



Center for Social & Economic Research

# Budget Crisis in Russia

by

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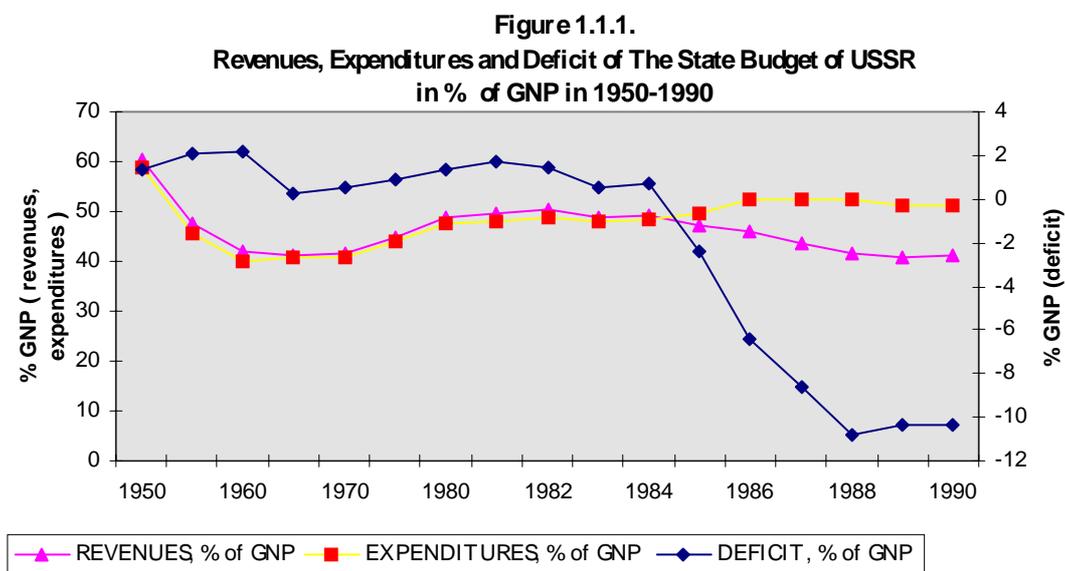
## 1. Economic transformation and macroeconomic changes in Russia

In the end of 1991 dissociation of the Soviet Union and formation of new independent states out of its former republics took place. As an independent state, Russia exists since 1992. This event defined the period under consideration in our study: 1991-1994. Only starting from 1992 the Russian budget system has begun to perform the whole complex of the functions peculiar to any independent state. Before that Russia was a republic in a federal state where finances were highly centralized. In our opinion, any attempts to reconstruct Russian budget before 1992 taking into account all the proceeds generated in its territory from the Russian and state budgets cannot be correctly done due to lack of the necessary statistics.

Hence before 1992 the subject of our studies (except specified cases) is the Soviet Union budget system.

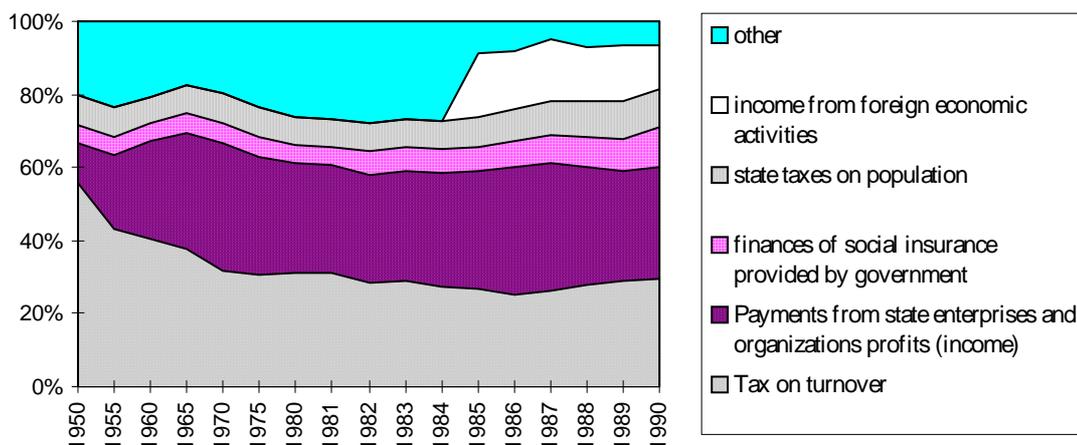
### 1.1. Pre-conditions of the budget crisis in Russia in 1991-1994

After World War II and up to beginning of the 1980s the Soviet Union budget system showed a high degree of stability, lacks any serious fluctuations in volumes and setup of income and expenses, non-existent or small deficit covered, as a rule, by the budget balances in the beginning of a year (Fig 1.1.1).



The main income sources of the USSR consolidated budget were the enterprises' profit payments, turnover tax, income tax exacted from population, foreign economic activities income (Fig 1.1.2).

Figure 1.1.2. Structure of the Revenues of State Budget of USSR in 1950-1990



1985 has been a crucial year initiating a series of processes that triggered occurrence of an acute budget crisis in 1990-1991. A part of the said processes took place at the State's income side, the other - at the expenses side.

The unfavorable change in the foreign trade condition that was pronounced in the state of the energy carriers market is to be mentioned as the first factor of the budget crisis. Despite some growth of the crude oil, petroleum products and natural gas volumes export, State income provided by selling of energy carriers decreased almost twice in 1985-1990 owing to fall in the world prices.

At the same time a sharp decrease of importation of consumer goods occurred in 1985-1987. Consumer good imports cuts were an effort to make up for a fall in volumes of hard currency proceeds in order to preserve volumes of imports of machinery, equipment, materials, etc. Nonetheless the outcome of those cuts was a decrease of the turnover tax proceeds gained from selling of the imported consumer goods. In 1985-1986 share of imports of the consumer goods and raw materials for industry decreased from 36% to 31% in the total imports. The machinery and equipment share therein grew from 37% to 41%.

The second most significant precondition of the financial crisis in 1990-1991 was a vigorous boosting of processes of partial reforms in economy. In comparison with previous times when the enterprises that were not to be subjected to centralization have been determined in five-years plans and finalized in annual plans, and the whole balance confiscated from enterprises in the form of payments out of profit, since 1987 introduction of the new system of the state-owned enterprises management named "complete cost-accounting and self-financing" began. In compliance with that system each enterprise was to effect payments out of profit for funds, governmental and local budgets, deductions to an appropriate ministry. The remaining profit was shared between the cost-accounting funds of enterprises. In accordance with the USSR law "On state enterprise (association)"

enforced in January 1988, governmental order for product deliveries, economic standards, limits for resources assigned in a centralized way and a series of normative indices.

As a consequence of these novelties two serious changes in the nature of the USSR economy emerged. First, enterprises became keenly oriented to maximize their profit. Second, the circumstances providing the enterprises with opportunities to get the financial results incremented were brought about, because the governmental order was not covering the whole production program of an enterprise.

As a result enterprises proceeded to increase the profit volumes at a rapid rate, including also the part thereof that remained at their disposal, assigned for labor payments, material stimulation and social development (Table 1.1.1). Since 1988 rates of growth of the mean monthly wages increased from 2-3% up to 8-10% in 1988-1989 and 13% in 1990.

**Table 1.1.1. National economy profits, wages & income of population in 1980-1990**

	1980	1985	1986	1987	1988	1989	1990
Volume of profits	121,6	175,9	200,6	209,0	240,2	268,2	282,4
in % of previous year	105,4	105,4	108,8	106,9	112,3	109,0	103,9
parts of profits remained at disposal of enterprises & organizations in USSR in 1986-1990	41	45	46	47	50	52	51
mean monthly wage in national economy (rouble)	168,9	190,1	195,6	202,9	219,8	240,4	274,6
in % previous year		102,9	102,9	103,7	108,3	109,4	114,2
Monetary income of population (bil.roubles)	342,3	420,1	435,3	452,1	493,5	558	652,5
in % of previous year	125,9	122,7	103,6	103,9	109,2	113,1	116,9

Approximately since 1988 the enterprises obtained the opportunity to manipulate prices of the products manufactured in surplus of the state order, that formally were produced not by an enterprise itself, but co-operatives and other private and quasi-private entities (controlled by the parent enterprise), as well as products marketed through commodities exchanges, etc.

As a result, acceleration of the wholesale prices growth alongside with simultaneous preservation of a sufficiently rigid control over retail prices commenced. In the presented official statistics data (Table 1.1.2) the abrupt upward change of retail prices is observed only in 1991. This fact is attributed to use of the manufacturers' wholesale prices index, i.e. the index that does not take into account the foregoing techniques to evade the prices control.

The persistently enhanced degradation of the administrative control over wholesale prices with a sufficiently rigid control over retail prices preserved

resulted in reduction of the turnover tax budget receipts (Table 1.1.3). Moreover, the same trend in 1990-1991 was responsible for increased subsidies load on the budget.

**Figure 1.1.2. Dynamics of wholesale & retail prices in 1970-1991**

	1970	1975	1980	1985	1986	1987	1988	1989	1990	1991
Retail prices for consumer goods	100	99,7	103	105	102	101	101	102	105	189
Wholesale prices of enterprises & manufacturers	100	98,6	98,1	98,1	111,1	99,7	100,1	100,5	102,7	238,0

The third budget crisis factor is commencement of implementation of economic policy of "Speed-up of social and economic development" in 1985. This policy was aimed at a next stage of industrialization of national economy through rapid growth of investment volume.

This attempt to speed up the development was performed regardless the fact that the strict system of administrative management did not exist any more by that time, and all the means and stimuli that had been making it function had already degraded.

Investment volumes growth rates increased from 3% in 1985 to 8.4% in 1986 (Table 1.1.4). Afterwards the rates began to decrease once again up to 1990-1991 with start of fall of investments volumes. As a result, since 1986 a sharp growth of budgetary expenditures for investments occurred. Coincidentally, the "Speed-up" policy provided for increase of investments that were to be made by enterprises themselves. That induced reduction of budget receipts due to growth of the profit share withheld by enterprises and remained at their disposal in accordance with the production development central plans. Decrease of budget receipts from the enterprises profit deductions since 1987 is evident from the data presented in Table 1.1.3. From 1986 to 1989 the above-mentioned payments declined from 16% of GDP to 12% of GDP. The "Speed-up" also affected the imports setup in favor of means of production, and in the outcome was reduction of the turnover tax budget receipts.

The fourth factor owing to which the budget problems gained momentum and which was specific for the USSR: deployment of campaign against hard drinking and alcoholism in 1985 that reduced the turnover tax budget receipts. In comparison with 1984 sales of vodka and liquor in the USSR declined in kind in 1985 by 14%, in 1986 - by 45%, in 1987 - by 57%; wines, respectively, by 20%, 60%, 67%. As a result volumes of the turnover tax budget receipts (Table 1.1.3) reduced from 13.5% of GDP (in 1984) to 11.5% of GDP (in 1986-1987). Reduction of public revenues from the alcohol sales made up almost 10 billion roubles (slightly over 1% of GDP) during 1985-1988. Only in 1988 because of lack of enthusiasm in combating the hard drinking the turning point was reached.

Since 1989 a rapid growth of income from alcoholic beverages production and restoration of the traditional proportions of budget receipts began.

Table 1.1.3. STATE BUDGET OF USSR AS PER SECTIONS (mln.roubles, % of GDP) 1980-1990

	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990
GDP	619000	645000	702600	735400	764300	777000	799000	825000	875000	943000	1000000
	mln. roubles										
	% of GDP										
<b>INCOMES</b>											
Total incomes	302700	320635.2	353032.5	357912.1	376400	372600	371600	378400	378900	401900	410100
Tax on turnover	94109	15.2	100602	14.3	102722	13.4	91547	11.5	102994	11.5	121200
Payments from state enterprises and organizations (profits (income))	89819	14.5	102358	14.6	115556	15.1	129802	16.2	119656	13.7	116500
Tax income on cooperative & social enterprises & organizations	1718	0.3	1878	0.3	2612	0.3	2641	0.3	2825	0.3	6400
finances of social insurance provided by government	13957	2.3	22349	3.2	24528	3.2	26513	3.3	30077	3.4	43200
state taxes on population	24511	4.0	26638	3.8	28788	3.8	31227	3.9	35870	4.1	43500
income from foreign economic activities							64400	8.1	62631	7.2	75200
other	78586	12.7	99208	14.1	102194	13.4	25471	3.2	26868	3.1	4100
<b>EXPENDITURES</b>											
Total	294631	47.6	343150	48.8	371184	48.6	417100	52.2	459576	52.5	513200
National economy	161031	26.0	197289	28.1	211716	27.7	226300	28.3	242824	27.8	297500
Social & cultural services	98797	16.0	109556	15.6	119658	15.7	133700	16.7	151251	17.3	170000
Defences	17124	2.8	17054	2.4	17054	2.2	19063	2.5	20244	2.5	69100
Administration	2544	0.4	2638	0.4	2861	0.4	3000	0.4	3037	0.3	5100
Foreign economic activities	0	0.0	0	0.0	0	0.0	18000	2.5	26000	3.0	28500
Other	15135	2.4	16697	2.6	16463	2.6	4299	0.6	16169	1.8	43000
	% of GDP										

The fifth factor that is difficult to be confirmed quantitatively due to lack of appropriate statistics is attributed to growth of military expenditures connected with warfare in Afghanistan and a new turn in armaments race because of the tense international situation.

In the beginning of 1989 the budget situation started to raise serious anxiety among the governing circles of the nation. As a consequence, starting from March 1989 attempts to somehow strengthen the priorities of rigid budget policy were made. A series of governmental and party decisions were taken that determined necessity to reduce the investment growth rate, military spending cuts, continuation of alcoholic beverages production, increase of the consumer goods in the total volume of imports. These decisions also set the goal to restrain growth of social expenses.

However, the investment cycle that had started in 1984-1985 was not traditionally completed by way of correction of disproportions in the budget. Shrinkage of the governmental investment expenses in 1989 was terminating in a set of natural negative consequences: growth of number of uncompleted construction projects, increase of periods of industrial projects commissioning, reduction of production volumes in the industries, the dynamics of which were closely tied to investments volumes. Coincidentally, positive results of the investments expenses cuts were not achieved because of the abrupt growth of the social and subsidies load on the budget (Table 1.1.3).

Growth of social expenses was motivated by total liberalization of social life. The 1st Congress of People's Deputies of the USSR caused a splash of populism and expansion of social programs. Efforts to render the budget policy stricter underwent serious criticism. The pension reform was outlined, and relief programs for veterans, students, families with children, etc., were approved.

Growth of social expenses (by 1.2% of GDP) and the price increase subsidies (over 1% of GDP) in 1990 outweighed the effect of decline of the investment and defence expenses, growth of income from spirits and imports of consumer goods (Table 1.1.3).

In 1990 legal bases of the tax reform were provided, USSR laws on taxes imposed on enterprises and private persons and laws of procedure of their enforcement in Russian Federation were adopted. General direction of the tax reform in Russia on the whole agree with reform directions in East European countries. The reform included transition from the individualized distribution of profit between an enterprise and the budget to the tax on profits, transformation of the turnover tax and customs dues, modification of the personal income tax with introduction of tax returns, modification of the social insurance system and other items.

## 1.2. Economic policy in 1991

Thus serious changes in the USSR economy setup took place by 1991.

Traditional means of economy management, including planned tasks for enterprises concerning production volumes and efficiency of production, prices that were being fixed by the central government, funds and limits for deliveries of products and acquisition of resources lost their effectiveness abruptly. The background of this process was the total liberalization of social life in the course of which interests and stimuli that previously made the administrative management system work were deforming and vanishing.

In 1988-1990 the laws that provided foundation for future liberalization of economy were: Co-operative Law (1988), Banks Law, Central Bank Law (1988); State enterprise law (1987), Ownership law (1990), etc.

Nonetheless all these measures did not open ways for setting-up of the market mechanism of economic processes. They merely weakened the administrative means of enterprise management, provided managers of enterprises with a certain freedom for making administrative decisions under the circumstances when all the value parameters were utterly distorted and could not serve as goals for economic activities. As a result the products and resources deficit started to be regenerated in an increased scale, price growth and national income and formation of forced savings became more rapid.

To stave off these phenomena it was necessary to implement a complex of measures for liberalization of economy, but the central government failed to decide on a serious modification of the economic policy and kept on adhering to the course of partial reforms and petty improvements of the economy mechanisms. In consequence during the entire 1991 the material-financial disproportions were rising. At the same time postponing of radical changes every month was strengthening the social tensions and lending the future reform potentially a morbid nature.

In order to balance receipts and expenditures of the USSR budget for 1991 even formally the government went as far as to impose some additional taxes. The following taxes were imposed: wages fund tax assigned to the stabilization fund; the deduction rate for social insurance was increased up to 26%; a procedure for exaction of a part (20%) of enterprise depreciation charges was introduced; a procedure of mandatory sale of a part of hard currency proceeds realized by exporters was established.

These measures were to increase level of budget revenues, which in previous years accounted for 40-45% of GDP, to 55% of GDP. They were to make up for the following budget disproportions accumulated in the years before: growth of social expenses (budget and extra-budgetary funds), strong increase of the price

subsidies owing to a centralized raise of the agricultural products purchase prices (autumn 1990) and the industrial goods wholesale prices (January 1991).

But unreality of such projects was quite obvious. In the end of 1991 on the basis of the declaration of independence of the republic, laws concerning procedure of application of the USSR tax laws in territory of the Russian Federation were adopted. These documents initiated the beginning of the "budget warfare" during which the Union government strove to keep its control over the budget system, and the Russian government strove to ensure its autonomy.

In course of these processes that were disorganizing the economic life, legislative authorities and governments of all levels were making decisions that contradicted initial budget estimates. Personal income taxes and tax on profits rates were lowered, sales tax transformed from cumulative ad valorem tax (as it was provided for in the drafts) into an analogue of the value added tax; moreover, for numerous goods the zero sales tax was set.

Already in the first quarter of 1991 the lack of realism of the budgets adopted for the USSR and Russia was clear. As regards realization of their revenue sides, the emerging state of affairs was catastrophic: only about 40% of the Union budget was realized, and 60% of the Russian.

An effort to improve the state of budgets of all levels was the retail prices reform implemented on April 2, 1991 and was devised to reduce considerably the subsidies load on the budget, enhance the turnover tax proceeds, diminish the sphere of application of the administratively controlled prices.

However, actually the retail prices reform that mostly implied their administrative rise did not result in any improvement of the budget situation. This is explained by degradation of traditional means of the centralized control over movement of prices and national income.

Stability of wholesale prices and national income freezing (over the established 85% of the prices rise compensation) were the main pre-conditions of the budgetary effectiveness of the price reform. But the government was unable to ensure these pre-conditions. Nominal money income rose in fact twice instead of the planned 1.3 times. Retail prices - 1.9 times instead of 1.6 times; wholesale prices - 2.4 instead of 1.95 times. In light and food industries, the enterprises of which were bringing to the budget the great share of the turnover tax, growth of wholesale prices was even greater: 3.1 and 2.6 times, respectively. The effect of these processes was such that the turnover tax budget receipts lessened in comparison with those that were planned, and budgetary expenditures both for compensation for the prices growth for the population and for support of the budget-supplied organizations, the military, investment expenses, etc.

In summer 1991 tension in relation between the Union and Russian governments was building up persistently. After suppression of coup attempt on

August 19-21, 1991 real self-dependency of the republics increased greatly so that the nation's budget system collapsed completely.

Starting from November 1, 1991 Russia terminated transfers of proceeds collected within its territory and agreed to finance till the end of the year the expenditures that previously were being covered by the Union budget and the economy stabilization fund.

Thus the situation concerning the Union budget realization can be studied only up to October 1991. According to the official statistics the Union budget for 1991 made up 83.2 billion roubles, and totally (including the all-Union extra-budgetary economy stabilization fund) 119.6 billion roubles. There was a deficit of the republic budget of the Russian Federation (taking into account settlement of difference of prices for the agricultural products at the expense of the credit resources). As a whole deficit of consolidated budget of the former USSR states increased from 10% of GDP in 1990 to approximately 13-16% in 1991.

But the aforementioned data do not include entirely all financial government operations. By evaluations performed by the World Bank the budget deficit was financed from the surplus (forced) savings belonging to population and enterprises. The monetary-credit system received from enterprises funds amounting to 10.3% of GDP (total enterprises' deposits in 1991 made up 14% of GDP). Funds from private deposits amounted to 21% of GDP. Active balance of Russia's external accounts made up 1.5% of GDP. Thus in 1991 Russia's budget deficit was rated at 30.9% of GDP (See *Russian Economic Reform. Crossing the Threshold of Structural Change*. World Bank, 1992).

### 1.3. Economic policy in 1992-1993

By the end of 1991 the lack of feasibility of a gradual conversion of the administrative economic system into a market one became obvious. Of course, legislative gaps, absence of the needed market institutions, overwhelming prevalence of state ownership, and a high level of economy monopolization were hindering the implementation of stabilization measures. Under such circumstances liberalization of markets and prices, with all macroeconomic proportions utterly out of balance, could lead the nation to hyperinflation. But a complete break-down of the financial system was not providing any time to take measures to perform an institutional transformation and a partial stabilization that would precede liberalization of prices.

Thus the aggregate financial situation described above accelerating decline of production and foreign trade volumes determined the necessity of implementing a complex version of economic reform in Russia within the shortest possible period.

### 1.3.1. Liberalization of prices and inflation processes

The carried-out liberalization of most prices merely legalized in practice the fact of a complete collapse of the system of the governmental centralized pricing and realized transition of inflation from its suppressed state into an overt one. The government's efforts to evade hyperinflation in the course of liberalization of prices and liquidation of the monetary "overhang" required enforcement of a tough budgetary and monetary-credit policy.

In January 1992, after liberalization of prices, their surge in comparison with December 1991 was 3.5 times for consumer prices, and 4.8 times for wholesale prices. In subsequent months up to summer of 1992 characteristic reduction of the inflation rates was to approximately 10% in a month as regards retail prices, and 12-15% as regards wholesale ones. In autumn the mean monthly increment of retail and wholesale prices reached 25-26%. By and large, during that year prices for consumer goods and services grew by 2600%, wholesale prices for industrial goods - by 3400% (Table 1.3.1).

As it was pointed out by different authors, change in prices in 1993 reflected, with a certain lag, dynamics of the main monetary aggregates (Table 1.3.1).

The rouble-dollar exchange rate grew in a year by 132% and reached 418 roubles by December 1992. Average exchange rate in that year was 248 roubles.

The aforementioned data represent a relatively tough monetary policy in winter and autumn of 1992. Rates of growth of M2 monetary aggregate were within the range of 9-14%. These figures are relatively small against the background of an abrupt fall of demand for money, and in that period that was the main inflation factor. By June demand for money, in the main, was stabilized, and inflation began to be determined essentially by growth of money supply. Coincidentally, rates of growth of cash mass increased considerably.

During 1992 when Central Bank credit volume grew 24.4 times, volume of credits for commercial banks increased 19.6 times, and credits for the government - 18.1 times. Credits for the rouble zone states, which began to be granted in February 1992, reached the amount of 1566 billion roubles in December. Credits for the government represented nearly 37.3% of the Central Bank's credit increase; credits for commercial banks - 38.2%; credits for the rouble zone states - 24%.

For credit investment the problems of support for national industry, agriculture and other sectors were being solved, and also efforts to surmount the enterprises' insolvency crisis were made. A marked seasonal fluctuation of the Russia's national economy influenced seriously such a considerable growth of the credit volume. In the end of spring large credits were allocated for agricultural manufacturers and enterprises responsible for goods supply to the Far Northern regions. Practically all those credits were preferential, and finances to serve them were assigned from the Republic's budget.

In July and in August rates of increase of Central Bank credit volume were extremely (50% in a month) high. And only in September they somewhat reduced.

Peculiarity of autumn of 1992 was implementation of a rather tough budgetary policy against background of a considerable growth of cash mass. In October and November volumes of Central Bank credit for the government practically had no increase, and growth of the central credit in the fourth quarter was mainly for account of the credits granted for commercial banks. A great role in this fact was played by offsetting of enterprises' mutual defaults.

In the beginning of 1993 high rates of prices rise persisted. But by and large, as it is evident from the presented data (Table 1.3.1), monthly rates of M2 cash mass growth in 1993 (16%) were somewhat lower than in 1992 (average 19-20%). At the same time the mean monthly rates of prices rise in 1993 (23%) were somewhat lower than in 1992 (21%), if the January sudden rise is not taken into account.

In 1993 serious changes occurred both in the cash mass setup, and in the sources of its growth. The mean monthly rate of increment of Central Bank credit in twelve months of 1993 amounted to about 14.6%. As this took place a considerable growth was observed in March, when credits for the Government were greatly increased.

Central Bank credit volume growth was 275%, and among them approximately 51.2% of this growth were credits for the government; 34% - for commercial banks; 13.8% - for the ruble zone states.

In the first two months over half of Central Bank credit was granted for CIS governments. Then the situation changed: since May Central bank stopped crediting the rouble zone states. These credits started to be channeled through the federal budget and decreased considerably.

In 1993 M2 totally increased by 316%. During that year share of the credits allocated for the government came to 51% of Central Bank credit growth; credits for commercial banks - 34%; for CIS - 14%.

Rouble exchange rate grew from 442 roubles per dollar in January 1993 to 1247 roubles in December. Rate of growth was 198%. Average exchange rate for that year was - 1034 roubles/USD.

Buildup of international reserves of the Russian Federation that were being generated mainly as a result of mandatory sale of a part of hard currency proceeds by exporters and purchase of currency by Central Bank influenced seriously the monetary situation in 1993. International reserves of Russian considerably increased in 1993 (from 2.8 billion dollars to 4.9 billion) and in the first half of 1994.

In 1994 Central Bank credit volumes growth was 213%. The mean monthly growth rate of Central Bank credit during twelve months was 11.2%. A

considerable increment was in the beginning of the year (in February - to 18%) and July-August (by 17%) owing mainly to growth of credits granted for the government.

By and large during that year M2 increased by 188.9%. The mean annual rate of increase came to 9.1%. In April M2 increase made up 17% and remained high in May-June (13%), and that was one of the causes of inflation in October (15%) - December (10%), thus confirming the hypothesis of 4-5-months lag between growth of cash mass and inflation. Inflation index in that year was 300% (by December 1993).

Rate of exchange of the rouble to the dollar by the end of that year was 3550 dollars: 184% more than in December 1993.

### 1.3.2. Banking system <sup>1</sup>

In 1992-1994 the banking sector was not subjected to any radical reforms, because changes therein were provided for before in RSFSR laws of December 1990: "On banks and banking activities in the RSFSR" and "On the Central Bank of the USSR".

Before 1989 the banking system had been a one -level system: there were six governmental specialized banks between which all customers had been shared. Any central bank in its proper traditional meaning did not exist, because the total volume of credits investments, distribution of credits between banks and directions of their use were being determined by the governmental plan. Since 1989 the process of advent of the first commercial banks started. But their number and sphere of operations were very insignificant.

Since 1991 growth of number of commercial banks started like an avalanche. All subordinate branches of the governmental specialized banks (except the State Bank) were declared independent in accordance with legal prescriptions. They were allowed to choose customers and grant credits autonomously. Instead of the State Bank the Central Bank of the Russian Federation and its territorial branches were established. The Central Bank according to the "Central Bank Law" deals with refinancing of commercial banks, manages the federal budget accounts, settles accounts between banks, issue licenses for banking activities and supervises commercial banks activities.

At first (in 1989) operations performed by commercial banks were limited to opening of settlement accounts and credits granting. Afterwards bank obtained permission to render cash services for customers. Since 1991 the second level banks were allowed to handle foreign currency operations, both inside the country and abroad. Furthermore, commercial banks carry out operations with government

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<sup>1</sup> This section was compiled by G. Gritsenko

securities and those of non-financial corporations; leasing and trusteeship operations.

Up to 1992 settlement of accounts between banks was being carried out by method of inter-branches clearings. Such system of settlements, being a left-over of the one-level system, did not agree with the two-level banking system because it gave some banks the opportunity to pay their customers' invoices at the expense of other banks without any formal conclusion of an agreement on interbank credit. For this reason during 1992 all the commercial banks were ordered to perform settlement through correspondent accounts, which were opened either at the Central Bank settlement-cash service centers, or directly by a bank with some other bank.

In 1992-1994 growth of number of new commercial banks was accompanied by closing or restructuring of the already existing banks. Subjected restructuring by merger were those banks, which were unable to fulfill demands of the supervising authorities in respect of observance of the liquidity standards, and only through merger with other banks could avoid closing. Licenses for banking operations were withdrawn from a series of banks because either due to insolvency of their customers, or owing to risky crediting operations those banks let themselves to incur heavy losses, and their indebtedness to other banks overdrew the reserve accounts.

### 1.3.3. Liberalization of foreign trade<sup>2</sup>

By beginning of 1992 reform of foreign economic activities in Russia in its evolution had gone through a number of stages. At the onset of perestroika destruction of the government monopoly over foreign economic activities began. The right for direct carrying-out of export-import operations obtained 21 USSR ministries and all the republics of the Union. In 1988 practically all the industrial ministries obtained this right by the enactment of the government. Already by the end of 1988 the number of enterprises entitled to have direct approach to the world market exceeded 200. By the end of 1990 around 26 thousand such enterprises were registered, but extent of their transactions still remained rather insignificant ( in 1988-1990 their share came to only slightly over 1% of the trade turnover).

For the purpose of development of money market the free sale and purchase of currency funds for roubles at "contractual" prices at the currency auctions that were arranged by Foreign Economic Activities Bank of the USSR since November 1989. This technique was somewhat modified by the Presidential Decree of November 02, 1990, which provided for establishment of a special fund whereto exporting enterprises were bound to sell 40% of their currency proceeds bought by roubles at the commercial exchange rate.

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<sup>2</sup> This section was compiled by S. Prikhodko

In March 1989 the list of products (works, services), importation and exportation of which were subject to licenses. Initially this list of products of mandatory licensing in case of its exportation comprised comparatively a small number of items of fuel and raw materials goods constituting a significant part of exports in respect of its cost. Later this list was extended. Up to 1991 over 90% of export items were subject to licensing.

In 1992 measures of liberalization of foreign economic activities were accompanied by toughening of ever stricter administrative regulations. In the territory of the Russian Federation allocation and licensing of exports was introduced. Since January 1992 the mandatory sale of 40% of currency proceeds at the special rate and 10% at the market rate, and exports dues were introduced.

Up to the middle of 1992 imported commodities were free of imposition of customs duties, and that facilitated an abrupt growth of consumer goods imports. However in July initially the temporary customs tariff, and starting from September - the standing tariff were introduced. Also in July limitations on strategically important raw materials goods by way of introduction of the special exporters status were enforced. On the other hand, since July 1992 the universal floating rate of exchange of the rouble to dollar became effective, limitations on sale of foreign currency to private persons and mandatory sale of currency at a fixed rate were abolished.

Measures aimed at restraint of exports (customs duties, licenses, quotas, mandatory sale of currency) turned out to be more effective than any stimulation measures. Attempts to halt the sharp decline of exports, that meant a reduction of volume of currency proceeds needed for the required imports, failed. Exports of the products exempted from regulation was decreasing at the rates 1.5-2 times higher than the mean ones.

The budget situation was most seriously affected by introduction of the system of subsidies for centralized purchase of imported goods whereby subsidies coefficients were used.

In 1993 stimulation of export activities was handled by means of strengthening of governmental regulation in combination with an effort to create a protective treatment of trade for the fuel-power generation, agro-industrial and engineering complexes industries. Already by the end of 1992 the special exporters institution was reduced considerably and in the beginning of 1993 allocation procedure for wood and timber exports was restored. At the same time the fuel-power complex was given the customs and tax preferences for export deliveries within the range of governmental needs. By the end of 1993 export duties rates were reduced in average 50% and the list of goods subject to them was diminished almost twice. But proceeds of currency finances provided by the export activities proved to be considerably lesser than expected. Allocations and exportation preferences granted to the centralized exporters were not recouping themselves.

Russian imports in 1993 experienced a hard period caused by abolition of the centralized imports subsidies and the enforced customs and tax policy. During 1993 imports volume fell by 27%. In the first quarter of 1993 the value-added tax on imported goods was imposed, customs duties for imports were increased. During the whole year excise rates were being revised, and as a result by the end of that year they became for certain kinds of goods (for instance, vehicles) became prohibitive. In November 1993 the customs duties were increased once again, and in December the regulations concerning importation by physical persons was changed to be more tough.

Presidential Decree of May 23, 1994, No. 1007, titled "On abolition of allocation and licensing of export deliveries of goods and services", which true enough, was given some corrections, became an important document that confirmed new rules of the foreign economic activities control. Detailed enactments that completed the above-mentioned Decree preserved for the entire 1994 all the former tariff preferences regarding deliveries of crude oil and petroleum products.

In 1994, as before, the goods exported from the the Russian Federation customs territory within the volume limits of deliveries for export to meet federal government's needs, were exempted from customs duties. Since January 01 crude oil, oil gas and products of their processing were exempted from duties against the exports allocations for governmental needs. The material resources to be used in industry that were being purchased by the oil complex enterprises for account of amount received from export of crude oil, oil gas and products of their processing also were not subject to exaction of the imports dues.

In 1994 five export modes were in force: crude oil and petroleum products export regime; strategically important raw materials exports regime; regime of delivery of the goods that were exported in compliance with Russia's international commitments; regime of the special export procedure (weapon, dual designation goods, medicine, nuclear materials, etc.); exports contracts registration regime.

Since July 01, 1994 new rates of the imports tariff are in force in the Russian Federation. The greatest impact of changes in the dues rates was rendered to the foodstuff goods, the most part of which up to the recent time was imported without any duties at all.

Since January 01, 1994, new special tax on the imported goods was introduced; exported goods, both home-made and acquired, exported services and works, certain kinds of goods were exempted from the value-added tax in case of their importation to Russia.

In 1994 sale of goods and services for the population for currency cash was terminated. The procedure of transfer of goods across the customs border by physical persons, which are not assigned for industrial or any other commercial activities, was changed: duty-free importation amount was decreased 2.5 times.

### 1.3.4. Privatization<sup>3</sup>

Since November 1991 the activities in the field of practical introduction of privatization gained strong momentum. Government of B. Yeltsin - E. Gaidar, having at the outset proclaimed the privatization as one of the key components of the economic reform, pressed forward the development of privatization enactments, but at the same time had no real possibility to gain any management control over the privatization process immediately. For this reason one of the peculiarities of the said government's economic reform program was liberalization of prices prior to start of a large-scale official privatization.

This is accounted for by impossibility to expect completion of the "large" privatization due to extreme deficit of goods in 1991, as well as an intensive spontaneous privatization.

As early as on December 29, 1991, "The main provisions of the program of privatization of governmental and municipal enterprises in the Russian Federation for 1992 were adopted, and their implementation began since January 01, 1992. The Main Provisions actually became the first document regulating the practical privatization process and actuating the programmed (i.e. not spontaneous) privatization in Russia. Nowadays the normative basis of privatization in Russia comprises over 200 only key documents.

Regardless all that tensions of the political dueling respect of Russian privatization problems "at high and nether places", the actual privatization process in 1992-1994 was developing with a sufficient intensity. Within the scope of the lesser privatization program by July 01, 1994, in Russia over 40% of all small enterprises were privatized; more than 70% of privatization applications were fulfilled. In the course of "bigger privatization" by July 01. 1994 on the basis of medium and major state-owned enterprises over 20 000 joint-stock companies were established. In the middle of 1994 number of shareholders of the newly set-up joint-stock companies or cheque investment funds was about 40 million.

In the Russian privatization program a special place was assigned for the cheque privatization. Decision on the cheque model (summer of 1992) as a method of stimulation of the privatization process in Russia was being made under the circumstances of lack population's solvent demand.; "zero" interest in privatization in Russia for part of foreign investors; presence of over 240 000 governmental and municipal enterprises (which required standard privatization procedures); necessity of a maximum high pace of legal privatization process for the purpose to interlock the intensive spontaneous privatization and ensure the irreversibility of economic reform in general; necessity of the moat immediate and massive formation of new social strata not interested in a communistic revenge.

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<sup>3</sup> This section was compiled by A. Radyghin

Al these economic and political factors themselves determined development and launch of Russian cheque model. What were strategic goals?

The real goal was only one: temporary large-scale redistribution and fixation of the private ownership rights in Russia with a minimum of social conflicts with the aim at further transactions in favor of really effective responsible owners. Taking into account the conditions under which the privatization process in Russia had started, and the said real goal of the Russian version of the mass privatization, one can reconcile to the cheque.

The first stage of the Russian privatization is connected with termination of function of the cheque. This stage began in 1992 and was completed on June 30, 1994. Despite numerous economic, political and social costs of circulation of the cheque, the real principal goal was achieved: mass re-distribution and consolidation of the property rights in the extent of the nation was carried out. Be it still formal and not so "civilized", but above all owing to introduction of the cheque by the middle of 1994 the following is already exist in Russia:

- corporate sector in economy;
- exchange and extra-exchange markets of securities, including infrastructure of privatization cheques trade, auctions systems for privatization and secondary market of the privatized enterprises shares;
- system (still transitory, but already rather powerful) institutional interests in the form of investment funds and other structures;
- social stratum, which - with numerous stipulations and taking into account its extreme heterogeneity and legal defenselessness - nonetheless may be named as the owners stratum.

It can be already said that first and foremost owing to the implemented privatization program in 1992-1994, any process of resuscitation of the government monopoly and the administrative-bureaucratic control over Russian enterprises has become difficult to obtain; however it is still early to discount such probability. In a more broader sense, gigantic changes for the better in this period in the sphere of property relations have created the basis for modifications and power relations in Russian society. In that period the problem of organizational restructuring of Russian enterprises, attraction of investments still was not, as a rule, being raised in the real terms. At best, the case in point was the acquisition of a share in stock by a relatively big foreign investors - a share, which at least at the first stage of placement of shares is not the controlling one.

In this connection and taking into account the already set up property structure in Russia and its possible dynamics, for a potential investor in the secondary market, as well as changes in the privatization ideology in the middle of 1994.

The second stage that has begun in July 1994 must be directed precisely to the effective and warranted by the laws provision of the next assignment of the property rights acquired in the course of the initial distribution to the benefit of the really responsible owners.

In the respect of the privatization proper, it means first of all transition from the free-of-charge system of dispensation of the property to its real sale, from the sped-up "privatization for the sake of privatization" as the reform quantitative basis - to a slow privatization directed to the restructuring and investment.

To put this another way: the new privatization model must have two underlain key ideas determining the technique of, at least, the "big privatization": investment orientation of sale, provision of an investor with opportunity of acquisition of the control package in the course of the initial placement of shares.

Beside the purely privatization tasks, there is a series of tasks, fulfillment of which will require a longer period: to ensure a dynamic and effective development of the Russian share market, realty markets (land including), development of an investment institutes network, a civilized system of corporate management, which are the most important conditions of effective functioning of the Russian privatized enterprises.

#### 1.3.5. Agrarian reform<sup>4</sup>

The main direction of the reforms in the agriculture was of a pragmatically economic nature - to render the agricultural sector more effective and less heavy for the budget.

The first steps in this direction were aiming at bringing about opportunities for development of family farmer units. The first experimental attempts of this kind were made in 1987-1988. But already in the period of the reforming efforts it became obvious that only 10-15% of peasants wished to manage their land independently, and the farming sector would have been unable to become the principal sector in the nation's agrarian economy in the middle-term prospective. That is why the necessity to re-organize then existed collective and Soviet farms and transform them into market subjects came about.

In the end of 1991 the main decisions that initiated contemporary stage of the agrarian reform were taken.

All the collective and Soviet farms of the country were to be re-organized during a year. In the course of such rather formal procedure their personnel were given the collective ownership of practically the entire land they cultivated before and all the funds. All the received funds were subject to division between workers and pensioners into conditional shares; the land was to be divided into equal parts

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<sup>4</sup> This section was compiled by E. Serova

and proportionally with the number of years of work at the given farm. Then the share owners got the right to take their shares in kind or leave the farm to manage their own farming, or to contribute these shares to the collective economy and stay thereat to work.

Land shares turned out to be, by the Russian standards, not so vast: 6-10 hectares per person. To avoid fragmentation of the land use, the possibility to sell and rent the shares to/at a collective or Soviet farm was provided for. So, a peasant who would wish to establish his own farm, could enlarge his plot by buying or renting his neighbor's shares.

As a result of the taken decisions quantity of farmers increased sharply: if in the beginning of 1992 their number was less than 50 thousand, now there are already over 285 thousand farmers. The problem to get the land ceased to be the main problem to the farmers. The farming sector now possesses about 5-6% of the nation's agriculture.

In the years recently passed practically all the collective and Soviet farms have been re-organized. At first, they could transform into joint stock companies or production co-operatives. The major part of agricultural economies went this way.

Secondly, the government, having encountered a certain resistance on part of peasants, allowed in spring of 1992 to maintain their former status for those farms that were unwilling to be re-organized. Today about one third of farms remained as collective and Soviet farms. But, nonetheless, they took the land and the funds in their possession and, as a rule, divided them into the shares.

The third, and the most radical way of re-organization: the complete liquidation of an old agricultural unit and its division into farming units, agricultural co-operatives, private or co-operative service enterprises. As a rule, such enterprises jointly use and maintain the productional infrastructure of a former farm. Number of such cases of the complete division of major enterprises is around one thousand (from amongst 27 thousand collective and Soviet farms).

At first it was supposed that remaining and division into shares would create a novel motivational mechanism for workers and enterprises by and large. The objective was as follows: a formal legal severing of an agricultural enterprise from the governmental financing systems, marketing and procurement while expecting that under influence of the market environment an enterprise would start its economic conformation, changing its internal setup and behavior within ambient environment in compliance with a new situation.

Such changes had been designed for the long run and were unable to manifest itself rapidly. Nonetheless now three main trends of transformation of former collective and Soviet farms have already revealed themselves.

The first trend leads eventually into division of an agricultural enterprise into smaller independent production units - family farms, partnerships, co-operatives, etc.

The second method of economic transformation of large farming enterprises is typical for zones of large-scale extensive grain-producing enterprises, whereat skilled personnel, highly-productive and big funds have been maintained. At such enterprises the process of concentration of property in possession of a small group of owners by way of purchase, exchange, equities rent, etc. is under way.

Finally, the third way \_ the least desirable, but evidently unavoidable in the current situation \_ is rather typical for many regions of Nechernozemye regions of Russia. Majority of agricultural enterprises in this zone, most probably, will formally preserve the form of a collective enterprise (regardless its actual denomination - collective farm or joint-stock company), but peasants will go asunder to manage their private homesteads. Production will be diminished to a level necessary for survival of a peasant family. With growing demand for agricultural products in the middle run, the most viable of these homesteads shall be the basis for making of farming economy in the above-mentioned regions.

Besides the institutional changes in the agrarian sector the market economy begins to form. Actually, the system of governmental purchases system is liquidated - despite some administrative relapses at federal and regional levels. Commercial intermediary structures, the organized markets begin to form and the vertical agro-industrial integration has started its development. It must be noted that many crisis phenomena in the food-producing complex today are connected with the fact that the speed, with which the government left the agricultural market essentially exceeded that, with which the market infrastructure was coming to the fore.

In the purchase, wholesale and retail prices within the food sector at the federal level are presently not being controlled any more. Today the agricultural machinery and fertilizers market is sufficiently liberalized. Though the demand from the agricultural producers is abruptly decreased due to financial restrictions.

The agricultural crediting system remains one of the most non-reformed spheres of the agricultural complex. Under circumstances of the persisting high rates of inflation the agriculture cannot do without the governmental credit support. Nonetheless today actually the old system of finances distribution causing an utterly inefficient utilization of credits persists.

Nowadays the reforms' center of gravity in agriculture is being transformed from institutional changes to the filed of creation of an adequate market infrastructure for agricultural producers and consolidation of an effective governmental policy in agriculture.

### 1.3.6. Budget policy

Basic principles of the tax reform that is being carried out since 1992 were as follows: to stabilize the portion of mandatory tax exactions at the level that existed in the USSR in 1988-1990; maximum possible maintenance of continuity of the tax system in respect of the share of the indirect taxation that allows to ensure stability of budget receipts while prices are rising; to arrange equal conditions of taxation for economic agents of all the forms of ownership.

In the financial policy that is being carried out since 1992 the following three sufficiently distinct phases have passed: the first: from beginning of the year till end of spring - a relatively tough budget policy; the second: summer - relaxation of the budget policy, abrupt growth of the governmental finances deficit; the third - from autumn to December: adoption of extraordinary restrictive measures, toughening of the budget policy.

The initial budget draft for the first quarter of 1992 provided for the setting-up of balance of income and expenditures for account of severe cuts of expenditures (at first, expenses for national economy and defence) and a rather large share of governmental income of GDP.

Actually, consolidated budget receipts in three months of 1992 amounted to 19.1% of GDP, expenses - 19.5% of GDP. Budget deficit in the period of January-March came to about 0.4% of GDP. Therewith the expenditures part of the budget was being executed as receipts were coming. In April orientation to a relatively tough budget policy continued. Cash deficit of the budget totaled 1% of GDP.

By middle of summer pressure onto the Government and the President for the purpose to strengthen the financial support for population and enterprises began to increase. As a result in the period from May to August around twenty enactments of the Russian Federation, President's decrees and government's divisions that demanded an additional funding in 1992 to the amount over 2% of GDP for use for social purposes, were adopted. Issues of support for home's industry, agriculture and other sectors, as well as overcoming the insolvency crisis were being solved by extension of Central Bank credit volume.

In comparison with the first quarter, in the first half-year period expenditures of the consolidated budget for national economy (from 5.8% up to 8.4% of GDP), social expenditures increased for 5% of GDP in the first quarter up to 6.8% of GDP in the first half-year period; defence expenses - from 3.2% up to 4.7% of GDP.

These processes along with shortage of the budget receipts in comparison with the projected figures resulted in a considerable worsening of the governmental finances situation. Budget deficit in the first half of 1992 amounted to 6.2% of GDP. In July the deficit reached 7.7% of GDP. In eight months it came to 10.8% of GDP.

Escalation of the cash mass growth caused, as was explained previously, along with monetization of the budget deficit by extension of crediting for enterprises, and favorable balance in trade with the rouble zone states, terminated by summer in a considerable sped-up of prices rise and decrease of the rouble exchange rate.

Due to the causes described above, a strengthening of the restrictive nature of the budget policy in autumn of 1992 became one of the major tasks of the Government. For provision of restraint of the budget deficit within the allowed range determined by the law titled "On the budget system of the Russian Federation for 1992" (901.5 billion roubles) it was required to maintain increase of deficit in September-October within amount of 130 billion roubles, and that practically meant a possibility of its absolute increase by 13.6% of the planned annual amount.

In September-November expenditures of the state were cut sharply. At the same time in October-November 1992 the tax proceeds increased in a considerable degree. Budget receipts from the taxation sources increased from 23% of GDP in September to 26.7% of GDP in November 1992 (Fig 1.3.2).

As a result, in September republic budget deficit decreased from 820 billion roubles to 716 roubles, or to 7.5% of GDP. Of course, some budget indebtedness to social sphere institutions, labor remuneration, settlement of accounts for weapons deliveries and agricultural enterprises were disordered, etc. These expenditures were financed as proceeds were being received.

In October 1992 actual deficit of the federal budget came to 4.4% of GDP. In December deficit of the republic budget lowered to 4.2% of GDP. Deficit of the federal budget in twelve months according to official statistics data amounted to 950 billion roubles (5.3% of GDP); that was slightly more than the limiting value of the deficit determined by law of "Budget system of the Russian Federation for 1992". At the same time increase of expenditures of consolidated budget as on December after E. Gaidar was dismissed totaled over 60% of a monthly GDP. Surplus of receipts over expenditures of local budgets according to results of the year came to 316 billion roubles.

In the budget policy of 1993 two sufficiently expressed periods can be set off. The first period continued from January till September 1993 up to the date of issue of Presidential Decree No. 1400 on September 21: " On gradual constitutional reform in the Russian Federation". This Decree features escalation of expenditures decisions of all bodies of legislative and executive powers without any support by increase of the budget receipts. Whereas, as this took place, Russian Ministry of Finance was carrying-out a relatively tough policy, a gap between the cash and planned budget deficits was widening acceleratingly. The second period continued from October to December 1993. Radical change of ratio of political forces in September allowed to achieve a reduction of the said difference between the

planned and actual expenditures, thus providing a potential possibility to strengthen the budget equation.

In view of lack of any approved budget in the beginning of 1993 its execution in January was being performed in the amount of one third of the volume provided for appropriate goals in the fourth quarter of 1992. As a result, in January a surplus of revenues over expenditures of the federal budget in the amount of 0.5% of GDP was created, while the total level of the taxation exaction was 28.7% of GDP, and the level of the federal budget receipts - 17.6% (Table 1.3.2., 1.3.3).

But after that the Supreme Soviet made the decision according to which the government was allowed to finance undertakings in the amount of 1/12 of the volume of the appropriations provided for by the draft of the republic budget of the Russian Federation. In February it has not yet affected the state of the budget. Deficit of the republic budget came to 4.8% of GDP. However in March expenses of all the levels budgets continued to increase. Deficit of the federal budget reached 10.6% of GDP, deficit of the consolidated budget - 6.3% of GDP. In April the deficit of the republic budget decreased to level of 7.1% of GDP, consolidated budget - to 3.4% of GDP.

Increasing confrontation between the Parliament and the Government, strengthening of contradictions between various groups within the Government only in the end of March allowed the Parliament to adopt the second version of Law of "Republic Budget of the Russian Federation for 1993". Deficit of the budget in this law approximated 18% of GDP.

A certain, though a temporary, strengthening of the reformist forces occurred after in April the National Referendum, which supported the economic reform course, was held. As a result, the joint statement of the Central Bank and the Government on the economic policy was signed, wherein quarter limits of the centralized crediting were set; Presidential Decree No. 842 "On some measures to restrain the inflation" adopted, in which the moratorium on increase of the budgetary system was imposed. The important positive aspect was termination, since May 1993, of technical crediting for the CIS countries. The change-over to granting of the inter-state credits from Russia's republic budget was established.

The same change of ratio of the political forces let the Ministry of Finance stabilize the budget situation. In May the federal budget expenses for maintenance of the governmental bodies of power and administration for defence, national economy; expenses for the social sphere were somewhat reduced. As a result, the deficit of the federal budget diminished to 5.7% of GDP. In June a certain decrease of expenses for the national economy and defence with simultaneous stabilization of other kinds of expenditures continued. As a result the deficit of the federal budget in the first half of 1993 amounted to 4.8% of GDP, whereas the federal budget receipts for the consolidated budget amounted to 26.8% of GDP.

On July 22, 1993 the Supreme Soviet adopted the law "On revision of the indices of the republic budget for 1993, in which the deficit was determined in amount of 22.6% of GDP. The President B. Yeltsin did not signed the law and returned it to the Parliament to be studied in its second version. On August 27 the Parliament approved practically the same version of the budget, having adopted the Law "On introduction of changes and addenda to the Law "On the republic budget of the Russian Federation for 1993", wherein amount of the deficit was reduced only by 60 billion roubles, i.e. to 22.1% of GDP.

The main contradictions between positions of the Supreme Soviet and the Government, as well as between the conservative flank of the government and the radical flanks, related to the proportions between the financial stabilization priorities and the necessity to support the nation's industry, agriculture and other sectors of economy by means of the emission financing.

In July and August the negative trends in the budget situation strengthened. That time decrease of receipts was to a considerable degree autonomous in respect of the policy of Ministry of Finance of Russia, and in the main was caused by speed-up of inflation in summer of 1993. Deficit of the consolidated budget (Table 1.3.2.) increased from 2.8% of GDP in June to 5% of GDP in July, and 6% of GDP in August. Deficit of the federal budget increased from 4.8% of GDP in June to 7.2% of GDP in July and to 8.1% of GDP in August (Table 1.3.3.).

Proceeds to the budget system were about 26% of GDP in July-August (without the extra-budgetary funds). The important trend was the decrease of the tax exactions share from 28.4% of GDP in May to 26.4% of GDP in July, and 26.3% of GDP in August. That was occurring mainly due to decrease of the tax proceeds to the federal budget from 13.9% of GDP in May to 11.8% of GDP in August.

In September the situation still was deteriorating. The deficit of the consolidated budget - 8.6% of GDP; meanwhile the federal budget expenditures increased only slightly. However the tax income of the budget reduced to 11.1% of GDP. An additional income to the budget became the profit of the Russian Central Bank in the amount of 0.5% of GDP. Financing of expenses was being carried out for account of sale of currencies by the Government that provided 1.6% of GDP during 9 months, realization of precious metals (0.8% of GDP), IMF credit (1.6% of GDP).

The radical change in the balance of political interests and spheres of influence after the President B. Yeltsin dissolved the Supreme Soviet and the Congress of People's Deputies in September 1993, allowed to alter the budget policy sharply.

The said alteration concerned not the cash implementation of the budget (deficit of the federal budget in the fourth quarter was kept at the level of 8% of GDP), but applied to the Government's expenditures liabilities. After the

Parliament was dissolved, the Government got the real opportunity to render the expenditure part of the budget in conformity with receipts and set limits of crediting for the Government by the Central Bank.

A number of decisions to reduce the expenditures that were too heavy for the Government was undertaken. That concerned primarily the following: abolishment of the grain prices indexation, as well as prices for other crops delivered to the State; abolishment of the bread subsidies (with introduction of the bread allowance for indigent citizens); abolishment of the imports subsidies; the most part of the preferential credits (except the budget credits); raising of the Central Bank refinancing rate. Volumes of the governmental investment were seriously cut and the twenty-percent sequestering of all the expenditure items of the federal budget for the fourth quarter of 1993 implemented. The pension fund and other extra-budgetary funds were subordinated to the Government, which obtained the opportunity to use their spare resources for financing of the deficit of the federal budget.

Despite the sufficiently tough measures adopted in autumn of 1993, inertia of the previous decisions on expenditures kept to determine an high level of the deficit of the budget. Furthermore, decrease of the tax exactions share in the GDP continued, though more smoothly (Table 1.3.2.). The tax receipts of the Russian consolidated budget lowered from 25.4% in the January-September period to 24.6% in the January-December period of 1993; the republic budget receipts: from 11.1% to 10.3%, respectively.

As a result of the hard and practically extremely painful procedure of the expenditure obligation cutting, maintenance of deficit of the federal budget in 1993 at the level of 9.4% of GDP and establishment of the basis for gradual decrease of the inflation rate (16% in November, 13% in December of 1993) were accomplished.

Situation in the sphere of the governmental finances that was developing in 1993, largely was similar to that of the previous year and featured lack of an approved budget in the beginning of the year and the continuously increasing gap between the government's obligations and the resources being really at its disposal.

In the first quarter of 1994 the federal budget was being implemented on the basis of the Presidential Decree issued in December 1993 that provided for the expenditures financing at the level of the fourth quarter of 1993 having regard to increase of the labor remuneration level in 1.9 times.

In March 1993 the draft of the federal budget for 1994 prepared by the Government was presented to the State Duma of the Federal Assembly of the Russian Federation. After it had been discussed at committees and commissions of the Duma and revised by the Government, the budget was adopted by Duma in the first version on May 11, 1994. The federal budget revenues in comparison with the initial draft were increased to 17.2% of GDP despite the fact that implementation

of the budget had already demonstrated the stark unreality of the projected values: in three months of 1994 tax revenues in the republic budget were - 8.1% of GDP (1993 - 11.8% of GDP), including the profits tax - 2.0% of GDP (1993 - 2.4%); value-added tax - 3.5% of GDP (1993 - 4.5% of GDP); excises - 0.5% of GDP (1993 - 0.6% of GDP).

In the law adopted in the first version the budget expenditures increased in comparison with the draft to 26.8% of GDP (194.5 trillion roubles). That took place mainly for account of increase of expenditures for agro-industrial complex, while growth of expenditures for the social sphere was obviously insufficient. Deficit of the federal budget increased from 8.6% of GDP (62.4 trillion roubles) to 9.7% of GDP (70.0 trillion roubles). This draft of the budget with insignificant changes was adopted by State Duma on June 24, 1994 and approved on the same date by the Council of Federation.

Thus, almost for the whole first half-year of 1994 the nation, as in the past year, was functioning without an approved federal budget. In the second quarter the budget was being implemented on the basis of the adopted by the State Duma Law "On financing of expenditures from the federal budget in the second quarter of 1994". A similar situation was observed regarding the local budget too which were everywhere adopted with a delay.

The most important peculiarity of the 1994 budget that was determining the budget policy in many aspects, was an erroneous projection of GDP, both real (the magnitude of the decline was under-estimated), and nominal: for the budget calculations volume of GDP was adopted in the amount of 725 trillion roubles and the basis of its projection was a significantly higher rate of inflation than that which might be. In reality the annual GDP in 1994 came to 630 trillion roubles.

Owing to the restrictive budgetary and monetary policy of the end of 1993, the inflation rates by spring-summer 1994 reached its least values during the reforms years. As a result, the nominal volumes of the budgets revenues began to lag increasingly behind the nominal volumes of expenditures specified in the budget law. Thus build-up of the unmet budgetary obligations in 1994 was caused, unlike 1993, not only by the over-estimated share of expenditures in GDP, but also by their over-estimated nominal volumes.

In the beginning of the year the trend of decline of the tax revenues supply to the budget system that for the first time manifested itself kept on worsening. As a result, incomings of the consolidated budget in the first quarter were 22% of GDP compared with 28% of GDP in 1993; those of the republic budget - 10.4% of GDP compared with 13% in 1993 (Table 1.3.3.).

Under these circumstances the Government was financing the federal budget expenditures as incomings of Central Bank allocated credits became available. Governmental expenses decreased from 19.2% of GDP in 1993 to 17.1% of GDP in the first quarter of 1994. As a result, the federal deficit in three months of 1994

came to 6.7% of GDP with 7.8% of 1993. The federal budget deficit was financed mainly at the expense of Central Bank credit in the amount of 7.5 trillion roubles (7.7% of GDP).

In the second quarter the situation of supply of incomings to the budget system somewhat improved. revenues of the consolidated budget in the half-year period amounted to 24.4% of GDP, in seven months of 1994 - 25% of GDP; those of the republic budget - 12.1% of GDP and 12.0 of GDP, respectively.

Implementation of the expenditure part of the budgets followed the incomings dynamics. In the federal budget amount of expenditures increased to 16.6% of GDP in July and 18.3% of GDP in August. Amount of loans, less repayments - to 2.6% of GDP in July and 3.2% of GDP in August.

During the January-August period of 1994 expenditures for the governmental administration increased to 0.8% of GDP (0.5% of GDP \_- in the first quarter), and due to under-financing of the defence order, the defence expenditures decreased to 4.0% of GDP (4.6 % of GDP in the first quarter), to 1.9% of GDP increased the budget expenditures for the social sphere (17% of GDP in the first quarter), to 3.0% of GDP increased expenditures for the national economy (2.2% of GDP in the first quarter).

Deficit of the federal budget increased to 7.1% during six months and 9.4% during seven months of 1994. This deficit was financed to 80% at the expense of Central Bank credit (8.8% of GDP), issue of securities (1% of GDP) and foreign financing - 1.3% of GDP (including IMF credit amounting to 0.5% of GDP).

In September and October 1994 the situation practically did not change. tax revenues to the Russia's budgets were maintained at level of 22.3% - 22.4% of GDP; deficit of the federal budget - at level of 9% - 10% of GDP.

In November also any considerable changes in the budget situation did not occur. The consolidated budget revenues amount to 25.9% of GDP, of this tax revenues - 35.5% of GDP (Table 1.3.2.).

The federal budget is implemented as regards the incomings in the volume of 12.1% of GDP, as regards expenditures - 22.1 % of GDP. The deficit came to 10.1% of GDP. Tax incomings in the federal budget amounting to 10.7% of GDP are sufficiently stable during the last half-year period (Table 1.3.3.).

Financing of the budget deficit is implemented at the expense of the Central Bank of Russia (7.6 % of GDP), issue of securities (1.2% GDP) foreign financing (1% of GDP).

Preliminary estimates of the federal budget implementation in the course of twelve months present approximately a similar pattern. The federal budget has been implemented with the deficit around 11% of GDP. Thus warfare in Chechnya in December did not have enough time to affect the budget situation seriously. According to replies of officials, financing of military actions can fall within the

current estimates of the "force ministries", and expenditures to settle refugees and restoration of economy was not executed on any serious scale.

Various estimates of eventual expenditures in connexion with the warfare being waged are encountered. They vary from 5 to 15 trillion roubles, i.e. 0.5% to 1.5% of the projected GDP for 1995, and it is hardly possible to set off the most correct estimate from them now. For the time being it is only clear that the expenses both for warfare itself and restoration of devastation are and will be, if it goes on, macroeconomically efficient.

While evaluating the financial consequences of the warfare, the accumulated indebtedness of the budget to all recipients of the budget resources shall be also taken into account. Terms and volumes of repayment of this indebtedness will be specified by the real budget expenditures for financing of different items. In connection with carrying-out military actions it is completely evident that repayment of the budget indebtedness to the "force ministries" will be done with priority.

## 2. Organization of the budget system and the budget process, specifics of the budget classification

Before 1991 the USSR budget system comprised an aggregate of all the budgets of the nation that were united in the state budget of the USSR. In 1991, as it was pointed out above, budgets of republics were separating themselves, and by the end of the year such budget system existed no more. Nonetheless let us schematically study: with what a budgetary arrangement the USSR entered 1991.

The USSR state budget consisted of the Union budget, union republics state budgets, state social insurance budget. State budgets of the union republics in their turn consisted of republic budget of a union republic, state budgets of autonomous republics included into a given republic, and local budgets. In composition of local budgets three groups of local budgets can be distinguished: budgets of regions and territories, budgets of the republican subordination cities, budgets of areas ( in the republics that had no administrative division into regions).

Moreover, the regions budgets comprised those of regions themselves and the territory budgets (by analogy with the structure of state budgets of union republics). However in this case the second group of local budget should be distinguished: regional, territorial budgets (were incorporated into budgets of regions, territories), budgets of autonomous regions (districts), budgets of cities of regional, territorial subordination, budgets of areas.

In their turn budgets of areas included the budgets of regions themselves, budgets of cities of areal subordination, budgets of settlements, rural budgets.

The income basis of the USSR budget was formed from the following sources:

• Payments out of profits (deductions from profits of state enterprises and organizations, payment for use of basic means of production and rated current assets, fixed (rent) payments, available profit balance. In 1991 this group of payments was replaced by the tax of profits;

• Payments from enterprises and organizations for turnover (tax on turnover, tax on proceeds from demonstration of films). In 1991 the tax on sales, the exaction method of which was similar to the value-added tax;

• Payments out of income of enterprises (income tax exacted from co-operative enterprises, collective farms, wood tax (payment for timber), payment for water). The payments included into the cost value (deduction from prospecting);

• Charges and payments for services rendered by governmental organizations (state duty, road police charge, other charges and non-tax payments);

• Payments effected by population (income tax, tax on single persons, lone and childless persons, agricultural tax (paid by collective farmers, owners of homesteads), tax on house-owners, land tax (not paid by collective farms and the citizens free from agricultural tax), tax on vehicles-owners.

Distribution of these incomes between budgets at various levels, in general, was as follows. The following were transferred to the union budget (less the part handed over to the union republics budgets), tax on profits of enterprises and organizations of the union subordination, income tax imposed on population, contributions to the governmental social insurance, customs payments.

The following were transferred to the union republics budget:

• a part of the tax on profits of enterprises and commercial organizations of republican subordination,

• wood income,

• income tax from collective farms, co-operative and social enterprises,

• agricultural tax,

• deductions from the turnover tax and other all-union incomes in the amount provided for in the Law of the state budget of the USSR for the corresponding year and some other payments.

The following were transferred to budgets of autonomous republics, territories and regions: payments out of profits of subordinate enterprises and a part of payments out of profits of enterprises and organizations subordinate to the union industries and authorities handed over to these budgets, state duties, proceeds from demonstration of films, local taxes and charges.

Deductions out of profits of the enterprises of local subordination, transfers from higher budgets also constituted income of local budgets.

Incomes of the budget of the state social insurance were made up of contributions from enterprises, which (contributions) were differentiated in respect of branches regarding their industries as a percentage of wages funds, payments for recreation vouchers, allocations out of the union budget (its share was 52% of the social insurance budget).

Extra-budgetary fund of stabilization provided for the following sources of its formation: deductions from enterprises in the amount of 11% of the wages fund, 20% of the amount of the depreciation deductions for complete restoration of capital assets of all the forms of property; enterprises profits obtained from increase of contractual prices in surplus of the specified limit values of profitability, etc.

In the end of 1991 the law of RSFSR titled "On bases of the budgeting arrangement and budget process in the RSFSR" was adopted. In accordance with this law the following budgets are included into the RSFSR budget system as the independent parts:

- republic budget of the RSFSR,
- republic budgets of republics of the RSFSR,
- territorial budgets,
- regional budgets of territories and regions,
- budgets of Moscow and Saint-Petersburg,
- regional budget of autonomous region,
- district budgets of districts,
- city budgets of cities,
- area budgets of areas,
- area budgets in area of cities, settlements, rural settlements.

It should be noted that the independent budgets are: the budget of the RSFSR, budgets of the republics of the RSFSR, and budgets of nationality, state, and administrative-territorial entities.

In accordance with the above-mentioned law the unity of Russia's budgetary system is ensured by the universal legal basis, use of unified budgetary classifications, unity of forms of budgetary documents, presentation of the statistics information from one level of the budget system to another for drawing-up of the RSFSR consolidated budget.

In 1991 in the Russian Federation the law of "Principles of the tax system that specifies general principles of arrangement of the tax system in Russia, types of taxes, determines charges and duties and other payments, was adopted. Consequently it was replaced by the law "On introduction of changes into the

Russia's tax system", dated 16 07 92 and the Law "On introduction of changes and addenda to some tax laws of the Russian Federation," dated 22 12 92.

In accordance with the said law the following 3 groups of taxes are distinguished:

- federal taxes,
- taxes of republics of the Russian Federation, and
- taxes of territories, regions, autonomous regions, autonomous districts, local taxes.

In 1992-1993 there were 89 budgets of the second level in Russia corresponding to the same number of subjects of the Russian Federation, i.e. 21 republics, 10 autonomous districts, 6 territories, 1 autonomous region, 51 regions and Moscow and Saint-Petersburg.

During 1992-1994 rules of distribution of taxes between budgets of various levels, despite some corrections, in general were remaining sufficiently stable. Information on taxes that formed the federal budget revenues and those of budgets of the Federation subjects are presented in the attached Table (Table 2.1.).

Beside the taxes that are exacted in accordance with concrete laws and go to budgets of different levels, there are customs duties (payments) that are transferred to the federal budget. Procedure of their execution is regulated by the Customs Code and the regulation documents issued by the State Customs Committee of the Russian Federation.

A considerable portion of the Russia's consolidated budget together with local and federal budgets is formed by the extra-budgetary funds that can be divided into the funds of social and industrial orientations.

Several extra-budgetary funds comprise the following funds: Employment, Mandatory Health Insurance funds.

RSFSR law of November 20, 1990 titled "On governmental pensions in RSFSR it was prescribed that payment of pensions shall be effected for account of the Pension Fund of RSFSR. In 1991 the insurance rate for enterprises and organizations was specified in the amount of 26% of the calculated remuneration of labor. Moreover, employed citizens shall pay contributions in the amount of 1% of the earnings.

On December 27, 1991 to the "Law of Governmental Pensions of RSFSR" some changes were introduced. Insurance tariff to Pension Fund was specified at 31.6%.

Law of December 25, 1992 "On introduction of changes into Clause 8 of RSFSR law on Governmental Pensions in RSFSR" in addition to new rules of deductions (28%) completed the basis of the insurance fund by remuneration of labor by contracts and commissions.

Rate of deductions to the Social Insurance Fund was set in the end of 1991 at 5.4%. Afterwards the rate of deductions did not change. Resources of this fund are allocated for allowance for temporary disability in certain cases for payment of medical treatment and treatment diet. Still in 1992 no penalties for the enterprises that did not calculate and transfer the insurance contributions were provided for. Only since 1993 the mandatory registration of each enterprise in a branch of the social insurance fund was decreed, then mass transfer of the calculated (1992 including) resources began.

Deductions for the governmental Fund of employment amount to 2% of the labor remuneration fund, for the mandatory health insurance - 3.6% of the labor remuneration fund.

Law of the Russian Federation on employment of population dated April 19, 1991 specified the procedure for establishment of the Governmental Fund of Population Employment. In April 1991 the mandatory monthly deductions from employers at 1% of the calculated labor remuneration were prescribed. Since the second quarter of 1993 till now standard deduction for the Governmental Fund of employment is 21% of the calculated labor remuneration.

There is also a series of extra-budgetary funds established for industrial purposes. In accordance with the law "On roads funds of the RSFSR" dated 18.01.91, roads funds in Russia were established. For account of these funds financing of the expenses for maintenance, repairs, reconstruction and construction of public roads is performed.

The above-mentioned law introduced several taxes: tax on sales of fuel and lubricants, tax on owners of vehicles, tax on acquisition of automotive means of transportation (except motor cars acquired by citizens for personal use, excises on cars acquired by citizens for personal use.

Beside the road funds major funds of the industrial assignment are: Research and Development fund, Fund for Financial regulation in Metallurgy, Fund for Financial regulation in the fuel-energy complex and some other. While analyzing these funds it is difficult to determine a magnitude of resources centralization, because that share of the calculated resources that remain at the enterprise acquiring a purpose-oriented nature is rather significant. For tax payers use of such resources of the funds is tantamount to receipt of a remission for the tax on profits.

Since 1995 all the extra-budgetary industrial funds, must be abolished save the funds for financing of all-sectoral or inter-sectoral R&D and schemes performed to bring new products to a commercial level. These funds are formed for account of resources at 1.5% of cost value of goods (works, services). 10% of the collected resources are supplied to the Russian extra-budgetary fund for financing of R&D ("Russian Fund for Technological Development") at the Ministry of Sciences of the Russian Federation.

In the Russian Federation exist the uniform methodical principles of accounting, which were enforced by the Governmental Enactment dated 16 02 92 - with subsequent revisions and changes. The Regulation on accounting and balance are mandatory for all enterprises, organizations, institutions that are legal entities according to the applicable laws of THE RUSSIAN FEDERATION, including the enterprises with foreign investments, international associations and organizations carrying out the entrepreneurial activities.

In spring 1992 the Law "On principles of budgetary rights and rights for establishment and utilization of extra-budgetary funds of the representative and executive bodies of state power of republics of THE RUSSIAN FEDERATION, an autonomous region, autonomous districts, territories, regions, Moscow and Saint-Petersburg, bodies of local self-government". This is the main law that regulates the budget process in Russia, determines the power bodies rights of various levels for receipt of incomes for appropriate budgets and for spending of resources thereof. However, corrections of the budget process are introduced by many other laws; for instance, amounts and procedure of transfers from the federal budget to budget of lower levels, distribution of federal taxes between budgets of different levels are specified annually in the law of federal budget for the respective year.

Budget classification and accounting are regulated by Ministry of Finance of THE RUSSIAN FEDERATION. Only in the end of 1992 letter of the Finance Ministry titled "About monthly accounting of implementation of budgets in THE RUSSIAN FEDERATION" replaced the main rules of accounting. Classification of receipts and expenditures of the budget was approved in the end of 1990 and changed in summer of 1992. Since then various slight and major changes have been introduced, gradually, making it approach the universally approved classification. In the end of 1994 by order of the Finance Ministry dated 29 December, 1994 the new budgetary classification valid as of 1 January, 1995 was introduced.

The presented herein figures on the state of governmental finances in the analyzed period differ from the official statistics. The reason is that we took into account a series of operations conducted by the Government that had been left out in reports of the Ministry of Finance of Russia in accordance with the then applied budget classification.

The data pertaining to the Russian budget in 1991 are based on the official statistics of Ministry of Finance of the Russian Federation complete with reports of extra-budgetary funds. We failed to find trustworthy data to reconstruct the Russian budget that would take completely into account the foreign economic activities and those operations of Central Bank that must be considered as the budget operations. As regards the figures that evaluate the consolidated budget of the late USSR, they are based on the data on implementation of the union budget and those data on budgets of former union republics that were available to us.

Data on state of the Russian governmental finances in 1992-1994 are by far more trustworthy. Nonetheless the budget classification that was in use in Russia in 1992-1994 had been substantially far from that which is universally accepted. For this reason in this attempt to reconstruct the consolidated budget beside the Ministry of Finance statistics have used the information of the State Committee for Statistics of the the Russian Federation, Taxation Board, Ministry for Foreign Economic Relations of the Russian Federation, Ministry of Economy, and the information concerning the extra-budgetary funds. Moreover, it is important to note that before 1993 statistics reports of the Finance Ministry were not providing for collection and presentation of any data on economic classification of the budget expenditures. And available economic classification of expenditures for 1993 relates only to the federal budget and is extremely aggregate.

In 1992 the budget statistics of the Finance Ministry were corrected by us both as regards evaluation of revenues and expenditures of the budget. In evaluation of the budget revenues we re-grouped the sources of incomes in such manner as to be able to analyze separately the different taxes (on profits of enterprises, personal income, on property, goods and services, foreign trade) and the non-tax proceeds.

While estimating values of incomes, beside changes of their classification it is also necessary to take into account the resources which the government was receiving in the first half-year period of 1992 as a result of the mandatory realization of a part of the currency proceeds of the exporting enterprises at the over-estimated exchange rate (0.018 USD/rouble). These budget revenues in the first half-year period came to 110 billion roubles (or 2.4% of GDP) taking into account both the proceeds to Republic currency reserve, and a part of the currency returns that is left by the exporting enterprises abroad for centralized purchases of foodstuff medicines, mineral fertilizers, etc.

In evaluation of expenditures in 1992 it is necessary to take into account subsidies for imports that was left out in the statistics of Ministry of Finance. In the first half-year subsidies for imports was being performed through sale of currency amounts for importing enterprises at the over-estimated exchange rate (in January-July averaging 0.05 USD/rouble). Since the second half-year of 1992 the unified rate of exchange of the rouble was introduced and it was supposed that since summer the importing enterprises would buy currency at the market rate of exchange, and should the sale of the imported goods be carried out at the prices lower than the contractual prices recalculated according to the rate of exchange, in such case subsidizing of this difference shall be performed for account of the budget. However, in actual practice that procedure was corrected. Currency was being allocated for the importing enterprises, but they did not repay the immediately arising liabilities. At first importation of goods was carried out, then it was sold at a settlement price, which averaged 30% of the contractual one converted into roubles, and the proceeds were transferred to the budget. As a result

prices for the goods imported for account of the government's credits were subsidized for about 70%.

It must be pointed out that the amounts of the foreign financing we were informed of, as well as volumes of the price subsidies are distinctly over-estimated owing to the fact that for their (subsidies) evaluation the current rate of exchange of the rouble to the dollar was applied. This rate reflects ration of demand and supply of currency which was determined by ratio of internal and external prices for a narrow group of goods participating in the foreign commodity exchange. At various moments of the studied period dynamics of the rate of exchange was considerably differing from that of parity of the buying capacity of the rouble in reference to foreign currencies. In 1992 as a whole the real rate of exchange of the rouble increased about seven times. In 1993 and 1994 growth of the real rate of exchange of the rouble went on (the figures are to be inserted here), however in the beginning of 1995 too the Russian prices were only 30-35% of the level of the American ones.

So, conversion of the foreign financing obtained in 1992 from the dollar equivalent into roubles over-estimates its (financing) real estimation more than by a magnitude. But, to use for this conversion not the current rate of exchange of the rouble, which is quoted at the Interbank Exchange Market, but other artificial assessments whatsoever like the settlement parity of the buying capacity of the rouble and the dollar, in our opinion would be much more correct.

The data we present herein for 1993 also differ from the official statistics of Russian Ministry of Finance. The Ministry used to reflect the Government's foreign economic operations in its reports on implementation of budgets as follows. Receipts imports duties, exports duties, cover in roubles of the currency expenditures for the centralized importation. Expenditures: purchase of goods for the centralized exports, purchase of currency for the currency reserve of the republic.

Such classification obscures the economic meaning of the reflected operations; for this reason we include into the expenditures the following: imports and exports duties, incomes from realization of the government monopoly over the centralized exports operations (goods sales proceeds, less expenses for their purchase). Into the expenditures: purchase of currency for the currency reserve of the republic.

As a consequence, in the report prepared by the Ministry of Finance for 1993 incomes from the foreign economic activities average 1.4% of GDP, but according to our estimates - 4.1% of GDP.

Due to lack of the precise data we failed to take into account correctly the entire foreign economic activities of the state. In the first place, incomes from realization of the government monopoly over the centralized exports were coming unevenly during the year, so we had to converse the currency incomes into the

roubles at the mean annual rate. Secondly, a part of the said incomes was not coming to Russia, but remained on accounts with foreign banks and was used for repayment and service the debt. However, we could not take into account the corresponding expenditures or balance them with the incomes. Thirdly, proceeds from realization of the exported goods and government's expenditures to pay them for the producing enterprises are taken into account according to shipments, though a considerable delays of payment for the goods do occur. Fourthly, it turned out to be unfeasible to perform the quantitative evaluation of the budget expenses which had been financed for account of the monopoly over the centralized exports. The expenditures in this study were designated for service and repayment of the external debt, financing of non-trade operations, imports subsidies, and also for formation of the currency reserve of the republic.

A part of expenditures for these operations had not been reflected in the official statistics. In or tables their estimate has been taken into account in the foreign economic activities expenditures item, as well as in the "Other expenditures" section.

It also should be noted that in the Ministry of Finance's statistics sales of currency from the governmental reserve is included into the financing section. We take it into account in the section of the governmental monopoly over the centralized export.

In 1994 essential changes in the budgetary classification have taken place. In May 1994 in the item "Incomes from the foreign economic activities" along with the exports-imports duties and other incomes, the returns on the centralized exports also began to be taken into account. The item "Allocation of the purpose-oriented resources to lessen the deficit of the budget", in which till May sales of currency including the currency obtained from the centralized exports was being reflected, was abolished. In Table 2.1.2. of this compilation, since May the rates difference gained from the performed by the Government operations with currency and defined in the Ministry of Finance official statistics as the difference between the "Sales of Currency" and "Purchase of Currency" items, has been reflected. This determines increase of the budget revenues since May for about 1% of GDP.

Moreover in 1994 the statistics accounting for the extra-budgetary fund was modified. State Committee for Statistics of the Russian Federation stopped to collect from enterprises the data on "availability and movement of the governmental extra-budgetary funds" (form No. 8 -F). As a result we have only the data on incomings and spending of the resources centralized in the extra-budgetary funds, and no data on charging of the finances and their spending at enterprises.

### 3. Incomings, expenditures and deficit of government finances

As it was pointed out above, it is impossible to somehow assess the parameters of the budgets of Russia and the USSR in 1991. Approximate estimation demonstrates that without taking into account the operations of the foreign economic activities and a series of quasi-budgeting performed by the government, deficit of the budget system of the states of the late USSR was approximately 15%, and they are taken into account, the deficit will amount to about 30% of GDP. Revenues of the consolidated budget came to, approximately, 38% of GDP, and expenditures (with the extra-budgetary funds - about 53% of GDP).

And deficit of the Union budget in aggregate with the economy stabilization fund amounted, approximately, to 6% of GDP of the former USSR (GDP - 2100 billion roubles), revenues at that period were 7.5% of GDP. Deficit of the Russian budget together with the expenditures that in the fourth quarter were inherited from the union government for the Russian government, also taking into account expenditures for the subsidies for prices of agricultural goods that were granted for account of Central Bank credit reached 7.3% of the Russian GDP (GDP - 1300 billion roubles), including deficit of republic budget - 8.5% of GDP. Revenues of the Russian budget came to 25% of GDP.

Reconstruction of the government finance system in 1992 (Table 3.1.) demonstrate that budget receipts and extra-budgetary funds were about 50% of GDP. This approximately corresponds with the level observed in the USSR in the relatively well-off, as regards the state of finances, years of 1980-1985, and considerably exceeds the level of 1991. Such level of the tax exactions that to some extent contradicts a difficult situation in respect of the state finances, requires a special comments. Firstly, we do not exclude the possibility that an underestimated assessment of GDP for 1992 had been used. State Committee for Statistics of the Russian Federation initially published the assessment of GDP to the amount of 14.5 trillion roubles. Then it was increased to 18.063 roubles. Secondly, the following circumstance should be taken into account: a considerable surplus of revenues over expenditures that existed in extra-budgetary funds - 5.1% of GDP, was not being used for financing of the deficit of the budget. Thirdly, assignments for the industrial extra-budgetary funds are not any taxes in their proper meaning. Charged amount to a considerable degree remained at enterprises under the condition of their utilization for specified purposes.

Into the revenues of the Russian consolidated budget the extra-budgetary funds were included to the amount of 18.6% of GDP; of them - social funds: 11.9%.

Expenditures of the consolidated budget in 1992 amounted to 60% of GDP, and expenditure and loans, less repayments - 65.2% of GDP. Into expenditures of the Russian consolidated budget also were included extra-budgetary funds - 13.4%.

As the Table demonstrates, balance of revenues and expenditures in the federal budget together with loans, less repayments, in 1992 amounted to 23% of GDP. As concerns how the deficit of the government finances affected the monetary situation: the above-mentioned balance of revenues and expenditures in the federal budget together with loans, less repayments, but without taking into account the subsidies for importers - is more informative index than the deficit of the federal budget computed by the Ministry of Finance. This index in 1992 was 12.6% of GDP.

In Table 3.2 the reconstruction of the consolidated budget of the Russian Federation for 1993 is presented. Firstly, the analysis demonstrates that a rather high level of the tax exactions in Russia was maintained. The share of taxes and revenues in the extra-budgetary funds of GDP amounted in 1993 to 43% of GDP. The share of government's revenues - 45.7% of GDP. Revenues of the extra-budgetary funds remained at the 1992 level - about 16% of GDP.

Expenditures of budgets and extra-budgetary funds came to 48.3% of GDP, and together with loans, less repayments - 50.3% of GDP. Deficit of the federal budget reached 9.8% of GDP, and deficit of government finances - 3.6% of GDP.

## 4. National Debt

Up to 1993 it is difficult to discourse about the internal national debt. Its most part had the nature of indebtedness of the government to the Central Bank, and was not reflected in any official agreements. Only 1993 the whole volume of the government indebtedness acquired a clear structure.

Despite a rather considerable volume of the government's borrowings both in 1992 and 1993, the problem of service of the internal debt had not yet become too serious. It is explained by the fact that the most part of the internal financing of deficit of the federal budget was being provided for account of Russian Central Bank credit for the interest which was many times lower than the Central Bank rates of refinancing (usually 10% annually). As a result the real value of the internal debt was increasing not too rapidly.

The peculiarity of the Russian internal debt is as follows: in a series of cases on the eve of prices liberalization, in the period of the most severe goods deficit the State undertook to repay the debt by durable consumer goods (cars, washing machines, refrigerators, etc.). Such loans were, in particular, the purpose-oriented loan in 1990, purpose-oriented deposits, "Harvest-90" cheques, etc. The level of relative prices for such goods sharply rose after liberalization of prices on January 01, 1992, and as a result its main part turned out to be considerably indexed and is

indexing up to the present time. The problem of repayment of this debt (about 2% of GDP in 1993) before the relevant decisions were taken on observance of the drawing conditions in general, had been a source of acute social conflicts.

Amount of the external government debt by beginning of 1994 amounted to 35 trillion roubles (about 22% of GDP in 1993), the budget expenditures for its service - 0.6% of GDP.

The national external debt of Russia by the end of 1992 came to 110.5 billion USD (104.4% of GDP), or per capita - 743 USD (5 times more than the similar index for the USSR in 1980). In 1993 and 1994 Russia's external debt was, respectively, 112.81 and 119.3 billion dollars. Along with growth of the absolute value of the external debt, its relative value in %% of GDP decreased from 104.4% in 1992 to 42.9% in 1994.

## 5. Financing the budget deficit

Financing of deficit of the union and Russian budget in 1991 was being carried out for account of the federal Bank and foreign credit. We have not a plausible information, as we pointed out above, neither on quasi-budgetary operations of the governments, nor on foreign economic activities performed by the governments in 1991, that is why we shall study the scheme of financing of the budget deficit since 1992 with more detail.

Deficit of the federal budget in 1992 reached 23% of GDP. Its financing was being executed for account of the external credits (12.5% of net GDP) and Central Bank credit (10.6% of GDP). As it has been already mentioned, the approach to the volume of financing from abroad shall be a rather conditional due to differences between the current rate of exchange and the parity of the buying capacity of the rouble. Into the volume of the external

Crediting through Russia's Central Bank are included both the credits for the government to cover the deficit of the budget, and the credits not officially included into the 1992 budget<sup>5</sup>.

In 1993 situation in the sphere of the budget deficit financing changed considerably. The external financing had already amounted not to 54% of the total financing volume, but only to 20%. In a considerable extent that change was determined by a real growth of rouble exchange rate and, respectively, a decrease in estimation of the external borrowings valued in USD. The internal financing amounted to 7.8% of GDP. Among them: Central Bank credit for the government -

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<sup>5</sup> Probably, but the numbers must be checked, allocated for support of the enterprises that implement the conversion of military production (0.4% of GDP), for investments (0.6% of GDP), for prospecting (0.1% of GDP), for replenishment of enterprises' current assets (3.3% of GDP).

6.1% of GDP, sales of securities - 0.1% of GDP, IMF credits - 0.9% of GDP, sales of gold - currency assets - 0.7% of GDP.

## 6. Budget revenues setup

In 1990 legal bases of the tax reforms were created and Union laws on personal and enterprise income taxes and their application procedure in the RSFSR were adopted. The main direction of the tax reform in Russia in general agrees with the directions of reformation in East Europe. The reform included transition from the tax on profits, transformation of the turnover tax and the foreign trade proceeds exaction mechanism, modification of the personal income tax by introduction of returns, modification of the social insurance system, etc.

In 1991 the main sources of the budget revenues were the tax on profits, turnover tax, tax on sales, income tax exacted from population, proceeds from the foreign economic activities, non-tax revenues.

Enterprises tax law provided for payment of the tax on profits for the union budget in amount of 22% of profit, and for the state budgets of union and autonomous republics, and for the local budgets - within the range not exceeding 23% of profits, by enterprises of all the sectors of the national economy (except certain types of payers who had other rate values). 1991 was the first year of application of the tax on profits instead of the individualized as per the enterprises deductions to the budget. Meanwhile any effective utilization of the unified taxation rates in 1991 was being precluded by rigid prices for vast varieties of commodities, mandatory inclusion and implementation of the products delivery for the government into the production plans of enterprises. Under such circumstances there was a possibility of evolution of events by two trends that might prevent differentiation of financial situation at enterprises, which (differentiation) was connected with administrative control over prices and decisions made by authorities. Firstly, further sharp diminishing of the sphere of administrative-mandatory tasks and acceleration of the process of liberalization of prices allowing a leveling of profitability of enterprises. Second trend meant granting of the address taxation preferences determined by discretion decisions taken by governmental economic authorities.

Practice has demonstrated that neither union government, nor the Russian one in 1991 had a sufficient political decisiveness to carry out liberalization of prices and economic activities of the state-owned enterprises. The discretion policy of subsidies and tax preferences did not enjoy any extensive introduction. These facts are explained by such reality that the process of disintegration of the system of administrative management of the national economy, particularly, control over prices and implementation of governmental tasks in 1991 was abruptly sped up by dissociation of the Union. Already in the middle of the year the union government structures were not functioning, and the Russian structures had not yet taken over

the necessary functions. In the outcome the work of enterprises and financial results of their activities to much lesser degree were depending on the state plan approved for 1991 than could be expected in the end of 1990.

The important feature of the tax on profits in 1991 was the fact that in RSFSR it was exacted from enterprises depending on their administrative subordination: in accordance with the union or Russian tax on profits law. Russia, having preserved the 45% tax on profits rate, reduced it for the republic subordination enterprises to 38% for the purpose to bring into being stimuli for enterprises to go under the Russian jurisdiction. The entire amount of the tax on profits under the Russian laws was to be transferred to RSFSR budgets.

As a whole in 1991 Russian budget revenues from the tax on profits amounted totally to 7.1% of GDP, estimate of volumes of revenues for the budget of the USSR former states - 8.2% of GDP, and this is equal to 28% of the budget incomings without the extra-budgetary funds.

According to the tax on enterprises law all the enterprises that were producing and marketing the goods subject to imposition of the turnover tax, were payers of the tax on turnover. Its rates could be specified in percent of the turnover subject to tax imposition or in fixed amounts as per a goods unit. The goods, for which the retail (industry wholesale prices) and enterprises wholesale could not be specified, calculation of the tax was done as expressed by difference between these prices with taking into account the trade and wholesale-marketing discounts. In practice in 1990-1991 over 90% of the tax on turnover was exacted by the last method: through difference between the values of the wholesale and retail prices that were fixed by the centralized way. As it is mentioned above, this mechanism was being utterly destroyed under the conditions of slackening of the pricing control. For this reason in the entire 1991 the distinguishing feature was the constant decrease of the tax on turnover revenues. Its volume in the consolidated budget of the former USSR amounted to 6.3% of GDP, or 21% of the budget revenues.

The USSR income tax on citizens' income law, adopted in April of 1990, was enforced since July 01, 1990. It meant introduction of unitary (global) personal income tax (with progressive scale and minimum 13% rate), but provided for different imposition scales for various categories of payers. The largest tax payers group - persons who get earnings for being employed.

The RSFSR law on procedure of application of the union law on the citizens' income tax in a considerable extent overcome the discriminating nature of the union laws regarding the citizens working in the economy sectors that are different in respect of the nature of property and also somewhat decreased the degree of progressiveness of taxation. The minimum income exempt from taxation was raised, and the limit rate on higher incomes was determined at the level of 50%.

The national income tax proceeds in the consolidated budget of the former USSR in 1991 came to 3.3% of GDP or 11.3% of GDP.

As a whole, the share of tax revenues in GDP of the former USSR amounted in 1991 to 28.1%, and taking into account deductions for the economy stabilization fund and the pension fund - 3.7% of GDP. Together with the non-tax revenues, the budget system revenues accounted for 39.6% of GDP.

The tax system valid since 1992 is based on the package of the RSFSR tax laws adopted in the end of 1991. An important role in this package plays the Law "On principles of the tax system of the Russian Federation". It specifies the structure of the tax system, distribution of taxes in respect of the administration level (federal taxes, taxes of the republics of the Russian Federation, territories, regions and autonomous administrative units and local taxes), rights and responsibilities of tax payers.

In 1992 the taxation technique has been constantly being corrected by instructions of Ministry of Finance and Taxation Board of the Russian Federation, and the largest changes were introduced by the Law of July 1992 "On introduction of changes and addenda to the Russia's tax system" and the Law of December "On introduction of changes and addenda to certain tax laws of the Russian federation".

As a result of such major and small alterations in the tax laws and enactments that regulate the taxation methods, the share of the budget revenues was always variable. The similar rather abrupt variations in the tax system structure occurred (fig. 6.1., 6.2.).

The most serious change in the tax system in 1992 was introduction of the value-added tax and excises instead of the tax on turnover and tax on sales. Payer of the value-added tax in Russia are all the legal entities, as well as citizens involved in the entrepreneurial activities with establishment of a legal entity whatsoever.

Turnovers connected with realization of goods, works and services, including realization of the goods inside the enterprises themselves (if costs and expenses are not transferred to the cost value) and their employees, are subject to taxation. In industry the difference between the tax amount exacted from purchases and the tax amount paid for suppliers of material resources, fuel, works and services, cost of which is transferred to the cost value, is subject to deduction to the budget. In 1992 it was not permitted to deduct from the liabilities for the budget the tax paid for suppliers of the basic means and non-material assets.

The value-added tax revenues in 1992 amounted to 11.7% of GDP (22.4 % of the budget revenues), i.e. by 5.4% of GDP more than the tax on turnover revenues in 1991.

In 1992 simultaneously with the value-added tax the excises that are the ad valorem taxes, the rates of which are differentiated according to the goods groups, were introduced. They were imposed for spirits, tobacco goods, a series of durable commodities. Excises are exacted when the given goods are realized at the retail trade network and specified in percent of the sale price (i.e. while paying the

excises, the trading entities, unlike the case of VAT, transfer to the budget the specified part of the realization price, which includes the excise). As with VAT, before 1993 the imported excise-worthy goods were exempted from the excise charges. Volume of excise proceeds in 1992 amounted to 1.2% of GDP (2.4 % of the budget revenues volume).

Like in 1991 the tax on profits is paid by all the enterprises that are legal entities. Enterprises' profits which consists of profits from realization of its products and incomes from extra-realization operations, less costs of such operations, are subject to taxation. Profits from realization of products is equal to proceeds from realization of products (less the tax on value-added and excise), and after deduction of the production and realization costs included into the cost value. The tax on profits revenues in 1992 came to 8.7% of GDP (17.6 % of the budget revenues volume ). Thus the share of the tax on profits in GDP was maintained, approximately, at the level of 1991 (8.2% of GDP)

Basic principles of personal income tax in respect of the tax on profits in 1992 did not undergo any serious changes in comparison with 1991. Volume of the tax on profits revenues in the budget system of Russia in 1992 came to 2.4% of GDP (4.8 % of the budget revenues volume).

The four described above types of taxes in 1992 gave 78% of revenues for the republic and local budgets and 48% of revenues for the Russia's budget system. Beside them should be mentioned payments for extra-budgetary funds,. described above, and the following taxes that are supplied for the budget system:

- Tax on property of enterprises which is imposed on the cost of property on the balance, less depreciation. In 1992 rate of this tax was determined by legislative authorities of republics, territories and regions of Russia in amount of 1%.

- Payments for the road funds of the Russian Federation, including the tax on roads users (0.4% of volume of marketed products), tax on owners of vehicles (roubles per horse power), tax on acquisition of automotive vehicles (for motor cars - 40% of the cost of a car without VAT), tax on realization of fuels and lubricants (federal tax - 18% of the amount of realization, territorial - 7%).

- Taxes that regulate use of natural resources, including payment for land (land tax on land-owners and land-users, imposed as a fixed payment per unit of acreage. Rates of the land tax on agricultural areas are specified on the basis of their cadaster assessment that varies in different regions. Rates of the land tax in cities and settlements are specified by relevant authorities); payments for discharge of polluting substances into the air and water (amount of such payments are determined together with allowed limits of discharges per unit of pollution, and if the limit is exceeded, the rate is raised five times); payment for the water taken in by enterprises from water systems (these rates are differentiated according to the types of water systems); payment for use of natural resources (payments for the

rights for prospecting and mining, deductions for regeneration of the minerals-raw materials base, charges for issue of licenses, oil and gas extraction excise).

Reconstruction of the government finances system in 1992 (Table 3.1) demonstrates that the revenues of the budget and extra-budgetary funds provided about 45.5% of GDP. This approximately corresponds with the level that existed in relatively well-off 1980-1985 years in respect of the state of finances, and in a considerable degree exceeds the level of 1991. In 1992 tax revenues for the budget of the republic and local budgets amounted to 28.3% of GDP.

If 1992 is studied more closely, then in its structures of the tax revenues the following trends can be noted: decrease of share of the tax on profits (from 11% of the tax revenues amount in the first quarter to 8% with an increasing total in III quarter), decrease of the tax on profits share after growth in the 1st half-year period, decrease of significance of VAT beginning from III quarter (maximum proceeds from VAT was in November-December 1992), even decrease of the excises share during the whole year, increase of the share of the property and foreign trade taxes, which in figures 6.1, 6.2 are included into the number of other taxes.

As a whole, the similar dynamics of volume and structure can be considered as the proof of success of the taxation policy conducted during the first year of radical reforms. Tax revenues, though they were not sufficiently stable in time, allowed to ensure an high level of the budget expenditures that taking into account their high rigidity were hardly able to be reduced in one year more considerably under the circumstances of the then existing political situation.

Since January 01, 1993 the VAT rate was reduced from 28% to 20% for all goods (works, services) except foodstuff (with the excise-worthy goods) and goods for children for which the rate was specified in the amount of 10%. The VAT preferences list was cut and made more specified. Since February 01, VAT was imposed on the goods imported to the Russian Federation. Procedure of the VAT credits and terms of its payment was changed. As a result, the volume of this tax proceeds diminished considerably.

In 1993 preferences for the tax on profits were changed (the amounts allocated for financing of investments of not only the productional, but also non-productional designation became tax-exempted). The important novelty was introduction of procedure for additional payment of interests charged for the difference between the tax on profits effected advance payments and the actual amount of the tax in amount of the Central Bank re-financing rate.

Despite decrease of the VAT rate, in January 1993 tax proceeds were rather significant because its charging as per the last year rates continued. But since 1993a noticeable decrease of the VAT share in the total volume of the tax revenues in the consolidated budget and coincidental raise of shares of other taxes (tax on profit, income tax and other) occurred.

Afterwards during 1993 the taxes setup was not changing essentially, as in the main the tax laws remained unchanged. As a whole in 1993, as it is pointed out above, a gradual decrease of the tax revenues share in GDP was observed, and that process took place practically for account of all kinds of taxes. In 1993 the tax revenues amounted to 24.6% of GDP, tax on profits came to 41.8% of the budgets, tax revenues (10.3% of GDP), VAT- 28.1% (6.9% of GDP), income tax - 10.9% (2.7% of GDP), excises - 4.5% (1.1% of GDP).

The first months of 1993 featured extremely low volumes of tax revenues. By April - May the situation began to improve, though in comparison with the level of 1993 the share of the tax exactions in GDP during a half-year period declined from 28% to 21-22%. The most significant change in the setup of the tax revenues that occurred in May 1994 (fig 6.1,6.2) resulted from the above-mentioned change in the classification of the budget revenues. In the beginning of 1994 some raise of the VAT share took place (from 39% in 1993 to 42% in January 1994), and that was due to extension of taxation basis by means of inclusion thereto all resources received from other enterprises and some other changes.

Some growth of the personal profit tax (by 0.3% of GDP) was caused by changes in the taxation basis - money incomes of population. Moreover, in the beginning of the year the income tax recalculated on the basis of returns according to results of the year was being received.

Increase of the enterprises expenses for remuneration of labor that was exempted from the profit tax to six minimal rates of remuneration resulted in decrease of the profit tax share to 36% in January 1994 in comparison with 42% in 1993.

As a whole, in 1994 variations in the tax revenues setup were insignificant. The tax revenues in the Russian budget amounted to 22.3% of GDP. Tax on profits - 34% of the tax revenues (7.6% of GDP), VAT - 26% of tax revenues (5.8% of GDP), income tax - 12% (27% of GDP, excise - 5% (1% of GDP).

Dynamics of the tax revenues in 1992-1994 cannot be explained only by changes in the taxation technique. Volumes of tax exactions during this entire period were affected by numerous macro- and microeconomic factors. Besides, when in 1992 it was quite difficult to find out such affection without a special in-depth study due to an extreme instability of the law and enactment basis of taxation, in 1993 under the conditions of a relative stability of legislature the trend of decrease of the tax revenues in the federal and local budgets manifested itself vividly. In winter and in spring 1994 this trend continued, and by summer turned to the opposite, and volumes of the exacted taxes improved to a degree. The following are the most important factors that affect the dynamics of the tax revenues:

- An high rate of inflation in Russia resulting in distortion of the taxation and tax rates scales basis practically for all taxes, and also causing the inflationary

devaluation of the tax revenues within the period between emergence of the payer's tax liabilities and the moment when the tax reaches the budget.

- A state of the payment-settlement relations in the national economy. Value of enterprises' defaults for the budget strongly depends on the value of the unsettled debit indebtedness (mutual defaults of enterprises), because insolvency of enterprises directly affect the solvency of their creditors and relations of the latter with the budget.

- Adaptation of economic agents to the tax system and the changes within it. Striving for minimization of taxes and deductions to the extra-budgetary funds is one the priority goals of an enterprise. Method for under-estimation of incomes and over-estimation of expenses can be conditionally divided into the following groups: performance of an accounting that allows the maximum delay of the earnings crediting and the fastest possible registration of the expenses; utilization of the preferences granted by the law; use of discrepancies in the tax laws; unlawful evasion of tax-paying.

The budget non-tax revenues in 1992 amounted to, approximately, to 0.6% of GDP; in 1993 - 2.3% of GDP. This growth in the main is caused by appearance of such source of income as the profit of the Central Bank transferred to the federal budget and a certain growth of proceeds from privatization.

## 7. Budget expenditures setup

Analysis of the expenditures part of the Russian budget in 1991 is also, like analysis of revenues, hampered by the fact of dissociation of the USSR and lack of the necessary statistics. In accordance with the official statistics the Russian budget expenditures, taking into account expenses for the agricultural products prices, granted for account of resources of the Central Bank, amounted to 30.4% of GDP. Together with the Pension Fund expenditures reached 37.2% of GDP. Meanwhile expenses for the national economy came to 10.1% of GDP (27% of the budget expenditures), expenses for social purposes - 14.7% of GDP (39% of the budget - together with the Pension Fund).

But, in our opinion, these figures are not much informative and require, as an addition, consideration of evaluation of expenditures of the consolidated budgets of the former USSR states. These expenses in 1991 reached 48% of GDP (estimate of GDP of the former union republics - 2100 billion roubles). At the same time the budget expenses came to 40.5% of GDP, those of the Pension Fund - 7.4% of GDP. For the national economy, without taking into account expenses for subsidies of prices for agricultural products (4.7% of GDP) 12.9% of GDP, for social purposes - 9.8% of GDP, for defence - 4.9% of GDP were spent.

As it is mentioned above, no analysis of the budget of 1992-1994 is necessary to take into account the over-estimated assessing of those revenues and

expenditures that initially had been determined in foreign currency. Considering this, expenditures of the consolidated budget and loans, less repayments, in Russia in 1992 amounted to 66.9% of GDP (Table 1.3.2).

Expenditures for the national economy reached 26.3% of GDP, including the imports subsidies - 10.5% of GDP, expenditures for account of the non-budgetary funds - 4.4% of GDP. An assessment of the imports subsidies we took into account the imports carried-out for account of the fund left by exporters abroad (101 million USD), imports for account of the currency reserve of the Republic (606 million. USD), imports for account of foreign credits, liabilities of repayment of which bears the government (7.1 billion USD in the first half-year period; 8.8 billion USD for three quarters and 10.8 billion USD in the entire 1992). As a result, the subsidies for prices of the imported product amount to 1600 billion roubles, most part of which was financed for account of foreign credits.

Expenditures for governmental authorities in 1992 amounted to 0.6% of GDP, for the law enforcement bodies - 1.4% of GDP, science - 0.6% of GDP, for service of the national debt - 1.5% of GDP. Social expenses - 17.1 % of GDP (including those for account of extra-budgetary fund - 9% of GDP). Subsidies, less repayments in 1992 came to 5.2% of GDP.

In 1993 setup of the governmental expenditures changed rather considerably. Expenditures for the national economy decreased in a considerable degree (up to 14.4% of GDP). The main reason for this was decrease of amount for the imports subsidies (to 1.2% of GDP). Investments that were performed in the national economy for account of the federal budget also decreased in an extent (from 1.7% to 0.8% of GDP).

Up to 0.3% of GDP increased expenditures for government power and administration authorities (to 0.9% of GDP) to 0.7% of GDP - state's social expenditures that reached 18% of GDP, also including those for account of the extra-budgetary funds - 8.4% of GDP. Defence expenditures in 1993 somewhat decreased to 4.4% of GDP. Expenses for the law enforcement bodies rose to 1.6% of GDP, expenses for science remained at the same level of 0.6% of GDP.

As a whole, expenses in 1993 amounted to 48.3% of GDP, expenditures together with loans, less repayments - 50.3% of GDP. And loans, less repayments decreased from 5.2% of GDP in 1992 to 2.0% of GDP in 1993.

Study of the economic classification of the budget expenses in 1993 (table 7.1) demonstrates a rather large share of the capital expenditures of the federal budget (19% of expenditures), which in the industrial nations rarely exceeds 8-9%. A relatively small value of subsidies and current transfers (14%) is explained, obviously, by the fact that the majority remained unspecified under the item "other expenditures for goods and services." A small volume payment of percents, for the national debt is explained by obtainment of deferments for servicing of the external debt and defaults (in 1993 among the total amount of servicing of the national debt

of 31 billion dollars, including payment of interests and repayment of the principal sum, 20 billion dollars were deferred, and 9 billion dollars were an overdue indebtedness) and extremely low rates of interests for the Central Bank credits for the Government that make up the prevailing part of the internal borrowings.

## 8. Budget policy outlooks

Budget draft for 1995 was presented for the State Duma on November 05, 1994. After discussions at its committees it was declined in the first reading. For further work the conciliatory commission was set up for the purpose to revise the main indices of the draft, after the work of which the draft was adopted on December 23, 1994 in the first reading and sent to the Government for corrections. On January 09 the Ministry of Finance presented for Duma the revisions for the draft, and on January 25 the Law "On the federal budget for 1995" was adopted in the second reading. It means that the figures of the budget revenues were approved - 175 trillion roubles (18.4% of GDP), expenditures - 248 trillion roubles (26.7% of GDP), and the deficit limit amount - 73 trillion roubles (7.7% of GDP).

The budget draft was prepared by the Government in the context of the macroeconomic program for 1995. The main objective of the program in accordance with the wording used in the report of Finance Ministry is completion of the macroeconomic stabilization in spring-summer of 1995. Mean monthly rate of inflation in 1995 must not exceed 2%.

To fulfill this objective the Government in 1995 proposed the following:

- to finance the budget deficit for account of emission of the government securities and foreign financing;
- to ensure a low growth of Central Bank net credits for commercial banks;
- to ensure a positive real rate of refinancing, to develop credit auctions;
- to carry out the policy of the floating decreasing rate of exchange of the rouble.

Today it is absolutely clear that rates of inflation this year will be higher than the program provides for. Inflation in January amounted to 17.1 %. Nonetheless, under-estimated rates of the price rise and volume of GDP taken into account in the calculations performed by the Ministry of Finance allows to avoid, in this year, the last year situation, when an unreal nominal volumes of the budget revenues and expenditures were approved. The real rates of inflation being half as much again compared with those specified in the program, the nominal volumes of the budget revenues that are much lower both in real terms and specified in fraction of GDP will allow to perform financing of the nominal volumes of expenditures that are approved in the budget, without increase of the deficit volume.

Financing the budget deficit this year is a complicated problem. The budget provides for its non-inflationary financing, abandoning the use of Central Bank credits. The calculations are based on receipt of the external financing in the amount of 12.3 billion USD and internal borrowings at the financial markets in the amount of 41.4 trillion roubles. We believe that receipt of such volume of the internal borrowings will pose problems if there is no considerable rise of the real interest rate that would lead to increase of expenditures for servicing of the national debt and suppression of the investment activities. Purchase of a certain volume (15-20 trillion roubles) of governmental securities by the Central Bank with coincidental increase of the monetary base and exaction of Central Bank profit to the budget revenues.

Today implementation of the budget is carried out on the basis of Law "On financing of government expenditures from the federal budget in the 1st quarter of 1995" adopted on December 23, 1994, according to which financing is performed based upon projections of the 1st quarter, which were presented by the Government for Duma, and as the taxes actually are received and finances in the amount of up to 18 trillion roubles (including Central Bank credit - 5 trillion roubles) borrowed.