

Country Strategy Paper 2002-2006

National Indicative Programme 2002-2003

Russian Federation

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Summary

The Russia CSP was adopted by the Commission on 27 December 2001 and provides the strategic framework within which EC assistance will be provided for the period 2002-2006. The CSP follows the guidelines set out in the Framework for Country Strategy Papers, and takes its basis from the Regulation for the provision of assistance to the partner countries in Eastern Europe and Central Asia (Council Regulation (EC, Euratom) No 99/2000 of 29 December 1999). The CSP constitutes the Indicative Programme as described in article 3.2 and 3.3 of the Regulation and revises and updates (as foreseen in article 3.6 of the Regulation) the Indicative Programme for 2000-2003 adopted in 2000. The CSP sets out EC co-operation objectives, policy response and priority fields of co-operation based on a thorough assessment of policy agenda and political and socio-economic situation of Russia. The National Indicative Programme (Chapter 6 of the CSP) sets out the response in more detail, highlighting programme objectives, expected results and conditionality for Tacis in the priority areas of co-operation for 2002-2003.

EU/EC relations with the Russian Federation are based on the Partnership and Co-operation Agreement (PCA), which provides for trade liberalisation and closer relations, as well as on a CSFP Common Strategy, aimed at strengthening the strategic partnership with Russia and addressing common challenges on the European continent. While the EU is Russia's main trading partner, it has a huge trade deficit with this country, originating mainly in its dependence on energy supplies from Russia. The EU has thus an important strategic and economic interest in Russia's development. The case for closer EU-Russia relations will be even greater after enlargement. Recent developments in the relationship include the launching of thematic dialogues on energy, space and science and technology co-operation as well as the establishment of a High-Level Group to develop the concept of a common European economic space between Russia and the EU. Russia should be able to develop its position as a prosperous market for EU exports and investments and a reliable source of EU energy supplies, as well as a stable, predictable and co-operative partner for security in Europe. "Soft" security threats from Russia are a serious concern for the EU and require continued engagement: nuclear safety, the fight against crime, including drug trafficking and illegal immigration, the spread of diseases and environmental pollution.

After the presidential elections of 2000, Russia has experienced political stability, with a consolidation of presidential powers and strengthening of the state, but with a tendency towards weakening of opposition and media independence. After almost a decade of economic decline, there has been a marked economic recovery since 1999, mainly due to high world prices for energy, but also to clear direction of economic policies. An ambitious programme of socio-economic reforms was launched in 2000 with an impressive amount of new legislation passed by Parliament or under preparation. The main challenges facing Russia over the medium term are the effective implementation of the new legislation, requiring a deep reform of the public service and of the judiciary, and to improve the investment climate in order to make current economic growth sustainable. The issues of poverty, public health and social protection have to be tackled in a country where inequalities between groups of population and regions have been growing. Finally, democratic and civic institutions, as well as media pluralism, need to be consolidated, at a time when central state power is being reinforced after 10 years of weakening.

Since 1991, EC technical assistance has been one of the leading programmes supporting the transition process in Russia. An evaluation, in 1999, of the country programme for Russia highlighted the sometimes limited impact of this assistance on the regulatory and policy framework, while at the same time commenting on the successful implementation of individual projects. In response to these findings, EC assistance has been progressively refocused on a limited number of areas, in order to support institutional reforms in Russia

and achieve a systemic impact in key socio-economic fields linked to the PCA implementation process. This assistance is complemented by other EC instruments, such as the European Initiative for Democracy and Human Rights, humanitarian aid in Chechnya and co-operation in science and technology. Increased co-ordination at all levels is also been sought with the EU Member States, the International Financial Institutions and other major donors.

In its response strategy 2002-2006, the EU should lend its full support to the Government's socio-economic reform programme and should concentrate on building the legal, institutional and administrative framework to allow economic development through private initiative and market forces. Legislative, regulatory and institutional convergence on the basis of European models and standards should be supported. The EU has an interest and a capacity to contribute to the solution of Russia's serious social challenges, e.g. in health, education and social welfare, as an accompanying measure for the consolidation of a market economy and democracy. On the political side, it is essential to maintain and intensify the political dialogue and to use assistance programmes for strengthening all aspects of civil society and free media, as well as the judiciary, and to support Russia's integration into international institutions, e.g. Council of Europe, OSCE, G8 and WTO.

Within that context and on the basis of the areas of co-operation defined in the Regulation No 99/2000 "**support for institutional, legal and administrative reform**", "**support to the private sector and assistance for economic development**" and "**support in addressing the social consequences of transition**", the following priorities have therefore been identified under the National Indicative Programme 2002-2003:

- **Legal, administrative reform and regional policy**
- **Judicial reform**
- **Civil Society, training and education**
- **Deregulation and corporate governance**
- **Social reform**
- **Municipal services**

Other important issues related to nuclear safety, the environment, the information society and justice and home affairs will be given particular attention under separate regional and horizontal indicative programmes.

1. EU/EC co-operation objectives

1.1. Partnership and Co-operation Agreement, Common Strategy and the Northern Dimension

The EU's co-operation objectives with the Russian Federation are to foster respect of democratic principles and human rights, as well as transition towards market economy. They are based on the **Partnership and Co-operation Agreement (PCA)**, the EU's **Common Strategy** and subsequently the **Northern Dimension** approach, specifically for north-west Russia and the Baltic Sea area, which form part of a proximity policy, reflecting the political and strategic importance of Russia to the EU. The PCA provides for trade liberalisation and wide-ranging co-operation, based on respect of democratic principles and human rights. EC assistance is the main financial instrument supporting the implementation of the PCA, assisting Russia in the strengthening of democracy and the rule of law, the consolidation of a market economy and the strengthening of administrative capacity linked to the implementation of the agreement, particularly in the areas of trade and the internal market.

Due to its size and location, Russia is a key actor for the stability and security of the entire European continent and a bridge between the EU and Asia. For the EU, neighbouring Russia

is crucial as a supplier of energy. Our trade relationship with Russia is already very significant and offers very great potential for further growth, given Russia's huge market size and natural resources. Russia is naturally a factor for many EU policies. After enlargement, the EU will be even closer to Russia and there will be even greater need for joint approaches to tackle crucial common issues.

The **PCA** provides the framework for political and economic relations with Russia and offers a perspective for future deeper integration (common economic space, free trade area). It establishes political dialogue between the EU and Russia and sets the basis for trade and economic relations, social, scientific, technological and cultural co-operation. The PCA aims at bringing Russia more in line with the legal framework of the single European market and the World Trade Organisation (WTO). Priorities and specific targets of EU-Russia co-operation are developed under the institutional structures of the PCA. PCA work has highlighted trade issues, the investment climate and increasingly economic co-operation areas, e.g. energy, transport, science and technology, cross border co-operation and fight against crime, environment and nuclear safety. More recently EU enlargement, including Kaliningrad, the energy dialogue and the concept of a common European space, have gained importance under the PCA.

In view of the consequences of **enlargement**, e.g. in the field of trade and of movement of people, the EU's objective is to have Russia benefit from the stability and prosperity which enlargement is expected to bring to the accession countries, and to avoid the creation of new dividing lines. In that respect, cross-border co-operation between regions has an important role to play. The Commission Communication on **Kaliningrad** of January 2001 expresses the willingness to give special attention to this enclave region, including issues such as movement of goods and people, energy supplies, fisheries, economic development, fight against crime, environment and health.

The EU-Russia Summit of October 2000 decided to establish an EU-Russia **energy dialogue** to develop an even stronger, stable partnership in this field, with a medium to long-term perspective of improving the investment climate and attracting co-operation between EU and Russian companies in the production and transport of Russian energy. The EU-Russia Summit of May 2001 decided that the concept of a **Common European Economic Space** between Russia and the EU should be developed, in accordance with the perspectives offered under the PCA.

The **EU's Common Strategy (CS)** for Russia, in June 1999, aimed at strengthening the strategic partnership on the basis of the PCA through binding orientations and increased coherence of EU and Member States action. The principal objectives of the CS are:

- Consolidation of democracy, the rule of law and public institutions in Russia;
- Integration of Russia into a common European economic and social space;
- Co-operation to strengthen stability and security in Europe and beyond;
- Addressing common challenges on the European continent, e.g. the environment, nuclear safety, and the fight against crime.

Under the CS, an EU plan to combat organised crime was adopted in March 2000, focussing on judicial and law enforcement co-operation, money laundering, trafficking in drugs, human beings and stolen vehicles, with a focus on north-west Russia.

The **Northern Dimension** initiative was developed in order to enhance co-ordination and complementarity of EU and Member States' programmes in northern Europe, the Baltic Sea region and Russia. The Northern Dimension Action Plan 2000-2003 of June 2000 highlights co-operation on the environment and nuclear safety, the fight against international crime and on the Russian region of Kaliningrad, as well as information society and public health issues. The Northern Dimension Environmental Partnership, developed in close co-operation

with the EBRD and the Nordic Investment Bank (NIB), will address environmental and nuclear safety issues of particular interest to the EU, e.g. clean-up of nuclear waste in north-west Russia and waste-water treatment in the Baltic Sea area.

Cleaning up nuclear waste in north-west Russia is also the objective of the **Multilateral Nuclear Environmental Programme for Russia (MNEPR)**. If negotiations can be concluded successfully, it should mobilise substantial additional resources for this objective. Since 2001, environmental objectives in Russia, which are of particular interest to the EU can also be supported by the **European Investment Bank** (up to EUR 100 million).

1.2 Trade and economic relations

The EU is now by far Russia's main trading partner and accounts for about one third of Russia's imports and exports (see Annexes 1 and 2). This figure could go up to 50% after EU enlargement. The EU-Russia trade structure is unbalanced, with mineral fuels accounting, in 1999, for 60 % of EU imports, while machinery and transport equipment represent around 40 % (and food 15 %) of EU exports. Together with Russia's current huge trade surplus with the EU, this illustrates, on the one hand, the EU's continued dependence on energy supplies from Russia, and on the other hand, the need for restructuring and improved competitiveness of Russian industry, as well as for tackling access restrictions on Russia's market. Given the low level of living standards in Russia and the size of its market, there is great potential for EU exporters and investors, if the framework of the market economy and the investment climate can be improved and steady economic growth can be achieved. The EU considers Russia's **WTO accession** on regular commercial terms highly desirable in order to stabilise Russia's market reform and to improve its investment climate.

Russian energy supplies are particularly important for both sides. The EU has a key interest in maintaining and enhancing Russia's role as a secure and reliable supplier of natural gas and oil on favourable conditions to the EU market. For Russia, oil and gas export to the EU are of strategic importance as a source of foreign exchange required for the modernisation of the country and as a source of budget revenue.

1.3 Political and security issues

The EU is interested in the consolidation of democratic institutions, the strengthening of the rule of law and the continuation of political (including administrative and judicial) and economic reform in Russia. Effective and consistent implementation of legislation is fundamental to the protection of human rights and civil liberties, as well as to the improvement of the investment climate. This will also require further reduction of bureaucratic regulations of business activities, de-monopolisation, improved regulation of financial institutions and efforts to combat corruption.

The EU assigns high priority to human rights in Russia and should use opportunities offered by political dialogue, trade and external assistance to support this objective. The actual respect of human rights principles in Russia continues to lag behind the country's formal commitments. Russia should be encouraged to fulfil the obligations undertaken as part of its membership of the Council of Europe and other international agreements. The EU is also concerned about the human rights situation in Chechnya, a central issue of EU-Russia relations. The EU supports a political solution of the conflict and restoring the rule of law in Chechnya, thorough investigation and appropriate prosecution of reported violations. The EU has expressed concern about media pluralism and possible political intolerance, and attacks and intimidation of journalists. Traditionally weak in Russia, the development of civil society is considered a major objective in order to consolidate democracy, the rule of law, media freedom and social safety.

The EU seeks Russia's co-operation to promote the democratisation of Belarus, where Russia's influence could have a significant role. Russia is progressively complying with the

commitments undertaken during the OSCE Istanbul Summit of 1999 regarding the withdrawal of its armed forces from Georgia and the breakaway region of Transdniestria in Moldova. The EU also invites Russia to play a constructive role in the resolution of frozen conflicts in the southern Caucasus (Abkhazia, South Ossetia, Nagorno-Karabakh).

At the EU-Russia Summit in October 2000, it was agreed to examine possible Russian contribution to EU-led initiatives to respond to humanitarian crises, conduct peacekeeping, peace-enforcement and de-mining operations within the framework of a common **European Security and Defence Policy** (ESDP). In area of **chemical weapons**, Russia ratified the international Convention on Chemical Weapons (CW) in 1997, committing itself to destroy a 40,000-ton stockpile within a decade. In fact, the Russian Government will probably request the five-year extension that the convention allows, to complete the liquidation programme. The EU is supporting the destruction process, while EC assistance is dealing with environmental monitoring and the conversion process of former CW production facilities. In area of **nuclear weapons**, EU efforts concentrate on conversion of earlier military installations to civil production and destruction of weapon grade plutonium. They also focus on re-directing the activity of former weapon scientists towards civil jobs, through a contribution to the International Science and Technology Centre (Moscow), jointly founded together with the USA, Japan and Russia.

In the field of Justice and Home Affairs, the EU is interested in co-operating with Russia on **security challenges** such as illegal migration, trafficking in drugs and human beings, money laundering and other forms of organised crime.

1.4 Nuclear safety

Helping Russia to achieve a high level of nuclear safety has been a priority for the EU for the last decade. Russia has a large civilian nuclear sector, including many old reactors with security standards, which are below international standards. The EU's main objective is improvement of the safety of nuclear power plants and radioactive waste management, particularly in north-west Russia. Russia's ambition to sell electricity produced by nuclear power plants to the EU will have to be considered in the light of progress on safety standards, including decommissioning of the oldest reactors and their possible replacement by more recent, safer models.

2. Policy agenda of the Russian Federation

After the presidential election of May 2000, a liberal ten-year strategic socio-economic and political programme was approved together with a short-term action plan. The central objective is sustainable high economic growth (average of 5%), which would allow Russian GDP to increase by 70% by the end of the decade. The programme has won the broad backing of the international community. It sets out to improve business operating conditions by reducing bureaucratic interference in the activities of enterprises (e.g. licensing procedures), cutting transaction costs and the scope for corruption. Taxation is to become more transparent and the overall tax burden reduced, with the aim of encouraging compliance and enforcement. A better investment climate is recognised as the key to reversing the trend of capital flight. The protection of minority shareholder rights, the adoption of international accounting standards, and the consistent enforcement of contracts are identified as main concerns. Structural reform, especially of the so-called "natural monopolies" (state-owned or state-controlled energy and transport companies) and of the financial sector is intended to ensure transparency and introduce good corporate governance. Social security reform, including pension reform (in the direction of a contributions-based, earnings-related scheme) is also envisaged.

The President confirmed these strategic priorities in his annual address to the Duma in April

2001. He highlighted the need for transparent privatisation, the liberalisation of capital flows and currency controls, and accession to the WTO. Further measures to improve the coherence of legislation and consistency in its implementation should promote a sound business environment. Judicial reform (powers of the courts; increasing the number of judges and improving their professional training) will be essential. Other priorities include the development of a science and technology policy, able to provide the resources necessary to take advantage of Russia's highly qualified scientific community for the benefit of the country's technological development. In terms of industrial modernisation, the defence sector is given high priority with a view to increasing its export capacity.

In foreign policy, the Commonwealth of Independent States (CIS) is re-affirmed as Russia's top priority, apparently based on a more pro-active approach in promoting closer relations with CIS countries on a bilateral basis. Strengthening ties with China, India and Iran is considered important in order to boost revenue from arms sales and to support Russia's ideas of a multi-polar world. At the same time it appears that Russian foreign policy is increasingly geared to relations with the EU. In response to the EU's Common Strategy on Russia (June 1999), Russia adopted its own medium-term strategy of co-operation with the EU (2000-2010). The strategy foresees the development of a mature partnership. It highlights the approximation of economic legislation and co-operation in the sphere of law enforcement. Russia is interested in attracting EU investment, especially in the energy sector, and wants to address the impact of EU enlargement on trade and Kaliningrad. Another objective is to ensure a sympathetic EU approach to Russia's accession to the WTO. Particular importance is assigned to the EU's emergence as a major actor in world affairs and as a prospective new power in European security.

The President has repeatedly underlined Russia's commitment to strengthen partnership with the EU, in a context in which Russian foreign policy is increasingly driven by economic interests. The EU is seen as a very promising source of investment capital, advanced technologies and technical expertise, which are necessary for the modernisation of the Russian economy. Russia seems increasingly aware of the EU's economic importance and growing strength through enlargement, the introduction of the Euro and further European integration. The energy dialogue and the development of a Common European Economic Space fit into this context. Following the Summit of October 2001, a High-Level Group will be established to elaborate the concept of such a Common Space, aiming at closer legislative and economic integration between Russia and the EU, based on legislative approximation.

While being on the whole positive about EU enlargement, Russia has being opposed to NATO expansion and US plans for a national missile defence system (though it has recently softened its position on these issues). Overall, Russia has taken a positive view of the development of the ESDP and has expressed the wish to co-operate with it. Following the terrorist attacks in the US on 11 September, Russia has expressed its readiness to co-operate fully with the counter-terrorism campaign conducted by the international community. This could result in enhanced co-operation with the EU in a series of fields, e.g. money laundering, with a view to preventing the flow of funds from illegal activities being used by terrorists and criminal organisations. A number of PCA positions are relevant for this purpose.

3. Country analysis

Area (km ²) 17,075,000	Population (million) 2000 145.2	GNP/capita (USD) 1999 2,270
Real GDP growth rate (%) 2000 8.3	Real level of 1999 GDP as % of 1989 GDP 57	Inflation rate (%) 2000 20.8

3.1 Political situation

Russia has a presidential democracy. Presidents and Parliament have been democratically elected. The presidential elections of early 2000 have brought relative political stability and a consolidation of presidential powers.

The President's first priority has been to reverse the at times chaotic decentralisation of power, primarily through the appointment of presidential representatives to the newly created seven federal districts and the reform of the Federation Council. The President can now dismiss elected governors and dissolve regional legislatures on the basis of a court decision, if they have violated federal legislation. Gubernatorial elections in 2000 generally strengthened the ranks of pro-presidential governors, often as a result of federal support for pro-Kremlin candidates or pressure on out-of-favour candidates to stand down.

The consolidation of presidential power has been reinforced by a more co-operative Duma. In 2001, four centrist factions pledged to work together as a large pro-presidential bloc. This appears to have enhanced the Government's ability to rapidly pass reform legislation. A new law on political parties is likely to lead to a drastic reduction in the number of political parties and forms a further incentive for the consolidation of political forces. It may lead to the emergence of a three-party system: the Communists, the pro-presidential factions and liberals (possible merger between the "Union of Rightist Forces" and "Yabloko").

Since 2000, there has been remarkable stability in the composition and policy direction of the Government in comparison with the '90s. Only the so-called "power structures" (Ministry of Defence, Ministry of Interior, Security Council) and the energy/natural resources sectors have been affected by reshuffles, leaving economic policy and the overall course of reforms largely unchanged.

Media pluralism has generally been considered one of Russia's most significant achievements in the field of democratisation, although the state-owned media has a strong position, and state authorities maintain some leverage over formally independent media, especially in the regions. More recent concern about media independence is linked with the emergence of powerful media empires which came to control almost all media outlets reaching the whole of Russia's territory. Despite the President's assurance of commitment to media pluralism, a series of investigations directed at media critical of the leadership may suggest a political motivation. The take-over of the Media-MOST TV channel and of most Media-MOST outlets, officially motivated by financial disputes, has raised considerable concern, irrespective of the legal and financial aspects of the case. Another worrying development is the number of reported attacks against independent journalists and intimidation in the regions, with the result that self-censorship is applied.

There has been, by and large, continuity in Russia's foreign policy, with some more emphasis on co-operation with the EU. But consolidation of power and stability as well as improvements in Russia's economic situation have led to a more assertive stance *vis-à-vis* Russia's NIS neighbours. Some 15-20 million Russians are still living in the other NIS.

Overall, the improvement of political stability has been accompanied by a tendency towards centralisation of power and weakening of opposition and free media. This is irrespective of the war in Chechnya, which has not raised substantial opposition inside Russia, but has caused serious concerns about human rights, especially from Russia's international partners.

3.2 Economic and social situation

After a decade of virtually uninterrupted economic decline, gross domestic product (GDP) grew by 3.5 % in 1999 and 8.3 % in 2000 and industrial output increased by 8.1 and 9.2 % respectively. The resumption of growth was primarily attributable to import substitution effects after the devaluation of August 1998, and to the sharp increase in Russia's oil, gas and commodity exports prices. But sound fiscal and monetary policies, a steady economic

policy direction and political stability are likely to have also contributed to this positive trend. In a less favourable environment, the GDP growth rate is expected to be maintained, even if at a lower level, with an official target of 5.5% for 2001 and 4% for 2002.

The trade surplus amounted to a record USD 60 billion in 2000 (40 billion in 1999). Foreign exchange reserves have grown steadily and reached the record level of EUR 41 billion* in July 2001. Economic growth brought a significant reduction in the official unemployment rate (currently at around 9%) and in Russia's formerly notorious arrears in payment of wages and pensions. Real disposable incomes, down by 14.2 % in 1999 from the 1998 level, went up by 9.1 % in 2000, finally giving Russians the perception of an increase in living standards. However, in 2001, about 50 million Russians, or some 35 % of the population, were still living below the subsistence level of EUR 50 a month. In June 2001, the average monthly nominal wage was only around EUR 130.

The ratio of investment to GDP has been and still is low. This has resulted in a rundown of the stock of private and public capital. Only a sustained increase in the investment ratio could bring long- term economic recovery to Russia. But Russia also needs to combine investment with massive technological and management modernisation, much of which has to come from abroad. Cumulative net foreign direct investment in Russia between 1991 and 1999 amounted to about USD 20 billion (compared, for instance, with over USD 30 billion in Poland or 300 billion in China during the same period). At the same time, capital flight has remained an issue of great concern, reaching an estimated level of USD 20-25 billion in 2000. The amount of Russian flight capital abroad is considered huge. Some recent return of Russian flight capital may indicate increasing confidence of Russian investors and a chance to reverse the negative trend.

The public finance situation is currently fairly satisfactory. Given the positive results from budgetary consolidation since the 1998 crisis, in March 2001, Russia could afford to decline a Stand-by Agreement with the IMF, although it remains subject to monitoring procedures, which entail a consultation every 6 months. On the basis of current spending and revenue projections, the federal budget is expected to be in balance at least throughout 2002. Nevertheless, the high level of foreign debt (around EUR 152 billion in July 2001, equivalent to around 48% of GDP) and Russia's large dependence on exports of oil, whose price is very volatile, imply that the budgetary situation will remain a crucial issue in the coming years. In particular, debt payments will rise markedly, from EUR 15 billion in 2001 and 2002, to EUR 22 billion in 2003.

During the last decade, most Russians have experienced two dramatic losses of their savings (during hyperinflation in the early 90s and during the financial crisis of 1998). There is still widespread lack of trust in the banking system, which has also been incapable of channelling funding towards productive investment in the economy.

The most worrying picture concerns social indicators and demographic trends. The Russian population is expected to decline from 145 million today to perhaps 135 million by 2015 and 100 million by 2050, unless current trends reverse. By 2015, the dependency ratio will be 4 workers for every 3 non-workers. The health situation of Russia is a matter of deep concern: alcohol abuse, high rates of cardio-vascular diseases and poisoning from heavy metals and other toxic materials, coupled with a degraded medical service, have caused an unprecedented drop in life expectancy for males to 58 years. The health situation is particularly worrying with regard to communicable diseases: tuberculosis, hepatitis and diphtheria have re-appeared in Russia as major problems and the HIV/AIDS epidemic is spreading at an alarming rate. The social security system is underfunded and in disarray. The

* *Figures in EUR are converted from USD as necessary, at rates applicable in July 2001*

formerly well functioning education system and other public services are in a dilapidated state, lacking maintenance, investment and adequate funding of current expenses.

3.3 Progress of reforms so far

Russia still faces formidable hurdles in the process of transition of its economy and society, in spite of considerable progress made since 1991 towards the establishment of a democratic political system and a market economy governed by the rule of law. Some fundamentals of a real democracy, such as wide acceptance of political pluralism and freedom of opinion, have been established. But autocratic tendencies are still strong, and civil society and the level of trust in the judicial system and in public institutions are still weak. In spite of these concerns it looks, however, more likely that the far-reaching freedoms already achieved, together with Russia's international opening and exposure especially to Europe, will have enough momentum to maintain and develop a democratic state governed by the rule of law.

The Government has expressed its adherence to market principles and basic market mechanisms are in operation. Legislation is being progressively adapted to the needs of the new environment. Economic reform policies are now probably steadier and more sustainable than they used to be, favoured by political stability, a democratic majority in support of such policies, high export earnings and greater public acceptance of market economy rules thanks to a gradual increase in living standards. However, the process is not finished yet. Some key institutional foundations of a market economy still need to be significantly consolidated. Law enforcement remains a major issue and public administration often lacks transparency and efficiency. Relations between the centre and the regions are still unclear in many ways. The judicial system cannot be considered completely independent from other branches of power, and basic individual rights are often not adequately protected. In the absence of a strong civil society, citizens' rights are insufficiently represented.

Privatisation in the 1990s transferred considerable amounts of shares and property of former state enterprises (including real estate) to private hands. It has, however, often not been followed by serious in-depth restructuring of firms. The development of medium and small service companies has been slow. The country is heavily dependent on the exports of a small range of raw materials, primarily oil and gas, which are subject to fluctuating world market prices. Foreign direct investment remains low.

Since early 2000 there has been a new major effort in legislative reform. The main emphasis of political reform was placed upon **federal reform**, which was carried out swiftly. Progress is noticeable in **judicial reform** and the Duma will be expected to pass important legislation in this sphere in 2001, clarifying the role of the different branches of power. **Military reform** has started, but is expected to progress slowly. No comprehensive plans for **administrative reform** have been made public yet, although a programme is being developed by the Government in 2001 to streamline responsibilities of the federal centre and regions, particularly in the fiscal area. A law is also under preparation to lay down the foundations for a genuine anti-corruption policy. A draft plan for **housing and utility reform** was adopted in May 2001. The elaboration of **pension reform** has begun, with relevant legislation expected to be passed before the end of 2001. **Education reform** is also on the agenda, following the publication of a White Book outlining reform options to adapt the education system to the future needs of the country. The main **economic reforms** passed to date concern the **Budget Code**, **tax legislation** (personal income tax, excises, social security tax, turnover tax), **import tariffs** and the simplification of **customs procedures**. A new bill on **money-laundering** was passed in July 2001 following Russia's ratification of the relevant Council of Europe convention, but further measures will be required to allow Russia's removal from the list of non-co-operating countries established by the Financial Action Task Force in 2000.

A new schedule for reforms in 2002-2003 is intended to re-inject further confidence into the process of economic recovery. In 2001, new legislation was passed in four areas: a law on **business tax**, which contains business-friendly provisions, such as the deductibility of operational costs from the tax base and the reduction of the corporate profit tax from 35% to 24%; a package of **deregulation laws** to reduce the number of bureaucratic registration and authorisation requirements for businesses; a law on **land reform**, left to the regions to decide and implement, which introduces a regime allowing purchase, sale and leasing of non-agricultural land ; a package of three laws to increase the transparency in the **banking sector** and the supervisory role of the central bank. The principle that commercial banks should switch to International Accounting Standards has now been agreed. The Government is also committed to push forward an impressive number of legislative measures that are needed to meet the **WTO membership requirements** and to improve market access in industrial goods and services.

Changes to the leadership of gas giant “Gazprom”, the Energy ministry and the Federal Energy Commission (spring 2001) suggest that the **de-monopolisation of the utilities** (and also of the railways), whose completion is planned by 2005, may be getting under way.

3.4 Sustainability of current policies

The President has support in the two chambers of Parliament. This situation should facilitate the adoption of most of the ambitious reform legislation. However, problems are likely to arise with the enforcement and implementation of new laws and regulations. Implementation of the economic programme is slow and difficult, mainly due to a lack of capacity and maybe willingness in the bureaucracy to cope with such an ambitious agenda. Regional and municipal leaders have in the past shown excessive autonomy in their ways of applying national legislation, although this seems to be changing. The President has backed reformist lines through public statements, enforcement of greater discipline in the regions and reallocation of responsibilities in areas crucial for the economic reform (such as the reform of the so-called “natural monopolies”). But the Government may not always be able to steer reforms expeditiously through vested interests and bureaucracy inertia, especially when it comes to tackling strong regional autocracies or the giant public enterprises, such as railways, the electricity grid monopoly RAO EES, telecommunication companies or Gazprom, the world’s largest gas company.

3.5 Medium-term challenges

Recent stability and economic growth could be threatened in the longer term by inadequate economic policies preventing the required massive investment efforts. Much remains to be done in Russia in respect of key reforms to improve the business and investment climate. These include seeing through a serious reform of the judiciary; an attractive regime for investment in the energy sector; modern rules on corporate governance; transparent bankruptcy procedures, further reform of the tax system, the banking sector, and the pension and social system.

Should Russia go in a more authoritarian direction, e.g. with regard to media freedom, and should it not achieve a deep reform of its judiciary and public administration, this would threaten the investment climate and economic development and make deeper partnership with the EU and other western partners more difficult.

Even with steady economic development, Russia needs to address deep social problems, which could threaten the stability of the reform process. Many people are affected by poverty and this has been aggravated in some regions by serious energy crises: Russia needs to ensure that there are adequate social safety nets and that the costs of utilities remain fair and affordable. Furthermore, Russia needs to pay attention to the spread of HIV/AIDS and the growing problem of drug-addiction, all of which threaten to hinder reform. Another

challenge is the ethnic problem, embodied first and foremost by the conflict in Chechnya, which urgently needs a peaceful, political solution.

Russia also needs to adjust to a new demographic situation, caused by a low birth rate and low life expectancy, for example by coupling its economic development with support for greater public safety and a more effective health system.

4. Overview of past, ongoing and planned co-operation

4.1 Past and on-going EC assistance

Since 1991, Tacis has been the leading technical assistance programme supporting the transition process in Russia. More than EUR 2.4 billion has been earmarked in the form of national action programmes and through multi-country initiatives or miscellaneous support activities (see Annexes 3 and 4). Know-how has been transferred, exchanges organised, institutions reformed or built, and people have been trained in priority sectors, like enterprise support (covering privatisation, conversion, financial services and small and medium enterprises), human resources development and social protection (including also training and education, public administration, legal reform and health care), energy, environment, transport and telecommunications, food and agriculture.

According to several sector and country evaluations, the results of the national programmes have been mixed, primarily due to the slow progress in the Russian structural reforms until recently, and also to an insufficient policy dialogue. Beyond the successful implementation of projects, as shown by their regular monitoring, the impact on the regulatory and policy framework has, on the whole, not always been up to expectations. Positive achievements at the level of “pilot” regions, enterprises or institutions have too often not been translated into significant breakthroughs in the reform process, particularly in sectors like agriculture and energy.

In the area of legal reform, Tacis has however played a significant role in contributing to the development of market-oriented legislation and regulations. High-level policy advice instruments have proven to be particularly useful, such as the Policy Advice Programme and the Russian-European Centre for Economic Policy. On the basis of the PCA, Tacis has given priority to the harmonisation of rules and practices in areas such as state aids and competition, statistics and customs. On the implementation and enforcement side, Tacis has aimed at improving the efficiency of individual Ministries and institutions, as well as at strengthening public administrations in selected regions and municipalities. The impact of these actions has, however, often been limited in the past by the lack of an overall strategy for administrative reform in Russia. In the judicial field, past Tacis initiatives have focused on the legal protection of economic operators, but these activities have so far been insufficient to achieve a major impact, and the judiciary is still the weakest pillar of power.

While technical assistance has exposed thousands of enterprises of all sizes to modern management techniques, actual restructuring has been slow, there has been little investment in companies receiving advice, and the business climate has not improved sufficiently yet.

Impact has probably been more important in human resources development, with a significant improvement of training quality in higher education institutions. One of the main instruments in this area is the Tempus programme to which about EUR 76 million have been allocated in Russia between 1994 and 2000. It significantly contributed to the development of co-operation between Russian and EU higher education institutions.

The social sector attracted less Tacis support than expected, due to unclear policies and relatively low absorption capacity by the Russian authorities. Past Tacis actions have, however, contributed to improve the overall governance of social security, promote partnerships with NGOs on social welfare and enhance the efficiency of municipal services.

Following the conclusions and recommendations of the evaluations, in particular of the Country Programme evaluation conducted in 1999, Tacis has progressively focused its intervention on a limited number of areas and projects, increasingly agreed in a dialogue-driven approach linked to the PCA implementation process. Tacis refocusing culminated in 2000, with the adoption of a new Regulation and the Indicative Programme 2000-2003 which identified three priority areas of a cross-cutting nature, key for EU-Russian relations and the Government's reform programme: support for institutional, legal and administrative reform; support to the private sector and assistance for economic development; support in addressing the social consequences of transition. Within this framework, the 2000 and 2001 programmes have focused on:

- (i) support to the administrative and judicial reforms; the adaptation of the legal environment to the requirements of the PCA and the WTO; the improvement of public expenditure management and control; and strengthening democracy by promoting civil society, independence of mass media and local self-government;
- (ii) strengthening the financial sector, in particular at the level of the Central Bank; supporting the introduction of International Accounting Standards and the enforcement of bankruptcy legislation; restructuring individual industrial enterprises and training managers; and facilitating SME establishment and development;
- (iii) restructuring the health care system, through the reform of medical education, the development of the profession of general practitioners and the dissemination of health promotion principles; social reform (management of social services and protection of vulnerable groups); as well as the definition of labour and employment policies.

Partnership programmes between EU and Russian institutions, from both the public and non-governmental sectors, have also been increasingly promoted. In parallel, co-operation with other donors has been strengthened at the programming and implementation levels.

Significant assistance has also been provided to Russia under other Tacis initiatives, complementing country action programmes, such as: **Nuclear Safety** (about EUR 300 million earmarked between 1991 and 2000), the **Regional** (formerly Interstate) Programme, the **Cross-Border Co-operation** (CBC) Programme, as well as the Special Action in favour of the **Baltic** region (with a focus on Kaliningrad). These are the subject of separate indicative programmes. Regional and CBC programmes relevant for Russia have focused mainly on issues best addressed at a multi-country level, such as cross-border economic co-operation, control of transmissible diseases, environment (particularly water and waste management), justice and home affairs (fight against organised crime, women and drug trafficking, money laundering, etc.).

4.2 Main other EU policies and instruments

Trade. Because of the unbalanced trade structure and the EU's dependency on energy imports from Russia, trade promotion and the removal of access restrictions to the Russian market will remain key elements in the relationship between the EC and the Russian Federation. The main instrument is the PCA, as explained in 1.1, implementation and full use of which is supported by technical assistance. Recent initiatives, such as the launching of the energy dialogue and of the work on a common European economic space, will promote deeper trade relations and economic integration.

The **European Initiative for Democracy and Human Rights** (EIDHR) is the EU's major instrument of assistance for the promotion of democracy, human rights and civil society in Russia, a focus country for 2002-2004. The EIDHR can finance human rights, democratisation and conflict prevention activities, to be carried out primarily in partnership with NGOs and international organisations. These activities are complementary to other human rights related activities carried out under Tacis. In Russia, projects with NGOs, the

UN High Commissioner for Human Rights and the Council of Europe are at present under implementation, covering a wide range of areas, e.g. promotion of independent media, strengthening the independence of the judiciary, a humane prison system, and assistance for victims of human rights violations in the northern Caucasus. Maximum complementarity is and will be sought with related initiatives carried out on a larger scale under Tacis, in the field of judicial reform, public governance and civil society development.

Humanitarian Assistance. Since the mid-nineties, ECHO has provided humanitarian assistance to the most vulnerable strata of society, addressing in particular their food and medical needs. Several pilot projects concerning tuberculosis have also been funded (while the priority in the health sector is now given to Tacis-supported systemic reforms). In line with ECHO's core mandate of emergency relief, for the past years, assistance has focussed on the Northern Caucasus, where considerable humanitarian needs have arisen due to the Chechnya conflict. Almost EUR 51 million have been allocated to its victims since 1999. Support, channelled through international NGOs, the Red Cross and UN agencies, has been given in the food, health, medical, shelter, water & sanitation sectors, as well as through the provision of relief items. Since the situation in Chechnya continues to be rather volatile and comprehensive aid programmes announced by the Russian Government have not yet been fully implemented, large humanitarian needs persist. Therefore, ECHO will continue funding operations in line with its mandate, the security situation permitting. However, operating conditions for NGOs in Chechnya remain extremely difficult and despite several EU demarches and promises by the Russian authorities, no progress has been achieved on the major outstanding issues.

Food Aid. After food aid programmes of several hundred million EUR had been provided to Russia in the early 90s, Russia was considered capable of covering its food deficit through commercial imports. Russia subsequently became a very important food export market for the EU. Following the financial crisis of 1998, the Russian market collapsed. The EC decided on a major free food delivery programme (about 1.85 million tonnes to over 50 regions in the Russian Federation and with an EAGGF budget expenditure of EUR 400 million). Deliveries commenced in March 1999 and were completed by April 2000. With the exception of limited quantities for free distribution to Chechen IDPs, all product was sold at prevailing market values. The proceeds from these sales were due to be used for clearing pension arrears (80 %) and budget line support in the Russian Ministries for Health and Labour (20%). After completion of this food supply programme, commercial exports from the EU have gradually reached normal levels again.

Between 1993 and 2000, EC support to **science and technology co-operation** has amounted to about EUR 185 million, enabling around 45,000 Russian scientists to be involved in EU-funded programmes. In spite of the difficult economic situation and shrinking public funding of science and technology, Russian research organisations have a recognised excellence in many fields, including aerospace, chemistry, mathematics and physics, nuclear applications and earth sciences. Tacis has contributed around EUR 100 million, essentially through the **International Science and Technology Centre** (EUR 90 million), and other projects, e.g. for innovative SMEs in scientific cities. The other sources of funding were the EU's Framework Programmes, through INCO-Copernicus (applied research in environment, production technologies and health) and INTAS (fundamental research). Russian participation in other thematic sub-programmes is still very difficult in the absence of adequate financing. A **Science and Technology Agreement**, foreseen in the PCA, entered into force in May 2001 to improve the access of Russian scientists to European programmes and ensure EU scientists a reciprocal access to Russian research projects. Technical assistance will support the commercialisation of Russian research results and the development of related small- and medium-sized businesses.

The Commission has been authorised by the Council to negotiate a **Fisheries Co-operation Agreement** with Russia. It will enhance legal security for private operators, co-operation on fishing rights, quotas, research and conservation, and provide assistance to support economic co-operation in the fisheries sector, e.g. establishment of joint ventures.

INTERREG is a Community Initiative aimed at promoting interregional co-operation within the European Union, financed by the Structural Funds. It is, however, also a way to promote co-operation across the relevant EU external borders. Contrary to Tacis, its budgeting is multi-annual and the responsibility for project selection and implementation lies with the Member State(s). In order to increase complementarity between both programmes, guidelines have recently been issued to facilitate the double application process and link the two selection procedures.

4.3 Member States' and other donors' co-operation

Member States and other main bilateral donors. Over the period 1996-1999, Russia has received around EUR 520 million of bilateral financial assistance from EU Member States (amounts actually disbursed, including 14 million in debt cancellation). Member States have also significantly contributed to multilateral assistance programmes, e.g. EUR 0.9 billion through the EBRD, 1.5 billion through the World Bank and 3.1 billion through the IMF. While the final aim of supporting the process of economic reform prevails in the bilateral programmes, Member States' assistance (see Annex 5) often has a more focussed regional approach. Finland, Sweden and Denmark, for instance, focus on Kaliningrad and north-west Russia, and on environmental protection (including nuclear safety and energy efficiency), transport and telecommunications. Most Member States support the Russian managers training programme. The British, German, French and Dutch Governments have the most comprehensive assistance programmes to date, while the majority of Member States consider the social sector as a key priority (children at risk, development of social services, modernisation of health-care management, drug prevention, mother-child health and the handicapped, pension fund management and safety at work). Regular exchanges of views with, and information from, the Commission, particularly on the spot in Moscow, have led to a good level of co-ordination on the spot among projects and programmes and prevented overlapping activities. Recent consultations during the 2002-2003 programming process have contributed to further improve the complementarity of EC and bilateral activities.

In the early 90s, the **USA** were a major provider of technical assistance but their programme has been scaled down in recent years. US assistance concentrated on tax reform, business promotion, environment, civil society development and social issues, judicial training, support to human rights, ethnic and religious minorities, and the legal profession (both judges and lawyers). USAID has also provided significant support to the health sector (control of transmissible diseases) and to management training. US assistance has generally favoured working directly with institutions and enterprises at the regional and local levels.

International Financial Institutions (IFIs). The activities of the **European Bank for Reconstruction and Development (EBRD)** in Russia include support to the creation of a sound financial sector, small and medium-sized enterprises, infrastructure development (including railways, roads, ports and airports), large enterprise restructuring, equity investment, promotion of a sound investment climate and environment. By March 2001, the EBRD had approved a total project value of EUR 14.6 billion, including EUR 4.9 billion of own financing. Following the damaging effects of the 1998 financial crisis, more attention is given to political and institutional issues, to improve the policy framework and corporate governance and to promote systemic reforms and competition in the banking sector. Particular attention will be paid to international accounting standards, the reform of the electricity, gas, railways, and telecom sectors, as well as environment. Under the Tacis programme, the EC/EBRD Investment Preparation ("**Bangkok**") Facility has funded about

EUR 60 million of technical assistance that has prepared or accompanied about 1 billion of actual EBRD investment in Russia. The total investment leveraged (including bilateral donors and private co-investment) is estimated at some EUR 2.5 billion.

Since 1992, the **International Bank for Reconstruction and Development** (World Bank) has committed about USD 11 billion to Russia for Structural Adjustment Loans (coal sector, social protection and education systems), sector and investment loans, including technical assistance projects (transport, energy, housing, tax management, education and management training, agriculture and land reform, legal reform). Since the 1998 financial crisis, the policy of the World Bank has been reviewed and redirected towards the structural reform process and poverty reduction, while reducing adjustment lending. Sector-specific investments, particularly in energy and infrastructure, as well as specific regional projects will be re-considered, and priority given to institutional barriers to growth and private sector development, public sector reform and social issues. Recently approved loans include: support to coal and forest industries; modernisation of municipal heating and water systems; education reform, focusing on general secondary and primary vocational education; resettlement of population from the Far North. The **International Finance Corporation** is taking the lead in financing commercial activities, focusing on export-oriented projects.

From 1992 onwards, **International Monetary Fund** (IMF) lending has focussed on macro-economic stabilisation and fiscal consolidation. In 2001, Russia's IMF borrowing totalled about USD 16 billion, making Russia the largest single borrower of the IMF. A stand-by credit of about USD 4.5 billion approved in July 1999, was suspended but will be replaced by an informal IMF monitored programme without lending. While Russia's financial situation may be sufficiently comfortable to avoid further IMF borrowing in the short term, the discipline of an IMF-endorsed programme would enhance confidence in the economy and improve the investment climate.

5. EC response strategy

A broad, deep, long-term strategic partnership between the EU and Russia is desirable and should be pursued as much as circumstances in Russia allow for it.

The EU has an important strategic and economic interest in Russia's development. EU-Russia relations over the last decade have been shaped by the EU's interest in developing liberalised **trade and investment** relations and in providing European technical assistance and know-how to Russia to facilitate the country's transition to a fully fledged market economy, founded on the core principles of democracy, respect for human rights and rule of law. On this basis, Russia should be able to develop its position as a prosperous market for EU exports and investment and a reliable source of energy supply, as well as a stable, predictable and co-operative partner for security on the European continent. These longstanding EU objectives are still valid.

In the longer term, Russia's GDP is expected to grow substantially and its economic weight will rise accordingly. Russia is endowed with ample natural resources such as oil and gas, forestry and fisheries. It offers a large market at a relatively short distance from the EU, with a large potential for trade growth and for EU investments, if business conditions improve sufficiently. There is strong complementarity between the EU's and Russia's economic potentials and interests. Russia badly requires modernisation of technology and management for its economy and socio-economic models and institutions for which the EU is a natural partner. All these factors call for a deepening of the partnership in areas of key mutual interest and full use of the PCA including its evolutionary potential.

Under its response strategy 2002-2006, it would be appropriate for the EC to lend its full support to the implementation of the Government's **socio-economic reform** programme.

Priorities should include the key administrative, legal and judicial reforms, with a strong focus on trade and investment related matters, including approximation of legislation in the context of the PCA, eventual accession to WTO and the initiative to create the concept of a Common European Economic Space; the improvement of corporate governance and de-regulation and de-monopolisation of the economy, with particular attention paid to the strategic **energy** sector through the EU-Russia Energy Dialogue.

Assuming that Russia's economic consolidation and transformation will continue and that economic growth and healthy external finances can be maintained, Russia will progressively need less direct aid for its economy and industry. Its economic development should increasingly be left to private initiative and market forces including local and imported investment capital and capacities in management, consultancy and training. To the extent that Russia could be considered as having "graduated" from dependency on direct financial aid, public assistance from the EU should concentrate on building the **legal, institutional and administrative framework**, rather than supporting individual companies and interests.

As the EU and Russia will grow even closer together economically through trade, investment and people-to-people contacts and partnerships, it will be natural to support legislative, regulatory and institutional convergence on the basis of European models and standards, and to examine possibilities for a future preferential trade relationship. As regards the common European economic space with Russia, the terms of reference of the Common Space High-Level Group were agreed during the EU-Russia Summit of October 2001 and its first meeting should take place by the end of the same year. Issues under discussion are expected to include standards and certification, banking, accounting, public procurement, customs and transport.

EU enlargement to countries, which formerly belonged to Soviet Union's sphere of influence adds to both sides' interest in examining closer forms of partnership. EU-Russia co-operation should facilitate the understanding of the benefits of enlargement and of the introduction of the Euro in Russia and should seek to build bridges across the future external borders of the EU. This applies particularly to the Russian region of **Kaliningrad**. In view of enlargement, the EU's assistance will pay particular attention to the regions bordering the EU and the candidate countries.

While Russia can probably be considered a more dynamic partner on the economic side, this is less the case for its social transition, where very serious challenges remain, e.g. in health, **education and social welfare**, which need to be tackled by the public sector. The EU has an interest and a capacity to contribute to the solution of these problems as a accompaniment to the consolidation of a market economy and democracy in Russia.

On the political side, it is essential to maintain and intensify the political dialogue and to use assistance programmes, such as Tacis and EIDHR, for strengthening all aspects of **civil society** and free media as well as the judiciary, and to support Russia's integration into international institutions, e.g. Council of Europe, OSCE, G8 and WTO.

"**Soft**" security threats from Russia are a serious concern for the EU and require continued engagement: nuclear safety, the fight against organised crime, including drugs and illegal immigration, the spread of diseases, environmental pollution, e.g. waste water management in the Baltic Sea. Persistent and even growing inequalities between groups of population and regions could threaten support for the reform process and should be taken into consideration in developing the EC response strategy.

On the basis of the analysis above and of the areas of co-operation identified in the Council Regulation No 99/2000 "**Support for institutional, legal and administrative reform**", "**Support to the private sector and assistance for economic development**" and "**Support in addressing the social consequences of transition**", the National Indicative Programme (NIP) 2002-2003 will focus on the following issues:

- Support to the reform of **public administration** and of the **judicial system**, with a focus on trade and investment promotion and institutions related to PCA implementation and WTO accession processes, while tackling the corruption issue;
- **Deregulation of the economy and corporate governance.** Priority will be given to the crucial energy sector, in the framework of the EU-Russia energy dialogue. Improved public and corporate governance and facilitation to business creation will also support other policy initiatives such as the Science and Technology Agreement;
- Development of **civil society** (both under Tacis and under the European Initiative for Democracy and Human Rights), co-operating in particular with non-governmental sectors, e.g. professional organisations, trade unions, academics and students. Particular attention should be given to journalists and the media;
- Reform of the **social security**, pension and health systems in line with market principles, with the aim of helping Russia to tackle the issue of inequalities and improve the quality of basic public social and health services, covering the modernisation of municipal services and prevention and control of transmissible diseases.

Crosscutting environmental benefits will be sought in the different components of the NIP. In addition, other crucial issues related to environment (water and border river management, Caspian Sea, environmental standards, climate change), telecommunications and information society, JHA (migration questions, fight against drug trafficking, organised crime and money laundering) will be mainly considered under **Cross-Border** and **Regional Co-operation** programmes, focusing on “**Development of Infrastructure Networks**”, “**Promotion of Environmental Protection and Management of Natural Resources**”, as well as **Justice and Home Affairs**. Significant additional assistance will also be provided under the **Nuclear Safety** Programme.

6. National Indicative Programme 2002-2003

6.1 Support for institutional, legal and administrative reform

During the period 2002-2003, the overarching priority will be the establishment of a legal and regulatory climate conducive to trade and investment, in accordance with PCA implementation and WTO accession processes. Continued support to the on-going reform of public administration and of the judicial system will be seen in this context. Through partnership with EU institutions, this will also contribute to the development of civil society.

6.1.1 Legal, administrative reform and regional policy

6.1.1.1 Background and justification

Over the past decade, Russia has already come a long way in reforming its legislative and regulatory framework. Since 2000, the process has gained a new momentum with the Government's socio-economic reform programme, which focuses particularly on establishing the legal and regulatory framework required to improve the business environment and to reform the social safety system. The new Government is also addressing administrative and civil service reform more resolutely than in the past. It is designing a reform strategy and developing a major programme to rebuild and reorganise public administration, as part of its efforts to develop a functioning state.

Technical assistance should be supportive to the implementation of this comprehensive reform of legislation and public administration. In the medium-term, the focus will be on institutions and bodies, which have a key role in dealing with the requirements of PCA

implementation and WTO accession, as well as in the development of the Common European Economic Space between the EU and Russia. EC assistance is in a position to play a crucial role in this process, thanks to the direct links with the PCA structures and to the EC's place in WTO negotiations.

6.1.1.2 Objectives

Main Objective

- To adapt legislation and public administration to the requirements of a market economy and a democratic society.

Specific Objectives

- To support the Russian Government in implementing public service reform and strengthen the rule of law;
- To help Russia implement PCA provisions and to approximate its legislation most relevant for trade and investment co-operation;
- To help Russia comply with WTO requirements prior to and after accession;
- To approximate EU and Russian legislation on the health and safety of workers.

6.1.1.3 Expected results

- Implementation of a comprehensive human resource development programme with priority given to public bodies key to PCA implementation and WTO accession, leading to an intensification and acceleration of Russia's approximation to EU and world-wide standards;
- Significant progress made in the approximation of a set of standards and technical regulations for a selected number of goods important in the PCA and WTO context;
- Greater approximation of legislation on the health and safety of workers between EU and Russia in line with the terms of Article 74 of the PCA, and development of relevant training programmes;
- Progress of the socio-economic reform process in key Russian regions, including improved budget planning, execution and control at different levels of power;
- An effective, sustainable and visible policy advice capacity, integrated in the local network of think-tank institutions, dealing efficiently with analytical work and policy development, contributing effectively to the EU-Russia policy dialogue and to PCA implementation.

6.1.1.4 Description of programmes

- Specific technical assistance will be offered in key areas of PCA implementation and WTO accession. Particular attention will be paid to the approximation requirements of a possible future common European economic space. Relevant executive and legislative bodies will be assisted in deepening the PCA implementation process and preparing Russia's membership of the WTO. Advice and training will be provided, on the basis of PCA/WTO progress, to screen and approximate domestic legislation and improve the enforcement of new pieces of regulation. The experience achieved under the 2001 programme will be used and priority will be given to support trade liberalisation issues. As much as possible, partnerships will be organised between Russian and similar EU institutions. Continuation of the Intellectual Property and Customs programmes, covering legislative development, implementation and training, will be consistent with and support this approach. In the field of statistics, further assistance will be provided to approximate

Russian technical regulations, conformity assessment and standardisation procedures to the EU's. Environmental legislation is another important area for regulation convergence.

- Technical assistance and training will be provided to the Russian bodies involved in standardisation, with the aim of adapting the Russian system of standards, regulations and conformity assessment procedures to PCA and WTO requirements. Relevant State Duma Committees will be involved. The experience gained from Tacis 2001 initiatives will be used and disseminated. The Institution Building Partnership Programme should be used to twin central and regional Gosstandart structures with similar EU institutions.
- Support and advice for the approximation of Russian legislation on the health and safety of workers to EU standards in line with the terms of Articles 55, 68 and 74 of the PCA. The aim will also be to improve the level of protection afforded to workers through the development of training programmes on health and safety issues.
- Technical assistance and training will be provided at different levels of public administration to deal with financial and budgetary, as well as regional development issues. Activities initiated under the 2000 state budget reform project will be expanded to focus on relations between federal and regional budgets, concentrating on the division of expenditures and revenues and transparency of transfers.
- Technical assistance and training will be provided at central and regional level to design and implement development strategies for regional and social development based on EU practice. In the selection of regions, a special attention will be given to the Northern Dimension initiative.
- Provision of technical assistance and, if required, further strengthening of the Russian-European Centre for Economic Policy (RECEP), consolidating the local capacity to provide high-level medium-term policy advice on economic and social policy issues based on applied research and forecasting, including to the high-level group to be established in the framework of the Common Economic Space.
- Continuation of the Policy Advice Programme for short-term high-level policy advice on issues related to trade and investment, social reform, energy, environment, science and technology, in close co-ordination and synergy with other projects and RECEP. Particular attention will be paid, in complement to other programmes, to Justice and Home Affairs issues related the fight against organised crime and money laundering.

6.1.1.5 Conditionality

The successful implementation of this programme is conditional upon the commitment of the federal authorities, particularly the presidential administration, to make progress on a number of legislative, organisational and procedural issues related to the recently initiated public service reform. Particularly important will be the clear division of responsibilities and functions between federal and regional levels, to be decided on the basis of the proposals to be developed by the presidential commission established in 2001

Financing support to PCA implementation and WTO accession will be conditional upon overall commitment of Russia to make progress on these issues. Continued commitment in the approximation of legislation to the EU will be particularly important. Work on health and safety in the workplace shall be conditional upon the Government's support and inclusion of the necessary items in its legislative programme.

6.1.1.6 Indicators

- Number of harmonised pieces of legislation leading to a progressive reduction of trade and investment obstacles (precise indicators to be developed annually at project level, in

line with the work of PCA committee and sub-committees). Adoption of legislation on health and safety in the workplace in line with the PCA.

6.1.1.7 Indicative budget: EUR 31 million (15 in 2002 and 16 in 2003)

6.1.2 Judicial reform

6.1.2.1 Background and justification

Fair, predictable, transparent and timely law enforcement is a prerequisite for the consolidation of democracy and civil society. It is also essential for establishing a climate conducive to business and investment. Properly functioning arbitration, civil and other courts, respecting the rule of law and independence from the other branches of power will guarantee fundamental freedoms and rights and equality of treatment for all citizens and economic actors before the law.

Judicial reform, initiated by the President, is a priority under Russia's long-term development programme. Planned legislation would guarantee the independence of the judiciary and limit prosecutors' powers. Real reform requires strengthening professional training of judges and their assistants, particularly on economic matters and human rights issues. The programme 2001 includes the design of a training programme and its initial implementation,. Large-scale follow-up is required in 2002-2003 in order to achieve the needed critical mass, particularly as far as re-training of judges in the regions is concerned.

6.1.2.2 Objectives

Main Objective

- To strengthen the independence, competence and effectiveness of the judiciary, particularly in economic matters.

Specific Objectives

- To enhance the skills and qualification of judges, their staff and other actors of the judiciary;
- To support the establishment of administrative courts.

6.1.2.3 Expected results

- Institutional strengthening of relevant training institutions (curricula, training modules, methodologies);
- Implementation of a comprehensive training programme for judges and court staff in selected regions, via the training of trainers;
- Support to the launching and functioning of administrative courts.

6.1.2.4 Description of programmes

- The judicial reform programme will follow the lines developed in the Russian Government reform programme. Assistance will be provided to relevant training institutes, as well as selected regional courts, in implementing a large training and re-training programme for judges and their assistant staff, covering commercial law (i.a. competition and bankruptcy issues, protection of ownership and shareholders rights), as well as the respect of individual rights. Training should include principles of the rule of law and anti-corruption. The project will build on previous Tacis initiatives.
- Provision of advice for the establishment of administrative courts, using EU practice and implementation of training and re-training programmes for judges and their assistant

staff. The programme should facilitate the access of citizens to justice and may comprise the supply of equipment to regional courts.

- Advice and training of prosecutor offices on economic matters, including intellectual property rights protection, money laundering, as well as human rights principles.

6.1.2.5 Conditionality

The successful implementation of the judicial reform programme is conditional upon the commitment of the central bodies, particularly the Supreme Court, the Supreme Arbitration Court, the Parliament and the presidential administration, to effectively strengthen the rule of law in Russia. The package of judicial reform laws currently under examination at Parliament must be adopted and enter into force. An appropriate share of the federal budget must be devoted to the financing of the court system. The law on administrative courts has to enter into force.

6.1.2.6 Indicators

- 400 judges re-trained per year;
- Number/share of courts exposed to new training methods;
- Improved independence of the judiciary and better access to justice.

6.1.2.7 Indicative budget: EUR 20 million (10 million per year)

6.1.3 Civil society, training and education

6.1.3.1 Background and justification

The reform of training and education is an important element of the transition process to a democracy and a market economy governed by the rule of law. Promotion of democratic and market principles starts with the training and education systems, which also have to develop skills in relation with the requirements of the labour markets.

The development of civil society is essential for the respect and protection of the rights of the individual, and independence of the mass media is a key element in this respect. NGOs witness difficulties in their activity: financial resources are undoubtedly scarce, and there is certainly a need for training to allow for increased professionalism of NGO staff. Freedom and professionalism of the media and journalists will also be supported, particularly in the regions, mainly through partnership programmes between EU and Russian institutions.

6.1.3.2 Objectives

Main Objective

- To contribute to democracy, the rule of law and economic reform through the training and education systems and support to civil society in Russia.

Specific Objectives

- To modernise the structure and management of higher education institutions through the Tempus programme;
- To promote co-operation and networking between civil society institutions in Russia and the EU in the framework of partnership programmes;
- To enhance the independence of mass media.

6.1.3.3 Expected results

- Improved training and management methods in the Russian education system, through partnership activities with EU institutions;

- In the framework of Tempus projects, up-grading of curricula and teaching materials, strengthening of the role of higher education institutions in the society, implementation of staff and student mobility programmes and development of professional skills in public and private institutions;
- Strengthened civil society institutions and media exposed to EU practice.

6.1.3.4 Description of programmes

- Tempus aims at supporting the reform and restructuring of the Russian higher education system and its adaptation to the new socio-economic needs, with a particular focus on the regions. It does so through interaction and balanced co-operation between institutions in the EU member States and the partner countries organised in consortia. Consortia create long term co-operation links between the partners, which should evolve towards issues such as academic recognition, credit transfer and development of joint-curricula. Priority areas of Tempus activities are jointly defined by the European Commission and national authorities in line with the areas of co-operation in the mainstream Tacis programme. Projects address in particular: (1) curriculum development and renewal in priority areas; (2) reform and modernisation of the structure and management of higher education institutions in view of strengthening their role in the society; (3) development of skills-related training to address specific higher and advanced level skills shortage during the economic reform, in particular through improved and extended links with industry; (4) contribution of higher education and training to citizenship and the strengthening of democracy. Special attention will be given to training in journalism and media.
- Strengthening of the civil society through the Institution Building Partnership Programme, targeting a wide range of grass-root organisations (NGOs, including in the social and environmental fields, professional and consumer associations, media organisations, trade unions, cities and regions) helping them to redefine their role with respect to the state. Twinning, combined with relevant policy advice, will be considered for non-governmental media regulatory structures.

6.1.3.5 Conditionality

The main condition is the continuation of the education system reform and of a liberal framework for civil society development, as well as the willingness and commitment of higher education institutions, NGOs and the media to work with their EU partners.

6.1.3.6 Indicators

- Up to 1000 students participate in exchanges per year;
- Share of higher education institutions involved in co-operation activities with EU partners;
- Number of civil society organisations twinned with EU partners.

6.1.3.7 Indicative budget: EUR 30 million (15 million per year)

6.2. Support to the private sector and assistance for economic development

During the period 2002-2003, the priority will be the promotion of EU trade and investment through the introduction of international practice in competition, management, accounting and auditing, business entry facilitation, in the framework of the ongoing policy dialogue with Russia (including in relation to energy, the common economic space and science and technology).

6.2.1 Deregulation and corporate governance

6.2.1.1 Background and justification

Russia has suffered from excessive sector-specific and firm specific state intervention particularly in the so-called natural monopolies. The Ministry of Anti-Monopoly Policy and Entrepreneurship Support, has now prepared the legal framework for competition policy in Russia, with a contribution from Tacis. Assistance is required to enforce the recently passed pieces of legislation in the field of deregulation, business registration, etc. In many sectors, however, monopolies continue to dominate their respective markets, leaving little or no room for new entrants. The problem is aggravated by the state aid issue, taking the form of non-collection of taxes, the application of unrealistic utility tariffs and direct subsidies, which are also obstacles to the full implementation of the PCA.

The Government is consistently conducting reform programmes in the field of natural monopolies (electric power, energy and fuel, gas, railway and telecommunications sectors), promoting market principles with the aim to spin-off economically viable activities. Following the decision to establish the EU-Russia energy dialogue at the Summit of October 2000 and the preparatory technical examination of areas of mutual interest, the Summit of October 2001 agreed on its future direction. A number of areas were identified where progress could be made in the short-term, while other issues were highlighted requiring further examination. Important issues for Russia include the need to pursue economic reforms and de-monopolisation, as well as to introduce basic market principles in the energy sector and to ensure the security of the energy transportation networks. This should lead to a strategic partnership in the energy field and enhance the reliability of energy supply both in the EU and Russia. Other sectors in which Government efforts to de-monopolise should be supported are telecommunications and railways, for which a three-stage long-term reform programme was announced in April 2001. These initiatives, together with the PCA dialogue, will generate sector programmes for collaboration between Russian and EU business associations. In addition, growing co-operation under the Science and Technology Agreement should be supported, mainly by policy advice and assistance to the commercialisation of the results of scientific research in Russia.

In the past, an emphasis has put been on direct assistance to individual enterprises, development of advisory services and management training. However, the required resources can now be obtained at market conditions, and bank and enterprise restructuring should now be left to Russian institutions. In a context where the private consultant sector is rapidly growing, direct EC's support to individual banks and large companies will therefore be phased out.

6.2.1.2 Objectives

Main Objective

- To improve the business and investment climate, by enhancing public and corporate governance principles.

Specific Objectives

- To support the reform of Russia's monopolies on the basis of market principles, primarily in electricity, oil, gas and district heating, possibly also with respect to railways and telecommunication, as well as other monopolies undergoing reform;
- To bring the Government's economic role closer to standard market economy requirements, with less interference in economic management, and to promote the development of self-regulating structures and principles;
- To improve the environment for bank and enterprise development, especially SMEs, lower barriers to market access resulting in the creation of new companies, particularly related to innovation, science and technology;

- To improve the performance of enterprises and sectors, through management training and exchange programmes with EU firms and business associations.

6.2.1.3 Expected results

- Gradual de-monopolisation of natural monopolies and emergence of new market participants in their competitive segments. New opportunities for foreign investment in key sectors, leading to know-how transfer, infrastructure development, rehabilitation and enhanced security and efficiency of energy transportation;
- Extensive use of internationally compatible accounting and auditing standards;
- Improved performance of enterprises involved in training and exchanges with the EU;
- Better integration of Russia into the global economy and the international system, bringing the country closer to a common European economic space.

6.2.1.4 Description of programmes

- A programme to support the introduction of key market principles for de-monopolisation and de-regulation in the energy sector will be developed in the framework of the EU-Russia energy dialogue. Assistance will give priority to legal and regulatory issues, competition matters, Production Sharing Agreements (PSA), investment promotion, “fast-track” dispute settlement mechanism, pricing systems, independent regulatory mechanisms, energy saving and energy efficiency, environmental standards, improvement of the security and efficiency of energy transportation.
- Programme, as well as targeted expertise under the Policy Advice Programme, will support reform efforts in the area of de-monopolisation, financial transparency and improved market access in sectors other than energy, such as telecommunications and railways. The Ministry of Economic Development and Trade, the Ministry of Finance and the Ministry for Antimonopoly Policy will be the main counterparts. The programmes will include co-operation through partnerships between public organisations and sector business associations from the EU and Russia. Further support will also be provided for the development and enforcement of anti-monopoly legislation, promoting competition in areas such insurance, banking and financial markets, leasing.
- Further support, through advice and training, to the on-going tax reform process, with a focus on tax collection and simplification of procedures for SMEs.
- Continued support for the introduction of International Accounting and Auditing Standards, particularly in the banking sector. The programme will follow the Russian plan (under preparation) for the migration to International Accounting Standards (IAS) for commercial banks and companies by 2004. Particular attention will be paid to the fight against money laundering, to the training of accountants and auditors, including development of training programmes and training of trainers, as well as to the strengthening of professional associations.
- Support to the enhanced commercialisation of results of research in science and technology, through existing and newly created innovative enterprises, with an emphasis on scientific cities, in co-operation with existing enterprise and SME support institutions.
- The Managers’ Training Programme will be continued, as an internship programme of Russian managers in EU host companies, with the aim of developing business management capacity and promoting industrial co-operation.

6.2.1.5 Conditionality

Sustained political commitment by the Russian Government will be necessary to implement the reforms of the natural monopolies. The new energy tariff policy will have to be pursued

with gradual increases of tariffs to reflect costs, while protecting the poorest groups of the population. Approval by the legislature and implementation by the executive of the amended legislation on PSA, as well as ratification of the Energy Charter Treaty will provide strong messages in support of the Government reform commitments. The package of laws covering registration, inspection and licensing has to be fully enforced. The overall success of the programme will depend on continued commitment to restructuring industry and banking, and on successful co-operation on specific sector aspects of the PCA. The introduction of IAS must be confirmed by the Central Bank of Russia and the Government, as a priority for the commercial banking sector.

6.2.1.6 Indicators

- Natural monopolies restructured and independent regulatory authorities created;
- Completion of the PSA regulatory framework;
- Growing prevalence of market mechanisms (taxation, pricing, subsidies, etc.);
- Enhanced security and efficiency of energy transportation;
- Share of joint stock companies and commercial banks reporting according to IAS;
- 500 Russian managers per year trained via internships in the EU;
- Strength of sector co-operation of business associations linked to the PCA process;
- Number of research products commercialised.

6.2.1.7 Indicative budget: EUR 42 million (20 in 2002 and 22 in 2003)

6.3 Support in addressing the social consequences of transition

During the period 2002-2003, the emphasis will remain on the reform of the social security system according to market economy principles, particularly in the areas of pensions, the social integration of vulnerable groups, as well as the improvement of municipal services. Environmental issues with an EU interest, such as wastewater treatment will be addressed here, including with the support of capital investment in co-operation with IFIs.

6.3.1 Social reform

6.3.1.1. Background and justification

The Government reform programme gives particular attention to social issues, including the reform of the education, health and social systems. A broader political consensus seems to exist on the need to launch deep structural reforms of the social sector, which should enhance the quality of basic public social services, while providing a minimal safety net to the most vulnerable population groups. Work has started on the establishment of a modern social policy, incorporating concepts of medical and social insurance. The pension reform is a particularly important item on the agenda. The Policy Advice Programme has started to address this issue with the Ministry of Economic Development and Trade.

In recent years, the Tacis programme has focussed on the reform of health care systems in Russia and has implemented a number of projects, which have contributed to improved health management, financing and training. Tacis has also supported regional initiatives in north-west Russia, including an action in 2001 to help control communicable disease in the Baltic Sea region. On the other hand, the EC will in the coming years make significant contributions to the recently proposed UN Global Health Fund, dedicated to the fight against i.a. HIV/AIDS and tuberculosis. Russia may in the future apply to this fund and assistance will be provided to prepare it for this process.

6.3.1.2 Objectives

Main Objective

- To mitigate the social cost of restructuring of the economy and to reduce social disparities.

Specific Objectives

- To contribute to the on-going social reform process, in particular to pension reform;
- To improve prevention and control of communicable diseases in selected regions.

6.3.1.3 Expected results

- Implementation of a transparent and publicly accountable pension system, based on accumulative and distributive principles;
- Implementation of an efficient and sustainable social policy, guaranteeing at the same time a minimal safety net to most vulnerable groups of population;
- Reduced incidence of key transmissible diseases in selected regions.

6.3.1.4 Description of programmes

- Support will be provided for the implementation of the Government's "second pillar" pension reform programme. The programme will include the administration, investment and custody/supervision of assets to ensure effective and transparent payment of pensions and advice on possible private sector alternatives to the Pension Fund.
- Further support to the implementation of social reforms for the efficient delivery of social services at the regional and local levels, in close relation with national policies. A particular attention will be paid to the needs of most vulnerable groups (and, if deemed necessary, to former military officers).
- In the context of the Global Health Fund, training and advice will be provided to develop the capacity of health authorities to design and implement a national strategy/master plan, including work planning and budgeting, for the prevention, monitoring and control of transmissible diseases. This strategy should enable the health authorities to call upon the Global Health Fund. Capacity of health and social workers to deal with prevention and control will be developed. NGOs should be involved in partnerships with public authorities to help in targeting the most vulnerable population groups. The experience gained in north-west Russia, in particular Kaliningrad and Karelia, will be expanded to neighbouring regions, while exposure to EU best practices in transmissible diseases prevention and monitoring would be promoted.

6.3.1.5 Conditionality

The Social Reform programme will be conditional upon the commitment of beneficiaries at the federal and local levels to implement the activities and put into practice the results. Particular attention will be paid to the issue of systemic impact and economic sustainability. Counterparts will be selected on the basis of their capacity to design and disseminate low-cost solutions and models.

Support for the proposals on pension reform shall be conditional on the establishment of satisfactory and publicly accountable supervisory mechanisms, including ethical norms and the use of corporate governance standards.

Work on transmissible diseases will be conditional upon the positive outcome of a preliminary appraisal on the possible impact of a Tacis intervention in this area, as well as on the clear commitment of the Ministry of Health and other bodies to tackle HIV/AIDS issues.

6.3.1.6 Indicators

- Adoption of legislation for pension reform and establishment of the Supervisory Council with representation from public and non-state organisations;
- Reduction in growth rates of transmissible disease incidence in selected regions.

6.3.1.7 Indicative budget: EUR 28 million (8 in 2002 and 20 in 2003)

6.3.2. Municipal services

6.3.2.1 Background and justification

The living standard of the population depends on the delivery of appropriate services by the municipal authorities. They cover areas such as water, heating, housing and also waste and wastewater treatment. The latter has a particular impact on large areas and groups of population. In addition to the transfer of know how to municipalities (including utility management, tariff policy, etc.), investments are required to modernise the facilities. Numerous investments in water treatment facilities are funded in northern Poland and the Baltic States under Phare and other EU instruments, leading to significant and rapid improvements of the ecological situation. In comparison, St. Petersburg, by far the largest city on the Baltic Sea rim with 5 million inhabitants, and Kaliningrad have so far benefited from very limited EU/Tacis support, although they are the two major polluters of the Baltic Sea, because of insufficient capacities of existing treatment plants.

The EBRD and the Nordic Investment Bank (NIB) have contributed to the drafting of a long-term water sector development programme. One recommendation is to tackle the St. Petersburg South West Waste Water Treatment Plant (SWWWTP) as a priority in the Northern Dimension context, as it will significantly contribute to decrease the effluents into the Baltic Sea. While moving water quality closer to EU standards, the programme will bring, according to a recent externality study, significant public health and social advantages (reduction of the incidence of water-borne diseases and housing development). A consortium of multilateral and bilateral financial institutions was created and feasibility and technical studies were funded by Tacis, Finland and Sweden. The cost of the SWWWTP is estimated at EUR 130-140 million. Financing is planned to be provided through loans from EBRD, NIB/NEFCO and the European Investment Bank, and grants from Sweden, Finland, Denmark and Tacis.

6.3.2.2. Objectives

Main Objective

- To improve the delivery of municipal services and the living standard of the population.

Specific Objectives

- To reduce the discharge of untreated effluents into the Gulf of Finland and the Baltic Sea and to contribute to the restructuring of the water management system in St Petersburg;
- To attract investment in municipal utilities with a focus on water and energy saving.

6.3.2.3. Expected results

- Functioning new St Petersburg South West Waste Water Treatment Plant and sound financial situation of St. Petersburg water management system;
- Improved management and delivery of basic social services in selected municipalities, primarily in north-west Russia.

6.3.2.4 Description of programmes

- Construction and equipment of the incineration plant part of the SWWWTP;
- Technical assistance and training to the St Petersburg City Administration and to the staff of the utility, to introduce institutional changes in the field of tariff policy, cash collection, etc.;
- Implementation of investment support activities to promote smaller scale investment in utilities, in the framework of the on-going housing reform, with priority given to water management and energy saving in north-west Russia, including Kaliningrad. Delivery of advice and training to municipal authorities and utility management, required to make full use of the investment provided by IFIs.

6.3.2.5 Conditionality

The Tacis contribution will be conditional upon co-financing by IFIs and other donors. Support to the reform of municipal services will be contingent on the approval of a legislative framework for regulating the shift of overall utility costs towards consumers.

6.3.2.6 Indicators

- Levels of untreated effluents discharged into the Baltic Sea and of cash collection for water in St Petersburg;
- Levels of investment in municipal utilities.

6.3.2.7 Indicative budget: 33 million (22 in 2002 and 11 in 2003)

7. Indicative Budget

The Programme will be financed through an EC grant of EUR 90.0 million in 2002 and 94.0 EUR million in 2003, allocated among the different priorities as follows:

<u>Area/Priority</u>	<u>Indicative budget (EUR million)</u>	
	2002	2003
1. Support for institutional, legal and administrative reform	40.0	41.0
• Legal, administrative reform and regional policy	15.0	16.0
• Judicial reform	10.0	10.0
• Civil society, training and education	15.0	15.0
2. Support to the private sector and assistance for economic development	20.0	22.0
• Deregulation and corporate governance	20.0	22.0
3. Support in addressing the social consequences of transition	30.0	31.0
• Social reform	8.0	20.0
• Municipal services	22.0	11.0
Total	90.0	94.0

8. Conditionality

Assistance in the period of 2002-2003 is provided on the basis of the existence of the necessary elements for the continuation of co-operation through assistance, in particular the respect of democratic principles and human rights, as well as the obligations of the Russian Federation as set out in the Partnership and Co-operation Agreement.

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Annex 1 Russia – selected economic and social indicators

GENERAL

Area (square km):	17,075,000
Population 1999 (million):	145.9
Urban Population (1999) :	77.3 %
Life Expectancy (1999) :	65.9 years
Population growth rate (1990-99) :	-0.1 %
Fertility Rate per woman (1998) :	1.2
Unemployment rate (% of labour force, 2000):	10.5
Human Development Index (HDI) Rank:	55

ECONOMY

Nominal GNP 1999 (USD):	332.5 billion
GNP per capita 1999 (USD):	2,270
GDP Breakdown by sector value added (1999) :	
Agriculture:	7 %
Industry:	34 %
Services:	58 %
Real GDP growth rate:	
1998	-4.9%
1999	3.2%
2000	8.3%
Estimated real level of 1999 GDP as % of 1989 GDP :	57 %
Inflation: 1998	27.7%
1999	85.7%
2000	20.8%
External debt stock (1999,USD):	158 billion
Debt Service (1999):	19.1 % due of current account revenues, excl. transfers
Foreign reserves (2000, USD):	28 billion

(all figures in billion USD for 1999)		(all figures in billion EUR for 1999)	
Exports of goods & services:	115.1	Exports to EC:	25.9
Imports of goods & services:	74.7	Import from EC:	14.7
Current account balance:	20.7	Trade balance with EC:	11.2
FDI :	4.3	FDI of European origin:	1.4

SOCIAL DEVELOPMENT

Adult Literacy Rate:	99.5 %
Primary Enrolment Rate (1997):	100 %
Secondary enrolment rate (1997):	88 %
Infant mortality (1999) :	18 per 1,000 live births
Under 5 mortality (1999):	22 per 1,000
Contraceptive prevalence rate (1998):	34 %
Access to essential drugs	66%
Access to safe water:	99 %
Access to sanitation:	not available
Under 5 malnutrition (1998) :	3 %
Number of doctors/per 100.000 people :	421

Sources: World Development Report 2000/2001; Human Development Report 2001; UN Economic Survey of Europe 2001(1); Transition Report 2000 (EBRD); IMF World Economic Outlook (May 2001); The World Bank website.

Annex 2 The EU and Russia – economic and trade indicators 2000

	EU	Russia
Population (million)	376.5	145.2 (estimate)
Area (1000 km ²)	3,231	17,075
Population density (inhabitants per km ²)	116.5	8.5
GDP (current prices, EUR billion)	8,485	272 (forecast)
GDP per capita (current prices, EUR)	22,400	1,870 (forecast)
External trade turnover (EUR billion)	1,958	173*
Exports (EUR billion)	936	121*
Imports (EUR billion)	1,022	52*
Trade balance (EUR billion)	- 86	+ 69
Exports as share of total world exports (%)	18.4	1.7
Imports as share of total world imports (%)	18.4	0.8

Source : Eurostat (EU-15); Goskomstat (Russia), * including non-traditional trade

Annex 3**TACIS PROGRAMME OF TECHNICAL COOPERATION - Funds committed for Russia****1. FUNDS ALLOCATED through Russian Federation Action Programmes***

(EUR million)	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	Total
Support for institutional, legal and administrative reform	47	9	18	19	46	24	16	30	15	28	28	280
Support to the Private Sector and Assistance for Economic Development	27	31	50	43	41	31	29	31	18	14	19	334
Support in addressing the Social Consequences of Transition	0	16	19	0	7	10	11	3	7	6	16	95
Development of Infrastructure Networks (including energy, transport and telecommunications)	74	35	39	38	35	23	24	20	14	0	3	305
Promotion of Environmental Protection and management of natural resources	13	0	0	0	0	6	5	10	8	4	0	46
Development of the rural economy	51	20	12	16	17	10	13	9	5	0	0	153
Policy advice, Small Project Programmes (SPPs), Bistro and reserves	0	0	13	19	4	21	27	24	20	35	20	183
Tempus	0	0	0	15	11	8	8	13	11	11	10	87
Total Russian Federation AP	212	111	151	150	161	133	133	140	98	98	96	1.483

* Including the Baltic Line in 1999-2001

2. FUNDS ALLOCATED through other Programmes

In addition to the National Action Programmes, other Tacis programmes also allocate funds to Russia

Below is an **estimate** based on the hypothesis that, in case of multi-country programmes, 50% of funds allocated to the CIS concern Russia.

(EUR million)	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	Total
Regional and other Programmes *	25	12	35	29	27	31	27	27	21	17	23	274
Nuclear Safety	27	30	44	33	30	40	34	17	12	33	19	319
Donor Coordination **	0	28	10	10	20	25	27	28	28	32	30	238
Programme Implementation Support ***	3	12	6	11	12	19	18	16	17	18	18	150
Total from other programmes	55	82	95	83	89	115	106	88	78	100	90	981

* Including the Russian share of the Regional (ex-Inter-State), Cross-Border Cooperation (from 1996 onwards) and Democracy (until 1998) Programmes

** Including the International Science & Technology Centre and 50% of EBRD Bangkok Facility

*** Including Coordinating Units, Information, Monitoring and Evaluation, STAP facility, ATA (Assistance Technique et Administrative)

3. TOTAL FUNDS ALLOCATED to Russia

(EUR million)	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	Total
Total allocated to Russia	267	193	246	233	250	248	239	228	176	198	186	2.464

Annex 4 Past and ongoing EC technical assistance

Support for the institutional, administrative and legal reform

Tacis has aimed at offering technical assistance with a view to building democratic institutions in a civil society and improving the conditions for the development of a market economy. Under the Indicative Programme 1996-1999, it particularly focussed on human resource development, including education and training, as well as public administration reform.

In **training and education**, Tacis concentrated its support on: the reform of educational systems and their management; legal training in view of strengthening the rule of law; management and economics training; re-training of selected groups, such as military officers. In addition, the Tempus programme significantly contributed to the development of both co-operation between Russian and EU higher education institutions, and student exchange activities. In the area of **public administration**, Tacis aimed at supporting a large variety of programmes at various levels of government (federal, regional and local), strengthening institutions and civil service performance. Tacis has thus worked actively on improving the efficiency of such bodies as the State Duma, the Federation Council, the Ministries of Economy, Finance, Anti-monopoly, Labour, Education, Health, etc. Significant efforts have been implemented in the field of taxation (advice to tax reform and legislation, tax collection and training of tax personnel). On **legal reform**, the objectives have been twofold: to provide better legal protection for economic operators, and to support the development of improved legal training and education. Work on the legal and regulatory framework has been conducted in areas such as the land market, the electricity market, environmental monitoring, road transport and telecommunications. High-level policy advice has been provided to key people and institutions, particularly on economic and social issues.

In the field of public administration, although individually most projects in the regions have been successful and have brought results, the impact has often been limited by the lack of an overall strategy for administrative reform in Russia. The impact has probably be rather more important in human resources development, with a significant improvement of training quality in higher education and in public administration institutions. Altogether, thousands of students and officials have been exposed to EU best practice, thanks to new curricula developed with the support of Tacis, and to training and seminars organised by the projects.

In the institutional field, the absence of an overall strategy at the national level, has, on the whole, limited the overall impact of Tacis on the reform process. Tacis has however played a significant role in both contributing to the development of market-oriented legislation and regulations, and improving the teaching of law. Numerous projects touching on, for example economic federalism and public law, administrative code, legal protection of economic operators, public health management and financing, and the environment have or are having a systemic impact, although results in the energy and agricultural sectors have often been insufficient so far.

Support for private sector development and assistance for economic development

Under past Action Programmes, Tacis' overarching objective in this area of co-operation was to establish conditions leading to an increase in private investment. More concretely, Tacis aimed at supporting a federal policy for **SME** activity and a network of development agencies for emerging SMEs. Small innovative businesses and spin-offs from large enterprises in mono-company towns were also supported. The EBRD Russian Small Business Fund received Tacis technical co-operation funds to support training of credit officers. As for support to **larger enterprises**, originally most attention was given to the privatisation process and therefore to federal policy. Companies have been directly supported through consulting provided by Enterprise Support Centres (ESC) and the Tacis Enterprise Restructuring Facility (TERF). Tacis contributed to the modernisation and the

development of the **financial sector** by enhancing the operations of the banking sector. Over the years the objective has been to move from working solely on the development of the banking sector to the wider area of financial reform covering taxation, securities markets, accounting, audit and insurance.

In the first years of technical assistance, the state and public institutions were the main counterparts in the implementation of projects. When the programme developed, more projects were carried out within the private sector, e.g. in co-operation with industrial and professional associations.

In the enterprise sector, results have sometimes been mixed. Noticeable success often arose when companies shared the cost of technical assistance. Some projects contributed to improve the legislative framework and administrative practices, in fields such as competition policy, and bankruptcy law. The ESCs delivered quality consulting services to enterprises. Sector projects provided advice on restructuring policy at federal and enterprise level (pharmaceutical steel, non-ferrous metals, textile), fostering EU-Russia industrial partnerships and approximation of standards.

The impact of all the efforts made so far is particularly visible at the level of SMEs. SME agencies that have been assisted directly or indirectly are still in existence and do not rely on Tacis funding for their existence. Associations are beginning to form and to lobby on behalf of the sector at the federal, regional or local levels. Another output is the attention paid by politicians to SMEs, as they start to realise the role played by this sector in economic development. This has yet to translate into fully working initiatives, but is a major step forward.

In the financial sector, targeted projects, such as the Russian Project Finance Bank, revealed themselves as useful in retrospect: the bank, known as KMB Bank and owned by EBRD, is now getting extensively involved in small-business lending. Successful work was done with academic institutions, such as bank training institutions, which are already significantly contributing to raise the level of skills in the profession. The adoption of some new accounting standards and some consolidation of the insurance sector are also encouraging results.

Support in addressing the social consequences of transition

Past Tacis projects in the **social protection** sector mainly focused on the reform of the health system, through projects addressing the management of healthcare, its financing and the promotion of preventive health. Tacis also supported improvements in the overall governance of social security, the development of partnerships between public and private organisations and NGOs in delivering health and social services to vulnerable groups, and enhanced the efficiency of the delivery of municipal services.

To alleviate the **social impact** of economic restructuring, Tacis supported the development and implementation of municipal strategies in regions affected by industrial reorganisation and in particular, in the elaboration of policies to encourage diversification of industry and the creation of employment. Assistance was concentrated on two types of municipalities: former coal-mining towns and scientific cities, both of which were undergoing considerable social change and economic re-orientation. Significant effects have been achieved from the work with the latter, as Tacis contributed directly to central policy planning and to the development of targeted training actions, including in the commercialisation of research results. Tacis also addressed social reconstruction issues through regional policy projects, supporting regional co-operation, as well as the reduction of economic asymmetries between the regions, particularly in the north-west.

Investment in **employment** and the labour market has resulted in the formulation of strategic recommendations on social partnership and their implementation in pilot enterprises in two pilot industrial sectors as well as the establishment of a model labour court. The legal framework for labour relations still remains fragmented with no statutory role assigned to employers to date. In terms of the re-training of military personnel, in spite of institutional issues, the Russian partners

have gained a thorough understanding of the requirements and the social benefits of the re-training process for military personnel.

Nuclear Safety and other Tacis initiatives

Lack of state funding, the growing nuclear share in national power output and the acute need to introduce international safety standards have made nuclear safety a priority for Tacis in Russia. Since 1991, around EUR 300 million have been earmarked for nuclear safety projects. Efforts have focused on encouraging the development of independent regulation of the nuclear industry through the strengthening of the national safety authorities and on helping nuclear power plants address priority safety issues (“design safety” and large “plant improvement projects”, with important deliveries of equipment). Assistance has also been provided in other key areas, such as radioactive waste management and the establishment of a climate conducive to investment. Emergency preparedness, safeguards system development and industrial co-operation with EU industry have been supported as well.

Significant assistance has also been provided under other Tacis initiatives, complementing country programmes: the **Regional** (formerly Interstate) Programme, the **Cross-Border Co-operation** (CBC) Programme, the technical co-operation programme with the EBRD (“**Bangkok Facility**”), the support to the **International Science and Technology Centre**, which have been dealt with in separate Indicative Programmes, as well as the Special Action in favour of the Baltic region. The Regional and CBC programmes have focused mainly on issues best addressed at a multi-country level, such as networks development (transport and energy), environment (particularly water management), justice and home affairs (women and drug trafficking, money laundering).

Annex 5 Member States' and other donors' co-operation

	EC	Member States	Other Donors	Comments
Support to institutional, legal and administrative reform				
- Administrative reform	X	UK, FR, DE, ES	USAID, Canada, WB	
- Judicial reform	X	UK, NL, FR	USAID, Canada, WB	
- PCA implementation and WTO accession	X	UK, DE, SW	USAID, Canada	
- Civil and company law		DE		
Support to the private sector and assistance for economic development				
- Corporate governance improvement	X	UK, DK, DE	OECD, CH, Canada, EBRD	
- Deregulation of the economy	X	UK	USAID, WB	
- Development of a mortgage market and financial mechanisms		UK	USAID	
- Bank restructuring and regulation	X	DE, UK	USAID, NW, Canada, EBRD	Norway also includes finance.
- International Accounting Standards	X	UK	USAID, EBRD	
- SME development	X	DE, NL, UK	USAID, CH, EBRD (*)	(*) Very focused regional approach
- Sectoral reform			EBRD (*)	(*) Energy, railways, telecom
- Training of managers/human resources and education development	X	DE, UK , FR	WB	

Support in addressing the social consequences of transition				
- Labour market and employment	X	F, DE, FR	ILO	
- Social reform	X	SW, UK, NL	ILO, WB	
- Health and social protection		FR, UK	Canada	Health system management reform – public health education
- Working with disabled people	X	IT, UK	Canada	IT co-operation includes equipment and training
- Hospital partnerships		IT	USAID	
- Support to NGOS at local and regional level		FIN, UK	USAID, CH, NW, Canada	NW includes support to employers' and employees' organisations
- Women's reproductive health			USAID	
- Communicable diseases		SW, IT, FR, UK	WB	Mother-to-child AIDS transmission
- Poverty analysis		UK	WB	
- Gender issues		SW	NW	
- Co-operation and research in education, health and social welfare		FR (education)	NW	
- Barents Co-operation Programme			NW	aims at improving health services and controlling communicable diseases in the regions
- Municipal governance		FR, UK	Canada	Regional economic development
Other areas				
- Environment		FIN, SW, DK	USAID, CH, NW, Canada	Finland is particularly active in influencing the reduction of the risk of environmental pollution and nu

				accidents. Danish Co-operation for Environment Eastern Europe –offers soft loans investments in env. projects (*). No includes nuclear safety and energy efficiency.
- Support to emergency situations		UK	UN, Red Cross	
-Restructuring of large agricultural enterprises/agriculture		DE, FIN	EBRD	
- Promotion of independent media		SW	CH, NW	

(*) Renewable, wastewater treatment and drinking water supply, waste management and treatment, air purification and district heating.

Support for Institutional, Legal and Administrative Reform

The most active Member State in this area is the **United Kingdom** with its mainly regional approach in projects such as: judicial support (Moscow Oblast, Krasnodar Krai), retraining for judges of General Jurisdiction Courts, simplification of court procedures, and training for the new bailiffs service, prison twinning aimed at *professionalising* the prison service; support to regional NGOs to monitor compliance with Council of Europe obligations; legislative support to the Ministry of Labour and Social Protection concerning vulnerable groups; public administration training in Nizhny Novgorod; support to the Police Academy in St. Petersburg and support in developing alternative dispute settlement mechanisms [?] for a [?] in Samara. Other active Member States are the **Netherlands**, with projects that pair a western (usually Dutch) NGO with a Russian partner to work on the drafting of new legal documents, and **France** which focuses on *professionalising* public administration, and includes such programmes as support for an Academy for Training of the Civil Service and the training of Russian civil servants through internships in France. Finally, **Germany** (Transform programme) has placed two German consultants within the Duma to work on banking legislation and two others to work on drafting SME/privatisation legislation. Consultants are also working with the State Property Committee on privatisation law and practice. Since 1992 the **Swedish** Government has worked with the Ministry of Finance and relevant authorities on budget and tax reform, as well as other public finance issues.

The **World Bank** has implemented a legal reform project since 1996. The main objectives of the project are to improve the quality of drafting of economic laws, to design the appropriate classification of legislation including its electronic format, to introduce new methods and materials for legal education and to improve the training of judges. The coordinator of this project on the Russian side is the Russian Foundation for Legal Reform. **USAID** activities concern judicial training, support to human rights, particularly with regard to ethnic and religious minorities, enhancing the professionalism of the legal profession (both judges and lawyers). The US conducts other programmes through different executive departments; for example, the US Department of Commerce does much work with Russian governmental counterparts to reduce the administrative burden on foreign investors, and the FBI and US Department of Justice work with Russian police organs and the Prosecutor's Office on matters of organised crime, money laundering, drug smuggling and other matters of mutual concern. The US Department of Commerce is also working on a Code of Conduct for businesses to which Tacis could make a worthwhile contribution. The **OECD** has taken up the role of coordinating donors in the area of taxation. It has organised a biannual conference on taxation within the Ministry and coordinated the activities of the international tax training centre, which has mainly financed by Tacis.

Support to private sector development and assistance for economic development

The **British-Russian Development Partnership** (formerly the KnowHow Fund) has been particularly active at the regional level in assisting local SMEs to set up and retain unemployed people to work in the SME sector. They have set up 12 business centres in the Leningrad Oblast and they work in Samara, Kemerovo and Ekaterinburg. Furthermore they are actively supporting accounting reform through the International Centre for Accounting Reform. They have also advised the Central Bank of Russia on banking supervision.

The Iris Project is one of **USAID**'s main projects supporting SME development agencies. It works with 33 agencies throughout Russia to strengthen their skill base and provide grants for projects aimed at assisting SMEs. The **OECD** created the Forum for Entrepreneurship and Enterprise Development in response to the August 1998 crash. This forum brings together both Russian and international organisations interested in the development of SMEs to discuss policy issues. A recent meeting established the overriding need for the creation of a sound, simple and transparent legislative and taxation basis for SMEs throughout the Russian Federation. The **EBRD** is the most

active player on the funding side of SME development. Since 1994 it has been offering micro and small loans for up to three years to SMEs through accredited banks. Today it concentrates its activity mainly on Sberbank, the Russian Small Business Bank (KBM Bank), also supported by Tacis, and a few regional banks. The objective was both to train Russian banks in lending to small banks as well as to fund small businesses. The EU funds much of this training through the Bangkok facility. Furthermore the **EBRD** has a higher share [than what?] of its loan portfolio in Russia (over EUR 600 million) which covers natural resources, oil and gas, mining, power and energy, transport and telecommunications sectors. The **IMF** focuses specifically on macroeconomic policy. The **World Bank** has also been active in this area (monopolies and private sector development).

Support in addressing the social consequences of transition

The **German** bilateral programme continues to support projects in the areas of industrial safety, co-operation between Russian and German companies, vocational training and qualifications, as well as occupational rehabilitation and vocational guidance for the handicapped. The **British-Russian Development Partnership** has invested heavily in the reform of the health care system and has supported efforts to reform the Russian pension system in co-operation with **ILO** and the **World Bank** over the past year. In the future BRDP co-operation will concentrate on poverty reduction and the development of a coherent social policy to protect those most affected by economic restructuring (support to NGOs, development of the social protection system, reform of the pension system, HIV/AIDS and TB prevention programmes, etc.) The **British Council** will continue to support management training, the restructuring of school curricula, the development of educational assessment tools and education for special needs groups and ethnic minorities as well as university partnerships between British and CIS universities through the REAP programme. The **Dutch** bilateral assistance programme (MATRA) provides support for the development of a range of micro projects for the benefit of social NGOs and other civil society organisations. It also provides funding for training in private pension fund management and health care reforms. **Danish** assistance covers the training and re-training of workers for light industry and health and safety at work. **Finnish** bilateral assistance focuses particularly on north-west Russia and on human resources development and also on the areas of health and safety at work, the development of a women's centre in Siberia (in co-operation with **UNDP**), as well as a project on street children in St Petersburg with the **ILO**. **Swedish** bilateral assistance has identified the social sector as a key priority (children at risk, development of social services, the modernisation of healthcare management and specific programmes for drug prevention, mother-child health and the handicapped). **French** bilateral assistance will support the development of employment services and vocational training (Kemerovo, Moscow and Yaroslavl oblasts), labour legislation and arbitration in co-operation with the **ILO**, as well as a project on occupational health and safety in Bachkortostan. Projects in the areas of reproductive health for young people, psychiatric care and hospital management continue to be supported. **Italian** bilateral assistance provides support for projects in the health and social spheres, with a particular focus on the social rehabilitation of disabled children and orphans in Tambov and Moscow oblasts, as well as the social rehabilitation of disabled adults and staff training. Member States continue to support the training of Russian managers in Europe within the framework of the "**Presidential Initiative**" and in conjunction with the Tacis **MTP** Programme. **German** bilateral assistance will invest over DM 24 million in management training and substantial investment will also be provided by both the **British** and **French** Governments. **Norwegian** b-lateral co-operation targets the most northern parts of north-west Russia, particularly Murmansk oblast (health and social reforms).

The **World Bank** through its loans programmes tries to support health reform and TB/Aids eradication programmes in co-operation with **WHO**. The **World Bank** has completed negotiations on a project to encourage and plan for the out-migration of people from Russia's extreme northern regions. Over the past year **USAID** has provided assistance to the health sector principally in

combating the spread of HIV, TB and sexually transmitted diseases as well as targeting mother-child health programmes. It has also provided significant support for management training through its own Productivity Enhancement Programme since 1993 as well as programmes in the areas of employment, insurance, poverty re-education and education. In future, it will focus its attention on interventions at the regional and municipal levels particularly in Tomsk and Samara oblasts and in the Russian far east in Magadan. The social impact of transition remains one of **USAID**'s main concerns and it hopes to maximise the impact of its work through inter- and intra-regional networking. **Canadian** assistance has also invested in the health sector and in management training, whereas **Japanese** aid principally targets the latter with two-thirds of its internship places reserved for candidates from the Russian far east.

UNDP has supported a wide range of programmes in the areas of health, employment services, NGOs, continuing vocational training and tourism and gender policy projects. **UNESCO** provides support for vocational training reform, in-service training for secondary schools teachers and has provided assistance for a programme for urban youth. Pension reform is a key policy area for the **ILO**, and it has been assisting both the Ministry of Labour, Ministry of Economic Development and Trade and the Pension Fund in preparing the outlines of a major long-term pension reform programme in consultation with the **World Bank**, **Finnish** and **Swedish** co-operation and the **UK's RBDP**. The **Open Society Institute** (Soros Foundation) works in co-operation with the **World Bank** and **UNESCO** on internet projects for schools, electronic publishing and development of university and rural libraries.