BLOG

Russian budget framework for 2026–2028 foresees tax hikes and lots of red ink

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AUTHOR

Heli Simola
Senior Economist

The latest preliminary budget framework approved by the Russian government suggests a tightening of the government's fiscal stance.[1] The large war deficits of recent years have complicated Russia's finances, forcing the government to harness all parts of the economy to finance the war effort. On top of an increase in the corporate profit tax this year, regular citizens will experience a hike in the value-added tax (VAT) that takes effect at the start of next year.

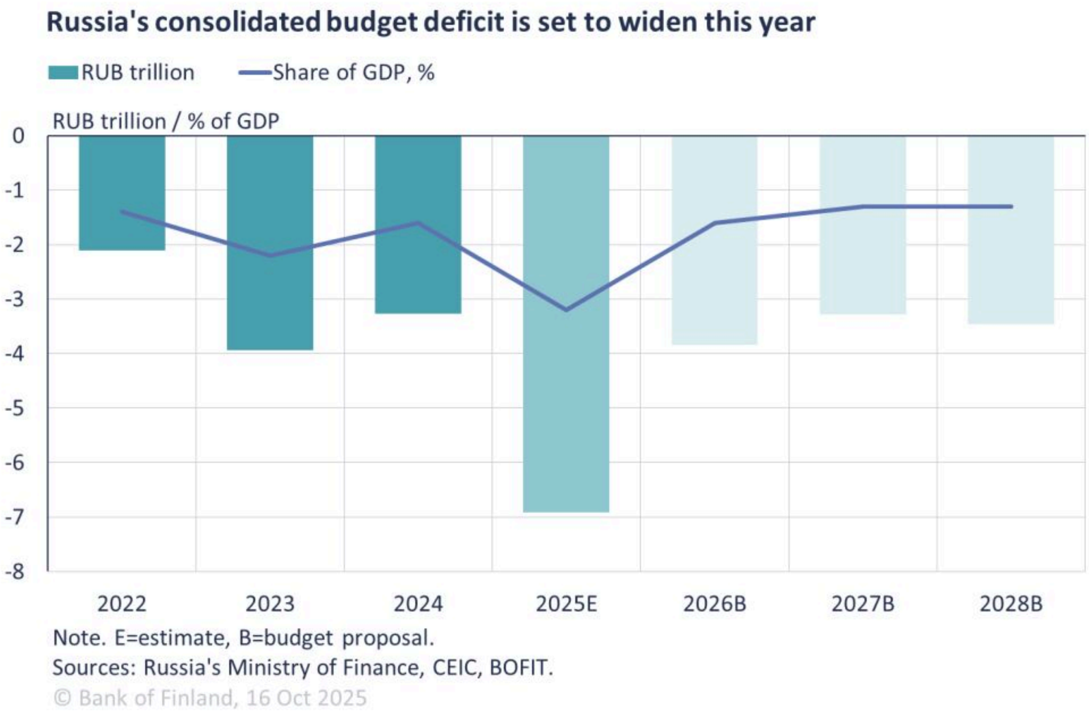
Further inspection of the budget framework hints that it is based on an assumption that Russia can push through the goals it has set for the war in near-term. Then Russia would not need to further increase defence spending. Notably, a similar prudent budget plan was prepared in autumn 2022, only to be largely ignored amidst a drastic loosening of fiscal policy. In any case, defence spending will remain high through 2028, the final year of the new budget framework. Russia's military would continue to replenish its stockpiles even if the war ends.

2025 deficit larger than planned

This year's government sector revenue estimate is considerably lower than previously planned.[2] Expenditures, in contrast, are clearly higher than anticipated. Indeed, spending has risen so fast (up 20 % y-o-y in January-July) that even if the current spending estimate materialises, annual growth in budget expenditure would remain at zero for the rest of the year – increasing the risk that the Russian economy sinks into recession. The government's deficit figure has also been raised considerably. This year's consolidated budget deficit is now expected to reach 6.9 trillion rubles, nearly double last year's deficit. The original budget plan called for a deficit of 1.7 trillion rubles. This year's deficit is the largest since Russia's invasion of Ukraine also in relation to GDP

(3.2 % of projected GDP).

Chart 1.



Increase in 2026 budget revenues relies largely on VAT rate hike

Government revenues are projected to rise by 9 % in 2026. Detailed information on the distribution of budget revenues is available only for the federal budget. Oil & gas earnings are expected to rise by 3 % and other revenue streams by 10 %. The price of benchmark Brent crude oil is assumed to average $70 a barrel this year, which is slightly above the current prediction of futures markets. The average export price of Russian oil next year would climb by $1 to $59 a barrel, implying that the discount on Russian oil would narrow slightly from $12 a barrel to $11. The contribution of oil & gas earnings to federal budget revenues would decline further to 22 % in 2026.

Increases from other revenue streams would come almost entirely from the hike in the value-added tax (VAT). The VAT rate is set to increase by two percentage points to 22 % at the start of next year, so growth in VAT revenues is expected to reach 20 %. (The previous 2-percentage-point increase at the start of 2019 resulted in a 19 % increase in 2019 VAT revenues). Revenues from income taxation (includes corporate profit tax and income taxes on private individuals) are expected to rise by 7 % next year, mainly due to increased tax income from collections on interest income of private individuals. The revenue stream from corporate profit taxes is not expected to grow next year, as it has soared this year due to the tax hike (the corporate profit tax was raised from 20 % to 25 % at the start of this year) and corporate profits are declining. The anticipated impact from income taxation on revenue growth overall, however, is small. The dividend income revenue stream is expected to sharply decline next year.

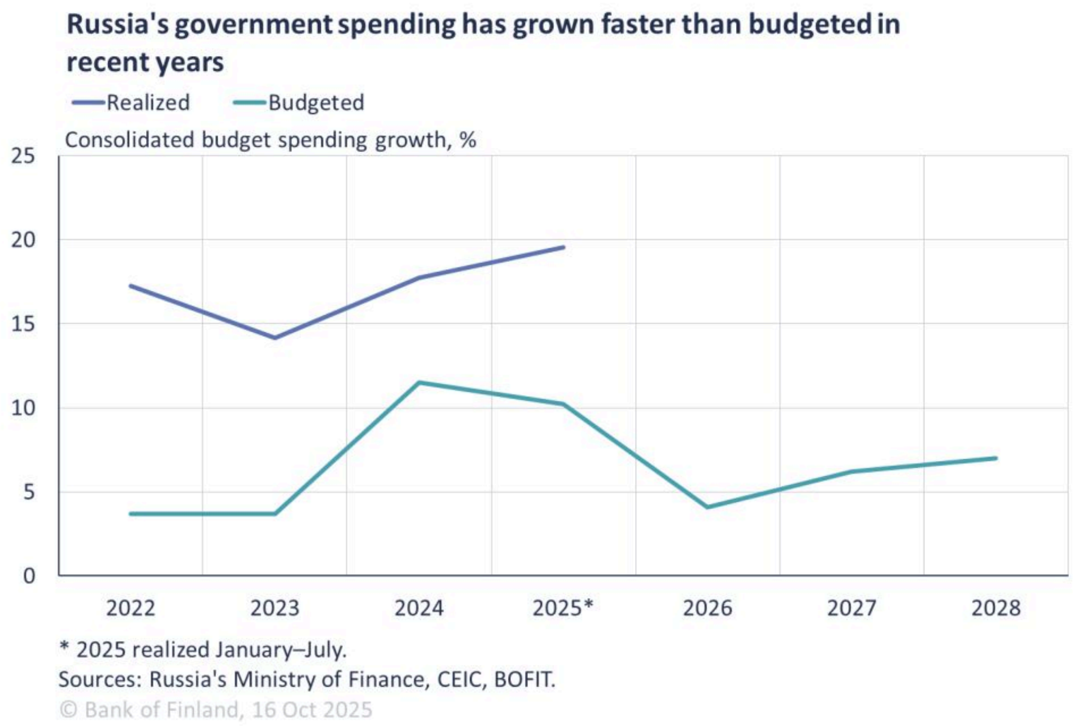
Defence spending cuts planned for 2026 budget

Consolidated budget expenditures are set to increase next year by 4 %, and federal budget spending by 3 %. Given that Inflation is assumed to only reach the government's target level of 4 % p.a. at the end of 2026, government spending would slightly decline in real terms next year. The government may find it difficult to cut spending overall, however, in the current weakening economy. A similar budget plan for 2023 was presented in autumn 2022. Despite budgeted consolidated spending growth of just 4 %, actual growth ultimately reached 12 %.

The budget framework includes a breakdown of spending by category (not realised expenditures). While the budget framework calls for a 5 % reduction (about 600 million rubles) in defence spending next year, it also foresees a rise in national security spending of roughly the same amount. Together, spending on defence and national security would continue to represent about 20 % of total government spending[3] Again, these numbers are reminiscent of the autumn 2022 budget plan for 2023, when defence spending ultimately skyrocketed despite moderate plans. Thus, the draft budget for next year seems to indicate an expected end (or at least the hope for an end) to the Ukraine war. An end to the conflict obviates the need to further increase military spending, while national security spending is likely to rise significantly in order to maintain control of occupied territories. If these assumptions do not materialize, defence spending could exceed the budget plan.

Among the major spending categories, spending on national economy (including e.g. infrastructure investment) is planned to rise by 13 % next year. Spending on social policy and health care would rise by 7 %. Culture, with a 20 % increase in funding, would be the largest beneficiary among the smaller spending categories. Russia's new national goals include programmes for teaching of patriotism and traditional cultural values.

Chart 2.



Considerable uncertainty surrounds 2027–2028 budget plans

Consolidated budget revenues are expected to rise by 7 % a year during 2027–2028, while spending grows by 6–7 % a year. Revenues from oil & gas are expected to continue to rise gradually along with rising oil prices. An underlying assumption is that the average export price of Russian crude will rise to $61 a barrel in 2027 and $65 in 2028. The price of benchmark Brent blend crude is expected to remain at $70 a barrel, which indicates that the government expects the discount on the price Russian crude to diminish. In terms of spending, a slight increase has been budgeted for 2027 defence spending, with spending remaining at about the same level the following year. These figures suggest that Russia plans to replenish its drained stockpiles even if actual military operations would have ended.

Government eyes increased borrowing, seeks to preserve reserve fund assets

Although the budget deficit is expected to shrink significantly next year, it would still remain in the red for the entire three-year period covered under the spending limits. According to the budget framework, the 2026 deficit would amount to 3.8 trillion rubles (1.6 % of GDP), with the deficit thereafter gradually shrinking further (1.3 % of GDP in 2027 and 2028). The deficit would be covered entirely through increasing government borrowing. New government debt would amount to 9.5 trillion rubles this year and to a total of15 trillion rubles during 2026–2028.

The ratio of public debt to GDP at the end of 2028 is expected to be five percentage points higher than at the end of 2023. Russia's government debt-to-GDP ratio (20 % of GDP at end-2028) is still relatively low by international standards. The budget framework sees government debt-servicing costs at around 4 trillion rubles a year in 2026–2028. Even if the amount of debt rises rapidly, interest expenses would not rise as fast if the central bank eases its monetary stance as expected. Of course, if interest rates do not fall as fast as expected, debt-servicing costs would be higher.

The government now wants to save the remaining assets in the National Wealth Fund for the event of unexpected economic disturbances. According to Russia's finance ministry, the liquid assets in the National Wealth Fund at the end of September amounted to 4.2 trillion rubles (2 % of GDP).

Key words

fiscal policy, Russia