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World Bank Sees Poverty Down, Inflation as Biggest Risk

By Irina Filatova

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The government's social spending measures appeared to bear fruit last year, resulting in declining poverty rates, although Russians are likely to face additional inflationary pressure ahead of the 2012 presidential elections, the World Bank said Wednesday.

The government should focus on controlling inflation in the short term, as the growth of budget expenditures is possible due to upcoming elections and preparations for the Sochi Olympics in 2014, the bank warned in a report.

"The upside risks for inflation, associated with additional fiscal spending during the election cycle, will remain in 2011 and 2012," the report said.

According to the report, the government's economic policy should be aimed at "a more ambitious fiscal adjustment and a long-term non-oil fiscal deficit of about 4.3 percent of gross domestic product," as the budget remains vulnerable to a sudden decline in oil prices.

Zeljko Bogetic, the World Bank's leading economist for Russia, said efficient budget policy was crucial, since the Russian economy largely depended on oil prices.

The country is facing a risk of returning to "the oil curse" with high oil prices resulting in "unjustified government expenditures, especially in the pre-election time," he told reporters at the bank's Moscow office.

The government should reduce the budget's vulnerability to new spending by cutting the non-oil fiscal deficit, which currently stands at a very high level of 12.7 percent of GDP, Bogetic said, adding that the government's current plan to reduce the budget deficit was "reasonable."

The World Bank supports the Finance Ministry's recent initiative to put additional revenues coming from the oil and gas sector in reserve as a measure to lower inflation rates, said World Bank economist Sergei Ulatov.

"We support this decision because it's aimed to fulfill two tasks — first to lower inflation rates and second not to cause additional expenditures," Ulatov said.

Finance Minister Alexei Kudrin said earlier this month that part of the additional revenue coming from the oil and gas taxes and duties would be used to lower the budget deficit and increase the reserve fund, which now stands at just 2 percent of GDP.

The reserve fund decreased almost 50 percent over the last year, having reached $26 billion by March 1, compared with $59 billion in March 2010, according to the Finance Ministry's web site.

Inflation stood at 8.8 percent in 2010, while the Central Bank expects that it will drop to 6 percent to 7 percent this year.

"Inflation is Russia's main problem in the short term," Bogetic said.

He said inflation was not only a macroeconomic problem but a social one as well, because it resulted in serious pressure on real incomes for the middle and lower class.

According to the report, food prices jumped by 17.5 percent in June to February largely because of last summer's severe drought.

Low-income households were most affected by the surge in food prices, which caused a 5 percent drop in consumption, the report said.

However, the government's social support measures, which included increasing pensions and wages in the public sector as well as unemployment benefits, resulted in the percentage of the population living below the poverty line falling from 13.2 in 2009 to 12.7 last year, it said.

An impoverished person, according to the government figure, is anyone earning less than 5,902 rubles ($208) per month.

Prime Minister Vladimir Putin said late last year that the government had no intention to trim social spending.

The government will increase pensions by 10.3 percent starting Friday, with a total of 20 billion rubles ($700 million) being set aside in the Pension Fund's budget.

The World Bank expects a further decline of the poverty rate, which is likely to reach 11.2 percent this year and 10 percent in 2012 due to the positive economic growth rates and falling unemployment.

The bank lowered its forecast of economic growth rates in 2011 to 4.4 percent, compared with last year's prediction of 4.5 percent.

Bogetic said cutting inefficient expenditures was one possible way to reduce budget spending and prevent inflation growth. Additional funds, which will appear as a result of the move, could be used to finance "priority infrastructure projects," he said.

Upgrading transport and road infrastructure will require significant budget spending, while the funds currently appropriated for these purposes are not sufficient, the World Bank said.

The government plans to spend a total of 644 billion rubles on upgrading transportation infrastructure this year, with 453 billion rubles being spent on road maintenance.

"According to estimates, the proposed funding levels for the road sector by 2013 will narrow –– but not eliminate –– the funding gap for maintenance of the federal highway system," the World Bank reported.

According to the bank, poor infrastructure is a key factor constraining economic competitiveness.

Improving the country's investment climate is one of the crucial tasks for the government for the coming years, Bogetic said.

"It's not a problem of one sector. It requires the government's highest attention and the attention of state agencies in charge of developing small and medium business, as well as the issues of investment climate in general," he said.

The full World Bank Report can be found here.