DAILY REPORT ON RUSSIA

AND THE FORMER SOVIET REPUBLICS

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RUSSIAN FEDERATION

Politics

Gazprom Headed For Power Struggle

• *Gazprom* is headed for a power struggle at its annual shareholders' meeting on Friday, as company management, the Russian government, and minority shareholders vie for positions on the new board of directors. The groups must attain 8 percent of the vote required for each board seat. The Financial Times reports that at stake is whether Boris FYODOROV, who represents minority shareholders' rights, will be re-elected alongside Burkhard BERGMANN of *Ruhrgas*; whether *Gazprom's* destabilized "old guard" executives will retain their existing four seats; and whether the Russian state will acquire an additional, sixth, director. The latter would give the government an outright majority on the 11-seat board, with holding just a 38 percent stake in *Gazprom*. Steven DASHEVSKY of *Aton* brokerage predicted that the government's representation will rise. Last year, *Gazprom* executives attempted to undermine FYODOROV by courting his supporters. In exchange for their vote, the company converted the domestic shares held by the US-based George SOROS and Kenneth DART into ADSs in January. This year an obscure minority shareholders' group, believed to be supported by the *Gazprom* "old guard," won a court order freezing the votes of more than 2 percent of the company's shares held by *UFG*, a Moscow brokerage chaired by FYODOROV. Following the appointment of Alexei MILLER, as *Gazprom* Chief Executive Officer, the court lifted the order. *UFG* is believed to manage 6 percent to 8 percent of *Gazprom*. *Alfa Group*, which controls up to 1 percent of *Gazprom*, is expected to support *UFG* again this year. MILLER has promised to implement reforms and improve transparency. MILLER's appointment was widely seen as a Kremlin move to assert control over key businesses and push through reforms at *Gazprom* opposed by Rem VYAKHIREV, who has managed the company as a personal fiefdom since taking over in 1992, Reuters reported. Concerns over *Gazprom's* financial management under VYAKHIREV have sparked calls for shareholders to reject the 2000 annual report, balance sheet, profit, and loss statement. *Gazprom* shares have increase 35 percent since PUTIN installed MILLER. Gazprom accounts for 8 percent of Russia's gross domestic product. It produces 25 percent of the world's gas output and boast around 24 percent of world gas reserves. It posted a net profit of 60.75 billion rubles (around $2 billion) in 2000, nearly twice that of the previous year. MILLER has said *Gazprom* hopes to raise output 10-15 percent by 2010 by exploiting Arctic gas deposits.

Russia Denies Submarine Deal

• The Russian Foreign Ministry on Wednesday denied press reports that Russian military experts are negotiating a deal with Taiwan to help the Taiwan government build a "Kirov-class" submarine. Russian Foreign Ministry spokesman Alexander YAKOVENKO said the reports, including one published in the British defense journal Jane's Defense Weekly, on a submarine contract were groundless. Russia in principle does not engage in any form of military technical cooperation with Taiwan, he said. YAKOVENKO upbraided the foreign media for fabricating stories "every time" prior to a Russian-Chinese summit. China's President JIANG Zemin is scheduled to visit Russia for talks with Russian President Vladimir PUTIN in mid-July.

Economy

Ruble = 29.14/$1.00 (NY rate)
Ruble = 29.12/$1.00 (CB rate)
Ruble = 24.73/1 euro (CB rate)

Russia Needs Surplus In 2002

• Russia needs a budget surplus of 1.6 percent of gross domestic product (GDP) in 2002 to repay principle foreign debt falling due next year without new borrowing, an International Monetary Fund (IMF) official said on Friday. The government's 2002 budget draft is the first one since the Soviet era to include a surplus, but surplus foreseen is 1.26 percent, including debt payments. "If there will be a total surplus of 1.6 percent of GDP, this will provide for paying a part of principle debt," Alexei MOZHIN, the IMF's executive director for Russia, told the Vedomosti in an interview. "But if there will be a zero surplus, some additional resources will be needed to repay principle debt," he added. The draft 2002 budget provides for $14.2 billion in foreign debt payments, including $6.8 billion in principle, Reuters reported. MOZHIN said refinancing foreign debt was a normal practice and the government could easily borrow next year on the domestic market, which is short of investment instruments after the 1998 financial crisis.

This year, the government expects 280 billion rubles ($9.6 billion) in additional budget revenues. A senior Finance Ministry official noted that the government already has plans on how to spend 198 billion rubles of this sum, including 62 billion rubles earmarked for repayment of principle foreign debt. However, the government had yet to decide how to spend 82 billion rubles of expected extra revenues and could also channel them towards the foreign debt payment. Russia had to amend the tight $40 billion 2001 budget, hailed as the first post-Soviet balanced budget, as it was originally short of 183 billion rubles to meet foreign debt obligations, including some $3.8 billion owed to the Paris Club. Under the amended budget, the first 41 billion rubles in extra revenues will go toward paying interest on foreign debt and the rest split 50-50 between debt and other spending.

Russia Scheduled Foreign Currency Auction

• Russia's Central Bank on Friday scheduled an auction of foreign currency for July 9th. The Central Bank's head of open market operations Sergei SHVETSOV said $50 million would be offered at the sale. The auction is aimed at foreign investors, who can use rubles received in a GKO debt restructure to buy hard currency. The rubles are currently effectively frozen in so-called "S" accounts, but the auction is one of the few ways foreign investors can use the ruble funds. The last auction was on June 18th and was heavily over-subscribed. Demand came in at $125.87 million and the rate at which the currency was sold was 30.90 rubles a dollar.

Business

LUKoil Plans To Issue Eurobond

• Russia's leading oil producer *LUKoil* plans to issue a $300 million to 400 million convertible Eurobond in October or November of this year, company Vice President Leonid FEDUN said on Wednesday. He noted that the issue will depend on the market and demand. *LUKoil* is holding an annual shareholders' meeting Wednesday in Volgograd. FEDUN said, "There is a good market for convertible bonds. Second, we are interested in refinancing bonds that mature in 2002-2003." A vote on a share issue to facilitate the convertible Eurobond is on the agenda of the shareholders' meeting. *LUKoil* has two Eurobonds already on issue. One is a $230 million 2002 Eurobond issued in May, 1997, and the second a $350 million 2003 Eurobond issued in November 1997, Reuters reported.

Sibneft Profit, Plans To Boost Volume

• *Sibneft's* net profit, which was calculated in accordance with GAAP standards, reached $674.8 million in 2000, which is 114 percent more than in the previous year. According to *Sibneft*, earnings before interest, taxes, depreciation costs and amortization grew 88 percent to $1.027 billion against $547.1 million in 1999. Total earnings increased 37 percent to $2.398 billion in 2000, compared with $1.746 billion in 1999. Earnings before taxes rose 133 percent to $753.2 million in 2000, against $323.6 million in 1999. Last year, the return on capital reached 17.9 percent, compared with 7 percent in 1999. The level of borrowings remained relatively low and came to 5.9 percent (4.9 percent in 1999). *Sibneft* paid $50 million in dividends for 2000. The growth of operating expenses did not surpass 15 percent, and direct operating expenses were $12.6 per ton or $1.75 per barrel of oil.

The oil company plans to increase the volume of oil production in oil fields under development to 29 million tons a year (570,000 barrels a day), according to *Sibneft* Vice President Andrei MATEVOSOV. He said the volume of oil production by the company will reach 19 million tons this year (375,000 barrels a day). The company will put emphasis on assets that can be put into service in the medium term. The level of investments in production was $105.6 million in 1999 and $220 million in 2000. This year it reached $595 million. Last year, *Sibneft* launched programs of development of 4 new oil fields, and the program of full-scale development of the Sugmutskoye oil field, whose reserves amount to 1 million barrels of oil, is to commence this summer. METEVOSOV pointed out that the volume of the company's confirmed oil reserves had increased to 4.64 billion barrels as of January 1st; the volume of likely reserves amounted to 2 billion barrels, and the volume of possible reserves was 1.5 billion barrels of oil.

European Republics

Fitch Cuts Moldova Late Bond Rating

• International rating agency *Fitch* on Tuesday cut Moldova's long-term foreign currency rating from CCC+ to CC due to mounting concern over the country's ability to service its external debt. Moldova has missed a semi-annual interest payment of $3.7 million on its $75 million Eurobond that was due on June 13th. A grace period is still in place until July 3rd. If Moldova fails to make the payment before this date, it will formally be in default, the Financial Times pointed out. This would lead to a further downgrade. *Fitch* noted, "While there is sufficient foreign exchange to cover the semi-annual coupon, our discussions with the authorities lead us to believe that there is no defined strategy over how this will be achieved." Nick EISINGER, sovereign analyst for Moldova at *Fitch* in London said the rating cut, "should send a signal to the market that prospects for full and timely payment are poor." *Fitch*, which also cut Moldova's local currency rating from B- to CCC, said the foreign currency rating would remain at CC even if the payment were made, "as there are serious doubts over the country's ability to repay the $75 million 2002 Eurobond, which matures in June next year." The agency said Moldova's government had serious cash flow problems and appeared to be prioritizing payment of wage and pension arrears over timely debt servicing. *Fitch* said Moldova had made late coupon payments in the past but that this was the first instance of such a lengthy delay, Reuters reported.

Latvian Parliament Backs 2001 Budget Changes

• Latvia's parliament on Tuesday, with a vote of 60 to 1 and 25 abstentions, approved the 2001 budget amendments in the second and final reading. This raised the fiscal deficit slightly above the International Monetary Fund (IMF) limit to a planned 1.82 percent of gross domestic product (GDP). Last year, the parliament approved the 2001 budget with a fiscal gap of 1.68 percent of GDP or 79.2 million lats ($125 million), and the Cabinet agreed with the IMF not to widen the gap above 1.75 percent of GDP. Finance Minister Gundars BERZINS said, "The deficit right now is 1.82 percent of GDP or around 85 million lats. The exact deficit figure (in lats) is not yet available." The amendments put the 2001 budget revenues at 1.45 billion lats from earlier 1.44 billion lats, and expenditures are planned at 1.53 billion lats, a rise from earlier 1.51 billion lats. BERZINS said the 2001 budget was a compromise as the Cabinet had to raise social and education spending, but the IMF, whose mission will arrive in Latvia in late July, does not view the changes positive. He added, "This budget was a tough compromise. As a finance minister I would have, of course, liked to see the deficit unchanged or even reduced." BERZINS said the situation could be alleviated by steady and strong inflow of revenues with the first half fiscal deficit expected to come 10 million lats below the IMF target of 46 million lats. Last year, Latvia's preliminary fiscal deficit stood at 2.75 percent of GDP, but the government agreed in the IMF memorandum to gradually lower it, promising to cut the gap to one percent of GDP in 2002.

South Caucasus & Central Asia

Baramidze On Russian Base Talks

• Chairman of the Georgian Parliamentary Committee for Defense and Security Georgy BARAMIDZE expressed outrage at Russia for dragging its feet in talks about withdrawing from the two remaining military bases, Batumi and Akhalkalaki. Russia has withdrawn from the Vaziani base outside of Tbilisi and is expected to withdraw from the Gudauta base before July 1st. Moscow claims it needs 14 more years to withdraw some 3,500 troops from two other bases in Georgia. A Kremlin spokesman for Kremlin's top aide on the Caucasus Sergei YASTRZHEMBSKY's office said, "We have calculated that Russia needs that long to build infrastructure somewhere else, to build bases somewhere inside Russia." BARAMIDZE responded, "Fourteen years is absolutely crazy. We have calculated the necessary time frame for the complete withdrawal of equipment, weapons and personnel. Our conclusion is that it should only take two or three years," Reuters reported. Anna MATVEEVA, an independent consultant on the Caucasus said, "The Russians are trying to see how long they can extend their military presence. They have a clear security interest in the south Caucasus region so of course they want to stay." BARAMIDZE added, "Russia is still irritated by Georgia's independence. They fear Georgia will make new friends—the wrong friends—if they don't keep a military presence here." He noted, "We are more determined than ever that the bases should close. We want good neighborly relations with Russia, but we don't want to be just an object of manipulation." Georgia has adopted a pro-Western stance and earlier this month hosted a major NATO training exercise along its Black Sea coast. Russia has done all it can to discredit Georgia through the media, criticize its investment climate by not accepting debt rescheduling, and destabilize Georgian society by cutting off winter energy supplies and imposing a strict visa regime. US President George W. BUSH told Russian President Vladimir PUTIN that Russia should, "develop constructive relations with its neighbors, like Georgia, that are trying to find their own way."

Chevron Plays Down Bosphorus Fears

• *Chevron* has tried to play down official fears in Turkey that larger shipments of Kazakhstan's oil through the Bosphorus and Dardanelles straits might clog or pollute the busy waterways. *Chevron*, which holds a 50-percent stake in the *Tengizchevroil* joint venture exploiting Kazakhstan's giant Tengiz oilfield, is eyeing larger and cheaper tanker crude supplies to world markets after the launch of the *CPC* pipeline linking northwestern Kazakhstan with Russia's Black Sea port of Novorossiisk. The first oil will reach Novorossiisk through the pipeline in early August. Turkish officials have voiced concerns that increased shipments of Kazakh oil might congest or damage the Turkish Straits linking the Black Sea with the Mediterranean via populous Istanbul, Reuters reported. *Chevron*, which predicts output at Tengiz rising from this year's 260,000 barrels per day (bpd) to 700,000 bpd by the end of this decade, denies this. "We will minimize any chance of accident, including an oil spill or other harm to the Turkish Straits," Ismail KAFESCIOGLU, *Chevron* country manager in Turkey, told an international conference in Kazakhstan. "*Chevron* understands that if it is not trusted in a certain region it can hardly have its business there," he added. Last year, 60 million tons of crude passed through the Bosphorus, where the narrowest stretch is just 700 meters wide, and officials want to see firm safety guarantees. KAFESCIOGLU said *Chevron*, which owns 33 tankers and charters another 30 or 40, would apply tight vetting standards to all its ships crossing the busy Turkish Straits. He said *Chevron* would try to use mostly modern double-hulled Suezmax tankers to carry the flammable commodity. Double-hulled vessels comprise around two thirds of *Chevron's* fleet. He said that out of an average 48,000 vessels passing the Turkish Straits every year crude tankers accounted for just three percent.

The Daily Report On Russia And The FSU will not be published on July 4th in observance of Independence Day.

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