The Russian Stabilization Fund and Its Successor: Implications for Inflation

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Abstract: A senior Japanese specialist on Russia's economy and its oil- and gas-producing sectors analyzes the functions and performance of the Stabilization Fund of the Russian Federation and the new system replacing it in 2008. The Fund, created to diminish the effects of possible future decreases in oil prices on federal budget revenues and to absorb excess liquidity in the economy, was expected to exert a major curb on inflation. The author investigates the extent to which the latter, inflation-fighting role of the Fund has been fulfilled, given increases in the country's money supply and in state-regulated prices within the natural monopolies. *Journal of Economic Literature*, Classification Numbers: E50, E62, H20, H60. 4 figures, 5 tables, 25 references. Key words: Russia, Stabilization Fund, oil and gas revenues, federal budget, inflation, natural monopolies, non–oil-gas balance, Dutch disease, fiscal policy.

INTRODUCTION

The Stabilization Fund of the Russian Federation was enacted in late 2003 and went into force the following year.[2] Its purpose was to reduce the impact of a possible decrease in oil prices on revenues of Russia's federal budget. It was also anticipated that the Fund would absorb excess liquidity in the economy generated by increasing oil export earnings. A portion of revenues from export duties and mineral extraction (severance) taxes on crude oil were to be transferred into the Fund when world market prices on oil exceeded a specified base price.[3] The amount to be transferred would be determined by subtracting (a) *hypothetical revenues* from export duties and severance taxes (assuming that the base price for crude oil is equivalent to the world market price)[4] from (b) *actual revenues* from export duties and severance taxes. The base price initially was set at $20 per barrel and increased to $27 on January 1, 2006.

During the period from 2004 until November 1, 2007, as much as 4,456.7 billion rubles generated from export duties and severance taxes were transferred into growing coffers of

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[2]Federal Law No. 184 of December 23, 2003 inserted Chapter 13-1, the "Stabilization Fund of the Russian Federation" into the Budget Code of the Russian Federation.

[3]For a detailed study of oil and gas taxes in Russia, see Tabata (2006b, pp. 48-52).

[4]For the purpose of generating revenues for the Fund, the *de facto* base price is set well below the actual world price.

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Table 1. Stabilization Fund of the Russian Federation, 2004–2007, bill. rubles

Category	2004	2005	2006	2007[a]	Sum
Revenues	522.3	1,387.9	1,708.5	1,388.6	5,007.3
Crude oil tax revenues[b]	416.3	1,107.7	1,637.8	1,231.9	4,456.7
Other revenues[c]	106.0	217.2	70.7	156.7	550.6
Expenditures	0.0	673.1	604.7	33.6	1,311.4
Debt repayment	0.0	643.1	604.7	33.6	1,281.4
Paris Club	0.0	425.8	604.7	0.0	1,030.5
Other	0.0	217.3	0.0	33.6	250.9
Pension fund of Russia	0.0	30.0	0.0	0.0	30.0
Currency exchange gain or loss[d]	0.0	-0.1	0.1	-52.6	-46.6
End-of-period balance	522.3	1,237.0	2,346.9	3,649.3	—
End-of-period balance, bill. dollars	18.8	43.0	89.1	147.6	—

[a]January–October.
[b]Revenues of severance taxes and export duties on crude oil.
[c]Includes the remainder of the federal budget as of the beginning of the year.
[d]Calculated from revenues, expenditures, and balance.
Sources: Compiled by the author from Ministry of Finance, 2007a.

Table 2. Price Increases in Russia, 2000–2007[a]

	2000	2001	2002	2003	2004	2005	2006	2007[b]
Consumer prices	20.2	18.6	15.1	12.0	11.7	10.9	9.0	9.3
Foods	17.9	17.1	11.0	10.2	12.3	9.6	8.7	11.6
Other products	18.5	12.7	10.9	9.2	7.4	6.4	6.0	4.9
Services	33.7	36.9	36.2	22.3	17.7	21.0	13.9	11.7
Producers' prices (industry)	31.9	8.3	17.7	12.5	28.8	13.4	10.4	17.0
Electricity	43.5	28.1	25.5	13.9	12.5	11.5	9.8	16.1
Cargo transport tariffs	51.5	38.6	18.3	23.5	9.3	16.6	15.8	10.9
Rail	69.3	34.4	19.5	26.5	12.6	13.3	8.9	7.7
Pipeline	37.4	58.5	19.2	24.1	3.4	21.5	23.7	14.6

[a]December as percentage of previous year's December.
[b]October as a percentage of previous December.
Sources: Compiled by the author from *Rossiyskiy*, 2006, p. 713; *Sotsial'no-*, 2006, No. 12, pp. 163–164; *Rossiya*, 2007, pp. 427, 430–432, 447; and Rosstat website [http://www.gks.ru].

the Stabilization Fund (Table 1). Such transfers accounted for 22.8 and 26.1 percent of total federal budget revenues in 2005 and 2006, respectively, and 72.6 and 82.1 percent shares of the federal budget surpluses in those years (*Rossiya*, 2007, p. 350; *Rossiyskiy*, 2006, p. 617).

The Fund's enabling legislation specified that once the resources of the Fund exceeded 500 billion rubles, the excess would be used for the purposes stipulated in the federal budget law each year. While no mention of the Fund was made in the federal budget law governing the year 2004, for 2005 a portion of the Fund was earmarked for financing the deficit of the Pension Fund and also for the repayment of foreign debts (Table 1). The 2006 and 2007 federal budget only mention use of the Stabilization Fund for the repayment of debts.

Fig. 1. Exchange rates of the ruble in real terms, 1992–2007, in percent of June 1992. Official exchange rates were deflated by the Consumer Price Index (CPI). *Sources*: Calculated by the author from *Izvestiya*, June 3, 1992, p. 8; various issues of *Kratkosrochnyye*; and websites of Rosstat (http://www.gks.ru) and the CBR (http://www.cbr.ru).

By November 1, 2007, 1,311.4 billion rubles of the Stabilization Fund's resources had been spent, the bulk (1,030.5 billion rubles—i.e., $15 billion in 2005 and $21.6 billion in 2006) to accomplish an early repayment of debt to the Paris Club. Other expenditures also were primarily related to early foreign debt repayments. The balance as of November 1, 2007 was 3,649.3 billion rubles ($147.6 billion; Table 1) or 11.9 percent of the predicted GDP in 2007 (Ministry of Finance, 2007c, p. 10).

One of the stated purposes of the Stabilization Fund is to curb inflation. In Russia, inflation rates higher than 10 percent persisted since 2000, dropping only to 9 percent by 2006 (Table 2). Two main factors have been responsible for inflationary pressures: (1) increases in money supply, prompted by purchases of dollars by the Central Rank of Russia (CBR) on exchange markets; and (2) increases in state-regulated prices within the realm of the so-called natural monopolies, such as natural gas, electricity, and rail cargo transport.

With respect to the first factor, it should be noted that in order to mitigate symptoms of the "Dutch disease" brought about by high oil prices,[5] the CBR was expected to adopt a proactive stance in order to prevent a sharp appreciation of the ruble in real terms. Because of the huge trade surpluses resulting from oil price increases, it had to purchase enormous quantities of dollars on exchange markets. Despite these interventions, the ruble appreciated rapidly in real terms after 1998, both in relation to the U.S. dollar and the euro (Fig. 1). During

[5]"Dutch disease" refers to the hypothesis that Russia's increasing oil revenues will have a negative effect on other sectors of its economy (particularly manufacturing) by raising the exchange rate of the ruble, thus making exports less competitive on world markets. A strong ruble would discourage investments in these (manufacturing) industries, and also discourage imports of investment goods. It should be emphasized here that the cause of the Dutch disease is the *present* high level of the ruble's exchange rate, and not its future appreciation *per se*.

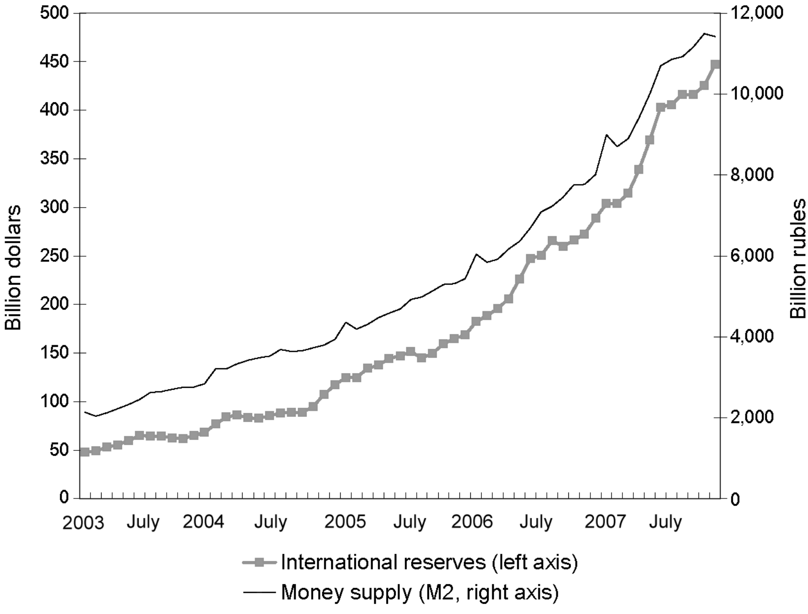

Fig. 2. Increases in international reserves and the money supply (M2) of Russia, 2003–2007 (monthly values are for the beginning of each month).

the period from the third quarter of 1998 through that of 2007, the ruble has appreciated by 2.9 times versus the dollar and 2.4 times versus the euro. In other words, the ruble strengthened during this period by 12.6 percent and by 10.2 percent annually in relation to the dollar and the euro, respectively. Few countries in the world have experienced such a sharp appreciation of their national currencies in recent years.[6]

As a result of the CBR's purchases of dollars, Russia's international reserves have skyrocketed (as shown in Fig. 2, compiled by the author from the CBR database), reaching 447 billion dollars on November 1, 2007. Russia now ranks third in the world after China and Japan in terms of its international reserves. The correlations between increases in international reserves and current account surpluses are depicted in Figure 3; since 2004, the growth of both indicators has been especially large, with oil price increases clearly the underlying cause.[7]

Accompanying Russia's mounting international reserves has been the impressive growth in the money supply (Fig. 2), at annual rates exceeding 30 percent (or nearly double that in some years) since 2000. Table 3 shows how the Stabilization Fund has been employed in an effort to sterilize the money supply, via increases in Stabilization Fund reserves and in repayment of foreign debt.[8] Sterilization effects, as measured by the ratio of the amount of

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[6]Interestingly, in other major oil-exporting countries (e.g., Saudi Arabia, Kuwait, and Mexico), the national currencies did not appreciate, but rather had depreciated in real terms from 2002 through 2004 (see Kudrin, 2006b, pp. 5–6).

[7]The reasons for discrepancies between these two indicators in 2006 and 2007 are discussed later in this paper.

[8]Kudrin (2006b, pp. 10-11) has demonstrated that sterilization by the government amounted to 1095.9 billion rubles in the first eight months of 2006, compared to 212.9 billion for the CBR.

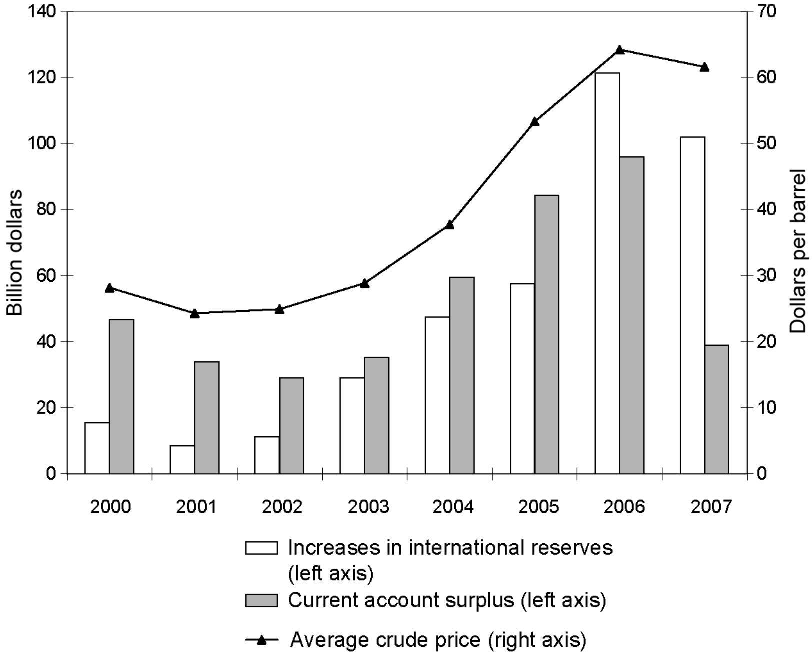

Fig. 3. Increases in international reserves and the current account surplus of Russia, 2000–2007 (the 2007 data are for the period January–June). *Sources*: Compiled by the author from the CBR website (http://www.cbr.ru) and International Financial Statistics (IFS) website maintained by the International Monetary Fund (http://www.imfstatistics.org).

Table 3. Increases in Money Supply and Sterilization in Russia, 2000–2007, in bill. rubles

Indicator	2000	2001	2002	2003	2004	2005	2006	2007[a]
Increases in money supply	439.8	458.2	521.9	1,078.2	1,150.6	1,682.3	2,950.2	2,425.9
Sterilization by SF[b]					522.3	1,357.8	1,714.6	1,336.0
Increases in SF					522.3	714.7	1,109.9	1,304.2
Debt repayment from SF					0.0	643.1	604.7	33.6
Increases in money supply minus sterilization	439.8	458.2	521.9	1,078.2	628.3	324.5	1,235.6	1,090.0
Effects of sterilization (percent)					45.4	80.7	58.1	55.1
Increase in rates (percent)								
International reserves	124.6	30.9	30.5	61.0	61.9	46.3	66.7	47.2
Money supply	61.5	39.7	32.4	50.5	35.8	38.6	48.8	27.0
Money supply minus sterilization	61.5	39.7	32.4	50.5	19.6	7.4	20.4	12.1

[a]January–October.
[b]SF = Stabilization Fund.
Sources: Compiled by the author from Table 1 and the website of the CBR [http://www.cbr.ru].

sterilization brought about by the Stabilization Fund to the increase in money supply, totaled 45.4 percent in 2004, 80.7 in 2005, and 58.1 percent in 2006. Rates of increase in the category "money supply *minus* sterilization" have been much lower than those of money supply alone (without sterilization); in 2005 the former was only 7.4 percent, which can be considered normal if GDP growth in that year (6.4 percent) is taken into account.[9]

If the Ministry of Finance and the CBR are considered for the moment to be a single, unified monetary authority, then it is possible to say that the purchase of foreign currencies by the CBR was made possible by the existence of the Stabilization Fund. Actually, Government Resolution No, 229 of April 21, 2006 empowers the Ministry of Finance to purchase foreign currencies (dollars, euros, and pounds sterling) using reserves from the Stabilization Fund. Thus the mechanism for purchasing foreign currencies in the markets using the resources of the Stabilization Fund has been spelled out rather clearly.[10] In fact, all of the money in the Stabilization Fund is held in the three foreign currencies in the ratio of 45:45:10 (dollars: euros: pounds sterling, respectively), as specified by the Ministry of Finance.

THE NEW SYSTEM IN 2008

The Stabilization Fund was modified significantly by Federal Law No. 63 (enacted on April 26, 2007), which went into force on January 1, 2008.[11] In place of the Stabilization Fund, the government introduced a new system based on a concept involving the non–oil-gas balance,[12] the main features of which are explained as follows:

1. Unlike the Stabilization Fund, which had been financed by the additional revenues from severance taxes and export duties on crude oil, the oil-gas revenues of the new system are to include (in addition to oil export duties and severance taxes), severance taxes on natural gas and export duties on natural gas and petroleum products. Furthermore, whereas under the Stabilization Fund, additional tax revenues were transferred to the Fund only in the event of rising oil prices (relative to the base price), under the New System, *all* tax revenues are to be transferred to oil-gas revenues.[13]

2. A deficit ceiling for the newly introduced concept of a "non–oil-gas balance" (i.e., a balance not including oil-gas revenues) was set at 4.7 percent of GDP.

3. Oil-gas revenues are to be divided into three parts: the oil-gas transfer, the Reserve Fund, and the Fund for Future Generations. The oil-gas transfer comprises a transfer to the

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[9]In Russia, the monetization ratio, as measured by the ratio of M2 to GDP, remains low—28.3 percent in 2006. It is expected to reach 60 to 65 percent in 2015 and 70 to 75 percent in 2020 (Ministry of Economic Development, 2007b, p. 43).

[10]See Gurvich (2006, p. 8) and the interview with Yevgeniy Gavrilenkov in *Rossiyskaya gazeta* (January 23, 2007, p. 10).

[11]Chapter 13-1 of the previous legislation ("Stabilization Fund of the Russian Federation") was replaced by Chapter 13-2 ("Use of Oil-Gas Revenues") in the new law.

[12]The idea of the oil-gas balance was first proposed by the Ministry of Finance on August 26, 2006 (Ministry of Finance, 2006a), and explained in Kudrin (2006a) as well. It seems that a major purpose of this proposal was to prevent other ministries from increasing their expenditures in the draft federal budget for 2007.

[13]In the Ministry of Finance's original proposal (Ministry of Finance, 2006a), profit taxes on the oil and gas sectors and excises on natural gas and petroleum products were included in oil-gas revenues. In the revised version of the proposal released on December 4, 2006, excises on petroleum products were excluded from oil-gas revenues (see footnote 3 in Ministry of Finance, 2006b). It was not explained why oil-gas revenues were ultimately restricted to severance taxes and export duties.

federal budget designed to finance deficits in the non–oil-gas balance; it is calculated in the federal budget law each year as an amount equivalent to 3.7 percent of GDP.[14]

4. The base amount of the Reserve Fund is to be calculated as an amount equivalent to 10 percent of GDP in the federal budget law of each year. If the amount of that fund falls below its base and the actual oil-gas revenues are larger than the designated amount of the oil-gas transfer to the federal budget, additional oil-gas revenues are to be transferred to the Reserve Fund. When actual oil-gas revenues are not sufficient to cover the oil-gas transfer, then money must come from the Reserve Fund.[15] The Reserve Fund also can be used for early repayment of foreign debt, or invested in foreign currencies and bonds.

5. The Fund for Future Generations is to be built by the use of accumulated oil-gas revenues when the amount of the Reserve Fund exceeds its base level. The Budget Code makes no mention of the Fund for Future Generations, although President Putin in his annual address to the Federal Assembly on April 26, 2007 proposed to call it the National Prosperity Fund.[16] He has proposed to spend some of the money from that fund on voluntary pension savings programs and on institutions (Development Bank, Investment Fund, Russian Venture Company) financing projects to: (1) remove infrastructure bottlenecks that impede economic growth (e.g., generation of electricity; transportation); (2) increase the efficiency of natural resource use; and (3) modernize and develop high-technology industrial production. Money in the Fund for Future Generations is to be invested in high-yield bonds or securities.

The money accumulated to date in the (old) Stabilization Fund is to be transferred to the Reserve Fund and the Fund for Future Generations. On January 1, 2008, an amount corresponding to 10 percent of projected GDP in 2007 will be moved to the Reserve Fund, and the remainder will augment the Fund for Future Generations by February 1, 2008. According to the basic guidelines of the budgetary and tax policies for 2008–2010 released by the Ministry of Finance on May 2, 2007, the Reserve Fund will have as much as 3,690 billion rubles on February 1, 2008 and the Fund for Future Generations clearly less at 470.7 billion rubles (Ministry of Finance, 2007b, p. 7). It therefore appears that the Reserve Fund will basically inherit the money and functions of the Stabilization Fund.

It should be emphasized that the new system will be phased in gradually; interim measures will be adopted during the period from 2008 through 2010. Federal Law No. 63 specified that the figures designated in points 2 and 3 above (4.7 and 3.7 percent of GDP, respectively) would not be applied in the years from 2008 to 2010. Rather, during this period a deficit of the non–oil-gas balance larger than 4.7 percent of GDP will be allowed, and in order to cover this deficit, an oil-gas transfer in an amount larger than 3.7 percent of GDP will be tolerated. As shown in Table 4, the oil-gas transfer in 2008 is to comprise 6.1 percent of GDP and the deficit of non-oil-gas balance is to amount to 6.6 percent of GDP.

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[14]If the non–oil-gas balance has a deficit that exceeds 3.7 percent of GDP, the excess must be covered by other means (see note 15). As observed by Uegaki (2007, pp. 4–5), Russia's new system is similar to Norway's Government Petroleum Fund, in the sense that the non–oil-gas deficit is to be financed by the oil-gas transfer. It should be noted that the Government Petroleum Fund of Norway was transformed into the Government Pension Fund–Global in 2006.

[15]The long-term forecast (Ministry of Economic Development, 2007b, p. 163 and Table 4) maintains that oil-gas revenues will not be sufficient to maintain the Reserve Fund at the level of 10 percent of GDP beginning in 2014, and that it will fall below 3.7 percent of GDP in 2017. Accordingly, that the deficit in the non–oil-gas balance will in fact need to be covered by the Reserve Fund. This forecast is based on the assumption that oil prices (Urals) will decrease to $56 per barrel by 2011, then increase to $60 by 2015 and $65 by 2020 (ibid., p. 25).

[16]From the official website of the President of the Russian Federation [http:president.kremlin.ru/eng/text/speeches/2007/04/26/].

Table 4. Federal Budget and Oil-Gas Revenues of Russia, 2000–2010, in percent of GDP

Category	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2008[a]
Federal budget												
Revenues	15.5	17.8	20.3	19.5	20.1	23.7	23.6	20.3	19.0	18.8	18.0	19.0
Non–oil-gas revenues	11.7	13.1	15.1	14.1	13.5	13.6	12.7	12.2	12.2	12.9	12.8	12.2
Oil-gas revenues	3.8	4.7	5.2	5.4	6.6	10.1	10.9	8.1	6.8	5.9	5.2	6.8
Oil-gas transfer	2.4	1.9	2.9	3.7	2.0	2.3	2.9	4.9	6.1	5.3	4.5	3.7
Savings	1.4	2.8	2.4	1.7	4.7	7.8	8.0	3.2	0.7	0.6	0.7	3.1
Expenditures	14.1	14.8	18.9	17.8	15.9	16.2	16.1	17.0	18.8	18.8	18.0	16.9
Surplus	1.4	3.0	1.4	1.7	4.2	7.5	7.5	3.3	0.2	0.0	0.0	2.1
Non–oil-gas balance	-2.4	-1.7	-3.8	-3.7	-2.4	-2.6	-3.4	-4.8	-6.6	-5.9	-5.2	-4.7
Stabilization Fund[b]												
Revenues	—	—	—	—	3.1	6.4	6.4	4.5	—	—	—	—
Expenditures	—	—	—	—	0.0	3.1	2.3	0.1	—	—	—	—
Savings	—	—	—	—	3.1	3.3	4.1	4.4	—	—	—	—

[a]Test calculation, assuming the same revenues as shown in “2008,” as well as the statutory norms of the oil-gas transfer and non–oil-gas-balance.
[b]As for 2007, data for January–October.
Sources: Compiled by the author from Ministry of Finance, 2007b, p. 6 and Table 1.

It is rather obvious that these interim measures will cause federal budget expenditures to increase. In 2008 such expenditures will amount to 18.8 percent of GDP, the highest level since 2002. Table 4 clearly indicates that from 2004 through 2006 federal budget expenditures were substantially curtailed (at 15.9 to 16.1 percent of GDP) because of the Stabilization Fund. An amount of oil-gas revenues equivalent to 4.7 percent of GDP in 2004, 7.8 in 2005, and 8.0 percent in 2006 was not treated as federal budget expenditures, but rather was frozen in the Stabilization Fund.

Estimated expenditures are shown in the Table 4 column for the year 2008, calculated on the assumption that no interim measures are to be employed, and that non-oil-gas revenues and oil-gas revenues are the same as shown in 2008. In such a case, federal budget expenditures would amount to 16.9 percent of GDP. This test calculation thus clearly shows that the interim measures have been adopted for the purpose of increasing federal budget expenditures in 2008–2010.[17]

THE DILEMMA OF A STRONG RUBLE AND INFLATION

If the historically high oil prices persist, Russia’s economic outlook will likely be favorable at least over the foreseeable 5 to 10 years. However, even if the oil price picture remains positive, a looming problem for the Russian economy will involve a dilemma between a

[17]Obviously, predicted decreases in oil-gas revenues are not explicitly factored into these interim measures, because in the new system only an amount of oil-gas revenue corresponding to 3.7 percent of GDP is to be transferred to the federal budget, and oil-gas revenues are forecast to be larger than this amount in 2008–2010.

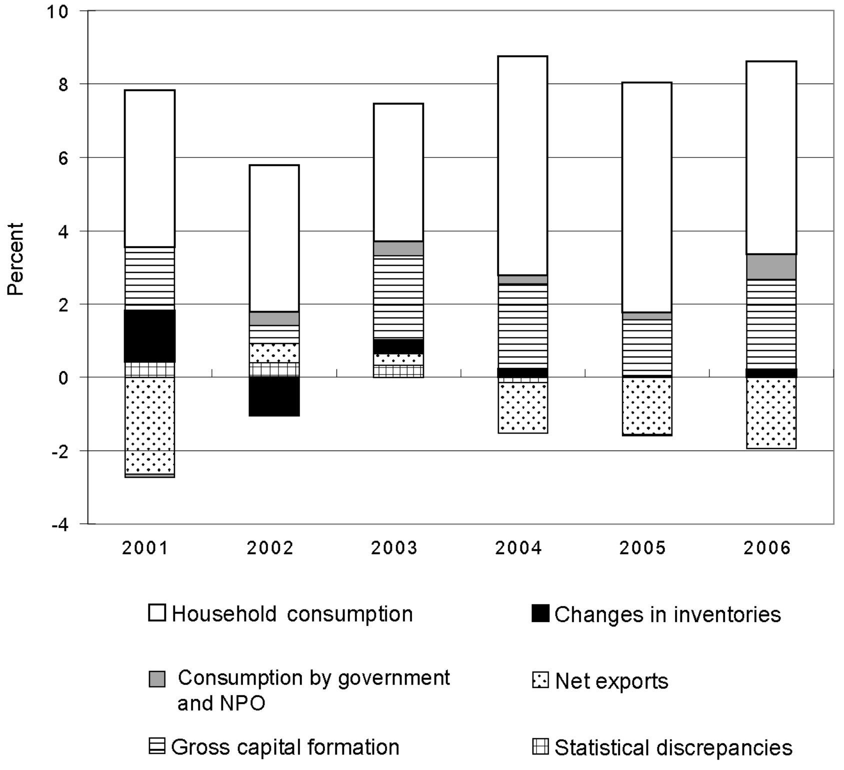

Fig. 4. Contributions to GDP growth by final use, 2001–2006. *Sources:* Calculated by the author from Rosstat website [http://www.gks.ru].

strong ruble and inflation. As noted earlier, the appreciation of the ruble in real terms has continued (due to persistent growth in oil and gas export earnings; Fig. 1), despite large purchases of foreign currencies by the CBR. In view of the above, it does not seem possible for Russia to elude the onset of Dutch disease: if the CBR seeks to prevent further appreciation of the ruble, it must purchase substantially greater volumes of dollars on the exchange markets, thus increasing the money supply. Therefore, the CBR will be compelled to tolerate the ruble's continued appreciation in real terms (in greater or lesser degree) in the foreseeable future.

It should be emphasized at this point that Russia's strong economic growth in the early 21st century has not been driven by investment, but by household consumption. As shown in Figure 4, the contribution to GDP growth by household consumption has been roughly 4 to 6 percent annually, compared to rates in the range of 0.5 to 2.4 percent for gross capital formation.[18] Although investment did increase rapidly during that period,[19] the investment ratio, as measured by the share of gross capital formation in GDP, has hovered around 18 percent since 2000.

Some observers expect imports of consumer and investment goods to increase sharply in the near future, in tandem with appreciation of the ruble. For example, while current account

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[18]For an analysis of Russia's GDP growth by final use, see Tabata (2006a, pp. 105–110).

[19]During 2001–2006, the average annual rate of increase in the rate of gross capital formation was 10.0 percent.

surpluses increased on a year on year basis until 2006 (Fig. 3), the situation seems now to have changed. In the first half of 2007, the current account surplus fell to $39.0 billion, almost 30 percent less than during the first half of 2006 ($55.5 billion), with an increase in imports thought to be the basic cause.[20] It is noteworthy that imports of machinery (categories 84 to 90 in the Harmonized System foreign trade code) have grown considerably in recent years, and that the majority of such imports were consumer (e.g., automobiles) rather than investment goods.

The inflow of foreign capital into Russia also appears to have resulted in an increase in the country's international reserves in 2006 and 2007 (Fig. 3), thus contributing to the potential for further appreciation of the ruble. According to balance of payments statistics issued by the CBR, foreign direct investment (FDI) in Russia increased from $12.9 billion dollars in 2005 to $30.5 billion in 2006 (www.cbr.ru). In the first half of 2007, FDI totaled $27.9 billion, a 58.5 percent increase from the corresponding period of 2006.[21] In addition, loans issued by Russian banks increased from $17.8 billion in 2005 to $47.6 billion in 2006. As a result, net private capital flows into Russia jumped from $0.1 billion in 2005 to $40.1 billion in 2006, as noted in Hanson (2007, pp. 884-885). Such an influx of foreign capital may be responsible for the rather abrupt increase in international reserves shown in Figure 3.

Now I will focus more specifically on the inflationary impacts of the current situation. As noted above, the main factors driving the current inflation in Russia are the increases in money supply and those in state-regulated prices charged by the natural monopolies (natural gas, electricity, and rail cargo transport). Increases in money supply will depend on the magnitude of current account surpluses, which are expected to decrease in the government's forecast (Ministry of Economic Development, 2007b, p. 41). However, one should also take into account the change in fiscal policies (explained above) after the abolition of the Stabilization Fund in 2008. If the federal budget expenditures are increased at the same time as the decrease in sterilization of oil-gas revenues, the increases in money supply will clearly heighten inflation.

One can only guess at the rationale underlying such a policy change. It may reflect political considerations such as efforts to enhance the mood of voters in the run-up to the State Duma and Presidential elections in December 2007 and March 2008, respectively. Social spending, such as increases in pensions and salaries of civil servants, as well as investments in a number of national projects, are to be increased.[22] One should remember, however, that Aleksey Kudrin, the Minister of Finance, who is regarded as an advocate of conservative

[20]During the period from January to September 2007, exports increased by 10.4 percent compared with the corresponding period of 2006, but imports grew by a much more rapid 36.3 percent, reducing the trade surplus by 15.9 percent (data from www.cbr.ru). If this trend continues, Russia's trade balance would turn negative by 2010, as anticipated in the draft of the Concept of Long-Term Socio-economic Development of the Russian Federation (Ministry of Economic Development, 2007b, p. 41).

[21]Rosstat statistics generally show the same trend, although the figures sometimes differ substantially: FDI did not increase significantly in 2006 relative to 2005 ($13.7 billion compared to $13.1 billion; *Rossiya*, 2007, p. 414), but grew more substantially in 2007 (when FDI for the first half amounted to $15.8 billion, 2.5 times larger than the increase exhibited during the corresponding period in 2006). The more recent growth has been due to investments in the fuel extraction sector by the Netherlands ($10.7 billion dollars; *Sotsial'no-*, 2007, No. 7, pp. 191–193). The difference between the FDI figures reported by the CBR and by Rosstat reflect the differing definitions of investment employed by the two agencies. The latter does not include foreign investments received by the CBR and commercial and savings banks (*Rossiyskiy*, 2006, p. 700), whereas the former includes them. However, FDI data disaggregated by sector are available only from Rosstat.

[22]The former Minister of Economics, Yevgeniy Yasin (2007), is a proponent of such active fiscal policies.

fiscal policies, was concurrently appointed deputy prime minister in September 2007, whereas German Gref, the Minister of Economic Development and Trade and an advocate of liberal investment policies, did not retain his post. Kudrin's main concern still appears to be fighting inflation.[23]

It is also worth noting in this context that public opinion does seem to be running in favor of utilizing a portion of the revenues that have accumulated in the Stabilization Fund. A public opinion poll conducted by the Levada Center in September 2007 revealed that 73 percent of respondents favored the option: "Even a part of the money of the Stabilization Fund should be used for social programs or investments in the economy." Another 13 percent were opposed, and 15 percent did not select either option.[24]

Increases in state-regulated prices, the other main inflationary factor, also warrant closer inspection. As Kudrin (2007, p. 19) has noted, "In 2000–2001 the Government refused to freeze the prices of natural monopolies and [rather] switched to their successive increases." As shown in Table 2, prices in the sphere of the natural monopolies, including electricity as well as railroad and pipeline transportation/services, have grown more rapidly than consumer prices.[25] This is especially the case for producers' prices in industry, which increased 28.8 percent in 2004 (and 17.0 percent through October of this year) and rail/ pipeline cargo tariffs (up 10.9 percent during January–October 2007).[26]

Table 5 shows the upper limits of price increases in the natural monopolies designated by the Ministry of Economic Development and Trade (Ministry of Economic Development, 2007a), and approved by the Government on April 19, 2007.[27] As shown in the table, the Ministry projects a continuation of rapidly increasing gas prices until 2010, in accord with the government's/Gazprom's intention to gradually increase domestic gas prices in order to reduce the gap between domestic and international prices. This policy conforms with structural reforms in the gas industry[28] and to EU demands in the negotiations on Russia's accession to the World Trade Organization.[29] In addition, Government Resolution No. 333, issued on May 28, 2007, stipulated that from January 1, 2011, gas supplies from Gazprom and its affiliates would be provided at prices that guarantee equal profitability of sales to domestic as well as foreign consumers.

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[23]For example, Kudrin authored an article in *Voprosy ekonomiki* on the subject (Kudrin, 2007), and has stated (quite reasonably) that it will be impossible for the ruble to become convertible unless annual inflation rates are reduced to 2–3 percent (*Rossiyskaya Gazeta*, May 13, 2006, p. 2).

[24]The poll results are posted on the Levada Center website [http://www.levada.ru/press/2007/100203.html], and have been reported in *Ekonomika i zhizn'* (2007, No. 41, p. 9). When queried about specific preferences regarding the purpose for which such Fund resources should be used, respondents chose, among other options, "the development of education, health care, science and culture," "additions to resources of the Pension Fund," "an increase in civil servants' salaries," and "agricultural subsidies."

[25]Clearly, decreases in prices of imports, caused by the ruble's appreciation, contributed substantially to the relatively modest increase in consumer prices. Pantyushin (2007, pp. 3–4) has demonstrated that the contributions of food and services to consumer price increases were each 40 percent, whereas the shares of the overall consumer basket corresponding to food, other consumer products, and services were 40.2, 35.1, and 24.7 percent, respectively.

[26]Interestingly, much higher increases in 2006 for tariffs on cargo and pipeline transportation (individually) — 32.1 percent and 58.0 percent, respectively—were reported until May 2007 (*Rossiya*, 2007, p. 447; *Sotsial'no-*, 2007, No. 4, pp. 190-191). These were somehow reduced to 15.8 percent and 23.7 percent, respectively (as shown in Table 2) in the May issue of *Sotsial'no-* (2007, No. 5, p. 170).

[27]The schedule of gas price increases shown in Table 5 was adopted by the government in November 2006.

[28]Gazprom also will need to raise prices in order to compensate for rapidly rising costs of developing new gas fields located in increasingly remote and difficult environments (see Sagers, 2007, pp. 652–653).

[29]For details on Russia's efforts to join the WTO, see Åslund (2007) and Tarr (2007).

Table 5. Schedule of Increases in Prices[a] Charged by the Natural Monopolies, 2008–2010[b]

Sector	2008	2009	2010
Gas	25	27.7	27.7
Electricity	12	12.5	13.5
Housing and communal services	17	18–19	18–19
Railroad cargo transportation	11	9	8
Railroad passenger transportation[c]	14	13	12

[a]Tariffs.
[b]December in percent of preceding December.
[c]Regulated tariffs for long distance.

And in fact domestic gas prices increased about 20 percent annually during 2003–2005 and 11 percent in 2006 alone (*Rossiya*, 2007, p. 444).[30] A further increase of 15 percent for 2007 was approved at a Cabinet meeting on August 17, 2006 (from the Russian Government's website—http://www.government.gov.ru/government/governmentactivity/). And gas price increases for 2008–2010 (Table 5) will be higher still.[31] These steep increases in gas prices, in turn, will contribute to increases in the price of electricity and other categories.

In summary, the two main factors expected to drive inflation in Russia will not weaken over the next two to three years (during the period when the interim provisions of the new system are in effect). It is thus quite difficult to imagine how inflation (as measured by consumer price indexes) can be reduced to 6 percent by 2010, as called for in the federal budget law for 2008–2010.

CONCLUDING NOTE

Three major conclusions can be derived from the analysis in this paper. First, during the period from 2004 to 2007 the Stabilization Fund had a substantial sterilization effect, which kept inflation rates relatively low despite sharp increases in money supply generated by current account surpluses. Second, the termination of the Stabilization Fund in the beginning of 2008 may entail a shift toward active fiscal policies—including the adoption of interim or exceptional measures in 2008–2010 and active use of the Fund for Future Generations—which are likely to stimulate inflation. And finally, increases in state-regulated prices in the natural monopolies, necessitated by structural reforms, will also create inflationary pressures within a few years.

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[30]These are purchasers' prices of natural gas for industrial organizations.

[31]Here, two offsetting factors should be taken into consideration. First, as international gas prices have been rising in tandem with oil prices in recent years, the gap between international and domestic gas prices in Russia has tended to increase. Second, and on the other hand, as the ruble has appreciated sharply in recent years, domestic gas prices (expressed in dollars) have been rising as well.

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