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The review provides a detailed analysis of main trends in Russia's economy in 2007. 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.

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The Long-Term Sustainability of Russia's Budgetary Policy

Implementation of the Measures from the Conception
for the Long-Term Socio-Economic Development in Russian
Federation: Evaluating the Consequences to the Budget System

Debates on drafts of the currently designed Conception for The Long-Term Socio-Economic Development of the Russian Federation (below referred to as the Conception) engender a number of questions concerning the problem of a balanced budgetary policy. To examine budgetary implications of implementation of the Conception's measures we employed preset in the Conception scenario-based conditions of the world oil prices and design parameters of the annual (2008–2020) growth rates of GDP and CPI under the innovation-based scenario. The respective data are given in *Table 27*[1].

Table 27

Original Data for Calculations

	2008	2009	2010	2015	2020	Averaged over the period 2008–2020
World oil prices (Urals), as USD/barrel, current prices[2]	62	57	56	60	65	60
GDP, as % to the prior year	106.2	106.2	106.2	106.3	106.8	106.4
CPI, as % to the prior year (December to December)	107.3	106.6	106.0	104.5	102.7	104.9
The population's real disposable incomes, as % to the prior year	108.6	108.6	108.6	106.8	106.7	107.5

In addition to the above data, we employed the following assumptions as original premises:

- The rates and collection rates of main taxes remain unchanged (with account of the oil prices declining in real terms over time);
- Greater revenues from the Personal Income Tax and the Uniform Social Tax along with a rise in the population's real incomes (without account of reduction in the UST-based revenues due to transition to higher schedules);
- Depletion of mineral fields wherein there are no the mineral tax benefits;
- The doubling of GDP over 10 years (2010–2020) and contraction in the proportion of the oil and gas sector from 19.7% in GDP in 2006 to 12.1% of GDP by 2020 will result in a considerable contraction of the share of the oil- and gas-related revenues to the federal budget. Hence the federal budget deficit and the one of the enlarged government's budget.

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[1] It should be noted that the data given in *Table 27* corresponds to the innovation-based scenario of the RF Ministry of Economic Development and Trade, according to which the nation will be maintaining high economic growth rates over the whole time interval in question. That the proportion of tax revenues in GDP will fall all the scenarios in question to a significant degree attribute to the process of an accelerated growth in GDP at a rate greater than the growth of the oil and gas sector.

[2] We consider the current oil prices, as the forecast of these very prices is presented in the Concept. However, while examining the effect of the oil prices on GDP and tax revenues to the enlarged government's budget, one should consider real prices for energy sources, rather than the current ones. Translation of the latter into real prices is possible using deflator indexes whose choice appears largely related to the way proceeds from sales of energy sources are consumed. The set of the said indexes comprises the USD inflation (its appreciation against the basket of international currencies, the Russian CPI, Russia's GDP deflator, to name a few).

Whereas the Conception falls short of a detailed projection of the enlarged government's budget revenues, while the respective final values stipulated therein appear somewhat inflated, we have calculated dynamics of tax revenues to the enlarged government in 2006-2020 (*Table 28*) and the federal budget (*Table 29*)[3].

Assessment of the Dynamics of Tax Revenues to the Budget of the Enlarged Government in Russia in 2008–2020, as % of GDP

	2008	2009	2010	2015	2020
(1) Revenues to the enlarged government budget (1)=(1.1.)+(1.2)	**37.48**	**37.4**	**33.91**	**31.52**	**29.97**
(1.1) Tax revenues to the enlarged government budget	34.28	34.2	30.81	28.52	27.07
UST, without indexation of the scale	4.81	4.78	4.72	4.2	3.78
VAT	6.11	6.14	6.18	6.34	6.5
Corporate profit tax	5.21	5.11	5.01	4.49	3.98
PIT	3.7	3.84	3.97	4.39	4.75
Mineral tax	3.75	3.7	2.33	1.59	1.17
Taxes on foreign trade	7.4	7.33	5.31	4.21	3.59
Other taxes	3.3	3.3	3.3	3.3	3.3
(1.2) Non-tax revenues	3.2	3.2	3.1	3	2.9
(2) The enlarged government budgetary expenditures (at the 2006 level=)	31.3	31.3	31.3	31.3	31.3
(3) Surplus prior to increase in expenditures (3)=(1)–(2)	**6.18**	**6.1**	**2.61**	**0.22**	**-1.33**
Accumulated reserve of the budgetary system* prior to increase in expenditures, as % of GDP (with account of the annual 4% nominal yields)	*16.55*	*20.84*	*21.35*	*19.82*	*15.32*

* Under the accumulated reserve of the budgetary system we understand savings resulting from the excess of the enlarged government's budget revenues over its budgetary expenditures in the Reserve Fund and the Social Welfare Fund.

Main Parameters of the Federal Budget of RF in 2008–20, as % of GDP

	2008	2009	2010	2015	2020
(1) Federal budget revenues (1)=(1.1.)+(1.2)	21.73	21.61	18.24	16.30	15.15
(1.1.) Oil-and-gas	8.86	8.76	6.03	4.55	3.71
(1.2). Non-oil-and-gas	12.87	12.85	12.21	11.75	11.44
(2 Federal budgetary expenditures (on the 2006 level)	16.00	16.00	16.00	16.00	16.00
(3) Non-oil-and-gas budget deficit (3)=(1.2)–(2)	–3.13	–3.15	–3.79	–4.25	–4.56
(4) Oil and gas transfer	3.13	3.15	3.79	3.7	3.7
(5) Oil-and-gas budget deficit	0.00	0.00	0.00	–0.55	–0.86
For reference:					
The Reserve Fund	*10*	*10*	*10*	*10*	*8.44*
The Welfare Fund*	*6.45*	*10.65*	*11.08*	*9.32*	*6.53*

* With account of the co-funding of voluntary pension savings at the level of 0.1% of GDP until 2014 (these values are employed in the Conception).

The projected calculations of the dynamics of budgetary spending show that given the oil (Urals) prices hold at the average level of USD 60/barrel over the period 2008–20, as per the Conception, the proportion of the enlarged government budget revenues in GDP should fall from the 2008 GDP level of 37–38% to 30% in 20020. It will be the federal budget revenues that will plummet most dramatically (from 21–22% of GDP to 15% of GDP).

This means the rise and further growth of deficit of the enlarged government's budget, provided expenditures are kept at the 2006–07 level (as % of GDP) since 2016, while the oil-

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[3] Here and hereafter the forecast of tax revenues is given on the basis of the IET's calculations, providing tangibility of macroeconomic indicators under the MEDT's innovation-based development scenario.

and-gas deficit arises substantially earlier, that is, in 2011. The assessment is made in an assumption that the level of collection of main taxes and their rates remain unchanged, while the world oil prices are down in real terms (which constitutes a fairly moderate, rather than quite conservative, scenario)

Meanwhile the Conception provides for greater public spending to finance health care, education, pensions, as well as other budgetary items, including public capital investment[4], by 2020.

Estimation of the Dynamics of Budgetary Expenditures of Russia's Enlarged Government in 2006–20, as % of GDP

	2006	2007	2010	2015	2020
Education	3.9	4.1	3.9	4.3	4.5
Health care	4.0	4.2	4.1	4.3	4.8
Fundamental research and support of the scientific-technical progress	0.7		0.9	1.1	1.3
Public investment	3.3		3.5	4.5	4.0
Pensions (consistent increase in the replacement rate up to 30% by 2020)[5]	4.8		5.9	7.0	8.1
Other expenditures	14.7	14.7	14.7	14.7	14.7
The enlarged government's budgetary expenditures, total	**31.3**	**34.1**	**33.0**	**35.9**	**37.4**
Surplus/deficit after expenditures increase, as % of GDP	**8.6**	**6.1**	**0.91**	**–4.38**	**–7.43**

* Expenditure values as per the Conception are marked in color.

The above data evidence that the proposed measures to boost expenditures result in a general rise of the enlarged government budget expenditures at 6 percentage points by 2020 vis-à-vis 2006. The bulk of the rise will be formed by the health care and pension expenditures, and for the given variant the enlarged government budget deficit will account for over 4% of GDP by 2015 and over 7% of GDP by 2020.

Under such circumstances the federal budget will be in a far greater jeopardy. As the non-oil-and-gas deficit may not exceed 4.7% of GDP, a part of the RF Pension Fund's deficit should be funded out of the National Welfare Fund as early as in 2010, and the National Welfare Fund will have consequently exhausted by 2016–17[6]. Since 2010 the oil and gas transfer will be short

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[4] At this point it should be noted that according to the Concept, between 2010 and 2015, it is envisaged to cut down health care expenditures from 4.0% of GDP in 2006 to 3.3% of GDP by 2010 and to 3.8% of GDP by 2015. Between 2015 and 2020, on the contrary, the respective expenditures should be up to 4.8% of GDP. Analogously, expenditures on education should be cut back from 3.9% of GDP in 2006 to 3.5% of GDP in 2010, followed by their increase up to 4.5% of GDP by 2020. However, given the current trends in the dynamics of budgetary spending of the enlarged government, dramatic cuts in the healthcare and educational expenditures appear highly unlikely. That is why in *Table 29* we provide expenditures across these items for the period 2010–2015, proceeding from the assumption of a linear rise in these expenditures as percentage of GDP at such a rate, so that to match the values stipulated in the Concept by 2020.

[5] According to the Concept, the rise in the number of pensioners, as well as an assumption of the advanced indexation of pensions for the sake of an increase in the correlation between the average labor pension and the average salaries and wages (the replacement coefficient) up to 30% in 2020 should form the cause for a consistent growth in the volume of public obligations in the pension provision area. In conjunction with this, the RF MEDT projects a rise in the pension expenditures of the budgetary system up to 8.1% of GDP by 2020 against 6.1% in 2011. These values appear close to the IET experts' calculations, which evidence that a keeping of the replacement rate at the level of 30% will necessitate growth in the budgetary system's expenditures on pensions up to 8.2% of GDP by 2020 vs. 6.2% of GDP in 2010.

[6] The current budgetary law seems to care much more of the Reserve Fund than the National Welfare Fund. The Reserve Fund may be consumed only for the sake of the oil-and-gas transfer in the event the oil-and-gas revenues fall short of financially securing the said transfer whose value is strictly limited by the Budgetary Code of RF. Under moderate oil prices laid down in the Concept, the amount of oil and gas gains should be in excess of the value of the oil-and-gas transfer within the whole time interval in question, and it will be only in 2020 that they will match. Consequently, providing the current budgetary law is unchanged, it may happen that resources of the Reserve Fund would not be touched in the event of a budgetary crisis, unless it caused by a price downfall for energy resources. By contrast, the National Welfare Fund's mission, save for other purposes, is to ensure the balanced pension system. As an increase in spending (which, in many ways, appears an objective factor) on the pension system poses the

of closing the non-oil-and-gas federal budget gap, while to fund the oil-and-gas federal budget deficit since 2011 the nation will have to attract borrowings in a maximum permissible by the current law volume (1% of GDP). So, by 2017 it will have become impossible to fund the growing spending, complying, at the same time, with the budgetary law requirements not to transcend the oil and gas deficit equivalent up to 4.7% of GDP. Hence the need for either drastic cuts in spending (tax boost), or for raising the values of the permissible non-oil-and-gas deficit and the oil-and-gas transfer. Should the government opt for refusing to cut down budgetary spending (boost taxes), the Reserve Fund would be able to secure the balance of the federal budget just for two years.

Table 31

Main Parameters of the RF Federal Budget in 2008–20, as % of GDP

	2008	2009	2010	2011	2015	2020
(1) Federal budget revenues (1)=(1.1.)+(1.2)	21.73	21.61	18.24	17.85	16.30	15.15
(1.1.) Oil-and-gas	8.86	8.76	6.03	5.74	4.55	3.71
(1.2). Non-oil-and-gas	12.87	12.85	12.21	12.12	11.75	11.44
(2) Federal budget expenditures*	16.41	16.56	17.46	16.82	19.52	21.86
(3) Consumption of resources of the National Welfare Fund to cover the deficit of the pension system)	0.00	0.00	0.00	1.22	0.84	0.00
(4) Non-oil –and- gas budget deficit (4)=(1.2)–(2)**	–3.54	–3.72	–5.25	–4.70	–7.77	–10.42
(5) Oil and gas transfer***	3.54	3.72	4.50	3.7	3.7	3.7
(6) Oil –and- gas budget deficit	0.00	0.00	–0.75	–1.00	–4.07	–6.72
For reference:						
The Reserve Fund	*10.00*	*10.00*	*10.00*	*10.00*	*10.00*	*9.85*
*The national Welfare Fund**	*6.04*	*9.71*	*9.50*	*8.63*	*0.00*	*0.00*

* Calculated proceeding from the assumption that the increase in public expenditures, as per the Conception, is made at the expense of the federal budget, while the compensation for the Pension Fund's deficit is made at the expense of the federal budget revenues and, accordingly considered to be the federal budget expenditures (until the non-oil-and-gas deficit is in excess of 4.7% of GDP beginning 2011) and the National Welfare Fund (in the event the non-oil-and-gas deficit is in excess of 4.7% of GDP beginning 2011). The use of the National Welfare Fund to cover the Pension Fund deficit is not accounted in the federal budget expenditures (line 3).
** In compliance with the Budgetary Code of RF, the non-oil-and-gas deficit is in excess of 4.7% of GDP.
*** Parameters of the federal budget whose projected values contradict requirements of the current budgetary law are marked in color.

There are some other critical considerations. First, the above data on increase in spending constitute averaged landmarks, while actual figures may prove to be substantially greater, particularly when the respective large-scale project gains momentum. Second, the above calculations are unlikely to take into account a number of expenditures, such as for instance, Sochi-2014; finally, given the aging population factor, the health care expenditures, as well as some other kinds of expenditures, may substantially exceed the planned ones.

Third, in the event oil prices are down earlier than forecasted, the enlarged government budget will be challenged by the problem of the budget balance earlier than in 2020, as the mission of propelling economic growth (following the innovational scenario of the Conception) in 2013–17 would presumably demand for greater expenditures in 2010–15.

Fourth, in full appreciation of the size of the required increase in spending, the RF MEDT laid down proposals to cut other expenditure items (*Table 32*).

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greatest threat to the budgetary system, the Fund may find itself under a serious fiscal pressure. An indirect evidence to this is the current provision, according to which, should the additional 2008 revenues to the federal budget be insufficient to secure the balanced budget of the National Pension Fund, the RF Government will have the right to spend as much as Rb. 138 bln out of the National Welfare Fund to bridge the gap. So, even without grave challenges facing the budgetary sphere, the current law does not prohibit a considerable voluntary consumption of the Fund's resources.

Table 32

**Proposals to Cut Down Expenditures of the Budget of the Enlarged Government,
as per the Conception, as % of GDP**

	2007	2015	2020
General government matters	3.3	3.0	2.4
National defense, security, and law enforcement	5.5	5.3	5.0
National economy	4.0	3.9	3.3
Housing and utilities sector	2.3	1.3	1.0
Culture, cinematography, and mass media	0.7	0.4	0.3
Cuts on the above items to the 2007 level, total		*-1.9*	*-3.8*

Source: the Conception data

So, it is cuts across the expenditure items by which the measures were not definitely estimated that the Conception identifies as one of major sources to compensate for a possibly arising deficit. It appears fairly unfeasible in practice, as out of the 12.1% of GDP these expenditures account for the bulk falls on items that can hardly be cut down, that is, 8.3% on general government matters[7], law enforcement, and national defense, while another 2.4% – on the housing and utilities sector. Thus, the landmarks given in *Table 32* are fairly unrealistic and unlikely to be realized within the period in question, which, accordingly, would not allow one to balance the budgetary system under the noted circumstances.

Securing Russia's balanced budgetary system under the increase in public spending provided for by the Conception and maintenance of the current tax law is possible only under steadily high prices for energy sources. In its original draft, the Conception projected in 2010–20 the average oil price to be at the level of USD 60/barrel, but during consequent debates around the Conception everyone agreed this forecast was too low and should be revised. We calculated the oil price between 2008–2020 which will ensure a balanced budgetary system in 2020 under the condition of greater budgetary spending, as per the Conception (*Fig. 19, Table 33*). The calculations show that under the average annual oil prices of USD 68/barrel (and given a significant price rise for oil up to USD 82/barrel by 2020) the Russian enlarged governments budget should become balanced within the whole time interval in question.

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[7] Despite the fact the public spending on general state matters is down, thanks to lower public debt servicing figures, as of Sep.1, 2007, the share of spending on the public debt servicing in the aggregate public expenditures accounted for just 17%. Thus, the respective projected values referenced in the Conception appear substantially lowered.
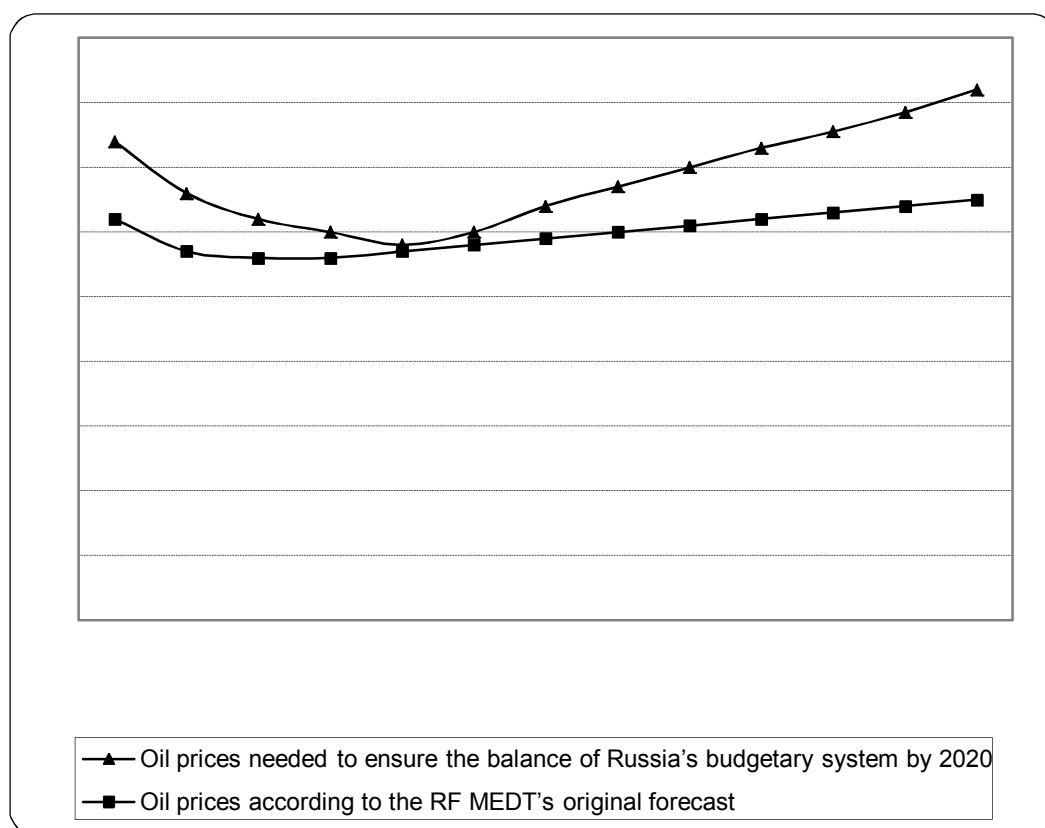
Source: IET's calculations.

Fig. 19. The World Oil Prices for Urals, USD / barrel

**Estimation of Main Parameters of Russia's Budgetary System
in 2008–20 under the World Prices Forecasted at the Level of USD 68/Barrel,
as % of GDP**

	2008	2009	2010	2015	2020
(1) The enlarged government budget revenues	**43.26**	**41.69**	**38.56**	**36.27**	**37.49**
UST, without indexing the scale	4.4	4.4	4.4	4.1	3.6
VAT	6.11	6.11	6.11	6.11	6.11
Corporate profit tax	7.3	6.7	6.3	6.7	7.8
PIT	3.7	3.84	3.97	4.39	4.75
Mineral tax	4.97	4.6	4.45	2.72	3.36
Taxes on foreign trade	9.68	8.94	6.33	5.35	5.07
Other taxes	3.9	3.9	3.9	3.9	3.9
Tax revenues to the consolidated budget, total	40.06	38.49	35.46	33.27	34.59
Non-tax revenues	3.2	3.2	3.1	3	2.9
(2) Expenditures of the consolidated budget	**32.1**	**32.4**	**32.7**	**35.9**	**37.4**
(3) Surplus after increase in spending (3)=(1)–(2)	**11.16**	**9.29**	**5.86**	**0.37**	**0.09**

But as demonstrated by the data of *Table 33*, even under steadily high prices for energy sources (the nominal prices are constantly on the rise since 2013), the enlarged government budget surplus shrinks.

This modification of the prognosis of macroeconomic indicators can be viewed as a swing-back from the moderate estimation of the world prices for energy sources. At this point it should be noted there presently are no trustworthy methodologies of forecasting oil prices. The uncertainty in the future of the world oil market is also mirrored by medium-term forecasts of the world oil prices. The table below presents results of the December 2007 Reuters's survey on

over 20 agencies that deal with forecasting the oil prices. They suggest the 2010 prices for Brent should be within the range between USD 55.75 and 86.8/barrel.

<div align="right">Table 34</div>

Oil Prices in 2008-10, as Forecasted by Participants in the Reuters's Survey, as USD/barrel

	2008	2009	2010
Average	76.49	71.61	68.72
Peak	95.00	82.00	86.80
Minimum	61.75	64.00	55.75

Source: Reuters.

The further is the horizon of planning, the greater becomes dispersion in the oil price forecasts. According to the basic variant by OECD's International Energy Agency[8] of November 2007, the world price for oil calculated as an average price for oil imported into OECD countries should fall to USD 60/barrel (in the 2006 prices), followed by its extremely slow growth up to USD 62/barrel (in the 2006 prices), or USD 108/barrel in nominal terms. A scenario of high economic growth rates suggests that in 2030 it should climb up as high as to USD 86/barrel (in the 2006 prices). Interestingly this IEA's forecast reference figures notably greater than the prior one, which suggested that in 2015 the world oil price should stand at USD 47.8/barrel and USD 55/barrel (in the 2005 prices) in 2030[9].

Not quite in unison, the US Department of Energy suggested in 2007 that in the period through 2020 the world oil prices would be fluctuating within the range between USD 34.1 and 89.1/barrel.

Such a variety of opinions highlights the contemporary science's complete inability to foretell the state of affairs on mineral markets for any reasonably distant perspective. Under the present uncertainty in this area the budgetary planning should be scenario-based, in order to ensure a budgetary system is balanced, regardless of external developments.

All the above implies that as far as the budget expenditures are concerned, the Conception can be realized with a substantial budget deficit, and, only provided the world oil prices stick to the 2006 level in real terms (in the 2006 USD), the balanced budget system can be attained. Even under a slight decline in the oil prices the budgetary system appears unbalanced, and since 2011 the federal public debt begins to grow (at 1% of GDP annually), and the use of the accumulated funds to cover the deficit will result in a complete exhaustion of the National Welfare Fund by 2016 and the Reserve Fund – by 2018–20.

An Analysis of Possible Scenarios of Boosting
Up the Balance of the Budgetary System in 2008−20

The analysis of possible options with regard to giving a boost to the balance of the RF budgetary system is conducted basing on the premise of a substantial rise in the pension-related expenditures. As evidenced by data of *Table 30*, the imperativeness to increase spending of the budgetary system to hold the replacement coefficient at a socially permissible level (not lower than 30%) will result in a consolidated budget deficit up to 8.1% of GDP by 2020, even providing the state of affairs in the foreign trade area remains relatively favorable. This can be explained by the fact that according to the Conception, the aging population and a rapid rise in salaries and wages will require, from year to year, an increasing proportion of GDP to maintain the replacement coefficient.

The balanced budgetary system can be secured by following means:
1. Prevention the budgetary spending from an accelerating escalation. Specifically, the 2007-to-2006 growth in the federal budget spending accounted for 2.2 percentage points of GDP,

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[8] World Energy Outlook 2007. OECD/IEA, 2007.
[9] World Energy Outlook 2007. OECD/IEA, 2006.

while revenues rose at 0.3 percentage points of GDP. In this respect, we mean the refusal to rise spending on capital investment. If the share of the enlarged government spending were maintained at the 2006 level (excluding of pension payments), this would allow one to cut the 2020 budgetary system deficit by 2.7% of GDP (*Table 35*).

2. Conduct of a systematic indexation of the UST scale. *Table 35* presents results of its indexation since 2010 once in three years, with account of growth rates in salaries and wages. It is worth noting that this variant may prove to be unacceptable from the political standpoint (as it may be conceived of as a greater tax pressure on labor). So, a more plausible and, perhaps, even desirable means appears a soft indexation of the UST scale with account of the CPI. However, such an option does not allow one to substantially axe the consolidated government budget deficit (under such a variant, the UST-based revenues would fall from 4.81% of GDP in 2008 to 4.3% in 2020 against 3.87% of GDP in 2020, as suggested by the variant without indexation of the scale).

3. Increase of the mineral tax on natural gas. In compliance with Government Resolution of May 28, 2007, No. 333, it is assumed that since January 1, 2011 Gazprom and its affiliated entities will deliver natural gas at a price calculated by a formula which would ensure an equal profitability rate of domestic and overseas supplies, which would give a dramatic boost to the national gas corporations' gains. Meanwhile, the tax system lacks automatic regulators that would otherwise ensure an adequate rise in the sector's tax payments. *Table 36* contains calculations that demonstrate that should the mineral tax on the natural gas be raised and the tax rate be subject to annual indexation with account of the domestic prices for natural gas, extension of the surplus (reduction of deficit) of the enlarged government's budget may account for 0.25% of GDP in 2008 and 0.43% of GDP in 2020.

4. Refusal to cut down the VAT rate and a partial substitution for the corporate profit tax with VAT. Against the above background, it seems to us proposals to significantly lower the VAT rate are overly provocative. One cannot help but admit that VAT is a complex tax to administer, particularly in Russia, and main challenges in this area most often concern VAT refunds to exporters. Equally challenging are various schemes involving a well-developed infrastructure formed by fly-by-night firms. All this calls for a serious work on refining the VAT administration technique – the developed economies' record in this area has proved that if a success, this measure substantially diminish magnitude of such phenomena.

Today's heated debate exposed yet another argument in favor of lowering the VAT rate, that is, the statement that whereas the tax is levied on value added, the tax itself affects most seriously the very sectors with a high share of value added, which are most likely to form priority sectors in the future. This is *mal-entendu*, as the VAT burden is divided between producer and consumer according to the correlation between the demand price elasticity for, and the one of offer of the respective product, rather than by the proportion of value added in its cost.

It is a common knowledge that VAT's role in the budgetary system is huge: in 2007 alone, the respective revenues accounted for 6.68% of GDP, or a. 30% of all the budget revenues. Once the current VAT rate is cut down to 15% (along with abrogation of the 10% lowered rate), the budget losses would amount up to 0.8% of GDP. Accordingly, a 5% cut in the current VAT rate would be equivalent to a loss of 1.5% of GDP. It goes without saying, this is almost nothing against the current huge surplus figures (in 2006 – 7.4% of GDP, in 2007 – 5.5% of GDP), but, as demonstrated above, one cannot help ignoring such losses in a longer run, when the budgetary system is started getting out of balance. That is why any proposal on the tax cuts should be concomitant with proposals on cuts in budgetary spending.

The willingness to lower taxes, thus improving corporations and individuals' financial stands, is quite explicable, particularly if one runs a budgetary surplus. It should be remembered, though, that such tax cuts in today's situation, when a tight budgetary policy forms a critical instrument of sterilization of the monetary issuance fueled by monetization of the positive balance of payments, will give a boost to monetary base and, accordingly, inflation. According

to some estimations, the transition to the 15% VAT rate will result in a 0.9 p.p. surge of inflation, while the one to the 13% rate will accelerate inflation up to 1.5 p.p.

It should also be noted that proponents of tax cuts often argue that they ensure a quick return in the form of an accelerated economic growth, which in the circumstances does not form a credible assertion. The IET's business surveys show that since 2006 Russian enterprises began to face serious problems with labor force shortages, while since 2007 they were challenged by the shortage of production capacities. So, in the given circumstances it is quite naïve to hope for the tax multiplier, for economic growth in the country can advance only under extension of production opportunities, which is associated with investment in production capital and human capital.

The problem of getting revenues and expenditures balanced under the conservative scenario of price dynamics for oil to some degree can be solved by modifying the structure of the tax system in favor of the taxes revenues from which are to a lesser degree tied with the situation on the world markets for energy sources. According to some estimations, in 2006–07 the proportion of the component (whose value is determined by oil price fluctuations) in corporate tax revenues accounted for some 15%, while in the VAT-based revenues – 1–2%. So, to secure the balance and ensure sustainability of Russia's budgetary system the tax reform should be pursued under the following scenario: raising VAT rates along with a simultaneous cut in the corporate profit tax. As the value of the latter's component (the aforementioned one) is significant, once the state of affairs on the foreign trade arena drakens, the share of the tax in GDP should plummet notably. In proportion to the fall in the share of this tax in GDP the budget system will suffer a lesser loss from its lower rates. In other words, under high oil prices, it is appropriate to cut the rate of a tax which appears most vulnerable to a price downfall for energy sources.

The tax effect from the proposed reform depends on the degree to which revenues from the corporate profit tax will be substituted by those from VAT. The greater proportion of the corporate profit tax is substituted by the VAT-based revenues, the more sustainable is the budgetary system in the long run. However, in all likelihood, the respective rate of substitution presented in *Table 35* appears ultimately permissible, as further cuts in the corporate profit tax rate may destabilize regional finance, while revenues from this tax become insignificant for the budgetary system. As the developed economies' experience shows, diversification of taxes exerts a positive influence on the tax system's stability, so far as external shocks and tax dodging are concerned.

Let us also note that in contrast to corporate profit tax cuts, those in the VAT rates mean a less effective level of tariff protection of the domestic producer. Indeed, under quite natural assumptions that the offer curve with regard to imports is horizontal (any quantity of goods can be supplied at a given price), while elasticity of offer of domestic goods that compete with the imports has a negative gradient (differs from perpetuity), cuts in the VAT rates will result in a greater price downfall for import, rather than for domestic goods.

Germany has recently launched a reform effort that implies modification of rates of basic taxes. Sensing a certain pressure on the part of eastern European countries (in Poland, the corporate profit tax is 17.4%, in Slovakia – 19%, Estonia – 23%), in 2008 Germany is to cut the respective tax rate from 25 to 15%, extending, at the same time, the tax base using revenues from taxing bank deposit interest rates, rental and leasing operations. These measures are complemented by the recently (in 2007) cut social tax, which is used for the sake of unemployment insurance, and the 3% increase of the VAT rate (from 16 to 19%).

5. Privatization, the growing capitalization and the rise in the share of profits transferred to the federal budget by federal public companies can form one of the most efficient and socially acceptable ways to boost assets of and, accordingly, revenues to the pension Fund of RF or the National Welfare Fund, and, at the same time, the means to lower the role the state plays in economic activities. The aggregate value of the national public companies is estimated at the level of 55% of GDP. Given the volume of foreign investment in Russia in 2005–07 and

the peak volume of the federal budget revenues from the public property privatization (0.77% of GDP in 1997), it seems possible to ensure annual additional revenues from the public property (privatization, greater capitalization, dividends, placement of privatization proceeds to financial markets, etc.) which would roughly account for. 1% of GDP, without any risk of a drastic fall in the value of the public assets.

Table 35

Surplus (Deficit) of the Enlarged Government's Budget Under Realization of Different Scenarios of Reforming the expenditure and Revenue Components of the Budget in 2008–20*, as % of GDP

1	2010	2015	2020
1	2	3	4
1. Surplus (deficit) of the enlarged government's budget under increase in expenditures, as per the Conception, and the replacement coefficient being maintained at the level of 30%	+0.91	–4.38	–7.43
2. Surplus growth (decrease of deficit) of the federal government's budget in the event:			
2.1. The enlarged government budget spending is at the 2006 level	+0.5	+2.3	+2.7

Table 35 (continued)

1	2	3	4
2.2. Indexation of the UST scale since 2010 once in 3 years, with account of the wages growth rates	+0.39	+0.87	+1.22
2.3. Increase of the mineral tax on natural gas	+0.66	+0.66	+0.43
2.4. partial replacement of the corporate profit tax with VAT (cutting the corporate profit tax down to 17%, abolition of the 4% regional benefit with regard to the corporate profit tax, abolition of the beneficial 10% VAT rate, raising the basic VAT rate up to 20%)	+0.07	+0.27	+0.37
2.5. additional privatization of public property	+1.00	+1.00	+1.00
3. Surplus (deficit) of the enlarged government's budget under realization of the integrity of the scenarios of reforming the expenditure and revenue component of the budget over 2008–20**	**+3.53**	**+0.72**	**–1.71**
4. The accumulated reserve of the budgetary system, as % of GDP (with account of the 4% annual nominal interest)***	*22.70*	*23.07*	*19.43*

* Under costs of energy sources as per the RF MEDT's original forecast.
** Under the replacement coefficient being maintained at the level of 30%.
*** Understood as savings in the form of excess of revenues to the enlarged government budget over expenditures in the Reserve Fund and the National Welfare Fund, without account of the federal public corporations' assets assigned to the Pension Fund of RF or the National Welfare Fund, as it is only funds collected from sales of the assets in question or from management of them (dividends, profit, etc) that are taken into account.

Table 36

Main Parameters of the Federal Budget of RF in 2008–20 in the Event the Proposed Measures Have Been Realized*

	2008	2009	2010	2015	2020
(1) Federal budget revenues (1)=(1.1.)+(1.2)	22.62	22.60	19.40	17.77	16.80
(1.1.) Oil-and-gas	9.11	9.31	6.69	5.21	4.14
(1.2). Non-oil-and-gas	13.51	13.29	12.71	12.56	12.66
(2Federal budgetary expenditures (on the 2006 level)	16.41	16.37	16.51	16.57	17.27
(3) Non-oil –and- gas budget deficit (3)=(1.2)–(2)	–2.90	–3.09	–3.80	–4.01	–4.61
(4) Oil and gas transfer	2.90	3.09	3.80	3.7	3.7
(5) Oil and gas federal budget deficit	0.00	0.00	0.00	–0.31	–0.91
For reference:					
The Reserve Fund	*10.00*	*10.00*	*10.00*	*10.00*	*9.85*

The Welfare Fund*	6.93	11.71	12.70	13.07	9.58

* Under costs of energy sources as per the RF MEDT's original forecast.

In conclusion, it should be once again stated that a responsible budgetary policy demands for a great deal of conservatism in assessing versatile scenarios of the economic dynamic, as a failure to duly consider effects from decisions made or overestimation of probability of a future favorable contour can entail dire, if not catastrophic, consequences for a country.