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<td>Author(s)</td>
<td>Kuboniwa, Masaaki</td>
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<tr>
<td>Citation</td>
<td>Hitotsubashi Journal of Economics, 37(2): 101-133</td>
</tr>
<tr>
<td>Issue Date</td>
<td>1996-12</td>
</tr>
<tr>
<td>Type</td>
<td>Departmental Bulletin Paper</td>
</tr>
<tr>
<td>Text Version</td>
<td>publisher</td>
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<tr>
<td>URL</td>
<td><a href="http://doi.org/10.15057/7749">http://doi.org/10.15057/7749</a></td>
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RUSSIAN FISCAL TRENDS FOR 1992–1995*

MASAAKI KUBONIWA

Abstract

This paper examines Russian budget trends from 1992 to 1995. Following a devastating bout of hyperinflation from 1992 to 1994, the Russian government reversed policy course from emphasizing economic liberalization and, assisted by crucial assistance from the International Monetary Fund, implemented a program of strict fiscal austerity with the 1995 budget. The paper examines major components of revenues and expenditures, with attention to ratio shifts between the central and regional governments. Although important progress toward economic stability has been achieved, further efforts for stabilization are necessary while difficulties in collecting taxes mean the revenue base remains shaky.

Introduction: Major Issues in Analyzing Fiscal Trends

In the first phase of liberalization during the four years from 1992 to 1995, Russia, unlike most other East European countries, failed even to hold annual inflation rates in the two-digit percentage range. From the end of 1991 to the beginning of 1992, the Boris Yeltsin-Yegor Gaidar government put more effort into liberalization than into stability. The government stated in a “Policy Memorandum” issued to the IMF in February 1992 that it would take several measures to correct matters and that it would shift its policy emphasis to achieving stability, but this approach lasted a very short time. Instead, the policy-making emphasis shifted to privatization, which caused an increase in the fiscal deficit though it did not become a subject of debate. The first IMF support program for Russia (from June 1992) was a Stand-By Arrangement type. It came to an end on January 4, 1993. During this period, inflation was assumed to have fallen to 5% a month, but it then surged to the hyperinflationary rate of 25% a month during the last quarter of 1992. How this situation changed through 1993 cannot be clearly explained. The second IMF program (from June 1993) was an STF (Systemic Transformation Facilities) type. Its objective, to bring the monthly inflation rate down to single digits, met with complete failure. Entering the fall of 1994, the government suddenly set the ambitious goal of bringing inflation down to a monthly rate of 1% by the

* The author wishes to thank Charles Weathers for translating and editing this paper. Research was partially funded by grant-in-aid (COE, Priority Areas, and General Study C) from the Ministry of Education and Sciences of Japan for fiscal year 1996.
second half of 1995, and accordingly decided on a stringent fiscal policy. In April 1995, the IMF used this objective as its base in establishing rather relaxed standards of an average monthly inflation rate of 3% for 1995 and fiscal deficit equal to 5% of GDP as conditions for a Stand-By Arrangement (SBA) eventually worked out with the Russian government. In 1995, the target of 3% of GDP or less was bettered by a surprisingly wide margin. But while the real monthly inflation rate averaged in the 5% range, the government had to repeatedly announce to the parliament that it would be brought down to 1%, a target not initially accepted by the parliament. Ultimately, however, there was quick approval of the 1996 budget in February 1996 based on figures of a fiscal deficit of 3.85% of GDP and a 1.9% monthly (25% annual) rate of inflation. Further, agreement was reached in February 1996 between the Russian government and the IMF based on real 1995 performance and the 1996 budget. The agreement was formally approved in March 1996, and it states that on condition of progressive implementation of step-by-step abolition of export taxes on oil and gas, an Extended Fund Facility (EFF) totaling 10.2 billion dollars will be extended for three years from 1996. This suggests that the IMF has high regard for Russia's 1995 economic and fiscal performance.

The purpose of this paper is to examine trends in Russian budgets between 1992 and 1995. In tracing general fiscal trends, and particularly by examining how a large reduction in the fiscal deficit was accomplished in 1995, we seek to analyze whether the economic stability it seemingly generated in the latter half of the year will prove to be durable. Before beginning this analysis, we should briefly mention why no policy measures were taken to promote stability prior to 1995. In addition to the several systemic conditions related to the collapse and rebuilding of the state itself we need to bear in mind the two points below regarding peculiarities in Russia when the country was first restored.

First, it is estimated that fiscal deficits reached 20-30% of GDP during the step-by-step liberalization process pursued in 1991. Monetary overhang was estimated at around one third of the money supply, but may have been much greater judging from a monthly inflation rate that reached as high as 245% in January 1992 immediately following price liberalization [Koen and Philips (1994)]. However, the Gaidar Plan estimated inflation for that month at 100%, and this figure had great influence on IMF advice. IMF advice also relied heavily on analyses by M.I. Blejer [Blejer (1991)]. Blejer argued that early price rises could not exceed 50-75% if excessive fluctuations were to be eliminated. The IMF itself seems to have estimated that inflation would be in the 50% range for January 1992. On the other hand, Russia's Economics Ministry forecast a 200% rate, but that was denied by Yegor Gaidar, who was then pushing liberalization. Apart from the issue of the extent to which that error proved disastrous, it is clear that the budget for the first quarter of 1992, which was Gaidar's first budget, was unreliable and invited a series of policy mistakes [Gomulka (1995)].

Second, because Russia assumed the former Soviet Union's debts, and because of the low reliability of policy-making capacities of the new government, the country was in no position to obtain large-scale or concessionary foreign financing. Although the G-7 prepared a large-scale financial aid package, the government would not have used the funds to good effect. Fortunately, since the necessary conditions did not exist in Russia, the aid plan was not implemented.

Of course, following the experience of instability in the three-year period from 1992 to 1994 which followed the birth of the new Russia, and after the IMF began providing funds through its third program of a Stand-By Arrangement (totaling 6.5 billion dollars) in 1995,
Table 1. Russia's Fiscal Accounts (Ministry of Finance Data), 1992–1995

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<th></th>
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<tbody>
<tr>
<td><strong>Total revenue</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Consolidated budget</td>
<td>28.0</td>
<td>24.4</td>
<td>29.0</td>
<td>29.0</td>
</tr>
<tr>
<td>Federal budget</td>
<td>15.9</td>
<td>10.0</td>
<td>14.9</td>
<td>14.1</td>
</tr>
<tr>
<td>Regional budget</td>
<td>14.1</td>
<td>16.9</td>
<td>17.6</td>
<td>18.6</td>
</tr>
<tr>
<td><strong>Total expenditure</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Consolidated budget</td>
<td>31.4</td>
<td>33.6</td>
<td>33.6</td>
<td>39.3</td>
</tr>
<tr>
<td>Federal budget</td>
<td>20.9</td>
<td>20.1</td>
<td>20.6</td>
<td>24.8</td>
</tr>
<tr>
<td>Regional budget</td>
<td>12.4</td>
<td>16.1</td>
<td>16.4</td>
<td>18.1</td>
</tr>
<tr>
<td><strong>Fiscal balance</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Consolidated budget</td>
<td>-3.4</td>
<td>-9.3</td>
<td>-4.6</td>
<td>-10.3</td>
</tr>
<tr>
<td>Federal budget</td>
<td>-5.0</td>
<td>-10.1</td>
<td>-5.7</td>
<td>-10.7</td>
</tr>
<tr>
<td>Regional budget</td>
<td>1.7</td>
<td>0.8</td>
<td>1.1</td>
<td>0.4</td>
</tr>
</tbody>
</table>

MEMO: GDP

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<tbody>
<tr>
<td>19,005.5</td>
<td>171,509.5</td>
<td>610,993.1</td>
<td>1,658,932.8</td>
<td></td>
</tr>
</tbody>
</table>

Note: Russian Ministry of Finance, various issues of Monthly Budget Execution Report and the new GDP data of Goskomstat RF as of February 1996.

Note: Russian Ministry of Finance, various issues of Monthly Budget Execution Report and the new GDP data of Goskomstat RF as of February 1996.

The columns 1993(a) and 1993(b) are based on the initially reported budget figures and the revised official data respectively. Due to rounding of numbers, there are some discrepancies in figures.

conditions began to change. Still, the initial conditions which caused instability from 1992 to 1995 cannot be ignored.

This paper will examine the outcome outlined above and then proceed to an analysis of trends in Russian finance.

I. Macroeconomic Situation

Table 1 shows comprehensively the financial trends from the Budget Execution Report issued by Russia's Ministry of Finance (commitment base). The category "consolidated budget" in the chart consolidates budgets of the central and regional governments. It does not therefore include transfers between the center and regions. The coverage of the consolidated budget is smaller than the category "general government budget" which includes off-budget social funds (social security funds). The parts of Table 1 which usually draw the most attention are the indicators of federal (central) government financial trends.

Table 2 shows financial trends estimated by the IMF-World Bank formula. The key to the IMF-World Bank formula is that it judges financial performance by the "enlarged government budget" which adds off-budget items to the revenues and expenditures of the "consolidated budget." (Off-budget items include off-budget social funds and other off-budget funds whose effects of federal revenues and expenditures are hidden.) The relationship among these types,
TABLE 2. RUSSIA'S FISCAL ACCOUNTS (IMF-WORLD BANK DATA), 1992–1994 (as a percentage of GDP)

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<tr>
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<tbody>
<tr>
<td><strong>Total revenue</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Enlarged budget</td>
<td>46.2</td>
<td>40.7</td>
<td>36.3</td>
</tr>
<tr>
<td>Federal budget</td>
<td>16.2</td>
<td>11.9</td>
<td>12.7</td>
</tr>
<tr>
<td>of which: intergovernmental transfers</td>
<td>0.3</td>
<td>0.0</td>
<td>0.1</td>
</tr>
<tr>
<td>Regional budget</td>
<td>14.6</td>
<td>17.7</td>
<td>17.5</td>
</tr>
<tr>
<td>of which: intergovernmental transfers</td>
<td>1.7</td>
<td>2.7</td>
<td>3.5</td>
</tr>
<tr>
<td>Off-budget</td>
<td>17.4</td>
<td>13.9</td>
<td>9.6</td>
</tr>
<tr>
<td><strong>Total expenditure</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Enlarged budget</td>
<td>69.1</td>
<td>49.2</td>
<td>46.0</td>
</tr>
<tr>
<td>Federal budget</td>
<td>25.2</td>
<td>19.9</td>
<td>23.0</td>
</tr>
<tr>
<td>of which: intergovernmental transfers</td>
<td>1.8</td>
<td>2.7</td>
<td>3.5</td>
</tr>
<tr>
<td>Regional budget</td>
<td>13.0</td>
<td>17.0</td>
<td>17.5</td>
</tr>
<tr>
<td>of which: intergovernmental transfers</td>
<td>0.3</td>
<td>0.0</td>
<td>0.1</td>
</tr>
<tr>
<td>Off-budget</td>
<td>33.0</td>
<td>15.1</td>
<td>9.1</td>
</tr>
<tr>
<td>of which: import subsidies</td>
<td>11.9</td>
<td>2.3</td>
<td>0.0</td>
</tr>
<tr>
<td><strong>Fiscal balance</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Enlarged budget</td>
<td>−22.9</td>
<td>−8.5</td>
<td>−9.7</td>
</tr>
<tr>
<td>Federal budget</td>
<td>−9.0</td>
<td>−8.0</td>
<td>−10.3</td>
</tr>
<tr>
<td>Regional budget</td>
<td>1.6</td>
<td>0.7</td>
<td>0.0</td>
</tr>
<tr>
<td>Off-budget</td>
<td>−15.6</td>
<td>−1.2</td>
<td>0.5</td>
</tr>
</tbody>
</table>

**MEMO:**

- Qusai-fiscal spending by CBR (estimate) 22.5 8.3 n.a.
- Credit to the former Soviet Republics (estimate) 7.0 3.3 n.a.
- CBR directed credit (IMF estimate) 15.5 5.0 n.a.

*Sources: Document of the World Bank (June, 1996).*

*Note: GDP data before revisions in October 1995 are employed.*

from the viewpoint of coverage comprehensiveness, is: consolidated budget < general government budget ≤ enlarged government budget.

Because budget accounts formulas are revised every year, and because the Russian State Statistics Committee, Goskomstat, also changes GDP figures frequently and extensively, it is necessary to bear the following points in mind when examining the time series data in Table 1. First, import subsidy expenditures for 1992 and 1993 are not included in the budget outlays. Second, foreign currency sales and purchases are included in income and expenditures for 1994 but are distinguished from foreign currency operations. Third, federal funds for roads and the environment previously constituted part of the off-budget funding but became part of the regular budget as of 1995 (off-budget funds which have become part of the regular budget are called “budget funds”). Fourth, incomes from, and expenditures of, state reserves (precious metals such as gold and jewels) also were first entered in the budget in 1995. Fifth, in October 1995 Goskomstat revised estimates for nominal GDP for 1992 and 1993 upwards by around 7%, and at the end of 1995 it also revised nominal GDP figures for 1994 upwards by 3%.

(That was the third revision for nominal 1992 GDP figures. The earlier announced figure was 15 trillion rubles, the first revised figure was 20 trillion rubles, and the second revised figure was 18 trillion rubles. The current estimate is 19 trillion rubles.)

With the above qualifications noted, let us proceed to an examination of Russian fiscal trends. Judging from Table 1, federal revenues for 1992 were equivalent to 16% of GDP while outlays were 21% of GDP, meaning that the fiscal deficit reached 5% of GDP. Since regional budgets compiled a surplus equivalent to 1.7% of GDP, the consolidated budget deficit amounted to somewhat over 3% of GDP. On the other hand, Table 2 indicates that 1992 federal revenues reached 16% of GDP and outlays 25%, so that the fiscal deficit actually amounted to 9% of GDP. Regional governments compiled a surplus equal to 1.6% of GDP but off-budget sectors accumulated deficits equal to 16% of GDP. As a result, the deficit of the enlarged government budget actually amounted to 23% of GDP.

Clearly, there is a striking difference in estimates between the Russian formula and the IMF-World Bank formulas. The consolidated budget of the former indicates a deficit of just under 3% in 1992 while the enlarged government approach of the latter indicates a deficit of 23%, an amount several times greater. Further, while the Russian formula estimates the fiscal deficit for the central government at 5% of GDP, the estimate of the IMF-World Bank climbs to 9% (there is almost no difference in the respective estimates for regional governments). This is because there was a huge growth in import subsidies due to the plunging real value of the ruble in exchange markets, and also because Russia continued to extend credit to former Soviet Republics.

The IMF took full account of data on 1992 import subsidies provided by the Ministry of Finance, but Goskomstat only finished compiling its estimates in the summer of 1995. The results of Goskomstat's estimates of subsidies and import subsidies by product sectors compiled for the purpose of constructing the 1992 input-output table can be seen in Table 3. Import subsidies amount to 12.8% of GDP, exceeding the IMF-World Bank estimate of 12%. Agricultural and food products account for 40% and 19%, respectively, of the subsidies. The machinery and light industry sectors both account for more than 14% of the total. Total product subsidies declined by half as a proportion of GDP from 1991 to 1992. Agricultural and food products together accounted for 47% of total subsidies, but declined as a proportion of GDP from 8.8% in 1990 to less than 1/4 of that figure. Coal subsidies account for 18% of the total. As a proportion of GDP, coal subsidies were equivalent to 0.5% in 1990, and increased that share 1.5 times. In 1992, subsidies for housing and public utilities accounted for just under 19% of total subsidies, and transportation (passenger) and communications accounted for 8%. Goskomstat achieved good results in its attempts to estimate import subsidies, but it seemed to underestimate product subsidies, especially for agriculture. In any case, it is clear, first of all, that the government greatly reduced import subsidies as a proportion of GDP, and that outlays for off-budget items were drastically reduced as well. Table 2 shows that import subsidies declined nearly 10% in terms of proportion of GDP, and that off-budget items declined 18%. Of course, the 1993 subsidy reduction is in part an effect of the appreciation of the real exchange rate. From 1994, the system of providing favorable treatment through implicit import subsidies was almost totally abolished. Total elimination of measures favoring overseas economic activities was established in March 1995. Presidential Decree No. 244 legally summarized this situation. Therefore, from 1993 import subsidies ceased to be a major factor contributing to reducing fiscal deficits. Quasi-fiscal spending by the
<table>
<thead>
<tr>
<th>Subsidies to products</th>
<th>subsidies to imports</th>
<th>Total subsidies</th>
</tr>
</thead>
<tbody>
<tr>
<td>billions of rubles (%)</td>
<td>billions of rubles (%)</td>
<td>billions of rubles (%)</td>
</tr>
<tr>
<td>Coal</td>
<td>150.3 (18.2)</td>
<td>- (0.0)</td>
</tr>
<tr>
<td>Ferrous metallurgy</td>
<td>- -</td>
<td>85.9 (3.5)</td>
</tr>
<tr>
<td>Chemical industry</td>
<td>- -</td>
<td>204.5 (8.4)</td>
</tr>
<tr>
<td>MBMW</td>
<td>- -</td>
<td>348.2 (14.3)</td>
</tr>
<tr>
<td>Wood and paper</td>
<td>- -</td>
<td>17.8 (0.7)</td>
</tr>
<tr>
<td>Construction materials</td>
<td>- -</td>
<td>11.1 (0.5)</td>
</tr>
<tr>
<td>Light industry</td>
<td>- -</td>
<td>345.9 (14.2)</td>
</tr>
<tr>
<td>Food industry</td>
<td>26.6 (3.2)</td>
<td>453.4 (18.6)</td>
</tr>
<tr>
<td>Industry n.e.c.</td>
<td>- -</td>
<td>1.7 (0.1)</td>
</tr>
<tr>
<td>Industry</td>
<td>177.0 (21.5)</td>
<td>1,468.4 (60.4)</td>
</tr>
<tr>
<td>Agriculture</td>
<td>359.8 (43.6)</td>
<td>964.2 (39.6)</td>
</tr>
<tr>
<td>Transport and communications</td>
<td>68.8 (8.3)</td>
<td>- -</td>
</tr>
<tr>
<td>Trade and restaurants</td>
<td>56.0 (6.8)</td>
<td>- -</td>
</tr>
<tr>
<td>Other material branches</td>
<td>5.5 (0.7)</td>
<td>- -</td>
</tr>
<tr>
<td>Material production, total</td>
<td>667.1 (80.9)</td>
<td>2,432.6 (100.0)</td>
</tr>
<tr>
<td>Education and culture</td>
<td>3.1 (0.4)</td>
<td>- -</td>
</tr>
<tr>
<td>Housing and public utilities</td>
<td>153.7 (18.6)</td>
<td>- -</td>
</tr>
<tr>
<td>Science</td>
<td>0.9 (0.1)</td>
<td>- -</td>
</tr>
<tr>
<td>Total</td>
<td>824.7 (100.0)</td>
<td>2,432.6 (100.0)</td>
</tr>
</tbody>
</table>

MEMO: as % of total in GDP 
[4.3] [12.8] [17.1]

Sources: Goskomstat RF, Russian 1992 Input-Output Table, 1995.

Notes: Price support subsidies to agriculture, 43.094 billion rubles are included in subsidies to agricultural products.

Central Bank, especially provisions of credit to CIS/former Soviet countries along with direct credit from the Bank, declined greatly as a proportion of GDP from 1992 to 1993. In reality, credit to CIS countries declined (as a proportion of GDP) by half, from 7% in 1992 to 3.3% in 1993. From 1994, the Russian formula included credit to CIS countries in the form of credit operations added to expenditure accounts. According to the Budget Execution Report of the Ministry of Finance, (net) credit extended to CIS countries amounted to a trifling 0.06% of GDP. Furthermore, in 1995 (1 January 1996) repayments (759 billion rubles) from CIS countries exceeded credit (174 billion rubles) to those countries, making the figure minus 0.04% of GDP. Thus fiscal deficits, mainly caused by off-budget deficits, practically ceased to be a problem from 1993, as far as can be judged from any statistics. There was therefore little difference from 1993 between the Russian formula and IMF formula analyses regarding fiscal trends.

There are two important points regarding import subsidies. First, in 1992, the expansion of the fiscal deficit caused by the rapid increase in import subsidies was not a direct source of inflation. This was because foreign credit was a major contributor to the growth of the import subsidy (however, the rapid fall of exchange rates, in both nominal and real terms, fueled the
import subsidy expansion and was itself a source of inflation). The direct cause of the rise in inflation from mid-1992 was the Central Bank's high-powered money expansion policy, adopted to help enterprises handle accumulating bad debts. Naturally, extensions of direct credit by the Central Bank to compensate for fiscal deficits also contributed to inflation, but the credit extensions by the Central Bank did not help to fund the payment for growing government deficits which funded the growth in import subsidies.

Second, the rapid growth in import subsidy outlays in 1992 was a new problem which was not foreseen by the new Russian government. The problem became unexpectedly severe for a number of reasons. There was the former Soviet government's implicit "indirect taxation system" (with both domestic prices and the exchange rate determined by the government), plus the new government inherited a poorly understood Gorbachev-era/policy of import promotion; then the introduction of an import tax was delayed; and finally, the government proved incapable of properly supervising customs transactions.

Further, although federal revenues in 1993 declined from 16% to 10% of GDP from 1992, according to Table 1, outlays remained constant at 20% of GDP, so the fiscal deficit ballooned to 10% of GDP. The share of regional government revenues and expenditures declined from 1992, amounting to a surplus equal to only 0.8% of GDP. As a result, the deficit of the consolidated budget soared to 9% of GDP. Thus the direct cause of the rapid growth of the 1993 fiscal deficit was the central government's sudden loss of revenues.

Although federal revenues showed improvement in 1994, rising from the 1993 figure of 10% to 14% of GDP (12% if income from sales of foreign currency is excluded), outlays grew to 25% of GDP, and the federal fiscal deficit as a proportion of GDP rose to nearly 11%, exceeding the level of 1993. As surpluses by regional governments fell to only 0.4% of GDP, the deficit for the consolidated budget rose to just over 10%, above the level of 1993. Thus the direct cause of 1994's large fiscal deficit was rapid rise in federal outlays, in effect lax fiscal practices.

Conditions changed drastically in 1995. According to a Ministry of Finance report, federal revenues remained steady at 13.7% of GDP but outlays fell to the unheard of low of 16.6%. As a result, the fiscal deficit declined to less than 3% of GDP. More specifically, the deficit was rapidly reduced to 2.9%. Finally, regional governments compiled deficits equivalent to 0.4% of GDP. Thus the deficit for the consolidated budget reached 3.3% of GDP. The major factor in the marked improvement in the fiscal deficit in 1995, therefore, was the reduction in federal expenditures.

However, other important factors regarding the 1995 outcome were actual cutbacks as well as expenditures arrears, such as unpaid wages. In addition, spending reductions or slowdowns also led to feedback in the form of increased tax arrears. Reductions and arrears in outlays included, in addition to necessary cuts in subsidies and direct credits, delays in paying employees and civil servants in the public sector, as well as delays in providing funds to regions. According to a survey by the Ministry of Finance, arrears in tax payments from enterprises and organizations in the mining and manufacturing industries, and in the transportation, construction, and agricultural sectors reached 53.7 trillion rubles as of November 1, 1995 (then equivalent to 4.2% of GDP, and about 20% of total tax revenues). The figure also represents 32% of taxes on profits and value-added actually collected for that period. Tax arrears amounted to 57.4 trillion rubles as of January 1, 1996. The same situation was evident in the first half of 1994, but 1995 was different in that expenditures continued to be held down
in the second half of the year so that the problem of tax arrears reached its most serious level. A vicious cycle emerged in which the squeeze on expenditures aggravated the revenue shortfall, and the lack of revenues worsened the expenditures situation.

Figure 1 shows how changes in the fiscal deficits of the federal government and the enlarged government were linked to trends in monthly inflation rates. To begin with, stringent fiscal measures in 1995 brought inflation down from a peak of 18% in January of that year to 11% in February, 9% in March, 8.5% in April, 7.9% in May, and 6.7% in June. The rate continued to slow to 5.4% in July, 4.6% in August, and 4.5% in September. After marking time at 4.7% in October and 4.5% in November, the December rate was reported at 3.2%, the lowest since the birth of the new Russia (the average annual rate for 1995 was 130% that of December 1994). As Figure 1 makes clear, the basic situation which lasted until the summer of 1995 had developed in the summer of 1994 (monthly inflation rates for May through August 1994 were 7%, 6%, 5% and, 5% respectively). Then the exchange rate collapsed on October 11, and the monthly inflation rate soared to 15% and beyond. To prevent the ruble from crashing, the government and the Central Bank introduced the so-called “exchange rate corridor” from July 6, 1996 until the end of the year to limit the fluctuation of the ruble to the 4300-4900 ruble/USD range. In order to hold down inflation, the government, in addition to adopting a stringent fiscal policy, took measures to limit currency market fluctuations and to control domestic oil prices. Further, credit provisions to the Central Bank were also severely restricted from April 1995 by enactment of a budget law for fiscal 1995 as well as a Central Bank law.

With the fiscally stringent measures of 1995 still in effect and the results of the policy still evident, parliament approved a 1996 budget in December 1995 which foresaw a federal fiscal deficit of 3.85% and a monthly inflation rate of 1.9%. Moreover, currency fluctuation
restriction measures have maintained exchange rates in the 4450 to 5150 ruble/USD range during the first half of 1996.

Compared to the 11% fiscal deficit in 1994, holding the deficit below 3% during 1995 was certainly a notable achievement. This also made it possible to lower the rate of inflation. Furthermore, the contents of the 1996 budget foretell important progress in fighting inflation and containing fiscal deficits. However, whether the 1995 trends are sustainable or not is another issue. The following section will consider this matter, but first let us briefly examine the problems inherent in the fiscal deficit, inflation, and the macro-level connection between federal and regional government finances.

As is well known, one of the first problems addressed by the Russian government following the collapse of the Soviet Union was adjusting political relations between the center and the regions. During this process of adjustment from 1992 through 1993, revenues were steadily divided among regions. Table I shows that while the central government intake of revenues as a proportion of GDP fell from 16% in 1992 to 10% in 1993, regional governments increased their share from 14% to 17% during the same period. As a result, the distribution of revenues between center and regions changed drastically, from 53:47 in 1992 to 37:63 in 1993.

Table I shows that in 1994 the revenue distribution share shifted to a 43:57 ratio between center and regions, marking an increase in share for the central government. However, if we consider that the 1993 ratio was 40:60 where revenues from foreign currency sales not included in the budget are excluded, then basically the same situation existed in 1993 and 1994. Nevertheless, a clear shift can be seen in 1995, when an increase in the central government’s share of revenues brought the ratio to 49:51.

Outlays also saw a shift, though not to the same extent as revenues, as decentralization was pursued in 1992 and 1993, accompanied by a progressive takeover of functions by the regions. Table I reveals that the share of outlays (burden) between center and regions changed from 63:37 in 1992 to 55:45 in 1993. Basically, the same situation continued in 1994. In 1995, however, the ratio of expenditures (burden) between center and regions was 54:46. Although the regional governments saw their share of revenues begin to decline from the beginning of 1995, their share of expenditures continued to rise. As a result of the transformation in the revenue-outlay framework, fiscal deficits began to emerge as a problem for the regional governments.

II. Revenue Performance

1) Components of Revenue

Tables 4, 5, and 6 show actual revenues broken down by components for the consolidated budget, the federal budget, and regional budgets. These are based upon raw data gathered from the Ministry of Finance. Table 4 shows the different items as a proportion of GDP, and Table 5 indicates the proportional composition of revenues. Table 6 shows the ratio of the distribution of revenues between center and regions broken down by items.

The two pillars of consolidated budget revenues are the profit tax and the value-added tax.
### Table 4. Breakdown of Revenues, 1992–1995  
(as a percentage of GDP)

<table>
<thead>
<tr>
<th>Year</th>
<th>Consolidated Budget</th>
<th>Federal Budget</th>
<th>Regional Budget</th>
<th>Consolidated Budget</th>
<th>Federal Budget</th>
<th>Regional Budget</th>
<th>Consolidated Budget</th>
<th>Federal Budget</th>
<th>Regional Budget</th>
<th>Consolidated Budget</th>
<th>Federal Budget</th>
<th>Regional Budget</th>
</tr>
</thead>
<tbody>
<tr>
<td>1992</td>
<td>10.5</td>
<td>3.4</td>
<td>7.1</td>
<td>12.3</td>
<td>3.2</td>
<td>9.1</td>
<td>10.9</td>
<td>8.0</td>
<td>2.8</td>
<td>8.0</td>
<td>3.3</td>
<td>6.6</td>
</tr>
<tr>
<td>1993</td>
<td>9.3</td>
<td>2.7</td>
<td>6.6</td>
<td>11.7</td>
<td>5.9</td>
<td>5.8</td>
<td>14.1</td>
<td>8.3</td>
<td>5.8</td>
<td>8.3</td>
<td>1.8</td>
<td>6.5</td>
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<tr>
<td>1994</td>
<td>10.5</td>
<td>7.9</td>
<td>2.6</td>
<td>10.5</td>
<td>7.9</td>
<td>2.6</td>
<td>12.7</td>
<td>10.0</td>
<td>2.7</td>
<td>10.0</td>
<td>6.6</td>
<td>3.4</td>
</tr>
<tr>
<td>1995</td>
<td>8.3</td>
<td>3.6</td>
<td>4.7</td>
<td>10.5</td>
<td>7.9</td>
<td>2.6</td>
<td>12.5</td>
<td>9.0</td>
<td>3.5</td>
<td>9.0</td>
<td>6.6</td>
<td>2.4</td>
</tr>
</tbody>
</table>

#### Tax revenue
- **Taxes on income**: 10.5%
- **Profit tax (including wage tax)**: 8.2%
- **Profit tax (excluding wage tax)**: 7.0%
- **Wage tax**: 0.3%
- **Personal income tax**: 2.3%
- **Other profit/income taxes**: 0.0%
- **Taxes on goods and services**: 11.7%
- **Value-added tax**: 10.5%
- **Value-added tax on domestic products**: 5.1%
- **Value-added tax on imported products**: 0.6%
- **Excise tax of which: on oil**: 1.1%
- **Surtax to finance important sectors**: 0.0%
- **Other taxes on goods and services**: 0.0%
- **Property tax**: 0.3%
- **Turnover taxes on stocks and bonds**: 0.0%
- **Taxes on fixed assets**: 0.3%
- **Payments for natural resources**: 1.0%
- **Underground resources**: 0.6%
- **Mineral resource reservation fund**: 0.4%
- **Land tax and rental**: 0.4%
- **Other Payments**: 0.1%
- **Trade taxes**: 0.3%
- **Import duties**: 0.5%
- **Export taxes**: 0.0%
- **Other taxes**: 0.4%

#### Total tax revenue: 21.7%

#### [Trade tax and overseas economic activities]: 2.5%

#### Non-tax revenue
- **Revenue from State property and businesses**: 0.4%
- **Interest transfers from the Central Bank**: 0.2%
- **Other revenue from State property and businesses**: 0.2%
- **Revenue from sales of State property**: 0.3%
- **Revenue from sales of State reserves**: 0.8%
- **Overseas economic activities revenue**: 1.2%
- **Other Non-tax revenues**: 1.3%

#### Total non-tax revenue: 3.2%

#### Grants/Transfers
- **From administrative organizations**: 0.3%
- **Said to related administrative organizations**: 0.1%
- **Regional assistance**: 0.7%
- **Federally-Regional mutual settlement of accounts**: 0.3%
- **Transfer to equalize income distribution**: 0.0%
- **Other transfers**: 0.02%
- **Transfers from off-budget funds**: 0.0%
- **Transfers from state organizations**: 0.0%
- **Transfer from (off)-budget fund**: 0.2%
- **Federal road fund**: 0.2%
- **Federal ecology fund**: 0.0%
- **Federal Tax Services Office/Tax Police**: 0.1%

#### [Credit]
- **Federal loan**: 0.1%
- **Repayment of state loan**: 0.1%
- **Repayment from regions**: 0.0%
- **Budget deficits finance**: 0.04%
- **Of budget program finance**: 0.07%
- **Foreign currency sale**: 1.8%

#### Total revenue: 28.0%

**Notes:** Compiled by using the Ministry of Finance, **Budget Execution Reports** and the new official GDP data.
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<th></th>
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<td>83.1</td>
<td>75.1</td>
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<td>Interest transfers from the Central Bank</td>
<td>0.8</td>
<td>1.5</td>
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<tr>
<td>Other revenue from State property and business</td>
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<tr>
<td>Revenue from sales of State property</td>
<td>1.2</td>
<td>0.6</td>
<td>1.6</td>
<td>0.8</td>
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<tr>
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<td>3.1</td>
<td>1.5</td>
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<tr>
<td>Overseas economic activities revenue</td>
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<td>0.8</td>
<td>0.0</td>
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<tr>
<td>Other Non-tax revenues</td>
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<td>5.1</td>
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<tr>
<td>Grants/transfers</td>
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<td>13.5</td>
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<tr>
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<tr>
<td>-Transfers to equalize income distributions</td>
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<td>Other transfers</td>
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<tr>
<td>Transfers from off-budget funds</td>
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<td>[Credits: 1992-94]</td>
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<td>From foreign currency sale (1994)</td>
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<td>Federal road fund</td>
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<td>/Crime prevention fund (deduction)</td>
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Notes: Compiled by using the Ministry of Finance, *Budget Execution Reports* and the new official GDP data.
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<td>Federal budget</td>
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<tr>
<td><strong>Tax revenue</strong></td>
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<td>Taxes on income</td>
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<td><strong>Total tax revenue</strong></td>
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<tr>
<td>[Trade tax and overseas economic activities]</td>
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<td>Revenue from sales of State property</td>
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<td>Revenues from sales of State reserves</td>
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<td><strong>Total non-tax revenue</strong></td>
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<td><strong>Grants/transfers</strong></td>
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<td><strong>Total revenue</strong></td>
<td>53</td>
<td>47</td>
<td>37</td>
<td>63</td>
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**Sources:** Table 4.
(VAT). The central government’s major source of revenues is the VAT, followed by the profit tax, and then by revenues from trade taxes and overseas economic activities. The demarcation between the tax on trade and non-tax revenues from overseas economic activities was established from the budget for 1995 (from 1992 to 1994, the category “revenues from overseas economic activities” included the tax on trade). Revenues from overseas economic activities, demarcated in this manner, comprise an important portion of revenues from centralized exports. In order to make possible comparisons of the 1992–94 period with 1995, Table 4 adds the category “trade tax & overseas economic activities.”

The major source of revenue for regional governments is the profit tax, followed by personal income taxes, VAT, and taxes on natural resources and property. Let us examine revenue sources by items.

(1) Profit Tax

(A) Consolidated Budget

Taxes on enterprise and organization profits became the major source of consolidated budget revenues in 1993. Table 4 indicates that revenues from profit taxes (including taxes on wages) as a proportion of GDP came to 8.2% in 1992, 9.8% in 1993, 8.0% in 1994, and 7.3% in 1995. Table 5’s breakdown by composition shows that profit taxes accounted for 29.4% of total revenues in 1992, 40.2% in 1993, 27.5% in 1994, and 28.0% in 1995. The share reached an exceptionally high proportion in 1993. The profit tax varies considerably according to how costs are determined prior to being deducted from profits, and even more so by the means used to adjust for inflation. Profit taxes increase to the extent that inflation depreciates the book value of fixed assets, and can decrease according to revaluations. Further, the profit tax varies according to the arbitrariness of limits on deductions for wage expenses decided by the government (in 1993 it was four times the official minimum wage, and in 1994 and 1995 it was six times). In 1993, the profit tax rose sharply over 1992 in terms of both proportion of GDP and proportional composition due to the impact of inflation in shrinking amortization allowances and forcing up wages (the profit tax is absorbed by a rise in the so-called “wage tax”). At the beginning of 1994, the maximum rate of the profit tax was raised from 32% to 38% but revenues from the tax actually declined as a proportion of GDP because from January 1 of that year a reevaluation of fixed assets raised amortization charges and limits on deductions for wages. Moreover, there was a large increase in arrears in payments of profit taxes. In 1995, the maximum rate was brought down to 35%, while on January 1, 1995 fixed assets were again reevaluated and there was a partial introduction of an accelerated amortization schedule. These factors caused revenues from the profit tax to decline further as a proportion of GDP. One of the main reasons was a large jump in payments arrears. On November 1, 1995, total arrears in payments of profit taxes totaled 14.5 trillion rubles, then equivalent to 1.1% of GDP, and profit taxes collected amounted to 15.2% of GDP.

(B) Federal Budget

Revenues from profit taxes for the central government were equivalent to 3.4% of GDP in 1992, 3.2% in 1993, 2.8% in 1994, and 2.5% in 1995. A gradual but steady decreasing trend is evident. A notable feature of the central government’s profit tax is that in 1992, when the
distribution between the center and regions was undecided, it reached its highest value in terms of GDP proportion. The profit tax composed 21.4% of central government revenues in 1992, 31.9% in 1993, 19.8% in 1994, and 18.1% in 1995. This tax has consistently served as the second largest source of revenues. When the VAT levy declined drastically in 1993, the profit tax came to account for an unusually large share of total tax revenues. But, unlike the case of the consolidated budget, it declined in terms of composition in 1995 compared to 1994. Arrears in payments of profit taxes to the central government amounted to 5.8 trillion rubles on November 1, 1995, equivalent to 0.4% of GDP and 17.2% of profit taxes collected. Thus arrears in profit tax payments are a major source of decline in this source of revenue.

(C) Regional Budgets

Profit taxes are the most important source of revenues for regional governments. As a proportion of GDP, revenues from profit taxes to regional governments amounted to 4.8% of GDP in 1992, 6.6% in 1993, 5.2% in 1994, and 4.8% in 1995. The large increase from 1992 to 1993 reflected a change in the distribution of shares in favor of the regions. The downward trend from 1993 to 1995 occurred for the same reasons as with the consolidated and federal budgets. Profit taxes accounted for 34.5% of revenues for regional budgets in 1992, 39.0% in 1993, 27.9% in 1994, and 34.1% in 1995. The high value reached in 1993 reflected, not just a change in share distribution in favor of regions, but a fall in the share of value-added tax revenues going to regions. Arrears in payments of profit taxes to the regions amounted to 8.7 trillion rubles on November 1, 1995, equivalent to 0.7% of GDP and to 14.1% of profit taxes collected. This was not as bad as the situation confronting the federal government, but is nevertheless damaging to the regional profit tax base.

(D) Central-Regional Share Distribution

Table 6 shows that the ratio of the distribution of revenues from profit taxes between the center and regions stood at 41:59 in 1992, and from 1993 through 1995 was 33:67, 35:65, and 34:66 respectively. The distribution ratio clearly favored the regions by a wide margin in 1993 when it was determined by tax rates. Theoretically, the enterprise profit tax should result in a distribution ratio of 37:63, and in fact the profit tax is divided between center and regions almost exactly as indicated by the theory.

(2) Value-added Tax (VAT)

(A) Consolidated Budget

As shown in Table 4, the value-added tax, as a proportion of GDP, amounted to 10.5% in 1992, 6.6% in 1993, 6.1% in 1994, and 5.7% in 1995. Thus 1993 saw major fall-off in this source of revenue, and a declining trend has continued. The breakdown by components in Table 5 shows that VAT as a proportion of total revenues amounted to 37.5% in 1992, 27.0% in 1993, 21.0% in 1994, and 22.0% in 1995. From 1992 through 1994, the VAT shows a declining trend as a share of total revenues as well as proportion of GDP, though there has been some rise in the former in 1994.

Among the causes for the large fall-off in 1993 there was, above all, a large cut in the tax rate. The purpose for the cut was to enlarge the tax base but the main result was to reduce
revenues. Aggravating the situation was a fall in the inflation rate and an increase in payments arrears, both of which further reduced revenues. As already pointed out, during the first half of 1994, payments arrears for the profit and value-added taxes amounted to 26%. From 1993, the VAT began to cover imported goods, while from April 1994, preferential tax treatment was limited to basic food items. However, results in 1994 were worse than those of 1993. The deterioration is evident in figures showing VAT as a proportion of GDP. The problem of payments arrears is also a major reason for the fall-off in VAT revenues. Arrears on payments of VAT reached 26 trillion rubles as of November 1, 1995. Further, these arrears grew to 34.8% of VAT revenues actually collected, higher than payment arrears ratio of the profit tax. This gravely undermined government finances.

To supplement VAT revenues and, at the same time, ensure funding for finance for important sectors, the amount of the surtax introduced in 1994 was reduced from 0.9% of GDP for 1994 to 0.7%. As the surtax is included in VAT revenues, it showed greater results in terms of proportion of GDP in 1994 than in 1993, but needless to say there was a deterioration in results in 1995 compared to 1994. The surtax was abolished on January 1, 1996.

(B) Federal Budget

The VAT became the main source of revenues for the federal budget from the birth of the new Russia. In 1992, a thorough-going monthly prepayment VAT system started out quite well, contributing the equivalent of 7.9% of GDP to the federal budget. However, VAT revenues fell by nearly half in 1993, declining to 4.2% of GDP. Nearly all of the reduction in VAT revenues going to the consolidated budget affected the central budget. The drop in VAT payments into the central budget (equal to 3.7% of GDP) was the major cause of the sharp decline in central revenues (5.9% of GDP) in 1993. Federal VAT revenues declined further in 1994 to 3.9% of GDP. There was some improvement in 1995 as VAT revenues rose to 4.3% of GDP. That translated into an equivalent of 3.6% of GDP raised on domestic products and 0.6% raised from imports, which accounted for 15% of VAT revenue. The percentage contribution of VAT to the federal budget revenues declined steadily from 49.7% in 1992, to 42.3% in 1993, and to 27.5% in 1994, before improving somewhat to 31.2% in 1995. It is at the same time a fact that the VAT is the federal government’s largest source of revenue. 1995 showed some improvement over 1994, but VAT revenues did not match the 36.6% share of revenues and 5.5% of GDP of the first budget.

As of November 1, 1995, payments arrears of VAT to the federal government amounted to 18 trillion rubles. This equaled 33% of VAT revenues actually collected during the same period. Thus the increase in VAT arrears also had a major impact on federal revenues. The improvement in collections in 1995 over the previous year is probably due to the considerably increased activity of the Federal Tax Police.

(C) Regional Budgets

Regional VAT as a proportion of GDP came to 2.6% in 1992, and then decreased steadily to 2.3% in 1993, 2.2% in 1994, and 1.5% in 1995. VAT revenues accounted for 18.6% of regional government revenues in 1992, and then 13.9% in 1993, 12.0% in 1994, and 10.4% in 1995. There was a major fall-off in 1993 in VAT revenues in terms of both contribution to regional budgets and, like VAT, in terms of proportion of GDP. And while the federal
government saw some improvement in collection of its own value-added taxes in 1995, VAT payments arrears to regional governments amounted to 7.2 trillion rubles on November 1 that year, equal to over 40% of VAT collected and signifying a turn for the worse from a year earlier.

(D) Central-Regional Distribution Ratio

The distribution ratio of the VAT revenues between the center and regions stood at 75:25 in 1992, 64:36 in both 1993 and 1994, and at 74:26 in 1995. The budget laws for fiscal years 1993 and 1994 fixed the ratio at 75:25, but the federal government's take actually fell below its prescribed share (VAT revenues from imports go to the central government so, in theory, it should receive more than 75% of total VAT revenues). This reflected the central government's lower efficiency in collecting the tax during that period. In 1995, invigorated tax officials enabled the central government to ensure collection of almost exactly its prescribed share. For the first nine months of 1995, the ratio was 69:31, but thereafter the central government quickly boosted its share.

- The distribution ratio of the surtax was 67:33 in 1995, virtually matching its theoretical distribution.

(3) Excise Taxes

Total excise taxes raised revenues equal to 1.1% of GDP in 1992, declining to 1.0% in 1993, then rising to 1.2% in 1994 and 1.5% in 1995. Much of the 1994 increase came from a rise in the share of the oil excise tax to 0.3% of GDP from 0.1% the previous year. 1995's improvement reflected marked revenue increases from both oil and gas excise taxes. In fact, oil excise taxes amounted to 0.4% of GDP. As both oil and gas excise taxes go to the central government, they helped push the center's excise tax revenues well upward. In fact, federal revenues from excise taxes increased from 0.5% of GDP in 1993 to 0.7% in 1994, and showed another large increase to 1.1% in 1995. On the other hand, regions lacking oil and gas resources saw revenues from excise taxes decline steadily from 0.6% of GDP in 1992, to 0.5% in both 1993 and 1994, and finally to 0.4% in 1995.

Naturally, as a result of the above trends, the center's share of excise taxes grew rapidly from 1994. The center-region ratio was 48:52 in 1992, moved to 60:40 in 1994, and then to 73:27 in 1995, marking two consecutive years of major changes in shares.

(4) Customs Duties and Revenues from Overseas Economic Activities

A pillar of tax reform was the shift from an implicit "foreign trade tax" (in effect, a disadvantageous obligatory exchange rate imposed on trading companies and centralized exports) to a system of explicit "customs duties" on imports and exports. In 1992 and 1993, half of the trade tax was an implicit trade tax but from 1994 a change to an almost totally explicit custom duty system was completed. 100% of custom duty revenues go to the central government, as do all but a negligible portion of revenues from overseas economic activities.

Table 4 indicates that trade taxes and revenues from overseas economic activities remained at a steady level from 1992 to 1993, but from 1994 fell to about half the previous level in terms of GDP as a result of the 1993 tax reform. This "fall-off" in 1993 needs to be
explained. According to The 1994 Russian Economy, an annual report produced by the Institute of Problems in Economic Transition (headed by Igor Gaidar), trade taxes and revenues from overseas economic activities amounted to 4.1% of GDP in 1993, including import duties equal to 0.5% of GDP, export taxes at 1.1%, and centralized exports at 2.5%. If that is so, then Table 4’s figure of 1.4% totally excludes centralized exports, and the situation in 1993 then differs from Table 4 and from the Institute’s annual report. Since Table 4 and the annual report show the same figures for 1994, the former indicates that trade taxes and revenues from overseas economic activities rose for that year, while the latter indicates that they fell. Economic Transition Research Institute data indicate that export taxes declined rapidly in terms of GDP from 1.6% in 1992, to 1.1% in 1993, and to 0.4% in 1994. Further, centralized exports grew rapidly in 1993 only, in 1994, to plunge back to 0.6% of GDP. The report also states that revenues from import duties remained low but steady at 0.4% of GDP in 1992, 0.5% in 1993, and 0.4% in 1994.

What trade taxes and overseas economic activities revenues actually comprise should be examined. The Ministry of Finance began to differentiate between import duties, export taxes, and other overseas economic activities in its monthly Budget Execution Reports from 1995. These reports show, as does Table 4, that in 1995 import duties were equal to 0.5% of GDP, export duties equal to 0.9%, and revenues from overseas economic activities equal to 1.2%, making for an aggregate 2.7% of GDP. Linking these figures to data from the Institute of Problems in Economic Transition indicates that revenues from export taxes remained at nearly the same level as in 1993, and that there was little change in import duties, but that revenues from overseas economic activities declined. Thus combined revenues from trade taxes and overseas economic activities declined from 1994.

The primary sources of export taxes are oil and gas. Because the export tax comprises the difference between domestic prices of natural resources and their international market prices, it was expected to be abolished at the beginning of 1996 but that did not happen. Further, in 1993 and 1994 measures were taken to exempt 80% of taxes on oil exports, and the measures were continued in 1995. The Ministry of Finance believed that it could boost revenues by lowering the export duty and raising the excise tax rate. However, exports during 1995 amounted to 77.8 billion dollars (up 18% over the previous year) so that both export and excise taxes raised substantially more revenue than in 1994 in terms of GDP [figures on exports are from Goskomstat’s 1995 Annual Report].

Although duties on food products and other items were increased in July 1995 in an attempt to enact a large tax rise, tax revenues fell as a proportion of GDP. 57.9 billion dollars’ worth of imports entered the country in 1995 (a 14% increase over 1994).

Frustrated by growing tax arrears and low revenues, the government did not take the steps of abolishing the export tax or lowering duties on imported food products. That meant that realizing a significant increase in revenues from foreign trade required fundamentally revising the favorable tax treatment extended to oil and gas. However, as a result of the appreciation of the ruble, export firms were in no position to absorb the costs of such measures.

(5) Personal Income Taxes

Almost all personal income taxes were paid into regional budgets in the form of residential taxes until 1994. In 1995, personal tax revenues were divided between the center
and regions at a ratio of 10:90, making receipts of personal income taxes by the federal government equal to 0.2% of GDP. Table 6 indicates that the real distribution ratio of personal income taxes in 1995 was 9:91, approximately matching the legally established ratio.

Total receipts of personal income taxes in terms of percentage of GDP rose from 2.3% in 1992, to 2.6% in 1993, and to 2.9% in 1994. The first decline, to 2.2%, occurred in 1995. The Ministry of Finance has seized enough payments arrears that uncollected personal income taxes amount to only 0.2% of the amount actually collected. It is not personal income tax arrears which caused the drastic reduction in revenues but non-payment of wages in the public sector, tax evasion or failure to declare liabilities in the private sector, and failure to properly implement a progressive tax system.

(6) Property Taxes

Almost all fixed asset taxes are paid to regional governments. Regional revenues from fixed asset taxes amounted to 0.3% of GDP in 1992, 0.3% in 1993, 0.8% in 1994, and 1.0% in 1995. The large jump in 1994 stemmed from a reevaluation of property values. Fixed asset taxes made up 4.3% of total regional government revenues in 1994, and that figure rose to 6.8% in 1994. Its importance grew as other revenue sources continued to slump.

The greater part of turnover taxes on stocks and bonds are paid to the central government. This tax has been kept low, however, to encourage development of the stock and bond markets, so federal revenues from this source amounted to a mere 0.1% of GDP in 1994 and 1995.

(7) Payments for Natural Resource Utilization

Resource utilization payments (including land taxes) bring in low and declining levels of revenue, from 1.0% as a proportion of GDP in 1992, to 0.9% in 1993, to 0.8% in 1994, and to 0.7% in 1995. Broken down into components (as proportions of GDP), underground resource utilization payments amounted to 0.4%, mineral resource reserve funds 0.1%, land taxes and rental payments (rents) to 0.2%, and other resource utilization payments to 0.1%. Resource utilization fees accounted for 6.2% of regional government revenues in 1992. That share fell by half to 3.0% in 1993, but has since risen and grown in importance. The ratio in 1995 was 3.9%. Resource utilization fees accounted for 0.6% of federal revenues in 1992, and rose sharply to 3.5% in 1993, only to fall back to 1.3% in 1994. The share remained at the same low level, 1.3% of total revenues, in 1995.

The issue of dividing resource utilization payments between the center and regions is intimately linked to the problem of determining who has rights over the resources, an especially important subject in resource-rich Russia. In 1992, the central government began to receive payments on all underground resources. The ratio of payments to the center and regions in 1993 was 29:71, reflecting the sudden intake of funds by the federal government. In 1994, the ratio was 16:84, indicating a new rise in shares for the regions, and the level remained constant in 1995. The reverse situation held for mineral resource reserve funds, all of which were paid to the central government in 1993 and 1994. In 1995, the regions gained a share, and the ratio stood at 74:26. One fourth of total land taxes and rental fees in 1992 went to the center, but its share has since declined, and in 1995 almost all such revenues have gone to the
regions.

The ratio of revenue distribution from resources has fluctuated greatly, but the most urgent problem is that the federal government has realized relatively small gains from the nation's underground national resources. Deputy Director Dmitri L'vov of the Central Economics and Mathematics Institute of the Russian Academy of Sciences has argued that appropriate setting of utilization fees for oil and gas could resolve the fiscal deficit and price reform problems at a stroke. This argument was first proposed during the Gorbachev era by such people as Nikolai Petrakov, a former advisor to the president, and Andrei Vavilov, a First Deputy Minister of Finance. The adoption of such measures would certainly dramatically increase resource utilization payments, but they would not resolve the dispute over the distribution ratio between the center and regions. In fact, a large rise in the payments might well aggravate the dispute.

(8) Revenues from Sales of State Property (So-called Privatization Revenues)

Revenues from sales of state property by the federal and regional governments, along with proceeds from privatization, accounted for decreasing proportions of GDP from 1992 through 1994 at 0.3%, 0.2%, and 0.1% respectively. However, 1995 saw a sharp rise to 0.3%. The sudden increase resulted from a surge in revenues from privatization from 0.02% of GDP in 1994 to 0.2% in 1995 (1.5% of central revenues).

A key feature of the 1995 budget was the importance placed on revenues from privatization. It was initially estimated that these would equal 0.9% of GDP, and 5% of central government revenues (considering that the Czech Republic's revenues from privatization gained the equivalent of 1% of GDP in 1993, the estimates do not seem unfounded). The main asset to be sold was stocks in the state oil enterprises. To be sure, revenues from privatization grew substantially in 1995, but they did not match the estimates of the 1995 Budget Law. Of the 8.8 trillion rubles foreseen in the initial budget, no more than 645.8 billion rubles had been received by the government by December 1, 1995. During the month of December, a surge of privatization brought revenues to 3.4077 trillion rubles by January 1, 1996, but that still represented less than half the amount foreseen in the initial budget. During the first half of 1995, federal revenues from privatization amounted to more than 108.7 billion rubles, or less than one tenth that amount, so in September the government announced that it would use its own stocks from very large enterprises as collateral in order to attract funds from investors. Once the deadline was past, investors would be able to sell the sales rights to the collateralized stocks. The decision on financing would be made by a bidding formula. The government assumed that major commercial banks would be the main bidders. The government estimated that by using this plan it would increase revenues 2 trillion rubles by the end of 1995. The attempt succeeded, yet even with these funds the government failed to meet the revenue projections of the initial budget.

2) Causes of Revenue Shortfalls

The two mainstays of fiscal resources, the profit tax and the VAT, both underwent repeated changes in rates and coverage. Instead of improved income flows, however, such readjustments brought further confusion and revenue losses. Russia gained oil-dollars, but the
government realized few tax gains. In addition, sales of government-owned assets, which proceeded through a process of ‘insider privatization,’ made almost no contribution to boosting revenues. Finally, from 1995, the government found itself forced to take the ultimate step to reduce deficits, namely cutting expenditures. However, spending cuts brought an increase in tax arrears, meaning a further loss of income, because the government used such cost-cutting means as delaying wage payments to public sector workers and civil servants. To end this vicious cycle, therefore, the government must make a tax reform package and economic growth the priorities of fiscal policy.

The five main reasons for the revenue shortfall, in order of importance, are (1) 'industrial hollowing,' reflected in the declining activity and poor wages of state enterprises; (2) tax arrears; (3) the increase in tax evasion in the burgeoning private sector even as it supports the 'shift to a service economy'; (4) delays in adjusting the tax system to deal with these changing conditions; and (5) numerous hidden tax preferences and deductions.

It has been much easier for the Tax Service Office to collect taxes from the large state enterprises, whose locations and financial situations it knows quite well, than from the myriad small private businesses, such as restaurants, trading firms, and commercial banks, which have sprung up since the middle of 1992. When I interviewed a manager in Moscow's "Watch Factory No. 1" late in 1993, he complained at length that the Tax Service Office levied high rates on his factory because it was easy to do so. It is an open secret that major state joint-stock companies maintain double and even triple sets of books, as I learned from a Moscow city assemblyman (formerly the vice-president of the large Moscow Aircraft Factory) while conducting field research in July 1995. There is little public sentiment in favor of tackling tax evasion, and the mass media has provided little information which might encourage a campaign against tax evasion. The high tax rates encourage people to regard tax evasion as a means of survival, or a necessary evil (Valery Makarov, Director of the Central Economics and Mathematics Institute of the Russian Academy of Sciences). But it was actually hyperinflation and not simply high profit and value-added taxes which from 1992 through 1995 generated a perception of ruinous taxation. Hyperinflation rates of 6% a month (or 100% a year) and more meant that enterprises with relatively long production cycles had to sell their output with considerably higher profit margins than would have been the case in the absence of inflation, but these nominally high profit margins were being taxed at rates exceeding 30%. To compensate for these inflationary losses, enterprises began to use post-tax profits. This can be confirmed through simple mathematical equations.

To calculate production \( x(t) \) at time \( t \), a given enterprise attempts to sell its input \( k(t-s) \) for the price \( q(t-s) \) at the time \( t-s \). If \( p(t) \) is the price of the product, then at time \( t \) the enterprise's accounts are recorded as follows:

\[
\text{Production-input materials} = p(t)x(t)-q(t-s)k(t-s) \quad [Z]
\]

However, if there is no inflation, enterprise accounts are entered as follows:

\[
\text{Production-input materials} = p(t)x(t)-q(t)k(t-s) \quad [Z^*]
\]

Losses on input materials due to inflation are:
If the enterprise is not taxed then excess profits $Z - Z^*$ enable it to compensate its losses without excess loss. But, if the profit tax is assessed at rate $u$, and if hyperinflation also progresses, then the enterprise will not be able to cover all of the above losses.

The difference in value between the after-tax profits entered in firm ledgers and the above industrial accounts is:

$$ (1 - u)(Z - Z^*) = (1 - u)[q(t) - q(t-s)]k(t-s) $$

Therefore the deficit incurred in covering the loss rises to:

$$ u[q(t) - q(t-s)]k(t-s) $$

The higher the tax rate and the higher the inflation rate, the more the deficit swells. Thus, under this tax system, hyperinflation threatens simple capital reproduction. Simply to survive, or to maintain larger reserve profits, enterprises have to request extensions on tax payments from the authorities, or else understate production and pre-tax profits. Manufacturing firms with relatively long production cycles (such as the watch factory) have repeatedly pleaded to the government that this inflation tax and the tax system itself disrupt business. However, manufacturers with very short production cycles (such as producers of chocolate) do not at first experience this problem. However, as previously noted, it is an open secret in Russia that enterprises of all types generally keep two or three sets of books to deal with the price increases generated by inflation and rising wages.

The spread of tax evasion and capital flight does not just reduce government revenues, but leads to under-reporting of GDP and under-estimates of manufacturing output. In other words, it causes a downward bias in production statistics. In November 1994, Vincent Koen of the IMF and Evgeny Gavrilenkov, then Director of the Center for Economic Analysis, Russian Government, presented a paper arguing that the progressive real drop in growth was in the 30% range rather than the officially announced figure of 50% [Gavrilenkov and Koen (1994)]. Facing such criticism, Goskomstat, with support from the World Bank, took the step of revising official GDP statistics upwards in October 1995. The results can be seen in Figure 2. This task of revision centered on service sector indicators but did not deal with manufacturing statistics, so that the nominal values of base GDP for the years 1992 and 1993 were shown to rise no more than 7%. Many other problems remain as well. For example, as Figure 3 shows, an alternative estimate can be made for industrial production [Kuboniwa (1995)]. Revising GDP figures upwards means that fiscal deficits decline as proportions of GDP, and revenues decline as well, but the reduction in revenues clarifies further the government's difficulties.

The Ministry of Finance has thought about taking measures to improve tax collection efficiency such as introducing a tax reform package, along with reorganizing the Tax Services Office and strengthening the tax authorities. A new Basic Tax Law, currently under discussion in parliament, may also be used to strengthen tax-collecting measures. To deal with the difficult problem of tax evasion, the Tax Police want to bypass the courts and seize assets directly, an approach favored by the Ministry of Finance, but since such practices touch upon Constitutional issues, the matter has become complicated.

The Ministry of Finance has adopted both hardline ("stick") and more cooperative
("carrot") strategies to cover fiscal deficits and encourage the development of capitalism in Russia. Among the former are strengthening the Tax Police. The latter include, apart from running up the national debt and issuing Ministry of Finance bonds, increasing tax deductions for major commercial banks and large enterprises. In addition, in order to accumulate funds for R&D and economic stabilization and development, the Ministry has also extended favorable tax provisions to numerous sectors, including the oil and gas industry and the steel industry. During an interview we conducted in July 1995 with Andrei Rappoport, then President of Alfabank, a leading commercial bank, Mr. Rappoport stated unequivocally, "I do not think that taxes are high, but we have such a short history of capital accumulation that very favorable [tax] provisions are necessary."

The main reasons for the decline in revenues are arrears in tax payments along with the poor performance of the government, including the Ministry of Finance, in collecting taxes. Insufficient collections of the profit tax and shortages of operating revenues lead to shortfalls
in revenues, and that makes it difficult to implement an income redistribution (equalization) policy.

III. Expenditure Performance

Tables 7, 8, and 9 summarize by components the consolidated, federal, and regional budgets from 1992 through 1995. Table 7 shows the components as proportions of GDP. Table 8 indicates the composition of the expenditures. Table 9 shows the center-region distribution ratio for each component of expenditure.

The major causes for the growth of the former Soviet Union’s fiscal deficit in the 1980s were subsidies for agriculture (subsidies for price differentials) which cost nearly 10% of GDP and were growing, and a defense burden which consumed over 10% of GDP. It was quite difficult to conduct a ‘sustainable’ fiscal policy which so heavily subsidized agriculture and the “planned deficit” coal industry, and it distorted the working of the price mechanism. Thus, at the same time that a shift from military to civilian priorities was pursued and defense expenditures drastically reduced, the pillar of Russian fiscal reform came to be price liberalization, through which national economy expenditures, especially for agriculture and coal, would be cut back decisively.

(1) National Economy Expenditures

(A) Consolidated Budget

National economy expenditures (NEE) are the largest component in the consolidated budget. Industrial expenditures, which constitute one part of this component, amounted in total to a fluctuating ratio of GDP, starting with 10.8% in 1992, falling to 9.6% in 1993, increasing to 10.5% in 1994, and finally declining sharply to 8.0% in 1995. Cutbacks in NEE were an important reason for this decline in spending. The share of NEE in total expenditures declined from an initial level of 34.5% in 1992, to 28.4% in 1993, and to 26.7% in 1994; then during the overall cost-cutting of 1995, the share increased somewhat to 27.2%. Naturally, new Russia’s shift to a market economy meant major cuts in NEE, which accounted for the equivalent of 19.8% of Soviet GDP in 1990, including 38.5% of the Soviet budget. (NEE reached 26.9% of Soviet GDP in 1985, including 55% of the budget, but at the time the statistical calculation of the component included the military procurement portion of defense expenditures.) However, since agriculture still receives implicit subsidies in the form of favorable tax treatment, this sector continues to pose important problems for the economy.

(B) Federal Budget

NEE constituted the largest component of expenditure in the 1992 federal budget, but from 1993 the top position was claimed by defense. This was because the federal government cut NEE by over half, from 5.8% of GDP to 2.6% from 1992 to 1993. From 1994 to 1995, there was another substantial drop, from 3.1% to 2.0%. Spending on two portions of NEE, agriculture and fishing, and manufacturing industries and construction, amounted to no more than 0.4% and 1.6% of GDP respectively. As shares of federal NEE expenditures, the
### Table 7. Breakdown of Expenditures, 1992–1995
(as a percentage of GDP)

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<td>Urgent crisis, Disaster prevention &amp; relief</td>
<td>99</td>
<td>1</td>
<td>98</td>
<td>2</td>
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<tr>
<td>Social &amp; cultural expenditure</td>
<td>30</td>
<td>70</td>
<td>18</td>
<td>82</td>
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<tr>
<td>Education</td>
<td></td>
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<tr>
<td>Culture &amp; Arts</td>
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<tr>
<td>Mass media</td>
<td></td>
<td></td>
<td></td>
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</tr>
<tr>
<td>Health and sports</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Social Policy</td>
<td></td>
<td></td>
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<td></td>
</tr>
<tr>
<td>(Off-)budget funds: 1995</td>
<td></td>
<td></td>
<td></td>
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</tr>
<tr>
<td>Federal road fund</td>
<td></td>
<td></td>
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</tr>
<tr>
<td>Federal ecology fund</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Federal tax police social development fund</td>
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<td></td>
<td></td>
</tr>
<tr>
<td>Social development</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Tariff system development fund</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>State crime prevention fund</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total expenditure</td>
<td>63</td>
<td>37</td>
<td>55</td>
<td>45</td>
</tr>
</tbody>
</table>

Sources: Table 7.
combined share of these two components fell from 27.5% in 1992 to 13.2% in 1993. The combined share remained low and steady at 12.4% in 1994 and 12.2% in 1995.

Although not shown in the charts, there was also a sharp decline in state investment finance for market producers. State investment finance equaled some 10% of GDP in 1992 and 1993 (about 70% of the total was federal financing). Until 1993, two thirds of federal financing went to off-budget funds, primarily to enterprises. In 1994, the federal government took measures to end operation of off-budget funds, and it is believed that as a result state investment finance as a proportion of GDP fell drastically.

In 1995, the federal investment program totaled no more than around 2 billion dollars, or 5.2% of federal expenditures.

(C) Regional Budgets

NEE constitutes the largest component of expenditure for regional governments. In contrast to federal NEE, regional NEE grew steadily as a proportion of GDP, from 5.1% in 1992, to 6.9% in 1993, and to 7.4% in 1994, before falling to 6.0% in 1995. NEE accounted for a consistently high proportion of regional expenditure at 40.9% in 1992, 42.9% in 1993, 40.8% in 1994, and 41.0% in 1995. Overall, NEE spending started to decline as a proportion of GDP in 1995. On December 1, 1995, regional expenditures on manufacturing and construction approached the federal level at 1.2% of GDP, but fell back to the 0.6% level of GDP on January 1, 1996. However, regional agriculture and fishery expenditures were at twice the level of the center's, at 0.9% of GDP. All subsidies for housing and public utilities are disbursed by regional governments, which cut spending on these components by the equivalent of 1% GDP, from 4.7% in 1994 to 3.7% in 1995. Thus cutting expenditures on housing and public utilities, and on manufacturing and construction accounted for the major part of the reduction in regional NEE in 1995.

(D) Central-Regional Share Distribution

The federal-regional share distribution of NEE shifted drastically from 53:47 in 1992 to 28:72 in 1993. Afterwards, the ratio remained in that range, standing at 25:75 in 1995. The decentralization of revenue receipts meant that regional governments also took over more of the burden of expenditures.

(2) Social Expenditures

Social expenditures constitute the second largest component of NEE in the consolidated budget. Social expenditures equaled 7.3% of GDP in 1992 and rose to 8.3% in 1993, and to 9.0% in 1994, before falling back to 7.7%, or toward the 1992 level, in 1995. However, Table 8 shows that social expenditures rose as a proportion of spending from 1994 to 1995, recording the highest level since 1992 at 26.1%. During a period of budget cutbacks, spending reductions for this component were relatively slight. Further, spending on social policy, which comprises part of social expenditures, stood at 1.2% in 1995, or around double the level of 1993 and 1994. This signifies that the social safety net has shrunk drastically, even when off-budget funds are counted, from 1985 during the Soviet era when social expenditures (including science funding) accounted for over 30% of spending and equalled a hefty 16.2% of GDP.

From 1992 to 1993, the regions steadily assumed an increasing burden of covering social
expenditures. Table 9 shows that the center-regional distribution ratio of such spending shifted from 30:70 in 1992 to 18:82 in 1993. The shift became even more pronounced in 1995 when the ratio moved to 15:85.

(3) Defense and Other Expenditures

Spending on defense, international affairs, legislation, public security, the judiciary, science, and trade are all federal responsibilities.

Table 7 shows that defense expenditures equaled from 4.2% to 4.6% of GDP in 1992 to 1994, but fell to 2.9% in 1995. Since public statistics indicate that defense spending consumed 6.9% of GDP in 1990, at the end of the Soviet era, expenditures in this area have fallen drastically, especially considering that real GDP has fallen as well. Nevertheless, defence spending remains at twice the level of central and eastern European countries in terms of proportion of GDP. How Russian managed to fund its 1995 defense spending, even after major cuts, is hard to understand. People involved in the government have suggested that much of the funding comes from the gas industry, considered the “black hole” of the Russian economy; like defense and public security, the gas industry accounts for some 3% of GDP (E. Gavrilenkov, “Macroeconomic Stabilization and ‘Black Hole’ in the Russian Economy,” Hitotsubashi Journal of Economics, December 1995).

Spending for international activities (called overseas economic activities until 1994), including outlays for destroying nuclear weapons, plunged from the of 2.2% of GDP in 1992 to 1.3% in 1995. The share of regional government spending on legislation, public security, and the judiciary, equal to a combined 1.5% of GDP, rose quickly in 1995. The expenditures ratio between the central and regional governments moved in turn from 95:5 in 1993 and 1994 to 75:25.

The paper so far has discussed movements in the major components of expenditure, as well as major problems, notably instability in the financial base for executing planned budgets. (In addition, further difficulties result from delays in determining budgets.) In order to sustain stability, the government has announced a new Basic Tax Law needed to implement the Basic Budget Law simulating an American-style cash budgeting process. A cash budgeting process is effective for short-term budgeting because it simplifies the process of execution, determination, and control. However, it has not proven effective at dealing with long-term budgeting issues, including planned long-term expenditures and deficit reduction.

IV. Financing the Fiscal Deficit

Russia’s federal fiscal deficit as a proportion of GDP stood at 5% in 1992, according to the Russian formula (6.4% at the initially published GDP figures). More than 90% of the deficit was covered by Central Bank credit. There were no deficit government bills. Even the Russian formula put the deficit at 10.1% in 1993. As Table 10 (based on Ministry of Finance primary date) indicates, national bonds covered no more than 1% of the deficit. Central Bank credit covered 57% of the amount, and another 12% was financed through transfer of a portion of Central Bank profits. Over 8% of the deficit (equivalent to 0.8% of GDP) was financed through foreign (IMF) sources.
Table 10. Sources of Financing the Federal Deficit, 1993–1994

<table>
<thead>
<tr>
<th>Source</th>
<th>1993</th>
<th>1994</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Amount</td>
<td>Pct. of GDP (%)</td>
</tr>
<tr>
<td>Total fiscal deficit</td>
<td>17,258,010</td>
<td>(10.6)</td>
</tr>
<tr>
<td>Total domestic finance</td>
<td>12,085,575</td>
<td>(7.4)</td>
</tr>
<tr>
<td>Short-term TB; GKO (net)</td>
<td>183,975</td>
<td>(0.1)</td>
</tr>
<tr>
<td>Ministry of Finance special securities; KO (net)</td>
<td>9,860,000</td>
<td>(6.1)</td>
</tr>
<tr>
<td>Credit from Central Bank</td>
<td>2,041,600</td>
<td>(1.3)</td>
</tr>
<tr>
<td>Total foreign finance</td>
<td>1,450,767</td>
<td>(0.9)</td>
</tr>
<tr>
<td>Credit from Foreign Economic Trade Bank</td>
<td>3,728,322</td>
<td>(2.3)</td>
</tr>
<tr>
<td>Other</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: Russian Ministry of Finance.

The federal deficit rose again in 1994, to the level of 11.8% of GDP (an amount greater than the 10.7% shown in Table 1 was covered). Issuances of short-term treasury bonds (GKO) and Ministry of Finance Special Securities (KO) surged to cover more than 19% of the deficit (equal to 2.2% of GDP). (GKO financed 6,911 trillion rubles of deficit; KO financed slightly more, 6,992 trillion rubles.) Nevertheless, the government remained heavily reliant on the Central Bank to finance deficits. Direct credit from the Bank covered 66.9% of the amount, and transfers of Bank profits covered another 2.2%. Foreign finance covered some 8%, about the same as in 1993.

Federal Budget Execution Reports for the first half of 1995 (as of July 1, 1995), for January to September (as of October 1, 1995), and for January through December (as of January 1, 1996) indicate that the deficit stood at 3.2%, 2.7%, and 2.9% of GDP, respectively. As noted earlier, if one looks only at the federal deficit, a comparatively positive situation appears since the systemic transformation of the end of 1991. In addition, Table 11 includes more detailed information than previously available from the Ministry of Finance.

Table 11 indicates that from 73% of deficit compensation during the first 9 months of 1995 was provided by domestic financing, and the other 27% by foreign financing. National bonds and securities accounted for some 79% of the domestic portion. Central Bank credit covered 13% of the deficit during the first half of the 1995, but this declined sharply to minus 0.4% for the first nine months of the year, as intended in the original plan.

By the end of 1995, the ratio of the federal deficit financed by domestic sources plunged to 48%. This reflected a rise in foreign financing to 52% of the amount as well as an increase in the proportion of foreign currency purchases. There was also major change in the state of domestic financing from November to December 1995 regarding Central Bank credit provided for deficit compensation repayments from the Ministry of Finance to the Central Bank). This resulted from provisions of a budget law governing repayments from the Ministry of Finance. In addition, the share of national bills and securities in deficit financing dropped to 55%, in line with the falling share of domestic finance in deficit finance.

Russia thus began early in 1995 to shift from using direct credit from the Central Bank...
## Table 11. Sources of Financing the Federal Deficit, 1995

<table>
<thead>
<tr>
<th></th>
<th>1995 (Jan./June)</th>
<th>1995 (Jan./Sept.)</th>
<th>1995 (1 January 1996)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Amount million</td>
<td>Pct. of GDP (%)</td>
<td>Composition %</td>
</tr>
<tr>
<td>Total fiscal deficit</td>
<td>19,324,400</td>
<td>(3.2)</td>
<td>100.0</td>
</tr>
<tr>
<td>Total domestic finance</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Credit from Central Bank (net)</td>
<td>13,725,618</td>
<td>(2.3)</td>
<td>71.0</td>
</tr>
<tr>
<td>Foreign currency sales</td>
<td>-1,573,443</td>
<td>(-0.3)</td>
<td>8.1</td>
</tr>
<tr>
<td>Treasury bills (TB) and securities (net)</td>
<td>13,439,611</td>
<td>(2.2)</td>
<td>69.5</td>
</tr>
<tr>
<td>Short-term TB; GKO (net)</td>
<td>12,398,559</td>
<td>(2.0)</td>
<td>64.2</td>
</tr>
<tr>
<td>Gold-backed securities; ZS (net)</td>
<td>-930</td>
<td>(-0.0)</td>
<td>0.0</td>
</tr>
<tr>
<td>Government special securities; GKV (net)</td>
<td>-505,000</td>
<td>(-0.1)</td>
<td>2.6</td>
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<tr>
<td>Ministry of Finance special securities; KO (net)</td>
<td>2,088,182</td>
<td>(0.3)</td>
<td>10.8</td>
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<tr>
<td>Other state securities (net)</td>
<td>-541,200</td>
<td>(-0.1)</td>
<td>2.8</td>
</tr>
<tr>
<td>State saving bonds OGSZ (net)</td>
<td>722,784</td>
<td>(0.1)</td>
<td>2.5</td>
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<tr>
<td>Other domestic debt (net)</td>
<td>-637,500</td>
<td>(-0.1)</td>
<td>-3.3</td>
</tr>
<tr>
<td>Total foreign finance</td>
<td>5,598,782</td>
<td>(0.9)</td>
<td>29.0</td>
</tr>
<tr>
<td>Credit from international organizations (net)</td>
<td>8,957,039</td>
<td>(1.5)</td>
<td>46.4</td>
</tr>
<tr>
<td>Credit from foreign governments, banks and enterprises (net)</td>
<td>-4,218,960</td>
<td>(-0.7)</td>
<td>-21.8</td>
</tr>
<tr>
<td>Credit from Foreign Economic Trade Bank</td>
<td>-4,218,960</td>
<td>(-0.7)</td>
<td>-21.8</td>
</tr>
<tr>
<td>Purchases of foreign currency</td>
<td>860,703</td>
<td>(0.1)</td>
<td>4.5</td>
</tr>
</tbody>
</table>

Source: Russian Ministry of Finance.
RUSSLAN FISCAL TRENDS FOR 1992-1995

to treasury bills and state securities to finance the deficit. This reflected, first, the use of IMF funds to finance the deficit. IMF financing covered 59% of the deficit in the first nine months of 1995, and 61% for the whole year, nearly matching the planned objective. Foreign financing in 1995 covered 52% of the deficit in 1995, falling short of the original estimate of 58%, but that resulted from repayments (deducted from deficit financing) of past debts to foreign governments, banks, and enterprises. Still, the ratio of 52% foreign financing for 1995, when compared to 29% for the first six months and 27% for the first nine months of the year, is quite close to the original objective.

Among the treasury bills and state securities used to finance the deficit during the first nine months of 1995, GKO short-term treasury bonds covered the largest share at 17 trillion rubles (equal to 1.6% of GDP, and to 59% of deficit finance). Second, KO (Ministry of Finance Special Securities) covered 7 trillion rubles (0.7% of GDP, and 25% of the deficit). OGSZ (State Savings Bonds), issued during the last half of 1995 (they could not reach maturity during 1995) covered 700 billion rubles (0.1% of GDP, and 2.5% of the deficit). ZS (gold-backed securities) and GKV (government special securities), which the government had already ceased issuing, accounted for a negative portion of the deficit as they began to mature.

By the end of 1995, GKO, short-term treasury bills, sharply increased their share of deficit financing to 27.5 trillion rubles (1.7% ratio of GDP, and 57% of deficit finance). However, the share of debt financed by KO, Ministry of Finance Special Securities, actually fell to minus 0.4 trillion rubles as new issues, at 21.9 trillion rubles, were less than the value, 22.3 trillion rubles, of the large quantity of KO securities which came to term. The financing share of a “new product,” the OGSZ State Savings Bonds, grew steadily to 2 trillion rubles (0.1% of GDP, and 4.0% of the deficit financing).

OFZ (Federal Government Bonds), which were issued from the last half of 1995, do not appear in Table 11. At the beginning of February 1996, when I asked Deputy Minister of Finance Vyugin why, he responded that OFZ were being included in the short-term bond category. He acknowledged that there was a problem in classification, a point confirmed at the end of the month in then Finance Minister V. Panskov’s report to the cabinet. In December 1995, the Ministry of Finance official responsible for compiling Budget Execution Reports testified in a hearing that OFZ bonds were included with OGSZ, State Saving Bonds, in the Budget Execution Report. On September 27, 1995, the Ministry of Finance issued OGSZ bonds (not including OFZ) with a par value of 1 trillion rubles (the real value equals 0.98 of par, or 0.98 trillion rubles). During 1995, the second and third procedures for issuance were completed (the second and third times, the value fell below 1 trillion rubles, so the total was in the 1 trillion ruble range). By September 1995, 4.8 trillion rubles worth of OFZ had been issued, and on January 1, 1996, 10.5 trillion rubles worth had been issued (according to Universe, a private information agency). However, as the Ministry of Finance official stated and as Table 5 shows, OFZ are included in calculations of OGSZ, so there is a large difference in the figures displayed by the chart for issuances and sales value (0.7 trillion rubles for January-September; 2 trillion rubles for January-December). Starting from this point, a financial specialist from the Center for Economic Analysis, the Russian Government stated in a hearing that OFZ are included in GKO. But because the average redemption period for OFZ is one to one and a half years, classifying them as short-term treasury bills seems inaccurate. For this reason, a macro-economic specialist from the Center for Economic Analysis includes OFZ with “other government securities” (hearing). Nevertheless, this interpretation appears
unhelpful since it seems to indicate that "other government securities" account for a negative share of debt financing. Not only this author, therefore, but prominent government analysts as well find some parts of the Ministry of Finance Budget Execution Reports hard to accept.

Regardless of the above problems, the need to finance the deficit has forced the government to continue issuing GKO and KO, as well as OFZ and OGSZ. Since short-term bonds and securities constantly reach maturity during the course of budget accounting years, it is necessary to make sufficient new issuance to generate a continuous net surplus in value outstanding. In addition, we are seeing steady development of "new products" in the form of state-owned securities with favorable conditions for commercial banks. While maintaining attractive interest rates (presently 40–45% for GKO), attempts are being made to lengthen maturity periods. Of course, it is essential that economic stability be maintained if maturity periods are to be lengthened past three years.

It has to be acknowledged that the appreciation of the ruble brought about by the introduction of restrictions on the currency exchange market has served to increase sales of national bonds and securities. This undermined the incentive for commercial banks to speculate in currency markets, encouraging them to deal in profitable national bonds instead.

Drastically altering the means of financing the deficit, holding the deficit to 3% of GDP, and taming inflation are achievements which owe greatly to the strict operation of the IMF's monitoring system and to the extension of IMF credit equal to 1.6% of GDP. A 1.1 billion dollar credit has been arranged for the first quarter of 1996, and it comes from the 6.5 billion dollar Stand-By Arrangement agreed to in 1995. This represents the fulfillment of the Stand-By Arrangement. The Russian government and the IMF held discussions on a further 9 billion dollars in financing for the rest of 1996 and, following a final adjustment decided between February 14 to 20, the IMF agreed to extend new financing worth 10.2 billion dollars for three years from 1996. This new EFF constitutes a 3-year financial assistance package. Thus IMF financing for deficit compensation has been decided for 1997 and after, but the framework for this financing will be quite restricted compared to the situation which existed in 1995. As stated in Government Decree No. 439 of April 28, 1995, "Russian Economic Reform and Development in 1995–1997," this means that the government will face a marked cutback in IMF financial assistance from 1997. Therefore, the government will need to substantially reduce the deficit and develop new means of financing it. The most urgent areas to examine in this regard are, first, tax reform, including improved collection of taxes; second, expansion of revenues through sales of state-owned property (privatization); and, third, development of a treasury bills market. The government program recognizes that it must above all reduce the deficit, and do so by gaining natural increases in revenues by boosting the economy into positive growth. 1997 will, the government believes, be the turning point for economic growth.

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References


