

# **Is Russia Getting into the International Financial Market?: An Analysis of the Balance of Payments Statistics**

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## **Introduction**

In February 1992, the balance of payments statistics of the USSR and the RSFSR for the years 1990 and 1991 were released after a 56 year interruption of the publication of such data. In March 1993, the Russian Official Statistical Office (Goskomstat) published the balance of payments related to the transactions between the Russian Federation and so-called "Distant Foreign Countries (hereafter DFCs)" for the first nine months of 1992. After that, the balance of payments statistics of the Russian Federation have been available every three months, though they are only related to DFCs\*<sup>1</sup>. Since the balance of payments represents the flows of goods, service and capital of a country within a certain period, it shows the country's economic status in the international arena. Therefore, we now have a strong method for constructing an exact picture of the Russian economy from the international point of view.

## **Reliability of the Statistics**

(1) From 1990 to 1992

Despite their availability some of the published statistics are not reliable for use in scientific analysis. The RSFSR's balance of payments for 1990 and 1991 are only figures estimated by researchers based on the assumption that Russia's exports are 78% of that of the USSR and that 67% of the mined gold in the USSR belongs to Russia and so on\*<sup>2</sup>. Moreover, the RSFSR's

balance of payments for 1990 and 1991 do not take into consideration the amount of *postponed or unpaid debt service* and *an amendment* concerning non-equivalent barter trade,<sup>\*3</sup> both of which are critically important items of the capital flow of Russia. We can use the RSFSR's balance of payments for 1990 and 1991 only as reference figures.

Russia's balance of payments for 1992, compiled by the Central Bank of the Russian Federation and Goskomstat, is a more reliable statistic because it maintains strict consistency among figures and takes the two above mentioned items into careful consideration. One of the problems that remains in the balance of payments for 1992 is the fact that it excludes humanitarian assistance from commodity import and service import. Therefore, the positive balance of commodity trade and service trade are too large<sup>\*4</sup>.

The second problem is that the *amendment* concerning the non-equivalent barter is too large. The balance of payments for 1992 names it as *an amendment to export*. The note attached to the balance explains it as an amendment which represents "the non-equivalent amount of international barter trade which is related to the price of the exported goods discounted by the Russian exporters as compared with the world standard"<sup>\*5</sup>. This means the following: the amount of barter trade under the clearing agreement is recorded on the items of commodity export and commodity import by the world standard price, but the value of the Russian exported goods is higher than that of imported goods on every barter transaction. Therefore, Russia exchanges valuable things for less valuable things, because the quality of Russian goods is not competitive and because the Russian authorities have some political consideration. Consequently, the difference must be recorded somewhere in the balance of payments and is called *an amendment to export*<sup>\*6</sup>. Considering the special characteristics of Russian trade, the intention of introducing such an item in the balance of payments is understandable. But if the amount of this item is too large, an analyst must take a very careful approach to the figures, since it is

not easy to determine the international standard prices, especially those of complicated industrial products.

In the case of 1992, the *amendment to export* is US\$ -6,414 million which is large enough to reverse the current account from positive to negative. This means that whether the current account is positive or negative depends on the estimation of the prices of Russia's exported goods on barter trade. The balance of payments of 1992 is more reliable than that of 1990 and 1991, but still has some problems.

## (2) 1993 and after

The balance of payments of the Russian Federation for 1993 has two items *of amendment to import* instead of *an amendment to export*. One is exactly the same as the *amendment to export*, which is US\$ -1204 million. The other is an un-calculated amount of import based on the foreign trade data of the counterpart countries. Although the former is a factor which makes the statistics unreliable, as is pointed out above, the latter is a result of the efforts of the Russian statisticians to make the balance of payments more realistic. Therefore, the balance of payments for 1993 has improved as compared to 1992.

Russia's balance of payments for 1994 is, as far as we can tell from newspapers and journals, fundamentally different from those for preceding years. That is, it omits debit and credit figures of every item, thereby only presenting a net balance. This is an inconvenient change for researchers, especially for analyzing the financial flows of the Russian Federation. However, it has some indisputable merit because it includes Russia's economic transaction both with DFCs and with CIS. Up to the end of 1993, "in the balance of payments is calculated the balance with Luxembourg and Western Samoa, but not included the transaction with Ukraine, Kazakhstan, Uzbekistan or Kirghizia"\*<sup>7</sup>. This problem is solved by the changes made in 1994. Besides, 1994's balance includes only a small amount of *amendment concerning* non-equivalent barter trade, which might make the statistics more reliable.

1995's balance of payments of the Russian Federation which was published in newspapers and journals was similar in style to the 1994 balance. That is, it omits debit and credit figures but includes the transaction with CIS. The important change in 1995 balance is the fact that it strictly follows the newest 5th version of the IMF's *Balance of Payments Manual*, which does not include the notion of *factor service* and distinguishes *current transfer* from *capital transfer* and so on. It makes international comparison easier.

Without access to the original materials for the balance of payments, an exact estimation of the reliability of the statistics cannot be made. From the argument above, however, it is generally accepted that the reliability of the balance of payments statistics of the Russian Federation has been improving year by year.

### **Why Is the Current Account Surplus So Large?**

#### (1) Special character of the Russian economy?

Hereafter, I will examine the international economic relations of the Russian Federation only with DFCs. Table 1 shows the balance of payments of the RSFSR and the Russian Federation. Due to the reasons mentioned above the figures of 1990-1992 are not reliable, so let us examine the figures from 1993 to 1995. The most striking aspect is that the *current account* surplus is very large. On the other hand, *capital and financial account* has remained *negative* from 1993 to 1995. This means that Russia has earned many dollars from her trade activities and re-invested it abroad or kept it in her pocket as international reserve assets. Considering the fact that the economy of the Russian Federation is in crisis and that the Russian government is calling for international assistance, the large amount of *current account surplus* warrants sufficient interest to investigate in detail. It seems that the basis of Russia's economy is fundamentally different from developing countries that are also seeking international assistance.

Table 1

Balance of Payments of the RSFSR (1990-1) and the Russian Federation (1992-5)

(with distant foreign countries) (millions of US\$)	1990 1991 1992 1993 1994 1995					
	1990	1991	1992	1993	1994	1995
(1) Current account	-4300	7100	-2702	6058	4836	12617
(2) Commodity trade balance	-2000	9100	-1372	10394	13913	22578
(3) Export	80900	54700	35493	42149	50671	64913
(4) Import	-82900	-45600	-36865	-32959	-36758	-42335
(5) Non-factor service	-600	-200	-2377	-2533	-6862	-1215
(6) Compensation of employees	-	-	-	-	-	-87
(7) Investment income	-2500	-2100	-1990	-2923	-2015	-3005
(8) Transfer	-1000	-2200	3037	2324	-200	406
(9) Capital and financial account	4300	-7100	2702	-6058	-4836	-12617
(10) Investment	2700	1100	7168	-2188	-7087	3461
(11) Direct investment	-400	-100	-112	682	-169	1916
(12) Reserve assets	1600	-8200	160	-1346	1547	-9310
(13) Errors & omissions	1200	-1700	-4626	-2524	704	-6768

Sources) *Ekonomika i Zhizn'*, No. 6, 1992, p. 11.

Goskomstat Rossii, *Rossiiskii Statisticheskii Ezhegodnik*, 1995, pp. 427-428. Goskomstat Rossii, *Ekonomika Rossii*, Ianvar' - Aprel', 1996., pp. 68-72. All the figures except 1990 and 1991 are recalculated by the author to the effect that (1) + (9) = 0, (9) = (10) + (12) + (13). As for 1990 and 1991, because of inconsistency of the figures recalculation cannot be made. Notes)

(1)-(4): All kinds of *amendment to export or import* are included in *export* and therefore added in *commodity trade balance* and *current account*.

(8) : From 1995 *transfer* means *current transfer*

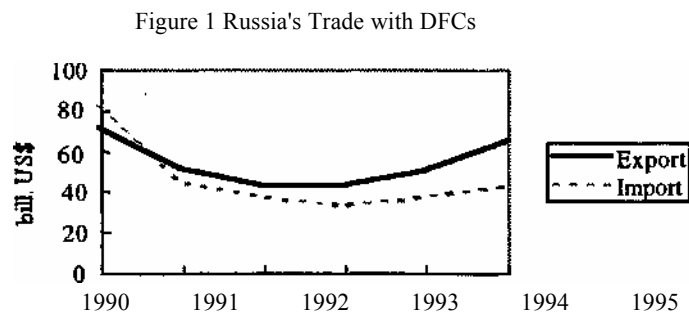
(10): (10) = (9) - (12) - (13) = *direct investment* + *portfolio investment* + *other investment* + *capital account* (capital transfer and others) in the system of 5 *Balance of payments manual* of the IMF. But since the amount of *capital account* is negligible, the item (10) represents long-term and short-term *investment*

(12): *Amendment to reserve assets* is included in *reserve assets* (13): *Amendment to re export in convertible currency to the countries of CIS* is included in *errors & omissions* in 1994 and 1995.

## (2) Commodity structure of the Russian trade

Since most of the surplus has been earned by *commodity trade surplus* (Table 1), we need to study the trend and structure of Russia's commodity trade. As is shown in Figure 1 (not based on the balance of payments statistics), Russia's export and import decreased sharply in 1991. The important thing is that import suffered a greater loss than export. Besides, export has recovered at a higher speed than that of import. All of these things made the *commodity trade surplus* large.

Figure 1



Source) Goskomstat Rossii, *Rossiiskii Statisticheskii Ezhegodnik*, 1995, p. 432 (corrected by the balance of payments Data) and Goskomstat Rossii, *Ekonomika Rossii*, Ianvar' - April', 1996., pp. 68-72.

Why did import suffer a greater loss and why has export recovered at a higher speed? This problem is connected to the structural change of the Russian trade, which is shown in Table 2 and Table 3. According to Table 2, the commodity structure of Russia's export has changed significantly over the past several years. "Machine" has become a negligible item of the Russian export. This was mainly caused by the collapse of the CMEA trade, where Russia (the USSR) had a considerable share of Machine trade in the trade agreement arrangements. Of course,

the decline of machine industry in Russia was one of the reasons for this change. In contrast, "Mineral" and "Metal" have maintained their status as main items of the Russian export and have even raised their share. This reflects the fact that under the circumstance of declining industries in Russia, only the resource-related sectors are maintaining their production.

Table 2

Commodity Structure of Export of Russia with DFCs  
(billions of US\$ and % [in parentheses])

	1990	1991	1992	1993	1994
Machine, Equipment	12.5	5.2	3.8	2.9	2.5
& Transportation Vehicle	(17.6)	(10.2)	(8.9)	(6.5)	(4.9)
Mineral Products	32.3	26.3	22.0	20.7	21.9
	(45.4)	(51.7)	(52.1)	(46.7)	(43.8)
Metals, Precious Stones	9.2	7.3	7.0	10.3	13.1
& Their Products	(12.9)	(14.3)	(16.4)	(23.2)	(26.3)

Source)

Goskomstat Rossii, *Rossiiskii Statisticheskii Ezhegodnik*, 1995, p. 432

Table 3

Commodity Structure of Import of Russia with DFCs  
(billions of US\$ and % [in parentheses])

	1990	1991	1992	1993	1994
Machine, Equipment	36.3	15.8	13.9	9.1	10.6
& Transportation Vehicle	(44.3)	(35.6)	(37.7)	(33.8)	(37.6)
Food Stuffs & Agricultural	16.6	12.4	9.6	5.9	8.6
Materials (without Textile	(20.3)	(27.9)	(26.0)	(22.2)	(30.4)
Goods)					

Source)

Goskomstat Rossii, *Rossiiskii Statisticheskii Ezhegodnik*, 1995, p. 432

With respect to import, it is noteworthy that the amount of "Machine" import has been declining sharply, as is shown in Table 3. One reason for that is also the collapse of the CMEA. After the collapse of the transferable ruble trade, where Russia

(the USSR) had imported a lot of machinery from Eastern Europe in the system of the international division of labor of the CMEA, machine import of Russia from Eastern Europe declined sharply. The other reason is the reduction in the demand for investment goods as a result of the depression of the system transformation. The import of "Foodstuffs and Agricultural Material" could not compensate for this decline; instead it also declined until 1993\*<sup>8</sup>. This might be related to the anxiety of the Russian citizens concerning their real disposable income in the near future\*<sup>9</sup>.

### (3) Regional structure of trade

In order to make clear the effect of the collapse of the CMEA the regional structure of trade must be examined. Table 4 shows the change of the USSR's trade with the European CMEA countries from 1990 to 1991.

**Table 4**  
USSR's Trade with European CMEA  
(millions of ruble)

	1990		1991		
	(a)	(b)	(a)	(b)	(c)
<i>Bulgaria (ex*)</i>	7492.0	6.3	2243.9	2.8	-70.0
<i>(im)</i>	9907.8	7.2	3741.5	4.7	-62.2
<i>Hungary (ex)</i>	6927.0	5.8	3032.1	3.7	-56.2
<i>(im)</i>	7125.8	5.2	2312.0	2.9	-67.6
<i>Poland (ex)</i>	7908.3	6.6	4036.8	5.0	-49.0
<i>(im)</i>	12763.7	9.3	3473.2	4.4	-72.8
<i>Romania (ex)</i>	4731.0	3.9	1717.3	2.1	-63.7
<i>(im)</i>	1784.2	1.3	1571.1	2.0	-11.9
<i>Czechoslovakia (ex)</i>	8803.6	7.3	5081.6	6.2	-42.3
<i>(im)</i>	10031.0	7.3	4197.8	5.3	-58.2
<i>Total (ex)</i>	35861.9	29.9	16111.7	19.8	-55.1
<i>Total (im)</i>	41612.5	30.3	15295.6	19.3	-63.2
<i>Total (balance)</i>	-5750.6		816.1		

Source) Statisticheskii Komitet SNG, *Vneshne-Ekonomicheskie Sviazi v 1991*, pp. 5-7, pp. 12-13. Notes) \* = export of CIS

(a) = amount of trade in millions of ruble

(b) = share in the trade with all (not only CMEA) European countries (%)

(c) = change of (a) from 1990 to 1991 (%)



From this table, the trend of Russia's trade can be seen. It shows that the USSR's trade with the European CMEA countries fell sharply in 1991 to less than half of its previous level. It is interesting that the loss of USSR's import is greater than that of its export. Therefore, in 1990 there was a considerable trade deficit in the USSR's trade with European CMEA, whereas there was a small amount of surplus in 1991.

The share of trade with European CMEA relative to the trade with overall Europe fell by about 10 % point. This made Russia's *current account surplus* so large. It is true that the transferable ruble was overestimated and that the decline of intra-CMEA trade must not be overestimated in the analysis of the real Russian economy. From an accountant's point of view, however, the fact that the deficit of trade balance with European CMEA was reversed into surplus is noteworthy.

(4) The current account surplus will disappear in the long run

Thus, the collapse of the CMEA, the systemic depression of the Russian economy and the relative maintenance of the production level of the resource-related sectors are the main reasons for the large amount of *current account surplus*. But all of these are just temporary. First of all, the collapse of the CMEA was a shock which will be compensated for by the growth of trade with other countries or by the restoration of trade with Eastern Europe. Second, the systemic depression will and *must* be replaced by some industrial boom in the near future that will create a demand for imported goods. Third, the resource-related sectors cannot maintain their production level in the long run unless the equipment in these sectors is improved. In order to improve the equipment it will be necessary to import a lot of capital goods.

Regarding one of the other aspects of the current account, that is, the service trade, Russia will continue to have a deficit because the service sector is far less advanced in Russia than in the western industrialized countries. For example, Russia will have to pay high fees for telecommunications or license fees for

newly invented products\*<sup>10</sup>. Therefore, the surplus in the *current account* of the Russian Federation will disappear in the long run.

### Analysis of Financial Account

(1) Real financial resource flow calculated by the method of the World Bank

Behind the export and import of commodities and services there must be financial flow. Since the *current account* was positive from 1993 to 1995, the *capital and financial account* was negative by definition. *Reserve assets* and *errors & omissions* are included in the *capital and financial account* in Table 1, so if we want to examine the real financial flow, we must study the item of *investment*, which has been calculated in the table (see the note (9) of Table 1). According to Table 1, *investment* was negative in 1993 and 1994. Even though it may be curious, it is apparent that Russia "exported" capital in these years. In order to solve this problem, we must investigate the contents of *investment*.

*World Debt Tables* of the World Bank presents the following framework for studying the debt problem (all of the items are long-term).

- Loan disbursements - Loan amortizations = Net resource flows on debt
- Net resource flows on debt - Loan interest = Net transfers on debt
- Net resource flows on debt + Official grants, foreign direct investment and portfolio equity flows = Aggregate net resource flows
- Aggregate net resource flows - Loan interest and profit of foreign direct investment = Aggregate net transfers\*<sup>11</sup>

Using this framework, analysts can study the real long term financial inflow and outflow of a country. For example, Net

transfers on debt is the net receipt of financial resources of a country in some kind of loan arrangement. While they can be used for the country's industrialization or improvement of the welfare of the people, they must be repaid in the future. Aggregate net transfers are more stable resources, because they consist of semi-permanent capital.

The framework of *World Debt Tables*, however, is not suitable for Russia, because it has been formulated for the analysis of the debt problem of developing countries and it does not consider the debits side of the balance of payments statistics. It supposes that the country being analyzed has no capital to export abroad. On the contrary, Russia has offered a large amount of capital to other countries. Therefore, in the case of Russia, the debits side of the balance of payments must be taken into consideration.

The second point that we must pay attention to is the *postponed or unpaid principal and interest*. This item is very large in Russia's balance of payments, at US\$ 5659 million in 1993. Under the system of Russia's balance of payments, any transaction must be recorded at the time of transaction, not at the time of settlement. If Russia borrowed money in 1992, with the understanding that Russia would repay it starting in 1995, the amount of money that is to be repaid in 1995 must be recorded in the balance of payments for 1995 as a loan amortization. If Russia failed to repay the money in 1995, the unpaid money must be recorded in the *capital and financial account* as *unpaid principal* and/or *unpaid interest*. Therefore, in the calculation of the net resource flows on debt, *postponed or unpaid principal* must be taken into consideration. Likewise, the *postponed or unpaid interest* must be taken into consideration in the calculation of net transfers on debt and aggregate net transfers. Thus, the framework for analyzing Russia's financial flow is the following.

- Net disbursements = Utilization of accepted loan by residents - Utilization by nonresidents of loan offered by

- residents
- Net loan amortization = Amortization of accepted loan by residents - Amortization by nonresidents of loan offered by residents
  - Net resource flows on debt = Net disbursements - Net amortization + Postponed or unpaid principal
  - Net transfers on debt = Net resource flows on debt - Loan interest + Postponed or unpaid interest
  - Net resource flows on debt + Official grants, foreign direct investment and portfolio equity flows = Aggregate net resource flows
  - Aggregate net resource flows - Loan interest and Foreign direct investment profit + Postponed or unpaid interest = Aggregate net transfers

where

Postponed or unpaid principal: excess of payments by

residents is *negative*

Postponed or unpaid interest: excess of payments by

residents is *negative*

Loan interest: excess of payments by residents is *positive*

Official grants, foreign direct investment and portfolio equity flows: excess of payments by residents is *negative*

Loan interest and Foreign direct investment profit: excess of payments by residents is *positive*

Here we can study the long-term financial resource flow of Russia instead of using the item *of investment* in Table 1 which includes *capital transfer* and *other short-term credit*\*<sup>12</sup>. Tables 5-7 show Russia's long-term financial resource flow. It is interesting that there is an apparent difference between government and non-government financial resource flow. Whereas the government sector had positive resource inflow both on debt and investment during these three years, the non-government sector made financial resource outflows in 1994 and 1995. What made such a difference is the structure of the net loan amortization and the *postponed or unpaid principal and interest*.

In 1993 and 1994, a large amount of planned amortization or loan interest payments by nonresidents was offset by the *postponed or unpaid principal and interest* in the government sector. In 1995, the net disbursement was so large that the net resource flow on debt was positive in spite of a large amount of positive net loan amortization. But in 1993 the aggregate net transfer was about 3 billion which was as much as in 1995 and large enough for Russia's balance. The *official grants* in 1993 made it possible

Table 5

Analysis of financial resource flow of Russia (millions of US\$)  
(government)

	1993	1994	1995
Net disbursements	139	73	8192
Net loan amortization	-9745	-9106	3886
Postponed or unpaid principal	-9717	-9152	989
Net resource flows on debt	167	27	5295
Loan interest	-1869	-2411	3565
Postponed or unpaid interest	-1399	-2209	1189
Net transfers on debt	637	229	2919
Official grants, FDI and portfolio equity flows	2324	-200	353
Aggregate net resource flows	2491	-173	5648
Loan interest, portfolio interest and FDI profit	-1869	-2411	3565
Aggregate net transfers	2961	29	3272

Sources) Calculated by the author on the data of [1993] Goskomstat Rossii, Rossiiskii Statisticheskii Ezhegodnik, 1995, pp. 527-428; [1994-95] Goskomstat Rossii, *Ekonomika Rossii*, Ianvar' - Aprel', 1996, pp. 68-70; *Ekonomika i Zhizn'*, No. 22, 1996, pp. 4-9. Notes)

1. Official grants, FDI and portfolio equity flows  
= official grants (government)  
= FDI and portfolio equity (non-government)
2. Official grants include payment to international organizations
3. Government transaction excludes private transaction guaranteed by the government in 1993 and 1994, but includes it in 1995.

**Table 6**  
Analysis of financial resource flow of Russia (millions of US\$)  
(Non-government)

	1993	1994	1995
Net disbursement's Net loan	6107	2105	-24110
amortization Postponed or	16239	13671	-19156
<u>unpaid principal</u>	12570	11705	-24
Net resource flows on debt	2438	139	-4978
Loan interest Postponed or	4792	4426	-628
<u>unpaid interest</u>	4205	3199	0
Net transfers on debt	1851	-1088	-4350
Official grants, FDI and	-276	-1135	1882
<u>portfolio equity flows</u>			
Aggregate net resource flows	2162	-996	-3096
Loan interest, portfolio interest and FDI profit	4292	4426	-561
Aggregate net transfers	2075	-2223	-2535

Sources) Same as Table 5

**Table 7** Analysis of financial resource flow of Russia (millions of US\$) (Consolidated)

	1993	1994	1995
Net disbursements Net loan	6246	2178	-15918
amortization Postponed or	6494	4565	-15270
<u>unpaid principal</u>	2853	2553	965
Net resource flows on debt	2605	166	317
Loan interest Postponed or	2923	2015	2937
<u>unpaid interest</u>	2806	990	1189
Net transfer on debt	2488	-859	-1431
Official grants, FDI and	2048	-1335	2235
<u>portfolio equity flows</u>			
Aggregate net resource flows	4653	-1169	2552
Loan interest, portfolio interest and FDI profit	2423	2015	3004
Aggregate net transfer	5036	-2194	737

Sources) Same as Table 5

In the non-government sector, a large amount of net loan amortization to be paid by the residents (Russians) was offset by a large amount of *postponed or unpaid principal* in 1993 and

1994. Loan interest to be paid by the residents was also offset by *postponed or unpaid interest* in the same years. The most remarkable thing about the non-government sector is that a tremendous amount of negative net disbursements was recorded in 1995 and that it was mostly offset by net loan amortization paid by nonresidents. This means that there was a huge outflow and inflow of Russia's non-government financial resources.

In brief, both in the government and non-government sector, *postponed or unpaid principal and interest* played an important role in the balance of payments of Russia in 1993 and 1994. Because of them there was not so much inflow and outflow of real financial resources. On the contrary, in 1995 *postponed or unpaid principal and interest* did not play an important role and there was a substantial amount of real inflow and outflow of financial resources. Therefore the year of 1995 was a turning point of Russia from the view point of international finance.

## (2) Short-term financial flows

Now we must investigate the trend of the items of *other short-term credit* (1993 and 1994) or *foreign cash currency and deposit*(1995) which are excluded from the analysis in Tables 5-7, as mentioned in note 12. It is also necessary to study *reserve assets* here. All of these are items which are short-term and fluctuate automatically as a result of current transactions.

Table 8

Long-term and short-term financial resource flows  
(millions of US\$)

	1993	1994	1995
Current account	6416	4836	12617
<u>Net transfer on debt</u>	2488	-859	-1431
<u>Aggregate net transfers</u>	5036	-2194	737
Other short-term capital <sup>(1)</sup>	-7323	-7107	-933
Reserve assets	-3356	3924	-9310

Sources) Same as table 5

Note) 1. Foreign cash currency and deposit + unreceived export charge and received export charge which had not been received before

Table 8 shows the relation between *long-term financial resource flow*<sup>\*1\*</sup> analyzed in Tables 5-7 (*net transfers on debt and aggregate net transfers*) and *short-term financial resource flow* (*other short-term capital and reserve assets*). In 1993, the inflow of *long-term financial resources* was offset by *short-term financial outflow*. In 1994, both *long-term financial resources* and *short-term financial resources* flowed out. In 1995, the outflow of *long-term financial resource flow* was not so large, whereas two thirds of the surplus of the *current account* was absorbed by the item of *reserve assets*<sup>\*14</sup> instead.

In these three years *other short-term capital* (or *foreign cash currency*) and/or *reserve assets* played a decisive role in upsetting the surplus of the *current account*. This means that a large amount of the surplus of the *current account* in these years was not used for productive financial operation which would bear fruit in the future but flowed into *short-term financial resources*.

Since *other short-term capital* represents "current account (in banks) and deposit", "increase of foreign cash currency accumulation outside banks", "foreign currency account in banks" and others, an increase of it reflects the actions of the Russian commercial banks to keep earned money in foreign banks (it is usually considered capital flight) or dollarization of the Russian economy. In both cases, hyper-inflation of the Russian Federation prevented the effective utilization of a large amount of the surplus of the *current account*.

The policy change of the government and the central bank after the sudden fall of the ruble rate in October 1994 made the situation fundamentally different. From February 1995, the demand for dollar decreased relative to the supply in the market and the difference was absorbed into the central bank. This is shown in the column for 1995 in Table 8. Consequently, *official reserve assets* reached US\$ 17.2 billion on January 1, 1996, which is 2.6 times more than it was at the beginning of 1995<sup>\*15</sup>. This gave the central bank of Russia a strong means to regulate the currency market of the ruble.



### (3) Capital flight?

It is widely believed that a large amount of capital is leaking out across the Russian border. But we need to take a careful approach to this problem, because the amount of fled capital depends on the definition of capital flight. If the total amount of net capital outflow (for example, Net disbursements in Table 5) is regarded as capital flight, Japan is surprisingly a country of capital flight.

Mikhail Sarafanov, Director of VNIKI, explains that there are three kinds of capital flight. The first one is legal capital flight which is created by the increase of the Russian commercial banks' active in foreign banks. The second type is illegal but included in the item of *errors & omissions*. This can be made through the non-transfer of earned foreign currency by the Russian exporters or advance for goods to be imported but not imported in fact, or by other ways. The third is illegal and not recorded anywhere. This is the result of underground smuggling. All of this is connected with the limited opportunities for investment in the Russian economy\*<sup>16</sup>.

Table 9 shows the amount of financial resources that could be estimated as capital flight. Since some specialists point out that 50% of *errors & omissions* is "un-reported export" or "smuggling" (by false report of export), 50% of *errors & omissions* are added in the table here\*<sup>17</sup>. In addition to these figures, underground smuggling which was not reported anywhere must be considered.

Whether "increase of cash foreign currency accumulation outside banks" is to be included in capital flight or not is a matter of debate, because this can be absorbed into the central bank easily by an effective financial policy of the government and the central bank and because the figure for this item depends on a doubtful estimation.

The amount of capital flight in Table 9 is different from that of EBRD's estimation\*<sup>18</sup>. In any case, it is necessary to note that the calculation of capital flight is not an easy task. But if the capital flight was more than US\$ 7 billion a year, as is shown in

Table 9, the Russian economy might have actually been undermined.

Table 9  
Capital Right ( million US\$)

	1993	1994	1995
Current account* and deposit	-1068	2095	3989
Increase of cash foreign currency accumulation outside banks	-5700	-6000	61
Other capital	-555	-2954	
Foreign currency account in banks		-247	-71
Unpaid charge of export***			-4829
50% of errors & omission	-1271	**	-2290
Total	-8594	-7106	-3140

sources) Goskomstat, *Rossiiskii Statisticheskii Ezhegodnik, 1995* , p. 428

*Ekonomika i Zhizn* , No. 22, 1996, pp. 8-9.

notes) \* = current account in banks

\*\*= *errors & omission* in 1994 is +, so omitted. \*\*\*= this item is included in "Other capital" in 1993 and 1994

#### (4) Movement of financial resources

From the discussion above, the main characteristics of the movement of financial resources around Russia are the following:

- 1) Although Russia had to repay the debt of the former USSR in 1993 and 1994, much of that was postponed or unpaid mainly because of rescheduling arrangements.
- 2) In 1994 and 1995, Russia engaged in foreign investment abroad, the amount of which, however, did not offset the surplus of the *current account*.
- 3) In 1993 and 1994, *other short-term capital* was recorded in the negative sign, which means that the Russian commercial banks only kept their earned money in foreign banks or that Russian citizens accumulated dollars in their pockets. These are not productive ways to use the surplus of the *current account*.

- 4) The situation changed in 1995 when the dollar cash in the market was absorbed into the central bank because of a policy shift. The accumulated *reserve assets* will be a substantial help in stabilizing the Russian financial economy.
- 5) Considering the conclusion of section 2, that the surplus of the *current account* will disappear in the long run, capital inflow from industrialized countries will play an important role in the stabilization and development of the Russian economy.

### **Russia in the International Financial Market**

#### (1) Who will be a partner?

It is clear that Russia has to establish financial resources from foreign countries in the long run. But who can do that? The most important change in the international financial market in recent years is that the USA has become a net debtor nation. The structure of the balance of payments of the USA in the 1960s, when the net inflow in trade balance and investment income had been absorbed by the net outflow in the transfer and financial accounts, has drastically changed since 1983 and the *current account* of the USA has accumulated a large deficit. This deficit has been financed by *direct investment*, *portfolio investment* and *deposit* by British and Japanese investors and enterprises. Though the deficit of the *current account* of the USA was temporarily improved in 1991 by the international relief for the Gulf War, since 1992 the deficit of the *current account* has been growing\*<sup>19</sup>.

This is a critically important change for the future of the Russian economy because it means that the USA is no longer a supplier of financial resources for the world but a huge absorber. What is worse, the USA has a gigantic budget deficit and it must also be financed by someone. All of these things lead us to the conclusion that a second Marshall Plan is impossible. Today's international financial situation is totally different from that of

1947.

In place of the USA, West Germany had been the nation to provide financial resources in the 1980s. In 1989, the export of capital\*<sup>20</sup> of West Germany reached DM 134,651 million. This is more than US\$ 70 billion at the exchange rate at that time. On the other hand, the balance of the *current account* had been positive from 1982 until 1990. The unification of Germany, however, brought the accounts into the opposite position. In 1991, the balance of the *current account* fell into deficit and since then Germany has become a net absorber of financial resources. Germany is a country that has a long tradition of investing in Russia and Eastern European countries. Now, from the macro economic point of view, this country lacks the resources to invest abroad.

From the micro economic point of view, however, Germany could play an important role in providing financial resources to Russia and Eastern European countries, because Germany is very actively engaged in *direct foreign investment* even today. From 1993 to 1995, Germany's net outflow of *direct foreign investment* was DM 22,400 million, DM 25,914 million and DM 37,084 million, respectively\*<sup>21</sup>. The discrepancy between the macro and micro situation means that German investors must be selective in deciding where to invest. Thus, there will be stiff competition among Russia and Eastern European countries, including the eastern region of Germany, to attract German investors.

Japan is the only country of the western industrialized economies that can provide a considerable amount of financial resources to the rest of the world in the 1990s. On average, from 1991 to 1994 Japan's surplus of the *current account* per year was more than US\$ 83 billion. That was large enough to cover the USA's deficit of the *current account* in the same period\*<sup>22</sup>. Japan has been the last resort for the relief of the transition economies from the financial point of view.

The recent financial movements in Japan, however, cast a shadow over the problem. The scandal of financial institutions

has made Japanese bankers so timid that they would not invest in the transition economies which they know little about. Besides, diminishing the surplus of the *current account* would undermine Japan's status as an exporter of capital.

All of these things reveal that today's international financial market can not provide a stable basis for the development of the Russian economy.

## (2) Foreign direct investment (FDI) and Russia

**Table 10**  
Foreign Direct Investment, Cumulations of Gross Inflows  
(Cash basis, millions of US\$)

	1991	1991	1992	1993	1994	per-capita 1994*
Albania	-	-	20	68	116	36
Bulgaria	4	60	102	157	205	23
Croatia			16	56	104	22
Czech Republic	436	947	1951	2519	3319	319
Hungary Poland	526	1985	3456	5795	6941	670
	94	211	495	1075	1602	42
Romania	-	40	120	207	501	22
Slavakia	28	110	210	354	434	102
Slovenia	7	72	183	294	374	185
Macedonia	-	-	-	-	5	3
Russian Federation	-	100	1554	2958	3958	27

Note)\* = Dollars per capita.

Source) United Nations, Economic Commission for Europe, *Economic Survey of Europe in 1994-95*, 1995, Geneva., p. 145.

Among the various financial arrangements, *foreign direct investment* (FDI) is the most convenient method for countries like Russia. Russia lacks the know-how, manpower and latest equipment which must be reconstructed from the beginning. That is what distinguishes Russia from the USA, which lacks financial resources but is rich in know-how, manpower, the latest equipment etc. *Foreign direct investment* would bring all this into Russia.

Table 10 shows the cumulative amount of FDI into Central and Eastern Europe and the Russian Federation. It reveals that Russia lags behind Central and Eastern Europe in this sphere. It is true that the total amount of accepted FDI of Russia is more than that of the Czech Republic, but the amount is too small for Russia, with a population of 150 million. For example, the per-capita cumulative amount of FDI from 1990 to 1994 was only US\$ 27, which is less than Albania's figure.

Besides, net flow of FDI was negative in 1992 and 1994 (see Table 1), that is, Russia was a net exporter of FDI in these years. This is an ironic result of the large surplus of the current account. FDI is a risky and time-consuming economic activity and requires economic, political and social stability.

All the above figures show that the investors in and out of Russia do not believe in the future of the Russian economy.

### **Conclusion**

In order to answer the question in the title of this paper, it is necessary to define the meaning of the question. *To get into the international financial market* means:

- (A) to be an importer of financial resources, consequently, to be a promising and profitable country which would absorb excess capital, like Asian countries today.
- (B) to be an active player in the international financial market as an exporter of financial resources which would provide capital to the world, like oil producing countries in the 1970s'.

Based on the definitions in (A) and (B), Russia is not getting into the international financial market. Russia is not an importer of financial resources. In the long run, Russia has to introduce much capital, but it is not likely that Russia will be an attractive country for the investors of the USA, Germany, Japan and others whose financial resources are not abundant today.

Russia is not an exporter of financial resources for the development of other countries. The excess of capital is accumulated in a non-productive way. The financial institutions of Russia do not have the know-how, experience or even volition to circulate financial resources productively.

### Notes

- 1 From 1994 on, the balance of payments with CIS began to be published.
- 2 *Ekonomika i Zhizn'*, No. 6,1992 (Feb.), p. 11.
- 3 The *postponed or unpaid debt service* and the *amendment* concerning non-equivalent barter are to be explained later.
- 4 *Ekonomika i Zhizn'*, No. 18,1993 (May), p. 5. This problem is solved in the revised balance of payments statistics of the Russian Federation in the Annual Statistical Handbook, *Rossiskii Statisticheskii Ezhegodnik, 1995*, Goskomstat Rossii, Moskva, 1996, pp. 427-428.
- 5 *Ekonomika i Zhizn'*, No. 18,1993 (May), p. 5.
- 6 *Ekonomika i Zhizn'*, No. 11, 1993 (Mar.), p. 1. Amendment concerning the export for the repayment of credit in Transferable Ruble is also called "Amendment to Export" which is US\$ -468 million in 1992.
- 7 S. M. Borisov, "Platezhnyibalans Rossii" ,*Den'gi i Kredit*, No. 10-11,1993, p. 12.
- 8 The figures for 1993 and 1994 are taken from the data of the central office of customhouses and underestimates the real import, because there were a lot of goods which did not go through customhouses. Therefore, import of "Foodstuffs", for example, might be more.
- 9 As for imports, it must be noted that so-called centralized import financed by foreign debt fell drastically from 1991 to 1993. It was more than US\$ 30 billion in 1991 but in 1993 it was not more than US\$ 12 billion. *Finansovye Izvestiia*, No. 3,1994, p. 1.
- 10 One factor that brings the balance to the opposite direction is

*tourism* which was US\$ - 8.1 billion in 1995 (*Ekonomika Rossii*, Ianvar' - Aprel' 1996, p. 71). It was caused by a lot of tourists who went abroad to buy consumer goods. This is a temporary phenomenon that will diminish as the Russian society becomes stabilized.

- 11 The World Bank, *World Debt Tables*, 1994-5, p. xix.
- 12 *World Debt Tables* omits short-term loan from consideration, therefore the author also omits *other short-term capital* (in 1993 and 1994) or *foreign cash currency and deposit* (in 1995). However, in Russia's balance of payments there are consolidated items of accepted *long-term and short-term credit* and *offered long-term and short-term credit*. With respect to these items, short-term credit is included in the analysis.
- 13 Strictly speaking, it includes short-term credit as is pointed out in note 12, but is long-term compared to *other short-term capital* or *reserve assets*.
- 14 Accumulation of *reserve assets* in the central bank must be recorded in the *minus* sign.
- 15 *Ekonomika Rossii*, Ianvar' - Aprel', 1996, p. 72; *Izvestiia*, May 13, 1996, p. 2.
- 16 *Ekonomika i Zhizn'*, No. 18, 1993, p. 5; *Finansovye Izvestiia*, No. 3, 1994, p. 2.
- 17 *Ekonomika i Zhizn'*, No. 29, 1993, p. 21; *Ekonomika i Zhizn'*, No. 42, 1993, p. 10.
- 18 EBRD, *Transition report 1995*, p. 95. An article in the *Asahi Shinbun* of March 23, 1996 which refers to the EBRD's estimation is misleading. It mistakes stock figures for flow figures.
- 19 US Department of Commerce, *Survey of Current Business*, Vol. 75, No. 6, pp. 84 - 85.
- 20 Net outflows (minus) of financial account. *Deutsche Bundesbank Monthly Report*, March 1996, p. 68.
- 21 *Ibid.* p. 71.
- 22 Shigeki Takada, "90 nendaino kokusai shihon ido", *Kaigai Toshi Kenkyusho Ho*, No. 4, 1996, p. 8.