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Russia's annual budget plan portrays subdued stimulus to cope with recession, larger deficits could lie ahead

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Russia's government budget plan that covers all budget levels in 2022–2025 contains optimism. Revenue estimates are based on a relatively benign economic forecast, deficits have been set low, and expenditures are seen to grow very weakly in real terms despite the recession.



The government budget plan for 2023–2025 covers the entire consolidated budget, which incorporates federal, regional and local budgets plus state social funds. Publication of consolidated budget data was discontinued last spring after Russia's outrageous military attack on Ukraine, but the plan drawn up by the Ministry of Finance (MinFin) still offers revenue and

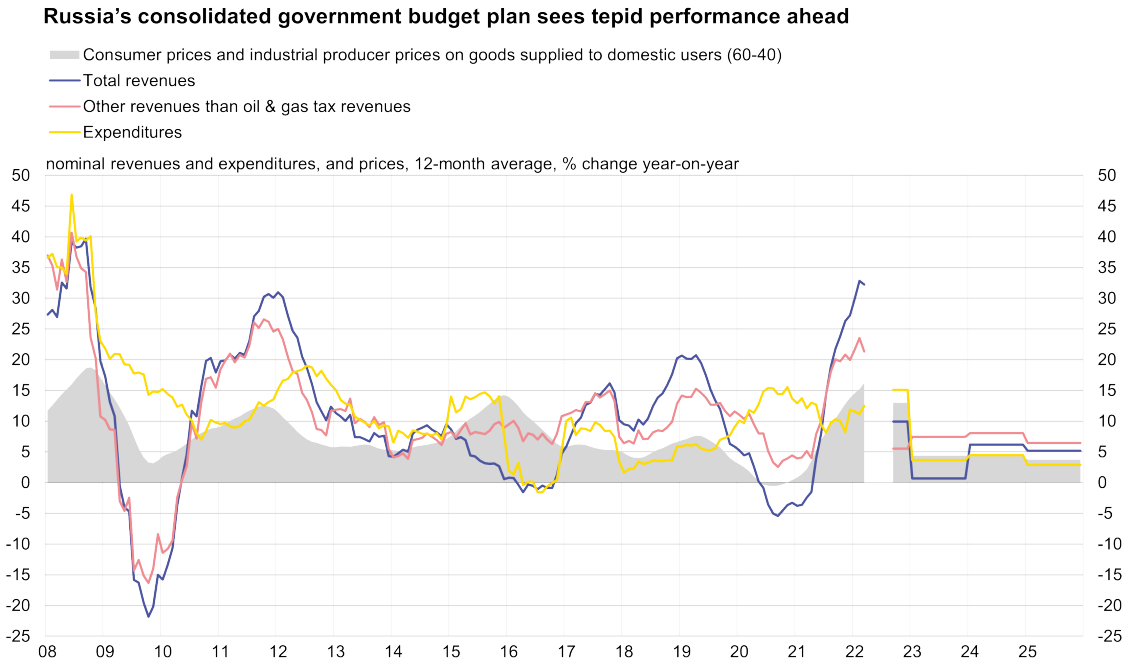
expenditure estimates for this year. Focusing on 2022 and 2023 is worthwhile as Russia's war of attrition adds even more uncertainty to the 2024 and 2025 projections.

The budget plan is based on forecasts by Russia's Ministry of Economic Development (MinEcon). The forecast sees GDP diminishing by just 3.7 % during 2022–2023, a much smaller drop than in other major forecasts. And it is followed in 2024 with a return to considerable growth. MinEcon's import projection is also less downbeat than in other forecasts.

Taxes levied on production and exports of oil & gas sectors have contributed slightly less than a fifth of revenues to the consolidated budget since 2015, including in 2021. For these revenues, defined almost completely in dollars, the assumptions used in the MinEcon forecast appear quite cautious. The dollar-price of Urals blend crude oil is assumed to fall next year to its 2021 level and the ruble's exchange rate to remain virtually unchanged from this year. Production of crude oil has accounted for around 65 % of oil & gas tax revenues in recent years. Output is expected to decrease next year, even if exports of crude oil keep rising as this year despite Western restrictions on buying Russian crude oil kicking in. As a result, oil & gas tax revenues should fall sharply next year from this year's peak.

MinFin's estimates for other budget revenues are also based on the MinEcon forecast. The GDP and import projections have direct upward impacts on more than 50 % of the consolidated budget revenue estimate (e.g. VAT and social taxes on wages). Even with the relatively benign GDP and import forecasts, increases in various taxes and an assumed improvement in tax collection next year, the nominal rise in other consolidated budget revenues will lag inflation over 2022–2023 (Chart 1). In real terms, they decline by about 2 % p.a. Total real revenues will decline more due to the fall in oil & gas tax revenues.

Chart 1.



Last year's budget surplus (0.8 % of GDP) turns to deficit this year. The plan sets the deficit at only about 1 % of GDP this year and 2 % next year. The deficit would be financed entirely from Russia's reserve fund (the National Wealth Fund) this year and largely next year. Besides drawing from the reserve fund, excess oil & gas tax revenues will be set aside according to a revised budget rule. Together with the administratively engineered appreciation of the ruble's exchange rate this year, they would reduce the ruble value of the combined amount of the fund's liquid part and set-aside oil revenues from 9 % of GDP at the end of 2021 to 2½ % of GDP at the end of 2023. The Fund's liquid part would decline from 6½ % of GDP to slightly over 1½ %. Thus, a large part of deficit financing comes from drawing down previous savings.

The plan's revenue estimates and deficit limits lead into an expenditure track where growth of nominal consolidated budget expenditures should slow sharply next year, thereby constraining spending growth in real terms during 2022–2023 to just half a percent p.a. (and 2024–2025 would see zero real growth). This is cautious indeed considering that Russia is at war and grappling with a recession. It also contrasts starkly with e.g. the spending stimulus launched during the first wave of covid in 2020. On the other hand, the government has marked a large amount of state guarantees for this year to support domestic bank lending.

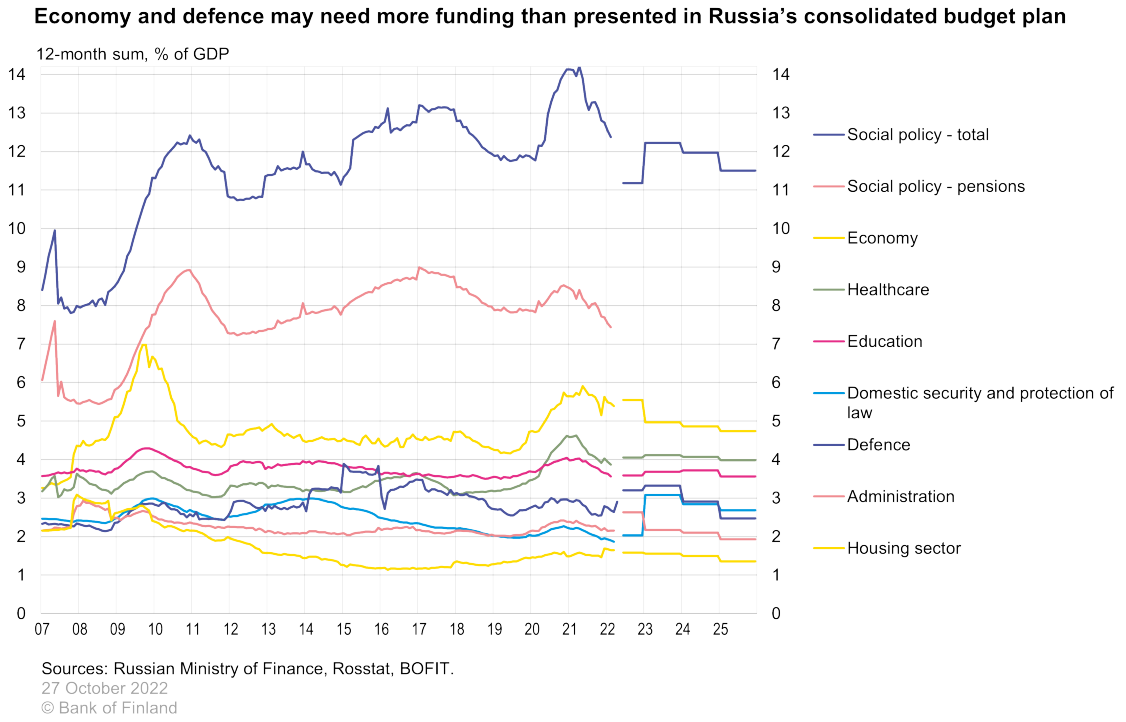
However, this year and next could see larger deficits than expected in the plan. First, adjusting MinFin's consolidated budget revenue estimate with the difference between GDP and import

projections of MinEcon and other forecasters shifts the deficit from 2 % to 3½–4 % of GDP next year. Second, the expenditure plan may not be sufficient. If spending increases in the second half of this year are similar to the first half (about 20 % year-on-year), it would result in (including the adjusted revenue estimate) a deficit of 2½–3 % of GDP this year already. Continuing from that 20 % spending increase just with the plan's 2023 modest spending growth would deepen next year's deficit to 4–5½ % of GDP.

Moreover, increased budget spending could be needed in 2023 unless there is a substantial increase in state guarantees for bank lending as this year. More generally, spending pressure could emerge e.g. if inflation does not slow in line with MinEcon's projection (4 % for consumer prices and 2 % for industrial producer prices on goods supplied to domestic users) and the government wants to avoid even weaker real-term spending than contained in the plan.

More specifically, the plan's views of two main spending categories raise questions of sufficiency of funding (Chart 2). Despite the economic slump, nominal spending on various sectors of the economy (subsidies to companies and government investments) is set to fall significantly next year. Defence spending is assumed to rise modestly even in nominal terms next year and decline in 2024. Despite the government's current policy of limiting price increases by suppliers to the defence sector, a large real fall in defence spending would be hard to avoid with the existing plan. On the other hand, spending on domestic security will receive a massive boost included in the federal budget now in the Duma.

Chart 2.



Sources: Russian Ministry of Finance, Rosstat, BOFIT.
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Larger deficits would lead to more borrowing from domestic banks, particularly state banks, as the liquid assets of the National Wealth Fund become more scarce even with the plan's smaller deficits. Government borrowing from the central bank, if necessary, would not be surprising in the wartime nation. The consequent higher inflation, like numerous other problems facing the Russian economy, would be handled later on.

Keywords

BOFIT, budget plan, government budget, public finances, Russia