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# Development of Russian commercial banks and financial crisis of 1998

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# DEVELOPMENT OF RUSSIAN COMMERCIAL BANKS AND FINANCIAL CRISIS OF 1998

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A Project

Presented to the

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California State University,

San Bernardino

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by

Anna Barc

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# ABSTRACT

This report describes the development of commercial banks in Russia and role of government and Central Bank in advance of Russian financial system. First banks appeared in late 80s - early 90s as soon as they were legally permitted using the capital created by distribution of state funds and assets and with trade operations involving natural resources. Further, banks were adapting to extremely unstable economic situations. Instability of political and economical environment determined the orientation of banks' activities on short-term profits rather then on building long-term foundation for normal functioning. In order to provide such profits, banks got involved in foreign exchange operations, short-term (up to a year) lending, governmental securities trade, and in creation of FIGs - affiliate enterprises supported by banks. Crisis of August 1998 became a sound culmination of consequences of every wrong step that had been taken by banks' management and Russian government. Today, high operating, default, and liquidity risks and governmental practices make Russian banks unsafe for long-term relationships, but likely profitable for short-term gains.

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# CHAPTER ONE

## INTRODUCTION

In recent years, foreign investors considered Russia as risky but potentially profitable market. Hedging funds and portfolio managers were actively involved in dealing with Russian governmental securities. But to successfully conduct business in any country presence of developed or at least normally functioning banks are necessary.

This research is thought to describe the current situation for commercial banks in Russia as a mirror of developing economic reforms in the country with detailed analysis of reasons and consequences of crisis of August 1998. It touches also question of money laundering that strongly affect the activities of commercial banks. This paper can be useful to not only financial majors or potential investors but also to any business entrepreneur who is thinking of doing business with Russian companies.

The data presented and analyzed in this report was collected form numerous business magazines, newspapers, and web pages in USA and Russia. No specific researches that utilize whole area presented in this report were found - the information was collected piece by piece. However, some

Russian sources are thought to be neutral and objective in their evaluations and some particularly detailed articles about specific sides like legal environment of banking industry or historical development of commercial banks, were very directing and beneficial.

Development of commercial banks in Russia was shown from historical perspective, in connections with the general progress of market reforms in the country.

Due to the large amount of the different data sources, the biggest problem faced during this research was the contradictory statistical numbers - especially for historical trends. Presented data was chosen by majority principle, as less emotional and biased data, or as imply averaged. Nevertheless, although generally all presented information is correct from author's perspective, there is a possibility of mistake in the preciseness of numbers.

## Functions of Commercial Banks

Banking crisis is long-standing inability of the majority of the banks to fulfill their obligations and responsibilities to their partners and customers. In particular, obligations of payments, responsibilities for investors and depositors of banks, bankruptcies and liquidations of banking branches and filials. More banks are involved into critical conditions of operations, harder are the consequences of such economic crisis which can affect existence of the whole banking industry of the country especially if involved are the banks with higher volumes of operation in the industry.

Crisis of 1998 was a result of external financial troubles of Russian banking system such as almost bankruptcy of the government, sharp devaluation of national currency, and break up of financial markets, as well as internal structural weaknesses: management mistakes, low level of capitalization, inadequate evaluation and estimation of risks, weak development of real banking businesses. Magnitude of losses in crisis of 1998 was estimated as 50-60% of country's whole banking system capital.[1]

Financial intermediaries facilitate the capital formation process by efficiently directing the flow of funds from lenders to borrowers. When current income exceeds current consumption desires, people tend to save the excess. Or when people deliberately lay aside part of

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[1] S. Aleksashenko. Banking Crisis: Does Fog Go Away? Questions of Economics, 5/1999.

their income in order to get higher returns in future, excess of funds created. These resources become available for investment purposes. However, coordinating savings and investing is difficult because many different participants are involved in this process. Coordinating such process is primary function of financial services industry. The major representatives of financial industry are banks.

Market-driven banks compete to attract savings by offering the highest deposit rates that are consistent with their cost structure and revenue stream. At the same time, they compete to lend to creditworthy customers by offering the lowest lending rates that will cover overhead costs and interest payments on deposits.

To write about Russian banks is challenging because Russian banks are not financial intermediaries in the Western banking glossary meaning - basic rules of banking may not apply to Russian banks. For example, changes in supply and demand on funds, interest rates, and conditions of borrowing in Russia are just barely following Western style logic. Not many economists consider banking in Russia even as separate industry or as basis for development of nation's economy.

Due to specific conditions, commercial banks in Russia were evolving as profit oriented non-production organizations. For Russian banks actual lending, especially for long-term, takes far smaller part of activities than for Western banks. They are oriented on getting profits today, not next year, and not even tomorrow. The most popular activities are foreign currency exchange and manipulations with governmental bonds.

Another specific tradition is the close relationships with clients and partners. Tell me who your friends are, and I will tell you who you are - Russian folklore idiom became the strategy among businessmen and bankers in today's Russia.[1] Relying on personal connections in business became traditional diplomacy in Russia.

Most of the functions performed by commercial banks may be divided into few categories:

- Payments - creating and efficiently transferring the nation's mean of payment. Because an efficient payment system is vital to a stable economy, banks are the essence of payment system.

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[1] The Russian F-connections. Problems of Post-Communism, Section: Formal Institutions 1/1999.

- Intermediation. Commercial banks intermediate between those who have money (savers or depositors) and those who need money (borrowers). To the savers or depositors, commercial banks offer various types of deposits that meet the needs of those customers better than alternative uses of funds. To attract depositors banks provide deposit instruments with low denomination, low risk, and high liquidity. Banks are able then to package large amount of small deposits and lend those funds to borrowers.
- Providing trust services to individuals and business firms.
- Financing international trade.
- Offering financial planning and securities related services (brokerage and investment banking related services).
- Off-balance sheet risk taking (generating fee income by assuming certain contingent liabilities); and insurance and real estate related activities.

During Soviet Era, the main functions of Central Bank and its subsidiaries were to provide stable and reliable payment transferring system and provide distribution of

State budget's subsidies. Although payment system was inefficient and slow, it was operating. Another function of the bank was to help enterprises to meet the targets for output and investment that had been laid down in the government's annual plan for the economy. The Bank performed this function by putting at the disposal of the enterprises the necessary amount of credit to realize the "planned" transactions.

Other functions did not exist at all or were provided through Central Bank with governmental central control. Both prices and credits served primarily as accounting tools. Enterprises paid each other by instructing the Bank to affect a transfer from one deposit (or overdraft) account to another, and the Bank would - more or less automatically - permit overdrafts to accumulate. Plan prices were state-determined and were adjusted very infrequently. Interest rates, which were also changed infrequently, bore little relation to the return on capital. The system left no role for profits as a motivating factor.

Although banks in Russia were always present, history of commercial independent banks has started just recently. In the country where planned economy existed for a 70 years and Central Bank's functions were mostly to control payments transfers; development of commercial independent banks was interdependent with development of market economy reforms.

## Personal Connections

Coordinating movements of the securities from lenders to borrowers may have form of direct or indirect transfers. Direct transfers - face-to-face negotiations - considered inefficient from point view of Western style banking because of the additional costs incurring during process of matching needs of borrowers and lenders. From Russian point view, it is primary duty of bank's top officials to search for trustable and reliable clients.[1]

In an economy where nonpayment of debts is contagious, there is no tradition of loan repayment and there is no legal recourse for defaulting on a loan because of the Soviet practice of subsidies. Under these circumstances, the F-connection serves as a minimum protection against irresponsible borrowers and dishonest dealers. Reacting to the risks of lending, many banks concentrate on a few well-

[1] The Russian F-connections. Problems of Post-Communism, Section: Formal Institutions 1/1999.

known customers, develop very close patron-client relations, and remain suspicious toward outsiders.

Relying on personal connections in business became traditional tactic in Russia. If one would ask today's Russian bankers and businessmen about the early days of their careers, businessmen would refer to personal connections: friends or relatives invited them to work, a family member telephoned a manager to refer them as potential candidates for vacant positions, or former colleagues recommended them to bosses.[1] New Russian businesses reconnect friends, classmates, former coworkers, and extended families. Russians believe their tradition of heart-to hard conversations is superior because it builds trust, makes people be involved and interdependent with each other, and creates usually long-lasting relationships.

The network of personal connections known as blat provided access to information and resources. The pattern of krugovaya poruka -circular support and responsibilities - ensured an interconnected cover-up of activities, including illegal ones. Patron - client relationships are nurtured by the risks of doing business in Russia. Groups,

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[1] The Russian F-connections. Problems of Post-Communism, Section: Formal Institutions 1/1999.

or clans, or gruppirovkas, function as cooperatively organized entity pursuing its own interests.[1]

Personal connections provide security and certainty of business. It is very important for such groups to have support or be connected to powerful businessman or leader. From another side, as good as it gets to have powerful friends, strong connections, and to belong to respected group, as much dangerous it became to interfere with other clans' interests.

Though profitable, banking in Russia is a dangerous business. Armies of security guards are no guarantee against hostile competitors and criminals. The president of one bank stated: "Nothing can save one from a contract killer, and anything less than the security service of the president of a country is ineffective." As an alternative, he suggested personal connections as a reliable means of protection. Another bank founder and president prided himself on his access to a large social network, regarding it as a guarantee against the collapse of his bank. He said: "If you ask me now to name all my friends and

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[1] The Russian F-connections. Problems of Post-Communism, Section: Formal Institutions 1/1999.

acquaintances, I can give you 10,000 names - who, where, and why. All this information is in my head."[1]

Bankers and leading Russian businessmen prefer to speak in plural of themselves - "we", rather then "I." Bankers describe their commercial space as a "village," in which everyone knows everyone else, and where business deals depend on evaluations of people as well as projects. In the words of one of the businessman: "Much business is done on intuition and on the knowledge of the personal qualities of your partners. If an intelligent, wise as Solomon, Muscovite takes my position; he would not accomplish what I can. He does not know the specifics of St. Petersburg, of its banks, of the people behind these banks... St. Petersburg is a small town for us. Moscow is the same for Muscovites: everyone knows each other, although the population there is twice as large.[2]"

Moscow became a central point where all biggest deals are made, capital of Russian capitalism. The city makes up to six percent of Russian population, but attracts two-

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[1] The Russian F-connections. Problems of Post-Communism, Section: Formal Institutions 1/1999.

[2] The Russian F-connections. Problems of Post-Communism, Section: Formal Institutions 1/1999.

thirds of foreign investment and provides 24 percent of the country tax revenue. Majority of Russian banks are Moscow-based.

# CHAPTER TWO

## DEVELOPMENT OF BANKING INDUSTRY

### 1985 - 1991: First Private Capital

In 1985 perestroika movement was thought to modernize the Soviet system of production and distribution by opening Russia to the world market with intentions of introducing advanced technology, to diversify the Soviet economy so that it would be less dependent on sale of raw materials, and raising the basic standard of living. Government permitted opening of private companies and allowed direct dealing with foreign firms without central control and intervention.

The best and easiest way to earn money in end of the 80s and early 90s was to buy materials such as metals or oil at low, state-controlled prices in Russia and then resell them abroad at world prices. In early 1990, for example, the Moscow free-market price of a package of Marlboro cigarettes was 30 rubles - exactly the same price as a ton of crude oil.[1] In 1988, state enterprise managers

[1] Russian Corruption And Money Laundering (L.H. Summers). FDCH Congressional Testimony, 9/21/99.

were allowed to set up private cooperatives for arbitrage with "their" government-owned businesses. Managers of state oil companies bought oil from their enterprises privately, obtained export licenses and quotas from corrupt officials, and sold the oil abroad at the market price.[1] This situation created opportunities for quick fortunes to be made by those who were able to purchase oil domestically and then resell it overseas. From different sources, from 30 and up 60 percent of GDP was lost in this type of business in 1990 - 1992. In 1992, the Russian price of oil was still one percent of the world market price. Eventually, after 1992, the reformers succeeded in deregulating commodity prices, but only after few managers had extracted billions of dollars from their state enterprises.

Another way of making big money in this period was through food - import subsidies. Slowdown of internal production of food and agriculture products in the winter of 1991-92 caused the reformers inability to cancel the existing subsidies for food. A food importer paid only one percent of the going exchange rate when purchasing essential foods from abroad, but could resell them

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[1] Winner Takes It All. Foreign Affairs, 9/1/99.

relatively freely on the domestic market and pocket the subsidy.

These imports were paid for with Western "humanitarian" export credits that were added to Russia's state debt. Total import subsidies were 17.5 percent of Russia's GDP in 1992. These profits were highly concentrated, benefiting a limited number of traders in Moscow who operated through the old state agricultural monopolies.

Altogether, the gains from these two business activities amounted to no less than 79 percent of GDP in 1992. Most of the profits, billions of dollars, were highly concentrated among a small elite - tight inner circle of governmental officials, their friends, and relatives who had access to useful resources and information. Inside information, insider lending, and insider privatization were the key tools of this distribution.[1]

Before perestroika the banking system in Russia consisted of Central Bank and its regional branches and few government controlled specialized banks. Functions of Central Bank were to provide payments system, accept

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[1] Winner Takes It All. Foreign Affairs, 9/1/99.

savings from people, and print additional money to cover budget deficit when government spent more than it was supposed to. Central Bank had specialized branches, such as Sberbank - Savings bank that accepted deposits from people, Vneshtorgbank - state trade bank, and Vnesheconombank - bank that dealt with international operations of Russia. Less important branches included Selhosbank that served farms - kolhoz- and agricultural organizations; Industrial bank - served production companies especially in natural resources, heavy machinery and equipment industries. Securities markets were virtually absent.

The recent monetary history of Russia begins in the late perestroika period, when the Central Bank printed vast quantities of money to finance an out-of-control budget, while the government used strict price controls to limit inflation.

By the end of 1991, when the Soviet Union became Russia and Boris Yeltsin declared the disbandment of Communist Party, there were about five times as many rubles in circulation as were needed to finance national income.[1] Presence of money excess not supported by appropriate

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[1] When Property Is Theft. Reason, 12/98.

quantity of goods called for hyperinflation, long lines, and empty stores that symbolized that period. Before reforms, during Soviet era, people were allowed to save but not to invest. Investment as an option of money managing did not exist at all. People were trying to save for retirement by laying aside part of their wages. During the hyperinflation of 1992-1993 most of these savings were simply lost. For example, money that would have bought a cottage in south would now buy a winter coat. Money saved by a pensioner to pay for the burial would buy only a candle.

### 1991 - 1994: Growth

This period can be characterized by explosion of new banks: the number of registered credit organizations rose from 1,700 to 2,600. It can be explained by low requirements of starting capital and by attraction of banking business due to high profitability potentials of high inflation and continuous fall of the ruble. In early 1991 Russia transformed all 900 regional branches of specialized government banks on its territory into independent banks, the banking business became the first evolved market with a competitive structure.

Absence of legal regulations and lack of professional experience of operating commercial banks caused opening of commercial banks almost on each corner of the streets. Even as late as in 1993 the capital requirement to set up a bank was about $100,000 - giving new Russian entrepreneurs a choice between buying a luxury apartment and opening a bank (from 1999 - the minimum capital requirement is set at ECU 3 million for new banks and ECU 1 million for existing banks).[1]

For the new banks to discover that taking deposits from savers and making loans to businesses was not the quickest way to get rich did not take much time. A much more profitable strategy was to attract Central Bank's credits at interest rates well below the rate of inflation, invest the proceeds in hard-currency assets, and pay off the credits later in devalued rubles. Under Soviet system, interest rates had no economic function and were fixed at three percent per year by Russian Central Bank. Even in 1992, when inflation was at 1,500 percents, Central Bank continued to give away 10-25% interest rate loans. In 1992

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[1] The Financial System In Russia Compared To Other Transition Economies: The Anglo-American Versus The German-Japanese. Comparative Economic Studies, Spring 1999.

alone, the net credit issue of the Central Bank was 32 percent of GDP.[1]

For the first years of commercial banks existence, Central Bank's low interest rates credits substituted the savings deposits. There were no particular interests in having such anchor - private accounts; banks were opening accounts just because they supposed to.

In addition to the fall of ruble and government loans, other sources of profits were "free" uses of resources on the accounts of the industrial enterprises. Resources of banking system were formed from money of the enterprises that in 1994 accounted of 35% and in 1995 - 24% of banking passives, which excided several times deposits of the population.

The first major act of economic reform, on January 2, 1992, was to decontrol prices. President Boris Yeltsin and Prime Minister Egor Gaidar introduced so-called "shock therapy". They presented it as initial step toward macroeconomic stabilization and privatization of the economy and claimed that, although the process would be very painful, the situation would begin to improve in six -

[1] Winner Takes It All. Foreign Affairs, 9/1/99.

nine month. Given the huge excess of money supply, the price levels were jumping, rising by 245 percent in January 1992 alone. If no new money had been created, inflation would soon have run out of steam. But inefficient state industries, which fail to rationalize their production processes and labor distribution, began complaining that they didn't have enough cash to stay in operation.

It also was proved politically incorrect to hold the levels of wages and pensions. Number of people living below poverty line increased unexpectedly high; economic strikes followed one after another, disappointed people, especially elder, turned back to support Communist Party. The reformers gave up. Viktor Gerashchenko, head of Central Bank, turned an unavoidable one-time jump in the price level into continuous hyperinflation. Gerashchenko stayed in charge of the Central Bank until October 1994, during which period the annual rate of money growth never fell below 200 percent. Under Gerashchenko, the Central Bank had been willing to print enough money to cover the gap, but if progress was to be made against inflation, something else had to be done. There were three options: to cut spending, to increase taxes, or to borrow.

The first Russian reform governments, headed by Egor Gaidar and Viktor Chernomyrdin with Viktor Gerashchenko as Head of Central Bank, had bridged the budget deficit with funds borrowed from the Central Bank - by printing money as needed. Although everyone involved understood that this was inflationary, there was simply no alternative.

By June 1992, when the first phase of market reform was officially over, it had failed to accomplish the regime's main goal. Inflation raged and inefficient enterprises continued to operate. Political pressures and successful maneuvering by the main economic participators managed to deform and distract real market reforms.[1]

But government rushed with implementation of second step of reforms - privatization. The minister of privatization Anatoliy Chubais hurried with distribution of public property. Millions of privatization vouchers were distributed to the public at large, one for every man, woman, and child. These could be exchanged for stock at auctions of state enterprises. But the vouchers turned out to be worth less than $20 each. Most people either sold them immediately, investing the proceeds according to their

[1] Empire Envy And Other Obstacles To Economic Reform In Russia. Problems of Post-Communism, 6/1998.

tests or needs, or else placed them with fraudulent voucher pyramids masking themselves as legitimate mutual funds. In the end, the shares purchased with vouchers mostly ended up in the hands of the same former communists, government officials and other used-to-be-rulers and now businessmen who benefited from other quick but profitable forms of businesses.[1]

Although idealistic ideas that voucher privatization would lead to a broad-based people's capitalism turned to dust, but in it's own terms privatization was a success. In just two years, from early 1992 to early 1994, 104,000 state enterprises were privatized. At the end of this period the private sector accounted for more than 50 percent of GDP and some 60 percent of employment.[2]

In the largest and most attractive Russian companies with high market liquidity, outside investors by now owned more shares than workers and managers, and this pattern was likely to emerge in other companies, whose shares were not yet traded in the market and which were still controlled by work collectives. In the large, but not the largest,

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[1] When Property Is Theft. Reason, 12/98.

[2] When Property Is Theft. Reason, 12/98.

privatized Russian companies outsiders owned in 1996 only 31% of shares, with 59% of shares belonging to insiders and 9% to the state, while in the 100 largest Russian companies outsiders owned on average 57% of all shares (insiders - 22%, the state - 21%).[1]

At that period there were also lots of speculations in the press where institutional investors, namely banks, gained strength after the "shares for loans" auctions—sales of the most profitable pieces of government property to the highest bidder that started in late 1995, and did not involve any concessions to the work collectives. Several major banks received—as a collateral for credits issued to the government—large blocks of shares of non-financial companies (Menatep bank won 78% of shares of Yukos—the second largest oil producer, Oneximbank got 38% of the shares of Norilsk Nickel, etc.).

By the end of 1996 the newspapers were writing about the group of five-seven banks that control a good half of the Russian economy. The largest group, Oneximbank, in 1996 reportedly controlled several banks with total assets of

[1] The Financial System In Russia Compared To Other Transition Economies: The Anglo-American Versus The German-Japanese. Comparative Economic Studies, Spring 1999.

some $ 5 billion and few industrial enterprises with sales of about $ 9 billion. The second largest, Menatep, had banking assets of about $2 billion and held control over enterprises with sales of about $6 billion. This is obviously a significant proportion of national economy (1995 GDP was $ 364 billion).

In Russia, similarly to other post-communist economies, commercial banking became one of the few growing sectors - it expanded even in the middle of the recessions, hiring new employees and opening new offices. The GDP created in banking, finance and insurance grew by 57% in 1991-94, while the total GDP decreased by a good 35%. However, this increase was largely due to the growth of operations other than issuing credits to the enterprises.[1]

Russian banking activity until recently was concentrated in processing payments, not in attracting deposits and issuing credits. Back in Soviet times total bank credit to enterprises exceeded half of GDP, with long term credits alone amounting to 12% of GDP. After deregulation of prices in 1992, the demonetisations of the

[1] The Financial System In Russia Compared To Other Transition Economies: The Anglo-American Versus The German-Japanese. Comparative Economic Studies, Spring 1999.

economy proceeded surprisingly quickly: total bank credits outstanding fell to about 10% of GDP by the end of 1996, while the long term credits shrank to less than 1% of GDP. By the end of 1997 total net assets of Russia's banking system amounted to only about $100 billion, less than that in Luxembourg or Singapore. When the possibility of a bank crisis was discussed in the summer of 1996, a frequently made argument was that the total bank assets are so small compared to the size of the economy that even the collapse of major banks would not become a disaster. [1]

Banks' focuses on individuals fluctuated widely during 1990-1997: the share of personal deposits in banks stood at 50 to 60% in the 1980s, decreased to below10% in late 1992, and then increased to over 40% by the end of 1996. Enterprises' cash and bank deposits went down from the highest point of 28% of GDP in late 1992 to only 4% of GDP by the end of 1996.[2] Initially, in 1992-94, newly created weak banks survived only because they were able to get huge credits from the CBR—Central Bank of Russia.

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[1] The Financial System In Russia Compared To Other Transition Economies: The Anglo-American Versus The German-Japanese. Comparative Economic Studies, Spring 1999.

[2] The Financial System In Russia Compared To Other Transition Economies: The Anglo-American Versus The German-Japanese. Comparative Economic Studies, Spring 1999.

Table 1. Balance Sheet of Commercial Banks in 1992, Billion of Rubles

| ASSETS | 1-Jan | 1-May | LIABILITIES | 1-Jan | 1-May |
|---|---|---|---|---|---|
| Credits: short-term | 395 | 850 | Founding capital | 43 | 76 |
| Credits: long-term | 40 | 50 | Deposits (rubles) | 315 | 475 |
| Inter-bank credits | 15 | 25 | Deposits (foreign currency) | 3 | 390 |
| Cash | 5 | 7 | Loans from banks | 190 | 460 |
| Correspondents account | 130 | 110 | Government loans | 45 | 110 |
| Foreign currency | 5 | 445 | Others | 34 | 154 |
| Precious metals | 0 | 10 | | | |
| Others | 40 | 168 | | | |
| Total | 630 | 1665 | Total | 630 | 1665 |

Table: The Financial System In Russia Compared To Other Transition Economies: The Anglo-American Versus The German-Japanese. Comparative Economic Studies, Spring 1999.

Commercial banks formed out of regional branches of specialized banks acted in fact as "channel banks": a good part of their liabilities were credits from CBR intended for specific industrial enterprises. To be eligible for such a centralized credit an enterprise was supposed to apply to the respective industrial department. If the application approved, the CBR issued credit to the commercial bank from which the enterprise was willing to get this credit. Normally, these were ex-specialized banks providing services to that particular enterprise before transition and continuing to do so afterwards. In late 1992, CBR's credits to commercial banks amounted to 30-40% of total credits outstanding to enterprises and to over 50% of total credits of "channel banks". For "channel banks" these CBR credits were more important sources of funds than deposits of enterprises and households and interbanking credits.[1]

On the asset side of the balance sheet, the most impressive disproportion was the high share of total assets invested in hard currency (at that time the rapidly growing exchange rate of the dollar in rubles provided greater real returns than interest charged on ruble credits). Russian commercial banks were mostly borrowing long-term and lending short term: long-term loans constituted only a very small portion of their total assets.

Later the CBR stopped issuing credits to enterprises through commercial banks, inflation slowed down and the share of assets invested in hard currency decreased. However, these changes only revealed the real structural weaknesses of the Russian banking sector. It turned out

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[1] The Financial System In Russia Compared To Other Transition Economies: The Anglo-American Versus The German-Japanese. Comparative Economic Studies, Spring 1999.

that bank services to enterprises were more centered not on accepting deposits and issuing credits, but on processing payments.

The lion's share of activity of Russian banks has to do with processing payments, which is a sharp contrast to the operations of the Western banks - the share of liabilities in the form of processed payments in Russian banks was over two times higher. Banking operations per se—accumulating deposits and issuing credits—was only a small visible part of the iceberg, whereas about 70% of total liabilities and about 50% of assets were engaged in operations of clearing payments.[1]

## Development of Commercial Banks in 1995-1996

Since 1995, the government has pursued a "forced lending" policy of not paying workers and pensioners on time. This was intended to satisfy the IMF's budget-cut targets: it's easier to "borrow" from workers and pensioners than to collect taxes from the wealthy and well connected. By the end of 1997, a quarter of workers had not been paid in at least six months--the government had $10

[1] A Pile Of Ruble. The New Republic, 9/7/1998.

billion in unmet wage obligations, it owed another $12 billion in back pensions, and it had yet to collect some $21 billion in back taxes. But this strategy worked – the Federal government deficit fell from 11 percent in 1994 to 5 percent in 1995.[1]

The growth of the internal public debt derives from a 1994 decision by Boris Fedorov, Minister of Finance, to stop financing the budget deficit with loans from the CBR. The traditional method of printing money finally proved to be inflationary and not acceptable anymore. Although there were high numbers of operating banks, banks' sizes and capitalization made them incapable of making large loans to government. In addition, foreign investors were not optimistically inclined to lend but were ready to buy issued by government securities.

The IMF and Western advisers endorsed Fedorov's method of financing the budget deficit by issuing governmental securities. During 1995 the market for Russian Treasury bills (GKOs) and bonds (OFZs) began to grow. This enabled the CBR to pursue a tighter monetary policy. As a result, the inflation rate declined and the ruble exchange rate

[1] A Pile Of Ruble. The New Republic, 9/7/1998.

stabilized. Moreover, as a consequence of reducing inflation, the nominal rate of interest on government securities also declined, which helped national finances. The nominal interest rate fell from 95 percent in September 1996 to about 20 percent in the summer of 1997.[1]

Also by early 1995, under the new leadership of Sergei Dubinin, the Central Bank began to apply conservative monetarist methods. Inflation steadily slowed. When the disinflation effort began, government expenditures at all levels accounted for more than 40 percent of GDP, a higher figure than in the United States or Japan, and very high indeed for a country of low income level. Tax revenues were over a third of GDP, but were not high enough to prevent a budget deficit of more than 7 percent of GDP.[2]

When inflation slowed, machinations with cheap loans stopped bringing as much profit as it used to, but another way of getting high earnings took place. By 1996, Russian government bonds were paying interest rates of up to 100 percent per year, double or triple the inflation rate.

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[1] The Russian Financial Panic and The IMF. Problems of Post-Communism, September-October 1998.

[2] When Property Is Theft. Reason, December 1998.

Banks became the largest buyers of Russian government debt, still financing some of their purchases with cheap government credits but increasingly also borrowing dollars and German marks on international financial markets.

Such schemes made the banks so rich and powerful that those five - seven banks that raised on food subsidiaries and natural resources schemes became to be described as "oligarchs," widely perceived to have dominant influence over the Russian government. Unfortunately, along the way, the banks failed to develop true financial customs. Instead of being used for loans to businesses, all available funds were invested into the government debt market.[1]

As it was already said, the loans-for-shares deals at the end of 1995 were a scandal that damaged reputation of Prime Minister Anatoli Chubais and paled the significance of privatization. A few large banks were allowed to privatize some large enterprises in auctions they themselves controlled. Several huge cash cows of oil export business changed hands, most notably three big oil companies: Yukos, Sibneft, and Sidanko.

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[1] When Property Is Theft. Reason, December 1998.

No qualitative change accompanied these takeovers. The new majority owners did not behave like self-interested proprietors but just continued to manage with orientation on instant profits, primarily by selling the products below market prices to their own trading companies, letting the old state companies corrupt. After a short-lived boom, these companies' values fell below their low purchase prices. For instance, Norilsk Nickel, the large metal company, was long worth less than what Oneximbank paid for it in a 1995 noncompetitive deal. In 1998, the big new "capitalists" showed yet again that they could not care less for the market value of their enterprises. Many minority shareholders responded by selling off their holdings. The Russian stock index consequently drove down 94 percent from its peak in 1997.[1]

Financial-Industrial Groups

Since 1995, large industrial and commercial enterprises have created close ties with the leading banks. This was a common strategy in the Soviet era and was a reasonable response to current pressures. Mergers through interlocking shareholdings and directorates allowed having

[1] Winner Takes It All. Foreign Affairs, 9/1/99.

greater control of assets through the development of assets, equity, and personal ties. The creation of financial-industrial groups (FIGs) allowed key players to go around, co-opt, suspend, or eliminate market ties and to control competition, conditions that could increase chances of survival for the incorporated financial institutions and firms. By owning industrial firms, banks were receiving guaranteed customers and tax havens, could reduce uncertainty in lending, and expand enterprise revenue for short-term financial dealings. Fears of an anonymous market produced this strategy.

These new conglomerates (Financial-Industrial Groups or FIGs) have begun to form, seeking to vertically integrate all stages of the production process. The most powerful FIGs controlled large parts of the most profitable sectors of the Russian economy - those relating to natural resources, especially to oil and gas - the result of a deals to secure support for Yeltsin in the 1996 presidential elections. The key figures in the FIGs have become exceedingly wealthy, buying up the Russian media, and becoming increasingly involved in political decision-making processes. The importance of seven leading banking figures has led them to be called the 'oligarchs', a term which reveals their influence.[1] As of now, President Putin is closely investigating operations of "oligarchs" and connected to them businessmen - top managers of that period are now under arrest or giving testimonies.

Lack of parliamentary control over government and the presidential apparatus has allowed the relationships between financial figures and state officials to become a revolving door. Boris Berezovsky, head of the LogoVAZ combine, was rewarded for bankrolling Yeltsin's 1996 election campaign with a key position in the Security Council - a body frequently referred to as the functional equivalent of the old Politburo.

Other politicians have found themselves comfortable positions as directors of FIGs. In addition, criminal groups (mafia) also exercised a growing influence, pocketing substantial resources that were not productively invested or channeled to the state in the form of tax revenue.[2] But even after the creation of bank-based FIGs, it did not appear that banks were becoming long-term strategic stockholders of production-oriented companies.

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[1] Russia's Crisis. Capital and Class, Summer 1999.

[2] Russia's Crisis. Capital and Class, Summer 1999.

## Capitalization of Banking Industry

In 1995-97, when inflation was finally brought down to reasonable levels, part of the banking activity associated with processing payments decreased considerably. The other major change was the sharp rise of the share of government securities in total banks' assets (over 20% of total assets in mid 1997) - partially at the expense of the reduction of the share of bank credits to businesses.

By the end of 1996 Russia had over 2,600 banks (about 500 of them were not operating though), by the end of 1997 - 1675 operating banks and 22 other credit institutions (including 730 with capital less than ECU 1 million).

The concentration in the Russian banking sector was very low. As of January 1, 1997, in Russia the share of the largest 5 banks in total banking assets was only 33%, whereas in western economies it is within the range of 57-79%. By the beginning of 1997 the average bank had only 2 branches (if Sberbank with its branches across Russia is excluded) and the registered capital (equity) of less than $500,000. There are no "big three" or "big four" nation-wide banks. The largest Russian bank—Sberbank (former state Savings bank still controlled by the CBR) accounted for 13%

of total credit outstanding, while the ten largest banks accounted for only 1/3 of total credits. Only two Russian banks had assets of over $5 billion and capital of over $500 million by early 1997.[1]

Also, banks virtually stopped the financing of capital investment. Total bank credits outstanding in relation to GDP declined steadily. In 1992 they ensured the financing of only 10% of total capital investment, in 1993 - less than 6%, in 1995-96 - less than 1%, i.e. an amount comparable with equity financing. No less important, long term credits (over 1 year term) amounted to only 5% of total bank credits and did not play any significant role in the financing of capital investment. In late 1996, when inflation was already under control, interest rates on bank credits to industry still stood at a level of about 100%, higher than the rates on inter-bank credits, the CBR rate (about 50%), the returns on GKOs—government treasury bills 30%), and much higher than the rates of return in industry itself.[2]

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[1] The Financial System In Russia Compared To Other Transition Economies: The Anglo-American Versus The German-Japanese. Comparative Economic Studies, Spring 1999.

[2] The Financial System In Russia Compared To Other Transition Economies: The Anglo-American Versus The German-Japanese. Comparative Economic Studies, Spring 1999.

Table 2. Assets, Registered Capital, and Credits of 10 Largest Russian Banks as of January 31, 1996

Legend for Chart: A - Bank
B - Assets, trillion rubles
C - Registered capital, trillion rubles
D - Credits outstanding, trillion rubles
E - Share in total credit outstanding, %

| A | B | C | D | E |
|---|---|---|---|---|
| Sberbank | 256.5 | 15.3 | 31.9 | 13 |
| Vneshtorgbank | 27.9 | 6.1 | 8.1 | 3 |
| Inkombank | 22.2 | 2.0 | 7.7 | 3 |
| ONEXIMbank | 20.6 | 2.9 | 10.6 | 4 |
| Mosbiznesbank | 17.7 | 1.0 | 3.1 | 1 |
| Rossiyskiy Credit | 16.3 | 1.2 | 2.5 | 1 |
| Tokobank | 14.5 | 1.1 | 3.3 | 1 |
| Stolichniy Bank | 13.9 | 1.3 | 2.5 | 1 |
| Sberezheniy Menatep | 12.2 | 1.0 | 7.8 | 3 |
| Natsional'niy | 11.2 | 1.6 | 2.2 | 1 |
| Total | 413.0 | 33.5 | 79.7 | 33 |

Table: The Financial System In Russia Compared To Other Transition Economies: The Anglo-American Versus The German-Japanese. Comparative Economic Studies, Spring 1999.

Markets for corporate securities were only emerging, and only large companies could classify for equity and bond financing. Nevertheless, it seemed like these sources of investment financing for large companies were already more important than bank credits. Total volume of trade in shares in 1995 (mostly OTC) was estimated at about $5 billion - 1-2% of GDP or 25% of market capitalization. And market capitalization as well as the volume of trading increased threefold in the second quarter of 1996 after stock prices soared on the eve of presidential elections, and twofold - in late 1996 and early 1997 - after Yeltsin recovered from heart surgery. Estimates for 1996 put the total market capitalization at $50-55 billion (13% of GDP) and the volume of trade in shares—at 40-70 millions a day, or $13 billion annually (3-4% of GDP).[1]

Banking Crisis of Year 1995

Activation of business life and increase of values in market capital provoked banks to lower their already weak security measures. The share of bad loans rose from 32% in 1994 to 37% in 1995 and to 45% in the first quarter of 1996.[2] The banking crisis of August 1995 was a logical result of the foolish credit policy of many banks that lent money without collateral or good guarantees. Russian government had to make state debt more attractive as an investment for the private sector.

When the ruble was in danger of falling for the first time, the interest went up to as high as 200 percent. Because of high interest rates, most of the private banks had their assets in rubles, not in dollars. So, by the

[1] The Financial System In Russia Compared To Other Transition Economies: The Anglo-American Versus The German-Japanese. Comparative Economic Studies, Spring 1999.

[2] The Financial System In Russia Compared To Other Transition Economies: The Anglo-American Versus The German-Japanese. Comparative Economic Studies, Spring 1999.

spring of 1995, majority of commercial banks were loaded with bad debts and, to function, they had to be net borrowers on the money markets. About 90% of Russian banks had less than 100 billion rubles in equity and, thus, were very sensible to market changes.

In April 95, one of the big banks, MMKB, stopped to pay its debts. This bank was one of the biggest borrowers for about two months and after it went bankrupt, it was in debt for several thousand of billions of rubles.

In the summer 1995, when debts of those banks that became borrowers after the spring events increased enormously, banks started to decrease or close credit lines to each other. That led to bankruptcy of several small banks, as well as two well-known banks - Lefortovsky and National Credit. Two weeks after that the markets became so nervous that one small rumor of something else going wrong was enough to crash the whole system.

A technical glitch in Mosbusinessbank became such a thing. Their computers went down one day preventing the bank from making payments to anybody. Next day they had to pay with penalties but a wave of delay of payments was already triggered. Almost nobody paid, as everybody preferred to wait and rather pay later with penalties, than to pay to on time and not get the money from a counter party in return.

Interest rates on ruble money markets reached 1000-1500% for overnight deposits and 50% for USD denominated deposits, but there were no lenders. In two or three days, the Central Bank tried to increase the liquidity in the markets by placing its deposits with the biggest of the commercial banks and by massively buying government bonds. This measure helped the markets, but not the banks. Customers, hearing about problems in their bank, rushed to transfer money out.

When the state debt pyramid did collapse, the banking system also collapsed. Most of the banks lost most of their assets, so they were not able to pay their customers.[1] A lot of money accumulated in forms of so-called financial capital - state debt, state bonds - that didn't go into production but were recirculating in the banking system.[2]

That was the week that changed the psychology of bankers in Russia. It took half a year to reestablish links between banks and set clean credit lines again. But

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[1] On The Russian Collapse. Multinational Monitor, 10/1998.

[2] On The Russian Collapse. Multinational Monitor, 10/1998.

attitude to risk became much more serious. Another result of the crisis was the fact that bad banks either disappeared or their names became well known. The crisis led to reduction of 2,500 commercial banks to about 2,300 in January 1996. The state-owned Sberbank, by far the largest with a capital base of $1.3 billion in 1996, ranked below the worlds top 500 banks. Most Russian banks were much smaller. About 80% had capital of just $1 million or less, and only 4% had capital greater than $5 million.

Persistent high real interest rates meant that borrowing costs remain high, and little lending took place on terms of more than 30 days. Interbanking lending rates rose sharply following an August 1995 liquidity crisis and reached 120% in June 1996. Commercial lending was still a small share of business, and long-term lending—in Russia meaning anything over one year—accounts for less than 8 % of all credits. Most businesses were concentrated in projects and trade finances, trading in various types of securities, and foreign exchange dealings.

The new commercial banking law, effective in January 1996, permitted foreign banks to establish full-service subsidiaries in Russia, though it allowed the Central Bank to use mutuality as a criterion for granting approval.

Republic National Bank of New York took advantage of the new law to obtain a license and begin full-service operations in September 1996.

On May 16 1996 the Central Bank announced that the ruble exchange band, which since January 1996 had been set between 4,550 and 5,150 rubles per dollar, would be replaced with a crawling-peg mechanism, with parameters that would shift gradually from 5,000 to 5,600 rubles per dollar on July 1 and then to 5,500 to 6,100 rubles per dollar by the end of 1996.

1997: Stability

This year was the most stable year during reforms. Banks were counting wounds and accumulating new strength, government was spending IMF loans, and businesses were enjoying soft economic and financial constraints.

Main characteristic of this period was the fast growth of banks' investments into governmental obligations: from 1996 to 1997 the volume of such investments had tripled. Volume and technology of investments into governmental obligations allowed the participants of this market to quickly and almost without expenses to turn their obligations into highly liquid and profitable governmental instruments. The election company of 1996 and constant need of the government in "live" cash guarantied high interest rates that were unmatched with current inflation rates and economical indexes. Russian banks become active buyers governmental obligations denominated not only in rubles but also in dollars and other foreign currencies. Governmental obligations become the major source of revenue for banks: in 1996 the revenues on such obligations were 40% of all banking revenues, in 1997 - 30%.[1]

Mr. Fischer, former economics professor at Massachusetts Institute of Technology and No. 2 at the International Monetary Fund, and Mr. Summers, a former economist at Harvard and No. 2 at the US Treasury termed 1997 as "a year of achievement." They noted "dramatic progress - toward stabilizing economy and integrating it more closely with the global economy." What they referred to was a stable exchange rate for the ruble and lower inflation - 11 percent in 1997, down from 35 percent in 1996 and from 2,500 percent in 1992. Further, according to

[1] S. Aleksashenko, Banking Crisis: Does Fog Go Away? Questions of Economics, 5/1999.

them, the Russian financial markets survived the East Asian crisis, though not without some troubling days.[1]

Both economists also ranked getting its tax collection system in order as Russia's No.1 economic problem. Russia collects taxes equal to about 10.8 percent of gross domestic product, its total output of goods and services. That is far less than the 19 percent of GDP collected by Washington. But Russia's government spending amounts to 18.5 percent of GDP.

After six years of decline, output was up a bare 0.3 percent last year, but it was positive. One estimate finds 70 percent of Russian economic activity accounted for by private enterprise. For all its imperfections, the private sector has "become the major agent of economic growth and change." Money that was flowing out of Russia has apparently been flowing back. Russian banks become active participants in activities of external markets. Stability of ruble, low interest rates of external markets, and almost absence of internal savings pushed banks to borrow big time and borrow from foreign investors.

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[1] Russia: Progress at Last. Christian Science Monitor, 1/20/98.

Year 1997 was also characterized by excessive inflow of foreign portfolio investments. In 1997, they amounted $46 billion or over ten percent of GDP - far more than Russia could absorb. The consequences became evident on August 17, 1998, when Russia suffered a cataclysmic crash. Total foreign stock ownership in Russia peaked in late 1997 at about 30 percent of market capitalization - about $30 billion, or 7 percent of GDP.[1]

By mid 1997 market capitalization was presumably at a level of $100 billion, about 25% of GDP, whereas the volume of trading - over 5% of GDP made Russia one of the leaders of stock market development together with China and Central European countries.

In 1993-97, with short setback in summer 1995, Russian stocks definitely outperformed the stock markets in East European countries. In summer and fall 1994 the demand for shares of major Russian companies increased greatly (mostly due to the inflow of foreign capital), and the stock prices skyrocketed for the first time. Later, the stock market remained slow due to the Chechen war and political uncertainty in the country, but in April - June 1996 stock

[1] Winner Takes It All. Foreign Affairs, 9/1/99.

prices increased again about 3 times in real and dollar terms anticipating and then welcoming Yeltsin's victory in the presidential elections.[1] Investing in Russia was a fad for hedging funds, which enjoyed high returns in 1993-1994 on Russian securities.

By the end of 1997 the quantity of channels and bridges linking Russia with the global financial system had increased significantly. The credit and investment sphere was the principal source of these ties. According to various estimates, the aggregate share of foreign capital in the Russian banking system had reached 5.6-8% by the beginning of 1998, given a legal limit of 12%.

Russia has been attractive for large amounts of capital investment. Direct investment, even through Russia banks, reached nearly $3 billion in 1997, which is actually less then 2% of the world market of capitalization ($300-320 billion a year). At the end of January 1998, the Economics Ministry reported that the list of foreign investors ready to invest in Russia looked something like the following: Exxon, MacDurmet, Sodeko, and Shell - $28

[1] The Financial System In Russia Compared To Other Transition Economies: The Anglo-American Versus The German-Japanese. Comparative Economic Studies, Spring 1999.

billion (in Sakhalin); Pepko - $23 billion (Yakutia); a consortium of European banks and firms - $14 billion (a gas pipeline from Yamal to Berlin); Domineko - $8 billion (Volgograd region); Cyprus Mineral, OPEC, and Shroeder Finance Holding - $4.7 billion (eastern Siberia); Conoco - $2 billion (the Nenets Autonomous area); General Motors - $1.4 billion (Yelabuga); United Technology, Pratt and Whitney, Rockwell Collins - $1 billion (Voronezh, Moscow, Perm); British Gas - 1 billion (Komi); British Petroleum - $700 million (Irkutsk region); and Coca Cola - $600 million (Moscow, Orel, St. Petersburg, Novgorod, Krasnoyarsk, Rostov-na-Donu). There were reports of other, less extensive projects.[1]

By 1996, there were some 200 taxes in Russia. Nevertheless, Russia's chief tax collector, Boris Fedorov, cited in August 1998 that almost 5,000 companies owed nearly $50 billion in unpaid taxes and fees. To collect that money, the government built a force of hundreds of thousands of police, where upon many underpaid and unpaid policemen began holding back tax receipts for themselves.

[1] Web Page of Ministry of Internal Business Affairs of Russia.

Tax collection in Russia is a dangerous profession. In 1996 alone, 26 tax collectors were killed, 74 wounded, 6 kidnapped, and 41 burned out of their homes. Attempts to extract even small sums of money from needy workers have produced big waves of discontent. But, in general, Tax Police began gain weight and respect. Business people started to understand that they are better off paying than hiding. The fights now are not about "to pay or not to pay", but about how much to pay.[1]

1998: Development of Crisis

As of 1/1/98, 1697 credit organizations were operating in the country. On average, on 18,500 men of population of the country there was one credit organization: bank or branch. Although majority of commercial banks issued their own stocks and commercial papers, none on them with exception of Sberbank was able to achieve appropriate liquidity of such papers and had appropriate market capitalization.

Barter

Even though previous year was stable with positive growth in GDP and massive cash inflow from foreign and

[1] The Russian Far East's Endless Winter. Orbis, Winter 1999.

domestic investors there were few negative moments that could destroy fragile success. Russia's large industrial companies were still living by Soviet era rules, not by market economy regulations. Yet few went out of business. More U.S. companies are going bankrupt during a four-week period than did Russian businesses all of 1997 year. This anomaly is made possible through the widespread use of barter. The enterprises could continue to produce goods because they had a guaranteed set of 'buyers' and because they avoid the use of money.

Avoiding money, through barter and other forms of non-monetary exchange, allows the goods to be overpriced, giving the appearance of more value being produced than is the case. These overpriced goods are then delivered to the government instead of taxes, or to value-adders, mainly energy suppliers such as the natural gas monopoly Gazprom. It continues to function by using barter and other non-monetary devices to generate products less valuable than the required inputs, while pretending to add value.[1] More than 50 percent of payments made among industrial companies and 40 percent of corporate tax payments were made through

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[1] Seeing Russia Plain. The National Interest, Spring 1999.

the exchange of actual goods and services. For accounting purposes, such exchanges can be given whatever value makes the books balance.[1]

Russia and Foreign Investors

From 1996, banks become active borrowers on the external markets and lenders to industrial enterprises. By the 1997 possibility of expanding banks' passives from internal sources almost did not existed. Leading and big banks borrowed form foreign investors with majority of such investments (80%) with repayments within one year and opportunity to prolong payment period upon agreement of both sides. Guaranteed stability of ruble and high profitability of governmental securities allowed banks to convert currency into rubles and invest into governmental obligations.

The difference between passives and actives denominated in foreign currency for commercial banks reached about 40% of volume of banks' currency obligations, which showed that there were structural disproportions in banking operations and high dependency on stable exchange

[1] Why Did Reform In Russia Fail? Wilson Quarterly, Summer 1999.

rates and currency risks.[1] Although the situation when foreign banks were lending to Russian banks in 1995-1997 presented high level of trust and positive evaluation of economical situation in the country, in 1997 these the duration of such funds was mostly up to a year due partially to the Asian financial crisis. Short terms funds pushed Russian banks to borrow even more in order to pay matured debts.

In 1998-99, Asian crisis finally reached Russia. In the first stage of crisis, Thailand's currency depreciation triggered a sudden collapse in other Asian exchange rates, causing a rash of bankruptcies among corporations and financial institutions that had borrowed heavily in U.S. dollars in the first half of the 1990s. In turn, the devaluations contributed to a slide in world commodity prices, leading currencies of other commodity producers such as Australia, Canada, New Zealand, Chile, and Mexico to fall as well.

During these two stages, Russia escaped ruble devaluation thanks to previously pledged IMF support and investors demands for high-yield Russian Treasury bonds.

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[1] A. Astapovich, D. Sipmolotov. Russian Banks in 1998: Development of Crisis. Questions of Economics, 5/1999.

But when the IMF failed to help sustain the ruble in the spring and early summer 1998 as it came under pressure from Russia's large budget deficit and first post-communist trade deficit, investors panicked.

In July 1998, foreigners held at least $25 billion of the $70 billion of outstanding Russian treasury bills - some six percent of GDP. They provided revolving credit to the Russian government easing Russian enterprises' need to pay taxes but still permitting them the enjoying government subsidies. Private and regional bond issues were even worse, with poor guarantees of repayment. The 1997 foreign investment inflow was so huge that in the early 1998 some "tycoons" concluded they had better take the money while they could.

The West has decided to allow Russian domestic banks to open operations abroad. In January 1998 70 banks had 10 branch offices and 100 representative offices in the far abroad (outside the CIS). Such expansion has begun to reveal its negative side. By the end of 1997 the total obligations of credit institutions outside Russia exceeded their assets by almost $6 billion. For comparison, in the fall of 1997 this amount was only $2.5 billion, and in 1996 their assets had actually exceeded their liabilities by

$500 million. The share of non-residents' funds in Russian inter-bank loans had increased to 60% by the beginning of 1998.

Nearly 400 foreign banks are holders and traders in the Soviet debts to the London Club totaling $32.6 billion. In the fall of 1997, as per an agreement with the Club, the debt was restructured, that is, stretched over 25 years with a 7-year grace period given the payment of the current interest ($3 billion in 1997). At the same time Russian banks tried to diversify investment portfolio by buying 10% of all debts of former Soviet Union to London Club spending 2.5 milliard of dollars in hope that restructurization will raise the its value. However, price fall started in October 1997 till December 1997 caused losses of $300 million.[1]

Europe was becoming more and more active in crediting the republics and regions, bypassing the government. Of the various Russian institutions emitting "Eurobonds" ($7 billion), nearly $1 billion was emitted by the regions. Of those emissions, 40% were acquired by investors from the US, 45% by Western Europe and 15% by investors from Asia. In 1998 16 regions expressed their willingness to come

[1] A. Astapovich, D. Sipmolotov. Russian Banks in 1998: Development of Crisis. Questions of Economics, 5/1999.

forward as borrowers on the world capital market. There has also been a lot of interest in Russian short-term bills, the value of which has reached $12-15 billion. Of these $6-7 billion were emitted by corporations and nearly $8 billion were emitted under banks' guarantees.

Dollar-denominated former Soviet debts to the private sector were publicly traded and in 1998 were worth around 8-10 cents on the dollar. It was renegotiated on very favorable terms in the early 1990s, in the hope that Russia would be booming by the end of the decade. Servicing this debt will soon become very expensive. For year 1999 repayments on the biggest category will be $1 billion, rising to nearly $5 billion by 2010. The last and most immediately sensitive category is Russia's $16 billion in Eurobonds, for which the legal penalties for default are frightful. No sovereign Eurobond has ever defaulted. Banks view Russian eurobonds as an attractive way to serve their clients. They earn commissions, and investors who like junk bonds accept the risks. Russia has to find the $500 million needed for the year 1998, and the $1.6 billion due in 1999.[1]

[1] Default Settings. The Economist, November 7, 1998.

As a result of panic following Asian crisis foreign investors started to withdraw capital from Russia, domestic businessmen were just transferring money offshore to secure accounts. Domestic banks had net foreign liabilities of around $4 billion, where a year ago they had net foreign assets of $2.5 billion.[1] In order to prevent further outflow of capital from country, Central Bank had to increase interest rates on domestic securities.

## Central Bank Policies of Issue of Governmental Obligations

One of the main reasons of financial crisis coming into existence was unbalanced practice of governmental finances. Since 1995, the process of macroeconomics stabilization - reducing inflation growth, controlling rates of exchange, and interest rates - was implemented based on hard management monetary mass. However, the problem with this practice is that at the same time budget deficit fluctuations 11.8% in 1994 to 3.9% in 1998, which causes huge instability and unpredictability of consequences of such practice for future.

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[1] Russia: The Next Domino? Forbes, June 1, 1998.

Table 3. The Federal Budget (Outcomes, Percent GDP)

| | 1993 | 1994 | 1995 | 1996 | 1997 |
|---|---|---|---|---|---|
| | According to the Ministry of Finances | | | | |
| Income | 13.2 | 14.1 | 3.9 | 2.5 | 2.1 |
| Expenditure | 20.1 | 24.0 | 6.9 | 15.8 | 5.3 |
| Deficit | 6.9 | 9 | 3.0 | 3.3 | 3.2 |
| | According to the IMF | | | | |
| Income | 13.0 | 11.9 | 12.0 | 12.8 | 10.9 |
| Expenditure | 28.6 | 22.5 | 17.4 | 20.5 | 17.4 |
| Deficit | 15.6 | 10.6 | 5.3 | 7.8 | 6.5 |

Table: The Russian Financial Panic and IMF. Problems of Post-Communism, 9-10/98.

From this table we can see that the income, expenditures, and deficit of the federal government have all been falling, but the deficit (using IMF methodology) remained high as a percentage of the GDP. In 1997 only 63 percent of federal expenditures were covered by income. As a result, the Russian government must sell securities every week to finance its current deficit and redeem maturing securities.

Table 4. State Debt of Federal Government

| | 1992 | 1993 | 1994 | 1995 | 1996 | 1997 | 1998 | Sep-98 |
|---|---|---|---|---|---|---|---|---|
| In Milliard rubles | | | | | | | | |
| Total | 43.0 | 134.0 | 490.6 | 749.9 | 1,059.9 | 1,238.2 | 1,360.9 | 2,749.6 |
| Denominated In Currency | 34.7 | 118.5 | 402.2 | 558.7 | 694.3 | 737.2 | 854.9 | 2,279.6 |
| Denominated In Rubles | 8.3 | 15.5 | 88.4 | 191.2 | 365.6 | 501.0 | 506.0 | 470.0 |
| Incuding GKOs | | 0.2 | 10.3 | 73.7 | 237.1 | 384.9 | 436.0 | 387.1 |
| GKOs as Percent To Total | 0.0% | 0.1% | 2.1% | 9.8% | 22.4% | 31.1% | 32.0% | 14.1% |
| In Milliard of Dollars | 103.6 | 107.4 | 134.4 | 161.6 | 190.8 | 207.3 | 217.0 | 171.2 |
| Denominated In Currency | 83.6 | 95.0 | 110.2 | 120.4 | 125.0 | 123.4 | 136.3 | 141.9 |
| Denominated In Rubles | 20.0 | 12.4 | 24.2 | 41.2 | 65.8 | 83.9 | 80.7 | 29.3 |
| Incuding GKOs | | 0.2 | 2.8 | 15.9 | 42.7 | 64.4 | 69.5 | 24.1 |
| GKOs as Percent To Total | 0.0% | 0.1% | 2.1% | 9.8% | 22.4% | 31.1% | 32.0% | 14.1% |

Table: A. Illarionov, How Was Russian Financial Crisis Organized. Questions of Economics, 11/98

These transactions occur in a financial and economic environment marked by economic recession and extraordinarily high real rates of interest. According to one estimate, in 1997 interest payments comprised about 28 percent of federal expenditures. In 1998 this figure was at least 30 percent. According to Prime Minister Kirienko, in the first five months of 1998 interest payments comprised 34 percent of all federal expenditures.

The reason why it happens concerns the close relationship among the government, private banks, and the new business elite. Arrangements where banks managed the cash flows of government agencies created a windfall for the banks. They pocketed the interest earned by redepositing this money in the money market or using it to buy Treasury bills. Although such schemes have supposedly ended, other comfortable arrangements favoring the banks still exist. For example, state guarantees for bank loans to businesses have replaced the old system of direct state loans or subsidies for firms. The high interest rates paid on the GKO and OFZ market were particularly advantageous for the banks, which are the main holders of these securities.

Given Russia's changing and uncertain economic and political conditions, market operators strongly preferred very short horizons. Thus, the maturity profile of the government securities issued varied between very short and extremely short, usually between one and six months. It was continually necessary to issue new securities to repay maturing ones. For example, in 1998 if there was no crisis, the government would have to find 379 billion rubles (about $60 billion) to redeem maturing securities. At the beginning of July, the average yield on GKOs exceeded 94 percent, even though inflation in the previous twelve months was only 6.5 percent and part of the planned sale of GKOs had to be canceled because of insufficient buyer interest.

By the beginning of 1998 the stock market lost half of its value and capitalization and volume of trade indicators returned to their 1996 levels. Short-term ruble-denominated bonds (GKO) were issued at attractive rates of interest. These did indeed bring in much-needed resources - the value of GKO in August 1998 was estimated at $40 billion, $11 billion of which came from foreign sources.

This situation, however, created two additional problems: first, it reinforced the shift to barter arrangements by diverting banks' resources away from loans to industry; second, these bonds had to be paid back with money that the state could only obtain by issuing further bonds at ever-increasing rates of interest. Furthermore, many Russian banks had themselves borrowed from abroad in order to invest in GKO. The pyramid of borrowing became increasingly insupportable and the government had to manufacture revenue from any source it could in order to cover its due debts.[1]

Unfortunately, potential sources of revenue were rapidly disappearing. At the end of May 1998 the government failed to find a buyer for 75 percent of shares

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[1] Russia's Crisis. Capital and Class, Summer 1999.

in Rosneft, the largest state oil company-blue chip, missing out on an anticipated windfall of $1.6 billion. For Shell and British Petroleum who had earlier expressed considerable interest decided that, with oil prices falling, Rosneft no longer looked an attractive proposition. The few Russian companies with the resources to participate also withdrew.

In mid-1997, with oil prices rising, the Russian government could have harvested $2.5 billion from the sale. Now the only option was to reschedule the sale for later in the year. At the same time, the yield on GKO rose to an 84 percent, forcing the Russian Central Bank to raise interest rates to a 150 percent in order to defend the ruble, but the pressure on the government to devalue was enormous. The first tranche of IMF money ($4.3 billion) arrived just in time to meet some GKO commitments, but too late to prevent the devaluation of the ruble, an option previously ruled out by Yeltsin. [1]

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[1] Russia's Crisis. Capital and Class, Summer 1999.

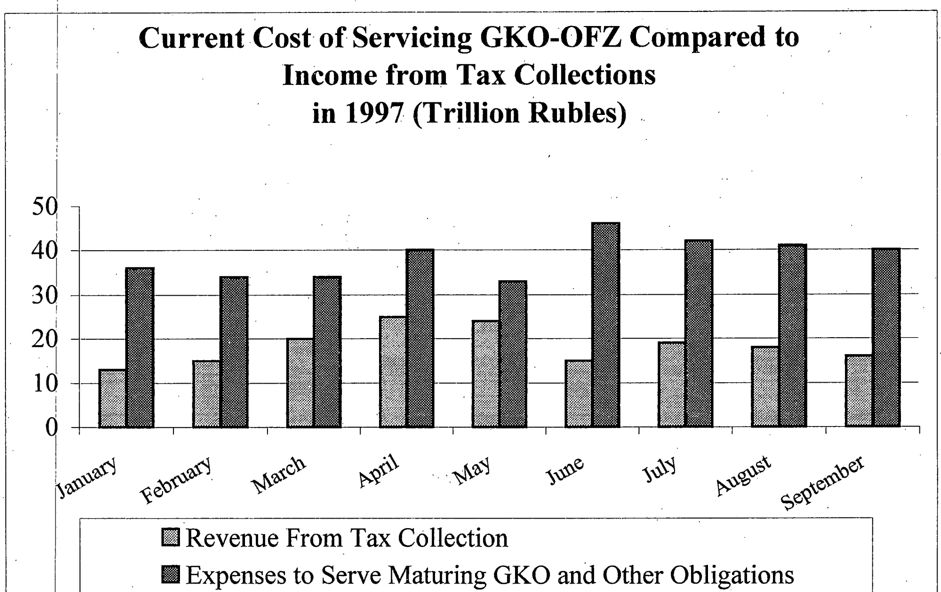


Figure 1. Current Cost of Servicing GKO-OFZ Compared to Income from Tax Collections in 1997 (Trillion Rubles). Sibirov A., Banks and Industry, Bulletin of Financial Information, August 99.

After raising interest rates to 150% from 94% to stop a run on the ruble, the Central Bank's head said that the tide had turned and that hard-currency reserves were being replenished. Yields on the shortest-term treasury bills, which had jumped to around 130% at the height of the panic, fell back to a still high 50%. But with the Central Bank's reserves still at only $15 billion, markets remained unstable.[1]

[1] Can Russia Fight Back? The Economist, 6/6/98.

Table 5. Reserves of the Central Bank of Russia (in Billions of Dollars)

| | 12/31/96 | 6/30/97 | 9/30/97 | 12/31/97 | 3/31/98 | 5/31/98 | 7/14/98 |
|---|---|---|---|---|---|---|---|
| Foreign exchange | 11.3 | 20.4 | 18.7 | 12.9 | 11.9 | 10.0 | 8.5 |
| Gold | 4.0 | 4.2 | 4.4 | 4.9 | 4.9 | 4.9 | 5.0 |
| Total | 15.3 | 24.5 | 23.1 | 17.8 | 16.8 | 14.9 | 13.5 |

Table: Can Russia Fight Back? The Economist, 6/6/98.

By July 1998 economic success of 1997 turned to dust. Sharp drop in oil and other raw material prices during 1998 decreased Russia's earnings from export. This caused the value of Russia's oil exports, its main source of foreign currency earnings, to fall by almost half in the first six months of 1998 compared to the same period of 1997.[1] The government had to redeem $5 billion in treasury bills every month - over a third of the budget was going on servicing debt. Also capital flight out of Russia increased to enormous proportions. And an accumulation of unpaid taxes and unpaid wages has pushed half of Russia's economic transactions into barter, thus reducing the collection of tax revenue.

The population has withdrawn its money from the credit institutions. Primarily in Sberbank, which held about 75%

[1] Capitalist Collapse, How Russia Can Recover. Dollars and Sense, Nov/Dec 1998.

of the savings accounts and 65% (without including the CBR) of all state securities. But the account holders, frightened by announcements regarding the ruble's revaluation, began to withdraw their money from their accounts and convert it to freely convertible currencies. In August-September the flight from the ruble reached 2 trillion rubles.

The first, mini, crisis was in November-December 1997. On November 11, 1997, the Central Bank raised its refinancing rate to 28 percent. CBR handled it mostly due to issuing new high-yielding debts. At the beginning of the May-July 1998 crisis, this rate was raised to 150 percent. (It was reduced to "only" 60 percent as of June 5, but increased again to 80 percent as of June 29.)

## Summer 1998: Pre-Crisis Situation

As of summer 1998, from point of view of groups of ownership of Russian commercial banks, banking system did not present homogeny. Every major or leading bank was fully controlled by the group of interconnected people /organizations or government. The type of the ownership could divide commercial banks on following groups:

* Banks under control of the government: Sberbank, Vneshtorgbank, Vnesheconombank, Roseximbank, International Moscow Bank, Eurofinance, Mosnarbank.

All these banks attacked more than 80% of deposits denominated in rubles and about 40% of deposits denominated in foreign currency of population and were deeply involved in operations with governmental obligations. For example, as of 1997 65% of the revenues of Sberbank came from manipulations with GKO.[1] In addition to operations with governmental securities issued inside the country, these banks due to close relationship with government were serving governmental need on foreign markets.

* Second group of banks were organized by privatization of former governmental specialized banks: Agroprombank, Vozrozhdenie, Moscow Industrial Bank, Unicombank, Mosbusinessbank, Promstroibank.

These banks had about 8-10% of actives of banking industry.[2] The major problem these banks faced was the tight relationships with depressed industries of Russian

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[1] A. Astapovich, D. Sipmolotov, Russian Banks in 1998: Development of Crisis, <u>Questions of Economics</u>, 5/1999.

[2] A. Astapovich, D. Sipmolotov, Russian Banks in 1998: Development of Crisis, <u>Questions of Economics</u>, 5/1999.

economics: agriculture, heavy machinery construction, military industry, metal industry and continuous growth of the defaulted credits and limited acceptance of these group to the market of interbanking credits. The only plus of banks in this group was their existence of many filials and high coverage of country's territory.

- "Oligarch" banks - banks that were created based on tight relationships between several profitable industries: banking-industrial groups (BIG): Oneximbank, Incomebank, Menatep, Rossiisky Credit, Alpha-Bank, Most-Bank, CBS-Agro.[1]

These banks presented the private financial sector and specialized on serving monetary flows of controlled by banks enterprises. The primary sources of revenues of this group were interbanking credits, external borrowing, deposits of population, and service of the enterprises financial needs on external markets.

- Next group is very close to the previous: banks that were created by the leading non-governmental enterprises: Gasprombank, NRB, Imperial Bank, Guta-Bank, Mapo-Bank.

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[1] A. Astapovich, D. Sipmolotov, Russian Banks in 1998: Development of Crisis, Questions of Economics, 5/1999.

- Banks controlled by local (city or regional) governments: Bank of Moscow, Promstroibank St. Petersburg, Bashcreditbank.

These banks based their operations on financial resources of local administrations including resources of regional budgets.

- Credit organizations with high proportions of foreign capital: Avtobank, Tokobank, Dialogbank.

These banks represented Russian banking system abroad and were more suitable to the "classic" description of banks. Their operations were more specialized with emphasis on operations with low-risk governmental securities.

- Banks - branches of foreign credit organizations (16).

These banks served foreign companies operating in Russia and were not involved into dealing with Russian companies and population. However, during rise of market of governmental securities, significant part of GKOs belonged to these banks. In addition, these banks made big number of short-term deals and were active participants of interbanking ruble and currency credits markets. Proportion of foreign starting capital in banking actives did not excided 5%, which represented low level of internationalization of Russian banking system.[1]

- Final group - small banks that were not branches and did not have relationships with big and industrial banks, central or local governments.

They belong usually to private group of people, did not have tight connections with industries, and played insignificant role in banking system.[2]

In may 1998, profitability of GKOs rose up to 80% and stock indexes had fallen 40% which can be explained by outflow of capital of foreign investors and refusal of government to issue further GKOs and obligations with higher profitability. Falling prices on governmental obligations led to fall of overall capitalization of banking system for 20%. As of second quarter of 1998, only six banks out of first 30 showed positive profit. Majority of banks refused to serve their futures contracts. Criticism of situation was made greater by lack of legal support of defaults on such deals - courts did not

[1] A. Astapovich, D. Sipmolotov, Russian Banks in 1998: Development of Crisis, Questions of Economics, 5/1999.

[2] A. Astapovich, D. Sipmolotov, Russian Banks in 1998: Development of Crisis, Questions of Economics, 5/1999.

recognize this kind of deals as official but as bet-deals and refused to force payments.

Operations on currency markets grew significantly and reached maximal numbers of operation volumes. Banks were buying currency for three major goals:

- Serving customers requests including non-residents for transferring money out of the country.
- Payments of bank's own obligations.
- Investments in currency with expectation of ruble devaluation.

Although the investments flew into financial markets and period of increasing deposits of population was fairly long, Russian banking system was not able to become affective tool of accumulation and transition of investments. Functions of transformation of savings into investments and credits between different sectors of economics did not developed appropriately and credits to industries especially long-term took low proportion of banking actives.

- The market of industrial credits did not provide as high profitability as market of governmental obligations.

Risks of default of credits to enterprises, liquidity and ability to pay of borrowers were poor. Lack of legal support in case of default made banks frustrating and legal actions against debtors long and unpredictable. However, in 1997, with stable ruble rate and increase of deposits, credits to industries and private slightly increased.

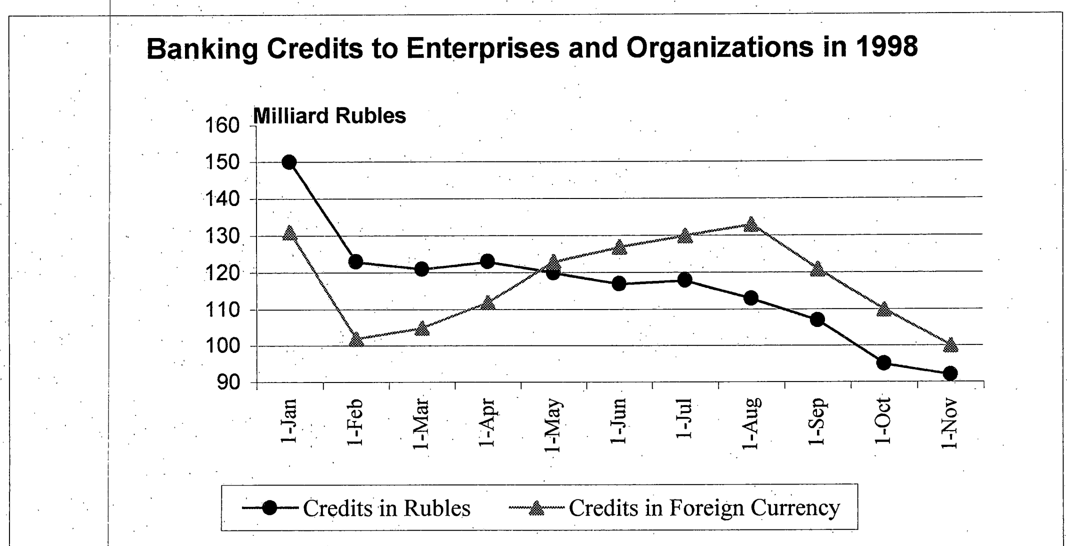


Figure 2. Banking Credits to Enterprises and Organizations in 1998. Astapovich A., Sipmolotov D. Russian Banks in 1998: Development of Crisis, Questions of Economics, 5/1999.

- In the period from 1995 through 1997, majority of the banks were involved into manipulations with GKOs and other governmental obligation with revenues from these operations as significant portion of overall profits of banking industry.

The proportion of investments into GKO constantly grew throughout the banking industry and reached 12,2% in 1/97 from 7.1% in1/96. In early 1998, 40% of 300 biggest Russian commercial banks had about 10% of their actives as governmental obligations, 12% of banks it exceeded 25%.[1] But if in 1995-95, banks' sources of borrowing were deposits of population, in 1997 - external credits which made banks more sensitive to currency rates.

- Stability of ruble made deposits into banks more attractive for population. However, increased activity of population forced banks to improve their reliability and efficiency.

Operations with people's deposits are more expensive than with funds of enterprises and require higher expenses for banks' infrastructure creation and maintenance. In addition, in case of trouble, the withdrawals of population' savings from banks is more active.

- Another factor of banking crisis was the behavior of top management of commercial banks.

Lack of professionalism and experience, situation when banks were created around group of tightly related people,

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[1] S. Aleksashenko. Banking Crisis: Does Fog Go Away? Questions of Economics, 5/1999.

or around just one person and, as a consequence, internal hierarchy and domination of relationships over professionalism, and political influence were common for majority of the banks' top management teams. As of the style of management, funds were spent on wide advertisements and luxury offices; investments decisions were made based on profitability and friendship between the managers rather than risk and liquidity analysis.

- Inadequate legal support and enforcement of banking laws.

Although for several years of existence of commercial banking in Russia, Central Bank was constantly developing laws and regulations to enforce operations of banks, functions and structure of control, reporting, and dispute solving procedures, ten years were not enough to create optimum database of regulations that would govern operation of banking industry effectively and fairly. In addition, enforcement practices were inadequate and personnel did not have experience and skills to competently perform the jobs.

- Asian crisis led to withdrawal of currency investments of foreign residents.

Although Central Bank was able to handle the situation, reduced reserves of gold (from 18.4 milliards to 12.2 milliards of dollars) provoked rumors and doubted about further stability of ruble. In addition, falling prices of raw and oil materials - major source of currency earnings for Russia - reduces inflow of dollars into country. Trust to the government as guarantee of its obligations was declining, banks began to have troubles with prolongation of contracts with foreign investors and shorter terms to pay back their loans. Decision of government in June of 1998 to stop placement of new issues of GKOs and other obligations caused rapid loss of value of existing obligations.[1]

- Reduction of investments of foreign residents.

Investments of foreign residents reduced for 0.9 milliards of dollars, event that showed changed behavior of external investors. They began to refuse to prolong terms of credits and, in the worst cases, to call back their loans. According to Institute of International Finance, obligations of Russian banks to foreign investors reached

[1] S. Aleksashenko. Banking Crisis: Does Fog Go Away? Questions of Economics, 5/1999.

16 milliards of dollars with 13.8 milliards - in short-term credits.

The reasons of worsen conditions of commercial banks in 1998 were:

- Loss of value of governmental obligations denominated in rubles and foreign currency.
- Stopped external financing and refuse of majority of foreign investors to prolong the terms of credits.
- Growth of losses and bad debts of enterprises and finance-industrial groups controlled by banks.
- Reduced liquidity of banks. Expectations of ruble rumble put banks in front of choice: increase reserves of foreign currency by refusing serving of customers and using funds to buy currency in hope of receiving profit after reevaluation with new rates or serving he customers by selling currency now and having losses.[1]

[1] S. Aleksashenko. Banking Crisis: Does Fog Go Away? Questions of Economics, 5/1999.

Table 6. Structure of Revenues of Banking System

Structure of Revenues of Banking System
(in % to total revenues)

| | 1996 | 1997 | 1998 | | |
|---|---|---|---|---|---|
| | | | I-II Q | III Q | IV Q |
| Revenues | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 |
| Interest received from credits | 39.0 | 33.0 | 32.0 | 18.0 | 4.5 |
| GKOs and other governmental | 40.0 | 29.0 | 28.0 | 14.0 | 2.5 |
| Revenues from operations with c | 6.0 | 12.0 | 7.0 | 50.0 | 84.0 |
| Other revenues | 15.0 | 26.0 | 33.0 | 18.0 | 9.0 |

Table: A. Chernyavsky, Perspectives of Solving Banking Crisis in Russia, Questions of Economics, 5/1999.

- Reducing of deposits of population in both currency and rubles and "bank runs": expectations of coming financial troubles and non existent deposit insurance for banks (no guaranty from the government in case of bank bankruptcy) made the situation of loosing everything on accounts real for depositors.

One of the specifics of dealing with foreign investors was "cross-default" contracts where if one of the Russian banks default on payment, other lending banks can request payments from other Russian bank ahead of the schedule. The first defaulted Russian bank was TOKObank, 14th of August - Imperial, and 17 of August - Menatep. The decision of the government to impose 90-days moratorium is thought to be right. The primary goal of this moratorium was an organization of talks between Russian banks and their foreign lender about reviewing terms of contracts. The first round of talks started on September 2 in Moscow; however, after change of management of Central Bank, talks stopped and every bank was on its own in dealing with lenders.

In third quarter, liquidity and profitability of banks sharply dropped, the only profits that were showed came from reevaluation of assets with new currency rates. In fourth quarter, profits and expenses of currency manipulations accounted for 83.7% of profits and 76.8% of expenses of whole banking system which suggest that big proportion of the operations was still tighten to currency actives reevaluation. Growth of bad credits and default on loans of enterprises and private groups could also characterize this period. Majority of enterprises especially enterprises with import operation suffered from growth of ruble.[1]

As a result of fall in prices of Russian debts and obligations banks operating on external markets faced

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[1] S. Aleksashenko, Banking Crisis: Does Fog Go Away? Questions of Economics, 5/1999.

increased number of margin calls. These banks began to sell huge packages of governmental obligations and delay payments of budget disbursements in order to pay off needed margin calls. Losses from these payments were up to 10 milliards of rubles. Banking system began to shake under the sharp demand of rubles; rubles on accounts in Central Bank went down to 11 milliards.

From the beginning of August, SBS-Agro and Incomebank - the biggest banks with payment servings of more than half of all federal tax flows - began to delay payments. From $11^{th}$ of August due to mass defaults on payments, market of IBC ceased to exist. Reducing of resources denominated in rubles financial markets caused jumps in interest rates in interbanking credit market.

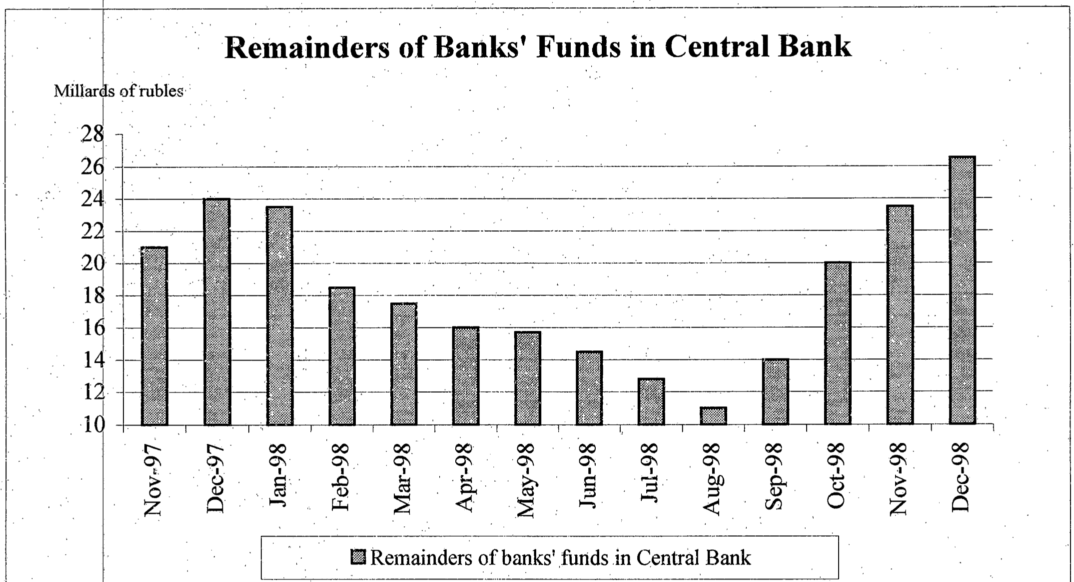
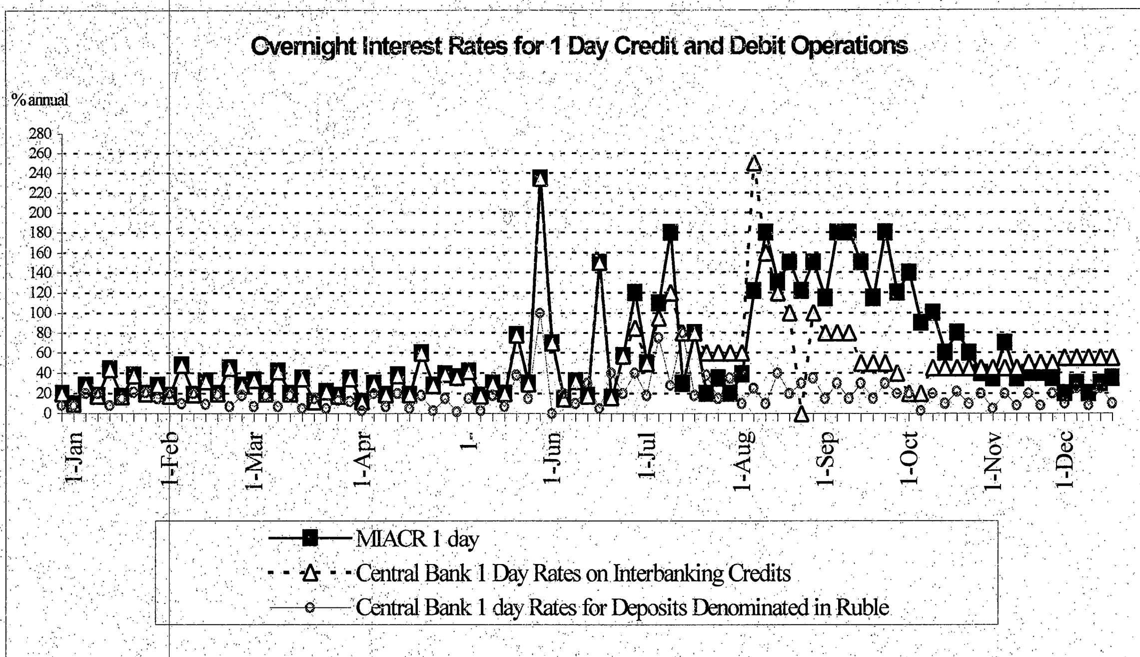



Figure 3. Remainders of Banks' Funds in Central Bank. Astapovich A., Sipmolotov D., Russian Banks in 1998: Development of Crisis, Questions of Economics, 5/1999.

First jump of profitability on 1-day interbanking credits (IBC) happened in the end of May. Although contract of Central Bank forced rates into its limits, preference of dealing in dollars remained strong. Devaluation of market of GKO and other governmental obligations destroyed the only one scheme of IBC market - credits with GKOs and other governmental obligations as collateral. Lack of ruble mass in Central Bank freed market mechanisms and interest rates rode up and down from middle of June till end of July when non-existence of ruble on market led to absence of deals at all.[1]




* MIACR - Moscow Inter Bank Actual Rate is calculated as average based on volumes of deals in interbanking credit market.

Figure 4. Overnight Interest Rates for 1 Day Credit and Debit Operations. Astapovich A., Sipmolotov D. Russian Banks in 1998: Development of Crisis. Questions of Economics, 5/1999.

## August 1998

On August 17, Prime Minister Sergei Kiriyenko announced that the government would allow the ruble to fall from the former official rate of 6.3 rubles to the U.S.

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[1] A. Astapovich, D. Sipmolotov. Russian Banks in 1998: Development of Crisis. Questions of Economics, 5/1999.

dollar to 9.5 rubles to the dollar. Further, a 90-day foreign debt moratorium was announced to prevent further capital flight out of country. The Central Bank had to intervene for two reasons: the outflow of capital and the lack of market confidence in a stable exchange rate, given the devaluations in Asia and the fall in world energy prices. The Central Bank defended the exchange rate with intervention and interest rate increases.

Devaluation supposed to have its pluses and minuses. The devaluation would make it much more expensive to repay foreign currency-denominated debt. The moratorium has frightened already skeptical investors and likely will reduce foreign investment for years to come. But from another point of view, devaluation has its benefits: It would preserve the reserves of the Central Bank and improve the competitive position of Russian goods and services on both foreign and domestic markets. For some years now Russia has had a current account surplus, but the IMF is already forecasting a growing trade deficit.

To save banking system, Central Bank and the government did following:

- To reduce pressure on currency reserves of Central Bank: changed limits of currency corridor (moved up and widened). Official rate is agreed to set according to trades on Moscow Currency Trading Exchange.[1]
- To reduce governmental expenses: stop trading GKOs and other governmental obligation and restructure obligations - default on internal debts by the government.
- To help private sector and banking system: establishment of 90-days moratorium on payments to non-residents and margin calls, insurance payments, and currency deals.

Established new currency rate was available only for 9 days. Banks were transferring into currency rubles given by Central Bank for liquidity purposes and payment servicing. 26 of August fall of exchange rate exceeded 5% and trades on Moscow Currency Stock Exchange were stopped. Floating exchange rate was introduced September 3 and by September 30th dollar/ruble exchange rate reached 30 rubles for dollar - devaluation of 5 times for 3 weeks.

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[1] A. Astapovich, D. Sipmolotov, Russian Banks in 1998: Development of Crisis, Questions of Economics, 5/1999.

Further fast ruble devaluation was stopped by introducing rule of mandatory sell of 50% of currency revenues, closing currency licenses for troubled banks, and restructure of mechanism of currency trades to avoid selling currency for speculative goals. Panic of population from banks and "bank runs" were increasing for second half of August. The most pressure was on Moscow banks, which attracted biggest volume of deposits.[1]

Table 7. Volume of Population Deposits in Commercial Banks

| Bank | Volume of deposits (mlrd rubles) | Percent of Total (%) |
|---|---|---|
| Sberbank | 133.2 | 69.2 |
| Incomebank | 7.5 | 3.9 |
| SBS-Agro | 7.3 | 3.8 |
| Most-bank | 2.7 | 1.4 |
| Rossisky Kredit | 2.6 | 1.4 |
| Menatep | 2.1 | 1.1 |
| Promstroibank of Russia | 1.3 | 0.7 |
| Avtobank | 1.2 | 0.6 |
| Vorohdenie | 0.8 | 0.4 |
| Gasprombank | 0.8 | 0.4 |
| Mosbusinessbank | 0.8 | 0.4 |
| Promstroibank St. Petersburg | 0.8 | 0.4 |
| ONEXIMbank | 0.7 | 0.4 |
| Vneshtorgbank | 0.7 | 0.4 |
| Total for banks above | 162.5 | 84.5 |
| Other banks | 29.9 | 15.5 |
| Total deposits of population | 192.4 | 100.0 |

Table: Astapovich, D. Sipmolotov, Russian Banks in 1998: Development of Crisis, Questions of Economics, 5/1999.

[1] A. Astapovich, D. Sipmolotov, Russian Banks in 1998: Development of Crisis, Questions of Economics, 5/1999.

The acts that were taken to ease the situation and reduce pressure on banks were limits of withdrawal from accounts in rubles and currency, payment of currency accounts in ruble often with lower than market rate, creating of preliminary list for withdrawals. According to Central Bank, volume of deposits in August only was reduced for 4% in rubles and for 18% in currency.

Central Bank also had forbidden to six major banks to have any operations with deposits and requested to transfer accounts of private depositors to Sberbank. Currency accounts would be transferred to rubles with fixed rate of 9.33 rubles per dollar. Transferring deposits under this scheme meant losses to up to 50% for currency accounts due to continuous devaluation of ruble and lost interest rates.

The main question of relationships between foreign and Russian banks was about payments on futures currency deals. From 8/17/98 the trades on Moscow Currency Stock Exchange (MCSE) were stopped and the volume of open positions on future and forward deals were estimated in one milliard of dollars with 1/3 of it belonged to foreign investors. MCSE decided that banks would pay off such deals till end of October with rate established as of 8/14/98 (7.1-7.4 rubles for dollar). Only small percentage of foreign investors was agreed to this type of rate, others were demanding of payments according current market exchange rate. This decision worsen situation around external debts for banks still capable of serving their payment obligations.[1]

As a result of mass play on rise of ruble in the middle of September, the exchange rate grew up within four days from 20.8 to 8.7 rubles for dollar, but later had fallen back to 16.4 rubles per dollar. However, during this period some banks were capable to pay off their obligations and some even to earn a profit on currency manipulation.

From ceasing of GKOs and other governmental obligations markets, the most suffering bank was Sberbank, which held up to 2/3 of its actives in governmental obligations (83 milliard of ruble). Other banks that endured big hit from GKOs were banks investments in such obligations of more than 20% of their actives - about 170 of them with 40 - regional. Majority of these banks had foreign initial capital. In comparison with leading big banks, majority of smaller regional and small banks did not suffered much from internal default due to limited access

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[1] A. Astapovich, D. Sipmolotov, Russian Banks in 1998: Development of Crisis, Questions of Economics, 5/1999.

to currency operations and insignificant investments into GKOs.

Former leading banks in the second half of August:

- Tried to rebuild liquidity. They were counting on help form government and Central Bank, local administrations with local budget resources, and existing currency reserves.
- Fought with "bank runs" by offering different schemes of restructuring of deposits into long-term obligations and refusing in registration of legal action from depositors.
- Separated vital and potentially profitable parts of banks, transferring clients and their own resources into filials. Part of resources was transferred abroad under scheme of sellouts of actives to pay obligations to foreign clients.[1]
- Tried to solve problems with payments to foreign investors. Banks were mostly on their own and were responsible for talks to restructure their external debts.

[1] A. Astapovich, D. Sipmolotov, Russian Banks in 1998: Development of Crisis, Questions of Economics, 5/1999.

Table 8. Obligations of Russian Banks to Foreign Investors

Obligation of Russian Banks to Foreign Investors
(as of 10/1/1998, millions of dollars)

| Bank | Volume of Short-Term Debts | Credits | Issued Eurobonds | Forward Contracts |
|---|---|---|---|---|
| Sberbank | 100 | 225* | 0 | 325 |
| Vneshtorgbank | 356 | 120 | 0 | 608 |
| SBS-Agro | 631 | 113** | 0 | 84 |
| Menatep | 515 | 80** | 0 | 100 |
| ONEXIMbank | 353 | 70** | 300 | 1900 |
| MFK | 97 | 0 | 0 | 51 |
| Incomebank | 274 | 140** | 0 | 1884 |
| Alpha-bank | 214 | 77** | 175 | 0 |
| Most-bank | 129 | 0 | 0 | 0 |
| Rossisky Kredit | 118 | 229** | 200 | 70 |
| NRB | 208 | 42 | 0 | 268 |
| Bank of Moscow | 15 | 20 | 0 | 0 |
| Avtobank | 108 | 47 | 0 | 380 |
| Vorozhdenie | 51 | 0 | 0 | 0 |
| Totals: | 3169 | 1163 | 675 | 5670 |

* Paid
** Delayed / in process of restructure

Table: A. Astapovich, D. Sipmolotov, Russian Banks in 1998: Development of Crisis, <u>Questions of Economics</u>, 5/1999.

Governments and Central Bank play active role in developing, maintaining, and controlling the banking system of the country. According to S. Aleksashenko, there are four main directions of such actions:

- Solving crisis of liquidity.

One of the most painful experiences of banking crisis is liquidity problem when banks are not capable to perform payment functions between economic entities. The crisis of payments should be solved first of all before business connections are broken. To solve the crisis of 17 of August 1997, Central Bank offered to Incomebank and SBS-Agro - two biggest banks involved into interbanking credits operations. Although to offer credit in that situations would result in spending it on buying currency, Central Bank by doing so was trying to stop domino effect of payments defaults.

Central Bank also reduced reserve requirements for banks, using part of reserve for payment obligations (10 milliard rubles), some of the banks including Sberbank received credits to pay the depositors (population) (15 milliard rubles), transfer of deposits from banks-bankrupts to Sberbank to stop "bank runs"; ruble devaluation allowed banks to sell currency and serve payments in rubles (from middle of September till end of October Bank of Russia bought around 2 milliard of dollars - 30 milliard rubles). Although Central Bank was able to solve liquidity problem, it was not able to stop further ruble devaluation and growth of prices.[1]

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[1] S. Aleksashenko. Banking Crisis: Does Fog Go Away? Questions of Economics, 5/1999.

- Improving control over banking industry and creation of legal basement.

Political fights and conflicts of interest between higher and lower lines of government caused non-acceptance of suggested law of deposits insurance; law about bankruptcy was under consideration of low line of government - Duma - for two years and become out of date when finally was approved. One of the other main deficiencies of control of banking system in Russia is decentralization of agencies performing control over financial institutions.

- Restructure of banking system.

Restructure of banking system is organizational checkup and foreclosure of instable banks and banks closed to bankruptcy. At the same time government creates a list of banks it is not interested to be closed based on social and political reasons. Reorganization actions for such banks are created including the limitation and sometime total replacement of management and stakeholders. As of February 1999, 397 banks were recognized to be closed in the future (every 4th bank).[1] However, with the level of

[1] S. Aleksashenko. Banking Crisis: Does Fog Go Away? Questions of Economics, 5/1999.

legal regulations of closures and forced bankruptcies and level of business activity of appropriate agencies, to bankrupt these banks will take 3-4 years. In addition, these banks can file contracts against "illegal" acts of such agencies in the higher courts and prolong time.

- Recapitalization of banks.

The important goal of overcoming the financial crisis is to rebuild and recapitalize banking system in general and most important banks separately. There are two sources: deposits of population and resources of the government. The problem as government sees it is that roots of financial crisis were in excessive currency risk and high involvement in manipulation with governmental securities. Therefore, the traditional method of banking system recapitalization - buyout of "bad" actives from banks - is not feasible.

Central Bank could, however, offer credits under guarantee of stocks and ownerships of banks or full buyout of banks. Low level of savings of population, political and business interests conflicts such as 51% of stocks is equal 100% and 49% - 0% in management, refuse to make any changes by current management, and low current attractiveness of

Russian economy for external investments would be the rakes of effective implementation of recapitalization program.[1]

- Hope for real sector.

Because of devaluation of governmental securities and relatively stable ruble rates, banking system of credits started to become more industry oriented as it was in 1992-95. Volume of credits to industrial enterprises increased from 9.4% to 11% in 1998. Now banks face limited range of profitable placement of funds. Governmental credits to banks to improve liquidity do not find effective investment. Following graph compares profitability of investments into different sectors of industry with profitability of operations on market of interbanking credits and manipulation with GKOs.

[1] S. Aleksashenko. Banking Crisis: Does Fog Go Away? Questions of Economics, 5/1999.

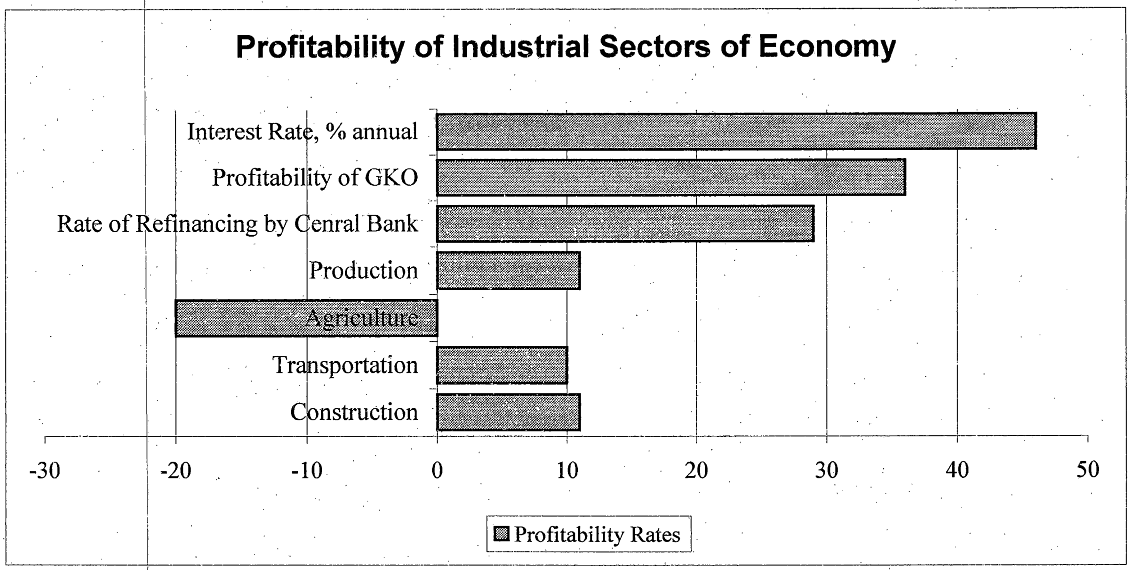
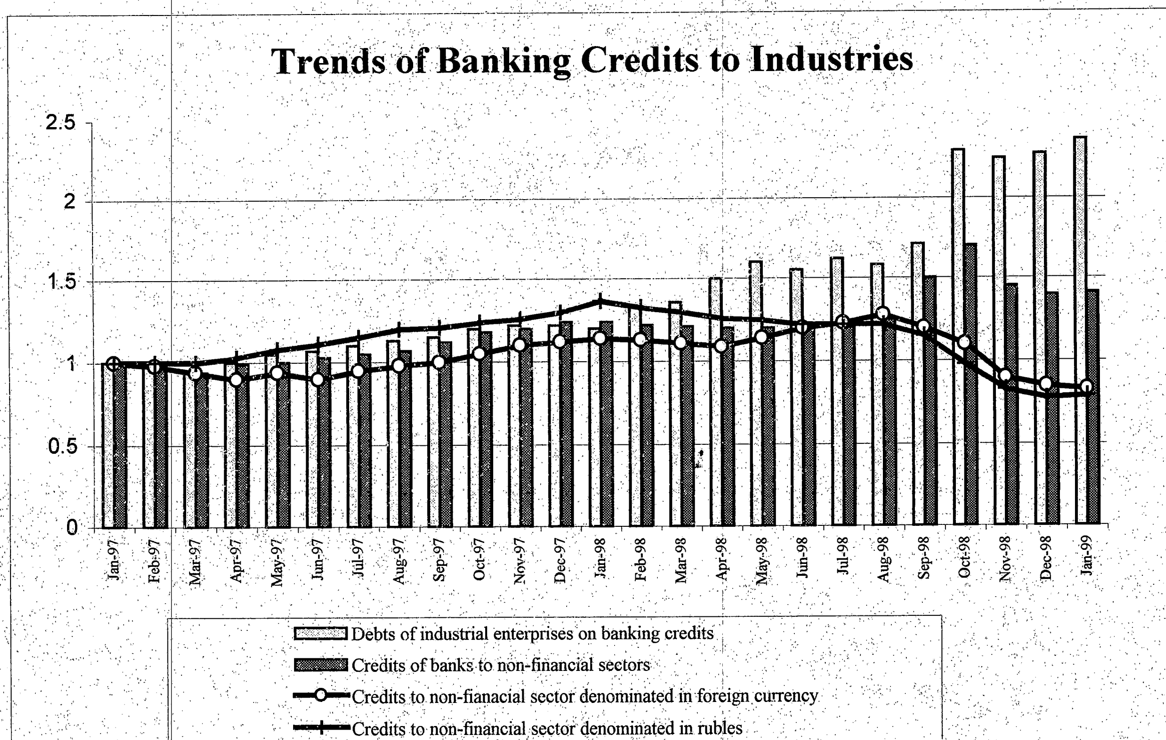



Figure 5. Profitability of Industrial Sectors of Economy. Sibirov A. Banks and Industry, Bulletin of Financial Information, August 99.

Deposits of enterprises denominated in rubles grew in 1998-1999, purchasing power of enterprises increased 28% from crisis till the end of the year 1998. There is a good chance that resources of enterprises would be the main source of resource growth of banking system and, since volume of such funds is tightly related to volume of credits to enterprises, credits to enterprises will increase as well.




* 1 – level as of beginning of year 1997.
Figure 6. Trends of Banking Credits to Industries. Aleksashenko S. Banking Crisis: Does Fog Go Away? Questions of Economics, 5/1999.

Although the debts of industrial sector to banks grew, in 1998 bank credits to industrial banks reduced. The structure of banking credits began to change towards crediting industries oriented on finished consumers' goods, export, and industries that would replace import - metal industry, forestry, food industry and machine sector.

- Creation of ARKO.

Since early 1998 the Bank of Russia has been committed to the restructuring of the banking system in order to improve commercial banks' activity and to enhance their liquidity. The key part of that program was the set-up of the Agency for Restructuring of Credit Organizations (ARCO or ARKO). After Russia's financial system exploded, pushing most of the country's banks into insolvency, not a single significant one has been properly wound up. The World Bank estimated that, at the top 18 banks alone, liabilities exceed assets by $9.8 billion. [1]

After crisis of August 1998, Central Bank divided all commercial banks into four categories:

- Credit organizations survived crisis and do not have financial troubles.
- Stable regional banks, which will receive assistance from Central Banks.
- System banks, which could not operate on their own but which should be kept operating due to social and economic reasons.
- Hopeless banks without significant accounts of enterprises or population deposit.

[1] S. Aleksashenko. Banking Crisis: Does Fog Go Away? Questions of Economics, 5/1999.

ARKO was created as commercial organization to continue this reconstruction of banking system started by Central Bank. It should determine banks worth to offer credits, establish size of credits, force bankruptcies, etc. Central Bank established starting capital of ARKO of 10 milliards of rubles but additional funds would be available also.

The hardest part of operations would be to evaluate, select, and support banks of third group. These banks can offer as collateral for credits only their own stocks. Therefore, ARKO would be involved in managing and operating of such banks majority of which were leading banks before crisis and managed by respectful "oligarchs". The question that arises from this situation is that in case if control packets of these banks belong to ARKO then ARKO obtains powerful influence over whole financial system.[1]

Idea of creation of ARKO was born by Central Bank, which in fact controls ARKO although it was supposed to be commercial credit organization. Through ARKO, Central Banks can go around the law, which forbids Central Bank to participate in activities and take part in capitals of any

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[1] K. Simonov. ARKO - Beginning of Great Advantage. Banking Business, 3/1999.

commercial banks. 100% of ARKO stocks would be held by governmental organization - Russian Fund of Property with possibility of transfer of 49% of portfolio to Central Bank. The majority of ARKO personnel consisted of former Central Banks employees and management - of active leaders of Central Bank.

Until creation of ARKO, Central Banks performed these actions. Central Bank's move to revoke the licenses of 12 commercial banks in 1998 looked promising. The 12 included the once leading banks - Bank Menatep and Unikombank, which had the largest branch network in the area around Moscow.[1] Naming the 12 will not change situation - partly because none has done much business lately. Menatep, for example, had transferred all its good assets to its subsidiary in St. Petersburg. That now operates as a separate bank, and runs all of Menatep's former branches in Moscow. All that was left for the Central Bank to liquidate was an empty facade, once the center of the financial and industrial empire built up by Mikhail Khodorkovsky, one of Russia's oligarchs.

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[1] Russian Banks: Stable Doors. Economist. May 22, 1999.

Nor was there much left of Unikombank. Its extensive branch network in the suburbs of Moscow was recently taken over by Guta-Bank, which is controlled by the city government. Some of the smaller among the 12 banks were running what has become quite a common tax-evasion scheme. Company with a tax bill pays the managers of a defunct but still licensed bank a fifth of its tax arrears; the bank pretends to have received the full amount, but fails to make the transfer to the government.[1]

Closing down a mere 12 banks is not going to drastically change this situation. By one estimate more than 100 banks are now technically insolvent and more bankruptcies must surely follow, not just to improve the health of the banking system, but also to boost tax collection.

However, interest from Cabinet of Ministers toward ARKO was almost identical with interest of Central Bank - control over banking sector- and Cabinet of Ministers can change the regulations, which govern activities of ARKO in order to get control over the organization.

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[1] Russian Banks: Stable Doors. Economist. May 22, 1999.

Since ARKO started its operation in 1999, the performance was not what was expected. The organization is not properly financed, does not have appropriate authority, experience, and reputation. By the time agency began operations majority of funds were already spent. Central Bank, which performed activities of ARKO, issued credits to banks in 1998 with maturity of 1 year and by 1999 could not collect majority of its loans. Central Bank offered prolongation and transferred loans to ARKO. The volume of activities is also higher than ARKO can handle.

Of the few banks that ARKO helped to lose their licenses, most were those trying to deal honestly with their creditors; the immediate violator is the bank-restructuring agency, ARKO itself. The evidence so far suggests that ARKO was less harmful doing nothing. Just hours after it announced that it was putting $127 million, nearly a third of its war chest, into Promstroibank - survivor with, supposedly, a chance of meeting its obligations—the Central Bank of Russia announced that it would withdraw its license.

Now ARKO works with small and average banks and its activity does not aim on increasing stability and recapitalization of banking industry, but on financial help to small banks to meet their ends. Funds available are barely enough to help meet financial obligations of banks and cannot significantly reconstructure or change situation in the banks.

ARKO governor, Viktor Geraschenko, said that 130 bank licenses would be withdrawn year 1999.[1] There has been no official censure of ensuring stronger control against the widespread asset stripping. One bank, Menatep, closed, only to reopen as a new, debt-free, legal entity based in St. Petersburg. Some other banks merged into new ones, leaving their debts behind. SBS-Agro set up a convincing-sounding First Mutual Credit Society for new accounts, but refuses to pay out on old ones—despite receiving at least $300m from the government in aid and loans.[2] After the August crisis, the Central Bank gave banks about $3.5 billion in credits. But much of the money was wasted as banks switched ruble credits into dollars and transferred them to hard-to-trace accounts abroad.[3]

In summer 1998 Standard & Poor's credit rating service gave six Russian banks their very lowest rating "N.M." for

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[1] The Great Pretenders. Economist, August 21, 1999.

[2] The Great Pretenders. Economist, August 21, 1999.

[3] The Great Pretenders. Economist, August 21, 1999.

"not meaningful." Four of the six are among the group of 12 leading banks pooling their resources in an attempt to stay afloat. "It all depends on the Central Bank," said Al Breach, an economic analyst at Moscow's Russian-European Center for Economic Policy. "They will have to decide how to bail out the banks, and which ones to keep in place."[1]

## Year 1999

Russia has a large and growing public debt (i.e., government securities, T-bills, and so on). External public debt is currently estimated to be about $120 billion, and internal public debt at around $60 to $80 billion. The external debt was mainly inherited from the USSR. According to rescheduling agreements, in the years 1996-98 about $9.5 to $11 billion per year should be paid in interest and capital repayments, rising to $16 to $17 billion beginning in 1999 and to $20 billion beginning in 2002, assuming no further loans after 1996. Since Russia has already borrowed more abroad, external debt servicing obligations starting in 2002 are likely to be in the $25 to $30 billion range.[2]

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[1] Sifting Through The Ruble Rubble. Christian Science Monitor, 8/19/1998.

[2] The Russian Financial Panic And The IMF. Problems of Post-Communism, September-October 1998.

Even the most optimistic bankers no longer expect Russia to pay the entire $17.5 billion in interest and principal that is due. Without further aid, even finding the $9 billion Russia needs to service the debt incurred since 1991 looks impossible. The country's annual current-account surplus, excluding interest payments, is a healthy $18 billion. But Russians' reluctance to invest at home, or hold their own currency, means that most of the inflow flies straight out of the country to Switzerland, USA, or Cyprus. Little reaches the tax collectors, or the Central Bank's reserves. Neither the government nor the Central Bank can pay Russia's debts. Tax revenues last year were running at around $1 billion a month, less than those of New York City. The central government was spending $1.5 billion a month.

Although tax collection is improving, there is no chance of finding $9 billion from that. Only $7 billion of country's $11.6 billion reserves are in cash; the bare minimum, to cover a month's imports, is $4 billion. Were the state to drain central-bank reserves as well as sell gold and shares in state-owned energy companies, chiefly Gazprom, it would raise only some $4 billion. That is not enough to pay the IMF, let alone satisfy all the other creditors. The Russian budget for 1999 assumes that $7 billion will come from new international credits. But burned by default of August 1998, western bankers say they 'would rather eat nuclear waste than lend to Russia in its current state'. Foreign governments might lend a little, but only if the IMF and its sister organizations also help with some cash. [1]

Russia's Debts

What are the Russia's most important debts? The chief claimants are:

- Eurobonds.

No country has ever defaulted or restructured a sovereign Eurobond. Russia does not want to be the first. Default on one of issues triggers cross-default on all others, making the whole amount on all outstanding Eurobonds due immediately. Anyway, Russia will want to raise more money in the future. Because the amount due this year is only $1.7 billion, Russia may yet succeed in servicing its Eurobonds. In any case, negotiating a restructuring would be difficult (although Pakistan is now

[1] Money Can't Buy Me Love. The Economist, 2/6/99.

being asked to do it), because the bonds are held in small chunks ($10,000 is the minimum holding) by thousands of investors all round the world.

- Other foreign private-sector creditors (inherited external Soviet era debts).

These account for $27 billion in rescheduled debt from Soviet days. Although one kind, known as IANs, which are notes representing rescheduled interest payments, has priority and is being honored, the majority, which are restructured principal, known as PRINS, are already in default. In theory, banks representing the bondholders could sue. In practice, they are unlikely to do so. This is partly because they fear Russia's ungraceful memory. It also reflects the slight chance of a better deal - Russia is now offering new IANs instead of cash.

- The multilaterals.

International financial institutions are supposed to come top of the range of debt holders, as "preferred creditors". The biggest part is hold by the IMF, which is technically unable to reschedule or rollover debt.

- Western governments (Paris and London Clubs).

Most of this debt was rescheduled after the collapse of the Soviet Union. Government-to-government loans are hard to collect; their repayment depends chiefly on political relations. A deal with the IMF would involve another restructuring of this debt, but there would be fury - particularly in Germany, which has a big payment due this year.

- MinFins (governmental bonds, GKO and OFZ).

These are ruble and dollar-denominated bonds, issued domestically by Russia since 1993. Foreign investors hold big part, the rest is held by local investors.

- Russians.

The most patient and long-suffering creditors are those whose salaries, pensions and budgets have been left unpaid for months. Wage and pension arrears currently stand at 77 billion rubles ($3.1 billion); the backlog on maintenance, investment and other public-sector bills is incalculable.

Boris Nemtsov said in an interview at the Harvard symposium that it is necessary to restructure Russia's debts, spreading repayment over 30 to 50 years. Russia's central government, he noted, has revenues of $20 billion to $22 billion. It owes $17.5 billion on its debts this year.[1] Under the current system, it is impossible to make that large payment and carry on normal government spending for defense, for instance, he said. Mr. Maslyukov is reported as saying, wants the holders of its Soviet-era debts to forgive 75 cents on the dollar. Almost half of Russia's $148 billion in total external debts was piled up by the Soviet Union before its breakup in 1991. Maslyukov was likely making an opening gambit for future debt rescheduling negotiations. The percentage forgiven may end up less than 75 percent.[2]

Recent meeting of Russian President with premier-minister of Germany showed that European financial Community is not going to forgive any part of debt and views Russia as capable of carrying out its obligations.

Russia's economy remains precarious after the August 1998 financial collapse. Gross domestic product fell by 4.6 percent year of 1998 and estimated to fall by another percentage point in 1999 and 2000. Except for 1997, GDP has decreased every year for the past decade, with an

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[1] Steadying A Giant. Christian Science Monitor, January 25, 1999.

[2] Economic Scene. Christian Science Monitor, April 5, 1999.

accumulated decline since 1991 of 40 percent. Inflation rose to 84 percent in 1998 and remains high. Yet Russia may have finally passed its bottom. Industrial production will likely increase significantly this year, and the fastest-growing industries are not raw materials but machinery, forestry, textiles, food, and construction materials, suggesting a qualitative change. The higher oil price helps too-a $5 rise brings in, at least in theory, an extra $900m a month.

At long last, business restructuring and new product development appear to have caught on. Moscow shops have been suddenly flooded with good Russian produce, in many cases last seen in the 1960s. Barter is abating, from 54 percent of industrial firms' sales in August 1998 to 46 percent in January 1999. Major companies paid 49 percent of their February 1999 taxes in real money, compared with only 35 percent last August. Bankruptcies have multiplied, forcing malfunctioning companies out and allowing good companies to thrive. Profitability is improving.

The financial crisis imposed hard budget constraints on both businesses and governments, which pushed them to achieve real economic growth. But the ruble's devaluation has sharply cut imports and turned around Russia's external finances. Russia is therefore unlikely to default on its external debt, even if it receives no IMF or World Bank funding this year. The Russian stock index has tripled since October 1998, indicating that there is renewed reason to worry about too much foreign portfolio investment too quickly.[1]

Industrial output during April-June 1999 exceeded the levels of one year earlier by over 5 percent on average. The recovery appears to have been primarily led by import substitution following the depreciation of the ruble. Foreign exchange market pressures have also eased and the ruble has stabilized, while monthly inflation has come down to under 2 percent in June, reflecting a tightening of fiscal and monetary policies.

The improved revenue performance reflects the recovery in output, the impact of the ruble depreciation and higher energy prices on the tax base, and an effort to improve tax collections. The overall balance of payments position has also become stronger. Following the recent recovery of energy prices and a sharp compression of imports, the external current account, on a cash basis, has swung from a

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[1] Winner Takes It All. Foreign Affairs, 9/1/99.

deficit of $2.7 billion in the first quarter of 1998 to a surplus of $4.8 billion in the first quarter of 1999.

On paper, Russia has made enough progress in rearranging its finances to make a new credit from the IMF seem defensible. The ruble's devaluation has pushed up Russian industry, at least for now. Coupled with a higher oil price, it has helped the government collect more taxes and balance its books. That keeps interest rates down. The economy may even grow slightly; if so, it will be for only the second time in years of chaotic reform.

Table 9. Russia: Selected Economic Indicators

| | 1996 | 1997 | 1998 | 1999 |
|---|---|---|---|---|
| (Annual percentage changes) | | | | |
| Production and prices | | | | |
| Real GDP | -3.5 | 0.8 | -4.6 | -2.0 |
| Change in consumer prices | | | | |
| Annual average | 47.6 | 14.6 | 27.8 | 92.5 |
| 12-month | 21.8 | 1.0 | 84.4 | 50.0 |
| Change in GDP deflator | 43.9 | 16.6 | 11.4 | 74.9 |
| *(In percent of GDP)* | | | | |
| Public sector[1] | | | | |
| Federal government | | | | |
| Overall balance | -8.4 | -7.1 | -5.9 | -5.1 |
| Primary balance | -2.5 | -2.5 | -1.3 | 2.0 |
| Revenue | 12.5 | 12.3 | 10.7 | 11.6 |
| *of which*: cash | 9.2 | 10.0 | 9.0 | 11.6 |
| Expenditure | 20.9 | 19.0 | 15.6 | 13.9 |
| Interest | 5.9 | 4.7 | 4.0 | 4.3 |
| Non-interest | 15.0 | 14.3 | 11.6 | 9.6 |
| In billions of U.S. dollars unless otherwise indicated) | | | | |
| External sector | | | | |
| Total exports, fob | 90.6 | 89.0 | 74.8 | 72.1 |
| Total imports, fob | 72.8 | 77.4 | 56.8 | 46.1 |
| External current account | | | | |
| (deficit -) | 3.9 | -3.0 | 2.3 | 11.4 |
| Federal govrnmnt external | | | | |
| Debt service due | 17.2 | 15.9 | 17.4 | 18.5 |
| As percent of exports of | | | | |
| goods and services | 17.0 | 15.4 | 19.8 | 22.3 |
| Stock of federal | | | | |
| government external debt | 136.1 | 134.6 | 152.4 | 157.0 |
| As percent of GDP | 32.6 | 30.9 | 48.7 | 93.1 |
| Gross reserves coverage | | | | |
| (months of imports of | | | | |
| goods and services) | 2.0 | 2.2 | 2.0 | 2.6 |
| (Units as indicated) | | | | |
| *Memorandum items:* | | | | |
| Nominal GDP (billions | | | | |
| of rubles) | 2,146 | 2,522 | 2,685 | 4,600 |
| Exchange rate (rubles per | | | | |
| US$ period average) | 5.1 | 5.8 | 9.7 | ... |

Table: Russia's Crisis. <u>Capital and Class</u>, Summer 1999.

The core problem of the Russian economy is still the budget deficit. Also, the state has failed to establish an effective taxation system and especially a mechanism for the collection of tax revenue. Additionally, continuing high levels of capital flight into tax havens have removed resources which could be used for productive investment: more than 90 percent of companies trading on the Russian stock exchange are registered in Cyprus, and more than $76 billion has been illegally exported since 1991.[1]

Next step would be creating guarantied and profitable conditions for average Russian to place his or her savings in the banks - necessary element of efficient banking system.

Although average Russians lost about $2 billion in the August banking crash, economists estimate that there are further $40 billion to $60 billion in hard-currency savings that remain hidden in places other than banks. That amount of money, if unlocked and injected into the domestic economy, might go far to stimulate Russian industry and commerce into growth after almost a decade of steady decline. "Ordinary people are hoarding staggering amounts of dollars. Thanks to the extreme distrust of the ruble and the official financial system, all that money remains

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[1] Russia's Crisis. Capital and Class, Summer 1999.

frozen in economically inert forms," says Leonid Vardomsky, an economist with the Institute of Economic Studies in Moscow.[1]

Following the August crisis, Russia's Central Bank promised to guarantee all deposits stuck in failed commercial banks "100 percent." In September the government announced all accounts transferred to the state-owned savings bank, Sberbank, would be redeemed by Nov. 30 - but in rubles, at a rate of 9.3 on the dollar. Sberbank even began paying back depositors from four failed private banks - Menatep, MOST Bank, Mostbusiness bank and Promstroybank. More are expected to join the list. Alexander Torkunov, spokesman for the Central Bank, says the government will provide 5 billion rubles (about $250 million) to redeem some 300,000 defaulted accounts. That still leaves thousands of depositors out.

The future role of institutional investors is still an open issue. Until recently banks were not the major owners of shares of non-financial companies and mutual, pension and insurance funds are just starting to emerge. In the largest Russian banks investment in non-government

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[1] Letting Foreign Banks Into Russia? Christian Science Monitor, 12/9/1998.

securities increased from 1% of total assets in the beginning of 1995 (as compared to 3% in the American banks and much more in other Western countries) to about 10% in mid 1997. Still, according to the CBR, in late 1997 total investment of Russian banks into the companies shares amounted to 8 trillion rubles ($1.4 billion), or just about 1.5% of total stock market capitalization. This numbers fell sharply after August crisis of 1998, but hopefully will come back.[1]

In the 100 largest Russian corporations the share of stocks owned by financial institutions is somewhat higher -- 18%, but the proportion of stocks belonging to outsiders is also higher, so that the share of financial institutions in total outsider ownership is approximately the same for the large and largest companies - about 1/3. Besides, industrial companies control banks more often than banks control industrial companies: Gazprom alone by early 1998 was the major shareholder in three large banks (Promstroybank, Natsionalniy Reservniy Bank, Imperial) and was going to buy Inkombank (all these banks went bankrupt

[1] The Financial System In Russia Compared To Other Transition Economies: The Anglo-American Versus The German-Japanese. Comparative Economic Studies, Spring 1999.

in summer 1998). Recent developments were even less favorable to major banks: the August 1998 financial crisis undermined the positions of FIGs bringing some of them to the verge of bankruptcy and forcing others to sell their industrial property to pay back the debts.

It is reasonable to predict that high-income inequalities will persist in the foreseeable future: even if the government is to adopt a strong social policy, it has only limited abilities to fight illegal incomes - a major source of income differentiation, to collect taxes (especially personal income taxes), and to increase expenditure on welfare.

Recent, and very interesting, studies by of the Oneksimbank (owner of Norilsk Nickel - biggest supplier nickel alloys, one of top four in the world) and Menatep groups characterize their activities towards acquired firms as, first and foremost, preparation for resale, while Alfa Bank publicly proclaims this as a primary goal. As a source of working capital, bank credits were traditionally very important in light and food industries, machinery and equipment and wood industries (i.e. exactly those sectors that recorded the greatest reduction of output in recent years); whereas in resource industries (fuel and energy, steel and non-ferrous metals) over 90% of the working capital was financed from internal sources.

There is an obvious negative relationship between the exposure of particular industries to bank credit and the growth of employment and real wages: the more exposed industries are normally poorly performing machinery and equipment and light industry, while the less exposed are fuel and electric energy, steel and non-ferrous metals. The share of Russian industrial enterprises not using bank credits at all increased from 22% in 1994 to 32% in 1996 (37% in resource industries).[1]

Paradoxically, the performance of these enterprises in terms of output, employment and investment change, capacity utilization, wages, financial conditions, orders and inventories was superior to those that used bank credits. To put in differently, it was the poorly performing companies that borrowed from banks, while bank credits were regarded as the financial source of last resort and were used not for the expansion of output (and even less so—for capital investment), but for survival.

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[1] The Financial System In Russia Compared To Other Transition Economies: The Anglo-American Versus The German-Japanese. Comparative Economic Studies, Spring 1999.

In a sense such strategy of Russian enterprises is not surprising: other surveys suggest that most of them are controlled by insiders and are not aimed at profit, but at maintaining financial stability, output and employment. It is only natural that under these circumstances 71% of Russian managers considered the lack of financial resources, not profitability or uncertainty, the major obstacle to capital investment.[1]

Distribution of long term bank credits across industries follows a similar pattern: it is mostly enterprises in non-resource industries that borrow from banks to finance capital investment, while better performing resource industries rely mostly on internal sources. There is a strong negative correlation between bank financing on the one hand and investment and output on the other. It may well be that larger credits to declining industries are issued under pressure from regional governments. Thus, the Russian banking system redistributes funds not from weak to growing industries, as it normally

[1] The Financial System In Russia Compared To Other Transition Economies: The Anglo-American Versus The German-Japanese. Comparative Economic Studies, Spring 1999.

happens in mature market economies, but vice versa, in favor of declining industries.

Redistribution of funds by Russian banks from strong to weak enterprises; from relatively better off to poorly performing industries do not really contribute to restructuring. Despite the recent emergence of bank-based FIGs, the Russian financial system does not have much chance to evolve in the direction of the bank-based model. FIGs still control a very small portion of the economy, are not able to provide the funds needed for restructuring, and do not yet look like strategic long-term investors.

Banks in particular and institutional investors in general appear to be just one of the groups of important players fighting for control over Russian companies, the other groups being foreign investors, Russian non-financial companies (such as Gazprom, UES, Lukoil, etc.), and individual shareholders. Moreover, losses suffered by major banks during and after August 1998 financial crisis lead many observers to believe that the "era of oligarchs" in the newest history of Russian capitalism is already over.[1]

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[1] The Financial System In Russia Compared To Other Transition Economies: The Anglo-American Versus The German-Japanese. Comparative Economic Studies, Spring 1999.

Three state-controlled banks are expected to dominate: Sberbank, the state savings bank; Vneshtorgbank, the state trade bank; and Vneshekonombank, which issues government obligations. The government also plans to take over SBS-Agro, a commercial bank with a near monopoly on farm lending that lost heavily in T-bills. Finally, a few of regional or sectoral banks will also be allowed to operate. Medium-size commercial banks that survived the crisis will likewise stay in business. Others, such as once powerful Oneximbank, may not close but will remain inactive unless their tycoon owners can accumulate together new capital.

The surprise winners could be foreign banks. Even Russian companies are turning to them. Some 18 foreign banks have licenses in Russia, including Citibank and Bank Austria. Tensions between foreign creditors and local banks are set to rise. Although most foreigners have written off their Russian debt, that won't stop them from suing Russian banks after Nov. 17. Already, Lehman Brothers Inc. and Deutsche Bank have filed suits in European courts to freeze Russian assets. Meanwhile, the government and foreign creditors are close to an agreement to restructure short-term debt. But the Russian offer is worth an effective 10 cents on the dollar at most, says investment bank MFK Renaissance.

# CHAPTER THREE

# GOVERNMENTAL BANKS

## The State Bank of Russia.[1]

The State Bank of the Russian Empire was founded in 1860 in the process of reorganization of Russia's entire banking system. It was established when capitalism was taking root in the Russian Empire and its creation was the first of the "great reforms", by the Russian Emperor Alexander II. Considerable state interference in the economy predetermined the genesis of the State Bank as an institutional element of the government's economic policy.

The State Bank was a short-term commercial credit bank and, according to its statute, it was established "to boost trade turnovers and strengthen the monetary credit system". Its functions were to discount bills of exchange and other government and public interest-bearing securities and foreign bills, buy and sell gold and silver, receive payment on bills and other fixed-term monetary documents for the account of trustees, accept deposits, extend loans and buy government securities for its own account.

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[1] HISTORY, The People's Bank of the RSFSR. www.cbr.ru/eng/history

In the early 1880s the State Bank began to prepare a monetary reform, which was launched in 1895 and ended in 1898 with the introduction of gold production in Russia. In the course of the reform the State Bank was granted the issuing rights.

After the monetary crisis of 1905-1906 caused by the Russo-Japanese war and revolution, the State Bank began to be transformed into a banks' bank. By the beginning of the First World War the State Bank had become one of the most influential credit institutions in Europe. It had vast gold reserves, whose ratio never fell below 93%, except in the crisis year of 1906, and on average exceeded 100%. The State Bank regulated Russia's money circulation and foreign exchange settlements and through commercial banks actively participated in crediting industry and trade.

During the First World War the State Bank was mainly engaged in financing Russia's war effort, and on the eve of the October 1917 revolution the lion's share of its assets was represented by treasury bills and loans against interest-bearing securities. Its gold reserves shrank from 1,604 million rubles as of June 16, 1914, to 1,101 million rubles as of October 8, 1917. The pre-revolutionary history of the State Bank ended on October 25 (November 7), 1917, when its Soviet history began.

On October 25 (November 7), 1917, the Bolsheviks seized the State Bank building in Petrograd (St. Petersburg), but it was two months later that they actually began to control the bank and its operations. In the morning of December 14 (27) the Bolsheviks seized the Petrograd commercial banks and later in the evening the All-Russian Central Executive Committee (VTSIK) issued a decree on nationalization of the banks, which established state monopoly in banking. Private credit institutions were nationalized and merged with the State Bank, which a month later was renamed the People's Bank of the Russian Republic (still later it was renamed the People's Bank of the RSFSR, the Russian Soviet Federative Socialist Republic).

After the autumn of 1918 the People's Bank, which was a part of the People's Commissariat (Ministry) of Finance, known by the abbreviation Narkomfin, began to finance the economy and draft budgets. The policy of War Communism brought about non-cash settlements between the state enterprises and institutions and eventually the bank stopped conducting any lending operations. Its functions as a settlement center were reduced to a minimum, because all settlements were effected with the state budget in line with budgetary financing of enterprises, their profits being transferred to the budget.

When the New Economic Policy (NEP) was launched, the All-Russian Central Executive Committee (VTSIK) and the Council of People's Commissars (SNK) on October 3 and 10, 1921, respectively, passed resolutions re-establishing the bank under the name of the State Bank of the RSFSR. On November 16, 1921, it began to conduct operations and in 1923 it was transformed into the State Bank of the USSR. The bank had the right to extend credits to industrial and commercial enterprises based on different forms of ownership, farms and self-employed handicraftsmen "only under the condition of their solvency and economic expediency".

During the NEP the following types of bank credits were used: bills of exchange discounting, loans on call from special current accounts covered by bills of exchange, and time loans against bills of exchange. In addition, three years after it's founding, the bank began to practice direct target crediting. In October 1924 the State Bank compiled its first consolidated credit plan comprising all branches. As a result of the reform of the cash structure of the State Treasury, conducted in 1925, the cash holdings of the State Bank and Narkomfin were merged.

Soviet Russia's first commercial banks, including sectoral joint stock banks (specialized banks) and mutual loan societies, appeared in 1922. These banks were to extend short-or long-term credits to individual sectors of the economy. In 1924 the Committee on Banks was set up under the State Bank's Board to co-ordinate their activities. In June 1927 as a result of the tighter regulation of the short-term capital movement the State Bank was vested with the responsibility of exercising immediate day-to-day control over the entire credit system, while the Narkomfin retained its function of general regulation.

The State Bank was to supervise the activities of the other credit organizations in accordance with government credit policy directives. Specialized banks were required to keep their free funds in and make borrowings from the State Bank only and the latter was granted the right to be represented in their boards and auditing units. In addition, the State Bank was to increase its share in the specialized banks' equity capital.

As the banking system was re-organized in February 1928, most short-term credit operations began to be concentrated in the State Bank. It also took control of many affiliates of the joint-stock banks, which began to play an auxiliary role in crediting the economy.

In the late 1920s and early 1930s the USSR carried out a series of reforms aimed at creating an effective mechanism of centrally planned regulation of the material and financial aspects of the reproduction process. Accordingly, a credit reform was carried through in 1930-1932, which resulted in the creation of a mechanism of centrally planned regulation of the monetary and credit resource flows. In January 1931 the acceptance form of non-cash settlements through the State Bank was introduced.

As a result of the credit reform the State Bank lost the last commercial elements of its activity and became a typical Soviet state bank, whose main functions were extending planned credits to the economy, managing money circulation and settlements, ensuring the cash servicing of the state budget and effecting international settlements. The structure of the credit system that was established at that time would remain in place for 55 years practically unchanged.

In 1939 the State Bank began to collect cash. During the Second World War (1941-1945) the State Bank issued cash to cover the budget deficit, increasing the money supply fourfold. To normalize the money circulation a monetary reform of confiscatory type was conducted in 1947, during which old money was exchanged for new at the rate of 10 to 1, cash accounts in the savings banks were re-evaluated and the conversion of all state loans, except the 1947 loan, was implemented.

In 1960 the State Bank began to compile long-term investment crediting plans. In May 1961 the ruble was denominated and devalued. One new ruble exchanged for 10 old rubles. At the same time the gold content of the ruble was increased four times from 0.222168 only to equal 0.987412 grams of fine gold.

In 1965-1969 the economic reform brought about some changes in the activities of the State Bank, which were connected with lending and settlements, money circulation planning and regulation, financing capital investments and organizing the savings system. Credits on material assets turnover and wage costs and credits on ordinary loan accounts became the main means of crediting industry.

In July 1987 as a result of the reorganization of the credit system new specialized banks were founded (Vneshekonombank SSSR, Promstroibank SSSR, Zhilsotsbank SSSR and Sberbank SSSR) and the State Bank began to perform the functions of the country's main bank. It was assigned the task of elaborating the consolidated credit plan and planning the distribution of funds and credit investments among all banks.

In March 1989 the transfer of the specialized banks to full cost-accounting and self-financing required that the State Bank provide them with target figures on the volume of credit resources, the amount of funds attracted from the population, and the volume of foreign-currency receipts and payments on banking operations.

In December 1990 the Law on the State Bank of the USSR and the Law on Banks and Banking were passed. In accordance with them, the State Bank of the USSR and national banks, which were being established at that time on the basis of the republican divisions of the State Bank, were to create a single system of central banks based on a single monetary unit (the ruble) and performing the functions of a reserve system.

The Central Bank of the Russian Federation (Bank of Russia) was founded on July 13, 1990, on the basis of the Russian Republic Bank of the State Bank of the USSR. Accountable to the Supreme Soviet of the RSFSR, it was originally called the State Bank of the RSFSR.

On December 2, 1990, the Supreme Soviet of the RSFSR passed the Law on the Central Bank of the RSFSR (Bank of Russia), which declared the Bank of Russia a legal entity and the main bank of the RSFSR, accountable to the Supreme Soviet of the RSFSR. The law defined the functions of the bank in organizing money circulation, monetary regulation, foreign economic activity and regulation of the activities of joint stock and co-operative banks.

In November 1991 due to the establishment of the Commonwealth of Independent States and the dissolution of the Union structures, the Supreme Soviet of the RSFSR declared the Central Bank of the RSFSR the only organ of state monetary and foreign currency regulation of the economy on the territory of the RSFSR. The functions of the State Bank of the USSR in issuing money and setting the ruble exchange rate were transferred to it.

In 1991-1992 an extensive network of commercial banks was created in the Russian Federation under Bank of Russia guidance through commercialization of the specialized banks' affiliates. The Central Bank began to buy and sell foreign exchange in the currency market it established and to set and publish the official exchange rates of foreign currencies against the ruble.

In December 1992 as a result of the establishment of a single centralized federal treasury system, accountable to the Ministry of Finance, the Bank of Russia was no longer required to fulfill the functions of cash servicing of the federal budget.

In 1992-1995 to maintain stability of the banking system the Bank of Russia set up a system of supervision and inspection of the commercial banks and a system of foreign exchange regulation and foreign exchange control. As an agent of the Ministry of Finance, it organized a government securities market, known as the GKO market, and began to participate in its operations.

On April 26, 1995, the Bank of Russia terminated direct lending to finance the federal budget deficit and stopped extending centralized targeted credits to individual industries and sectors of the economy.

Since 1998 the Bank of Russia has been committed to the restructuring of the banking system in order to improve commercial banks' activity and to enhance their liquidity. The key part of that program was the set-up of the Agency for Restructuring of Credit Organizations (ARCO) and Inter-Agency Coordinating Committee for Banking Sector Development (ICC). The Bank of Russia pays much attention to conducting talks with international credit organizations in order to secure funds to maintain the process of restructuring Russia's banking system and to stipulate conditions of technical support. Today the Bank of Russia considers the increase in foreign capital volume in the Russian banking sector justifiable.

The Bank of Russia is accountable to the State Duma of the Federal Assembly, which appoints and discharges the Chairman of the Bank of Russia (at the representation of the President of the Russian Federation) and members of the Bank of Russia's Board of Directors as well as appoints an auditor to the Bank of Russia and approves the Bank of Russia's annual report and auditor's report.

The tasks and functions of the Bank of Russia are set by the Constitution of the Russian Federation and Federal Law on the Central Bank of the Russian Federation (Bank of Russia). The Bank of Russia's main objective is to protect the ruble and ensure its stability. The Bank of Russia is also the sole issuing center and the body of banking regulation and supervision. Its main functions are:

- In collaboration with the government of the Russian Federation, it elaborates and implements a uniform national monetary policy designed to protect the ruble and ensure its stability;
- It is the only issuer of cash and the organizer of its circulation;
- It is the creditor of last resort for credit organizations and organizes the refinancing system;
- It sets the settlement rules of the Russian Federation;
- It sets the rules of conducting banking operations and accounting and the reporting rules for the banking system;
- It conducts state registration of credit organizations and issues and revokes the licenses of credit organizations and the organizations that audit them;
- It supervises the activities of credit organizations;
- It registers the issue of securities by credit organizations in accordance with federal laws;
- It conducts, on its own behalf or on behalf of the government of the Russian Federation, all kinds of

banking operations necessary for the Central Bank's implementation of its main duties;

- It conducts foreign exchange regulation, including operations to buy and sell foreign exchange, and establishes the procedure for effecting settlements with foreign countries;
- It organizes and exercises foreign exchange control on its own and through authorized banks in accordance with the laws of the Russian Federation;
- It participates in making Russian Federation balance of payments forecasts and organizes the drafting of the Russian Federation's balance of payments;
- It analyses and forecasts the state of the Russian Federation's economy as a whole and by region, concerning specifically monetary, credit, foreign exchange, financial and price relations, publishes the corresponding materials and statistical data and performs other functions in accordance with federal laws.

Bank of Russia has more than 25 departments. The most important ones and their functions are following:

The Foreign Exchange Regulation and Foreign Exchange Control Department. Its main functions are:

- To provide a legal framework for the Bank of Russia policy in the field of foreign exchange regulation and foreign exchange control and participate in its implementation;
- To regulate foreign currency operations requiring permission in accordance with legislation;
- To co-operate in accordance with the established procedure with the central banks of foreign countries and international banks and other international and national monetary and financial organizations in the field of foreign exchange regulation and foreign exchange control;
- To analyze the state and development of foreign exchange regulation and foreign exchange control in the Russian Federation in order to improve the foreign exchange regulation and foreign exchange control mechanisms.

The Open Market Operations Department. Its main functions are:

- Participating in the implementation of government's uniform monetary policy by conducting (on behalf of the Bank of Russia) trade operations in the organized government securities market (OGSM);

- Acting as an agent for the Ministry of Finance of the Russian Federation in placing and servicing GKO and OFZ issues in the OGSM and maintaining market liquidity and stability;
- Participating in the management of the banking system's liquidity through operations in the OGSM;
- Participating in drafting regulatory rules related to the functioning and development of the OGSM's Trading, Settlements and Depository Systems;
- Organizing the admission of new OGSM participants and supervising the market participants' trade, settlements and depository operations in the OGSM;
- Conducting broker operations in the OGSM for CIS countries;
- Developing accounting and settlements methods related to operations with securities traded in the OGSM, keeping accounts of the Bank of Russia's own operations in the OGSM, effecting settlements with issuers on the results of OGSM operations and

supervising the activities of the OGSM's Settlements Centers;

- Organizing the collection and processing of primary data on the OGSM, developing new methods and tools of analysis of the OGSM and conducting regular surveys of the OGSM, Bank of Russia operations and the activities of market participants;
- Coordinating the activities of the securities departments of the Bank of Russia's regional branches (national banks).

The Cash Issue Operations Department. Its main functions are:

- Forecasting the volume and organizing the production of banknotes and coins;
- Creating banknote and coin reserve funds and organizing their transportation and safekeeping;
- Upgrading and keeping track of operations involving the issue of money into circulation and organizing its circulation;
- Studying the note structure of cash in circulation and in reserve funds and supplying a sufficient

amount of notes and coins of the required denominations in cash turnover;

- Establishing the procedure for upgrading cash operations in the Bank of Russia’s institutions and credit organizations;
- Establishing the payment capacity criteria for banknotes and coins and the procedure for replacing damaged banknotes and coins, withdrawing from circulation and destroying worn banknotes and coins, and organizing expert examination of Bank of Russia and foreign banknotes and coins;
- Drafting proposals for issuing commemorative coins made of precious and non-precious metals and organizing their manufacture and issue;
- Drafting the rules and regulations for questions within the Department's competence;
- Automating cash operations; organizing technical fortification of the Bank of Russia’s institutions.

The Currency Circulation Regulation Department. Its main functions are:

- Studying and drafting proposals for improving the state of cash turnover passing through banks’ cash departments and the changes in its structure in the Russian Federation;

- Analyzing current changes in the use of personal cash incomes and the sources of these incomes, the causes of these changes and their effect on the state of cash turnover and drafting the corresponding conclusions and proposals;
- Calculating cash volumes in circulation;
- Making cash supply forecasts and evaluating the cash issue levels in the Russian Federation as a whole;
- Drafting proposals on changing the effective cash balance limit in the Russian Federation as a whole and establishing such limits for the Bank of Russia's regional institutions;
- Studying the effect of wage and social payments by legal entities on the state of currency circulation in the Russian Federation and preparing communiqués on these matters;
- Analyzing statistical reports and accounting which characterize the state of cash turnover in the Russian Federation and its regions;

- Drafting Bank of Russia rules and regulations on organizing cash turnover; providing guidance for the Bank of Russia's regional institutions in matters related to organizing cash turnover and rendering them practical assistance in conducting this work.

The Bank Rehabilitation Department.

The main duty of this Department is to organize work on preparing and implementing measures to revive the activity of credit organizations with financial problems and also to ensure reorganization and liquidation procedures concerning the corresponding credit organizations and control over and organization of the work of the provisional administrations appointed to these organizations.

The Department of Organization and Servicing of the Federal Budget and Extra-Budgetary Funds. Its main functions are:

- Organizing methodological work in the banking system on the accounting of budget funds of all levels, program budgetary funds and state extra-budgetary funds and arranging cooperation with the Ministry of Finance of the Russian Federation, state extra-budgetary funds, the budgets of the constituent territories of the Russian Federation and local self-government bodies in tackling these issues;

- Organizing the cash implementation of the federal budget in the banking system and compiling banking reports on the cash implementation of the federal budget and on the balances in the accounts of the local governments and state extra-budgetary funds of the Russian Federation;
- Drafting proposals for the elaboration of uniform state monetary policy with regard to the Bank of Russia's relations with the budgets of all levels and state extra-budgetary funds and on the domestic government debt of the Russian Federation.

The Prudential Banking Supervision Department.

The task of the Prudential Banking Supervision Department is to provide methodological and organizational support for the Bank of Russia's functions in the sphere of prudential supervision over the activities of credit organizations.

The International Operations Department. Its main functions are:

- To elaborate and implement measures to regulate the exchange rate of the ruble against foreign currencies;
- To create and manage the Bank of Russia’s international reserves;
- To work out and implement measures to encourage the development of the domestic foreign exchange market;
- To work out and implement measures to encourage the development of the precious metals market;
- To regulate banking operations with precious metals;
- To manage non-reserve precious-metal assets;
- To participate in the elaboration and implementation of state foreign exchange policy, promote international cooperation in the foreign exchange and investment spheres and establish a system of interstate settlements;
- To work out and analyze the Russian Federation's balance of payments.

Overall, the Russian payments system comprises about 1,400 resident credit institutions, more than 4,000 branches of credit institutions and nearly 1,200 subdivisions of the settlement system and it is the principal means of implementing the official monetary policy by the Bank of Russia.

The credit institutions located in the Russian Federation (resident credit institutions) and having the banking license of the Central Bank of the Russian Federation open only one correspondent account with one of the Bank of Russia institutions (a cash settlement center or operations department), which services them. The branches of credit institutions may have correspondent subaccounts to implement settlements and may not have such accounts.

Credit institutions and their branches with correspondent accounts and subaccounts with the Bank of Russia effect settlements for their clients for commodities, works and services and make tax and other compulsory payments and their own income payments to the budget and payments to the accounts of state extrabudgetary funds through the various divisions of the Bank of Russia settlement network.

Settlements effected through the Bank of Russia settlement network are based not only on paper, but also electronic payment documents. These are the so-called intra- and interregional electronic settlements. The latter are regulated by the Provisions on Inter-Regional Electronic Settlements Effected through the Bank of Russia Settlement Network. The exchange of electronic documents through the Bank of Russia settlement network is regulated by the Provision on the Rules of Exchange of Electronic Documents between the Bank of Russia, Credit Institutions (Branches) and Other Clients of the Bank of Russia in Effecting Settlements through the Bank of Russia Settlement Network, adopted in March 1998. The divisions of the Bank of Russia settlement network participate in electronic settlements as the bodies registering and supervising payments.

After January 1,1998, the Bank of Russia charges a fee for its settlement services. Some kinds of settlement operations are conducted by the Bank of Russia free of charge. The operations conducted with correspondent accounts of correspondent banks are divided into two types: operations to service clients and own interbanking operations.

Savings Bank of the Russian Federation (Sberbank)

The Joint-Stock Commercial Savings Bank of the Russian Federation (Sberbank) has been created as a joint-stock company pursuant to the RSFSR Law "On Banks and Banking Activities in the RSFSR". Its founder is the Central Bank of the Russian Federation. On 20 June 1991, the Joint-Stock Commercial Savings Bank of the Russian Federation (Sberbank) was registered with the Central Bank of the Russian Federation.

The bank's trade (full formal) name is the Savings Bank of the Russian Federation (an open joint -stock company), the abbreviated name - Sberbank. The Savings Bank of the Russian Federation is an open joint-stock company. Its shareholders are the Central Bank of the Russian Federation (57,7% of stock) and over 300,000 legal entities and individuals. The principal objective of Sberbank is to mobilize households' funds and to provide cash and settlement services to individuals and a full range of banking services to legal entities. Sberbank's paid-in authorized capital is 750,100,000 rubles as of January 1, 1999.

Presently the Savings Bank of the Russian Federation:

- Is the leader among Russia's largest commercial banks;
- Runs a countrywide network of offices comprising 73 regional banks, 1,814 branches, 27,544 sub-branches, and 567 agencies. The bank has a representative office in the Czech Republic (Prague) (as of 01.01.99);
- Has the status of a general agent authorized to service accounts of the federal budget and to keep records of its revenues and funds. The bank also enjoys the status of a payment agent of the Ministry of Finance of the Russian Federation for the Domestic Foreign Currency Bond Loan, the State Savings Loan, the State Special-Purpose Non-interest Bearing Loan;
- A payment agent for the 1992 Russian Domestic Lottery Loan;
- A primary dealer in the organized securities market;
- An authorized depository for Lombard operations;
- A licensed agent for managing assets of non-governmental pension funds.

Sberbank bases its policy of operations with state securities on using existing instruments circulating in the market under condition of bringing the risk of loss to the minimum. It is a member of associations of operators in the Russian securities market: PAUFOR (Professional Association of Stock Market Participants), NAUFOR (National Association of Securities Market Participants), PARTAD (Professional Association of Registrars, Transfer Agents and Depositories). At the present moment, it is the only Russian bank in which the State guarantees the safety and payment of households' deposits. To secure its liabilities to customers, the bank maintains a reserve fund equal to about 50% of its paid-in capital.

Sberbank offers corporate customers a full range of banking services in rubles and foreign currencies. Its institutions maintain over 1,000,000 corporate accounts, federal administration bodies and major industrial enterprises being among Sberbank's largest customers.

Sberbank:

- Is the largest bank in Russia to service households' depositors: Sberbank institutions account for 84,9% (as of 01.01.99) of all funds deposited by individuals in this country's commercial banks. Sberbank offers a broad range of retail banking services, different types of ruble and foreign currencies deposits designed for various sections of the population;

Share of Population Deposits in the Savings Bank of Russia and Commercial Banks


Compared to Total Individual Deposits in Banks.

Figure 7. Share of Population Deposits in the Savings Bank of Russia and Commercial Banks. Web page of Central Bank of Russia.

- Issues and services plastic cards of the international systems VISA and Europay, its own chip and magnetic-stripe cards SBERCARD. Sberbank of Russia is a principal member of the international payment systems VISA International and Europay International;
- Maintains correspondent relations with more than 250 foreign correspondent bank. The bank performs transactions in 29 foreign currencies. As a member of the

Society for Worldwide Interbank Financial Telecommunication (SWIFT), Sberbank ensures a prompt transfer of funds to any bank of the world;

- Is a member of several specialized international organizations: the World Savings Banks Institute, the European Savings Banks Group (an observer), the International Banking Security Association, the International Chamber of Commerce, and some others;
- Is sharing actively in the international program to promote small- and medium-sized businesses in Russia implemented under the auspices of the European Bank for Reconstruction and Development (EBRD);

The Bank occupied the top position among 12 biggest Russian commercial banks and, following their 1997 performance, has been included in the listing of the World's Top 1000 banks measured by Tier One Capital and ranks 134 in the world according to the same rating published in the 1998 July issue of "The Banker" magazine. According to *"The Banker"* (September, 1998), Sberbank has been placed 64th in Europe by its first-tier capital, and 103rd by its assets in the 1997 rating list of 500 largest European banks. Sberbank of Russia takes the lead among

Russian banks included in the rating of 500 largest European banks.

Recent History of Sberbank

1990: The Russian Republican Bank of the Savings Bank of the USSR is declared property of the Russian Soviet Federative Socialist Republic. The Savings Bank of the RSFSR is transformed into a joint stock commercial bank.

1991: The general shareholders meeting re-established the Joint Stock Commercial Savings Bank of the Russian Federation as a joint stock company under the Russian Law "On Banks and Banking Activities in the RSFSR", dated December 2, 1990.

1993: Sberbank was appointed an official dealer of the Central Bank of the Russian Federation in Government Short-Term Zero Coupon Bonds and in Federal Loan Bonds. The Bank was also authorized to deal with Gold Certificates issued by the Russian Ministry of Finance. It started the issue of its own promissory notes and certificates of deposit.

1996: Based on the annual results, Sberbank is the only Russian bank to be included in the top one hundred major European lending institutions (ranking eighth in profit and eleventh in return on capital).

1997: The international rating agencies Fitch IBCA and Thomson BankWatch assigned Sberbank a BB+ long-term credit rating - the highest among Russian commercial banks and equal to the sovereign rating of the Russian Federation. The Bank received the status of observer with the European Savings Banks Group (ESBG). Sberbank was included in the list of the top two hundred major world banks.

December 17, 1998: "About 80% or nearly 60,000 depositors, using the opportunity of having liabilities under their deposits transferred from six commercial banks to Sberbank of Russia, have already withdrawn their deposits or transferred their funds to Sberbank", - said Mr. Kazmin, President and Chairman of the Board of Sberbank of Russia, in the program "Hero of the Day".

Currently, Sberbank seems to the only bank in which people's trust. Amount of deposits in Sberbank is 3-4 times higher than in other commercial banks taken together.

# CHAPTER FOUR

# CONCLUSION

## Reasons of Banking Crisis in Russia

1) Specifics of development of financial sector in Russia: political interests and conflicts, high dependency from market of GKOs and other governmental obligations; structure of ownership which allowed one related group of people or organization to have control over bank's operations; low level of capitalization and low requirements of initial capital to open a bank; high expenses on banking infrastructure in order to start operations; demonetizations and active use of barter deals in business which lower demands on banking credits and limited resources available for financial sector, which force seeking of resources abroad for banks and dependency on currency rates; high level of defaults on payments in industrial sector and high credit risk.[1]

2) Politics of banking regulations: mistakes of strategic planning of Central Bank; low control over banking industry

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[1] A. Astapovich, D. Sipmolotov, Russian Banks in 1998: Development of Crisis, Questions of Economics, 5/1999.

and low involvement of enforcement agencies; virtually non-existent legal basement for banking operations including responsibilities of management and stakeholders, system of deposits insurance, procedure of bankruptcy and reorganization of troubled financial organizations; out-of-date laws and regulations by the time they were passed and accepted by every layer of government; mistakes in evaluation of consequences of financial crisis in Asia; not far-sighted decisions of moratorium pack of August 17, 1998.

3) Banking management: inexperience and mistakes of top management of banks; weak development of investment risks and practices; extensive expenses on image, support of fillials, maintaining numerous staff, construction of offices and buildings; high level of operations risks - issuing credits based on personal relationship and friendship; operations within banks-enterprises groups.

4) World economics and Asian crisis: inclusion of Russia into world economics processes, intensive inflows/outflows of foreign capital into/from Russia; reducing prices of world's material markets including raw materials.

Table 10. Dynamics of Oil Export

| Years | Mlns. $ | Mlns. Tons | Price, $/ton |
|---|---|---|---|
| 1992 | 8,545 | 66.2 | 129.1 |
| 1993 | 8,370 | 79.9 | 104.7 |
| 1994 | 11,513 | 95.4 | 120.6 |
| 1995 | 10,413 | 96.2 | 108.2 |
| 1996 | 13,849 | 105.0 | 131.9 |
| 1997 | 13,013 | 109.8 | 118.6 |
| 1998 | 8,790 | 117.9 | 74.5 |
| 1999 | 12,800 | 118.0 | 108.0 |

S. Aleksashenko, A. Klepach. Russian Banks After Crisis, Questions of Economics, 4/2000.

5) Non-compliance of financial sector to demands of economy in general.

With a gradual adaptation of banks to the new conditions of doing business in process, it would be premature to claim that the banking crisis has been overcome. This crisis is being manifested in the persisting problems of recapitalization of those banks, which have suffered the most in the crisis, stagnation on the securities and inter-bank operations market and the continued lack of clients' confidence, above all, population. The banks' current conditions are characterized by lack of experience with credit evaluation, the absence of (or inadequate) legal basement, cross - ownership between enterprises and banks, poorly developed accounting rules, weak enforcement of regulations and the uncertainties raised by the unstable economic processes.

Deposits

Real volumes of banking activity have not regained pre-crisis levels. Between August 1, 1998, and May 1, 1999, the ruble-denominated assets of the banking system increased by 14.4%, while its foreign exchange assets in the dollar equivalent decreased by 26.5%. Growing foreign exchange and credit risks led to a reduction of programs for crediting the economy's real sector.

The sum total of the loans extended by banks to enterprises between August 1, 1998, and May 1, 1999, fell by 7% in rubles and 36% in foreign exchange (the dollar equivalent). The share of loans to the real sector of the economy in the aggregate banking system assets shrank from 34% to 33% in the same period. The inevitable consequence of the financial crisis was the deterioration of bank assets' quality. The share of overdue debt to banks on extended credits in the total credit volume almost doubled: from 5.3% as of August 1, 1998, to 10.3% as of May 1, 1999. The proportion of bad loans also grew.

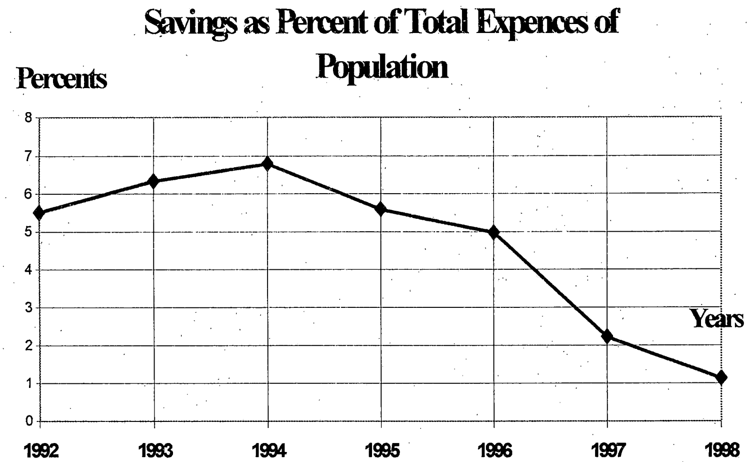


Figure 8. Savings as Percent of Total Expenses of Population. Web Page of Central Bank of Russia.

The investment activity of banks is largely restrained by the narrowness of the resource base. Household bank savings considerably decreased between August 1, 1998, and May 1, 1999: the sum total of the ruble deposits of individuals dropped by 44% and that of foreign exchange deposits by 54%. By and large, the proportion of household deposits in the aggregate liabilities of credit institutions fell from 14.9% as of August 1, 1998, to 13.4% as of May 1, 1999.

However, the fact that the outflow of household savings from commercial credit institutions in 1999 has stopped can be regarded as a positive development. In June-April the ruble deposits of individuals went up by 1.1

billion rubles, or 6.3%, and their foreign exchange deposits remained at the level of the beginning of this year. Between August 1, 1998, and May 1, 1999, attracted inter-bank loans reduced considerably (by 4.8 billion dollars, or 37%) mostly as a result of outflow from the market of the funds of non-resident banks.

Table 11. Composition and Use of Incomes of Households (in Billions of Rubles)

| | 1992 | 1993 | 1994 | 1995 | 1996 | 1997 | 1998 |
|---|---|---|---|---|---|---|---|
| Money expenditures, total | 6132 | 72539 | 348445 | 877602 | 1320712 | 1615724 | 1672652 |
| Including: | | | | | | | |
| Purchase of goods and payment for service | 5175 | 55066 | 235427 | 641488 | 922348 | 1115371 | 1331552 |
| Payment of obligatory dues and various contributions | 580 | 6087 | 24784 | 51884 | 80397 | 116901 | 108464 |
| Accumulation of savings in contributions and securities | 338 | 4959 | 23682 | 49115 | 65789 | 35998 | 18991 |
| Purchase of currency | 39 | 6427 | 64552 | 135115 | 252178 | 347454 | 213645 |
| Increase (+), decrease (-) of money in hands of population | 968 | 7410 | 16389 | 33146 | 18802 | 27489 | 27835 |
| Savings as percentage to expenditures | 5.51 | 6.34 | 6.8 | 5.6 | 4.98 | 2.23 | 1.14 |

Table: Web page of Central Bank of Russia.

## Decapitalization

Decapitalization of the banking system is one of the most serious problems. The largest multidivisional banks sustained the most tangible losses due to the customs of the structure of their transactions (such as considerable investments in the GKO-OFZ markets, a huge volume of futures in the foreign exchange market, borrowings in foreign currencies and active work with household deposits). The assets of the 30 major banks (with adjustments for changes in the exchange rate of the US dollar) shrank by 19.3% in August-December 1998. Capital declined by 57.3% in the same period of time. The situation of the group of the major banks continued to deteriorate. In January-April of 1999, their capital decreased by 40.6%. On May 1 1999, their balance losses constituted 21.2 billion dollars and the number of this group's banks, which are in a critical financial situation, grew by almost 40%.

Against the background of the growing losses sustained by credit institutions, the number and share of loss-making credit institutions decreased from 588 to 415 and from 37.4% to 29.2%, respectively, largely thanks to the Bank of Russia's more vigorous efforts to revoke licenses from such credit institutions. As many as 162 credit institutions lost their banking licenses in the period of January - May 1999 with 52 of them losing their licenses this year.

Lack of experience

Another difficulty is that expertise and procedures in many banks are poorly developed. This is not surprising because banks in the pre-reform system often performed few market economy's banking functions. Their ability to judge lending opportunities from a commercial perspective tends to be weak. Russian banks primarily make short-term loans to affiliated enterprises, which are continually rolled over due to the inability of these enterprises to service the loans. Russian banks thus currently serve in some respects as conduits for state subsidization of enterprises. No restrictions are imposed in Russia on loans by banks to their affiliates.

Russian banks lend funds borrowed from the Central Bank primarily to their owners and affiliates, which generally are insolvent enterprises undergoing privatization. Enterprises in many cases are incapable of repaying the loans. But banks are not required to identify or take provisions against bad loans.

Bank Supervision

Strong bank supervision, including on-site inspection, should be established by legislation. Whether the supervisory function is assigned to the central bank or to a new agency, the supervisors should be insulated from external interference and political pressures.

A major impediment to the effectiveness of banking supervision is not only the lack of appropriate legislation in line with international standards, but also the lack of reliable information and the limited experience of supervisory agencies and auditors. In many cases, the necessary data are lacking which would enable an accurate assessment of the amount of risk borne by a bank. Bank supervisors and auditors should work together with the accountants to improve definitions and practices with the objective of better assessing banks' performance and financial conditions. It is recommended that auditors and bank officials would not be personally interconnected.

Ownership

Most commercial banks in Russia are at least partially owned by enterprises. The conflict of interest this creates is a recipe for crisis. It threatens not only the effectiveness of banks, but is also likely to prevent competition in the financial spheres and to mislead the allocation of resources. As it has been written above, this threat can be avoided by the introduction of regulations to limit the lending to shareholders to the equivalent of a small proportion of capital.

Although Russian banks generally are limited to banking activities, they are not prevented from owning subsidiaries engaged in any line of business. Russian banks own life insurance and real estate development companies, among other non-banking activities.

<u>Deposit insurance system</u>

Deposit insurance system will provide additional sense of security for savers and will allow uncovering stashed under mattresses funds.

Russian commercial banks generally fund their lending activities with borrowings from the Central Bank and deposits of affiliated enterprises rather than with deposits from the general public. Only about 10-15 percent of the deposits of individuals in Russia are held by Russian commercial banks, with the Central Bank-controlled Sberbank, the main savings bank in Russia, holding 85-90 percent of individuals' deposits. Although Sberbank is backed by a government guarantee, no deposit insurance currently is available for deposits in commercial banks.

The Russian banking law provides that "banks shall be required to maintain insurance and contingent funds," the procedures for which shall be prescribed by the Central Bank. In addition, the law provides that "banks shall be required to insure deposits of individuals in accordance with the procedure and on the terms prescribed by" the

Central Bank. The Central Bank, however, does not appear to have prescribed any deposit insurance requirements as yet and no Russian banks appear to offer deposit insurance.

Legal responsibilities, disclosure, bankruptcy

Legal responsibilities, disclosure and bankruptcy procedures laws are needed to prevent capital flow from one insolvent bank to another by changing legal attributes - name, addresses and other.

Securities market

The extent of securities activities permissible for Russian banks is unclear, mostly because the securities market in Russia in Western meaning is undeveloped. Russian banks are authorized to act as agents in brokering securities for their customers, but their authority to underwrite and deal in securities is not clear.

Some banks may organize and manage mutual funds in connection with the privatization process. A representative of the Russian Anti-Monopoly Committee expressed his view informally, however, that banks should not be allowed to sponsor such funds.

Bank Risks

- Default, operating, interest rate, and liquidity risks.

These risks are extremely high due to the incompetent lending practices (mostly to affiliate enterprises that often insufficient), lack of experience and knowledge, absence of legal foundations, and due to overall unstable economic and political situation in the country.

- Fraud risk.

High as shown by recent scandal where inside employee(s) of one of processing centers were involved in fraud with ATM cards. Information form about 280 ATM cards used in ATM machines mostly in Moscow was used abroad to withdraw cash form these accounts.

The key activity for Russian banks remains the struggle for access to budget resources at all levels, and rivalry for participation in investment and monetary competitions, as well as the redistribution of state and privatized property. Russian banks are inconstant with the goals and functions of Western banks and oriented primarily on gaining short-term profits. Services they provide that compatible in quality and importance with Western banks are payment system and support in international trade (that also became an official way for capital outflow).

- Credit Risks: risks of default on loans.
- Financial risks: risk related to rate of exchange and potential future reevaluation due to exchange rate fluctuations, risk related to operations with stocks, governmental obligations, changes in interest rates.
- Risks of loosing liquidity: expenses to rebuild necessary levels of liquidity.
- Risk of non-balance operations: forwards and futures deals including with currencies.[1]

Publicly available information about banks

Although there is a list of financial statements, which are supposed to be submitted to different governmental and taxation agencies, my efforts to find these statements from publicly available sources were unsuccessful. I did have found a magazine that would contain only tables, numbers, and other statistics. However, as I have began searching for particular banks, I have noticed that some information was missing - if bank

[1] S. Aleksashenko, Russian Banks After Crisis, Question of Economics, 4/2000.

feels that a number is not favorable it does not submit it because this magazine does not requires to send information but is expecting that information would be sent. Thus, it would be hard for potential depositors and investors to properly evaluate banks' operations and condition without asking friend of the friend who works in tax police to find needed documentation.

No formulas used to evaluate bank's condition in West would work properly in Russia due to huge difference in structure of banks actives and passives, availability of true information, and types of activities.

## What is Next?

Active participation of the government in financial markets are required in order to create legal base, protection of new forms of financial institutes (which would be banks and financial organizations operating according "classic" definitions of financial institutions), creation of institutions that would solve and arbitrage disputes and conflicts, support economic policies of stable ruble and stock market.

If nothing undertaken to stabilize financial markets and rationalize financial industry, the development of economy and financial organizations will repeat itself as it was from 1991 till 1998. First, stocks of profitable enterprises will grow hundreds of percents. The prize of these enterprises is underevaluated and was underevaluated even right before crisis. Future potential of their stocks growth would attract Russian and foreign investors and show at the beginning that economy is stabilizing. Inflow of foreign capital will help stabilization of ruble, increase currency reserves, inflation will fall, and even some industries will show growth in production.

However, high profitability of speculations with stocks would prevent investments into real production industries, lower risks of manipulations with stocks and bonds may even cause outflow of financial funds from production sector of economy toward financial speculations. This situation would lead to worst conditions in production industry, decrease in operations, increase in defaults, and further decrease in investments into production.

Depressing conditions of production sector would sharply contrast with flourishing financial markets. Salaries of production workers would decrease or paid late, demand on products manufactured inside the country would decrease causing further fall of production and bankruptcies. On other hand, active inflow of investments into financial markets will cause its instability. Growth of monetary mass would exceed growth of production and supply of goods. Investors will jump from one profitable sector of financial market toward another reducing stability of market and ruble. Temporary stabilization of financial markets would be caused by disproportional growth of financial markets with dying industry sectors on the background. Soon enough, system will lose stability, investors will convert rubles into currency and send out of country, and crisis will happen again.

New crisis will probably completely destroy financial markets of the country including banks that survived crisis of 1998 due to support and control of the government. The government will not posses enough funds and power to prevent or lessen degree of the next crisis.

As of crisis of 1998, there were warnings from scientist to government and management of Central Bank about coming troubles in financial markets and were suggested some contracts to liquidate crisis conditions. There were several seminars of leading scientists about crisis conditions. Half-year before crisis, Duma accepted the law about emergency acts of preventing coming crisis, but this law was dismissed by the government. Four months before crisis the document that contained detailed prognosis of crisis development and preventing acts was submitted to government and Central Bank by head of Trade-Financial Union D. Mityaev[1]. But nothing was made. The basic reasons, as was determined by investigation later after crisis, were incompetence of management, negligence, and conflict of interests - Central Bank was the biggest operator on the governmental obligations and GKOs.

Central Bank will have hard situation of managing monetary masses inside the country: expected increasing inflow of Russian and foreign investors will force Central Bank to participate in order to control volume of rubles.

If Bank will not buy incoming currency, stability of ruble rate will fall and production manufactured inside the country will lose its competency. It happened inn 1993-1994 when ruble grew three times; Russian goods were forced out of market. Decrease in production sector was 21% in 1994, heavy machinery construction - 31%, consumer goods - 30%, Russian goods were supplemented by imported goods.[2] The

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[1] C. Glasev, New Financial Crisis in Russia? Questions of Economics, 6/2000.

[2] C. Glasev, New Financial Crisis in Russia? Questions of Economics, 6/2000.

policy Russian government and Central Bank used to avoid inflation pressure of growing monetary masses, excess of mass was supposed to be tighten by administrative (increase in reserve requirements) and market (increasing interest rate on governmental obligations and deposit rates) measures.

One way to tighten exceeding monetary mass is to borrow under percent. Since Central Banks does not have aim to benefit from commercial investment, to pay the interest Bank will have to print which will lead to growth of mass. Bank would avoid this situation if it would invest into some kind of operations and use revenue to pay interest. But in case of industrial or production sector loans, but the situation in these areas of economy would lead only to losses rather than profits. Another way to tight funds is to operate in highly speculative financial markets not related with industrial sectors; however, such speculation again would cause increase in monetary mass not supported by supply of goods. As this financial "pyramid" growth, stability of financial markets will lessen and as soon as investors feel it, capital will start to flow out of country.

The way to avoid such destructive policies is to make production sector of economy attractive for investments.[1]

- Central Bank can give credits to commercial banks for obligations of enterprises as collateral - first, profitable enterprises, then less and less profitable with privileges in dealing with losses of commercial banks due to credits to non-profitable enterprises (tax exempt, lower interest rates, e.t.c.).
- Transfer operations with monetary supply by regulation of interest rates and decrease of rates until level of average profitability of industrial enterprises would be reached. This level should be identical with rates on bank deposits.
- Central Bank should guaranty the credits to enterprises.
- Control flow of internal and foreign speculative portfolio capital by studying its dynamics and create adequate reactive measures. Uncontrolled excessive inflow or outflow of foreign speculative capital could cause financial shocks and lead to crisis. The

[1] C. Glasev, New Financial Crisis in Russia? Questions of Economics, 6/2000.

prevention could be done by creation of paper regulations such as, for example, law to declare preliminary significant amounts of currency withdrawals from country.

## Possible Solutions to Restructure the Banking System

- Lack of banking capital.

It can be a result of losses due to crisis and not necessary leads to banks' inability to serve their obligations.

  - Establishment of realistic regulations and time schedule for fixed time period in order to increase resources of banks.
  - Governmental participation and buyout of part of banks actives (through credits) to rebuilt capital in order to meet capital requirements. To avoid inflationary processes, banks would spend received credits to buy long-term governmental obligations.

- Current lack of liquidity.

As a result of mistakes of banks' management of matching actives and passives, or sellout banks' liquid actives to serve their obligations.

- Buyout by government of operating actives of banks and following sellout to other banks.
- Involvement of banks, in whose capitals government actively participates, to fund reliable long-term actives.
- Offer credits to support current liquidity.

- Lack of current profits.

As a result of losses of operating actives parts related to necessity of serving obligations or due to fall in quality of actives.

- Involvement of banks to participate in governmental programs such as crediting, serving governmental profitable enterprises, credits of export business of governmental enterprises.
- Transfer of banks to serve governmental enterprises in banks' regions.
- Buyout by governmental of regional filials of banks' and joining them with regional banks that government is interested in.

- Buyout of actives with low quality.
- Direct financial help (one-time donations, credits with lower interest rates, selling to banks highly profitable governmental obligations.)

- Losses of banks due to growth of costs of obligations (exchange rates reevaluations, forward deals, losses of actives due to bankruptcy of borrowers).
    - Transfer of part of obligations to banks controlled by government and provide guarantees to receiving banks.
    - Direct financial help (one-time donations, credits with lower interest rates, selling to banks highly profitable governmental obligations.)

- Force joining and merging of small and inessential banks to form bigger and more reliable banks.

- Involvement of foreign investments to banking organizations, which have financial troubles currently but possess high potentials in future operation. Attract such investors by showing them that investing or participating in such banks would require lower investments compared to building financial institution from scratch. Increase requirements to banks operating with foreign investments and create necessary governmental guarantees to foreign participators.

# CHAPTER FIVE

## MONEY LAUNDERING

Many different terms exist to describe cash outflow from country: money laundering, money run, outflow of capital, capital leakage, etc. However, transferring of capital abroad can include official and legal ways. Inclusion of Russia into world markets would consequentially lead to increase in outflow/inflow of capital from Russia. In addition, activities that are considered illegal abroad may be officially accepted in Russia. Thus, it is hard to say that law is broken and specify whose law was broken.

There are different estimation numbers of annual capital outflow used by different agencies: fro example, during period of 1992-1998 volume of outflow according to different agencies fluctuated from $40 to $400 milliards. Minimal balance belongs to official statistics bureau and was derived from BOP, maximum amount was given by Ministry of Internal Affairs of Russian Federation, which used volume of resources spent by Russian citizens abroad. Between these two extremes, there are several other estimations:

- $230 milliards - according to Ministry of Economics of Russian Federation,
- $130-140 milliards - according to Central Bank,
- $130 milliards - according to independent consulting agency "Fitch,"
- $50-60 milliards - according to World Bank and Paris Club.[1]

Dynamics of outflow is not constant: according to Ministry of Internal Affairs, maximum amount of $15-20 milliards a year were in years of 1992-1993. Currently this numbers are around $9-14 milliards per year. Majority of transfers from Russia have money-laundering flavor.

[1] Graph: E. Gvozdeva, A.Oleinik, Analysys of Capital Outflow, Questions of Economics, 2/2000

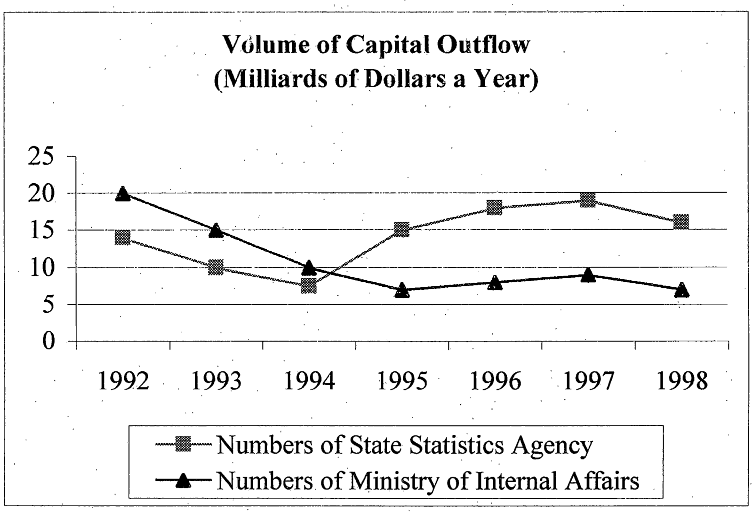


Figure 9. Volume of Capital Outflow (Milliards of Dollars a Year). Gvozdeva E., Oleinik A. Analysis of Capital Outflow, Questions of Economics, 2/2000.

The general reason of capital outflow could be described as to avoid instability of markets and economics inside the country including taxation policies, and non-existent legal support for investors. Capital may come back to Russia as highly speculative funds that would be used for very short-terms and would go out of country again. Russian investors prefer to invest abroad because of guarantees and protection of other state and international laws.

There are several reasons of transferring capital out of Russia:

* Creating predictable conditions for investment - reducing risk of investment including financial risks and legal support for recovery of defaults.
* Legal support and protection for investors in developed countries.
* Minimization of taxes.
* Insurance against inflation.
* Money laundering.
* Savings for "rainy day" due to political, social, and economical instability.

Table 12. Reasons and Locations of Capital Outflow

| Goal | Form of Outflow | Countries | % of Total |
|---|---|---|---|
| Business Development and Investments | Direct investments into foreign companies | Hungary, Finland, Czech Republic | 10-15 |
| Minimization of Taxes | Deposits in foreign bank and/or direct investments into foreign companies | Bahamas, Cyprus, Latvia, Nauru, Canary Islands | 15-20 |
| Savings | Investments into real estate, savings accounts | UK, Spain, Canada, Cyprus, Malta, Holland, USA, Swiss, Italy | 65-70 |

Table: E. Gvozdeva, A.Oleinik, Analysys of Capital Outflow, <u>Questions of Economics</u>, 2/2000.

Channels used to transfer funds out of country:

1. Obtaining permission from Central Bank. Residents can apply for permit from Central Bank to operate with capital currency operations by presenting supportive documents from Ministry of Economics or Ministry of Trade, or other agencies. If permit were valid, there would be no question to further currency operations including transfers abroad.
2. Fake deals: deals with foreign companies for import with pre-payment without receiving goods or bankruptcy of supplier right after receiving payment; higher/lower prices shown in documents than actually paid with difference transferred offshore; export without pre-payment; penalty payments as if company broke the conditions of contract; payments for services, value of which is hard to estimate (marketing research or consulting service).
3. Offshore companies. Signing the contracts with offshore companies and leaving biggest part of profit there is official and do not break laws however unethical it is. Offshore companies can be used also for fake deals and laundering money because local authorities are interested in capital inflow.

4. Issuing if credits abroad. "Default" of foreign partners leaves money abroad on bank accounts. In addition, interest rates can be shown higher / lower than actual.
5. Using slacks in customs laws and regulations.
6. Carrying money abroad as cash.
7. Financial mechanisms. Using such instruments requires skills and experience but, at the same time, allows using slacks in laws, reduce taxes, transfer capital.[1]
8. Other: art, valuable materials, etc.

Milliards of dollars are flowing out of Russia to foreign bank accounts. Russia's exports, as a country, stands for about $80 billion - so, there's lots of transactions that take place. That might be money that Russians have earned, and they may have earned it legitimately. It may also be money that foreign investors invest into Russia. Some of the activities may result from Russian individuals and businesses sending their legitimate assets abroad for safekeeping. Some could involve Russians conducting business with Western companies and paying for Western goods. Neither of these activities is per se

[1] L.Abalkin, Changes in Structure of Financial Market and Outflow of Capital, Question of Economics, 2/2000.

illegal under United States law. However, the activities could involve violations of Russian currency tax or other laws.[1]

Communist Party and KGB had started money outflows long time ago. In 1991 after Soviet Union became Russia, the huge sensation was the disappearance of Party’s money. According to F. Ermarth, one international detective firm had been hired by the Yeltsin - Gaidar government to find astronomical sums essentially stolen by the KGB on behalf of itself and the Communist Party of Soviet Union (CPSU) and deposited abroad in bank accounts and front companies.

Specialists on the KGB had observed such activity since the late 1980s. Using semi-private cooperatives, the KGB was selling cheaply acquired Soviet commodities abroad at world prices, putting the proceeds into disguised foreign accounts and front companies. Initially the KGB objective was simply commercial cover. But the program evolved into operating businesses for off-budget revenues, and from there into avenues for squirreling away funds for the safe retirement or political comeback of embattled communist leaders.

[1] U.S. representative Jim Leach Holds Hearing On Russian Money, September 22, 1999.

What sums were involved? Some in the U.S. intelligence community estimated about $20 billion. But there was a width of uncertainty: one private analysis estimated $4-6 billion; Russian press speculations ran to 100 billion. By all reckonings the amounts were very substantial. About a year later company located substantial funds expatriated by the KGB. It informed its client and suggested approaches for recovering the funds. By that time, however, the Russian government no longer seemed to be interested. Obviously, top officials and organizations had found ways to access the funds that did not require, indeed would be disrupted by, official efforts to repatriate them.[1]

Details from another investigation conducted in Switzerland shows records and signed receipts indicating financial payoffs to Yeltsin and his daughters, Tatyana Dyachenko and Yelena Okulova.[2] A Swiss construction company called Mabetex, which won contracts for extensive restoration work at the Kremlin, allegedly provided them credit cards, paid bills amounting to tens of thousands of dollars, and put $1 million in a Budapest bank account at

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[1] Seeing Russia Plain. The National Interest, Spring 1999.

[2] Kremlin Gilt - Or Is It Guilt? U.S. News & World Report, September 20, 1999.

their disposal. Mabetex is owned by businessman Behgjet Pacolli, an Albanian Kosovar. Swiss investigators are looking into charges that Mabetex paid $10 million in bribes in exchange for $300 million in contracts to renovate the Kremlin and other official buildings in Moscow.

Last January Swiss authorities raided Mabetex's headquarters in Lugano and found records documenting credit-card purchases in the names of Boris Yeltsin, his daughter and close adviser Tatyana Dyachenko, and her older sister, Yelena Okulova. The bills for the American Express card in Yeltsin's name were small, but the Eurocards purportedly held by the daughters ran up charges of nearly $600,000 in 1993 and 1994. The bills allegedly were paid by Pacolli. He has denied doing so, but concedes he did pay credit-card charges for some Kremlin officials. The Kremlin calls the entire Mabetex story "fictitious."

Investigators also discovered a mysterious account called "Dean" at Switzerland's Banca del Gottardo. According to documents obtained by the Italian newspaper Corriere della Sera, the Dean account was held in the names of three people: Pavel Borodin, the official in charge of Kremlin renovations; Borodin's daughter, and Behgjet

Pacolli. (Borodin denies that he ever had foreign bank accounts.) Documents show that on Dec. 5, 1995, $1 million went into the Dean account from Pacolli's personal account. That day, $1 million was transferred to an account at the Central European Bank in Budapest.[1]

Payoffs and bribery were deeply ingrained during the old Soviet system, and the transition to free-market democracy has fostered international money laundering and corruption on a grand scale. Since the collapse of the Soviet Union, legal chaos and punitive taxes have been additional incentives for many Russians - especially business owners, politicians, and crime bosses - to hide finances and legitimize illegal income. Lev Makarevich (1999) of the Russian Association of Banks believes $2 billion to $3 billion now leaves Russia each month, most of it illegally. And he estimates $500 billion has been spirited to offshore institutions — like the Bank of New York - since 1991, three times the total of all Western aid received by Russia.[2]

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[1] The Incredible Fleecing Of Russia. Newsweek, October 4, 1999.

[2] Kremlin Gilt - Or Is It Guilt? U.S. News & World Report, September 20, 1999.

Says Richard Palmer, a former CIA station chief in the Baltics: "There are literally no Russian banks without ties to organized crime." When Primakov unleashed General Prosecutor Yuri Skuratov in 1998 with orders to track down the illegal flight of capital, one of his first targets was Yeltsin friend Boris Berezovsky, suspected of diverting Aeroflot profits to Switzerland. In turn, Yeltsin fired Primakov, who had refused to stop the investigation.

Skuratov persisted, naming some 780 officials under investigation for illegal trading in lucrative treasury bills. Among them was Anatoly Chubais, Yeltsin's deputy prime minister and close adviser, initiator of privatization. Last April, Yeltsin suspended Skuratov after the Kremlin had Moscow television station broadcast videotape that appears to show the prosecutor cavorting with two young prostitutes. But members of the upper house of parliament, suspecting a Kremlin plot to block his investigation, refused to accept Skuratov's request to resign for "health reasons."

With the help of Swiss authorities, Skuratov has continued to follow the money in Switzerland, turning up apparent evidence of kickbacks to Yeltsin, his daughters, and Kremlin property czar Pavel Borodin, who directed the

Kremlin's costly refurbishing. Once Skuratov's Moscow apartment, country home, and his mother-in-law's apartment were searched by investigators in what he decried as an effort to silence him. Skuratov says he has evidence of Kremlin misdeeds and is aggressively investigating Yeltsin, although he stops short of directly accusing the Russian leader of corruption.[1]

There is also much speculation about the millionaire Boris Berezovsky. Primakov had feuded with the powerful banker and was said to be behind the money-laundering charges filed against him. Some insiders believe that Berezovsky and Russia's other "oligarchs" got their revenge by plotting Primakov's ouster with the help of Yeltsin's daughter, Tatyana Dyachenko. "The talk of prosecuting Berezovsky must have really hit Yeltsin's family, because he is reputed to be their financial adviser," says David Satter, a Russia scholar at the Hudson Institute in Washington. "Yeltsin must be concerned that his family could become a scapegoat once he's no longer in power."[2]

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[1] Kremlin Gilt - Or Is It Guilt? U.S. News & World Report, September 20, 1999.

[2] Relapse In Russia. U.S. News & World Report, May 24, 1999.

The current situation with criminal money laundering and corruption is briefly described by Jim Moody, former Deputy Assistant Director, FBI Criminal Investigative Division and by Strobe Talbott, Deputy Secretary of State during U. S. Senate Committee hearing on corruption and money laundering in Russia:

TALBOTT: "Russia's criminal class has evolved from the black marketeers, minor thugs, and fixers that existed at the fringe of the old Soviet state, into the sophisticated power brokers and money men who are pushing a once vast and powerful empire into wholesale criminality and corruption. Russians describe the current period as a smutna, or time of troubles, a chaotic interregnum like that of the early 17th and 20th century when anarchy ended only with the establishment of yet another autocracy. Russia is going through a revolution, a depression and a gold rush simultaneously. Everything is up for grabs and might make right."[1]

"... I quoted Mr. Yeltsin, who acknowledged publicly that the mafia is the single greatest threat to the survival of Russian democracy. And a statement that was

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[1] U.S. representative Jim Leach Holds Hearing On Russian Money, September 22, 1999.

underscored by the 1994 mafia contract killing of Dimitri Kaladov, the investigative reporter who was looking at what was happening in Moscow at the time.

I started dealing with the Russians in October 1990, and from day one I found out that corruption was one of the major problems that they were facing: corruption and organized crime. To give you an example, during one of my trips to Russia, in the early morning hours - and it must have been 3:00 or 4:00 in the morning - a high- ranking Russian official brought seven officers in to meet me so we could talk a little bit, and he wanted me to meet people in Russia that weren't corrupt. In other trip I met a high-ranking officer and he estimated that 90 percent of his officers were corrupt, which is a monumental problem to address. But almost always, when they talk about corruption over there, they say the court system is worse."[1]

MOODY: "... The biggest threat facing us today in the United States is the literally billions of dollars that these people have generated that they're going to start investing. And the best place in the world to invest right now is the United States. So they're going to be purchasing

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[1] U.S. representative Jim Leach Holds Hearing On Russian Money, September 22, 1999.

companies, they're going to be establishing companies, or they're going to be investing in our stock market to have a tremendous economic effect upon us. Now, I am an experienced organized crime investigator, and I have never found anybody who was a criminal, who gained his money as a criminal, that did not run a business illegally once they get control of it. The long-term effect of what we're facing is monumental, and I don't know how bad it's going to be."[1]

According to the Hudson Institute, "20,000 crimes connected with official corruption are recorded every year, but this is probably less than 1% of the real total. A recent poll of Moscow businessmen revealed that several thousand bribes are given and taken in the capital every day." Corruption and crime act as confiscatory taxes and make normal, unfettered commerce impossibility. [2]

On of the numbers shown during hearing is that 80 percent of the funds form Russian organized crime operations first coming to the United States. And of those funds from the U.S., 60 percent arrive from the city of

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[1] U.S. representative Jim Leach Holds Hearing On Russian Money, September 22, 1999.

[2] Russian Meltdown: Don't Blame Capitalism. Human Events, October 1998.

Boston. Britain Criminal Intelligence Agency sent a report to Premier-Minister that every year around $20 milliard of laundered money from Russia come to Great Britain and that London is popular place of living or visitors for at least 200 leaders of criminal organizations of Russia.[1]

Another sensation of year of 1998 is laundering about 70 milliards of dollars through small island of Pacific Ocean - Nauru. However, according to Victor Melnikov - assistant of president of Central Bank - these money represent total amount transferred through the island during official business processes. Majority of operations are performed through Ecumene Bank, Inc. (Nauru), whose customers are biggest corporations and companies of Russia including Gasprom and other companies involved into oil and gas business.[2]

How is it happening? There are few scenarios:

A Laundering Scenario: Tolling.

1. Russian company sells oil to its own overseas shell company at far below world price.

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[1] Dirty Money Flow From Russia, Argumenti I Fakti (Moscow), May, 2000.

[2] Miracle Island, Argumenti I Fakti (Moscow), 8 November, 1999.

2. Shell company resells oil at international market price, earning huge profits.

3. Profits are funneled through foreign banks into overseas investments or back to Russia.

Another Scenario: Loan Theft.

1. State funds, which could include IMF loans, are funneled to a shell company overseas.

2. Shell company deposits money in multiple accounts at a foreign bank.

3. Deposits are transferred to offshore investment or back to launderer in Russia.

Third Scenario: Offshore.

1. Company opens an offshore account, somewhere in Cyprus where there is no checking of income sources.
2. Transfer money to other offshore account in another place or country.
3. Returning money back to Russia as payment for some fake service.

Fourth Scenario: Improved Offshore.

1. Because company pays taxes on profits for performed services, company still transfer money to offshore accounts.

2. But funds are returned to Russia not as payment but as a credit (that is not taxable).

One troubling charge has been that the Russian Central Bank that received the money from IMF loan programs sent some of that money to an offshore bank - FIMACO a small offshore company located in the British Channel Islands. Most recently, the Russian Prosecutor General Yuri Skuratov reported that the Russian Central Bank transferred $50 billion in hard currency reserves in FIMACO. Central Bank officials have since confirmed they used FIMACO to protect assets from foreign lawsuits and that some of the money originated from the IMF. But officials have offered glaring discrepancies over the sum involved. The bank's deputy chairman, Oleg Mozhaiskov, says $1.4 billion was parked there at the height of its activity in 1994. But a predecessor of Mr. Mozhaiskov, Sergei Alexashenko, confirmed the prosecutor's citation of $50 billion. Also unclear is where the profits earned on commission went. Current and former Central Bank officials deny wrongdoing.[1]

FIMACO was fully owned by the Paris-based Eurobank, which is 77.75 percent owned by Russia's Central Bank.

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[1] Laundering Yeltsin. Nation, October 4, 1999.

Other Eurobank shareholders include some of Russia's giants - diamond firm ALROSA and oil companies Yukos and Rosneft. In turn, the Monitor has learned that FIMACO owns 35 percent of another Eurobank subsidiary, Eurofinance, which holds stakes in Russian banks and firms.[1] A 1993 document signed by a senior deputy to Viktor Gerashchenko, then and now the head of the Central Bank, makes it clear that cash transfers to the offshore firm were highly sensitive. "The balance of the investment account of the [Central Bank] in FIMACO shouldn't be disclosed on the balance sheet of the bank," wrote the aide, A. V. Voilukov.

Just a week before Russia's first major devaluation, Gerashchenko ordered a transfer of $1.4 billion in hard-currency reserves to FIMACO--one third of the bank's reserves at the time. Why the bank chose to transfer that sum a week before devaluation is unclear. What is clear is that the reserves were not used to help defend the ruble. FIMACO's most controversial transactions came in early 1996, as Yeltsin was gearing up to win re-election. The Central Bank channeled tens of millions through FIMACO into Russian domestic bonds. The transfers were made before

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[1] Lenders Learn From Russian Ploy. Christian Science Monitor, February 23, 1999.

foreign institutions like Eurobank were permitted to buy domestic bonds. In three separate investments, the Central Bank invested more than $143 million in domestic bonds during the 1996 campaign. At the time, interest rates on the bonds were stratospherically high; the bank made a profit of $38 million. There are some suggestions that some of the profits may well have ended up helping to fund President Boris Yeltsin's 1996 re-election.

Aside from the issue of hiding money from creditors, many questions have been raised over whether FIMACO served as a conduit for capital flight, estimated at $150 billion over the past decade. That sum is equal to the country's entire foreign debt. Analysts believe FIMACO's relationship with other Central Bank subsidiaries - a circle of companies that own parts of each other -could enable it to be used as a passage for channeling capital abroad. The Central Bank, via these daughter companies, invests commercially - a highly unusual practice.

The FIMACO revelations come at a delicate moment in Russian-IMF negotiations, which may explain the IMF's reluctance to comment further. Moscow, in the throes of a severe economic crisis, is seeking more loans because it says it cannot repay $17.5 billion of debt falling due this year. Central Bank reserves are dangerously low for such an indebted country - $11.3 billion dollars, of which only $7 billion is held in cash.

The Central Bank says FIMACO--a company it controls but that apparently has no employees or offices--invested the hard-currency reserves wisely. But it has yet to provide a real accounting of how that was done or of where the profits from those investments have ended up. Skuratov resigned his post the next day (medical problems was the explanation); the bank claimed it hid the reserves to protect the money from foreign creditors; and now Nikolai Gonchar, an independent deputy in the Duma, is accusing the Russian Central Bank of having transferred those reserves from the offshore account back into government treasury bills and concealing the profits.[1]

A recent independent audit confirmed that the Russian government had channeled $1 billion in foreign currency reserves offshore in an apparent speculative scheme and that Russian officials cannot explain what happened to a $4.8 billion IMF loan last year. Russian Central Bank

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[1] Just Say Nyet. New Republic, 3/22/99.

officials said the $1 billion was transferred offshore in an attempt to boost the market for government debt.[1]

The Kremlin's own study of corruption, released in the summer of 1998 estimated that it was costing the country somewhere between $15 billion and $20 billion every year. For comparison, the IMF has loaned a total of just $16 billion to Russia since 1992.[2]

In Russia, money is stolen hand over fist in all sorts of ways. One despicable practice is known as "authorized banking," whereby a politically connected bank is authorized to handle federal budget money. Pension payments, subsidies for Russia's remote Far North communities, funds to rebuild Chechnya - all of it pours into these banks, and far from all of it comes back out.

Yeltsin's regime has also handed out lucrative exemptions from customs duties on imported alcohol and cigarettes. These have gone, among others, to the Orthodox Church and to a fund for excellence in sports headed by Yeltsin's tennis coach and friend, Shamil Tarpishchev.

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[1] The New Debate: Will A Cold Shoulder Replace Post-Cold War Optimism? CQ Weekly, 7/10/1999.

[2] Laundering Yeltsin. Nation, October 4, 1999.

Collectively these exemptions have cost the national coffers hundreds of millions of dollars.

Money is also sometimes diverted from corporations, often with Kremlin acquiescence. Prosecutors say hundreds of millions of dollars have been siphoned from the airline Aeroflot--a partly state-owned company that was run by Yeltsin's son-in-law--into a Swiss shell company. And when parliamentary auditors uncovered massive theft at the state-owned Ostankino television station in 1995--Channel 1, the only station that could be seen throughout Russia--Yeltsin "solved" the problem by signing a decree liquidating Ostankino and transferring all its equipment and privileges to a new company called ORT.[1]

Operations of governmental companies give the ground for thoughts about the aim of the business. State budget receives from majority of these companies almost nothing because state does not know what is going on inside organizations. For example, according to labor laws, the difference between earnings of highest and lowest wages should not be more than 10 times. However, often it is far form true: the difference reaches up to 100 times. In

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[1] Laundering Yeltsin. Nation, October 4, 1999.

addition, resources of companies are used to purchase houses, apartments, and cars for their management.

Another example is October Rail Road corporation that sold stocks of Baltiysky Bank for 10 million of rubles in May 1998 and bought it back in October for 276.5 millions of rubles. Even if take into considerations inflation after August crisis, the difference between selling and buying prices is significant and probably pocketed by somebody from top management.

Big state owned enterprises have tenth and hundreds of "daughter" – companies – companies organized and sponsored by these enterprises. Through such "daughters" cash flows outside the enterprise and outside of country. For example, "Rosvooruzhenie" – enterprise in military equipment and weaponry – invested more than $100 millions of dollars into 61 "daughter" – organizations, but received as dividends so far only $2.2 millions.[1]

Privatization auctions also bring questions about its legality. The criminality of these auctions was well detailed in the Russian- and English-language press: Izvestia, for instance, reported that $50 million in

[1] Who Cuts Profits From State Property? Argumenti I Facti (Moscow), 17 April, 2000.

Ministry of Finance funds had been transferred to Bank Menatep before the latter won a huge stake in the oil company Yukos. More than one paper noted the curious anomaly of two banks (Stolichny Bank and Menatep) guaranteeing each other's bids in a "competitive" auction for a stake in the oil company Sibneft. The winning bid in that auction was just $100.3 million, despite the fact that the company, which at the time produced more than 22 million tons of crude per year, was clearly worth a lot more. Most observers at the time believed that the sweeping victory by the Communists in the 1995 parliamentary elections was at least partly fueled by public disgust over these auctions. And every sane observer recognized that the auctions represented a profound step away from the Western capitalist model.[1]

On August 19th, Bank of New York (BoNY), one of America's oldest, admitted to co-operating with an investigation into alleged money-laundering of as much as $10 billion. The paper trail has touched several European banks too, all of which are said to have helped, over the past year, to move $4 billion from Russia to BoNY's London

[1] The Journal's Russia Scandal. Nation, October 4, 1999.

office. All the banks deny wrongdoing. One focus of the investigation (who also denies wrongdoing) is Bruce Rappaport, a 76-year-old Swiss banker whom Antigua, a well-known Caribbean tax haven, recently appointed as its ambassador to Moscow. He is joint-owner, with BoNY, of Bank of New York-InterMaritime, a Swiss bank that does lots of Russian business.

Another focus is Benex, a company run by Peter Berlin, husband of Lucy Edwards (born Lyudmila Pritzker), a BoNY executive and a firm that authorities say is controlled by Semyon Mogilevich, allegedly a vicious mafioso known as the "brainy don". The bank has suspended her, along with a second Russian-born executive, Natasha Kagalovsky, manager of the department through which all accounts were flowing -- who is married to Konstantin Kagalovsky, a rich Russian businessman, who in the early 1990s was Russia's IMF representative.[1]

Konstantin Kagalovsky after leaving his IMF post plunged into Russia's financial world, working as VP at Menatep Bank. The now bankrupt Menatep was known to have been deeply connected to the Russian Central Bank - the

[1] Crime Without Punishment. Economist, August 28, 1999.

recipient of IMF money--through its purchase of Russian treasuries. Through their New York attorney, Stanley Arkin, the couple said they "have never been involved in money laundering in any way, shape or form." The point was well taken: is it even possible to "launder" from a country where the theft of state assets is not against the law?[1]

As much as $200m that passed through BoNY may have come from IMF loans to Russia. The IMF says allegations of money laundering are serious and it is looking into them. But it also says that its loans to Russia were deposited directly into the accounts of the Russian central bank and That it has neither the locus nor the ability to monitor what happens next.

Venyamin Sergeyevich Sokolov, Russia's chief auditor, a scientist and former university rector, is, as he puts it, "leading the hunt" to find the $4.8 billion the IMF gave Russia's Central Bank to save the ruble last July, much of which was "diverted, misused, or simply stolen." Within weeks of the Deval, Sokolov was instructed to audit the Central Bank, and by now he has dozens of binders stuffed with evidence of theft and fraud. "There's never

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[1] The Gangster State. Newsweek, September 6, 1999.

been an audit of the Central Bank," beams Sokolov, "let alone one in which we have the legal right to obtain every piece of paper pertaining to every transaction and when so much money is at stake. We are progressing through the pile. And what we've found already smells."[1]

In conclusion of his report is written: "Nearly 68 percent of the total sum of the IMF credits were spent on the current needs of the Federal Budget, approximately 10 percent went to the payment of the foreign debt, the remaining 22 percent, which should have gone to the [financial rescue plan], went to purposes having no clear relation to these activities." In other words, 22 percent of the $4.8 billion IMF loan-or $1.06 billion - vanished.

Although all figures in this area are inherently unreliable, the Russian Interior Ministry has estimated that organized crime controls 40% of the economy; other estimates are even higher. Half of Russia's banks were thought to be controlled by crime syndicates. Illegal revenues are funneled through businesses that are kept going only as money-laundering operations, or thanks to monopolies maintained by force. But it does at least offer

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[1] Russia In The Red. Harper's Magazine, June 1999.

a kind of stability. One recent opinion poll in Moscow showed that a majority of residents believed that the municipal administration was corrupt--but that a majority would still be ready to re-elect it.

What could happen in the future with Russian criminal structures? There are three troubling possibilities. One is of Russian organized crime abroad. Russian racketeers in businesses such as prostitution and smuggling are already a well-established feature of the criminal landscape in countries with a big Russian immigrant presence, including Germany and America.

More worrying is co-operation with foreign criminals in areas where Russian gangsters have a competitive advantage, in either skills or ruthlessness. Dr Galeotti's research, for example, suggests that Japanese gangs have used Russian hackers to attack law-enforcement agencies' databases. Russian professional assassins are also in big demand.

But the worst threat comes from the fusion of a corrupt state with powerful gangsters. It has never been explained, for example, how the menacing Aum Shinrikyo cult was able to continue operating in Russia, even after its nerve-gas attack on the Tokyo subway. Russia is a major staging-post for smuggling weapons and drugs, something that would be impossible without the close co-operation of state bodies. "Organized crime interests are global, not isolationist," says one western security specialist. "They would love it if Russia was in the European Union."

# APPENDIX

# RUSSIA IN FIGURES

TABLE 1. MAIN SOCIO - ECONOMIC INDICATORS[1)]

| | 1992 | 1993 | 1994 | 1995 | 1996 | 1997 | 1998 |
|---|---|---|---|---|---|---|---|
| Gross Domestic Product: | | | | | | | |
| Total, trillion rubles (bln. rubles in 1998) | 19 | 172 | 611 | 1540 | 2146 | 2522 | 2685 |
| Per capita, thos.rubles (rubles in 1998) | 128 | 1155 | 4117 | 10399 | 14523 | 17421 | 18275 |
| Expenditure on final consumption, trillion rubles (bln. rubles in 1998) | 9,1 | 106,8 | 422,1 | 1095,9 | 1544,7 | 1888,8 | 2048,3 |
| Gross accumulation, trillion rubles (bln. rubles in 1998) | 6,6 | 46,3 | 156,0 | 391,6 | 528,7 | 582,1 | 438,0 |
| Fixed assets, in book value (at be-ginning of year), trillion rubles (bln. rubles in 1998) | 2,1 | 43,2 | 1189,6 | 5182,0 | 13072,4 | 13286,2 | 14133,6 |
| Resident population (at end of year), mln. persons | 148,3 | 148,0 | 147,9 | 147,6 | 147,1 | 146,7 | 146,3 |
| Including: | | | | | | | |
| Under working age, total | 35,2 | 34,5 | 33,9 | 33,2 | 32,3 | 31,3 | 30,3 |
| Males | 17,9 | 17,6 | 17,3 | 16,9 | 16,5 | 16,0 | 15,5 |
| Females | 17,3 | 16,9 | 16,6 | 16,3 | 15,8 | 15,3 | 14,8 |
| Working age, total | 83,7 | 83,8 | 84,1 | 84,2 | 84,3 | 84,8 | 85,6 |
| Males | 43,5 | 43,7 | 44,0 | 44,1 | 44,0 | 44,0 | 44,0 |
| Females | 40,2 | 40,1 | 40,1 | 40,1 | 40,3 | 40,8 | 41,6 |
| Over working age, total | 29,4 | 29,7 | 29,9 | 30,2 | 30,5 | 30,6 | 30,4 |
| Males | 8,2 | 8,2 | 8,2 | 8,3 | 8,5 | 8,8 | 9,1 |
| Females | 21,2 | 21,5 | 21,7 | 21,9 | 22,0 | 21,8 | 21,3 |
| Natural increase, decrease (-): | | | | | | | |
| thos. persons | -219,8 | -750,4 | -893,2 | -840,0 | -777,6 | -755,9 | -705,1 |
| Per 1000 population | -1,5 | -5,1 | -6,1 | -5,7 | -5,3 | -5,2 | -4,8 |
| Average annual number of those engaged in national economy, mln. persons | 72071 | 70852 | 68484 | 66441 | 65950 | 64639 | 63642 |
| including those at enterprises of non-state forms of ownerships (without municipal and individual sector) | 22411 | 33327 | 37877 | 38470 | 38224 | 38744 | 39267 |
| Total number of unemployed, thos. persons | 3937 | 4511 | 5689 | 6539 | 7280 | 8133 | 8930 |
| Number of officially registered unemployed, thos. persons | 578 | 835 | 1637 | 2327 | 2506 | 1999 | 1929 |
| Money incomes of households, trillion rubles (bln. rubles in 1998) | 7,1 | 79,9 | 364,8 | 910,7 | 1339,5 | 1643,2 | 1700,5 |
| Money expenditures of households, trillion rubles (bln. rubles in 1998) | 6,1 | 72,5 | 348,4 | 877,6 | 1320,7 | 1615,7 | 1672,7 |
| Average money wages of those employed in economy, thos. rubles (rubles in 1998) | 6,0 | 58,7 | 220,4 | 472,4 | 790,2 | 950,0 | 1100,7 |
| Industrial products,2) trillion rubles (bln. rubles in 1998) | 18,5 | 129 | 384 | 1108 | 1443 | 1601 | 1681 |
| Produce of agriculture, trillion rubles (bln. rubles in 1998) | 2,7 | 22,4 | 73,7 | 203,9 | 286,9 | 309,3 | 302,4 |
| Including: | | | | | | | |
| Produce of plant-growing | 1,3 | 10,3 | 38,0 | 108,3 | 156,5 | 171,5 | 142,8 |
| Produce of animal husbandry | 1,4 | 12,1 | 35,7 | 95,6 | 130,4 | 137,8 | 159,6 |
| Commissioning of total living area in residential houses, mln. sq. m | 41,5 | 41,8 | 39,2 | 41,0 | 34,3 | 32,7 | 30,7 |
| Cargo turnover of general-purpose transport, trillion ton km | 4,7 | 4,2 | 3,6 | 3,5 | 3,4 | 3,3 | 3,1 |
| Passenger turnover of general-purpose transport[3)], bln. passenger-km | 681,2 | 661,0 | 596,2 | 552,9 | 527,7 | 511,5 | 481,2 |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| Retail trade turnover, bln. rubles (mln. rubles in 1998) | 5600 | 58762 | 213430 | 553633 | 756357 | 884656 | 1065200 |
| Marketable services rendered to households, bln. rubles (mln. rubles in 1998) | 515 | 6166 | 34107 | 113043 | 200051 | 274385 | 318605 |
| Receipts of consolidated budget: | | | | | | | |
| bln. rubles (mln. rubles in 1998) | 5328 | 49730 | 172380 | 437007[4] | 558532[4] | 711620[4] | 657083 |
| In per cent to GDP | 28,0 | 29,0 | 28,2 | 28,4 | 26,0 | 28,2 | 24,5 |
| Expenditures of consolidated budget: | | | | | | | |
| bln. rubles (mln. rubles in 1998) | 5970 | 57674 | 230385 | 486112 | 652720 | 839489 | 753009 |
| In per cent to GDP | 31,4 | 33,6 | 37,7 | 31,6 | 30,4 | 33,3 | 28,1 |
| Deficit of consolidated budget: | | | | | | | |
| bln. rubles (mln. rubles in 1998) | 642 | 7944 | 65494[5] | 49105 | 94188 | 127869 | 95926 |
| In per cent to GDP | 3,4 | 4,6 | 10,7 | 3,2 | 4,4 | 5,1 | 3,6 |
| Profit, loss (-) in economy[6], bln. rubles (mln. rubles in 1998) | 5623 | 40763 | 80443 | 250599 | 124989 | 173998 | -34632 |
| Money supply (at end of year), trillion oubles (bln. rubles in 1998) | ... | 33,2 | 97,8 | 220,8[7] | 295,2[7] | 384,5[7] | 452,5[8] |
| Including: | | | | | | | |
| Ready cash off banking system | ... | 13,3 | 36,5 | 80,8 | 103,8 | 130,4 | 187,8 |
| Deposit money | ... | 19,9 | 61,3 | 140,0 | 191,4 | 254,1 | 264,7 |
| Credit investments into economy (at end of year), bln. rubles (mln. rubles in 1998) | 5101,6 | 30019 | 83561,2 | 186972[9]<br>134508 | 202308[10] | 276310[10] | 320326[11] |
| Including: | | | | | | | |
| Short-term | 4835,3 | 28982 | 79284,6 | 160713[9]<br>116751 | 196202,4[10] | 265935[10] | |
| Long-term | 266,3 | 1037 | 4276,6 | 26259[9]<br>17757 | 6105,2[10] | 10375[10] | |
| Capital investments, trillion rubles (bln. rubles in 1998) | 2,7 | 27,1 | 108,8 | 267,0 | 376,0 | 408,8 | 402,4 |
| | 1992 | 1993 | 1994 | 1995 | 1996 | 1997 | 1998 |
| Index of consumer prices (December as compared to December of previous year, times) | 26,1 | 9,4 | 3,2 | 2,3 | 1,2 | 1,1 | 1,8 |
| Index of industrial producers prices (December as compared to December of previous year, times) | 33,8 | 10,0 | 3,3 | 2,7 | 1,3 | 1,1 | 1,2 |
| Index of prices for agricultural produce sold by agricultural enterprises (times to previous year) | 9,4 | 8,1 | 3,0 | 3,3 | 1,4 | 1,1 | 1,1 |
| Index of prices in construction (times to previous year) | 16,1 | 11,6 | 5,3 | 2,7 | 1,7 | 1,1 | 1,1 |
| Index of tariffs for cargo shipments (December as compared to December of previous year, times) | 35,6 | 18,5 | 3,5 | 2,7 | 1,2 | 1,0 | 1,2 |
| External trade turnover with countries of the world (excluding CIS countries), bln. US dollars | 79,4 | 71,1 | 90,0 | 109,7 | 120,1 | 125,9 | 104,8 |
| Including: | | | | | | | |
| Exports | 42,4 | 44,3 | 53,0 | 65,6 | 71,0 | 70,0 | 59,0 |
| Imports (including officially non-registered imports) | 37,0 | 32,8 | 37,0 | 44,1 | 49,1 | 55,9 | 45,8 |
| External trade turnover with CIS countries (including officially non-registered exports and imports), bln. US dollars | 17,2 | 26,8 | 28,1 | 32,3 | 37,3 | 36,1 | 28,6 |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| Including: | | | | | | | |
| Exports | 11,2 | 15,3 | 14,5 | 15,5 | 17,6 | 18,4 | 14,9 |
| Imports | 6,0 | 11,5 | 13,6 | 16,8 | 19,7 | 17,7 | 13,7 |

1) Data in value terms are given in actual prices, for 1998 in price effective since January 1, 1998.

2) Data are given within the structure and the methodology of the respective years, with account taken of the correction for informal activity.

3) Since 1996 with account taken of the valuation for the volumes of transportation by rail of passengers entitled to free travel in suburban traffic.

4) With account taken of contributions to target-oriented budget funds.

5) Considering funds received by the Central Bank of the Russian Federation, but they yet did not written into correspondence accounts of Minfin of Russia as well as the balance by credit and currency operations.

6) In 1995-1997 the data of accounting record.

7) According to the calculation methodology adopted by the Central Bank of the Russian Federation in 1996.

8) According to the calculation methodology adopted by the Central Bank of the Russian Federation in 1998 excluding data on credit organizations with abolished license.

9) In the numerator, according to the methodology adopted by the Central Bank of the Russian Federation in 1996-1997 in rubles and foreign currency; without the Vnesheconombank; in the denominator according to the calculation methodology which was effective in 1995.

10) According to the calculation methodology adopted by the Central Bank of the Russian Federation in 1997, without the Vnesheconombank, excluding long-term credits for financing of investments into basic main capital.

11) According to the calculation methodology adopted by the Central Bank of the Russian Federation in 1998; the data were given on credits extended to enterprises, organizations and physical persons.

TABLE 2. INDUSTRIAL PRODUCTION BY BRANCHES

| | 2000 in % to 1999 | December 2000 in % to | | | |
|---|---|---|---|---|---|
| | | Dec-99 | | Nov-00 | |
| | | By total volume | Influence of the working time fund is not taken into consideration (is excluded) | By total volume | Influence of the working time fund is not taken into consideration (is excluded) |
| Electric power | 101,8 | 102,2 | 102,2 | 112,6 | 109,0 |
| Fuel | 105,0 | 105,2 | 105,2 | 103,1 | 99,8 |
| Ferrous metallurgy | 115,6 | 101,5 | 101,5 | 101,0 | 97,7 |
| Non-Ferrous metallurgy | 111,3 | 105,1 | 105,1 | 98,3 | 95,1 |
| Chemical and petro-chemical | 114,3 | 108,7 | 110,2 | 102,5 | 100,4 |
| Industrial machinery and metal cutting | 115,5 | 97,2 | 106,8 | 99,1 | 103,9 |
| Loggin, wood working, pulp-and-paper | 109,5 | 99,5 | 105,8 | 111,5 | 113,7 |
| Building materials | 107,6 | 96,0 | 101,3 | 92,0 | 93,3 |
| Glass, china and ceramics | 110,9 | 106,3 | 107,5 | 98,5 | 96,2 |
| Light | 122,0 | 101,3 | 111,4 | 99,6 | 104,6 |
| Food | 107,1 | 101,0 | 105,0 | 103,8 | 103,8 |
| Microbiological | 73,8 | 103,7 | 104,6 | 94,5 | 92,1 |
| Flour-grinding and mixed-fodder | 93,5 | 91,8 | 92,4 | 98,4 | 95,9 |
| Medical, pharmaceutical | 118,9 | 91,9 | 100,0 | 85,0 | 88,4 |
| Printing | 113,8 | 93,9 | 103,3 | 96,7 | 101,6 |
| Others | 108,3 | 100,4 | 104,3 | 102,9 | 102,9 |

TABLE 3. DYNAMICS OF GROSS INDUSTRIAL PRODUCTION

| | Billion of rubles | In % to | | | | Billion of rubles | In % to | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | | The corresponding period of the previous year | | Previous period | | | The corresponding period of the previous year | | Previous period | |
| | | The volume of the whole | Influence of the working time fund is not taken into consider (is excluded) | the volume of the whole | influence of the working time fund is not taken into considern (is excluded) | | The volume of the whole | Influence of the working time fund is not taken into consideration (is excluded) | the volume of the whole | influence of the working time fund is not taken into consideration (is excluded) |
| | 1999 | | | | | 2000 | | | | |
| January | 187,6 | 97,6 | 99,1 | 92,5 | 98,4 | 331,7 | 110,7 | 110,7 | 92,1 | 98,0 |
| February | 189,8 | 97,0 | 97,0 | 100,8 | 104,7 | 350,8 | 113,7 | 109,3 | 103,6 | 103,3 |
| March | 223,0 | 100,4 | 98,9 | 111,3 | 100,7 | 387,5 | 109,6 | 109,6 | 107,2 | 101,0 |
| Quarter I | 600,4 | 98,4 | 98,4 | 102,1 | 105,9 | 1070,0 | 111,9 | 110,5 | 102,4 | 104,8 |
| April | 223,2 | 100,6 | 100,6 | 95,7 | 97,8 | 359,2 | 105,5 | 108,9 | 92,1 | 97,1 |
| May | 213,2 | 106,0 | 106,0 | 93,6 | 97,4 | 361,1 | 110,6 | 107,2 | 98,1 | 95,9 |
| June | 228,6 | 109,0 | 109,0 | 101,6 | 99,2 | 384,5 | 109,8 | 109,8 | 100,9 | 101,6 |
| Quarter II | 665,0 | 105,0 | 105,0 | 99,0 | 97,7 | 1104,8 | 108,5 | 108,5 | 96,6 | 96,6 |
| The first half of the year | 1265,4 | 103,1 | 103,1 | | | 2174,8 | 110,3 | 109,6 | | |
| July | 242,3 | 112,8 | 114,5 | 102,1 | 98,4 | 391,6 | 108,5 | 110,1 | 100,9 | 98,7 |
| August | 252,7 | 116,0 | 114,2 | 101,6 | 101,6 | 407,7 | 110,2 | 108,6 | 103,2 | 100,2 |
| September | 271,2 | 120,2 | 120,2 | 100,8 | 103,0 | 417,6 | 107,2 | 108,9 | 98,0 | 103,3 |
| Quarter III | 766,2 | 116,3 | 116,3 | 102,3 | 98,9 | 1216,9 | 108,6 | 109,1 | 102,3 | 99,5 |
| January-September | 2031,6 | 107,0 | 107,0 | | | 3391,7 | 109,7 | 109,4 | | |
| October | 293,7 | 110,3 | 112,0 | 102,6 | 101,9 | 442,7 | 110,4 | 108,7 | 105,6 | 101,8 |
| November | 311,8 | 112,9 | 111,2 | 102,1 | 104,3 | 451,9 | 107,6 | 107,6 | 99,5 | 103,3 |
| December | 358,1 | 111,1 | 111,1 | 107,4 | 103,5 | 476,2 | 102,5 | 105,6 | 102,3 | 101,6 |
| Quarter IV | 963,6 | 111,5 | 111,5 | 107,7 | 108,8 | 1370,8 | 106,5 | 107,0 | 105,8 | 106,9 |
| Year | 2995,2 | 108,1 | 108,1 | | | 4762,5 | 109,0 | 108,9 | | |

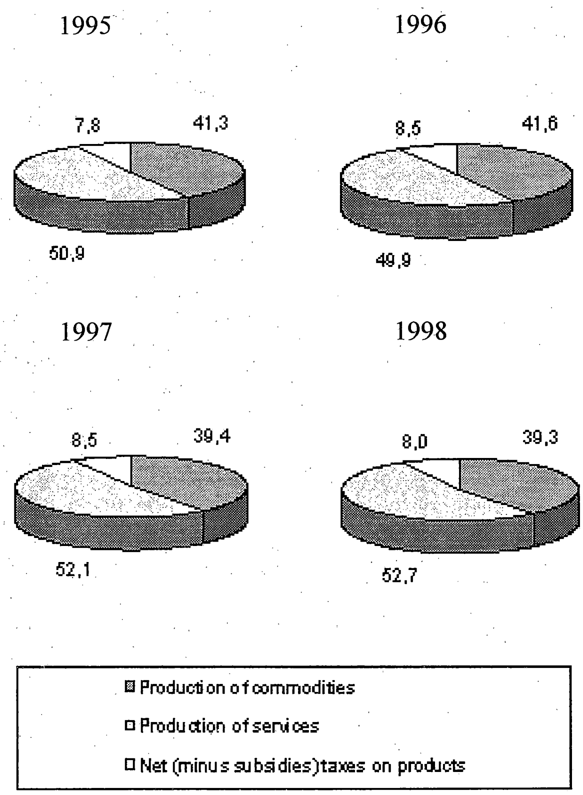
TABLE 4. INDICES OF MAIN SOCIO-ECONOMIC INDICATORS
(in comparable prices; in per cent to previous year)

| | 1992 | 1993 | 1994 | 1995 | 1996 | 1997 | 1998 |
|---|---|---|---|---|---|---|---|
| Gross Domestic Product | 85,5 | 91,3 | 87,3 | 95,9 | 96,6 | 100,9 | 95,4 |
| Expenditure on final consumption | 94,8 | 99,0 | 96,9 | 97,3 | 96,9 | 103,0 | 97,2 |
| Fixed assets in economy | 101,9 | 100,5 | 99,7 | 100,2 | 99,6 | 98,7 | 99,8 |
| Population | 99,98 | 99,8 | 99,96 | 99,8 | 99,7 | 99,7 | 99,7 |
| Average annual employment in economy | 97,6 | 98,3 | 96,7 | 97,0 | 99,3 | 98,0 | 98,0 |
| Total unemployment (at end of year) | - | 115 | 126 | 115 | 111 | 112 | 110 |
| Money incomes of households1) | 8,5 times | 11,3 times | 4,6 times | 2,5 times | 1,5 times | 122,7 | 103,5 |
| Money expenditures of households1) | 8,2 times | 11,8 times | 4,8 times | 2,5 times | 1,5 times | 122,3 | 103,5 |
| Average money wages accrued (consumer prices index considered) | 67 | 100,4 | 92 | 72 | 106 | 105 | 87 |
| Industrial output2) | 82 | 86 | 79 | 97 | 96 | 102 | 95 |
| Agricultural output | 91 | 96 | 88 | 92 | 95 | 101,5 | 87,7 |
| Produce of plant-growing | 95 | 97 | 90 | 95 | 100,3 | 107,3 | 76,5 |
| Produce of animal husbandry | 88 | 95 | 87 | 90 | 89 | 95,0 | 99,1 |
| Commissioning of total living area in residential houses | 84 | 100,7 | 94 | 105 | 84 | 95 | 94 |
| Cargo turnover of general-purpose transport | 86 | 89 | 86 | 99 | 95 | 97 | 97 |
| Passenger turnover of general-purpose transport | 87 | 97 | 90 | 93 | 93 | 97 | 94 |
| Retail trade turnover | 97 | 102 | 100,1 | 93 | 96 | 105 | 95 |
| Marketable services rendered to households | 82 | 70 | 62 | 82 | 94 | 106 | 99,5 |
| Profit in economy 1) | 15,5 times | 6,7 times | 1,9 times | 3,1times | 49,9 | 102,4 | - |
| Credit investments into economy (at end of year) 3) | 11,6 times | 5,9 times | 2,8 times | 1,6 times | 1,1 times | 1,4 times | 1,4 times |
| Capital investments | 60 | 88 | 76 | 90 | 82 | 95 | 93 |
| External trade turnover with countries of the world (excluding CIS countries) 4) | 83 | 97 | 117 | 122 | 110 | 105 | 83 |
| External trade turnover with CIS countries 4) | | 156 | 105 | 115 | 116 | 97 | 79 |

1) In actual prices.
2) Data are given taking into account estimates for non-formal activities.
3) Since 1996 according to the calculation methodology adopted by the Central Bank of the Russian Federation in 1996-1997, in roubles and

foreign currency; without Vnesheconombank. Effective from 1997, financing of capital investments has been excluded from long-term credits.

TABLE 5. STRUCTURE OF PRODUCTION OF GROSS DOMESTIC PRODUCT[1)]
(in current market prices; in percent to total)




1) Imputed services of financial intermediation are included in the intermediary consumption and distribution between branches producing commodities and services.

TABLE 6. GDP IN COMPARABLE PRICES.

| In comparable prices, in % to the correspondent period of the previous year | q I 1998 | q II 1998 | q III 1998 | q IV 1998 | 1998 | q I 1999 | q II 1999 | q III 1999 | q IV 1999 | 1999 | q I 2000 | q II 2000 | q III 2000 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Gross domestic product | 98.7 | 99 | 91.9 | 91.8 | 95.1 | 97.3 | 101.2 | 107 | 107.3 | 103.2 | 108 | 107 | 107,9 |
| Including: | | | | | | | | | | | | | |
| Final consumption | 99.7 | 99.9 | 100 | 92.3 | 97.7 | 93.8 | 95.1 | 95.5 | 101.1 | 96.5 | 108 | 108,3 | 109,6 |
| Households | 98.9 | 99.2 | 98.9 | 89.9 | 96.4 | 91.2 | 92.4 | 93.9 | 100.7 | 94.7 | 109 | 110,9 | 112,6 |
| Government | 102 | 102 | 103 | 96.2 | 100.6 | 101 | 100.7 | 100 | 102.2 | 100.9 | 102 | 102 | 101,5 |
| Nonprofit institutions serving households | 98.4 | 98.5 | 98.6 | 98.1 | 98.4 | 99.6 | 100.1 | 99.4 | 100.8 | 100 | 99.6 | 98.8 | 99,9 |
| Gross accumulation | 110 | 94.7 | 69.8 | 17.9 | 68.7 | 54.1 | 82.7 | 112 | 4154 | 109.3 | 121 | 98,3 | 109,9 |
| Gross capital formation | 86.4 | 94 | 88.3 | 85.3 | 88.8 | 93 | 92.1 | 102 | 114.2 | 102.4 | 112 | 115 | 119,1 |
| Changes in inventories | 245 | 97.7 | 41.9 | | | | 43.4 | 151 | | | | | 90.4 |
| Net exports | | 77 | 301 | 516 | 211 | | 2755 | 245 | 68 | 160.2 | 102 | 106 | 97,7 |

TABLE 7. USE OF GROSS DOMESTIC PRODUCT
(in actual prices; trillion rubles)

| | 1992 | 1993 | 1994 | 1995 | 1996 | 1997 | 1998 bln. rubles |
|---|---|---|---|---|---|---|---|
| Gross Domestic Product (in market prices), total | 19,0 | 171,5 | 610,8 | 1540,5 | 2145,7 | 2522,0 | 2684,5 |
| Including: | | | | | | | |
| Final consumption expenditures | 9,1 | 106,8 | 422,1 | 1095,9 | 1544,7 | 1888,8 | 2048,3 |
| Including: | | | | | | | |
| Households | 6,2 | 68,0 | 267,1 | 760,0 | 1056,1 | 1287,6 | 1507,4 |
| Government institutions | 2,6 | 29,8 | 136,7 | 299,4 | 436,8 | 544,2 | 485,9 |
| Out of them: | | | | | | | |
| For individual goods and services | 1,3 | 13,8 | 60,1 | 145,9 | 205,2 | 245,7 | 233,5 |
| For collective services | 1,3 | 15,9 | 76,6 | 153,5 | 231,6 | 298,5 | 252,4 |
| Non-profit organizations serving households | 0,3 | 9,0 | 18,3 | 36,5 | 51,8 | 57,0 | 55,0 |
| Gross accumulation | 6,6 | 46,3 | 156,0 | 391,6 | 528,7 | 582,1 | 438,0 |
| Including: | | | | | | | |
| Gross capital formation | 4,6 | 35,0 | 133,2 | 327,9 | 454,4 | 489,9 | 471,7 |
| Changes in inventories | 2,0 | 11,3 | 22,8 | 63,7 | 74,3 | 92,2 | -33,7 |
| Net exports of goods and services | 2,7 | 13,2 | 27,9 | 53,1 | 89,4 | 73,5 | 210,9 |
| Statistical discrepancy | 0,6 | 5,2 | 4,8 | 0,1 | 17,1 | 22,4 | 12,7 |

TABLE 8. ENTERPRISES AND ORGANIZATIONS BY ECONOMY'S BRANCHES
(as of 1st January; thos.)

| | 1994 | 1995 | 1996 | 1997 | 1998 | 1999 |
|---|---|---|---|---|---|---|
| Total including: | 1245 | 1946 | 2250 | 2505 | 2727 | 2901 |
| Industry | 212 | 289 | 310 | 324 | 339 | 352 |
| Agriculture | 121 | 287 | 335 | 339 | 338 | 332 |
| Forestry | 4,6 | 4,2 | 4,2 | 4,1 | 4,1 | 4,1 |
| Construction | 164 | 235 | 259 | 273 | 287 | 298 |
| Transport | 36,0 | 47,5 | 53,1 | 62,7 | 60,1 | 67,4 |
| Communications | | | | | 11,1 | 12,1 |
| Trade and public catering | 302 | 525 | 640 | 746 | 852 | 935 |
| Wholesale trade of produce for production-technical purposes | 25,4 | 31,8 | 33,9 | 36,9 | 39,4 | 41,1 |
| Information and computer services | 7,6 | 9,5 | 10,0 | 10,9 | 11,8 | 12,6 |
| Real estate transactions | 2,3 | 4,8 | 7,3 | 9,6 | 12,3 | 15,7 |
| General commercial activity to support market performance | 39,9 | 58,2 | 66,7 | 77,4 | 88,0 | 97,8 |
| Geological prospecting and surveying, geodesy and hydrometeorology services | 2,7 | 3,8 | 4,2 | 4,5 | 4,8 | 5,1 |
| Housing and communal services | 13,2 | 23,5 | 34,3 | 38,0 | 40,3 | 42,3 |
| Non-production services rendered to households | 12,6 | 17,7 | 18,7 | 19,5 | 20,8 | 22,0 |
| Public health, physical culture and social security | 42,5 | 56,5 | 63,7 | 68,6 | 73,7 | 79,1 |
| Education | 33,3 | 44,3 | 57,5 | 70,0 | 83,5 | 96,7 |
| Culture and arts | 26,8 | 33,5 | 37,3 | 40,2 | 43,9 | 47,8 |
| Science and scientific service | 72,2 | 91,1 | 96,8 | 100,5 | 103,9 | 105,7 |
| Finances, credit, insurance, pension security | 21,9 | 36,6 | 43,6 | 47,7 | 50,9 | 52,4 |
| General government | 61,0 | 72,4 | 78,8 | 83,0 | 85,2 | 85,7 |
| Public unions and associations | 18,3 | 41,1 | 57,2 | 105,3 | 129,0 | 144,6 |

TABLE 9. ALLOCATION OF ENTERPRISES AND ORGANIZATIONS BY OWNERSHIP TYPES (as of 1st January)

| | Number of enterprises and organizations, thos. | | | | In per cent to total | | | |
|---|---|---|---|---|---|---|---|---|
| | 1996 | 1997 | 1998 | 1999 | 1996 | 1997 | 1998 | 1999 |
| Total | 2250 | 2505 | 2727 | 2901 | 100 | 100 | 100 | 100 |
| Including by the types of ownership: | | | | | | | | |
| State property | 322 | 233 | 143 | 148 | 14,3 | 9,3 | 5,4 | 5,1 |
| Municipal property | 198 | 184 | 178 | 183 | 8,8 | 7,4 | 6,5 | 6,3 |
| Property of public associations (organizations) | 95 | 130 | 158 | 183 | 4,2 | 5,2 | 5,8 | 6,3 |
| Other property types including mixed property, property of juridical persons, individuals and persons without citizenship | 209 | 227 | 235 | 240 | 9,3 | 9,0 | 8,6 | 8,3 |
| Private property | 1426 | 1731 | 2014 | 2147 | 63,4 | 69,1 | 73,9 | 74,0 |

TABLE 10. NUMBER OF SMALL - SIZE ENTERPRISES BY ECONOMY'S BRANCHES (as of 1st January)

| | 1997 | | 1998 | | 1999 | |
|---|---|---|---|---|---|---|
| | Total | In per cent to total | Total | In per cent to total | Total | In per cent to total |
| Total | 841737 | 100 | 861063 | 100 | 868008 | 100 |
| Including: | | | | | | |
| Industry | 131878 | 15,7 | 134810 | 15,6 | 136117 | 15,7 |
| Agriculture | 10879 | 1,3 | 11899 | 1,4 | 13759 | 1,6 |
| Construction | 137970 | 16,4 | 142087 | 16,5 | 137511 | 15,8 |
| Transport | 17506 | 2,1 | 18588 | 2,2 | 18570 | 2,1 |
| Communications | 2865 | 0,3 | 2733 | 0,3 | 3213 | 0,4 |
| Trade and public catering | 359357 | 42,7 | 372836 | 43,3 | 386110 | 44,5 |
| Wholesale trade of produce for production-and-technical purposes | 14593 | 1,7 | 14268 | 1,7 | 13214 | 1,5 |
| Information and computer services | 6167 | 0,7 | 6355 | 0,7 | 5201 | 0,6 |
| Real estate transactions | 3859 | 0,5 | 4625 | 0,5 | 5865 | 0,7 |
| General commercial activity to support market performance | 35919 | 4,3 | 35955 | 4,2 | 35244 | 4,0 |
| Other kinds of activity in sphere of material production | 17397 | 2,1 | 17236 | 2,0 | 18890 | 2,2 |
| Housing and communal services | 2797 | 0,3 | 3949 | 0,5 | 5062 | 0,6 |
| Non-production services rendered to households | 10190 | 1,2 | 11252 | 1,3 | 9152 | 1,1 |
| Public health | 11008 | 1,3 | 15385 | 1,8 | 17239 | 2,0 |
| Education | 6655 | 0,8 | 6956 | 0,8 | 6668 | 0,8 |
| Culture and art | 6488 | 0,8 | 7948 | 0,9 | 8114 | 0,9 |
| Science and scientific service | 46710 | 5,5 | 43818 | 5,1 | 38812 | 4,5 |
| Finance, credit, insurance, pension security | 10773 | 1,3 | 7839 | 0,9 | 7494 | 0,9 |
| Other kinds of activity in sphere of non-material production | 8726 | 1,0 | 2524 | 0,3 | 1766 | 0,2 |

TABLE 11. STRUCTURE OF PRIVATIZED ENTERPRISES (ENTITIES) BY OWNERSHIP TYPES AND PRIVATIZATION METHODS in 1993 - 1997

| | 1993 | 1994 | 1995 | 1996 | 1997 |
|---|---|---|---|---|---|
| Number of privatized enterprises (entities), total | 42924 | 21905 | 10152 | 4997 | 2743 |
| Including by ownership types[1]: | | | | | |
| Municipal | 26340 | 11108 | 6960 | 3354 | 1821 |
| Of the subjects of the Russian Federation | 9521 | 5112 | 1317 | 715 | 548 |
| Federal | 7063 | 5685 | 1875 | 928 | 374 |
| Structure of privatized enterprises (entities) by privatization methods, in per cent to total: | 100 | 100 | 100 | 100 | 100 |
| Auctioning | 31,1 | 44,8 | 27,7 | 22,5 | 18,1 |
| Sales in auctions | 6,3 | 4,4 | 4,2 | 3,9 | 5,5 |
| Commercial competition | 30,4 | 24,0 | 15,9 | 8,9 | 9,6 |
| Investment competition | 1,3 | 1,2 | 1,1 | 0,7 | 0,5 |
| Redemption of leased property | 29,5 | 20,8 | 29,8 | 32,1 | 14,6 |
| Sales of property of winding-up, winded-up enterprises and construction projects in process | 0,4 | 1,5 | 4,2 | 5,7 | 9,1 |
| Sales of real estate | - | - | 15,4 | 22,9 | 38,5 |
| Sales of land | - | - | 0,6 | 1,5 | 2,6 |
| Other | 1,0 | 3,3 | 1,1 | 1,8 | 1,5 |

129,5 thos. enterprises (entities) exchanged their ownership types in 1992 - 1997.

[1] As of the date of privatization.

TABLE 12. STRUCTURE OF PRIVATIZED ENTERPRISES (ENTITIES) BY OWNERSHIP TYPES AND PRIVATIZATION METHODS in 1998

| | |
|---|---|
| Number of privatized enterprises (entities), total | 2129 |
| Including by ownership types[1]: | |
| Municipal | 1544 |
| Of the subjects of the Russian Federation | 321 |
| Federal | 264 |
| Structure of privatized enterprises (entities) by privatization methods, in per cent to total: | 100 |
| Sales of state and municipal property: | |
| In auction | 12,1 |
| In commercial competition | 11,0 |
| Including: | |
| With investment and social conditions | 3,8 |
| With investment conditions | 4,1 |
| With social conditions | 3,1 |
| Redemption of property granted on lease: | |
| By leaseholder according to lease agreement | 6,8 |
| By means of transforming in open type joint - stock company with right on priority acquisition of shares by leaseholder | 0,3 |
| Sales of property of winding-up and winded-up enterprises | 5,6 |
| Sales of real estate | 47,6 |
| Sales of land plots in property complex of privatized enterprises | 4,0 |
| Sales of enterprises - debtors | 0,4 |
| Sales of shares of open type joint - stock companies established by privatization: | |
| To employees of company | 9,6 |
| In specialized auction | 1,6 |
| Transforming state and municipal enterprises in open type joint - stock companies with fixed 100 per cent of shares in state or municipal ownership | 0,85 |
| Inclusion of state and municipal property in kind of contribution in authorized capitals of economic companies | 0,1 |
| Alienation of state (municipal) own shares of open type joint - stock companies, established in result of privatization by owners of state (municipal) securities, certifying the right on acquisition of these shares | 0,05 |

[1] As of the date of privatization.

TABLE 13. PRODUCTION PRICE INDICES FOR PRODUCTION MEANS, INTERMEDIATE AND CONSUMER GOODS IN % TO THE END OF PERIOD.

| | In total | | Including | | | | | |
|---|---|---|---|---|---|---|---|---|
| | To the previous period | To December of the previous year | Capital goods | | Intermediate goods | | Consumer goods | |
| | | | To the previous period | To December of the previous year | To the previous period | To December of the previous year | To the previous period | To December of the previous year |
| 1999 | | | | | | | | |
| January | 106,9 | 106,9 | 108,1 | 108,1 | 104,8 | 104,8 | 109,8 | 109,8 |
| February | 105,6 | 112,9 | 102,6 | 110,9 | 105,6 | 110,7 | 106,8 | 117,3 |
| March | 103,9 | 117,2 | 105,2 | 116,6 | 104,5 | 115,7 | 102,8 | 120,5 |
| Quarter I | 117,2 | 117,2 | 116,6 | 116,6 | 115,7 | 115,7 | 120,5 | 120,5 |
| April | 103,7 | 121,5 | 104,9 | 122,3 | 103,8 | 120,1 | 103,1 | 124,2 |
| May | 103,6 | 125,9 | 101,8 | 124,5 | 103,8 | 124,7 | 101,6 | 126,3 |
| June | 103,7 | 130,5 | 103,3 | 128,6 | 105,4 | 131,4 | 100,3 | 126,6 |
| Quarter II | 111,4 | 130,5 | 110,2 | 128,6 | 113,6 | 131,4 | 105,1 | 126,6 |
| July | 103,1 | 134,6 | 102,7 | 132,0 | 104,7 | 137,6 | 101,9 | 129,0 |
| August | 104,7 | 141,0 | 102,5 | 135,3 | 105,4 | 145,0 | 102,4 | 132,2 |
| September | 105,9 | 149,4 | 104,6 | 141,5 | 107,1 | 155,3 | 102,0 | 134,7 |
| Quarter III | 114,4 | 149,4 | 110,0 | 141,5 | 118,2 | 155,3 | 106,4 | 134,7 |
| October | 105,5 | 157,6 | 103,5 | 146,4 | 106,8 | 165,9 | 101,1 | 136,2 |
| November | 103,9 | 163,7 | 105,2 | 154,0 | 104,9 | 174,1 | 100,7 | 137,2 |
| December | 102,2 | 167,3 | 102,3 | 157,6 | 103,1 | 179,5 | 100,3 | 137,6 |
| Quarter IV | 112,0 | 167,3 | 111,4 | 157,6 | 115,6 | 179,5 | 102,2 | 137,6 |
| 2000 | | | | | | | | |
| January | 104,0 | 104,0 | 106,1 | 106,1 | 103,9 | 103,9 | 99,6 | 99,6 |
| February | 103,7 | 107,9 | 105,6 | 112,1 | 103,7 | 107,7 | 100,5 | 100,0 |
| March | 102,6 | 110,7 | 103,2 | 115,7 | 102,7 | 110,6 | 100,5 | 100,6 |
| Quarter I | 110,7 | 110,7 | 115,7 | 115,7 | 110,6 | 110,6 | 100,6 | 100,6 |
| April | 101,6 | 112,4 | 102,1 | 118,1 | 101,8 | 112,5 | 100,7 | 101,2 |
| May | 101,7 | 114,4 | 101,8 | 120,2 | 101,5 | 114,2 | 101,2 | 102,4 |
| June | 102,3 | 117,0 | 101,3 | 121,7 | 103,0 | 117,6 | 101,5 | 103,9 |
| Quarter II | 105,7 | 117,0 | 105,2 | 121,7 | 106,4 | 117,6 | 103,3 | 103,9 |
| July | 103,4 | 121,0 | 102,6 | 124,8 | 103,4 | 121,7 | 102,1 | 106,1 |
| August | 101,7 | 123,0 | 101,8 | 127,0 | 101,5 | 123,5 | 101,6 | 107,8 |
| September | 101,9 | 125,3 | 101,7 | 129,2 | 101,6 | 125,5 | 102,8 | 110,9 |
| Quarter III | 107,1 | 125,3 | 106,2 | 129,2 | 106,7 | 125,5 | 106,6 | 110,9 |
| October | 102,7 | 128,7 | 101,5 | 131,1 | 103,6 | 129,9 | 103,4 | 114,6 |
| November | 101,2 | 130,3 | 101,1 | 132,5 | 101,0 | 131,3 | 102,2 | 117,1 |
| December | 101,0 | 131,6 | 101,0 | 133,9 | 100,9 | 132,4 | 100,4 | 117,6 |
| Quarter IV | 105,0 | 131,6 | 103,6 | 133,9 | 105,6 | 132,4 | 106,1 | 117,6 |

TABLE 14. CONSUMER PRICE INDICES.

| | Consumer price index | | Including | | | | | |
|---|---|---|---|---|---|---|---|---|
| | To the previous period | To December of the previous year | Food Stuffs | | Non-food Goods | | Paid services For the population | |
| | | | To the previous period | To December of the previous year | To the previous period | To December of the previous year | To the previous period | To December of the previous year |
| 1999 | | | | | | | | |
| January | 108,4 | 108,4 | 110,3 | 110,3 | 106,2 | 106,2 | 104,1 | 104,1 |
| February | 104,1 | 112,9 | 104,4 | 115,1 | 104,0 | 110,4 | 103,2 | 107,4 |
| March | 102,8 | 116,0 | 102,8 | 118,3 | 103,2 | 114,0 | 101,9 | 109,5 |
| Quarter I | 116,0 | 116,0 | 118,3 | 118,3 | 114,0 | 114,0 | 109,5 | 109,5 |
| April | 103,0 | 119,5 | 102,6 | 121,4 | 104,0 | 118,6 | 103,1 | 112,9 |
| May | 102,2 | 122,2 | 102,0 | 123,8 | 102,7 | 121,8 | 102,1 | 115,3 |
| June | 101,9 | 124,5 | 101,7 | 126,0 | 101,6 | 123,7 | 103,5 | 119,3 |
| Quarter II | 107,3 | 124,5 | 106,4 | 126,0 | 108,6 | 123,7 | 109,0 | 119,3 |
| July | 102,8 | 128,0 | 103,2 | 130,0 | 101,9 | 126,1 | 103,1 | 123,1 |
| August | 101,2 | 129,5 | 100,5 | 130,5 | 102,4 | 129,1 | 101,9 | 125,5 |
| September | 101,5 | 131,4 | 100,8 | 131,6 | 102,7 | 132,6 | 102,0 | 128,0 |
| Quarter III | 105,6 | 131,4 | 104,5 | 131,6 | 107,2 | 132,6 | 107,2 | 128,0 |
| October | 101,4 | 133,2 | 100,9 | 132,7 | 102,2 | 135,5 | 102,0 | 130,6 |
| November | 101,2 | 134,8 | 101,0 | 134,0 | 101,5 | 137,6 | 101,7 | 132,8 |
| December | 101,3 | 136,5 | 101,4 | 135,9 | 101,1 | 139,2 | 100,9 | 134,0 |
| Quarter IV | 103,9 | 136,5 | 103,3 | 135,9 | 104,9 | 139,2 | 104,7 | 134,0 |
| 2000 | | | | | | | | |
| January | 102,3 | 102,3 | 102,2 | 102,2 | 102,2 | 102,2 | 103,4 | 103,4 |
| February | 101,0 | 103,4 | 100,5 | 102,6 | 101,3 | 103,5 | 103,0 | 106,4 |
| March | 100,6 | 104,1 | 100,1 | 102,7 | 101,4 | 105,0 | 101,5 | 108,0 |
| Quarter I | 104,1 | 104,1 | 102,7 | 102,7 | 105,0 | 105,0 | 108,0 | 108,0 |
| April | 100,9 | 105,0 | 100,3 | 103,0 | 101,5 | 106,5 | 102,1 | 110,3 |
| May | 101,8 | 106,8 | 102,2 | 105,3 | 101,1 | 107,7 | 101,3 | 111,8 |
| June | 102,6 | 109,5 | 103,3 | 108,7 | 100,8 | 108,6 | 103,0 | 115,2 |
| Quarter II | 105,3 | 109,5 | 105,8 | 108,7 | 103,5 | 108,6 | 106,6 | 115,2 |
| July | 101,8 | 111,5 | 101,8 | 110,6 | 100,8 | 109,5 | 103,8 | 119,5 |
| August | 101,0 | 112,6 | 100,3 | 110,9 | 101,4 | 111,0 | 103,0 | 123,1 |
| September | 101,3 | 114,1 | 100,6 | 111,6 | 102,1 | 113,3 | 102,8 | 126,5 |
| Quarter III | 104,1 | 114,1 | 102,7 | 111,6 | 104,3 | 113,3 | 109,8 | 126,5 |
| October | 102,1 | 116,5 | 102,1 | 114,0 | 101,9 | 115,4 | 102,4 | 129,5 |
| November | 101,5 | 118,2 | 101,5 | 115,7 | 101,5 | 117,1 | 101,6 | 131,6 |
| December | 101,6 | 120,2 | 101,9 | 117,9 | 101,2 | 118,5 | 101,6 | 133,7 |
| Quarter IV | 105,4 | 120,2 | 105,6 | 117,9 | 104,6 | 118,5 | 105,7 | 133,7 |

TABLE 15. CONSOLIDATED BUDGET DEFICIT OF THE RUSSIAN FEDERATION
(in per cent to GDP)

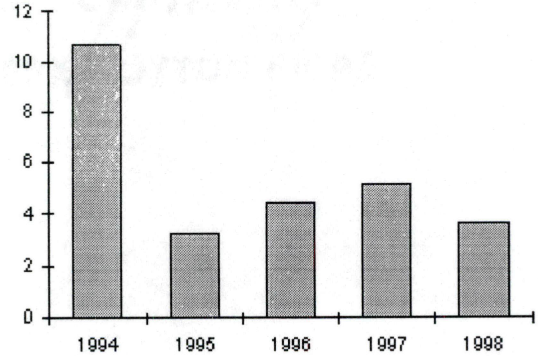



TABLE 16. MAIN INDICATORS OF PRIMARY MARKET OF STATE SHORT-TERM BONDS (GKO) AND FEDERAL LOAN BONDS (OFZ)
(according to data of Bank of Russia; trillion rubles)

| | 1993 | 1994 | 1995[1)] | 1996 | 1997 | 1998 bln. rubles |
|---|---|---|---|---|---|---|
| Emission volume | 0,2 | 20,5 | 171,0 | 479,0 | 605,5 | 353,5 |
| Allocation volume (by face value) | 0,2 | 17,5 | 140,4 | 399,7 | 449,1 | 225,5 |
| Revenues from sales | 0,2 | 12,9 | 106,2 | 297,2 | 386,5 | 169,6 |
| Drawings of funds into budget | 0,2 | 5,7 | 11,0 | 15,4 | 6,9 | -39,9 |

1) Starting from June 1995, the Minfin of Russia began placing federal loan bonds

TABLE 17. STRUCTURE OF MONEY SUPPLY[1)]
(at beginning of year; trillion rubles)

| | 1994 | 1995 | 1996 | 1997 | 1998 bln. rubles | 1999 bln. rubles |
|---|---|---|---|---|---|---|
| Money supply cluding: | 33,2 | 97,8 | 220,8 | $\frac{288,3}{295,2}$ | $\frac{374,1}{384,5}$ | 452,5 |
| Disposable money off banking system | 13,3 | 36,5 | 80,8 | 103,8 | 130,4 | 187,8 |
| Deposit money | 19,9 | 61,3 | 140,0 | $\frac{184,5}{191,4}$ | $\frac{243,7}{254,1}$ | 264,7 |

[1)] Data as of beginning 1996, as well as in denominator as of beginning 1997 and 1998 are calculated according to methodology adopted the Central Bank of the Russian Federation in 1996; date in numerator and as of beginning 1999 are calculated according to methodology adopted in 1998, without recording date for credit organizations with revoked license.

TABLE 18. GROUPING OF FUNCTIONING CREDIT ORGANIZATIONS ACCORDING TO SIZE OF REGISTERED AUTHORIZED CAPITAL[1)]
(at beginning of year)

| | 1998 | 1999 |
|---|---|---|
| Number of functioning credit organizations, total | 1697 | 1476 |
| Including size of authorized capital: | | |
| Up to 500 thos. rubles | 198 | 90 |
| From 500 thos. to 2 mln. rubles | 284 | 173 |
| From 2 to 5 mln. rubles | 327 | 219 |
| From 5 to 10 mln. rubles | 345 | 335 |
| From 10 to 20 mln. rubles | 255 | 245 |
| From 20 to 40 mln. rubles | 156 | 213 |
| From 40 mln. rubles and over | 132 | 201 |

1) Authorized capital the size of which has been paid by participants, included in By-rules of credit organization

TABLE 19. PROFITS OF ENTERPRISES AND ORGANIZATIONS BY MAIN ECONOMY'S BRANCHES
(bln. rubles)

| | 1992 | 1993 | 1994 | 1995[1)] | 1996[1)] | 1997[1)] | 1998 mln. rubles |
|---|---|---|---|---|---|---|---|
| Profits, losses (-) in economy | 5623 | 40763 | 80443 | 250599 | 124989 | 173998 | -34632 |
| Including by branches: | | | | | | | |
| Industry | 4015 | 27160 | 52706 | 154458 | 84143 | 90254 | -4706 |
| Agriculture | 433 | 3062 | -318 | 1345 | -22847 | -26817 | -34986 |
| Construction | 249 | 3119 | 9408 | 22718 | 21545 | 17410 | 7478 |
| Transport | 243 | 3658 | 9323 | 30140 | 17483 | 28697 | 25495 |
| Communications | 26 | 398 | 1858 | 6964 | 7889 | 11058 | 4793 |
| Trade and public catering | 127 | 1175 | 1172 | 14629 | 7532 | 11388 | -17417 |
| Wholesale trade with goods for production-and-technical purposes | 120 | 777 | 1732 | 5569 | 2541 | 3108 | -800 |
| Housing and communal utilities | 18 | 459 | 1799 | 2280 | 706 | -2922 | -13501 |
| Other branches | 392 | 955 | 2763 | 12496 | 5997 | 41822 | -988 |

1) According to accounting data.

TABLE 20. NUMBER OF LOSS-MAKING ENTERPRISES AND ORGANIZATIONS AND SUMS OF LOSSES BY ECONOMY'S BRANCHES

| | 1995[1] | | 1996[1] | | 1997[1] | | 1998 | |
|---|---|---|---|---|---|---|---|---|
| | Number of loss-making enterprises | Total losses, bln. rubles | Number of loss-making enterprises | Total losses, bln. rubles | Number of loss-making enterprises | Total losses, bln. rubles | Number of loss-making enterprises | Total losses, bln. rubles |
| Total | 45159 | 37151 | 69804 | 113504 | 71492 | 135010 | 64440 | 274316 |
| Industry | 6985 | 12770 | 11809 | 45382 | 12510 | 53255 | 12084 | 139278 |
| Including: | | | | | | | | |
| Electric power industry | 115 | 456 | 199 | 1523 | 201 | 1069 | 283 | 2687 |
| Fuel industry | 177 | 2425 | 209 | 5799 | 276 | 8742 | 325 | 28134 |
| Out of which: | | | | | | | | |
| Oil extraction | 23 | 1488 | 23 | 1801 | 35 | 2556 | 63 | 13816 |
| Oil refining | 1 | 0,0 | 7 | 197 | 14 | 959 | 19 | 7963 |
| Gas | 3 | 142 | 4 | 264 | 10 | 1184 | 17 | 1656 |
| Coal | 124 | 771 | 130 | 3520 | 161 | 3956 | 170 | 4670 |
| Ferrous metallurgy | 40 | 265 | 91 | 2780 | 120 | 4585 | 123 | 10598 |
| Non- ferrous metallurgy | 144 | 747 | 244 | 4366 | 265 | 3655 | 223 | 8151 |
| Chemical and petrochemical industry | 101 | 1215 | 238 | 5375 | 270 | 5932 | 306 | 12195 |
| Machine-building and metal cutting | 1721 | 3265 | 2853 | 10012 | 2965 | 11342 | 2920 | 37918 |
| Logging, wood-working, pulp-and-paper industry | 108 | 1112 | 1844 | 6929 | 1962 | 7721 | 1815 | 11674 |
| Building materials industry | 604 | 533 | 986 | 1614 | 1091 | 2066 | 1167 | 2930 |
| Light industry | 1519 | 1302 | 2247 | 2037 | 2127 | 2385 | 1904 | 2641 |
| Food industry | 896 | 1092 | 1859 | 3936 | 2157 | 4495 | 2157 | 20249 |
| Agriculture | 15333 | 8669 | 21862 | 28972 | 22069 | 35193 | 22565 | 39087 |
| Construction | 2061 | 820 | 4767 | 3471 | 4833 | 4989 | 4497 | 7417 |
| Transport | 2117 | 2744 | 3655 | 13143 | 3659 | 12678 | 3635 | 14742 |
| Communications | 198 | 131 | 238 | 333 | 255 | 367 | 451 | 6685 |
| Trade and public catering | 8789 | 3485 | 13553 | 6318 | 12240 | 6901 | 9201 | 29284 |
| Wholesale trade with goods for production-and-technical purposes | 674 | 1743 | 1254 | 2021 | 1321 | 930 | 1179 | 5051 |
| Housing and communal utilities | 3210 | 4736 | 4644 | 9582 | 4867 | 15495 | 6226 | 21003 |
| Other branches | 5792 | 2053 | 8022 | 4282 | 9738 | 5202 | 4602 | 11769 |

TABLE 21. CHANGES IN OFFICIAL RATE OF RUSSIAN ROUBLE
AS RELATED TO US DOLLAR
(at end of month)

| | Rate | | | Rate | |
|---|---|---|---|---|---|
| | Ruble/US dollar | In per cent to previous month | | Ruble/US dollar | In per cent to previous month |
| 1992 | | | May | 5773 | 100,2 |
| December | 415 | | June | 5782 | 100,2 |
| 1993 | | | July | 5798 | 100,3 |
| December | 1247 | 102,7 | August | 5830 | 100,6 |
| 1994 | | | September | 5860 | 100,5 |
| December | 3550 | 109,8 | October | 5887 | 100,5 |
| 1995 | | | November | 5919 | 100,5 |
| December | 4640 | 101,3 | December | 5960 | 100,7 |
| 1996 | | | 1998[1)] | | |
| January | 4732 | 102,0 | January | 6,026 | 101,1 |
| February | 4815 | 101,8 | February | 6,072 | 100,8 |
| March | 4854 | 100,8 | March | 6,106 | 100,6 |
| April | 4932 | 101,6 | April | 6,133 | 100,4 |
| May | 5014 | 101,7 | May | 6,164 | 100,5 |
| June | 5108 | 101,9 | June | 6,198 | 100,6 |
| July | 5191 | 101,6 | July | 6,238 | 100,6 |
| August | 5345 | 103,0 | August | 7,905 | 126,7 |
| September | 5396 | 100,9 | September | 16,065 | 203,2 |
| October | 5455 | 101,0 | October | 16,010 | 99,7 |
| November | 5511 | 101,0 | November | 17,880 | 111,7 |
| December | 5560 | 100,9 | December | 20,650 | 115,5 |
| 1997 | | | 1999 | | |
| January | 5629 | 101,2 | January | 22,60 | 109,4 |
| February | 5676 | 100,8 | February | 22,86 | 101,2 |
| March | 5726 | 100,9 | March | 24,18 | 105,8 |
| April | 5762 | 100,6 | | | |

[1)] Since 1998 considering the change in nominal cost of Russian banknotes, effective since January 1, 1998.

TABLE 22. SHARE OF POPULATION DEPOSITS IN THE SAVING BANK OF RUSSIA AND COMMERCIAL BANKS IN TOTAL INDIVIDUAL DEPOSITS IN BANKS
(as of first day of month; in per cent)

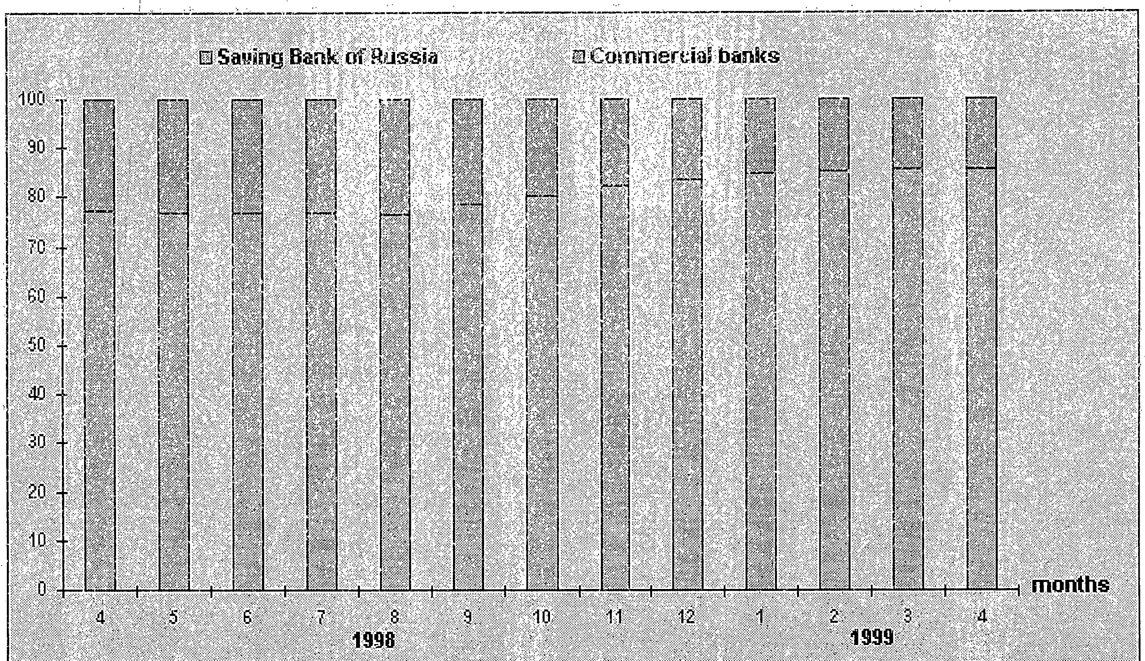



TABLE 23. STRUCTURE OF MONEY INCOMES OF HOUSEHOLDS
(in per cent to total)

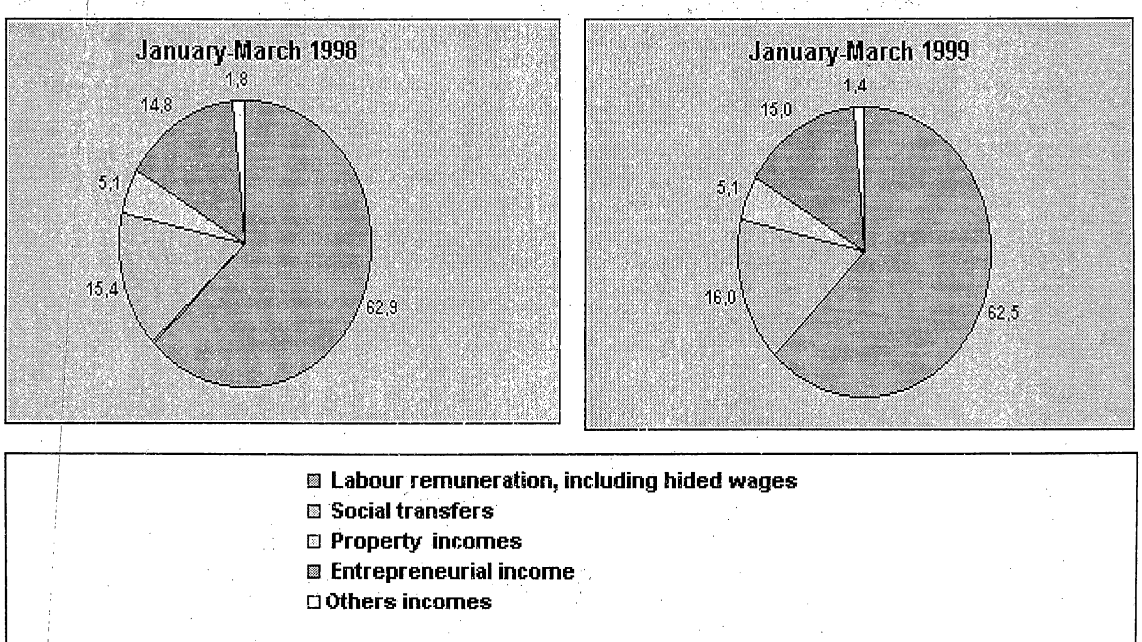


TABLE 24. REFINANCING RATES OF CENTRAL BANK OF RUSSIAN FEDERATION.

| Period in Effect | % | Period in Effect | % |
|---|---|---|---|
| Jan. 1, 1991 - Apr. 9, 1992 | 20 | July 24, 1996 - Aug. 18, 1996 | 110 |
| Apr. 10, 1992 - May 22, 1992 | 50 | Aug. 19, 1996 - Oct. 20, 1996 | 80 |
| May 23, 1992 - March 29, 1993 | 80 | Oct. 21, 1996 - Dec. 1, 1996 | 60 |
| March 30, 1993 - June 1, 1993 | 100 | Dec. 2, 1996 - Feb. 9, 1997 | 48 |
| June 2, 1993 - June 21, 1993 | 110 | Feb. 10, 1997 - Apr. 27, 1997 | 42 |
| June 22, 1993 - June 28, 1993 | 120 | Apr. 28, 1997 - June 15, 1997 | 36 |
| June 29, 1993 - July 14, 1993 | 140 | June 16, 1997 - Oct. 05, 1997 | 24 |
| July 15, 1993 - Sept. 22, 1993 | 170 | Oct. 06, 1997 - Nov. 10, 1997 | 21 |
| Sept. 23, 1993 - Oct. 14, 1993 | 180 | Nov. 11, 1997 - Feb. 1, 1998 | 28 |
| Oct. 15, 1993 - Apr. 28, 1994 | 210 | Feb. 2, 1998 - Feb. 16, 1998 | 42 |
| Apr. 29, 1994 - May 16, 1994 | 205 | Feb. 17, 1998 - March 1, 1998 | 39 |
| May 17, 1994 - June 1, 1994 | 200 | March 2, 1998 - March 15, 1998 | 36 |
| June 2, 1994 - June 21, 1994 | 185 | March 16, 1998 - May 18, 1998 | 30 |
| June 22, 1994 - June 29, 1994 | 170 | May 19, 1998 - May 26, 1998 | 50 |
| June 30, 1994 - July 31, 1994 | 155 | May 27, 1998 - June 4, 1998 | 150 |
| Aug. 1, 1994 - Aug. 22, 1994 | 150 | June 5, 1998 - June 28, 1998 | 60 |
| Aug. 23, 1994 - Oct. 11, 1994 | 130 | June 29, 1998 - July 23, 1998 | 80 |
| Oct. 12, 1994 - Nov. 16, 1994 | 170 | July 24, 1998 - June 9, 1999 | 60 |
| Nov. 17, 1994 - Jan. 5, 1995 | 180 | June 10, 1999 - January 23, 2000 | 55 |
| Jan. 6, 1995 - May 15, 1995 | 200 | January 24, 2000 - March 6, 2000 | 45 |
| May 16, 1995 - June 18, 1995 | 195 | March 7, 2000 - March 20, 2000 | 38 |
| June 19, 1995 - Oct. 23, 1995 | 180 | March 21, 2000 - July 9, 2000 | 33 |
| Oct. 24, 1995 - Nov. 30, 1995 | 170 | July 10, 2000 - November 3, 2000 | 28 |
| Dec. 1, 1995 - Feb. 9, 1996 | 160 | November 4, 2000 - | 25 |
| Feb. 10, 1996 - July 23, 1996 | 120 | | |

TABLE 25. INTEREST RATES (IN% PER ANNUM) IN 2000.

| | Jan | Feb | March | April | May | June | July | Aug | Sept | Oct | Nov |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Interbank Rate[1] | 11.8 | 11.3 | 6.5 | 11.1 | 7.6 | 5.1 | 3.4 | 4.6 | 3.3 | 5.2 | 8.5 |
| GKOs Yield [2] | — | — | 17.2 | 14.9 | 11.4 | 13.1 | 12.9 | 10.0 | 10.6 | 11.3 | 12.2 |
| OBRs Yield[3] | — | — | — | — | — | — | — | — | — | — | — |
| Deposit Rate[4] | 13.4 | 7.9 | 7.6 | 5.4 | 7.3 | 7.2 | 6.4 | 5.1 | 4.6 | 4.4 | 4.6 |
| Credit Rate[5] | 34 | 31.3 | 29.8 | 29.2 | 25.5 | 23 | 22.7 | 20.9 | 20.5 | 20 | 18.1 |

1) Interbank Rate - an average-weighted rate on overnight interbank credits in the Moscow market.
2) GKOs Yield - an average-weighted GKOs yield by volume and terms of circulation with maturities of up to 90 days.
3) OBRs Yield - an average-weighted by volume and terms of circulation.
4) Deposit Rate - an average-weighted rate on deposits of private individuals in credit institutions (including Sberbank) for a term of up to one year.
5) Credit Rate - an average-weighted rate on legal entities' credits in credit institutions (including Sberbank) for a term of up to one year.

TABLE 26. INTEREST RATES (IN% PER ANNUM) IN 1999.

| | 1999 | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Jan | Feb | March | April | May | June | July | Aug | Sept | Oct | Nov | Dec |
| Interbank Rate[1)] | 28.1 | 20.4 | 20.7 | 15.2 | 7.1 | 8.4 | 9 | 9.3 | 18.2 | 16.1 | 13.2 | 11.8 |
| GKOs Yield [2)] | – | 33.4 | 30.7 | 27.4 | 20.2 | 16 | – | – | – | – | – | – |
| OBRs Yield[3)] | 31.9 | 18.4 | – | – | – | – | – | – | – | – | – | – |
| Deposit Rate[4)] | 24.2 | 22.8 | 18.9 | 14.6 | 14.7 | 11 | 12.6 | 8.8 | 9.7 | 9.0 | 9.4 | 8.5 |
| Credit Rate[5)] | 45.5 | 44.1 | 45.7 | 43.8 | 43.5 | 32.2 | 38.9 | 38.5 | 37.8 | 37.0 | 38.3 | 31.3 |

TABLE 25. INTEREST RATES (IN% PER ANNUM) IN 1998.

| | 1998 | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Jan | Feb | March | April | May | June | July | Aug | Sept | Oct | Nov | Dec |
| Interbank Rate[1)] | 24.1 | 30.3 | 25.9 | 29.5 | 47.6 | 56.1 | 58.8 | 45.3 | 139.7 | 84.9 | 36.7 | 27.8 |
| GKOs Yield [2)] | 29.4 | 26.4 | 22.2 | 25 | 43.9 | 51.3 | 58 | 84.2 | - | - | - | - |
| OBRsYield[5)] | - | - | - | - | - | - | - | - | 80.1 | 54.9 | 40.8 | 48.1 |
| Deposit Rate[3)] | 11.6 | 12.2 | 11.2 | 11 | 12.9 | 14 | 15.1 | 17.5 | 23.8 | 27.3 | 22.3 | 25.7 |
| Credit Rate[4)] | 29.8 | 30.4 | 38.3 | 38.8 | 40.4 | 48 | 44.9 | 48.6 | 46.8 | 49 | 44.8 | 41.7 |

TABLE 25. INTEREST RATES (IN% PER ANNUM) IN 1997.

| | 1997 | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Jan | Feb | March | April | May | June | July | Aug | Sept | Oct | Nov | Dec |
| Interbank Rate[1)] | 21.1 | 25.8 | 32.4 | 28.2 | 14.8 | 16.1 | 14.3 | 16.2 | 15.6 | 18.2 | 20.5 | 28.4 |
| GKO Yield [2)] | 29.1 | 25.4 | 29.3 | 31.3 | 23.2 | 18.7 | 17.2 | 17.6 | 18.3 | 18.3 | 20.7 | 32 |
| Credit Rate 4) | 44.2 | 46.1 | 41.6 | 32.5 | 34.0 | 28.5 | 28.8 | 28.3 | 24.8 | 24.0 | 23.0 | 28.5 |
| Deposit Rate[3)] | 30.2 | 26.8 | 18.3 | 18 | 17.3 | 17.1 | 16.6 | 15.4 | 10.3 | 9.5 | 9.9 | 11.8 |

1) Interbank Rate - an average-weighted rate on overnight interbank credits in the Moscow market.
2) GKOs Yield - an average-weighted GKOs yield by volume and terms of circulation with maturities of up to 90 days.
3) OBRs Yield - an average-weighted by volume and terms of circulation.
4) Deposit Rate - an average-weighted rate on deposits of private individuals in credit institutions (including Sberbank) for a term of up to one year.
Credit Rate - an average-weighted rate on legal entities' credits in credit institutions (including Sberbank) for a term of up to one year.

TABLE 26. LABOR FORCES IN 1999.

| | Economically active population | | Including | | | | | |
|---|---|---|---|---|---|---|---|---|
| | | | Employed | | Unemployed | | Unemployed, oficially registered in the employment services | |
| | Mln people | In % to the correspondi ng period of the previous year | Mln people | In % to the correspondi ng period of the previous year | Mln people | In % to the correspondi ng period of the previous year | Mln people | In % to the correspondi ng period of the previous year |
| 1999 | | | | | | | | |
| January | 73,3 | 101,1 | 63,2 | 98,4 | 10,1 | 122,3 | 1,9 | 98,4 |
| February | 73,6 | 101,7 | 63,2 | 98,8 | 10,4 | 123,2 | 2,0 | 98,6 |
| March | 73,5 | 101,7 | 63,5 | 99,5 | 10,0 | 118,7 | 1,9 | 98,0 |
| Quarter I (on the average in a month) | 73,5 | 101,5 | 63,3 | 98,9 | 10,2 | 121,4 | 1,9 | 98,3 |
| April | 73,4 | 101,7 | 63,8 | 100,2 | 9,6 | 113,2 | 1,8 | 95,3 |
| May | 73,3 | 101,8 | 64,2 | 100,8 | 9,1 | 110,0 | 1,7 | 92,7 |
| June | 73,3 | 101,9 | 64,5 | 101,1 | 8,8 | 109,2 | 1,6 | 89,0 |
| QuarterII (on the average in a month) | 73,3 | 101,8 | 64,2 | 100,8 | 9,2 | 110,8 | 1,7 | 92,4 |
| July | 73,3 | 102,1 | 64,6 | 101,4 | 8,7 | 107,0 | 1,5 | 84,8 |
| August | 73,3 | 102,1 | 64,6 | 101,7 | 8,7 | 104,9 | 1,4 | 81,1 |
| September | 73,2 | 101,7 | 64,4 | 101,6 | 8,8 | 102,3 | 1,3 | 76,3 |
| Quarter III (on the average in a month) | 73,3 | 101,9 | 64,5 | 101,6 | 8,7 | 104,7 | 1,4 | 80,8 |
| October | 73,2 | 101,4 | 64,3 | 101,6 | 8,9 | 100,5 | 1,3 | 70,9 |
| November | 73,2 | 100,7 | 64,1 | 101,3 | 9,1 | 96,8 | 1,3 | 67,5 |
| December | 72,9 | 99,9 | 64,0 | 101,1 | 8,9 | 91,5 | 1,3 | 65,5 |
| Quarter IV (on the average in a month) | 73,1 | 100,7 | 64,1 | 101,3 | 9,0 | 96,1 | 1,3 | 67,9 |
| Year | 73,3 | 101,5 | 64,0 | 100,6 | 9,3 | 107,9 | 1,6 | 85,1 |

TABLE 27. LABOR FORCES IN 2000.

| | Economically active population | | Including | | | | | |
|---|---|---|---|---|---|---|---|---|
| | | | Employed | | Unemployed | | Unemployed, oficially registered in the employment services | |
| | Mln people | In % to the corresponding period of the previous year | Mln people | In % to the corresponding period of the previous year | Mln people | In % to the corresponding period of the previous year | Mln people | In % to the corresponding period of the previous year |
| 2000 | | | | | | | | |
| January | 72,5 | 98,9 | 63,8 | 100,9 | 8,7 | 86,4 | 1,2 | 63,7 |
| February | 72,1 | 98,0 | 63,5 | 100,5 | 8,6 | 82,5 | 1,2 | 62,8 |
| March | 72,1 | 98,1 | 63,9 | 100,6 | 8,2 | 81,3 | 1,2 | 62,6 |
| Quarter I (on the average in a month) | 72,2 | 98,2 | 63,7 | 100,6 | 8,5 | 83,4 | 1,2 | 63,1 |
| April | 72,2 | 98,4 | 64,4 | 100,9 | 7,8 | 81,0 | 1,2 | 62,3 |
| May | 72,2 | 98,5 | 64,8 | 100,9 | 7,4 | 81,2 | 1,1 | 61,8 |
| June | 72,3 | 98,6 | 65,0 | 100,8 | 7,3 | 82,5 | 1,0 | 63,3 |
| Quarter II (on the average in a month) | 72,2 | 98,5 | 64,7 | 100,8 | 7,5 | 81,6 | 1,1 | 62,4 |
| July | 72,3 | 98,6 | 65,1 | 100,8 | 7,2 | 82,6 | 1,0 | 66,0 |
| August | 72,3 | 98,6 | 65,2 | 100,9 | 7,1 | 81,5 | 1,0 | 69,3 |
| September | 72,3 | 98,8 | 65,1 | 101,2 | 7,2 | 81,4 | 1,0 | 72,3 |
| Quarter III (on the average in a month) | 72,3 | 98,6 | 65,1 | 100,9 | 7,1 | 81,8 | 1,0 | 69,1 |
| October | 72,3 | 98,8 | 65,1 | 101,2 | 7,2 | 80,7 | 1,0 | 75,5 |
| November | 72,4 | 99,3 | 65,0 | 101,6 | 7,4 | 81,0 | 1,0 | 79,3 |

Note. The total number of the unemployed for the period since May 2000 has been adjusted based on the survey results for August 2000.

TABLE 28. COST OF LIVING
(average per capita)

| | 1998 | | | | | | | | | | 1999 | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | March | April | May | June | July | August | Sept | Octob | Novmb | Dec | Jan | Febr | March |
| | rubles | | | | | | | | | | | | |
| Total population | 427,4 | 431,9 | 434,9 | 435,5 | 438,4 | 449,7 | 552,0 | 572,9 | 618,5 | 716,8 | 786,9 | 829,1 | 856,8 |
| including: | | | | | | | | | | | | | |
| working-age | 480,7 | 485,8 | 489,2 | 489,9 | 493,1 | 505,8 | 620,9 | 644,4 | 695,7 | 806,2 | 860,0 | 906,1 | 936,4 |
| pensioners | 301,3 | 304,5 | 306,6 | 307,0 | 309,1 | 317,0 | 389,2 | 403,9 | 436,0 | 505,3 | 558,7 | 588,7 | 608,4 |
| children | 431,7 | 436,2 | 439,2 | 439,8 | 442,8 | 454,1 | 557,5 | 578,6 | 624,6 | 723,9 | 787,2 | 829,5 | 857,2 |

The cost of living has been estimated on the basis of the methodology adopted by the Ministry of Labor of the Russian Federation on November 10, 1992. In accordance with the Federal Law of October 24, 1997 № 134-FL "On cost of living in the Russian Federation" presently the new procedure has been developed for determining the size of cost of living.

TABLE 29. POVERTY LEVEL CHANGE RATE

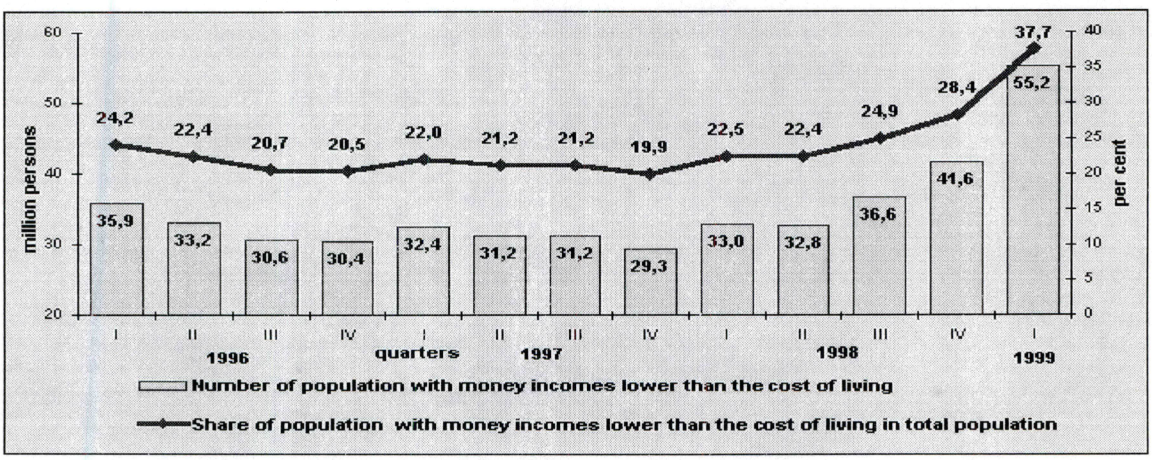



TABLE 30. STRUCTURE OF CAPITAL INVESTMENTS BY OWNERSHIP TYPES

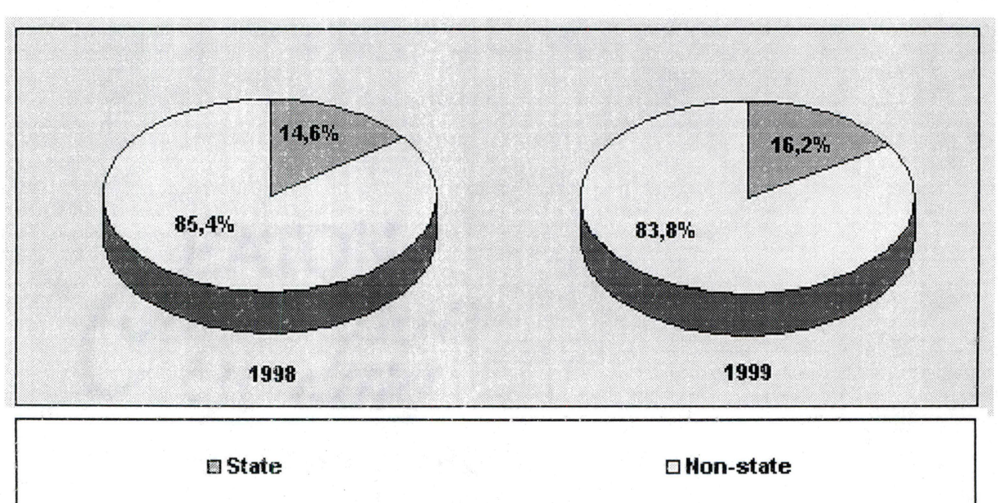


TABLE 31. COUNTRIES WITH THE LARGEST INVESTMENTS INTO RUSSIA'S ECONOMY

| | 1999 | | |
|---|---|---|---|
| | Accumulated at end of the first quarter | | In reference: invested in the first quarter, million US dollars |
| | Million US dollars | In per cent to total | |
| Investments, total | 26019 | 100 | 1556 |
| Germany | 6344 | 24,4 | 239 |
| USA | 5058 | 19,4 | 357 |
| UK | 3446 | 13,2 | 184 |
| France | 3237 | 12,4 | 43 |
| Cyprus | 3022 | 11,6 | 202 |
| Italy | 616 | 2,4 | 6 |
| Netherlands | 469 | 1,8 | 67 |
| Sweden | 372 | 1,4 | 18 |
| Japan | 336 | 1,3 | 8 |
| Finland | 297 | 1,1 | 44 |

TABLE 32. CHANGE IN US DOLLAR EXCHANGE RATE AND CONSUMER PRICES INDEX (in per cent to previous month)

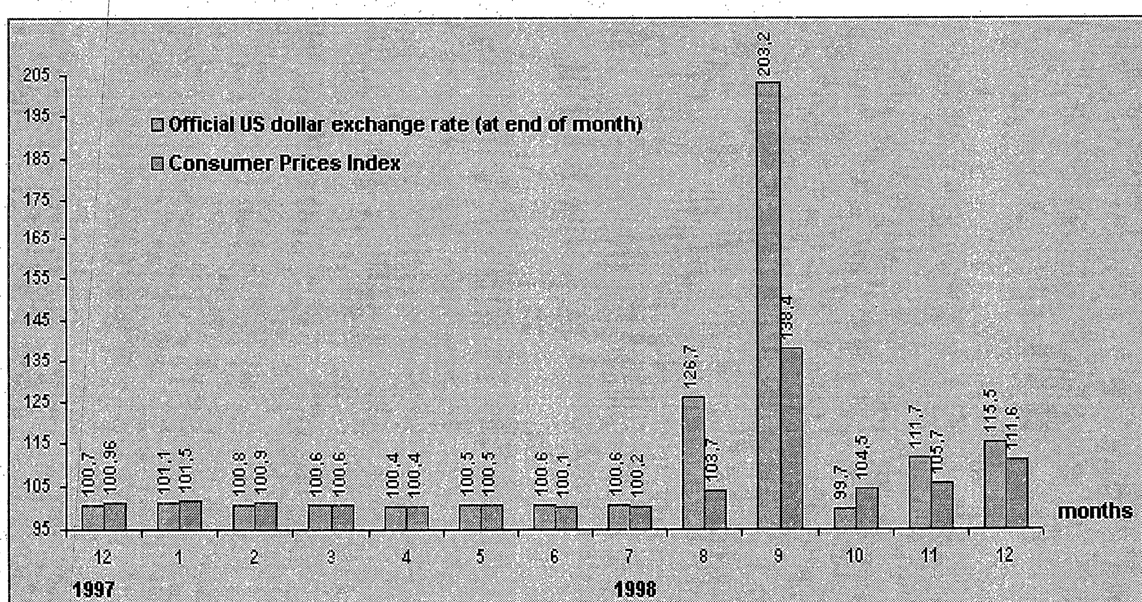


TABLE 33. REMAINDERS OF POPULATION DEPOSITS IN BANKS IN 1998
(at beginning of month)

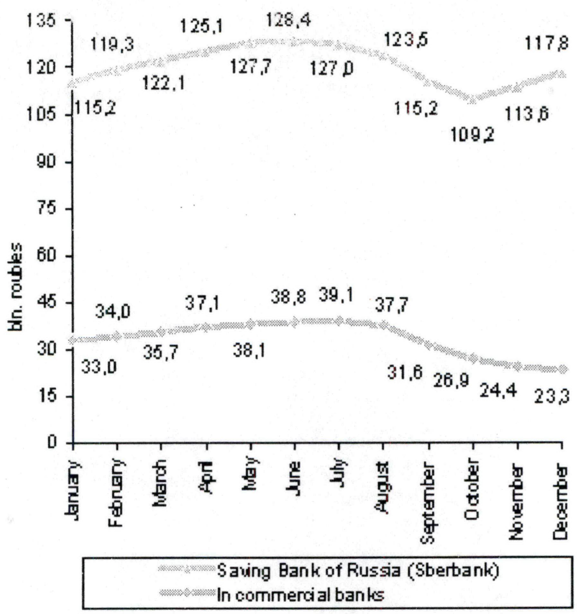


TABLE 34. NUMBER OF OPERATING CREDIT ORGANIZATIONS AND THEIR BRANCHES (WITHOUT SBERBANK AND VNESHEKONOMBANK)

| As of | No. of operating credit organizations | No. of branches | No. of Sberbank outlets | No. of branches opened by credit organizations in CIS countries |
|---|---|---|---|---|
| Jan. 1, 1996 | 2,295 | 5,581 | 38,567 | 40 |
| Feb. 1, 1996 | 2,285 | 5,542 | 38,567 | 39 |
| Mar. 1, 1996 | 2,275 | 5,533 | 38,567 | 31 |
| Apr. 1, 1996 | 2,268 | 5,514 | 34,426 | 30 |
| May 1, 1996 | 2,266 | 5,505 | 34,426 | 30 |
| June 1, 1996 | 2,172 | 5,312 | 34,426 | 22 |
| July 1, 1996 | 2,154 | 5,297 | 34,426 | 21 |
| Aug. 1, 1996 | 2,141 | 5,245 | 34,426 | 21 |
| Sep. 1, 1996 | 2,120 | 5,218 | 34,426 | 21 |
| Oct. 1, 1996 | 2,090 | 5,193 | 34,426 | 18 |
| Nov. 1, 1996 | 2,073 | 5,135 | 34,426 | 18 |
| Dec. 1, 1996 | 2,053 | 5,114 | 34,426 | 16 |
| Jan. 1, 1997 | 2,029 | 5,123 | 34,426 | 14 |
| Feb. 1, 1997 | 2,025 | 5,100 | 34,426 | 13 |
| Mar. 1, 1997 | 2,005 | 5,078 | 34,426 | 13 |
| Apr. 1, 1997 | 1,936 | 4,933 | 34,426 | 14 |
| May 1, 1997 | 1,887 | 4,828 | 34,426 | 14 |
| June 1, 1997 | 1,872 | 4,781 | 34,426 | 14 |
| July 1, 1997 | 1,841 | 4,741 | 34,426 | 12 |
| Aug. 1, 1997 | 1,808 | 4,672 | 34,426 | 12 |
| Sep. 1, 1997 | 1,789 | 4,618 | 34,426 | 10 |
| Oct. 1, 1997 | 1,764 | 4,577 | 34,426 | 9 |
| Nov. 1, 1997 | 1,739 | 4,549 | 34,426 | 8 |
| Dec. 1, 1997 | 1,719 | 4,508 | 34,426 | 5 |

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