

Chapter 4.

**STATE FINANCES AS THE RESOURCE  
IN INTERELITE STRUGGLE**

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## **4.1 The Struggle for the Budget and Stabilization Fund**

In the previous years the budget process was the prerogative of the Ministry of Finances, and the government's budget commission was always headed by Alexei Kudrin. This year, when they started to prepare the budget for the next three years, Fradkov became the head of the budget commission, who did not like the forecasts of the Ministry of Economic Development and Trade (MEDT), (based on which the budget must be developed). The latter had practically sabotaged the tasks given by his direct chief and played for time as much as possible until the moment when it was too late to change the forecasts in a radical way. On top of that German Gref suggested establishing a new state „money-box” – the Investment Fund, against which the Ministry of Finances actively contested initially. This situation was superimposed by the acute disputes concerning the decrease of the VAT, which just deteriorated Fradkov's already existing dissatisfaction with the liberal economic policy of the Cabinet of Ministers. Simultaneously, the situation was further complicated by the confrontation between the „power” section of the President's Administration and the „liberal” Ministry of Finances (MinFin) over the amendments to the Tax Code, by the confrontation between MEDT and Alexei Miller over gas prices and by the problem of doubling the pensions and salaries of state budget workers within 3 years which was the reason why it was de-facto allowed to „forget” about the idea of doubling the GDP. Thus, the Budget-2006 had become again the result of inter-clans elite compromises, i. e. had nothing in common with the united break-through plan of modernization of the Russian economy. The most important thing for the elite groups today is the accumulation of financial and administrative resources needed to win on the forthcoming elections.

In this regard, it looks quite logical that almost all the participants of the budget formation process insisted on the same thing – on the increase in the state's expenses by increasing the state's investment costs (which is the most „corrupted” part of state expenses). The first person to announce it was German Gref who proposed establishing the Investment Fund controlled by the MEDT. The head of this office planned to create a new governmental fund complementary with the law „On special economic zones” which included significant state expenses for special economic zones (SEZ) (for example, it was initially intended that the infrastructure of SEZ, based on the green-field principle, will be developed at the expense of the state budget). Gref's idea with the special economic zones in general failed, because he lost the control over its' implementation. Finally, the head of MEDT „squeezed” 70 billion RUR out of the Ministry of Finances for his Investment Fund, but he will hardly be able to use them in the next year – because Kudrin did his best to ensure that this money remains unused in the budget.

Interestingly enough, defending Investment Fund, German Gref proposed stopping financing about 30 Federal Targeted Investment Programs because of their inefficacy. The MinFin had made a similar statement before, and expressed the opinion that only 25% of Federal Targeted Investment Programs give at least minimal return. However Kudrin, having no desire to give 70 billion RUR to Gref, had „frozen” them with the reason that there were no readily available and more or less detailed proposals on their usage. Thus, ***two leading economic ministers admitted that the Institute of Federal Targeted Investment Programs is not efficient, and they have no suggestion on how to use this money.*** From the point of view of struggle for budget money, Gref lost to Kudrin.

It is significant that both ministers are the members of one and the same nomenclature political group (NPG) and act in concert on many topics (for example, on tax policy), however their positions were in confrontation when it came to the Investment Fund. It seems that the reason for this is the struggle for leadership within the group, because Gref practically tried to blackmail Kudrin, stating that if he did not agree to support his Investment Fund, the head of MEDT would not support the MinFin budget. Finally, Alexei Kudrin „beat” Gref.

From the point of view of the struggle for resources, the transition of Dmitry Medvedev to the government is very interesting – he will now be responsible for almost half of the budget. Kudrin reacted quite nervously on this appointment, because he now has got a new boss who has no less of the President’s trust that he does (in this regard Fradkov was much less influential person than his formal subordinate Kudrin). And considering the growth of importance of the national projects, supervised by new Vice Prime Minister, the „weight” of Alexei Kudrin on the administrative arena will gradually decrease. However, if Medvedev can come to agreement with Kudrin on the future cooperation (for example, by proposing him the Prime Minister chair after Medvedev is elected President of the RF), they will be able to avoid conflicts in the future.

The budget process was not devoid of attention of parliament members. In brief, their claimed for increasing the sums allocated for state expenses which was supported by Mikhail Fradkov. Saying this, the deputies, similarly to Gref, did not suggest any specific investment projects which would not provoke inflation. In all likelihood, their main interest was to „squeeze” some additional money out of the government which they could spend on different expense items of the budget.

Because of all administrative conflicts and the struggle of different lobbyists for the budget money, the main financial document of this country for the next year ***again appeared to be inert and not able to solve any problem of the economy. Even on the***

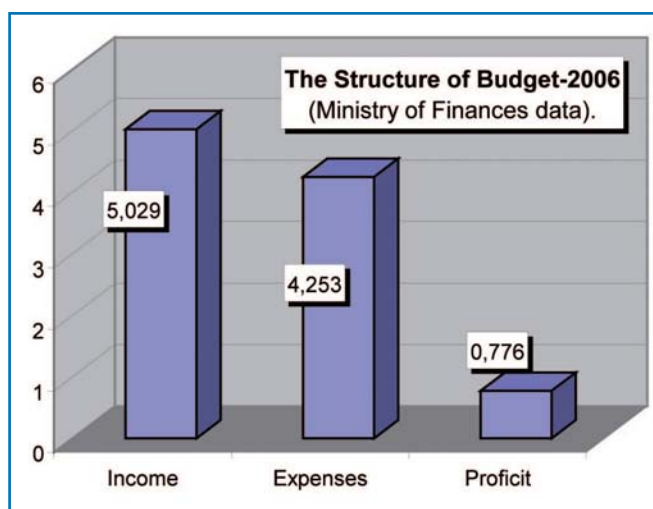
*contrary – it forms the basis for new difficulties. The main of them is a huge budget profit which does not allow to increase, to any extent, the rate of economic growth,* which practically stopped after the sharp drop down of oil and gas production rate in the end of last year. So, the Budget 2006 suggests the profit of 500 billion RUR with the Stabilization Fund exceeding RUR 1 trillion. In reality, if oil prices do not fall down and stay at the current level, one can multiply the forecasts regarding the profit by two, and the sum of Stabilization Fund – by 1.5. Even the Investment Fund, for which the MinFin agreed to give about 2 billion RUR, will not help – Russian budget will be overflowed with money anyway.

From the economic point of view, the problem is to determine the amount of the budget profit (Russian elite in general has no doubts that the budget must have profit). This question is directly related to the structure of economy and the system of state expenditures. It is known that the Russian economy depends almost completely on the export of natural resources, and for this reason the changes in the world conjuncture influence its well-being proportionally. For example, if the oil price decreases – the budget revenues also decrease. However it is extremely difficult to make prognosis for the world prices for energy carriers, and for this reason the MinFin had to secure itself from year to year by entering wittingly lower prices for them in the budget.

At the same time, the government has no possibility to increase state expenses significantly, and first of all – in the social sphere, because it will not only lead to the inflation growth, but can cause problems in the future, when the oil price drops, and the state will not be able to fulfill its obligations. The solution for this problem can be the diversification of economy and growth of budget incomes which are not dependent of the oil export, i. e. increase in collection of taxes from the economy branches not related to natural resources. However the recent tax innovations implemented by the Ministry of Finances show that it is not going to develop small and medium business. In figures, the Budget 2006 looks as follows. Out of more than 5 trillion RUR, which the state will receive if the oil price is no less than estimated US \$40 per barrel, almost 4.3 trillion RUR will be spent. Compared to the current year, the growth will be 1.2 trillion RUR. To the biggest extent, in percentage terms, social expenses will grow, which happens for the first time after Vladimir Putin was elected President, while earlier the expenses on security agencies had been growing faster compared to other items. Thus, the total social expenses (about 1 trillion RUR) will increase by 28% compared to those of the previous year.

*In the rating of expenses items of the budget, the first place belongs to the housing and communal services sector.* Expenses on this part will increase three

times, up to RUR 31.6 billion. This fact means that *monetization of the housing and living services will not take place next year – otherwise these expenses should have gone down* after the implementation of 100% payment of housing and communal services by the citizens. The second place by the growth, in percentage terms, is taken by the health-



care system – 81.3% growth (127.3 billion RUR), the third place is taken by sport – 48.7% (5.6 billion RUR), the fourth – by education 29.5% (206 billion RUR). Notably, in percentage, the expenses for the „power” block will increase by less percents than the expenses for social needs, while in reality the gap between them is five units (thus, 5% of the GDP will be spent for security agencies in 2006, which is a record figure for the country which is not at war, and 1% for social policy).

In 2006 the budget will spend on defense 20.5% more (668.3 billion RUR), than in the current year, and on security – 22.5% (540 billion RUR) more. The direct expenses for the army will increase by 22.1%. The Prosecutor’s Office will receive by 31.6% more, the Federal Security Service (FSB) by 37%, penitentiary institutions – by 27%. The state will spend almost by almost one third of the money more on the officials, and by 38% – for judges.

The income of the federal budget in 2006 is being planned in the amount of 5046.1 billion RUR (20.70% of GDP), including the amount without unified social tax and contributions to the Stabilization Fund of Russian Federation –3886.5 billion RUR (15.94% of GDP). In the structure of the federal budget incomes the income from taxes makes 3167.8 billion RUR (12.99% of GDP), including the amount without unified social tax and contributions to the Stabilization Fund of the Russian Federation –2591.2 billion RUR (10.63% of GDP). In the structure of the federal budget incomes non-tax incomes are 1878.2 billion RUR (7.70% of GDP).

*Traditionally, the growth of expenses is not accompanied by the corresponding return from tax, and, which is even more importantly, by economic growth. As a result, non-percent (non-interest) budget expenses (all expenses excluding the payments for external debt) will increase in the next year by 24.4%* (plan of economic

growth – 5.8%). ***This situation results in the disbalance of the budget system of the country.*** The danger here is that in case of sharp decrease of the world oil prices and in the view of forthcoming elections the state will not be willing to decrease the expenses (especially the social expenses), and if the resources of Stabilization Fund do not suffice, the government will have just two ways out: either to take external loans, or to sharply increase taxes. Such a situation will signify a complete failure of all economic policies carried out by the Russian governments of the recent years.

In 2005 various lobbyists struggled not only for the budget money and money of the Investment Fund: the serious fight has also evolved for the money of Stabilization Fund, which still has not been „unsealed” despite of this fight. Moreover, part of foreign debt of Russia to the Paris Club was paid at the expense of this Fund, for which credit should be given to the Finance Minister. So, on August 20, 2005 the deal for the payment to the Paris Club of US \$15 billion by nominal, i. e. without reductions, but also without discount for prepayment, was made. At that time, in order to come to implementation of this plan, the Ministry of Finances had to endure 5 months of difficult negotiations with the European colleagues, and also listen to extensive criticism in its address from the Russian opponents of prepayment. However in November the Finance Minister of Russia Alexei Kudrin declared once again that Russia is ready to repay another part of its debt to the Paris Club. The total sum of Russia’s foreign debt is about US \$ 86.8 billion, out of which US \$29.8 billion Russia is to pay to the Paris Club. To the moment, the intention is to repay just US \$3 billion of this sum, but soon the question on the repay of the rest US \$ 26.8 billion can come up. According to tradition, Alexei Kudrin suggested to repay the debts at the expense of Stabilization Fund.

The benefit of paying the debts ahead of schedule is obvious: if Russia pays this debt at the market rate, it would have to pay to the creditors 12-13% more. As per Kudrin’s estimates, this year Russia will save on the interest US \$ 400 million, and by 2020 – US \$6 billion. Here one should note that in the course of negotiation in the beginning of the year the parties agreed on not only a single prepayment, but also on the fact that the negotiators can return to this question again before the year 2008. ***Russia has all the chances to pay its’ debts completely. Then Vladimir Putin will enter the history of the contemporary Russia as the president who did not leave after himself even a cent of external state debt,*** while before him the country leaders just increased the debts, and thus annually blocked significant sums of the state budget which were spent on their upkeep, instead of working inside the country. It seems that this goal is principally important personally for Vladimir Putin, and this is the reason for the support he gives to Kudrin in this regard.

## 4.2. Situation on Financial Markets

Besides the budget, Investment Fund and Stabilization Fund, financial markets were another object of struggle in the past year. The start of this process was given by the summer banking pseudo-crisis of 2004. At that time under the excuse of the fight against money-laundering the licenses were revoked from a number of small banks. The license revoke coincided with the strict statements of the Central Bank (CB) that not all the banks should be able to enter the bank deposit insurance system. As a result, the spirit of panic reigned in bank sector which was caused by lack of understanding of the situation by the market members and the obscurity of the nearest perspectives of its development.

At that moment Head of the Federal Financial Monitoring Service Viktor Zubkov (who belongs to the „power” NPG) announced about the existence of some „black list” of large banks, from whom the license can be revoked in the immediate future. After this statement the thousands of private investors rushed to take their money from the banks, which resulted in practical bankruptcy of, for example, „Guta-Bank”, and placed „Alfa-Bank” on the margin of survival. A year ago the situation ended up by the purchase of „Guta-Bank” for the symbolical price of RUR 1 million by the „power” Vneshtorgbank, and the flow of the major part of private investments in the same „power” Vneshtorgbank (VTB). In other words, VTB was the main winner.

Following the summer pseudo-crisis of 2004 the situation on the interbank market stabilized, although the interest for carrying out most banking operations was increased. The similar situation recurred last spring. Thus, *the licenses were revoked from some banks, but it did not lead to the repeat of the crisis. It seems that the cause of that were the opposite goals of the organizers of the summer „clean ups” and spring „raids” on banks. Thus, if in the summer 2004 the main goal of „siloviki” („power” NPG) was to bring down „Alpha-Bank” and to secure a grip on a couple of private banks, in the beginning of this year the goal was to take under control the money encash market.*

This market exists not only for laundering criminal money. It assumes the encashing of any money practically. For example, if some company does not pay to its employees „white” salary (official salary), it must take part of its money from the bank account in cash every month. If this company needs to bribe officials, it is also done through the use of encashing schemes, because the „payments” to officials are done in cash, not in bills of exchange. The money encash market is extremely widespread, and the profits the banks gain are compared with the profits of some oil companies. Until this spring the biggest sums of money in this market were gained by



Sberbank which practically „fed” the market with cash by purchasing all types of promissory notes from the other banks.

In this regard the „attack” of the „power” structures on the banks hit both Sberbank and the money encash market. During this process the maximum activity was demonstrated by the officers of Federal Financial Monitoring Service (FFMS) headed by Viktor Zubkov.

The number of identified crimes related to the legalization of criminal incomes during eight months of 2005 reached 5,833, including criminal incomes of large and extremely large scale – 1,426, and for the whole previous year – a total of 1,349 (including 590 large-scale). In 2005 already 5,000 cases on Article 174 of the Criminal Code („On the laundering of money or any other property obtained by individuals in a criminal way”) and 174.1 („On the laundering of money or any other property obtained by individuals as a result of committing a crime”) were passed to the court.

The number of people brought to justice for money-laundering is also growing in an avalanche-like manner – from less than 100 people in 2004 to 867 from the beginning of this year. The revealed damage increased from RUR 14 billion during the whole 2005 to RUR 162 billion from the beginning of this year. Moreover, as the source in the Ministry of Interior (MVD) commented, these RUR 162 billion do not include US \$7 billion, which are incriminated by the General Prosecutor’s Office to „YUKOS” as the legalizing of stolen profit.

The result of this activity of the „power” group was the collapse of the money encash market. So, if by the early May of 2005 money in Moscow was encashed for 1-1.5%, after May 2005 the interest rose to 2-2.5%. By the end of October the interest further rose to 5.5-6%, and many banks had no cash at all. Thus one can clearly see the broad-scale redistribution of financial market which was most probably organized by one of the branches of the „power” NPG with the purpose of expanding their business interests.

Redistribution of this market is not completed yet, and it will continue until the „power” NPG reaches its goal. The situation will end, most likely, by a non-significant increase in the interest rate for money encashing. However it does not mean that the banks will earn more – it means that those who control this market will get „extra profit”, while banks will not gain anything from the increase of this margin. Meanwhile the „power” group will continue justifying its actions by the fight against the laundering of „mafia money”.