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TRENDS AND OUTLOOKS**

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The review “Russian economy in 2017. Trends and outlooks” has been published by the Gaidar Institute since 1991. This publication provides a detailed analysis of main trends in Russian economy, global trends in social and economic development. The paper contains 6 big sections that highlight different aspects of Russia's economic development, which allow to monitor all angles of ongoing events over a prolonged period: the socio-political issues and challenges; the monetary and budget spheres; financial markets and institutions; the real sector; social services; institutional changes. The paper employs a huge mass of statistical data that forms the basis of original computation and numerous charts confirming the conclusions.

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## Russia's Fiscal Policy in 2017<sup>1</sup>

2.2.1. The characteristic features of budgets across the RF budgetary system

### *The basic parameters of the RF budgetary system*

The year 2017 saw some notable changes in the main parameters of the execution of the general government budget of the Russian Federation: the budgetary system's revenue gained nearly 1 percentage point of GDP, while expenditure, on the contrary, lost 1.2 percentage points of GDP. Thus, the revenue volume amounted to 32.6 percent of GDP, and that of expenditure – to 34.1 percent of GDP. As a result, the budgetary system's deficit shrank by 2.2 percentage points of GDP, to 1.5 percent of GDP (*Table 7*).

*Table 7*

**The main parameters of the RF budgetary system**

	2013		2014		2015		2016*		2017*		Change in 2017 relative to 2016, percentage points of GDP*
	trillions of rubles	percentage points of GDP	trillions of rubles.	percentage points of GDP	Trillions of rubles	percentage points of GDP	trillions of rubles	percentage points of GDP	trillions of rubles	percentage points of GDP	
Revenue	24.4	33.3	26.7	33.7	26.6	31.9	27.6 (27.2)*	32.1 (31.6)*	30.0	32.6	1.0
Expenditure	25.2	34.5	27.5	34.8	29.4	35.3	30.7 (30.3)*	35.7 (35.2)*	31.4	34.1	-1.2
Deficit (-) / Suplus (+)	-0.8	-1.2	-0.8	-1.1	-2.8	-3.4	-3.1	-3.7	-1.3	-1.5	2.2
<i>For reference: GDP, trillions of rubles</i>	73.13		79.20		83.39		85.92		92.08		-

**Note:** The total volumes of revenue and expenditure volume are adjusted by the 'duplicated' records of insurance contributions for the non working population.

\*To achieve full comparability with 2017, the indices for 2016 are supplemented by data (shown in brackets) derived from reports of the Federal Treasury as of January 1 for each relevant year (cash basis accounting); these indices are lower than the indices taken from the annual reports for each relevant year (accrual basis accounting), first of all due to the specificities of the Federal Social Insurance Fund's operations. Growth in terms of share in GDP (last column) reflects data from the reports as of January 1 for each relevant year.

*Source:* Federal Treasury; Rosstat; Gaidar Institute calculations.

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When reviewing the main parameters of the budgetary system in 2017, it is worthwhile to note that the government has indeed succeeded in halting the trend that began to emerge in 2015–2016 – that of a budget deficit surge. The budget volume returned to its level observed in 2013–2014. This was achieved thanks in part to the budget consolidation measures, and in part to the positive budget revenue movement. As a result, the movement of the deficit and expenditure over the period 2015–2017 displayed a counter-cyclical pattern, i.e., their indices rose during the period of economic decline, and then shrank when the rate of economic growth returned into positive zone by the year-end of 2017 (according to Rosstat’s preliminary data, the growth rate of GDP amounted to 1.5 percent).

It became possible to suppress budget expenditure growth, the necessity to comply with the goals set by the May 2012 Presidential Executive Orders notwithstanding, by saving the surplus oil and gas revenues through their conversion into foreign currency, and also by the early redemption, in 2016, of a significant portion of the loans issued to enterprises of the defense-industrial complex, thus significantly reducing the amount of expenditure earmarked for defense in 2017. The reduction of both budget expenditure and the budget deficit alongside an aggressive monetary policy translated into an inflation plunge from 5.4 percent at year-end of 2016 to 2.5 percent in 2017.

### *The Main Tax Receipts in the RF Budgetary System*

According to data for 2017, the level of general government budget revenue rose by 1.0 percentage point GDP, from 31.6 to 32.6 percent of GDP. Revenue growth was observed across nearly all the components of the aggregate tax load (see *Table 8*).

*Table 8*

### **The main tax receipts in the general government budget of the Russian Federation, percent of GDP**

	2013	2014	2015	2016	2017	Change in 2017 relative to 2016	
						percentage points of GDP	growth in real terms, percent
<b>Revenue, total</b>	<b>33.3</b>	<b>33.7</b>	<b>31.9</b>	<b>32.1 (31.6)*</b>	<b>32.6</b>	<b>1.0</b>	<b>7.9</b>
Corporate profit tax	2.9	3.0	3.1	3.2	3.6	0.4	15.9
PIT	3.5	3.4	3.4	3.5	3.5	0.0	5.1
Insurance contributions	6.3	6.3	6.4	6.6 (6.3)*	6.4	0.1	6.3
VAT	5.0	5.0	5.1	5.4	5.6	0.2	8.2
Excises	1.4	1.4	1.3	1.6	1.7	0.1	15.1
MRET	3.6	3.7	3.9	3.4	4.5	1.1	37.5
Customs duties and fees	7.0	6.9	4.0	3.0	2.8	-0.2	-2.6

**Note.** Total revenue and insurance contributions are adjusted by the ‘duplicated’ records of insurance contributions for the non working population.

\* To achieve full comparability with data for 2017 taken from the Federal Treasury’s report as of 1 January 2018 (cash basis accounting), the indices for 2016 are supplemented by data (shown in brackets) derived from reports of the Federal Treasury as of 1 January 2017 (cash basis accounting); these indices are lower than the indices taken from the annual reports for each relevant year (accrual basis accounting), first of all due to the specificities of the Federal Social Insurance Fund’s operations. Growth indices (last two columns) relative to data in the corresponding rows are taken from the reports as of 1 January for each relevant year.

Source: Federal Treasury; Rosstat; Gaidar Institute calculations.

The amount of the budgetary system’s oil and gas revenues, after having shrank in 2016, then significantly increased in 2017 due to the rising global prices for raw materials, and primarily energy resources. Thus, in particular, the amount of MRET receipts increased by 1.1 percentage points of GDP (or 37.5 percent in real terms). At the same time, the overall

volume of customs duties and fees continued to decline (by -0.2 percentage points of GDP relative to 2016, or -2.6 percent in real terms), which can be explained by the ongoing ‘tax maneuver’ in the oil and gas sector (for more details, see below). Insurance contributions, excises and VAT increased at about 0.2 percentage points of GDP. PIT receipts remained practically unchanged.

**Oil and gas revenues.** The movement patterns of MRET and customs duties on energy carrier exports are shown in *Table 9*.

*Table 9*

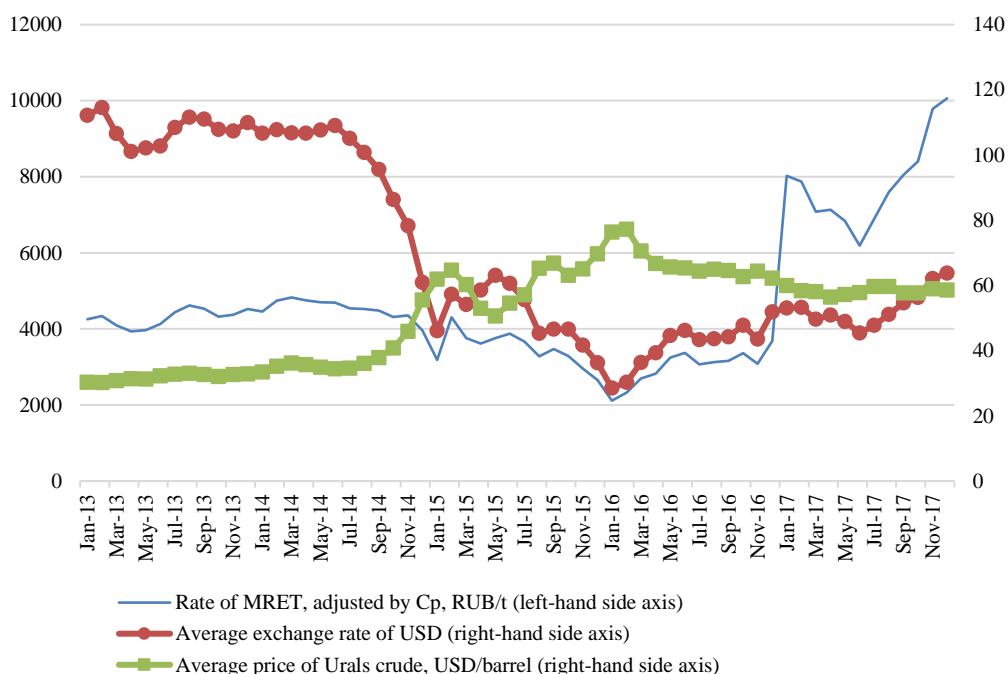
**The receipts of MRET and export duties on energy carriers, percent of GDP**

	2013	2014	2015	2016	2017
MRET	3.6	3.7	3.9	3.4	4.5
Export duties for:					
- energy carriers	5.7	5.8	3.3	2.3	2.1
- crude oil	3.3	3.3	1.7	1.2	1.1
- petroleum products	1.7	1.9	0.9	0.5	0.4
- natural gas	0.7	0.6	0.7	0.6	0.6

*Source:* Rosstat; RF Central Bank; RF Federal Customs Service, RF Federal Tax Service; Gaidar Institute calculations.

An analysis of the movement patterns of the tax and customs bases demonstrates that in 2017, exports and crude oil production remained practically unchanged relative to 2016. Exports amounted to 256.9 million *t* (+3.2 million *t* relative to 2016), and the production volume – to 546.7 million *t* (-0.5 million *t* relative to 2016).

The growth of oil and gas revenues was positively influenced by the movement pattern of the price of Urals crude. Meanwhile, the USD to RUB exchange rate responded weakly to changes in oil price (see *Fig. 17*).



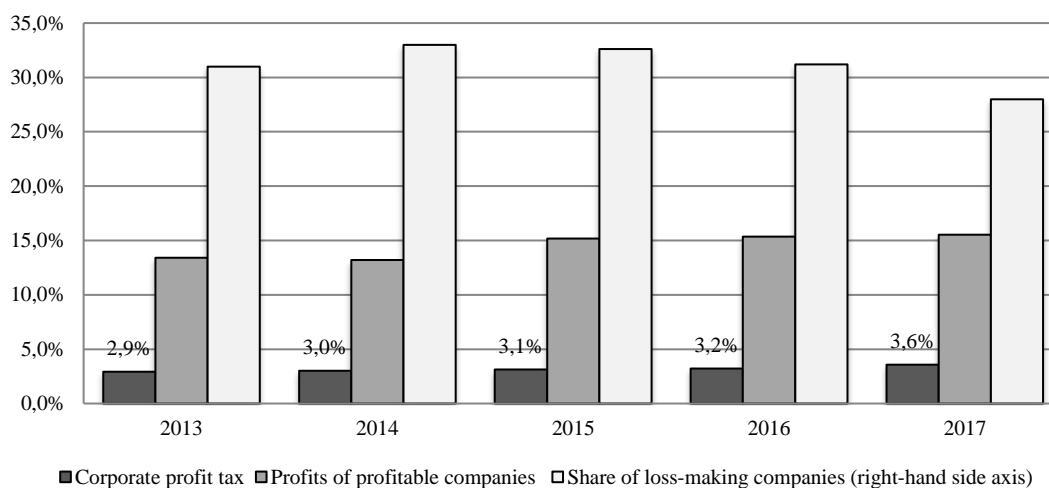
*Fig. 17.* The movement patterns of the actual rate of MRET, prices of Urals, and the exchange rate of USD

**Note.** Cp is the coefficient describing the movement of world oil prices (in ruble terms, i.e., prices in USD and the USD to RUB exchange rate)

At the same time, the main input in the oil and gas revenue increase was made by the continuing tax maneuver in the oil and gas sector: from January 1, 2017, the basic rate of MRET for oil was raised from RUB 857 to RUB 919 per t, while the rate of export duty was reduced from 42 to 30 percent. In response to the combined effects of the price factor (the price of oil in rubles) and the legislative factor (raised basic rate), the actual ruble denominated rate of MRET amounted on the average in 2017 to more than RUB 7,800 per t, while in 2016 it was on the average slightly above RUB 3,000 per t, thus not only compensating for the shrinkage of the amount of customs duties in the framework of the tax maneuver, but also triggering growth of the total volume of oil and gas revenues.

As before, the bulk of the tax burden associated with MRET is borne by the oil industry: the tax receipts generated by crude oil production increased, in 2017, by 0.9 percentage points of GDP, or 43.1 percent in real terms, while those generated by natural gas production gained only 0.2 percentage points (48.1 percent in real terms). It should be noted that the budget dependence on MRET has been gradually on the rise: while in 2013 the receipts of MRET accounted for 38.0 percent of the total volume of oil and gas revenue and for 19.1 percent of total federal budget revenue, in 2017 these indices amounted to 67.7 and 26.8 percent respectively.

**Corporate profit tax.** The year 2017 saw a rather notable growth of the corporate profit tax receipts (by 0.4 percentage points of GDP). As can be seen in *Fig. 18*, the profits of profitable companies slightly increased (by 0.1 percentage points of GDP), while the share of loss-making ones declined (by 3.2 percent). At the same time, a significant additional factor shaping the movement pattern of the tax receipts was the restriction on the possibility of carry-forward of the losses of previous periods in the amount of not more than 50 percent of the amount of taxable profit, which entered into force on January 1, 2017.



*Fig. 18.* The movement patterns of the corporate profit tax receipts in the RF budgetary system

Source: RF Federal Tax Service; Rosstat.

**Value added tax.** In 2017, the receipts of VAT on goods sold in RF territory ('domestic VAT') somewhat increased in terms of share in GDP (by 0.2 percentage points), while the

receipts of VAT on goods imported into RF territory slightly decreased, returning to their 2014 level (Table 10). As before, Russia's typical feature is the higher collectability of VAT on imports than that of VAT on goods produced in RF territory.

Table 10

**The movement patterns of VAT receipts in the RF budgetary system, percent of GDP**

	2013	2014	2015	2016	2017
Revenue generated by VAT	5.0	5.0	5.1	5.4	5.6
VAT on goods sold in RF territory	2.6	2.8	2.9	3.1	3.3
VAT on goods imported into RF territory	2.4	2.2	2.1	2.3	2.2
<i>For reference:</i>					
Effective rate of VAT, <sup>1</sup> percent	6.8	7.0	7.3	7.7	7.7
Effective rate of VAT on goods sold in RF territory <sup>2</sup>	5.0	5.4	6.0	6.3	6.3
Effective rate of VAT on goods imported into RF territory <sup>3</sup>	11.2	10.8	10.4	10.8	10.8

<sup>1</sup>VAT receipts to final consumption ratio.

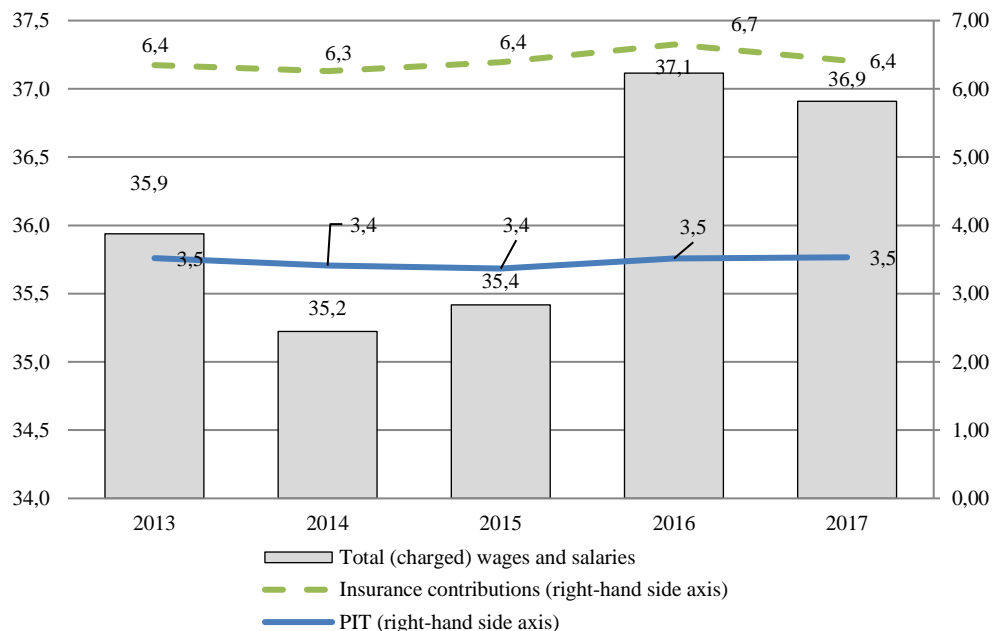
<sup>2</sup>Ratio of receipts of VAT on goods sold in RF territory to final consumption, less value of imports.

<sup>3</sup>Ratio of receipts of VAT on imported into RF territory to value of imports.

Source: Rosstat; RF Ministry of Finance; Gaidar Institute calculations.

**Payroll taxes.** The year 2017 saw no changes in the rates of insurance contributions. The total charged wages and salaries in terms of share in GDP lost nearly 0.2 percentage points of GDP; however, the receipts of insurance contributions gained 0.1 percentage points of GDP, in the main due to the increased wage and salaries level in the groups with incomes below the income threshold, to which the basic rate applies.

The receipts of PIT in terms of share in GDP remained at the same level as in 2016.



**Note.** Insurance contributions data are derived from the monthly reports released by Roskazna (RF Federal Treasury) (as of January 1 of the corresponding year) and adjusted by the 'duplicated' records of insurance contributions for the non working population.

*Fig. 19.* The receipts of insurance contributions and PIT, total (charged) wages and salaries, percent of GDP

In 2017, the total volume of mandatory social insurance contributions amounted to RUB 4,495.3 billion (or 4.9 percent of GDP). When taken in nominal terms, the volume of social insurance receipts increased by 8.5 percent, and in real terms – by 4.6 percent. The compulsory medical insurance contributions of the working population (including self-employed individuals) amounted in 2017 to RUB 1,089 billion, and the compulsory medical insurance contributions for the *non working population* – to about RUB 619 billion.

**Excises.** In 2017, the aggregate revenues generated by excises on tobacco and alcohol products significantly increased, rising above 1 percent of GDP (see *Table 11*).

*Table 11*

**The input to the budget of the excises on tobacco and alcohol products**

	2012	2013	2014	2015	2016	2017
Receipts of excises on tobacco products, billions of rubles	183	253	319	386	483	591
Receipts of excises on alcohol products, billions of rubles	255	307	333	294	349	397

*Source:* RF Federal Tax Service.

The data presented above are sufficiently positive, considering the fact that over recent years, both the tobacco and alcohol markets have been displaying a downward trend in consumption in terms of physical volume.<sup>1</sup> So, there exist some grounds for arguing that at present, two possible excise policy goals can be achieved in the addictive product markets:<sup>2</sup> consumption decline and budget revenue increase. Thus, increasing excises translate into increasing consumer prices, and these, in their turn, influence retail sales volumes. However, due to the low price elasticity of demand, raised excises, as a rule, trigger growth of their receipts in the national budgetary system. According to these data, in 2017 the revenues generated by excises on tobacco products amounted to RUB 591 billion vs. RUB 483 billion a year earlier, while those generated by excises on alcohol products increased from RUB 349 to RUB 397 billion.

Among the revenues from alcohol products, the biggest input was made by those from beer and liquor, in particular in 2017, the share of excises on liquor gained 2.5 percentage points relative to 2016, rising to 54.7 percent; meanwhile, the share of excises on beer lost 4.4 percentage points, shrinking to 38.9 percent. Due to the significantly raised rates, the input of revenues from wines increased.

***The Expenditure Side of the RF Budgetary System***

The total expenditure of the budgetary system of the Russian Federation shrank in 2017 by 1.2 percentage points of GDP relative to 2016 (see *Table 12*). Meanwhile, the changes in the volume of general government budget expenditure, when broken down by function, varied in the range from -1.3 to +0.18 percentage points of GDP.

*Table 12*

**General government budget expenditure, percent of GDP**

<sup>1</sup> For example, there have been a stable decline in the consumption of tobacco products: while in 2006 total tobacco product consumption amounted to 380 billion units, in 2016 this index was 290 billion units. The situation in the alcohol market, according to Rosstat data, has been similar: the consumption record high, observed in 2007, amounted to 1.47 billion dal for all types of products, and in 2016, the total market volume did not exceed 1.07 billion dal.

<sup>2</sup> Addictive products are those that, once consumed, may trigger addiction effects. The majority of products in this category are demerit goods, i.e. goods that can have a negative impact on the consumer.



	2013	2014	2015	2016	2017	Change in 2017 relative to 2016, percentage points
Expenditure, total	34.5	34.8	35.3	35.7 (35.2)*	34.1	-1.2
Nationwide issues	2.1	2.1	2.2	2.2	2.1	-0.0
National defense	2.9	3.1	3.8	4.4	3.1	-1.3
National security and law enforcement activity	3.0	2.8	2.5	2.3	2.2	-0.1
National economy, including:	4.5	5.7	4.5	4.5	4.7	0.2
agriculture and fisheries	0.5	0.4	0.4	0.4	0.4	-0.0
transport	0.7	0.8	0.8	0.8	0.9	0.1
motor road system (road funds)	1.6	1.5	1.5	1.6	1.6	0.0
communications and IT	0.1	0.1	0.1	0.1	0.1	0.0
Housing and community amenities	1.4	1.3	1.2	1.2	1.3	0.2
Environmental protection	0.1	0.1	0.1	0.1	0.1	0.0
Education	3.9	3.8	3.6	3.6	3.5	-0.1
Culture, cinematography	0.5	0.5	0.5	0.5	0.5	0.0
Healthcare	3.1	3.1	3.1	3.0	3.1	0.1
Social policies	12.0	11.1	12.5	12.6 (12.1)*	11.9	-0.2
Physical culture and sports	0.3	0.3	0.3	0.3	0.4	0.1
Mass media	0.2	0.1	0.2	0.1	0.1	0.0
Government and municipal debt servicing	0.6	0.7	0.8	0.9	0.9	0.0

**Note.** The total expenditure volume, as well as the government spending under the *Healthcare* and *Social Policies* sections are adjusted by the ‘duplicated’ records of insurance contributions for the non working population.

\*To achieve full comparability with data for 2017 taken from the Federal Treasury’s report as of 1 January 2018 (cash basis accounting), the budget system expenditure indices for 2016 are supplemented by data (shown in brackets) derived from the Federal Treasury’s report released as of 1 January 2017 (cash basis accounting); these indices are lower than the indices taken from the annual reports for each relevant year (accrual basis accounting), first of all due to the specificities of the Federal Social Insurance Fund’s operations. Growth indices (last column) relative to data in the corresponding rows are taken from the reports as of 1 January for each relevant year.

Source: Federal Treasury; Rosstat; Gaidar Institute calculations.

The most significant cuts were made in the government spending under the *National Defense* section (-1.3 percentage points of GDP), thus interrupting the constantly upward trend in military expenditure observable over recent years. In addition to the early redemption (in 2016) of the loans issued to defense enterprises, the shrinkage of expenditure allocated to *National Defense* may also have to do with the fact that the new government armaments program was approved only as late as 2018 (for 2018–2027), which means that this movement pattern may simply represent a ‘technical pause’.

At the same time, the latest federal budget for 2018–2020 envisages a volume of spending to be allocated to this budget function that is slightly below the level of 2017, even when taken in absolute terms. In this connection it should be borne in mind that in accordance with the practice typical of recent years, the initial budget version is drawn up less the funding earmarked for the repayment of bank loans to the organizations belonging to the defense-industrial complex, received by the latter against government guarantees granted to secure the fulfillment of state defense orders. It is not known if the corresponding spending volumes are included in the approved budget functions for the period 2018–2020, or not. So, the possibility of an upward adjustment of the allocations to defense relative to the planned targets already in the course of execution of the 2018 federal budget cannot be ruled out, and we should not make any definite conclusion as to the sustainability of this change in trend from growth to a gradual reduction in the volume of government spending.

In 2017, a slight decline on 2016 (in the range of 0.1 percentage points of GDP) was also demonstrated by allocations to *National Security and Law-Enforcement Activity* and *Education*.

At the same time, there was an increase in the amount of funding designated to some expenditure functions: *National Economy* (by 0.2 percentage points of GDP), *Housing and Community Amenities* (0.2 percentage points of GDP), and *Healthcare* (0.1 percentage points

of GDP). If we take a closer look at the items listed in the *National Economy* section, it can be noticed that more than half of the increased government spending was accounted for by infrastructure projects (allocations to transport, roads, and communications), and this should be interpreted as a positive fact.

As far as social policy is concerned, we may note the reinstatement of the long-established practice of indexation of pensions and social benefits (in this connection it was decided that the size of pensions should be adjusted not by the actual inflation rate, but by the targets approved alongside the budget projections for 2017).

On the whole, from the point of view of the ratio of ‘productive’ to ‘unproductive’ spending (the former meaning the allocations to infrastructure and human capital), the year 2017 saw a certain improvement in the general government budget expenditure structure.<sup>1</sup> However, this happened largely due to a sizable shrinkage of the government spending on defense coupled with a slight increase of that allocated to infrastructure, and a somewhat decreased amount of government spending on education. As a result, even without our earlier considerations concerning changes in the government spending under the *National Defense* section, it can still be concluded that so far, there has been no definite trend reversal and a switchover to a systematic and targeted shift in the government expenditure structure in favor of ‘productive’ spending items.

### *The Deficit of the RF Budgetary System*

Table 13 presents data concerning the sources of general government budget deficit financing in 2013–2017.

Table 13

#### The sources of deficit financing in the RF budgetary system

	2013		2014		2015		2016		2017		Change in 2017 relative to 2016, percentage points of GDP
	billions of rubles	percent of GDP	billions of rubles	percent of GDP	billions of rubles	percent of GDP	billions of rubles	percent of GDP	billions of rubles	percent of GDP	
<b>Sources of deficit financing, total</b>	849	1.2	845	1.1	2,814	3.4	3,142	3.7	1,349	1.5	-2.2
<b>Deficit financing from domestic sources</b>	797	1.1	992	1.3	3,110	3.7	3,127	3.6	1,475	1.6	-2.0
Government securities	436	0.6	1,016	1.3	9	0.0	524	0.6	1,221	1.3	0.7
Loans issued by credit institutions	283	0.4	217	0.3	102	0.1	-103	-0.1	-126	-0.1	0.0
Movement of residuals	-715	-1.0	-3,047	-3.8	1,339	1.6	3,492	4.1	632	0.7	-3.4
Other sources	793	1.1	2,805	3.5	1,660	2.0	-786	-0.9	-250	-0.3	0.6
<b>Deficit financing</b>	52	0.1	-147	-0.2	-296	-0.4	15	0.0	-126	-0.1	-0.2

<sup>1</sup> For more details concerning ‘productive’ and ‘unproductive’ spending, see Kudrin A., Sokolov I. *Fiscal maneuver and restructuring the Russian economy*. Voprosy Ekonomiki, 2017, No. 9, pp. 5-27. (In Russian).

<b>from external sources</b>											
Government securities	185	0.3	-47	-0.1	-183	-0.2	110	0.1	41	0.0	-0.1
Credits granted by foreign states	-22	0.0	-25	0.0	-51	-0.1	-17	0.0	-20	0.0	0.0
Loans denominated in foreign currencies, issued by credit institutions	-1	0.0	0	0.0	0	0.0	-28	0.0	0	0.0	0.0
Other sources	-110	-0.2	-74	-0.1	-63	-0.1	-50	-0.1	-147	-0.2	-0.1

Source: Federal Treasury; Rosstat; Gaidar Institute calculations.

In 2017, the entire general government budget deficit was covered by financing from domestic sources (in the amount of approximately RUB 1,475 billion (or 1.6 percent of GDP), whereas the repayment of borrowings from external sources exceeded that of new borrowings, thus producing a negative balance of RUB 126 billion (or -0.1 percent of GDP).

The bulk of financing that was used to offset budget deficit in 2017 (to the value of approximately RUB 1,221 billion, or 1.3 percent of GDP) was received from the source *Government Securities*. The section *Movement of Residuals in Budget Accounts* generated a total of RUB 632 billion (or 0.7 percent of GDP). This budget function is formed in the main by the operations involving the use of sovereign reserves.

Generally speaking, we may note the increased importance of government bonds as a source of financing to cover the budgetary system deficit in 2017, alongside an emerging upward trend in government borrowing in the domestic market. If this trend should persist over the course of next year, it may give rise to some potentially negative macroeconomic effects, when private investment will be replaced by government funding.

## 2.2.2 The characteristics of the federal budget

### *The Basic Parameters of the Federal Budget*

In 2017, federal budget revenue amounted to 16.4 percent GDP, which is 0.7 percentage points of GDP above its 2016 level (*Table 14*). The growth of aggregate federal budget revenue was caused by the increase of its oil and gas component by 0.9 percentage points of GDP, while the volume of non-oil and gas revenues shrank by 0.2 percentage points of GDP.

Table 14

### **The main parameters of the federal budget, percent of GDP**

	2013	2014	2015	2016	2017			Change in 2017 relative to 2016, percentage points of GDP
					2017 Federal Budget Law*	2017 Federal Budget Law, as amended **	Budget execution	
<b>Revenue</b>	<b>17.8</b>	<b>18.3</b>	<b>16.4</b>	<b>15.7</b>	<b>15.5</b>	<b>16.0</b>	<b>16.4</b>	<b>0.7</b>
oil and gas revenues	9.0	9.4	7.0	5.6	5.8	6.3	6.5	0.9
non-oil and gas revenues	8.8	8.9	9.4	10.1	9.7	9.7	9.9	-0.2
<b>Expenditure</b>	<b>15.7</b>	<b>18.7</b>	<b>18.7</b>	<b>19.1</b>	<b>18.7</b>	<b>18.1</b>	<b>17.8</b>	<b>-1.3</b>
<b>Deficit (-) / surplus (+)</b>	<b>2.1</b>	<b>-0.4</b>	<b>-2.3</b>	<b>-3.4</b>	<b>- 3.2</b>	<b>-2.1</b>	<b>-1.5</b>	<b>2.0</b>
Non-oil and gas deficit	-6.9	-9.8	-9.3	-9.0	- 9.0	-8.4	-7.9	1.1

Price of Urals crude, USD/barrel	108.0	97.6	51.2	41.9	40.0	49.9	53.0	-
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\* Federal Law No 415-FZ dated December 19, 2016 'On the Federal Budget for 2017 and the Planning Period 2018-2019'.

\*\* As amended by Federal Law No 326-FZ dated November 14, 2017.

Source: Federal Treasury; Rosstat; Gaidar Institute calculations.

In 2017, the volume of federal budget expenditure amounted to 17.8 percent of GDP, which is 1.3 percentage points of GDP below the 2016 level, and 0.9 percentage points of GDP below the initially approved expenditure projection for 2017. The amount of deficit in 2017 shrank by 2.0 percentage points of GDP relative to 2016, while at the same time staying at -1.5 percent GDP, a level that was sufficiently high to ensure budget sustainability. Meanwhile, the actual amount of federal budget deficit turned out to be far below both the projection entered in the first version of the budget law for 2017–2019 (-3.2 percent of GDP) and that approved in the latest amendment thereto (-2.1 percent of GDP). This can be explained by the reduced volume of expenditure relative to the planned target, as well as by the high volume of revenue. On the revenue side, this effect was produced by its oil and gas component is a situation where the actual prices of oil turned out to be far above the corresponding budget projection (*Table 14*).

It should be noted that there was a shrinkage of the non-oil and gas deficit: its volume, in 2017, amounted to 7.9 percent of GDP, which is 1.1 percentage points of GDP below the 2016 level, and 1.9 percentage points of GDP below the record high of the past 5-year period (-9.8 percent of GDP in 2014). At the same time, the year 2017 interrupted the downward trend displayed by the index of the federal budget's dependence on the situation in the global markets for energy carriers: the share of oil and gas revenues in total budget revenue consistently declined from 51 percent in 2014 to 43 and 35 percent in 2015 and 2016 respectively, and then, in 2017, it surged to 39.6 percent.

In 2017, the RF Budget Code was amended, with the introduction of the basic parameters of a new budgetary rule (hereinafter – BR)<sup>1</sup>. Although the new BRs formed the foundation only of the Law of the Federal Budget for 2018–2020, the parameters of the 2017 federal budget were also projected with due regard for their structure (e.g., the oil price level projected in the budget for 2017), in order to ensure a smoother transition to the new set of rules.

The new BR determines the expenditure cap as a sum of the following three components: 1) the basic volume of oil and gas revenues calculated at a constant baseline price of Urals crude amounting to USD 40 per barrel (with a subsequent annual upward adjustment by 2 percent, from 2018 onwards); 2) the volume of non-oil and gas revenues calculated in accordance with the basic medium-term economic development scenario of the RF Ministry of Economic Development; 3) the cost of debt servicing.

Importantly, the new budgetary rule has a number of significant drawbacks.<sup>2</sup>

Firstly, it should be noted that the new BR lacks flexibility. The justification for setting price of oil at USD 40 per barrel (even with the subsequent annual 2-percent upward adjustment). The current long-term forecasts place the oil price significantly above that level, while oil price is influenced by multiple factors, and it is very difficult to predict technological and other shifts in the structure of demand over a period longer than 3 years. Besides, these BRs do not protect the National Welfare Fund (NWF) from political pressures aiming at a revision of the basic oil

<sup>1</sup> Federal Law No 262-FZ dated July 29, 2017 'On the Introduction of Alterations in the Budget Code of the Russian Federation in the Part Regulating the Use of the Oil and Gas Revenues of the Federal Budget'.

<sup>2</sup> Kudrin A., Sokolov I. Fiscal rules as an instrument of balanced budget policy. *Voprosy Ekonomiki*, 2017, No. 11, pp. 1–28. (In Russian).

price applied; these pressures will potentially mount as the amount of accumulated sovereign reserves increases (as it already happened in 2005), which in its turn casts doubt on the possibility of properly implemented fiscal maneuver.

Secondly, the new BRs lack counter-cyclical effects. Because the non-oil and gas revenues are pegged to GDP and display a pro-cyclical behavior, the pattern of government spending allocated to debt servicing is acyclical, and oil and gas revenues are correlated with the price of oil (it is exogenous relative to the structural cycle of Russia's economy), none of the components of the BRs takes into account the cyclical character of Russia's economic development, and this means that they neither sustain the economy during its decline phase (by functioning as a substitute for the diminished market demand), nor restrain the economic growth rate during the upward movement phase (and thus avoid economy overheating).

Thirdly, the RF Ministry of Finance, by means of introducing the BR, aims only at smoothing the shocks of oil and gas revenues caused by the behavior of price of oil. However, global experience demonstrates that non-oil and gas revenues may also be sensitive to shocks produced by price of oil (first of all, corporate profit tax), and at the same time incorporate a cyclical component unrelated to price of oil.

Fourthly, there is the issue of approaches to spending the NWF. In the current version, it is suggested that a cap of 1 percent of GDP should be set on the amount of spending if the NWF has accumulated no more than 5 percent of GDP. However, if the government of the Russian Federation should attempt to launch a comprehensive anti-crisis program (as it happened in 2009), the rule will not allow it, and so the rule will have to be suspended.

### *The Main Revenue Sources*

The parameters of execution of the revenue side of the federal budget for 2017 are presented in *Table 15*. In 2017, the aggregate revenue of the federal budget increased by 0.7 percentage points of GDP relative 2016.

*Table 15*

### **The main tax receipts in the federal budget**

	Percent of GDP					Change in 2017 relative to 2016, percentage points of GDP
	2013	2014	2015	2016	2017	
<b>Revenue, total</b>	<b>18.3</b>	<b>18.3</b>	<b>16.4</b>	<b>15.7</b>	<b>16.4</b>	<b>0.7</b>
<b>Oil and gas revenues</b>	<b>9.2</b>	<b>9.4</b>	<b>7.0</b>	<b>5.6</b>	<b>6.5</b>	<b>0.9</b>
<i>including:</i>						
MRET	3.5	3.6	3.7	3.3	4.4	1.1
export duties	5.7	5.8	3.3	2.3	2.1	-0.2
<b>Non-oil and gas revenues</b>	<b>9.1</b>	<b>8.9</b>	<b>9.4</b>	<b>10.1</b>	<b>9.9</b>	<b>-0.2</b>
<i>including:</i>						
corporate profit tax	0.5	0.5	0.6	0.6	0.8	0.2
VAT on goods sold in RF territory	2.6	2.8	2.9	3.1	3.3	0.2
VAT on goods imported into RF territory	2.4	2.2	2.1	2.2	2.2	0.0
excises on goods produced in RF territory	0.6	0.7	0.6	0.7	1.0	0.3
excises on goods imported into RF territory	0.1	0.1	0.1	0.1	0.1	0.0
import duties	1.0	0.8	0.7	0.7	0.6	-0.1
export duties	0.2	0.2	0.1	0.0	0.0	0.0
other revenues	1.7	1.6	2.3	2.7	1.9	-0.8

*Source:* Federal Treasury; Rosstat; Gaidar Institute calculations.

As noted earlier, thanks to the ongoing tax maneuver in the oil and gas sector, the increased MRET fully offset and even overshot the shrinkage of receipts of export duties, and thus the volume of oil and gas revenues gained 0.9 percentage points of GDP.

In 2017, the non-oil and gas component of tax-generated revenues in the federal budget increased, relative to 2016, thanks to receipts of corporate profit tax (by 0.2 percentage points of GDP), of VAT on goods sold in RF territory (by 0.2 percentage points of GDP), and of excises on goods produced in RF territory (by 0.3 percentage points of GDP). At the same time, there was a drop in the receipts of import duties — by 0.1 percentage points of GDP. The growth of receipts of corporate profit tax in the federal budget was generated, in part, by the centralization, in 2017, of 1 percentage point of the tax rate, with a subsequent redistribution of these receipts in the form of equalization subsidies transferred to regional budgets.

The volume of non-tax revenues in the 2017 federal budget lost 0.8 percentage points of GDP relative to 2016. This revenue shrinkage was caused by the absence of any sizable income generated by state property, in contrast to 2016, when this revenue category notably surged at year-end in response to the additional inflow of proceeds generated by the partial privatization of PAO *Rosneft*.

### ***Federal Budget Expenditure***

In 2017, the volume of federal budget expenditure amounted to 17.8 percent of GDP, which represented a drop by 1.3 percentage points of GDP relative to 2016, or by 0.3 percent in nominal terms (see *Table 16*).

*Table 16*

#### **Federal budget expenditure (by-function classification of federal budget expenditure)**

	2016	2017	Change		Budget execution, relative to approved annual budget projections, percent	
	percent of GDP	percent of GDP	nominal growth rate, percent	percentage points of GDP	2016	2017
<b>Expenditure, total</b>	<b>19.1</b>	<b>17.8</b>	<b>-0.3</b>	<b>-1.3</b>	<b>98.7</b>	<b>96.1</b>
Nationwide issues	1.3	1.3	7.6	0.0	97.1	94.5
National defense	4.4	3.1	-24.4	-1.3	99.2	93.2
National security and law enforcement activity	2.2	2.1	1.0	-0.1	100.4	97.8
National economy	2.7	2.6	4.8	-0.1	95.9	93.5
Housing and community amenities	0.1	0.1	64.0	0.0	95.5	94.8
Environmental protection	0.1	0.1	46.4	0.0	99.6	99.2
Education	0.7	0.7	2.9	0.0	99.1	98.7
Culture and cinematography	0.1	0.1	2.0	0.0	96.3	90.5
Healthcare	0.6	0.5	-13.1	-0.1	97.6	97.3
Social policies	5.3	5.4	8.8	0.1	99.7	99.2
Physical culture and sports	0.1	0.1	61.4	0.0	88.7	93.8
Mass media	0.1	0.1	8.6	0.0	99.9	99.9
Government debt servicing	0.7	0.7	9.3	0.0	97.1	92.9
General-purpose inter-budgetary transfers	0.8	0.8	17.6	0.0	99.8	95.3

*Source:* Federal Treasury; Rosstat; Gaidar Institute calculations.

The deepest drop was demonstrated by the government spending under the *National Defense* section (by 1.3 percentage points of GDP) as a result of cuts of allocations to the '*Armed Forces*' stream from 4.4 percent of GDP in 2016 to 3.1 percent of GDP in 2017, while its cash execution amounted to 95.1 percent. Besides, downward movement could be observed in the *National Security and Law-Enforcement Activity* and *Healthcare* sections (by 0.1 percentage points of GDP each). The increased volume of financing allocated to *Social Policy* by 0.1 percentage points of GDP in 2017 occurred in response to growth in the amount of on pension provision

liabilities, including the one-time payment, in the amount of RUB 5,000 in January 2017, by way of compensation for the lack of full pension indexation in 2016. As far as all the other significant budget expenditure functions are concerned, these in 2017 did not change on 2016 in terms of share in GDP.

With regard to the cash execution level of federal budget expenditure over the period 2016–2017, it can be noted that, while in 2016 the execution level was at 98.7 percent the budget revenue and expenditure targets, in 2017 that index plunged to 96.1 percent. As in the previous year, the highest budget execution level in 2017 relative to the total amount of budget allocations (above 99.0 percent) was noted under the sections *Environmental Protection*, *Social Policy*, and *Mass Media*. At the same time, the lowest year-end cash execution index for 2017 was achieved for *Culture and Cinematography* (90.5 percent), *Government Debt Servicing* (92.9 percent), *National Defense* (93.2 percent), *National Economy* (93.5 percent), and *Housing and Community Amenities* (94.8 percent). In this connection, it is worthwhile to note that the cash execution level of budget expenditure allocated to defense declined from 99.2 percent in 2016 to 93.2 percent in 2017.

In the framework of by-department classification of federal budget expenditure, we can analyze the evenness and the implementation rate of budget spending by each of the government ministries and departments. *Table 17* shows the list of chief budget funds managers (CBFMs) with the least year-end indices of federal budget expenditure implementation over the period 2016–2017. It is noteworthy that 6 out of 9 CBFMs improved their cash execution indices in 2017 relative to 2016.

*Table 17*

**CBFMs with the least degree of budget expenditure implementation relative to annual targets\***

No	CBFMs	CBFM code	Budget execution, percent	
			2016	2017
1	Federal Agency for Ethnic Affairs	380	67.1	61.5
2	Federal Agency for Air Transport	107	70.9	83.5
3	RF Ministry of Justice	318	86.9	94.5
4	RF Ministry of Economic Development	139	88.1	91.3
5	RF Ministry of Sport	777	88.8	93.9
6	State Duma of the Federal Assembly of the Russian Federation	330	91.9	92.8
7	Executive Office of the President of the Russian Federation	303	92.2	95.2
8	Federal Agency for Mineral Resources	49	93.1	88.9
9	Federal Water Resources Agency	52	93.5	92.9

\* Annual budget revenue and expenditure projections as of October 1, 2017 (with due regard for amendments introduced into the Law on Federal Budget for 2017).

Source: Federal Treasury; Gaidar Institute calculations.

***Deficit and Debt at the Federal Level***

The volume of the federal budget deficit in 2017 amounted to RUB 1,338 billion, or 1.5% of GDP, having shrunk more than by half on the previous year (the corresponding indices for 2016 are RUB 2,956 billion, or 3.4 percent of GDP). *Table 18* presents data concerning the sources of federal budget deficit financing in 2013–2017.

*Table 18*

**The sources of federal budget deficit financing**

	In absolute terms, billions of rubles					Percent of GDP				
	2013	2014	2015	2016	2017	2013	2014	2015	2016	2017

<b>Sources of deficit financing, total</b>	<b>323</b>	<b>334</b>	<b>1,955</b>	<b>2,956</b>	<b>1,338</b>	<b>0.4</b>	<b>0.4</b>	<b>2.3</b>	<b>3.4</b>	<b>1.5</b>
<b>Deficit financing from domestic sources</b>	<b>270</b>	<b>480</b>	<b>2 251</b>	<b>2 914</b>	<b>1464</b>	<b>0.4</b>	<b>0.6</b>	<b>2.7</b>	<b>3.4</b>	<b>1.6</b>
Government securities	358	1,025	15	492	1,123	0.5	1.3	0.0	0.6	1.2
Movement of residuals	-951	-3,248	954	3,506	852	-1.3	-4.1	1.1	4.1	0.9
Other sources	863	2,703	1,282	-1,085	-518	1.2	3.4	1.5	-1.3	-0.6
<b>Deficit financing from external sources</b>	<b>53</b>	<b>-147</b>	<b>-296</b>	<b>43</b>	<b>-126</b>	<b>0.1</b>	<b>-0.2</b>	<b>-0.4</b>	<b>0.1</b>	<b>-0.1</b>
Government securities	185	-47	-183	110	41	0.3	-0.1	-0.2	0.1	0.0
Credits granted by foreign states	-22	-25	-51	-17	-20	0.0	0.0	-0.1	0.0	0.0
Other sources	-110	-74	-63	-50	-147	-0.2	-0.1	-0.1	-0.1	-0.2

**Note.** The difference between the total and the corresponding indices in each row is explained by smoothing of the resulting values, as well as by the exclusion, from this table, of some subsections with a negligible financing volume (of not more than several billion rubles).

*Source:* Federal Treasury; Rosstat; Gaidar Institute calculations.

In 2017, most of the funds spent on financing the federal budget deficit came from domestic sources (RUB 1,464 billion, or 1.6 percent of GDP), while the balance of external sources provided was negative: -RUB 126 billion (or -0.1 percent of GDP), that is, the volume of redemption was higher than that of new borrowing.

In the contrast to the period 2015–2016, the federal budget deficit in 2017 was covered in approximately equal proportion from the following two sources: *Government Securities* (about RUB 1,123 billion, or 1.2 percent of GDP) and *Movement of Residuals in Budget Accounts* (about RUB 852 billion, or 0.9 percent of GDP). The balance for 2017 of the section *Other Sources* was negative, amounting to about -RUB 511 billion (-0.6 percent of GDP). As a result, the role of government ruble-denominated bonds in the structure of federal budget deficit financing became much more prominent in 2017, surging above the balance for *Movement of Residuals*.

The section *Movement of Residuals* in the main reflects the operations involving the use of the Reserve Fund, which covered much of the deficit in the 2017 federal budget, and thus the Fund was eaten up. However, given that the amount of deficit turned out to be notably below its target projected in the previous autumn,<sup>1</sup> and also that according to data released by the Federal Treasury,<sup>2</sup> operations in the Reserve Fund's accounts were conducted only in December 2017, to the amount of slightly over RUB 1 trillion (entered in records as financing to cover federal budget deficit), it may be assumed that the fact that the Fund was totally expended as of January 1, 2018 can be viewed in part as a 'technicality'. The reason may be that, in accordance with the recent amendments to the RF Budget Code,<sup>3</sup> the Reserve Fund is expected to cease to operate (from 2018). (It should be added that in this connection, the new legislative provisions allowed the transfer of the Reserve Fund's residuals to the accounts of the National Welfare Fund before February 1, 2018).

*Table 19* shows the composition of the government debt of the Russian Federation in 2013–2017.

*Table 19*

### Government debt of the Russian Federation

	In nominal terms, billions of rubles					percent of GDP				
	2013	2014	2015	2016	2017	2013	2014	2015	2016	2017

<sup>1</sup> In accordance with the materials attached as an explanatory note to the draft federal budget for 2018–2020, the deficit target projected for 2017 was to be at the level of RUB -2,008.1 billion.

<sup>2</sup> URL: <http://www.roskazna.ru/finansovye-operacii/svedeniya-o-dvizhenii-sredstv-po-schetam/rezervnyj-fond/>

<sup>3</sup> Federal Law No 262-FZ dated July 29, 2017 'On the Introduction of Alterations in the Budget Code of the Russian Federation in the Part Regulating the Use of the Oil and Gas Revenues of the Federal Budget'.



<b>RF domestic debt, billions of rubles</b>	5,722	7,241	7,308	8,003	8,690	7.8	9.1	8.8	9.3	9.4
<i>less government guarantees, billions of rubles</i>	4,432	5,476	5,573	6,100	7,247	6.1	6.9	6.7	7.1	7.9
<b>RF foreign debt</b>										
billions of rubles, at RF Central Bank's exchange rate	1,822	3,057	3,647	3,106	2,870	2.5	3.9	4.4	3.6	3.1
<i>less government guarantees, billions of rubles</i>	1,450	2,377	2,781	2,395	2,273	2.0	3.0	3.3	2.8	2.5
<b>Total, billions of rubles</b>	7,544	10,298	10,955	11,109	11,560	10.3	13.0	13.1	12.9	12.6
<i>less government guarantees, billions of rubles</i>	5,882	7,853	8,354	8,495	9,520	8.0	9.9	10.0	9.9	10.3

Source: RF Ministry of Finance; Rosstat; Gaidar Institute calculations.

The aggregate year-end 2017 government debt of the Russian Federation amounted to 12.6% percent of GDP vs. 13.2 b percent of GDP a year earlier. The shrinkage in the amount of government debt by 0.1 percentage points of GDP was caused by Russia's domestic debt having increased by 0.1 percentage points of GDP against the background of a 0.5 percentage point drop in the amount of foreign debt (recalculated in rubles in accordance with the official exchange rate of the ruble set by the Central Bank). In 2017, the amount of government guarantees contained in the federal budget was 2.2 percent of GDP. It can be noted that for the second year in a row, the volume of government guarantees as a share of GDP has been on the decline. Besides, while in 2016 the volume of government guarantees shrank by only 0.1 percentage points of GDP, in 2017 its plunge amounted to 0.8 percentage points of GDP.

In 2017, the share ruble-denominated debt in the total volume of government debt of the Russian Federation increased from 72 percent at the start of the year to 75 percent at year-end, due to a significant surge in the value of the market component of ruble-denominated domestic debt – by more than RUB 1.1 trillion. Meanwhile in 2017, the RF Ministry of Finance placed two Eurobond issues on the international debt market: one with a 10-year maturity to the value of approximately USD 2.4 billion, and the other with a 30-year maturity, to the amount of USD 4.5 billion. However, these operations had to do with refinancing of the previously issued debt liabilities, and so they did not produce an increase in the amount of total federal budget debt in US dollar terms.

### 2.2.3. Interbudgetary relations and subnational finance

#### *Analysis of the Main Parameters of the Consolidated Budgets of RF subjects*

The main trend observed in the relations between different levels of state authority are also reflected by the revenue and expenditure structure in the consolidated budget of the Russian Federation. Fig. 20 presents data on the relative shares of the tax-generated and non-tax revenues and the final expenditure of subjects of the Russian Federation in the total amount of the tax-generated and non-tax revenues and the final expenditures of Russia's budgetary system (the consolidated budget of the Russian Federation and government extrabudgetary funds).

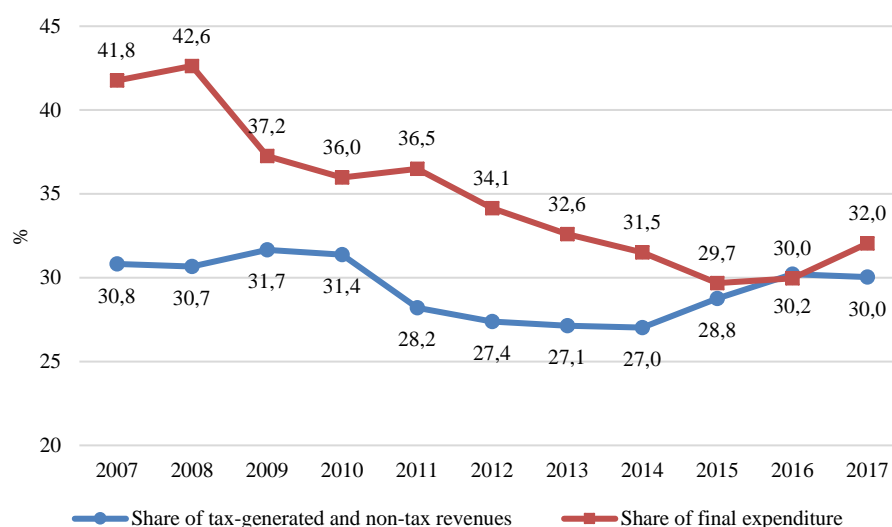


Fig. 20. Share of tax-generated and non-tax revenues

Source: Federal Treasury; Gaidar Institute calculations.

The share of tax-generated and non-tax revenues and subnational budget expenditures in the revenue and expenditure of the budgetary system of the Russian Federation in 2007–2017

In Fig. 20, it can be seen that the period 2014–2016 saw some decentralization of the tax-generated and non-tax revenues, and that in 2016, the closest correlation between the revenue and expenditure decentralization levels was achieved. However, the year-end results of 2017 demonstrate that the degree of centralization of tax-generated and non-tax revenues once again slightly increased, thus giving rise to an increase in the volume of the regions' spending obligations. More particularly, the share of tax-generated and non-tax revenues of the regions in the total tax-generated and non-tax revenues of the budgetary system declined from 30.2 percent in 2016 to 30.0 percent in 2017, while that of the regions' final expenditure in the budgetary system's total expenditure over the same period increased from 30.0 percent to 32.0 percent.

Let us take a closer look at the revenue side of the subnational budgets. The movement pattern of the main revenue components in the consolidated budgets of the subjects of the Russian Federation is presented in Table 20. On the right-hand side, revenue growth is shown in real terms.<sup>1</sup>

Table 20

### Consolidated Budget Revenue of Subjects of the Russian Federation

	Revenue volume (in nominal terms), billions of rubles					Growth in real terms, percent			
	2013	2014	2015	2016	2017	2014/ 2013	2015/ 2014	2016/ 2015	2017/ 2016
<b>Revenue, total</b>	<b>8,165</b>	<b>8,906</b>	<b>9,308</b>	<b>9,924</b>	<b>10,758</b>	<b>-2.0</b>	<b>-7.4</b>	<b>1.2</b>	<b>5.8</b>
<b>Tax-generated and non-tax revenues</b>	<b>6,589</b>	<b>7,177</b>	<b>7,625</b>	<b>8,289</b>	<b>8,986</b>	<b>-2.2</b>	<b>-5.9</b>	<b>3.2</b>	<b>5.8</b>
<i>including tax-generated revenues:</i>	<i>5,967</i>	<i>6,493</i>	<i>6,925</i>	<i>7,574</i>	<i>8,205</i>	<i>-2.3</i>	<i>-5.5</i>	<i>3.8</i>	<i>5.7</i>
Corporate profit tax	1,720	1,964	2,108	2,279	2,528	2.6	-5.0	2.6	8.2
PIT	2,499	2,693	2,808	3,019	3,252	-3.2	-7.7	2.0	5.1
Excises	491	480	487	662	612	-12.3	-10.2	29.1	-9.8
Taxes on aggregate income	293	315	348	388	447	-3.4	-2.3	6.0	12.2
Taxes on property	901	957	1,069	1,117	1,250	-4.5	-1.2	-0.8	9.2

<sup>1</sup> Adjusted by the inflation index in 2017 (-2.5 percent), according to Rosstat data.

<i>Non-tax revenues</i>	622	685	700	715	781	-1.2	-9.4	-3.0	6.5
<b>Transfers from other budgets</b>	<b>1,515</b>	<b>1,671</b>	<b>1,617</b>	<b>1,578</b>	<b>1,703</b>	<b>-1.0</b>	<b>-14.3</b>	<b>-7.4</b>	<b>5.3</b>
<b>Other revenues</b>	<b>62</b>	<b>58</b>	<b>66</b>	<b>56</b>	<b>69</b>	<b>-16.1</b>	<b>2.0</b>	<b>-19.2</b>	<b>18.7</b>

Source: Federal Treasury; Gaidar Institute calculations.

As demonstrated by data in *Table 20*, in 2017, the consolidated budget revenue of the subjects of the Russian Federation increased relative to 2016 by 5.8 percent in real terms. Thus, the regions' revenue movement pattern has been dominated by an upward trend since 2016. The receipts of the following taxes displayed significant growth in real terms: corporate profit tax (8.2 percent); taxes on aggregate income (12.2 percent); other revenues (18.7 percent). For the first time over the entire period 2013–2017, growth in real terms was demonstrated by the inflow of interbudgetary transfers in the consolidated budgets of the subjects of the Russian Federation (5.3 percent relative to 2016). At the same time, there was a shrinkage in the volume of excise receipts (9.8 percent in real terms relative to 2016); nevertheless, as excises take up only a small part in the overall structure of subfederal budgets, this change had practically no effect on the total revenue movement pattern.

Now let us consider in more detail the situation concerning the by-region pattern of tax-generated and non-tax revenues (*Table 21*).

Table 21

**Russia's regions, grouped according to the movement of main tax-generated and non-tax revenues in the consolidated budgets of the subjects of the Russian Federation**

	Change in main tax-generated and non-tax revenues in consolidated budgets of subjects of Russian Federation, relative to previous year											
	growth by more than 25 percent		growth between 10 and 25 percent		growth by less than 10 percent		decline by less than 10 percent		decline between 10 and 25 percent		decline by more than 25 percent	
	2016	2017	2016	2017	2016	2017	2016	2017	2016	2017	2016	2017
<b>in nominal terms</b>												
Tax-generated and non-tax revenues, total	5	5	47	16	26	48	5	13	0	3	2	0
Corporate profit tax	35	18	26	29	7	18	3	9	9	5	3	6
PIT	1	1	11	9	72	69	2	5	0	1	0	0
<b>in real terms</b>												
Tax-generated and non-tax revenues, total	0	3	16	12	49	48	16	18	3	4	2	0
Corporate profit tax	29	18	23	22	11	24	8	8	8	7	6	6
PIT	1	0	4	1	46	72	31	11	1	1	0	0

Source: Federal Treasury; Gaidar Institute calculations.

A comparative analysis of changes in the volume of major revenue sources in the regional budgets for 2016 and 2017 has led to the following conclusions. Since 2016, the average movement patterns of regions' revenues across Russia has changed their vector from decline to growth. At the same time, the growth rates of tax receipts were sufficiently high: out of a total of 78 regions with positive movement patterns of their tax-generated and non-tax revenues in 2016, 52 regions demonstrated revenue growth by more than 10 percent in nominal terms. When taken in real terms, revenue growth was observed in 65 regions, and in 16 of them the rate of growth was above 10 percent. The highest input into revenue growth was made by corporate profit tax. In 2016, the receipts of that tax in real terms increased in 68 regions, and the growth rate of that index was above 25 percent in 29 subjects of the Russian Federation.

In 2017, the revenue movement patterns in the consolidated budgets of the Russian Federation's subjects continued their positive trends. However, after the 'breakthrough' of

2016, the tax receipts in regions' budgets began to display more moderate growth rates, both in nominal and real terms. Over the course of 2017, the amount of revenues increased in 69 regions in nominal terms, and 63 regions – in real terms. The growth rates of corporate profit tax receipts became slower. While the number of regions where the amount of revenues generated by corporate profit tax had increased in real terms remained approximately at the same level as in 2016 (64 regions), the number of regions with the growth rates of corporate profit tax receipts above 25 percent plunged from 29 to 18.

It is necessary to point out the increased number of regions demonstrating growth of PIT receipts in real terms. In 2016, their number was 51, and in 2017 it jumped to 73. In 2016, PIT receipts were on decline in real terms in 33 regions. In 2017, the number of such regions shrank to 12.

In 2017, the best movement patterns of tax-generated and non-tax revenues were demonstrated by the Republic of Crimea (47 percent<sup>1</sup>), Yamalo-Nenets Autonomous Okrug (43 percent), the Republic of Kalmykia (29 percent), Belgorod Oblast (26 percent), and Kemerovo Oblast (26 percent). All these regions became leaders in growth thanks to their increased corporate profit tax receipts. Besides, in all these regions the rates of growth displayed by corporate profit tax receipts in 2017 were exceptionally high: 239 percent in the Republic of Kalmykia (vs. 26 percent in 2016); 222 percent in the Republic of Crimea (vs. decline by 18 percent in 2016); 108 percent in Yamalo-Nenets Autonomous Okrug (vs. decline by 55 percent in 2016); 99 percent in Belgorod Oblast (vs. growth by 5 percent in 2016); 97 percent in Kemerovo Oblast (vs. growth by 11 percent in 2016). It is worthwhile to note that among the regions with the highest growth rates of corporate profit tax receipts relative to the previous year, only the Republic of Tyva retained its leader position (139 percent in 2016, and 70 percent in 2017) In the Republic of Ingushetia, corporate profit tax receipts displayed 100-percent growth in 2016, which in 2017 gave way to a plunge by 10 percent.

Some regions, according to their consolidated budget data, demonstrated a notable decline in the amount of their tax-generated and non-tax revenues. Thus, the tax-generated and non-tax revenues in Chukotka Autonomous Okrug and Sakhalin Oblast shrank by 22 percent and 17 percent respectively on the previous year, and the same index for the Republic of Kabardino-Balkaria – by 15 percent. A notable decline of that index could also be observed in Khanty-Mansi Autonomous Okrug, where the downward movement of tax-generated and non-tax revenues had persisted since 2016 (-9 percent in 2016, and -7 percent in 2017.)

Thus, in 2017 relative to 2016, the rates of growth, in the regions budgets, of aggregate receipts from tax-generated and non-tax sources, as well as those of corporate profit tax receipts, became lower. At the same time, there was growth of PIT receipts in real terms, which is an indirect indication that personal income was on the rise.

Let us now analyze the changes in the consolidated budget expenditure of the subjects of the Russian Federation that occurred in 2017 (*Table 22*).

*Table 22*

### **Expenditure of the consolidated budgets of the subjects of the Russian Federation**

	Percent of total		Percent of GDP		Change	
	2016	2017	2016	2017	in nominal terms, percent	as percentage points of GDP
Nationwide issues	6.3	6.1	0.73	0.71	5.2	-0.02
National security and law enforcement activity	1.1	1.1	0.13	0.13	3.1	0.00
National economy, including:	20.2	21.2	2.33	2.49	14.3	0.16

<sup>1</sup> Hereinafter, the indices are presented in nominal terms.

agriculture and fisheries	2.8	2.5	0.32	0.29	-1.9	-0.03
transport	4.4	5.2	0.51	0.61	28.2	0.10
motor road system (road funds)	8.7	8.8	1.01	1.03	9.4	0.02
other national economy issues	2.3	2.6	0.27	0.31	24.1	0.04
Housing and community amenities	9.4	10.4	1.09	1.22	20.5	0.13
Environmental protection	0.2	0.3	0.03	0.03	25.2	0.00
Education, including:	25.6	24.9	2.96	2.92	5.6	-0.04
pre-school education	6.8	6.7	0.79	0.78	6.5	-0.01
general education	14.7	12.2	1.70	1.43	-10.0	-0.27
vocational training	1.9	1.9	0.22	0.22	6.0	0.00
other education issues	1.2	1.3	0.14	0.15	11.9	0.01
Culture, cinematography	3.4	3.8	0.40	0.45	20.5	0.05
Healthcare	12.9	7.8	1.49	0.92	-33.9	-0.57
Social policies	16.6	20.4	1.93	2.40	33.4	0.47
Physical culture and sports	2.1	2.3	0.25	0.28	19.8	0.03
Mass media	0.4	0.4	0.05	0.05	1.9	0.00
Government and municipal debt servicing	1.5	1.2	0.18	0.15	-12.9	-0.03
<b>Expenditure, total</b>	<b>100.0</b>	<b>100.0</b>	<b>11.57</b>	<b>11.74</b>	<b>8.8</b>	<b>0.17</b>

Source: Federal Treasury; Gaidar Institute calculations.

From *Table 22* it can be seen that in 2017, the by-function structure of regions' budget expenditure changes only slightly relative to the previous year. We should make note of the increased allocations to transport in the National Economy section (while those to agriculture were reduced), as well as the shrinkage of expenditures earmarked for the social sphere, especially the allocations to general education. The notable cuts in the allocations to *Healthcare* and increased allocations in the *Social Policy* section can largely (though not exclusively) be explained by technical procedures: from 2017 onwards the insurance contributions paid by the regions for their non-working population have been entered in records under the *Social Policy* heading, whereas in 2016, in the majority of regions these allocations were treated as part of the *Healthcare* section. However, on the whole over the period 2016–2017, the composition of the regions' budget expenditure followed the same trends as over the previous period.

Now we are going to look at the movement patterns of the main parameters of consolidated budgets of the Russian Federation's subjects in terms of share in GDP (*Table 23*).

*Table 23*

**The movement of revenue and expenditure in the consolidated budget of the subjects of the Russian Federation, percent of GDP**

	2013	2014	2015	2016	2017
<b>Revenue</b>	<b>11.16</b>	<b>11.24</b>	<b>11.16</b>	<b>11.55</b>	<b>11.68</b>
including:					
corporate profit tax	2.35	2.48	2.53	2.65	2.75
PIT	3.42	3.40	3.37	3.51	3.53
transfers from FB	2.03	2.03	1.92	1.82	1.68
<b>Expenditure</b>	<b>12.04</b>	<b>11.81</b>	<b>11.37</b>	<b>11.57</b>	<b>11.74</b>
<b>Deficit (-) / Suplus (+)</b>	<b>-0.88</b>	<b>-0.57</b>	<b>-0.21</b>	<b>-0.01</b>	<b>-0.06</b>

Source: Federal Treasury; Gaidar Institute calculations.

The data in *Table 23* demonstrate that over the last three years, both subnational budget revenue in general and the receipts of PIT and corporate profit tax in particular have been on the rise in terms of share in GDP. Meanwhile, the amount of transfers from the federal budget over the period 2013–2017 continued to decline. Subnational budget expenditure has been increasing since 2016. The budget deficit in 2016 hit its five-year low, and then in 2017 it somewhat increased. Let us consider in more detail the by-region execution of the consolidated budgets of RF subjects (deficit/suplus) (see *Table 24*).

*Table 24*

### The execution (deficit/suplus) of the consolidated budgets of subjects of the Russian Federation

Year	Number of RF subjects executing their budget	
	with deficit	with surplus
2013	77	6
2014	74	11
2015	76	9
2016	56	29
2017	47	38

Source: Federal Treasury; Gaidar Institute calculations.

The by-region data demonstrate that the consolidated budgets in most RF subjects have become more balanced. So, aggregate deficit growth has been caused by the dramatic deterioration of the situation in a few regions against the backdrop of increasingly well-balanced budgets in the majority of regions.

#### *Financial Assistance from the Federal Budget*

In 2017, the total volume of interbudgetary transfers from the federal budget to the regions shrank relative to 2016 both in nominal terms (-1.5 percent) and in terms of share in GDP (-0.15 percentage point GDP) (Table 25). Shrinkage was typical of all categories of targeted interbudgetary transfers, and especially the transfers earmarked for properly balancing regional budgets. At the same time, the total volume of equalization transfers was on the rise, because the increased amount of transfers earmarked for budget equalization (+0.07 percentage point GDP) was offset by the reduced amount of those earmarked for ensuring well-balanced regional budgets (-0.03 percentage points of GDP). The deepest plunge, both in nominal terms and in terms of share in GDP, was demonstrated by subsidies, and this was especially true of subsidies earmarked for the support of the national economy. These changes were also reflected by the structure of federal financial assistance to the budgets of RF subjects. Thus, in 2017 relative to 2016, the share of subsidies lost 5 percentage points, while that of equalization transfers, on the contrary, gained 7.3 percentage point

Table 25

### Federal budget transfers to the budgets of subjects of the Russian Federation

	2015		2016		2017		Growth in 2017 relative to 2016	
	billions of rubles	percent of total	billions of rubles	percent of total	billions of rubles	percent of total	in nominal terms, percent	percent points of GDP
<b>Transfers to regions, total</b>	1,603.7	100.0	1,567.8	100.0	1,543.5	100.0	-1.5	<b>-0.15</b>
<b>Equalization transfers</b>	651.0	40.6	656.2	41.9	759.0	49.2	15.7	<b>0.06</b>
including:								
transfers to budget sufficiency equalization	487.7	30.4	513.7	32.8	614.5	39.8	19.6	0.07
transfers to support measures designed to ensure well-balanced budgets	152.4	9.5	131.7	8.4	113.8	7.4	-13.6	-0.03
<b>Subsidies</b>	400.2	25.0	356.5	22.7	273.2	17.7	-23.4	<b>-0.12</b>
including:								
subsidies to sustain national economy's development	258.2	16.1	231.9	14.8	106.1	6.9	-54.2	-0.15
<b>Subventions</b>	<b>336.6</b>	<b>21.0</b>	<b>334.3</b>	<b>21.3</b>	<b>326.1</b>	<b>21.1</b>	<b>-2.4</b>	<b>-0.03</b>
<b>Other interbudgetary transfers</b>	<b>216.0</b>	<b>13.5</b>	<b>220.8</b>	<b>14.1</b>	<b>185.2</b>	<b>12.0</b>	<b>-16.1</b>	<b>-0.06</b>

Source: Federal Treasury; Rosstat; Gaidar Institute calculations.

Changes in the volume of subventions point to the increasing independence of subnational budgets in executing the powers delegated to them. At the same time, in 2017, the total number of subventions was 30 – that is, the same as in 2016. Of these, 10 subventions were allocated to the Republic of Crimea and to the city of Sevastopol; some of these subventions duplicate those allocated to other subjects of the Russian Federation.

Formally speaking, the total number of subsidies allocated in 2017 was 79. However, the subsidies funded from the Reserve Fund of the Government of the Russian Federation are now entered in records as separate budget expenditure lines, and thus the total number of subsidies is artificially inflated. If one takes into account only the subsidy targets, and not their sources, the number of subsidies would shrink to 66 (in 2016 – 98). The Government Program of the Russian Federation *Development of Federative Relations and Creation of proper Conditions for Efficient and Responsible Administration of Regional and Municipal Finance* (hereinafter – *GP Development of Federative Relations*) envisages that the total number of subsidies in 2017 should be reduced to 60. Thus, in 2017, their number was significantly optimized (first of all, by pooling the subsidies allocated to agriculture), but the planned target was still not achieved.

The volume of other interbudgetary transfers shrank both in nominal terms and in terms of share in GDP, which should be regarded as a positive development, considering their inadequate transparency and distribution on the basis of formal principles.

One of the budgetary policy priorities, as before, has been the reduction of targeted financial assistance. Overall, the relative share of equalization subsidies in the total volume of federal transfers to RF subjects has increased, and in accordance with the corresponding target set by the *GP Development of Federative Relations* (Table 26). In 2017, that target was met, even if we take into consideration the fact that transfers earmarked for the compensation of additional expenditures to cover the raised salaries in the budget-funded sector are essentially subsidies, and not equalization transfers.

It should be noted that the increased share of equalization transfers in the overall structure of interbudgetary transfers to regions in 2017, in contrast to 2016, was achieved not only thanks to cuts in the amount of targeted interbudgetary assistance, but also as a result of the significantly increased volume of non-targeted transfers.

Table 26

**The movement pattern of the share of equalization transfers in the total volume of interbudgetary transfers**

Index	2015	2016	2017
Share of equalization transfers in total volume of interbudgetary transfers as stated in government program (plan), percent	40.0	41.0	46.0
Share of equalization transfers in total volume of interbudgetary transfers (estimate), percent	40.6	41.9	49.2
Share of equalization transfers in total volume of interbudgetary transfers, less transfers earmarked for compensation, in part, of additional expenditures on increased salaries in budget-funded sector (estimate), percent	36.9	39.9	46.6

Source: Federal Treasury; Government Program of the Russian Federation *Development of Federative Relations and Creation of Proper Conditions for Efficient and Responsible Administration of Regional and Municipal Finance*; Gaidar Institute calculations.

When analyzing the process of transfer allocation by the federal center to the regions, it is essential to review the impact of federal budget assistance on the differentiation of the budget revenue across all subjects of the Russian Federation, and to assess its actual equalizing effect (Table 27).

Table 27

**The variance coefficient of the consolidated regional budget revenue (per capita, with due regard for the budget expenditure index), percent**

Year	Tax-generated revenues	Tax-generated revenues and equalization transfers	Tax-generated revenues, transfers, subsidies
2013	63.7	55.3	48.1
2014	59.0	51.2	49.9
2015	66.1	60.3	56.0
2016	55.6	42.1	37.3
2017	55.8	41.3	37.7

Source: Federal Treasury, RF Ministry of Finance; Gaidar Institute calculations.

As seen from *Table 27*, in 2017 relative to the previous year, the degree of differentiation of tax-generated revenues in the subnational budgets somewhat increased. At the same time, the equalizing effect of budget equalization transfers became stronger in response to their increased total volume and the more prominent emphasis on equalization in the methodology of their distribution, while the equalizing effect after the allocation of budget transfers and subsidies weakened as a result of the reduced total volume of interbudgetary subsidies and other budget transfers.

***Deficit and Debt at the Regional Level***

*Table 28* presents the structure of deficit financing sources in the consolidated budgets of RF subjects over the period 2013–2017.

*Table 28*

**The sources of deficit financing in the consolidated budgets of RF subjects, billions of rubles**

	2013	2014	2015	2016	2017
<b>Deficit financing sources – total</b>	<b>642.0</b>	<b>447.8</b>	<b>171.6</b>	<b>12.6</b>	<b>51.9</b>
<b>Deficit financing from domestic sources</b>	<b>642.8</b>	<b>447.8</b>	<b>171.6</b>	<b>40.8</b>	<b>51.9</b>
Government (municipal) securities	77.6	-9.2	-5.8	32.0	97.0
Loans issued by credit institutions	282.6	217.4	101.6	-102.6	-126.3
Budget loans	43.0	169.3	167.4	181.6	19.7
Movement of residuals	98.1	19.2	77.4	-32.0	-21.2
Other sources	139.3	52.2	-168.9	-37.6	83.4
<b>Deficit financing from external sources</b>	<b>-0.8</b>	<b>0.0</b>	<b>0.0</b>	<b>-28.2</b>	<b>0.0</b>

Source: Federal Treasury; Gaidar Institute calculations.

As seen from the data in this table, overall across the consolidated budgets of RF subjects, as a year earlier, the situation remained better than it had been in 2012–2015: budget deficit amounted to only RUB 51.9 billion, which is significantly below the corresponding indices for 2012–2015. At the same time, the downward trend displayed by the amount of deficit in nominal terms was reversed – now it more than tripled in nominal terms.

The balance of bank loans in 2017 was negative and, moreover, rather high in absolute terms (RUB -126.3 billion), which means that the volume of loan repayment exceeded that of new loans. At the same time, the balance of budgeting loans, on the contrary, was positive (RUB 19.7 billion); however, in contrast to the previous year, this index was lower than the balance of commercial loans. These figures reflect the changed priorities in the federal center's policy with regard to budgeting loans: the volume of newly issued loans shrank significantly, and those that had been issued previously, were restructured. In December 2017, the RF Ministry of Finance concluded 410 additional agreements with 73 RF subjects, which envisaged annual repayment of budgeting loans: over the period 2018-2019 in the amount of 5 percent of total debt; in 2020 – 10 percent of total debt; and over the period 2021–2024 – in equal annual



installments, 20 percent each. According to the RF Ministry of Finance’s estimations, the budgeting effect, in the form of reduction of the amount of loan repayment by the regions, in 2018–2019 will be up to RUB 418 billion (including RUB 238 billion in 2018, and RUB 180 billion in 2019). On the whole, all these changes are positive, because the massive-scale continual issuance of budgeting loans to many regions only resulted in an artificially inflated volume of regional debt and lower transparency of the interbudgetary relations.

At the same time, in conditions of diminishing accessibility of cheap budgeting loans, the role of securities grows in importance – their balance has been positive for the second year in a row (RUB 97.0 billion); besides, in contrast to the situation in 2016, it surged significantly above that of budgeting loans.

On the whole over the period 2012–2015, the regional debt movement pattern, in terms of share in GDP, displayed a stable upward trend, that index increasing from 2.38 percent of GDP at year-end 2013 to 2.78 percent of GDP at year-end 2015 (*Table 29*). Over the same period, the volume of debt owed by municipal formations somewhat declined – from 0.50 to 0.44 percent of GDP.

*Table 29*

**The volume of government and municipal debt in subnational budgets,  
as a percentage of GDP**

	2013	2014	2015	2016	2017	Growth in 2017 relative to 2016
Government debt of subjects of Russian Federation	2.38	2.64	2.78	2.74	2.51	-0.22
Debt of municipal formations	0.50	0.46	0.44	0.42	0.40	-0.02

*Source:* RF Ministry of Finance; Rosstat; Gaidar Institute calculations.

The year 2017 saw the emergence of a downward trend in the volume of debt owed by the subjects of the Russian Federation: according to the year-end result of 2016, it declined by 0.16 percentage points of GDP, and by the year-end 2017 – already by 0.2 percentage points of GDP, to 2.51 percent of GDP. Simultaneously, the volume of debt for the first time was reduced not only in terms of share in GDP, but also in absolute terms – by RUB 37.8 billion, or 1.6 percent (in 2016, this index had also slightly increased in nominal terms – by 1.5 percent, or RUB 35 billion). At the municipal level, the downward trend displayed by the volume of debt in terms of share in GDP was still present – that index declined by 0.02 percentage points to 0.40 percent of GDP (meanwhile, when taken in nominal terms, it demonstrated slight growth by RUB 3.6 billion, or by 1.0 percent).

Thus, in 2017, in the framework of cooperation between the RF Ministry of Finance and the authorities of RF subjects, it became possible to consolidate the trend towards halting the accumulation of sizable budget debt at the subnational level, as well as to adopt relevant decisions concerning the amount of budgeting loans already accumulated by the regions. On the whole, these measures should result in establishing more understandable ‘rules of the game’ and increasing the transparency of interbudgetary relations. At the same time, there still remain some unresolved issues with regard to the medium- and long-term sustainability of regional budgets, in view of the continuing trend towards reducing the volume of transfers from the federal budget and discontinuing the issuance of new budgeting loans. It is expected to become clear in 2018 if the regions will indeed possess sufficient finance resources, including the resources needed for the ultimate achievement of ‘the goals set by the May 2012 Presidential Executive Orders’.