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Tax burden and tax behavior of branches of the Russian economy - Part I

Taxation in the Russian mining and metals sector

by

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Table of Contents

Introduction

The mining and metals (M&M)[1] sector has with regard to tax, as indeed with respect to other aspects of its existence, a dual character, being made up of miners and metal producers, usually in the guise of juridically independent enterprises.[2] The two sub-sectors often have different interests and difficulties. Both claim to be harshly treated by the taxation system, with it being said that the M&M sector bears a tax burden double that of the economy as a whole, with the miners' burden being double that of the metal producers'.[3] Further, it is claimed, an enterprise in the Russian M&M sector bears a tax burden double that of the typical Western M&M firm.[4]

The miners claim to suffer from liability to a range of particular taxes related to their resource exploitation activities as well as heavy liability to assets tax. The difficulties claimed by the metal producers are based on their VAT liability at each stage of a multi-stage production process; they also find themselves subject to the sudden imposition of export duties. The claimed difficulties of the M&M sector can be seen in the context of the general discussion of whether the resource sector is the milk cow or wolf of the Russian economy. That discussion is generally focused on the oil and gas sector, but the complaints of the M&M sector of an unfair tax burden, on the one hand, and accusations of massive tax evasion and capital flight against the sector, on the other, suggest that it is not an irrelevant issue here.

The main tasks, therefore, in the first part of this paper, dealing with taxation in the M&M sector in the 1990s, is to examine relative tax rates in the two branches of the sector; the specific issues of the VAT and export duty liabilities of metal producers and the resource taxes faced by the miners; the tax evasion issue among metal producers, something generally although not always related to their export activities; and finally whether or not the M&M sector is being exploited through the tax system as part of a general exploitation of the resource sector. These questions will necessarily be approached with a degree of vagueness, given the paucity, inconsistency and uncertain reliability of the data.

The second part of the paper will deal with efforts at tax reform since Putin came to the presidency, including an account of lobbying by the M&M sector within the tax reform process. This part of the paper will have to be open-ended, since some of the most important changes for the M&M sector had not been implemented or taken effect at the time this paper was written.

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[1] The Russian usage is *metallurgicheskaia promyshlennost'*, the direct translation of which is the misleading 'metallurgical industry'. The sector includes enterprises dealing in activities ranging from mining and benefication to the production of metal of all stages of completion. The analysis here does not include precious or nuclear-related metals.

[2] Although on merger and acquisition activities across the boundary between the two sub-sectors, usually in the form of metal producers buying major shareholdings in miners, see Fortescue, Stephen: The Russian mining and metals sector: integration or disintegration?, in Tikhomirov, Vladimir (ed.): Anatomy of the 1998 Russian Crisis, Contemporary European Research Center, University of Melbourne, 1999, chapter 8.

[3] Chernaia metallurgiia, nos. 7-8, 1998, p. 4; Delovoi mir, 6 August 1996, p. 4; Metallosnabzhenie i sbyt, no. 2, 1999, p. 15; Metally Evrazii, no. 3, 2000, p. 7.

[4] Chernaia metallurgiia, nos. 3-4, 1997, p. 7.

The tax burden of the M&M sector in transition

Levels of tax

Table 1 shows average tax rates within the M&M sector as a percentage of GDP compared to the economy as a whole.[5] The table shows the sector as being more lightly taxed than the economy as a whole as transition got underway, but with a steadily and massively widening gap operating against the metals sector as the decade continued. Data for 1999 indicate that taxes represented 60% of GDP in the mining sector, 50% among metal producers, and 35-40% in industry (not the economy) as a whole.[6]

Table 1. M&M and economy-wide tax takes as a percentage of gross domestic product

Year	Whole economy	M&M sector
1990	34.4	38.2
1991	33.2	27.8
1992	41.4	29.7
1993	48.2	30.6
1994	29.0	55.9
1995	26.1	62.9

Source: Chernaia metallurgiia, nos. 5-6, 1997, p. 8.

Table 2 shows tax takes as a percentage of realized production for metals producers and for miners. Again the mining sector is worse off. In 1997 the figure for the economy as a whole was 10-15.[7]

Table 2. Tax takes as a percentage of realized production

	Mining	Metals
1990	12	
1994	25.4	12.7
1995	34.0	19.0
1997		22.0

Sources: Metally Evrazii, no. 3, 1996, p.5; no. 4, 1996, p. 5; no. 5, 1998, p. 9.

The data in the tables appear to broadly confirm industry claims of a significant tax bias against the M&M sector, in particular the miners. The sector complains bitterly not just of the level of taxation that it has to pay, but also of the bewildering number and variety of taxes. The following list gives an indication of taxes to be paid by M&M sector enterprises before the tax reform of 2000/01. Most are controversial and will be described in more detail below.

- Value-added tax
- Profits tax
- Assets tax
- Resource and environmental levies
  - raw materials replenishment levy
  - resource royalties
  - road and transport taxes
  - tailings tax

[5] For other data presenting a similar picture, see Metally Evrazii, no. 6, 1997, p. 24; no. 5, 1998, p. 9.

[6] Chernaia metallurgiia, nos. 1-2, 2000, p. 12.

[7] Metally Evrazii, no. 5, 1998, p. 9.

- Social fund payments
  - pension fund
  - social insurance fund
  - federal employment fund
  - compulsory health insurance
- Export duties
- Local and regional taxes

It is worth pointing out that despite the sector's claims of special tax mistreatment, the sector is not seen as a major tax defaulter.[8] Table 3 provides data on tax arrears as of 1 January 1999. The sector's indebtedness generally stands at less than 4% of total tax indebtedness, both at regional and federal levels. This can be compared to the fuel sector's 21.71% of indebtedness in 1997 (at a time when the metal sector held 5.79% of tax indebtedness).[9]

Table 3. Tax indebtedness as of 1 January 1999, billion roubles

	Russian Federation	M&M sector	M&M sector as % of RF
Total indebtedness	259.01	10.28	3.97
of which federal	160.03	6.12	3.82
Total arrears	235.58	7.68	3.26
of which federal	148.98	4.97	3.34
of which - profits tax	19.89	0.49	2.46
- VAT	107.74	4.02	3.73
- resource taxes	4.88	0.37	7.58
Total deferred	23.43	2.6	11.10
of which federal	11.05	1.15	10.41

Source: Chernaia metallurgiia, nos. 3-4, 1999, p. 12

One would have hoped to be able to present data showing the distribution of the overall tax burden between different types of tax, particularly in comparison to economy-wide data, in order to evaluate sectoral claims of tax discrimination. Unfortunately the available data are too inconsistent over time and between categories to be of much value in tabular form. One is dealing either with rouble payments over periods of very high inflation or percentages where different combinations of taxes are included in the totals. Some data include only federal taxes, others all taxes. In recent times VAT payments are particularly distorted in official statistics since delays in government VAT refunds on exports can leave minus signs in front of those particular figures. This can be seen in official government's data for the year ending 1 January 2000. The metals sector's VAT payments are shown as minus RUR 4,738,430,000.[10] This was at a time when the tax authorities were deliberately withholding VAT repayments to those they considered to be 'false exporters' and their intermediaries, many of whom are to be found in the metals sector.[11] The negative in the VAT column makes it impossible to calculate and compare percentages from that data.

With these difficulties very much in mind, two tables are nevertheless presented and carefully interpreted. On the basis of these and other data each category of tax will be examined. In doing so we will consider in particular those categories of tax most relevant to the basic question

[8] Profil', 12 October 1998, p. 16. A list of 46 major tax defaulters identified by the Federal Administration of Insolvency Matters in 1995 included three from the M&M sector. Kommersant, 7 September 1995, p. 3.

[9] Data taken from Russian Federal Tax Service, 1997.

[10] Government data on tax payments are collected by the tax ministry. The data are then distributed to relevant agencies of the executive and legislative branch but they are not published.

[11] Kommersant, 30 March 2000, p. 2; 7 April 2000, p. 5.

posed in this paper: is the M&M sector unreasonably taxed or does it avoid its responsibilities through the tax system and indeed constitute a key part of 'bandit capitalism'?

Table 4: The tax obligations by category of tax of the consolidated budget of the Russian Federation and the enterprises of the M&M sector, %

Type of tax	M&M sector	RF budget
Taxes on goods and services	13.2	27.2
Taxes on profit	10.0	26.2
Assets taxes	18.7	5.3
Natural resource taxes	6.0	5.2
Road fund	13.5	5.5
Social funds	29.9	23.6
Others	8.7	7.0

Source: Metally Evrazii, no. 6, 1997, p. 25.

Table 5. Tax payments by the M&M sector into the federal budget, billion new roubles[12]

Type of tax	1995	1996	1997
Assets tax	1.5	2.8	2.8
Profits tax	6.2	1.6	1.0
VAT	1.5	1.3	1.4
Resource taxes	0.3	0.3	0.3

Source: Chernaia metallurgiia, nos. 7-8, 1998, p. 6.

VAT

While VAT rates varied somewhat through the decade the generally ruling rate was 20%, of which 15% went to the federal budget and 5% to the regional budget. The M&M sector claims to be particularly hard hit by the way in which VAT is levied at each stage of the production process in what is described as a sector with a multi-stage production process. It is claimed that metals production has eight or more stages at which VAT is levied, a problem which obviously becomes more serious the further one moves down the production chain.[13] More specifically, it is noted that the levying of VAT on even in-house repair and refitting work adds appreciably to the cost of technological upgrades.[14]

To determine whether the metals industry is indeed more multi-staged than other industrial sectors requires a degree of technical knowledge of production processes which is beyond the scope of this paper. However, one wonders whether the making of metals is any more multi-staged and value-adding than the production process in other advanced industrial sectors. Beyond that it is necessary to remember that a large proportion of the sector's production is exported, and that the VAT on goods shipped for export is refundable. Indeed, until 2000 metals processed and exported under tolling schemes had no VAT levied on them at all.[15] At the end of 1999 the highly controversial tolling schemes were 'ended' in the sense that VAT was now payable, but it became refundable once the fact of export could be proven through trade documentation. The change certainly added to the sector's financing costs, and given the tax

[12] The table in the original source uses trillions of roubles as the unit of measurement. This was before the currency reform which removed three zeros from the Russian monetary unit.

[13] Finansovye Izvestiia, 16 May 1996, p. 2.

[14] Metally Evrazii, no. 6, 2000, p. 19.

[15] Tolling is a process, relatively widespread in the metals sector throughout the world, by which a metals producer processes ore for a fee, rather than purchasing it on its own account. It is has been very widely used in the Russian aluminium industry, particularly by traders importing bauxite or alumina for processing in Russia, with the resulting metal being immediately re-exported. The process is seen as having provided enormous opportunities for tax avoidance within Russia. Ekspert, 25 October 1999, pp. 10-11.

authorities' willingness to withhold refunds on arbitrary grounds, in an unpredictable way. But the situation remains that much of the sector's 'final' added value is ultimately VAT free.

Given that, and doubts about how multi-staged the sector really is, it is not surprising that the data, such as they are, do not support the claim of S. V. Kolpakov of the International Union of Metallurgists that the sector pays more than double the VAT typical of the economy as a whole.[16] Table 4 shows that only 13.2% of the taxes paid by the M&M sector are 'taxes on goods and services', as against 27.2% for the economy as a whole. More recent data, official 1999 tax statistics, cannot be used in any comparative or longitudinal way, because of the refund problem mentioned above. Nevertheless it can be pointed out that, according to those data, in 1999 such resource sectors as oil extraction, gas and forestry paid as federal VAT RUR 11.21 billion, RUR 5.15 billion and RUR 1.36 billion respectively. Processing sectors such as machine tools and the food sector paid RUR 168.61 billion and RUR 14.69 billion respectively. In 1997 the metals sector paid RUR 1.4 billion roubles. The comparison is very rough and ready, but it does not suggest an overwhelming VAT burden.

Profits tax

Profits tax through most of the 1990s was levied at 13% for federal payments and up to 22% at the regional level. It can be seen from Table 6 that it is one of the most volatile components of the sector's tax liability, obviously because of the volatility of profits in the sector.

Table 6. Profits and profits tax paid by the M&M sector, billion roubles

	1995	1996	1997
Profitability, %	18.4	5.8	4.0
Gross profits	19.1	7.4	5.7
Taxable profits	17.6	4.6	2.9
Profits tax	6.2	1.6	1.0
of which to federal budget	2.3	0.6	0.4

Source: Chernaia metallurgiia, nos 3-4, 1997, p. 6.

By 1999 the profits tax paid by the sector into the federal budget had rebounded to RUR 9.76 billion.[17] Clearly profits within the sector fluctuate greatly from product to product according to market conditions, with prices for commodity metals always being highly volatile and variable across the sector. Russian exporters have also found themselves susceptible to anti-dumping actions, with dramatic effects on export volumes to major markets.[18] However, the blame for the collapse in profitability sector-wide after 1995 is attached primarily to the so-called 'rouble corridor', introduced in that year. The rouble corridor was a declared policy of the government and Central Bank to maintain the value of the rouble against the US dollar within a broad and only gently declining band. Until August 1998 the policy was successfully maintained, not least because domestic inflation was brought under some sort of control. However, the relatively strong rouble had a major negative effect on the M&M sector, given its by now overwhelming dependence on exports.[19] This was particularly the case for metal producers facing large price increases in such major cost categories as power and transport. It is claimed that through 1995

[16] Chernaia metallurgiia, nos. 7-8, 1998, p. 4.

[17] Official government data (unpublished).

[18] Fortescue, Stephen: The mining and metals industry and globalisation, in: Klaus Segbers (ed.): Explaining Post-Soviet Patchworks, vol. 1, Ashgate, Aldershot, 2001, pp. 136-163.

[19] Russia has a 10% share of world ferrous metal exports, and 16.4% of non-ferrous exports. In 1999 metal exports represented 20-22% of Russia's total exports, with ferrous shipments worth $US6 billion and non-ferrous $US7.6 billion. These values were down on 1998, but a strong upturn was evident in 2000. For many of the largest Russian metal producers exports take up to 80% of their output. Metallurg, no. 6, 2000, pp. 3-5; no. 12, 2000, p. 11; Chernaia metallurgiia, no. 4, 2001, p. 4.

the rouble declined in value against the dollar by 130%, providing a major boost for exporters' rouble receipts. However over the same period inflation was 231%, with the price increases for power and transport being at even higher rates.[20]

The August 1998 crisis brought with it a massive devaluation of the rouble, a development which greatly improved the sector's profitability, both through the direct effect on its rouble receipts and through some increase in domestic demand throughout the economy. The positive effects on the government's profits tax receipts are evident.

While there is logic and some validity to the exchange rate explanation of the volatility of the sector's profitability and profits tax payments, there is also a suspicion among many commentators - and even more tax officials - that there is a high level of tax evasion in this category within the M&M sector. Although the figures are taken from a time when the rouble corridor was in operation and the sector's profits could well have been 'legitimately' reduced, one notes from Table 4 that in the mid-1990s profits tax represented 10.0% of the sector's tax burden as against 26.2% of the tax burden of the economy as a whole.

Because the sector is so export-oriented, it has enormous opportunities to engage in transfer pricing to the benefit of trading intermediaries, in order to strip assets in the most rapacious cases and in all cases to reduce liability to profits tax, as well as VAT. Metal is sold at cost or below to traders with close ownership links with the producer enterprise and invariably registered offshore. The profits remain offshore, taxed at vastly below their real rate (the producer makes no or minimal profit and so pays no profit tax, VAT is levied on a greatly undervalued transaction between producer and trader).[21] One notes in this regard the strong presence in the M&M sector from the very beginning of privatization of traders, both domestic and international;[22] one also notes that the first thing any new owners of a metal producer do is annul the trading contracts signed by their predecessors. The tax authorities have tried to impose imputed profit values, something clearly designed to overcome tax-evading transfer pricing, but something which also leaves considerable opportunity for arbitrary decisions by tax authorities.[23] The provisions for imputed profits in the old Tax Code have been removed in the new Code. However extra tax can still be charged if goods have been sold at more than 30% below market price.[24]

Assets tax[25]

It is presumably at least partly because of the tax-avoidance opportunities in the profits tax category, that the Russian tax system puts heavy emphasis on taxes that do not depend on profits, most strikingly assets tax. The tax, variable according to the nature of the business holding the assets, is generally levied at the maximum of 2% of taxable assets.[26] As can be seen from Table 5, between 1995 and 1997 assets taxes paid by the sector increased significantly while profits

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[20] Chernaia metallurgiia, nos. 3-4, 1997, p. 7.

[21] For specific accusations, although accusations that have never moved to the stage of legal action, see the Audit Chamber's case against the Novosibirsk Electrode Company and its owners Siberian-Urals Aluminium (SUAL), and then Minister for Taxation Pochinok's threats against the tax-evading trading operations of Severstal in particular. Ekspert, 17 May 1999, p. 35; Metallosnabzhenie i sbyt, no. 4, 1997, p. 10. We have already mentioned the failure of the tax authorities to refund VAT payments where they believe the value of exports to have been undervalued.

[22] Fortescue: Russian mining and metals sector, pp. 218-21.

[23] Metally Evrazii, no. 6, 1997, p. 26.

[24] Chernaia metallurgiia, nos. 5-6, 1999, p. 74.

[25] *Nalogi na imushchestvo* is often translated as 'property tax'. I have preferred to retain that translation for *nalogi na nedvizhimost'*.

[26] 'Some changes to the tax obligations and interrelationships of budgets at different levels', Presidential decree No. 2270, 22 December 1993, as amended, art. 13. Taken here from Federal'nye nalogi, Agentstvo Biznes-inform, Moscow, 1995, p. 12.

taxes plummeted and VAT remained steady. Table 4 shows that assets tax made up a considerably greater share of the M&M sector's tax burden, at 18.7%, than the 5.3% for the economy as a whole, a reflection of the capital-intensive nature of the sector. In 1997 the tax paid on assets was only slightly below the total taxable profits of the whole sector.[27] Unfortunately more recent government data provide no figures on assets taxes.

Not surprisingly there are regular complaints about a tax which can be charged at very high levels even to enterprises which are loss-making. It is claimed that the tax is particularly burdensome for the struggling mining sector, since mining operations require particularly high levels of fixed assets, and that such assets are likely to be greater in enterprises facing difficult geological or geographical conditions and so already burdened with higher costs.[28]

Related to concern about the assets tax is discussion of Russian depreciation rates. Commentators claim with increasing urgency over the years, that the 'real' rate of depreciation in the Russian M&M sector is somewhere around 1% per annum, as against over 10% in Russia's industrialized competitors.[29] Despite its low level, depreciation is nevertheless one of the few and major sources of investment in the sector.[30] The depreciation problem has become acute as inflation has eaten away at the value of assets. And yet if assets are revalued to enable more realistic depreciation, firms' liability to assets tax increases dramatically.[31]

Resource taxes

Another set of taxes which are payable regardless of the profitability of the enterprise are resource taxes, something by which the miners are seen as being particularly hard hit. There is a straight resource royalty. Royalties are charged for 'search', exploration and extraction rights, the amount payable being determined separately for each specific deposit. 'Search' rights are granted for 1-2% of the cost of the work done; exploration rights for 3-5% of exploration costs; and extraction rights for 2-4% of the sales price of the metal produced from the extracted minerals.[32] The proceeds are divided 25% to the federal budget, 25% to the regional budget and 50% to the local budget.

The other, and seemingly more controversial, resource tax is the so-called Replenishment of the Raw Material Base Levy, often referred to as the 'geology fee'. Introduced in February 1993, the Levy is payable only on deposits which have been discovered and investigated at state expense, although one imagines that that would cover all currently exploited and most listed reserve deposits.[33] The Levy is set at between 3.7% and 10% of realized production, the rate depending on the type of ore being exploited. It is payable over the life of a deposit.[34] The money collected, which is divided between the federal and regional authorities, is supposed to be spent on geological prospecting and exploration work, although it is claimed that it is not.[35] According

[27] Chernaia metallurgiia, nos. 7-8, 1998, p. 6.

[28] Metallurg, no. 3, 1996, p. 5; Chernaia metallurgiia, nos. 5-6, 1997, p. 8; Gornyi zhurnal, no. 3, 1999, p. 62.

[29] Chernaia metallurgiia, no. 4, 1999, p. 63; Metally Evrazii, no. 1, 2001, p. 19.

[30] Gornyi zhurnal, no. 3, 1999, p. 63.

[31] Metally Evrazii, no. 6, 2000, p. 19.

[32] "Amendments and additions to the Law of the Russian Federation 'On sub-surface resources'", Federal Law No. 27-FZ, 3 March 1995 (Sobranie zakonodatel'stva, no. 10, 1995, item 823).

[33] The procedures for the Levy are set out in 'Procedures for the use of levies for the replenishment of the mineral raw material base and the exemption of raw material users from such levies', implemented by government decree No. 597, 17 May 1996, Sobranie zakonodatel'stva, no. 21, 1996, art. 2518.

[34] Metallurg, nos. 11-12, 1993, pp. 7-9; Gornyi zhurnal, no. 8, 2000, p. 4; Metally Evrazii, no. 6, 1997, p. 43. The 'Procedures' allow for an exemption from the Levy to be obtained once the deposit user has paid off all the costs incurred by the state. However the Levy itself cannot be counted as part of the payment of such costs. Point 18 of the 'Procedures'.

[35] Kommersant, 13 October 2000, p. 4.

to the 'Procedures' governing the Levy it is possible for money from it to be given to private firms to undertake their own geological and prospecting work; however the author has no information on whether such transfers are in fact made.

Also included in the resource tax category are tailings taxes, on which little information is available but which it is claimed are particularly injurious to low-grade operators, since they produce higher volumes of tailings.[36] Indeed mining representatives claim that the Russian tax system is generally inappropriate for the Russian mining sector, in which the great majority of deposits are low grade. It is said that the system would be more appropriate for a mining industry characterized by high-grade ores such as Australia's.[37]

In the mid-1990s the sector's resource tax payments were steady at around RUR 300 million per annum, with the taxes' share of the overall tax burden roughly the same as for the economy as a whole (Table 4). However later in the 1990s the level of payments increased sharply, reaching RUR 1.6 billion in 1999.[38] Those payments by the M&M sector can be compared to the RUR 4.12 billion paid by the oil extraction sector, RUR 1.48 billion by the gas sector, and RUR 385 million by the forestry sector in 1999. Further increases were budgeted for in the 2001 budget.[39]

Critics of the resources tax burden on miners claim that it is helping produce a crisis in the sector. The Levy in particular, designed to fund geological work and ensure the adequacy of mineral reserves, is in fact having the opposite effect. The state which collects the money has neither the will nor the capacity to spend it on its stated purpose; the mining enterprises themselves, who in a market economy one would expect to fund their own geological work, have no money, not least because of the tax burden they bear. The result is a looming major minerals deficit.[40]

Road and transport tax

Although the mining sector is particularly upset about its liability to resources taxes, it did in the mid-1990s represent the smallest tax category in Table 4. It is overshadowed by one innocuous sounding tax category, road and transport tax. In Table 4 it makes up 13.5% of the M&M sector's tax burden, as against 6.0% for resource taxes and 5.5% for the economy as a whole.[41] The data suggest that complaints that this tax discriminates against the sector, with its need to shift bulk loads over long distances, have some validity. The tax is 2.5% of gross revenue (minus VAT), with 0.5% going to the Federal Road Fund and 2.0% to the regional fund.

Social fund payments

Another even bigger burden for the sector, although not one from which it suffers significantly more than other sectors, are various social fund payments. According to Table 4, such payments represent 29.9% of the tax burden and are made to the Pension Fund (28% of the wages fund, reduced to 20.6% in March 1999), the Social Insurance Fund (5.4% of the wages fund), the Federal Employment Fund (2.0% of the wages fund), and compulsory health insurance (3.6% of the wages fund).[42]

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[36] Gornyi zhurnal, no. 3, 1999, p. 62.

[37] Gornyi zhurnal, no. 3, 1999, p. 63.

[38] Unpublished government data; Gornyi zhurnal, no. 7, 1998, p. 4.

[39] Metallurg, no. 9, 2000, p. 7.

[40] Gornyi zhurnal, no. 3, 1999, p. 62; Tsvetnye metally, no. 10, 1999, pp. 4-8.

[41] One 1996 source stated that road and transport levies took 14.9% of profits. Delovoi mir, 24 April 1996, p. 1.

[42] Metallurg, nos. 11-12, 1993, pp. 7-9; Chernaia metallurgiia, nos. 5-6, 1999, p. 74.

It is a burden that depends on the size of the workforce and the level of wages paid. Although the M&M workforce has been cut during transition, the decline has been nothing like the workforce cuts during the restructuring of the Western metals sector in the 1970s and 1980s.[43] The sector, particularly among the non-ferrous producers, pays above-average wages,[44] something reflected in the sector's slightly higher than average social fund burden.

Export duties

Although not strictly speaking a tax and not included in tax statistics, export duties have become a major and volatile part of the M&M sector's government-imposed cost structure. They clearly affect the price and therefore competitiveness of Russian metal producers on world markets. They are levied for two declared reasons: to raise revenue, and as a policy instrument to reduce levels of exports and thereby increase the supply of metal to domestic buyers.[45] In the wake of the August 1998 crisis revenue-raising duties were introduced by the Primakov government, comprising 5% on ferrous products and primary aluminium and up to 10% on copper, zinc and nickel. The duties have been subject to constant adjustment and temporary withdrawal, but are still seen as a legitimate form of revenue raising.

Regulatory export duties have been applied above all to ferrous and particularly non-ferrous scrap exports. Set for some time at 20%, there has been considerable pressure from domestic metal producers to raise them to 50%.[46] Producers claim to have been hard hit by shortages and high prices for scrap as ever-increasing amounts are exported. It is one issue which, in terms of the sectoral lobbying to be described in the second part of this paper, splits the sector, with the influential scrap enterprises pushing hard for the removal of the duties.[47] Not surprisingly, nevertheless, the producers won the day, and the 'official' position of the sector is for the imposition of high regulatory duties.[48]

Local taxes

Most of the data and commentary in this paper concern federal taxes. However probably more than half of the total taxes paid by M&M enterprises are paid to regional and local authorities. As seen above, Russia's regions receive a share of a number of federally collected taxes, including VAT and resource royalties. Only about 40% of profits tax goes to the federal budget.[49] Regional and local authorities collect a further vast range of taxes and charges which vary greatly from locality to locality. They include levies on housing and social-cultural facilities, and for the provision of police and municipal services. It should be noted that electricity tariffs,

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[43] The workforce in the Russian ferrous sector declined from 772,000 in 1991 to 673,000 in 1997. Among US integrated steel producers employment levels have dropped by over 75% since restructuring began in the mid-1970s., Chernaia metallurgiia, nos. 1-2, 2000, p. 9; Ahlbrandt, Roger S. /. Fruehan, Richard J, / Giarratani, Frank: The Renaissance of American Steel. Lessons for managers in competitive industries, Oxford University Press, New York and Oxford, 1996, p. 24.

[44] In November 1998 non-ferrous wages were 2.25 times average (fourth highest sector) and ferrous wages were 24.5% above average. Chernaia metallurgiia, nos. 3-4, 1999, p. 12.

[45] Andrei Kushnirenko, head of the tariff policy department of the Ministry of Trade, refers to the fiscal and regulatory functions of export duties. A trade ministry to raise export tax on some commodities, in: Inside-news, 19 November 1999, citing Reuters, Moscow, 18 November 1999.

[46] Kommersant, 15 April 2000, p. 5.

[47] See the debate at the 1999 Duma conference on the metals industry. Metallosnabzhenie i sbyt, no. 2, 1999, pp. 14-26.

[48] See the position of Shevtsov, the head of metals department of the Ministry of Economics, in: Vedomosti, 23 September 1999, p. B4.

[49] Chernaia metallurgiia, nos. 7-8, 1998, p. 6.

imposed by local suppliers under the influence of regional governments, are openly described as a form of taxation, and indeed at times as a punitive tax.[50]

It should also be remembered that large M&M enterprises make up a major proportion of the tax revenues of a region or locality. Thus in 1999 the Norilsk Nickel Combine contributed 53% of the tax revenues of Krasnoiarsk region, 88% of those of the city of Noril'sk, and 75% of those of the Taimyr Autonomous Region.[51] This makes such enterprises of enormous sensitivity for local leaders, with regional governors in particular being able and willing to deal very sternly with enterprise owners who are not paying their way.[52] Nevertheless governors still struggle to get their full measure, as can be seen from figures for Sverdlovsk region, run by the tough Eduard Rossel. There in 1998 nearly 50% of profits and over 60% of industrial profits made in the region came from the metals sector. However the sector provided only 21.5% of corporate taxes, 42.7% of the total coming from industrial corporations.[53]

Who is milking whom?

Do these details on taxation in the M&M sector in the 1990s, as sketchy as they are, allow us to come to any conclusions as to the nature of the Russian political economy? As an intended or unintended consequence of its general economic reform policy, the government has reduced a highly industrialized economy to a 'raw material appendage'.[54] Will it now be forced to rely on the excessively high taxation of the resource sector in order to have any budget revenue at all? While much of the focus of such analysis is on the oil and gas sector, it can be equally applied to the M&M sector, including its implication that such excessive taxation will eventually, and quite possibly sooner rather than later, destroy the goose that lays the golden eggs. That claim is made particularly sharply with regard to the miners and the future of Russia's mineral reserves.

Or is the Russian economy rather one where the resource sector, including M&M, has attracted, because it is one of the few areas of the Russian economy with an export-oriented comparative advantage, an unsavory collection of asset-stripping and influence-peddling entrepreneurs who through their commercial activities and their ability to transform commercial gain into political influence deprive the Russian state and people of a reasonable share of the proceeds from the exploitation of the raw material assets of the country?

Hopefully without having to face such extreme possibilities, any taxation system has to find a balance between a fair, just and socially efficient distribution of wealth and income among all members of society, on the one hand, and allowing particular parts of society to retain a sufficient proportion of the wealth and income they generate to provide both the incentive and the resources to continue their wealth generation into the future, on the other.

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[50] In 2000 the deputy chair of the board of United Energy Systems justified a mooted increase in electricity charges to the aluminium industry on the grounds that because of tolling the industry had not been paying sufficient tax and that UES deserved a cut from export earnings. Metallosnabzhenie i sbyt, no. 6, 2000, pp. 22-23.

[51] Tsvetnye metally, no. 6, 2000, p. 9.

[52] As evidence one need look only at the fate of Anatolii Bykov, a major shareholder in the Krasnoiarsk Aluminium Factory, and now in prison on conspiracy to murder charges following a falling out with Krasnoiarsk governor Aleksandr Lebed. Mikhail Zhivilo had major interests in Siberian ferrous and non-ferrous metals until Kemerovo governor Tuleev turned against him. He is in Paris fighting extradition proceedings on charges of conspiracy to murder the governor. In both cases it is suggested the souring of relations was related to disagreements over the size of the cut of enterprise profits the region and its governor were entitled to.

[53] Metallosnabzhenie i sbyt, no. 1, 2000, p. 73.

[54] Conservative opponents of Russian economic reforms during the 1990s, of whom Sergei Glaz'ev is a prominent representative, argue that those reforms have worked to destroy Russia's industrial and technological capacity, leaving the country with no choice but to rely on low value added resource exports, i.e. become a 'raw material appendage' of the industrialized world. See Fortescue, Stephen: Policy-Making for Russian Industry, Macmillan, Basingstoke and London, 1997, p. 28. For analysis of the technological downgrading of the sector's product range, see Fortescue: Globalisation.

The combination of the particular complexity of those distributional issues in the Russian case and the extreme opacity of the financial condition of the M&M sector ensures that on both philosophical and practical grounds we will arrive at no single and correct answer to our question, who is milking whom. Further, a full answer to the question requires a judgement as to whether investment levels in key Russian economic sectors, generally seen as low, reflect enterprises stripped of cash required for investment by a rapacious government or by rapacious owners. It is not, therefore, our intention here to answer the question fully, but rather to summarize what the operations of the tax system tell us about the issue.

Firstly, the evidence does suggest grounds for complaint on the part of the mining component of the M&M sector. It could be seen as particularly hard done by because of the focus on non-profit related taxes, it being generally a low-profit sector. The assets tax burden seems inappropriate in the circumstances, particularly if it inhibits a generous depreciation regime.

Clearly if the Replenishment Levy is not being spent on what it is set aside for in the legislation, the miners paying it have grounds for complaint. However that does raise the question of who should most appropriately fund mineral exploration: the state, whether funded by a levy imposed on the mining sector or out of general revenue, or the sector directly? One hesitates to assume that a mining sector more lightly taxed and left to its own devices would adequately fund mineral exploration, but it is unlikely that it would do worse than today's state.

The data also suggest that the mining sector receives no favors in comparison with other resource sectors, particularly the gas industry. One might justify the resource-related taxes on environmental grounds, and might also claim that to treat the sub-sector more generously would be a form of subsidization of mining enterprises which in terms of ore quality and accessibility are in fact not competitive. Nevertheless, overall the sub-sector's tax burden appears to be heavy and such as to at least contribute to low profitability and lack of funds for its future development. Those mining enterprises which are not moribund are very susceptible to takeover by metal producing enterprises, suggesting that there is something wrong with their profitability levels.

It is at the metal producer level that ownership in the M&M sector is concentrated, and it is there that the most persistent accusations of tax evasion on a massive scale are made. One notes with some sympathy the sector's volatile profitability and accepts that this could be based on market volatility and exchange rate movements beyond the sector's control. However one also notes the savage, at times literally murderous, struggles for control over assets which were at the time being described as unprofitable. One also notes the levels of capital flight, some proportion of which one strongly suspects comes from trading operations in metals. It could be said that there is something suspicious about the level of both VAT and profits taxes in the metal sector. But having said that, there is evidence, to be seen in Table 4 and other places, that even the metal producing component of the M&M sector pays a disproportionate level of tax compared to other sectors of the economy, primarily it would seem as a consequence of high assets tax liabilities. While one appreciates the claims that assets taxes, in their discrimination against capital-intensive industries and indifference to poor profitability, are unjust, in this particular case they could well be offsetting some highly illegitimate behavior by their victims. The same could be said of export duties. Nevertheless one could hope for a less arbitrary and longer-term approach to solving the problems of 'bandit capitalism' than the relatively arbitrary imposition of non-performance related taxes.

Recent changes to tax arrangements in the M&M sector

Regardless of how an outside commentator might see the reasonableness or otherwise of the form and levels of taxation in the M&M sector, sector participants themselves have long made it clear that they are unhappy and have lobbied hard for changes.

One assumes that there has been a degree of insider lobbying by powerful businesspeople with political clout. Having said that, it should be recognized that there are few top-flight oligarchs in the M&M sector. Potanin is the only 'classic' example, moving from the financial sector to the 'real' economy with the generous assistance of the shares-for-credit deals in 1995. Potanin, however, was unusual in moving into the M&M sector, specifically Norilsk Nickel. Generally the M&M sector is owned by industry insiders, albeit of a post-Red Director generation. While significant figures in the industry, they do not appear to have the financial clout and political connections to operate at the highest oligarch levels. Only Oleg Deripaska has emerged from the industry into something like oligarch status. Even before teaming up with an oil baron, Roman Abramovich, he was powerful enough to push through the 'end' of tolling, something the rest of the aluminium industry had been resisting for a number of years.

Perhaps because the M&M ownership elite are not top-rank oligarchs, most of the sector's lobbying that we can discern has been undertaken by formal sectoral bodies and officials.

State sectoral bureaucratic agencies

Since the collapse of the Soviet Union there have been regular restructurings and steady downsizings of the state bureaucratic agency responsible for the M&M sector, the successor body of the old Ministries of Ferrous and Non-Ferrous Metallurgy. From 1992 to 1997 the main body was the Committee for Metallurgy (Kommet), although throughout that period there was also a metals department within the Ministry of Economics, the direct descendent of the metals department of the old Gosplan.[55] When Kommet was abolished, the Ministry of Economics unit, under the name Department for the Economics of the Metallurgical Complex (DEMK), became the sole sectoral agency in the central bureaucracy. Most recently the new Ministry for Industry, Science and Technology has within it a Department of Metallurgy.[56] It is unclear whether any unit remains in the Ministry of Economics.[57]

These agencies have invariably presented themselves as above all lobbyists for the sector, thus publicly opposing the rouble corridor, supporting tolling and pushing for tax changes. One might apply to M&M state agencies the claim, made in the context of Russia's widespread corruption, that 'ambitious tycoons have managed to acquire entire ministries'.[58]

'Peak' associations

There are a large number of sectoral trade and business associations. Some, such as 'Aluminium' and 'Rudprom' (Ore industry), have their origins in the *glavki* (sectoral administrations) of the old Soviet Ministries of Ferrous and Non-Ferrous Metallurgy. Others are post-Soviet creations, closer in form to Western sectoral trade associations. The Association of Industrialists of

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[55] On these agencies, see Fortescue: Russian mining and metals sector, pp. 206-11; Fortescue: Policy-Making for Russian Industry, chapter 4.

[56] Metally Evrazii, no. 1, 2001, p. 18.

[57] One notes that S. A. Stepanova, head of the Department of Metallurgy in the Ministry of Industry, signed the 2001 New Year greetings to the readers of Metallurg magazine. There is no signature from a Ministry of Economics official. However G. A. Shamanov of DEMK is still listed as a member of the editorial board. No. 12, 2000, pp. 2-3.

[58] The Economist, 19 December 1998, p. 122.

the Mining-Metallurgical Complex of Russia (AMROS) has official corporatist status, representing the employers in tri-partite negotiations with the government and the sector's trade union. It is headed by A. V. Sysoev, a long-time aluminium industry insider and general director of the Bogoslovo Aluminium Factory. He is willing to express very Red Directorish views while operating in the classic post-Soviet sector.[59] He is one of the most persistent spokespersons for the sector, with changes to the tax system being among his most urgent demands.

Other associations include the International Union of Metallurgists, headed by Serafim Kolpakov, the last Soviet Minister of Metallurgy; the Union of Metal Product Exporters, headed by Serafim Afonin, another senior ministry official of the Soviet era; the Russian Association of Metals Traders; and a whole range of sub-sectoral associations. The views of all these bodies tend to correspond closely with those of the sectoral state agency, with the exception mentioned above of the scrap metal association regarding scrap metal export duties.

Academic commentators

A feature of Soviet policy making was the use of academic research institutes as a source of policy studies, proposals and commentaries. It is a tradition which has not completely disappeared, with the major relevant institutes in the M&M sector being the Institute of Economics of the Central Research Institute for Ferrous Metallurgy and the Central Research Institute for Non-Ferrous Metallurgy. One wonders who wrote the virtually identical discussions of the shortcomings of natural resource legislation in two issues of Gornyi zhurnal. The first to appear, in early 1999, was signed by A. I. Sukhoruchenkov, the general director of Rudprom, and his deputy V. G. Evsin. The second appeared in mid-2000, signed by Professor M. E. Pevzner of one of the sector's research institutions.[60] Despite the later appearance of his version one suspects that Pevzner is the author.

As far as taxation is concerned the full array of lobbyists has been used. Academics from the two institutes mentioned above as well as many others publish articles in the specialized press. Anatolii Sysoev regularly writes on taxation issues, as do Shevelev of DEMK and Kolpakov of the International Union of Metallurgists. Officials and industry representatives sit together in such consultative bodies as the Coordination Council of the Metals Sector, set up by DEMK with leading enterprise, institute and association executives as members.[61] In 1999 AMROS, with its 'corporatist' partner, the Mining-Metallurgical Trade Union of Russia, lobbied for tax reductions, including sending a draft decree to the government entitled 'On measures for the optimization of the tax obligations of mining enterprises in the metals industry', a document which also had the support of the governors of the Sverdlovsk and Murmansk regions.[62] The DEMK included a list of tax proposals in its document 'Prospects for the development of the metals industry up to 2005'.[63] It has to be said that there has been no sign of those documents appearing in or as specific government decrees. However some of the proposals contained in them and their general tenor are evident in the new Tax Code which has been prepared in recent years.

The Tax Code, as a major piece of legislation, has to pass through parliament. The draft Code was considered by the Duma's Committee for Industry, Construction and High Technologies. Over 10,000 comments and proposed amendments were submitted to the Committee, including from AMROS, the International Union of Metallurgists and DEMK. For the consideration of

[59] Metally Evrazii, no. 1, 1997, pp. 67-68.

[60] Gornyi zhurnal, no. 3, 1999, pp. 62-64; no. 8, 2000, pp. 3-5.

[61] Chernaia metallurgiia, nos. 5-6, 1998, p. 89.

[62] Tsvetnye metally, no. 2, 2000, pp. 100-01. The two bodies also requested that tolling be retained for 1999.

[63] Metally Evrazii, no. 3, 1999, pp. 12-13.

these amendments, as they related to the M&M sector, the Committee constituted an Expert Committee for Metallurgy and the Mining Industry, chaired by A. Skoch, the deputy general director of the Lebedinsk Mining Combine.[64]

As part of the lobbying over the new code, industry representatives called most persistently for general reductions in profits and assets taxes, including the introduction of fixed upper limits to the amount of tax payable;[65] the increased use of differentiated rates according to the particular circumstances of the enterprise or sector;[66] a shift from the assets tax to a property tax;[67] a shift from VAT to a wholesale turnover tax, or failing that, at least the removal from the VAT net of construction and refitting work done within the enterprise;[68] and changes to depreciation rates.[69]

Tax changes

The overall strategy of Putin's tax reform has been a reduction in the tax burden and simplification of the tax system in order to encourage greater compliance. This is most evident in a low and flat income tax. The corporate sector has also gained from tax reductions, for example profits tax was reduced from 35% to 30% in September 1999.[70] The simplification is also evident in the replacement of the three main social fund taxes (Pensions, Social Insurance and Health) by a single social tax, although as shown in the relevant paragraphs of the new Tax Code, the 'single' tax still contains separate rates for each fund.[71] The sliding scales of the new rates, rates which apparently Putin wants further reduced,[72] makes it difficult to calculate how much of a saving they will represent for the sector. One commentator suggests as a minimum 2.9%.[73] It is curious that the social fund payments have never been a focus of industry complaints or lobbying, despite their high proportion of the overall tax burden.

The sector has achieved a small victory with the acceptance in the new Code of the removal of VAT from internal self-funded repair work.[74] However this seems less than the requested VAT relief on self-funded 'building and installation work, including mine development workings'.[75] The sector was not able to win VAT exemptions for the import of domestically unavailable equipment, much less any hint of a move from VAT to a wholesale turnover tax. Interestingly the new Code would seem to reinstate the zero VAT rating for the processing of products 'under customs regimes', i.e. for tolling.[76]

The sector is promised tax relief in the future in areas that will be of particular benefit to the miners. The road fund is to be abolished from 1 January 2003, although it is pointed out by one commentator that it will actually increase in the meantime.[77] The other big irritant for the mining industry, the Replenishment Levy, was also slated for abolition in Putin's original 'special

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[64] Metallurg, no. 7, 2000, p. 33.

[65] Metally Evrazii, no. 4, 1999, pp. 63-64.

[66] Gornyi zhurnal, no. 7, 1999, pp. 47-48; Chernaia metallurgiia, nos. 1-2, 2000, p. 12.

[67] Chernaia metallurgiia, nos. 3-4, 1997, p. 8.

[68] Metallurg, no. 7, 2000, p. 33.

[69] Metally Evrazii, no. 6, 2000, p. 19.

[70] Chernaia metallurgiia, nos. 5-6, 1999, pp. 73-74.

[71] Nalogovyi kodeks, part 2, art. 241. The Employment Fund is apparently to be abolished. Metallurg, no. 8, 2000, p. 13.

[72] Putin calls for reduction in single social tax, in: RFE/RL Newsline, vol. 5, no. 81, Part 1, 26 April 2001.

[73] Metallurg, no. 8, 2000, p. 13.

[74] Metallurg, no. 8, 2000, p. 13.

[75] Metallurg, no. 7, 2000, p. 33.

[76] Metallurg, no. 8, 2000, p. 11.

[77] Metallurg, no. 8, 2000, p. 14.

tax message' to the Duma and the Ministry of Finance's subsequent commentary.[78] The government apparently intends soon to send to the Duma the chapters of the new Tax Code dealing with resource taxes, with a single tax to replace the current royalty and Replenishment Levy. It is said that the new tax will be based on a halving of the current Replenishment Levy and a newly calculated royalty element.[79]

The area where it is recognized that the greatest benefit could come to the sector is the assets tax. There would have to be change in this area if the prediction of Sergei Shatalov, first deputy Minister of Finance, that the tax changes will lead to a redistribution of the tax burden away from capital intensive sectors such as the metals industry were to be realized.[80] Putin originally promised that the assets tax would be replaced with a property tax.[81] That, if and depending on how it were to be implemented, could indeed make a difference for M&M enterprises, and would also make feasible a more attractive depreciation policy. There is, however, no sign at this stage that Putin's proposal is proceeding.

Another key aspect of Putin's tax reform is an attempt to shift tax revenues from the regions to the federal center. That does not necessarily mean, of course, any reduction in the tax burden, but enterprises that dominate their regions, as many in the M&M sector do, might feel that they would be better off under a more distant tax collector more likely to impose uniform tax rates across the country. However one already sees signs that enterprises might end up paying more taxes to the center, but without being able to get away with reduced payments to the regions. In April 2001 the Belgorod regional government, which under the tax reforms was due to have its share of taxes collected in the region cut from 65% to 52%, signed an agreement with the Stoilen Mining Combine that the latter will pay a guaranteed RUR 188 million to the administration in 2001, RUR 11 million more than the previous year. The agreement included a commitment from the enterprise to support a whole range of the administration's social programs as well as a diversified investment program.[82] One doubts that a Putin tax reform and even his regional political changes will be enough to get regional and local governments off enterprises' backs.

It is still too early to come to firm conclusions on the effect of the tax changes on the M&M sector. The consequences of changes already legislated are not yet clear, to say nothing of mooted changes that have not yet appeared in legislation. Neither is it easy to determine whether the changes will affect the 'who is milking whom' question. So far it is the changes that have been promised but not yet implemented that would bring the greatest benefits, particularly to the mining sector - a move from the assets tax, the abolition of the Replenishment Levy and the road tax. Only if those are implemented could one see the shift in the tax burden away from the capital-intensive sector predicted by Sergei Shatalov. While the capital intensive sector is not the same thing as the resource sector, those are the changes nevertheless that would be needed to address the hypothesized scenario, that the resource sector, the M&M sector included, is being so heavily milked by the state through its tax system that the cow is in danger of going dry.

If however the situation is rather one of the sector draining away the wealth of the nation, the mooted changes would make things worse. It certainly would not meet the demands of more

[78] Kommersant, 24 May 2000, p. 1; 13 October 2000, p. 4. The latter source states that Putin, along with regional governors, is opposed to the levy's abolition.

[79] Ernst & Young: Russian Business Brief, April 2001.

[80] Kommersant, 4 November 2000, p. 4.

[81] Kommersant, 24 May 2000, p. 1.

[82] Belgorod governor signs enterprise treaties to avoid Putin tax reform losses, in: Russian Regional Report, East-West Institute, vol. 6, no. 15, 25 April 2001.

conservative economists that the tax burden on the resource sector be increased.[83] The stated aim of the reform is to encourage a higher level of tax compliance through the introduction of a more reasonable tax system. One doubts very much whether the carrot offered is enough to convert high-level tax evaders into model taxpayers, particularly when there are no signs of a more effective stick being deployed. While the single social tax might reduce the level of tax-avoiding employment and remuneration practices, those are relatively marginal issues within the M&M sector. The cuts in profits tax are unlikely to have any effect on the incentives to reduce the levels of declared profits. There is nothing in the new Tax Code or any other sphere of government activity to suggest that Putin's much vaunted anti-oligarch 'stick' is to be used against transfer pricing and capital flight.[84] While one notes the Duma's recent acceptance on the first reading of a government-sponsored bill on money laundering,[85] it is overwhelmed in symbolic and practical terms by Putin's distressingly selective anti-oligarch campaign, the total lack of action with regard to inadequate corporate governance, the apparent immunity of shadowy offshore trading companies, and the continuing high levels of capital flight. These are not things that can be dealt with by a tax system alone, but the current tax changes appear to have minimal regard for them anyway. It might be going too far to see tax reform as a victory for the resource-based oligarchs, but it is even harder to see it as a contribution to their taming.

[83] 'High taxes on the extractive industries would ensure that the Russian people are the main beneficiaries of the export of natural resources'. From the joint statement of Russian-US economists, New agenda for economic reform in Russia, in: Nezavisimaia gazeta, 9 June 2000, reproduced in English in the World Bank's Transition, May-June-July 2000, p. 21. See also Sergei Glaz'ev's plans to add to tax revenues by introducing new taxes on natural resources. As another committee considers new taxes, in: RFE/RL Newsline, vol. 4, no. 24, Part 1, 3 February 2000.

[84] Putin warns oligarchs that the state carries a big stick, in:, Monitor, Jamestown Foundation vol. 6, no. 201, 27 October 2000.

[85] Duma backs anti-money-laundering bill, in: RFE/RL Newsline, vol. 5, no. 100, Part 1, 25 May 2001.

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