

Russia

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City of Moscow

Returning after a short absence

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Sub sovereign/municipal

Having repaid the last of its remaining outstanding Eurobonds in April and May this year, the City of Moscow is planning a return to the Euromarkets before year-end.

Moscow is economically the largest and best performing of all of Russia's 89 regions. With just 6% of Russia's population, the City of Moscow accounts for 15% of Russia's GDP and provides around one-third of the entire revenues of the Federal budget.

Moscow's revenues have recovered sharply over the past two years. The 1998 devaluation caused the City's revenues to contract in dollar terms from US\$5.0bn in 1998 to US\$4.3bn in 1999. Revenue levels bounced back in 2000 to US\$6.9bn and US\$6.8bn is budgeted for 2001.

Since August 1998 Moscow has reduced indebtedness by two-thirds. Although debt service on its foreign currency debts burgeoned in rouble terms after the 1998 devaluation, the City met all obligations in full and on time. Even though refinancing was not available the City repaid US\$1.4bn of foreign credits plus interest over two and a half years.

Moscow is currently rated B by Standard & Poor's at the Russian sovereign ceiling. Moody's and Fitch rate Moscow B3 and B- respectively, both one notch below Russia.

Financial data (US\$m)

	1999	2000	1H01*
Tax revenues	3,179	4,700	2,644
Total revenues	4,312	6,958	3,770
City expenditures	2,804	3,846	1,998
Other expenditure	796	2,009	581
Debt service	694	299	541
Surplus	17	804	651
Total debt	2,376	1,944	1,078

Key ratios (%)

	1999	2000	1H01*
Debt service/rev	16.1	4.3	14.4
Total debt/rev	55.1	27.9	14.3
Surplus revenues	-	11.6	17.3

* ratios annualised where applicable

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Investment considerations

Moscow's record in international capital markets

Moscow has repaid its three Eurobond issues

At the time of writing (17 September 2001) the City of Moscow has no outstanding international bond issues. Nevertheless, the city has been one of the most active Russian participants in international capital markets over the past ten years. In addition to several bilateral and syndicated facilities from western banks, the City of Moscow issued three Eurobonds, as summarised below.

Fig 1 City of Moscow Eurobond issues

Amount	Issue date	Maturity date
US\$500m	May 1997	May 2000
DEM500m	April 1998	April 2001
LIT400bn	May 1998	May 2001

Source: Bloomberg

Debt service on foreign debt ballooned after the 1998 devaluation

The above three Eurobonds were issued prior to Russia's financial crisis in August 1998, which was sparked off by the Federation's default on its domestic debts (the GKO's). This ushered in a period of great financial instability for Russia, as the rouble collapsed and much of the banking system became insolvent. All Russian entities that had borrowed in foreign currency faced ballooning debt service payments in rouble terms at a time when liquidity in the Russian economy was drying up. Debt service problems were exacerbated as capital markets closed to Russian borrowers, thus removing the option of refinancing maturing obligations. As Russia's largest participant on international financial markets (after the Federation), Moscow faced a huge debt service bill at an exceptionally difficult time.

All debt service payments were met on time

The City of Moscow responded to the situation by taking active debt management measures, to ensure that all obligations would be met in full and on time. Throughout the period from August 1998 to May 2000, when Moscow's largest Eurobond (US\$500m) matured, the city made debt service and redemption payments on its external debt of US\$806m as well as payments on domestic debt of RBL20bn (US\$850m at the average exchange rate for the period). Moscow did not make a single late payment on any contractual payment on either its international or domestic borrowings. The city spread repayments by buying back during 1999 US\$220m face value of the May 2000 Eurobond. This is an impressive record and one that is not matched by the Russian Federation. It is evidence of the city's willingness to service its debts, as well as its ability and financial flexibility. In April and May 2001, the City of Moscow redeemed its remaining two Eurobonds in full and on time.

Moscow's New Issue plans

Putin's government curtails regional borrowing powers

In 2000 the (then) new government of Vladimir Putin passed legislation curbing the ability of Russia's regional governments to borrow 'externally', ie, on international capital markets. Regional governments are now limited to borrowing from domestic Russian banks and to issuing debt obligations on Russia's domestic capital markets. The only exception to this rule is the case of regions with international obligations outstanding at the time the new law was passed. Such regions may only borrow each calendar year to the extent they have international debts falling due during the same period. This effectively means that

regions may borrow internationally to refinance international debts but they must do so during the same calendar year. If capital markets remain closed during the year of a debt repayment and no new borrowing is possible (as happened with Moscow during 2000 when it repaid its US\$500m Eurobond), the ability to raise new borrowing to refinance the maturing obligations is lost.

***Moscow is authorised
to borrow US\$735m
externally in 2001***

During 2000, Moscow repaid over US\$400m of external debt but was unable to raise new borrowing internationally due to market conditions. During 2001, Moscow is due to repay US\$841m of external debt. During 2001, Moscow is authorised to issue up to US\$735m in external debt, most of which is expected to be Eurobonds. Not only will this enable the city to continue with its investment programme, but it will help the city to retain its status as a recognised issuer in the international capital markets with a strong reputation. Should the law limiting external borrowing be changed at some future date, Moscow should have ready access to international bond markets.

Regional government in Russia

Federal Constitution divides Russia into 89 regions

The constitution of the Russian Federation divides Russia into 89 'subjects' or regions. The regions vary enormously in geographic size and economic importance and the borders of the regions are derived from a variety of historical, geographic and ethnographic factors. Two of the 89 subjects (Moscow and St. Petersburg) are defined as 'cities of Federal importance' and, although they are only cities, they enjoy the same powers as the other 87 regions. Each region directly elects a Governor (in the case of Moscow, a Mayor) and also a Legislative Assembly, both for a four-year period. The Governor/Mayor is the chief executive of the region or city and appoints his own cabinet of ministers to manage the principal executive arms of the administration. Administration officials are career civil servants who generally remain in post throughout changes in elected chief executive.

Regional legislative powers

The Legislative Assembly (in Moscow known as the City Duma) is the legislative arm of regional government and is responsible for enacting local laws and statutes, reviewing their implementation by the executive through committees, and approving and controlling the regional budget. Regional assemblies are composed of directly elected deputies, each representing a constituency within the region. Regions have limited powers to enact regional taxes and levies, though most taxes are controlled at the Federal level and shared with the regions according to prescribed formulae.

The division of powers between the Federation and the regions is described in the Federal Constitution. Matters reserved to the Federation are defence, foreign relations, the management of Federal property and the issue of currency. Matters which are the joint responsibility of the Federation and the regions include tax administration and the ownership and use of land and natural resources. Matters not specifically reserved to the Federation under the Constitution are in the jurisdiction of the regions.

Regional devolution has been curbed under Putin

Following the fall of the Soviet Union, the early 1990s saw a process of devolution of power from the centre to the regional level. This process was typified by Boris Yeltsin's much quoted advice to the regions to "...take as much devolution as you can handle!" Although the Russian constitution allows regions to enact legislation and enter into agreements provided that they are not in contravention of Federal law, some regions (especially Tatarstan) pushed their devolved powers to the limits. This has led to a reaction from the government of President Putin to curb regional powers. President Putin has divided Russia into seven Federal Regions and has appointed a Governor General over each to supervise the activities of the regional governors in their area. In addition to this, his government has limited the regions' powers to borrow outside Russia following the default by some regions on their international borrowings. As a general observation, one could say that the process of regional devolution in Russia has stabilised, with regions retaining a similar degree of power as municipal bodies in many Western European countries.

City of Moscow Government

Mayor Luzhkov heads Moscow City Government

The city's administrative system is set down in the city Charter, adopted in June 1995. The executive branch is headed by the Mayor, currently Yuri Luzhkov who was elected on 19 December 1999 for his third four-year term. The Mayor has the right to appoint senior officials to head the main administrative branches of the city; these officials constitute the City Government and are directly responsible to the Mayor. The City Duma is the legislative arm of the administration and is composed of 35 directly elected deputies, each representing a specific area of Moscow. Under the Federal Constitution, each of Russia's

89 regions has two representatives in the Federation Council. Mayor Luzhkov is currently one of Moscow's representatives on the Federation Council.

City Government's responsibilities

The City Government's main areas of responsibility and activity are:

- Moscow's economy and infrastructure, including public transport, utilities and communications and engineering infrastructure.
- The provision and supervision of social services, such as public health, education, cultural activities and the provision of social assistance to certain targeted groups.
- The development, management and sale of the city's property and other assets.
- Construction activities.

Each of the main areas is headed by an official, appointed by and directly responsible to Mayor Luzhkov. The City Administration consists of approximately 14,000 employees. The largest unit is the Social Services department with 7,500 employees. Within Moscow, the City Administration is the largest single employer.

Moscow's elected City Duma

The City Duma's 35 deputies are elected for four-year terms. The next election for the City Duma is due in December 2001. The City Duma exercises its authority during its sessions when it can enact or repeal legislation, and in certain circumstances, it can pass motions of no confidence in the City Government or individual officials. Much of the City Duma's work takes place on a number of permanent committees, which supervise the activities of the administration and the City Government, and initiate the legislative process. The principal committees are:

- Budgetary and finance.
- Economic policy.
- Social policy.
- Law enforcement (ensuring that City legislation complies with the Federal Constitution).
- Administration and self-governance (co-ordinating the activities of the City administration).
- City Duma sessions (preparing agenda for sessions of the City Duma).
- Enterprise committee (supervising certain City enterprises).
- Housing policy.
- Environmental policy.

City of Moscow – economy

Moscow is the strongest region economically

Moscow is Russia's largest city with a population of 8.54m. The population has declined from a peak of around 9.0m in 1990 due to Russia's declining birth rate. Moscow's economy is the most vibrant of all of Russia's 89 regions and generally the city scores top on all standard indicators. Although the city accounts for about 6% of Russia's population, in 1998 (the last year for which full data is available) it made up around 15% of Russia's GDP. GDP per capita is over twice the Russian average and average incomes are four times the Russian average. Moscow's significance in the Russian economy is best illustrated by the fact that the city contributes on average one third of the Federal budget's revenues.

**Private sector
employment is growing**

In terms of employment, Moscow has a higher percentage of the workforce in registered employment than the overall average for the Russian Federation, and also a higher percentage employed in the private sector. The gap between public and private sector employment is widening rapidly throughout Russia though the trend is more marked in Moscow due to the strength of the city's growing private sector. The table below gives the percentage of the working population not in registered employment and includes housewives, students and others of working age but not actively in the labour market. Registered unemployment in Moscow is very low at 0.6% though this is not deemed to be an accurate measure. Using the methodology of the International Labour Organisation, unemployment was estimated to be 3.3% as of year-end 2000.

Fig 2 City of Moscow – employment

	1998		1999 (prelim)		2000 (prelim)	
	Moscow	Russia	Moscow	Russia	Moscow	Russia
Public sector %	29.0	28.6	28.6	27.8	27.6	N/A
Private sector %	53.7	46.5	53.6	45.0	55.9	N/A
% of labour force not in employ	17.3	24.9	17.8	27.2	16.5	N/A
Labour force (mio)	6.3	84.6	6.6	87.9	6.5	N/A

Source: City of Moscow – Department of Economic Policy

**Local economy is
strongly service based**

Moscow's economy is strongly service orientated, as one would expect for a major capital city. In 1998 services accounted for 66.5% of Gross City Product (GCP) against less than 50% for the Russian Federation as a whole. The decline in manufacturing is much in line with the experience throughout the whole of the former Soviet Union as previously inefficient enterprises are either restructured or closed. Moscow's industrial sector is dominated by 'machine building' (a category that in Russia encompasses a very wide range of manufacturing businesses), food processing and construction. Although general economic activity took a hit following the 1998 economic crisis, Moscow's industrial sector seems to have recovered faster than most of the rest of Russia, recording annual growth of around 8% since 1998.

**Some of Russia's
largest companies have
their HQ in Moscow**

An important feature of the City of Moscow's economy is that the city is headquarters to a large number of Russian companies, the bulk of whose activities are situated outside the city. This includes a very large proportion of Russia's sizeable oil and gas sector. Many of these companies have their exporting and financial subsidiaries situated in Moscow, which are not included for reporting purposes in GCP. On the other hand, certain service-orientated divisions are included in GCP. This goes some way to explaining the apparent anomaly between Moscow representing 15% of Russia's GDP while providing one third of Federal budget revenues. In 1999, Moscow was headquarters to 14 companies that accounted for 58% of the total sales of Russia's top 200 companies, and one of these – Gazprom – provided 23% of the city's total tax revenues. In our view, GCP data tends to underestimate the city's economic potential.

Fig 3 Gross city product (%)

	1996	1997	1998	1999*
Industry				
Manufacturing	16.7	13.6	13.0	11.6
Construction	8.6	7.7	7.7	6.0
Other industrial	1.1	1.6	1.4	1.4
Total industrial	26.4	22.9	22.1	19.0
Services				
Transport and telecommunications	9.6	10.8	10.0	9.4
Retail and catering	23.9	24.7	30.4	32.2
Logistics	0.8	1.2	1.0	1.7
Real estate	0.9	2.6	2.6	3.8
General commercial activities	3.5	6.1	2.4	5.0
Housing and utilities	7.5	4.5	5.1	3.8
Scientific and technical	1.4	2.5	1.7	2.0
Insurance	1.1	1.7	2.4	1.9
Other services	10.5	10.0	10.9	7.5
Total services	59.2	64.1	66.5	67.2
Net taxes on products	14.4	13.0	11.4	13.8

* preliminary data

Source: City of Moscow – Department of Economic Policy

Financial analysis

City budget – structure

Budgets are subject to annual approval by Duma

Moscow's annual budgets, which run for calendar years, are prepared by the City Government and after review by the office of the Mayor, are passed to the City Duma for review and approval. The whole budgetary process is normally completed with the final approval in the City Duma prior to the end of December. In the event that a budget has not been approved by year-end, the City Government is authorised to incur expenditure in the new fiscal year provided that monthly expenditure does not exceed one twelfth of the previous year's expenditure. Should the City Government seek to implement changes in either revenue or expenditure from the approved budget, an amendment to the budget must be approved by the City Duma.

Regional expenditure is not Federally regulated ...

Regional governments in Russia are at liberty to decide their own expenditure priorities, within their abilities to collect revenues and raise finance. The Federation exercises no direct control over regional budgets though its taxation policies indirectly determine the level of regional tax revenues. The maximum rate of most important direct and indirect taxes are set by the Federation; these are corporate profit tax, personal income tax, VAT and excise on certain goods and services. The Federal Government determines how each tax should be divided between the Federal budget and the budgets of the regions where the tax is collected. The same rate and split is applied throughout the Federation. All such taxes are collected by regional offices of the Federal tax authorities, which then divide and distribute the taxes between the Federal and regional budgets.

... though the Federation indirectly controls tax revenues

Regional governments therefore have no powers to increase the level of Federal taxes. This system of taxation leads to wide disparities in tax revenue levels between the regions due to differences in the local economies. The Federal budget transfers additional funds to those regions with low revenues, to enable them to provide a reasonable level of public services. Only about ten regions – including Moscow – do not receive Federal transfers, their revenues being deemed sufficient to provide the required level of public services.

Regional governments do have the power to raise some local taxes but in practise these do not constitute a significant proportion of overall revenues. Regional taxes include sales tax, road tax, taxes on gambling and various license fees.

Moscow operates a single unitary budget

Moscow's budget is different from most of Russia's other 89 regions in that since 1992, the city operates as a single municipality with a unitary budget. Most other regional governments operate a revenue equalisation system between the various municipalities in the region, and accordingly make and receive transfers between the subordinate municipalities. This is not the case with Moscow: the only inter-budgetary transfers are from the Federal budget to fund certain Federal projects within the city.

Budget reporting is on a cash basis

Budgetary reporting is strictly on a cash basis and no accruals are shown for tax arrears or payables (including arrears such as unpaid salaries). During much of the past ten years, significant levels of arrears of both revenues and expenditures accumulated at the regional level, making it difficult to assess the true financial position of regional governments. In addition, chronic shortages of liquidity led to the use of barter and offset between taxpayers and regional government, further complicating the picture. Generally speaking the City of Moscow has fared better than other regions in these respects. The level of liquidity in the city has always been better than in the regions and arrears and non-cash transactions have been kept to a much lower level.

Revenues

Throughout this analysis, all amounts have been translated from roubles into US dollars at the average rate of exchange for the relevant period. In the case of the plan budget for 2001, amounts have been translated into US dollars at the average for the first six months of 2001 to enable comparison with the 1H01 preliminary budget figures.

The City's revenues fall broadly into three categories:

- Taxation.
- Non-tax revenues comprising fees charged by the City and its earnings from its substantial property portfolio.
- Other revenues, made up mainly of the revenues of the Designated Purpose Funds (see below), which are accounted for separately.

Tax revenues

Direct taxation now accounts for over 68% of revenues

Tax revenues are by far the largest component of the city's budget, averaging over 68% of total revenues over the past few years. Direct taxes – corporate income tax and personal income tax – are the most important taxes, comprising around 56-60% of total tax revenues up to 2000. In 2001, direct taxes are budgeted to be around 75% of total tax revenues. This change has been prompted by a change in the Federal law on VAT, which is levied at either 10% or 20% on certain goods and services. Up to the end of 2000, Moscow was entitled to retain 15% of VAT collected but as of 2001, 100% of VAT revenues go to the Federal budget.

Moscow enjoys high levels of direct taxation revenues due to the presence of some of Russia's largest companies and a relatively affluent population. In US dollar terms, the level of direct taxes fell sharply in 1999 to US\$1.8bn from US\$2.6bn in 1998 as a result of the devaluation of the rouble and depressed economic conditions. Direct taxes recovered to US\$2.6bn in 2000 and the plan budget for 2001 forecasts US\$3.9bn.

Corporate profit tax is largest revenue source ...

Corporate profit tax is the largest single source of revenue for Moscow, raising US\$1.5bn in 2000 and US\$2.7bn is budgeted for 2001. The rate for companies in the financial sector (banks, insurance companies, financial intermediaries) 43% versus 35% for all other industrial and commercial enterprises. Federal law requires all enterprises to pay a corporate profit tax of 11% to the Federal budget with the balance of taxes paid accruing to the City. Moscow clearly benefits from being the financial and political centre of the Russian Federation, which accounts for it being the country's largest corporate headquarters. The presence of so many of Russia's largest companies – particularly from the oil and gas sector – is a major strength of the City's budget.

... but personal income tax is growing

In 2000 personal income tax constituted the second largest source of revenue for the city, raising US\$1.1bn. The amount raised from personal income tax has grown rapidly in recent years: in 1997 the total collected was just US\$178m. There are a number of factors behind this growth. An improving economy and rising incomes is part of the reason but also a wider acceptance of taxation as an important factor in civil life has been a major contributor. Up to year-end 2000, Russia taxed personal incomes on a progressive basis according to income levels, with a variety of tax reliefs for various groups. From 2001 onwards, earnings are taxed at a single rate of 13%. The new rate is very low by international standards and is intended both to be simpler than the previous system as well as removing the incentive for tax evasion. The experience of other countries that have introduced similar personal tax reforms has been that the tax take actually increases as a result of the lower rate. It is perhaps too early to assess whether this will be repeated

in Russia though the likelihood is that it will be and that the benefit of the increased tax collection will accrue almost entirely to the city budget.

Fig 4 Principal taxes – allocation between Moscow and Federation 2001

Type of tax, excise or fee	Tax rate (%)	% of total allocated to:	
		Moscow	Federation
Corporate profit tax – financial	43	74	26
Corporate profit tax – other	35	69	31
Personal income tax	13	99	1
VAT	10/20	-	100
Excise on oil, gasoline, cars	Various	-	100
Excise on alcohol, vodka, etc.	Various	50	50
Excise on tobacco, beer, luxury goods	Various	100	-
Sales tax	5	100	-
Land tax, land lease fees	Various	70	30
Natural resources tax	Various	40	60

Source: City of Moscow – Department of Finance

Indirect taxes have fallen since the loss of VAT revenues

Indirect taxes (taxes on goods and services such as VAT and excise) historically accounted for 18-22% of Moscow's total tax revenues. However, the 2001 plan budget forecasts indirect taxes at only 14% of total tax revenues. As mentioned above, this is mainly due to the loss of VAT receipts to the Federal budget. When this was announced in 2000, it was expected that the loss of VAT would hit regional budgets hard. Throughout the years of high inflation and low liquidity, due to its very nature VAT was virtually the only tax fully collected in cash. However, the City of Moscow has successfully softened the loss of this important tax through the introduction of the city's 5% Retail Sales Tax. It was first introduced in July 1999 during which year it accounted for US\$93m of revenues. In 2000 it accounted for US\$380m and a figure of US\$577m is forecast for 2001.

Property taxes

Enterprise property tax is established by the Federation at 2% of the book value (cost less accumulated depreciation) of property owned by enterprises. This same tax is also levied on property inherited by individuals and on transactions in certain securities, rather like a stamp duty. In 2000 this tax raised US\$382m and US\$453m is budgeted for 2001. Most other taxes accruing to the city's budget are relatively insignificant with the exception of the tax on maintenance of public housing and social amenities. This latter tax makes up the bulk of 'other taxes', which in 2000 amounted to US\$646m. The public housing maintenance tax was abolished by the Federation in the 2001 budget and so the city's budgeted figure for 'other taxes' is a much reduced US\$58m in 2001.

Non-tax revenues

Moscow generates significant revenues from its property portfolio

The City of Moscow's non-tax revenues consist mainly of payments and rentals for the use of city property, asset sales and privatisation proceeds plus a modest level of fines and administrative fees. The property portfolio of the City of Moscow is very large and diverse and thus generates a relatively large amount of revenue. Such payments make up a significant part of non-tax revenues, which totalled US\$213m in 2000. The level of these receipts depends very much on the economic environment, thus the amount collected in 1999 in the aftermath of Russia's economic crisis was a rather low US\$111m. Privatisation revenues are now insignificant and no such revenues are budgeted for 2001. This is due to the fact that the City's privatisation programme is largely complete.

Non-budgetary funds

Non-budget funds no longer off-budget

Up to year-end 1999 Moscow maintained several non-budgetary funds (NBFs), which were operated outside the city budget. A particular source of revenue or tax would be earmarked for a specific NBF and the money raised used for the specific purpose designated by the fund. NBFs were not separate legal entities and were managed by departments of the City Administration. The practice was common to all regional governments in Russia. The Federal tax code for the year 2000 abolished the right of regional governments to establish NBFs and from 2000 onwards the City of Moscow took the decision to consolidate all its NBFs into the city budget and to call them 'designated purpose funds' (DPFs). The rationale of the DPFs is to use specific sources of income to finance city programmes connected with the revenue source, eg, the road tax is used to fund the Road Fund. The overall amount represented by the DPFs is quite significant, totalling US\$1.3bn in 2000 and US\$1.1bn budgeted for 2001. The funds are listed below.

Fig 5 City of Moscow – designated purpose funds

Name of DPF	Authorised Manager of Fund
Administrative regions funds	Prefects of Moscow administrative regions
Sub-regions funds	Heads of Moscow sub-regions
Investment fund	Department of Construction and Investment Programmes – City of Moscow
Road fund	Dept of Economic Policy and Development – City of Moscow
Ecology fund	State Committee on Environmental Protection – City of Moscow
Anti-crime fund	Department of Finance – City of Moscow
Traffic safety fund	Department of Finance – City of Moscow
Fire protection fund	Department of Finance – City of Moscow
Advertising and Information fund	Directorate of Advertising, Information and Design – City of Moscow

Source: City of Moscow

Expenditure

The City's expenditure can be broadly categorised as the provision of services to the population of Moscow, the maintenance of the City's infrastructure and the economic development of the City. Excluding debt service and the expenditure of the DPFs, City expenditure totalled US\$3.8bn in 2000 (60% of revenues) and US\$4.5bn (67% of revenues) is budgeted for 2001. The major expenditure items are as follows:

Housing and communal costs

Principal expenditure items

This item includes the cost of maintaining and overhauling the City's housing stock, the provision of basic services (eg, refuse collection) and subsidies for certain utility costs. The trend is to undertake reforms in how the provision of housing is financed and certain communal services are now self-financed. At US\$1.3bn it was the largest item of expenditure in 2000 and a sum of US\$1.4bn is budgeted for 2001.

Education

The City is mainly responsible for the provision of meals to schoolchildren, social benefits for teachers, subsidies for utility bills as well as maintenance of school buildings. The cost of education is shared with the Federation and this budgetary item represents only that expenditure which is the responsibility of the City.

Healthcare

The City's healthcare budget aims at guaranteeing a basic level of free medical service and the functioning of healthcare institutions. Since 1994 healthcare in Russia is partly financed by private insurance.

Social services

The City provides a range of targeted social benefits including old people's homes, child allowances and protection for people with low incomes. Service is provided through 113 centres and approximately 0.5m people receive benefits, including 120,000 requiring permanent care.

Transport

Moscow has a large and sophisticated network of public transport. Budget expenditure consists mainly of subsidies paid to the Metro and bus systems.

Police and security

The cost of maintaining the police force is shared with the Federation. This budgetary item represents the City's share of the cost.

Administration

This item covers the cost of maintaining the City's administrative bodies and includes salaries, benefits and maintenance of administrative offices.

First half 2001 – preliminary budget results

Revenues this year running slightly over budget ...

Preliminary results for the first six months of the current fiscal year are extremely encouraging. Observers had feared that the loss of certain taxes such as VAT would have a negative impact on the City's revenues. Results for the first half would indicate that these lost taxes have been made up by buoyant receipts elsewhere. Tax revenues for 1H01 were US\$2.6bn or 51.5% of the total budgeted for the year. Whereas this might appear to be on target, in our estimation it represents a probable over-shoot of the budget. Tax collection in Russia displays a strong degree of seasonality with as much as 70% of total taxes being collected in the second half of the year. At this point we would prefer to be cautious in projecting tax revenues for 2001 because recent tax reforms might have reduced the seasonal effect seen in previous years. Nevertheless, we are confident in projecting tax revenues of around 10-15% above budget or US\$5.5-5.7bn. Revenues in 2000 were 41.8% over budget though we do not expect such a large over-shoot in the current year.

... but we expect an over-shoot of 10-15% for the year

High property revenues indicate a buoyant economy

Revenues from City property stood at US\$404m for 1H01 or 142% of the figure budgeted for the year. In our view, this greatly improved performance is representative of buoyant economic conditions in Moscow. Other non-tax revenues are showing a modest over-shoot of budget. Total revenues for 1H01 were US\$3.77bn or 55.7% of total budgeted revenues for 2001. On the basis of these figures we expect total revenues for 2001 to be in the region of US\$7.5bn or 116% of budget.

Expenditures are running below budget

City expenditures on the other hand are running below budget at US\$2.0bn or 44.3% of budget. Total expenditure – including debt service and DPFs – was US\$3.1bn or 48.5% of budget. Taken together with the improved revenue performance, this has resulted in a surplus of US\$650.5m or 199% of the budgeted surplus for 2001. At this stage, we are expecting the budget surplus to narrow in 2H01 to something closer to the budgeted figure of US\$326.6m.

Budgetary record – surplus/deficit

The table below summarises the City's budgetary record since 1997. The revenues and expenditures of the non-budgetary funds for the period 1997-99 together with their surpluses have also been shown. It should be noted that the City has consistently posted a surplus, sometimes quite sizeable. Although the City borrows regularly both on domestic markets and internationally, it does not borrow to finance regular budgetary expenditure. The City's charter does not allow the City to borrow for anything other than investment purposes. The City's substantial borrowings have been used to finance the development of the City's property, which is then sold or leased commercially. It is the intention that such development activities be self-financing and not dependent on the City budget for servicing or repayment. Nevertheless, all such borrowings carry the full faith and credit of the City, and funds can be made available for debt service should circumstances demand. This was in fact what happened in the aftermath of Russia's 1998 financial crisis. It was not possible to raise sufficient funds from the City's investments to meet debt repayments so assistance was provided from the City's budget.

Fig 6 City of Moscow – budgetary record (US\$m)

	1997 actual	1998 actual	1999 actual	2000 actual	2001 plan	1H01 actual
Revenues	9,532	5,003	4,312	6,958	6,764	3,770
Expenditures	9,203	4,992	4,294	6,154	6,438	3,120
Budgetary surplus	329	11	17	804	326	650
Non-budgetary funds - revenues	3,517	2,105	817			
Non-budgetary funds - expenditures	3,239	2,036	810			
Surplus of NBFs	278	69	7			

Source: City of Moscow/Federal Ministry of Finance

State debt of the City of Moscow

*All borrowing controlled
by the City is controlled
centrally*

The borrowing activities of Russia's 89 regions – including Moscow – is regulated by the Federal Ministry of Finance (MoF). The MoF registers debt issues by the regions and the Central Bank of Russia is responsible for issuing licenses to allow regions to borrow externally. In 1996, the City formed the Committee of Municipal Debt, Securities and Capital Market Development (Municipal Debt Committee) to manage the City's borrowing programme. It is a body of the executive branch of the City Government and its chairman is appointed by the Mayor. Its principal functions are:

- Develops strategies for financing the City's borrowing requirement.
- Organises the City's debt issuance both domestically and internationally.
- Examines and selects investment projects that can be financed on a recoverable basis.
- Organises the execution of approved investment projects, including repayment.
- Monitors the City's debt issuance and arranges timely servicing and repayment of debts.

*External borrowing
dates from before the
crisis*

Prior to August 1998, the City raised substantial amounts of debt denominated in foreign currencies from the international capital markets, in the form of bank borrowing and three Eurobond issues. Borrowing in roubles was relatively modest due to the exceptionally high real interest rates payable at that time. Some rouble borrowing was undertaken short-term from Russian banks for liquidity purposes but most rouble borrowing was on

the domestic bond market where Moscow was keen to establish its name. When the Federal government defaulted on its short-term debt obligations in August 1998 prompting a collapse of the rouble, Moscow had very high foreign currency debts outstanding. The City's revenues are almost entirely denominated in roubles and their value in dollar terms rapidly collapsed. In addition, capital markets closed to Russian borrowers rendering it nigh impossible to roll over or refinance maturing obligations. In actual fact some bilateral lenders did roll some obligations but this represented a small proportion of the total.

The Municipal Debt Committee set about managing available liquidity and was able to gain some relief by applying some imaginative solutions. Taxpayers were allowed to pay tax arrears with municipal bonds and holders of domestic bonds could elect to be repaid with real estate at attractive terms. Ultimately, some assistance was provided by the City Budget and all obligations were met in full and on time.

Fig 7 City of Moscow – Outstanding debt (US\$m)

	Dec 1997	Dec 1998	Dec 1999	Jun 2000	Jul 2001
Rouble debt	596	282	435	456	423
FX debt	1,016	1,603	1,600	1,193	180
Other	131	268	341	295	475
Total	1,743	2,153	2,376	1,944	1,078

Source: City of Moscow Municipal Debt Committee/Fitch IBCA

Moscow is authorised to borrow up to US\$735m in 2001

As can be seen from the above table, the City has reduced its debt stock dramatically in just three years. Such a drastic programme of debt repayment has forced the City to curtail some of its investment programmes. The City would like to resume some these in the current favourable economic climate in Russia and the 2001 budget authorises the Municipal Debt Committee to raise up to US\$735m in the current fiscal year. This figure represents most of the amount of debt principal repaid by the City this year and which it is authorised under Federal law to re-borrow by year-end.

Conclusion – Moscow's proven credit quality

Moscow's creditworthiness proved in difficult circumstances

When Moscow was first rated by Moody's and Standard & Poor's, its ratings were constrained by those of the Russian Federation. The events of the past three years have in our view amply demonstrated this to be the case. In extraordinarily difficult circumstances and at a time when several other Russian regions were in default on their external obligations, Moscow was able to both service its debt and reduce the outstandings by 50%. Debt outstanding as of 1 July 2001 is around 16% of total budgeted revenues for 2001.

Preliminary figures indicate even stronger performance in 2001

Preliminary first half budget figures for 2001 indicate that the loss of certain taxes to the Federal Budget has not had a negative impact due to the healthy growth of other tax revenues. As with previous years, we expect the outcome of the City's budget for the current fiscal year to be a considerable overshoot to the Plan Budget. Assuming that the City is able to borrow the full US\$735m permitted under the 2001 budget, we estimate that at year-end the City will have total direct debt of equivalent US\$1.35bn representing around 20% of total forecast revenues and around 25% of forecast tax revenues.

Fig 8 City of Moscow - historical budget performance (US\$m)

	1997	1998	1999	2000	2001	2001
	Actual	Actual	Actual	Actual	Plan budget	6-mth actual
Average exchange rate for period	5.786	10.041	24.9524	28.1466	28.7948	28.7948
Tax revenues	8,460.4	4,550.5	3,179.0	4,700.2	5,129.7	2,643.8
<i>Direct taxes</i>	<i>5,059.5</i>	<i>2,560.5</i>	<i>1,810.4</i>	<i>2,617.7</i>	<i>3,883.1</i>	<i>1,944.5</i>
Corporate	4,881.5	1,283.7	913.5	1,520.3	2,666.2	1,330.7
Personal	178.0	1,276.8	896.9	1,097.4	1,216.8	613.8
<i>Indirect taxes</i>	<i>1,420.1</i>	<i>834.4</i>	<i>580.1</i>	<i>1,043.1</i>	<i>725.2</i>	<i>338.1</i>
VAT		680.7	487.2	662.9	148.0	
Excise		110.8	0.0			83.4
Retail sales tax			92.9	380.2	577.2	249.9
Duties for issued licenses		17.0				0.9
Other		25.9				3.9
<i>Property taxes</i>	<i>745.1</i>	<i>458.9</i>	<i>266.8</i>	<i>392.9</i>	<i>463.0</i>	<i>251.8</i>
<i>Natural Resources Utilisation Taxes</i>	<i>124.4</i>	<i>17.7</i>	<i>7.6</i>			<i>6.6</i>
<i>Other taxes</i>	<i>1,111.2</i>	<i>679.0</i>	<i>514.1</i>	<i>646.5</i>	<i>58.4</i>	<i>102.8</i>
Non-tax revenues	643.7	386.1	335.3	958.1	490.3	517.9
Revs. from City property	169.4	202.5	111.1	212.9	284.5	404.4
Revenues from property sales	159.7	51.6	69.5			0.1
Admin. fee	6.7	3.7	0.0			6.9
Penalties	9.5	5.3	0.0			8.4
Other non-tax revenues	298.4	122.9	74.6	745.1	205.7	98.0
Other incl income from DPFs	428.2	66.2	797.5	1,299.9	1,144.4	608.3
Total revenues	9,532.3	5,002.8	4,311.8	6,958.2	6,764.3	3,770.0
City expenditures	9,203.4	4,764.5	2,804.7	3,846.3	4,510.9	1,998.1
Administration	165.0	132.2	69.3	98.7	148.6	57.5
Police & security	235.2	130.0	65.6	65.5	75.0	34.3
Industry, utility (energy) & construct.	38.9	129.1	120.1	111.3	217.0	71.1
Agriculture	134.5	24.1	86.8	56.6	89.9	-17.1
Environment	121.2	42.5	40.4	76.1	67.5	30.2
Transport	661.1	372.9	199.5	329.1	285.0	120.4
Housing & communal costs	3,436.9	1,611.1	793.1	1,284.0	1,358.6	763.9
Education & science	1,340.0	695.5	380.0	504.2	635.7	315.5
Culture & art	323.1	98.5	55.8	81.0	97.8	50.5
Mass media	87.8	46.5	37.6	67.6	64.2	32.7
Health & sport	1,418.5	778.2	436.8	527.9	592.0	275.6
Social welfare	664.1	435.6	261.5	364.8	500.0	248.1
Other	577.3	268.3	258.1	279.5	379.6	15.2
Expenditure of DPFs	N/A	N/A	796.2	2,009.2	1,358.4	580.7
Debt service		227.5	693.5	298.7	568.4	540.7
Total expenditure	9,203.4	4,991.9	4,294.4	6,154.1	6,437.8	3,119.5
Surplus (deficit)	328.9	10.9	17.4	804.1	326.6	650.5

Source: City of Moscow, Federal Ministry of Finance

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