

Putin's promises return to haunt Russian budget

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By Jason Bush

MOSCOW (Reuters) - The easy days are over for Russia. After years of rising oil prices that poured ever more revenues into the nation's coffers, it now faces tough decisions on spending.

A draconian budget plan, due to go before parliament on Friday, symbolizes the new era of austerity. And it raises big questions about how exactly Russia will make its books balance in the years ahead.

President Vladimir Putin has put enormous pressure on the finance ministry's sums with promises of public spending that aim to quieten domestic opposition and fund Russia's hosting of events including the soccer World Cup and Winter Olympics.

In a sign of the political tensions that creates, Putin recently rebuked ministers - and by implication his prime minister, Dmitry Medvedev - for failing to draw up a credible budget plan.

"The problem is that we have ourselves limited our expenditures - which is very correct," Finance Minister Anton Siluanov said at the Reuters Russia Investment Summit this week, "in order to reduce our oil-and-gas dependence."

"On the other hand we have to fulfill the decrees of the president ... How can we do all this? Of course it wasn't at all simple."

The hastily-reworked package nevertheless sticks to the austere budget targets drawn up by the fiscally-hawkish Finance Ministry.

Deputy Economy Minister Andrei Klepach, also speaking at the summit, warned that cutbacks envisaged in the plan could mean that Russia's ambitions to host the World Cup in 2018 might yet come under threat.

"It's necessary either to give up (hosting the World Cup), or to invest something," he said.

LARGESSE

Over recent years, the seemingly boundless oil revenues have enabled Putin to boost spending dramatically, smoothing his re-election to the Kremlin in March - and helping him ride out the first mass protests against his rule.

Putin's pre-election promises, later enshrined in a flurry of decrees, included generous hikes in public sector pay, additional social benefits and regional development programs.

The Finance Ministry reckons that the additional cost to the federal budget of these programs will tot up to some 1.145 billion roubles (\$36 billion) during the years 2013-2015 covered by the budget plan.

This is in addition to other expensive spending plans, such as a program to spend 20 trillion roubles (\$620 billion) on re-equipping the armed forces by 2020.

Costly state pensions are also adding to the fiscal burden, amid controversy over whether to wind down the part of the scheme under which workers save for their own retirement to release cash for today's pensioners.

On the other side is Russia's new fiscal rule, which bases spending plans on the long-run average oil price over previous years, and also caps government borrowing at no more than one percent of gross domestic product.

To keep within these tight guidelines, the budget plan aims to keep spending almost flat in real terms, with only small deficits projected in 2013 and 2014, and a balanced budget in 2015.

But even if Russia stays the course, the oil price at which the budget would balance is projected to decline only gradually, from around \$110 per barrel this year to \$104 in 2015.

That compares with a break-even oil price of around \$50-\$55 per barrel five years ago, noted Sergei Guriev, rector of the New Economic School in Moscow, signifying how Russia's reliance on high oil prices has soared in line with public spending.

"If the oil price goes down to say \$60 and stays there for say a year the government has enough resources," Guriev told the Summit. "If it stays there for two years the government will run out of cash and will not be able to borrow, because the markets will say: 'We know you are gone.'"

TOUGH CHALLENGE

No matter how impressive the fiscal targets are on paper, Russia will face a tough challenge to stick to them in future - not least because of growing signs of political discontent that is making Russia's leaders nervous.

"The government knows it needs to spend more and more. And that's why Putin had this spat about the budget," said Guriev.

Pressure for higher expenditures also comes from legitimate concerns that Russia needs to boost investment in key areas such as infrastructure and education.

"The budget is primarily cutting state investment," said Deputy Economy Minister Klepach, who argued that such investment is badly needed to sustain economic development.

Independent analysts have estimated hosting the World Cup could require Russia to spend up to \$50 billion to renovate clapped-out infrastructure.

"There are projects that aren't in the budget, but some sort of solution is needed," Klepach said.

OPAQUE

In its determination to make the budget numbers add up over the next three years, the Finance Ministry may be storing up trouble for later.

Siluanov has said that part of the answer to the conundrum lies in a scheme to issue state guarantees of 560 billion roubles (\$18 billion), mainly to finance purchases of military equipment, shifting the burden from 2013-15 into later years.

But the plan has raised concerns among economists that Russia is using creative accounting to balance the books.

"The credit scheme significantly worsens the transparency of the budget," said former Finance Minister Alexei Kudrin. "It's also debt, only in a hidden form."

He also noted that the costs of Putin's recent spending commitments will increase drastically after 2015.

By 2018, the deadline for several of Putin's social policy commitments, the government estimates they will cost 1.5 percent of GDP, or around \$30 billion, every year.

"The real fulfillment of these measures will take place only in 2016 to 2018," Kudrin said.

Uncertainty over how the spending promises will ultimately be financed - through higher taxes or cuts in other areas - is weighing on business confidence, he added.

"It won't be so easy to implement all these decisions. For the time being there is no answer." (\$1 = 31.0725 Russian roubles)

(Additional reporting by Darya Korsunskaya and Maria Tsvetkova; Writing by Jason Bush; Editing by Douglas Busvine and Patrick Graham)

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