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## Evolution of the Budgeting Process in St. Petersburg

### Introduction

This work addresses the development of budget federalism in Russia as well as the current trends in the taxation and budgeting policies of St. Petersburg. Since 1993 the city has been attempting to establish clear-cut relations with the central administration in Moscow and to achieve a balanced city budget by increasing the share of rental payments. The results, however, have been rather unimpressive. An understanding of the situation cannot be understood without analyzing both the external (federal relations) and internal (the city's socio-economic environment) factors.

The deep transformations in the country's economy and the mixed economic performance of the regions necessitate the creation of a new mechanism for territorial and economic relations within the federation. However, the incomplete state of economic reforms impedes both the formation and the clear division of authority, functions and responsibilities between the centre and the regions. This process now depends on the results of the current political struggle between the regions and the centre, during which an unpredictable variety of territorial and economic relations throughout the country is being forged.

The formation of new economic conditions, the development of entrepreneurship, and the organization of local self-government are largely determined by the policies of the centre. Despite the evident possibility of extremes in the development of the territorial and economic system in Russia, one cannot underestimate the current danger of stagnation in relations between the centre and the regions. It is in this context that we view here the evolution of the budgeting process in St. Petersburg in 1993-1994 and the prospects for 1995. Under the conditions of continued dependence on the taxation and budgeting policies of the centre, which are largely determined by the socio-economic situation, St. Petersburg resorts to a wide variety of methods to streamline its budget expenditures and revenues. However, these methods, in many respects similar to those of the federal taxation and budgeting policies, do not lead to a solution to the problem of an unbalanced city budget.

# 1 Budget Federalism and the Regionalization of the Russian Economy

The problems of centre-regional relations, inter-regional relations, the balance of interests, and the regulation of territorial and economic relations during the transitional period have moved to the forefront of the current political and economic situation and have recently received the special attention of researchers. Apart from everything else, these problems are of immense interest because they have emerged for the first time, and are still far from being completely crystallized.

It is in the regions that political forces have emerged that are powerful enough to resist the centre's decisions on reforming the country's economic environment, to bargain with the centre, and to take advantage of the contradictions appearing as a logical result of the economic changes in the provinces. At the same time, the policies of regional administrations have already outgrown traditional lobbying in Moscow. Every region, in regard to its relations with the centre, is thrashing out strategies that have a bearing on the drafting of local budgets.

This allows greater possibilities for multi-pronged developments, as well as for numerous interpretations and forecasts. Thus, for instance, according to the Institute of Economic Issues, within the period of transition (Russian Economy in the First Half of 1994. Trends and Outlooks. 1994, p. 9), 1994 can be defined as the year when the run-away tendencies in the Russian Federation, which had manifested themselves in the "sovereinization" of certain regions, drew to a close. However, this conclusion, having been quite true in the middle of 1994, had by the end of the year become badly tarnished. Separatist aspirations and the struggle against them then entered a new phase, confirming once again that any long-term forecasts in this area are hopeless. Among the existing wide range of forecasts the most popular are those that consider the extremes of development: either the complete integration or complete disintegration of the Federation. Still, it is safe to surmise that none of the extreme trends will dominate in the near future as any imbalance of interests is reproduced and conditioned both by qualitative changes in economic relations and by the formation of federative principles. It goes without saying that there are always two opposing trends determined by territorial factors of production efficiency: the byregion differentiation of the rates of socio-economic development and their levelling as a result of the actions of the centre. Currently, however, factors are at play that offset all attempts at establishing any principles or rules in this field.

Meanwhile, partly influenced by the uncertainty that exists in inter-budget relations, differences between the socio-economic situations in the regions and the disproportions in their standards of living are on the increase. In 1992 the economies of nine regions experienced a 25 percent drop and in eleven regions the figure was less than 10 percent, whereas in 1994 as compared to 1993 a 25 percent drop was suffered by 42 regions. All in all, during 1994 output in a more than half of the RF regions fell by 25 to 45 percent (I~e Socio-Economic Situation in Russia in 1994 Goscomstat).

Even now it is obvious that building new territorial relations will be a lengthy process as both new economic relations and the territorial organization of the

country are only in the initial stages of development. Under these conditions the search for an optimal federal model is accompanied by manifestations of separatism and a unique strategy of the regions in their struggle for survival. These processes have been nicknamed "sovereinization", "regionalization", "budget autarky", and so on.

None of these terms completely cover the existing principles of the relations between different levels of power in Russia, if only because the numerous variations of interaction with the centre are difficult to classify and more often than not depend on the political programmes of local bodies.

At the same time it would hardly be justified to reduce all of the problems of the regions to the capabilities or political orientation of local administrations. The key factor here is the incomplete state of the very mechanism of inter-relations between the centre and the regions.

The regionalization of the economy is a reflection of: a) objective trends in the disintegrating economic ties in a post-centrally planned economy; b) the lack of a "social contract" for the direction and content of economic reforms; c) inconsistencies in the implementation of economic changes.

The following problems stand out among those needing immediate analysis and practical solution: the division of functions between the centre and the regions; the policy of providing support to the regions; **a mechanism for resolving** controversies; and provisions for a unified taxation-budgeting system.

Should there be a delay in reaching a solution to these problems, there is the possibility that the present chaotic, poorly formed half-federal relations will continue indefinitely and become self-sufficient. As P. Sutela notes, "The ideal, however, is so far from contemporary Russian realities that one is easily left wondering whether Russia, during its withdrawal from a unitary state, will really see federalism as a destination, or whether it will only prove to be a way-station along the route to further devolution into something still unknown" (P. Sutela 1994, p. ~).

The very existence of political and administrative haggling between the centre and the regions which gives rise to different forms of taxation-budgeting interaction is a sign of weakness in the state power, which is troubled by the looming threat of Russia's disintegration like that of the USSR. Since 1994 the main problems of centre-regional interrelations have been in the taxation-budgeting area, which is the basis of federalism. According to Mr. Shumejko, Chairman of the Council of Federation, budget federalism does not mean simply a division of financial resources and taxation authority between the centre and the regions, but also a division of political responsibility for budgeting policies (Russian Economic Journal, 1995, No 1).

According to the Federative Agreement, republics, as distinct from other administrative entities, were given control over their natural resources, whereas the New Constitution formally endowed equal rights to all federative entities. However, the division of federal and municipal property has not been completed, and the policy of providing special privileges or preferences to certain regions subverts the principle of equality of all federative entities regardless of their status. In the three level system of federative relations-consisting of the centre; the federative entities and the local self-governmental bodies – the last level is practically nonexistent. And this is one of the reasons for the regions' increasing importance, which in fact signifies the centralization of management at the regional level.

And still, according to Hanson (1994), the most significant advantage held by regions is that the provision demanding that governors (administrative heads) be centrally appointed by the RF President does not extend to them. This relative political independence from the centre in conjunction with the availability of export-oriented resources allowed some republics (Saha, Tatarstan, Komi) to obtain greater independence (compared to other federative entities) and this further encouraged attempts by the elite of other regions to change their own federative status. One can also agree with the opinion (Hanson 1994, p. 31) that the main conflict between the two levels of power is unfolding largely around two basic components of economic transformation: stabilization and price liberalization. Stabilization, understood as striving for control over budget expenditures, deprives the regions of their traditional function of protecting the population from the difficulties entailed in the transitional period. For the same reason, a majority of regions retain price control over some products or even establish distributive systems of product supply (Uljanovsk Region).

The privatization of state property, on the contrary, does not incite equally strong opposition from regional powers because it provides local elites with an opportunity to legalize their de facto property rights and retain control. In the future the conflicts between regional bodies and local self-governmental bodies will predictably worsen after the latter gain actual independence, budget subsidies to producers are cancelled, and the participation of government officials in privatization is put under control.

Hence it is rather difficult at this stage to give a single-valued estimate of the idea of investing regions with political responsibility for their own decisions as it may lead to decentralization of the state budgeting system and centralization at the regional level. At the same time, as notes G.Semenov (Semenov 1994), a strategy of retaining the former degree of federal budget centralization will inevitably induce territories to unilaterally refuse to follow the imposed rules of the taxation-budgeting game and to invent their own.

As mentioned above, delays in reforming the taxation-budgeting system impede economic stabilization and growth. Provided the basic principles are in place, various types of federalism in different countries evolve according to national traditions.

At present, the development of the territorial and administrative system brings to life numerous forms and methods of separate interaction by each region with the centre. Meanwhile, within the basic framework of the principles of federalism there exist only two models of budget interaction: a) the American model with its separate categories of taxes to be paid to regional budgets and the central budget; b) the German model where total budget revenue is distributed in accordance with definite proportions or standards.

A study of the practice of developing budget federalism in Russia (Sutela 1994) shows the lack of a unified approach by federative entities. Thus regions with high export potential want taxation rates to be differentiated in line with their contribution to the consolidated budget; Tatarstan prefers an annually renewed agreement on its tax assignments in the federal budget; the particularly needy northern and eastern regions are in favour of a system with additional subventions from the support fund and tax privileges; the "Nizni Novgorod Initiative" proposes special standards for tax revenue distribution; and the Sverdlovsk Region Duma has brought forward the concept of tax reform involving a by-type differentiation of taxes.

The existing budgeting practices do not conform to the basic principle: "he who makes decisions pays". For instance, the centre grants privileges to certain social groups and then places the financial burden of their implementation on local budgets. This either seriously undermines the budgets or leaves such worthy matters hanging in mid-air. It is this type of interrelation, characteristic of 1994, which further aggravates the variegated picture of the taxation-budgeting system with its asymmetry between federal and regional budgets because of the growing differentiation of regions in terms of per capita tax collection. Thus, during the first ten months of 1994, thirteen federative entities accounted for 60 percent of all taxes paid to the federal budget. Among them, Moscow (20.6 percent), Moscow Region (5.4 percent), St. Petersburg, as well as Nizni Novgorod, Samara, and Sverdlovsk Regions (3.3 to 4.5 percent each), Chelyabinsk and Perm Regions, KhantyMansi Autonomous District, Krasnojarsk and Krasnodar Territories (2.3 to 2.8 percent), Rostov Region and Primorsky Territory (2.1 to 2.2 percent) (Russia-1994 (4) *Economicheskaja Conjunctura*).

At the same time a number of federative entities stand outside of the general budget mechanism: Komi is financed on a separate basis, and the Ingushetia and Tula Regions enjoy special budget conditions. The year 1994 saw some progress in increasing tax assignments from the two "refuseniks": Tatarstan and Bashkortostan, which, however, continue to operate on the basis of special budget agreements with the Federation. Of the 89 regions, 41 are recipients of 40 percent of the federal budget expenditure, with 22 regions accounting for 60 percent of the subsidies (Semenov 1994, p. 46). According to a report by the Analytical centre under the RF President, the highest degree of dependence on the federal budget is found in many autonomous districts, North Caucasus republics, republics such as Mari-El, Kalmykia, Mount Altaj, Tuva, and also the Jewish Autonomous Region, Altaj Territory, and the Kamchatka and Magadan Regions. Their own funds account for less than half of their total budget revenues (ECO 1995, No 1, p.177).

With the absence of rigid federal financial and budget restrictions regarding regions, the main method of levelling revenue discrepancies is by trying to obtain privileges or preferences which automatically leads to controversies between the subsidized and donor regions. The attempt (beginning in 1994) to devise a unified approach to interbudget relations on the basis of a unified technique of transfer accounting became immediately cluttered with all kinds of exceptions and amendments. Due to the vague principles of revenue sharing between the different levels of the budgeting system, the current transfer system resembles more a mechanism of redistributing financial resources than a device for providing help to poorer regions. The proof is in the scale of the process: 67 of the 89 federative entities are being subsidized, with 23 as especially needy regions.

Thus one can infer that disproportionate centralization of budget and finance resources leads to re-distribution in accordance with extremely vague criteria. In this case the very opportunity of obtaining subsidies from the centre, as well as their size, relies largely on separate political arrangements with each region, making it impossible to expect any degree of financial stabilization in the country. Thus, regions account for a sizeable share of the 5-trillion budget losses incurred through foreign-trade privileges: before the March 1995 decrees cancelled customs preferences, Udmurtia, Buriatia, Saha, Khakasia, Dagestan, and Komi Republics, as well as Murmansk and Kaliningrad Regions had been listed as duty-free exporters of raw materials and strategic goods.

From 1992 to 1994 the dynamics of relations between regions and the centre were far from smooth: periods of confrontation intermittently gave way to compromise. This situation can be largely accounted for by federal bodies' internal altercations manifested as proposals for new ideological constructions which emerged from time to time. (Rather illustrative in this sense is Sergej Shakhraj's suggestion voiced through "Nezavisimaja Gazeta" to radically reorganize the federal government and the regional administrations, as well as to downsize the territorial divisions of federal ministries and departments, and to introduce a new system of economic regionalization by moving new regional centres to large Russian cities. Mr. Shakhraj refers to certain advances made in this direction by St. Petersburg and the Leningrad Region and proposes to start his reform of "the resource of territorial and state refurbishment" from there ("Nezavisimaja Gazeta" March 23, 1995).

During the period 1992 to 1994, the reform proper of the budgeting system was in essence the result of bargaining and compromise. Given the absence of any clear programme enjoying strong political support, such development might have been considered inevitable, if the price of chaos in federative relations were not so high, jeopardizing the implementation of genuinely radical economic reform.

S. Pavlenko distinguishes several qualitative stages in the development of centre-regional relations in 1994 alone (S. Pavlenko 1994, p.11). As to budgeting interrelations, their stages follow a natural chronology. It is noted that during 1992 and 1993 "the intended shift from tax sharing to tax assignment had not taken place in practice" (P. Sutela 1994) .

The Federal Budget Law of 1994 was in fact the first serious attempt to realize the new budget system concept. With a unified federal profit tax of 13 percent, federative entities were provided with an opportunity to regulate the tax share remaining within the region by increasing the general rate up to 38 percent. A unified rate of VAT assignments (25 percent) was introduced. Instead of obscure subsidies, allocations for the "needy" and "especially needy" were established on the basis of a definite formula, and paid by the specially organized Federative Entities Support Fund comprised of 22 percent of total VAT revenues. The criterion for assigning a region to the federally subsidized category is their average per capita income compared to the Federation as a whole. No radical changes were projected for federative entities' local budgets where the RF Law "On the Basis of Budget Rights and Rights to Form and Use Non-Budget Funds of Legislative and Executive Bodies of State Power in RF Republics, Autonomous Districts, Territories, Regions, the Cities of Moscow and St. Petersburg, as well as those of Local SelfGovernment Bodies" is still in force. The principle of a minimum budget which underlies this law and envisages subsidies from the centre when additional expenses are the result of decisions of higher bodies is never implemented in practice, thus creating an environment leading to revenue-expenditure imbalances.

The actual execution of the 1994 expenditure budget was an indication of both a significant deviation from the new principles of inter-budget relations and methodological errors: undervaluing differentiation factors as the base for calculation (i.e. the rates of VAT assignments to territorial budgets), and an inaccurate account of regional price differentiation and regions' non-budget funds. Manipulations with territorial tax rates allowed changes in the average per capita rate of tax-collection and claims for an increase in transfer receipts.

Further, the actual VAT collection in 1994 amounted to only 50 percent of the plan, thus reducing the scope of federal aid to the regions. As a result, for instance, total transfers from the Federative Entities Support Fund in the federative entities' revenue budgets was 1.5 percent, whereas subsidies in the first quarter alone amounted to 4.4 percent (ECO, 1995, No 1, pp.167-168).

The semi-annual practice of distributing the resources of the Federative Entities' Support Fund showed that despite the calculations one in every three regions deviated by 10 percent. As noted during parliamentary hearings on inter-budget relations (Financy 1994, No 12, p.12), the introduction of adjustment coefficients resulted in a situation where one group comprised such vastly differing regions as Tatarstan with its special taxation and budgeting regime, Kalmykia with a practically subsidized budget, and the Samara Region, which is a donor.

The most notable deviations were registered in the most heavily subsidized regions: the Magadan Region received 44 percent of the amounts planned; the Kemerovo Region, 49 percent; the Koriak Autonomous District, 33 percent; and the Evenk Autonomous District, 41 percent. As mentioned during the hearings, "the defective practice of haggling, pounding out federal budget resources is still there, including pounding out already officially approved transfer amounts. Along with official transfers there were indirect subsidies in the form of additional VAT assignments with a further erosion of the rates of assignment to territorial budgets (from 22 to 50 percent).

This served as a basis for organizing the clearing of payments between the "needy", the "especially needy", and their support fund. At the same time regions excluded from this category (eg Moscow, Uyanovsk, and Irkutsk Regions) received an indirect subsidy of 139 billion roubles in the form of increased VAT assignments.

Transfers and indirect subsidies accounted for two-thirds of the federative entities' budgets. Thus the total amount transferred from the federal budget to the regions in the first ten months of 1994 exceeded 14 trillion roubles, or one-quarter of all federal budget revenues (Russia-1994. Economicheskaja Conjunctura, p. 18).

Mr. Panskov, the RF Finance Minister declared (Financy 1994, No 12, p. 6) that "by tax reform we understand not a radical change, but a strengthening of the taxation system ... with the aim of strengthening the Russian budget", and "improving the situation with the formation of the revenue base of the budget". He declared also that it will be a phased **transition to the new system, and the principles** of inter-budget relations in 1995 will be preserved while taking into account the adjusted requests of the regions. In this connection it is reasonable to try to generalize here the key points regarding the realization of this approach:

- regions obtained the right to form their own tax base by increasing tax rates and introducing their own taxes, but the basis of their budget revenues remains assignments from the federal budget; - the emergence of transfers means that regions acquire additional ways to tap into the federal budget; - the role of VAT assignment rate deviations as a source of indirect subsidies expanded;
- both the source for the formation of the support fund, and the calculation base require enhancing.

Taking into account the federal bodies' intention to preserve this order in the near future, we can surmise that most haggling and conflicts will take place in the sphere of interbudget relations. It goes without saying that the politically weak

centre, resorting to specific manoeuvres in view of the coming elections, is interested in maintaining the incomplete state of inter-budget relations, giving it the opportunity to preserve the "differentiated" approach to regions. Nevertheless, even the initial period of the formation of fiscal federalism - even where no clear perspectives are in sight - has inevitably affected local budget strategies. In this connection it is interesting to survey the evolution of the budgeting process in St. Petersburg in the context of the socio-economic situation.

## 2 The Socio-Economic Transformation of St. Petersburg

The city of St. Petersburg as part of the North-Western Economic Region, together with three regions (Leningrad, Novgorod and Pskov Regions), enjoys, like Moscow, the special status of a federative entity. This fact ensures the importance of St. Petersburg on the political scene and allows us to study it as an example of the process of forming budget interrelations with the centre. It must be remembered, however, that the methods and strategies applied are determined by the socio-economic situation in the city and so it would not be unreasonable to review here the key aspects of the social and economic changes taking place in St. Petersburg.

At the turn of 1995 St. Petersburg's population stood at 4.8 million, whereas three years prior this figure was 5 million. A large share of the population (1.3 million) are pensioners. The current downward demographic trend will continue in the future: the 1994 demographic forecast (Population of Russia, 1994) developed by Goscomstat and the Institute of Social and Economic Problems of Population (Russian Academy of Sciences) under the supervision of Dr. A. Vishnevsky projects the 1998 population of St. Petersburg to be 4.6 million. The key demographic indices (absolute and relative indices of births and natural deaths) have shown negative tendencies as far back as the second half of the 1980s. As a result of the surge in the death rate (11.7 per one thousand people in 1987, 13.5 in 1992, 18.3 in 1993, and 18.2 in 1994), the number of deaths in 1994 was 2.5 times greater than the number of births. Sharp changes in the socio-economic environment increased the incidence of deviant behaviour and suicides. According to the forecast, by the year 2000 the marriage potential will change: the ratio of women-to-men will increase from 1000:828 to 1000:807. At the same time, the demographic weight coefficient, which shows the ratio of unemployable to employable persons and serves as an index of the probable well-being and social security of society, is predicted to decrease. However, the consequences of the present demographic situation and its development trends on the labour market will show up only in the next century.

Currently, the employable population of St. Petersburg is 3.048 million people, with 2.3 million engaged in the city economy, one third of these in the non-state sector. The production slump, structural shifts, and socio-economic changes in the country inevitably affect the employment and mobility of labour resources in St. Petersburg. The situation is characterized by a sharp increase in the number employed in the non-state sector as a result of privatization, denationalization, and the organization of small businesses.

Over 60 000 small business enterprises have been registered in the city, 95 percent of which are non-state, employing one third of the total workforce. Small business accounts for 15 percent of output in the city. One of the peculiar features of St. Petersburg is the significant share of science-related production: 10 percent of all Russian small enterprises in science and science-related services are situated in St. Petersburg. However, small enterprises mainly operate in services, retail trade, and construction. Eight thousand enterprises with foreign participation are registered in the city (only 1520 of them monitored by the St. Petersburg Statistics Committee), and it is through these that most foreign investments flow into the city as well as 51 percent of city exports and 86 percent of imports.

The main taxpayers of St. Petersburg are enterprises situated within its area, so city budget revenue largely depends on their economic situation. Manufacturing in St. Petersburg has a mixed industrial structure, a fact that, unlike mono-industry cities, somewhat facilitates structural reconstruction and redistribution of the workforce. The most important industries in St. Petersburg are mechanical engineering and metal working, including enterprises of mechanical power engineering, heavy and transport mechanical engineering, shipbuilding, machine-tool building and electrical engineering, all producing industrial commodities.

Specific features of the city economy are the strong military-industrial complex (these enterprises formerly handled about 60 percent of defence orders, equalling 40 percent of the region's industrial output) and a developed scientific and technical sector comprising over 500 R&D institutions and planning and design organizations. These sectors were the first to face cuts in government funding and defence programme expenses, as well as a continually falling demand for their civil products. Currently, the share of defence industries is 13 percent, their production capacities having halved in the past four years and their workforce depleted by 120 000 people.

According to the St. Petersburg Statistics Committee, in 1994 the city had the following industries (shown below together with their percentage of total industrial output):

Mechanical Engineering and Metal Working	36.8
Food Industry	17.9
Electric Power Industry	13.6
Light Industry	9.0
Chemical & Petrochemical	4.6
Ferrous & Non-Ferrous Metallurgy	4.2
Forestry, Wood-Processing and Wood & Pulp Industry	3.4
Construction Materials	3.3
Other (Medical, Printing)	7.2

These industries accounted for 93 percent of the city's industrial output. At the beginning of 1994 the industrial complex of St. Petersburg included 495 enterprises with 548 300 employees, over a half of which worked in mechanical engineering and metal working. On the whole, the number of employees in manufacturing industries fell from 701 500 in 1991 to 450 000 by the end of 1994 (the decrease in 1994 compared to 1993 was 77 900 people, and in 1993 compared to 1992, 65 900 people).

In 1994 the rate of decline in the physical volume of production accelerated. The strongest decline was in mechanical engineering, light industry, and ferrous metallurgy. The slump in basic industries occurred in June-July, but the sector was again increasing by the end of the year. At the beginning of the year and in early autumn, producers' inflation expectations manifested themselves by increasing industrial product prices, especially in mechanical engineering and light industry (General Characteristics of the Socio-Economic Situation in St. Petersburg 1994 No 12).

Against the backdrop of the general production slump, economic performance of both different industries and enterprises within a particular industry is rather variegated. In 1992 the general production slump in manufacturing (by product output at comparable prices) compared to the 1991 level was 80 percent; in 1993, 67 percent. The January-November 1994 index of the physical volume of production, compared to the corresponding period of 1991, was 50.6 percent. (The average Russian IPVP is 52.1 percent, which puts St. Petersburg in 40th place) (St. Petersburg Statistics Committee, 1995).

However the slump was not as bad at enterprises producing food and consumer goods. Thus, although the general industrial output in 1994 compared to 1993 was 74.7 percent, the by-industry physical output index was as follows:

Electric Power Industry	93.1
Fuel Industry	66.6
Ferrous Metallurgy	33.9
Mechanical Engineering, and Metal Working	
Light Industry	51.1

The share of non-food products in the output of consumer goods went down by 8.6 percent: of the most important 129 types of goods, 111 registered a decrease. Compared to 1993, the production of cloth, consumer electric goods and radios decreased by one-half.

The crisis occurred simultaneously with enterprises' involvement in the on-going privatization. Since the beginning of privatization the process has spread to 3474 enterprises, and 543 enterprises totalling about half a million employees have been transformed into joint stock companies. According to the St. Petersburg Statistics Committee, in January to November 1994, 643 enterprises were privatized in St. Petersburg: 445 by sale and buy-out, and 198 by transformation into joint stock companies. Over half the privatized enterprises are in retail trade, public catering, and domestic services. Manufacturing and construction account for 21 and 9 percent respectively. During 1994 the number of non-state manufacturing enterprises increased by 1.5 times, with the share of industrial non-state sector employees growing from 40.2 to 59 percent. The non-state sector accounted for 87 percent of retail turnover, 31 percent of motor transport shipments, 89 percent of contract works, 40 percent of manufactured goods, and 35 percent of new residential buildings.

The financial situation of the majority of enterprises is further aggravated by the nonpayment crisis associated with the crisis in the financial and taxation systems. By mid-1994 total customer debt for goods, works and services in manufacturing, construction and transport amounted to 1.4 trillion roubles, with the debt to suppliers reaching 1.3 trillion roubles. By the end of 1994, accounts payable had amounted to 4 trillion roubles, and accounts receivable to 3.3 trillion roubles. Thirty-nine percent of enterprises had outstanding bank debts, and 119 enterprises had experienced delays in paying salaries. In November 1994 the outstanding debt of manufacturing enterprises for wages and social benefits was 27.2 billion roubles.

The number of loss-making enterprises had increased by 150 %, and by the end of 1994, their by-industry share (percentage) was as follows:

Manufacturing	11.1
Transport	25.3
Construction	6.5
Retailing	23.2
Supplies	6.7
Housing & Utilities	24.1

It is interesting to note that during the year all industries, except manufacturing, experienced some levelling off or even a decrease in their share of the total number of loss-making enterprises. Another interesting feature is that no actual bankruptcies occurred except in a few isolated cases. One can infer that the indices of loss-making (as well as those of indebtedness) are now mainly affected by the incompleteness of the transformation which allows enterprises to hang on at the lowest possible level of economic existence. Apart from this, the present tax system exerts a negative influence on production and so on the financial results of enterprises'. So it is highly probable that enterprises find their own methods of survival and thus escape from state custody.

Taking these circumstances into account, it seems expedient to survey here the relatively new developments occurring, to differing extent, in practically all basic industries as reflected in the following indices: reduction of employment, production stoppages at manufacturing enterprises, work-time losses.

As mentioned above, lay-offs have been most troublesome in mechanical engineering: the workforce there shrank from 386 800 people in 1993 to 298 500 in January 1995; in light industry, from 53 300 to 42 100. At the same time, employment cuts in forestry, the chemical & petrochemical industries, and metallurgy were not as radical; and in the electric power industry the workforce actually grew from 10 300 to 11 300 people (General Characteristics ..., No 12). Whereas the total figures for manufacturing and the economy as a whole indicate that the number of newly employed is smaller than the number of lay-offs the picture for finance, management, health care and education is quite the reverse. In finance in 1994, for instance, of the total number employed at the beginning of the year 18.9 percent left their jobs and 36.8 percent were newly employed.

Production stoppages occurred at 50 to 60 enterprises each month on average (with the exception of January with 11 enterprises). This means that over 20 000 workers were idled every day (On the Socio-Economic Situation in St. Petersburg and Leningrad Region in January to December 1994. 1995). In April, when production stoppages took place at 74 enterprises, work-time losses amounted to 554 900 man-days, and in May, stoppages at 66 enterprises resulted in a loss of 600 000 man-days. Work-time losses were especially severe at enterprises in the lighting, chemical and petrochemical industries, and in mechanical engineering. The economic difficulties experienced by enterprises make them seek specific methods to preserve their workforce: managements resort to unpaid or partly paid leave. For instance, in August the holding company Leninets sent 4059 people on forced leave, the jsc Kirov Plant 3439 people, Krasny Treugolnik 2894 people, and the Kirov Spinning and Thread Mill 1507 people (Smena, September 22, 1994) . The scale of hidden unemployment is shown by the indices of administrative leave numbers and the numbers of partly employed.

On average, during each quarter of 1994, around 240 000 people, or about 20 percent of the workforce, fell into the category of the hidden unemployed. Administrative leave alone accounted for 178 400 people. According to the St. Petersburg Statistics Committee, the partly employed accounted for 14 percent, and those on administrative leave for 18.3 percent.

A study (commissioned by the Committee on Labour and Employment) was undertaken in October 1994 by the St. Petersburg Economics and Mathematics Institute with the participation of the Leontief Centre to survey the situation in employment and determine the so-called vulnerability zone. Researchers succeeded in revealing the key parameters of the vulnerability zone and in determining the industry and qualifications that define its borders. The main vulnerability zone criteria were: the share of the partly employed in the total workforce, the share of those paid less than 100 000 roubles per month, the intensity of redundancy lay-offs, and the length of salary delays. The researchers obtained data on 320 enterprises of the ten most important industries in St. Petersburg.

According to this study the vulnerability zone is spread extremely unevenly among different industries and covers, on average, 9 percent of the employed. The most vulnerable industries are manufacturing, construction, education, health care, science and science-related services. At the same time, vulnerability in manufacturing manifests itself above all as a high proportion of the partly employed (10.4 percent) and the city's lengthiest salary delays (an average of 4.6 weeks), whereas construction is characterized by a significant number of people working part-time, and considerable salary delays (an average of 3 weeks). The most important index for non-production industries is the high proportion of low-paid workers (29.0 percent in education, and 29.4 percent in health care). The most negative component of the situation in science and science-related services is the high intensity of job redundancies. In the housing and public utilities sector, the problem is the high proportion of low-paid workers (10.5 percent).

However, according to official statistics, St. Petersburg is relatively well-off in comparison to other Russian cities: the number of the officially registered unemployed, though growing, remains at the low level of 1.35 percent of the employable population. According to the St. Petersburg Statistics Committee, at the end of 1993 the number of unemployed stood at 31 700 (with an average of 60 percent receiving allowances), and by the end of 1994 it amounted to 45 200 people (88 percent on allowances).

A distinctive feature of unemployment in St. Petersburg is the high proportion of unemployed women (71 percent), young people of 16 to 29 years (25.4 percent), and the disabled. In the course of the above study researchers established indices of the number and structure of vacant jobs. By-industry and by-profession vacancy coefficients prove the structural character of unemployment in St. Petersburg. Demand in certain professional categories in some industries remains rather high. In manufacturing, vacancies are mainly in existent, rather than newly created, jobs. In construction, housing & public utilities, and health care, on the other hand, a sizeable share of vacancies are newly created jobs (in construction, for instance - 29.4 percent of total vacancies). In practically all industries there are jobs for qualified workers, unqualified workers: are in demand in manufacturing, and there is a need for teachers.

Together with partial employment, the phenomenon of secondary employment, which is the taking of an additional job, has become widespread and is practised, according to some estimates, by 250 000 to 300 000 people. The most

widespread use of these workers is in the non-production sectors: health care, housing and public utilities, and domestic services. It is more rare in manufacturing and transport. It should be noted that wages constitute about 60 percent of incomes (21 percent is accounted for by pensions, student allowances, and other social transfers), which means there are other sources of income that are not completely captured by the statistics, such as activities involving securities, private business, or additional earnings.

According to the St. Petersburg Statistics Committee, nominal incomes in 1994 amounted to 9.2 trillion roubles, a 4.6-fold increase compared to 1993. Expenditure in the same period grew by a factor of 5.0. During 1994 incomes exceeded both inflation and average wages. One should bear in mind that the growing gap between the average and minimum wage is a rather dangerous tendency, as it shows above all that the minimum wage, used as a basis for the calculation of many social disbursements, has been frozen. (This fact also explains the relative decline of wages in management, culture, and science).

According to the St. Petersburg Statistics Committee, the lowest wages were in education, culture, science, and manufacturing; and the highest in finance, construction, transport, telecommunications, management, and housing and public utilities. The highest wages were in construction, telecommunications, and transport; the lowest in science and finance.

We can compare the level of wages in some regions of Russia:

	October 1994	
	000 roubles	as percent of the base
Moscow	364.6	105
Moscow Region	260.1	103
Novgorod Region	213.3	109
Pskov Region	191.1	110
St. Petersburg	279.6	106
Leningrad Region	241.4	108

(On the Socio-Economic Situation in St. Petersburg and Leningrad Region in January–December 1994 St. Petersburg. St. Petersburg Statistics Committee, 1995).

It is interesting to compare the dynamics between the highest and the lowest by-industry wage levels presented in a review by the Leontief Centre. This proportion had the lowest values in February (111 %), May (110 %), September (84 %), and October (92 %). It was in this period that price inflation slowed. In the period of high inflation the gap between the highest and the lowest wages was 138 % to 145 %.

In 1993 the all-Russia price growth exceeded that of St. Petersburg, whereas from mid-1994 prices in St. Petersburg rose faster than in Russia as a whole (for instance, in November inflation in St. Petersburg was 284.2 percent, in Russia 278.0 percent; and in December 335 and 322 percent respectively). During 1994 consumer prices increased by a factor of 3.3, of which: food prices 3.2, non-food prices 2.6, and services 8.2 (General Characteristics..., p.5).

Income growth and inflation rates determine consumer behaviour which is manifested in changes in the structure of expenditure. Last year saw several characteristic developments: expenditure on commodity purchases, which had contracted in the middle of the year, grew again from 58 to 67 percent by end-year; the share of expenditure on services grew from the middle of the year as a result of increased costs in housing and public utilities; expenditures on deposits and securities peaked at 11 percent during the period of low inflation; the share of expenditures on the purchase of hard currency increased steadily (from 9 to 21 percent).

One of the key indicators of the standard of living is the minimum cost-of-living budget which is (according to Ministry of Labour calculations) 68.3 percent of the cost of the minimum food basket. From August 1994 the cost of the minimum food basket grew sharply, thus pushing the minimum living cost up from 144 439 roubles to 192 527 roubles in December 1994.

Using the minimum cost of living as the poverty criterion, the Committee on Labour and Employment calculated that 17 percent of St. Petersburg's population is below the poverty level; however, if we use the calculations of the St. Petersburg Affiliate of the Sociology Institute of the Russian Academy of Sciences, then the portion increases to 25.6 percent. According to the Leontief Centre the gap between the wealthiest 10 percent and the poorest 10 percent of the population had reached a factor of 11 by November 1994, with the Jimmy coefficient amounting to 0.54 for the same period.

Whatever approach one chooses, one cannot help but observe the existence of a serious problem regarding low standards of living, which is causing a crisis in the sale of goods and services and is raising tensions in the society. This problem is aggravated by the absence of social programmes, support for the needy, and a procedure for classifying people as needy. The announced claim-submission procedure for granting allowances has never been developed by the Committee on Social Issues. Traditionally, social aid was provided through benefit payments (relief, and food and transport payments). In the course of one year these appreciated by 13 percent amounting to 32 100 roubles per person.

Significant difficulties in the administration are caused by the need to maintain and develop the city's infrastructure. Thus, the water-supply deficit in the city amounts to 15 percent of its design capacity; so emergency or pre-planned stoppages during periods of maximum water consumption cause water-supply problems for 750 000 people. Purification plants are overloaded, and 40 percent of heat-supply networks have served for 15 years and are in need of reconstruction. The ten heat and power supply stations as well as 2 000 boiler-houses cannot meet the demand. Half of all bridges and 36 percent of embankments with granite coating were built in the 18th and 19th centuries. Fifteen million square metres of the city's housing stock are in need of repair. Moreover, there are still 829 900 on the city's waiting list for municipal housing. Resolution of all these long-standing problems cannot be achieved through the city budget alone, which is itself in a state of crisis.

## 3 Evolution of Budgeting Policy in St. Petersburg

### 3.1 The 1993 Budget

The emerging and from time to time worsening, problems of the municipal economy and social funding are far from accidental. The general economic crisis inevitably also had an impact on the budget situation in St. Petersburg, which was eventually manifested in ever-worsening tax collection problems and a growing budget deficit. Obtaining information about profits and tax collection became a problem, mainly as a result of the new situation where in control over prices and scale of production was abolished; the practice of settling accounts by cash payments became widespread, physical and legal entities were allowed to keep their accounts in different banks instead of one, and taxation procedures were repeatedly amended and corrected. But even if these problems are solved, there will remain the other aspect-budget expenditures – which, in our opinion, lies at the root of all past failures in dealing with budget deficits. The understanding of this phenomenon did not come suddenly: to date, with the destabilization of the budgeting process, the main focus of regional authorities' efforts lay in increasing budget revenue. In connection with this, it is interesting to trace the evolution of the budgeting process in St. Petersburg and the efforts to create a new system of budget relations compatible with a market-economy.

The aspiration to loosen the dependence on the centre and provide favourable conditions for entrepreneurship led in 1991 to the idea of creating a special taxation regime which materialized in the concept of a free enterprise zone. Its realization was totally dependent on political bargaining and obtaining a series of approvals in Moscow. But when political and economic conditions had changed (the dissolution of the USSR and the beginning of radical economic reforms), the concept, based only minimally on economic expediency, lost its political edge as well. Inter-budgetary relations in that period were extremely vague and, because of the new situation, all local budget expenditures were covered by the federal budget. During 1993 this situation still prevailed: federal authorities provided for regional expenditures, and the share of tax collections that remained with the regions increased from 40 to 60 percent. The federal budget deficit led to a money issue and launched a new round of inflation. The local budget crisis came later, when the central power, striving for stabilization, had delegated part of budget expenditures to the regions. The decree of 22.12.93, No 2270, "On Some Changes in Taxation and Interrelation of the Budgets of Different Levels", foresaw, among other things, an increase of nontaxable amounts spent by enterprises on wage payments; a change in the composition of expenditures; and relief for small enterprises from paying advance contributions: which together narrowed the tax base and redacted local budget revenues.

Under these conditions, St. Petersburg proclaimed a policy of obtaining a certain degree of economic independence in conjunction with enhanced investment activity (St. Petersburg Vedomosti, December 30, 1994). But this is becoming increasingly at odds with the ongoing production slump in the region and the non-payment crisis. Perhaps one of the most significant events in the development

of the budgeting process in St. Petersburg was the decision (effected in 1994) to print a massive bilingual edition of the financial report of the city administration.

It must be noted that 1993 was comparatively favourable in terms of budget execution. For the first time a major part of the taxes collected in St. Petersburg remained in the city budget.

	1992	1993
Federal Budget	59	34
City Budget	41	66

Source: The City of St. Petersburg. 1993. p.22.

City budget revenue comes from more than 45 taxes and fees, which can be grouped as follows:

1. Direct taxes on profit, income and capital gains
2. Taxes related to the wage payments
3. Property taxes
4. Taxes on goods and services
5. Other taxes, fees, and duties
6. Income from state property or state-property based activities
7. Payments for the use of natural resources
8. Other non-tax revenues.

In analyzing the structure and character of taxes that constitute the revenue side of the budget one cannot fail to notice their multifaceted nature and dependence on various factors. Tax revenues in 1993 were characterized by erratic payments: the bulk of the receipts came only in the 4th quarter.

The key sources of revenue were the profits tax, VAT, and the income tax on physical entities (50, 20, and 13 percent of total taxes respectively). Changes in the structure of city budget revenues were connected with increased levels of assignments from federal taxes (from 20 to 50 percent of the VAT, from 19 to 22 percent of taxable profits, and 50 percent of the profits tax on banks and insurance companies). A local tax was introduced on the maintenance of the housing stock and social and cultural facilities which comprised 2.6 percent of budget revenue. At the same time, under conditions of high inflation, there was a reduction in the share of taxes unprotected against inflation, such as the land tax, physical properties tax, property rent, and payments for water used by industrial enterprises.

The 1993 budget included a large proportion of current expenses: capital investments amounted to 13.1 percent, mostly allotted to the construction of municipal economy facilities (54 percent), transport development (20 percent), and social infrastructure (11 percent). As to expenditures in the consolidated budget, 39.2 percent went towards financing the municipal economy. This was a somewhat larger share than in previous years (in 1991 it had been 38.4 percent, and in 1992 36.3 percent). This amount was distributed as follows: 27.2 percent for housing and public utilities, 36.4 percent for the maintenance of social and cultural institutions, and 8.6 percent for transport. It must be noted that the city budget provided almost totally for the housing stock and city passenger transport maintenance (98 and 88 percent of the costs respectively), compensated for

differences in the prices of electricity and gas, and subsidised bread production. Also during this period, as a result of nonpayments from the federal budget the number of city-budget subsidies to organizations and enterprises increased.

Characteristically the budget was reconsidered and implemented without deficit: the city's financial balance showed a 62.69 million rouble surplus (7 see City of St. Petersburg. 1993). However, a hidden budget deficit, as in earlier years, still existed: the budget crisis was not revealed because in the face of lagging revenues expenditures were covered by the transfer of funds from the federal budget through a mutual account settlement (for instance, the indexation of wages and an increased norm of assignments from federal taxes).

The reduction in budget revenues was determined by the character of taxes and by the general economic environment. Thus, the amount of taxes, collected as an interest rate applied to a taxable base and changing in direct proportion to price levels, depends on the actual volume of production. Some taxes have no anti-inflation protection (land tax, physical properties tax, and rent), and their indexation is implemented above all by political decisions which are inevitably inflationary.

Federal taxes account for 88 to 89 percent of budget revenues (with 77 percent coming from the profits tax and VAT), which made the budget highly susceptible to the decisions of federal bodies. Thus, at the end of 1993 federal authorities introduced corrections to all the basic taxes. The budget revenues in the 4th quarter of 1993 and the 1st quarter of 1994 were strongly affected by changes in the profits tax, which included: an increase in depreciation charges as a result of a revaluing fixed assets; the annulment of the 50 percent tax on wage payments, which was double the norm; and the increase in the non-taxable amount of wages from 4 to 6 times the minimum monthly wages.

Thus, in 1993 the budgeting process in St. Petersburg was characterized both by uncertainty and by a strong dependence on the centre, which excluded the possibility of the city conducting any sensible policy of its own.

### 3.2 The 1994 Budget

The old budgeting methods that have been retained have helped to postpone the budget crisis that is typical of a transitional economy. The commencement of the reform of the city budget system was immediately followed by the termination of federal financing of city development programmes and the exclusion of St. Petersburg from the group of potential recipients of federal support according to Ministry of Finance criteria.

Implementation of decree No 2270 brought about a contraction of budget revenue, and the centre's decision to increase expenditure on wages in budget entities, as well as allowances and compensation payments for children, pushed up the necessary minimum level of budget expenditures. As a result, the budget crisis revealed itself as a 40 percent city budget deficit. To curb the deficit, budget subsidies and commercial loans of 279 billion roubles (over 10 percent of total budget revenue) were extended.

It should be noted that in a formal sense several ways of improving the situation in the region have existed, all connected with budget reform in Russia.

In all of these, budget revenue was largely determined by federal policy while budget expenditure depended to a greater extent on the targets for the socio-economic development of the region. However, it was on the policy of budget revenue formation that city authorities focused their attention. At the same time, there was an awareness of the need to begin reconsidering budget expenditures as well. This process requiring political support and a guarantee of continued social stability.

In this period there was no generally accepted development programme, which on the one hand complicated the task of establishing revenue distribution priorities but on the other hand allowed for flexible reactions to frequently changing conditions. Apart from that, during almost all of 1994 the city government acted alone, without the traditional clashes with the City Council, which had been abolished by the presidential decree. (Elections in the legislative branch had been postponed, and the first session of the Legislative Assembly was held only at the end of the year.) Thus, the procedure for budget approval was essentially simplified: it needed only to be considered by the government and approved by the mayor, which took place at the end of March 1994. The absence of legislative power and, therefore, the traditional confrontation of powers eased social conflict to a certain extent. However, the objective struggle between different interest groups was inevitably shifted into the corridors of executive power, reducing the scope of control and the quality of decisions.

The policies of the city authorities were two-faceted: a multitude of established targets combined with passive measures to achieve them. This situation was largely determined by existing legislation, which keeps the centralized system of federal management in place and restricts the opportunities for conducting an independent policy. In addition, an explanation of the contradictory and extremely gradual changes lies in the aspirations of local authorities to provide favourable conditions for the functioning of enterprises, which are the key source of city budget revenue. It is well known that in accordance with the 1994 Russian budget-system concept, norms were established for the distribution of federal taxes among the different levels of the budget system, resulting in a reduction in the budget revenue base. As A.Kudrin, Chairman of the Committee on Economics and Finance admitted, in this way the city had lost about a trillion roubles (the VAT-related losses alone accounted for 303 billion roubles), or 17 percent of revenue (St. Petersburg Vedomosti, December 30, 1994). No disbursements from the Regions' Financial Support Fund could have compensated for the such a loss in revenue, especially with tax collection in St. Petersburg being higher than the Russian average: 163 000 roubles in St. Petersburg as compared to 153 000 roubles in Russia. So, by the criterion of per capita tax collection the city was not eligible for a grant from the Financial Support Fund for Regions. In that way the city's dependence on the centre for its revenues increased and, with regard to expenditures, decreased. The suggested changes in the structure of St. Petersburg's budget revenue is shown below (in percentages):

Revenue Sources	1993	1996
1. Federal taxes	88.68	62.0
including profits tax	46.47	20.0
2. Taxes of regions and territories	1.86	3.0
3. Local taxes	5.33	28.0
including land tax	0.93	20.0
4. Profits derived from the use of St. Petersburg city property	0.67	3.5
5. Proceeds of the sale of city property	1.77	1.0
6. Licence fees certain activities	0.15	1.5
7. Fines, paid services of budget entities etc.	1.51	2.0

Source: The Main Guidelines for the Taxation and Budgeting (Budget Revenue) Policies of St. Petersburg in 1993- 1996. (Draft), p.7.

The concept of budgeting policy in 1994 was the achievement of an independent budget. The Draft Main Guidelines of the Taxation and Budgeting (Budget Revenue) Policies of St. Petersburg in 1993-1996 includes the following main guidelines:

1. Enhancement of the share of rental payments to the city budget, with a simultaneous reduction of the profits-tax rate
2. Reducing the dependence of the St. Petersburg budget on federal taxes
3. Consolidation into the city budget of incomes that are currently placed on the accounts of different management bodies
4. Curtailing of city property taxes and rent support.

Concrete measures that were to be taken within the local reform of the budgeting process can be conventionally divided into:

- a) structural
- b) technological
- c) qualitative.

The thrust of city efforts was aimed at changing the structure of budget revenues. However, it was exactly in this area that no significant success was achieved: the bulk of St. Petersburg budget revenue continues to come from federal taxes.

Technical measures led to an improvement in the payment procedure and in the dynamics of tax collection, as well as to a transition from a normative to a unified method of budgeting.

The qualitative aspect of reform was to be a change in the character of taxes, i.e. an increase in the share of property taxes. Thus with the heavy dependence on the centre, this approach opted for a gradual restructuring of revenues as the key aspect of reform.

If we consider a budget not as a consolidated list of key indices, but as a statement of certain trends or a general declaration of policy, then the guidelines

above can be regarded as substantiated and realistic. Naturally, the above indicators were designed with a long-term outlook in mind, and it would be too optimistic to expect its realization in the near future. Nevertheless, the intrinsic controversies and the actual implementation of these tasks can be glimpsed in the example of the budgeting process in 1994 and in the 1995 budget.

Above all, the changes affected the structure of management and, therefore, the practice of budget implementation on different levels: from 1994, the budget has been formed without a dividing it into city and district budgets. This decision was based on the necessity to concentrate financial resources the financial deficit and growing differentiation of city districts in terms of their budget provisions, in order to conduct a unified financial and budgeting policy and determine the priorities for the major investments. As well, in accordance with the Presidential Decree On the Reform of the Bodies of State Power in St. Petersburg of 21.12.93, No 2252, the authority of district councils was terminated until passage of a law on local self-government. Districts' participation during the formation of the budget was reduced to their compiling draft expenditure budgets in the form of an application and to certain rights they had in regard to the budget implementation. As the explanatory note to "The Forecast of the 1995 St. Petersburg Budget" stated, the unified method for drafting and implementing the city budget, as compared to the normative method, allowed for a levelling of the budget provisions for city districts: revenues above the established limit were transferred to the main city budget account and use to finance priority needs. As a result, the spread of district budget provisions in the first nine months of 1994 was about 9 percent, whereas in 1993 this gap had topped out at 175 percent.

In accordance with the RF Presidential Decree No 2270 of 22 Dec. 1993, regions obtained the following rights:

1. To increase the rates of enterprise profits taxes in local budgets by up to 25 percent (since mid-1994, to 22 percent), and those of banks by up to 30 percent.
2. To establish tax rates: on enterprise properties (up to 2 percent of their book value), for the maintenance of the housing stock and social and cultural facilities (up to 1.5 percent of the volume of sales), and for educational establishments (up to 1 percent of the wage payments).

Under these conditions, St. Petersburg authorities opted for a low tax regime, and in comparison to other regions established low rates of property tax (1 percent) and tax on the maintenance of the housing stock and social and cultural facilities (1 percent of sales). The profits tax (remaining in the local budget) was also set at the low rate of 22 percent.

Decree No 2268 allowed for the introduction as of 1 April 1994, of new taxes and duties paid out of enterprises' profits after payment of profits taxes. City authorities resorted to this approach only in the third quarter by introducing a special hotel duty. In their turn, federal authorities introduced a special tax in order to support core industries and increased the rate of profits tax in the federal budget from 12 to 15 percent.

As we can see, regional-level changes in the budget revenue structure pursued the aim of not increasing the tax burden on enterprises and other key taxpayers. However, the measures taken were inadequate to provide a favourable environment either for the development of business or for increasing budget revenues. St. Petersburg is Russia's fourth most efficient collector of revenues for the city

treasury. The most significant tax evasion takes place in the street trade sector, where accounts are settled in cash; tax control over physical properties is also inefficient. In 1994, physical property taxes accounted for 1.171 billion roubles of city budget revenues, with 36 percent of the 1,158,000 private owners in St. Petersburg enjoying property tax benefits (Delovoj Petersburg, March 17, 1995).

Twice (in March and September) there were attempts to generate additional gains for the city budget by changing the structure of the tax system. However, only the September phase of the programme to mobilize additional revenues may be said to have been partly successful, with the majority of the 19 suggested tax items having been rejected as either inefficient (the duty on the right to use local symbols, and the re-sale tax), or unlawful (the registration fee for the use of the name of the city in enterprise names). In the fourth quarter, the projected proceeds of the sale of city shares in joint stock companies organized outside the privatization process as well as from the sale of city buildings to banks failed to enter the city budget; and the declared issue of municipal bonds totalling 100 billion roubles (a considerable part of the projected income) was postponed until 1995 because of registration and guarantee-provision problems (Commercant-Daily, 1994, No 240).

Budget revenues are affected by mutual non-payments in the total sum of 4 trillion roubles, with 280 billion roubles being Federation debt. In order to solve this problem, banker's bills (Tveruniversalbank and Incombank) were used, as well as Ministry of Finance securities, i.e. treasury bonds (TB). In 1994, city enterprises received TBs amounting to over 150 billion roubles. The Committee of Economy and Finance bought TBs totalling 56 billion roubles, issuing in return a "Certificate of the Payment of Taxes to the City Budget in 1995". These certificates were issued to Metrostroj, jsc Almaz, City Department of Capital Construction (CDCC), Lenmorzashchita, and the National Library. In turn, the Committee of Economy and Finance paid TBs to Gazprom, which transferred them to the federal budget. TBs were also used for financing capital construction carried out by the CDCC and Lenmorzashchita (Delovoj Petersburg, February 28, 1995, p. 25).

At the same time attempts were made to rationalize budget expenditure by increasing consumers' share in the financing of housing and public utilities and transport services. In doing so the authorities acted with extreme caution, taking into account the acute sensitivity of the population to rent and public utility payment increases, and being careful not to provoke social conflicts. Declaring their unwillingness to "implement reforms at any cost", city bodies gave very high priority to the provision of financing for social security. With this aim in mind, they provided additional funding for pensions and allowances to bring them up to the minimum cost-of-living level, introduced bread subsidies, and benefits. However they did not succeed in creating a system of target subsidies that would take into account the economic conditions of every consumer or the quality of the services received. Of the nearly 5 million population of St. Petersburg, 2 million enjoy various types of benefits.

Thus internal inconsistencies were emblematic of the budgeting process of 1994 in St. Petersburg, inconsistencies caused both by general economic factors and by specific features of the socio-economic environment in the region. Inflation and the production slump were to a much greater extent the causes of the budgeting crisis in St. Petersburg than the transformation of ownership relations. At the same time, the smoother flow of taxes into the city budget, compared to 1993, was a

result of the changed tax-collection procedure. Thus, the fourth quarter of 1992 saw 53.57 percent of total taxes collected, and the fourth quarter of 1993 48.03 percent; whereas in 1994 the figure was 35.33 percent. Changes in relations with the federal budget were not of a radical nature: the dependence of budgets on federal taxes (profits tax, income tax, VAT, and excises) still prevailed as did consequently the dependence on both the general economic situation and federal decisions on these taxes. The table below shows that despite the same profits tax rate of 22 percent being maintained for two years, the share of the tax in total revenues decreased. This tax suffered from the negative influences of three factors: a slump in industrial production, a simultaneous contraction of the tax base, and the introduction of tax relief for small enterprises.

In addition, for the first time in the history of the current reform, the growth trend of the amount of profits remaining in the city budget was reversed. On the whole, city budget revenue declined by 20 percent in 1994 as a result of the production slump and the nonpayment crisis. This gap could not be closed despite the introduction and enhancement of the share of property payments. The growth of the share and the rate of the property tax, land tax, and rent collection can undoubtedly be assessed as a positive development. The increase in the gains from city real property can be attributed to the reassessment of enterprises' fixed assets and the cost of real property owned by physical persons, the rise in the land tax rate, and the increased rent for non-residential premises. However, even their total did not rise to over 40 percent of the revenue.

Gains from the privatization of state property made up only a minuscule fraction of the total amount, which can be explained by the reduced (on average 2.5-fold times) norm of assignments to local budgets.

#### Structure of the St. Petersburg Budget Revenue (percent)

Source of Income	1993	1994
1. Profit tax	45.6	36.8
2. Income tax on physical persons	14.4	20.4
3. State duty	0.4	0.3
4. Property tax	1.9	3.7
5. Value-added tax	22.6	12.2
6. Excise duties	3.9	4.7
7. Privatization gains	1.4	0.6
8. Licenses for the right to produce and sell alcoholic beverages	0.1	0.3
9. Land tax and city land rent	0.9	2.8
10. Special tax for financial support to key industries	0	1.6
11. Local taxes, duties, and other payments	8.4	15.5
12. Residue of budget resources at the beginning of the year used for covering expenses	0.5	1.1
Total	100	100

Source: Draft Report of the Committee of Economy and Finance.

Thus in the process of establishing new interrelations between RF budgets of different levels, St. Petersburg has suffered something of a shock from the termination of federal budget subsidies. The attempt to form a revenue base without radically increasing the tax burden or changing the structure of expenses has led to a budget deficit challenging the success of any possible budget-taxation policy or development programme. The most vulnerable unprotected budget items turned out to be the financing of construction and development of the municipal economy infrastructure. The 1.3 trillion roubles received for federally financed programmes will not save the situation.

### 3.3 The 1995 Budget

Plans for 1995 include the development of the chosen principles of budget reform plus improvements along a number of lines. Pursuing the declared target - an independent and protected budget - will mean at the same time a continued budget deficit, a curtailing of city development programmes, etc.

But nevertheless, one can claim that the new budget year also marks a new stage in the development of the budgeting process, and mainly because the traditional opponent – the new City Legislative Assembly - has entered the political scene, this will inevitably require that some programme or substantiation of city development strategies be formulated and presented. To do them justice, it must be noted that the assembly has passed the laws On Taxation Policy in 1995 and On Issuing a St. Petersburg City State Loan.

As in 1994, the key stage of the budgeting process is the preparation and discussion of a draft budget, carried out in the traditional manner of instituting cuts in the requested resources. In summer 1994, during the drafting of the new 1995 budget, the projected budget deficit stood at 3.6 percent whereas after having been considered it by **district administrations** and city committees, it grew to 4.7 percent, or 438.627 billion roubles. The increase involved larger expenditures by district administrations, transport, culture, health care and the militia. This brought the deficit to 8.3 percent. The most sensitive issue turned out to be the problem of funds for capital construction, which though projected at the 1994 level turned out in the request for 1995 to be twice as high, 800 million roubles. As a result, the draft law on the St. Petersburg 1995 City Budget, which was submitted to the City Assembly, contained these amended figures: SUR 4, 654 billion in revenues and SUR 5, 475 billion in expenditures, for a deficit of SUR 821 billion (15 percent).

However, even by the beginning of April 1995 the budget had not been approved because of objections by the group on budget and finances and invited experts, who insisted that it was necessary for budget revenue to take into account the inflation component. Apart from that, discussions revealed a creditor indebtedness of 584 billion roubles which had been carried over into the new year (Smena, March 30, 1995).

In practice the process of budget formation is a search ways of cutting the padded expenditure requests. Thus, for instance, the total amount of expenses submitted by industry committees, departments, and directions reached 9,565.8 billion roubles, or 2 times more than forecast revenue for 1995. In the end, the expenditure demand was determined to be 5,383.8 billion roubles, which however

was also 15.1 percent greater than the future gains. At the same time the Committee for Economy and Finance established a target of cutting expenses by 7 percent.

As in 1994 tax policy is searching for the elusive balance that would allow the formation of the revenue side of the budget through additional taxes, without creating an intolerable economic environment that suppresses business activity. In this sense, the room left for manoeuvre is not adequate.

As to budget expenditure, there are plans to actually terminate capital construction funding and increase housing rents by up to 40 percent of housing maintenance costs.

Regarding federal taxes, the policy of keeping the low rates on the profits tax paid into the city budget (21 percent for enterprises and 22 percent for banks and insurance companies) will continue. According to a forecast by the Committee for Economy and Finance, taking into account the intended changes in tax legislation, gains from this tax will account for 40 percent of budget revenue in 1995.

At the same time the share of VAT must grow somewhat (14 percent) as a result of the annulment of income tax (22 percent) benefits (Presidential Decree No 1004 of 23 May 1994). There is also a forecast reduction in excises (down to 4.4 percent), and income tax on physical persons (22 percent). In the opinion of A.Kudrin, the Chairman of the Committee for Economy and Finance, total city budget losses due to federal decisions will amount to 7 percent (St. Petersburg Vedomosti, December 30, 1994).

A very specific decision, as compared to the majority of other the regions, is to cut assignments from three federal taxes: the means of transport purchase tax, highway use tax, and transport vehicle ownership tax, as only 30 percent of these payments return to St. Petersburg, which has no road fund of its own.

At the same time, the maximum increases were implemented on enterprises' property tax rates (2 percent), tax on the maintenance of the housing stock and social and cultural facilities, land tax, and land rent. In this way the authorities are hoping to stimulate enterprises to seek more efficient use of their resources.

The technological innovations of 1995 are as follows: a) determination of priority industries: potential recipients of tax reliefs, b) extension of the practice of granting tax loans to other enterprises, c) elaboration of a procedure for granting payment delays and instalments, d) retaining a unified city budget without further fragmenting it into district budgets.

However, the considerable budget deficit, as well as the attempts to curb it by cuts in financing the construction of municipal economy facilities, not only impedes the achievement of a balanced city budget, but also generates additional friction between mayoralty committees.

With the aim of finding additional sources of budget gains and simultaneously raising the activity of the regional securities market, a concept which has spread throughout Russia, i.e. that of a municipal loan, was realized for the first time in St. Petersburg. By developing this concept, the authorities succeeded in obtaining the status of state securities for municipal short-term bonds, which means that income from these operations are exempt from taxes (Economy and Life, 1995, No 12, p. 10).

The retirement of bonds will be implemented through loan funds and later from property taxes in an amount projected at 337.453 billion roubles. The Committee for Economy and Finance forecast of net budget income from the municipal loan will amount to 100 billion roubles with an expected annual profitability of 250

percent. The first three bond issues are planned in the amounts of 10, 20, and 20 billion roubles, and subsequently in amounts necessary for current debt repayment. The issuer, the St. Petersburg government, will arrange, through the Stock Exchange, a primary auction for floating the municipal short-term zero coupon bonds according to the procedure used for State Treasury Bonds (STB). However, the selling price will be established by a supervisory council, in contrast to the STB procedure, where by the selling price is formed in the course of the auction, and unsold STBs are bought by the Central Bank. The owner's income is comprised of the spread between the selling price and the retirement price (the nominal price is 100 000 roubles).

The launch of Municipal TBs (MTBs) began on March 23, and the results are somewhat different from what was expected. The city succeeded in distributing 94.51 percent of the declared issue. The distributed amount of the total 5 billion roubles issue was 3.443 billion roubles, and the number of offers submitted exceeded the declared amount by 44 percent, with the average weighted price established at 73 percent (Delovoj Petersburg, March 28, 1995). Dealers mainly represented the interests of banks and investment companies. The profitability of the first issue, taking into account tax reliefs, amounted to an annualized 227–235 percent. Secondary MTB sales on St. Petersburg exchanges produced an average profitability of 188.6 percent. Despite the fact that the amount of offers submitted was double that of the issue, the share of competitive offers at the second MTB issue was 26 percent, with an average weighted profitability of 186.6 percent p.a. (Delovoj St. Petersburg, April 7, 1995, p. 19).

It seems that a further decline in profitability is to be expected, as is the case with the STB market. Therefore, one can surmise that with the strong dependence on inflation the prospects for MTBs may differ substantially from those projected, and consequently the overall significance of this method of solving budget problems may be entirely different.

In addition, the particular areas in which the proceeds of MTB sales are to be used are as yet unknown. The methods of the MTB guarantee-provision appear not to be realizable in practice: some centrally located buildings leased by banks are used as collateral. One might infer that in this way the authorities are hoping to shift the attention of local banks from STBs to MTBs and to promote the purchase of leased buildings. All previous attempts to include real city property are known to have failed, among other things, because of high prices (USD 2 000 per sq. m in buildings around Nevsky Prospect for banks to buy out), and the absence of a system for registering transactions. For the same reason one should regard as too optimistic the plans for mobilizing proceeds from real property sales for capital construction in the city. Besides, the new Civil Code forbids the sale of real property other than through the privatization programme, which may mean a loss of 405 billion roubles (Delovoj Petersburg, February 21, 1995).

Considerable room for reducing expenditures is provided by monitoring the implementation of the budget and streamlining the various reliefs that are often granted without sufficient substantiation. For the first time, in 1995 a procedure for granting city budget payment deferrals and instalments in cases of budget financing delays was set up, as support to priority industries when moving manufacturing enterprises from the centre of the city, during force majeure, or when an enterprise is threatened by bankruptcy which is to take place immediately after an up-front payment of taxes, fines or penalty fees (St. Petersburg Financovy Vestnik, March 31, 1995, p.2).

And so, the budget deficit and the available means to cover it in 1995 (municipal loans, crediting, under funding) leave no chance for either financing the programmes of the municipal economy, or providing conditions for the development of entrepreneurship in St. Petersburg. Any further aggravation of the tax burden will contract the scope of profitable activities and, in the end, will reduce tax revenues. The numerous taxes, even with reduced rates, and payment reliefs, create purely technical difficulties both for tax payers and taxing bodies.

In turn, the shortage of funds hampers the development of an infrastructure for business activity and for offsetting the social impact of economic transformation.

Under these conditions the need for outside loans remains, the most traditional of these being federal budget subsidies. Obtaining these funds depends on the lobbying talents of St. Petersburg deputies in the State Duma. For instance, in the course of the adoption of the federal budget, they succeeded in providing for a target federal disbursement of 300 billion roubles. At the same time, Moscow, the only other city-federative entity, will receive about 3 trillion roubles, including 2 trillion roubles for carrying out its functions as the capital of the country (Smena, February 23, 1995).

**St. Petersburg bids for the following subventions from the federal budget:**

Metro construction -	SUR 815 billion;
Purchase of rolling stock -	SUR 227 billion;
Organization of bus, trolley-bus and tram production -	SUR 23.4 billion;
Reception and initial settlement of refugees, maintenance of refuges for them -	SUR 1.2 billion;
Programme "Anti-Pollution Protection in the Baltic Sea Basin" -	SUR 79.7 billion;
Programme "Organization of the Production of Facilities for Collecting and Neutralizing Industrial Toxic Wastes in the St. Petersburg Region" -	SUR 15 billion;
Liquidation of vast radiation-polluted areas in St. Petersburg -	SUR 7.0 billion;
Integrated solution to the transport problems of St. Petersburg (feasibility study and preparatory works for the construction of a ring motorway -	SUR 10 billion;
Programme for the preservation and reconstruction of the historic centre of St. Petersburg -	SUR 653.0 billion;

The total amount requested for 1995 is 2.9 trillion roubles.

However, at this point the federal budget financing that is likely to be received will be for several federal target programmes, namely: "Development and Preservation of the Historic Centre of St. Petersburg", "Reconstruction and Construction of Federal Properties" (the Public Library, and the Hermitage), "Improvement of Medicine Supply and Development of the Pharmaceutical Industry".

## Conclusion

The formation and implementation of particular budget – taxation policies in St. Petersburg under the prevailing conditions of economic crisis is characterized by contradictions resulting from incomplete system transformations in the country. The 1994 budget reflects the specific features of a transitional economy and the struggle between fiscal and regulatory functions. This explains the abundance of reliefs on numerous taxes.

At the same time, in the period from 1994 to the beginning of 1995 the region developed and implemented its own methods of curbing the budget deficit, including MTBs, streamlining reliefs, and treasury bonds.

One can speak of the restrained position of St. Petersburg authorities in their interrelations with the centre and in implementing the regional budget policy. However, the St. Petersburg budget deficit and the methods of covering it follow in the tracks of federal budgeting policy and, therefore, are dangerously dependent on the centre's political decisions.

Under these conditions the authorities resort to an original strategy of obtaining funds from the federal budget, bidding for inclusion in federal programmes, which, in the future, will make it possible to exert pressure upon the centre to obtain either funding for the adopted programmes, or tax clearance from the federal budget.

However, the remaining dependence on the centre does not at all signify the impossibility of advancing its own methods of reform and implementing intelligent economic policies in St. Petersburg.

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