

ONLINE MONITORING OF RUSSIA'S ECONOMIC OUTLOOK

TRENDS AND CHALLENGES OF SOCIO-ECONOMIC DEVELOPMENT

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MAIN TRENDS AND CONCLUSIONS

As the threat of the Russian economy's collapse is less often being considered to be a reality, – such an assumption usually implying that the price of oil should plummet far below \$ 40 per barrel and stay at that level for a period much longer than one or two quarters, – economic development forecasts and the related commentaries have begun to focus on the question: 'When Will Growth Begin?' Moreover, the statistics for the autumn months demonstrate some signs in confirmation of the fact that slight growth in certain areas indeed took place over that period. Or, at least, that recession is indeed nearly over. Therefore it is only natural that forecasts and studies of the projected movement of Russia's GDP in 2016 are currently in demand.

One of the latest documents in this vein is the RF Ministry of Economic Development's adjusted forecast, on which the federal budget for 2016 is based. And one of the latest studies is the decomposition of Russian GDP Growth Rates in 2015–2016, prepared with due regard for the Ministry's economic development forecast by the experts of the Gaidar Institute and the RANEPA. This methodology, which is broadly applied in the OECD countries (and further elaborated with due regard for economy's high dependence on foreign trade conditions), makes it possible to separate the main factors influencing GDP growth: structural, foreign-trade and situational. The goal of this multi-factor analysis is to determine, on a sufficiently reliable basis, the areas that offer a potential for economic growth, as well as the areas where such a potential is lacking, or which make a negative input in the behavior of GDP.

The forecast prepared by the RF Ministry of Economic Development's offers three scenarios for 2016. One of them – the baseline scenario - implies that the current trends in the economy will persist, so it can be regarded to be inertia-oriented. The second – the conservative one – envisages that the price of oil will decline to \$ 40 per barrel, and that the current recession will continue. The third – the target scenario (which, in fact, is the desirable one) – is focused on growth at a rate comparable with the average world growth rate. It does not follow from that scenario that Russia may achieve such a rate as early as next year, but it implies that from 2016 onwards, this country will begin its transition to a new development model. And the main role in that process should be played by the factors that have already been mentioned many times by the RF Ministry of Economic Development (and also by some other government departments).

So what does the decomposition point to? It demonstrates that, in 2015–2016, the input of foreign-trade factors (and primarily oil prices) in the behavior of GDP will be negative. The inputs of structural growth factors (in all the three scenarios) will be on the decline. Therefore the achievement of the desirable growth rates in the coming year can be possible only in case of a sharp growth of the inputs of the situational factors: the economy must either be not in the lowest (as it is now) phase of the business cycle, but in its highest phase; or it must experience some 'positive shock', the nature of that shock being 'unclear' to the experts. Such a role could possibly be assigned

to factors like the lifting of the economic sanctions and robust growth of oil prices, in absence of any 'negative shocks'.

The decomposition shows that, in all the three scenarios for 2015–2016, actual output in the Russian economy will be below its potential level. In theory, this means that, in the short run, stimulatory monetary and budgetary policy measures may indeed exert a positive effect on GDP growth. But its sustainable long-run upward movement will become possible only when the structural factors begin to play a dominant role.

An active credit inflow into the economy over next year appears to be unlikely not only due to the high inflation expectations, the RF Central Bank's key rate still being high, and the rather weak desire of many companies to borrow from banks. No less important in this connection is the state of affairs in the banking sector. Although the periodically made declarations of a 'profound banking crisis' are evidently an exaggeration, the situation in that sector may aptly be described as 'stagnation'.

Data for the first ten months of 2015 confirm the low returns on banking operations, as well as the low financial result for the sector as a whole; the well-known effect of economies of scale has also been quite visible: big banks are more profitable than small ones. It is an interesting fact that a significant part of the losses in this sector have been sustained by big state banks, which display (with the exception of Sberbank) the lowest rates of return on their regular operations. This probably has to do with the significant amount of government aid provided by those banks (on non-market conditions) to certain sectors of the national economy.

It is possible that state banks will also be the source of funding for various import substitution programs to be launched next year, because in 2015 (anyway, since mid-year) that process had begun to balk. This became evident from the surveys of Russian industrial enterprises as to their activity in Q3 and their production plans for Q4. In this connection, the substitution for imported machinery and equipment was progressing at a higher pace than the substitution for raw materials. However, machine-building is no longer making cuts on its purchases of imported equipment. And the food industry is less actively looking for substitutes for imported raw materials, possibly having been disappointed in the domestic raw materials base, of having exhausted its potential. Nevertheless, Russian industry on the whole displays a tendency for an 'import-preservation' policy (that is, the share of imports is no longer shrinking), or even for 'import expansion'.

The latter, however, is by no means true of the agricultural and food sectors, where import substitution (or substitution of one import item by another one) is still an ongoing process. From January 2016 onwards, Russia imposes a ban on food imports from Ukraine. But this can no longer have any serious effect on Russia's economy, or even on the Ukrainian suppliers, because the shrinkage of the role of these supplies has been visible for a rather long time already. While in 2012 Ukraine had accounted for more than 5% of Russia's food imports (and up to 10% with regard to some import items), in 2015 its share dwindled to 1.2%, and in money terms – more than six-fold, to \$ 235m. It can be said that the disappearance of relatively cheap Ukrainian products from Russian food stores is already an accomplished fact.

Somewhat different is the ban on agricultural imports from Turkey. In 2014–2015, Turkey (in terms of volume) took up approximately the same share in Russia's food imports as had previously belonged to Russia's food

imports, and for some import items its share was even bigger. According to some estimates, this measure may make a significant input in another wave of 'food inflation', and even become the reason why the RF central Bank may once again postpone the reduction of its key rate. So, in order to dump the inflation-triggering effect, the government plans to introduce this ban gradually, so that the Russian trade sector could have some time to find substitutes for the Turkish imports in some other countries.

Inflation remains one of the main factors responsible for the downward movement of real incomes and wages. Under such conditions, government expenditures in the social sphere – both at the federal and local levels, including direct social support, play an important compensatory role. Data for the first three quarters of 2015 demonstrate that, in spite of the complicated state of affairs in the budgets of many regions, no serious expenditure reduction has occurred so far.

Growth of expenditures on education (on the whole for all the regions) remains at its last-year's level, although their structure has changed in favor of pre-school education thanks to the kindergarten construction program. Expenditure growth in the social security sphere has fallen behind its 2014 index (so far by only 1 p.p.), two-thirds of this amount being taken up by the payment of social benefits. As for the healthcare sector, here more than half of regions' expenditures is covered not by their budgets, but by the territorial compulsory medical insurance funds. Due to the existence of these funds, expenditures in the healthcare sector were rising at a rate close to the inflation rate; the bulk of these expenditures is taken up by the insurance payment to resident. However, experts note that the structure of regions' healthcare expenditures is becoming increasingly less transparent – budget statistics now yield little information on this issue. In this connection it is hardly worth reminding that social priorities - and consequently, the amount of spending – varies greatly between regions. ●

1. GDP GROWTH RATE IN 2015–2016: WHAT ITS DECOMPOSITION SPEAKS OF

S.Drobyshevsky, M.Kazakova

The RF Ministry of Economic Development presented three scenarios in its socioeconomic development forecast for 2016, which envisaged that the GDP decline trajectory would hit its lowest point in 2015 (-3.9%), and the rate of GDP growth would be fluctuating somewhere between (-1.0) and +2.3% in 2016. A decomposition of the growth rate of GDP, with due regard for the projections of the movement of investment in fixed assets, the number of employed in the economy and the expected level of the price of oil, demonstrates that this growth rate may be achieved either on condition of a dramatic acceleration of the cyclical component, or a revision of the existing projections of the cyclical component's movement with a view towards growth of the total factor productivity in the economy. The input of the foreign trade component, which is linked to the movement of oil price, in the growth rate of GDP in all the scenarios is negative, because at present oil prices are below their multi-year average. All these development, irrespective of the roles played by each separate component in the behavior of GDP in 2016 and of the scenario under consideration, imply that both in 2015 and in 2016 the output gap in Russia's economy will remain negative. In other words, in all the three scenarios the actual output index is expected to be below its potential value.

The RF Ministry of Economic Development released an adjusted version of its forecast of Russia's socio-economic development in the years 2015–2016, to serve as the foundation for the draft federal budget for 2016. The forecast contains three scenarios – baseline, conservative and target. According to this document, it is expected that in 2015, GDP will decline by 3.9% on 2014, while the average annual price of Urals crude will amount to \$ 53 per barrel; investment in fixed assets will shrink by 9.9%, and the number of employed will amount to 68.4m (in 2014 the number of employed in the Russian industry was 67.8m).

For 2016, the baseline scenario of the forecast 'describes the main macroeconomic parameters of economic development in conditions of persisting conservative trends in the evolution of the external factors and a conservative budgetary policy'¹. Thus, in the framework of that scenario, it is expected that GDP growth in 2016 will amount to 0.7% on 2015 (in other words, recession in the economy will give way to a slightly positive growth rate), the average annual price of oil will amount to \$ 50 per barrel, investment in fixed assets will shrink by 1.6% on the previous year, the employment rate will change only slightly. So, the baseline version of the forecast for 2016 relies on the continuation of the existing trends in the Russian economy, without the emergence of any additional factors capable of boosting the rate of economic growth.

The conservative version of the forecast, as noted by the RF Ministry of Economic Development, builds upon the expectation of a very unfavorable

1 <http://economy.gov.ru/minec/about/structure/depmacro/20151026>

external economic situation (where the average annual price of oil declines to \$ 40 per barrel), a continuing decline of investment (by 6,4% on 2015) and consumer demand, a high inflation rate, and a negative movement of indices in the other sectors of the economy (industry and retail). In other words, the main blow under this scenario will be delivered to the consumer and investment spheres. Thus, the conservative scenario is the most pessimistic one in this forecast; it envisages that GDP will decline by 1.0% on 2015.

The target version of the forecast is more optimistic, it is elaborated by way of implementing the RF President's executive order concerning the launch of Russia's economy onto a long-run sustainable growth trajectory at the level of the world's average, and the achievement of a proper macroeconomic balance in conditions of a low inflation rate and labor productivity growth. In fact, this scenario implies a switchover, from 2016 onwards, to a new economic growth model. As noted by the RF Ministry of Economic Development, on the whole 'the main inputs in the accelerating rate of economic growth in 2016–2020 will be made by the following factors:

- growth of investment in production expansion and the production infrastructure;
- growth of investment in exports of commodities other than raw materials, and promotion of hi-tech exports;
- total factor productivity growth as a result of increased investment in the innovation sectors of the economy;
- implementation of measures designed to save resources and cut costs, including labor costs and the tariffs set by natural monopolies;
- development of small businesses, improvement of the conditions for doing business, and other factors'¹.

As the scenarios offer projections for the movement of oil prices, the investment index and the number of employed, we can decompose the forecasted behavior of the growth rate of GDP in 2016 in accordance with all the three scenarios, on the basis of our algorithm. *The method that we suggest, which relies on the methodology of decomposition of macroeconomic indices into their structural, foreign-trade and situational components (business cycles and accidental shocks), makes it possible to identify separately the input of each of the main factors in GDP growth.* The methodology is broadly applied in the developed countries (OECD), but we further elaborated it with due regard for the specificities of the Russian economy. Its specific feature is the high dependence on foreign trade conditions, which can be approximated on the basis of the movement of world price of oil².

The actual, structural and foreign-trade growth rates in Russia's GDP, as well as that of its situational component (i.e., the sum of the business-cycle component and the accidental-shock component), for the three scenarios presented in the forecast of the development of the Russian economy in 2015–2016 are shown in *Fig. 1–4*.

According to our estimates, the structural component of GDP growth will continue to decline in 2016 under all the three forecast scenarios (from 1.1% in 2015 to 0.6% in 2016, see *Fig. 1*). Similarly to the situation observed over

1 <http://economy.gov.ru/minec/activity/sections/macro/prognoz>

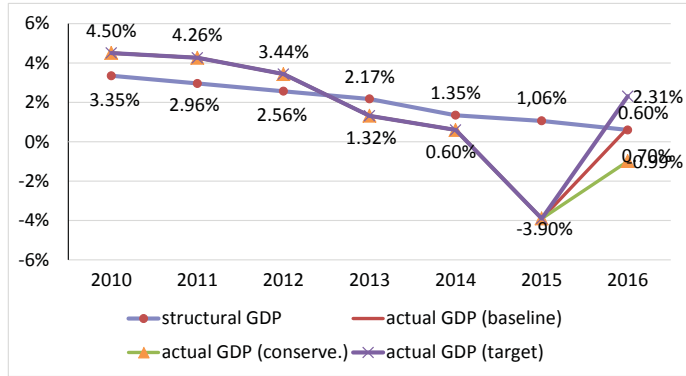
2 For more details on the methodology applied in the decomposition of Russian GDP growth rates, as well as on the interpretation of our results, see S. Sinelnikov-Murylev, S. Drobyshevsky, M. Kazakiva. Decomposition of Russian GDP Growth Rates in 1999–2014. Economic Policy. 2014. No 5. P. 7–37; also see <http://iep.ru/ru/publikacii/7125/publication.html>

the previous years, this will be caused by the negative dynamics of the fundamental growth factors (the shrinking number of people engaged in economic activities due to the current demographic trends, the shrinking capital stock due to capital outflow resulting from the negative behavior of the investment index), and the total factor productivity decline.

At the projected oil price levels for 2015–2016 in all the three scenarios, which are expected to be at their multi-year low (\$ 80–85 per barrel), the foreign-trade component of the growth rate of GDP in 2015 will be negative in each scenario (-1.2% in the baseline and target scenarios; and -1.6% in the conservative scenario).

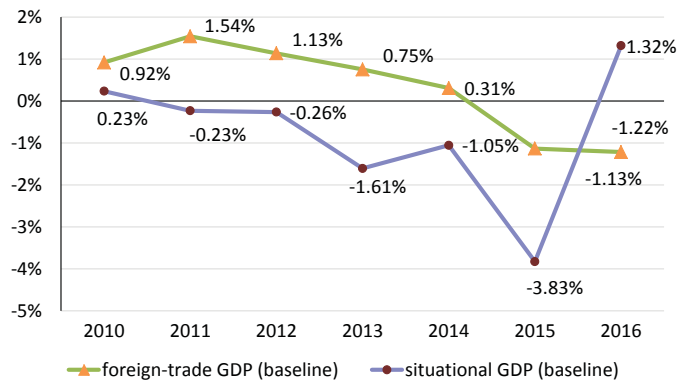
The situational component of the growth rate of Russian GDP in 2015 will remain negative, its cyclical decline obviously having been enhanced by a negative shock, which is estimated to amount to 2.5–3.0 p.p. of the growth rate of GDP. This shock was produced by a combination of negative consequences of the economic sanctions introduced against Russia, and Russia's retaliatory sanctions, the increasing uncertainty and risks in the economy in view of the highly volatile exchange rate of the ruble against major world currencies, rising inflation and restricted access to borrowed capital.

As far as the GDP growth rate decomposition for 2016 is concerned, we must note that the achievement of the forecasted rate of growth in all the three scenarios, given the relatively low prices of oil and absence of total factor productivity growth, can be possible only if its situational component should display a sharp rise: in the most optimistic scenario from -3.8% in 2015 to 2.9% in 2016, and in the pessimistic scenario from -3.8% in 2015 to -0.04% in 2016. Such a rise of the situational component may occur as a result of either a sharp accelera-



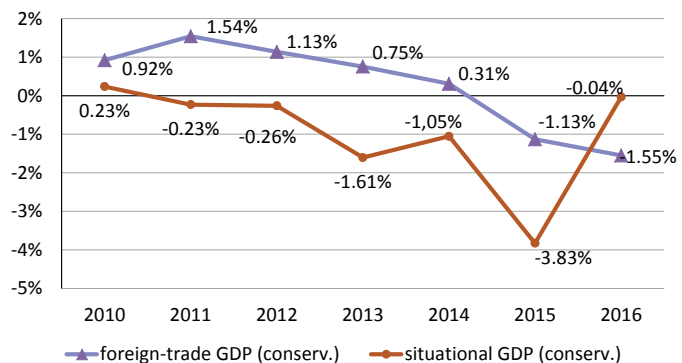
Source: Rosstat; RF Ministry of Economic Development; IMF; the authors' estimates.

Fig. 1. The Actual and Structural Components of the Growth Rate of GDP, as % of Previous Year, 2010–2016 (All Forecast Scenarios)



Sources: Rosstat; RF Ministry of Economic Development; IMF; the authors' estimates.

Fig. 2. The Foreign-trade and Situational Components of the Growth Rate of GDP, as % of Previous Year, 2010–2016 (Baseline Scenario Forecast)



Sources: Rosstat; RF Ministry of Economic Development; IMF; the authors' estimates.

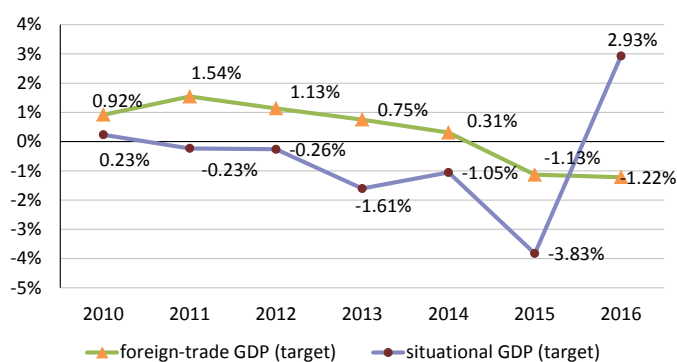
Fig. 3. The Foreign-trade and Situational Components of the Growth Rate of GDP, as % of Previous Year, 2010–2016 (Conservative Scenario Forecast)

tion of the cyclical GDP growth rate in a situation when the negative shock of 2015 becomes ‘a thing of the past’; or we may make such a projection based on the assumption that the economy, while remaining in the lower phase of the business cycle, will experience a noticeable positive shock, the nature of that shock being unclear.

At the same time, our results (and so our conclusions) rely on the total factor productivity model estimates based on the 2000–2014 time series, and consequently, the model structural growth rate of Russia’s GDP, which display a stable downward trend. If we assume that the movement of total factor productivity has changed, and the structural growth rate of GDP has halted its decline (for example, due to an increased competitive capacity of Russia’s domestic production after the ruble’s depreciation, or a boost of economic performance in the current crisis situation after the bankruptcies of a number of companies, cuts on non-production costs, release of part of the previously employed workforce, and ‘clear-up’ of the banking system), then part of the GDP growth projected for 2016 may indeed be explained by this component. In such a case, the behavior of the situational component (in the interval between -1.5 and 2.0 p.p. of the growth rate of GDP) would appear to be logical after the disappearance of the effects of the negative shock of 2015 and the gradual progress towards the upward phase of the business cycle (and in the target scenario – the acceleration of the cyclical component due to the switchover to a new economic growth model). The econometric data relating to changes in the structural component’s growth rate can be estimated only if we augment the model by a time series of new actual annual GDP data – that is, only after a period of no less than 1–2 years.

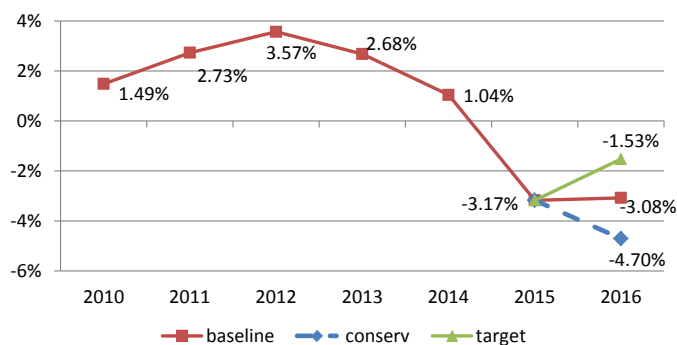
The results of decomposition of the Russian economy’s growth rate have also made it possible to obtain estimates of the output gap for 2015–2016; these estimates which indicate that in 2015 the output gap has slipped into negative territory. This is the upshot of the negative inputs of two components (foreign-trade and situational – the latter having already been observed over the period of 5 years, since 2011) in combination with the declining structural growth rate. It should also be noted that the output gap is to remain in negative territory also in 2016, even in the RF Ministry of Economic Development’s optimistic (target) scenario (Fig. 5).

Thus, over the period 2015–2016, actual output in all the three scenarios



Sources: Rosstat; RF Ministry of Economic Development; IMF; the authors’ estimates.

Fig. 4. The Foreign-trade and Situational Components of the Growth Rate of GDP, as % of Previous Year, 2010–2016 (Target Scenario Forecast)



Source: the authors’ estimates.

Fig. 5. Output Gap in the Russian Economy (as %), 2010–2016 (Three Forecast Scenarios)

is below its potential level. If such is the case, then from the point of view of the theory of economics the stimulatory monetary and budgetary policy measures may indeed exert a positive effect on the economy, at least over the short-term period. However, for an acceleration of the long-run economic growth rate to become a reality, it will be necessary, first of all, to ensure an upward movement of the structural growth rate on the basis of fundamental growth factors and total factor productivity. In the present-day economic situation this means an improvement with regard to Russia companies' access to foreign capital and direct foreign investment, a boost of the investment activity of Russian businesses, and easing of the constraints on the use of available labor resources. It should be noted that, in the scenario preconditions developed by the RF Ministry of Economic Development, no mention is made of any such improvements, except in the target scenario. ●

2. THE BANKING SECTOR: ECONOMIES OF SCALE AFOOT

M.Khromov

During ten months of 2015, the banking sector has demonstrated very low results. Operating income and profitability have declined and many credit institutions have obtained negative financial results. State owned banks and banks under resolution regime have been bearing losses. Obvious economies of scale is being observed: large banks are more profitable than the small ones even despite the more active provision of reserves against potential losses.

Dramatic decline of profit and, correspondingly, the fall of the banking operations profitability represent paramount indicator revealing serious problems existing in the banking sector. By the period-end results for ten months of 2015, the banking sector financial results have constituted barely Rb 193bn. Return on assets (ROA) for January–October 2015 has decreased to merely 0.3% year-on-year, and profitability of the capital base – to 3.4%. This year, all these indicators turned out to be 3.5–5-fold less than a year earlier. Over ten months of 2014, the banking sector profit constituted Rb 723 bn (in 2015 reduction by 3.8-fold), return on assets – 1.4% year-on-year (reduction by 4.7-fold), and profitability of the capital base – 13.5% year-on-year (reduction by 4-fold).

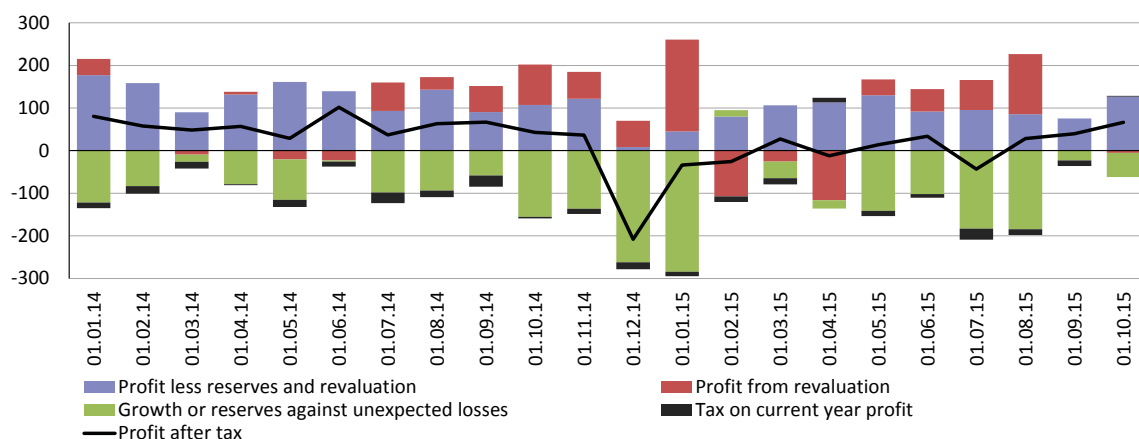
Significant number of the credit institutions boasted negative financial result. By the period-end for ten months of 2015, two hundred and fifteen credit institutions have shown losses totaling Rb 413bn. Meanwhile, profit of the remaining 538 institutions came to Rb 606bn. The magnitude of profitability of the profitable banks' assets (1.3% year-on-year) has turned out to noticeably below the absolute value of the negative profitability of the loss-making banks (-2.3% year-on-year). Thus, the losses have proved to be more significant than the profit. The share of the bank assets which accrue to the loss-making banks constitute 27% of the total volume of assets.

Main roots for the sharp drop of the banking profit, as we stated before,¹ consisted in the decrease of the bank assets quality resulting in considerable increase of provision for reserves against potential losses as well as reduction of profitability generated by the main banking operation.² These causes have revealed themselves especially in relation to the loss-making credit institutions.

Overall, the banking sector's provisions for reserves came to more than Rb one trillion during ten months of 2015 and the ratio of reserves to potential losses to the total assets have moved up by 1.3 p.p. (from 5.2% to 6.5%). This indicator reflects estimate of the soft assets in the overall volume of the bank assets. The loss-making banks were marked both by lower assets quality and by higher rate of the soft assets growth. The ratio of reserves against potential losses to the total assets regarding the loss-making banks has moved up

1 See, for example, «Income tax have resulted in losses for the banking sector», The Online Monitoring of Russia's Socio-economic Outlook, № 7 2015; «Banks: deterioration of assets quality and earnings reduction», The Online Monitoring of Russia's Socio-economic Outlook, № 13 2015.

2 Income less operation with reserves and adjustment to revaluation of accounts denominated in foreign currency.



Source: Bank of Russia.

Fig. 1. The main components of the banking sector's profits, Rb bn

in 2015 from 7.2 to 9.2%, meanwhile for the profitable banks – from 4.4 to 5.3%. At the same time, the growth of reserves in both groups of banks in nominal terms has turned out to be comparable: Rb 546bn for the profitable and Rb 539bn for the loss-making banks, wherein the assets of the profitable banks 2.6-fold exceed assets of the loss-making banks.

Net operating income for the profitable banks also remains at a significantly higher level than for the loss-making ones. Over ten months of 2015, all credit institutions have gained Rb 929bn (1.5% year-on-year) less provision for reserves and revaluation of deposits in foreign currency of which Rb 889bn (2.0% year-on-year) accounts for profitable banks and merely Rb 106bn (0.6% year-on-year) for the loss-making banks.

A year earlier (over ten months of 2014), net operating income amounted to Rb 1.29 trillion or 2.4% of assets year-on-year. This speaks for a notable reduction of this component of the banking sector financial performance.

More detailed analysis of the financial performance structure with separating certain groups of banks reveals the following features of the banking profit pattern (Table 1).

Table 1

FINANCIAL PERFORMANCE PATTERN OF MAJOR GROUPS OF BANKS

	Share in assets as of 1 Nov 2015 %	Profit Rb bn	ROA %	Provision of reserves Rb bn	Profit from revaluation Rb bn	Profit less reserves and revaluation Rb bn	ROA (less reserves and revaluation) %
Banking system	100	193	0.3	1018	282	929	1.5
Sberbank	29	210	1.1	213	30	393	2.1
Major state banks*	27	-92	-0.5	242	17	133	0.8
Banks under resolution regime**	3	-61	-3.3	126	4	60	3.2
Major foreign banks	6	38	0.9	20	77	-19	-0.5
Major private banks	15	59	0.7	224	83	200	2.3
Other banks	21	40	0.3	193	71	162	1.2

*VTB group of banks (VTB, VTB24 and Bank of Moscow), GPB and Rosselkhozbank.

**Banks subject to resolution regime as of 1 November 2015, minus Bank of Moscow designated as state bank.

Sources: Bank of Russia, banks' books, IEP calculations.

Major state banks and banks under resolution regime make more than half of the losses bore by the loss-making banks. Among banks, comprising major state banks solely head bank of the VTB group received profit as of the period-end for ten months of the current year in the amount of Rb 65bn. Other banks comprising VTB group of banks (VTB24 and Bank of Moscow) have suffered losses totaling Rb 70bn as well as other two banks – GPB and Rosselkhozbank. Total loss of these four banks for ten months of 2015 has reached Rb 157bn.

In 2015, the state banks have boasted of the lowest profit margin obtained from the regular operations. ROA for this indicator constituted merely 0.8% year-on-year against 1.5% across the banking sector as a whole. This shows that these banks have a significant volume of transactions of non-market character. For example, aimed at the implementation of state support of certain sectors of the economy. In case of Rosselkhozbank this is most pronounced. Its main operations in 2015 were loss making in the amount of 1.0% of assets year-on-year.

Among banks affiliated with the state, Sberbank stays apart. Much better assets quality gave the largest bank an advantage to obtain a relatively high return of assets. Regarding net operating income, Sberbank is at the head of the pack.

Apart from the state banks, further Rb 70bn of losses accrue to the banks under resolution regime (part of these banks obtained profit). Banks under resolution regime have the worst assets quality: ratio of accumulated reserves to the total volume of assets for these banks reached 18%. Growth rate of provision for reserves against potential losses over ten months constituted 40% (Rb 126bn).

The level of profit less reserves and revaluation of the banks under resolution has proven to be higher than normal. In 2015, return of assets of this indicator constituted 3.2% year-on-year. Such high level comparable solely with the banking sector indicators in the course of 2008–2010 crisis when similar trends, reduction of the total profit amid notable growth on net operating income, were intrinsic to the banking sector as a whole. Then, it, clearly, signified wide use of certain accounting mechanisms leading to the losses offset in banker's books with proactive recording of soft assets.

At present, the regulator moves to exercise stringent control over the banks under resolution. The regulator helps to resolve issue linked to the actual assets quality preventing manipulations with accounting. However, in order to reduce bank resolution costs implementation of certain arrangements is feasible aimed at reduction of lump sum losses. For example, let us take the situation with the Bank of Moscow in 2011, when in order to compensate unexpected non-performing assets; the bank obtained a loan from the regulator at the preferential rate. Income of interest payments allowed the bank to offset the costs on provision of reserves in required volumes. To note, currently no additional measures are being taken regarding Bank of Moscow and its net operating income is on the average level for the banking system.

In 2015, it was typical for foreign banks to bear losses on the regular operations. The subsidiary banks' principal source of income was revaluation of deposits denominated in foreign currency. In other words, their financial situation totally depended on the exchange rate movement. Despite a relatively fair quality of assets, low profitability predetermines drastic reduction of the investment interest of nonresidents to the Russian banking sector especially

taking into account external political risks. Gradual reduction of the non-residents' share in the capital of the Russian banks from 25–26% in 2014 to 20% in 2015 support this fact.

Economies of scale is being observed: large banks are more profitable than the small ones even despite a proactive provision of reserves against potential losses. This is the result of high net operating income of large private banks. Small and medium banks face serious competition from large banks and are forced to proactively increase profitability of borrowed assets which determines lower profitability of regular operation due to decreasing net interest income.

Over recent months, the situation in the banking sector as a whole, at first sight, was improving. In the course of three months (August–October), total financial performance of all credit institutions has come to Rb 159bn and October was the first month of 2015 when the volume of the total banking profit happened more than in the corresponding month of 2014. However, significant share of the profit was ensured by another upsurge of ruble devaluation and growth of net revenues generated by revaluation of deposits denominated in foreign currency which over these three months came to Rb 136bn or 85% of the profit. Net operating income during three months (Rb 288 bn) remained at the level comparable with the turn of the year: 1.5% of assets year-on-year. ●

3. "IMPORT PRESERVATION" IN LIEU OF IMPORT SUBSTITUTION

S.Tsukhlo

Import substitution in the Russian industry shows obvious signs of a slowdown. Both comparative results of actually implemented import substitution quarter-on-quarter and plans of enterprises for the last quarter of the current year attest to this. At the same time, import substitution of machines and equipment was at a higher rate than import substitution of industrial inputs. It is true that the Russian machine building industry does not reduce procurements of imported equipment. The food processing industry is losing momentum in import substitution of inputs either having disillusioned in the domestic raw material base or having exhausted its potential. Significant part of the Russian industry pursues a policy of "import preservation" (in other words, does not reduce the share of imports) or even goes to "import expansion". The latest assessment of the actual import substitution has been obtained for Q3 and forecast one for Q4 2015. Herewith, estimates of import substitution regarding industrial inputs was done separately from import substitution of machines and equipment.

According to the obtained results for Q3 2015 one can make a rather definitive general conclusion: the Russian industry has reduced the scale of import substitution. This refers to all indicators: inputs, equipment, actual changes and plans for Q4 2015. Let us conduct an in-depth analysis of import substitution taking into account comparable results for Q2 2015.

Industrial inputs

In Q3 2015, eighteen percent of enterprises have indicated a reduction of the share of imported industrial inputs. This result happened to be below the scale of import substitution registered in Q2 when 28% of enterprises reported a reduction of the quantum of import. Import substitution plans developed by the industry in Q2 2015 have failed to materialize in Q3 2015. Then 28% of enterprises were planning to cut the share of import. Current plans for Q4 2015 seem to be more realistic: 18% of enterprises are planning to cut the volume of import regarding their procurements of industrial inputs. In other words, to preserve the scale of import substitution in Q4 at the existing level of Q3 2015. Thus, actual import substitution of industrial inputs has contracted by 4 p.p. and plans for import substitution – by 10 p.p.

Similar results were developed by the analysis based on the comparable responses of enterprises which participated both in July and August business surveys. The analysis has indicated that the majority of enterprises (73%) preserved the existing import substitution policy in Q3 2015. Herewith, among all feasible scenarios the industry opted for the policy of retaining the existing share of import in its procurements of industrial inputs. There were 52% of such enterprises in the Russian industry.

Just over quarter of enterprises have reported shifts in import substitution in Q3 against Q2 2015. At the same time, responses regarding the slowdown of import substitution have prevailed. There were 17% of such enterprises in two business surveys. Barely ten percent of enterprises indicated stepping

up import substitution in Q3 against Q2 2015. In other words, merely ten percent of the Russian industrial enterprises have increased phasing out foreign made industrial inputs in Q3 2015.

Industrial plans for Q4 are clearer. 66% of enterprises are ready to stick to Q3 trends. Again, they prefer to preserve the existing share of import in their procurements. Remaining one third of enterprises decided to review their policy but not in favor of the Russian analogues.

23% of enterprises project slowdown of import substitution and merely 11% of Russian industrial enterprises project stepping up import substitution. Thus, balance of plans is also negative, i.e. import substitution will give way to import expansion.

Let us analyze sectoral features of import substitution in procurements of industrial inputs in Q3 and Q2 2015 (*Fig. 1*). Juxtaposition of import substitution scale which is estimated by the share of enterprises that actually reduced the quantum of import of industrial inputs has also demonstrated slowdown of import substitution practically in all sectors. Solely light, wood processing and metallurgical industries have shown an increase in the quantum of imports in Q3. In the light industry, this indicator has moved up to 8% against 4% in Q2. Thereat, 78% of the light industry enterprises reported that they had failed (did not want) to reduce the share of imports in Q3. In timber industry, the share of enterprises which have cut import procurements has gone up by 3 p.p. to 16%, where 80% of enterprises preserve existing dependence on imports. In metallurgical industry, the share of enterprises which have reduced import procurements is negligible (1 p.p.). Thus, these positive, at first sight, results of import substitution are very insignificant.

The remaining sectors have failed to achieve even these results. The most noticeable backtracking on import substitution has taken place in the food processing industry. In Q2 2015, the share of procurements of industrial inputs fell at 36% of enterprises. In Q3 2015, merely 16% of enterprises have managed to stick to the import substitution policy. As a result, decline in import substitution constituted 20 p.p. According to Q3 plans, 31% of enterprises projected import substitution in the procurement of industrial inputs. Q4 plans indicate feasible increase of import substitution by merely 3 p.p. (up to 19% of enterprises).

Therefore, the food processing industry having received unique advantages in the marketing of its products in August 2014, which were augmented by the ruble depreciation, became disappointed with the domestic raw materials. Now the industry is looking for other suppliers across the border.

Manufacture of construction materials takes the second place in import substitution slowdown. This sector is hardly dependent on imports of industrial inputs, but in Q2 2015, a quarter of enterprises managed to cut their dependence on imports. However, cooperation with the Russian producers has revealed the low quality and instability of supplies even of small volumes

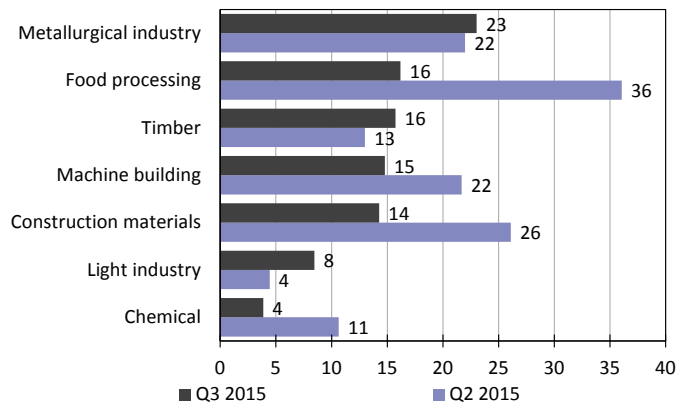


Fig. 1. Extent of actual import substitution in procurements of industrial inputs in manufacturing sector, %

of critically important types of industrial inputs which traditionally arrived from abroad. As a result, construction industry decided, most likely, to turn to imports and reduced the scale of import substitution in Q3 to 14% of enterprises, although planned to stick to existing level of 25% of enterprises. Q4 plans envisage preservation of the Q3 indicators.

Machine building and chemical industries occupy the third place on the scale of reduction of import substitution with 7 p.p. of decline. However, the extent of import substitution reduction in these industries differ drastically. The Russian chemical industry showed minimum (in comparison with other sectors) import substitution levels both in Q2 and Q3 2015: 11% and 4% of enterprises, respectively, reported transition from imported industrial inputs to the Russian analogues. In Q4 2015, merely 5% of chemical enterprises plan to stick to the import substitution policy which is the minimum compared to other sectors. Russian machine building registers greater volumes of import substitution. In Q2, 22% of enterprises participated in import substitution and in Q3; 15% of them remained in this process.

Machines and equipment

In the sphere of machines and equipment, the Russian industry demonstrates more readiness for the transition to the Russian analogues than in case of industrial inputs. Actually 26% of enterprises were switching to the Russian made equipment in Q3 2015, although 31% planned to do so. In Q4 2015, a quarter of enterprises reported plans for import substitution.

In Q3 2015, the timber industry has achieved best results in the sphere of import substitution. Nearly half of enterprises of this industry reported a reduction of the share of imported equipment in their procurement. These results are improved taking into account the fact that 23% of enterprises registered import substitution and plans for Q3 envisaged its preservation at Q2 level. However, the sector managed (or was forced) to achieve better results in this sphere amid stagnation of the Russian economy and decline demand for its products on the domestic market, economic instability of the countries which consume Russian timber industry products and features of the sector investment cycle. All other sectors at best preserved existing (Q2 2015) proportions of import substitution.

High proportions of import substitution is observed regarding equipment used in the construction materials industry. Both in Q2 and Q3 2015, no less than 40% of enterprises of this industry substituted more expensive import equipment with the Russian analogues. In the wake of the crisis which engulfed the construction industry, increased competition for supply of inputs amid falling market and pessimistic expectations regarding the crisis, enterprises of the industry are revising their investment programs both in terms of reduction and cost-cutting. Industry's plans for Q4 (41% of enterprises) demonstrated Q2 proportions of import substitution and proved to be the highest against other sectors. To note, sectoral plans for Q3 envisaged import substitution of machines and equipment for about 40% of enterprises. Thus, the construction material industry demonstrates not only the highest proportions of import substitution but also the most stable indicators in this sphere.

Russian metallurgical industry shows high stability of actual and planned results of import substitution of equipment. In this sector, a quarter of enterprises actually reduces the share of the investment import and plans to continue doing so in Q4 2015.

The food processing industry demonstrates the same proportions of import substitution. 24% of enterprises of the industry were cutting the share of import in their procurements of machines in Q2 and 23% – in Q3 2015. However, sectoral plans for Q3 were a bit higher amounting to 29% and fell a little bit to 27% for the last quarter of this year. Nevertheless, the food processing industry registered the highest level of import preservation. We can call so those enterprises of the industry which reported unchanged (or even growth) share of imports in their procurement of equipment.

There are 74% of such enterprises in the food processing industry. As a result, conventional for the business surveys balance of responses (import substitution – import preservation) has worked out not in favor of the national policy in this sphere (-51 p.p.) with the minimum independence of the sector from foreign made equipment. Sector plans for Q4 indicate attempts of enterprises aimed at import dependency. For example, solely 62% of enterprises project to preserve the existing share of imports which dropped the balance of import substitution investment plans to -35 p.p.

The machine building industry proved to be one of the two sectors which cut the scale of actual import substitution in Q3 compared to Q2 – 22% after 32%. Similar situation is true of the plans in this sector: they fell from 33% in Q3 to 22% in Q4. Thus, both actual scale and plans of import substitution lost 11 p.p. each. The machine-building sector definitely refuses to procure domestic means of production and tries to preserve the existing share of imports: in Q3, the share of advocates of import preservation in the sector went up to 64% after 52% in Q2. Resolution of this problem even after the devaluation and rising costs of imported equipment is offset by a sharp fall of the sector investment plans.

The light industry was the second one which reported a decline in import substitution of equipment. In Q2 2015, this industry reported that 25% of its enterprises had refused to procure equipment from abroad. However, in Q3 2015, solely 12% of its enterprises have stuck to the import substitution policy. Similar scenario is unfolding with their plans: in Q3 31% of light industry enterprises reported about plans to refuse foreign equipment. However, in Q3 merely 15% have reported such plans. Two-fold reduction of the import substitution pace in the light industry can be explained both by a lack of required equipment production in the territory of Russia and by the attempts of the industry to market its products across the border following ruble depreciation. In However, they seem to be unsuccessful so far. September 2015, barely 7% of enterprises have reported increase of export demand for their products following ruble devaluation. Furthermore, due to ruble devaluation 17% of enterprises of the light industry have indicated an increase of domestic demand: more expensive foreign made consumer goods force the Russian consumers to cross over to the products made in Russian, although not in

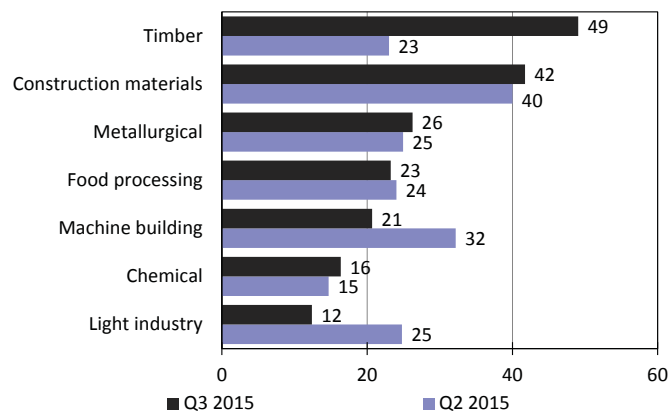


Fig. 2. Extent of actual import substitution in procurements of machines and equipment in manufacturing sector, %

the amounts which the followers of the devaluation protection of domestic producers expected.

On the whole, we can say that the lack of required industrial inputs and equipment actually makes the Russian industrial enterprises to turn to critically important import and gradual adjustment to new prices allows them to achieve it. ●

4. RUSSIA'S IMPORT BAN ON UKRAINIAN FOODS: MAGNITUDE AND IMPLICATIONS

N.Shagaida

The Russian government will impose a ban from 1 January 2016 on the import of foods from Ukraine¹.

None of the two countries however will be affected substantially by the ban:

- Ukrainian imports in Russia play an insignificant part in terms of both total volume and as per each article of foods import (1.2%);
- Ukraine saw its share of Russia's foods import structure (which as early as in 2012 was more than 5%) begin to shrink even prior to what happened in 2014. Russia's Rosselkhoznadzor (Federal Service for Veterinary and Phytosanitary Surveillance) and Rospotrebnadzor (Federal Service for Surveillance on Consumer Rights Protection and Human Wellbeing) were largely responsible for creating the foregoing situation by complaining heavily about Ukrainian products, thereby making Russia-Ukraine trade relations become nontransparent and unpredictable;
- Ukraine managed in large part to refocus to other markets after its Russian market share shrank.

Russia-Ukraine trade relations were complicated even prior to imposing sanctions and Russia's tit-for-tat measures in 2014. For instance, with Russia increasing its total food imports in previous years², the volume of imports from Ukraine already saw a decline (Fig. 1). Foods import from Ukraine kept declining in absolute and relative terms compared to other countries after Russia imposed an import ban on foods from certain countries, which initially did not cover Ukraine (Fig. 2). In 2015, Ukrainian imports to Russia decreased to \$235m (6.2 times less than in 2012).

The Rospotrebnadzor and the Rosselkhoznadzor were responsible for taking measures which affected the decline in the foods import from Ukraine even before Russia imposed tit-for-tat sanctions; in particular, the measures were aimed to increase control over the imports of raw materials and meat and dairy products³. As a result, imports of dairy products saw a cut from \$250m in 2012 to \$7m in 2015, and the Ukrainian share of Russia's foods import dropped from 5% to 1.2%. The decline rates have

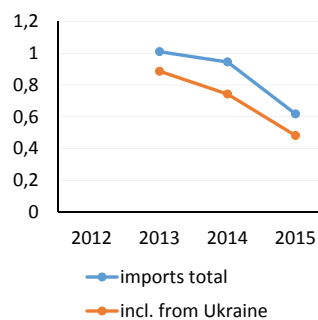


Fig. 1. Food supplies as compared year-on-year basis

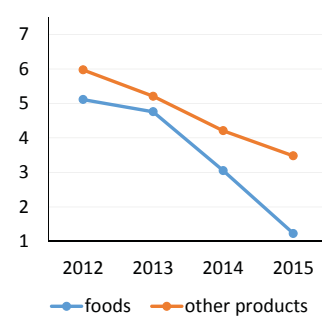


Fig. 2. Ukraine's share in Russia's imports, %

1 On the expansion of the list of countries covered by the ban on imports to Russia of agricultural products, raw materials and food products. <http://government.ru/docs/19265/>

2 Analysis hereinafter is made by years according to a comparable time frame of January–September.

3 For example: <http://www.agroinvestor.ru/markets/news/16163-rosselkhoznadzor-ostanovil-partiyu-sukhogo-moloka-iz-ukrainy/>, <http://161.ru/text/newsline/779277.html?full=3>

Table 1

UKRAINIAN FOODS THAT ACCOUNT FOR THE BIGGEST SHARE OF RUSSIA'S IMPORTS
(BY GROUP OF FEACN)

2012			2015		
	Millions of US dollars	As a percentage of group's total imports in Russia, %		Millions of US dollars	As a percentage of group's total imports in Russia, %
18. Cocoa and cocoa-containing foods	290.43	32.1	14. Vegetable matter for basket-ware and wickerwork	0.12	6.32
19. Finished products of cereal grains	99.03	14.1	02. Meat and edible meat subproducts	89.11	3.90
20. Vegetables and fruits by-products ...	129.35	11.6	11. Grain mill products; malt; starch; inulin	2.93	3.38
11. Grain mill products	15.46	11.6	18. Cocoa and cocoa-containing foods	21.11	3.20
17. Sugar and confectionery	58.69	11.2	23. Animal feeds left-over and by-products	19.26	2.77
04. Dairy products	249.89	10.7	22. Alcoholic and other beverages	31.75	2.69
22. Alcoholic and other beverages	203.38	10.3	12. Oilseeds and oleaginous fruit	20.05	1.82
Total	1463	5.2	Total	235	1.2

Source: Russia's Federal Customs Service.

been faster than those of supplies of nonfood products (the Ukrainian share fell from 6% to 3.2%).

Ukraine indeed used to be a major trade partner for Russia. For instance, the Ukrainian share in 2012 was more than 10% for seven of the 24 groups of foods (*Table 1*). Ukrainian entrepreneurs managed to arrange for regular supplies to Russia of foods that are not produced in Ukraine. For instance, Ukraine accounted for more than 32% of Russia's imports of cocoa and cocoa-containing foods.

Ukraine's trade positions have been restricted to an extremely insignificant level for the past few years. Only six groups of foods remain in 2015, which account for 2% or less of Ukraine's total imports to Russia. Meat is the biggest in value among the groups of foods (\$89m, or 3.9% of meat imports to Russia), by share of imports – meat filaments (6.3%).

The structure of the foods imported from Ukraine to Russia has seen substantial changes. For instance, most essential in 2012 were cocoa and cocoa-containing foods (19.9%), dairy products etc. (code 04) (17%), alcoholic beverages (14%), meat (11%), vegetables and fruits by-products (about 9%), finished products of cereal grains (7%), vegetables, sugar and confectionery (4% each). The rest of the foods accounted for less than 4%. The following groups of foods have been found to prevail in 2015: meat (about 40%), alcoholic beverages (13.55%), cocoa and oleaginous foods (9% each), animal feed (8%).

The new restrictions on Ukrainian imports to Russia will therefore result in nearly invisible potential losses.

One of the arguments advanced during discussions on Ukraine's accession to the European Union was that Ukrainian goods will see no demand in new markets if the Russian border is closed. Indeed, Ukrainian exports have been declining since 2012. However, the decline in foods import cannot be regarded as critical, which in 2015 is by 15% down from 2012, whereas the nonfoods import has been facing much more problems (*Fig. 3*). At the same

time, the foods export to Russia has indeed seen a major cut by more than 6 times (from \$1.45bn to \$0.24bn). In 2015, Ukrainian exports to Russia were merely 0.26 of the level seen in 2014 (Fig. 4).

Overall, comparing the decline rates of Ukrainian foods export to Russia is evidence that Ukraine has already refocused to other markets. Russia's ban on Ukrainian foods will bring about problems only for specific items, not the Ukrainian economy as a whole. For instance, the value of the most essential article of export to

Russia – meat and meat foods – is about \$89m (32% of Ukraine's total meat exports), but this is merely 0.9% of Ukraine's foods export. The increase in the share of meat of the Ukrainian foods export structure (1.8% in 2012, 2.2% in 2013, 2.7% in 2015) indicates that Ukraine has found new markets and not cut the production of the foods which were previously exported to Russia. Total volume in the cost estimate increased 30% in 2012 to 2015, whereas exports of this product to Russia in 2015 nearly halved during the same period. The fact that Russia's foods import ban covers Ukraine is rather more of informative nature. Since Russian consumers have already experienced cuts in import volumes, disappearance of relatively cheap Ukrainian foods in the Russian market, it is unlikely that this will seriously affect the same consumers amid the recent overall appreciation of food prices and cuts in consumption. ●

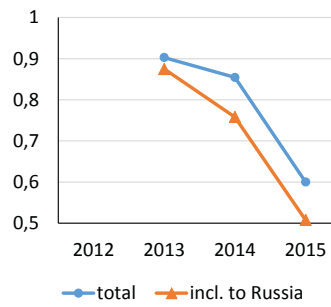


Fig. 3. Nonfood export from Ukraine compared to the previous period (January–September) last year

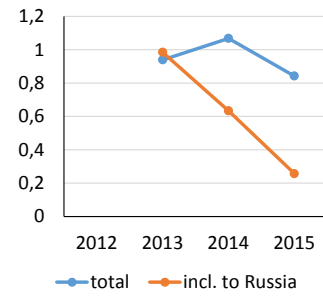


Fig. 4. Food export from Ukraine compared to the previous period (January–September) last year

5. REGIONAL SOCIAL EXPENDITURES: A COUNTRY OF CONTRASTS

N.Zubarevich

Regional consolidated budgets are facing three main trends in 2015, namely marked growth of budget revenues, slower growth of budget expenditures, insignificant growth of debts and enhanced debt profile. The dynamics of the regional consolidated budget revenues in 2015 (according to the data on January–September) has improved amid economic downturn over the dynamics seen in 2013–2014. However, there is a large difference between the regions: some (most) of them have seen their budget revenues decline, whereas others have experienced a substantial growth in the same. The regions and municipalities have seen their debts grow slower than in 2013–2014, increasing by merely 5% in the period between January and earlier in November 2015. Consolidated budget expenditures have increased by merely 4% due to strengthening the responsibility of the regions for their budget policy. However, analysis of the dynamics of social spending has shown a strong differentiation as to both certain budget lines and regions. The nontransparent regional budgets' Health care spending pattern is an apparent problem.

The dynamics of the regional consolidated budget revenues in January–September 2015 improved amid economic downturn over the dynamics seen in the same period of 2013–2014. The dynamics of the regional consolidated budget revenues in January–September 2015 improved amid economic downturn over the dynamics seen in the same period of 2013–2014. Budget revenues in the first three quarters of 2015 increased 8% from the same period of 2014 due to profit tax revenues (an increase of 14%, or 10%, excluding Sakhalin) and property tax revenues (up 15%). However, this growth may turn out to be unstable or have an adverse effect on regional budgets, because a considerable growth in profit tax revenues was determined largely by the heavy devaluation of the Russian ruble late in 2014¹. Due to the fact that the profit tax is calculated on the previous periods basis (2014 was more beneficial), many large companies overpaid their profit tax in 2015, and it is budgets that will have to compensate them for the amounts overpaid. The growth in profit tax revenues was determined by higher rates, thereby increasing the tax burden on businesses amid crisis. The overwhelming majority of the regions have seen the principal tax (personal income tax) revenues (up 5%) and transfers (less than 2%, or 4%, excluding the Republic of Crimea) grow at a considerably slower pace.

The overall dynamics of the regional budgets does not reflect how large the difference between the regions is: budgets revenues have declined in 23 regions, whereas they have increased substantially (by 20–54%) in five regions.

The regions and municipalities have seen their debts grow slower than in 2013–2014, increasing by merely 5% in the period between January and ear-

¹ Large exporting companies generate incomes denominated in foreign currencies, they accumulated by the end of the year large FX balances on their accounts, on which the profit tax was levied given a difference of exchange.

lier in November 2015. The debts saw the highest growth rates in October 2015 in response to a decline in transfers to the regions and increase in the expenditures commitments. The overall annual dynamics may be worse because debts tend to grow in a period between November and December. The debt profile has improved due to increased federal support in the form of extra budget loans from Russia's Finance Ministry: the share of commercial bank loans that are most expensive to service has decreased to 38% to become equal to the share of budget loans. By contrast, the proportion earlier in 2015 was more of a problem for the regions, 44 and 31%, respectively. Although Finance Ministry's budget loans allow for easing the burden on the regions, they cannot be a systemic solution for the debt issue.

Consolidated budget expenditures have increased by merely 4% due to strengthening the responsibility of the regions for their budget policy. What were the priorities in 2015? On the face of it, social priorities, which dominated in previous years, have become less apparent in 2015. National economy's expenditures have been growing at a faster pace than during the past two years (Fig. 1).

However, this is due to the policy of Moscow, the single region with a huge budget, which has been responsible for large increase in the national economy expenditures (up 26%), on transport and road construction. Excluding Moscow, the dynamics of national economy expenditures is one half as high (down 5%) and comparable with the overall growth in budget expenditures, whereas expenditures have been cut in 33 regions. Utilities expenditures have declined in 50 regions, but the cost-effectiveness has been reached for account of the two federal-status cities, Moscow (a decrease by 8%) and St. Petersburg (down 21%), which totally account for more than two thirds of all the regional budget expenditures on utilities. A substantial growth in utilities expenditures in 15 regions (up 30–230%) has been determined by having to pay accrued debts to service providers (companies that supply gas, water and electric power) under threat of shutting down supplies. It therefore is not arguable that the social expenditure priority has decreased.

The priority social expenditures have differed in recent years: social protection expenditures saw above-normal growth rates in the 2009–2010 crisis; education and health care expenditures increased in 2012–2013 and culture expenditures in 2014 pursuant to Presidential decreases. According to the data on the three quarters of 2015, the differences in dynamics of specific types of social expenditures have been smoothed out. Social policy and health care expenditures have increased a bit faster with a minimal growth in culture spending. However, this is a general picture. Analysis of the dynamics of social expenditures shows large differentiation by both specific line and region.

The growth in *education* expenditures in the first three quarters of 2015 (5%) remained at the level seen in 2014, but the differences in the dynam-

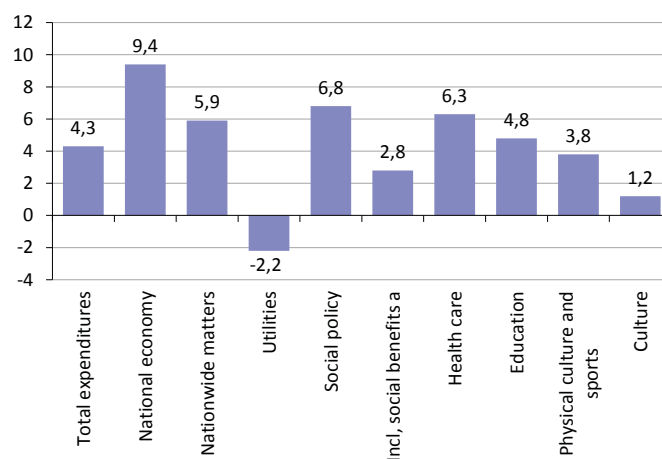


Fig. 1. Regional consolidated budget expenditures in January-September 2015, as a percent change from the same period of 2014

ics as per budget lines became more visible. Pre-primary education expenditures (13%) increased most, because the regions must implement a nursery construction program despite a decline in birth rates caused by the specific features of the Russian age pyramid. The growth in basic education financing has been minimal (2%) due to ongoing streamlining of the school network. Secondary vocational education expenditures, which relates to compensating the regions, have decreased by 0.3% with a reduction in the number of students and in the network of secondary vocational education institutions.

Health care expenditures are distributed between regional budgets and territorial funds of compulsory medical insurance (TFCMI). TFCMI in 2015 account for the first time for half of the total expenditures (51%). Including TFCMI, health care expenditures have increased substantially by 11.6% (Fig. 2).

The structure of regional health care budget expenditures has become the least transparent among other types of social expenditures: the so-called “sundry health care expenditures” account for two thirds, including inter-budgetary transfers, social security and other benefits to individuals, etc. It is these expenditures that are growing faster than budget financing of inpatient and outpatient medical treatment which has been cut by 5–10% due to streamlining the network of institutions or granting the autonomous non-profit status to some of such institutions. “Sundry health care expenditures” account for 84% of total budget expenditures and TFCMI, including primarily insurance compensations to individuals and transfers to municipal budgets. Centralization of health care financing at the regional budget level with transfers to municipalities and growth of financing from TFCMI have made budget statistics on regional health care financing show hardly anything.

Social protection expenditures (“social policy” budget line) increased 6.8% in the first three quarters of 2015, but the growth did not catch up with the dynamics seen in 2014 (7.8% overall annual, excluding the Crimea). Regional social benefits account on average for more than 70% of social policy expenditures. The dynamics of social protection expenditures as whole and social benefits did not differ in the previous years, but social benefits expenditures in 2015 have been growing at a slower rate (2.8%). It is the Moscow policy that is primarily responsible for this, cutting social benefits expenditures by 10%. Excluding Moscow, the dynamics of social benefits expenditures is almost the same (5.5%) as that of all social protection expenditures.

Cumulative data do not reflect the variety of regional policies with regard to social expenditures. As in the previous years, the *regional dynamics* by key type of social expenditures has been extremely patchy (Fig. 3). Overall, 13 regions (excluding the Crimea) have cut their expenditures, mostly in the Amur Region (down 13%), the Jewish Autonomous Region (down 11%), the

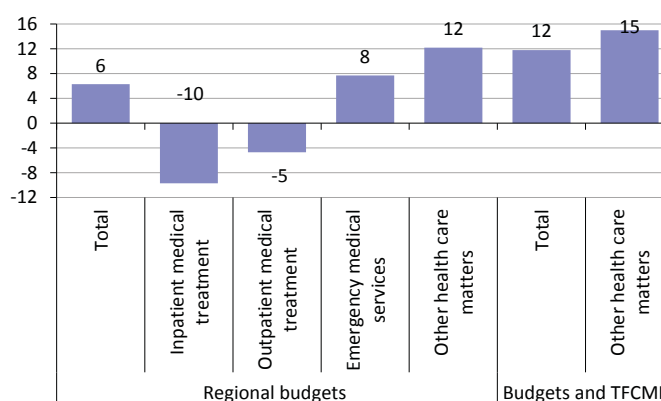


Fig. 2. Regional health care budget expenditures and TFCMI in January-September 2015, as a percent change from the same period of 2014

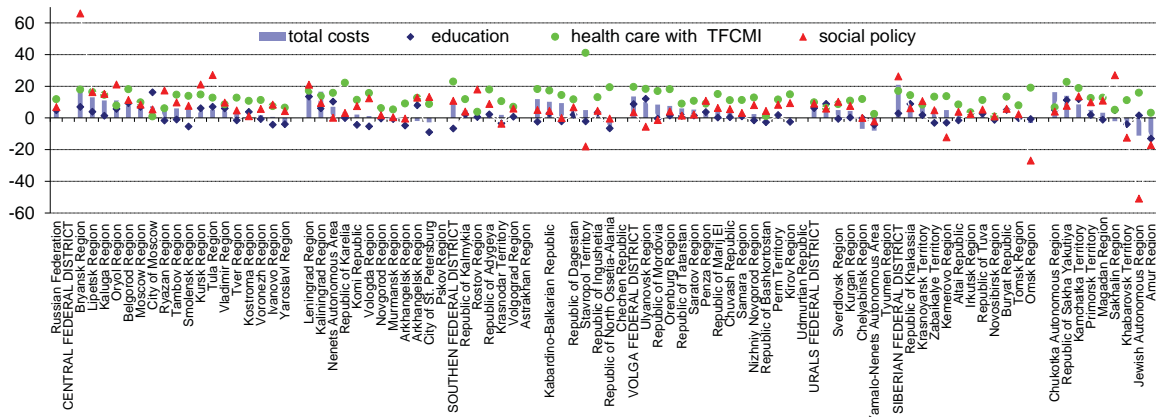


Fig. 3. The dynamics of all expenditures and basic types of social expenditures in January–September 2015, as a percent change from the same period of 2014

Tyumen Region, the Yamalo-Nenets Autonomous Area and the Chechen Republic (down 7–8%). This is mostly due to a decline in their budget revenues and, in some cases, the burden of substantial debt owed by a given region.

In 2015 the social expenditure streamlining process has become more widespread in terms of territorial coverage, but only for specific budget expenditure lines. Education is on the top of the list. In 2014 education expenditures as a whole were cut in nine regions, in January–September 2015 in 32 regions. Education expenditures have been cut most in the Amur Region (down 13%), the Pskov Region (down 9%), and the Republic of Kalmykia and the Chechen Republic (down 7%), in which the number of secondary school students has been growing. The biggest growth in education expenditures (up 16%) has been reported in Moscow due to almost trebled financing of pre-primal education, mostly on the construction of nurseries. High growth rates in education expenditures (11–13%) have been reported in regions with different degree of fiscal capacity: the Leningrad Region and the Republic of Sakha Yakutiya which are facing favorable situation with their budget, the Republic of Mordovia which has a huge debt, budget deficit and decline in revenues, and the heavily subsidized Kamchatka Territory.

Health care budget expenditures in January–September 2015 were cut in 15 regions, mostly in the Republic of Adygeya (down 12%), Amur Region (down 10%), Moscow, the Buryat Republic and the Sverdlovsk Region (down 7–8%). However, 2014 saw twice as much regions with negative dynamics of budget health care expenditures. It is incorrect to consider budget expenditures alone, TFCMI expenditures should be considered too. They have increased in total in all of the regions, mostly in the Republics of Ingushetia (up 43%), Karelia, Kalmykiya, Sakha Yakutia, the Chechen Republic, the Altai Republic, the Kamchatka Territory and the Ulyanovsk Region (up 19–23%). Budget financing of the construction of medical institutions is most often responsible for considerable growth. Moscow, the Perm Territory and the Buryat Republic have seen the slowest growth in expenditures of 1%, the Tyumen Region, 2%.

Social policy expenditures have been cut only in 10 regions, as in 2014, except that half of them have been cut considerably because of completed social payments to flood victims (Jewish Autonomous Region, Altai Republic, Amur Region, Khabarovsk and Altai Territories). the Republic of Ingushetia

have seen most of the cuts (down 18%) in 2015, which in 2014 experienced inadequately high growth of social benefits expenditures. Substantial growth of social policy expenditures, especially social benefits expenditures, in September 2015 was mostly due to numerous regional election campaigns. The Bryansk Region is on the top of the list (66%), followed by the Tula, Oryol, Kursk and Leningrad Regions, the Republic of Khakassia (21–27%) despite that most of the regions have large debts and budget deficit. There is only one superrich Sakhalin region which can afford a substantial growth of 27% in social policy expenditures. ●

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