PROSPECTUS

Russian Federation

Russian Federation U.S.$907,788,786 Bonds due 31 March 2007 to 31 March 2030 ("2030 Bonds") and Russian Federation U.S.$140,534,766 Bonds due 31 March 2006 to 31 March 2010 ("2010 Bonds" and, together with the 2030 Bonds, the "Bonds")

This Prospectus relates to an offering of Bonds by the Ministry of Finance of the Russian Federation acting on behalf of the Russian Federation (the "Offering"). The Offering implements an exchange offer described in greater detail in "Terms of the Offering—Background to the Offering" herein.

The Bonds will be direct, unconditional and unsecured obligations of the Russian Federation and will be fungible in all respects with Bonds previously issued in connection with the Russian Federation's August 2000 London Club restructuring. U.S.$20,310,387,870 aggregate principal amount of 2030 Bonds and U.S.$3,122,231,850 aggregate principal amount of 2010 Bonds are currently outstanding.

Interest on the 2030 Bonds is payable semi-annually in arrear on 31 March and 30 September in each year, commencing on 30 September 2000, at the rates set out in "Terms and Conditions of the 2030 Bonds—5. Interest" herein. Interest on 2030 Bonds payable prior to 28 November 2006 (the "Settlement Date") will be paid on the Settlement Date to the holders of 2030 Bonds issued in the Offering. See "Terms of the Offering—Cash Payments" herein. Interest will be paid thereafter on 31 March and 30 September of each year, commencing on 31 March 2007. Unless previously redeemed, or purchased and cancelled, 2030 Bonds will be redeemed on 31 March and 30 September in each year, commencing on 31 March 2007, in 47 semi-annual instalments in the respective amounts set forth in the terms and conditions of the 2030 Bonds. See "Terms and Conditions of the 2030 Bonds—6. Redemption, Purchase and Cancellation" herein.

Interest on the 2010 Bonds is payable (except as noted below) semi-annually in arrear on 31 March and 30 September in each year, commencing on 30 September 2000, at the rates set out in "Terms and Conditions of the 2010 Bonds—5. Interest" herein. Interest on 2010 Bonds payable prior to the Settlement Date will be paid on the Settlement Date to the holders of 2010 Bonds issued in the Offering, together with 29.610% of the principal amount of the 2010 Bonds. See "Terms of the Offering—Cash Payments" herein. Interest will be paid thereafter on 31 March and 30 September of each year, commencing on 31 March 2007. Unless previously redeemed, or purchased and cancelled, 2010 Bonds will be redeemed on 31 March and 30 September in each year, commencing on 31 March 2007, in 7 semi-annual instalments in the respective amounts set forth in the terms and conditions of the 2010 Bonds. The initial holders of 2010 Bonds issued on the Settlement Date will be required to waive the right to receive a portion of the Initial Interest Payment. See "Terms of the Offering—Cash Payments" and "Terms and Conditions of the 2010 Bonds—6. Redemption, Purchase and Cancellation" herein.

The Bonds have not been and will not be registered under the United States Securities Act of 1933 (the "Securities Act") or any other securities laws and may be offered and sold only in transactions that are exempt from, or are not subject to, the registration requirements of the Securities Act. The Bonds are being offered in the United States only to Qualified Institutional Buyers (as defined in Rule 144A under the Securities Act) and outside the United States in offshore transactions in reliance on Regulation S under the Securities Act.

The Bonds will be issued in the form of one or more permanent global bonds in registered form without interest coupons attached. On the Settlement Date, global bonds representing Bonds offered and sold in the United States will be deposited with the custodian, and registered in the name of the nominee, for The Depository Trust Company and global bonds representing Bonds offered and sold outside the United States will be registered in the name of, and deposited with, the sub-common depositary for the common depositary for Euroclear and Clearstream. See "Form and Transfer of Bonds" herein.

Application has been made for the Bonds to be listed on the Official List and admitted to trading on the regulated market of the Luxembourg Stock Exchange, which is a regulated market within the meaning of Directive 2004/39/EC.

The Prospectus comprises a Prospectus for the purposes of Article 5 of Directive 2003/71/EC.

The date of this Prospectus is 23 November 2006.

The Russian Federation, having made all reasonable enquiries, confirms that this Prospectus contains all information with respect to the Russian Federation and the Bonds which is material in the context of the issue and offering of the Bonds, that such information is true and accurate in every material respect and is not misleading in any material respect and that this Prospectus does not omit to state any material fact necessary to make such information not misleading. The opinions, assumptions and intentions expressed in this Prospectus with regard to the Russian Federation are honestly held, have been reached after considering all relevant circumstances and are based on reasonable assumptions. The Russian Federation accepts responsibility for the information contained in this Prospectus.

Information contained herein that is identified as being derived from a publication of the Russian Federation or one of its agencies or instrumentalities is included herein on the authority of such publication as an official public document of the Russian Federation. All other information contained herein is included as an official public statement made on the authority of the Minister of Finance of the Russian Federation.

No person has been authorised to make or provide any representation or information regarding the Russian Federation or the Bonds other than as contained in this Prospectus and in the related offering circular. Any such representation or information should not be relied upon as having been authorised by the Russian Federation or any agency thereof. The delivery of this Prospectus at any time does not imply that the information contained herein is correct as at any time subsequent to its date. Unless otherwise indicated, all information in this Prospectus is given as of its date.

The Fiscal Agent, the Registrar, the Paying Agent and the Transfer Agents referred to herein make no representation regarding this Prospectus or the Bonds.

This Prospectus does not constitute an offer of, or an invitation by or on behalf of, the Russian Federation or any agency thereof in any jurisdiction where an offer or invitation by or on behalf of the Russian Federation or any agency thereof is not permitted by the laws of such jurisdiction. The distribution of this Prospectus and the offering of the Bonds in certain jurisdictions may be restricted by law. Persons into whose possession this Prospectus comes should inform themselves of and observe all such restrictions.

With effect from 1 January 1998, the rouble was redenominated, with one new rouble being set equal to one thousand old roubles. All references herein to amounts in "roubles" are references to new roubles, and any rouble amounts relating to the period prior to 1 January 1998 have been restated in new roubles. The rouble/dollar exchange rate as reported by the Central Bank of the Russian Federation (the "Central Bank") on 21 November 2006 was 26.6402 roubles to the dollar.

In this Prospectus, all references to "dollar," "U.S.$" and "$," are to the lawful currency of the United States of America, all references to "ECU" are to European Currency Units, all references to "euro" and "€"are to the currency introduced at the start of the third stage of European economic and monetary union pursuant to the Treaty establishing the European Community, as amended, and all references to interest accruing from a specified date or to a specified date are to interest accruing from and including the first specified date to but excluding the second specified date.

Except as otherwise provided, translations of amounts from one currency into another currency are solely for the convenience of the reader and are made at various exchange rates. No representation is made that amounts referred to herein could have been, or could be, converted into another currency at any particular exchange rate or, in the case of rouble and dollar amounts, at all.

Prior to the dissolution of the Soviet Union, the collection of data and production of official statistical information with respect to the Russian economy was geared to the needs of central planning. Since that time, the means employed in collecting data and methodologies used in the production of statistics have evolved significantly from year to year. Statistical information reported herein has been derived from official publications of, and information supplied by, a number of agencies of the Russian Federation, including the State Committee on Statistics ("Goskomstat"), the Central Bank, the Ministry of Finance of the Russian Federation (the "Ministry of Finance") and the State Customs Committee of the Russian Federation (the "Customs Committee"), and by The Bank for Foreign Economic Affairs of the USSR ("Vnesheconombank"). In certain cases, the Ministry of Finance has performed arithmetic calculations or otherwise determined the form in which information is classified or presented herein. Unless otherwise stated, all annual information, including budget information, is based on calendar years, and interim statistical information has not been annualised. Data included in this Prospectus has been subject to rounding adjustments; accordingly, data shown for the same item of information may vary, and total figures may not be arithmetical sums of their components. In addition, certain data presented herein differ from data made public previously due to regular revisions conducted by Goskomstat, the Central Bank, the Ministry of Finance, the Customs Committee, Vnesheconombank and other Russian authorities.

Except as otherwise provided herein, any reference in this Prospectus to an action being taken by the Russian Federation should be construed as a reference to such action being taken by the Ministry of Finance acting on behalf of the Russian Federation.

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SUMMARY

This summary should be read as an introduction to the Prospectus. Any decision to invest in the Bonds by an investor should be based on consideration of the Prospectus as a whole. Where a claim relating to the information contained in the Prospectus is brought before a court in a Member State of the European Economic Area, the plaintiff may, under the national legislation of the Member State where the claim is brought, be required to bear the costs of translating the Prospectus before the legal proceedings are initiated.

Issuer	Ministry of Finance of the Russian Federation acting on behalf of the Russian Federation. The Russian Federation, or Russia (Rossiya), is a sovereign and democratic federal state, consisting of 88 sub-federal political units, referred to as "Federation subjects." Russia is the largest country in the world, covering 17.1 million square kilometres, approximately one-eighth of the earth's land area. Russia borders 16 countries and spans 11 time zones, extending some 9,000 kilometres from the Baltic Sea in the west to the Pacific Ocean in the east and some 4,000 kilometres from its southern border on the Black and Caspian Seas to its northern limits on the Arctic Ocean.
Securities Offered:	
2030 Bonds	
Title................................	Russian Federation U.S. Dollar Denominated Bonds due 2007 to 2030.
Interest	2030 Bonds bear interest from 31 March 2000 to 30 September 2000 at 2.25% per annum, from 30 September 2000 to 31 March 2001 at 2.50% per annum, from 31 March 2001 to 31 March 2007 at 5.00% per annum, and thereafter at 7.50% per annum, payable semi-annually on 31 March and 30 September in each year, commencing on 30 September 2000. Pursuant to the Exchange Offer and subject to the terms thereof, interest payable on 2030 Bonds prior to the Settlement Date will be paid to participating Holders on the Settlement Date. See "Terms of the Exchange Offer—Principal Amount of New Bonds and Cash to be Received Pursuant to the Exchange Offer—Cash Payment in Respect of 2030 Bonds" herein.
Redemption	Unless previously redeemed, or purchased and cancelled, 2030 Bonds will be redeemed on 31 March and 30 September in each year, commencing on 31 March 2007, in 47 semi-annual instalments in the respective amounts set forth in Condition 6(a).
Repurchase	The Russian Federation may at any time purchase 2030 Bonds in the open market or otherwise at any price. 2030 Bonds so repurchased may be cancelled or resold.
Status	2030 Bonds constitute direct, unconditional, unsecured and unsubordinated obligations of the Russian Federation and rank *pari passu* without any preference among themselves and at least *pari passu* in all respects with all other present and future unsecured and unsubordinated obligations of the Russian Federation.
Events of Default .... (1)	Failure to pay any amount of principal or interest in respect of the 2030 Bonds when due and payable (except for interest amounts due to Russian residents not entitled to receive interest payments on the 2030 Bonds) and such failure continues for a period of fifteen business days.

(2) Failure to perform or comply with any obligation in respect of the 2030 Bonds, which default (if capable of remedy) is not remedied within sixty days after written notice from any Bondholder.

(3) The acceleration of the maturity of any Public External Indebtedness (as defined in Condition 4), any failure to pay the final instalment of principal in respect of any Public External Indebtedness following the expiration of any applicable grace period, or the acceleration of any obligation under a guarantee constituting Public External Indebtedness or the failure to pay the final instalment of principal in respect of any such guaranteed obligation following the expiration of any applicable grace period, and such guarantee is not honoured; provided that the aggregate amount of the relevant Public External Indebtedness equals or exceeds U.S.$75,000,000 (or its equivalent in any other currency or currencies).

(4) The Russian Federation declares a moratorium on the payment of principal of or interest on any part of its Public External Indebtedness.

(5) The Russian Federation or any agency or entity acting on behalf of the Russian Federation contests the validity of the 2030 Bonds or denies any of the Russian Federation's obligations under the 2030 Bonds or it is or becomes unlawful for the Russian Federation to perform or comply with any of its obligations under or in respect of the 2030 Bonds or under or in respect of the Fiscal Agency Agreement or any of such obligations shall be or become unenforceable or invalid.

(6) The Russian Federation ceases to be a member of the IMF or eligible to use the general resources of the IMF pursuant to Article 26 of the IMF Articles of Agreement.

(7) Any regulation, decree, consent, approval, licence or other authority necessary to enable the Russian Federation to enter into or perform its obligations under the 2030 Bonds or under the Fiscal Agency Agreement or for the validity or enforceability thereof shall expire or be withheld, revoked or terminated or otherwise cease to remain in full force and effect or shall be modified in a manner which adversely affects any rights or claims of any holder of 2030 Bonds.

Negative Pledge............ So long as any 2030 Bonds remain outstanding, the Russian Federation will not create or permit to subsist any Lien (as defined in Condition 4(c)) upon the whole or any part of the International Monetary Assets (as defined in Condition 4(c)) to secure any Public External Indebtedness unless, at the same time or prior thereto, the obligations of the Russian Federation under the 2030 Bonds are secured equally and rateably therewith.

Form.............................. 2030 Bonds will be issued only in definitive, fully registered form, without coupons attached. 2030 Unrestricted Bonds (generally, bonds offered and sold outside the United States in reliance on Regulation S under the Securities Act) will be represented by beneficial interests in one or more 2030 Unrestricted Global Bonds, which will be deposited on or before the Settlement Date with, and registered in the name of, J.P. Morgan Bank Luxembourg S.A., as sub-common depositary for the common depositary in respect of interests in such global bonds held through Euroclear and Clearstream.

2030 Restricted Global Bonds (generally, bonds offered and sold in the United States in reliance on Rule 144A under the Securities Act) will be represented by beneficial interests in one or more 2030 Restricted Global Bonds, which will be deposited on or before the Settlement Date with JPMorgan Chase Bank, N.A., New York office, as custodian for, and registered in the name of Cede & Co. as nominee for, DTC.

2030 Bonds will be subject to certain restrictions on transfer. See "Form and Transfer of New Bonds" and "Transfer Restrictions" herein.

Further Issues .... The Russian Federation may from time to time, without the consent of the holders of 2030 Bonds, create and issue further 2030 Bonds ranking equally in all respects (except for payments made prior to the issuance of such further 2030 Bonds and, if applicable, the date and amount of the first payment on such further 2030 Bonds) so that the same shall be consolidated and form a single series with the 2030 Bonds.

Denominations .... Minimum denomination of U.S.$1.00 or any amount in excess thereof which is an integral multiple of U.S.$1.00.

Taxes............................ Subject to customary exceptions, all payments under the 2030 Bonds will be made free and clear of any taxes imposed by the Russian Federation.

Governing Law............. Laws of England.

Waiver of Immunity...... The Russian Federation has not waived any of its sovereign immunity, and has not submitted to the jurisdiction of any court, in respect of its obligations under the 2030 Bonds.

Listing and admission to trading .... Application has been made for the Bonds to be listed on the Official List and admitted to trading on the regulated market of the Luxembourg Stock Exchange.

2010 Bonds

Title............................... Russian Federation U.S. Dollar Denominated Bonds due 2006 to 2010.

Interest .... 2010 Bonds bear interest from 31 March 2000 at the rate of 8.25% per annum, payable (except as noted below) semi-annually on 31 March and 30 September in each year, commencing on 30 September 2000.

Pursuant to the Exchange Offer and subject to the terms thereof, interest on 9.5% of the initial principal amount of 2010 Bonds (referred to herein as the Initial Interest Payment), together with interest payable on 2010 Bonds prior to the Settlement Date, will be paid to participating Holders on the Settlement Date, subject to the Holder's irrevocable waiver of the right to receive the Specified Amount of the Initial Interest Payment. See "Terms of the Exchange Offer—Principal Amount of New Bonds and Cash to be Received Pursuant to the Exchange Offer—Cash Payment in Respect of 2010 Bonds" herein.

Redemption .... 29.610% of the initial principal amount of the 2010 Bonds will be redeemed on the Settlement Date. Thereafter, unless previously redeemed, or purchased and cancelled, 2010 Bonds will be redeemed on 31 March and 30 September in each year, commencing on 30 September 2006, in 8 semi-annual instalments in the respective amounts set forth in Condition 6(a).

Repurchase .... The Russian Federation may at any time purchase 2010 Bonds in the open market or otherwise at any price. 2010 Bonds so repurchased may be cancelled or resold.

Status .... 2010 Bonds constitute direct, unconditional, unsecured and unsubordinated obligations of the Russian Federation and rank *pari passu* without any preference among themselves and at least *pari passu* in all respects with all other present and future unsecured and unsubordinated obligations of the Russian Federation.

Events of Default .... (1) Failure to pay any amount of principal or interest in respect of the 2010 Bonds when due and payable (except for interest amounts due to Russian residents not entitled to receive interest payments on the 2010 Bonds) and such failure continues for a period of fifteen business days.

(2) Failure to perform or comply with any obligation in respect of the 2010 Bonds, which default (if capable of remedy) is not remedied within sixty days after written notice from any Bondholder.

(3) The acceleration of the maturity of any Public External Indebtedness (as defined in Condition 4), any failure to pay the final instalment of principal in respect of any Public External Indebtedness following the expiration of any applicable grace period, or the acceleration of any obligation under a guarantee constituting Public External Indebtedness or the failure to pay the final instalment of principal in respect of any such guaranteed obligation following the expiration of any applicable grace period, and such guarantee is not honoured; provided that the aggregate amount of the relevant Public External Indebtedness equals or exceeds U.S.$75,000,000 (or its equivalent in any other currency or currencies).

(4) The Russian Federation declares a moratorium on the payment of principal of or interest on any part of its Public External Indebtedness.

(5) The Russian Federation or any agency or entity acting on behalf of the Russian Federation contests the validity of the 2010 Bonds or denies any of the Russian Federation's obligations under the 2010 Bonds or it is or becomes unlawful for the Russian Federation to perform or comply with any of its obligations under or in respect of the 2010 Bonds or under or in respect of the Fiscal Agency Agreement or any of such obligations shall be or become unenforceable or invalid.

(6) The Russian Federation ceases to be a member of the IMF or eligible to use the general resources of the IMF pursuant to Article 26 of the IMF Articles of Agreement.

(7) Any regulation, decree, consent, approval, licence or other authority necessary to enable the Russian Federation to enter into or perform its obligations under the 2010 Bonds or under the Fiscal Agency Agreement or for the validity or enforceability thereof shall expire or be withheld, revoked or terminated or otherwise cease to remain in full force and effect or shall be modified in a manner which adversely affects any rights or claims of any holder of 2010 Bonds.

Negative Pledge............ So long as any 2010 Bonds remain outstanding, the Russian Federation will not create or permit to subsist any Lien (as defined in Condition 4(c)) upon the whole or any part of the International Monetary Assets (as defined in Condition 4(c)) to secure any Public External Indebtedness unless, at the same time or prior thereto, the obligations of the Russian Federation under the 2010 Bonds are secured equally and rateably therewith.

Form.............................. 2010 Bonds will be issued only in definitive, fully registered form, without coupons attached. 2010 Unrestricted Bonds (generally, bonds offered and sold outside the United States in reliance on Regulation S under the Securities Act) will be represented by beneficial interests in one or more 2010 Unrestricted Global Bonds, which will be deposited on or before the Settlement Date with, and registered in the name of, J.P. Morgan Bank Luxembourg S.A., as sub-common depositary for the common depositary in respect of interests in such global bonds held through Euroclear and Clearstream.

2010 Restricted Global Bonds (generally, bonds offered and sold in the United States in reliance on Rule 144A under the Securities Act) will be represented by beneficial interests in one or more 2010 Restricted Global Bonds, which will be deposited on or before the Settlement Date with JPMorgan Chase Bank, N.A., New York office, as custodian for, and registered in the name of Cede & Co. as nominee for, DTC.

	2010 Bonds will be subject to certain restrictions on transfer. See "Form and Transfer of New Bonds" and "Transfer Restrictions" herein.
Further Issues	The Russian Federation may from time to time, without the consent of the holders of 2010 Bonds, create and issue further 2010 Bonds ranking equally in all respects (except for payments made prior to the issuance of such further 2010 Bonds and, if applicable, the date and amount of the first payment on such further 2010 Bonds) so that the same shall be consolidated and form a single series with the 2010 Bonds.
Denominations	Minimum denomination of U.S.$1.00 or any amount in excess thereof which is an integral multiple of U.S.$1.00.
Taxes............................	Subject to customary exceptions, all payments under the 2010 Bonds will be made free and clear of any taxes imposed by the Russian Federation.
Governing Law.............	Laws of England.
Waiver of Immunity.....	The Russian Federation has not waived any of its sovereign immunity, and has not submitted to the jurisdiction of any court, in respect of its obligations under the 2010 Bonds.
Listing and admission to trading	Application has been made for the Bonds to be listed on the Official List and admitted to trading on the regulated market of the Luxembourg Stock Exchange.
Risk Factors..........................	Risks associated with the Bonds generally include: (1) the market for the Bonds may be illiquid, which may have a material adverse effect on the market value of the Bonds; and (2) the Bonds are denominated in U.S. dollars, which may present currency-related risks for certain purchasers.
	Risks associated with Russia generally include: (1) Russia is a foreign sovereign state and accordingly it may be difficult to obtain or enforce judgements against it; (2) economic instability may affect Russia's economic results; and (3) there can be no assurance that Russia's credit rating will not change.
	These risk factors are described under "Risk Factors".

RISK FACTORS

This section describes certain risks associated with investing in the Bonds. You should consult your financial and legal advisors about the risk of investing in the Bonds.

Risk Factors relating to Russia

Russia is a foreign sovereign state and accordingly it may be difficult to obtain or enforce judgments against it.

Russia is a foreign sovereign state. As a result, it may not be possible for investors to effect service of process within their own jurisdiction upon Russia or to enforce against Russia judgments obtained in their own jurisdictions.

Certain economic risks are inherent in any investment in a country such as Russia.

Investing in a country such as Russia carries economic risks. These risks include economic instability that may affect Russia's economic results. Economic instability in Russia in the past and in other countries has been caused by many different factors, including the following:

- general economic and business conditions;
- high interest rates;
- changes in currency values;
- high levels of inflation;
- exchange rates;
- exchange controls;
- foreign currency reserves;
- changes in economic or tax policies; and
- the imposition of trade barriers issues.

Any of these factors, as well as volatility in the markets for securities similar to the Bonds, may adversely affect the value or liquidity of the Bonds.

There can be no assurance that Russia's credit rating will not change.

Russia's long-term foreign currency debt is currently rated BBB+ by Standard and Poor's and Fitch Ratings and Baa2 by Moody's. A credit rating is not a recommendation to buy, sell or hold securities and may be subject to suspension, reduction or withdrawal at any time by the assigning rating agency. Any adverse change in Russia's credit rating could adversely affect the trading price of the Bonds.

Risk Factors relating to the Bonds

Market for the Bonds

Although Russia has applied for the Bonds to be admitted to trading on the Luxembourg Stock Exchange's regulated market, no assurance can be given as to how any Bonds will trade in the secondary market or whether such market will be liquid or illiquid. Illiquidity may have a material adverse effect on the market value of the Bonds.

Certain economic risks are inherent in any investment denominated in a currency other than the currency of the country in which the purchaser is resident or the currency in which the purchaser conducts its business or activities.

An investment in a security denominated in a currency other than the currency of the country in which the purchaser is resident or the currency in which the purchaser conducts its business or activities may present currency-related risks not associated with a similar investment in a security denominated in the home currency. Such risks include, without limitation, the possibility of significant changes in rates of exchange between the home currency and the U.S. dollar and the possibility of the imposition or modification of foreign exchange controls with respect to the U.S. dollar and the home currency. Such risks generally depend on events over which Russia has no control, such as economic and political events and the supply of and demand for the U.S. dollar and the home currency. In recent years, rates of exchange for certain currencies have been highly volatile and such volatility may be expected to continue in the future.

Fluctuations in any particular exchange rate that have occurred in the past are not necessarily indicative, however, of fluctuations in such rate that may occur during the term of the Bonds. Depreciation of the U.S. dollar against the relevant home currency could result in a decrease in the effective yield of a particular security below its coupon rate and, in certain circumstances, could result in a loss to the investor on a home currency basis.

This description of foreign currency risks does not describe all the risks of an investment in securities denominated in a currency other than the home currency. Prospective investors should consult their own financial and legal advisers as to the risks involved in an investment in the Bonds.

TERMS OF THE OFFERING

Background to the Offering

On 2 December 1997, The Bank for Foreign Economic Affairs of the USSR ("Vnesheconombank") agreed to assume responsibility for certain unpaid Soviet-era debt originally owed to foreign banks and other financial institutions organised as the London Club, and the holders of this debt agreed to exchange their existing claims for new obligations of Vnesheconombank. On 25 August 2000, the Russian Federation agreed to assume responsibility for Vnesheconombank's London Club debt, and Vnesheconombank's London Club creditors agreed to exchange their existing claims on Vnesheconombank for Bonds.

On 12 April 2001, representatives of the Russian Federation and representatives of holders of certain trade indebtedness of the former USSR ("FTO Debt"), located in twelve countries and organised as the Forum of Trade Creditor Group Representatives, agreed in principle to restructure FTO Debt on the terms set out in the FTO Debt Exchange Term Sheet initialled on that date. As contemplated by the FTO Debt Exchange Term Sheet, the Ministry of Finance of the Russian Federation subsequently invited holders of FTO Debt to exchange their FTO Debt for Bonds on terms broadly comparable to those afforded to London Club creditors. The Offering implements that exchange offer and only holders of FTO Debt who elected to participate in the exchange offer are receiving Bonds in the Offering.

Cash Payments

Holders of Bonds issued in the Offering will receive on the Settlement Date 29.610% of the initial principal amount of their 2010 Bonds and (except as noted below) all of the interest payments on their 2030 Bonds and 2010 Bonds that would have been made if their 2030 Bonds and 2010 Bonds had been issued on 25 August 2000 in connection with the Russian Federation's London Club restructuring, as follows:

Cash Payment in Respect of 2030 Bonds

- $298.75 in cash in respect of each $1,000 principal amount of such Holder's 2030 Bonds, subject to the rounding rule referred to below.

  This payment will comprise, with respect to each $1,000 principal amount of such Holder's 2030 Bonds, all of the interest payments (in the case of each interest payment, rounded down to the nearest cent) that would have been made on such 2030 Bonds if such 2030 Bonds had been issued on 25 August 2000 in connection with the Russian Federation's London Club restructuring, as follows:

Interest Payments Due on Each $1,000 Principal Amount of 2030 Bonds

Interest Payment Date	Amount (before rounding)
30 September 2000	$11.25
31 March 2001	$12.50
30 September 2001	$25.00
31 March 2002	$25.00
30 September 2002	$25.00
31 March 2003	$25.00
30 September 2003	$25.00
31 March 2004	$25.00
30 September 2004	$25.00
31 March 2005	$25.00
30 September 2005	$25.00
31 March 2006	$25.00
30 September 2006	$25.00
Total=	$298.75

Due to the rounding of individual interest payments referred to above, the amount of cash that will be received by a Holder in respect of its 2030 Bonds may not be exactly proportionate to the total amount of the cash payment, noted above, that will be received in respect of each $1,000 principal amount of 2030 Bonds.

The terms and conditions of the 2030 Bonds are set out in the "Terms and Conditions of the 2030 Bonds" below.

Cash Payment in Respect of 2010 Bonds

- $797.77617 in cash in respect of each $1,000 principal amount of such Holder's 2010 Bonds (assuming the 2010 Bonds are issued on 18 December 2002), subject to the rounding rule referred to below.

This payment will comprise, with respect to each $1,000 principal amount of 2010 Bonds:

- 9.5% of the initial principal amount of such 2010 Bonds (the "Initial Principal Payment");
- 10.055% of the initial principal amount of such 2010 Bonds (being the principal payment due on such 2010 Bonds on 31 March 2006);
- 10.055% of the initial principal amount of such 2010 Bonds (being the principal payment due on such 2010 Bonds on 30 September 2006);
- interest on the Initial Principal Payment at 8.25% per annum from 31 March 2000 to the Settlement Date, rounded down to the nearest cent (the "Initial Interest Payment"), less the portion of the Initial Interest Payment required to be waived as a condition to participating in the Exchange Offer, referred to in "—Waiver of Specified Amount of Initial Interest Payment" below; and
- all of the other interest payments (in each case, rounded down to the nearest cent) that would have been made on such 2010 Bonds if such 2010 Bonds had been issued on 25 August 2000 in connection with the Russian Federation's London Club restructuring.

A breakdown of the cash payments that will be made in respect of each $1,000 principal amount of 2010 Bonds is set out below.

Cash Payments Due on Each $1,000 Principal Amount of 2010 Bonds

Cash Payment	**Amount (before rounding)**
Initial Principal Payment	$95.00
Initial Interest Payment*	$20.41
31 March 2006 Principal Payment	$100.55
30 September 2006 Principal Payment	$100.55
Interest Payment on:	
30 September 2000	$37.33125
31 March 2001	$37.33125
30 September 2001	$37.33125
31 March 2002	$37.33125
30 September 2002	$37.33125
31 March 2003	$37.33125
30 September 2003	$37.33125
31 March 2004	$37.33125
30 September 2004	$37.33125
31 March 2005	$37.33125
30 September 2005	$37.33125
31 March 2006	$37.33125
30 September 2006	$33.18356
Total Cash Payment=	$797.77617

* Net of the required waiver of the Specified Amount referred to below.

Due to the rounding of individual interest payments referred to above, the amount of cash that will be received by a Holder in respect of its 2010 Bonds may not be exactly proportionate to the total amount of the cash payment, noted above, that will be received in respect of each $1,000 principal amount of 2010 Bonds.

The terms and conditions of the 2010 Bonds are set out in the "Terms and Conditions of the 2010 Bonds" below.

Waiver of Specified Amount of Initial Interest Payment

Holders will be required to irrevocably waive the right to receive a portion of the Initial Interest Payment due on their 2010 Bonds, in an amount (the "Specified Amount") in respect of each $1,000 principal amount of 2010 Bonds of $30.81800, equal to the difference between the amount of interest accrued without compounding on the Initial Principal Payment due in respect of such 2010 Bonds from 31 March 2000 to the Settlement Date (a) in accordance with the terms of the 2010 Bonds (rounded down to the nearest cent) and (b) at three-month U.S. dollar LIBOR, reset quarterly (rounded down to the nearest cent). The 2010 Bonds bear interest at 8.25% per annum. The applicable three-month U.S. dollar LIBOR rates will be as follows:

Interest Period	**Three-month U.S. dollar LIBOR**
31 March 2000 to 30 June 2000	6.28%
30 June 2000 to 30 September 2000	6.78%
30 September 2000 to 31 December 2000	6.815%
31 December 2000 to 31 March 2001	6.40125%
31 March 2001 to 30 June 2001	4.87625%
30 June 2001 to 30 September 2001	3.79%
30 September 2001 to 31 December 2001	2.6%
31 December 2001 to 31 March 2002	1.90875%
31 March 2002 to 30 June 2002	2.03%
30 June 2002 to 30 September 2002	1.86%
30 September 2002 to 31 December 2002	1.79813%

Interest Period	Three-month U.S. dollar LIBOR
31 December 2002 to 31 March 2003	1.40%
31 March 2003 to 30 June 2003	1.29%
30 June 2003 to 30 September 2003	1.10%
30 September 2003 to 31 December 2003	1.14%
31 December 2003 to 31 March 2004	1.1625%
31 March 2004 to 30 June 2004	1.11%
30 June 2004 to 30 September 2004	1.58625%
30 September 2004 to 31 December 2004	1.975%
31 December 2004 to 31 March 2005	2.56%
31 March 2005 to 30 June 2005	3.0925%
30 June 2005 to 30 September 2005	3.49%
30 September 2005 to 31 December 2005	4.02038%
31 December 2005 to 31 March 2006	4.52688%
31 March 2006 to 30 June 2006	4.97938%
30 June 2006 to 30 September 2006	5.49875%
30 September 2006 to the Settlement Date	5.37163%

Further Issuances of New Bonds

The Russian Federation will be at liberty from time to time, without the consent of the Holders of the Bonds, to create and issue further Bonds ranking equally in all respects (or in all respects save for, in the case of the 2010 Bonds, the date and amount of the first payment of principal thereon and, in the case of all Bonds, the date and amount of the first payment of interest thereon) so that such further Bonds will be consolidated and form a single series with the Bonds.

Cross-Acceleration of Russian Federation Eurobonds

Each series of Russian Federation Eurobonds issued during the life of the 2030 Bonds or the 2010 Bonds will include a provision that treats an acceleration of the 2030 Bonds or the 2010 Bonds on the same basis as an acceleration of the Russian Federation's then-existing Eurobonds for the purpose of determining whether a cross-acceleration Event of Default has occurred (an "Expanded Cross-Acceleration Clause"). For the avoidance of doubt, an Expanded Cross-Acceleration Clause will not treat the Bonds as Excluded Indebtedness (as defined in the terms and conditions of the Eurobonds issued by the Russian Federation prior to August 1998, referred to below as "Existing Eurobonds") or as any other category of indebtedness having a similar effect.

If the 2030 Bonds or the 2010 Bonds become due and payable prior to their stated maturity (or the Russian Federation fails to make the final payment of principal on the 2030 Bonds or the 2010 Bonds in accordance with their terms), and the principal amount of the affected bonds is at least equal to U.S.$75 million (or its equivalent in other currencies), then holders representing at least 25% in aggregate outstanding principal amount of any series of Existing Eurobonds may, by delivering a written notice to the Russian Federation (a "Repurchase Notice") no later than twelve months following the date on which the 2030 Bonds or the 2010 Bonds became due and payable prior to their stated maturity (or the date on which the Russian Federation failed to make the final payment of principal on such bonds in accordance with their terms), require the Russian Federation to purchase the Eurobonds of such series held by such holders at their principal amount, together with accrued interest to the date of purchase (the "Repurchase Date"), not later than 90 days following the date of delivery (the "Repurchase Notice Delivery Date") of Repurchase Notices representing at least 25% in aggregate principal amount of such series of Existing Eurobonds (the "Repurchase Right"). The remaining holders of such series of Existing Eurobonds may require the Russian Federation to purchase their Existing Eurobonds of such series on the same terms by delivering a Repurchase Notice to the Russian Federation within 30 days of the Repurchase Notice Delivery Date.

Notwithstanding the foregoing, holders of any series of Existing Eurobonds will not have any Repurchase Rights for so long as any Russian Federation Eurobonds which contain an Expanded Cross-Acceleration Clause (other than Bonds) are outstanding in an aggregate principal amount in excess of U.S.$1 billion (or its equivalent in other currencies). Repurchase Rights will be reinstated if the Russian Federation issues a series of Eurobonds during the life of the 2030 Bonds or the 2010 Bonds that does not contain an Expanded Cross-Acceleration Clause.

A holder wishing to exercise its Repurchase Right must deliver a Repurchase Notice to the Russian Federation, in care of the Ministry of Finance, by letter or facsimile at the following address, with copies to the Fiscal Agent or the Luxembourg Paying Agent for the Bonds and the clearing system in which such holder's Existing Eurobonds are held:

Ministry of Finance
9 Ilynka Street
Moscow 103097
Russia
Tel.: + 7 495 298 9168
Fax: + 7 495 298 9168
Attention: Director of the Department of International
Financial Relations, State Debt and State Financial Assets

Such notice may only be provided by or through persons that are direct accountholders or participants in the applicable clearing system. If a person wishing to exercise its Repurchase Right holds its Existing Eurobonds through an accountholder or participant in a clearing system, it must make appropriate arrangements for such accountholder or participant to deliver a Repurchase Notice to the Ministry of Finance on its behalf.

The Russian Federation will provide written notice of any Repurchase Notice Delivery Date to the applicable clearing systems, issue a press release to the Dow Jones News Service and Reuters News Service no later than 5:00 p.m., London time, on the next Business Day immediately following such Repurchase Notice Delivery Date and (so long as the Bonds are listed on the Luxembourg Stock Exchange and the rules of the Luxembourg Stock Exchange so require) publish a notice in a leading newspaper having general circulation in Luxembourg (which is expected to be the *d'Wort*). The Russian Federation will give notice of any Repurchase Date in the manner specified above no later than 5:00 p.m., London time, on the thirty-fifth day prior to such Repurchase Date.

The Repurchase Right was implemented in connection with the Russian Federation's 2000 London Club restructuring by means of a deed of covenant (the "Deed of Covenant") executed by the Russian Federation in favour of all holders from time to time of any series of Existing Eurobonds. The Deed of Covenant is held by the Fiscal Agent and is available for inspection at the offices of the Fiscal Agent.

Any reference under this heading to any action being taken by the Russian Federation shall be construed as a reference to such action being taken by the Ministry of Finance acting on behalf of the Russian Federation or, in the case of the reference to the Russian Federation's issuance of Eurobonds during the life of the 2030 Bonds or the 2010 Bonds, to such action being taken by the Ministry of Finance or another such body of executive authority whose functions, pursuant to a decision of the Government of the Russian Federation, include the preparation and/or implementation of the federal budget and which is hereafter authorised under the laws of the Russian Federation to issue Eurobonds on behalf of the Russian Federation during the life of the 2030 Bonds or the 2010 Bonds.

TERMS AND CONDITIONS OF THE 2030 BONDS

The following, save for the paragraphs in italics, is the text of the terms and conditions of the 2030 Bonds which, subject to amendment, will be endorsed on each Bond Certificate and will be attached and (subject to the provisions thereof) apply to each Global Bond:

The U.S. Dollar Denominated Bonds due 2007 to 2030 (the "Bonds") (which expression includes any further Bonds issued pursuant to Condition 13 and forming a single series with the Bonds) of the Ministry of Finance of the Russian Federation (the "Ministry of Finance") acting on behalf of the Russian Federation were authorised pursuant to the provisions of Federal Law No. 136-FZ of 29 July 1998, Government Resolution No. 478 of 23 June 2000, Government Resolution No. 931 of 29 December 2001, Government Resolution No. 829 of 15 November 2002 and Government Resolution No. 402 of 7 August 2004. A fiscal agency agreement dated 24 August 2000, as amended and supplemented on 17 December 2002, 15 March 2004 and 27 November 2006 (the "Fiscal Agency Agreement") has been entered into in relation to the Bonds by the Russian Federation, The Chase Manhattan Bank (now JPMorgan Chase Bank, N.A.), London branch, as fiscal and principal paying agent (the "Fiscal Agent") and as registrar (the "Registrar"), the other paying agents named therein (together with the Fiscal Agent and the Registrar, the "Paying Agents") and the transfer agents named therein (the "Transfer Agents").

In these Conditions, "Fiscal Agent," "Registrar," "Paying Agent" and "Transfer Agent" shall include any successors appointed from time to time in accordance with the provisions of the Fiscal Agency Agreement for the Bonds, and any reference to an "Agent" or "Agents" shall mean any or all (as applicable) of such persons.

Copies of the Fiscal Agency Agreement are available for inspection during usual business hours at the principal office of the Fiscal Agent (currently at 9 Thomas More Street, London E1W 1YT, England) and at the specified offices of each of the other Agents. The Bondholders (as defined in Condition 1(b)) are bound by, and are deemed to have notice of, the provisions of the Fiscal Agency Agreement for the Bonds.

1. Form, Denomination and Title

(a) Form and Denomination

The Bonds are in definitive fully registered form, without interest coupons attached, in a minimum denomination of U.S.$1.00 and any amount in excess thereof which is an integral multiple of U.S.$1.00 (each an "authorised denomination"). A certificate (each a "Bond Certificate") will be issued to each Bondholder in respect of its registered holding or holdings of Bonds. Each Bond Certificate will be numbered serially with an identifying number which will be recorded in the register (the "Register") which the Russian Federation shall procure to be kept by the Registrar.

(b) Title

Title to the Bonds will pass by and upon registration in the Register. In these Conditions, "Bondholder" and "holder" mean the person in whose name a Bond is registered in the Register (or, in the case of joint holders, the first-named thereof). The holder of any Bond will (except as otherwise requested by such holder in writing, or as otherwise ordered by a court of competent jurisdiction or required by law) be treated as its absolute owner for all purposes, whether or not it is overdue and regardless of any notice of ownership, trust or any interest therein, any writing thereon by any person (other than a duly executed transfer thereof in the form endorsed thereon) or any notice of any previous theft or loss thereof, and no person will be liable for so treating the holder.

2. Transfer of Bonds and Issue of Bonds

(a) Transfer

Subject to Condition 2(d), a Bond may be transferred in whole or in part in an authorised denomination upon the surrender of the Bond Certificate representing that Bond, together with the form of transfer (including any certification as to compliance with restrictions on transfer included in such form of transfer) endorsed thereon (the

"Transfer Form") duly completed and executed, at the specified office of the Registrar or any Transfer Agent, together with such evidence as the Registrar or, as the case may be, such Transfer Agent may reasonably require to prove the title of the transferor and the authority of the persons who have executed the Transfer Form. In the case of a transfer of part only of the Bonds represented by a Bond Certificate, neither the part transferred nor the balance not transferred may be less than the applicable authorised denomination and a new Bond Certificate in respect of the balance not so transferred will be issued to the transferor.

(b) Delivery

Each new Bond Certificate to be issued upon a transfer of any Bonds will, within five business days of the request for transfer being duly made, be delivered at the specified office of the Registrar or, as the case may be, any Transfer Agent or (at the request and the risk of such transferee) be mailed by uninsured post to such address as the transferee entitled to the Bonds represented by such Bond Certificate may have specified. In this Condition 2(b), "business day" means a day (other than a Saturday or Sunday) on which commercial banks are open for business (including dealings in foreign currencies) in the cities in which the Registrar and any such Transfer Agent have their respective specified offices.

(c) No Charge

Registration or transfer of Bonds will be effected without charge to the holder or transferee thereof, but upon payment (or against such indemnity from the holder or the transferee thereof as the Registrar or the relevant Transfer Agent may reasonably require) in respect of any tax or other duty of whatever nature which may be levied or imposed in connection with such registration or transfer.

(d) Closed Periods

No Bondholder may require the transfer of a Bond to be registered during the period of 15 calendar days ending on the due date for any payment of principal in respect of such Bond.

(e) Regulations Concerning Transfer and Registration

All transfers of Bonds and entries on the Register will be made subject to the detailed regulations concerning transfer of Bonds scheduled to the Fiscal Agency Agreement. The regulations may be changed by the Russian Federation in a manner which is reasonably required by the Russian Federation (after consultation with the Registrar) to reflect changes in legal requirements or in any other manner which is not prejudicial to the interests of the Bondholders. A copy of the current regulations will be sent by the Registrar to any Bondholder who so requests.

3. Status

The Bonds constitute direct, unconditional, unsecured and unsubordinated obligations of the Russian Federation and the full faith and credit of the Russian Federation is pledged for the due and punctual payment of principal of, and interest on, the Bonds and for the performance of all other obligations of the Russian Federation pursuant to the Bonds. The Bonds shall at all times rank *pari passu* without any preference among themselves and at least *pari passu* in all respects with all other present and future unsecured and unsubordinated obligations of the Russian Federation.

Under the Constitution and laws of the Russian Federation, certain of the Russian Federation's assets are not available to satisfy the claims of creditors, including Bondholders. In particular, Article 126 of the Civil Code, as amended, provides that assets which have been transferred to state-owned entities under "economic management" or "operational management" are not available for such purpose. The laws of the Russian Federation do not restrict the Russian Federation from transferring any of its assets to such state-owned entities. In addition, Article 126 provides that certain other assets which may only be owned by the state (for example, subsoil, federal transportation systems and nuclear power installations) are not available to satisfy the claims of creditors.

4. Negative Pledge and Covenant

(a) Negative Pledge

So long as any of the Bonds remains outstanding (as defined in the Fiscal Agency Agreement) the Russian Federation will not create or permit to subsist any Lien upon the whole or any part of the International Monetary Assets to secure any Public External Indebtedness unless, at the same time or prior thereto, the obligations of the Russian Federation under the Bonds are secured equally and rateably therewith.

(b) Covenant

So long as any Bond remains outstanding the Russian Federation shall obtain, and do or cause to be done all things necessary to ensure the continuance of, all consents, licences, approvals and authorisations, and make or cause to be made all registrations, recordings and filings, which may at any time be required to be obtained or made in the Russian Federation for the execution, delivery or performance of the Bonds or for the validity or enforceability thereof.

(c) Definitions

In these Conditions:

"Excluded Indebtedness" means any obligation of the Russian Federation, the Government of the Russian Federation, the Ministry of Finance, Vnesheconombank of the U.S.S.R. or any other person that may arise from time to time representing restructured indebtedness originally incurred prior to 1st January 1992 by the government of the former Soviet Union or any of its legally authorised entities, other than the Bonds and the Russian Federation U.S. Dollar Denominated Bonds due 2006 to 2010.

"External Indebtedness" means Indebtedness (i) which is not Excluded Indebtedness, (ii) which is denominated or payable, or at the option of the relevant creditor or holder thereof may be payable, in a currency other than the lawful currency of the Russian Federation and (iii) which was not originally incurred or assumed under an agreement or instrument made with or issued to creditors substantially all of whom were residents of the Russian Federation or entities having their head office or principal place of business within the territory of the Russian Federation. For the avoidance of doubt, External Indebtedness does not include Internal Government Hard Currency Bonds known as "OVVZs," "Taiga" bonds or "MinFins" or any bonds representing restructured internal hard currency bonds of the Government of the Russian Federation.

"Government of the Russian Federation" means the Government of the Russian Federation as provided in Article 110 of the Constitution of the Russian Federation, or any successor article, from time to time.

"IMF" means the International Monetary Fund.

"Indebtedness" means any legal obligation or any obligation intended by its terms to be a legal obligation (whether present or future, actual or contingent, secured or unsecured, incurred as principal, surety, guarantor or otherwise) for the payment or repayment of borrowed money created (or intended by its terms to have been created) under an agreement or instrument in which the Russian Federation, the Government of the Russian Federation or the Ministry of Finance is designated as the obligor, or which by operation of Russian law constitutes a legal obligation of the Russian Federation, the Government of the Russian Federation or the Ministry of Finance (it being understood that neither the Central Bank of the Russian Federation, nor any political subdivision, regional or municipal government, ministry (other than the Ministry of Finance), department, authority or statutory corporation of the Russian Federation nor any joint stock company, enterprise or other entity organised or existing under the laws or regulations of the Russian Federation or any of the above, is considered to be part of the Russian Federation, the Government of the Russian Federation or the Ministry of Finance for purposes hereof).

"International Monetary Assets" means all official holdings of gold, Special Drawing Rights, Reserve Positions in the Fund and Foreign Exchange of the Ministry of Finance or the Government of the Russian Federation from time to time (but not, for the avoidance of doubt, any such assets of the Central Bank of the Russian Federation at any time), and the terms "Special Drawing Rights," "Reserve Positions in the Fund" and "Foreign Exchange" have, as to the types of assets included, the meanings given to them in the IMF's publication entitled "International Financial Statistics" or such other meanings as shall be formally adopted by the IMF from time to time.

"Lien" means any lien, pledge, hypothecation, mortgage, security interest, deed of trust, charge or any other encumbrance arising under a security agreement or arrangement.

"Public External Indebtedness" means External Indebtedness which (i) is in the form of, or represented by, bonds, notes or other securities or any guarantee thereof and (ii) is, or may be, quoted, listed or ordinarily purchased and sold on any stock exchange, automated trading system or over-the-counter or other securities market (including, without prejudice to the generality of the foregoing, the market for securities eligible for resale pursuant to Rule 144A under the United States Securities Act of 1933, as amended (the "Securities Act").

5. Interest

Each Bond bears interest on its outstanding principal amount from 31 March 2000 at the rates set forth below, payable semi-annually in arrear on 31 March and 30 September in each year until maturity, commencing on 30 September 2000. Interest will be paid subject to and in accordance with the provisions of Condition 7.

Interest Period (from and including the first indicated date to but excluding the second indicated date)	**Interest Rate**
31 March 2000 to 30 September 2000	2.25 per cent. per annum
30 September 2000 to 31 March 2001	2.50 per cent. per annum
31 March 2001 to 31 March 2007	5.00 per cent. per annum
Thereafter	7.50 per cent. per annum

Each Bond will cease to bear interest from each Principal Payment Date (as defined in Condition 6) on the portion of the outstanding principal amount of such Bond scheduled to be paid on such Principal Payment Date unless, after presentation and (in the case of the Final Principal Payment Date) surrender of such Bond, payment of principal is improperly withheld or refused, in which case the outstanding principal amount of such Bond will continue to bear interest in accordance with this Condition 5 (after as well as before judgement) until whichever is the earlier of (i) the day on which all sums due in respect of such Bond up to such day are received by or on behalf of the relevant Bondholder and (ii) the day which is seven days after notice has been given to the Bondholders that the Fiscal Agent has received all sums due in respect of the Bonds up to such seventh day (except, in the case of payment to the Fiscal Agent, to the extent that there is any subsequent default in payment in accordance with these Conditions).

If interest is required to be calculated for a period of less than 12 months, it will be calculated on the basis of a year of 360 days consisting of 12 months of 30 days each and, in the case of an incomplete month, the actual number of days elapsed.

6. Redemption, Purchase and Cancellation

(a) Redemption

Unless previously redeemed, or purchased and cancelled, each Bond will be redeemed in 47 semi-annual instalments on the dates set forth below (each a "Principal Payment Date") commencing on 31 March 2007 in the amount (expressed as a percentage of the outstanding principal amount of each Bond on the date of issue) set forth below opposite such Principal Payment Date. Principal will be paid subject to and in accordance with the provisions of Condition 7.

Principal Payment Date	Percentage
31 March 2007	0.5 per cent.
30 September 2007	0.5 per cent.
31 March 2008	0.5 per cent.
30 September 2008	0.5 per cent.
31 March 2009	2.0 per cent.
30 September 2009	2.0 per cent.
31 March 2010	2.0 per cent.
30 September 2010	2.5 per cent.
31 March 2011	3.0 per cent.
30 September 2011	3.0 per cent.
31 March 2012	3.0 per cent.
30 September 2012	3.0 per cent.
31 March 2013	3.0 per cent.
30 September 2013	3.0 per cent.
31 March 2014	3.0 per cent.
30 September 2014	3.0 per cent.
31 March 2015	3.0 per cent.
30 September 2015	3.0 per cent.
31 March 2016	3.0 per cent.
30 September 2016	3.0 per cent.
31 March 2017	3.0 per cent.
30 September 2017	3.0 per cent.
31 March 2018	3.0 per cent.
30 September 2018	3.0 per cent.
31 March 2019	4.0 per cent.
30 September 2019	4.0 per cent.
31 March 2020	4.0 per cent.
30 September 2020	4.0 per cent.
31 March 2021	3.0 per cent.
30 September 2021	3.0 per cent.
31 March 2022	3.0 per cent.
30 September 2022	3.0 per cent.
31 March 2023	2.0 per cent.
30 September 2023	2.0 per cent.
31 March 2024	2.0 per cent.
30 September 2024	2.0 per cent.
31 March 2025	0.5 per cent.
30 September 2025	0.5 per cent.
31 March 2026	0.5 per cent.
30 September 2026	0.5 per cent.
31 March 2027	0.5 per cent.
30 September 2027	0.5 per cent.
31 March 2028	0.5 per cent.
30 September 2028	0.5 per cent.
31 March 2029	0.5 per cent.
30 September 2029	0.5 per cent.
31 March 2030	remainder

(b) Purchase and Cancellation

The Russian Federation and its affiliates may at any time purchase Bonds in the open market or otherwise at any price. Any Bonds so purchased may be cancelled or held and resold (provided that such resale is outside the United States, as defined in Regulation S under the Securities Act). Any Bonds so cancelled will not be reissued.

7. Payments

(a) Principal

Payments of principal in respect of each Bond will be made by transfer to a U.S. dollar account maintained by the Bondholder with a bank in New York City or (i) if it does not have such a U.S. dollar account or (ii) the principal amount of Bonds held by such person is less than U.S.$250,000, by a U.S. dollar cheque drawn on a bank in New York City mailed to the registered address of the Bondholder by uninsured mail at the risk of the Bondholder. Such payment will be made only upon presentation and (in the case of final redemption) surrender of the relevant Bond Certificate at the specified office of any of the Paying Agents and will be rounded downwards, if necessary, to the nearest cent. For the purposes of this Condition 7(a) the holder of such Bond will be deemed to be the person shown as the holder (or the first-named of joint holders) on the Register at the Registrar's close of business on the fifteenth day before the due date for such payment of principal and the outstanding amount of each Bondholder's registered holding will be deemed to be the amount shown as such on the Register for such Bondholder at the same time on that date.

(b) Interest

Payments of interest (other than interest due on a Principal Payment Date) in respect of each Bond will be made by U.S. dollar cheque drawn on a bank in New York City and mailed to the holder (or to the first-named of joint holders) of such Bond at the address appearing in the Register not later than the due date for such payment and will be rounded downwards, if necessary, to the nearest cent. For the purposes of this Condition 7(b) the holder of such Bond will be deemed to be the person shown as the holder (or the first-named of joint holders) on the Register on the fifteenth day before the due date for such payment of interest.

Upon application by a Bondholder with respect to Bonds having a principal amount of U.S.$250,000 or more to the specified office of the Registrar not less than fifteen days before the due date for the payment of any interest (other than interest due on a Principal Payment Date) in respect of such Bonds, such payment will be made by transfer to a U.S. dollar account maintained by the payee with a bank in New York City. Any such application for transfer to a U.S. dollar account shall be deemed to relate to all future payments of interest (other than interest due on a Principal Payment Date) in respect of the Bonds which become payable to the Bondholder who has made the initial application until such time as the Registrar is notified in writing to the contrary by such Bondholder.

Payment of interest due on a Principal Payment Date will be made in the same manner as payment of the principal of a Bond.

(c) Payments Subject to Fiscal Laws

All payments of principal and interest in respect of the Bonds are subject in all cases to any applicable fiscal or other laws and regulations, but without prejudice to the provisions of Condition 8.

Consistent with the terms of Regulation No. BG-4-06/1n of 12 July 2000 approved by the Ministry of Taxes and Duties of the Russian Federation and agreed by the Ministry of Finance, Russian residents, other than physical persons, may not receive interest on the Bonds in any form.

The Regulations do not contain a definition of "Russian residents." Accordingly, it is unclear whether, for example, Russian branches and representative offices of foreign entities would be considered to be Russian residents for this purpose. See "Taxation – Russian Taxation."

(d) Commissions

No commissions or expenses shall be charged to the Bondholders in respect of any payments of principal or interest in respect of the Bonds.

(e) Payments on Business Days

Where payment is to be made by transfer to a U.S. dollar account, payment instructions (for value the due date or, if that is not a business day, for value the first following day which is a business day) will be initiated on the due date for payment or, if later, in the case of principal and interest due on redemption in whole or in part, on the business day on which the relevant Bond Certificate is presented and, in the case of a Final Principal Payment Date, surrendered at the specified office of any of the Paying Agents.

Where payment is to be made by cheque, the cheque will be mailed on the due date for payment or, if later, in the case of principal and interest due on redemption in whole or in part, on the business day on which the relevant Bond Certificate is presented and, in the case of a Final Principal Payment Date, surrendered at the specified office of any of the Paying Agents.

In these Conditions, "business day" means a day (other than a Saturday or Sunday) on which commercial banks are open for business in New York City and, in the case of the surrender of a Bond Certificate, in the place where the Bond Certificate is surrendered.

(f) Delay in Payments

Bondholders will not be entitled to any interest or other payment for any delay after the due date in receiving any amount due in respect of any Bond as a result of (i) the due date not being a business day, (ii) the Bondholder being late in presenting or surrendering its Bond Certificate (if required to do so) or (iii) a cheque mailed in accordance with this Condition 7 arriving after the due date for payment or being lost in the mail.

(g) Partial Payments

If at any time a partial payment is made in respect of any Bond, the Registrar shall endorse the Register with a statement indicating the amount and date of such payment.

(h) Agents

The initial Agents and their initial specified offices are listed below. Any of the Agents may resign in accordance with the provisions of the Fiscal Agency Agreement and the Russian Federation reserves the right at any time to vary or terminate the appointment of any Agent and appoint additional or other Agents, provided that while the Bonds are outstanding it will maintain (i) a Fiscal Agent, (ii) a Registrar and (iii) a Paying Agent and a Transfer Agent having a specified office in a major European city which will be in Luxembourg, so long as the Bonds are listed on the Luxembourg Stock Exchange and the rules of the Luxembourg Stock Exchange so require. Notice of any change in the Agents or their specified offices will promptly be given to the Bondholders in accordance with Condition 14.

8. Taxation

All payments of principal and interest in respect of the Bonds by the Russian Federation shall be made free and clear of, and without withholding or deduction for, any taxes, duties, assessments or governmental charges of whatever nature imposed, levied, collected, withheld or assessed by the Russian Federation or any political subdivision or any authority thereof or therein having power to tax (together, "Taxes"), unless such withholding or deduction is required by law. If at any time any Taxes are withheld or deducted, the Russian Federation shall increase the payment of principal or interest, as the case may be, to such amount as will result in the receipt by the Bondholders of such amounts as would have been received by them had no such withholding or deduction been required, except that no such increased amount shall be payable:

(a) to a holder, or to a third party on behalf of a holder, if such holder is liable to such Taxes by reason of having some connection with the Russian Federation other than the mere holding of a Bond or the receipt of payments thereunder; or

(b) if the Bond Certificate representing a Bond is presented and (in the case of final redemption) surrendered for payment more than 30 days after the Relevant Date, except to the extent that the holder would have been entitled to such additional amounts on presentation and (in the case of final redemption) surrender of such Bond Certificate for payment on the last day of such period of 30 days.

If, in relation to any payment under the Bonds (a "Payment") any Bondholder has received any increased amount as provided in this Condition 8, the Russian Federation shall have the right to retain any refund of any amount withheld or deducted in respect of such Payment, which refund may be available under a tax treaty or otherwise to such Bondholder. Notwithstanding the foregoing, no Bondholder makes any representation or warranty that the Russian Federation will be entitled to any such refund (or to make any claim in respect thereof) and no Bondholder shall incur any obligation with respect thereto (including, without limitation, incurring any expense or liability in connection therewith).

For the avoidance of doubt, the Russian Federation acknowledges that it shall have no right to make any deduction or withholding in respect of (nor will it purport to set off any amount equal to) any such refund from any payment in respect of any Bond.

In these Conditions, "Relevant Date" means whichever is the later of (i) the date on which the payment in question first becomes due and (ii) if the full amount payable has not been received in New York City by the Fiscal Agent on or prior to such due date, the date on which (the full amount having been so received) notice to that effect has been given to the Bondholders.

Any reference in these Conditions to principal or interest in respect of the Bonds shall be deemed to include any increased amounts which may be payable under this Condition 8.

9. Events of Default

If any of the following occurs and is continuing (each an "Event of Default") in respect of the Bonds, as applicable:

(a) Non-payment

The Russian Federation fails to pay any amount of principal or interest in respect of the Bonds, as the case may be, when due and such failure continues for a period of fifteen business days, provided, however, that it shall not constitute an Event of Default if interest is not paid to a Bondholder which is a Russian resident (other than a physical person) as contemplated in Condition 7(c) ;or

(b) Breach of other obligations or undertakings

The Russian Federation defaults in performance or observance of or compliance with any of its other obligations or undertakings in respect of the Bonds, as the case may be, which default (if capable of remedy) is not remedied within sixty days after written notice of such default shall have been given to the Russian Federation by any holder of the Bonds, as the case may be, it being understood that a default in respect of the undertaking set forth in Condition 4(a) shall be deemed capable of remedy for purposes hereof; or

(c) Cross-acceleration

Any other Public External Indebtedness shall become due and payable prior to the stated maturity thereof otherwise than at the option of the debtor following a default or the Russian Federation, the Government of the Russian Federation or the Ministry of Finance shall fail to make the final payment of principal in respect of any Public External Indebtedness on the date on which such final payment is due and payable or at the expiration of any grace period originally applicable thereto or, in the case of any guarantee which constitutes Public External Indebtedness, the underlying obligation in respect of which such guarantee has been given shall have become due and payable prior to the stated maturity thereof otherwise than at the option of the debtor following a default or the debtor shall have failed to make the final payment of principal in respect of such underlying obligation on the date on which such final payment is due and payable or at the expiration of any grace period originally applicable thereto and the guarantee shall not be honoured when due and called upon; provided that the aggregate amount of the relevant Public External Indebtedness in respect of which one or more of the events mentioned in this Condition 9(c) shall have occurred equals or exceeds U.S.$75,000,000 (or its equivalent in any other currency or currencies) ;and provided, further, that any secured Public External Indebtedness that by its terms is fully non-recourse to the Russian Federation, the Government of the Russian Federation or the Ministry of Finance shall not be counted as Public External Indebtedness for purposes of this Condition 9(c);or

(d) Moratorium

A moratorium on the payment of principal of, or interest on, all or any part of Public External Indebtedness; or

(e) Unlawfulness or Invalidity

The validity of the Bonds is contested by the Russian Federation or any agency or entity acting on behalf of the Russian Federation or the Russian Federation or any agency or entity acting on behalf of the Russian Federation shall deny any of the Russian Federation's obligations under the Bonds or it is or will become unlawful for the Russian Federation to perform or comply with any of its obligations under or in respect of the Bonds or under or in respect of the Fiscal Agency Agreement or any of such obligations shall be or become unenforceable or invalid; or

(f) IMF

The Russian Federation ceases to be a member of the IMF or eligible to use the general resources of the IMF pursuant to Article 26 of the IMF Articles of Agreement; or

(g) Consents etc.

Any regulation, decree, consent, approval, licence or other authority necessary to enable the Russian Federation to enter into or perform its obligations under the Bonds or under the Fiscal Agency Agreement or for the validity or enforceability thereof shall expire or be withheld, revoked or terminated or otherwise cease to remain in full force and effect or shall be modified in a manner which adversely affects any rights or claims of any of the holders of the Bonds, as the case may be, then holders of 25 per cent. or more in aggregate outstanding principal amount of the Bonds may declare the Bonds to be immediately due and payable whereupon the Bonds shall become immediately due and payable at their principal amount, together with accrued interest, without any further formality.

10. Prescription

Claims against the Russian Federation in respect of principal and interest shall become void unless made within a period of ten years, in the case of principal, and five years, in the case of interest, from the appropriate Relevant Date (as defined in Condition 8).

11. Replacement of Bond Certificates

If any Bond Certificate is lost, stolen, mutilated, defaced or destroyed, it may be replaced at the specified office of the Registrar or the Transfer Agent with its specified office in Luxembourg subject to all applicable laws and stock exchange requirements, upon payment by the claimant of the expenses incurred in connection with such replacement and on such terms as to evidence, security, indemnity and otherwise as the Russian Federation may reasonably require. Mutilated or defaced Bond Certificates must be surrendered before replacements will be issued.

12. Meetings of Bondholders, Modification and Waiver

(a) Meetings of Bondholders

The Fiscal Agency Agreement contains provisions for convening meetings of holders of Bonds to consider any matter affecting their interests, including the modification by Extraordinary Resolution of these Conditions. The quorum at any such meeting for passing an Extraordinary Resolution shall (subject as provided in the Fiscal Agency Agreement in the event that all Bonds for the time being outstanding are held by one person) be two or more persons holding or representing a clear majority of the principal amount of the Bonds for the time being outstanding, or at any adjourned meeting two or more persons being or representing holders of the Bonds whatever the principal amount for the time being outstanding so held or represented, except that at any meeting the business of which includes consideration of proposals, *inter alia*, (i) to modify the maturity of the Bonds, (ii) to reduce or cancel the principal amount of, or interest on, the Bonds, (iii) to change the currency of payment of the Bonds, (iv) to modify the provisions concerning the quorum required at any meeting of holders of the Bonds or the majority required to pass an Extraordinary Resolution or (v) to modify the percentage required to pass any resolution, the necessary quorum for passing an Extraordinary Resolution shall (subject as provided in the applicable Fiscal Agency Agreement in the event that all Bonds for the time being outstanding are held by one person) be two or more persons holding or representing not less than three-quarters, or at any adjourned such meeting not less than one-quarter, of the principal amount of the Bonds for the time being outstanding. An Extraordinary Resolution duly passed at any meeting of holders of the Bonds will be binding on all holders of the Bonds whether or not they are present at the meeting.

(b) Modification and waiver

The parties to the Fiscal Agency Agreement may agree, without the consent of the holders of the Bonds, to any modification of any provision of the Fiscal Agency Agreement or the Bonds which is of a formal, minor or technical nature or is made to correct a manifest error.

13. Further Issues

The Russian Federation shall be at liberty from time to time, without the consent of the holders of the Bonds, to create and issue further Bonds ranking equally in all respects (or in all respects save for payments made prior to the issuance of such further Bonds and, if applicable, the date and amount of the first payment on such further Bonds) so that the same shall be consolidated and form a single series with the Bonds.

14. Notices

Notices to the Bondholders will be sent to them by first class mail (airmail if overseas) at their respective addresses on the Register, and will be deemed to have been given on the fourth day after the date of mailing. So long as the Bonds are listed on the Luxembourg Stock Exchange and the rules of the Luxembourg Stock Exchange so require, notices with respect to the Bonds will also be published in a leading newspaper having general circulation in Luxembourg (which is expected to be the *d'Wort*) or, if such publication is not practicable, in an English language newspaper having general circulation in Europe, and each such notice shall be deemed to have been given on the date of such publication, or if published more than once or on different dates, on the first date on which publication is made.

A copy of all notices provided pursuant to this Condition 14 shall also be given to Euroclear and Clearstream.

15. Currency Indemnity

The U.S. dollar is the sole currency of account and payment for all sums payable by the Russian Federation under or in connection with the Bonds, including damages. Any amount received or recovered in a currency other than the U.S. dollar (whether as a result of, or the enforcement of, a judgement or order of a court of any jurisdiction or otherwise) by any Bondholder in respect of any sum expressed to be due to it from the Russian Federation shall only constitute a discharge to the Russian Federation to the extent of the U.S. dollar amount which the recipient is able to purchase with the amount so received or recovered in that other currency on the date of that receipt or recovery (or, if it is not practicable to make that purchase on that date, on the first date on which it is practicable to do so). If that U.S. dollar amount is less than the U.S. dollar amount expressed to be due to the recipient under any Bond, the Russian Federation shall indemnify such recipient against any loss sustained by it as a result. In any event, the Russian Federation shall indemnify the recipient against the cost of making any such purchase. These indemnities constitute separate and independent obligations from the Russian Federation's other obligations, shall give rise to a separate and independent cause of action, shall apply irrespective of any indulgence granted by any Bondholder and shall continue in full force and effect despite any judgement, order, claim or proof for a liquidated amount in respect of any sum due under any Bond or any judgement or order.

16. Governing Law

The Bonds and the Fiscal Agency Agreement shall be governed by and construed in accordance with the laws of England.

TERMS AND CONDITIONS OF THE 2010 BONDS

The following, save for the paragraphs in italics, is the text of the terms and conditions of the 2010 Bonds which, subject to amendment, will be endorsed on each Bond Certificate and will be attached and (subject to the provisions thereof) apply to each Global Bond:

The U.S. Dollar Denominated Bonds due 2006 to 2010 (the "Bonds") (which expression includes any further Bonds issued pursuant to Condition 13 and forming a single series with the Bonds) of the Ministry of Finance of the Russian Federation (the "Ministry of Finance") acting on behalf of the Russian Federation were authorised pursuant to the provisions of Federal Law No. 136-FZ of 29 July 1998, Government Resolution No. 478 of 23 June 2000, Government Resolution No. 931 of 29 December 2001, Government Resolution No. 829 of 15 November 2002 and Government Resolution No. 402 of 7 August 2004. A fiscal agency agreement dated 24 August 2000, as amended and supplemented on 17 December 2002, 15 March 2004 and 27 November 2006 (the "Fiscal Agency Agreement") has been entered into in relation to the Bonds by the Russian Federation, The Chase Manhattan Bank (now JPMorgan Chase Bank, N.A.), London branch, as fiscal and principal paying agent (the "Fiscal Agent") and as registrar (the "Registrar"), the other paying agents named therein (together with the Fiscal Agent and the Registrar, the "Paying Agents") and the transfer agents named therein (the "Transfer Agents").

In these Conditions, "Fiscal Agent," "Registrar," "Paying Agent" and "Transfer Agent" shall include any successors appointed from time to time in accordance with the provisions of the Fiscal Agency Agreement for the Bonds, and any reference to an "Agent" or "Agents" shall mean any or all (as applicable) of such persons.

Copies of the Fiscal Agency Agreement are available for inspection during usual business hours at the principal office of the Fiscal Agent (currently at 9 Thomas More Street, London E1W 1YT, England) and at the specified offices of each of the other Agents. The Bondholders (as defined in Condition 1(b)) are bound by, and are deemed to have notice of, the provisions of the Fiscal Agency Agreement for the Bonds.

1. Form, Denomination and Title

(a) Form and Denomination

The Bonds are in definitive fully registered form, without interest coupons attached, in a minimum denomination of U.S.$1.00 and any amount in excess thereof which is an integral multiple of U.S.$1.00 (each an "authorised denomination"). A certificate (each a "Bond Certificate") will be issued to each Bondholder in respect of its registered holding or holdings of Bonds. Each Bond Certificate will be numbered serially with an identifying number which will be recorded in the register (the "Register") which the Russian Federation shall procure to be kept by the Registrar.

(b) Title

Title to the Bonds will pass by and upon registration in the Register. In these Conditions, "Bondholder" and "holder" mean the person in whose name a Bond is registered in the Register (or, in the case of joint holders, the first-named thereof). The holder of any Bond will (except as otherwise requested by such holder in writing, or as otherwise ordered by a court of competent jurisdiction or required by law) be treated as its absolute owner for all purposes, whether or not it is overdue and regardless of any notice of ownership, trust or any interest therein, any writing thereon by any person (other than a duly executed transfer thereof in the form endorsed thereon) or any notice of any previous theft or loss thereof, and no person will be liable for so treating the holder.

2. Transfer of Bonds and Issue of Bonds

(a) Transfer

Subject to Condition 2(d), a Bond may be transferred in whole or in part in an authorised denomination upon the surrender of the Bond Certificate representing that Bond, together with the form of transfer (including any certification as to compliance with restrictions on transfer included in such form of transfer) endorsed thereon (the

"Transfer Form") duly completed and executed, at the specified office of the Registrar or any Transfer Agent, together with such evidence as the Registrar or, as the case may be, such Transfer Agent may reasonably require to prove the title of the transferor and the authority of the persons who have executed the Transfer Form. In the case of a transfer of part only of the Bonds represented by a Bond Certificate, neither the part transferred nor the balance not transferred may be less than the applicable authorised denomination and a new Bond Certificate in respect of the balance not so transferred will be issued to the transferor.

(b) Delivery

Each new Bond Certificate to be issued upon a transfer of any Bonds will, within five business days of the request for transfer being duly made, be delivered at the specified office of the Registrar or, as the case may be, any Transfer Agent or (at the request and the risk of such transferee) be mailed by uninsured post to such address as the transferee entitled to the Bonds represented by such Bond Certificate may have specified. In this Condition 2(b), "business day" means a day (other than a Saturday or Sunday) on which commercial banks are open for business (including dealings in foreign currencies) in the cities in which the Registrar and any such Transfer Agent have their respective specified offices.

(c) No Charge

Registration or transfer of Bonds will be effected without charge to the holder or transferee thereof, but upon payment (or against such indemnity from the holder or the transferee thereof as the Registrar or the relevant Transfer Agent may reasonably require) in respect of any tax or other duty of whatever nature which may be levied or imposed in connection with such registration or transfer.

(d) Closed Periods

No Bondholder may require the transfer of a Bond to be registered during the period of 15 calendar days ending on the due date for any payment of principal in respect of such Bond.

(e) Regulations Concerning Transfer and Registration

All transfers of Bonds and entries on the Register will be made subject to the detailed regulations concerning transfer of Bonds scheduled to the Fiscal Agency Agreement. The regulations may be changed by the Russian Federation in a manner which is reasonably required by the Russian Federation (after consultation with the Registrar) to reflect changes in legal requirements or in any other manner which is not prejudicial to the interests of the Bondholders. A copy of the current regulations will be sent by the Registrar to any Bondholder who so requests.

3. Status

The Bonds constitute direct, unconditional, unsecured and unsubordinated obligations of the Russian Federation and the full faith and credit of the Russian Federation is pledged for the due and punctual payment of principal of, and interest on, the Bonds and for the performance of all other obligations of the Russian Federation pursuant to the Bonds. The Bonds shall at all times rank *pari passu* without any preference among themselves and at least *pari passu* in all respects with all other present and future unsecured and unsubordinated obligations of the Russian Federation.

Under the Constitution and laws of the Russian Federation, certain of the Russian Federation's assets are not available to satisfy the claims of creditors, including Bondholders. In particular, Article 126 of the Civil Code, as amended, provides that assets which have been transferred to state-owned entities under "economic management" or "operational management" are not available for such purpose. The laws of the Russian Federation do not restrict the Russian Federation from transferring any of its assets to such state-owned entities. In addition, Article 126 provides that certain other assets which may only be owned by the state (for example, subsoil, federal transportation systems and nuclear power installations) are not available to satisfy the claims of creditors.

4. Negative Pledge and Covenant

(a) Negative Pledge

So long as any of the Bonds remains outstanding (as defined in the Fiscal Agency Agreement) the Russian Federation will not create or permit to subsist any Lien upon the whole or any part of the International Monetary Assets to secure any Public External Indebtedness unless, at the same time or prior thereto, the obligations of the Russian Federation under the Bonds are secured equally and rateably therewith.

(b) Covenant

So long as any Bond remains outstanding the Russian Federation shall obtain, and do or cause to be done all things necessary to ensure the continuance of, all consents, licences, approvals and authorisations, and make or cause to be made all registrations, recordings and filings, which may at any time be required to be obtained or made in the Russian Federation for the execution, delivery or performance of the Bonds or for the validity or enforceability thereof.

(c) Definitions

In these Conditions:

"Excluded Indebtedness" means any obligation of the Russian Federation, the Government of the Russian Federation, the Ministry of Finance, Vnesheconombank of the U.S.S.R. or any other person that may arise from time to time representing restructured indebtedness originally incurred prior to 1st January 1992 by the government of the former Soviet Union or any of its legally authorised entities, other than the Bonds and the Russian Federation U.S. Dollar Denominated Bonds due 2007 to 2030.

"External Indebtedness" means Indebtedness (i) which is not Excluded Indebtedness, (ii) which is denominated or payable, or at the option of the relevant creditor or holder thereof may be payable, in a currency other than the lawful currency of the Russian Federation and (iii) which was not originally incurred or assumed under an agreement or instrument made with or issued to creditors substantially all of whom were residents of the Russian Federation or entities having their head office or principal place of business within the territory of the Russian Federation. For the avoidance of doubt, External Indebtedness does not include Internal Government Hard Currency Bonds known as "OVVZs," "Taiga" bonds or "MinFins" or any bonds representing restructured internal hard currency bonds of the Government of the Russian Federation.

"Government of the Russian Federation" means the Government of the Russian Federation as provided in Article 110 of the Constitution of the Russian Federation, or any successor article, from time to time.

"IMF" means the International Monetary Fund.

"Indebtedness" means any legal obligation or any obligation intended by its terms to be a legal obligation (whether present or future, actual or contingent, secured or unsecured, incurred as principal, surety, guarantor or otherwise) for the payment or repayment of borrowed money created (or intended by its terms to have been created) under an agreement or instrument in which the Russian Federation, the Government of the Russian Federation or the Ministry of Finance is designated as the obligor, or which by operation of Russian law constitutes a legal obligation of the Russian Federation, the Government of the Russian Federation or the Ministry of Finance (it being understood that neither the Central Bank of the Russian Federation, nor any political subdivision, regional or municipal government, ministry (other than the Ministry of Finance), department, authority or statutory corporation of the Russian Federation nor any joint stock company, enterprise or other entity organised or existing under the laws or regulations of the Russian Federation or any of the above, is considered to be part of the Russian Federation, the Government of the Russian Federation or the Ministry of Finance for purposes hereof).

"International Monetary Assets" means all official holdings of gold, Special Drawing Rights, Reserve Positions in the Fund and Foreign Exchange of the Ministry of Finance or the Government of the Russian Federation from time to time (but not, for the avoidance of doubt, any such assets of the Central Bank of the Russian Federation at any time), and the terms "Special Drawing Rights," "Reserve Positions in the Fund" and "Foreign Exchange" have, as to the types of assets included, the meanings given to them in the IMF's publication entitled "International Financial Statistics" or such other meanings as shall be formally adopted by the IMF from time to time.

"Lien" means any lien, pledge, hypothecation, mortgage, security interest, deed of trust, charge or any other encumbrance arising under a security agreement or arrangement.

"Public External Indebtedness" means External Indebtedness which (i) is in the form of, or represented by, bonds, notes or other securities or any guarantee thereof and (ii) is, or may be, quoted, listed or ordinarily purchased and sold on any stock exchange, automated trading system or over-the-counter or other securities market (including, without prejudice to the generality of the foregoing, the market for securities eligible for resale pursuant to Rule 144A under the United States Securities Act of 1933, as amended (the "Securities Act").

5. Interest

Each Bond bears interest from 31 March 2000 at the rate of 8.25 per cent. per annum. On the date of issue of each Bond (the "First Payment Date"), interest accrued on 9.5% of the outstanding principal amount of each Bond, from and including 31 March 2000 to but excluding the First Payment Date will be payable. Thereafter, interest on the outstanding principal amount of each Bond will be payable semi-annually in arrear on 31 March and 30 September in each year until maturity, commencing on 30 September 2000. Interest will be paid subject to and in accordance with the provisions of Condition 7.

Each Bond will cease to bear interest from each Principal Payment Date (as defined in Condition 6) on the portion of the outstanding principal amount of such Bond scheduled to be paid on such Principal Payment Date unless, after presentation and (in the case of the Final Principal Payment Date) surrender of such Bond, payment of principal is improperly withheld or refused, in which case the outstanding principal amount of such Bond will continue to bear interest in accordance with this Condition 5 (after as well as before judgement) until whichever is the earlier of (i) the day on which all sums due in respect of such Bond up to that day are received by or on behalf of the relevant Bondholder and (ii) the day which is seven days after notice has been given to the Bondholders that the Fiscal Agent has received all sums due in respect of the Bonds up to such seventh day (except, in the case of payment to the Fiscal Agent, to the extent that there is any subsequent default in payment in accordance with these Conditions).

If interest is required to be calculated for a period of less than 12 months, it will be calculated on the basis of a year of 360 days consisting of 12 months of 30 days each and, in the case of an incomplete month, the actual number of days elapsed.

6. Redemption, Purchase and Cancellation

(a) Redemption

Unless previously redeemed, or purchased and cancelled, each Bond will be redeemed on the First Payment Date and in nine subsequent semi-annual instalments on the dates set forth below (each, together with the First Payment Date, a "Principal Payment Date") commencing on 31 March 2006 in the amount (expressed as a percentage of the outstanding principal amount of each Bond on the date of issue without giving effect to the payment of principal made on that date) set forth below opposite such Principal Payment Date. Principal will be paid subject to and in accordance with Condition 7.

Principal Payment Date	Percentage
First Payment Date	9.500 per cent
31 March 2006...	10.055 per cent.
30 September 2006	10.055 per cent.
31 March 2007...	10.055 per cent.
30 September 2007	10.055 per cent.
31 March 2008...	10.055 per cent.
30 September 2008	10.055 per cent.
31 March 2009...	10.055 per cent.
30 September 2009	10.055 per cent.
31 March 2010...	remainder

(b) Purchase and Cancellation

The Russian Federation and its affiliates may at any time purchase Bonds in the open market or otherwise at any price. Any Bonds so purchased may be cancelled or held and resold (provided that such resale is outside the United States, as defined in Regulation S under the Securities Act). Any Bonds so cancelled will not be reissued.

7. Payments

(a) Principal

Payments of principal in respect of each Bond will be made by transfer to a U.S. dollar account maintained by the Bondholder with a bank in New York City or (i) if it does not have such a U.S. dollar account or (ii) the principal amount of Bonds held by such person is less than U.S.$250,000, by a U.S. dollar cheque drawn on a bank in New York City mailed to the registered address of the Bondholder by uninsured mail at the risk of the Bondholder. Such payment will be made only upon presentation and (in the case of final redemption) surrender of the relevant Bond Certificate at the specified office of any of the Paying Agents and will be rounded downwards, if necessary, to the nearest cent. For the purposes of this Condition 7(a) the holder of such Bond will be deemed to be the person shown as the holder (or the first-named of joint holders) on the Register at the Registrar's close of business on the fifteenth day before the due date for such payment of principal and the outstanding amount of each Bondholder's registered holding will be deemed to be the amount shown as such on the Register for such Bondholder at the same time on that date.

(b) Interest

Payments of interest (other than interest due on a Principal Payment Date) in respect of each Bond will be made by U.S. dollar cheque drawn on a bank in New York City and mailed to the holder (or to the first-named of joint holders) of such Bond at the address appearing in the Register not later than the due date for such payment and will be rounded downwards, if necessary, to the nearest cent. For the purposes of this Condition 7(b) the holder of such Bond will be deemed to be the person shown as the holder (or the first-named of joint holders) on the Register on the fifteenth day before the due date for such payment of interest.

Upon application by a Bondholder with respect to Bonds having a principal amount of U.S.$250,000 or more to the specified office of the Registrar not less than fifteen days before the due date for the payment of any interest (other than interest due on a Principal Payment Date) in respect of such Bonds, such payment will be made by transfer to a U.S. dollar account maintained by the payee with a bank in New York City. Any such application for transfer to a U.S. dollar account shall be deemed to relate to all future payments of interest (other than interest due on a Principal Payment Date) in respect of the Bonds which become payable to the Bondholder who has made the initial application until such time as the Registrar is notified in writing to the contrary by such Bondholder.

Payment of interest due on a Principal Payment Date will be made in the same manner as payment of the principal of a Bond.

(c) Payments Subject to Fiscal Laws

All payments of principal and interest in respect of the Bonds are subject in all cases to any applicable fiscal or other laws and regulations, but without prejudice to the provisions of Condition 8.

Consistent with the terms of Regulation No. BG-4-06/1n of 12 July 2000 approved by the Ministry of Taxes and Duties of the Russian Federation and agreed by the Ministry of Finance, Russian residents, other than physical persons, may not receive interest on the Bonds in any form.

The Regulations do not contain a definition of "Russian residents." Accordingly, it is unclear whether, for example, Russian branches and representative offices of foreign entities would be considered to be Russian residents for this purpose. See "Taxation – Russian Taxation."

(d) Commissions

No commissions or expenses shall be charged to the Bondholders in respect of any payments of principal or interest in respect of the Bonds.

(e) Payments on Business Days

Where payment is to be made by transfer to a U.S. dollar account, payment instructions (for value the due date or, if that is not a business day, for value the first following day which is a business day) will be initiated on the due date for payment or, if later, in the case of principal and interest due on redemption in whole or in part, on the business day on which the relevant Bond Certificate is presented and, in the case of a Final Principal Payment Date, surrendered at the specified office of any of the Paying Agents.

Where payment is to be made by cheque, the cheque will be mailed on the due date for payment or, if later, in the case of principal and interest due on redemption in whole or in part, on the business day on which the relevant Bond Certificate is presented and, in the case of a Final Principal Payment Date, surrendered at the specified office of any of the Paying Agents.

In these Conditions, "business day" means a day (other than a Saturday or Sunday) on which commercial banks are open for business in New York City and, in the case of the surrender of a Bond Certificate, in the place where the Bond Certificate is surrendered.

(f) Delay in Payments

Bondholders will not be entitled to any interest or other payment for any delay after the due date in receiving any amount due in respect of any Bond as a result of (i) the due date not being a business day, (ii) the Bondholder being late in presenting or surrendering its Bond Certificate (if required to do so) or (iii) a cheque mailed in accordance with this Condition 7 arriving after the due date for payment or being lost in the mail.

(g) Partial Payments

If at any time a partial payment is made in respect of any Bond, the Registrar shall endorse the Register with a statement indicating the amount and date of such payment.

(h) Agents

The initial Agents and their initial specified offices are listed below. Any of the Agents may resign in accordance with the provisions of the Fiscal Agency Agreement and the Russian Federation reserves the right at any time to vary or terminate the appointment of any Agent and appoint additional or other Agents, provided that while the Bonds are outstanding it will maintain (i) a Fiscal Agent, (ii) a Registrar and (iii) a Paying Agent and a Transfer Agent having a specified office in a major European city which will be in Luxembourg, so long as the Bonds are listed on the Luxembourg Stock Exchange and the rules of the Luxembourg Stock Exchange so require. Notice of any change in the Agents or their specified offices will promptly be given to the Bondholders in accordance with Condition 14.

8. Taxation

All payments of principal and interest in respect of the Bonds by the Russian Federation shall be made free and clear of, and without withholding or deduction for, any taxes, duties, assessments or governmental charges of whatever nature imposed, levied, collected, withheld or assessed by the Russian Federation or any political subdivision or any authority thereof or therein having power to tax (together, "Taxes"), unless such withholding or deduction is required by law. If at any time any Taxes are withheld or deducted, the Russian Federation shall increase the payment of principal or interest, as the case may be, to such amount as will result in the receipt by the Bondholders of such amounts as would have been received by them had no such withholding or deduction been required, except that no such increased amount shall be payable:

(a) to a holder, or to a third party on behalf of a holder, if such holder is liable to such Taxes by reason of having some connection with the Russian Federation other than the mere holding of a Bond or the receipt of payments thereunder; or

(b) if the Bond Certificate representing a Bond is presented and (in the case of final redemption) surrendered for payment more than 30 days after the Relevant Date, except to the extent that the holder would have been entitled to such additional amounts on presentation and (in the case of final redemption) surrender of such Bond Certificate for payment on the last day of such period of 30 days.

If, in relation to any payment under the Bonds (a "Payment") any Bondholder has received any increased amount as provided in this Condition 8, the Russian Federation shall have the right to retain any refund of any amount withheld or deducted in respect of such Payment, which refund may be available under a tax treaty or otherwise to such Bondholder. Notwithstanding the foregoing, no Bondholder makes any representation or warranty that the Russian Federation will be entitled to any such refund (or to make any claim in respect thereof) and no Bondholder shall incur any obligation with respect thereto (including, without limitation, incurring any expense or liability in connection therewith).

For the avoidance of doubt, the Russian Federation acknowledges that it shall have no right to make any deduction or withholding in respect of (nor will it purport to set off any amount equal to) any such refund from any payment in respect of any Bond.

In these Conditions, "Relevant Date" means whichever is the later of (i) the date on which the payment in question first becomes due and (ii) if the full amount payable has not been received in New York City by the Fiscal Agent on or prior to such due date, the date on which (the full amount having been so received) notice to that effect has been given to the Bondholders.

Any reference in these Conditions to principal or interest in respect of the Bonds shall be deemed to include any increased amounts which may be payable under this Condition 8.

9. Events of Default

If any of the following occurs and is continuing (each an "Event of Default") in respect of the Bonds, as applicable:

(a) Non-payment

The Russian Federation fails to pay any amount of principal or interest in respect of the Bonds, as the case may be, when due and such failure continues for a period of fifteen business days, provided, however, that it shall not constitute an Event of Default if interest is not paid to a Bondholder which is a Russian resident (other than a physical person) as contemplated in Condition 7(c); or

(b) Breach of other obligations or undertakings

The Russian Federation defaults in performance or observance of or compliance with any of its other obligations or undertakings in respect of the Bonds, as the case may be, which default (if capable of remedy) is not remedied within sixty days after written notice of such default shall have been given to the Russian Federation by any holder of the Bonds, as the case may be, it being understood that a default in respect of the undertaking set forth in Condition 4(a) shall be deemed capable of remedy for purposes hereof; or

(c) Cross-acceleration

Any other Public External Indebtedness shall become due and payable prior to the stated maturity thereof otherwise than at the option of the debtor following a default or the Russian Federation, the Government of the Russian Federation or the Ministry of Finance shall fail to make the final payment of principal in respect of any Public External Indebtedness on the date on which such final payment is due and payable or at the expiration of any grace period originally applicable thereto or, in the case of any guarantee which constitutes Public External Indebtedness, the underlying obligation in respect of which such guarantee has been given shall have become due and payable prior to the stated maturity thereof otherwise than at the option of the debtor following a default or the debtor shall have failed to make the final payment of principal in respect of such underlying obligation on the date on which such final payment is due and payable or at the expiration of any grace period originally applicable thereto and the guarantee shall not be honoured when due and called upon; provided that the aggregate amount of the relevant Public External Indebtedness in respect of which one or more of the events mentioned in this Condition 9(c) shall have occurred equals or exceeds U.S.$75,000,000 (or its equivalent in any other currency or currencies);and provided, further, that any secured Public External Indebtedness that by its terms is fully non-recourse to the Russian Federation, the Government of the Russian Federation or the Ministry of Finance shall not be counted as Public External Indebtedness for purposes of this Condition 9(c); or

(d) Moratorium

A moratorium on the payment of principal of, or interest on, all or any part of Public External Indebtedness; or

(e) Unlawfulness or Invalidity

The validity of the Bonds is contested by the Russian Federation or any agency or entity acting on behalf of the Russian Federation or the Russian Federation or any agency or entity acting on behalf of the Russian Federation shall deny any of the Russian Federation's obligations under the Bonds or it is or will become unlawful for the Russian Federation to perform or comply with any of its obligations under or in respect of the Bonds or under or in respect of the Fiscal Agency Agreement or any of such obligations shall be or become unenforceable or invalid; or

(f) IMF

The Russian Federation ceases to be a member of the IMF or eligible to use the general resources of the IMF pursuant to Article 26 of the IMF Articles of Agreement; or

(g) Consents etc.

Any regulation, decree, consent, approval, licence or other authority necessary to enable the Russian Federation to enter into or perform its obligations under the Bonds or under the Fiscal Agency Agreement or for the validity or enforceability thereof shall expire or be withheld, revoked or terminated or otherwise cease to remain in full force and effect or shall be modified in a manner which adversely affects any rights or claims of any of the holders of the Bonds, as the case may be, then holders of 25 per cent. or more in aggregate outstanding principal amount of the Bonds may declare the Bonds to be immediately due and payable whereupon the Bonds shall become immediately due and payable at their principal amount, together with accrued interest, without any further formality.

10. Prescription

Claims against the Russian Federation in respect of principal and interest shall become void unless made within a period of ten years, in the case of principal, and five years, in the case of interest, from the appropriate Relevant Date (as defined in Condition 8).

11. Replacement of Bond Certificates

If any Bond Certificate is lost, stolen, mutilated, defaced or destroyed, it may be replaced at the specified office of the Registrar or the Transfer Agent with its specified office in Luxembourg subject to all applicable laws and stock exchange requirements, upon payment by the claimant of the expenses incurred in connection with such replacement and on such terms as to evidence, security, indemnity and otherwise as the Russian Federation may reasonably require. Mutilated or defaced Bond Certificates must be surrendered before replacements will be issued.

12. Meetings of Bondholders, Modification and Waiver

(a) Meetings of Bondholders

The Fiscal Agency Agreement contains provisions for convening meetings of holders of Bonds to consider any matter affecting their interests, including the modification by Extraordinary Resolution of these Conditions. The quorum at any such meeting for passing an Extraordinary Resolution shall (subject as provided in the Fiscal Agency Agreement in the event that all Bonds for the time being outstanding are held by one person) be two or more persons holding or representing a clear majority of the principal amount of the Bonds for the time being outstanding, or at any adjourned meeting two or more persons being or representing holders of the Bonds whatever the principal amount for the time being outstanding so held or represented, except that at any meeting the business of which includes consideration of proposals, *inter alia*, (i) to modify the maturity of the Bonds, (ii) to reduce or cancel the principal amount of, or interest on, the Bonds, (iii) to change the currency of payment of the Bonds, (iv) to modify the provisions concerning the quorum required at any meeting of holders of the Bonds or the majority required to pass an Extraordinary Resolution or (v) to modify the percentage required to pass any resolution, the necessary quorum for passing an Extraordinary Resolution shall (subject as provided in the applicable Fiscal Agency Agreement in the event that all Bonds for the time being outstanding are held by one person) be two or more persons holding or representing not less than three-quarters, or at any adjourned such meeting not less than one-quarter, of the principal amount of the Bonds for the time being outstanding. An Extraordinary Resolution duly passed at any meeting of holders of the Bonds will be binding on all holders of the Bonds whether or not they are present at the meeting.

(b) Modification and waiver

The parties to the Fiscal Agency Agreement may agree, without the consent of the holders of the Bonds, to any modification of any provision of the Fiscal Agency Agreement or the Bonds which is of a formal, minor or technical nature or is made to correct a manifest error.

13. Further Issues

The Russian Federation shall be at liberty from time to time, without the consent of the holders of the Bonds, to create and issue further Bonds ranking equally in all respects (or in all respects save for payments made prior to the issuance of such further Bonds and, if applicable, the date and amount of the first payment on such further Bonds) so that the same shall be consolidated and form a single series with the Bonds.

14. Notices

Notices to the Bondholders will be sent to them by first class mail (airmail if overseas) at their respective addresses on the Register, and will be deemed to have been given on the fourth day after the date of mailing. So long as the Bonds are listed on the Luxembourg Stock Exchange and the rules of the Luxembourg Stock Exchange so require, notices with respect to the Bonds will also be published in a leading newspaper having general circulation in Luxembourg (which is expected to be the *d'Wort*) or, if such publication is not practicable, in an English language newspaper having general circulation in Europe, and each such notice shall be deemed to have been given on the date of such publication, or if published more than once or on different dates, on the first date on which publication is made.

A copy of all notices provided pursuant to this Condition 14 shall also be given to Euroclear and Clearstream.

15. Currency Indemnity

The U.S. dollar is the sole currency of account and payment for all sums payable by the Russian Federation under or in connection with the Bonds, including damages. Any amount received or recovered in a currency other than the U.S. dollar (whether as a result of, or the enforcement of, a judgement or order of a court of any jurisdiction or otherwise) by any Bondholder in respect of any sum expressed to be due to it from the Russian Federation shall only constitute a discharge to the Russian Federation to the extent of the U.S. dollar amount which the recipient is able to purchase with the amount so received or recovered in that other currency on the date of that receipt or recovery (or, if it is not practicable to make that purchase on that date, on the first date on which it is practicable to do so). If that U.S. dollar amount is less than the U.S. dollar amount expressed to be due to the recipient under any Bond, the Russian Federation shall indemnify such recipient against any loss sustained by it as a result. In any event, the Russian Federation shall indemnify the recipient against the cost of making any such purchase. These indemnities constitute separate and independent obligations from the Russian Federation's other obligations, shall give rise to a separate and independent cause of action, shall apply irrespective of any indulgence granted by any Bondholder and shall continue in full force and effect despite any judgement, order, claim or proof for a liquidated amount in respect of any sum due under any Bond or any judgement or order.

16. Governing Law

The Bonds and the Fiscal Agency Agreement shall be governed by and construed in accordance with the laws of England.

RUSSIAN FEDERATION

Territory, Population and Natural Resources

The Russian Federation, or Russia (Rossiya), is a sovereign and democratic federal state, consisting of 88 sub-federal political units, referred to as "Federation subjects." Russia is the largest country in the world, covering 17.1 million square kilometres, approximately one-eighth of the earth's land area. Russia borders 16 countries and spans 11 time zones, extending some 9,000 kilometres from the Baltic Sea in the west to the Pacific Ocean in the east and some 4,000 kilometres from its southern border on the Black and Caspian Seas to its northern limits on the Arctic Ocean. The European area of the country consists of a large plain west of the Ural Mountains, while the Asian portion is divided into Siberia, occupying the vast central region of the country, and the Russian Far East, which borders on the Pacific. Russia has the tallest mountain in Europe (Elbrus, in the Caucasus, at 5,642 metres), the largest lake in Europe (Ladoga, near St. Petersburg) and the world's deepest lake (Baikal, near Irkutsk).

Russia is home to approximately 143 million people (2.3% of the world's population at the beginning of 2005), ranks seventh in the world by population and has a population density of approximately 8.4 persons per square kilometre. Roughly 73% of the population live in European Russia, and approximately the same percentage of Russia's population live in cities. Russia's capital and largest city is Moscow with 10.4 million inhabitants. Other major cities include St. Petersburg, Novosibirsk, Nizhny Novgorod, Ekaterinburg and Samara. Eleven Russian cities have a population of more than one million residents, including three in the Ural Mountains and two in Siberia.

According to the most recent general census, conducted in 2002, ethnic Russians are the largest demographic group and account for approximately 80% of the total population. Other ethnic groups include Tatars (approximately 3.8% of the total population), Ukrainians (2.0%), Bashkirs (1.2%) and Chuvashs (1.1%). No other ethnic group accounts for more than 1% of Russia's total population.

Russia has a well-developed system of education, with a literacy rate exceeding 99%. Education is compulsory for those between the ages of seven and 15. The country has approximately 1,071 institutions of higher education, with 6.8 million students. Russia's labour force was estimated at 75 million people in August 2005. As of year-end 2004, over 99% of the labour force had at least eight years of schooling, 93% had at least ten years, 23.8% had received higher education and 43% had received professional training.

Russia is rich in natural resources. It is the world's leading producer of natural gas, the second-largest producer of oil and a significant producer of coal, uranium, nickel, palladium and platinum. The country also has substantial gold deposits (located mainly in Eastern Siberia and the Russian Far East) as well as significant deposits of zinc, lead, tin, silver, other rare metals and precious and semiprecious stones. Russia is among the world's leading producers of electricity, steel, fertilisers, cotton textiles and other goods. Forests cover approximately 51% of Russia's total land area and Russia's timber reserves, the largest of any country, are estimated at 82.1 billion cubic metres.

Russia and the Dissolution of the Soviet Union

From 1922 to 1991, Russia was the largest republic in the Union of Soviet Socialist Republics (the "Soviet Union"). For most of this period, the politics and economy of the Soviet Union were centralised under Communist rule. Beginning in 1985, Mikhail Gorbachev, the General Secretary of the Communist Party of the Soviet Union, led a movement to reform the Soviet political and economic system through the policies of openness (glasnost) and restructuring (perestroika). As a result of these policies, the Soviet Union greatly improved its relations with the West, effectively ending the Cold War, and as a result the Soviet press gained greater independence and public discussion became increasingly open and informed. At the same time, the leading role of the Communist Party as a matter of law was abolished.

General Secretary Gorbachev's economic reforms were mostly unsuccessful, however. The aim of *perestroika* was to revive economic growth through the introduction of market incentives within the framework of a planned economy. Despite a number of initiatives, the economy continued to decline and economic conditions deteriorated significantly in 1990 and 1991. This decline was mainly due to increases in social expenditures enacted by the Supreme Soviet, the Soviet Union's legislative body, and a jurisdictional dispute between Soviet and Russian authorities over the collection of taxes, causing central government revenues to decline. The resulting budget deficit reached approximately 20% of GDP in 1991. To cover this deficit, the Soviet Union resorted to short-term and uncoordinated foreign borrowing, the sale of virtually all of its gold and foreign exchange reserves and the increased printing of roubles. The increase in the money supply, combined with price controls on most products, led to excess money holdings, acute shortages of consumer goods and significant inflationary pressure (prices rose by 160% in 1991). Over the same period, output contracted and the Soviet Union fell into recession.

In 1990, Russia declared its sovereignty (though not its independence) and began to challenge the central Soviet government's authority. On 17 June 1991, Boris Yeltsin became Russia's first popularly elected president and he and the leaders of eight other Soviet Republics reached agreement with the central authorities on a new power sharing arrangement, known as the New Union Treaty. In August 1991, the imminent signing of the New Union Treaty provoked a coup attempt by Soviet hardliners. In the wake of the coup's failure, President Yeltsin banned the Communist Party of the Soviet Union within Russia.

On 8 December 1991, the Soviet Union was formally dissolved by the leaders of Russia, Ukraine and Belarus, the original signatories of the 1922 Union Treaty that had constituted the Soviet Union, and Russia became a fully independent state.

For some time after the dissolution of the Soviet Union, the division of authority between Russia's federal, executive and legislative branches was unclear. Beginning in the summer of 1992, the Supreme Soviet, elected during the Soviet Union, sought to assert its authority over Russia's economic policy, opposing the reform programme of the Russian Government. Support for the Government's programme was demonstrated in a national referendum in April 1993, in which a majority of voters voted in favour of continuing the reform process. In September 1993, relations between the Government and the Supreme Soviet reached an impasse. That month, President Yeltsin issued a decree dissolving the Supreme Soviet, prompting several of its members to occupy the Russian parliament building and call for an armed uprising. Within a short time, the occupation was ended with the assistance of Interior Ministry troops. A new Constitution was subsequently drafted by the office of the President and approved by a specially convened Constitutional Assembly. In December 1993, the new Constitution was adopted in a national referendum. On the same day, the first elections were held for the members of the State Duma, the lower house of Russia's legislature, known as the Federal Assembly.

Political System

Constitution

The Constitution of Russia provides for a tripartite governmental structure in which the power of the state is divided among the executive, legislative and judicial branches, each independent of the others. The Constitution also establishes a federal system, allocating responsibilities between federal, sub-federal and local authorities.

The Constitution protects certain fundamental "rights and freedoms of the person and the citizen," and charges the state with guaranteeing the equal treatment of people of all races, nationalities and beliefs. In contrast to the Soviet Union's constitution, which emphasised state property and the one-party system, under the Russian Constitution all forms of property (including private property) are equal before the law and ideological diversity and a multi party system are expressly recognised.

In general, the Constitution may be amended through passage of a special federal constitutional law, and its ratification by the legislatures of at least two-thirds of the Federation subjects. Passage of such a law requires the vote of a two-thirds majority of the State Duma, a three fourths majority of the Federation Council (the upper house of the Federal Assembly) and signature by the President. The provisions of the Constitution that govern the nature of the constitutional system, individual rights of citizens and the amendment process, however, can be changed only by convening a Constitutional Assembly. A proposed new constitution may be adopted either by the vote of a two-thirds majority of the Constitutional Assembly or by a simple majority in a national referendum in which more than half of the eligible voters participate.

Executive Branch

President

The President of the Russian Federation is Vladimir Putin. President Putin was initially appointed acting President upon the resignation of Boris Yeltsin in January 2000. President Putin was subsequently elected President in March 2000, receiving approximately 53% of the vote. President Putin was re-elected in an election held on 14 March 2004, when he received approximately 71% of the vote. See "—Political Parties, Recent Elections and Political Developments."

The President is the Head of State and the Supreme Commander of the Armed Forces. The President has broad powers, including the authority to declare a state of emergency, subject to approval of the Federation Council, the ability to commence military engagements, subject to immediate notification of the State Duma and Federation Council, the power to issue decrees and orders that have the force of law (although these may not contravene the Constitution or federal legislation), to suspend acts of sub-federal and local executive authorities, and to call national referenda. In addition, the President is empowered to arbitrate disputes between the federal authorities and the Federation subjects. The President is also responsible for foreign policy.

The President has the power to veto bills passed by the Federal Assembly and, under certain circumstances, to dissolve the State Duma. The President may dissolve the State Duma if (i) the State Duma fails to accept the President's proposed candidate for Prime Minister in three successive votes, (ii) the State Duma twice within three months passes a motion of no confidence in the Government or (iii) the Government loses a confidence motion put before the State Duma by the Prime Minister. The State Duma may not, however, be dissolved at any time during the last six months of a presidential term, during the period between passage by the State Duma of an accusation initiating impeachment proceedings against the President and action by the Federation Council on such accusation, while a state of emergency covering all of Russia is in effect, or, in the case of (ii) or (iii) above, within the first year after State Duma elections. In the event the State Duma is dissolved, the President must schedule elections and a newly elected State Duma must be convened within four months.

The President enjoys significant appointment powers, including the power to appoint the Prime Minister (with the consent of the State Duma) and the other members of the Government (upon the nomination of the Prime Minister). The President may also dismiss deputy prime ministers and federal ministers at any time and may dismiss the Prime Minister, which would simultaneously lead to a dismissal of the Government. In addition, the President nominates candidates for Governor of the Central Bank (for appointment by the State Duma), Prosecutor General (for appointment by the Federation Council) and judges to the Constitutional Court, the Supreme Court and the Supreme Arbitration Court (for appointment by the Federation Council). The President also has the power to dismiss the legislative and executive authorities of Federation subjects under certain circumstances. Beginning in December 2004, the President's powers were expanded to include nominating the heads of Federation subjects, who are now appointed by the legislatures of the relevant Federation subject and were previously elected by the residents of the relevant region. See "—Federal Structure and Regional Issues."

The President is elected in a national election for a term of four years. The Constitution provides for the early termination of the President's term of office in the event of the President's death, resignation, impeachment, or persistent inability to exercise his powers for health reasons. New presidential elections must be held within three months of an early termination. Impeachment of the President requires an accusation supported by the vote of a two-thirds majority of the State Duma, followed by a vote in favour of impeachment by a two-thirds majority of the Federation Council, with the subsequent confirmation by the Supreme Court of the legality of the accusation and by the Constitutional Court of the observance of due process. Under the Constitution, whenever the President is incapable for any reason of carrying out his duties, the obligations of the office are temporarily assumed by the Prime Minister, except that the Prime Minister, as acting President, may not dissolve the State Duma or propose any national referendum or changes to the Constitution.

Government

The Government consists of the Prime Minister, deputy prime ministers and federal ministers, all of whom are appointed by the President as described above. The Government is automatically dissolved after each presidential election in order to permit the President to form a new Government.

The Government is responsible for implementing federal laws, presidential decrees and international agreements. In particular, the Government is responsible for preparing and implementing the federal budget, establishing a unified financial, credit and monetary policy, carrying out social policy, preserving public order and defending the rights and freedoms of citizens.

Legislative Branch

The legislative branch consists of the Federal Assembly, which comprises a lower chamber, known as the State Duma, and an upper chamber, known as the Federation Council.

The State Duma consists of 450 deputies, elected for a four-year term by a mixed system of single mandate and proportional representation. Half the deputies are elected by majority vote in single mandate electoral districts. The other half are chosen from "party lists" on the basis of a nationwide election, with seats allocated in proportion to the number of votes received by the party. Only parties receiving 7% or more of the vote qualify for "party list" seats. "Party list" deputies are free to change their party affiliations during their term of office without the need for a new election. No person may simultaneously serve as a State Duma deputy and hold a position in the Government.

The Federation Council, with 178 deputies, represents Russia's 88 Federation subjects. See "Federal Structure and Regional Issues." Each Federation subject appoints two members of the Federation Council, one chosen by the legislative body of the Federation subject and the other by its executive body. The members of the Federation Council have to work on a full-time basis and cannot occupy any other office.

For a bill to become federal law, it must first be passed by a majority vote in the State Duma, be approved by a majority vote in the Federation Council and finally be signed by the President. Rejection of a bill by the Federation Council can be overridden by a two-thirds majority vote in the State Duma. Rejection of a bill by the President can be overridden by a two-thirds majority of each of the Federation Council and the State Duma.

Judicial Branch

Russia has three courts of final appeal. The Constitutional Court has jurisdiction over matters relating to the interpretation of the Constitution, including the constitutionality of federal laws, decrees of the President, resolutions of the Government, resolutions of the State Duma and the Federation Council, laws and legal documents of Federation subjects and agreements between federal and sub-federal authorities. The Supreme Arbitration Court and lower arbitration courts have jurisdiction over economic disputes. Judicial authority is otherwise vested in the Supreme Court and lower courts of general jurisdiction over civil, criminal, administrative and other matters.

Judges of the Constitutional Court, Supreme Court and Supreme Arbitration Court are nominated by the President and appointed by the Federation Council. Judges of lower federal courts are appointed by the President in accordance with procedures established by federal legislation.

Political Parties, Recent Elections and Political Developments

Under federal law, all Russian citizens who are at least 18 years old have the right to vote in presidential and State Duma elections as well as national referenda.

Russian legislation contains a number of provisions designed to encourage the development of a stable party system. First, candidates must collect a specified number of signatures to qualify for elections. In the case of presidential elections, a candidate must collect at least two million signatures in order to be placed on the ballot. A candidate for election to the State Duma must also obtain a specified number of signatures supporting their candidacy. The number varies depending on whether the candidate is running as an independent or a representative of a political party. Second, political parties must garner at least 7% of the votes in party list elections to qualify for seats in the State Duma. Third, the rules for presidential elections, which call for a run-off election between the first and second place candidates if no candidate wins a majority in the initial round of voting, discourage fragmentation of the vote.

In the most recent State Duma election, held in December 2003, the pro-Kremlin party, *Edinaya Rossiya* (United Russia), the product of the 2001 merger of two large centrist parties—Yedinstvo (Unity) and *Otechestvo-Vsya Rossiya* (Fatherland-All Russia)—received a plurality of the party-list votes cast (37.6%) and currently holds 310 State Duma seats. The Communist Party received 12.6% of the party-list votes cast in 2003 (down from 24.3% in 1999) and now holds 46 State Duma seats. Two other parties are also represented in the State Duma: the Liberal Democratic Party (11.5% of the party-list votes cast and a total of 35 seats) and *Rodina* (the National-Patriotic Union) (9.0% of the party-list votes cast and a total of 29 seats). Narodnaya Volya-SEPR, a new political party that split off from Rodina in July 2005, holds 12 seats. The remaining seats belong to deputies who are not affiliated with any political party.

The Federal Law on the Elections of Deputies of the State Duma, which will become effective in December 2006, will dramatically change the electoral system of the Russian Federation. Under the current system, half of the deputies are elected by majority vote in single mandate electoral districts and half chosen from party lists on the basis of a nationwide election. Under the new system, all deputies will be chosen from parties lists with seats allocated in proportion to the results of a nationwide election. Deputies will not be able to change party affiliations during the term of office without giving up their seats.

Following his initial election to the presidency in 2000, President Putin nominated Mikhail M. Kasyanov to serve as Prime Minister. On 24 February 2004, President Putin dismissed Mr. Kasyanov's government and appointed Deputy Prime Minister Viktor Khristenko as Acting Prime Minister. On 1 March 2004, President Putin appointed Mikhail Fradkov as Prime Minister. The State Duma approved Mr. Fradkov's appointment on 5 March 2004. Mr. Fradkov was reappointed Prime Minister following President Putin's re-election in March 2004. See "— Political System — Executive Branch — President" above.

Federal Structure and Regional Issues

Russia consists of 88 Federation subjects, comprising twenty-one republics, seven *krais*, forty-eight oblasts, two cities of federal importance (Moscow and St. Petersburg), one autonomous *oblast* and nine autonomous *okrugs*.

In an effort to accelerate socio-economic development through the combination of resources and the reduction of duplicative services, several Federation subjects have recently merged. On 1 December 2005, Perm Oblast and Komi-Permiatsky Autonomous Okrug merged into a new, single sub-federal unit, known as Perm Krai. In April 2005, the residents of Krasnoyarsk Krai, Evenki and Taimyr Autonomous Okrug approved a merger of the three territories. The Federal Assembly subsequently enacted a Federal Constitutional Law, scheduled to take effect on 1 January 2007, authorising the merger of the three territories into an enlarged Krasnoyarsk Krai.

In a referendum held on 23 October 2005, residents of the Kamchatka Oblast and the Koryak Autonomous Okrug approved the merger of these territories into Kamchatka Krai. In June 2006, the Duma approved a Federal Constitutional Law authorizing the creation of an enlarged Kamchatka Krai effective 1 July 2007.

On 16 April 2006, residents of Irkutsk Oblast and the Ust-Orda Buryat Autonomous Okrug approved by separate referendums the merger of these two regions into an enlarged Irkutsk Oblast.

All of the republics and autonomous regions contain a substantial number of ethnic non-Russians, with non-Russians constituting a majority in certain regions (e.g., the Republic of Tatarstan).

Federation subjects form the intermediate level of government, and are further subdivided into approximately 11,700 municipalities, comprising cities or geographically separated county territories *(raions)*.

Lower-level governments at the county *(raion)*, city and village levels are subordinate to their respective Federation subjects.

Throughout its history, Russia has generally been a unitary state with a single central government. Since the dissolution of the Soviet Union, however, Federation subjects have obtained greater decision-making authority and financial autonomy, and Russia is now a federal state.

The Federation Treaty of 31 March 1992, signed by 87 Federation subjects (all but the Chechen Republic and the Republic of Tatarstan), initially granted each Federation subject a measure of control over budgetary and external policy, as well as local natural resources. The Constitution subsequently refined the division of authority between Russia and the Federation subjects, expressly incorporating the provisions of the Federation Treaty to the extent they were not inconsistent with other provisions of the Constitution. Certain areas of governance are reserved by the Constitution exclusively to the federal authorities, including management of federal property, the issuance of currency and currency regulation, customs policy, foreign relations, military defence, atomic energy and space exploration. Joint federal-regional authority is prescribed in a number of other areas, including tax administration, ownership and use of land and natural resources, environmental protection, social assistance, education, health, science and cultural facilities, and the selection of certain court and law enforcement officials. Responsibility for all matters not reserved to the federal authorities or to joint federal-regional competence is reserved for Federation subjects. The Constitution prohibits any sub-federal barriers to the free movement of goods, capital and labour throughout Russia.

In May 2000, President Putin signed a presidential decree creating seven federal circuits, each comprising several Federation subjects, and authorising the President to appoint a representative to each federal circuit. The representatives' responsibilities include facilitating the implementation of the President's domestic and foreign policies, supervising the implementation of federal decisions in the Federation subjects and reporting to the President on the state of affairs in the Federation subjects.

In August 2000, a law aimed at improving management of the Federation subjects and lower-level authorities came into effect. The law grants the President the power to dismiss the chief legislative and executive authorities of a Federation subject if the authorities refuse to repeal local legislation held by a court to be contrary to the Constitution or federal law and harmful to the fundamental rights and freedoms of Russian citizens or that prevent federal authorities from performing their statutory functions.

A new law abolishing the direct election of executives of the Federation subjects was adopted in December 2004. Under this law, the President may nominate and dismiss the executives of a Federation subject, but Presidential nominations must still be approved by the Federation subject's legislative body. This law was intended to strengthen central control of the country and to combat terrorism.

In general, disputes between the federal authorities and Federation subjects have been resolved peacefully through the political process, with the notable exception of the military confrontation in the Chechen Republic.

International Relations

Russia's Position in the International Community

Russia has been recognised by the international community as the successor to the Soviet Union and maintains diplomatic relations with 186 countries. Russia is currently a member of many international organisations, including the United Nations, where it is a permanent member of the Security Council and, accordingly, plays an active role in maintaining international peace and security.

Russia is a member of the "G-8" group of industrial nations and is chairing that group in 2006. Since 1992, Russia has been a member of the International Monetary Fund ("IMF") and the International Bank for Reconstruction and Development (the "World Bank"). See "Public Debt—Relations with International Financial Institutions." Russia is also a member of the International Finance Corporation and participates as a donor in the International Development Association. In December 1996, the Central Bank of the Russian Federation (the

"Central Bank") became a member of the Bank for International Settlements, and in September 1997 Russia became a member of the Paris Club of creditor nations.

In December 1994, Russia applied for membership in the World Trade Organisation (the "WTO"). The Government has placed a high priority on joining the WTO, in part because entry into the WTO would allow Russia to use the organisation's procedures to combat discrimination against Russian producers and exporters, which the Government believes has had a negative effect on Russian exports. In 2002, both the European Union (the "EU") and the United States recognised Russia as a "market economy." Russia has concluded agreements on its accession to the WTO with all but one WTO member. Russia expects to achieve full membership in the WTO during 2007.

In 1994, Russia concluded a Declaration on Cooperation with the Organisation for Economic Cooperation and Development (the "OECD"), which granted Russia observer status in the 13 working groups and 11 committees of the OECD. In May 1996, Russia formally applied for membership in the OECD and, in 1997, a committee on relations between Russia and the OECD was established.

In 1997, President Yeltsin and the leaders of 16 NATO nations signed the "Founding Act on Mutual Cooperation," establishing new principles to govern their relationship and providing for consultation between Russia and NATO. In December 2001, Russia and NATO agreed upon a process aimed at enhancing future cooperation and in May 2002 agreed to work together to fight terrorism and to curtail the spread of nuclear, chemical and biological weapons. Russia and NATO have also agreed to cooperate in the areas of missile defence, arms control, peacekeeping, civil defence and maritime search-and-rescue. In May 2002, a NATO-Russia Council was established, enhancing political contacts and cooperation between Russia and NATO members.

Russia and Regional Cooperation

Russia has wide-ranging contacts with the EU, its most significant trading partner. The Agreement on Partnership and Cooperation between Russia and the EU, in effect since December 1997, was amended in April 2004 to allow new EU members to accede to it. The agreement establishes a framework for the parties' economic and political relationship.

The strategic cooperation between Russia and the EU is realised through ongoing political dialogue and collaboration within international organisations. Since May 2003, the EU and Russia have arranged three Russia-EU summits to discuss integration in four areas of common interest: economy, freedom and justice, foreign policy and security, and research, education and culture. At the May 2005 summit, a "road map" for each area of common interest was developed setting out the parties' plan for further integration.

Russia is a member of the European Bank for Reconstruction and Development (the "EBRD") and the Black Sea Bank for Trade and Development. Russia also participates in a number of regional cooperation forums, including the Council of Barents/Euroarctic Regions, the Council of Baltic Sea States and the Black Sea Economic Cooperation Council.

Russia participates in working meetings of the Association of South-East Asian Nations and participates as an observer in working meetings of the Asian Development Bank. Russia became a member of the Council on Pacific Economic Cooperation in 1992, the Pacific Economic Council in 1994 and the Asian Pacific Economic Cooperation Forum in 1976.

Russia, the Former Soviet Union and the CIS

After the dissolution of the Soviet Union, Russia concluded separate agreements ("zero-option agreements") with all of the other republics of the former Soviet Union except the three Baltic republics. All of the zero-option agreements have been mutually ratified, except the agreement with Ukraine, which has not yet been ratified by Ukraine. Each zero-option agreement provides that, as between Russia and the other former Soviet republic, Russia is responsible for virtually all the external debt contracted on behalf of the authorities of the former Soviet Union and receives in return all claims on former Soviet Union assets located outside the territory of the other former Soviet republic. The Government has since regularized its relations with virtually all the external creditors of the former Soviet Union, and has agreed to a schedule for the repayment of former Soviet Union debt that is consistent with the Government's capacity to service that debt.

In April 1996, the Government entered into an agreement rescheduling approximately U.S.$33 billion of indebtedness to the Paris Club of official creditors. In August 1999, the Government concluded a further rescheduling agreement providing for the deferral of approximately U.S.$8.3 billion of indebtedness to Paris Club creditors. In the summer of 2005, Russia prepaid U.S.$15 billion of its Paris Club indebtedness. In August 2006, Russia prepaid the remaining U.S.$22.7 billion owed to its Paris Club creditors.

In December 1997, Vnesheconombank restructured the Soviet-era debt owed to the London Club of commercial creditors. In the wake of the events of 17 August 1998, Russia, Vnesheconombank and a committee of London Club creditors agreed, in February 2000, on terms for the further restructuring of Vnesheconombank's London Club debt. The agreed restructuring terms were implemented through an exchange offer in August 2000. In December 2002, Russia restructured most of the Soviet-era debt owed to uninsured trade creditors, and in March 2004 Russia restructured most of the Soviet-era debts owed by Vnesheconombank to the International Bank for Economic Co-operation ("IBEC") and to the International Investment Bank ("IIB"). See "Public Debt—External Debt Restructuring" for a further discussion of Russia's indebtedness to the Paris Club, the London Club, Soviet-era uninsured trade creditors, IBEC and the IIB.

All of the former Soviet Union republics except the Baltic states constitute the Commonwealth of Independent States (the "CIS"), which promotes mutual cooperation among its members. In 1993, an Agreement on the Establishment of an Economic Union was signed by all the CIS countries and the CIS Interstate Bank was established by the CIS member governments and Central banks. The CIS Interstate Bank's main goals include facilitating multilateral settlements among CIS national central banks and providing financing for interstate projects.

In 1995, a customs union agreement was concluded between Russia, Belarus and Kazakhstan. Kyrgyzstan joined this customs union in 1996 and Tajikistan in 1999. In 1999, all of the member countries signed a treaty creating a customs union and a common economic territory, and in 2000 a treaty concerning the creation of a Euroasian economic community. In September 2003, Russia, Belarus, Kazakhstan and Ukraine signed an agreement on the creation of a single economic space.

Since 1996, Russia and Belarus have pursued closer economic and political integration. In December 1999, Russia and Belarus signed a treaty on the creation of a unified state and a programme for its implementation. Under the treaty, Russia and Belarus are to preserve their independence and sovereignty, while developing a single economic space, joint social policies and coordinated foreign and defence policies. Amendments to the laws of Russia or Belarus may be necessary to fully implement this treaty. A draft constitution for the two countries was approved in April 2003, which envisaged the unification of Belarus and Russia's tax and social welfare systems, and provided Belarus the option to adopt the Russian rouble.

In June 1997, Russia and Ukraine entered into agreements which, among other things, resolved questions relating to the division of the Black Sea fleet and the status of the city of Sevastopol on the Crimean peninsula. In October 2001, Russia and Ukraine entered into a separate agreement providing for the settlement of the indebtedness of NAK Naftogaz Ukrainy, the Ukrainian state owned oil and gas company, to Gazprom, the Russian state owned gas company, for previously delivered natural gas. The agreement also contains provisions governing the transit of Russian natural gas through Ukrainian territory. On 15 June 2001, Russia, China, Kazakhstan, Kyrgyzstan, Tajikistan and Uzbekistan signed a declaration on the creation of the Shanghai Co-operation Organisation (SCO). The aims of the SCO are the strengthening of mutual confidence and friendship between the member-countries, encouragement of effective cooperation in different fields, and joint efforts in maintaining and ensuring peace, security and stability in the region.

THE RUSSIAN ECONOMY

Overview of Economic Reforms

Russia's initial economic reform programme, first outlined by President Yeltsin in October 1991, set out to achieve three principal goals: liberalisation, privatisation and financial stabilisation.

Liberalisation of the Russian economy required a fundamental redefinition of the role of the state, which had in the Soviet era regulated virtually all economic and financial activities. The subsequent liberalisation of most prices has permitted market forces to determine prices to a significant extent and to play an increased role in the allocation of resources and output. At present, only certain public services and legislatively defined "natural monopolies" (for example, pipeline transport of oil and gas, household and industrial natural gas supply, electricity transmission and supply, railway transport, terminal, port and airport services, and postal services) are subject to price regulation. Internationally, liberalisation of Russia's trade regime has helped redirect trade flows away from historically important former socialist markets towards OECD countries and developing nations, and contributed to an overall rise in exports. See "Balance of Payments and Foreign Trade—Foreign Trade."

Beginning in January 1992, the Government implemented a privatisation programme, made possible by the legal recognition of private property and the creation of an economic and legal environment more conducive to the development of private economic activity. In 2004, wholly state-owned or municipal enterprises accounted for only a small portion of output in the major sectors of the economy: 8% of industrial output, 7% of construction and 3% of retail trade.

Russia's economic programme came under severe pressure in the second half of 1997 and the first half of 1998, following the Asian currency and financial crisis and a sharp fall in world prices for oil and other commodities, which adversely affected the Government's ability to continue to finance its budget deficit and to maintain the value of the rouble against the U.S. dollar. See "Public Debt – The Events of August 1998."

In 2004, the responsibilities of Federal Governmental structures were reformed. A new three-tiered system of federal executive bodies was established, which assigned responsibility to federal ministries for the elaboration of state policy and legal regulation, to federal services for the supervision, control and protection of state security and state borders, and to federal agencies for the provision of public services and the management of state property and law enforcement (other than supervision and control).

In January 2006, the Government adopted a new Medium-Term Program for the period 2006-2008. The principal priorities of the program are improving the investment climate, diversifying the economy, modernising the industrial sector; reducing Government involvement in the economy, stimulating Russian innovation, developing the housing and mortgage markets and improving the quality of the healthcare and education systems.

Civil and Commercial Law

Since 1992, Russia has sought to establish a legal framework for economic relations between independent legal persons and entities. The rule of law in Russia nonetheless continues to be undermined by the recent nature of much of Russian legislation, persistent gaps in that legislation, inconsistencies between legal norms at the federal level as well as between norms at the federal and regional levels, the significant degree of discretion given to state officials in many areas and the inexperience of some Russian judges and their susceptibility to outside influences, especially at the regional and local levels.

The Constitution protects the right of Russian citizens to hold private property. Property rights and basic rules for commercial relations are set out in Russia's Civil Code (the "Civil Code"). Part I of the Civil Code, passed in 1994, establishes the principles of contract and property law. The Civil Code also specifies the forms that private enterprises may take, including corporations, partnerships and limited liability companies. Part II of the Civil Code, passed in 1996, regulates particular types of contractual relationships, including sales contracts, leases, credit agreements and insurance policies. The third and final part of the Civil Code came into effect in 2002 and covers inheritance law and private international law.

The Land Code regulates the ownership of non-agricultural real estate and establishes general principles of private land ownership. The law in this area remains incomplete, however, and there are many local rules and standards that limit the purchase and ownership of land. As a result, private ownership of land is not widespread in Russia and an active land market has not yet developed. According to the Federal Law on the Enactment of the Land Code, enacted in 2001, legal entities that are currently using their land based on the right of permanent (perpetual) use are required to purchase or lease their land before 1 January 2008. The Land Code does not cover agricultural land, which is instead regulated by the Federal Law on the Circulation of Agricultural Land. This law creates a unified market framework at the federal level for the purchase and sale of farmland. Under the agricultural law, foreigners are not allowed to purchase farmland.

The Law on Joint-Stock Companies came into effect in 1996 and was subsequently amended in 2001 and 2004. The Law on Joint-Stock Companies sets forth the basic framework for corporate organisation and corporate governance, including the formation of companies, shareholder rights and liabilities, the role of directors, interested party transactions, mergers and acquisitions and share capital and dividends. The Law on the Securities Market, adopted in 1996 and subsequently amended, regulates the issuance and circulation of securities. Pursuant to this law, companies that issue securities must, with limited exceptions, register the issuance by filing a prospectus and publicly reporting certain information on a quarterly basis. The law also regulates the activities of professional participants in the securities market and aims to strengthen the protection of investors by imposing rules on market professionals.

The current bankruptcy law came into effect in November 2002, replacing the prior law adopted in 1998. The bankruptcy law provides basic rules for declaring an enterprise bankrupt, for managing and liquidating an enterprise after it has been declared bankrupt, for satisfying creditors' claims and for the bankruptcy process generally. The bankruptcy law permits an enterprise to be declared bankrupt if it is unable to make payments to its creditors (including tax authorities) in excess of 100,000 roubles within three months of such payments becoming due. The bankruptcy law also expands the types of legal entities that are subject to the bankruptcy law and clarifies the procedure for appointing managers of bankrupt enterprises and for initiating insolvency proceedings.

The legislative framework for the restructuring of banks is set out in the Law on Insolvency (Bankruptcy) of Credit Institutions, adopted in February 1999 and subsequently amended between 2001 and 2004. This legislation details the standards for the appointment by the Central Bank of temporary bank administrators, provides an expedited liquidation procedure for banks and gives the Central Bank the power to licence the receivers of bankrupt banks and to propose receivers for approval by arbitration courts.

Under Russia's Foreign Investment Law, adopted in July 1999, foreign investors are ensured equal treatment with domestic investors, with some exceptions in the area of land ownership and leasing, access to natural resources and participation in privatisations. The law provides protections against nationalisation and expropriation without compensation, ensures the free transfer of investment proceeds in foreign currency and the reinvestment of profits in local currency, and provides recourse to Russian courts.

Russia has a competition and anti-monopoly law under which enterprises with a market share exceeding 35% may be, and enterprises with a share exceeding 65% must be, entered in a register of monopolistic enterprises maintained by the Federal Antimonopoly Service (the "FAS"). The FAS replaced the Ministry for Antimonopoly Policy in this role as part of administrative reforms adopted in March 2004. The FAS is authorised to employ a variety of means to restrain anti-competitive behaviour, and can in extreme cases compel the break-up of enterprises. FAS consent is required for any acquisition of 20% or more of the voting stock of any commercial entity with total assets above a specified threshold and for any merger or acquisition that would lead to the creation of a monopoly enterprise.

A new Customs Code took effect in January 2004. The new Code seeks to reduce the volume of required documentation and to shorten customs clearance times, reflecting a shift in policy to a focus on developing foreign economic activity. These laws strive to bring current legislation into line with international standards.

In an attempt to maximise value and increase the efficiency of state assets, a law on concession agreements, enacted in July 2005, establishes a framework for the Government to transfer the management of state-owned property to private companies for a period of 99 years.

A law on special economic zones in the Russian Federation, adopted in July 2005, aims to create technical, industrial and production zones. Commercial and industrial residents of these zones will enjoy reductions in property and land tax, and import duties. They will also benefit from greater depreciation allowances, and will be permitted to write-off research and development costs to future periods without limitation.

Gross Domestic Product

The following table sets forth certain information regarding Russia's gross domestic product ("GDP") for the years 2001 to 2005:

Gross Domestic Product(1)

	2001	**2002**	**2003**	**2004**	**2005(2)**
Nominal GDP (billions of roubles)	8,944	10,818	13,201	16,779	21,598
At official exchange rate (U.S.$ billions)	306.3	344.5	430.0	582.6	763.2
Real GDP as compared to 2000 (%)	105.1	110.0	118.1	126.5	134.5
Nominal GDP per capita (roubles)	61,429	74,607	91,546	116,927	151,246
At official exchange rate (U.S.$)	2,104	2,376	2,982	4,060	5,344
Real GDP as compared to 2000 (%)	105.6	111.0	119.8	128.9	137.8
GDP deflator (%)	16.5	15.5	13.7	18.7	21.0
Memo:					
Official exchange rate, rouble/U.S.$, average	29.2	31.4	30.7	28.8	28.3
Total population, millions (end of period)	145.6	145.0	144.2	143.5	142.8

Notes:
(1) Certain data presented in this table differ from previously published data due to regular revisions by Goskomstat.
(2) This data is based on a newly established classifier, and is therefore not fully comparable with annual data.
Source: Goskomstat, Central Bank.

Russia has experienced significant economic growth since 2000. Real GDP growth from 2001 through 2005 amounted to 34.5%, including a 6.4% increase in 2005 compared to 2004.

The initial impetus for growth in this period was provided by the devaluation of the rouble against most major currencies following the events of 17 August 1998. This devaluation improved the competitiveness of Russian products, resulting in increased export volumes and import substitution. Economic growth and recovery was also supported by a decrease in barter and other non-monetary transactions. See "Public Debt – The Events of August 1998."

Economic growth has continued since 1999, resulting primarily from improved labour productivity due to increased investment and improved management. Average annual productivity growth from 2001 to 2005 was 5.0%. This growth was aided significantly by increases in international commodity prices, which constitute a significant proportion of Russia's exports. Increased export proceeds also contributed to expanding domestic demand (both consumer and investment). Government spending was a less significant contributor to GDP in this period, as the Government pursued a generally conservative fiscal policy with limited budget expenditures. See "Public Finance."

Strong real appreciation of the rouble and production growth led to an aggregate increase in the U.S. dollar value of Russia's GDP of 194% between 2001 and 2005, an average annual increase of 18%.

GDP by Source

The following table illustrates Russia's GDP by source for the years 2000 to 2004:

Gross Domestic Product by Source[1]

	2000		2001		2002		2003		2004	
	(%)	**% change[2]**	**(%)**	**% change[2]**	**(%)**	**% change[2]**	**(%)**	**% change[2]**	**(%)**	**% change[2]**
GDP total	**100.0**	**10.0**	**100.0**	**5.1**	**100.0**	**4.7**	**100.0**	**7.3**	**100.0**	**7.1**
Non-service sector	**45.0**	**12.4**	**43.1**	**6.5**	**40.7**	**3.6**	**40.3**	**8.2**	**41.1**	**6.3**
Industry	31.4	11.1	28.3	4.9	27.2	4.0	26.7	7.5	27.9	6.1
Agriculture	6.4	12.7	6.6	11.4	5.7	2.9	5.4	5.7	5.0	2.9
Construction	6.6	17.4	7.4	9.9	6.9	2.8	7.2	14.3	7.2	10.2
Services	**55.0**	**6.9**	**56.9**	**3.6**	**59.3**	**5.6**	**59.7**	**6.9**	**58.9**	**7.9**
Market services	**46.6**	**8.3**	**47.6**	**4.4**	**48.3**	**6.2**	**48.7**	**7.4**	**48.4**	**8.7**
Transportation and Communications	9.0	6.1	9.0	5.7	9.0	5.8	8.9	8.7	8.6	9.5
Trade, distribution and Catering	23.7	12.1	22.3	3.9	22.1	8.2	22.2	10.9	21.9	10.1
Housing and communal services	2.2	(1.0)	2.3	(0.8)	2.5	(3.0)	2.7	(1.5)	2.4	(1.0)
Financial sector	1.4	(2.1)	2.5	27.4	3.1	10.2	3.4	12.3	3.7	9.6
Public services	**8.4**	**1.4**	**9.3**	**(0.6)**	**11.0**	**2.2**	**11.0**	**4.0**	**10.6**	**2.3**
Health care and social security	1.4	(0.2)	1.6	(0.9)	2.2	5.3	2.2	0.8	1.9	1.0
Education and culture	2.1	(0.7)	2.3	(0.2)	3.1	1.2	2.8	1.1	2.7	0.6
Fundamental sciences	0.1	2.7	0.1	0.1	0.1	(0.3)	0.1	(0.1)	0.1	(2.9)
Public administration and Defence	4.3	2.5	4.7	(1.2)	4.9	2.8	5.0	2.6	5.2	3.6

Notes:
(1) Certain data presented in this table differ from previously published data due to regular revisions by Goskomstat.
(2) In constant prices.
Source: Goskomstat.

The major trend in the composition of GDP by source in recent years has been an increase in the share of the service sector and a decrease in the share of non-service sectors, resulting primarily from the appreciation of the rouble and the general economic recovery following the 1998 crisis. This trend was reversed in 2004 due largely to significant increases in commodity prices. In 2004, services (most of which are provided domestically and paid for in roubles) accounted for 58.9% of GDP compared with 55.0% in 2000, while the non-service sectors (where a portion of production is exported and paid for in foreign currency) comprised 41.1% of GDP in 2004 compared to 45.0% in 2000.

Between 2000 and 2004, the contribution of public services to GDP increased, from 8.4% of GDP in 2000 to 10.6% in 2004, reflecting the general recovery of the economy. The contribution of market services to GDP increased from 46.6% in 2000 to 48.4% in 2004, due primarily to an acceleration of the financial sector.

These shifts in the composition of Russia's GDP resulted from changes in performance in real terms and from changes in relative prices. Between 2000 and 2004, the fastest growing sectors were the non-service (42.7%) and market service (40.1%) sectors, while public services increased by only 9.6% in real terms. During the same period, significant growth in real terms was recorded in all major non-service sectors: industry increased by 38.2%, agriculture by 40.5% and construction by 67.1%. Growth in real terms in market services was similar, with transportation and communications increasing by 41.3% and trade, distribution and catering by 53.8%.

In 2005, a new system for the classification of economic activity was introduced, rendering economic data reported by sector no longer comparable with economic data reported by sector for previous periods. The following table sets forth Russia's GDP by sources, classified in accordance with the new system of classification, for the years 2004 and 2005.

Gross Domestic Product by Source

	2004		**2005**	
	%	**% change(1)**	**%**	**% change(1)**
GDP total	**100.0**	**7.2**	**100.0**	**6.4**
Agriculture	5.6	3.0	5.0	1.1
Fishery	0.4	2.0	0.4	4.6
Mining	9.5	7.9	10.5	1.7
Manufactures	17.5	7.8	17.5	4.4
Production and supply of electricity, gas and water	3.5	2.1	3.4	1.0
Construction	5.5	10.2	5.7	9.7
Trade	20.7	9.8	20.5	12.4
Hotels and catering	0.9	3.0	0.9	15.6
Transportation and communications	11.1	10.5	10.2	6.2
Financial services	3.4	4.5	3.7	6.4
Rent and other operations with real estate	9.1	4.5	9.1	9.0
Public administration, defence, and mandatory social security	5.1	0.6	5.1	2.8
Education	2.7	1.2	2.6	1.9
Public health and social services	3.1	1.1	3.1	1.0
Communal and other services	2.0	18.4	2.1	7.7

Notes:
(1) In constant prices.
Source: Goskomstat.

The most significant change in the composition of GDP by source in 2005 compared to 2004 was the mining sector's contribution, which increased from 9.5% of GDP in 2004 to 10.5% of GDP in 2005, and the transportation and communications sector's contribution, which decreased from 11.1% of GDP in 2004 to 10.2% of GDP in 2005. The fastest rate of growth among Russia's large sectors was recorded in trade, which grew by 12.4% in 2005 compared to 2004; construction, which grew by 9.7% in 2005 compared to 2004; and real estate operations, which grew by 9.0% in 2005 compared to 2004.

GDP by Use

The following table illustrates Russia's GDP by use for the years 2001 to 2005.

Gross Domestic Product by Use(1)

	2001		2002		2003		2004		2005	
	(%)	% change[(2)]	(%)	% change[(2)]	(%)	% change[(2)]	(%)	% change[(2)]	(%)	% change[(2)]
GDP	**100.0**	**5.1**	**100.0**	**4.7**	**100.0**	**7.3**	**100.0**	**7.2**	**100.0**	**6.4**
Domestic demand	**87.4**	**9.1**	**89.2**	**4.6**	**88.7**	**7.8**	**87.5**	**9.5**	**86.3**	**9.3**
Consumption	**65.5**	**6.8**	**69.1**	**7.0**	**67.9**	**6.2**	**66.4**	**8.9**	**65.2**	**8.6**
Public	16.4	(0.8)	17.7	2.6	17.5	2.2	16.7	2.1	16.6	1.8
Private	49.2	9.3	51.3	8.3	50.4	7.4	49.7	11.3	48.5	10.9
Investment	**21.9**	**16.7**	**20.1**	**(2.6)**	**20.7**	**13.2**	**21.1**	**11.5**	**21.1**	**11.4**
Fixed assets	18.8	10.2	18.0	2.8	18.3	12.8	18.6	11.3	18.4	10.5
Inventory Accumulation	3.0	76.5	2.1	(33.7)	2.4	16.7	2.5	13.5	2.7	18.1
Net exports	**12.6**	**(13.2)**	**10.8**	**3.2**	**11.3**	**3.0**	**12.5**	**(9.6)**	**13.7**	**(13.7)**
Exports	36.7	4.2	35.4	10.3	35.1	12.5	35.0	11.8	35.5	6.3
Imports	24.1	18.7	24.5	14.6	23.7	17.7	22.6	22.0	21.8	17.3

Notes:
(1) Certain data presented in this table differ from previously published data due to regular revisions by Goskomstat.
(2) In constant prices.
Source: Goskomstat.

The composition of GDP by use was affected by shifts in price ratios, primarily attributable to the real appreciation of the rouble and international prices of Russia's primary exports, which resulted in an increase in the contribution of net exports from 12.6% of GDP in 2001 to 13.7% of GDP in 2005, and a decrease in the contribution of domestic demand from 87.4% in 2001 to 86.3% in 2005.

Domestic consumption's contribution to GDP grew from 65.5% in 2001 to 67.9% of GDP in 2003, but decreased to 65.2% of GDP in 2005. Both public and private consumption, at current prices, exhibited generally similar trends between 2001 and 2005, although they differed at constant prices. Private consumption rose in real terms by 56.8% between 2001 and 2005 while public consumption grew by 8.1% in real terms during the same period. The contribution to GDP made by public consumption increased from 16.4% of GDP in 2001 to 17.5% of GDP in 2003, but decreased to 16.6% of GDP in 2005. In each year from 2001 to 2005, public consumption, as a percentage of GDP, was significantly lower that its pre-August 1998 crisis levels. The contribution of private consumption to GDP increased from 49.2% of GDP in 2001 to 51.3% in 2002 before decreasing to 48.5% of GDP in 2005.

Between 2001 and 2005, gross investment grew by 59.8% in real terms, outpacing the overall growth rate of GDP during the same period. Despite the growth in gross investment during the 2001-2005 period, gross investment as a percentage of GDP decreased from 21.9% in 2001 to 21.1% in 2005. Fixed investment grew by 57.2% in real terms between 2001 and 2005, although its contribution to GDP decreased from 18.8% to 18.4% over the same period.

Between 2001 and 2005, real growth of exports and imports accelerated at a faster pace than overall GDP. During this period, the real value of exports grew by 53.7%, and the real value of imports grew by 129.1%; however, the contribution to GDP made by exports and imports contracted over this period primarily due to the real appreciation of the rouble. In 2005, exports accounted for 35.5% of GDP compared to 36.7% in 2001 and imports accounted for 21.8% of GDP compared to 24.1% in 2001. Net exports decreased in real terms by 28.0% between 2001 and 2005, but grew as a share of GDP from 12.6% of GDP to 13.7% of GDP.

Principal Sectors of the Economy

Industry

Russia is highly industrialised, with a large share of its industrial activity concentrated in heavy industry and chemicals. Russia is the world leader in natural gas extraction, is second in oil extraction, and produces significant amounts of electricity, iron, steel, rolled products, mineral fertilisers and coal. Manufacturing activity is heavily concentrated in machine building, including power equipment, transportation vehicles, oil and mining equipment, and food processing.

The Federal State Statistic Service has changed the format in which it presents information related to industrial output and GDP. Information related to Russian industrial output and GDP in this Prospectus is presented on the basis of new industrial sector classifications. Under the new industrial classifications, industrial output increased by 4.0% in 2005 compared with 2004.

The following table illustrates the structure of industrial output and period-on-period changes in real industrial output by sector for the years 2000 to 2004:

Industrial Output by Sector(1)

	2000		2001		2002		2003		2004	
	%	%change[(2)]	%	%change[(2)]	%	%change[(2)]	%	%change[(2)]	%	%change[(2)]
Total	**100.0**	**11.9**	**100.0**	**4.9**	**100.0**	**3.7**	**100.0**	**7.0**	**100.0**	**6.1**
Electricity	9.1	2.3	10.4	1.6	11.9	(0.7)	12.0	1.0	10.5	0.3
Fuel	20.3	4.9	19.7	6.1	19.9	7.0	18.5	9.3	21.4	7.1
Ferrous metallurgy	8.9	15.7	7.9	(0.2)	8.1	3.0	9.8	8.9	12.1	5.0
Non-ferrous metallurgy	10.1	15.2	8.4	4.9	7.7	6.0	7.4	6.2	7.2	3.6
Chemicals and petrochemicals	7.2	13.1	6.9	6.5	6.3	1.6	5.5	4.4	5.4	7.4
Machine building	19.0	20.0	20.3	7.2	20.1	2.0	19.9	9.4	18.6	11.7
Wood processing	4.6	13.4	4.4	2.6	4.4	2.4	4.2	1.5	3.8	3.0
Construction materials	2.8	13.1	3.1	5.5	3.1	3.0	3.1	6.4	2.9	5.3
Textiles	1.6	20.9	1.6	5.0	1.5	(3.4)	1.4	(2.3)	1.1	(7.5)
Food-processing	12.8	14.4	13.7	8.4	13.9	6.5	14.1	5.1	13.2	4.0
Other	3.6	—	3.6	—	3.1	—	4.1	—	1.3	—

Notes:
(1) Certain data presented in this table differ from previously published data due to regular revisions by Goskomstat.
(2) In constant prices.
Source: Goskomstat.

Industrial output grew in each year between 2000 and 2004, with overall real output growth equalling 38.2% over the period. This increase was due to the improved competitiveness of Russian products in both domestic and international markets resulting from the devaluation of the rouble in 1998, the positive effects of market mechanisms, which resulted themselves in improved management and growth in private investment, and strong global commodity prices.

Growth from 2000 through 2004 was recorded in all major industrial sectors. The greatest growth over the period was recorded in machine building (60.3%), food-processing (44.4%) and non-ferrous metallurgy (40.9%), as these industries benefited from strong investment and external demand. The weakest growth rate was recorded in electricity, reflecting energy savings practices and government-mandated price caps.

In 2004, Russia's total industrial output increased by 6.1% in real terms compared to 2003. Growth was recorded in most major industries, with machine building, food processing and fuels experiencing the highest growth rates. This acceleration was fuelled by an expansion of both domestic and foreign demand. The contraction in the textile sector's output in 2004 was largely due to a shift in demand to higher quality imported textiles.

In 2005, a new system for the classification of economic of activity was introduced, rendering economic data reported by sector no longer comparable with economic data reported by sector for previous periods. The following table sets forth the structure of Russia's industrial output and period-on-period changes in real industrial output by sector, classified in accordance with the new system of classification, for the years 2004 and 2005:

Industrial Output by Sector(1)

	2004		**2005**	
	%	**% change(2)**	**%**	**% change(2)**
Total	100.0	8.3	100.0	4.0
Mining	20.4	6.8	23.3	1.3
of which:				
Fuels	17.6	7.7	20.5	1.8
Other minerals	2.9	8.5	2.8	(3.2)
Manufactures	67.4	10.5	65.1	5.7
of which:				
Foods	12.5	4.4	11.4	4.4
Textiles and clothing	1.1	(4.0)	1.0	(1.5)
Leather and footwear	0.2	(0.6)	0.2	(2.7)
Wood products	1.1	8.7	1.1	4.5
Pulp, paper, and printing	2.3	5.1	2.4	1.2
Coke and oil products	7.2	2.4	7.9	5.4
Chemicals	5.2	6.6	5.3	2.6
Rubber and plastics	1.5	13.5	1.5	5.5
Other non-metal mineral products	3.0	8.4	3.4	3.5
Metals and metal products	15.4	3.9	14.3	5.7
Machines and equipment	3.8	21.1	3.6	(0.1)
Electrical equipment and electronics	3.8	34.5	3.6	20.7
Vehicles	6.8	11.5	6.3	6.0
Other manufactures	3.5	10.5	3.2	0.7
Production and supply of electricity, gas and water	12.2	1.3	11.6	1.2

Notes:
(1) Certain data presented in this table differ from previously published data due to regular revisions by Goskomstat.
(2) In constant prices.
Source: Goskomstat.

Growth in industrial production decelerated in 2005 in certain capital-intensive industries, as available industrial capacity became scarce. In 2005, the largest growth rates in output volumes were recorded in the electrical equipment and electronics sector, which grew by 20.7% compared to 2004; the vehicles sector, which grew by 6.0% compared to 2004; and the metals and metal products sector, which grew by 5.7% compared to 2004. The fuels mining sector increased its contribution to overall industrial output from 17.6% in 2004 to 20.5% in 2005, primarily due to a marked increase in international oil prices. Industrial sectors that reduced their contribution to overall industrial output between 2004 and 2005 included the foods, metals, and electricity, gas and water sectors, which decreased from 12.5% to 11.4%, from 15.4% to 14.3% and from 12.2% to 11.6%, respectively.

Energy

In 2004, energy accounted for approximately 32% of Russia's total industrial output and 57% of its exports. Approximately 41% of the energy produced by Russia is exported. In 2005, oil and petroleum products accounted for 47.7% of total exports, while natural gas accounted for 12.4%, coal for 1.5% and electricity less than 1%.

Domestic energy prices were heavily subsidised in the Soviet Union (amounting to only 10% to 20% of world market prices in 1992). By 1996, however, domestic energy prices had risen relative to other prices as a result of export liberalisation and the real appreciation of the rouble against foreign currencies. The devaluation of the rouble in 1998 led to a sharp fall in domestic energy prices in dollar terms. Despite a recovery in prices in subsequent years (for example, from January 2000 to December 2004, producer prices in the gas industry grew approximately 1.8 times faster than industrial prices generally), domestic prices for gas, electricity and crude oil remain lower than international prices. Domestic prices for petroleum products, however, are more similar to international prices after deducting export duties and transportation costs. Federal budget revenues and Russia's balance of payments are affected to a significant extent by world prices for oil and gas. See "Balance of Payments and Foreign Trade" and "Public Finance."

Oil and Natural Gas

Russian methodologies for calculating oil and gas reserves and Russian reserves classifications differ from standard international methodologies and classifications, in particular with respect to the manner and extent to which commercial factors affecting exploration, development and production are taken into account. Generally, Russian methodologies classify oil and gas deposits as reserves if such deposits are technically recoverable, even if the recovery of a portion of such reserves, using currently available technology, is uneconomic. In contrast, most international methodologies classify oil and gas deposits as reserves only if such deposits are economically extractable on the basis of existing technologies, prices and costs. Accordingly, the oil and gas reserves information contained in this prospectus is not comparable, and cannot be made comparable, to oil and gas reserves information provided on the basis of standard international methodologies and classifications. The oil and gas reserves information contained in this prospectus represents total "explored" reserves, consisting of oil and gas reserves in categories A, B and C1 of the Russian classification system.

Oil

Oil output declined significantly following the dissolution of the Soviet Union but has been growing in recent years. Output in 2005 was 470 million tonnes (approximately 12% of world output), an increase of 2.4% compared to the 459 million tonnes produced in 2004, but 17.4% lower than the peak output of 570 million tonnes recorded in 1988. Overall oil output increased by 45.1% between 2001 and 2005. Oil exports to non-CIS countries were 214 million tonnes in 2005, while exports to the CIS were 38 million tonnes.

Beginning in 1993, the state oil industry was split into several holding companies and operating subsidiaries. This resulted in the creation of a number of large vertically integrated oil groups, with each holding company managing and controlling a stake in many operating subsidiaries. The Government privatised its shareholdings in Slavneft (75%) and Lukoil (13.5%) between 2002 and 2003. In December 2004, a 76.79% stake in Yuganskneftegaz, the main production subsidiary of what was then Russia's largest oil company, Yukos, was sold at auction for $9.35 billion, in partial settlement of Yukos's tax obligations, to Baikalfinancegroup, which was in turn acquired by Rosneft, then a wholly state-owned entity. In July 2006, the Government privatised approximately 15% of its shareholdings in Rosneft as part of the company's initial public offering.

In 2005, three Yukos shareholders commenced an arbitration under the Energy Charter Treaty, which Russia has signed but has not ratified, seeking in aggregate approximately U.S.$33.1 billion as compensation for the Russian Federation's alleged breach of its treaty obligations.

Natural Gas

Russia's A, B and C1 natural gas reserves were estimated at 47 trillion cubic metres as of January 2004. Natural gas output has stabilised in recent years after declining immediately following the dissolution of the Soviet Union, increasing by 0.8% in 2005 as compared to 2004 and 9.2% overall in the period from 2001 to 2005. In 2005, total natural gas and oil gas was 636 billion cubic metres compared to 632 billion cubic metres in 2004. Approximately 204 billion cubic metres of natural gas were exported in 2005, with approximately 77% of exports going to non-CIS countries and the remainder to CIS countries.

Russia's natural gas industry is dominated by Gazprom, which has an effective monopoly on gas transmission, storage and export, and accounts for most of Russia's natural gas reserves and production. Approximately 38.4% of Gazprom's shares are owned directly by the Russian Government, although through its ownership of Gazprom's subsidiaries, the Government controls a majority stake in the Company. Gazprom holds production licences with respect to almost two-thirds of Russia's natural gas reserves, accounts for 92% of Russia's gas production (86% including oil gas) and owns and operates the Unified Gas Supply System, which includes approximately 152,800 kilometres of high pressure pipelines.

Coal

Russia had approximately 200 billion tonnes of coal reserves as at 1 January 2004. Since the dissolution of the Soviet Union, coal production has been negatively affected by a decrease in overall demand, a reduction in budgetary subsidies and under-investment. As a result, many mines are today inefficient. Russia adopted a four-stage rationalisation plan, supported by World Bank lending, for the restructuring of the coal industry and the gradual closure of inefficient and subsidised mines. These measures, together with growing demand, resulted in 15.5% growth of coal production between 2001 and 2005. Approximately 298 million tonnes of coal were produced in Russia in 2005, an increase of approximately 5.7% over 2004. Coal exports amounted to approximately 79.8 million tonnes in 2005, with the greatest volumes sold to customers in Japan, the United Kingdom, Turkey and Ukraine. The Government sold its holdings in Kuznetskugol, Kuzbassugol and Vostsibugol in 2001, as a result of which state-owned enterprises accounted for only 8% of total coal production in 2004.

Electricity

Russia's electricity output was 952 billion kWh in 2005, representing an increase of 8.7% since 2001 and 2.3% compared with 2004. In 2004, total Russian generating capacity was 217 MW, approximately 10% of which was attributable to nuclear power plants. Electricity is exported primarily to CIS countries, China, Finland, Latvia, Lithuania, Norway and China.

The Russian electricity industry was restructured in 1992 and split into RAO Unified Energy Systems ("UES"), 73 regional energy companies (energos), and a separate nuclear power industry operated since 2004 by the newly created Ministry of Industry and Energy, the successor to the Ministry of Atomic Energy, the Federal Service for Ecology, Technological and Nuclear Supervision and the Federal Agency for Nuclear Energy. UES is the largest producer of electricity in Russia, owning more than 70% of Russia's generating capacity, and is also the monopoly high voltage distributor and wholesale purchaser and seller of electricity. At year's end 2004, UES owned at least a 49% equity share in 78 of the 91 regional energy, retail, management and grid companies. The Russian Government owns approximately 53% of UES.

Legislation adopted in 2003 provides for the restructuring of UES and for the separation of UES' generation, transmission and distribution businesses. The legislation also mandates the creation of Government-controlled electricity companies responsible for managing the uniform electric network and distribution system, subject to a requirement to provide other electricity producers with equal access to the uniform network. The legislative programme had been partially implemented, with new Government-controlled companies formed and operating. Several regional energy companies have also been successfully restructured, with most of the successor companies having completed the state registration process. The restructuring of RAO UES is scheduled to be completed by 2008.

A wholesale electricity market was established in October 2003, accounting for between 5% and 15% of total Russian electricity production. This wholesale market is intended to serve as the basis for the creation of a competitive wholesale and retail electric power market.

Agriculture

Russia's agricultural sector has faced significant challenges in recent years, as major structural changes have been implemented under difficult conditions and agricultural commodity prices have fallen steeply. Since the dissolution of the Soviet Union, Government subsidies to the agricultural sector have decreased significantly, the state food purchasing monopoly has been replaced by a decentralised market system and the share of agricultural output purchased by the state has fallen steadily.

The agricultural sector consists primarily of large collective farms (estimated to account for approximately 74% of land under cultivation and 41% of agricultural output) and private plots, both urban and rural, worked by people who are part-time farmers (estimated to account for 8% of land under cultivation and 53% of agricultural output). Small farms account for the remainder of agricultural production and less than 5% of Russia's agricultural land is state-owned. The Law on the Circulation of Agricultural Land, which came into effect in January 2003, created a unified market framework at the federal level for the purchase and sale of farmland. It also prohibits the non-agricultural use of farmland, regulates the amount of farmland any one owner may hold and prohibits foreign ownership of farmland.

Agricultural output grew by 22.9% between 2000 and 2004, including by 3.1% in real terms in 2004. Under the new methodology used to calculate agricultural output introduced in 2005, real growth in the agriculture sector was 3.1% and 2.0% in 2004 and 2005, respectively. While Russia still imports substantial amounts of food and agricultural products, foodstuffs and agricultural products amounted to 1.9% of total exports in 2005.

Construction

The construction sector accounted for approximately 5.5% of GDP in 2004 and 5.7% of GDP in 2005. Following a steep decline after the dissolution of the Soviet Union, output in the construction industry has grown significantly in recent years. The construction sector grew 10.2% in 2004 and 9.7% in 2005, with overall growth of 56.1% between 2001 and 2005. New housing construction amounted to 43.6 million square metres in 2005, compared to 41.0 million square metres in 2004.

Transport and Communications

Russia has a well-developed railway network, a large merchant fleet, a large number of airports, well-developed municipal transport systems, a reasonably comprehensive road network and a major space industry. The market for the provision of transport and communication services has been liberalised and restructured, particularly in air transport, water transport and communications. Although investment in transport and communications has fallen in real terms since the dissolution of the Soviet Union, its share in total fixed investment has increased.

Railways

There are approximately 140,000 kilometres of railways in Russia, of which 61% are used for general passenger and freight transportation. Railways accounted for 84% of all freight transport in tonne-kilometres (excluding pipeline transport) and 43% of all passenger journeys in passenger-kilometres in 2005, making it the country's most important form of transport.

Tariffs for passenger transport are currently subsidised from railway freight revenues and are insufficient to cover total capital and operating costs. In the future, the railways will require a significant increase in investment to maintain track and replace rolling stock.

The Government has developed a three-stage programme of structural reforms in the railways sector. Key aspects of the first two stages, completed in early 2006, included separating control and management functions through the establishment of a state-owned joint-stock company, fostering the emergence of new independent companies to enhance competition and reducing cross-subsidies. The third stage, scheduled for completion by 2010, envisages the privatisation of state-owned companies in the railway sector.

Roads

There are approximately 871,000 kilometres of roads in Russia, 85% of which have hard surfaces. Some 74% of the hard-surface roads are in public use, 6% under federal and 68% under regional supervision. The rest of Russia's roads are supervised by particular agencies and generally link enterprises with the public road network. Prior to 2001, roads were financed by taxes earmarked for the Federal Road Fund and for road funds of Federation subjects. The Federal Road Fund was abolished in 2001. Roads falling under federal jurisdiction are now maintained by the Russian Government, while roads falling under the jurisdiction of Federation subjects are maintained by the Federation subjects in which they are located.

Ports and Shipping

Russia had 44 commercial seaports and 351 freight complexes with a total capacity of 230 million tonnes per year in 2003. In 2005, 48 billion tonne-kilometres of freight were transported by sea from Russian ports, representing 2.4% of Russia's total freight transport, (excluding pipeline transport). This represents an increase of 2% compared to the 47 billion tonnes-kilometres of freight transported in 2004, and reverses a decline in Russian commercial shipping caused by unfavourable tax conditions. In early 2006, a new federal law took effect that addresses this tax burden and is expected to encourage further growth. More than 79% of freight transported by sea from Russian ports was transported to international destinations in 2005.

Russia has over 1,000 river ports, providing access to Russia's 102,000 kilometres of navigable rivers. Because Russia lacks deep water ports, commercial shipments of oil to the United States and other distant locations are not currently economically attractive. Domestic water transport (via rivers, canals, lakes and combined river and sea navigation) accounted for 71 billion tonne-kilometres (3.5% of all freight, excluding pipeline transport) in 2005. Rivers play a particularly important role in northern and eastern Siberia, where in some areas they are the dominant means of freight transport.

Prior to 1991, each of Russia's commercial seaports was run by a shipping line, while ports were under central state control. By the end of 1995, the state had disposed of its controlling interest in the majority of ports and shipping companies.

Air Transport

Russia has 393 airports, 70 of which are international. Over the last five years, the number of Russian airports has decreased by 20% due to a decline in commercial air travel and the country's ageing fleet of aircraft. The largest international airports are located in Moscow and St. Petersburg. Air transport in 2005 accounted for 21.5% of total intercity domestic passenger traffic in passenger-kilometres.

The national airline, Aeroflot, was the monopoly carrier until 1991. Following the dissolution of the Soviet Union, Aeroflot was split into over 140 regional airlines and an international carrier, Aeroflot International Airlines. Most of the regional airlines were subsequently privatised. In 1995, Aeroflot International Airlines was partially privatised, although the state continues to own 51% of its shares. A number of new private Russian carriers have commenced domestic and international operations since 1991.

Pipelines

As of the end of 2005, Russia had 223,000 kilometres of trunk pipelines, consisting of 160,000 kilometres of natural gas pipelines, approximately 48,000 kilometres of oil pipelines and 16,000 kilometres of oil product pipelines. In 2005, a total of 2,474 billion tonne-kilometres of commodities were transported by pipeline, an increase of 2.5% compared with the previous year. The transmission capacity of Russia's pipelines to non-CIS countries is more than 170 million tonnes of crude oil and more than 140 billion cubic metres of natural gas per year.

Pipelines from major oil- and gas-producing areas in Russia are generally connected to pipelines in the CIS and former Soviet bloc countries. A number of significant new pipeline projects are planned or under construction. Gazprom is currently building new trunk pipelines (the "Yamal-Europe project") that will extend nearly 6,000 kilometres from the northern part of the Tyumen region of Russia through Belarus and Poland to Germany. Gazprom is also participating in the Northern-European pipeline construction, expected to extend 1,200 kilometres from Vyborg, Russia to Griefswald, Germany. Gazprom has also constructed a trunk pipeline to Turkey (the "Blue Stream project") that crosses the Black Sea, significantly increasing Russia's gas export capacity. Initial gas flows through the undersea portion of this pipeline commenced in December 2002, with the first commercial delivery to Turkey in February 2003. The Black Sea pipeline is expected to have an annual capacity of 16 billion cubic metres beginning in 2010.

New pipeline-related projects intended to increase the export capacity of the oil industry are also being implemented or planned in Europe and Asia, including the Baltic pipeline system, which connects West Siberia with a major new harbour at St. Petersburg, where inadequate tanker facilities have reduced pipeline through-put. The project was completed in 2006 and increased annual pipeline capacity to 65 million tonnes of crude oil. Other programmes currently under way include upgrading the Druzhba oil pipeline through Eastern Europe by constructing by-passes and extensions, and the construction of the East Siberia–Pacific ocean pipeline, which will have a capacity of 80 million tonnes and will extend from Taishet to Primorski Krai, connecting West and East Siberia with the Asia-Pacific region.

Over 70% of Russia's existing oil pipeline network has been in operation for at least 20 years and over 30% for more than 30 years. The gas pipeline network is also ageing. Repair and maintenance costs are accordingly high and increased by 17% in 2004 to more than $6,000 per kilometre of oil pipeline.

The crude oil and oil product trunk pipeline networks are owned and managed by state-owned monopolies, Transneft and Transnefteproduct, respectively. Transneft's pipeline capacity, including its export pipeline capacity, is allocated quarterly to oil producers, generally in proportion to the amount of oil produced and delivered to Transneft's pipeline network in the prior quarter. Generally, a Russian oil company is given an allocation for export to non-CIS countries equal to approximately one-third of its total crude oil so produced and delivered to Transneft. The gas trunk pipeline network is owned and managed by Gazprom.

Telecommunications

As of year-end 2004, there were 45.2 million telephone lines in Russia. It is estimated that the capacity of long distance (intercity) telephone lines increased by 59%, from 718,900 to 1,140,800, between 2000 to 2004. By the end of 2004, there were approximately 70 million mobile telephone subscribers in the 76 regions of Russia for which data was available, a 97.2% increase compared to 2003. The Government, law enforcement agencies, the military, the railways and other important public service providers use telecommunications systems that are separate from those that service the general population.

Russia's telecommunications industry was restructured in the early 1990s through the creation of Rostelekom and Svyazinvest. Rostelekom, founded in 1992 through the merger of 20 independent enterprises, is the monopoly provider of long distance (intercity) telecommunications in Russia, providing international services as well. The company was privatised in 1993, with 38% of its shares (representing the majority of the voting stock) subsequently transferred to Svyazinvest. Svyazinvest was established in 1994 as the holding company for majority voting interests in all of Russia's 85 regional telecommunications companies, and provides local telephone services.

In August 1997, a group of Russian and international investors acquired Svyazinvest shares representing 25% of its charter capital plus one vote.

In 2004, 18% of all telecommunications services were provided by public sector entities and 82% by other operators. There are currently nearly 9,000 domestic and several international operators active in Russia.

Environment

Environmental protection in Russia is primarily the responsibility of the Federal Service for Ecological, Technological and Atomic Supervision, which replaced the State Environment Committee in this role following a 2005 Government restructuring. Environmental regulations require enterprises to pay fees for emissions or discharges of most pollutants. These fees, which are low by international standards, may be used to fund investment to improve the environment. Russia's environmental protection programme has focused on replanting forests, constructing spent gas treatment plants, installing water recycling systems and constructing sewage purification plants. Total public and private sector investment in environmental protection in Russia during 2005 amounted to 0.4% of GDP. Federal expenditure to protect the environment and to address the effects of environmental catastrophes and natural disasters in 2005 amounted to approximately 0.1% of GDP and 0.8% of total non-interest expenditure for the year.

In November 2004, President Putin signed the Kyoto Protocol to the United Nations Framework Convention on Climate Change, which became effective in February 2005. Under the terms of the Kyoto Protocol, Russia is to maintain its emissions of greenhouse gases at a level no higher than the level prevalent in 1990. Due to the decrease in heavy industry following the collapse of the Soviet Union, Russia's current level of greenhouse emissions is approximately 30% less than its 1990 level.

Employment

Overall employment declined in Russia from the dissolution of the Soviet Union through 1998. The rise in export volumes and import substitution, beginning in 1999, led to a rise in employment. The rate of increase in employment was less than the rate of increase in real GDP, however, due to gains in productivity. The unemployment rate fell by 27.6% between 2001 and 2005. In 2005, 34.6% of all employees worked in the state sector, 57.6% in the private sector and 7.8% in enterprises with a mixed form of ownership.

The following table sets forth quarterly information regarding unemployment in Russia for the period from 2000 through 2005:

Unemployment at the End of Period[1]

	Official (ILO) definition unemployed[2]		Registered unemployed[3]		Registered jobseekers[4]	
	Million	% of labour force	Million	% of labour force	Million	% of labour force
2001						
First Quarter	6.8	9.5%	1.1	1.5%	1.3	1.8%
Second Quarter	6.1	8.5%	1.0	1.4%	1.2	1.6%
Third Quarter	6.2	8.6%	1.0	1.4%	1.2	1.7%
Fourth Quarter	6.2	8.6%	1.1	1.6%	1.3	1.8%
2002						
First Quarter	5.9	8.3%	1.3	1.90%	1.6	2.2%
Second Quarter	5.5	7.6%	1.3	1.8%	1.5	2.1%
Third Quarter	5.7	7.8%	1.3	1.8%	1.6	2.1%
Fourth Quarter	6.5	9.0%	1.5	2.1%	1.7	2.3%
2003						
First Quarter	6.6	9.2%	1.6	2.3%	1.9	2.6%
Second Quarter	6.0	8.4%	1.5	2.1%	1.7	2.4%
Third Quarter	6.0	8.2%	1.5	2.1%	1.7	2.3%
Fourth Quarter	6.3	8.6%	1.6	2.2%	1.8	2.5%
2004						
First Quarter	6.5	8.9%	1.7	2.3%	1.9	2.6%
Second Quarter	5.5	7.5%	1.6	2.1%	1.8	2.4%
Third Quarter	5.7	7.7%	1.6	2.2%	1.9	2.5%
Fourth Quarter	6.1	8.3%	1.9	2.6%	2.1	2.9%
2005						
First Quarter	5.8	8.0%	2.0	2.7%	2.2	3.1%
Second Quarter	5.4	7.3%	1.8	2.5%	2.0	2.7%
Third Quarter	5.4	7.3%	1.7	2.3%	1.9	2.6%
Fourth Quarter	5.7	7.6%	1.8	2.5%	2.0	2.7%

Notes:
(1) Certain data presented in this table differ from data previously made public due to regular revisions by Goskomstat.
(2) Based on survey data. Persons not working, looking for a job and ready to start work are counted as unemployed.
(3) Based on number of individuals who choose to register as unemployed with the Federal Employment Agency; registration is required as a condition of receiving unemployment benefits.
(4) Based on number of individuals who choose to register as seeking employment with the Federal Employment Agency.
Source: Goskomstat.

On the basis of International Labour Organisation ("ILO") definitions, there were 5.7 million unemployed people in Russia at the end of 2005 (7.6% of the labour force), slightly less than at the end of 2004 (6.1 million, or 8.3% of the labour force), and significantly less than the number of unemployed workers at the beginning of 2001 (7.1 million, or 9.9% of the labour force). This decline was primarily due to strong domestic demand and a positive economic outlook, which have resulted in increased employment. The ILO unemployment figures do not take into account certain "hidden unemployment" resulting from shortened workdays and temporary lay-offs. The total number of lay-off days for these two categories represented an additional 107,700 unemployed workers in 2005 and 130,600 unemployed workers in 2004.

Wages and Income

The sharp increase in consumer prices following the devaluation of the rouble in the second half of 1998 led to a significant decline in real wages. This trend has since reversed, with real wages increasing by 10.6% in 2004 and by 12.6% in 2005. Overall, real wages grew by 92.4% in real terms between 2001 and 2005, though total employee compensation (including wages and social contributions) remains below the level prevailing prior to August 1998.

The minimum wage has remained relatively low, amounting to just 8.6% of the average monthly wage in January 2006. The minimum wage, established by the State Duma, serves as a benchmark in setting the level of federal benefits and also plays a role in determining certain types of budget expenditures. The minimum wage was increased by 10% in October 2005, and further increased by 37.5% in May 2006.

Approximately 29% of the population had income below the official subsistence level in 2000. By 2004, this figure had declined to less than 15% due primarily to high and constant income growth, notwithstanding modifications to the official subsistence calculations in 2000, which raised the subsistence level by approximately 15% in real terms.

Organised labour does not play a prominent role in the Russian economy. Whereas nearly 100% of workers in the Soviet Union were unionised, far fewer Russian workers are now members of labour organisations.

Social Benefits and Expenditure

Social security reforms were introduced in Russia beginning in 1991, with new institutions founded to deliver social benefits, including unemployment insurance and benefits for the very poor. Social benefits amounted to 9.2% of GDP in 2002, 9.3% of GDP in 2003, 8.3% of GDP in 2004 and 8.0% of GDP in 2005.

Total social expenditure (other than housing subsidies) amounted to 19.3% of GDP in 2002, 17.1% of GDP in 2003, 16.3% of GDP in 2004 and 16.6% in 2005.

Prior to 2002, most social expenditure was provided through federal extra-budgetary funds or by sub-federal authorities. In 2002, 2003, 2004 and the first nine months of 2005, 51%, 48%, 47% and 48% of social expenditure was provided by extra-budgetary funds and 36%, 38%, 40% and 40% was provided by sub-federal authorities, respectively. Direct payments from the federal budget accounted for approximately 13% of social expenditure in each of 2002, 2003 and 2004, and 12% the first nine months of 2005. The extra-budgetary funds finance expenditure on health, certain social benefits and pensions. Sub-federal budgets finance housing and transportation subsidies, most education and health expenditures and certain social benefits, while the federal budget is responsible for a portion of the expenditure on education, health, culture and social benefits, and for financing the "basic component" of pensions, which accounts for a substantial portion of pension payments. See "Public Finance—2005 Federal Budget Law" and "—Pension Reform" below.

In 2004, the Government adopted several benefit-related fiscal measures that took effect in 2005. These measures eliminated unfunded benefit entitlements and replaced social privileges financed by the federal budget (e.g., free passenger transportation and free medical drugs) with targeted social benefits largely in the form of monthly cash compensation of between 50 roubles and 2,000 roubles, adjusted for inflation. This monetisation of federal social benefits is available to the disabled, World War II veterans, survivors of the siege of Leningrad, Chernobyl cleanup workers and heroes of the Soviet Union and Russia.

Decisions related to the eligibility for and the provision of social benefits and compensation to other groups is delegated to regional authorities. Regional beneficiaries include labour veterans, victims of Soviet-era political repression, people with dependent children and students. Most regional authorities have followed the Federal Government's approach and replaced a number of social privileges with cash compensation.

Pension Reform

Pension reform legislation was enacted in 2001 and a new social security system came into effect on 1 January 2002. Under the new system, a retiree's pension consists of a basic pension, an insurance pension and a funded pension.

The basic pension and the insurance pension are paid from current pension contributions on a 'pay-as-you-go' basis. The basic pension is funded from the federal budget and its size does not depend on past social security contributions. The insurance pension is funded from the State Pension Fund and varies depending on past contributions by the pensioner. The funded pension is based on the amount of funds accumulated in a pensioner's individual pension investment account. One half of overall pension contributions are transferred to the federal budget and earmarked to fund basic pensions. The other half goes to the State Pension Fund and is split between insurance and funded pensions, depending on the beneficiaries' year of birth. There is no funded pension for those born before 1966. For those born in 1966 or after, the share of contributions accumulated in personal accounts now equals 6% of the wage bill. The Pension Law envisages that the size of the basic and insurance pensions will be adjusted for inflation within the amount earmarked in the budget for the basic pension. Payments to pensioners from the funded pension will start in 2012. Prior to 2012, the funds allocated to the funded pension will be accumulated in personal accounts.

Contributions to the funded pension system are collected by the State Pension Fund and are managed by state and private trust companies, and private pension funds. According to the Law On Investments for Financing the Funded Part of Pensions, enacted in 2002, individuals may choose a private trust manager once a year from those selected on the basis of a public tender. The initial tender was held in September 2003, and 55 private trust companies were selected. Individuals were required to choose a trust manager by 31 December 2003, and funds were transferred to private trust companies in the beginning of 2004. Only a limited number of individuals chose private management companies, leaving most pension savings to be managed by Vnesheconombank ("VEB"), which was appointed as the State Trust Management Company. As the State Trust Management Company, VEB is responsible for the management of funds held by individuals who selected VEB as their pension fund manager, as well as funds held by those citizens who did not select a trust company. Private trust companies may invest pension funds in securities of Russian private and public issuers, rouble and foreign currency bank deposits, and shares in foreign securities index funds. VEB may also invest pension funds in rouble and foreign currency denominated government bonds, mortgage-backed bonds and bank deposits.

BALANCE OF PAYMENTS AND FOREIGN TRADE

Balance of Payments

The following table sets forth Russia's consolidated balance of payments for the years 2001 to 2005:

Consolidated Balance of Payments(1)(2)

	2001	2002	2003	2004	2005
Current account	33,935	29,116	35,410	58,592	83,558
Goods and non-factor services (nfs)	38,990	36,449	48,966	72,383	103,417
Export of goods & nfs	113,326	120,912	152,158	203,497	268,136
Import of goods & nfs	(74,336)	(84,463)	(103,192)	(131,114)	(164,718)
Trade balance	48,121	46,335	59,860	85,825	118,266
Exports of goods (fob)	101,884	107,301	135,929	183,207	243,569
Imports of goods (fob)	(53,764)	(60,966)	(76,070)	(97,382)	(125,303)
Non-factor services	(9,131)	(9,886)	(10,894)	(13,443)	(14,849)
Exports of services	11,441	13,611	16,229	20,290	24,566
Imports of services	(20,572)	(23,497)	(27,122)	(33,732)	(39,415)
Income	(4,238)	(6,583)	(13,171)	(13,114)	(18,736)
Employee compensation	130	197	(144)	(603)	(1,869)
Investment income	(4,368)	(6,780)	(13,027)	(12,511)	(16,867)
Received	6,176	4,973	10,243	10,792	15,718
Paid	(10,544)	(11,753)	(23,270)	(23,303)	(32,585)
Current transfers	(817)	(750)	(385)	(677)	(1,122)
Capital and financial account	(23,961)	(22,615)	(25,702)	(52,320)	(71,895)
Capital account	(9,356)	(12,388)	(993)	(1,624)	(12,764)
Capital transfers credit	2,147	7,536	616	862	678
Capital transfers debit	(11,503)	(19,924)	(1,609)	(2,486)	(13,442)
Financial account	(14,605)	(10,227)	(24,709)	(50,696)	(59,131)
Direct investment	(216)	(72)	(1,769)	1,662	1,790
Abroad	(2,533)	(3,533)	(9,727)	(13,782)	(12,393)
In Russia	2,748	3,461	7,958	15,444	14,183
Portfolio investments, net	(653)	2,960	(4,509)	586	(11,521)
Financial derivatives, net	—	13	640	(100)	(233)
Other investments	(5,956)	(1,754)	7,293	(7,610)	12,294
Assets	573	2,120	(15,352)	(25,290)	(30,060)
Cash foreign currency	(1,123)	(1,080)	5,911	1,896	1,422
Demand and time deposits(3)	293	2,267	1,567	(1,140)	(4,576)
Trade credits and advances(4)	827	564	(3,926)	(546)	(7,645)
Loans extended, net	(739)	(2,816)	4	1,189	(5,042)
Arrears	9,120	15,992	(2,661)	(832)	11,047
Indebtedness on supplies according to inter-governmental agreements	(365)	(197)	165	(110)	1,893
Non-repatriation of export proceeds and import advances not repaid in time(5)	(6,388)	(12,244)	(15,435)	(25,903)	(27,195)
Other assets, net	(1,051)	(367)	(978)	155	36

	2001	2002	2003	2004	2005
Liabilities	(6,528)	(3,874)	22,645	17,680	42,353
Cash national currency	49	11	97	157	94
Demand and time deposits	1,480	489	3,767	(1,377)	2,322
Loans received, net	(6,339)	(1,747)	18,550	21,845	39,601
Arrears	(1,036)	(2,790)	(7)	(2,837)	17
Other liabilities, net	(682)	163	238	(109)	320
Reserve assets(6)	(8,212)	(11,375)	(26,365)	(45,235)	(61,461)
Errors and omissions, net	(9,974)	(6,501)	(9,708)	(6,272)	(11,664)

Notes:

(1) Certain data presented in this table differ from previously published data due to regular revisions by the Central Bank.

(2) At current rouble/U.S. dollar exchange rates. Precise information on the volume of Russia's foreign trade with neighbouring CIS countries is difficult to obtain due to the lack of customs posts. The creation of a customs union with Belarus, Kazakhstan, Kyrgyzstan and Tajikistan adds to the difficulty of tracking regional trade flows. Statistical problems are particularly severe in the case of imports from CIS and non-CIS countries, because of the importance of so-called "unregistered trade," consisting of commercial (in contrast to private) transactions that escape customs records or are undervalued by customs authorities. Value adjustments for unregistered trade are made in the official balance of payments accounts. These adjustments added approximately U.S.$11 billion in 2000, U.S.$12 billion in 2001, U.S.$15 billion in 2002, U.S. $20 billion in 2003, U.S. $23 billion in 2004, and U.S. $29 billion in 2005.

(3) Includes adjustment of reserve assets (previously shown as a separate line item) made to avoid double counting of official reserves deposited in resident banks.

(4) Includes received trade credits and advances in export and import of non-factor services.

(5) Beginning with the third quarter of 2001, includes the estimated value of import of services advances not repaid on time. Since the fourth quarter of 2002, includes the estimated value of fictitious transactions in securities.

(6) Changes in reserve assets that arise as a result of transactions with reserve assets, i.e., excluding monetisation of gold and valuation changes. This definition differs from that employed in the calculation of official international reserves. See "—Official International Reserves."

Source: Central Bank.

Current Account

In 2001, the current account balance was U.S.$33.9 billion, compared to U.S.$46.8 billion in 2000. This 28% decrease was caused predominantly by a lower trade surplus, as well as by a deterioration in the balance of trade in non-factor services. In 2001, imports of goods increased by 22%, compared to 2000. This growth was caused by the real appreciation of the rouble and a 5% growth in GDP that resulted in increased domestic demand. An important factor in the growth of overall imports in 2001 was the increase in imports of machinery and equipment (by 34%) as compared with 2000. Despite the increase in imports and decline in world oil prices (by 14%), the current account balance of U.S.$33.9 billion (11.1% of GDP) and trade surplus of U.S.$48.1 billion remained high in 2001, though below their 2000 levels. The 2001 trade balance surplus was attributable to higher world prices for natural gas (14% price increase over 2000), and higher physical volumes of crude oil exports (14% volume increase over 2000) and non-energy exports (4% volume increase over 2000). Overall physical volumes of Russian exports increased by 4% and export prices decreased by 7% on average over 2000.

The negative balance of non-factor services increased to U.S.$9.1 billion in 2001, as compared with U.S.$6.7 billion in 2000, mainly due to an increase in imports. The negative investment income balance decreased from U.S.$7.0 billion in 2000 to U.S.$4.4 billion in 2001.

In 2002, the current account balance declined to U.S.$29.1 billion (8.4% of GDP) due to decreases in both trade and income payment balances. In 2002, the value of Russian exports increased by 7% as compared with 2001 due to an increase in volumes shipped, which was partially offset by lower average export prices mainly due to the delayed adjustment of gas prices to oil price increases. In 2002, export volumes exceeded 2001 volumes by 10%, while average export prices decreased by 4%. A significant real appreciation of the rouble and increased economic activity led to a 14% rise in imported goods, which cause the trade surplus to decrease in 2002 to U.S.$46.3 billion. The balance of services deteriorated as well.

The negative balance of non-factor services increased to U.S.$9.9 billion in 2002 as compared with U.S.$9.1 billion in 2001, due to an increase in imports that exceeded the increase in exports. The investment income deficit also increased from U.S.$4.4 billion in 2001 to U.S.$6.8 billion in 2002, due to a decline in the investment balance of the private sector.

In 2003, the current account balance was U.S.$35.4 billion (8.2% of GDP), a 22% increase compared to 2002. This growth largely resulted from substantial increases in both export prices and volumes shipped. In particular, the average contract price for Russian oil increased by 13% in 2003 due mainly to the war in Iraq and instability in the Middle East generally. The prices for ferrous and base metals also increased considerably, expanding by 20%. Strong appreciation of the euro versus the U.S. dollar, which increased the competitiveness of Russian goods in comparison with European goods, also contributed significantly to the increase in volumes shipped.

Real appreciation of the rouble and an increase in domestic economic activity led to a 22.2% increase in imports of goods in 2003. The appreciation of the euro against the U.S. dollar restrained further growth of import volumes, due to the increased competitiveness of Russian producers and the increased prices of imports in dollar terms The effects on volumes and prices effectively offset on another. The net effect was that changes in the euro/dollar exchange rate did not materially affect the value of the Russian imports.

As a result of faster export growth, the trade surplus increased to U.S.$59.9 billion in 2003, a 29.2% increase compared to 2002. The negative balance of trade in non-factor services amounted to U.S.$10.9 billion in 2003, a 10.2% increase compared to 2002.

In 2004, the current account surplus expanded by 65% compared to 2003, increasing to U.S.$58.6 billion (10.1% of GDP). Exports, which continued to grow at a faster rate than imports, coupled with favourable terms of trade, contributed to significant growth in the current account surplus. The value of Russian exports increased by 34.8% in 2004 compared to 2003, primarily as a result of an increase in export prices, in particular, the price of oil. In 2004, the average contract price for Russian oil rose by 30%, while the price for ferrous and base metals grew by 40%, each compared to 2003. Continuing real appreciation of the rouble and a general increase in domestic economic activity led to an increase in imports of 28.0% in 2004.

The negative balance of non-factor services amounted to U.S.$13.4 billion in 2004, which was 23.4% higher than in 2003. The investment income deficit remained relatively stable, decreasing from U.S.$13.0 billion in 2003 to U.S.$12.5 in 2004.

In 2005, Russia recorded a current account surplus of U.S.$83.6 billion (11.0% of GDP), a 43% increase compared to 2004. The growth in the current account surplus was primarily due to the increase in the value of exported goods (which grew by 32.9% in 2005 compared to 2004), which in turn was largely the result of a 27% rise in export commodity prices. The persistent rise in international oil prices caused in part by political instability in oil producing regions and greater demand from east and south Asia underpinned Russia's export growth. The average contract price for Russian oil grew by 46% in 2005 compared to 2004. Russian imports increased by 28.7% in 2005 compared to 2004, largely as a result of the continued real appreciation of the rouble against the euro and the U.S dollar, and a general acceleration of economic activity. Notwithstanding the growth in Russian imports, Russia's 2005 trade surplus was U.S.$118.3 billion, a 37.8% increase compared to 2004.

The negative balance of non-factor services increased by U.S.$1.46 million in 2005 compared to 2004, amounting to U.S.$14.8 billion. The investment income deficit increased from U.S.$12.5 billion in 2004 to U.S.$16.9 billion in 2005.

Capital and Financial Account

In 2001, the capital and financial account improved despite the increase in official sector external debt payments. The deficit decreased by U.S.$13.7 billion compared to 2000, declining to U.S.$24.0 billion. This improvement was mainly due to reduced demand by the Central Bank for foreign currency. Net capital outflows from the private sector also decreased due to both higher short-term foreign capital inflows into the banking and corporate sector and lower Russian capital outflows. In 2001, the other investments deficit decreased by U.S.$15.9 billion to U.S.$6.0 billion compared to U.S.$21.8 billion in 2000. This primarily reflected a decrease in foreign assets due to U.S.$11 billion in debt relief provided by Russia to the poorest Paris Club debtors. This debt relief also appeared as an offsetting amount in the balance of payments as a capital transfers debit. Net of the decrease in foreign assets due to the debt relief provided by Russia, the balance of other investments improved by U.S.$10.8 billion because of increased short-term foreign investment in Russia's private sector and a decline in Russian capital outflows. The net portfolio investment deficit decreased from U.S.$10.3 billion in 2000 to U.S.$0.7 billion in 2001. The higher deficit in 2000 reflected the U.S.$11.0 billion debt reduction granted to Russia by the London Club of commercial creditors in August 2000. This reduction was reflected in the balance of payments as a decrease in foreign liabilities. However, this decrease was not accompanied by foreign capital outflows since it was compensated by a capital transfer to Russia. Net of this debt reduction, the net portfolio investment balance remained unchanged. In 2001, the net foreign direct investment deficit improved only slightly, to U.S.$0.2 billion from U.S.$0.5 billion in 2000.

In 2002, the capital and financial account deficit declined by 6%, to U.S.$22.6 billion, compared with U.S.$24.0 billion in 2001. This improvement was due to an increased balance of portfolio and other investments, despite a larger increase in official foreign currency reserves, as compared to 2001. The other investments deficit also declined in 2002, by U.S.$4.2 billion, as compared to 2001, amounting to U.S.$1.8 billion, while the balance of capital transfers connected with debt forgiveness was U.S.$3 billion lower than in 2001 due to greater debt relief provided by Russia to the poorest Paris Club debtors. The exchange of Russian Federation Eurobonds for a portion of the uninsured Soviet-era trade indebtedness for which Russia has agreed to be responsible ("FTO Debt") resulted in a U.S.$1.4 billion decline in foreign liabilities in the form of other investments in 2002. Net of the FTO exchange, the improvement in the other investment balance amounted to U.S.$3.3 billion. This improvement was mainly attributable to increased disbursements of foreign loans and credits to the corporate sector. The portfolio investment balance improved from a deficit of U.S.$0.7 billion in 2001 to a surplus of U.S.$3.0 billion in 2002. The main reasons for the improvement were increased purchases of corporate shares by non-residents and the exchange of U.S.$1.4 billion of newly issued Russian Federation Eurobonds for a portion of Russia's FTO Debt. In 2002, reserve assets increased by U.S.$11.4 billion, or U.S.$3.2 billion more than in 2001.

In 2003, the capital and financial account deficit was U.S.$25.7 billion, an increase of U.S.$3.1 billion compared with 2002. This increase reflected growth in official foreign currency reserves, as the Central Bank sought to prevent excessive real appreciation of the rouble, and a decline in the portfolio investment balance. In 2003, reserves increased by U.S.$26.4 billion, compared to a U.S.$11.4 billion increase in 2002. The portfolio investment deficit reached U.S.$4.5 billion in 2003, a significant decrease from the U.S.$3.0 billion surplus recorded in 2002. The main reasons for this deterioration was the repayment of two series of Russian Federation Eurobonds and the Series IV Ministry of Finance Hard Currency Bonds ("MinFins"), as well as declining demand from non-residents for investments in shares and other securities issued by Russian banks and corporations. The other investments balance, which registered a U.S.$1.8 billion deficit in 2002, recorded a surplus of approximately U.S.$7.3 billion in 2003. The improvement was primarily attributable to increasing foreign capital inflows to the banking and corporate sectors and the reduced interest of Russian individuals and small businesses in foreign currency cash as a form of short-term savings. In 2003, the balance of foreign direct investments showed a deficit of U.S.$1.8 billion, compared to a deficit of U.S.$0.1 billion in 2002.

In 2004, the capital and financial account deficit increased by approximately 100% to U.S.$51.3 billion compared to U.S.$25.7 billion in 2003. This increase was largely due to a U.S.$45.2 billion increase in the Central Bank reserves during 2004. The other investments deficit increased to U.S.$7.6 billion in 2004 compared to a surplus of U.S.$7.3 billion in 2003. This drop was due to an increase in the non-repatriation of export proceeds and import advances not repaid in time (U.S.$10.5 billion), as well as a decrease of U.S.$5.1 billion in foreign liabilities in the form of demand and time deposits. The foreign direct investment balance improved from a deficit of U.S.$1.8 billion in 2003 to a surplus of U.S.$1.7 billion in 2004. The net portfolio investment deficit of U.S.$4.5 in 2003 improved to a net surplus of U.S.$0.6 billion in 2004.

In 2005, the capital and financial account deficit grew by 37%, from U.S.$52.3 billion in 2004 to U.S.$71.9 billion, primarily as a result of the growth in official foreign currency reserves and the large capital transfers deficit caused by debt relief granted mainly to Syria. The balance of direct investments improved by U.S.$0.1 billion in 2005 compared to 2004, while the net portfolio investment balance reversed from a surplus of U.S.$0.6 billion in 2004 to a deficit of U.S.$11.5 billion in 2005. The reversal in the net portfolio investment balance was primarily caused by the monetary authority and banking sector's combined acquisition of approximately U.S.$8.9 billion principal amount of long-term foreign debt securities.

Since 1992, increasingly liberal foreign exchange regulations, economic uncertainty and exchange rate fluctuations have prompted Russian banks, enterprises and households to convert their current holdings and savings into foreign currency (particularly U.S. dollar-denominated) assets. Though the impact of these factors has declined in recent years, capital flight has nevertheless been significant in Russia, caused mainly by illegal outflows through non-repatriation of export proceeds and unrefunded import advances. The high level of unaccounted for transactions may also reflect significant capital flight.

Between 2000 and 2002, the stock of foreign currency cash held by Russian residents increased slightly. However, the nominal depreciation of the dollar during 2003 encouraged Russian individuals and small businesses to convert U.S. dollar cash into roubles and resulted in a U.S.$5.9 billion decline in the stock of foreign currency cash. In 2004, the dollar continued to depreciate and foreign currency cash held by residents further decreased by U.S.$1.9 billion. A significant decline in the nominal exchange rate of the U.S. dollar in the fourth quarter of 2004 combined with a decline in the nominal exchange rate of the euro during 2005 caused Russia's foreign currency cash stocks to decrease to U.S.$1.4 billion in 2005.

A sharp increase in the non-repatriation of export proceeds and import advances not timely repaid in 2002 and 2003 reflected better recording of transactions by the Central Bank due to improved methodology. Non-repatriation of export proceeds and unrefunded import advances amounted to U.S.$6.4 billion in 2001, U.S.$12.2 billion in 2002, U.S.$15.4 billion in 2003, U.S.$25.9 billion in 2004 and U.S.$27.2 billion in 2005.

Russia's balance of payments accounts include a high level of unaccounted transactions, which have been subject to significant fluctuation, amounting to U.S.$10.0 billion in 2001, U.S.$6.5 billion in 2002, U.S.$9.7 billion in 2003, U.S.$6.3 billion in 2004 and U.S.$11.7 billion in 2005.

Foreign Trade

Foreign Trade Regime

Until 1992, exports and imports were fully centralised. One of the first post-Soviet economic reforms was to abolish the state monopoly on external trade.

Because of severe goods shortages and the need to ensure the importation of vital supplies, most restrictions on imports were abolished in early 1992 and import tariffs were introduced for a broad range of goods as of 1 July 1992. In 1995, Russia adopted a 30% tariff ceiling on most imports and announced a schedule of gradual reductions in import tariffs. The weighted average of Russia's import tariffs, which stood at 14.5% in 1996, was reduced to 11.4% in 2000. In 2001, the Government further decreased the maximum import tariff rates and worked to unify rates within commodity groups, bringing Russia's external trade regime more closely in line with WTO standards. Although the maximum rate of import tariffs continues to be 20% (with the exception of five commodity groups, which are levied at various rates, reaching 100% for spirits), the weighted average import tariff rate was 11.9% in 2001, 12.1% in 2002, 13.4% in 2003, 13.4% in 2004 and 12.9% in 2005. The recent adjustments in the weighted average import tariff was the result of concessions made by Russia in its ongoing WTO entry negotiations.

From 1992 to 1994, exports were an important source of foreign exchange earnings for the federal budget and remained controlled even as imports were liberalised. By the second half of 1996, all export quotas, export tariffs and other export restrictions, other than certain restrictions related to precious metals, were abolished. Excise taxes were subsequently introduced on oil, gas, petroleum, automobiles, alcohol and certain other goods, and voluntary export restraints continue to exist on a list of goods agreed between Russia and the European Union (for some steel products) and between Russia and the United States (for some steel products and certain consumer goods).

In 1999, the Government reintroduced export tariffs on certain natural resources in order to increase federal budget revenues and restrain growth in domestic prices. The export tariff on crude oil, which generally varies depending upon crude oil export prices, was initially set at €2.5 per metric tonne, increased to €48 at the beginning of 2001 and declined after that in line with fluctuations in world prices of oil. The Law on Customs Tariffs was amended in 2002. Export tariffs on oil are now based on world oil prices, increasing their predictability. A new Customs Code became effective on 1 January 2004, and is intended to facilitate customs clearance procedures, further liberalising Russia's foreign trade regime.

Russia has achieved significant progress in its negotiations on admission to the WTO. In May 2004, Russia and the European Union signed a protocol on Russia's accession to the WTO. Under this agreement, the average tariff level is not to exceed 7.6% for industrial goods, 11% for fishery products and 13% for agricultural goods. At the end of a transition period of five to seven years, the weighted average import tariff is not to exceed 11.5%.

Composition of Trade

The following table illustrates the composition of Russia's exports and imports on a customs basis (excluding unregistered trade adjustments) for the years 2001 to 2005:

Structure of Trade(1)(2)(3)
(excluding unregistered trade)

	2001		2002		2003		2004		2005	
	U.S.$ billion	%	U.S.$ billion	%	U.S.$ billion	%	U.S.$ billion	%	U.S.$ billion	%
Exports										
Machinery, equipment and transport	10.5	10.5	10.0	9.5	12.0	9.0	14.2	7.8	13.5	5.6
Metals, precious stones and their products	18.8	18.8	19.9	18.7	23.7	17.7	36.7	20.3	41.0	19.8
Mineral products(4)	54.5	54.7	58.9	55.2	76.5	57.3	105.0	57.7	155.8	64.6
Chemical products and rubber	7.5	7.5	7.4	6.9	9.1	6.9	12.0	6.6	14.3	5.9
Timber, woodpulp and paper Products	4.4	4.4	4.9	4.6	5.6	4.2	7.0	3.9	8.3	3.4
Textiles	0.8	0.8	0.9	0.8	0.9	0.7	1.1	0.6	0.9	0.4
Leather and fur products	0.2	0.2	0.3	0.3	0.3	0.3	0.4	0.2	0.3	0.1
Foodstuffs and agricultural products (excluding textiles)	1.9	1.9	2.8	2.6	3.4	2.5	3.3	1.8	4.5	1.9
Other	1.2	1.2	1.5	1.4	1.9	1.4	2.1	1.1	2.5	1.1
Total trade	99.8	100.0	106.7	100.0	133.5	100.0	181.7	100.0	241.4	100.0

	2001		2002		2003		2004		2005	
	U.S.$ billion	**%**	**U.S.$ billion**	**%**	**U.S.$ billion**	**%**	**U.S.$ billion**	**%**	**U.S.$ billion**	**%**
Imports										
Machinery, equipment and transport	14.3	34.1	16.8	36.3	21.4	37.3	31.1	41.2	43.4	44.0
Metals, precious stones and their products	3.1	7.4	3.0	6.4	4.2	.3	6.0	7.9	7.6	7.8
Mineral products(4)	1.7	4.1	1.7	3.7	2.2	3.8	3.0	4.0	3.0	3.1
Chemical products and rubber	7.6	18.2	7.7	16.7	9.6	16.8	12.0	15.8	16.2	16.5
Timber, woodpulp and paper products	1.7	4.0	1.9	4.2	2.4	4.2	2.9	3.8	3.3	3.3
Textiles	2.3	5.5	2.4	5.3	2.8	4.8	3.3	4.3	3.6	3.7
Leather and fur products	0.2	0.5	0.2	0.5	0.2	0.4	0.2	0.3	0.3	0.3
Foodstuffs and agricultural products (excluding textiles)	9.2	22.0	10.4	22.5	12.1	21.1	13.9	18.3	17.4	17.7
Other	4.8	4.3	2.0	4.4	2.5	4.3	3.2	4.3	3.6	3.7
Total trade	41.8	100.0	46.2	100.0	57.3	100.0	75.6	100.0	98.5	100.0
Balance										
Machinery, equipment and transport	(3.8)	—	(6.6)	—	(9.4)	—	(16.9)	—	(29.9)	—
Metals, precious stones and their products	15.7	—	16.7	—	19.5	—	30.7	—	33.4	—
Mineral products(4)	52.8	—	56.7	—	74.3	—	102.0	—	152.8	—
Chemical products and rubber	(0.1)	—	(0.3)	—	(0.5)	—	0.0	—	(1.9)	—
Timber, woodpulp and paper products	2.7	—	2.9	—	3.2	—	4.1	—	5.0	—
Textiles	(1.5)	—	(1.5)	—	(1.9)	—	(2.2)	—	(2.7)	—
Leather and fur products	0.0	—	0.1	—	0.1	—	0.2	—	0.0	—
Foodstuffs and agricultural products (excluding textiles)	(7.3)	—	(7.6)	—	(8.7)	—	(10.6)	—	(12.9)	—
Other	(0.6)	—	(0.5)	—	(0.6)	—	(1.1)	—	(1.1)	—
Total trade	58.0	—	59.8	—	76.2	—	106.1	—	142.8	—

Notes:

(1) Figures differ from the presentation in "—Balance of Payments" due to classification, coverage and other adjustments.

(2) Reflects Customs Committee statistics data with certain Goskomstat adjustments.

(3) At current rouble/U.S. dollar exchange rates.

(4) Includes oil, gas and coal.

Source: Goskomstat, Customs Committee.

Exports of mineral products (including oil, gas and coal) and metals and precious stones account for the vast majority of Russia's total exports, representing 73.9% of exports in 2002, 75.0% in 2003, 78.0% in 2004 and 84.0% in 2005. The gradual increase since 2002 is primarily the result of an increase in global oil and metal prices over the same period.

Other significant exports include machinery and other equipment (9.0% of total exports in 2003, 7.8% in 2004 and 5.6% in 2005) and chemical products and rubber (6.9% in 2003, 6.6% in 2004 and 5.9% in 2005).

Imports of machinery, equipment and transport accounted for approximately 37.3% of total imports in 2003, 41.2% in 2004 and 44.0% in 2005. Russia also imports significant amounts of raw and processed foodstuffs and agricultural products. In the aggregate, these products accounted for 21.1% of total imports in 2003, 18.3% in 2004 and 17.7% in 2005.

Direction of Trade

The following tables illustrate the geographic distribution of Russia's trade on a customs basis (excluding unregistered trade adjustments) for the years 2001 to 2005:

Exports (1)(2)(3)
(excluding unregistered trade)

	2001		2002		2003		2004		2005	
	U.S.$ million	**% change**	**U.S.$ million**	**% change**	**U.S.$ million**	**% change**	**U.S.$ million**	**% change**	**U.S.$ million**	**% change**
Exports to non-CIS countries	85,352	(4.4)	91,001	6.0	113,157	24.3	152,129	34.4	208,625	37.1
OECD countries	58,635	(4.1)	61,545	5.0	75,662	22.9	105,451	39.4	152,558	44.7
Germany	9,194	(0.4)	8,060	(12.3)	10,420	29.3	13,302	27.7	19,736	48.4
Great Britain	4,283	(8.3)	3,803	(11.2)	4,919	29.3	5,640	14.7	8,277	46.7
Netherlands	4,695	8.0	7,529	60.4	8,674	15.2	15,272	76.1	24,608	61.1
Switzerland	2,309	(40.1)	5,360	132.1	5,814	8.5	7,707	32.6	10,476	35.9
Japan	2,427	(12.2)	1,803	(25.7)	2,421	34.3	3,404	40.6	3,743	10.0
USA	4,198	(9.6)	3,989	(5.0)	4,216	5.7	6,624	57.1	6,318	(4.6)
Italy	7,401	2.0	7,441	0.5	8,514	14.4	12,086	42.0	19,052	57.6
Other OECD	24,127	0.3	23,561	(3.8)	30,685	30.2	41,416	35.0	60,348	45.7
Transition economies[4]	7,411	2.6	9,014	21.6	10,960	21.6	14,315	30.6	19,525	36.4
Other non-CIS countries	19,306	(7.5)	20,442	5.9	26,536	29.8	32,364	22.0	36,542	12.9
Exports to CIS countries	14,617	5.7	15,711	7.5	20,498	30.5	29,471	43.8	32,594	10.6
Ukraine	5,282	5.1	5,885	11.4	7,598	29.1	10,770	41.8	12,403	15.2
Belarus	5,348	(4.0)	5,922	10.7	7,602	28.4	11,219	47.6	10,094	(10.0)
Kazakhstan	2,778	23.6	2,403	(13.5)	3,281	36.5	4,664	42.2	6,526	39.9
Uzbekistan	409	49.1	453	10.8	512	13.0	767	49.7	861	12.2
Other CIS	800	18.2	1,397	24.0	1,506	7.8	2,051	36.2	2,711	32.2
Total exports	99,970	(3.0)	106,712	6.7	133,656	25.7	181,600	36.1	241,219	32.8

Notes:
(1) Certain data presented in this table differ from previously published data due to regular revisions by the Customs Committee.
(2) Figures differ from the presentation in "—Balance of Payments" due to classification, coverage and other adjustments.
(3) At current rouble/U.S. dollar exchange rates.
(4) Includes Bulgaria, China, Cuba, Mongolia, North Korea, Romania, Slovakia and Vietnam.
Source: Customs Committee statistics.

Imports[1][2][3]
(excluding unregistered trade)

	2001		2002		2003		2004		2005	
	U.S.$ million	% change	U.S.$ million	% change	U.S.$ million	% change	U.S.$ million	% change	U.S.$ million	% change
Imports from non-CIS countries	30,680	37.7	36,011	17.4	44,207	22.8	57,856	30.9	79,641	37.7
OECD countries	23,746	35.9	27,398	15.4	33,664	22.9	44,466	32.1	59,991	34.9
Germany	5,808	49.0	6,598	13.6	8,112	22.9	10,556	30.3	13,260	25.6
USA	3,253	20.7	2,980	(8.4)	2,962	(0.6)	3,200	8.0	4,562	42.6
Italy	1,715	41.4	2,228	29.9	2,407	8.0	3,199	32.9	4,413	37.9
Finland	1,285	34.1	1,519	18.2	1,854	22.0	2,336	25.8	3,089	32.2
Netherlands	846	14.4	1,060	25.3	1,258	18.6	1,375	9.3	1,935	40.7
France	1,538	29.5	1,896	23.3	2,347	23.7	3,072	30.9	3,670	19.5
Japan	871	52.2	980	12.6	1,883	92.1	3,941	109.3	5,832	48.0
Other OECD	8,431	35.7	10,135	20.2	12,843	26.7	16,787	30.7	23,230	38.4
Transition economies[4]	2,445	59.4	3,028	23.8	3,836	26.7	5,386	40.4	8,021	48.9
Other non-CIS countries	4,489	37.3	5,585	24.4	6,707	20.1	8,004	19.3	11,630	45.3
Imports from CIS countries	11,202	(3.5)	10,163	(9.3)	13,139	29.3	17,713	35.0	18,935	6.9
Ukraine	3,845	5.3	3,230	(16.0)	4,438	37.4	6,101	37.4	7,777	27.5
Belarus	3,960	6.7	3,977	0.4	4,880	22.7	6,485	32.4	5,714	(11.9)
Kazakhstan	2,018	(8.3)	1,946	(3.6)	2,474	27.1	3,429	40.7	3,209	(6.4)
Uzbekistan	584	(11.9)	344	(41.1)	485	40.9	613	26.3	904	47.4
Other CIS	795	(42.4)	666	(16.2)	863	29.5	1,086	25.4	1,331	22.6
Total imports	41,881	23.6	46,173	10.2	57,347	24.2	75,569	31.8	98,577	30.4

Notes:
(1) Certain data presented in this table differ from previously published data due to regular revisions by the Customs Committee.
(2) Figures differ from the presentation in "—Balance of Payments" due to classification, coverage and other adjustments.
(3) At current rouble/U.S. dollar exchange rates.
(4) Includes Bulgaria, China, Cuba, Mongolia, North Korea, Romania, Slovakia and Vietnam.
Source: Customs Committee statistics.

Between 2001 and 2005, Russia's exports to OECD countries grew in accordance with the general tendency in Russian exports, remaining relatively stable in 2001 and 2002, and increasing significantly in 2003, 2004, and 2005. The total increase in exports to OECD countries between 2001 and 2005 was approximately 160%. As a percentage of total exports, exports to OECD countries remained stable, accounting for 57% to 63% of Russia's total exports in each year from 2001 through 2005. In 2005, Russian exports to OECD countries accounted for 63.2% of total exports compared to 58.1% in 2004.

Russian exports to CIS countries increased by 5.7% and 7.5% in 2001 and 2002, respectively, and accounted for approximately 14.7% of total exports in each of 2001 and 2002. Exports to the CIS increased by 30.5% in 2003, and by 43.8% in 2004, due primarily to an increase in export prices and the growth of economic activity in CIS countries. In 2005, exports to the CIS grew by 10.5%, due mainly to a decrease in Russia-Belarus trade caused by a Russian policy switch to the country-of-destination method of calculating VAT payments, which took effect on 1 January 2005. Exports to the CIS as a percentage of total exports were 15.3% in 2003, 16.2% in 2004, and 13.5% in 2005.

From 2001 to 2004, growth in exports to transition economies followed the growth trends in Russia's total exports, remaining stable at approximately 7-8% of total export value. Russian exports to other non-CIS and non-OECD countries accounted for approximately 18-20% of total exports between 2001 and 2004, but declined to 15.1% in 2005.

Russia's increasing GDP in the post-August 1998 crisis period helped support increased levels of imports from OECD countries. Russian imports from OECD countries, as a percentage of total imports, amounted to 57% and 59% in 2001 and 2002, respectively. Following 2002, Russian OECD imports returned to their 1998 level. In 2003 and 2004, the share of OECD imports remained stable at approximately 59% in each year. In 2005, imports originating from OECD countries as a percentage of total Russian imports increased to 60.9%, primarily as a result of the real appreciation of the rouble against the euro.

Russia's economic recovery following the 1998 crisis and the resulting increase in GDP led to a decline in the share of imports from CIS countries to 27% of total imports in 2001 and 22% in 2002, as imports from other countries became more attractive to Russian consumers. Despite an appreciation of the euro and a corresponding depreciation of the rouble in 2003, CIS imports, as a percentage of total imports, have remained relatively stable at approximately 23% in both 2003 and 2004. In 2005, imports from CIS countries accounted for 19.2% of total imports.

Imports from transition economies have contributed significantly less to Russia's total imports compared to imports originating from other countries. The share of non-CIS and non-OECD countries in Russia's total imports varied between 11% and 12% between 2001 to 2005.

Germany, Ukraine, China, Italy, the Netherlands, Belarus Italy, China and the United States are Russia's leading trading partners, as measured by value. The role of Belarus in Russia's foreign trade has increased significantly since 1995 due to intensified political and economic links between the two countries. Russia's largest export markets in 2005 were the Netherlands (10% of Russian exports), Germany and Italy (8% each), China and Ukraine (5% each) and Belarus (4%). The most important exporters to Russia in 2005 were Germany (13% of Russian imports), Ukraine (8%), China (7%), Belarus and Japan (6% each), Italy and the United States (5% each). Ukraine and Belarus together account for 70% of Russia's foreign trade with CIS countries.

In 2005, the global distribution of Russia's foreign trading partners remained relatively unchanged compared to 2004, except that the share accounted for by Belarus decreased, with exports declining from 6% to 4% and imports declining from 9% to 6%.

Official International Reserves

The following table sets forth information with respect to the official international reserves of the Russian Federation as at 1 January of each year from 2001 to 2006:

Official International Reserves(1)(2)

	As of 1 January					
	2001	**2002**	**2003**	**2004**	**2005**	**2006**
	(millions of U.S. dollars=					
Official foreign exchange reserves	24,265	32,542	44,054	73,175	120,809	175,891
Special Drawing Rights	1.0	2.9	1.2	0.7	0.9	5.6
Reserve position in IMF.......................	1.0	1.4	1.6	2.1	2.8	195.9
Other foreign exchange........................	24,263	32,538	44,051	73,172	120,805	175,690
Official gold reserves (fine troy ounces, million)	12.4	13.6	12.5	12.5	12.4	13.4
U.S.$ million (national valuation)(3)	3,708	4,080	3,739	3,763	3,732	6,349
Total official international reserves (including gold)....................................	27,972	36,622	47,793	76,938	124,541	182,240
Net official international reserves (including gold)(4)	16,258	27,115	41,312	71,870	120,979	182,240

Notes:

(1) Since the third quarter of 2002, short-term liabilities of the Central Bank have been excluded from both assets and liabilities in the calculation of official international reserves.

(2) At current rouble/U.S. dollar exchange rates.

(3) From 2001-2005, at U.S.$300 per troy ounce; at current Central Bank reference prices since 1 January 2006.

(4) Total official reserves less gross international reserve liabilities (the latter being defined and calculated in accordance with IMF requirements).

Source: Central Bank, Ministry of Finance.

In 2000, the improved situation in world commodity markets and the Central Bank's policy of preventing sharp real appreciation of the rouble by buying dollars led to an increase in Russia's reserves. As at 1 January 2001, official international reserves (including gold) stood at U.S.$28.0 billion, of which approximately U.S.$24.3 billion was in foreign currency and approximately U.S.$3.7 billion was in gold. These reserves represented 5.5 months of import coverage. Net international reserves stood at U.S.$16.3 billion as at 1 January 2001.

Russia's reserve position improved further in 2001. As at 1 January 2002, gross international reserves (including gold) stood at U.S.$36.6 billion, representing 5.9 months of import coverage. Foreign currency reserves amounted to U.S.$32.5 billion and gold reserves stood at U.S.$4.1 billion. In 2001, net official international reserves increased by U.S.$10.9 billion, amounting to U.S.$27.1 billion at 1 January 2002. This improvement was due to both an increase in gross reserves (backed by Russia's large trade surplus) and significant principal payments on the Government's and Central Bank's debt to the IMF, including voluntary early repayments.

The growth of international reserves continued in 2002 and 2003 due to favourable world commodity prices and a strong inflow of foreign capital. As at 1 January 2003, gross international reserves (including gold) stood at U.S.$47.8 billion, representing approximately 6.8 months of import coverage. Foreign currency reserves amounted to U.S.$44.1 billion and gold reserves stood at U.S.$3.7 billion as at 1 January 2003.

At 1 January 2004, gross international reserves (including gold) were U.S.$76.9 billion, representing approximately 9.0 months of import coverage. Foreign currency reserves amounted to U.S.$73.2 billion and gold reserves stood at U.S.$3.8 billion. The Bank of Russia's net international reserves were U.S.$71.9 billion at 1 January 2004.

Russia's international reserves continued to grow during 2004, mainly as a result of high export commodity prices and the Central Bank's policy of supporting the U.S. dollar/Russian rouble exchange rate.

As of 1 January 2005, official international reserves (including gold) stood at U.S.$124.5 billion, of which approximately U.S.$120.8 billion was in foreign currency and approximately U.S.$3.7 billion was in gold. These reserves represented approximately 11.4 months of import coverage. Net international reserves stood at U.S.$121.0 billion as at 1 January 2005.

During 2005, a significant increase in world oil prices resulted in a corresponding increase in the Bank of Russia's international reserves. The growth in reserves was also supported by private sector foreign capital inflows of U.S.$73 billion, an 88% increase compared to 2004. Official international reserves (including gold) stood at U.S.$182.2 billion as at 1 January 2006, representing approximately 13.3 months of import coverage. As of 1 January 2006, the Bank of Russia's international reserves included foreign currency reserves of U.S.$175.9 billion and gold reserves of U.S.$6.3 billion. Net official international reserves (including gold) were U.S.$182.2 billion as at 1 January 2006 and U.S. $247.3 billion as at 1 June 2006.

The Government strictly regulates Russia's output, sale and export of precious metals and stones, including gold, platinum and diamonds. As part of this regulatory regime, the Government licences and has a right of first refusal to purchase Russia's precious metals output. The Government may add to its reserves any purchased output or any proceeds from the sale and export of precious metals.

Both the Central Bank and the Ministry of Finance currently have official foreign exchange and gold reserves. Reserves of the Ministry of Finance, however, make up only a small portion of Russia's total official international reserves. There is no constitutional or federal legislative requirement that the Ministry of Finance maintain foreign currency reserves.

PUBLIC FINANCE

The information presented herein with respect to the federal budget has been prepared, with limited exceptions, substantially in accordance with the guidelines and definitions set forth in the IMF's publication "Government Finance Statistics" (GFS-1986). The differences between the historical presentation herein of federal budget information and the GFS guidelines and definitions relate mainly to (i) sales of gold and precious metals and privatisation proceeds, which are treated as positive elements of deficit financing in the presentation herein but as revenue items under GFS, and (ii) purchases of gold and precious metals, which are treated as negative elements of deficit financing in the presentation herein but as expenditure items under GFS.

Some federal budget information presented herein differs in significant respects from budget information prepared in accordance with federal budgetary laws and published in other official sources. For example, official 2002 federal budget reports included the Government's purchase of Vneshtorgbank stock in October 2002 (0.4% of GDP) in non-interest expenditure. In the budget information presented herein, this purchase is characterized as a reverse privatisation and therefore as a financing item. Prior and subsequent budget laws were prepared in accordance with the GFS guidelines and the methodologies used to present budget information herein. It is expected that all federal budget information published in the future will also be prepared in accordance with these methodologies.

Overview

Russia has significantly improved its fiscal position since 1998, running surpluses of 3.1%, 1.0%, 1.8%, 4.9% and 8.1% of GDP in 2001, 2002, 2003, 2004 and 2005, respectively. The federal budget has produced a primary surplus of 5.6%, 3.5%, 3.4%, 5.5% and 8.4% of GDP in 2001, 2002, 2003, 2004 and 2005, respectively. This improvement is attributable largely to favourable conditions in world energy markets, resulting in higher revenues from related production, export duties, excise and other taxes as well as higher profit tax revenues, combined with improvements in the federal budgetary process, allowing for greater control over expenditure, and more efficient tax policy.

The following table sets forth certain summary information regarding Russia's public finances for the years 2001 to 2005:

Enlarged Budget[1]

	2001	2002[2]	2003	2004	2005
	(millions of roubles)				
Enlarged Budget					
Revenue	3,349,983	4,021,783	4,836,536	6,301,163	8,667,684
Expenditure	3,067,926	3,917,694	4,592,236	5,470,889	6,909,602
Surplus (deficit)	282,057	104,092	244,300	830,275	1,758,082
Federal budget					
Revenue	1,593,978	2,204,728	2,586,191	3,428,873	5,125,093
Expenditure	1,321,903	2,054,194	2,358,546	2,698,867	3,512,183
Surplus (deficit)	272,075	150,534	227,645	730,006	1,612,910
Primary surplus (deficit)(3)	503,180	380,137	448,534	934,736	1,821,277
Sub-federal (regional and local) budgets					
Revenue	1,315,375	1,633,645	1,930,423	2,403,158	2,997,559
Expenditure	1,368,927	1,687,215	1,984,252	2,371,947	2,940,427
Surplus (deficit)	(53,552)	(53,570)	(53,830)	31,211	57,132
Extra-budgetary funds[4]					
Revenue	832,259	1,060,914	1,256,474	1,374,784	1,814,970
Expenditure	820,920	1,057,352	1,183,691	1,305,727	1,727,196
Surplus (deficit)	11,339	3,562	72,783	69,057	87,774

	2001	2002[2]	2003	2004	2005
	(millions of roubles) (% of GDP)				
Enlarged Budget					
Revenue	37.1	37.2	36.4	37.1	40.1
Expenditure	33.9	36.2	34.6	32.2	32.0
Surplus (deficit)	3.1	1.0	1.8	4.9	8.1
Federal budget					
Revenue	17.6	20.4	19.5	20.2	23.7
Expenditure	14.6	19.0	17.8	15.9	16.3
Surplus (deficit)	3.0	1.4	1.7	4.3	7.5
Primary surplus (deficit)[3]	5.6	3.5	3.4	5.5	8.4
Sub-federal (regional and local) budgets					
Revenue	14.5	15.1	14.5	14.2	13.9
Expenditure	15.1	15.6	14.9	14.0	13.6
Surplus (deficit)	(0.6)	(0.5)	(0.4)	0.2	0.3
Extra-budgetary funds[4]					
Revenue	9.2	9.8	9.5	8.1	8.4
Expenditure	9.1	9.8	8.9	7.7	8.0
Surplus (deficit)	0.1	0.0	0.5	0.4	0.4
Memo:					
Nominal GDP (billions of roubles)	9,041	10,818	13,285	16,966	21,598

Notes:
(1) Calculated on the basis of cash or other items of value actually collected or spent. Certain data presented in this table differ from data made public previously due to regular revisions made by the Ministry of Finance.
(2) Expenditure for the purchase of a stake in Vneshtorgbank in October 2002 is characterized as a reverse privatisation, i.e., a financing item, rather than as non-interest expenditure.
(3) Federal budget revenues less non-interest expenditure.
(4) Excluding transfers among extra-budgetary funds.
Source: Ministry of Finance.

Federal Budgetary Process

The Ministry of Finance is centrally involved in each stage of the federal budgetary process, including establishing fiscal policy objectives, preparation of the budget, adoption of the budget by the Federal Assembly, executing the budget (including later amendments) and auditing the budget's execution.

Budget Preparation and Adoption

Under the Budget Code, the draft budget is prepared by the Ministry of Finance and presented, first, to the Government, and then to the State Duma, where it proceeds through four readings. In the first reading, the budget's overall macroeconomic framework and the budgeted revenue, deficit and expenditure are established. The State Duma cannot increase revenues or the deficit ceiling without the approval of the Government. The second reading is devoted to allocating total authorised expenditure to specific purposes according to functional classifications within limits defined after the first reading. The third reading allocates the expenditure among government institutions, lending and borrowing programmes, and other items. In the fourth reading, the budget as a whole is adopted and no further amendments are permitted. After the State Duma's fourth reading, the Federation Council votes on the bill. Once passed by the Federation Council, the bill is sent to the President for consideration. The draft budget becomes law following its signature by the President and publication in the authorised print media. During the course of the fiscal year, the Government may submit to the State Duma amendments to the budget law for consideration in accordance with normal legislative processes.

Budget Execution

The Ministry of Finance is responsible for the execution of the budget law.

The budget law sets overall nominal levels for revenue, expenditure and deficit, as well as caps for domestic and foreign borrowing and other sources of deficit financing. Approval of the State Duma is required if the budget plan exceeds the nominal level of expenditure or borrowing. In each year since 1992, the Ministry of Finance has executed the budget using only revenue actually collected and without violating the deficit ceiling established in the budget law, with the exception of 1998, when the deficit was 14 billion roubles higher than the budgeted amount due to the financial crisis following the events of 17 August 1998. See "Public Debt – The Events of August 1998."

The expenditure levels established in the budget law are annual spending limits with a breakdown for each line item. Upon adoption of the budget law, the Government establishes indicative (i.e., non-binding) quarterly allocation targets for each line item in order to enhance operational control over budgetary performance. The Government can choose how to allocate expenditure on an item over the course of the year so long as it does not exceed by year-end the expenditure figure set forth in the budget law for that item. According to the Budget Code, the Government may reduce expenditure proportionally up to 10% for each line item if revenues and sources of financing do not reach prescribed targets. The Government may reduce expenditure by more than 10% only after corresponding amendments are made to the budget law.

The 2001 budget law was the first zero-deficit budget law since the end of the Soviet Union. In 2001, budget performance further improved, with the surplus reaching 3.0% of GDP. In accordance with the 2001 budget law, a significant portion of this additional revenue (approximately 3.0% of GDP out of an additional 4.6% of GDP) was spent on debt reduction.

The budget law adopted in 2002 provided for a budgetary surplus of 1.6% of GDP. Actual revenue exceeded budgeted revenue by 0.4% of GDP, 0.1% of which was spent on debt reduction. In addition, foreign borrowing was partially replaced by domestic borrowing and amounted to only 0.2% of GDP, compared to 0.8% of GDP as contemplated in the budget law.

The 2003 budget law envisaged a surplus of 1.1% of GDP. The year ended with an actual surplus of 1.7% of GDP. Higher than projected GDP growth resulted in a reduction of expenditure as a proportion of GDP, while revenue exceeded nominal budgeted figures and remained the same relative to actual GDP. Privatisation proceeds were 0.3% of GDP, which were also higher than planned. Additional revenues were contributed to financial reserves, part of which were in turn transferred to the newly created Stabilisation Fund. See "—Deficit Financing" below.

The budget law in 2004 provided for a fiscal surplus of 0.5% of GDP, based on an assumed price of U.S.$20 per barrel of Russian crude oil. Actual revenue exceeded the budgeted estimate by approximately 25%, while expenditures were only 1.5% higher, resulting in a surplus of 4.4% of GDP, 3.8% of which was transferred to the Stabilisation Fund.

In 2005, the federal budget registered a surplus of 7.4% of GDP, or 6.0% of GDP higher than the budgeted estimate. Supported by higher than projected oil prices, federal budget revenues in 2005 amounted to 23.7% of GDP, as compared to the budgeted estimate of 17.8% of GDP, while total expenditure equalled the budgeted estimate of 16.3% of GDP. A significant portion of the budgetary surplus from this period (6.2% of GDP) was transferred to the Stabilisation Fund. A portion of these funds, equal to 3% of GDP, was subsequently withdrawn to prepay outstanding indebtedness to the Paris Club, the IMF and VEB. See "Public Debt—External Debt."

2006 Federal Budget Law[1]

	(billions of roubles, unless otherwise noted)	(% of GDP)
Total revenue	5,046.1	20.7
Tax revenue	3,197.4	13.1
Profit tax	344.8	1.4
Taxes on domestically produced goods and services	1,212.2	5.0
VAT	1,123.7	4.6
Excises	88.5	0.4
Taxes on Imported goods and services	532.3	2.2
VAT	510.6	2.1
Excises	21.7	0.1
Natural resources taxes[2]	782.9	3.2
Unified Social Tax	302.1	1.2
Other taxes	23.1	0.1
Non-tax revenue	1,848.8	7.6
Customs duties	1,607.8	6.6
Other non-tax revenue	240.9	1.0
Total expenditure	4,270.1	17.5
Debt service	198.5	0.8
Interest on domestic debt	66.2	0.3
Interest on external debt	132.3	0.5
Non-interest expenditure	4,071.6	16.7
General public services	440.4	1.8
Defence	666.0	2.7
Public order and safety	541.6	2.2
Economic affairs	339.3	1.4
Housing	38.9	0.2
Environmental protection	6.3	0.0
Education	201.6	0.8
Culture and mass media	51.2	0.2
Health care and sports	149.1	0.6
Social policy	205.3	0.8
Financial aid to regions	529.4	2.2
Transfer to the Pension Fund	902.5	3.7
Fiscal surplus	776.0	3.2
External financing	(212.6)	(0.9)
Borrowing	31.8	0.1
Tied credits	31.8	0.1
Financial credits	0.0	0.0
of which Eurobonds	0.0	0.0
Principal repayment	(244.5)	(1.0)
Domestic financing	(563.4)	(2.3)
Borrowing	238.2	1.0
Principal repayment	(110.4)	(0.5)
Privatisation	39.0	0.2
Net gold sales	5.0	0.02
Change in deposits (including Stabilisation Fund)	(735.2)	(3.0)
Primary Surplus	974.5	4.0

Memo:		
GDP	24,380	—
CPI (December on December, %)	7.0-8.5	—
Average exchange rate (U.S.$/rouble)	28.6	—
Average oil price, Urals (U.S.$/barrel)	40.0	—

Notes:
(1) In accordance with the definition used throughout this section.
(2) Natural resources taxes include resource extraction taxes, royalties, water taxes and taxes charged for the use of fauna products and aquatic biological resources.
Source: Ministry of Finance

The Government's initial macroeconomic assumptions for 2006 included: an average price per barrel of Russian crude oil of U.S.$40, overall GDP growth of 5.8% and annual inflation of 7.0-8.5%.

The 2006 Budget Law envisages revenue of 5,046.1 billion roubles, or 20.7% of GDP. This revenue estimate assumes value added taxes on domestically produced and imported goods and services equal to 6.7% of GDP, profit taxes equal to 1.4% of GDP, excise taxes equal to 0.5% of GDP, natural resource extraction taxes equal to 3.2% of GDP and foreign economic activity revenues (including custom duties) equal to 6.8% of GDP. Total expenditure is budgeted to be 4,270.1 billion roubles, or 17.5% of GDP, with debt service costs accounting for 0.8% of GDP.

The 2006 Budget Law provides for a fiscal surplus of 776.0 billion roubles, or 3.2% of GDP, and a primary surplus of 974.5 billion roubles, or 4.0% of GDP, substantially all of which the Government intends to transfer to the Stabilisation Fund or to apply to the early repayment of external debt.

The Government does not intend to seek new external budget financing in 2006, as it believes that its financing requirements will be met through the anticipated budget surplus and planned net domestic borrowings of 127.8 billion roubles, or 0.5% of GDP.

In June 2006, the Government's budgeted average international oil price for 2006 was raised to US$62 per barrel. As a result, actual federal budget revenue and fiscal surplus in 2006 are expected to increase to 22.8% of GDP and 6.6% of GDP, respectively, considerably higher than originally budgeted. Gross revenue of the Stabilisation Fund (before giving effect to the approximately U.S.$22.3 billion used in August 2006 to prepay Russia's remaining Paris Club debt) is expected to reach 1,651.0 billion roubles, or 6.2% of GDP in 2006.

Federal Budget Revenue

The following table sets forth information regarding federal budget revenue for the years 2001 to 2005:

Federal Budget Revenue(1)

	2001	**2002**	**2003**	**2004**	**2005(2)**
			(millions of roubles)		
Total Revenue	1,593,978	2,204,728	2,586,191	3,428,873	5,125,093
Total Revenue net of social tax	1,593,978	1,865,267	2,221,597	2,986,655	4,857,578
Tax revenue	1,460,398	2,035,598	2,394,161	3,154,273	3,188,157
Profit taxes	213,777	172,212	170,936	205,720	377,592
Personal income tax	2,750	(1)	9	3	23
VAT	638,966	752,655	882,064	1,069,692	1,472,210
Excise taxes	203,124	214,865	252,531	117,205	107,192
Natural resources taxes(3)	49,693	214,237	249,508	434,253	930,218
Custom duties	331,340	323,369	452,789	859,736	—
Import duties	104,161	128,695	158,002	204,151	—
Export duties	227,174	194,674	294,787	655,585	—
Property tax	2,817	1,441	1,442	121	9

	2001	2002	2003	2004	2005(2)
			(millions of roubles)		
Social tax	—	339,461	364,594	442,218	267,515
Other tax revenue	20,747	17,359	20,288	25,321	33,398
Non-tax revenue	119,069	154,000	177,682	260,526	1,936,936
Custom duties	—	—	—	—	1,622,845
Import duties	—	—	—	—	270,936
Export duties	—	—	—	—	1,351,909
Central Bank profit transfer	2,090	9,042	24,923	29,805	15,281
Non-tax revenue from foreign economic activity	51,506	65,559	52,924	38,493	57,961
Other non-tax revenue	64,473	79,399	99,835	192,228	280,849
Revenues of Budgetary Funds	14,512	15,130	14,349	14,075	—
			(% of GDP)		
Total Revenue	17.6	20.4	19.5	20.2	23.7
Total Revenue net of social tax	17.6	17.2	16.7	17.6	22.5
Tax revenue	16.2	18.8	18.0	18.6	14.8
Profit taxes	2.4	1.6	1.3	1.2	1.7
Personal income tax	0.0	0.0	0.0	0.0	0.0
VAT	7.1	7.0	6.6	6.3	6.8
Excise taxes	2.2	2.0	1.9	0.7	0.5
Natural resources taxes(3)	0.5	2.0	1.9	2.6	4.3
Custom duties	3.7	3.0	3.4	5.1	—
Import duties	1.2	1.2	1.2	1.2	—
Export duties	2.5	1.8	2.2	3.9	—
Property tax	0.0	0.0	0.0	0.0	0.0
Social tax	—	3.1	2.7	2.6	1.2
Other tax revenue	0.2	0.2	0.2	0.1	0.2
Non-tax revenue	1.3	1.4	1.3	1.5	9.0
Custom duties	—	—	—	—	7.5
Import duties	—	—	—	—	1.3
Export duties	—	—	—	—	6.3
Central Bank profit transfer	0.0	0.1	0.2	0.2	0.1
Non-tax revenue from foreign economic activity	0.6	0.6	0.4	0.2	0.3
Revenue of Budgetary Funds	0.2	0.1	0.1	0.1	—
			(% of total revenue net of social tax)		
Tax revenue (excl. UST)	91.6	90.9	91.4	90.8	60.1
Profit taxes	13.4	9.2	7.7	6.9	7.8
Personal income tax	0.2	0.0	0.0	0.0	0.0
VAT	40.1	40.4	39.7	35.8	30.3
Excise taxes	12.7	11.5	11.4	3.9	2.2
Natural resources Taxes(3)	3.1	11.5	11.2	14.5	19.1
Custom duties	20.8	17.3	20.4	28.8	—
Import duties	6.5	6.9	7.1	6.8	—
Export duties	14.3	10.4	13.3	22.0	—
Property tax	0.2	0.1	0.1	0.0	0.0
Other tax revenue	1.3	0.9	0.9	0.8	0.7
Non-tax revenue	7.5	8.3	8.0	8.7	39.9
Custom duties	—	—	—	—	33.4
Import duties	—	—	—	—	5.6
Export duties	—	—	—	—	27.8
Central Bank profit Transfer	0.1	0.5	1.1	1.0	0.3

	2001	2002	2003	2004	2005(2)
	(millions of roubles)				
Non-tax revenue from foreign economic activity	3.2	3.5	2.4	1.3	1.2
Other non-tax revenue	4.1	4.3	4.5	6.4	5.0
Revenue of Budgetary Funds	0.9	0.8	0.6	0.5	—
GDP (billions of roubles)	9,041	10,818	13,285	16,966	21,598

Notes:

(1) Since 2000, the federal budget has received all revenue in cash.

(2) Since 2005, customs duties are considered as non-tax revenue and all budgetary funds have been abolished.

(3) For 2001, natural resource taxes included royalties, oil excise tax and mineral restoration payments. From 2002, these taxes were replaced with a new modified resource extraction tax.

Source: Ministry of Finance.

Sources of Federal Revenue

The main elements of Russia's tax system are a value-added tax ("VAT"), a system of excise taxes, an enterprise profits tax, duties on foreign economic activities, a natural resources extraction tax, and a personal income tax. Following tax reforms that came into effect in 2001, the total number of taxes and tax exemptions has been reduced together with the overall tax burden, and income tax collection has been improved. Sub-Federal Governments may impose only those taxes that are contemplated by the Federal tax code. Following the second stage of tax reforms, which took effect in 2002, a new modified royalty tax on resource extraction has replaced three previous taxes: royalties, oil excise tax and mineral restoration payments. In the case of crude oil, the modified royalty tax on resource extraction is calculated at a specific rate (in roubles per tonne) depending on the current international oil price. For natural gas, the tax was calculated as a percentage of the price of gas produced through 2003, and as of 1 January 2004 has been set at a specified rate per unit volume of gas produced. The excise on natural gas was eliminated in 2004, and replaced by an increased export duty on natural gas. As part of the policy of reducing the tax burden, turnover sales tax and a substantial part of regional and local taxes were also abolished in 2004.

Since 2002, the federal budget includes a portion of the newly adopted Unified Social Tax (the "UST"), the revenue from which is transferred to the Pension Fund after its collection by the Government. The UST's contribution to the federal budget equalled 15.4%, 14.1%, 12.9% and 5.2% of total federal budget revenue in 2002, 2003, 2004 and 2005, respectively. Prior to 2005, these amounts were budgeted as part of both the federal budget's revenues and expenditures, and therefore did not affect the budget balance. The UST is excluded from the following discussion and, unless otherwise noted, figures in this section are exclusive of UST. See "—Tax Reform."

VAT has been the largest source of federal budget revenue since 1992, accounting for approximately 36% of total cash revenue in 2004 and 30% in 2005. Since 2001, all VAT payments for domestically-produced and imported goods and services have been transferred to the federal budget. The generally applicable rate of VAT is 18% (20% prior to 1 January 2004), though certain items are charged at a reduced rate of 10%, and exports and certain other limited items are exempt from VAT.

Revenue from foreign economic activity consists mainly of duties and fees on exports and imports and interest payments on loans abroad. In 1996, significant steps were taken towards the abolition of centralised exports and the gradual replacement of export duties by domestic excise taxes. Between 1 July 1996 and 1 January 1999, export duties did not exist in Russia. The 1998 devaluation of the rouble and the subsequent increase in world commodity prices made Russian exports more profitable. In response, the Government imposed export duties on most exported goods. Export duties accounted for 14.3% of federal revenues in 2001, declining to 10.4% in 2002, primarily due to lower international oil prices at the beginning of that year. As a result of the subsequent increase in international oil prices, export duties, as a percentage of total federal budget revenue, rose to 13.3% in 2003, 22.0% in 2004 and 27.8% in 2005.

The natural resource extraction tax is an important, but fluctuating, source of revenue, due to the volatility of global commodities prices for exported goods, particularly oil and gas. Until 2001, resource extraction in Russia was taxed by royalties and contributions to the Mineral Resources' Replenishment Fund, in addition to excise taxes.

Approximately 40% of natural resource tax revenue went to the federal budget. Since 2002, those taxes have been replaced by a modified tax on resource extraction that is adjusted in accordance with the international prices of commodities. In 2004 and 2005, the natural resource extraction tax accounted for 14.2% and 17.6% of total federal budget revenue, respectively. The natural resource tax's prominence results from favourable global prices for oil and gas and the 2004 and 2005 increases in the Federal Government's allocated share of natural resource extraction tax revenue, which is now 94%.

Import duties are also an important source of federal budget receipts, and amounted to between 5.7% and 7.1% of federal revenues in the period 2000 – 2003. Due to the increasing importance of export duties and the natural resource extraction tax, import duties receipts, as a percentage of total federal budget revenue, decreased to 6.8% and 5.6%, respectively, in 2004 and 2005. See "Balance of Payments and Foreign Trade—Foreign Trade—Foreign Trade Regime."

The corporate profit tax base rate was lowered on 1 January 2002 from 35% to 24%. In connection with the 2001 tax reforms, the profit tax was made more market-oriented, with enhanced accelerated depreciation and loss carry-forward mechanisms, while limits on many cost deductions and certain tax exemptions were eliminated. The federal portion of the profit tax in 2005 was set at a uniform rate of 6.5%, as compared to 5.0% in 2004, 6.0% in 2003, 7.5% in 2002, and 11% in each of 2001 and 2000. The federal share of profit tax was increased in 2005 to reflect the division of powers among the various levels of government. Corporate profit tax accounted for 13.4%, 9.2%, 7.7%, 6.9%, 7.8% of total cash revenue in 2001, 2002, 2003, 2004 and 2005, respectively.

Personal income tax is currently assessed at a flat rate of 13%. Since 2001, all income tax revenue has been allocated to sub-federal budgets.

Russia's tax system also includes excise duties and a number of other taxes, though they are relatively insignificant to the federal budget. In 2004, these taxes combined constituted approximately 4.8% of federal budget revenue and, in 2005, accounted for 2.9% of federal budget revenue.

Federal budget revenue are further enhanced by non-tax revenue, including proceeds from Federal Government-owned property and the transfer to the federal budget of 80% of the Central Bank's profits (50% prior to 2004), with the balance retained by the Central Bank.

Prior to 2001, budgetary funds (former extra-budgetary funds that were previously consolidated in the budget) were an important part of federal budget revenue. Most of the federal budgetary funds have been eliminated since 2001, except for the Ministry of Atomic Power's fund, which was eliminated in 2005.

Revenue Performance

Since 2000, federal budget revenue in each year has been higher than originally budgeted. In 2001, federal budget revenue amounted to 17.6% of GDP, 33% higher than the budget target. The increase was attributable to more efficient tax collection, with federal budget tax revenues expanding to 16.2% of GDP.

In 2002, federal budget revenue amounted to 20.4% of GDP (17.2% of GDP excluding the UST), 1% higher than the originally budgeted target. The favourable fiscal result was attributable to additional and unforeseen revenues from customs duties due to increased oil prices and higher non-tax revenues. Federal budget tax revenues excluding the UST decreased to 15.7% of GDP in 2002, primarily as a result of the reduction in the profit tax base rate that became effective in 2002.

In 2003, federal budget revenue declined to 19.5% of GDP (or 16.7% of GDP excluding the UST), but was nevertheless 1% higher than the budgeted amount. Federal tax revenue declined in 2003, largely as a result of the allocation of a portion of the profit tax and some excise taxes to Federation subjects. In 2003, federal tax revenue amounted to 15.3% of GDP.

In 2004, further growth in the price of oil and an increase in the natural resource extraction tax rates increased federal budget revenues to 20.2% of GDP (17.8% of GDP excluding the UST). Supported by an increase in the modified royalty tax on resource extraction, federal tax revenues increased to 16.0% of GDP, despite the reduction of VAT from 20% to 18%.

In 2005, proceeds from tax arrears, increasing international oil prices and fiscal reform combined to increase federal budget revenues to 23.7% of GDP (or 22.4% of GDP excluding the UST). Federal budget tax and customs duties revenue increased to 21.0% of GDP during the same period.

Following the Government's adoption of a resolution in 2000 allowing enterprises to reschedule their tax arrears in exchange for the full and orderly payment of current tax payments, tax arrears were reduced to 15% of GDP in 2000, 13% of GDP in 2001, 5% of GDP in 2002 and 4% of GDP in 2003. In 2004, tax arrears increased to 5% of GDP, due to tax inspections of oil and other companies. In nominal terms, tax arrears increased by 359 billion roubles in 2004, much of which was owed by the Yukos Oil Company and related to unpaid taxes from the period 2000 – 2003. In December 2004, a portion of the equity of Yukos' main production subsidiary Yuganskneftegaz Oil Company was sold at auction, in partial settlement of Yukos' unpaid tax obligations. As a result, tax arrears decreased to 3.5% of GDP in 2005.

Federal Budget Expenditure

The following table sets forth information regarding federal budget expenditure for the years 2001 to 2005:

Federal Budget Expenditure[(1)]

	2001	2002	2003	2004	2005[(2)]
			(millions of roubles)		
Total expenditure	1,321,903	2,054,194	2,358,546	2,698,867	3,512,183
Total expenditure net of social tax	1,321,903	1,722,591	1,990,308	2,257,550	3,244,668
Debt service	231,104	229,667	220,889	204,730	208,367
Of which					
Domestic debt service	46,410	37,385	45,121	39,860	54,136
Foreign debt service	184,694	192,282	175,768	164,870	154,231
Non-interest expenditure	1,090,799	1,824,527	2,137,657	2,494,138	3,303,816
Non-interest expenditure net of social tax	1,090,799	1,492,924	1,769,419	2,052,820	3,036,301
State administration	41,971	56,168	66,739	80,721	290,925
International activity	23,766	34,202	31,530	56,653	—
Internal security	160,716	209,906	273,051	348,363	450,096
Defence	247,703	295,394	355,691	429,999	581,132
National economy	134,063	178,355	204,717	231,938	260,125
Social and cultural sphere	204,129	286,720	304,756	352,622	475,949
Budgetary funds	14,527	15,075	14,349	14,074	—
Transfers to regions	230,007	318,253	376,933	401,203	486,729
Social tax transfer to the Pension Fund	—	331,603	368,238	441,317	267,515
Other expenditure	33,917	98,851	141,652	137,247	491,345
			(% of GDP)		
Total expenditure	14.6	19.0	17.8	15.9	16.3
Total expenditure net of social tax	14.6	15.9	15.0	13.3	15.0
Debt service	2.6	2.1	1.7	1.2	1.0
Of which					
Domestic debt service	0.5	0.3	0.3	0.2	0.2
Foreign debt service	2.0	1.8	1.3	1.0	0.7
Non-interest expenditure	12.1	16.9	16.1	14.7	15.3
Non-interest expenditure net of social tax	12.1	13.7	13.3	12.1	14.1
State administration	0.5	0.5	0.5	0.5	1.4

International activity	0.3	0.3	0.2	0.3	—
Internal security	1.8	1.9	2.1	2.1	2.1
Defence	2.7	2.7	2.7	2.5	2.7
National economy	1.5	1.6	1.5	1.4	1.2
Social and cultural sphere	2.3	2.7	2.3	2.1	2.2
Budgetary funds	0.2	0.1	0.1	0.1	—
Transfers to regions	2.5	2.9	2.8	2.4	2.3
Social tax transfer to the Pension Fund	—	3.1	2.8	2.6	1.2
Other expenditure	0.4	0.9	1.1	0.8	2.3
	(% of total expenditure net of social tax)				
Debt service	17.5	13.3	11.1	9.1	6.4
Of which					
Domestic debt service	3.5	2.2	2.3	1.8	1.6
Foreign debt service	14.0	11.2	8.8	7.3	4.8
Non-interest expenditure	82.5	86.7	88.9	90.9	93.6
Non-interest expenditure net of social tax	3.2	3.3	3.4	3.6	9.0
State administration	1.8	2.0	1.6	2.5	—
International activity	12.2	12.2	13.7	15.4	13.9
Internal security	18.7	17.1	17.9	19.0	17.9
Defence	10.1	10.4	10.3	10.3	8.0
National economy	15.4	16.6	15.3	15.6	14.7
Social and cultural sphere	1.1	0.9	0.7	0.6	—
Budgetary funds	17.4	18.5	18.9	17.8	15.0
Transfers to regions	1.1	0.9	0.7	0.6	15.1
GDP (billions of roubles)	9,041	10,818	13,285	16,752	21,665

Notes:
(1) Since 2000, the federal budget has financed all expenditure in cash.
(2) In 2005, a new budgetary classification came into effect, making detailed 2005 data incomparable in functional classification with previous year figures.
Source: Ministry of Finance.

Total federal budget expenditure increased from 14.6% of GDP in 2001 to 15.9% of GDP in 2002. Expenditure subsequently declined to 15.0% of GDP in 2003 and to 13.3% of GDP in 2004 primarily as a result of a reduction in debt service expenditure and structural changes in non-interest spending. In 2005, total federal budget expenditure increased to 15% of GDP, primarily as a result of increased social spending. Debt service (which includes only payments in respect of discount and interest on Government debt) declined between 2001 and 2005, both in terms of GDP from 2.6% of GDP in 2001 to 1.0% in 2005 and as a share of total expenditure from 7.5% of total expenditure in 2001 to 6.4% in 2005. The decline in debt service is attributable in part to the Government's conservative debt and fiscal policies implemented following the 1998 financial crisis. See "—Deficit Financing" and "Public Debt – The Events of August 1998."

The share of non-interest spending in federal expenditure increased from 82.5% of total cash spending in 2001 to 93.6% in 2005 (beginning in 2002, total cash spending does not include transfers of social tax revenue to the Pension Fund). Spending by the defence and internal security ministries increased from 4.5% of GDP in 2001 to 4.8% of GDP in 2005, while Government spending on social and cultural programmes decreased from 2.3% of GDP in 2001 to 2.2% in 2005. Federal spending on the national economy decreased from 1.5% of GDP in 2001 to 1.2% of GDP in 2005. The volume of financial aid disbursed by the Federal Government for use in sub-federal budgets decreased from 2.5% of GDP in 2001 to 2.3% in 2005 due primarily to the increased centralisation of the budget system.

Deficit Financing

Russia inherited a significant budget deficit from the Soviet Union. In 1992, the enlarged budget deficit (comprising deficits associated with federal, sub-federal, local budgets and extra-budgetary funds) amounted to over

40% of GDP. A reduction in the enlarged budget deficit was an essential precondition for financial stabilisation, a key objective of Russia's initial economic reform programme. In each year since 2000, the enlarged budget has registered a surplus. The enlarged budget's surplus was 3.1% of GDP in 2001, 1.0% of GDP in 2002, 1.8% of GDP in 2003, 4.9% of GDP in 2004 and 8.1% of GDP in 2005.

The federal budget has also registered annual surpluses of 3.0% of GDP in 2001, 1.4% of GDP in 2002, 1.7% of GDP in 2003, 4.3% of GDP in 2004 and 7.5% of GDP in 2005. The federal budget's primary surplus was 5.6% in 2001, 3.5% in 2002, 3.4% in 2003, 5.5% in 2004 and 8.4% of GDP in 2005. The rapid surplus increase in 2004 and 2005 resulted from high international oil prices and the Government's decision to accumulate revenues in the newly created Stabilisation Fund.

In 2000, the Federal Government made significant changes in its financing structure, contributing to the first surplus since the break-up of the Soviet Union. In a change from prior practice, domestic financing consisted of non-monetary borrowing (short-term credits from large commercial banks and government securities issues) and sales of state assets. Declining interest rates and investor optimism enabled the Ministry of Finance to resume issuing rouble-denominated short-term bills (GKOs), though primarily for the purpose of creating liquidity in the banking sector rather than as a means of deficit financing.

The federal surplus accounted for 3.0% of GDP in 2001. Although the 2001 budget law envisaged U.S.$4.8 billion in foreign borrowing, mainly from international financial institutions, a revenue performance that exceeded the Government's expectation allowed the Government to finance foreign principal debt amortisation of U.S.$8.4 billion with only U.S.$0.7 billion of new foreign borrowing. Domestic debt policy continued to be conservative in 2001, with domestic debt amortisation exceeding borrowing by 0.3% of GDP.

In 2002, proceeds from privatisations equalled U.S.$0.3 billion, despite having been budgeted at U.S.$1.1 billion. This resulted in part from the booking in 2003 of U.S.$2.5 billion proceeds from the sale of a portion of the Government's stake in oil companies LUKoil and Slavneft. The sale of state reserves of precious metals and stones in 2002 produced net gains of 14.6 billion roubles, while foreign borrowing consisted almost entirely of tied credits (U.S.$0.6 billion). The U.S.$2 billion of Eurobonds that had been budgeted for issuance were not issued because revenues exceeded budgeted expectation, with the shortfall replaced by domestic borrowing.

In 2003, a higher than expected budgetary surplus enabled foreign borrowing to be reduced below budgeted amounts. Net foreign financing amounted to 2.2% of GDP, including the redemption of foreign debt amounting to 2.4% of GDP, while net domestic borrowing was zero. Proceeds from privatisations in 2003 amounted to 94.1 billion roubles (0.7% of GDP), including approximately 76.7 billion roubles from the privatisation of a portion of the Government's stakes in oil companies LUKoil and Slavneft. Excess revenue was contributed to the financial reserve, which increased from 228.6 billion roubles at the start of the year to 255.0 billion roubles at the end of 2003.

In 2004, domestic borrowing accounted for an increased share of the sources of deficit financing. Net domestic borrowing amounted to 0.4% of GDP, and a substantial amount of foreign debt, equivalent to approximately 1.5% of GDP, was redeemed. Net foreign financing represented negative 1.3% of GDP.

At the start of 2004, the Government contributed approximately 106.0 billion roubles from the financial reserve to the newly created Stabilisation Fund. The Stabilisation Fund, the rules for which are set out in the Budget Code, was created to reduce the effects of oil price fluctuations on the Russian budgetary process. Revenue derived from export duties on crude oil and the oil extraction tax, attributable to oil prices in excess of the budget's oil price assumption (originally U.S.$20 per barrel and, beginning in 2006, U.S.$27 per barrel), are contributed to the Fund. The base amount of the Stabilisation Fund is fixed at 500 billion roubles. If oil prices fall below the budget's assumed price and, as a consequence, the Stabilisation Fund's assets fall below the base amount of 500 billion roubles, the Fund can only be used for deficit financing. In 2004, 634.7 billion roubles in extra revenue were transferred to the Stabilisation Fund, including 476.3 billion roubles of tax and custom proceeds and 158.4 billion roubles of cash balance. In 2005, the Government transferred 1,397.1 billion roubles to the Stabilisation Fund, including 1,351.6 billion roubles of tax and custom proceeds and 45.5 billion roubles of cash balance.

In 2005, higher than expected budget revenue enabled the Government to limit its foreign borrowing to existing credit arrangements. At the same time, a large part of Russia's outstanding debt was redeemed. Net foreign financing in 2005, as a result, amounted to negative 4.2% of GDP, including the redemption of foreign debt representing 4.3% of GDP. Net domestic borrowing during this period equalled 0.3% of GDP.

Privatisation revenue is classified as "deficit financing" under the international accounting methodology used herein. In 2001, the Government's privatisation proceeds accounted for 8.8% of gross federal budget deficit financing (0.1% of GDP). Privatisation proceeds amounted to 5.6% of the federal budget surplus (0.1% of GDP) in 2002, but increased to 41.3% of the federal budget surplus (0.7% of GDP) in 2003, due to the Government's privatisation of a portion of its ownership in LUKoil and Slavneft oil companies, before declining to 9.5% of the federal budget surplus (0.4% of GDP) in 2004 and then to 2.5% of the federal budget surplus (0.2% of GDP) in 2005.

Foreign disbursements, including tied and untied credits, but excluding IMF disbursements, were 0.2% of GDP in 2001, 0.6% of GDP in 2002, 0.2% of GDP in 2003, 0.3% of GDP in 2004 and 0.1% of GDP in 2005, continuing the general trend that began in 1993.

Federal-Sub-Federal Fiscal Relations

Sub-federal and local authorities are required to set budgets based on the existing tax system, taking into account the distribution of expenditure responsibilities and revenue transfers laid down in higher level budgets.

Sub-federal and local governments are directly assigned a specified portion of the revenue from certain taxes collected in their jurisdictions. In 2004, sub-federal and local governments received 100% of personal income tax, property taxes, land taxes (from 2003), and excise taxes (except excise taxes derived from automobiles and natural gas), 60% of excise taxes on gasoline, diesel fuel and motor oil (from 2003), and approximately 25% of natural resource taxes. Federation subjects do not, however, enjoy the statutory right to alter the tax base or to increase the marginal rate of these taxes.

Prior to April 1999, Federation subjects were able to impose their own profit taxes at rates up to 22 percentage points above the federal rate of 13%, and were directly assigned 25% of domestic VAT revenues. As of April 1999, the upper limit of the regional profit tax was reduced to 19% (with the federal portion of the tax rate equal to 11%). This limit was then increased to 24% in 2001 to compensate for the abolition of a turnover housing tax. The share of domestic VAT transferable to the regions was reduced to zero in 2001.

In 2002, the profit tax rate was reduced to 24%, of which 7.5% represented federal tax and between 12.5% and 16.5%, subject to the discretion of regional authorities, represented sub-federal and local tax. In 2003, the turnover tax on road users was abolished and, in exchange, regions received a portion of the excise tax on car fuel and motor oil, revenue from the new transport tax and a 1.5% increase in the share of profit tax (offset by a corresponding reduction in the rate of the federal profit tax). Regional sales tax was abolished in 2004, but, beginning in the same year, sub-federal regions receive a portion of the excise tax on alcohol. In 2004, the federal portion of the profit tax was reduced to 5% and the maximum sub-federal rate increased to 19%. Natural resource taxes (rent taxes) are gradually being consolidated into the federal budget, with the share of natural resource taxes allocated to sub-federal governments declining from 35% in 2002 to 25% in 2004.

In 2005, amendments to the Budget and Tax Codes fixed the distribution of taxes between federal and regional levels. These amendments also provide that the Federal Government may change the distribution of taxes through legislative amendment. Significant changes effected by the 2005 amendments included an enlargement of the federal portion of profit tax to 6.5% and a reduction to 17.5% in the maximum share of profit tax that can be allocated to the regions. The tax on natural gas extraction was also consolidated into the federal budget and the regional share of tax on hydrocarbon extraction (other than natural gas) was reduced to 5%.

The Government allocates a portion of its tax revenues to various regional support funds for redistribution to the regions. The Fund for Regional Support was established in 1994 as the primary source of federal transfers to regional governments. The revenue received by the Fund is set forth in the budget law. In 2001, the Fund received

103.2 billion roubles, representing slightly more than 9% of the year's federal tax receipts, excluding import and export duties. Although Federal Government transfers to the regions in 2001 were higher than envisaged in the 2001 budget laws, a reduction in the share of additional federal tax revenue allocated to the Fund resulted in a reduction in the overall percentage of federal tax revenue transferred to the Fund in 2001. In 2002, the Fund for Regional Support received 147.5 billion roubles representing 10.7% of federal tax receipts, excluding custom duties. In 2003, the Fund received 173.2 billion roubles, or 11.1% of federal tax receipts excluding custom duties, in 2004 it received 175.8 billion roubles, or 9.5%, of budgeted federal tax receipts excluding custom duties and, in 2005, the Fund received 189.9 billion roubles or 6.0% of budgeted federal tax receipts. According to new budget classifications that took effect in 2005, customs duties are now regarded as non-tax revenue.

In 2001, a new regional support fund, the Compensation Fund, was established. The Compensation Fund provides federal subsidies to regional budgets to help finance obligations under the Law On Social Protection of the Handicapped and the Law On Childhood Benefits. In 2001, 2002, 2003, 2004 and 2005, the Compensation Fund received 33.4, 40.8, 47.0, 56.2 and 35.0 billion roubles, respectively. The reduced contributions to the Compensation Fund in 2005 reflects a change in the inter-governmental allocation of the responsibility for social benefits. Federation subjects are now responsible for the provision of fewer social benefits and, accordingly, receive smaller payments under this programme.

The Fund for Co-Financing Social Expenditure was established in 2002. The primary aim of this Fund is to improve the financing by Federation subjects of basic public services. This Fund received 18.7, 5.0, 6.3 and 25.1 billion roubles in 2002, 2003, 2004 and 2005, respectively. The increased contribution in 2005 resulted from federal co-financing of social benefit provisions for labour veterans and World War II-era workers. Since 2005, social benefits for these groups are principally provided by regional governments, and supplemented by the Federal Government.

Sub-federal budget expenditures (including expenditures financed by federal transfers and federal budget loans) were 13.6% of GDP in 2005. Social expenditures by regional and local authorities is substantial (approximately 7.1% of GDP in 2005), reflecting the transfer of social expenses from enterprises to the public sector since 1992. In 2005, sub-federal governments accounted for approximately 79% of education expenditure, 84% of health expenditure and 65% of social expenditure.

Significant progress has been made in Russia in the area of federal-sub-federal fiscal relations. All extraordinary fiscal arrangements between the regions and the Federal Government were eliminated by 2001. The transfer of federal funds to the regions has become more transparent and efficient through the creation of new funds, the reconfiguration of existing funds and the introduction of new methods to calculate transfer volumes. In 2003, the Law on General Principles of Regional Government Organisation was amended and a new law on local self-governance was adopted. These two laws established a clear division of spending powers among the various levels of the budgetary system. They also introduced a mechanism for transferring authority from one budgetary level to another, intended to prevent non-financed mandates and to impose temporary restrictions on the budgetary powers of insolvent regional and local authorities. Amendments to the Budget Code and to the Tax Code that came into effect in 2005 provide a framework for the implementation of the division of fiscal powers.

Extra-Budgetary Funds

Russia had more than 60 extra-budgetary funds in 1992 and 1993, which significantly complicated fiscal management. Since that time, most of these funds have been consolidated into the federal budget. At present there are only three federal extra-budgetary funds: the Pension Fund, the Social Insurance Fund and the Medical Insurance Fund. There are also extra-budgetary funds of federal state agencies (for example, the Russian Fund for Technological Development and the Fund for the Financing of Research and Development) and regional extra-budgetary funds (for example, medical insurance funds).

The largest extra-budgetary funds are the Pension Fund (expenditure of 804.1 billion roubles in 2003, 967.5 billion roubles in 2004 and 912.4 billion roubles in the first three quarters of 2005), the regional medical insurance funds (expenditure of 151.3 billion roubles in 2003, 189.5 billion roubles in 2004 and 177.3 billion roubles in the first three quarters of 2005) and the Social Insurance Fund (expenditure of 136.2 billion roubles in 2003, 140.6

billion roubles in 2004 and 117.6 billion roubles in the first three quarters of 2005). Together, these funds account for approximately 98% of total estimated extra-budgetary expenditure.

In 2001, nearly all social contributions were consolidated into a single 35.6% payroll tax, paid by employers, referred to as the Unified Social Tax. This tax was subsequently reduced to 26.0% in 2005. Since the adoption of pension reform measures in 2005, 20% of the Unified Social Tax is transferred to the Pension Fund, 14% of which is used to finance pensions, while the remaining 6% is directed initially into the federal budget and subsequently used to support the federal budget's contribution to the Pension Fund. See "The Russian Economy—Pension Reform" above. Revenues equal to 3.1% and 2.9% of the Unified Social Tax are transferred to the federal and regional medical insurance funds, and to the federal Social Insurance Fund, respectively. Since 2005, the Pension Fund also receives transfers from the federal budget to finance social benefits and to cover the difference between Unified Social Tax proceeds and pensions commitments. Regional medical insurance funds receive transfers from regional budgets and the federal Medical Insurance Fund.

The current extra-budgetary funds have generally remained balanced since their creation in 1992, reflecting their stable revenue base. Extra-budgetary funds recorded an overall surplus of 0.1% of GDP in 2001, were balanced in 2002 and recorded surpluses of 0.3% of GDP in 2003, 0.4% in 2004 and 0.5% of GDP in the first half of 2005. The Pension Fund ran surpluses of 0.2% of GDP in 2001, 0.1% of GDP in 2002, 0.3% in each of 2003 and 2004, and 0.2% in 2005.

In 2006, the Pension Fund's budget law envisages revenue of 1,566.4 billion roubles, or 6.4% of GDP, and expenditure of 1,489.5 billion roubles, or 6.1% of GDP. The reduction in the surplus is primarily a result of the reduction in the Social Tax rate.

Tax Reform

Prior to 1999, the federal tax system consisted of a number of unconsolidated tax laws and regulations. In 1999, the general part of a new Tax Code, dealing with the framework of the tax system, general definitions and administrative aspects of taxation, came into force. The second part of the new tax code, dealing with VAT, excise duties, social tax, personal income tax, profit tax, resource extraction tax, sales tax and the taxation of agricultural producers came into force in stages in 2001 and 2002. Chapters of the tax code dealing with transport tax, a simplified tax system, a unified tax on imputed income on certain types of activities, property tax, land tax, water tax, stamp duty, gambling tax, taxation of production sharing agreements and the use of animal products came into force between 2003 and 2006.

The main objectives of the Government's tax reform programme are to reduce the total number of taxes, to improve the stability, transparency and fairness of the system through the elimination of tax exemptions, to reduce the overall tax burden and to improve tax collection.

The tax changes made effective in 2001 included the adoption of a flat personal income tax rate (13%) in place of the previous progressive scale of between 12% and 30%. Certain types of income, such as interest income from bank deposits in excess of certain limits, remain subject to tax at 35%. The tax rate for income in the form of dividends was set at 6% (9% since 2005) and the personal income tax rate for non-residents is now 30%. The introduction of a flat income tax was accompanied by the abolition of certain exemptions. The 2001 measures also unified various social contributions (38.5% of payroll for the employer, plus 1% of payroll for the employee) into one social tax at a rate of 35.6% of payroll (26% since 2005), declining on a regressive scale of payroll for higher wages. Turnover taxes were also reduced in 2001, from 4% to 1%, and were abolished in 2003. A transport tax was introduced in 2003. Other reforms adopted in 2002 included indexing specific rates of excise taxes, replacing the fuel sales tax with excise taxes on diesel and motor oil and exempting certain items from profit tax and VAT.

Since January 2002, a profit tax has been imposed at a unified rate of 24%, down from 35% generally and 43% for banks and certain types of enterprises, and the tax base and related procedures have become closer to those of market-oriented economies. Between 2003 and 2005, the intergovernmental allocation of the profit tax has been redistributed. The regional rate was raised from 14.5% to 16% in 2003 and to 17% in 2004, while the federal rate was reduced from 7.5% to 6% in 2003 and to 5% for 2004. Prior to 2005, the municipal profits tax rate was 2%. Beginning in 2005, the federal tax rate is 6.5% and the regional tax rate is 17.5%, while municipal rates are determined by regional authorities. In 2006, the number of permitted profit-related tax deductions was expanded (they now include research and development expenses) and an accelerated amortisation rate of 10% on new capital assets was introduced.

In 2002, a new modified royalty tax on natural resource extraction replaced three taxes on natural resources, including the royalty and excise taxes on crude oil and mineral restoration payments. The natural resource extraction tax on oil is calculated according to a formula that takes international oil prices and the rouble exchange rate into account. In 2004, the natural resource extraction tax rate for oil was raised from 340 roubles per tonne to 347 roubles per tonne, and in January 2005, it was raised further to 419 roubles per tonne. Between 2004 and 2006, the natural resource extraction tax charged on natural gas was adjusted from 16.5% of the value of gas extracted to 147 roubles per thousand cubic metres.

Beginning on 1 January 2003, a simplified tax regime was introduced for small businesses that replaced most existing taxes with a single tax. Under the new regime, small firms may elect to pay either 6% of revenues or 15% of profits.

In 2004 and 2005, sales tax and a number of local taxes and fees were either reduced or eliminated. The general VAT rate was reduced from 20% to 18% (though some goods retained their preferential 0% and 10% rates) and the 0.8% tax on securities operations was abolished. A stamp duty applicable to the issuance of securities was introduced and is assessed at a rate of 0.2% of the aggregate amount of the securities being issued up to 100,000 roubles. Excise duties were indexed or, in the case of natural gas, abolished.

Beginning in 2006, general VAT is calculated using an accrual method, as opposed to the previously used cash method. Additionally, VAT may now be offset as soon as an invoice is received, instead of after the purchased asset is put into operation. As of 1 January 2007, VAT refunds may be claimed through a VAT declaration, eliminating the need for a special application.

In January 2004, property tax was increased for legal entities, with the new maximum property tax rate increasing from 2% to 2.2% of the tax base. Property tax revenue is allocated to sub-federal budgets, and regional authorities may set lower rates in their jurisdictions. A preferred tax regime for agricultural producers was also introduced, under which a new unified agricultural tax replaced corporate income tax, value-added tax, Unified Social Tax (other than obligatory pension insurance contributions) and property tax. Regional land fees are determined region-by-region and are calculated on a cadastral-value base, with a maximum rate of 1.5%.

Amendments to the Law on Customs Duties in 2004 established a new range of export duties. With effect from July 2004, export duties on oil were increased. For oil prices of up to U.S.$109.50 per tonne there is no export duty; at prices of up to $146 per tonne, the tax is assessed at 35% of the difference between the average market price and U.S.$146; for average market prices between U.S.$146 and U.S.$182.50, the tax is assessed at 45% of the difference between the average market price and U.S.$146 plus U.S.$12.78; and when the average price exceeds U.S.$182.50 per tonne, the tax is 65% of the difference between the market price and U.S.$182.50 plus U.S.$29.2. The export duty on natural gas is 30%.

The Unified Social Tax was reformed effective in 2005, with the rates changed to 26% on annual wages up to 280,000 roubles, to 10% on the portion of annual wages between 280,001 and 600,000 roubles and to 2% for the portion of annual wages in excess of 600,000 roubles. These changes are expected to reduce the total tax burden and will affect the social tax collected by the Federal Government, mandatory contributions to the Social Insurance Fund and medical insurance funds.

Beginning in 2006, inheritance and donation taxes were abolished. Income earned by an individual from a donation or inheritance is now subject to 13% personal income tax.

Fiscal Reforms

Several new fiscal measures were adopted for the 2005 fiscal year, including the reform of social benefits, the centralisation of oil tax revenue, and the redistribution of tax revenue and obligations between budgets of different levels.

Social benefit reform is focused on eliminating unfunded benefit entitlements and replacing social privileges with targeted social benefits, generally in the form of monthly cash payments. See "The Russian Economy—Social Benefits and Expenditure" These changes are intended to improve the efficiency of the social protection programmes, and to balance the responsible government's social obligations and financial resources.

Certain obligations have also been redistributed between governments. Civil defence and internal security outlays, military commissariats, and care for the disabled have been transferred to the federal budget. Expenditures for the maintenance of kindergartens, vocational-technical schools and general-education schools, and certain other social expenses have been transferred to regional budgets.

In 2005, federal and all regional and local budgets were prepared in accordance with new budgetary classifications adopted in 2004. These new classifications relate to budget revenues, expenditures and sources of deficit financing. The new classifications were developed in accordance with international standards of budget accounting.

A plan for the reform of the 2004-2006 budgetary process has been adopted by the Federal Government, which is intended to focus on results-oriented budgeting, in an attempt to shift the focus from managing financial resources to managing results. The reform measures include increased autonomy for the departments and agencies responsible for managing expenditures and explicit medium-term benchmarks. The plan also provides for a shift to multi-year budgeting and the development of rules regulating deviations from the volume and structure of budget appropriations. Government liabilities will be subdivided into separate recurring and non-recurring amounts.

MONETARY AND FINANCIAL SYSTEM

The Central Bank of the Russian Federation

The Central Bank of the Russian Federation is Russia's central bank, established by the Constitution and federal law as an independent entity with specific powers and responsibilities. Pursuant to the revised Central Bank Law enacted in April 1995 (the "Central Bank Law"), the Central Bank is charged with responsibility for protecting and ensuring the stability of the rouble, developing and strengthening Russia's banking system and ensuring the efficient and uninterrupted functioning of the settlement system. The Central Bank Law prohibits any government authority from interfering with activities undertaken by the Central Bank in furtherance of its constitutionally and legislatively determined responsibilities, permits the Central Bank to issue resolutions having the force of law within its area of competence and subjects all federal laws and federal executive actions that would affect the activities of the Central Bank to review by the Central Bank. The Central Bank is accountable to the State Duma in that it is required to present an annual report of its activities to the State Duma and to solicit the State Duma's views on the Central Bank's monetary policy.

The Central Bank is also responsible for acting as the Government's bank, acting as lender of last resort to Russian credit institutions, holding most of Russia's official reserves, issuing banking licences and overseeing the bankruptcy and liquidation proceedings of credit institutions.

The Central Bank's governor, who is also the chair of the Bank's 12-member board of directors, is nominated by the President and confirmed by the State Duma. The governor is appointed for a four-year term, and under the Central Bank Law may not be dismissed except for violation of a federal law relating to the activities of the Central Bank or the commission of a crime. Sergei Ignatiev, who began his term on 20 March 2002, is the current governor of the Central Bank. Members of the board of directors of the Central Bank are nominated by the Central Bank governor and confirmed by the State Duma. Board members serve four year terms, may be dismissed only with the governor's approval and may not be officers of the Government or members of the Federal Assembly.

The Central Bank registers and licences all credit institutions, regulates their banking activities and establishes accounting and record-keeping standards. The Central Bank also sets standards for banks with respect to minimum capital requirements, capital adequacy, loan loss provisions and exposure to individual creditors and shareholders. The Central Bank monitors compliance by commercial banks with its regulations through a reporting system, periodic inspections and requests for information, and enforces its regulations through a variety of sanctions, including the power to issue warnings, demand changes in a commercial bank's operations, impose temporary restrictions on a bank's activities, appoint a temporary administrator, impose fines and revoke banking licences.

The Central Bank also supervises acquisitions in the banking sector. Any acquisition of more than 5% of the charter capital of a credit institution requires notice to the Central Bank, and any acquisition of more than 20% requires Central Bank approval.

A federal law relating to the status and functions of the Central Bank, enacted in 2002, expanded the Central Bank's functions and adjusted the composition of the National Banking Committee, the government-controlled supervisory board of the Central Bank. The Committee consists of representatives of the Government, the Federal Council, the State Duma, the Presidential Administration and the Central Bank's Governor. The Central Bank's accounting rules and staff salaries are subject to the Committee's approval. As of 1 January 2006, the statutory capital of the Central Bank was 3 billion roubles.

Monetary Policy

Money Supply and Inflation

The following table sets forth information concerning Russia's money supply as of the dates indicated:

Monetary Survey[1]

	As of 1 January				
	2002	2003	2004	2005	2006[2]
	(millions of roubles, except ratio)				
Net foreign assets	1,092,955	1,577,818	2,096,852	3,209,960	4,910,705
Monetary authorities	888,275	1,382,648	2,170,458	3,395,553	5,256,002
Banking system	204,680	195,171	(73,606)	(185,593)	(345,297)
Domestic credit extended by the Central Bank and the banking system	2,288,168	2,895,016	3,662,241	4,345,645	4,460,764
Net claims on enlarged government	708,352	821,783	688,931	(5,928)	(1,392,620)
Claims on non-financial public enterprises	83,318	122,996	143,024	166,590	193,813
Claims on private sector	1,473,265	1,917,289	2,774,725	4,111,237	5,560,009
Claims on other financial institutions	23,232	32,948	55,561	73,747	99,562
Broad money	2,138,210	2,859,988	3,962,084	5,298,700	7,221,117
Money[3]	1,193,394	1,498,464	2,181,934	2,848,345	3,858,514
Quasi-money[4]	944,816	1,361,524	1,780,151	2,450,355	3,362,603
Restricted Deposits	77,582	43,759	30,360	36,112	32,068
Money market instruments	263,885	399,866	545,464	533,652	579,954
Capital accounts (capital of banking system)	594,452	856,009	984,880	1,086,356	1,455,368
Other items, net	306,995	313,212	236,305	600,785	82,962
Memo:[5]					
Base money (national definition)[6]	717,200	935,200	1,398,600	1,746,200	2,298,900
Rouble broad money (M2) (national definition)[7]	1,602,600	2,119,600	3,212,700	4,363,300	6,045,600
Velocity of M2[8]	7.0	6.2	5.3	4.6	4.3

Notes:

(1) Certain data presented in this table differ from previously published data due to regular revisions by the Central Bank.

(2) Preliminary estimate.

(3) Comprises cash outside banks and demand deposits (other than deposits of the enlarged government) within the banking system (M1).

(4) Comprises time and savings deposits and foreign currency deposits within the banking system.

(5) Only aggregates denominated in roubles.

(6) Comprises cash outside the Central Bank and reserves of commercial banks maintained at the Central Bank.

(7) Comprises M1 and time and savings deposits in the banking sector, including deposits with credit organisations with revoked licences (M2).

(8) Average velocity based on monthly series of nominal GDP and M2.

Source: Central Bank.

The Central Bank's monetary policy is focused on inflation targeting and maintaining a stable national currency. The Central Bank considers low inflation to be one of the main preconditions for macroeconomic stability and expanding domestic credit, which are in turn essential for sustained economic growth.

After the crisis of 1998, the Central Bank implemented monetary policy in an environment characterised by a significant current account surplus and a preference for a competitive exchange rate. As a result of the influx of foreign currency that resulted from increases in world energy prices and the initial over-shooting of the exchange rate, the Central Bank was forced to find a balance between controlling inflation and preventing excessive real appreciation of the rouble that might undermine the competitiveness of domestic producers and economic growth. In response to these developments, the Central Bank adopted a managed floating exchange rate regime to neutralise sharp exchange rate fluctuations in the domestic foreign currency market and to restrain the real appreciation of the rouble.

Large purchases of U.S. dollars by the Central Bank resulted in the rapid growth of Russia's international reserves and monetary aggregates in the post-1998 period. Between 2000 and 2002, M2 grew by 300%. In both 2003 and 2004, positive trends in foreign trade continued and Russia experienced additional growth in its current account surplus. Concurrently, positive changes in the Russian economy, an improved investment climate, sustained economic growth and political stability led to increases in foreign investment. The general decline of the U.S. dollar against other major currencies also contributed to this exchange inflow, as did the low interest rates available in the international capital markets, which facilitated increased foreign borrowing by the Russian corporate sector. In 2003, Moody's Investors Service assigned Russia an investment grade rating. Fitch Ratings and Standard & Poors followed suit in 2004. These ratings upgrades further supported international investment in Russia and helped underpin an appreciation of the rouble. Russia's international reserves increased by U.S.$29.2 billion in 2003, by U.S. $47.6 billion in 2004 and by U.S.$57.7 billion in 2005.

In 2005, the foreign exchange market continued to experience a heavy inflow of foreign currency, causing a persistent excess of foreign currency supply over demand. To prevent excessive rouble appreciation, the Central Bank continued to purchase foreign exchange in large amounts. International reserves increased by U.S.$57.7 billion in 2005. The effects of sterilisation operations undertaken by the Central Bank were constrained by relatively low interest rates, which helped discourage an inflow of short term international capital into the Russian market. The Central Bank has been supported in this effort by the Stabilisation Fund, which in 2005 absorbed approximately 60% of the roubles used by the Central Bank to purchase foreign currency. The growth in monetary and credit aggregates remained high, however, and, in December 2005, the year-on-year increase in M2 was 38.6%, compared to 35.8% in December 2004.

Notwithstanding the increases in the money supply, inflation has declined in recent years. In 2000 and 2001, inflationary effects were partially offset by higher monetary demand generated by rapid economic recovery and falling demand for barter transactions. In subsequent years, the effects of the rapid increases in money aggregates have been offset by economic growth and increased confidence in the rouble.

The following table illustrates the rise in consumer and producer prices for the periods indicated:

Inflation: Consumer and Producer Prices

	Consumer Price Inflation(annual)	**Producer Price Inflation (annual)**
	(% change, end of period)	
2001	18.6	10.7
2002	15.1	17.1
2003	12.0	13.1
2004	11.7	28.3
2005	10.9	13.4

Source: Goskomstat.

Prudent monetary policy helped to constrain the increase in inflation resulting from the events of August 1998. In subsequent years, the combined efforts of the Central Bank and the Government resulted in a continued decline in inflation, though the rate of the decrease slowed. In 2005, consumer price inflation increased by 10.9%, compared to 11.7% in 2004. The gradual adjustment of prices for communal services, electricity and transport continues to be one of the leading drivers of overall inflation. High oil prices and the rapid expansion of monetary aggregates also continue to exert additional upward pressure on consumer prices.

Instruments of Monetary Policy

The primary instruments of monetary policy employed by the Central Bank are open-market operations (including the purchase and sale of government securities in the secondary market), bank reserve requirements and credit-deposit operations.

The Central Bank principally influences interest rates through its official refinancing rate and a standing deposit facility. The upper limit of the market interest rate corridor is set by the overnight loan rates (equal to the refinancing rate), while the lower limit is set by the short-term deposit rate. The refinancing rate has generally remained above the rate available on the interbank market, and most borrowing by commercial banks has accordingly been conducted on the interbank market. The Central Bank's refinancing rate thus is not used extensively for the financing of commercial banks. It remains important, however, for statistical purposes and is used to determine the overnight credit and currency swap rates. From 26 June 2006, the refinancing rate, as well as the overnight credit and currency swap rates, has been set at 11.5%.

In the post-1998 period, excess liquidity in the money market, caused in part by the Central Bank's purchases of foreign exchange on the domestic market, required sterilisation operations to limit their inflationary effects. Sterilisation operations include deposit auctions and stand-by deposit facilities, reverse repo auctions, the issuance of Central Bank bonds and the sale of Russian Government bonds from the Central Bank's portfolio.

The inadequate development of the Russian money market and its excessive segmentation prevent the interbank market from adequately fulfilling its functions of redistributing monetary resources and evening out and reducing fluctuations in interest rates. The refinancing instruments offered by the Central Bank include free intra-day loans, overnight loans and seven-day Lombard loans. In addition, the Central Bank conducts weekly short-term Lombard auctions and provides longer term liquidity to banks. At the end of each business day, credit institutions have access to Central Bank instruments (overnight loans and currency swaps) at interest rates equal to the official refinancing rate.

Exchange Rates

Exchange rate policy is formulated by the Government in consultation with the Central Bank and is implemented by the Central Bank.

The following table sets forth information with respect to rouble/U.S. dollar exchange rate for the years 2001 to 2005:

Official Rouble/U.S. Dollar Exchange Rates

	Average[1]	**End of Period**
2001	29.17	30.14
2002	31.35	31.78
2003	30.69	29.45
2004	28.81	27.75
2005	28.28	28.78

Notes:
(1) Simple average.
Source: Goskomstat.

The Central Bank adopted a managed floating exchange rate regime in September 1998. Under this policy, the Central Bank's presence in the market has been limited to reducing the effects of short-term fluctuations that are not the result of fundamental economic factors.

Beginning in 2000, Russia's balance of payments surpluses, due primarily to high oil prices, caused the Central Bank to intervene on the foreign exchange market to limit the appreciation of the rouble. The rouble nevertheless experienced real appreciation against the U.S. dollar of 11.4% in 2000, 7.6% in 2001 and 6.2% in 2002.

In 2003, the Central Bank revised its exchange rate policy and let the rouble appreciate against the dollar in nominal as well as in real terms. This decision reversed the Central Bank's prior policy of allowing a steady nominal depreciation, averaging approximately 0.5% per month, to slow the real appreciation of the rouble. As a result, during 2003, the rouble appreciated against the dollar by 19.1% in real terms, while the trade-weighted real exchange rate of the rouble increased by 4.1%. In 2004, faced with the rapid appreciation of the rouble, the Central Bank resumed active support of the U.S. dollar on the domestic market. During 2004, the rouble appreciated against the U.S. dollar by 14.0% in real terms and against the euro by 6.0%, and the trade-weighted real exchange rate of the rouble increased by 4.7%.

In 2005, Russia continued to experience large inflows of oil-related foreign capital, as well as significant amounts of foreign lending to Russia's corporate sector. Growing international confidence in the Russian economy and the profitability of the oil sector supported the corporate sector's intensive borrowing and accumulation of large liabilities denominated in foreign currency. During the first six months of 2005, Russia's large trade surplus coupled with the strengthening of the U.S. dollar against other currencies caused a rapid appreciation of the real exchange rate of the rouble against the euro as well as the real effective exchange rate of the rouble. In the second half of the year, the strengthening of the U.S. dollar decelerated, resulting in a slower appreciation of the rouble. In all of 2005, the rouble appreciated against the U.S. dollar by 3.9% in real terms and against the euro by 18.8% in real terms, in each case as compared to December 2004. The trade-weighted real exchange rate of the rouble increased in 2005 by 10.5%.

In managing the U.S. dollar exchange rate on the domestic market, the Central Bank had until 2005 focused primarily on maintaining a stable exchange rate. Beginning 1 February 2005, the Central Bank adopted a basket of currencies as an operating benchmark and began using movements in the U.S. dollar/euro exchange rate as a reference point for its exchange rate policy. The basket initially consisted of €0.1 and U.S.$0.9. Over time, the weighting of the euro has gradually increased and, as of 2 December 2005, was set at 0.4% of the basket of currencies used as the Central Bank's reference point. The U.S. dollar retains its leading position and continues to be the preferred currency for exports and domestic savings.

Russia believes that the current managed floating exchange rate regime is necessary to prevent sharp fluctuations in the exchange rate. The supply of foreign exchange through the current account generally exceeds demand, while the capital and financial account is unstable both in value and the direction of financial flows. As the Stabilisation Fund becomes more established and the structure of the Russian economy improves, the Central Bank plans to reduce its presence on the domestic foreign exchange market, shifting to a free floating exchange rate and focusing its efforts on inflation targeting.

Banking

Structure of the Banking Industry

All credit institutions are required to be licensed by the Central Bank. A general banking licence is the most comprehensive licence available and allows a credit institution to engage in various banking operations in a range of prescribed currencies. Under Russian law, commercial banks holding general licences are allowed to own, underwrite and deal in all types of securities. Banks without a general licence require a separate licence to conduct foreign exchange operations.

As of 1 April 2006, there were 1,238 licensed banks, of which 289 held general licences and 834 held foreign exchange licences. Licensed banks included 43 wholly foreign-owned banks and 12 banks with majority foreign ownership. Licensed foreign banks are subject to the general banking laws and regulations and are entitled to participate in the same range of banking activities as their Russian counterparts. As of 1 April 2006, there were also 32 representative offices of foreign banks in Russia and 46 licensed non-bank credit organisations.

As of 1 January 2006, there were 3,266 branches of operating domestic banks in Russia, of which approximately one-third are branches of Sberbank, which is the successor of the former state savings bank in the Soviet Union and is controlled by the Central Bank. As of 1 July 2005, Sberbank held approximately 57% of all household deposits and itself accounted for approximately 28% of total banking assets. Prior to 2004, household deposits, other than deposits with Sberbank, were not guaranteed by the state. At the end of 2003, in an effort to enable private sector banks to better compete with Sberbank for retail deposits, Russia enacted a federal deposit insurance law, which requires banks to make annual contributions equal to 0.15% of their deposits to a federal deposit insurance fund. The fund insures the full repayment of deposits up to 100,000 roubles. Until 2007, Sberbank's contributions to the fund are kept on a separate account. The state's guarantee of Sberbank's deposits will end in 2007, or earlier if Sberbank's share of the retail market drops below 50%.

Banking Supervision and Regulation

The Central Bank operates an early warning system under which it analyses the most significant prudential ratios for all banks on a monthly basis. Banks that fail to comply with their reporting obligations can be forced to close their correspondent accounts with other banks and make all settlements exclusively through the Central Bank. The ratios reviewed by the Central Bank include ratios relating to capital, overdue loans, open foreign exchange positions and loans to insiders. On the basis of these ratios, banks are placed in one of four groups, according to the level of risk of failure. As of 1 January 2006, there were 11 banks in the highest risk group and 38 in the second highest risk group, indicating a likelihood of closure without the injection of new capital. These banks accounted for less than 1% of total banking assets, are generally small and borrow in the interbank market only to a limited extent. There is only a low risk that their closure would trigger systemic failure.

Russian banks (other than Sberbank) are subject to prudential regulations intended to move the Russian banking industry toward compliance with the capital adequacy standards established by the Basel Committee on Banking Supervision. These regulations impose requirements with respect to minimum capital, capital adequacy, exposure to individual borrowers and shareholders, deposit taking and equity investments in other companies. As of 1 January 2006, all Russian banks satisfied applicable capital adequacy requirements.

The Central Bank imposes a reserve requirement on all banks. The reserve ratios are currently 3.5% for corporate deposits denominated in both roubles and foreign currencies and for rouble-denominated retail deposits, and 2% for deposits of non-resident banks denominated both in roubles and foreign currencies. In 2004, the Central Bank reduced reserve ratios by an average of 5.0% in an attempt to bolster the competitiveness of Russian banks vis-à-vis their international counterparts. Credit institutions are required to meet their reserve requirements on average during each calendar month or reserve maintenance period. This provision provides for flexible liquidity management and decreases the day-to-day dependence on interbank funds.

The Law on Insolvency (Bankruptcy) of Credit Institutions provides the legislative framework for the restructuring of banks. This law sets out the standards to be used by the Central Bank in appointing temporary bank administrators, provides an expedited liquidation procedure for banks, and gives the Central Bank the power to licence the receivers of bankrupt banks and to propose receivers to arbitration courts for their approval.

Foreign Exchange Regulation*s*

Russia has adopted Article 8 of the IMF's Articles of Agreement with respect to current account convertibility and has met all obligations imposed thereunder.

Prior to June 2004, the convertibility of the rouble was heavily regulated. Russian residents (including Russian legal entities and organisations formed under Russian law, Russian citizens and permanent residents) were able to freely convert foreign currency into roubles through authorised banks, but only if the purpose of the conversion was to settle a "current" transaction or to repay principal on a loan denominated in a foreign currency under circumstances where the foreign currency-denominated loan either did not require a Central Bank licence or was made on the basis of a Central Bank licence. The conversion of roubles into foreign currency under other circumstances required a Central Bank licence. "Current" transactions included payments for imported or exported goods within 90 days of the date of sale, lending or borrowing money for terms of up to 180 days and payments of interest, dividends and certain other amounts in respect of loans, investments or securities.

Legal entities that were not Russian residents could only convert foreign currency into roubles through type "N" or type "K" accounts at authorised Russian banks. These accounts could be opened to conduct export-import transactions, to maintain representative offices in Russia and to invest or reinvest in Russia. Non-resident legal entities could convert roubles into foreign currency for repatriation through type "K" accounts. Roubles could not be exported except with the approval of the Central Bank, the Ministry of Finance and the Customs Committee.

In July 2001, Russia relaxed its foreign exchange regulations. The currency repatriation period for proceeds from exports by machinery and construction firms was extended from three months to three and five years, respectively, and individuals were permitted to transfer up to U.S.$75,000 each year abroad without Central Bank approval for the purpose of investing in foreign equities. The range of operations not requiring a special permit from the Central Bank was expanded to include payments made by residents outside Russia for construction, insurance and reinsurance contracts, as well as the extension of loans by non-residents to Russian residents in excess of 180 days. The process for licensing currency operations licensing through the Central Bank was also simplified.

In June 2004, a new currency law came into force that liberalised the exchange control regime, although a transition period is in effect until 1 January 2007, during which time the Central Bank and the Russian Government may impose currency control measures. Under the new law, only enumerated currency operations are subject to regulation, and neither the Central Bank nor the Government may adopt currency regulations except in cases expressly prescribed by the new law. In particular, in the absence of a prescribed procedure, residents and non-residents may open bank accounts and conduct currency operations without limitation. The law further provides that all unsolvable doubts, contradictions and ambiguities in the new currency law or in any currency regulation are to be resolved in favour of residents and non-residents conducting currency operations.

The new currency law distinguishes between two types of capital operations, those that are regulated by the Government (principally commercial credits granted by residents to non-residents) and those regulated by the Central Bank (loans, cash transfers and securities transactions). The instruments of currency regulation include reserve requirements, use of special accounts and (as described below) the pre-registration of accounts. In general, the Government may require the deposit of up to 50% of the total amount of a covered currency transaction in a non-interest bearing account for a term of up to two years. The Central Bank may also require the deposit of capital intended to be exported from Russia for a period of up to two months, the deposit of up to 20% of capital being repatriated to Russia for a term of up to one year, and that a special account be opened and maintained with a Russian authorised bank (or depositary, if the settlement involves securities) for the settlement of certain enumerated transactions. Under the new law, restrictions may still be imposed to prevent a significant reduction in Russia's gold or foreign currency reserves, to prevent a severe currency fluctuation and to support the stability Russia's balance of payments.

The new law does not impose any restrictions on investments in foreign securities by individual residents, up to a maximum of U.S.$150,000 per year. Individual Russian residents may now open accounts in foreign banks in any country that is a member of the Organization for Economic Cooperation and Development and a party to the Financial Action Task Force on Money Laundering, subject only to notification of the Russian tax authorities. Russian residents desiring to open accounts in other countries are required to pre-register their account with the tax authorities. Legal entities obtained similar rights in June 2006. Under the new law, the maximum percentage of export revenues that must be converted into roubles is set at 30% until 2007.

Although the new law envisaged that all restrictions on capital operations would be abolished on 1 January 2007, the new law was subsequently amended to provide for full convertibility of the rouble as of 1 July 2006. The amendments repealed the government and the Central Bank's right to set reserve requirements on foreign currency operations between residents and non-residents, eliminated the use of special accounts in Russian banks for calculating and converting capital transfers, and abolished the requirement for exporters to sell a portion of their foreign currency revenue. The amendments also eased restrictions on personal foreign currency transactions, abolishing the need to seek permission to open, and the requirement to register, foreign currency accounts in Russia and abroad, though a system requiring the notification of account openings remains in place. Finally, the limit on investments made by Russian citizens in foreign companies will be lifted as of 1 January 2007.

Foreign Exchange Market

The largest share of Russia's foreign exchange trading occurs in the over-the-counter interbank currency market, with other trading conducted on the MICEX. The Central Bank buys and sells currencies through MICEX when it acts to influence exchange rates. MICEX was established in 1991 as a department of the Central Bank's Soviet predecessor, and was transformed in January 1992 into a closed joint-stock company. MICEX's largest shareholder is the Central Bank. Commercial banks and the Association of Russian Banks are also shareholders.

Only MICEX members, which include commercial banks, financial institutions and certain other investment institutions, may participate in currency exchange trading on MICEX.

The major currency traded on MICEX is the U.S. dollar, with trading volume of U.S.$425.8 billion in 2005, accounting for more than 98% of total turnover. MICEX also trades euro and CIS currencies. CIS currencies may only be converted in countries that have a special agreement on mutual currency convertibility.

The Central Bank and MICEX have supported the establishment of a system of regional currency exchanges within Russia. There are currently seven regional exchanges. The largest regional currency exchanges are the St. Petersburg Currency Exchange ("SPCEX") and the Siberian Interbank Currency Exchange.

Capital Markets

Government Securities

The market for rouble-denominated government securities comprises Federal Government rouble-denominated bonds and sub-federal government rouble-denominated bonds. The Government's rouble-denominated securities include short-term bills (GKOs) and medium-term bonds (OFZs). GKOs and OFZs are initially issued through MICEX. See "—Foreign Exchange Market" above. Secondary trading of GKOs and OFZs takes place on MICEX and its representative regional exchanges. GKOs and OFZs are held in book entry form, which minimises transaction risks. As of 1 January 2006, the par value of marketable Federal Government bonds was approximately U.S.$25 billion. For a detailed description of the various Government domestic debt instruments, see "Public Debt—Domestic Debt—Government Domestic Debt."

The market for rouble-denominated sub-federal government bonds prior to 2002 consisted mainly of City of Moscow bonds placed and traded on MICEX and City of St. Petersburg bonds placed and traded on SPCEX. Bond issuances by sub-federal entities have since increased. As of January 2006, 46 of the then 89 Federation subjects had outstanding rouble-denominated bonds in an aggregate principal amount of approximately 145 billion roubles (U.S.$5.1 billion), of which approximately 58 billion roubles (U.S.$2.0 billion) was issued by the cities of Moscow and St. Petersburg.

Corporate Securities

The trading of privatisation vouchers issued in connection with Russia's mass privatisation programme, implemented between 1992 and 1994, played an important role in the development of the equity securities market in Russia. A certificateless securities system was subsequently adopted, largely in response to fraud encountered in vouchers trading. As a result, virtually all common and preferred stock in Russia are held in book entry form, with ownership recorded in the issuer's share register.

The Russian stock market was originally based on an electronic over-the-counter trading system, known as the Russian Trading System ("RTS"), which was introduced in 1995 and managed by the National Association of Stock Market Participants, a self-regulatory body responsible for the development of rules for trading on the RTS. There are currently five licensed stock exchanges in Russia, including the RTS, and their share of exchange-based trading is increasing. In 2005, the average daily stock turnover reached approximately U.S.$473 million on MICEX, the largest Russian exchange, and approximately U.S.$31 million on the RTS over-the-counter section.

The market capitalisation of companies listed on Russian stock markets has increased significantly in recent years. The total market capitalisation of the RTS was U.S.$60.6 billion at the end of 2001, U.S.$85.2 billion at the end of 2002, U.S.$143 billion at the end of 2003, U.S.$142 billion at the end of 2004, and U.S.$257 billion at the end of 2005.

The Russian corporate bond market is a fast-growing segment of the Russian financial market, though it remains relatively small compared to the stock market. The number of bond issues and their tenor has increased significantly since 2002. New corporate bond issues typically have a term ranging from two to five years and include a "put back" right. In December 2005, the outstanding volume of corporate bonds amounted to 420 billion roubles (U.S.$15 billion). The average daily turnover in the Russian corporate bond market (both the exchange market and over-the-counter market) was approximately U.S.$209 million in 2005.

Regulation of the Capital Markets

The Federal Service for Financial Markets (the "FSFM"), which succeeded the Federal Commission for the Securities Markets, has primary responsibility for regulating the Russian securities market. The FSFM is a federal executive authority subordinated to the Government. Its functions include registration of securities issues, ensuring the disclosure of information on securities markets and control and supervision of securities issuers and professional securities market participants. The Central Bank oversees government securities transactions (as an instrument of monetary policy), foreign investment (as a matter of currency exchange control), and securities offerings by banks (as the primary regulator of banks).

PUBLIC DEBT

External Debt

As at 1 January 2006, the total outstanding external debt of the Government, or for which the Government has agreed to be responsible, amounted to approximately U.S.$79.7 billion. This amount included all loans contracted or guaranteed by the Government, loans contracted or guaranteed by Vnesheconombank and debt contracted or guaranteed by other entities legally authorised to borrow on behalf of the government of the former Soviet Union, as well as outstanding arrears unpaid as at the end of December 2005. Undisbursed commitments and public or private sector borrowings not guaranteed by the Government are excluded from the U.S.$79.7 billion outstanding at the end of December 2005. The Government incurred additional external debt of U.S.$38.2 million under multilateral facilities and U.S.$27.8 million from bilateral sources in the first quarter of 2006.

On 16 June 2006, Russia agreed in principle to prepay all of its debt to the Paris Club of official creditors in the amount of approximately U.S.$21.6 billion. This prepayment, effected in August 2006, is not reflected in the table below.

The following table sets forth information with respect to the Government's external debt at period end for the years 2000 through 2005:

External Debt Stock of the Government of the Russian Federation by Creditor[(1)]

	As of end of period					
	2000	2001	2002	2003	2004	2005
			(U.S.$ billion)			
Total external debt	139.7	127.4	119.3	115.6	110.5	79.7
External debt of the Government of the Russian Federation	46.4	39.2	37.9	33.5	29.6	20.5
Multilateral creditors[(2)]	18.9	14.9	14.0	11.6	9.7	5.6
Bonds	15.5	14.4	14.7	13.4	12.2	8.4
Official creditors[(3)]	8.5	6.4	5.7	4.9	4.2	3.0
Ministry of Finance Hard Currency Bonds[(4)]	3.5	3.5	3.5	3.5	3.5	3.5
Commercial creditors	0.0	0.0	0.0	0.0	0.0	0.0
External debt of the former Soviet Union for which the Government of the Russian Federation has agreed to be responsible	93.2	88.2	81.4	82.1	80.9	59.2
Multilateral creditors	0.0	0.0	0.0	0.0	0.0	0.0
Bonds[(5)]	20.9	20.9	22.3	22.3	23.1	23.1
Official creditors[(3)]	58.5	53.3	48.9	51.4	50.9	29.3
Ministry of Finance Hard Currency Bonds[(6)]	7.3	7.3	5.8	3.8	3.8	3.8
Commercial creditors[(7)(8)]	6.6	6.8	4.5	4.7	3.0	3.0
Ministry of Finance obligations owed indirectly to the Central Bank	6.4	6.4	6.2	6.2	5.5	0.0

Notes:

(1) Foreign currency values of outstanding external debt have been converted into U.S. dollars at the relevant market exchange rates prevailing at the end of the indicated period.

(2) Excludes contingent liabilities amounting to approximately $0.05 billion in the form of guarantees and counter-guarantees.

(3) Includes government-to-government credits and official export credits.

(4) Ministry of Finance Hard Currency Bonds, Series VI and VII (MinFins), representing Russian debt issued in 1996.

(5) Represents outstanding 2010 Bonds and 2030 Bonds issued in exchange for London Club debt in 2000, FTO debt in 2002, and IBEC/IIB debt in 2004.

(6) Ministry of Finance Hard Currency Bonds, Series III, V and VIII (MinFins), representing restructured former Soviet debt.

(7) Includes uninsured trade suppliers of the former Soviet Union not exchanged for 2010 and 2030 Bonds in the first tranche FTO Exchange and claims owed to IBEC.

(8) Subject to reconciliation.
Some totals may not add due to rounding.
Source: Ministry of Finance, Vnesheconombank.

Of the U.S.$79.7 billion outstanding at 31 December 2005, U.S.$20.5 billion represents loans and bonds contracted or guaranteed by the Government since 1 January 1992. These obligations have been honoured in full.

The remaining U.S.$59.2 billion represents external debt obligations of the former Soviet Union for which the Government has agreed to be responsible. In view of the short maturity of most of these obligations (approximately two-thirds fell due between 1992 and 1995, with more than half falling due in 1992 and 1993) and in the absence of sufficient foreign exchange to service them as scheduled, the Government was forced to restructure these obligations beginning in December 1991. Comprehensive rescheduling agreements in respect of virtually all the Soviet-era debt for which the Government has agreed to be responsible were agreed by the Government in 1996 and 1997, with the exception of the Eurobonds issued by Vnesheconombank prior to the dissolution of the former Soviet Union, which were honoured in full on their due dates.

The Government prepaid approximately US$22.6 billion of its external debt in 2005. The prepaid debt included approximately US$15 billion of rescheduled Soviet-era debt owed to the Paris Club, which was prepaid at face value in July and August 2005, and US$3.3 billion owed to the IMF, which was paid ahead of schedule in the first quarter of 2005. U.S.$4.3 billion in respect of Ministry of Finance obligations owed indirectly to the Central Bank was also repaid ahead of schedule in 2005.

Russia has in the past purchased Russian Government Eurobonds and other Federal Government obligations in the open market, and may do so in the future.

External Debt Restructuring

Paris Club

In January 1992, the Government concluded an initial annual rescheduling agreement with the Paris Club of official creditors, followed by three further annual reschedulings in 1993, 1994 and 1995, covering debt service falling due during the period from December 1991 to the end of 1995.

In April 1996, a comprehensive rescheduling was agreed with the Paris Club covering approximately U.S.$33 billion of debt owed to Paris Club creditors, including debt service falling due between the beginning of January 1996 and the end of March 1999 and virtually all the debt rescheduled under the previous agreements. Of this amount, 45% was scheduled to be repaid over a period ending in 2020, while the remaining 55% (which includes all short-term debt owed to these creditors) was due to be repaid over a period ending in 2016, in gradually increasing semi-annual instalments.

In August 1999, the Government concluded a further rescheduling agreement with the Paris Club. This agreement provided for the deferral of approximately U.S.$8.3 billion of debts owed to Paris Club creditors, including payment arrears outstanding at the end of June 1999 and debt service falling due between the beginning of July 1999 and the end of December 2000 in respect of both previously rescheduled and non-previously rescheduled Soviet-era obligations. The rescheduled principal was to be repaid in gradually increasing instalments commencing in 2002, with approximately 30% due to be repaid over a period ending in 2020 and approximately 58% due to be repaid over a period ending in 2016. The remaining approximately 12% was reprofiled over a period ending in 2005.

In May 2005, the Government reached an agreement with the Paris Club under which approximately US$15 billion of the debts rescheduled under the 1996 and 1999 rescheduling agreements was prepaid at face value. All of Russia's remaining Paris Club debt, in the approximate amount of U.S.$21.6 billion, was prepaid in August 2006.

U.S.$1.6 billion of Soviet-era obligations owed to Paris Club creditors were never rescheduled under any agreement with the Paris Club. These obligations have been entirely repaid.

London Club

A comprehensive restructuring agreement in respect of Soviet-era debt owed to Vnesheconombank's London Club (commercial bank and other financial) creditors was closed in December 1997. Under the terms of this agreement, the entire stock of outstanding principal owed to London Club creditors, amounting to approximately U.S.$22.2 billion, was restructured as PRINs and the interest regarded as having accrued on this debt (net of a cash down-payment) was restructured into U.S.$6.0 billion principal amount of IANs.

In July 2000, the Russian Federation offered to exchange Vnesheconombank's PRINs and IANs for 2030 Bonds and the interest arrears on PRINs and IANs for a combination of 2010 Bonds and cash. For each U.S.$1,000 principal amount of PRINs tendered, a creditor received U.S.$625 principal amount of 2030 Bonds, and for each U.S.$1,000 principal amount of IANs tendered, a creditor received U.S.$670 of 2030 Bonds. In August 2000, U.S.$18.2 billion of 2030 Bonds and U.S.$2.5 billion of 2010 Bonds were issued in exchange for PRINs and IANs, and U.S.$275 million was paid in cash in exchange for PRIN and IAN interest arrears. A further U.S.$129 million of 2030 Bonds and U.S.$18 million of 2010 Bonds have been issued in subsequent re-openings of this exchange. At 1 January 2006, U.S.$0.5 million of PRINs and U.S.$33.5 million of IANs have not been tendered for exchange and remain outstanding.

FTO Debt

In November 2002, the Russian Federation offered to exchange 2030 Bonds and 2010 Bonds for eligible uninsured trade debt of the former Soviet Union for which the Government has agreed to be responsible ("FTO claims") on terms broadly comparable to the terms previously offered to PRIN and IAN holders. In December 2002, U.S.$1.19 billion principal amount of 2030 Bonds and U.S.$183.8 million principal amount of 2010 Bonds were issued in exchange for FTO claims and U.S.$171.5 million was paid in cash. A further U.S.$720 million of FTO claims are the subject of the Exchange Offer contemplated in this Prospectus.

Other Former Soviet Union Debt

Following the dissolution of the former Soviet Union, the Government assumed responsibility for Soviet-era debts owed to the former member countries of the Council for Mutual Economic Assistance ("CMEA"). These debts relate to the CMEA trade settlement systems that were in place between CMEA member countries. Most of these debts were incurred as a result of an imbalance in the settlements in favour of the creditor country at the time of the dissolution of the CMEA and the Soviet Union. As of the end of December 2005, CMEA debt amounted to U.S.$2.1 billion. A substantial portion of this debt will be repaid in the form of equipment, goods and services, with the balance to be repaid in cash.

The Government has also concluded negotiations with a number of non-Paris Club official creditors under which repayment is partly in the form of equipment, goods and services. The Government intends to conclude negotiations with the remaining non-Paris Club official creditors on similar terms by the end of 2006.

In 1993, the Government issued U.S. dollar denominated Internal Government Hard Currency Bonds ("OVVZs," known as "Taiga" bonds or MinFins) to compensate Russian legal entities whose funds had been frozen in 1991 in foreign currency accounts at Vnesheconombank. MinFins were initially issued in five series, with maturities ranging between one and 15 years. Two additional series were issued in May 1996 with maturities of 10 and 15 years, respectively. All of the MinFins pay a 3% coupon annually until redemption. OVVZs trade in the over-the-counter market. The principal amount of outstanding OVVZs stood at U.S.$7.3 billion at the end of December 2005. Historically, OVVZs were regarded as domestic public debt. Starting in 2000, they were reclassified as external debt for budgetary purposes.

On 11 May 1999, the Ministry of Finance requested the holders of U.S.$1.3 billion aggregate principal amount of Series III MinFins maturing on 14 May 1999 not to present their bonds for redemption, pending the development of a restructuring proposal. The Ministry of Finance did, however, pay all of the interest accrued on Series III MinFins and announced that interest on these bonds would continue to accrue at the original rate of 3% until they were restructured into new instruments. Following consultations with representative investor groups, the

Government made a proposal in November 1999 to exchange all Series III MinFins for (i) new U.S. dollar denominated Government bonds with an average life of seven and a half years and bearing interest at 3% payable semi-annually or (ii) rouble denominated OFZs with maturities of four years, paying interest semi-annually at 15% in the first year, declining to 10% in subsequent periods. Under the Government's proposal, Series III MinFins were exchanged for new U.S. dollar denominated bonds at par, and for new rouble denominated bonds at par at the rate of 26.2 roubles per U.S. dollar, that being the average official exchange rate for the first week of November 1999. As of 1 January 2006, the Ministry of Finance had received applications for the exchange of approximately U.S.$1.24 billion face value of Series III MinFins, of which approximately U.S.$890 million was exchanged for U.S. dollar instruments and the remaining U.S.$349 million was exchanged for OFZs.

External Debt Service Projection

The following table sets forth a projection of the Government's contractual external debt service by type of creditor from 2006 to 2012, including principal and interest payable on all external debt outstanding at the end of December 2005, on the basis of the exchange rates and interest rates prevailing at that time. This table includes the contractual payments that will be due on 2010 Bonds and 2030 Bonds expected to be issued to holders of FTO claims pursuant to the exchange offer contemplated in this Prospectus, but does not give effect to the prepayment of all of Russia's remaining Paris Club debt, which was made in August 2006.

This table does not reflect the external debt service (i) on any borrowings by or on behalf of the Government since 31 December 2005, which have not been significant, or (ii) on any new drawdowns on existing borrowings by or on behalf of the Government during the period covered by the table, which are expected to be significant.

External Debt Service Projections by Type of Creditor(1)

	2006	2007	2008	2009	2010	2011	2012
				U.S.$billion			
Principal	**5.81**	**6.61**	**6.43**	**4.20**	**4.03**	**5.82**	**4.08**
External debt of the Government of the Russian Federation	3.13	3.71	1.16	1.00	0.91	2.54	0.64
Multilateral creditors	0.74	0.76	0.70	0.69	0.67	0.59	0.49
Bonds(2)	0.00	2.40	0.00	0.00	0.00	0.00	0.00
Official creditors	0.64	0.55	0.46	0.31	0.24	0.19	0.15
Ministry of Finance Hard Currency Bonds(3)	1.75	0.00	0.00	0.00	0.00	1.75	0.00
External debt of the former Soviet Union for which the Government of the Russian Federation has agreed to be responsible	2.68	2.90	5.27	3.20	3.12	3.28	3.44
Multilateral creditors	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Bonds	0.65	0.85	0.85	1.48	1.26	1.26	1.26
Official creditors	1.59	1.60	1.58	1.72	1.87	2.02	2.19
Ministry of Finance Hard Currency Bonds(4)	0.44	0.44	2.84	0.00	0.00	0.00	0.00
Interest	4.29	3.98	3.89	3.59	3.33	3.09	2.80
External debt of the Government of the Russian Federation	1.38	1.14	0.97	0.93	0.89	0.85	0.77
Multilateral creditors	0.23	0.20	0.17	0.14	0.11	0.08	0.06
Bonds(2)	0.94	0.82	0.70	0.70	0.70	0.70	0.70
Official creditors	0.10	0.07	0.05	0.03	0.02	0.02	0.01
Ministry of Finance Hard Currency Bonds(3)	0.11	0.05	0.05	0.05	0.05	0.05	0.00

	2006	2007	2008	2009	2010	2011	2012
				U.S.$billion			
External debt of the former Soviet Union for which the Government of the Russian Federation has agreed to be responsible	2.91	2.84	2.92	2.66	2.44	2.24	2.03
Multilateral creditors	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Bonds	1.46	1.48	1.67	1.59	1.47	1.38	1.29
Official creditors	1.34	1.26	1.16	1.07	0.97	0.86	0.74
Ministry of Finance Hard Currency Bonds(4)	0.11	0.10	0.09	0.00	0.00	0.00	0.00
Total	**10.10**	**10.59**	**10.32**	**7.79**	**7.36**	**8.91**	**6.88**

Notes:

(1) Includes contractual payments of existing obligations, as well as contractual payments of 2010 Bonds and 2030 Bonds expected to be issued to holders of FTO claims pursuant to the exchange offer contemplated in this Prospectus.

(2) This table assumes that the put option on the Government's U.S.$2.5 billion Eurobond maturing in 2028 is not exercised in 2008. This bond currently trades at prices greatly in excess of its face amount.

(3) Ministry of Finance Hard Currency Bonds, Series VI and VII (MinFins), representing Russian debt issued in 1996.

(4) Ministry of Finance Hard Currency Bonds, Series III, V and VIII (MinFins), representing restructured former Soviet Union debt.

Some totals may not add due to rounding..

Source: Ministry of Finance, Vnesheconombank.

External Borrowings

Since the dissolution of the former Soviet Union, the Ministry of Finance has borrowed externally on behalf of Russia only in respect of certain multilateral facilities, through bond issues and through certain medium and short-term financings. All other external borrowings of the Government have been implemented through Vnesheconombank, Vneshtorgbank (Russia's foreign trade bank), or Roseximbank (Russia's export-import bank), which are all authorised on a case-by-case basis to borrow externally under the guarantee of the Government and are responsible for recording and monitoring these borrowings. Borrowings by these banks under the Government's guarantee are included in the external debt statistics of the Government.

Apart from guarantees of obligations of these banks, the Government has not provided external guarantees for public or private sector entities, with the exception of certain contingent liabilities to the World Bank and EBRD, amounting to approximately U.S.$ 0.05 billion as at 1 January 2006. No ministry, regional authority or public sector entity is authorised to borrow in its own name under a Government guarantee.

The Government has provided letters of comfort to creditors in respect of certain borrowings by the public and private sectors. These letters commit the Government to take (or refrain from taking) certain actions but do not require it to pay any funds. The Government is not the obligor in respect of such borrowings, and they are not included in the Government's external debt statistics.

The Government has paid in full all of the debt service due on borrowings contracted by the Government since 1 January 1992, including payments on the approximately U.S.$36.9 billion aggregate principal amount of Eurobonds issued by Russia since November 1996.

Current External Debt Policy

The prime objective of the Government's external debt policy is to further reduce its outstanding stock of external debt and its external debt service to lower levels; to reduce the absolute and relative amounts of external state debt through the substitution of domestic debt; to preserve and develop the government securities market; and to use debt instruments to accelerate Russia's social and economic development, to sterilise surplus monetary supply and to reduce inflation. The Government has also announced a programme to adopt the best international practices in debt management, to ensure appropriate management of its risk exposure and to reduce its debt-servicing costs while meeting the Government's fund raising targets.

Domestic Debt

The following table sets forth information with respect to Russia's domestic debt at period-end for the years 2001 to 2005.

Domestic Debt of the Federal Government(1)

	As of 31 December				
	2001	**2002**	**2003**	**2004**	**2005**
			(billions of roubles)		
Total	533.5	679.9	682.0	778.5	875.4
GKOs	19.5	18.8	2.7	0.0	0.0
OFZs with variable coupon	24.1	24.1	24.1	0.0	0.0
OFZs with fixed rates	307.8	350.7	50.5	43.3	123.6
OFZs with fixed coupon	138.5	207.1	199.3	171.2	131.1
Amortising OFZs(2)	—	42.3	375.4	542.2	596.3
Other	43.5	36.9	30.0	21.8	24.3
			(% of total)		
Total	100.0	100.0	100.0	100.0	100.0
GKOs	3.7	2.8	0.4	0.0	0.0
OFZs with variable coupon	4.5	3.5	3.5	0.0	0.0
OFZs with fixed rates	58.0	51.6	7.4	5.6	14.1
OFZs with fixed coupon	26.0	30.5	29.3	22.0	15.0
Amortising OFZs(2)	—	6.2	55.0	69.6	68.1
Other	8.2	5.4	4.4	2.8	2.8
			(% of GDP)		
Total	6.0	6.3	5.1	4.6	4.0
GKOs	0.2	0.2	0.0	0.0	0.0
OFZs with variable coupon	0.3	0.2	0.2	0.0	0.0
OFZs with fixed rates	3.4	3.2	0.4	0.3	0.6
OFZs with fixed coupon	1.5	1.9	1.5	1.0	0.6
Amortising OFZs(2)	—	0.4	2.8	3.2	2.8
Other	0.5	0.3	0.2	0.1	0.1
Memo:					
Exchange rate, rouble/U.S.$, end of period	30.14	31.78	29.45	27.75	28.78
GDP (billions of roubles)	8,944	10,831	13,243	16,966	21,598
Total domestic debt of the Government (U.S.$ billion)	17.7	21.4	23.2	28.0	30.4

Notes:

(1) Certain data presented in this table differ from previously published data due to changes in the accounting methodology of the Ministry of Finance.

(2) In accordance with the federal budget law for 2003, non-marketable rouble government bonds (fixed rate OFZs) held by the Central Bank were exchanged for amortizing OFZs with a total face value of 282.5 billion roubles in February 2003. The goal of this exchange operation was to reinforce liquidity management by the Central Bank.

Source: Ministry of Finance.

Government Domestic Debt

The Government's domestic indebtedness consists principally of medium- and long-term OFZs. As of 31 December 2005, the Government's domestic debt amounted to 875.4 billion roubles (U.S.$30.4 billion), or 4.0% of GDP for 2005. The Government has in the past also issued short-term GKOs.

OFZs are rouble denominated obligations with a maturity of over one year, and pay interest quarterly, semi-annually or annually. Initially issued in June 1995, OFZs (including OFZs issued in the GKO/OFZ restructuring discussed below) represented 93.1% of the Government's domestic debt (17.5% of GDP) at the end of 1998 and 97.2% of the Government's domestic debt (3.9% of GDP) at the end of 2005.

OFZs were initially issued with floating coupons pegged to the average weighted market yields of GKOs redeemable during the period beginning 30 days before and ending 30 days after the coupon payment. Floating rate OFZs represented 10.6% of total Government domestic debt at the end of 1997 but declined in importance thereafter.

In June 1996, fixed rate OFZs were introduced and have subsequently replaced floating rate OFZs. The Government issued two- and three-year fixed rate OFZs until the middle of 1998, paying annual or semi-annual interest at rates between 10% and 20% per annum. As of 31 December 2005, fixed rate OFZs represented 14.1% of the Government's domestic debt (0.6% of GDP).

GKOs are rouble denominated zero-coupon instruments with a maturity of less than one year. GKOs were first issued in May 1993 and are sold at a discount and redeemed at par. The aggregate amount of GKOs outstanding increased steadily until the middle of 1997. A shift to medium-term borrowing and the subsequent restructuring of certain GKOs and OFZs reduced the amount of GKOs outstanding. By the beginning of 2005, GKOs represented less than 0.01% of outstanding Government domestic debt.

As part of the restructuring of GKOs and certain OFZs following the events of 17 August 1998, the Ministry of Finance issued OFZs with maturities of three and five years and fixed declining coupons. Fixed coupon OFZs have since been issued with maturities varying from two to four years. As of 31 December 2005, fixed coupon OFZs comprised 15.0% of the Government's domestic debt (0.6% of GDP).

In May 2002 and September 2002, the Government issued fixed coupon amortizing OFZs (serial bonds) with maturities of 4.5 and 6 years. In 2004 amortizing OFZs became the main instrument of domestic borrowing. As of 31 December 2005, fixed coupon amortizing OFZs represented 68.1% of the Government's domestic debt (2.8% of GDP).

The restructuring of GKOs and certain OFZs that took place following the events of 17 August 1998 radically changed the structure of the Government's domestic debt. As a result of the restructuring, the affected GKOs and OFZs were converted into medium-term bonds with fixed declining coupons, and the Government did not issue new GKOs or OFZs until December 1999, significantly lengthening the average maturity of the Government's domestic debt.

In 2000 and 2001, net domestic borrowing was negative, contributing to a rapid decline in interest rates. As a result of subsequent improvement in market conditions, in 2002 and 2003 the Government increased the average term of its borrowing, and in 2002 and 2003 issued 10-year and 15-year amortizing bonds. As at 31 December 2005, the average maturity of the Government's marketable domestic debt was 1,892 days, as compared to 375 days as at 31 December 2001. OFZs with a maturity in excess of one year represented 92.0% of the total stock of GKOs and OFZs as of 31 December 2005, as compared to 28% as at 31 December 1997.

Non-Residents' Access to Local Bond Market

Following the events of 17 August 1998 and the adoption of the restructuring scheme for GKOs and certain OFZs in late 1998, the Central Bank reintroduced additional restrictions on non-resident holders of GKOs and OFZs. Conversion of rouble investments in GKOs and OFZs was limited to foreign exchange auctions held by the Central Bank, special currency conversion GKO issues offered by the Ministry of Finance and transfers of funds from investment "S" accounts to conversion "S" accounts. The latter required funds to be deposited in non-interest bearing "transit" accounts for 365 days before repatriation.

The restrictions on repatriation of money from "S" accounts by non-residents were subsequently liberalised. Effective 15 September 2003, non-residents were allowed to transfer money from investment S accounts to conversion S accounts freely for subsequent repatriation. Certain restrictions on new foreign investment in the

Government's domestic rouble bonds were retained, however, to avoid the adverse effect of short-term capital inflows on the balance of payments and securities market.

Government Domestic Debt Service

Payments in respect of discount and interest on Government domestic debt declined from 2.4% of GDP in 1998 to 1.6% of GDP in 1999. The decrease in domestic debt service in 1998 and 1999 was attributable mainly to the restructuring of GKOs and certain OFZs. In 2000 to 2005, domestic debt service declined from 0.8% of GDP, to 0.2% of GDP, as a result of a reduction in domestic debt to GDP ratio and a decline in interest rates.

Government Domestic Debt Policy

After the 1998 financial crisis, the Government's domestic debt policy was principally aimed at restoring the domestic debt market. The Government has subsequently been able to increase the number of available domestic debt instruments and to improve their liquidity and lengthen their maturity.

Going forward, the Government intends in the medium-term to borrow domestically to repay both its domestic and external debt. This will lead to a moderate increase in the domestic debt stock. The Ministry of Finance also anticipates issuing new domestic debt instruments to facilitate the development of the domestic debt market. Demand for medium- and long-term debt instruments is expected to increase following the pension reforms enacted in 2001, which are expected to lead to increased investment by management companies and pension funds.

Other Public Sector Domestic Debt

Russia's total domestic public debt includes debt of sub-federal and local governments in the form of municipal bonds and bank credits. The Government is not legally responsible for the debts of sub-federal and local governments in the absence of a Government guarantee. The aggregate principal amount of consolidated debt of Federation subjects and local authorities outstanding at 31 December 2005 is estimated at 359.7 billion roubles, or 1.7% of GDP.

The Events of August 1998

On 17 August 1998, the Government announced that it would not meet its obligations under its short-term rouble-denominated treasury bills ("GKOs" and "OFZs") and certain other rouble-denominated securities. At the same time, the Government announced a relaxation of its exchange rate policy and a 90-day moratorium on certain foreign currency payments. These events precipitated a severe devaluation of the rouble; a sharp increase in the rate of inflation; the near collapse of the country's banking system; significant defaults by Russian public and private borrowers on their foreign currency obligations; dramatic declines in the prices of Russian debt and equity securities (including Russian Federation Eurobonds); and an inability of Russian borrowers to raise funds internationally.

In the fourth quarter of 1997, the Asian financial crisis severely tested the stability of Russia's financial markets and the Central Bank's ability to meet its debt obligations, maintain the rouble and restrain the growth of the money supply. Like most emerging market economies, Russia experienced significant capital outflows. These outflows caused a sharp decline in the prices of Government securities and a consequent increase in demand for U.S. dollars, while the unfavourable situation in key export markets produced a deterioration in the balance of payments, which also contributed to difficulties in the foreign exchange market.

The Central Bank responded to this pressure on both the Government securities market and the rouble by increasing the refinancing rate and the Lombard rate in November 1997 and by increasing the reserve requirements for foreign currency deposits with Russian banks. When these measures proved insufficient, the Central Bank elected not to raise rates further out of concern for the stability of the banking sector and the impact on the federal budget, and instead engaged in open-market purchases of GKOs. During this period, the Central Bank also depleted its reserves in an effort to prevent the devaluation of the rouble. The simultaneous support of both the government securities market and the rouble soon proved to be unsustainable. The Central Bank ultimately chose to pursue exchange rate stability, tightening its monetary policy through a gradual increase in the refinancing rate and limiting the liquidity available to banks and growth in the money supply. The Central Bank managed to keep control over the exchange rate and inflation until July 1998. During this period, the exchange rate remained within the trading corridor set by the Central Bank and a stable rouble produced low inflationary expectations, with inflation slightly exceeding 4% in the first half of 1998. Despite the increase in interest rates caused by a rouble liquidity shortage maintained by the Central Bank, private deposits were withdrawn from commercial banks, declining by 12.2% between June and August 1998, and savings were increasingly held in foreign currency.

On 20 July 1998, the IMF approved an additional U.S.$11.2 billion financing to Russia in support of its economic programme. Approval of this facility did not, however, restore confidence in financial markets and Russia's international reserves, as well as prices of Government securities, continued to fall. Servicing of the Government's domestic debt during this period was aggravated by the deterioration in Russian financial markets and unsatisfactory federal budget revenues. Massive interventions in the foreign exchange market in August 1998 resulted in a sharp reduction of gross international reserves, notwithstanding a U.S.$4.8 billion drawing of IMF funds at the end of July.

On 17 August 1998, the Government and Central Bank announced a three-part programme intended to address these pressures. First, the corridor within which the rouble was permitted to trade against the U.S. dollar was revised from 5.25 - 7.15 roubles/U.S.$1 to 6.00 - 9.50 roubles/U.S.$1. This corridor was subsequently abandoned. Second, GKOs and OFZs issued prior to 17 August 1998 and maturing before 31 December 1999 were restructured into new longer-term instruments. Finally, for a period of 90 days, Russian private individuals were restricted from conducting certain foreign exchange operations of a capital nature, including making payments of foreign currency under forward contracts and repurchase agreements and making principal payments on long-term credits.

As a result of the events of 17 August 1998, the rouble depreciated against the U.S. dollar by 246.5% in nominal terms and by 47.6% in real terms during 1998. The decline in the rouble's value and the increase in the money supply also intensified inflationary pressures. During 1998, consumer price inflation increased 84.4%, producer price inflation increased by 23.2% and Russia's GDP contracted by 4.9%.

Beginning in September 1998, the Central Bank undertook a series of measures aimed at restricting foreign exchange speculation and preventing capital outflow. The obligatory sale of 50% of export revenue, originally introduced in 1992, was centralised on the Moscow Interbank Currency Exchange ("MICEX"), where trading was split into two sessions: a morning session for the sale of a portion of export revenue and an afternoon session for ordinary transactions with foreign currency for banks' needs and import contracts not confirmed by the required documentation. The Central Bank also required a 100% prepayment for any purchase of foreign exchange at the morning session. At the same time, additional restrictions were imposed on commercial banks. Foreign exchange could be purchased only for execution of clients' orders or fulfilment of foreign currency liabilities to counterparties, and banks were prohibited from having open positions in foreign currency at the end of each day.

Separation of the trading sessions on MICEX and the other currency control measures strengthened the Central Bank's regulatory function and helped to reduce demand for foreign currency. However, relatively relaxed monetary policy and lack of control over capital flows created substantial additional pressure on the foreign exchange market, while insufficient reserves forced the Central Bank to rely mostly on administrative mechanisms. The floating exchange rate policy continued in 1999, with the Central Bank's presence in the market limited to smoothing excessive short-term fluctuations and preventing speculative attacks. At the same time, to prevent high capital outflow, the Central Bank was forced to take a series of measures to strengthen foreign exchange regulations. Beginning in January 1999, Russian residents were required to convert 75% of their export revenues into roubles. Strict controls also were established over purchases of foreign currency by Russian banks, and foreign banks were prohibited from purchasing foreign currency with roubles in their correspondent accounts with Russian banks. Additionally, Russian importers prepaying import contracts were required to create rouble security deposits with Russian banks in an amount equivalent to the value of the prepayment. As a result of these measures, the Central Bank managed to restore relative calm to the foreign exchange market and the real value of the rouble against the U.S. dollar began to stabilise after December 1998. Following the rouble's stabilisation and as part of the economic programme agreed with the IMF, the Central Bank took steps to liberalise the foreign exchange market. At the end of June 1999, MICEX returned to a single trading session and foreign banks were allowed to purchase hard currency with roubles in their correspondent accounts with Russian banks.

Following consultations between the Government and various groups of investors, GKOs and affected OFZs were exchanged for new rouble denominated securities with longer maturities. Moreover, The restructuring of GKOs and certain OFZs that took place following the events of 17 August 1998 radically changed the structure of the Government's domestic debt. The restructured GKOs and OFZs were converted into medium-term bonds with fixed declining coupons, and the Government did not issue new GKOs or OFZs until December 1999. As a result, the maturity of the Government's domestic debt substantially increased.

Between September and December 1998, M2 grew by 30.5%, resulting in overall growth of 19.8% at the end of 1998 as compared to year-end 1997. Beginning in the second half of 1999, monetary policy was affected by the large current account surplus. Moreover, a large inflow of foreign exchange associated with high export prices for oil and other commodities, combined with a devaluation-related drop in imports, created upward pressure on the rouble. Since the events of August 1998 and their aftermath, the Central Bank has pursued a policy of building up reserves while resisting excessive real appreciation of the rouble, based on its view that record-high oil prices were a temporary phenomenon and its emphasis on long-term rouble stability. In addition, Russia's overall economic situation has stabilised and the period since 1998 has witnessed several positive developments, including significant GDP growth, resulting in part from the devaluation of the rouble; a deceleration in the depreciation of the rouble against the U.S. dollar, with the rouble appreciating against the U.S. dollar in real terms in 2002 and in both real and nominal terms in 2003, 2004 and 2005; a decline in consumer price inflation (as measured by Russia's consumer price index to 10.9% in 2005); an improved trade balance; improved fiscal conditions resulting in a significant primary fiscal surplus and an overall fiscal surplus from 2000 to 2005; a marked reduction in net private capital outflow; improved market conditions for debt and equity securities of Russian issuers; a very significant decrease in barter and arrears, both in inter-enterprise transactions and in the execution of regional budgets; and the restructuring of a significant portion of Russia's rouble-denominated domestic indebtedness, the rescheduling and subsequent prepayment of all of Russia's Paris Club indebtedness and a reduction and restructuring of its London Club and uninsured trade indebtedness.

External Assets

Following the dissolution of the Soviet Union, the Government assumed responsibility for virtually all the external debts contracted on behalf of the Government of the former USSR pursuant to agreements signed with 11 of the other former Soviet republics. In return, Russia received the right to the republics' claims on the external assets of the former Soviet Union. These assets included claims on other countries, the majority of which are claims on less-developed countries. In most cases, the loans are non-performing. As of 1 January 2006, the value of these credits was estimated at U.S.$72.3 billion, including accrued interest. The debt owed to the Russian Federation by CIS member states was equal U.S. $3.3 billion.

In September 1997, Russia became a member of the Paris Club of official creditors. As a result, the Government now pursues its claims against debtor governments within the Paris Club framework. In connection with Russia's joining the Paris Club, the Government agreed to reduce its claims on Paris Club debtors with the understanding that claims denominated in Gosbank roubles and transferable roubles would be converted into U.S. dollars at the rate of 0.6 Gosbank rouble and one transferable rouble per U.S. dollar, respectively. From 2001 to 2004, Russia received total payments from its government debtors in the approximate amount of U.S.$3.8 billion, of which U.S.$2.9 billion represented principal repayments and U.S.$0.9 billion represented interest payments.

Russia is a participant in the international initiative to alleviate the debt of highly indebted poor countries (the HIPC Initiative). As part of the HIPC Initiative, Russia has since 1999 cancelled 75% (approximately U.S.$2.7 billion) of the debt owed to Russia by seventeen predominantly Sub-Saharan African countries.

The World Bank and the IMF have recognized six additional debtors of Russia as HIPC-eligible. These countries owe Russia in the aggregate approximately U.S.$11.1 billion, with Afghanistan accounting for by far the largest share, estimated at U.S.$10.3 billion.

At the 2005 G-8 summit, Russia announced its intention to grant 100% Paris Club debt relief to certain of its poorest debtors. Russia has also started a "debt-for-aid swap" program with certain HIPC participants. These initiatives have brought Russia's debt relief policy in line with that of other G-8 members and most of the members of the Paris Club.

Relations with International Financial Institutions

The Government has in the past received financial and technical assistance from various international financial institutions, including the IMF, the World Bank and the EBRD.

In January 2005, Russia fully prepaid all of its indebtedness to the IMF.

Through end February 2006, the World Bank had approved 65 loans in Russia, 42 of which had been implemented, directed primarily to infrastructure development and industrial restructuring. The World Bank loans represent current commitments of U.S.$13.8 billion, of which approximately U.S.$8.9 billion has been drawn. Disbursements of up to U.S.$691 million are envisaged for 2006, aimed at improving the business environment and enhancing competition, improving public sector management and mitigating social and environmental risks.

The EBRD has committed to 251 projects in Russia, largely in the private sector, including projects relating to the financial sector, industry, agriculture and infrastructure development, with a total investment of €7.2 billion.

FORM AND TRANSFER OF THE BONDS

Form of Bonds

All Bonds will be in definitive registered form, without interest coupons attached. Each series of Bonds offered and sold outside the United States in reliance on Regulation S will be represented by interests in one or more permanent global bonds in definitive fully registered form, without interest coupons attached (the "Unrestricted Global Bonds"), which will be deposited on or before the Settlement Date with, and registered in the name of, J.P. Morgan Bank Luxembourg S.A., as sub-common depositary for the common depositary in respect of interests held through the facilities of Euroclear Bank, S.A./N.V. ("Euroclear") and Clearstream Banking, S.A. ("Clearstream"). A beneficial interest in an Unrestricted Global Bonds may at all times be held only through Euroclear and Clearstream.

Each series of Bonds offered and sold to Qualified Institutional Buyers within the meaning of Rule 144A under the Securities Act ("QIBs") will be represented by interests in one or more permanent global bonds in definitive fully registered form, without interest coupons attached (the "Restricted Global Bonds"), which will be registered in the name of Cede & Co., as nominee for The Depository Trust Company ("DTC"), and which will be deposited on or before the Settlement Date with JPMorgan Chase Bank, N.A., New York office, as custodian (the "Custodian") for DTC. The Restricted Global Bonds and any Bond Certificate issued in exchange therefor (a "Restricted Bond Certificate") will be subject to certain restrictions on transfer contained in a legend appearing on the face of such Bonds set forth below.

The Unrestricted Global Bonds and the Restricted Global Bonds (each a "Global Bond" and together, the "Global Bonds") of each series will have separate CUSIP and ISIN numbers and separate Common Codes.

All Bonds will initially be in the form of Unrestricted Global Bonds and/or Restricted Global Bonds. Bond Certificates (as defined below) will only be available in certain limited circumstances described below.

Exchange of Interests in Global Bonds for Bond Certificates

Registration of title to Bonds initially represented by a Restricted Global Bonds in a name other than DTC or a successor depositary or one of their respective nominees will not be permitted in respect of a series of New Bonds unless (a) such depositary notifies the Russian Federation that it is no longer willing or able to discharge properly its responsibilities as depositary with respect to the Global Bonds of that series or ceases to be a "clearing agency" registered under the United States Securities Exchange Act of 1934 (the "Exchange Act"), or is at any time no longer eligible to act as such, and the Russian Federation is unable to locate a qualified successor within 90 days of receiving notice of such ineligibility on the part of such depositary, or (b) following a failure to pay principal in respect of any Bonds of that series that is due and payable, the Fiscal Agent has received notice from the registered holder of any Global Bonds of that series requesting the exchange of such Global Bonds in full for individual Restricted Bond Certificates.

Registration of title to Bonds initially represented by an Unrestricted Global Bonds in a name other than the sub-common depositary for the common depositary for Euroclear and Clearstream or any nominee of such sub-common depositary will not be permitted in respect of a series of New Bonds unless (a) Euroclear or Clearstream is closed for business for a continuous period of 14 days (other than by reason of legal holidays) or announces an intention permanently to cease business or (b) following a failure to pay principal in respect of any Bonds of that series that is due and payable, the Fiscal Agent has received a notice from the registered holder of the Unrestricted Global Bond of that series requesting the exchange of a specified amount of the Unrestricted Global Bond of that series for individual bond certificates (the "Unrestricted Bond Certificates" and, together with the Restricted Bond Certificates, the "Bond Certificates").

In such circumstances, the relevant Global Bonds will be exchanged in full or in part, as the case may be, for Bond Certificates and the Russian Federation will, at the cost of the Russian Federation (but against such indemnity as the Registrar or any relevant Transfer Agent may require in respect of any tax or other duty of whatever nature which may be levied or imposed in connection with such exchange), cause sufficient Bond

Certificates to be executed and delivered to the Registrar for completion, authentication and dispatch to the relevant holders of the Bonds. A person having an interest in a Global Bonds of the relevant series must provide the Registrar with (a) a written order containing instructions and such other information as the Russian Federation and the Registrar may require to complete, execute and deliver such Bond Certificates and (b) in the case of a Restricted Global Bonds only, a fully completed, signed certificate substantially to the effect that the exchanging holder is not transferring its interest at the time of such exchange or, in the case of a simultaneous sale pursuant to Rule 144A, that the transfer is being made in compliance with the provisions of Rule 144A. Bond Certificates issued in exchange for a beneficial interest in a Restricted Global Bonds will bear the legends applicable to transfers pursuant to Rule 144A, as set out under "Transfer Restrictions" herein. Such transfer restrictions will terminate with respect to each series of Bonds two years (or such other period as provided by Rule 144) after the date on which Bonds of that series which are represented by an interest in a Restricted Global Bonds are last issued, assuming compliance with Condition 6(b) of the Terms and Conditions of the Bonds.

If interests in Global Bonds are exchanged for Bond Certificates in the limited circumstances where this is permitted, there will be a 15% withholding tax on interest received by holders of the Bond Certificates which are legal persons, subject to any available double tax treaty relief, and the redemption proceeds paid on Bond Certificates may be subject to taxation. See "Taxation – Russian Taxation" below.

The holder of a Bond may transfer such Bond in accordance with the provisions of Condition 2 of the Terms and Conditions of the Bonds. Bond Certificates may not be eligible for trading in the DTC, Euroclear or Clearstream systems.

If principal in respect of any Bonds represented by an Unrestricted Global Bonds is not paid when due and payable (but subject as provided below), the registered holder of the Unrestricted Global Bonds may from time to time elect that direct enforcement rights ("Direct Rights") against the Russian Federation will come into effect. Thereupon, each relevant holder of an account with Euroclear or Clearstream, as the case may be, shall, at the relevant time, acquire against the Russian Federation all rights (including the right to receive payments due on the Bonds) that such accountholder would have received if it had been the holder of Unrestricted Bond Certificates. Such election shall be made by the holder of the Unrestricted Global Bonds by notice to the Registrar and presentation of the Unrestricted Global Bonds to or to the order of the Registrar whereupon the Registrar shall reduce the principal amount of Bonds represented by the Unrestricted Global Bonds entered on the Register and shall make the appropriate entry or entries on the Register to reflect that such Direct Rights have come into effect. Such Direct Rights may not be eligible for trading in the Euroclear or Clearstream systems.

No Direct Rights election may be made on or before an Exchange Date (as defined in each Unrestricted Global Bonds) unless the registered holder elects in such notice that the exchange in question shall no longer take place.

Upon the transfer, exchange or replacement of a Restricted Bond Certificate bearing the legend referred to under "Transfer Restrictions," or upon specific request for removal of the legend on a Restricted Bond Certificate, the Russian Federation will deliver only Restricted Bond Certificates that bear such legend, or will refuse to remove such legend, as the case may be, unless there is delivered to the Russian Federation and the Registrar such satisfactory evidence, which may include an opinion of counsel, as may reasonably be required by the Russian Federation that neither the legend nor the restrictions on transfer set forth therein are required to ensure compliance with the provisions of the Securities Act. Such transfer restrictions will terminate with respect to each series of Bonds two years (or such other period as provided by Rule 144) after the date on which Bonds of that series which are represented by an interest in a Restricted Global Bonds are last issued, assuming compliance with Condition 6(b) of the Terms and Conditions of the Bonds.

The Registrar will not register the transfer of or exchange of interests in a Global Bonds for Bond Certificates during the three Business Days ending on the due date for any payment of principal of the Bonds.

DTC, Euroclear and Clearstream Arrangements

So long as DTC or its nominee or Euroclear, Clearstream or the sub-common depositary for the common depositary or any nominee of such sub-common depositary is the registered holder of a Global Bond, DTC, Euroclear or Clearstream, the sub-common depositary or such nominee, as the case may be, will be considered the sole owner or holder of the Bonds represented by such Global Bond for the purposes of the Fiscal Agency Agreement and the Bonds. Payments of principal, interest and additional amounts, if any, in respect of a Global Bonds will be made to DTC, Euroclear, Clearstream or such sub-common depositary or nominee, as the case may be, as the registered holder thereof. Neither the Russian Federation nor any affiliate controlled by it for the purposes of the Securities Act will have any responsibility or liability for any aspect of the records relating to or payments made on account of beneficial ownership interests in a Global Bonds or for maintaining, supervising or reviewing any records relating to such beneficial ownership interests.

Holders of book-entry interests in Bonds held through DTC will receive from the Fiscal Agent through DTC, to the extent received by DTC from the Fiscal Agent, all distributions of principal and interest made with respect to book-entry interests in such Bonds.

Distributions of principal and interest with respect to book-entry interests in Bonds held through Euroclear or Clearstream will be credited, to the extent received by Euroclear or Clearstream from the Fiscal Agent, to the cash accounts of Euroclear or Clearstream customers in accordance with the relevant system's rules and procedures.

Interest on the Bonds (other than interest on redemption) will be paid to the holder shown on the register maintained by the Registrar on the third Business Day before the due date for such payment so long as the Bonds are represented by a Global Bonds, and on the fifteenth day before the due date for such payment if the Bonds are in the form of Bond Certificates (the "Record Date"). Trading of Bonds will therefore be net of accrued interest from the relevant Record Date to the relevant interest payment date.

The laws of some states of the United States require that certain persons take physical delivery of securities in definitive form. Consequently, the ability to transfer interests in a Global Bonds to such persons may be limited. Because DTC, Euroclear and Clearstream can only act on behalf of direct and indirect participants, the ability of a person having an interest in a Global Bonds to pledge such interest to persons or entities which do not participate in the relevant clearing system, or otherwise take actions in respect of such interest, may be affected by the lack of a physical certificate in respect of such interest.

The holdings of book-entry interests in the Bonds through DTC, Euroclear and Clearstream will be reflected in the book-entry accounts of each institution. The Registrar will adjust the amounts of Bonds on the Register as necessary for the accounts of (a) Cede & Co. and (b) J.P. Morgan Bank Luxembourg S.A. to reflect the amounts of Bonds held through DTC, Euroclear and Clearstream, respectively. Beneficial ownership in Bonds will be held through financial institutions as direct and indirect participants in DTC, Euroclear and Clearstream.

Interests in the Global Bonds will be in uncertificated book-entry form.

Trading between Euroclear and/or Clearstream Accountholders

Secondary market sales of book-entry interests in Bonds held through Euroclear or Clearstream to purchasers of book-entry interests in Bonds through Euroclear or Clearstream will be conducted in accordance with the normal rules and operating procedures of Euroclear and Clearstream and will be settled using the procedures applicable to conventional eurobonds.

Trading between DTC Participants

Secondary market sales of book-entry interests in Bonds between DTC participants will occur in the ordinary way in accordance with DTC rules and will be settled using the procedures applicable to U.S. corporate debt obligations in DTC's Same Day Funds Settlement System.

Trading between DTC Seller and Euroclear/Clearstream Purchaser

When a book-entry interest in Bonds is to be transferred from the account of a DTC participant holding a beneficial interest in a Restricted Global Bonds to the account of a Euroclear or Clearstream accountholder wishing to purchase a beneficial interest in an Unrestricted Global Bonds (subject to such certification procedures as are provided in the Fiscal Agency Agreement), the purchaser must send instructions to Euroclear or Clearstream at least one business day prior to the settlement date. Euroclear or Clearstream, as the case may be, will instruct the common depositary to receive the beneficial interest and make payment for it. Payment will include interest accrued on the beneficial interest in the Bonds from and including the last interest payment date to and excluding the Settlement Date. On the settlement date, the common depositary will make payment to the DTC participant's account against delivery of the beneficial interest. After settlement has been completed, the beneficial interest will be credited to the respective clearing system, and by the clearing system, in accordance with its usual procedures, to the Euroclear or Clearstream accountholder's account. The securities credit will appear the next day, European time. The cash debit will be back-valued to, and interest on the Unrestricted Global Bonds will accrue from, the value date, which will be the preceding day when settlement occurs in New York. If settlement is not completed on the intended value date, that is, if the trade fails, the Euroclear or Clearstream cash debit will be valued instead as of the actual settlement date, whenever that may be.

The Euroclear or Clearstream accountholder will need to make available to its clearing system the funds necessary to process same-day funds settlement. The most direct means of doing so is to pre-position funds for settlement, either from cash on hand or existing lines of credit, as it would for any pre-settlement occurring within Euroclear or Clearstream. Under this approach, the purchasing accountholder may take on credit exposure to Euroclear or Clearstream until the beneficial interest in the Unrestricted Global Bonds is credited to its account one day later. As an alternative, if Euroclear or Clearstream has extended a line of credit to the purchasing accountholder, it can elect not to pre-position funds and allow that credit line to be drawn upon to finance settlement. Under this procedure, the Euroclear or Clearstream accountholder purchasing the beneficial interest in the Unrestricted Global Bonds would incur overdraft charges for one day, assuming it cleared the overdraft when the beneficial interest was credited to its account. However, interest on the Unrestricted Global Bonds would accrue from the value date. Therefore, in many cases, the investment income on the Unrestricted Global Bonds earned during that one-day period may substantially reduce or offset the amount of such overdraft charges, although this result will depend on each accountholder's particular cost of funds.

Because the settlement is taking place during New York business hours, the DTC participant can use its usual procedures for transferring a beneficial interest in the Global Bonds to the common depositary for the benefit of the Euroclear or Clearstream accountholder. The sale proceeds will be available to the DTC seller on the settlement date. Thus, to the DTC participant, a cross-market transaction will settle no differently than a trade between two DTC participants.

Day traders that use Clearstream or Euroclear to purchase interests in the Bonds from DTC participants for delivery to Clearstream participants or Euroclear participants should note that these trades will automatically fail on the sale side unless affirmative action is taken. At least three techniques should be readily available to eliminate this potential problem:

- Borrowing through Clearstream or Euroclear for one day, until the purchase side of the day trade is reflected in their Clearstream or Euroclear accounts, in accordance with the clearing system's customary procedures; or

- Borrowing the interests in the United States from a DTC participant no later than one day prior to settlement, which will give the interests sufficient time to be reflected in their Clearstream or Euroclear account in order to settle the sale side of the trade; or

- Staggering the value date for the buy and sell sides of the trade so that the value date for the purchase from the DTC participant is at least one day prior to the value date for the sale to the Clearstream participant or Euroclear participant.

Trading between Euroclear/Clearstream Seller and DTC Purchaser

Due to time zone differences in its favour, a Euroclear or Clearstream accountholder may employ customary transfer procedures when transferring a book-entry interest in an Unrestricted Global Bonds to the account of a DTC participant wishing to purchase a beneficial interest in a Restricted Global Bonds (subject to such certification procedures as are provided in the Fiscal Agency Agreement). The seller must send instructions to Euroclear or Clearstream at least one business day prior to the settlement date. Euroclear or Clearstream will instruct the common depositary to credit the beneficial interest in the Global Bonds to the DTC participant's account and receive payment. Payment will include interest accrued on the beneficial interest in the Bonds from and including the last interest payment date to and excluding the Settlement Date. Payment will be reflected in the account of the Euroclear or Clearstream accountholder the following day. Receipt of cash proceeds in the Euroclear or Clearstream accountholder's account will be back-valued to the value date, which will be the preceding day, when settlement occurs in New York. If the Euroclear or Clearstream accountholder has a line of credit with its clearing system and elects to draw on such line of credit in anticipation of receipt of sale proceeds in its account, the back-valuation may substantially reduce or offset any overdraft charges incurred over that one-day period. If settlement is not completed on the intended value date, that is, if the trade fails, receipt of the cash proceeds in the Euroclear or Clearstream accountholder's account will instead be valued as of the actual settlement date, whenever that may be.

For a further description of restrictions on the transfer of Bonds, see "Transfer Restrictions" below.

DTC has advised the Russian Federation that it will take any action permitted to be taken by a holder of Bonds (including, without limitation, the presentation of a Global Bonds for exchange as described above) only at the direction of one or more participants in whose account with DTC interests in Global Bonds are credited and only in respect of such portion of the aggregate principal amount of the relevant Global Bonds as to which such participant or participants has or have given such direction. In the circumstances described above, DTC will surrender the Global Bonds for exchange for individual Bond Certificates, which will, in the case of Restricted Bond Certificates, bear the legend applicable to transfers pursuant to Rule 144A.

DTC has advised the Russian Federation as follows: DTC is a limited-purpose trust company organised under the laws of the State of New York, a member of the United States Federal Reserve System, a "clearing corporation" within the meaning of the New York Uniform Commercial Code and a "clearing agency" registered pursuant to the provisions of Section 17A of the Exchange Act. DTC was created to hold securities for its participants and to facilitate the clearance settlement of transactions between its participants through electronic book-entry changes in accounts of its participants, thereby eliminating the need for physical movement of certificates. DTC participants include securities brokers and dealers, banks, trust companies and clearing corporations and may in the future include certain other organisations. Indirect access to the DTC system is also available to banks, brokers, dealers and trust companies that clear through, or maintain a custodial relationship with, a participant, either directly or indirectly. DTC is owned by a number of its direct participants and by the New York Stock Exchange, Inc., the American Stock Exchange, Inc. and the National Association of Securities Dealers.

Euroclear and Clearstream have advised the Russian Federation as follows: Euroclear and Clearstream hold securities for participating organisations and facilitate the clearance and settlement of securities between their respective accountholders through electronic book-entry changes in accounts of such accountholders. Euroclear and Clearstream provide to their accountholders, among other things, services for safekeeping, administration, clearance and settlement of internationally traded securities and securities lending and borrowing. Euroclear and Clearstream interface with domestic securities markets. Euroclear and Clearstream accountholders are financial institutions such as underwriters, securities brokers and dealers, banks, trust companies and certain other organisations. Indirect access to Euroclear or Clearstream is also available to others such as banks, brokers, dealers and trust companies that clear through or maintain a custodian relationship with a Euroclear or Clearstream accountholders, either directly or indirectly.

Although the foregoing sets out the procedures of DTC, Euroclear and Clearstream to facilitate transfers of beneficial interests in Global Bonds among participants and accountholders of DTC, Euroclear and Clearstream, none of DTC, Euroclear or Clearstream is under any obligation to perform or continue to perform such procedures, and such procedures may be discontinued at any time. Neither the Russian Federation nor any agent of the Russian Federation nor any person by whom any of them is controlled for purposes of the Securities Act will have any responsibility for the performance by DTC, Euroclear or Clearstream or their respective direct or indirect participants or accountholders of their respective obligations under the rules and procedures governing their operations or the sufficiency for any purpose of the arrangements described above.

While a Global Bond is lodged with DTC or the Custodian, Bonds represented by individual Bond Certificates will not be eligible for clearing or settlement through DTC. While a Global Bond is lodged with Euroclear or Clearstream or the sub-common depositary for the common depository for Euroclear or Clearstream, Bonds represented by individual Bond Certificates will not be eligible for clearing or settlement through Euroclear or Clearstream.

TRANSFER RESTRICTIONS

Transfers of interests in Global Bonds within DTC, Euroclear and Clearstream will be in accordance with the usual rules and operating procedures of the relevant system.

A beneficial interest in a Restricted Global Bond may be transferred to a person who wishes to take delivery of such beneficial interest through an Unrestricted Global Bond only upon receipt by the Registrar of a written certification from the transferor (in the applicable form provided in the Fiscal Agency Agreement) to the effect that such transfer is being made to the Russian Federation or an affiliate of the Russian Federation or in accordance with Regulation S or Rule 144 (if available) under the Securities Act.

In respect of any such transfer as is referred to above, the transferee must give details of the accounts at Euroclear and Clearstream, as the case may be, and DTC to be credited or debited, as the case may be, with an interest in the relevant Global Bonds.

With respect to each series of Bonds, transfer restrictions will terminate two years (or such other periods as provided by Rule 144) after the date on which Bonds of that series which are represented by an interest in a Restricted Global Bonds are last issued, assuming compliance with Condition 6(b) of the Terms and Conditions of the Bonds.

Any beneficial interest in either a Restricted Global Bond or an Unrestricted Global Bond that is transferred to a person who takes delivery in the form of a beneficial interest in the other Global Bonds will, upon transfer, cease to be a beneficial interest in such Global Bonds and become a beneficial interest in the other Global Bonds and, accordingly, will thereafter be subject to all transfer restrictions and other procedures applicable to a beneficial interest in such other Global Bonds for so long as such person retains such an interest.

The Bonds are being offered and sold in the United States only to QIBs. Because of the following restrictions, purchasers of Bonds offered in the United States are advised to consult legal counsel prior to making any offer, resale, pledge or transfer of such Bonds.

Each purchaser of Bonds offered hereby other than in reliance on Regulation S will be deemed to have represented, agreed and acknowledged as follows (terms used herein that are defined in Rule 144A are used herein as defined therein):

(a) The purchaser is (1) a QIB and (2) acquiring the Bonds for its own account or for the account of a QIB.

(b) The purchaser understands that the Bonds have not been and will not be registered under the Securities Act and may not be offered, resold, pledged or otherwise transferred except in accordance with the legend set forth below.

(c) Each Restricted Global Bond and any Restricted Bond Certificates offered hereby will bear a legend to the following effect, unless the Russian Federation determines otherwise in accordance with applicable law:

THIS BOND HAS NOT BEEN AND WILL NOT BE REGISTERED UNDER THE U.S. SECURITIES ACT OF 1933, AS AMENDED (THE "SECURITIES ACT"), OR WITH ANY SECURITIES REGULATORY AUTHORITY OF ANY STATE OR OTHER JURISDICTION OF THE UNITED STATES AND MAY NOT BE OFFERED, RESOLD, PLEDGED OR OTHERWISE TRANSFERRED EXCEPT (1) TO THE RUSSIAN FEDERATION OR AN AFFILIATE OF THE RUSSIAN FEDERATION, (2) IN ACCORDANCE WITH RULE 144A UNDER THE SECURITIES ACT TO A PERSON THAT THE HOLDER REASONABLY BELIEVES IS A QUALIFIED INSTITUTIONAL BUYER WITHIN THE MEANING OF RULE 144A PURCHASING FOR ITS OWN ACCOUNT OR FOR THE ACCOUNT OF A QUALIFIED INSTITUTIONAL BUYER, (3) IN AN OFFSHORE TRANSACTION IN ACCORDANCE WITH RULE 903 OR RULE 904 OF REGULATION S OR (4) PURSUANT TO AN EXEMPTION FROM REGISTRATION UNDER THE SECURITIES ACT PROVIDED BY RULE 144 THEREUNDER (IF AVAILABLE), IN EACH CASE IN ACCORDANCE WITH ANY APPLICABLE SECURITIES LAWS OF ANY STATE OF THE UNITED STATES. NO REPRESENTATION CAN BE MADE

AS TO THE AVAILABILITY OF THE EXEMPTION PROVIDED BY RULE 144 UNDER THE SECURITIES ACT FOR RESALES OF THIS BOND.

The Russian Federation and its affiliates and others will rely upon the truth and accuracy of the foregoing acknowledgements, representation and agreements.

TAXATION

Russian Taxation

General

The following is a summary of certain Russian tax considerations relevant to the ownership and disposition of Bonds. This summary is based on the laws of the Russian Federation, including administrative regulations and interpretations, in effect on the date of this Prospectus.

Unless specifically indicated otherwise, this summary is limited to the tax treatment of "non-resident holders" of Bonds. For these purposes, "a non-resident holder" is a legal person or organisation that is not organised under Russian law and holds and disposes of Bonds otherwise than through a permanent establishment in the Russian Federation. Generally, a legal person or organisation will not have a permanent establishment in the Russian Federation if it does not have a branch, representative office, division, office, bureau, agency or other separate division or place of economic activity through which it conducts business on a regular basis within the Russian Federation. A holder of the Bonds will not be deemed to have a permanent establishment in Russia solely by virtue of having acquired the Bonds.

This summary does not address the availability of, or procedures for claiming, double tax treaty relief, the practical difficulties involved in claiming such relief, or the applicability of, or procedures in relation to, taxes levied by regions, municipalities or other non-federal level authorities of the Russian Federation. Prospective investors should consult their own tax advisors regarding an investment in the Bonds.

The substantive provisions of Russian tax law are subject to more rapid and unpredictable change and to greater inconsistency than is generally the case in jurisdictions with more developed capital markets. The tax system of the Russian Federation has recently been fundamentally reorganised. As a result of this reorganisation, a substantial portion of the tax legislation of the Russian Federation has been changed and the prior array of tax laws has been unified into a single Tax Code. As discussed below, these changes have affected the tax treatment of Bonds and the ownership and disposition of the Bonds.

Many aspects of current Russian tax law applicable to the ownership and disposition of Bonds are subject to significant uncertainty. Prior to the adoption of the Tax Code, certain of these issues were addressed by Regulation No. BG-4-06 of 12 July 2000, approved by the Ministry of Taxes and Duties of the Russian Federation and agreed by the Ministry of Finance (the "Tax Regulations"). Although the Tax Regulations were issued and approved by the Federal authorities now responsible for the administration of the Tax Code, and have not been withdrawn, the Tax Regulations have not been updated since the passage of the Tax Code and would not in any event be regarded by a Russian court as having the status of law. By letters dated 12 September 2002 and 15 November 2002, the Ministry of Finance and the Ministry of Taxes and Duties of the Russian Federation have each confirmed that the Tax Regulations will apply to the Bonds to be issued in the Offering, except to the extent the Tax Regulations contradict provisions of the Tax Code that have taken effect after the Tax Regulations were issued. The Tax Code does not contradict the provisions of the Tax Regulations described herein.

Interest on Bonds

The Tax Regulations describe the treatment of interest payments made in respect of Bonds that are held in global form. Although the Tax Regulations have not been updated following the adoption of the Tax Code, the Tax Regulations should continue to apply to the payment of interest in respect of the Bonds that are held in global form.

The Tax Regulations state that if (i) the Bonds are evidenced by a global certificate held by a clearing or depositary organisation which is a resident of a state that is a party to a treaty with the Russian Federation on the avoidance of double taxation and (ii) the treaty provides that residents of that other state are exempt from Russian tax on interest income, then the clearing or depositary organisation will be treated as a qualifying resident of that other state and will be the beneficial owner of the interest payments made on such Bonds for purposes of such treaty. Under these circumstances, the Tax Regulations further provide that no income tax will be withheld from the interest payments made on such Bonds if, prior to the first interest payment on the Bonds, a certification is filed with the Russian tax authorities confirming that the clearing or depositary organisation is a resident of that other state and the terms of the Bonds provide that organisations resident in the Russian Federation may not receive interest on the Bonds in any form.

The Tax Regulations do not contain a definition of "clearing or depositary organisation" or "Russian resident" or any guidance on the form of confirmation which will be regarded as satisfactory by the relevant tax authorities in the Russian Federation. The Tax Regulations also do not contemplate that Bonds will be evidenced by two or more global bonds or that interest payments that would have been due on Bonds prior to the Settlement Date if the Bonds had been then outstanding will be made on the Settlement Date.

The Bonds will be represented by two or more Global Bonds as described above in "Form and Transfer of Bonds." The Global Bonds will be registered in the name of Cede & Co. (as nominee for DTC) and J.P. Morgan Bank Luxembourg S.A. (as sub-common depositary for the common depositary). Condition 7(c) provides that Russian residents, other than individuals, are not permitted to receive interest payments on the Bonds. On or prior to the first interest payment in respect of the Bonds, the Ministry of Finance will certify to the appropriate tax authorities (based on a certification made to it by DTC and the sub-common depositary) that the Global Bonds are being held by DTC and the sub-common depositary as clearing or depositary organisations and that DTC and the sub-common depositary are residents of a state that is party to a double taxation treaty of the type referred to above.

Based on the Tax Regulations, interest on the Bonds should not be subject to Russian profits tax or, under the circumstance described above, income tax, whether imposed directly or by withholding so long as the Bonds are represented by Global Bonds in the manner described above.

If the Bonds cease to be held in the form of a global certificate by a clearing or depositary organisation at any time, the exemption from withholding tax referred to in the Tax Regulations will not be available. Accordingly, if interests in the Global Bonds are exchanged for Bond Certificates in the limited circumstances where this is permitted (see "Form and Transfer of Bonds—Exchange of Interests in Global Bonds for Bond Certificates"), there will be a 15 percent withholding tax on interest received by non-resident holders, subject to any available double tax treaty relief.

Interest payments on Bonds will also be subject to a 15 percent withholding tax if the Regulations were held not to apply to Bonds in the manner described above, or if the Tax Regulations were to be repealed.

Condition 8 of the Terms and Conditions of the Bonds contains a provision requiring the Russian Federation to increase the payment of principal or interest in respect of the Bonds if in certain cases Taxes (as defined therein) are withheld or deducted from such payment. Contractual provisions for the payment by one party of a tax levied on another party may generally not be enforced in the Russian Federation. The Tax Regulations, however, state that an agreement may include provisions relating to the increase of amounts payable, including interest, by one party in the event additional tax obligations are imposed after the date of the agreement.

If Bonds are sold or disposed of by a non-resident holder between coupon payment dates to (i) a legal person or organisation organised under Russian law, (ii) a foreign legal entity's permanent establishment within the Russian Federation, or (iii) an individual entrepreneur resident in the Russian Federation for tax purposes, then the sale proceeds attributable to accrued but unpaid interest will be treated as an interest payment to the seller and will not be eligible for the beneficial treatment provided by the Tax Regulations for interest payments made to the nominee for DTC or the nominee for the sub-common depositary. Under these circumstances, the purchaser of the Bonds would be required to withhold 15 per cent. of the purchase price attributable to accrued but unpaid interest from the proceeds payable to the seller, subject to applicable double tax treaty relief.

Disposal or Redemption of Bonds

Under the Profits Tax Chapter of the Tax Code, a foreign legal entity is subject to profits tax on income from the sale of Bonds only if the sale is effectively connected with a permanent establishment of the seller in the

Russian Federation. Therefore, no Russian tax will be due on a sale of Bonds by a non-resident holder to the extent not attributable to accrued interest.

Other Taxes

Payments made in respect of Bonds will not be subject to value added tax.

The housing fund maintenance tax, road users' tax and securities operations tax previously applicable in the Russian Federation have been abolished. A stamp duty applicable to the issuance of securities was introduced in place of the securities operations tax, however, securities issued by the Federal Government are exempt from the application of the stamp duty.

No property tax will be payable in respect of Bonds.

Except as described in this Prospectus, including as set forth below under "General Information" (i) no federal stamp, registration, documentary or similar federal taxes are payable in the Russian Federation by reason of the issue of the Bonds or in relation to any enforcement proceedings in respect of Bonds brought in Russian courts, (ii) non-resident holders of Bonds will not incur any federal tax on income or capital gain, stamp duty, registration, transfer or other similar federal taxes by reason only of the acquisition, ownership or disposal of Bonds and (iii) all payments by the Russian Federation of principal and interest on Bonds to non-resident holders may be made without withholding or deduction for or on account of any other federal taxes, duties, assessments or governmental charges in the Russian Federation.

Luxembourg Taxation

The following summary is of a general nature and is included herein solely for information purposes. It is based on the laws presently in force in Luxembourg, though it is not intended to be, nor should it be construed to be, legal or tax advice. Prospective investors in the Bonds should therefore consult their own professional advisers as to the effects of state, local or foreign laws, including Luxembourg tax law, to which they may be subject.

Non-resident holders of Bonds

Under Luxembourg general tax laws currently in force and except as provided for by the Laws (as defined below), there is no withholding tax on payments of principal, premium or fixed or floating interest made to non-resident holders of Bonds, nor on accrued but unpaid interest in respect of the Bonds, nor is any Luxembourg tax payable upon redemption or repurchase of the Bonds held by non-resident holders of Bonds.

However, under the Luxembourg laws of 21 June 2005 (the "Laws"), implementing the Council Directive 2003/48/EC of 3 June 2003 on taxation of savings income in the form of interest payments and ratifying the treaties entered into by Luxembourg and certain dependent and associated territories of EU Member States (the "Territories"), payments of interest or similar income made or ascribed by a paying agent established in Luxembourg to or for the immediate benefit of an individual beneficial owner or a residual entity, as defined by the Laws, which are resident of, or established in, an EU Member State (other than Luxembourg) or certain of the Territories will be subject to withholding tax of currently 15 per cent, unless the relevant recipient has opted for an exchange of information procedure as defined in the Laws. Responsibility for the withholding of the tax will be assumed by the Paying Agent in Luxembourg.

Resident holders of Bonds

Under Luxembourg general tax laws currently in force and except as provided for by the December 2005 Law (as defined below), there is no withholding tax on payments of principal, premium or fixed or floating interest made to Luxembourg resident holders of Bonds, nor on accrued but unpaid interest in respect of Bonds, nor is any Luxembourg withholding tax payable upon redemption or repurchase of Bonds.

Luxembourg resident holders of Bonds that are corporate entities or Luxembourg branches of foreign corporate entities to which the Bonds are allocated are taxable on any interest whether paid or accrued as well as on the gain realized upon redemption or repurchase of the Bonds. The repayment of principal is tax exempt.

Under the Luxembourg law of 23 December 2005 (the "December 2005 Law") payments of interest or similar income made or ascribed by a Paying Agent in Luxembourg to or for the immediate benefit of an Luxembourg resident individual holder of Bonds will be subject to a withholding tax of 10 per cent. Such withholding tax will be in full discharge of income tax if the individual holder of Bonds is acting in the course of the management of his/her private wealth. Responsibility for the withholding of the tax will be assumed by the Paying Agent in Luxembourg.

A gain realized by a Luxembourg resident individual holder of Bonds acting in the course of the management of his/her private wealth upon transfer including sale, redemption or repurchase of the Bonds, is not subject to Luxembourg income tax, provided such transfer took place more than six months after the Bonds were acquired. However, any portion of such gain corresponding to accrued but unpaid interest income is subject to the 10 per cent withholding.

GENERAL INFORMATION

1. The Bonds will be accepted for clearance through DTC, Euroclear and Clearstream. The CUSIP numbers, ISIN numbers and Common Codes of the Bonds are as follows:

	2030 Bonds		2010 Bonds	
	Restricted Global Bonds	**Unrestricted Global Bonds**	**Restricted Global Bonds**	**Unrestricted Global Bonds**
CUSIP...................	78307ACZ4	X74344DM5	78307ACY7	X74344DL7
ISIN	US78307ACZ49	XS0114288789	US78307ACY73	XS0114295560
Common Code......	011528406	011428878	011528376	011429556

The Bonds represented by interests in the Restricted Global Bonds have been accepted for trading in the Private Offerings, Resale and Trading through Automated Linkages Market ("PORTAL"), a subsidiary of the Nasdaq Stock Market, Inc. The PORTAL reference numbers are RUSFNP30 for the 2030 Bonds and RUSFNP10 for the 2010 Bonds.

2. Application has been made for the Bonds to be listed on the Official List and admitted to trading on the regulated market of the Luxembourg Stock Exchange. So long as either series of Bonds is listed on the Luxembourg Stock Exchange and the rules of the Luxembourg Stock Exchange so require, the Russian Federation will maintain a paying agent and transfer agent in Luxembourg with respect to that series. Copies (and English translations where the documents in question are not in English) of the following documents with respect to each series of Bonds may be inspected during usual business hours on any weekday (Saturdays, Sundays and public holidays excepted) at the offices of the Paying Agent in Luxembourg so long as any Bonds of that series are listed on the Luxembourg Stock Exchange:

2.1 The Fiscal Agency Agreement, which includes the forms of the Global Bonds and the Bond Certificate;

2.2 The authorisations referred to in item 4 below; and

2.3 The Deed of Covenant.

Copies of this Prospectus are available free of charge at the specified office of the Luxembourg Listing Agent and will also be available on the website of the Luxembourg Stock Exchange (http://www.bourse.lu).

Copies of Russia's Federal Budget are available free of charge on the website of the Ministry of Finance of the Russian Federation (http://www1.minfin.ru).

3. The Russian Federation will obtain prior to the Settlement Date all necessary consents, approvals and authorisations in the Russian Federation (other than annual budget appropriations for years subsequent to 2006) in connection with the issue of, and performance of its obligations under, the Bonds and the Deed of Covenant.

4. The issue of the Bonds and the execution of the Deed of Covenant were authorised pursuant to Federal Law No.136-FZ of 29 July 1998, Government Resolution No.478 of 23 June 2000, Government Resolution No. 931 of 29 December 2001, Government Resolution No. 829 of 15 November 2002 and Government Resolution No. 402 of 7 August 2004.

5. The Central Bank has confirmed by letter No. 09-39/2993 of 6 July 2000 that (i) the Ministry of Finance may issue the Bonds in foreign currency without the consent of the Central Bank, (ii) it will not impose any limitations on the making of payments on the Bonds to non-Russian residents outside of the Russian Federation, (iii) it does not object to the fulfilment in foreign currency by the Ministry of Finance of its payment obligations to the Fiscal Agent and (iv) with the consent of the Customs Committee, it does not object to the export by the Ministry of Finance of the Global Bonds representing the Bonds.

6. During the previous twelve months, the Russian Federation has been involved in a number of litigation and arbitration proceedings in which substantial claims have been asserted or substantial damages sought against the Russian Federation. The Russian Federation does not believe, however, that any pending litigation or arbitration proceeding involving the Russian Federation, or any threatened litigation or arbitration proceeding of which the Russian Federation is aware, is material in the context of the issue of the Bonds.

7. Article 1210 of the Civil Code provides that the parties to any foreign economic transaction may choose the governing law of the relevant transaction. Article 1210 will apply with respect to the choice of English law to govern rights and obligations in respect of the Bonds in the case of any Bonds held by a foreign person. There is no express provision of Russian law that permits a choice of governing law for a transaction to which all the parties are Russian persons. Accordingly, it is uncertain whether the choice of English law to govern rights and obligations in respect of the Bonds would be given effect by a court of the Russian Federation in the case of a Bonds held by a Russian person.

8. Under current Russian Federal law, state duty may be payable upon the initiation of any action or proceeding arising out of the Bonds in any court of the Russian Federation. In the case of an action or proceeding initiated in a court of general jurisdiction such duty may be a proportion of the amount of the relevant claim. State duty will also be payable upon an action or proceeding initiated in an arbitration court.

9. The Russian Federation has not waived any rights to sovereign immunity it may have in any jurisdiction. Accordingly, the Russian Federation may be entitled to immunity from suit in any action or proceeding arising out of the Bonds and the Russian Federation and its assets, properties and revenues may be entitled to immunity in any enforcement action. In addition, the Russian Federation has not submitted to the jurisdiction of any court, agreed that disputes may be resolved in any forum or appointed any agent for service of process in any jurisdiction in connection with any action or proceeding arising out of the Bonds. Accordingly, holders of Bonds may have difficulty obtaining effective redress in connection with the Russian Federation's obligations under the Bonds.

10. Enforceability in the Russian Federation of a final judgement for the payment of a sum of money rendered by a court in any jurisdiction other than the Russian Federation will be recognised by a court of the Russian Federation as a basis upon which to approve enforcement of a judgement against the Russian Federation or its assets, properties or revenues in the Russian Federation provided that there exists an international treaty between the Russian Federation and the country where the foreign judgement was rendered concerning the recognition and enforcement of judgements in civil cases and, unless such international treaty otherwise provides, provided that the relevant requirements set forth in Article 409 of the Civil Procedure Code and any other relevant law, decree or regulation of the Russian Federation are met. No international treaty exists between the Russian Federation and the United Kingdom or the United States of America concerning the recognition and enforcement of judgements in civil cases. Accordingly, it is unlikely that a court of the Russian Federation would recognise or enforce such a judgement without re-examination of the issues. Moreover, a court of the Russian Federation may refuse or limit enforcement of a foreign judgement, *inter alia*, on public policy grounds and may seek to decline jurisdiction over a dispute arising out of an agreement governed by foreign law.

11. Save as disclosed in this Prospectus, since December 31, 2005, there have been no significant changes relating to public finance and trade.

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