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Laura Solanko: The largest fiscal stimulus package ever?

Russia's fiscal policy has been extremely conservative ever since the sovereign debt crisis of 1998. Backed by rising export revenues, a growing economy and tight fiscal policies, Russia's general government budget has shown sizable surpluses since 2000. Relative to GDP, the enlarged government revenues have increased from 30% to 40%. On average, the annual budget surplus was 4.3% of GDP over the period 2000–2009. The surplus funds were mostly transferred to the Stabilization Fund (later split into two funds, both of which are managed by the central bank).

Revenues decline…

Over this period the proceeds from oil and gas-related taxes and fees increased rapidly in tandem with the increases in oil prices. These proceeds mainly accrue to the federal government and consequently their relative share in total federal government revenues increased to almost 50% in 2008. As federal government revenues constitute some 60% of the enlarged government income, we can estimate that oil and gas-related revenues accounted for a quarter of all public sector revenues in Russia in 2008.

The current crisis has hit oil and gas exports particularly hard, contributing to a 47% decline in export duties and a 53% decline in proceeds from taxes on natural resource extraction during the first four months of this year. The economic contraction has not, however, been confined to the oil and gas sectors, as the 10% y-o-y GDP decline in January–May illustrates. The drop in economic activity has unavoidably reduced proceeds from all revenue sources. The enlarged government revenues in January–April were 20% lower than a year earlier. The federal revenues contracted by a quarter, while the consolidated regional budgets saw only a 5% drop in their revenues, mainly due to advance transfers from the federal budget (WB Russian Economic Report 19/2009). If current trends continue, enlarged government revenues may drop to close to 35% of GDP this year.

…while public expenditure skyrockets

Meanwhile, government expenditure has increased dramatically at all levels. In January–April this year, enlarged government expenditure increased by 23% to RUB 4,140 billion. The expenditure at the core of the Russian fiscal system, the federal budget, increased by an astonishing 37% compared with the same period a year earlier. Even taking the fairly high inflation into account, this equals a 20% increase in federal expenditure in real terms. Relative to GDP, general government expenditure has risen to 37% and federal expenditure to 23% of GDP, against 28% and 16%, respectively, a year earlier. To sum up, public sector expenditure has nominally increased by 23%, and relative to GDP by a whopping 9 percentage points compared with the first four months of 2008. The sheer magnitude of such a fiscal stimulus is huge. During the 1990s, Russia's public sector shrank dramatically, its GDP share decreasing by 12 percentage points to 26% of GDP in 1999. The current fiscal stimulus has shot public expenditure back to the level of the early 1990s.

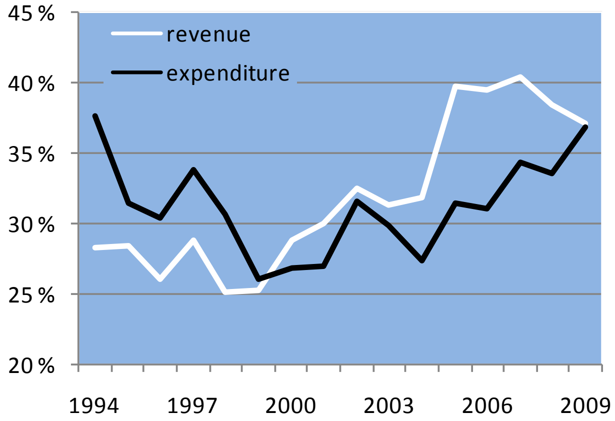
As the automatic stabilisers in the Russian fiscal system are small, the expenditure increase largely reflects expenditure on anti-crisis measures and advance transfers to the regions by the federal government. The government's anti-crisis measures announced by mid-March 2008 alone would increase federal expenditure by some RUB 2,000 billion, or 15%, in 2009. Roughly half of that is directed to strengthening the financial system, and the other half to supporting the real sector (Simachev et al., BOFIT Online 6/2009).

The return of budget deficits in Russia

Russia is in an especially fortunate situation, as the government can draw on the Reserve Fund to finance the resulting budget deficits. But this cannot not last indefinitely. The current federal budget foresees a deficit of 7% of GDP, a figure only slightly larger than last year's surplus – and only slightly smaller than the total assets of the Reserve Fund. This implies that most of the Reserve Fund will be exhausted by year end and the Russian government will have to re-enter the domestic and external bond markets in 2010 at the latest.

Given the current extremely low level of public sector debt in Russia, resorting to domestic or foreign borrowing should not threaten fiscal sustainability (Korhonen, in BOFIT Online 4/2009) in the long term. But investors' appetite for Russian government bonds is likely to be low if the budget balance continues to deteriorate. At close to 40% of GDP, the public sector is already large for a country of Russia's income levels. Therefore, public expenditure will need to be cut from the current levels in 2010–2011. Everyone hopes that by then the impressive fiscal stimulus will have jump-started the economy and the global environment will look brighter.

Enlarged government revenue and expenditure, % of GDP



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