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# Analysis: Taxes May Be Real Challenge to Putin

By The Moscow Times

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Winning Russia's March presidential election could be the easy part for Prime Minister Vladimir Putin, who has called for a "decisive tax maneuver" to put the country's increasingly oil-dependent public finances on a more sustainable footing.

Although Russia, the world's largest energy producer, ran a fiscal surplus last year thanks to strong oil prices, the high and increasing price at which the budget balances poses the real risk of a fiscal crisis in the next six-year presidential term.

"The Russian government needs to carry out a major budget consolidation over time," said Odd Per Brekk, the International Monetary Fund's representative in Moscow. Without one, he warned, "Russia is much more exposed to an oil price shock."

Since 2006, the volume of government expenditures has risen by an average of more than 20 percent each year — double the rate of inflation. Their share of gross domestic product has rocketed from 29 percent to 39 percent.

That now places Russia in the same league as relatively high-spending, high-tax European economies rather than low-tax emerging markets such as China and India.

The challenge for Putin, assuming he takes office in May as appears highly likely, will be to squeeze revenues out of an economy that is already stuttering under a mounting tax burden.

The so-called "tax maneuver," aimed at reducing taxation on entrepreneurs by shifting it onto under-taxed sectors and activities, is one solution gaining favor among policymakers.

Putin stated the rationale for the tax maneuver in a 5,000-word newspaper article on Monday.

"We have reserves for increasing tax revenues in several directions: expensive property, consumption of luxury goods, alcohol, tobacco, the collection of rents in those sectors where it is currently low," he wrote.

Putin has borrowed the idea from Delovaya Rossia, a lobby group for small and mid sized businesses that backs selective tax hikes — on oil and gas extraction, tobacco and alcohol and property — to finance business tax cuts.

"In Russia, those taxes that hinder development are either very high or very uncompetitive, and those taxes that don't hinder development are on the contrary very low," said Alexander Galushka, president of Delovaya Rossia.

The lobby group's initiative reflects widespread discontent over high payroll taxes levied on employers to fund ballooning state outlays on pensions, health care and welfare benefits.

The government last year attempted to raise payroll taxes from 26 percent of employee salaries to 34 percent. Following a backlash from business, it scaled back the rate to 30 percent, but businesses complain that the tax is still crushingly high.

In contrast, some other taxes — such as the 13 percent flat rate of income tax — are incongruously low.

Yet tax dodging remains a rampant problem, with about 40 percent of economic activity unreported to the taxman.

"If they set a higher rate for rich people, that will increase tax evasion," said Yevsei Gurvich, head of the Economic Expert Group, which advises the Finance Ministry.

Officials are focusing instead on consumption taxes that are harder to evade. According to Delovaya Rossia, were Russia to raise its low excise duties on tobacco and alcohol to the European average, the government could raise an extra $35 billion in tax yearly.

The taxman now takes only 51 rubles ($1.70) on a half-liter bottle of vodka and 9 rubles on a packet of 20 cigarettes.

The lobby group also backs higher taxes on the oil and gas sectors. "You're simply taking away rent — unearned income — which is fair from the point of view of the economy, and politically and socially just," Galushka argued.

Most analysts are skeptical over the potential to squeeze yet more tax out of the oil industry, where high taxes are widely blamed for curbing investment and stunting output growth.

But the case for upping the tax take from Gazprom, the state-controlled gas export monopoly, is more compelling.

Gurvich calculates that the gas sector's share of value added paid as tax, about 35 percent, is less than half the 80 percent level paid by the oil sector.

Closing that gap would raise an additional 1.5 percent of GDP — about $25 billion dollars per annum — in tax.

The discrepancy is even more obvious when looking at the taxes paid by the metals and mining sector, where the average tax take represents about 25 percent of profits.

"Oil is overtaxed, metallurgy is under taxed, and the gas sector is in the middle," said Kingsmill Bond, chief strategist at Citigroup in Russia.

Russia may in practice have less wiggle-room than appears on paper.

Higher excise duties could backfire by hurting the pockets of ordinary Russians. They also face stiff opposition from the tobacco and alcohol lobbies, which argue that higher taxation would encourage counterfeit production.

Proposals to bring taxation of the gas and metals sectors closer into line with the oil sector would entail challenging even more powerful lobbies with good connections in government.

"There is substantial potential to increase taxation of the gas sector, but the political feasibility is not substantial," Gurvich said.

When it comes to metals, he said, "only a minor increase is politically realistic," which would be "insignificant from the macroeconomic viewpoint."

Nor would property taxes produce a bonanza. Russia's slow-moving bureaucracy has struggled for years with the complicated preparations needed to register and value property holdings.

"It costs more to administer this tax than the tax collects. It collects very, very little," Galushka said.

A more basic problem is that simply shifting the tax burden will not address the root cause of Russia's fiscal conundrum: ever-rising government spending.

"The government should focus primarily on raising the efficiency of public expenditure," said Gurvich. "It concerns everything: public investment, public procurements, more focused social support, and pension reform."

Without a convincing answer to such problems, businesses are wary about planning more than a couple of years ahead, said Alexei Shestoperov, a researcher at Moscow's National Institute for System Studies of Entrepreneurship.

"The budget demands more and more resources and where are they going to come from? It's hard to understand," he said.