

## Memorandum on the Economic Policy of the Russian Federation

1. For approximately the past sixty years, Russia's economy, as part of the USSR economy, has been subjected to strict centralized planning. This system has been undergoing a gradual dismantling since the mid-1980s, but it has not been replaced by any other integral economic mechanism. Macroeconomic disproportions have built up during this same period. As a result, the economy entered the new decade in a state of acute crisis that is manifested in lowered productivity, higher inflation, obsolete fixed capital, gross distortions of price relationships, serious structural disproportions, and a number of grave ecological problems. The transition to a democratic form of government in 1991 created prerequisites for eliminating the basic causes of these negative phenomena. The principal economic goals of the Russian government were articulated in the speech given by the Russian president, B. Yeltsin, on 28 October 1991: the transition to a market economy and the attainment of macroeconomic stabilization. The economic policy of the first months of 1992 and the basic provisions of the program the government intends to carry out in the last three quarters of 1992 are briefly presented below. The Russian leadership hopes that this bold, comprehensive program will receive the appropriate support of the international financial community.

### A. The economy at the beginning of 1992

2. As a result of the large-scale liberalization of prices on 2 January 1992, approximately 90 percent of consumer prices and 80 percent of prices of producers' goods (in value terms and in average 1991 prices) are now free of direct administrative regulation. This price action, in addition to the 3-5-fold increase in prices that continue to be regulated, led to an estimated 3.5-fold rise of the average level of prices in January, which was to some degree connected with the reduction of the amount of excess money supply in the possession of enterprises and the population. There are, however, signs that the bulk of the price increases took place in the first weeks of January, while in February the level of inflation was significantly lower. In a number of instances, prices fell in comparison with their peak level in January because producers and trade organizations met with a sharp decline in demand.

3. Yet it is clear that the jump in prices in January would have been significantly smaller if competition—both in production and in trade – had been sufficiently developed in the economy. The government has already taken steps to encourage competition and to make supply more sensitive to changes in prices. First, Presidential Edict No. 65 of 29 January 1992 declared that everyone has the right to trade in whatever they choose wherever they choose unless such trade is specifically prohibited. Second, we are trying to implement the privatization plans set forth in Presidential Edict No. 341 of 29 December 1991 at all levels of state management as quickly as possible. The program for 1992 calls for the privatization of 50 percent of all enterprises (organizations) in the construction-materials industry, wholesale trade, and public catering; 60 percent of all enterprises in the food industry, agriculture, and retail trade; and 70 percent of all enterprises in light industry, construction, motor transport, and repair. Privatization will continue in 1993-95. An appreciable improvement in the supply of goods can obviously be achieved most quickly by privatizing retail and wholesale trade and trucking.

4. Our intention was to combine the liberalization of prices with a substantially tighter financial policy in order to keep the initial large jump in prices from turning into a "price-wage" spiral and hyperinflation and in order to bring inflation down to a low level. Our approach includes two basic elements.

5. First, considering Russia's estimated budget deficit of more than 20 percent of the GDP [*gross domestic product*] in 1991,<sup>1</sup> the government plans to reduce the consolidated budget deficit to 1 percent of the GDP in the first quarter of 1992. The budget is basically strengthened by the substantial reduction of subsidies (as a result of the price measures noted above), of military spending, and of budget-financed investments. Revenues must at the same time be increased by replacing the sales tax and turnover tax inherited from the centralized planned economy with a value-added tax; exports of energy carriers and raw materials will also be taxed. If the budget is recalculated in accordance with international norms, i.e., if external financing is excluded from revenues and if the cost of servicing the domestic state debt is included in expenditures, the budget deficit increases to 4.4 percent of the GDP. Even though a strict expenditure sequestration policy was pursued in January, the possibility was nevertheless not excluded that a shortfall in revenues and cost overruns might raise the budget deficit to more than 10 percent of the GDP in the first quarter as a whole.

<sup>1</sup> "Memorandum ob ekonomicheskoi politike Rossiiskoi Federatsii," *Ekonomika i zhizn'*, 1992, no. 10 (March), pp. 4-5. A publication of the Russian Union of Industrialists and Entrepreneurs and the Union of Entrepreneurs and Lease Holders.

6. Second, the Central Bank of Russia (CBR) has instituted a tighter money policy. In particular, plans for the first quarter of 1992 call for sharp restrictions on the growth of CBR loans to commercial banks. The CBR raised the rate on such loans from 2 to 9 percent in 1991 to 20 percent and liberated the interest rates that commercial banks can set. Reserve requirements will also gradually be raised to 20 percent in April, and their level will be the same for all commercial banks. Cash savings in real terms will probably be reduced sharply as a result of the liberalization of prices in the first quarter, and the excess money supply will be eliminated.

7. The liberalization of the majority of domestic prices was accompanied by the liberalization of the foreign-trade and currency-exchange system. In principle, any economic unit is entitled to participate in foreign trade. Imports have been liberalized almost completely, whereas a large percentage of exports in the first quarter of 1992 were still subject to quotas and licensing. This applies first of all to exports of energy carriers and other types of raw materials (55 percent of exports) and arms (another 15 percent of exports). Exports of all other goods are free of quantitative restrictions. Even though the currency-exchange system remains more complex than we would like, the exchange rates at which exporters must sell foreign currency and which importers must pay to acquire it are substantially lower in real terms compared with the commercial rate of 1.7 rubles per U.S. dollar at the end of 1991. The exchange rates that are presently used in foreign trade are significantly understated. We expect that the policy described in this memorandum will lead to the raising of the exchange rate compared with the existing level, which will help to restrain inflationary pressure.

8. The Russian Federation remains true to the foreign debt servicing obligations it adopted vis-a-vis official and commercial creditors in November-December 1991 and January 1992. The government intends to pay its debt. However, at the present time it is impossible to make interest payments in full. We are discussing our foreign-debt problem with our creditors. A system for regular transfers of funds from the Russian Foreign-Trade Bank to the Foreign Economic Bank (FEB) was introduced in February. Control over transactions involving foreign currency will be increased through the banking system, and starting in March 1992 bank accounts will be checked against customs documents. This will increase the state's possibility of ensuring the receipt of hard currency.

9. We believe that the measures indicated above are being carried out in the right direction and that they represent a fundamental turn from the economic system of the past to the principles of a market economy with a low level of inflation and with stable economic growth. However, we admit that additional measures will be required to make the reforms successful and to obtain foreign financial resources. We are therefore striving to strengthen and implement as soon as possible our reform and stabilization program. This presupposes the implementation of long-term, significant reforms in a number of areas and the formulation of a comprehensive, integrated stabilization program within the framework of the reforms slated for the last three quarters of 1992.

## **B. The government program from 1 April to 31 December 1992**

### **1. *The program's goals***

10. The program's goals are to bring about a sharp reduction of the rate of inflation to a low level by the end of 1992 and to counteract the decline in production as far as possible. It is also planned to effect a radical improvement in the foreign-economic situation. This would be the basis for obtaining foreign aid and for the influx of direct foreign investments required to restructure the economy.

### **2. *Price policy and inflation***

11. Prices of twelve types of basic foods, certain municipal services, and a limited number of energy carriers and semifabricated goods are still regulated administratively at the present time. Our goal is to remove all remaining administrative restrictions on prices of consumer goods and services (with the exception of apartment rent, municipal services, and public transit) before the end of March 1992. As a result, only about 5 percent of the population's monetary expenditures (in value terms and in average prices for 1991) will be for goods and services that are sold at regulated prices. Local authorities will be allowed to use local budgets to regulate milk and bread prices.

12. It would be unrealistic to allow the prices of fuel and certain other key types of resources in the production sector to rise to the level of world market prices immediately. This would lead to an unacceptably precipitous decline in production. However, it is deemed important to liberalize fuel prices immediately. By 20 April 1992 a new system of export duties that will cover the entire difference between the domestic and the world prices of these commodities will replace the existing system. As a result of the revision of these export duties in accordance with the previously announced schedule, prices will reach the level of world market prices before the end of 1993. In the price liberalization process, we intend to take into account the interests of other former republics of the USSR, to inform them of our intentions beforehand, and to secure a single price level within the framework of a single economic space. This will help avert

retaliatory measures that would probably lead to a sharp reduction in interstate trade and would only intensify the decline in production that is expected in the transition period during the restructuring of the economy along market lines.

13. We intend to liberalize all prices of fuel and other producers' goods that are still regulated before 20 April 1992, which corresponds to the end of the heating season. The regulation of prices of natural gas and electric power will continue temporarily. Crude oil prices will be raised from 350 rubles a ton at the beginning of January to 2,000–2,500 rubles a ton, excluding value-added tax. With the exchange rate of about 50 rubles per U.S. dollar, this would mean raising the domestic price of crude oil to a point where it would be more than one-third of the world market price compared with the situation in January, when, given the average weighted exchange rate for oil producers of more than 100 rubles per U.S. dollar, the price of oil was about 3 percent of the world market price. Export duties on fuel will be revised before 1 January 1993 in such a way that domestic prices will be about two-thirds of world market prices during that period.

14. Bringing fuel and other basic-resource prices decisively closer to world market prices will make a still greater contribution to reducing direct budget subsidies and the need for special tax exemptions for these sectors of the economy. The sharp rise of the relative prices of fuel will stimulate its production, especially given the organizational changes in the fuel-energy sector, and will lead to the substantial reduction of fuel-energy losses.

15. The overall price level is expected to rise by an additional 50–75 percent in April as a result of further price liberalization. However, with a firm financial and income policy, the average monthly level of inflation should then quickly drop to 1-3 percent in the fourth quarter of 1992. In this case, the overall level of inflation in the last three quarters of 1992 will be 100–140 percent compared with 145 percent in 1991 and about 350 percent in the first quarter of 1992.

### ***3. The system of social protection***

16. We propose to protect the most vulnerable groups of the population during the transition period. This will require the use of various political instruments.

17. First, the government will place a budget ceiling on consumer subsidies, and this means that those prices on services that continue to be administratively regulated at the end of March (see Section 2) must rise following the further rise of production costs. The remaining subsidies should in the future be distributed in the form of cash payments – taking income levels into account as accurately as possible – in order to compensate citizens receiving social grants (pensions or family grants) for higher prices.

18. Second, we intend to introduce as soon as possible a system of family grants that will be oriented to a greater degree toward low-income groups of the population. What is more, this system will be reviewed for the purpose of putting it in order and of eliminating the possibility of double compensation. The indexing of revised grants will be limited.

19. Third, unemployment compensation must be reduced in order to lighten the burden of budgetary expenditures and to ensure the necessary incentives for productive work. The existing system of unemployment compensation, which provides compensation at the level of 100 per-cent of the unemployed person's previous average wage during the first three months and gradually declines over a twelve-month period to the level of the minimum wage, will be modified. Present compensation, which is based on the average wage in the past, will be replaced by two alternative types of compensation: ordinary compensation and higher compensation. Higher compensation will be paid to unemployed persons who are discharged in connection with the shutdown or major reorganization of their enterprises. All other unemployed persons will receive ordinary compensation. Higher compensation will exceed ordinary compensation but will not total more than 90 percent of the average wage in the past. Ordinary compensation will not exceed 75 percent of the minimum wage. After six months all unemployed persons will receive only ordinary compensation. The expectation is that the new system will be instituted no later than 1 June 1992.

20. The more precise goal-specific orientation of this compensation will mean a significant saving of budget resources and the resources of the Employment Fund. Part of this saving will enable us to finance an active labor-market policy, including programs for retraining the unemployed and projects for stimulating entrepreneurship. We will be ready to use labor-intensive public-works projects as an extreme remedy.

21. Finally, the payment of pensions and social insurance grants must be limited to the Pension Fund's and Social Insurance Fund's own available resources at a given time. The government will not subsidize these funds in 1992. Nor will it raise the rate of social insurance withholdings from the already high level of 37 percent of the basic wage or lower the pension age any further. The government is planning to take steps to stimulate the development of private pension funds and to privatize the state pension system.

### ***4. Financial policy***

22. In order to reach the goal we have set of reducing inflation, financial policy will have to be even stricter than it was in the first quarter of 1992. Important steps will be taken in the realm of both fiscal and monetary policy.

#### ***(a) Fiscal policy***

23. The government intends to make rapid progress toward the attainment of a balanced budget. Serious additional measures will have to be adopted in view of the fact that a large budget deficit is expected in the first quarter of 1992.

24. There have already been significant spending cuts in a number of areas, particularly in defense. They will continue throughout the year, thereby making it possible to attain an overall reduction in budget expenditures. There will be an additional reduction in the overall volume of subsidies, which the budget for the first quarter has planned at the level of approximately 5 percent of GDP. Price policy, which is examined in Section 2, will make the greatest contribution in this respect. By the fourth quarter of 1992, direct subsidies to enterprises will have been reduced by 1.5 percent of GDP. The further dismantling of the centralized-planning system will make it possible to reduce the cost of managing the economy significantly. Accordingly, the number of state office employees in the central apparatus will be reduced by 5 percent by mid-1992 and by an additional 10 percent by the end of 1992. What is more, we will avoid the rigid indexing of wages in budget organizations to the level of inflation; wage costs in budget organizations will not increase by more than 90 percent of the growth of the wage fund in the material sector (see also Section 5).

25. Additional measures will be adopted to increase budget revenues. They will include:

(a) the restoration of the value-added tax on all goods, which will be proposed in the draft budget submitted to the Supreme Soviet in March 1992;

(b) the replacement of the existing system requiring the sale of part of all hard-currency receipts at a higher exchange rate and the replacement of existing export duties by a single system for taxing exports of fuel and raw materials;

(c) the introduction as of 1 July 1992 of a single customs tariff with an average level of 15 percent of the declared price;

(d) additional taxation (in the form of rent payments, etc.) in the amount of on the average approximately 50 percent of domestic prices of oil and natural gas (without value-added tax) from the time these prices are liberalized in mid-April 1992;

(e) the further reduction of the number of tax benefits, including benefits that are enjoyed by regions on the basis of the volume of their exports;

(f) the extension of value-added and excise taxes to imports as of 1 July 1992; and

(g) the empowerment of local authorities to impose additional taxes.

Efforts to improve the tax service, which are benefiting from the IMF's technical assistance, are expected to make the work of the new State Tax Inspectorate more effective.

26. Budget oversight will be strengthened by three basic measures. First, the government will continue to adhere to the principle of strict sequestration, i.e., expenditures will be limited depending on revenues received. The Treasury will become operative within the Ministry of Finance by the end of 1992; the IMF will provide technical assistance in this area. Second, the government will refrain from establishing new nonbudget funds, and certain existing funds will be consolidated into the Federation budget by the end of 1992. Third, the government, together with the CBR, intends to restrict the possibilities for local authorities to use bank loans to finance budget deficits.

27. The government believes that the measures examined above will make it possible to eliminate the budget deficit by the fourth quarter of 1992. We also intend to continue medium-term fiscal and budget reforms. They will include the introduction of a more effective system of taxes on natural resources and tight restrictions on all types of tax benefits and exemptions.

*(b) Monetary policy*

28. Credit and monetary policy will become even stricter compared with the approach taken in the first quarter of 1992. Credit policy for the next three quarters of the year calls for an increase in the nominal volume of credit at a rate corresponding to the projected growth rate of inflation and to the growth of net hard-currency reserves. This should ensure the growth of loans at a moderate rate in the second half of the year, which would be sufficient – in the period of a possible decline in profits – to provide enterprises with the financial means they require to adapt to the new price structure and market stimuli. The existing indeterminacy makes it impossible to establish quantitative monetary-policy indicators before the end of the year. The state of affairs in the area of monetary policy will be carefully analyzed, and we will discuss it every month with IMF officials.

29. We expect that the decisive implementation of a strict financial policy will make it possible to restore confidence in the ruble as a means of accumulation. In this case, accumulation will increase and the nominal exchange rate will be strengthened appreciably. The latter will become an indicator of the state of the money market and can be used to evaluate the correctness of the monetary policy being pursued.

30. The CBR will try to make the transition to a positive refinancing rate as quickly as possible. Enterprises will not be subsidized with the aid of interest rates except for those cases in which the subsidies come directly from budget and

nonbudget funds. The interest rates of commercial banks will be liberalized, although for a certain time it may be necessary to limit the difference between the rates on deposits and those on loans. Otherwise banks with large portfolios of nonperforming obligations may try to make this difference excessively high in order to recapitalize. Moreover, starting 1 April 1992 the government will pay a more realistic interest on its domestic debt, and this, in addition to everything else, will allow the Savings Bank to pay higher interest to small depositors. After a certain time, interest rates will become the main indicator regulating the investment of financial resources in the economy.

31. Prior to this, the growth of loans will for the most part be restricted by the establishment of uniform ceilings on CBR loans to commercial banks. A ceiling of 15 percent has been established for the first quarter of 1992, although it can be revised if circumstances change. Other potential sources of liquidity for commercial banks will be restricted by the introduction in March 1992 of corresponding re-serve requirements for Savings Bank time deposits. Additional measures are being taken to reduce excessive cash reserves in the banking system (see Section 6). It may possibly also be necessary to use loan ceilings in the second half of the year until the CBR attains the necessary level of competence and the banking system becomes sufficiently mature to make the transition to a monetary policy based primarily on indirect regulatory methods. (We are counting on considerable technical assistance from the IMF in this area.) What is more, if there is evidence of an excessive expansion of credit, the CBR will be ready to institute additional measures to restrict loans issued by commercial banks. Even if it becomes necessary to impose ceilings on CBR loans to commercial banks for a certain period of time, we intend to pursue a nondiscriminatory policy in the distribution of loans among enterprises and branches. We are also counting on technical assistance in the formulation of a strategy concerning the debt obligations of enterprises to commercial banks that cannot be met.

32. The CBR intends to make the procedure for licensing banking activity more strict in order to prevent an excessive increase in the number of banks, to improve normative regulation, and to strike an acceptable balance between internal and external audits. The improvement of the system of mutual payments is a necessary condition for ensuring financial brokerage activity and the creation of an interbank monetary and currency market. Special measures will be taken to ensure the unobstructed movement of payments between republics. We have appealed to the IMF for technical assistance in the development of a new system that will be activated in the third quarter of 1992. What is more, the World Bank will assist us in restructuring the system of commercial banks.

33. The CBR will extend loans to cover the budget deficit in an amount not exceeding 2 percent of the GDP.

#### **5. *Income policy***

34. From the very beginning of its activity, the government has been dedicated to a wage liberalization policy. Nevertheless, considering the rapid rise of wages in the material sphere in late 1991 and early 1992, which carries the threat of higher inflation and excessive unemployment, the government is ready to institute measures to prevent the excessive growth of wages if necessary. Such a necessity will arise if the heads of state enterprises, which are still prevalent in the Russian economy, do not firmly resist workers' demands for higher pay, which, even with a rather tight credit policy, can be accompanied by the exhaustion of enterprises' financial assets, thereby worsening the prospects for structural restructuring and long-term development.

35. If the rise of wages is excessive, the government will introduce a progressive tax on the increase in wages paid by state enterprises in excess of the norm. There will be no restrictions on wages. The tax will be collected from the wage fund. However, private enterprises will not be subject to this tax in order to create incentives to increase their number and to privatize state enterprises. This system will be applied without exception. The tax rates will be high and sufficiently progressive to prevent the excessive rise of wages; we do not expect an increase in budget revenues as a result. The tax will be 100 percent for the first percent of the increase in wages in excess of the norm, 200 percent for the second percent, and 400 percent for all the rest of the wage increase. The limit beyond which the rise of wages will be considered to be in excess of the norm will be uniform for all taxed enterprises. In the second quarter, this limit for every enterprise will be equal to the volume that is paid in February and will be increased 0.7-fold of projected price rises in February-April. The limit in the third quarter will analogously be equal to the volume that is paid in February and will be increased 0.7-fold of projected price rises in February-July, etc. The figure of 0.7 needs to be confirmed in negotiations on a general wage agreement. The tax will be paid monthly. If the forecast of prices proves to be erroneous or if new data on the consumption fund become known, taxes will be revised at the end of the quarter. The tax will be paid from enterprise pretax profits and will not be included in the enterprise cost of production.

#### **6. *Foreign-economic policy***

36. We intend to introduce a uniform exchange rate with a fixed ruble exchange rate as quickly as possible in order to create a nominal anchor to which a substantial role is assigned in our stabilization efforts. The introduction and maintenance of a uniform exchange rate will over time make it possible to increase the effectiveness of foreign trade and to

ensure Russia's integration into the world economy. The success of this policy will depend on certain conditions being met. One of the main conditions is the attainment of macroeconomic stabilization with the aid of the implementation of the program of measures examined in this memorandum. Moreover, in order to ensure the stability of a fixed exchange rate, it will be necessary to amass sufficient hard-currency reserves, which are now depleted. External financing will be required for this and for the general support of the economic program.

37. As the main step on the road to a uniform exchange rate, we intend to make the transition before 20 April 1992 from the existing system with several exchange rates to two exchange rates with a single floating exchange rate that will be used in all day-to-day operations, including the transfer of interests and dividends, and a separate constant exchange rate pertaining to the movement of capital. This exchange rate, which will be higher than the floating exchange rate, will be rescinded simultaneously with the introduction of a fixed exchange rate, and a uniform exchange rate will thereby be introduced. When the two-exchange-rate system is introduced, enterprises will be obligated to sell a gradually increasing part of their hard-currency receipts at the market exchange rate. It is ultimately planned to raise the sale of hard currency to 100 percent of enterprises' hard-currency receipts. Export duties, which enterprises may elect to pay either in rubles or in hard currency, will total 20 percent of their hard-currency receipts. What is more, absolutely free access to foreign currency will be ensured for importers of goods and services and for foreign investors wishing to transfer dividends and profits. Measures will be taken at the same time to standardize the economic activity of national enterprises and enterprises involving the participation of foreigners.

38. We will take the following measures before 15 March 1992 to increase liquidity and the efficiency of the currency market. First, authorized banks will be given the right to hold currency auctions; it will be possible to open currency exchange points throughout the entire country; we will suggest that other former Union republics do the same. Second, interbank currency auctions will be held twice a week so that they may subsequently be held daily. Third, restrictions on the exchange rate that banks are authorized to use in operations on behalf of their clients will be lifted. As soon as it becomes possible, nonresidents will be allowed to buy and sell foreign currency in the interbank market for day-to-day operations. With certain restrictions, banks will be entitled to take an open position in hard-currency accounts so that they will not have to act merely as the agents of specific enterprises and for specific operations as is the case today. The gap between cash operations, primarily connected with tourism, and noncash operations will be bridged by the elimination of existing barriers between the two markets. In accordance with the new exchange rate, Russia's Supreme Soviet is discussing a new law on hard-currency regulation and hard-currency oversight that will make it possible to secure the convertibility of the ruble for residents and nonresidents in day-to-day operations. It is expected that this law will be passed in March and will take effect on 1 April 1992.

39. The floating exchange rate will be retained until macroeconomic stabilization is attained and hard-currency reserves are accumulated at a level that is sufficient to maintain a fixed exchange rate. The government and the CBR will try to strengthen the ruble with the aid of instruments of monetary and fiscal policy. Economic and political risk will remain high during this period. It is for this reason that we attach great importance to securing appropriate external financing for the government's economic program. What is more, the creation of a stabilization fund would increase the reliability of the fixed-exchange-rate policy and its chances for success.

40. All export quotas and export licenses (unlike direct export duties mentioned in clause 26) will be eliminated before 1 July 1992, with the exception of quotas on exports of energy carriers, which will be rescinded gradually by the end of 1993, and goods whose export is limited for security reasons. Export quotas on energy carriers will be established with regard to the expected reduction of the domestic consumption of these resources due to the decline in production and energy saving that is connected with the rise of relative prices of energy carriers. There will be no return to quantitative restrictions on imports.

41. These changes in the hard-currency and foreign-trade system and the corresponding macroeconomic policy will significantly improve the prospect for strengthening Russia's balance of payments. However, the balance-of-payments situation in 1992 will remain very grave, chiefly because of the solvency crisis in 1991 and malfunctions in the economic and financial system. After the collapse of trade within the framework of the Council for Mutual Economic Assistance and the intensification of domestic macroeconomic disproportions, exports declined by one-third last year. As a result of the sharp reduction in hard-currency income, large debt-servicing payments that were made on time, and the rejection of short-term loans, imports declined by more than 40 percent and hard-currency reserves were depleted. In spite of the postponement of debt payment, which was coordinated with official creditors and commercial banks, the situation remains very complex in early 1992. The further reduction of exports is expected, because the absence of key production resources—raw materials and equipment—will be highly detrimental to both production and exports. Even in the absence of any increase in aggregate imports, the need for external financing will be considerable.

42. We shall turn to international organizations, official creditors, commercial banks, and foreign suppliers for external financing. Such financing is required to maintain the necessary level of imports and to replenish currency reserves in a short space of time. Food and humanitarian aid will be required for the general support of the population, including a system of social protection for its most vulnerable strata. The stabilization fund would increase the reliability of the fixed-exchange-rate policy. We are also discussing the foreign debt burden with our creditors.

#### **7. Economic relations with former republics of the USSR**

43. The government intends to develop Russia's foreign economic relations on a nondiscriminatory basis in accordance with the principles of multilateral trade that are generally accepted in the world economy. In this connection, the government recognizes the necessity of maintaining close economic relations with other former republics of the USSR. It is striving to expand cooperation in all areas of interstate economic and financial relations.

44. The government of the Russian Federation intends to take the measures that are possible to preserve the common economic space and to refrain from unilateral steps that would harm trade. It is trying to eliminate quantitative restrictions in interstate trade, to promote direct trade among enterprises, and to limit direct state participation in trade relations. Steps will not be taken to counteract market pressure, which leads to the equalization of prices in different states.

45. Quantitative restrictions on deliveries to other former republics will be reduced to those goods whose export is subject to quantitative restrictions in trade between the Russian Federation and third countries (after the revision of this system; see Section 6). Every effort will be made to secure the observance of existing bilateral trade agreements regarding these goods. What is more, in keeping with the agreement reached in Minsk on 14 February 1992, a Court of Arbitration will be established before 1 July 1992 for the purpose of resolving trade disputes between former republics.

46. As regards interstate monetary relations, the CBR has come to an agreement with the central banks of other former republics on precise rules governing payments and settlements, including correspondence accounts in the CBR and exceeding the technical credit limits of such accounts. The CBR will strive toward a coordination of monetary policy with other central banks within the framework of the ruble zone, including the establishment of similar indicators of credit emission, uniform central bank refinancing rates, and uniform reserve requirements. The CBR is prepared to come to an agreement on the uniform distribution of the emission of money with members of the ruble zone. It will also come to agreement on pursuing a general ruble exchange-rate policy and the mechanism for integrating the currency markets of former republics. The CBR makes it a practice to conclude special agreements on the regulated removal of rubles [*from circulation*] with republics that are planning to introduce their own currency so that the previously examined inflation indicators would remain compatible with the program for extending loans to the CBR itself.

47. Obviously, the attainment of the interstate agreements mentioned above cannot be the result of the efforts of Russia alone and will require similar actions on the part of other former republics. We note that the range of IMF tasks includes helping states avoid steps that are destructive to national or international welfare. We have in mind that the IMF will persuade other former republics to enter into such agreements.

#### **8. Systemic changes**

48. The government is planning to undertake numerous structural and systemic reforms within the framework of the transition to a more open economy that is oriented toward the market. It presupposes changes of a political and institutional nature in a number of areas, including price liberalization; enterprise reform and the development of the private sector, encouraging competition and antimonopolistic measures; development of the financial sphere, foreign trade, and investments; and the creation of a system of social protection. There will also be major systemic reforms in energy and agriculture.

49. Structural and systemic reforms are necessary to strengthen macroeconomic management. Special systemic measures will consequently be required to attain our goals. The government intends to finish drafting the plan for reforms in all the areas indicated above in the near future but no later than June 1992, with an eye to their early implementation. We have already begun and hope to continue discussions with the World Bank and other foreign creditors on structural and branch reforms in these areas. The government proposes that World Bank officials inform IMF officials on the formulation and implementation of these programs. This will help IMF officials analyze the course of fulfillment of the government's economic program that is set forth in the present memorandum.

50. As noted above, the scale of price increases in January was unquestionably substantially influenced by the lack of competition in the economy – both in production and in trade. The government therefore intends to devote special attention to the development of more competitive markets. This presupposes a complex of measures, specifically: the elimination of obstacles to the creation of new enterprises (such as inconsistent legislation and the lack of developed real estate markets); the creation of a system for regulating the licensing of production and trade without restrictive requirements; and the prompt detection and control of abuses of monopolistic status. With the exception of natural

monopolies, the advance regulation of prices set by monopolistic enterprises in individual markets will be terminated as of 1 July 1992, and maximum profitability norms will also be lifted. Instead of this we will concentrate on a positive program for promoting competition in combination with reacting to detected serious abuses of monopolistic status. The present maximum 25-percent markup for state trade enterprises, which is not applied to the private sector or to commercialized state stores, will be retained temporarily in order to prevent monopolistic abuses and to create incentives for commercialization.

51. As already noted, we intend to begin privatizing state enterprises as quickly as possible. Initially the emphasis will be on the quick sale – through open competitive bids [*konkursy*] or auctions – of small enterprises and stores. The privatization of large industrial enterprises will unquestionably be slower than the privatization of small enterprises and organizations in trade and the service sphere. The incorporation of all enterprises with more than 200 employees will be carried out as soon as possible; this will compel them to submit to market discipline and will make it possible to strengthen management during the period in which their future fate will be decided. We also intend to prepare a detailed draft of a mass privatization program than can be carried out by the beginning of 1993. This program will be based on the following fundamental principles:

(a) free privatization coupons will be widely disseminated for the purpose of securing broad support for the privatization program;

(b) workers will be offered a share of enterprise property, but not the controlling package;

(c) restrictions on the privatization of individual enterprises and branches will be sharply reduced;

(d) restrictions on the participation of foreign investors will for the most part be eliminated;

(e) privatized property will include the land on which it is located; and

(f) construction projects in progress will be subjected to a special tax to encourage their completion or sale. The formation of a collective (indivisible) form of property is possible only as an exception.

52. Mandatory state orders [*goszakazy*] have been abolished in order to reduce the scale of direct state intervention in the economy. The benefits that are still enjoyed by enterprises delivering output to the state will be reduced significantly in 1992. All other elements of centralized distribution of material resources will be eliminated by the end of 1992.

53. Presidential edicts on land reform in agriculture and the restructuring of collective- and state-farm enterprises were adopted on 29 December 1991 with the aim of stimulating agricultural production and extending privatization to economic activity in rural areas. We intend to carry out these edicts in their entirety in the next two years and are presently implementing the necessary organizational measures to this end. We hope to complete the privatization of the resource distribution system for agriculture and the food industry by the end of 1992. Serious efforts will also be made to demonopolize and privatize both the processing sphere and wholesale trade in food.

### ***9. Analysis of program fulfillment***

54. The economic program described in this memorandum was formulated in a highly uncertain atmosphere. The Russian government is counting on the IMF's continued assistance in the adaptation and correction of this program as events unfold and additional information is received. If circumstances require, the government will strengthen the reform policy. It is also uncertain whether we will receive foreign financial aid in support of the economic program. The basic parameters of this program will be revised depending on the level of foreign financing. This will be done in such a way as to ensure the attainment of stabilization and the program's other goals.

55. The government is convinced that its policy and program correspond to the goals that have been set but will implement additional measures if necessary. During the implementation of the program, the government of the Russian Federation will maintain close ties with the IMF, which will supervise its fulfillment and the attainment of the goals articulated in this memorandum. IMF officials are expected to analyze the fulfillment of the program in April, July, and October 1992. Special attention will be paid to the degree to which the measures required to attain the goals indicated in the program are being fulfilled and to the degree to which the necessary instruments of economic policy are being developed.

Appendix 1

### **The budget**

The Table presents an estimate of the Russian Federation's consoli-dated budget in 1992, including the budgets of local authorities and nonbudget funds. It takes into account the consequences to the budget of measures described in the memorandum on economic policy. The initial estimate of the basic economic indicators (i.e., wages, interest rates) on the whole correspond to the program presented in the memorandum.



The estimate is based on methodology used by the IMF. The latter differs from the methodology used by the government of the Russian Federation in the following respects:

– incomes and expenditures are considered on the basis of existing circumstances; the government considers certain items – including debt servicing (both the foreign and domestic debt) and expenditures for centralized imports – on the basis of actual payments; and

– certain items are viewed as modes of budget financing and are therefore not cited in the Table, whereas according to the government's methodology they are counted as incomes (or expenditures); the basic items of this type are net foreign loans and incomes from privatization.

These differences in methodology led to differences in the estimate of the budget deficit in the first quarter of 1992.

<b>The Russian Federation's Consolidated Budget in 1992</b>			
<b>(in percent of GDP)</b>			
	<b>January-March</b>	<b>April-December</b>	<b>The year as a whole</b>
<b>1. INCOMES</b>	<b>20.1</b>	<b>35.7</b>	<b>33.4</b>
of which:			
value-added tax (excluding imports)	7.0	10.3	9.9
tax on oil and gas	0.0	4.7	4.0
tax on profits	6.0	4.9	5.1
income tax	1.6	1.1	1.2
export duties	2.8	9.1	8.2
import duties	0.0	1.5	1.3
<b>2. EXPENDITURES</b>	<b>34.3</b>	<b>31.2</b>	<b>33.4</b>
of which:			
investments	2.3	2.5	2.4
consumer subsidies	2.6	0.6	0.9
wages	4.7	6.3	6.1
social costs	6.5	8.8	8.5
expenditures on foreign economic activity	9.7	4.5	5.2
<b>3. BALANCE OF NONBUDGET FUNDS</b>	<b>0.0</b>	<b>-3.0</b>	<b>-2.6</b>
<b>4. OVERALL BALANCE (no. 1 - no. 2 + no. 3)</b>	<b>-14.2</b>	<b>1.4</b>	<b>-0.9</b>