reporting requirements on banks regarding foreign exchange transactions, restrictions on the repatriation of the proceeds of nonresidents' transactions in the GKO/OFZ market, and intensified regulation of cash transfers by nonresidents. Despite these measures, illegal capital flight reportedly remains sizable and imposes marked pressures on Russia's balance of payments.

The authorities conducted last year a review, in consultation with Fund staff, of the problem of capital flight, and have identified shortcomings in the exchange control system. They include: (i) the continued participation of some banks in criminal activities and unauthorized capital flight; (ii) low penalties for noncompliance with the exchange regulations; and (iii) the use for capital flight of nonresident banks' correspondent accounts with Russian banks. In response to these findings, the authorities are considering a number of corrective measures, including tighter bank licensing rules, strengthening the ability of banks to detect and refuse to undertake suspicious foreign exchange transactions, enhanced regulation of correspondent accounts, amendments to the Civil and Criminal Codes to provide for greater penalties for violations of exchange controls, and a system of prior approval of import contracts.

[1] For a discussion of capital flight in Russia, see Box 8 in SM/99/178 (July 14, 1999).

[2] See Box 4, EBS/99/124, Sup. 4 (July 27, 1999), and Annex III in SM/99/178.

Box 3. Russian Federation: Rescheduling of External Debt

Following a sharp reduction in external reserves in the run-up to the August 1998 crisis, Russia suspended debt service payments and designed a strategy for obtaining debt relief that was based on two principles: (i) servicing in full debts contracted by the Russian Federation ($51.1 billion at end-1999), which represented about 1/3 of total debt; and (ii) restructuring all external obligations inherited from the Soviet times ($103.5 billion at end-1999), which represented about 2/3 of total debt. Payments on Russia-era debt have been made on time and no arrears have accumulated on such debt. Considerable progress has been made in negotiations with three groups of creditors that together represent about 85 percent of the Soviet-era debt, but negotiations with former COMECON countries, non-Paris Club official creditors, and foreign suppliers are not well advanced.

Paris Club Debt

- A Paris Club rescheduling agreement was reached with official creditors on August 1, 1999, covering arrears and maturities falling due on Soviet-era debt in the period July 1999 to December 2000, estimated at $8.1 billion. The flow rescheduling provided for a differential treatment between previously rescheduled and non-previously rescheduled debts, as well as arrears. The new maturities were between 16 and 20 years, with grace periods between 1 and 1½ years, and payments were graduated.

- Most bilateral agreements have been signed, and the remaining ones are expected to be signed shortly (Canada, Italy, Portugal, and Norway). The deadline for completing bilateral arrangements is expected to be extended to end-September.

- The agreement includes a goodwill clause whereby creditors expressed their readiness to consider further the situation of the Soviet-era obligations, aiming at a comprehensive solution at a later stage, once conditions are established for the implementation of a more ambitious economic reform program.

- Discussions on a new Paris Club agreement are expected to begin during the fall of 2000. The authorities have explained that they are likely to request a comprehensive debt restructuring of all Soviet-era debt to the Paris Club, which amounts to about $38½ billion, involving debt and debt service reduction. Debt service payments on such debt amount to $3.8 billion in 2001. The Paris Club has indicated so far that it is willing to consider a nonconcessional rescheduling.

London Club Debt

- An agreement in principle was reached with the Bank Advisory Committee on February 11, 2000 on a comprehensive debt and debt service reduction operation that would exchange the entire stock of $31.8 billion of Soviet-era debt owed London Club creditors for $21.2 billion in new Eurobonds issued by Russia (the old instruments, PRINs and IANs were issued by Vneshekonombank, market participants value the change in the obligor).
- It is estimated that this operation will yield debt reduction of over 40 percent (in present value terms) at a minimal cost in the form of up-front cash payments. A total of about $13 billion in debt reduction (in NPV terms) will be obtained of which: (i) $10½ billion will be written off in the exchange as the new Eurobonds will carry a lower face value than the previous bonds (37.5 percent discount for PRINs and 33.0 percent discount for IANs); and (ii) $2½ billion will be accrued in present value terms due to the below-market interest rate imbedded in the new Eurobonds. The up-front cost of the operation is estimated at only $¼ billion.

- This operation provides considerable debt relief by lengthening maturities. The new Eurobonds will have a 30-year maturity with a 7-year grace period and over 1/3 lower face value than the original maturities (as opposed to 15–20 years remaining maturity of the previous bonds; interest arrears will be rescheduled at less favorable terms). The debt service will be reduced by about $1½ billion in the first 5 years and by close to $2 billion in the following 5 years.

- The operation was scheduled to be finalized on August 25. By August 11, the official closing date for acceptance, participation exceeded 95 percent, more than enough to validate the exchange. Closing was unofficially extended to August 17 to give the small number of remaining debt-holders a further opportunity to participate.

MinFin Bonds

- A bond exchange (novation) was announced to reschedule the defaulted MinFin-3 bonds in November 1999. The authorities missed the $1.3 billion bullet principal payment for the MinFin bond series 3 on May 14, 1999, but interest payments have been made in both 1999 and 2000. The announced scheme was modified in January 2000 to allow greater flexibility to investors. The exchange is open ended, and there is no deadline for participation.
- About 75 percent of the defaulted amount has already been exchanged. There is a menu of options for investors to exchange their defaulted bonds for combinations of new (foreign currency denominated) 8-year bonds similar to the MinFin's and 4-year OFZs (ruble denominated) bonds at an interest rate of 15 percent the first year and 10 percent thereafter. Vneshekonombank is the guarantor of the new bonds.

- The authorities continue servicing other series of MinFin bonds although at least series 4 and 5 (about $4.8 billion) are considered to be Soviet-era debt. The cost of servicing these obligations is relatively low as the interest rate on MinFin bonds is 3 percent.

Box 4. Russian Federation: Restructuring the Banking System

Progress has been made in establishing the legal and institutional framework for restructuring the banking system. The CBR has taken decisions on a number of major insolvent banks and ARCO (the bank restructuring agency) is implementing several approved restructuring projects. However, the implementation of CBR decisions has been frustrated by legal challenges from strong vested interests in the sector, the passage of amendments to strengthen the legislative framework has been delayed, and progress in developing a strategy for Sberbank has been slow. Moreover, a common vision has not yet emerged among Russian officials on the structure and shape of the future banking system.

The banking system is dominated by ***Sberbank***, which accounts for about 85 percent of household deposits. Deposits at Sberbank, unlike at private banks, are explicitly guaranteed by the government. During the 1998 crisis, deposits from a number of insolvent institutions were transferred to Sberbank in order to provide reassurance to depositors. A financial review of Sberbank by external auditors was initiated on July 18, 2000, after a lengthy delay. This financial review is intended to lay the basis for carrying out a strategic review of the operations of the bank, which will complement a similar review recently completed by Sberbank itself. These reviews will provide a basis for the authorities to assess the future role of Sberbank within the financial system.

Following the crisis, due diligence reviews of 18 large banks were conducted. As a result, the **CBR revoked the licenses of six of these banks** that were judged to be insolvent, without systemic value, and, at the time, with no expectation of a restructuring by the existing shareholders and creditors. In each case, bankruptcy proceedings were initiated. Four of the banks have challenged the license revocation by the CBR in the courts and either had their license reinstated (Promstroi bank and Unexim bank) or the license revocation temporarily suspended. Two of these banks have been able to negotiate a restructuring agreement with their creditors. One of the other 12 banks, ***SBS Agro*** (among the three largest banks in Russia prior to the crisis) was assigned to ARCO for review. A resolution involving a very small payoff to this bank's creditors has been proposed by ARCO. Of the remaining 11 banks, two have entered into voluntary restructuring programs under ARCO supervision; one is being restructured under CBR supervision; and the other eight were not deemed to be bankrupt under current criteria.

Amendments to five laws have been formulated in order to address identified weaknesses in the bank restructuring process The proposed amendments would make solvency a criterion for bank bankruptcy, tighten the solvency definition, require the CBR to write down banks' capital if overstated and protect the rights of secured creditors. The amendments, which have been prepared in close cooperation with Fund and World Bank technical assistance experts, have been resubmitted to the Duma, following the receipt of comments from the President of the Russian Federation.

ARCO has also continued the projects that were initiated mainly with regional banks under the ***voluntary restructuring program***. Rub 4 billion in funding has already been committed (about Rub 2 billion disbursed) for participation in the statutory capital, the provision of credit lines, and in the form of promissory notes. The projects are targeted to improve the provision of banking services in the regions. Following the approval of the revised bank restructuring law, banks are no longer permitted to voluntarily apply to ARCO for restructuring.

Since the crisis, ***substantial technical assistance has been provided by joint Fund/Bank missions*** in bank restructuring. The international community has provided substantial technical assistance to banking sector reform coordinated by the Inter-Agency Coordinating Committee. A major effort is currently underway to identify and implement the necessary steps to bring accounting standards for commercial banks in line with international standards.

Regarding the broader bank restructuring strategy, ***a joint paper prepared by the IMF/WB and EBRD*** has been transmitted to the authorities. The paper lays out the key elements of a forward looking strategy involving a move toward a banking system based on a core group of competitive private banks consistent with the broad objectives of the government's reform program in this area.

27. A number of important reforms have been instituted in the fiscal area. Most importantly, the authorities have recently succeeded in securing parliamentary approval of ambitious tax laws, involving simplification and unification of taxes and elimination of exemptions, as discussed in Section III.B, below. As to tax administration, there has been progress in downsizing the Tax Ministry, tax irregularities involving closed administrative territories have been addressed, and the threat of denial of access to export pipelines has been used to help bring oil companies to full cash tax compliance. As to expenditure management, the Ministry of Defense is being progressively brought under Treasury control, and initial steps have been taken to control the use of off-budget accounts by budget institutions. Moreover, the government adopted a new Budget Code, operative since the beginning of 2000, which introduced a unified legal framework for budget preparation, execution, and reporting. However, some initiatives envisaged under the Stand-By Arrangement have not been followed through, including plans to conduct public expenditure reviews in the health and education sectors.

28. The incidence of barter and arrears accumulation in the economy has continued to fall (Figure 2), and cash collections in the infrastructure monopolies have risen strongly, although performance in the gas sector remains disappointing. While these improvements stem in large part from the easing of enterprises' financial conditions due to the improved macroeconomic environment, they have been helped by a strengthened collection effort by the utilities, and the federal government has also contributed through its avoidance of tax offsets, efforts to improve tax compliance, and strengthened expenditure control. However, limited progress has been made in implementing other legislative and institutional reforms identified in the structural program to address nonpayments, in particular, legislative amendments to facilitate the disconnection of delinquent customers and amendments to the bankruptcy law.

29. There has been significant back-tracking on commitments to liberalize the energy sector. Export restrictions have been employed to ensure domestic supplies of oil and oil products to certain sectors and regions, and to restrain domestic price increases. These restrictions were imposed on the basis of government resolutions making access to oil export pipelines contingent on fulfillment of domestic supply targets. These targets have involved, at various times, bans on gasoline and fuel oil exports and severe restrictions on other oil product exports.

III. Report on the Discussions

30. The discussions of macroeconomic policies focused primarily on the combination of fiscal, monetary, and exchange rate policies required to prevent an excessive real appreciation of the ruble while maintaining control over inflation. This part of the discussions took place against a backdrop of heightened political concerns about the rise in inflation in May and June, but also of concerns that the recent ruble appreciation could jeopardize the output recovery and pressures for using part of the revenue windfall for higher-than-budgeted expenditures. Other macroeconomic issues discussed included the main parameters of the 2001 budget and the medium-term outlook, including relations with external creditors. As to structural reforms, the discussions were primarily focused on a few key elements of the reform program that would be important for the sustainability of macroeconomic stabilization.

A. Macroeconomic Policies

The nominal framework

31. The authorities explained that policies were still based on an inflation target of 18 percent in 2000 (December–December). While developments in early 2000 had suggested that an outcome well below this target had been possible, the recent increase in inflation and the prospect that liquidity injections from foreign exchange market interventions would continue to challenge reserve money management in the near future meant that such an overperformance was no longer likely. In 2001, policies would target a further reduction in inflation, to about 11 percent.

32. As to real GDP, the authorities expected an increase of 5 percent in 2000, although a revision of this projection was being considered. Staff noted that their projections implied that the growth rate would be close to 6 percent if output on a seasonally adjusted basis remained at current levels during the remainder of 2000, which, in light of the momentum of the recovery, suggested an outturn of 6–7 percent in 2000.[11] The authorities expected that real GDP growth would amount to about 4 percent in 2001.

33. There was agreement that—barring a major drop in oil prices—a continuation of the recovery hinged in the short run primarily on the success of macroeconomic policies in preventing the strong balance of payments position from causing a major real ruble appreciation. There was also agreement that the generally positive sentiments that have taken hold in the wake of recent elections could further strengthen growth in the near term provided that the new government demonstrated its determination to advance reforms. In this regard, the authorities were keenly aware that the recovery had to a large extent been helped by an exceptionally favorable environment and that it could not be sustained over the medium term without a broad-based acceleration of market-oriented reforms.

Macroeconomic policies for the remainder of 2000

34. There was agreement that the policy of preventing a major appreciation of the ruble had contributed importantly to sustaining the output recovery and that macroeconomic policies should remain focused on this objective as long as the current account-driven strength of the balance of payments remained. The discussions revealed differences, however, between the views of the authorities and the staff on the short-term outlook for the balance of payments, and, therefore, on the extent to which macroeconomic policies would remain circumscribed by this surplus. In addition, there were some differences between the views of CBR and Ministry of Finance officials on the relative importance of fiscal, monetary, and exchange rate policies in coping with the surplus.

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[11] A slowdown in the quarterly year-on-year growth rates is likely during 2000 because of the acceleration in growth that occurred during the second half of 1999.

35. Staff projections suggested that the current account and balance of payments surpluses during the second half of 2000 would decline steadily, although relatively slowly, from the current level, but that the need for sterilized interventions—under the assumption of a continuation of the current policy of allowing a gradual nominal appreciation of the ruble—would remain sizable. Staff projections also indicated, however, that central government revenues would continue to exceed budgeted expenditures by a significant amount, implying that a continuation of the policy of mostly depositing the revenue windfall at the CBR could significantly reduce the need for sterilization through the CBR's market-based instruments.

36. The authorities argued that policies for the second half of 2000 should be based on the assumption of a significantly weaker balance of payments than projected by the staff. They believed that the projections should incorporate a more conservative estimate for world oil prices and that the recent stepped-up pace of ruble appreciation would soon have a significantly negative impact on the overall balance of payments surplus. Accordingly, they argued that the need for sterilization through use of market-based instruments for reserve money management would be less than expected by the staff, while Ministry of Finance officials were more optimistic on the scope for using the revenue windfall to increase expenditures above budgeted levels. Preliminary plans were for an increase in expenditures above budgeted levels by Rub 80 billion (1.2 percent of GDP, of which close to 60 percent would be for the clearance of arrears) with the remainder of the revenue windfall to be deposited with the CBR, which would help meet sterilization needs.

37. In discussing the policy options in the event that the balance of payments surplus would only abate gradually from current levels, CBR officials explained that the level of deposits at the CBR contemplated by the government would leave a residual sterilization need through market-based instruments for reserve money management well above what the CBR could afford. They reiterated that the CBR's financial position was weak because its large claims on the government carry a below market yield. CBR officials stressed that the regularization of the government's financial relations with the CBR should be a priority. In the meantime they felt that the government should bear a larger share of the responsibility for effectively sterilizing the bulk of the foreign exchange market interventions either by building up (unremunerated) deposits at the CBR or by retiring government obligations to the CBR. If such operations, in combination with the limited further use of market-based instruments, prove to be insufficient to sterilize interventions, higher inflation would ensue.

38. CBR officials noted that a proposal was under discussion to restructure part of the government's obligations to the CBR into marketable securities, which would both strengthen the CBR's income position and increase the instruments available to the CBR for reserve money management. The issuance of CBR bills was still under consideration. However, the CBR noted that existing regulations would imply an adverse tax treatment of these bills compared to

government debt instruments, making the CBR bills unattractive to commercial banks. The staff welcomed the proposed restructuring of the government obligations into marketable instruments and encouraged the CBR and the government to resolve the outstanding issues that had prevented the issuance of the CBR bills.

39. While acknowledging that the balance of payments outlook was subject to considerable uncertainty, staff warned against assuming that a sudden reduction in the surplus would significantly enhance the room for maneuver in the conduct of macroeconomic policies in the coming months, especially in light of the fact that the recent uptick in inflation suggested that inflationary pressures were already building. Given the uncertain outlook, staff recommended that, although some increase in government spending—particularly on arrears reduction—would be justified, the fiscal surplus should be allowed to increase in response to the stronger growth and terms of trade. A larger budget surplus, by tending to reduce interest rates, would also offset the tendency of foreign exchange sterilization to raise interest rates. While agreeing on the need to regularize relations between the government and the CBR, including on a proper recapitalization for the CBR if required, staff argued that the issue of whether the interest cost of sterilizing the intervention should be borne by the CBR or the government was immaterial in the short run, and that the CBR should stand ready to incur the cost required to keep control over liquidity, keeping the main focus of monetary policy on inflation control. As to the role of exchange rate policy, staff believed that there was some scope for further nominal appreciation of the ruble, especially in view of the current strength of the output recovery, notably the fact that it is now relatively broad based, and of the medium-term balance of payments outlook. Staff agreed, however, that a major nominal appreciation was not appropriate, and therefore that continued intervention would be required. However, in the event that policy constraints made a larger real appreciation inevitable, this should be accommodated through a faster nominal appreciation rather than through higher inflation, because higher inflation was likely to further curtail the room for maneuver by jeopardizing the prospect for a recovery in money demand.

The 2001 budget

40. The authorities explained that the 2001 budget for the federal government would target a zero overall deficit on a cash basis, consistent with a primary surplus of about 3 percent of GDP on a commitment basis. This would compare to a primary surplus of 6.1 percent of GDP in 2000, assuming that expenditures are increased by Rub 80 billion relative to the original 2000 budget, in line with the Ministry of Finance's current plan.[12]

41. The expenditure envelope for 2001 that would be consistent with this target had not yet been determined because of uncertainty about the final form of the proposed tax reforms. As submitted to the Duma by the government, the proposals for tax reform could entail a revenue loss at the level of the general government of about 2 percent of GDP, but a revenue *gain* at the

[12] About Rub 50 billion would be assigned for arrears clearance, including Rub 40 billion for military arrears.

federal level of about 1 percent of GDP. However, due to modifications by the Duma to these proposals, the revenue implications—and, therefore, the need for transfers from the federal government to lower levels of government to compensate for revenue losses—could turn out to be significantly different from the government's original estimates. The government planned to submit its 2001 budget proposal in August–September, after the Duma and the Federation Council had adopted tax reforms.

42. Staff's preliminary judgment was that the proposed target for the 2001 federal budget was consistent with the current macroeconomic outlook for 2001. Staff expressed concern, however, that the authorities might be unable to mobilize support from the Duma and regional governments for the expenditure reforms that would be necessary to at least partly offset the revenue losses resulting from the tax reform. Staff pointed, in particular, to uncertainty about whether local governments could achieve the required expenditure reduction without incurring arrears, and about support for the proposed elimination of unfunded expenditure mandates and for the revised formula for redistribution of centralized revenues across regions. Finally, the cost of structural reforms, including the cost of bank rehabilitation and of measures to alleviate the social impact of the reforms, would not be known before the government had formulated its structural reform program in more detail. Against this background, staff noted that the sustainability of fiscal policy depended importantly on the authorities using the current revenue windfall arising from the favorable environment to cover arrears clearance and expenditures relating to structural reforms, including one-off expenditures for civil service redundancies and bank restructuring.

The medium-term outlook and relations with external creditors

43. The authorities explained that they intend to seek a new agreement with Paris Club creditors to succeed the existing agreement, which covers payments falling due on Soviet-era debt through end-2000. They hoped for an agreement on exceptional terms, comparable to the recent agreement with London Club creditors, which had entailed a significant reduction in the net present value of Soviet-era debt to commercial banks. They reiterated that the exceptional strength of the balance of payments at the present time was a reflection of temporary factors—which they expected to unwind soon, due to a decline in oil prices from current highs and a recovery in imports from compressed levels—and they were adamant that this temporary strength should not disguise the fact that the medium-term balance of payments outlook was much less favorable. They also emphasized the fiscal dimension of the problem, expressing concern that the heavy debt burden from Soviet-era obligations on the federal budget could severely circumscribe policy options in the future, especially in light of the fact that key expenditure categories like health, education, and social transfers were already very compressed and that the budget would have to mobilize additional resources for reform-related expenditures in the future. They felt that an easing of the debt burden would significantly enhance the prospect for reform, not only by easing fiscal constraints, but also by signaling strong support by the international community of the government's reform plans.

44. The staff acknowledged that the current strength of the balance of payments was likely to be temporary and the current account surplus was expected to decline significantly over the

medium term. The staff also agreed that the medium-term outlook was subject to exceptionally large uncertainty, especially because of the dependence of the balance of payments on volatile commodity prices, as well as uncertainty about the impact of reforms on the savings and investment behavior of both the private and government sectors. This uncertainty also pertained to the fiscal sector, especially due to uncertainty about the sustainability of the expenditure compression and the cost of reform. Staff noted, however, that an early normalization of relations with external creditors could accelerate the restoration of Russia's access to international capital markets, which could also facilitate enterprise adjustment. In any case, staff stressed that the issue of further exceptional balance of payments support from official creditors was an issue that had to be resolved between Russia and its creditors.

45. A detailed medium-term outlook is discussed in Appendix V. Assuming steadfast implementation of structural reforms, the baseline scenario envisages strong investment and productivity gains supporting annual growth of 4–6 percent over the medium term. The scenario suggests that Russia should achieve external and fiscal viability over the medium term, with the ratio of federal government external debt halving to 35 percent by 2005, and external debt service declining from 31 percent of exports of goods and services in 1999 to 19 percent on average in 2006–15. Modest financing gaps may, however, persist over the next few years as reserves are rebuilt. As noted above, the outlook is subject to an unusual degree of uncertainty. A low growth scenario combined with a considerably less favorable external environment would result in persistent financing gaps and a less favorable development of public debt indicators.

Exchange and trade system

46. In the view of the staff, five of the six exchange restrictions and/or multiple currency practices subject to Article VIII approval identified at the time of the previous Article IV consultation remain in place: (i) the inconvertibility of S-accounts; (ii) the repatriation restrictions on nonresidents that did not participate in the GKO novation scheme; (iii) the restrictions on the repatriation of moderate amortization payments from balances on T-accounts; (iv) the restrictions on advance import payments; and (v) the restrictions on certain payments to Latvian residents.[13] The previously identified restriction and multiple currency practice on the use of a more depreciated exchange rate for conversion of S-accounts established in special auctions by the CBR is no longer in place as no auctions have been conducted in the last 12 months and no further use of this mechanism is envisaged by the authorities. Moreover, the authorities indicated that a series of initiatives that are underway, in particular the proposed amendments to the foreign exchange law, would allow them to remove some of the other five restrictions on current account transactions in the near future. Stressing the discriminatory nature of several of the restrictions, staff welcomed the authorities' plans and noted that the strong

[13] S-accounts are used by nonresidents for transactions involving government securities. T-accounts are used by nonresidents for current international transactions and some short-term non-government securities transactions.

external position created a favorable environment for the removal of these restrictions on current transactions.

47. As to illicit capital flows, there was agreement that they reflected primarily fundamental systemic problems, including high tax rates and the sometimes arbitrary nature of tax enforcement, the basic lack of confidence in the banking system, and the history of uneven macroeconomic performance. In this regard, the authorities expressed frustration with much of the public criticism, in Russia and abroad, of their inability to stem capital flight, arguing that the critique represented a simplistic view of the underlying causes. They noted that some progress had been made in reducing capital flight and that the outflows would abate as the investment climate within Russia improved, particularly measures to strengthen the banking system, improve governance, and rationalize the tax system.

48. The authorities are considering a simplification of the trade system.[14] A proposal recently submitted by the State Customs Committee to the government would affect more than 4,500 commodity positions, reducing the number of tariff rates from seven to four, and the average tariff rate from about 13½ percent to about 11 percent. Staff welcomed this proposal. The authorities also mentioned that negotiations toward WTO accession are continuing, focusing on tariffs, services, and agricultural issues. The second proposal on tariffs and the first proposal on services were made in March 2000 and the first proposal on agriculture in May 2000. The authorities noted that the process of accession to the WTO would be slow as about 40 legal documents would need to be amended by the Duma. Staff urged the authorities to give priority to an early completion of this process.

B. Structural Reform Policies

49. The authorities acknowledged that the overall progress in structural reforms had been disappointing in recent years, and they stressed that the new government was committed to an acceleration of such reforms, seeing this as an essential prerequisite for sustained growth. They explained that President Putin had entrusted a group of pro-reform experts to develop a structural reform strategy, and that the sweeping proposals by this group for a broad-based push for market-oriented reforms had been reflected in the long-term program recently approved by the government. The government's program is summarized in Box 5. While they agreed that this program was mostly concerned with relatively broad objectives, with specific policy proposals in many areas yet to be determined, they stressed that concrete action plans would be developed in the coming months and that the government in the meantime was pushing ahead with ambitious tax reforms.

[14] Russia's trade system is currently rated 5 on the Fund's index of trade restrictiveness, including a rating of 2 for tariffs, and a rating of 2 for non-tariff barriers.

Box 5. Russian Federation: The Government Reform Program

In July 2000, the government adopted a far-reaching plan for development of the Russian economy over the next 10 years. The plan includes priority objectives and measures to be taken in 2000 and 2001. These are summarized below.

Social Policy. Objectives: (i) improve the protection of socially vulnerable households; (ii) ensure universal accessibility and acceptable quality of basic social benefits, especially health and education; (iii) enable working-age individuals to enjoy higher consumption levels based on their own income; (iv) attract household and enterprise funds to help finance social sector institutions. Priority sectoral measures include:

- Increase public spending **in education**, and improve the transparency of financial flows in the education sector. Restructure small rural schools. Establish federal and regional education standards. Provide full financing to fulfill state guarantees for the delivery of free **health** care to the public. Expand the range of organizational and legal forms of health care institutions.
- Reform **labor** legislation, including the Labor Code, with a view to increasing labor mobility and improving the balance of interests between workers, employers and the state. Simplify termination procedures. Transfer the financing of unemployment benefits to the federal budget. Continue to raise the minimum wage.
- Reform **social assistance** on the principle of providing mostly targeted assistance, only to households whose consumption is below the subsistence level. Eliminate social category-based federal benefits except for groups such as war veterans and invalids, and transform such benefits into cash payments. Increase real **pensions** while ensuring financial sustainability of the pension system. Introduce a funded pillar to the pension system. Index pensions to a combination of wages and prices. Consider the need for a gradual adjustment of the pension age. Reduce subsidies and increase targeting of **housing** benefits.

Economic Improvement. Objectives: (i) establish legislative principles promoting a favorable business and investment climate; (ii) substantially reduce the tax burden while ensuring medium-term financial stability; (iii) stimulate progressive structural changes in the economy, reform the infrastructure monopolies, develop financial infrastructure, and foster the development of Russia's technical and research potential. Priority sectoral measures include:

- Improve protection of **property rights**, including laws to protect shareholder and creditor rights, and intellectual property rights. Create **equal competition conditions**, including elimination of most direct and indirect subsidies to inefficient companies. Reduce excessive **state interference in business**, with simplified registration and licensing procedures and reductions in numbers of inspection and monitoring bodies. Introduce **International Accounting Standards** and vigorously enforce financial disclosure requirements.
- **Banking system reform**, including legal amendments to facilitate liquidation of unviable banks, and development of deposit insurance. **Capital market development**: extend the range of available financial instruments, introduce tax incentives to encourage the growth of nongovernment pension funds and investment in Russian securities, and improve capital market regulation. Develop **mortgage** markets. Encourage development of national **insurance** companies, with tax incentives, legislation on mandatory insurance, and development of a public regulation and supervision system.
- **Tax reform,** as detailed in Section III.B. Reduce average **customs** duty rates and their diversity (in concordance with WTO accession negotiations), eliminate customs privileges, and introduce new customs administration technologies. **Fiscal policy** objectives include elimination of unfunded mandates, inventory of public assets and liabilities, evaluation of public expenditure effectiveness, and ensuring an appropriate, transparent allocation of expenditure responsibility and resource availability to different levels of government. Reduce inflation to low levels by targeting money supply growth, extend the range of available **monetary policy** instruments, and modernize the payments system.
- **Privatize** a significant number of state-owned enterprises, and improve state property management. Provide state funding for **R&D** and venture investment. Restructure the **military-industrial complex** to increase efficiency, reduce energy intensity and encourage conversion to civilian use. Establish competitive **agricultural product** markets.
- Reform the **infrastructure monopolies**, including restructuring to separate naturally monopolistic and potentially competitive activities, improved network access for independent gas producers and rail operators, demonopolization of electricity generation and telecoms, significant reductions in lists of customers whose energy supply may not be cut off, and reductions in cross-subsidies between categories of customers. Encourage energy efficiency, improve taxation of the **fuel and energy** sector, and develop Production Sharing Agreement legislation.

50. Staff welcomed the government's intention to accelerate reform and broadly endorsed the recently approved long-term program, acknowledging that the envisaged objectives were generally ambitious. It argued that the action plans for how to realize these objectives should be developed in close cooperation with the World Bank, stressing that a new arrangement with the Fund would be expected to go hand-in-hand with agreement with the World Bank on a successor arrangement to the existing SAL3. Staff also explained that the structural reform component of a Fund-supported program should focus on measures that are important for sustainable macroeconomic stabilization, notably on fiscal reform, bank restructuring, measures to reduce the incidence of barter and arrears accumulation, and enhancing governance and transparency in economic policy-making institutions.

Fiscal reform

51. The authorities explained that they viewed the overhaul of Russia's tax system as the key structural reform objective to be achieved in 2000. The tax system was widely perceived as punitive and unfair, and its excessive complexity bore much of the blame for the problems that Russia had faced in tax administration. In April 2000, the authorities had sponsored the Duma submission of a comprehensive set of proposals for Part 2 of the Tax Code, which contains the provisions relating to domestic tax policy. These proposals, which are to take effect from January 1, 2001, were the product of considerable work over a number of years, including substantial technical assistance input from the Fund and others. The first four chapters of the Tax Code, relating to personal income tax, social fund contributions, VAT, and excises had already been passed in their second Duma reading.[15] While it had not been possible for the Duma to consider the amendments to the profit tax before the summer recess, the authorities hoped that these would be passed in the fall.

52. The authorities noted that high marginal tax and social contribution rates were one of the prime reasons for tax evasion by high earners. This was the main rationale for the proposal to replace the current progressive income tax structure with a flat 13 percent tax, and for the introduction of a regressive social tax rate structure. In order to reduce the administrative burden on government and businesses, social fund contributions were to be unified into a single social tax to be collected by the Ministry of Taxation, rather than the current system whereby each of the four social funds was responsible for its own collections. As part of the reform of the social funds, the Employment Fund would be abolished and its functions moved onto the budget, and the contribution rate for the Social Insurance Fund reduced. These changes reflected the authorities' views that these funds involved considerable waste, and were poorly equipped to address regional disparities in social needs.

53. Approved changes in Part 2 of the Tax Code would also move the VAT tax to a destination principle for CIS trade, excluding oil and gas, and eliminate many exemptions under

[15] Since the mission, these amendments were passed in their third and final Duma reading, and by the Federation Council, with little further modification.

this tax. In addition, the authorities were proposing that all VAT receipts should be allocated to the federal budget. The reason for this centralization was that VAT receipts were currently very unequally distributed across the country: raising the federal share from 85 percent to 100 percent and distributing the increased federal receipts in the form of transfers would help ensure regional revenues were better matched to spending needs. The Duma had not yet considered this change, which would be submitted as part of the 2001 budget.

54. The authorities noted that the turnover taxes used to finance regional road funds and housing expenditures were highly distortionary and also tended to be administered in a burdensome and nontransparent way. The bulk of these taxes is to be replaced with a 5 percent municipal surcharge on the profit tax and a three-fold increase in gasoline excise duty. The remaining 1 percent of turnover tax is to be eliminated in 2003. The authorities explained that their proposals to reform the profit tax were intended to streamline the profit tax system, reduce exemptions, and ensure that allowances (including for investment) better reflected companies' actual economic costs.

55. The staff welcomed the proposed changes in Part 2 of the Tax Code, stressing that they were generally in line with long-standing recommendations of Fund technical assistance experts. While important elements of the government's proposals had not been accepted by the Duma, the overall package as approved is a strong one and it would significantly strengthen the tax system.[16] Overall, the changes to the tax system represented the boldest move seen in the area of structural reforms for some years.

56. The authorities explained that they did not expect the Duma to have time in 2000 to discuss a full set of amendments to the provisions for tax administration incorporated in Part 1 of the Tax Code. However, they had identified a subset of about five key amendments which might be considered by the Duma during the fall. These included measures to tackle abuses involving tax payments being stuck in problem banks, to adjust penalties for late tax payment, and to streamline arrangements for payment of outstanding fees and penalties. The authorities also described a number of institutional initiatives to improve tax administration, including a shift of Ministry of Taxation resources from rural to urban areas, where the bulk of the tax base was located, and plans to ensure that Ministry of Taxation operations in the regions were fully financed from the federal budget. The staff recommended that the authorities should also seek amendments to Part 1 of the Tax Code aimed at achieving a better balance of rights between taxpayers and the tax authorities, including lifting bank secrecy on individuals' accounts and introducing personal liability of company directors for certain tax debts, and also stressed the need to improve procedures for dealing with tax arrears.

[16] The main elements of the government's proposals that were not accepted by the Duma included: establishment of VAT and all excises on an accruals basis; complete elimination of turnover taxes, compensated by a larger increase in gasoline excises; and a comprehensive elimination of VAT exemptions.

57. The authorities indicated that a number of changes to expenditures and intergovernmental relations would be implemented in 2001 as counterparts to the tax reform package. As well as the planned increase in transfers to regions in compensation for the centralization of VAT revenues, the switch from financing road expenditures through local-level turnover taxes to federal excises will be offset by higher federal transfers to the territorial road funds. These road funds, many of which are currently operated as extra-budgetary funds, are to be consolidated with local budgets as earmarked budgetary funds, thus improving transparency. The authorities explained that the reduction in local government revenues resulting from the tax reforms would not, however, be fully compensated by higher federal transfers, as they saw scope for further local-level spending reductions, particularly through improved cost recovery in housing and communal services. Staff emphasized the importance of conducting a comprehensive expenditure review to identify how spending allocations should be changed, noting that the absence of such a review made it difficult to assess the sustainability of the expenditure compression that had taken place in recent years.

58. Reforms were also planned in other areas of fiscal policy, including further development of the Treasury function, and the elimination of unfunded mandates. The authorities explained their intention to continue the expansion of Treasury control in the Ministry of Defense, local governments, and the extrabudgetary funds. They also intended to pursue legislative and administrative reforms aimed at removing commercial institutions from the sphere of government, and eliminating the use of off-budget accounts by budgetary organizations. Draft amendments suspending unfunded expenditure mandates at the federal level during 2000 had been submitted to the Duma, and amendments suspending mandates affecting both federal and subnational governments that the federal government did not intend to finance would be submitted with the 2001 budget. The authorities noted their intention to increase the ceiling on the Individual Pension Coefficient (IPC) from August 2000, as part of their ongoing efforts to make pensions more responsive to contribution history. Staff cautioned that rapid increases in the IPC could contribute to unsustainable deficits in the Pension Fund and stressed the need for a comprehensive reform of the pay-as-you-go system, including increases in retirement ages.

Bank restructuring

59. The staff argued that, notwithstanding the legal obstacles that had arisen, progress with bank restructuring had been disappointing. In particular, a more determined response by the authorities might have prevented some of the asset stripping that occurred in the aftermath of the crisis. In addition, while licenses of a large number of banks had been withdrawn, intervention and resolution of the large insolvent banks had been slow and the bankruptcy process seemed to be used to encourage restructuring rather than liquidation. The staff agreed that deficiencies in the legislative base had contributed to the slow pace of bank restructuring, but noted that this pointed to the need for a more concerted effort by the authorities to ensure passage of the necessary amendments. More generally, the staff stressed the importance of the authorities formulating a clear vision for the future development of the banking system, particularly the role of the state banks. In this context, the staff expressed concern about plans attributed to the government for enhancing the role of state banks, including the establishment of development

banks. They welcomed assurances by the authorities that major public resources would not be made available to such banks.

60. While acknowledging that bank restructuring was lacking in some areas, the authorities felt that the progress had been as good as could have been expected under the existing legal framework. CBR officials considered that they had intervened in problem banks in a timely manner, using the CBR's existing powers to withdraw the licenses of a large number of problem banks, as a first step towards liquidation, and referring other banks to ARCO for restructuring. Difficulties had been encountered, however, in securing the liquidation of banks due to legal challenges of the CBR's decisions. In this regard, the authorities emphasized that the existing legal framework left much to be desired and that the restructuring process would be expedited by passage of the proposed amendments to the bank bankruptcy legislation that would require the CBR to write down the capital of banks to reflect their true net worth and introduce a solvency criterion for the initiation of bankruptcy proceedings. It was hoped that, after prolonged delay, the amendments could be approved by the Duma during its fall session. The authorities also stressed that the staff, in assessing the progress to date, should be mindful of the fact that the economic recovery had resulted in an improvement of the financial health of many banks, with capital injections on the rise and banks adopting viable spontaneous restructuring programs. They noted that bank restructuring was a time-consuming process, even in countries that had a much stronger legal and institutional foundation.

61. On the specific issue of Sberbank, the authorities agreed that its central role within the banking system—it accounts for about 85 percent of total household deposits and over 25 percent of total banking system credit to the private sector—suggested that the development of a strategy for this bank would be a key element of bank restructuring. They stressed that the recently initiated financial review, which was to be followed by a strategic review, would be crucial in this regard. They noted, however, that even after the results of the strategic review were available, any reforms would have to be approved at a shareholders' meeting. Emphasizing that vested interests had successfully delayed the development of an action plan for this bank in the past and that the CBR was a majority shareholder in the bank, staff argued that the preparation and implementation of a strategy for Sberbank would be a key test of the authorities' ability to advance bank restructuring in general.

Policies to reduce barter and arrears accumulation

62. The authorities believed that measures taken by all levels of government to eliminate offsets and reduce budgetary arrears had played an important role in the improvement in the nonpayments situation since the August 1998 crisis. They were engaged in discussions with the World Bank to identify further measures to ensure that the government paid in full for its energy use. In addition, they noted the difficulty in controlling the actions of local budgets, but said that various incentives involving links to the system of federal transfers were under consideration. However, the authorities agreed with the staff that the budgetary sector was not the only source of the nonpayments problem, and that further measures were required to reduce noncash transactions in the economy as a whole. Gazprom in particular continued to suffer from a very low level of cash collections. Amendments to the Civil Code facilitating the disconnection of

delinquent customers had been drafted, with the hope that they might be passed by the Duma in the fall. The authorities noted that energy companies were already making stronger efforts to cut off nonpaying customers, but that there were considerable political obstacles to disconnection in many cases. These obstacles would remain even when legislative changes to facilitate disconnection were in place.

63. The authorities intended to resubmit amendments to the bankruptcy law, but these might not be approved until 2001. Amendments meeting requirements under the Stand-By Arrangement had been passed by the Duma, but Duma deputies had also added some unwelcome measures, and the President had vetoed the amendments. The authorities felt that the Duma might now accept the government's original proposals, and that this narrow set of amendments could probably be passed before end-2000. However, the authorities were also considering a more comprehensive evaluation of the bankruptcy legislation, focusing on a broad range of issues, including the role of external conservators and procedures for enterprise liquidation. It would probably not be possible to introduce such fundamental changes before end-2001.

Enhancing governance and transparency

64. A key component of the government's reform program is to strengthen governance in order to enhance the investment climate. Important elements in this agenda include strengthening corporate governance with greater protection of shareholder and creditor rights, a move to IAS, clarifying the legal framework governing the actions of the state, reducing excessive state interference in business, and a general strengthening of the rule of law.

65. The authorities have taken a number of steps to strengthen identified weaknesses in transparency and governance that have resulted in problems in the recent past. However, while acknowledging the importance of such issues, they found that problems in this area fundamentally reflected the fact that the legal and institutional framework for a market economy was still being developed and they believed, therefore, that these problems could only be expected to be overcome as this framework was strengthened. They expressed frustration that Russia was being expected to observe standards that many other countries, including some with a long tradition as a market economy, did not observe, and they considered much of the criticism of Russia to be driven by domestic political consideration in other countries. Further, Russia had, with the assistance of the Fund, recently conducted a Report on the Observance of Standards and Codes (ROSC)—covering transparency in monetary and financial policies, fiscal policies, and data dissemination practices—and this report had identified few departures from standard international practices. The staff noted the generally positive assessment in the ROSC, but added that the draft modules had identified important weaknesses in a number of areas and suggested priorities for improvement, including fuller explanation of considerations underlying monetary policy decisions and greater disclosure regarding the CBR and its interactions with the rest of the economy; in the fiscal area, improved transparency in basic budget management procedures and intergovernmental fiscal relations, more comprehensive provision of fiscal data, strengthened internal audit capacity, and incorporation of off-budget activities of budgetary organizations into the Treasury system; and strengthened quality of economic statistics. The staff urged the authorities to address these weaknesses and make the ROSC public once it is finalized.

66. In response to criticism both at home and abroad following the FIMACO affair, the CBR has strengthened its reserve management procedures to a level that it considers to be comparable to that of central banks in industrial countries. In September 1999, a thorough review of reserve management practices was conducted by the CBR with the assistance of a technical cooperation mission from the Fund. The authorities noted that this review gave a very positive assessment of existing procedures. Key recommendations covering the decision-making structure and procedures for the assessment of risk and currency composition of reserves had now been implemented. The CBR had also contracted its external auditor to produce a quarterly review of the CBR's reserve management practices. CBR officials noted that the CBR's annual report for 1999, which had already been submitted to the Duma, had included much greater disclosure than in previous years and that a financial statement consistent with IAS (except for a small number of standards) would soon be completed. Staff agreed that the findings of the technical cooperation mission had generally been positive and welcomed the decision to conduct quarterly reviews of reserve money management practices and introduce IAS-consistent financial statements, urging the CBR to publish both the quarterly reviews and the financial statements.

67. The authorities acknowledged that the CBR's involvement in commercial activities, in particular through its role in foreign subsidiary banks, reduced the transparency of the operations of the central bank and created a tension with its role as the banking supervisory agency. While CBR officials agreed with the need to remove the CBR from these institutions, they argued that this could not be achieved in the short term as it would necessitate securing amendments to the law on the CBR, require negotiations with the supervisory agencies in a number of countries, and the identification of buyers acceptable to those supervisory agencies. One option under consideration was to transfer the CBR's shares in these subsidiaries to Vneshtorgbank (VTB), though this would not necessarily be a permanent solution as plans would also have to be elaborated for the privatization of VTB itself. In the interim, the CBR had taken steps to strengthen firewalls in internal decision-making processes to limit potential conflicts of interest. The authorities noted that the investigation by PricewaterhouseCoopers (PwC) into the relationship between the CBR and its foreign subsidiaries had found no evidence of additional instances of deliberate changes in records affecting the balance sheet of the CBR, as had occurred with FIMACO.[17] The staff added that the CBR's operations in precious metals, which had been identified in the ROSC as a particular source of nontransparency in the operations of the CBR, were inconsistent with the operations of a normal central bank and that the secrecy surrounding these operations made it difficult to assess the CBR's balance sheet, including its income statement. Staff urged the CBR to produce a time-bound plan for early divestiture of its subsidiaries and to complete financial and strategic reviews of each of them as a first step.

68. The authorities were disappointed that Russia had been included on the OECD-coordinated Financial Action Task Force on Money Laundering (FATF) list as a country that

[17] This is the fourth PwC report. The report and a staff comment were circulated to the Board as "Russian Federation—Staff Note Regarding the Report by PricewaterhouseCoopers on the Central Bank of Russia's Relationship with its Foreign Subsidiaries" (EBS/00/7, 1/19/2000).

was not cooperating in the fight against money laundering. They considered the existing system for countering money laundering in Russia to be no worse than in other transition countries, none of whom had been included on the list. They recognized the shortcomings identified in the FATF report, but pointed to the fact that progress was being made in resolving these issues. In particular, a strengthened law on money laundering was at an advanced stage of development by a Duma sub-committee, and amendments to the foreign exchange law that would permit the control of suspicious transactions were also under discussion. The authorities believe that once the new law is in place and an implementing agency identified and funded, the concerns of FATF will be assuaged.

IV. STAFF APPRAISAL

69. Russia's macroeconomic performance has been impressive, with a strong output recovery and a notable measure of financial stability. While the favorable external environment has certainly contributed significantly to the success, generally sound macroeconomic policies, notably the sharp improvement in the fiscal position, have done much to preserve and extend the initial gains from the depreciation. As the government has not only captured part of the windfall gain accruing to the energy sector, but has also been more determined in enforcing compliance with statutory tax obligations, it appears that the fiscal improvement might prove robust even under somewhat less favorable external conditions. This underlying improvement in the federal government's fiscal position partly reflects the successful implementation of measures incorporated in the government's programs for 1998 and 1999, including the strengthening of Treasury expenditure control, downsizing of the civil service, tax administration reforms, and an increased federal share of tax receipts. While significant improvements in macroeconomic policy and the institutional framework have indeed taken place, it cannot be overlooked that many of the deep-seated structural problems that were at the root of the 1998 crisis remain to be tackled, making recent achievements vulnerable to a major deterioration in the environment. The main tasks facing the authorities are to launch a broad-based acceleration of structural reform that will be key to sustainable growth over the medium term as growth will be held back in the absence of effective restructuring, while continuing to navigate the risks to the recovery and inflation arising from the strong current account-driven balance of payments in the short run.

70. An exceptionally strong external current account and overall balance of payments position remains the salient feature of the outlook for the short term. In light of the recent uptick in inflation and with no evidence yet that the surplus is narrowing, some further nominal appreciation of the ruble appears unavoidable. This should not choke the output recovery considering its present strength, especially the fact that it appears to be more broadly based than previously thought. Moreover, staff believe that the overshooting of the ruble depreciation in real terms and the excessive import compression that took place after the 1998 crisis have not yet been fully corrected; some further real appreciation and a substantial import recovery are consistent with a sustainable medium-term balance of payments position, provided that structural reforms take hold. However, there are genuine risks from allowing too rapid an appreciation, and continued intervention would seem appropriate.

71. As to fiscal policy, it would be a serious mistake to reduce policy options by undertaking large additional expenditure commitments given the uncertainties over the medium-term outlook and in the absence of a fuller assessment of the costs of planned reforms. Rather, the fiscal surplus should be allowed to increase. The larger surplus, by tending to reduce interest rates, would also offset the tendency of foreign exchange sterilization to raise interest rates.

72. The responsibility for controlling liquidity and inflation in the short run ultimately rests, however, with the CBR. In this regard, the CBR should be more determined in using its market-based instruments to keep control over reserve money. Passing the cost of sterilization on to commercial banks by continuing to increase unremunerated reserve requirements merely exacerbates the already difficult situation of many banks. In order to strengthen the CBR's ability to conduct reserve money management with market-based instruments, the government should delay no longer the decisions required to enable the CBR to begin issuing the bonds needed to conduct open market operations. As an interim solution, the staff welcome the proposal to restructure part of the obligations of the government to the CBR into marketable instruments that could be used for liquidity management.

73. The staff are concerned that the issue of whether the cost of sterilization should be borne by the CBR or the government is deflecting monetary policy from focusing on inflation control. The CBR should stand ready to incur such costs in the short run. This being said, staff strongly agree that the government should give priority to regularizing its relations with the CBR, including by paying a market-determined interest rate on CBR credits. The financial situation of the CBR should be reviewed, and the CBR should, if necessary, be recapitalized. However, any such recapitalization should be accompanied by increased transparency and accountability on the part of the CBR, including termination of functions not normally performed by a central bank, such as ownership of subsidiaries engaged in commercial banking activities and CBR operations in precious metals.

74. Looking to 2001, staff believe that the authorities' target of a zero deficit of the overall balance of the federal government is appropriate given the current macroeconomic outlook. The main risks are the ability of the authorities to obtain support for the expenditure reduction at the local level corresponding to the tax reform and the uncertain cost of future structural reforms. Depending on the revenue loss associated with the planned tax reforms and the uncertain outlook for debt servicing, this target could entail a notable increase in federal expenditures. In this regard, the authorities should be mindful that revenues from export taxes will decline if oil prices subside from current heights, suggesting that increased expenditures should primarily be directed towards reform-related expenditures or clearance of the existing stock of outstanding budgetary arrears. Using temporary windfall gains to increase recurrent expenditures could significantly curtail the room for maneuver in the future.

75. The staff take note of the authorities' intention to seek a new agreement with Paris Club creditors on exceptional terms—possibly involving debt reduction—when the current agreement expires at end-2000. While the balance of payments should be expected to weaken significantly over the medium term as reforms take hold and imports recover from compressed levels, the outlook is subject to an exceptionally large degree of uncertainty, partly because of Russia's

dependence on volatile commodity prices. The fiscal outlook is also uncertain because of questions pertaining to the sustainability of expenditure compression and the cost of reform. The question of whether Russia can service the existing debt without excessively constraining its options for economic reforms is thus a difficult one to answer at this juncture. One important issue for the authorities to consider is the extent to which an early normalization of relations with all creditors could facilitate the restoration of access—of the government and the private sector—to international capital markets.

76. The overall progress in advancing market-oriented structural reforms has been disappointing, and a broad-based acceleration of such reforms remains a prerequisite for sustainable macroeconomic stabilization and medium-term growth. The government's stated determination to advance reforms is, therefore, encouraging, as is its insistence on assuming full ownership of the reform program. It is also encouraging that the recently approved long-term reform program sets ambitious reform objectives for most sectors, emphasizing liberalization, enterprise restructuring, and measures to tackle deep-seated problems of corruption and poor governance, although detailed action plans for how to achieve these objectives are still being developed.

77. It cannot be overlooked, however, that most of the policies envisaged in the long-term program have been part of Fund and World Bank supported programs in the past, and that previous governments have failed to implement these policies because of fierce resistance from vested interests. The disappointing progress in advancing bank restructuring, notably in liquidating insolvent banks, is a case in point. The recent political changes and the breathing space provided by the good macroeconomic environment provide, however, a backdrop that possibly is more conducive to a determined acceleration of reforms than at any time since the early transition process. The key challenge facing the authorities is to use the momentum and strong mandate afforded by President Putin's sweeping election victory—and by their much improved relations with the Duma—to ensure up-front implementation of some of the most politically sensitive elements of their reform program. The emphasis in recent months on improving governance and the rule of law, and the determination with which the authorities have pursued tax reforms, augur well in this regard, but the authorities must be mindful of the fact that reforms have also been off to a strong start under some previous governments, only to falter because of failure to sustain implementation in the face of entrenched resistance to reforms.

78. While an acceleration of reforms needs to be broad based, the areas that are particularly important for macroeconomic stabilization are fiscal reform, bank restructuring, measures to reduce the incidence of barter and arrears accumulation, and policies to strengthen governance in key policy-making institutions. A new program that could be supported by the Fund would have to include strong up-front measures in these areas in order to be credible, and most of the structural benchmarks for end-September and end-December 1999 agreed under the current Stand-By Arrangement remain relevant in this regard.

79. In view of the need to avoid a potentially sharp increase in capital outflows, and given their temporary and non-discriminatory nature, the staff recommend temporary approval of the exchange restrictions and multiple currency practices arising from the limitations on the

convertibility of balances held in nonresidents' S- and T-accounts and on the repatriation of certain balances arising from GKO/OFZ investments held by nonresidents who chose not to participate in the novation scheme. The staff take note of the proposed modifications to these restrictions currently under consideration and urge the authorities to take advantage of the currently favorable external environment and positive investor sentiment to explore means of liberalizing these current account restrictions. Approval is not recommended for the restriction arising from the rules governing the making of advanced import payments or the specific restriction imposed upon the making of advanced import payments to Latvian residents. The staff take note of the authorities' intention to eliminate the deposit requirement for the making of advance import payments as soon as already proposed legislation providing appropriate alternative measures for capital controls is adopted by the Duma, and urge the authorities to remove Russia's remaining exchange restriction.

80. The quality of Russia's statistical data base has improved substantially since the initiation of market reforms. The authorities regularly provide a broad array of timely data to the Fund, but problems related to the coverage and internal coordination of data compilation hinder effective economic analysis. The staff note the authorities' intention to subscribe to the SDDS and urge them to address as a matter of priority the weaknesses identified in the ROSC. The authorities' commitment to strengthening reporting systems and designing appropriate safeguards to ensure data quality is encouraging and the staff take note of the authorities' intention to take measures that, in their view, would correct the shortcomings identified in the FATF report.

81. The findings of the fourth PwC report that additional encumbered deposits with subsidiaries had been included in international reserves of the CBR in 1996 and again in late 1998 meant that, as in the case of similar deposits reported earlier, the balance sheet of the central bank gave a misleading impression of the true state of its international reserves. Russia, thus, failed to provide the Fund, as required under Article VIII, Section 5, with accurate information on these transactions. The staff welcome the correction that has now been made to the published reserves figures, as well as to the data reported to the Fund, and encourage the authorities to make the fourth PwC report available publicly. The problem of encumbered deposits further highlights the issues of lack of transparency and possible conflict of interest involved in the CBR owning subsidiaries involved in commercial operations; and the need for the CBR to proceed without delay to divest these subsidiaries. The staff welcome the commitment to prepare a plan for divestiture of the CBR's foreign subsidiaries and urge the authorities to implement it expeditiously.

82. It is proposed that the next Article IV consultation for Russia be conducted on the standard 12-month cycle.

Table 5. Russian Federation: Macroeconomic Indicators, 1996-2001

	1996	1997	1998	1999 Est.	2000 Proj.	2001 Proj.
				(Annual percentage changes)		
Production and prices						
Real GDP	-3.4	0.9	-4.9	3.2	7.0	4.0
Change in consumer prices						
Annual average	47.6	14.7	27.7	85.9	18.6	13.8
End of period	21.8	10.9	84.5	36.7	16.0	10.7
Change in GDP deflator	44.2	16.5	12.4	63.3	32.0	13.2
				(In percent of GDP)		
Public sector						
Enlarged government balance	-8.9	-7.9	-8.0	-3.8	3.5	-0.6
Federal government						
Overall balance (commitment basis)	-8.4	-7.1	-5.9	-4.7	1.5	-0.6
Primary balance (commitment basis)	-2.5	-2.5	-1.3	1.6	6.1	3.2
Revenue	12.5	12.3	11.0	13.4	16.3	15.9
of which: cash	9.2	10.0	9.0	13.4	16.3	15.9
Expenditure (commitment basis)	20.9	19.4	16.9	18.1	14.8	16.4
Interest	5.9	4.7	4.5	6.3	4.6	3.8
Noninterest	15.0	14.8	12.3	11.8	10.1	12.6
				(In billions of U.S. dollars unless otherwise indicated)		
External sector						
Total exports, fob	90.6	89.0	74.9	75.3	93.9	95.0
Total imports, fob	72.8	71.6	57.8	39.5	46.7	55.2
External current account (deficit -)	3.8	2.8	1.0	20.8	31.6	23.0
Government external debt service due	18.0	15.2	16.6	17.3	15.4	15.5
Stock of federal government external debt	136.1	134.6	152.4	147.6	149.8	150.4
Gross reserves coverage (months of imports of GNFS)	1.9	2.9	2.8	2.9	4.7	5.2
Memorandum items:						
Nominal GDP (billions of rubles)	2,146	2,522	2,696	4,545	6,419	7,560
Exchange rate (rubles per US$, period average)	5.1	5.8	9.7	24.6	...	...

Sources: Russian authorities; and Fund staff estimates and projections.

Table 6. Russian Federation: Quantitative Performance Criteria, July 31, September 30, and December 31, 1999

	July				September				December			
	Target	Adjusted target 1/	Outcome	Excess(+)/ shortfall (-)	Target	Adjusted target 1/	Outcome	Excess(+)/ shortfall (-)	Target	Adjusted target 1/	Outcome	Excess (+)/ shortfall (-)
Net domestic assets of the MA (Rub bn)	456.0	461.9	417.7	44.2	437.0	445.0	405.9	39.1	423.0	435.6	398.0	37.6
MA net credit to the enlarged government (Rub bn)	347.0	355.3	328.6	26.7	328.0	338.8	320.8	18.0	309.0	321.9	305.1	16.8
MA net credit to the federal government (Rub bn)	358.0	366.3	345.2	21.1	338.0	348.8	344.2	4.6	317.0	329.9	329.0	0.9
Balance of the federal government (Rub bn) 2/	-149.0	-147.1	-130.6	16.5	-180.0	-173.1	-160.5	12.6	-236.0	-230.0	-191.3	38.7
Balance of the enlarged government (Rub bn) 2/	-149.0	-147.1	-99.0	48.1	-180.0	-173.1	-118.4	54.7	-236.0	-230.0	-150.8	79.2
Federal government cash revenues (Rub bn)	266.0	266.0	280.8	14.8	365.0	365.0	385.8	20.8	530.0	530.0	608.0	78.0
Net international reserves of the MA (US$bn) 3/	-9.0	-9.2	-6.6	2.6	-8.2	-8.5	-6.3	2.3	-6.3	-6.8	-3.0	3.8
External debt of the MA of 1 year or less (US$bn)	0.2	0.2	0.0	0.2	0.2	0.2	0.0	0.2	0.2	0.2	0.0	0.2
Disbursement of external loans to the MA with maturities of: (in US$bn)												
More than 1 year	1.7	1.7	0.9	0.8	2.8	2.8	1.3	1.5	5.3	5.3	2.2	3.1
of which: 1-5 years	0.7	0.7	0.0	0.7	0.8	0.8	0.0	0.8	0.8	0.8	0.0	0.8

1/ To take into account automatic adjustors in the program.
2/ Data differ from those shown in the fiscal tables as the latter have a more complete coverage of arrears, including data that are only available with a long lag.
3/ Performance concept of NIR, which differs from the monetary concept due to the inclusion of contingent liabilities in the former.

Table 7. Russian Federation: Federal Budget Operations, 1997-2001

(In billions of rubles, unless otherwise indicated)

	1997	1998	1999		2000		2001
	Year	Year	H1	Year	H1 Est.	Year Proj. 1/	Year Proj. 2/
Revenue	310.4	296.3	225.5	608.0	505.1	1,043.7	1,192.5
VAT	117.9	117.4	80.7	218.8	178.0	376.1	506.3
Excises	50.4	52.4	38.9	84.2	64.9	130.0	186.3
Profit and income taxes	34.8	32.3	33.3	98.9	87.2	175.1	188.2
Taxes on trade	30.1	45.3	46.7	86.3	103.8	212.1	193.5
Other	77.2	48.9	25.9	119.8	71.2	150.4	118.1
Expenditure 3/	479.9	427.7	291.8	674.2	410.0	886.1	1,239.1
Interest	118.0	107.4	80.6	162.8	94.3	189.8	286.7
Noninterest	361.9	320.3	211.2	511.4	315.7	696.3	952.4
Wages	81.5	84.3	...	124.0	...	150.4	190.0
Transfers to regions and population	119.3	76.4	...	134.0	...	171.0	333.0
Other	161.1	159.6	...	253.4	...	374.9	429.4
Overall balance (cash)	-169.4	-131.3	-66.3	-66.2	95.1	157.6	-46.6
Rescheduled interest	0.0	15.0	61.2	124.8	61.6	107.1	0.0
Change in domestic arrears	10.4	12.1	12.5	23.3	3.5	-45.0	0.0
Primary balance (commitments)	-61.8	-36.1	1.8	73.3	185.9	392.4	240.1
Overall balance (commitments)	-179.8	-158.5	-140.0	-214.3	30.1	95.5	-46.6
Financing (cash)	169.3	131.3	66.4	66.1	-95.1	-157.6	-35.7
Foreign	35.1	51.1	-5.8	9.3	-17.5	-17.2	-67.3
Domestic	134.3	80.2	72.2	56.8	-77.6	-140.4	31.6
Bank financing	43.7	50.2	68.2	71.7	-63.6	-141.4	-15.0
Monetary authorities 4/	34.1	125.5	70.5	45.6	-68.5	-146.2	-15.0
Commercial banks	9.6	-75.3	-2.3	26.1	4.8	4.8	0.0
Nonbank financing	90.6	30.0	4.0	-14.9	-14.0	1.0	46.6
Privatization	18.8	15.3	-0.3	-4.4	2.5	16.5	12.0
Other	71.8	14.8	4.3	-10.5	-16.5	-15.5	34.6
Financing gap (- indicates underfinancing)	...	...	...	...	...	...	-82.4
			(In percent of GDP)				
Revenue	12.3	11.0	12.0	13.4	17.3	16.3	15.8
VAT	4.7	4.4	4.3	4.8	6.1	5.9	6.7
Excises	2.0	1.9	2.1	1.9	2.2	2.0	2.5
Profit and income taxes	1.4	1.2	1.8	2.2	3.0	2.7	2.5
Taxes on trade	1.2	1.7	2.5	1.9	3.6	3.3	2.6
Other	3.1	1.8	1.4	2.6	2.4	2.3	1.6
Expenditure (cash)	19.0	15.9	15.5	14.8	14.0	13.8	16.4
Interest	4.7	4.0	4.3	3.6	3.2	3.0	3.8
Noninterest	14.3	11.9	11.2	11.3	10.8	10.8	12.6
Wages	3.2	3.1	...	2.7	...	2.3	2.5
Transfers to regions and population	4.7	2.8	...	2.9	...	2.7	4.4
Other	6.4	5.9	...	5.6	...	5.8	5.7
Primary balance (commitments)	-2.5	-1.3	0.1	1.6	6.4	6.1	3.2
Overall balance (commitments)	-7.1	-5.9	-7.5	-4.7	1.0	1.5	-0.6
Primary balance (cash)	-2.0	-0.9	0.8	2.1	6.5	5.4	3.2
Overall balance (cash)	-6.7	-4.9	-3.5	-1.5	3.3	2.5	-0.6
Memorandum items:							
Noncash revenues	58.5	53.4	...	...	...	...	...
GDP	2,522	2,696	1,879	4,545	2,921	6,419	7,560

Sources: Russian authorities; and Fund staff estimates.

1/ Expenditure projections for 2000 incorporate the authorities' stated plans to raise spending by Rub 80 billion compared to the original budget, mostly for arrears clearance.

2/ Expenditure projections for 2001 are based on the authorities' stated plans to achieve an overall balanced budget on a cash basis, assuming rescheduling of external debt service obligations that is not shown in these projections.

3/ Measured on a cash basis.

4/ Excludes valuation changes in treasury bill portfolios.

Table 8. Russian Federation: Enlarged Government Operations on a Commitments Basis, 1997-2001
(In percent of GDP)

	1997	1998	1999	2000	2001	
				Proj.	Unchanged policies	New policies 1/
Federal government						
Revenue	12.3	11.0	13.4	16.3	14.8	15.8
Expenditure	19.4	16.9	18.1	14.8	14.2	16.4
Interest	4.7	4.5	6.3	4.6	3.8	3.8
Noninterest 2/	14.8	12.3	11.8	10.1	10.4	12.6
Transfers to regions	2.2	1.9	1.6	1.3	1.6	2.7
Transfers to EBFs	0.9	0.4	0.4	0.4	0.5	0.5
Health	0.6	0.4	0.4	0.4	...	...
Education	0.6	0.5	0.5	0.5	...	...
Defense	3.2	2.1	3.1	2.4	...	...
Other	7.3	7.0	5.9	5.1	...	...
Primary balance	-2.5	-1.3	1.6	6.1	4.4	3.2
Overall balance	-7.1	-5.9	-4.7	1.5	0.6	-0.6
Local government 3/						
Revenue	18.5	16.2	15.8	15.8	15.5	14.3
Own revenue	15.2	14.2	14.0	14.2	13.6	11.2
Transfers from federal government	2.2	1.9	1.6	1.3	1.6	2.7
Other transfers	1.1	0.1	0.2	0.3	0.3	0.3
Expenditure 2/	19.4	17.4	15.9	15.1	15.5	14.3
Housing and communal services	4.3	3.5	2.7	2.5	2.5	2.1
Health	2.7	2.2	2.0	1.8	1.9	1.9
Education	3.7	3.1	2.8	2.5	2.5	2.5
Other	8.7	8.5	8.3	8.3	8.6	7.8
Overall balance	-0.9	-1.2	0.0	0.7	0.0	0.0
Extrabudgetary funds						
Revenue	9.9	8.7	8.6	9.1	8.7	7.9
Own revenue	9.0	8.2	8.2	8.7	8.3	7.4
Federal transfers	0.9	0.4	0.4	0.4	0.5	0.5
Expenditure	9.8	9.6	7.7	8.2	8.7	7.9
Pension Fund	7.0	7.1	5.4	5.9	6.4	6.1
Employment Fund	0.3	0.3	0.3	0.3	0.2	0.0
Social Insurance Fund	1.2	1.2	1.0	1.1	1.1	0.8
Medical Insurance Funds	1.1	1.2	1.0	1.0	1.0	1.0
Overall balance	0.1	-0.9	0.9	0.9	0.0	0.0
Enlarged government						
Revenue	36.5	33.4	35.6	39.1	36.7	34.4
Expenditure	44.4	41.4	39.4	36.0	36.0	35.1
Noninterest expenditure	39.7	36.9	33.1	31.4	32.2	31.3
Primary balance	-3.2	-3.4	2.5	7.7	4.4	3.2
Overall balance	-7.9	-8.0	-3.8	3.1	0.6	-0.6
Memorandum item:						
GDP (billions of rubles)	2,522	2,696	4,545	6,419	7,560	7,560

Sources: Russian authorities; and Fund staff estimates.

1/ Policy changes include amendments to Part 2 of the Tax Code, full centralization of VAT revenues, and increases in federal transfers to region Projections of policy changes, and their effects, are based on latest available information but remain highly uncertain.

2/ Components of spending are shown on a cash basis prior to 1999, with arrears accumulation included in the "other" category.

3/ Consolidated with total territorial road fund budgets.

Table 9. Russian Federation: Monetary Authorities' Accounts, 1997-2000
(In billions of rubles, unless otherwise indicated)

	1997	1998	1999				1999	2000		
	Dec. Act.	Dec. Revalued	March Act.	June Act.	Sept. Act.	Dec. Act.	Dec. Revalued	March Act.	June Act.	Dec. Proj.
Base money	164.5	210.4	205.9	259.2	259.6	324.3	324.3	318.9	397.2	430.0
Currency issued	137.0	197.9	186.5	230.4	228.0	288.6	288.6	268.9	340.5	365.3
Required reserves on ruble deposits	27.5	12.5	19.4	28.8	31.6	35.6	35.6	50.0	56.7	64.7
NIR (at program rates) 1/	22.4	-204.1	-218.1	-177.4	-146.3	-73.7	-76.5	34.3	204.7	409.4
Memorandum item: NIR in billions of US$	3.7	-8.4	-9.0	-7.3	-6.1	-3.0	-2.8	1.3	7.6	15.2
NDA	142.1	414.5	424.0	436.6	405.9	398.0	400.7	284.6	192.5	20.7
Net credit to enlarged government	191.8	276.2	319.7	338.9	320.8	305.1	309.2	240.3	170.9	89.2
Net credit to federal government	199.9	283.4	330.8	353.9	344.2	329.0	333.1	301.6	264.6	186.9
CBR net credit to the federal government 2/ 3/	134.7	177.3	197.4	191.3	185.3	201.7	205.8	196.1	185.2	133.1
VEB credit 3/	...	40.3	85.4	133.5	143.5	137.8	137.8	137.8	137.8	133.4
Ruble counterpart 4/	65.2	65.8	48.0	29.1	15.4	-10.5	-10.5	-32.3	-58.4	-79.6
CBR net credit to local government	-3.6	-2.1	-4.6	-6.8	-8.7	-9.0	-9.0	-17.2	-28.5	-28.5
CBR net credit to extrabudgetary funds	-4.5	-5.1	-6.5	-8.2	-14.7	-14.9	-14.9	-44.1	-65.2	-69.2
Net credit to banks	-21.4	-23.8	-38.2	-42.4	-38.2	-45.9	-45.9	-91.0	-123.4	-216.5
Gross credit to banks	10.0	15.8	21.6	25.1	26.8	26.7	26.7	26.9	26.7	26.7
Gross liabilities to banks and deposits	-31.4	-39.6	-59.8	-67.5	-65.0	-72.6	-72.6	-117.9	-150.1	-243.2
Correspondent account balances	...	-32.6	-44.4	-51.8	-55.2	-68.9	-68.9	-74.8	-80.5	-88.6
Deposit facility and OBRs held by banks	...	-7.0	-15.4	-15.7	-9.8	-3.7	-3.7	-43.1	-69.6	-154.6
Other items (net)	-28.3	162.1	142.5	140.1	123.3	138.8	137.4	135.3	145.0	148.0
Memorandum items:										
Gross reserves (US$ billions)) 5/	17.8	10.9	9.6	11.1	11.0	12.6	12.5	15.6	21.1	27.9
CBR	17.2	10.8	9.5	10.9	10.6	12.1	11.9	15.2	20.6	27.4
Ministry of Finance	0.6	0.1	0.2	0.2	0.4	0.5	0.5	0.4	0.5	0.5
Reserve liabilities (US$ billions)	14.0	19.4	18.6	18.4	17.1	15.7	15.3	14.4	13.5	12.8
CBR	0.0	4.0	4.1	4.6	3.6	3.1	3.0	3.0	3.0	3.0
Ministry of Finance	14.0	15.3	14.6	13.8	13.5	12.6	12.3	11.4	10.6	9.8

Sources: Russian authorities; and Fund staff estimates.

1/ At program accounting exchange rate, (Rub 24.18/US$ and US$1.4/SDR for 1998-99) and (Rub 27/US$ and US$1.37/SDR for 1999 Dec. revised onwards).
2/ Beginning December 1999, revalued, includes government securities held by the CBR's pension fund which amounted to Rub 4.1 billion at end-1999.
3/ The intended split between repayment of CBR credit and repayment of VEB credit during 2000 H2 is not known.
4/ Represents the government's NIR, calculated in flow terms using the exchange rate in effect at the time of the transaction.
5/ From December 1998, excludes all amounts held with domestic banks and at CBR-owned banks abroad.

Table 10. Russian Federation: Monetary Survey, 1997-2000
(In billions of rubles, unless otherwise indicated)

	1997	1998	1999				1999	2000		
	Dec. Act.	Dec. Revalued	March Act.	June Act.	Sept. Act.	Dec. Act.	Dec. Revalued	March Act.	June Proj. 1/	Dec. Proj.
Broad money	455.3	671.9	688.8	801.2	831.5	964.6	994.9	1,069.0	1,193.3	1,320.0
Ruble broad money	370.3	448.4	473.8	567.7	597.4	704.7	704.7	751.3	863.0	989.6
Currency in circulation	130.5	187.8	174.1	216.4	212.8	266.6	266.6	251.5	320.2	342.8
Ruble deposits	239.8	260.5	299.7	351.3	384.6	438.1	438.1	499.8	542.7	646.8
Forex deposits 2/	85	223.5	215.0	233.4	234.1	259.9	290.2	317.7	330.4	330.4
(memorandum item: in US$ billions)	*14.3*	*9.2*	*8.9*	*9.7*	*9.7*	*10.7*	*10.7*	*11.8*	*12.2*	*12.2*
Net foreign assets 2/	-19	-184.8	-162.5	-97.1	-20.2	58.7	71.4	230.8	388.2	592.9
NIR of monetary authorities	22.4	-204.1	-218.1	-177.4	-146.3	-73.7	-76.5	34.3	204.7	409.4
NFA of commercial banks	-41.4	19.3	55.6	80.3	126.1	132.4	147.9	196.5	183.5	183.5
(memorandum item: in US$ billions)	*-3.2*	*-7.6*	*-6.7*	*-4.0*	*-0.8*	*2.4*	*2.6*	*8.5*	*14.4*	*22.0*
NDA	474.3	856.7	851.3	898.2	851.7	905.8	923.5	838.2	805.1	727.1
Domestic credit	655.6	911.0	946.0	987.5	1,008.4	1,087.2	1,132.4	1,087.9	1,040.2	961.1
Net credit to general government	365.4	487.3	519.7	538.6	529.9	529.6	550.8	465.0	385.6	303.9
Net credit to federal government	370.4	482.2	519.3	550.4	555.8	553.9	574.9	541.4	511.2	433.5
Net credit from the monetary authorities	199.9	283.4	330.8	353.9	344.2	329.0	333.1	301.6	264.6	186.9
Net credit from commercial banks	170.5	198.8	188.5	196.5	211.6	224.9	241.8	239.8	246.6	246.6
Ruble credit	147.8	76.6	64.1	70.6	83.7	80.6	80.6	71.8	71.2	71.2
Securities	...	81.3	70.1	75.5	83.0	69.9	69.9	80.9	86.4	...
Other	...	-4.6	-6.1	-4.8	0.8	10.7	10.7	-9.1	-15.2	...
Forex credit 2/	22.7	122.1	124.4	125.8	127.9	144.3	161.1	168.0	175.4	175.4
Net credit to local government and EBFs	-5.1	5.1	0.4	-11.8	-25.9	-24.4	-24.1	-76.4	-125.6	-129.6
Net credit from monetary authorities	-8.2	-7.2	-11.1	-15.0	-23.4	-23.9	-23.9	-61.3	-93.7	-97.7
Net credit from commercial banks	3.1	12.3	11.5	3.2	-2.5	-0.5	-0.2	-15.1	-31.9	-31.9
Credit to the economy	290.2	423.7	426.3	448.9	478.6	557.6	581.6	622.9	654.6	657.2
Loans in foreign currency 2/	97.4	256.5	230.5	203.0	191.4	206.1	230.2	231.0	240.4	240.4
(memorandum item: in US$ billions)	*16.3*	*10.6*	*9.5*	*8.4*	*7.9*	*8.5*	*8.5*	*8.6*	*8.6*	*8.6*
Other loans	192.8	167.2	195.7	245.9	287.1	351.5	351.5	391.9	414.3	416.9
Other items (net)	-181.3	-54.3	-94.7	-89.3	-156.7	-181.3	-208.9	-249.6	-235.1	-234.0
Memorandum items:										
Seasonally adjusted ruble broad money velocity 3/	7.1	7.0	7.6	7.7	8.0	7.8	7.8	7.9	7.5	7.0
Ruble broad money multiplier	2.3	2.1	2.3	2.2	2.3	2.2	2.2	2.4	2.2	2.3

Sources: Russian authorities; and Fund staff estimates.

1/ Actuals for CBR, projection for commercial banks based on end-May data.
2/ At program accounting exchange rate, (Rub 24.18/US$ and US$1.4/SDR for 1998-99) and (Rub 27/US$ and US$1.37/SDR for 1999 Dec. revalued onwards).
3/ December 1999 calculated excluding Rub 20 billion from broad money as an estimate for the temporary increase in liquidity associated with Y2K concerns.

Table 11. Russian Federation: Quarterly Balance of Payments, 1999-2000
(In billions of U.S. dollars)

	1999					2000				
	Q1	Q2	Q3	Q4	Year	Q1	Q2	Q3	Q4	Year
Current account	3.1	2.9	6.6	8.2	20.8	8.8	9.7	6.6	6.6	31.6
Trade balance	6.5	6.9	9.4	13.1	35.8	13.6	13.5	10.3	9.8	47.1
Exports	15.6	17.0	18.8	24.0	75.3	23.3	24.1	22.9	23.6	93.9
Non-energy	9.5	10.6	11.5	13.6	45.2	10.9	12.4	12.6	13.3	49.3
Oil	2.9	4.3	5.2	6.4	18.8	7.7	8.0	7.1	6.3	29.1
Natural gas	3.2	2.1	2.1	3.9	11.4	4.7	3.7	3.2	3.9	15.5
Imports	-9.1	-10.1	-9.5	-10.9	-39.5	-9.7	-10.6	-12.6	-13.8	-46.7
Services	-3.3	-4.1	-3.0	-5.3	-15.7	-4.7	-3.7	-3.6	-3.1	-15.2
Nonfactor services	-0.8	-0.9	-1.0	-1.1	-3.8	-1.5	-0.7	-0.7	-0.6	-3.4
Factor services	-2.5	-3.3	-2.0	-4.2	-11.9	-3.2	-3.0	-3.0	-2.6	-11.7
Current transfers	0.0	0.1	0.2	0.4	0.6	-0.1	-0.1	-0.1	-0.1	-0.3
Financial and capital account	-4.2	-2.1	-7.9	-2.4	-16.6	-4.4	-4.3	-4.8	-5.1	-18.5
Public sector capital	-0.8	-0.1	-0.7	-0.3	-1.9	-0.8	-0.3	-1.0	-0.1	-2.3
Disbursements	0.4	0.3	0.3	1.1	2.1	0.3	0.4	0.4	0.7	1.9
Amortization	-0.6	-0.9	-0.9	-0.9	-3.3	-0.9	-0.4	-1.2	-0.6	-3.2
Net purchases of government securities	-0.5	0.7	-0.1	-0.3	-0.3	-0.1	-0.1	-0.1	-0.1	-0.5
Other 1/	-0.1	-0.1	-0.1	-0.1	-0.5	-0.1	-0.1	-0.1	-0.1	-0.5
Private sector capital	-3.4	-2.1	-7.2	-2.1	-14.7	-3.5	-4.0	-3.7	-5.0	-16.2
Foreign direct investment	0.4	-0.1	0.1	0.4	0.8	0.3	0.3	0.3	0.3	1.1
Short-term private flows 2/	-4.3	-1.9	-6.8	-1.9	-14.9	-3.8	-4.3	-4.0	-5.3	-17.4
Other	0.6	-0.1	-0.4	-0.7	-0.6	0.0	0.0	0.0	0.0	0.1
Errors and omissions, net	-1.0	-1.7	0.0	-4.3	-7.0	-2.2	0.0	0.0	0.0	-2.2
Overall balance	-2.1	-0.9	-1.3	1.5	-2.9	2.2	5.4	1.8	1.5	10.9
Financing	2.1	0.9	1.3	-1.5	2.9	-2.2	-5.4	-1.8	-1.5	-10.9
Net international reserves	0.5	-2.3	-0.6	-3.0	-5.4	-4.1	-6.3	-3.7	-3.9	-18.0
Gross reserves (- increase) 3/	1.3	-1.4	0.1	-1.6	-1.7	-3.2	-5.4	-3.0	-3.4	-15.0
Net Fund liabilities	-0.7	-0.9	-0.7	-1.3	-3.6	-0.9	-0.9	-0.7	-0.6	-3.0
Other liabilities 4/	0.0	0.0	0.0	-0.1	-0.1	-0.1	0.0	0.0	0.1	0.0
Exceptional financing	1.6	3.2	1.9	1.5	8.3	1.9	0.9	1.9	2.4	7.1
Memorandum items:										
Current account (in percent of GDP)	8.6	6.9	12.8	15.4	11.3	18.0	18.6	10.9	10.0	13.7
Gross reserves	9.6	11.1	11.0	12.6	12.6	15.8	21.2	24.2	27.6	27.6
in months of imports of G&S	2.5	2.5	2.5	2.6	2.9	3.6	4.7	4.5	4.8	4.7
Russian oil price ($/barrel)	8.7	11.8	16.9	21.8	14.7	21.6	21.2	21.9	20.7	21.4
World oil price ($/barrel)	11.8	16.4	20.7	23.7	18.1	26.7	26.2	27.1	25.6	26.4

Sources: Russian authorities; and Fund staff estimates.

1/ Receipts and payments on debts denominated in non-convertible currencies net of reschedulings and deferrals, including debts to former COMECON countries (payable almost entirely in kind).

2/ Includes cash-related transactions, enterprise credits, inter-FSU trade arrears, unrepatriated export proceeds, and unspecified short-term financing.

3/ Change in gross reserves in Jan-June 1999 according to BoP methodology differs from that in the monetary survey, due mainly to gold-related operations undertaken by the CBR.

4/ Treatment of liabilities differs from the monetary accounts due to the inclusion in the latter of some Vneshekonombank deposits with the CBR.

Table 12. Russian Federation: Medium-Term Balance of Payments Projections, 1997-2005
(In billions of U.S. dollars, unless otherwise indicated)

	1997	1998	1999	Projections 2000	2001	2002	2003	2004	2005
Current account	2.8	1.0	20.8	31.6	23.0	15.5	10.7	6.3	1.5
Trade balance	17.4	17.1	35.8	47.1	39.8	32.8	29.0	26.2	23.1
Exports	89.0	74.9	75.3	93.9	95.0	95.2	99.7	105.4	111.0
Oil	22.0	14.2	18.8	29.1	25.4	22.4	22.2	22.7	22.7
Gas	16.4	13.3	11.4	15.5	16.3	15.4	15.8	16.3	16.9
Non-energy	50.7	47.4	45.2	49.3	53.3	57.4	61.7	66.4	71.5
Imports	-71.6	-57.8	-39.5	-46.7	-55.2	-62.4	-70.6	-79.2	-88.0
Services	-14.3	-15.8	-15.7	-15.2	-16.9	-17.2	-18.4	-19.9	-21.6
Nonfactor services	-4.7	-3.9	-3.8	-3.4	-5.0	-6.3	-7.8	-9.3	-10.8
Factor services	-9.6	-11.9	-11.9	-11.7	-11.8	-10.9	-10.6	-10.6	-10.8
Transfers	-0.3	-0.4	0.6	-0.3	0.0	0.0	0.0	0.0	0.0
Capital account	6.3	-7.1	-16.6	-18.5	-20.0	-11.4	-5.9	0.7	5.4
Public Sector	15.1	7.7	-1.9	-2.3	-3.2	-1.2	-3.3	-2.0	-3.7
Disbursements	8.8	9.5	2.1	1.9	2.7	3.5	4.5	4.5	5.0
Amortizations	-4.6	-4.1	-3.3	-3.2	-4.2	-3.0	-6.5	-6.4	-9.1
Other 1/	10.9	2.3	-0.7	-1.0	-1.7	-1.7	-1.2	-0.1	0.4
Private Sector	-8.7	-14.8	-14.7	-16.2	-16.8	-10.2	-2.7	2.7	9.1
Medium- and long-term	5.8	2.8	0.2	1.2	1.4	2.3	6.4	7.8	9.1
Foreign direct investment	3.6	1.7	0.8	1.1	1.7	2.4	4.9	5.8	7.0
Other	2.2	1.1	-0.6	0.1	-0.3	-0.2	1.5	2.0	2.1
Short term 2/	-14.5	-17.6	-14.9	-17.4	-18.2	-12.4	-9.1	-5.2	0.1
Errors and omissions	-13.6	-9.2	-7.0	-2.2	0.0	0.0	0.0	0.0	0.0
Overall balance	-4.5	-15.3	-2.9	10.9	3.0	4.1	4.8	7.0	6.9
Financing	4.5	15.3	2.9	-10.9	-3.0	-4.1	-4.8	-7.0	-6.9
Net international reserves	-1.4	10.2	-5.4	-18.0	-6.0	-7.2	-7.8	-7.0	-6.9
Gross reserves (- increase) 3/	-2.5	5.6	-1.7	-15.0	-4.5	-4.3	-4.7	-5.5	-5.7
Net Fund liabilities	1.5	5.3	-3.6	-3.0	-1.5	-2.9	-3.1	-1.5	-1.2
Other liabilities 4/	-0.4	-0.7	-0.1	0.0	0.0	0.0	0.0	0.0	0.0
Exceptional financing	5.9	5.2	8.3	7.1	0.0	0.0	0.0	0.0	0.0
Financing gap	0.0	0.0	0.0	0.0	3.0	3.0	3.0	0.0	0.0
Memorandum items:									
Current account (percent of GDP)	0.6	0.3	11.3	13.7	8.4	5.2	3.3	1.8	0.4
Gross reserves 6/	17.8	12.2	12.6	27.6	32.1	36.4	41.0	46.5	52.2
(months of imports of goods and services)	2.9	2.8	2.9	4.7	4.8	4.8	4.8	4.9	5.0
Public external debt (percent of GDP)	30.9	48.2	80.5	65.7	55.3	48.6	43.4	39.0	34.8
External debt service payments 7/	15.4	17.5	25.7	24.1	25.5	25.6	29.6	28.9	31.6
(percent of exports of goods and services)	14.9	20.0	30.5	23.2	24.1	24.0	26.4	24.4	25.2
Import volume growth (percent)	6.8	-18.4	-15.7	16.1	14.8	12.0	12.0	11.0	10.0
Export volume growth (percent)	-2.0	-0.7	9.5	7.0	3.3	3.8	4.0	4.2	4.0
Energy volume growth (percent)	1.5	-1.3	2.0	0.3	0.2	0.6	1.0	1.2	0.7
Non-energy volume growth (percent)	-4.5	-0.3	15.8	11.7	6.0	6.0	6.0	6.0	6.0
Terms of trade (percent)	8.8	-14.3	26.5	19.3	-4.8	-4.4	-0.4	0.5	0.3
World price of oil ($/barrel)	19.3	13.1	18.1	26.4	23.0	20.5	20.4	21.0	21.2

Sources: Data provided by the Russian authorities, and staff estimates.

1/ Includes purchases of government securities as well as receipts and payments on debts denominated in non-convertible currencies net of reschedulings and deferrals, including debts to COMECON countries (payable almost entirely in kind).
2/ Includes cash-related transactions, enterprise credits, intra-CIS trade arrears, unrepatriated export proceeds, and short-term banking sector flows.
3/ For 1999, accumulation of gross reserves not equal to change in reserve stocks, owing to change in definition of gross reserves after end-1998.
4/ Treatment of liabilities differs from the monetary accounts due to the inclusion in the latter of some Vneshekonombank deposits with the CBR.
5/ In 1998, includes accumulation of arrears of $1.2 billion to London and Paris Club creditors.
6/ After 1998, gross reserves of the monetary authorities according to program definition, i.e. excluding assets held with nonresident Russian banks and financial institutions, and correspondent account balances at the CBR of domestic banks. From end-1998 onward, assets are valued at end-1998 cross-exchange rates.
7/ Including both public and private sectors, but excluding payments on short-term debt.

Table 13. Russian Federation: Indicators of Fund Credit, 1997-2008

	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
Outstanding Fund credit												
in percent of:												
Quota	227.4	318.4	186.7	149.9	131.2	95.3	57.4	38.6	24.3	11.3	3.5	0.0
Exports	14.9	25.8	20.4	13.2	11.1	8.1	4.7	3.0	1.8	0.8	0.2	0.0
Gross reserves	74.4	158.2	121.5	44.8	33.0	21.3	11.4	6.8	3.8	1.6	0.5	0.0
Total external debt	7.9	10.1	8.5	6.8	5.9	4.3	2.6	1.8	1.2	0.5	0.2	0.0
Total official external debt	9.8	12.7	10.4	8.3	7.2	5.3	3.2	2.2	1.5	0.7	0.2	0.0
Fund charges and repurchases												
in percent of:												
Quota	18.1	27.9	61.0	45.0	27.0	41.9	41.9	21.3	16.0	14.0	8.1	3.6
Exports	1.2	2.2	6.6	3.9	2.3	3.7	3.6	1.8	1.2	1.0	0.5	0.2
Gross reserves	6.1	13.3	39.3	13.3	6.8	9.7	8.7	4.0	2.5	2.0	1.1	0.5
	(In billions of U.S. dollars)											
Total liabilities to the Fund	13.2	19.3	15.4	12.4	10.6	7.7	4.7	3.2	2.0	0.9	0.3	0.0
Fund purchases	2.0	6.2	0.6	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Fund repurchases	0.5	0.9	4.2	3.0	1.5	2.9	3.1	1.5	1.2	1.1	0.6	0.3
Fund charges	0.6	0.7	0.7	0.7	0.7	0.6	0.5	0.3	0.1	0.1	0.0	0.0
Memorandum items:												
Quota (SDR billion)	4.313	4.313	5.945	5.945	5.945	5.945	5.945	5.945	5.945	5.945	5.945	5.945
U.S. dollar/SDR exchange rate (period average)	1.376	1.356	1.367	1.353	1.357	1.365	1.373	1.380	1.387	1.387	1.387	1.387

Sources: Russian authorities; and Fund staff estimates and projections.

Table 14. Russian Federation: Indicators of External and Financial Vulnerability, 1998-2000
(In units as indicated)

	1998	1999				2000	
	Dec.	Mar.	June	Sep.	Dec.	Mar.	June
External indicators							
Exports (percent change, 12 month basis, US$s) 1/	-24.1	-16.2	-9.9	3.7	23.9	49.9	41.7
Imports (percent change, 12 month basis, US$s) 1/	-61.8	-49.0	-41.9	-29.4	16.6	6.9	5.4
Current account balance (12 months) 1/	1.0	7.4	13.3	18.6	20.8	26.4	33.3
(percent of GDP) 1/	0.3	3.5	6.5	9.5	11.3	13.5	16.2
Oil price	10.4	14.2	17	23.7	25.2	25.1	30.7
Gross official reserves (US$ bn)	12.2	10.8	12.2	11.2	12.5	15.6	21.1
(in months of imports)	2.8	2.5	2.5	2.5	2.6	3.6	4.7
(ratio to reserve money) 2/	107.1	113.1	103.5	106.3	103.7	139.6	149.0
NIR of monetary authorities (US$ bn)	-8.4	-9.0	-7.3	-6.1	-2.8	1.3	7.6
NFA of commercial banks (US$ bn)	0.8	2.3	3.3	5.3	5.4	7.2	6.8
Total external debt (US$ bn)	191.4	...	...	...	181.3	...	...
o/w public sector	152.4	...	...	...	147.6	...	...
External debt/exports	255.6	...	...	...	240.7	...	...
External debt/GDP	60.6	...	...	...	98.9	...	...
Total external debt service to exports	20.0	...	...	...	30.5	...	...
o/w interest	13.9	...	...	...	14.2	...	...
o/w amortization	6.2	...	...	...	16.3	...	...
Foreign currency debt rating 3/	CCC- neg	Sel. Def.	Sel. Def.	Sel. Def.	Sel. Def.	Sel. Def.	Sel. Def.
Spread of benchmark bonds	n.a.	3,646.00	1,901.00	2,336.00	1,240.00	1,021.00	1,016.00
Exchange rate (per US$)	20.65	24.18	24.22	25.08	27.00	28.46	28.07
Real depreciation (-) vs US$, 12-month	-46.8	-47.7	-45.5	-10.3	-1.0	-2.0	0.4
Financial sector							
M2 growth (12 month basis) 4/	20.9	31.4	54.0	63.3	57.2	58.6	53.4
Domestic credit (12 month growth) 2/ 4/	30.8	44.3	52.6	27.4	33.5	19.7	15.3
Growth of credit to private sector 4/	33.1	55.1	57.8	26.9	50.6	48.8	61.6
Share of foreign currency loans in total lending 2/ 4/	55.2	52.5	42.7	38.9	37.9	36.5	35
Share of foreign currency deposits in total deposits 2/ 4/	41.9	41.8	40	38.8	39.8	40.8	38.9
Share of Ruble demand deposits in total Ruble deposits 4/	61.6	58.9	59.1	58.3	60	59.1	59.3
Share of nonperforming loans in total loans 5/	24	22	20	23	23	19	...
Total domestic debt (Rub billion)	480.1	...	...	...	583.6	573.4	...
(percent of GDP)	17.8	...	...	...	12.8	9.1	...
Stock market index (US$ terms)	38.1	61.0	97.4	63.3	114.8	178.0	134.9

Sources: Russian authorities; and Fund staff estimates.

1/ Data for June 2000 are projections.
2/ At end of period exchange rates.
3/ Ratings on Russia's Eurobonds are higher. In mid-July, these were rated B-/B3 by all three major ratings agencies (Sel.Def. – Selective Default).
4/ Data in final column refer to end-May 2000.
5/ Loans classified as non-standard, doubtful or bad. Data are for the 30 largest banks only.

Table 15. Russian Federation: Macroeconomic Framework, 1997-2015

	1997	1998	1999 Est.	Projections 2000	2001	2002	2003	2004	2005	2006-15 Average
				(In percent of GDP, unless otherwise indicated)						
I. Savings-investment balances										
General government										
Consumption	21.6	19.6	18.8	16.8	15.8	15.8	15.1	14.9	14.6	15.2
Gross investment	11.9	12.0	11.5	10.7	10.5	10.9	10.9	11.1	11.3	10.9
Net income from abroad	-2.1	-3.9	-4.9	-3.7	-3.3	-2.9	-2.6	-2.3	-2.1	-1.1
National savings	4.0	4.0	7.7	13.8	9.9	9.8	10.0	10.5	10.9	11.2
National savings - investment	-7.9	-8.0	-3.8	3.1	-0.6	-1.0	-0.8	-0.6	-0.5	0.3
Private sector										
Consumption	52.6	60.3	48.7	49.4	56.0	58.6	61.0	62.2	63.2	66.3
Gross investment	11.0	3.4	3.6	4.2	5.0	5.7	6.4	7.0	7.5	8.7
Net income from abroad	-0.2	-0.5	-1.2	-1.5	-1.0	-0.8	-0.7	-0.7	-0.7	-0.8
National savings	19.5	11.7	18.7	14.7	14.0	12.0	10.5	9.4	8.4	5.4
National savings - investment	8.5	8.3	15.1	10.6	9.0	6.3	4.2	2.4	0.9	-3.3
Overall economy										
Consumption	74.2	79.9	67.5	66.2	71.8	74.5	76.1	77.1	77.9	81.4
Gross investment	22.9	15.4	15.1	14.9	15.5	16.6	17.2	18.1	18.9	19.6
Net income from abroad	-2.3	-4.4	-6.1	-5.2	-4.3	-3.7	-3.3	-3.0	-2.9	-1.9
National savings	23.5	15.7	26.4	28.5	23.9	21.8	20.6	19.9	19.3	16.7
National savings - investment (current account)	0.6	0.3	11.3	13.7	8.4	5.2	3.3	1.8	0.4	-3.0
				(In percent of GDP, unless otherwise indicated)						
II. Federal government accounts and debt indicators										
Revenues	12.3	11.0	13.4	16.3	15.8	15.6	15.3	15.1	14.9	14.5
Primary balance, commitments	-2.5	-1.3	1.6	6.1	3.2	2.4	2.3	2.2	2.1	1.8
Overall balance, commitments	-7.1	-5.9	-4.7	1.5	-0.6	-1.0	-0.8	-0.6	-0.5	0.3
reign financing 1/	1.4	1.9	0.2	-0.3	-0.9	0.0	-0.7	-0.2	-0.7	-1.1
omestic financing 1/	5.3	3.0	1.2	-2.2	0.4	0.1	0.6	0.8	1.2	0.8
Total federal govt domestic debt	19.8	17.8	12.8	7.7	7.0	5.9	6.0	6.3	6.7	6.2
Total federal govt external debt	30.9	48.2	80.5	65.7	55.3	48.6	43.4	39.0	34.8	17.0
External federal govt debt service/revenues (in percent) 2/	11.0	27.2	22.2	18.5	29.8	26.0	31.1	26.2	28.9	18.2
External federal govt debt service/expenditures (in percent) 2/	7.1	18.8	20.1	21.8	28.7	24.4	29.5	25.2	28.0	18.5
				(In billions of U.S. dollars, unless otherwise indicated)						
III. Balance of payments and external debt										
External current account	2.8	1.0	20.8	31.6	23.0	15.5	10.7	6.3	1.5	-20.3
Change in external terms of trade (in percent)	5.2	-14.3	13.4	24.8	-4.1	-4.4	-0.4	0.5	0.3	0.0
Change in Russian crude oil price (in percent)	...	...	42.2	45.5	-12.9	-10.9	-0.7	2.9	1.0	1.0
Change in export volumes (in percent)	-2.0	-0.7	9.5	7.0	3.3	3.8	4.0	4.2	4.0	4.5
Change in non-energy export volumes (in percent)	-4.5	-0.3	15.8	11.7	6.0	6.0	6.0	6.0	6.0	6.0
Change in import volumes (in percent)	6.8	-18.4	-15.7	16.1	14.8	12.0	12.0	11.0	10.0	6.8
Nongovt net capital flows 3/	-16.5	-24.0	-21.8	-18.5	-16.8	-10.2	-2.7	2.7	9.1	32.1
o/w gross FDI inflows	6.2	2.8	2.7	3.0	3.7	4.5	7.1	8.1	9.4	19.4
Official reserves	17.8	12.2	12.6	27.6	32.1	36.4	41.0	46.5	52.2	79.8
in months of imports	2.9	2.8	2.5	4.7	4.8	4.8	4.8	4.9	5.0	5.0
Total external debt (public and private)	167.4	191.4	181.3	182.5	180.2	179.5	178.1	176.7	173.8	156.6
as percent of GDP	38.4	60.6	98.8	78.8	65.5	60.6	55.6	50.7	45.9	26.5
External debt service / exports of goods and services (in percent)	14.9	20.0	30.5	23.2	24.1	24.0	26.4	24.4	25.2	19.3
Balance of payments: exceptional financing / financing gap 4/	0.0	0.0	0.0	7.1	3.0	3.0	3.0	0.0	0.0	0.0
				(In percent, unless otherwise indicated)						
IV. Growth and prices										
Real GDP growth	0.9	-4.9	3.2	7.0	4.0	4.0	4.0	4.5	5.0	6.0
CPI Inflation, end of period	10.9	84.5	36.7	16.0	10.7	8.5	6.7	6.0	5.4	5.4

Source: Staff estimates and projections based on official data.

/ Net Fund financing is included in domestic financing, as a component of CBR credit; foreign financing therefore excludes the Fund.
2/ From 2001 onward, before any rescheduling. Excludes debt service in kind ($1.2 billion per annum until 2010). Includes debt service to the Fund.
3/ Including net errors and omissions.
4/ For 2000, refers to the (identified) exceptional financing. For subsequent years, refers to the (unidentified) financing gap.

Table 16. Russian Federation: Basic Social Data, 1991-99

	1991	1992	1993	1994	1995	1996	1997	1998	1999
Population, end of year (million)	...	148.3	148.0	147.9	147.6	147.1	146.7	146.3	145.6
GDP per capita (USD)	...	...	1239	1842	2284	2830	2960	2154	1254
Average wage (USD)	...	321	698	1190	1278	1883	1998	1652	766
Distribution of income per capita: GINI coefficient 1/	0.260	0.289	0.398	0.409	0.381	0.375	0.381	0.398	0.394
Distribution of employee earnings:									
Q90 / Q10	4.28	8.17	15.55	9.41	9.96	9.60	10.40	...	...
Q90 / Q50 (percent)	207.5	228.6	270.6	272.8	286.6	282.4	290.0	...	...
Q10 / Q50 (percent)	48.5	28.0	17.4	29.0	28.8	29.4	27.8	...	...
Population below subsistence level (percent)	...	33.5	31.5	22.4	24.7	22.1	20.8	23.4	29.9
Unemployment rate (percent)	...	...	5.3	6.9	8.1	9.3	10.8	11.6	12.6
Life expectancy at birth (years)	69.0	67.9	65.1	64.0	64.6	65.9	66.9	67.2	65.9
Male	63.5	62.0	58.9	57.6	58.3	59.8	61.0	61.8	59.9
Female	...	73.8	71.9	71.2	71.7	72.5	73.1	72.8	72.4
Birth rate (per 1000 people)	...	10.7	9.4	9.6	9.3	8.9	8.6	8.8	8.3
Death rate (per 1000 people)	...	12.2	14.5	15.7	15.0	14.2	13.8	13.6	14.7
Infant death rate, under 1 year old (per 1000 live births)	...	18.0	19.9	18.6	18.1	17.4	16.9	16.7	16.9
Rate of natural population increase (per 1000 people)	...	-1.5	-5.1	-6.1	-5.7	-5.3	-5.2	-4.8	-6.4

Sources: Goskomstat; World Bank (1998), "Poverty Policy in Russia: Targeting and the Longer-Term Poor"; UNICEF.

1/ For 1991 and 1992, refers to aggregate income, including the value of net products of household land plots.

RUSSIAN FEDERATION: FUND RELATIONS

(as of July 31, 2000)

I. Membership Status: Joined: 06/01/1992; Article VIII

II. General Resources Account:

	SDR Million	Percent of Quota
Quota	5,945.40	100.0
Fund Holdings of Currency	15,609.12	262.5
Reserve Position in Fund	0.93	0.0

III. SDR Department:

	SDR Million	Percent of Allocation
Holdings	0.01	N/A

IV. Outstanding Purchases and Loans:

	SDR Million	Percent of Quota
Stand-By Arrangements	1,145.35	19.3
Extended Arrangements	5,104.69	85.9
Contingency and Compensatory	2,156.55	36.3
Systemic Transformation	1,257.99	21.2

V. Financial Arrangements:

Type	Approval Date	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
Stand-By	07/28/1999	12/27/2000	3,300.00	471.43
EFF	03/26/1996	03/26/1999	13,206.57	5,779.71
Stand-By	04/11/1995	03/26/1996	4,313.10	4,313.10

VI. Projected Obligations to Fund: (SDR million; based on existing use of resources and present holdings of SDRs):

	Overdue	Forthcoming				
	07/31/2000	2000	2001	2002	2003	2004
Principal		931.5	1,111.0	2,136.0	2,254.0	1,117.4
Charges/Interest		254.6	451.8	369.1	247.0	156.8
Total		1,186.1	1,562.8	2,505.1	2,501.6	1,274.2

VII. Exchange rate arrangement: Floating rate. The exchange rate of the ruble is determined in the interbank foreign exchange market, which was unified on June 29, 1999. The interbank market electronically links exchanges across the country. The official rate of the ruble is set equal to the previous day's weighted average rate in the interbank market.

The Russian Federation accepted the obligations of Article VIII, sections 2, 3, and 4 of the IMF Articles of Agreement with effect from June 1, 1996. The Russian authorities, however, presently impose a number of exchange measures that are subject to approval under Article VIII. Many of these were imposed in August 1998 in order to stem capital flight and stabilize the exchange rate. Russia's restrictions under Article VIII are as follows:

- Suspension of conversion operations through nonresidents' S-accounts (exchange restriction and multiple currency practice). These are special accounts used for GKO/OFZ-related transactions. Before balances arising from such transactions can be repatriated, funds have to be either transferred to a noninterest bearing transit account or invested in special short-term GKOs that are convertible at maturity. As a result, the repatriation of interest earnings and other current proceeds from GKO/OFZ investments would be made with possibly a long delay and at unfavorable terms. Fund approval granted on July 28, 1999, and a temporary extension on July 25, 2000.

- Repatriation restrictions on ruble balances of nonresidents not participating in the GKO/OFZ novation (exchange restriction and multiple currency practice). The rules governing the repatriation of ruble balances are similar to those described above with respect to the S-accounts. They apply to ruble balances arising from GKO/OFZ investments which matured before December 31, 1998. Fund approval granted on July 28, 1999, and a temporary extension on July 25, 2000.

- Restrictions on nonresidents' T-accounts (exchange restriction). These are nonresident bank accounts used for trade and some bond-related transactions. Existing restrictions limit the ability of nonresidents to effect moderate amounts of amortization from the proceeds of bond transactions. Fund approval granted on July 28, 1999, and a temporary extension on July 25, 2000.

- Restrictions on advance import payments (exchange restriction). The authorities do not freely permit the making of all advance payments that are required under valid import contracts. Fund approval not granted.

- Restrictions on certain advance payments to Latvian residents (exchange restriction). Fund approval not granted.

VIII. Article IV consultation: Russia is on the standard 12–month consultation cycle. The last consultation was concluded on July 28, 1999.

IX. Resident Representatives:

Mr. Martin Gilman, Senior Resident Representative, since February 3, 1997.
Mr. Jonathan Anderson, Resident Representative, since August 24, 1998
Mr. Geoffrey Barnard, Resident Representative since July 17, 1999.
Mr. Timo Välilä, Resident Representative as of October 2, 2000.

Russian Federation: Relations with the World Bank Group

1. As of June 30, 2000, IBRD commitments (net of cancellations) were $10.4 billion in 44 operations (33 of which were active, including one guarantee), of which just over $7.2 billion has been disbursed ($4.7 billion in the form of fast disbursing adjustment loan proceeds). Intensive portfolio monitoring efforts in response to the financial-economic crisis in August 1998 have resulted in a strong recovery of portfolio performance. Overall, the percentage of projects rated as satisfactory declined from 74 percent in June 1998 to 33 percent by July 1999. Through a series of Country Portfolio Performance Review meetings held in August 1998, November 1998, April 1999, July 1999, September 1999, and February 2000, the Bank has, jointly with the government, agreed on a Portfolio Improvement Program that includes: (i) immediate implementation of partial cancellations; (ii) subsequent unconditional cancellations and cancellations in the event of failure to meet agreed critical targets; (iii) an agreed set of targets for each problem project that would lead to potential upgrading of these projects by the end of the year; and (iv) a follow-up mechanism to monitor and manage improvements in the portfolio.

2. The implementation of the portfolio improvement measures was subject to a joint review by the government and the Bank in September 1999 and February 2000, when an assessment was made of the progress of agreed actions and further key actions were proposed for the Russian government's approval. The results of Country Portfolio Performance Review held in February 2000 proved that the overall portfolio performance had dramatically improved with 60 percent of projects rated as satisfactory, up from 33 percent recorded by the July 1999 CPPR. By end-June 2000 further progress was made and the satisfactory rating increased to 73 percent. The Bank and the government agreed that vigorous efforts, both by the government and the Bank, are still required to ensure further improvement and sustainability of the active portfolio. Since July 1999, over $860 million of uncommitted loan proceeds was canceled from eight loans.

3. In December 1999, the Bank's Board approved the Country Assistance Strategy (CAS) for the Russian Federation. Overall, the planned strategy envisages a further shift in emphasis to deepen structural reform and address more directly the need for systemic reforms. In particular, the CAS: (i) increases emphasis on reform of systemic policies and institutions intended to improve the performance of public sector that are critical for public administration and for the development of an environment attractive to investors—domestic and foreign alike—and conducive to efficient private sector development; (ii) reduces emphasis on sector-and/or region-specific interventions—particularly in energy and infrastructure. In the social sectors, the CAS: (i) emphasizes pilot projects testing approaches to increase service delivery efficiency and crisis interventions; (ii) in social protection, focuses more narrowly on more equitable distribution of the social costs of transition, with special emphasis on segments of the population that appear to be the hardest hit and most vulnerable—single-parent families, pensioners, and children.

4. As of June 30, 2000, IFC's approved portfolio consisted of 30 projects totaling $443 million, of which $276.4 million is comprised of "A" loans and $138.7 million in equity. An additional $93 million in syndications have been approved. Undisbursed commitments

totaled $65 million. As of same date, total disbursed and outstanding loan balances (net of cancellations and repayments) held by IFC on its own account was $128.9 million, equity $117.2 million. Provisions as of June 30, 2000 totaled $42.7 million (33 percent of loan balance), and equity loss reserves were $69.5 million (59 percent of equity).

5. The recent return of positive economic growth and Vladimir Putin's victory in the March Presidential elections have contributed to increased interest in IFC financing for Russian projects, albeit from a low level. Serious proposals in the automotive, retail, construction, oil and gas, and mining sectors are now under review. Despite continuing significant impediments to private investment, the 1998 devaluation of the ruble and import substitution opportunities have renewed interest in the Russian economy. The new government may attract foreign direct investment and portfolio capital in the coming months if reforms to the tax regime and corporate governance are put in place and anti-corruption efforts continue.

6. The current pipeline for FY01 has eleven projects: a total of $148.8 million for IFC's account, including $99.5 million in five projects that have a high probability of being approved in FY01. An additional $32.5 million ($12.5 for high-probability projects) is to be syndicated.

7. In addition to its investment pipeline, IFC is proposing the establishment of the Private Enterprise Partnership to consolidate its TA activities and improve their effectiveness. The Partnership would prepare and execute technical assistance projects that would strengthen financial institutions to provide credit to SMEs, improve corporate governance and transparency, build up/modernize local supply chains for foreign investors, and contribute to the preparation and introduction of legislation to improve the region's business environment.

8. Russia has MIGA's fourth largest exposure, accounting for 6.16 percent of MIGA's total Gross Exposure. MIGA's portfolio in Russia is divided between the manufacturing (47 percent), financial (40 percent) and mining sectors (12 percent). MIGA's outstanding portfolio in Russia consists of ten contracts of guarantee, with a total gross exposure of $269.0 million. MIGA's net exposure is $127.0 million (as of June 30, 2000). The total amount of Foreign Direct Investment facilitated by MIGA in Russia is $1.17 billion.

9. MIGA is currently accepting new applications for Russia. Coverage is provided for Transfer Restriction, Expropriation, War and Civil Disturbance, and Breach of Contract on a case-by-case basis. Investors have expressed interest in MIGA's coverage for investments in the services, mining, agribusiness and financial sectors. In FY00, MIGA issued one contract of guarantee for a project in the agribusiness sector (Louis Dreyfus Negoce) for a gross exposure of $5.0 million. In early April, MIGA submitted another guarantee proposal for Louis Dreyfus to the Board in the amount of $20 million. In addition, MIGA's Board approved two projects in 1999; a leasing project (gross exposure of $24 million) and a mining project (gross exposure of $38.5 million) for which contract negotiations are still ongoing. Investors have expressed interest in MIGA's coverage for a total investment potential of $766.62 million in the agribusiness, financial, mining, oil and gas, services and telecommunications sectors.

10. MIGA has never received any claims in Russia. MIGA did obtain a waiver from the Russian government with respect to the Moratorium of the Central Bank on capital transactions (August 15–November 15, 1998). Transfers of funds by clients who had MIGA coverage during the period of the Moratorium were executed without delay.

11. MIGA's total guarantee capacity for Russia, taking into consideration the Treaty Reinsurance Agreement, is $620 million, and its per-project capacity is $200 million. However, through MIGA's Cooperative Underwriting Program (CUP), MIGA could raise additional capacity in the private market in amounts up to $150 million per project and $500 million per country, bringing MIGA's per-project capacity to $350 million and its per-country capacity to $1.12 billion.

Table 17. Russian Federation: World Bank Operations, 1992-2000

Project	Loan Amount ($ million)		Disbursed (as of [06/30/00])
Rehabilitation I (Rehab I)	600.00	(closed)	600.00
Rehabilitation II (Rehab II)	600.00	(closed)	600.00
Privatization implementation assistance	90.00	(closed)	86.00
Oil rehabilitation	610.00	(closed)	413.4
Employment services and social protection	70.00	(closed)	55.8
Highway rehabilitation and maintenance	300.00	(closed)	281.4
Agriculture reform implementation support	240.00		107.5
Land reform implementation support	80.00		29.0
Financial institutions development	200.00		72.4
Enterprise support	200.00		39.9
Second oil rehabilitation	500.00		346.5
Emergency oil spill recovery and mitigation	99.00		81.5
Management and financial training	40.00	(closed)	40.00
Housing	400.00		166.6
Tax administration modernization	16.80		11.7
Portfolio development	40.00		18.8
Environmental management	110.00		48.0
Urban transport	329.00		244.8
Standards development	24.00		17.5
Coal SECAL	500.00	(closed)	500.00
Coal implementation assistance	25.00		12.4
Bridge rehabilitation	350.00		104.1
Legal Reform Project	58.00		19.2
Enterprise housing divestiture	300.00		26.2
Capital markets development	89.00		14.1
Energy efficiency	106.50		13.3
Medical equipment	270.00		191.3
Community social infrastructure	200.00		32.3
Structural Adjustment Loan (SAL I)	600.00	(closed)	600.00
Social Protection Adjustment Loan (SPAL)	800.00		550.00
Structural Adjustment Loan 2 (SAL2)	800.00	(closed)	800.00
Coal SECAL 2	800.00		650.00
Bureau of economic analysis	22.60		12.7
St. Petersburg City Center Rehabilitation	31.00		14.6
Electricity sector reform support	40.00		0.00
Health reform pilot	66.00		10.7
Education Innovation	71.00		7.1
Enterprise restructuring services	85.00	(lapsed)	0.00
Social Protection Implementation Loan (SPIL)	28.60		9.2
Structural Adjustment Loan 3 (SAL3)	1,500.00		400.00
Second Highway rehabilitation and maintenance	400.00	(lapsed)	0.00
State Statistics System	30.00		0.3
Regional Fiscal Technical Assistance	30.00		Not yet effective
Sustainable Forestry Pilot Project	60.00		Not yet effective
Sea Launch Guarantee	100.00		Not applicable
Subtotal (45 operations)	11,911.50		7,229.1
Cancellations & Lapsed Loans	1,284.07		
TOTAL	**10,627.43**		**7,229.1**

RUSSIAN FEDERATION: STATISTICAL ISSUES

1. Russia has a reasonably comprehensive and timely statistical data base, but difficulties remain in terms of the accuracy of statistical reporting. State and private enterprise activities are measured through forms sent to firms included in enterprise registers, with sample surveys increasingly replacing full-count collections. The authorities are generally cooperative in reporting to the Fund, mainly through the resident representative office and missions. Data are transferred on a timely basis, albeit with a few exceptions. Russia produces a wide range of regular, timely publications on financial and economic statistics. The authorities report data for the Fund's International Financial Statistics, Government Finance Statistics Yearbook, the Direction of Trade Statistics, and the Balance of Payments Statistics Yearbook.

2. An IMF Resident Statistical Advisor continues to assist the Russian authorities in improving macroeconomic statistics. Also, an EU/Tacis advisor assists the national statistical agency, the Statistical Committee of the Russian Federation (Goskomstat, or GKS).

National Accounts

3. Goskomstat compiles and publishes discrete quarterly and annual national accounts data on a regular, timely basis, based on the *1993 System of National Accounts*. Source data are obtained from surveys of businesses and households, supplemented by reports from other agencies. There has been much effort to improve coverage, but the basic data are widely considered to substantially understate economic activity. The official estimates of gross domestic product (GDP) incorporate approximate adjustments for gaps in coverage and for under-recording—based in part on surveys of informal markets and comparisons of different statistics—amounting to around 20 percent of GDP. There is no hard evidence at hand to conclude that, on balance, there is a systematic bias in the official GDP estimates. The production-based estimates of GDP are considered more reliable than those derived from expenditure and income approaches, but the differences between the production and expenditure approaches are generally no more than 5 percent. More effort would be desirable to expand data coverage, improve presentation of the data (with an eye to highlighting data revisions, and facilitating time series analysis), and ease access to the data. Full financial accounts by institutional sector are also needed. The delay in finalizing a modern statistics law—requiring firms to provide data and with realistic penalties for noncompliance, together with a guarantee of confidentiality—is an impediment to the further improvement of the national accounts data.

4. The quarterly volume measures, however, follow a non-standard approach. They are compiled and presented at the prices of the same quarter of the previous year and, typically, as year-on-year growth rate, rendering time series analysis impossible. Moreover, long time series with quarterly estimates are not published and revision to the data are not flagged in their publications, nor in the data posted on their web site. As a result it is difficult for users, including the Fund, to maintain any form of long consistent time series.

Prices

5. Goskomstat compiles a good quality national consumer price index (CPI), developed with Fund technical assistance. With the substantial reduction in inflation since 1996, the full index is now only calculated on a monthly basis, with weekly estimates based on a limited number of items. Further improvements could be made on the basis of a new household budget survey, under consideration for some time, and from current efforts to improve the treatment of seasonal items in the index and to standardize specifications of items. World Bank and Tacis assistance will be used in these areas. Goskomstat also publishes a producer price index. The State Customs Committee has initiated the development of foreign trade indexes.

6. However, the CPI, as well as the producer price index (PPI), data are not published in a time series format, rendering time series analysis difficult. The main focus is on a set of derived measures of change, presented for each month as a percentage of a previous month (the previous month and the same month in the previous year). The presentation differs substantially from practice in the rest of the world of presenting index levels and derived percentage changes.

Government Finance Statistics Data

7. The staff is provided with monthly information on revenues, expenditures, and financing of the federal and local governments and quarterly information on revenues, expenditures, and financing of extrabudgetary funds. The published functional classification of expenditure differs slightly from international standards. Expenditure data classified by economic type are compiled on an annual basis but are not published. Data on domestic and external federal debt are compiled monthly, but are made public only in summary form on an annual basis; in addition, there is no unified debt monitoring and reporting system. The statistical capabilities of the Ministry of Finance are being strengthened to meet these deficiencies. A government finance statistics (GFS) unit has been formed in the Federal Treasury and with technical assistance from STA has developed a two-year work program for statistical improvement. The Treasury has been reporting aggregate government finance data for publication *IFS* since April 1996. The latest detailed preliminary data reported for GFSY refers to 1995.

Monetary Statistics

8. Monetary data are reasonably comprehensive and generally in accordance with international standards. The new plans of accounts that were introduced in the beginning of 1998 for the central bank and commercial banks are fairly adequate for the compilation of analytically sound monetary statistics directly from accounting records. Nevertheless, the recent money and banking statistics mission made recommendations on several important methodological issues that have not been properly addressed in the compilation of monetary data, such as the appropriate treatment of: (i) repurchase agreement operations with nonresidents; (ii) accounts of insolvent banks with revoked licenses; and (iii) foreign-owned banks operating in the Russian Federation and branches of Russian commercial banks that are officially licensed abroad and carry out regular banking activities. With a few exceptions (e.g., the treatment of repurchase agreement operations), all recommendations have been implemented. Analytical accounts for the

monetary authorities and commercial banks are reported for publication in IFS with a lag of one month. Timely interest rate data are available.

Balance of Payments Statistics

9. The balance of payments is compiled on a *Balance of Payments Manual (Fifth Edition)* basis. In cooperation with the Fund, significant progress has been made with regard to balance of payments statistics. More detailed data have been published, a Goskomstat survey of trade in services has begun to provide data, the compilation of data on private sector debt has improved markedly, and the Central Bank of Russia (CBR) has published an international investment position for the banking sector. Significant improvements have been made to enhance the quality of the balance of payments statistics, but coverage problems still remain both in the current and the capital and financial account.

10. Merchandise imports data published by the State Customs Service (SCS) are subject to large adjustments for under recording, especially for "shuttle trade" by individuals. Accurate measurement of the large trade credit items is difficult and improvements are needed in the "passport" source data compiled by the SCS, which relate trade flows to actual receipts and payments. The SCS has instituted a program for improving coverage of trade transactions. Specific measures include the adoption of a number of internal resolutions to improve valuation procedures, a program to identify transactions for which volumes are incorrectly measured, and the inclusion of goods under financial leases and for humanitarian aid. The program appears to have generated some positive result, nevertheless, significant improvements are still needed to bring trade coverage up to international standards. Large, persistent differences between partner country and customs data on imports remain, although statistical agencies are seeking to reconcile the data with those of partner countries. The CBR has developed a methodology for calculating components of export and import transactions unrecorded by the customs authorities.

11. The new services survey has improved measurement in this area, but is subject to coverage and reporting problems. A data model is used to estimate travel based on data on the number of travelers provided by the Federal Migration Service and estimates of per capita expenditure. Income data on direct and other foreign investment need improvement. With respect to private investment, indirect measurement suggests that a considerable unrecorded amount of investment has occurred in the past five years.

12. Efforts will need to be made to improve the coverage of nonbank corporate sector debt (including off-balance sheet obligations), private debt service and capital movements, short-term capital flows, and official external debt data. Moreover, it would be desirable to post data on private and regional government debt on the CBR website, as is done with some government debt instruments.

13. The CBR has developed a high standard of technical expertise in balance of payments compilation and a Russian expert has been appointed to a committee advising the Fund in this field.

Special Data Dissemination Standard

14. The authorities have indicated that they would like to subscribe to the Fund's Special Data Dissemination Standard. The STA resident advisor is assisting the authorities in this endeavor.

Table 18. Russian Federation: Core Statistical Indicators
(as of August 1, 2000)

	Exchange Rates	International Reserves 1/	Central Bank Balance Sheet	Reserve / Base Money	Broad Money	Interest Rates	Consumer Price Index	Exports/ Imports	Current Account Balance	Overall Government Balance	GDP/ GNP	External Debt / Debt Service
Date of Latest Observation	8/1/00	7/24/00	7/24/00	7/24/00	5/31/00	8/1/00	June 2000	4/00	12/99	3/31/00	12/99	12/99
Date Received	8/1/00	7/31/00	7/31/00	7/31/00	7/15/00	8/1/00	7/20/00	6/00	4/00	6/30/00	4/00	4/00
Frequency of Data	D	W	W	W	M	D	W	M	Q	M	Q	Biannual
Frequency of Reporting	D	W	W	W	M	D	W	M	Q	M	Q	Biannual
Source of Data	MAR	F, C	C	C	C	MAR	GKS	C	C	F	GKS	C
Mode of Reporting	E	E	E	E	E	E	E	E	E	V	E	F
Confidentiality	U	Gross-U Net-C	C	U	U	U	U	U	U	U	U	C
Frequency of Publication	D	W	N/A	W	M	D	W	M	M	M	Q	N/A

1/ The authorities have been reporting information on the basis of definitions that are different from those under the program.

Explanations of Abbreviations:

Frequency of data, reporting of publications: D-daily, W-weekly, M-monthly, Q-quarterly.

Source of data: MAR-Market, F-Ministry of Finance, C-CBR, GKS-Goskomstat

Mode of reporting: E-electronic, V-variable, F-cable/fax.

Confidentiality: U-unrestricted, C-for use by Fund staff and the Executive Board.

RUSSIAN FEDERATION: PROGRESS TOWARDS STRUCTURAL BENCHMARKS

Structural Benchmarks met

- Implement a system of preapproval of all federal contracts, ensuring that all obligations lacking such approval will be declared invalid. This preapproval will rely on a reporting system monitoring the amount of registered contracts against budget limits on an ongoing basis, with all contracts that exceed federal budget spending limits being denied.
- Verify and restructure all budgetary arrears from previous years.
- Submit amendments to the Duma on the Law on Banks and Banking that will require banks to: (i) disclose annually key financial indicators, such as capital adequacy ratios and provisions against bad assets; (ii) introduce income statements by December 31, 1999 for fiscal year 1999; to have annual accounts prepared and audited by a qualified firm; and to publish quarterly reports.
- Carry out a review of monetary policy instruments available to the CBR, and take additional measures necessary to allow the CBR to achieve the monetary policy objectives.
- Oil companies to be current on statutory tax liabilities at end-1999.
- Reduce employment in the federal executive authorities by 41,000 by end-1999 compared with end-1998.

September 30, 1999 Structural Benchmarks outstanding

- Award contracts for the execution of financial management reviews, leading to annual audits, carried out in line with international auditing standards, of the Pension Fund (PF), Social Insurance Fund (SIF), Medical Insurance Fund (MIF), and the Road Fund (RF).
  Status*: The contracts for the PF and SIF have been awarded. Terms of reference are not yet finalized for the MIF. The government proposes to abolish the Federal Road Fund as an earmarked budgetary fund from January 1, 2001.*
- Submit to the Duma amendments to the Bank Bankruptcy Law, as described in paragraph 45 of the Statement on Economic Polices (SEP) in EBS/99/124.
  Status*: Amendments were submitted, but require further revision to meet the SEP requirements.*
- Issue a decision requiring Gazprom, RAO UES, the Railways, and Transneft to prepare and publish on a quarterly basis financial accounts consistent with the IAS, commencing with accounts for the first quarter of 2000.
  Status*: Gazprom, RAO UES and Transneft are to publish reports that combine the first and the second quarter by September. However, the Railways will only be able to publish an annual report for 2000.*
- Eliminate the deposit requirement for prepayment of imports.

Status: Alternative foreign exchange control measures to replace the deposit requirement are not yet in place. A set of such measures has passed its first reading in the Duma, and is in the process of being revised before the second reading.

- Increase cash collection rates for electric power, district heating, and natural gas to 35 percent, and for freight service provided by the railways to 60 percent.
  ***Status:** See equivalent December 31 benchmark.*

- Pass amendments to the Law on Insolvency (Bankruptcy) to eliminate the bias in the law toward reorganization rather than liquidation of enterprises, eliminate court discretion in overruling the creditor's decision to liquidate the debtor enterprise; and provide for the participation of the state in bankruptcy proceedings at all stages where relevant for the protection of the public interest.
  Status: A version of such amendments that generally satisfied the above concerns but introduced other problems was approved by the Duma but vetoed by President Putin. The amendments are being reworked.

December 31, 1999 Structural Benchmarks outstanding

- Bring the operations of the Employment Fund (EF) under Treasury control.
  ***Status:** The government intends to abolish the EF and to bring its functions onto the budget.*

- Bring the operations of the Road Fund under Treasury control.
  ***Status:** The government intends to abolish the Federal Road Fund as an earmarked budgetary fund.*

- Complete due diligence study for Sberbank.
  ***Status:** The contract for the study has been signed and work is under way.*

- Increase cash collection rates for electric power, district heating, and natural gas to 40 percent, and for freight service provided by the railways, increase cash collection rate to 65 percent.
  ***Status:** Data for May: power and heating–65 percent; gas–34 percent; railways–81 percent. Certain administrative actions have been taken to improve cash collections, including to introduce prepayment and letters of credit for settling utility bills and requiring that all utility payments of federal budgetary organizations are made through the Treasury. Amendments to the Civil Code to facilitate disconnection of delinquent customers by energy suppliers have been drafted, but not yet submitted to the Duma.*

RUSSIAN FEDERATION: MEDIUM-TERM OUTLOOK

1. The baseline scenario suggests that Russia should be able to achieve external and fiscal viability over the medium term, but that modest financing gaps may persist over the next few years. These gaps are within what could be covered through a traditional flow rescheduling of Russia's official bilateral debt. The continued need for exceptional support in this period reflects mainly the need to continue rebuilding international reserves to a level that would provide adequate coverage in the event of a sudden temporary deterioration in the external environment. The projections suggest that Russia could graduate from needing exceptional balance of payments support within three years. External debt and debt service ratios would decline rapidly over the medium term, with the ratio of federal government external debt to GDP halving to 37 percent by 2005, and external debt service declining from 31 percent of exports of goods and services in 1999 to 19 percent on average in 2006–15.

2. The baseline scenario assumes steadfast implementation of structural reforms and a significant positive impact of reforms on economic growth. The key assumptions underlying the baseline projections are described in Box 6. Output growth is expected to slow in the latter part of 2000 from its current very high level as the current account weakens due to a decline in the world oil price, a recovery in imports and the effects of the real appreciation of the exchange rate. Real GDP is though expected to continue to grow at around 4 percent in 2001 driven by investment and consumption. Real GDP growth is expected to accelerate gradually to 5–6 percent over the medium term as structural reforms take hold and the investment climate improves. The expansion of real GDP would continue to be driven mainly by investment as the obsolete capital stock is renewed, which—in combination with improved management and business conditions—should be associated with substantial productivity growth. This would also allow for a recovery in real wages and private consumption. While the strength of external competitiveness should permit a sustained expansion of non-energy exports, import growth would likely be relatively more dynamic reflecting the observed high price elasticity and recovery of domestic demand. The external balance would, thus, contribute negatively to output growth and the current account surplus would be gradually eliminated.

3. The deterioration in the external current account balance would be largely reflected in a decline in the private sector savings-investment balance though with some easing of the fiscal position. In the private sector, the rise in investment would likely be accompanied by a decline in savings, certainly in the energy sector as the terms of trade normalize. The medium-term fiscal projections assume that the primary surplus is gradually reduced from its very high level in 2000, but held at about 2 percent of GDP over the medium term so as to maintain approximate overall balance in the fiscal accounts. The fiscal scenario takes into account the envisaged far-reaching reforms on both the revenue and expenditure sides. The tax reforms combined with the changes in the macroeconomic environment are expected to reduce the ratio of revenue to GDP for the enlarged government from 39 percent in 2000 to 33 percent in 2005, matched by roughly similar cuts in spending. The projections include additional expenditures related to future structural reforms of around 0.5 percent of GDP per annum; the adequacy of this allocation is

subject to considerable uncertainty and will depend, inter alia, upon the extent and pace of the implementation of the government's reform program.

4. The capital account is likely to remain in deficit over the medium term owing to significant debt repayments falling due and time needed to restore confidence among private investors. The projections include the recent debt reduction agreement with the London Club creditors. It is assumed that access to international capital markets is slowly but gradually restored, and that capital flight responds favorably to the improved domestic investment climate. A certain level of private capital outflows, however, is likely to persist in the foreseeable future. There is also considerable scope for a pick-up in foreign direct investment, although perhaps not to levels seen in other advanced transition economies. The overall balance of payments should remain in surplus throughout the medium term, with a modest amount of exceptional financing ensuring that international reserves are rebuilt relatively quickly to a level of 5–6 months of imports.

5. The projections and conclusions about the need for exceptional balance of payments support are subject to an unusually large degree of uncertainty at the current juncture. First, recent developments with respect to output growth, the balance of payments, and fiscal revenues have been considerably more favorable than expected a few months ago, but questions remain about the sustainability of this performance. A major uncertainty pertains to the timing of the recovery in imports from their current compressed level, the risk that energy prices could decline more rapidly than assumed in the projections, and the response of the real sector to an appreciation of the real exchange rate. Second, the cost of structural reforms could be considerably higher than assumed. It may be very difficult to cut expenditures where required to finance the desired tax reform, pent up pressures in the social areas may be underestimated, and only limited allowances have been made for the costs associated with the restructuring of banks and enterprises. Third, there are considerable risks relating to the implementation of the structural reform program. Without strong progress in this area, the investment climate would not improve as needed and growth would suffer.

6. Should a low-growth scenario be combined with a considerably less favorable external environment, financing gaps would persist and exceed what could be covered by traditional rescheduling. Fiscal gaps would be higher as a result of lower revenues, and public sector debt indicators would develop less favorably. External financing gaps would likely also increase as exports would be lower (and possibly foreign direct investment lower and private capital flight higher), although imports would also be lower as investment and incomes would be weaker than under the baseline scenario. The heavy dependence of the Russian economy—both the external and fiscal sectors—on the production of primary commodities thus renders any conclusion about the need for debt relief highly sensitive to assumptions about not least energy prices, as long as foreign reserves remain at a relatively low level. Viability could also be jeopardized if the fiscal cost of structural reforms is higher than assumed or if the recent expenditure compression turns out to be unsustainable.

Box 6. Russian Federation: Assumptions Underlying the Medium-Term Baseline Scenario

The key assumptions underlying the medium-term projections are as follows:

- The international price of oil averages $26.4 per barrel in 2000 and declines to $23.0 in 2001 and $21.2 in 2005. Gas prices strengthen to $106.9 per thousand cubic meters in 2000 and decline over the medium term in tandem with oil prices.

- Output growth is assumed to reach 5–6 percent over the medium term as structural reforms take hold.

- Import volumes are expected to grow 16 percent in 2000 from very depressed levels on account of pent-up demand, reflecting observed high short-term income and price elasticities, as well as a higher import content of investment. Import volume growth will moderate to about 7 percent over the medium term.

- Direct foreign investment is expected to recover gradually from $1 billion in 2000 to $6 billion in 2005 as the overall investment climate improves.

- Private capital outflows (including errors and omissions) will persist in the short run reflecting nonrepatriation of export proceeds, but subside over the medium term as confidence is regained, and access to capital markets is restored.

- The Russian economy continues to be relatively undiversified, resource-based, and potentially subject to sharp swings in commodity prices. In order to prevent the disruptive consequences of export price fluctuations, reserve coverage should be relatively high. It is assumed that it will reach 5–6 months of imports over the medium term, which would translate into reserve accumulation of $6–7 billion per year.

- The fiscal projections incorporate far-reaching tax and expenditure reforms aimed at a significant downsizing of the public sector relative to GDP. There is also a limited allowance for the fiscal costs of structural reform.

INTERNATIONAL MONETARY FUND
Public Information Notice
EXTERNAL RELATIONS DEPARTMENT

Public Information Notice (PIN) No. 00/83
FOR IMMEDIATE RELEASE
November 9, 2000

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Concludes Article IV Consultation with the Russian Federation

On September 15, 2000, the Executive Board concluded the Article IV consultation with the Russian Federation.[1]

Background

Recent macroeconomic performance has been strong. Driven by a combination of a large real ruble depreciation following the August 1998 crisis, a sharp improvement in the terms of trade, and strengthened monetary and fiscal policies, the external current account has moved into a substantial surplus while output has rebounded sharply and is now above its level immediately before the crisis. The fiscal balance has improved significantly reflecting policy adjustments and the windfall gains from high world oil prices. Monetary policy has focused on bringing down inflation while preserving relative stability of the exchange rate. However, the liquidity injections resulting from large foreign exchange market interventions (to prevent an excessive appreciation of the ruble) have been associated with some uptick in inflation in the last few months.

After declining by 4.9 percent in 1998, output grew by 3.2 percent in 1999 and is on course to grow by around 7 percent in 2000. The recovery was initially based on import substitution in response to the 40 percent real depreciation of the ruble, but has subsequently broadened as domestic consumption and investment have begun to recover and non-energy exports have grown strongly. A recovery in enterprise profitability coupled with the stronger fiscal position and an insistence by the federal government on payment of taxes in cash have resulted in a reduction in barter and domestic arrears accumulation.

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[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. In this PIN, the main features of the Board's discussion are described.

The external current account has swung from a deficit of 3 percent of GDP in the first half of 1998 to an estimated surplus of 18 percent of GDP in the first half of 2000. This sharp turnaround largely reflects the compression of imports following the ruble depreciation, as well as the increase in world energy prices. Despite continuing high levels of capital flight and a small deficit for the public sector capital account, the overall balance of payments has moved into significant surplus with gross reserves increasing by $8.6 bn in the first half of 2000 to over $21 bn (equivalent to 4.7 months of imports) compared to a stock of $10.9 bn (2.5 months of imports) at end-1998. The balance of payments position has also benefited from debt restructuring provided by both Paris Club and London Club creditors.

The fiscal position of all levels of government has improved sharply. At the federal level, the primary balance has moved from a deficit of about 1½ percent of GDP in 1998 to a surplus of 1½ percent of GDP in 1999 and a surplus of about 6½ percent of GDP in the first half of 2000. The improvement has been driven by a large increase in revenues from the growing tax base, discretionary tax changes including the reintroduction of export taxes that have captured a portion of the windfall revenue gains in the energy sector, and a more determined effort to improve compliance. Balances of the local governments and extrabudgetary funds have also improved, in this case due to expenditure reductions.

Monetary policy has sought to bring down inflation while resisting pressures for a sharp nominal appreciation arising from the balance of payments surplus. During 1999, inflation was kept on a downward path, falling to less than 1 percent per month (seasonally adjusted) at the end of the year. Liquidity injected through CBR purchases of foreign exchange was partly absorbed by an increase in the demand for money, on account of the output recovery and the decreased use of barter, as well as an increase in commercial bank deposits at the CBR. The expanding balance of payments surplus in the first part of 2000 has resulted in the CBR making substantial purchases of foreign exchange in the market which has placed great pressure on the CBR's ability to sterilize the liquidity injected. While the demand for money has continued to grow and the CBR has been helped by a large build-up in balances by all levels of government, base money grew by almost 25 percent in the second quarter of 2000. After remaining at less than 1 percent per month (seasonally adjusted) through the first four months of 2000, there has been a notable uptick in inflation since May. While this coincided with an increase in utility tariffs, it is also likely that underlying inflation has increased.

Progress with structural reforms has been mixed, though it has received new impetus in the post-election period. Reforms in a number of areas, such as privatization, accounting reform, and bank restructuring, have been delayed, in some cases due to delays in securing passage through the Duma of key legislation. There has been backtracking in the energy sector through the reintroduction of export restrictions to ensure domestic supplies of oil and oil products to certain sectors and regions and to restrain domestic price increases. Progress was made in fiscal reform during 1999 with measures to strengthen tax administration and enhance expenditure control. In July 2000, the government adopted a comprehensive and ambitious plan for the development of the Russian economy over the next 10 years. One key component of this plan, a major tax reform designed to streamline the tax system and lower the tax burden, has already been approved in large part by the parliament and will come into effect in 2001.

Executive Board Assessment

Executive Directors commended the authorities for Russia's impressive recent macroeconomic performance, with a strong output recovery and the achievement of a considerable measure of financial stability.

Directors noted that the favorable external environment had contributed to the recent success, and welcomed the improved macroeconomic policies, particularly the strengthening of the fiscal position, which has helped to preserve and extend the initial gains from the ruble depreciation and the high price of oil. However, Directors cautioned that many of the deep-seated structural problems that were present before the 1998 crisis still remain to be tackled, making recent achievements—particularly on growth—more vulnerable to a major deterioration in the environment. Thus, Directors believed that the main challenge facing the authorities remains the need to implement a broad-based acceleration of structural reform, to ensure that the recovery and the stabilization gains will be sustained over the medium term.

Given the massive external current account surplus, most Directors believed that real appreciation would be both desirable and unavoidable, and that it would be preferable for this to take place through a nominal appreciation rather than through inflation. However, Directors noted that an excessive real appreciation could threaten the recovery and generally regarded continuation of the current policy of sterilized intervention to slow the rate of appreciation as appropriate. A few Directors recommended that the authorities should consider instituting an inflation-targeting monetary regime.

In this regard, several Directors expressed concern that the issue of whether the cost of sterilization should be borne by the Central Bank of Russia (CBR) or by the government risked deflecting monetary policy from focusing on inflation. They stressed that the responsibility for controlling liquidity and inflation in the short term rests with the CBR. Directors noted that fiscal policy has been conducted in a very responsible manner during this episode of rapid foreign exchange purchases, and considered that the CBR should be more determined in using its market-based instruments to keep control over reserve money. Directors called on the government to regularize its relations with the CBR, including by paying a market-related interest rate on CBR credits. The financial position of the CBR should be reviewed, and the CBR should, if necessary, be recapitalized. However, any such recapitalization should be accompanied by increased transparency and accountability on the part of the central bank, including the termination of functions not normally performed by a central bank, such as ownership of subsidiaries engaged in commercial banking activities and operations in precious metals.

As to fiscal policy, Directors commended the authorities for their restraint in limiting new expenditure commitments despite the strong revenue performance. They encouraged the authorities to continue this cautious approach, given the uncertainties over the medium-term outlook and in the absence of a fuller assessment of the costs of planned reforms. Directors noted that, while revenues had been boosted by the windfall gain accruing to the energy sector, collections from the energy sector had also improved due to more determined efforts to enforce compliance with statutory tax obligations. Directors welcomed other policy improvements including the strengthening of Treasury expenditure control, downsizing of the civil service, reform in tax administration, an increased federal share of tax receipts, and determined efforts to collect revenues in cash.

Looking to 2001, Directors believed that the authorities' target of a zero deficit for the overall balance of the federal government is broadly appropriate given the current macroeconomic outlook. They noted that this target is likely to entail a significant increase in federal expenditures and cautioned that the increased expenditures should be directed primarily toward reform-related expenditures, or the clearance of arrears, rather than increasing recurrent expenditures, which would significantly curtail the room for maneuver in the future. A few Directors considered that the overall fiscal objective should be more ambitious in light of the large external debt and the uncertainties about the outcome of the tax reform.

Directors generally agreed that the current strength of the balance of payments could not be expected to be sustained over the medium term as imports recover from their compressed levels and oil prices subside from recent highs. Most Directors also acknowledged that the fiscal outlook was particularly uncertain, partly due to questions pertaining to the sustainability of expenditure reductions and the cost of reform. These uncertainties notwithstanding, several Directors felt that the current strength of the balance of payments meant that the case for exceptional balance of payments support is not apparent at this stage. Directors considered that, given Russia's healthy external position, emphasis should be placed on normalizing relations with creditors, improving market confidence and attracting foreign investment. In this regard, a few Directors felt that the time was ripe for the removal of remaining restrictions on current transactions.

Directors were of the view that the overall progress in advancing market-oriented structural reforms had been disappointing to date. The government's stated determination to accelerate reforms was therefore encouraging. In this regard, Directors welcomed the long-term reform program recently adopted by the government, especially the emphasis on market liberalization, enterprise restructuring, and measures to tackle deep-seated problems of corruption and governance. They judged the objectives of the government's program to be appropriately ambitious. Directors urged the authorities to move resolutely ahead with the implementation of the envisaged reforms, taking advantage of the opportunity provided by the strong macroeconomic environment and by what appeared to be strengthened political support for reforms following the recent elections.

Several Directors noted, however, that most of the policies envisaged in the government's program had been part of Fund and World Bank supported programs in the past, and that previous governments had failed to implement these policies because of fierce resistance from vested interests. In this regard, Directors noted that any new program that could be supported by the Fund would have to include strong up-front measures in those areas of structural reform that would be key to macroeconomic stability, notably tax reform, bank restructuring, including the completion of financial and strategic reviews of Sberbank, measures to reduce the incidence of barter and arrears accumulation, and steps to strengthen governance and transparency in policy-making institutions. A few Directors were of the view that, given Russia's stronger external position, any future Fund program support should be of a precautionary nature to help catalyze private investment activity. There was also a call for post-program monitoring of the evolution of the economy in the period ahead.

Directors were encouraged by the authorities' efforts to further strengthen the statistical data base including through the design of proper safeguards to ensure data quality. In this regard, the Report on the Observance of Standards and Codes (ROSC) modules on fiscal policy, monetary and financial policies, and on data dissemination provided a generally favorable evaluation of the existing framework, though these also highlighted a number of areas in which further progress is necessary. Directors welcomed the authorities' intention to subscribe to the Special Data Dissemination Standard (SDDS) and encouraged them to address as a matter of priority the weaknesses identified in the ROSC modules.

Directors took note of the authorities' disappointment at their inclusion on the Financial Action Task Force on Money Laundering (FATF) list of countries not cooperating in the fight against money laundering. They welcomed the authorities' intention to introduce measures to correct the shortcomings identified in the FATF report.

Public Information Notices (PINs) are issued, (i) at the request of a member country, following the conclusion of the Article IV consultation for countries seeking to make known the views of the IMF to the public. This action is intended to strengthen IMF surveillance over the economic policies of member countries by increasing the transparency of the IMF's assessment of these policies; and (ii) following policy discussions in the Executive Board at the decision of the Board. As part of a pilot project, the staff report for the 2000 Article IV consultation with the Russian Federation is also available.

Russian Federation: Selected Economic Indicators

	1997	1998	1999	2000 Proj.
Production and prices				
Real GDP	0.9	-4.9	3.2	7.0
Change in consumer prices				
Annual average	14.7	27.7	85.9	18.6
End of period	10.9	84.5	36.7	16.0
Change in GDP deflator	16.5	12.4	63.3	32.0
Public sector				
Enlarged government balance	-7.9	-8.0	-3.8	3.5
Federal government				
Overall balance (commitment basis)	-7.1	-5.9	-4.7	1.5
Primary balance (commitment basis)	-2.5	-1.3	1.6	6.1
Revenue	12.3	11.0	13.4	16.3
of which: cash	10.0	9.0	13.4	16.3
Expenditure (commitment basis)	19.4	16.9	18.1	14.8
Interest	4.7	4.5	6.3	4.6
Noninterest	14.8	12.3	11.8	10.1
External sector				
Total exports, fob	89.0	74.9	75.3	93.9
Total imports, fob	71.6	57.8	39.5	46.7
External current account (deficit -)	2.8	1.0	20.8	31.6
Government external debt service due	15.2	16.6	17.3	15.4
Stock of federal government external debt	134.6	152.4	147.6	149.8
Gross reserves coverage (months of imports of GNFs)	2.9	2.8	2.9	4.7
Memorandum items:				
Nominal GDP (billions of rubles)	2,522	2,696	4,545	6,419
Exchange rate (rubles per US$, period average)	5.8	9.7	24.6	...

Sources: Russian authorities; and IMF staff estimates and projections.