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Fiscal maneuver and restructuring of the Russian economy ☆

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Abstract

The paper discusses fiscal policy parameters through 2024. The suggested way to ensure long-term fiscal stability is stabilizing both the general government revenues and expenditures as percentages of GDP at levels differing by the public debt service payments and then applying a new version of the fiscal rule. The redistribution of fiscal spending from unproductive to productive areas (primarily investment in human and physical capital) is considered to boost economic growth. The possible use of additional spending on education, public health, and transport systems is presented, as is the optimization of expenditures in nonproductive areas.

JEL classification: B22, H21, H30, H41, H51, H52, H54, H55, H56, H61, H62.
Keywords: fiscal policy, fiscal maneuver, state budget, productive expenditures, budget expenditures structure, structural reforms, economic growth.

1. Short-term and long-term fiscal policy objectives

The Russian economy has faced serious problems in the past few years. The physical GDP was lower during Q1 2017 than at the beginning of 2012. In other words, the production is in a state of long-term stagnation. Of course, this situation can be partially attributed to negative external factors: the sharp drop in oil prices in 2014 and foreign sanctions. However, Russia's economic problems are mostly internal in nature. This is evidenced by the fact that the deceleration

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started as early as 2013, when GDP growth was at a low rate of 1.3%, and continued to slow down during the first half of 2014. The situation is aggravated by the emergence of new but entirely expected challenges. For example, in 2017, Russia entered a long period of deteriorating demographic performance; the workforce will decline by 0.5%–0.7% per year over the next 10 years, threatening an additional deceleration of economic growth to 0.5 percentage points ("p.p.") during the period (Ivanova et al., 2017). Analysts are unanimous in predicting a lengthy stagnation of the Russian economy unless serious structural reforms are undertaken. According to the baseline scenario put forth by the Russian Ministry of Economic Development, from 2017 to 2020 Russia's GDP growth will average 1.6% per year, while the IMF estimates an average annual growth rate of 1.5% over the next six years.

Dramatic problems have arisen in the state budget system as well. Thus, due to falling oil prices, oil and gas revenues declined almost by half in real terms[1] during 2016, compared to 2014. However, problems have also been identified in non-oil-and-gas revenues, as declining production has led to a reduction in the main tax base. The law on the federal budget for 2014–2016 was based on a GDP growth rate of 9.7% in three years; however, production actually dropped by 2.3%. The total revenues in the state budget were 15% lower in real terms during 2016 than in 2013, and 24% lower than the government predicted in the Main Guidelines of Fiscal Policy for 2014–2016.

Budgetary problems also appeared prior to the latest drop in oil prices. Per Goryunov et al., 2013, the budget deficit (the excess expected long-term reduced amount of future expenditures over the corresponding future revenues) was estimated at 8.4% of GDP.[2] In a later publication (Goryunov et al., 2015), due to the sharp reduction in current and expected oil prices, the estimated budget deficit increased to 13.6% of GDP. Thus, falling oil prices only aggravated the long-term budget imbalances.

An increase in the budget deficit will be caused by a reduction in state revenues (their long-term estimate is 27.8% of GDP, compared with an average of 32.8% in 2015 and 2016) and an increase in governmental expenditures (the average long-term value is estimated at 41.5% of GDP, compared to 36.4% over the past two years). If the current fiscal regime is maintained over the long-term, the current deficit in the general government budget at 3.5% of GDP (the average over the past two years) will increase by another 10 p.p. of GDP, of which 5 p.p. will be attributable to decreasing budget revenues, and the remaining 5 p.p. will be attributable to the unavoidable growth in expenditures. This may lead to a drastic increase in the national debt, which could snowball into a debt crisis.

To avoid this scenario, the basic provisions of current fiscal policy must be thoroughly revised. Changes must be directed towards three correlated tasks:

- restoring short-term and long-term budget balance and risk protection;
- ensuring long-term budget stability; and
- creating favorable conditions for economic growth.

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[1] Unless specifically stated, indicators stated in real terms are calculated using domestic demand deflators which, in our opinion, ensure the best possible estimate of the purchasing power of budget funds.

[2] The budget deficit is calculated based on long-term discounted forecasts of revenues and expenditures for the state budget and the GDP.