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FOCUS:
North-European Gas Pipeline: Reasons and Consequences

Throughout the last year, the Russian and international public lively discussed the project envisaging the construction of the Northern-European Gas Pipeline (NEGP).

The debates began to acquire especially acute form, when the participants of the project – the Russian "Gazprom" and German concerns concluded the respective agreement and the project entered the stage of practical implementation.

There were voiced absolutely polar points of view, from most well-disposed ones: "this project is of historical importance for Germany that will be granted reliable power supply for decades ahead" (Gerhard Schroeder, the Chancellor of Germany) and "the Russian-German Project of the Northern-European Gas Pipeline (NEGP) across the Baltic Sea floor is going to become an environmentally safe way of power supply" (Benita Ferrero-Waldner, Member of the European Commission (EC) for Foreign Relations and European Neighborhood Policy) to the most strong and negative remarks, like "the pact signed by Putin and Schroeder is bad from the environmental and poor from the economic and political points of view" (President of Poland Alexander Kwasniewski), "[it] threatens the security and independence of Poland" (a resolution of the Polish Sejm), and "[it] will become an ecological catastrophe" (Algirdas Brazauskas, the Prime-Minister of Lithuania).

Indeed, it can not be denied that this project per se is a rather expensive and complex enterprise both in technical and political terms.

The technical complexity of the project is determined primarily by the fact that at present, according to a number of ecologists, the seafloor of the Baltic Sea is littered with deathly German chemical ammunitions sunken by the anti-Hitler coalition allies after the World War II (303 thousand metric tons in total). Some of these ammunitions containing mustard gas, lewisite, phosgene, nerve gas, and other deathly poisons are laying on the seafloor of the Gulf of Finland, where the gas pipeline will run. At the same time, according to a statement made by Alexei Yablochkov, a famous Russian ecologist, there are no maps showing the exact locations of such underwater dumps. This circumstance creates a threat of a serious ecological catastrophe, which may occur in the case the sunken ammunitions are harmed during construction works, and will have an extremely negative impact on the ecosystem of the whole region.

On the other hand, the project has triggered a number of political issues. The main problem is that natural gas will be supplied from Russia to Western European countries by a direct route bypassing transit countries. It is a well-known fact that as an option alternative to the Northern-European Gas Pipeline there had been considered ground routes going through the territories of Lithuania, Latvia, Estonia, and Poland. It would have made construction much cheaper; however, it would have hardly lessened the maintenance costs, since the calculation of the final price of fuel should also take into account the amount of transit payments. Finding themselves outside of this project, the Baltic States and Poland characterize the decision to lay the gas pipeline across the floor of the Baltic Sea (and not through their territories) as politically motivated and erroneous.

A certain political poignancy of the discussion around the NEGP issue was also caused by the fact that with respect to this matter the new members of the European Union had engaged in controversy against the EU old-timers (first of all, Germany) and Brussels itself stating that the construction of the gas pipeline without taking into account their interests undermined the principles of the EU common energy policy.

The third political consequence of the project was the appointment of Gerhard Schroeder, the former Chancellor of Germany, as the head of the gas pipeline construction. It is well-known that he had actively supported the project, and now many German politicians accuse him of drawing personal gains from the decisions he had taken as the head of the state. However, a number of experts hail this appointment pointing out that it was necessary to use Schroeder's political "weight" to promote the project more successfully, especially as concerns the relations with the countries voicing their negative attitude to the NEGP.

Indeed, it would be hardly possible

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to think that such a large-scale project could satisfy all interested parties and thus avoid an active international discussion. However, let us try to puzzle out what are the usefulness and significance of this project for the Russian-European relations at large and the Kaliningrad oblast in particular, and what risks the construction of this gas pipeline may involve. Let us try to distinguish facts and speculations.

First, the international importance of this project is that it will permit to significantly enhance the capacity to supply the "blue fuel" to the member-countries of the European Union, what acquires special importance taking into account the fact that the volumes of consumption of natural gas in these countries have been steadily growing. Second, the project will contribute to the increasing degree of reliability of gas supplies to the EU member-countries and their energy safety because of the diversification of energy sources. Third, it will permit to lessen the risks of interruptions in deliveries resulting from possible shifts in the political situation. And, finally, due to the fact that no transit states are involved in supplies carried out via the NEPG, there arises the possibility to reduce the costs of transportation of the Russian natural gas. No doubt, it is an important advantage both for the supplier of natural gas and its end-consumers.

The NEPG project will directly connect the Russia's unified system of gas supply to the common European gas network and will become a significant contribution to the creation of the common Russian-European space as concerns energy issues. Moreover, as it was stressed at the meeting of Mikhail Fradkov, the RF Prime-Minister, with Michael Glos, the German Minister of Economy, which took place at the inauguration ceremony of the NEGP, the project should give an additional impetus to the interaction between Russian and the European Union in the framework of the "roadmap" of formation of the common economic space. Therefore, the all-European importance of the new gas pipeline as one of the "bridges" connecting Russia and the European Union in practical terms and increasing the degree of their mutual integration can not be open to question.

The project also plays a special role on the all-Russian scale, since in the NEGP framework it is planned to build a spur to Kaliningrad, what should permit to increase the gas supplies to the oblast, as well as ensure the absence of natural gas shortages, reliability and diversification of the sources of natural gas supplies, and avoid political risks associated with the transit of gas across the territories of third countries. In this connection, experts express the opinion that the NEGP construction will facilitate the enhanced predictability and stability of economic operations conducted by industrial enterprises of the region and will give a powerful impetus to the economic development of the Kaliningrad oblast.

As concerns the criticisms addressed to the project, these critical remarks are based on the fact that all countries situated in the region of the Baltic Sea, including Russia and Germany, bear the common responsibility to each other for its preservation and the state of its ecology. Therefore, the project should exclude any threat of pollution of the Baltic Sea, since in the case it is polluted, the countries, not participating in the project, will be also affected. Proceeding from this fact, the opponents of the NEGP insist on the guarantees of ecological safety of the project. However, here it should be noted that the developers of the project, who clearly understand their responsibility, themselves raise this issue as a priority. According to a "Gazprom" statement, "the construction of NEGP will be conducted meeting the most strict ecological standards and will not damage the ecosystem of the Baltic Sea."

Involuntary it comes to mind the comparison with the similar recent situation concerning the construction of the D-6 oil platform on the Baltic Sea shelf by the Russian "LUKOIL" company. This project had been also sharply criticized by ecologists. According to a number of experts, in this case the hysteria about the ecological risks was nothing more than a secret tool used to attain not ecological, but economic and political objectives. As time has shown, the existing engineering solutions permit to implement projects of any technical complexity in the open sea without detriment to the environment, what proves that ecological risks are often exaggerated in the course of evaluation of such initiatives. Moreover, it should be noted that ecological concerns belong to technical aspects of implementation of projects and should primarily draw attention of experts in ecology and not politicians.

A substantial point supporting the groundlessness of statements that the decision to lay the gas pipeline across the Baltic Sea floor along a route bypassing the Baltic States and Poland had been politically motivated was voiced by Javier Solana, the High Representative for the Common Foreign and Security Policy, Secretary-General of the Council of the European Union, who said that "in the end, the construction of a new pipeline is a business decision. It would be far too expensive a project to be undertaken for political purposes."

In conclusion, Andris Piebalgs, a representative of Latvia, the EU Commissioner for Energy could be quoted. His point of view looks very balanced; besides, he can be hardly accused of expressing a biased judgment, since Latvia, as it is well known, was a most bitter opponent of the NEGP construction. In particular, Mr. Piebalgs said: "No doubt, investors decide, where the project should be implemented. In 2003, there was taken the decision that supplies of natural gas from Russia to the European Union were a priority… [from three possible routes] the only option, in which investors took interest, was the route across the Baltic Sea floor. In my opinion, it does not pose any problems as concerns the reliability of gas supplies to Latvia, since in the case the need arises, there may be built a spur. Besides, for the EU at large, where this market is formed, it would be more favorable if a new way of gas supplies appeared. And the better the common European market is supplied, the better it is for Latvia, because it provides it with more opportunities."

The example of the NEPG construction graphically illustrates the complexity of the Russian-European relations: conflicts of interests take place not only between Russian and the EU, but inside the European Union as well, among its member-states. However, in this case the placing of stake on cooperation with the EU "old-timers," its economic and political "heavyweights" is an absolutely justified decision, which seems to be the most promising as concerns the development of the new quality of the Russian-European partnership.

Reference note on the project

The Northern-European Gas Pipeline (NEGP) is a brand new route to export Russian gas to Europe. The target markets of the NEGP supplies are Germany, Great Britain, the Netherlands, France, and Denmark. By a decision of the European Commission, the project was awarded the "TEN" status (Trans-European Networks).

The length of the gas pipeline offshore section (from Vyborg to Greifswald) will make 1,198 km. The first leg of the Northern-European Gas Pipeline will be commissioned in 2010. Its annual capacity should make about 27.5 billion cubic meters. It is envisaged that there will be built the second leg of the gas pipeline, what will increase the NEGP capacity two times up to 55 billion cubic meters a year (by 2013). The estimated cost of works related to the laying of the gas pipeline should make Euro 4 billion.

The first joint of the NEGP was welded in the Vologda oblast (the town of Babyevo) on December 9, 2005. ■

Interview with German Gref: the economic performance of Russia in 2005 and prospects of country's further economic development

Mr German Gref, Minister of Economic Development and Trade of the Russian Federation tells NEt about the results of the economic performance of Russia in 2005 and prospects for the country's further economic development

- Mr Gref, what were the strategic priorities that the Ministry of Economic Development and Trade worked on in 2005?

- The activities of the Ministry in 2005 were aimed at bolstering high rates of economic development through the improvement of quality of human capital, promotion of competition and enhancement of the efficiency of state governance.

A special attention was paid to the development of mechanisms for financial support of small exporting companies and enterprises that operate in R&D sector. New rules for VAT reimbursement and income tax calculation allowed the companies to keep more revenues to themselves.

The bills that we adopted such as "About special economic zones", "About concession agreements" are expected to spur the attraction of private investments into the innovative and processing sectors of the economy and to lure more funds into the development of infrastructure projects and speed up the modernization of transport networks, utilities and power generating sectors.

With the view of developing land and real estate market the Ministry drafted a set of normative acts that we hope will help improve the regulation and inventory of land and real estate facilities and will drive the development of more effective mechanisms for appraisal and taxation of real estate property.

The 29th of June 2005 saw the adoption of important Federal bills "About amendments to the Federal bill "About turnover of agricultural-purpose land" and "About land organization".

On June 8, 2005 the Russian State Duma adopted Federal legislation "About introduction of changes to the Land Code of the Russian Federation, Timber Code of the Russian Federation" and Federal bill "About introduction of civil construction Code of the Russian Federation".

With the view of improving privatization mechanisms a resolution of the Russian Government was approved on October 4, 2005 to enhance the efficiency of such privatization option as a specialized auction as well as to prevent from accumulation of small stakes in state and municipal-owned property.

On the 2nd of July 2005 Russian State Duma approved such bills as "On introduction of amendments to Federal bill "On licensing specific types of activities", "On protection of the rights of legal entities and individual entrepreneurs during implementation of state control (supervision)" and "Code of the Russian Federation about administrative offenses". These are the bills that are aimed at reducing administrative barriers. Federal Bill "On licensing specific types of activities" envisages a step-by-step abolition of 49 types of activities that currently need to be licensed and aims to optimize the licensing procedures.

When drafting the list of activity types to be abolished we based ourselves on an assumption that licensing is the most stringent form of state regulation that restrains the entrance of entrepreneurs into the market and thus it should be used in exclusive cases when during the implementation of business activities it is not possible (for objective reasons) to prevent damage by other mechanisms of business activity regulation.

Since there exist other forms of state regulation we will abolish the obligatory licensing of activities in the area of construction (effective since 1st January 2007), tourism (effective since 1st January 2007), passenger transportation by passenger vehicles (effective from the moment when the federal bill comes into effect).

On July 21, 2005 Russian State

Duma adopted the Federal bill that regulates production and turnover of ethyl alcohol, alcoholic and alcohol-containing products.

The bill envisages abolition of a series of state regulation norms (that build excessive bureaucratic barriers) such as imposing quotas on procurement of ethyl alcohol, systems of excise storages and regional marking of alcoholic products, additional licensing of exports and imports, registration of product titles etc. At the same time the bill introduces a series of norms aimed at tightening state control over production and turnover of indicated types of products including through introduction of the unified state automated system of information control.

Formation of the Stabilization fund was the most important event in the budget policy. The accumulation of significant financial resources in the Stabilization fund is an important tool that ensures additional capabilities for prevention of crisis situations in the financial sector. Currently the financial standing of the country is very stable. In 2005 the revenues of the federal budget will exceed the planned indicators by a significant margin.

With the view of setting up the Investment Fund of the Russian Federation the Ministry drafted the Provisions that define the order of Investment Fund formation. In particular, the Provisions describe the forms and mechanisms for allocation of state support for implementation of investment projects of state importance on the conditions of state and private partnership through the use of the Fund's money. Currently the Ministry's Department of the investment policy develops a package of documents (including draft Resolutions of the Russian Government and orders of the Russian Ministry of Economic Development and Trade) that will pave the way for a successful operation of the Investment Fund of the Russian Federation.

The strategic objectives of the Ministry are defined by the priorities of the Russian economic policy. As it is outlined in the Russian President's Address to the Federal Assembly of the Russian Federation one of the main tasks of the Ministry is development of cooperation with the CIS countries.

In 2005 economic ties with the CIS countries developed at healthy rates. The trade turnover (January-September 2005) stood at 37.2 bln. USD – a 12.5% growth against the same period of previous year. The Russian export to the CIS countries was valued at 23.4 bln. USD. The CIS countries accounted for 15,4% of the Russian overall foreign trade turnover.

The CIS markets are important for us as these countries are consumers of Russian engineering products. Machines and equipment make up 1/5 of the Russian export to the CIS countries

The Ministry deals with bilateral trade and economic ties with the CIS countries and coordinates the issues of multilateral cooperation, Russia's participation in integration processes on the territory of the CIS countries.

- What will Russia gain from its accession to the WTO?

- As Russia gets around a third of its GDP through foreign trade operations it is crucial for the country to become a full-blown participant of the international trade. That is why the talks on Russia's accession to the WTO is so important to us. Whilst wanting to join the WTO, Russia is guided by its own interests and a desire to be an equal partner in the modern system of international trade.

We think of Russia's accession to the WTO as one of the keys that will help enhance the efficiency of Russian foreign trade activities in medium and long term. The WTO membership will open up new opportunities and create advantages for Russia. Amongst the most important benefits are:

1) Formation of more favorable conditions for obtaining access to the international markets of commodities and services. This can be achieved through the continuing liberalization and stability of relations with our trade partners – WTO members.

2) Access to WTO mechanism on trade dispute settlement. This mechanism ensures the protection of national interests (if they are restrained by partners) and thus removes discrimination.

3) Creation of conditions for ensuring stability of internal legislation and transparency of trade policy. This will allow to enhance the attractiveness of the national economy for foreign investments.

4) Realization of immediate and strategic trade and economic interests. Russia will be able to obtain this opportunity through participation in multilateral trade talks under the aegis of WTO that will develop new rules for international trade.

Russia plans to complete an eleven-year negotiation process on the WTO accession before the middle of next year. A large volume of works has been done to achieve this goal.

The Russian side still needs to complete bilateral talks with 6 countries (out of 58 participating states) that are part of the Working group on Russia's accession to WTO.

The work on harmonizing the Russian legislation with the norms and rules of the WTO is almost finished now. That means even though Russia is not a formal member of the WTO yet it is already operating in the legal environment developed in compliance with the WTO standards. We expect to see a positive effect from this work in the nearest future.

Let me remind you that Russia is implementing an unprecedented task (in terms of both scale and importance) of transforming once world's largest planned economy into the market one. Joining the WTO is one of the most important components of this process. But we are facing a lot of other top-priority tasks such as overhaul of social sphere, reforms of natural monopolies and financial system. We have to implement all these processes in parallel. Though different in scale and consequences these processes require a lot of attention from both the Russian

Government and the Parliament.

It should be pointed out that Russia is striving for openness and transparency. But this is something that Russia also expects of its trade partners. The integration of Russia into the world economy removes borders for Russian companies wanting to access international markets and for foreign companies that want to enter into the Russian market.

Currently Russia is entering the final stage of WTO accession talks. At the same time still on the table are several issues that are most sensitive to both us and our trade partners. This is one of those cases when delaying of talks serves the interests of neither sides. That is why we have every reason to believe that all the remaining issues will be resolved soon.

- Which directions of the international economic cooperation spell better prospects for our country and with which countries Russia should develop closer ties?

The directions of the international cooperation and ways of integration of the Russian economy into the world economy are defined by existing regional and country priorities of which the most important are as follows.

First group – traditional partners of Russia such as the EU (including enlargement countries), the CIS states, China, India, Japan and the Republic Korea. The most distinctive features of this subgroup (except for the Republic of Korea) are a long history and traditions of trade and economic cooperation with Russia, high intensity and diverse character of business cooperation, geographical proximity and significant potential for increase of foreign trade turnover etc.

Expanding cooperation with the EU – the largest trade and economic partner of the Russian Federation is a top priority. The cooperation with the EU should be developed on the principle of Strategic partnership to be based on 4 "common spaces":

- economic;
- freedom, security and justice;
- external security;
- science and education including cultural aspects.

These and many other topics of Russian – European cooperation were discussed during the negotiations with the European Union leadership that were held on the 7th of December 2005.

Russia's cooperation with European countries will revolve around implementation of large-scale joint projects in science-intensive sectors (aviation, aerospace, nuclear energy); expansion and enhancement of efficiency of investment cooperation, intensification of collaboration in high tech sectors (attraction of modern technologies and know-how from developed European countries for an accelerated modernization of the national economy).

An important component of Russian – European relations is the development of long-term energy cooperation. Equally important will be formation of a network of trans-European and trans-Eurasian transport corridors that will allow to enhance the attractiveness of bilateral trade and will help Russia increase revenues from the export of transit services. In order to ensure stability and diversification of Russian foreign trade ties it is necessary to involve more Russian regions, small and medium enterprises in the Russia – EU cooperation.

Asia's largest countries such as China, India, Japan and the Republic of Korea are very important trade partners of Russia. But the potential of cooperation with these countries remains underdeveloped. The strategic task here is to ensure a higher level of Russia's commercial presence in this most promising region of the world.

Part of the second group of countries are promising but geographically remote partners of Russia – countries of North and South Americas and South-East Asia. The strategic task here is to enhance the level of Russia's commercial presence in the corresponding countries and regions (mainly in the markets of the US and Canada and emerging countries of Latin America and South-East Asia). These are relatively new markets for Russia that hold significant trade and investment potential.

The third group is represented by countries – net exporters of raw materials that boast excessive natural resources. These include countries of Africa and Middle East. From the point of view of strategic interests of Russia the indicated countries are important not only as distribution markets but as a factor for maintenance and optimization of Russian's raw material exports.

Apart from a prevailing "raw material" interest for Russia the countries of Africa and Middle East are lucrative markets for the distribution of our engineering products, different final products and for implementation of infrastructure projects (for example in the area of power generation and water management).

It is very important for us to strengthen our ties with all CIS countries. The most important CIS trade partners of Russia are Ukraine, Belarus and Kazakhstan. Russia's foreign trade turnover with these countries stood at over 33 bln. USD in January-September 2005. These states have stable and dynamically developing economies and take a most active part in the integration processes on the territory of the CIS countries.

When organizing the work within the framework of inter-governmental commissions with the CIS states we base ourselves on the principles of mutual benefits and propose our CIS partners to consider promising investment projects many of which are strategically important for the Russian economy. One of illustrative examples is cooperation in development of hydro energy resources in the Central Asia. Russia invests significant funds into the economies of the CIS states – in 2000 – 2005 the volume of Russian investments into the CIS countries leapt by 5 five-fold rising from 130 mln. USD to 713 mln. USD.

In the nearest future we plan to open Russian trade representations in all CIS countries. The most important task of the new representations will be to strengthen and further develop economic ties with the CIS countries.

On a regular basis Russia holds national exhibitions in the CIS countries. These provide a boost to the trade turnover and drive the development of investment cooperation. In 2005 exhibitions were held in Belarus, Tadjikistan and Armenia. In 2006 a national exhibition of Russia will be held in Azerbaijan.

When talking about multilateral cooperation it is necessary to point out that different forms of integration initiatives on the territory of the CIS countries in which Russia takes part pursue one main objective – development of unified economic space with a free movement of commodities, capital, workforce, harmonized legislation in different sectors and customs tariffs.

The development of multilateral cooperation is done within the framework of the Commonwealth of Independent States (CIS), the Russia-Belarus Union State, the Eurasian Economic Community (EurAsEC), the Unified Economic Space and the Shanghai Cooperation Organization.

On a regular basis the Ministry of Economic Development and Trade tracks the status of execution of the Action Plan on implementation of the revisions of the Agreement on the development of the Union State and keeps an eye on the realization of the Action Plan aimed at development and enhancement of efficiency of cooperation between countries – members of the CIS in economic sphere in 2003-2010.

Eurasian Economic Community

The main tasks for development of the Eurasian Economic Community revolve around the formation of the Unified Customs Tariffs for EurAsEC, implementation of effective cooperation of the Community member states at the WTO accession talks, harmonization and unification of legislation in the area of non-tariff regulation, competition policy and protection of domestic markets. In parallel we conduct work on the development of energy market of the Community countries, Transport Union and expansion of cooperation in the real sector of economy.

Crucial to formation of the Unified Economic Space will be projects that will lead to the development of unified domestic markets in aerospace and aviation, nuclear energy sectors, markets of metal products, oil and gas, foodstuffs and vegetative raw materials, transport services (for example, aviation transportation, railway tariffs etc.).

- A huge amount of work has been done by your Ministry on the development of special economic zones in Russia. Which Russian regions will be given such a status and what are the prospects of this project?

Throughout 2005 the Ministry participated in the implementation of a series of measures that were aimed at developing special economic zones (SEZs) and improving the taxation system.

With the view of creating favorable conditions for investment activities and stimulating the production of high tech products and development of processing sectors the Ministry drafted federal bills (were adopted by Russian State Duma in July 2005) that regulate the creation and operation of special economic zones on the territory of the Russian Federation (Federal bills from 22.07.2005 № 116-FZ and № 117-FZ).

In compliance with the adopted legislation the residents of the SEZs are provided with tax incentives – they are exempt from property and land tax within 5 years since the moment of registering themselves as SEZ residents. Residents of industrial-production special economic zones can be provided with incentives on income tax (the residents of SEZs can apply an accelerated depreciation coefficient of 2 for the property to be depreciated and can hope for an accelerated reimbursement of their R&D costs and removal of limitations of loss transfer to future years). The residents of technical-introduction SEZs (innovative and R&D SEZs) will be entitled to use reduced base rate of unified social tax (14%). In addition customs breaks will be provided and favorable conditions for land use will be created for SEZ residents.

In November 2005 the Ministry of Economic Development and Trade and the Federal agency on management of special economic zones conducted the first stage of the contest that will create SEZs. From the executive bodies of 47 Russian regions and municipal formations we received 72 requests for creation of special economic zones. Of these 29 requests asked for development of SEZs of a technical-introduction type. 2 requests (from Orenburg region and Khanty-Mansiysk Autonomous Okrug – Yugra) were rejected as the documents submitted by these two regions didn't comply with the Revisions of the contest documentation.

The members of the contest commissions agreed with the conclusions of expert councils and proclaimed as winners the requests from Moscow region (town of Dubna), Tomsk region (town of Tomsk), Moscow (administrative okrug Zelenograd) and Saint-Petersburg. Special economic zones of a technical-introduction type are expected to be set up in these regions. Industrial-production SEZs will be created on the territory of Lipetsk region (Gryzinskiy area) and the Republic of Tatarstan (town of Elabuga).

In compliance with clause 6 of "On special economic zones in the Russian Federation" legislation the Ministry compiled draft resolutions of the Russian Government on creation of SEZs of a technical-introduction type on the territories of the afore-mentioned Russian regions.

As far as prospects for further economic development are concerned it is obvious that one of the factors that stalls the development of investment and business activities in the country is a high level of administrative-bureaucratic burden on business that creates hurdles for market entrance.

Overcoming bureaucratic barriers is usually a very expensive exercise for businessmen. We hope the work that we launched will allow the residents of SEZs to reduce their costs related to overcoming these barriers. The costs of residents of SEZs of a industrial-production type are expected to fall by 5-7% and the same indicator for the residents of technical-introduction zones could decrease by 3-5%.

In addition the development of infrastructure through the use of budget funds of different levels will allow to reduce the costs of investment projects (for residents of SEZs) by 8-12%. Concentration of production facilities in industrial-production zones and intellectual potential in technical-introduction ones will contribute to the reduction of production costs by 5-7%.

According to the calculations of our

Ministry the creation of one industrial-production zone will allow:

- to attract foreign and domestic investments to the tune of at least 25 bln. rubles;
- in 5 years' time after a SEZ creation the output of a zone will be worth at least 30 bln. rubles;
- to create 14 thousand additional workplaces;
- to ensure revenues to the budget system of the Russian Federation and extra budgetary in excess of 1 bln. rubles per annum.

Creation of technical-introduction (R&D and innovation-oriented) zones will allow to increase the number of people engaged in production of competitive science-intensive products and services by 2.5 fold by 2020. Thanks to the operation of the residents of the zones the share of high tech exports from regions that have SEZs is expected to rise to 20% by 2020. If the labor productivity at SEZs were to increase in line with our calculations the wages of the employees of SEZs could grow 6-fold as compared to the level of 2004. The increase in real incomes will contribute to the expansion of the capacity of the consumer markets in the Russian regions and will help improve the living standards of the population on the whole.

In the nearest future the Russian Ministry of Economic Development and Trade will submit the results of the conducted contest that determined the territories on which SEZs will be set up to the Russian Government.

- The Russian Ministry of the Economic Development and Trade initiated the implementation of "Electronic Russia" program. What impact will this program have on the development of the Russian market of high technologies and their export?

- The state, society and business will be much better off if they made the most of the latest technologies. "Paper" state is becoming a remnant of the past. "Electronic" state is in fashion now. These are the international trends. Under the new circumstances formation of demand in products of high tech sector by the state is an effective indirect tool for industry development stimulation.

The main objective of "Electronic Russia" federal purpose-oriented program is a mass distribution of information and communications technologies in the state and the public life. We need to change the relations between the state, society and business by making the state more open, transparent and accountable.

In all countries of the world the governments set themselves a task of enhancing the economic performance and improving state governance through a wide use of information and communications technologies by creating technological prerequisites for development of a civil society through ensuring rights for a free access to information.

An accelerated growth of technologies in the private sector of economy has created a gap between the legal system, public mentality and technological realities. Our Ministry thinks that the legal system needs to be changed in such a way that the current practices of technology use (electronic interaction between the state, businesses and citizens) should be integrated into the legal field. Currently these are outside legal regulation as electronic forms of interaction are usually used unofficially.

The Ministry is now working on compilation of the policy aimed at enhancing the quality of state governance. The Russian Government has already approved the Concept of the administrative reform. Our Ministry has drafted a series of legal acts in the area of information relation regulation, development of the institutions of electronic state, standardization of software etc. These legal acts will be submitted to the Russian Government for consideration in 2006.

Development of the high tech sector including its export constituent is done within the framework of the implementation of industrial policy and improvement of the country's business climate. A series of measures of the industrial policy (such as creation of special economic zones) are undertaken by the Russian Ministry of Economic Development and Trade as well as respective ministries of the Russian Government.

- The activities of the Ministry of Economic Development and Trade cover a lot of different directions and it is close to impossible to talk about all of them in one interview. Since "National Export today" magazine is a publication that is dedicated to export topics, the readers of the magazine will be interested to know what policy your Ministry intends to implement to this end?

- One of the crucial factors that could ensure stability and sustained growth of export volumes is a free or at least a non-discriminative access of Russian goods to the international markets. Our Ministry works hard to make sure that such an access is granted to Russian commodities and services. We work on prevention of an unsubstantiated creation of trade barriers for Russian competitive export. We cooperate with our partners on revision of existing anti-dumping measures with the view of their lifting or significant extenuation, liberalization of other non-tariff measures in trade etc.

Anti-dumping measures are traditional mechanisms that are widely used to protect domestic markets. According to the data provided by the WTO anti-dumping measures account for over 90% of all protective measures implemented worldwide. The popularity of these measures is simple to explain: in terms of their economic effect they "hit right into bull's eye" as the subject of anti-dumping is always concrete. As often as not the implementation of anti-dumping measures is driven by the desire of specific companies to squeeze out a competitor in the lucrative distribution markets. Although the procedures for anti-dumping investigation are clearly described in the corresponding legislation in contrast with other protective mechanisms anti-dumping measures may be applied on a selective basis.

The application of anti-dumping measures is simple if they are used in relation to the countries whose economy is not recognized as a market one. In practice, this leads to the situation when during the course of the anti-dumping investigation the data of enterprises (for example, information on calculation of the price of a commodity which is the subject of investigation) is not being taken into account. In this case the investigation body applies the method for construction of a normal price of this commodity on the basis of so-called "surrogate" countries.

The essence of a "surrogate" approach is the following: the investigation body calculates the normal price for a commodity not on the basis of internal prices provided by the actual commodity producer but on the basis of a price submitted by a producer of similar products in another country. This "surrogate" country is chosen by the investigation body for the purpose of making comparison. As often as not, under these circumstances natural competitive edges of the actual producer of the commodity are not taken into account. As a result the constructed price turns out to be higher (in most cases) than the actual one and this leads to unsubstantiated accusations in dumping.

The majority of Russian trade partners do not doubt the market character of the Russian economy. However there exist several states that decline to recognize the market status of the Russian economy trying to win over certain concessions from Russia in exchange for confirmation the market status.

Unfortunately up to date many of Russian exporters are driven by short-term export objectives and underestimate the possible consequences of anti-dumping investigations and because of that refuse to take part in the corresponding procedures preferring to redirect their commodity flows. As a result when determining dumping occurrence the investigation bodies base themselves on the information provided by local claimants and this puts Russian exporters into a no-win situation.

I would like to point to the work that we do on updating the "trade restrictions" section of our www.exportsupport.ru website. Hopefully the information that we are going to put there will help our producers and exporters to maintain business ties with their foreign partners more effectively.

The issue of VAT reimbursement during export of commodities is very important indeed. It is regulated by clause 176 of chapter 21 of the Russian Tax Code and is unified for all payers of the valued added tax (VAT).

Today in order to avoid losses for the federal budget due to the improper reimbursement of VAT to unscrupulous tax payers, tax authorities of the country have to violate VAT reimbursement order and deadlines set by chapter 21 of the Russian Tax Code. This situation leads to the withdrawal of significant funds from the turnover of diligent exporters (that often act as export arms of large integrated corporations) and contributes to the worsening of the financial standing of these enterprises.

On July 22, 2005 the Russian State Duma adopted Federal bill "On making amendments to chapter 21 of the Tax Code of the Russian Federation and on recognition of expired individual revisions of the legislation acts of the Russian Federation on taxes № 119-FZ". This bill is directed at improving the existing order of VAT application with an aim of reducing the distraction of financial resources of a tax payer. The bill envisages the implementation of a series of measures aimed at simplifying the confirmation of a tax payer right to the application of a zero rate of value added tax and easing the procedures for obtaining tax deductions. As of January 1, 2006 the taxable base of VAT will cease to include payments and partial payments that were made to cover future commodity supplies (execution of works and provision of services) that are taxed at "zero" percent rate.

The bill also implies introduction of several revisions that will reduce the tax burden of exporters and will come into force on January 1, 2007. One of the revisions proposes abolition of a separate tax declaration on operations to be taxed at a zero rate. All operations are expected to be reflected in a unified tax declaration.

In addition the Russian Ministry of Economic Development and Trade in partnership with the Ministry of Information Technologies and Communications, the Ministry of Finance, the Federal customs service, the Federal tax service and the Bank of Russia have drafted the Concept for the development of a system of control over the export of commodities from the territory of the Russian Federation and reimbursement of value added tax (hereinafter referred to as the System).

The System unites the federal bodies of the executive power that participate within the framework of their competences and authorities in implementation of functions of control over export of commodities from the territory of the Russian Federation and reimbursement of VAT.

We have reasons to believe that the indicated set of measures will contribute to the timely reimbursement of VAT in case of commodity exports.

- The year of 2005 was characterized by a positive dynamics of inflow of foreign investments into the Russian economy. To a large extent this was the achievement of the Russian Ministry of Economic Development and Trade. Which steps were taken to speed up this process and how do you think this process will be developed?

- Frankly speaking the positive dynamics of investments is the result of the simultaneous work of several factors. One of the main factors was stably high economy growth rates that were shown by Russia in the last few years. Foreign investors also name the macroeconomic stability as one of the main competitive edges of the Russian Federation. It goes without saying that the most favorable price environment of international raw materials markets was the main driver behind impressive economy growth of the Russian economy. But earlier implemented structural reforms that reduced tax burden, lowered administrative barriers and improved legal bases in many areas such as land use, new institutions in financial sector (deposit insurance, bureau of credit histories etc.) are also bearing fruit.

If we were to talk about specific activities that our Ministry implemented in 2005 with the view of stimulating the growth of foreign investments I would point out the following. A lot of work has been done on perfection of normative acts related to stimulation of investment activities. Our Ministry drafted important Federal bills “On special economic zones” and “On concessions agreements” that were adopted in July 2005.

With the view of developing proposals for further improvement of Russia’s investment climate the Ministry holds regular consultations with foreign investors including within the framework of its Advisory Council on foreign investments.

The huge prospects for attraction of foreign investments into the Russian economy are confirmed by international organizations. Recently A.T. Kearney – a leading international consultancy published its survey which polled the executives of the world’s largest companies. According to this survey Russia scored an impressive 6th place in the world in terms of investment attractiveness and lagged behind only China, the US, the UK, India and Poland.

We have no intentions to rest on our laurels and will continue our work on creation of most favorable conditions for investment and further improvement of the investment reputation of our country. The latter is very important. A recent survey of foreign investors showed that foreign companies that do not currently operate in Russia scored the Russian investment climate much lower than it actually is.■

MARKET ANALYSES:
Electronic Commerce Development in Russia

Electronic commerce is growing rapidly in Russia due to the increase in the number of Internet users, recent improvements in the country’s telecommunications infrastructure and general economic growth. 90 percent of Russian companies used the Internet for business in 2004-2005. A good web site is considered a must for a reliable company.

More and more companies are going beyond web marketing and are investing in online commerce. The development of e-commerce infrastructure and the growth of e-sales present good opportunities for foreign firms, however according to existing regulation a reliable Russian partner is a must.

B2C (Business to Consumer):

In 2004, E-commerce retail sales were estimated at $660 million (20 % of all Russian etrade), according to the National Association of E-Commerce Participants (Nauet). By the summer of 2005, Russia counted 4,000 online stores. B2C commerce accounts for 1 percent of Russian retail turnover, compared to 14-15 percent in the United States.

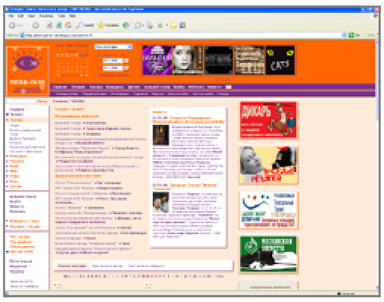
Currently, 80 percent of online stores are located in Moscow and St. Petersburg where the Internet penetration rate is the highest. Most e-retailers require cash on-delivery or credit card payment.

There are several contributing factors to a lack of interest in on-line purchasing:

- Currently the Internet/computer penetration rate is only about 7-10 percent.
- There is still a distinct lack of trust in the banking system and consequently credit cards are not prevalent among the general population nor businesses.
- There is no confidence in the privacy of virtual transactions.
- The Russian postal delivery system is inconsistent.

The following on-line sales sites are the most popular:

1. www.parter.ru



Product category: tickets to cultural events

2. www.sendflowers.ru
Product category: gifts, flowers, toys

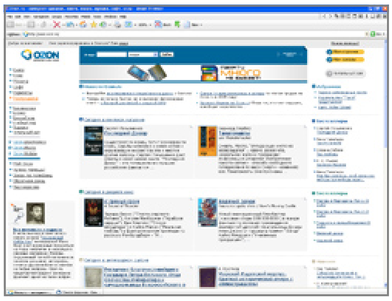
3. www.planetashop.ru
Product category: PCs, peripherals

4. www.mebeldom.ru
Product category: housewares, furniture

5. www.shinashop.ru
Product category: Auto parts, cars

6. www.vipmir.ru
Product category: Toys, gifts, hobby, flowers

7. www.ozon.ru



Product category: Books, CD, DVD, VHS, periodicals

8. www.pchome.ru
Product category: Computers and peripherals

9. www.renins.com
Product category: Financial services

10. www.vigodno.ru
Product category: Food

B2B (Business to Business):

Russian companies are actively exploring web opportunities in B2B marketing. In 2004, B2B sales totaled around $400 million according to Nauet and are expected to grow exponentially over the next few years. Major industrial groups are doing business online and have developed e-commerce projects. Large Russian corporations are establishing large-scale B2B ventures to open new markets. Metallurgical plants like Severstal, oil companies (TNK-BP, Tatneft), and energy giants (RAO UES) are trying to increase operational efficiency by establishing e-marketplaces. The number of Internet trading systems has grown dramatically from almost zero in 1998 to over 100 in 2005. Most emarket places offer Internet interfaces to trade commodities, including steel, metals, oil products and grain. However, privacy concerns and lack of pricing transparency is impeding the growth of online trading.

E-government:

Recently, the demand of state orders have become an important force driving ecommerce development. Increased government spending on information technologies has contributed to the growth of the sector, as has more tender offerings for government projects and budget-funded public schools in rural areas. An important Russian government sponsored program, called "E-Russia" also aims at increasing the use of Internet technology in government and education, and development of the information and communications infrastructure across Russia.

The government's top priorities are as follows:

- To build a reliable legislative and regulatory framework for the sector: (the Federal law on Electronic signature was signed by President Putin in January 2002 and a draft Law on Electronic Commerce is in the State Duma for approval)
- To provide Internet access to more Russians and public sector organizations
- To stimulate investment in the development of Internet technologies including support to domestic developers.

IT infrastructure:

According to J'son & Partners Consulting Group the market for internet service providers in Russia is expected to grow by roughly 50 percent to $1.5 billion by the end of 2005, with the number of users estimated to reach 9.8 million. The most developed market in terms of Internet access is Moscow followed by St. Petersburg and the Russian Far East regions where more traffic goes in the direction of East Asian countries than toward Moscow. The majority of Russians (70%) still use dial-up connections. As disposable incomes rise more people are getting broadband connections at home and accessing the web though their mobile phones. As of Spring 2005, just less than 1 million Russians were accessing the Internet from their mobile phones using WAP (Wireless Application Protocol), and 300,000 used their cell phones as modems. According to Yandex (a web company) around 19 million Russians log on to the Internet at least once a month.

Consequently, interest in IT in Russia runs very high, and there is little doubt of the huge potential demand for e-commerce as the standard of living and disposable income continue to rise. ■

BUSINESS NEWS TICKER

Google, the owner of one of the most popular search engines on the Internet, is planning to open a representation in Russia in 2006. Google plans to expand the number of its employees in Russia that are highly qualified.

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Russian car manufacturer Severstal Avto announced it had signed a licensing agreement with Italian company Fiat Auto to produce Fiat cars in Russia. Severstal is to produce the Fiat Palio and Fiat Albea models under the agreement. Production of the two models will begin in 2007 at Severstal's ZMA plant in Naberezhnye Chelny, in the Volga republic of Tatarstan. The ZMA plant produces the Russian Oka car, but will end production of that model in summer this year. At the end of 2005, Severstal began producing Korean Ssang Yong off-road vehicles.

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Russian Prime Minister Mikhail Fradkov has signed a resolution imposing anti-dumping duties on Ukrainian steel pipes. The measure aims to protect the interests of Russian producers of steel pipes after the Economic Development and Trade Ministry's anti-dumping inquiry into exports of the relevant Ukrainian products to Russia. The new customs duties vary from 8.9% to 55.3% depending on he type of pipe.

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Russian Prime Minister Mikhail Fradkov signed a resolution dated December 30, 2005 to lift the export duty on liquefied natural gas (LNG), currently 40 euros per tonne. The resolution enters into effect a month after its official publication.

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Russia's crude exports fell last year because companies supplied more to domestic refineries amid higher shipping taxes. Exports last year dropped 1.1 percent to 251 million tons (5 million barrels per day), down from 253.8 million tons in 2004, according to figures from the Industry and Energy Ministry.

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Russia is introducing a special, permanent duty on January 15 for the import of car components to implement projects in the auto sector under the so-called industrial assembly regime. The corresponding No. 757 government resolution entered into force on January 15. In order to implement this regime, enterprises should make agreements with the Economic Development and Trade Ministry for seven years for existing enterprises and for eight years for those being set up. The agreements should state the list of car components imported at reduced rates.

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Audi increased car sales through its official dealers in Russia 49% from the previous year to 6,115 cars in 2005. The Audi A6 model was the sales leader in Russia, with 2,357 vehicles sold in 2005, up 47.6% from the previous year. Audi will offer seven new models in Russia in 2006. It will start selling the Audi Q7 in both Russia and in Europe in March 2006.

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Russian-German trade reached a new high of $32 billion in 2005, Vladimir Putin said at a meeting with German Chancellor Angela Merkel. Germany is Russia's leading trade partner and the two countries have forged close business links, particularly in the energy sector, where German companies have been quick to sign deals with Russian energy giant Gazprom. German utility E.On holds a 6.5% stake in Gazprom, and is a partner in the scheme to construct a gas pipeline from Russia under the Baltic Sea directly to Germany, bypassing Ukraine's land-based pipelines. Also a member of the consortium is chemicals firm BASF, owner German gas company Wintershall, which also operates the Wingas joint venture with Gazprom.

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Russian Defense Minister Sergei Ivanov said that Russia would gradually merge its defense industry companies into large holdings. According to his words, a large aircraft manufacturing holding, which will combine both civilian and military components will be created in future. Ivanov said such a system could be very effective for both the Russian defense industry and the armed forces, because it would reduce the number of organizational problems and simplify pricing policies for different types of military equipment.

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Belarus boosted industrial output 10.4% in current prices to 60.509 trillion Belarussian rubles in 2005. Industrial output in December 2005 was 16% higher than in December 2004 and 2.1% more than in November 2005.

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Companies working in special economic zones will be exempted from all local taxes for five years. Yury Zhdanov, the head of the Federal Agency for Control of Special Economic Zones, said he would seek further cuts in the tax burden for companies operating in such zones. As a first step, Zhdanov wants to propose to regions that they prolong tax holidays for companies working in such zones for another three to five years.

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Russia produced 132.38 million dal of vodka and alcohol products in 2005, down 2% from 2004. Production totaled 18.74 million dal in December 2005, up 19.4% from December 2004. Food-grade ethyl alcohol output fell 8.2% to 71.6 million dal in 2005. In December alone, production was 8.9 million dal, down 1.6% from December 2004. Wine production decreased 18.6% to 31.77 million dal in 2005, but rose 8.4% to 4.15 million dal in December. Champagne and sparkling wine production increased 16.4% to 14.09 million dal in 2005 and grew by 23.5% to 2.017 million dal in December. Brandy plants produced 4.474 million dal of brandy in 2005, up 14.5%. In December alone, brandy production grew 42.9% to 704,920 dal. Output of low-alcoholic products fell 0.4% to 47.43 million dal in 2005, but grew 9.4% to 4.8 million dal in December.

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Direct foreign investment in the Russian economy more than doubled in 2005 to $26.1 billion from $12.5 billion in 2004. The country accounted for almost half of the $50 billion in foreign investment recipient into the whole region covering Southeast Europe and the Commonwealth of Independent States. The global inflow of direct foreign investment rose by 29% in 2005, year-on-year, to $897 billion. For the first time since 1977, Great Britain turned into the largest recipient of foreign investment ($219 billion), mainly through the merger of the two halves of oil major Shell - Royal Dutch Petroleum Company and the UK-listed Shell Transport and Trading Company - followed by the United States ($106 billion) and China ($60.3 billion). Direct foreign investment rose by 76% to $408 billion in the old EU countries and by 36% to a record high of $38 billion in the newly admitted EU states. Direct foreign investment in developing countries rose by 13% in 2005 to a record high level of $274 billion.

UPCOMING EVENTS:

Feb 1: Oil export duty down to $160.8 per tonne from $179.6 per tonne

Feb 2: Transaero Finance to offer 2.5 billion ruble 3-year bond

Feb 2: Gazprombank to offer debut 5 billion rubles 5-year bond

Feb 2: Viktoriya Finance to offer 1.5 billion ruble 3-year bond

Feb 6-7: Energy and Coal of Russia Forum in Moscow

Feb 10-11: Russia to chair meeting of G8 finance ministers in Moscow

Feb 16-17: Development of Leasing in Russia Conference in Berlin

Feb 21: Banking on Ukraine Conference in London

Feb 22: Informa & Europa's Russian IPOs Conference in London

Feb 27-28: Central & Eastern European Power Project Conference in Budapest

Feb 27-Mar 1: 4th Annual international Forum Russian Mergers and Acquisitions in London

BECOME A MEMBER OF RUSSIAN CHAMBER OF COMMERCE IN EUROPE

In support of the RusCham's core activities, which actively work to improve the business environment for businesses in Russia and Europe, the Russian Chamber of Commerce in EU also provides valuable business networking opportunities for members.

Russian Chamber of Commerce in EU serves as a center for assistance and information, keeps members apprised of rapidly evolving government laws and regulations, and organizes meetings for representatives of member businesses.

RusCham is an information center that gives much-needed information and contacts to visiting delegations, fosters co-operation between potential investors and established businesses, and encourages businesses to take advantage of business opportunities in the Russian Federation or Europe.

Also RusCham is enabling business representatives to air their grievances and create a common agenda of needs and concerns, to act as one voice in presenting that agenda to the governments and local business communities enable member businesses to collectively lobby for legislative and regulatory changes.

The Chamber's most important assets are its members. They are our clients, our workforce and our strength. Our mission is to promote the development of commercial relations between the Russian Federation, EU and the international community.

RusCham membership is made up of enterprises and entrepreneurs from the member states of the European Union (EU) and the Russian Federation, which have business activities with and in the Russian Federation, NIS and Europe. These members determine the overall strategy and policies of the organization.

To become a member of RusCham please send an e-mail to membership@ruscham.com or contact us at +421 55 728-967

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