

## RUSSIA'S STATE BUDGET IN H1 2014

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According to the data provided by the Federal Treasury of Russia, in H1 2014 federal budget revenues kept growing and accounted for 21.1% of GDP, gaining 1.1 p.p. of GDP over the level observed during the corresponding period of the previous year. At the same time, during the period between January and May of the current year consolidated budget revenues of the constituent territories of the Russian Federation as percentage of GDP stop shrinking, which has been observed since the beginning of the year<sup>1</sup>, and remained at 12.6% of GDP observed within the first five months in 2013. At the end of the period of January to June of the current year the federal budget ran a surplus of 1.9% of GDP; in addition, a positive balance was reached as a result of the execution of the consolidated budget of the constituent territories of the Russian Federation in the period between January and May 2014, 1.1% of GDP. Therefore, the Russian Federation is currently showing positive dynamics of the key parameters of the Russian budget system, which implies that budget sustainability isn't exposed to material risks in the short run (a few months to come). However, the status of the Russian budget system doesn't seem to be optimistic in the mid run. The *Main Trends in the Budget Policy in 2015 and the Planning Period of 2016 and 2017* (hereinafter – “the MTBP-2015”) were published on the official website of the Ministry of Finance of Russia in July 2014, in which the budget system is anticipated to run a deficit from 1.0% of GDP in 2014 to 1.5% of GDP in 2017.

### Analysis of the basic execution parameters of the federal budget in H1 2014

In the period between January and June 2014, federal budget revenues amounted to Rb 7120,1bn or 21.1% of GDP, showing a growth of 1.1 p.p. of GDP above the value observed in the corresponding period of the previous year (*Table 1*). Oil and gas revenues increased to 11.0% of GDP or 1.1 p.p. of GDP over the value observed in H1 2013, while by the end of H1 2014 revenues (other than oil and gas revenues) as percentage of GDP saw no changes relative to the corresponding period of the previous year, accounting for 10.1% of GDP. In January–June of the current year, the federal budget generated 52.5% of the annual projected revenues, including oil and gas revenues (56.8%), revenues (other than oil and gas revenues (48.5%); and in H1 2013 federal budget revenues accounted for 48.6% of the annual projected values, including oil and gas revenues (52.3%), and revenues (other than oil and gas revenues (45.5%).

In the period of January to June 2014, federal budget expenditures amounted to Rb 6470,8bn (19.2% of GDP), 0.2 p.p. of GDP over the value observed in the corresponding period of the previous year. Cash execution of the federal budget reached 46.4% in H1 2014, whereas during the corresponding period of 2013 it accounted for 44.4% of the approved annual value.

At the end of H1 2014 the federal budget ran a surplus of 1.9% of GDP, showing an increase of 0.9 p.p. of GDP over the balance of federal budget execution in the period of January–June 2013. Furthermore, non-oil-and-gas deficit increased by 0.1 p.p. of GDP against the level observed during the corresponding period of the previous year.

During the first five months of the current year federal budget revenues increased, comparing to the corresponding period of the previous year 2013 (*Table 2*), through growth in revenues from internal VAT GDP (by 0.3 p.p.), as well as revenues generated from the mineral extraction tax and foreign trade (by 0,4 p.p. of GDP each). Revenues from “imports” VAT and excises contracted by 0.1 p.p. and 0.02 p.p. of GDP respectively in January to June 2014 relative to the period of January to June 2013. In H1 2014, federal budget revenues from the profit tax and internal excises as percentage of GDP remained at the level of 0.5% and 0.7% of GDP respectively which was observed in the period between January and June of the previous year.

Comparing the end of H1 2014 and the period of January to June 2013, the following expenditure sections of the federal budget saw growth (*Table 3*) as percentage of GDP:

*Nationwide Issues* (by 0.2 p.p. of GDP), *National Defense* (by 0.8 p.p. of GDP), *National Economy* (by 0.3 p.p. of GDP), *Environmental Protection* (by 0.01 p.p. of GDP), *Inter-Budget Transfers* (by 0.2 p.p. of GDP).

<sup>1</sup> For example, the consolidated budget revenues of the constituent territories of the Russian Federation lost 0.2 p.p. of GDP in the period between January and May 2014 relative to the first four months in 2013.

Table 1

**RUSSIA'S FEDERAL BUDGET BASIC PARAMETERS IN THE PERIOD BETWEEN JANUARY AND JUNE IN 2013 AND 2014**

	January to June 2014		January to June 2013		Deviation, as p.p. of GDP
	billions of rubles	as % of GDP	billions of rubles	as % of GDP	
Revenues, including:	7120,1	21.1	6257,5	20.0	1.1
Oil and gas revenues	3703,4	11.0	3099,1	9.9	1.1
Revenues (other than oil and gas revenues)	3416,7	10.1	3157,4	10.1	0.0
Expenditures, including:	6470,8	19.2	5948,6	19.0	0.2
interest expense	200,8	0.6	175,9	0.6	0.0
non-interest expense	6270,0	18.6	5772,7	18.4	0.2
Federal budget surplus (deficit)	649,3	1.9	308,9	1.0	0.9
Deficit (other than oil and gas deficit)	-3054,1	-9.0	-2790,2	-8.9	-0.1
GDP evaluation	33770		31215		

Source: Ministry of Finance of Russia, Federal Treasury of the Russian Federation, Gaidar Institute's estimates.

Table 2

**FEDERAL BUDGET BASIC TAX REVENUES IN THE PERIOD BETWEEN JANUARY AND JUNE IN 2013 AND 2014**

	January–June 2014		January–June 2013		Deviation, as p.p. of GDP
	billions of rubles	% of GDP	billions of rubles	% of GDP	
Tax revenues, including:	6533,5	19.3	5700,1	18.3	1.0
corporate profit tax	181,2	0.5	160,6	0.5	0.0
VAT on goods sold on the territory of the Russian Federation	1163,1	3.4	978,7	3.1	0.3
VAT on goods imported to the Russian Federation	799,5	2.4	769,0	2.5	-0.1
excises on goods manufactured on the territory of the Russian Federation	242,1	0.7	210,6	0.7	0.0
excises on goods imported to the Russian Federation	32,8	0.1	27,1	0.08	-0.02
Mineral extraction tax	1465,9	4.3	1234,0	3.9	0.4
Foreign trade revenues	2648,9	7.8	2320,1	7.4	0.4

Source: Federal Treasury of the Russian Federation, Gaidar Institute's estimates.

Table 3

**FEDERAL BUDGET EXPENDITURES IN THE PERIOD BETWEEN JANUARY AND JUNE IN 2013 AND 2014**

	January to June 2014		January to June 2013		Deviation, as p.p. of GDP
	billions of rubles	as % of GDP	billions of rubles	as % of GDP	
Expenditures, total	6470,8	19.2	5948,6	19.0	0.2
Including					
Nationwide Issues	428,7	1.3	350,6	1.1	0.2
National Defense	1454,9	4.3	1086,9	3.5	0.8
National Security and Law Enforcement	909,6	2.7	847,8	2.7	0.0
National Economy	789,2	2.3	633,3	2.0	0.3
Public Utilities Sector	42,5	0.1	62,3	0.2	-0.1
Environmental Protection	18,0	0.05	12,8	0.04	0.01
Education	320,7	0.9	341,3	1.1	-0.2
Culture and Cinematography	41,3	0.1	32,2	0.1	0.0
Healthcare	204,7	0.6	225,0	0.7	-0.1
Social Policy	1602,8	4.7	1750,0	5.6	-0.9
Physical Culture and Sports	18,5	0.05	29,4	0.09	-0.04
Mass Media	38,6	0.1	37,9	0.1	0.0
Public Debt Servicing	200,8	0.6	175,9	0.6	0.0
Inter-Budget Transfers	400,4	1.2	304,3	1.0	0.2

Source: Federal Treasury of the Russian Federation, Gaidar Institute's estimates.

The following expenditure sections of the federal budget saw decline: *Public Utilities Sector* (by 0.1 p.p. of GDP), *Education* (by 0.2 p.p. of GDP), *Healthcare* (by 0.1 p.p. of GDP), *Social Policy* (by 0.9 p.p. of GDP), and *Physical Culture and Sports* (by 0.04 p.p. of GDP).

Within the first six months in 2014 the other expenditure sections of federal budget as percentage of GDP remained at the level observed in the period of January and June 2013.

In June 2014, the volume of the Reserve Fund and the National Wealth Fund contracted by Rb 89,3bn and Rb 75,8bn because of the foreign exchange difference, and as of 01.07.2014 they amounted to Rb 2,937,0bn and Rb 2,957,5bn respectively. As of 01.07.2014, the state debt was as follows:

- internal debt amounted to Rb 5757,2bn (gained Rb 23,6bn in H1 2014), including Rb 1261,2bn (Rb 28,6bn less in H1 2014) of state guarantees of the Russian Federation:
- external debt amounted to \$54,8bn (\$1,0bn less in H1 2014).

#### Execution of the consolidated budget of the constituent territories of the RF in the period between January and May 2014

According to the data provided by the Federal Treasury of Russia, in the period between January and May 2014 consolidated budget revenues of the constituent territories of the Russian Federation amounted to Rb 3493,0bn or 12.6% of GDP while, consolidated budget expenditures to Rb 3192,2bn or 11.5% of GDP, equaling, as percentage of GDP, to the volume of

revenues and expenditures reported during the corresponding period in 2013 (*Table 4*).

Two revenue sections of the consolidated budget of the constituent territories of the Russian Federation saw changes within the first five months in 2014 comparing to the corresponding period of 2013: revenues from the corporate profit tax increased by 0.2 p.p. of GDP, whereas revenues from the personal income tax contracted by 0.1 p.p. of GDP. In the period between January and May 2014, revenues from internal excises, aggregate income tax and profit tax, as well as non-repayable receipts from other budgets of the Russian budgetary system as percentage of GDP remained at the level observed during the corresponding period of the previous year.

Within the first five months of the current year, consolidated budget expenditures of the constituent territories of the Russian Federation (*Table 5*) in most of the budget sections as percentage of GDP remained at the level observed in January–May of the previous year. Four expenditure sections of the consolidated budget of the constituent territories of the Russian Federation as percentage of GDP saw a contraction during the period: *Environmental Protection* (by 0.01 p.p. of GDP), *Education* (by 0.1 p.p. of GDP), *Healthcare* (by 0.1 p.p. of GDP), *Mass Media* (by 0.01 p.p. of GDP). Expenditures on *Social Policy* and *Public and municipal debt servicing* increased by 0.1 and 0.04 p.p. of GDP respectively comparing to the period of January to May 2013. Other expenditure sections as percentage of GDP remained unchanged within the first five months, comparing to the corresponding period of the previous year 2013.

Table 4

#### BASIC PARAMETERS OF THE CONSOLIDATED BUDGET OF THE CONSTITUENT TERRITORIES OF THE RUSSIAN FEDERATION IN THE PERIOD OF JANUARY TO MAY IN 2013 AND 2014

	January to May 2014		January to May 2013		Deviation as p.p. of GDP
	billions of rubles	as % of GDP	billions of rubles	as % of GDP	
Revenues including:	3493,0	12.6	3219,0	12.6	0.0
- corporate profit tax	886,1	3.2	775,6	3.0	0.2
- personal income tax	975,9	3.5	914,1	3.6	-0.1
- internal excises	191,9	0.7	191,0	0.7	0.0
- aggregate income tax	161,4	0.6	150,9	0.6	0.0
- property tax	409,9	1.5	390,0	1.5	0.0
- non-repayable receipts from other budgets of the Russian budgetary system	634,3	2.3	587,7	2.3	0.0
Expenditures, including:	3192,2	11.5	2956,3	11.5	0.0
Surplus (deficit) of the consolidated budget of the constituent territories of the Russian Federation	300,8	1.1	262,7	1.0	-0.1
GDP evaluation	27728		25590		

Source: Federal Treasury of the Russian Federation, Gaidar Institute's estimates.

**CONSOLIDATED BUDGET EXPENDITURES OF THE CONSTITUENT TERRITORIES OF THE RUSSIAN FEDERATION  
IN THE PERIOD OF JANUARY TO MAY IN 2013 AND 2014**

	January to May 2014		January to May 2013		Deviation, as p.p. of GDP
	billions of rubles	as % of GDP	billions of rubles	as % of GDP	
Expenditures, total					
Including	3192,2	11.5	2956,3	11.5	0.0
Nationwide Issues	202,8	0.7	189,7	0.7	0.0
National Security and Law Enforcement	32,2	0.1	29,1	0.1	0.0
National Economy	490,5	1.8	458,9	1.8	0.0
Public Utilities Sector	245,9	0.9	230,3	0.9	0.0
Environmental Protection	7,0	0.02	7,0	0.03	-0.01
Education	959,2	3.4	887,9	3.5	-0.1
Culture and Cinematography	110,1	0.4	101,6	0.4	0.0
Healthcare	470,8	1.7	455,0	1.8	-0.1
Social Policy	551,9	2.0	496,8	1.9	0.1
Physical Culture and Sports	60,8	0.2	52,2	0.2	0.0
Mass Media	15,4	0.05	14,8	0.06	-0.01
Public and municipal debt servicing	41,3	0.15	28,0	0.11	0.04

Source: Federal Treasury of the Russian Federation, Gaidar Institute's estimates.

At the end of the period of January–May 2014, the consolidated budget of the constituent territories of the Russian Federation ran a surplus of Rb 300,8bn or 1.1% of GDP, by 0.1 p.p. of GDP below the level observed during the first five months in 2013.

It is external geopolitical and internal macroeconomic factors that create risks for the sustainability of the budget system in the mid run. According to the MTBP-2015<sup>1</sup>, Russia's GDP growth rate is projected to slow down to 0.5% in the current year, while the forecast for growth rates in retail trade turnover have been downgraded from 4.0% to 1.9% and that for real disposable income from 3.4% to 0.5% .

Budget system revenues in the Russian Federation are anticipated to shrink from 36.9% of GDP in 2014 to 35.3% of GDP by 2017, including federal budget revenues from 19.9% of GDP to 18.1% of GDP. The budget expenditures of the general government are expected to decline from 37.8% of GDP in 2014 to 36.7% of GDP by 2017, including federal budget expenditures from 19.5% of GDP to 18.7% of GDP, will not be able to fully cover the revenue contraction, and therefore the budget system deficit will increase from 1.0% of GDP in 2014 to 1.5% of GDP in 2017.

From the spending behavior point of view, budget system expenditures on the national defense are expected to grow from 3.5% of GDP in 2014 to 3.9% of GDP in 2017, while economic support programs will be reduced: expenditures on *National Economy* in

2017 will be cut off by 1.1 p.p. of GDP relative to 2014. At the same time, budget system expenditures on the key budget sections relating to social support, such as education, healthcare and social policy will increase in 2017 by 1.0 p.p. of GDP relative to 2014.

Therefore, the mid-run prospects of the budget system in the Russian Federation don't look optimistic. It should be taken into account that using the resources of the Reserve Fund (as well as actual use of the resources of the National Wealth Fund through investment thereof in infrastructural projects whose effectiveness remains to be proved) may create material risks in the long run, while the economic situation may not allow reserves to be recovered to a level ensuring sustainability of economic growth.

Optimization of expenditures and/or increase in tax revenues, for example, by rising the VAT base rate to 20%, which has recently become a subject matter for consideration in the Russian Government<sup>2</sup>, seem to be the best alternative to the use of reserve funds . The tax burden on the economy has recently been 33–35% of GDP, but excluding the natural resource rent from both the tax base and GDP, a tax burden, according to the estimates of the Ministry of Finance of Russia, would be 27–28% of GDP, which is less than the OECD average (34% of GDP) but a bit higher than that in the Asian countries with emerging markets (25% of GDP).

1 [http://www.minfin.ru/common/upload/library/2014/07/main/ONBP\\_2015-2017.pdf](http://www.minfin.ru/common/upload/library/2014/07/main/ONBP_2015-2017.pdf)

2 [www.interfax.ru/business/387810](http://www.interfax.ru/business/387810)

Furthermore, approaches towards taxation of solid minerals production should be changed. In particular, export duties on crude oil and oil products could be gradually reduced by 17% on an annual basis beginning with 2015 through to 2020, while revenues from export duties could be covered by rising the mineral extraction tax. Such a “fiscal maneuver” will encourage modernization within the oil refining sector of the Russian economy and efficient use of energy resources.

Optimization of the spending behavior requires a “budget maneuver” which provides for an increase of 3.0 p.p. of GDP in budget system expenditures on education (by 1.2 p.p. of GDP), healthcare (by 1.0 p.p. of GDP), public roads facilities (by 0.8 p.p. of GDP) and cutting off expenditures on law enforcement (by 0.9 p.p. of GDP), defense (by 1.1 p.p. of GDP), national economy (less of public roads facilities) and public utility sector (by 1.0 p.p. of GDP). ●