We Don’t Want a Bailout, Just Support

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In early 1998 the Russian economy appeared poised to enter a period of moderate expansion. Inflation had decelerated to the lowest levels since the onset of economic reforms, interest rates were on a downward trend, there were growing signs of an output recovery, and the government, after lengthy debates in parliament, had finally secured approval of a realistic budget.

Unlike many of its predecessors, the 1998 budget was prepared on the basis of realistic assumptions, and efforts were made during its preparation not to inflate revenue forecasts in order to create additional room for expenditures as a way of gaining support for its approval. Use of this strategy in the past had created enormous uncertainties at the level of the spending departments or agencies, most of which would never know what fraction of their budgeted commitments would be financed. This ultimately undermined the credibility of the budget and hampered the ability of the government to tackle tax collection.

But a number of factors significantly complicated fiscal management in the period immediately following the signing of the budget in late March.

Declines in raw materials prices (oil, metals and other products of which Russia is a major exporter) adversely affected revenues and spurred a revision of the government's balance of payments forecasts for 1998. While not large, the shift of the current account into a (small) deficit may have enhanced investor concerns against the background of a weaker external reserve position at the central bank.

The change in government itself, involving the possibility of early parliamentary elections, is also thought to have created uncertainties at a time when the Ministry of Finance was planning to improve the operational mechanisms for the implementation of the budget, including a strengthened treasury and the introduction of certain institutional innovations to improve revenue collection.

Finally, the above factors emerged in the midst of a remarkable intensification of the crisis in Asia and the associated weakening of confidence in the investment community in emerging markets. In Russia, it resulted in a significant increase in yields on government securities and required an increase in the amount of borrowing required to finance the budget.

The government's response to the crisis has been twofold. Restating its commitment to exchange rate stability as the cornerstone of macroeconomic policy in 1998, the Central Bank of Russia raised its refinance and Lombard (emergency lending) rates on two occasions to signal to markets its determination to defend the ruble. More importantly, and to support the central bank's tight money policies, on May 29 the government announced a package of fiscal measures intended to ensure achievement of the budget's deficit target.

The package envisages the closure of a number of spending units at the federal level, including a reduction in defense orders and security-related expenditures, even at the cost of public sector employment cuts. Ceilings on the energy consumption of departments and agencies were introduced. Significant improvements in public sector administration in the regions were planned, including closer monitoring and control over their external borrowing activities and, more generally, fiscal management. A broad range of administrative sanctions are also envisaged to introduce an element of discipline and fiscal prudence at the level of the spending units. When fully implemented, these measures are expected to save some 2.5 percentage points of GDP.

On the revenue side, early this year the government eliminated tax offsets and other schemes to settle taxes in non-cash forms. This has already significantly improved cash revenues, which rose by 9% in real terms during the first five months of 1998. The government is also committed to improving tax compliance by some of the largest enterprises and will carry through on threats to start bankruptcy proceedings against serious tax debtors, including the seizure and sale of assets. Oil producers who have not met their tax obligations as of July 1 will be penalized. A more ambitious program of sales of state shares in some of the largest enterprises in the energy, transport, and telecommunications sectors has been announced.

To support the above measures, the government will continue to work in favor of building the consensus in the Duma for approval of a new tax code in the period ahead, so that the 1999 budget can be passed on the basis of a radically different and improved climate for tax policy in the Russian Federation.

The government is deeply aware that the short-term prospects for the Russian economy will very much depend on its determination to follow through on the plans outlined above. Preliminary data for the first five months of the year show a primary budget surplus (before payments on existing debt) of 0.7% of GDP, compared to a primary deficit of 2.4% of GDP in the corresponding period of 1997. Thus, through the recent crisis, the government has implemented a tight fiscal policy and will continue to do so. Inflation should continue to slow down and the 8% annual target looks eminently achievable. That the current account of the balance of payments has shifted into a small deficit should not be a major concern. (Such has happened in other transition economies.) To enhance confidence, the government is entering into negotiations with the International Monetary Fund with the aim of securing additional money to provide a second layer of financial support for the ruble—not, it should be stressed, for some kind of bailout.

In the midst of a global financial crisis, it is often easy to forget the dramatic progress that Russia has made in the introduction of the key policies and institutions needed for the effective functioning of a market economy. Russia is now part of the global economy, with all the benefits and occasional risks that implies. The government recognizes that in an interdependent international community there is no alternative to rigorous macroeconomic management at home and active Russian participation abroad in discussion on the future evolution of the global economy and its supporting institutions. There should be no doubt about the government's commitment to both.

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