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**REPORT TO THE MEETING OF INTOSAI
WORKING GROUP ON PUBLIC DEBT
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1 The Russian Federation Public Debt Status

In accordance with the Russian law, the public debt of the Russian Federation is divided into the internal and external debt, the latter until recently translated into USD equivalent. So in the official reports on the federal budget execution, two figures, formally unrelated, have always been cited under the public debt category, namely, the internal public debt (shown in Russian rubles) and the external public debt (shown in USD).

As of January 1, 2003, the external public debt of the Russian Federation was \$127.0 bln, i.e. about \$10 bln less than that of January 1, 2001. The 2002 federal budget law sets the statutory upper limit of the external public

debt including the external loan guarantees to third parties and the indebtedness to Vnesheconombank for 1998-1999 credits at \$123,7 bln for January 1, 2003.

The reduction of the public external debt is achieved mainly through reducing the number of new external credits and loans, and through individual advance payment operations.

The external loans policy of the Russian Federation is based on the Russian President's annual addresses to the Parliament. Currently the Russian Federation is faced up with the problem of reducing the amount of external debt and, consequently, cutting down its debt service expenditures, but with the task of accomplishing a more effective use of loans. The President's message to the Federal Assembly of 3 April 2001 stresses that Russia's integration into the world economy requires an up-to-date well-balanced approach to the problem of debt. Lessons need to be learnt from the current situation. Before incurring new debts we have to make sure we will be able to achieve good leverage and to pay, so that the debt burden will not pass on to our children and grandchildren. This is why the government needs to act cautiously when making their decision on new loans.

As for the internal public debt, it was 531.1 bln Rubles, as of 1 January

2002. In the 2002 budget year there was increase of debt by 168,6 bln Rubles. In the 2003 budget year, even bigger increase of the debt is expected. By 1 January 2004, the internal public debt will have reached 842,1 bln. Rubles. This increase will happen as we change priorities moving from external loans to internal sources. The 1998 crisis slowed down this process. However, investors' confidence in the Russian stock market is gradually restoring, which creates real opportunities for a growing role of internal sources financing the budget deficit.

It should be noted that the internal debt levels cited above do not show the true size of the state's internal loan liabilities, as the earmarked liabilities in the amount of 30.0 bln Rubles are treated as a separate item. These liabilities deal with the state guarantees for citizens' savings.

The entire public internal debt of the Russian Federation covering the guaranteed savings of the Russian Federation citizens is estimated at 7 trillion Rubles, if calculated using the existing guidelines. If these guidelines were complied with, the yearly budget expenditure to service and pay against this debt would be at least 240 bln Rubles, i.e. 3.0-3.5% of the GDP, or 20-25% of the expenditure part of the federal budget. As such payments are clearly not feasible, work is now underway to develop solutions. In the meantime, compensations are paid to elderly citizens.

2. MANAGEMENT OF THE RUSSIAN FEDERATION PUBLIC DEBT SYSTEM

Currently, the problem of establishing a specialized Agency for managing the Russian Federation public debt is being considered. Such Agency can be already set up by the end of 2002.

One of the reasons for discussing the need for setting up this Agency was that despite numerous enactments providing for the establishment of such, no comprehensive public debt management system has been set up so far. Although the regulating documents on this question were elaborated as far back as 1997 the problem of standard planning and accountability of all the operations on attracting, paying and servicing the Russian Federation's internal and external loans still remains unresolved.

Until now the cumulated data prepared by the Warburg Dillon Read consulting company and the Vnesheconombank have been used by the Ministry of Finance as a source of information concerning the consolidated Soviet and RF debt.

The current public external debt obligations accounting is purely a formal registration of the international agreements and filing them into a general

portfolio, which is called "The External Debt Book". As the RF Accounts Chamber pointed out repeatedly, the above "book" does not show whether the obligations have been fulfilled completely or partially by both sides (a change of debt obligation amounts and their payment), and whether the agreements have been suspended or canceled. Besides, the book is not used for registering the former Soviet external debt obligations, which the Russian Federation has accepted. The Russian Ministry of Finance is going to resolve this problem by establishing the above Agency for public debt management.

Still certain positive changes do take place and some of these come as a result of the RF Accounts Chamber's activity. For example, in order to conduct a complete count of, and register all the documents containing the Russian Federation debt obligations in hard currency, the Russian Ministry of Finance is drafting an RF Government enactment which will coordinate the efforts by the Russian Ministry of Foreign Affairs, the Russian Federal Archival Service in the transfer of copies of the RF and former Soviet agreements on foreign currency debt obligations to the Russian Ministry of Finance. At the same time, there has been little progress in this.

3.PRINCIPAL DIRECTIONS OF AUDIT MEASURES

3.1. Presently, alongside with the audits of certain operations with the state debt obligations, top-priority is given to the control over the debt obligation amounts formation when drafting a state loan program and federal budget acts for the next budgetary year. This orientation is, first of all, due to the fact that while inspecting draft federal budget acts for the next budgetary year the RF Accounts Chamber has established more than once that the structures of internal and external debt obligations which are attached to the draft laws do not correspond to the expenditures and loans that are proposed in the articles of the draft acts and should be shown in the state debt and its structure.

Special audits of the accumulated public debt obligations and the state budget execution performed in the previous years have revealed facts of placing the sums that lack documentary confirmation to liabilities, they also revealed shortcomings in the state debt obligations accounts methodology and accounts proper.

For instance, the examination of state guarantees disclosed facts of understating the public debt in its state guarantees portion as a result of exclusion by the Finance Ministry of guaranteed interest yield from the

aggregate guarantees amount and failure to indicate, in violation of Article 98 of the Russian Budget Code, the guarantees issued on the internal debts structure.

In some cases federal draft budgets tend to partially reflect in the debts structure for the next fiscal year the operations proposed with the Federal budget funds, inclusive in the public debt, and vice versa changes that have occurred in the debt obligations structure tend to be omitted in the draft budgets.

3.2. The need to control and analyze the expedience and performance of debt capital is still topical. This concerns in the first place the loans issued by international financial organizations (IBRD, EBRD, European Investment Bank, Northern Investment Bank).

The Accounts Chamber's audits show that Russia's executive bodies still follow the stereotype of reducing the amount of existing loans and simultaneously attracting new credits for public sector fund management, i.e. state management where consulting services account for a larger share of expenses. The practice of diffusing loaned funds into too many projects still perseveres; these projects lack coordination, and involve too few Russian manufacturers. This is due to the fact that no unified strategy

has been worked out so far regarding the Russian Federation's participation in the World Bank, while the Russian Government has loosened its control over the elaboration of programs for attracting World Bank loans.

It should also be noted that the process of reconciliation of loans issued by the international financial organizations and credits from foreign governments suffers from excessive negotiations, which tend to last several years. For example, 3 to 4 years pass before the parties come to agreement on loan terms and conditions in case of borrowing from international organizations, and it may take up to 8 years to negotiate a foreign government credit. As a result, the foreign loan program often includes entities that no longer exist as final recipients of funds.

3.3. Another priority direction of auditing is control over the organization of state guarantees accounting.

The Russian internal guarantees debt amounts to 18.4 mln. Rubles, which makes up just 0.003% of the total internal debts. At the same time, such guarantees accounted for as much as 4.7% of the aggregate amount of internal obligations in 1997. The Accounts Chamber revealed numerous violations related to both the guarantees issuance and the management of loaned funds by final recipients. The existing internal guarantees issuance

standards were found extremely ineffective. The audit of these standards conducted by the RF Accounts Chamber prompted the Russian President to sign a Decree in May, 1997, stopping the issuance of guarantees and security for commercial banks' credits drawn by the Russian federal regions as well as other recipients of the Federal budget funds in order to finance the expenses envisaged by the Federal budget.

Since the break-up of the USSR and the acceptance of all the Soviet foreign debt obligations by the Russian Federation ten years ago some of the outstanding debts to foreign creditors have still not been verified. This circumstance calls for audits to be made for some of the debts. The amount of debts included into of the country's total foreign debt, is estimative because the negotiations have not been concluded yet. Neither has the accounting of commercial debts been completed. The RF Accounts Chamber's audits found the former Soviet Union's total commercial indebtedness to foreign creditors at the Vnesheconombank to be \$2.2 bln including verified open accounts. The RF Ministry of Finance estimates these debts to be worth \$3,5 billion and incorporates them in the external public debt structure.

As a result of the audits by the RF Accounts Chamber Russia's Ministry of Finance reduced the amount of unverified debts in the total foreign debt

structure by \$3 billion and, correspondingly, cut down the planned expenditures on servicing and payment of the Russian Federation's foreign debt obligations.

The above facts call for yearly audits to be continuously carried out in order to check the reliability of information on the amount and structure of the public debt and show the need for tighter control over the federal budget execution related to the operations that are used to service and pay public debts and to attract funding for state debt operations.