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The fiscal gap: An estimate for Russia ☆

Evgeny Goryunov[a,*], Lawrence Kotlikoff[a,b], Sergey Sinelnikov-Murylev[c]

[a] *Gaidar Institute for Economic Policy, Moscow, Russia*
[b] *Boston University, Boston, USA*
[c] *Russian Foreign Trade Academy, Moscow, Russia*

Abstract

The fiscal gap is an indicator of the long-term balance of public finance and is calculated based on the intertemporal government budget constraint, which links government tax revenues and expenditures over long intervals. The estimate of the fiscal gap for the Russian general government has been determined according to three scenarios with varying assumptions regarding demographic trends, productivity growth rates, oil and gas prices and the quantity of extractable reserves. The calculations show that the current fiscal policy cannot provide for the stability of public finance in the long run. The main factors of budget imbalances are the growth of pension and health care expenditures caused by demographic trends and the gradual decline in tax receipts from the oil and gas sector.

JEL classification: E62, H51, H52, H55, H62, H63, H68, J11.
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1. Introduction: The current stance and expected developments of public finance in Russia and other countries

Stabilizing public finance and ensuring fiscal sustainability became a priority for economic policies following the financial crisis in 2008 and 2009. In many advanced economies, the recession caused budget revenues to decrease and expenditures on crisis-response measures to increase, which led to sizable budget

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* Corresponding author, *E-mail address*: gorunov@iep.ru.
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deficits and to national debts jumping to levels that threatened long-term economic growth rates.

According to IMF data, the average general government debt among the advanced economies increased from 73% to 107% of GDP from 2007 to 2013 (IMF, 2014). Over that period, debt rose from 64% to 105% of GDP in the U.S., from 183% to 243% in Japan, from 36% to 94% in Spain, from 44% to 90% in Great Britain, and from 64% to 94% in France. General government budget deficits widened considerably in Japan (from 2.1% to 8.4% of GDP), the U.S. (from 2.7% to 7.3%), Spain (from –1.9% to 7.2%), and Great Britain (from 2.8% to 4.2%) over the same period.

On average, general government budget deficits increased from 1.1% to 4.9% of GDP among advanced economies. The fiscal positions of emerging market economies appeared much better. From 2007 through 2013, their average general government debt hovered around 35% of GDP and their general government budget deficit grew from zero to 2.4% of GDP.

Russia's fiscal stance appears sufficiently sustainable in comparison with both emerging markets and advanced economies. Russia is one of the few countries in the G20 in which the general government budget ran a surplus in 2012 and ran a moderate deficit in 2013 (1.3% of GDP). Russia's national debt was 13% of GDP in 2013, which is among the lowest in the group. In addition, Russia possesses considerable international reserves, which were USD 510 billion, i.e., ¼ of GDP in early 2014. However, 2014 was a very challenging year for the country. Falling oil prices and the reciprocal trade sanctions triggered by the Ukraine conflict led to a major devaluation of the national currency, a higher inflation rate and a reduction in output. Nevertheless, the general government budget deficit barely moved from 2013 levels and was running at 1.2% of GDP at the end of 2014, whereas international reserves shrank to RUB 390 billion (according to early 2015 data).

Judging from these indicators, one may conclude that Russia's public finances are in a relatively good shape. The consequences of the international conflict and changes in the commodities market have weakened the fiscal positions moderately, although Russia's budget continues to retain a certain margin of safety.[1]

However, standard fiscal indicators such as the actual budget deficit and the debt-to-GDP ratio reflect the current condition of the country's public finances; therefore, they are insufficient for long-term fiscal policy sustainability analysis. The coming decades are expected to have higher pension and health care spending. These trends are driven by demographic factors and will affect both emerging markets[2] (including Russia) and advanced economies. In addition, oil and gas revenues as a proportion of total budget receipts and as a percentage of GDP will gradually decline following stagnant oil and gas production. How sensitive is the Russian budget system to these trends in the long

[1] The short- and long-term fiscal challenges Russia is encountering are discussed in the following papers: Drobyshevsky et al. (2011, 2012), Idrisov and Sinelnikov-Murylev (2013, 2014), Mau (2014, 2015), Mau and Ulyukaev (2014), Ulyukaev and Mau (2015).

[2] For an overview of the pension systems of various states and an estimate of their long-term balance, see OECD (2013) and IMF (2011b). For a forecast of changes in health care spending and an estimate of their effect on the fiscal positions of various countries, see De la Maisonneuve and Martins (2013), Clements et al. (2012), IMF (2010).