

GAIDAR INSTITUTE FOR ECONOMIC POLICY

**RUSSIAN ECONOMY IN 2016
TRENDS AND OUTLOOKS
(ISSUE 38)**

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The review provides a detailed analysis of main trends in Russian economy in 2016. The paper contains 6 big sections that highlight single aspects of Russia's economic development: the socio-political context; the monetary and budget spheres; financial markets; 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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2.2. Fiscal policy

2.2.1. Assessment of budgets of the budgetary system of the Russian Federation¹

Basic parameters of Russia's budgetary system

In 2016, fiscal revenues of the enlarged government surpassed 2015 volumes both in absolute terms (by RUB 1,253bn) and in relative terms by 0.5 percentage point of GDP (see *Table 6*). Expenditures of the enlarged government went up by 0.8 percentage point of GDP and by RUB 1,581bn in absolute terms. The fiscal deficit of the enlarged government in 2016 was up compared to the level of the previous year (3.7% of GDP in 2016 against 3.4% of GDP in 2015). It should be noted that the fiscal deficit reported in 2015–2016 surpassed manifold its 2013-2014 volumes both in absolute and in relative terms.

Table 6

Basic parameters of the budget of the RF enlarged government in 2012–2016

	2012		2013		2014		2015		2016		Change in 2016 against 2015, percent of GDP
	RUB bn.	% GDP	RUB bn.	% GDP	RUB bn.	% GDP	RUB bn.	% GDP	RUB bn.	% GDP	
Revenues	23 089	34.5	24 082	33.9	26 371	33.3	26 494	31.8	27 747	32.3	0.5
Expenditures	22 826	34.1	24 931	35.1	27 216	34.4	29 308	35.2	30 889	36.0	0.8
Deficit (-) / Surplus (+)	263	0.4	-849	-1.2	-845	-1.1	-2814	-3.4	-3 142	-3.7	-0.3
<i>Reference: GDP, RUB bn.</i>	66 927		71 017		79 200		83 233		85 881		–

Sources: Federal Treasury, Rosstat, Gaidar Institute own calculations.

Analysis of the main parameters of the enlarged government demonstrates that in 2016 growth of state expenditure against 2015 was more moderate – with revenues growing by 0.5 percentage point of GDP, expenditures moved up by 0.8 percentage points of GDP. Meanwhile, in 2015 expansion of state spending by 0.8 percentage point of GDP occurred amid decline of revenues by 1.5 percentage point of GDP. Nevertheless, the outstripping growth of expenditures in comparison with revenues dynamics resulted in larger deficit of the budgetary system in 2016. Emerging trend urges restriction of further budget deficit growth of the enlarged government in order to avoid grave risks for budget and macroeconomic stability.

Revenues from the main taxes to the budgetary system of the Russian Federation

In 2016, the tax burden practically stabilized at the level of the previous year (*Table 7*). Meanwhile, dynamics was mixed across certain components of the tax burden. Revenues from mainly oil and gas sector (hereinafter oil and gas revenues) continued falling – the amount of

¹ Authors of chapter: S. Belev – Gaidar Institute, IAES RANEPA; A. Mamedov – Gaidar Institute, IAES RANEPA; E. Fomina – Gaidar Institute, IAES RANEPA; S. Shatalova – Gaidar Institute, IAES RANEPA.

customs duties and levies declined by 1.0 percentage point of GDP against the 2015 level (by 25.0% in real terms) and revenues from the Mineral Extraction Tax (MET) contracted by 0.5 percentage point of GDP (by 13.9% in real terms). Shortfall in revenues from oil and gas sector was offset by the growth of revenues from other taxes. At the same time, revenues from personal income tax, VAT and profit tax marginally – in the range of 0.1–0.2 percentage point of GDP (by 1.0–2.0%). Revenues from insurance contributions and excises demonstrated notable growth by 0.6 and 0.3 percentage point of GDP, respectively (by 7.1% and 20.4%).

A number of changes were implemented in taxation of the oil and gas sector. In 2016, export duty standard rate on crude oil was not cut to 36% and stayed at 42%. The rate's reduction to 30% is planned from 2017. In the course of implementation of the so-called tax maneuver, the MET standard rate increased from RUB 766 to 857 per ton from January 1, 2016. Simultaneously, coefficient C_{met} was raised from 530 to 559 used for calculation of the indicator, which describes specifics of oil extraction. Planned increase from 4.4 to 5.5 of correcting coefficient C_{mc} (critical micelle concentration) regarding gas condensate was also effected. Moreover, natural gas tax calculation received coefficient, which measures export profitability of a unit of reference fuel ($K_{гн}$) of extracted hydrocarbons. During 2016, its basic value amounted to 0.7317 and equated to 1 for certain categories of tax payers. This decision was aimed at withholding additional profit obtained by natural gas exporters owing to positive ruble devaluation effect.

Table 7

Revenues from the main taxes to the budget of the enlarged government of the Russian Federation 2012–2016, % of GDP

	2012	2013	2014	2015	2016	Change in 2016 against 2015	
						Percent of GDP	Real growth, %
Tax burden	32.1	31.6	31.1	29.0	29.1	0.1	-2.0
Profit tax	3.5	2.9	3.0	3.1	3.2	0.1	1.1
Personal income tax	3.4	3.5	3.4	3.4	3.5	0.1	2.0
Insurance contributions	5.8	6.2	6.0	6.4	7.0	0.6	7.1
VAT	5.3	5.0	5.0	5.1	5.3	0.2	2.4
Excises	1.3	1.4	1.4	1.3	1.6	0.3	20.4
MET	3.7	3.6	3.7	3.9	3.4	-0.5	-13.9
Customs duties and levies	7.4	7.0	6.9	4.0	3.0	-1.0	-25.0

Sources: Federal Treasury, Rosstat, Gaidar Institute own calculations.

Despite the fact that the tax maneuver envisaged to replace revenue shortfall due to reduction of export duty of crude oil and petroleum products with receipts from the MET increased rates on crude oil, external economic conditions resulted in a reduction of receipts on crude oil profit in share of GDP (*Table 8*).

Table 8

Volume of export duties on energy resources and MET in 2012–2016, % of GDP

	2012	2013	2014	2015	2016
MET	3.7	3.6	3.7	3.9	3.4
Export duties on energy resources	6.1	5.7	5.8	3.3	2.3
Crude oil	3.7	3.3	3.3	1.7	1.2
Petroleum products	1.7	1.7	1.9	0.9	0.5
Natural gas	0.6	0.7	0.6	0.7	0.6

Sources: Bank of Russia, Federal Treasury, Rosstat, Gaidar Institute own calculations.

The decline of oil and gas revenues was mainly determined by falling prices on Urals crude, which finally was offset neither by ruble's devaluation nor by indexation of the MET standard rate (see *Fig. 16*). In 2016, the MET rate actually averaged a bit over RUB 3,000 per ton against nearly RUB 3,500 per ton in 2015.

Value added tax on goods sold on the territory of the Russian Federation (“internal VAT”) increased slightly in 2016 as a percentage of GDP (by 0.2 percentage point). Whereas VAT on goods imported to the territory of Russia reflected the values seen in 2014 (see *Table 9*). Russia continues to have better VAT collection rate on imported goods over that on goods manufactured in Russia as well as an upward trend of the VAT effective rate, which is gradually returning to the 2012 level.

In 2016, revenues from *excises* stopped falling and even surpassed the level seen during the relatively successful 2013 as a percentage of GDP. As *Fig. 17* suggests, revenues from all main groups of excisable products increased last year. Excise duties on tobacco products increased by 0.1 percentage point of GDP and remained the main excisable group. Revenues from excise duties on petroleum products and natural gas moved up (by 0.12 percentage point of GDP). Trend on revenues from alcoholic products reversed (+0.07 percentage point of GDP in 2016). Revenues from excise duties on sale of motor vehicles and motorcycles remained flat and continued to make up an inconsiderable share of revenues.

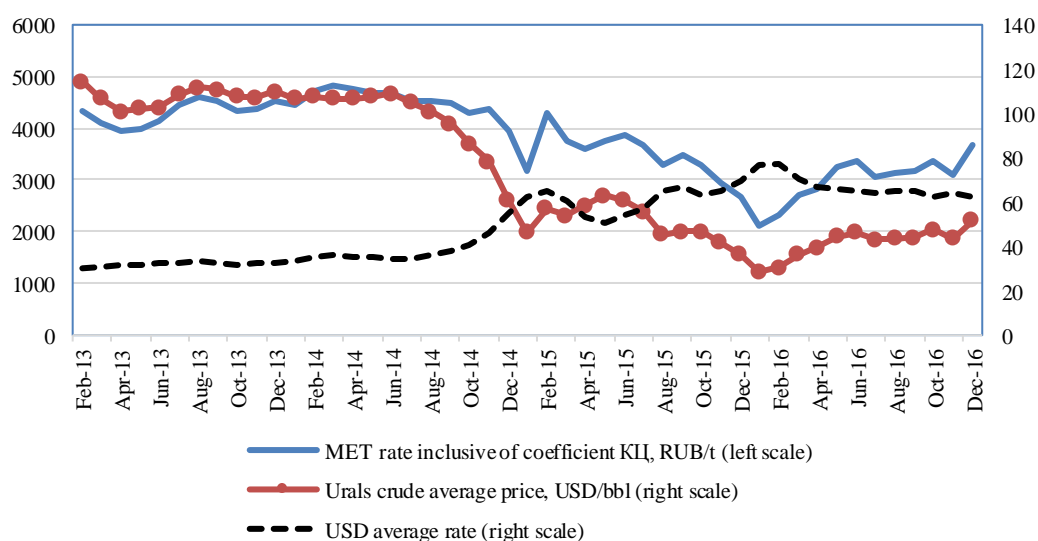


Fig. 16. Dynamics of actual MET tax rate, Urals crude price and USD rate in January 2013–2016

Sources: Consultant+, Bank of Russia, Gaidar Institute own calculations.

Table 9

Dynamics of final consumption, imports and VAT receipts to RF budgetary system in 2012–2016, % of GDP

	2012	2013	2014	2015	2016
Revenues from VAT	5.7	5.0	5.0	5.1	5.3
VAT on goods sold on the territory of the Russian Federation	3.0	2.6	2.8	2.9	3.1
VAT on goods imported to the territory of the Russian Federation	2.7	2.4	2.2	2.1	2.2

RUSSIAN ECONOMY IN 2016

trends and outlooks

VAT effective rate*, %	8.1	6.8	7.0	7.3	7.7
VAT effective rate on goods sold on the territory of the Russian Federation**	6.0	5.0	5.4	6.0	6.3
VAT effective rate on goods imported to the territory of the Russian Federation***	13.1	11.2	10.8	10.4	10.8

* The ratio of VAT receipts to final consumption.

** The ratio of VAT receipts for goods sold on the territory of the Russian Federation to final consumption less import value.

*** The ratio of VAT receipts for goods imported to the territory of the Russian Federation to the value of imports.

Sources: Rosstat, Finance Ministry of Russia, Gaidar Institute own calculations.

Observed dynamics on excises reflects the fact that in 2016 tobacco products to a major extent were subject to indexation of rates (in particular, on cigarettes excise duty went up from RUB 960 to RUB 1,250 per 1,000 sticks and from 11% to 12% of calculated value). Regarding alcoholic products, either there was no rate growth (for strong beverages) or it was insignificant (for wines, cider, and mead came to 1 ruble per liter and for beer 2 rubles per liter). Meanwhile, contraction of sale volume of alcoholic products in physical quantity slowed down for all types.

Regarding *insurance payments* 2016 saw raised threshold requirement for contributions taxed at base rate (the rate remained flat):

- RUB 718,000 for contributions to Social Insurance Fund (against RUB 670,000 in 2015)
- RUB 796,000 for contributions to Russia's Pension Fund (against 711,000 in 2015).

This increase coupled with wage bill growth (estimate according to average gross payroll) by 2.8 percentage points of GDP in 2016 resulted in insurance payments growth.

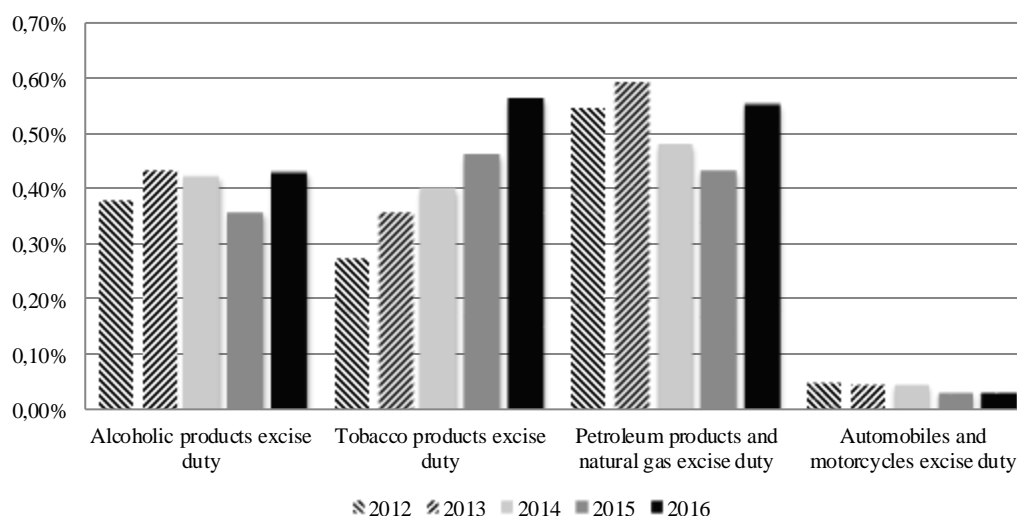


Fig. 17. 2012–2016 revenues from excise duties by group of excisable products, as % of GDP

Sources: Federal Treasury, Gaidar Institute own calculations.

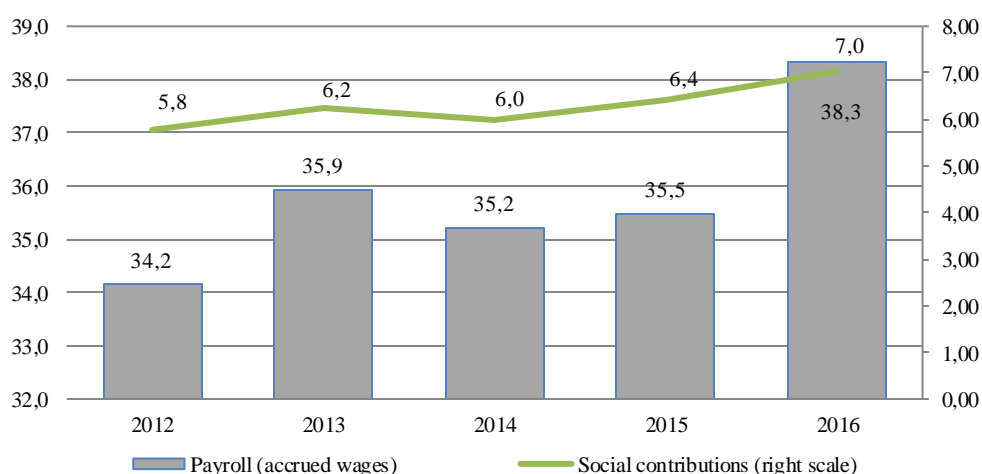


Fig. 18. 2012–2016 revenues from insurance contributions and wage bill (according to gross payroll), as % of GDP

Sources: Federal Treasury, Rosstat, Gaidar Institute own calculations.

Personal income tax. In 2016, cash income minus social contributions declined by 1.4 percentage point of GDP whereas revenues from the personal income tax all the same increased insignificantly by 0.1 percentage point. This reflected the growth of payroll fund in the economy as a whole in percent of GDP (Fig. 19) and, consequently, its share in cash income went up. Increased share of officially reported salary, which led to a larger personal income tax base and affected Rosstat macro indicators to a lesser extent calculated with an account of shadow economy.

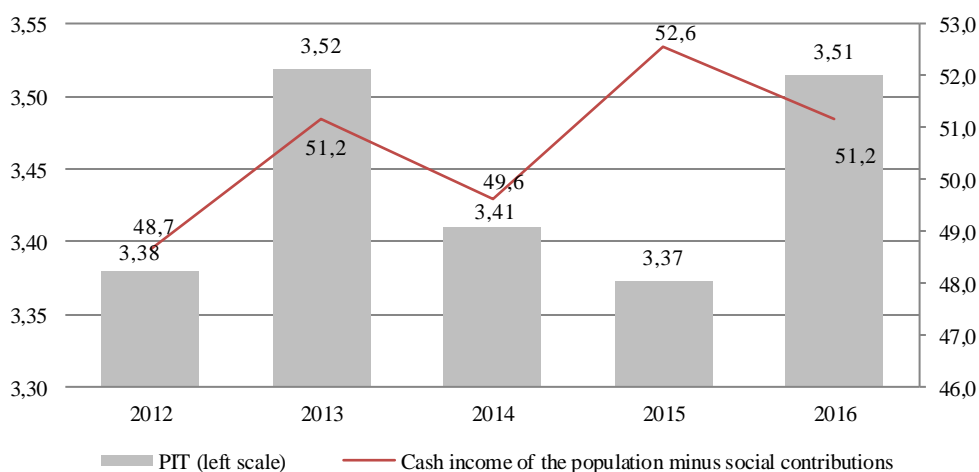


Fig. 19. Revenues from PIT and cash income less social benefits in 2012–2016, as % of GDP

Source: Federal Treasury, Rosstat, Gaidar Institute own calculations.

The profit tax. 2016 saw revenues from the profit tax grow slightly as a percentage of GDP by 0.1 percentage point) reflecting growing profit of profit-making businesses as a share of GDP from 15.2% to 17.1% (see Fig. 20). Partly it was due to depreciation of the ruble that

helped Russian exporting enterprises to enhance competitiveness against foreign manufacturers by partially offsetting the effect of falling aggregate demand as well as to generate “extra” revenues for such enterprises. Moreover, the share of loss-making businesses continued declining (back to the 2013 level of 31%).

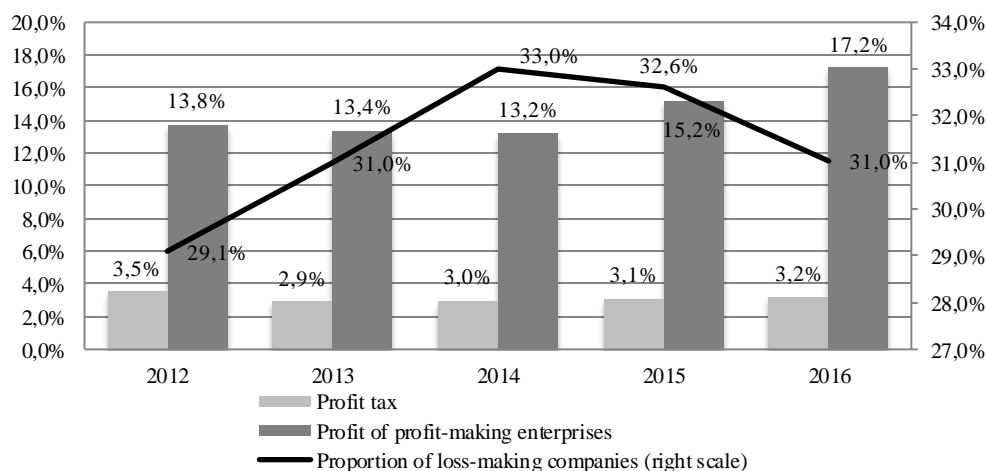


Fig. 20. Dynamics of revenues from the profit tax to Russia's budgetary system, profit of profit-making businesses (% of GDP) and share of loss-making enterprises in 2012–2016

Sources: FTS of Russia, Rosstat, Gaidar Institute own calculations.

Russia's federal budget expenditure

As was mentioned above, the federal budget expenditure in 2016 increased by 0.8 percentage above those in 2015 (see Table 10). Herewith, one can note changes in spending for certain lines of budget expenses of the enlarged government in the range of -0.1 to +0.6 percentage point of GDP.

Table 10

Enlarged government expenditure in 2012–2016, as % of GDP

	2012	2013	2014	2015	2016	Change in 2016 against 2015, percentage of GDP
Expenditure, total	34.1	35.1	34.4	35.2	36.0	0.8
General public issues	2.1	2.1	2.1	2.2	2.2	-0.1
State and municipal debt service	0.6	0.6	0.7	0.8	0.9	0.1
National defense	2.7	3.0	3.1	3.8	4.4	0.6
National security and law-enforcement	2.9	3.0	2.8	2.5	2.3	-0.1
National economy	4.9	4.6	5.7	4.5	4.5	0.0
Housing and community amenities	1.6	1.5	1.3	1.2	1.2	0.0
Environmental protection	0.1	0.1	0.1	0.1	0.1	0.0
Education	3.8	4.1	3.8	3.6	3.6	0.0
Culture and mass media	0.7	0.7	0.7	0.6	0.6	0.0
Health and sports	3.7	3.6	3.5	3.7	3.9	0.2
Social policies	11.0	11.8	10.6	12.1	12.2	0.1

Sources: Federal Treasury, Rosstat, Gaidar Institute own calculations.

Commenced even in 2011, increased spending for ‘National Defense’ continued. In 2016, growth came to 0.6 percentage point of GDP and was driven by the implementation of state armaments program designed for 2011–2020 coupled with the introduction of a new system of

military compensation and war pensions. Moreover, in November 2016, the Law on the Federal Budget for 2016 was amended triggering noticeable growth of spending for ‘National Defense’ (by RUB 740bn, in more detail see below). Additionally, in 2016, expenditure of the enlarged government for ‘Health and Sports’ went up by 0.2 percentage point on 2015. Increased expenditure for this budget item reflected spending growth of health care in nominal terms by 9.2% on 2015 and physical culture and sports by 2.9%. The most noticeable growth of expenditure for health care was due to provision of outpatient care, which grew by 7.4% in nominal terms against 2015. In more detail, we analyze factors affecting dynamics of expenditure for health care when we look at the budget of the mandatory medical insurance federal fund.

In 2016, spending for ‘Social Policy’ grew by 0.1 percentage point against 2015. In 2016, we can talk about the containment of social expenditure due to lump sum indexation of pensions by 4% (since April 1) meanwhile in 2015 it was done twice. This being said, the amount of other social benefits was indexed in line with the real inflation level recorded in 2015.

In 2016, expenditure for ‘Service of State and Municipal Debt’ also went up by 0.1 percentage point of GDP.

Meanwhile, regarding a number of budget items there was a small reduction of spending in shares of GDP – ‘General Public Issues’ by 0.1 percentage point of GDP and ‘National Security and Law Enforcement’ by 0.1 percentage point of GDP. Regarding other budget items, budget expenditure of the enlarged government in percent of GDP remained at the level of the previous year.

The ratio of “productive” (human capital and infrastructure) and “unproductive” outlays was in favor of unproductive expenses in 2016 in the enlarged government budget, first of all, owing to increasing spending for ‘National Defense’ as well as weak growth of spending on social policy.

Deficit of Russia’s budgetary system

At year-end 2016, the volume of deficit of the enlarged government amounted to 3.7% of GDP up 0.3 percentage points of GDP against 2015 3.4% of GDP). As was mentioned above, the deficit of the enlarged government has been growing since 2013. *Table 11* provides sources for financing the budget deficit of the enlarged government in 2012–2016.

Table 11

Sources for financing budget deficit of budgets in Russia in 2012–2016, as % of GDP

	RUB bn					% GDP				
	2012	2013	2014	2015	2016	2012	2013	2014	2015	2016
Sources for financing deficit of budgets, total	-263	849	845	2 814	3 142	-0.4	1.2	1.1	3.4	3.7
Sources for internal financing of deficit of budgets	-281	797	992	3 110	3 127	-0.4	1.1	1.3	3.7	3.6
State securities	550	436	1 016	9	524	0.8	0.6	1.3	0.0	0.6
Loans of credit institutions	162	283	217	102	-103	0.2	0.4	0.3	0.1	-0.1
Change in budget account balances	-923	-715	-3 047	1 339	3 492	-1.4	-1.0	-3.8	1.6	4.1
Other sources	-70	793	2 805	1 660	-786	-0.1	1.1	3.5	2.0	-0.9
Sources for external financing of deficit of budgets	18	52	-147	-296	15	0.0	0.1	-0.2	-0.3	0.02
State securities	164	185	-47	-183	110	0.2	0.3	-0.1	-0.1	0.1
Loans of foreign states	-26	-22	-25	-51	-17	0.0	0.0	0.0	-0.1	0.0
Loans of credit institutions in foreign currency	0	-1	0	0	-28	0.0	0.0	0.0	0.0	0.0

RUSSIAN ECONOMY IN 2016

trends and outlooks

Other sources	-119	-110	-74	-63	-50	-0.2	-0.2	-0.1	-0.1	-0.1
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Sources: Federal Treasury, Gaidar Institute own calculations.

The most part of the deficit of the enlarged government in 2016 was financed from internal sources – around RUB 3,127bn (3.6% of GDP), and from external sources – solely RUB 15bn (0.02% of GDP). We can also stress that for the first time since 2013, there was a surplus balance as a whole both on sources of financing the deficit in foreign currency, and securities denominated in foreign currency.

A significant part of funds obtained from internal sources for financing deficit in 2016 – around RUB 3,492bn or 4.1% of GDP – came from item “Change in budget account balances”. Mainly, this item is formed from the funds of the Reserve Fund (see below).

* * *

Overall in 2016, analysis of the budget parameters of the enlarged government demonstrates that the growth of public expenditure slowed down somewhat. Nevertheless, as in 2015, it exceeded the revenue part, which triggered further increase of the budget deficit. This fact urges further reduction of the deficit in order to avoid significant risks for budget and macroeconomic sustainability. Additional issue is the fact that the deficit growth was accompanied by non-production expenses, first of all, due to build-up of spending on defense as well as somewhat growth of interest expenses and social policy spending.