ECONOMY OF RUSSIA

More than a decade after the collapse of the Soviet Union in 1991, Russia is now trying to further develop a market economy and achieve more consistent economic growth. Russia saw its comparatively developed centrally planned economy contract severely for five years, as the executive and the legislature dithered over the implementation of reforms and Russia's aging industrial base faced a serious decline. After the breakup of the USSR, Russia's first slight recovery, showing signs of open-market influence, occurred in 1997. That year, however, the Asian financial crisis culminated in the August depreciation of the ruble. This was followed by a debt default by the government in 1998, and a sharp deterioration in living standards for most of the population. Consequently, 1998 was marked by recession and an intense capital flight.

Nevertheless, the economy started recovering in 1999. The recovery was greatly assisted by the weak ruble, which made imports expensive and boosted local production. Then it entered a phase of rapid economic expansion, the GDP growing by an average of 6.7% annually in 1999-2005 on the back of higher petroleum prices, a weaker ruble, and increasing service production and industrial output. The country is presently running a huge trade surplus, which has been helped by protective import barriers, and rampant corruption which ensures that it is almost impossible for foreign and local SMEs (small and medium sized enterprises) to import goods without the help of local specialist import firms, such as the Russia Import Company. Some import barriers are expected to be abolished after Russia's accession to the WTO in 2006.

The recent recovery, made possible due to high world oil prices, along with a renewed government effort in 2000 and 2001 to advance lagging structural reforms, has raised business and investor confidence over Russia's prospects in its second decade of transition. Russia remains heavily dependent on exports of commodities, particularly oil, natural gas, metals, and timber, which account for about 80% of exports, leaving the country vulnerable to swings in world prices. In recent years, however, the economy has also been driven by growing internal consumer demand that has increased by over 12% annually in 2000-2005, showing the strengthening of its own internal market. The economic development of the country has been extremely uneven: the Moscow region contributes one-third of the country's GDP while having only a tenth of its population. GDP increased by 7.2% in 2004 and 6.4% in 2005.

The country's GDP(PPP) shot up to reach €1.2 trillion ($1.5 trillion) in 2004, making it the ninth largest economy in the world and the fifth largest in Europe. If the current growth rate is sustained, the country is expected to become the second largest European economy after Germany (€1.9 trillion or $2.3 trillion) and the sixth largest in the world within a few years. In 2005, according to State Statistics Committee, GDP reached $765 billion nominally (21.7 billion rubles), equal to $1.748 trillion in international dollars (PPP; power purchase parity). Inflation was 10.9% percent. The consolidated budget took 38.6% of country's GDP: $675 bil-

lion (PPP). The government plans to reduce the tax burden, although the time and scale of such a reduction remains undecided. By August 17th, 2006, Russia's international reserves reached $277 billion nominally and projected to grow to $320 billion by the end of this year and to $350-450 billion by the end of 2007. Formed by State in 2004, Stabilisation Fund (SF) grew to $75 billion and is projected to achieve $110 billion by the end of the year, $173 billion by the end of 2007, and about $300 billion by the end of 2009. According to the Federal State Statistics Service of Russia, the monthly nominal average salary was about RUR 10,975 (about $408 nominally; about $800 PPP) in June, 25.6 percent higher than in June 2005 and 7 percent more than in May 2006.

For 2007 year, GDP is projected to grow to about $1.2 trillion nominally (31.2 billion rubles; about $2-2.5 trillion PPP).

Some perceive the greatest challenge facing the Russian economy to be encouraging the development of SMEs in a business climate with a young and less-than-sufficient functional banking system. Few of Russia's banks are owned by oligarchs, who often use the deposits to lend to their own businesses. The 2005 Milken Institute's ratings place Russia at the 51st place in the world, out of 121 countries by the availability of capital. The European Bank for Reconstruction and Development and the World Bank have attempted to kick-start normal banking practices by making equity and debt investments in a number of banks, but with very limited success. However, about 25 biggest banks of Russia get entry into Top 1000 banks of the world by The Banker. Many more Russian banks have very high international ratings by Moodys and Fitch, including "investment" level. Other problems include disproportional economic development of Russia's own regions. While the huge capital region of Moscow is a bustling, affluent metro-

polis living on the cutting edge of technology with a per capita income rapidly approaching that of the leading Eurozone economies, much of the country, especially its indigenous and rural communities in Asia, lags significantly behind. Market integration is nonetheless making itself felt in some other sizeable cities such as Saint Petersburg, Kaliningrad, and Ekaterinburg, and recently also in the adjacent rural areas.

Most of the large fortunes currently prevailing in Russia are the product of either acquiring government assets at particularly low costs or gaining concessions from the government. Other countries have expressed concerns and worries at the "selective" application of the law against individual businessmen, though the government actions have been received positively by most of the aggravated Russians.

There has been a significant inflow of capital in recent years from many European investors attracted by cheaper land, labor and higher growth rates than in the rest of Europe. Amazingly high levels of education and societal involvement achieved by the majority of the population, including women and minorities, secular attitudes, mobile class structure, better integration of various minorities in the mainstream culture set Russia far apart from the majority of the so-called developing countries and even some developed nations.

So far, the country is also benefiting from rising oil prices and has been able to pay off almost all of its formerly huge debt. Equal redistribution of capital gains from the natural resource industries to other sectors is however a problem. Still, since 2003, exports of natural resources started decreasing in economic importance as the internal market has strengthened considerably largely stimulated by intense construction, as well as consumption of increasingly diverse goods and services. Yet teaching customers and encouraging consumer spending is a relatively tough task for many provincial areas where consumer demand is primitive. However, some laudable progress has been made in larger cities, especially in clothing, food, and entertainment industries.

Additionally, some international firms are investing in Russia. According to the International Monetary Fund (IMF), Russia had nearly $26 billion in cumulative foreign direct investment inflows during the 2001-2004 period (of which $11.7 billion occurred in 2004).