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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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Challenges of Russian economic growth: reconstruction or acceleration?

In 2013 the Russian economy entered a new phase of socio-economic development. The period of tempestuous development, during which the primary trends and objectives had been those of recovery and which had lasted almost twelve years (1999–2012), had come to an end. The crisis of 2009 did not end in a replacement of this growth model; on the contrary it perpetuated its existence, given the need for a return to pre-crisis levels of output. The need for a new model became one of practical necessity, since rates of economic growth fell to a level that was unprecedented, a deceleration that could not be attributed exclusively, or even predominantly, to external factors. Corresponding conclusion was politically executed in the President's Address of 12 December 2013.

The internal factors at work within the Russian economy have to be examined in the context of the continuing global economic crisis. This crisis provides not only the economic but also the socio-economic background to Russian economic development and in particular circumstances it can be a significant factor in the adoption of internal political decisions.

We shall begin with an analysis of the current phase of the global crisis (Section1.1.1). Then, in Section 1.1.2 we shall provide a brief account of the key socio-economic achievements in Russia by 2014. In Section 1.1.3 we shall deal with the reasons for the deceleration of economic growth and on this basis we shall consider in Section 1.1.4 the risks surrounding economic policy. The concluding Section 5 describes institutional priorities that will be needed in socio-economic policy if a new growth model is to emerge.

The global economic crisis

Defining somewhat schematically the problem that we encountered this year we could say that at a time when the leading world economies were beginning to emerge from the crisis, Russia began, perceptibly, to descend into it. Of course, the contrast was not so clear-cut: the crisis in the West remains severe and the effects of anti-crisis measures will continue to be felt for a long time. The macroeconomic situation continues to be complicated. Nor can one discount the slow down of growth in China, with all of the consequences that this entails for the world economy. (*Table 1*)

The developed world has once again demonstrated its stability and strategic effectiveness. The locomotive force for exiting the crisis has once again been provided by the USA, and the economic stability of Germany has been crucial in enabling the European economies to overcome the crisis. A significant role in the American case has been played by cheap energy; limits, during the years of the crisis, on the level of wages; and a relative depreciation of the dollar. These factors combined to ensure a recovery of economic growth. Growth in the American economy, though it was to a greater degree domestic than before the crisis (the current-account deficit fell to below 2.2% of GDP), stimulated a growth in demand for goods throughout the entire world. Presumptions that, this time round, the growth of emerging markets would make an important contribution to bringing the crisis to an end were not confirmed. Of course, the high growth rates of the Chinese economy played an important part in damping down the risks of global recession.

Table 1

Growth rates for selected countries and groups of countries 2005-2013 (% of previous year)

	2005	2006	2007	2008	2009	2010	2011	2012	2013
World	4.7	5.2	5.3	2.7	–0.4	5.2	3.9	3.2	2.9
Developed countries	2.8	3.0	2.7	0.1	–3.4	3.0	1.7	1.5	1.2
Major developed countries (G7)	2.5	2.6	2.2	–0.3	–3.8	2.8	1.6	1.7	1.2
European Union	2.4	3.6	3.4	0.6	–4.4	2.0	1.7	–0.3	0.0
Canada	3.2	2.6	2.0	1.2	–2.7	3.4	2.5	1.7	1.6
France	1.8	2.5	2.3	–0.1	–3.1	1.7	2.0	0.0	0.2
Germany	0.8	3.9	3.4	0.8	–5.1	3.9	3.4	0.9	0.5
Italy	0.9	2.2	1.7	–1.2	–5.5	1.7	0.4	–2.4	–1.8
Japan	1.3	1.7	2.2	–1.0	–5.5	4.7	–0.6	2.0	2.0
Great Britain	3.2	2.8	3.4	–0.8	–5.2	1.7	1.1	0.2	1.4
USA	3.4	2.7	1.8	–0.3	–2.8	2.5	1.8	2.8	1.6
Portugal	0.8	1.4	2.4	0.0	–2.9	1.9	–1.3	–3.2	–1.8
Ireland	6.1	5.5	5.0	–2.2	–6.4	–1.1	2.2	0.2	0.6
Spain	3.6	4.1	3.5	0.9	–3.8	–0.2	0.1	–1.6	–1.3
Greece	2.3	5.5	3.5	–0.2	–3.1	–4.9	–7.1	–6.4	–4.2
Brazil	3.2	4.0	6.1	5.2	–0.3	7.5	2.7	0.9	2.5
China	11.3	12.7	14.2	9.6	9.2	10.4	9.3	7.7	7.6
India	9.3	9.3	9.8	3.9	8.5	10.5	6.3	3.2	3.8
Russia	6.4	8.2	8.5	5.2	–7.8	4.5	4.3	3.4	1.3
South Africa	5.3	5.6	5.5	3.6	–1.5	3.1	3.5	2.5	2.0

Source: IMF.

The financial markets of the developed countries experienced a revival amounting to 15-30% over the year (the growth of S&P reached 30%, a level that had not been attained for almost 20 years). Macroeconomic indicators in these countries improved. Most notably, there was a reduction in budget deficits. There was a fall in unemployment, albeit with a delay relative to the recovery of GDP, a circumstance that, in our opinion, reflects the structural modernization of the developed economies.

It is true that this positive dynamic took place in the context of an unprecedentedly soft monetary policy introduced by the central banks of the leading countries, primarily the USA and Japan. Amongst economists there are great doubts as to the feasibility of returning in the foreseeable future to the high growth rates of the last two decades. These doubts apply to the developed world as much as to developing markets[1]. A debate continues over the "new normal" - a post-crisis growth model typified by lower growth rates than those that were experienced during the period 1990-2000.

[1] Laurence Summers has expressed doubts as to the feasibility of achieving sustainable growth in the USA in the foreseeable future and in this connection has warned against drastic measures by the Federal Reserve System to stimulate growth. See Summers Laurence. 2013. Why stagnation might prove to be the new normal // Financial Times. 2013. December 15; Summers Laurence. 2014. Washington must not settle for secular stagnation // Financial Times. 2014. January 5). In parallel, there have been discussions as to whether the high growth rates of the developing economies during the last twenty years were anomalous, such that there will now be a correction to the levels typical for the 1970s-1980s. (Aslund Anders. 2013. Why Growth in Emerging Economies Is Likely to Fall. Washington D.C.: Peterson Institute for International Economics. Working Paper 13-10. 2013, September)

From this point of view, a key problem in 2014 will be the effect upon economic development of a tightening of monetary policy, a change that seems unavoidable in the immediate future. There is a more general problem: what are the medium-term macroeconomic prospects of the leading world economies, given the unprecedented growth in the balances that have been accumulated by their central banks during the last few years? This question is of interest not only from a theoretical point of view, but also in terms of current economic policy. Here, the contribution of the USA to the trends that will emerge during 2014-2015 can once again be decisive – if the ending of the stimulation programs of the Federal Reserve System has the effect of slowing down the growth of the American economy and increases the cost of capital throughout the world.

Another problem is of a long-term nature and has to do with the outlook for globalization. Despite the recovery of GDP and the overcoming of acute financial crisis, the movement of capital across frontiers has slowed down significantly. Whereas in 2007 financial flows between the economies of the G-20 amounted to 18% of GDP, this indicator now stands at under 4.5% and in the world economy as a whole it has fallen by 60%[1]. Of course, some economists might see in this a strengthening of the stability of the world economy, and an expression of the well-known dichotomy "stability that fends of the crisis or growth that precipitates the crisis". In our opinion, the cost of this stability could be a long-term deceleration of economic development.

Gradually, the contours of the post-crisis world system are becoming clear. These reflect new geo-economic and geo-political balances of power, new technological priorities, and changing prospects for world currencies, state regulation and economic doctrines. We do not yet have a full picture, but some features are already apparent. Let us list a number of the trends that will assert themselves in the foreseeable future.

- There are new trends in the regional distribution of production throughout the world. The importance of industry in the developed world has increased, in some cases amounting to a "re-industrialization". However, even if this re-industrialization becomes established in the long-term it would be incorrect to interpret it in term of traditional branches of industry returning from developing to developed countries. Rather, we are witnessing the formation of new branches of industry, one characteristic of which is a relative reduction of the share of labor in productions costs and an increase in the importance of such factors as proximity of the research base (resulting from an increase in the share of research and development (NIOKR or R&D)) and of basic consumer demand. An important consideration is the increased cost of labor in the leading developing countries, particularly those of South-East Asia.
- A lowering of energy prices, associated both with the introduction of new technologies for the extraction of non-traditional forms of gas and oil, and with a significant expansion the infrastructure for delivery. As a result, there has been an unexpected revolution in the field of energy prices, to the point where, during the last year, there was discussion not so much of the possible scale of price increases as of a possible price stagnation or fall in prices (to be more precise, whether a fall in real prices would be accompanied by a decline in nominal prices). Naturally, this revolution in the energy market is also becoming a factor in the process of re-industrialization.

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[1] Lund Susan, Daruvala Toos, Dobbs Richard, et al. 2013. Financial Globalization: Retreat or Reset. Global Capital Market 2013. McKinsey Global Institute, 2013; Atkins Ralph, Fray Keith. 2014. Rapid fall in capital flows poses growth risk // Financial Tomes. 2014. January 6.

- The situation in world currency markets is becoming clearer. On the one hand the dollar and the Euro have retained their key role as world reserve currencies. It has become clear that of these two the dollar will predominate, given that the American economy once again been at the forefront in overcoming the world economic crisis. At the same time, notwithstanding serious challenges and risks, the Euro consolidated its international role, albeit in second place to the dollar. The Yuan has not yet become a reserve currency and is unlikely to acquire this status until the Chinese economy and Chinese society have undergone liberalization and are able to demonstrate the political stability that will result from this. For the time being, it remains unclear whether the role of regional reserve currencies can be increased – this will depend upon the stability of the regional economic alliances that are currently forming.
- In the past, the resolution of world economic crisis gave rise to the formation of new models of economic management – with the sharp increase in dirigisme in the mid-twentieth century (after the 1930s) and the liberalization of state regulation at the end of the twentieth century (after the crisis of the 1970s). At the beginning of the recent crisis there was some talk of returning to the "big state", but this has not come about. At the same time, some increase in state regulation of the economy is to be expected. In all probability, this will take the form not of direct intervention or of an increase in the share of state-owned property, as during the Great Depression, but in closer regulation of financial markets at national and international levels. This is especially the case with the banks, which are now more strictly regulated in respect of capital requirements and of the kind of transactions they are allowed to engage in.
- The world economic crises of the twentieth century resulted in the formation of a new, dominant, economic philosophy. Although the present crisis has provided a significant amount of data for economic research, there are as yet no grounds for concluding that a new economic philosophy has materialized.

Russian socio-economic performance in 2013

In formal, macroeconomic terms, the situation in Russia seems to be stable (see *Table 2*). The economy is growing, albeit at a decelerating rate; there is a policy of balancing the budget; there is a low level of government debt; employment is high and inflation is under control. However the outlook for development gives grounds for concern.

Two sets of circumstances account for the important change comparing with Russian economic developed in previous twelve years.

The first is an abrupt deceleration of economic growth which in year 2013 fell below the world average (1.3% of GDP compared with 3%). This is unprecedented in the last 12 years, if one excludes 2009. However, in that year, the steep decline resulted from an external shock, had a catastrophic impact and was rapidly contained thanks to fairly effective measures adopted by the government.

Now the situation is different. The world economy is emerging from the crisis. Of course, in some countries of the BRICS group growth is also slowing down, but this framework for comparison is not valid politically or economically. Economic growth was the key issue in discussions of economic policy during 2013 and we shall now consider this question in more detail below.

Table 2

Basic macro-economic indicators of Russian development 2007-2013

	2007	2008	2009	2010	2011	2012	2013
GDP % relative to corresponding period in preceding year	8.5	5.2	–7.8	4.5	4.3	3.4	1.3
Industry % relative to corresponding period in preceding year	6.8	0.6	–9.3	8.2	4.7	2.6	0.4
Agriculture % relative to corresponding period in preceding year	3.3	10.8	1.4	–11.3	23.0	–4.8	6.2
Final household consumption % relative to corresponding period in preceding year	14.3	10.6	–5.1	5.5	6.8	7.9	3.4
Investments in basic capital, % relative to corresponding period in preceding year	23.8	9.5	–13.5	6.3	10.8	6.6	–0.3
Surplus (+)/Deficit (-) of consolidated budget, % of GDP	6.0	4.9	–6.3	–3.4	1.5	0.4	–1.3
Reserve Fund (2007) – Stabilization fund, end of year, billion dollars	156.81	137.09	60.52	25.44	25.21	62.08	87.38
National Welfare Fund, end of year, billion dollars		87.97	91.56	88.44	86.79	88.59	88.63
Consumer Price Index, December to December	11.9	13.3	8.8	8.8	6.1	6.6	6.5
Producer Price Index December to December	25.1	–7.0	13.9	16.7	12.0	5.1	3.7
Average interest rate on rouble loans to enterprises	10.0	12.2	15.3	10.8	8.5	9.1	9.5
Average interest rate on private deposit accounts (excluding instant withdrawal accounts)	7.2	7.6	10.4	6.8	5.4	6.5	6.5
General level of unemployment (MOT methodology), average for year	6.0	6.2	8.3	7.3	6.5	5.5	5.6
Average monthly salary paid out (thousand roubles)	13.6	17.3	18.6	21.0	23.4	26.6	29.9
Level of savings % relative to available income	23.0	16.5	22.4	23.9	18.5	17.4	15.5*
Balance of payments, billion dollars							
Current account	71.3	103.9	50.4	67.5	97.3	72.0	32.9
Balance of trade	123.4	177.6	113.2	147.0	196.9	192.3	177.3
Exports	346.5	466.3	297.2	392.7	515.4	528.0	521.6
Imports	–223.1	–288.7	–183.9	–245.7	–318.6	–335.7	–344.3
Direct investments	11.1	19.1	–6.7	–9.4	–11.8	1.8	–18.6**
–in the economy of the RF	55.9	74.8	36.6	43.2	55.1	50.6	78.4**
–Abroad	–44.8	–55.7	–43.3	–52.6	–66.9	–48.8	–97**
–Reserves ("-" growth)	–148.9	38.9	–3.4	–36.8	–12.6	–30.0	22.1

* For January-November 2013.
** Investments in the banking sector excluded.
Source: Rosstat, CBRF, MinFin of Russia.

The second serious problem was increasing strain on the budget, It has been customary in the Russian budget process since 1999 for de facto realized revenues to exceed planned revenues annually. This was the result of a more rapid increase in oil prices and of higher inflation than had been envisaged in the Budget Law. The political opposition constantly accused the government of incompetence in its budget planning, but it was more generally understood that the government's approach created a stability reserve and that the surplus revenues facilitated the solution of not only economic but also political problems.

Now this reserve no longer exists. The oil price, whilst it has remained at an exceptionally high level, has stopped increasing and in real terms will, in all probability, fall. Inflation, although it is at present somewhat higher than the level forecast, is nevertheless approaching the level assumed in the budget and if a rigorous system of inflation targeting is introduced this source of supplementary nominal revenues might completely disappear.

It is against this background that a number of trends, important for the medium-term development of the economy, have emerged.

The problem of modernization: Labor productivity is increasing slowly, as can be seen from the high level of employment. However, at a time of structural crisis the pace of modernization should increase more significantly.

If we compare the branch structure of the economy with that of the pre-crisis year, 2008, the problem becomes clear (*Table 3*). By comparison with the *pre-crisis period*, the increase in industrial production in 2013 was 105.7%. This level was achieved thanks to a growth in the extraction of natural resources, in the output of processed goods of the chemical industry, in the production of transport equipment and of food produce. The majority of processing industries have not regained the levels of output of 2008. Moreover, the 2013 figures for the production of investment goods are even farther from pre-crisis levels than the figures for 2012.

Table 3

Growth of industrial output by category 2009-2013
(% relative to 2008)

	2009	2010	2011	2012	2013
Index of industrial output	**–9.3**	**–1.9**	**2.7**	**5.4**	**5.7**
Extraction of minerals	**–0.6**	**3.0**	**4.9**	**6.1**	**7.4**
Extraction of energy minerals	0.4	3.5	4.9	6.1	7.4
Extraction of minerals excepting energy minerals	–7.4	–0.6	4.1	5.1	6.9
Processing industries	**–15.2**	**–5.2**	**1.0**	**5.1**	**5.2**
Production for consumer demand	***–3.7***	***2.0***	***3.4***	***7.6***	***8.9***
production of food produce, including drinks and tobacco	–0.6	4.8	5.8	11.2	13.8
Textile and clothing	–16.2	–6.1	–3.6	–5.5	–0.9
Leather, leather goods and footwear	–0.1	18.6	28.8	15.8	9.6
Pulp and paper production, publishing and printing	–14.3	–9.2	–7.6	–5.7	–10.6
Production of intermediary goods	***–10.1***	***0.0***	***4.0***	***7.6***	***8.3***
Timber processing and production of timber products	–20.7	–11.7	–8.1	–5.1	–3.8
Coke and refined petroleum	–0.6	4.4	7.4	9.8	12.0
Production of chemical industries	–6.9	6.7	12.2	13.7	19.3
Production of rubber and plastic goods	–12.6	6.2	20.1	29.0	35.7
Basic metals and fabricated metal products	–14.7	–4.1	–1.3	3.1	0.7
Production of investment goods	***–32.9***	***–18.8***	***–7.3***	***–0.6***	***–2.1***
Manufacture of transport equipment	–37.2	–17.0	3.4	16.6	17.6
Production of investment goods excluding transport equipment	*–30.4*	*–19.8*	*–13.5*	*–10.5*	*–13.3*
Production of various non-metallic mineral products	–27.5	–19.7	–12.3	–7.4	–7.1
Production of machinery and equipment	–31.5	–23.1	–15.8	–15.5	–21.9
Manufacture of electrical equipment, electronic and optical equipment	–32.2	–16.7	–12.5	–8.7	–11.3
Production and distribution of electricity, water and gas	**–3.9**	**0.0**	**0.1**	**1.3**	**–0.5**
Reference: Investments in basic capital	–13.5	–8.1	1.9	8.6	8.3
Retail trade turnover	–5.1	1.1	8.2	15.1	19.6

Source: Rosstat.

One factor determining this trend in the development of Russian industry is the dynamic of domestic demand for its goods. The output of investment goods recovered steadily from the first quarter of 2010 to the second quarter of 2012, but the rate of growth of this output was ambivalent. Growth was achieved against a background of accelerating recovery of investment activity in the economy as a whole: investments in basic capital over this period grew at average rates of around 10% per annum. However, as of the third quarter of 2012 investment programs began to slow down and this was accompanied by a fall in the output of investment goods. It is of significance that for the greater part of this output, the decline began before pre-crisis levels of output were attained. The output of machinery and equipment during 2013 was 22% lower than the pre-crisis level, the output of electrical equipment was 11% lower and the output of construction materials was 8% lower.

Employment remained at a high level. Unemployment remains low and after a slight increase in the first quarter of 2013 (when it was 5.8% of the economically active population) it ended up at 5.6% by the end of the year. This is an exceptionally low level in the post-communist period of the Russian economy (though the absolute minimum of 5.1% occurred in October 2012) and also in comparison with the world's leading economies. Other significant parameters are the growth of budget funded wages and the continuing tendency for the growth of incomes top exceed that of labor productivity; an increase in revenues from personal income tax (NDFL) accompanied by a reduction in revenues from profits tax and VAT; and an increase in contributions to the Pension Find and other social extra-budgetary funds.

Trends in the labor market have remained unchanged during the last 20 years. Employers are reluctant to cut back on their labor force under crisis conditions. Certainly, there is a new phenomenon – a stable level of employment, in conditions in which rates of economic growth are slowing down, is being accompanied by increases in wages. This can be attributed to an increase in wages in the social sectors (in conformity with the Decree of the President of the Russian Federation "On measures for the implementation of government social policy" of 7 May 2012) and to the continuing decline in the number of people of working age who are employed which increases pressure from above on the labor market (in terms of employment and wages).

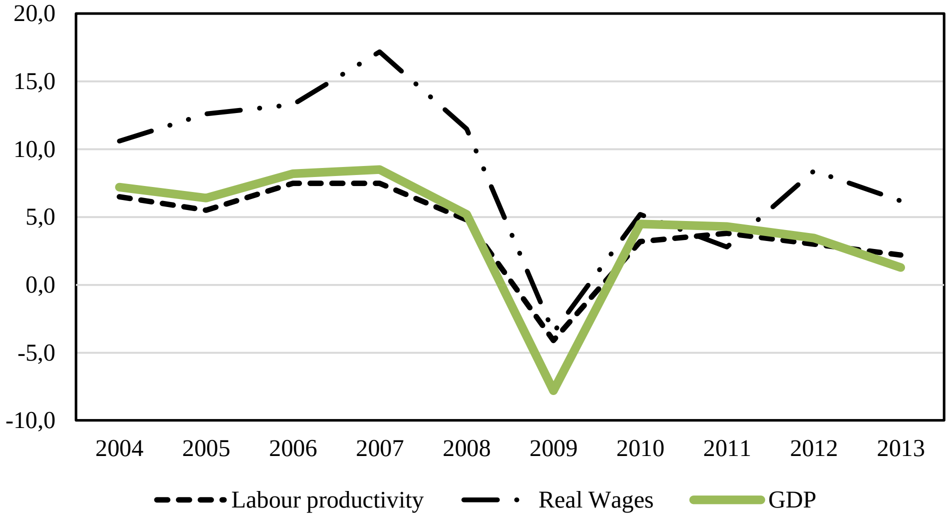
Social leniency and financial strain:

A significant aspect of developments during 2013 was an increase in the share of wages relative to a reduction in the share of profits in GDP. The economic system is becoming more socially oriented and less attractive to investors. This is reflected in the structure of tax revenues which reports an increase in revenues from personal income tax and a reduction in revenues from profits tax and VAT.

During 2013 the growth of the Russian economy continued to be determined, essentially, by factors of consumer demand, attributable to a growth in wages and consumer credit. The growth of wages consistently exceeds the rates of growth of GDP and of labor productivity (*Fig. 1*). Whereas GDP grew in 2013 by only 1.3%, the growth of real disposal income was of the order of 3.3%, wages increased by 5.2% and the volume of credit granted to physical persons increased by 28%. As a result, retail trade turnover increased by 3.9% and the volume of paid services to the population by 2.1%.

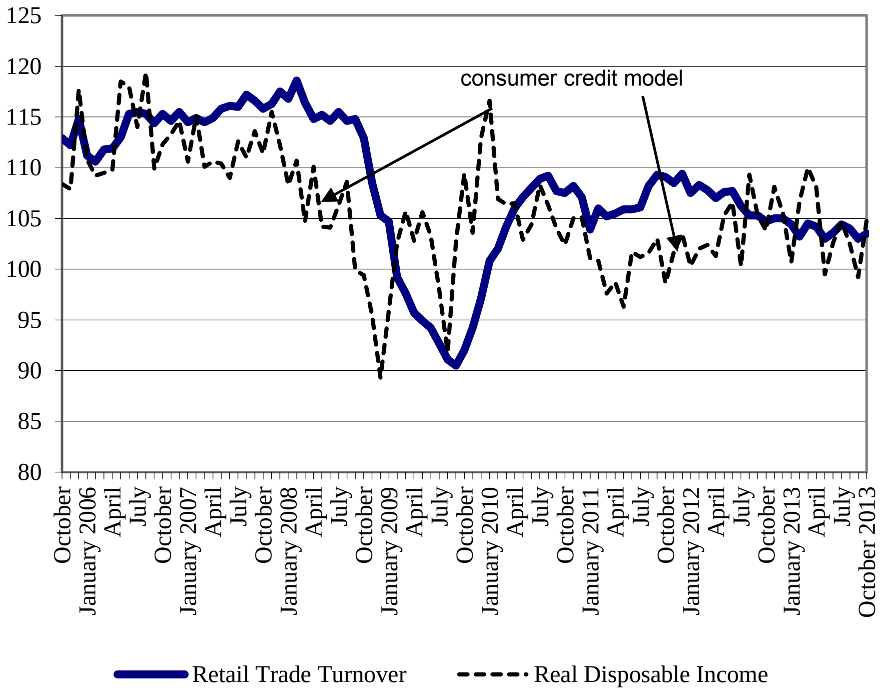
Certainly, in the year that has past, the rates of growth of retail trade turnover declined, though they exceeded the growth of GDP, which in turn was influenced by a fall in the rates of growth of the population's disposable income and of retail credit. In *Fig. 2* we indicate those periods when consumption was to a noticeable degree stimulated by bank lending and those when it was stimulated by an increase in wages.

The share of wages of hired workers exceeded 50% of GDP. This not only strengthened the consumer orientation of the economy but might even signal the approach of a crisis. When this proportion exceeded the 50% threshold in 1997-1998 and in 2007-2008 the result was a crisis: either a devaluation of the currency or a decline in the volume of production, or both at once.



Source: Rosstat.

Fig. 1. Annual rates of growth of GDP, labor productivity and real wages

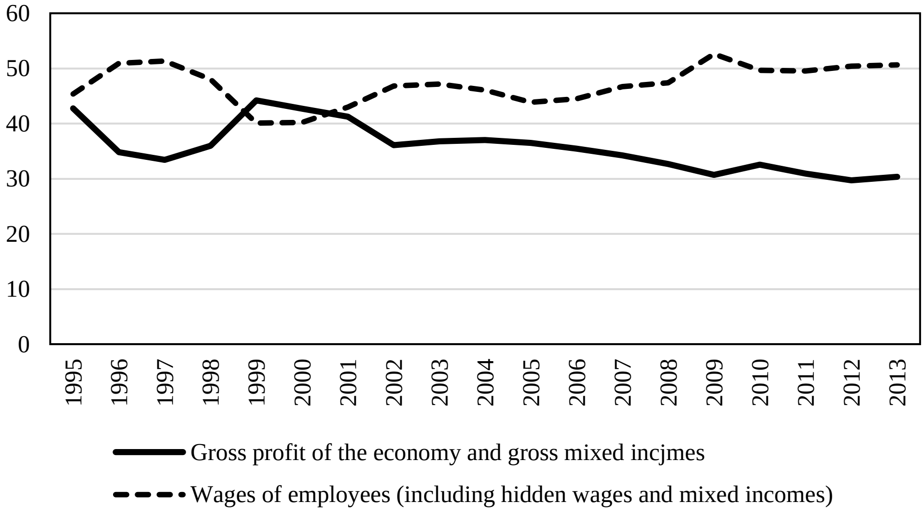


Source: Rosstat.

Fig. 2. Real disposable income and retail trade turnover growth

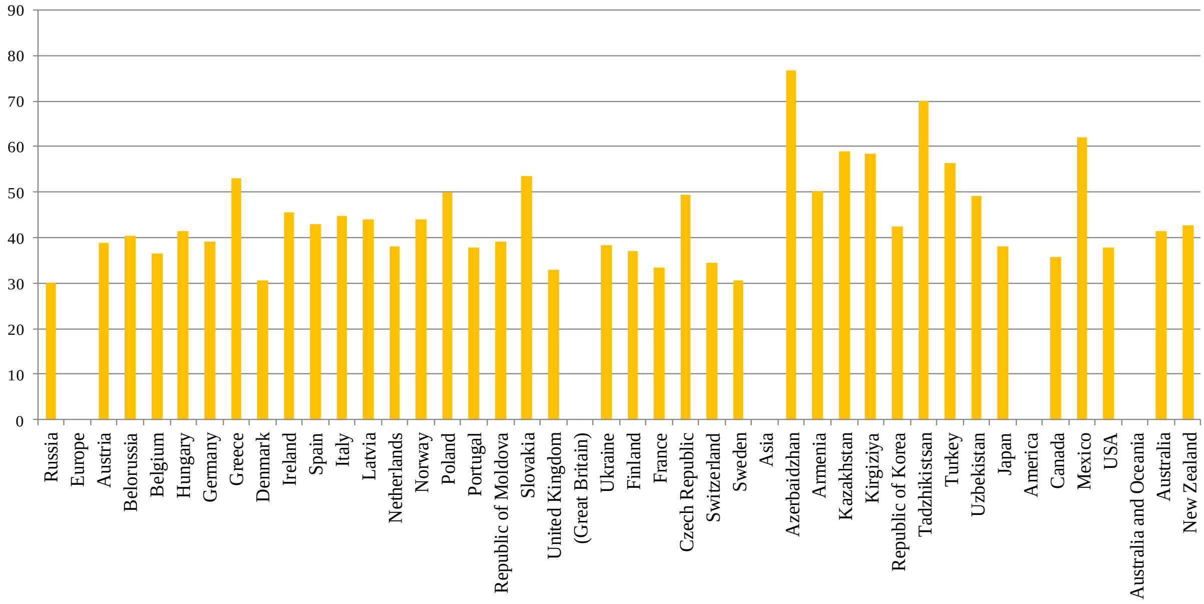
The increase in personal incomes was accompanied by a deterioration in the position of enterprises – the balance of profits relative to basic forms of activity fell by almost 20%. Profits are one of the principal sources of investments for the average Russian enterprise. At the same time, in sectors of production and investment demand, profits contracted to a significantly greater extent than in sectors of consumer demand and trade. The share of profits in Russian GDP is at a low level when compared to the majority of developing and developed countries

(*Fig. 3* and *4*). Furthermore, since the beginning of the global crisis there has been a tendency for the share of own resources in investments to increase, whilst borrowing for investment and budget funded investment have decreased (in the latter case in respect of regional budget funding). This is reminiscent of the situation that existed at the beginning of the 2000s.



Source: Rosstat.

Fig. 3. Gross profit and mixed incomes, wages of employees, as % of GDP



Source: IMF.

Fig. 4. Share of gross profit in GDP by country

In so far as, in present-day Russia, 50-75% of investments are funded out of enterprise profits and approximately 60% of profits derive from the oil and gas sector and trade, a reduction in the share of profits denotes a diminution of investment resources, predominantly in the non-raw materials sectors.

The Growth of wages in the budget sector became an important issue of social and economic policy in 2013. Recently, military personnel in all of the armed forces and Federal level civil servants were awarded significant pay rises and last year saw the implementation of the Decree of the President of the RF on pay increases for workers in education and health care. The government's intention is to make work in the development of human capital more attractive and to highlight the importance of these workers in the country's socio-economic policy. It is the expectation that the increase in wages will attract highly qualified specialists and bring about a significant institutional transformation.

The *budget* is in a fairly healthy state, especially when one bears in mind the budget crisis being experienced in the majority of developed countries. The Federal budget is in balance, and government debt, though it has increased somewhat, remains at an exceptionally low level (10% of GDP, of which external debt is under 2.5% of GDP). A partial amendment of budget rules affects only shortfall in budget revenues and for that reason does not create additional risks of an uncontrollable increase in budgetary obligations. Even so, any departure from the principle of balancing revenues, given that estimates are based on an multi-year average for the price of oil, represents an actual relaxation of budget policy and in future could result in an further increase in the non-oil budget deficit. The non-oil budget deficit, which leapt to 6.7% of GDP in 2008 and to 13.8% of GDP in 2009, is at a dangerously high level.

Taking all of this into account, the high degree of reliance, for stability, on the oil price (a parameter that lies outside of the control of the government), and the habit, formed over a decade, of relying upon increasing revenues, are problems that cannot be ignored.

Regional finances are in a more precarious state. Here the problem is a significant fall in revenues in circumstances where a rapid and appropriate reduction in the volume of expenditures is rendered impossible by an increase in sub-national borrowing.

According to data of the Federal Treasury, for 2013 the fall in the sum of the overall revenues to the consolidated budgets of subjects of the Russian Federation amounted to 0.9% of GDP in comparison with 2012. Meanwhile, tax revenues fell by 3.4% and transfers from the Federal Budget fell by 12.4%. The overall decline in tax revenues was due to changes in profits tax, revenues from which fell during the period in question by 18.4%. The decline in the general volume of tax revenues paid into regional budgets might have been greater if there had not been an increase in revenues from other taxes, primarily personal income tax (NDFL) of 4.0%.

In the meantime, expenditures of the consolidated regional budgets fell in 2013 by only 0.4% of GDP. In order to offset the fall in revenues while maintaining expenditures at a given level the sub-national authorities were obliged to increase their borrowing: the volume of regional debt (municipal debt excluded) during 2013 for all subjects of the Russian Federation increased by over 10% in nominal terms. At the end of 2013 aggregate regional debt stood at around 2.5% of GDP or 22.8% of the aggregate tax and non-tax revenues of sub-Federal budgets. There is also a trend towards steadily increasing volumes of borrowing, which, unless there is a change in budgetary policy, could lead to an increase in the debt burden which could attain critical proportions (by some indicators) in the medium term.

For 5 years now there has been an increase in the social expenditures of the regions, and a decline in expenditures aimed at investment: the share of social expenditures in the general expenditures of the consolidated budgets of subjects of the Federation increased by almost 10% over the period 2009-2013 and in the past year this has amounted to around 62%. By contrast, expenditures on housing and communal services (ZhKKh) and transport (which are most closely tied to investment) fell by about 21%.

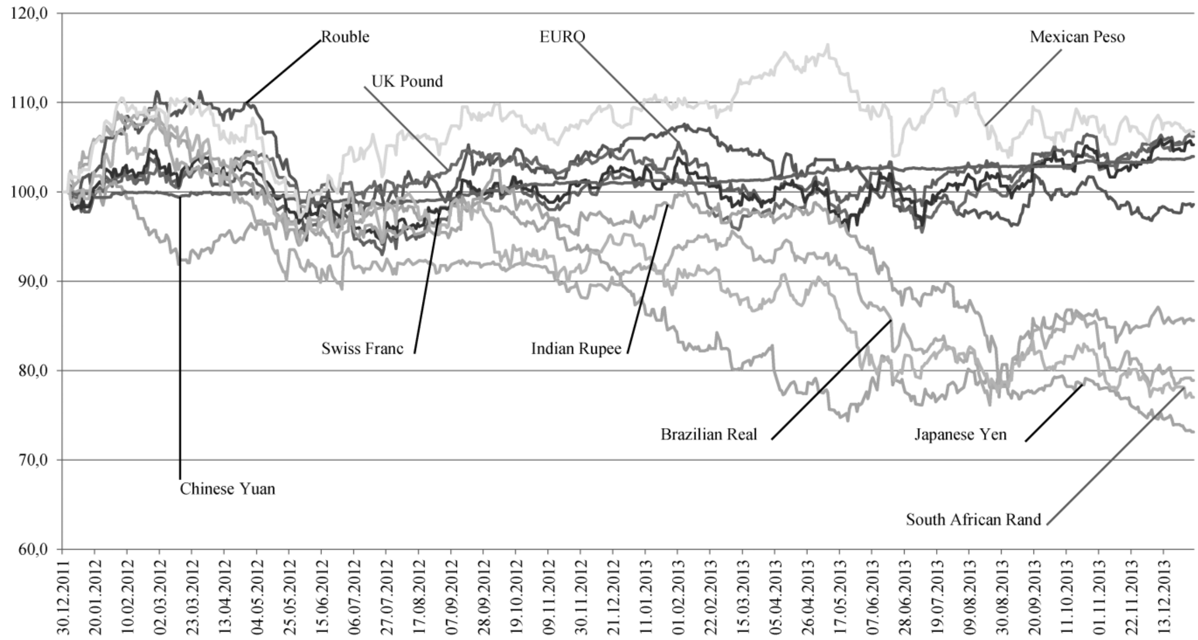
Monetary policy remains conservative and gives priority to inflation targeting. The first objective is disinflation and only once this has been achieved will the objective become a lowering of interest rates. Although there has been widespread criticism of the conservative approach of the Central Bank, we consider this approach to be justified. The less than perfect credit history of the national currency and continuing risks of high inflation mean that there must be the monetary authorities must exercise great caution with regard to any increase in the money supply. This is all the more the case in that in conditions of declining growth, stagflation could become a serious problem.

A rate of inflation of 6.5% exceeds the targets adopted by the Central Bank and remains the greatest problem for monetary policy. By this measure, the performance of the Russian economy lags behind that of the majority of the leading world economies (above all behind the performance of the "G-20"). There are both macroeconomic and institutional factors behind continuing high inflation: the macroeconomic factors have to do with growing household demand; the institutional factor is increasing charges by natural monopolies.

Finally, during 2013 the exchange rate of the rouble fell by 7.6%, which is attributable to both domestic and foreign reasons. Domestic factors include the slowing down of the economy and an entrepreneurial climate which encourages the export of capital abroad. Developments in the world economy were no less important: the marked recovery of the US economy and an attenuation of the crisis in Europe produced the response that is typical in such circumstances of a "flight into quality" – an outflow of capital from developing into developed markets. Money is being transferred into the US dollar and the Euro. This is an entirely natural process and one that has recurred in the history of markets during the last 50 years.

In the circumstances described, the exchange rate of the rouble fell much less during 2013 than the exchange rates of other emerging market economies that are comparable with Russia. This is evidence of the stability of the Russian monetary system and suggests that the policy of the Russian monetary authorities was correct (*Fig. 5*).

However, it would be a mistake to assume that a fall in the rouble exchange rate will serve to stimulate the economy and encourage import substitution, as was the case after the crisis of 1998. Now any positive consequences of a depreciation of the rouble would be very limited: the revenues of exporters would increase and there would be a slight improvement in competitiveness, but this would have no impact on the structure of exports (a reduction in the share in exports of raw materials and energy resources) and there would be no boost to technology exports. Any serious effect of import substitution would require not a fractional devaluation but a devaluation of several times the current rate and this would carry the risk of political upheaval. Furthermore, in present conditions, devaluation would punish those who participate in the chain of technological cooperation and who depend on supplies of parts or equipment. In 2013, 65% of imports consisted of intermediary and investment goods, so that, unlike the situation of five years ago, a rouble devaluation would bring about a drastic division of the industrial manufacturing industry into distinct groups of "winners" and "losers".



Source: According data of central banks of corresponding countries

Fig. 5. Dynamic of rouble exchange rate compared with other currencies

During 2013 there were significant changes in the *regulation of the financial markets*. The Central Bank became the sole regulator. Only time will tell how effective this model is going to be. In present conditions this reform seems to make sense, being in line with a global trend towards strengthening financial regulation.

One new measure that could have far reaching consequences consisted in steps taken by the Bank of Russia to sanitize the commercial banking sector. Licenses were withdrawn not only from insolvent banks but also from banks involved in illegal financial operations. These measures had the effect of cleaning up the banking market. This policy does involve one particular risk, namely that of provoking a run on the commercial banks and a transfer of deposits into the state banks. This would be a regrettable consequence as far as the strategic development of the banking system is concerned and so there is a need for accompanying measures to increase the size of banks and encourage mergers between healthy banks.

Finally, one can see a number of *initiatives in foreign economic relations* which will have definite consequences for internal economic development. The most important of these were two projects for post-Soviet integration – the formation of a Customs Union and the creation of a Eurasian economic space. These initiatives will soon acquire greater significance as new member states join in.

This recent political progress in the international arena is undoubtedly the result of 10 years of political stability and an accumulation of financial reserves. Russia is one of the few developed countries at present to have financial reserves that provide some scope for initiatives in foreign affairs Of course, these reserves are not unlimited and they cannot be allocated simultaneously to both domestic and foreign objectives. The events of 2013-2014 demonstrated that the Russian authorities are ready to invest in international and military policy, and in the foreseeable future expenditures in those areas will have a significant impact on budget policy.

Challenges of economic growth

A most important development in the socio-economic life of Russia is a significant slowing down of growth rates. Investment activity slowed down, there was almost zero growth of industrial production, and there was a deceleration of the growth of consumer demand. It is likely that in the near future these problems will cease to be merely economic and will acquire an important political dimension.

There are several reasons for this slowing down of growth rates. The external economic conjuncture played an important part. It was inevitable that the recession in the EU, Russia's principal foreign trade partner, would have a negative impact on the dynamics of the Russian economy.

Another factor was the particular character of the domestic investment cycle. In Russia, the large state companies play an important part in the investment process. Recently they concluded huge investment projects and this had a due effect on growth rates.

However, these conjunctural factors were not crucial to developments. In Russia a braking *mechanism* is at work which results from the exhaustion of the model of economic growth that has been in existence since 1999. The problem is essentially institutional in nature.

The 1999-2011 growth model was based on a rapid increase in demand (internal and external) which was catered for by mobilizing a significant volume of inactive production capacity. Essentially, opportunities for stimulating internal demand (from an extremely low starting level that originated in the immediate post-Communist reforms) fortuitously combined with a dynamic recovery of the world economy, which generated external demand. Given a favorable external conjuncture, recovery growth can be achieved almost irrespective of the investment climate, provided there is socio-economic stability. However, recovery growth is a diminishing and finite process. The exhaustion of reserves makes for a deceleration that can only be reversed by the formation of conditions favorable to investment and by the emergence of conditions for new growth.

Exhaustion of the post-transformation (recovery) model of growth has been discussed during the last few years, but this model still possessed specific internal advantages, including continuing high prices for oil and an accumulation of financial reserves. The 7% fall in GDP in 2009 also played a part: a response to this was the mobilization, for a certain period, of production capacities, but these have now once again been exhausted. The slow down began in the second half of 2012, when Russian GDP rose above the pre-crisis level (that is, reconstruction capacities were exhausted) and the growth of exports practically came to a halt.

It is worth noting that recovery growth, as a rule, lasts longer than economists tend to forecast. This means that at a particular stage, when, according to forecasts, growth rates should start to decline, but they do not decline significantly, politicians start thinking that the high level of growth of the recovery period is a natural consequence of their policies and that this growth will continue as long as it suits them. These kinds of assumptions can themselves contribute to the outbreak of an economic crisis.

The *basic components of the mechanism of deceleration in the present-day Russian economy* are as follows:

Firstly: the dominance of consumer demand (wages) at the expense of investments (profits). This is evident in the growth of the share of wages and the decline in the share of profits, and also in the more rapid increase in wages than of GDP and of the productivity of labor. The level of accumulation has remained low – at, on average, 21.8% of GDP during the last five years. During the last half-century, the countries that have achieved stable dynamic growth have been those where investments has been no less than 25% of GDP and investment in education and healthcare has remained around 7-8% of GDP. Overcoming the lag in labor productivity requires a higher level of investment; but the consumer-led growth model functions thanks to a relatively low level of investments.

Secondly: market inefficiency, which prevents the transfer of labor and capital into the more efficient sectors, creates the risk of preservation of the existing economic structure. There as a low level of competitiveness of internal markets that is associated with unattractive conditions for conducting business and with the existence of an overlarge non-market or monopoly sector of the economy and of an over large state sector; there is labor market inefficiency against a background of high and increased expenditures on labor.

Thirdly: the low level of effectiveness of state regulation inhibits the emergence of institutional and macroeconomic conditions for long-term investment; there is a high level of inefficient public expenditure.

Fourthly: there is a low level of participation in world trade - there are obstacles to the expansion of non-raw materials exports and to the integration of Russian firms into the international chain of added value; tariff levels are high.

All of this has resulted in Russia falling into the "middle income trap". This is a predicament in which a country, having achieved a fairly high level of welfare, encounters obstacles in the form of the price of labor (it is already high) and institutions (they are already inadequate). Such a country is unable to compete with developed economies that possess a highly qualified labor force and with low income economies that have low wage levels and produce low cost industrial goods. The dilemma of the Russian economy at the present time derives from inefficient utilization of labor and capital, the absence of conditions for increasing output of high value-added goods and services. All of these factors are critical given the relatively high level of costs.

The way out of this dilemma is to be found in a qualitative renewal of institutions a renewal of the formal and informal rules that govern economic development. Much has been said in recent years about the need for institutional reforms. However, these discussions will never be transformed into action until economic indicators show that within the existing institutional framework the potential for growth has been exhausted. Of course, measures can be taken to accelerate growth within the existing institutional framework, but such a policy is unlikely to have a sustainable outcome.

This brings us the question of the risks confronting Russian economic development and Russian society in the period that lies ahead.

Socio-economic risks in the short and medium term

Let us begin by examining those risks that are associated with the adoption of a new growth model, or, more accurately, the risks that would derive from an inadequate response to the present deceleration of growth. These risks fall into two categories and they are divergent in nature: firstly, a passive acceptance of the current rate of growth as being historically unavoidable; and, secondly, the adoption of artificial (inappropriate) measures intended to achieve a break-through.

In 2013 there were significant changes in official evaluations of the prospects for socio-economic development. If, previously, the government's economic forecasts bore a resemblance to plan variants of the past and included aspirational (and at times even fantastic) development scenarios, then from the autumn of last year the official forecast comprised, for the most part, an extrapolation of existing trends, which is to say that it almost entirely excluded scenarios involving institutional reforms.

The official forecast is now based on an assumption of 3% economic growth in the period up to 2030, that is, substantially less than the 5% that had been considered desirable, and the need for which has been officially declared during the last few years. In part, this was justifiable, in so far as a forecast, by its very nature, cannot allow for changes in economic policy that have not yet been made. However, this new forecast carries the risk of becoming self-fulfilling, the risk that a variant of development based on low growth rates will be politically accepted and that institutional reform will be avoided. During 2013 there were significant changes in official evaluations of the prospects for socio-economic development. Whereas previous government economic forecasts had resembled "plan variants" and contained desirable (and sometimes even fantastic) development scenarios, as of autumn of last year the official forecast came to be based primarily on an extrapolation of current trends, that is, projections based on the introduction of institutional reforms were almost entirely disregarded.

The risk associated with a policy of nominal acceleration – an increase in economic growth rates without improvement in the quality of growth, is potentially more dangerous. A policy of acceleration in these conditions would entail a weakening of budgetary and monetary policy, especially if there is a relaxation of "the budget rule".

A conservative macroeconomic policy always encounters sharp criticism, and the advocates of such a policy come up against the combined forces of the representatives of all sectors and branches, and are always in a minority. The arguments of those who favour increases in budget expenditure, a lowering of interest rates and currency manipulation are always very persuasive, since the supporters of such measures believe (quite sincerely) that they will achieve high rates of economic growth. Of course, it is difficult to implement a conservative budgetary policy in a country that has many serious socio-economic problems. Such a policy is twice as difficult to implement where there is a substantial accumulation of reserves and the government has funds at its disposal. But it is this kind of policy that always achieves sustainable economic growth, whereas a policy of unrestricted budgetary expansion always results in a serious crisis – as was the case during the "great leap forward" of the 1930s and the "acceleration" of the 1980s.

The experience of economic policy during the last decade of the Soviet régime offers many lessons for the present day. The present macroeconomic situation is remarkably similar to that of the turn of the 1970s-1980s. The oil price in real terms is at approximately the same level; the USSR achieved a steady annual rate of growth of 3%; the budget was in balance thanks to the fact that all revenues from exports of carbohydrates were used to cover budget expenditures; there was an active construction of gas pipelines; prices were stable, though the goods shortage was becoming increasingly acute (this denoted inflation masked by fixed prices); the level of external government debt was not high; universal employment was guaranteed, though labour productivity was low; the political system of the USSR was incapable of responding flexibly to new global changes (technological, economic and political).

All of this was in contrast with the situation in the West, which was in the throes of a deep structural crisis, characterized in CPSU publications of the time as the "third stage of the general crisis of capitalism". The growth rates of the leading capitalist countries were either negative or close to zero. There were high levels of unemployment and inflation, the unprecedented combination of which gave led to the formulation of a new economic category – "*stagflation*".

At that time is seemed that the Soviet economy was experiencing sustainable growth whilst the West was in a state of crisis. In reality, the market-based democracies were going through a phase of structural and technological modernization, the necessary prerequisite of a qualitative leap forward, whereas the Soviet Union preserved its economic structure and became the hostage of fluctuations in raw materials prices that the government could not control. As later became clear, the crisis in the West was actually approaching its conclusion by the end of the 1970s and a new paradigm of economic policy was being adopted that entailed a reduction in the regulatory role of the state (deregulation),

By 1985, economic growth rates in the West exceeded Soviet growth rates and the obsolescence of a system based on central planning had become evident to all. The Soviet government attempted to redeem the situation with methods of aggressive budget stimulus. It undertook a vigorous programme of investments at the expense of increasing government debt (which doubled between 1985 and 1990) and of a budget deficit (which appeared in 1985 and increased rapidly thereafter). The growth rate of the USSR did, indeed, increase and came almost to equal that of the USA (though it remained lower than that of Great Britain) but this lasted only two years, from 1987 to 1988. In 1989 an economic decline commenced that lasted for almost 10 years (*Fig. 6* and *7*).

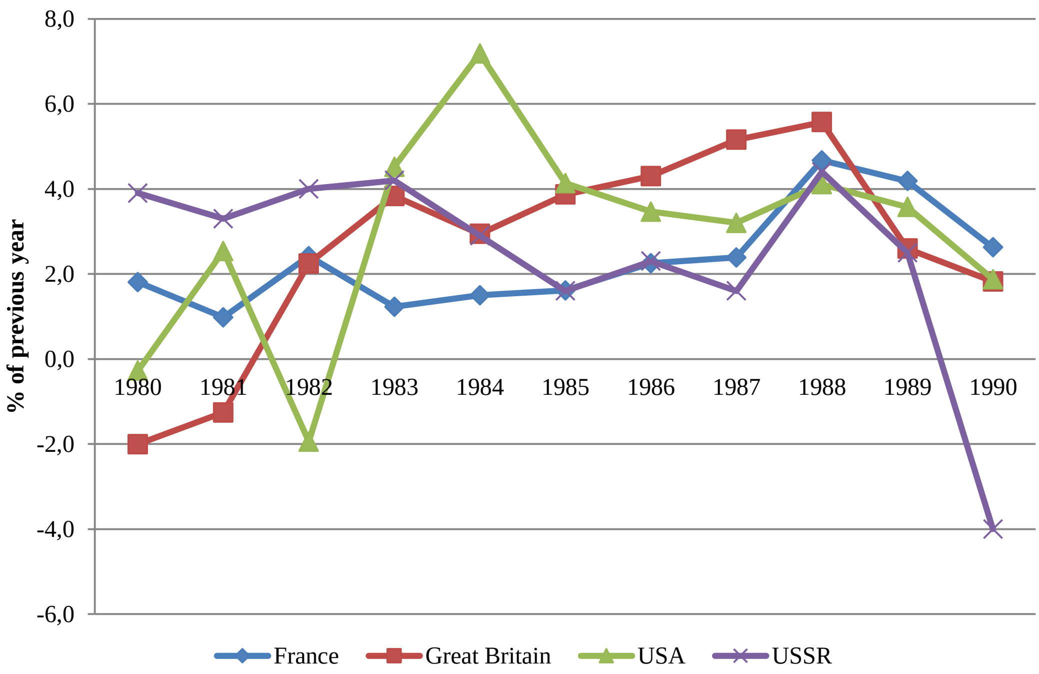


Fig. 6. GDP growth rates in the USSR, USA, Great Britain and France (1980-1990)

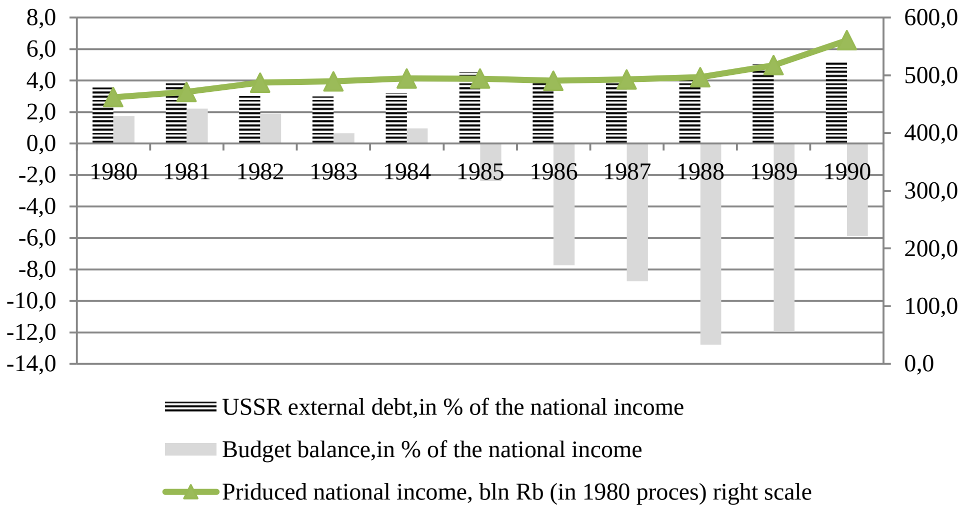


Fig. 7. National Income, Budget Balance, Foreign Debt of the USSR

The budget policy of present-day Russia takes into account the risks of fluctuations in the global economic conjuncture, though, following the crisis of 2008, the Federal budget began completely to absorb current revenues from the export of energy resources. The sovereign debt of the Russian Federation is much less than that of the USSR. The Russian Federation does not depend on food supplies to the extent that the Soviet Union did. The existence of private property means that the situation is qualitatively different. The political system is unquestionably more flexible than the Soviet system was.

Even so, there are similarities with the situation of thirty years ago. In the developed countries the structural crisis is gradually being overcome, The USA is witnessing a rapid technological renewal that will stimulate a similar process in Europe. When growth rates in the developed countries recover, in Russia the idea of "catching up and overtaking" (as a rule, at any price), usually become popular.

It is this possibility that Russia might be drawn into the pursuit of, not qualitative, but quantitative parameters of growth, and be willing to pay the price in terms of macroeconomic destabilization (which is usually followed by political destabilization) that constitutes the *principal political-economic risk of the years that lie ahead*.

In addition to these dangerous consequences, budgetary and monetary stimulus could, in present circumstances, drive the country into the trap of stagflation – low or negative growth rates accompanied by steady high inflation. Exiting from stagflation is a difficult and painful process. Present day Russia differs from the majority of developed countries in maintaining a high level of inflation. For this reason, it is unable to apply the measures of low interest rates and quantitative easing that were so popular in the West after 2008. In our opinion the *risk of stagflation is real* and must be taken into account in the drafting of economic policy.

A policy of *budgetary stimulation of demand would, at present, be ineffective and fraught with risk*. As recent research has shown, an increase in effective demand in the absence of any increase in productivity and competitiveness results in inflation and an increase in imports. There is already evidence of this, in that we are unable to achieve an acceptable level of inflation (lower than 5%) and imports are growing faster than exports. In a country with a high level of demand and low productivity there is a marked tendency for the rich to purchase the goods of rich countries and for the poor to purchase the goods of poor countries. This results in a situation in which, domestically, primarily raw materials and services are competitive and everything else is imported.

The budget system must avoid *the risk of increasing indebtedness in the regions*. Special institutional measures should be introduced to restrict (or even prohibit) the deficit financing of regional budgets. The risks become even more acute if the Federal government lacks revenue surpluses that can be rapidly mobilized in the event of any increase in social tensions.

We draw attention to the *risks associated with an increase in wages in the budget sector* aimed at achieving a renewal of personnel and attracting highly qualified specialists. In this instance, a failure to synchronize wage increases with institutional reforms can result in continuing inefficiency, in so far as in-post staff will have no incentive to make way for newcomers, and new staff will have no incentive to apply for jobs if they perceive that the old principles of organization are being preserved.

A rise in wages also creates macroeconomic risks. As it happens, the budget sector is beginning to set the pace and dynamic of wage levels in the economy and is competing with the private sector. At a time when overcoming the crisis requires improvements in efficiency, the economy is being sent a signal that increasing costs is acceptable. However, the budget sectors do not exist in isolation and the dynamic of wages in these sectors has an impact on the rest of the economy.

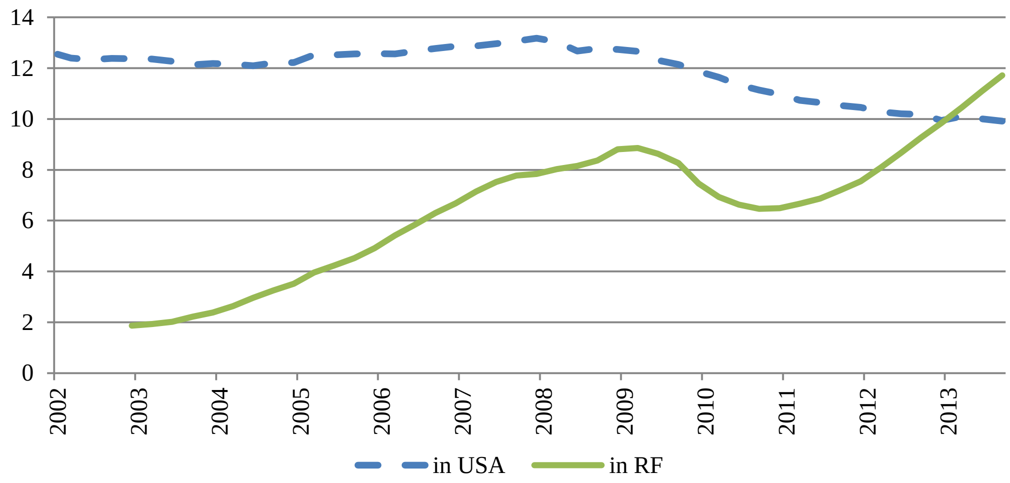
This is all the more important in that the budget sector, from the standpoint of its attractiveness to employees, has ceased being uncompetitive. From the stand point of security of employment, work load, and wages, work in budget funded organizations (as well as in state corporations and institutions of public administration) has become highly attractive to a significant part of the population. The result is a competition for labor between the state sector and private enterprise and this will have a negative impact on the competitiveness of the Russian economy.

The ever increasing appeal of the state sector is becoming a serious impediment to private business activity. Insufficient attention is currently being paid to this aspect of the investment climate. The time when public sector wages were uncompetitive has passed. Now work in the public sector (state-owned companies included) has become extremely attractive to employees. To some extent this state of affairs resembles the financial market of the mid-1990s when the yield of state bonds (GKO) sucked investments out of the private sector.

The *risk of rising unemployment* cannot be disregarded. Traditionally, Russian businesses, in times of economic difficulty, have tended to retain workers, reduce wages and go over to part-time employment. Such measures, while they contributed to socio-political stability were an impediment to modernization. It is likely that, this time, the business community will respond differently. Entrepreneurs are now more inclined to adopt the employment model that is used in the market economies, and the government in the autumn to winter of 2013 gave a signal that it would no longer impose political restrictions on redundancy that was needed for purposes of modernization. This could create an entirely new situation in the labor market, and this, in turn, will force the government to improve the efficiency of the employment agencies, with particular attention to their role in facilitating labor mobility throughout the territory of the Federation.

Given possible changes in the labor market, *the high and constantly increasing level of consumer credit presents an additional risk*. The volume of accumulated debt of the population in Russia is not great when compared with that of the developed market economies – just under 10 trillion roubles (15.9% of GDP). However, taking into account a significantly higher level of interest rates (on average 17.5% per annum) and the limited duration of loans (under 3 years on average), the servicing of bank debt (the cost of the entire debt portfolio) in Russia is approximately 12% of the population's disposable income (in the USA this indicator is around 11% for a volume of indebtedness of around 80% of GDP).

In other words, the debt service burden is already higher than that of the USA, notwithstanding a lower volume of debt (*Fig. 8*)



Source: Rosstat, CBRF, FRS USA.

Fig. 8. Servicing of household debt to disposable household income, %%

Certainly, this risk may be partly offset by the slowing down last year of the rate of increase of consumer borrowing. New loans to physical persons in 2013 were to a large extent granted not for consumption but for the refinancing of existing loans. However, this does dispel the serious risk of a rapid increase in debt arrears, which might make for an increase in social tension.

Amongst serious institutional risks we should also include any rapid change in the "rules of the game", even if these are changed for the better. When law enforcement practices change (even if the laws do not), and what until recently had been normal business behaviour becomes a crime, entrepreneurs and citizens can be deterred from forming new businesses and organizations. This is all the more likely in that private initiative and entrepreneurship in Russia have always been regarded with suspicion and mistrust – whether in the nineteenth century or the twenty first.

Priorities of an economic policy aimed at consolidating growth

The priority objective at the present time should be the formulation of an economic policy that will secure sustainable growth in the medium term at rates exceeding the world average and include structural modernization. To this end, a new growth model must be adopted which will be underpinned not so much by a growth of factors of production – labor and capital (in respect of which we are limited both by domestic conditions of development and the external conjuncture) as by an increase in the efficiency of labor and capital, that is by an increase in aggregate factor productivity.

If our analysis is correct, the following guidelines for economic policy logically follow. These guidelines can be divided into "negative" (practices that should be discontinued and measures that should not be undertaken); and positive (measures that should be implemented).

Firstly: We must adhere to a conservative (prudent) macroeconomic policy. This means a balanced budget and reinstatement of the "budget rule".

The "budget rule" must be reinforced by a readjustment of expenditures, that is, by a reduction in expenditures in some sectors and an increase in others. The existing structure of budget expenditures requires rationalization and enhanced efficiency. This cannot be achieved by bureaucratic and organizational measures. The fact that a budget is a performance budget is purely formal and does not ipso facto, alter its content.

The Federal Ministry of Finance in 2013, in consultation with experts, began work on the revision and reinterpretation of budget expenditures. This work must be continued, and priority must be given to the sectors that have a significant multiplier effect. Of course, decisions for rationalizing expenditure are always painful, politically, especially when the state disposes of significant resources and the level of debt is low.

It is no less important to improve the quality and transparency of budget procedures. In particular, the requirement to make all payments within calendar intervals (by the year end) or returning funds to the budget. This problem is beginning partly to be resolved in cases where budget institutions are funded by subsidy. However, this mechanism is not applied consistently in the sphere where it is most difficult of all to achieve planned targets in time, namely in investments.

Finally, there must be a thoroughgoing reconstruction and modernization of the network of budget institutions. This cannot be achieved merely by introducing normative-per capita funding and by liquidating inefficient budget-funded institutions. Rather, the organs of executive power must themselves decide on the future of particular state and municipal institutions (state, budget-funded, and autonomous).

Secondly: We must get beyond a situation in which economic policy is, essentially, reduced to the budget process. Every decision at Federal level is converted into a quest for funds to support one project or another (at branch, regional or institutional level) and then, once the project has been successfully completed, into a quest for budget funds to purchase whatever has been produced at budget expense (for example, funds are allocated to develop ship construction and then, if these investments bear fruit, additional funds are allocated for purchase of the ships.)

Thirdly: In agreeing the principles upon which economic policy should be based, we must avoid decisions that lead to an increase in costs. For all the importance of development in the social sphere and of the wages of public-sector employees, any disregard of the need for competitiveness will impact negatively on the willingness of investors to locate production in Russia.

Fourthly: We must introduce order into budget management in the regions and adopt measures to contain the increase in expenditure obligations and of debt. At the same time we must incentivize the regions to improve tax collection. We should encourage a broad debate around the true principles of federalism, expand the tax base and improve the collection of taxes that are the responsibility of the regions and municipalities and on this basis create the conditions that will encourage regions to compete for investors and entrepreneurs.

This will require thoroughgoing institutional change. To some extent, we could draw upon the experience of those states in the USA that, in the mid-nineteenth century, experienced a number of defaults. At that time many states introduced a constitutional ban on deficit budgeting. This meant that states could borrow for specific projects but could not borrow to cover an overall budget deficit In other words, borrowing could be undertaken for a specific purpose, but the cost of capital repayments and debt servicing were charged to the budget, which had to remain in balance.

Fifthly: Reform of the welfare state. The welfare state principles that were adopted at the turn of the nineteenth and twentieth centuries are no longer effective in post-industrial society. There is no point in allocating substantial funds to the social sphere unless it can be modernized and made fit to meet the challenges of the twenty first.

The post-industrial welfare state will differ significantly from its industrial-era predecessor. A number of new features are already apparent and these include the continuous and life-long delivery of educational and health-care services. Individualization means that a citizen will be able to define his or her educational needs and also the varieties and providers of health care and choose from a range of available options. The globalization of services will bring about international competition for customers – educational and medical institutions will compete not only at neighborhood or even national level but with corresponding institutions throughout the world. The privatization of social services will be accompanied by an increase in the share of private funding in the development of human capital, given that private funding or co-funding is not only a natural but also an inevitable consequence of the technological modernization of these sectors and of the growth of welfare of the population. New technologies will appear that will radically alter the nature of the services provided by these sectors.

Sixthly: An improvement in the conditions for conducting business, with emphasis on improvement in those areas where Russia figures particularly badly in ratings of the business environment (for example in Doing Business). This relates primarily to the five criteria by which Russia is rated below the first 100.

These are:

- “Dealing with construction permits”. This is the most difficult area and the one where our rating is lowest – at 178th.
- “Trading across borders” – 157 th.
- “Getting electricity” – 117 th.
- “Getting credit” – 109th.
- “Protecting Investors” – 115th (In this sphere particular attention must be paid to reducing risks associated with the possible criminalization of business activity, lowering the burden of regulation and reducing the burden associated with law enforcement.).

Seventh: Stimulating competition is one of the main institutional priorities. This will require thoroughgoing institutional and even ideological change. The focus of the anti-monopoly authorities must be redirected towards the support of competition and against the restriction of competition by administrative methods. They must cease obstructing successful firms whose efficiency has won them a large share of the market.

In this area there must be a significant reduction in the number of antimonopoly investigations and a concentration on the larger, and economically more significant companies; less preoccupation in antimonopoly policy with individual entrepreneurs, small and medium sized enterprises and companies with a small market share; less attention to regulating small and medium sized business and more resistance against the monopolistic tendencies of large companies that have substantial administrative resources.

Eighth: Reform of the labor market and improvements in the territorial mobility of the labor force.

Steps must be taken to improve the flexibility of labor legislation, which at the present time does not reflect the realities of the post-industrial era, especially in production where information technologies predominate. We must move from strict labor legislation that is weakly observed by economic actors, to flexible legislation that is strictly observed by market participants. Legislation must be introduced that relates to new forms of employment deriving from the development of information technologies. Specific measures in the reform of labor legislation should include:

– a redefinition of fundamental concepts such as "working time", "the working day", "job", etc.
– improvements in the flexibility of employment relations, a simplification of the procedures for hiring and firing; a reduction in the period of obligatory notice of redundancy, a reduction in the costs of redundancy, including the size of the severance payment.
– a significant expansion of the conditions in which a time-delimited contract can be concluded, up to an including the right to abandon non-time-delimited contracts;
– simplification of procedures for changing the employment contract and terminating the labor contract on economic grounds;
– changes in the organization of working time, increasing scope for the introduction of flexible timetables, distance forms of employment, zero hours contracts, etc.
– Simplification of the system for keeping staff records, including abolition of the system of personal employment records.

In parallel, we must cease exerting political pressure on the regions and entrepreneurs to maintain artificial levels of employment. It is understandable that the government should wish to minimize the socio-political risks that can result from the dismissal of workers. Such risks are real, but they are mitigated by demographic trends (a reduction in the number of employees of working age).

Over and above reform of labor legislation, steps must be taken to encourage labor mobility between the regions. The potential for such mobility is not great – according to research of the Russian Academy for the National Economy and Public Administration, no more than 30% of the population is willing to change their region of domicile in order to find work and amongst those there is a trend for movement from east to west. Even so, we must encourage the mobility of employees in the interests of economic growth and this could in part be facilitated by a reduction in the numbers of the economically active population.

The following measures would assist in stimulating internal labor migration in the short term: the formation of a national data base of employment opportunities; improving the access of Russian citizens to social and other services in their place of actual residence – this relates primarily to medical insurance; the granting of notifying registration upon registration for tax purposes, which will ensure access to social entitlements throughout the territory; the provision of affordable rented housing for service personnel and of hostels for migrant labour, etc[1].

[1] Maleva, T. 2011 The Russian labour market: efficiency of employment or reduction of unemployment? // *Modernizatsiya i chelovecheskoe razvitie (Modernization and human development).* UNDP report on the development of human potential (Moscow, UNDP, 2001).

Ninth: Greater efforts to integrate the Russian economy into the international division of labor. In the first instance, the development and strengthening of the Eurasian Economic Community (EurAsEC) and determined efforts to create a single economic space with the EU. The need for integration must be at the forefront of the work of the monetary authorities. The rouble has genuine prospects of becoming established in the market of regional reserve currencies and monetary policy must strive to make progress in that direction.

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The measures that have been proposed may be described as a policy for stimulating supply as distinct from a policy of stimulating demand. Different countries have given precedence to one or the other growth model over the years. The stimulation of supply depends upon creating conditions that are favorable to an increase in national productivity, which include a low level of inflation and, on that basis, low interest rates, the removal of institutional barriers to business, comprehensible and transparent rules of the game, a predictable and stable macroeconomic policy. The task of the government is to develop the social and technical infrastructure, including effective financial markets, create a flexible labor market and guarantee a superior quality of human capital through the systems of education and health care.