EFFECTS OF THE CRISIS AND RUSSIA'S SOCIO-ECONOMIC DEVELOPMENT OUTLOOKS

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The past year was transitional from the crisis period to a normal development. Russia's GDP increased 4% in 2010. GDP and industrial production nearly recovered by the end of 2010, reaching 97-99% of the values recorded in September 2008, as estimated by Rosstat. These values show that as early as the beginning of 2011 Russia's economy is more likely to eclipse its pre-crisis level. A few industries, however, are showing levels which are still far behind the values recorded prior to the crisis, namely machine building industry (20%), metallurgy (8%), construction industry (5%). Therefore, most industries may not be expected to recover completely until the second half of 2011 or early in 2012.

Regretfully, the past year confirmed once again that Russia's economy still depends on the external environment. GDP showed the lowest growth rates within the first three quarters of 2010. Production began to grow dynamically in the fourth quarter when crude oil prices began to increase in the global markets. Accordingly, the Russian economy's orientation on mineral resources and dependence on export of hydrocarbons have not yet been overcome and can hardly be changed within just a year or two.

Crisis-related decline factors and lessons from the crisis

Russia has found itself among the countries hit most by the crisis. In 2009, Russia's GDP dropped 7.8%, whereas global GDP fell merely 0.6%, and developing countries and emerging markets increased their output by 2.6%. It is financial and trade shocks that spurred crisis developments in such countries, just like in Russia. A relatively more apparent negative dynamics in Russia's economy can be explained by its high vulnerability to such shocks. Following listed are the factors of external vulnerability.

The economy's overheating prior to the crisis. The economy's overheating facilitates accumulation of internal imbalances, and the more is "ballooned" the demand, the more should be done, all things being equal, to level out such imbalances. It is *rise in loans* that should be mentioned first and foremost among the overheating factors. The volume of loans increased from 16.8% to 37.8% of GDP basically through banks' foreign borrowings in Russia in the period of 2003 thru 2007. Furthermore, such borrowings were often intended and used to finance high-risk projects and investment in rising assets. Later, this indicator had to be adjusted drastically in response to deteriorated return on projects and value of assets.

Foreign liabilities piled up rapidly both in the banking sector and non-banking sector in Russia. Eventually, *private external debt* increased more than 20% of GDP at 2007 year end. The increase was mostly determined by the activity of large companies with public ownership, which might have resulted in undercounting of risks due to inexplicit state guarantees to bail these companies out of bankruptcy. Heavier dependence on external financing and existing macroeconomic issues *worsened the economy's vulnerability to the effect of crisis-related reverse of capital flows*. The problem is that capital inflow basically comprises resources of unstable nature. Any, even insignificant, deterioration of the economic situation may trigger a drastic capital outflow. A reason is poorly developed institutions and economy's heavy dependence on mineral resources.

The dynamics of credit and debt leverage was governed by the behavior of the private sector. Furthermore, the regulators' policy made a contribution too. The Bank of Russia raised interest rates in terms of inflation-related goals of the monetary policy due to the need to sterilize extra liquidity and amid overgrowth in budget expenditures. This encouraged further growth in capital inflow. The Bank of Russia's exchange policy should be more flexible under the circumstances. Maintaining a predictable exchange rate was responsible for increase in currency imbalances against the backdrop of capital flow liberalization.

Despite the establishment and intensive replenishment of oil and gas funds, early redemption of a major part of the external debt, Russia found itself among a few oil producing countries whose public expenditures grow vs. GDP prior to the crisis. Oil budget deficit reached 6.5% of GDP by 2008. A more hard-line policy would allow not only the demand to be "cooled", but also the ruble weakened, short-term capital inflow reduced.

The depth of the Russian economy's recession was also governed by its *heavy dependence on oil and gas export revenues*. The physical volume of export fell merely 4.7% but dropped 36% in value terms. To compare, the value of exports in China and Germany, the world's largest exporters, decreased 17% and 23% respectively. All in all, the revenues of exporters of higher processed products were affected less hard (in terms of value) than those of exporters of raw materials.

Leveling out "boom-and-bust" cycles in the future will facilitate more stable and rapid growth. The Central Bank of Russia has consistently been making the ruble exchange rate more flexible, allowing it to fluctuate and expanding the exchange rate band, thus allowing the economy to adapt in a better way to external (e.g., price-related) shocks while economic agents to evaluate exchange risks more efficiently, stimulating the development of hedging instruments, discouraging a short-term capital inflow. A course towards consolidation and efficient management of oil and gas revenues in the fiscal policy has recently been set.

Global economy outlooks and consequences for Russia

It is safe to say that the post-crisis rapid recovery phase has been gone through. The IMF's forecast shows that growth is expected to slow down to 4.4% in 2011 against 5.0% in 2010. Furthermore, the slowdown is expected in both developed and developing countries. In the former case, such a dynamics is determined by, besides the base effect, the launch of fiscal consolidation programs (e.g., British GDP fell 0.5% in Q4 2010 against the backdrop of launching such a program in Great Britain) and weak investment growth because of risks which still exist in the banking system, thereby slowing down the lending process. A new large-scale investment is needed to maintain high growth rates, because slowdown in the growth rates in developing countries and emerging markets is associated with exhausted available capacities. However, capital inflow to these countries still remains below the values recorded prior to the crisis.

The growth remains high globally by historical standards despite a certain slowdown; additionally, international organizations anticipate a more than 4% growth rate in the mid-run. However, *sustainability of such growth spawns doubts*. Global imbalances have resumed to grow after insignificant slowdown following the most acute phase of the crisis. It is the internal demand that still remains the key source of growth in countries with current account deficit, such as the United States, whereas in China the internal demand has a relatively small contribution to the economic dynamics. The issue could be defused by making exchange rates more flexible. According to certain countries, however, there is no sufficient progress in this field, which may trigger currency wars.

Both external and internal imbalances have been increasing. While developed countries' average public debt exceeds 100% of GDP, neither the United States, nor Japan has an efficient plan of fiscal consolidation. Maintaining low interest rates and implementing government bond-buying programs in these countries may facilitate an increase in volatile short-term capital flows in emerging markets. Additionally, such a soft monetary policy may trigger speculative activity and volatility in primary commodity markets, according to certain research studies.

Most of the developing countries and emerging markets are showing signs of their economy's overheating. In particular, experts have reported overheating in the Chinese housing market which, if collapsed, might have serious effects, e.g., a nosedive of prices of metals and lowered level of investor risk tolerance. To prevent such a scenario, the Chinese government has raised interest rates and real property taxes. These measures, however, don't work globally. For instance, higher interest rates may increase capital inflow and further heat the economy against the backdrop of liberalization of capital transactions. Imposing restrictions on accepted currency risks, e.g., raising the reserve requirements, may be a way out to solve the problem.

The recently anticipated growth in the global economy and prices of raw materials is still favorable for Russia, but exposed to significant risks. Furthermore, even though the forecast was correct, it is the external demand that is most unlikely to become the key sources of growth in Russia. In the medium-term, annual export growth rates are expected to be 3% to 5% or less due to stagnation in supplies of crude oil and oil products while import is expected to grow 8% to 13% annually. Therefore, *it is the internal demand, especially investment, which encourages growth in labor productivity along with fixed capital that should contribute most to GDP growth in the years to come.*

On the one hand, this requires measures aimed at improving the investment climate in order to recover direct investment inflow (Russia's contribution to direct investment in developing countries and emerging markets shrank from 13% in 2008 to 8% in 2010). Additionally, incentives for the transfer of advanced technologies should be available too. In 2010, despite its recent progress, Russia was ranked (according to the World Economic Forum (WEF)) the 120th out of the 139 countries on this indicator.

On the other hand, terms of fixed capital accumulation with domestic savings should be established. Prior to the crisis Russia was nearly as good as the "Asian Tigers" – South Korea, Hong Kong, Malaysia – on the savings rate which was maintained more than 30%. Recovery of savings is a vital task since they dropped to 23.4% of disposable income in 2009. The accumulation rate didn't exceed 22% of GDP, except in the period of 2007 thru 2008, which is more than 10 p.p. less than in the said countries.

Russian capital outflow from the private sector (which accounts for 7% to 13% of GDP, i.e., more than a half of the fixed capital accumulation value) should be prevented first of all to harmonize the savings rate and the accumulation rate. The outflow reflects in part the process of Russian companies' normal integration into the global economy, the way they create the value-added chain with the participation of foreign manufacturers. However, a major part of capital outflow is caused by unfavorable investment climate and business constraints in this country. The respective terms should be improved drastically, i.e., enhance ownership protection, ease the administrative pressure on businesses, etc.

Modernization trends in the economy prior to/in time of the crisis and the external sector

The "new" economy's contribution to GDP was high before the crisis. For instance, in 2007, the share of IT expenditures in GDP stood at 3.8% (similar to India and 1.5-2 times less than in Brazil and China). Moreover, a positive trend began to develop in the dynamics of financing and conduct of applied research in the period of 2004 thru 2005. For instance, the number of patents issued to residents increased 20% while research financing (in real terms) grew up more than 50% in the period of 2006 thru 2008. Russian high-tech products proved competitive as evidenced by export growth from $3,7bn in 2005 to $5,1bn in 2008. The sector of IT services developed even more intensively: export tripled (more than $3bn) in 2008.

Indeed, the development of the innovative sector was significant both by itself and in terms of enhancing productivity in other sectors of Russia's economy. However, perception and adaptation of advanced foreign technologies are no less important for middle-income countries. It is direct foreign investment and import of capital goods that play a major role. Direct foreign investment in manufacturing sector almost doubled in the period of 2006 thru 2008. Investment import increased by an average of more than 30% annually in the same period; in 2008, it accounted for 24% of the total import, almost $70bn in absolute terms.

Direct foreign investment inflow in the non-resource sector saw a 1.5-fold fall during the crisis. Investment import dropped even lower (45%). Nevertheless, these indicators recovered in the post crisis period: in 2010 investment and investment import was estimated to grow about 10% and 25% respectively. One may infer that the crisis has temporally slowed down the import-based development of technologies. From a qualitative point of view, however, economy's sensitivity to foreign technologies increased during the crisis, according to the WEF. For instance, the technology readiness index, including but not limited to "the use of advanced technologies", "firms' adaptation to new technologies", and "technology transfer from direct investors", increased from 3.45 in 2008 to 3.56 in 2009. Furthermore, it should be noted that the innovative sector of the Russian economy was less hit by the crisis than other sectors. For instance, export of commodities increased 7%, whereas export of services dropped 15% (total export fell 34%) for the IT sector.

Supporting inefficient giant companies

Inefficient enterprises of strategic importance were kept subsidized. Furthermore, such subsidies increased for certain companies. On the one hand, bankruptcy of such enterprises is socially unacceptable, because large enterprises employ a major part of the population of towns (including monotowns) where they are located. On the other hand, the global economic history can provide many examples showing political inefficiency of supporting ineffective enterprises.

The Japan's experience in the 1990s which gave rise to the zombie company phenomenon is a classic example of national policy towards ineffective enterprises. The Japanese economy plunged into a deep stagnation after a bubble-burst in its real estate market, showing annual growth rates nearly 0.5% (the so-called "lost-growth decade" in Japan) against approx. 2.6% in the United States in the 1990s. Furthermore, numerous inefficient enterprises kept receiving loans, because the Japanese government made attempts through its anti-recessionary policy to put pressure on banks so that they keep certain firms afloat. As a result, about 30% of all Japanese companies turned into "zombies" by the end of 1990s. Additionally, such zombie companies prevailed in the sectors protected from international competition, namely construction, retail trade, services.

According to experts, it is the degraded economic productivity, especially in the sectors dominated by "zombie" companies, that was the key adverse effect of the Japan's policy of supporting ineffective enterprises. Had Japan let them go bust, this would have triggered the investment process (investment would have been accelerated 36% annually in certain industries).

The existence of ineffective enterprises imitates an increase in the level of employment in certain industries. Additionally, inefficient companies divert resources from banks and taxpayers, thereby impeding the development of financially healthy enterprises. Finally, inefficient companies retain their personnel by way of paying unreasonably high wages, thereby reducing the supply of skilled labor force in the economy. Indeed, all these factors interfere with economic modernization. Accordingly, a course towards gradual cutting of subsidies should be set, and support should be provided exclusively to upgrade, if impossible, or restructure rather than retain ineffective companies as they are now (a program of adaptation of reformed enterprises' personnel or, in the case of one-company towns, citizens of a specific town should be developed where appropriate). The crisis has shown that such costs are eventually paid off.

New governance system requirements

The need to look for new sources of growth

The crisis has revealed the vulnerability of the development model which was in use in Russia in the 2000s. The model only could work under favorable external conditions such as consistent growth in crude oil prices and growth in the flow and decline in the cost of capital in emerging markets. Russia's economy is expected to face more severe conditions, namely stabilized crude oil prices and moderate capital flows in emerging markets, in the years to come. Factoring in the foregoing, Russia should design and implement a new development model intended to rely on investment promotion, business environment improvement, economic modernization, and preparation to the transition to innovative development rather than broadening the demand using external sources.

In this context it should be noted that the Ministry of Economic Development's (MED) so-called innovative version of the Russia's economic development forecast until 2030 suggests budget deficit until 2020, a larger dependence on global oil prices than in pre-crisis period, high exposure to risks of inflation and exchange rate volatility. The forecast is based on the promotion of public investment activity and broadening of the government demand. This version can hardly be considered innovative.

A development strategy should be selected on the basis of economy's health diagnosis, i.e., identification of key development constraints. Three groups of such constraints should be mentioned, namely macroeconomic constraints which relate to capital deficiency; microeconomic constraints which relate to the lack of viable investment projects; institutional constraints which are associated with unfavorable business environment.

Russia is facing no fundamental macro- and microeconomic issues: this country has high rate of domestic savings and a great deal of efficient projects. Furthermore, Russia's public institutions are of poor quality. According to the World Bank Good Governance, Russia is listed among the countries which are ranked lowest on openness and government officials' accountability, the rule of law, and corruption. The WEF ranks Russia the 118th out of the 139 countries on the common quantity of public institutions.

Close relationship between the quality of institutions and economic development has been proved more than once: there is no way of developing with success if the former is poor. Research studies suggest that most of economic policy measures (including but not limited to build-up of development institutions) are of threshold nature: they have a positive effect if institutions are of high quality (low administrative barriers, qualified and non-corrupt public officers, an independent judicial system, transparency of government's actions, etc.) and provide no results (or have an adverse effect) if institutions are of poor quality. Consequently, radical institutional modernization is a must for further economic development. *Indeed, it is modernization of the state that should be the cornerstone of economic policy at this stage, otherwise there is no way of accelerating economic growth.*

The quality of institutions is of prime importance for mineral-rich countries. Recent research studies show that mineral wealth facilitates successful development in countries with strong institutions whereas impedes the development in those which have weak institutions. *Therefore, countries which have rich mineral resources and low-quality social institutions are exposed to a serious threat of resource curse, i.e., retaining economic and institutional backwardness, whereas strong institutions allow mineral resources to be turned into a source of development.*

Modernization suggests lots of externally imperceptible but very important steps. Let's list the key ones. Restricting monopolism in the Russian markets; reducing government intervention into the economy; lowering inflation to 5% initially and then to 3%; cutting the implementation costs of investment projects; reducing the share of non-competition public procurement; shrinking the share of illegal business.

Efforts should be resumed to create a comfortable investment and business environment. First, a critical mass of those who advocate economic modernization, e.g., private owners, should be created. This can be done through widespread privatization and further deregulation of small businesses.

Second, measures of improving the investment climate in Russia should rely on an external support. For instance, the Central and East European countries relied on their EU membership in making institutional changes to recover the economy. Russia may rely on its accession to the WTO and the OECD. These organizations help stand up for the rule of law on behalf of domestic and foreign investors. Additionally, strengthening of the ruble and its ascent to the status of international reserve currency, as well as the establishment of a modern financial center in Moscow could play the role of such an external support in improving the investment climate in Russia.

Public administration framework requirements

The public administration framework must facilitate solution of the socio-economic development tasks. It is, however, the peculiarities of the existing framework that interfere most with the development.

Transition to a new model of public administration – from the model of hierarchy-based public bureaucracy to a net-based scheme, which has increasingly been gaining popularity worldwide, when certain government agencies become conductors rather than suppliers of services focused on the common tasks of the national economic policy, — will help create a favorable business environment which promotes investment, more efficient performance of the public sector and lower corruption. To ensure gradual transition to such a framework, public institutions should be upgraded as follows.

Introducing a strategic planning system. A law on strategic planning is being under consideration by the Russian government. The law creates a legal framework for developing, building, and operating an integrated system of national strategic planning of socio-economic development factoring in both objective development preconditions, external conditions, and budget and organizational constraints to achieve assigned strategic goals. Long-term decisions should, within a common strategy, be reflected in a set of medium- and short-term objectives which are interlinked and focused on the same goal. However, adoption of such a law will be just the initial step. An integrated system, when every public administrative body, region, and municipality establishes priorities and acts consistent with assigned goals and government's master plan should be created.

Observing the principle of openness. It is vital to ensure maximum transparency of public institutions and a broad discussion of public agencies' performance – from planning to performance measurement, from submission to execution of new draft laws. *Partnership relations between the state, the society, and the business sector* should be developed. Modern approaches towards industrial policy make the corner-stone of establishing fruitful relations with the business community, receiving the latter's signals about production development constraints and their elimination, rather than state support of certain "promising" industries (because it's getting harder to identify them in the modern world).

Reducing government intervention into the economy. The public sector has recently increased its role in the Russian economy. The share of state-owned and state-controlled companies has reached 45 – 50%, as estimated by the Ministry of Economic Development of Russia. Such companies account for about 40% of investment. However, research studies in a few countries support the argument of non-state companies being more efficient because they operate in a market-driven environment whose mechanisms facilitate higher labor productivity, selection of best investment projects, more intensive innovative processes. Therefore, *private companies as the key source of development* should be focused on and non-market relations reduced (ideally, eliminated) as quick as possible in the Russian economy.

Public services outsourcing plays an important role in the transition to a new model of public administration system, in which case public administrative agencies only allot their own objectives and goals as part of a single policy while the required measures are to be performed on a completive basis by external business organizations or using the arrangements of public-private partnership.

The transition to *integrated provision of public services* would allow this process to be simplified and accelerated through deeper integration of public administrative bodies, *enhancing the quality of information exchange.* A unified electronic document and information exchange system between government agencies, incorporating the private sector into the common information exchange system, should be established. It is important to simplify and make public service delivery procedure as transparent as possible, thereby reducing corruption.

A new approach towards the delivery of public services provides for new requirements to public administrative bodies, allows an adequate system of incentives for public servants to be established. Today, civil servants have no incentives for making changes. Transition to the principles of performance-based budgeting; tightening job specifications; creating a system of public service quality monitoring would help improve the quality of civil servants' performance. It is extremely important to have both strict control from higher-level agencies, and non-governmental organizations engaged in measuring such performance. The thick bureaucratic body can't change itself without civil institutions being simultaneously developed.

The reforms aimed at enhancing the quality of public services and efficiency of spending should include:

— *a package of measures to ensure full funding of the commitments assumed by government agencies at the federal and regional level, as well as self-government bodies.* This requires a systematic work on inventory of budget commitments especially in the social sector. The work should be completed with proposals to abolish statutory acts whose financing bears heavily on the budget system instead of facilitating sustainable economic growth and social development;

— *introducing the program-based principle into the budget process.* A system of allocation of budget resources for subsidiary programs designed to solve severe social and economic issues should be developed and introduced here. Additionally, principles of competitive selection of state-financed programs should be established, the institution of individual contracts for those employed by public administrative bodies should be introduced and a system of program performance measurement should be created to prevent industry-specific lobbying. The priority of medium-term planning is important here;

— *enhancing methods of public and municipal procurement of goods, works and services.* Financing public and municipal procurement and contracts should be based exclusively on a transparent, competitive basis, and fair competition terms for such competitions should be created;

— *reforming the system of public and municipal unitary and treasury enterprises and state-financed institutions.* Basically, the reform is intended to shrink the public sector and simultaneously enhance its effectiveness. The public sector should be shrank through voluntary movement of a part of state-financed organizations to the private sector along with a stage-wise cutting of their state-financed component (first of all, this refers to the social sector, especially education and healthcare). Such organizations participate on a competitive basis in the allocation of budget resources and are fully liable for their commitments. The rest of state-financed organizations will cease to be financially independent and will be state-financed through a strictly fixed budget;

— *enhancing accountability.* Public and municipal organizations' operations using budget and extrabudgetary resources should be fully recognized in accounting books, as well as the budget classification should be upgraded with a view to improving transparency of operations using budget resources;

— *enhancing energy efficiency in the public sector.* State-financed organizations consume annually about 20% of total thermal power and a major part of electric power in Russia. Public sector entities are quite power-consuming due to extremely ineffective technologies and major losses in the heat supply system. The foreign practice shows that public-private partnership schemes can be efficient to achieve the required energy-efficient effect. The legislation provides for temporal (for the duration of a contract) withdrawal of saved resources from the budget turnover to pay for services delivered by a provider of such services, as well as the introduction of an energy efficiency indicator in the public procurement system, in which case public administrative bodies act as customers rather than contractors, outsourcing the performance of works to a more efficient private sector.

Additionally, the national policy should be revised in order to enhance energy efficiency in the private sector. The practice shows that current measures are basically of restrictive nature. A good illustration of a private sector's response to half-baked decisions was the transition of a few enterprises' to the production of 95W instead of 100W electric bulbs which were banned in 2011. Indeed, the Russian Government expected a different response. Not only should the state, in conjunction with the private sector, work out restrictive measures, but they should take steps towards promotion of investment in energy-efficient equipment and production facilities.

Fiscal policy, crisis and modernization

Russia had a relatively moderate fiscal policy within several years prior to the crisis. A favorable external environment at that period allowed this country to build up budget reserves within the Stabilization Fund, then the Reserve Fund, and the National Welfare Fund. As a result, the Russia's budget system reserves in oil and gas funds reached Rb 7,8 trillion (18.8% of GDP) by the end of 2008.

The favorable long-lasting period allowed Russia to repay most of its external debt (which was reduced to account for 6.5% of GDP by the end of 2008). Russia has one of the lowest levels of external debt in the world: in 2007 the external debt of the OECD countries and the euro-area countries accounted for 73% and 71% of GDP respectively.

For several consecutive years Russia ran both the federal budget and the enlarged government's budget with a surplus which, however, was shrinking[1] because of growing government spending. *The establishment of the Stabilization Fund in 2004 resulted in faster growth in revenues vs. expenditures. However, the gap began to narrow by 2007 in response to a softer fiscal policy toward expenditures.* In other words, both revenues and expenditures grew at a faster rate vs. the economy. A part of the "excess" profit was nonetheless saved.

While Russia had extremely favorable pre-crisis years, most of the developed countries ran their budget with a deficit at that time. The OECD countries ran their budget with an average deficit of 1.2% of GDP in the period of 2006 thru 2007, the United States, Great Britain, and the euro-area countries ran their budget with a deficit of 2.8%, 2.7%, and 0.6% of GDP respectively in 2007.

However, Russia and other countries encountered a similar issue, i.e., *a new level of budget revenues fails to cover the level of expenditures (without showing any growth in deficit and, consequently, debt) reached during the "quiet" pre-crisis period.* Serious measures of fiscal consolidation should be taken narrow the gap between revenues and expenditures which widened during the crisis period (because of both decline in revenues and, in many countries, growth in expenditures resulted from anti-crisis measures), even if growth rates recover. The issue of budget instability has been worsened by adverse demographic trends which were mounting almost worldwide.

The crisis has shown that the degree of Russian economy's and budget system's external dependence, in particular in the period of favorable outlook, was underestimated while expenditures showed overgrowth and extremely low efficiency.

In Russia, like in many other countries, the effect of external shock amid crisis was mitigated by the measures of the government and the central bank. With regard to budget revenues, it was automatic fiscal stabilizers – a mechanism of shaping the rate of mineral extraction tax and oil export duties which allows tax burden on the oil sector to be automatically relieved when crude oil prices fall – that played a vital role in coping with the crisis. Factoring in the effectiveness of automatic stabilizers for budget revenues (e.g., unemployment benefits) in Russia, the government adopted an ambitious program of discretionary support of the economy which is intended to address the key objectives, namely stabilize the financial system; back up the internal demand and the real sector of economy; provide social support.

Expenditures officially covered by the anti-crisis program climbed above Rb 1 trillion (2.7% of GDP). Total volume of anti-crisis measures (factoring in lowered income and budget loans to the regions) can be estimated 4.2% of GDP. In 2010, the anti-crisis costs program included support measures totaling about Rb 325bn (0.7% of GDP), except that no pension increase, which also may be regarded as social support measure, is recognized in official estimates of the volume of anti-crisis measures. Factoring in pension increase costs, discretionary economic support measures in Russia accounted for 4.5% of GDP in 2009, about 5.3% in 2010, while in 2011 they are estimated 4.7% of GDP, according to the IMF[2]. The pension increase was indeed one of a few measures of the anti-crisis package

[1] In the period of 2006 thru 2008 the enlarged government budget surplus fell from 8.4% to 6.0, and 4.9% of GDP respectively. During the same period Russia ran its federal budget with a surplus of 7.4%, 5.4, and 4.1% of GDP respectively.
Fiscal Exit: From Strategy to Implementation // IMF Fiscal Monitor. 2010. Nov.

which wasn't of temporal nature and furthermore implied budget's extra public (irrevocable) commitment in the medium-and long-term period. This is a very big volume of discretionary fiscal measures vs. other countries.

For instance, in 2009, the volume of discretionary fiscal stimulation measures as percentage of GDP is estimated 1.8% in the United States, 1.6% in Great Britain, 1.7% in Germany, according to IMF's experts. The G20 countries' discretionary measures as part of the stimulating fiscal policy accounted for an average of 2.1% of GDP in 2009, and are estimated 2.0% of GDP in 2010. In the period of 2009-2010, Russia's volume of support only could be compared with the expenditures of Saudi Arabia (5.4% and 4.2% of GDP respectively) which, however, plans to discontinue its anti-crisis measures in 2011 (to 1.6% of GDP).

The structure of anti-crisis measures in Russia differed largely from that in other countries. The difference was indeed predetermined by the economic situation prior to the crisis.

Many countries (e.g., Great Britain, Spain) included construction of infrastructure facilities (toll-free public motor roads, hospitals, schools) into their anti-crisis package and provided simultaneous support to the labor market and domestic suppliers of industrial products. Not only could such a support, despite extra budget expenditures, bolster the economic development, but also it was provided using market transparent methods (competitive selection of contractors, etc.).

There was no way the Russian economy could be supported through public investment in the infrastructure, because Russia has poor infrastructure and fails to efficiently finance its modernization. As a result, a major part of the anti-crisis measures was aimed at providing direct support to specific industries and enterprises through contribution of extra subsidies to the charter capital of and state guarantees to such enterprises. In 2009, infrastructure costs lowered (approx. by one-fourth) from Rb 386,2bn, under the Budget Act, to Rb 283,1bn as part of the Federal Target Program on Modernization of the Russia's Transport System. Such a policy was predetermined by inadequate management (there is no way that new institutions can be established within a few months) and the need to promptly make the required decisions.

Though the problem of pensioners' poverty was technically solved through pension increase, the existing pension system was rendered even more unstable and misbalanced in the long-run, consequently so did the federal budget because of increased (and further increasing) expenditures to cover the pension system deficit.

All in all, the anti-crisis measures in the social sector and the real sector could mitigate the effect of the crisis in its active phase. Both the budget system (because of growth in deficit and liabilities) and the economy at large (infrastructure-related issues and other issues still remain to be solved, however budget expenditures should be cut considerably) were found themselves being exposed to higher medium- and long-term risks in the post-crisis period.

Post-crisis objectives and outlooks

As noted above, budget expenditures are extremely inefficient in Russia. According to the World Bank, road network spending (maintenance and repair, etc.) in Russia amount to \$27 to \$55/km vs. about \$9,5/km in Finland which has similar climate conditions. In other words, the same results could have been obtained 3-5 times cheaper. Russia has an enormous need to establish its infrastructure. According to the World Bank, an average density of the motor roads in this country is about 37 km per 1000 sq. km (about 110 in the European Russia and about 6 in the Far East District) vs. 110 km per 1000 sq. km in Canada which occupies a relatively similar territory with similar climate conditions. Therefore, *enhancing the* *effectiveness of all kinds of expenditures*, without increasing their volume, must be the key issue of the fiscal policy when there is the need for fiscal consolidation and simultaneous reforms, modernization in the public sector of the economy.

For instance, expenditures of the national economy which increased as percentage of GDP from 3.5% in 2005 to 5.4% in 2008 and 7.1% in the crisis year of 2009 had no decisive impact on its development and modernization. However, such a considerable growth was reached through increased public subsidies, i.e., direct support to certain sectors and enterprises, rather than growth in investment costs (the volume of public investment saw insignificant changes in the period under review. The total volume of budget subsidies as percentage of GDP increased from 1.7% in 2006 to 4.1% in 2008, and 5.4% in 2009 .

The effectiveness of expenditures should be improved along with the adoption of market, transparent mechanisms of budget allocation required for modernization of the public sector in Russia.

The issue of ensuring *long-term budget sustainability* and curtailing the dependence on external economic situation is vital for fiscal policy. There is the need to resume application of (properly adjusted) budgetary rules to the use of oil and gas revenues. While crude oil prices are going up, the crisis lessons for the Russian budget system must be learned and expenditures should not be increased unreasonably. In that context, when budget reserves totally exhausted, a new fall of crude oil prices might trigger a severe budget crisis, the need to cut expenditures.

It would be reasonable within this year to prohibit the use of oil and gas revenues generated beyond the Budget Act. The practice of imposing restrictions on the volume of used oil and gas revenues through the establishment of a "cut-off price", i.e., a crude oil price beyond which revenues must be saved, not spent, should be adopted later. Such an approach would secure faster fiscal consolidation and balanced, sustainable budget.

All countries are facing the challenge of fiscal consolidation, i.e., reducing the level of the primary budget deficit. According to IMF's experts, most countries can hardly obtain positive results simply reducing their expenditures.

The recent years have shown that cuts in expenditures contributed 70% and tax increase merely 30% to successful cases of fiscal consolidation. Failed attempts were often accompanied by a bigger share (about 60%) of increased revenues vs. cuts in expenditures. The IMF Monitoring[3] shows that most (about 60%) countries began to mitigate their budget deficit as early as 2010. Furthermore, many countries announced medium-term fiscal consolidation plans. According to the latest IMF's data[4], the budget deficit as percentage of GDP in the G20 countries is expected to slide from an average of 8.3% in 2010 to 5.6% in 2012. In emerging markets the deficit as percentage of GDP is expected to decline from 3.9% in 2010 to 2.8% in 2012.

Fiscal consolidation is assumed to lead to a recession. However, there is a great deal of historic evidence when drastic cuts in expenditures resulted in high and sustainable growth, even in a short-term period. Furthermore, research studies show that cuts in expenditures promoted growth in the same number of cases as rise in expenditures did. In other words, fiscal multipliers are insignificant in most cases. It is well known that they are lower than for poorer countries, countries with an open economy, flexible exchange rate and high government debt[5].

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[3] Fiscal Exit: From Strategy to Implementation.
[4] Strengthening Fiscal Credibility // IMF Fiscal Monitor Update. 2011. Jan.
[5] *Benetrix A. S., Lane Ph. R.* International Differences in Fiscal Policy during the Global Crisis // NBER Working Papers. 2010. No 16346.

To make fiscal consolidation successful and painless, economic agents should be sure that there is no further need to repeat the same. At present, cuts in expenditures and income growth can be perceived better to the extent that budget issues are addressed, default avoided and even more heavier tax burden prevented or future expenses reduced. Moreover, any short-term fiscal measures have a stronger impact as long as agents are sure that the measures don't expose long-term budget sustainability to risk and therefore necessitate unpopular decisions in the future. The government should retain agents' confidence in its decisions which are to be made following well-defined rules.

The current crisis, like the crisis in 1998, has a positive impact nonetheless. It has helped detect unsound, unpromising lines of development, understand new approaches, and made it much easier to implement new, bold solutions. In other words, the crisis opens a "window of opportunities" to take advantage of. Most importantly, there is no time for relaxation nowadays, when most of the world's leading expert organizations forecast high prices of energy products. Many unsolved problems seem to be fading out and government's vigilance dulled amid consistently high oil prices. The crisis has shown that in emergency such unsolved problems constitute a threat to the economic stability and budget safety. And this lesson must be learned.