



Russian Federation

U.S.\$2,968,695,000 8.75% Bonds Due 2005 ("Bonds Due 2005")

and

U.S.\$3,466,398,000 11% Bonds Due 2018 ("Bonds Due 2018")

Of the U.S.\$2,968,695,000 Bonds Due 2005 and the U.S.\$3,466,398,000 Bonds Due 2018 (collectively, the "Bonds") being offered hereby, U.S.\$2,968,695,000 and U.S.\$2,966,398,000, respectively, are being offered pursuant to the invitation (the "Invitation") made by the Ministry of Finance of the Russian Federation (the "Ministry of Finance") acting on behalf of the Russian Federation (the "Federation" or the "Issuer") to holders of *Gosudarstvennyye Kratkosrochnyye Obyazatel'stva* maturing before 1st July 1999 (the "GKO's") to submit offers (collectively, the "Exchange Offer") to exchange the GKO's for the Bonds, as described in the Federation's Preliminary Offering Circular dated 14th July 1998, and U.S.\$500,000,000 of Bonds Due 2018, are being offered for cash in an underwritten offering (the "New Cash Offering," and together with the Exchange Offer, the "Bond Offering"). The Dealer Managers for the Invitation are named below. The Bonds being offered in the New Cash Offering are being offered solely by Goldman Sachs International or through its selling agents, Goldman, Sachs & Co., subject to receipt and acceptance by it and subject to its right to reject any order in whole or in part.

Interest on the Bonds is payable semi-annually in arrear on 24th January and 24th July in each year, commencing on 24th January 1999. Payments under the Bonds will be made free and clear of, and without withholding or deduction for, any taxes imposed by the Federation, to the extent described under "Taxation." Unless previously redeemed, or purchased and cancelled, the Bonds Due 2005 will be redeemed at their principal amount together with accrued interest on 24th July 2005, and the Bonds Due 2018 will be redeemed at their principal amount together with accrued interest on 24th July 2018.

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

The Bonds will be offered and sold in registered form in denominations of U.S.\$1,000 or any amount in excess thereof which is an integral multiple of U.S.\$1,000, and will be transferable in denominations of U.S.\$1,000 or any amount in excess thereof which is an integral multiple of U.S.\$1,000. Bonds ("Unrestricted Bonds") which are offered and sold outside the United States of America (the "United States") will be represented by beneficial interests in permanent global Bonds (the "Unrestricted Global Bonds"), without interest coupons attached, which will be registered in the name of National City Nominees Limited as nominee for, and shall be deposited on or about 24th July 1998 (the "Settlement Date") with, Citibank, N.A. London, as common depository for, and in respect of interests held through, Morgan Guaranty Trust Company of New York, Brussels office, as operator of the Euroclear System ("Euroclear") and Cedel Bank, *société anonyme* ("Cedel Bank"). Bonds which are offered and sold in the United States will be represented by beneficial interests in permanent global Bonds (the "Restricted Global Bonds" and, together with the Unrestricted Global Bonds, the "Global Bonds"), without interest coupons attached, which will be deposited on or about the Settlement Date with Citibank, N.A. London, as custodian (the "Custodian") for, and registered in the name of Cede & Co. as nominee for, The Depository Trust Company ("DTC"). Interests in a Restricted Global Bond will be subject to customary restrictions on transfer. Beneficial interests in the Global Bonds will be shown on, and transfers thereof will be effected only through, records maintained by DTC, Euroclear and Cedel Bank and their participants. With limited exceptions, certificates for Bonds will not be issued in exchange for beneficial interests in the Global Bonds.

Issue Price of Bonds Due 2005: 73.801%

Issue Price of Bonds Due 2018: 73.858%

Bonds acquired by the Dealer Managers and others pursuant to the Invitation may be sold by them at prices that may vary from time to time. Bonds being offered pursuant to the New Cash Offering are being offered initially at the issue price set forth above. See "Subscription and Sale."

THE BONDS HAVE NOT BEEN AND WILL NOT BE REGISTERED UNDER THE U.S. SECURITIES ACT OF 1933 (THE "SECURITIES ACT") OR ANY OTHER SECURITIES LAWS AND MAY BE OFFERED AND SOLD ONLY IN TRANSACTIONS THAT ARE EXEMPT FROM, OR ARE NOT SUBJECT TO, THE REGISTRATION REQUIREMENTS OF THE SECURITIES ACT. THE EXCHANGE OFFER IS BEING MADE IN THE UNITED STATES ONLY TO QUALIFIED INSTITUTIONAL BUYERS IN A PRIVATE OFFERING UNDER SECTION 4(2) OF THE SECURITIES ACT AND OUTSIDE THE UNITED STATES IN OFFSHORE TRANSACTIONS IN RELIANCE ON REGULATION S UNDER THE SECURITIES ACT. THE NEW CASH OFFERING IS BEING MADE IN THE UNITED STATES ONLY TO QUALIFIED INSTITUTIONAL BUYERS IN RELIANCE ON RULE 144A UNDER THE SECURITIES ACT AND OUTSIDE THE UNITED STATES IN OFFSHORE TRANSACTIONS IN RELIANCE ON REGULATION S UNDER THE SECURITIES ACT.

Goldman Sachs International

Avtobank
Citicorp Securities, Inc.
ING Barings
UNEXIM Bank

Chase Manhattan International Limited
Credit Suisse First Boston
International Moscow Bank
Vneshtorgbank

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

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

No person has been authorised to make or provide any representation or information regarding the Issuer or the Bonds other than as contained in this Offering Circular. Any such representation or information should not be relied upon as having been authorised by the Issuer or any agency thereof or the Dealer Managers (as defined under "Subscription and Sale"). The delivery of this Offering Circular at any time does not imply that the information contained in it is correct as at any time subsequent to its date. Unless otherwise indicated, all information in this Offering Circular is given as of its date.

The Dealer Managers do not make any representation or warranty, express or implied, as to the accuracy or completeness of the information in this Offering Circular. Each person receiving this Offering Circular acknowledges that such person has not relied on any Dealer Manager or any person affiliated with any Dealer Manager in connection with its investigation of the accuracy of such information or its investment decision. Each person contemplating making an investment in the Bonds must make its own investigation and analysis of the creditworthiness of the Issuer and its own determination of the suitability of any such investment, with particular reference to its own investment objectives and experience, and any other factors which may be relevant to it in connection with such investment.

This Offering Circular does not constitute an offer of, or an invitation by or on behalf of the Issuer or any agency thereof or any Dealer Manager to subscribe or purchase, any of the Bonds. The distribution of this Offering Circular and the offering of the Bonds in certain jurisdictions may be restricted by law. Persons into whose possession this Offering Circular comes are required by the Dealer Managers to inform themselves about and to observe any such restrictions. For a description of certain further restrictions on offers and sales of Bonds and distribution of this Offering Circular, see "Subscription and Sale."

With effect from 1st January 1998, the rouble was redenominated, with one new rouble being set equal to one thousand old roubles. References herein to amounts in "roubles" are references to old roubles, and references to amounts in "redenominated roubles" are references to new roubles.

In this Offering Circular, all references to "roubles" and to "redenominated roubles" are to the lawful currency for the time being of the Federation, all references to "dollars," "U.S.\$" and "\$" are to the lawful currency for the time being of the United States of America and references to "ECU" are to European Currency Units. Translations of amounts from roubles to dollars are solely for the convenience of the reader and are made at various exchange rates. No representation is made that the rouble or dollar amounts referred to herein could have been or could be converted into dollars or roubles, as the case may be, at any particular exchange rate or at all. The rouble/dollar exchange rate as reported by the Central Bank of the Russian Federation (the "Central Bank") on 20th July 1998 was 6.219 redenominated roubles to the dollar.

Prior to the dissolution of the Soviet Union, the collection of data and production of official statistical information with respect to the Russian economy were geared to the needs of central

planning. Since that time, the means employed in collecting data and the methodologies used in the production of statistics have evolved significantly from year-to-year. Statistical information reported herein has been derived from official publications of, and information supplied by, a number of agencies of the Federation, including the State Committee on Statistics ("Goskomstat"), the Central Bank and the Ministry of Finance, and by Vnesheconombank. In certain cases, the Ministry of Finance has performed arithmetic calculations or otherwise determined the form in which information is classified or presented herein. Unless otherwise stated, all annual information, including budget information, is based upon calendar years, and interim statistical information has not been annualised. Data included in this Offering Circular have been subject to rounding adjustments; accordingly, data shown for the same item of information may vary, and figures which are totals may not be arithmetical sums of their components. In addition, certain data presented herein differ from data made public previously due to regular revisions conducted by Goskomstat, the Central Bank, the Ministry of Finance, the Customs Committee and other relevant Russian authorities.

IN CONNECTION WITH THIS ISSUE, GOLDMAN SACHS INTERNATIONAL OR ONE OF ITS AFFILIATES MAY OVER-ALLOT OR EFFECT TRANSACTIONS WHICH STABILISE OR MAINTAIN THE MARKET PRICE OF THE BONDS AT A LEVEL WHICH MIGHT NOT OTHERWISE PREVAIL. SUCH TRANSACTIONS MAY BE EFFECTED ON THE LUXEMBOURG STOCK EXCHANGE, IN THE OVER-THE-COUNTER MARKET OR OTHERWISE. SUCH STABILISING, IF COMMENCED, MAY BE DISCONTINUED AT ANY TIME.

TABLE OF CONTENTS

	<u>Page</u>
TERMS AND CONDITIONS OF THE BONDS	5
USE OF PROCEEDS	22
THE RUSSIAN FEDERATION.....	23
THE RUSSIAN ECONOMY	31
BALANCE OF PAYMENTS AND FOREIGN TRADE.....	44
PUBLIC FINANCE	53
MONETARY AND FINANCIAL SYSTEM	69
PUBLIC DEBT.....	78
TAXATION.....	89
FORM OF BONDS AND TRANSFER RESTRICTIONS RELATING TO U.S. SALES.....	95
SUBSCRIPTION AND SALE.....	100
GENERAL INFORMATION	102

NOTICE TO NEW HAMPSHIRE RESIDENTS

NEITHER THE FACT THAT A REGISTRATION STATEMENT OR AN APPLICATION FOR A LICENCE HAS BEEN FILED UNDER CHAPTER 421-B OF THE NEW HAMPSHIRE REVISED STATUTES WITH THE STATE OF NEW HAMPSHIRE NOR THE FACT THAT A SECURITY IS EFFECTIVELY REGISTERED OR A PERSON IS LICENSED IN THE STATE OF NEW HAMPSHIRE CONSTITUTES A FINDING BY THE SECRETARY OF STATE OF THE STATE OF NEW HAMPSHIRE THAT ANY DOCUMENT FILED UNDER RSA 421-B IS TRUE, COMPLETE AND NOT MISLEADING. NEITHER ANY SUCH FACT NOR THE FACT THAT AN EXEMPTION OR EXCEPTION IS AVAILABLE FOR A SECURITY OR A TRANSACTION MEANS THAT THE SECRETARY OF STATE HAS PASSED IN ANY WAY UPON THE MERITS OR QUALIFICATIONS OF, OR RECOMMENDED OR GIVEN APPROVAL TO, ANY PERSON, SECURITY OR TRANSACTION. IT IS UNLAWFUL TO MAKE, OR CAUSE TO BE MADE, TO ANY PROSPECTIVE PURCHASER, CUSTOMER OR CLIENT ANY REPRESENTATION INCONSISTENT WITH THE PROVISIONS OF THIS PARAGRAPH.

TERMS AND CONDITIONS OF THE BONDS

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

Terms and Conditions of Bonds Due 2005

The U.S.\$2,968,695,000 8.75% Bonds Due 2005 (the "Bonds," which expression includes any further Bonds issued pursuant to Condition 13 and forming a single series therewith) of the Ministry of Finance of the Russian Federation (the "Ministry of Finance") acting on behalf of the Russian Federation (the "Issuer" or the "Federation") were authorised pursuant to the provisions of Federal Law No. 76-FZ of 26th December 1994 and Government Resolution No. 302 of 14th March 1998. A fiscal agency agreement dated 24th July 1998 (the "Fiscal Agency Agreement") has been entered into in relation to the Bonds between the Issuer, Citibank, N.A. London as fiscal and principal paying agent (the "Fiscal Agent") and as registrar (the "Registrar"), the other paying agents named therein (together with the Fiscal Agent and the Registrar, the "Paying Agents") and the transfer agents named therein (the "Transfer Agents").

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

Copies of the Fiscal Agency Agreement are available for inspection during usual business hours at the principal office of the Fiscal Agent (currently at 5 Carmelite Street, London EC4Y 0PA) and at the specified offices of each of the other Agents. The Bondholders (as defined in Condition 1(b)) are bound by, and are deemed to have notice of, the provisions of the Fiscal Agency Agreement.

1. Form, Denomination and Title

(a) Form and Denomination

The Bonds are in definitive fully registered form, without interest coupons attached, in a minimum denomination of U.S.\$1,000 or any amount in excess thereof which is an integral multiple of U.S.\$1,000 (each, an "authorised denomination"). A certificate (each a "Bond Certificate") will be issued to each Bondholder in respect of its registered holding or holdings of Bonds. Each Bond Certificate will be numbered serially with an identifying number which will be recorded in the register (the "Register") which the Issuer shall procure to be kept by the Registrar.

(b) Title

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

2. Transfer of Bonds and Issue of Bonds

(a) Transfer

Subject to Condition 2(d), a Bond may be transferred in whole or in part in an authorised denomination upon the surrender of the Bond Certificate representing that Bond, together with the form of transfer (including any certification as to compliance with restrictions on transfer included in such form of transfer) endorsed thereon (the "Transfer Form") duly completed and executed, at the specified office of the Registrar or any Transfer Agent, together with such evidence as the Registrar or,

as the case may be, such Transfer Agent may reasonably require to prove the title of the transferor and the authority of the persons who have executed the Transfer Form. In the case of a transfer of part only of the Bonds represented by a Bond Certificate, neither the part transferred nor the balance not transferred may be less than the applicable authorised denomination and a new Bond Certificate in respect of the balance not so transferred will be issued to the transferor.

(b) Delivery

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

(c) No Charge

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

(d) Closed Periods

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

(e) Regulations Concerning Transfer and Registration

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

3. Status

The Bonds constitute direct, unconditional, unsecured (subject as provided in Condition 4) and unsubordinated obligations of the Issuer and the full faith and credit of the Federation is pledged for the due and punctual payment of principal of, and interest on, the Bonds and for the performance of all other obligations of the Issuer pursuant to the Bonds. The Bonds shall at all times rank *pari passu* without any preference among themselves and at least *pari passu* in all respects with all other present and future unsecured and unsubordinated obligations of the Issuer.

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

4. Negative Pledge and Covenant

(a) Negative Pledge

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

(b) Covenant

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

(c) Definitions

In these Conditions:

"Excluded Indebtedness" means any obligation of the Issuer, the Government of the Federation, the Ministry of Finance, Vnesheconombank or any other person that may arise from time to time representing restructured indebtedness originally incurred prior to 1st January 1992 by the government of the former Soviet Union or any of its legally authorised entities.

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

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

"IMF" means the International Monetary Fund.

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

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

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

"Public External Indebtedness" means External Indebtedness which (i) is in the form of, or represented by, bonds, notes or other securities or any guarantee thereof and (ii) is, or may be, quoted, listed or ordinarily purchased and sold on any stock exchange, automated trading system or over-the-counter or other securities market (including, without prejudice to the generality of the foregoing, the market for securities eligible for resale pursuant to Rule 144A under the United States Securities Act of 1933, as amended (the "Securities Act")).

5. Interest

Each Bond bears interest from 24th July 1998 at the rate of 8.75 per cent. per annum, payable semi-annually in arrear on 24th January and 24th July in each year until maturity (each an "Interest Payment Date"), commencing on 24th January 1999. Interest will be paid subject to and in accordance with the provisions of Condition 7.

Each Bond will cease to bear interest from the due date for redemption unless, after surrender of such Bond, payment of principal is improperly withheld or refused, in which case it will continue to bear interest at the rate specified above (after as well as before judgment) until whichever is the earlier of (a) the day on which all sums due in respect of such Bond up to that day are received by or on behalf of the relevant Bondholder and (b) the day which is seven days after notice has been given to the Bondholders that the Fiscal Agent has received all sums due in respect of the Bonds up to such seventh day (except, in the case of payment to the Fiscal Agent, to the extent that there is any subsequent default in payment in accordance with these Conditions).

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

6. Redemption, Purchase and Cancellation

(a) Final Redemption

Unless previously redeemed, or purchased and cancelled, the Bonds will be redeemed at their principal amount on 24th July 2005, subject as provided in Condition 7.

(b) Purchase and Cancellation

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

7. Payments

(a) Principal

Payment of principal and interest due other than on an Interest Payment Date will be made by transfer to the registered account of the Bondholder or if (i) it does not have a registered account or (ii) the principal amount of Bonds held by such person is less than U.S.\$250,000, by a U.S. dollar cheque drawn on a bank in New York City mailed to the registered address of the Bondholder by uninsured mail at the risk of the Bondholder. Such payment will only be made upon surrender of the relevant Bond Certificate at the specified office of any of the Paying Agents.

(b) Interest

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

Upon application by the holder of a Bond to the specified office of the Registrar not less than 15 days before the due date for the payment of any interest (other than interest due on redemption) in respect of such Bond, such payment will be made by transfer to a U.S. dollar account maintained by the payee with a bank in New York City. Any such application for transfer to a U.S. dollar account shall be deemed to relate to all future payments of interest (other than interest due on redemption) in respect of the Bonds which become payable to the Bondholder who has made the initial application until such time as the Registrar is notified in writing to the contrary by such Bondholder.

Payment of the interest due in respect of each Bond on redemption will be made in the same manner as payment of the principal amount of such Bond.

(c) Payments Subject to Fiscal Laws

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

Consistent with the terms of Regulations "On Taxation Matters in Connection with Bonds of External Bond Debt of the Russian Federation of 1998" No. 14n//AP-4-06/3n dated 17th March 1998 issued by the Ministry of Finance and the State Tax Service of the Russian Federation, Russian residents, other than physical persons, may not receive interest on the Bonds in any form.

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

(d) Commissions

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

(e) Payments on Business Days

Where payment is to be made by transfer to a registered account, payment instructions (for value the due date or, if that is not a business day, for value the first following day which is a business day) will be initiated (i) on the later of the business day on which the relevant Bond Certificate is surrendered at the specified office of any of the Paying Agents and the due date for payment (in the case of principal and interest due other than on an Interest Payment Date) and (ii) on the due date for payment (in the case of interest due on an Interest Payment Date).

Where payment is to be made by cheque, the cheque will be mailed (i) on the later of the business day on which the relevant Bond Certificate is surrendered at the specified office of any of the Paying Agents and the business day preceding the due date for payment (in the case of principal and interest due other than on an Interest Payment Date) and (ii) on the business day preceding the due date for payment (in the case of interest due on an Interest Payment Date).

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

(f) Delay in Payments

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

(g) Partial Payments

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

(h) Agents

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

8. Taxation

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

(a) to a holder, or to a third party on behalf of a holder, if such holder is liable to such Taxes in respect of such Bond by reason of having some connection with the Federation other than the mere holding of such Bond; or

(b) if the Bond Certificate representing such Bond is surrendered for payment more than 30 days after the Relevant Date, except to the extent that the holder would have been entitled to such additional amounts on surrender of such Bond Certificate for payment on the last day of such period of 30 days.

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

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

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

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

9. Events of Default

If any of the following occurs and is continuing (each an "Event of Default"):

(a) Non-payment

The Issuer fails to pay any amount of interest in respect of any of the Bonds when due and such failure continues for a period of 15 business days, provided, however, that it shall not constitute an Event of Default if interest is not paid to a Bondholder which is a Russian resident (other than a physical person) as contemplated in Condition 7(c); or

(b) Breach of other obligations or undertakings

The Issuer defaults in performance or observance of or compliance with any of its other obligations or undertakings in respect of the Bonds which default (if capable of remedy) is not remedied within 60 days after written notice of such default shall have been given to the Issuer by any Bondholder, it being understood that a default in respect of the undertaking set forth in Condition 4(a) shall be deemed capable of remedy for purposes hereof; or

(c) Cross-acceleration

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

(d) Moratorium

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

(e) Unlawfulness or Invalidity

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

(f) IMF

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

(g) Consents etc.

Any regulation, decree, consent, approval, licence or other authority necessary to enable the Issuer to enter into or perform its obligations under the Bonds or the Fiscal Agency Agreement or for the validity or enforceability thereof shall expire or be withheld, revoked or terminated or otherwise cease to remain in full force and effect or shall be modified in a manner which adversely affects any rights or claims of any of the Bondholders,

then holders of 25 per cent. or more in aggregate outstanding principal amount of the Bonds may declare the Bonds to be immediately due and payable whereupon the Bonds shall become immediately due and payable at their principal amount, together with accrued interest, without any further formality.

10. Prescription

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

11. Replacement of Bond Certificates

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

12. Meetings of Bondholders, Modification and Waiver

(a) Meetings of Bondholders

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

(b) Modification and waiver

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

13. Further Issues

The Issuer shall be at liberty from time to time, without the consent of the Bondholders, to create and issue (whether for cash, pursuant to an exchange for other obligations of the Issuer or other consideration) further Bonds, including in a related transaction or series of related transactions, ranking equally in all respects (or in all respects save for the date for and amount of the first payment of interest thereon) so that the same shall be consolidated and form a single series with the Bonds.

14. Notices

Notices to the Bondholders will be sent to them by first class mail (airmail if overseas) at their respective addresses on the Register, and will be deemed to have been given on the fourth day after the date of mailing. So long as the Bonds are listed on the Luxembourg Stock Exchange and the rules of the Luxembourg Stock Exchange so require, notices will also be published in a leading newspaper having general circulation in Luxembourg (which is expected to be the *Luxemburger Wort*) or, if such

publication is not practicable, in an English language newspaper having general circulation in Europe, and each such notice shall be deemed to have been given on the date of such publication, or if published more than once or on different dates, on the first date on which publication is made.

A copy of all notices provided pursuant to this Condition 14 shall also be given to Morgan Guaranty Trust Company of New York, Brussels office as operator of the Euroclear System, and Cedel Bank, société anonyme.

15. Currency Indemnity

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

16. Governing Law

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

Terms and Conditions of Bonds Due 2018

The U.S.\$3,466,398,000 11% Bonds Due 2018 (the "Bonds," which expression includes any further Bonds issued pursuant to Condition 13 and forming a single series therewith) of the Ministry of Finance of the Russian Federation (the "Ministry of Finance") acting on behalf of the Russian Federation (the "Issuer" or the "Federation") were authorised pursuant to the provisions of Federal Law No. 76-FZ of 26th December 1994 and Government Resolution No. 302 of 14th March 1998. A fiscal agency agreement dated 24th July 1998 (the "Fiscal Agency Agreement") has been entered into in relation to the Bonds between the Issuer, Citibank, N.A. London as fiscal and principal paying agent (the "Fiscal Agent") and as registrar (the "Registrar"), the other paying agents named therein (together with the Fiscal Agent and the Registrar, the "Paying Agents") and the transfer agents named therein (the "Transfer Agents").

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

Copies of the Fiscal Agency Agreement are available for inspection during usual business hours at the principal office of the Fiscal Agent (currently at 5 Carmelite Street, London EC4Y 0PA) and at the specified offices of each of the other Agents. The Bondholders (as defined in Condition 1(b)) are bound by, and are deemed to have notice of, the provisions of the Fiscal Agency Agreement.

1. Form, Denomination and Title

(a) Form and Denomination

The Bonds are in definitive fully registered form, without interest coupons attached, in a minimum denomination of U.S.\$1,000 or any amount in excess thereof which is an integral multiple of U.S.\$1,000 (each, an "authorised denomination"). A certificate (each a "Bond Certificate") will be issued to each Bondholder in respect of its registered holding or holdings of Bonds. Each Bond Certificate will be numbered serially with an identifying number which will be recorded in the register (the "Register") which the Issuer shall procure to be kept by the Registrar.

(b) Title

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

2. Transfer of Bonds and Issue of Bonds

(a) Transfer

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

(b) *Delivery*

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

(c) *No Charge*

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

(d) *Closed Periods*

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

(e) *Regulations Concerning Transfer and Registration*

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

3. Status

The Bonds constitute direct, unconditional, unsecured (subject as provided in Condition 4) and unsubordinated obligations of the Issuer and the full faith and credit of the Federation is pledged for the due and punctual payment of principal of, and interest on, the Bonds and for the performance of all other obligations of the Issuer pursuant to the Bonds. The Bonds shall at all times rank *pari passu* without any preference among themselves and at least *pari passu* in all respects with all other present and future unsecured and unsubordinated obligations of the Issuer.

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

4. Negative Pledge and Covenant

(a) *Negative Pledge*

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

(b) Covenant

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

(c) Definitions

In these Conditions:

“Excluded Indebtedness” means any obligation of the Issuer, the Government of the Federation, the Ministry of Finance, Vnesheconombank or any other person that may arise from time to time representing restructured indebtedness originally incurred prior to 1st January 1992 by the government of the former Soviet Union or any of its legally authorised entities.

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

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

“IMF” means the International Monetary Fund.

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

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

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

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

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

5. Interest

Each Bond bears interest from 24th July 1998 at the rate of 11 per cent. per annum, payable semi-annually in arrear on 24th January and 24th July in each year until maturity (each an "Interest Payment Date"), commencing on 24th January 1999. Interest will be paid subject to and in accordance with the provisions of Condition 7.

Each Bond will cease to bear interest from the due date for redemption unless, after surrender of such Bond, payment of principal is improperly withheld or refused, in which case it will continue to bear interest at the rate specified above (after as well as before judgment) until whichever is the earlier of (a) the day on which all sums due in respect of such Bond up to that day are received by or on behalf of the relevant Bondholder and (b) the day which is seven days after notice has been given to the Bondholders that the Fiscal Agent has received all sums due in respect of the Bonds up to such seventh day (except, in the case of payment to the Fiscal Agent, to the extent that there is any subsequent default in payment in accordance with these Conditions).

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

6. Redemption, Purchase and Cancellation

(a) Final Redemption

Unless previously redeemed, or purchased and cancelled, the Bonds will be redeemed at their principal amount on 24th July 2018, subject as provided in Condition 7.

(b) Purchase and Cancellation

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

7. Payments

(a) Principal

Payment of principal and interest due other than on an Interest Payment Date will be made by transfer to the registered account of the Bondholder or if (i) it does not have a registered account or (ii) the principal amount of Bonds held by such person is less than U.S.\$250,000, by a U.S. dollar cheque drawn on a bank in New York City mailed to the registered address of the Bondholder by uninsured mail at the risk of the Bondholder. Such payment will only be made upon surrender of the relevant Bond Certificate at the specified office of any of the Paying Agents.

(b) Interest

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

Upon application by the holder of a Bond to the specified office of the Registrar not less than 15 days before the due date for the payment of any interest (other than interest due on redemption) in

respect of such Bond, such payment will be made by transfer to a U.S. dollar account maintained by the payee with a bank in New York City. Any such application for transfer to a U.S. dollar account shall be deemed to relate to all future payments of interest (other than interest due on redemption) in respect of the Bonds which become payable to the Bondholder who has made the initial application until such time as the Registrar is notified in writing to the contrary by such Bondholder.

Payment of the interest due in respect of each Bond on redemption will be made in the same manner as payment of the principal amount of such Bond.

(c) Payments Subject to Fiscal Laws

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

Consistent with the terms of Regulations "On Taxation Matters in Connection with Bonds of External Bond Debt of the Russian Federation of 1998" No. 14n//AP-4-06/3n dated 17th March 1998 issued by the Ministry of Finance and the State Tax Service of the Russian Federation, Russian residents, other than physical persons, may not receive interest on the Bonds in any form.

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

(d) Commissions

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

(e) Payments on Business Days

Where payment is to be made by transfer to a registered account, payment instructions (for value the due date or, if that is not a business day, for value the first following day which is a business day) will be initiated (i) on the later of the business day on which the relevant Bond Certificate is surrendered at the specified office of any of the Paying Agents and the due date for payment (in the case of principal and interest due other than on an Interest Payment Date) and (ii) on the due date for payment (in the case of interest due on an Interest Payment Date).

Where payment is to be made by cheque, the cheque will be mailed (i) on the later of the business day on which the relevant Bond Certificate is surrendered at the specified office of any of the Paying Agents and the business day preceding the due date for payment (in the case of principal and interest due other than on an Interest Payment Date) and (ii) on the business day preceding the due date for payment (in the case of interest due on an Interest Payment Date).

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

(f) Delay in Payments

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

(g) Partial Payments

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

(h) Agents

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

8. Taxation

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

(a) to a holder, or to a third party on behalf of a holder, if such holder is liable to such Taxes in respect of such Bond by reason of having some connection with the Federation other than the mere holding of such Bond; or

(b) if the Bond Certificate representing such Bond is surrendered for payment more than 30 days after the Relevant Date, except to the extent that the holder would have been entitled to such additional amounts on surrender of such Bond Certificate for payment on the last day of such period of 30 days.

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

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

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

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

9. Events of Default

If any of the following occurs and is continuing (each an "Event of Default"):

(a) Non-payment

The Issuer fails to pay any amount of interest in respect of any of the Bonds when due and such failure continues for a period of 15 business days, provided, however, that it shall not constitute an Event of Default if interest is not paid to a Bondholder which is a Russian resident (other than a physical person) as contemplated in Condition 7(c); or

(b) Breach of other obligations or undertakings

The Issuer defaults in performance or observance of or compliance with any of its other obligations or undertakings in respect of the Bonds which default (if capable of remedy) is not remedied within 60 days after written notice of such default shall have been given to the Issuer by any Bondholder, it being understood that a default in respect of the undertaking set forth in Condition 4(a) shall be deemed capable of remedy for purposes hereof; or

(c) Cross-acceleration

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

(d) Moratorium

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

(e) Unlawfulness or Invalidity

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

(f) IMF

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

(g) Consents etc.

Any regulation, decree, consent, approval, licence or other authority necessary to enable the Issuer to enter into or perform its obligations under the Bonds or the Fiscal Agency Agreement or for the validity or enforceability thereof shall expire or be withheld, revoked or terminated or otherwise cease to remain in full force and effect or shall be modified in a manner which adversely affects any rights or claims of any of the Bondholders,

then holders of 25 per cent. or more in aggregate outstanding principal amount of the Bonds may declare the Bonds to be immediately due and payable whereupon the Bonds shall become immediately due and payable at their principal amount, together with accrued interest, without any further formality.

10. Prescription

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

11. Replacement of Bond Certificates

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

12. Meetings of Bondholders, Modification and Waiver

(a) Meetings of Bondholders

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

(b) Modification and waiver

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

13. Further Issues

The Issuer shall be at liberty from time to time, without the consent of the Bondholders, to create and issue (whether for cash, pursuant to an exchange for other obligations of the Issuer or other consideration) further Bonds, including in a related transaction or series of related transactions, ranking equally in all respects (or in all respects save for the date for and amount of the first payment of interest thereon) so that the same shall be consolidated and form a single series with the Bonds.

14. Notices

Notices to the Bondholders will be sent to them by first class mail (airmail if overseas) at their respective addresses on the Register, and will be deemed to have been given on the fourth day after the date of mailing. So long as the Bonds are listed on the Luxembourg Stock Exchange and the rules of the Luxembourg Stock Exchange so require, notices will also be published in a leading newspaper having general circulation in Luxembourg (which is expected to be the *Luxemburger Wort*) or, if such

publication is not practicable, in an English language newspaper having general circulation in Europe, and each such notice shall be deemed to have been given on the date of such publication, or if published more than once or on different dates, on the first date on which publication is made.

A copy of all notices provided pursuant to this Condition 14 shall also be given to Morgan Guaranty Trust Company of New York, Brussels office as operator of the Euroclear System, and Cedel Bank, société anonyme.

15. Currency Indemnity

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

16. Governing Law

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

USE OF PROCEEDS

The proceeds of the issue of the Bonds in the New Cash Offering (net of commissions but before deduction of expenses) are expected to amount to approximately U.S.\$364,915,000 and will be used for general governmental purposes, including the retirement of short-term debt.

THE RUSSIAN FEDERATION

Territory, Population and Natural Resources

The Russian Federation, or Russia (*Rossiya*), is a sovereign and democratic federal republic, consisting of 89 sub-federal political units, the "Federation subjects." It is the largest country in the world, covering 17.1 million square kilometres, more than one-tenth of the earth's land area. Russia borders 14 countries and spans 12 time zones, extending some 9,000 kilometres from the Baltic Sea in the west to the Pacific Ocean in the east, and some 4,000 kilometres from its southern border on the Black and Caspian Seas to its northern limits on the Arctic Ocean. The European part of the country consists of a large plain west of the Ural Mountains, while the Asian portion is divided into Siberia, occupying the vast central region of the country, and the Russian Far East, which borders on the Pacific. The tallest mountain in Europe (Elbrus, in the Caucasus at 5,642 metres), the largest lake in Europe (Ladoga, near St. Petersburg) and the deepest lake in the world (Baikal, near Irkutsk) are all found in Russia.

Russia is home to approximately 147 million inhabitants (2.7 per cent. of the world's population) and ranks sixth in the world by population size. Overall population density is approximately 8.6 persons per square kilometre, although most of the population (78 per cent.) lives in European Russia. About 73 per cent. of Russia's people live in cities. Russia's capital and largest city is Moscow (8.5 million inhabitants), and other major cities include St. Petersburg, Nizhny Novgorod, Kazan, Samara, Volgograd and Ekaterinburg. In all, 13 Russian cities have a population of more than one million, including four in the Urals and two in Siberia.

The most recent general census in 1989 found that ethnic Russians accounted for more than 80 per cent. of the population. There are more than 100 other ethnic groups in Russia, the largest being Tatars (approximately 3.8 per cent. of the total population), Ukrainians (3.0 per cent.), and Chuvashes (1.2 per cent.). No other ethnic group accounts for more than 1 per cent. of Russia's total population.

Russia has a well developed system of education, and the literacy rate exceeds 99 per cent. Education is compulsory for those between the ages 7 and 15. The country has approximately 800 institutions of higher education with over 3 million students, including 74 universities attended by more than 500,000 students. Russia's labour force numbered approximately 71.4 million at the end of 1997, of which over 98 per cent. had at least eight years of schooling, 86 per cent. had at least 10 years, 18 per cent. had received higher education and 33 per cent. had received professional training.

Russia is rich in natural resources. It has large energy reserves, and is the world's leading producer of gas, the third largest producer of oil, and a significant producer of coal, electricity and uranium. Russia is a leading producer of nickel (21 per cent. of world output in 1996), palladium (67 per cent. of world output) and platinum (25 per cent. of world output). The country also has significant deposits of zinc, lead, tin, silver, rare metals and precious and semiprecious stones. Russia has substantial gold deposits (mainly located in Eastern Siberia and the Russian Far East) and accounts for approximately 6 per cent. of world gold production. Forests cover over 40 per cent. of Russia's total land area, and Russia's timber reserves are estimated at 80.2 billion cubic metres, more than any other country's.

Russia and the Dissolution of the Soviet Union

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

The aim of General Secretary Gorbachev's political reform policy was to make Soviet social and political life more democratic, open, and decentralised. As a result of this policy, the Soviet Union

greatly improved its relations with the West, effectively ending the Cold War, the Soviet press gained greater independence, and public discussion became increasingly open and informed. At the same time, the leading role of the Communist Party was abolished.

General Secretary Gorbachev's economic reform policy was mostly unsuccessful, however. The aim of *perestroika* was to revive economic growth by the introduction of market incentives within the framework of a planned economy. Despite a number of initiatives, the economy continued to decline. Economic conditions deteriorated significantly in 1990 and 1991. The main reasons were large increases in social expenditures enacted by the Supreme Soviet, the Soviet Union's legislative body, and a jurisdictional dispute between Soviet and Russian authorities over the collection of taxes, which caused central government revenues to fall. The budget deficit widened appreciably, reaching approximately 20 per cent. of GDP in 1991. To cover this deficit, the Soviet Union resorted to short-term and uncoordinated foreign borrowing, the sale of virtually all its gold and foreign exchange reserves, and the printing of large amounts of roubles. The resulting increase in the money supply, in combination with price controls on most products, led to excess money holdings ("monetary overhang"), acute shortages of consumer goods, and significant inflation: prices rose by 160 per cent. in 1991. Over the same period, output contracted and the Soviet Union fell into recession.

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

On 24th October 1991, President Yeltsin delivered a speech in which he outlined a comprehensive economic reform programme. He then appointed a team of economists to design and implement policies that would liberalise prices and foreign trade, privatise a large portion of the assets of the state, and achieve financial stabilisation. See "The Russian Economy."

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

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

Political System

Constitution

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

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

In general, the Constitution may be amended through passage of a special Federal constitutional law which is then ratified by the legislatures of not less than two-thirds of the Federation subjects. Passage of such a special law requires the vote of a two-thirds majority of the Duma, a three-fourths majority of the Federation Council (the upper house of Russia's parliament) and signature by the President. Those provisions of the Constitution that govern the nature of the constitutional system, individual rights and the amendment process itself, however, can only be changed by convening a Constitutional Assembly. A proposed new constitution may be adopted either by the vote of a two-thirds majority of the Constitutional Assembly or by a simple majority in a national referendum in which more than half the eligible voters participate.

Executive Branch

The executive branch consists of the President and the Government.

The President of Russia (the "President") has broad powers. The President is Head of State and Supreme Commander of the Armed Forces, with authority to declare states of military emergency and other states of emergency, subject to approval by the Federation Council, the upper chamber of the Federal Assembly. He also carries responsibility for foreign policy and national defence. The President has the power to issue decrees and orders that are mandatory for execution on the territory of Russia (although these may not contradict the Constitution or Federal legislation), to suspend acts of sub-federal and local executive authorities, and to call a national referendum on matters of special importance. The President also has the power to veto bills passed by the Federal Assembly and, under certain circumstances, to dissolve the Duma, the lower chamber of the Federal Assembly. In addition, the President is empowered to arbitrate disputes between the Federal authorities and the Federation subjects.

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

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

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

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

On 23rd March 1998, President Yeltsin dismissed all of the then-current members of the Government, including the Prime Minister. The Prime Minister, one of the First Deputy Prime Ministers and the Minister of the Interior were dismissed with immediate effect and the rest of the ministers were requested to remain in their positions pending their replacement. Under Russian law, any replacement Prime Minister generally must be confirmed by the Duma before taking office, and the other members of the Government must be nominated by the Prime Minister prior to their appointment by the President. On 25th April 1998, the Duma confirmed Sergei Kiriyenko as the new Prime Minister.

Legislative Branch

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

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

The Federation Council represents Russia's 89 Federation subjects. See "Federal Structure and Regional Issues." Each Federation subject has two representatives on the Federation Council, one being the head of its legislative or other representative body, and the other being the head of its executive branch. The Federation Council's membership changes as these officials change.

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

The President may dissolve the Duma if (i) the Duma fails to accept the President's proposed candidate for Prime Minister in three successive votes, (ii) the Duma twice passes a motion of no confidence in the Government within three months or (iii) the Prime Minister puts before the Duma a confidence motion which the Government loses. Notwithstanding the above, the Duma may not be dissolved at any time during the last six months of a presidential term, during the period between passage by the Duma of an accusation initiating impeachment proceedings against the President and action by the Federation Council on such accusation or while a state of emergency is in effect covering the territory of the entire Federation, or, in the case of (ii) or (iii) above, within the first year after Duma elections. In the event the Duma is dissolved, elections must be scheduled by the President, and a newly elected Duma must be convened, within four months.

Judicial Branch

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

Judges on the Constitutional Court, Supreme Court, and Supreme Arbitration Court are nominated by the President and appointed by the Federation Council. Judges on lower Federal courts are appointed by the President according to procedures established by Federal legislation.

Political Parties, Recent Elections and Political Developments

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

The Constitution contains a number of provisions designed to encourage the development of a stable party system. First, candidates must collect a number of signatures to qualify for elections. In particular, a candidate must collect at least one million signatures in order to be placed on the presidential ballot, and a party must collect at least 200,000 signatures (meeting certain requirements as to regional distribution) in order to contend for the "party list" seats in the Duma. Second, the allocation of half the Duma seats only among parties receiving 5 per cent. or more of the "party list" votes cast tends to discourage parties that cannot command significant electoral support. Third, the structure of presidential elections, whereby if no candidate wins a majority in an initial round of voting a run-off election is held between the two top finishers, discourages fragmentation of the vote.

Only four parties received 5 per cent. or more of the "party list" votes in the most recent parliamentary elections held in December 1995. The Communist Party is currently the largest in membership and had the greatest success in the election, with its "party list" securing 22.3 per cent. of the vote. Communist Party deputies currently occupy nearly one-third of all Duma seats (31.0 per cent.). "Our Home is Russia," the pro-Government political movement headed by former Prime Minister Chernomyrdin, received 14.6 per cent. of the "party list" votes cast in the Duma elections, and its deputies currently occupy 14.9 per cent. of all Duma seats. The two other parties that qualified for "party list" seats in the December 1995 elections are Yabloko, a reform party headed by Grigori Yavlinsky which is critical of the current Government (which received 6.9 per cent. of the "party list" votes and whose deputies currently occupy 10.0 per cent. of all Duma seats), and the Liberal-Democratic Party of Russia, headed by Vladimir Zhirinovskiy (which received 11.2 per cent. of "party list" votes and whose deputies currently occupy 11.3 per cent. of all Duma seats). Other parties with significant representation in the current Duma include the "Russian Regions" party, with 9.5 per cent. of all Duma seats. *Narodovlastie* ("Power to People"), with 9.5 per cent. of all seats, and the Agrarian Party, with 7.9 per cent. of all seats.

Presidential elections were held in 1996. At an early stage, Gennadi Zyuganov, leader of the Communist Party, emerged as the strongest challenger to President Boris Yeltsin, sparking significant uncertainty about the future direction of economic policy. In a run-off election in July, Mr. Yeltsin was re-elected President by a margin of 54 per cent. to 40 per cent.. As a result of President Yeltsin's successful campaign for re-election, the Russian Federation has yet to experience a presidential succession, and if a new administration assumes power following any presidential elections required to be held under the Constitution, the reform policies followed since the establishment of the Russian Federation could possibly be subject to reconsideration.

President Yeltsin underwent heart surgery on 5th November 1996. During the surgery and the immediate post-operative period, Victor Chernomyrdin, the then-serving Prime Minister, served as acting President, in accordance with the Constitution. See "– Political System – Executive Branch." President Yeltsin reassumed his Presidential duties on 6th November 1996.

Federal Structure and Regional Issues

Russia consists of 89 Federation subjects, among which are 21 republics, 10 autonomous regions, six *krais*, 49 *oblasts*, one autonomous oblast and two cities of federal importance (Moscow and St. Petersburg). Each of the republics and autonomous regions contains a substantial group of ethnic non-Russians and is typically named after this group, although in most ethnic Russians constitute the majority. The Federation subjects form the intermediate level of government. Lower-level governments at the county (*raion*), city, and village levels are subordinate to their respective Federation subjects.

Throughout its history, Russia has generally been a unitary state with centralised governance. The last six years, however, have witnessed significant changes, with Federation subjects receiving greater decision-making authority and financial autonomy.

The Federation Treaty of 31st March 1992, signed by 88 Federation subjects (all but the Chechen Republic), initially secured to each a measure of control over budgetary and external policy as well as over the natural resources of their territories. The Constitution subsequently confirmed and refined the terms of the division of authority between Russia and its subjects, expressly incorporating the provisions of the Federation Treaty to the extent that they were not inconsistent with other provisions of the Constitution. Certain areas of governance are reserved by the Constitution exclusively to the Federal authorities, including management of Federal state property, the issue of currency, foreign relations, military defence, and the nation's continental shelves. Joint federal-regional management is prescribed in a number of other areas, including tax administration, ownership and use of land and natural resources, and the selection of certain court and law enforcement officials. Responsibility for all matters not reserved to the Federal authorities or to joint federal-regional competence is assigned to the Federation subjects. The Constitution also provides for the free movement of goods, capital, and labour throughout Russia, and explicitly prohibits any sub-federal barriers to such movement.

Within this Constitutional framework, bilateral agreements have been concluded between the Federal authorities and a majority of the sub-federal authorities, allocating powers as between the two. A number of these agreements provide for an even greater degree of regional autonomy.

In general, disputes between the Federal authorities and Federation subjects have been resolved peacefully through a political process. The military confrontation with separatists in the Chechen Republic, which began in December 1994, was the exception. Before the intervention of Russian forces in Chechnya and the declaration of a state of emergency, the authorities in the Chechen Republic had openly defied the legal authority of the Government. In August 1996, the Government signed an agreement on the cessation of the military confrontation and withdrew its troops from Chechnya, and in May 1997, the Government and the Chechen Republic signed a peace treaty; in addition, one-year agreements were concluded between the Government, the Central Bank of the Russian Federation (the "Central Bank") and the Chechen Republic stipulating basic principles of economic and financial cooperation. On 27th January 1997, presidential elections were held in the Chechen Republic, and the future status of the Chechen Republic will be decided in negotiations between Russia and the Chechen Republic after 2000.

International Relations

Russia's Position in the International Community

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

Russia regularly participates in political discussions during meetings of the heads of state and governments, as well as in discussions of finance ministers and central bank governors, of the "G-7" group of industrial nations. Since 1992, Russia has been a member of the International Monetary Fund (the "IMF") and the International Bank for Reconstruction and Development (the "World Bank"). See "Public Debt – Relations with International Financial Institutions." Russia received IMF credits annually until March 1996, when the IMF granted Russia a three-year Extended Fund Facility ("EFF") of approximately U.S.\$10 billion. Russia is currently seeking from the IMF another facility for stabilisation purposes. At the end of March 1998, the World Bank's Russian loan portfolio included 39 approved loans, representing commitments of approximately U.S.\$9.4 billion. Russia is a member of the International Finance Corporation (the "IFC") and participates as a donor in the International Development Association. In December 1996, the Central Bank became a member of the Bank for International Settlements.

In September 1997, Russia became a member of the Paris Club of creditor nations.

Russia applied for membership in the World Trade Organisation (the "WTO") in December 1994. The Government has placed a high priority on joining the WTO, in part because entry into the WTO would allow Russia to use the organisation's procedures to combat discrimination against Russian producers and exporters, which the Government believes continues to have a negative effect on Russian exports. A Government commission has been established to ensure that Russia's trade policy is in line with WTO rules, and discussions on Russia's accession to WTO membership are proceeding. The Government currently expects that Russia will become a WTO member during 1998.

Since 1993, Russia has had working contacts with the Organisation for Economic Cooperation and Development (the "OECD"). In 1994, a Declaration on Cooperation was signed with the OECD, on the basis of which an annual programme of cooperation now exists. Russia has been granted observer status with the 24 working bodies of the OECD, and formally applied for membership in May 1996.

On 27th May 1997, President Yeltsin and the leaders of 16 NATO nations signed the "Founding Act on Mutual Cooperation" establishing new principles to govern the relationship, and providing for consultation, between Russia and NATO.

Russia and Regional Cooperation

Russia has wide-ranging contacts with the European Union (the "EU"), its most significant trading partner. An interim customs, trade, and standardisation agreement is now in force, pending ratification by EU member states of the full Agreement on Partnership and Cooperation, which was signed by President Yeltsin and the heads of state and governments of the EU countries in 1994.

Russia is a member of the European Bank for Reconstruction and Development (the "EBRD"), the Soviet Union having been one of its founders. The EBRD has provided funding for more than 106 projects in Russia in the aggregate amount of more than ECU 3.7 billion.

Russia participates in a number of regional cooperation forums: the Council of Barents/Euroarctic Regions, the Council of Baltic Sea States, and the Black Sea Economic Cooperation (the "BSEC"). Together with other member countries of the BSEC, Russia has signed and ratified a treaty on the creation of the Black Sea Bank of Trade and Development. Russia is also significantly involved in the creation of the Middle East and North Africa Development Bank.

Russia participates in working meetings of the Association of South-East Asian Nations and became a member of the Council on Pacific Economic Cooperation in 1992, and of the Pacific Economic Council in 1994. Russia has applied for full membership in the Asian Pacific Economic Cooperation Forum, and intends to apply for membership in the Asian Development Bank.

Russia, the Former Soviet Union, and the CIS

After the dissolution of the Soviet Union, Russia concluded agreements ("zero-option agreements") with 11 of the 14 other republics of the former Soviet Union, although two of these agreements, with Ukraine and Georgia, have not yet been ratified. These agreements provided, as between the Government and the relevant republic, for the Government's acceptance of responsibility for virtually all external debt liabilities contracted on behalf of the authorities of the former Soviet Union, in return for all claims on former Soviet Union assets located outside the territory of the relevant republic. The Government has since worked with the external creditors of the former Soviet Union to regularise relations as rapidly as possible, and to establish a profile for the repayment of former Soviet Union debt that is consistent with its capacity to service that debt. In December 1997, Russia completed a comprehensive restructuring of the Soviet Union's debt to the London Club of financial creditors. A similarly comprehensive restructuring agreement has been reached with the Paris Club of official creditors and is currently being implemented. In contrast to the former Soviet Union debt, all payments in respect of new debt incurred by the Government since 1st January 1992, have been made in full. Moreover, all debt service obligations on eurobonds issued by VEB prior to 1st January 1992, have also been honoured in full. See "Public Debt – External Debt."

Twelve of the former Soviet Union republics – all but the Baltic republics – comprise the Commonwealth of Independent States (the “CIS”), which promotes mutual cooperation between its members. In September 1993, an Agreement on the Establishment of an Economic Union was signed by all CIS countries. In addition, Russia and certain other CIS countries have concluded agreements on the creation of a free trade zone and payments union.

In 1995, an agreement on the creation of a customs union was concluded between Russia, Belarus and Kazakhstan; Kyrgyzstan joined this customs union in 1996. In March 1996, Russia and Belarus signed an agreement calling for the mutual convertibility of their currencies and the stabilisation of exchange rates. In April 1997, President Yeltsin and President Lukashenko of Belarus signed a treaty calling for a union of Russia and Belarus and declaring the countries’ intent to strengthen political, economic and military cooperation. On 23rd May 1997, the two Presidents signed the union’s charter, which declares the equality and sovereignty of its members, calls for the coordination of policies in the political, economic and military spheres, creates supranational authorities to be staffed by the representatives of the legislative and executive bodies of the member states and introduces the concept of union citizenship in addition to national citizenship. The union is open for other countries to join. In June 1997, Russia and Ukraine entered into agreements which, among other things, resolved questions relating to the division of the Black Sea fleet and the status of the city of Sevastopol on the Crimean peninsula.

THE RUSSIAN ECONOMY

Economic Reforms

Russia's economic reform programme, first outlined by President Yeltsin in October 1991, set out to achieve three principal goals: liberalisation, privatisation, and financial stabilisation. Significant progress has been made in each of these areas.

Liberalisation of the Russian economy required a fundamental redefinition of the role of the state, which had previously regulated virtually all economic and financial activities. Price liberalisation has permitted market forces to determine prices to a significant extent, and to play an increased role in the allocation of resources and output. See "Price Liberalisation." Liberalisation of Russia's trade regime has helped redirect trade flows away from historically important former socialist markets towards OECD countries and developing nations, and has contributed to an overall rise in exports. See "Balance of Payments and Foreign Trade – Foreign Trade."

Ownership structures have been altered through a mass privatisation programme, supported by the legal recognition of private property and the creation of an economic and legal environment conducive to the development of private economic activity. The process of establishing competitive markets, linked to the privatisation process, has been begun through new legislative and regulatory initiatives. See "– Private Sector Development."

Financial stabilisation, essential as a foundation for sustainable economic growth, has been pursued through a commitment to fiscal restraint, the development of non-inflationary means of deficit financing, in particular the state treasury bill ("GKO/OFZ") market, and management of exchange rate fluctuations. See "Public Finance – Deficit Financing" and "Monetary and Financial System – Monetary Policy." As part of its programme of financial stabilisation, Russia has reduced its Federal budget deficit from 44.6 per cent. of GDP in 1992 to 6.7 per cent. of GDP in 1997. See "Public Finance – Overview."

Price Liberalisation

In January 1992, prices for approximately 90 per cent. of wholesale goods and services (apart from prices in the energy and transportation sector), along with prices for about 80 per cent. of retail goods and services, were freed from state control. At the same time, control over the pricing of most social services passed from central to regional or municipal authorities. In the years that followed, the scope of regulated prices was further reduced. At present, only certain public services and legislatively defined "natural monopolies" (for example, pipeline transport of oil and gas, electricity transmission and supply, railway transport, terminal, port and airport services, and postal services) are subject to price regulation. Prices for certain basic foodstuffs, though unregulated, are subsidised by some local authorities.

Private Sector Development

Russia's privatisation process can be divided into two basic stages. During the first stage, between 1992 and 1994, the main objective was to boost private ownership as quickly as practicable with the broad participation of the population. The second stage, dating from the second half of 1994, has sought to reduce the remaining majority stakes of the state, but has shifted its focus to privatising individual enterprises, increasing privatisation proceeds, finding long-term investors, and enhancing the governance and management of enterprises. The Ministry of State Property is the successor to the State Committee for the Management of State Property (the "GKI") which was originally formed in 1991, with the responsibility for drafting, coordinating, and supervising the privatisation programme and associated legislation, and later awarded the status of a Federal ministry.

Mass Privatisation

The Government's mass privatisation programme received legislative approval in June 1992. Privatisation was mandated at the local, regional and Federal levels. Local authorities were responsible for the privatisation of small-scale enterprises, and regional authorities for most medium-sized enterprises. The GKI was responsible for the privatisation of large-scale enterprises and those in

strategic sectors, as well as for managing all Government stakes in privatised enterprises. Under the privatisation programme, certain specific enterprises and assets, such as public utilities and strategic enterprises involved in the defence industry and in the development of natural and mineral resources, were designated as not subject to privatisation, while privatisation of others, mainly large enterprises in the telecommunications and energy sectors, required a special GKI order and retention by the state of a 51 per cent. voting stake in the enterprise for three years.

A central feature of mass privatisation was the distribution of privatisation vouchers. Each Russian citizen was given the right to collect one voucher between October 1992 and February 1993 for a nominal fee. Some 147 million Russian citizens received vouchers, which were traded in an active secondary market over the course of the mass privatisation programme.

Large and medium-sized enterprises initially scheduled for privatisation were first reorganised as joint stock companies ("corporatised") pursuant to a June 1992 Presidential decree. These enterprises were obliged to set up a board, which then had to choose one of three possible methods of privatisation. Although these options differed significantly in many respects, under each of them workers and managers obtained a majority or substantial minority of the new joint stock company's share capital, in order to give them a stake in its future development. Each option also required that 29 per cent. of the company's shares be sold in voucher auctions. The remaining shares were to be placed in an open commercial competition or investment tender, or sold in a cash auction. As at the end of 1997, 54.3 per cent. of former state enterprises (about 129,500 companies) had completed this process.

As a result of Russia's mass privatisation programme, a significant proportion of the economic assets of the state had been transferred out of government hands. In 1997, state enterprises (wholly owned by Federal or other governmental authorities) accounted for 24 per cent. of GDP.

Other Privatisation Initiatives

Since the end of mass privatisation, the Government has employed a number of approaches to privatising Federal assets including the "loans-for-shares" programme (under which loans were extended to the Government through an auction process in return for collateral consisting of state-owned shares of 15 companies with most of the pledged shares subsequently being sold in accordance with the terms of the programme in order to repay the loans), investment tenders (which generally require bidders to commit to make investments over a specified period in the enterprises being privatised) and cash auctions. Current law authorises various methods of privatising state enterprises, including cash auctions, commercial tenders, employee share purchases, purchases of leased state property, contributions of state-owned shares to the charter capital of business entities and issuance of state debt securities convertible into state-owned equity of open joint-stock companies.

In 1997, the Federal budget received 18,078 billion roubles from privatisation revenues. The Government has announced its intention to sell further stakes in enterprises in six major oil companies (Rosneft, Eastern Oil Company, Tyumen Oil Company, Slavneft, Norsioil and Lukoil), the petrochemical enterprise Sibur, the telecommunications enterprise Svyazinvest, the Moscow region's communications company Electrosvyaz and the Novosibirsk Electrode Plant. See "– Principal Sectors of the Economy – Energy" and "– Transport and Communications." The Government's policy is to seek to maximise proceeds from any such sales taking into account the interests of the enterprises to be privatised. The 1998 budget law envisages privatisation revenues of 8.1 billion redenominated roubles.

Land and Real Property Privatisation

Since 1992, a number of Federal legislative measures and decrees have addressed the privatisation of land. To date, however, efforts to enact a comprehensive Land Code have been unsuccessful, largely because of issues relating to ownership of agricultural land. Federal law in this area accordingly remains incomplete and there are many local rules and standards which limit the purchase and ownership of land. The uncertainties thus created have meant that private ownership of land is not widespread in Russia, and an active land market has not yet developed.

Under current law, the land on which an enterprise is situated is effectively leased from the state until it is purchased by the enterprise. Rules governing the process by which privatised enterprises may apply to purchase the land they occupy have developed slowly and, as a result, purchases of land pursuant to such rules have been very limited in practice.

Special rules govern rights in agricultural land. In 1991, agricultural land and other property was transferred to workers and pensioners in the form of shares, which could be sold or "rented" to other shareholders. The state now owns less than 5 per cent. of agricultural land, and agricultural landowners and the holders of agricultural land shares have the right to sell, rent, pledge, and bequeath their property. The collective nature of most agricultural land ownership, however, makes such rights difficult to exercise effectively in practice. In addition, significant legal restrictions remain on property rights in agricultural land, including limitations on the use of such land for nonagricultural purposes and on foreign ownership. Many citizens also own small land plots for recreation and gardening.

Privatisation of Housing

In the Soviet Union, 75 per cent. of urban residential housing belonged to the state, a figure that reached almost 90 per cent. in larger cities. Other dwelling units were owned by housing cooperatives, organised by residents. Some individual houses were owned by their occupiers.

Although legislation permitting the privatisation of residences was in place as early as June 1991, only after January 1992, when residences in Moscow began to be privatised free of charge, did the level of private ownership of housing become significant. Since December 1992, privatisation of residences has proceeded free of charge throughout Russia, although the speed of privatisation has varied somewhat from place to place. By 31st December 1997, some 44.8 per cent. of all state-owned apartments had been privatised in Moscow, as compared to 41.5 per cent. in the whole of Russia.

Competition

Before 1991, the State encouraged specialisation and the minimisation of "unnecessary duplication" of production. Russia's economic reform programme has sought to foster the development of competitive markets. Russia has a competition and anti-monopoly law under which enterprises with a market share exceeding 35 per cent. can be, and enterprises with a share exceeding 65 per cent. are, entered in a register of monopolistic enterprises maintained by the State Committee for Antimonopoly Policy (the "GKAP"). The GKAP is authorised to employ a variety of means to restrain the anti-competitive behaviour of these enterprises, and can in extreme cases compel their break-up. GKAP consent is required for any acquisition of 20 per cent. or more of the voting stock of any commercial entity with a size above a certain threshold and for any merger or acquisition that would lead to the creation of a monopoly enterprise.

Civil and Commercial Law

Since 1992, Russia has begun to establish a legal framework to govern economic relations between independent legal persons and entities, including a new civil code, a joint-stock company law and a bankruptcy law. Such enactments have not, however, eliminated legal uncertainty in these areas, and further legislation, decrees, and regulations clarifying existing law are anticipated.

The Constitution protects the right of Russian citizens to hold private property. Property rights and basic rules for commercial relations are elaborated in Russia's new Civil Code. Part I of the Civil Code, passed in 1994, establishes the principles of contract and property law. It also specifies the forms that private enterprises may take, including corporations, partnerships and limited liability companies. Part II of the Civil Code, passed in 1996, regulates particular types of contractual relationships, such as sales contracts, leases, credit agreements, and insurance policies. The third and final part of the Civil Code is intended to cover, among other matters, laws on trademarks and copyrights and is under consideration by the Duma.

The law on joint-stock companies came into effect on 1st January 1996, replacing old regulations adopted in 1990. The law sets forth the basic framework for corporate organisation and corporate governance, covering the formation of companies, shareholder rights, and liabilities, the role of directors, interested party transactions, mergers and acquisitions, and share capital and dividends.

A new bankruptcy law came into effect on 1st March 1998, replacing the original law adopted in 1993. The new bankruptcy law provides basic rules for declaring an enterprise bankrupt, for managing and liquidating an enterprise after it has been declared bankrupt, for satisfying creditors' claims, and for the bankruptcy process generally. The bankruptcy law permits an enterprise to be declared bankrupt if it is unable to effect payments due to its creditors (including tax authorities) within three months of the time when such payments are due. It is expected that the new law will provide a more effective insolvency regime than its predecessor, in particular because the standard of insolvency on which the law is based is straightforward and far simpler to apply than the old standard.

Russia also has a Foreign Investment Law and a Law on the Securities Market. The purpose of the Foreign Investment Law is to ensure foreign investors equal treatment with domestic investors (with some exceptions in the area of land ownership and leasing, access to natural resources, and participation in privatisation). The law provides a guarantee against nationalisation or expropriation without compensation, ensures the free transfer of investment proceeds in foreign currency and reinvestments of profits in local currency, and provides recourse to Russian courts. The Law on the Securities Market, adopted in April 1996, regulates the issue and circulation of securities. Pursuant to the law, companies that issue securities must, with limited exceptions, register the issuance by filing a prospectus and must publicly report information on a quarterly basis. The law also regulates the activities of professional securities market participants and aims to strengthen the protection of investors by imposing rules on market professionals. Certain regulations implementing the law have been adopted, and others are currently being developed.

Gross Domestic Product

The following table sets forth certain information regarding Russia's GDP for the years 1993 to 1997:

	Gross Domestic Product ⁽¹⁾				
	1993	1994	1995	1996	1997
Nominal GDP (trillions of roubles).....	172	611	1,585	2,200	2,602
At official exchange rate (U.S.\$ billion).....	173	279	348	429	450
Real GDP as compared to 1993 (per cent.).....	100.0	87.3	83.7	80.8	81.4
Nominal GDP per capita (thousands of roubles).....	1,156	4,117	10,709	14,915	17,689 ⁽²⁾
At official exchange rate (rouble/U.S.\$).....	1,165	1,879	2,349	2,910	3,057 ⁽³⁾
Real GDP per capita as compared to 1993 (per cent.) ...	100.0	87.4	83.9	81.3	82.2
GDP deflator (per cent.).....	888.4	307.6	170.2	43.8	17.3
<i>Memo:</i>					
Official exchange rate (rouble/U.S.\$).....	992	2,191	4,559	5,125 ⁽³⁾	5,787 ⁽³⁾
Total population, million (end of period).....	148.4	148.3	148.0	147.5	147.1

Notes:

⁽¹⁾ Certain data presented in this table for 1995, 1996 and 1997 differ from previously published data due to regular revisions by Goskomstat.

⁽²⁾ As estimated by the Ministry of Finance.

⁽³⁾ Simple average.

Source: Goskomstat, Ministry of Finance.

In 1997, Russia's gross domestic product increased by 0.8 per cent. in real terms as compared with 1996, the first year in which real GDP growth has been achieved since the initiation of reforms. By contrast, real GDP is estimated to have declined by approximately 19 per cent. overall between 1993 and 1997, reflecting the prolonged economic downturn associated with the collapse of Russia's established trade relationships, massive reductions in its public expenditure and the sharp contraction of certain of its industrial sectors in the face of competition from foreign imports, all of which followed in the wake of the dissolution of the Soviet Union. The modest real GDP growth in 1997 was primarily attributable to rising consumer demand fuelled by increased household incomes, aided by a smaller decline in fixed investment than in prior years. Nominal GDP in U.S. dollar terms increased significantly in the years from 1993 to 1997; however, this is wholly attributable to the substantial real appreciation of the rouble over the period. See "Monetary and Financial System – Monetary Policy – Exchange Rates."

Further economic growth was impeded in 1998 by diminishing investment demand resulting from the high interest rates, sharp reduction of Government non-interest expenditure and shrinking export demand for commodities. As a result, during the first five months of 1998, real GDP has declined by 0.2 per cent., as compared to the same period of last year.

GDP by Source

The following table illustrates Russia's GDP by source for the years 1993 to 1997:

Gross Domestic Product by Source⁽¹⁾

	1993		1994		1995		1996		1997	
	% ⁽²⁾	% ⁽²⁾	% ⁽²⁾	% ⁽²⁾	% ⁽²⁾	% ⁽²⁾	% ⁽²⁾	% ⁽²⁾	% ⁽²⁾	% ⁽²⁾
GDP	100.0	100.0	(12.7)	100.0	(4.1)	100.0	(3.5)	100.0	0.8	0.8
Industry	32.4	31.5	(20.1)	28.7	(3.3)	27.5	(4.0)	26.1	2.0	2.0
Agriculture and forestry	7.5	6.0	(11.9)	7.2	(7.9)	6.9	(2.9)	6.6	1.9	1.9
Construction	7.5	8.7	(19.0)	8.2	(7.0)	7.6	(13.7)	7.8	(5.7)	(5.7)
Production of other goods	0.6	0.5	(10.0)	0.7	(5.0)	0.8	(4.1)	0.8	(1.3)	(1.3)
Services	46.4	49.3	(5.2)	48.6	(2.9)	49.7	1.5	50.2	1.1	1.1
Market services.....	34.7	36.2	(4.1)	37.0	(3.0)	37.3	(2.0)	37.6	1.5	1.5
Transportation and communications.....	7.8	9.2	(16.1)	10.4	(2.6)	12.3	(4.4)	11.4	(2.2)	(2.2)
Trade, distribution, and catering.....	17.6	17.4	0.1	17.2	(4.1)	14.5	0.0	14.4	4.5	4.5
Financial sector.....	4.9	4.2	2.0	1.4	(0.1)	0.6	(5.0)	0.9	8.2	8.2
Other.....	4.4	5.4	(5.6)	7.9	(2.5)	9.8	(2.6)	10.9	1.3	1.3
Public service	11.6	13.1	(8.3)	11.6	(2.6)	12.4	0.0	12.6	0.1	0.1
Health care.....	2.2	2.7	0.0	2.1	0.5	2.2	0.5	2.3	(0.1)	(0.1)
Education and culture.....	3.4	3	(2.3)	3.2	1.5	3.4	0.7	3.4	(0.1)	(0.1)
Fundamental sciences.....	0.7	0.6	(18.0)	0.6	(10.4)	0.6	(8.4)	0.5	(7.9)	(7.9)
Defence	1.5	2.7	0.0	1.7	(5.0)	1.9	0.0	1.7	(1.2)	(1.2)
Public administration.....	1.0	1.4	6.1	2.6	4.0	2.9	3.0	3.1	2.9	2.9
Other.....	2.9	2.0	(28.5)	1.5	(12.8)	1.5	(4.1)	1.5	0.0	0.0

Notes:

(1) Certain data presented in this table for 1995 and 1996 differ from previously published data due to regular revisions by Goskomstat.

(2) Contribution to GDP of indirect taxes, subsidies and financial intermediary services has been excluded; accordingly, sectoral contributions to GDP do not total 100 per cent.

(3) In prices of the previous year.

Source: Goskomstat.

From 1993 to 1997 the contribution of the service sector to GDP has increased, amounting to 50.2 per cent. in 1997, while that of the non-service sector declined steadily to 41.3 per cent. in 1997. Within the service sector, there were significant increases in transportation and communications (from 7.8 per cent. of total GDP in 1993 to 11.4 per cent. in 1997) and other market services such as housing and communal services (from 4.4 per cent. to 10.9 per cent.) offset by decreases in trade, distribution and catering (from 17.6 per cent. to 14.4 per cent.) and the financial sector (from 4.9 per cent. to 0.9 per cent.). Within the non-service sector, the largest decrease was in industry (from 32.4 per cent. of total

GDP in 1993 to 26.1 per cent. in 1997), while the share attributable to construction rose slightly (from 7.5 per cent. to 7.8 per cent.).

These shifts reflect different real performances. While material (non-service) output fell by 26.5 per cent. in real terms between 1993 and 1997, output of services declined by only 8.3 per cent. The real decline over the period from 1993 to 1997 was largest in construction (31.1 per cent. decrease), industry (24.3 per cent. decrease) and transportation and communication (23.6 per cent. decrease).

GDP by Use

The following table illustrates Russia's GDP by use for the years 1993 to 1997:

	1993		1994		1995		1996		1997	
	%	%	%	% change ⁽²⁾	%	% change ⁽²⁾	%	% change ⁽²⁾	%	% change
GDP used ⁽³⁾	100.0	100.0	100.0	(11.7)	100.0	(4.5)	100.0	(5.0)	100.0	0.9
Domestic demand.....	92.0	95.4	96.6	(11.6)	96.6	(4.9)	96.0	(5.9)	97.3	1.5
Consumption.....	64.2	69.7	72.8	(3.1)	72.8	(2.7)	73.0	(2.1)	74.7	1.8
Public.....	23.3	25.6	22.3	(10.5)	22.3	(2.5)	22.9	0.2	23.8	0.4
Private.....	40.9	44.1	50.5	1.2	50.5	(2.8)	50.1	(3.1)	50.9	2.4
Investment.....	27.9	25.7	23.8	(31.2)	23.8	(10.8)	23.0	(17.7)	22.6	0.6
Fixed assets.....	21.0	22.0	21.4	(26.0)	21.4	(7.5)	20.8	(19.0)	20.0	(2.2)
Inventory accumulation.....	6.8	3.8	2.3	(47.1)	2.3	(30.4)	2.2	(5.2)	2.6	27.6
Net foreign balance.....	8.0	4.6	3.4	(13.0)	3.4	3.2	4.0	21.5	2.7	(12.5)
Exports of goods and services.....	39.4	28.0	28.3	4.9	28.3	9.5	24.6	0.6	23.5	0.4
Imports of goods and services.....	31.4	23.4	24.8	9.4	24.8	9.2	20.6	(2.3)	20.8	3.0

Notes:

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

⁽²⁾ At prices of the previous year.

⁽³⁾ Because of a statistical bias, GDP used may differ from GDP produced by up to 3 per cent. in compliance with international practice.

Source: Goskomstat.

Between 1993 and 1997, real consumption dropped by less than real GDP, increasing the share of consumption in nominal GDP from 64.2 per cent. in 1993 to 74.7 per cent. in 1997. Consumption nonetheless dropped by 6.0 per cent. in real terms over the period reflecting a real decline in private consumption of 2.4 per cent. and a larger real decline in public consumption of 12.3 per cent. primarily due to reductions in defence and research spending.

The contribution of investment to nominal GDP fell from 27.9 per cent. to 22.6 per cent. between 1993 and 1997, reflecting the overall decline in investment over the period (49.2 per cent. in real terms). This decline in fixed investment itself reflects the general economic downturn brought about by the dissolution of the Soviet Union, as the destruction of links with traditional trading partners occasioned a fall in domestic demand which reduced incentives for capacity expansion, and public spending was drastically curtailed. In addition, the availability of unusually high rates of return through investment in the GKO/OFZ market has from time to time absorbed resources that might otherwise have been available for fixed investment. Total investment increased in 1997 (by 0.6 per cent.), the first such increase this decade. Although fixed investment decreased again in 1997, the fall of 2.2 per cent. as compared with 1996 was the smallest decline posted in any year since the initiation of reforms.

The share of net exports in nominal GDP, which rose sharply with the institution of trade liberalisation measures to 14.5 per cent. in 1992, then declined to 8.0 per cent. in 1993 and stood at 2.7 per cent. in 1997.

Principal Sectors of the Economy

Industry

Russia is highly industrialised, with a large share of industrial activity in heavy industry and chemicals. Russia leads world output in gas extraction, is third in oil extraction and production of wood products, and holds an important place in the production of electricity, iron, steel, cement, mineral fertilisers and coal. Manufacturing activities are heavily concentrated in the defence industry, which produces both for military use (arms, anti-aircraft missiles, fighters, submarines) and for civilian use (power equipment, space technology, aeroplanes).

The following table illustrates the structure of industrial output and period-on-period changes in real industrial output by sector for the years 1993 to 1997:

Industrial Output by Sector⁽¹⁾

	1993		1994		1995		1996		1997 ⁽²⁾	
	% ⁽³⁾	% ⁽³⁾	% ⁽³⁾	% change ⁽⁴⁾	% ⁽³⁾	% change ⁽⁴⁾	% ⁽³⁾	% change ⁽⁴⁾	% ⁽³⁾	% change ⁽⁴⁾
Total	100.0	100.0	100.0	(20.9)	100.0	(3.3)	100.0	(4.0)	100.0	1.9
Electricity	9.1	13.4	12.5	(8.8)	12.5	(3.2)	14.0	(1.6)	16.3	(2.1)
Fuel	16.3	15.0	16.5	(10.2)	16.5	(0.8)	16.0	(2.7)	18.1	0.3
Ferrous metallurgy.....	8.3	8.3	9.3	(17.3)	9.3	9.6	7.0	(4.5)	8.4	1.2
Non-ferrous metallurgy.....	7.6	6.6	6.4	(8.9)	6.4	2.8	5.0	5.4	5.8	5.0
Chemicals and petrochemicals	7.2	7.4	8.1	(24.5)	8.1	7.6	5.0	(11.0)	6.9	2.0
Machine building.....	20.5	19.6	18.2	(30.8)	18.2	(9.1)	17.0	(11.1)	18.7	3.5
Wood processing	4.3	4.6	5.2	(30.5)	5.2	(0.7)	4.0	(22.3)	3.7	1.2
Construction materials.....	4.2	4.8	4.9	(27.3)	4.9	(8.0)	4.0	(25.3)	4.1	(4.0)
Textiles.....	5.1	3.2	2.5	(46.0)	2.5	(30.2)	2.0	(27.6)	1.9	(2.4)
Food processing	13.0	12.5	12.1	(17.5)	12.1	(8.2)	13.0	(10.0)	11.8	(0.8)
Other	4.2	4.5	4.4	—	4.4	—	13.0	—	4.3	—

Notes:

- (1) Certain data presented in this table for 1995 and 1996 differ from previously published data due to regular revisions by Goskomstat.
(2) Preliminary.
(3) At current prices.
(4) At prices of the previous year.

Source: Goskomstat.

In 1997, Russia's total industrial output increased by 1.9 per cent. in real terms as compared with 1996, the first such annual increase since the initiation of reforms. The overall rise in output reflected real growth in output in ferrous and non-ferrous metallurgy, chemicals and petrochemicals and, also for the first time since the initiation of reforms, machine building (which embraces the defence industry). In prior years, however, output fell sharply, primarily due to the steep decline in domestic demand and the rapid increase in domestic energy prices towards world market levels following the dissolution of the Soviet Union. Overall, total industrial output declined by 25.2 per cent. in real terms in the period from 1993 to 1997. The extent of the drop in output over this period varied greatly by sector. The smallest real declines were recorded in electricity (15 per cent. decrease), fuel (12 per cent. decrease) and ferrous metallurgy (12 per cent. decrease), which benefited from strong external demand, while larger reductions were recorded in textiles (73 per cent. decrease), machine building (42 per cent. decrease) and chemicals and petrochemicals (26 per cent. decrease).

Energy

In 1997, energy accounted for about 34 per cent. of Russia's industrial output, and 46 per cent. of exports. About 30 per cent. of Russia's energy output is exported, with natural gas accounting for 42 per cent., oil and petroleum products 55 per cent., coal 2 per cent., and electricity 1 per cent. of total energy exports in 1997.

Domestic energy prices were heavily subsidised in the Soviet Union, and stood at just 10 per cent. to 20 per cent. of world market levels in 1992. The continued availability of cheap domestic energy

after the initiation of reforms gave rise to significant distortions within the Russian economy. By 1996, however, domestic gas prices in the enterprise sector had risen roughly to the level of central European market prices, while domestic oil prices were close to world market levels, in each case net of transport costs. This increase in energy prices was achieved through export liberalisation in 1995 and as a result of the real appreciation of the rouble against foreign currencies.

World market prices for sources of energy have fluctuated widely, and, since the beginning of 1997, world market prices for most of these commodities have fallen significantly, in particular in the fourth quarter of 1997. Federal budget revenues in 1998 have been and are likely to continue to be somewhat adversely affected by lower energy prices through a reduction in profits tax payable by energy sector companies (but not through a reduction of the other taxes they pay). Profits tax paid by oil companies was approximately 4 per cent. of total Federal budget revenue in 1997, and profits tax paid by RAO Gazprom (see below) was also significant. In addition, if energy prices remain at low levels for an extended period of time, tax arrears of energy sector companies may also increase. The Government's new Fiscal Programme (see "Public Finance – Revised Fiscal Programme for 1998") reflects the anticipated impact on Government revenues of the low prices for energy and other commodities. The decline in energy prices has also affected Russia's balance of payments in 1998. See "Balance of Payments and Foreign Trade – Balance of Payments – Current Account".

Russian methodologies for calculating oil and gas reserves and Russian reserves classifications differ from standard international methodologies and classifications, in particular with respect to the manner in which and the extent to which commercial factors regarding exploitation and production are taken into account. Accordingly, the oil and gas reserves information contained herein is not comparable, and cannot be made comparable to oil and gas reserves information provided on the basis of standard international methodologies and classifications. The oil and gas reserves information contained herein represents total "explored" reserves, consisting of oil and gas reserves in categories A, B and C1, of the Russian classification system.

Oil

Russia has A, B, and C1 oil reserves of approximately 6.6 billion tonnes. Oil output has declined significantly since the initiation of reforms. Output in 1997 was 297 million tonnes (9.5 per cent. of world output), only 52 per cent. off the peak of 570 million tonnes in 1988 although some 1.3 per cent. above output in 1996. Oil exports to non-CIS countries were 110 million tonnes in 1997, while exports to the CIS were just 17 million tonnes.

Starting in 1993, the state oil industry was split up into various holding companies and operating subsidiaries. This resulted in the creation of a number of sizeable vertically integrated oil groups, with each holding company managing and controlling a stake in as many as 50 subsidiaries. Only one of these, Rosneft, currently remains wholly state-owned. The first privatisation auction of Rosneft, in May 1998, was unsuccessful, and the Government currently intends to sell 75 per cent. of the charter capital plus one share of Rosneft in October 1998. The major oil pipelines and other transportation infrastructure are managed by the state-owned monopolies, Transneft and Transnefteproduct.

Natural Gas

Russia's A, B, and C1 natural gas reserves are estimated at 48.0 trillion cubic metres. Natural gas output has declined in every year but one since the initiation of reforms, falling by 5.5 per cent. in 1997 as compared with 1996 and by 7.5 per cent. overall in the period from 1993 to 1997. Total natural gas output in 1997 was 544 billion cubic metres. Of this amount, approximately 185 billion cubic metres was exported, with around two-thirds of such exports going to non-CIS countries and the remainder to the CIS.

Russia's natural gas industry is dominated by RAO Gazprom ("Gazprom"), a 41 per cent. state-owned company with an effective monopoly on gas production, transmission, storage, and export. Gazprom owns and operates the Unified Gas Supply System, which includes approximately 145,000 kilometres of high pressure pipelines, holds production licences with respect to over two-thirds of

Russia's natural gas reserves, and accounts for 93 per cent. of gas production. Gazprom has announced plans to corporatise its gas-related enterprises and to dispose of its non-core operations. The former national gas distribution company, Rosgazifikatsiya, was split into a number of independent gas distribution companies in December 1993.

Coal

Russia has reserves of approximately 202 billion tonnes of coal. Some 244 million tonnes of coal was produced in Russia in 1997, only 80 per cent. of the amount produced in 1993 and 4.8 per cent. less than in 1996. Since the initiation of reforms, coal production has been negatively affected by both the decrease in overall demand and cash shortages associated with non-payment by energy users. Such non-payment has caused interruptions of coal deliveries to customers, and cash shortfalls have been reflected in the non-payment of wages, which has led to strikes by miners. The decline in production also reflects underinvestment in the industry over an extended period, and as a result, many mines are currently uneconomic. Russia has adopted a four stage rationalisation plan for the restructuring of the coal industry and the gradual closure of inefficient and subsidised mines. The plan is currently being implemented with the help of a World Bank loan in the amount of U.S.\$ 500 million. Coal exports, over half of which go to Japan, Turkey and Ukraine, amounted to some 22.6 million tonnes in 1997.

Electricity

Russia's electricity output was 834 billion kWh in 1997, representing a drop of 13 per cent. compared with 1993 and a 1.7 per cent. decrease compared with 1996. This drop in output in 1997 was largely attributable to electricity producers having been granted permission early in the year to discontinue deliveries of electricity to non-paying customers not engaged in industrial production. Total Russian generating capacity is about 210,000 MW; approximately 10 per cent. of this amount is attributable to nuclear power plants. Electricity is exported to, among others, CIS countries (Georgia and Kazakhstan), Finland, Bulgaria, China, Mongolia and Norway.

The Russian electricity industry was restructured in 1992 and split into RAO Unified Energy Systems ("UES"), 73 energoes (regional energy companies), and a separate nuclear power industry which is run by the Ministry of Atomic Energy. UES is the largest single producer of electricity in Russia, owning more than half of the country's generating capacity, and is the monopoly high voltage distributor and wholesale purchaser/seller of electricity. It also owns an equity stake of 49 per cent. or more in 68 of the 73 energoes. UES is currently 53 per cent. state-owned.

Agriculture

Russia's agricultural sector has faced significant challenges in recent years, as major structural changes have been implemented under difficult conditions and agricultural prices have fallen steeply. Agricultural output had declined by 23 per cent. between 1993 and 1997. In 1997, however, overall agricultural output was essentially unchanged from its level in 1996, reflecting a 28 per cent. increase in grain production as production of meat and milk fell by 10 per cent. and 5 per cent., respectively. Russia imports substantial amounts of food and agricultural products. See "Balance of Payments and Foreign Trade – Foreign Trade – Composition of Trade."

The agricultural sector consists primarily of large collective farms (which by preliminary estimates account for 90.5 per cent. of land under cultivation and 52 per cent. of agricultural output) and of private plots, both urban and rural, worked by people who are not full-time farmers (which by preliminary estimates account for 2.9 per cent. of land under cultivation and 46 per cent. of agricultural output). Family farms account for the remainder of agricultural production. Less than 5 per cent. of Russia's agricultural land is state owned. See " – Privatisation – Land and Real Property Privatisation."

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

Construction

The construction sector is among the largest in the Russian economy, accounting for 8.3 per cent. of GDP in 1996. Output in the construction industry has declined significantly since the initiation of reforms, by 44.6 per cent. between 1993 and 1997, in line with the fall in investment generally and large reductions in state funding, which private and commercial sources have only gradually begun to replace. New housing construction amounted to 32.6 million square metres in 1997, approximately 5 per cent. less than in 1996.

Transport and Communications

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

Railways

There are 150,000 kilometres of railways in Russia, of which 58 per cent. are engaged in general passenger and freight transportation and the remainder service particular agencies. Railways accounted for 78 per cent. of all freight transport in tonne-kilometres (excluding pipeline transport) and 41 per cent. of all passenger journeys in passenger-kilometres in 1997, making it the country's most important form of transport.

Tariffs for passenger transport are currently kept at relatively low levels and are insufficient to cover economic costs. Such costs are subsidised from revenues of railways for freight. These subsidies are gradually being eliminated. The railways will in future require a significant increase in investment to maintain track and replace rolling stock.

Roads

There are 945,000 kilometres of roads in Russia, 80 per cent. with a hard surface. Some 53 per cent. of roads are in public use, 5 per cent. being under Federal and 48 per cent. being under regional supervision. Federal roads are financed by the Federal Road Fund, which is funded by a tax on petrol. Regional roads are financed by various taxes which accrue to the budgets of the Federation subjects. The rest of Russia's roads are supervised by particular agencies, and in general serve as links between enterprises and the public road network.

Ports and Shipping

Russia has 43 commercial seaports and 289 freight complexes with a total capacity of 158 million tonnes per year. In 1997, 208 billion tonne-kilometres of freight was transported by sea from Russian ports (15 per cent. of Russia's total freight transport, excluding pipeline transport), of which over 90 per cent. was carried by Russian ships in foreign navigation. In addition, Russia has some 2,400 river ports, providing access to Russia's 84,000 kilometres of navigable rivers. Domestic water transport (via rivers, canals, lakes and combined river and sea navigation) accounted for 75 billion tonne-kilometres (5.3 per cent. of all freight, excluding pipeline transport). Rivers play a particularly important role in North and in Eastern Siberia, where in some areas they are the only means of freight transport.

Prior to 1991, each of Russia's commercial seaports was run by a particular shipping line, while control over ports was centralised. The ports and shipping lines were organisationally separated in 1991, later to be corporatised and privatised. By the end of 1995 the state had disposed of a controlling block of shares in the majority of ports and shipping companies.

Air Transport

Russia has 845 airports, 52 of which are international. The largest international airports are located in Moscow and St. Petersburg. Air transport in 1997 accounted for 15 per cent. of total intercity domestic passenger traffic in passenger-kilometres.

The national airline, Aeroflot, which was the monopoly carrier until 1991, was split up into over 140 regional airlines, which were privatised, and an international carrier, Aeroflot International Airlines, which remained state-owned. In 1995, Aeroflot International Airlines was partially privatised, although 51 per cent. of the shares continue to be owned by the state. A number of other Russian carriers have commenced domestic and international operations since 1991.

Pipelines

Russia has 210,000 km of main pipelines, consisting of 148,000 km of gas pipelines (70 per cent. of the total), 47,000 km of oil pipelines, and 15,000 km of oil product pipelines. In 1997, a total of 1,844 billion tonne-kilometres of commodities were transported by pipeline, a decline of 3.6 per cent. compared with the previous year. The export capacity of Russia's pipelines is approximately 124 million tonnes per year. Pipeline exports of hydrocarbons contribute about 40 per cent. of total exports.

Pipelines from major oil and gas producing areas in Russia are usually connected to pipelines in the CIS and former Socialist countries. A number of significant new pipeline projects are planned or under construction. Gazprom is currently building new trunk pipelines (the "Yamal-Europe project") that will extend nearly 6,000 kilometres from the northern part of the Tyumen region of Russia through Belarus and Poland to Germany. New pipeline-related projects to increase the export capacity of the oil industry include a programme to improve the Druzhba oil pipeline through Eastern Europe, involving the construction of by-passes and extensions, and a major new harbour at St. Petersburg, where inadequate facilities for tankers have resulted in reduced pipeline through-put.

Over 50 per cent. of Russia's existing pipeline network has been in operation for at least 20 years, over 20 per cent. for more than 33 years, and requirements with respect to repairs and maintenance are accordingly high.

Telecommunications

In 1997, there were 29.9 million telephone lines in Russia. It is estimated that the capacity of long distance (intercity) telephone lines was increased by 10 per cent., from 455,400 to 506,000, as a result of the new Moscow-Khabarovsk radio relaying line installed in 1996. During 1997, additional 1.26 million domestic lines were installed in Russia. There are separate telecommunications systems for the Government, the law enforcement agencies, the military, the railways and the energy sector. In 1997, there were 440,000 mobile telephone registrations in Russia, an increase of 97.3 per cent. compared to 1996. These registrations exist in 73 regions of Russia, although Moscow and St. Petersburg account for 59 per cent. of the total number.

Russia's telecommunications industry has been restructured through the creation of Rostelekom and Svyazinvest. Rostelekom was founded in 1992 through the merger of 20 independent enterprises, and is the monopoly provider of long distance (intercity) telecommunications in Russia, providing international services as well. The company was privatised in 1993, with 38 per cent. of its shares (representing the majority of the voting stock) subsequently being transferred to Svyazinvest. Svyazinvest was established in 1994 as the holding company for majority voting interests in all of Russia's 85 regional telecommunications companies, and provides local telephone services. In August 1997, a group of Russian and international investors acquired a block of shares of Svyazinvest representing 25 per cent. of its charter capital plus one vote through a cash auction. Further privatisation of the company is currently being pursued.

In 1996, 22 per cent. of all communications services were provided by public sector entities and 78 per cent. by private operators. There are currently more than 100 domestic operators and several international operators active in Russia.

Environment

Environmental protection in Russia is primarily the responsibility of the State Committee on Environmental Protection. Environmental regulations require enterprises to pay fees for emissions or discharges of most pollutants; such fees may then be used to fund investment to improve

environmental performance. Russia's environmental protection programme has focused on replanting woods, constructing spent gas treatment plants, installing recycling water supply systems and constructing sewage purification plants. Total public and private sector investment in environmental protection in Russia during 1996 amounted to 0.4 per cent. of GDP for the year. Federal expenditure to address the effects of environmental catastrophes and natural disasters in 1997 amounted to approximately 1.63 per cent. of total expenditure for the year, in line with the amount provided for this purpose in the 1998 budget law.

Employment

Overall employment has declined in Russia since reforms were initiated, though by far less than GDP. The sharpest reductions in employment have occurred in science, construction, and industry; employment in agriculture, trade, domestic services, the financial sector, and the main public services (health care, education) has risen. Of the total number of employees in the first nine months of 1997, 44 per cent. worked in the state sector, 31 per cent. in the private sector, and 24 per cent. in enterprises with a mixed form of ownership. Over 400,000 new jobs were created in large and middle-sized enterprises in 1997, 24 per cent. more than in 1996.

The following table sets forth quarterly information regarding unemployment in Russia for the period from 1994 through 1997 and the first quarter of 1998:

	Unemployment as per the end of the period ⁽¹⁾					
	Official (ILO) definition unemployed ⁽²⁾		Registered unemployed ⁽³⁾		Registered jobseekers ⁽⁴⁾	
	million	%	million	%	million	%
1994						
First Quarter.....	4.9	6.6	1.1	1.3	1.4	1.9
Second Quarter.....	5.2	7.0	1.3	1.7	1.5	2.0
Third Quarter.....	5.4	7.4	1.4	1.9	1.7	2.3
Fourth Quarter.....	5.5	7.5	1.6	2.2	1.9	2.6
1995						
First Quarter.....	5.6	7.8	1.9	2.6	2.2	3.1
Second Quarter.....	5.9	8.1	2.0	2.7	2.2	3.0
Third Quarter.....	6.3	8.6	2.1	2.9	2.3	3.2
Fourth Quarter.....	6.4	8.8	2.3	3.0	2.5	3.5
1996						
First Quarter.....	6.5	8.9	2.7	3.7	3.0	4.1
Second Quarter.....	6.7	9.2	2.6	3.6	2.9	4.0
Third Quarter.....	6.8	9.4	2.5	3.4	2.7	3.7
Fourth Quarter.....	7.2	9.9	2.5	3.4	2.8	3.8
1997						
First Quarter.....	7.6	10.5	2.6	3.6	2.8	3.9
Second Quarter.....	7.9	10.9	2.3	3.3	2.5	3.4
Third Quarter.....	8.0	11.0	2.1	2.9	2.3	3.2
Fourth Quarter.....	8.2	11.3	2.0	2.8	2.2	3.1
1998						
First Quarter.....	8.3	11.4	2.0	2.7	2.2	3.1

Notes:

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

⁽²⁾ Based on survey data. Persons not working, looking for a job and ready to start work are counted as unemployed.

⁽³⁾ Based on number of individuals who choose to register as unemployed with the Federal Employment Agency; registration is required as a condition of receiving unemployment benefits.

⁽⁴⁾ Based on number of individuals who choose to register as seeking employment with the Federal Employment Agency.

Source: Goskomstat.

On the basis of International Labour Organisation ("ILO") definitions, there were 8.3 million unemployed in Russia at the end of March 1998 (11.4 per cent. of the labour force), up from 8.2 million (11.3 per cent. of the labour force) at the end of 1997. The number of officially registered unemployed increased in 1996 but returned to 1995 levels in 1997. These figures do not take account of certain "hidden unemployment." For example, at the end of 1997, 3.6 per cent. of the Russian labour force was on shortened workdays and 2.1 per cent. had been temporarily laid off. In 1997, the total number of lay-off days for these two categories represented additional unemployment of 1.3 million people (1.8 per cent. of the labour force). The number of registered unemployed increased by 14 per cent. in 1996 and decreased by 20 per cent. in 1997.

Wages and Income

In real terms, average wages fell sharply after price liberalisation in January 1992. An excess wage tax served to discourage high wages for some time thereafter, but was abolished at the start of 1996. In 1997, average real wages were 3.7 per cent. higher than 1996. The minimum wage has also declined in real terms since 1992. Established by the Duma, the minimum wage not only sets the floor for wages but also serves as a benchmark in setting the level of Federal benefits, thereby playing a role in determining the level of Federal expenditures. In 1997, 21 per cent. of the population had incomes below the official subsistence level, a substantial improvement from 1992, when 34 per cent. had incomes below that level.

In recent years, a significant portion of wages have not been paid when due as a result of the generally difficult economic conditions in Russia. Wage arrears have given rise to sporadic strikes and protests, and assumed importance as a political issue during the 1996 presidential campaign. At the start of 1998, the total stock of wage arrears in the Russian economy amounted to 49.1 trillion roubles, up from 47.2 trillion roubles at the beginning of 1997. Federal budget wage arrears are monitored by the Government on a weekly basis. Such arrears stood at 6.0 trillion roubles at the beginning of 1997, but were fully paid as of 1st January 1998.

Organised labour has played a relatively minor role in setting wages. The percentage of organised workers in the national economy, close to 100 per cent. in the Soviet Union, fell by approximately 40 per cent. by 1997. Traditional trade unions founded during the Soviet era have functioned essentially as welfare organisations which provide social services, while new trade unions have yet to build up significant membership.

Social Security System

Social security reforms were introduced in Russia beginning in 1991. New institutions were founded to deliver social benefits, such as unemployment insurance or benefits for the very poor, which did not exist in the Soviet system. In 1992, social benefits declined substantially in real terms, reflecting the impact of inflation. Social benefits amounted to 6.6 per cent. of GDP in 1996 and 8.6 per cent. of GDP in 1997.

Most social expenditure (51 per cent. in 1996) is provided through extrabudgetary funds (see "Public Finance – Extrabudgetary Funds"), or by sub-federal authorities (40 per cent. in 1997). Direct payments from the Federal budget accounted for only 9 per cent. of social expenditure in 1996. The extrabudgetary funds finance pensions, unemployment benefits, some other social benefits and some health expenditure. Sub-federal budgets finance subsidies on housing and transportation, most education and health expenditure, and some social benefits. The Federal budget is responsible for some expenditure on education, health, culture, and other social benefits.

BALANCE OF PAYMENTS AND FOREIGN TRADE

Russia inherited a dual trade regime from the Soviet Union, in which trading arrangements with the other CIS countries differed from those with the Rest of the World ("ROW"). In particular, whereas Russia's ROW trade has been conducted for the most part on a hard-currency basis since the initiation of reforms, trade with Russia's CIS trading partners was, during 1992 and 1993, conducted partially in roubles or through barter, often at subsidised prices. As a result, complete accounts consolidating Russia's CIS and ROW trade are available only for 1994 and thereafter.

Balance of Payments

The following table sets forth Russia's consolidated balance of payments for the years 1994 to 1997:

	Consolidated Balance of Payments ⁽¹⁾			
	1994	1995	1996	1997
	<i>(U.S.\$ million, including unregistered trade adjustments)</i>			
Current account.....	9,284	7,938	12,096	3,342
Goods and non-factor services (nfs).....	11,177	11,268	17,361	12,127
Export of goods & nfs.....	76,219	93,185	103,456	102,195
Import of goods & nfs.....	(65,042)	(81,917)	(86,096)	(90,068)
Trade balance.....	17,838	20,807	23,076	17,325
Exports of goods (fob).....	67,826	82,663	90,512	88,676
Imports of goods (fob).....	(49,989)	(61,856)	(67,436)	(71,351)
Non-factor services.....	(6,661)	(9,539)	(5,715)	(5,198)
Exports of services.....	8,392	10,522	12,945	13,519
Imports of services.....	(15,053)	(20,061)	(18,660)	(18,717)
Income.....	(1,782)	(3,368)	(5,289)	(8,424)
Compensation of employees.....	(114)	(303)	(406)	(342)
Investment income.....	(1,668)	(3,065)	(4,883)	(8,082)
Received.....	3,392	4,112	4,232	4,059
Paid.....	(5,060)	(7,177)	(9,115)	(12,140)
Current transfers.....	(111)	38	24	(362)
Capital and financial account.....	(8,880)	(23)	(3,962)	4,854
Capital account.....	2,051	(347)	(463)	(797)
Capital transfers credit.....	5,523	3,122	3,066	2,137
Capital transfers debit.....	(3,472)	(3,469)	(3,529)	(2,934)
Financial account.....	(10,931)	324	(3,499)	5,651
Direct investment.....	538	1,710	1,708	4,675
Abroad.....	(101)	(306)	(771)	(2,489)
In Russia.....	640	2,016	2,479	7,164
Portfolio investments, net.....	81	(1,623)	9,743	46,212
Other investments.....	(11,602)	9,547	(16,307)	(43,402)
Assets.....	(17,683)	4,947	(29,305)	(26,102)
Cash foreign currency.....	(5,740)	39	(8,906)	(13,481)
Demand and time deposits.....	162	4,327	(1,000)	1,496
Trade credits and advances.....	(3,698)	8,043	(9,501)	(6,791)
Loans extended, net.....	9,536	8,641	9,499	7,001
Arrears.....	(12,771)	(10,553)	(9,475)	(3,048)
Non-repatriation of export proceeds and import advances not repayed in time.....	(3,860)	(4,928)	(9,773)	(11,460)
Other assets, net.....	(1,312)	(622)	(149)	181
Liabilities.....	6,081	4,600	12,996	(17,300)
Cash national currency.....	(325)	391	(230)	(20)
Demand and time deposits.....	1,686	2,464	1,547	(5,881)
Trade credits and advances.....	(978)	(8,050)	(799)	(64)
Loans received, net.....	2,197	7,723	8,888	12,703
Arrears.....	3,162	1,131	2,692	(24,549)
Other liabilities, net.....	339	941	899	510
Reserve assets ⁽²⁾	1,896	(10,386)	2,841	(1,815)
Adjustment of reserve assets ⁽³⁾	(1,844)	1,076	(1,484)	(19)
Errors and omissions, net.....	(404)	(7,915)	(8,134)	(8,196)

Notes:

⁽¹⁾ Certain data presented in this table for 1994, 1995 and 1996 differ from previously published data due to regular revisions by the Central Bank. In addition, significant revisions were made as a result of the reclassification of a portion of loans as trade credits.

⁽²⁾ Changes in reserve assets which arise as a result of transactions with reserve assets, i.e., excluding monetarisation of gold and valuation changes. This definition differs from that employed in the calculation of official international reserves. See "Official International Reserves".

⁽³⁾ To avoid double counting of official reserves deposited in resident banks.

Source: Central Bank.

Precise information on the volume of Russia's foreign trade with neighbouring CIS countries is difficult to obtain, due to the lack of customs posts. The recent creation of a customs union with Belarus, Kazakhstan and Kyrgyzstan adds to the difficulty of tracking regional trade flows. This is particularly true in the case of imports, because of the importance of so-called "unregistered trade," consisting of commercial (in contrast to private) transactions that escape customs records. Value adjustments for unregistered trade are made in Russia's official balance of payments accounts; such adjustments added approximately U.S.\$20.6 billion to import values in 1996 and U.S.\$19.5 billion in 1997.

Current Account

Russia registered a current account surplus in 1994 (U.S.\$9.3 billion), 1995 (U.S.\$7.9 billion) and 1996 (U.S.\$12.0 billion), representing 3.3 per cent., 2.3 per cent. and 2.8 per cent. of GDP, respectively. In each of these years, the current account balance reflected a large trade surplus, partially offset by a substantial deficit in non-factor services. The trade surplus grew throughout the period, amounting to U.S.\$17.8 billion in 1994, U.S.\$20.8 billion in 1995 and U.S.\$23.1 billion in 1996. Russia was, however, a net importer of non-factor services in each of these years, registering a negative balance in non-factor services of U.S.\$6.7 billion in 1994, U.S.\$9.5 billion in 1995 and U.S.\$5.7 billion in 1996. Travel accounted for the largest portion of these deficits, reflecting Russia's liberalised travel policies and its increased economic links with other countries. Transportation services, by contrast, registered surpluses in 1994, 1995 and 1996. The deficit in income payments increased significantly over the period from U.S.\$1.8 billion in 1994, to U.S.\$3.4 billion in 1995 and to U.S.\$5.3 billion in 1996.

During 1997, the current account surplus decreased by U.S.\$8.8 billion compared to 1996 and fell to U.S.\$3.3 billion (representing 0.7 per cent. of GDP) primarily due to an increased deficit in income payments and a decreased trade balance, despite an improved non-factor services balance. The trade balance surplus decreased from U.S.\$23.1 billion in 1996 to U.S.\$17.3 billion in 1997 due to a fall in export earnings caused by unfavourable prices for oil and oil products, metals and other exported goods, a trend which has continued into 1998. In 1997 export of goods fell by 2.0 per cent. in comparison with 1996. The fall in the value of exports was due to a fall in prices rather than to changes in physical volumes. According to the estimates of the Ministry of External Economic Relations, export prices fell by 3.4 per cent., while physical volumes increased by 1.7 per cent. The negative balance in non-factor services decreased from U.S.\$5.7 billion in 1996 to U.S.\$5.2 billion in 1997. A deficit in income payments of U.S.\$8.4 billion was recorded in 1997 as against a deficit of U.S.\$5.3 billion in 1996, reflecting higher interest payments on securities and deposits as a result of substantial foreign portfolio investment in GKO/OFZs and eurobonds.

Although official data is not yet available, the decline in energy prices on the world markets has had an adverse effect on the current account in 1998, offset in part by an increase in certain energy export volumes.

Capital and Financial Account

Russia recorded a capital and financial account deficit of U.S.\$4.0 billion in 1996, significantly lower than the U.S.\$8.9 billion deficit recorded in 1994, but higher than the almost zero deficit recorded in 1995. Net foreign direct investment inflows rose to U.S.\$1.7 billion in 1995 and 1996 from only U.S.\$538 million in 1994. Net portfolio investment inflows reached U.S.\$9.7 billion in 1996 due to non-residents' investment in the GKO/OFZ market and the equity market and the issuance of eurobonds. The 1996 figures reflect significant investment flows both with respect to assets (trade and medium-term credits, foreign exchange holdings, arrears) and liabilities (including U.S.\$3.8 billion in IMF disbursements), which were in positive balance of some U.S.\$16.3 billion for the year. See "Official International Reserves" for discussion of Russia's reserve assets.

In 1997 Russia's capital and financial account surplus was U.S.\$4.9 billion against a deficit of U.S.\$4.0 billion during 1996. Net foreign direct investment rose from U.S.\$1.7 billion to U.S.\$4.7 billion and net portfolio investments rose from U.S.\$9.7 billion to U.S.\$46.2 billion primarily as a result of

further liberalisation of non-residents' access to the GKO/OFZ market, the issuance of eurobonds by Federal and local authorities and securitisation of U.S.\$28.0 billion of debt (together with interest arrears) of the former Soviet Union to the London Club of commercial creditors. The latter also led to a sharp decrease in arrears on loans received and subsequently caused the increase in the negative balance of other investment flows from U.S.\$16.3 billion to U.S.\$43.4 billion. Purchase of foreign currency in cash increased to U.S.\$13.5 billion in 1997 as against U.S.\$8.9 billion in 1996 mainly due to the Asian financial crisis. Movements of arrears on loans extended and liabilities in the form of demand and time deposits were heavily influenced by the settlement of some U.S.\$8 billion of mutual obligations between Russia and Poland. Reserve assets increased by U.S.\$1.8 billion in 1997.

Capital flight has been significant in Russia, including both legal outflows through shifts by residents from rouble to foreign currency holdings, and illegal outflows through non-repatriation of export proceeds or over-invoicing of imports. Since 1992, increasingly liberal foreign exchange regulations and uncertainties generated by the economic situation and exchange rate fluctuations have prompted Russian enterprises and households to switch their current holdings and savings into foreign exchange (particularly U.S. dollar) denominated assets. Such outflows decreased in 1995, but increased in 1996 due to political uncertainty before the presidential election, some weakening of the rouble and a decrease in interest rates on rouble deposits in the second half of the year. The level of unaccounted transactions ("errors and omissions") in Russia's balance of payments accounts was high, amounting to U.S.\$7.9 billion in 1995, U.S.\$8.1 billion in 1996 and U.S.\$8.2 billion in 1997.

Foreign Investment

By 1st January 1998, accumulated foreign capital in the Russian economy (excluding monetary authorities and the banking sector and taking into account only foreign currency investment) amounted to U.S.\$21.8 billion.

In 1996, new foreign investment in the non-financial sector was U.S.\$6.5 billion, some 2.3 times greater than in 1995, primarily as a result of increased non-resident participation in the GKO/OFZ market. See "Public Debt – Domestic Debt – Government Domestic Debt." During 1997, such new foreign investment increased to U.S.\$10.5 billion. Foreign investment grew in 1997 on the strength of increased trade credits and bank deposits, which accounted for 59.6 per cent. of all new foreign investment. New direct foreign investment amounted to U.S.\$3.9 billion, representing 37.1 per cent. of all new foreign investment in 1997 as compared to U.S.\$2.1 billion, representing 32 per cent. of all new foreign investment during 1996.

The principal sources of new foreign investment in Russia in 1997 were the United States (U.S.\$2.8 billion), the United Kingdom (U.S.\$2.3 billion), Switzerland (U.S.\$1.7 billion) and Germany (U.S.\$1.5 billion). Since 1992, OECD countries have accounted for more than 95 per cent. of total new foreign investment in Russia.

Foreign Trade

Foreign Trade Regime

Until 1992, exports and imports were fully centralised. One of the first tasks of reform was to abolish the state monopoly on external trade.

Because of severe goods shortages and the need to ensure vital supplies, practically all restrictions on imports were abolished in early 1992. Import tariffs were subsequently introduced for a broad range of goods as of 1st July 1992. In 1996, Russia adopted a 30 per cent. tariff ceiling on most imports, and announced a schedule of gradual reductions in import tariffs. The schedule envisages cuts in the tariffs on various items ranging up to 50 per cent., with a weighted average reduction of 20 per cent. by 1998 and 30 per cent. by 2000 from the levels of July 1995, which stood at approximately 13 per cent. Notwithstanding these planned reductions, Russia's weighted average import tariff now stands at 14 per cent., with higher rates applying to food products.

From 1992 to 1994, exports were an important source of foreign exchange earnings for the Federal budget, and therefore remained controlled even as imports were being liberalised. By the

second half of 1996, all export quotas, export tariffs and other export restrictions had been abolished. Excise taxes were subsequently introduced on oil, gas, petrol, automobiles, alcohol and certain other goods, and voluntary export restraints continue to exist on a list of goods agreed between Russia and the EU (for example, aluminium and textiles).

Composition of Trade

The following table illustrates the composition of Russia's exports and imports on a customs basis (excluding unregistered trade adjustments) for the years 1994 to 1997:

Structure of Trade ⁽¹⁾⁽²⁾

	Exports								Imports			
	1994		1995		1996		1997 ⁽⁴⁾		1994		1995	
	U.S.\$ billion	%	U.S.\$ billion	%	U.S.\$ billion	%	U.S.\$ billion	%	U.S.\$ billion	%	U.S.\$ billion	%
Machinery, equipment and transport..	5.6	8.4	8.1	10.1	8.2	9.4	9.2	10.6	13.6	35.2	15.9	34.0
Metals, precious stones and their products.....	17.7	26.5	20.9	26.2	20.3	23.2	20.6	23.9	2.6	6.7	4.0	8.6
Mineral products ⁽³⁾	30.1	45.0	33.4	41.8	42.2	48.1	41.0	47.7	2.5	6.5	2.8	6.0
Chemical products and rubber.....	5.4	8.1	7.9	9.9	7.4	8.6	7.0	8.2	3.8	9.8	5.1	10.9
Timber, woodpulp and paper products.....	2.7	4.0	4.4	5.5	3.6	4.1	3.5	4.1	0.6	1.6	1.1	2.4
Textiles.....	1.3	1.9	1.1	1.4	0.9	1.1	0.8	1.0	3.1	8.0	2.6	5.6
Leather and fur products.....	0.4	0.6	0.3	0.4	0.4	0.4	0.4	0.4	0.2	0.5	0.1	0.2
Foodstuffs and agricultural products (excluding textiles).....	2.8	4.2	2.7	3.4	3.2	3.7	2.5	2.9	10.7	27.7	13.2	28.3
Other.....	0.9	1.3	1.1	1.4	1.4	1.6	1.0	1.2	1.5	3.9	1.9	4.1
Total trade.....	66.9	100.0	79.9	100.0	87.6	100.0	86.1	100.0	38.6	100.0	46.7	100.0

Notes:

⁽¹⁾ Figures differ from the presentation in the " - Balance of Payments" due to classification, coverage and other adjustments.

⁽²⁾ Reflects Customs Committee statistics data with certain Goskomstat adjustments.

⁽³⁾ Includes oil, gas and coal.

⁽⁴⁾ Preliminary.

Source: Goskomstat, Central Bank.

Exports of mineral products (including oil, gas and coal) and metals and precious stones account for the vast majority of Russia's total exports, 71.3 per cent. in 1996 and 72.0 per cent. in the first nine months of 1997. Other significant exports include chemical products and rubber (8.0 per cent. of total exports in the first nine months of 1997) and machinery and other equipment (10.2 per cent. in the same period).

Imports of machinery, equipment and transport accounted for some 34.2 per cent. of total imports in the first nine months of 1997. Russia also imports significant amounts of raw and processed foodstuffs and agricultural products. In the aggregate, these products accounted for 26.1 per cent. of total imports in the first nine months of 1997, and net imports of these products reached U.S.\$7.9 billion during this period.

Direction of Trade

The following table illustrates the geographic distribution of Russia's trade on a customs basis (excluding unregistered trade adjustments) for the years 1993 to 1997:

Exports⁽¹⁾⁽²⁾

	1993		1994		1995		1996		1997	
	U.S.\$ million	U.S.\$ million	% change	U.S.\$ million	% change	U.S.\$ million	% change	U.S.\$ million	% change	
Exports to ROW	44,297	53,001	19.6	63,687	20.2	69,212	8.7	68,411	(1.2)	
OECD countries	26,906	35,739	32.8	39,374	10.2	40,997	4.1	41,403	1.0	
Germany	5,074	6,376	25.7	6,208	(2.6)	6,735	8.5	6,531	(3.0)	
U.S.A.	1,997	3,561	78.3	4,315	21.2	4,839	12.1	4,482	(7.4)	
Switzerland.....	1,609	3,719	131.1	3,525	(5.2)	3,724	5.6	3,542	(4.9)	
Great Britain.....	3,353	4,259	27.0	3,066	(28.0)	3,209	4.7	2,848	(11.2)	
Japan	2,005	2,245	12.0	3,173	41.3	2,915	(8.1)	2,935	(0.7)	
Italy.....	2,629	2,984	13.5	3,376	13.1	2,828	(16.2)	3,564	(26.0)	
Other OECD.....	10,238	12,595	23.0	15,712	24.7	16,748	6.6	17,500	4.5	
Transition economies ⁽³⁾	10,757	9,888	(8.1)	12,204	23.4	14,827	21.5	14,404	(2.8)	
Other non-CIS countries ..	6,634	7,374	11.1	12,109	64.2	13,389	10.6	12,604	(5.9)	
Exports to CIS countries.....	14,880	13,861	(6.8)	14,530	4.8	15,895	9.4	16,583	4.3	
Ukraine	—	6,885	—	7,149	3.8	7,547	5.6	7,240	(4.1)	
Belarus.....	—	2,998	—	2,940	(1.9)	3,522	19.8	4,631	31.5	
Kazakhstan	—	1,938	—	2,555	31.8	2,550	(0.2)	2,472	(3.1)	
Kyrgyzstan.....	—	104	—	105	1.0	159	52.1	167	5.1	
Other CIS.....	—	1,936	—	1,782	(8.0)	2,117	18.8	2,073	(2.1)	
Total exports	59,177	66,862	13.0	78,217	17.0	85,107	8.8	84,994	(0.1)	

Notes:

(1) Certain data presented in this table for 1995 and 1996 differ from previously published data due to regular revisions by the Customs Committee.

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

(3) Comprises Bulgaria, China, Cuba, Czech Republic, Hungary, Mongolia, North Korea, Poland, Romania, Slovakia and Vietnam.

Source: Customs statistics.

Imports⁽¹⁾⁽²⁾

	1993		1994		1995		1996		1997	
	U.S.\$ million	U.S.\$ million	% change	U.S.\$ million	% change	U.S.\$ million	% change	U.S.\$ million	% change	
Imports from ROW.....	26,807	28,344	5.7	33,117	16.8	31,485	(4.9)	38,805	23.2	
OECD countries	16,685	20,119	20.6	23,220	15.4	21,657	(6.7)	26,971	24.5	
Germany	5,142	5,675	10.4	6,483	14.2	5,192	(19.9)	6,643	28.0	
U.S.A.....	2,304	2,070	(10.2)	2,648	27.9	2,901	9.6	4,058	39.9	
Italy.....	1,106	1,596	44.3	1,851	16.0	2,339	26.4	2,640	12.9	
Finland	724	1,628	124.9	2,041	25.4	1,675	(17.9)	1,874	11.9	
Netherlands.....	431	1,611	273.8	1,646	2.2	1,010	(38.6)	1,206	19.4	
France.....	899	1,005	11.8	1,074	6.9	1,269	18.1	1,594	25.7	
Other OECD.....	6,079	6,534	7.5	7,478	14.4	7,272	(2.8)	8,956	23.2	
Transition economies ⁽³⁾	5,264	4,240	(19.5)	4,654	9.8	4,316	(7.3)	5,361	24.2	
Other non-CIS countries ..	4,857	3,985	(18.0)	5,242	31.5	5,513	5.2	6,473	17.4	
Imports from CIS countries .	9,248	10,317	11.6	13,592	31.7	14,549	7.0	14,080	(3.2)	
Ukraine	—	4,404	—	6,617	50.2	6,294	(4.9)	3,982	(36.7)	
Belarus.....	—	2,094	—	2,088	(0.3)	3,024	44.9	4,626	53.0	
Kazakhstan	—	1,996	—	2,675	34.0	3,041	13.7	2,743	(9.8)	
Kyrgyzstan.....	—	98	—	101	3.1	147	45.2	148	0.8	
Other CIS.....	—	1,725	—	2,111	22.4	2,043	(3.2)	2,580	26.3	
Total imports	<u>36,055</u>	<u>38,661</u>	<u>7.2</u>	<u>46,709</u>	<u>20.8</u>	<u>46,034</u>	<u>(1.4)</u>	<u>52,885</u>	<u>14.9</u>	

Notes:

(1) Certain data presented in this table for 1995 and 1996 differ from previously published data due to regular revisions by the Customs Committee.

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

(3) Comprises Bulgaria, China, Cuba, Czech Republic, Hungary, Mongolia, North Korea, Poland, Romania, Slovakia and Vietnam.

Source: Customs statistics.

The dissolution of the former Soviet Union and the more liberal foreign trade regime since 1992 have resulted in a significant change in the geographical pattern of Russian trade. Russia's exports to OECD countries increased by more than 50 per cent. between 1993 and 1996, and rose in relative terms as well, accounting for almost half of exports in 1996 (U.S.\$41.2 billion). Exports to transition economies (including all former members of CMEA) decreased in 1994, but rose thereafter, reaching 17.5 per cent. of total exports in 1996, reflecting rapidly expanding trade with Central European Free Trade Agreement (“CEFTA”) trading partners. Exports to China have remained stable at 4 per cent. to 6 per cent. of total exports, excluding unregistered trade, which is believed to be quite significant along the long Sino-Russian border. Other non-CIS countries received some 15.8 per cent. of Russia's total exports in 1996.

Compared with 1996, exports to CIS countries in 1997 increased by 4.3 per cent., while exports to non-CIS countries fell by 1.2 per cent. The share of non-CIS countries in total exports decreased from 81.3 per cent. in 1996 to 80.5 per cent. in 1997, while the share of CIS countries increased from 18.7 per cent. to 19.5 per cent. over the same period. Despite the fall in total exports to non-CIS countries in 1997, exports to OECD countries increased by 1.0 per cent. compared with 1996.

Imports from OECD countries rose in each of 1994 and 1995 but fell in 1996 and represented approximately 50 per cent. of total imports in each year. Imports from CIS countries were relatively low following the dissolution of the Soviet Union, but have since registered substantial growth, accounting for 31.6 per cent. of total imports in 1996.

In 1997, imports from non-CIS countries increased by 23.2 per cent. compared with 1996, while imports from CIS countries fell by 3.2 per cent. The share of non-CIS countries in total imports

increased from 68.4 per cent. in 1996 to 73.4 per cent. in 1997, while the share of CIS countries decreased from 31.6 per cent. to 26.6 per cent.

Ukraine and Germany are Russia's leading trading partners. The largest importers of Russian goods in 1997 were Ukraine (9 per cent. of Russian exports), Germany (8 per cent.) and the United States and Belarus (5 per cent. each). The most important exporters to Russia were Germany (13 per cent. of Russian imports), Belarus (9 per cent.) and Ukraine and the United States (8 per cent. each). Three countries, Ukraine, Belarus and Kazakhstan, account for approximately 85 per cent. of exports and imports involving CIS countries.

Official International Reserves

The following table sets forth information with respect to the official international reserves of the Russian Federation at period end for the years 1993 to 1997 and as at 31st May 1998:

	Official International Reserves ⁽¹⁾					As at 31st May 1998
	As at 31st December					
	1993	1994	1995	1996	1997	
	<i>(U.S.\$ million, except fine troy ounce amounts)</i>					
Official international reserves						
(excluding gold)	5,835	3,981	14,383	11,276	12,895	9,625
SDRs	5.1	3.1	116.8	4.5	122.4	2.5
Reserve position in IMF	1.4	1.2	1.1	1.3	1.2	0.9
Foreign exchange.....	5,829	3,976	14,265	11,271	12,771	9,622
Official gold reserves						
(fine troy ounces, million)	10.2	8.4	9.4	13.5	16.3	16.7
U.S.\$ million (national valuation) ⁽²⁾	3,059	2,525	2,824	4,047	4,889	5,002
Total official international reserves (including gold).....	8,894	6,506	17,207	15,323	17,784	14,627
Gross international reserves liabilities	2,520	4,210	9,627	13,628	14,044	14,451
of which:						
Hedging contracts of the Central Bank in relation to non-residents' investment in GKO/OFZ market....	0	0	0	1,099	0	0
Net official international reserves (including gold) ⁽³⁾	6,374	2,296	7,580	1,696	3,740	176

Notes:

⁽¹⁾ Data presented in this table differ from previously published data due to certain changes in accounting methodology of the Central Bank.

⁽²⁾ In U.S.\$300 per troy ounce.

⁽³⁾ Total official reserves less gross international reserves liabilities (the latter being defined and calculated in accordance with IMF requirements).

Source: Central Bank, Ministry of Finance.

Russia's initial official international exchange reserve position at the end of 1991 amounted to only U.S.\$2.8 billion, consisting almost entirely of gold reserves. Only in 1995, as a result of growing trade surpluses and rising confidence in the rouble, did the Central Bank become a large buyer of foreign exchange assets, and during the course of the year foreign exchange reserves (excluding gold) more than tripled.

During 1995 total official international reserves (including gold) rose by U.S.\$10.7 billion amounting to U.S.\$17.2 billion at the end of 1995, representing approximately 2.5 months of import

coverage. In 1996 they fell by U.S.\$1.9 billion amounting to U.S.\$15.3 billion at the end of 1996, representing approximately 2.1 months of import coverage. Net official international reserves (including gold) were U.S.\$7.6 billion at the end of 1995, but fell to U.S.\$1.7 billion by the end of 1996, largely as a result of exchange rate stabilisation measures undertaken by the Central Bank and the introduction of the Central Bank's hedging contracts. See "Public Debt – Relations with International Financial Institutions."

During the first half of 1997, official international reserves increased significantly due to substantial foreign capital inflows mainly in the form of portfolio investment in Government securities, and also as a result of the Central Bank policies aimed at preventing the real appreciation of the rouble. At 30th June 1997, total official international reserves (including gold) reached U.S.\$24.5 billion. However, because of the Asian currency crisis in the autumn of 1997, foreign capital inflows decreased significantly in the second half of the year and had reversed by the year end. To protect the rouble, the Central Bank was forced to intervene in the foreign currency market (see "Monetary and Financial System – Monetary Policy – Recent Developments"), reducing reserves to U.S.\$17.8 billion at the end of 1997, representing approximately 2.4 months of import coverage.

Official international reserves (including gold) declined during the first two months of 1998, mainly due to seasonal factors, although the fallout from the Asian currency crisis continued to have significant effect, especially in January. Official international reserves (including gold) stood at U.S.\$15.0 billion at 28th February 1998, representing 2.0 months of import coverage, of which U.S.\$10.2 billion was in foreign currency and U.S.\$4.8 billion was in gold. However, in March reserves increased significantly, and as of 31st March 1998, gross official international reserves (including gold) were U.S.\$16.9 billion, representing 2.3 months of import coverage, of which U.S.\$11.9 billion was in foreign currency and U.S.\$5.0 billion was in gold. Net official international reserves (including gold) stood at U.S.\$2.4 billion at 31st March 1998.

Official international reserves (including gold) declined in the second quarter of 1998 due to unfavourable commodity prices on the world markets, foreign currency operations in support of the rouble and external debt service. As at 31st May 1998, official international reserves (including gold) stood at U.S.\$14.6 billion, representing 1.9 months of import coverage, of which U.S.\$9.6 billion was in foreign currency and U.S.\$5.0 billion was in gold. Net official international reserves (including gold) stood at U.S.\$0.2 billion at 31st May 1998. On 14th July 1998, gross international reserves (including gold) stood at U.S.\$13.5 billion.

The Government is responsible for Russia's output, sale, and export of precious metals and stones, such as gold, platinum, and diamonds. The Ministry of Finance finances Russia's precious metals output through Federal budget expenditure and receives in return output (which it can but does not have to add to reserves) along with proceeds from output sales and exports. See "Public Finance – Deficit Financing."

Both the Central Bank and the Ministry of Finance currently have official foreign exchange and gold reserves. Reserves of the Ministry of Finance are built up by tax receipts in foreign currency, and the acquisition of precious metals and stones by the Ministry of Finance in connection with the financing of the precious metals industry by the Government. Reserves of the Ministry of Finance, however, make up only a small portion of Russia's total official international reserves, and there is no Constitutional or Federal legislative requirement that the Ministry maintain reserves.

PUBLIC FINANCE

The information presented herein with respect to the Federal budget has, with limited exceptions, been prepared substantially in accordance with the guidelines and definitions set forth in the IMF's publication *Government Finance Statistics* ("GFS"). The differences between the historical Federal budget information presented herein and GFS' relate mainly to (i) sales of gold and precious metals and privatisation proceeds, which are treated as positive elements of deficit financing in the presentation herein but as revenue items under GFS, and (ii) purchases of gold and precious metals, which are treated as negative elements of deficit financing in the presentation herein but as expenditure items under GFS. The Federal budget information presented herein differs in significant respects from budget information prepared in accordance with Federal budgetary laws in past years and published in other official sources. For example, the Federal budget information presented herein differs from that presented in accordance with the 1997 Federal budget law principally in that the latter, for technical and operational reasons, does not include non-coupon debt service costs (for example, GKO/OFZ interest) as an element of expenditure. Unlike past budgets, the 1998 budget law was prepared in accordance with GFS and it is expected that all Federal budget information published in the future will similarly accord with GFS.

Overview

Russia has reduced its Federal budget deficit from 44.6 per cent. of GDP in 1992 to 6.7 per cent. of GDP in 1997. This reduction is primarily attributable to expenditure cuts made possible by structural economic reforms over this period (for example, privatisation and price liberalisation) and to improvements in the Federal budgetary process. At the same time, direct and indirect monetary financing of the budget deficit has been reduced from 29.9 per cent. of GDP in 1992 to only 1.1 per cent. in 1997. As a result, Russia has made significant progress toward achieving its financial stabilisation objectives.

The following table sets forth certain summary information regarding Russia's public finances for the years 1992 to 1997 and the first quarter of 1998:

Enlarged Budget⁽¹⁾

	1992	1993	1994	1995	1996 ⁽²⁾	1997 ⁽³⁾	1998 Q1
<i>(billions of roubles)</i>							
Enlarged budget							
Revenue	6,765	62,204	226,775	546,177	784,320	966,639	187,427
Expenditure	14,420	88,121	286,169	643,498	985,952	1,178,712	220,202
Deficit	7,655	25,917	59,394	97,321	201,633	212,074	32,775
Federal budget							
Revenue	2,780	22,268	72,506	196,504	296,261	310,831	62,133
Expenditure	11,244	49,098	137,392	283,180	474,258	484,034	87,959
Deficit	8,465	26,830	64,886	86,676	177,997	173,203	25,826
Primary deficit ⁽⁴⁾	8,258	23,734	53,831	37,516	53,607	55,415	(2,630)
Local (sub-federal and municipal) budgets ⁽⁵⁾							
Revenue	2,314	23,195	93,864	204,728	274,869	360,374	58,967
Expenditure	1,943	23,569	91,088	211,852	296,849	397,012	63,980
Deficit/(surplus)	(372)	374	(2,776)	7,124	21,980	36,638	5,013
Extrabudgetary funds ⁽⁶⁾							
Revenue	1,671	16,741	60,406	144,945	213,190	295,433	66,326
Expenditure	1,233	15,454	57,689	148,467	214,846	297,666	68,262
Deficit/(surplus)	(438)	(1,287)	(2,7127)	3,522	1,656	2,233	1,936
<i>(per cent. of GDP)</i>							
Enlarged budget							
Revenue	35.6	36.2	37.1	34.5	35.6	37.1	33.0
Expenditure	75.9	51.2	46.8	40.6	44.8	45.3	38.7
Deficit	40.3	15.1	9.7	6.1	9.2	8.1	5.8
Federal budget							
Revenue	14.6	12.9	11.9	12.4	13.5	11.9	10.9
Expenditure	59.2	28.5	22.5	17.9	21.6	18.6	15.5
Deficit	44.6	15.6	10.6	5.5	8.1	6.7	4.5
Primary deficit ⁽⁴⁾	43.5	13.8	8.8	2.4	2.4	2.1	(0.5)
Local (sub-federal and municipal) budgets ⁽⁵⁾							
Revenue	12.2	13.5	15.4	12.9	12.5	13.8	10.4
Expenditure	10.2	13.7	14.9	13.4	13.5	15.3	11.2
Deficit/(surplus)	(2.0)	0.2	(0.5)	0.4	1.0	1.4	0.9
Extrabudgetary funds ⁽⁶⁾							
Revenue	8.8	9.7	9.9	9.1	9.7	11.4	11.7
Expenditure	6.5	9.0	9.4	9.4	9.8	11.4	12.0
Deficit/(surplus)	(2.3)	(0.7)	(0.4)	0.2	0.1	0.1	0.3
Memo:							
Nominal GDP, rouble trillion	19	172	611	1,585	2,200	2,602	569

Notes:

(1) Information presented in this table is calculated on the basis of cash or other items of value actually collected or spent. Certain data presented in this table for 1996 differs from data made public previously due to regular revisions made by the Ministry of Finance.

(2) Includes adjustments to Federal revenues and expenditures for monetary offsets recorded in 1997 but attributable to 1996 (48.1 trillion roubles).

(3) Subject to adjustments to be made in respect of certain items of revenue and expenditure that are incurred after 31st December 1997, which are appropriate to record in respect of 1997. Includes monetary offsets recorded in January and February 1998 but attributable to 1997 (18.4 billion redenominated roubles).

(4) Federal budget deficit less interest payments on Governmental debt.

(5) Excluding transfers from the Federal budget.

(6) Excluding transfers from the Federal and local budgets and among extra-budgetary funds.

Source: Ministry of Finance.

Federal Budgetary Process

The Ministry of Finance is centrally involved in each stage of the Federal budgetary process, which includes: the determination of fiscal policy objectives; development of macroeconomic forecasts consistent with fiscal and monetary policy objectives; preparation of the budget; adoption of the budget by the Federal Assembly; execution of the budget, including later amendments; and audit of the budget's execution.

Budget Preparation and Adoption

The draft budget is prepared by the Ministry of Finance and then presented to the Government. It is then presented to the Duma, where it proceeds through four readings. In the first reading, the budget's overall macroeconomic framework and size of revenue, deficit and expenditure are established; the second reading is devoted to allocation of the total authorised expenditure to specific purposes according to functional classifications; the third reading involves allocation of the expenditure among government institutions; the fourth reading adopts quarterly targets for budget execution. After the Duma's fourth reading, action on the bill proceeds in accordance with the normal legislative process. During the course of the fiscal year, the Government may submit amendments to the budget law to the Duma for consideration in accordance with the normal legislative process.

Federal law provides deadlines for each stage of the budget process, including the preparation, review and adoption of the budget law. The Government submitted the draft budget law for 1998 to the Duma in September 1997, meeting the prescribed deadline. See "– The 1998 Federal Budget Law."

Budget Execution

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

The budget law sets nominal levels for the deficit as a whole, as well as for the amounts of domestic and foreign borrowing. The approval of the Duma is required if the nominal level of expenditure or borrowing is to be exceeded. In each year since 1992, the Ministry of Finance has executed the budget using only the sum of revenue actually collected and without violating the deficit ceiling established in the budget law.

Expenditure levels set forth in the budget law are annual spending limits, with indicative (i.e. non-binding) quarterly targets being established in order to enhance operational control over budgetary performance. The Government can accordingly choose how to allocate expenditure on an item over the course of the year so long as it does not exceed by year-end the expenditure figure for that item laid down in the budget law.

Prior to 1998, the budget law identified certain "protected expenditure items" (generally representing between 30 per cent. and 40 per cent. of total expenditure) to be funded ahead of other budgeted expenditures in the event of any shortfall in revenues. The policy of the Ministry of Finance, in executing the budget, was to treat scheduled debt service payments as similarly protected. Accordingly, when there were shortfalls in revenue, debt service payments and protected expenditure items (which together make up so-called "fixed" expenditure) were funded in full, while all other expenditures were "sequestered," or cut back proportionally, to the extent required by the shortfall. Protected expenditure items identified by the Duma in connection with the 1997 budget law consisted primarily of wage payments and social transfers.

The 1997 budget law contained provisions with respect to the mandatory sequestering of budget expenditure in the event that either Federal budget revenue or deficit financing for any calendar quarter was below the amounts targeted in the budget. When the first quarter produced a shortfall in revenues, the Government was required to introduce to the Duma a "Law on Sequestering Federal Budget Expenditures" identifying expenditure to be sequestered in order to eliminate the shortfall. The Duma voted on but did not pass the draft law introduced by the Government; however, the Government made expenditures throughout 1997 as if the draft law were in effect.

The 1998 budget law does not formally identify any protected expenditure items and does not contain sequestration provisions like those included in the 1997 budget law. However, the 1998 budget law does empower the Ministry of Finance to sequester expenditure as necessary to reflect any shortfall in revenues, with the exception of specified expenditures including debt service, seasonal supplies and international activities, which cannot be sequestered.

Federal Budget Revenue

The following table sets forth information regarding Federal budget revenue for the years 1993 to 1997 and the first quarter of 1998:

Federal Budget Revenue⁽¹⁾

	1993	1994	1995	1996 ⁽²⁾	1997 ⁽³⁾	Cash revenues ⁽⁴⁾		1998 Q1
						1996	1997	
	<i>(billions of roubles)</i>							
Total revenue	22,268	72,506	196,504	296,261	310,831	198,216	251,971	62,133
Profit taxes.....	5,472	17,126	40,995	37,796	36,334	19,161	28,868	6,561
Personal income tax	—	114	3,250	5,143	1,747	5,139	1,747	36
VAT	7,251	27,961	77,970	131,312	128,621	74,701	92,451	23,405
Excise taxes	899	4,456	17,682	55,754	55,278	35,307	41,583	11,530
Natural resource taxes.....	599	1,126	3,043	5,892	7,389	3,633	6,072	874
Revenue from foreign economic activity.....	5,398	16,734	30,505	27,498	30,084	27,498	30,084	8,296
Other revenue	2,649	4,990	23,060	32,866	51,379	32,777	51,167	11,432
of which								
Central Bank profit transfer	2,042	1,580	3,475	5,000	1,985	5,000	1,985	0
Revenues of Budgetary Funds	—	—	14,128	22,090	37,462	22,090	37,462	6,414
	<i>(per cent. of GDP)</i>							
Total revenue	12.9	11.9	12.4	13.5	11.9	9.0	9.7	10.9
Profit taxes.....	3.2	2.8	2.6	1.7	1.4	0.9	1.1	1.2
Personal income tax	—	0.0	0.2	0.2	0.1	0.2	0.1	0.0
VAT	4.2	4.6	4.9	6.0	4.9	3.4	3.6	4.1
Excise taxes	0.5	0.7	1.1	2.5	2.1	1.6	1.6	2.0
Natural resource taxes.....	0.3	0.2	0.2	0.3	0.3	0.2	0.2	0.2
Revenue from foreign economic activity.....	3.1	2.7	1.9	1.2	1.2	1.2	1.2	1.5
Other revenue	1.5	0.8	1.5	1.5	2.0	1.5	2.0	2.0
of which								
Central Bank profit transfer	1.2	0.3	0.2	0.2	0.1	0.2	0.1	0.0
Revenues of Budgetary Funds	—	—	0.9	1.0	1.4	1.0	1.4	1.1
	<i>(per cent. of total revenue)</i>							
Total revenue.....	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Profit taxes.....	24.6	23.6	20.9	12.8	11.7	9.7	11.5	10.6
Personal income tax	—	0.2	1.7	1.7	0.6	2.6	0.7	0.1
VAT	32.6	38.6	39.7	44.3	41.4	37.7	36.7	37.7
Excise taxes	4.0	6.1	9.0	18.8	17.8	17.8	16.5	18.6
Natural resource taxes.....	2.7	1.6	1.5	2.0	2.4	1.8	2.4	1.4
Revenue from foreign economic activity.....	24.2	23.1	15.5	9.3	9.7	13.9	11.9	13.4
Other revenue	11.9	6.9	11.7	11.1	16.5	16.5	20.3	18.4
of which								
Central Bank profit transfer	9.2	2.2	1.8	1.7	0.6	2.5	0.8	0.0
Revenues of Budgetary Funds	—	—	7.2	7.5	12.1	11.1	14.9	10.3
<i>Memo:</i>								
Nominal GDP (trillions of roubles).....	172	611	1,585	2,200	2,602	2,200	2,602	569

Notes:

(1) Information presented in this table is calculated on the basis of cash or other items of value actually collected.

(2) Includes adjustments for monetary offsets recorded in 1997 but attributable to 1996 (48.1 trillion roubles).

(3) Subject to adjustments to be made in respect of certain items of revenue that are incurred after 31st December 1997, which are appropriate to record in respect of 1997. Includes monetary offsets recorded in January and February 1998 but attributable to 1997 (18.4 billion redenominated roubles).

(4) Excluding all offsets.

Source: Ministry of Finance.

Sources of Revenue

The main elements of Russia's tax system are a value added tax ("VAT"), a system of excise taxes and natural resource taxes, an enterprise profits tax, a personal income tax and duties on foreign economic activities.

VAT (at the general rate of 20 per cent. and the reduced rate of 10 per cent. for certain items) has been the largest source of Federal budget revenue since 1992, accounting for more than 40 per cent. of total revenue during 1997. Collection rates for VAT have fluctuated between 50 per cent. and 60 per cent. of total estimated VAT payable since the beginning of 1995. All VAT payments for imported goods and services, and 75 per cent. of VAT payments for domestic goods and services are transferred to the Federal budget (the remainder going directly to sub-federal budgets). VAT on imports accounted for approximately 15 per cent. of total VAT receipts in 1995 and in 1996, rising to 25 per cent. in 1997 because of increased domestic VAT arrears.

Revenue from excise taxes has played an increasing role in the Federal budget in conjunction with the gradual replacement of export duties. The most important excise taxes for the Federal budget are those charged on oil, gas and petrol, revenues from which are exclusively Federal. The collection rate for excise taxes was approximately 60 per cent. of total estimated excise tax payable in 1996 and more than 65 per cent. in 1997.

The Federal profits tax is set at a uniform rate of 13 per cent. Collection rates for profits tax have fluctuated between 50 per cent. and 60 per cent. of total estimated profits tax payable since the beginning of 1995.

Revenue from foreign economic activity consists of taxes on exports and imports, and direct revenue from centralised exports and other activities. In 1995, significant steps were taken towards the abolition of centralised exports and the gradual replacement of export duties by domestic excise taxes. These steps were completed by 1st July 1996, and no revenue from export duties, and very limited revenue from centralised exports, is expected in the future. Import tariffs are currently an important source of Federal budget revenue, but are expected to be reduced gradually over the next three years. See "Balance of Payments and Foreign Trade – Foreign Trade Regime."

Under the budget laws of 1994 to 1996, the Federal budget was assigned 10 per cent. of the revenues from personal income taxes. In the budget law of 1997, all income tax revenues were assigned to sub-federal budgets. The 1998 budget law provides for a similar allocation.

Federal budget revenue includes other tax and non-tax revenues, the most important of which are profit transfers from the Central Bank and revenues of budgetary funds (former extra-budgetary funds consolidated in the budget). Previously, provision had been made for the transfer of profits from the Central Bank in the budget law each year; clear standards to govern the circumstances under which such transfers might otherwise be made, however, had been lacking. Federal legislation now provides for the transfer of 50 per cent. of all Central Bank profits to the Federal budget, with the other 50 per cent. being retained by the Central Bank.

Revenue Performance

Revenue performance in recent years has been poor, undermined both by low cash tax collection and by extensive use of "tax offsets" (tax credits issued by Government ministries in payment for their purchases of goods and services) and "monetary offsets" (ad hoc arrangements involving the crediting and debiting of cash to enterprises that are owed amounts from and owe amounts to the Federal budget). Revenue performance was among the reasons cited for the delays in drawdowns under Russia's EFF with the IMF in the last two years. See "Public Debt – Relations with International Financial Institutions."

Federal tax arrears (including interest and penalties on overdue taxes) equalled 7.8 per cent. of GDP at the end of 1996 and 11.9 per cent. of GDP at the end of 1997. As a result, total Federal (cash and non-cash) tax revenues in 1996 were only 93 per cent. of budgeted levels as envisaged in the

Federal budget law for the year, and in 1997 were only 71 per cent. of budgeted levels. Significant sequestration of budgeted expenditures in each year prevented the shortfalls in revenue from increasing Federal budget deficits. See “– Federal Budget Process – Budget Execution” and “– Federal Budget Expenditure.”

Official Federal budget revenue (including offsets) was 13.5 per cent. of GDP in 1996; cash revenue (excluding offsets), however, was just 9.0 per cent. of GDP. In 1997, although official Federal budget revenue dropped to 11.9 per cent. of GDP, primarily as a result of the reduced amount of offsets attributable to 1997, cash revenue rose to 9.7 per cent. of GDP, reflecting payments by a number of large taxpayers of a significant portion of their tax arrears. As part of the Government's efforts to enhance revenue collection, a November 1997 presidential decree abolished all forms of monetary offsets in lieu of cash payments to the Federal budget. See “– Efforts to Improve Revenue Performance.”

Cash revenue collection in the first quarter of 1998 was 62 billion redenominated roubles, representing 107 per cent. of the planned amount for that period. Compared with the first quarter of 1997, cash revenue collection in the first quarter of 1998 improved by 27 per cent. in real terms. During the second quarter of 1998, revenue performance was to a certain extent undermined by political uncertainty surrounding the appointment of the new Government. Nevertheless, cash revenues to the Federal budget for the first five months of 1998 (including tax revenues and other items) were almost 15 per cent. higher than in 1997 if calculated in constant prices, reflecting an increase in cash tax revenues of 8 per cent. Revenue collection in 1998 has been, and may continue to be, adversely affected by the low world prices for oil and gas. See “The Russian Economy – Principal Sectors of the Economy – Energy.”

Efforts to Improve Revenue Performance

Beginning in the second half of 1996, significant efforts have been made to address practices which have undermined Federal tax collection, such as overly generous tax exemptions, insufficiently strong tax administration and special tax payment schemes. In October 1996, an Emergency Tax Commission, headed by the then-serving Prime Minister Chernomyrdin, was established to coordinate the Government's efforts to improve tax revenue performance, particularly through collection of tax arrears from the largest delinquent taxpayers. Special tax inspection teams were installed on-site to monitor the activities of the 20 enterprises with the largest outstanding tax bills, representing approximately 60 per cent. of all tax arrears. This programme did not result in a significant reduction in tax arrears, however. In addition, tax offsets, which were used extensively during 1996, and were largely responsible for low cash tax revenues in the period, have not been issued or accepted in settlement of outstanding taxes since 1996, although monetary offsets continued through the end of 1997. Other initiatives in 1996 included the establishment of financial control units at enterprises that produce alcohol and the transfer of responsibility for collection of the excise tax on oil exports to the State Customs Committee.

Efforts to improve tax revenue performance continued throughout 1997. Special efforts were made to collect tax arrears from a number of large enterprises, which resulted, for example, in Gazprom and several major oil companies settling a significant portion of their outstanding tax arrears. Initiatives were and continue to be taken to reschedule the tax arrears of certain other enterprises under a programme whereby controlling stakes in such enterprises are, in effect, pledged to the Government as security for the rescheduled obligations. This scheme has been already implemented with respect to a number of enterprises, including the car maker Avtovaz in September 1997. Efforts to improve revenue collection resulted in repayment by 31st December 1997 of more than 70 trillion roubles of tax arrears to the Federal budget, representing more than 20 per cent. of total tax arrears, including penalties and fines.

At the end of 1997 and the beginning of 1998, the Government implemented further measures aimed at improving financial and tax discipline and enhancing revenue collection. These include abolishing all forms of offsets to the Federal budget, introducing the accrual method for assessing

excise taxes (with a view to extending the same to calculating VAT and profit tax), transferring the treasury accounts from commercial banks to the Central Bank, requiring quarterly publication of accounts by large taxpayers (such as Gazprom, UES and others) in accordance with International Accounting Standards ("IAS"), granting the State Tax Commission the right to debit tax payments directly from enterprises' bank accounts and requiring enterprises generally to move to IAS. Taken together, these measures are expected, when fully implemented, to bring additional cash tax revenues of about 1.5 per cent. of GDP per annum.

In the spring of 1998, in line with the revised Fiscal Programme for 1998 (see "– Revised Fiscal Programme for 1998"), the Government adopted additional revenue measures and implemented certain measures it had adopted previously, including moving to the accrual basis for excise taxes and VAT effective 1st August 1998. The new measures include improved collection of tax arrears, in particular from the largest taxpayers such as Gazprom, UES and the Ministry of Railways. In addition, oil companies that have tax arrears to the Federal budget may now be deprived of access to Russia's oil export pipelines for oil exports that have not been assigned to credit facilities entered into prior to 15th June 1998.

The Government has prepared a new tax code which is currently under consideration by the Duma, the main objectives of which are to reduce the total number of taxes, improve the stability, transparency and fairness of the system through the elimination of many tax exemptions and reduce the overall tax burden on the Russian economy. The general part of the new tax code dealing with the legislative aspects of taxation in Russia was passed by the Duma and the Federation Council on 17th July 1998. See "– Proposed New Tax Code."

Federal Budget Expenditure

The following table sets forth information regarding Federal budget expenditure for the years 1993 to 1997 and the first quarter of 1998:

Federal Budget Expenditure⁽¹⁾

	1993	1994	1995	1996 ⁽²⁾	1997 ⁽³⁾	Cash expenditure ⁽⁴⁾		
						1996	1997	1998 Q1
	<i>(billions of roubles)</i>							
Total expenditure	49,098	137,392	283,180	474,258	484,034	376,213	425,173	87,959
National economy								
(subsidies)	5,182	21,176	38,554	57,917	59,021	36,384	49,283	3,759
Social and cultural sphere	2,588	10,477	18,649	36,329	52,089	28,866	46,751	11,208
State administration	656	3,847	4,490	5,602	9,674	5,502	9,347	1,947
Law and order	2,513	10,754	19,194	33,016	44,428	25,281	40,108	7,326
Defence	7,214	28,018	47,553	80,240	80,626	56,741	62,284	10,860
Expenditure on foreign								
economic activity	2,684	4,722	21,492	25,272	8,177	23,326	7,873	960
Debt service	3,096	11,055	49,161	124,390	117,788	124,390	117,788	28,456
of which								
GKO interest	—	1,424	23,821	89,687	87,168	89,687	87,168	21,207
Net credit operations	2,809	11,921	21,737	16,461	18,355	5,822	18,255	1,994
Other expenditure	22,356	35,422	62,352	95,030	93,877	69,902	73,485	21,449
of which								
Quasi-budget expenditure	15,495	7,131	—	—	—	—	—	—
Budgetary Funds	—	—	14,063	18,359	29,214	17,890	28,714	4,851
Transfers to sub-federal								
budgets	4,373	22,033	29,224	57,250	58,563	48,065	40,512	7,969
	<i>(per cent. of GDP)</i>							
Total expenditure	28.5	22.5	17.9	21.6	18.6	17.1	16.3	15.5
National economy								
(subsidies)	3.0	3.5	2.4	2.6	2.3	1.7	1.9	0.7
Social and cultural sphere	1.5	1.7	1.2	1.7	2.0	1.3	1.8	2.0
State administration	0.4	0.6	0.3	0.3	0.4	0.3	0.4	0.3
Law and order	1.5	1.8	1.2	1.5	1.7	1.1	1.5	1.3
Defence	4.2	4.6	3.0	3.6	3.1	2.6	2.4	1.9
Expenditure on foreign								
economic activity	1.6	0.8	1.4	1.1	0.3	1.1	0.3	0.2
Debt service	1.8	1.8	3.1	5.7	4.5	5.7	4.5	5.0
of which								
GKO interest	—	0.2	1.5	4.1	3.3	4.1	3.3	3.7
Net credit operations	1.6	2.0	1.4	0.7	0.7	0.3	0.7	0.4
Other expenditure	13.0	5.8	3.9	4.3	3.6	3.2	2.8	3.8
of which								
Quasi-budget expenditure	9.0	1.2	—	—	—	—	—	—
Budgetary Funds	—	—	0.9	0.8	1.1	0.8	1.1	0.9
Transfers to sub-federal								
budgets	2.5	3.6	1.8	2.6	2.3	2.2	1.6	1.4
	<i>(per cent. of total expenditure)</i>							
Total expenditure	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
National economy								
(subsidies)	10.6	15.4	13.6	12.2	12.2	9.7	11.6	4.3
Social and cultural sphere	5.3	7.6	6.6	7.7	10.8	7.7	11.0	12.7
State administration	1.3	2.8	1.6	1.2	2.0	1.5	2.2	2.2
Law and order	5.1	7.8	6.8	7.0	9.2	6.7	9.4	8.3
Defence	14.7	20.4	16.8	16.9	16.7	15.1	14.6	12.3
Expenditure on foreign								
economic activity	5.5	3.4	7.6	5.3	1.7	6.2	1.9	1.1
Debt service	6.3	8.0	17.4	26.2	24.3	33.1	27.7	32.4
of which								
GKO interest	—	1.0	8.4	18.9	18.0	23.8	20.5	24.1
Net credit operations	5.7	8.7	7.7	3.5	3.8	1.5	4.3	2.3
Other expenditures	45.5	25.8	22.0	20.0	19.4	18.6	17.3	24.4
of which								
Quasi-budget expenditure	31.6	5.2	—	—	—	—	—	—
Budgetary Funds	—	—	5.0	3.9	6.0	4.8	6.8	5.5
Transfers to sub-federal								
budgets	8.9	16.0	10.3	12.1	12.1	12.8	9.5	9.1
Memo:								
Nominal GDP, trillion roubles	172	611	1,585	2,200	2,602	2,200	2,602	569

Notes:

(1) Information presented in this table is calculated on the basis of cash or other items of value actually spent.

(2) Includes adjustments for monetary offsets recorded in 1997 but attributable to 1996 (48.1 trillion roubles).

(3) Subject to adjustments to be made in respect of certain items of expenditure that are incurred after 31st December 1997, which are appropriate to record in respect of 1997. Includes monetary offsets recorded in January and February 1998 but attributable to 1997 (18.4 billion redenominated roubles).

(4) Excluding all offsets.

Source: Ministry of Finance.

Total Federal expenditure declined from 28.5 per cent. of GDP in 1993 to 18.6 per cent. of GDP in 1997, reflecting both the reduction of budgeted expenditure and the re-assignment of responsibility for the bulk of health, education, and other social expenditure to local and sub-federal authorities. Most components of Federal expenditure have been reduced or sequestered to a significant extent over this period, the largest reductions occurring in the national economy (subsidies) (from 3.0 per cent. to 2.3 per cent. of GDP), defence spending (from 4.2 per cent. to 3.1 per cent. of GDP), and foreign economic activity (from 1.6 per cent. to 0.3 per cent. of GDP). Debt service, meanwhile, increased significantly between 1993 and 1997, both in terms of GDP (1.8 per cent. of GDP in 1993, 4.5 per cent. in 1997) and total expenditure (6.3 per cent. of total expenditure in 1993, 24.3 per cent. in 1997). The sharp increase in debt service is attributable to the emergence of the GKO/OFZ market as a significant source of deficit financing and to increased payments in respect of external debt. See “– Deficit Financing.”

In both 1996 and 1997, non-“fixed” expenditure was heavily sequestered, reflecting both poor revenue performance (see “– Federal Budget Revenue”) and high debt service payments attributable to high yields prevailing in the GKO/OFZ market. See “– Deficit Financing.” As a result of the Government’s sequestering policies, overall non-interest Federal budget expenditure equalled 14.1 per cent. of GDP in 1997 (as compared with the level of 16.3 per cent. of GDP envisaged in the 1997 Federal budget law) and 15.9 per cent. of GDP in 1996 (as compared with the budgeted level of 16 per cent.).

At the end of 1997, the Government adopted a programme of measures aimed at reducing the expenditure commitments of Federal agencies and improving control over their spending of budgetary funds. Under this programme, implemented during 1998, ceilings are imposed on energy and utilities spending, all Federal agencies are being brought within the Federal Treasury system, a full accounting of arrears owed by Federal agencies is being carried out and a census of all Federal employees is in the process of being completed. Overall, the Government is aiming to cut expenditure commitments by around 42 billion redenominated roubles both in 1998 and 1999 and to avoid accumulation of any further arrears. See “– Revised Fiscal Programme for 1998.”

Deficit Financing

Russia inherited a significant budget deficit from the Soviet Union: in 1992, the enlarged budget-deficit (comprising the deficits associated with Federal, sub-federal and local budgets, and extrabudgetary funds) amounted to over 40 per cent. of GDP. A reduction in the enlarged budget deficit was the essential precondition for progress toward the realisation of the financial stabilisation objectives of Russia’s economic reform programme. The enlarged budget deficit was 9.2 per cent. of GDP in 1996, and 8.1 per cent. of GDP in 1997. During the first quarter of 1998, the enlarged budget deficit represented 5.8 per cent. of GDP for the same period. The Federal budget deficit stood at 4.5 per cent. of GDP for the first quarter of 1998, down from its level of 5.2 per cent. of GDP for the first quarter of 1997.

Prior to 1995, non-inflationary alternatives to monetary financing of the budget deficit were not well developed and the deficit was largely financed in a manner which fueled inflation. See “Monetary and Financial System – Monetary Policy – Money Supply and Inflation.” Significant sources of non-inflationary finance first became available with the emergence of the market for state treasury bills (GKO/OFZ). As a result, monetary financing dropped to 1.6 per cent. of GDP in 1995, from 9.1 per cent. of GDP in 1994. The availability of a substantial source of non-inflationary deficit finance has been an important factor in Russia’s progress towards achieving its stabilisation goals.

The enlarged budget deficit increased in 1996, primarily as a result of developments associated with the political uncertainties produced by the presidential election, which led to a sharp increase in debt service costs in the second half of the year and in the first half of 1997, as investors in the GKO/OFZ market demanded higher yields, and to a shortfall in revenues, as enterprises deferred payment of taxes. For the most part, the resulting deficit was financed through further GKO/OFZ issuances: GKO/OFZ financing amounted to 5.8 per cent. of GDP and accounted for 74 per cent. of total deficit

financing in 1996. Monetary financing dropped thereafter, and stood at only 27 per cent. of total deficit financing and 2.2 per cent. of GDP in 1996, while the level of GKO/OFZ deficit financing (not including purchases of GKO/OFZs by the Central Bank, which are counted as part of monetary financing) was 59 per cent. of all deficit financing and 4.7 per cent. of GDP.

In 1997, Russia's Federal budget deficit declined to 6.7 per cent. of GDP, from 8.1 per cent. of GDP in 1996. The "primary deficit" (the deficit net of payments in respect of interest) declined slightly in 1997, from 2.4 per cent. of GDP in 1996 to 2.1 per cent. of GDP. In the first quarter of 1998, Russia had a primary surplus of 0.5 per cent. of GDP for the same period. Interest expenditure was lower (4.5 per cent. of GDP) in 1997 than in 1996 (5.7 per cent. of GDP) but increased to 5.0 per cent. of GDP for the first quarter of 1998 due to the servicing of debt with higher interest rates issued at the end of 1997.

Monetary financing represented 17.5 per cent. of total deficit financing and 1.1 per cent. of GDP in 1997, while GKO/OFZ financing represented about 70 per cent. of total deficit financing and 4.7 per cent. of GDP. Monetary financing had been very low or negative during the first ten months of 1997, but increased in November due to substantial secondary market purchases of GKO/OFZs by the Central Bank. See "Monetary and Financial System – Monetary Policy – Recent Developments." During the first quarter of 1998, monetary financing of the Federal budget deficit was 0.7 per cent. of GDP for that period.

Sales of gold, other precious metals, and precious stones have been used by the Government largely as a flexible source of financing rather than a regular source. Gold sales are conducted in two ways. The first involves the sale by the Ministry of Finance of gold from its reserves, proceeds of which are recorded as monetary financing. The second involves the acquisition by the Ministry of Finance of precious metals or stones in connection with the Government's financing of the precious metals industry (see "Balance of Payments – Official International Reserves") followed by their sale in domestic or external markets. Such sales do not reduce Government reserves, and proceeds are treated as non-monetary financing. Sales of gold and precious metals and stones were of limited significance in 1997, accounting for less than 1 per cent. of total deficit financing.

Privatisation revenues are classified as "deficit financing" under the international accounting methodology used herein. Prior to 1997, such proceeds were of limited significance as a source of deficit financing. During 1997, however, the Government sold significant stakes in large companies at commercial auctions generating substantial proceeds. For the year, privatisation proceeds accounted for about 10.8 per cent. of federal budget deficit financing (0.7 per cent. of GDP).

Foreign disbursements, including tied and untied credits but excluding IMF disbursements, amounted to 12.0 per cent. of GDP in 1992, but dropped substantially in 1993 and have remained low since, representing only 2.0 per cent. of GDP in 1997. Net of cash principal repayments to foreign lenders, foreign financing was 1.5 per cent. of GDP in 1997 and 1.1 per cent. of GDP during the first quarter of 1998.

Federal-Local Fiscal Relations

The political and economic reforms initiated at the end of 1991 included laws establishing a new distribution of revenues and expenditures among the Federal, sub-federal and local governments in the Russian Federation. The basic principle of this legislation was that sub-federal authorities should set budgets based on the existing tax system, taking into account the distribution of expenditure responsibilities as laid down in the Federal budget and transfers allocated to them.

The Fund for Regional Support was established in 1994 to be the primary source of Federal transfers to regional governments. The revenues to be received by the Fund are set forth in the budget law. The 1998 budget law provides for an allocation to the Fund of 14 per cent. of total Federal tax receipts, with the exception of import tariffs. In 1997, actual allocations to the Fund were 32.7 trillion roubles, representing 15.1 per cent. of total Federal tax receipts, excluding import tariffs.

Since the initiation of reforms, significant progress has been made in Russia in the area of Federal-regional fiscal relations. However, some Russian regions have at times failed to comply with Federal

budget legislation. Other Federation subjects have retained value added tax revenues in excess of the amounts allocated to sub-federal budgets rather than waiting for such excess revenues to be returned to them through Federal transfers. Still others have bargained for a larger share of the taxes collected in their region and for larger transfers from the Federal budget, on the grounds that the Government had increased sub-federal expenditure responsibilities without providing to them corresponding sources of revenue. The Government's aim is to eliminate special fiscal arrangements with particular Federation subjects, and to prevent funds owed to the Federal budget from being diverted to sub-federal budgets. Accordingly, the Government will continue to explore ways of rationalising its fiscal relations with the regions.

Local Budget Revenue and Expenditure

Sub-federal governments are directly assigned a specified portion of the revenue from certain taxes collected in their jurisdictions: currently, 100 per cent. of personal income taxes; 100 per cent. of land and property taxes; 50 per cent. of most excise taxes (no portion of oil, gas and petrol excises); and 80 per cent. of natural resource taxes. Federation subjects do not, however, enjoy the statutory right to alter the tax base or to increase the marginal rate of these taxes. Federation subjects may impose their own profit taxes at rates up to 22 per cent. in excess of the Federal rate of 13 per cent., and they are directly assigned 25 per cent. of domestic VAT revenues. In addition, the Government allocates a portion of its tax revenues to the Fund for Regional Support for redistribution to the regions.

Local budget expenditure (including expenditure financed by Federal transfers and Federal budget loans) was equal to approximately 17.5 per cent. of GDP in 1997. Expenditure on education and social policy is substantial (each approximately 1 per cent. of GDP), reflecting the transfer of social expenses from enterprises to local authorities since 1992. Sub-federal and local governments now pay for about 75 per cent. of total public expenditure on subsidies, 85 per cent. of education expenditure, 90 per cent. of health expenditure and 85 per cent. of social expenditure.

Extrabudgetary Funds

Russia had more than 60 extrabudgetary funds in 1992 and 1993, which significantly complicated fiscal management. Since that time, most of these funds have been consolidated in the Federal budget, and at present there are only eight extrabudgetary funds remaining: the Pension Fund, Social Insurance Fund, Employment Fund, Medical Insurance Fund, Fund for Social Support of the Population, Local Road Fund, Russian Fund for Technological Development and Fund for Financing of Research and Development. In the future, the Government plans to consolidate into the Federal budget all remaining extrabudgetary funds other than the Pension Fund, Social Insurance Fund and Employment Fund.

The four largest extrabudgetary funds are the Pension Fund (expenditures of 176.2 trillion roubles during 1997); the Local Road Fund (estimated expenditures of 32.5 trillion roubles), the Social Insurance Fund (30.4 trillion roubles) and the Medical Insurance Fund (29.0 trillion roubles). Together, these funds account for more than 96 per cent. of total extrabudgetary expenditure. The Pension Fund, Social Insurance Fund, Employment Fund and Medical Insurance Fund raise revenue from a 38.5 per cent. payroll tax and a 1 per cent. tax on wages. The Pension Fund and Employment Fund also derive substantial revenue from the Federal budget. Revenue for the Local Road Fund is provided by certain corporate and personal taxes.

In general, the current extrabudgetary funds have remained broadly balanced since their creation in 1992, reflecting the stable revenue base from which they are supported. In 1995 and 1996, the Pension Fund recorded significant deficits in part as a result of a shortfall in revenues (due to rising unemployment and a lack of contributions from the informal private sector), in part as a result of a rise in the number of people qualifying for benefits and in part as a result of increases in the level of pension benefits, which are determined by reference to the minimum pension set by the Duma. The deficit was covered by loans from the Federal budget, the Employment Fund and from banks. The Pension Fund deficit for 1997 was 3.5 trillion roubles (on the basis of preliminary data). The

Government is considering a variety of pension reform measures, including a plan to link pensions to changes in the rate of consumer price inflation and the growth in Pension Fund revenues rather than to the minimum pension.

The 1998 Federal Budget Law

The following table sets out planned revenues and expenditures according to the 1998 Federal budget law (but see “– Revised Fiscal Programme for 1998” for a discussion of currently anticipated revenues and expenditures for the year):

	1998 Federal Budget Law ⁽¹⁾		
	(millions of redenominated roubles)	(% of GDP)	(% of total)
Total revenue	350,952	12.4	100.0
<i>of which</i>			
Profit taxes	48,141	1.7	13.7
VAT	141,270	5.0	40.3
Excise taxes	78,700	2.8	22.4
Natural resources taxes	8,448	0.3	2.4
Revenue from foreign economic activity	30,935	1.1	8.8
Other revenue	43,458	1.5	12.4
<i>of which</i>			
Central Bank profit transfer	2,000	0.1	0.6
Revenue of Budgetary Funds	32,079	1.1	9.1
Total expenditure	493,200	17.4	100.0
National economy (subsidies)	55,228	1.9	11.2
Social and cultural sphere	67,324	2.4	13.7
State administration	12,056	0.4	2.4
Law and order	46,008	1.6	9.3
Defence	81,765	2.9	16.6
Expenditure on foreign economic activity	14,497	0.5	2.9
Debt service ⁽²⁾	124,135	4.4	25.2
<i>of which</i>			
GKO interest	63,500	2.2	12.9
Other expenditures	92,187	3.2	18.7
<i>of which</i>			
Budgetary funds	32,079	1.1	6.5
Transfers from Federal budget	39,184	1.4	7.9
Deficit	142,248	5.0	
Primary Deficit ⁽³⁾	18,112	0.6	
Memo:			
Nominal GDP	2,840,000		

Notes:

⁽¹⁾ In accordance with international definitions used throughout this section.

⁽²⁾ May be increased by the Government by up to 18 billion redenominated roubles in unfavourable financial circumstances, with other expenditure items to be proportionally reduced.

⁽³⁾ Taking into account Russia's projected domestic Government debt service requirements for 1998, expenditure for debt service will be higher than envisaged in the table above (see note 2 above). As a result, Russia is expected to have a zero primary deficit for the year.

Source: Ministry of Finance.

A draft 1998 Federal budget law was approved by the Duma in its third reading at the end of January 1998. However, prior to the final reading, the Government proposed new amendments to the draft calling for reduction of planned expenditures to address the increase in borrowing costs and higher future debt services requirements attributable to developments in the financial markets associated with the Asian currency crisis in the last quarter of 1997. As amended, the draft 1998 budget law was adopted by the Duma in its fourth reading on 4th March 1998 and by the Federation Council on 12th March 1998. The law was signed by the President on 26th March 1998.

In its amended form, the 1998 budget law, envisages revenue of 351 billion redenominated roubles, or 12.4 per cent. of GDP, with VAT representing 40.3 per cent. of the total, profit taxes representing 13.7 per cent. of the total and excise taxes representing 22.4 per cent. of the total. Expenditure is planned at 493.2 billion redenominated roubles, or 17.4 per cent. of GDP. More than one quarter of total expenditure is accounted for by debt service. The limits on new net borrowings envisaged by the 1998 budget law, combined with anticipated financing via privatisation and net gold receipts, envisage a deficit of up to 142.2 billion redenominated roubles, or 5.0 per cent. of GDP. This implies a primary deficit of 18.1 billion redenominated roubles, or 0.6 per cent. of GDP. The revenue, expenditure and other assumptions underlying the 1998 budget law have been developed with reference to the IMF performance criteria for the year, and are consistent with such performance criteria. See "Public Debt – Relations with International Financial Institutions."

Unlike the 1997 budget law, the Federal budget law for 1998 does not provide for mandatory sequestration of expenditures or introduction by the Government of a sequestration law in specified circumstances involving shortfalls in revenue or deficit financing. See "– Federal Budget Process – Budget Execution." Nonetheless, because the 1998 budget law places a cap on the total permissible budget deficit, the Government will be required to sequester expenditures in response to any such shortfalls. The 1998 budget law grants the Government authority to do so, but requires that all expenditures (other than specified expenditure items including debt service, transfers to Federation subjects, seasonal supplies and international activities) be reduced proportionally, with deviations from proportionality not to exceed 5 per cent.

There are no protected expenditure items identified in the 1998 budget law. As noted above, however, under the budget law, debt service is exempt from the requirement of proportional reduction when expenditure is reduced, and the Government is authorised to increase debt service expenditure by up to 18 billion redenominated roubles over budgeted levels, with other expenditures to be proportionately reduced.

Article 31 of the 1998 budget law provides that only those contracts relating to loans incurred in 1998 which are set out in a "Programme of state external borrowings of the Russian Federation in 1998" (the "Programme") may be performed in 1998. The Government is required to submit the Programme for approval to the Duma within 30 days of the effective date of the 1998 budget law. The 1998 budget law became effective on 31st March 1998, and the Government submitted the Programme for approval to the Duma on 16th April 1998. On 1st July 1998, the Duma approved the Programme. The Programme as so approved does not encompass the Bonds (or certain other anticipated external borrowings of the Russian Federation, including the new IMF facility described under "Public Debt – Relations with International Financial Institutions"), and an amendment to the Programme is expected to be submitted shortly, as contemplated by Article 3 of the 1998 budget law.

Revised Fiscal Programme for 1998

In response to the recent pressure on the GKO/OFZ markets (see "Monetary and Financial System – Monetary Policy – Recent Developments"), and as permitted by the Budget Law, the Government adopted a new fiscal programme for 1998 (the "Fiscal Programme") in order to cut expenditures in light of reduced revenues. Under the Fiscal Programme, 1998 revenue is projected to be 290 billion redenominated roubles, or 10.6 per cent. of GDP, which represents a reduction by more than 60 billion redenominated roubles compared to the budgeted amount. The Fiscal Programme envisages a reduction of non-interest expenditure by 74 billion redenominated roubles, of which a cut of 42 billion

redenominated roubles represents a permanent reduction of various budget commitments. The Fiscal Programme also provides for a shift towards external sources in deficit financing (see "Public Debt – Domestic Debt – Government Domestic Debt Policy"). In addition, increased privatisation revenues and net gold receipts are expected to bring further reduction in the required amount of expensive domestic borrowing.

The following table sets out planned revenue and expenditure for 1998 under the Fiscal Programme:

New Fiscal Programme for 1998		
	<i>(millions of redenominated roubles)</i>	<i>(% of GDP)</i>
Revenue	289,600	10.6
Expenditure	432,700	15.9
Interest expenditure	137,600	5.1
GKO/OFZ	90,000	3.3
Non-interest expenditure	295,100	10.8
Balance	(143,100)	(5.3)
Deficit financing	143,100	5.3
Foreign financing	23,700	0.9
Domestic financing	119,400	4.4
Privatisation	15,000	0.6
Net gold receipts	4,200	0.2
Other domestic financing	100,200	3.7
Expenditure cuts	(74,210)	(2.7)
reduction of budget commitments	(41,900)	(1.5)
other expenditure cuts	(32,310)	(1.2)
of which transfers and loans to regions	(11,300)	(0.4)
Nominal GDP	2,720,000	

Proposed New Tax Code

President Yeltsin called for a sweeping reform of the tax system through the rapid adoption of a new tax code in his 1997 State of the Nation Address and reiterated the necessity of such action in his address in 1998. The Ministry of Finance proposed a new tax code, the initial version of which was passed by the Duma on its first of three readings on 19th June 1997. The draft tax code was subsequently considered by a reconciliation commission comprising members of the Government, the Duma and the Federation Council with a view to preparing a revised draft tax code for submission to the Duma for its further readings. However, later in 1997, this initial version was rejected by the Duma. On 1st February 1998, the Government submitted an amended version of the tax code to the Duma. The Duma has passed that draft on the first of its three readings on 16th April 1998. The general part of the new tax code dealing with the legislative aspects of taxation in Russia was approved by the Duma and the Federation Council on 17th July 1998. The Government currently expects that a new tax code will come into force in 1999. However, no assurance can be given that a new tax code will be adopted or, if adopted, that it will be adopted in the form described herein.

The main objectives of the Government's current proposed draft tax code are to reduce the total number of taxes, improve the stability, transparency and fairness of the system through the elimination of many tax exemptions and reduce the overall tax burden on the Russian economy. Certain significant aspects of the Government's proposed new tax code are summarised below.

The proposed new tax code would reduce the total number of taxes significantly, from the current level of about 200 to no more than 30. Regional and local authorities would be permitted to impose only such taxes as are contemplated by the tax code. Implementing regulations will not be required, which it is hoped will contribute to the stability of the tax system and the uniformity of tax administration.

All enterprises, with the exception of a relatively insignificant group of enterprises supplying certain services to the public, will be required to move to an accrual basis of accounting for tax purposes (from the current modified cash basis).

Significant new taxes would include a retail sales tax imposed on all goods (excluding certain socially significant goods) at the rate of up to 5 per cent., and on luxury goods at the rate of up to 10 per cent., to be imposed and collected by regional authorities. Investment income (including income on deposits and government securities) would be subject to a new federal tax at the rate of 12 per cent. VAT would remain basically unchanged, amounting to 20 per cent. on most goods and 10 per cent. on food products and goods for children. The ceiling for the profits tax would be decreased from 35 per cent. to 30 per cent. The method of calculation of the tax basis would be revised significantly, to be the difference between revenue from sales and costs that are related to production and marketing. Expenditures on advertising, interest payments, and insurance premiums would be allowed to be included in such costs. Finally, personal income of up to 20,000 redenominated roubles per annum would be subject to a minimum 12 per cent. income tax rate, and income above 100,000 redenominated roubles would be subject to a maximum 35 per cent. rate.

Stabilisation Programme

At the end of June 1998, the Government proposed a series of measures intended to stabilise the Government's finances (the "Stabilisation Programme"). Certain of these measures are to be adopted through Presidential decrees and Government resolutions. Other measures are to be reflected in Federal laws, and a number of bills have been submitted to the Federal Assembly.

The main goals of the Stabilisation Programme are to increase Government revenue and to reduce Government expenditure. The increase in revenue is intended to be achieved by putting into effect certain measures envisaged by the new tax code before its adoption by the Federal Assembly and several other measures, including the introduction of lump-sum taxation for small enterprises, the enhancement of control over alcohol production, a reduction in the rates of personal income tax in conjunction with an expansion of the income base to which personal income tax applies, the abolition of double-tax treaties with certain off-shore zones and the application of bankruptcy procedures to enterprises with tax arrears. The measures intended to reduce Government expenditure include a reduction in the personnel of Federal bodies, the cutting of subsidies to agriculture and transport, the consolidation of some of the extrabudgetary funds with the Federal budget and a shift towards targeted as opposed to general social support in conjunction with a reduction in the number of beneficiaries of such support. No assurance can be given, however, that the Stabilisation Programme will be adopted in the form described herein or in its entirety or that it will attain its intended objectives.

The Duma has considered a number of the proposed measures and certain of them have been adopted by the Duma. These measures include the establishment of a state monopoly on alcohol production, permission to regions to levy a tax of up to 5 per cent. on sales of goods and services (except for necessity goods and certain services), the introduction of a tax on imputed income of small business, the introduction of a tax on the casino and gambling industry, as well as the implementation of targeted social support in conjunction with a reduction in the number of beneficiaries of such support. The Duma has failed to pass several other measures proposed by the Government, including bills intended to change the income tax law and to increase the land tax. Passage of these bills is a condition to the disbursement of the first tranche of the stabilisation facility provided by the IMF. See "Public Debt – Relations with International Financial Institutions." It is expected that certain of these measures to increase revenue will be adopted by Presidential decrees and Government resolutions. On 20th July 1998, the President signed a decree increasing the land tax. In addition, in response to the Duma's failure to pass certain legislation, the President vetoed the reduction of the profits tax from the present 35 per cent. to 30 per cent. and the reduction of the excise tax on oil from 55 roubles to 25 roubles per tonne, measures initially proposed as part of the Stabilisation Programme. The Government also intends to abolish the reduced VAT rate and increase import tariffs by 3 per cent.

MONETARY AND FINANCIAL SYSTEM

The Central Bank of the Russian Federation

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

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

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

The Central Bank's governor, who also heads its 12-member board of directors, is nominated by the President and confirmed by the Duma. The governor is appointed for a four year term, and under the Central Bank Law may not be dismissed except for violation of a Federal law relating to the activities of the Central Bank, or of a criminal law. The current governor of the Central Bank started his term on 22nd November 1995. Members of the board of directors of the Central Bank are nominated by the Central Bank governor and confirmed by the Duma for four year terms, and may be dismissed only with the approval of the governor. Board members may not be officers of the Government or members of the Federal Assembly.

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

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

Monetary Policy

Money Supply and Inflation

The following table sets forth information concerning Russia's money supply at year-end for 1993 to 1997 and as at 30th April 1998:

	Monetary Survey ⁽¹⁾					As at 30th April 1998
	As at 31st December					
	1993	1994	1995	1996	1997	
	<i>(billions of roubles)</i>					
Net foreign assets.....	28,576	59,387	70,216	49,335	6,503	(15)
Monetary authorities.....	17,483	24,544	54,044	35,353	47,908	34,028
Banking system.....	11,093	34,843	16,172	13,982	(41,405)	(34,043)
Domestic credit extended by the Central Bank and the banking system.....	44,413	193,640	363,673	539,298	669,441	693,911
Net claims on enlarged government.....	8,458	71,127	166,578	311,467	378,907	411,176
Claims on non-financial public enterprises.....	15,726	48,424	62,546	69,439	64,366	29,566
Claims on private sector.....	20,229	74,089	134,024	158,150	226,158	247,409
Claims on other financial institutions.....	—	—	525	242	9	5,762
Broad money.....	40,983	129,731	275,780	357,324	462,849	444,140
Money ⁽²⁾	23,881	68,544	151,267	192,402	270,602	269,489
Quasi-money ⁽³⁾	17,102	61,187	124,513	164,922	192,247	174,651
Money market instruments.....	211	3,516	11,859	30,372	27,868	39,636
Capital accounts (capital of banking system).....	16,663	49,374	99,768	177,996	220,222	220,989
Other items, net.....	15,167	70,406	46,489	22,940	(34,995)	(27,264)
Memo: ⁽⁴⁾						
Base money (national definition) ⁽⁵⁾	16,649	48,188	103,800	130,900	164,500	161,200
Net international reserves (NIR) ⁽⁶⁾	7,958	8,100	35,700	9,500	22,400	8,400
Net domestic assets (NDA).....	8,691	40,088	68,100	121,400	142,100	152,800
Rouble broad money (M2) (national definition) ⁽⁷⁾	33,200	97,800	220,800	295,200	374,100	368,000
Velocity of M2 ⁽⁸⁾	10.5	10.4	10.4	9.8	8.3	6.7

Notes:

⁽¹⁾ Certain data presented in this table for 1995, 1996 and 1997 differ from previously published data due to regular revisions by the Central Bank.

⁽²⁾ Comprises cash outside banks and demand deposits (other than deposits of the enlarged government) within the banking system (M1).

⁽³⁾ Comprises time and savings deposits and foreign currency deposits within the banking system.

⁽⁴⁾ Only aggregates denominated in roubles.

⁽⁵⁾ Comprises cash outside the Central Bank and reserves of commercial banks maintained at the Central Bank.

⁽⁶⁾ The NIR figures presented differ from those presented in the table "Official International Reserves" due to the fact that the NIR figures presented in this table include liabilities in the form of option and forward contracts.

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

⁽⁸⁾ Annualised nominal GDP (last month of period) divided by M2 (end of period).

Source: Central Bank.

The principal aim of the Central Bank's monetary policy since 1992 has been to restrain the growth of the money supply in order to curb inflation and achieve financial stabilisation. Between 1992 and 1994, however, achievement of this aim was hampered by the fact that the Government had no substantial non-inflationary sources of financing available to it, resulting in significant monetary financing of the deficit. See "Public Finance – Deficit Financing." Accordingly, this period saw a number of significant instances of monetary financing by the Central Bank which gave rise to significant periods of inflation and largely explain the very large annual increases in prices in these years.

Since October 1994, however, in the wake of "Black Tuesday" (see "– Exchange Rates"), the Central Bank has succeeded in slowing the growth of the money supply. Underlying this success were the emergence of the GKO/OFZ market as a dependable source of non-inflationary financing in 1993 (reflected in net claims on the enlarged government), followed by the enactment of amendments to the Central Bank Law in April 1995 which prohibited direct monetary financing of the budget deficit. As a result, money supply growth was relatively modest in the period from 1995 through 1996, as reflected, among other things, in growth of M2 over this period. This trend continued during 1997, when M2 rose by 26.7% compared with year-end 1996 and amounted to 374.1 trillion roubles at the end of 1997.

The sources of growth in the money supply have varied in recent years. In 1995, the main source of growth in base money was the significant increase in net international reserves during the last three quarters of the year. In 1996, by contrast, net international reserves decreased, offsetting in part a substantial increase in net domestic assets. The increase in net domestic assets was partly attributable to the conversion into roubles of disbursements under the IMF's EFF and the purchase of GKO's by the Central Bank. In June 1996, when budgetary pressures were most acute, the Central Bank was instructed to make a transfer of 1994 profits to the Government, and monetary financing accordingly rose for the first six months of the year. The Central Bank managed the inflation risk associated with this transfer by increasing reserve requirements temporarily. In February 1997, net international reserves began to increase, reflecting the inflow of foreign capital and growing demand for roubles, but have since declined. See "Balance of Payments and Foreign Trade – Official International Reserves." At 1st May 1998 base money stood at 161.2 billion redenominated roubles, of which net international reserves were 8.4 billion redenominated roubles and net domestic assets were 152.8 billion redenominated roubles.

The following table illustrates the rise in consumer and producer prices at period-end for the years 1992 to 1997:

Inflation: Consumer and Producer Prices		
	Consumer Price Inflation (annual, unless otherwise indicated)	Producer Price Inflation (annual, unless otherwise indicated)
	<i>(per cent. change, end of period)</i>	
1992	2,641.9	3,377.7
1993	841.6	902.6
1994	202.7	235.1
1995	131.4	181.8
1996	21.8	25.9
1997	11.0	7.4
1998 January – May ⁽¹⁾	4.0	0.5

Note:

⁽¹⁾ As compared with the respective levels at the end of 1997.

Source: Goskomstat.

Changes in the implementation of monetary policy over time are evident in Russia's inflation statistics. Price liberalisation in January 1992 gave rise to a sudden jump in price levels, reflecting the suppressed inflation arising in the last years of the Soviet Union, when the money supply and real wages increased significantly but price controls remained in place. The overall level of inflation in 1992 and in the two years that followed, however, is explained in significant part by large budget deficits and by the extent of monetary financing. Reduced levels of inflation since then have in part reflected reduced deficits and the increased level of GKO/OFZ (non-monetary) deficit financing. In 1997, overall consumer price inflation totalled 11.0 per cent., down significantly from the 1996 level of 21.8 per cent. Similarly, producer price inflation was substantially reduced, from 25.9 per cent. in 1996 to only 7.4 per cent. in 1997. In 1998, the Central Bank intends to continue the implementation of its financial stabilisation policy. Its targeted average inflation in 1998 ranges between 0.4 per cent. and 0.6 per cent. per month, giving a range of 5 per cent. to 8 per cent. on an annual basis. It is expected that growth of the money supply will be limited within the range of 22 per cent. to 30 per cent. During the first 5 months of 1998, consumer prices rose by 4.0 per cent. and the producer prices rose by 0.5 per cent., in both cases compared with their level at the end of 1997.

Instruments of Monetary Policy

The primary instruments of monetary policy employed by the Central Bank are: interest rates and lending to commercial banks; open-market operations (including the purchase and sale of Government securities in the secondary market); and reserve requirements for banks.

Since 1992, the Central Bank has maintained an official refinancing rate for its lending activities. The refinancing rate has generally remained above the rate available on the interbank market and most borrowing by commercial banks has accordingly been interbank borrowing. The refinancing rate thus has not been used extensively for the refinancing of commercial banks, and has been of importance primarily for statistical purposes and for tax, penalty and other calculations.

Since October 1996 the Central Bank has maintained a standing lombard-credit facility under which commercial banks are permitted to borrow funds at a given discount rate at any time against appropriate collateral. In addition, a test programme is underway, currently limited to the ten soundest banks, involving overnight credits. Finally, the Central Bank has recently begun to enter into repurchase operations (with GKOs), although such operations have been quite limited to date.

The Central Bank also holds periodic deposit auctions in order to absorb excess liquidity, conducts open market operations and maintains reserve requirements. Currently, reserve requirements for both hard currency and rouble deposits are 11 per cent. irrespective of maturity of the deposits. Banks that fail to meet their reserve requirements face escalating cash penalties for each day that reserves are inadequate. No interest is paid either on reserve requirements or on excess reserves (correspondent accounts) held by commercial banks at the Central Bank.

Exchange Rates

Exchange rate policy is formulated by the Government in consultation with the Central Bank and the Ministry of Finance, and is implemented by the Central Bank. The primary goal of this policy is to ensure the external stability of the rouble.

The following table sets forth information with respect to rouble/U.S. dollar exchange rates for the years 1992 to 1997 and the first six months of 1998:

**Official Rouble/
U.S. Dollar Exchange Rates**

	Average ⁽¹⁾	End of Period
1992	226	415
1993	992	1,247
1994	2,191	3,550
1995	4,559	4,640
1996	5,125	5,560
1997	5,787	5,960
1998 January – June ⁽²⁾	6.101	6.198

Notes:

⁽¹⁾ Simple average.

⁽²⁾ Redenominated roubles.

Source: Goskomstat.

Following the initiation of reforms, high inflation caused the value of the rouble to decline in nominal terms more or less consistently. From 1992 to 1995, the rouble fell in value relative to the U.S. dollar at a slower rate than the inflation rate, thus appreciating in real terms against the U.S. dollar. This real appreciation amounted to 263 per cent. in 1992, 249 per cent. in 1993, 11 per cent. in 1994, 77 per cent. in 1995. Although the rouble depreciated by 1.2 per cent. in real terms against the U.S. dollar in 1996, reflecting the relatively low rate of inflation for the year, in 1997, the rouble appreciated by 1.8 per cent. against the U.S. dollar in real terms, primarily because of the pressure associated with the Asian currency crisis. During the first 5 months of 1998, the rouble appreciated against the U.S. dollar in real terms by 0.4 per cent.

Between 1992 and 1994, periodic fluctuations of the value of the rouble increased the uncertainty of the overall economic environment and fuelled inflationary expectations, undermining progress towards financial stabilisation. The most extreme example of these fluctuations came on 11th October 1994 ("Black Tuesday"), when the rouble lost more than 25 per cent. of its value against the U.S. dollar in a single day, before rebounding to its original level in the days that followed.

These events led to renewed support for a commitment to a policy of fiscal and monetary restraint. The consistent implementation of this policy, particularly after the first quarter of 1995, succeeded in stabilising the value of the rouble. Since July 1995, the Central Bank has successfully maintained the exchange value of the rouble against the U.S. dollar within a pre-set range (the "rouble corridor"). The corridor was initially set at 4,300-4,900 roubles to the U.S. dollar for the period through 1st October 1995 and, in late August 1995, was extended unchanged through 31st December 1995. A shift of the rouble corridor followed to 4,550-5,150 roubles to the U.S. dollar, and was successfully maintained through 30th June 1996. Until that time, the exchange rate has been set in an "inclining" corridor which moved from 5,000-5,500 roubles to the U.S. dollar at 1st July 1996 to 5,500-6,100 roubles to the U.S. dollar at 31st December 1996. Throughout the whole of 1997, the exchange rate was set daily in an "inclined" corridor which moved from 5,500-6,100 roubles to the U.S. dollar on 1st January 1997, to 5,750-6,350 roubles to the U.S. dollar on 31st December 1997. In November 1997, the Central Bank announced a change in exchange rate policy designed to allow the monetary authorities greater flexibility in accommodating shifts in short-term capital flows. Under the new policy, which covers the three years 1998 through 2000, exchange rates will be set within a flat trading band from 5.25 to 7.15 redenominated roubles to the U.S. dollar, representing a permitted variance of 15 per cent. on either side of the central exchange rate of 6.2 redenominated roubles to the U.S. dollar. The official rouble/U.S. dollar exchange rate as reported by the Central Bank on 20th July 1998 was 6.219 redenominated roubles to the U.S. dollar.

The Central Bank has taken further steps to strengthen the rouble and increase its role as a currency for the settlement of obligations between countries of the CIS. Among other things, the Central Bank has developed procedures that would allow central banks of the other CIS states to hold

a portion of their foreign currency reserves in Russian roubles through the investment of these assets in GKO/OFZs. In May 1997, an agreement to this effect was signed with the National Bank of Belarus.

Redenomination of the Rouble

In light of the stabilisation of the monetary system in the country, as of 1st January 1998, the Central Bank implemented a redenomination of the rouble, pursuant to which one thousand old roubles were exchanged for one new rouble. It is expected that throughout 1998 rouble bills with old and new nominal value will have parallel circulation. The old bills will be in circulation until 1999 and, thereafter, will be accepted by the Central Bank until 2002.

Recent Developments

The Asian financial crisis severely tested the stability of Russia's financial markets and the sustainability of the Central Bank's policy in the last quarter of 1997. In common with other similarly situated countries, Russia experienced significant capital outflows from financial markets, sharply lower foreign demand for Treasury bills and mounting pressure on reserves. The Central Bank responded by increasing the refinancing rate and the lombard rate on 11th November 1997 from 21 per cent. to 28 per cent., and by increasing the reserve requirements for foreign currency deposits with Russian banks from 6 per cent. to 9 per cent. These measures coincided, however, with the shift, described above, in long term exchange rate policy to a much wider intervention band of 15 per cent. either side of the central rate, which resulted in greater uncertainty, further constraining demand for GKOs. The Central Bank, concerned about the stability of the banking sector and the impact on the Federal budget, was initially unwilling to raise rates further, engaging instead in open-market purchases of GKOs while drawing on reserves in an effort to sterilise the incremental rouble liquidity.

The simultaneous support of both the GKO/OFZ market and the currency market soon proved to be unsustainable, and the Central Bank declared the primacy of exchange rate stability. Concurrently, it raised the lombard rate to 36 per cent., leaving the refinancing rate unchanged, and allowed GKO yields to rise.

In January 1998, further capital outflows from financial markets and renewed pressure on the GKO/OFZ market led the Central Bank to raise the refinancing rate and the lombard rate further, to 42 per cent. Effective 2nd February 1998, reserve requirements for both foreign currency and rouble deposits, irrespective of maturity, were raised to 11 per cent. Due to renewed foreign demand, GKO yields, after having risen to more than 45 per cent., declined, eventually allowing the Central Bank to reduce the refinancing rate and the lombard rate to 30 per cent. By the end of March 1998, average GKO yields had fallen to approximately 26 per cent.

In mid-May, further capital outflows and renewed pressure on the rouble and the GKO/OFZ market led the Central Bank to raise the lombard rate from 30 per cent. to between 36 per cent. and 40 per cent. (depending on the maturity of the credit), leaving the refinancing rate unchanged. When this proved to be insufficient, the Central Bank raised both the lombard and the refinancing rates to 50 per cent. Despite these actions, GKO yields continued to climb, reaching 80 per cent. in late-May. At this point, the Central Bank raised the lombard and refinancing rates dramatically – to 150 per cent. This step, together with other measures, helped relieve pressure on the rouble and reduce GKO yields (to below 50 per cent.); on 4th June 1998, the Central Bank reduced the lombard and refinancing rates to 60 per cent. However, due to resumed capital outflows from the GKO/OFZ market later that month, the Central Bank raised once again the lombard and refinancing rates to 80 per cent. on 29th June 1998.

Banking

Structure of the Banking Industry

All credit institutions are required to be licensed by the Central Bank. The most comprehensive licence available is a licence for general banking, which allows a credit institution to engage in all types of banking operations in a range of prescribed currencies. Under Russian law, commercial

banks holding general licences are allowed to own, underwrite and deal in all types of securities. Banks without a general licence require a separate licence to conduct foreign exchange operations.

There were 1,616 licensed banks and 25 non-bank credit organisations in Russia at 1st April 1998, 264 with general licences and 669 with foreign exchange licences. On the same date, licences had been issued to 16 wholly foreign-owned banks and 11 banks that are more than 50 per cent. foreign owned; there were also 140 representative offices of foreign banks in Russia as well. Only two banks, Sberbank and Vneshtorgbank, are controlled by the Central Bank. As at 1st April 1998, Sberbank, the successor of the former state savings bank in the Soviet Union, held approximately 72 per cent. of all household deposits and itself accounted for 26.3 per cent. of total banking assets. Wholly owned foreign banks, as at 1st April 1998, held only 5 per cent. of total banking assets, reflecting regulatory restrictions on their permissible activities. These restrictions were lifted, however, at the start of 1996, and foreign banks are now entitled to participate in the same range of banking activities as their Russian counterparts.

There were 34,755 branches of operating domestic banks as at 1st April 1998. Some 88 per cent. of all branches, however, are Sberbank branches.

Household deposits, other than deposits with Sberbank made before 1992, are not guaranteed by the state. The Duma is considering draft legislation that would establish a deposit insurance fund, funded by the commercial banks. The deposit insurance law, if enacted, is expected to enable other banks to compete more effectively with Sberbank in the market for private household deposits.

Banking Supervision and Regulation

Within the Central Bank a special supervisory department ("OPERU 2") has been established to monitor the affairs of the largest national banks. Fourteen banks have been made subject to OPERU 2 supervision, and it is expected that this number will remain unchanged over the next two years. These 14 banks represent approximately 50 per cent. of Russia's banking assets (excluding assets of Vnesheconombank) and over 90 per cent. of Russia's bank deposits.

The Central Bank operates an "early warning system" under which it analyses the most significant prudential ratios for all banks on a monthly basis. Banks that fail to comply with the reporting obligations imposed in connection with this system can be forced to close their correspondent accounts with other banks and make all settlements exclusively through the Central Bank. Among the ratios scrutinised are those relating to capital, overdue loans, open foreign exchange positions and loans to insiders. On the basis of these ratios, banks are placed in one of three groups, according to the level of risk of failure. On 1st April 1998, there were 401 banks in the highest risk group (representing 3.8 per cent. of total banking assets) and 212 in the next highest (representing 3.3 per cent. of total banking assets), indicating a likelihood of closure without the injection of new capital. These banks are generally small and borrow in the interbank market only to a limited extent. Accordingly, the risk that their closure would trigger systemic failure is low. Three of Russia's largest banks were closed or reorganised by order of the Central Bank in 1996 because of concerns over their soundness and the licenses of 282 banks were revoked. In 1997, the licences of 282 banks were revoked and 57 of Russia's credit organisations were liquidated. Additionally, the Central Bank imposed new temporary management on 13 banks during 1997.

In January 1996, the Central Bank issued a revised set of prudential standards ("Instruction No. 1") applicable to all banks (other than Sberbank) in order to move the Russian banking industry toward compliance with the capital adequacy standards of the Basle Accord. These regulations, as amended, impose more stringent requirements with respect to minimum capital, capital adequacy, exposure to individual borrowers and shareholders, deposit taking and equity investments in other companies. These requirements will be phased in over time, and are expected to be fully implemented by 1999. Approximately 400 of Russia's banks did not meet the applicable capital adequacy requirements in November 1997. As at 1st April 1998, there were 119 such banks, representing only 7.4 per cent. of all Russia's banks and 1.8 per cent. of total banking assets. Such banks will be required either to increase their capital, to merge or to liquidate.

Foreign Exchange Regulations

Russian currency exchange laws regulate the convertibility of the rouble.

Russian residents (including Russian legal entities and organisations formed under Russian law, Russian citizens, and permanent residents) may freely convert foreign currency into roubles through authorised banks. Russian residents may similarly convert roubles into foreign currency, but only if the purpose of the conversion is to settle a "current" transaction, to repay principal on a loan denominated in hard currency in circumstances where the hard-currency loan either did not require a Central Bank licence or was made on the basis of a Central Bank licence. The conversion of roubles into foreign currency in other circumstances would require a Central Bank licence. "Current" transactions include payments for imported or exported goods within 180 days of the date of sale, lending or borrowing money for terms of up to 180 days, and payments of interest, dividends, and certain other amounts in respect of loans, investments, or securities. As of 1st July 1996, Russia adopted Article 8 of the IMF's Articles of Agreement with respect to current account convertibility and since that time has met all obligations imposed by Article 8.

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

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

Foreign Exchange Market

Russia's foreign exchange trading takes place in the over-the-counter interbank currency market and the Moscow Interbank Currency Exchange ("MICEX"), with the biggest share of the currency trading taking place in the over-the-counter interbank currency market. It is through MICEX that the Central Bank buys and sells currencies when it acts to influence exchange rates. MICEX was established in 1991 as a department of the Central Bank's Soviet Union predecessor, and was transformed in January 1992 into a closed joint-stock company. As of 22nd May 1997, the Central Bank was its largest shareholder, owning 7.06 per cent. of its capital, followed by 28 Russian commercial banks each owning 3.3 per cent., the Ministry of Finance, the Moscow City Government, and the Association of Russian Banks, each of which owned 0.13 per cent. at that date.

Only MICEX members, which include commercial banks, financial institutions, and certain other investment institutions, may participate in currency exchange trading on MICEX. The Central Bank and MICEX have supported the establishment of a system of regional currency exchanges within Russia. There are currently seven regional exchanges. The largest currency exchanges include the St. Petersburg Currency Exchange and the Ural Regional Currency Exchange. MICEX has set up forward markets for roubles and GKO's.

The major currencies traded on MICEX are the U.S. dollar (approximately 80 to 85 per cent. of foreign exchange turnover) and the Deutsche mark (approximately 10 per cent. of turnover). Economic re-integration with CIS countries has been reflected in the quotation on MICEX of CIS currencies, which can be converted only in countries that have a special agreement on mutual currency convertibility.

Capital Markets

Government Securities

Russia has an active market in Government securities, which have typically been issued at relatively high yields. For a description of the various Government domestic debt instruments in issue and the markets for them, see "Public Debt – Domestic Debt – Government Domestic Debt."

Equity Securities

The trading of privatisation vouchers issued in connection with the mass privatisation programme played an important role in the development of an equity securities market in Russia. See "The Russian Economy – Private Sector Development". A certificateless securities system came to be adopted, largely in response to the voucher fraud encountered in the trading of vouchers. As a result, virtually all common and preferred stock in Russia is held via book entry, with ownership recorded in the issuer's share register.

The Russian stock market is based on an electronic over-the-counter trading system, the Russian Trading System (RTS), which was introduced in 1995. RTS is managed mainly by the National Association of Stock Market Participants ("NAUFOR"), a self-regulatory body that has developed rules for trading on RTS. The average daily turnover in the RTS in the second half of 1997 was U.S.\$81.2 million, up from U.S.\$42 million in the first half of 1997 but declined to U.S.\$73.2 million during the first five months of 1998. Although there are more than 60 licensed stock exchanges in Russia, exchanged-based trading is limited.

The market capitalisation of Russia's 21 most liquid companies rose from U.S.\$23.5 billion at the end of 1996 to U.S.\$56.8 billion at the end of September 1997 but declined considerably later in the year and stood at U.S.\$44.9 billion at the end of December 1997. The market capitalisation of all stocks traded on RTS declined from U.S.\$71.6 billion as at 1st January 1998 to U.S.\$58.9 billion as at 1st April 1998 and has declined to U.S.\$31.7 billion as at 1st June 1998.

Regulation of the Capital Markets

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

PUBLIC DEBT

External Debt

At the end of 1997, the total outstanding external debt of the Government, or for which the Government has agreed to be responsible, amounted to approximately U.S. per cent.123.5 billion. This amount included all loans contracted or guaranteed by the Government, loans contracted or guaranteed by Vnesheconombank, the Bank for Foreign Economic Affairs ("VEB"), and debt contracted or guaranteed by entities legally authorised to borrow on behalf of the government of the former Soviet Union, as well as outstanding arrears unpaid as at the end of 1997. Excluded from this amount are all undisbursed commitments and public or private sector borrowings not guaranteed by the Government, as well as obligations in respect of Internal Government Hard Currency Bonds ("OVZs," known as "Taiga" bonds or "MinFins"), which are domestic debt instruments. Since the end of 1997, the Government has incurred additional external debt through a 1.25 billion Deutsche Mark bond issue, a 750 billion Italian Lire bond issue, a 1.25 billion U.S. dollar bond issue, a 2.5 billion U.S. dollar bond issue and disbursements under multilateral, bilateral and commercial facilities. The Government has incurred no short term external borrowings since the end of 1997.

The following table sets forth information with respect to the Government's external debt at period end for the years 1992 to 1997:

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

	As at 31st December					
	1992	1993	1994	1995	1996	1997
	<i>(U.S.\$ billion)</i>					
Total external debt	107.7	112.7	119.9	120.4	125.0	123.5
External debt of the Government of the Russian Federation	2.8	9.0	11.3	17.4	24.2	32.1
Multilateral creditors	1.0	3.5	5.4	11.4	15.3	18.7
Bonds	0.0	0.0	0.0	0.0	1.0	4.5
Official creditors ⁽²⁾	1.8	5.5	5.9	6.0	7.9	7.6
Commercial creditors	0.0	0.0	0.0	0.0	0.0	1.3
External debt of the former Soviet Union, for which the Government of the Russian Federation has agreed to be responsible..	104.9	103.7	108.6	103.0	100.8	91.4
Multilateral creditors	0.0	0.0	0.0	0.0	0.0	0.0
Bonds	1.7	1.6	1.7	1.1	0.1	0.1
Official creditors ⁽²⁾	69.2	68.1	69.9	62.6	61.9	56.9
Commercial creditors ⁽³⁾⁽⁴⁾	34.0	34.0	37.0	39.3	38.8	34.4

Notes:

(1) Foreign currency values of outstanding external debt have been converted into U.S. dollars at the relevant market exchange rates prevailing at the end of the indicated period.

(2) Includes government-to-government credits and official export credits.

(3) Includes London Club creditors and uninsured trade suppliers.

(4) Subject to reconciliation.

Source: Ministry of Finance, Vnesheconombank.

Of the U.S.\$123.5 billion outstanding at the end of 1997, U.S.\$32.1 billion represented loans contracted or guaranteed by the Government since 1st January 1992. These obligations have been honoured in full.

The remaining U.S.\$91.4 billion represented external debt obligations of the former Soviet Union for which the Government has agreed to be responsible. In view of the short maturity of most of these obligations (approximately two-thirds fell due between 1992 and 1995, with more than half falling due in 1992 and 1993), and in the absence of sufficient foreign exchange to service them as scheduled, the Government was forced to seek to restructure these obligations beginning in December 1991. Notwithstanding the shortfall in foreign exchange, the Eurobonds issued by VEB prior to the dissolution of the former Soviet Union have always been honoured in full on their due dates.

Against this background, the objectives of the Government's external debt policy have been to regularise relations with the external creditors of the former Soviet Union as rapidly as possible, and to establish a profile for the repayment of the former Soviet Union debt that is consistent with its capacity to service these obligations.

External Debt Restructuring

Paris Club

In January 1992, the Government concluded an initial annual rescheduling agreement with the Paris Club of official creditors, followed by three further annual reschedulings in 1993, 1994, and 1995, covering debt service falling due during the period from December 1991 to the end of 1995. In April 1996, a comprehensive exit rescheduling was agreed with the Paris Club covering approximately U.S.\$33 billion of debts owed to Paris Club creditors, including debt rescheduled under previous agreements as well as virtually all future maturities. Of this amount, 45 per cent. will be repaid over a period ending in 2020, while the remaining 55 per cent. (which includes all short term debt owed to Paris Club creditors) will be repaid over a period ending in 2016. Rescheduled principal will be repaid in gradually increasing installments commencing in 2002.

London Club

VEB's comprehensive restructuring agreement in respect of Soviet-era debt owed to its London Club (commercial bank and other financial) creditors closed on 2nd December 1997. Under the terms of this restructuring, the entire stock of outstanding principal, amounting to approximately U.S.\$22.1 billion, will be repaid over a period ending in 2020 with the first principal repayment in 2002. The restructured principal will bear a floating rate of interest. During the grace period, the amount of interest payable in cash will be subject to a gradually increasing ceiling. Any resulting unpaid interest will be capitalised.

At the closing of the London Club restructuring, more than U.S.\$3.0 billion was paid in respect of interest arrears which fell due before the closing date. The remaining interest arrears, plus the interest capitalised on the restructured principal during the grace period, will be paid over a period ending in 2015, with the first principal repayment date in 2002, and will bear a floating rate of interest.

VEB is the legal obligor with respect to the restructured London Club debts, and the Government, acting on behalf of Russia, has issued a non-contractual declaration in support of VEB's London Club obligations. Although the Government is not the legal obligor with respect to these obligations, they have been included in the Government's external debt statistics.

Council for Mutual Economic Assistance Debt

Following the dissolution of the former Soviet Union, the Government assumed liability for Soviet-era debts owed to the former CMEA countries. These debts relate to the CMEA trade settlement systems that were in place between CMEA member countries; most were incurred as a result of an imbalance in the settlements in favour of the creditor country at the time of the dissolution of the CMEA and the Soviet Union. As of the end of 1997, CMEA debt amounted to U.S.\$14.9 billion. A substantial portion of this debt will be repaid in the form of equipment, goods or services, with the balance to be repaid in cash.

Other Former Soviet Union Debt

In December 1996, an agreement in principle was reached with representatives of twelve national creditor groups on the key financial terms of a restructuring of the uninsured trade indebtedness of the former Soviet Union. The agreement provides, in general, for cash payments equal to 25 per cent. of unpaid interest falling due between 1st January 1992 and the initial closing of the restructuring. Registered Notes will be issued in respect of the remaining interest and the outstanding principal. The Notes will be repaid over 22 years with the first principal repayment in 2002, and bear a fixed rate of interest from the date of issue up to the end of 2001 and a floating rate of interest thereafter. The legal structure for the rescheduling will be comparable to that agreed for VEB's London Club rescheduling. Although the Government is not the legal obligor with respect to these obligations, they have been included in the Government's external debt statistics.

Negotiations with a small number of non-Paris Club official creditors are currently in progress with the objective of reaching agreements on the terms of the rescheduling arrangements to apply to these creditors.

External Debt Service Projection

The following table sets forth a projection of the Government's contractual external debt service by type of creditor over the period 1998 to 2005, including principal and interest payable on all external debt outstanding at the end of 1997, on the basis of the exchange rates and interest rates prevailing at that time. The table accordingly does not reflect any external debt service (i) on the Bonds to which this Offering Circular refers, (ii) on any borrowings by or on behalf of the Government since the end of 1997 or (iii) on any new borrowings by or on behalf of the Government during the period covered by the table, which are expected to be significant.

For the projection of external debt service for former Soviet Union debt, the table reflects the Government's estimate of the payments that will be required in respect of the rescheduling of the uninsured trade supplier debt. The Government's estimation of payments to former CMEA member countries and other non-Paris Club official creditors is also included in the table, with the exception of payments to be made in the form of equipment, goods, or services.

External Debt Service Projections by Type of Creditor⁽¹⁾

	1998	1999	2000	2001	2002	2003	2004	2005
				<i>(U.S.\$ billion)</i>				
Principal	3.11	6.06	5.86	5.46	4.71	4.75	5.31	4.59
External debt of the Government of the Russian Federation.....	2.77	4.44	4.32	4.30	2.92	2.53	2.80	1.46
Multilateral creditors	1.00	3.42	3.19	1.43	1.54	1.67	1.35	1.23
Bonds.....	—	—	—	1.00	—	—	1.11	—
Official creditors.....	0.89	0.92	1.12	1.61	1.38	0.86	0.34	0.23
Commercial creditors	0.88	0.10	0.01	0.26	—	—	—	—
External debt of the former Soviet Union, for which the Government of the Russian Federation has agreed to be responsible ..	0.34	1.62	1.54	1.16	1.79	2.22	2.51	3.13
Multilateral creditors	—	—	—	—	—	—	—	—
Bonds.....	0.07	—	—	—	—	—	—	—
Official creditors.....	0.27	1.62	1.54	1.16	1.42	1.48	1.77	1.93
Commercial creditors	—	—	—	—	0.37	0.74	0.74	1.20
Interest	6.29	6.16	6.39	6.61	6.69	6.42	6.14	5.65
External debt of the Government of the Russian Federation.....	1.86	1.67	1.44	1.25	0.97	0.83	0.72	0.52
Multilateral creditors	0.96	0.87	0.70	0.57	0.49	0.42	0.34	0.26
Bonds.....	0.43	0.43	0.43	0.43	0.34	0.34	0.34	0.24
Official creditors.....	0.40	0.35	0.29	0.23	0.14	0.07	0.04	0.02
Commercial creditors	0.07	0.02	0.02	0.02	—	—	—	—
External debt of the former Soviet Union, for which the Government of the Russian Federation has agreed to be responsible ..	4.43	4.49	4.95	5.36	5.72	5.59	5.42	5.13
Multilateral creditors	—	—	—	—	—	—	—	—
Bonds.....	—	—	—	—	—	—	—	—
Official creditors.....	2.64	2.61	2.84	2.78	2.72	2.63	2.52	2.41
Commercial creditors	1.79	1.88	2.11	2.58	3.00	2.96	2.90	2.72
Total	9.40	12.22	12.25	12.07	11.40	11.17	11.45	10.24

Note:

⁽¹⁾ The external debt service projections take into account the Government's assumptions in respect of the partial capitalisation of interest which will take place under certain rescheduling arrangements in the period up to 2002, and exclude payments to be made in the form of equipment, goods and services.

Source: Ministry of Finance, Vnesheconombank.

It is projected that, following completion of the restructuring of the external debt of the former Soviet Union, only 32 per cent. of the Government's external debt outstanding at the end of 1997 will fall due between 1998 and 2005. Total contractual external debt service is projected to increase from U.S.\$9.4 billion in 1998 to approximately U.S.\$12.2 billion in 1999 and 2000. Thereafter, it is projected to decline to U.S.\$10.2 billion by 2005.

External Debt Policy

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

borrowings. Borrowings by these banks under the Government's guarantee are included in the external debt statistics of the Government.

Apart from these banks, the Government has not provided external guarantees for public or private sector entities, and no ministry, regional authority, or public sector entity is authorised to borrow in its own name under a Government guarantee.

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

The purpose of the Government's borrowings is to finance the Federal budget deficit. The Government's priority is to fund the deficit by means of non-inflationary rouble denominated instruments issued in the domestic securities market. The decision to raise funds from the international financial markets, rather than the domestic securities markets, is determined principally by the relative interest rates and maturities available in the two markets and by the Government's desire to raise foreign currency.

It is an important objective of the Government's external debt policy to reduce the level of external borrowing in line with the planned reduction in the budget deficit, and to limit its recourse to tied credits. As part of its external debt policy, the Government has set a long term objective of lowering its borrowing costs and lengthening the repayment periods of the credits it receives.

Domestic Debt

The following table sets forth information with respect to Russia's domestic public debt at period-end for the years 1992 to 1997 and the first quarter of 1998:

Domestic Public Debt⁽¹⁾

	As at 31st December						As at
	1992	1993	1994	1995	1996	1997	31st March 1998
	<i>(billions of roubles)</i>						
Total domestic public debt	3,567	25,804	115,447	231,399	449,479	606,879	649,109
Government	3,567	25,804	115,447	226,505	427,323	565,992	603,029
GKOs	—	203	10,594	65,759	203,583	272,612	288,742
OFZs with floating rates	—	—	—	10,831	33,525	47,618	45,562
OFZs with fixed rates	—	—	—	—	—	115,776	139,639
OVVZs ⁽²⁾	—	9,833	27,047	35,352	61,766	66,437	67,927
Debt to the Central Bank accumulated in 1992-1994 ⁽³⁾	2,869	11,984	58,752	61,022	59,579	—	—
Securitized direct credits of 1992-1996	—	—	5,442	30,040	29,480	28,920	28,920
Other	698	3,784	13,612	23,501	39,389	34,629	32,239
Sub-federal/local governments ⁽⁴⁾	—	—	—	4,894	18,489	37,651	40,637
State Pension Fund	—	—	—	—	3,667	3,236	5,442
	<i>(per cent. of total)</i>						
Total domestic public debt	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Government	100.0	100.0	100.0	97.9	95.1	93.3	92.9
GKOs	—	0.8	9.2	28.4	45.3	44.9	44.5
OFZs with floating rates	—	—	—	4.7	7.5	7.9	7.0
OFZs with fixed rates	—	—	—	—	—	19.1	21.5
OVVZs ⁽²⁾	—	38.1	23.4	15.3	13.8	11.0	10.5
Debt to the Central Bank accumulated in 1992-1994 ⁽³⁾	80.4	46.4	50.9	26.4	13.3	—	—
Securitized direct credits of 1992-1996	—	—	4.7	13.0	6.6	4.8	4.5
Other	19.6	14.7	11.8	10.2	8.8	5.7	5.0
Sub-federal/local governments ⁽⁴⁾	—	—	—	2.1	4.1	6.2	6.3
State Pension Fund	—	—	—	—	0.8	0.5	0.8
	<i>(per cent. of GDP)</i>						
Total domestic public debt	18.8	15.1	18.9	14.6	20.4	23.3	23.9
Government	18.8	15.1	18.9	14.3	19.4	21.8	22.2
GKOs	—	0.1	1.7	4.2	9.3	10.5	10.6
OFZs with floating rates	—	—	—	0.7	1.5	1.8	1.7
OFZs with fixed rates	—	—	—	—	—	4.5	5.1
OVVZs ⁽²⁾	—	5.7	4.4	2.2	2.8	2.6	2.5
Debt to the Central Bank accumulated in 1992-1994 ⁽³⁾	15.1	7.0	9.6	3.9	2.7	—	—
Securitized direct credits of 1992-1996	—	—	0.9	1.9	1.3	1.1	1.1
Other	3.7	2.2	2.2	1.5	1.8	1.3	1.2
Sub-federal/local governments ⁽⁴⁾	—	—	—	0.3	0.8	1.5	1.5
State Pension Fund	—	—	—	—	0.2	0.1	0.2
<i>Memo:</i>							
Exchange rate, rouble/U.S.\$, end of period	415	1,247	3,550	4,640	5,555	5,974	6,090
GDP (trillions of roubles)	19	172	611	1,585	2,200	2,602	569
Total domestic public debt (U.S.\$ million)	8,594	20,692	32,520	49,870	80,914	101,587	106,593

Notes:

(1) Certain data presented in this table differ from previously published data due to certain changes in accounting methodology of the Ministry of Finance.

(2) Internal Government Hard Currency Bonds ("OVVZs", known as "Taiga" bonds or "MinFins").

(3) Includes debt to the Central Bank accumulated in 1992-1994. In March 1997, the Government's debt to the Central Bank incurred during 1991 and 1994, together with accrued interest, was converted into fixed rate OFZs with face value of 79.8 trillion roubles.

(4) The debt of sub-federal and local governments for 1997 was calculated as the sum of debt stock for 1996 and the new borrowings for 1997 as provided in the consolidated budget.

Source: Ministry of Finance.

At the end of March 1998, Russia's total outstanding domestic public debt amounted to 649.1 trillion roubles (U.S.\$106.6 billion), or 23.9 per cent. of estimated GDP for 1998. This public debt comprised domestic debt of the Government amounting to 603.0 trillion roubles, debt of the sub-federal local governments of 40.6 trillion roubles and 5.4 trillion roubles owed by the State Pension Fund.

Government Domestic Debt

Domestic indebtedness of the Government consists of state treasury bills (GKOs), Federal Loan Bonds ("OFZs"), rouble-denominated savings bonds ("OGSZs"), Internal Government Hard Currency Bonds ("OVVZs" known as "Taiga" bonds or "MinFins") and securitised arrears on centralised credits to the agriculture sector and the Northern regions, as well as various smaller items.

GKOs are rouble-denominated zero-coupon instruments of less than one-year maturity, sold at a discount and redeemed at par. GKOs were first issued in May 1993 and have since become the Government's main debt instrument, increasing steadily in aggregate amount outstanding (representing 47.9 per cent. of outstanding Government domestic debt at 1st April 1998). To date, GKOs have been issued with maturities of between three and twelve months. Since late 1995, the Ministry of Finance has gradually increased the proportion of longer term instruments in order to extend the maturity structure.

Floating rate OFZs are obligations of Russia with maturities of over one year, denominated in roubles and paying quarterly or semi-annual coupons pegged to the average market yields of GKOs redeemable during the period beginning 30 days before and ending 30 days after the coupon payment. Initially issued in June 1995, the outstanding stock of OFZs at the end of the first quarter of 1998 represented 6.8 per cent. of estimated GDP for 1998. The share of outstanding domestic debt of the Government attributable to OFZs increased from 28.9 per cent. at the end of 1997 to 30.7 per cent. at the end of the first quarter of 1998, comprising net OFZ issuances by the Government (17.5 per cent. of outstanding domestic debt) and securitised indebtedness owed to the Central Bank (13.2 per cent.), as discussed below.

In July 1997, a new domestic debt instrument, the fixed-rate OFZ, was introduced. To date, two- and three-year fixed-rate OFZs have been issued, paying annual or semi-annual coupons at rates between 12 per cent. and 20 per cent. per annum. As of 1st April 1998, 23.9 trillion roubles principal amount of fixed-rate OFZs had been issued. It is currently expected that fixed-rate OFZs with maturities in excess of two years will be issued during 1998 in order to refinance a portion of the outstanding GKO stock.

The GKO/OFZ market is the most active Government security trading market, and the largest financial market in Russia. The market value of GKOs/OFZs outstanding (not including the securitised debt to the Central Bank) at 1st April 1998 was around U.S.\$60 billion, while average daily secondary market turnover was U.S.\$760 million at the then current exchange rate. Initial issuance of GKOs/OFZs takes place through MICEX, and secondary market trading of GKOs/OFZs takes place only on MICEX and its representative exchanges in the regions.

During the first quarter of 1998, 89.7 per cent. of new GKO and OFZ issues by face value carried maturities of more than six months while during 1997, 71.3 per cent. of new issues had such maturities. At 1st April 1998, Government domestic debt with maturities of fewer than three months stood at 15.1 per cent. of the total Government domestic debt, while at the end of 1997 this proportion was 15.8 per cent.

Annualised GKO/OFZ yields (which averaged 86 per cent. in 1996 overall and had been at an historic high of 176 per cent. in June 1996) fell to approximately 19 per cent. in August 1997, rose again in response to the financial crisis in Asia to a high of 36.6 per cent. in December 1997, fell to 26 per cent. at the end of March 1998 only to rise again, to 80 per cent., in late-May. After an initial fall to below 50 per cent. in June 1998, annualised GKO/OFZ yields rose to above 120 per cent. in early July, but dropped again in mid-July to 45 per cent. after the announcement of the Invitation and the

stabilisation facility from the IMF described below. See “– Relations with International Financial Institutions.”

OVVZs are U.S. dollar-denominated bonds first issued in 1993 in order to compensate holders of funds which had been frozen in foreign currency accounts of VEB. The bonds were initially issued in five series with maturities ranging between 2 and 15 years; two additional series were issued in May 1996 with maturities of 10 and 15 years. Each bond pays a 3 per cent. coupon annually until redemption. The principal amount of OVVZs outstanding stood at U.S.\$11.1 billion (equivalent to 2.5 per cent. of GDP for 1997) at the end of March 1998 and represented approximately 11.3 per cent. of Russia's Governmental domestic debt. OVVZs trade in the over-the-counter market.

Government debt instruments include OGSZs which are rouble-denominated savings bonds. Issued for the first time in September 1995, they were intended to provide an alternative to bank deposits so as to attract financial resources from retail investors. OGSZs pay a quarterly or semi-annual coupon at the OFZ rate, which in turn is tied to GKO yields, and trade in the over-the-counter market. The total stock of OGSZs outstanding at 1st April 1998 was equal to 15 trillion roubles.

Government debt to the Central Bank (both principal and interest) was restructured in the form of securities issued in March 1997 in accordance with the 1997 Federal budget law. As a result of that securitisation, as at 1st April 1998, 79.8 trillion roubles (2.9 per cent. of GDP for 1997 or 13.2 per cent. of total Government domestic debt at the beginning of 1998) had been issued in the form of Government securities with 10 per cent. annual interest payments from 1998 until redemption. Principal repayment will be made in equal annual installments in the period from 2001 to 2013. The Government's securitised debt to the Central Bank was incurred between 1992 and 1994, and includes centralised credits extended by the Central Bank, mainly to agricultural enterprises and the Northern regions. These credits were channelled through the banking system but were not repaid on schedule by the enterprises that received them, and the Government subsequently assumed the outstanding liability. The Government itself had extended similar credits, and in 1995 and 1996 it issued 29.5 trillion roubles worth of treasury bonds (*veksels*), equivalent to 1.3 per cent. of GDP for 1996, in order to reschedule the liability. In 1997, the Government began to redeem this debt, and at the end of March 1998, this share of domestic debt was equivalent to 1.1 per cent. of GDP.

Foreign investor access to the market for Russia's Government securities was significantly liberalised over the course of 1997, all restrictions on repatriation of profits from operations with GKO and OFZs were eliminated as of 1st January 1998. The only remaining limitation on the access of foreign investors to the GKO/OFZ market is the requirement that non-residents trade in such securities through special “S” accounts with authorised banks. At 1st June 1998, non-residents held approximately 29.9 per cent. of all GKO/OFZ stock by face value.

Government Domestic Debt Service

Total Government domestic debt service payments increased from 1.1 per cent. of GDP in 1992 to 4.8 per cent. of GDP in 1996 and declined to 3.6 per cent. of GDP in 1997. Domestic debt service for the first quarter of 1998 increased to 3.9 per cent. of GDP for the same period due to payment of yearly coupon on securitised debt to the Central Bank. All principal and interest payments in respect of the domestic debt of the Government have been made in full in accordance with current budgetary laws. During 1996 and 1997, allegations were made that certain of the OVVZs outstanding had been stolen. Pending determination of the ownership of these securities, interest payments in respect of them were temporarily frozen. As at 1st May 1998, interest payments in respect of OVVZ bonds with a face value of U.S.\$17.1 million were still frozen, compared to U.S.\$25.1 million as of 1st July 1997.

Government Domestic Debt Policy

Russia's Government domestic debt policy has been significantly affected by developments associated with the financial crisis in Asia at the end of 1997 and by the recent pressure on the GKO/OFZ market. See “Monetary and Financial System – Monetary Policy – Recent Developments.” As

difficulties intensified in late 1997 as a result of the financial crisis in Asia, GKO/OFZ yields rose appreciably, resulting in a projected increase in domestic debt service payments for 1998 of approximately 0.9 per cent. of GDP. In response, the Government curtailed new GKO/OFZ issuances, limiting such issuances to those required to roll over existing obligations. At that time the Government issued securities with shorter maturities, which caused the duration of the outstanding GKO/OFZ stock (not including securitised indebtedness owed to the Central Bank) to decrease from nine months at 31st October 1997 to only eight months at 1st January 1998. The Government was able to reverse this trend in the first quarter of 1998, however, as the duration of the outstanding GKO/OFZ stock (not including securitised indebtedness owed to the Central Bank) increased to 9.4 months, mainly through the issuance of two and three-year OFZs.

The recent pressure on the GKO/OFZ market has caused the Russian Government to refine its domestic debt policy. In order to limit the issuance of domestic debt while rates remain high, the Government will seek to refinance some of its GKO obligations as they come due through external debt issued at lower rates and with longer maturities. In addition, the Government may repay some GKO obligations out of the Federal budget, without recourse to refinancing. Finally, the Government will seek to continue to increase the duration of its outstanding GKO/OFZ stock, through new issues with longer maturities and has announced its intention not to issue GKOs having maturities of less than one year. Accordingly, the Government intends to meet its anticipated domestic debt service in the coming period mainly through a combination of external debt, repayments out of the Federal budget and longer-term GKO/OFZ issuances. The Invitation was part of this strategy.

Other Public Sector Domestic Debt

Russia's total domestic public debt also includes debt of the sub-federal and local governments, incurred in the form of municipal bonds and bank credits. Because such government accounts were in surplus until 1995, this portion of the overall public debt is small, amounting to no more than 0.3 per cent. of GDP in 1995, 0.8 per cent. of GDP in 1996, 1.4 per cent. of GDP in 1997 and 1.5 per cent. of estimated GDP for 1998 at the end of March 1998. In 1995, the State Pension Fund also incurred debt for the first time in the form of bank credits; such debt amounted to 0.2 per cent. of estimated GDP for 1998 as of 1st April 1998.

The first bond issued by a Federation subject in Russia was issued by the Khabarovsk region in 1992. Although the Civil Code provides that debts of sub-federal and local authorities have the status of "state" debt, the Government has stated that such status does not constitute a Federal guarantee against default. Some 40.6 trillion roubles (about U.S.\$6.7 billion) aggregate principal amount of debt of Federation subjects was outstanding at the end of March 1998.

External Assets

Following the dissolution of the Soviet Union, the Government assumed responsibility for virtually all the external debts contracted on behalf of the Soviet authorities pursuant to agreements signed with 11 of the other former Soviet republics. In return, Russia received the right to these republics' claims on the external assets of the former Soviet Union.

These assets included claims on other countries, the majority of which are claims on less developed countries. It has been estimated that the face value of the official credits provided to these countries could amount to more than U.S.\$150 billion. In most cases, the loans are non-performing. In 1997, principal and interest payments (including payments in kind) received in respect of these claims amounted to U.S.\$1.1 billion. As a result of Russia having become a member of the Paris Club of official creditors on 17th September 1997, the Government now intends to pursue its claims against debtor governments within the Paris Club framework. In connection with Russia's joining the Paris Club, the Government has agreed to discount its claims on Paris Club debtors with the understanding that claims denominated in Gosbank roubles and transferable roubles will be converted into U.S. dollars at the rate of 0.6 Gosbank roubles and one transferable rouble per U.S. dollar, respectively. Russia's joining the Paris Club is expected to increase the amount of the cash payments Russia receives from its government debtors, notwithstanding the reduction in the face amount of its claims. The amount of the increased cash payments is not expected to be significant, at least in early years.

Relations with International Financial Institutions

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

In 1992, the IMF provided Russia with a standby arrangement amounting to approximately U.S.\$1.0 billion. This was followed by a Systemic Transformation Facility under which drawings were made in 1993 and 1994, each in the amount of approximately U.S.\$1.5 billion. A U.S.\$6.2 billion standby arrangement was provided by the IMF in 1995. In March 1996, the IMF approved a three-year EFF totalling approximately U.S.\$10 billion and providing for the amount that can be drawn down to increase on a monthly, and from the beginning of 1997 on a quarterly, basis until the full amount of the facility has been reached. Drawdowns under the facility are generally conditional on Russia meeting targets with respect to certain key indicators ("performance criteria"), for example, net domestic assets, net credits from the monetary authorities to the enlarged government and to the Government, the budget deficits of the enlarged government and the Government, net official international reserves and external borrowings. Other performance criteria relate to the maintenance of a liberal regime for current international transactions and the absence of arrears on Russia's external borrowings (save for those being rescheduled). Moreover, drawdowns under the EFF may not take place until the completion by the IMF of any periodic review (quarterly under the 1998 programme) of Russia's compliance with the EFF performance criteria and its achievement of certain qualitative benchmarks in connection with structural reforms.

Significant delays in Russia's drawdowns under the EFF occurred in the last two years, caused mainly by the IMF's concerns about the Government's poor revenue performance. See "Public Finance – Revenues." Of the total amount to be made available under the EFF, approximately U.S.\$4.5 billion had been disbursed through 1997. Total drawdowns under the EFF for 1997 amounted to U.S.\$2.0 billion. Subject to compliance with the performance criteria and satisfactory reviews by the IMF, the total drawdowns for 1998 under the EFF are expected to be approximately U.S.\$2.8 billion. In February 1998, the Managing Director of the IMF announced an extension of the EFF to 2000.

Russia is currently seeking from the IMF another facility for stabilisation purposes. In this regard, on 13th July 1998, the Managing Director of the IMF stated that he would recommend to the Executive Board of the IMF that the IMF provide additional support to the Russian Federation in the amount of approximately U.S.\$11.2 billion in 1998. Half of this amount (approximately U.S.\$5.6 billion) would be provided as soon as certain agreed actions of the Government are taken, by legislation where necessary, and upon IMF Executive Board approval. The rest would be made available during the remainder of the year. Together with the resources provided under the current EFF arrangement for Russia, total financing from the IMF during the remainder of 1998 would amount to approximately U.S.\$12.5 billion. The IMF Executive Board was expected to consider the new programme on 20th July 1998. No decision was announced by the IMF by the close of business on 20th July 1998. No assurances can be given that the programme will be approved or that the conditions to the disbursement of funds will be met.

The Government has also informed the IMF that it intends to request a new EFF for the years 1999-2001. The Managing Director of the IMF also stated on 13th July 1998 that, with continued reform, he would recommend further IMF financial support for Russia's medium-term economic programme on a scale similar to that of the present EFF, approximately U.S.\$2.6 billion per year. No assurances can be given that a new EFF will be provided.

As at the end of March 1998, the World Bank had approved 39 loans in Russia, mostly directed to infrastructural development and industrial restructuring, representing aggregate commitments of approximately U.S.\$9.4 billion of which approximately U.S.\$5.8 billion had been drawn. The World Bank's management has also reached agreement in principle with the Government on a structural reform programme and has stated that it intends to recommend to its Board of Executive Directors the approval of structural adjustment lending which would make available an additional U.S.\$800 million in 1998. Together with disbursements of already committed adjustment loans, total adjustment loan disbursements by the World Bank to Russia during the remainder of 1998 could then amount to U.S.\$1.25 billion.

The EBRD has committed to 106 projects in Russia, largely in the private sector, including projects relating to the oil and gas sectors and market infrastructural development, with a total value in the order of ECU 3.7 billion.

External Debt Payment Record

The Government has honoured in full all the external debt it has contracted or guaranteed since 1st January 1992.

Virtually all payments due in respect of the external debt of the former Soviet Union for which the Government has agreed to be responsible have already been (or are in the process of being) rescheduled, with the exception of the Eurobonds issued by VEB prior to the dissolution of the former Soviet Union which have been honoured in full. The Government has also honoured in full all its obligations under its Paris and London Club rescheduling agreements.

TAXATION

General

An exchange pursuant to the Invitation may be a taxable transaction under the laws applicable to a particular holder of GKO's. Each such holder is urged to consult its own tax adviser to determine its particular tax consequences in respect of the exchange of GKO's pursuant to the Invitation and the ownership and disposition of Bonds, including the availability of double tax treaty relief.

Russian Taxation

The following is a summary of certain Russian tax considerations relevant to an exchange of GKO's for Bonds pursuant to the Invitation and to the purchase, ownership and disposition of the Bonds. The summary is based on the laws of the Federation in effect on the date of this Offering Circular. The summary does not address the provisions of double tax treaties, except as described below, or the applicability of, and procedures in relation to, taxes levied by regions, municipalities or other non-federal level authorities of the Federation and does not address the availability of, and procedures for claiming, double tax treaty relief. It should be noted that there may be practical difficulties involved in claiming such benefits. Prospective investors should consult their own tax advisers regarding an investment in the Bonds.

Many aspects of Russian tax law are subject to significant uncertainty. Certain Russian tax rules applicable to financial instruments and in particular to the tax treatment of a holder which is a physical person with no permanent place of residence in Russia for tax purposes or a legal person or organisation, in each case, not organised under Russian law which holds and disposes of the Bonds other than through a permanent establishment in Russia (each a "non-resident holder"), have been addressed by the Regulations of the Ministry of Finance of the Russian Federation and of the State Tax Service of the Russian Federation No. 14n//AP-4-06/3n dated 17th March 1998 "On Taxation Matters in Connection with Bonds of External Bond Debt of the Russian Federation of 1998" (the "Regulations") which were registered with the Ministry of Justice on 20th March 1998, and, as of the date of this Offering Circular, had been officially published and come into effect. In this regard, the Regulations state that no holder of a bond will be deemed to have a permanent establishment in Russia simply by virtue of the acquisition of a bond. For the purposes of this summary the term "permanent establishment" has the meaning given to it in Instruction of the State Tax Service of the Russian Federation of 16th June 1995 No. 34 "On Taxation of Profits and Income of Foreign Legal Persons." The Regulations are a statement in respect of certain matters in relation to the tax treatment of non-resident holders. Although the Regulations would not be regarded by a Russian court as themselves having the status of law, they have been issued by the Russian Federal authorities with legal authority to interpret Russian tax law and, for the purposes of this summary, it is assumed that they will be given full effect by such Federal tax authorities.

The substantive provisions of Russian tax law are subject to more rapid and unpredictable change and inconsistency than in a jurisdiction with more developed capital markets. In particular (i) the interpretation and application of such provisions will in practice rest substantially with local tax inspectors and (ii) such provisions and their interpretation are subject to the adoption of a proposed new Tax Code of the Russian Federation, which is under consideration by the State Duma and would have to pass through the Federal Assembly and be signed by the President. See "Public Finance – Proposed New Tax Code."

Exchange of GKO's for Bonds

The exchange of GKO's will be effected as a technical matter through (i) the early redemption for redenominated roubles at the GKO Exchange Price of the GKO's being exchanged, (ii) the crediting of such redenominated roubles to the account of the Central Bank, acting on behalf of the Ministry of Finance, pursuant to instructions to be given by the GKO holders, (iii) the conversion by the Central Bank of such redenominated roubles into U.S. dollars, (iv) the crediting by the Central Bank of such U.S. dollars to the account of the Ministry of Finance of the Russian Federation and (v) the issuance of

the Bonds by the Ministry of Finance acting on behalf of the Russian Federation and the delivery of the Bonds to the new Bondholders through DTC, Euroclear or Cedel Bank. The gain from the redemption of GKO's would be calculated as the difference between the amount of the redenominated roubles paid on redemption of the GKO's and the acquisition cost of the GKO's (making no adjustment for any part of such difference which is attributable to accrued interest). In the case of a holder of GKO's who is a legal person or organisation, any gain arising on the redemption is subject to tax in Russia at 15 per cent. subject to any available double tax treaty relief. In the case of a physical person, any gain would not be subject to Russian taxation.

In the case of non-resident GKO holders, if double tax treaty relief is unavailable, deduction of this tax would normally be required to be made by the payer of income. Legal entities organised under Russian law and foreign legal persons or organisations holding and disposing of GKO's through a permanent establishment in the Federation would be required to pay the 15 per cent. tax themselves.

Interest on the Bonds

Under existing tax legislation, there is no individual income tax on interest received by holders of state securities who are physical persons, although there is a 15 per cent. income tax (levied by withholding) on interest from state securities received by holders which are legal persons. The Regulations, however, state that no amounts should be withheld in respect of the latter tax in respect of any state securities which comply with the terms of the Regulations. According to the Regulations, if (a) an issue of bonds is structured in the form of a global certificate held by a clearing or a depository organisation which is a resident of a state that is a party to a treaty with the Federation on the avoidance of double taxation and (b) the treaty provides that residents of that other state are exempt from Russian taxation on interest income, then the clearing or depository organisation will be considered to be a qualifying resident of that state and to be the beneficial owner of interest payments in respect of such bonds. The Regulations state that no income tax on interest will be withheld, provided that (i) the terms of such bonds state that Russian residents, other than physical persons, may not receive interest on such bonds in any form and (ii) prior to the first interest payment on such bonds, a one-time confirmation is filed with the tax authorities in the Federation to the effect that the clearing or depository organisation holding the relevant global certificate is a resident of such state. The Regulations do not contain a definition of "clearing or depository organisation" or "Russian residents," nor do they contemplate the issue of bonds being structured in the form of two or more global certificates, nor do they contain any guidance on the form of confirmation which may be satisfactory to the relevant tax authorities in the Federation. Each of the Bonds Due 2005 and the Bonds Due 2018 will be represented by two or more Global Bonds (see "Form of Bonds and Transfer Restrictions relating to U.S. Sales"). The Unrestricted Global Bonds will be registered in the name of a nominee for, and deposited with, a common depository for Euroclear and Cedel Bank. The Restricted Global Bonds will be registered in the name of Cede & Co., as nominee for The Depository Trust Company ("DTC"). Condition 7(c) provides that Russian residents, other than physical persons, are not permitted to receive interest payments in respect of the Bonds. Prior to the first interest payment in respect of the Bonds, the Ministry of Finance will certify to the appropriate tax authorities (based on the certification made to it by such common depository) that the Unrestricted Global Bonds are being held by such common depository as a depository organisation and that such common depository is resident of a state that is party to such a treaty as referred to above and (based on a certification made to it by DTC) that the Restricted Global Bonds are being held by DTC as a clearing organisation and that DTC is resident of a state that is party to such a treaty as referred to above. Accordingly, based on current Russian tax legislation as interpreted by the Regulations, interest on the Bonds should not be subject to Russian profits tax or income tax directly or by withholding.

If the Bonds cease to be held in the form of a global certificate by a clearing or depository organisation at any time, the exemption from withholding tax referred to in the Regulations will not be available. Accordingly, if interests in the Global Bonds are exchanged for Bond Certificates in the limited circumstances where this is permitted (see "Form of Bonds and Transfer Restrictions relating to U.S. Sales – Exchange of Interests in Global Bonds for Bond Certificates"), there will be a 15 per cent. withholding tax on interest received by holders which are legal persons.

Condition 8 contains a provision requiring the Issuer to increase the payment of principal or interest, as the case may be, pursuant to the Bonds if at any time Taxes (as defined therein) are withheld or deducted from such payment. Contractual provisions for the payment by one party of tax which is levied on another party may generally not be enforced in the Federation. However, the Regulations indicate that a contract may include provisions relating to the increase of sums payable by one party in the event of the imposition of additional tax obligations after the date of the contract.

Sale or Other Disposal of Bonds

A gain realised on a sale or other disposal of Bonds by a holder prior to redemption will generally be subject to profits tax or income tax levied directly or by withholding depending on the tax status of the seller and the buyer. The gain on any disposal of Bonds is calculated as the difference between the disposal price and the acquisition cost of the relevant Bonds, making no adjustment for any part of such difference which is attributable to accrued interest. Any gain realised on a sale or other disposal of the Bonds may be caused or affected by changes in the exchange rates between the currency of acquisition and the currency of sale of the Bonds. Furthermore, if the gain is to be calculated in redenominated roubles to fulfil Russian statutory requirements, any gain realised on a sale or other disposal of the Bonds may be caused or affected by changes in the exchange rates between the currency of acquisition of the Bonds, the currency of sale and redenominated roubles.

A non-resident holder which is a legal person or organisation will generally be subject to withholding tax at the rate of 20 per cent. on any gain or on the gross amount of proceeds (if the gain cannot be quantified) on the disposal of Bonds where the proceeds of such disposal are received from a source within the Federation, subject to any available double tax treaty relief.

A non-resident holder which is a physical person (generally any person resident in the Federation for a period of less than 183 days in a given calendar year) will also generally be subject to individual income tax at the rate of 20 per cent. on the gross proceeds from the disposal of Bonds received from a source within the Federation, subject to any available double tax treaty relief. In certain circumstances deduction of this tax is required to be made by the payer of the disposal proceeds.

In accordance with the terms of the Regulations, income shall be construed as received from a source in the Federation when the Bonds are sold to a Russian legal person or a physical person having permanent residence in the Federation, or to a foreign legal person if a permanent representative office of such legal person in the Federation is directly involved in concluding the sale transaction with respect to the Bonds as a representative of a party.

Legal entities organised under Russian law, and foreign legal persons or organisations holding or disposing of the Bonds through a permanent establishment in the Federation, are generally subject to profits tax on any gain at rates of up to 35 per cent. (or possibly more in the case of certain legal persons such as banks or insurers). Physical persons with a permanent place of residence in the Federation are ordinarily subject to individual income tax on any gain at rates of up to 35 per cent. subject to certain relief and, where appropriate, subject to the submission of an appropriate application. In certain circumstances deduction of this tax may be required to be made by the payer of the disposal proceeds. In respect of any aforementioned tax payers there is a risk that, if calculated in redenominated roubles to fulfil any applicable Russian statutory requirements, any gain may be caused or affected by changes in the exchange rates between the currency of acquisition of the Bonds, the currency of sale and the redenominated roubles.

Payments on Redemption of Bonds

Any gain realised on redemption of the Bonds will generally be subject to profits tax or income tax levied directly or by withholding depending on the tax status of the holder of the Bonds. Such a gain will be equal to the difference between the redemption proceeds and the issue price of the relevant Bonds for the original nominee holder for the common depositary for Euroclear and Cedel Bank and Cede & Co., as original nominee holder for DTC. If interests in the Global Bonds are exchanged for

Bond Certificates in the limited circumstances where this is permitted, such a gain shall be equal to the difference between the redemption proceeds and the acquisition cost (making no adjustment for any part of such difference which is attributable to accrued interest) of the relevant Bonds. In such circumstances any gain realised on redemption of the Bonds may be caused or affected by changes in the exchange rates between the currency of acquisition of the Bonds and U.S. dollars. Furthermore, if the gain is to be calculated in redenominated roubles to fulfil Russian statutory requirements, any gain realised on redemption of the Bonds may be caused or affected by changes in the exchange rates between the currency of acquisition of the Bonds, U.S. dollars and redenominated roubles. Since there is no specific regime under Russian law which provides for the taxation of redemption proceeds, there is a risk that, if interests in the Global Bonds are exchanged for Bond Certificates in the limited circumstances where this is permitted, a non-resident holder who is a physical person may be subject to individual income tax levied by withholding at a rate of 20 per cent. on the redemption proceeds, subject to any available double tax treaty relief. If any Taxes are required to be withheld or deducted by the Issuer with respect to payments on redemption of the Bonds, see the description under “– Interest on the Bonds” above with respect to the provisions contained in Condition 8 and the Regulations in this respect.

Other Taxes

Payments made to holders of Bonds pursuant to the terms thereof will not be subject to value added tax.

Securities tax (if any) on the issue of the Bonds will be payable by the Issuer. No securities tax will be payable on a sale or other disposal of the Bonds.

The Regulations state that no road users' tax or housing fund maintenance tax on a sale outside the territory of the Federation will be payable by or deducted from payments to non-resident holders of the Bonds. Russian legal entities, and foreign entities acting through Russian permanent establishments, which receive income effectively connected with trading in the Bonds in the Federation, in each case licensed in the Federation as professional participants in the securities market, may be subject to these taxes. Housing fund maintenance tax is imposed, if at all, at a local level and the nature of the liability and methods of its collection may vary.

The Regulations state that no property tax will be payable by virtue of the holding of the Bonds.

General

Except as described in this Offering Circular (including under “General Information”) (1) no federal stamp, registration, documentary or similar federal taxes are payable in Russia by reason of the issue of the Bonds or in relation to any enforcement proceedings in respect of the Bonds brought in the Russian courts, (2) the holders of the Bonds will not incur or become liable for any federal tax on income or capital gain, stamp duty, registration, transfer or other similar federal taxes by reason only of the acquisition, ownership or disposal of the Bonds and (3) all payments by the Issuer of principal and interest on the Bonds may be made without withholding or deduction for or on account of any other federal taxes, duties, assessments or governmental charges in Russia.

United States Taxation

The following summary describes certain United States federal income tax consequences relating to an exchange of GKO's for Bonds pursuant to the Invitation, and to the purchase, ownership and disposition of Bonds, by a holder that is (i) an individual who is a citizen or resident of the United States, (ii) a U.S. domestic corporation or (iii) any other person that is subject to U.S. federal income tax on a net income basis in respect of the GKO's and any Bonds received in exchange therefor or acquired in the New Cash Offering (each, a “U.S. holder”). This summary is based on laws, regulations, rulings and decisions now in effect, all of which are subject to change. This summary deals only with United States holders that acquire Bonds in the New Cash Offering or in exchange for GKO's pursuant to the Invitation and hold Bonds, and any GKO's exchanged therefor, as capital assets,

and does not address tax considerations applicable to holders that are subject to special tax rules, such as holders that are not eligible for benefits under the income tax treaty currently in force between the Russian Federation and the United States (the "Treaty"), banks, tax-exempt entities, insurance companies, dealers in securities or currencies, traders in securities electing to mark to market, persons that hold GKO or Bonds as part of an integrated investment (including a "straddle" or "conversion transaction") comprised of a GKO or Bond and one or more other positions or persons that have a "functional currency" other than the U.S. dollar. Investors should consult their own advisers regarding the tax consequences of an exchange of GKOs for Bonds, and an investment in Bonds, in light of their particular circumstances, including the effect of any state, local or other national laws.

Exchange of GKOs for Bonds

A U.S. holder that exchanges GKOs for Bonds pursuant to the Invitation generally will recognise taxable gain or loss equal to the difference between the amount realised on the exchange (calculated in U.S. dollars) and such U.S. holder's adjusted tax basis in the GKOs. Except to the extent attributable to acquisition discount or original issue discount not previously included in income (which will be taxed as ordinary income), or foreign exchange gain or loss, gain or loss recognised by a U.S. holder on the exchange of GKOs for Bonds will be short term capital gain or loss. Upon the receipt of an amount attributable to previously accrued acquisition discount or original issue discount, a U.S. holder will recognise ordinary income or loss measured by the difference between the amount realised on the exchange (determined in U.S. dollars on the date of the exchange) and the amount accrued (using the exchange rate applicable to such previous accrual). Gain or loss realised upon the exchange of a GKO that is attributable to fluctuations in currency exchange rates will be ordinary income or loss and will not be treated as an adjustment to interest income received on the GKOs. Such foreign currency gain or loss will be recognised only to the extent of the total gain or loss realised by a U.S. holder on the exchange.

U.S. holders that have established their eligibility for Treaty benefits in accordance with applicable procedures will not be subject to Russian tax in respect of an exchange of GKOs for Bonds (see "– Russian Taxation"). Russian tax may be withheld in respect of an exchange of GKOs for Bonds by a U.S. holder that has not established its eligibility for Treaty benefits, in which event such a holder would be required to seek a refund under the Treaty. U.S. holders are advised to consult their tax advisers regarding the availability of, and the procedures for obtaining, benefits under the Treaty and the consequences of obtaining, or failing to obtain, any available refund of Russian tax.

Payments on the Bonds: Interest and Original Issue Discount

U.S. holders generally will recognise ordinary income with respect to interest payments on the Bonds when such interest is accrued or received, in accordance with the holder's normal method of accounting for United States federal income tax purposes.

It is expected that the Bonds will be issued at a discount from their stated principal amount. If the difference (if any) between the issue price and the stated principal amount of a Bond exceeds a *de minimis* amount (i.e., 0.25% of the stated principal amount of the Bond multiplied by the number of complete years to maturity), such difference will constitute original issue discount ("OID"). For this purpose, if a substantial amount of the Bonds is sold in the New Cash Offering, the issue price of a Bond will be the first price at which a substantial amount of the Bonds is sold to persons that are not underwriters, placement agents or wholesalers. Otherwise, the issue price will be the fair market value of the Bond on the issue date. In general, each U.S. holder of a Bond, whether such holder uses the cash or the accrual method of tax accounting, will be required to include in ordinary gross income the sum of the "daily portions" of any OID on the Bond for all days during the taxable year that the holder owns the Bond. The daily portions of OID are determined by allocating to each day in any accrual period a rateable portion of the OID allocable to that accrual period. Accrual periods may be any length and may vary in length over the term of the Bond, provided that no accrual period is longer than one year and each scheduled payment of principal or interest occurs on either the final day or the first day of an accrual period. The amount of OID allocable to each accrual period is determined by multiplying the "adjusted issue price" (as defined below) of the Bond at the beginning of the accrual

period by the yield to maturity of the Bond (appropriately adjusted to reflect the length of the accrual period). The yield to maturity of a Bond is the discount rate that causes the present value of all amounts payable on the Bond through maturity as of its original issue date to equal the issue price of such Bond. The "adjusted issue price" of a Bond at the beginning of any accrual period will generally be the sum of its issue price and the amount of OID allocable to all prior accrual periods.

Under the terms of the Bonds, the Federation has the right to issue additional Bonds that will be consolidated, and form a single series, with the Bonds being offered hereby. If such additional Bonds are sold reasonably close in time to the Bond Offering pursuant to a common plan that includes, or in a transaction that forms part of a series of related transactions with, the Bond Offering, such Bonds will be considered for U.S. tax purposes to have the same issue price as the Bonds issued in the Bond Offering. Upon request, the Federation will inform U.S. holders of the amount of OID, as well as the issue price, the issue date and the yield to maturity of the Bonds and, in the event that Bonds of the same series are issued with a different issue price for U.S. tax purposes, the maximum amount of OID with which Bonds of that series have been issued.

Disposition of Bonds

Upon the sale, exchange or other disposition of a Bond, a U.S. holder generally will recognise taxable gain or loss equal to the difference between the amount realised on the disposition and such U.S. holder's adjusted tax basis in the Bond. Such gain or loss will be the long-term capital gain or loss if, at the time of the disposition, the Bond has been held for more than one year. For these purposes, the amount realised does not include any amount attributable to accrued interest, which will be treated as such. A U.S. holder's adjusted tax basis in a Bond acquired in exchange for GKO's will generally be the fair market value of the Bond at the time of the exchange, increased by any amounts includible in income by the holder as OID.

United States Information Reporting and Backup Withholding

Interest on the Bonds, and payments of the proceeds of a sale of Bonds, paid within the United States or through certain U.S.-related financial intermediaries are subject to information reporting and may be subject to backup withholding at a 31 per cent. rate unless the holder (i) is a corporation or other exempt recipient or (ii) provides a taxpayer identification number and certifies that no loss of exemption from backup withholding has occurred. Holders that are not U.S. persons generally are not subject to information reporting or backup withholding. However, such a holder may be required to provide a certification as to its non-U.S. status in connection with payments received within the United States or through certain U.S.-related financial intermediaries.

FORM OF BONDS AND TRANSFER RESTRICTIONS RELATING TO U.S. SALES

The following information relates to the form, transfer and delivery of the Bonds.

1. Form of Bonds

All Bonds will be in definitive registered form, without interest coupons attached. Bonds offered and sold outside the United States in reliance on Regulation S will be represented by interests in the Unrestricted Global Bonds, in definitive fully registered form, without interest coupons attached, which will be deposited on or about the Settlement Date with Citibank, N.A. London, as common depositary for, and registered in the name of National City Nominees Limited, as nominee for, such common depositary in respect of interests held through Euroclear and Cedel Bank. A beneficial interest in an Unrestricted Global Bond may at all times be held only through Euroclear and Cedel Bank.

Bonds offered and sold in reliance on Rule 144A will be represented by interests in the Restricted Global Bonds, in definitive fully registered form, without interest coupons attached, which will be registered in the name of Cede & Co., as nominee for, and which will be deposited on or about the Settlement Date with Citibank, N.A. London, as custodian (the "Custodian") for, DTC. The Restricted Global Bonds (and any Bond Certificates issued in exchange therefor) will be subject to certain restrictions on transfer contained in a legend appearing on the face of such Bond set forth under item 2 below.

The Unrestricted Global Bonds will have an ISIN and the Restricted Global Bonds will have a CUSIP number.

2. Transfer Restrictions

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

Transfer restrictions will terminate two years (or such other period as provided by Rule 144) after the Settlement Date, assuming compliance with Condition 6(b).

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

The Bonds are being offered and sold in the United States only to qualified institutional buyers within the meaning of and in reliance on Rule 144A. Because of the following restrictions, purchasers of Bonds offered in the United States in reliance on Rule 144A are advised to consult legal counsel prior to making any offer, resale, pledge or transfer of such Bonds.

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

(i) The purchaser is (A) a qualified institutional buyer, (B) acquiring the Bonds for its own account or for the account of such a qualified institutional buyer and (C) aware, and each beneficial owner of such Bonds has been advised, that the sale of the Bonds to it is being made in reliance on Rule 144A.

(ii) The purchaser understands that the Bonds have not been and will not be registered under the Securities Act and may not be offered, resold, pledged or otherwise transferred except in accordance with the legend set forth below.

(iii) Each Restricted Global Bond and any Restricted Bond Certificates offered hereby will bear a legend to the following effect, unless the Issuer determines otherwise in accordance with applicable law:

"THIS BOND HAS NOT BEEN AND WILL NOT BE REGISTERED UNDER THE U.S. SECURITIES ACT OF 1933, AS AMENDED (THE "SECURITIES ACT"), OR WITH ANY SECURITIES REGULATORY AUTHORITY OF ANY STATE OR OTHER JURISDICTION OF THE UNITED STATES AND MAY NOT BE OFFERED, RESOLD, PLEDGED OR OTHERWISE TRANSFERRED EXCEPT (1) TO THE ISSUER OR AN AFFILIATE OF THE ISSUER, (2) IN ACCORDANCE WITH RULE 144A UNDER THE SECURITIES ACT TO A PERSON THAT THE HOLDER REASONABLY BELIEVES IS A QUALIFIED INSTITUTIONAL BUYER WITHIN THE MEANING OF RULE 144A PURCHASING FOR ITS OWN ACCOUNT OR FOR THE ACCOUNT OF A QUALIFIED INSTITUTIONAL BUYER, (3) IN AN OFFSHORE TRANSACTION IN ACCORDANCE WITH RULE 903 OR RULE 904 OF REGULATIONS OR (4) PURSUANT TO AN EXEMPTION FROM REGISTRATION UNDER THE SECURITIES ACT PROVIDED BY RULE 144 THEREUNDER (IF AVAILABLE), IN EACH CASE IN ACCORDANCE WITH ANY APPLICABLE SECURITIES LAWS OF ANY STATE OF THE UNITED STATES. NO REPRESENTATION CAN BE MADE AS TO THE AVAILABILITY OF THE EXEMPTION PROVIDED BY RULE 144 UNDER THE SECURITIES ACT FOR REALES OF THIS BOND."

The Issuer and the Dealer Managers and their affiliates and others will rely upon the truth and accuracy of the foregoing acknowledgements, representations and agreements.

3. Exchange of Interests in Global Bonds for Bond Certificates

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

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

In such circumstances, the relevant Global Bond shall be exchanged in full or in part, as the case may be, for Bond Certificates and the Issuer will, at the cost of the Issuer (but against such indemnity as the Registrar or any relevant Transfer Agent may require in respect of any tax or other duty of whatever nature which may be levied or imposed in connection with such exchange), cause sufficient Bond Certificates to be executed and delivered to the Registrar for completion, authentication and dispatch to the relevant Bondholders. A person having an interest in a Global Bond must provide the Registrar with (i) a written order containing instructions and such other information as the Issuer and the Registrar may require to complete, execute and deliver such Bond Certificates and (ii) in the case of a Restricted Global Bond only, a fully completed, signed certificate substantially to the effect that the exchanging holder is not transferring its interest at the time of such exchange or, in the case of simultaneous sale pursuant to Rule 144A, that the transfer is being made in compliance with the provisions of Rule 144A. Bond Certificates issued in exchange for a beneficial interest in a Restricted

Global Bond shall bear the legends applicable to transfers pursuant to Rule 144A, as set out under "Transfer Restrictions." Such transfer restrictions will terminate two years (or such other period as provided by Rule 144) after the Settlement Date assuming compliance with Condition 6(b)).

The holder of a Bond may transfer such Bond in accordance with the provisions of Condition 2 of the Terms and Conditions of the Bonds (see "Terms and Conditions of the Bonds – Transfer of Bonds and Issue of Bonds"). Bond Certificates may not be eligible for trading in the Euroclear, Cedel Bank and DTC systems.

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

No such election may however be made on or before an Exchange Date (as defined in each Unrestricted Global Bond) fixed in accordance with an Unrestricted Global Bond with respect to the Bonds to which that Exchange Date relates unless the registered holder elects in such notice that the exchange in question shall no longer take place.

Upon the transfer, exchange or replacement of a Restricted Bond Certificate bearing the legend referred to under "Transfer Restrictions," or upon specific request for removal of the legend on a Restricted Bond Certificate, the Issuer will deliver only Restricted Bond Certificates that bear such legend, or will refuse to remove such legend, as the case may be, unless there is delivered to the Issuer and the Registrar such satisfactory evidence, which may include an opinion of counsel, as may reasonably be requested by the Issuer that neither the legend nor the restrictions on transfer set forth therein are required to ensure compliance with the provisions of the Securities Act. Such transfer restrictions will terminate two years (or such other period as provided by Rule 144) after the Settlement Date assuming compliance with Condition 6(b).

The Registrar will not register the transfer of or exchange of interests in a Global Bond for Bond Certificates during the three business days ending on the due date for any payment of principal. For the purposes hereof and for payment of interest, "business day" means a day on which commercial banks and foreign exchange markets are open for business in London and New York City.

4. Euroclear, Cedel Bank and DTC Arrangements

So long as DTC or its nominee or Euroclear, Cedel Bank or the nominee of their common depositary is the registered holder of a Global Bond, DTC, Euroclear, Cedel Bank or such nominee, as the case may be, will be considered the sole owner or holder of the Bonds represented by such Global Bond for all purposes under the Fiscal Agency Agreement and the Bonds. Payments of principal, interest and additional amounts, if any, in respect of Global Bonds will be made to DTC, Euroclear, Cedel Bank or such nominee, as the case may be, as the registered holder thereof. None of the Issuer, any Agent or any Dealer Manager or any affiliate of any of them or any person by whom any of them is controlled for the purposes of the Securities Act will have any responsibility or liability for any aspect of the records relating to or payments made on account of beneficial ownership interests in Global Bonds or for maintaining, supervising or reviewing any records relating to such beneficial ownership interests.

Distributions of principal and interest with respect to book-entry interests in the Bonds held through Euroclear or Cedel Bank will be credited, to the extent received by Euroclear or Cedel Bank

from the Fiscal Agent, to the cash accounts of Euroclear or Cedel Bank customers in accordance with the relevant system's rules and procedures.

Holders of book-entry interests in the Bonds through DTC will receive, to the extent received by DTC from the Fiscal Agent, all distributions of principal and interest with respect to book-entry interests in the Bonds from the Fiscal Agent through DTC. Distributions in the United States will be subject to relevant U.S. tax laws and regulations.

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

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

The holdings of book-entry interests in the Bonds through Euroclear, Cedel Bank and DTC will be reflected in the book-entry accounts of each such institution. As necessary, the Registrar will adjust the amounts of Bonds on the Register for the accounts of (i) National City Nominees Limited and (ii) Cede & Co., to reflect the amounts of Bonds held through Euroclear and Cedel Bank, and DTC, respectively. Beneficial ownership in Bonds will be held through financial institutions as direct and indirect participants in Euroclear, Cedel Bank and DTC.

Interests in the Unrestricted Global Bond and the Restricted Global Bond will be in uncertificated book-entry form.

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

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

Trading between DTC Seller and Euroclear/Cedel Bank Purchaser. When book-entry interests in Bonds are to be transferred from the account of a DTC participant holding a beneficial interest in a Restricted Global Bond to the account of a Euroclear or Cedel Bank accountholder wishing to purchase a beneficial interest in an Unrestricted Global Bond (subject to such certification procedures as are provided in the Fiscal Agency Agreement), the DTC participant will deliver instructions for delivery to the relevant Euroclear or Cedel Bank accountholder to DTC by 12 noon, New York time, on the settlement date. Separate payment arrangements are required to be made between the DTC participant and the relevant Euroclear or Cedel Bank accountholder. On the settlement date, the Custodian will instruct the Registrar to (i) decrease the amount of Bonds registered in the name of Cede & Co. and evidenced by such Restricted Global Bond and (ii) increase the amount of Bonds registered in the name of the nominee of the common depository for Euroclear and Cedel Bank and evidenced by such Unrestricted Global Bond. Book-entry interests will be delivered free of payment to

Euroclear or Cedel Bank, as the case may be, for credit to the relevant accountholder on the first business day following the settlement date. See item 4 above concerning the Record Date for payment of interest.

Trading between Euroclear/Cedel Bank Seller and DTC Purchaser. When book-entry interests in the Bonds are to be transferred from the account of a Euroclear or Cedel Bank accountholder to the account of a DTC participant wishing to purchase a beneficial interest in a Restricted Global Bond (subject to such certification procedures as are provided in the Fiscal Agency Agreement), the Euroclear or Cedel Bank participant must send to Euroclear or Cedel Bank delivery free of payment instructions by 7.45 p.m., Brussels or Luxembourg time, one business day prior to the settlement date. Euroclear or Cedel Bank, as the case may be, will in turn transmit appropriate instructions to the common depository for Euroclear and Cedel Bank and the Registrar to arrange delivery to the DTC participant on the settlement date. Separate payment arrangements are required to be made between the DTC participant and the relevant Euroclear or Cedel Bank accountholder, as the case may be. On the settlement date, the common depository for Euroclear and Cedel Bank will (i) transmit appropriate instructions to the Custodian who will in turn deliver such book-entry interests in the Bonds free of payment to the relevant account of the DTC participant and (ii) instruct the Registrar to (a) decrease the amount of Bonds registered in the name of the nominee of the common depository for Euroclear and Cedel Bank and evidenced by an Unrestricted Global Bond and (b) increase the amount of Bonds registered in the name of Cede & Co. and evidenced by such Restricted Global Bond. See item 4 above concerning the Record Date for payment of interest.

Although the foregoing sets out the procedures of Euroclear, Cedel Bank and DTC in order to facilitate the transfers of interests in the Bonds among participants of Euroclear, Cedel Bank and DTC, neither Euroclear, nor Cedel Bank nor DTC is under any obligation to perform or continue to perform such procedures, and such procedures may be discontinued at any time. None of the Issuer, any Agent or any Dealer Manager or any affiliate of any of them, or any person by whom any of them is controlled for the purposes of the Securities Act, will have any responsibility for the performance by DTC, Euroclear and Cedel Bank or their respective direct or indirect participants or accountholders of their respective obligations under the rules and procedures governing their operations or for the sufficiency for any purpose of the arrangements described above.

SUBSCRIPTION AND SALE

The Federation has entered into a Dealer Managers Agreement, dated 18th July 1998 (to take effect from 14th July 1998), with Goldman Sachs International (the "Lead Manager" or "GSI") and the other dealer managers named therein (together with the Lead Manager, the "Dealer Managers") pursuant to which (a) the Federation has retained the Dealer Managers to act on behalf of the Federation as dealer managers in connection with the Invitation, (b) the Federation has agreed to pay the Dealer Managers fees based on the principal amount of Bonds issued pursuant to the Exchange Offer, (c) the Federation and the Dealer Managers have agreed to the matters described under the captions "Terms of the Bond Offering – Participation by the Federation, the Lead Manager and the other Dealer Managers" and "Terms of the Bond Offering – New Cash Offering" in the Federation's Preliminary Offering Circular dated 14th July 1998 (the "Preliminary Offering Circular"), (d) the Federation has agreed to issue, and the Lead Manager has agreed to subscribe, at a price per U.S.\$1,000 principal amount of each type of Bonds equal to the relevant Bond Issue Price less a selling commission of 0.625 per cent. of the principal amount of the Bonds to be subscribed pursuant to the New Cash Offering (the "New Cash Offering Bonds") and a combined management and underwriting commission of 0.25 per cent. of the principal amount of such Bonds, the New Cash Offering Bonds and (e) the Federation has agreed to indemnify the Dealer Managers against certain liabilities, including liabilities under the Securities Act. The Federation has retained Citibank, N.A. London to act as Exchange Agent in connection with the Invitation.

The following are the results of the Bond Offering, including the Exchange Offer and the New Cash Offering:

Aggregate Nominal Amount of GKO's Accepted for Exchange	27,545,793,000 roubles
Latest Maturity Date of GKO's Accepted for Exchange	27th January 1999
Average Currency Conversion Rate.....	6.2038 roubles/U.S.\$
UST Benchmark Rate for Bonds Due 2005.....	5.505 per cent.
UST Benchmark Rate for Bonds Due 2018.....	5.797 per cent.
Bond Clearing Spread over UST Benchmark Rate (for Bonds Due 2005/2018).....	9.40 per cent.
Aggregate Principal Amount of Bonds Due 2005 to be Issued pursuant to the Exchange Offer.....	U.S.\$2,968,695,000
Aggregate Principal Amount of Bonds Due 2018 to be Issued pursuant to the Exchange Offer.....	U.S.\$2,966,398,000
Aggregate Principal Amount of Bonds Due 2018 to be Issued pursuant to the New Cash Offering.....	U.S.\$500,000,000
Aggregate Principal Amount of all Bonds to be Issued pursuant to the Bond Offering.....	U.S.\$6,435,093,000

The Aggregate Nominal Amount of GKO's Accepted for Exchange, the Aggregate Principal Amount of Bonds Due 2005 to be Issued pursuant to the Exchange Offer, the Aggregate Principal Amount of Bonds Due 2018 to be Issued pursuant to the Exchange Offer and the Aggregate Principal Amount of all Bonds to be Issued pursuant to the Bond Offering may vary slightly from figures listed above as a result of the final reconciliation of accepted offers to exchange GKO's.

Terms used above have the meanings given to them in the Preliminary Offering Circular.

The exchange ratios for each series of GKO being exchanged (i.e., the principal amount of Bonds to be issued in exchange for each 1,000 redenominated roubles nominal amount of GKO's (subject to rounding)) are as follows:

Series of GKO's	GKO Exchange Price (redenominated roubles)	Exchange Ratios (2005/2018)
21082 Maturity: 29 Jul. 98	1,000.00	109.21/109.12
21083 Maturity: 05 Aug. 98	1,000.00	109.21/109.12
21085 Maturity: 12 Aug. 98	1,000.00	109.21/109.12
21086 Maturity: 19 Aug. 98	1,000.00	109.21/109.12
21088 Maturity: 26 Aug. 98	1,000.00	109.21/109.12
21089 Maturity: 02 Sep. 98	1,000.00	109.21/109.12
21090 Maturity: 09 Sep. 98	1,000.00	109.21/109.12

Series of GKO's	GKO Exchange Price (redenominated roubles)	Exchange Ratios (2005/2018)
21092 Maturity: 16 Sep. 98	985.40	107.61/107.53
21109 Maturity: 23 Sep. 98	983.60	107.42/107.33
21094 Maturity: 30 Sep. 98	981.70	107.21/107.13
21104 Maturity: 07 Oct. 98	951.10	103.87/103.79
21110 Maturity: 14 Oct. 98	946.80	103.40/103.32
21097 Maturity: 21 Oct. 98	931.80	101.76/101.68
21111 Maturity: 28 Oct. 98	926.90	101.22/101.15
21112 Maturity: 04 Nov. 98	910.10	99.39/99.31
21125 Maturity: 11 Nov. 98	904.60	98.79/98.71
21114 Maturity: 18 Nov. 98	886.40	96.80/96.73
21102 Maturity: 25 Nov. 98	880.40	96.15/96.07
21129 Maturity: 02 Dec. 98	861.00	94.03/93.95
21119 Maturity: 09 Dec. 98	854.60	93.33/93.26
21131 Maturity: 16 Dec. 98	834.30	91.11/91.04
21105 Maturity: 23 Dec. 98	827.70	90.39/90.32
21108 Maturity: 13 Jan. 99	793.20	86.62/86.56
21113 Maturity: 20 Jan. 99	786.60	85.90/85.84
21115 Maturity: 27 Jan. 99	780.20	85.20/85.14

As a result of the Invitation, several holders of GKO's will become owners of significant amounts of Bonds. These Bonds may be sold without restriction at any time. Such sales could have an adverse effect on the trading price of the Bonds.

The Bonds have not been and will not be registered under the Securities Act and may be offered or sold within the United States only in transactions that are exempt from, or not subject to, the registration requirements of the Securities Act.

The Dealer Managers Agreement provides that GSI may through its agents or affiliates registered as broker-dealers in the United States arrange for the resale of the New Cash Offering Bonds in the United States to qualified institutional buyers pursuant to and in accordance with Rule 144A.

In addition, until 40 days after the commencement of the offering, an offer or sale of the New Cash Offering Bonds within the United States by any dealer, whether or not it is participating in the offering, may violate the registration requirements of the Securities Act if such offer or sale is made otherwise than in accordance with Rule 144A.

Each Dealer Manager has represented and agreed that it has complied and will comply with all applicable provisions of the Financial Services Act 1986 with respect to anything done by it in relation to the Invitation in, from or otherwise involving the United Kingdom. GSI has represented and agreed that it has complied and will comply with all applicable provisions of the Financial Services Act 1986 with respect to anything done by it in relation to the New Cash Offering Bonds in, from or otherwise involving the United Kingdom.

Each Dealer Manager has represented and agreed that it has not offered and will not offer, directly or indirectly, any Bonds to the public in the Republic of France and that it has not distributed or caused to be distributed, and will not distribute or cause to be distributed, this Offering Circular or any other offering material relating to the Bonds to the public in the Republic of France.

GSI has represented and agreed that it has not offered or sold, and will not offer or sell, any New Cash Offering Bonds constituting part of its allotment to any purchaser located within the territory of the Federation.

From time to time the Dealer Managers and/or their affiliates may provide financial services to the Federation and may hold short-term or long-term external or domestic debt of the Federation or its agencies or instrumentalities. In addition, the Dealer Managers may buy and sell GKO's, or enter into over-the-counter option agreements or similar arrangements with respect to the Bonds to be issued in exchange for GKO's in connection with the Invitation.

GENERAL INFORMATION

1. The Unrestricted Bonds have been accepted for clearance through Euroclear and Cedel Bank under Common Code No. 8937206 in respect of the Bonds Due 2005 and 8937524 in respect of the Bonds Due 2018. The ISIN for the Unrestricted Bonds is XS0089372063 in respect of the Bonds Due 2005 and XS0089375249 in respect of the Bonds Due 2018. The Restricted Bonds have been accepted for clearance through DTC and for trading in PORTAL. The CUSIP number for the Restricted Bonds is 78307AAFO in respect of the Bonds Due 2005 and 78307AAG8 in respect of the Bonds Due 2018. The Common Code for the Restricted Bonds is 8941157 in respect of the Bonds Due 2005 and 8941122 in respect of the Bonds Due 2018. The ISIN for the Restricted Bonds is US78307AAF03 in respect of the Bonds Due 2005 and US78307AAG85 in respect of the Bonds Due 2018. The PORTAL reference number is RUSFNP05 in respect of the Bonds Due 2005 and RUSFNP18 in respect of the Bonds Due 2018.

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

2.1 the Fiscal Agency Agreement, which includes the forms of the Global Bonds and the Bond Certificates; and

2.2 English translations of the authorisations referred to in item 4 below.

3. The Issuer has obtained all necessary consents, approvals and authorisations in the Federation (other than annual budget appropriations) in connection with the issue of, and performance of its obligations under, the Bonds.

4. The issue of the Bonds was authorised pursuant to Federal Law No. 76-FZ of 26th December 1994 and Government Resolution No. 302 of 14th March 1998.

5. The Central Bank has confirmed in writing that (i) the Ministry of Finance may issue external bonds in 1998 in foreign currency, which would include the Bonds, without consent from the Central Bank, (ii) the Central Bank does not object to the export in 1998 by the Ministry of Finance of global certificates representing such external bonds, which would include the Global Bonds, and (iii) the Central Bank does not object to the fulfilment of payment obligations by the Ministry of Finance to its fiscal agents, which would include the Fiscal Agent, in foreign currency.

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

7. Article 166 of the USSR Fundamental Principles of Civil Legislation of 31st May 1991 provides that the parties to any foreign economic transaction may choose the governing law of the relevant transaction. Article 166 will apply with respect to the choice of English law to govern rights and obligations in respect of the Bonds in the case of any Bond held by a foreign person. There is no express provision of Russian law which permits a choice of governing law for a transaction to which all the parties are Russian persons. Accordingly, it is uncertain whether the choice of English law to govern rights and obligations in respect of the Bonds would be given effect by a court of the Federation in the case of a Bond held by a Russian person.

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

the relevant claim. State duty will also be payable upon an action or proceeding initiated in an arbitration court.

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

10. Enforceability in the Federation of a final judgment for the payment of a sum of money rendered by a court in any jurisdiction other than the Federation will be recognised by a court of the Federation as a basis upon which to approve enforcement of a judgment against the Issuer or its assets, properties or revenues in the Federation provided that there exists an international treaty between the Federation and the country where the foreign judgment was rendered concerning the recognition and enforcement of judgments in civil cases and, unless such international treaty otherwise provides, provided that the relevant requirements set forth in Article 437 of the Civil Procedure Code and any other relevant law, decree or regulation of the Federation are met. No international treaty exists between the Federation and the United Kingdom or the United States of America concerning the recognition and enforcement of judgments in civil cases. Accordingly, it is unlikely that a court of the Federation would recognise or enforce such a judgment without re-examination of the issues. Moreover, a court of the Federation may refuse or limit enforcement of a foreign judgment, *inter alia*, on public policy grounds and may seek to decline jurisdiction over a dispute arising out of an agreement governed by foreign law.

Issuer

Russian Federation
c/o The Ministry of Finance
9 Ilyinka Street
Moscow 103097

Fiscal Agent and Registrar

Citibank, N.A.
5 Carmelite Street
London EC4Y 0PA

Paying Agents and Transfer Agents

Citibank, N.A.
Building 726
1931 Brucargo Brussels

Banque Générale du Luxembourg SA
50 avenue J.F. Kennedy
L-2951 Luxembourg

Legal Advisers to the Issuer

Cleary, Gottlieb, Steen & Hamilton
City Place House
55 Basinghall Street
London EC2V 5EH

Legal Advisers to the Dealer Managers

As to English and United States law

Linklaters & Paines
One Silk Street
London EC2Y 8HQ

As to Russian law

Linklaters & Paines
Tsvetnoy Boulevard 25/3
Moscow 103051

Listing Agent

Banque Générale du Luxembourg SA
50 avenue J.F. Kennedy
L-2951 Luxembourg