

# The tax manoeuvre in the oil industry as a threat of Russia's claim of world leadership

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**Abstract** Back in 2019, Russian Prime Minister Dmitry Medvedev stated that Russia has to become the locomotive for the world economy and the centre of gravity. However, Russia does not use this main competitive advantage – being a major energy power, although it could provide a global leadership role for the country. High energy prices for domestic enterprises impede development of industries and agriculture; hamper the growth of the living standards of the majority of the population. Electricity rates for industry in Russia in 2015 were higher than in the United States even by ruble exchange rate and twice as high as those in purchasing-power-parity terms.

Meanwhile in 2018, the Ministry of Finance of Russia decided to continue the tax reform in the oil industry. The reform stimulates the export of raw materials and the tax burden for using the oil industry production is shifting to the domestic consumers.

This paper focuses on the so-called “tax manoeuvre” in the oil industry as a threat of Russia's claim of world leadership. Export duties for oil and oil derivatives will be reduced from current 30% up to 0% (of oil prices) in 6 years, beginning in January 2019. The mineral extraction tax for oil will simultaneously increase proportionally by 2024. It becomes apparent that the tax manoeuvre will lead to the rise in fuel prices by 1.5 times in 6 years and bringing domestic energy prices to world market level which is equivalent 100 rubles per litre of petrol by current exchange rate. We argue that the rise in fuel prices will contribute to higher inflation every year. On the one hand, higher inflation will provide the state budget growing, but, on the other hand, it will foster the social tension in the country.

We show that the tax manoeuvre was widely criticized by large oil companies and independent petrol stations chains. We think that an alternative mode of development of Russia that can provide a global leadership for the country is transition to the solidarity-based system of national income allocation.

## 1 Introduction

Russia is one of the few countries in the world having the richest potential of human and natural resources, which is sufficient to ensure high rates of economic growth and a high living standard to its citizens (Medvedev 2015). However, over the last 25 years the production industry and agriculture were deteriorating due to the imposed false theoretical concepts in the field of ideology and economy and because of incompetent management. From 1990 to 2016 the share of Russia's GDP with the world GDP by PPP was steadily going down from 10-12% to 3.1% (Novokmet et al. 2018; or Nikolaev 2018). The tax and tariff policies of the country, as in the case of any country, are very much to blame as they do not satisfy business, government bodies and population (Strielkowski and Čábelková 2015). The tax policy fails to promote the production industry,

agriculture or contribute to the wealth of the country (Svatoš and Smutka 2010). In addition, high energy prices for enterprises inside the country do not allow using the main competitive advantage of Russia and making the economy competitive (Maitah et al. 2016).

The bite of taxes from the economy of the country in 2018 accounted for about 31% of GDP. Today this indicator is noticeably lower in Russia not only in comparison with other countries in the Organization for Economic Cooperation and Development (OECD), but also comparing to the average OECD level (34.4%) (Factograph 2018). However, apart from tax payments, Russian business has to pay insurance fees and numerous non-tax payments, which are not stipulated in the Tax Code (Wagstaff 2010). The latter ones include, for example, the environment and waste fees, "Platon" system charge for cargo vehicle transportation, payment for the state services and state funds, etc.

In the Doing Business Ranking by the World Bank, in one year, Russia reduced from 45<sup>th</sup> position in 2017 down to the 52<sup>nd</sup> position in 2018 by "taxation" parameter. According to the calculations of the expert from the World Bank, the general level of tax burden in Russia in 2018 was 47.3% of the profit obtained. The structure of the tax burden on business by countries around the world is presented in Table 1.

**Table 1.** Tax burden on business: the general tax rate structure, %

<b>Region</b>	<b>Profit taxes</b>	<b>Labour taxes</b>	<b>Other taxes</b>	<b>Total</b>
South America	17	16.4	18.9	52.5
Russia	8.8	<b>36.1</b>	2.5	47.4
Africa	18.2	15.1	13.8	47.1
Central America	22	12.4	7.2	41.6
World on average	16.3	16.3	8	40.6
Europe	12.4	26.3	1.6	40.3
North America	19.2	16	3.8	3.8
Asia-Pacific Rim	17.6	10.7	7.9	36.2
Eastern Europe and Central Asia	12.7	18.7	2.8	34.2
The Middle East	9.2	14.4	0.6	24.2

Source: Factograph (2018)

It is remarkable that the share of labour taxes in Russia in the general structure of tax and non-tax payments that business has to pay according to the national legislation is 36.1% with the average world indicator being 16.2%. Despite such a heavy tax burden, in autumn 2018 the RF Government decides to increase the VAT rate from 18% to 20% and to continue the "tax reform" in the oil sector (Federal law 2018). It is the VAT that causes the utmost discontent among the companies with a large share of components and materials in the composition of production, having a long production cycle and oriented on the domestic market. The "tax reform" in the oil sector, which stimulates exports of raw materials and shifts the tax burden for using oil industry products to the consumers inside the country does not satisfy the interests of large oil companies, independent filling stations, business, and population (Masood et al. 2019).

## **2 "Tax manoeuvre" in the oil sector**

Since January 1, 2015 the oil sector in Russia has been living according to the new rules introduced during 2014. The key novelties of this reform are:

- gradual increase in the basic level of severance tax rate, applied to oil (as the final result by 1.7 times);
- gradual reduction in the export customs duty rates for oil and light petroleum products;
- decrease and further increase in the export customs duty rates for dark petroleum products;
- gradual rise in export customs duties for individual ethane, butane and iso-butane;
- gradual decrease in excise duties for petroleum products;
- introduction of new items in the list of excisable goods (some petrochemical products).

The idea of tax manoeuvre was to decrease the dependence of the Russian budget on export duties (which reduce as oil prices go down), to increase budget revenues, and grow the depth of raw materials processing and export of petroleum products (Shadrina 2017). The essence of the reform was an attempt to shift the main part of fiscal burden in the oil sector from the segment related to the exports of oil and petroleum products onto the oil and petroleum production segment itself.

The criticism of the "tax manoeuvre" followed almost immediately after its main parameters had been revealed. The tax policy, stimulating exports of raw materials, makes an impact on the entire economy, reduces investment attractiveness of the non-raw material sector and even the oil refining sector. As a result, the "tax manoeuvre" causes appreciation of goods, transportation services and municipal engineering services, reduction in the real purchasing power of the population, growth in inflation, and disruption in the competitiveness of Russian non-raw material goods.

**Table 2.** Comparative dynamics of the "tax manoeuvre" key parameters

Indicator/period, year	2014	2015	2016	2017
Basic rates of oil severance tax, rub./t	100	150	170	185
Oil export duties, USD/t.	100	78	70	60
Straight-run gasoline export duties, USD/t.	100	70	50	38
Export duties on light petroleum products, USD/t.	100	55	42	30
Commercial gasoline excise rates (class 5), rub./t	100	83	115	90

Source: Information and analytical centre "PUREC" (2015)

In the short run, the budget can benefit from collecting more taxes, but this growth of budget income is short-lived, since the tax manoeuvre can result in a shrunk taxation base because non-raw material enterprises go bankrupt. Table 3 shows how budget revenues have been changing after the "tax manoeuvre" was introduced and includes the inflation indicators. During all these years the growth of budget revenues was accompanied by negative dynamics in the GDP growth: in 2015 (-3.7%), in 2016 (- 0.2%) and a slight increase in 2017 (+1.5%) and 2018 (+1.7%).

**Table 3.** Individual revenue items of the RF consolidated budget

Revenue items/ year	2014	2015	2016	2017
Severance tax, bil. rub.	2837	3131	3517	4022
Export duties, bil. rub.	4597	2732	2459	1950
Fuel excise duty, bil.rub.	323	300	328	342
Inflation, %	11.4	12.9	5.4	2.5

Source: Ministry of Finances (2018)

During the years of the "tax manoeuvre" its main objective – growth of advanced refining petroleum products – was not reached (Table 4).

**Table 4.** Export of the major products of the RF

Product/year	2014	2015	2016	2017
Crude oil, including natural gas liquid, mil. t	223	245	255	253
Petroleum products, mil. t	165	172	156	148
Natural gas, bil. m3	174	186	199	210

Source: Rosstat (2018)

However, the implementation of the "tax manoeuvre" caused a growth in gasoline prices by 30% on average in the period from 2014 to 2018. Moreover, the Ministry of Finances had promised that the prices in filling stations would not go up. Yet, the need to refill the road funds in the regions did not make it possible to reduce the excise duties on petroleum products so that gasoline prices could be kept stable. Over the recent years due to a growth in the fuel excise duties in Russia, the cost of electricity and freight tariffs have been rising as well as the debt burden of the regions (Putintseva 2016).

**Table 5.** Tariffs for individual types of services, 2017

Tariff types/ country	Russia	China	Ukraine	Belarus	Kazakhstan
Railroad freight tariff, rub. per 1km driven	64.5	42.7			46.4
Automobile freight tariff, rub. per 1km driven	44.5	38.9	39.52		29.34
Water supply tariff, rub. per 1 cubic m.	48.6	39.2	35.9	15.6	

Source: Chamber of Commerce (2018)

In 2017 only, the size of gasoline excise duties grew from 7,500 to 10,100 per ton, and diesel fuel excise duties increased from 4,200 to 6,800 rubles per ton. Today the cost of electricity in Russia (on average 4.2 rub/kW) largely exceeds the similar indicator not only in the neighbouring developing countries, but also in some developed countries, for example, Canada (on average 2.4 rub/kW). The freight tariffs also grow much faster comparing to the inflation rates. Thus, the growth of automobile and railroad freight tariffs in 2017 amounted to 2.8% and 4% respectively (Table 5)

Despite such ambiguous results, in the summer 2018, the Ministry of Finances of the RF decided to continue the implementation of the "tax manoeuvre" in the oil sector (Federal law 2018). The export duties for oil and petroleum products will be reduced from current 30% to 0% of the oil price within the next 6 years, starting from January 2019. At the same time, the severance tax will increase proportionally by 2024.

The expected result of the tax manoeuvre will be a growth in gasoline prices by 1.5 times over the next 6 years and "bringing the domestic prices for energy resources inside the country to the level of the world ones". With the current ruble-dollar rate, a litre of gasoline will cost about 100 rubles per litre in 2024. Growing oil prices will again stimulate appreciation of goods, transportation services and municipal engineering services, reduce the real purchasing power of the population, contribute to escalation of inflation, disrupt the competitiveness of Russian non-raw material goods and, eventually, cause growing social unrest inside the country.

### **3 Reverse tax manoeuvre in the oil sector**

Over the recent years, growing gasoline prices have been substantiated by high costs of oil. In 2003 a litre of gasoline cost 13 rubles in Russia, with the price of oil being 80-100 dollars per barrel. By 2017 the price of one litre of gasoline in Russia had more than tripled, while the world oil prices reduced. So it can be concluded that higher prices of gasoline in the domestic market do not have anything to do with the fluctuations of the world prices of oil and is the consequence of the policy pursued by the Government of Russia, which is aimed at increasing the internal prices for energy resources.

Providing cheap raw materials must be a competitive advantage of the country and serve as a basis for developing a non-raw material economy (Pimenov and Rodionov 2015). A well-developed economy must bring much more material assets and opportunities for creative development and career growth of the population in comparison with just receiving rent income. Consequently, in order to develop the production industry in Russia, a reverse tax manoeuvre must be undertaken. Its essence is to increase the attractiveness of refining in comparison with crude oil exports:

- abolishing the severance tax on oil and gas raw materials;
- abolishing fuel excise duties;
- abolishing VAT return in case of export;
- increasing export duties (but preserving the profitability of export);
- involving the Federal Anti-Monopoly Service to control price reductions on the petroleum products market (Chamber of Commerce 2016).

According to the current legislation in 2017 the oil sector paid 4.02 trillion rubles of severance tax, 342 billion rubles of fuel excise duties and 1.9 trillion rubles of export duties. In the context of the reverse tax manoeuvre, it is expected that the above burden will be shifted to a maximum degree from internal sales onto export deliveries. This solution will cause a reduction in the consolidated budget income. However, these losses can be compensated by a growth in tax payments from processing industries in the perspective of 2-3 years. Moreover, the reverse tax manoeuvre is associated with a decrease in the cost of petroleum products, which can have a very positive income on the level of business activities. Now the share of severance tax and excise duties in the price of automobile fuels on the internal market is about 65% (Chamber of Commerce 2016). So, if the severance tax and excise duties are cancelled, it can ensure a growth in investment and thus a considerable potential can be created to decrease the internal price. However, to implement this potential to a maximum degree, some administrative and market levers must be applied to affect the market.

### **4 Conclusions**

As it is well-known, taxes paid by oil and gas companies have a critical significance for the budget of the country. The entire domestic system of taxes and payments in the field of hydrocarbon production and realization performs the fiscal function exceptionally. Thence, it is not aligned with the times in term of stimulating the mineral developers to increase the efficiency of their activities. The fiscal approach is especially

unsuitable given the constantly growing specific costs in the exploring and producing of hydrocarbons in the increasingly difficult geological-geographical and climatic conditions.

Therefore, today, the taxation system concerning extraction and realization of hydrocarbons must be reformed. A comprehensive reformation of the taxation system in the field of extracting and realizing hydrocarbons, which increases its instrumentality, implies the following:

1. A considerable reduction of customs duties shares in taxes and payments. However, differently from the "tax manoeuvre", it must be done with due consideration of the interests of the Russian companies producing high value-added goods.
2. Receiving taxes not from a ton of produced oil, but from the winning potential of specific deposits (production facilities) (NG 2018). The total amount of taxes must be calculated by the extracting enterprise with further redistribution of this value between all facilities that are exploited. Thus, it will allow subsoil users to build a flexible system and stimulate their teams and executives to achieve final results, to contribute to a faster development of production facilities and bring the latter ones to a specific extraction level etc
3. A comprehensive use of the world experience is recommended, in particular, of the most reputable elements of the best taxation systems abroad, including such payments as royalty, rental for sites that are explored and developed, an excess profit tax, etc. In particular, it will become possible to involve small and medium-sized geological enterprises in the process of exploration and supplementary exploration of deposits with their further assignment to large companies, which will make the exploration faster and improve the efficiency of this process.

Overall, the experience of the previous two decades provides us with solid evidence that every single of the above-mentioned directions for tax burden optimization and all of them together can increase tax receipts in the budget system of the country, in particular, due to a larger taxation basis and growing production volumes of industrial products. There is no doubt that such work must be supported by the interested ministries and agencies.

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