

# ECONOMY OF PUBLIC SECTOR

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## Matters of state regulation of distribution processes and of income use in modern Russia

*The article proves that in modern Russia the system of non-optimal and unfair income distribution between the state and managing subject and between the social groups of the population has developed. The author thinks that in order to provide optimal and fair distribution and use of income it's necessary to refuse from discredited liberal-monetarist policy and to turn to the model of market economy development, regulated by the state.*

*State regulation, tax system, optimization of budget revenues, rationalization of expenditures, state financial control, social justice.*



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Nowadays in political and science circles the problems of the role and functions of the state in economy and social sphere as well as problems of state security and law and order are widely discussed. Though these issues had been already discussed by many scientists and experts, but today they have become the most urgent problems.

The matter is that in the 1990s during the economic reforms in Russia the leading tendency was the weakening role of the state and state regulation. It caused inefficiency of public authority activities.

There are still many proponents of reducing the state function to minimum. In this case market relations are understood as self-reproduced system, i.e. the so-called "invisible hand" of the market regulates everything and the state must not play an important role. The

idea was realized in practice and as a result this "self-reproduced" system was filled with oligarchic, criminal and semi-criminal structures which began to fulfill the functions of the state. Naturally, they do it with the aim of getting super profits. And of course, they pay the least possible amount of taxes, customs duties and rents. All these facts make a negative impact on the processes of fair distribution and use of income in modern Russia.

In any country finance and credit system, pricing and a number of other economic instruments play the most important role in the process of regulation of distribution and use of income. Fiscal and tax policy takes the leading position in this process. The value of GDP (proceeds of returns from sales of goods, services and national wealth) is distributed, redistributed and used through the state fiscal

system. At the stage of initial distribution of clear national product (national income) as part of the volume of GDP the revenues of managing subjects are formed, such as wages, salaries, profit of enterprises (industrial, agricultural, trade and other branches), rents, interests and others. On the basis of further redistribution of mentioned revenues with the help of tax and nontax payments, large finance resources are formed in centralized state funds (state budgetary funds, state off-budget funds).

As the central and leading part of the state finance system, the fiscal policy serves as an important economic instrument of regulation of macroeconomic proportions with the help of redistribution of monetary funds between different branches of economy, production and non-production spheres, economic regions, and social groups of the population, etc. The higher the level of centralization of state budget revenues, the more important is the role of the state and state regulation in economy, social sphere and other spheres of social life. Owing to a high share of participation in distribution and redistribution of GDP the state will have more financial possibilities to meet its engagement to the society and to secure social protection of the population. As a result, it is also very important to study the state regularity in distribution and redistribution of the value of GDP with the help of correlation coefficient between this value and state expenditures (mostly including the state fiscal expenditures). The correlation coefficient defines the level of efficiency of the state regulation of distribution

and use of income in a country; in particular, it defines the depth of socialization. *Table 1* shows the dynamics of correlation between the state expenditures and the value of GDP in some developed countries, the USA and Russia over the period 1936 – 2002.

As it can be seen from the table, the state expenditures growth in comparison with the GDP value reflects at the same time the growth of the share of the state participation in distribution and use of the indicated values. And it is the main tendency of the world economy development. Since the first half of the 20<sup>th</sup> century state involvement in distribution and use of GDP value in the indicated countries has been constantly increasing and this tendency continues to the present. Moreover, the tendency is keeping on in the 21<sup>st</sup> century. In these countries more than half of the produced value of GDP is used through the state expenditures growth. Owing to constant growth of the indicated expenditures the above mentioned states became social-oriented and it helps them to guarantee social protection of the population at the necessary level. In support of this fact these countries have a relatively high level of wages and salaries, pensions, benefits and other social payments for the population.

The table also shows that in Russia during the economic reforms (1991 – 1998) the state involvement in distribution and use of GDP value decreased 6 times. Taking into account the double decrease of GDP over the period, it turns out that the total amount of the state budget dropped almost 10 times<sup>1</sup>. Being the

Table 1. State expenditures (as a percentage of GDP)

Country	Index				
	1936	1960	1991	1998	2002
England	22,0	32,2	36,2	40,2	42,6
Germany	25,8	34,6	44,5	54,3	53,8
France	23,6	32,4	39,7	46,9	48,2
Sweden	20,8	31,1	44,8	58,5	58,3
USA	13,6	27,0	30,9	32,9	33,8
Russia	65,0	72,3	65,0	11,0	30,5

Source: Soviet Russia. – 2001. – December, 8. – P. 2; Budget process as an instrument of efficient management. The Government concept. – Stockholm, 2005. – P. 20.

richest country in natural resources, in 1991 – 1998 Russia had a very small, almost "poor" budget funds. The sharp drop of budget revenues was caused not only by a small volume of GDP but also by its unfair distribution. The distribution of GDP value and redistribution of revenues was done not so much in the interests of the state, as in favour of big private corporations in the person of oligarchs and criminal and semi-criminal structures. Such situation, in turn, was determined by the fact that during economic reforms that were carried out without the state control, corrupt black economy formed, together with the legal and official market economy. The existence of corrupt economy puts an obstacle to fair distribution and use of incomes in the country on the whole and between the regions.

After the default of 1998 in Russia the process of state recovery was starting. The role of the state in the regulation of macroeconomic and social processes began to grow. The turn from radical and liberal reforms of the 90-s was accompanied by the destruction of scientific and production potential and social infrastructure. New reforms ensured the turn to stabilization of the country and its social and economic development. After the default the country experienced a constant economic growth. The average rate of economic growth over the period 2000 – 2008 varied from 5 to 6,5%. For the last 8 years GDP volume increased by 68%<sup>2</sup> and the growth was caused mainly by the price increase on natural resources (oil, natural gas) at the world market. In 2007 Russia took the 7<sup>th</sup> place in GDP volume among the world countries. The volume of the state budget (the consolidated budget of the Russian Federation) over the period increased several times and the federal budget became profit, i.e. its revenues exceeded the expenditures. There was also the growth of the reserves of foreign currency and gold of the Central Bank of Russia and the Stabilization Fund of the country. By 2008 they had big assets: 129,7 billion dollars of the reserve fund, 32,7 billion of the Future Generation Fund (the Stabilization Fund),

595,9 billion of gold and foreign currency reserves of the Bank of Russia, the total sum – 758,3 billion dollar<sup>3</sup>.

The Stabilization Fund consists of oil and gas incomes that are formed by excess difference between real and nominal prices on oil and gas, and all the rest incomes, connected with unaccounted inflation and economic growth rates, when the federal budget revenues are calculated (including the rest of federal budget resources). Among the listed revenues, oil and gas incomes prevail and they are planned separately. At the same time the sources of the Stabilization Fund since the day of its establishment (2003) and gold and foreign currency reserves have been frozen, i.e. they have not been used for financing national economy and social sphere on the pretext of inflation threat. At the expense of the Stabilization Fund and gold and foreign currency resources the government should have mobilized savings to ensure stable development of innovative and investment activity. But the assets were put into foreign bonds with low interest rates to serve the economy of foreign countries. In fact, the real chances to use super incomes were lost. The super incomes were received from the raw materials export at high prices and could have been directed to develop the real economy sector, to solve urgent social problems, to secure production growth and these measures could have reduced inflation. Oligarchs and rich people have to pay off for the banking system and stock market collapse. Though the low-income (poor) citizens don't deal with securities or bank deposits, they have to pay off too. According to unofficial sources, 15% of the Russian population account for 85% of total bank savings and 92% of property income, while 85% of the population account for the other 15% and 8% respectively<sup>4</sup>. While world and Russian stock exchange indices were going up, the property prices were rising, the number of oligarchs and their personal wealth was growing. The oligarchs borrowed money from western banks but when the day of reckoning came, the ordinary people have to pay off their debts.

Today our country faces a great number of serious and unsolved problems in national economy and social life. Moreover, the current financial crisis caused new problems and they must be solved urgently.

In Russia there is no development of innovation economy, especially of high-technology industries and knowledge-intensive industries. The above-mentioned 68% of GDP growth for the last 8 years is the same as the GDP growth in 1990. But according to analysts and independent experts, even by the end of 2008 Russia won't overcome the economy recession of the 90-s. At the end of 2008 the volume of industrial output will make up 84,5% of the industrial output of 1989. It won't be achieved even by 2010 (at the expected 3,8 – 5,4% growth rates), because it will account for 91 – 94% by the level of 1989<sup>5</sup>. In spite of some improvements in economic diversification, very little money is allocated in the form of state investment to the development of manufacturing industries, such as machine-building, light industry, shipbuilding, car industry and others. Russian industry is oriented to the raw materials industry development and the country continues to live and to develop in the conditions of monostructural economy which depends on world market prices.

It is also observed a significant backlog in the development of such Russian key industry, as agriculture. For example, in 2004 the volume of agricultural production was 67,9% compared with 2005. And good growth rates – 3,9% – were achieved in this branch only over the period 1999 – 2004. Unfortunately, after that there was a serious slowdown in growth rates – down to 1,4%. It means that by the end of 2008 it will be possible to achieve only 71,7% by the level of 1989<sup>6</sup>. During the period of transition to market economy the agricultural sector suffered a lot because of insufficient state financing and now serious efforts must be undertaken to improve the situation. A solution to the agricultural crisis brooks no delay, that's why the state has to take urgent measures for solving economic, financial and social prob-

lems, especially because the financial crisis has already set new tasks and there will be more problems in the future, including the problems of agriculture.

One of the principal criteria for fair and optimal distribution and use of income is a degree of socialization which is determined by measuring national quality of life and national development. Quality of life indicators are as follows: standards of living (income standards), education, and standards of living in retirement, average life expectancy, etc. In this regard the situation is paradoxical: Russia had high macroeconomic and financial levels of development before the crisis, but the Russian standard of living lagged far behind that of many countries. And the tendency still remains. For example, Russia takes the 67th place in the standards of living, the 119<sup>th</sup><sup>7</sup> place in average life expectancy, etc. It turns out that the economy and income growth cannot guarantee the increase of quality of life, as it takes place in many social-oriented countries.

Over the period 2000 – 2008 there was much talking about rise of minimum wage, pensions, state employees salaries, but because of the high inflation rates (since price for consumer goods and services increased) and the lack of differentiation of personal taxation of individual income, first of all real income of poor people is decreasing. The real income growth can be observed in the incomes of rich and super-rich people, because when inflation rate rises, the prices grow several times slower for the rich. Because of the big income gap, inflation influences different social groups unevenly.

One cannot but notice that low quality of life in Russia is caused mainly by lower wages compared with the wages in industrial and developing countries. For example, the share of wages accounts for about 30 – 35% of GNP instead of necessary 60 – 70%, i.e. twice times lower<sup>8</sup>. Low wages are typical for the most industries, except for fuel and energy complex. For example, wages lower than substance minimum are received by one-third of light industry workers, two-thirds of agriculture workers and

from one quarter to half of employees in the sphere of public health, education and culture<sup>9</sup>. Besides, over the period of transition to market relations Russia was the only European country where the minimum wage was set lower than substance minimum. Only since the January, 1, 2009 the national minimum wage is set at the level of the substance minimum and is equal to 4330 roubles. And in the developed European countries the substance minimum, including its quantitative and qualitative characteristics, is much higher.

The same gloomy situation is true for old-age insurance (as can be seen from the data in the *table 2*).

We can draw a conclusion that Russia takes the last place in old-age benefits among the countries in the table. Meanwhile, according to the European Social Charter the minimum old-age benefits must be 1,5 of the substance minimum and the International Labour Organization Convention stipulates that pension should not be lower than 40% of previous

average earnings. In most countries old-age benefits reach 60% or more of average earnings. In Russia the old-age pension of ordinary citizens make up 24% of their average wages<sup>10</sup> and the state employees get not less than 70% of their previous earnings. The old-age pension in Russia will average 5 461 roubles in 2009 and 6 091 roubles in 2010<sup>11</sup>. The sum is trifling, taking into account constantly increasing prices and the financial crisis.

Low wages and pensions have a negative impact on average income per capita which is rather low in comparison with that of the developed countries (*table 3*).

The national average income is the average income of low-income, middle-income and high-income population and as it is seen from the table the Russian average income is several times lower compared with the average incomes of the developed countries or G8 countries.

Because of inadequate state regulation of distribution and redistribution of income in modern Russia crying injustice exists in the distribution and redistribution of money resources, property and national wealth among different social groups. The economic reforms of the 90s in Russia led to breaking of property relations and an uncontrolled predatory privatization of state property and national natural resources. Radical liberal reforms opened the doors to an unlimited growth of social inequality. Income differentiation has attained a dramatic scale. The decile coefficient (the ratio between the average incomes of the richest 10% of the population and the poorest 10%) rose from 4,5% in 1991 to 15% in 2004. Gini

Table 2. Average old-age pension benefits in 2005

Country	Index	
	in US\$	In roubles
1. Switzerland	4 500	118 350
2. Norway	3 040	80 000
3. Portugal	2 900	76 270
4. Sweden	2 600	68 380
5. Germany	2 220	58 480
6. New Zealand	2 000	52 600
7. France	1 600	42 080
8. Netherlands	1 500	39 450
9. Spain	1 360	35 840
10. Italy	1 300	34 190
11. Finland	980	26 000
12. the USA	800	21 040
13. Austria	800	21 040
14. Great Britain	680	17 880
15. Hungary	570	15 000
16. Estonia	260	6 840
17. Latvia	140	3 680
18. China	114	3 000
19. Belarus	100	2 630
20. Russia	87	2 300

Source: Soviet Russia. – 2007. – June, 5. – P. 4.

Table 3. Average income per capita in 2005

Country	In US\$
The USA	39 900
Japan	36 600
Great Britain	35 500
France	34 400
Germany	32 800
Canada	31 100
Italy	28 900
Russia	4 030

Source: Soviet Russia. – 2006. – August, 1. – P. 1.

coefficient (measure of inequality of income distribution) rose from 0,26 to 0,406. Experts estimate that the difference in quality of life of "Poor Russia" and "Rich Russia" was hundred-fold (the poor received 300 dollars, the rich received 3000 dollars monthly)<sup>12</sup>.

Today the quantity of poor people in Russia is artificially underestimated because of the incorrect statistical methods. In official statistical calculations the experts base their estimates on minimum subsistence level. In this case about 20% of Russians may be called "poor" (30 million people whose income does not reach the subsistence minimum)<sup>13</sup>. But poverty threshold can be measured on the basis of minimum social needs (for example, the possibility to buy dwelling), as it is done in the countries with socially oriented economies. In this case according to the independent experts' estimates the number of the poor will grow three times and will reach 90 million people (60% of the Russian population)<sup>14</sup>.

The reliable research of the Institute of National Economic Prognosis shows that the income gap between rich and poor has been enlarged to 23 times<sup>15</sup>. The Academician D.S. Lvov regarding this gap noted that in Russia the decile coefficient had reached an astronomical level of 20–21 but even these figures did not reflect the real level of income differentiation. The decile coefficient among the wealthiest amounts to 40 times. In Lvov's opinion, there is no middle class in Russia and there are only super-rich people, poor people and beggars<sup>16</sup>. Isn't this unbelievable for the country whose Constitution proclaims Russia a social state (Article 7, the Constitution of the Russian Federation).

The social inequality has reached a threatening scale and in this regard Russia gives way only to some African and Latin American countries (like Zambia and Brazil). Meanwhile in 2007 Russia had the second largest number of billionaires in the world. At the same time in many social-oriented European countries the income gap between rich and poor fluctuates in the range of 5 and 8 times. According to the world experience the optimal decile coefficient

should amount to 4 – 4,5. For example, in the USSR the coefficient was optimal as it fluctuated in the range of 3 – 4 times<sup>17</sup>. In modern Russia injustice in redistribution of incomes, property and national wealth causes the high level of material inequality and poverty as well as painful feelings of ordinary people humiliated by the authority negligence (the moral aspect). As a result of this state authorities must realize that a high level of social inequality, both morally and materially, undermines political stability, fuels social tension in the society and diminish government efficiency and can lead to political upheaval.

In spite of the recovery, Russia is still far from being an ideal state. Having excessively high salaries and different kinds of benefits, Russian government officials have worked and are still working mainly for their own wealth and for oligarchy. The vertical of power of the government indulges in fraud, corruption and gerrymandering. Corruption penetrated into every sphere of social life and the highest echelons of government and threatens the safety of the Russian state. For many years corruption has been a constant problem in Russia, that's why in 2008 the President endorsed the initiative to develop different measures to fight corruption, including forming special anti-corruption commissions, approving a package of anti-corruption laws and others. He vowed to fight against corruption by taking the effort to take under his personal control.

Russian state apparatus is too enormous for national economy. In 2007 the average salary of federal state officials is 25,6 thousand roubles<sup>18</sup> along with low benefits, old-age pensions, scholarship payments and rather low salaries of public sector employees.

Inefficiencies in state regulation of optimum and just distribution of income are caused by modern tax policy in Russia. The development of new tax system in the current market relations new mechanisms of income redistribution in favour of the rich and oligarchs created many economical and social problems, and the most urgent one is a high level of social differentiation.

One of the negative aspects of Russian tax policy is its orientation to indirect taxation. For example, value-added taxes, customs and excise duties make up about 70% of tax revenues into the federal budget. These taxes are included in the prices of goods and in the tariffs on services. The introduction of indirect prices into the price equation causes price increase and finally the inflation growth. The main function of indirect taxes is fiscal, it means that they are safer and more stable revenue sources and do not depend on inflation rates. As far as final consumers, the population and the state establishments of the budgetary sphere are the final payers of indirect taxes, the least wealthy suffer above all, because their real incomes decrease. Tax payment irrespective of the payer's income level leads to the fact that the more people earn the less the proportion of their income they pay in tax and such taxes are regressive. Besides, indirect taxation leads to reduction in consumer demand, as well as production volume reduction and consumption of realization of goods and services and finally the reduction of tax revenues. Furthermore since the final payers of indirect taxes are manufacturing enterprises, these taxes have a negative impact on the financial statement of these enterprises what makes them enter the shadow economy partially or totally. In this case the state does not get any taxes. It proves the fact that indirect taxes do not stimulate but slows down the production development.

Russian tax reforms implemented on the 1st of January, 2001 along with radical measures undertaken to regulate tax legal relations made changes in the sphere of indirect taxes. At the start of 2004 sales tax was abolished, the basic rate of value-added tax (VAT) was reduced from 20% to 18%, There is also 0% rate, which applies to the majority of export operations and some other specific supplies. As for the basic rate of VAT, many scientists, experts, law-makers and politicians propose to abolish VAT or reduce it to 16% or even 12%. They explain that such reduction will stimulate production growth of manufacturing

enterprises. Till recently it could be possible, because in case of VAT reduction the loss of budget revenues could be compensated from extra income, received in the result of growing prices on natural gas and oil on the world market. But today under the circumstances of the global financial crisis and falling energy costs it seems hard to realize the proposal to abolish or reduce VAT.

In Russia budget revenues are formed not at the expense of direct taxes, such as natural resources consumption tax, property tax, tax on profits, land tax, capital gains tax (as it is done in majority of countries), but at the expense of taxes on consumers and labour. Such tax structure is unhealthy. Natural resources make up 75% of Russian GDP and 13% of all proceeds of tax and 5% of national wealth is formed at the expense of labour and accounts for two thirds of all taxes<sup>19</sup>. Only wage fund is levied on the whole at 39% (consists of 13% of personal income tax and 26% of unified social tax).

It is known that except fiscal and stimulative functions taxes have also regulatory and social functions. Taxes play a very important role in the process of state regulations of distribution and income use in order to optimize and provide balance between the state, enterprises and citizens. Under market economy conditions it's necessary to increase the role of tax regulation, because market economy generates large income differentiation. The functions of taxes are realized through the appropriate mechanism of different legal regulations concerning tax collections, including a wide choice of tax instruments (tax rates, tax credits, methods of tax calculations). With the help of this mechanism and methods of taxation the state receives the possibility to influence the whole process of reproduction (production, exchange, consumption) and regulate distribution, redistribution and use of incomes in the society.

The regulatory function is closely connected with its social function. It helps to provide the social balance both of distribution and use of incomes. For this purpose states of the whole world use progressive tax scale (low incomes

of natural or juridical persons are taxed at a lower percentage of rate, high incomes – at a higher percentage of rate), certain groups of people are exempt from a number of taxes (low-income people, disabled, pensioners and parents, having many children), essential goods and services are taxed at a lower rate (the VAT rate is decreased), indirect taxes are increased on luxury goods. In this connection tax on income of natural persons is one of the main and powerful instruments of regulation of income redistribution and can smooth the income difference between social groups.

In all developed countries personal income tax is levied on a progressive scale of taxation. Progressive taxation is an effective policy for mitigating social inequities and for narrowing the income gap between the rich and the poor (the decrease of decile coefficient). In the above-mentioned countries the highest rate on personal income tax ranges from 30 to 60% and more, e.g. the highest marginal tax rate in the USA is 31%, in China and Denmark – 51% and 63%, respectively. Moreover, in some countries the low-income people are exempt from income tax. For example, in France high earners pay 45% tax and the poor under a certain level of poverty don't pay income tax. In some countries the average wage is 5000\$ and as it is considered the income below the poverty level, such income is not taxed<sup>20</sup>.

Until 2001 Russia applied progressive tax schedule on tax on profits (now it is called income tax on natural person) and its lowest rate was 12% and the highest rate was 30%. There is no doubt that such differentiation contributed to narrowing a big income gap between the rich and the poor. Since 2001 when the second part of the Tax Code was adopted Russia implemented a low 13% flat tax on personal income for all types of income and for all payers (except several types of income which are taxed at 35, 30 and 9 per cent). According to Russian tax legislation in determining the taxable base some categories of tax payers are entitled to get standard deductions, property-related deductions, social and professional deductions

and the income subject to taxation is reduced by the amount of the deduction. The possibility of receiving such deductions is estimated as a positive aspect of tax system. But other income taxes at the stated above rates (35, 30 and 9%) account only for a small part of all income tax collection, because the greatest part of all income tax for all payers are subject to 13% tax, regardless of its amount.

In spite of unfavourable opinion of some economists and world experience, a low 13% flat tax, specified in the second part of the Tax Code, has been successfully implemented in Russia. It should be also noted that among economists, experts and politicians there has been a lot of debates about income on personal tax and now the problem is still being discussed, taking a very important social significance. There is no need to prove that one of the main reason of a big income gap between the rich and the poor and growing social inequity is abolishing of a progressive tax schedule and adopting the unified and non-differential tax rate on income. The developers of a flat tax schedule as well as executive and legislative authorities try hard to prove the opposite; nevertheless we are strongly convinced that the regressive tax schedule works in favour of the rich. Unlike many other countries, tax on income of natural persons does not fulfill its regulative and social function. Non-differentiation of taxes and flat tax schedule do not take into account big incomes of some people (the rich and the super-rich layers) and do not contribute to higher tax on such incomes and in such case there is no fair income redistribution between different groups in society. In fact taxes on income of natural persons are regressive in character, because the rich become richer and the poor become poorer.

To justify a flat tax schedule the opponents of progressive taxation give the following reasons: it will increase tax collection and will help to get more income out of the shadow economy. It is true that after implementing a unified 13% rate for all tax payers income tax revenues increased. But it happened for some



other reasons. First, tax burden on low-income people increased (till 2001 they paid income tax at the rate of 12% and since 2001 the rate have grown by one per cent). Secondly, tax deductions were abolished for a significant part of payers, in particular, for the representatives of military forces. And in the third place, the constant growth of wage funds of enterprises and establishments also contributed to the increase in tax collection. The statistics show that 90% of all income tax is paid by the poor, but not by the rich. And the poor have to pay this tax at the same level as millionaires and billionaires. Furthermore, the implementation of a unified tax rate didn't justify itself as a measure capable to take "black" and "grey" salaries out of shadow economy. For example, "envelope" wages (meaning payment in cash that is not officially recorded for tax and social security purposes) are still widespread and account for more than 40% of official wages<sup>21</sup>. Since the 90s in Russia some methods of money-laundering have been used, e.g. money export with the help of import goods without crossing customs borders. Under such scheme, milliards of dollars flow abroad annually and then the doubtful money is laundered by means of cash operations. The scheme is used for tax evasion. In modern Russia corruption incomes as part of shadow incomes amount to hundreds of thousands of roubles.

All these facts prove that it is necessary to refuse from single rate of income tax and turn to differentiation of taxes with the help of implementing a progressive tax schedule. Only under progressive tax schedule personal income tax will become one of the most important instruments of state regulation in the sphere of fair distribution and use of income.

According to the Russian tax legislation the rate of unified social tax is also regressive, i.e. the higher the income of the taxpayer the smaller the proportion or percentage paid in that tax. The current rate of contributions to the Pension Fund budget accounts for 26% of the unified social tax and it is the aid budget.

To improve the state pension system there was developed a new concept according to which a 26% unified social tax will be replaced by insurance payments. They would amount to 34% of the wage funds of enterprises. As for small business and agricultural enterprises, the high rate of insurance payments will be paid from the budget. The new pension reform will be implemented in 2010. From 34% of insurance payments 26% will go to the Pension Fund, 5% to the Mandatory health Insurance Fund and the rest 2,3% to the Social Insurance Fund. Companies will only pay for those who earn less than 415 000 rubles a year, or 35 000 rubles per month. It is easy to understand that the super-rich will not pay any insurance payments from what is earned over 415 000 rubles. It follows that the main insurance payers will be citizens with the monthly incomes not higher than 35 000 rubles and they are the very persons who will fill the social money-box of the country. In our opinion, such pension reforms will keep and increase the income differentiation and social inequity.

According to Russian tax legislation, inheritance tax and gift tax among family members has been recently abolished. The owners of enterprises, palaces and expensive property, stocks, securities and other innumerable treasures – that is all the possessions of criminal oligarchy for the last 20 years – are free from inheritance and gift taxes. It would be impossible for the civilized world. It is true that the poor layers of the population are also free from inheritance and gift taxes, but their possessions are nothing but huts, shabby houses and private apartments. It's not difficult to realize that the lack of differentiated approach to exemption from inheritance and gift tax will widen the income gap between the rich and the poor.

Thus for today in Russia taxes fulfill only its fiscal function. The mechanism of realization of stimulative function does not work sufficiently. The social function of taxes is not fulfilled either and the tax system is regressive in character, i.e. the higher the income the less the share of taxes is paid. Actually, mechanism

of taxation aimed at narrowing a big income gap does not work. Under existing tax policy the authorities can not receive adequate taxes from the rich and super-rich people having huge assets (as it is done in many civilized countries) and can not get them to take part in the national economy development. Moreover, under existing regressive tax system the contrary task is fulfilled - the income is redistributed from poor to the rich. It is reasonable that it has a negative impact on the efficiency of the state regulation in the sphere of fair distribution and use of income and as a consequence, the state can not fight such social evil as poverty.

Pricing system plays an important part in the process of state regulation of distribution and use of income. In the market economy conditions the net of natural monopolies caused uncontrolled corporative pricing. It results in galloping prices and rapidly growing inflation. In our country inflation is a very serious and painful disease, because, as it was noted above, it affects the poor more than the rich, thus increasing the income gap. It is also noteworthy that under the circumstances of financial and economic crisis along with growing inflation, well-to-do people become poor. Therefore, in order to stop inflation growth, it's necessary to reinforce antimonopoly regulation and the state control over pricing system. Unfortunately in practice the measures, proposed by the Federal Antimonopoly Service and the Federal Tariff Service, are inefficient.

As the high inflation rate is caused by unrestrained growth of prices on food and housing and utilities tariffs, in the context of optimization of the state antimonopoly policy there is an urgent need to freeze prices on fuel, energy and gas. Besides, the state authorities should take administrative and legal measures against decriminalization of food retail network, i.e. the elimination of organized criminal and mafia groups that control food markets in cities. For example, according to figures for 2006, the Muscovites overpaid three times as much for fruit and vegetables and to 8 times for some items, twice for meat and milk products, 4 times for bakery items<sup>22</sup>. These are the

additional payments to the criminal structures that make difficulties for the development of efficient competition. It is clear that for the authorities struggle against decriminalization of food markets is a difficult task and they should manifest strong political will. At the same time one must not forget that it is impossible to solve the problem of high prices and inflation merely with the help of administrative measures. In order to reduce prices on consumer goods it's necessary to provide constant development of production and in the first place, the growth of agricultural and industrial production and other branches of national economy, especially its real sector.

And finally, the problem of state regulation of distribution and use of incomes at the regional level is no less important. The point is that nowadays there is also a big income gap between the regions. There are "donor" regions and "recipient" regions where the incomes are lower and the share of poor people is bigger. According to All-Russia Centre of the Standard of Living, in 2007 13 regions were among the poorest regions where the poverty rate is more than 30%. The poorest regions are Ust-Ordynsky Buryatsky avtonomny okrug (72% of the population live below poverty line), Republic of Kalmykiya (59%), Ivanovskaya oblast (41%). The wealthiest regions are Khanty-Mansiysky avtonomny okrug (poor people account for 7,9%) Yamalo-Nenetsky avtonomny okrug (8,6%), Saint-Petersburg (10,2%). Moscow is the city of contrasts: on the whole the standard of living is higher than in other regions and at the same time 13,2% of Muscovites have incomes below subsistence minimum<sup>23</sup>.

There is a mechanism of equalization of regions through regular budget allocations in the form of federal budget subsidies to the budgets of the subjects of the Russian Federation and inter-budget transfer funds (the so-called "budget regulation"). But in practice this system does not solve the urgent problem of elimination of income disproportion between the regions. Moreover, this mechanism of the state regulation of distribution and redistribution of income between the regions forms

subjectivism and certain parasitic attitude and doesn't stimulate the regional development and infringes upon the financial rights of the regions and increases their dependency on central authorities. Eventually it leads to residual-based financing of regional economy and social sphere, increasing confrontation between the federal center and the subjects of the RF.

The state regulation of distribution and use of income between the regions is closely connected not only with financial equaling of income gap and poverty reduction, but, what is more important, with the aim of ensuring the unity of economic and financial space and territorial integrity and it is a very important geopolitical problem that needs urgent solutions. It is known that behind the Urals, in the Asian part of the country, 20 million of people live on 15 million square kilometers of the territory (it is 5 times more than the European part of Russia). Besides, about 80% of all natural resources of Russia are concentrated here. To stop the population outflow and to increase the inflow, quicker pace of economic and social development is necessary for the regions of Far East, Eastern Siberia and Transbaikalia. It means that when the federal authorities determine the volume of direct allocations from federal budget to the regions and under the state regulation of income redistribution between the regions with the help of inter-budget transfer funds, the task of financing the above-mentioned regions must be top-priority and the central authorities should take the problem under their close control. Therefore, there is an urgent need to develop and apply a new mechanism of the state regulation of distribution and use of income between the regions. These problems are in turn connected with improvement of regulation of inter-budget relations, but it will be the other research topic.

To summarize, the state regulation of distribution and use of income in the country on the whole as well as between regions is the pivot of the system of state economic and financial policy which covers a wide range of social, economic, financial, geopolitical, legal and instrumental problems. The analysis of the problems shows, that in view of inefficiency and irregularity of this policy, including imperfection of the current tax legislation and the absence of strong state control over the pricing system, non-optimal and unfair income distribution takes place in our country.

The current tax system of modern Russia is regressive in character, i.e. the higher the income of tax payers, the lower the rate of tax payable and vice versa. Under the unified for all citizen rate of the flat tax schedule (for example, natural person income tax), irrespective of their income, the income gap between the rich and the poor is widening and the social stratification is growing. That's why new approaches are required for carrying out the state fiscal and tax policy and it's also necessary to change the tax legislation.

A differentiated approach must be applied to taxation of natural persons. In particular concerning natural person tax income, a progressive taxation should be implemented, as it is done in many countries. It should be also emphasized to solve the above mentioned problems it's necessary to revise the state social and economic policy and to increase the role of the state regulation in the social life of country. So, the time has come, in our opinion, to refuse from liberal-monetary course of economic and finance policy, from powerful help of the so-called "invisible hand" of the market that led the country into a dead end and to turn to the realization of the state regulation policy of the development of the social-market economy.

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## Notes

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