# Russia and the IMF: The Political Economy of Macro-Stabilization

For the past two and a half years, the Russian reformers have been struggling with the gigantic task of stabilizing the Russian economy while transforming it into a modern and efficient structure able to compete in international markets and respond to the needs of the Russian people. They have travelled a long distance. Since January 1992 the Russian reformers have abolished central planning, sharply cut the system of state orders, decontrolled most prices, at least at the federal level, unified and liberalized the foreign exchange market, made the ruble convertible, and privatized two thirds of the economy. They have accomplished all this in spite of the crushing burdens and the historically unprecedented problems they inherited from the communist system: huge industrial enterprises that are unprofitable under the new structure of relative prices and require extensive reorganization or liquidation; an obsolete capital stock; a crumbling energy sector; armies that must be repatriated from distant countries and resettled at home; and a huge external debt. And they have accomplished all that in spite of constant resistance from political groups opposed to reform, including, until its dissolution last fall, the Supreme Soviet.

Most of these impressive achievements have been in the area of structural reform. In contrast, success in the area of macroeconomic stabilization has remained elusive. From mid-1992 to the end of 1993, consumer price inflation fluctuated around 20 percent per month (nearly 800 percent at an annual rate), the ruble dropped from Rub 144 to almost

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Rub 1,250 to the dollar, and capital flight may have been somewhere around $20 billion. Since the end of 1993, monthly inflation has declined significantly--to an average of less than 10 percent in the first 6 months of 1994--but it remains too high and the task of bringing it down to levels where it ceases to have adverse effects on the economy will be a difficult one.

Why have the Russian reformers not been more successful in this area? And why has it proved so difficult for the IMF, which provided the Russian authorities with policy advice, technical assistance and financial support, during this difficult period, to persuade Russia to adopt and implement a decisive stabilization program? Is it now possible to consolidate the limited progress that has been made and hope that a renewed effort will be successful? This paper attempts to answer these questions from the perspective of a staff member of the IMF who has been deeply involved in negotiations with the Russian authorities since early 1992, and who appreciates the extraordinary difficulties that they confront.

**Inflation: Fables, Tall Tales and Old Truths**

From the outset, the fight for stabilization encountered several difficulties which were certainly not unique to Russia, but were exacerbated by the particular conditions prevailing after the breakdown of the Soviet Union. Some reflected the misconceptions that were to be expected in a country where economic analysis had been clouded by Marxist ideology for several decades, while others were clearly political.

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The first set of difficulties was of an intellectual nature. When the reforms started, most Russians knew very little about the nature, the causes or the consequences, of inflation; or about how to deal with it. After all, prior to 1991 the most recent experience with high, open inflation dated to Lenin's days, and few had any clear recollection of what had happened then. The debate about monetary policy and inflation was plagued by numerous misconceptions, and there was a great deal of convincing to be done.

In scores of discussions with officials and staff from the government, the central bank and the Parliament, IMF missions supported the reformer's view that high inflation was bound to damage the Russian economy in many ways: by generating uncertainty about key prices, including the real interest rate and the real exchange rate, thus deterring long-term credit, investment and growth; by encouraging unproductive activities aimed solely at hedging against inflation; by hurting those social groups that lack the political strength to protect their real incomes against rising prices; and by contributing to a general climate of uncertainty and lack of confidence in government policies, thus encouraging one-way speculation against the ruble and capital flight. And, of course, IMF teams often referred to the extensive statistical evidence suggesting that, over the medium to long term, low inflation tends to be associated with high growth among both developing and industrial countries. 1/

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1/ See, for example, International Monetary Fund, *World Economic Outlook*, May 1993 (pp. 47, 50); Motley, Brian "Growth and Inflation: A Cross Country Study," Working Paper 93-11, Federal Reserve Bank of San Francisco, 1993; and Lucas, Robert E., Jr., "On the Welfare Costs of Inflation." University of Chicago: 1994.

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Another source of controversy related to the causes of inflation. There was a widespread view, included within the central bank, that inflation in Russia resulted from the high degree of monopolization of the economy. But whereas monopolies can lead to an excessively high price level for certain goods, they cannot explain continuously rising prices. Besides serious research indicates that the Russian economy is not particularly monopolistic by international standards. 1/ Others, claimed that inflation resulted from price liberalization. We replied that a comprehensive price liberalization could lead to a once-and-for-all jump in the general price level--possibly a very large one if, as in the case of Russia, it occurred against the background of a sizeable monetary overhang--but not to a continued inflationary process. The Russian experience clearly supports that view: consumer prices surged by almost 300 percent in January 1992, when most prices were decontrolled; but afterwards, the monthly rate of price increase fell sharply, to 27 percent in February and to 7 percent in July. Inflation began to accelerate in the summer of 1992 as monetary policy became expansionary. By then, however, price decontrol was no longer a significant factor.

So, we argued that inflation does not result from price liberalization, market imperfections, greedy workers or monopolists; that, in the end, it results from excessive growth in the money supply, which in turn reflects excessive credit expansion by the central bank. We also maintained that capital flight and the weakness of the ruble did not reflect a conspiracy by

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1/ See Ickes, Barry, Annette Brown, and Randi Ryterman, "The Myth of Monopoly; A New View of Industrial Structures in Russia," October 1993.

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speculators at the Moscow Interbank Foreign Exchange market, as a popular tale would have it. To be sure, capital fight reflected in part tax evasion by wealthy individuals and enterprises. But it resulted mainly from a perfectly rational assessment of relative rates of return by wealth holders in Russia: at least through mid-1993 the rate of interest on ruble-denominated assets was much too low to offset the depreciation of the ruble that was to be expected as long as domestic inflation exceeded inflation abroad by a huge margin.

The implication, of course, was that credit had to be tightened and interest rates raised. But many in Russia--and more than a few Western "experts" as well--vehemently disagreed. Some because they were persuaded that higher interest rates would lead to higher prices--an interesting, but not entirely new misconception. Others, more sophisticated, because they believed that an anti-inflationary monetary policy would exacerbate the fall in production--a sort of Russian version of the Phillips curve. But there is no evidence of an inverse relation between inflation and growth in Russia, even in the short run. 1/ Output has been falling in Russia (as well as in other countries of the former Soviet Union) primarily because state orders have been slashed, particularly for defense industries, and because large segments of the old productive structure are unprofitable under the new, much freer, structure of relative prices. There are other reasons, no doubt, for the recorded fall in production, including the

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1/ While it is too early to test for long-term relationships, it is clear that those economies in transition that have succeeded in bringing down inflation rapidly (like the Czech Republic, Estonia and Poland) have also experienced a relatively early resumption of output growth.

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collapse of trade with CMEA countries and with other states of the FSU, and the fact that the contribution of output in the new private sector, which is growing very rapidly albeit from a very small base, is not adequately captured by the official statistics. But none of this has anything to do with monetary policy being too tight.

Some did not need to be convinced that Russia needed macroeconomic stabilization, and that stabilization required a much tighter monetary policy. In fact, the IMF's message on this point was very similar to the one delivered consistently and to a much wider audience by men like Fedorov, Gaidar and Chubais, who played a leading role in the Russian Government since the re-birth of the country in 1991. And while some remain unconvinced, the debate about inflation and macroeconomic policy has helped to persuade many, including at the Central Bank of Russia (CBR), that the IMF's recommendations are in the best interest of the country. Indeed, a number of officials at the CBR are today among the most serious and courageous advocates of monetary discipline.

**Revolt Against Macro-Stabilization: Centralized Credits, Budget Subsidies, Tax Exemptions, and Interenterprise Arrears**

Unfortunately, however, the fundamental root of the opposition to macro-stabilization was political more than intellectual. Within Russia, it came from those who represented ailing, but still powerful sectors and regions such as the Northern Territories, agriculture and agro-industry and, to a lesser extent, the military industrial complex. Outside Russia, it came from many of the other states of the former U.S.S.R. (FSU), where newly

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created central banks--supported by their governments and sometimes by accomplices in Russia--were eager to expand domestic credit, largely by borrowing from the CBR. This indirect source of inflationary pressures apparently disappeared with the collapse of the ruble area last year, 1/ although recent negotiations between Russia and Belarus suggest that a return to some kind of currency union cannot be ruled out.

Within Russia, those who lobbied for special interest groups knew that a tighter monetary policy--particularly one that operated indirectly through financial markets and not through the centralized distribution of credit--would mean that their share of the pie would be considerably diminished. So they fought to retain the existing system in which the bulk of financial resources was administratively directed to them, at heavily subsidized interest rates--often well below the central bank refinance rate which until

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1/ The evolution of the IMF's attitude vis-à-vis the ruble area, which could be the subject of a separate paper, has often been misrepresented. To make a long and complicated story short, the Fund staff did not try to "save" the ruble area, as is sometimes alleged. Rather, it tried to eliminate the inflationary bias built into the ruble area by proposing at the interstate conference of Tashkent, in May 1992, a set of rules for a coordinated monetary policy. The proposal failed, largely because it was torpedoed by the Russian delegation--although, in light of hindsight, it is fair to say it may not have worked had it been approved because several countries in the area probably would not have followed its relatively strict rules. Convinced that the ruble area could not be reformed, we sought to persuade countries that a rapid choice had to be made between (i) remaining in the ruble zone with a single monetary authority; and (ii) issuing a separate currency. Russia's decision on July 1, 1992 to discontinue the automatic extension of CBR credit to other central banks led to the de facto fragmentation of the ruble area and to the appearance of separate deposit currencies in other FSU countries. However, the quest for a clear-cut solution remained elusive as supporters and adversaries of the ruble area continued to fight, even within Russia. The CBR's sudden withdrawal of pre-1993 ruble notes in July 1993 and the collapse of negotiations between Russia and Kazakhstan on a monetary union in November of that year sealed the fate of the old ruble area.

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the Summer of 1993 was itself well below market rates--and with as much flexibility as possible regarding the repayment of principal. As to other borrowers, including many in the incipient private sector, they would, if they were lucky, obtain some credit from commercial banks at market interest rates--otherwise they would simply be rationed out. So the system turned into a process of political competition for credit, a political scramble in which each special interest group would use its' political clout with the Government, with the Supreme Soviet, the Credit Policy Commission or even the President, in a race to maximize its share of directed credits and stay ahead of inflation.

The IMF, on the contrary, fought to eliminate the centralization and the subsidization of credit, and it did so with the support of then Finance Minister Fedorov. The existing system needed to be overhauled for both macro- and microeconomic reasons: because the process of political competition it involved made it extremely difficult to limit aggregate credit expansion to anything consistent with the goal of reducing inflation; but also because, in the absence of restraint on monetary expansion and as long as market conditions did not play a proper role in the allocation of financial resources, Russian enterprises would continue to operate without the discipline of hard budget constraints and one of the key objectives of reforms--to encourage a competitive and profitable enterprise sector--would be jeopardized.

For the same reasons, IMF teams opposed any plan to monetize inter-enterprise arrears. The buildup of arrears in the first half of 1992 was,

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in part, a revolt of state enterprise managers against the tightening of monetary policy sponsored by Acting Prime Minister Gaidar and carried out by then-CBR Chairman Grigory Matiukhin. 1/ But in July of 1992, Matiukhin was forced to resign by the Supreme Soviet--perhaps because he was effectively resisting exorbitant demands for credit--and a few months later the CBR cleared the net stock of arrears by extending credit to the net creditor enterprises. The action took many by surprise, including officials at the GKI (the government privatization agency) who had elaborated specific plans to deal with the problem without resorting to credit expansion. In 1993, interenterprise arrears started to grow again, reaching 7 percent of GDP by June 1994 and prompting the creation of a Government Commission under First Deputy Prime Minister Soskovets to explore ways to resolve the problem. We in the IMF staff have taken the view that a second bailout by the central bank would be a disaster. Not only would it boost the money supply and raise inflationary expectations, but it would give enterprise managers a clear signal that in the future they can respond to a tightening of credit conditions simply by not paying their bills.

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One of the key elements of IMF-supported programs, the need to reduce Russia's huge budget deficit, was fully accepted by Acting Prime Minister Gaidar and then by Boris Fedorov who became Finance Minister in December

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1/ To some extent, the buildup of interenterprise receivables, which is often confused with the accumulation of *arrears*, has represented the normal growth of inter-enterprise credit. This is a welcome development that calls for government action in the form of market supervision and regulation, but not for credit expansion.

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1992. However, in his efforts to tackle the fiscal problem, Fedorov quickly met with the opposition of sectoral lobbyists who wished to maintain the generous transfers and subsidies they received from the budget. A higher budget deficit would have to be financed largely by credit expansion, thus fueling inflation and eroding the real incomes of the entire population, but this did not bother them; as long as they received a disproportionate share of the budgetary pie, they thought they would come out ahead. The IMF staff, of course, argued for cuts in budgetary transfers and subsidies, not only to reduce the budget deficit and the Government's need to borrow from the CBR and thus bring down inflation, not only to do away with the misallocation of resources implied by those subsidies, but also to make room for an adequate social safety net and in particular for a well funded unemployment insurance system. Here again macro-stabilization and micro-efficiency objectives pointed in the same direction, and so did social considerations.

But the budget deficit was large (more than 20 percent of GDP in 1992), and cutting subsidies would not be enough. A strategy to achieve a sufficient reduction in the deficit had to involve across-the-board restraint on expenditure and higher revenue, notably from the VAT and from the energy sector, and this would require improvements in tax administration and, at least for some time, higher tax rates. None of this was politically easy, of course. At various times in 1992-93, the Supreme Soviet opposed increased rates on the VAT and reduced the yield of various taxes, including the VAT and import duties, by granting a large number of exemptions. Energy companies claimed that they could not pay existing excise taxes (let alone

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higher taxes) because Russian households and enterprises were not paying their energy bills and because continued shipments of natural gas to Ukraine and Belarus had resulted in a huge accumulation of arrears to Gazprom, the Russian natural gas giant. All this was true, but it did not prevent Russian energy companies from holding large bank deposits--in rubles as well as in foreign currency--that would have allowed them to pay their taxes, had the will been there and the threat of enforcement been credible.

### Changing the Structure of Deficit Financing as an Alternative to Fiscal Adjustment: A Fairy Tale

As if domestic political opposition to budget cuts had not been enough, we drew some unexpected fire from Professor Jeffrey Sachs. On various occasions Mr. Sachs argued that the IMF was wrong in asking for deep budget cuts; this, he said, was not necessary to reduce inflation. 1/ The IMF had failed to understand, and therefore had failed to explain to the Russians, that monetary financing of the budget deficit (and therefore inflation) could be reduced quite simply by increasing the proportion of the deficit financed by borrowing from abroad or by issuing domestic interest bearing debt. A remarkably simple proposition that leads to an obvious question: why would any country that has benefitted from such good advice continue to suffer from high inflation? Perhaps, because things are not quite that simple.

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1/ See, for example, Testimony to the Committee on Banking, Housing and Urban Affairs of the U.S. Senate, February 5, 1994.

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First, foreign financing does not grow on trees. To be sure, and contrary to Professor Sachs' allegations, Russia has received considerable external financing--altogether around $60 billion in the two-year period 1992-93. It is true that most of it has been in the form of debt-rescheduling or tied export credits, and it can be argued that these do not provide cash financing to the budget. 1/ It would certainly have been much better if external financing had been predominantly in the form of long-term credits to the Government or, even better, in the form of grants. But large-scale financing of this type is not available. 2/ One can hope for a world in which Parliaments and public opinion in the wealthy countries recognize that the international community is facing a challenge of historical significance--that of ensuring the transition from a totalitarian, centrally planned, and bellicose Soviet state to a new, peaceful, democratic and free Russia--and that this extraordinary challenge requires a measure of sacrifice in the form of a temporary increase in taxes to finance temporary assistance to Russia and the other countries in the former U.S.S.R. But that, unfortunately, is not the world in which we live today. Foreign financing on favorable terms is, and will continue to be, limited.

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1/ This is probably correct in the case of debt rescheduling, since cash payments by Russia probably would not have been much larger in the absence of the agreements. As for export credits, they should have provided cash financing to the budget had the Russian authorities collected counterpart fund from the enterprises.

2/ A notable exception has been the grants provided by Germany to finance the withdrawal of Russian troops from German territory.

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There is another unfortunate complication that Mr. Sachs chooses to ignore in his analysis. External debt--unless it is entirely in grant form--must be serviced. And, of course, this applies also to domestic debt. It is fine to say that bond financing can substitute for monetary financing; in fact, the IMF has encouraged the Russian authorities to create a market for Treasury bills and provided technical assistance to speed up the process. But we recognize, as do the Russian authorities, that there are risks in going too far and too fast in this direction. If, in present circumstances, the Russian Government attempted to finance a large share of its budget deficit by issuing Treasury bills, the public probably would insist on very short maturities and very high real interest rates, and the resulting debt burden could well mean a higher deficit in subsequent years, even in percent of GDP. 1/ This would be particularly the case given the less than perfect record of Russian (and Soviet) governments in meeting their financial obligations, of which last year's demonetization of "old rubles" and continued arrears on internal commodity debt are only two examples.

The more general point here is that Russia's fiscal problem is a structural problem that must be resolved over time: the deficit cannot be eliminated in one year (this would be socially and politically impossible); but deficit reduction cannot be postponed indefinitely, it must begin now.

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1/ The pitfalls of excessive reliance on interest-bearing government debt as a tool of deficit financing in a context of high inflation are illustrated by the Brazilian case. See, for example, Marcio G. P. Garcia, "Avoiding some of the costs of inflation and crawling towards hyperinflation: The case of the Brazilian domestic currency substitute," Pontifical Catholic University of Rio de Janeiro, April 1994.

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This means that a serious fiscal program must involve from the outset a combination of financing and adjustment: there must be some domestic financing--hopefully with a rising share of debt financing and a diminishing share of monetary financing over time--and there should be some external financing--if possible on better terms than we have seen so far. But in any event there must be fiscal adjustment so that structural deficits are reduced, year after year, and that in the foreseeable future Russia be able to avoid excessive reliance on both indebtedness and inflationary financing.

Incidentally, some of the points made above also apply to financing by the international organizations, including the IMF. The Fund has made its contribution: $2 1/2 billion in 1992-93 in support of adjustment programs that did not work very well; 1/ and in April 1994 the Fund's Executive Board approved an additional credit of $1 1/2 billion under the Systemic Transformation Facility (STF)--a facility that was created especially to assist economic reform in countries like Russia. And the Fund's contribution could increase substantially. If all goes well under the current program the next stage would be the negotiation of a program that could be supported by a full stand-by arrangement under which Russia could receive additional credits of several billion dollars. And this would create favorable conditions for the rescheduling of Russia's debt to its official creditors, perhaps including the provision of longer term relief.

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1/ A $1 billion first credit tranche arrangement was approved in August 1992 and the first tranche of an STF arrangement ($1 1/2 billion) was approved in July 1993.

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But the IMF's money belongs to the international community. It is there to help member countries deal with temporary balance of payments difficulties and therefore it can only be made available subject to certain conditions. The rationale for these conditions is well known: to provide a reasonable assurance that existing imbalances will be corrected so that the country will be in a position to repay its liabilities to the Fund and, more importantly, so that its economic situation will show a lasting improvement. Here, too, financing can complement adjustment; but there is no substitute for fiscal adjustment.

## The May 1993 Program

The difficulties that have been faced in the struggle for macroeconomic stabilization in Russia can be illustrated with a specific historical example. In late May 1993, the representatives of the Russian Government and the CBR, headed by Finance Minister Fedorov, agreed with an IMF staff team on a program which was subsequently approved by Prime Minister Chernomyrdin and CBR Chairman Gerashchenko in the form of a *Statement of Economic Policies of the Russian Federation*. On July 1, 1993, the program was approved by the Fund's Executive Board and supported by a credit of $1.5 billion under the Systemic Transformation Facility. Two aspects of this program are worth noting.

(1) The program specified that the $1.5 billion to be obtained from the Fund would not have to be added to the stock of Russia's official international reserves, but would be available to provide additional credit

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to the economy (including to the budget) without relying on monetary expansion. In other words, IMF financing was to facilitate a gradual adjustment in the fiscal position while beginning the process of reducing credit growth and inflation. (To some extent, the program was doing what Mr. Sachs accuses the IMF of not having done.) Financing, logically, was to be coupled with adjustment: it was expected that the deficit of the enlarged government--including federal and local budgets, extra-budgetary funds and unbudgeted import subsidies--would fall from 11 percent of GDP in the second quarter of 1993 to 8 1/2 percent in the fourth quarter which would have made it possible for inflation to drop from a monthly average of 17 percent in the second quarter to 8 percent in the fourth quarter. This, of course, was still 150 percent at an annual rate, but given the failures of the past, it seemed preferable to make sustained, albeit undramatic progress.

(2) The financial program envisaged not only a decline in the rate of growth of money and credit--that had been tried in early 1992 and by itself it had failed--but also a number of measures aimed at breaking the system of politically motivated, administratively directed and heavily subsidized credits, and replacing it by a system in which financial markets would play an increasing role and a restrained monetary policy would have a chance of success. To achieve that objective, the program included five key elements: (i) upward pressure on market-determined interest rates through a reduction in the growth of net domestic credit and base money; (ii) a rule tying the CBR lending rate to the market-determined, Moscow interbank rate; (iii) a commitment by the CBR not to extend credit to enterprises (directly or through commercial banks) at interest rates below the CBR's normal lending

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rate; (iv) a commitment to limit budgetary interest rate subsides; and (v) a commitment of both government and central bank not to repeat the bailout of interenterprise arrears that had occurred in 1992.

The program went on to a good start. In June-July 1993, the Government liberalized the price of coal and took several measures to reduce the budget deficit, including cuts in import subsidies and in subsidies to grain producers; and the Central Bank of Russia increased its lending rate from 100 percent in May 1993 to 170 percent on July 1 and then honored its commitment under the program by allowing its lending rate to rise along with the interbank rate. 1/ The results came very soon: the ruble, which had been loosing value almost continuously against the U.S. dollar for about one year, appreciated by more than 10 percent from mid-June to end-July 1993, and the CBR found itself intervening in the foreign exchange market to moderate the appreciation of the ruble, to the tune of $1.2 billion. The Russian economy appeared to be on the way to stabilization.

Unfortunately, soon after that the economic program went off track, and its monetary and fiscal targets for the third and fourth quarters of 1993 were exceeded by wide margins. Monthly inflation averaged around 20 percent in the second half of 1993 and by the end of the year the ruble had lost all the ground it had gained in June-July, in spite of substantial intervention by the CBR.

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1/ The CBR finance rate peaked at 210 percent on October 15, 1993 and remained at that level until April 29, 1994. Since then it has been allowed to drop in stages following, albeit with a substantial lag, the fall in the interbank rate.

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What went wrong? The answer is simple: the program was working. But once again, tight financial policies met with political resistance and sabotage from those special interest groups that were deprived of the subsidies and the cheap credits to which they had become accustomed and to which they thought they were entitled. These groups pressured and lobbied through the Supreme Soviet, and even within the Government; and in the end, in spite of staunch resistance by Fedorov and his associates, they obtained the support they were seeking--not all of it, but enough to derail the program.

A few examples, by way of illustration. First, grain subsidies were cut as had been expected, but this was more than offset by a large increase in budgetary spending on agriculture, including an increase in the procurement price of grain over and above what could be justified by market conditions and large subsidies for cattle raising. Second, the scheduled reimbursement to the federal government of a Rub 1 trillion loan (roughly 1 percent of GDP in those days) by *Rosskhleboprodukt*, the state grain procurement agency, failed to materialize. Third, in a courageous move the Government liberalized the price of coal, but this was followed by a substantial rise in government support to the coal sector. Fourth, the Supreme Soviet refused to increase excise taxes on energy and to raise the VAT by 7 percentage points, as had been proposed by the Government. Fifth, under pressure, the Government and the CBR extended large scale, unscheduled credits to the agricultural sector and the Northern Territories, breaking the commitment under the program to phase out the direct allocation of subsidized credits to specific sectors and regions.

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So, this is the story of the May 1993 program. It went off track not because it was technically flawed; it went off track because it was not adhered to; and it was not adhered to because major political forces within the country refused to live by its provisions and because the Government, in spite of the efforts of Boris Fedorov and his associates, was not able to protect the program against those who wanted to derail it. In the last months of 1993, Fedorov used the only weapon that remained in his arsenal: he simply refused to pay. The policy of aggressive sequestration continued in the first half of 1994 and, coupled with a restrained monetary policy by the CBR, it helped to achieve a significant reduction in the monthly rate of consumer price inflation to an average of less than 10 percent in the first half of the year. But the other result of sequestration was a buildup in government arrears, some of which would have to be repaid, thus raising the base on which sequestration would have to be applied in the future.

## The March 1994 Program

Boris Fedorov resigned on January 16, 1994, following by a few weeks the resignation of Egor Gaidar as Deputy Prime Minister and Minister of the Economy. Anatoly Chubais, another key figure among the reformers, remained in the Cabinet; but he could not be expected to play a leading role in the stabilization effort, as he would have to devote all his energies to the continuation of the privatization plan that his GKI had implemented so successfully. But many of Fedorov's former associates in the Ministry of Finance remained in place, including his former Deputy, Sergei Dubinin, now Acting Finance Minister. In January-March of 1994, a Russian negotiating

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team headed by Dubinin and including senior Finance Ministry and central bank officials worked out with an IMF staff team an economic program on which final agreement was reached on March 20 between Prime Minister Chernomyrdin and the Managing Director of the IMF. The program was approved by the Fund's Executive Board on April 20 and supported by a second credit of $1.5 billion under the STF.

The major goals of the program were to safeguard the achievements of reform in the areas of price and exchange market liberalization, extend privatization, make some progress in liberalizing external trade, and reduce the monthly rate of inflation to 7 percent at the end of 1994, on the way to further reductions in 1995. The program included revenue measures expected to yield 2 1/2 percent of GDP this year; a tight expenditure plan; and a monetary program that envisages a gradual reduction in the growth of money and credit, a gradual increase in the share of central bank credit extended through credit auctions and other market-related mechanisms and a gradual phasing out of directed credits. For all the fables about "shock therapy" and "big bang," gradualism was the key operating concept--not out of design, but because a more audacious approach was politically impossible.

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The second STF program already has past a few major tests, loosing some feathers in the process, but staying alive. Its centerpiece, the budget for 1994, was approved by both the Duma and the Federation Council in June 1994. During the preceding Parliamentary debate the Government of Prime Minister Chernomyrdin managed to deflect pressure for a large increase in defense

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spending although it had to accept a rise in expenditure, particularly in the form of higher transfers to agriculture. In the first half of 1994, the Government managed to keep its borrowing from the CBR under control in spite of a collapse in revenue, mainly through aggressive sequestration of expenditure. For its part the Central Bank of Russia has kept credit expansion to commercial banks within the program targets, and has managed its lending rate prudently, keeping it significantly above the rate of inflation. But the jury is still out on the second STF program. Success or failure will now depend crucially on the ability of Government, and the President, to defend the program against the pressures of interest groups.

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