

7. THE RUSSIAN BUDGET DEFICIT- WHAT IS OBSTRUCTING THE FINANCIAL STABILIZATION ?

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1. Introduction

The purpose of this paper is to explain what is obstructing the financial stabilization of Russia.

In the first quarter of 1992, the financial stabilization policy was aggressively implemented yet did not continue past the second quarter of that year. In consideration of why this policy did not last, the basic reason(s) for the financial deficit can be analyzed in depth. Moreover, I would like to consider solutions to this problem.

The results of the annual budget for Russia for 1992 have yet to be made public. According to the Goskomstat (State Committee of Statistics), the Federal budget deficit from January through November of last year reached 623 billion rubles, however, at the present time, there are no accurate figures available. With this in mind, I will use the final draft of the Federal budget for 1992, adopted on December 18th of the same year (Rossiiskaia gazeta, January 16th, 1993), as the main subject of my analysis. As indicated in Table 1, according to this final draft, the budget deficit was 1258.2 billion rubles (32.5% of the total expenditures).

In this paper, I will cover three factors that are thought to be critical in the consideration of the financial problems existing in Russia: 1. subsidies, 2. foreign economic activities, and 3. financing of state domestic debts and budget deficits.

2. Subsidies

At this point, I would like to cover the subject of price subsidies (compensation for differences in prices) and agricultural subsidies.

According to the budget proposal for 1992, the sum total of price subsidies was 313.9 billion rubles (8.1% of the total expenditures). A breakdown of this is as follows: coal, 148.4 billion rubles (3.8% of the total expenditures), foodstuffs, 165.6 billion rubles (4.3% of same) - up until now, price subsidies comprised from 15-20% of annual expenditures, and of these subsidies, 90% was allotted to agricultural products. In addition to this, agricultural subsidies (subsidies for agro-industrial complex and individual farms) are calculated to be 235.9 billion rubles (6.1% of the total expenditures).

The price subsidies for coal were already calculated in the initial budget for the first quarter of 1992. The price of coal was not liberalized - it remained a state-regulated price, and price subsidies were left over. In this scenario, the coal industry is not very profitable (the deficit for the coal mining industry for 1992 was 150 billion rubles, cf. Rossiiskie vesti, February 16th, 1993), however, the situation is the same worldwide. In the "Financial and economic policy of Russia in 1993" deliberated on by the Russian government in January of this year, the marked reduction in coal subsidies was clearly defined (Izvestiia, January 26, 1993). Yet it is thought that the price of coal should be determined from the standpoint of a national energy policy, and, moreover, it cannot be said that these subsidies should be abolished immediately.

After the procurement price of agricultural products was liberalized, there should not have been any necessity for price subsidies, however, price subsidies on livestock products were restored in May of 1992, and the amount increased in both July and August. This is a prime example of the true nature of "price liberalization". As has been the case up until now, the majority of agricultural products are purchased by the State Procurement Agency, and even though the name and form of this agency has changed, in reality, the procurement price remains a state-regulated price. Consequently, just as in the case of the coal mining industry, due to low profitability, price subsidies became necessary. Furthermore, the subsidies currently allotted to various livestock products amount to 20-30% of their retail price. Until now, the amount of subsidies was up to twice that of retail prices - with this in mind, subsidies have been considerably

reduced.

In regards to the 235.9 billion rubles in subsidies for agro-industrial complex and individual farms, of this amount, it has been indicated that 62.6 billion rubles went to assist in the supplement of bank interest payments. It is not clear, however, as to how the remainder of this sum has been used. If you add this amount (235.9 billion rubles) to the amount allotted for subsidies on agricultural products, then the total for agricultural subsidies comes to 10.4% of annual expenditures of the Federal budget. There are differing schools of thought as to whether this percentage is too high or too low, however, it should be pointed out that agricultural subsidies, just as in the case of coal subsidies, exist in countries throughout the world. These subsidies should also be determined from the standpoint of a national food policy, and here again, too, it cannot be said these subsidies should be abolished immediately. The truth is, according to the government decree on urgent measures for financial support of the agro-industrial complex of the Russian Federation, which was adopted on January 23rd of this year (Rossiiskaia gazeta, February 2nd, 1993), price subsidies on livestock products are being supported. Furthermore, as stated in the government decree on state regulation of prices on bread and bakery products, dated February 3rd, 1993, in order to regulate the price of bread, there are plans to implement price subsidies on grain products.

In regards to the above mentioned subsidies, it is thought that not only it is not possible to immediately abolish said subsidies, it is not even desirable to do so. The main issue is that it should be made public as to which industries are receiving subsidies.

3. Foreign economic activities

Regarding the budget for 1992, special mention should be made of the fact that foreign economic activity that yielded, up until now, 15-20% of annual revenue has vanished. According to the initial budget proposal for the first quarter of last year, the revenue from this activity amounted to 228 billion rubles (54% of the total revenue), and the expenditures from this activity were indicated as being

219.7 billion rubles. As indicated in the final budget proposal for the first quarter, only the difference between these two amounts (8.3 billion rubles) is listed as revenue, and, as a result, both expenditures and revenue have dropped by one-half. Thus, the practice of listing only the balance of revenue and expenses relating to foreign economic activity in the budget was implemented. It was related to the practice of compiling two budgets, begun since the end of the first quarter: the one in rubles which is discussed and approved by the parliament, and the other based in foreign currencies which is not revealed to the public (cf. Program for deepening of economic reform). Only the balance of revenues and expenses of the dollar-based budget is listed in the ruble-based budget. As a result of this practice, as indicated in Table 1, the revenue from foreign economic activities is not listed in the budget proposal for 1992. Instead, it is listed under annual expenses as 89.7 billion rubles and calculated to be 2.3% of the total expenditures.

In regards to this point, I would like to consider three problems. The first is the problem of the practice of concealing the foreign economic activities budget within a double-standard (dollar and ruble-based) budget. Much of the data essential to the stabilization of the Russian economy, such as export duties, import duties, import subsidies, international debt payments, etc., is being concealed within this dollar-based budget - this in itself is a big problem, as this information is not made available to the public. Unfortunately, there are few papers in existence that criticize the government and the Ministry of finance on this point, that is, to the extent of those written by V. Grechikhin and Iu. Petrov (*Izvestiia*, October 13th, 1992), of the Ministry of Foreign Economic Relations. One of the factors that led to the creation of the double-standard budget is the problem of the exchange rate. The extent of expenses and revenues relating to foreign economic activity depends on the exchange rate. However, the rate established the ruble at an abnormally low level, moreover, the range of fluctuation is too great. As a result, it is impossible to appropriately reflect the amount of annual expenses and revenues derived from foreign economic activities in a ruble-based budget.

For example, in regards to centralized imports, such as critical machinery, facilities, foodstuffs, etc., because a relatively high ruble rate is applied, import subsidies are required. These rates are applied to differing degrees to various products, yet if you average it out, it comes to approximately 20% of the market (official) rate (*Ekonomika i zhizn'*, 1992, No. 35). According to Grechikhin and Petrov, as a result of this practice, in the first half of 1992 alone, 634 billion rubles were required for these subsidies. And, according to the Program for deepening of economic reform, if there is no significant reduction in these import subsidies, or no abolishment of same after 1993, then it is concluded that financial restoration is impossible. In addition, regarding the payment of foreign debt, Russian financial statistics offer no information whatsoever. As far as credit from foreign countries is concerned, it is indicated that Russia received 90.6 billion rubles of credit in 1992 from foreign countries which was used to supplement the budget deficit, however, there is no detailed account of how it was used.

The second issue is the problem of what happened to the export revenues, or excess profits, derived from the sale of commodities such as oil and gas. Until now, due to the fact the domestic prices for oil and gas were set at a low rate, when these commodities were exported, their revenue took the form of special foreign trade earnings. In 1992, when the domestic prices of oil and gas were raised in gradual stages, this revenue disappeared.

In 1992, export duties were implemented, and a tariff of 34 dollars per ton of oil was established. As the volume of Russian oil exports was 66 million tons for the year 1992, by simple calculation, there should have been 2.2 billion dollars of export duty revenue. This export duty was paid in rubles, for example, 1 dollar=110 rubles, and the revenue from the export of oil alone should have been 242 billion rubles. However, concerning export duties, a variety of tax reduction and tax exemption measures were carried out in every region with every company. According to Grechikhin and Petrov, it was estimated that in 1992, the loss of export duties due to a series of tax exemption measures reached 440 billion rubles.

It is evident that Russia has a relative abundance of oil and that oil will

undoubtedly remain the most important source of economic prosperity for the nation. It is indeed advantageous for Russia that for several decades to come, the nation will exist as a great power based upon its huge supply of fuel and natural resources. As was advocated by Dmitri L'vov and Vsevolod Pugachev, there is even a possibility of establishing a unique tax system that almost wholly depends upon fuel and exempts almost all other incomes of enterprises and individuals. According to these men, based on calculations using global prices, over 70% of profits can be generated by fuel and energy industries. If only half of this amount (in 1991, 125-130 billion dollars, and at the rate of 1 dollar=110 rubles, 13,750-14,300 billion rubles) is consumed, all financial annual expenses can be met (Rossiiskaia gazeta, February 16th, 1993).

Nevertheless, in actuality, despite the fact that the price of oil was raised in gradual stages, after November 1992, a special tax was levied on oil. According to a government decree issued on November 1st of last year, an excise tax on oil was implemented appropriately to various companies from the same day (Rossiiskaia gazeta, November 18th, 1992). However, the tax rate was only between 5-30% of the price of oil. The average wage in the oil extracting industry as of December 1992 was the highest (53,215 rubles) as ranked by industries, and was considerably higher than the national average (16,132 rubles, cf. Rossiiskie vesti, February 16th, 1993). Just by looking at this data alone, it is evident there is a big possibility remaining to raise taxes on the oil companies.

The third problem concerns the necessity of an adequate exchange rate. At the present level of exchange rate, large amounts of import subsidies are needed. As V. Maevsky and P. Khlebnikov are justified in arguing, this is required because the present official exchange rate is set at an excessively low level (Izvestiia, January 12th, 1993). Furthermore, there is another problem as well. Even though the domestic prices of oil have been gradually raised in order to narrow the gap between international and domestic rates, the domestic prices of oil still remain far below world prices due to the rapid decrease in the exchange rate of the ruble.

In order to solve this type of problem, the current ridiculous attempt to make

a market rate (determined by an extremely limited currency market) the official rate should be halted. Instead, a method of supporting an appropriate official rate in a stable manner must be implemented. In that scenario, would it not be desirable to somehow link the domestic price standard of oil and the rate of the ruble? As previously mentioned, oil is the core of Russian industry, and without a doubt, the implementation of financial, exchange, and price policies centered around oil would be intelligent.

4. Financing of state domestic debts and budget deficits

In the draft of the federal budget for 1992, the financing of state domestic debts accounted for 187.3 billion rubles (4.8% of the total expenditures). The state domestic debts of the former Soviet Union, which are the accumulated sum of the past budget deficits, debt write-off (spisanie) for enterprises, deposit compensation paid to households for price increases in 1991, etc., exceeded 900 billion rubles at the end of 1991 (Financy, No.1, 1992, pp.7-11). It is not clear as to how much of this sum Russia assumes the responsibility for. Nor is it clear as to how the money appropriated for the financing of state domestic debts, mentioned above, has been used. The first thing the Russian government needs to do to solve this problem is to answer these questions.

A considerable amount of the state domestic debts are the debts to the Savings Bank of Russia. At the beginning of 1992, out of 411.1 billion rubles in total financial assets held by the Savings Bank, the government and the Ministry of Finance withdrew 285 billion rubles in order to cover a part of the state domestic debts. It was reported that the Ministry of Finance paid only 11% interest to the Savings Bank for this "loan" (Izvestiia, May 28th, 1992).

If an adequate amount of interest for the state domestic debts is not paid to the Savings Bank, then the latter is not able to pay, in turn, an adequate amount of interest to households. If the interest rate on deposits is far below the inflation rate, as is the case in Russia, effective monetary policies cannot be implemented. Therefore, in order to immediately increase the interest rates on deposits, the cost of financing state domestic debts has to be increased. The problem lies in where

to locate the financial means to this end. The Program for deepening of economic reform concluded that during the period 1992-93, if the budget deficit is less than 5% of GDP, then the financing of the state domestic debts would receive an adequate treatment only after 1994.

The next problem concerns the present, not the past, budget deficit. How is it financed now? According to the draft of the Federal budget for 1992, out of the total deficit of 1,258.2 billion rubles, 90.6 billion rubles was to be covered by foreign credits, as were mentioned earlier. The remainder, 1,167.6 billion rubles, was to be covered completely by credit from the Central Bank of Russia. It was stipulated that the Ministry of Finance would repay the Bank at a rate of 10% over a period of 10 years, beginning from 1996. This method of repayment is essentially the same as before, with the exception that the rate of interest and the time limit for repayment are clearly specified.

In 1991, the Savings Bank of Russia was reorganized into a corporation, and the Central Bank holds a 40% share of the total stocks of this corporation. According to the articles of association for the Central Bank, the Central Bank is authorized to use a portion of the deposits held by the Savings Bank. As a result of this restructuring, the Central Bank has a more expedient and legal access to the financial resources of the Savings Bank than it had previously.

As was the case in the past, this method of financing the budget deficit provides an easy "solution" for increasing the deficit and hinders the Savings Bank's capacity to finance other projects. The government has had no other option but to use this method - all efforts to issue state bonds in order to finance the budget deficit have failed thus far due to a lack of demand for state bonds. If the scenario of issuing state bonds is opted for, a higher yield of interest will be necessary. Once again, the problem lies in where to locate the financial means to this end.

In 1992, at least in the early months, Russia gave top priority to reducing the budget deficit, yet treated the task of establishing an adequate level of interest rates and an adequate method of financing the budget deficit as secondary. If a more realistic approach is to be taken, then we believe that this order of priority should be reversed.

5 . Concluding remarks

In response to the above mentioned, we can arrive at the following conclusions:

First, financial expenses are not something that can be reduced in a reckless manner. For example, in regard to subsidies, in consideration of the structure and productivity of industries in present-day Russia, it becomes evident that those subsidies cannot readily be abolished. It would seem that the same holds true for investments, the cost of social policies, national defense expenditures, and so forth.

Second, if there is a limit imposed on the reduction of financial expenses, then the important issue is an orderly implementation of supplementary methods, and not an unreasonable reduction of the financial deficit. In order to achieve this, the nation should issue state bonds and must pay an appropriate rate of interest on these bonds. It is also essential that an appropriate rate be paid on accumulated deficit (state domestic debts) as well. Moreover, there is the major problem of the guarantee of financial sources. Even with this in consideration, the establishment of an appropriate method of supplementing the financial deficit should be given the highest priority.

Third, a plan should be considered to increase revenues through energy resources centered around oil.

And fourth, in order to achieve financial stabilization, the establishment of an appropriate standard for the ruble rate is essential. In this situation as well, it is probably necessary to base this rate on the price of oil.

Table 1. Drafts of the Russian Federal Budget for 1992

	Final draft for 1992 bill.rubles %		Original draft for 1992 bill.rubles %		Final draft for Jan.-March bill.rubles %	
Revenue						
Value-added tax	1476.7	56.5	1503.3	63.5	129.0	66.4
Excise tax	145.4	5.6	65.7	2.8	7.2	3.7
Funds of price regulation	159.6	6.1	159.6	6.7	—	—
Profit tax	565.4	21.6	406.0	17.1	35.6	18.3
Tax on natural resources	26.1	1.0	29.4	1.2	—	—
Geological fees	67.9	2.6	67.9	2.9	5.4	2.8
Revenues from privatization	39.9	1.5	39.9	1.7	1.8	0.9
Foreign economic activities	—	—	—	—	8.3	4.3
Other	89.2	3.4	85.8	3.6	6.9	3.5
Sub-total	2570.1	98.4	2357.7	99.5	194.2	100.0
Intergovernmental transfers	19.0	0.7	—	—	—	—
Land tax(from local budgets)	24.2	0.9	11.6	0.5	—	—
Total revenue	2613.2	100.0	2369.2	100.0	194.2	100.0
Expenditure						
National economy	863.0	22.3	708.3	21.3	56.4	21.6
-Price subsidies	313.9	8.1	275.7	8.3	11.4	4.3
-Coal	148.4	3.8	148.4	4.5	10.5	4.0
-Agricultural products	165.6	4.3	127.4	3.8	0.8	0.3
-Agricultural subsidies	235.9	6.1	207.5	6.3	2.3	0.9
Foreign economic activities	89.7	2.3	89.7	2.7	0.0	0.0
Social & cultural activities	421.5	10.9	417.2	12.6	47.2	18.1
-Education	227.1	5.9	211.7	6.4	21.5	8.2
Science	102.3	2.6	87.5	2.6	10.8	4.1
Justice & security	233.0	6.0	216.5	6.5	16.8	6.4
Administration	64.1	1.7	55.7	1.7	3.8	1.4
Investment	362.9	9.4	346.6	10.4	25.8	9.8
-Agro-industrial complex	130.2	3.4	117.2	3.5	0.0	0.0
Defense	847.8	21.9	715.7	21.6	50.7	19.4
State domestic debts	187.3	4.8	134.9	4.1	0.1	0.0
Intergovernmental transfers	174.7	4.5	127.8	3.9	29.0	11.1
Total expenditure	3871.4	100.0	3319.3	100.0	261.7	100.0
Balance	1258.2	32.5	950.1	28.6	67.5	25.8

Notes: The final draft for 1992 was adopted on December 18, 1992.

The original draft for 1992 was adopted on July 17, 1992.

The final draft for January-March of 1992 was adopted on April 4, 1992.

Sources: Rossiiskaia gazeta, February 25, March 25, May 14, August 21,

September 15, 1992, January 16, 1993.