

# MONITORING OF RUSSIA'S ECONOMIC OUTLOOK:

## TRENDS AND CHALLENGES OF SOCIO-ECONOMIC DEVELOPMENT

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# 1. REDUCING THE DAMPER WILL REDUCE SUPER PROFITS OF RUSSIAN REFINERIES, BUT WILL NOT MAKE THEM UNPROFITABLE

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*The RF Ministry of Finance is considering halving the payments to oil refining companies under the damping mechanism from September 2023 for a period of one year. The publication assesses the effects of the adjustment on the economics of the refining industry, in particular, the possibility to provide the domestic market with break-even production of petroleum products.*

The damping mechanism was introduced in 2019 to curb gasoline and diesel prices on the domestic market. The calculation formula implied that if export prices for petroleum products were higher than domestic ones, oil producers would receive payments from the budget and have an opportunity to avoid raising prices in Russia (if domestic prices were higher than export ones, companies would deduct part of this difference to the budget).<sup>1</sup>

The formula for export prices was based on the tax period average Urals price on global crude oil markets (quotes from Argus, which considers shipments to ports in Italy and the Netherlands).

The introduction of the ban on the export of Russian oil and petroleum products to the EU by sea and the establishment of a price ceiling distorted the price quotations for Urals oil due to the building up of new logistical chains and a sharp increase in the transport arm of deliveries from ports in Western Russia to new markets in the Asian region. The use of such quotations resulted in the loss of a considerable part of the budget revenues, therefore, in February 2023 amendments to the Tax Code were adopted, having limited from April 1, 2023, the discount for the Russian Urals oil in relation to the North Sea Dated for the calculation of oil taxes.<sup>2</sup>

The changes should have resulted in a reduction in budget expenditures on subsidies to oil companies using the damping mechanism, but payments from the budget in April 2023 turned out to be higher than in the previous month: according to the RF Ministry of Finance, in April 2023 the amount of Rb 107.2bn was paid using the damping mechanism, which is 10.86% higher than in March 2023 (Rb 96.7bn); payments decreased by 4.2 times as compared with April 2022.<sup>3</sup> In order to remedy the situation, the RF Ministry of Finance proposes to

1 *Kaukin A.S., Miller E.M.* Tax maneuver in the oil industry: interim results and risks of further implementation // *Voprosy ekonomiki* - 2020. - No.10 - P. 28–43.

2 *Kaukin A.S., Miller E.M.* Legislative limitation of the Urals crude oil price discount vs Brent // *Economic Development of Russia - 2023 - Volume 30 - No.4 - P. 57–60.*

3 *Alifrova E.* Adjustment of the damper is postponed pending a full discussion// *Neftegaz.ru*. 01.06.2023. URL: <https://neftegaz.ru/news/neftechim/781685-korrektirovka-dempfera-otklayvaetsya-do-vsestoronnego-obsuzhdeniya/>

adjust the formula for calculating the damper by reducing it by 2 times introducing a ratio of 0.5 from September 2023 for a year.<sup>1</sup>

The assessment was made whether this adjustment would not worsen the economics of the Russian oil refining industry while reducing budget costs and, in particular, would provide the domestic market with break-even production of petroleum products. Two scenarios were used for calculations.

Scenario 1 assumed that Russian exporters of oil and petroleum products are experiencing difficulties selling their products: EU sanctions on exports of oil and petroleum products are in full force, and the introduction of new restrictions may be associated with significant damage to some EU countries. Therefore, control over compliance with the existing sanctions has been enhanced; demand for oil from other Russian trading partners is limited due to the likely introduction of secondary sanctions; demand for Russian oil and petroleum products falls and in response their production decreases (in proportion to gasoline production at Russian refineries).

Scenario 2 assumed that Russian exporters of oil and petroleum products are experiencing difficulties selling their products: EU sanctions on oil and petroleum product exports are in full force, but control over their compliance is assumed to be not as strict as in Scenario 1 due to the actual compliance with the \$60/bbl oil price ceiling; there is still a reduction in exports both due to reorienting EU imports from other countries and due to the gradual transition to RES; demand for Russian oil and petroleum products falls and in response their production decreases (in proportion to gasoline production at Russian refineries).

Forecast values on the volumes of oil production, oil exports and refining and production of petroleum products in the scenarios 1–2 are presented in *Table 1*.

*Fig. 1* shows the results of GVA calculations for the oil refining industry under two scenarios. In case of scenario 1, i.e. a more significant reduction of external demand for Russian oil and oil products and oil prices below \$60/bbl, the volume of break-even oil refining, taking into account the halved subsidy, starting from September 1, 2023, will make 197 mln tons (or 64% of the total volume of oil raw materials coming for processing).

Domestic consumption of petroleum products in scenario 1 amounts to 139 mln tons taking into account that the average depth of oil refinery in Russia is around 84%<sup>2</sup>, while up to 167 mln tons should be processed to meet domestic demand. Thus, the adjustment of the damping markup, starting from September 1, 2023 using parameters included in scenario 1, will only reduce the refineries' excess profits: all the petroleum feedstock supplied to refineries will be processed at a positive profit.

According to the Ministry of Finance, at the beginning of 2023 the average refinery profit was Rb 8.000/t, earlier it was less than Rb 2.000/t, i.e. under the current situation part of the refinery profit is paid from the budget. Based on the results of calculations and statistics of the Russian Ministry of Finance it can

1 The mechanism has been changed five times over its lifespan: in 2019 and 2021, it changed the indicative domestic price; in 2022, it changed the amount of compensation to oil companies for the difference between export and indicative domestic fuel prices, and will take into account the Urals to Brent discount when calculating the gasoline dampener; in 2023, it will take into account the Urals to Brent discount when calculating the diesel dampener.

2 *Krasinskaya A.* Russia reduced oil refinery by 3% in 2022. – Vice-Prime-Minister Novak // Argus. 13.02.2023. URL: <https://www.argusmedia.com/ru/news/2419141-rossiia-sokratila-pererabotku-nefti-na-3-v-2022-g--vitsepremer-novak>

## 1. Reducing the damper will reduce super profits

Table 1

Forecast of production volumes, exports and domestic consumption of oil and petroleum products in 2023, mln tons

Indicator	Scenario 1	Scenario 2
Currency rate of exchange, ruble/dollar	76.53 <sup>a</sup>	76.53
Oil price, dollar/barrel	51.23 <sup>b</sup>	60.00
Oil extraction	488.9 <sup>c</sup>	488.9
Oil exports	185.2 <sup>d</sup>	196.1 <sup>e</sup>
Domestic oil consumption <sup>f</sup>	303.7	292.8
Increased demand for oil due to import substitution in the chemical, rubber, and plastic industries	55.3 <sup>g</sup>	37.8
Production of petrochemicals <sup>i</sup>	233.0	239.2
Exports of petrochemicals	94.1	100.4
Domestic consumption of petrochemicals	138.8	138.8
Growth of domestic tourism <sup>j</sup>	4.6	4.6
Increased demand for freight transportation due to reorientation to the East <sup>k</sup>	1.2	1.2

**Note.**

<sup>a</sup> Scenario conditions for the functioning of the economy of the Russian Federation and the main parameters of the forecast of socio-economic development of the Russian Federation for 2024 and for the planning period 2025 and 2026 // Ministry of Economic Development of the Russian Federation. 2022. April 14 // URL: [https://www.economy.gov.ru/material/directions/makroec/prognozy\\_socialno\\_ekonomicheskogo\\_razvitiya/scenarnye\\_usloviya\\_funkcionirovaniya\\_ekonomiki\\_rossiyskoy\\_federacii\\_i\\_osnovnye\\_parametry\\_proгноza\\_socialno\\_ekonomicheskogo\\_razvitiya\\_rossiyskoy\\_federacii\\_na\\_2024\\_god\\_i\\_na\\_planovyy\\_period\\_2025\\_i\\_2026\\_godov.html](https://www.economy.gov.ru/material/directions/makroec/prognozy_socialno_ekonomicheskogo_razvitiya/scenarnye_usloviya_funkcionirovaniya_ekonomiki_rossiyskoy_federacii_i_osnovnye_parametry_proгноza_socialno_ekonomicheskogo_razvitiya_rossiyskoy_federacii_na_2024_god_i_na_planovyy_period_2025_i_2026_godov.html)

<sup>b</sup> The mechanism has been changed five times over its lifespan: in 2019 and 2021, it changed the indicative domestic price; in 2022, it changed the amount of compensation to oil companies for the difference between export and indicative domestic fuel prices and took into account the Urals to Brent discount when calculating the gasoline dampener; in 2023, it took into account the Urals to Brent discount when calculating the diesel dampener.

<sup>c</sup> Additional reduction of production of 500,000 bpd from February 2023 levels will be 9.7 million bpd by the end of the year // OPEC. 2023. April 3. URL: [https://www.opec.org/opec\\_web/en/press\\_room/7120.htm](https://www.opec.org/opec_web/en/press_room/7120.htm).

<sup>d</sup> Oil exports from Russia are expected to decline by 15% (the average between EIA and IEA forecasts). See, for example: *Savenkova D., Milkin V.* Export of oil and oil products from Russia approached a historical maximum // *Vedomosti*. 2023. February 15. URL: <https://www.vedomosti.ru/business/articles/2023/02/15/963134-eksport-priblizilsya-maksimumu>; Short-term Energy Outlook (STEO) // EIA. 2022. 11 April. URL: <https://www.eia.gov/outlooks/steo/>

<sup>e</sup> It is expected to decrease to 3.3 mln bpd, or by 10%. Short-term Energy Outlook (STEO) // EIA. 2022. 11 April. URL: <https://www.eia.gov/outlooks/steo/>

<sup>f</sup> Difference between the volume of oil production and the volume of oil exports.

<sup>g</sup> Forecasts of oil production and exports of petroleum products are not consistent due to different sources of providing data. To eliminate this problem, it is assumed that the demand for oil is growing on the part of the chemical industry and the production of rubber products due to import substitution. See: *Katkov M.* The Ministry of Industry and Trade conducted an audit of the chemical industry // *Vedomosti*. 2022. 30 September. URL: <https://www.vedomosti.ru/business/articles/2022/09/30/943198-minpromtorg-provel-audit-himicheskoi-promishlennosti>

<sup>h</sup> Total volume of petroleum products exports and of domestic consumption.

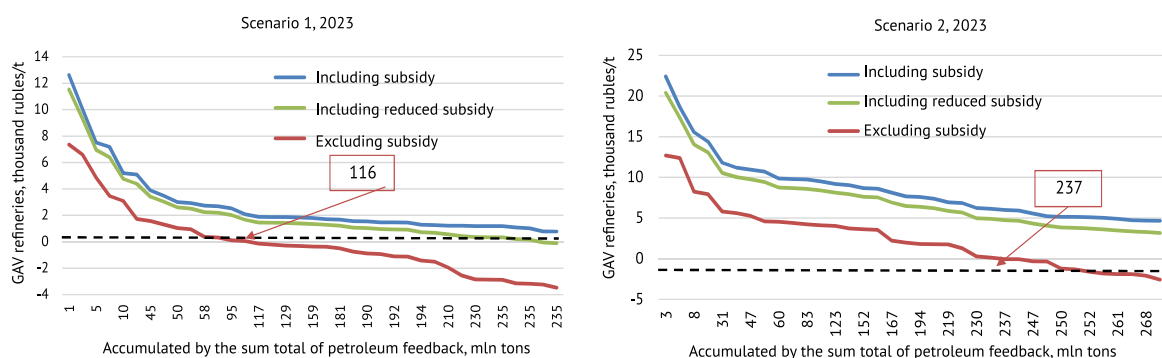
<sup>i</sup> The scenario assumes that the export of petroleum products from Russia will drop by 25%, which is more than experts' forecasts, ref., for example: *VEB.RF* forecasted a 16% reduction in Russian exports of petroleum products in 2023 // *TASS*. 2023. March 3. <https://tass.ru/ekonomika/17187181>. This can be explained by the reason that it is much more difficult to reorient petroleum products to the East than oil, since the main buyers (India, China) have their own refineries.

<sup>j</sup> The Association of Tour Operators predicts that demand for domestic tourism will grow by 30% in 2023. URL: <https://tourism.interfax.ru/ru/news/articles/97169/>. It is assumed that the demand for fuel will also grow by 30% (according to the Fuel and Energy Complex CDD, the demand from airlines in 2021 was 6.8 mln tons. Thus, in 2023 it will grow by 2 mln tons; average monthly demand for gasoline, diesel fuel, fuel oil, naphtha and middle distillates in 2021, according to the Fuel and Energy Complex CDD, was 8.6 mln tons, thus, in 2023 it will grow by 2.6 mln tons).

<sup>k</sup> It is assumed that growth will be 0.3%, as in 2022: ref. for example, *Korenyako A.* "Subsidiary" of "Sber" predicted growth of freight road transport to P 3 trillion. This is what analysts rely upon expectin an increase in turnover // *RBC*. 2023. March 30. URL: <https://www.rbc.ru/business/30/03/2023/642435409a7947e436f4d7d2>

Source: own calculations.

## Monitoring of Russia's Economic Outlook



**Note.** Ordinate axis means oil refineries sorted in descending GVA; abscissa axis means volumes of petroleum feedstock used in refining of the sorted refineries, cumulative total. The frame presents values of petroleum feedstock volumes processed with positive GVA.

*Fig. 1. GVA of Russian refineries in 2023 including and excluding subsidies*

Source: own calculations.

be concluded that the reduction of the damper should not affect the increase in the cost of petroleum products (diesel fuel and gasoline) on the domestic market.

In case of scenario 2, the volume of break-even refining, taking into account the halved subsidy under the damping mechanism, will be 100% of the total volume of the petroleum feedstock supplied for refining. Thus, the adjustment of the damping surcharge, starting from September 1, 2023, if the parameters in scenario 2 are implemented as in scenario 1, will only reduce the refineries' excess profits: all the petroleum feedstock supplied to refineries will be processed at a positive profit.

It is worth noting that system of taxation of the oil and oil refining industry in Russia is associated with a number of unresolved problems, which, in particular, affect the damping mechanism:

- there is still no statutory deadline for the end of a refinery subsidy in the form of a reverse excise tax accounting the dampening surcharge (unlike the deadline for zeroing export duty), which creates the basis for potentially unlimited subsidies to the industry, which (given that companies under sanctions can count on the reverse excise tax) will not even necessarily be associated with increased production efficiency at refineries and growth in the share of light fractions in the basket of petroleum products;
- frequency of adjusting the parameters of the damping markup to contain domestic wholesale fuel prices. In fact, the current mechanism allows for "manual" price management in the domestic market;
- a combination of two actually contradictory taxation mechanisms: the damper, protecting against rising prices at the domestic market, is superimposed on the growth of excise payments on petroleum products (resulting in rising retail prices). ▀

## 2. FEDERAL BUDGET EXECUTION FOR 5 MONTHS OF 2023

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*At the end of the first five months of 2023 federal budget revenues in nominal terms were Rb2.2 trillion lower than a year earlier. Oil and gas revenues evidenced the main reason for such a visible reduction in budget revenues, which did not even reach the level of the same period in 2021. Stable dynamics of revenues to the budget is still ensured only by VAT, whose revenues grew by Rb0.6 trillion in current prices. Federal budget expenditures during the period under review grew by Rb2.7 trillion in nominal terms, which can partially be explained by a higher level of cash execution (45% of the annual values in 2023 vs 33-36% in the previous two years). As a result of the revenues and expenditures variety of trends the budget balance for the first 5 months of this year amounted to Rb3.4 trillion vs surplus of Rb0.3 trillion and 1.5 trillion for the same periods of 2021 and 2022.*

**Revenues** of the federal budget for January-May 2023 were less than Rb10 trillion or 37.6% of the forecasted annual total (Table 1). It should be noted that dynamics of revenues to the budget so far repeats the path of 2021 both in terms of cash execution and in absolute terms. If it continues (which would be a positive scenario given the current volumes and prices of exported hydrocarbons), the total volume of federal budget revenues may not exceed Rb25 trillion by the end of 2023, which is below the forecasted revenues by Rb1 trillion according to the federal budget law.

The amount of oil and gas revenues over 5 months of the current year was Rb2.8 trillion, which is lower by Rb0.3 trillion and Rb2.8 trillion in current prices respectively than in January-May 2021 and 2022. As a result, the oil-and-gas component's share in the federal budget structure has declined to 29.1% vs 33.6% and 47.0% respectively as of the first five months of 2021 and 2022. Such dynamics of oil and gas revenues in 2023 was rather an expected result of the Western sanctions imposed on hydrocarbon exports. If these dynamics continue, oil and gas revenues to the budget may not exceed Rb7.5 trillion by the end of 2023, which will be Rb1.5 trillion lower than it was envisaged in the law on the federal budget for the current year.

The decline in oil and gas revenues to the federal budget has been observed since the first month of this year when the proceeds to the federal budget from extraction and circulation of hydrocarbons dropped by more than 2 times to Rb425 bn (5.1% of the annual forecasted volume) compared to Rb931.5 bn for the previous month (December 2022).

According to the Russian Ministry of Finance, the drop in revenues happened due to two factors: a drop in hydrocarbon prices and accelerated VAT refunds to Russian exporters. Indeed, the dynamics of oil and gas revenues in the next four months is positive relative to January: the average monthly revenues in

Table 1

## Main parameters of the federal budget for January-May 2021–2023

	January-May 2021		January-May 2022		January-May 2023		Change in 2023 (in current prices, billion rubles) vs	
	Billion rubles	Cash exe- cution, %	Billion rubles	Cash exe- cution, %	Billion rubles	Cash exe- cution, %	2021	2022
Revenues including:	9320	36.9	12043	43.3	9818	37.6	498	-2225
- oil & gas revenues	3129	34.6	5658	48.8	2853	31.9	-276	-2805
- non-oil and gas revenues, including:	6191	38.1	6385	39.3	6965	40.5	774	580
- income tax	558	36.0	810	44.6	688	42.1	130	-122
- VAT	3520	38.2	3757	39.3	4368	41.9	848	611
- other revenues	2113	38.7	1818	36.6	1909	37.1	-204	91
Expenditures	9004	36.4	10544	33.6	13229	45.5	4225	2685
Deficit	316		1499		-3411		-3727	-4910
- oil and gas deficit	-2813		-4159		-6264		-3451	-2105

Source: Ministry of Finance of Russia, Russian Treasury, Portal "Electronic budget", Rosstat, own calculations.

February-May this year rose to Rb607 bn, but still below the average monthly values for 2021–2022 (Rb755 bn and Rb965 bn respectively). The dynamics of oil and gas revenues in the first 5 months of 2023 was influenced to some extent by changes in tax policy in terms of calculating excise taxes on oil raw materials intended for processing, allowing to reduce the amount of reimbursement by almost 2 times.

On the contrary, positive dynamics is observed in non-oil and gas revenues: in January-May 2023 they grew by Rb0.6 trillion in current prices compared to the first five months of 2022. The VAT has a stabilizing effect on the collection of non-oil and gas revenues. If the accumulated growth rate continues, there is a high probability of reaching the volume of revenues from this tax in the amount of Rb11 trillion by the end of this year, which corresponds to the initial expectations of the Ministry of Finance of Russia.

In the wake of declining profitability of enterprises in the real sector (according to Rosstat, the balanced financial result over the first 3 months of this year dropped by 22.3% compared to the same period of the previous year) the dynamics of revenues to the federal budget on the income tax in January-May 2023 was even better than one could expect. The reduction made up only Rb0.1 trillion in nominal terms compared with the same period of the previous year. However, it will be possible to forecast income tax revenues for the whole year only after receiving semiannual data on the balanced financial result.

**Expenditures** of the federal budget for 5 months of 2023 relative to January-May 2022 grew by Rb2.7 trillion in current prices mainly due to growth of the budget provisions for the restricted part (by Rb3.5 trillion), whose volume has not been allocated to the functional sections of the budget classification of expenditures, as well as expenditures on inter-budgetary transfers, which, given the unusually high level of cash execution (66% vs 32–33%), demonstrate the RF Ministry of Finance's readiness to deliver funds to the regions at an accelerated pace (*Table 2*).

In nominal terms, the volume of budget allocations in all areas of funding for January-May 2023 (excluding "power" expenditures) was not lower than last year. The increased level of cash execution of the federal budget by expenditure items has to be noted separately: 45.5% vs 36.4% and 33.6% of the approved



## 2. Federal budget execution for 5 months of 2023

Table 2

### Federal budget expenditures by open items for January-May 2021–2023

	January-May 2021		January-May 2022		January-May 2023		Change in 2023 (in current prices, billion rubles) relative to	
	Billion rubles	Cash execution, %	Billion rubles	Cash execution, %	Billion rubles	Cash execution, %	2021	2022
Total expenditures including:	9004	36.4	10544	33.6	13229	45.5	4225	2685
National issues	604	34.3	692	33.7	571	28.6	-33	-121
National defense	1340	37.5	1918	22.1	884	17.7	-456	-1034
National security and law enforcement	809	34.6	871	33.3	721	15.3	-88	-150
National economy	1249	27.2	1168	24.9	1269	36.1	20	101
Housing and utilities	245	41.2	273	30.0	277	45.8	32	4
Education	469	42.4	592	45.1	718	52.7	249	126
Healthcare	493	33.4	677	39.2	673	45.8	180	-4
Social policy	2604	39.0	2985	33.3	2896	39.4	292	-89
Servicing of the government debt	411	37.9	552	41.5	601	39.6	190	49
Inter-budgetary transfers	375	33.8	402	32.3	727	66.5	352	325

Source: Ministry of Finance of Russia, RF Treasury, Portal "Electronic budget", own calculations.

annual amounts in 2021–2022, respectively. On the one hand, one can expect some "slowdown" in the build-up of budget expenditures in H2 of this year, on the other hand, there are tangible risks that the planned parameters of the federal budget in terms of expenditures (Rb29 trillion) will be exceeded by Rb1.5–2.0 trillion.

According to the results of the first 5 months of 2023 the federal budget has been executed with a significant deficit (-Rb3.4 trillion), which is quite unusual for the practice of the federal budget execution in recent years. We adhere to the earlier Gaidar Institute estimates of the relative annual budget deficit of more than Rb4 trillion or about 2.5% of GDP.<sup>1</sup> Given the availability of liquidity in the NWF, whose total volume amounted to Rb12.4 trillion as of 01.06.2023, as well as a relatively low level of debt (the volume of domestic public borrowing as of 01.06.2023 amounted to Rb19.8 trillion, meaning growth by Rb1.0 trillion over five months of 2023, there will be no problems concerning funding of such a considerable deficit during the year, however, the situation could change for the worse as early as next year (as the NWF is exhausted and the RF internal debt increases).

Although it is not yet possible to objectively assess the stability of the budget system in the medium term due to the continuing high uncertainty, including in geopolitics, as well as the reorientation of the Russian economy towards the Asian sales market, it should be recognized that the Russian Ministry of Finance manages to keep the situation in the sphere of public finance under control. ▀

<sup>1</sup> Sokolov I.A., Kazakova Ju.E. Federal budget: results of 2022 and prospects for 2023 / economic development of Russia, Volume 30, No. 4, April 2023.

### 3. REGIONAL BUDGETS IN Q1 2023

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*The transfer of taxpayers to a single tax account from January 1, 2023, which is very convenient for them, has created a lot of issues for regional budgets. Thus, the postponement of tax payments, more rapid mutual repayment of obligations to pay and reimburse overpaid taxes, as well as the reduction of the period of refunds for property and social deductions have led to a decrease in the regional budgets' tax revenues growth rate, making them more volatile and less predictable, and the need for additional borrowing.*

#### **Revenues**

In Q1 2023, total revenues of consolidated budgets of the subjects of the Russian Federation amounted to Rb4.91 trillion, which is by 12.9% more than in the relevant period of 2022 and above the inflation rate.<sup>1</sup> Since it is for the first time that regional budget statistics data is published in 2023, including data on the Donetsk People's Republic, Luhansk People's Republic, Zaporozhye and Kherson oblasts, in order to ensure comparability of general budget indicators and a more accurate assessment of their rates of change, their totals are given without regard to the above regions (unless otherwise indicated). Without them total revenues to consolidated budgets of the subjects of the Federation amounted to Rb4.77 bn, while their growth rate amounted to 9.7%. In contrast to Q1 2022, when tax and non-tax revenues of regional and local budgets were the main growth drivers, in Q1 2023 intergovernmental fiscal transfers from other budgets were growing most rapidly (+33.2%), while tax revenues were at the same level of inflation - 5.3%.

Tax revenues demonstrated multidirectional dynamics: the growth of corporate income tax revenues by 18.2% was accompanied by a decrease in personal income tax by 20.3%, which is not typical of crisis periods, when the biggest drop is usually demonstrated by corporate income tax, and personal income tax remains relatively stable.

The reasons for a significant drop in personal income tax revenues could be attributed to the peculiarities of tax payment through the unified tax account (UTA), involving the postponement of tax payment (or rather, their transfer to the unified tax account, from which the tax authorities for another few days' transfer funds to the budgets of all levels) to a later date – the 28<sup>th</sup>. Other reasons include more rapid mutual repayment of tax liabilities and reimbursement of overpaid taxes, which arise both when using UTA and due to the reduction from 45 to 15 days of the period of refunds for property and social deductions.

<sup>1</sup> According to Rosstat, in March 2023, the consumer price index came to 103.51% relative to March 2022, and in Q1 2023 relative to Q1 2022 – 108.62%.

### 3. Regional budgets in Q1 2023

Among other major taxes, we can single out the growth of excises (+10.1%) and property tax (+61.7%), as well as the reduction in tax revenues collected in connection with the application of the simplified taxation system (-14.1%). Non-tax revenues grew by 13.9%

Thus, the weak dynamics of tax revenues in Q1 2023 was largely the result of technical changes in the order of payment and reimbursement of taxes, so until the end of this year we can expect this situation to improve and the average growth rate of tax revenues to increase.

High growth rates of non-repayable receipts from other budgets were ensured by an increase in grants (+46.6%), including regional fiscal capacity equalization grants (+34.7%) and grants for fiscal balance (+3416.4%), and subsidies (+62.6%). Other intergovernmental fiscal transfers rose by 3.1%, while subventions decreased by 26.0%.

The increase in equalization grants was due to the need to at least partially compensate for the above issues with regional budgets' tax revenues and occurred as a result of outpacing provision of these grants in January 2023, when the regions received almost twice as much as they should have in the context of their equal provision during the fiscal year. In Q1 2022, there were no transfers ahead of schedule. The same can be said about grants for balancing: in Q1 2022, only the Chechen Republic received them (Rb895 mn), while most of the regions only received them in November-December. In Q1 2023, 14 subjects of the Federation received subsidies to the tune of Rb31.5 bn, while the new regions received another Rb126.5 bn.

By the end of Q1 2023, 69 subjects of the Russian Federation saw positive growth rates in consolidated budget revenues, the highest growth rates being in the Republic of Crimea (+84.4%), the Belgorod Oblast (+48.4%), the Jewish Autonomous Oblast (+46.0%) and Sevastopol (+44.9%), where in all cases federal budget fiscal transfers were the growth drivers. In the Sakha Republic (+44.6%) and the Yamal-Nenets Autonomous Okrug (+39.9%) high growth rates of revenues were due to growth of their own tax and non-tax revenues.

Of the 16 subjects that faced a decline in budget revenues, in 4 of them it exceeded 10%: in the Republic of Khakassia (-26.8%), the Kemerovo Oblast-Kuzbass (-16.5%), the Samara Oblast (-13.8%) and the Arkhangelsk Oblast (-10.7%), where the high base of Q1 2022 can be named the main reason for the decline.

The beginning of the data release on the execution of the budgets of four new subjects of the Federation allows us to say that the main sources of their revenues are donations to support measures of equalization of fiscal capacity (92.6%), personal income tax (3.8%), as well as revenues from paid services and compensation of state costs (1.4%).

In general, the problems associated with the use of a unified tax account, as well as issues of general reduction of regional budgets' own revenues due to problems in the economy in Q1 2023 were solved by the advance provision of intergovernmental fiscal transfers from the federal budget (primarily equalization grants, grants to balance and subsidies), which allowed to keep revenue growth rates above inflation for most of the RF subjects. In the future, as the technical problems are solved, some increase in the growth rate of tax revenues is feasible, while, at the same time, (due to the gradual exhaustion of the limits) the growth rate of intergovernmental fiscal transfers decreases, so one can expect decisions to provide additional amounts of transfers to the regions by the end of the year.

### Expenditures

According to Q1 2023 results, consolidated regional budgets' expenditures amounted to Rb4.09 trillion, having increased by 20.0% as compared to Q1 2022, which is higher than both the inflation rate and the growth rate of budget revenues.

Expenditures on the national issues (+49.8%), the national economy (+39.1%), including agriculture and fisheries (+61.5%), transportation (+47.6%) and road sector (+35.7%), housing and utilities (+25.1%), as well as physical culture and sports (+25.5%) were leading the growth. Expenditures on general education (+15.1%), preschool education (+9.5%), culture and cinema (+16.0%) and social policy (+15.5%), including social services (+17.5%) and social security (+18.1%) grew a bit slower. Expenditures on health care (-10.0%) as well as expenditures on public and municipal debt service (-32.5%) showed a negative trend continuing the 2022 trend. In the health care sector, this was due to the winding down of many anti-Covid measures, while spending on debt service declined due to continued substitution of commercial debt by regional budget loans.

In Q1 2023, consolidated budget expenditures grew in 80 subjects of the Federation, in 78 of them the growth exceeded inflation over the same period and in 5 subjects expenditures grew by more than 50%: in the Republic of Crimea (+90.3%, the main increase was in road infrastructure and social security), the Republic of Adygea (+59.1% in housing and utilities, general education, and social security), the Kursk Oblast (+58.4% in national defense, road infrastructure and health care), the city of Sevastopol (+56.8% in housing and utilities, national defense, fuel and energy sector, healthcare) and the Jewish Autonomous Oblast (+54.9% in water, road sector, housing and utilities).

Budget expenditures decreased in the Yamal-Nenets Autonomous Okrug (-19.2%), the Republic of Tatarstan (-17.0%) and the Tyumen Oblast (-3.6%), which can be explained by a very high rate of growth in Q1 2022.

In Q1 2023, the structure of expenditures of the new subjects of the Federation differed from the structure of other subjects by a smaller share of expenditures on the national economy (4.5% vs. 19.2%), public utilities (2.2% vs. 8.8%) and education (12.8% vs. 23.8%), but a larger share of spending on national security and law enforcement (7.5% vs. 1.3%) and social policy (57.6% vs. 23.0%).

### Balanced regional budgets and public debt

A surplus of the consolidated regional budget was observed in 72 subjects of the Russian Federation, and its total amount came to Rb679.0 bn or 14.5% of the total revenues of the consolidated budgets of the subjects, excluding subventions. Most of the new regions of Russia also finished Q1 with a surplus and only the budget of the Lugansk People's Republic was executed with a deficit.

Despite the high rates of fiscal balance of regional budgets, at the end of Q1 2023 the total volume of public debt of the subjects of the Federation increased since the beginning of the year by Rb177.4 bn (up 6.4%), amounting to Rb2.97 trillion having increased over the year by 19.8%. The notable rise in the volume of public debt at a high level of budget surplus can be explained both by the need to provide treasury loans to cover cash gaps, which emerged in the regions on the back of the change of tax payment terms, mentioned above, and by the provision of infrastructure budget loans, which by their nature are not related to the value of the fiscal balance of the region.

### 3. Regional budgets in Q1 2023

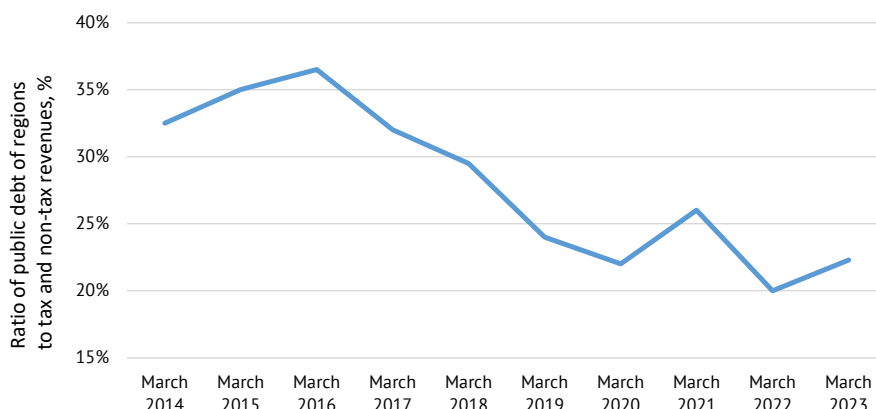


Fig. 1. Debt burden of RF subjects, %

Source: Own calculations on data released by the Finance Ministry of Russia and the Federal Treasury.

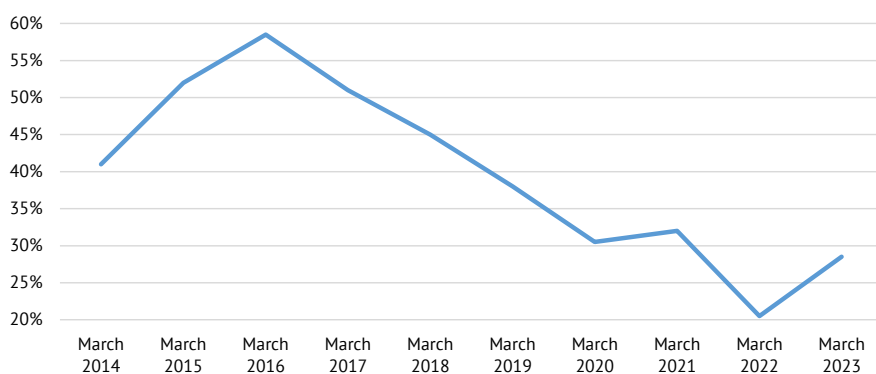


Fig. 2. Number of RF subjects with debt burden over 50%

Source: Own calculations on the data released by the Finance Ministry of Russia and the Federal Treasury.

The size of the regions' debt burden,<sup>1</sup> while increasing from 19.6% as of April 1, 2022, to 21.8%, as of April 1, 2023, continues to remain at a safe level, significantly lower than that recorded between 2014 and 2018 (Fig. 1).

The number of regions with a debt burden above 50% increased from 21 to 27 during the year, but still does not pose a threat to the stability of regional budgets (Fig. 2).

As of April 1, 2023, Udmurtia (109.3%) and the Republic of Kalmykia (104.6%) had a high level of public debt exceeding 100% of their tax and non-tax revenues.

Overall, in the 12 months between late March 2022 and late March 2023, 76 subjects of the Russian Federation had a high level of public debt and 60 subjects of the Russian Federation had a high debt burden.

The policy of active replacement of regional commercial public debt (and government securities) with budget loans, which is very expensive to service, continued to yield results: the share of loans of credit institutions in the structure of public debt dropped from 4.5% to 2.6%, the share of securities decreased from 23.4% to 21.8% in Q1 2023, while the share of budget loans increased from 71.0% to 74.4% (Fig. 3).

<sup>1</sup> The debt burden of a subject of the Russian Federation is defined as the ratio of the volume of public debt of the region to the volume of tax and non-tax revenues of the regional budget.

## Monitoring of Russia's Economic Outlook

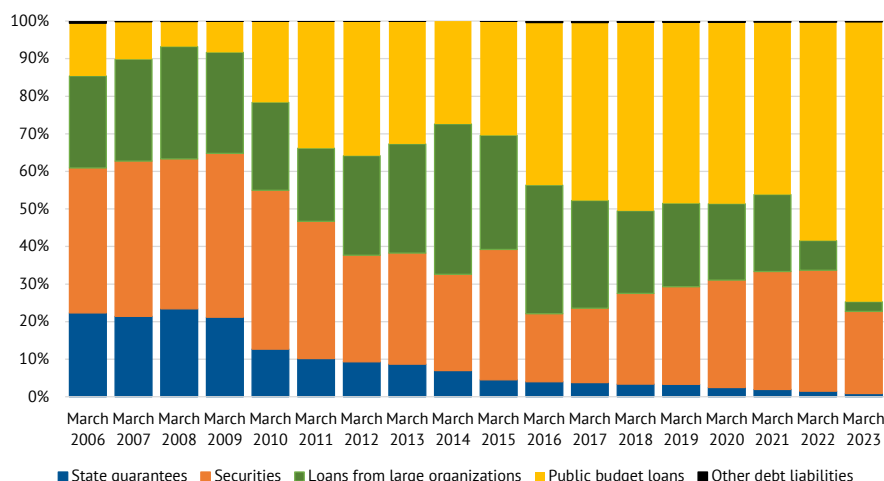


Fig. 3. Public debt structure in the RF subjects, as % to total

Source: Own calculation on data released by the Finance Ministry of Russia.

Thus, the increase in the public debt of the regions in Q1 2023 was more of a technical nature and was not related to any general deterioration of the balance of regional budgets. Until the end of 2023, the growth of the regional public debt will continue due to further provision of infrastructure budget loans. At the same time, the gradual resolution of the problems with the unified tax account will lead to a certain increase in the growth rate of tax revenues, as well as the repayment of some treasury loans, which will help to reduce both the growth rate of total public debt of regions, and their debt burden.

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The problems with the execution of regional budgets in terms of revenues caused by the transition from January 1, 2023 to the payment of taxes through a unified tax account, are of technical nature and are gradually being solved, which will lead to the normalization and growth of tax revenues, as well as reducing the growth rate of public debt of the regions by the end of 2023.

The anticipated provision of grants and subsidies from the federal budget to the regions in Q1 2023 allowed to some extent compensate for the problems of tax revenues shortfall in the regional budgets.

The debt burden of the regions, despite some growth, continues to remain at a safe level.

The budgets of the subjects of the Federation joined in 2022 are mainly formed by subsidies to support measures to ensure the fiscal balance from the federal budget, while expenditures are more focused on security and social policy. ▀