

**Institute for the Economy in Transition**

**RUSSIAN ECONOMY IN 2008**

**TRENDS AND OUTLOOKS**

*(ISSUE 30)*

**Moscow  
2009**

UDC 33(470+571)(066)"2008"  
BBC 65.9(2Рос)я54

*Agency CIP RSL*

**Institute for the Economy in Transition**

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R95 Russian economy in 2008 (issue 30): Trends and outlooks / Inst. for the Economy in Transition; [Y. Gaidar and others]. – M.: IET, 2009. – 597 p.: il. – ISBN 978-5-93255-276-6.

The review provides a detailed analysis of main trends in Russia's economy in 2008. The paper contains five big sections that highlight single aspects of Russia's economic development: the socio-political context; the monetary and credit and financial spheres; the real sector; social sphere; institutional challenges. The paper employs a huge mass of statistical data that forms the basis of original computation and numerous charts.

**The publication of the present paper was sponsored with the grant from the United States Agency for International Development (USAID)**

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ISBN 978-5-93255-276-6  
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### Russia's State Budget in 2008

#### 2.2.1. The General Characteristic of the Budget System of the Russian Federation

The dynamic of main parameters of the budgetary system of the Russian Federation in 2008 appeared substantially different from trends prevailing over the prior year. While in 2007 revenues and expenditures of budgets of all levels were on the rise vis-à-vis their respective figures of 2006, in 2008, changes were differently directed (*Table 1*) – against the backdrop of the economic crisis the enlarged government's revenues fell fairly significantly to 38.5% of GDP (at 1.7 p.p. of GDP vs. 2007) and so did revenues to the federal budget (down to 22.3% of GDP, or at 1.3 p. p. of GDP). At the same time, revenues to consolidated budgets of the Subjects of the Federation posted a 0.2. p. p. growth - up to 14.9% of GDP.

In the second half 2008, the progressive deterioration of the economic agents' financial health has inevitably entailed a fall in the budget revenues and put into question financial stability of the national budgetary system as a whole. The fall in the enlarged government's revenues against the 2007 figures was determined primarily by the contraction of tax revenues<sup>1</sup> (at 0.5% of GDP). It was the federal level where tax revenues slid most notably (at 0.1 p.p., down to 21.2% of GDP), while the fall of non-tax revenues (by 0.4 p.p. - to 1.1% of GDP) and uncompensated receipts from other budgets of the budgetary system (at 0.7 p.p. – to 0.03% of GDP<sup>2</sup>) have formed major factors behind the overall fall in the federal budget revenues in 2008. The growth in revenues to regional budgets is related solely to a 0.8 p.p rise in transfers from the federal budget – up to 2.7% of GDP (meanwhile, both tax revenues and non-tax ones were on decline).

Vectors of changes in the expenditure volume were also different across budgets of different levels. While the federal and regional budgetary expenditures rose at 0.1 p.p. and 0.5 p.p. (up to 18.2% and 15.1% of GDP, respectively) vis-à-vis the 2007 figures, the enlarged government's budgetary expenditures, on the contrary, tumbled by 0.4 p.p. – to 33.7% of GDP. The point is the federal budget expenditures grew solely thanks to the rise in expenditures on interbudgetary transfers (at 0.7 p.p. – up to 6.4% of GDP). At the same time, a closer look at expenditures less this particular section of the functional classification allows noticing their fall at 0.6 p.p. of GDP. A similar situation is noted, as far as regional budgets are concerned. It was transfers to extrabudgetary funds that made growth in expenditures possible – they rose at 0.4 p.p. – up to 0.5% of GDP, while other sections on the whole were likewise on the rise, albeit at a more moderate rate (0.06% of GDP). So, the rise in the federal and regional budgetary expenditures in 2008 vs. the 2007 figures was fueled mostly by intebudgetary

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<sup>1</sup> For the purposes of the present analysis tax revenues comprise insurance premiums to the compulsory medical insurance and revenues from foreign trade (in compliance with effective provisions of the effective variant of the Budget Code of RF, these categories of revenues are attributed to nontax ones)

<sup>2</sup> This contraction is related to the fact that in 2007, this revenue item reflected the collection to the federal budget of additional revenues from YUKOS, while in 2008, there were no such transfers to the budget.

transfers and, accordingly, this rise cannot help but affect the enlarged government's volume of budgetary expenditures.

The rise in the federal budget expenditures vs. the 2007 figures took place against the background of plunging revenues, which resulted in a shrinking surplus of the federal budget (at 1.4 p.p. – down to 4.1% of GDP). Because of the advanced growth in expenditures of the RF Subjects' budgets, the latter ran a minor deficit by results of 2008, which equaled to 0.1% of GDP. While the enlarged government's budgetary expenditures plunged in the shares of GDP equivalent, they did so to a far lesser degree than the revenues. That resulted in a substantial fall of the surplus at 1.3 p.p. – down to 4.8% of GDP.

*Table 6*

**Execution of Revenues and Expenditures Across Budgets of All the levels  
of Government in 2000–2008 (as% of GDP)**

	2000	2001	2002	2003	2004	2005	2006	2007	2008
<b>The federal budget</b>									
Revenues	15.5	17.8	20.3	19.5	20.1	23.7	23.3	23.6	22.3
Expenditures	14.2	14.8	18.9	17.8	15.8	16.3	15.9	18.1	18.2
Deficit (-)/Surplus (+)	1.4	3.0	1.4	1.7	4.3	7.4	7.4	5.5	4.1
<b>Consolidated budgets of the RF Subjects</b>									
Revenues	14.1	14.5	15.1	14.6	14.1	13.9	14.1	14.7	14.9
Expenditures	13.4	14.5	15.5	14.9	13.9	13.6	13.6	14.6	15.1
Deficit (-)/Surplus (+)	0.7	0.0	-0.4	-0.3	0.2	0.3	0.5	0.1	-0.1
<b>The budget of the enlarged government</b>									
Revenues	38.3	38.4	37.8	37.1	37.5	39.7	39.6	40.2	38.5
Expenditures	34.3	35.2	36.3	36.0	32.9	31.6	31.2	34.1	33.7
Deficit (-)/Surplus (+)	4.0	3.2	1.5	1.1	4.6	8.1	8.4	6.1	4.8

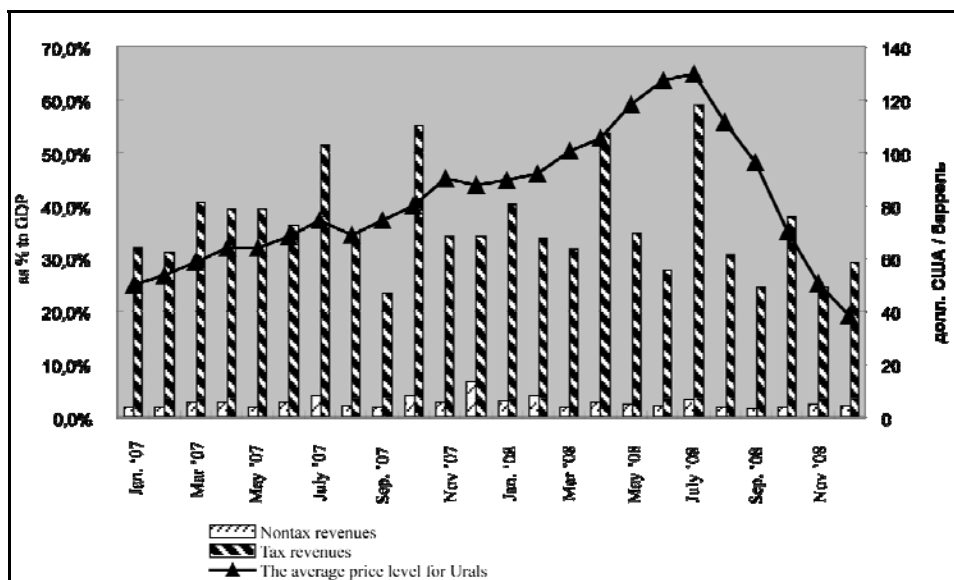
*Source:* The RF Ministry of Finance, the IET calculations.

A distinctive feature of the dynamic of budgetary revenues on all the levels over the period in question became an intensifying swing of monthly tax revenues with an explicitly subsiding trend (*Fig. 10*).

An important factor of changes in the dynamic of tax revenues compared with the 2007 figures became the domestic VAT, which has been paid on the quarterly basis since the beginning of 2008. This factor was behind spikes in tax revenues noted in January, April, July and October, as well as the subsequent two-month periods when revenues were on decline compared with the respective time periods of 2007, as in the absence of revenues from VAT, the budget kept on reimbursing economic agents. But because of the crisis, the RF government ruled to grant them with payments of the domestic VAT over the third quarter in installments. Hence, a fairly visible contraction in tax revenues in October 2008.

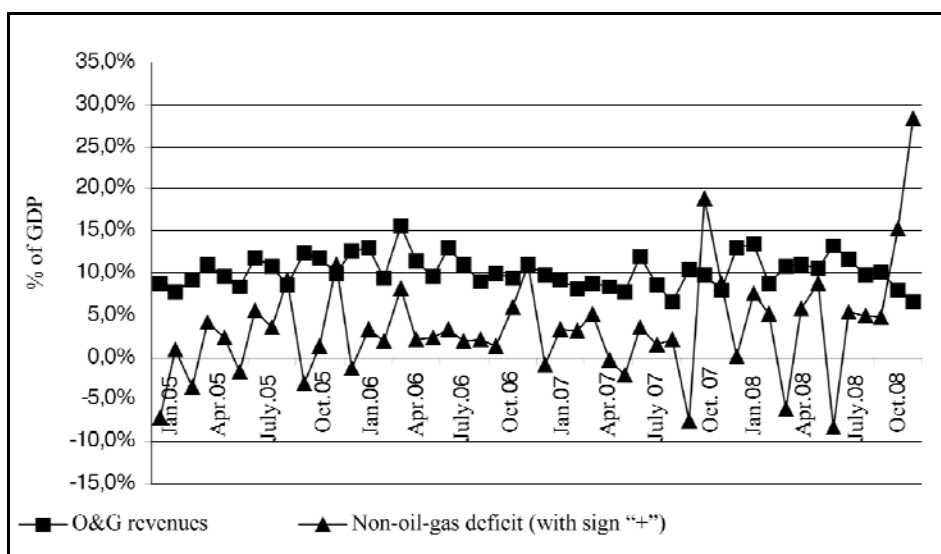
As evidenced by *Fig. 11*, in 2008, the share of oil-and-gas revenues to the federal budget in GDP fluctuated within the range between 6.6 and 13.4%. Affected by the aggravating state of affairs on the world market for oil, the indicator declined steadily in the second half-year. However, it should be noted that despite some decline, the proportion of O&G revenues still is fairly high.

Meanwhile, the 2008 value of the non-oil-and-gas deficit of the federal budget was over 5% of GDP during nearly the whole year, except for the three months the budget was running a surplus. This evidences retention of serious market risks facing Russia's public finance system. One cannot help noticing a sharp rise in the non-oil-and-gas deficit of the federal budget by the end of the year, when it hit a record-breaking value (23.8% of GDP) ever observed over the period between 2005 and 2008. The increase in expenditures in shares of GDP at the end of the year, that engendered such a deficit, is mostly related to the traditional unevenness of execution of expenditure obligations and the decline of the nominal GDP in December 2008 (tentatively at some 4.5% vs. December 2007).



Note: the monthly GDP was calculated on the basis of the Rosstat quarterly data and the RF Ministry of Finance's monthly data

Fig. 10. The Dynamic of Tax and Nontax Revenues to the Enlarged government's Budget



Note: the monthly GDP was calculated on the basis of the Rosstat quarterly data and the RF Ministry of Finance's monthly data

*Fig. 11. The average Values of the Oil-and-Gas Revenues and the non-Oil-and-Gas Deficit of the Federal Budget in 2005-2008 (as% of GDP)<sup>3</sup>*

Huge oil-and-gas revenues collected in the prior year allowed a substantial financial reserve in the form of a budget surplus, which made it possible for the government not only to fulfill its expenditure obligations, but also to replenish the Reserve Fund and the National Welfare Fund every month (see *Table 7*).

*Table 7*

**Avenues of the Use of the Oil-and-Gas Revenues to the federal Budget in 2008, as Rb. Bn**

	02.08	03.08	04.08	05.08	06.08	07.08	08.08	09.08	10.08	11.08	12.08	Total
Oil-and-gas revenues	303.4	371.2	328.9	345.4	368.0	391.4	454.6	432.4	435.8	411.8	303.1	4145.8
<b>Avenues of their use:</b>												
On securing the oil-and-gas transfer	303.4	371.2	328.9	345.4	368.0	391.4	26.8	0.00	0.00	0.00	0.00	2135.0
Transfers to the Reserve Fund	0.00	0.00	0.00	0.00	0.00	0.00	420.6	0.00	0.00	0.00	0.00	420.6
Transfers to the National Welfare Fund	0.00	0.00	0.00	0.00	0.00	0.00	7.2	432.4	435.	411.8	303.1	1590.2

*Source:* the RF Ministry of Finance.

The size of the 2008 oil-and-gas transfer<sup>4</sup> was limited with a value equaling 6.1% of GDP. The O&G transfer had already been fully financed by August 2008. Since that moment the government started collecting O&G revenues to the Reserve Fund and the National Welfare Fund. As of the early-2009, the ultimate volume of resources accumulated in these two funds accounted for 9.7% and 6.2% of GDP in Rb. equivalent, respectively.

Furthermore, a rapid depreciation of the Rb. in January 2009 de-facto resulted in the Reserve Fund lacking just 0.7% of GDP to hit its threshold value set for early-February 2009. This means that because of the appreciation of the USD and Euro against the Rb., within a month the Reserve Fund rose just at more than Rb. 830bn, or some 2% of GDP.

The 2009 oil-and-gas transfer was set at the level of Rb. 2,531.1bn, while the January volume of collection of oil-and-gas revenues accounted just for Rb. 243.6bn, or 9.6% of the value of the oil-and-gas transfer. In other words, with this rate of replenishment of the budget, the transfer should be complete only in 10 months. That is why, should the effective prices for hydrocarbon minerals remain unchanged through the year, the nation should not hope for any additional revenues to the Reserve Fund.

In addition to a substantial fall of revenues from the mineral tax and customs duties to the federal budget, according to some moderate projections, the 2009 missing volume of budgetary revenues from other taxes may account for a. 2.9-3.3% of GDP. Hence, the bulk of the burden of execution of the undertaken expenditure obligations will be laid upon the Reserve Fund. Its resources undoubtedly appear sufficient to execute all the obligations stipulated in the 2009 Federal Budget Act. However, given the unforeseen expenditures (the anti-crisis package of measures on stabilization of the financial market, support of individual sec-

<sup>3</sup> The non-oil-and-gas deficit is shown in the Figure with the sign “+” for a more demonstrative comparison with the volume of oil-and-gas revenues. Also, it must be noted that while calculating the non-oil-and-gas deficit, we did not take into account revenues from managing the Stabilization fund of RF (since 2008 – the Reserve Fund and the National Welfare Fund, because the accurate monthly data on these indicators is hardly accessible

<sup>4</sup> The oil-and-gas transfer is a fraction of the federal budget funds used to finance the oil-and-gas deficit of the federal budget at the expense of oil-and-gas revenues and resources of the Reserve Fund

tors of the economy, and social protection of the population the RF Ministry of Finance introduced to the government on March 19, 2009, in the form of amendments to the 2009 federal budget), a long-standing nature of the crisis, unpredictability of exchange rate fluctuations, stability of the budgetary system in the medium term depends on changes of a general vector of the budgetary policy towards restricting public expenditures and increasing requirements to their efficiency.

### 2.2.2. Analysis of execution of the federal budget of RF in 2008

In the initial draft of the bill on the 2009 federal budget, revenues to the federal budget were planned to make up Rb. 6,644.4bn, or at 4.6 p.p. down against the actual execution of the revenue part of the 2007 budget (*Table 3*). The planned for 2008 budget decrease of the share of revenues in GDP compared with the prior year was determined by extremely cautious projections of the 2008 values of Russia's main macroeconomic parameters and prices for minerals in particular. Meanwhile, the 2008 projection of the federal budget revenues, less contributions to the Stabilization Fund of RF (the Reserve Fund and the National Welfare Fund), was even increased at 0.5% of GDP compared with the level of the actual execution in 2007.

Despite a rapid downfall in oil prices since August 2008, their average annual values ultimately proved to be greater than those set in the 2008 budget. As in 2007, it likewise helped to outperform the plan with respect to revenues to the budgetary system. Accordingly, amendments to the Federal Budget Act implied an increase of its revenues up to Rb. 8,965.7bn and an increase of expenditures up to Rb. 7,773.8bn.

*Table 8*

### Main Characteristics of the Federal Budget of RF in 2008

	For reference: executed in 2007		2008 – the Act		2008 the amended Act		2008 - execution	
	Rb. bn	% of GDP	Rb. bn	% of GDP	Rb. bn	% of GDP	Rb. bn	% of GDP
<b>Revenues, including:</b>	7 779.1	23.6%	6 644.4	19.0%	8 965.7	21.2%	9 274.1	22.3%
tax revenues	7042.0	21.3%	–	–	–	–	8817.6	21.2%
nontax revenues*	737.1	2.3%	–	–	–	–	456.5	1.1%
<b>Contributions to the Reserve Fund and the National Welfare Fund (Stabilization Fund)</b>	1 903.1	5.8%	248.1	0.7%	2 114.0	5.0%	2 342.6	5.6%
Revenues, less funds subject to collection to the Reserve Fund and the National Welfare Fund	5 876.0	17.8%	6 396.3	18.3%	6 851.7	16.2%	6 931.5	16.7%
<b>Expenditures, including:</b>	5 983.0	18.1%	6 570.3	18.8%	7 737.8	18.3%	7 566.6	18.2%
interest expenditures	143.1	0.4%	187.9	0.5%	157.4	0.4%	153.3	0.4%
non-interest expenditures	5 839.9	17.7%	6 382.4	18.2%	7 580.4	17.9%	7 413.3	17.8%
<b>The federal budget surplus</b>	1 796.1	5.5%	74.1	0.2%	1 227.9	2.9%	1 707.5	4.1%
Surplus /deficit (less funds sub- ject to collection to the Reserve Fund and the National Welfare Fund )	–107.0	–0.3%	–174.0	–0.5%	–886.1	–2.1%	–635.1	–1.5%
<b>GDP (estimates)</b>	<b>32 987</b>		<b>35 000</b>		<b>42 240</b>		<b>41 540</b>	

\* including uncompensated receipts.

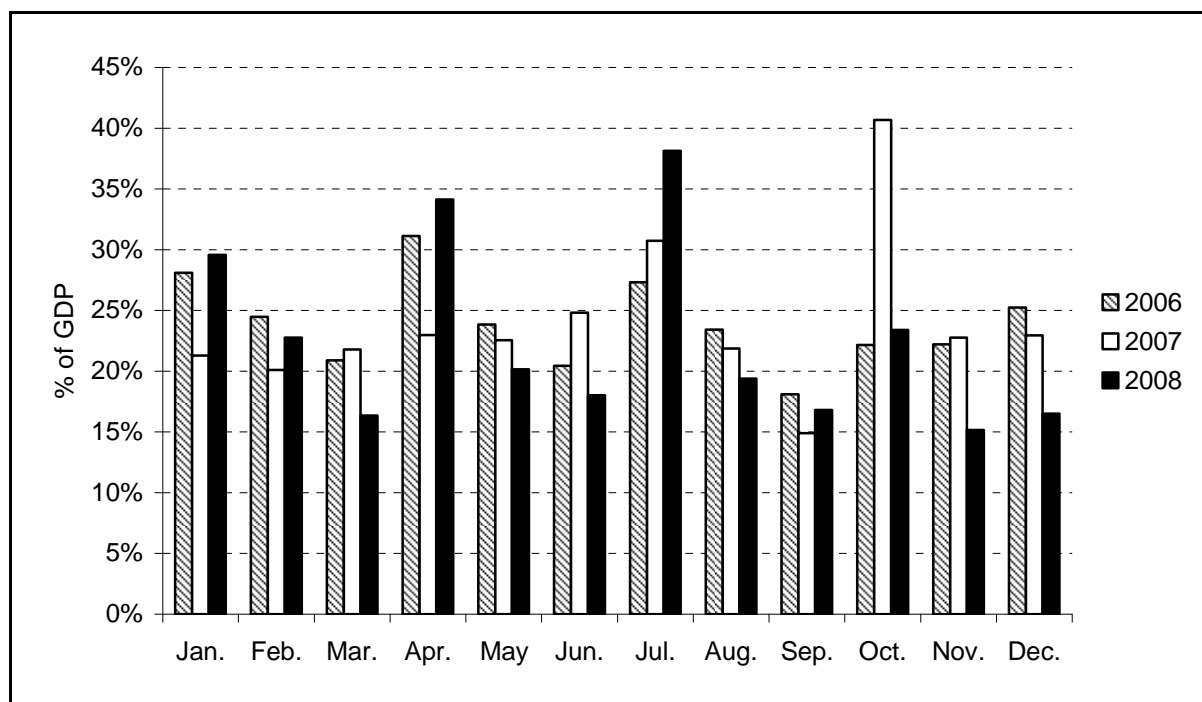
Source: the RF Ministry of Finance, the IET calculations.

*Fig. 3* presents the monthly dynamic of revenues to the federal budget in 2006-2008. It is worth noting a dramatic fall in the share of revenues in GDP over the last months of 2008

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compared with the respective periods of 2006 and 2007. That was steered by the deteriorating situation in the foreign trade area and the unfolding of the financial crisis at the end of the year (see *Table 4*). If not for a concomitant drop of the nominal GDP in December 2008, the fall in revenues in shares of GDP in December would have been yet more notable.



*Fig. 12* The Federal Budget Revenues in 2006-2008 (as% of GDP)

*Table 9*

### Oil Prices in 2005–2008 *rr.*<sup>5</sup>

The average level of Urals price, as USD/barrel	2005	2006	2007	2008
January	40.02	59.18	49.79	89.61
February	40.65	56.37	53.73	92.01
March	47.87	57.53	58.69	100.14
April	46.86	65.17	63.88	105.18
May	44.66	64.33	64.09	118.39
June	50.94	63.85	68.05	127.38
July	54.84	68.93	74.37	129.45
August	58.72	68.64	68.82	111.31
September	57.91	58.52	74.17	96.26
October	54.81	54.65	79.55	69.72
November	51.55	55.18	90.06	50.53
December	53.57	58.35	87.94	38.50
<b>Averaged over the year</b>	<b>50.20</b>	<b>60.89</b>	<b>69.43</b>	<b>94.04</b>

*Source:* the data of the Federal Tax Service of RF.

<sup>5</sup> These prices are used for purposes of taxation.



Intensification of the unevenness of the monthly dynamic of execution of the federal budget revenues in 2008 was to a significant extent determined by transition towards VAT collection on the quarterly basis (see above). Plus, the decline in business activity noted in the 4<sup>th</sup> quarter, due to the rise of crisis developments in the economy, manifested itself in falling volumes of revenues to the federal budget. To give a specific example, in the 4<sup>th</sup> quarter of the year the federal budget saw a considerable (at Rb. 665bn) fall in revenues vis-à-vis the prior quarter.

Against the background of the decline in budget revenues in shares of GDP equivalent against 2007, the softening of the budgetary policy was giving rise to a continuous growth of the expenditure part of the budget. Originally, the federal budgetary expenditures were set at the level of Rb. 6,570.3bn, or at 0.7 p.p. higher than in 2007 (see *Table 8*). Capitalizing on a favorable state of affairs in the foreign trade area has led to the approval of specified budgetary expenditures at a level being at Rb. 1,167.5bn greater than in the initial draft of the Federal Budget Act.

It should be noted that the allocation of budgetary funds in the late-2008 on financing the anti-crisis measures on support of the real sector and ensuring the banking sector's stability became possible thanks to the redistribution of the federal budgetary expenditures. Hence, by results of 2008, there was noted a notable rise in shares of GDP equivalent of expenditures on "The National Economy" item (at 0.4 p.p. against the 2007 figures), while expenditures on general government issues slid at 0.45 p.p. The traditional growth in interbudgetary transfers (at 0.7 p.p.) coincided in time with a 0.6 p.p. fall of expenditures on housing and utilities, which was related to the establishment in 2007 of a public corporation "The Fund for Assistance to the Housing and Utilities Complex Reform". The truth is, the federal budget expenditures on formation of the corporation's capital were inserted in a respective item under the "Housing and utilities Complex" section. That is why the year of 2007 saw a substantial rise in spending on the HUS as percentage of GDP (from 0.2% to 0.9% of GDP) against the 2006 figures. In the absence of such expenditures in 2008, the level of financing of this particular section was back to its normal level and accounted for some 0.3% of GDP.

The federal budgetary expenditures ultimately retained their stability – in 2008, they were executed at the level of 18.2% of GDP, or at 0.1% greater than in 2007.

The situation with the execution of expenditure obligations on the cash basis over the financial year still was unsatisfactory. While there were some minor positive shifts in this area compared with 2007 (by results of the first half-year the execution on the cash basis grew from 33.2% in 2007 to 38.7% in 2008), the tendency to expenditures growing by the end of the year has remained unchanged (*Table 10*).

It was the "Housing and utilities" item by which execution of expenditure obligations by the end of the year proved to be the worst one. By contrast, main directions of the social sphere were financed at the level of 99.7% on average. It should be particularly emphasized that execution of expenditures on the cash basis by the priority national projects improved notably – in 2008, it accounted for 94.5% vs. 82.1% in 2007 and 81.0% in 2006.

However, traditional causes for government agencies spending the budgetary funds unevenly, which manifested themselves in failures to meet timelines of conclusion of contracts on placement of orders on delivery of goods (works, services) for public needs, failures to meet contract timelines, the absence of documents needed for execution of the federal budget, etc. fall short of providing a comprehensive explanation of a record-breaking rise in the share of expenditures in GDP in December 2008 ( see *Fig. 13*). We assume that the rise in the

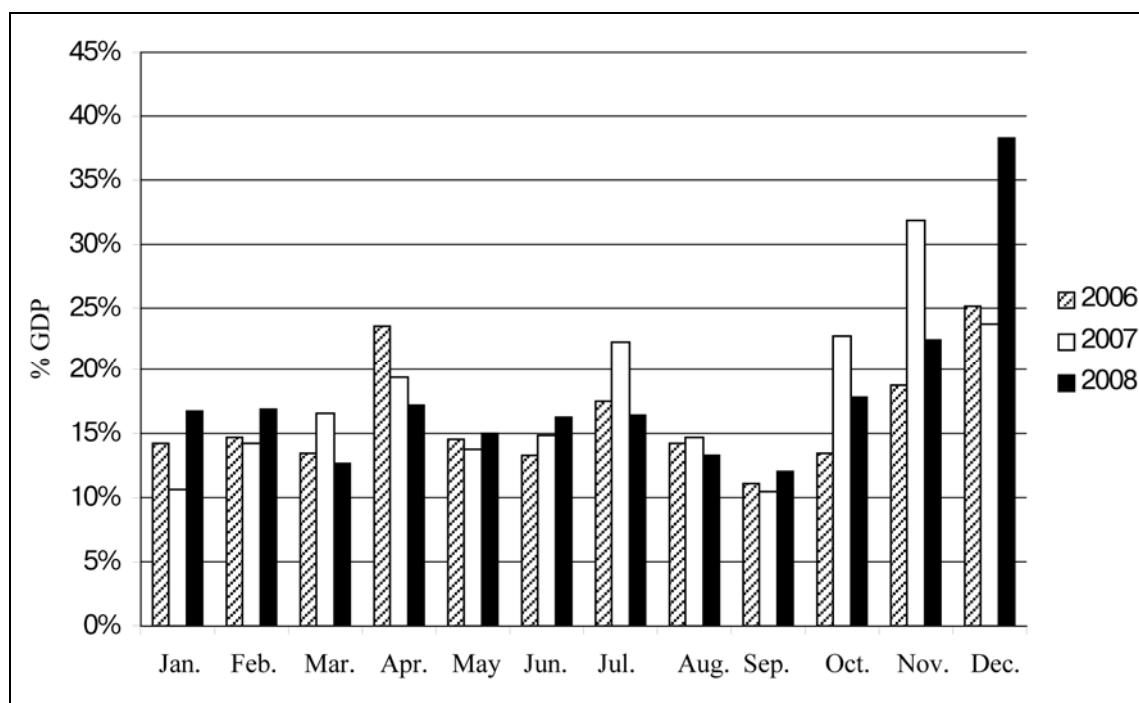
share of expenditures in GDP in November and December 2008 was to some extent fueled by the fall in the nominal GDP at the end of the year, due to the decline in business activity in the country, which was affected by the crisis developments in the national economy and world-wide.

*Table 10*

**Execution of the Federal Budget on the Cash Basis in 2008  
(as% to the Budget Estimate over the Year)**

	1st quarter	1 <sup>st</sup> half-year	9 months	Year
<b>EXPENDITURES</b>	17.2%	38.7%	59.4%	97.8%
General government issues	22.3%	40.4%	61.4%	91.6%
of which: the public debt servicing	33.8%	47.6%	83.2%	97.4%
National defense	16.9%	39.9%	59.3%	99.7%
National security and law enforcement	19.4%	43.0%	65.9%	99.9%
National economy	8.2%	26.3%	42.0%	96.3%
Housing and utilities	2.6%	11.2%	24.8%	93.6%
Environment	13.1%	36.8%	60.0%	98.8%
Education	13.4%	37.6%	58.4%	101.1%
Culture, cinematography and mass media	13.7%	40.6%	60.5%	100.5%
Health care and sport	12.3%	33.7%	56.9%	98.9%
Social policy	22.9%	44.8%	68.5%	98.4%
Interbudgetary transfers	19.8%	42.6%	64.6%	98,6%

*Source:* the RF Ministry of Finance, the IET calculations.



*Fig. 13.* The Federal Budget Expenditures in 2006-2008 (as% of GDP)

Clearly, the negative external background and fall in revenue volumes from the domestic taxes necessitate pursuance of a more conservative budgetary policy. Such a policy should rest upon the seeking of a proper balance between obligations undertaken and possibilities for their financing. One of directions of scaling back the federal budget expenditures can be revision of volumes of financing of the priority national projects. The fact is, the absence of a systemic approach to shaping their contents has led to an annual extension of the list of directions and measures of the government support. Hence, additional budgetary expenditures (to finance new bottlenecks, such as, for instance, getting schools connected to the Internet subsequently required payments for the Internet traffic, while the respective costs had not been foreseen in municipal budgets).

The implementation of the national projects generates additional expenditure obligations for the regional governments, too. The problem is, the spheres picked as the national projects mostly fall within the regional governments' mandate. Intervening in the regional governments' area of competence, the national projects generate for them latent unfunded expenditure mandates, such as:

- in the frame of projects “Education” and “Healthcare”, additional stimuli and pay rises for individual categories of the so-called “budgetary” employees take place against the background of retention of a planned rise in labor compensations across the educational and healthcare sectors on the whole. To keep the staff, the regional authorities' natural reaction was compulsory pay rises for the other categories of employees in these sectors;
- the national projects do not provide in full for financing expenditures on maintenance and repair of high-tech medical equipment and training of specialists who are supposed to operate it.

### 2.2.3. Analysis of collection of main taxes to the budgetary system of RF

In his 2008 Budgetary Address to the Federal Assembly, President enunciated continuation of the course to lowering dependence of the budgetary revenues on the world prices as one of key priorities of, and guides for the national fiscal and budgetary policy. The rapid aggravation of the state of affairs in the foreign trade area in the second half of 2008 generated prerequisites for a compulsory realization of the President's thesis – the crisis made the need for seeking ways to compensate for the falling oil-and-gas budgetary revenues a pressing challenge. By results of 2008, the contraction in the tax revenue collection to the enlarged government's budget accounted for some 1 p.p. of GDP. The government has managed to avoid a more dramatic decline in budgetary revenues only thanks to sky-high prices for energy sources on the world markets over the first half of the year.

Another guide of the recent Budgetary Address was easing the tax burden on the economy. *Table 11* displays the dynamic of the tax burden on Russia's economy in 2001-2008 and proves that it has been fluctuating just insignificantly, being within the range between 35.3% - 36.3% of GDP.

Table 11

**The Dynamic of the Level of Tax Burden and Collection of Main Taxes to the Budget of the Enlarged Government of the Russian Federation in 2000–2008 (as% of GDP)**

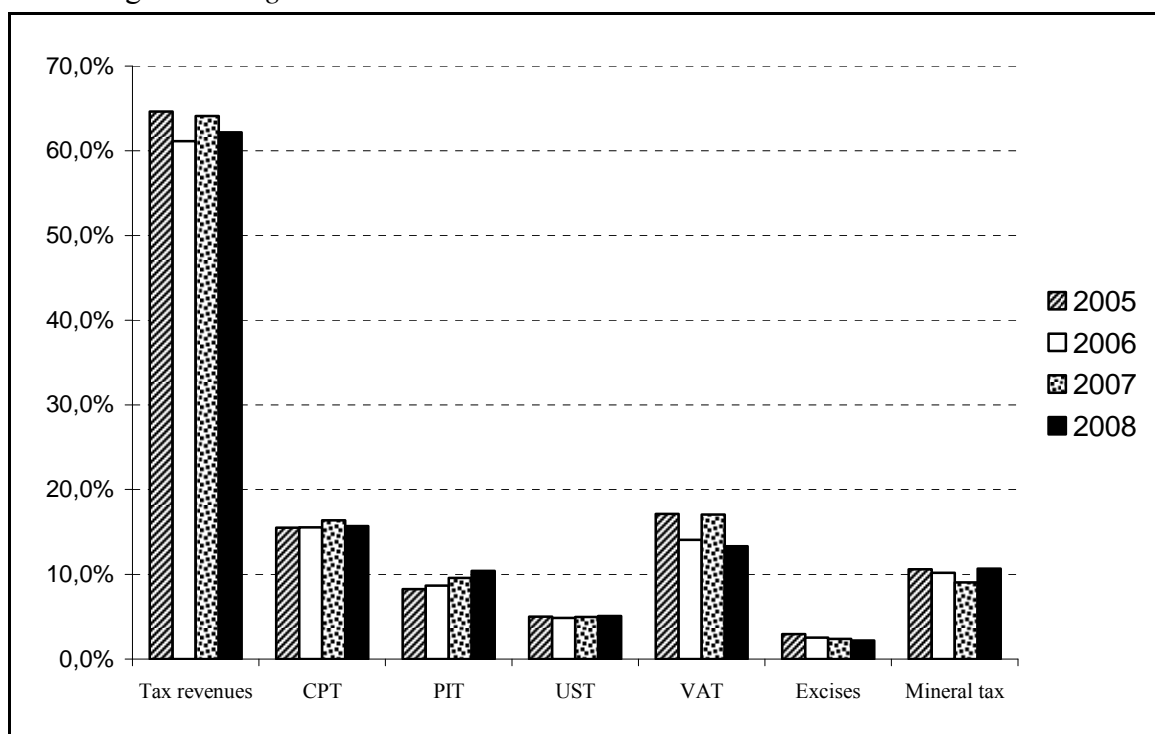
	2001	2002	2003	2004	2005	2006	2007	2008
<b>The level of tax burden (1+2+3)</b>	<b>36,17</b>	<b>36,29</b>	<b>35,28</b>	<b>35,82</b>	<b>36,30</b>	<b>35,94</b>	<b>36,06</b>	<b>35,58</b>
Tax receipts (1), including:	31,96	29,80	28,21	27,47	25,65	24,44	25,74	23,95
Corporate profit tax	5,75	4,28	3,98	5,09	6,16	6,21	6,58	6,05
Personal income tax	2,86	3,31	3,44	3,37	3,27	3,46	3,84	4,01
Uniform Social Tax*	5,79	4,13	3,68	3,49	1,99	1,94	1,98	1,95
VAT	7,17	6,96	6,66	6,27	6,81	5,62	6,86	5,13
excises	2,72	2,44	2,59	1,43	1,17	1,01	0,95	0,84
Mineral tax**	0,74	2,55	2,50	2,99	4,20	4,07	3,63	4,11
Insurance premiums on the compulsory pension insurance (2)	0,00	2,76	2,94	2,80	2,88	2,93	3,05	3,00
Revenues from foreign trade (3)	4,21	3,73	4,13	5,54	7,77	8,57	7,27	8,63

\* without regard to insurance premiums on the compulsory pension insurance.

\*\* for 2001- the value of mineral extraction fees instead of the mineral tax

Source: the RF Ministry of Finance, Rosstat, the IET calculations

The 2008 volume of tax revenues to the budgetary system tumbled by 1.8 p.p. of GDP vs. the prior year's figures. The structure of tax revenues to the budget of the enlarged government is given in Fig. 14.



\* without regard to insurance premiums on the compulsory pension insurance

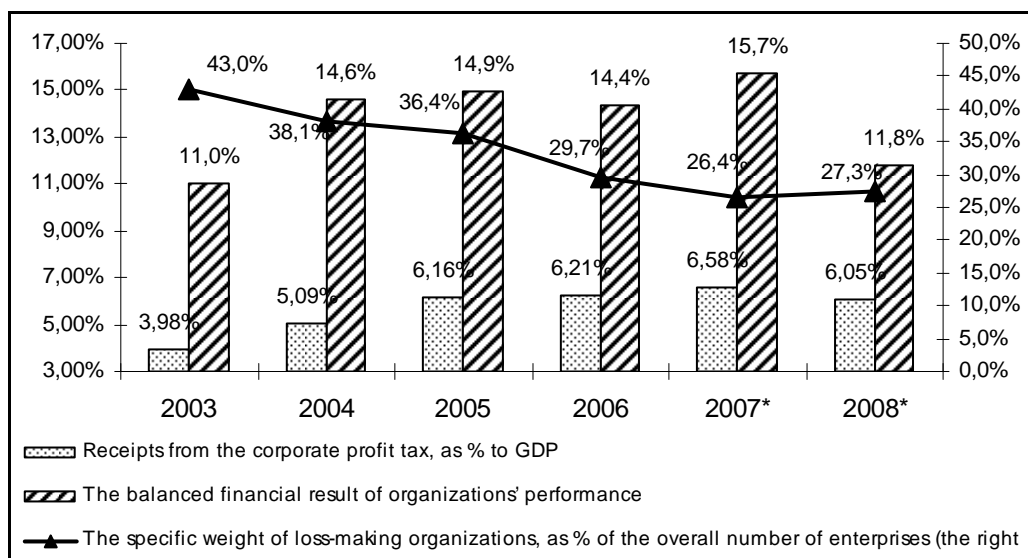
Fig 14. The Proportion of the Tax Revenues in the Aggregate Revenues to the Budget of the Enlarged Government in 2005–2008, as%

The 2008 structure of tax revenues underwent notable changes. More specifically, revenues from VAT plunged below their 2006 level; also, revenues from the corporate profit tax were on decline. These were crucial factors behind a substantial fall in tax revenues to the budget of the enlarged government vs. the 2007 level. However, it should be noted that notwithstanding some expectations, the proportion of the mineral tax in GDP and the amount of revenues from foreign trade did not share the path of the 2007 indicators – on the contrary, budgetary revenues from these specific taxes were on the rise in 2008. It should also be noted that in the period of 2005-08 there were noted sustained trends to rise in the share of the personal income tax, fall in the share of excises, and stabilization of the proportion of UST in GDP.

In 2009, let alone an expected decline in oil-and-gas revenues, it is the corporate profit tax, VAT, personal income tax and UST the budgetary revenues from which are envisaged to fall most dramatically, as they would be affected by aggravation of the corporations' financial standing, contracting business activity, growth in the number of the unemployed, and a general fall in incomes from labor and entrepreneurship activities. It is going to be property-related taxes (the corporate property tax, the land tax, the transport tax, etc.) revenues from which should remain stable in the crisis conditions; however, should the crisis persist for long, these revenues should tumble, too.

***The corporate profit tax***

In 2008, revenues from the corporate profit tax plunged at 0.5 p.p. compared with the 2007 figures and accounted for 6.05% of GDP. The main causes behind the fall were the slump in business activity and the downfall in oil prices. All this resulted in the rise of the specific weight of loss-making corporations in the economy, while the net balanced financial result of enterprises and organizations' performance in shares of GDP reported in 2008 evidences the tax base contracting with respect to the corporate profit tax (see Fig. 15).



\* The values of the balanced financial result of organizations' performance and the specific weight of loss-making organizations are given by results of 11 months of 2007-2008

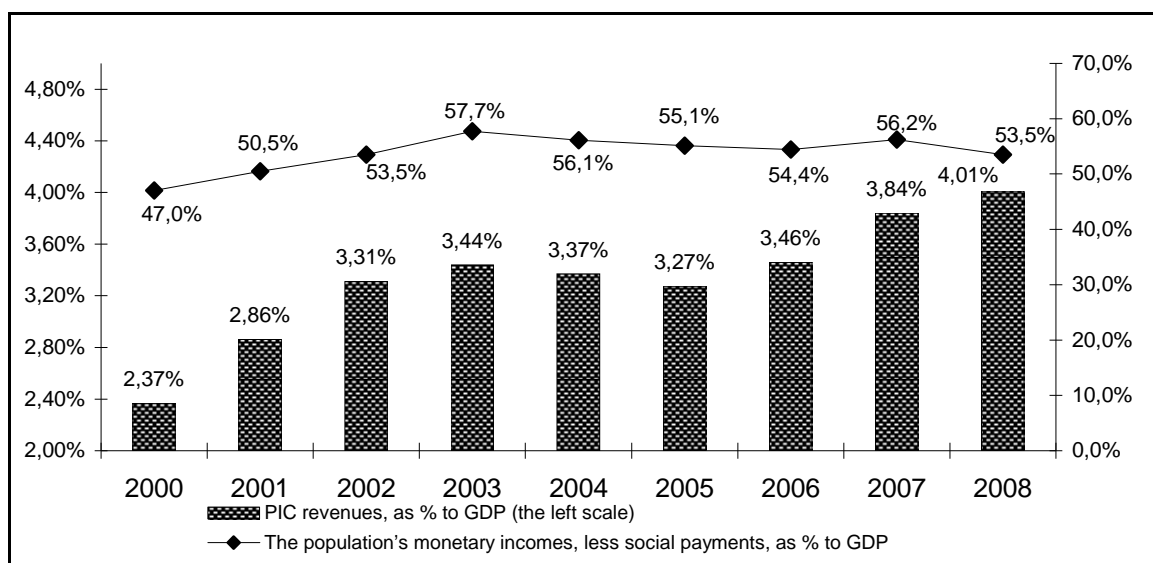
*Fig. 15. The Dynamic of Revenue Collection from the Corporate Profit Tax to the Budgetary System of RF, the balanced Financial Result of organizations' Performance and the proportional Weight of Loss-Making Enterprises in 2003-2008*

The following modifications of the tax law ensured some constraining impact on the dynamic of revenues from the corporate profit tax:

- the write-off of a debt before the state extrabudgetary funds is not recognized as proceeds (sp. 21 p.1. art. 251 of the tax Code of RF);
- it is allowed to apply zero rate of the corporate profit tax to incomes in the form of dividends, providing compliance with conditions stipulated in sp. 1. p.3. art. 284;
- the right is granted to apply to the basic depreciation rate a special coefficient, which should not be over 3 with regard to depreciated fixed assets utilized solely for the sake of R&D;
- the timeline of effect of zero rate of the corporate profit tax for agrarian producers was extended for 2008;
- the marginal size of R&D expenses effected in the form of contributions to formation of the Russian Fund for Technological development and other sectoral and inter-sectoral funds registered in the order as per the Federal Act “On science and the public research and technical policy” recognized for the taxation purposes was increased from 0.5 up to 1.5% of the taxpayer’s income (gross earnings).

***The personal income tax***

The trend to growth in the PIT revenues started in 2005 and continued through 2008, when the revenues in question broke a new record of 4.01% of GDP, or nearly at 0.2 p.p greater than in the prior year. Interestingly, the growth took place against the background of the population’s monetary incomes, less social payments, falling at 2.7 p.p. of GDP (see Fig. 16).



*Fig. 16. The Dynamic of Revenue Collection from PIC to the Budgetary System of RF and the Population’s Monetary Incomes Less Social Payments in 2000-2008*

Contraction of the tax base of the personal income tax was caused particularly by changes in legislation effective as of January 1, 2008, in compliance with the following items were exempted from PIC:

- grants on support of science, education, culture and fine arts in the Russian Federation awarded to private individuals by Russian organizations, the list of which is subject to the RF government’s approval;

- sums of nonrecurrent material aid provided to parents, adoptive persons, *in loco* parents against the birth (adoption) of a child within the limit of Rb. 50,000 per each child;
- the marginal amount of per diem up to 700 Rb. per every day of a business trip within the territory of the Russian Federation and up to Rb. 2,500 per every day of a business trip overseas.

The multidirectional dynamic of the population's real incomes, less social payments, and collection of the personal income tax under retention of the basic tax rates and some extension of tax remissions in the part of the tax collection presented by *Fig. 16* gives an illustrative evidence of the improving tax administration.

***The uniform social tax***

Despite the rise of the proportion of the labor compensations fund in GDP in 2008 against the 2007 figures (at 0.36 p.p. of GDP), revenues from UST and premiums on the compulsory medical insurance plunged at 0.08 p.p. of GDP. The fall is determined primarily by the regressivity of the UST scale and the absence of its indexation. This has entailed the situation in which a rise in salaries and wages in nominal terms lowers the effective UST rate.

In the conditions of economic growth, with the advanced rate of the population's incomes, the pace of growth of the UST base appeared greater than the pace of decline of its efficient rate. As a result, the respective revenues even posted growth in percentage to GDP. Such a situation was noted over 2006-2007. But in 2008 the rise in the tax base fell short of compensating for the decrease of the effective rate of UST and the revenues from this tax were on decline.

*Table 12*

**Comparison of the Dynamic of Collection of Revenues from UST with the Dynamic of the Labor Compensations Fund in 2001–2008, as% to GDP**

	2001	2002	2003	2004	2005	2006	2007	2008
Revenues from UST (without regard to the CMI premiums)	5.79	4.13	3.68	3.49	1.99	1.94	1.98	1.95
Premiums on the compulsory medical insurance	0.00	2.76	2.94	2.80	2.88	2.93	3.05	3.00
Revenues from UST and the CMI premiums combined	5.79	6.89	6.61	6.29	4.87	4.86	5.03	4.95
Labor compensations fund*	43.03	46.77	47.05	46.02	43.81	44.55	46.27	46.63

\*labor compensations to employees (including latent labor compensations and mixed incomes).

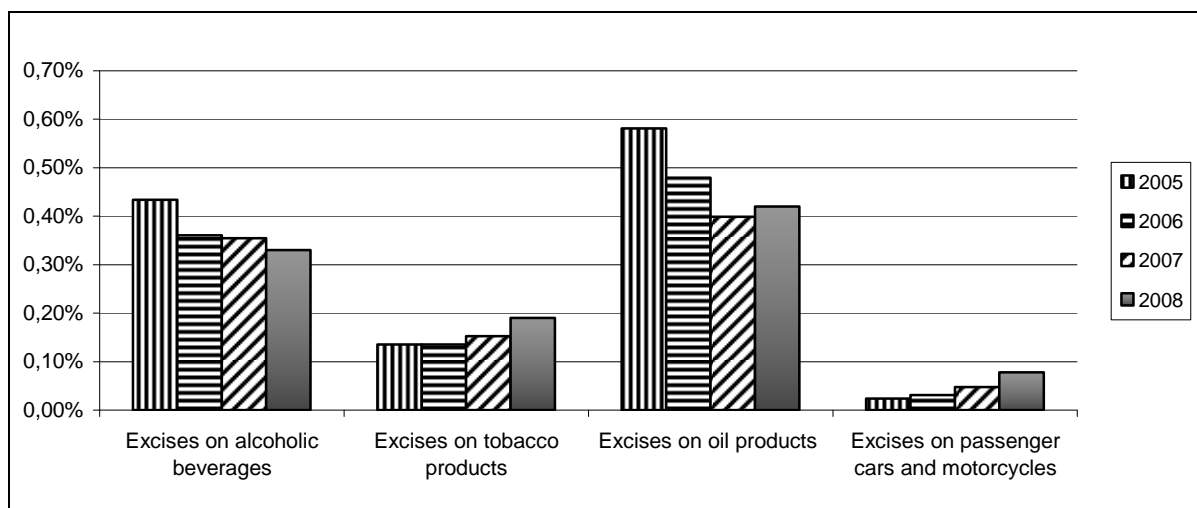
Source: the Federal Tax Service of RF, Rosstat

***Excise taxes***

In 2008, the volume of tax revenues to the budgetary system from excises was Rb. 350bn in absolute terms vs. 314bn. The rise was powered by indexation of specific excise rates at a pace that outran the inflation rates and by the expansion of the tax base. However, in relative terms the revenues from excises tended to decline. The tendency had started back in 2004, and in 2008 the revenues from excises in relative terms accounted for 0.84% of GDP vs. 0.95% of GDP reported in 2007.

Back in 2007, the government promulgated Federal Act №75-FZ “On introducing amendments to article 22 of Part two of the Tax Code of the Russian Federation”, which has set the formula of indexation of excise rates on excised merchandise for 2008-2010. The dynamics of indexation of excise rates on different groups of goods vary substantially. More specifically, while excise rates on oil products, tobacco and cigars remained unchanged, those

on alcoholic beverages and passenger cars were raised at 7%, while excises for cigarettes were up at more than 23%<sup>6</sup>.



*Fig. 17. Collection of Excise Revenues by Groups of Excised Merchandise, as% of GDP*

The general trend of the period between 2000 and 2008 became the growth rates of the tax base by all the excised commodity groups, except for alcoholic products, falling behind the dynamic of the real GDP, which in large measure explains contracting volumes of collection of excises to the national budgetary system.

***The value added tax***

The year of 2008 saw a permanent stability of the tax base of VAT levied on sales of goods (works, services) on the domestic market, as evidenced by the dynamic of final consumption cleared from VAT and fluctuating since 2004 within 1 p.p. of GDP (see *Table 13*)<sup>7</sup>.

Import in 2008 likewise continued the earlier started upward trend and by results of the year accounted for 16.0% of GDP vs. 15.5% registered in 2007. So, despite some deceleration of economic growth in the 4<sup>th</sup> quarter of the prior year, the dynamics of main macroeconomic indicators were generating quite positive prerequisites for growth in revenues from VAT over the above period of time.

*Table 13*

**The Dynamics of Final Consumption, Import and Collection of VAT in the Budgetary System of RF in 2000–2008 (as% of GDP)**

	2000	2001	2002	2003	2004	2005	2006	2007	2008
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<sup>6</sup> Thus, in 2008, the indexation of excise rates on cigarettes concerned both the specific part of the rate and the ad-valorem one. While in 2007 the excise rate on filter cigarettes was Rb. 100 per 1,000 pcs+ 5% of the estimated value, but not less than Rb. 115 per 1,000 pcs, the 2008 rate was Rb. 120 per per 1,000 pcs+ 5.5% of the estimated value, but not less than Rb. 142 per 1,000 pcs .

<sup>7</sup> We believe that as far as a macroeconomic characteristic of the tax base of VAT is concerned, it would be more appropriate to employ the value estimate of final consumption in market prices, less the tax, rather than the whole value added or GDP. Such an approach is quite fair, as the value added tax is a tax on consumption and as such it is not used for the sake of levying investment activities (the sum of the tax by capital goods is subject to reimbursement (rebate)), whose results are also reflected in the nation’s GDP.



	2000	2001	2002	2003	2004	2005	2006	2007	2008
Revenues from VAT, less revenues from YUKOS	6.20	7.17	6.96	6.66	6.27	6.17	5.62	6.13	5.13
Final consumption (less computed by tax returns VAT)	n/a	59.1	61.5	61.4	60.8	60.1	60.6	60.1	60.9*
Import**	13.0	13.7	13.4	13.3	12.8	12.9	13.9	15.5	16.0

\* preliminary estimate

\*\* The share of import in GDP was calculated as correlation between values of import according to the customs statistical data and GDP in USD equivalent computed on the basis of values of the average USD/Rb. nominal exchange rate in the respective year.

Source: Rosstat, the RF Ministry of Finance, the Federal Customs Service, the IET calculations.

However, against the background of an insignificant expansion of the tax base, there was no rise in revenues to budgets from VAT in relative terms in 2008. On the contrary, the share of VAT tumbled and accounted for 5.13% of GDP, or at 1 p.p. down vs. its respective value of 2007 (at the same time, from the volume of actual VAT-generated revenues was deducted a value equaling to the amount of repayment of YUKOS's tax arrears (some 0.7 p.p. of GDP).

The main factor underpinning such a failure by the budget to collect revenues from VAT is the transition to payment of the domestic VAT on the quarterly basis. Thus, when compared with 2007, the VAT revenues over the 4th quarter of 2008 were not collected within the same year. Plus, the VAT collection statistics in the last quarter was under an adverse effect of the growing liquidity shortages in the corporate sector and an accelerated reimbursement of VAT from the budget. More specifically, in the 4th quarter 2008, the revenues from the domestic VAT, which accounted for 1.84% of GDP, were not just substantially inferior to the respective index of the prior year's analogous period (4.87% of GDP), but dwindled notably vis-à-vis the preceding quarter of 2008 (3.13% of GDP).

The fall in collection of VAT-related revenues over the year found itself under a certain impact of growth in tax rebates and extension of the list of operations exempted from VAT. Specifically, since 2008 the following operations have been exempted from VAT:

- Sales of exclusive rights on inventions, useful models, industrial samples, software, databases, topologies of integral chips, know-how, and rights for the use of the said products of intellectual activity on the basis of a license agreement;
- Conduct of R&D and technological works pertaining to creation (improvement) of new products and technologies;
- Conduct of works (delivery of services) within territories of port economic zones by their residents.

Along with that, the government specified the list of cases in which sums of received forward payments are not included in the VAT tax base: against the upcoming shipping of goods (conduct of works, provision of services) the length of the production cycle of manufacture of which is over 6 months (providing compliance with the conditions stipulated in the Tax Code of RF); against delivery of goods (works, services) which are subject to 0 VAT rate in compliance with p.1 art. 164 of the Tax Code of RF; and against delivery of goods (works, services) which are not subject to taxation (tax exempt).

The use of the 10% preferential rate of VAT is permitted in the event of sales (importation) of medicines designated for running clinical tests (pp. 4. p. 2 art 164 of the Tax Code of RF).

***The mineral tax***

In 2008, the revenues from this tax collected from oil companies accounted for 94% of the overall amount of the respective revenues. Accordingly, the dynamic of overall revenues from the MT to a critical extent is determined by factors that form tax revenues from the oil sector, that is, the volume of oil output, the level of the world oil prices, and the dynamic of the USD exchange rate. Though in the second half of 2008 oil prices tumbled more than 3-fold, the average annual price level was notably greater than in 2007, nonetheless. That was the main cause behind the rise in the share of the MT in GDP up to 4.11% against the backdrop of stabilization of oil output and production of gas condensate, as well as the 2008 unchanged basic rate of the mineral tax (see *Table 14*).

*Table 14*

**The Dynamic of Revenues from the Mineral Tax and Main Macroindicators in 2002–2008**

	2002	2003	2004	2005	2006	2007	2008
MT, as% to GDP	2.55	2.50	2.99	4.20	4.07	3.63	4.11
Oil output, including gas condensate, as m.t.	379.6	421.4	458.8	470.0	480.5	491.0	488.0
The average annual price level for URALS, USD/barrel	23.43	27.07	34.57	50.20	60.89	69.43	94.04

*Source:* Rosstat, the Federal Tax Service’s data, the IET calculations.

In addition to the average annual rise in world prices for oil, it was depreciation of the Rb. that notably affected the level of collection of the mineral tax<sup>8</sup> - in 2008, the Rb. plunged against the USD at 3.5Rb., or 14.5%, with the greatest rate of the depreciation falling on the 4<sup>th</sup> quarter of the year, thus somewhat compensating for a rapid fall in the MT rate due to the downfall of the world prices for oil.

**2.2.4. Expenditures of the Budgetary System**

Main characteristics of the expenditure part of the RF budgets of all the levels are given in *Table 15*.

The most considerable volumes of financing were earmarked in 2008 on sections “Social policy”, “National economy”, “Education”, “Healthcare and sport”. Their share combined in the overall amount of the enlarged government’s expenditures surged to 64.8% vs. 62.3% reported in 2007.

In 2008, the expenditure structure of Russia’s budgetary system underwent no fundamental modifications. By results of the year it was only two sections of the fundamental classification by which expenditures were increased. Those were “National economy” (up at 0.7p.p. of GDP) and “Social policy” (0.4 p.p. of GDP). Meanwhile, the following sections saw a fall in the respective expenditures in shares of GDP: “Housing and utilities” (down at 0.6 p.p.), “Healthcare and sport” (0.5 p.p.), “General government matters” (0.4 p.p.). All the other sections remained practically unchanged.

<sup>8</sup> The USD/Rb/ exchange rate is used to calculate the oil price dynamic coefficient which is employed for the purpose of calculation of the MT rate with regard to oil production.

Table 15

**Expenditures of the Enlarged Government in 2005–2008 (as% of GDP)**

	2005	2006	2007	2008	the 2008-to-2007 rise
EXPENDITURES	31.54	31.19	34.09	33.68	-0.41
General government matters	3.49	3.07	3.54	3.10	-0.44
of which: servicing the public debt	1.11	0.74	0.53	0.46	-0.07
National defense	2.69	2.54	2.53	2.51	-0.02
National security and law enforcement	2.71	2.66	2.62	2.63	0.01
National economy	3.53	3.53	4.73	5.42	0.69
Housing and utilities	2.18	2.35	3.34	2.77	-0.57
Environment	0.10	0.09	0.08	0.08	0.00
Education	3.71	3.84	4.07	4.01	-0.06
Culture, cinematography and mass media	0.71	0.70	0.75	0.75	0.00
Healthcare and sport	3.69	4.00	4.20	3.73	-0.47
Social policy	8.74	8.40	8.24	8.68	0.44
Interbudgetary transfers	x	x	x	x	x

*Source:* the RF Ministry of Finance.

Like in the prior years, a positive development is contraction of the share of expenditures on servicing the public and municipal debts.

In all likelihood, in the conditions of a drastic fall in tax revenues and facing the need to tame inflationary processes and to lower risks of instability of public finance, the proportion of expenditures in the 2009 budget of the enlarged government will be shrinking, but the process should be coupled with compulsory modifications in reserves of financing in favor of anti-crisis expenditures.

Already today the anti-crisis nature of the 2009 budget has manifested itself in reallocation of federal expenditures (according to amendments to the 2009 federal budget considered at the government meeting on March 19, 2009, it was proposed to cut the earlier approved appropriations by Rb. 943.3bn) in favor of financing of priority avenues of the anti-crisis program approved by the RF government. Specifically, it is planned to spend Rb. 1.61trln on measures on stabilization of the financial market, support of certain sectors of the economy, and social support of the population. The banking system is going to receive an additional government support package worth a total of Rb. 300bn.; the agrarian sector is to receive Rb. 45bn via Rosselkhozbank and another 25bn via JSC “Rosagrolizing”, and 17bn. in subsidies to regional budgets to reimburse for the agrarian producers’ interest on loans; small businesses will receive Rb. 6.2bn; JSC Russian Railways – 50bn; automakers – 39bn; and the military and industrial complex – 70bn.

These measures have not come out of the blue – they were implemented to some degree over recent years. But in the present circumstances they formed the *Schwerpunkt* for the government. Hence, the attempt of a comprehensive remedy to the pressing challenges in the noted areas. But these measures are somewhat late already, and they are not preventive ones, as the production slump and the fall in entrepreneurial activity have been already there. It is unlikely that the government would be able to reverse the trend, even by means of additional

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infusions of public funds, while there are no guarantees of their efficient use, but it is quite real to cushion the fall.

As concerns the social component of the anti-crisis package, it is intended to carry out pro-active employment policy measures (with Rb. 43.7bn allocated to this effect), raise unemployment benefits (Rb. 33.9bn), use the maternity capital to repay mortgage loans (Rb. 26.3bn). As a compensation for thus missing revenues, the state extrabudgetary funds should receive Rb. 388.5bn and the RF Subjects Rb. 150bn in additional interbudgetary transfers.

At the end of the day, the aggregate volume of the federal budget expenditures grew at Rb. 667.3bn. vis-à-vis the initially approved volume and now accounts for Rb. 9.69trln. There is a great probability that such an expenditure reallocation in favor of implementation of priority measures of support of the real sector and the population will be noted through the whole year of 2009 on the level of regional budgets, too. Hence, a question arises as to which expenditures will be axed down the road.

The comparative analysis of the functional structure of the enlarged government's expenditures in the OECD countries and RF presented in *Table 16*, allows noting that reserves for such an exercise should be looked for across such sections as "Housing and utilities" (in Russia, these expenditures are on average twice as high as in the OECD countries), "National defense" and "National security". It goes without saying, in the conditions of an objective deterioration of the criminogenic situation in the country, one should exercise a great deal of caution while scaling back expenditures on national security and law enforcement and be at pains to compensate for them by bolstering efficiency of the use of the remaining budgetary funds.

Table 16

### Comparative Analysis of the Functional Structure of expenditures of the Enlarged Government in the OECD Countries and in RF, as% to GDP

	RF				OECD countries (averaged over the period of 2003-2007)								Other OECD countries (averaged over the period of 2003-2007)				
	2005	2006	2007	2008	25 EU countries	UK	France	Germany	Bulgaria	Czech Republic	Romania	Poland	Hungary	Canada	Japan	S. Korea	USA
<i>GDP per capita, USD .m. (2007)</i>	5.3	6.9	9.1	11.8	32.6	35.7	32.7	34.4	5.0	16.2	7.7	10.7	13.4	38.5	33.6	24.8	45.5
<i>Expenditures, total</i>	31.56	31.49	34.09	33.68	47.0	43.3	53.0	46.4	39.5	44.8	34.5	43.3	50.0	39.9	37.4	29.5	36.7
<i>General government matters</i>	3.49	3.10	3.54	3.10	6.4	4.3	7.2	5.7	5.5	4.9	3.7	6.1	9.3	7.8	5.8	3.6	4.8
<i>National defense</i>	2.69	2.57	2.53	2.51	1.6	2.5	1.9	1.0	2.0	1.5	2.5	1.2	1.3	1.0	1.0	2.6	4.2
<i>National security and law enforcement</i>	2.71	2.68	2.62	2.63	1.8	2.5	1.3	1.6	2.9	2.2	2.2	1.7	2.1	1.6	1.4	1.4	2.1
<i>National economy</i>	3.54	3.57	4.73	5.42	3.9	2.9	3.0	3.6	5.0	7.4	5.9	3.9	6.1	3.4	4.0	7.4	3.7
<i>Environment</i>	0.10	0.09	0.08	0.08	0.7	0.7	0.8	0.6	1.0	1.1	0.2	0.6	0.7	0.5	1.3	0.9	0.0
<i>Housing and utilities</i>	2.18	2.37	3.34	2.77	1.0	1.0	1.8	1.0	0.8	1.4	2.0	1.3	0.9	0.9	0.7	1.3	0.6
<i>Healthcare</i>	3.69	4.04	4.20	3.73	6.5	6.8	7.2	6.4	5.1	7.1	3.8	4.4	5.4	7.1	7.0	3.5	7.5
<i>Culture, sport, leisure activities</i>	0.71	0.71	0.75	0.75	1.1	1.0	1.5	0.7	0.8	1.3	0.7	1.0	1.6	0.9	0.2	0.8	0.3
<i>Education</i>	3.71	3.88	4.07	4.01	5.3	6.0	6.1	4.0	4.1	4.9	3.8	5.9	5.8	7.2	3.9	4.8	6.3
<i>Social policy</i>	8.74	8.48	8.24	8.68	18.7	15.6	22.2	21.8	12.2	13.2	9.7	17.2	16.8	9.4	12.1	3.2	7.0

Source: data of the RF Ministry of Finance, Eurostat, OECD.

### 2.2.5. Assessment of Budget Parameters without Regard to the Contribution of the Oil-and-Gas Sector and the Impact of the World Oil Prices

To have their national budgets balanced, countries whose tax revenues to a significant degree depend on mineral exports and prices on the world markets for minerals, have found it fundamentally important to single out the structural component and the market component in the tax burden for the sake of assessing market risks facing the government budget and margins of lowering of the tax burden on their economies.

The market component comprises a fraction of tax revenues which is determined by a favorable state of affairs on external markets, while the structural component reflects the level of taxes collected to the budgetary system under average multiyear parameters of the situation in the foreign trade area.

There exist various approaches to identification of the structural and market components of the tax burden. Whereas the dynamic of the world oil prices constitutes one of key factors of the market component of the dynamics of Russia's GDP and tax revenues, accordingly, one of possible ways is to find the market component is singling out oil-and-gas revenues in the budget. The RF Ministry of Finance has employed this approach since 2007. In a nutshell, it rests upon the division of taxes into "structural" and "market" ones. In this particular case it is taxes that appear directly dependent on prices for oil and gas that are attributed to "market" ones. An undisputable advantage of this approach is simplicity and the methodological certainty of the necessary calculations. Meanwhile, the approach in question does not take into consideration an impact the situation in the foreign trade area has on volumes of collection of revenues from other taxes. For example, it is pretty clear that the profitability rate of the oil-and-gas sector depends on price levels for oil and gas, which in turn affects the level of collection of revenues from the corporate profit tax.

The aforementioned drawback is overcome by employing a fundamentally different approach towards singling out the structural and market components of the tax burden. The approach is based upon singling out the structural and market components in revenues across major taxes, rather than on singling out two groups of taxes. The approach implies econometric modeling of correlation between GDP and tax revenues, and major market factors<sup>9</sup>, such as:

- the domestic demand factors (real investments in fixed assets and the population's real disposable incomes),

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<sup>9</sup> The equilibrium employed to single out the structural and market components of GDP takes the following form:  $Y_t = a_0 + a_1 Rev_t + a_2 Inv_t + a_3 P_{OIL_t} + a_4 REER_t + \varepsilon_t$ ,

where  $Y$  – GDP;  $C$  – consumption;  $Rev$  – the population's real disposable incomes;  $Inv$  – investments in fixed assets;

$P_{OIL}$  – the nominal price level for URALS (as USD/barrel);

$REER$  – the real effective exchange rate of the Rb. (basing on CPI);

$NEX$  – net export.

Variables  $Y_t$ ,  $Rev_t$  и  $Inv_t$  in real terms – in prices of the 4<sup>th</sup> quarter 1998 г., the deflator- CPI.

As a result, we have got the following correlation:  $Y_t = 239,75 + 1,38 * Inv_t + 8,69 * P_{OIL_t} + 3,19 * REER_t + \omega_t$  (apparently the positive sign of the coefficient under variable  $REER$  is explained by the incomplete specification of the model).

The present analysis employed quarterly data of Rosstat and the International Financial Statistics database over the period between 1999 and 2008.

- external factors (the world price for oil),
- other factors (the Rb. real effective exchange rate, random factors that steer short-term fluctuations, etc.)

First we singled out the structural and market components of GDP. The *structural* GDP is a volume of GDP that might be obtained under average values of explanatory variables, while any biases from the average level constitute the *market component* of GDP. To estimate the structural component of GDP, we calculated smoothed value of explanatory variables of the model. Proceeding from the different nature of the respective variables, to smooth such factors as real investment in fixed assets and real effective exchange rate, we employed the Hodrick-Prescott filter. The average multiyear price for oil was calculated by the moving-average method over the period of 25 years.

On the basis of thus received coefficients we calculated shares of the market GDP explained by the aforementioned different factors (see *Table 17*).

*Table 17*

**The Dynamic of the Structural and Market GDP Estimated over the Period of 2000–2008**

	2000	2001	2002	2003	2004	2005	2006	2007	2008 (est'd)
Structural GDP, as% of GDP	98.5	97.1	97.1	96.2	90.3	86.1	83.5	81.0	78.6
Market GDP, as% of GDP	1.5	2.9	2.9	3.8	9.7	13.9	16.5	19.0	21.4
<b>Including factors affecting the market GDP dynamic:</b>									
Domestic demand, as% of GDP	1.2	1.6	-0.9	-1.1	0.0	0.0	0.8	0.9	1.0
Oil prices, as% of GDP	1.0	1.2	3.1	4.6	8.1	12.6	14.0	16.1	18.1
Other factors, as% of GDP	-0.7	0.1	0.4	0.4	1.6	1.3	1.7	2.0	2.3
<b>For reference:</b>	7305.6	8943.6	10817.5	13243.2	17048.1	21625.4	26903.5	33113.5	41540.4
The nominal volume of GDP, as Rb. bn									
The real volume of GDP, as% to the prior year	110.0	105.1	104.7	107.3	107.2	106.4	107.7	108.1	105.6

*Source:* Roststat, IMF (IFS database, CD-ROM edition, December 2008), the IET calculations.

Tax revenues to Russia's budgetary system were split into the structural component and the market one on the basis of earlier obtained proportions of the structural and market GDP, and with the use of the calculation of the share of revenues that depend on oil prices (in the frame of the building of pair regressions models of the respective tax receipts from nominal oil prices).

Table 18

**The Dynamics of the Structural and Market Components of Tax Revenues  
to the Budgetary System of RF<sup>10</sup>, as Estimated over the Period  
of 2000–2008, as% to GDP**

	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008 (est'd)
<b>Tax revenues to the federal budget</b>										
<i>Revenues, total</i>	10.6	14.5	16.3	18.9	18.2	18.6	22.3	22.0	21.3	21.2
Structural component	10.9	10.6	10.9	15.0	14.0	11.8	12.3	12.2	13.7	14.4
Market component, including	-0.3	3.9	5.5	3.9	4.2	6.8	10.0	10.0	7.6	6.8
<i>domestic demand</i>	0.0	0.2	0.3	-0.1	-0.3	0.0	0.0	0.2	0.1	0.1
<i>oil prices</i>	0.0	3.8	5.1	4.0	4.4	6.4	9.7	9.5	7.3	5.6
<i>other factors</i>	-0.3	-0.1	0.0	0.1	0.1	0.4	0.3	0.4	0.2	0.1
<b>Tax revenues to the budget of the enlarged government</b>										
<i>Revenues, total</i>	31.4	35.7	35.7	35.6	34.6	35.3	36.9	36.9	36.8	35.7
Structural component	32.0	30.2	29.9	32.6	31.0	28.2	26.3	25.9	28.2	29.0
Market component, including	-0.6	5.5	5.8	3.0	3.6	7.1	10.6	11.0	8.6	6.7
<i>domestic demand</i>	0.0	0.4	0.6	-0.2	-0.4	0.0	0.0	0.3	0.2	0.1
<i>oil prices</i>	0.0	5.3	5.2	3.1	3.8	6.5	10.2	10.1	8.1	6.4
<i>other factors</i>	-0.5	-0.3	0.1	0.2	0.1	0.6	0.5	0.6	0.4	0.2
<b>Personal income tax</b>										
<i>Revenues, total</i>	2.4	2.4	2.9	3.3	3.4	3.4	3.3	3.5	3.8	4.0
Structural component	2.4	2.3	2.8	3.2	3.1	3.0	2.8	3.1	3.1	3.3
Market component, including	0.0	0.1	0.1	0.1	0.3	0.4	0.5	0.4	0.7	0.7
<i>domestic demand</i>	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.1
<i>oil prices</i>	0.0	0.0	0.1	0.1	0.2	0.4	0.4	0.4	0.7	0.6
<i>other factors</i>	0.0	0.0	0.0	0.0	0.1	0.0	0.1	0.0	0.0	0.0
<b>Uniform social tax<sup>11</sup></b>										
<i>Revenues, total</i>	-	-	5.8	7.0	6.6	6.3	2.0	2.0	2.0	1.9
Structural component	-	-	6.0	6.8	6.4	5.7	1.7	1.7	2.8	2.7
Market component, including	-	-	0.2	0.2	0.2	0.6	0.3	0.3	-0.8	-0.7
<i>domestic demand</i>	-	-	0.1	0.0	-0.1	0.0	0.0	0.0	0.0	0.0
<i>oil prices</i>	-	-	0.1	0.2	0.3	0.5	0.2	0.2	-0.7	-0.7
<i>other factors</i>	-	-	0.0	0.0	0.0	0.1	0.0	0.0	-0.1	0.0
<b>Corporate profit tax</b>										
<i>Revenues, total</i>	4.6	5.4	5.7	4.3	4.0	5.1	6.2	6.2	6.6	6.0
Structural component	4.5	5.3	5.6	4.1	3.6	4.5	5.3	6.1	4.8	4.1
Market component, including	0.1	0.1	0.1	0.2	0.4	0.6	0.8	0.1	1.8	1.9
<i>domestic demand</i>	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.1	1.3	1.5
<i>oil prices</i>	0.1	0.1	0.1	0.2	0.3	0.6	0.7	0.1	1.3	1.5
<i>other factors</i>	0.0	0.0	0.0	0.0	0.1	0.1	0.1	0.0	-0.8	-0.7
<b>Value added tax</b>										
<i>Revenues, total</i>	5.9	6.2	7.2	7.0	6.7	6.3	6.8	5.7	6.9	5.1
Structural component	5.8	6.1	7.0	6.7	6.1	5.5	6.0	5.6	7.2	5.3
Market component, including	0.1	0.1	0.2	0.3	0.6	0.8	0.9	0.1	-0.3	-0.2
<i>domestic demand</i>	0.1	0.1	0.1	-0.1	0.0	0.0	0.0	0.0	0.0	0.0
<i>oil prices</i>	0.1	0.1	0.1	0.3	0.5	0.7	0.7	0.1	-0.3	-0.1
<i>other factors</i>	-0.1	-0.1	0.0	0.0	0.1	0.1	0.1	0.0	0.0	-0.1

Note. «-» – UST was not levied.

Source: the RF Ministry of Finance, Rosstat, IMF (IFS database, CD-ROM edition, December 2008), the IET calculations.

The rising oil prices made a great contribution to the market component of tax revenues to the budget of the enlarged government (*Table 18*): in 2006, the market component secured revenues to the said budget at a level of 11.0% of GDP (including 10.1% of GDP secured by oil prices alone) and 10.0% of GDP - to the federal budget (the contribution of oil prices

<sup>10</sup> For the purposes of our calculations we include in the tax revenues of the federal budget and the budget of the enlarged government over the period in question compulsory pension insurance contributions, revenues from foreign trade, and revenues of target extrabudgetary funds.

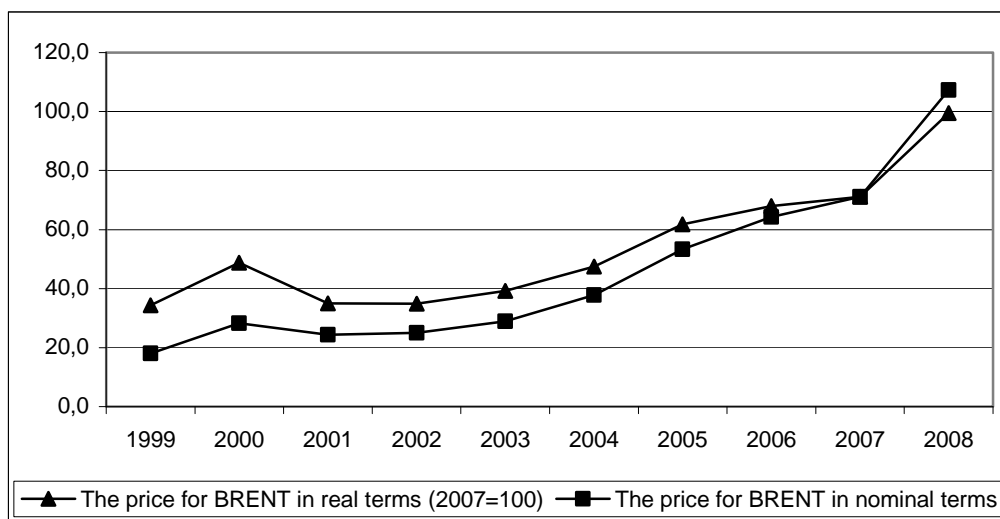
<sup>11</sup> Since 2005 the data are given without regard to the compulsory pension insurance premiums.

equaling 9.5% of GDP). The market component has been on decline since 2007, which can be attributed to a gradual exhaustion of the role market factors played in the dynamic of aggregate revenues. Thus, in 2007, the market component of the enlarged government's revenues accounted for 8.6% of GDP and 7.6% of the federal budget, while the respective figures in 2008 were 6.8% and 6.7% of GDP.

Such logic of the post-component division is also applicable to the personal income tax. As demonstrated by *Table 18*, the 2006 proportion of the market component of PIT was 0.4% of GDP, while in 2007 and 2008 it was 0.7% of GDP. In all likelihood, such a dynamic is explained by growth in the population's incomes in the conditions of a favorable situation in the foreign trade area in 2007, on the one hand, and the impact of the global financial downturn in late-2008, on the other hand.

The market component of the revenues from the uniform social tax in 2006 was 0.3% of GDP (of which 0.2% were backed by a positive dynamic of oil prices); in 2007 and 2008, the sign of the component has become negative (-0.8 and -0.7% of GDP, respectively), which can be explained by the regressive scale of the tax (in other words, with salaries and wages rising, the effective rate of the tax declines), and, accordingly, the growing role the structural factors played in tax revenues from the UST (2.8 and 2.7% of GDP, respectively) over the period in question.

Let us note that the 2006 proportion of the market component of tax revenues from the corporate profit tax was not a huge one – it accounted for 0.1% of GDP, with the bulk of the revenues secured by rising oil prices and factors of the domestic demand. By 2008, in contrast, it had soared up to 1.9%, which can be attributed to oil price spikes between the second half of 2007 and the first half of 2008 (see *Fig. 18*).



Source: IMF (IFS database, CD-ROM edition, October 2008), the authors' calculations.

*Fig. 18.* Dynamics of nominal and real (2007 prices) price on Brent crude oil (bar/dol) annualized, 1999-2008

*Table 18* shows that as in the case of the UST, market factors had minor effect on VAT. More specifically, in 2006, the market component of revenues from this particular tax accounted for a meager 0.1% of GDP, while in 2007 and 2008 its sign is negative (-0.3% and



0.2%, respectively). This can be explained by a greater role played by structural factors in the dynamic of VAT-based revenues – namely, the aforementioned recently promulgated modifications in the legislation that concern the tax in question.

Recapping on the analysis of the structural and market components of tax revenues to Russia's budgetary system over the period of 1999-2008 allows the following conclusions:

As evidenced by *Table 18*, the structural component of tax revenues had been mostly on the rise through 2002-2003. Post-2003, the favorable state of affairs in the foreign trade area exerted a positive influence on tax revenues and, accordingly, the structural component was on decline, while the market one was rising through 2006 when it hit its peak value. Then, fueled by an advancing growth in investment, the factors of the domestic economic activity resumed playing a greater role.

With account of the above, overall, between 2002 and 2008 the market component of tax revenues to the budget of the enlarged government rose from 3.0 до 6.7% of GDP, while that of tax revenues to the federal budget soared from 3.9 до 6.8% of GDP. Similarly, the market component of revenues from PIT increased from 0.1 up to 0.7% of GDP, while that of revenues from the corporate profit tax surged from 0.2 up to 1/9%. The favorable dynamic of the world prices for energy sources has had practically no effect on such taxes as UST and VAT, in respective revenues from which a more major role was played by structural factors, primarily modifications of the tax law and peculiarities of the functioning of these taxes.

In conclusion, it appears appropriate to once again focus on main trends of, and outlooks for the budgetary system of the Russian Federation.

1. Driven by the unfolding crisis developments in the national economy, the progressing decline of the economic agents' financial standing has inevitably engendered a fall in the budget revenues and called in question the financial stability of the national budgetary system as a whole. The revenues of the enlarged government tumbled at 1.7 p.p. of GDP vs. the 2007 figures. The fall was determined primarily by revenues from tax collection that were drying out (at 1.8 p.p. of GDP). The major factor of changes in the tax revenues dynamic vs. 2007 was the domestic VAT, the payments of which have become quarterly, effective as of the early 2008. This factor was behind tax revenues spikes in January, April, July and October and the subsequent 2-month decline in revenues (when in the absence of the VAT-based revenues, the government continued to reimburse VAT to economic agents) compared with the respective period of 2007.

2. One should note the direction of the RF Ministry of Finance's 2008 policy, which is aimed at loosening the dependence of revenues to the national budgetary system on the world oil prices. More specifically, the debate between the RF Ministry of Finance and the RF Ministry of Economic Development in the summer of 2008 on the issue of lowering the rate of either VAT, or the corporate profit tax was won by the former agency, and the CPT rate was lowered to 20% since 2009. In the current conditions, with account of the existing trend to decrease of the structural component of revenues to the budgetary system (i.e. a component that does not depend on world oil prices), it is imperative to at least retain the quality of administration of base and rates of the taxes that to the least degree directly depend on the world oil prices.

3. In 2008, sky-high windfall revenues enabled the government to stock up a substantial financial reserve in the form of budgetary surplus. That in turn made it possible not only to fulfill in full the government's expenditure obligations, but to replenish the Reserve Fund and

the National Welfare Fund whose volume combined ultimately accounted, respectively, for 9.7% and 6.2% of GDP in Rb. equivalent, as of the early-2009.

4. While having plummeted in shares of GDP (at 0.4 p.p., down to 33.7% of GDP), expenditures of the enlarged government's budget, nonetheless, have decreased to a far less degree than its revenues. That has resulted in a substantial fall of the budgetary surplus at 1.3 p.p. - down to 4.8% of GDP. The situation with execution of expenditure obligations on the cash basis was still unsatisfactory over the financial year. While there was noted a slight progress in this area vs. the 2007 performance (by results of the first half-year the execution on the cash basis grew from 33.2% in 2007 г. to 38.7% in 2008), the tendency to growth in expenditures by the end of a year remained unchanged.

5. The negative backdrop in the foreign trade area and falling volumes of revenues from domestic taxes determine the need for pursuance a more conservative budgetary policy rested upon a reasonable balance between volumes of undertaken obligations and possibilities for their financing. The comparative analysis of the functional structures of the enlarged government in the OECD countries and RF allows noticing that reserves of cutbacks should be sought in such sections as "Housing and utilities" (in Russia, these expenditures are on average twice as high as in the OECD countries), "National defense" and "National security". It goes without saying, in the conditions of an objective deterioration of the criminogenic situation in the country, one should exercise a great deal of caution while scaling back expenditures on national security and law enforcement and be at pains to compensate for them by bolstering efficiency of the use of the remaining budgetary funds. Meanwhile, given that the crisis has already imposed certain budget constraints, a fully justified move would be to profoundly optimize military expenditures with a subsequent use of thus saved funds to finance the economy.

6. Notwithstanding the appropriateness of pursuance of a more conservative budgetary policy, the RF government proposed amendments to the 2009 Act on federal budget to bolster expenditure obligations as a means of financing anti-crisis measures.

When compared with the current version of the 2009 federal budget Act, the projected volume of revenues should fall from Rb. 10.93trln (21.23% of GDP) to Rb. 6.71trln. (16.6% of GDP). Over 60% of the decline in revenues fell on the contraction of revenues from MT and export customs duties that form the oil-and-gas revenues to the budget. In addition to the fall in the oil-and-gas revenues, it is the corporate profit tax, VAT, the personal income tax and UST, revenues from which should fall at most, which will be determined by the worsening state of Russian corporations, nose-diving business activity, rising unemployment and falling incomes from labor and entrepreneurial activities.

The anti-crisis nature of the budget manifests itself in the reallocation of expenditures (it was proposed to scale back the earlier approved appropriations at Rb. 943.3bn) in favor of financing the priority avenues of the anti-crisis program approved by the RF government. Specifically, it is planned to spend some Rb. 1.61trln on measures on stabilization of the financial market, support of industry branches, and on the social support of the population.

These measures have not come out of the blue – they were implemented to some degree over recent years. But in the present circumstances they formed the Schwerpunkt for the government. Hence, the attempt of a comprehensive remedy to the pressing challenges in the noted areas. But these measures are somewhat late already, and they are not preventive ones, as the production slump and the fall in entrepreneurial activity have been already there. It is unlikely that the government would be able to reverse the trend, even by means of additional

infusions of public funds, while there are no guarantees of their efficient use, but it is quite real to cushion the fall.

The overall volume of expenditures has ultimately increased at Rb. 667.3bn vs. the earlier approved volume and currently accounts for Rb. 9.69trln (24% of GDP). It is for the first time in the 2000s that the federal budget will run a deficit of Rb. 2.98trln. (7.4% of GDP). Because the deficit will be financed with the help of resources from the Reserve Fund, the inflationary pressure on the Rb. from the increase in expenditures will unlikely to be a significant one, as additional funds will be pouring in the economy against the background of the crisis in demand, when the value of cash grows significantly. Already now there is noted a downfall or stabilization of retail and producer prices across a number of group of goods, so an even spending of additional budgetary resources should not engender an explicit inflationary effect.

7. The government's refusal to continue the practice of drafting a three-year budget is particularly noteworthy. Under the present uncertainty, it is impossible of course to ensure a high quality of the three-year budgetary planning. But one should realize that a comeback to the annual budget planning constitutes a step back on the path towards development of the strategic budgetary planning, as it derails the public appreciation of the government's long-term budgetary and fiscal policy and does not allow transition to medium-term public contracts, nor it helps lay down the foundation for enhancement of transparency of financial fundamentals of the public investment expenditures.