Section 1. Russian Economic Policy in 2015: Anti-Crisis Measures or Structural Reforms[1]

1.1. Global trends: the general and the specific

Today, the world is looking for the new equilibrium that should occur after the global structural (systemic) crisis that began in 2008 and still more or less continues. We are witnessing the formation of a new macroeconomic (including the nature of monetary policy and economic growth potential) and institutional growth model, a change in the roles of certain economic sectors, the emergence of a new model for globalization and international trade, and a re-thinking of the role of inequality in the economic and social development of the leading states.[2] The situation remains unstable, although the global crisis itself is nearing completion.

Nevertheless, the end of the *global crisis* will not necessarily mean that the situation in all affected countries and regions will improve. It will depend on the ability of countries to "exploit the crisis," i.e., to find institutional solutions to help them adapt to the new reality – technological, economic, social, and even ideological. Some countries may come out of the crisis renewed and more competitive, but others will continue trying to overcome the negative trends. However, this will no longer be a global crisis, but rather a crisis of specific national models.[3]

We can identify a number of features that were characteristic of the global crisis during the past year and that will remain relevant in 2016.

The first is the staged nature and lack of geographical synchrony to the global crisis. Although the crisis affected almost all developed and leading emerging economies, its progress was asynchronous across the countries and regions of the world. At first, it seemed that the crisis might engulf the majority of the leading countries, and therefore, global economic coordination institutions were created in 2008: the G20 was formed, and the mandate of the Financial Stability Board was expanded.

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[1] Author of this section: Mau V. – RANEPA. The author should like to express his sincere gratitude to V. Gurevich, S. Drobyshevsky, G. Idrisov, P. Kadochnikov, A. Mamedov, and M. Khromov for their assistance in preparing this section and fruitful comments in the course of its discussion.

[2] These issues are discussed in detail in Mau and Ulyukaev (2014). Global Crisis and Trend of Economic Development. Voprosy Ekonomiki. 2014, No 11. pp. 4-24.

[3] In fact, the crisis with the Soviet system during the 1980s and 1990s represented this particular kind of deferred crisis. It was a result of the failure of the Soviet elite to adapt to the new reality that emerged during the crisis in the 1970s. Thus, the crisis in the Soviet system was not part of the structural crisis in developed countries but undoubtedly arose as its consequence.

The decoupling hypothesis appeared, arguing that the leading developing countries were, to a certain degree, independent of the trends in developed countries. This provided a basis for the idea that emerging economies would drive the world out of the crisis. The highest hopes lay with the BRICS countries. However, the crisis soon began to accelerate in Brazil and Russia, and then in other major developing countries. In 2015, it became clear that even China was affected by the crisis, as its growth rate dropped below 7% for the first time in 35 years (since 1981). Although China demonstrates a high rate of growth relative to other countries and that growth contributes much more to the global GDP than it did in the early 1980s, the impact of a slowdown will be felt globally. We should also note the unprecedented volatility of the Chinese stock market, the USD 513 billion contraction in international reserves, and the aggressive (on the Chinese scale) movements of the yuan. The Brazilian economy is also declining, and only India managed to keep growth at approximately 7.3%.

The BRICS countries showed more political unity last year, and provided increasingly fewer reasons for economic positivism. The unity turned out to be more political than economic (as observed 15 years ago, when it was "invented" by J. O'Neil, chief economist at Goldman Sachs).

The second is overcoming the crisis by developed economies. The crisis is aggravated in developing countries, whereas developed economies are recovering. First of all, we can point to the United States, where macroeconomic conditions (growth rates and low unemployment) enabled the Federal Reserve to increase interest rates for the first time in nine years. Undoubtedly, the crisis is not yet over: past experience has proven that such large-scale transformations could quite possibly lead to renewed deterioration in economic trends. This, however, does not change the general trend.

The Federal Reserve acted with caution because of the domestic situation (GDP and unemployment trends) and not as a result of evaluating this factor's impact on other countries, which is tolerably in line with the point voiced by J. Connelly, US Secretary of the Treasury, during the dismantling of the Bretton- Woods system in 1971, "the dollar is our currency and your problem." The turn- around in US monetary policy supports the "escape to quality" trend (capital flight from emerging markets) and seems to herald the beginning of a long period of an expensive dollar. The latter will factor into amortizing one of the global imbalances that had formed before the outbreak of the global crisis.

The situation in the EU is improving gradually, which is caused, to a lesser extent, by general macroeconomic success and, to a greater extent, by the manifested ability to resolve acute issues with the single currency system. On the whole, the crisis with the single European currency (related to the situation in Greece) is resolved. The euro has persevered under the conditions of, and according to, the paradigm of fiscal austerity (the German approach) and not on the exotics of unfettered budget stimulation, as was advocated by the leftist Greek government and the governments of some southern European countries. At the same time, the European Central Bank (ECB) is continuing its policy of strong quantitative easing, which now turns out to be just the opposite of the course taken by the Federal Reserve in 2015. The euro's weakening against the dollar may become an additional incentive for the European economy (if the inflation trap can be avoided).

Ireland's success was less noticeable, but still important: for three quarters in 2015, economic growth was 7%, the best performance in the Eurozone. This is the more important because in 2008 and 2009, Ireland suffered a deep crisis that brought it to the verge of economic disaster. The country's experience over the past seven years shows that a responsible policy may resolve complicated issues, even within a currency union and with a lack of monetary tools at the disposal of the national government.

The result in 2015 was the de facto preservation of the euro, which demonstrated the stability of currency unions in current circumstances and, at the very least, provided the post-crisis world with a second reserve currency, In all probability this experience will continue to play a part in the formation of new integrational structures, the importance of which will continue to grow.

However, an overestimation of the recuperation in the Eurozone would be a mistake. It still requires a number of institutions to ensure its stable functioning, including banking regulations and budget system coordination. The results of the referendum in Great Britain concerning its membership in the EU are still open. Europe has not overcome the crisis for economic and political reasons.

The medium-term prospects for the unprecedented monetary expansionism of recent years is still an open issue. Although deflation remains the primary threat for developed countries, the risks of accelerated inflation processes cannot be ignored.

The prospects for overcoming the immigration crisis in Europe are closely related to this matter. The wave of migrants into the EU raises serious short-term issues. The same wave, however, can offer additional possibilities to neutralize the negative demographic trends and increase productivity.

The third is the search for and development of new economic growth models. We should seek multiple new models, rather than a single, one-size-fits-all approach. Even with some convergence between developed and leading developing countries during the pre-crisis period (the 1990s and 2000s), the challenges facing them now differ significantly. The difference between the ongoing structural crisis and those of the 1930s and 1970s is the different scope of macroeconomic and institutional reforms needed to achieve a sustainable growth trajectory.[1]

For some countries, it should be about the economy's greater focus on domestic demand (this pertains to quite different countries such as Germany and China). For others, the focus should be on enhancing and diversifying foreign demand (this also pertains to Russia). A number of countries need serious institutional reforms. Some countries need to raise prices to achieve the required inflation targets, whereas others need to suppress them. Nevertheless, all countries need to take measures to enhance economic growth potential given a new technological base. In virtually all of the growth models, human capital development is one of the key priorities.

The fourth is the prospect for globalization. Globalization faces serious challenges, economic and political alike. International trade value declined by 11% in 2015. This has been a rare occurrence during the past 30 years, nearly unprecedented, overlooking 2008, when the 22.6% decline was fully offset by 2010.

We have seen the evident enhancement of political forces arguing for protecting national values and identity, in contrast to universalism and globalization. All this is happening against a backdrop of greater rigidity in international relations, including crude protectionism, sanctions, aggressive regulation, and even armed conflicts, all of which had been almost unacceptable until recently. A crucial, albeit not entirely clear, question is what will become of the political

[1] Mir prognozov 2016. http://www.mirprognozov.ru/prognosis/economics/neft-skoro-zakonchitsya-syirev-yie-tsiklyi/ru.

mainstream. A related question is whether the trend towards nationalism, which was marginalized in recent decades (since the end of World War II in Europe), will prevail during the next quarter of a century?[1]

From an economic point of view, globalization is one of the key phenomena and will remain so in the post-crisis world. However, the recent trend towards adjusting the globalization model is becoming increasingly apparent. We are speaking about the shift of the center of gravity from "global globalization" (which has the WTO as its symbol and quintessence) towards "globalization by interests" or regions. Regionalization of globalization has recently gained fresh momentum.

The expansion of the multilateral (universal) integration agenda in the world will apparently experience long-term stagnation: the WTO can provide only liberalization of global trade to a certain degree and define the acceptable boundaries of protectionism, beyond which the global economy will not move. Basically, the architecture of trade and economic relations will be determined by regional and mega-regional blocs, such as the Transatlantic Trade and Investment Partnership, the Trans-Pacific Partnership (TPP; this treaty was signed in February 2016), the Silk Road Economic Belt (SREB), the Euro-Asian Economic Union (EAEU), and other treaties on free trade.

This is manifested in the development of existing and newly emerging trade and economic alliances as well as increased interest in inter-country free trade zones. In 2015, the movement to form the SREB gained new momentum, and economic and political ties also strengthened within the SCO and BRICS. In October, negotiations concluded on formation of the TPP, which involved the United States, Japan, Canada, Mexico, Australia, New Zealand, Singapore, Brunei, Chile, Peru, Malaysia, and Vietnam.

The expansion of the EAEU, joined by Armenia and Kyrgyzstan, should be viewed within the same context. Admittedly, the intensification of post-Soviet integration processes and the trend towards a common economy, which occurred about five years ago, proved to be very well-timed. Further developments showed the error of interpreting this policy as a "look back," i.e., an attempt to restore the Soviet Union. Even recognizing the Soviet nostalgia prevalent in certain parts of the Russian elite, the establishment of the EAEU addressed not the issues of the past but the challenges of the future, reflecting the new trend towards the "regionalization of globalization."

The fifth is the formation of future currency configurations. Expectations of the imminent collapse of the US dollar, popular among journalists for a certain period of time, have not come true, and the dollar apparently will continue to serve as the global reserve currency. The outcome of the 2015 European crisis indicates that the euro is also likely to retain its status as an international currency. This is evidenced by the resolution of the crisis in Greece. However, Eurozone countries will have to make some difficult institutional decisions concerning the budget and other financial matters to enable the euro to become a full-fledged international currency.

Despite – or, perhaps, thanks to – the 2015 devaluation, the yuan is moving in the direction of becoming a reserve currency. This is also facilitated by its inclusion in the IMF "currency basket." A weaker currency provides competitive advantages for an economy, which is important for the sustainable economic development of a country largely focused on exports.

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[1] "We may be entering a world dominated by a new paradigm where politicians, including central banks, have fewer opportunities to reduce risks. This suggests the possible beginning of a process by which a number of earlier assumptions will no longer be relevant," wrote Citi analysts (Citi-GPS, 2016 Global Political Risk, p. 4).

Despite its high volatility, the ruble could still be regarded as a regional reserve currency. By stabilizing the ruble and giving up elements of monetary control, Russian monetary authorities are laying the foundation for improving its international position in the future. It is important for this task to maintain its critical focus, although its practical implementation has been postponed and is inseparable from serious structural and institutional reforms within the country.

The sixth is the decrease in commodity prices, particularly for fuel and energy products. The average annual oil price dropped by 50% compared with 2014. A drop of this magnitude over one year's time has almost no precedent in modern history: in the past 50 years, this only occurred in 1986 and 2009 (*Fig. 1* and *Fig. 2*). In the first case, it foreshadowed the beginning of a long period of low oil prices, though they rose slightly in the short term. The situation in 2008 and 2009 may also have indicated a future change in the trend, which became more apparent in 2014 and 2015. However, this suggests no firm conclusions, as the history of oil price cycles is very short and we cannot build responsible forecasts based on two waves.

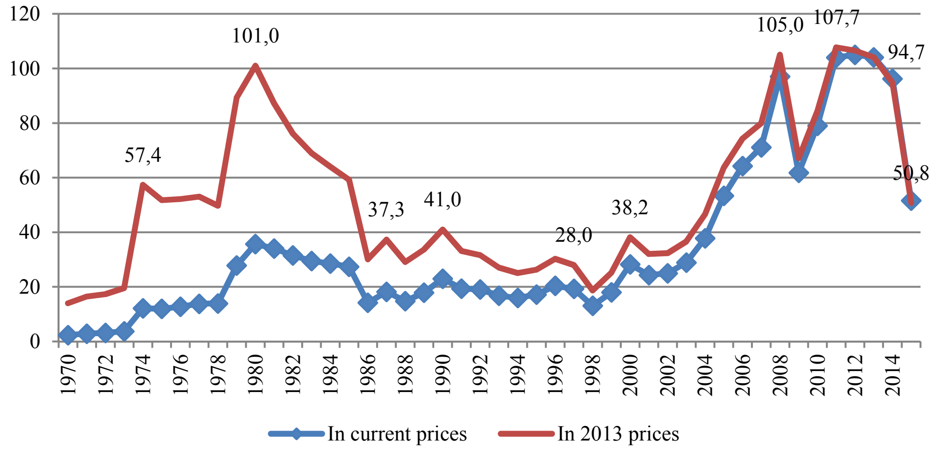

Fig. 1. Global oil price (USD/barrel)

Source: International Monetary Fund.

Moreover, we still do not know whether fluctuations in the oil market follow a wavelike pattern. Demand for oil as a commodity is influenced by technological progress, and it is far from certain that oil as a fuel will always be in demand during an economic recovery. It is possible that the "oil supercycle" mentioned so often in recent years is only a phenomenon of a certain phase of technologi cal progress during the last half of the 20th and early 21st century (a mature industrial society that is becoming post-industrial). It is the high demand for oil that made its price an indicator of not only the economic but also the political well-being of many countries, including both producers and consumers, and the movements of oil prices determined the fate of political regimes and even social systems. When the technological model is changed, oil may once again become an ordinary exchange commodity needed in the energy and chemical industries and could lose the political significance that has been attached to it over the past 40 years.

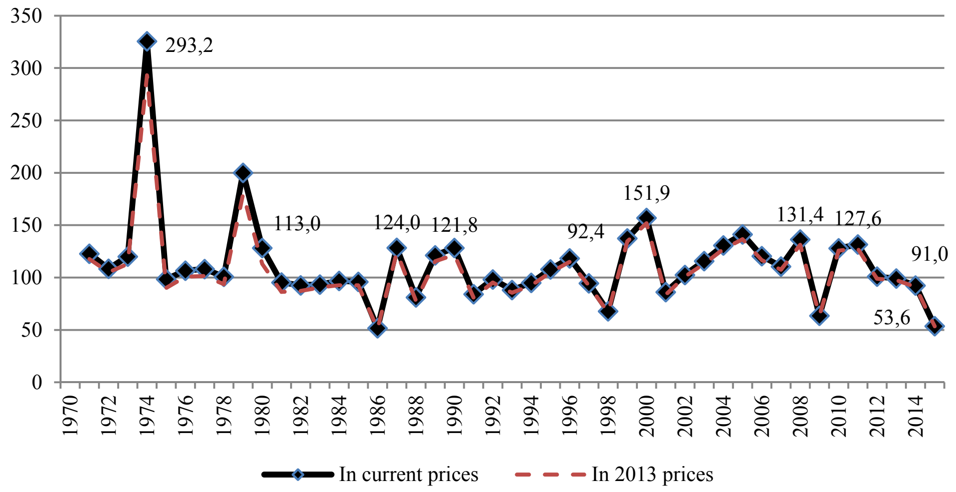

Fig. 2. Changes in the global oil prices (% of the previous year)

Source: International Monetary Fund.

Low commodity prices can result from powerful technological advances that lower the demand for (specific weight of) metals and fuels in the production of modern products. Demand for new products (advanced metals and fuels) is driven by advanced technologies. If this assumption proves to be reasonable, there may be no new cyclical recovery of prices for traditional commodities.

These are just assumptions, however. The practical conclusion is that an economic policy cannot be based on an expected resumption of high oil prices or on maintaining a consistently low level. The only thing we can assume is that oil prices fluctuate within a varying range depending on the interaction of multiple hard-to-predict parameters. The less a country's economy depends on market fluctuations beyond the control of its national government, the better the prospects for sustainable economic growth over the long term. Norway is the most obvious example of this policy, with its oil rent concentrated in a sovereign fund. At the other end of the spectrum is Venezuela, which spent much of its oil rent proceeds: its GDP fell by 10% in 2015 (*Table 1*). Generally, economic out- comes during 2015 clearly demonstrate that commodity price movements are not a dominant growth factor, even in countries with a significant share of commodity sectors. The quality of institutions is much more important.

Table 1

Macroeconomic indicators for selected countries in 2014 and 2015

Country/group of countries	GDP growth rate, %		Inflation, %		National debt, % of GDP		Budget balance, % of GDP	
	2014	2015	2014	2015	2014	2015	2014	2015
1	2	3	4	5	6	7	8	9
World total	3.4	3.1	3.2	3.6	79.8	80.7	–3.1	–3,6
Developed economies	1.8	1.9	0.7	0.8	104.6	104.5	–3.4	–3,1
Developing economies	4.6	4.0	5.1	5.7	41.4	44.4	–2.6	–4,3
G7	1.7	1.9	0.8	0.7	118.6	117.4	–4.0	–3,5
EU	1.5	1.9	0.0	0.6	88.1	87.7	–2.9	–2,5
United Kingdom	2.9	2.2	0.9	0.3	89.4	88.9	–5.7	–4,2
France	0.2	1.1	0.0	0.1	95.6	97.1	–4.0	–3,8
Germany	1.6	1.5	0.2	0.2	74.6	70.7	0.3	0,5
Italy	–0.4	0.8	–0.1	1.9	132.1	133.1	–3.0	–2,7
Spain	1.4	3.2	–1.0	0.7	97.7	98.6	–5.8	–4,4

Cont'd

Ireland	5.2	4.8	0.2	0.2	107.6	100.6	–4.0	–2,0
Poland	3.4	3.5	–1.0	0.1	50.1	51.1	–3.2	–2,8
Greece	0.8	–2.3	–2.6	1.5	177.1	197.0	–3.9	–4,2
Norway	2.2	0.9	2.1	2.3	28.1	28.1	8.8	6,0
Switzerland	1.9	1.0	–0.3	–1.2	46.3	46.2	–0.1	–0,2
USA	2.4	2.5	0.6	0.9	104.8	104.9	–4.1	–3,8
Canada	2.5	1.2	1.9	1.1	87.9	90.4	–1.6	–1,7
Australia	2.7	2.4	1.6	2.4	33.9	36.0	–2.8	–2,4
Saudi Arabia	3.6	3.4	2.4	2.1	1.6	6.7	–3.4	–21,6
BRICS	5.7	4.7			44.7	47.3	–2.6	–3,8
Brazil	0.1	–3.8	6.4	9.3	65.2	69.9	–6.2	–7,7
India	7.3	7.3	5.3	5.4	66.1	65.3	–7.0	–7,2
China	7.3	6.9	1.5	1.8	41.1	43.2	–1.2	–1,9
South Africa	1.5	1.3	5.8	5.5	46.0	48.4	–3.8	–4,1
Argentina	0.5	0.4	23.9	19.3	45.3	52.1	–2.7	–4,9
Venezuela	–4.0	–10.0	68.5	190.0	51.8	53.0	–15.0	–24,4
EAEU	1.0	–3.1			18.4	21.2	–0.8	–5,3
Russia	0.6*	–3.7	11.4	12.9	17.8*	20.4**	–1.2**	–5,7**
Belorussia	1.6	–3.6	16.2	16.9	40.5	40.4	0.2	–2,4
Kazakhstan	4.3	1.5	7.4	9.0	14.9	18.3	1.8	–3,2
Ukraine	–6.8	–9.0	24.9	45.8	71.2	94.4	–4.5	–4,2

* Data on RF GDP growth rate in 2014 were upgraded the Federal Service of State Statistics in February 2016 to 0.7%.
** IEP estimates of National debt and budget deficit differ from the IMF data, see Table 5 of the present chapter.
Source: World economic outlook database, January 2016.

Low commodity prices will contribute to an even greater divergence between leading countries, both developed and developing. For commodity importers, it will become a factor in economic growth; for exporters, it will be a source of crisis that will need to be addressed with structural reforms, some of which will be painful, socially as well as politically. They are highly likely to be delayed, but the price of delaying reforms may turn out to be very high in terms of political and economic stability, which was clearly demonstrated by the Soviet experience.

The seventh is the prospects for the social structure of developed countries and the problem of inequality. Studies show the existence of social shifts leading to the polarization of society and an erosion of the middle class. Much has been written about the middle class amid the transformational crisis in Russia. Last year, discussions began regarding the impact of the recession on the middle class in 2014 and 2015. In the broader context, this problem is related to deep structural transformations inherent in the global crisis. Although a powerful middle class is forming in developing countries, developed countries are witnessing a dilution of the middle class and increases in the proportions of more affluent strata, on the one hand, and of poorer people, on the other. This is largely connected with the profound changes in the technological structure, with the division of professions into more advanced and financially attractive areas (finance, ICT, biotechnology) apart from traditional fields, where income is not growing.

At the beginning of the 21st century, and especially in the early years of the global crisis, researchers sought to determine the top 1% of the population who concentrated wealth in their hands.[1] There has been an increasing amount of discussion lately about the formation of considerably large segments of the rich and the poor, with the middle class being diluted. In 2015, J. Furman, Obama's chief economic adviser, said, "You have seen a hollowing out of the

[1] See, e.g., Alvaredo F., Atkinson A.B., Piketty Th, Saez E. The top 1 percent in international and historical perspective. *Journal of Economic Perspectives.* 2013, Vol. 27, No 3, pp. 3-20; Mankiw N.G. Defending the one percent. *Journal of Economic Perspectives.* 2013, Vol. 27, No 3, pp. 21-34.

middle of the income distribution, and there's neither one cause for it nor a single answer. It's a big problem, it is decades in the making, and it will require a lot of solutions."[1] This shift is partly evidenced by the labor market structure: in the modern United States, it is much easier to find a low-paying job for a person with a low level of education, or a high-paying job for a graduate of a top university, than a mid-level job that would be most in line with the concept of the middle class.[2]

Social stratification, inequality, and the impact on prospects for economic growth in developed countries will apparently be among the key topics of economic and political discourse in the coming years. These issues are important not only in terms of creating a contemporary model of economic growth but also for ascertaining the more general prospects for preserving the socio-economic system currently known as capitalism. Some of the leading modern social scientists consider the erosion of the middle class as a deferred realization of Marx's forecast about the ejection of workers from the labor process, underlying his conclusion about the doom of social relations based on commodity production.[3]

The eighth is the substantial increase in global tension, particularly the enhanced use of the military to resolve conflicts. The number of conflicts has been steadily rising over the past three years. In a sense, it has become a political sequel to the global crisis. It is as yet difficult to fully estimate the real prospects for armed conflict as an indispensable factor in socio-economic and political life.

In summarizing the above, we can draw two conclusions about the development of the global situation. From a purely economic point of view,

it is developing positively. The global crisis is coming to an end, and the growth rates of the world economy and most of the world's leading regions are recovering, albeit relatively slowly and unevenly across countries and regions. Barring major turmoil in China (those risks are related to both economic and political factors), we will see a gradual return to a normal, non-crisis economic and political agenda. The problems for individual countries (e.g., Russia, Brazil and Venezuela), where the processes of structural modernization will be delayed, will not significantly impede the ability to overcome the structural crisis.

However, these completely peaceful prospects are being overshadowed by destabilizing political and military factors. Governments of the leading countries have become increasingly active in resorting to military force to address the challenges they face. This, in turn, dramatically increases risks, and not just economic ones. In other words, the risk of uncontrollable developments is increasing, which further enhances the role of non-economic factors in the implementation and efficiency of economic policies. In practice, it has no advantage over the resolution of military and occasional foreign policy objectives.

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[1] Fleming S., Donnan Sh. America's middle-class meltdown: Core shrinks to half of US homes. *Financial Times*. December 9, 2015. Whereas in 1970, US middle-class households accounted for 62% of the total income, in 2014, they only accounted for 43%. However, the share of the upper-middle class rose from 29% to 49% during the same period (Pew Research Center, 2015. The American Middle Class Is Losing Ground. December 9. http://www.pewsocialtrends.org/2015/12/09/the-american-middle-class-is-losing-ground/).

[2] Thompson D. The hollowing out of America's middle class. http://www.theatlantic.com/business/archive/2010/09/the-hollowing-out-of-americas-middle-class/62330/.

[3] See: Collins R. Middle class without jobs: Exits are closing. *Does capitalism have a future?* 2015. Gaidar Institute Publishers, pp. 61-62.

1.2. Economic situation in Russia: put-off crisis in the context of rent model

In 2015, the economic situation in Russia was driven by two groups of factors. On the one hand, it was the continued effect of the external shocks, including sanctions (especially in the financial sector) and falling prices for key Russian export products. On the other hand, there were apparent and serious structural problems that have reduced growth potential since the middle of the past decade and have caused stagnation in the Russian economy.

Both groups of factors led to the negative trends that appeared as early as 2014, which was reflected in the GDP decline in 2015 (*Table 2*). Almost all experts acknowledge that as important as the external shocks were, the structural crisis was the key problem. Indeed, a decrease in investment activity has been observed since 2012, when growth rates began to decline. These negative processes started before the sanctions and falling oil prices. The reason behind this slowdown was the decreased economic growth potential, first observed during the second half of the 2000s.

The structural crisis of the Russian economy is to some extent bound up with the global crisis that is driving all of the developed countries to search for a new growth model. But to a significant extent the crisis in Russia has been generated by internal problems, and above all by exhaustion of an extensive growth model that is based on the utilization of free resources (capacities and manpower) and the rapid growth of external and internal demand (stimulated by revenues from the export of raw materials). The need for a new model of economic growth was noted in the "Strategy for 2020", drawn up in 2011.[1]

Historical analogies can help us understand the nature of present-day problems, even if they do not provide us with clear-cut anti-crisis remedies, whether positive (what is to be done?) or negative (what should not be done?). Leaving the global crisis top one side, let us examine the problems experienced in Russia during the second half of the 1980s.[2] The two periods display many macroeconomic, institutional and geopolitical similarities.

- a similarity in the magnitude of the fall in oil prices;
- a double shock to the budget (from the decline in revenues from exports and excise duties consequent upon the anti-alcohol campaign of 1985);
- a slowing down of growth rates, especially when compared with the developed economies of the West and the rapidly growing economy of China;
- confrontation in the geopolitical arena, including external military initiatives, and sanctions.

In both cases we note a delay in dealing with a structural crisis, one that had begun ten years earlier in the more developed economies and led to a reappraisal of the existing economic model. The scale of the inflow of resources from the export of hydrocarbons in both cases made for avoidance (or at least attenuation the impact) of the crisis in its early stages, at a time when the more developed countries were experiencing a period of turbulence. But the subsequent attempt to deal with the crisis was all the more difficult, since by this time other countries were already implementing institutional and structural changes in order to adapt to the new challenges.

As regards present day Russia, overcoming the structural crisis will entail abandoning an economy based on rent, that is, a model based on large-scale redistribution of revenues, the

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[1] Strategy - 2020: New growth model - New Social Policy. Two Volumes (Moscow, Delo, 2013)

[2] A comparison of the current crisis with problems experienced by the post-Soviet economy is to be found in V. Mau, 'Awaiting a new growth model: the socio-economic development of Russia in 2013', Voprosy ekonomiki, 2014, No. 2, 4-32.

generation and growth of which do not derive from any growth in productivity. This does not mean that we are advocating repudiation of the significant role of the raw materials branches of the economy: an economy based on raw materials is not an economy based on rent. Unlike the economies of the nineteenth and twentieth centuries, economies in the present day are no longer divided into advanced and backward. Nowadays the distinction is between advanced and backward technologies, and both can be found in any branch of an economy.

The history of the last 50 years shows that a country can be highly developed in the technological, institutional and economic spheres, while having a significant share in its economy of raw materials and, specifically, hydrocarbons (Norway, Canada, Australia). In other words, the problem resides not in raw materials so such as in the inefficiency of technologies and institutions. Overcoming this problem requires a complex range of measures that belong to the institutional sphere rather than to the removal of rental revenues (if there are any) from the current budget. This poses the question whether the national élite is capable of creating an appropriate business climate, enhancing the quality of human capital (including immigration of qualified workers), and of thereby creating a country that is efficient and competitive in all of its institutions. The experience of the last 50 years shows that it is extremely difficult to manage the development of an economy based on raw materials: the existence of rent does not facilitate, but, rather, complicates the tasks that confront the national government. [1]

Of course, notwithstanding all similarities, the current situation significantly differs from that which obtained on the eve of the second half of the 1980s. The present day Russian economic and political systems are much more flexible and stable than the Soviet. There are now "automatic stabilizing mechanisms" (market prices, flexible exchange rate), significant gold and foreign currency reserves and a more flexible labour market. There is no longer the burden of being a global super-power. Considerable experience has been acquired of managing the economy in both a favourable and an unfavourable external economic environment.

However there are additional complications of a strategic character that cannot be ignored. It is at present impossible to anticipate that in future prices for hydrocarbons will be comparable with the levels they reached in 2008 or even 2012. As we have indicated above, that these price fluctuations are cyclical is only one hypothesis amongst many. It would appear that a "new oil price reality" is taking shape. It would therefore be a mistake to base economic policy upon an expectation of high price levels. The need for a new "budget rule", and a more responsible policy for expenditures in the event of an increase in revenues from the export of hydrocarbons, is only one of a number of topics of discussion.

There is another, no less immediate question: what is the mechanism for the development of a country that is rich in reserves of raw materials, in conditions in which the accumulation of rent is no longer appropriate? As we have noted above, what is being proposed is not a limitation of the role of raw materials so much as a change in the technological basis of the raw materials branches of the economy, above all a stimulation of the development value-added products, a transition from the production and export of fuel towards organic chemistry and associated

[1] When in 1976 José López Portillo became President of Mexico, the country, thanks to a leap in the oil price, acquired huge budget revenues. The new President, who was popular both inside Mexico and in the outside world. assumed that henceforth all difficulties could be overcome and that the principal problem of government would consist in the "management of affluence". However, the outcome of his six-year administration was the growth of corruption and inefficiency and he became one of the most unpopular Presidents of Mexico in the twentieth century.

production (fertilizers, polymers, plastics, etc.). Russia possesses all the material and intellectual resources needed for such a transition.

While working out this policy it will be important to avoid mistakes that will have fatal long-term consequences. In crisis conditions it is always tempting to have recourse to solutions that are as dangerous as they are simple. We have in mind various exotic and populist economic and political measures that will lead to macroeconomic stabilization and will be supported by the excuse that "this time, everything will be different".

1.3. Anti-crisis economic policy

The distinguishing feature of external economic shocks on the Russian economy has been that the macroeconomic outcome of the crisis has assumed the form of stagflation. This was not classical stagflation involving price increases and unemployment. Russian stagflation is distinctive in two respects. Firstly, employment has so far not been significantly affected - it fluctuated only to an insignificant degree in 2014-2015. Secondly, the cause of inflation was not monetary but budgetary expansionism, not an attempt to counter the economic downturn by Keynesian methods (as in the West during the 1970s), but a devaluation of the rouble that resulted from a sharp change in the external economic and geopolitical conjunctures and an ensuing "knock-on effect". This meant that opportunities for acting on inflation, and influencing the dynamic of production were very limited.

Experience shows that external shocks should be addressed with monetary and fiscal consolidation. Cash injections in such a situation would lead to increasing inflation and undermine – rather than stimulate – investment activity. A healthy expansion of budget funding is also very difficult due to the sharp decline in budget revenues as the demand for military funding is increasing.

In December 2014, the situation seemed to be on the verge of disaster. The ruble fell rapidly following the imposition of external sanctions and the decline of oil prices, and monetary authorities opted to hold the reserves, rather than spending them to maintain the national currency. The budget, which the parliament just adopted, was becoming unrealistic before our very eyes.

At the beginning of 2015, the government of the Russian Federation adopted a package of anti-crisis measures that included a budget review and reduction of expenditures by an average of 10%. A Government commission (in effect, an anti-crisis commission) set to work on economic policy and integration and this body examined specific problems of the functioning of individual sectors that were important to economic and social stability. The implementation of a number of measures succeeded in stabilizing the situation, but it proved impossible to control certain negative trends. Subsequently, the government was criticized for not having fully implemented the anti-crisis programme (or, rather, for under-expenditure of the resources that had been allocated to it); but it would be more correct to say that the measures adopted had been themselves ineffective.

Due to the anti-crisis policies implemented throughout 2015, the results for the year look somewhat better than expected at the end of 2014. At that time there had been the risk of serious destabilization, and the development of a macroeconomic situation that would be out of control of the government and of the monetary authorities. The worst-case scenarios have not materialized. The timely transition to a floating exchange rate (called a transition to "inflation targeting"), the consolidation of budget expenditures and the implementation of the government's anti-crisis plan prevented the situation from spinning out of control, preserved the international reserves, and significantly slowed the GDP slump.

In the following discussion, we will study the main economic and political problems and solutions from 2015 and their impact on the prospects for the country's socio-economic development.

Economic trends. GDP declined by 3.7% in 2015. This is the second recession since 1999, when the Russian economy shrank by 7.8% in the wake of the global crisis (*Fig. 3*). However, whereas in 2009, the decline occurred in the majority of developed countries, growth is now accelerating there. Throughout the year, statesmen and experts discussed the "passing of the bottom" of the recession, i.e., the point at which it should stop (*Table 2*).

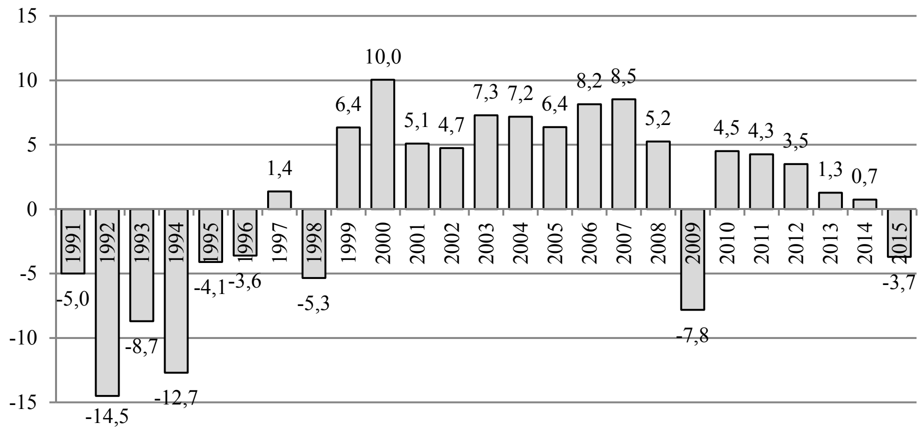

Fig. 3. Dynamics of GDP of Russia (growth rates to the previous year %)

Source: Rosstat.

Table 2

Industrial production: passing the low point in 2015 (%)

Industry	Share in the industrial production index	"Bottom" passed	Change in the output index, October 2015 against July 2014
Industrial production index		√ (June)	96.19
Mining and minerals	33.99	√ (May)	101.31
Manufacturing	52.50	√ (July)	93.44
including:			
Food products, beverages and tobacco	17.05		101.65
Textiles and textile products	1.43		83.88
Leather, leather products and footwear	0.32	√ (June)	89.60
Wood processing and wood products	2..20		95.92
Pulp and paper	3.92	√ (May)	96.81
Coke, petroleum products	18.78		100.09
Chemical production	7.46	√ (no reduction)	107.61
Rubber and plastic products	2.26	√ (May)	95.90
Other non-metal mineral products	4.41		86.90
Metallurgy and metal product	17.23		92.39
Machinery and equipment	6.24	√ (July)	86.84
Electrical and optical equipment	6.05		84.04
Transport vehicles and equipment	7.06	√ (July)	81.18
Other production	5.59		87.58
Electricity, gas and water	13.51		98.00

Source: Rosstat.

Two important factors drove the nature and duration of the downturn in 2015 and made it difficult to predict, i.e., the industry structure and exchange rate trends. The changing terms of trade – and, as a consequence, the devaluation of the national currency[1] – had different effects on particular industries, which showed differing trends over the past year. Export-oriented industries demonstrated growth, whereas those associated primarily with domestic consumption shrank. The hardest blow, however, was dealt to those industries that had previously benefited most from the inflow of rental income, i.e., services, trade, and construction. Indeed, an analysis of the problems associated with the Dutch disease has shown that a powerful inflow of rental income undermines competition in most industries producing tradable goods but contributes to the development of sectors in which there are no imports (trade, construction, financial and non-financial services). Accordingly, there can be no import substitution there. Those sectors grew at an especially rapid pace in the past. However, for the same reason, it is these sectors that are most susceptible to decreased demand as a result of the devaluation. Without a doubt, the trend in each particular sector was strongly affected by the share of incoming imported goods and the high proportion of borrowings in foreign currencies within the sector.[2]

A combination of those factors drove the GDP trend. When the devaluation processes had stalled by mid-2015, industry began to show signs of recovery. However, a new round of oil price declines, and the further weakening of the ruble that followed, prolonged the recession.

The investment situation evolved similarly, which appeared to be stabilized by the early autumn. However, the uncertainty about the exchange rate, and accordingly, the effectiveness of the business environment, has led to a continued decline in investment.

We can assume that in the absence of political shocks, a new equilibrium will be achieved in several months. In terms of macroeconomic factors, to restore growth, Russia needs neither high nor low, but stable, oil prices to determine clear conditions for businesses to make decisions.

Structural policies and import substitution. Devaluation, for all its drawbacks, has been linked with opportunities for import substitution and diversification of the economy, especially in the sphere of exports. But from the very outset, it became evident that, for a number of reasons, there would be no repetition of the effect of 1999: owing to the global situation (political and economic); owing to a lack of significant spare capacities and manpower; owing to the much deeper integration of the Russian economy in the value-added chain, that is the dependence of domestic production upon supplies of imported equipment or spare parts; and owing to the fact that amongst the developing countries that were in competition with Russia, devaluation was being widely used as an instrument for managing inflation.

In the past (this applies not only to Russia), the consequences of devaluation were deferred, but the main results were already visible during the first year. However, in the context of modern multilateral devaluations and the global contraction of demand, their effect will be uneven across countries and will be deferred, at best, if the devaluation can be enhanced with

[1] See in detail on mechanism of changes: Idrisov G.I., Ponomarev Yu.Yu., Sinelnikov-Murylev S.G. Terms of Trade and Economic Development of Contemporary Russia. Ekonomicheskaya Politika. 2015, № 3. pp. 7–37.
[2] See G.I. Idrisov, 'Winners and losers: consequences of changes in the terms of trade for Russian industry', Russian Economic Development, 2015, No.4, 26-29; G. Idrisov, A. Kaukin, O. Morgunova, M. Turuntseva, 'Industry: trends appear worse than the data', Operational Monitoring of the Economic Situation in Russia. Tendencies and Challenges of Socio-Economic Development, 2015, No.7 (April), 21-24.

relevant structural reforms. This has been demonstrated by the experience of many countries, the most prominent being Japan, which failed to start the growth mechanism in this way.

The effect of import substitution is important and possible, but it is not straight-forward or automatic. The following are the reasons behind the modified impact of devaluation on economic growth:

– the structural effects of a long period of Dutch disease physically degrades manufacturing businesses (and related labor resources), which could become a source of import substitution: they simply cease to exist and cannot recover automatically. Therefore, recovery primarily concerns export sectors that have the ability to expand production without significant investment;
– in the absence of free capacity, import substitution requires investment and, consequently, a healthy investment climate. Devaluation could, to a certain extent, compensate for the poor business climate by reducing the risk-profit ratio. However, when making investment (i.e., long-term) decisions, devaluation is not the most important argument;
– devaluation makes the country more attractive for foreign investment. However, Russia's situation is currently aggravated by the sanctions;
– the country's involvement in international trade (global value chains) also limits the potential benefit from devaluation, as some of the cost components are increasing as a result. Thus, the impact of devaluation on import substitution can be discussed only subject to a correct analysis of specific sectors and products.

As a result, the opportunity to benefit from devaluation arose only within specific sectors in 2015. They are primarily associated with exports. At the same time, the devaluation helped identify weak spots and revealed the excessive dependence on imports for a number of manufacturing businesses and certain areas of the consumer market. The business models based on foreign exchange loans and related purchases of imported equipment began to collapse.

As a consequence of devaluation, Russian producers obtained a number of additional competitive advantages in external markets. Results for 2015 showed that the most stable position in the Russian economy was occupied by companies producing goods for export, and not export of raw materials, moreover. It is this group that is becoming the new locomotive for the expansion of exports.

A government commission to support import substitution was established in 2015, as was the Russian Export Center to support non-commodity exports. An understanding of the nature and mechanics of this support formed gradually. President Vladimir Putin and Prime Minister Dmitry Medvedev[1] spoke unambiguously in favor of linking import substitution support with the ability to make products that would be competitive on foreign markets. This means that the government is aware of the risk (known from the experience of a number of countries, particularly in Latin America) that import substitution could actually mean closing off the market to foreign goods and forcing domestic consumers to purchase more expensive and inferior goods produced within the country.

Throughout 2015, attempts were made to limit the exports of goods that benefited from devaluation (e.g., grain, metals, chemicals). This argument was the concern about the physical scarcity of goods for domestic consumption and the idea that exporting those goods would lead to higher domestic prices. (In fact, these are the same argument, only in the former case it acts as

[1] Medvedev Dmitry. A new reality: Russia and global challenges. *Journal of Russian Economics*, 2015, Vol. 1. No 2, p. 120

the "phantom pain" of the Soviet-era shortages, whereas in the latter, it was embedded in the market economy rhetoric.) However, no tangible action was taken in this area. Only the ban on the exports of hides and skins was extended, and a ban on the export of wastepaper was imposed in December.

Fiscal policy. In the face of external shocks, the government pursued a prudent fiscal policy, although it cannot entirely be called conservative. The federal budget deficit totaled 2.4% of the GDP compared with 0.5% in 2014, and national debt remained at 14.3% – a very low value by all international standards – whereas foreign debt actually decreased slightly (obviously as a result of the sanctions, rather than conscious fiscal conservatism).

With export revenues declining, the Russian government should have adjusted the federal budget to reduce expenditures in February and March 2015. A 10% sequestration was selected as the appropriate tool. Technically, it was the simplest solution, not precluding the possibility of using it in the future. However, it can have adverse implications in the medium term.

The problem is that over the past seven to eight years, the allocation of budget expenditures has deteriorated: the proportion of productive expenditures has diminished, and the proportion of unproductive ones has increased.[1] To address the long-term challenges of the country's socioeconomic development, the economy needs investment in human capital and transportation infrastructure, as these public expenditures increase potential growth. At the same time, it is these sectors that lose the most from sequestration.

Further sequestration of expenditures without structural reforms (including reforms for budget-funded organizations) is posing grave risks for the country's economic, social and political stability in the coming years (2017–2020). Without structural reforms, fiscal policy will lose the leeway that may be needed in 2017 and 2018, and the positive macroeconomic effects of devaluation will be offset.

Under these conditions, the allocation of budgetary expenditures is becoming as important as a well-balanced budget (low deficit). Achieving balance at the expense of productive sectors threatens to start a vicious cycle: reducing spending on productive sectors will undermine economic development, thereby shrinking budget revenues. Consequently, the key objective now is to optimize expenditures, i.e., to look for more sophisticated budget savings methods through structural and institutional solutions, rather than by mere sequestration.

In 2016, the government will have to resort to increasing the federal budget deficit in light of sharply decreasing hydrocarbon prices.

The key question is – what will be the size of the deficit? The President of the RF in his address of December 2015 stipulated that it should not exceed 3% of GDP. However, there is a considerable likelihood that this level will be exceeded. There will be a complicated search for a compromise – how to ensure socio-political stability while at the same time avoiding a deterioration of macroeconomic indicators.

It is often noted that low debt creates additional macroeconomic problems, particularly by depriving the monetary system of adequate collateral instruments. Proposals have even been made to set a floor for the national debt rather than a cap ("at least" instead of "not more than" a certain level).[2] This is hardly possible or feasible. On the one hand, Russia lacks a

[1] For more detail, see G. Idrisov and S. Sinelnikov-Murylev, "Budget policy and economic growth", Problems of Economics, 2013, No.8, 35-59.

[2] The Stolypin Club's proposals, published in autumn 2015, state that "the share of domestic national debt should not fall below 60% of the GDP in terms of total borrowings". (The Stolypin Club. 'Economic Growth'. Report (Moscow, 2015), 60. http://expert.ru/data/public/499741/499785/dir-polnaya-versiya-19_10_15.pdf

significant amount of private savings that the state could borrow without prejudice to private investments, let alone the transition to direct funding of the budget deficit through money creation by the Central Bank. On the other hand, given Russia's unfavorable "credit history," a substantial increase in borrowings will lead to their significant appreciation. In our opinion, ensuring macroeconomic stability means a rather long period of low debt for Russia.

The budget situation remains difficult for the subjects of the Russian Federation. Although actual tax revenues have fallen in real terms, the debt situation had not deteriorated significantly (*Fig. 4*, *Table 3*). Nominal income growth prevents uncontrollable developments. A slowdown was observed in spending growth within the consolidated budgets, which increased by only 1.4% (93% of budgeted expenditures were actually made).

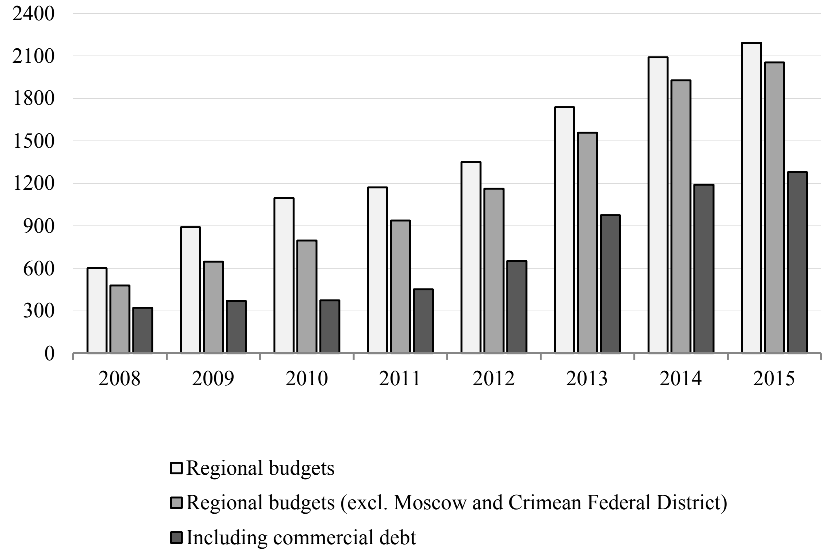

Fig. 4. Debt of the budgets for subjects of the Russian Federation (RUB billion)

Source: Ministry of Finance of the Russian Federation.

Table 3

Growth rates of main types of tax revenues included in consolidated budgets for subjects of the Russian Federation in 2015, in (%) to the previous year

	In nominal terms	In real terms*	The share of tax and non-tax revenue,%
Tax and non-tax revenues	**6,2**	**-5,9**	**100,0**
Individual income tax	4,3	-7,6	36,8
Corporate income tax	7,3	-4,9	27,6
Property tax	11,6	-1,1	14,0
Excise duties on excisable goods	1,5	-10,1	6,4
Small business tax	10,4	-2,2	4,6

* Given the CPI for 2015.

Source: Federal Treasury (Roskazna); Rosstat; Author's calculations.

An important trend was the slowing down of the growth of the debt of consolidated regional budgets by comparison with 2013 and 2014. Growth in 2015 had been of the order of 11% (compared with 29% in 2013 and 20% in 2014). In 2015, commercial debt was replaced by debt owed to the Ministry of Finance. The share of commercial debt fell in 2015 from 64% to 60% ,but by contrast the share of budget credits increased from 31% to 35%. This made possible a slight improvement in the structure of debt in terms of the cost of debt servicing. Meanwhile, medium term prospects for debt servicing are somewhat problematical and the question periodically arises within the political élite whether it would be sensible to write off a proportion of the budgetary indebtedness of the regions.

A further deterioration of revenues will most likely lead to the need to raise taxes. The official positions remain intact regarding the impermissibility of raising taxes during times of crisis and maintaining a moratorium on decisions in this area until 2018. However, in certain situations, raising certain taxes may be a more appropriate solution than sequestration or increasing domestic debt.

Monetary policy. The transition to a floating exchange rate for the ruble has saved the foreign exchange reserves, which in itself is important for long-term economic development. Raising the discount rate was also an important and responsible decision, despite fierce criticism from a significant segment of the political and business elite. It is equally important that V. Putin has repeatedly spoken about supporting the Russian Central Bank's policy. Monetary authorities continue to show support for the goal of bringing inflation down to 4% by 2018, thereby creating qualitatively new business conditions.

In addition to maintaining reserves, the Central Bank's policy has contributed to reducing capital flight, although much of the outflow resulted from Russian borrowers paying off foreign debts (*Table 4*).

Table 4

Capital outflow (USD billion)

Indicator	2014	2015
Net capital outflow from the non-governmental sector	–153.0	–56.9
Liabilities to non-residents ("+" means growth)	–36.7	–64.3
FDI in the non-banking sector	18.5	6.7
Other liabilities	–55.2	–71.0
Including foreign debt repayment according to schedule	–208.3	–126.4
New borrowings	153.1	55.4
Foreign assets ("–" means growth; "+" means reduction)	–116.3	7.4

Source: Bank of Russia.

Thus, in 2015, the net outflow of capital equaled USD 57 billion (USD 153 billion in 2014). The main channel for capital outflows was the net repayment of liabilities to non-residents, which dropped by USD 64 billion compared with USD 37 billion in 2014. However, we can assume that capital flight was also driven by geopolitical factors, as concerns about potentially expanding the sanctions could have made foreign investments less attractive. In particular, this is illustrated by the decline in foreign direct in- vestments from USD 18 billion in 2014 to USD 7 billion in 2015.

The propensity towards the "dollarization" of savings also decreased, as household ruble assets grew significantly faster than foreign exchange savings. Although Russian banks, companies and households (in terms of foreign currencies) increased investments in foreign assets in 2014, foreign assets held by Russian residents declined slightly in 2015 amid the intensive external debt re-payment. In 2014, the main channel for capital flight was the growth in foreign assets (by USD 116 billion, including USD 30 billion of investments in foreign currencies in cash), which declined by USD 7 billion in 2015. This decline is al- most entirely due to reduced investments in foreign currencies in cash.

The severe criticism of the policy pursued by the Central Bank, which is often blamed for all of the problems with the Russian economy, seems unfair. Paradoxically, those who particularly criticize the "monetarists" turn out to be true monetarists in practice, as they exaggerate the ability of monetary authorities to neutralize negative impacts from the external environment or geopolitical crises.

The banking sector remains a focus for the authorities. On the one hand, the efforts to clean up have continued. Licenses were with- drawn from 93 credit organizations (86 in the previous year). Financial recovery (rehabilitation) procedures were initiated for 15 banks in 2015. The total assets for banks that lost their licenses in 2015 were not very large, as they accounted for approximately 1% of the total assets in the banking sector.

On the other hand, some of the major banks have received strong financial support from the state, as the crisis in the banking sector would have led to dire consequences, not only economic but also social and political. Most of the government support went to state-owned banks.

The capital of the largest banks, affiliated to state institutions or state companies (banks of the VTB group, Gazprombank and Rosselkhozbank)[1] increased by more than 900 billion rubles from the beginning of 2015 and that of all other banks by less than 200 billion rubles. A consequence of this preference in state support will be a strengthening of the position of state banks in the key sectors of the banking services sector, primarily in the retail credit sector and in personal savings.

Lending to businesses slowed but still showed a positive trend of almost 7%, and the indebtedness of individuals declined by about the same amount, a much milder reaction than in 2009. The quality of bank loans does raise concerns, however. Past due debts held by corporations under ruble loans have already reached the high set in 2009, and the individual debts broke record values. The quality of loans continues to deteriorate in all segments of the market.

The greatest problem is still poor financial results in the banking sector and losses of a large number of banks. In 2015, almost 30% of operating banks recorded losses, compared with only 11% in 2009. In contrast to the situation six years ago, the current decline in banking profit margins was caused not only by deteriorating asset quality and the need to drastically increase spending on provisioning but also by lower profit margins on core banking operations. The latter was due to the high-interest-rate policy. The value of bank liabilities proved to be more sensitive to increases in the discount rate than the returns on loan portfolios, resulting in a significant reduction in overall net interest income.

The social situation and the labor market. In 2015, as in previous post-Soviet crises, incomes decreased against the relative stability in the labor market. Unemployment hovered at approximately 5.5%, which is higher than the US figure, but considerably lower than the European level. In a tense demographic situation, and with the decline in the working-age population, businesses are hesitant to severely reduce employment, instead trimming working hours and payments.

Well-being dropped significantly during the year, with real disposable income decreasing by 3.4% and real wages by more than 9.5%. This fits into the "Russian labor market model," i.e., reducing wages rather than employment.

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[1] Sberbank did not attract new credits but its capital increased in the first quarter by 215 billion roubles thanks to previously agreed subordinated credits from the Bank of Russia, received in the summer of 2014 in conformity with a new edition of the law "On supplementary measures for the support of the financial system of the Russian Federation", 173-FZ of 13.10.2008.

At the same time, bank savings have increased, mostly in rubles. This signifies a transition from consumption-driven to savings-driven behavior, which is an additional factor slowing down the economy in the short term, as demand becomes even more limited, but the crisis-related uncertainty does not encourage the transformation of savings into investments. Consequently, retail trade turnover fell by approximately 10%.

As a result, the poor population began to grow rapidly. The share of Russians in the poor category returned to the level of the mid-2000s (20.3 million persons with income below the subsistence level). This is a new phenomenon in recent years. In 2008 and 2009, despite the 7.5% decline in GDP, this figure was 19 million persons, having significantly decreased afterwards (*Table 5*). At that time, the state possessed considerable budgetary savings (the Reserve Fund), which were allocated to maintain the standard of living. The economy had to pay for this with a budget deficit of 6% of GDP in 2009, with the non-oil deficit reaching a record-breaking 14%. Those resources are no longer available in the budget.

Table 5

Basic economic indicators of the Russian Federation 2007–2015

	2007	2008	2009	2010	2011	2012	2013	2014	2015
1	2	3	4	5	6	7	8	9	10
Macroeconomic indicators (rate of growth as a % of the preceding year)									
GDP	8.5	5.2	–7.8	4.5	4.3	3.5	1.3	0.7	–3.7
Industry	6.8	0.6	–10.7	7.3	5.0	3.4	0.4	1.7	–3.4
Agriculture	3.3	10.8	1.4	–11.3	23.0	–4.8	5.8	3.5	3.0
Construction	18.2	12.8	–13.2	5.0	5.1	2.5	0.1	–2.3	–7.0
Wholesale trade	9.5	5.4	2.0	3.0	4.4	3.6	0.7	–3.9	–9.9
Retail trade	16.1	13.7	–5.1	6.5	7.1	6.3	3.9	2.7	–10.0
Final consumption of domestic economies	14.3	10.6	–5.1	5.5	6.8	7.4	3.7	1.7	–10.1
Investment in basic capital	23.8	9.5	–13.5	6.3	10.8	6.8	0.8	–2.7	–8.4
Share of wages in GDP	46.7	47.4	52.6	49.6	43.9	44.2)	46.1)	44.8)	45.4)
Share of profit and mixed revenues in GDP	34.1	32.6	30.8	32.6	41.5	41.1	39.7	41.1	43,6
Indicators of public finance and international reserves									
Surplus («+»)/Deficit («+») of the consolidated budget(including extra-budget funds) as % of GDP	6.0	4.9	–6.3	–3.4	1.5	0.4	–1.3	–1.2	–3,5
Surplus («+»)/Deficit («+») of the Federal Budget as % of GDP.	5.4	4.1	–6.0	–3.9	0.8	–0.1	–0.5	–0.5	–2,4
Oil and Gas Deficit of the Federal Budget as a % of GDP	–3.3	–6.5	–13.7	–12.2	–9.3	–10.5	–10.4	–10.9	–9,7
Domestic State Debt of the RF in Securities, billion roubles	1248.8	1421.5	1837.2	2461.6	3546.4	4064.3	4432.4	5475.7	5573,1
Foreign State Debt, billion USD (Date of Ministry of Finance)	44.9	40.6	37.6	40.0	35.8	50.8	55.8	54.4	50,0
Consolidated State Debt as % of GDP	7.2	6.5	8.3	9.0	9.5	10.5	11.4	14.4	14,3[1]
Reserve Fund (in 2007, Stabilization Fund), end of year, billion USD	156.81	137.09	60.52	25.44	25.21	62.08	87.38	87.91	49,95
National Welfare Fund, end of year, billion USD		87.97	91.56	88.44	86.79	88.59	88.63	78.00	71,72
International Reserves of the Bank of Russia, end of year. billion USD	478.8	427.1	439.0	479.4	498.6	537.6	509.6	385.5	368,4

Cont'd

Prices and interest rates									
Growth rates of consumer prices, December to December %	11.9	13.3	8.8	8.8	6.1	6.6	6.5	11.4	12,9
Growth rates of producers' prices, December to December %	25.1	–7.0	13.9	16.7	12.0	5.1	3.7	5.9	10,7
Key rate of the Bank of Russia (until 2013 the minimal one-day REPO rate), annual average, % per annum	6.0	6.9	8.3	5.3	5.3	5.3	5.5	7.9	12,6
Average interest rate on loans to enterprises in roubles, annual average, % per annum	10.0	12.2	15.3	10.8	8.5	9.1	9.5	11.1	15,7
Annual interest rate on deposits of physical persons (excluding no-notice deposits)	7.2	7.6	10.4	6.8	5.4	6.5	6.5	6.7	9,7
Labour Market									
General level of unemployment, year average, %	6.0	6.2	8.3	7.3	6.5	5.5	5.5	5.2	5,6
Average Wage, thousand roubles per month	13.6	17.3	18.6	21.0	23.4	26.6	29.8	32.5	34,0
Growth of real wages, %	17.2	11.5	–3.5	5.2	2.8	8.4	4.8	1.2	–9,5
Dynamic of real disposable income of households, %	12.1	2.4	3.0	5.9	0.5	4.6	4.0	–0.7	–4,0
Numbers of population with money incomes below subsistence level, million persons	18.8	19	18.4	17.7	17.9	15.4	15.5	16.1	20,3[2)]
Banking Sector									
Number of active credit organizations, end of year, units	1136	1108	1058	1012	978	956	923	834	733
Number of licences for the conduct of banking operations withdrawn during the year, units	49	33	43	27	18	22	32	86	93
Growth of assets, %	46.1	32.7	3.7	14.8	21.4	20.4	14.2	18.6	-1,5
Growth of bank-loan indebtedness of resident legal entities (excluding banks), %	52.4	28.6	0.0	9.6	22.8	15.5	11.6	12.7	5,0
Growth of bank-loan indebtedness of resident physical persons, %	58.3	31.2	–11.7	14.4	35.5	39.1	27.7	11.6	–7,3
Percentage of overdue loans to resident legal entities, excluding banks, %	0.9	2.2	6.0	5.5	4.8	4.6	4.1	4.1	6,0
Percentage of overdue loans to physical persons, %	3.1	3.6	6.9	7.1	5.3	4.1	4.5	6.0	8,4
Profit, billion roubles	508	409	205	573	848	1012	994	589	192

[1] For January- September 2015.
Source: Rosstat, Treasury of Russia, Finance Ministry of Russia, Bank of Russia.

Researchers have begun to note the erosion of the middle class within the country,[1] although one needs to distinguish between the problems of cash flows (reduced current income) and

[1] T. Maleva (Senior Editor). *2014-2015 Economic Crisis - The Social Dimension* (Moscow. Russian Academy of the National Economy and Public Administration, 2015, 12-13.

reserves (accumulated well-being, behavioral stereotypes). The crisis has led to a certain reduction in inequality, with the Gini coefficient decreasing from 0.141 to 0.399 and the decile funds ratio from 15.8 to 14.2.[1] However, this can hardly be called a positive trend.

The data for 2015 indicate that the situation is difficult and tending to deteriorate, but that there is, as yet, no threat of socio-political destabilization. Whereas, during the period of high economic growth an excess of consumer demand adversely affected the structure of growth, and an intensification of measures to stimulate production had to be considered, the situation is now different. At present, the growth of incomes and population consumer behaviour indicate that to re-launch economic growth special measures will be needed to stimulate demand. This does not mean, however, that the need for active measures on the supply side should be ignored.

1.4. Priorities and risks for forthcoming period

Russia's economic policy is facing two key challenges: starting economic growth and dampening reductions in household well-being. These challenges are correlated, as the first leads to increased well-being and the second generates demand for economic growth.

Solving these tasks is tricky because we are facing a structural crisis rather than a cyclical one. The end of the downturn, which cannot last long (much less forever), in this case does not automatically restore growth. Unless we make special efforts to build a new growth model, the potential for growth will remain low, which means that the economy will hover around zero (or within statistical error). Unlike a recession, this may last long enough for the political elite to form a model suitable for modern challenges, with the respective impact on well-being and social stability.

The most serious challenge facing Russia is not overcoming the recession but achieving economic growth. Of course, we mean sustainable, long-term growth accompanied by structural modernization, rather than achieving good-looking statistics. In the foreseeable future, Russia must strive for growth rates exceeding the world average (or somewhere between those of Germany and China).

This is not a trivial task and has no standard solutions, unlike stabilization. Solutions will be contingent upon the features of the current era and our country. An answer to this challenge requires major institutional reforms in all spheres of society, not exclusively in the economy. Here, there will have to be initiatives on the side of demand as well as supply.

If we are to re-launch the growth mechanism, we must first of all identify the sources of growth – external and internal. State procurement, the procurement of corporations with state participation, and social expenditures, must be undertaken with regard to opportunities for influencing the demand for high-quality goods and services. We must also qualitatively change the situation as it develops on the supply side, that is, in relation to factors that influence the decision of entrepreneurs either to develop their business or leave the market.

We suggest the following key points for economic policy that can solve both issues.

Disinflation and the realization of a target level for inflation of 4%, if not by the end of 2017 as inscribed in the Basic Goals of Monetary-Credit Policy then in the fairly near future. Steady progress towards this target will provide a number of interlinked results that will be contributory to economic growth:

– the predictability of economic life will be improved, that is, business will acquire the perceptible quantitative guidelines that are essential to its functioning;

[1] T. Maleva (Senior Editor). *2014-2015 Economic Crisis - The Social Dimension* (Moscow. Russian Academy of the National Economy and Public Administration, 2015, pp. 15-17.

- credit will become accessible, given that the rate of inflation is linked to the key interest rate and the commercial lending rate;
- price stability will contribute to social stabilization and a growth of consumer demand in the economy.

Budgetary policy, including:

- a gradual return to non-deficitory budgets together with constraint on the growth of government debt, this being fundamental to confidence in the country's macroeconomic policy;
- budget manoeuver in favour of the productive branches of the economy (transport and social infrastructure) as an indispensable precondition of increasing the potential for growth;
- a rationalization of expenditures by optimizing the budget network and budget procedures, while abandoning sequestration as the principle means of balancing the budget;
- adoption of a new budget rule in the event of the return of a favourable conjuncture in the sphere of hydrocarbons. [1]

The *formation of a favourable investment climate* must become a priority at all levels of government. This should become one of the key success indicators of the work of regional administrations. A rating system has been designed to measure the investment attractiveness of regions, and regional investment teams have been formed, with these objectives in mind.

The attainment of a high score in the rating "Doing Business", as experience shows, is a valuable goal, but in itself does not provide an answer. Russia has advanced from 120th in the ranking in 2012 to 51st in 2015 but the indicators for investment activity and economic growth over this period have been quantitatively worse. We face the paradox that in 2011 Russia was in 120th place with a growth of GDP of 4.3%, but when it achieved 51st place GDP growth had fallen to 3.9%. Of course, this is not an argument for returning to 120th place, but the rating obviously has its limitations as a goal of economic policy. Clearly, improvement of the investment climate should be key.

Priority measures for the improvement of the investment (and entrepreneurial) climate should include:

- deregulation of the economy;
- a reform of the supervisory bodies. Reform should involve a reduction in the number of state functions, which should lead to a reduction in the number of supervisory bodies and in the number of inspections. A risk-oriented approach should be encouraged;
- support for small and medium-sized business. This is the objective of the Federal Corporation for the Development of Small and Medium sized Business, set up in 2015;
- the protection of property and safety for the entrepreneur.

The *growth of competition* provides an important stimulus for the development of entrepreneurial activity. Devaluation complicates this issue since it limits the access of foreign goods to the domestic market.

In this sphere there are serious issues concerning the need for a change in the key tasks of anti-monopoly policy. Russian anti-monopoly authorities must concentrate upon countering administrative and infrastructural monopolies, the sources of which are the political authorities and natural (environmental or technological) constraints upon competition. There should be less preoccupation with private-economic entities that are achieving success (even domination)

[1] Mau Vladimir. Between crises and sanctions: economic policy of the Russian Federation. Post-Soviet Affairs. http://www.tandfonline.com/doi/pdf/10.1080/1060586X.2015.1053723.

in local markets thanks to their superior productivity. At present, the anti-monopoly service is focussing upon precisely such cases. [1]

Stimulation of non-raw materials exports: for present-day Russia with its relatively limited market (this is one of the many features distinguishing Russia from China) external demand is extremely important for ensuring stable economic growth. It was for this reason in particular that the Russian Export Centre was founded in 2015. However, the administrative decision needs to be backed up by institutional measures, namely:

- the removal of barriers to exporting and to external economic activity in general. In the rating "Doing Business 2016", Russia's position in international trade fell over the year from 155th to 170th. There must be a radical simplification of procedures for permitting goods to cross the frontier (a reduction in the number of documents to be presented to three or four, completed online and on a single website);
- any extension of the practice of administrative restriction of the export of non-raw materials goods must be prevented;
- a removal of barriers to imports, given that in conditions of global value-added chains the efficiency of exports frequently depends upon the efficiency of imports associated with particular exports;
- the stimulation of exports must be directly linked to a policy for import substitution. In principle, the ability to deliver goods for export must be the main criterion when deciding whether to support the projects for import substitution of particular enterprises.

Institutional reforms in the sphere of human capital - education, health care, the pension system. We need to achieve a balanced solution of the tasks that confront us in the social (development of human potential in particular), fiscal (efficient expenditure of available financial resources) and investment spheres.

The objective of *social policy* must be the differentiated delivery of essential assistance, an increase in social support that is concentrated on those in greatest need. Over and above the social effects, targeted social care will act as a factor stimulating demand for the goods and services of domestic producers.

While discussing how to set growth in motion, we should not neglect measures, the implementation of which will be long-term. These include, primarily:

- the formation and development of international economic unions and zones, beginning with the Eurasian Economic Union, but not resting there. Russia must continue to promulgate with the EU the idea of a single economic space ("from Lisbon to Vladivostock"), and strive to participate in the various free trade zones that are at present being formed;
- notwithstanding the complexity of the contemporary currency situation, the monetary authorities must not abandon the objective of making the rouble a regional reserve currency.

The priorities that have been listed are also associated with **risks** that the Russian economy will encounter in the foreseeable future.

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[1] International research into the anti-monopoly policy of 36 countries shows that of 3527 cases of abuse of a dominant position examined by thirty-six participants in the rating, 3056 or 87% of these were carried out by the Federal Anti-Monopoly Agency. Moreover the Russian agency had only 3% of the aggregate budget of participants and 22% of the aggregate personnel. What is significant is that inspections of small and medium sized businesses were much more numerous than those of the first hundred largest companies by turnover, specifically 25 and 6 cases. (See Rating Enforcement 2015: The Annual Rating of the World's Leading Competition Authorities. *Global Competition Review*, 2015, Vol. 18, Issue 6, p. 28).

It will be a major problem, obviously, if *low growth rates continue* into the foreseeable future and the élite becomes accustomed to these growth rates. At present, no one is contemplating the possibility of a 5% growth rate, and as recently as 2013 many economists considered 3% to be unrealistic and extremely risky. The Prime Minister of Japan has expressed the view that long-term stagnation cannot be ruled out. However, in Russia a growth rate significantly lower than the average for the world economy will result in social and economic degradation.

One source of risk is the *volatility of prices for hydrocarbons.* If there is to be stability of economic development we need stability of the external economic environment, which will translate into relative stability of the exchange rate. From the standpoint of economic policy, stability is preferable to volatility, whether in an upward or downward direction. In present Russian conditions both increases and falls in the oil price have an inflationary effect, in the first instance through the mechanism of the "Dutch Disease", and in the second through the "knock on effect" on the exchange rate and prices. But containing inflation, is, as we have shown above, is one of the principal preconditions of a return to a trajectory of economic growth.

There is also a risk of adoption of a policy of artificial acceleration - a repeat of the policy of 1986-1989. Experimentation with the exchange rate (fixing the exchange rate), accompanied by state debt and state investments aimed at stimulating rates of growth, can only lead to a repetition of the crisis of the end of the 1980s-1990s.

There is a corresponding risk of the *persistence for an extended period of high inflation.* As it happens, there are powerful economic agents who have a vested interest in this. These include many recipients of budget funds, given that the inflation model makes possible the continuation and even increase of nominal expenditures, thereby easing the current operational burden of the budget sector.

The debate over the relative merits of an inflationary approach to balancing the budget and of sequestration persists in discussions of the economy. Arguments based on considerations of political economy are sometimes put forward, namely that inflation would make it possible to introduce cuts in real expenditure gradually, given that nominal cuts are as a rule introduced at the expense of those sectors that are most important for growth, but politically least influential - education, health care, science , infrastructure. A number of structures in the banking sector and in the services sector that suffer most from the squeezing of demand, also have a vested interest in inflation. In other words, the habit of inflation and a growth of pro-inflation attitudes have become a serious problem in contemporary Russia, and an abandonment of the 4% target would be dangerous not only for monetary stability but also for the prospects for structural modernization.

And, of course, the persistence of a trend towards a reduction in welfare, which could result in acute socio-political destabilization, is also a serious problem. However this topic does not belong in the present section.

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2015 was a difficult year, but the results achieved were better than expected at the end of 2014. The prime objective for the period 2016-2018 must be the formation of a mechanism for a return to economic growth, and the avoidance of populist scenarios. A great many aspects of Russian life, in the post-crisis world that is evolving around us, will be affected by the manner in which this objective is realized.