

# DAILY REPORT ON RUSSIA

AND THE FORMER SOVIET REPUBLICS

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## RUSSIAN FEDERATION

### Politics

#### **Alexiy II Rules Out Pope's Visit**

• Russian Orthodox Church Patriarch Alexiy II has ruled out permitting Pope John Paul II to visit Russia until the Roman Catholic Church ended what he described as its "war" against Orthodox Christians in neighboring Ukraine and the, "Vatican stops its expansion into Russia, Belarus and Ukraine." The Pope is due later this month to visit Ukraine, where some 5 million Eastern-rite Catholics recognize the supremacy of the Vatican. The Ukrainian government invited the Pope without the approval of Ukraine's Moscow-led Orthodox Church. Moscow church officials have bitterly opposed this month's papal visit to Ukraine, citing property disputes in Western Ukraine and accusing Catholics of seeking converts in former Soviet republics, Reuters reported. Alexiy II said that a visit would only deepen divisions and that the Orthodox Church in Ukraine should have been consulted before the visit was planned. Russian leaders have said they will invite the pontiff to Moscow only with the backing of the Orthodox Church. It should be noted that Georgia was the first of the former Soviet Orthodox countries to invite the Pope under similar circumstances.

### Economy

#### **FinMin Presents 2002 Draft Surplus Budget**

• Russian Finance Minister Alexei KUDRIN said his ministry has submitted to the government a draft 2002 budget, which provides for a surplus of 1.26 percent of gross domestic product (GDP). He confirmed draft targets of 12 percent to 13 percent for year-on-year inflation. KUDRIN said, "In the budget that we have worked out, targets for income and expenses will be met both under pessimistic and optimistic forecasts for prices on Russia's chief

exports." The ministry's draft budget is targeting a crude oil price of \$22 per barrel for Russia's Urals blend. It also forecasts an average ruble rate for the year of 31.5 rubles per dollar. GDP is set at 10.27 trillion rubles, while the Finance Ministry foresees budget revenues of 1.64 trillion rubles versus expenditures of 1.51 trillion rubles, Reuters reported. KUDRIN noted that revenue targets for next year were significantly dependent on proposed tax reform legislation passing through the Russian State Duma. The government will consider the draft budget on June 7<sup>th</sup> and President Vladimir PUTIN has made clear his wish for a balanced and realistic document passed through parliament. PUTIN sees political stability and improving living standards as cornerstones for Russia. Three in 10 Russians live below the poverty line. The President chastised his government Monday for delays in raising pay levels for the armed forces and last week criticized ministers for failing to meet budget targets.

#### **Tax Reforms Could Cut Shadow Economy**

• Deputy Trade and Economic Development Minister Arkady DVORKOVICH told Kommersant Daily that tax reforms could halve the proportion of firms in the shadow economy, currently estimated at almost a third. He noted that Russia's tax regime had already improved since part of the new Tax Code became effective on January 1<sup>st</sup>. He said, "The most serious changes to the tax system have already occurred. If the chapters of the second part of the Tax Code dealing with profit tax and taxes on

mineral resources are adopted, all that remains are technical questions." The government made tax reform a priority for this year and from January 1<sup>st</sup> a major cut in income tax came into effect, replacing a multi-scale income tax with a flat 13 percent tax. The move was aimed at raising the number of registered taxpayers. DVORKOVICH said plans for further tax reform could cut the number of firms in the gray sector of the economy to 15 percent from an estimated 30 percent currently. He said, "That is, half of these companies could come out of the shadow economy only through tax reform... The general mood is that Russia's tax system at the present time precludes carrying out normal business. [But] a significant number of firms, regardless of changes in the tax regime, will stay in the shadow economy because they are following other interests." The deputy minister added that for those companies that refused to legalize their activities fully, law enforcement bodies should adopt the most severe measures.

<p><b>Ruble = 29.16/\$1.00 (NY rate)</b>  <b>Ruble = 29.18/\$1.00 (CB rate)</b>  <b>Ruble = 24.81/1 euro (CB rate)</b></p>
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### Business

#### **Soros Presents Gazprom Restructuring Plan**

- US financier George SOROS has presented his own plan to restructure *Gazprom's* two-tier share system to Economy and Trade Minister German GREF. Russian residents are allowed to trade *Gazprom* shares on the domestic market, while foreigners are only entitled to American Depositary Shares (ADS), which trade at a huge premium to local shares. SOROS explained, "Every ADR holder, in addition to holding an ADR, would also have the right to buy an additional share in the domestic market." He said his plan would lead to an increase in supply of *Gazprom* shares for foreigners, who would see the current system breaking down, so boosting demand for the company. SOROS added that the price differential between the foreign and domestic markets would quickly halve. *Gazprom* local shares earlier today stood at 13.45 rubles (\$0.46), while ADRs, which cover 10 shares, stood at \$9.50. The ring-fence has long annoyed foreign investors, led to semi-legal schemes to bypass it, and prevented *Gazprom* from raising new capital to solve its core problem of falling gas output. The

Russian government plans to discuss a program to restructure *Gazprom* in the autumn. Last week, the *Gazprom* board replaced chief executive officer Rem VYAKHIREV, widely regarded as an obstacle to reforms, with President Vladimir PUTIN's ally Alexei MILLER.

#### **Rus-India To Sign New Arms Accord**

- Russia's Deputy Prime Minister Ilya KLEBANOV and India's Foreign and Defense Minister Jaswant SINGH held talks on Monday to discuss the joint production of the next-generation of fighter jets and submarines under development in Russia. A contract for the joint production as well as for other arms transfers could be signed as early as Wednesday, KLEBANOV said. Russia has also reached a basic agreement with India to sell A-50 airborne warning and control systems (AWACS) aircraft to India. Last December, Russia agreed to sell four Bariev A-50 AWACS to China for an estimated \$200 million each. SINGH said the value of India's existing defense projects with Russia stands at about \$10 billion. He stressed that defense co-operation between the two countries in the future would focus on joint development and production of military transport aircraft and other projects. Itar-Tass news agency also quoted a military source as saying India was eyeing several Russian A-50 long-range reconnaissance planes fitted with Israeli-made equipment.

#### **China Looks To Russia For Airliners**

- In response to diplomatic tensions with the US, China has turned to Russian aviation company for the purchase of *Tupolev* Tu-204 commercial airliners, similar to *Boeing's* 757. China is negotiating to buy 10 airliners, according to aviation weekly Flight International. The order could potentially rise to between 30 and 32 units, it said. The Tu-204 is available in two main versions: one with western equipment, including *Rolls-Royce* engines and one with equipment from former-Soviet countries. Russian planes are not popular because they lack the support of an after-sales service and global support networks needed to supply parts and engineering expertise.

#### **Alfa To Help Vimpelcom Win St. Petersburg**

- *Alfa Group* plans to help Russian mobile phone company *Vimpelcom* secure an operator's license in the lucrative St. Petersburg market. *Vimpelcom*

has applied for a mobile phone operator's license in the city in the past, but has yet to receive one. *Vimpelcom* announced on May 30<sup>th</sup> that *Alfa* would take a strategic 25 percent plus one share stake in the company and pay \$220 million to help fund its regional expansion plans. *Alfa* chief executive officer Mikhail FRIDMAN said that first and foremost "we will fight" for St. Petersburg and the surrounding region. St. Petersburg is dominated by a single GSM-standard operator, *NorthWest GSM*, which is partially owned by the politically well-connected *Telekominvest* holding. *Vimpelcom's* chief rival, *Mobile TeleSystems (MTS)*, announced earlier this month that it had sealed a deal to acquire a St. Petersburg operator. "I hope that in a short time we can significantly increase the company's market capitalization and significantly increase its number of subscribers in the regions." As part of its agreement with *Vimpelcom*, *Alfa* will also take a 42 percent stake in the firm's regional expansion vehicle —*Vimpelcom-R*. *Vimpelcom* chief executive officer Jo LUNDER said *Vimpelcom* shocked the market last week by unveiling a \$5.13 million profit for the first quarter of 2001, breaking a chain of chronic losses.

### EUROPEAN REPUBLICS

#### US Gets Assurances From Ukraine

- US Secretary of Defense Donald RUMSFELD on Monday met with Ukrainian President Leonid KUCHMA, Prime Minister Anatoly KINAKH, and Defense Minister Alexander KUZMUK. RUMSFELD cautioned KUCHMA that the world is watching Ukraine as it takes measures to implement social and economic reforms along the path to democracy. KUCHMA in turn requested that RUMSFELD convey to US President George W. BUSH that Ukraine is continuing to make the transition from communism to a Western oriented democracy. RUMSFELD said, "Certainly, a stable and prosperous Ukraine oriented to the West, to Europe, to the Atlantic alliance, is important." RUMSFELD is the highest-level BUSH Cabinet member to visit Ukraine since a wave of protests, political scandals, and the ousting of its prime minister shook the nation. KUCHMA has been accused of ordering the murder of Internet journalist Georgy GONGADZE. RUMSFELD raised the case of the murdered reporter in his meeting with KUCHMA and reiterated Washington's call for a

thorough and independent investigation. The US Defense Secretary's visit comes also as Russia has shown a renewed interest in Ukraine. In May, Russia installed a former prime minister, Viktor CHERNOMYRDIN, as ambassador to Kiev. Ukraine has spent most of the last decade delicately balancing the opposing currents of Russian and Western influence, but Western diplomats in Kiev have said it has shown signs of drift towards Russia in recent months, Reuters reported. Doug BANDOW, a senior fellow at the Cato Institute, wrote that Ukraine is in "dangerous political water," making it vulnerable to Russian intrigues. "Washington may be able to do little more than nudge Kiev back toward the West, but nudge Kiev it should do." RUMSFELD and KUZMUK renewed a series of military agreements. Today, Prime Minister KINAKH noted that he will continue with reforms started by his predecessor Viktor YUSHCHENKO. "We leave here with the very solid commitment of the president and the ministers we have been meeting of their determination to proceed down the [reform] path," RUMSFELD said.

#### Estonian WB Office To Close

- Following a meeting between World Bank Vice President Johannes LINN and Estonian Premier Mart LAAR, it was announced that the World Bank will close its office in Estonia. LINN said, "Estonia is doing so well that the World Bank has decided to close its local representation. But this does not mean an end to cooperation. The projects on health care, renovation of the Tallinn to Tartu road and agriculture that are currently in the works will be jointly brought to end." Estonia joined the World Bank in June 1992. At the end of the last year the bank had committed \$136 million for eight projects.

#### Latvian Deficit Meets IMF Requirements

- The Latvian Finance Ministry on Monday said that May budget data showed the country was on track to meet an International Monetary Fund (IMF) requirement to keep the six-month budget deficit within the 46 million lat (\$72.55 million) limit, Reuters reported. The May fiscal deficit stood at 30.125 million lats, up from 26.765 million lats at the end of April. Finance Minister Gundars BERZINS said, "The May budget data allows us to forecast that the (consolidated) fiscal deficit in the first six months of the year will definitely be within the

norm mentioned in the IMF memorandum." Latvia agreed in an IMF memorandum to keep its 2001 fiscal deficit from rising above 1.75 percent of gross domestic product (GDP) after a preliminary deficit of 2.75 percent of GDP in 2000. The country's 2001 budget sees a fiscal gap of 79.2 million lats or 1.7 percent of GDP. The state treasury said the central government budget revenue stood at 297.3 million lats at the end of May, with expenditure at 310.2 million lats. BERZINS added, "The last data shows the continuation of the economic growth started last year. The Finance Ministry hopes that Latvia's economic development will continue despite some stagnating European economic indicators." Latvian GDP grew an annual 6.6 percent in 2000 after 1.1 percent growth in the previous year. The government expects GDP growth at 5.5 percent this year.

### SOUTH CAUCASUS & CENTRAL ASIA

#### Airzena Offers Flight To Tashkent

- Georgian *Airzena Airlines* is opening a regular flight from Tbilisi to Tashkent via Baku starting June 26<sup>th</sup>, according to the airlines' press service. This will be offered weekly. The ticket price will be determined after negotiations with the aviation departments of Uzbekistan and Azerbaijan. *Airzena* previously had a direct flight to Tashkent, but it was cancelled because it was not commercially viable. *Airzena's* leadership believes that the new route will attract customers. This is because from Baku passengers will be able to fly to other Commonwealth of Independent States (CIS) and Asia countries, which do not have direct flights in Georgia. *Airzena* offers flights to Germany, France, the Netherlands, Greece, Austria, Israel, Iran, Ukraine, and Russia. *Airzena* stated it will not cancel its Tbilisi to Tel Aviv flight or place limitations on any of its flights to Israel due to recent terrorist actions.

#### CPC To Launch Trans-Caspian Pipeline

- Following talks with Kazakhstan's Prime Minister Kasymzhomart TOKAYEV in Moscow today, Russian Prime Minister Mikhail KASYANOV said

that the *Caspian Pipeline Consortium's (CPC)* Trans-Caspian pipeline will be launched on August 6<sup>th</sup>. He added that the presidents of Russia and Kazakhstan had agreed to take under personal control the project of Kazakhstan's Tengiz oil transportation through the Russian territory to the Black Sea port of Novorossiisk. KASYANOV and TOKAYEV discussed the legal status of the Caspian Sea, two countries' cooperation in oil and gas exports, and the prospect of Kazakhstan's joining a project of a North-South transport corridor. Russian and Kazakh transportation ministers have signed on the sidelines of the premier's talks an inter-governmental agreement on navigation on the Irtys River.

#### Fitch Rates KazTransOil

- Fitch*, the international rating agency, has assigned an international foreign currency Senior Unsecured rating of BB- and international foreign currency Short-term rating of B to *KazTransOil (KTO)*. The rating outlook is stable. *KTO* is the monopoly operator of crude oil transportation pipelines within Kazakhstan. The company operates 6,500 kilometers of crude pipeline, serving the major oil-producing regions of the republic. In 2000, the company transported 27.8mt, though capacity utilization varies sharply across the three, unconnected pipeline corridors. *KTO* is 100 percent owned by the Kazakh Government. Tariffs are regulated by the Agency for Natural Monopolies Regulation (ANMR). *KTO* generated adjusted cash flow of \$136 million on adjusted revenues of \$253 million in 2000. According to a *Fitch* press release, the ratings reflect *KTO's* modest leverage and a favorable tariff environment, as well as the company's monopoly position within a core element of the country's energy sector. The ratings are also impacted by high levels of systemic obsolescence within the existing networks; the brevity of the regulatory system's track record; and to a modest extent by the competitive threat posed by the new *Caspian Pipeline Consortium's (CPC)* export pipeline for high quality crude.

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