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## The regulation of the Federal Budget in Russia

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**39<sup>TH</sup> CONGRESS OF THE EUROPEAN REGIONAL SCIENCE  
ASSOCIATION / REGIONAL SCIENCE ASSOCIATION INTERNATIONAL  
(ERSA/RSAI)**

**24 –27 AUGUST 1999 IN DUBLIN**

**THE REGULATION FEDERAL BUDGET IN RUSSIA**

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Russian Federal budget is the general mechanism with which the government impacts and performs its economic programme, checks the correctness of state expenses, fulfils the money distribution among regions and different industries of the country. The crisis contradictions of Russia's budget show themselves first of all in the budget deficit. It reflects the elements of the economic stability, the value of attracted foreign investments, the possibilities of production development, and the future of the economic growth. Due this, the development of the clear strategic policy in the process of composing and fulfilling the state budget is utmost important.

The absence of firm confidence in the stability of the Russian financial system has caused the capital outflows of the foreign and domestic investors. For the Russian economy in transition period, this is fraught with the economic crises, with the decrease of the production, and therefore, with various social crises, which arise on this basis. Under this difficult circumstances of the economy in transition period, the development of the clear strategic policy of the government behaviour for the settling state budget contradictions is the major priority goal. The realisation of this will become a prerequisite for the future economic growth.

This article concerns the current changes and the governmental manipulations with the federal budget; the budget structure, the basic clauses of its incomes and expenditures, the budget functions and its major principles of formation. Besides that the article describes the variety of the budget policies and also the main Russian budget contradiction that is the budget deficit.

The author analyses the Russian budget policy in 96-98, underlines the specific reasons and contradictions of the Duma's budget ratification and describes the consequences to the state economy they caused.

## **Introduction**

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Due this, the development of the clear strategic policy in the process of composing and fulfilling the state budget is utmost important. The absence of firm confidence in the stability of the Russian financial system has caused the capital outflows of the foreign and domestic investors. For the Russian economy in transition period, this is fraught with the economic crises, with the decrease of the production, and therefore, with various social crises, which arise on this basis. Under this difficult circumstances of the economy in transition period, the development of the clear strategic policy of the government behaviour for the settling state budget contradictions is the major priority goal. The realisation of this will become a prerequisite for the future economic growth.

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### ***The essence of budget***

Budget is an estimate of state incomes and expenses [2, 510].

Budget relations determine financial relations between organisations, enterprises, and the population, on the one hand, and the state, on the other hand. This financial relations take place due to formation of a centralised fond of money resources intended for joint usage. [4, 433].

Budget relations are supposed to be many-sided as they organise various directions of the distributional process and comprehend all the levels of the economy (federal, regional, local). These relations depend on the principles of managing the state economy, of social and cultural evolution of the country and of the financial policy conducted by the state government. The necessity of organising such relations are linked with the fact that the state government concentrates in its fond a part of the national income (in the form of different types of taxes) which is to be distributed so as to solve important problems of the society such as defence, government, social and cultural development etc. Budget relations are reflected in the special budget fond of the country. The volume of this fond depends on the needs of the society to develop certain industries of the state economy, on the necessity of conducting structural changes in the economy of the country.

The economical essence of the budget reflects those monetary relations which arise between the state and the population. It is concluded in the redistribution of the national income on purpose of realising the state social policy, developing science, culture, education and financing the state defence and government [4, 434].

In the economic theory the following functions of budget can be revealed:

- *Distributive function* (the government uses its money resources concentrated in the budget fund to satisfy the needs of the society. Such redistribution can be inter-industrial, interregional, federal and local.)

- *Controlling function* (the budget makes clear the process of money resource movement from the population to the state, on the one hand, and from the state to the population, on the other hand. The budget reflects the economic processes, which take place in the structural sections of the economy. This makes possible to find out how much and who receives money).

The state uses budget as a mechanism of regulating the national economy by means of using concentrated money resources. During realising the budget policy the state may impact the economy of the country by subsidising important enterprises, making investments, financing defending industry conversion, etc. The aims of such impacts are national income growth, solution of actual and urgent social problems, increase or decrease of the aggregate demand and supply, creation the necessary infrastructure.

### ***Budget Incomes and Expenses***

The state budget consists of two parts: expenses and incomes.

*Budget Incomes* are those economic relations between the population and the state which show themselves in making tax payments, which are collected in the budget fund of the country. The market economy creation tells the necessity of using different forms of taxes as the main way of collecting money resources and thus forming state incomes. The economical essence of taxes is concluded in letting the state receive certain sums of money from the primary income recipients. Any tax is considered to be an economical category, which fulfils two main functions:

- fiscal function (the function of collecting money resources and replenishing state incomes)
- economic function (which influences the production by stimulating or restraining its growth)

Besides taxes, state incomes can be replenished also by different types of collections: for trading, for vehicle parking, resort collections, customs-duties, excise duties and so on.

*State Budget Expenses* are those economic relations which arise in the process of budget resources distribution on the needs of the economy and on state function fulfilment [4, 436]. State budget expenses can be divided into two groups: governmental purchases of goods and services and transfer payments.

Depending on the social purpose of the state expenses, budget resources can be spent on the needs of the whole economy, on the socio-cultural programmes, on the state defence and government. The major part of expenses on the whole economy, are those which are spent on financing the most important and large economic programmes. Thus programmes aimed to support the key industries of the economy, to solve urgent socio-economical problems, to develop the production and socio-domestic infrastructure are financed from the state budget.

Significant budget resources spent on socio-cultural programmes are aimed to develop education, to support culture, medicine and to raise the material status of the poor. Weapon and military technique purchases, expenses on the current financing of the military forces and also of the research projects are the major military expenses. As for expenses on government, they are necessary for the state to perform its important economic and organising functions.

### ***Russia's Budget system***

All the budgets of the country in aggregate are called "*the state budget system*" [4, 439]. The budget system of the country is organised on the basis of the specified principles.

The budget system of Russia is organised on the basis of the federal law “of the principles of the budget system and the budget process” (October, 1991). In accordance with this law budgets of all the governmental levels are independent and are not parts of the superior budgets.

The budget system of Russia consists of:

- the federal budget
- the budgets of republics, regions, and two cities (Moscow and St. Petersburg)
- the budgets of cities, towns, and other local regions

Russia’s budget system is organised on the basis of the following two rules:

- the principle of the independence
- the principle of unity

The principle of unity means that all the budget are regulated by the same rules, they are kept using the same budget classifications, the same documentation, and other data, which is necessary for creating the consolidated budget of the country.

The independence of budgets means that all the levels of the budget system have their own sources of incomes. They possess the right to use this incomes depending on the needs of each region of the Russian Federation.

### ***Budget Deficit***

Budget deficit takes place in the economy of the country when the state incomes are insufficient to cover the necessary expenses. Having a budget deficit, the state has to borrow money resources, first of all from the credit system of the country. This negatively influences the stability of the whole monetary system and becomes the main reason of inflation. Budget deficit does not necessarily mean that the economy is in crisis. It can be caused, for example, by the necessity to realise large state investments into the economy. On the other hand, unplanned expenses in case of emergencies, such as wars and disasters, which have to be done without condition may definitely cause the budget deficit.

If a temporary budget deficit takes place, if there are perspectives to overcome it, if the volume of this deficit is insignificant in comparison with the volume of the gross national product, then it should not be treated as a crisis phenomenon in the economy. But in the cases when this deficit is very large, if it takes place as a result of emergent circumstances and reflects crisis processes in the state economy, then, off course, this deficit causes a serious detriment to the whole society and surely such situations require cardinal measures to overcome the gap between state expenses and incomes. Usually the budget deficit up to 10% of the total volume of incomes is considered to be acceptable, while the deficit which is over 20% is already critical.

### ***Russia’s Budget Policy in 96-99***

For Russia, as for many countries with economy in transition period, the budget deficit is one of the most important and urgent problems. It is caused by a number of factors which can be conditionally divided into two groups:

First of all, these are objective reasons, which reflect negative processes in the state economy:

- low production efficiency
- significant social expenses
- tax payment evasion
- irrational budget expense structure
- inefficient budget mechanisms
- economical link rapture due to disintegration of the Soviet Union

Secondly, these are the weaknesses of the state ruling organs:

- inability of the government to determine strict priorities
- absence of the clear strategic line aimed to overcome the problem of the budget deficit
- lack of the political will of the government to introduce unpopular measures
- absence of support on the part of the Federal Council in introducing this measures
- irresponsible and very often destructive behaviour of the State Duma

Due this, in the middle of the 90-s the Russia's budget deficit was above 20% (and sometimes 25%) of the state incomes and exceeded 5% of the GNP [4, 438].

### **1996**

By 1996 the main elements of the market economy have been established in Russia. Significant private sector has arisen. The State Duma has accepted the laws that protect the property. Civil code, the laws about securities and joint-stock companies have been introduced. An open economy with convertible currency has been created. Inflation in general has been stopped.

However this achieved stabilisation was based on the shaky ground of large monetary injections both from outside, and from domestic market by means of issuing short term loans. This inevitably led the country to the financial crisis.

In this situation there was the only way out. It supposed:

1. *state finance stabilisation*. This meant that the government had to undertake strict measures to limit the budget deficit, to reform the tax system and the system of social help. And by making reasonable estimations clearly determine the opportunities of the state, thus overcoming the budget crisis and liquidating budget defaults in paying
2. *providing the strict control in the sphere of paying taxes and spending state resources*. The government had to set clear law restrictions to stop tax evasions. The cabinet was supposed to accept a reasonable Tax Code and to control its observing (especially by the largest corporations such as GazProm, RAO EES, TransNeft etc)

However the government ruled by Victor Chernomirdin was unable to realise the strict policy aimed to reform the economy and to stabilise finances. This happened because the cabinet was strongly influenced by large financial groups and thus it could not provide strict tax collections and was unable to see to their spending.

Conducting such an irresponsible, irrational policy the government reduced its control over the tax-payments by GazProm - the biggest corporation in Russia (which supplies 25% of the budget incomes) and at the same time did not realise any serious structural reformation, did not reduce the state expenses and on the contrary, increased them. The climax was introducing into Duma the most unrealistic budget of all the reformation years, which (as expected) was not fulfilled. (see Table 14, Diagram 11)

The result of such political and economic behaviour of Chernomirdin's cabinet was the intensification of the budget crisis, which caused pension and wages defaults in paying - and thus internal and external debt growth.

### **1997**

In the beginning of 1997 the situation became more complicated but still it didn't have the lethal character. The measures, that had to be taken then were simple and unpopular. These were the same steps the government didn't realise in 1996. However in comparison with 1996 the situation in the social sphere became significantly worse.

The government had to introduce the following measures:

- 1) *Tax reform*, which would include
  - lowering the tax rates of those taxes, which the government was unable to collect (first of all the income tax)
  - simplification the whole tax laws, e.g. eliminating a great deal of taxes and introducing the new ones (more effective and simple)
  - cancellation of a big number of the tax benefits, due to which the government was deprived of billions of rubles each year.
- 2) *Strict monopoly policy*, which would include:
  - strict control over the biggest monopolies (especially in the sphere of correct tax payments)
  - introducing clear antimonopoly law base, and demonopolisation of those sectors of the state economy, which were not monopolistic by its essence
- 3) *Social defence system reformation*:
  - realisation of the individual social help system, which would allow to direct money resources to those who are really in need of them.
  - reducing the number of those who had benefits and privileges.
- 3) *Housing sphere reformation*
- 4) And the *reformation of the mid-budget relations* (which will allow to see to spending the money resources in the regions)

These problems were off course very difficult and unpopular, because of both the political and the economic situation in Russia. However, the situation in the country told the necessity of introducing these measures.

In April of 1997 the new government directed to the state Duma a number of the most important laws: the new Tax code, and the documents improving the social defence system. And although Duma rejected almost all the laws, the cabinet managed to increase the tax payments to the budget and started to make wages and pension debt payments to the population.

Boris Nemtsov, who was in charge of the monopoly sphere started to realise the gradual policy aimed to organise the strict control over the biggest monopolies, and to set “clear rules of the game” for all the biggest organisations. In this sphere the government achieved the following results:

- 1) *In the biggest monopolies (such as GazProm, EES, Transneft) boards of state representatives were organised. State control over the activity of this monopolies was recovered. Management organs were formed under the state control.*
- 2) *The order of GazProm’s share turnover was determined.*
- 3) *The access of independent gaz producers to GazProm’s gas-network was organised*<sup>1</sup>

But these measures were still insufficient. Due to the policy of blowing state expenses actively realised by the left-winged majority of the State Duma, significant budget deficit increased. It was finances also by means of issuing state short term loans.

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<sup>1</sup> *Decrees of the President of the Russian Federation:*

*Resolutions of the Government of the Russian Federation: <sup>1</sup> 978 (07.08.97), <sup>1</sup> 239 (21.02.98), <sup>1</sup> 439 (22.04.98), <sup>1</sup> 858 (14.07.98), <sup>1</sup> 1269 (30.09.98).*



The state economy which took to the injections of internal and external loans could not have a stable finance system. Any changes in the policy of creditors toward Russia led the country to the financial and thus social crisis.

In November 1997 the financial crisis struck in the Asia region. This caused huge capital outflows from Russia, leaving the country with a significant budget deficit, large scale internal debt in the form of short term loans and also in the form of wage and pension defaults in paying.

### **1998**

In March 1998 the new government ruled by Sergey Kirienko took over the leading posts in the cabinet. The main aim of the this government was to stabilise the budget and the whole financial system of the country. These goals were supposed to be achieved by reducing the state expenses and increasing state incomes.

In April budget sequester was realised, and in June the cabinet proposed the stabilising programme to the Federal Counsel. This programme consisted of two part. The first part was called “the programme of state expense economy”. The second part contained tax laws aimed to replenish the state incomes.

#### ***The programme of state expense economy***

This programme declared that “in order to stabilise the state budget, to eliminate the budget deficit and to create the necessary base for forming and executing the real budgets in 1999-2000” the following steps were necessary to be done:

- *optimisation of the number of workers employed in the organisations, financed from the budget*
- *the analysis of wages and salaries of these employees*
- *liquidation and consolidation in the federal budget all the non-budget funds*
- *gradual elimination of all the benefits and subsidies*
- *control over budget organisations in the sphere of using energy, in the sphere of concluding contracts and in the area of regulating the amount of debts to the population and other organisations*
- *legal base clarification on purpose of excluding budget expenses, which are not linked with real sources of incomes.*
- *etc*

In other words this programme supposed cutting down budget expenses, reducing the amount of people engaged in the budget sphere, for instance at the expense of firing a great deal of regional and local bureaucrats and officials. The liquidation of the non-budget funds and consolidation of their resources in the budget would economise approximately 3.2 billion rubles a year. And gradual cancellation of benefits and subsidies from the federal centre would give the future budgets over 4.6 billion rubles.<sup>2</sup>

Besides that the stabilising programme of the government included changes in the tax law base. The cabinet proposed:

- to accept measures which would stimulate the income tax payments
- to set the common rate of VAT (e.g. reducing the list of goods with beneficial rate of VAT)
- to collect the income tax from all the kinds of the population incomes (the government supposed to introduce the horizontal scale of the income tax with the rate set in 20%)
- to increase the rate of collection from the population to the pension fond

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<sup>2</sup> The information is given by the Ministry of finances of the Russian Federation (<http://www.minfin.ru/>)

- to introduce the sale tax with the rate of 5%
- to increase the land tax rates
- to raise the penalty for tax evasions
- and to introduce the customs duty on imported goods with the rate of 3%

In accordance with the estimations of the governmental organs the realisation of this plan would give more than 105 billion rubles to the budget of 1999. And thus this budget would become balanced.

However the State Duma rejected this program. As a result some parts of the program were introduced by means of governmental resolutions and President's decrees. And that part of the program, which changed the tax law base, were not realised at all. This situation did not give guarantees of finance stabilisation in the near future. It could not console the market participants both inside the country and outside. And besides any governmental resolution could have been canceled by the State Duma, in the beginning of the autumn session. In other words these resolutions have a very shaky legal base.

Besides the government faced a serious problem concluded in the colossal internal short debt (collected since 1994) and in the big external debt, which was equal to

such circumstances the government having no support on the Federal Council, having no fiscal policy accepted by the State Duma made a resolution of short term loan debt restructuring. This caused serious political and economic crises.

There are a lot of estimations and opinions about this resolution, but from the view of a budget policy this decision meant the following. The pyramid of the state loans was liquidated. All the terms of the payments were prolonged, and all the resources were directed to the needs of the budget, covering its deficit.

In August the President fired the whole cabinet and appoints Chernomyrdin V.S. as a temporary prime minister. Due to the fact that Chernomyrdin's government did nothing, the bank system collapsed, the ruble was devaluated, the capital outflows got a perilous character. The country began drowning in the financial and economic crisis.

On September, 11 E. M. Primakov took over the post of the prime minister of the Russian Federation. His cabinet faced a serious choice, which way to go, which programme to choose. In October two reasonable programs were suggested to the government by two political movements: "Yabloko", and "DVR".

#### ***"Yabloko" programme***

The essence of "Yabloko" programme can be revealed in 4 points:

- 1) The economical evolution of Russia is to take place in conditions of permanent ruble falling, fast raising prices and indexed wages and salaries:
- 2) "Yabloko" suggests another rate policy according to which the exporters will have to sell 100% of their dollar incomes
- 3) "Yabloko" insists on raising the amount of the state social guarantees
- 4) "Yabloko" also proposes tax rate lowering on purpose of stimulating small businesses. And then suggests the introduction of excises on oil, alcohol, etc.

#### ***"DVR" programme***

Unlike the programme of "Yabloko" movement, the programme of "DVR" can be described as non-inflationary. The main measures are:

- 1) the recovery of the trust in the national currency
- 2) accepting the real budget on 1999

- 3) restructuring the state social system and other liabilities of the state (mainly reducing them)
- 4) other tax reform (described above), and rate-policy (in accordance with the monetary reserves of the Central Bank)
- 5) structural and institutional reforms in the economy of the country

### 1999

Making an objective estimate of the economic situation in October 1998, it is necessary to point out that the government had to work in a very difficult situation. On the one hand the cabinet had to solve a tremendous problem, which was concluded in the reformation of the whole bank system of the country. The government had to recover finance stability and to start paying wages and pensions. But on the other hand the cabinet could continue the course of structural reforms counting on support of the loyal Federal Counsel.

In the end of December the State Duma accepted the budget of 1999. This budget is considered to be realistic and strict. And that is somewhat true. The cabinet worked it out using the programme of the previous government (the one about the state expense economy). However the ways how the cabinet wants to replenish the state incomes remain dim.

First of all, the real rate of ruble is less than it was expected in the budget. This will cause serious problems with the clauses of the budget which are supposed to be paid in foreign currencies (external debt payments, international activities, etc).

Besides, the first steps of the government proved that the cabinet will not be able to collect the income part of the budget. These steps are:

- signing contract with Gazprom, according to which the company was given the right to pay only a part of the whole tax payments.
- realising new credits and "forgiving" the old ones
- using the practice of accepting the tax payments not in the monetary form but in the form of products or services
- recovery of the clearing practice between the organisations
- tax reform, which is concluded in lowering the rates of the best collected taxes.

These measures reduce the income part of the budget, which sooner or later will force the government either to issue rubles or to realise the budget sequester.

The third, and probably the most important problem is restructuring the external debt of the country, which will (otherwise) cover approximately the whole income part of the budget of 1999. Therefore it is necessary to conduct negotiations with IMF on purpose of prolonging the debt terms.

**State budget income structure in 96-99\***

<i>Incomes (billion rubles)</i>	<i>1996</i>	<i>1997</i>	<i>1998</i>	<i>1999</i>
<b><i>Taxes (total):</i></b>	<b>282,5</b>	<b>374,7</b>	<b>306,9</b>	<b>399,1</b>
PAYE	55,5	76,5	48,1	34,6
Income tax	5,0	(both)	(both)	25,2
Value added tax	127,0	171,9	141,2	145,2
Excises	44,0	75,8	78,7	87,1
Custom duties	3,1	21,8	27,1	91,3
<b><i>Non tax incomes</i></b>	<b>40,1</b>	<b>25,2</b>	<b>28,5</b>	<b>33,0</b>
State property	5,3	3,8	5,3	7,9
Privatisation	12,4	4,1	8,1	-
External Economic Activity	13,6	7,7	6,9	23,3
<b><i>Special budget fond incomes</i></b>	<b>26,7</b>	<b>35,7</b>	<b>32,1</b>	<b>41,6</b>
<b><i>Total</i></b>	<b>349,3</b>	<b>434,4</b>	<b>367,5</b>	<b>473,7</b>

**Table <sup>1</sup> 2 State budget expense structure in 96-99\***

<i>Expenses (billion rubles)</i>	<i>1996</i>	<i>1997</i>	<i>1998</i>	<i>1999</i>
Government	6,7	11,59	12,05	15,55
International Activity	28,0	10,23	14,49	40,89
State defence	80,2	104,31	81,76	92,20
Police	35,1	46,73	41,61	50,85
Federal judging system	2,2	2,97	4,45	4,70
Industry, construction, energy	49,5	49,63	27,43	13,58
Transport, communication	9,6	3,12	1,52	0,88
Education	15,2	18,47	17,25	20,87
Culture, art, Mass-media	5,1	6,20	5,50	4,65
Health services	7,5	11,42	9,42	8,74
Social policy	12,6	18,06	35,06	41,48
Emergency Liquidation	5,9	8,49	8,47	7,34
Environmental protection	2,1	2,71	2,93	2,90
Internal debt payments	58,0	31,04	81,62	66,92
External debt payments	(both)	41,38	42,51	99,93
Agriculture	14,5	16,10	12,01	9,28
Fundamental research works	11,6	15,25	11,15	11,43
Reserves	10,0	10,74	6,73	0,10
Special budget fond expenses	26,7	41,19	32,078	44,47
Other expenses	63,6	72,08	10,10	-7,83
<b><i>Total</i></b>	<b>444,1</b>	<b>529,80</b>	<b>499,90</b>	<b>575,05</b>

**Table <sup>1</sup> 3 Incomes, expenses and budget deficit in 96-99\***

	<i>1996</i>	<i>1997</i>	<i>1998</i>	<i>1999</i>
<b><i>Incomes</i></b>	<b>349,3</b>	<b>434,4</b>	<b>367,5</b>	<b>473,7</b>
<b><i>Expenses</i></b>	<b>444,1</b>	<b>529,8</b>	<b>499,9</b>	<b>575,1</b>
<b><i>Deficit</i></b>	<b>94,8</b>	<b>95,4</b>	<b>132,4</b>	<b>101,3</b>

\*Sources:

*Federal law "of the federal budget of 1996"*

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*Table 1 4 Budget execution in 97-98\*\**

	<b>1997plan</b>	<b>1997real</b>	<b>1998plan</b>	<b>1998real</b>
<i>Incomes</i>	434,40	322,83	367,50	302,39
<i>Expenses</i>	529,80	409,28	499,95	388,93
<i>Deficit</i>	95,40	86,45	132,40	86,54
<i>Internal debt payments</i>	49,50	42,51	105,83	27,11
<i>External debt payments</i>	45,90	53,47	26,57	90,19

*Diagram 1 1 Budget execution in 97-98\*\**

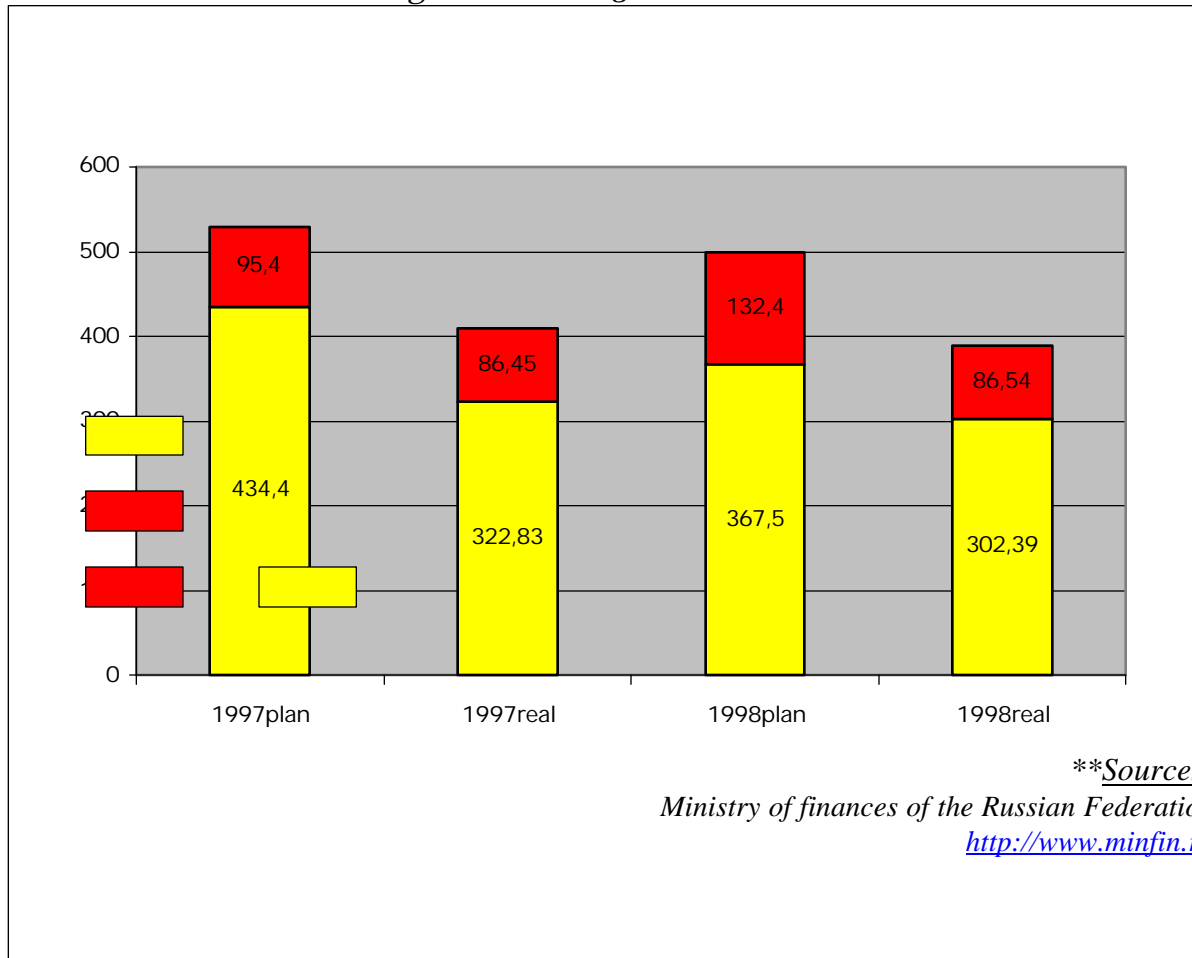
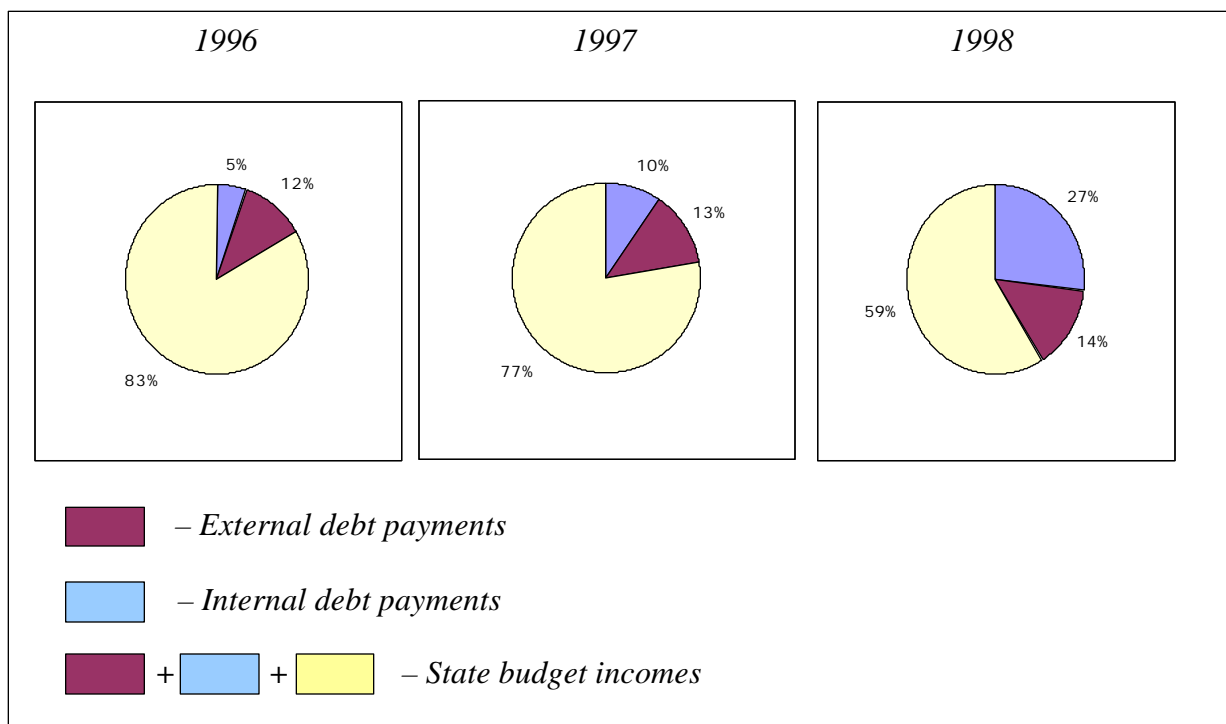


Table 1 5 Debt payments in 96-98 (in total sum of budget incomes)\*\*\*

	1996	1997	1998
Incomes	349,30	322,83	302,39
Internal debt payments	17,7	31,04	81,62
External debt payments	40,3	41,38	42,51

Diagram 1 2 Debt payments in 96-98 (in total sum of budget incomes)\*\*\*



\*\*\*Sources:

Ministry of finances of the Russian Federation

<http://www.minfin.ru>

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