MONITORING OF RUSSIA'S ECONOMIC OUTLOOK:

TRENDS AND CHALLENGES OF SOCIO-ECONOMIC DEVELOPMENT

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TRENDS AND CHALLENGES OF SOCIO-ECONOMIC DEVELOPMENT

The renewed interest in Russian federal loan bonds on the part of foreign investors, whose money pump in Russian OFZ bonds in January-February 2019 climbed to an 18-month high, was so unexpected that it has even resulted in the emergence of some purely conspirological explanations. However, it is evident that the latest wave of bond purchases was motivated by some much more logical and mundane incentives and counter-incentives.

It should be noted that the reasons for the existing trend towards foreign capital outflow from the Russian securities market have been apparent from the very beginning, especially against the backdrop of the recently proposed sanctions on issues of new Russian sovereign debt. Nevertheless, foreign investors have apparently overcome their fears concerning the introduction of such sanctions, probably due to the US Federal Reserve System's decision to abstain from toughening its policy, because such a move automatically increases the risk appetite of investors (the formulation that ideally fits the current situation on the securities market).

None the less, these highly interesting developments on the Russian financial market by no means determine any major parameters of Russia's budget and the long-term status of Russian securities in the framework of the global economy. Any global effect worth mentioning could be related to other factors, including those described in the International Energy Agency's latest forecast for 2024.

Although the IEA's forecasts are now regularly challenged by the rapidly changing reality (similarly to those issued by many other highly respected centers), it would certainly be unwise to ignore them. In this case, the matter at hand is the expectation of a situation where the USA, riding the crest of the new wave of the shale oil revolution, will account for more than 70% of growth in global oil production, thus becoming the world's second largest oil exporter after Saudi Arabia. According to this forecast, by the end of the next six-year period the USA will export 450 million tonnes of oil and petroleum products per year, which will definitely produce a huge impact on the state of the global economy. The IEA's forecasts regarding Russia are based on the future expiration of the OPEC+ deal, as a result of which oil production will rise again over the next two years and then slightly decrease.

In our experts' analysis exploring the production and processing of oil in Russia and the tax maneuver in the Russian oil industry it is emphasized that, in 2018, oil production in the Russian Federation increased by 1.7%, to 556m tonnes (including gas condensate), which represents an all-time high for the entire post-Soviet period and approaches that index's historical high (569m tonnes in 1987). In the past year, total exports of oil and petroleum products amounted to 410m tonnes (thus, the domestic market absorbs a quarter of raw materials output – only a half of what it absorbed in the Soviet period). It can be noted that the first phase of the tax maneuver promoted growth in the oil-refining sector alongside a shrinkage of the less profitable exports of fuel oil. The reduced rate of export duty brought the level of domestic price of oil (producer price) with world oil prices. However, according to expert estimates, over the years since the launch of the tax maneuver (2014–2018) the consumer prices of petrol in Russia remained practically unchanged relative to those in the USA, Canada, Japan and the EU (whenever there was a change in price, it was downward relative to foreign prices). This year, the tax maneuver has entered a new phase, to last until 2024. Our experts believe that under the current conditions (including the geopolitical situation), growth in the oil industry in Russia should rely on more efficient development of conventional onshore oil fields.

According to the latest data from the monitoring by the Gaidar Institute (for February), Russian industry has continued to be moderately optimistic about the demand for its products. The inflation expectations of enterprises have increased, and this factor may translate into increasing selling prices. The satisfaction with capital investment level has also been on the rise – in the sense that now, already 74% enterprises believe this level to be 'sufficient' (a record high share for the entire monitoring history of that index). The main obstacle to investment growth in industry is considered to be insufficiency of their own funds (54% of enterprises), but nevertheless, this is the lowest index reported with respect to this particular factor over the entire nearly quarter-century history of monitoring the constraints to investment activity. The factor of high equipment and assembly prices in this 'ranking of obstacles to investment' has hit its historic low of 29–31%, as did the factor of loan value and difficulties in getting a loan (it was mentioned by only 13% of industrial enterprises). On the other hand, the factor of uncertainty in a revival of Russian industry in the near future rose to 22%.

With regard to the year-end results of socioeconomic development of Russia's regions for 2018, the experts note the relatively high rate of growth in industry, its locomotive being the extractive industries. As far as investment is concerned, the number of regions reporting investment decline has remained significant (32 in 2017, and 37 in 2018). However, the impressive investment downfall in the city of Sevastopol, Rostov Oblast, and Nenets Autonomous Okrug could be explained solely by the last year's high base effect. The trend towards investment concentration in Russia's two biggest urban agglomerations has remained stable, the share of the Moscow agglomeration has increased to 20% of the nationwide investment index. As for the residential building construction sector, the year 2018 saw a continuation of decline (by 5%), observed across 47 regions. An estimation of regional budgets has revealed a better situation compared with recent years, the reason being the presidential election campaign and high prices of raw materials exports.

A separate analysis of budgets in the regions demonstrates that the year-end results of 2018 are the best relative to the entire previous decade. Thus, the consolidated budget revenue of RF subjects gained 15.2%, and the receipts of profits tax, which is always very sensitive to oil price fluctuations, have been increasing at an accelerated rate. The receipts of PIT likewise demonstrated a record-high growth rate. Budget revenue increased in all the 85 regions, and in 83 regions their growth rate was ahead of that of inflation. The growth rate of budget expenditure was also significantly above the inflation rate, but it was more modest (9.9%). This factor, in its turn, largely determined the overall deficit-free budget across the regions, and even a surplus of 0.5% of GDP. The number of RF subjects that at the year-end achieved a surplus in the consolidated budget was a record high for the entire period since 2000. Both the amount of government debt of the regions and its index relative to the amount of revenue demonstrated a decline. As of January 1, 2019, debt remained higher than budget revenue only in two regions – the Republic of Mordovia and Kostroma Oblast.

However, the experts' forecasts for 2019 are less optimistic. It is unlikely that the receipts of profits tax or PIT will continue to increase at the same rate. The former – because of the lower oil prices, and the latter – because of the lower growth rate of wages and salaries in the public sector. As a result, the growth rate of budget revenue can be confidently expected to follow suit as well.

1. MAIN TRENDS IN THE OIL SECTOR IN 2018–2019

Yu.Bobylev

Amid raising global oil prices, crude oil production in Russia in 2018 hit an all-time high for the post-Soviet period. Under the first stage of tax maneuver in force in the oil industry, production and export of fuel oil moved down resulting in contraction of oil refining volumes but refining depth went up notably. Year 2019 saw the launch of the second stage of the tax maneuver in force in the oil industry and the tax on extra revenue was adopted.

Recently oil production in Russia was determined by fulfillment of obligations under OPEC+ agreement. The real reduction in oil production by OPEC+ countries seen in H1 2018 has tuned out to be significantly higher target set by the agreement due to a serious production decline registered in a number of countries. In this context, in June 2018 OPEC+ decided to raise oil production from the beginning of July by 1 million barrels per day.

Amid growing global oil demand implementation of the OPEC+ agreement resulted in the reduction of the excessive supply and a notable price growth.

Owing to the opportunity obtained within the agreement to boost oil production in H2, oil extraction in Russia hit 556 million tons (up 1.7% in comparison with the previous year, *Table 1*). This is the peak level from 1989, i.e. for the last 30 years and is close to an all-time high of 569.4 million tons reported in 1987 (*Fig.1*).

Table 1

Production and refining of oil in Russia in 2010–2018

	2010	2014	2015	2016	2017	2018
Extraction of crude oil including gas condensate, million tons	505.1	526.7	534.0	547.6	546.8	556.0
Primary crude oil refining, million tons	249.3	294.4	287.2	284.5	284.3	290.7
Share of crude oil refining in crude production, %	49.4	55.9	53.8	52.0	51.9	52.3
Crude oil refining depth, %	71.1	72.4	74.4	79.1	81.0	82.1

Sources: Rosstat, Ministry of Energy of Russia.

Year 2018 demonstrates that the tax maneuver has delivered positive results from the first phase of the tax maneuver in the oil sector – a structural tax reform in this sector envisages gradual reduction of export duties on both crude oil and petroleum products, as well as higher mineral extraction tax (MET)[1].

Implementation of the tax maneuver resulted, firstly, in increased oil refining depth and reduction of fuel oil production. Secondly, growing exports of crude oil and decline of petroleum products exports due to reduced less lucrative fuel oil exports. Thirdly, crude oil refining declined in volume terms due to the above two factors. Oil refining depth in Russia increased from 72.4% in 2014 to 82.1% in 2018

1 Yu. Bobylev. Tax Maneuver in the Oil Industry. Russian Economic Developments. 2015. No. 8. P. 45–49.

which is the all-time high (*Fig.* 2). Production of gasoline and diesel fuel went up while production of fuel oil declined by 37.2%. The share of refined oil in its production decreased from 55.9 % to 52.3%. Petroleum products exports contracted by 8.9%.

In 2018, total Russia's exports of crude oil and petroleum products constituted 410.3 million tons, up 2.3% against the previous year. This indicator is close to an all-time high reached in 2015 — 416 million tons.

Analysis of Russia's crude oil exports over the course of a long period demonstrates a marked increase in the export-led component of oil industry. The share of net exports of crude oil and petroleum products in crude oil production went up from 47.7% in 1990 to 73.6% 2018. This, however, is due not only to the increase in absolute volumes of exports but to a crucial contraction of internal oil consumption against the Soviet period and more efficient oil consumption and the replacement of petroleum products (fuel oil) by natural gas[1].

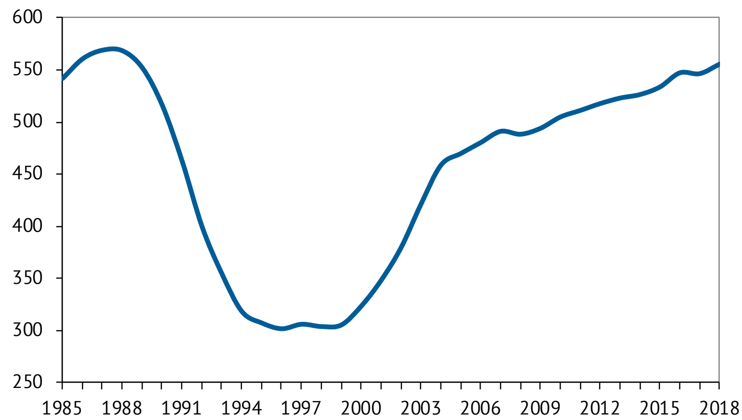

Fig. 1. Oil production, including gas condensate in 1985–2018, mln t

Sources: Rosstat, Ministry of Energy of Russia.

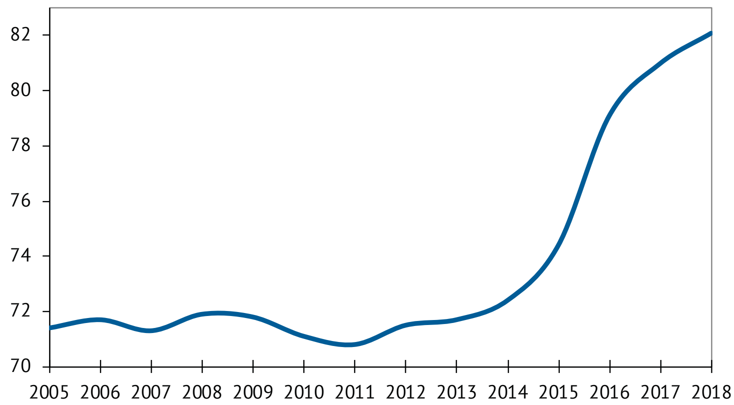

Fig. 2. Refining depth in 2005–2018, %

Sources: Ministry of Energy of Russia, Rosstat.

Table 2

Ratio of production, consumption and exports of crude oil in 2010–2018

	2010	2014	2015	2016	2017	2018
Crude oil, mn t						
Production	505.1	526.7	534.0	547.6	546.8	556.0
Exports, total	250.4	223.4	244.5	254.8	252.6	260.2
Exports to non-CIS countries	223.9	199.3	221.6	236.2	234.5	241.7
Exports to CIS countries	26.5	24.1	22.9	18.6	18.1	18.5
Net exports	249.3	222.6	241.6	254.0	252.0	259.7
Domestic consumption	125.9	141.3	122.2	138.3	147.1	146.7
Net exports as $ of production	49.4	42.3	45.2	46.4	46.1	46.7
Petroleum products, mln t						
Exports, total	132.2	164.8	171.5	156.0	148.4	150.1
Exports to non-CIS countries	126.6	155.2	163.3	148.1	137.4	139.0

1 Bobylev Yu. Development of Russia's Oil Sector // Voprosy ekonomiki. 2015. No. 6. P. 45–62; Bobylev Yu. The Development of the Russian Oil Sector // Problems of Economic Transition. Vol. 58. 2016. Issue 11–12: The Real Sector Potential. P. 965–987.

Table 2, cont'd

	2010	2014	2015	2016	2017	2018
Exports to CIS countries	5.6	9.6	8.3	8.0	11.0	11.0
Net exports	129.9	162.8	170.2	155.3	147.7	149.6
Crude oil and petroleum products, mln t						
Net exports of crude oil and petroleum products, mln t	379.2	385.4	411.8	409.3	399.7	409.3
Net exports of crude oil and petroleum products as % of crude oil production	75.1	73.2	77.1	74.7	73.1	73.6

Sources: Rosstat, Russian Ministry of Energy, Federal Customs Service, own calculations.

Table 3

Value and share of exports of oil sector in Russia's exports in 2017–2018

	Exports in 2017, $ billion	Share in total volume of Russia's exports, %	Exports in 2018, $ billion	Share in total volume of Russia's exports, %
Crude oil and petroleum products	151.55	42.2	207.1	45.8
Crude oil	93.31	26.0	129.0	28.5
Petroleum products	58.24	16.2	78.1	17.3

Sources: Federal Customs Service, own calculations.

The pricing mechanism for crude oil and petroleum products in the Russian domestic market is based on equal-netback pricing, that is, prices are equal to the world price less export duty and transportation costs. The domestic price on crude oil and petroleum products in dollar terms in reality reflects the dynamics of global prices (*Fig. 3*). There is still a wide gap between world and domestic oil prices due to the export duty. Along with this, a convergence of international and domestic prices is observed owing to a lower rate of export duty envisaged as part of the tax maneuver. In 2014, the domestic oil price (producers' price) constituted 42% of the global price (Urals crude price on the European market), while in 2018 – 66%.

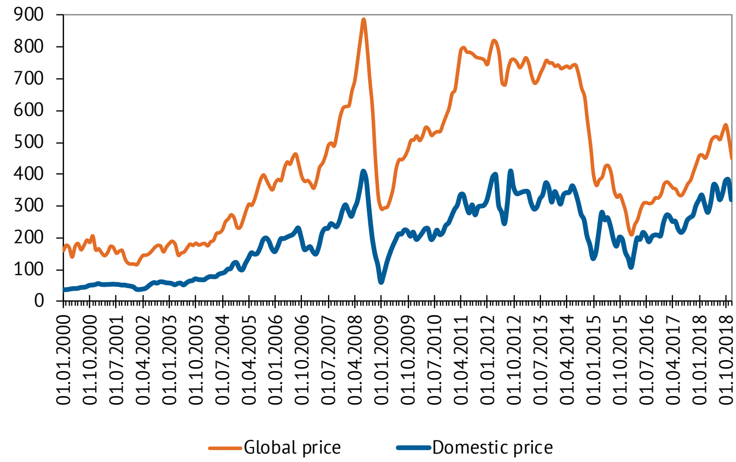

Fig. 3. Global and domestic oil prices in 2000–2018, USD/t

Sources: Rosstat, own calculations.

Final (consumer) prices on motor fuel on the domestic market are set on netback prices taking into account indirect taxes (excises, VAT) and markup. Russia regarding the share of indirect tax burden in the final motor gasoline price ranks in the middle between leading EU countries where this share is the highest and the USA where it is relatively low[1].

According to our calculations in late 2018 consumer motor gasoline price in Russia came to the level of the USA 96%, Canada 74%, Japan 45%, and regard-

1 Yu. Bobylev. Gasoline Prices in Russia and other countries: comparative analysis // Russian Economic Developments. 2016. No. 10. P. 28–31.

ing the average level of leading EU-5 — 41%. Thus, effective system of export duties and the level of tax burden on petroleum products in Russia ensures lower price level on motor fuel on domestic market in comparison with the developed countries. At the same time, implementation of the tax maneuver has not affected the relative price on gasoline — compared to the US the price has remained on the previous level, and compared with leading European countries — somewhat declined (*Table 4*).

Table 4

Consumer prices on motor gasoline in Russia against other countries, %

	2014 January	2018 December
USA	95.8	95.8
Canada	72.9	73.7
Japan	55.0	45.2
Germany	44.4	39.6
Great Britain	43.3	41.8
France	45.3	39.7
Italy	39.5	37.2
Spain	48.7	46.6
EU-5	44.1	40.8

Source: own calculations based on data released by OECD/IEA and Rosstat.

From early 2019 legislative decisions regarding gradual completion of the tax maneuver in the oil sector and the introduction of the Tax on Additional Revenues (windfall tax) adopted in 2018 were put in effect.

The Federal Law of August 3, 2018 No. 305-FZ "On Introduction of Amendments in the Article 3.1 of the Law of the Russian Federation 'On the Customs Tariff'" envisages gradual reduction of the oil export duty rate from 2019 through 2024 to the zero level. Simultaneously, the Federal Law of August 3, 2018 No. 301-FZ "On Introduction of Amendments into the Second Part of the Tax Code of the Russian Federation" envisages offsetting increase over the same period of Mineral Extraction Tax (MET) rates in oil production. Such tax system restructuring is creating incentives for further modernization of the oil refining sector, reduces subsidizing of domestic consumers, first of all, in the refining sector, cuts subsidizing by Russia of other EAEU countries, and strengthens incentives for increasing energy efficiency.

The Federal Law of July 19, 2018 No. 199-FZ from early 2019 introduced a new special tax — windfall tax on extraction of hydrocarbon raw materials. Implementation of this tax will promote investments in oil production, including development of oilfields with higher production costs[1]. Initially, application of windfall tax is envisaged on a limited number of oilfields, and it is envisaged to widen the scope of application of this tax in the future.

Vast crude oil reserves and growth of global oil demand permit Russia to maintain high levels of crude oil extraction and export for many years to come. Meanwhile, projected relatively low oil prices and sanctions against Russia which ban exports to Russia of equipment and technologies for the development of deposits located on the Arctic shelf, deep-water oil deposits and shale oil deposits will negatively affect the oil industry development.

1 Bobylev Yu., Rasenko O. On the introduction of tax on additional revenues in the oil sector // Russian Economic Developments. 2017. No. 10. P. 65–68.

In the circumstances, conventional oil reserves located onshore will be the basis for further development of the Russian oil sector. In-depth development of producing oilfields and increase of the oil recovery rate are of major importance. Options for additional oil production at such oil fields will largely depend on technological progress, development of import substitution aimed at increasing the oil recovery index and secure development of unconventional reserves including shale oil. Measures adopted within the state tax policy should contribute to the development of the oil sector.

2. INDUSTRIAL SECTOR IN FEBRUARY 2019 – INDUSTRIAL PRODUCTION EXPECTATIONS

S.Tsukhlo

Negative demand dynamics registered in early 2019 has not so far told on the output, estimates of finished products stocks and industrial enterprises forecasts. The industrial sector preserves optimism of expectations regarding demand, output and employment. However, the investment plans began being short of optimism gained in the previous months.

In February enterprises' estimates of demand dynamics on the industrial products returned to the positive trend seen in H2 2018. Although for the first two months of the current year estimates of sales deteriorated, demand projections still remain optimistic which was characteristic of the industry in late 2018. Hopes for demand growth allow the industry on the whole to neutrally estimate the stocks of finished products even amid negative actual dynamics of sales and output. The balance of estimates of stock has not been leaving the limits of -2…+2 points for 14 month in a row.

In February output again demonstrated a token positive dynamics after a zero January growth. Thus, businesses took a risk to increase output even in the context of a negative sales trend dynamics and so far have not reviewed their output plans. They keep a positive stance for the third month in a row. The industrial sector has not experienced such hopes for production growth for 15 months.

In February, enterprises' price forecasts moved up again and nearly hit the December level which preceded the VAT increase. Inflationary expectation can again push the industry to increase factory gate prices.

After the dismisses seen in January industrial enterprises proceeded to hire personnel. The balance of actual changes in the headcount moved up from -16 seen in January to +7 points registered in February. Enterprises' plans envisage continuation of employment — the balance of forecasts regarding the headcount change went up in February by another 5 points and hit levels which were not registered since 2011.

Plans of intensive staff hire is mainly due to a shortage of headcount registered in the industry in early 2019. Balance of estimates of the real headcount ("more than sufficient" – "less than sufficient") declined by 5 points and became negative hitting 10 quarters minimum.

A distinct situation exists regarding sufficient industrial capacities. Solely 5% of enterprises mention capacities shortage.

Minimal according to enterprises estimates shortage of capacities most likely was one of the reasons for the negative adjustment of the investment plans by the Russian industry. Traditional estimate of the real investment volume done last year demonstrated growth of satisfaction with capital investments. The share of responses "sufficient" moved up to 74% and hit an all-time high for the entire period of monitoring of this indicator. Industry better than ever since 1996 estimated the volume of investments in 2018 "owing to the expectations of demand change".

Industry traditionally considers shortage of own financial resources (54% of enterprises) as a main constraint for the investment growth in 2019. Nevertheless, this factor in 2017–2019 stood at an all-time minimum of responses for 24 year monitoring of investment activity constraints. Reference to high interest on loans and difficulties to obtain it (the 6–7th place in the rating of constraints) also fell to an all-time low and appear in responses of solely 13% of enterprises.

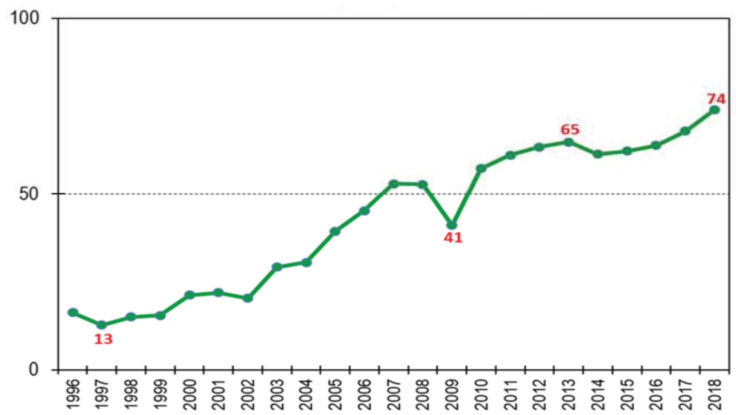

Fig. 1. Level of sufficient provision of investments in industry, 1996–2018, %

The 2nd place in the rating of constraints the Russian industry gave to high prices on equipment and construction lay-out. However, in 2017–2019 their share in responses (29–31%) fell to an all-time low.

Their uncertainty about prompt economic recovery enterprises put at the 3rd place in the rating (22%). This factor included in the surveys since 2013 hit the maximum of references at the beginning of 2016.

3. SOCIO-ECONOMIC DEVELOPMENT IN THE REGIONS: 2018 RESULTS

N.Zubarevich

Against the background of a more sustainable growth of industrial production than a year ago investments contracted in more than 40% of the subjects of the Russian Federation and as before concentrate in the metropolitan agglomeration and oil and gas producing regions. Housing construction continued downward trend in more than half of the regions and household cash income was falling in nearly ¾ of territories. Notable revenue growth of regional budgets was due not only to the growth of tax revenues but to transfers up 22%. This fact leads to a decline by three-fold of the number of regions with budget deficits and a reduction of debt burden, although debt volume decreased only by 4%.

In 2018, industry demonstrated fast growth in the RF regions. Extractive sectors were the drivers of growth (4.1%). They exceeded the dynamic growth of manufacturing sectors by 1.5-fold (2.6%). Among the leaders are regions that boast of crude oil and gas production and primary processing (Yamal-Nenets AO – 17% growth, Astrakhan region – 16%, Tyumen region – 10%, and Republic of Yakutia – 9%). Besides that, the leaders of industrial growth number the largest metropolitan agglomeration of the country (Moscow region – 10%, and Moscow – 9%) as well as a number of other regions (Tambov and Tver regions – 13–14%, Rostov, Sverdlovsk regions, and Republic of Mordovia – 9–10%). Industrial downturn was observed solely in 17 regions with entire south of the Far East, Ivanovo region (-2.4%), and Omsk region (-2.1%).

In 2018, growth of investments in all enterprises and organizations (4.3%) was twice as high as in large and medium enterprises. These data released by Rosstat is hard to explain. We can mark two trends seen in regions.

Firstly, retention of a significant number of regions with decline in investments: in 2017 there were 32 regions, and in 2018 – 37 regions. Heavy decline was registered in Sebastopol (-23%), Nenets AO (-16%), and Rostov region (-24%), which was due to the high base effect posted in the previous year. However, this fact is beside the point regarding other regions posting significant decline: Tambov region (-21%), Novgorod region and Republic of Mordovia (-19%), Kaluga, Ryazan, Lipetsk, Arkhangelsk, Vladimir, Volgograd, and Voronezh regions (-11–13%). The following regions with significant volume of investments posted the highest growth: Republic of Crimea (34%), external zones of largest agglomerations (Moscow and Leningrad regions – 23–27%), as well as Tyumen and Chelyabinsk regions (21–26%).

Secondly, concentration of investments is stable in two largest agglomerations, first of all, in Moscow one, as well as in leading and new oil and gas production regions (*Fig. 1*). The share of Moscow metropolitan agglomeration in 2018 hit 20% of all investments in the country. The share of St. Petersburg with Leningrad region is three times smaller (7%). In 2018, saw Crimea to join regional leaders regarding the investment volume: together with Sebastopol Crimea received 2% of the overall investments in the country with the share of population standing at 1.5%. Whereby, 69% of investments in Crimea are budgetary ones (on average in Russia – 15%). The Far East remains not too attractive for investment; its share stands at 8% counted in the new boarders of the federal district.

Three-year downward trend seen in the housing construction (2016–2018) resulted in the contraction of housing commission by 12%, of which in 2018 – by 5%, it was observed in 47 regions. The most revealing is the comparison between housing commission in per capita terms in 2015 (last year of growth) and 2018. Pre-crisis indices were exceeded by Leningrad region (1.5 sq. m. per capita, up 13% and St. Petersburg (0.75 sq. m. per capita, up 29%), among those regions which restored it are Moscow region (1.2 sq. m. per capita), and some other (Kaluga, Tambov, Voronezh, and Ulyanovsk regions - 0.8 sq. m. per capita). Housing commission in Sebastopol up 2.7-fold is due to completion of suspended construction left from the previous years. The lowest indices were seen in Tyumen region (-38%), Novosibirsk region (-33%), Kaliningrad region (-25%), and Belgorod region (-22%). As a result, housing demand is centered in the outskirts of the two metropolitan agglomerations and St. Petersburg, and Moscow has failed to restore pre-crisis volumes of the housing construction (-9%).

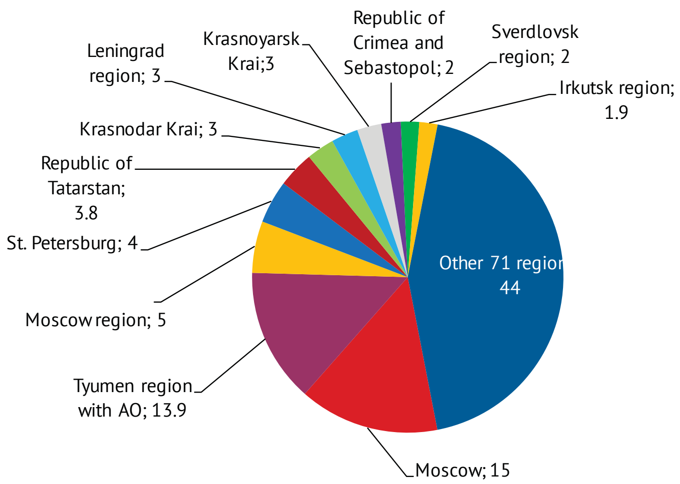

Fig. 1. Geographical structure of investments in 2018, % of all investments (amounts across federal districts)

Source: own calculations based on the data released by Rosstat.

The labor market in 2018 remained steady, the level of unemployment remained at an all-time minimum (4.8% in October-December 2018). Disparities among regions were also steady — from maximum unemployment indices seen in underdeveloped republics (Ingushetia – 27%, Chechnya, Dagestan, Karachaevo-Cherkassia, Tyva, and Altai – 13%) to minimum unemployment is registered in federal cities (1.2–1.5% and Moscow region (2.6%). In 2018, autonomous regions of Tyumen region (2.2–2.5%) joined the minimum disparities' range.

Downward trend of the household cash income slowed down in 2018. In contrast to the all-Russia statistics measuring real disposable cash income (less mandatory payments), the regional statistics measures the real income of the population. They moved up for 2018 by 0.9% (taking into account monthly cash payment in 2017). Regional dynamics is hard to explain due to unreliability of data. The real income of the population has contracted in 62 regions, most of all in Ivanovo, Yaroslavl, and Kostroma regions, and the Yamal-Nenets autonomous district (down 7–9%). Income also declined in the federal cities – by 2% in St. Petersburg, and by 3% in Moscow. Income growth registered in the Republic of Adygea (9%) is due to revaluation of proceeds from retail trade turnover—supermarkets serving in the city of Krasnodar are situated on the territory of Adygea. Growth of income of the population of Crimea and Sebastopol by 7–8% looks fully reliable because these regions receive special federal assistance.

The year 2018 was more favorable for the regional budgets than other years due to presidential elections and price growth on export resources. Consolidated budgets revenues moved up 15% due to proceeds growth from the profits tax by 23% and transfers by 22% (*Table 1*). In 2018, growth of transfers was the

Table 1

Revenue and expenditure of regional consolidated budgets in 2018

Revenue	Share, %	Growth rate, %		Expenditure	Share, %	Growth rate, %	
	2018	2018 to 2017	Jan-Sept. 2018 to Jan-Sept. 2017		2018	2018 to 2017	Jan-Sept. 2018 to Jan-Sept. 2017
Total	100	15	12	Total	100	10	9
PIT	29	12	12	National economy	21	8	6
Profit tax	25	23	15	Housing and utilities	10	8	4
Income tax	11	12	13	Education	25	12	12
Excises	5	3	3	Social policy	20	9	8
On aggregate income	4	16	17	Health care	8	18*	18*
Transfers	18	22	12	Culture	4	8	15

* Expenses of budgets and TFMMI.
Source: own calculations on data released by the Federal Treasury.

highest during the last decade. In the year of the previous presidential elections growth of transfers stood at 12%. The highest additional part of transfers the regions received in Q4. The structure of regional assistance is drifting towards "micromanagement": less equalization transfers which are distributed according to formula, the volume of other subsidies (for balancing, etc.) went up 2.7-fold, and other interbudgetary transfers – by 1.7-fold. Significant assistance granted to the regions in Q4 2018 can be linked to the rating downgrade of authorities seen since H2 2018 and elections of governors in the number of regions.

Regional budget expenditure in 2018 grew at a slower pace (10%) than revenue except expenses on healthcare (together with territorial funds of mandatory medical insurance). This sphere required more significant funds for the increase of doctors' wages to 200% of the average wages across the region in order to implement "decrees on wages and salaries". Regions were saving on non-social expenses – less Moscow budget, expenses on housing and utilities in 2018 moved up by 4%, on national economy – below 7%, that said main growth was secured by expenses on public road system (road funds) because by the year end the Finance Ministry allocated funds for these purposes to the regions.

Thanks to both transfers growth and own revenues in 2018 solely 15 regions closed a year with the budget deficit, in 2017 they numbered 47. Mordovia boasts of the largest budget deficit (17% of revenues), Khabarovsk krai (8%), Sakhalin, Moscow region and Jewish AO (5%). Large losses of the Sakhalin budget was due to withdrawal to the Federal budget of the major part of the receipts from the profit tax obtained from "Sakhalin-2" project and these losses were not compensated by transfers growth in 2018 by Rb 17.9bn (more than 11% of the regional budget revenues).

Total debt of the regional budgets and municipalities over 2018 has contracted merely by 4% despite fast revenue growth. Debt burden shrank in 57 regions and most notably – the less struggling ones. Debt notably went up only in regions with budget deficit – Moscow region (by 29%), Khabarovsk krai (23%), Sakhalin region and Mordovia (13%). As during the previous years, Republic of Mordovia has the maximum debt burden – twice their budget revenues (less transfers).

4. REGIONS' BUDGETS: BEST RESULTS OF THE DECADE

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In 2018, nominal and real revenues growth rates of regions' and local budgets hit top indices since 2012. Simultaneously, curbing expenditure growth allowed for the first time in eleven years to ensure surplus of the consolidated budget in the amount of 0.5% of GDP. The number of Russian regions with surplus budget at the year-end hit an all-time high – 70. This allowed to markedly reduce the regions' debt burden. At the same time, retention in 2019 similar growth rates of the budget revenues appears highly unlikely.

Revenue

In 2018, the total volume of revenues of the consolidated budgets of the subjects of the Russian Federation moved up by 15.2% hitting 11.9% of GDP. (*Table 1, Fig. 1*). Both these indices were top for the last 7 years.

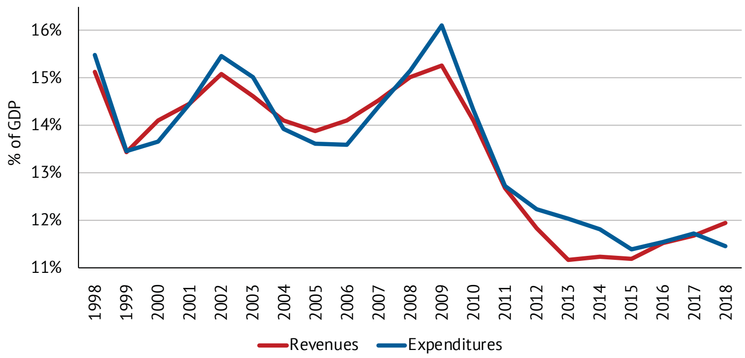

Fig. 1. Dynamics of revenues and expenditures of the consolidated budgets of RF subjects in 1998–2018, in % of GDP

Source: calculated on the basis of data released by the Federal Treasury and Rosstat.

As can be seen from *Table 1* proceeds generated from the corporate profit tax demonstrated the highest growth rates (122.8% against 2017), whose tax base is very sensitive to the oil prices, as well as to the interbudgetary transfers from the budgets of other levels (122.4%). Both excise duties (103.4%) and non-tax revenues (101.6%) demonstrated relatively low growth rates.

The PIT growth rates being the main source of revenues for regions' and local budgets, in 2018 although remained below the average dynamics of the budget revenues turned out to be top for the last 6 years – 112.4% against 2017.

In the context of the modest inflation seen in 2018, all major sources of revenues except excises and non-tax revenues demonstrated upward trends in real terms.

From the regions' perspective, the general growth trend of the regions' fiscal capacity outlined in 2017 was retained in whole. If we arbitrary divide regions into *three groups* – with high fiscal capacity (12 RF subjects that did not receive equalization payments made from the federal budget with the level of fiscal capacity over 1.0[1]), with average fiscal capacity (41 regions with the level of fiscal capacity in the range of 0.6–1.0 before equalization payments made in 2018), and with low level of fiscal capacity (32 regions with fiscal capacity below 0.6 before equalization payments made in 2018), then we note outstripping revenues growth rates in high fiscal capacity regions. Interbudgetary transfers

1 The level of the fiscal capacity of the subjects of the Russian Federation is determined according to methodology approved by the RF Government Regulation of 22.11.2004 No. 670 "On distribution of equalization payments of the RF subjects".

Table 1

Revenues of the consolidated budgets of the Russian Federation

	Revenues (in nominal terms), Rb billion						Revenues growth, %				
	2013	2014	2015	2016	2017	2018	2014/ 2013	2015/ 2014	2016/ 2015	2017/ 2016	2018/ 2017
Revenues, total	8 165	8 906	9 308	9 924	10 758	12 392	9.1	4.5	6.6	8.4	15.2
Tax and non-tax revenues	6 589	7 177	7 625	8 289	8 986	10 222	8.9	6.2	8.7	8.4	13.8
Tax revenues	5 967	6 493	6 925	7 574	8 205	9 429	8.8	6.7	9.4	8.3	14.9
Profit tax	1 720	1 964	2 108	2 279	2 528	3 105	14.2	7.3	8.1	10.9	22.8
PIT	2 499	2 693	2 808	3 019	3 252	3 654	7.8	4.2	7.5	7.7	12.4
Excises	491	480	487	662	612	632	-2.4	1.4	36.0	-7.6	3.4
Gross income taxes	293	315	348	388	447	520	7.6	10.4	11.7	15.0	16.5
Property taxes	901	957	1 069	1 117	1 250	1 397	6.3	11.6	4.5	11.9	11.7
Non-tax revenues	622	685	700	715	781	794	10.1	2.3	2.2	9.2	1.6
Transfers from other budgets	1 515	1 671	1 617	1 578	1 703	2 085	10.3	-3.2	-2.4	7.9	22.4
Other revenues	62	58	66	56	69	85	-6.6	15.2	-14.8	21.6	23.8
	Revenues, % of GDP						Change against previous year, p.p. of GDP				
Revenues, total	11.16	11.24	11.20	11.54	11.68	11.96	0.08	-0.04	0.34	0.14	0.28
Tax and non-tax revenues	9.01	9.06	9.18	9.64	9.76	9.86	0.05	0.11	0.46	0.12	0.11
Tax revenues	8.16	8.20	8.33	8.81	8.91	9.10	0.04	0.14	0.47	0.10	0.19
Profit tax	2.35	2.48	2.54	2.65	2.74	3.00	0.13	0.06	0.11	0.09	0.25
PIT	3.42	3.40	3.38	3.51	3.53	3.53	-0.02	-0.02	0.13	0.02	-0.01
Excises	0.67	0.61	0.59	0.77	0.66	0.61	-0.07	-0.02	0.18	-0.11	-0.05
Gross income taxes	0.40	0.40	0.42	0.45	0.49	0.50	0.00	0.02	0.03	0.03	0.02
Property taxes	1.23	1.21	1.29	1.30	1.36	1.35	-0.02	0.08	0.01	0.06	-0.01
Non-tax revenues	0.85	0.86	0.84	0.83	0.85	0.77	0.01	-0.02	-0.01	0.02	-0.08
Transfers from other budgets	2.07	2.11	1.95	1.83	1.85	2.01	0.04	-0.16	-0.11	0.01	0.16
Other revenues	0.08	0.07	0.08	0.07	0.07	0.08	-0.01	0.01	-0.01	0.01	0.01

Sources: Federal Treasury, own calculations.

have to a significant extent leveled the disparities. However, retention of the disparities growth rate in the long term perspective will result in the growing of regions' disparities and the need for further centralization of financial resources for further redistribution between regions. This will negatively tell on the financial independence of the subjects and incentives to economic development of the territories.

In 2018, revenues of the consolidated budgets of the RF subjects moved up in all 85 regions. Solely in the Republic of Mary-El and the Republic of Mordovia revenues growth rates turned out to be below the inflation. The highest revenue growth rates in 2018 demonstrated by the Tyumen region (143.5%), the Khanty-Mansi autonomous district (141.7%), the Republic of Khakassia (139.8%), the Republic of Karelia (132.3%), and the Astrakhan region (127.8%).

Expenditures

Expenditures of the consolidated budgets of the RF subjects in 2018 went up somewhat less – 9.9%. Although, expenses significantly exceeded the inflation, they turned out to be insufficient for growth as a percentage of GDP: this ratio decreased from 11.7% in 2017 to 11.47% in 2018 (*Table 2, Fig. 1*).

Table 2

Expenditure of the consolidated budget of the RF subjects

	% of total		% of GDP		Change	
	2017	2018	2017	2018	In nominal terms, %	In p.p. of GDP
General state issues	6.1	6.3	0.71	0.72	14.05	0.01
National security and law enforcement activities	1.1	1.2	0.13	0.13	19.14	0.01
National economy, including:	21.2	20.8	2.48	2.38	7.87	-0.10
Agriculture and fisheries	2.5	2.3	0.29	0.26	1.01	-0.03
Transport	5.2	4.7	0.61	0.54	-0.07	-0.07
Public road system (road funds)	8.8	8.9	1.03	1.02	11.12	-0.01
Other issues in the sphere of national economy	4.7	4.9	0.55	0.56	14.19	0.01
Housing and utility sector	10.4	10.2	1.22	1.17	7.60	-0.05
Environmental conservation	0.3	0.3	0.03	0.04	48.65	0.01
Education, including:	24.9	25.4	2.92	2.91	12.10	-0.01
Pre-school education	6.7	7.1	0.78	0.81	16.53	0.03
общее образование	12.2	12.2	1.43	1.40	10.34	-0.03
Secondary vocational education	1.9	1.9	0.22	0.21	9.35	-0.01
Other issues in education	4.2	4.2	0.49	0.49	11.41	0.00
Culture, cinematography	3.8	3.7	0.45	0.43	7.56	-0.02
Healthcare	7.8	8.0	0.92	0.92	12.22	0.00
Social policy	20.4	20.3	2.40	2.33	9.40	-0.07
Physical fitness and sports	2.3	2.4	0.28	0.27	11.47	0.00
Mass media	0.4	0.4	0.05	0.05	9.12	0.00
Servicing state and municipal debt	1.2	0.9	0.15	0.11	-16.83	-0.04
Expenditure, total	100.0	100.0	11.74	11.47	9.92	-0.27

Sources: Federal Treasury, own calculations.

One can separate the main two reasons for the budget expenditures lagging behind the revenues. Firstly, from the beginning of 2018 through September inclusive the expenditure growth against the same period of 2017 did not lag behind much from the budget revenues growth. A leap in the revenues growth rates occurred precisely in Q4 when regions' revenues increased (against Q4 2017) by 23.4%. Regions had not enough time to spend additional revenues received at the year-end. Moreover, it would have been rational to save additional revenues for the implementation of 2018 presidential May decree.

Secondly, restrictions taken by the Russian Finance Ministry aimed at fostering regional authorities to conduct tight budget policy.

The structure of regional budgets expenditure in comparison with 2017 did not undergo significant changes. One can note reduction by 0.1 p.p. of GDP expenditures on the national economy, of which 0.07 p.p. of GDP — reduction of expenses on the budget line "transport." Among other changes one can mark reduction of spending on servicing state and municipal debt, which share for the first time since 2013 decreased to less than 1% of the total expenditure of the regions' consolidated budgets. Expenses on general education somewhat fell (-0.03 p.p. of GDP). Slight growth was demonstrated by the expenses on "General state issues" (0.01 p.p. of GDP), "National security and law enforcement activities" (0.007 percentage points of GDP), "Environmental conservation" (0.01 p.p. of GDP), and spending on pre-school education (0.03 p.p. of GDP).

Budgets balance and state debt

Revenues growth as well as curbing of expenditures not only allowed regions for the first time over the last 11 years to end the year without deficit but to ensure surplus in the amount of 0.5% of GDP, which is an all-time high for the last 12 years. The number of the RF subject (70) ending the year with the consolidated budget surplus is the maximum since the year 2000 (*Table 3*).

The budget surplus of the majority of regions positively affected the dynamics of their state debt. Its size at year-end 2018 contracted from Rb 2.31 to 2.21 trillion. Against the revenues, it reduced from 30.5 to 25.3%, which is approximately, corresponds the level of 2011.

For the first time since 2006growth rates of the nominal state debt turned out to be below 100% not only in high and average fiscal capacity regions but in low fiscal capacity ones. Their state debt before 2018 solely grew despite tougher legislative restrictive measures regarding many regions of this group (*Fig. 2*).

As a result, ratio of the state debt of low fiscal capacity regions at year-end 2018 hit the minimum since 2013 constituting 49.8%, which significantly reduced their debt burden (*Fig. 3*).

The number of regions with high volume of the state debt has contracted. For 1 January 2019, there were only two RF subjects with the ratio of state debt to budget revenues above 100% – Kostroma region (115.2%) and the Republic of Mordovia (236.9%). At the year-end 2017 there 7 such regions.

Table 3

Number of RF subjects executing consolidated budget with deficit and surplus

	Number of RF subjects executing consolidated budget with	
	deficit	surplus
2000	26	63
2001	42	47
2002	25	64
2003	27	62
2004	46	43
2005	54	33
2006	33	54
2007	36	50
2008	45	39
2009	62	21
2010	63	20
2011	57	26
2012	67	16
2013	77	6
2014	74	11
2015	76	9
2016	56	29
2017	47	38
2018	15	70

Sources: Federal Treasury, own calculations.

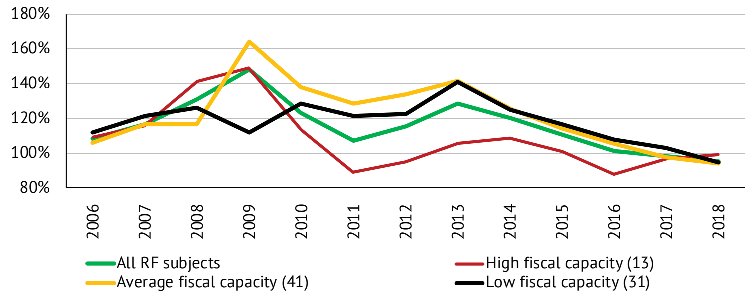

Fig. 2. Growth rate of the state debt of the RF subjects with various level of fiscal capacity

Sources: own calculation on the basis of data released by the RF Finance Ministry and Federal Treasury.

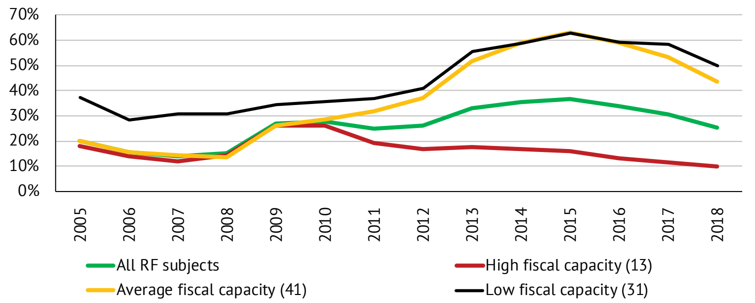

Fig. 3. Dynamics of the debt burden of the RF subjects with different level of fiscal capacity

Source: own calculations based on the data released by the RF Finance Ministry and Federal Treasury.

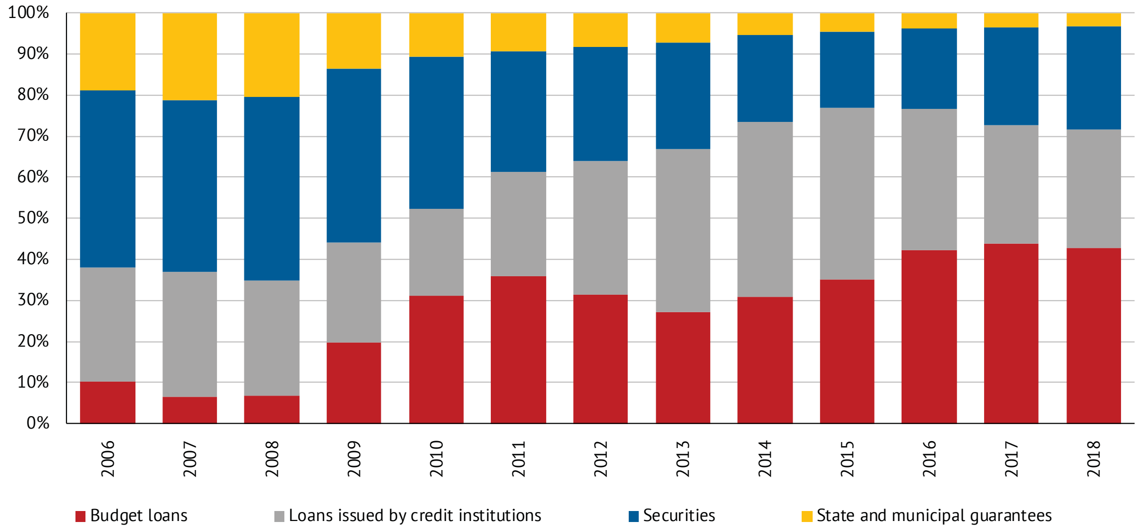

Fig. 4. Structure of state debt of the RF subjects, %

Source: calculated on the data released by the RF Finance Ministry.

The structure of regions' state debt over the year changed insignificantly: budget loans still prevail, which share at the end of 2018 came to 42.6% falling against late 2017 by 1 p.p. (*Fig. 4*). The share of government bonds over the year on the contrary went up by 1.3 p.p. hitting 25.0%. Securities became the sole regions' debt instrument growing in nominal terms over the year. The share of loans issued by credit institutions remained at 28.8%.

On the whole, one can call 2018 the best year for regions' and local budgets over the past decade: high revenues growth rates together with curbing expenditures allowed the majority of regions end the year with a surplus budget. Debt burden and servicing state debt have been significantly reduced. Can one expect the same results at 2019-end? Most likely not and the reason should be looked for in the main sources of the revenue base growth.

Main sources of regions' revenues are profit tax, PIT, and the federal budget transfers, which in 2018 totaled 71.4% of the overall volume of revenues. Growth of the corporate profit tax base was triggered by the oil price increase.

At the end of the first two months of 2019, they remain far from growing but instead are at the level below average seen last year. Lower oil prices will hamper growth of the profit tax base. Regarding the personal income tax, 2018 was the last year which saw wage growth in the public sector due to the implementation of the May 2012 decrees surpassing the wage growth of the average wage in the economy. In 2019, the public sector stops being the driver of the payroll growth in the economy. Upward trend of the interbudgetary transfers allocated from the federal budget will be decreasing in 2019: according to the law of the federal budget, in the current year they will amount to 107.9% against 122.4% seen in 2018.

Thus, after Q1 2019 when receipts from the corporate profit tax will include results of economic performances for 2018 one can expect slowdown of the regions' consolidated budgets revenues growth.

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