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## Financial Policy and Stabilization: The Case of Russia

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**Abstract:**

*The article looks into the state financial policy and, in particular, its most important component at the modern stage, the budget policy. A brief review of the main problems and the Russian financial policy development prospects is presented in the article.*

*Practical tasks of the Russian economy, anti-crisis stabilization and the transition process to the innovative models of the Russian Federation's economic development are also analyzed in this article. It is impossible to implement the proposed priorities without a balanced and reasoned financial policy carried out at all levels of the administration without a budget regulation as a catalyzer of the required processes.*

*The main tendencies to form income, expenditures and the Russian Federal budget balance management for the ongoing and perspective period are singled out. Consequently such a detailed factor analysis of the dynamics of the receipts from budget-forming taxes is necessary to be conducted.*

*To increase the budget operational effectiveness it is necessary to widen the application of the treasury support of state contracts and to develop a state financial control system.*

**Keywords:** *Financial policy, financial mechanism, fiscal policy, federal budget, inflation, balance, fiscal consolidation, tax revenues, budget-forming taxes, economic crisis, tax administration, state program, anti-crisis stabilization of the economy.*

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## 1. Introduction

At present the economic situation in Russia overcame the period of recession and has entered the phase of growth. The measures taken by the Government to stabilize the economy allowed to eliminate the crisis phenomena in the adjustment period and to create a reliable and healthy basis to restore the economic growth. Nevertheless it is too early to make any conclusions because it is too early to characterize the equilibrium stage in the Russian economy as an optimal one. The income growth rates of the most vulnerable classes of population are lower than the desired ones, the investment activity restoration is heterogeneous, considerable structural restrictions for dynamic and balanced development are preserved.

Under these conditions the main objective of the state economic policy plan is to expand the potential of the country's balanced development. To fulfill this task it is necessary to carry out the economic policy aimed, on the one hand, at ensuring stability and predictability of the economic and financial conditions, and on the other, at removing the structural misbalances and obstacles preventing the development and related to demographic challenges, competitiveness and effective allocation of the resources in the economy. The three year state budget policy will be aimed at solving these tasks. The consecutive implementation of the budget consolidation program designed while preparing the 2017 budget and the 2018 and 2019 planning period will contribute to the Russian economy equilibrium with low inflation and low cost of long-term capital.

Budget consolidation is a relatively new notion which appeared while discussing the 2008-2010 global economic crisis issues by the G20 countries. Budget consolidation means the process to cut the budget deficit accumulated during the crisis and includes both revenue boosting processes and expenditure reduction. The consolidation program structure is not supposed to raise the tax burden for the bona fide taxpayers, but is to intensify the measures to whitewash the economy, to increase the return on state assets and to increase the budget expenditure effectiveness on the basis of the project principles of management. This consolidation program structure does not only ensure sustainable liquidation of the budget misbalances but will encourage the removal of the structural obstacles to boost the economic potential development as well. There is budget consolidation experience, i.e., the review the approaches to formation of the revenue part of the budget and the formation of the expenditure priorities, in both foreign and Russian practice (Ivanova *et al.*, 2017).

## 2. Materials and methods

The research is based on the foreign and Russian scientists' works devoted to the issues of macroeconomic regulation of the financial system, budget policy state management, budget policy formation, economic analysis as well as economic reforms. Taking into the account the studied object the research is based on the

system approach to analyze the subject of the research. The authors have used different statistical methods, comparative analysis and an extrapolation method.

### **3. Results**

In Russia there are some difficulties to achieve the budget balance through budget consolidation. The adjustment of the economy to the new realia takes place together with price reduction on main export positions, the financial crisis, and the internal market destabilization due to economic policy mistakes. In accordance with the international experience the following main principles to avoid negative effects on the economic growth during the transition period are singled out.

The first principle is connected with the choice between expenditure optimization and tax burden growth. The tax increase generates some uncertainty in the tax system stability, restrains the growth of the most developing industries, and decreases investment activity. The second principle is to carry out structural reforms. The structural reforms allow to restore the balance between budget obligations and revenue sources. The labor incentive reforms, pension system reform, privatization aimed at liberalization and new market creation, health care reforms are referred to such structural changes. The third principle is based on public support. It concerns new public treaty on costs due to expenditure reduction. For example, in 1987 the Ireland government agreed with trade unions that the restrained growth of nominal wages in the public sector would be partially compensated by the income tax reduction. Higher level of employment in exchange for low growth of wages was supposed in the German treaty. The fourth principle is to coordinate fiscal and monetary policies. Under negative interest rates fiscal consolidation in the developed economies goes painless, the reduction of the public expenditures can be to a little extent compensated by the softening of the financial conditions. At the same time the measures of the budget consolidation do not only ensure positive effect in fiscal terms, but promotes the positive structural changes and removal of the obstacles to expand the economy potential as well.

Public sector effectiveness increase is among the main structural measures of the budget consolidation. To boost public sector effectiveness it is necessary to increase the minimum level of the norm to transfer dividends on state-owned shares and the profits of FSUE (Federal State Unitary Enterprise) to 50% from the net profit as well as to continue the privatization program implementation.

The increase in the minimum level of the norm of dividends transferred to the state (50%) from the net profit will bring this indicator close to other countries. For example, this norm in the European countries is 70%. This measure will promote firstly, the increase of deficit financial resources in the state budget, secondly, the state companies' capitalization increase, thirdly, it will promote the creation of

equal competitive conditions. Reduced norms of the dividends give ungrounded advantage in comparison with private companies. Such measures to increase the dividend norm to 50% will promote more effective use of the budget resources.

The reduction of other subsidies to the state companies is important to state sector effectiveness increase. This innovation presented in the 2017 Main Guidelines of the Budget policy and the 2018 and 2019 plan period will concern both direct subsidies and state support through the system of tax benefits and tax exemption. Such kind of state aid both open and hidden disguises low operational effectiveness. Moreover this state support has not been formalized yet, which results in lack of fiscal policy transparency and eventually promotes the reduction of the state economic policy effectiveness.

The second direction of the structural measures of the budget consolidation is filling budgets of all levels. Tax payments is the main tool. At the same time taxes reflect social and economic processes because they are becoming objective indicators of the financial and economic companies. While forming fiscal policy, governing bodies on behalf of the state fulfill the following tasks:

- ✓ regulate the tax collection volume, changing taxation methods, tax rates, tax benefits, applying tax exemption for some types of enterprises, territories, etc.;
- ✓ stimulate economic activity and increase human capital productivity;
- ✓ create optimal conjuncture at the market, conditions to modernize important economic industries;
- ✓ form effective social policy.

The budget system, accumulating the necessary financial resources in the frame of a realized tax policy, redistributes them to finance social projects and programs, i.e., directs them to the social system in the form of investments in human capital (education, health care, etc.). It is known from world practice and from the Russian scientists' works that such kind of redistribution increases the human capital quality, i.e., its number, education and health level, professionalism, personnel qualifications, infrastructure services for the population that in its turn has a positive impact on the production force development. Consequently such approach influences positively on the production efficiency, scientific and technical innovation introduction, output growth, i.e., on the country's social and economic system potential to be modernized. By introducing the innovation methods into the production and stimulating investments into the physical capital of the production system its aggregated financial result increases, which then results in the maximization of tax collection from the enterprises for the country's budget system as well as in consumption and population savings growth. This interaction has a mutually beneficial cyclical character.

The volume of tax collection into the budget system depends on population's well-being growth, i.e., and directly from the public goods value provided by the state. The impact on the final result of the production is determined by budget resources distribution to create, develop and use the mentioned factors in the production process. At the same time the public goods value depends on the resources whose volumes depend on consumption, taxation, capital and labor. While budget system expenditure is increasing to develop physical and human capital (namely, investments in production, education, health care, etc.), the quality of such investments is growing with a time lag. In other words while labor quality increases, the results of the complicated work growing, which promote the growth of the goods and services at the macro-level as well as tax revenues into the budget due to effective economic activity, also increase. This process is of permanent nature up to a certain critical point after which state investment growth stops influencing positively the economic growth and the tax collection volume into the budget.

The production system is influenced through tax burden limits, tax benefits and preferences for some economic branches and territories as well as through control over completeness and timeliness of tax payments, true tax and accounting statements. Under a rational tax regulation system the growing number of taxes affects the growth of the state investments into the social system. The state by stimulating human capital investment via the budget system (namely, health care quality, education, social guarantees), in exchange obtains labor resources growth and their better quality to promote further the economic growth and a sustainable development. It is necessary to attract additional sources to replenish the budget to finance the government expenditure, the social aspect in particular.

Consequently tax policy methods used by the tax system are to ensure incentives for work and savings for capital investments and companies' growing profit, including foreign investments. It is extremely difficult to reveal the interconnections and define the reasons, affecting the tax revenues dynamics. The main factors of the tax revenues analysis are social and economic, legal and administrative. These factors affect differently on each budget forming tax – company profit tax, value added tax (VAT), minerals extraction tax (MET), personal income tax and excise. In the first half of 2017 the tax revenues into the Russian Federation consolidated budget totaled to a 6.9 trillion rubles that is 1.3% lower than the same period in last year. At the same time receipts without oil and gas revenues totaled to a 5.6 trillion rubles and grew in comparison with the same period of 2016 by 5.1%.

Negative dynamics of the revenues into the Russian Federation consolidated budget resulted from serious reduction of the minerals extraction tax receipts (by 22%) and it proves strong resource dependence of the Russian economy. The minerals extraction tax (MET) is the tax that most quickly reacts on the external economic processes. In the first half of 2017, 78% of MET receipts are from oil extraction tax

that is why volatility of the oil price and dollar exchange rate affects the receipts. They dropped by one third in the first half of 2017. The key economic factors affecting MET receipts dynamics are the oil extraction volume, the Urals oil price and the dollar exchange rate. Apart from the economic factors, the legislative factor can be important – minerals extraction tax rate change.

Excise is of the most predictable taxes calculated through the direct method. 82% of the aggregated excise receipts volume consists of 38.7% tobacco excises, 32% oil products excises, the 12.2% alcohol excises. The population consumption activity is a determining economic factor in the dynamics of this tax revenue. Final consumption at the internal market affects excise behavior as an indirect tax. In other words this tax dynamics depends on the excisable products realization. Another determining factor is tax legislation changes. Tobacco and oil product excise increase by 73% (+84 billion rubles) formed the total increase in excise receipts (+115 billion rubles). The rest of the revenues was provided the increased volumes of the tobacco and oil products sold.

The US Dollar exchange rate growth increases costs (in rubles) on the imported goods (services) and additionally promotes price growth. Inflation can also increase tax basis due to price growth and simultaneously reduce it due to population purchasing power reduction and production and trade volume reduction. At the same time the impact of these macroeconomic indicators on the VAT revenue dynamics can be divided into the internal and external market factors. The export calculations showed the degree of their effect on the VAT sum collected in the first half of 2016. The main increase was due to growing inflation rate (+158 billion rubles) as well as due to decreased volume of the imported goods (+76 billion rubles) because of tax reduction whereas trade volume reduction and weak ruble reduced the revenues by 212 billion rubles.

Thus, the analysis of the factors influencing the tax revenue dynamics showed that the increase of the organization profit tax and VAT reached 90 billion rubles (total sum of the increase of these two taxes totaled to 105 billion rubles) due to better quality of these taxes administration. Such result is an expected reaction on all measures to improve tax collection whose main goal is to reduce pressure on business with retaining the tendency to tax revenue growth.

One of the main measures of the budget consolidation for three years is to freeze the budget expenditures in nominal terms at 15.8 trillion rubles (without taking into account payments to pensioners and the related expenditures) with prevailing expenditures on management, defense and social policy and underfunding expenditures on human capital. The planned reduction of the Federal budget expenditures (in nominal terms) and budget system (on GDP) will be accompanied with “freezing” of the existing expenditure structure.

It should be mentioned that during the last decade changes in the expenditure structure of the Russian budget system moved opposite to the movement in the OECD countries. For example, the period between 2007 and 2015 the average share of the expenditures on health care in the budgets of the OECD countries increased from 17.0% to 18.7% and in Russia within the same period reduced from 12.1% to 10.8%. The share of the expenditures on education in the budgets of the OECD countries within the last decade was kept at the level of 13% at the same time in Russia it reduced from 11.8% to 9.9%. The preservation of the existing expenditure priorities with the planned reduction of the total expenditure in relation to the GDP in the nearest years will move the education expenditure financing towards the levels inherent to the "third world" countries. This tendency does not solve the task to remove the obstacles for development. The measures to reduce the expenditures can be unsustainable if are not the results of the public consensus and is not well supported. Consequently, it is necessary to predict the budget expenditure growth in real terms minimum by 4% and in nominal terms not lower than 8% a year. Taking into account the multiplier effect the proposed expenditure growth can increase the GDP growth rate by the end of 2020 by 0.84 percentage points (cumulative total), and the Federal budget revenue due to the GDP growth rate by 0.42 percentage points.

The deficit in relation to GDP is not to exceed 4.0%. Thus, the successes in the balanced Federal budget is achieved due to the expenditure reduction, freezing projects envisaged under them as well as continuing the policy of consolidation and centralization both in budget revenues and in deficit funding. It is necessary to pay special attention to the budget fund use effectiveness while making the long-term financial sustainability, focusing on the selection of vectors and tools to achieve the goals. The key directions in this sphere in 2018-2020 are:

- ✓ to integrate the budgeting and purchasing process through the development institution of rationing of purchases, to automate the control procedures, to create the conditions to minimize the contract receivables, to develop information space to provide transparency and accountability;
- ✓ to expand the mechanism of treasury support of settlements for execution of state contracts throughout the depth of cooperation (including sub-contractors), state defense orders, single vendor contracts, etc.;
- ✓ to expand the scope of the Treasury letter of credit in granting subsidies to legal entities, to fulfill the state contracts as well as banking escort of certain state contracts;
- ✓ to finish the formation of the normative and legal basis giving the non-state organizations the access to provide state services as well as to use the competitive ways to select the organizations to provide state services;
- ✓ to introduce the planning procedure of the budget investment into the objects of the capital construction of the mechanism to reason the

investments and to do the technological and price audit.

It should be also mentioned that in 2020 it is planned to return to formation of the conditionally approved expenses, whose volume will total to 428.0 billion rubles or 2.5% from the total volume of the expenditure part of the Federal budget, that as practice shows is the effective measure to reduce budget system sustainability risk. The budget consolidation issues require carrying out adequate debt policy. In this connection the state borrowing policy has to adapted the new realia, to correct the Russia's strategy of its presence on the debt markets as a borrower, to work out the measures to preserve the flexibility while implementing state borrowings. In this connection the long-term internal borrowings is to be a priority to implement state borrowings. To provide the control over public debt dynamics and to increase the borrowing effectiveness, the debt policy is to be oriented on:

- ✓ the state borrowings cannot exceed the amount of public debt repayment;
- ✓ the amount of the public debt and its structure are to provide the guaranteed possibility for the Russian Federation to fulfill its obligations to repay and service it as well as the guaranteed possibility to refinance the debt regardless the budget standing and forecasted changes of the foreign economy conjuncture at a certain period of time;
- ✓ the debt policy is to provide the possibility for the flexible reaction on the changing conditions for the borrowings at different segments of domestic and foreign markets to be attracted and to provide the possibility to use the most favorable for the borrowings sources, forms and tools at the corresponding period;
- ✓ is aimed at constant active public debt management to reduce risks connected with its structure and to reduce its maintenance cost;
- ✓ the internal debt specific gravity in the public debt structure will grow.

To preserve the country's economic safety it is necessary to set limit values in the sphere of external and internal corporate debt. The Presidium of the Council for Strategic Development and Priority Projects selected 11 key directions to work. A part of the events of the given projects has already been downloaded into the budget and then with prioritizing costs, the additional events will replace the inefficient ones.

#### **4. Conclusion**

The authors' conclusions and proposes formed on the basis of the Russian Federation financial and budget policy research will allow to reach the macroeconomic stability and country's balanced development. Budget policy formation in accordance with the principles of the new budget rules will not only allow to increase the Federal budget sustainability and guarantee to fulfill all state



obligations regardless the oil price flexibility but will promote the formation of the predictable macroeconomic and financial conditions to ensure economic sustainable growth and to favor for the Bank of Russia's inflation targeting policy. Gradual reduction of the Federal budget structural deficit during 2018-2019 will create favorable conditions to stabilize inflation at a lower level, open additional space to reduce equilibrium real interest rates in the economy and remove preconditions to increase the tax burden, thus, providing the economy transition to target macroeconomic equilibrium, favorable for the investment growth model. The measures to mobilize the income base among others will also allow:

- ✓ to increase the return on state assets, thus contributing to the state companies' effectiveness increase;
- ✓ to increase the collection of the key taxes with lower administrative burden for the legal business;
- ✓ to increase the oil and gas sector effectiveness.

Measures on prioritization and budget expenditure efficiency increase will be based on both closer links among the results and budget allocation volume, and on the active formation of the tools applied to carry out the budget policy. The implementation of the mentioned above events to promote the national economy and national finance can become the basis to stimulate the economic growth and prosperity in the country.

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