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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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### Analysis of the main parameters of the federal budget of the RF in 2009-2013 and for the period 2014-2016

The main parameters of the federal budget for 2014-2016 compared with the corresponding data for 2008-2013 are presented in *Table 15*. For 2014-2016, reductions in both federal revenue and expenditure in terms of GDP are predicted. Revenues will continue the trend in line with the reduction that has been observed since 2013. Revenues of the federal budget decreased from 20.7% of GDP in 2012, to 19.5% of GDP in 2013, with further decreases being forecast: to 18.5% of GDP in 2014 and to 18.3% of GDP in 2015-2016. Expenditure, which has decreased from 20.7 to 20.0% of GDP in 2013, will continue decreasing to 19.0% in 2014, should then grow a little in 2015 to 19.3% but decrease again to 18.9% in 2016. It is planned that the deficit for 2014 will remain at the 2013 level of 0.5% of GDP, with a subsequent increase to 1.0% in 2015 followed by a decrease to 0.6% in 2016.

It is important to note that a considerable change in the structure of the revenues of the federal budget is planned due to a substantial reduction in oil and gas revenues from 9.9% of GDP in 2013 to 7.9% of GDP in 2016, which will result in a decrease in their share from 50.8% in 2013 to 43.2% in 2016. At the same time, non-oil and gas revenues are expected to grow from 9.6% of GDP in 2013 to 10.4% in 2016. It is important to note that the observed reductions in non-oil and gas revenues from 10.1% of GDP in 2012 to 9.6% in 2013, and, in particular, the decrease in VAT receipts, arouses doubts that the above forecast for growth in non-oil and gas revenues to the federal budget will actually take place.

Table 15

#### Actual and expected performance of revenues and expenditures of the federal budget for 2008-2016 (% of GDP)

	Actual performance						Federal Law on the Federal Budget for 2014-2016			Deviation of 2016 from 2013, p.p. of GDP
	2008	2009	2010	2008	2009	2010	2008	2009	2010	
Revenues Including:	22.5	18.9	17.9	20.3	20.7	19.5	18.5	18.3	18.3	-1.2
oil and gas revenues	10.8	7.8	8.3	10.2	10.6	9.9	8.9	8.6	7.9	-2.0
non-oil and gas revenues	11.6	11.1	9.7	10.1	10.1	9.6	9.6	9.7	10.4	0.8
Expenditure	18.3	24.8	21.8	19.5	20.7	20.0	19.0	19.3	18.9	-1.1
Including nominally approved	0	0	0	0	0	0	0	0.5	0.9	0.9
Deficit (-)/ surplus (+)	4.1	-6.0	-3.9	0.8	-0.06	-0.5	-0.5	-1.0	-0.6	-0.1
Non-oil and gas deficit	-6.7	-13.7	-12.2	-9.5	-10.6	-10.1	-9.4	-9.6	-8.4	1.7
GDP, Rb bn	41,276	38,809	46,308	55,967	62,218	66,755	73,315	79,660	86,837	-

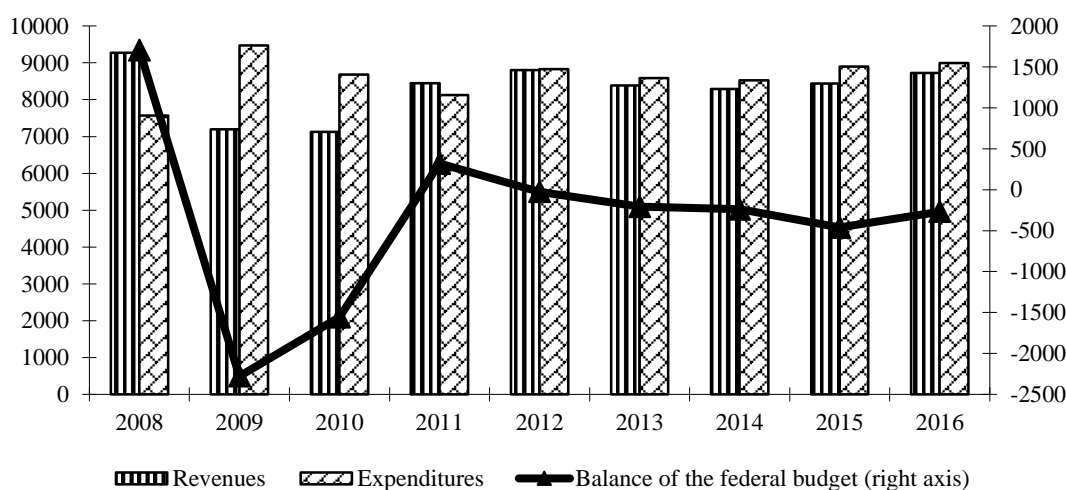
Source: Ministry of Finance of the Russian Federation, calculations by IEP.

Thus, for 2014-2016 a reduction is planned in the dependency of revenues to the federal budget on the foreign economic environment, mainly on the situation in the global oil market.

The major part of the reduction in the volumes of oil and gas revenue is accounted for by the reduction in export customs duties, the decrease in which is associated not only with changing macroeconomic indicators (export volumes, USD to ruble exchange rates, etc.) but also, to a large extent, with changes in customs legislation<sup>1</sup>.

Additional oil and gas revenues<sup>2</sup>, which could be received if the actual global oil price exceeded its base value, are estimated by the Ministry of Finance at: Rb 615.6bn, in 2014, Rb 384.9bn in 2015, and Rb 381.9bn in 2016. In 2014 a part of the additional oil and gas revenue is expected to be allocated to the Reserve Fund in the amount of Rb 343.5bn whilst the remaining amount of Rb 272.1bn will be used to increase the expenditure part of the federal budget to a maximum volume of Rb 13,869.1bn in accordance with clauses 3-6 of Article 199 of the Budgetary Code of the RF. In 2015 all additional oil and gas revenues will be allocated to the budget and in 2016, to the Reserve Fund.

At 2008 prices, revenues to the federal budget in 2014-2016 are comparable with the revenues of 2013 and are lower than revenues in 2008. Expenditures within the budget in 2014-2016 are comparable with the expenditure of 2013, and lower than the 2009 level but considerably higher than the pre-crisis values of 2008 (see *Fig. 19*).



Source: Russian Ministry of Finance, calculations by IEP.

*Fig. 19.* Dynamics of revenues, expenditures and deficits of the federal budget, Rb bn, at 2008 prices

It should be noted that in the formulation of the key parameters of the federal budget for 2014-2016 the macroeconomic indicators used for the calculation of the key parameters of the budgetary system were reduced, compared with the indicators in Federal Law No.216-FZ ‘On the Federal Budget for 2013-2015’ and formerly used in the ‘Guidelines for the Budgetary Policy for 2014-2016’ (published on the website of the Ministry of Finance in July 2013). For

<sup>1</sup> Decrease in the maximum oil export customs duty rate from 60 to 59% in 2014, to 57% in 2015, and to 55% in 2016. Decrease in the maximum export customs duty rate for “light” petroleum products from 66 to 65% of the oil duty rate in 2014, to 63% in 2015, and to 61% in 2016.

<sup>2</sup> “Additional” within the framework of the budgetary rules effective from 2013.

example, Federal Law No.216-FZ forecast GDP growth at 4.3-4.5% in 2014-2015 while the ‘Guidelines for the Budgetary Policy for 2014-2016’ forecast it at 3.7-4.1% and the new budgetary projections are based on GDP growth estimates of only 3.0 and 3.1%, respectively. However, taking into account the increasing problems in the Russian economy and with GDP growth of only 1.3%, based on the results for 2013, even the relatively low figures of the adjusted forecast seem very optimistic, so this raises questions regarding the execution of the federal budget revenue plan as early as 2014 (especially, with respect to non-oil and gas revenues).

In 2014-2016 some changes are planned in the structure of expenditure of the federal budget (*Table 16*).

*Table 16*

**Expenditures of the federal budget in 2013-2016 (% of GDP)**

	2013	2014	2015	2016	Changes between 2016 to 2013
<b>Total</b>	<b>20.0</b>	<b>19.0</b>	<b>19.3</b>	<b>18.9</b>	<b>-1.1</b>
<i>Nominally approved</i>	<i>0.0</i>	<i>0.0</i>	<i>0.5</i>	<i>0.9</i>	<i>0.9</i>
<b>Total (excluding nominally approved)</b>	<b>20.0</b>	<b>19.0</b>	<b>18.8</b>	<b>17.9</b>	<b>-2.1</b>
<i>Including:</i>					
General national issues	1.3	1.4	1.3	1.2	-0.1
National defence	3.2	3.4	3.8	3.9	0.7
National security and law enforcement activities	3.1	2.8	2.6	2.4	-0.7
National economy	2.8	3.1	2.7	2.3	-0.5
Housing and public utility sector	0.3	0.2	0.1	0.1	-0.2
Environment protection	0.0	0.0	0.0	0.0	0.0
Education	1.0	0.8	0.8	0.7	-0.3
Culture, cinematography	0.1	0.1	0.1	0.1	0.0
Healthcare and sports	0.8	0.6	0.5	0.5	-0.3
Social policy	5.7	4.8	5.1	5.0	-0.7
Physical culture and sports	0.1	0.1	0.1	0.1	0.0
The media	0.1	0.1	0.1	0.1	0.0
Servicing of state and municipal debt	0.5	0.6	0.6	0.7	0.2
General inter-budget transfers	1.0	0.9	0.9	0.8	-0.2

*Source:* Russian Ministry of Finance, calculations by IEP.

As can be seen from *Table 16*, with a general reduction of expenditure in terms of GDP, it is planned to increase expenditure on national defence from 3.2 to 3.9% of GDP and expenditure on servicing state and municipal debt from 0.5 to 0.7% of GDP. The increase of expenditure on defence should result in a growth in the share of this expenditure in the total amount (excluding nominally approved expenditure) from 15.8% in 2013 to 21.8% in 2016. At the same time, the greatest reduction, in terms of GDP, is planned for the sections “National security and law enforcement activities” (–0.7 p.p. of GDP), “Social policy” (–0.7 p.p.), “National economy” (–0.5 p.p.), “Education” (–0.5 p.p.) and “Healthcare” (–0.5 p.p.). From the perspective of the above-mentioned concept of “productive” and “non-productive” expenditures, the reduction in expenditure on law enforcement activities deserves a positive evaluation whilst the increase in expenditure on defence and the reductions in education and healthcare funding deserve a negative one.

In general, one can see that the budgetary projections do not correspond to the “budgetary manoeuvre” proposed by the IEP experts<sup>1</sup> within the framework of the entire budgetary system

<sup>1</sup> For more information see: G. Idrisov, S. Sinelnikov-Murylev. ‘Budgetary Policy and Economic Growth’//Voprosi ekonomiki, 2013, No.8; G. Idrisov, S. Sinelnikov-Murylev. ‘Creation of the Prerequisites for Long-Term Growth: How We Should Understand Them?’//Voprosi ekonomiki, 2014, No.3.

(with the important caveat, that in this section, only those expenditures of the federal budget have been analysed). The “budgetary manoeuvre” should be conducted within 3-5 years, which would mean an increase in productive expenditures of the budget of the enlarged government by 3 p.p. These additional expenditures would be allocated to increase the quality of the business and investment climate in the country, to improve the human potential and to create a modern transport and engineering infrastructure. At the same time, “non-productive” expenditures should be reduced by 3 p.p. of GDP. It is feasible to increase the expenditure of the budget of the enlarged government on education by 1.2 p.p. of GDP, on healthcare by 1.0 p.p., and on the public road system by 0.8 p.p. of GDP. At the same time, it is necessary to decrease expenditure on law enforcement activities by 0.9 p.p. of GDP, on defence by 1.1 p.p., on the national economy and on housing and public utilities (excluding the public road system) by 1.0 p.p. of GDP<sup>1</sup>.

In accordance with amendments made to the budgetary legislation, the federal budget for 2014-2016 is presented in a programme cost structure that previously had only an “analytical” status (*Table 17*). State programmes are grouped in 5 major directions: “New quality of life” (12 programmes), “Innovation development and modernisation of the economy” (17 programmes), “National security” (1 programme), “Balanced regional development” (5 programmes), “Effective state” (4 programmes).

*Table 17*

**Federal Budget allocations<sup>2</sup> in 2013-2016, allocated for the implementation of state programmes, Rb bn**

	2013 (Law No.216- FZ)*	2014			2015			2016		
		Passport**	Draft Federal Law on Federal Budget	Deviation	Passport**	Draft Federal Law on Federal Budget	Deviation	Passport**	Draft Federal Law on Federal Budget	Deviation
1	2	3	4	5=4-3	6	7	8=7-6	9	10	11=10-9
1	2	3	4	5	6	7	8	9	10	11
<b>Total federal budget expenditure</b>	13,387.3		13,960.1			14,977.5			15,572.6	
Out of which:										
<b>Total expenditure on implementation of state programmes of the RF</b>	7,733.2	7,633.9	8,161.1	527.2	7,723.6	8,422.6	698.9	8,138.5	8547.9	409.4
Share in the total amount, %	57.8		58.5			56.2			54.9	
Including in the areas:										
I. New quality of life (12 programmes)	3,349.9	3,230.0	3,408.2	178.2	3,196.5	3,410.2	213.7	3,276.5	3,422.5	145.9
II. Innovation development and modernisation of the economy (17 programmes), excluding a closed part	1,872.0	1,896.7	2,034.4	137.7	1,881.3	2,085.8	204.6	1,923.6	2,057.0	133.4

<sup>1</sup> Quantitative parameters are calculated on the basis of the structure of expenditure within the budget of the enlarged government in 2012.

<sup>2</sup> Open part.

1	2	3	4	5	6	7	8	9	10	11
III. National security (1 programme), excluding closed part	9.1	7.6	2.3	-5.3	5.7	1.5	-4.2	1.6	1.5	-0.1
IV. Balanced regional development (5 programmes)	678.1	627.8	740.2	112.3	604.4	778.6	174.2	761.4	787.1	25.7
V. Effective state (4 programmes)	1,084.3	1,137.4	1,115.1	-22.3	1,198.6	1,193.8	-4.8	1,205.8	1,239.7	33.8
Expenditure on implementation of state programmes of the RF (closed part)	739.7	734.4	861.0	126.6	837.2	952.7	115.5	969.6	1,040.2	70.6
<b>Expenditure on non-programme activities</b>	<b>5,654.1</b>		<b>5,799.0</b>			<b>6,555.0</b>			<b>7,024.7</b>	
Share in the total amount, %	42.2		41.5			43.8			45.1	
Including:										
Financial support of development of the pension system	2,850.3		2,307.4			2,776.0			3,058.3	
Closed expenditure, including ensuring the country's defence capability	2,242.4		2,556.8			3,028.7			3,310.9	
Other non-programme expenditure	561.4		934.8			750.3			655.6	

\* Analytical distribution in accordance with Federal Law dated 3 December 2012 No.216-FZ (in original revision).

\*\* In accordance with the basic option (without taking into account proposals for additional budgetary allocations)

Source: Ministry of Finance of Russia, calculations by IEP.

Considering the issues of formulating the federal budget for 2014-2016 in accordance with the programme principles, the following should be noted. Firstly, no state programmes have been adopted on such important and large expenditure items as defence and the pension system. As a result, in 2014 the share of programme expenditure is at 58.5% and its share is even planned to decrease to 54.9% by 2016 (if relevant state programmes are not adopted). Secondly, as seen from the data presented in *Table 17*, the parameters of the federal budget for 2014-2016 differ substantially from the corresponding ones envisaged by the passports of the state programmes. As a result, a situation is shaping where the budget is not being adopted on the basis of state programmes, but the passports of the state programmes have to be adjusted in accordance with the adopted law on the budget. As a result of all of the above, an unambiguous conclusion can be drawn: state programmes have not yet become a real tool for the formation of budgetary policy, and the distribution of funds amongst the state programmes still has a rather “analytical” nature.

When considering the other programme-target instruments of budgetary policy one can note that, out of total expenditure, the shares of federal budget expenditure allocated for implementing federal target programmes are to be reduced from 7.5% in 2013 to 6.8% in 2014-2015 and to 5.9% by 2016. In 2014 both the number of federal target programmes and the volumes of their budgetary funding will be reduced compared with the previous year: from 49 to 46 programmes and from Rb 1,009.9bn to Rb 956.5bn, respectively. Furthermore, from 2014, new programmes which have previously been implemented were accepted for funding, these include: “Scientific and Scientific-Pedagogical Human Resources of Innovative Russia in

2014-2020”, “Research and Development in Priority Areas of the Scientific and Technological Complex of Russia for 2014-2020”, “Sustainable Rural Development in 2014-2017 and in the period until 2020”, together with a number of other programmes<sup>1</sup>. At the same time, the largest volume of funding in 2014-2016 is to be allocated for the implementation of programmes for the development of transport infrastructure and high technology: 39.9 and 29.8% of the total funding for federal target programmes. The volume of investment expenditure in the form of capital investments funded within the framework of the Federal Address Target Programme is Rb 2,419.7bn in 2014-2016, peaking in 2015 at Rb 868.7bn.

According to an estimate by the Ministry of Finance: at the end of 2016, the volume of the Reserve Fund will be Rb 3,710.2bn, or 4.3% of GDP, which is Rb 850.5bn, or 0.1 p.p. of GDP higher than the 2013 figure. The volume of the National Wealth Fund will be Rb 2,990.4bn, or 3.4% of GDP, which is Rb 90.2bn higher than the 2013 level, and by the end of 2016, the volume of the National Wealth Fund will be reduced by 1.0 p.p. of GDP, compared with the 2013 level.

Taking into account the 2014-2016 forecasts for reductions in the growth rates of such indicators as the volume of industrial production, the real disposable income of the population and the possible reduction of import volumes, it can be admitted that the decrease in federal expenditure in terms of GDP for 2014-2016 is a justified measure from the point of view of ensuring the financial stability of the country’s budgetary system. However, the structure of expenditure should be adjusted towards an increase in the “productive” and a decrease in the “non-productive” areas.

## Prospects for the fiscal policy in 2014-2016

*1. Budgetary rules and government expenditure policy.* Due to the increasing uncertainty in the world, both geopolitical and financial, together with possible changes in key trends of social and economic development in Russia, it is impractical to revise the budgetary rules in the medium term. It is necessary to continue to restrict the deficit of the federal budget at the level of 1% of GDP and to calculate budgetary revenues based on average annual oil prices. Given the lack of sources of revenue we need to define more clearly the public spending priorities in the light of the concept of “productive/non-productive expenditures” and the above-mentioned “budgetary manoeuvre”.

*2. New public procurement procedures for goods and services.* On 1 January 2014 Federal Law dated 5 April 2013 No.44-FZ ‘On the Contractual System in the Field of Public Procurement of Goods, Works and Services for State and Municipal Needs’ became effective (Federal Contractual System — FCS). The transitional period for certain provisions will stretch as far as 2017. For example, chapter 2 (‘Planning’) will become effective only in 2015. This is, perhaps, the only principal innovation of the FCS compared with the former Federal Law No.94-FZ which the expert community will adopt without major controversies. Law No.94-FZ concerned only the stage of state procurement. Hence, the former purchasing legislation focused on combating the type of corruption which was manifested in overpricing a particular group of goods, works or services. However, this approach does not consider the situation of ineffective (unjustified) expenses where the economic feasibility of the choice (ahead of placement of an order) of object being procured, itself, raises doubts. Many stories about the manner in which

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<sup>1</sup> “Development of agricultural lands in Russia in 2014-2020”, “South of Russia (2014-2020)”, “Development of a unified state system for registration of rights and cadastral accounting for real estate (2014-2019)”.



purchases of executive-class cars or other “luxury articles” have been conducted, can serve as examples of the above situation. Measures which could potentially promote the efficiency of budgetary spending at the planning stage include the introduction of limitations on needs (relevant regulation has not been adopted yet), an almost complete prohibition on purchasing outside of the schedule (the customer places an order with goszakupki.gov.ru), public discussion of purchases (this requirement was optional until the FCS came into force in 2014 when it became obligatory for purchases of Rb 1bn and more), substantiation of the choice of the initial maximum price (the Ministry of Economic Development has developed relevant recommendations) and the type of procurement procedure (Law No.94-FZ did not specify any such constraints whatsoever).

However, in 2014 the FCS is already providing more freedom to customers at the stage of order placement (chapter 3 of the FCS). This is expressed in the extension of the list of purchasing procedures (two-stage tendering, tenders with prequalification, and invitations to tender, were introduced) and in the appearance of a new limit on the cost of ownership as a criterion for bid selection (for the creation of infrastructure objects). Such empowering of the customer, on the one hand, reduces the risk that the tender is won through unfair performance of the state contract procedure but, on the other hand, increases the risk of corruption. However, the expansion of the list of purchasing procedures concerns only a small circle of purchasing objects (*Table 18*).

The lists of goods, works and services which must be placed through an electronic auction and may be purchased from a single supplier have remained almost unchanged (with the exception of the withdrawal of invitations to tender and the inclusion of the purchase and leasing of real estate). The lists for new purchasing procedures appear to correspond with the ideas envisaged when they were introduced. For example, the list of purchases through an invitation to tender is actually a withdrawal of a small part of the grounds for purchasing from a single supplier which were included in Federal Law No.94-FZ. A final aspect worth noting is the potential for criticism of the inclusion of the provision of food services in public institutions into the list where the use of a tender with prequalification (also known as a tender with limited participation) is permissible.

*Table 18*

**New purchasing procedures (Federal Law No.44-FZ)**

<b>Purchasing procedure</b>	<b>Scope</b>	<b>List of goods, works, services</b>
Two-stage tender	Where it is necessary to find out the features of the purchasing object which are the best fit for the relevant need	Creation of culture and art objects Conduct of research and development works
Tender with prequalification	Where improper performance may endanger the life and health of individuals Or where damage can be caused to the property, resulting in irreparable loss of important features of the object	Creation of expensive infrastructure The creation of, and work with, nomenclature related to the atomic industry and energy sector Provision of food services in public sector institutions Preservation of cultural heritage
Invitation to tender	Where criteria which are not included in the list of acceptable criteria may be significant	Sports gear and equipment, sports outfits, necessary for the preparation of sports teams of the Russian Federation for Olympic and Paralympic sports Medical treatment of a Russian citizen abroad Medications for a particular patient Craftwork items Services of professionals in legal proceedings abroad