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The review provides a detailed analysis of main trends in Russia's economy in 2013. The paper contains 6 big sections that highlight single aspects of Russia's economic development: the socio-political context; the monetary and credit spheres; financial sphere; the real sector; social sphere; institutional challenges. The paper employs a huge mass of statistical data that forms the basis of original computation and numerous charts.

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In order to mitigate the influence of external factors, the federal budget for 2013, and for the period 2014-2015, had initially been formulated on the basis of budgetary rules aimed at decreasing the influence on it of the volatility of prices within the world market for energy resources. The aim was also to improve the accuracy of the long-term forecasting of revenues and expenditures within the budgetary system. However, in planning the main parameters of the federal budget, the possible changes in domestic factors related to social and economic development were underestimated; it was assumed that the key risks affecting the stability of the fiscal system would be created principally by external circumstances, such as the conditions in the world economy and hydrocarbon prices.

In 2013 the main cause of the reduction in budgetary revenues by 1.0% of GDP, as compared with the previous year, was not the decline in market-determined oil prices on the world markets, but the deterioration of the Russian economy<sup>1</sup>. The shortage of non-oil-and-gas revenues to the federal budget were offset by the growth of oil and gas revenues which exceeded the forecasts and helped to keep the federal budget deficit at the low level of 0.5% of GDP (which was lower than the planned level of 0.8% of GDP) but only due to the reduced transfers to the Reserve Fund. With the difference between the actual average annual price for Urals oil in 2013 (\$107.9 per barrel) and the base price used in formulating the budget within the framework of the fiscal rules (\$91 per barrel), the amount of additional oil and gas revenues planned for transfer to the Reserve Fund in 2013 was estimated at Rb 1 trillion. However, based on the results of last year, only Rb 212.2bn of oil and gas revenues will be transferred to the Reserve Fund. Thus, although the actual share of oil and gas revenues within the federal budget did decrease slightly from 51.2% in 2012 to 50.8% in 2013, the considerable, originally planned change in budget structure, towards non-oil-and-gas revenues, did not take place.

It is also important to note that the increasing tension in budget implementation in 2013 exacerbated the problems related to imperfections in the state forecasting system, which, amongst other things, is supposed to ensure the reliability of budgetary revenue predictions. The first signs of a slowdown in the Russian economy appeared already in the second half of 2012, when federal budget tax revenues and the consolidated budgets of the constituent entities of the Russian Federation, in terms of GDP, began to decrease, compared with 2011<sup>2</sup>. However, in autumn 2012 the Russian Ministry of Economic Development presented a forecast of social and economic development for the Russian Federation for 2013, pursuant to which GDP growth in 2013, according to the moderately optimistic scenario of development, was expected at a level of 3.7%. The 'Guidelines for Budgetary Policy for 2013 and the Planning Period of 2014-2015' also predicted an acceleration of growth rates: from 3.8% in 2013 to 4.7% in 2015. In 2013 the Ministry of Economic Development had to review its economic forecasts three times towards a considerable deterioration; and as a result, the expected GDP growth rates declared

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<sup>1</sup> For more information on this topic, see other sections of this work.

<sup>2</sup> See IEP's Monthly Overview "State Budget", August-November 2012.

in December 2013 turned out to be substantially lower than the initial predictions: 1.4% versus 3.7% whilst the initial estimate by Rosstat (Federal State Statistics Service) had been 1.3%.

The manifest tendency towards stagnation of the Russian economy, combined with such factors as the lack of completeness of reforms in the budgetary, housing and utilities sectors, etc. evidences that the next few years may be very difficult in terms of the long term fiscal sustainability of the system.

### Key trends in the development of the budgetary system of the Russian Federation in 2013

In 2013 the revenues of the budget of the enlarged government were Rb 24,082.4bn (36.1% of GDP), with budgetary system expenditure at Rb 24,931.1bn (37.4% of GDP) while the budgetary deficit was Rb 848.7bn (1.3% of GDP). The five-year dynamics of the key parameters of the budget of the enlarged government, in terms of GDP, show a growth of revenues from 35.0% of GDP in 2009 to 37.2% of GDP in 2011, with a subsequent decrease to 37.1% of GDP in 2012 and 36.1% of GDP in 2013 (see *Table 6*). Initially budgetary expenditure in terms of GDP decreased (in 2010-2011) compared with the previous year, this being mainly due to curtailing of the anti-recession programmes, but then it started to grow, by 1 p.p. in 2012 and by 0.7 p.p. in 2013. Thus 2012 marked the beginning of a new trend towards increased government spending whilst revenues were shrinking, ultimately leading to the budgetary surplus being replaced by a deficit.

Table 6

#### Revenues and expenditures of the budgetary system in 2009-2012

	2013		2012		2011		2010		2009		Deviation as p.p. of GDP, 2013 from 2012
	Rb bn	% of GDP	Rb bn	% of GDP	Rb bn	% of GDP	Rb bn	% of GDP	Rb bn	% of GDP	
<b>Federal budget</b>											
Revenue	13,019.9	19.5	12,853.7	20.7	11,366.0	20.3	8,305.4	17.9	7,337.7	18.9	-1.2
Expenditure	13,342.9	20.0	12,890.7	20.7	10,935.2	19.5	10,117.5	21.8	9,660.9	24.9	-0.7
Deficit (-)/ Surplus (+)	-323.0	-0.5	-37.0	-0.06	430.8	0.77	-1,812.1	-3.9	-2,322.3	-6.0	-0.4
<b>Consolidated budget of constituent entities of the Russian Federation</b>											
Revenue	8,164.7	12.2	8,064.3	13.0	7,643.9	13.7	6,537.3	14.5	5,926.6	15.3	-0.8
Including inter-budget transfers	1,576.6	2.3	1,679.6	2.6	1,644.0	2.9	1,398.9	3.1	1,487.4	3.8	-0.3
Expenditure	8,806.7	13.2	8,342.7	13.4	7,679.3	13.7	6,636.9	14.7	6,255.7	16.1	-0.2
Deficit (-)/ Surplus (+)	-642.0	-1.0	-278.4	-0.5	-35.4	-0.06	-99.6	-0.2	-329.0	-0.8	-0.5
<b>Budget of the enlarged government</b>											
Revenue	24,082.4	36.1	23,088.7	37.1	20,853.7	37.2	15,715.9	33.9	13,420.7	34.6	-1.0
Expenditure	24,931.1	37.4	22,825.8	36.7	20,004.8	35.7	17,301.0	37.4	15,847.3	40.8	0.7
Deficit (-)/ Surplus (+)	-848.7	-1.3	262.9	0.4	848.9	1.5	-1,585.1	-3.4	-2,426.7	-6.3	-1.7
<i>For reference: GDP, Rb bn</i>	66,755		62,218		55,967		46,309		38,807		-

Source: Rosstat, Ministry of Finance of the Russian Federation, calculations by IEP.

In 2013, in terms of the levels within the budgetary system, the revenues of the federal budget and of the consolidated budgets of the constituent entities of the Russian Federation decreased by 1.2 and 0.8 p.p of GDP, respectively, compared with the levels of the previous year, while the corresponding expenditure levels decreased by 0.7 and 0.2 p.p. of GDP. Thus, a major reduction of expenditure occurred within the federal budget while revenues decreased

considerably both at the federal and at the regional levels. The result was that the expenditure of the budget of the enlarged government grew from 36.7% to 37.4% of GDP, but this was solely due to expenditure from state non-budgetary funds, primarily, the Pension Fund.

The situation with the cash performance of the federal budget and consolidated budgets of the constituent entities in respect of expenditure remained practically unchanged in 2013, compared with the previous year: the federal budget performance in respect of expenditure was 99.1% (in 2012 it was 98.9%), while the consolidated budget of the constituent entities of the Russian Federation achieved 91.2% (in 2012 it was 90.8%) of the approved annual volumes.

In 2013 the budget deficit of the enlarged government was Rb 848.7bn, being 1.3% of GDP, which was Rb 585.8bn (or 1.7 p.p. of GDP) higher than the 2012 level. However, the deficit had increased both at the federal level (from 0.06 to 0.5% of GDP) and at the level of the constituent entities of the Russian Federation (from 0.5 to 1.0% of GDP). As a result, despite the fact that the deficit in the budgets was still quite a long way from being critical, at the regional level it had already reached a substantial value, based on the results of 2013, and this reflected the tension with the performance of the consolidated budgets of the constituent entities of the Russian Federation.

As of 1 January 2014 the volume of the Reserve Fund was Rb 2,859.7bn (4.3% of GDP) and the volume of the National Wealth Fund was Rb 2,900.6bn (4.3% of GDP). In 2013 the oil and gas revenues contributed to the Reserve Fund amounted to Rb 713.5bn. The exchange differences on revaluation of the funds in the accounts with the Bank Russia for January-December 2013 were Rb 260.5bn for the Reserve Fund, and Rb 216.0bn for the National Wealth Fund. In December 2013, based on a separate resolution of the Government of the RF, \$3.0bn of the National Wealth Fund was placed in the debt obligations of Ukraine, without requiring a long-term credit rating of the issuer.

In 2013 attempts were made to change the approaches to the management and use of sovereign funds, in particular, in respect of investing them in long-term projects. Before 2012 the practice of the accumulation of funds placed in debt obligations in the form of securities issued by foreign governments, or foreign government agencies and central banks, had been maintained in order to create a “safety cushion” for the Russian economy, the social sphere and the entire financial system (Reserve Fund) and to provide co-financing of individuals’ voluntary pension savings thereby ensuring the balance (deficit coverage) of the budget of the Pension Fund (National Wealth Fund). After the end of 2012 proposals were put forward to change the policy of saving in sovereign funds, and areas for the use of the relevant funds were announced. Initially it was expected that Rb 450bn would be used to finance 3 major investment projects: the modernisation and expansion of the Baikal-Amur Mainline and Trans-Siberian railway, the development of high speed rail lines between Moscow and Kazan and the construction of highways in the Moscow region. In the second half of 2013 other proposals for investing these funds started to be discussed, including the realisation of infrastructure projects using the Russian Direct Investment Fund (for the implementation of energy efficiency and information technology, the construction of sea ports, roads and pipelines and the development of the Moscow air hub). However, none of the projects discussed at meetings of the Russian President or in Government has obtained any funding from the National Wealth Fund. In many respects this situation reflects the fact that the efficacy of investing funds in the proposed projects is still highly questionable. It is also important to understand that, with the further slowdown of Russian economic growth and the uncertain prospects of replenishing the revenue part of the federal budget, it is hardly appropriate to use sovereign funds to initiate large-scale investment

projects, which, would then, perhaps, have to be frozen in the case of a sharp deterioration of the situation for replenishing the budget.