

SUPPLEMENT
to Offering Circular dated 18 July 2000 (the "Offering Circular")

Russian Federation

Offer to Exchange (the "Exchange Offer")
US Dollar Denominated Bonds due 2007 to 2030 (the "2030 Bonds") and
US Dollar Denominated Bonds due 2006 to 2010 (the "2010 Bonds" and, together with the 2030
Bonds, the "New Bonds") for
Vnesheconombank of the USSR's Floating Rate Interest Notes due 2002 to 2015 ("IANs")

This Supplement is a supplement to, and should be read in conjunction with, the Offering Circular. Capitalised terms used but not defined herein have the meanings given to them in the Offering Circular. The Russian Federation, having made all reasonable enquiries, confirms that the information contained in this Supplement is true and accurate in every material respect and is not misleading in any material respect and that this Supplement does not omit to state any material fact necessary to make such information not misleading. The Russian Federation accepts responsibility for the information contained in this Supplement accordingly.

For purposes of listing the New Bonds on the Luxembourg Stock Exchange (the "Exchange"), this Supplement as well as the Offering Circular are freely available from the Exchange, in accordance with its rules and regulations.

In connection with the Exchange Offer, Citibank (Luxembourg) S.A. (the "Luxembourg Exchange Agent") will perform all services customarily performed by Luxembourg-based exchange agents in exchange offers made for securities listed on the Exchange. The Luxembourg Exchange Agent will distribute or arrange for the distribution of the Offering Circular to holders of IANs, assist IANs holders needing assistance in connection with the Exchange Offer and request nominee holders of IANs to forward information relating to the Exchange Offer to beneficial holders of IANs. The back-office exchange agency services for the Exchange Offer will be performed at the London offices of Citibank, N.A. (the "Exchange Agent"), in consultation with the Luxembourg Exchange Agent, if necessary, but holders of IANs can communicate only with the Luxembourg Exchange Agent if they so choose.

Letters of Transmittal for the Exchange of IANs may be delivered to the Luxembourg Exchange Agent. In accordance with the rules of Euroclear, Clearstream (Luxembourg) and DTC, the Luxembourg Exchange Agent and the Exchange Agent will together liaise with the clearing systems to ensure that appropriate blocking instructions have been provided to the clearing systems by holders of IANs.

The section entitled "Cross-Acceleration of Russian Federation Eurobonds" beginning on page 22 of the Offering Circular describes rights granted to certain holders of Russia's currently existing Eurobonds, not to holders of IANs or the New Bonds. In addition, the Repurchase Rights are not part of the terms and conditions of Russia's existing Eurobonds, but are separate rights arising in favour of such holders. In connection with the exercise of Repurchase Rights, Repurchase Notices may be delivered to Russia's Luxembourg Paying Agent for the New Bonds, rather than the Fiscal Agent. So long as the New Bonds are listed on the Exchange and the rules of the Exchange so require, the Russian Federation will publish a notice of any Repurchase Notice Delivery Date and any Repurchase Date in a leading newspaper having general circulation in Luxembourg (which is expected to be the *Luxemburger Wort*).

The date of this Supplement is 3 August 2000

OFFERING CIRCULAR



Russian Federation

Offer to Exchange

Russian Federation U.S. Dollar Denominated Bonds due 2007 to 2030 ("2030 Bonds") and Russian Federation U.S. Dollar Denominated Bonds due 2006 to 2010 ("2010 Bonds")

for

Vnesheconombank of the USSR's Loans due 2002 to 2020 ("PRINs") and Vnesheconombank of the USSR's Floating Rate Interest Notes due 2002 to 2015 ("IANs")

The Exchange Offer will expire at 5:00 p.m., London time, on 11 August 2000, unless extended or earlier terminated.

The Ministry of Finance of the Russian Federation (the "Ministry of Finance") acting on behalf of the Russian Federation hereby offers to exchange 2030 Bonds and 2010 Bonds (together, the "New Bonds") for PRINs and IANs on the terms set forth herein (the "Exchange Offer"). The New Bonds will be direct, unconditional and unsecured obligations of the Russian Federation.

The principal amount of New Bonds to be exchanged for PRINs and IANs and accrued and unpaid interest thereon up to, but not including, 31 March 2000 will be as follows:

For each U.S.\$1,000 principal amount of U.S. dollar denominated PRINs tendered:

- U.S.\$625 principal amount of 2030 Bonds.
- U.S.\$104.9731 principal amount of 2010 Bonds.

For each U.S.\$1,000 principal amount of IANs tendered:

- U.S.\$670 principal amount of 2030 Bonds.
- U.S.\$86.3343 principal amount of the 2010 Bonds.

The principal amount of New Bonds to be exchanged for PRINs not denominated in U.S. dollars is set out under "Principal Amount of New Bonds to be Received by Holders Pursuant to the Exchange Offer."

A person may only participate in the Exchange Offer by delivering a Letter of Transmittal at or prior to 5:00 p.m., London time, on 11 August 2000 to Citibank, N.A. (the "Exchange Agent") at the address specified in the Letter of Transmittal by hand, courier or facsimile. Letters of Transmittal for the tender of IANs may also be delivered to the offices of Citibank (Luxembourg) S.A. (the "Luxembourg Exchange Agent") at the address set forth on the back cover hereof. Any Letter of Transmittal for the tender of PRINs must be completed by the registered holder thereof and delivered directly to the Exchange Agent. Any Letter of Transmittal for the tender of IANs must be completed by a direct account holder in Euroclear or Clearstream (Luxembourg) or by a direct participant in DTC and must be delivered directly to the Exchange Agent or to the Luxembourg Exchange Agent. Appropriate blocking instructions must also be delivered to the applicable clearing system at the time of delivery of a Letter of Transmittal for the tender of IANs, as described below under "Terms of Exchange Offer — Procedures for Tenders of PRINs and IANs."

The Russian Federation may at its option terminate the Exchange Offer if the total principal amount of tendered PRINs and IANs is less than U.S.\$25 billion (or its equivalent in other currencies). If the total principal amount of tendered PRINs and IANs is less than U.S.\$19 billion (or its equivalent in other currencies), the Russian Federation may not consummate the Exchange Offer without the consent of holders representing at least 75% of the principal amount of tendered PRINs and IANs.

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

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

Citibank, N.A.
as Exchange Agent

18 July 2000

The Russian Federation, having made all reasonable enquiries, confirms that this Offering Circular contains all information with respect to the Russian Federation and the New Bonds which is material in the context of the issue and offering of the New 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 Russian Federation are honestly held, have been reached after considering all relevant circumstances and are based on reasonable assumptions. The Russian Federation accepts responsibility for the information contained in this Offering Circular accordingly.

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

No person has been authorised to make or provide any representation or information regarding the Russian Federation or the New 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 Russian Federation or any agency thereof. 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.

A letter from the London Club Advisory Committee dated 18 July 2000 is included on page 11 below. The London Club Advisory Committee is the group of financial institutions formed at the request of the Ministry of Finance and Vnesheconombank of the USSR ("Vnesheconombank") to facilitate communications between, on the one hand, creditors holding PRINs or IANs and, on the other hand, the Ministry of Finance and Vnesheconombank. The members of the London Club Advisory Committee are Banca Nazionale del Lavoro S.p.A., Bank Austria AG, Bank of America NA, Banque Nationale de Paris, Commerzbank AG, Crédit Lyonnais, Deutsche Bank AG, Dresdner Bank AG and JP Morgan.

No member of the London Club Advisory Committee or any of the Exchange Agent, Luxembourg Exchange Agent, Restructuring Agent, Fiscal Agent, Registrar, Paying Agent or Transfer Agents referred to below (together, the "Agents") makes any representation regarding this Offering Circular or the New Bonds or any recommendation that persons exchange PRINs or IANs or refrain from exchanging PRINs or IANs pursuant to the Exchange Offer, and no one has been authorised by any member of the London Club Advisory Committee or any Agent to make any such recommendation. Persons must make their own decision as to whether to exchange PRINs or IANs pursuant to the Exchange Offer, and, if so, the principal amount of PRINs or IANs to exchange for New Bonds.

This Offering Circular does not constitute an offer of, or an invitation by or on behalf of, the Russian Federation or any agency thereof in any jurisdiction where an offer or invitation by or on behalf of the Russian Federation or any agency thereof is not permitted by the laws of such jurisdiction. The distribution of this Offering Circular and the offering of the New Bonds in certain jurisdictions may be restricted by law. Persons into whose possession this Offering Circular comes should inform themselves of and observe any such restrictions.

Holders of PRINs or IANs who exchange PRINs or IANs for New Bonds will, by doing so, make certain representations, warranties and acknowledgements, give certain consents (in the case of PRIN Holders only), and undertake to perform certain covenants, as described in "Terms of the Exchange Offer — Representations, Warranties, Acknowledgements and Covenants of Holders" and "— Consents" and in "Transfer Restrictions" herein.

This Offering Circular is being delivered only to holders of PRINs and IANs and is not an offer to any other person or the public generally. Distribution of this Offering Circular to any person other than a holder of PRINs or IANs or an advisor to such holder is not authorised by the Russian Federation, except to the extent required after the Settlement Date by the rules and regulations of the Luxembourg Stock Exchange. This Offering Circular is not an offer to the public in France, Italy or elsewhere.

With effect from January 1, 1998, the rouble was redenominated, with one new rouble being set equal to one thousand old roubles. All references herein to amounts in "roubles" are references to new roubles, and any rouble amounts relating to the period prior to January 1, 1998 have been restated in new roubles. The rouble/dollar exchange rate as reported by the Central Bank of the Russian Federation (the "Central Bank") on 17 July 2000 was 27.85 roubles to the dollar.

In this Offering Circular, all references to “dollar,” “U.S.\$” and “\$” are to the lawful currency of the United States of America, references to “euro” and “Euro” are to the lawful currency of the European Monetary Union, references to “Deutsche Mark” or “DM” are to the sub-denomination of euro which is the lawful currency of Germany, references to “Swiss Francs” or “CHF” are to the lawful currency of Switzerland and references to “Yen” or “¥” are to the lawful currency of Japan.

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

Prior to the dissolution of the Soviet Union, the collection of data and production of official statistical information with respect to the Russian economy was geared to the needs of central planning. Since that time, the means employed in collecting data and methodologies used in the production of statistics have evolved significantly from year-to-year. Statistical information reported herein has been derived from official publications of, and information supplied by, a number of agencies of the Russian Federation, including the State Committee on Statistics (“Goskomstat”), the Central Bank, the Ministry of Finance, the State Customs Committee of the Russian Federation (the “Customs Committee”) 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 on 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.

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



МИНИСТР

103097, Москва, ул. Ильинка, 9
телефакс: 112008
телефакс: 925-03-89

18.08.2000 № 26-01-01

На № _____

Владельцам инструментов PRIN и IAN Внешэкономбанка

Довожу до вас предложение Российской Федерации об обмене обязательств Внешэкономбанка, оформленных в виде реструктуризированных кредитов с погашением в 2002-2020 гг. (далее – “инструменты PRIN”), и процентных облигаций Внешэкономбанка с переменным купонным доходом с погашением в 2002-2015 гг. (далее – “инструменты IAN”) на новые еврооблигации Российской Федерации с погашением в 2006-2010 гг. и новые еврооблигации Российской Федерации с погашением в 2007-2030 гг.

Условия предложения об обмене, изложенные в прилагаемом Проспекте предложения (далее – “Предложение об обмене”), являются итогом продолжительных переговоров с банковским консультативным комитетом Лондонского клуба, а также консультаций с портфельными инвесторами-владельцами инструментов PRIN и IAN. Полагаем, что согласованные в результате условия, которые отражают компромисс и интересы обеих сторон, являются справедливыми и отвечают интересам России и владельцев инструментов PRIN и IAN.

Данная реструктуризация стала необходимой в результате финансового кризиса августа 1998 г., который, среди прочего, вынудил Россию отложить сроки платежей по задолженности бывшего СССР перед кредиторами, входящими в Парижский клуб, и другими официальными кредиторами и ОВВЗ серии III с погашением в 1999 г., провести реструктуризацию некоторых категорий своего внутреннего долга (ГКО и ОФЗ), а также приостановить выплаты процентов по инструментам PRIN (начиная с декабря 1998 г.) и инструментам IAN (начиная с июня 1999 г.).

После финансового кризиса в России вновь наблюдается экономический рост, восстановлена относительная стабильность цен, достигнуты профицит бюджета и значительное положительное сальдо счета текущих операций платежного баланса. Улучшение этих показателей произошло в значительной мере благодаря существенному росту мировых цен на сырьевые товары, четырехкратной девальвации рубля по сравнению с его стоимостью до августовского кризиса 1998 г. и приостановлению выплат по долгу советского периода, а также проведению Россией жесткой кредитно-денежной и налогово-бюджетной политики.

Российская экономика находится в настоящее время на важнейшем поворотном этапе. Правительством утверждена масштабная программа экономических реформ, направленная на то, чтобы воспользоваться текущей благоприятной экономической ситуацией с целью достижения устойчивого экономического роста и макроэкономической стабильности. В соответствии с этой программой экономических реформ Правительство намерено:

- проводить жесткую налогово-бюджетную политику в целях поддержания сбалансированности федерального бюджета;
- упростить и усовершенствовать налоговую систему;
- реформировать систему социального обеспечения и пенсионную систему;
- уменьшить государственное регулирование некоторых направлений экономической деятельности;
- улучшить инвестиционный климат путем ужесточения стандартов корпоративного управления, укрепления независимой судебной системы и восстановления доверия инвесторов;
- улучшить регулирование и контроль за банковским сектором;
- создать систему страхования банковских вкладов и ипотечную систему.

Правительство понимает, что добиться успеха в реализации этой программы экономических реформ будет невозможно без достижения на основе консенсуса комплексного решения проблемы внешнего долга России, около двух третьих которого унаследовано Россией от бывшего СССР. Исходя из такого понимания мы следуем стратегии управления долгом, которая в настоящее время направлена на реструктуризацию долгов бывшего СССР, включая:

- инструменты PRIN и IAN Внешэкономбанка (при помощи Предложения об обмене, описанного в прилагаемом Проспекте предложения);
- соответствующую задолженность по договорам, заключенным внешнеторговыми организациями от имени Правительства бывшего СССР; и
- задолженность России Парижскому клубу и другим официальным кредиторам.

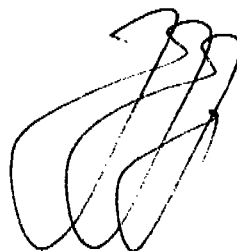
Предложение об обмене является важным шагом по реализации указанной стратегии. Правительство не прекращает своих усилий по урегулированию и реструктуризации прочих долгов бывшего СССР. Входящие в Парижский клуб кредиторы России заявили о своем намерении приступить осенью этого года к обсуждению комплексных решений по долгам России Парижскому клубу. Как уже было объявлено ранее, Правительство в ходе этих переговоров будет добиваться облегчения долгового бремени, сопоставимого с тем, которое предусмотрено Предложением об обмене. Наконец, как указывается в прилагаемом Проспекте предложения, Правительство предполагает позднее в

этом году предложить держателям соответствующей задолженности по договорам, заключенным внешнеторговыми организациями бывшего СССР от имени Правительства бывшего СССР, принять участие в Предложении об обмене на условиях, установленных для позднее присоединившихся кредиторов в рамках реструктуризации долговых обязательств Внешэкономбанка перед Лондонским клубом, проведенной в 1997 году. Эти меры, взятые в совокупности, обеспечат комплексное решение вопросов реструктуризации задолженности бывшего СССР, позволят восстановить кредитоспособность России, обеспечат реалистичный график обслуживания государственного долга в среднесрочной перспективе и будут способствовать социально-экономическому развитию страны.

Успешное осуществление Предложения об обмене должно привести к повышению цен на долговые инструменты Российской Федерации. Реализация Правительством программы реформ также должна оказать позитивное воздействие на рыночную стоимость этих инструментов.

Призываем вас внимательно рассмотреть Предложение об обмене и ознакомиться с прилагаемым Проспектом предложения. Российская Федерация не намерена делать каких-либо иных предложений об обмене инструментов PRIN и IAN.

Мы высоко ценим проявленные кредиторами в течение этого сложного периода терпение и выдержку и надеемся на восстановление нормальных отношений с международным инвестиционным сообществом.

A handwritten signature in black ink, consisting of several overlapping loops and lines, positioned in the lower right quadrant of the page.

[Letterhead of the Minister of Finance]

July 18, 2000

To: Holders of Vnesheconombank PRINs and IANs

I am pleased to transmit with this letter an offer by the Russian Federation to exchange new Russian Federation Eurobonds due 2006 to 2010 and new Russian Federation Eurobonds due 2007 to 2030 for Vnesheconombank's loans due 2002 to 2020 ("PRINs") and Vnesheconombank's floating rate interest notes due 2002 to 2015 ("IANs").

The terms of the exchange offer described in the attached Offering Circular (the "Exchange Offer") are the result of extensive discussions with the London Club Advisory Committee and consultations with portfolio holders of PRINs and IANs. We believe that the resulting terms, which reflect compromise and accommodation by both sides, are fair and in the best interests of Russia and the holders of PRINs and IANs.

This restructuring was made necessary by the financial crisis of August 1998, which, among other things, forced Russia to reschedule the debt of the former Soviet Union owed to Paris Club and other official creditors and the MinFin III Bonds scheduled to mature in 1999, to restructure certain categories of its internal debt (GKO and OFZs) and to suspend interest payments on PRINs (beginning in December 1998) and IANs (beginning in June 1999).

Subsequent to the financial crisis, Russia has seen an economic recovery, restored relative price stability, and run a budget surplus and a significant current account surplus. This improved performance is in large measure the result of a significant increase in world commodity prices, the devaluation in the rouble to one-fourth of its value prior to the August 1998 crisis and the suspension of payments on Soviet-era debt, as well as Russia's tight monetary and fiscal policies.

The Russian economy is now at a critical turning point. The Government has approved a sweeping economic reform program to take advantage of the current favorable economic situation with the objective of achieving sustainable economic growth and macroeconomic stability. Pursuant to the economic reform program, the Government will:

- pursue tight fiscal policies with a view to maintaining a balanced Federal budget;
- simplify and improve the tax system;
- reform the social security and pension system;
- deregulate certain business activities;
- improve the investment climate by strengthening corporate governance standards, strengthening the independent judicial system and restoring investor confidence;
- improve the regulation and supervision of the banking sector; and
- establish a system of deposit insurance and a mortgage system.

The Government understands that this economic reform program cannot succeed without a comprehensive, consensual solution to Russia's external debt burden, approximately two-thirds of which has been inherited from the former Soviet Union. In accordance with this understanding, we are pursuing a debt management strategy that currently aims to restructure debts of the former Soviet Union, including:

- Vnesheconombank's PRINs and IANs through the Exchange Offer described in the attached Offering Circular;
- the eligible debt contracted by foreign trade organisations on behalf of the Government of the former Soviet Union; and
- Russia's debt to the Paris Club and other official creditors.

The Exchange Offer is an important step in the implementation of this strategy. The Government is also proceeding with its efforts to resolve and restructure other debts of the former Soviet Union. Russia's Paris Club creditors have stated their intention to begin discussions of comprehensive solutions to Russia's Paris Club debts in the autumn of this year. As previously announced, the Government will seek in these discussions debt relief comparable to that contemplated in the Exchange Offer. Finally, as described in the attached

Offering Circular, the Government expects later this year to invite holders of eligible debt contracted by foreign trade organisations of the former Soviet Union on behalf of the Government of the former Soviet Union to participate in the Exchange Offer as if they were Late Joining Creditors under Vnesheconombank's 1997 London Club rescheduling. These measures, taken together, will provide a comprehensive solution to Russia's debt restructuring efforts, will reestablish Russia's creditworthiness, will give Russia a sustainable debt service profile over the medium term and will aid in Russia's economic and social development.

Successful completion of the Exchange Offer is likely by itself to reduce the discount applied by the market to Russian Federation debt instruments. Implementation of the Government's reform program should further enhance the market value of these instruments.

We encourage you to consider the Exchange Offer carefully and to read the attached Offering Circular. The Russian Federation does not intend to make any further exchange offers in respect of PRINs or IANs.

We appreciate the patience and forbearance shown by creditors during this difficult period and we look forward to restoring normal relations with the international investor community.

A.L. Kudrin



HORST KÖHLER
MANAGING DIRECTOR

INTERNATIONAL MONETARY FUND
WASHINGTON, D.C. 20431

CABLE ADDRESS
INTERFUND

July 17, 2000

To: The International Financial Community

Russian Federation — Progress under the Program and Economic Prospects

I would like to inform you about recent economic developments in the Russian Federation, its economic program, and its relations with the International Monetary Fund.

Russia has made impressive progress in macroeconomic stabilization. Economic growth has resumed following a decade of decline, while inflation has remained under control and external reserves have increased significantly. This favorable performance partly reflects the increase in energy prices in world markets, but also the fact that the authorities have shown a firm resolve to maintain sound macroeconomic policies, with a strengthened fiscal position, significant improvements in tax collections, and tight control of monetary aggregates. However, progress to date on the structural front has been disappointing. Problems in this area include delays in passage of key legislation, some of which is important banking reform legislation. As to relations with the Fund, Russia made only one purchase under the 17-month Stand-By Arrangement approved by the IMF's Executive Board in July 1999. Subsequent quarterly program reviews were not completed.

The new administration under President Putin has stated its intention to implement an economic program that will consolidate the gains obtained so far in the macroeconomic area while advancing market-oriented structural reforms. The Duma is in the process of passing the government's proposals for far-reaching and bold tax reforms. These reforms are generally in line with policies that the Fund has been advocating in the past and we believe that, if fully implemented and accompanied by measures to improve tax administration, they should strengthen significantly the tax system. The authorities have also underscored their intention to incorporate into the 2001 budget significant expenditure cuts in order to compensate for revenue losses associated with the tax reform.

As to other areas of structural reform, the government approved on June 28 its program of economic reform. This program is based largely upon proposals prepared by an expert group which involved consultations with the staff of the Fund and World Bank. These proposals call for an acceleration of market-orientated reforms in a large number of areas. The government is in the process of finalizing the priorities, timetable and details of its

program. Discussions are continuing with Fund staff with a view to securing Fund support for the program in the form of a new Stand-By Arrangement.

The balance of payments is expected to weaken significantly over the medium term as imports recover from exceptionally compressed levels and energy prices decline from recent highs. In this regard, it will be essential for the program to be adequately financed on terms that are consistent with a return to medium-term viability. In particular, the proposed debt exchange would assist in restructuring Russia's remaining debt service obligations to banks and financial institutions to levels consistent with the government's medium-term fiscal stance and the balance of payments path. I, therefore, believe that it warrants the support of the international community.

Sincerely yours,

A handwritten signature in cursive script, appearing to read "A. Kahl".

To: The International Financial Community
From: The London Club Advisory Committee
Date: 18 July 2000

The Russian Federation's Exchange Offer

1. As you are aware the Russian Federation has requested the restructuring of Vnesheconombank's Loans due 2002 to 2020 ("PRINs") and Vnesheconombank's Floating Rate Interest Notes due 2002 to 2015 ("IANs").
2. Since the Summer of 1999 there have been numerous meetings between representatives of the London Club Advisory Committee and a Russian delegation, headed by Mikhail Kasyanov, Prime Minister of the Russian Federation. Members of the London Club Advisory Committee have also met and heard other creditors' views which were reflected in the discussions.
3. During meetings held between the London Club Advisory Committee and the Russian delegation in Frankfurt on 11 February 2000 the main commercial and legal arrangements were finalised by way of an Outline Heads of Terms. Since then the Russian Ministry of Finance has worked to develop more fully the terms of the restructuring, which are outlined in detail in the enclosed Offering Circular prepared by the Russian Federation which is being distributed to you for your consideration.
4. Included in the Offering Circular are letters from the International Monetary Fund and the Minister of Finance of the Russian Federation. As part of your evaluation of the Exchange Offer, we would draw your specific attention to the information contained in the Offering Circular and the proposed timetable.
5. Each creditor is responsible for forming its own independent judgement on the Exchange Offer in light of its own position, knowledge and experience. Each member of the London Club Advisory Committee intends to respond positively to the Exchange Offer in respect of its own exposure in the form of PRINs and IANs. Other creditors have been requested by the Minister of Finance of the Russian Federation to respond positively to the Exchange Offer by sending Letters of Transmittal to the Exchange Agent (in the manner specified in the Offering Circular) as soon as possible and in any event no later than 11 August 2000.

Banca Nazionale del Lavoro S.p.A.
Bank Austria AG
Bank of America, NA
Banque Nationale de Paris
Commerzbank AG

Crédit Lyonnais
Deutsche Bank AG
Dresdner Bank AG
JP Morgan

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INSTRUCTIONS FOR LETTER OF TRANSMITTAL FOR EXCHANGE OF PRINS

Provide the information requested next to the indicated number in the Letter of Transmittal for Exchange of PRINs located immediately following these instructions. **Letters of Transmittal must be delivered at or prior to 5:00 p.m., London time on 11 August 2000 to the Exchange Agent at the address listed on the Letter of Transmittal by hand, courier or facsimile. Letters of Transmittal sent by e-mail will not be accepted.** Please send only one copy of each Letter of Transmittal by one of the means described above. Please do not send confirmation copies of any Letter of Transmittal by the same or different means.

The Exchange Agent will forward each Letter of Transmittal for Exchange of PRINs to the Restructuring Agent under the Restructuring Agreement referred to herein. **Please do not send Letters of Transmittal directly to the Restructuring Agent or to the Ministry of Finance.**

Letters of Transmittal may be signed only by the registered holder of the PRINs being tendered or by a person authorised to sign on its behalf. A separate Letter of Transmittal must be submitted for PRINs of each currency or tranche being tendered. Please retain a photocopy of each Letter of Transmittal submitted. If additional copies of the Letter of Transmittal for Exchange of PRINs are required, please photocopy the form located immediately following this instruction. Additional copies of the Letter of Transmittal may also be obtained from the Exchange Agent.

1. Provide the currency (tranche) of the tendered PRINs.
2. Provide the principal amount of the tendered PRINs (in words and numbers).
3. Provide the name, address, creditor number previously assigned by the Restructuring Agent, contact person, telephone and facsimile numbers and e-mail address of the registered holder of the tendered PRINs.
4. Indicate the Securities Account No. to which New Bonds are to be credited below the name of the clearing system in which New Bonds will be held (Euroclear, Clearstream (Luxembourg) or DTC). Please ensure that appropriate instructions regarding delivery of New Bonds have been provided to that clearing system.
5. Provide the name of the Euroclear or Clearstream (Luxembourg) Accountholder or DTC Participant receiving New Bonds.
6. Confirm either of the following U.S. securities law representations:
 - (A) "The beneficial owners of the PRINs that are the subject of this Letter of Transmittal will receive the New Bonds in an offshore transaction pursuant to Regulation S under the United States Securities Act of 1933;" or
 - (B) "The beneficial owners of the PRINs that are the subject of this Letter of Transmittal are Qualified Institutional Buyers acquiring the New Bonds for their own account or for the account of a Qualified Institutional Buyer (as such term is defined in Rule 144A under the United States Securities Act of 1933)."
7. Signature and Date. The Letter of Transmittal must be signed by the registered holder of the PRINs being tendered or by a person authorised to sign on behalf of such registered holder.

Vnesheconombank and the Restructuring Agent have entered into an amendment to the Restructuring Agreement dated 18 July 2000. The amendment provides, among other things, that (a) a duly completed Letter of Transmittal for Exchange of PRINs will constitute a Transfer Certificate and (b) the Russian Federation or its nominee may be a Transferee of a tendered PRIN for purposes of the Restructuring Agreement. The amendment to the definition of Transferee is subject to acceptance of Tenders from Holders representing in excess of 66 $\frac{2}{3}$ % of the outstanding PRINs. in accordance with the Restructuring Agreement. In connection with this amendment, the Russian Federation or its nominee, as transferee, will undertake to perform the obligations which by the terms of the Restructuring Agreement are to be assumed on the Settlement Date by the transferee pursuant to the Restructuring Agreement and the related Transfer Certificate.

The execution and delivery of a Letter of Transmittal for Exchange of PRINs will constitute the consent of the Holder to the amendment of the definition of Transferee described above. In accordance with the Restructuring Agreement, a Holder's failure to sign or deliver a Letter of Transmittal in respect of all of such Holder's PRINs will be counted as a vote against this amendment.

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INSTRUCTIONS FOR LETTER OF TRANSMITTAL FOR EXCHANGE OF IANS

Provide the information requested next to the indicated number in the Letter of Transmittal for Exchange of IANs located immediately following these instructions. **Letters of Transmittal must be delivered at or prior to 5:00 p.m., London time on 11 August 2000 to the Exchange Agent at the address listed on the Letter of Transmittal by hand, courier or facsimile. Letters of Transmittal sent by e-mail will not be accepted.** Letters of Transmittal may instead be sent by hand, courier or facsimile to the Luxembourg Exchange Agent at the address set forth on the back cover hereof with a copy to the applicable clearing system. Please send only one copy of each Letter of Transmittal by one of the means described above. Please do not send confirmation copies of any Letter of Transmittal by the same or different means. **Please do not send Letters of Transmittal directly to the Ministry of Finance.**

Letters of Transmittal may be signed only by a direct accountholder in Euroclear or Clearstream (Luxembourg) or by a direct participant in DTC, or by a person authorised to sign on behalf of such accountholder or participant. In the event a person wishing to participate in the Exchange Offer holds IANs through an accountholder in Euroclear or Clearstream (Luxembourg) or a participant in DTC, it must make appropriate arrangements for such accountholder or participant to submit a Letter of Transmittal on its behalf on or before the Expiration Date. Please retain a photocopy of each Letter of Transmittal submitted. If additional copies of the Letter of Transmittal for Exchange of IANs are required, please photocopy the form located immediately following this instruction. Additional copies of the Letter of Transmittal may also be obtained from the Exchange Agent.

1. Provide the principal amount of the tendered IANs (in words and numbers).
2. Indicate the Securities Account No. in which IANs are held below the name of the clearing system in which IANs are held (Euroclear, Clearstream (Luxembourg) or DTC).
3. Provide the name, address, contact person, telephone and facsimile numbers and e-mail address of the Euroclear or Clearstream (Luxembourg) accountholder or the DTC participant tendering the IANs.
4. Indicate the Securities Account No. to which New Bonds are to be credited below the name of the clearing system in which New Bonds will be held (Euroclear, Clearstream (Luxembourg) or DTC). Please ensure that appropriate instructions regarding delivery of New Bonds have been provided to that clearing system.
5. Provide the name of the Euroclear or Clearstream (Luxembourg) Accountholder or DTC Participant receiving New Bonds.
6. Confirm either of the following U.S. securities law representations:
 - (A) "The beneficial owners of the IANs that are the subject of this Letter of Transmittal will receive the New Bonds in an offshore transaction pursuant to Regulation S under the United States Securities Act of 1933;" or
 - (B) "The beneficial owners of the IANs that are the subject of this Letter of Transmittal are Qualified Institutional Buyers acquiring the New Bonds for their own account or for the account of a Qualified Institutional Buyer (as such term is defined in Rule 144A under the United States Securities Act of 1933)."
7. Signature and Date. The Letter of Transmittal must be signed by the direct accountholder in the facilities of Euroclear or Clearstream (Luxembourg) or by the direct participant in DTC or by a person authorised to sign on behalf of such accountholder or participant.

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LETTER OF TRANSMITTAL FOR EXCHANGE OF IANS

This form is to be completed in accordance with the instructions set forth under "Instructions for Letter of Transmittal for Exchange of IANs" on page 14 of the Offering Circular dated 18 July 2000 and must be delivered to the Exchange Agent at or prior to 5:00 p.m., London time, on 11 August 2000. Please insert the requested information or mark with an X where appropriate. Capitalised words used in this Letter of Transmittal but not defined herein will have the meanings given to them in the Offering Circular.

To: Citibank, N.A.
5 Carmelite Street
London EC4Y 0PA England
Attention: Citibank Agency and Trust Services; Ref.: Russian Federation
Phone No: ++ 44 207 508 3867
Fax No: ++ 44 207 508 3866

1. Principal Amount of tendered IANs (in words and numbers): _____
U.S.\$ _____

2. Indicate the Securities Account No. in which tendered IANs are held (below the name of the relevant clearing system):
Euroclear _____ Clearstream (Luxembourg) _____ DTC _____

3. Name of Euroclear/Clearstream (Luxembourg)/DTC Accountholder or Participant tendering IANs: _____
Address: _____
Contact Person: _____
Phone No. (including country code): _____
Fax No. (including country code): _____
E-mail Address: _____

4. Indicate the Securities Account No. to which New Bonds are to be credited (below the name of the relevant clearing system):
Euroclear _____ Clearstream (Luxembourg) _____ DTC _____

5. Name of Euroclear/Clearstream (Luxembourg)/DTC Accountholder or Participant receiving New Bonds: _____

6. Confirm the appropriate U.S. securities law representation referred to in paragraph 7 of "Instructions for Letter of Transmittal for Exchange of IANs":

	Regulation S	OR		QIB
(A)			(B)	

The sender of this Letter of Transmittal represents, warrants, acknowledges, covenants and consents as set forth in the Offering Circular under "Terms of the Exchange Offer -- Representations, Warranties, Acknowledgements and Covenants of Holders" and "Transfer Restrictions."

The sender of this Letter of Transmittal confirms that appropriate blocking instructions have been provided to the clearing system identified above. This Letter of Transmittal will be governed by and construed in accordance with the laws of England.

7. Signed: _____ Date: _____
Print Name:
Title:

SUMMARY TIME SCHEDULE FOR EXCHANGE OFFER

The following summarises the anticipated time schedule for the Exchange Offer assuming, among other things, that the Expiration Date is not extended. This summary is qualified in its entirety by, and should be read in conjunction with, the detailed information appearing elsewhere in this Offering Circular.

<u>Date</u>	<u>Action</u>
31 March 2000	Cut-off date for the accrual of interest on PRINs and IANs; date on which interest begins to accrue on New Bonds
18 July 2000	Announcement and launch of the Exchange Offer
18 July 2000 to 11 August 2000 ..	Exchange period during which tendering Holders of PRINs may deliver completed Letters of Transmittal to the Exchange Agent and tendering Holders of IANs may deliver completed Letters of Transmittal to the Exchange Agent and transfer instructions to Euroclear, Clearstream (Luxembourg) or DTC
5:00 pm, London time, 11 August 2000	Expiration Date
25 August 2000	Settlement Date and date on which 9.5% of the outstanding principal amount of the 2010 Bonds will be paid

TERMS OF EXCHANGE OFFER

The Russian Federation hereby offers, subject to the terms and conditions set forth in this Offering Circular, to deliver New Bonds to or for the account of each owner of PRINs or IANs (a "Holder") who tenders such PRINs or IANs pursuant to the terms of the Exchange Offer (a "Tender"). New Bonds will be exchanged for tendered PRINs or IANs and all accrued and unpaid interest thereon at the exchange ratios set out below under "Principal Amount of New Bonds to be Received by Holders Pursuant to the Exchange Offer." A Holder who decides to participate in the Exchange Offer may exchange all or a portion of its PRINs or all or a portion of its IANs for New Bonds as provided herein. The Russian Federation has appointed Citibank, N.A. as Exchange Agent and Citibank (Luxembourg) S.A. as Luxembourg Exchange Agent.

Debts Eligible to Participate in the Exchange Offer

Eligible Debt

The following debts are eligible to be tendered in the Exchange Offer:

(a) *PRINs*. Loans arising under a Restructuring Agreement, dated as of 6 October 1997, among Vnesheconombank, Bank of America, NA (the "Restructuring Agent") and the Closing Agent and Participating Creditors named therein (the "Restructuring Agreement").

(b) *IANs*. Floating Rate Interest Notes due 2002 to 2015 issued by Vnesheconombank pursuant to the Restructuring Agreement and an Exchange Agreement, dated as of 6 October 1997, among Vnesheconombank and the Closing Agent and Participating Creditors named therein.

Eligible FTO Debt

It is anticipated that holders of Trade Indebtedness of the Former USSR (referred to in the Declaration of the Government of the Russian Federation on the Restructuring of the External Debt of the Former USSR dated 1 October 1994) will be invited at a later date, as if they were Late Joining Creditors under Vnesheconombank's 1997 London Club restructuring, to exchange such trade indebtedness for 2030 Bonds and 2010 Bonds on the terms of exchange set forth herein. The Russian Federation's offer to exchange this trade indebtedness for 2030 Bonds and 2010 Bonds will be the subject of a separate Offering Circular.

Principal Amount of New Bonds to be Received by Holders Pursuant to the Exchange Offer

Each Holder who validly tenders one or more PRINs or IANs for exchange pursuant to the Exchange Offer will, subject to acceptance of that Tender by the Russian Federation and satisfaction of the conditions precedent to the Exchange Offer, receive on the Settlement Date the following:

- (a) For each U.S.\$1,000 principal amount of U.S. dollar denominated PRINs tendered:
 - 1. U.S.\$625 principal amount of 2030 Bonds.
 - 2. U.S.\$104.9731 principal amount of 2010 Bonds.
- (b) For each U.S.\$1,000 principal amount of IANs tendered:
 - 1. U.S.\$670 principal amount of 2030 Bonds.
 - 2. U.S.\$86.3343 principal amount of 2010 Bonds.

A different exchange ratio (reflecting a lower entitlement to past due interest) will apply to the exchange of 2010 Bonds for Tranche USDL1 PRINs, which arose on 2 December 1998 in favour of Late Joining Creditors under the Restructuring Agreement.

For purposes of determining the principal amount of New Bonds to be exchanged for PRINs denominated in a currency other than U.S. dollars, the principal amount of such PRINs will be translated into U.S. dollars at the mid-point rate which appeared on the Reuters Screen FEDSPOT Page as of 10:00 a.m. (New York City time) on 29 March 2000, except in the case of PRINs denominated in Deutsche Mark. The translation rate for PRINs denominated in Deutsche Mark will be equal to the irrevocably fixed Deutsche Mark/euro conversion rate specified by Council Regulation (EC) No. 2866/98 (1.95583), divided by the translation rate for PRINs denominated in euro (determined as described above) and rounded to the fourth decimal place. The translation rates applicable to PRINs not denominated in U.S. dollars are set out below.

<u>Currency</u>	<u>Translation Rate in Units of Currency per One U.S.\$ (in the case of euro, in U.S. dollars per one euro)</u>
Deutsche Mark	2.0529
Euro	0.9527
Swiss Francs	1.6723
Yen	105.5900

Holder of PRINs denominated in currencies other than U.S. dollars will accordingly receive on the Settlement Date the following:

- (a) For each DM1,000 principal amount of PRINs tendered:
 - 1. U.S.\$304.4474 principal amount of 2030 Bonds.
 - 2. U.S.\$32.9326 principal amount of 2010 Bonds.
- (b) For each Euro1,000 principal amount of PRINs tendered:
 - 1. U.S.\$595.4375 principal amount of 2030 Bonds.
 - 2. U.S.\$65.9308 principal amount of 2010 Bonds.
- (c) For each CHF1,000 principal amount of PRINs tendered:
 - 1. U.S.\$373.7368 principal amount of 2030 Bonds.
 - 2. U.S.\$23.3822 principal amount of 2010 Bonds.
- (d) For each ¥100,000 principal amount of PRINs tendered:
 - 1. U.S.\$591.9121 principal amount of 2030 Bonds.
 - 2. U.S.\$17.8905 principal amount of 2010 Bonds.

The principal amount of New Bonds to be issued to any Holder tendering a non-integral multiple of U.S.\$1,000 principal amount of IANs or a non-integral multiple of U.S.\$1,000, DM1,000, Euro1,000, CHF1,000 or ¥100,000 principal amount of PRINs will be calculated in proportion to the exchange ratios described above.

The principal amount of 2030 Bonds and 2010 Bonds to be issued to participating Holders will be rounded to the nearest U.S.\$1.00, with U.S.\$0.50 being rounded up. The Exchange Agent will calculate the amount of New Bonds to be received by each Holder. New Bonds will be credited on the Settlement Date to the securities accounts specified by tendering Holders in their Letters of Transmittal.

Expiration, Extension, Amendments and Termination

The Exchange Offer will expire at 5:00 p.m., London time, on 11 August 2000, unless extended or earlier terminated by the Russian Federation (such time and date, as so extended, is referred to as the "Expiration Date"). The Russian Federation may extend or amend the Exchange Offer, at any time and from time to time, and with respect to PRINs or IANs, in its sole discretion, by providing written notice of the new Expiration Date or any amendment to the Exchange Agent and the Restructuring Agent (if the extension or amendment applies to Holders of PRINs) or to the Exchange Agent and Euroclear, Clearstream (Luxembourg) and DTC (if the extension or amendment applies to Holders of IANs), by issuing a press release to the Dow Jones News Service and Reuters News Service by no later than 5:00 p.m., London time, on the day of such extension or amendment and (if the extension or amendment applies to Holders of IANs and so long as the rules of the Luxembourg Stock Exchange so require) by publishing a notice in a leading newspaper having general circulation in Luxembourg (which is expected to be the *Luxemburger Wort*). The Russian Federation may also reopen the Exchange Offer after the Expiration Date with respect to PRINs or IANs, or with respect to certain Holders of any PRINs or IANs, that have not yet tendered their PRINs or IANs by providing such notice.

The Russian Federation will (in consultation with the Exchange Agent) establish the Settlement Date with respect to all PRINs and IANs tendered as of the Expiration Date and will effect the exchange of such PRINs and IANs on the Settlement Date, as described under "— Settlement" below. The Russian Federation may, but will not be required to, reopen or extend the Exchange Offer in order to effect the exchange of PRINs or IANs tendered after the Settlement Date, in which case the New Bonds issued in exchange for such PRINs or IANs will include interest accrued on such New Bonds from 31 March 2000.

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

The Russian Federation may, in its sole discretion, terminate the Exchange Offer if the total principal amount of PRINs and IANs tendered by the Expiration Date is less than U.S.\$25 billion (or its equivalent in other currencies) by giving notice of any such termination, in the manner specified above, at any time prior to 5:00 p.m., London time, on the second Business Day following the Expiration Date, in which case all Tenders by Holders of PRINs or IANs will be legally null and void. The Russian Federation may not consummate the Exchange Offer without the consent of Holders representing at least 75% of the principal amount of tendered PRINs and IANs if the total principal amount of tendered PRINs and IANs is less than U.S.\$19 billion (or its equivalent in other currencies). If the total principal amount of PRINs and IANs tendered by the Expiration Date is less than U.S.\$19 billion (or its equivalent in other currencies) and the Russian Federation desires to consummate the Exchange Offer, the Russian Federation will give notice of such event in the manner specified above prior to 5:00 p.m., London time, on the second Business Day following the Expiration Date, at which time details regarding requests for consents from tendering Holders will be provided.

For these purposes, "Business Day" means a day other than a Saturday, a Sunday or a day on which banks in London are not open for domestic and foreign exchange business, banks in New York City are required or authorised to close, the Luxembourg Stock Exchange is not open for trading, or Euroclear, Clearstream (Luxembourg) or DTC are not open.

Settlement

The "Settlement Date" for the Exchange Offer will be the tenth Business Day following the Expiration Date unless the Russian Federation, in its sole discretion, selects another date. The Settlement Date will not be later than 30 September 2000.

Exchange Agent

Citibank, N.A. has been appointed Exchange Agent and Citibank (Luxembourg) S.A. has been appointed Luxembourg Exchange Agent for the Exchange Offer pursuant to an Exchange Agency Agreement (the "Exchange Agency Agreement") dated as of 18 July 2000 entered into between the Russian Federation, the Exchange Agent and the Luxembourg Exchange Agent. The Exchange Agent and the Luxembourg Exchange Agent, among other things, will distribute or arrange for the distribution of the Offering Circular to Holders of PRINs and IANs, will assist Holders of PRINs and IANs requesting assistance in connection with the Exchange Offer and may request nominee holders of PRINs and IANs to forward information relating to the Exchange Offer to beneficial holders. The Exchange Agent will also receive and verify Letters of Transmittal, provide to the Restructuring Agent copies of Letters of Transmittal for Exchange of PRINs, reconcile Tenders of PRINs with the records of the Restructuring Agent and Tenders of IANs with the records of the clearing systems, take reasonable steps to contact Holders submitting irregular Letters of Transmittal to enable the necessary corrections to be made, notify the Restructuring Agent of any Tenders of PRINs that are not accepted and the relevant clearing systems of any Tenders of IANs that are not accepted, calculate the principal amount of New Bonds to be delivered in exchange for tendered PRINs and IANs, confirm that all conditions precedent to the consummation of the Exchange Offer have been satisfied, and arrange for book-entry delivery of New Bonds to the accounts at the clearing system specified in each Letter of Transmittal. Delivery on the Settlement Date of legal opinions in a form satisfactory to the Exchange Agent will be a condition precedent to the consummation of the Exchange Offer, as described below under "— Conditions Precedent to Consummation of the Exchange Offer." The Russian Federation has agreed to pay certain fees and expenses and to indemnify the Exchange Agent against certain liabilities and expenses in connection with the Exchange Offer.

The Exchange Agent is the agent of the Russian Federation and owes no duty to any Holder. The Exchange Agent may rely on any Letter of Transmittal which appears on its face to be genuine and will have no responsibility to verify either the authenticity of the signature or the accuracy of the information in any Letter of Transmittal.

Holders of PRINs and IANs may contact the Exchange Agent at the following address for assistance in filling out and delivering Letters of Transmittal and for additional copies of the Offering Circular:

Citibank, N.A.
5 Carmelite Street
London EC4Y 0PA, England
Tel.: ++ 44 207 508 3867
Fax: ++ 44 207 508 3866
E-mail: exchange.gats@citicorp.com
(e-mail is for information requests only; Letters of Transmittal may not be delivered by e-mail)
Attention: Citibank Agency and Trust Services; Ref.: Russian Federation

Holders of IANs may also obtain additional copies of the Offering Circular by contacting the Luxembourg Exchange Agent at the following address:

Citibank (Luxembourg) S.A.
58 Boulevard Grande-Duchesse Charlotte, 3rd Floor
L-1330, Luxembourg
Tel.: ++ 352 451 414 301/378
Fax: ++ 352 451 414 303
Attention: Derek Able/Noelle Van Lonkhuyzen (Customer Service); Ref.: Russian Federation

Procedures for Tenders of PRINs and IANs

Letters of Transmittal

PRINs. A Holder wishing to tender PRINs must, at or before 5:00 p.m., London time, on the Expiration Date, deliver, or cause to be delivered, by hand, courier or facsimile, a duly completed Letter of Transmittal to the Exchange Agent, who will cause a copy of such Letter of Transmittal to be delivered to the Restructuring Agent. A Letter of Transmittal in respect of PRINs may only be submitted by the registered holder thereof or by a person authorised to sign on its behalf. A separate Letter of Transmittal must be submitted for PRINs of each currency being tendered.

IANs. A Holder wishing to tender IANs must, at or before 5:00 p.m., London time, on the Expiration Date, deliver, or cause to be delivered, by hand, courier or facsimile, a duly completed Letter of Transmittal to the Exchange Agent. Letters of Transmittal for the Tender of IANs may instead be delivered to the offices of the Luxembourg Exchange Agent. A Letter of Transmittal for the Tender of IANs may only be submitted by or through a person that is a direct accountholder in Euroclear or Clearstream (Luxembourg) or a direct participant in DTC, or by or through a person authorised to sign on behalf of such accountholder or participant. In the event a person wishing to participate in the Exchange Offer holds IANs through an accountholder in Euroclear or Clearstream (Luxembourg) or a participant in DTC, it must make appropriate arrangements for such accountholder or participant to submit a Letter of Transmittal on its behalf on or before the Expiration Date.

In no event should a person send a Letter of Transmittal to the Restructuring Agent or to the Ministry of Finance or any other agency of the Russian Federation.

Exchange Instructions for PRINs

A Holder of PRINs completing a Letter of Transmittal for the Tender of PRINs will, by so doing, irrevocably authorise and instruct the Restructuring Agent on such Holder's behalf (a) on the Settlement Date, to effect the transfer of such PRINs to the Russian Federation or its nominee upon receipt of confirmation from the Exchange Agent that the conditions precedent to the Exchange Offer have been satisfied and (b) to block any prior attempt to transfer such PRINs on or prior to the Settlement Date (subject to the automatic withdrawal of such irrevocable instructions if the Exchange Offer is terminated or such Tender is rejected). Such instructions may be revoked only as set forth below under "Procedures for Tenders of PRINs and IANs — Irrevocability."

Exchange Instructions for IANs Held Through Euroclear or Clearstream (Luxembourg)

A direct accountholder completing a Letter of Transmittal for the Tender of IANs held through Euroclear or Clearstream (Luxembourg) must deliver to Euroclear or Clearstream (Luxembourg) in accordance with such clearing systems' standard procedures and deadlines (a) irrevocable instructions (1) to block any attempt to transfer such IANs on or prior to the Settlement Date and (2) on the Settlement Date, to debit its account and credit the account designated by the Russian Federation in respect of such IANs upon receipt of an instruction from the Exchange Agent confirming that the conditions precedent to the Exchange Offer have been satisfied (subject to the automatic withdrawal of such irrevocable instructions if the Exchange Offer is terminated or such Tender is rejected), (b) an irrevocable authorisation to disclose the name and address of the direct accountholder and information about the foregoing instructions to and at the request of the Exchange Agent and (c) confirmation that the direct accountholder is concurrently delivering to the Exchange Agent an executed and completed Letter of Transmittal with respect to such IANs. The instructions and authorisations set forth in paragraphs (a) and (b) above may be revoked only as set forth below under "Procedures for Tenders of PRINs and IANs — Irrevocability."

Exchange Instructions for IANs Held Through DTC

A direct participant completing a Letter of Transmittal for the Tender of IANs held through DTC must deliver to DTC in accordance with DTC's standard procedures and deadlines (a) irrevocable instructions (1) to block any attempt to transfer such IANs on or prior to the Settlement Date and (2) on the Settlement Date, to debit its account and credit the account designated by the Russian Federation in respect of such IANs upon receipt of an instruction from the Exchange Agent confirming that the conditions precedent to the Exchange Offer have been satisfied (subject to the automatic withdrawal of such irrevocable instructions if the Exchange Offer is terminated or such Tender is rejected) and (3) to deliver to the Exchange Agent a computer generated message by means of DTC's Automated Tender Offer Program system confirming the book-entry transfer of the tendered IANs from the direct participant's DTC account and acknowledging and agreeing to be bound by the terms of the Letter of Transmittal and (b) confirmation that the direct participant is concurrently delivering to the Exchange Agent an executed and completed Letter of Transmittal with respect to such IANs. Tenders of IANs held through DTC must be processed through the Automated Tender Offer Program system. The instructions set forth in paragraph (a) above may only be revoked as set forth below under "Procedures for Tenders of PRINs and IANs — Irrevocability."

The exchange instructions referred to above under "Procedures for Tenders of PRINs and IANs — Exchange Instructions for PRINs," "— Exchange Instructions for IANs Held Through Euroclear or

Clearstream (Luxembourg)” and “— Exchange Instructions for IANs Held Through DTC” are collectively referred to as the “Exchange Instructions.”

Euroclear and Clearstream (Luxembourg) accountholders and DTC participants tendering IANs must ensure that Exchange Instructions can be allocated to their tendered IANs. A separate set of Exchange Instructions should accordingly be issued in respect of each Letter of Transmittal. The Russian Federation reserves the right to reject any Letter of Transmittal if corresponding Exchange Instructions are not provided to the applicable clearing system or cannot be allocated to the IANs tendered pursuant to such Letter of Transmittal.

Irrevocability

Except as provided below, any Tender of PRINs or IANs pursuant to, and in conformity with, the procedures set forth above will be irrevocable and cannot be withdrawn without the prior written consent of the Russian Federation. Any Tender and corresponding Letter of Transmittal may be revised on or prior to the Expiration Date, only to correct an error therein and only with the consent of the Russian Federation, by a written notice from the person or entity signing the Letter of Transmittal delivered to the Exchange Agent by hand, courier or facsimile. Any notice of revision must specify the name, address and telephone number of the person or entity that signed the Letter of Transmittal and must be accompanied by a revised Letter of Transmittal signed by such person or entity and an explanation of the changes made. If the Exchange Offer is terminated as provided for herein, all Tenders of PRINs and IANs, and all representations, warranties, acknowledgements, covenants and consents as set forth under “Terms of the Exchange Offer — Representations, Warranties, Acknowledgements and Covenants of Holders” and “— Consents” and under “Transfer Restrictions,” will be legally null and void. If the Russian Federation, subsequent to the date on which a Holder delivers its Letter of Transmittal, amends the terms of the Exchange Offer in a material respect, the related Tender of PRINs or IANs may be revoked without the consent of the Russian Federation by notice to the Exchange Agent no later than five Business Days following the date of the amendment. For these purposes, an amendment to the terms of the Exchange Offer will be “material” if it would be viewed by a reasonable Holder as having significantly affected the Holder’s decision to tender its PRINs or IANs. The Exchange Agent will have no responsibility for determining whether any Letter of Transmittal is revocable.

Irregularities

All questions as to validity, form and eligibility (including time of receipt) of any Letter of Transmittal will be determined by the Russian Federation, in consultation with the Exchange Agent and, if applicable, the Restructuring Agent. The determination of the Russian Federation will be final and binding. The Russian Federation reserves the right to reject any and all Tenders not in proper form or the acceptance of which would, in the opinion of the legal advisors to the Russian Federation, violate any applicable law, regulation or order. All other Tenders will be accepted, subject to their revocation and to termination of the Exchange Offer, in each case as provided for herein. The Russian Federation also reserves the right (but assumes no obligation) to waive any defect or irregularity in the Tender of any PRINs or IANs. Neither the Russian Federation nor the Exchange Agent will be under any duty to give notice to tendering Holders of any irregularities in Letters of Transmittal, Tenders or exchanges, nor will any of them incur any liability for failure to give such notice. The Exchange Agent will inform each Holder promptly of any rejection of its Tender.

Other Matters

Neither the Russian Federation nor the Exchange Agent will be responsible for the communication of Tenders to the clearing systems by the accountholders in Clearstream (Luxembourg) or Euroclear or the participants in DTC through which tendered IANs are held.

Holders will not be responsible for the payment of any fees or commissions to the Exchange Agent, the Luxembourg Exchange Agent or the Restructuring Agent.

The clearing reference numbers for the IANs and the New Bonds are set forth under “General Information.”

The New Bonds are new issues of securities with no established trading market. No assurance can be given as to the liquidity of the trading market for New Bonds. The price at which New Bonds will trade in the secondary market is uncertain.

Conditions Precedent to Consummation of the Exchange Offer

The consummation of the Exchange Offer will be subject to the following conditions:

(a) Written confirmation from the Luxembourg listing agent of acceptance of the New Bonds for listing on the Luxembourg Stock Exchange;

(b) Delivery to the Exchange Agent of legal opinions relating to the due authorisation, execution and delivery of the New Bonds, the enforceability of the New Bonds and other matters relating to the Exchange Offer from (1) the Head of the Legal Department of the Ministry of Finance, (2) a General Legal Manager of Vnesheconombank, (3) Cleary, Gottlieb, Steen & Hamilton, counsel to the Russian Federation with respect to English and U.S. law, and (4) Clifford Chance, counsel to the Exchange Agent with respect to English, Russian and U.S. law, in each case substantially in the form attached to the Exchange Agency Agreement;

(c) Due authorisation by the Government of the Russian Federation of the exchange of New Bonds for PRINs and IANs, the issuance of the New Bonds and the execution of the Deed of Covenant in a form sufficient to enable the issuance of the legal opinions referred to in paragraph (b) above;

(d) Subject to paragraph (e) below, if the total principal amount of validly tendered PRINs and IANs is less than U.S.\$25 billion (or its equivalent in other currencies), the consent of the Russian Federation;

(e) If the total principal amount of validly tendered PRINs and IANs is less than U.S.\$19 billion (or its equivalent in other currencies) and the Russian Federation desires to consummate the Exchange Offer, the consent of Holders representing at least 75% of the principal amount of tendered PRINs and IANs;

(f) Execution and delivery of the Deed of Covenant; and

(g) Delivery of a certificate from the Fiscal Agent certifying the Russian Federation's compliance with the payment terms of the Fiscal Agency Agreement with respect to the New Bonds.

For purposes of paragraphs (d) and (e) above, the amount of tendered PRINs denominated in a currency other than U.S. dollars will be calculated by reference to the translation rates set forth under "Terms of the Exchange Offer — Principal Amount of New Bonds to be Received by Holders Pursuant to the Exchange Offer" herein.

A copy of the forms of the opinions of counsel to the Exchange Agent may be obtained by contacting the Exchange Agent. The other legal opinions referred to above will be available in draft form prior to the Expiration Date for inspection by Holders at the London office of the Exchange Agent.

Representations, Warranties, Acknowledgements and Covenants of Holders

Each sender of a Letter of Transmittal will, by so doing, for the benefit of the Russian Federation:

(a) Represent and warrant, in the case of a Tender of PRINs or IANs, that (1) it has full power and authority to execute and deliver such Letter of Transmittal and to exchange such PRINs or IANs pursuant to the Exchange Offer and (2) it will, upon request, execute and deliver any additional documents deemed by the Russian Federation to be reasonably necessary or desirable to complete the exchange of such PRINs or IANs for New Bonds;

(b) Confirm, in the case of a Tender of PRINs, that (1) it is the holder of record of such PRINs on the registry maintained by the Restructuring Agent and (2) it has irrevocably instructed the Restructuring Agent not to transfer or attempt to transfer such PRINs on or prior to the earlier of (i) the Settlement Date and (ii) the date on which the Exchange Offer is terminated;

(c) Confirm, in the case of a Tender of IANs, that (1) such IANs are credited to its securities account at Euroclear, Clearstream (Luxembourg) or DTC as indicated in its Letter of Transmittal and (2) it has irrevocably instructed Euroclear, Clearstream (Luxembourg) or DTC, as the case may be, to block any attempt to transfer such IANs on or prior to the earlier of (i) the Settlement Date and (ii) the date on which the Exchange Offer is terminated;

(d) Agree that it will not assign, transfer, sell, pledge, hypothecate or otherwise encumber any tendered PRINs or IANs from the date of its Letter of Transmittal to the earlier of (1) the Settlement Date and (2) the date on which the Exchange Offer is terminated, and agree, subject to applicable law, that any purported assignment, transfer, sale, pledge, hypothecation or other encumbrance of such PRINs or IANs in violation of the foregoing covenant will be void and of no effect;

(e) Represent and warrant, in the case of a Tender of PRINs or IANs, that on the Settlement Date and to the extent New Bonds are exchanged for such tendered PRINs and IANs in accordance with the terms of the Exchange Offer and the related Letters of Transmittal, all right, title and interest in such tendered PRINs or IANs will be transferred to the Russian Federation or its nominee free and clear of all liens, charges, claims, encumbrances, interests and restrictions of any kind and thereafter the Holder will have no rights or claims in law or equity against Vnesheconombank or the Russian Federation arising from or in connection with any of such tendered PRINs or IANs or the debts represented thereby, and agree and acknowledge that it will record on its books the transfer of such PRINs or IANs;

(f) Represent and warrant that in evaluating the Exchange Offer and in making its decision whether or not to participate therein by submitting a Letter of Transmittal and tendering its PRINs and IANs, it has made its own independent appraisal of the contents of the Offering Circular and the Deed of Covenant and any related communications and is not relying on any statement, representation or warranty, express or implied, made to it by the Russian Federation (or any other person) other than those made by the Russian Federation in this Offering Circular and the Deed of Covenant;

(g) Acknowledge that no member of the London Club Advisory Committee (acting in that capacity) has any duties or obligations with respect to this Offering Circular, the Exchange Offer or the New Bonds or any action or document related thereto and acknowledge that the members of the London Club Advisory Committee (acting in that capacity), their respective affiliates, directors, officers, agents or employees are not liable in any way for any action taken or omitted to be taken by it or them with respect to this Offering Circular, the Exchange Offer or the New Bonds; and

(h) Acknowledge that neither the Exchange Agent nor any of its respective affiliates, directors, officers, agents or employees shall be liable for any action taken or omitted to be taken, or any determination made or omitted to be made, by it or them under or with respect to this Offering Circular, the Exchange Offer or the New Bonds (including, without limitation, any action taken or omitted to be taken prior to the date of this Offering Circular by any such person in preparation for acting hereunder) in the absence of gross negligence or wilful misconduct.

Paragraphs (a) through (h) above shall be deemed to be repeated and reconfirmed as of the Settlement Date.

The representations, warranties, acknowledgements and covenants in paragraphs (a) through (f) above shall also be for the benefit of Vnesheconombank, the representations and acknowledgement in paragraphs (f) and (g) above shall also be for the benefit of each member of the London Club Advisory Committee and the acknowledgement in paragraph (h) above shall also be for the benefit of the Exchange Agent. In each case, the Contracts (Rights of Third Parties) Act 1999 shall apply in relation thereto.

Consents

Vnesheconombank and the Restructuring Agent have entered into an amendment to the Restructuring Agreement dated 18 July 2000. The amendment provides, among other things, and solely for the purposes of the transfer of PRINs pursuant to the Exchange Offer, that (a) a duly completed Letter of Transmittal for Exchange of PRINs will constitute a Transfer Certificate and (b) the Russian Federation or its nominee may be a Transferee of a tendered PRIN for purposes of the Restructuring Agreement. The amendment to the definition of Transferee is subject to acceptance of Tenders from Holders representing in excess of 66 $\frac{2}{3}$ % of the outstanding PRINs (calculated pursuant to Part 1 of the Second Schedule to the Restructuring Agreement), in accordance with the Restructuring Agreement. Copies of the amendment to the Restructuring Agreement may be obtained from the Restructuring Agent upon request.

The execution and delivery of a Letter of Transmittal by a Holder tendering PRINs will constitute the consent of such Holder to the amendment of the definition of Transferee. The Expiration Date will be the record date for determining the Holders of PRINs eligible to vote on this amendment.

Cross-Acceleration of Russian Federation Eurobonds

Each series of Russian Federation Eurobonds issued during the life of the 2030 Bonds or the 2010 Bonds will include a provision that treats an acceleration of the 2030 Bonds or the 2010 Bonds on the same basis as an acceleration of the Russian Federation's then existing Eurobonds for the purpose of determining whether a cross-acceleration Event of Default has occurred (an "Expanded Cross-Acceleration Clause"). For the avoidance of doubt, an Expanded Cross-Acceleration Clause will not treat the New Bonds as Excluded

Indebtedness (as defined in the terms and conditions of the Russian Federation's existing Eurobonds) or as any other category of indebtedness having a similar effect.

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

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

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

Ministry of Finance,
9 Ilyinka Street
Moscow 103097
Russia
Tel.: ++ 7 095 298 9093
Fax: ++ 7 095 913 4542
Attention: Head of Department of External Debt

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

The Russian Federation will provide written notice of any Repurchase Notice Delivery Date to the applicable clearing systems, issue a press release to the Dow Jones News Service and Reuters News Service no later than 5:00 p.m., London time, on the next Business Day immediately following such Repurchase Notice Delivery Date and (so long as the New Bonds are listed on the Luxembourg Stock Exchange and the rules of the Luxembourg Stock Exchange so require) publish a notice in a leading newspaper having general circulation in Luxembourg (which is expected to be the *Luxemburger Wort*). The Russian Federation will give notice of any Repurchase Date in the manner specified above no later than 5:00 p.m., London time, on the thirty-fifth day prior to such Repurchase Date.

The Repurchase Right will be implemented by means of a deed of covenant (the "Deed of Covenant") to be executed by the Russian Federation in favour of all holders from time to time of any existing series of Russian Federation Eurobonds. Prior to the Settlement Date, a copy of the form of Deed of Covenant will be available for inspection by Holders at the London office of the Exchange Agent. After the Settlement Date, the Deed of Covenant will be held by the Fiscal Agent and will be available for inspection at the offices of the Fiscal Agent.

Any reference under this heading to any action being taken by the Russian Federation should be construed as a reference to such action being taken by the Ministry of Finance acting on behalf of the Russian Federation or, in the case of the reference to the issuance during the life of the 2030 Bonds or the 2010 Bonds

of Eurobonds by the Russian Federation, to such action being taken by the Ministry of Finance or another such body of executive authority whose functions, pursuant to a decision of the Government of the Russian Federation, include the preparation and/or implementation of the Federal budget and which is hereafter authorised under the laws of the Russian Federation to issue Eurobonds on behalf of the Russian Federation during the life of the 2030 Bonds or the 2010 Bonds.

Market for PRINs and IANs After the Exchange Offer

PRINs and IANs acquired by the Russian Federation or its nominee pursuant to the Exchange Offer may be held by the Russian Federation or its nominee following the Exchange Offer and, if so held, may result in a reduction in the aggregate principal amount of PRINs and IANs that otherwise might trade in the market. Under these circumstances, although the terms of the PRINs and IANs will not be amended directly as a result of the Exchange Offer, the Russian Federation or its nominee will acquire all rights, including rights in respect of voting currently exercisable by Holders of PRINs that are exchanged in the Exchange Offer, and the liquidity and market value of PRINs and IANs which are not tendered or accepted pursuant to the Exchange Offer could be significantly reduced. The terms and conditions of the IANs require Vnesheconombank to maintain the listing of the IANs on the Luxembourg Stock Exchange or another internationally accepted stock exchange.

Governing Law

THE EXCHANGE OFFER AND ANY LETTER OF TRANSMITTAL DELIVERED HEREUNDER SHALL BE GOVERNED BY, AND CONSTRUED IN ACCORDANCE WITH, THE LAWS OF ENGLAND.

TERMS AND CONDITIONS OF 2030 BONDS

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

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

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

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

1. Form, Denomination and Title

(a) Form and Denomination

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

(b) Title

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

2. Transfer of Bonds and Issue of Bonds

(a) Transfer

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

(b) Delivery

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

(c) No Charge

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

(d) Closed Periods

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

(e) Regulations Concerning Transfer and Registration

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

3. Status

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

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

4. Negative Pledge and Covenant

(a) Negative Pledge

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

(b) Covenant

So long as any Bond remains outstanding the Russian Federation shall obtain, and do or cause to be done all things necessary to ensure the continuance of, all consents, licences, approvals and authorisations, and make or cause to be made all registrations, recordings and filings, which may at any time be required to be

obtained or made in the Russian Federation for the execution, delivery or performance of the Bonds or for the validity or enforceability thereof.

(c) Definitions

In these Conditions:

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

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

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

“IMF” means the International Monetary Fund.

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

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

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

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

5. Interest

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

<u>Interest Period</u> (from and including the first indicated date to but excluding the second indicated date)	<u>Interest Rate</u>
31 March 2000 to 30 September 2000	2.25 per cent. per annum
30 September 2000 to 31 March 2001	2.50 per cent. per annum
31 March 2001 to 31 March 2007	5.00 per cent. per annum
Thereafter	7.50 per cent. per annum

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

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

6. Redemption, Purchase and Cancellation

(a) Redemption

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

<u>Principal Payment Date</u>	<u>Percentage</u>
31 March 2007	0.5 per cent.
30 September 2007	0.5 per cent.
31 March 2008	0.5 per cent.
30 September 2008	0.5 per cent.
31 March 2009	2.0 per cent.
30 September 2009	2.0 per cent.
31 March 2010	2.0 per cent.
30 September 2010	2.5 per cent.
31 March 2011	3.0 per cent.
30 September 2011	3.0 per cent.
31 March 2012	3.0 per cent.
30 September 2012	3.0 per cent.
31 March 2013	3.0 per cent.
30 September 2013	3.0 per cent.
31 March 2014	3.0 per cent.
30 September 2014	3.0 per cent.
31 March 2015	3.0 per cent.
30 September 2015	3.0 per cent.
31 March 2016	3.0 per cent.
30 September 2016	3.0 per cent.
31 March 2017	3.0 per cent.
30 September 2017	3.0 per cent.
31 March 2018	3.0 per cent.
30 September 2018	3.0 per cent.
31 March 2019	4.0 per cent.
30 September 2019	4.0 per cent.
31 March 2020	4.0 per cent.
30 September 2020	4.0 per cent.

<u>Principal Payment Date</u>	<u>Percentage</u>
31 March 2021	3.0 per cent.
30 September 2021	3.0 per cent.
31 March 2022	3.0 per cent.
30 September 2022	3.0 per cent.
31 March 2023	2.0 per cent.
30 September 2023	2.0 per cent.
31 March 2024	2.0 per cent.
30 September 2024	2.0 per cent.
31 March 2025	0.5 per cent.
30 September 2025	0.5 per cent.
31 March 2026	0.5 per cent.
30 September 2026	0.5 per cent.
31 March 2027	0.5 per cent.
30 September 2027	0.5 per cent.
31 March 2028	0.5 per cent.
30 September 2028	0.5 per cent.
31 March 2029	0.5 per cent.
30 September 2029	0.5 per cent.
31 March 2030	remainder

(b) Purchase and Cancellation

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

7. Payments

(a) Principal

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

(b) Interest

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

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

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

(c) Payments Subject to Fiscal Laws

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

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

The Regulations do not contain a definition of "Russian residents." Accordingly, it is unclear whether, for example, Russian branches and representative offices of foreign entities would be considered to be Russian residents for this purpose. See "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 U.S. dollar account, payment instructions (for value the due date or, if that is not a business day, for value the first following day which is a business day) will be initiated on the due date for payment or, if later, in the case of principal and interest due on redemption in whole or in part, on the business day on which the relevant Bond Certificate is presented and, in the case of a final Principal Payment Date, surrendered at the specified office of any of the Paying Agents.

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

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

(f) Delay in Payments

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

(g) Partial Payments

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

(h) Agents

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

8. Taxation

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

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

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

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

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

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

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

9. Events of Default

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

(a) Non-payment

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

(b) Breach of other obligations or undertakings

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

(c) Cross-acceleration

Any other Public External Indebtedness shall become due and payable prior to the stated maturity thereof otherwise than at the option of the debtor following a default or the Russian Federation, the

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

(d) Moratorium

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

(e) Unlawfulness or Invalidity

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

(f) IMF

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

(g) Consents etc.

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

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

10. Prescription

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

11. Replacement of Bond Certificates

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

12. Meetings of Bondholders, Modification and Waiver

(a) Meetings of Bondholders

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

(b) Modification and waiver

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

13. Further Issues

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

14. Notices

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

A copy of all notices provided pursuant to this Condition 14 shall also be given to Morgan Guaranty Trust Company of New York, Brussels office as operator of the Euroclear System, and Clearstream (Luxembourg).

15. Currency Indemnity

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

obligations from the Russian Federation's other obligations, shall give rise to a separate and independent cause of action, shall apply irrespective of any indulgence granted by any Bondholder and shall continue in full force and effect despite any judgement, order, claim or proof for a liquidated amount in respect of any sum due under any Bond or any judgement or order.

16. Governing Law

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

TERMS AND CONDITIONS OF 2010 BONDS

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

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

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

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

1. Form, Denomination and Title

(a) Form and Denomination

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

(b) Title

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

2. Transfer of Bonds and Issue of Bonds

(a) Transfer

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

(b) Delivery

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

(c) No Charge

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

(d) Closed Periods

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

(e) Regulations Concerning Transfer and Registration

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

3. Status

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

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

4. Negative Pledge and Covenant

(a) Negative Pledge

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

(b) Covenant

So long as any Bond remains outstanding the Russian Federation shall obtain, and do or cause to be done all things necessary to ensure the continuance of, all consents, licences, approvals and authorisations, and make or cause to be made all registrations, recordings and filings, which may at any time be required to be

obtained or made in the Russian Federation for the execution, delivery or performance of the Bonds or for the validity or enforceability thereof.

(c) Definitions

In these Conditions:

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

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

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

“IMF” means the International Monetary Fund.

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

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

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

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

5. Interest

Each Bond bears interest from 31 March 2000 at the rate of 8.25 per cent. per annum. On the date of issue of each Bond (the “First Payment Date”), interest accrued on 9.5% of the outstanding principal amount of each Bond, from and including 31 March 2000 to but excluding the First Payment Date will be payable. Thereafter, interest on the outstanding principal amount of each Bond will be payable semi-annually in arrear

on 31 March and 30 September in each year until maturity, commencing on 30 September 2000. Interest will be paid subject to and in accordance with the provisions of Condition 7.

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

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

6. Redemption, Purchase and Cancellation

(a) Redemption

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

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

(b) Purchase and Cancellation

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

7. Payments

(a) Principal

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

principal and the outstanding amount of each Bondholder's registered holding will be deemed to be the amount shown as such on the Register for such Bondholder at the same time on that date.

(b) Interest

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

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

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

(c) Payments Subject to Fiscal Laws

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

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

The Regulations do not contain a definition of "Russian residents." Accordingly, it is unclear whether, for example, Russian branches and representative offices of foreign entities would be considered to be Russian residents for this purpose. See "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 U.S. dollar account, payment instructions (for value the due date or, if that is not a business day, for value the first following day which is a business day) will be initiated on the due date for payment or, if later, in the case of principal and interest due on redemption in whole or in part, on the business day on which the relevant Bond Certificate is presented and, in the case of a final Principal Payment Date, surrendered at the specified office of any of the Paying Agents.

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

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

(f) Delay in Payments

Bondholders will not be entitled to any interest or other payment for any delay after the due date in receiving any amount due in respect of any Bond as a result of (i) the due date not being a business day, (ii) the Bondholder being late in presenting or surrendering its Bond Certificate (if required to do so) or

(iii) a cheque mailed in accordance with this Condition 7 arriving after the due date for payment or being lost in the mail.

(g) Partial Payments

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

(h) Agents

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

8. Taxation

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

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

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

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

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

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

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

9. Events of Default

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

(a) Non-payment

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

(b) Breach of other obligations or undertakings

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

(c) Cross-acceleration

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

(d) Moratorium

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

(e) Unlawfulness or Invalidity

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

(f) IMF

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

(g) Consents etc.

Any regulation, decree, consent, approval, licence or other authority necessary to enable the Russian Federation to enter into or perform its obligations under the Bonds or under the Fiscal Agency Agreement or for the validity or enforceability thereof shall expire or be withheld, revoked or terminated or otherwise cease

to remain in full force and effect or shall be modified in a manner which adversely affects any rights or claims of any of the holders of the Bonds, as the case may be,

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

10. Prescription

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

11. Replacement of Bond Certificates

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

12. Meetings of Bondholders, Modification and Waiver

(a) Meetings of Bondholders

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

(b) Modification and waiver

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

13. Further Issues

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

14. Notices

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

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

A copy of all notices provided pursuant to this Condition 14 shall also be given to Morgan Guaranty Trust Company of New York, Brussels office as operator of the Euroclear System, and Clearstream (Luxembourg).

15. Currency Indemnity

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

16. Governing Law

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

RUSSIAN FEDERATION

Territory, Population and Natural Resources

The Russian Federation, or Russia (*Rossiya*), is a sovereign and democratic federal 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. Russia has the tallest mountain in Europe (Elbrus, in the Caucasus at 5,642 metres), the largest lake in Europe (Ladoga, near St. Petersburg) and the world's deepest lake (Baikal, near Irkutsk).

Russia is home to approximately 146 million inhabitants (2.4% 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%) lives in European Russia. About 73% 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% of the population. There are more than 100 other ethnic groups in Russia, the largest being Tatars (approximately 3.8% of the total population), Ukrainians (3.0%), and Chuvashs (1.2%). No other ethnic group accounts for more than 1% of Russia's total population.

Russia has a well developed system of education, and the literacy rate exceeds 99%. Education is compulsory for those between the ages of seven and 15. The country has approximately 800 institutions of higher education with over three 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% had at least eight years of schooling, 86% had at least 10 years, 18% had received higher education and 33% 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, palladium and platinum. 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 5% of world gold production. Forests cover over 40% 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*).

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

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

cover this deficit, the Soviet Union resorted to short-term and uncoordinated foreign borrowing, the sale of virtually all its gold and foreign exchange reserves and the printing of roubles in large quantities. The resulting increase in the money supply, in combination with price controls on most products, led to excess money holdings, acute shortages of consumer goods and significant inflation (prices rose by 160% in 1991). Over the same period, output contracted and the Soviet Union fell into recession.

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

On 8 December 1991, the Soviet Union was formally dissolved by the leaders of Russia, Ukraine and Belarus, the original signatories of the 1922 Union Treaty 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. 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. In September 1993, President Yeltsin 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 a 58% majority vote in a national referendum in which 55% of eligible voters participated. On the same day, the first elections to the State Duma (the "Duma"), the lower house of Russia's new parliament, were held.

Political System

Constitution

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

The Constitution protects certain 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 President

The President of Russia has broad powers. The President is Head of State and Supreme Commander of the Armed Forces, with authority to declare states of military emergency and other states of emergency, subject to approval by the Federation Council, the upper chamber of the Federal Assembly. The President also bears 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. In addition, the President is empowered to arbitrate disputes between the Federal authorities and the Federation subjects.

The President has the power to veto bills passed by the Federal Assembly and, under certain circumstances, to dissolve the Duma, the lower chamber of the Federal Assembly. 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.

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 the President's death, resignation or impeachment, or if the President 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.

The Government

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.

Since March 1998, the Government has seen a number of significant changes. On 23 March 1998, President Yeltsin dismissed the Government, including Prime Minister Victor Chernomyrdin, who had been in office since 1993. To replace Mr. Chernomyrdin, President Yeltsin nominated Mr. Sergei Kiriyenko. Mr. Kiriyenko was rejected twice by the Duma and then approved on the third and final vote. Had the deputies voted against Mr. Kiriyenko a third time, President Yeltsin would have been entitled under the Constitution to dismiss the Duma and hold new Duma elections.

On 17 August 1998, the Government led by Mr. Kiriyenko announced that it would not meet its obligations under its short-term rouble-denominated treasury bills ("GKO's") and certain other rouble-denominated securities. The Government also announced a widening of the rouble trading corridor and a 90-day moratorium on certain hard currency payments. The rouble trading corridor was soon abandoned altogether. The actions of the Russian Government led to a severe economic crisis. See "Russian Economy — Overview of Economic Reforms" for a more detailed discussion of the events of 17 August 1998 and their consequences.

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

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

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

President Yeltsin resigned on 31 December 1999 and in accordance with the Constitution Mr. Putin became Acting President, retaining his position as Prime Minister as well. On 26 March 2000, Mr. Putin was elected President, and soon thereafter he nominated Mikhail M. Kasyanov to serve as his Prime Minister. The Duma approved the appointment of Mr. Kasyanov on May 17, 2000. See "Political Parties, Recent Elections and Political Developments."

Legislative Branch

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

The Duma consists of 450 deputies, elected by a mixed system of majority vote and proportional representation. Half the deputies are elected by majority vote in individual electoral districts. The other half are chosen from "party lists" on the basis of a nationwide election, with seats being allocated in proportion to the number of votes received by the party. Only parties receiving more than 5% of the vote, 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. In May 2000, President Putin introduced to the Duma new legislation that would alter the way in which the Federation Council is formed. Under the new proposals, the members of the upper chamber would work on a full-time professional basis and would be prohibited from occupying any other offices. Each of the Federation subjects would appoint two persons to the Federation Council, one to be nominated by the legislative body and the other to be nominated by the head of the Federation subject. On 23 June 2000, the draft law introduced by the President was passed by the Duma in its third and final reading. On June 28, 2000, however, the Federation Council rejected the law adopted by the Duma. On 7 July 2000, the Duma and the Federation Council created a reconciliation commission to work out an acceptable draft law. It is expected that the future of the proposed law will be decided by either the reconciliation commission and subsequent votes by each chamber of the Federal Assembly or by a vote by the Duma to override the Federation Council's rejection.

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.

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 to parties receiving 5% 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 six parties received 5% or more of the "party list" votes in the most recent parliamentary elections held in December 1999. The Communist Party is currently the largest in membership and had the greatest success in the election, with its "party list" securing 24.29% of the vote. Communist Party deputies currently occupy more than one-fifth of all Duma seats (21%). *Yedinstvo* (Unity), the pro-Government political movement headed by Deputy Prime Minister Sergei Shoigu, received 23.32% of the "party list" votes cast in the Duma elections, and its deputies currently occupy 18% of all Duma seats. The four other parties that qualified for "party list" seats in the December 1999 elections are *Otechestvo — Vsyá Rossiya* (Fatherland — All Russia), headed by former Prime Minister Evgeniy Primakov (which received 13.33% of the "party list" votes cast in the Duma elections and whose deputies currently occupy 10% of all Duma seats), the Union of Right Forces, headed by another former Prime Minister, Sergei Kiriyenko (which received 8.52% of the "party list" votes and whose deputies currently occupy 7% of all Duma seats), Yabloko, a party headed by Grigori Yavlinsky (which received 5.93% of the "party list" votes and whose deputies currently occupy less than 5% of all Duma seats), and the Zhirinovskiy Bloc, headed by Vladimir Zhirinovskiy (which received 5.98% of "party list" votes and whose deputies currently occupy less than 4% of all Duma seats). Other political movements with significant representation in the current Duma include the "People's Deputy" group, with 13% of all Duma seats, the "Russian Regions" group, with 9% of all seats, and the Agrarian Party, with 8% of all seats.

Presidential elections were held on 26 March 2000. Acting President Vladimir Putin was elected the President in the first round of elections, receiving 53% of the vote in which 68.74% of all Russian voters participated. The next candidate, the leader of the Communist Party Gennadi Zyuganov, received 29% of the vote, and each of the other candidates received less than 6%. As a result of Mr. Putin's majority, no second round was required.

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 Federation subjects ethnic Russians constitute the majority. The Federation subjects form the intermediate level of government. Lower-level governments at the county (*raion*), city and village levels are subordinate to their respective Federation subjects.

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

The Federation Treaty of 31 March 1992, signed by 88 Federation subjects (all but the Chechen Republic), initially 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 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 most of the Federation subjects, 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 in the Chechen Republic has been the exception. Before the intervention of Russian forces in Chechnya in December 1994 and the declaration of a state of emergency, the authorities in the Chechen Republic 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. In May 1997, the Government and the Chechen Republic signed a peace treaty. One-year agreements were also concluded between the Government, the Central Bank and the Chechen Republic, stipulating basic principles of economic and financial cooperation. Following the execution of these agreements, however, orderly management of the Chechen Republic was not restored and various instances of illegal activities, such as kidnapping and misappropriation of Federal funds, were not prosecuted by the Chechen authorities. Despite the peace treaty, in August 1999, Chechen armed groups attempted to capture by force territory in the neighbouring Republic of Dagestan, one of the Federation subjects. Russian interior and military troops repelled the attacks and continued to pursue the retreating forces into the territory of Chechnya through major ground and air operations there. By April 2000, Russian forces had captured most of the territory of the Chechen Republic. It is expected that the future of the Chechen Republic will be decided after the completion of operations by the Russian interior and military troops.

On 13 May 2000, the President signed a presidential decree creating seven Federal circuits, each comprising several Federation subjects. According to this decree, the President appoints a representative to each of these circuits. The representatives' responsibilities include facilitating the implementation of the President's domestic and foreign policies, supervising the implementation of Federal decisions in the Federation subjects and reporting to the President on the state of affairs in the Federation subjects.

In May 2000, President Putin introduced to the Duma two draft laws that aimed to improve management of the Federation subjects and lower-level authorities. The first draft law would grant the President the power to dismiss the chief legislative and executive authorities of the Federation subjects in circumstances where such authorities have declined to repeal local legislation held by a court to be (i) contrary to the Constitution or Federal laws and (ii) harmful to the fundamental rights and freedoms of Russian citizens or preventing bodies of Federal authority from performing their statutory functions. On 30 June 2000, the draft law introduced by the President was passed by the Duma in its third and final reading with amendments setting forth detailed and prolonged procedures for dismissal.

The second draft law would grant the President or the Federation subjects' governors the power to dismiss heads of local executive authorities who adopt legal acts held to be contrary to the Constitution, Federal laws or the laws of the Federation subject. The Federal Assembly and Federation subjects' legislative bodies would also be empowered to dismiss local representative authorities that adopt legislation held to be contrary to the Constitution, Federal laws or the laws of the Federation subject. On 30 June 2000, the draft law was adopted by the Duma in the second of three readings. The draft adopted in the second reading does not, however, provide for the powers of Federation subjects' governors to dismiss city mayors.

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 180 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 IMF and the International Bank for Reconstruction and Development (the "World Bank"). See "Public Debt — Relations with International Financial Institutions." 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 after 2000.

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 16 working bodies of the OECD, and formally applied for membership in May 1996.

On 27 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. After the actions taken by NATO in Yugoslavia in the first half 1999, however, Russia temporarily froze its relations with NATO and recalled its official representative from NATO headquarters. Russia resumed its participation in the NATO Permanent Council in July 1999 and in NATO Permanent Military Committee in September 1999 in order to discuss the practical issues of the peacekeeping operation in Yugoslavia.

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. After being ratified by the Federal Assembly, the Agreement became effective for Russia on 1 December 1997.

Russia is a member of the European Bank for Reconstruction and Development (the "EBRD"), the Soviet Union having been one of its founders. Russia 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 became a member of the Asian Pacific Economic Cooperation Forum in 1997 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 separate agreements ("zero-option agreements") with 11 of the 14 other republics of the former Soviet Union. Two of these agreements, with Ukraine and Georgia, have not yet been ratified. These agreements provide, as between the Government and the relevant republic, that the Government will be responsible 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 and to establish a profile for the repayment of former Soviet Union debt that is consistent with its capacity to service that debt.

In April 1996, the Government entered into an agreement rescheduling approximately U.S.\$33 billion of indebtedness to the Paris Club of official creditors. In August 1999, the Government concluded a further rescheduling agreement providing for the deferral of approximately U.S.\$8 billion of indebtedness to Paris Club creditors.

In December 1997, Vnesheconombank restructured the Soviet-era debt owed to the London Club of commercial creditors, and the Government, acting on behalf of Russia, issued a declaration confirming that Russia would not be legally responsible for these debts. In the wake of the events of 17 August 1998, Russia, Vnesheconombank and a committee of London Club creditors held negotiations in 1999 and 2000 with a view to further restructuring this debt. Terms for the further restructuring were agreed with the committee of London Club creditors in February 2000 and are being implemented through the Exchange Offer described herein. See "Public Debt — External Debt — External Debt Restructuring" for a further discussion of indebtedness owing to the Paris Club and the London Club.

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 23 May 1997, the two Presidents signed the union's charter, which declares the equality and sovereignty of its members, calls for the coordination of policies in the political, economic and military spheres, creates supranational authorities to be staffed by the representatives of the legislative and executive bodies of the member states and introduces the concept of union citizenship in addition to national citizenship. The union is open for other countries to join.

In December 1999, Russia and Belarus signed a treaty on the creation of a unified state and a program for its implementation. Under the treaty and the program, Russia and Belarus are to preserve their independence and sovereignty, while developing a single economic space, joint social policies and coordinated foreign and defence policies. Although the treaty does not interfere with the constitutions of either country, amendments to the laws of Russia or Belarus may be necessary in the future, and the unified state may also consider adopting its own constitution.

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

Overview of Economic Reforms

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

Liberalisation of the Russian economy required a fundamental redefinition of the role of the state, which had previously regulated virtually all economic and financial activities. 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 contributed to an overall rise in exports between 1992 and 1996. 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 more conducive to the development of private economic activity. The process of establishing competitive markets, linked to the privatisation process, has begun through new legislative and regulatory initiatives. See “— Private Sector Development.”

Financial stabilisation, essential as a foundation for sustainable economic growth, was pursued through a commitment to fiscal restraint, the development of non-inflationary means of deficit financing, in particular the short-term rouble-denominated state treasury bill (“GKO/OFZ”) market and management of exchange rate fluctuations. See “Public Finance — Deficit Financing” and “Monetary and Financial System — Monetary Policy.”

Russia's financial stabilisation programme came under severe pressure in the second half of 1997 and the first half of 1998, when the repercussions of the Asian currency and financial crises and sharp falls in world prices for oil and other commodities adversely affected the Government's ability to continue to finance its budget deficits and to maintain the value of the rouble against the U.S. dollar. On 17 August 1998, the Government and the Central Bank announced a three-part programme intended to address these pressures. First, the rouble trading corridor would be revised from 5.25–7.15 roubles for one U.S. dollar to 6.00–9.5 roubles for one U.S. dollar. This corridor was subsequently abandoned. Second, GKO/OFZ bonds issued prior to 17 August 1998 and maturing before 31 December 1999 would be restructured into new longer-term instruments and trading of these instruments would be suspended pending the restructuring. Finally, for a period of 90 days Russian private sector residents would be restricted from conducting certain foreign exchange operations of a capital nature, including payments of foreign currency under forward contracts and repurchase agreements and principal payments on long-term credits.

The events of 17 August led to:

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

The situation stabilised rapidly, however, and 1999 and the first months of 2000 witnessed several positive developments. These included:

- a slow-down in the decline in the value of the rouble against the U.S. dollar (and appreciation of the value of the rouble against the U.S. dollar in real terms);
- a decline in consumer price inflation;
- an increase in real industrial output, resulting in part from the devaluation of the rouble;
- an improved balance of trade, resulting in part from the devaluation of the rouble and a significant increase in oil prices;

- improved tax collection, resulting in a significant primary fiscal surplus;
- increasing prices for Russian debt and equity securities;
- a decrease in the share of barter, both in inter-enterprise transactions and in the execution of regional budgets; and
- the voluntary restructuring of a significant portion of Russia's rouble-denominated domestic indebtedness, the rescheduling of a portion of Russia's Paris Club indebtedness, and a planned reduction and restructuring of its London Club indebtedness to be implemented through the Exchange Offer described herein.

Despite these positive signs, Russia continues to experience economic difficulties, including a high level of capital flight in relation to GDP, a high level of inflation and a high incidence of payment arrears and barter or other non-monetary transactions.

On 28 June 2000, the Government approved in general terms the Strategy for Development of the Russian Federation until 2010 (the "2010 Strategy"). The 2010 Strategy is aimed at ensuring sustainable economic growth by further deregulating the economy, reinforcing market institutions and creating a more favourable business environment. Key elements of the strategy include enhancing protection of ownership rights and the rights of minority shareholders, eliminating sources of unfair competition, removing administrative obstacles to business activities, increasing the openness of the economy and implementing responsible monetary and fiscal policies.

The 2010 Strategy's top priority tasks are to implement tax reform, cut the Government's obligations with a view to maintaining a balanced budget, focus the social security program on the most vulnerable groups of the population, reform the pension system and rehabilitate the banking sector. The 2010 Strategy also envisages further structural reforms that would include cancellation of the remaining budgetary subsidies and cross-subsidies within Russian natural monopolies, such as electricity, gas and railroads, restructuring of loss-making subsidised enterprises, further development of market infrastructure and facilitation of the mobility of labour and capital.

Price Liberalisation

In January 1992, prices for approximately 90% of wholesale goods and services (apart from prices in the energy and transportation sector), along with prices for about 80% 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% 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% 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 a result of Russia's mass privatisation programme, a significant proportion of the economic assets of the state was transferred out of government hands. In 1999, state enterprises (wholly-owned by Federal or other state authorities) accounted for 25% 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 1998, the Federal budget received 15.2 billion roubles in privatisation revenues, and in 1999 7.1 billion roubles; the 2000 Budget Law envisages privatisation revenues of 18.0 billion roubles. The Government is considering selling further stakes in five major oil companies (Rosneft, Eastern Oil Company, Slavneft, Norsioil and Lukoil), the monopoly gas producer Gazprom, the national electricity company RAO Unified Energy Systems, the national operator of pipelines for oil products Transneftproduct and the telecommunications enterprise Svyazinvest, as well as certain companies in the coal sector. See "— Principal Sectors of the Economy — Energy" and "— Transport and Communications."

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% 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% of urban residential housing belonged to the state (almost 90% in larger cities). Other dwelling units were owned by housing cooperatives, organised by residents. Some individual houses were owner-occupied.

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 31 December 1999, some 49% of all state-owned apartments had been privatised in Moscow, as compared to 46% in Russia as a whole.

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% can be, and enterprises with a share exceeding 65% are, entered in a register of monopolistic enterprises maintained by the Ministry for Antimonopoly Policy (the "MAP"). The MAP is authorised to employ a variety of means to restrain the anti-competitive behaviour of these enterprises, and can in extreme cases compel their break-up. MAP consent is required for any acquisition of 20% or more of the voting stock of any commercial entity with a size above a certain threshold and for any merger or acquisition that would lead to the creation of a monopoly enterprise.

Civil and Commercial Law

Since 1992, Russia has sought 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. Nonetheless, the recent nature of much Russian legislation, persistent gaps in that legislation, inconsistencies between legal norms at the Federal level as well as between Federal and regional legal norms, the significant degree of discretion given to state officials in many areas and the inexperience of some Russian judges and their susceptibility to outside influences, especially at the regional and local levels, have all weakened the rule of law in Russia.

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 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 1 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. 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.

A new bankruptcy law came into effect on 1 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. While the new law provides a more effective insolvency regime than its predecessor, in particular because the

standard of insolvency on which the law is based is simpler to apply than the old standard, insolvency proceedings continue to be relatively unusual in Russia, notwithstanding the high incidence of payment arrears throughout the economy.

The legislative framework for the restructuring of banks was laid down in the Law on Insolvency (Bankruptcy) of Credit Institutions adopted in February 1999. This legislation details the standards for the Central Bank to appoint temporary administrators of banks, provides an expedited liquidation procedure for banks, and gives the Central Bank the power to license the receivers of bankrupt banks and to propose a receiver to the arbitration court for approval.

Russia also has a Foreign Investment Law. 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 reinvestment of profits in local currency and provides recourse to Russian courts.

Gross Domestic Product

The following table sets forth certain information regarding Russia's GDP for the years 1995 to 1999 and for the first quarters of 1999 and 2000:

	Gross Domestic Product ⁽¹⁾						
	1995	1996	1997	1998	1999 ⁽²⁾	1999 Q1	2000 Q1
Nominal GDP (billions of roubles)	1,540	2,146	2,479	2,696	4,545	836.5	1,389.1
At official exchange rate (U.S.\$ billion)	337.9	418.7	428.3	275.8	184.2	36.5	48.8
Real GDP as compared to 1995 (%)	100.0	96.6	97.5	92.7	95.7	n.a.	n.a.
Nominal GDP per capita (roubles)	10,409	14,547	16,851	18,380	31,130	5,710	9,529
At official exchange rate (U.S.\$ billion)	2,283	2,838	2,912	1,880	1,262	249	334
Real GDP per capita as compared to 1995 (%)	100.0	96.9	98.1	93.5	97.0	n.a.	n.a.
GDP deflator (%) ⁽³⁾	152.2	44.2	14.5	14.3	60.8	55.9	53.2
<i>Memo:</i>							
Official exchange rate (rouble/U.S.\$)	4.56	5.13	5.79	9.78	24.67	22.92	28.49
Total population, million (end of period)	148.0	147.5	147.1	146.7	146.0	146.5	145.8

Notes:

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

(2) Preliminary estimates.

(3) As compared to the same period last year.

Source: Goskomstat, Central Bank.

Following a steep decline in Russia's real GDP in the period between 1992 and 1995 after the dissolution of the former Soviet Union, real GDP is estimated to have declined by approximately 4.3% between 1995 and 1999. The decline in 1995 and 1996 reflected the prolonged economic downturn associated with the collapse of Russia's established trade relationships, massive reductions in 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 first signs of economic recovery were seen in 1997 when GDP increased by 0.9% in real terms, as compared with 1996. 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. This recovery was interrupted in 1998 by the economic crisis in Russia and the sharp decline in world commodity prices; in 1998, GDP declined by 4.9% in real terms.

Nominal GDP increased significantly in U.S. dollar terms from 1995 to 1997 due to the substantial real appreciation of the rouble over the period. The devaluation of the rouble following the events of 17 August 1998 resulted in a sharp decline in the U.S. dollar value of Russia's GDP in 1998. See "Monetary and Financial System — Monetary Policy — Exchange Rates." On the positive side, the devaluation of the rouble improved the competitiveness of Russian products, led to a rise in export volumes and promoted import substitution. These factors led to an increase in production, as real GDP grew by 3.2% in 1999. Growth of GDP in 1999 was also supported by the Government's restraint of price increases in the goods and services provided by the natural monopolies: electricity, natural gas and railroads. While average producer prices grew

by almost 70% in 1999, the price at which electricity is sold to industrial consumers, the price of natural gas and the price of railway freight transport increased by only 10-20% during the same period.

Moreover, barter and other non-monetary transactions began to play a smaller role in the Russian economy, contributing to an improvement in overall efficiency. The main reasons for the decrease of barter include increased liquidity in the real economy due to improved performance by the Government of its payment obligations to commercial enterprises (itself made possible by improved tax collection); the rise in profits of Russian commercial enterprises in rouble terms in 1999 due in significant part to the devaluation of the rouble following the events of 17 August 1998; and the decline in attractive alternative uses of free funds resulting from the contraction of the GKO/OFZ market and the decrease in interest rates on bank time deposits.

Further economic growth was recorded in the first quarter of 2000, when real GDP increased by 8.4%, as compared to the first quarter of 1999.

GDP by Source

The following table illustrates Russia's GDP by source for the years 1995 to 1999:

Gross Domestic Product by Source

	1995		1996		1997		1998		1999	
	(%) ⁽¹⁾	(%) ⁽¹⁾	% change ⁽²⁾	(%) ⁽¹⁾	% change ⁽²⁾	(%) ⁽¹⁾	% change ⁽²⁾	(%) ⁽¹⁾	% change ⁽²⁾	
GDP total	100.0	100.0	(3.4)	100.0	0.9	100.0	(4.9)	100.0	3.2	
Non-service sector	42.0	41.8	(6.4)	39.6	0.3	39.0	(7.4)	41.1	6.6	
Industry	27.0	27.1	(4.0)	26.0	2.0	26.8	(5.2)	29.1	8.0	
Agriculture	6.3	6.2	(5.3)	5.7	2.7	5.0	(18.9)	6.0	2.4	
Construction	7.9	7.7	(15.6)	7.3	(6.4)	6.6	(6.5)	5.4	5.4	
Services	51.1	50.0	(0.4)	52.0	1.5	53.5	(2.5)	50.2	1.0	
Market services	38.5	37.3	(0.7)	37.9	2.4	39.2	(3.5)	39.6	1.1	
Transportation and communications	11.0	11.2	(4.5)	11.1	(1.9)	10.2	(3.4)	9.2	9.5	
Trade, distribution, and catering	18.2	16.5	1.7	15.9	5.4	17.5	(5.5)	20.0	(3.3)	
Housing and communal services	3.1	3.8	(0.4)	3.8	(4.8)	3.9	(3.4)	2.9	(2.3)	
Financial sector	1.5	0.5	(1.5)	0.7	8.3	0.5	(2.2)	1.0	14.8	
Public services	12.6	12.7	0.2	14.1	(1.4)	14.3	0.4	10.6	0.5	
Health care	2.1	2.4	1.9	2.5	(1.7)	2.3	1.7	1.8	1.2	
Education and culture	3.2	3.5	(6.3)	3.7	(0.8)	3.4	(1.0)	2.6	0.7	
Fundamental sciences	0.6	0.5	(9.9)	0.5	(5.8)	0.4	(9.5)	0.2	(3.7)	
Public administration and defence	4.4	4.2	1.8	5.1	(3.1)	5.5	2.1	4.0	0.4	

Notes:

(1) 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.

(2) In prices of the previous year.

Source: Goskomstat.

The period between 1995 and 1998 witnessed an increase in the contribution of services (from 51.1% of GDP in 1995 to 53.5% in 1998) and a decline in the contribution of non-service sectors (from 42.0% of GDP in 1995 to 39.0% in 1998), in particular agriculture and construction. In 1999, these trends reversed, in part due to the devaluation of the rouble following the events of 17 August 1998. The share of services (most of which are provided domestically and paid for in roubles) decreased to 50.2% of GDP, while the share of non-service sectors (with a portion of its production exported and paid for in foreign currency) increased to 41.1%. Within the service sectors, the share of public services decreased sharply in 1999, and the share of market services slightly increased.

Between 1995 and 1999, within the service sectors, the share of transportation and communications declined (from 11.0% of GDP in 1995 to 9.2% in 1999) as did that of public services (from 12.6% to 10.6%). These declines were partly offset by an increase in the share of trade, distribution and catering (from 18.2% to 20.0%). Within the non-service sectors, the share represented by industry increased between 1995 and 1999 (from 27.0% to 29.1%), while the share of construction decreased (from 7.9% to 5.4%).

Shifts in the structure of Russia's GDP resulted from changes in performance in real terms and from changes in relative prices. Despite the fall in GDP overall between 1995 and 1999, production grew in industry (by 0.3%) and in the financial sector (by 19.8%) while production in public services remained practically unchanged. During that period, market services declined slightly (by 2.6%), in particular in transportation and communications (by 1.0%). The real declines over the period from 1995 to 1999 were largest in construction (22.1% decrease), agriculture (19.2% decrease), housing and communal services (10.6% decrease).

GDP by Use

The following table illustrates Russia's GDP by use for the years 1995 to 1999 and for the first quarters of 1999 and 2000:

Gross Domestic Product by Use⁽¹⁾

	1995		1996		1997		1998		1999		1999 Q1		2000 Q1 ⁽⁵⁾	
	%	%	% change ⁽²⁾	%	% change ⁽²⁾	%	% change ⁽²⁾	%	% change ⁽²⁾	%	%	% change ⁽²⁾	%	% change ⁽²⁾
GDP ⁽³⁾	100.0	100.0	(3.4)	100.0	0.9	100.0	(4.9)	100.0	3.2	100.0	100.0	100.0	8.4	
Domestic demand	96.6	96.6	(7.7)	99.1	1.3	94.1	(9.0)	86.1	(1.4)	86.2	78.0	n.a.		
Consumption	71.1	72.0	(3.1)	76.3	3.0	78.4	(2.3)	70.6	(3.5)	74.6	66.2	n.a.		
Public	19.4	20.4	0.8	21.8	(2.4)	19.6	0.6	15.9	0.9	12.5	14.5	n.a.		
Private	51.7	51.6	(4.5)	54.6	5.1	58.9	(3.5)	54.8	(5.0)	62.2	51.8	n.a.		
Investment	25.4	24.6	(20.6)	22.8	(3.6)	15.7	(31.3)	15.5	9.3	11.6	11.8	n.a.		
Fixed assets	21.3	21.2	(19.3)	19.5	(5.7)	17.5	(11.2)	16.3	2.4	14.0	14.0	n.a.		
Inventory accumulation	4.1	3.5	(27.3)	3.3	8.9	(1.9)	— ⁽⁴⁾	(0.8)	— ⁽⁴⁾	(2.4)	(2.2)	n.a.		
Net exports	3.4	4.2	21.2	3.0	(8.8)	7.5	111.0	16.8	60.2	16.2	24.7	n.a.		
Export	27.7	24.8	0.6	23.9	1.1	31.1	1.9	44.4	n.a.	47.4	51.5	n.a.		
Import	24.3	20.6	(2.3)	20.9	3.1	23.6	(13.6)	27.7	n.a.	31.2	26.8	n.a.		

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% in compliance with international practice.
- (4) Changes in inventory stock in 1998 and 1999 were negative.
- (5) Preliminary estimates.

Source: Goskomstat.

Between 1995 and 1997, GDP by use in real terms was characterised by relatively stable consumption, declining investment and growing net exports (with increases in both exports and imports). Following the events of 17 August 1998, these trends were somewhat modified, as consumption, investment and imports were adversely affected, and exports positively affected, by the economic crisis. Overall, between 1995 and 1999 consumption declined in real terms, investment decreased sharply and net exports increased.

Between 1995 and 1999, real consumption fell somewhat faster than real GDP and, as a result, the share of consumption in nominal GDP fell slightly, from 71.1% in 1995 to 70.6% in 1999. Consumption dropped by 5.9% in real terms over the period, reflecting a real decline in private consumption of 8.9%, while public consumption remained almost unchanged. The share of private consumption in nominal GDP increased (from 51.7% to 54.8%), while the share of public consumption decreased (from 19.4% in 1995 to 15.9% in 1999) as a result of cost-cutting in public services.

The contribution of investment to nominal GDP fell from 25.4% to 15.5% between 1995 and 1999, reflecting the overall decline in investment over the period (42.5% in real terms). This decline reflects a drop in fixed investment (by 30.8% over the period) and a larger decline in inventory accumulation. The decline in fixed investment reflects the general economic downturn brought about by the dissolution of the Soviet Union, as the destruction of links with traditional trading partners and cuts in public spending occasioned a fall in domestic demand which reduced incentives for capacity expansion. In addition, the availability of unusually high rates of return in the GKO/OFZ market absorbed resources from time to time that might otherwise have been available for fixed investment. The rate of decline in investment in real terms slowed down in 1997 but increased again in 1998. In 1999, this trend reversed and investment grew in real terms by 9.3%.

The share of net exports in nominal GDP increased from 3.4% in 1995 to 16.8% in 1999. Net exports grew in real terms between 1995 and 1999 by 273.6%. The devaluation of the rouble following the events of 17

August 1998 led to a sharp increase in net exports, as exports increased both in volume and in share of GDP, and import volumes fell.

During the first quarter of 2000, the share of net exports in GDP increased and reached 24.7%.

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 1995 to 1999:

Industrial Output by Sector⁽¹⁾

	1995		1996		1997		1998		1999 ⁽²⁾	
	% ⁽³⁾	% ⁽³⁾	% ⁽³⁾	% ⁽³⁾	% ⁽³⁾	% ⁽³⁾	% ⁽³⁾	% ⁽³⁾	% ⁽³⁾	% ⁽³⁾
Total	100.0	100.0	(4.0)	100.0	2.0	100.0	(5.2)	100.0	8.1	
Electricity	12.5	15.1	(1.6)	17.1	(2.1)	17.0	(2.5)	10.1	0.2	
Fuel	16.6	17.4	(1.5)	17.4	0.3	15.5	(2.5)	16.5	2.4	
Ferrous metallurgy	9.3	8.3	(2.5)	7.9	1.2	7.7	(8.1)	8.4	14.4	
Non-ferrous metallurgy	6.6	5.3	(3.6)	5.5	6.0	7.6	(5.0)	9.8	8.5	
Chemicals and petrochemicals	7.6	7.1	(8.1)	7.2	2.0	7.3	(7.5)	6.7	21.7	
Machine building	18.1	19.0	(4.7)	18.8	3.5	18.0	(7.5)	19.0	15.9	
Wood processing	5.2	4.0	(17.5)	3.7	0.9	3.9	(0.4)	4.8	17.2	
Construction materials	4.9	4.7	(17.3)	4.1	(4.0)	3.8	(5.8)	3.0	7.7	
Textiles	2.5	2.0	(22.5)	1.8	(2.4)	1.6	(11.5)	1.8	20.1	
Food processing	12.1	12.4	(4.2)	12.4	(0.8)	13.7	(1.9)	14.6	7.5	
Other	4.6	4.7	—	4.1	—	3.9	—	5.3	—	

Notes:

(1) Certain data presented in this table 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.

Following the dissolution of the Soviet Union, industrial output decreased in all years prior to 1997, primarily due to the steep decline in domestic demand and the rapid increase in domestic energy prices towards world market levels during that period. The first signs of economic recovery were seen in 1997 when industrial output increased by 2.0% in real terms, as compared to 1996. This recovery was interrupted in 1998 by the financial crisis in Russia and the sharp decline in world commodity prices; in 1998, industrial output declined by 5.2% in real terms.

In 1999, Russia's total industrial output increased by 8.1% in real terms as compared to 1998. The growth was recorded in all major industries, primarily in ferrous and non-ferrous metallurgy, chemicals and petrochemicals, machine building (which embraces the defence industry), wood processing and textiles production. Overall, total industrial output grew by 0.3% in real terms in the period from 1995 to 1999. The change in output volume varied greatly by sector. Throughout this period, growth was recorded in ferrous metallurgy (increase by 3.7%) and non-ferrous metallurgy (by 5.3%), chemicals and petrochemicals (by 5.5%), machine building (by 5.7%) and food processing (by 0.2%), all of which benefited from strong external demand and falling imports. Significant reductions were recorded in manufacturing of construction materials (decrease by 19.5%) and textiles (by 19.6). The reasons for the decline in these sectors were the fall in

investment and increased competition from imported goods. In addition, growth in the manufacturing sectors and decreases in the relative prices of electricity resulted in a decline in the energy sector's share in industrial output from 29.1% in 1995 to 26.6% in 1999.

Energy

In 1999, energy accounted for about 26.6% of Russia's industrial output, and 42.4% of exports. About 39% of Russia's energy production is exported, with natural gas accounting for 16%, oil and petroleum products 26%, coal 0.8%, and electricity 0.3% of total exports in 1999.

Domestic energy prices were heavily subsidised in the Soviet Union, and stood at just 10% to 20% of world market levels in 1992. 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 through the real appreciation of the rouble against foreign currencies. Federal budget revenues and Russia's balance of payments are affected to a significant extent by world energy prices.

Oil and Natural Gas

Russian methodologies for calculating oil and gas reserves and Russian reserves classifications differ from standard international methodologies and classifications, in particular with respect to the manner in which and the extent to which commercial factors 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 dissolution of the Soviet Union. Output in 1999 was 295 million tonnes (8.2% of world output), 48% off the peak of 570 million tonnes in 1988 and some 0.3% above output in 1998. Oil exports to non-CIS countries were 160 million tonnes in 1999, while exports to the CIS were 21 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 is currently studying possibilities for further privatisation of the company. The major oil pipelines and other transportation infrastructure are managed by the state-owned monopolies, Transneft and Transneftproduct.

In addition to Rosneft, the Government is currently considering selling stakes in Eastern Oil Company, Slavneft, Norski-Oil, Lukoil and Transneftproduct.

Natural Gas

Russia's A, B and C1 natural gas reserves are estimated at 48.0 trillion cubic metres. Natural gas output has stabilised in recent years after declining immediately after the dissolution of the Soviet Union, falling only by 0.3% in 1999 as compared with 1998 and by 1.2% overall in the period from 1995 to 1999. Total natural gas output in 1999 was 563 billion cubic metres. Of this amount, approximately 205 billion cubic metres was exported, with around 64% of such exports going to non-CIS countries and the remainder to the CIS.

Russia's natural gas industry is dominated by Gazprom, a 38.5% 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% 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 249 million tonnes of coal was produced in Russia in 1999, approximately 95% of the amount produced in 1995 and 7% less than in 1998. Since the dissolution of the Soviet Union, 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 27.7 million tonnes in 1999. The Government is currently considering selling stakes in several companies in the coal sector.

Electricity

Russia's electricity output was 845 billion kWh in 1999, representing a drop of 1.7% compared with 1995 and a growth of 2.2% compared with 1998. Total Russian generating capacity is about 210,000 MW; approximately 10% 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% or more in 68 of the 73 *energoes*. UES is currently 53% state-owned, and the Government is currently studying possibilities for further privatisation of the company.

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 declined by 14.4% between 1995 and 1999. In 1999, however, agricultural output grew by 2.4% in real terms, as compared to 1998. 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 are estimated to account for 90.5% of land under cultivation and 52% of agricultural output) and private plots, both urban and rural, worked by people who are not full-time farmers (which are estimated to account for 2.9% of land under cultivation and 46% of agricultural output). Family farms account for the remainder of agricultural production. Less than 5% 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 dissolution of the Soviet Union, Government subsidies to the agricultural sector have decreased significantly, the state food purchasing monopoly has been replaced by a decentralised 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 5.0% of GDP in 1999. Output in the construction industry has declined significantly since the dissolution of the Soviet Union, by 21.6% between 1995 and 1999, 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 million square metres in 1999, approximately 4.3% more than in 1998.

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 dissolution of the Soviet Union but its share in total fixed investment has increased.

Railways

There are 148,000 kilometres of railways in Russia, of which 58% are engaged in general passenger and freight transportation and the remainder service particular agencies. Railways accounted for 85.8% of all freight transport in tonne-kilometres (excluding pipeline transport) and 38.5% of all passenger journeys in passenger-kilometres in 1999, 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. It is intended that these subsidies will be gradually eliminated. The railways will in future require a significant increase in investment to maintain track and replace rolling stock.

Roads

There are 916,000 kilometres of roads in Russia, 82% with a hard surface. Some 63% of roads are in public use, 5% being under Federal and 58% 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 308 freight complexes with a total capacity of 168 million tonnes per year. In 1999, 114.6 billion tonne-kilometres of freight was transported by sea from Russian ports (8.2% of Russia's total freight transport, excluding pipeline transport), of which over 90% was carried by Russian ships in foreign navigation. In addition, Russia has over 2,000 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 61 billion tonne-kilometres (4.4% 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 1999 accounted for 14.5% 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 remains state-owned. In 1995, Aeroflot International Airlines was partially privatised, although 51% 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 214,000 km of main pipelines, consisting of 152,000 km of gas pipelines (71% of the total), 47,000 km of oil pipelines, and 15,000 km of oil product pipelines. In 1999, a total of 1,905 billion tonne-kilometres of commodities were transported by pipeline, an increase of 0.9% 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% of the value 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. Gazprom is also currently involved in a large-scale project on construction of a trunk pipeline to Turkey (the "Blue Stream project") a portion of which will cross the Black Sea. The Blue Stream project is expected to enhance significantly Russia's gas export capacity.

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

Telecommunications

In 1999, there were 32.1 million telephone lines in Russia. It is estimated that the capacity of long distance (intercity) telephone lines was increased by 87%, from 350,000 to 654,400, in the period from 1994 to 1998. There are separate telecommunications systems for the Government, the law enforcement agencies, the military, the railways and the energy sector. In 1999, there were 1,340,000 mobile telephone registrations in 79 regions of Russia, an increase of 17.2% compared to 1998. Moscow and St. Petersburg account for 68% of all mobile telephone registrations.

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% 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% of its charter capital plus one vote through a cash auction. Further privatisation of the company is currently being pursued. See "— Private Sector Development — Other Privatisation Initiatives."

In 1999, 15% of all communications services were provided by public sector entities and 85% 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. These fees may be used to fund investment to improve the environment. 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 1999 amounted to 0.3% of GDP for the year. Federal expenditure to address the effects of environmental catastrophes and natural disasters in 1999 amounted to approximately 1.1% of total expenditure for the year, in line with the amount provided for this purpose in the 2000 budget law.

Employment

Overall employment has declined in Russia since the dissolution of the Soviet Union, though by far less than GDP. The sharpest reductions in employment have occurred in science, construction, and industry; employment in trade, domestic services, the financial sector, and the main public services (health care, public administration) has risen. Of the total number of employees in 1999, 38% worked in the state sector, 43% in the private sector and 18% in enterprises with a mixed form of ownership. Some 539,000 new jobs were created in large and middle-sized enterprises in 1999, 23.3% more than in 1998.

The following table sets forth quarterly information regarding unemployment in Russia for the period from 1995 through 1999:

Unemployment as per the End of the Period⁽¹⁾

	Official (ILO) definition unemployed ⁽²⁾		Registered unemployed ⁽³⁾		Registered jobseekers ⁽⁴⁾	
	million	%	million	%	million	%
1995						
First Quarter	5.8	8.0	1.9	2.7	2.2	3.0
Second Quarter	6.1	8.4	2.0	2.8	2.2	3.1
Third Quarter	6.5	8.9	2.1	2.9	2.3	3.2
Fourth Quarter	6.5	9.0	2.3	3.2	2.5	3.5
1996						
First Quarter	6.7	9.2	2.7	3.7	3.0	4.1
Second Quarter	7.0	9.6	2.6	3.6	2.9	3.9
Third Quarter	7.1	9.8	2.5	3.4	2.7	3.7
Fourth Quarter	7.3	10.0	2.5	3.5	2.8	3.8
1997						
First Quarter	7.6	10.5	2.6	3.5	2.8	3.9
Second Quarter	7.9	10.9	2.3	3.2	2.5	3.5
Third Quarter	8.0	11.0	2.1	2.8	2.3	3.2
Fourth Quarter	8.1	11.2	2.0	2.8	2.2	3.0
1998						
First Quarter	8.5	11.7	2.0	2.7	2.2	3.0
Second Quarter	8.1	11.3	1.8	2.5	2.0	2.8
Third Quarter	8.6	11.9	1.8	2.4	2.0	2.8
Fourth Quarter	9.7	13.3	1.9	2.6	2.1	2.9
1999						
First Quarter	10.0	13.6	1.9	2.6	2.1	2.9
Second Quarter	8.8	12.0	1.6	2.2	1.8	2.4
Third Quarter	8.8	11.9	1.3	1.8	1.5	2.1
Fourth Quarter	8.9	12.1	1.3	1.7	1.4	2.0
2000						
First Quarter	8.6	11.7	1.2	1.6	1.4	1.9

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 8.9 million unemployed in Russia at the end of 1999 (12.1% of the labour force), down from 9.7 million (13.3% of the labour force) at the end of 1998. The number of officially registered unemployed increased in 1996 but has been declining since 1997. These figures do not take account of certain "hidden unemployment." For example, at the end of 1999, 1.2% of the Russian labour force was on shortened workdays and 1.1% had been temporarily laid off. In 1999, the total number of lay-off days for these two categories represented additional unemployment of 0.6 million people (0.8% of the labour force). The number of registered unemployed decreased by 20% in 1997, by 4% in 1998 and by 34% in 1999.

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. After several years of declines, average wages in real terms grew in 1996 and 1997. The sharp increase in consumer prices that resulted from the devaluation of the rouble following the events of 17 August 1998 led to a significant decline in real wages in 1998. Wages decreased in real terms by 13% in 1998 and by 23% in 1999. The rate of

decline slowed in 1999, with real wages ultimately increasing by 13% in December 1999 as compared with December 1998.

The minimum wage has also declined in real terms since 1992. Established by the Duma, the minimum wage serves as a benchmark in setting the level of Federal benefits, thereby playing a role in determining the level of Federal expenditures. The share of the population with incomes below the official subsistence level increased from 21% in 1997 to 24% in 1998 and 30% in 1999; this represents an improvement from 1992, when 34% had incomes below the official subsistence level.

In recent years, a significant portion of wages has not been paid when due as a result of the generally difficult economic conditions in Russia. Wage arrears have given rise to sporadic strikes and protests. At the start of 1999, the total stock of wage arrears in the Russian economy amounted to 77.0 billion roubles, up from 52.6 billion roubles at the beginning of 1998. Wage arrears steadily declined throughout 1999, with the total stock amounting to 43.7 billion roubles at the end of 1999. Federal budget arrears were fully paid off in the beginning of 1999 and the Federal budget has remained current since then. The stock of regional budget wage arrears as of 31 December 1999 amounted to 8.3 billion roubles.

Organised labour has played a relatively minor role in setting wages. The percentage of organised workers in the national economy, close to 100% in the Soviet Union, fell significantly by 1999. 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. In 1992, social benefits declined substantially in real terms, reflecting the impact of inflation. Social benefits amounted to 16.8% of GDP in 1998 and 16.1% of GDP in 1999.

Most social expenditure (47% in 1999) is provided through extrabudgetary funds (see "Public Finance — Extrabudgetary Funds"), or by sub-federal authorities (41% in 1999). Direct payments from the Federal budget accounted for only 12% of social expenditure in 1999. The extrabudgetary funds finance pensions, unemployment benefits, some other social benefits and some health expenditure. Sub-federal budgets finance housing and transportation subsidies, most education and health expenditure and some social benefits. The Federal budget is also responsible for some expenditure on education, health, culture and other social benefits.

BALANCE OF PAYMENTS AND FOREIGN TRADE

Balance of Payments

The following table sets forth Russia's consolidated balance of payments for the years 1995 to 1999 and for the first quarters of 1999 and 2000:

Consolidated Balance of Payments⁽¹⁾

	1995	1996	1997	1998	1999	1999 Q1	2000 Q1
	(U.S.\$ million, including unregistered trade adjustments)						
Current account	8,025	12,448	2,545	1,040	24,961	4,490	11,200
Goods and non-factor services (nfs) ...	11,323	17,809	11,611	13,250	32,058	5,636	12,072
Export of goods & nfs	93,481	103,844	103,088	87,255	84,346	17,325	25,127
Import of goods & nfs	(82,158)	(86,035)	(91,476)	(74,005)	(52,288)	(11,688)	(13,055)
Trade balance	20,726	22,933	17,361	17,101	35,847	6,482	13,606
Exports of goods (fob)	82,913	90,563	89,008	74,884	75,306	15,550	23,302
Imports of goods (fob)	(62,188)	(67,629)	(71,647)	(57,783)	(39,459)	(9,069)	(9,696)
Non-factor services	(9,403)	(5,124)	(5,750)	(3,851)	(3,789)	(845)	(1,534)
Exports of services	10,567	13,281	14,080	12,371	9,040	1,774	1,824
Imports of services	(19,970)	(18,406)	(19,829)	(16,222)	(12,829)	(2,620)	(3,359)
Income	(3,371)	(5,434)	(8,706)	(11,801)	(7,631)	(1,098)	(914)
Compensation of employees	(303)	(406)	(342)	(164)	221	57	63
Investment income	(3,068)	(5,028)	(8,365)	(11,637)	(7,852)	(1,155)	(976)
Received	4,112	4,232	4,140	4,000	3,416	2,167	2,390
Paid	(7,181)	(9,259)	(12,504)	(15,637)	(11,267)	(3,322)	(3,366)
Current transfers	73	72	(360)	(409)	534	(48)	42
Capital and financial account	730	(6,774)	5,480	8,193	(17,403)	(3,975)	(8,894)
Capital account	(347)	(463)	(797)	(382)	(328)	(30)	4
Capital transfers credit	3,122	3,066	2,137	1,704	885	220	193
Capital transfers debit	(3,469)	(3,529)	(2,934)	(2,086)	(1,213)	(250)	(189)
Financial account	1,077	(6,311)	6,277	8,575	(17,075)	(3,945)	(8,898)
Direct investment	1,658	1,708	4,036	1,734	1,164	227	188
Abroad	(358)	(771)	(2,603)	(1,027)	(2,145)	(415)	(380)
In Russia	2,016	2,479	6,639	2,761	3,309	642	569
Portfolio investments, net	(2,444)	4,410	45,807	8,619	(614)	67	141
Other investments	11,173	(13,786)	(41,610)	(7,032)	(15,672)	(5,312)	(6,217)
Assets	5,186	(29,074)	(26,608)	(16,003)	(15,124)	(6,306)	(5,792)
Cash foreign currency	134	(8,740)	(13,444)	900	848	203	(16)
Demand and time deposits	4,301	(1,028)	988	1,200	(3,889)	(1,095)	(1,648)
Trade credits and advances	8,215	(9,387)	(6,785)	(6,818)	(5,773)	(2,032)	(428)
Loans extended, net	8,641	9,499	7,004	5,345	4,857	1,800	1,622
Arrears	(10,553)	(9,475)	(3,048)	(7,425)	(5,765)	(4,065)	(3,799)
Non-repatriation of export proceeds and import advances not repaid in time	(4,928)	(9,773)	(11,458)	(8,879)	(5,384)	(1,173)	(1,611)
Other assets, net	(624)	(172)	135	(327)	(19)	54	88
Liabilities	5,987	15,288	(15,002)	8,971	(548)	995	(425)
Cash national currency	391	(230)	(38)	65	0	(2)	23
Demand and time deposits	2,464	1,547	(4,694)	(3,050)	162	(258)	148
Trade credits and advances	(8,050)	(799)	(64)	321	5	104	0
Loans received, net	9,128	11,187	13,622	7,003	(2,670)	(1,319)	(978)
Arrears	1,131	2,672	(24,339)	5,296	2,168	2,437	326
Other liabilities, net	922	911	511	(666)	(212)	33	56
Reserve assets ⁽²⁾	(10,386)	2,841	(1,936)	5,305	(1,778)	969	(3,102)
Adjustment of reserve assets ⁽³⁾ ...	1,076	(1,484)	(20)	(50)	(176)	104	92
Errors and omissions, net	(8,755)	(5,674)	(8,025)	(9,234)	(7,558)	(515)	(2,306)

Notes:

- (1) Certain data presented in this table differ from previously published data due to regular revisions by the Central Bank.
- (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 creation of a customs union with Belarus, Kazakhstan and Kyrgyzstan adds to the difficulty of tracking regional trade flows. Statistical problems are particularly severe in the case of imports from the CIS and non-CIS countries, because of the importance of so-called "unregistered trade," consisting of commercial (in contrast to private) transactions that escape customs records. Value adjustments for unregistered trade are made in Russia's official balance of payments accounts; such adjustments added approximately U.S.\$19 billion to import values in 1997, U.S.\$14 billion in 1998 and U.S.\$9 billion in 1999.

Russia's balance of payments deteriorated sharply in early 1998. Major declines in world commodity prices led to a decline in the U.S. dollar value of Russian exports. Moreover, the international financial situation, as well as the Government's budgetary problems, caused a significant decrease in foreign capital inflows to the GKO/OFZ market, as well as to the banking and corporate sectors, in the first half of 1998.

Attempts by the Government and the Central Bank to stabilise the situation through external borrowings, including an offer to exchange long-term U.S. dollar-denominated debt for short-term rouble-denominated debt, and a tightening of monetary policy had limited success and on 17 August 1998 they announced that the Government would not meet its obligations under GKO's and certain OFZs. They also announced a widening of the rouble trading corridor (subsequently abandoned) and a 90-day moratorium on certain hard currency payments abroad by private sector entities. See "Russian Economy — Overview of Economic Reforms." The real depreciation of the rouble against the U.S. dollar following the events of 17 August 1998 led to a significant contraction of Russian imports despite the very limited possibilities at the time for import substitution. The decrease in the value of the rouble also put additional pressure on the Government and the private sector in respect of servicing external debt.

Current Account

Russia registered a current account surplus in 1995 (U.S.\$8.0 billion) and 1996 (U.S.\$12.4 billion), representing 2.4% and 3.0% 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.\$20.7 billion in 1995 and U.S.\$22.9 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.\$9.4 billion in 1995 and U.S.\$5.1 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 each of these years. The deficit in income payments increased significantly over the period from U.S.\$3.4 billion in 1995 to U.S.\$5.4 billion in 1996, reflecting the increases in scheduled interest payments on non-residents' investment in GKO/OFZ market.

During 1997, the current account surplus decreased by U.S.\$9.9 billion compared to 1996, falling to U.S.\$2.5 billion (representing 0.6% of GDP), primarily due to a lower trade surplus and an increased deficit in income payments. The trade surplus decreased from U.S.\$22.9 billion in 1996 to U.S.\$17.4 billion in 1997 due to a fall in exports and an increase in imports. In 1997, exports fell by 2% in comparison with 1996 due to a fall in the prices of oil and oil products, metals and other exported goods which was offset only in part by an increase in export volumes. According to the estimates of the Ministry of External Economic Relations, average export prices fell by 3% (year-on-year), while volumes increased by 2%. In 1997, imports of goods increased by 6% compared to 1996 due to the slight real appreciation of the rouble with respect to the U.S. dollar (year-on-year) and an increase in overall economic activity. A deficit in income payments of U.S.\$8.7 billion was recorded in 1997 as against a deficit of U.S.\$5.4 billion in 1996, reflecting higher interest payments on securities and deposits as a result of substantial foreign portfolio investment in GKO/OFZs and Eurobonds. The negative balance in non-factor services increased from U.S.\$5.1 billion in 1996 to U.S.\$5.8 billion in 1997.

In 1998, the current account balance fell by U.S.\$1.5 billion as compared with 1997 but remained positive, amounting to U.S.\$1.0 billion (0.4% of GDP). The decline resulted mainly from a U.S.\$3.1 billion increase in the deficit in income payments which was partly offset by a U.S.\$1.9 billion reduction in the negative balance of non-factor services. The deterioration in the income balance was mainly due to higher debt service brought about by a significant increase in the amount of GKO/OFZ obligations held by non-residents (part of these obligations were incurred in 1997 but came due in 1998) and to an increase in yields on these bonds at the end of 1997 and in 1998. See "Public Debt — Government Domestic Debt Policy and Recent Events."

Both exports and imports of goods decreased in 1998 (by 16% and 19%, respectively) preserving the relative trade balance at approximately 1997 levels. The fall in export values was attributable to the fall in commodity prices rather than to changes in export volumes. In 1998, the physical volume of exports increased by 2% while export prices fell by 18% in U.S. dollar terms.

During the first six months of 1998, imports of goods to Russia grew by 9% compared with the first six months of 1997. Growth in imports of machinery and equipment amounted to 11% during that period. As a result of the severe financial and banking crisis in August 1998 that led to a crippling of the payments system, a sharp decline in the value of the rouble, a correspondingly sharp rise in the rouble prices of imports and a sharp fall in household real income, import growth in the first half of 1998 was offset by a steep contraction in imports, by 42%, during the second half of 1998, as compared with the second half of 1997. Accordingly, despite a 21% fall in exports of goods in the second half of 1998, the trade surplus increased by U.S.\$6.9 billion during that period as compared with the second half of 1997, due to the even faster fall in imports.

In 1999, Russia ran a current account surplus of U.S.\$25.0 billion (13.6% of GDP), an improvement from the same period in 1998 when the current account surplus was only U.S.\$1.0 billion. This improvement was mainly due to a U.S.\$18.7 billion increase in Russia's trade surplus. In 1999, the value of imports of goods fell by 32%, compared with 1998. The value of exports of goods increased slightly mainly because the decrease in the U.S. dollar prices of certain goods was more than offset by increases in export volumes. In 1999, the volume of exports increased by 10% compared with 1998, while average export prices fell by 9% despite the rise in the price of Russian crude oil. The principal reasons for the steep decline in imports were the rise in import prices in rouble terms and the decline in the population's real income due to the devaluation of the rouble and the general financial crisis. The decline in imports, while exports remained stable, led to a significant improvement in Russia's trade balance, from U.S.\$17.1 billion in 1998 to U.S.\$35.8 billion in 1999.

The income balance improved as well in 1999, with the negative balance of income payments amounting to U.S.\$7.6 billion, compared with U.S.\$11.8 billion in 1998. This reduction in the income payments deficit was due to the significant decrease in scheduled interest payments on GKO/OFZ bonds held by non-residents, as a result of the restructuring of those bonds effected in the first half of 1999, the devaluation of the rouble and the imposition of additional exchange controls on non-resident holders of restructured domestic debt. See "Public Debt — Domestic Debt — Government Domestic Debt." In 1999, the negative balance of services remained stable, as compared with 1998; both exports and imports of services decreased significantly (by 27% and 21%, respectively), compared with the previous year.

During the first quarter of 2000, the current account balance increased by U.S.\$7.1 billion, as compared with the first quarter of 1999, reaching U.S.\$11.2 billion (23% of GDP). The primary reason for this improvement was a sharp increase in the trade surplus (from U.S.\$6.5 billion in the first quarter of 1999 to U.S.\$13.6 billion in the first quarter of 2000). The significant improvement in the trade balance resulted from a 50% increase in the value of exports, compared with only moderate growth in the value of imports (7%). The growth in the value of exports was due mostly to increases in the prices of oil, oil products and natural gas. During the first quarter of 2000, average prices for these products increased by 95%, as compared with the same period in 1999, while the physical volumes exported grew by only 5%. At the same time, average overall export prices increased by 40% between January and March 2000, while physical volumes increased by only 9% during that period. The increase in imports was mainly due to the rise in economic activity, while the real exchange rate remained stable.

The investment income balance decreased slightly from U.S.\$1.1 billion in the first quarter of 1999 to U.S.\$0.9 billion in the first quarter of 2000. The negative balance of non-factor services increased in the first quarter of 2000, as compared with the first quarter of 1999 (from U.S.\$0.8 billion to U.S.\$1.5 billion), primarily due to an increase in imports (mainly travel) caused by growth in population's income.

Capital and Financial Account

Russia recorded a capital and financial account deficit of U.S.\$6.8 billion in 1996, a deterioration compared with 1995 when a surplus of U.S.\$0.7 billion was registered. 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.\$4.4 billion in 1996 (reversing negative inflows in 1995) 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). These flows were in positive balance by U.S.\$13.8 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.\$5.5 billion. Net foreign direct investment rose to U.S.\$4.0 billion, of which U.S.\$1.9 billion arose from the privatisation of Svyazinvest. See "The Russian Economy — Principal Sectors of the Economy — Transport and Communications — Telecommunications." Net portfolio investment rose to U.S.\$45.8 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 the 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 an increase in the negative balance of other investment flows from U.S.\$13.8 billion in 1996 to U.S.\$41.6 billion. Purchases of foreign currency in cash, which have a negative impact on the capital and financial account, increased to U.S.\$13.4 billion in 1997, as the foreign currency cash holdings increased as a hedge against market uncertainties, including the Asian financial and currency crisis, and the redenomination of the rouble announced by the Central Bank in the middle of 1997 to take effect in January 1998. Changes in 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.\$1.9 billion in 1997 (excluding valuation changes).

In 1998, the capital and financial account surplus increased to U.S.\$8.2 billion. The improvement was largely due to changes with respect to foreign currency holdings in cash. During 1997, the stock of foreign currency cash holdings had increased by U.S.\$13.4 billion, whereas during 1998 it decreased by U.S.\$0.9 billion. The decrease resulted from need to support living standards after the domestic financial crisis began in the second half of 1998 and from the reduction in unregistered trade where foreign currency is used as the means of payment. Moreover, reserve assets decreased by U.S.\$5.3 billion (net of valuation changes) in 1998, due to the efforts of the Central Bank to support the rouble, and this positively affected Russia's capital and financial account. At the same time, inflows of direct and portfolio investment weakened. Net foreign direct investment decreased to U.S.\$1.7 billion in 1998 due to the domestic financial crisis that diminished the interest of foreign investors in the Russian real sector. In 1998, net portfolio investment decreased to U.S.\$8.6 billion reflecting the change in attitude of foreign investors to the GKO/OFZ market following the Asian financial crisis, the Government's budgetary problems and the events of 17 August 1998, which effectively closed that market.

In 1999, the capital and financial account showed a deficit of U.S.\$17.4 billion, compared with a surplus of U.S.\$8.2 during 1998. The main cause of the deterioration was the domestic financial crisis, which precluded external borrowings by both the public and the private sectors. During that period, net direct investment was U.S.\$1.2 billion, a decrease of U.S.\$0.6 billion in 1998. On the other hand, gross direct investment (total foreign direct investment to Russia without taking account of Russian investment abroad) increased from U.S.\$2.8 billion in 1998 to U.S.\$3.2 billion in 1999. The investment (mainly from the United States and Germany) was channelled to the fuel sector, food industry, transportation and retail trade. These positive investment flows were offset by growth of Russian investment abroad (from U.S.\$1.0 billion during 1998 to U.S.\$2.1 billion during 1999). During 1999, Russian investment abroad came close to its 1997 levels (U.S.\$2.6 billion) after contracting sharply in 1998. This investment was channelled mainly by Russian companies in the oil and gas sector into developing their infrastructure and joint ventures abroad. Reserve assets increased in 1999 by U.S.\$1.8 billion, while in 1998 they decreased by U.S.\$5.3 billion. The increase in 1999 was mainly due to the limited capacity and decreased willingness of the Central Bank to support the rouble. Portfolio and other investment balances significantly deteriorated compared with 1998. Net portfolio investments were negative U.S.\$0.6 billion, as opposed to the strongly positive balance of portfolio investments in 1998 of U.S.\$8.6 billion. This deterioration was mainly due to the inability of Russian issuers to raise funds in the Eurobond market. The negative other investment balance increased from U.S.\$7.0 billion in 1998 to U.S.\$15.7 billion in 1999. The main reason for this increase was the very low disbursements of loans and credits to both the public and the private sectors.

In the first quarter of 2000, the capital and financial account deficit increased significantly and stood at U.S.\$9.0 billion, compared with U.S.\$4.0 billion in the first quarter of 1999. The increase was mainly due to a U.S.\$3.1 billion growth in Central Bank reserves, whereas between January and March 1999, reserves decreased by U.S.\$1.0 billion.

In the first quarter of 2000, the other investment deficit increased by U.S.\$0.9 billion, as compared with the same period of 1999, reaching U.S.\$6.2 billion. At the same time, net inflows of direct investment (U.S.\$0.2 billion in the first quarter of 2000) and portfolio investments (U.S.\$0.1 billion) remained at levels approximately equivalent to those in the first quarter of 1999.

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 import advances not repaid in time.

Since 1992, increasingly liberal foreign exchange regulations and uncertainties generated by the economic situation and exchange rate fluctuations have prompted Russian banks, enterprises and households to switch their current holdings and savings into foreign exchange (particularly U.S. dollar) denominated assets. Net cash foreign currency purchases 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. In 1997, as discussed above, net cash foreign currency purchases increased even more due to various market uncertainties, including the Asian financial crisis, and the uncertainty surrounding the redenomination of the rouble. These outflows fell in 1998 due to increased sales of foreign exchange, and this trend continued in 1999.

Capital outflows in the form of non-repatriation of export proceeds and import advances not repaid in time increased from U.S.\$4.9 billion in 1995 to U.S.\$11.5 billion in 1997 as a consequence of liberalisation of foreign trade and capital flows. In 1998 and 1999, illegal outflows related to foreign trade decreased significantly due to both contractions of trade turnover and tightening of foreign exchange controls by the Central Bank. Non-repatriation of exports proceeds and import advances not repaid in time amounted to U.S.\$8.9 billion in 1998 and U.S.\$5.4 billion in 1999.

The level of unaccounted transactions in Russia's balance of payments accounts has been high throughout the period, amounting to U.S.\$8.8 billion in 1995, U.S.\$5.7 billion in 1996, U.S.\$8.0 billion in 1997, U.S.\$9.2 billion in 1998 and U.S.\$7.6 billion in 1999.

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 1 July 1992. In 1995, Russia adopted a 30% tariff ceiling on most imports, and announced a schedule of gradual reductions in import tariffs. The weighted average of Russia's import tariffs, which stood at 16% in 1995, was reduced to 11% in 1999.

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 some steel products) and between Russia and the United States (for some steel products and certain consumer goods).

In 1998, Russia adopted a Trade Remedies Law that was based on general WTO principles and covered issues of various safeguards, anti-dumping and compensation measures in Russia's foreign trade.

In 1999, the Government reintroduced export tariffs on certain natural resources in order to increase the Federal budget revenues. Export tariff on crude oil was initially set at 2.5 euro per metric tonne and gradually increased to 20 euro at the end of the first quarter of 2000, in line with the increase in world prices on oil. In the middle of 1999, in order to secure supplies of oil and oil products within Russia, the Government introduced some non-tariff export limitations requiring oil producers to supply certain amounts of oil and oil products on the domestic market prior to receiving access to export facilities. While these measures were gradually relaxed, the requirements to supply certain oil products to the domestic market still exist. In the future, the Government is planning to abandon non-tariff methods of foreign trade regulation.

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 1995 to 1999:

Structure of Trade⁽¹⁾⁽²⁾ (excluding unregistered trade)

	1995		1996		1997		1998		1999 ⁽⁴⁾	
	U.S.\$ billion	%	U.S.\$ billion	%	U.S.\$ billion	%	U.S.\$ billion	%	U.S.\$ billion	%
Exports										
Machinery, equipment and transport	7.9	9.9	8.5	9.8	8.9	10.3	8.4	11.5	7.9	10.8
Metals, precious stones and their products	20.9	26.1	20.4	23.5	20.8	24.0	20.0	27.3	18.8	25.7
Mineral products ⁽³⁾	33.5	42.0	41.1	47.3	41.4	47.9	31.1	42.5	32.2	44.0
Chemical products and rubber	7.9	9.9	7.4	8.5	7.2	8.3	6.2	8.4	6.2	8.5
Timber, woodpulp and paper products	4.4	5.6	3.6	4.2	3.7	4.2	3.5	4.8	3.7	5.1
Textiles	1.2	1.5	0.9	1.1	0.9	1.1	0.8	1.1	0.8	1.1
Leather and fur products	0.3	0.4	0.4	0.4	0.4	0.5	0.4	0.8	0.2	0.3
Foodstuffs and agricultural products (excluding textiles)	2.7	3.3	3.2	3.7	2.4	2.8	2.2	3.0	2.0	2.7
Other	1.1	1.3	1.4	1.5	0.8	1.0	0.6	0.9	1.4	1.8
Total trade	79.9	100.0	86.9	100.0	86.6	100.0	73.3	100.0	73.2	100.0
Imports										
Machinery, equipment and transport	15.8	33.7	15.2	32.0	18.9	35.3	16.5	36.3	10.5	33.6
Metals, precious stones and their products	3.9	8.4	4.6	9.8	3.8	7.2	3.2	7.0	2.3	7.4
Mineral products ⁽³⁾	2.9	6.4	3.0	6.4	3.1	5.8	2.6	5.6	1.2	3.9
Chemical products and rubber	5.1	10.9	6.8	14.4	7.7	14.4	6.8	14.9	5.2	16.5
Timber, woodpulp and paper products	1.1	2.4	1.5	3.3	1.9	3.6	1.7	3.7	1.1	3.5
Textiles	2.6	5.5	2.3	4.7	2.4	4.5	1.8	3.9	1.7	5.3
Leather and fur products	0.2	0.4	0.2	0.4	0.2	0.3	0.1	0.3	0.1	0.3
Foodstuffs and agricultural products (excluding textiles)	13.2	28.2	12.0	25.3	13.4	25.0	11.3	24.8	8.1	25.9
Other	1.9	4.1	1.8	3.7	2.1	3.9	1.6	3.5	1.1	3.6
Total trade	46.7	100.0	47.4	100.0	53.6	100.0	45.4	100.0	31.3	100.0
Balance										
Machinery, equipment and transport	(7.9)	—	(6.7)	—	(10.0)	—	(8.1)	—	(2.6)	—
Metals, precious stones and their products	17.0	—	15.8	—	17.0	—	16.9	—	16.5	—
Mineral products ⁽³⁾	30.6	—	38.1	—	38.3	—	28.6	—	31.0	—
Chemical products and rubber	2.8	—	0.6	—	(0.5)	—	(0.6)	—	1.1	—
Timber, woodpulp and paper products	3.3	—	2.1	—	1.7	—	1.8	—	2.6	—
Textiles	(1.4)	—	(1.4)	—	(1.5)	—	(0.9)	—	(0.8)	—
Leather and fur products	0.1	—	0.2	—	0.2	—	0.3	—	0.1	—
Foodstuffs and agricultural products (excluding textiles)	(10.5)	—	(8.8)	—	(11.0)	—	(9.1)	—	(6.1)	—
Other	(0.8)	—	(0.4)	—	(1.3)	—	(1.0)	—	0.2	—
Total trade	33.2	—	39.5	—	33.0	—	27.9	—	41.9	—

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.

Exports of mineral products (including oil, gas and coal) and metals and precious stones account for the vast majority of Russia's total exports, 70% in 1998 and 1999. Other significant exports include chemical products and rubber (9% of total exports in 1999) and machinery and other equipment (11% in the same period).

Imports of machinery, equipment and transport accounted for some 34% of total imports in 1999. Russia also imports significant amounts of raw and processed foodstuffs and agricultural products. In the aggregate, these products accounted for 26% of total imports in 1999.

Direction of Trade

The following tables illustrate the geographic distribution of Russia's trade on a customs basis (excluding unregistered trade adjustments) for the years 1995 to 1999:

	Exports⁽¹⁾⁽²⁾										
	(excluding unregistered trade)										
	1995		1996		1997		1998		1999		
	U.S.\$ million	U.S.\$ million	% change	U.S.\$ million	% change	U.S.\$ million	% change	U.S.\$ million	% change	U.S.\$ million	% change
Exports to ROW	63,687	69,212	8.7	68,412	(1.2)	57,614	(15.8)	61,130	6.1		
OECD countries ⁽³⁾	39,374	40,997	4.1	48,440	18.1	41,497	(14.3)	42,401	2.2		
Germany	6,208	6,735	8.5	6,531	(3.0)	5,719	(12.4)	6,191	8.2		
Great Britain	3,066	3,209	4.7	2,848	(11.2)	2,960	3.9	2,838	(4.1)		
Switzerland	3,525	3,724	5.6	3,542	(4.9)	3,118	(12.0)	3,340	7.1		
Japan	3,173	2,915	(8.1)	2,935	(0.7)	2,176	(25.9)	2,109	(3.1)		
USA	4,315	4,839	12.1	4,482	(7.4)	5,100	13.8	4,689	(8.1)		
Italy	3,376	2,828	(16.2)	3,564	(26.0)	3,219	(9.7)	3,690	14.6		
Other OECD	15,712	16,748	6.6	24,500	46.3	19,205	(21.6)	19,544	1.8		
Transition economies ⁽⁴⁾	12,204	14,827	21.5	8,214	(44.6)	6,230	(24.2)	6,216	(0.2)		
Other non-CIS countries	12,109	13,389	10.6	11,795	(11.9)	9,888	(16.2)	12,513	26.6		
Exports to CIS countries	14,530	15,895	9.4	16,624	4.6	13,699	(17.6)	10,688	(22.0)		
Ukraine	7,149	7,547	5.6	7,240	(4.1)	5,560	(23.2)	4,786	(13.9)		
Belarus	2,940	3,522	19.8	4,673	32.7	4,670	0.1	3,761	(19.5)		
Kazakhstan	2,555	2,550	(0.2)	2,471	(3.1)	1,893	(23.4)	1,222	(35.5)		
Kyrgyzstan	105	159	52.1	168	5.3	132	(21.0)	84	(36.3)		
Other CIS	1,782	2,117	18.8	2,072	(2.1)	1,443	(30.4)	836	(42.1)		
Total exports	78,217	85,107	8.8	85,036	(0.1)	71,314	(16.1)	71,818	0.7		

Notes:

- (1) Certain data presented in this table for 1995, 1996 and 1997 differ from previously published data due to regular revisions by the Customs Committee.
- (2) Figures differ from the presentation in "— Balance of Payments" due to classification, coverage, and other adjustments.
- (3) Czech Republic, Hungary, Mexico, Poland and Republic of Korea joined the OECD in 1997.
- (4) Comprises Bulgaria, China, Cuba, Czech Republic, Hungary, Mongolia, North Korea, Poland, Romania, Slovakia and Vietnam in 1994-1996, and Bulgaria, China, Cuba, Mongolia, North Korea, Romania, Slovakia and Vietnam starting with 1997.

Source: Customs statistics.

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

	1995		1996		1997		1998		1999	
	U.S.\$ million	U.S.\$ million	% change	U.S.\$ million	% change	U.S.\$ million	% change ⁽³⁾	U.S.\$ million	% change ⁽³⁾	
Imports from ROW	33,117	31,485	(4.9)	38,804	23.2	32,266	(16.8)	21,846	(32.3)	
OECD countries ⁽³⁾	23,220	21,657	(6.7)	30,752	42.0	25,560	(16.9)	16,625	(35.0)	
Germany	6,483	5,192	(19.9)	6,643	28.0	5,486	(17.4)	4,195	(23.5)	
USA	2,648	2,901	9.6	4,058	39.9	4,114	1.4	2,385	(42.0)	
Italy	1,851	2,339	26.4	2,640	12.9	1,819	(31.1)	1,156	(36.4)	
Finland	2,041	1,675	(17.9)	1,874	11.9	1,440	(23.1)	947	(34.2)	
Netherlands	1,646	1,010	(38.6)	1,206	19.4	914	(24.2)	688	(24.8)	
France	1,074	1,269	18.1	1,594	25.7	1,595	0.1	1,180	(26.0)	
Other OECD	7,478	7,272	(2.8)	12,737	75.1	10,192	(20.0)	6,073	(40.4)	
Transition economies ⁽⁴⁾	4,654	4,316	(7.3)	2,500	(42.1)	2,156	(13.8)	1,588	(26.3)	
Other non-CIS countries	5,242	5,513	5.2	5,552	0.7	4,550	(18.1)	3,633	(20.2)	
Imports from CIS countries	13,592	14,549	7.0	14,234	(2.2)	11,313	(20.5)	8,338	(26.3)	
Ukraine	6,617	6,294	(4.9)	3,982	(36.7)	3,267	(17.9)	2,523	(22.8)	
Belarus	2,088	3,024	44.9	4,780	58.0	4,608	(3.6)	3,236	(29.8)	
Kazakhstan	2,675	3,041	13.7	2,743	(9.8)	1,884	(31.3)	1,391	(26.1)	
Kyrgyzstan	101	147	45.2	148	0.8	132	(10.7)	95	(28.3)	
Other CIS	2,111	2,043	(3.2)	2,580	26.3	1,422	(44.9)	1,093	(23.1)	
Total imports	<u>46,709</u>	<u>46,034</u>	<u>(1.4)</u>	<u>53,038</u>	<u>15.2</u>	<u>43,579</u>	<u>(17.8)</u>	<u>30,185</u>	<u>(30.7)</u>	

Notes:

- (1) Certain data presented in this table for 1995, 1996 and 1997 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) Czech Republic, Hungary, Mexico, Poland and Republic of Korea joined the OECD in 1997.
- (4) Comprises Bulgaria, China, Cuba, Czech Republic, Hungary, Mongolia, North Korea, Poland, Romania, Slovakia and Vietnam in 1995-1996, and Bulgaria, China, Cuba, Mongolia, North Korea, Romania, Slovakia and Vietnam starting with 1997.

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 8% between 1995 and 1999, and rose in relative terms as well, accounting for 59% of exports in 1999 (U.S.\$42.4 billion). A sharp increase in the value and share of exports to OECD countries in 1997 was mainly due to the Czech Republic, Hungary, Poland, Mexico and the Republic of Korea joining the OECD.

Exports to transition economies decreased from 16% in 1995 to 9% of total exports in 1999, despite the rapidly expanding trade with Central European Free Trade Agreement trading partners. In 1997, the volume and share of exports to transition economies dropped mainly due to the reclassification of the Czech Republic, Hungary and Poland as OECD countries. The share of other non-CIS countries increased from 15% of Russia's total exports in 1995 to 17% in 1999.

Between 1995 and 1998, the share of exports to CIS countries varied from 19% to 21% of total exports. Exports to CIS countries decreased by 22% in 1999 compared with 1998. The steep decrease in exports to CIS countries was due to a significant decline in the prices of the goods exported to the CIS, offset only in small part by fractional growth in export volumes. The share of CIS countries in total exports decreased from 19% in 1998 to 15% in 1999.

Imports from OECD countries rose from 50% of total imports in 1995 to 55% in 1999. The share of OECD countries in total imports increased in 1997 after the accession of new members to the OECD.

The share of transition economies in total imports decreased from 10% in 1995 to 5% in 1999 mainly due to the reclassification of the Czech Republic, Hungary and Poland as OECD countries that occurred in 1997. The share of other non-CIS countries in Russia's total imports increased from 11% in 1995 to 12% in 1999.

Imports from CIS countries, which were relatively low immediately following the dissolution of the Soviet Union, initially grew substantially but then stabilised accounting for 29% of total imports in 1995 and 28% 1999.

Germany, Belarus, United States and Ukraine are Russia's leading trading partners. The role of Belarus in Russia's foreign trade has increased significantly since 1995 due to intensified political and economic links between the two countries. The largest importers of Russian goods in 1999 were Germany (9% of Russian exports), the United States and Ukraine (7% each) and Belarus and Italy (5% each). The most important exporters to Russia were Germany (14% of Russian imports), Belarus (11%), the United States and Ukraine (8% each). Three countries, Ukraine, Belarus and Kazakhstan, account for almost 90% 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 31 December 1995 to 1999 and at May 1, 2000:

Official International Reserves

	As at 31 December					As at
	1995	1996	1997	1998	1999	1 May 2000
	(U.S.\$ million)					
Official foreign exchange reserves.....	14,383	11,276	12,895	7,801	8,457	13,410
SDRs	116.7	4.5	122.4	0.1	0.6	0.2
Reserve position in IMF	1.1	1.3	1.2	1.3	1.3	1.2
Other foreign exchange	14,265	11,271	12,771	7,800	8,455	13,409
Official gold reserves						
(fine troy ounces, million)	9.4	13.5	16.3	14.7	13.3	12.3
U.S.\$ million (national valuation) ⁽¹⁾	2,824	4,047	4,889	4,422	3,998	3,682
Total official international reserves (including gold)	<u>17,207</u>	<u>15,323</u>	<u>17,784</u>	<u>12,223</u>	<u>12,456</u>	<u>17,091</u>
Net official international reserves (including gold) ⁽²⁾	7,580	1,696	3,740	(7,197)	(2,832)	3,690

Notes:

(1) In U.S. \$300 per troy ounce.

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

Source: Central Bank, Ministry of Finance.

Russia's official international reserves amounted to U.S.\$2.8 billion at the end of 1991, and consisted 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. By 31 December 1996, Russia's official international reserves (including gold) had fallen to U.S.\$15.3 billion, 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 in relation to purchases of GKO's by non-residents. These contracts were recorded as foreign exchange liabilities.

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 Central Bank foreign exchange policies aimed at preventing the real appreciation of the rouble. At 30 June 1997, total official international reserves (including gold) reached U.S.\$24.5 billion. 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 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"), reducing reserves to U.S.\$17.8 billion by the end of 1997, representing approximately 2.4 months of import coverage.

In 1998, the decrease in the value of Russia's exports, outflows of private foreign capital and efforts by the Central Bank to support the rouble led to a decline in official international reserves (including gold) of U.S.\$5.6 billion. The decline in reserves occurred despite almost U.S.\$15 billion in external borrowings by the Government and the Central Bank in 1998 (excluding the exchange of Eurobonds for GKO's in July 1998).

As at 31 December 1998, official international reserves (including gold) stood at U.S.\$12.2 billion, of which U.S.\$7.8 billion was in foreign currency and U.S.\$4.4 billion was in gold. These reserves represented 2.0 months of import coverage. Net official international reserves (including gold) were negative U.S.\$7.2 billion as at 31 December 1998.

In 1999, the Central Bank was not able to increase significantly the level of official international reserves despite the strong improvements in the current account. While foreign capital inflows in 1999 were low, the large current account surplus was used mostly for the accumulation of foreign assets by Russian residents rather than to increase official international reserves. In addition, in line with its agreement with the IMF, throughout 1999 the Central Bank gradually excluded assets held with its subsidiary foreign banks from official international reserves. As at 31 December 1999, official international reserves (including gold) stood at U.S.\$12.5 billion, of which U.S.\$8.5 billion was in foreign currency and U.S.\$4.0 billion was in gold. These reserves represented 2.9 months of import coverage. Compared with 1998, the improvement in import coverage was due mainly to the sharp decrease in volume of imports. Net official international reserves (including gold) were negative U.S.\$2.8 billion as at 31 December 1999. The improvement in net international reserves was mainly due to the reduction of the Government's and the Central Bank's debt to the IMF from U.S.\$19.4 billion at the end of 1998 to U.S.\$15.3 billion at the end of 1999, resulting from the significant amortisation of this debt in excess of new IMF disbursements.

In the first quarter of 2000, the improved situation in world commodity markets led to an increase in Russia's reserves. As at 1 April 2000, official international reserves (including gold) stood at U.S.\$15.5 billion, of which approximately U.S.\$11.5 billion was in foreign currency and approximately U.S.\$4.1 billion was in gold. These reserves represented 3.6 months of import coverage (based on the value of imports of goods and services in 1999). Net international reserves stood at U.S.\$1.4 billion as at 1 April 2000. Russia's reserve position improved further in the second quarter, and on 7 July 2000, gross international reserves (including gold) stood at U.S.\$21.8 billion.

The Government strictly regulates Russia's output, sale and export of precious metals and stones, such as gold, platinum, and diamonds. As part of this regulation, the Government licenses Russia's precious metals output and has the right of first refusal to purchase this output. The Government can but does not have to add to its reserves any purchased output or any proceeds from sales and export of its precious metals.

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

PUBLIC FINANCE

The information presented herein with respect to the Federal budget, with limited exceptions, has 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 presentation of Federal budget information and the GFS guidelines and definitions relate mainly to (i) sales of gold and precious metals and privatisation proceeds, which are treated as positive elements of deficit financing in the presentation herein but as revenue items under GFS, and (ii) purchases of gold and precious metals, which are treated as negative elements of deficit financing in the presentation herein but as expenditure items under GFS.

The Federal budget information presented herein differs in significant respects from budget information prepared in accordance with Federal budgetary laws 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 the GFS and the budget laws for 1999 and 2000 were prepared in accordance with the methodologies used to present the budget information herein. It is expected that all Federal budget information published in the future will be prepared in accordance with such methodologies.

Overview

Russia reduced its Federal budget deficit from 44.6% of GDP in 1992 to 1.2% of GDP in 1999. In the first quarter of 2000, Russia ran a surplus of 3.0% of GDP. This improvement 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% of GDP in 1992 to only 1.1% in 1999.

The following table sets forth certain summary information regarding Russia's public finances for the years 1995 to 1999 and for the first quarter of 2000:

Enlarged Budget⁽¹⁾						
	<u>1995</u>	<u>1996⁽²⁾</u>	<u>1997⁽³⁾</u>	<u>1998⁽⁴⁾</u>	<u>1999</u>	<u>Q1 2000</u>
(millions of roubles)						
Enlarged budget						
Revenue	546,177	784,320	966,639	904,858	1,622,031	497,922
Expenditure	643,498	985,952	1,178,712	1,042,797	1,662,757	418,431
Deficit/ (surplus)	97,321	201,633	212,074	137,939	40,726	(79,491)
Federal budget						
Revenue	196,504	296,261	310,831	290,421	608,034	221,824
Expenditure	283,180	474,258	484,034	422,732	661,559	179,539
Deficit/ (surplus)	86,676	177,997	173,203	132,311	53,524	(42,285)
Primary deficit ⁽⁵⁾	37,516	53,607	55,415	25,740	(109,058)	(82,400)
Local (sub-federal and municipal) budgets⁽⁶⁾						
Revenue	204,728	274,869	360,374	352,142	561,088	139,347
Expenditure	211,852	296,849	397,012	358,963	563,614	133,590
Deficit/ (surplus)	7,124	21,980	36,638	6,821	2,526	(5,757)
Extrabudgetary funds⁽⁷⁾						
Revenue	144,945	213,190	295,433	262,295	452,909	136,750
Expenditure	148,467	214,846	297,666	261,101	437,584	105,302
Deficit/ (surplus)	3,522	1,656	2,233	(1,194)	(15,324)	(31,448)
(% of GDP)						
Enlarged budget						
Revenue	35.5	36.5	39.0	33.6	35.7	35.8
Expenditure	41.8	45.9	47.5	38.7	36.6	30.1
Deficit/ (surplus)	6.3	9.4	8.6	5.1	0.9	(5.7)
Federal budget						
Revenue	12.8	13.8	12.5	10.8	13.4	16.0
Expenditure	18.4	22.1	19.5	15.7	14.6	12.9
Deficit/ (surplus)	5.6	8.3	7.0	4.9	1.2	(3.0)
Primary deficit ⁽⁵⁾	2.4	2.5	2.2	1.0	(2.4)	(5.9)
Local (sub-federal and municipal) budgets⁽⁶⁾						
Revenue	13.3	12.8	14.5	13.1	12.3	10.0
Expenditure	13.8	13.8	16.0	13.3	12.4	9.6
Deficit/ (surplus)	0.5	1.0	1.5	0.3	0.1	(0.4)
Extrabudgetary funds⁽⁷⁾						
Revenue	9.4	9.9	11.9	9.7	10.0	9.8
Expenditure	9.6	10.0	12.0	9.7	9.6	7.6
Deficit/ (surplus)	0.2	0.1	0.1	0.0	(0.3)	(2.3)
Memo:						
Nominal GDP, rouble billion	1,540	2,146	2,479	2,696	4,545	1,389

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 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 billion roubles).
- (3) Includes monetary offsets recorded in January and February 1998 but attributable to 1997 (18.4 billion roubles).
- (4) Subject to adjustments to be made in respect of certain items of revenue and expenditure that are incurred after 31 December 1998, which are appropriate to record in respect of 1998. Includes monetary offsets recorded in January–April 1999 but attributable to 1998 (18.0 billion roubles).
- (5) Federal budget deficit less interest payments on Government debt.
- (6) Excluding transfers from the Federal budget.
- (7) 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 the budgeted 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 2000 to the Duma on 25 August 1999, meeting the prescribed deadline, and the budget was signed into law by the President on 31 December 1999. See "— The 2000 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, with the exception of 1998 when the deficit was 14 billion roubles higher than the budgeted amount due to the financial crisis following the events of 17 August 1998.

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% and 40% of total expenditure) to be funded ahead of other budgeted expenditures in the event of any shortfall in revenues. In 1997, these protected expenditure items consisted primarily of wage payments and social transfers. The 1997 budget law also 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. The 1998 budget law did not formally identify any protected expenditure items and did not contain sequestration provisions like those included in the 1997 budget law. However, the 1998 budget law did 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 could not be sequestered.

The financial crisis in August 1998 made it impossible for the Government to treat all of the debt service as protected expenditure. During the period between August and December 1998, the Government did not service GKO and OFZs with maturities falling due between 17 August 1998 and 31 December 1999 and certain categories of former Soviet Union debt for which it had agreed to be responsible. Following consultations between the Government and various groups of investors, the affected GKO and OFZs were exchanged for new rouble-denominated securities with longer maturities. The Government is now seeking to reduce and restructure a significant part of the former Soviet Union debt through the exchange offer described herein.

During 1999, the Government financed in full only the debt service that had been provided for explicitly in the 1999 budget law. See "— Federal Budget Expenditure." Contrary to the previous budgets, the 1999 budget law did not contain any provisions for sequestration of expenditure and instead provided that any additional revenues that appeared during the year due to the effects of higher inflation, depreciation of the rouble or other factors should be split evenly between debt service and other expenditure. The 2000 budget law allocates any additional revenues to expenditure.

Federal Budget Revenue

The following table sets forth information regarding Federal budget revenue for the years 1995 to 1999 and for the first quarter of 2000, including information on cash operations for the years 1996 to 1999 and for the first quarter of 2000:

Federal Budget Revenue ⁽¹⁾											
	1995	1996 ⁽³⁾	1997 ⁽⁴⁾	1998 ⁽⁵⁾	1999 ⁽⁶⁾	Q1 2000	Cash revenues ⁽²⁾				Q1 2000
							1996	1997	1998	1999 ⁽⁶⁾	
(millions of roubles)											
Total revenue	196,504	296,261	310,831	290,421	608,034	221,824	198,216	251,971	243,084	597,582	221,824
Profit taxes	40,995	37,796	36,334	37,086	78,838	27,101	19,161	28,868	29,872	78,189	27,101
Personal income tax	3,250	5,143	1,747	90	19,838	4,687	5,139	1,747	90	19,838	4,687
VAT	77,970	131,312	128,621	117,370	218,805	84,590	74,701	92,451	92,483	214,331	84,590
Excise taxes	17,682	55,754	55,278	56,633	84,212	26,237	35,307	41,583	42,149	83,194	26,237
Natural resource taxes	3,043	5,892	7,389	3,321	10,493	3,523	3,633	6,072	2,899	10,493	3,523
Revenue from foreign economic activity	30,505	27,498	30,084	39,398	117,309	53,434	27,498	30,084	39,398	117,309	53,434
Other revenue	23,060	32,866	51,379	36,523	78,540	22,252	32,777	51,167	36,191	74,228	22,252
<i>of which</i>											
Central Bank profit transfer	3,475	5,000	1,985	1,394	0.0	0.0	5,000	1,985	1,394	0.0	0.0
Property taxes	831	298	582	365	736	260	298	582	365	736	260
Revenues of Budgetary Funds	14,128	22,090	37,462	26,303	55,177	15,298	22,090	37,462	25,976	55,177	15,298
(% of GDP)											
Total revenue	12.8	13.8	12.5	10.8	13.4	16.0	9.2	10.2	9.0	13.1	16.0
Profit taxes	2.7	1.8	1.5	1.4	1.7	2.0	0.9	1.2	1.1	1.7	2.0
Personal income tax	0.2	0.2	0.1	0.0	0.4	0.3	0.2	0.1	0.0	0.4	0.3
VAT	5.1	6.1	5.2	4.4	4.8	6.1	3.5	3.7	3.4	4.7	6.1
Excise taxes	1.1	2.6	2.2	2.1	1.9	1.9	1.6	1.7	1.6	1.8	1.9
Natural resource taxes	0.2	0.3	0.3	0.1	0.2	0.3	0.2	0.2	0.1	0.2	0.3
Revenue from foreign economic activity	2.0	1.3	1.2	1.5	2.6	3.8	1.3	1.2	1.5	2.6	3.8
Other revenue	1.5	1.5	2.1	1.4	1.7	1.6	1.5	2.1	1.3	1.6	1.6
<i>of which</i>											
Central Bank profit transfer	0.2	0.2	0.1	0.1	0.0	0.0	0.2	0.1	0.1	0.0	0.0
Property taxes	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Revenues of Budgetary Funds	0.9	1.0	1.5	1.0	1.2	1.1	1.0	1.5	1.0	1.2	1.1
(% of total revenue)											
Total revenue	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Profit taxes	20.9	12.8	11.7	12.8	13.0	12.2	9.7	11.5	12.3	13.1	12.2
Personal income tax	1.7	1.7	0.6	0.0	3.3	2.1	2.6	0.7	0.0	3.3	2.1
VAT	39.7	44.3	41.4	40.4	36.0	38.1	37.7	36.7	38.0	35.9	38.1
Excise taxes	9.0	18.8	17.8	19.5	13.8	11.8	17.8	16.5	17.3	13.9	11.8
Natural resource taxes	1.5	2.0	2.4	1.1	1.7	1.6	1.8	2.4	1.2	1.8	1.6
Revenue from foreign economic activity	15.5	9.3	9.7	13.6	19.3	24.1	13.9	11.9	16.2	19.6	24.1
Other revenue	11.7	11.1	16.5	12.6	12.9	10.0	16.5	20.3	14.9	12.4	10.0
<i>of which</i>											
Central Bank profit transfer	1.8	1.7	0.6	0.5	0.0	0.0	2.5	0.8	0.6	0.0	0.0
Property taxes	0.4	0.1	0.2	0.1	0.1	0.1	0.2	0.2	0.2	0.1	0.1
Revenues of Budgetary Funds	7.2	7.5	12.1	9.1	9.1	6.9	11.1	14.9	10.7	9.2	6.9
<i>Memo:</i>											
Nominal GDP (billion of roubles)	1,540	2,146	2,479	2,696	4,545	1,389	2,146	2,479	2,696	4,545	1,389

Notes:

- (1) Information presented in this table is calculated on the basis of cash or other items of value actually collected.
- (2) Excluding all types of offsets.
- (3) Includes adjustments for monetary offsets recorded in 1997 but attributable to 1996 (48.1 billion roubles).
- (4) Includes monetary offsets recorded in January and February 1998 but attributable to 1997 (18.4 billion roubles).
- (5) Subject to adjustments to be made in respect of certain items of expenditure that are incurred after 31 December 1998, which are appropriate to record in respect of 1998. Includes monetary offsets recorded in January–March 1999 but attributable to 1998 (18.0 billion roubles).
- (6) Subject to adjustments (not more than 1 billion roubles) to be made in respect of certain items of revenues.

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, duties on foreign economic activities and a personal income tax.

VAT (at the general rate of 20% and the reduced rate of 10% for certain items) has been the largest source of Federal budget revenue since 1992, accounting for more than 36.6% of total cash revenue during 1999. Collection rates for VAT have fluctuated between 50% and 60% of total estimated VAT payable since

the beginning of 1995. All VAT payments for imported goods and services, and 85% 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% of total VAT receipts in 1995 and in 1996, rising to 25% in 1997, 31% in 1998 and 33% in 1999 because of increased domestic VAT arrears and as a result of the devaluation of the rouble following the events of 17 August 1998.

Revenue from excise taxes has played an increasing role in the Federal budget. The most important excise taxes are those charged on oil, gas and petrol, revenues from which are exclusively Federal. The collection rate for excise taxes was approximately 60% of total estimated excise tax payable in 1996, more than 65% in 1997, 75% in 1998 and 78% in 1999.

The Federal portion of the profits tax is now set at a uniform rate of 11%. Collection rates for profits tax have fluctuated between 50% and 60% of total estimated profits tax payable since the beginning of 1995, and approached 70% in 1999.

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. Between 1 July 1996 and 1 January 1999, export duties did not exist in Russia. The devaluation of the rouble and increase in world commodity prices made Russian exports more profitable and the Government has since imposed export tariffs on most exported goods. Export duties accounted for 5% of Federal revenues in 1999. Despite the decrease of their share from 11% to 9% since August 1998, 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% of the revenues from personal income taxes. In the budget laws of 1997 and 1998, all income tax revenues were assigned to sub-federal budgets. Starting on 1 April 1999, a 3% component of the personal income tax was assigned to the Federal budget. The 2000 budget law assigns 16% of the revenues from personal income taxes to the Federal budget.

Russia's tax system also includes a number of smaller taxes (including a turnover tax), but their significance for the Federal budget is relatively low. The total contribution of these taxes to the Federal budget revenues is less than 10%.

Federal budget revenue includes other tax and non-tax revenues, the most important of which are revenues of budgetary funds (former extra-budgetary funds which are now 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 provided for the transfer of 50% of all Central Bank profits to the Federal budget, with the other 50% being retained by the Central Bank. In 1999, however, the Federal budget law did not provide for the transfer to the Federal budget of any portion of Central Bank profits, and the 2000 Budget Law is to the same effect.

The oil and gas sectors currently account for approximately 30% of Federal budget revenues.

Revenue Performance

Revenue performance in years prior to 1999 was poor, undermined both by low cash tax collection and by extensive use of "tax offsets" (tax credits issued by Government ministries in payment for their purchases of goods and services) and "monetary offsets" (*ad hoc* arrangements involving the crediting and debiting of cash to enterprises that are owed amounts from and owe amounts to the Federal budget). Revenue performance was among the reasons cited for the delays in drawdowns under Russia's Extended Fund Facility ("EFF") with the IMF in 1997 and 1998. See "Public Debt — Relations with International Financial Institutions." In 1999, however, the situation improved significantly.

Federal tax arrears (including interest and penalties on overdue taxes) equalled 7.8% of GDP at the end of 1996, 11.9% of GDP at the end of 1997, 10.3% of GDP at the end of 1998 and 13.2% of GDP at the end of 1999. As a result, total Federal (cash and non-cash) tax revenues in 1996 were only 93% of budgeted levels as envisaged in the Federal budget law for the year, and in 1997 they were only 71% of budgeted levels. Significant sequestration of budgeted expenditures in each year prior to 1998 prevented the shortfalls in revenue from increasing Federal budget deficits. See "— Federal Budget Process — Budget Execution" and "— Federal Budget Expenditure." In 1998, Federal tax revenues were only 83% of budgeted levels to a large

extent due to the financial crisis following the events of 17 August 1998. In 1999, Federal budget tax revenues reached 126.4% of the originally established budgetary target and 111.4% of the budgetary target as revised in April 1999. Improved revenue performance made it possible to reduce the budget deficit by almost 60%, while the level of expenditure financing stood at 116.8% of the originally established budgetary target and 106.3% of the budgetary target as revised in April 1999.

Federal budget tax revenues (including offsets) was 13.5% of GDP in 1996; cash revenues (excluding offsets), however, was just 9.0% of GDP. In 1997, although Federal budget tax revenues dropped to 11.9% of GDP, primarily as a result of a reduced level of offsets, cash revenues rose to 10.2% 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.*"

At the beginning of 1998, tax revenue performance improved slightly; however, in the second quarter it started to decline following deterioration in the financial markets. The events of 17 August 1998 further undermined revenue performance; the devaluation of the rouble that led to an almost twofold reduction in the value of imports (and thus adversely affected revenues from import tariffs), and the banking crisis that resulted in delayed transfers of tax payments to the budget, caused a sharp reduction in tax collection. In September 1998, Federal tax collection stood at approximately half the monthly tax collection levels achieved in the first quarter of 1998. During the fourth quarter of 1998, tax revenues started recovering and by the end of the year had reached 7.6% of GDP, close to the 7.7% level achieved in December 1997. The adverse impact of the economic crisis on companies' ability to pay their taxes caused the Government to use so-called "target financing," a form of monetary off-set whereby the Government indirectly provides funds to an enterprise to cover the enterprise's tax liabilities to the Federal budget. As a result, total Federal cash revenues declined to 9.0% of GDP in 1998.

In 1999, Federal budget revenue performance continued to improve due to several measures aimed at improving revenue collection and changes in revenue sharing legislation. See "*— Efforts to Improve Revenue Performance.*" Federal budget revenues increased from 10.9% of GDP in the first quarter of 1999 to 15.8% of GDP in the fourth quarter. Cash revenues to the Federal budget reached 15.4% of GDP in the fourth quarter of 1999, resulting in cash revenues for the year of 13.1% of GDP. During the first quarter of 2000, cash revenues increased further to 16% of GDP.

Efforts to Improve Revenue Performance

Beginning in the second half of 1996, significant efforts were 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, Mr. 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% 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 and "target financing" was used in the second half of 1998. 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 31 December 1997 of more than 70 trillion roubles of tax arrears to the Federal budget, representing more than 20% 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 tax authorities the right to debit tax payments directly from enterprises' bank accounts and requiring enterprises generally to move to IAS.

In the spring of 1998, in line with the Government's 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 1 August 1998. The new measures included 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 had tax arrears to the Federal budget could be deprived of access to Russia's oil export pipelines for oil exports that had not been assigned to credit facilities entered into prior to 15 June 1998.

The Government's efforts to improve revenue collection were continued and reinforced in 1999. Starting with 1 April 1999, certain changes in taxation and revenue-sharing have been implemented. The profit tax rate has been reduced from 35% to 30%, reflecting the Government's policy of reducing the tax burden. At the same time, the share of taxes transferable to the Federal budget has been increased. Beginning with 1 April 1999, the Federal share of domestic VAT was increased from 75% to 85%, and a 3% component of the personal income tax became payable to the Federal budget. In order to compensate the regional budgets for these changes, they were allowed to impose sales taxes at the rate of up to 5% on most goods, except certain socially significant ones.

During 1999, the Government also implemented a system for scheduling the tax payments of the largest taxpayers, mostly natural monopolies and oil companies. The system involves a binding agreement between the Government and the taxpayer on a schedule of payments. If the taxpayer violates the agreement, the Government may take a number of measures, including disconnection from the export pipeline in the case of oil and gas exporters. This tightening of tax administration in 1999 resulted in an increase in cash payments to the Federal budget and significant reduction in tax arrears of the largest taxpayers. The system of "tax scheduling" is being used in 2000 as well.

The Government has prepared a new tax code, of which the general part dealing with the legislative aspects of taxation in Russia became law on 31 July 1998. The main objectives of the new 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. See "— The New Tax Code." The second part of the new tax code is currently under consideration by the Duma.

Federal Budget Expenditure

The following table sets forth information regarding Federal budget expenditure for the years 1995 to 1999 and for the first quarter of 2000, including information on cash operations for the years 1996 to 1999 and for the first quarter of 2000:

	Federal Budget Expenditure ⁽¹⁾						Cash expenditures ⁽²⁾				
	1995	1996 ⁽³⁾	1997 ⁽⁴⁾	1998 ⁽⁵⁾	1999 ⁽⁶⁾	Q1 2000	1996	1997	1998	1999 ⁽⁶⁾	Q1 2000
	(millions of roubles)										
Total expenditure	283,180	474,258	484,034	422,732	661,559	179,539	376,213	425,173	375,396	662,639	179,539
National economy (subsidies)	38,554	57,917	59,021	27,614	40,771	7,074	36,384	49,283	20,500	40,120	7,074
Social and cultural sphere	18,649	36,329	52,089	61,682	85,059	25,047	28,866	46,751	59,196	84,622	25,047
State administration	4,490	5,602	9,674	10,924	14,832	4,335	5,502	9,347	7,707	14,832	4,335
Law and order	19,194	33,016	44,428	37,235	60,433	18,933	25,281	40,108	32,281	59,365	18,933
Defence	47,553	80,240	80,626	65,062	116,127	41,968	56,741	62,284	47,233	112,739	41,968
Expenditure on foreign											
economic activity	21,492	25,272	8,177	14,888	36,111	9,174	23,326	7,873	14,871	36,111	9,174
Debt service	49,161	124,390	117,788	106,571	162,583	40,115	124,390	117,788	106,571	162,583	40,115
of which											
GKO interest	23,821	89,687	87,168	59,880	50,079	12,739	89,687	87,168	59,880	50,079	12,739
Net credit operations	21,737	16,461	18,355	11,053	11,017	8,658	5,822	18,255	10,788	18,317	8,658
Other expenditure	62,352	95,030	93,877	87,704	134,626	24,235	69,902	73,485	76,247	133,950	24,235
of which											
Budgetary Funds	14,063	18,359	29,214	26,071	55,275	12,778	17,890	28,714	26,071	55,275	12,778
Transfers from Federal budget	29,224	57,250	58,563	48,165	62,145	16,040	48,065	40,512	42,044	62,145	16,040
	(% of GDP)										
Total expenditure	18.4	22.1	19.5	15.7	14.6	12.9	17.5	17.2	13.9	14.6	12.9
National economy (subsidies)	2.5	2.7	2.4	1.0	0.9	0.5	1.7	2.0	0.8	0.9	0.5
Social and cultural sphere	1.2	1.7	2.1	2.3	1.9	1.8	1.3	1.9	2.2	1.9	1.8
State administration	0.3	0.3	0.4	0.4	0.3	0.3	0.3	0.4	0.3	0.3	0.3
Law and order	1.2	1.5	1.8	1.4	1.3	1.4	1.2	1.6	1.2	1.3	1.4
Defence	3.1	3.7	3.3	2.4	2.6	3.0	2.6	2.5	1.8	2.5	3.0
Expenditure on foreign											
economic activity	1.4	1.2	0.3	0.6	0.8	0.7	1.1	0.3	0.6	0.8	0.7
Debt service	3.2	5.8	4.8	4.0	3.6	2.9	5.8	4.8	4.0	3.6	2.9
of which											
GKO interest	1.5	4.2	3.5	2.2	1.1	0.9	4.2	3.5	2.2	1.1	0.9
Net credit operations	1.4	0.8	0.7	0.4	0.2	0.6	0.3	0.7	0.4	0.4	0.6
Other expenditure	4.0	4.4	3.8	3.3	3.0	1.7	3.3	3.0	2.8	2.9	1.7
of which											
Budgetary Funds	0.9	0.9	1.2	1.0	1.2	0.9	0.8	1.2	1.0	1.2	0.9
Transfers from Federal budget	1.9	2.7	2.4	1.8	1.4	1.2	2.2	1.6	1.6	1.4	1.2
	(% of total expenditure)										
Total expenditure	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
National economy (subsidies)	13.6	12.2	12.2	6.5	6.2	3.9	9.7	11.6	5.5	6.1	3.9
Social and cultural sphere	6.6	7.7	10.8	14.6	12.9	14.0	7.7	11.0	15.8	12.8	14.0
State administration	1.6	1.2	2.0	2.6	2.2	2.4	1.5	2.2	2.1	2.2	2.4
Law and order	6.8	7.0	9.2	8.8	9.1	10.5	6.7	9.4	8.6	9.0	10.5
Defence	16.8	16.9	16.7	15.4	17.6	23.4	15.1	14.6	12.6	17.0	23.4
Expenditure on foreign											
economic activity	7.6	5.3	1.7	3.5	5.5	5.1	6.2	1.9	4.0	5.4	5.1
Debt service	17.4	26.2	24.3	25.2	24.6	22.3	33.1	27.7	28.4	24.5	22.3
of which											
GKO interest	8.4	18.9	18.0	14.2	7.6	7.1	23.8	20.5	16.0	7.6	7.1
Net credit operations	7.7	3.5	3.8	2.6	1.7	4.8	1.5	4.3	2.9	2.8	4.8
Other expenditures	22.0	20.0	19.4	20.7	20.3	13.5	18.6	17.3	20.3	20.2	13.5
of which											
Budgetary Funds	5.0	3.9	6.0	6.2	8.4	7.1	4.8	6.8	6.9	8.3	7.1
Transfers from Federal budget	10.3	12.1	12.1	11.4	9.4	8.9	12.8	9.5	11.2	9.4	8.9
<i>Memo:</i>											
Nominal GDP, billion roubles	1,540	2,146	2,479	2,696	4,545	1,389	2,146	2,479	2,696	4,545	1,389

Notes:

- (1) Information presented in this table is calculated on the basis of cash or other items of value actually spent.
- (2) Excluding all types of offsets.
- (3) Includes adjustments for monetary offsets recorded in 1997 but attributable to 1996 (48.1 billion roubles).
- (4) Includes monetary offsets recorded in January and February 1998 but attributable to 1997 (18.4 billion roubles).
- (5) Subject to adjustments to be made in respect of certain items of expenditure that are incurred after 31 December 1998, which are appropriate to record in respect of 1998. Includes monetary offsets recorded in January - April 1999 but attributable to 1998 (18.0 billion roubles).
- (6) Subject to adjustments (not more than 1 billion roubles) to be made in respect of certain items of expenditures.

Source: Ministry of Finance.

Total Federal expenditure declined from 18.4% of GDP in 1995 to 14.6% of GDP in 1999, 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 2.4% to 0.9% of GDP), defence spending (from 3.1% to 2.5% of GDP), and foreign economic activity (from 1.4% to 0.8% of GDP). Meanwhile, debt service (which includes only payments in respect of discount and interest on Government debt) increased between 1995 and 1999, both in terms of GDP (3.2% of GDP in 1995, 3.6% in 1999) and total expenditure (17.4% of total expenditure in 1995, 24.5% in 1999). The sharp increase in debt service was 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.” Debt service, which reached 5.8% of GDP in 1996 and 4.8% in 1997, declined to 4.0% of GDP in 1998 and to 3.6% in 1999.

In both 1996 and 1997, unprotected expenditure (other than debt service) 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 14.7% of GDP in 1997 (as compared with 16.3% of GDP envisaged in the 1997 Federal budget law) and 16.3% of GDP in 1996 (as compared with the budgeted level of 16%).

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 were to be imposed on energy and utilities spending, all Federal agencies were to be brought within the Federal Treasury system, a full accounting of arrears owed by Federal agencies was to be carried out and a census of all Federal employees was to be completed. Overall, the Government cut expenditure commitments by around 22 billion roubles in 1998. Of these initiatives, spending limits were imposed on energy and utilities, and the other initiatives are currently being pursued.

In 1999, the policy of cutting expenditure commitments was continued. The general objectives of the policy are the optimisation of expenditures in the public sphere and tightening of control over public spending, including on the regional level. Among the measures to achieve these objectives is the transfer of budget beneficiaries to the Government’s treasury system of budget execution. The Government is planning to complete the transfer of accounts for all budgetary funds, the Employment Fund and the Ministry of Defence into the treasury system.

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% 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 9.4% of GDP in 1996, 8.6% of GDP in 1997, 5.1% of GDP in 1998 and 0.9% of GDP for 1999. The Federal budget deficit stood at 1.2% of GDP in 1999, down from its level of 4.9% of GDP in 1998. The 1999 Federal budget achieved a primary surplus, equal to 2.4% of GDP, compared to a primary deficit of 1.0% of GDP in 1998.

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 fuelled inflation. See “Monetary and Financial System — Monetary Policy — Money Supply and Inflation.” Significant sources of non-inflationary finance was available in the period between 1995 and 1998 with the emergence of the market for state treasury bills (GKO/OFZ). As a result, monetary financing dropped to 1.6% of GDP in 1995, from 9.1% of GDP in 1994.

In 1997, the Government’s stabilisation policy achieved a certain degree of success. The yields of GKO/OFZ bonds declined from more than 200% in June 1996 to 18% in September 1997. However, the Asian financial crisis and the decline in world commodity prices at the end of 1997 caused a fall in the prices of domestic debt instruments. Despite the attempts of the monetary authorities to stabilise the situation between November 1997 and July 1998, investors were gradually losing confidence in domestic Government securities, and following the events of 17 August 1998, the market closed and the value of the rouble fell.

The August 1998 financial crisis caused a significant change in the structure of deficit financing. Prior to June 1998, GKO/OFZs were the main sources of financing, although between January and May 1998 these bonds were issued only to roll over debt coming due. In January-May 1998, GKO/OFZ issuances net of the Central Bank’s purchases accounted for more than 80% of gross deficit financing; repayment of

GKO/OFZ debt held by the Central Bank exceeded by 0.7% of GDP purchases of GKO and OFZs by the Central Bank. In June and July 1998, the Government attempted to replace domestic financing by external borrowings through extensive issuance of Eurobonds and an offer to exchange Eurobonds for certain GKOs. During those two months, external sources (including IMF credits) accounted for more than 60% of gross deficit financing. After August 1998, both domestic and foreign market borrowing became impossible, and monetary financing became the most important source of financing. The deficit was financed by the Central Bank in two ways: purchases of Government short-term debt; and the extension of foreign currency credits to finance external debt payments. Between September and December 1998, monetary financing amounted to more than 80 billion roubles, accounting for 70% of gross deficit financing. Privatisation and gold sales became another important source of financing during that period, accounting for about 17% of gross deficit financing.

This structure of deficit financing continued into 1999. The share of monetary financing in the first six months declined from 90% of gross deficit financing in January 1999 to 75% in June 1999 and accounted for 8.1% of GDP, the rest being financed through tied credits and gold sales. However, in order to fulfil the targets set by the Financial Programme for 1999 negotiated with the IMF, monetary financing had to be reduced. Starting in July 1999, the Government began to repay the Central Bank credits, with repayment exceeding disbursements by 0.8% of GDP in the second half of 1999. As a result of tight fiscal discipline in 1999, the Federal budget deficit was 1.2% of GDP, while the primary surplus was 2.4% of GDP.

Sales of gold, other precious metals and precious stones have been used by the Government largely as a flexible source of opportunistic financing. Gold sales are conducted in two ways. The first involves the sale by the Ministry of Finance of gold from its reserves, the 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 the proceeds are treated as non-monetary financing. Sales of gold and precious metals and stones were of limited significance in 1998, accounting for 3% of gross deficit financing, increasing to 6% in 1999.

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 3.4% of gross Federal budget deficit financing (0.7% of GDP). In 1998, privatisation proceeds remained at approximately the same level, 3.5% of gross Federal budget deficit financing in 1998 (0.6% of GDP), and then decreased sharply to 0.6% of gross Federal budget deficit financing in 1999 (0.2% of GDP).

Foreign disbursements, including tied and untied credits but excluding IMF disbursements, amounted to 12.0% of GDP in 1992, but dropped substantially in 1993 and have remained low since, representing only 3.4% of GDP in 1998 and 1.3% in 1999. Net of cash principal repayments to foreign lenders, foreign financing was 2.0% of GDP in 1998 and 0.2% of GDP in 1999.

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.

Sub-federal governments are directly assigned a specified portion of the revenue from certain taxes collected in their jurisdictions: currently, 84% of personal income tax; 100% of land and property taxes; 50% of excise taxes on alcohol and 100% of all other excise taxes (with the exception of excise on cars, oil, gas and petrol excises); and 80% of natural resource taxes. Federation subjects do not, however, enjoy the statutory right to alter the tax base or to increase the marginal rate of these taxes. Prior to 1 April 1999, Federation subjects were able to impose their own profit taxes at rates up to 22% in excess of the Federal rate of 13%, and they were directly assigned 25% of domestic VAT revenues. After 1 April 1999, the upper limit of the regional profit tax has been reduced to 19% (with the Federal portion of the tax rate now equal to 11%) and the share of domestic VAT transferable to the regions has been reduced to 15%. The 2000 Budget Law envisages that 84% of revenues from personal income tax will go to the regional budgets. In addition, the Government allocates a portion of its tax revenues to the Fund for Regional Support for redistribution to the regions.

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. Since 1998, the budget laws have provided for an allocation to the Fund of 14% of total Federal tax receipts, with the exception of import and export duties. In 1998, actual allocations to the Fund were 30.1 billion roubles, representing 14.4% of total Federal tax receipts, excluding import and export duties. In 1999, the Fund received 44.3 billion roubles, representing less than 10.6% of Federal tax receipts (excluding import and export duties). The 2000 Budget Law envisages a transfer of 57.4 billion roubles to the Fund during the year.

Local budget expenditure (including expenditure financed by Federal transfers and Federal budget loans) was equal to approximately 15.0% of GDP in 1998. Expenditure on the social sphere is substantial (approximately 6.8% of GDP), reflecting the transfer of social expenses from enterprises to local authorities since 1992. Sub-federal and local governments now pay for about 87% of total public expenditure on subsidies (excluding extrabudgetary funds), 87% of education expenditure, 90% of health expenditure and 75% of social expenditure.

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 these Federation subjects with 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. For example, a new mechanism is expected to be developed where the amount of financial aid to the regions will be altered depending on the fulfilment of various Federal budget policy requirements. Such requirements are expected to include diminishing the share of non-cash operations, avoidance of wage and pension arrears and repayment of the Federal budget loans.

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 271.4 billion roubles during 1999), the Local Road Fund (expenditures of 97.5 billion roubles), the Medical Insurance Fund (46.0 billion roubles) and the Social Insurance Fund (43.9 billion roubles). Together, these funds account for more than 96% of total extrabudgetary expenditure. The Pension Fund, Social Insurance Fund, Employment Fund and Medical Insurance Fund raise revenue from a 38.5% payroll tax paid by employers. In addition, the Pension Fund raises revenue from a 1% tax on wages paid by employees. 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 surplus for 1998 was 2.4 billion roubles. 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 2000 Federal Budget Law

The following table sets out planned revenues and expenditures according to the 2000 Federal budget law:

2000 Federal Budget Law⁽¹⁾

	(billions of roubles)	(% of GDP)	(% of total)
Total revenue	797.2	14.9	100
Tax revenues	674.7	12.6	85
Profit taxes	63.4	1.2	8
Personal income tax	23.9	0.4	3
VAT	277.5	5.2	35
Excise taxes	119.9	2.2	15
Natural resources taxes	11.1	0.2	1
Customs duties	172.0	3.2	22
Other tax revenue	6.8	0.1	1
Non-tax revenues	61.9	1.2	8
Central Bank profit transfer	0.0	0.0	0
Non-tax revenue from foreign economic activity	34.6	0.6	4
Revenue of budgetary funds	60.6	1.1	8
Total expenditure	855.1	16.0	100
Debt service	220.1	4.1	26
Interest on domestic debt	63.3	1.2	7
GKOs/OFZs	48.2	0.9	6
Interest on external debt	156.8	2.9	18
Non-interest expenditure	635.0	11.9	74
National economy (subsidies)	53.3	1.0	6
Social and cultural sphere	121.4	2.3	14
State administration	25.7	0.5	3
Law and order	87.9	1.6	10
Defence	140.9	2.6	16
Expenditure on foreign economic activity	56.1	1.0	7
Financial aid to regions	69.1	1.3	8
of which: Fund for Regional Support	57.4	1.1	7
Budgetary Funds	60.6	1.1	7
Other expenditure	20.0	0.4	2
Total Deficit Financing	57.9	1.1	100
External financing (excluding the IMF)	62.6	1.2	108
of which			
Central Bank's foreign currency credits	32.0	0.6	55
Domestic financing	(4.8)	(0.1)	(8)
of which			
IMF (net)	(11.9)	(0.2)	
Privatisation	18.0	0.3	31
Net gold sales	2.0	0.0	3
Primary Surplus	162.2	3.0	
<i>Memo:</i>			
GDP	5350		
CPI growth (December-on-December, %)	18		
Average exchange rate (U.S. dollar/rouble)	32		

Notes:

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

Source: Ministry of Finance.

The 2000 Federal budget law was signed into law by the President on 31 December 1999 and came into effect in January 2000. The law envisages revenue of 797 billion roubles, or 14.9% of GDP, with VAT representing 35% of the total, profit taxes 8% of the total and excise taxes 15%. Expenditure is planned at 855 billion roubles, or 16.0% of GDP. More than one quarter of total expenditure is accounted for by debt service. The limits on new net borrowings, combined with anticipated financing via privatisation and net gold receipts, envisage a deficit of up to 57.9 billion roubles, or 1.1% of GDP. This implies a primary surplus of 162.2 billion roubles, or 3.0% of GDP. The revenue, expenditure and other assumptions underlying the 2000 budget law have been developed with reference to, and consistent with, the IMF performance criteria for the year. See "Public Debt — Relations with International Financial Institutions."

The Federal budget law for 2000 does not provide for mandatory sequestration of expenditures or for the introduction by the Government of a sequestration law in specified circumstances involving shortfalls in revenue or deficit financing. See “— Federal Budget Process — Budget Execution.”

There are no protected expenditure items identified in the 2000 budget law. However, debt service is exempt from the requirement of proportional reduction when expenditure is reduced.

Federal budget tax revenues have been, and continue to be, highly sensitive to world prices for various commodities that are exported from Russia, particularly oil and gas. The 2000 budget law implicitly assumes an average oil price of approximately U.S.\$16.4 per barrel of Urals crude oil. A decline in the average oil price to below that level could have a significant adverse effect on the ability of the Government to collect the budgeted tax revenues.

The 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 19 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 February 1, 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 16 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 17 July 1998, signed into law by the President on 31 July 1998 and came into force in 1999. In May 2000, the Government submitted to the Duma a new draft of the specific part of the tax code dealing with all the proposed taxes in the Russian Federation. No assurance can be given that the remainder of the 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 proposed tax code are to reduce the total number of taxes, to improve the stability, transparency and fairness of the system through the elimination of many tax exemptions, to reduce the overall tax burden on the Russian economy and to improve tax collection. The Government does not expect the new tax code to shift the tax burden away from enterprises to individuals, or to alter the incidence of taxes on the different sectors of the 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 to no more than 30. Regional and local authorities would be permitted to impose only such taxes as are contemplated by the tax code.

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) within a certain transition period.

VAT would remain basically unchanged, amounting to 20% on most goods and 10% on food products and goods for children. The profits tax, which currently applies differently to ordinary companies, banks, insurance companies and financial intermediaries, will be unified at a maximum rate of 35% (11% to the Federal budget and up to 19% to the relevant Federation subject budget; local authorities would be permitted to charge an additional 5%). The method for calculating the tax base for purposes of the profits tax would be revised significantly, to be the difference between revenue from sales and costs that are related to production and marketing (currently, a number of such costs are not deductible for tax purposes); expenditures on advertising, interest payments, insurance premiums and training would become deductible as a result. A new single social tax would replace the current system of payroll payments into four extra-budgetary social funds, and the burden of the social tax would be reduced from 38.5% to a maximum of 35.6% for legal entities and a maximum of 26.1% for agricultural enterprises. Under the new proposals, the rate of the social tax will decline as the payroll rises, the lowest rate being 2% of payroll. The income tax rate would also be reduced to a flat rate of 13%, although certain types of income, such as income from bank deposits with interest rates over the Central Bank's discount rate, would be subject to tax at either 30% or 35%. Over time, the Government also intends to abolish the turnover tax (currently 4%). Specific excise taxes (charged in roubles per unit) will be revised upward and additional excise taxes on diesel and motor oil will be introduced to compensate for

inflation and the loss of revenues from the abolition of the turnover tax and from the proposed changes in the taxation of fuel.

In addition, the new tax code is expected to introduce new depreciation schemes (such as accelerated depreciation), develop new methods in accounting for the costs of research and development, allow the carry-forward of losses for longer periods into the future and change the basis for determining royalties in the oil and gas sectors.

The Government is currently developing amendments to the general part of the new tax code that are intended to increase its efficiency and eliminate inconsistencies in its implementation. The Duma is now considering the remainder of the tax code submitted by the Government.

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 to protect and maintain 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 11 September 1998. 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 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 period-end for 1995 to 1998 and the four quarters of 1999 and for the first quarter of 2000:

	Monetary Survey ⁽¹⁾								
	1995	1996	1997	1998	1999Q1	1999Q2	1999Q3	1999Q4	2000Q1
	(end of period)								
	(millions of roubles)								
Net foreign assets	70,223	49,335	16,428	(98,769)	(80,289)	4,846	44,593	127,775	306,036
Monetary authorities	54,044	35,353	47,908	(115,226)	(135,860)	(75,617)	(86,424)	(20,249)	98,907
Banking system	16,172	13,982	(31,480)	16,456	55,571	80,463	131,017	148,025	207,129
Domestic credit extended by the Central Bank and the banking system	363,673	539,298	659,245	1,109,109	1,245,887	1,294,566	1,337,943	1,487,235	1,492,668
Net claims on enlarged government	166,578	311,467	381,187	722,235	818,411	844,569	851,717	905,199	856,878
Claims on non-financial public enterprises ..	62,546	69,439	33,263	33,228	30,738	36,678	43,669	47,015	48,251
Claims on private sector	134,024	158,150	236,719	346,375	386,410	396,312	426,574	521,961	569,566
Claims on other financial institutions	525	242	8,076	7,271	10,327	17,008	15,983	13,060	17,973
Broad money	275,780	357,324	457,244	628,641	675,333	786,070	823,509	984,873	1,090,398
Money ⁽²⁾	151,267	192,402	298,289	342,817	344,782	418,070	430,987	526,772	546,439
Quasi-money ⁽³⁾	124,513	164,922	158,955	285,824	330,551	368,000	392,522	458,101	543,959
Restricted Deposits	—	—	6,271	22,595	48,517	40,740	41,135	10,224	23,607
Money market instruments	11,859	30,372	42,436	43,312	55,296	69,730	78,653	107,817	106,969
Capital accounts (capital of banking system) ..	99,768	177,996	213,462	275,708	278,658	311,000	342,285	410,618	480,435
Other items, net	46,489	22,939	(43,739)	40,084	107,794	91,873	96,954	101,480	97,293
<i>Memo</i> ⁽⁴⁾									
Base money (national definition) ⁽⁵⁾	103,800	130,900	164,500	210,400	205,900	257,400	259,500	324,300	318,900
Rouble broad money (M2) (national definition) ⁽⁶⁾	220,800	288,300	374,100	448,300	473,800	567,700	597,400	704,700	751,400
Velocity of M2 ⁽⁷⁾	10.3	8.4	7.6	7.2	7.3	7.5	7.9	8.0	7.4

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

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

Source: Central Bank.

The principal aim of the Central Bank's monetary policy since 1992 has been to restrain the growth of the money supply in order to curb inflation and achieve financial stabilisation. Between 1992 and 1994, achievement of this aim was hampered by the 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 contributed to the high levels of inflation Russia then experienced.

After October 1994, in the wake of "Black Tuesday" (see "— Exchange Rates"), the Central Bank succeeded in slowing the growth of the money supply. Underlying this success was the emergence of the GKO/OFZ market as a 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 1995 and 1996, as reflected, among other things, in the limited 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 31 December.

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. Like most emerging market economies, Russia experienced significant capital outflows, which caused a sharp decline in the prices of Government securities, and a consequent increase in demand for U.S. dollars. Moreover, the unfavourable situation in key export markets produced a deterioration in the balance of payments, which also contributed to difficulties in the foreign exchange market.

The Central Bank responded to this pressure on both the Government securities market and the rouble by increasing the refinancing rate and the lombard rate in November 1997, and by increasing the reserve requirements for foreign currency deposits with Russian banks. When these measures proved insufficient, the Central Bank, concerned about the stability of the banking sector and the impact on the Federal budget, elected not to raise rates further, engaging instead in open-market purchases of GKO's while depleting its reserves in an effort to sterilise the incremental rouble liquidity.

The simultaneous support of both the GKO/OFZ market and the rouble soon proved to be unsustainable, and the Central Bank declared the primacy of exchange rate stability. The Central Bank tightened its monetary policy through a gradual increase in the refinancing rate, limitations on the liquidity available to banks and restraint of growth in the money supply. As a result, between January and August 1998, M2 fell by 8.2%.

Until July 1998, the Central Bank managed to keep control over the exchange rate and inflation. At that time, the exchange rate was within the bands set by the Central Bank. Stability of the rouble also secured low inflationary expectations, and during the first half of 1998, inflation slightly exceeded 4%.

At the same time, the state of other monetary aggregates between January and August 1998 evidenced the escalation of negative tendencies in Russia's financial markets and the banking system. The rouble liquidity shortage maintained by the Central Bank to suppress demand for foreign exchange inevitably led to a negative effect on the interbank credit market. Starting in May 1998, interbank credit rates steadily increased to levels of 150%–200%. Despite the increase in interest rates, private deposits started to leave commercial banks, decreasing by 12.2% between June and August 1998. In addition, the population began to shift its savings to foreign currency holdings, increasing the share of income allocated by households to foreign currency purchases from 14.1% in May to 19.2% in July 1998.

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

Following the events of 17 August the Central Bank relaxed its monetary policy with a view to supporting the Federal budget, as well as resolving the liquidity crunch and the crisis of the payment system. Between September and December 1998, M2 grew by 30.5%, resulting in overall growth of 19.8% at the end of 1998 as compared to year-end 1997. During 1999, M2 had grown further, by 57.2% driven by greater demand for roubles following the increase in economic activity. During the first quarter of 2000, money supply increased by 6.6%.

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."

From the start of 1998, net international reserves began to fall. Occasional upsurges in March and June were associated with Eurobond placements and the consequent currency conversion. However, by the middle of 1998, net international reserves had fallen to zero, and at the beginning of July 1998 they were negative. On the other hand, the volume of net domestic assets was rather stable, with moderate fluctuations in both directions. As a result, a sharp change in the base money structure was observed during the year.

In 1999, the growth in base money was generated by an increase in net international reserves. As of 1 January 2000, base money stood at 324.3 billion roubles. The significant growth of base money in the second and fourth quarters of 1999 was attributable to purchases by the Central Bank of foreign currency to increase its reserves and to service of the Government's and the Central Bank's external debt, as well as to seasonal factors, especially in the fourth quarter. In the first five months of 2000, the increase in the money supply was driven exclusively by accumulation of reserves. As of 25 May 2000, base money amounted to 361.0 billion roubles.

The following table illustrates the rise in consumer and producer prices at 31 December for years 1995 to 1999:

Inflation: Consumer and Producer Prices

	<u>Consumer Price Inflation (annual)</u>	<u>Producer Price Inflation (annual)</u>
	(% change, end of period)	
1995	131.4	181.8
1996	21.8	25.9
1997	11.0	7.4
1998	84.4	23.2
1999	36.5	67.3

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%, down significantly from the 1996 level of 21.8%. Similarly, producer price inflation was substantially reduced, from 25.9% in 1996 to only 7.4% in 1997.

Price stability was maintained in the first half of 1998, as consumer price inflation was held at slightly above 4% during the period. The decline in the value of the rouble and the increase in the money supply

following the events of 17 August intensified inflationary pressures, however, and the consumer price index increased by 80% between September and December 1998, amounting to 84.4% for the year. In early 1999, inflationary pressures were effectively arrested, and the inflation rate fell from 8.5% per month in January to 1.2%–1.5% per month in the last months of 1999; the inflation rate for 1999 as a whole was 36.5%. Inflation was 6.8% during the first five months of 2000, compared to 22.2% in the first five months of 1999.

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 were permitted to borrow funds at a given discount rate at any time against appropriate collateral. Overnight credits and repurchase operations with GKO/OFZ bonds were also introduced. In addition, the Central Bank held periodic deposit auctions in order to absorb excess liquidity, conducted market operations and maintained reserve requirements.

The financial crisis of 1998 substantially limited the range of monetary instruments available to the Central Bank. The refinancing rate was widely used as an instrument of monetary policy in the first half of 1998. Following the events of 17 August 1998, the Central Bank began to employ reserve requirements for banks as an important instrument of monetary policy.

During the last four months of 1998, the Central Bank relaxed reserve requirements in order to improve banks' liquidity and to restore the operation of the payment system. Improved banking sector liquidity and the need to reduce the pressure on the rouble precipitated the Central Bank's reversal of that process in 1999. Currently, the general reserve requirements for both hard currency and rouble deposits are 10% irrespective of maturity of the deposits, and 7% for funds borrowed from individuals in roubles. Banks that fail to meet their reserve requirements face escalating cash penalties for each day that reserves are inadequate. No interest is paid either on reserve requirements or on excess reserves (correspondent accounts) held by commercial banks at the Central Bank.

In the middle of 1999, the Central Bank took a first step towards adjusting the refinancing rate to the improving economic conditions by lowering it from 60% to 55%. Starting in early 2000, the favourable economic situation allowed this process to accelerate. Effective 21 March 2000, the Central Bank's refinancing rate has been set at 33%. This is the third downward change to the refinancing rate in 2000 and the second one in March. The Central Bank is considering further adjustments to bring the refinancing rate in line with the projected inflation, which is set by the 2000 Budget Law at 18%.

Exchange Rates

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

The following table sets forth information with respect to rouble/U.S. dollar exchange rates for the years 1995 to 1999:

Official Rouble/U.S. Dollar Exchange Rates

	Average ⁽¹⁾	End of Period
1995	4.559	4.64
1996	5.125	5.56
1997	5.787	5.96
1998	9.78	20.65
1999	24.67	27.00

Notes:

(1) Simple average.

Source: Goskomstat.

Following the dissolution of the Soviet Union, high inflation caused the value of the rouble to decline in nominal terms 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 206% in 1993, 3.2% in 1994 and 72.2% in 1995. Although the rouble depreciated by 1.2% in real terms against the U.S. dollar in 1996, reflecting the relatively low rate of inflation for the year, in 1997, the rouble appreciated by 1.2% against the U.S. dollar in real terms, primarily due to the Central Bank's actions in response to the Asian currency crisis. As a result of the events of 17 August 1998, the rouble depreciated against the U.S. dollar by 246.5% in nominal terms and by 47.6% in real terms during 1998. Nonetheless, following the Central Bank's tightening of monetary policy, the rouble remained relatively stable in 1999, appreciating against the U.S. dollar in real terms by 2.2% while depreciating against the U.S. dollar in nominal terms by 30.8%.

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 11 October 1994 ("Black Tuesday"), when the rouble lost more than 25% of its value against the U.S. dollar in a single day, before rebounding to its original level in the days that followed.

These events led to renewed support for a commitment to a policy of fiscal and monetary restraint. The consistent implementation of this policy, particularly after the first quarter of 1995, succeeded in stabilising the value of the rouble. From July 1995 to August 1998, the Central Bank 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 4.30–4.90 roubles to the U.S. dollar for the period through 1 October 1995 and, in late August 1995, was extended unchanged through 31 December 1995. A shift of the rouble corridor followed to 4.55–5.15 roubles to the U.S. dollar, and was successfully maintained through 30 June 1996. Until that time, the exchange rate has been set in an "inclining" corridor which moved from 5.00–5.50 roubles to the U.S. dollar at 1 July 1996 to 5.50–6.10 roubles to the U.S. dollar at 31 December 1996. Throughout the whole of 1997, the exchange rate was set daily in an "inclined" corridor which moved from 5.50–6.10 roubles to the U.S. dollar on 1 January 1997, to 5.75–6.35 roubles to the U.S. dollar on 31 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 that policy, which originally intended to cover the three years from 1998 through 2000, exchange rates were going to be set within a flat trading band from 5.25 to 7.15 roubles to the U.S. dollar, representing a permitted variance of 15% on either side of the central exchange rate of 6.2 roubles to the U.S. dollar.

The events of August 1998 (inability of the monetary authorities to support the rouble, sharp devaluation of the domestic currency, the collapse of the financial and banking system) forced the Central Bank to adopt a floating exchange rate regime. By sharply reducing the size of its interventions, the Central Bank passed to the market the determination of demand and supply equilibrium for foreign currency. To reduce speculative demand and massive capital flight, exchange regulations were severely tightened and additional controls introduced.

Beginning in September 1998, the Central Bank undertook a series of measures aimed at restricting foreign exchange speculation and preventing capital outflow. The obligatory sale of 50% of export revenue

(which was originally introduced in 1992) was centralised at MICEX, and the trading there was split into two sessions: the morning session for the sale of a portion of export revenue, and the afternoon session for ordinary transactions with foreign currency for banks' needs and import contracts not confirmed by the required documentation. Also, the Central Bank required a 100% prepayment for any purchase of foreign exchange at the morning session. At the same time, additional restrictions were imposed on commercial banks. Foreign exchange now could be purchased only for execution of clients' orders or fulfilment of foreign currency liabilities to counterparties and banks were prohibited from having open positions in foreign currency at the end of a day.

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

During 1999, the floating exchange rate policy was continued. Under that policy, the Central Bank's presence in the market was limited to smoothing excessive short-term fluctuations and preventing any speculative attacks. At the same time, to prevent high capital outflow, the Central Bank was forced to take a series of measures to strengthen foreign exchange regulations. Starting with 1 January 1999, Russian residents were required to convert 75% of their export revenues into roubles. Strict controls also have been established over purchases of foreign currency by Russian banks, and foreign banks were prohibited from purchasing hard currency with roubles in their correspondent accounts with Russian banks. In addition, Russian importers prepaying import contracts were required to create rouble security deposits with Russian banks in an amount equivalent to the value of the prepayment. Such security deposits bear interest and are returnable to the importers only after delivery of the imported goods is confirmed.

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

During the course of 2000, the U.S. dollar-rouble exchange rate will be determined by the supply and demand in the foreign exchange market without any pre-determined corridor. The Central Bank will proceed to establish the official exchange rate on the basis of the market exchange rate, and its efforts will be aimed at smoothing excessive short-term fluctuations in the U.S. dollar-rouble exchange rate and support of Russia's international reserves. In addition, it is expected that some restrictions will be lifted. The Government and the Central Bank plan to introduce amendments to legislation, and various law enforcement mechanisms, to increase the transparency of capital flows and secure the prevention of illegal capital outflows. In particular, certain draft legislation proposes to grant banks additional powers to control foreign trade activity, including the right to suspend transfers in foreign currency abroad whenever there are suspicions as to the legitimacy of the underlying transactions and the obligation to report on this immediately to law enforcement bodies.

The official rouble/U.S. dollar exchange rate as reported by the Central Bank on 17 July 2000 was 27.85 roubles to the U.S. dollar.

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 1,293 licensed banks and 37 non-bank credit organisations in Russia at 1 May 2000, 242 with general licences and 711 with foreign exchange licences. On the same date, licences had been issued to 21 wholly foreign-owned banks and 11 banks that are more than 50% foreign owned; there were also 129 representative offices of foreign banks in Russia as well. Only two banks, Sberbank and Vneshtorgbank, are controlled by the Central Bank. As at 1 April 2000, Sberbank, the successor of the former state savings bank in the Soviet Union, held approximately 76.2% of all household deposits and itself accounted for

25.7% of total banking assets. Wholly owned foreign banks, as at 1 April 2000, held only 6.0% of total banking assets. These banks are subject to the general banking laws and regulations and are entitled to participate in the same range of banking activities as their Russian counterparts.

There were 3,839 branches of operating domestic banks as at 1 May 2000. Some 42% 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

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 four groups, according to the level of risk of failure. On 1 April 2000, there were 75 banks in the highest risk group (representing 10.1% of total banking assets) and 156 in the next highest (representing 8.2% 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.

In January 1996, the Central Bank issued a revised set of prudential standards 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. Following the events of 17 August 1998, the Central Bank relaxed some of these requirements. Nonetheless, as at 1 April 2000, there were 54 banks that did not meet the applicable capital adequacy requirements, representing 4.1% of Russia's banks and 16.4% of total banking assets. Such banks will be required either to increase their capital, to merge or to liquidate.

The legislative framework for the restructuring of banks was laid down in the Law on Insolvency (Bankruptcy) of Credit Institutions adopted in February 1999. This legislation details the standards for the Central Bank to appoint temporary administrations on banks, provides an expedited liquidation procedure for banks, gives the Central Bank the power to license the receivers of bankrupt banks and propose the receivers to arbitration court for approval. In addition, certain amendments were made to the Civil Code and the Central Bank Law in 1999 to ensure the efficiency and transparency of the bank restructuring process.

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.

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

In November 1998, the Government and the Central Bank adopted new policies with respect to the restructuring of the banking system. The central component of the new policy is the Agency for Restructuring of Credit Organisations ("ARCO") that was established in January 1999. In March 1999, the comprehensive program of its activities was approved by the IMF and the World Bank, and in July 1999 the President signed the Law on Restructuring of Credit Organisations, the legislative basis for ARCO's activities. ARCO's objectives are to restore the banking system's ability to make settlements, provide credit to the economy and ensure the safety of clients' deposits. Under the Law on Restructuring of Credit Organisations, the Central

Bank makes the initial proposals to refer particular banks for ARCO's management; it can only select among core banks with strong presence in the regions that hold sizeable amounts of household deposits (at least 1% of total household deposits within Russia and 20% of household deposits within a Federation subject) and carry out extensive credit activities (at least 1% of total banking assets within Russia in the form of loans to legal persons, excluding banks, and 20% of total banking assets within a Federation subject).

Under the Law on Restructuring of Credit Organisations, as soon as the Central Bank refers a bank to ARCO, it simultaneously appoints a temporary administrator at such banks. Within a 90-day period, ARCO conducts a diagnostic examination to decide on acceptance or rejection of the referral. Upon acceptance, ARCO assumes legal and management control over the credit institutions and applies to them various restructuring measures with a view to overcoming their financial instability and restoring their solvency. These measures include the sale of assets and businesses, the negotiation of settlements arrangements with creditors, the commencement of new operations and the raising of external finance. It is expected that ARCO will sell each bank after its restructuring is completed. In certain cases, a bank may be liquidated.

Currently, ARCO is conducting 14 projects that involve 19 banks from 10 regions. In addition, it placed four banks, including SBS-Agro, under examination. Despite its broad powers, ARCO has experienced significant practical difficulties in recovering assets transferred out of a bank's control before the appointment of a temporary administrator.

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 90 days of the date of sale, lending or borrowing money for terms of up to 180 days, and payments of interest, dividends, and certain other amounts in respect of loans, investments, or securities. As of 1 July 1996, Russia adopted Article 8 of the IMF's Articles of Agreement with respect to current account convertibility and since that time has met all obligations imposed by Article 8.

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 1 January 2000, the Central Bank was its largest shareholder, owning 10.58% of its capital, followed by 27 Russian commercial banks each owning from 0.13% to 4.95%, the Ministry of Finance and the Association of Russian Banks, each of which owned 0.13% 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.

The major currency traded on MICEX is the U.S. dollar, accounting for U.S.\$68.3 billion in turnover (99% of foreign exchange turnover) during 1999. In addition, trading in euro was launched on 17 January 1999. Total turnover in euro amounted to 204 million, of which 192 million were traded between September and December 1999. 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

Prior to the events of 17 August 1998, Russia had an active market in Government securities, which were typically 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, a self-regulatory body that has developed rules for trading on RTS. The average daily turnover in the RTS in 1999 was U.S.\$9.3 million, down from U.S.\$35.6 million during 1998. There are more than 60 licensed stock exchanges in Russia, and the share of exchange-based trading is increasing.

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 1 January 1998 to U.S.\$31.7 billion as at 1 January 2000.

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 1999, the total outstanding external debt of the Government, or for which the Government has agreed to be responsible, amounted to approximately U.S.\$155.0 billion.

This amount included all loans contracted or guaranteed by the Government, loans contracted or guaranteed by Vnesheconombank 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 1999. The amount also includes obligations in respect of Internal Government Hard Currency Bonds ("OVVZs", known as "Taiga" bonds or "MinFins") which have been re-classified as external debt under the Budget Code, effective from the beginning of 2000. Excluded from the U.S.\$155.0 billion outstanding at the end of 1999 are all undisbursed commitments and public or private sector borrowings not guaranteed by the Government. The Government has incurred additional external debt of U.S.\$144.9 million under multilateral facilities and U.S.\$306.7 million from bilateral sources in the first quarter of 2000.

The following table sets forth information with respect to the Government's external debt at period end for the years 1994 to 1999:

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

	As at 31 December					
	1994	1995	1996	1997	1998	1999
	(U.S.\$ billion)					
Total external debt	127.5	128.0	136.1	134.6	158.1	155.0
External debt of the Government of the Russian Federation	11.3	17.4	27.7	35.6	55.4	51.4
Multilateral creditors ⁽²⁾	5.4	11.4	15.3	18.7	26.0	22.4
Bonds	0.0	0.0	1.0	4.5	16.0	15.6
Official creditors ⁽³⁾	5.9	6.0	7.9	7.6	9.7	9.8
Ministry of Finance Hard Currency Bonds ⁽⁴⁾	0.0	0.0	3.5	3.5	3.5	3.5
Commercial creditors	0.0	0.0	0.0	1.3	0.2	0.1
External debt of the former Soviet Union for which the Government of the Russian Federation has agreed to be responsible	116.2	110.6	108.4	99.0	102.7	103.6
Multilateral creditors	0.0	0.0	0.0	0.0	0.0	0.0
Bonds	1.7	1.1	0.1	0.1	0.0	0.0
Official creditors ⁽³⁾	69.9	62.6	61.9	56.9	59.4	58.3
Ministry of Finance Hard Currency Bonds ⁽⁵⁾	7.6	7.6	7.6	7.6	7.6	7.6
Commercial creditors ⁽⁶⁾⁽⁷⁾	37.0	39.3	38.8	34.4	35.7	37.7
<i>Memo Item:</i>						
Ministry of Finance obligations owed indirectly to the Central Bank	0.0	0.0	0.0	0.0	2.3	6.4

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 IMF disbursements to the Central Bank.
- (3) Includes government-to-government credits and official export credits.
- (4) Ministry of Finance Hard Currency Bonds Series VI & VII (MinFins) representing Russian debt issued in 1996.
- (5) Ministry of Finance Hard Currency Bonds Series II, III, IV, and V (MinFins) representing the former Soviet Union debt restructured in 1993.
- (6) Includes London Club creditors and uninsured trade suppliers.
- (7) Subject to reconciliation.

Source: Ministry of Finance, Vnesheconombank

Of the U.S.\$155.0 billion outstanding at the end of 1999, U.S.\$51.4 billion represented loans and bonds contracted or guaranteed by the Government since 1 January 1992. These obligations have been honoured in full.

The remaining U.S.\$103.6 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. Comprehensive rescheduling agreements in respect of virtually all Soviet-era debt for which the Government has agreed to be responsible were secured by the Government in 1996 and 1997, with the exception of the Eurobonds issued by Vnesheconombank prior to the dissolution of the former Soviet Union which were honoured in full on their due dates.

An additional U.S.\$6.4 billion was outstanding at the end of 1999 in respect of Ministry of Finance obligations owed indirectly to the Central Bank. These obligations arose in the absence of external sources of hard currency funding following the events of 17 August 1998. Approximately U.S.\$400 million of Ministry of Finance obligations to the Central Bank were repaid in 1999. No repayment period has been agreed for the U.S.\$6.4 billion outstanding at the end of 1999 and a further U.S.\$1 billion can be disbursed by the Central Bank under the 2000 Budget Law.

Since the events of August 1998 and the subsequent build up of arrears on Soviet-era obligations, the objectives of the Government's external debt policy have been to regularise relations with the external creditors of the former Soviet Union as rapidly as possible and secure new restructuring agreements on terms 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 rescheduling was agreed with the Paris Club covering approximately U.S.\$33 billion of debts owed to Paris Club creditors, including debt service falling due between the beginning of January 1996 and the end of March 1999 and virtually all the debt rescheduled under the previous agreements. Of this amount, 45% will be repaid over a period ending in 2020, while the remaining 55% (which includes all short term debt owed to these creditors) will be repaid over a period ending in 2016. The rescheduled principal will be repaid in gradually increasing instalments commencing in 2002.

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

As part of the August 1999 agreement, the Paris Club of official creditors has committed to start discussions of comprehensive solutions to the problem of the debts of the former Soviet Union owed to Paris Club creditors in the autumn of 2000.

London Club

A comprehensive restructuring agreement in respect of Soviet-era debt owed to Vnesheconombank's London Club (commercial bank and other financial) creditors was closed in December 1997. Under the terms of this agreement, the entire stock of outstanding principal owed to London Club creditors, amounting to approximately U.S.\$22.2 billion, was restructured as PRINs. Under the terms of this instrument, the amount of interest payable in cash prior to December 2002 is subject to a gradually increasing ceiling, with any resulting unpaid interest capitalised and then discharged by the issuance of IANs.

More than U.S.\$3.0 billion was paid in cash in December 1997 in respect of interest arrears which fell due before the closing date. The remaining interest arrears plus the interest capitalised on the PRINs during the period up to December 1998, which together total approximately U.S.\$6.8 billion, were restructured as IANs.

No cash interest payments in respect of PRINs have been made since June 1998. Since December 1998, no cash interest payments have been made in respect of IANs, and no IANs have been issued in discharge of capitalised PRIN interest. As a result, total past due interest in respect of both PRINs and IANs amounted to approximately U.S.\$2.8 billion as of 31 March 2000.

Vnesheconombank is the legal obligor with respect to the PRINs and IANs, and the Government, acting on behalf of Russia, has issued a non-contractual declaration in support of Vnesheconombank'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.

The PRINs and the IANs are the subject of the Exchange Offer contemplated in this Offering Circular.

Other Former Soviet Union Debt

It is anticipated that holders of Trade Indebtedness of the Former USSR (referred to in the Declaration of the Government of the Russian Federation on the Restructuring of the External Debt of the Former USSR dated 1 October 1994) will be invited at a later date, as if they were Late Joining Creditors under Vnesheconombank's 1997 London Club restructuring, to exchange such trade indebtedness for 2030 Bonds and 2010 Bonds on the terms of exchange set forth herein. The Russian Federation's offer to exchange this trade indebtedness for 2030 Bonds and 2010 Bonds will be the subject of a separate Offering Circular.

The Government intends to commence negotiations with a small number of non-Paris Club official creditors with the objective of reaching rescheduling agreements with these countries, which will incorporate payments in the form of equipment, goods or services.

Following the dissolution of the former Soviet Union, the Government assumed liability for Soviet-era debts owed to the former member countries of the Council for Mutual Economic Assistance ("CMEA"). These debts relate to the CMEA trade settlement systems that were in place between CMEA member countries. Most of these debts were incurred as a result of an imbalance in the settlements in favour of the creditor country at the time of the dissolution of the CMEA and the Soviet Union. As of the end of 1999, 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.

In 1993, the Government issued U.S. dollar-denominated Internal Government Hard Currency Bonds ("OVVZs", known as "Taiga" bonds or "MinFins") to compensate holders of funds which had been frozen in foreign currency accounts of Vnesheconombank. The bonds were initially issued in five series with maturities ranging between one and 15 years; two additional series were issued in May 1996 with maturities of 10 and 15 years. Each bond pays a 3% coupon annually until redemption. The principal amount of OVVZs outstanding stood at U.S.\$11.1 billion (equivalent to 6.1% of GDP for 1999) at the end of 1999 and represented approximately 7.2% of the Government's external debt. OVVZs trade in the over-the-counter market. Historically, OVVZs were regarded as a portion of domestic public debt, however, starting in 2000, they have been reclassified as external debt for budgetary purposes.

On 11 May 1999, the Ministry of Finance requested the holders of the U.S.\$1.3 billion aggregate principal amount of Series III OVVZs maturing on 14 May 1999 not to present these bonds for redemption of principal, pending the development of a restructuring proposal for these instruments. On 14 May 1999, the Ministry of Finance paid all holders of Series III OVVZs interest accrued as of that date and announced that interest on these bonds would continue to accrue at the original rate of 3% until they were restructured into new instruments. Following consultations with representative investor groups, the Government made a proposal in November 1999 to exchange all Series III OVVZs for (i) new U.S. dollar-denominated Government bonds with an average life of seven and a half years and coupons of 3% payable semi-annually or (ii) rouble-denominated OFZs with maturities of four years and with coupons at a declining rate from 15% in the first year to 10% in subsequent periods, in each case payable semi-annually. Series III OVVZs would be exchanged into the new U.S. dollar-denominated bonds at par on a dollar-to-dollar basis, and into the new rouble-denominated bonds at par at the rate of 26.2 roubles per U.S. dollar, being the average official exchange rate for the first week of November 1999. The share of OFZs in the exchange cannot exceed 51% per each tender. As of 20 June 2000, the Ministry of Finance had received applications for the exchange of approximately U.S.\$859 million face value of Series III OVVZs, of which U.S.\$678 million was exchanged into U.S. dollar instruments and the remaining U.S.\$181 million was exchanged into OFZs.

During 1996 and 1997, allegations were made that certain of the OVVZs outstanding had been stolen. Pending determination of their ownership, interest payments on these securities were temporarily frozen. As at 1 January 2000, interest payments in respect of OVVZ bonds with a face value of U.S.\$19.3 million were still frozen, compared to U.S.\$17.1 million as of 1 May 1998.

External Debt Service Projection

The following tables set forth a projection of the Government's contractual external debt service by type of creditor over the period 2000 to 2007, including principal and interest payable on all external debt outstanding at the end of 1999, on the basis of the exchange rates and interest rates prevailing at that time. The first table below reflects the contractual repayment terms of the existing instruments, while the second table below reflects the contractual repayment terms of the 2010 Bonds and the 2030 Bonds, on the assumption that 100% of the outstanding PRINs, IANs, accrued and unpaid interest on the PRINs and IANs, and trade indebtedness of the former USSR debt are exchanged for these bonds.

These tables do not reflect the external debt service (i) on any borrowings by or on behalf of the Government since the end of 1999, which have not been significant, or (ii) on any new borrowings by or on behalf of the Government during the period covered by the table, which are expected to be significant.

External Debt Service Projections by Type of Creditor⁽¹⁾

	2000	2001	2002	2003	2004	2005	2006	2007
Principal	5.11	6.21	7.05	12.37	6.53	9.06	6.89	7.52
External debt of the Government of the Russian Federation	4.97	4.91	5.29	6.78	4.13	6.14	3.73	3.88
Multilateral creditors ⁽²⁾	3.37	1.95	3.48	3.73	2.21	1.84	1.63	1.20
Bonds	0.00	1.00	0.00	1.64	1.02	3.61	0.00	2.40
Official creditors	1.53	1.96	1.81	1.41	0.89	0.69	0.35	0.28
Ministry of Finance Hard Currency Bonds ⁽³⁾ ..	0.00	0.00	0.00	0.00	0.00	0.00	1.75	0.00
Commercial creditors	0.06	0.01	0.00	0.00	0.00	0.00	0.00	0.00
External debt of the former Soviet Union for which the Government of the Russian Federation has agreed to be responsible	0.14	1.29	1.76	5.59	2.41	2.92	3.16	3.64
Multilateral creditors	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Bonds	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Official creditors	0.14	1.29	1.47	1.55	1.83	1.99	1.87	2.01
Ministry of Finance Hard Currency Bonds ⁽⁴⁾ ..	0.00	0.00	0.00	3.46	0.00	0.00	0.00	0.00
Commercial creditors	0.00	0.00	0.29	0.58	0.58	0.94	1.29	1.63
Interest	5.18	7.56	7.39	6.94	6.38	5.97	5.33	4.85
External debt of the Government of the Russian Federation	3.26	3.09	2.76	2.41	2.08	1.85	1.40	1.13
Multilateral creditors	1.08	0.97	0.84	0.65	0.50	0.40	0.30	0.22
Bonds	1.63	1.63	1.53	1.46	1.35	1.26	0.94	0.82
Official creditors	0.44	0.39	0.28	0.19	0.13	0.08	0.06	0.04
Ministry of Finance Hard Currency Bonds ⁽³⁾ ..	0.11	0.11	0.11	0.11	0.11	0.11	0.11	0.05
Commercial creditors	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
External debt of the former Soviet Union for which the Government of the Russian Federation has agreed to be responsible	1.92	4.47	4.64	4.54	4.29	4.13	3.93	3.72
Multilateral creditors	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Bonds	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Official creditors	0.38	2.58	2.51	2.42	2.32	2.20	2.07	1.95
Ministry of Finance Hard Currency Bonds ⁽⁴⁾ ..	0.19	0.19	0.19	0.19	0.09	0.09	0.09	0.09
Commercial creditors	1.35	1.70	1.93	1.92	1.88	1.84	1.77	1.68
Total	10.28	13.77	14.44	19.31	12.91	15.04	12.22	12.38

Notes:

(1) Debt service projection incorporating the contractual repayment terms of the existing instruments. Excludes payments to be made in the form of equipment, goods and services which are likely to be significant. Also excludes payments in respect of Ministry of Finance obligations owed indirectly to the Central Banks as no repayment profile has been agreed.

(2) Includes projected debt service on IMF disbursements to the Central Bank

(3) Ministry of Finance Hard Currency Bonds Series VI & VII (MinFins) representing Russian debt issued in 1996.

(4) Ministry of Finance Hard Currency Bonds Series IV, and V (MinFins) represented the former Soviet Union debt restructured in 1993. The above table does not include any future debt service in respect of MinFin Series III as the proposed restructuring of these bonds was not finalised at the end of 1999.

Some totals may not add due to rounding.

Source: Ministry of Finance, Vnesheconombank.

External Debt Service Projections by Type of Creditor⁽¹⁾

	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>	<u>2007</u>
Principal	5.41	6.20	6.76	11.79	5.96	8.13	6.90	7.40
External debt of the Government of the Russian Federation	4.97	4.91	5.29	6.78	4.13	6.14	3.73	3.88
Multilateral creditors ⁽²⁾	3.37	1.95	3.48	3.73	2.21	1.84	1.63	1.20
Bonds	0.00	1.00	0.00	1.64	1.02	3.61	0.00	2.40
Official creditors	1.53	1.96	1.81	1.41	0.89	0.69	0.35	0.28
Ministry of Finance Hard Currency Bonds ⁽³⁾ ...	0.00	0.00	0.00	0.00	0.00	0.00	1.75	0.00
Commercial creditors	0.06	0.01	0.00	0.00	0.00	0.00	0.00	0.00
External debt of the former Soviet Union for which the Government of the Russian Federation has agreed to be responsible	0.45	1.29	1.47	5.01	1.83	1.99	3.17	3.52
Multilateral creditors	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Bonds	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Official creditors	0.14	1.29	1.47	1.55	1.83	1.99	1.87	2.01
Ministry of Finance Hard Currency Bonds ⁽⁴⁾ ...	0.00	0.00	0.00	3.46	0.00	0.00	0.66	0.66
Commercial creditors	0.31	0.00	0.00	0.00	0.00	0.00	0.64	0.86
Interest	4.22	6.93	6.79	6.35	5.83	5.47	4.88	4.68
External debt of the Government of the Russian Federation	3.26	3.09	2.76	2.41	2.08	1.85	1.40	1.13
Multilateral creditors	1.08	0.97	0.84	0.65	0.50	0.40	0.30	0.22
Bonds	1.63	1.63	1.53	1.46	1.35	1.26	0.94	0.82
Official creditors	0.44	0.39	0.28	0.19	0.13	0.08	0.06	0.04
Ministry of Finance Hard Currency Bonds ⁽³⁾ ...	0.11	0.11	0.11	0.11	0.11	0.11	0.11	0.05
Commercial creditors	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
External debt of the former Soviet Union for which the Government of the Russian Federation has agreed to be responsible	0.96	3.84	4.04	3.95	3.74	3.62	3.48	3.55
Multilateral creditors	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Bonds	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Official creditors	0.38	2.58	2.51	2.42	2.32	2.20	2.07	1.95
Ministry of Finance Hard Currency Bonds ⁽⁴⁾ ...	0.23	0.23	0.23	0.23	0.12	0.12	0.12	0.10
Commercial creditors	0.36	1.03	1.30	1.30	1.30	1.30	1.28	1.49
Total	9.64	13.14	13.55	18.15	11.78	13.59	11.78	12.08

Notes:

- (1) Debt service projection incorporating the repayment terms of the 2010 Bonds and 2030 Bonds in respect of Vnesheconombank's 1997 London Club instruments and eligible FTO debt. Excludes payments to be made in the form of equipment, goods, and services which are likely to be significant. Also excludes payments in respect of Ministry of Finance obligations owed indirectly to the Central Banks as no repayment profile has been agreed.
- (2) Includes projected debt service on IMF disbursements to the Central Bank.
- (3) Ministry of Finance Hard Currency Bonds Series VI & VII (MinFins) representing Russian debt issued in 1996.
- (4) Internal Government Hard Currency Bonds Series III, IV and V (MinFins) representing the former Soviet Union debt restructured in 1993; incorporating repayment terms of the proposed US Dollar rescheduling of MinFin III.

Some totals may not add due to rounding.

Source: Ministry of Finance, Vnesheconombank.

External Borrowings

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

Apart from guarantees of obligations of these banks, the Government has not provided external guarantees for public or private sector entities, 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 Government has paid in full all amounts due and owing on external debt in respect of new funds raised by the Government since 1 January 1992, including payments on the roughly U.S.\$15.6 billion aggregate principal amount of Eurobonds issued by Russia since November 1996. All debt service obligations on Eurobonds issued by Vnesheconombank prior to 1 January 1992 have also been honoured in full.

External Debt Policy

The Government's prime objective of its external debt policy is to reduce both the outstanding stock of external debt and external debt service to sustainable levels. As part of this objective, the Government is aiming to secure a comprehensive restructuring agreement with the Paris Club of official creditors on terms both consistent with its capacity to service these obligations and comparable with the terms contemplated herein for London Club creditors. A further objective of the Government is to secure a successful return to the international capital markets.

Domestic Debt

The following table sets forth information with respect to Russia's domestic public debt at period-end for the years 1995 to 1999 and at 1 March 2000:

Domestic Public Debt⁽¹⁾						
(End of period)						
	1995	1996	1997	1998	1999	As at 1 March 2000
	(millions of roubles)					
Total domestic debt	196,047	387,713	540,442	587,415	644,333	637,857
Federal Government	191,153	365,557	499,555	537,753	583,638	574,745
GKOs	65,759	203,583	272,612	16,818	7,432	12,456
OFZs with variable coupon	10,831	33,525	47,618	133	42	42
OFZs with fixed rates	—	—	115,776	346,826	402,213	405,775
OFZ-FK (issued in course of restructuring)	—	—	—	112,565	112,430	112,726
Debt to the Central Bank accumulated in 1992-1994 ⁽²⁾	61,022	59,579	—	—	—	—
Securitized direct credits of 1992-1995	30,040	29,480	28,920	28,255	25,322	25,320
Other	23,501	39,389	34,629	33,157	36,199	18,425
Sub-federal governments ⁽³⁾	4,894	18,489	37,651	49,058	60,663	63,081
State Pension Fund	—	3,667	3,236	604	31	31
	(% of total)					
Total domestic public debt	100.00	100.00	100.00	100.00	100.00	100.00
Federal Government	97.50	94.29	92.43	91.55	90.58	90.11
GKOs	33.54	52.51	50.44	2.86	1.15	1.95
OFZs with variable coupon	5.52	8.65	8.81	0.02	0.01	0.01
OFZs with fixed rates	—	—	21.42	59.04	62.42	63.62
OFZ-FK (issued in course of restructuring)	—	—	—	—	17.45	17.67
Debt to the Central Bank accumulated in 1992-1994 ⁽²⁾	31.13	15.37	—	—	—	—
Securitized direct credits of 1992-1995	15.32	7.60	5.35	4.81	3.93	3.97
Other	11.99	10.16	6.41	5.64	5.62	2.89
Sub-federal governments ⁽³⁾	2.50	4.77	6.97	8.35	9.41	9.89
State Pension Fund	—	0.95	0.60	0.10	0.00	0.00
	(% of GDP)					
Total domestic debt	12.73	18.07	21.80	21.79	14.18	11.92
Federal Government	12.41	17.03	20.15	19.95	12.84	10.74
GKOs	4.27	9.49	11.00	0.62	0.16	0.23
OFZs with variable coupon	0.70	1.56	1.92	0.00	0.00	0.00
OFZs with fixed rates	—	—	4.67	12.86	8.85	7.58
OFZ-FK (issued in course of restructuring)	—	—	—	—	2.47	2.11
Debt to the Central Bank accumulated in 1992-1994 ⁽²⁾	3.96	2.78	—	—	—	—
Securitized direct credits of 1992-1995	1.95	1.37	1.17	1.05	0.56	0.47
Other	1.53	1.84	1.40	1.23	0.80	0.34
Sub-federal governments ⁽³⁾	0.32	0.86	1.52	1.82	1.33	1.18
State Pension Fund	—	0.17	0.13	0.02	0.00	0.00
<i>Memo:</i>						
Exchange rate, rouble/U.S.\$, end of period	4.64	5.56	5.97	20.65	27.00	28.65
GDP (billions of roubles)	1,540	2,146	2,479	2,696	4,545	5,350 ⁽⁴⁾
Total domestic public debt (U.S.\$ million)	42,251	69,795	90,466	28,446	23,864	22,264

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) 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.
- (3) The debt of sub-federal governments calculated sum of the net domestic new borrowings through issue of securities and other sources of domestic financing as provided in the consolidated budget.
- (4) As projected in 2000 Budget Law.

Source: Ministry of Finance

At 1 March 2000, Russia's total outstanding domestic public debt amounted to 637.9 billion roubles (U.S.\$22.3 billion), or 11.9% of estimated GDP for 2000. This public debt comprised domestic debt of the Government amounting to 574.7 billion roubles, debt of the sub-federal and local governments of 63.0 billion roubles and 31 million roubles owed by the State Pension Fund.

Government Domestic Debt

The Government's domestic indebtedness consists of GKO, OFZ, rouble-denominated savings bonds ("OGSZs") 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. The aggregate amount of GKOs outstanding increased steadily until the middle of 1997. At 1 March 2000 they represented about 2% of outstanding Government domestic debt.

OFZs are rouble-denominated obligations with maturities of over one year, and pay interest quarterly, semi-annually or annually. Initially issued in June 1995, the outstanding stock of OFZs at the end of 1999 represented 9.7% of estimated GDP for 2000. OFZs (including OFZs issued in the GKO/OFZ restructuring discussed below) represented 32.7% of the Government's domestic debt at the end of 1997 and 90.2% at 1 March 2000. See "— Government Domestic Debt Policy and Recent Events."

OFZs were initially issued with floating coupons pegged to the average market yields of GKOs redeemable during the period beginning 30 days before and ending 30 days after the coupon payment. Floating-rate OFZs represented 9.5% of total Government domestic debt by the end of 1997. Starting with November 1997, there were no further placements of these bonds, and the share of these bonds in total Government domestic debt decreased to almost zero by the end of 1999.

In July 1997, fixed-rate OFZs were introduced. Until the middle of 1998, two- and three-year fixed-rate OFZs were issued, paying annual or semi-annual coupons at rates between 12% and 20% per annum. As of 1 March 2000, 373.0 billion roubles principal amount of fixed-rate OFZs had been issued, amounting to 64.9% of the Government domestic debt.

In the course of restructuring GKOs and certain OFZs following the events of 17 August 1998, the Ministry of Finance issued fixed-coupon OFZs with maturities of four and five years and zero-coupon OFZs with maturities of three years. As of 1 March 2000, fixed-coupon OFZs comprised 19.6% of total domestic Government debt and zero-coupon OFZs comprised 5.7%. See "— Government Domestic Debt Policy and Recent Events."

The restructuring of the GKOs and certain OFZs that took place following the events of 17 August 1998 radically changed the structure of the Government debt stock. These bonds were converted into medium- and long-term bonds with fixed declining coupons, and the Government ceased to issue new GKOs or OFZs until December 1999. As a result of the restructuring, the share of long-term debt substantially increased. At 1 April 2000, the share of GKO/OFZ bonds with maturities over one year stood at 77% of the total GKO/OFZ stock traded in the market, whereas at the end of 1997, this proportion was 28%.

Annualised GKO/OFZ yields, which averaged 86% in 1996 overall and had been as high as 176% before the presidential elections in June 1996, began to fall in the second half of 1996 and reached their historical low of approximately 19% in August 1997. In response to the Asian financial crisis, GKO/OFZ yields fluctuated widely, rising to 36% in December 1997 and then to 80% in late July 1998. Since January 1999 when secondary market trading in GKO/OFZ bonds resumed, yields have declined from the permitted ceiling of 120% to approximately 40% in May 2000.

Government debt instruments also 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 1 March 2000 was equal to 2.9 billion roubles.

Government debt to the Central Bank (both principal and interest) incurred between 1992 and 1994 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, 79.8 billion roubles were issued in the form of Government securities with 10% annual interest payments from 1998 until redemption. Principal repayment will be made in equal annual

instalments in the period from 2001 to 2013. The Government's securitised debt to the Central Bank includes centralised credits extended by the Central Bank, mainly to agricultural enterprises and the Northern regions.

The Government has assumed responsibility for similar centralised credits disbursed to enterprises by the Central Bank through commercial banks but not repaid when due, and in 1995 and 1996 the Government issued about 30 billion roubles worth of promissory notes (*veksels*), equivalent to 1.4% of GDP for 1996, in order to reschedule the liability. In 1996, the Government began to redeem this debt, the remaining outstanding amount of which was equivalent to 0.5% of GDP and 4.4% of total Government domestic debt at 1 March 2000.

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 1 January 1998. From 1 January 1998 to 17 August 1998, the only remaining limitation on the access of foreign investors to the GKO/OFZ market was the requirement that non-residents trade in such securities through special "S" accounts with authorised banks. At 17 August 1998, non-residents held approximately 32% of the GKO/OFZ stock by face value.

In the beginning of 1999, after the adoption of the restructuring scheme for GKO and certain OFZs, the Central Bank reintroduced various restrictions on non-residents holding GKO and OFZs. Repatriation of proceeds was initially possible through special foreign exchange auctions conducted by the Central Bank, and through special "S" accounts, which required the funds to be deposited in non-interest bearing "transit" accounts for 365 days before repatriation. In total, six monthly auctions were held in which a total of U.S.\$300 million was sold for roubles and OFZs held by non-residents. At all of these auctions, the exchange rate was set as the official exchange rate multiplied by a factor of 1.1. Demand in these auctions greatly exceeded supply, and the Central Bank allocated U.S. dollars proportionately to bids made in the auctions. From December 1999 through February 2000, the Ministry of Finance offered to non-resident holders of GKO and OFZs five series of GKO having an aggregate free amount of 5 billion roubles, maturing between April and November 2000 and yielding less than 5%. The proceeds paid on redemption of these bonds may be used by non-residents to purchase foreign currency for repatriation. Pending repatriation, assets of non-resident investors in the GKO/OFZ market, may be invested in rouble-denominated Government securities and certain listed equities.

Government Domestic Debt Service

Payments in respect of discount and interest on Government domestic debt, excluding payments with respect to OVZs, increased from 2.1% of GDP in 1995 to 4.7% of GDP in 1996 and then declined to 3.7% of GDP in 1997 and to 2.4% of GDP in 1998 and 1.5% of GDP in 1999. The decrease in domestic debt service in 1998 and 1999 was attributable mostly to the restructuring of GKO and certain OFZs that reduced both principal and interest payments by the Government.

Government Domestic Debt Policy and Recent Events

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 pressure on the GKO/OFZ market in 1998. See "Monetary and Financial System — Monetary Policy — Money Supply and Inflation." As difficulties intensified in late 1997 as a result of the financial crisis in Asia, the Government curtailed its GKO/OFZ issuances, limiting such issuance only to those required to roll over existing obligations. At the end of 1997 and during the first half of 1998, the Government attempted to meet its anticipated domestic service mainly through a combination of external borrowings, repayments out of the Federal budget and refinancings through further GKO/OFZ issuances.

Limitations on issuance of securities in the domestic market produced a positive effect on GKO/OFZ yields in early 1998. However, the dismissal of the Government in March 1998 and the deterioration of the situation in emerging markets intensified pressure on the value of the rouble and the domestic debt market, and yields rose again, to over 60% in June 1998.

In order to reduce pressure on the Federal budget and Russia's international reserves, in July 1998 the Ministry of Finance offered to exchange Eurobonds with maturities in 2005 and 2018 for GKO maturing prior to 1 July 1999. As a result, approximately 27.5 billion face value of GKO were exchanged for U.S.\$5.9 billion face value of Eurobonds. The exchange offer had only a limited effect, however, and by the end of July GKO/OFZ yields remained above 80%. On 29 July 1998 the Government stopped all primary

placements of GKO and OFZs. At the same time, rouble proceeds from maturing securities were being used by market participants to purchase U.S. dollars, increasing pressure on Russia's international reserves.

Lack of demand for GKO and OFZs, intensifying pressure on the value of the rouble and depletion of Russia's international reserves precipitated the Government's and the Central Bank's announcement, on 17 August 1998, that the Government would not meet its obligations on GKO and certain OFZs. The Government and the Central Bank also announced at that time a widening of the rouble-trading corridor (which was subsequently abandoned) and a 90-day moratorium on certain hard currency payments. See "The Russian Economy — Overview of Economic Reforms."

Following discussions with various investor groups, in December 1998 the Government made an offer to restructure eligible GKO and OFZs. The restructuring called for 10% of the discounted obligations to be repaid in cash and two short-term GKO, 20% to be exchanged for one series of zero-coupon OFZ maturing in three years, and 70% to be exchanged for 12 series of OFZs with maturities of four and five years and a coupon declining from 30% by 5% each year until maturity. For certain Russian institutional investors with mandatory requirements to invest their assets in GKO and OFZs, the amount of the cash portion was increased from 10% to 30%, and certain holders (including medical insurance funds, mass media, physical persons and certain minor non-commercial investors) were repaid in full.

As of 27 June 2000, investors representing 99.48% of face value GKO and OFZs as of 17 August 1998 had tendered their securities for exchange. Pursuant to the provisions of the 1999 Budget Law, the Government also exchanged part of its GKO/OFZ debt held by the Central Bank as of 17 August 1998 for long-term OFZs with a coupon of 2% per annum.

The Government is currently developing its new domestic debt strategy. In the interim period it intends to engage in domestic borrowings for purposes of covering short-term fiscal gaps and refinancing maturing domestic debt.

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. These government accounts were in surplus until 1995, and this portion of the overall public debt amounted to no more than 0.3% of GDP in 1995, increasing up to 1.3% of GDP for 1999. In 1996, the State Pension Fund also incurred debt for the first time in the form of bank credits. This debt was negligible at the end of 1999.

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 this status does not constitute a Federal guarantee against default. Following the events of 17 August 1998, a significant portion of the debt of the sub-federal and local authorities has been rescheduled. An estimated 60.7 billion roubles (about U.S.\$2.2 billion) aggregate amount of debt of Federation subjects was outstanding at the end of 1999.

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 September 1997, Russia became a member of the Paris Club of official creditors. As a result, the Government now pursues its claims against debtor governments within the Paris Club framework. In connection with Russia's joining the Paris Club, the Government agreed to 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.

In 1999, the amount of the cash payments received by Russia from its government debtors totalled approximately U.S.\$1 billion, of which significantly less than U.S.\$100 million was received from Paris Club debtors.

Russia is also a creditor to a number of CIS countries. The total amount owed by these CIS countries to the Federal budget is approximately U.S.\$1.5 billion.

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 U.S.\$10.2 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 1996 and 1997, caused mainly by the IMF's concerns about the Government's poor revenue performance. See "Public Finance — Revenues." In February 1998, the Government and the IMF agreed on the extension of the EFF through early 2000. On 20 July 1998, the IMF Executive Board approved an additional U.S.\$11.2 billion facility to Russia in support of Russia's economic programme, of which U.S.\$4.8 billion was disbursed immediately. Despite this disbursement, Russia's financial situation could not be stabilised and the Central Bank's reserves continued to fall. After the actions taken by the Government and the Central Bank on 17 August 1998, the IMF temporarily froze its lending to Russia. Following consultations between the Government and the IMF, on 28 July 1999, the IMF approved a 17-month Stand-By Facility in the amount of U.S.\$4.5 billion to support the Government's economic programme in 1999 and 2000. The disbursements are conditional on achievement of certain macroeconomic targets and progress in structural reforms. The first tranche, in the amount of approximately U.S.\$640 million, was disbursed to Russia in July 1999 and used to repay the amounts coming due under outstanding IMF loans. No further tranche has been disbursed yet due to Russia's non-performance of structural measures in such areas as reduction of barter and other non-monetary forms of settlement, abolition of certain non-tariff methods of export regulation, publication of quarterly reports under IAS by certain natural monopolies, financial audit of certain large banks, reporting on management of Russia's international reserves, and gradual cessation of control by the Central Bank over state-owned foreign banks. Despite non-performance of these structural measures, Russia fulfilled most macroeconomic performance criteria with a surplus.

The proceeds of any future IMF financing are expected to be used to repay outstanding IMF loans. No assurances can be given that the conditions to subsequent disbursement of funds will be met. It is expected that the IMF and Russia will shortly develop a new economic program.

As at the end of September 1999, the World Bank had approved 39 loans in Russia, mostly directed to infrastructure development and industrial restructuring, representing aggregate commitments of approximately U.S.\$10.2 billion of which approximately U.S.\$6.8 billion had been drawn. The World Bank's management has also reached agreement with the Government on a structural reform programme and on 6 June 1997 its Board of Executive Directors approved the programme of structural adjustment lending. Total disbursements under this facility in 1997 and 1998 were U.S.\$1.7 billion. In 1999, Russia received only U.S.\$100 million for structural adjustments and U.S.\$150 million for restructuring its coal industry. As of 1 January 2000, undrawn allocations under the World Bank's structural adjustment loan were U.S.\$1.1 billion and under the facility for restructuring the coal industry were U.S.\$250 million. No assurances can be given that any of these funds will be disbursed in the future.

The EBRD has committed to 102 projects in Russia, largely in the private sector, including projects relating to the oil and gas sectors and market infrastructure development, with a total value in the order of 3.5 billion euro.

FORM AND TRANSFER OF NEW BONDS

Form of New Bonds

All New Bonds will be in definitive registered form, without interest coupons attached. Each series of New Bonds offered and sold outside the United States in reliance on Regulation S will be represented by interests in one or more permanent global bonds in definitive fully registered form, without interest coupons attached (the "Unrestricted Global New Bonds") which will be deposited on or before the Settlement Date with The Chase Manhattan Bank, London branch, as common depository for, and registered in the name of Chase Nominees Limited, as nominee for such common depository in respect of, interests held through the facilities of Morgan Guaranty Trust Company of New York, Brussels office, as operator of the Euroclear System ("Euroclear"), and Clearstream Banking, Luxembourg, société anonyme ("Clearstream (Luxembourg)"). A beneficial interest in an Unrestricted Global New Bond may at all times be held only through Euroclear and Clearstream (Luxembourg).

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

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

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

Exchange of Interests in Global New Bonds for New Bond Certificates

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

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

In such circumstances, the relevant Global New Bond will be exchanged in full or in part, as the case may be, for New Bond Certificates and the Russian Federation will, at the cost of the Russian Federation (but against such indemnity as the Registrar or any relevant Transfer Agent may require in respect of any tax or other duty of whatever nature which may be levied or imposed in connection with such exchange), cause sufficient New Bond Certificates to be executed and delivered to the Registrar for completion, authentication and dispatch to the relevant holders of the New Bonds. A person having an interest in a Global New Bond of

the relevant series must provide the Registrar with (a) a written order containing instructions and such other information as the Russian Federation and the Registrar may require to complete, execute and deliver such New Bond Certificates and (b) in the case of a Restricted Global New 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. New Bond Certificates issued in exchange for a beneficial interest in a Restricted Global New Bond will bear the legends applicable to transfers pursuant to Rule 144A, as set out under "Transfer Restrictions" herein. Such transfer restrictions will terminate with respect to each series of New Bonds two years (or such other period as provided by Rule 144) after the date on which New Bonds of that series which are represented by an interest in a Restricted Global New Bond are last issued, assuming compliance with Condition 6(b) of the Terms and Conditions of the New Bonds.

If interests in Global New Bonds are exchanged for New Bond Certificates in the limited circumstances where this is permitted, there will be a 15% withholding tax on interest received by holders of the New Bond Certificates which are legal persons and the redemption proceeds paid on New Bond Certificates may be subject to taxation. Legal persons and Russian physical persons holding the New Bond Certificates will be taxed on the difference between the redemption proceeds and the acquisition cost, with the calculation of that difference being made in roubles for certain holders. There is a risk that, if interests in Global New Bonds are exchanged for New Bond Certificates in the limited circumstances where this is permitted, a non-resident holder of a New Bond Certificate who is a physical person may be subject to individual income tax levied by withholding at a rate of 20% on the entire redemption proceeds, subject to any double taxation treaty relief. See "Russian Taxation."

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

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

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

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

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

DTC, Euroclear and Clearstream (Luxembourg) Arrangements

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

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

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

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

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

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

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

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

Trading between DTC Participants. Secondary market sales of book-entry interests in New 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/Clearstream (Luxembourg) Purchaser. When book-entry interests in New Bonds are to be transferred from the account of a DTC participant holding a beneficial interest in a Restricted Global New Bond to the account of a Euroclear or Clearstream (Luxembourg) accountholder wishing to purchase a beneficial interest in an Unrestricted Global New (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 Clearstream (Luxembourg) 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 Clearstream (Luxembourg) accountholder. On the settlement date, the Custodian will instruct the Registrar to (a) decrease the amount of New Bonds registered in the name of Cede & Co. and evidenced by such Restricted Global New Bond and (b) increase the amount of New Bonds registered in the name of the nominee of the common depository for Euroclear and Clearstream (Luxembourg) and evidenced by such Unrestricted Global New Bond. Book-entry interests will be delivered free of payment to Euroclear or Clearstream (Luxembourg), as the case may be, for credit to the relevant accountholder on the first business day following the settlement date.

Trading between Euroclear/Clearstream (Luxembourg) Seller and DTC Purchaser. When book-entry interests in the New Bonds are to be transferred from the account of a Euroclear or Clearstream (Luxembourg) accountholder to the account of a DTC participant wishing to purchase a beneficial interest in a Restricted Global New Bond (subject to such certification procedures as are provided in the Fiscal Agency Agreement), the Euroclear or Clearstream (Luxembourg) participant must send to Euroclear or Clearstream (Luxembourg) delivery free of payment instructions by 7:45 p.m., Brussels or Luxembourg time, one business day prior to the settlement date. Euroclear or Clearstream (Luxembourg), as the case may be, will in turn transmit appropriate instructions to the common depository for Euroclear and Clearstream (Luxembourg) 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 Clearstream (Luxembourg) accountholder, as the case may be. On the settlement date, the common depository for Euroclear and Clearstream (Luxembourg) will (a) transmit appropriate instructions to the Custodian who will in turn deliver such book-entry interests in the New Bonds free of payment to the relevant account of the DTC participant and (b) instruct the Registrar to (i) decrease the amount of New Bonds registered in the name of the nominee of the common depository for Euroclear and Clearstream (Luxembourg) and evidenced by an Unrestricted Global New Bond and (ii) increase the amount of New Bonds registered in the name of Cede & Co. and evidenced by such Restricted Global New Bond.

The record date for the payment of interest, discussed above, may be relevant to the trading of New Bonds by a purchaser or seller holding New Bonds through DTC, on the one hand, and a seller or purchaser holding New Bonds through Euroclear or Clearstream (Luxembourg), on the other.

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

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

DTC has advised the Russian Federation as follows: DTC is a limited purpose trust company organised under the laws of the State of New York, a "banking organization" under the laws of the State of New York, a member of the U.S. Federal Reserve System, a "clearing corporation" within the meaning of the New York Uniform Commercial Code and a "clearing agency" registered pursuant to the provisions of Section 17A of the Exchange Act. DTC was created to hold securities for its participants and facilitate the clearance and settlement of securities transactions between participants through electronic computerised book-entry changes in accounts of its participants, thereby eliminating the need for physical movement of certificates. Direct participants include securities brokers and dealers, banks, trust companies, clearing corporations and certain other organisations. Indirect access to DTC is available to others, such as banks, securities brokers, dealers and trust companies, that clear through or maintain a custodial relationship with a DTC direct participant, either directly or indirectly.

Euroclear has advised the Russian Federation as follows: Morgan Guaranty Trust Company of New York, Brussels office, as operator of Euroclear (the "Euroclear Operator") holds securities and book-entry interests in securities for participating organisations and facilitates the clearance and settlement of securities transactions between Euroclear participants, and between Euroclear participants and participants of certain other securities intermediaries through electronic book-entry changes in accounts of such participants or other securities intermediaries.

The Euroclear Operator provides Euroclear participants, among other things, with safekeeping, administration, clearance and settlement, securities lending and borrowing, and related services. Euroclear participants are investment banks, securities brokers and dealers, banks, central banks, supranationals, custodians, investment managers, corporations, trust companies and certain other organisations.

Non-participants of Euroclear may hold and transfer book-entry interests in securities through accounts with a direct participant of Euroclear or any other securities intermediary that holds a book-entry interest in the securities through one or more securities intermediaries standing between such other securities intermediary and the Euroclear Operator.

Clearstream (Luxembourg) has advised the Russian Federation as follows: Clearstream (Luxembourg) holds securities for its customers and facilitates the clearance and settlement of securities transactions between Clearstream (Luxembourg) customers through electronic book-entry changes in accounts of Clearstream (Luxembourg) customers, thereby eliminating the need for physical movement of certificates. Transactions may be settled by Clearstream (Luxembourg) in any of thirty-six currencies, including dollars. Clearstream (Luxembourg) provides to its customers, among other things, services for safekeeping, administration, clearance and settlement of internationally traded securities and securities lending and borrowing. Clearstream (Luxembourg) also deals with domestic securities markets in over thirty countries through established depository and custodial relationships. Clearstream (Luxembourg) is registered as a bank in Luxembourg, and as such is subject to regulation by the Commission de Surveillance du Secteur Financier, which supervises Luxembourg banks. Clearstream (Luxembourg)'s customers are world-wide financial institutions including underwriters, securities brokers and dealers, banks, trust companies and clearing corporations. Clearstream (Luxembourg)'s U.S. customers are limited to securities brokers and dealers, and banks. Currently, Clearstream (Luxembourg) has approximately 2,000 customers located in over eighty countries, including all major European countries, Canada, and the United States. Indirect access to Clearstream (Luxembourg) is available to other institutions that clear through or maintain a custodial relationship with an account holder of Clearstream (Luxembourg). Clearstream (Luxembourg) has established an electronic bridge with Morgan Guaranty Trust Company of New York as the Operator of the Euroclear System in Brussels to facilitate settlement of trades between Clearstream (Luxembourg) and Euroclear.

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

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

TRANSFER RESTRICTIONS

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

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

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

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

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

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

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

(a) The purchaser is (1) a QIB and (2) acquiring the New Bonds for its own account or for the account of a QIB.

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

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

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

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

RUSSIAN TAXATION

General

The following is a summary of certain Russian tax considerations relevant to the exchange of PRINs and IANs for New Bonds pursuant to the Exchange Offer and to the ownership and disposition of New Bonds. This summary is based on the laws of the Russian Federation in effect on the date of this Offering Circular. This summary does not address the availability of, or procedures for claiming, double tax treaty relief, the practical difficulties involved in claiming such relief, or the applicability of, or procedures in relation to, taxes levied by regions, municipalities or other non-federal level authorities of the Russian Federation. Prospective investors should consult their own tax advisors regarding an investment in the New Bonds.

The substantive provisions of Russian tax law are subject to more rapid and unpredictable change and to greater inconsistency than is generally the case in jurisdictions with more developed capital markets. At present, the Russian legislature is currently considering draft tax legislation that would significantly amend relevant provisions of the Tax Code, as described under "Public Finance — The New Tax Code." Enforcement and interpretation of Russian tax legislation, which in practice rest principally with local tax inspectors, may also vary by region.

Many aspects of current Russian tax law applicable to the exchange of PRINs and IANs for New Bonds and the ownership and disposition of New Bonds are subject to significant uncertainty. Certain of these issues have been addressed by Regulation No. BG-4-06/14 of 12 July 2000 approved by the Ministry of Taxes and Duties of the Russian Federation and agreed by the Ministry of Finance (the "Regulations"). The Regulations will become effective upon their registration with the Ministry of Justice of the Russian Federation and their publication in *Rossiyskaya Gazeta*. Although they will have been issued or approved by the Federal authorities with legal authority to interpret Russian tax law, the Regulations would not be regarded by a Russian court as having the status of law.

The Regulations state that no holder of a New Bond will be deemed to have a permanent establishment in Russia simply by virtue of the acquisition of a New Bond. For purposes of this summary the term "permanent establishment" has the meaning given to it in the Law of the Russian Federation No. 2116-1 of 27 December 1991 "On Taxation of Profits of Enterprises and Organisations" and the Instruction of the State Tax Service of the Russian Federation No. 34 of 16 June 1995 "On Taxation of Profits and Income of Foreign Legal Persons."

A legal entity is considered resident in the Russian Federation if it has been established under Russian law; a physical person is considered resident in the Russian Federation for any calendar year in which he or she spends at least 183 days in Russia.

Taxation of the Exchange

The Regulations provide that the exchange of PRINs or IANs for New Bonds will not be subject to tax until such time as the New Bonds are redeemed or disposed of, or interest is paid thereon.

The 2010 Bonds will be exchanged for a like amount of past due interest on tendered PRINs and IANs. The Regulations provide that this interest is taxable only when proceeds are actually received by a foreign organisation upon the redemption or disposal of the 2010 Bonds.

Interest on New Bonds

Under existing tax legislation, interest received on state securities by holders which are foreign organisations is subject to a 15 per cent. income tax levied by withholding. There is currently no Russian individual income tax on interest received by holders of state securities who are physical persons.

The Regulations provide that if (i) the New Bonds are evidenced by a global certificate held by a clearing or depositary organisation which is a resident of a state that is a party to a treaty with the Russian Federation on the avoidance of double taxation and (ii) the treaty provides that residents of that other state are exempt from Russian tax on interest income, then the clearing or depositary organisation will be treated as a qualifying resident of that other state and will be the beneficial owner of the interest payments made on such New Bonds for purposes of such treaty. Under these circumstances, the Regulations further provide that no income tax will be withheld from the interest payments made on such New Bonds if, prior to the first interest payment on the New Bonds, a certification is filed with the Russian tax authorities confirming that the clearing or

depository organisation is a resident of that other state and the terms of the New Bonds provide that organisations resident in the Russian Federation may not receive interest on the New Bonds in any form.

The Regulations do not contain a definition of “clearing or depository organisation” or “Russian resident”, nor do they contemplate the issue being structured in the form of two or more global bonds or contain any guidance on the form of confirmation which will be regarded as satisfactory by the relevant tax authorities in the Russian Federation.

The New Bonds will be represented by two or more Global New Bonds as described below in “Form and Transfer of New Bonds”. The Global New Bonds will be registered in the name of Cede & Co. (as nominee for DTC) and Chase Nominees Limited (as nominee for the Common Depository). Condition 7(c) provides that Russian residents, other than physical persons, are not permitted to receive interest payments on the New Bonds. On or prior to the first interest payment in respect of the New Bonds, the Ministry of Finance will certify to the appropriate tax authorities (based on a certification made to it by DTC and the Common Depository) that the Global New Bonds are being held by DTC and the Common Depository as clearing or depository organisations and that DTC and the Common Depository are residents of a state that is party to a double taxation treaty of the type referred to above.

Based on current Russian tax legislation, interest on the New Bonds should not be subject to Russian profits tax or, under the circumstance described above, income tax, whether imposed directly or by withholding.

If the New 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 New Bonds are exchanged for New Bond Certificates in the limited circumstances where this is permitted (see “Form and Transfer of New Bonds — Exchange of Interests in Global New Bonds for New Bond Certificates”), there will be a 15 per cent. withholding tax on interest received by holders which are organisations, subject to any available double tax treaty relief.

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

Disposal or Redemption of New Bonds

Any gain on the disposal or redemption of New Bonds will generally be subject to income tax or profits tax. This tax will be levied directly or by withholding depending on the tax status of the seller. The amount of the gain on any disposal or redemption of New Bonds will be equal to the difference between the disposal or redemption proceeds and the acquisition cost of the New Bonds (in all cases, net of accrued interest and, in the case of profits tax, net of expenses incurred in connection with their acquisition or disposal). The Regulations provide that the acquisition cost of the initial holder of New Bonds received by an organisation in exchange for PRINs or IANs will be equal to the original acquisition cost of such PRINs or IANs, adjusted for expenses incurred in connection with their acquisition. Any gain realised on the disposal or redemption of New Bonds may be caused or affected by changes in the exchange rate between the currency of acquisition and the currency of disposal or redemption of the New Bonds (and, if the gain is calculated in roubles to fulfil Russian statutory requirements, by changes in the exchange rates between the currency of acquisition, the currency of disposal or redemption and the rouble).

A non-resident holder which is an organisation and does not hold or dispose of New Bonds through a permanent establishment in the Russian Federation will generally be subject to withholding tax at the rate of 20 per cent., and a non-resident holder who is a physical person will generally be subject to individual income tax at the rate of 20 per cent., on any gain (or on the full amount of the proceeds if the gain cannot be quantified) from the redemption of New Bonds or the disposal of New Bonds if, in each case, the disposal proceeds are received from a source within the Russian Federation. Gain is calculated net of any accrued interest. Deduction of this income tax is required to be made by the payer of the disposal proceeds, except when the proceeds are paid to a non-resident holder who is a physical person by a Russian individual not registered with the Russian authorities as an individual entrepreneur. The 20 per cent. withholding tax and the individual 20 per cent. income tax are both subject to any available double tax treaty relief.

The Regulations provide that income shall be considered as received from a source in the Russian Federation when the New Bonds are sold to a Russian organisation or a physical person having permanent residence in the Russian Federation, or to a foreign organisation if a permanent representative office of such foreign organisation in the Russian Federation is directly involved, as the representative of a party to the agreement, in concluding the sale transaction with respect to the New Bonds.

Legal entities organised under Russian law, and foreign organisations holding or disposing of the New Bonds through a permanent establishment in the Russian Federation, are generally subject to profits tax on any gain at rates of up to 30 per cent. (or possibly more in the case of certain organisations, including banks, insurance companies and brokerage houses).

Physical persons with a permanent place of residence in the Russian Federation are generally subject to individual income tax on any gain at rates of up to 30 per cent. subject to certain relief (which in certain circumstances requires the submission of an appropriate application for relief). In certain circumstances deduction of this tax may be required to be made by the payer of the disposal proceeds.

Other Taxes

Payments made to holders of New Bonds pursuant to the terms under which they were issued will not be subject to value added tax.

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

The Regulations state that no road users' tax or housing fund maintenance tax on a sale outside the territory of the Russian Federation will be payable by or deducted from payments to foreign organisations holding New Bonds. Russian legal entities, and foreign entities acting through Russian permanent establishments, which receive income effectively connected with trading in New Bonds in the Russian Federation, in each case licensed in the Russian Federation as professional participants in the securities market, insurance companies or banks, will be subject to these taxes. Housing fund maintenance tax will be 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 in respect of New Bonds.

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

GENERAL INFORMATION

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

	2030 Bonds		2010 Bonds	
	Restricted Global New Bonds	Unrestricted Global New Bonds	Restricted Global New Bonds	Unrestricted Global New Bonds
CUSIP	78307ACZ4	X74344DM5	78307ACY7	X74344DL7
ISIN	US78307ACZ49	XS0114288789	US78307ACY73	XS0114295560
Common Code		11428878		11429556

The New Bonds represented by interests in the Restricted Global New Bonds have been accepted for trading in PORTAL. The PORTAL reference numbers are RUSFNP30 for the 2030 Bonds and RUSFNP10 for the 2010 Bonds.

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

2.1 The Fiscal Agency Agreement, which includes the forms of the Global New Bond and the New Bond Certificate;

2.2 The authorisations referred to in item 4 below; and

2.3 The Deed of Covenant.

3. The Russian Federation will obtain prior to the Settlement Date all necessary consents, approvals and authorisations in the Russian Federation (other than annual budget appropriations for years subsequent to 2000) in connection with the issue of, and performance of its obligations under, the New Bonds and the Deed of Covenant.

4. The issue of the New Bonds and the execution of the Deed of Covenant were authorised pursuant to Federal Law No. 136-FZ of 29 July 1998 and Government Resolution No. 478 of 23 June 2000. The Head of the Legal Department of the Ministry of Finance will confirm that in his opinion no legislative action is required for the authorisation of the issuance of the New Bonds. Russian counsel to the Exchange Agent will state in their opinion that although Russia's budget legislation is not explicit on this issue, on the basis of the information available to them, they agree with this conclusion. The opinion of Russian counsel to the Exchange Agent will also note that Federal Law No. 94-FZ of 10 July 2000 approving the Russian Federation's debt ceiling at U.S.\$158 billion as at the end of the fiscal year ending 31 December 2000 expressly states that this amount includes restructured debt of the Russian Federation to the creditors comprising the London Club. A copy of the forms of the opinions of counsel to the Exchange Agent may be obtained by contacting the Exchange Agent.

5. The Central Bank will confirm in writing that (i) the Ministry of Finance may issue the New Bonds in foreign currency without the consent of the Central Bank, (ii) it will not impose any limitations on the making of payments on the New Bonds to non-Russian residents outside of the Russian Federation, (iii) it does not object to the fulfilment in foreign currency by the Ministry of Finance of its payment obligations to the Fiscal Agent and (iv) with the consent of the State Customs Committee of the Russian Federation, it does not object to the export by the Ministry of Finance of the Global New Bonds representing the New Bonds.

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

7. Article 166 of the USSR Fundamental Principles of Civil Legislation of 31 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 New Bonds in the case of any New 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 New Bonds would be given effect by a court of the Russian Federation in the case of a New Bond held by a Russian person.

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

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

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

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