I Overview

At the breakup of the Soviet Union, the newly independent countries faced the daunting task of enacting their own tax laws and establishing separate tax and customs administrations. Initially, the new countries simply adopted the former Soviet tax system, which had been modified just days prior to the breakup of the Soviet Union to include a value-added tax (VAT). As the transition to a market economy proceeded, however, the new tax and customs administrations had to shift from handling the taxation transactions of a highly controlled state sector to dealing with the more challenging compliance activities of the emerging private sector and increasingly autonomous state-owned firms. This shift demanded a new approach to tax policy, and a totally different operational strategy for tax administration. Most of the countries of the Commonwealth of Independent States (CIS), which includes all countries of the former Soviet Union but the three Baltic countries, have struggled to adapt to the change and have experienced declining and inadequate revenue in varying degrees of severity.[1]

The consequences of the decline in revenue have been quite severe. The lack of structural adjustment in moving various functions away from the government, an inability to gain control over the level of government consumption in sectors such as energy, and the lack of administrative controls and planning mechanisms have prevented the countries from adjusting their expenditures appropriately. The response to the mismatch of expenditure obligations and cash revenues has frequently been to make unrealistic assumptions about both revenue and expenditures, ex ante, then to compensate through increasing levels of ad hoc payment arrears to suppliers, government employees, and pensioners, further compromising the ability to establish credible controls going forward. The decline in real revenue has a number of causes, such as the shifting composition of output away from the state sector, issues of fiscal federalism, and governance problems. These factors have been analyzed previously in a number of papers—for example, Cheasty and Davis, 1996; Hemming, 1995; Lopez-Claros and Alexashenko, 1998; Chand and Lorie, 1992; and Gaddy and Ickes, 1998, and are beyond the scope of the present paper.

IMF-supported adjustment programs have placed a major emphasis on addressing these problems. In early 1997, "revenue action plans" were developed by the IMF for several countries to address the reform of tax policy and tax administration. The Baltic countries rapidly implemented major revenue reforms at the outset of the transition process and did not experience a revenue decline in the years immediately preceding 1997; they therefore were not covered by the 1997 revenue action plans. Progress during 1997 and early 1998, in light of these plans, some but not all of which were incorporated into IMF programs, is discussed in Appendix I.

This paper has two purposes—to review briefly the revenue collection experience in the Baltics, Russia, and other countries of the former Soviet Union from 1993 through mid-1998, and to summarize and assess the overall tax policy and administration position of these countries in light of international best practices. Section II summarizes the revenue performance. Section III describes reforms in tax policy and tax administration. Section IV summarizes the paper's main findings and seeks to draw lessons for the future.

[1]The Commonwealth of Independent States (CIS) includes Armenia, Azerbaijan, Belarus, Georgia, Kazakhstan, the Kyrgyz Republic, Moldova, Russia, Tajikistan, Turkmenistan, Ukraine, and Uzbekistan.